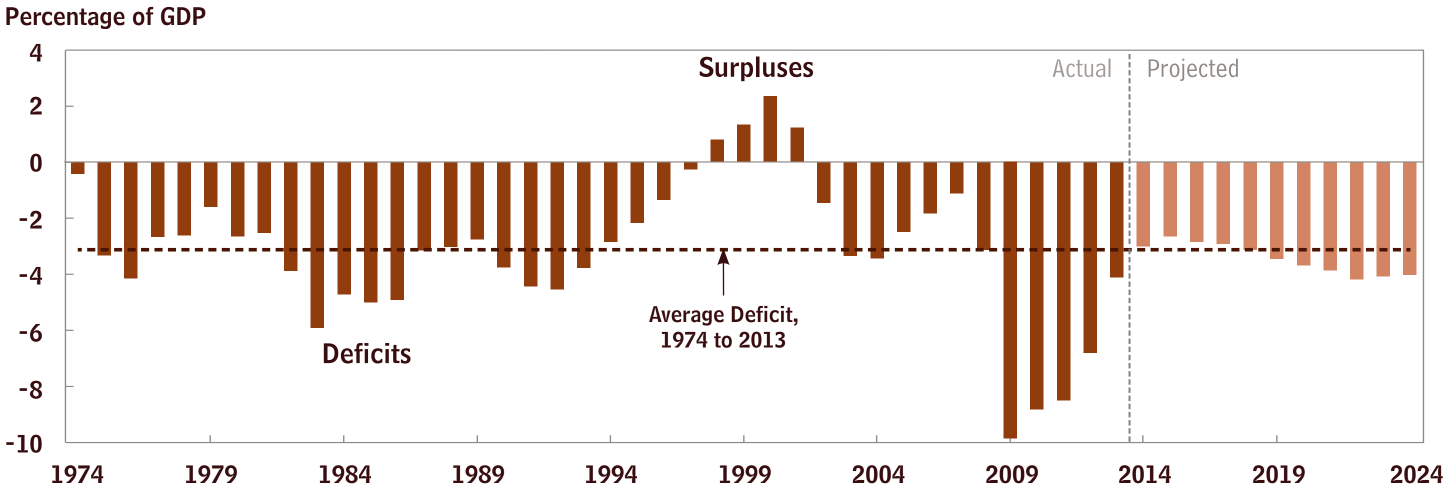
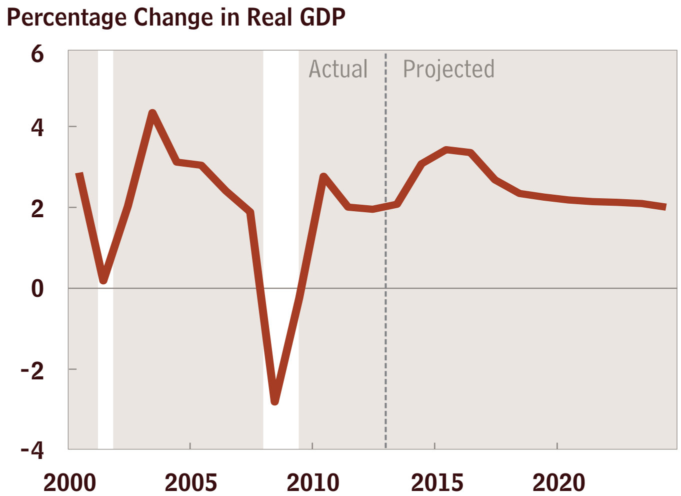
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

# CBO

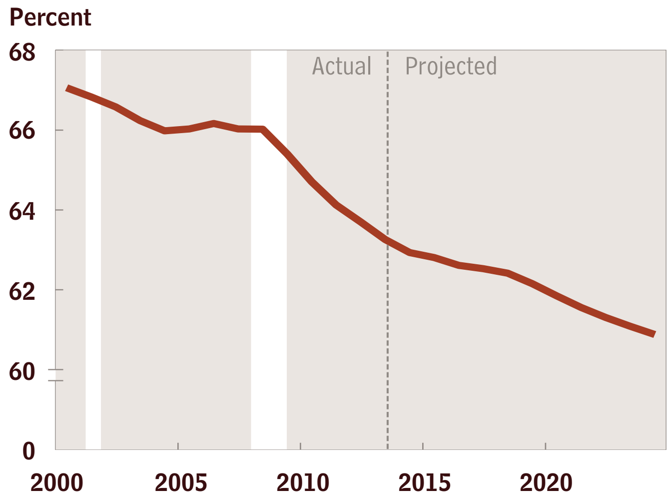
# The Budget and Economic Outlook: 2014 to 2024




Total Deficits or Surpluses




Economic Growth




Labor Force Participation Rate

FEBRUARY 2014

# Notes

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

Unless otherwise indicated, years referred to in describing the budget outlook are federal fiscal years (which run from October 1 to September 30) and years referred to in describing the economic outlook are calendar years.

Some figures in this report have vertical bars that indicate the duration of recessions. (A recession extends from the peak of a business cycle to its trough.)

The economic forecast was completed in early December 2013, and, unless otherwise indicated, the estimates of 2013 values shown in tables and figures in Chapter 2 and Appendixes E and G are based on information available at that time.

As referred to in this report, the Affordable Care Act comprises the Patient Protection and Affordable Care Act (Public Law 111-148), the health care provisions of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152), and the effects of subsequent judicial decisions, statutory changes, and administrative actions.

Supplemental data for this analysis are available on CBO's website (www.cbo.gov/publication/45010), as is a glossary of common budgetary and economic terms (www.cbo.gov/publication/42904).



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# Contents

# Summary

The federal budget deficit has fallen sharply during the past few years, and it is on a path to decline further this year and next year. The Congressional Budget Office (CBO) estimates that under current law, the deficit will total $514 billion in fiscal year 2014, compared with $1.4 trillion in 2009. At that level, this year's deficit would equal 3.0 percent of the nation's economic output, or gross domestic product (GDP)—close to the average percentage of GDP seen during the past 40 years.

As it does regularly, CBO has prepared baseline projections of what federal spending, revenues, and deficits would look like over the next 10 years if current laws governing federal taxes and spending generally remained unchanged. Under that assumption, the deficit is projected to decrease again in 2015—to $478 billion, or 2.6 percent of GDP (see Summary Table 1). After that, however, deficits are projected to start rising—both in dollar terms and relative to the size of the economy—because revenues are expected to grow at roughly the same pace as GDP whereas spending is expected to grow more rapidly than GDP. In CBO's baseline, spending is boosted by the aging of the population, the expansion of federal subsidies for health insurance, rising health care costs per beneficiary, and mounting interest costs on federal debt. By contrast, all federal spending apart from outlays for Social Security, major health care programs, and net interest payments is projected to drop to its lowest percentage of GDP since 1940 (the earliest year for which comparable data have been reported).

The large budget deficits recorded in recent years have substantially increased federal debt, and the amount of debt relative to the size of the economy is now very high by historical standards. CBO estimates that federal debt held by the public will equal 74 percent of GDP at the end of this year and 79 percent in 2024 (the end of the current 10-year projection period). Such large and growing federal debt could have serious negative consequences, including restraining economic growth in the long term, giving policymakers less flexibility to respond to unexpected challenges, and eventually increasing the risk of a fiscal crisis (in which investors would demand high interest rates to buy the government's debt).

After a frustratingly slow recovery from the severe recession of 2007 to 2009, the economy will grow at a solid pace in 2014 and for the next few years, CBO projects. Real GDP (output adjusted to remove the effects of inflation) is expected to increase by roughly 3 percent between the fourth quarter of 2013 and the fourth quarter of 2014—the largest rise in nearly a decade. Similar annual growth rates are projected through 2017. Nevertheless, CBO estimates that the economy will continue to have considerable unused labor and capital resources (or "slack") for the next few years. Although the unemployment rate is expected to decline, CBO projects that it will remain above 6.0 percent until late 2016. Moreover, the rate of participation in the labor force—which has been pushed down by the unusually large number of people who have decided not to look for work because of a lack of job opportunities—is projected to move only slowly back toward what it would be without the cyclical weakness in the economy.

Beyond 2017, CBO expects that economic growth will diminish to a pace that is well below the average seen over the past several decades. That projected slowdown mainly reflects long-term trends—particularly, slower growth in the labor force because of the aging of the population. Inflation, as measured by the change in the price index for personal consumption expenditures (PCE), will remain at or below 2.0 percent throughout the next decade, CBO anticipates. Interest rates on Treasury securities, which have been exceptionally low since the recession, are projected to increase in the next few years as the economy strengthens and to end up at levels that are close to their historical averages (adjusted for inflation).

**Summary Table 1.**

## CBO's Baseline Budget Projections

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| 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 |
| **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 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 | n.a. | n.a. |
| | | | | | | | As a Percentage of Gross Domestic Product | | | | | | | |
| Revenues | 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 |
| Outlays | 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 |
| **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** |
| 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: n.a. = not applicable.

a. Off-budget surpluses or deficits comprise surpluses or deficits in the Social Security trust funds and the net cash flow of the Postal Service.

## Deficits Are Projected to Decline Through 2015 but Rise Thereafter, Further Boosting Federal Debt

Assuming no legislative action that would significantly affect revenues or spending, CBO projects that the federal budget deficit will fall from 4.1 percent of GDP last year to 2.6 percent in 2015—and then rise again, equaling about 4 percent of GDP between 2022 and 2024. That pattern of lower deficits initially and higher deficits for the rest of the coming decade would cause federal debt to follow a similar path. Relative to the nation's output, debt held by the public is projected to decline slightly between 2014 and 2017, to 72 percent of GDP, but then to rise in later years, reaching 79 percent of GDP at the end of 2024. By comparison, as recently as the end of 2007, such debt equaled 35 percent of GDP (see Summary Figure 1).

### Revenues

Federal revenues are expected to grow by about 9 percent this year, to $3.0 trillion, or 17.5 percent of GDP—just above their average percentage of the past 40 years (see Summary Figure 2 on page 4). Revenues were well below that average in recent years, both because the income of individuals and corporations fell during the recession and because policymakers reduced some taxes. The expiration of various tax provisions and the improving economy underlie CBO's projection that revenues will rise sharply this year. Those factors will increase revenues further in 2015, with CBO's baseline showing another 9 percent rise. After 2015, revenues are projected to grow at about the same pace as output and to average 18.1 percent of GDP under the current-law assumptions of CBO's baseline.

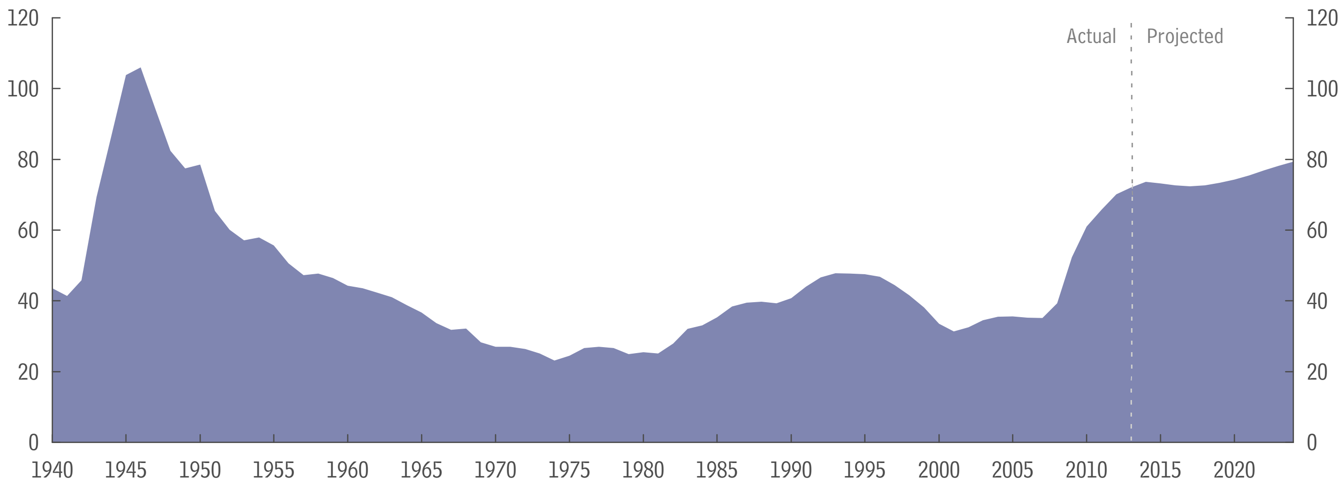
### Spending

Federal outlays are expected to increase by 2.6 percent this year, to $3.5 trillion, or 20.5 percent of GDP—their average percentage over the past 40 years. CBO projects that under current law, outlays will grow faster than the economy during the next decade and will equal 22.4 percent of GDP in 2024. With no changes in the applicable laws, spending for Social Security, Medicare (including offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies for health insurance

**Summary Figure 1.**

## Federal Debt Held by the Public

(Percentage of gross domestic product)




Source: Congressional Budget Office.

purchased through exchanges will rise from 9.7 percent of GDP in 2014 to 11.7 percent in 2024, CBO estimates. Net interest payments by the federal government are also projected to grow rapidly, climbing from 1.3 percent of GDP in 2014 to 3.3 percent in 2024, mostly because of the return of interest rates to more typical levels. However, the rest of the government's noninterest spending—for defense, benefit programs other than those mentioned above, and all other nondefense activities—is projected to drop from 9.4 percent of GDP this year to 7.3 percent in 2024 under current law.

### Changes From CBO's Previous Projections

Since May 2013, when CBO issued its previous baseline budget projections, the agency has reduced its estimate of this year's deficit by $46 billion and raised its estimate of the cumulative deficit between 2014 and 2023 by $1.0 trillion. (That 10-year period was the one covered by the previous baseline.) Those changes result from revisions to CBO's economic forecast; newly enacted legislation; and other, so-called technical factors, such as new information about recent spending and tax collections.

Most of the increase in projected deficits results from lower projections for the growth of real GDP and for inflation, which have reduced projected revenues between 2014 and 2023 by $1.4 trillion. Legislation enacted since May has lowered projected deficits during that period by a total of $0.4 trillion (including debt-service costs). Other changes to the economic outlook and technical changes have had little net effect on CBO's deficit projections.

## Economic Growth Is Projected to Be Solid in the Near Term, but Weakness in the Labor Market Will Persist

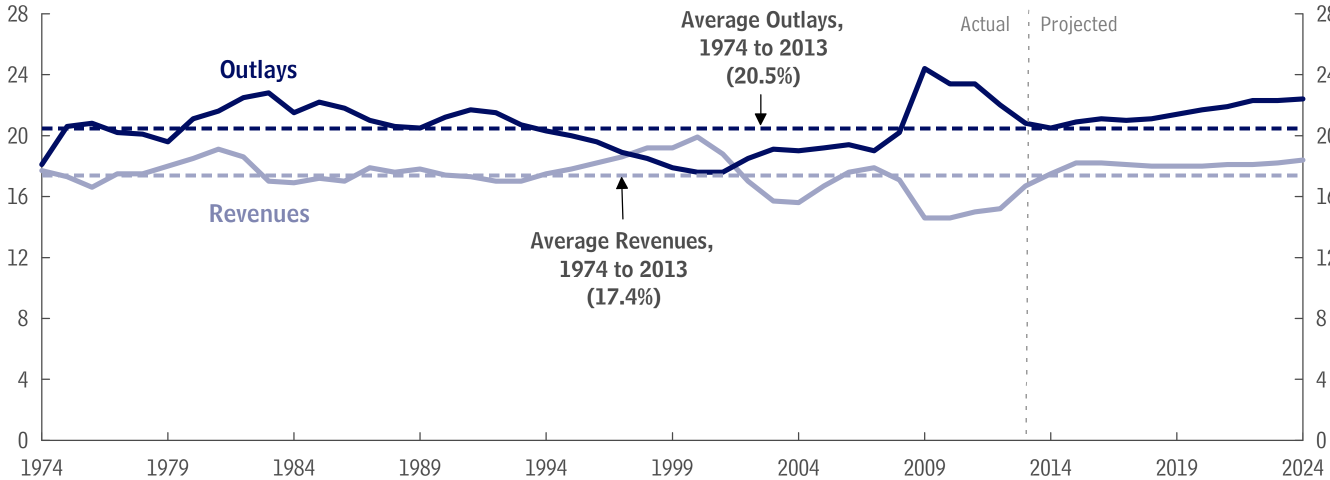
In the next few years, CBO expects, further growth in housing construction and business investment will raise output and employment, and the resulting increase in income will boost consumer spending. In addition, under current law, the federal government's tax and spending policies will not restrain economic growth to the extent they did in 2013, and state and local governments are likely to increase their purchases of goods and services (adjusted for inflation) after having reduced them for several years. As a result, CBO projects, real GDP will expand more quickly from 2014 to 2017—at an average rate of 3.1 percent a year—than it did in 2013.

By the end of 2017, the gap between GDP and potential GDP (the maximum sustainable output of the economy) is expected to be nearly eliminated (see Summary Figure 3 on page 5). Between 2018 and 2024, GDP will expand at the same rate as potential output—by an average of 2.2 percent a year, CBO projects. Thus, CBO anticipates that over the 2014–2024 period as a whole, real GDP will increase at an average annual pace of 2.5 percent.

**Summary Figure 2.**

## Total Revenues and Outlays

(Percentage of gross domestic product)




Source: Congressional Budget Office.

### The Economic Outlook Through 2017

Real GDP is projected to grow by 3.1 percent this year, by 3.4 percent in 2015 and 2016, and by 2.7 percent in 2017 (see Summary Table 2 on page 6).[1] CBO expects that those increases in output will spur businesses to hire more workers, pushing down the unemployment rate and tending to raise the rate of participation in the labor force (as some discouraged workers return to the labor force in search of jobs). That effect on participation in the labor force will keep the unemployment rate from falling as much as it would otherwise: CBO projects that the unemployment rate will decline only gradually over the next few years, finally dropping below 6.0 percent in 2017. Nevertheless, the labor force participation rate is projected to decline further because, according to CBO's analysis, the upward pressure on that rate from improvements in the economy will be more than offset by downward pressure from demographic trends, especially the aging of the baby-boom generation.

CBO expects that the PCE price index will increase by less than 2.0 percent a year for the next several years. With such low inflation and considerable slack in the labor market, CBO anticipates that the Federal Reserve will keep short-term interest rates (such as those on 3-month Treasury bills) at their current low levels until mid-2015 but that long-term interest rates (such as those on 10-year Treasury notes) will gradually rise as the economy strengthens.

### The Economic Outlook for 2018 to 2024

Beginning in 2018, CBO's projections of GDP are based not on forecasts of cyclical movements in the economy but on projections of trends in the factors that underlie potential output, including total hours worked by labor, capital services (the flow of services available for production from the nation's stock of capital goods, such as equipment, buildings, and land), and the productivity of those factors. In CBO's projections, the growth of potential GDP over the next 10 years is much slower than the average since 1950. That difference stems primarily from demographic trends that have significantly reduced the growth of the labor force. In addition, changes in people's economic incentives caused by federal tax and spending policies set in current law are expected to keep hours worked and potential output during the next 10 years lower than they would be otherwise. Although CBO projects that GDP will expand at the same rate as potential GDP, CBO also projects, on the basis of historical experience, that the level of GDP will fall slightly short of its potential, on average, from 2018 through 2024.

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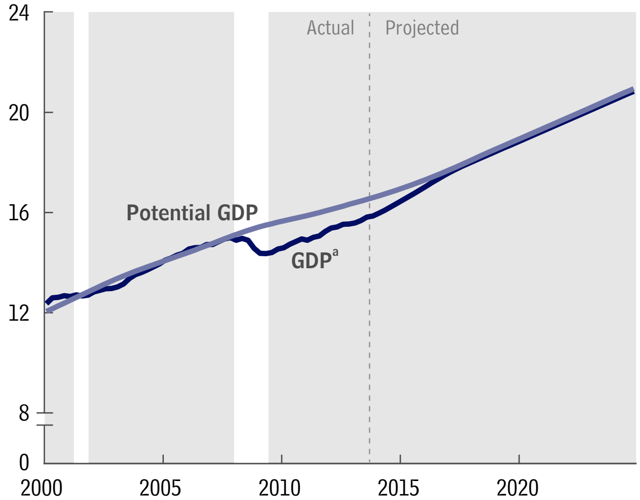
1. CBO's economic projections are based on information available through early December 2013. Data released since then indicate that the economy grew more rapidly at the end of 2013 than CBO had expected. If CBO were completing new economic projections now, it would probably trim its projection of growth for the next few years but make little change to its projections of the level or growth rate of GDP after that.

**Summary Figure 3.**

## GDP and Potential GDP

(Trillions of 2009 dollars)




Sources: Congressional Budget Office; Bureau of Economic Analysis.

Notes: Potential gross domestic product (GDP) is CBO's estimate of the maximum sustainable output of the economy.

Data are quarterly. Actual data are plotted through the second quarter of calendar year 2013; projections are plotted through the fourth quarter of 2024. Those projections, which are based on information available through early December 2013, do not reflect recently released data that show a higher level of GDP during the second half of 2013 than CBO had expected. If the projections were updated to incorporate those recent data, the gap between GDP and potential GDP would be slightly narrower in the second half of 2013 and in the next few years.

a. From 2018 to 2024, the projection for GDP falls short of that for potential GDP by one-half of one percent of potential GDP.

The unemployment rate is expected to edge down from 5.8 percent in 2017 to 5.5 percent in 2024 because factors associated with the persistently high long-term unemployment experienced in recent years are expected to have diminishing effects on the unemployment rate after 2017. As measured by the PCE price index, both inflation and core inflation (which excludes the prices of food and energy) are projected to average 2.0 percent a year between 2018 and 2024. Interest rates on 3-month Treasury bills are projected to average 3.7 percent during those years, and rates on 10-year Treasury notes are projected to average 5.0 percent.

**Summary Table 2.**

## CBO's Economic Projections for Calendar Years 2014 to 2024

| | Estimated, 2013 | Forecast 2014 | 2015 | 2016 | 2017 | Projected Annual Average, 2018-2024 |
|---|---|---|---|---|---|---|
| | **Fourth Quarter to Fourth Quarter (Percentage change)** | | | | | |
| Real Gross Domestic Product | 2.1 | 3.1 | 3.4 | 3.4 | 2.7 | 2.2 |
| Inflation | | | | | | |
| PCE price index | 0.9 | 1.5 | 1.7 | 1.8 | 1.9 | 2.0 |
| Core PCE price index[a] | 1.1 | 1.6 | 1.8 | 1.9 | 1.9 | 2.0 |
| Consumer price index[b] | 1.2 [c] | 1.9 | 2.1 | 2.1 | 2.3 | 2.4 |
| Core consumer price index[a] | 1.7 [c] | 1.9 | 2.2 | 2.2 | 2.3 | 2.3 |
| | **Fourth-Quarter Level (Percent)** | | | | | |
| Unemployment Rate | 7.0 [c] | 6.7 | 6.3 | 6.0 | 5.8 | 5.5 [d] |
| | **Calendar Year Average (Percent)** | | | | | |
| Interest Rates | | | | | | |
| Three-month Treasury bills | 0.1 [c] | 0.2 | 0.4 | 1.8 | 3.3 | 3.7 |
| Ten-year Treasury notes | 2.4 [c] | 3.1 | 3.7 | 4.3 | 4.8 | 5.0 |

Source: Congressional Budget Office.

Notes: Estimated values for 2013 do not reflect the values for gross domestic product and related series released by the Bureau of Economic Analysis since early December 2013.

Economic projections for each year from 2014 to 2024 appear in Appendix G.

PCE = personal consumption expenditures.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2013. (Actual values come from the Bureau of Labor Statistics and the Federal Reserve.)

d. Value for 2024.

CHAPTER

# 1

# 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.

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

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]

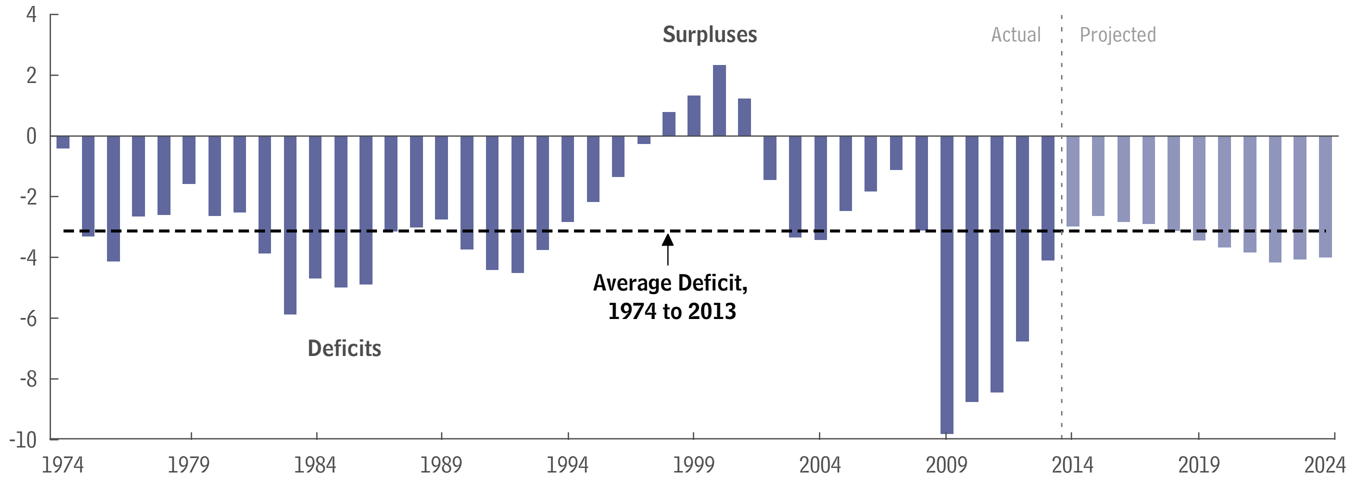
Projected deficits and debt for the coming decade reflect some of the long-term budgetary pressures facing the nation. The aging of the population, the rising costs of health care, and the expansion in federal subsidies for health insurance that is now under way will substantially boost federal spending 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

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.)

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

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.

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, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 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. 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

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).

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, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 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 overrode 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 nondefense 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 payments. 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.

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.

### 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.

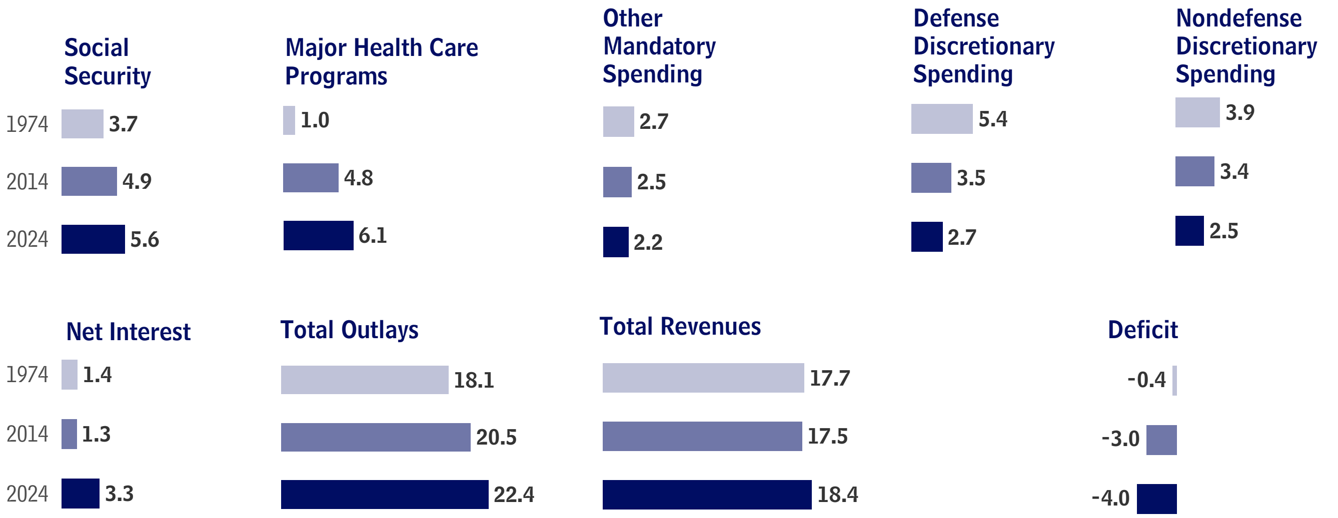
### Outlays

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

**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:

- 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

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.

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.

a. 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.

b. Federal debt held by the public plus Treasury securities held by federal trust funds and other government accounts.

c. 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.

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:

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.

- 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 2014-2018 | Total 2014-2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 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.

a. 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.

b. 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.

c. 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.

d. The caps were reduced in the American Taxpayer Relief Act of 2012 and increased in the Bipartisan Budget Act of 2013.

e. 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 nondefense are 9.8 percent and 7.2 percent, respectively.[4]

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.

4. 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 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **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 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | 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 subsequent 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.

CHAPTER

# 2

# The Economic Outlook

The Congressional Budget Office (CBO) projects that, under an assumption that current laws governing federal taxes and spending remain in place, economic activity will expand at a solid pace in 2014 and the next few years. Increases in housing construction and investment by businesses will boost overall output, employment, and incomes, and, therefore, consumer spending; in addition, federal fiscal policy will restrain the growth of the economy by much less than it has recently. As measured by the change from the fourth quarter of the previous year, real (inflation-adjusted) gross domestic product (GDP) is projected to increase by 3.1 percent this year and by 3.4 percent per year in 2015 and 2016; by comparison, real GDP increased by 2.7 percent in 2013.[1]

Nevertheless, CBO estimates that the economy will continue to have considerable unused labor and capital resources—or "slack"—for the next few years. According to the agency's projections, the unemployment rate will decline gradually but remain above 6.0 percent until late 2016. The labor force participation rate (the percentage of people in the civilian noninstitutionalized population age 16 or older who are either working or are available for and actively seeking work), which has been pushed down by an unusually large number of people deciding not to look for work because of a lack of job opportunities, will move only slowly back toward the level it would be without the cyclical weakness in the economy. The substantial amount of slack remaining in the labor market and elsewhere in the economy will help to keep the rate of inflation, as measured by the price index for personal consumption expenditures (PCE), below 2.0 percent during the next few years.

By the second half of 2017, CBO projects, real GDP will return to its average historical relationship with potential (or maximum sustainable) GDP, which implies that GDP will be slightly below its potential. Thereafter, from 2018 through 2024, CBO projects real GDP to grow at the same rate as potential output because the agency does not attempt to predict the timing or magnitude of fluctuations in the economy so far into the future. In CBO's projections, the unemployment rate falls to 5.5 percent by 2024, and inflation stays at 2.0 percent between 2018 and 2024. The interest rate on 10-year Treasury securities, which will gradually increase during the next few years as the economy strengthens, is projected to be 5.0 percent during the 2018–2024 period.

Over the next decade, potential output is projected to grow by 2.1 percent per year, on average, which is much lower than the average rate since 1950. That difference primarily reflects long-term trends, particularly slower growth of the labor force caused by the aging of the baby-boom generation. In addition, by CBO's estimates, potential output in 2024 will be constrained by the lingering effects of the recent recession and slow recovery and by federal tax and spending policies in current law.

The economic recovery has had unusual features that have been hard to predict, and the path of the economy in coming years is also likely to be surprising in various ways. Many developments, such as changes in laws governing federal fiscal policy and unforeseen changes in businesses' confidence, the economies of other countries, interest rates, stock prices, and the availability of mortgage credit, could cause economic outcomes to differ substantially, in one direction or the other, from those CBO has projected.

1. CBO's economic projections are based on data available through early December. Since then, the Bureau of Economic Analysis released data for the second half of 2013 that showed faster growth in real GDP during the second half of last year than CBO had expected (and other differences relative to CBO's projections). If CBO were completing new economic projections now, the agency would probably trim its projection of real GDP growth slightly over the next few years but make little change to the level or growth rate of GDP after that.

CBO's current economic projections differ in a number of ways from its previous projections, which were issued in February 2013.[2] In particular, CBO now projects real GDP growth averaging 2.6 percent annually during the 2014–2023 period, which is roughly 0.3 percentage points below the projection a year ago. That difference derives principally from three factors. First, CBO has revised downward its estimate of the growth of potential output, in part because the growth of potential during the past five years now appears to have been lower than previously estimated; in CBO's projections, potential output is about 1.5 percent lower in 2023 than the amount estimated a year ago. (In order to put the projections on a consistent basis, that comparison excludes the effects of changes the Bureau of Economic Analysis [BEA] made to the definition of GDP, which are described in Box 2-1.) Second, actual GDP currently appears to be closer to potential GDP than was previously estimated, in part because BEA's revisions raised estimated real GDP growth since 2009, leaving less room for GDP to grow before it nears its potential. Third, CBO now expects that output will fall slightly short of its potential, on average, even after the economy has largely recovered from the recent economic downturn in the later years of the projection period. In the same vein, CBO has revised its projection for the unemployment rate in the second half of the coming decade so that it remains above the natural rate (the rate arising from all sources except fluctuations in overall demand for goods and services). Also, the agency has lowered its estimates of interest rates in the latter part of the coming decade, primarily because of the slight projected shortfall of output relative to its potential.

CBO's current economic projections differ only modestly from the January 2014 *Blue Chip* consensus forecast (which is based on the forecasts of about 50 private-sector economists) and the December 2013 forecasts by members of the Federal Reserve Board and presidents of the Federal Reserve Banks. CBO's projection for the growth of real GDP is slightly higher than that of the *Blue Chip* consensus for 2014 but is within the central tendency of the range of Federal Reserve forecasts for both 2014 and 2015. CBO's projection for the unemployment rate is essentially the same as that of the *Blue Chip* consensus for 2014 but is slightly above the central tendency of the range of Federal Reserve forecasts for 2014 and 2015. CBO's projections for inflation are very similar to those of the outside forecasters.

## The Economic Outlook Through 2017

CBO projects that real GDP will grow notably faster over the next few years than it has over the past few years. On a fourth-quarter-to-fourth-quarter basis, real GDP is projected to increase by 3.1 percent this year, by 3.4 percent per year in 2015 and 2016, and by 2.7 percent in 2017 (see Table 2-1 on page 30, and Figure 2-1 on page 31). In CBO's view, continued improvement in housing construction and in investment by businesses will drive those gains, and the resulting increase in income will propel consumer spending. In addition, under current law, federal fiscal policy will not restrain growth in the demand for goods and services in coming years the way it did in 2013, and purchases of goods and services by state and local governments will contribute modestly to economic growth after holding back growth during the past few years.

That faster pace of growth will gradually narrow the gap between GDP and potential GDP, putting that gap in the second half of 2017 at approximately its average since World War II (see Figure 2-2 on page 32). In the second quarter of 2009, CBO estimates, real GDP was about 7½ percent below its potential. From that point through the end of 2013, real output grew at an average annual rate of about 2½ percent, leaving it roughly 4 percent below its potential at the end of last year.[3]

CBO also projects that the Federal Reserve will keep short-term interest rates at their current low levels until mid-2015 and that long-term interest rates will rise gradually as the economy strengthens. By CBO's estimates, as the economy grows more quickly, the unemployment rate will fall, from 7.0 percent in the fourth quarter of 2013 to 5.8 percent in the fourth quarter of 2017. Inflation will pick up slightly over the next few years. Even so, inflation as measured by the growth of the PCE price index is projected to remain below the Federal Reserve's goal of 2 percent during this period.

2. For CBO's previous economic projections, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2013 to 2023* (February 2013), www.cbo.gov/publication/43907.

3. That roughly 4 percent shortfall is the difference between the estimate of GDP produced by BEA and CBO's current estimate of potential GDP. BEA's estimate was released on January 30, 2014, after CBO completed its projection. According to BEA's release, GDP in the fourth quarter of 2013 was greater than what CBO had projected. Incorporating that higher level of GDP would probably raise CBO's estimate of potential output, but only slightly.

**Box 2-1.**

## Summary of the Comprehensive Revision to the National Income and Product Accounts

In July 2013, the Bureau of Economic Analysis (BEA) released its latest comprehensive revision of the national income and product accounts (NIPAs). That revision incorporated newly available data and included several conceptual changes, including the expansion of investment to incorporate new categories of intellectual property, the broadening of residential investment to incorporate a wider set of costs associated with home purchases, and changes to the treatment of transactions related to profits and other income. The net effect of those changes was to increase the value of nominal gross domestic product (GDP) in 2012 by 3.6 percent. The revision also updated the benchmark year for real (inflation-adjusted) series from 2005 to 2009.

The most significant conceptual change was the addition of two new categories of investment: research and development expenditures by business, government, and nonprofit institutions serving households; and expenditures by private enterprises for the creation of original entertainment, literary, and artistic works. Those two new categories are grouped together with software into a broader category called "intellectual property products." On the income side of the NIPAs, that additional output is balanced mostly by the depreciation of those new forms of investment, but also by an increase in domestic economic profits. Those new categories of investment account for 93 percent of the upward revision to nominal GDP over the past decade.

The addition of those new categories of investment causes reported net output (GDP minus depreciation) to better reflect the timing of the production of those investment items, as exemplified by the new treatment for movies. Movies were already part of GDP before the revision, as a component of personal consumption of recreation services. Under that previous approach, a movie was counted as net output when it was viewed. After the revision, the production of a movie boosts investment, so it counts as net output when it is made, and purchases of tickets to view the movie are offset in net output by higher depreciation. Consequently, the production of a movie now adds to net output when the movie is produced rather than when it is viewed.

BEA also expanded the types of ownership transfer costs that are counted as part of residential investment. Previously, only brokers' commissions were included in residential investment. Other transfer costs, such as those for title insurance, titling and attorneys' fees, and various other payments, were counted as intermediate inputs to the production of housing services and thus not directly in GDP. Those costs are now a component of GDP.

The handling of several types of economic transactions related to profits and other income has also been revised. Transactions involving defined benefit pension plans are now recorded on an accrual accounting basis rather than a cash basis; the new approach counts the cost of such pensions when the liabilities are incurred rather than when the pensions are funded. Proprietors' income now incorporates more accurate accounting of capital gains and losses, and measures of financial services provided by commercial banks have been improved.

Those revisions and others raised real GDP in 2012 by more than they raised it early in the post–World War II period and thereby increased the growth rate of real GDP in the intervening decades. For the period from 1950 to 2012, the average annual growth rate of real GDP is now 3.3 percent, or 0.1 percentage point higher than previously estimated. The revisions had a larger effect on the estimates of the growth of real GDP in recent years. In particular, average annual growth of real GDP from 2009 to 2012 was revised up from 0.8 percent to 1.1 percent. The revisions also reduced estimates of previous price inflation by less than 0.1 percentage point per year, on average, for 1950 to 2012.

**Table 2-1.**

## CBO's Economic Projections for Calendar Years 2014 to 2024

| | Estimated, 2013 | Forecast 2014 | Forecast 2015 | Forecast 2016 | Forecast 2017 | Projected Annual Average, 2018-2024 |
|---|---|---|---|---|---|---|
| | | **Fourth Quarter to Fourth Quarter (Percentage change)** | | | | |
| Gross Domestic Product | | | | | | |
| Real | 2.1 | 3.1 | 3.4 | 3.4 | 2.7 | 2.2 |
| Nominal | 3.5 | 4.7 | 5.2 | 5.3 | 4.7 | 4.2 |
| Inflation | | | | | | |
| PCE price index | 0.9 | 1.5 | 1.7 | 1.8 | 1.9 | 2.0 |
| Core PCE price index[a] | 1.1 | 1.6 | 1.8 | 1.9 | 1.9 | 2.0 |
| Consumer price index[b] | 1.2 [c] | 1.9 | 2.1 | 2.1 | 2.3 | 2.4 |
| Core consumer price index[a] | 1.7 [c] | 1.9 | 2.2 | 2.2 | 2.3 | 2.3 |
| GDP price index | 1.4 | 1.6 | 1.7 | 1.9 | 1.9 | 2.0 |
| Employment Cost Index[d] | 2.1 | 2.6 | 3.3 | 3.6 | 3.9 | 3.7 |
| | | **Fourth-Quarter Level (Percent)** | | | | |
| Unemployment Rate | 7.0 [c] | 6.7 | 6.3 | 6.0 | 5.8 | 5.5 [e] |
| | | **Year to Year (Percentage change)** | | | | |
| Gross Domestic Product | | | | | | |
| Real | 1.7 | 2.7 | 3.3 | 3.4 | 3.0 | 2.2 |
| Nominal | 3.2 | 4.2 | 5.1 | 5.3 | 4.9 | 4.2 |
| Inflation | | | | | | |
| PCE price index | 1.1 | 1.3 | 1.7 | 1.8 | 1.8 | 2.0 |
| Core PCE price index[a] | 1.2 | 1.4 | 1.8 | 1.9 | 1.9 | 2.0 |
| Consumer price index[b] | 1.5 [c] | 1.7 | 2.0 | 2.1 | 2.2 | 2.4 |
| Core consumer price index[a] | 1.8 [c] | 1.8 | 2.1 | 2.2 | 2.3 | 2.3 |
| GDP price index | 1.4 | 1.5 | 1.7 | 1.8 | 1.9 | 2.0 |
| Employment Cost Index[d] | 1.9 | 2.3 | 3.0 | 3.5 | 3.8 | 3.7 |
| | | **Calendar Year Average** | | | | |
| Unemployment Rate (Percent) | 7.4 [c] | 6.8 | 6.5 | 6.1 | 5.9 | 5.6 |
| Payroll Employment (Monthly change, in thousands)[f] | 190 [c] | 164 | 160 | 141 | 124 | 67 |
| Interest Rates (Percent) | | | | | | |
| Three-month Treasury bills | 0.1 [c] | 0.2 | 0.4 | 1.8 | 3.3 | 3.7 |
| Ten-year Treasury notes | 2.4 [c] | 3.1 | 3.7 | 4.3 | 4.8 | 5.0 |
| Tax Bases (Percentage of GDP) | | | | | | |
| Wages and salaries | 42.6 | 42.6 | 42.5 | 42.5 | 42.6 | 43.1 |
| Domestic economic profits | 9.9 | 9.5 | 9.5 | 9.5 | 9.0 | 7.6 |

Source: Congressional Budget Office.

Notes: Estimated values for 2013 do not reflect the values for GDP and related series released by the Bureau of Economic Analysis since early December 2013.

Economic projections for each year from 2014 to 2024 appear in Appendix G.

PCE = personal consumption expenditures; GDP = gross domestic product.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2013. (Actual values come from the Bureau of Labor Statistics and the Federal Reserve.)

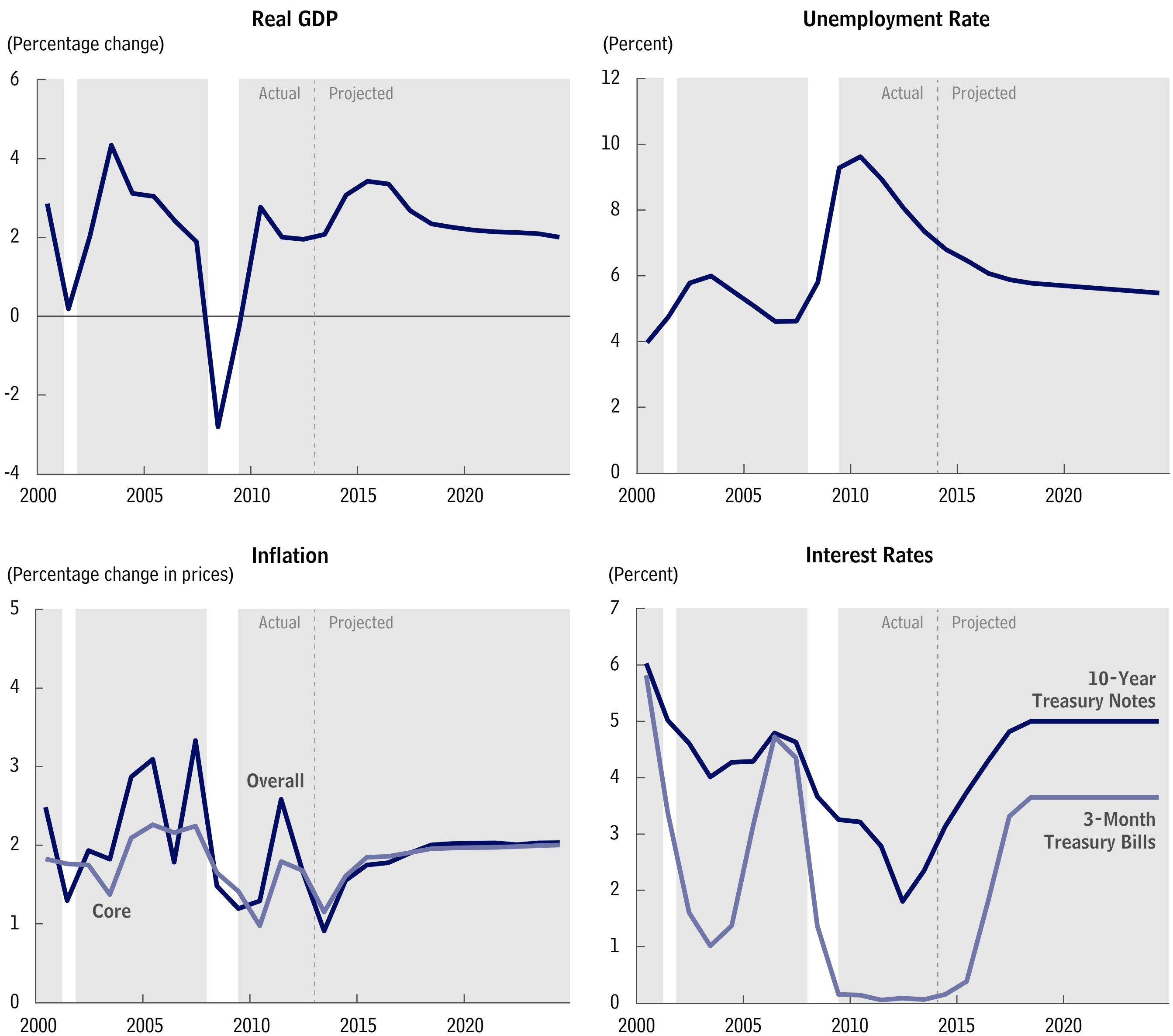
d. The employment cost index for wages and salaries of workers in private industry.

e. Value for 2024.

f. Calculated as the monthly average of the fourth-quarter-to-fourth-quarter change in the quarterly average level of payroll employment.

**Figure 2-1.**

## Actual Values and CBO's Projections of Key Economic Indicators




Sources: Congressional Budget Office; Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve.

Notes: Real gross domestic product (GDP) is the output of the economy adjusted to remove the effects of inflation. The unemployment rate is a measure of the number of jobless people who are available for and actively seeking work, expressed as a percentage of the labor force. The overall inflation rate is based on the price index for personal consumption expenditures; the core rate excludes prices for food and energy.

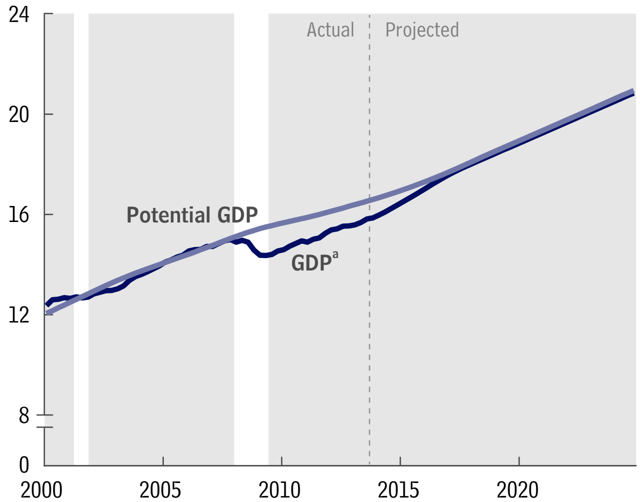
Data are annual. For real GDP and inflation, actual data are plotted through 2012; the values for 2013 reflect CBO's estimates for the third and fourth quarters and do not incorporate data released by the Bureau of Economic Analysis since early December 2013. For the unemployment rate and interest rates, actual data are plotted through 2013. Projections are plotted through 2024.

For real GDP and inflation, percentage changes are measured between the fourth quarters of successive years.

**Figure 2-2.**

## GDP and Potential GDP

(Trillions of 2009 dollars)




Sources: Congressional Budget Office; Bureau of Economic Analysis.

Notes: Potential gross domestic product (GDP) is CBO's estimate of the maximum sustainable output of the economy.

Data are quarterly. Actual data are plotted through the second quarter of 2013; projections are plotted through the fourth quarter of 2024. Those projections, which are based on data available through early December 2013, do not reflect recently released data that show a higher level of GDP during the second half of last year than CBO had expected. If the projections were updated to incorporate those recent data, the gap between actual GDP and potential GDP would be slightly narrower in the second half of last year and during the next few years.

a. From 2018 to 2024, the projection for actual GDP falls short of that for potential GDP by one-half of one percent of potential GDP.

### Federal Fiscal Policy

Under current law, federal fiscal policy will restrain the growth of the economy by much less in 2014 than it has in the past few years. Changes in fiscal policy between 2012 and 2013 restrained output growth in 2013 by roughly 1½ percentage points, by CBO's estimates, primarily because tax rates on some income increased when certain tax provisions expired and because the federal government cut spending relative to the size of the economy as sequestration under the Budget Control Act of 2011 (Public Law 112–25) took effect. In contrast, CBO estimates that changes in revenues and spending between 2013 and 2014 under current law will lower output growth in 2014 by only about one-quarter of a percentage point; the restraint this year is due principally to the expiration of extended unemployment insurance (which had helped cash-strapped households to maintain their spending) and bonus depreciation allowances (which had encouraged investment by permitting businesses to deduct new investment from taxable income more rapidly than without the allowances).[4]

From 2015 to 2017, according to CBO's current-law projections, federal fiscal policy will continue to have only small effects on economic growth. One small source of fiscal restraint will come from the waning of the "automatic stabilizers" in the federal budget (that is, provisions of law that automatically decrease revenues or increase expenditures during a recession); as the economy improves, those stabilizers will provide a smaller boost to the level of economic activity.[5]

### State and Local Governments

According to CBO's projections, purchases of goods and services by state and local governments will grow faster in the next few years than in the recent past, as the revenues of those governments pick up because of the strengthening of the economy and increases in the prices of houses and financial assets. Such purchases by state and local governments fell from the end of 2009 to the middle of 2013 (on an inflation-adjusted basis) because the weak economy depressed tax revenues and raised benefit payments. But as their tax revenues begin to increase more rapidly, state and local governments are projected to use a portion of those funds to restore some of the spending they cut during the years of tighter budgets. By CBO's estimates, the boost to GDP from increasing purchases by state and local governments will more than offset the drag from those rising tax revenues: Each dollar of additional government purchases directly boosts demand for goods and services by a dollar, but only a portion of each dollar of additional tax revenues directly reduces demand because taxpayers try to maintain their spending to some extent by drawing on their savings.[6]

4. For a detailed discussion of CBO's projections of federal spending and revenues, see Chapters 3 and 4.

5. For CBO's current estimates of the effects of automatic stabilizers, see Appendix E.

### Monetary Policy and Interest Rates

CBO expects that, during the next few years, considerable slack will persist in the labor market and inflation will stay below the Federal Reserve's goal, so monetary policy will continue to support economic growth. The Federal Reserve has committed to keeping its target for the federal funds rate (the interest rate on overnight lending among banks, which is adjusted by the central bank as one of its tools for conducting monetary policy) near zero at least until labor market conditions improve substantially or until inflation or projections of inflation increase notably. Given CBO's forecasts for economic activity and inflation, the agency expects that the federal funds rate will remain near zero until the second half of 2015 and will then rise at a rapid clip, reaching 3.9 percent by the end of 2017; correspondingly, the agency projects that the interest rate for three-month Treasury bills will remain near zero until late 2015 and then increase to 3.7 percent by the end of 2017 (see Figure 2-1 on page 31). Those estimates are broadly consistent with expectations for short-term interest rates inferred from financial markets.

The Federal Reserve will cease its temporary program of buying long-term Treasury securities and mortgage-backed securities in the second half of this year, CBO anticipates. The central bank began making those purchases in 2009 to reduce long-term interest rates, and in December of last year, it announced that it would begin to trim the pace of those purchases. CBO projects the Federal Reserve's balance sheet to reach $4.4 trillion by the fourth quarter of 2014 (up from $1.0 trillion in the third quarter of 2008) and then begin to shrink in 2015 as monetary policy becomes less accommodative.

By CBO's projections, the interest rate on 10-year Treasury notes will rise steadily from an average of 2.4 percent last year to 3.7 percent in 2015 and to 4.8 percent in 2017. That rate will be pushed up by market participants' expectations of an improving economy, the eventual rise in short-term rates, and an end to the Federal Reserve's program for purchasing long-term assets.

6. CBO estimates that changes in government spending and taxes have both direct and indirect effects on demand for goods and services. Indirect effects can enhance or offset the direct effects. For a discussion of such effects, see Felix Reichling and Charles Whalen, *Assessing the Short-Term Effects on Output of Changes in Federal Fiscal Policies*, Working Paper 2012-08 (Congressional Budget Office, May 2012), www.cbo.gov/publication/43278.

### The Household Sector

For the household sector in the next few years, CBO expects solid growth in spending on consumer goods and services and on residential investment.[7] That outlook reflects the agency's expectation that disposable (after-tax) personal income will grow at a moderate pace, households' net worth and consumers' confidence will continue to improve, and conditions for borrowing by consumers and homebuyers will become somewhat easier. According to CBO's projections, real consumer spending will grow by nearly 3 percent per year, on average, through 2016 (as measured from fourth quarter to fourth quarter) and by slightly less in 2017. Real residential investment will grow by 17 percent per year in 2014 and 2015, driven mostly by a rebound in starts of new housing units, and more slowly thereafter.

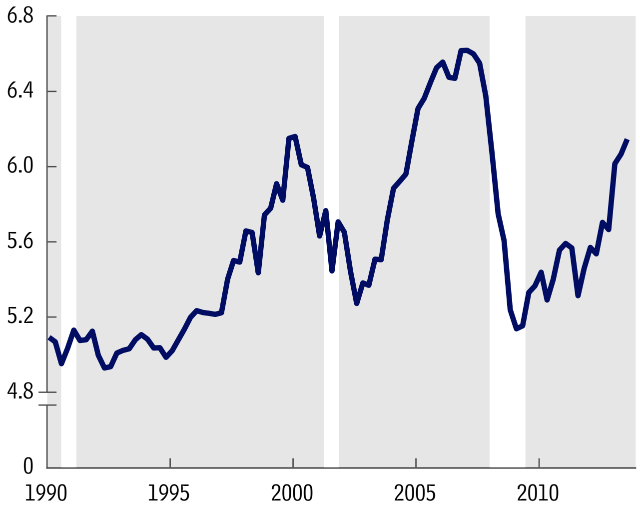
**Income, Net Worth, and Consumers' Confidence.** Disposable personal income will increase by 3.0 percent this year and at a similar pace during the next few years, CBO projects. Disposable income fell sharply in early 2013 after payroll tax rates and some income tax rates rose, but it grew at an annual rate of more than 3 percent for the rest of the year. Gains in employment and in hourly labor compensation are expected to boost income in 2014 and subsequent years. Moreover, households' net worth relative to disposable personal income has grown rapidly for the past year and a half, as substantial increases in equity and house prices have outpaced gains in disposable income. Indeed, although the ratio of net worth to disposable personal income is still short of the peak that it reached during 2007, the ratio is well above its average level for the preceding decade, suggesting that households' balance sheets have, on average, largely recovered from the financial and housing crises (see Figure 2-3). However, survey measures of consumers' confidence remain well below their prerecession levels, consistent with the generally soft growth in consumer spending since the recession. Nonetheless, confidence improved slightly, on net, during 2013, and CBO expects that confidence will continue to build in 2014 and thereafter in step with employment and income gains.

7. Residential investment consists primarily of construction of new housing units, improvements of existing units, and brokers' commissions and other closing costs. In addition, it includes construction of dormitories, purchases of manufactured housing, and net purchases of structures from other sectors (for example, the purchase of a school that is then converted into apartments).

**Figure 2-3.**

## Household Net Worth

(Ratio to disposable personal income)




Sources: Congressional Budget Office; Bureau of Economic Analysis; Federal Reserve.

Notes: Household net worth consists of the total assets minus the total liabilities on households' balance sheets, as reported in the Federal Reserve's flow-of-funds accounts.

Disposable personal income is the after-tax income of individuals, as reported in the Bureau of Economic Analysis's national income accounts.

Data are quarterly and are plotted through the third quarter of 2013.

**Credit Conditions.** Conditions in credit markets for households will become more supportive of households' spending, CBO anticipates. A range of indicators signals that households' creditworthiness and the availability of credit to households continue to improve. Notably, debt as a share of disposable personal income and delinquency rates on consumer loans have fallen since the end of the recession in 2009—and delinquency rates on mortgage loans have fallen markedly in the past year. Banks' standards for mortgage loans to borrowers posing good credit risks have eased a little in the past year, although standards remain much tighter than they were before the financial crisis. CBO expects that the effect of a continued easing of standards will more than offset the effect of rising mortgage interest rates, supporting growth in the housing market and enabling more households to refinance their mortgages in order to tap their home equity.

**The Housing Market.** Residential investment will rise rapidly this year and next, CBO forecasts, as housing starts near a long-term sustainable level of roughly 1.6 million annually.[8] Starts have been well below that level for the past several years, as the effects of the housing bubble and recession have lingered—especially the still-large number of vacant housing units, slow rates of household formation, and fairly tight standards for new mortgages. Going forward, the effects of an improving economy are expected to cause a pickup in household formation and a further decline in the number of vacant housing units—more than offsetting the effects of a rise in mortgage interest rates and pushing housing starts back up to the long-term sustainable level and then above it (see Figure 2-4). As a result, according to CBO's projections, real residential investment will grow by 12 percent per year, on average, during the 2014–2017 period.

CBO expects that stronger growth in home purchases will put upward pressure on house prices. That upward pressure will be mitigated to some degree by the projected increase in the supply of housing units. On balance, as measured by the Federal Housing Finance Agency's (FHFA's) price index for home purchases, house prices will increase, on average, by about 4 percent in 2014 and 2½ percent in 2015, less than the estimated 7½ percent in 2013. In CBO's forecast, FHFA's index of house prices surpasses its prerecession peak in 2017 (without any adjustment for inflation).

### The Business Sector

After growing much less rapidly in 2013 than in the preceding three years, investment by businesses will rise briskly over the next four years, CBO expects. Real business fixed investment (purchases of equipment, structures, and intellectual property products) grew by just 2.1 percent in 2013 (measured from fourth quarter to fourth quarter).[9] However, according to the agency's projections, the need to replace depreciating capital and expand productive capacity in line with rising demand will boost the growth of such investment to an average annual rate of 7 percent over the 2014–2017 period.

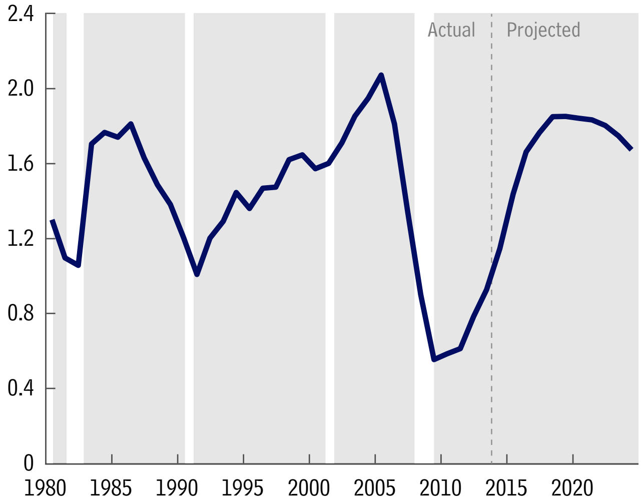
8. That sustainable level is determined by population growth and the need to replace depreciating structures.

9. Intellectual property products are a new category of business investment in the national income and product accounts, introduced by BEA in its comprehensive revision of those accounts last year. Intellectual property products include software, research and development, and original entertainment, literary, and artistic works.

**Figure 2-4.**

## Housing Starts

(Millions)




Sources: Congressional Budget Office; Bureau of the Census.

Notes: Housing starts are the number of privately owned housing units for which ground was broken in a given period throughout the United States.

Data are annual. Actual data are plotted through 2013; projections are plotted through 2024.

Net fixed investment by businesses (which equals gross investment minus depreciation) fell sharply during the 2007–2009 recession and remains low relative to potential GDP by historical standards (see Figure 2-5). In CBO's judgment, that shortfall is attributable primarily to the low rate of utilization of business capital during the recession and weak recovery, as firms did not need to make full use of their existing capital in light of weak demand for their products. However, the surprising sluggishness of investment last year (even though utilization has been rising since the end of the recession) makes clear that other factors are at work as well.

Net fixed investment at the end of 2013 was below what is needed for businesses to add to productive capital rapidly enough to keep pace with the growing demand for their products that CBO projects. Thus, CBO expects that businesses will boost net investment considerably in the next few years. Other factors influencing business investment will have smaller and partly offsetting effects, in CBO's view. On the one hand, rising interest rates and the expiration of bonus depreciation allowances at the end of last year will restrain investment. On the other hand, the cost of equity capital (the total return that businesses must pay to stockholders) has fallen as stock prices have risen, and banks have continued to ease lending standards for commercial and industrial loans and for commercial real estate loans. Moreover, domestic economic profits were a higher share of GDP at the end of 2013 than at almost any time since the 1960s, providing plenty of funds for most businesses that want to invest.[10]

### International Trade

CBO expects that real net exports (exports minus imports, after adjustments for inflation) will decrease this year and next before rebounding after 2016. That projected decline in 2014 and 2015 largely reflects CBO's expectation that growth in the United States will outpace average growth among the nation's leading trading partners during those years, causing the demand for imports to the United States to rise faster than the demand for U.S. exports (see Figure 2-6). (That pattern is not expected to continue over a longer horizon.) However, the decline in net exports in the next two years will be moderated by a projected increase in U.S. production of crude oil, which will decrease the growth rate of petroleum product imports. In CBO's forecast, after remaining steady in 2016, net exports rise in 2017, primarily because of a gradual decline in the exchange value of the dollar. Those changes in net exports are projected to have small effects on the growth of GDP—weighing on it in 2014 and 2015 but then making a small positive contribution to it in 2017.

In CBO's estimation, both advanced and emerging economies will grow modestly in the next few years. Taken as a group, the advanced economies are likely to sustain their sluggish recovery in 2014 and 2015. In particular, analysts expect the euro zone economy to gradually strengthen this year and next, following a recent recession.[11] Nevertheless, analysts remain concerned about the risks posed by continued declines in inflation (which increase real interest rates on existing debt) and persistent high unemployment in the euro zone. Likewise, growth

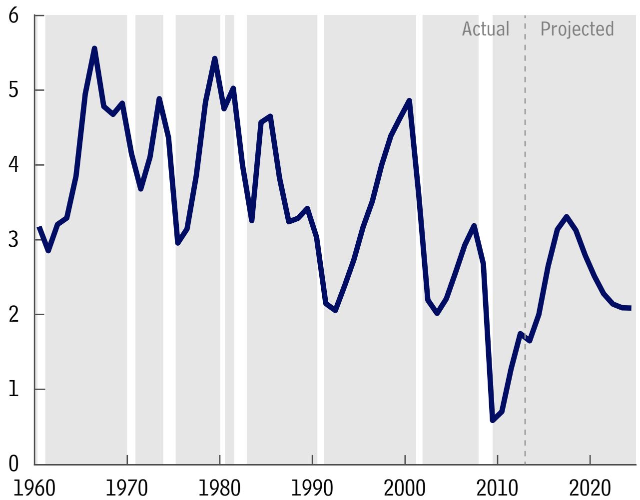
10. Domestic economic profits are corporations' domestic profits adjusted to remove distortions in depreciation allowances caused by tax rules and to exclude the effects of inflation on the value of inventories. Domestic economic profits exclude certain income of U.S.-based multinational corporations that is derived from foreign sources, most of which does not generate corporate income tax receipts in the United States.

11. Consensus Economics, *Consensus Forecasts* (January 2014), http://tinyurl.com/l2qmg5g.

**Figure 2-5.**

### Net Business Fixed Investment

(Percentage of potential gross domestic product)




Sources: Congressional Budget Office; Bureau of Economic Analysis.

Notes: Business fixed investment consists of businesses' spending on nonresidential structures, equipment, and intellectual property products. It is shown here net of depreciation.

Potential gross domestic product is CBO's estimate of the maximum sustainable output of the economy.

Data are annual. Actual data are plotted through 2012; the value for 2013 reflects CBO's estimates for the third and fourth quarters and does not incorporate data released by the Bureau of Economic Analysis since early December 2013. Projections are plotted through 2024.

for major emerging-market trading partners, which was lackluster in 2013, is likely to rebound slightly in 2014.[12] However, CBO expects growth in China in 2014 and 2015 to be the slowest in two decades (at about 7.5 percent), as that country's policymakers raise interest rates so as to suppress the rapid expansion of credit that has occurred in recent years.

By CBO's projections, the exchange value of the dollar (specifically, a weighted average of the exchange rates between the U.S. dollar and the currencies of major U.S. trading partners using shares of U.S. trade as weights) will remain steady for the next two years before resuming a decline that has been its general trend since 2002. Last year, the dollar's movements closely tracked changes in market expectations of U.S. monetary policy: When markets expected an earlier start to the tapering of the Federal Reserve's purchases of long-term assets, the dollar appreciated; conversely, when an earlier start appeared less likely, the dollar fell. Because CBO's projection for such tapering is roughly in line with current market expectations, the agency expects the value of the dollar to remain stable in 2014 and 2015.

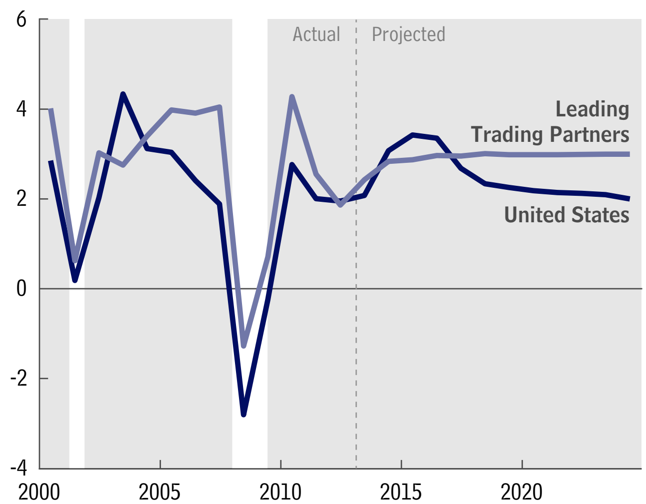
### The Labor Market

CBO expects that conditions in the labor market will continue to improve during the next several years. The unemployment rate fell by 0.8 percentage points from the fourth quarter of 2012 to the fourth quarter of 2013, reaching an average of 7.0 percent last quarter (and

**Figure 2-6.**

### Economic Growth in the United States and Among Its Leading Trading Partners

(Percentage change)




Sources: Congressional Budget Office; Bureau of Economic Analysis; Consensus Economics.

Notes: Growth among the leading trading partners is calculated using an average of the rates of growth of their real (inflation-adjusted) gross domestic products, weighted by their shares of U.S. exports. The trading partners included in the average are Australia, Brazil, Canada, China, Hong Kong, Japan, Mexico, Singapore, South Korea, Switzerland, Taiwan, the United Kingdom, and the countries of the euro zone.

Data are annual. Actual data are plotted through 2012; the value for 2013 reflects CBO's estimates for the third and fourth quarters and does not incorporate data released by the Bureau of Economic Analysis since early December 2013. Projections are plotted through 2024.

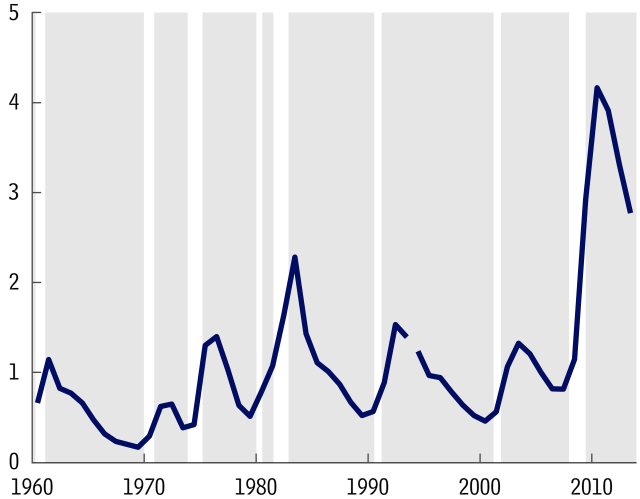
Percentage changes are measured between the fourth quarters of successive years.

12. Consensus Economics, *Asia Pacific Consensus Forecasts* (January 2014), http://tinyurl.com/qhq6sjz; and *Latin American Consensus Forecasts* (January 2014), http://tinyurl.com/nn4w5xl.

**Figure 2-7.**

## Rate of Long-Term Unemployment

(Percent)




Sources: Congressional Budget Office; Bureau of Labor Statistics.

Notes: The rate of long-term unemployment is the share of the labor force that has been out of work for more than 26 consecutive weeks.

The break in the series between 1993 and 1994 reflects the introduction of a new methodology for the Current Population Survey.

Data are annual and are plotted through 2013.

6.7 percent in December).[13] The unemployment rate has now reversed more than half of its rise during and shortly following the recession, although that decline in the rate has occurred in significant part because many people have become discouraged about finding a job and have left the labor force. The rate of long-term unemployment—which identifies the share of the labor force that has been out of work for more than 26 consecutive weeks—also declined last year but remains extraordinarily high (see Figure 2-7). According to CBO's estimates, employment at the end of last year was about 6 million less than it would be if the unemployment rate was back down to its prerecession level and the participation rate was back up to the level it would be without the current cyclical weakness.

CBO expects that the unemployment rate will decline further over the next few years, as GDP grows more quickly and spurs the demand for workers. However, the effect of a strengthening economy on the unemployment rate will be dampened significantly, in CBO's view, because some of the people who left or stayed out of the labor force will resume their search for a job in response to improving labor market conditions. Thus, by CBO's estimates, the unemployment rate will be 6.7 percent in the fourth quarter of 2014 and 5.8 percent in the fourth quarter of 2017 (see Table 2-1 on page 30). Despite the return to the labor force by some people, CBO expects that the rate of labor force participation will decline a bit further in the next several years, owing primarily to ongoing demographic changes. With a tightening labor market, the growth of hourly labor compensation (the combination of wages, salaries, and benefits paid to workers) is expected to pick up.

**Cyclical and Structural Unemployment.** Since the onset of the recession, the unemployment rate has been determined largely by the cyclical weakness of the economy (that is, the downturn and slow recovery of the demand for goods and services) but also by an increase in the importance of structural factors that have boosted the natural rate of unemployment. Of the roughly 2 percentage-point net increase in the unemployment rates between the end of 2007 and the end of 2013, CBO estimates that about 1 percentage point can be attributed to cyclical factors and about 1 percentage point to structural factors.

A broader measure of underutilization in the labor market (known as U-6) has risen even more than the standard measure of unemployment. That measure includes, in addition to people who are unemployed (that is, who are looking for work), people who are "marginally attached" to the labor force (that is, who are not currently looking for work but are willing and able to work and who have looked for work in the past 12 months) and people who work less than 35 hours either because of slack work or business conditions or because they cannot find full-time employment. In the fourth quarter of 2013, that measure stood at 13.3 percent of the labor force, up almost 5 percentage points from the rate in the fourth quarter of 2007 (8.5 percent).

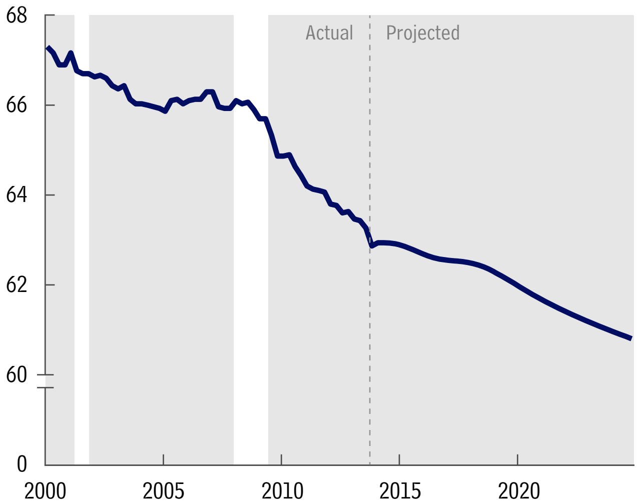
During the next few years, increases in the overall demand for goods and services will encourage firms to increase their output and to augment their workforces in order to do so. Thus, CBO expects that cyclical unemployment will recede further during the next few years.

13. For a more detailed discussion of the labor market, see Congressional Budget Office, *The Slow Recovery of the Labor Market* (February 2014), www.cbo.gov/publication/45011.

**Figure 2-8.**

## Rate of Participation in the Labor Force

(Percent)




Sources: Congressional Budget Office; Bureau of Labor Statistics.

Notes: The rate of participation in the labor force is the percentage of the civilian noninstitutionalized population age 16 or older that is either working or available for and actively seeking work.

Data are quarterly. Actual data are plotted through the third quarter of 2013; projections are plotted through 2024.

The agency also expects that some of the structural factors that have raised the unemployment rate will wane. First, incentives to continue to look for work arising from the extension of unemployment insurance benefits accounted for 0.1 percentage point of the unemployment rate just before those benefits expired at the end of 2013, CBO estimates, and that effect is now disappearing.[14] Second, unusually large difficulties in the process of matching workers and available jobs, which CBO estimates accounted for about one-half of a percentage point of the unemployment rate at the end of 2013, are expected to mostly fade away by the end of 2017. However, effects of the stigma and erosion of skills that can affect people who have been unemployed for a long time, which also accounted for about one-half of a percentage point of the unemployment rate at the end of last year, according to CBO's analysis, are not expected to begin to dissipate until after 2017.

**Participation in the Labor Force.** The labor force participation rate has fallen 3 percentage points during the past several years, from 66.0 percent in the fourth quarter of 2007 to 62.9 percent in the fourth quarter of 2013 (see Figure 2-8). CBO estimates that about 1½ percentage points of that decline stems from ongoing demographic changes—primarily the aging of the population, including the movement of baby boomers into retirement. (The oldest members of that group turned 62 and became eligible for Social Security retirement benefits in 2008.) Because older people are less likely to work than younger people, the aging of the population tends to lower the overall participation rate. In addition, the recent weakness in the economy has led some people to drop out of the labor force temporarily because their job prospects are poor; by CBO's estimates, that effect accounts for about 1 percentage point of the drop in the participation rate since 2007. And the limited opportunities for job-seekers in recent years have caused some people to leave the labor force permanently, a phenomenon that accounts for about one-half of a percentage point of the decline in the participation rate, in CBO's view.

According to CBO's projections, the labor force participation rate will edge down slightly during the next several years, falling to 62.5 percent by the end of 2017, reflecting a balance of opposing forces. On the one hand, the aging of the population will continue to put downward pressure on the participation rate. In addition, reduced incentives to work attributable to the Affordable Care Act (ACA)—with most of the impact arising from new subsidies for health insurance purchased through exchanges—will have a larger negative effect on participation toward the end of that period.[15] On the other hand, the improvement in employment prospects will draw some people who have left the labor force back into it.

14. The extension of benefits included emergency unemployment compensation—which had been available since July 2008 and, at the time it expired, provided up to 47 weeks of additional benefits to eligible unemployed workers who had exhausted their regular 26 weeks of benefits—and provisions under which people in states with high unemployment could receive up to 20 weeks of benefits beyond the regular benefits and emergency unemployment compensation.

15. By providing subsidies that decline with rising income (and increase with falling income) and by making some people financially better off, the ACA will create an incentive for some people to work less. For CBO's full analysis of the effects of the ACA on the labor market, see Appendix C.

**Hourly Labor Compensation.** The growth of labor compensation has been slow since the onset of the recession and continues to be restrained by the weak demand for labor. The growth of the employment cost index (ECI) for total compensation of private industry workers (an indicator of hourly labor costs faced by employers) slowed from around a 3 percent annual rate before the recession to slightly less than 2 percent during the past two years; other indicators of the growth of hourly wages or compensation have exhibited a similar slowdown. CBO expects the growth rate of the ECI to increase, to 2½ percent this year and to more than 3 percent during the following two years, as economic conditions improve.

## Inflation

CBO anticipates that prices will rise at a modest pace over the next several years, consistent with the slack in the economy and expectations for stable inflation. In the agency's projections, the price index for personal consumption expenditures excluding food and energy—the core PCE price index—increases by 1.6 percent (as measured by the change from the fourth quarter of the previous year) in 2014, up from the unusually low reading of 1.1 percent in 2013 (see Table 2-1 on page 30 and Figure 2-1 on page 31). Given current prices in futures markets for agricultural commodities and crude oil, the PCE price index including prices for food and energy is projected to increase by a similar amount this year—1.5 percent, up from 0.9 percent in 2013. After 2014, according to CBO's projections, the rate of inflation in the PCE price index will rise slowly toward 2.0 percent, which is the Federal Reserve's goal.

The consumer price index for all urban consumers (CPI-U) and its core version are expected to increase a little more rapidly than their PCE counterparts, reflecting both different methods used to calculate those indexes and a larger role for housing rents in the consumer price indexes. CBO projects that the difference between inflation as measured by the CPI and the PCE price index will generally be 0.3 to 0.4 percentage points per year (consistent with the average difference in the past several decades implied by the revised national income and product accounts published by BEA in July 2013).

## Some Uncertainties in the Economic Outlook Through 2017

Economic forecasts are always uncertain, but the uncertainty surrounding CBO's forecast for the next several years is probably greater than it was during the years following previous recessions because the current business cycle has been unusual in a variety of ways.[16] CBO constructed its current forecast to be, like its previous forecasts, an average of possible outcomes for the economy given the federal fiscal policies that are embodied in current law.

Even if no significant changes are made to those fiscal policies, economic outcomes will undoubtedly differ from CBO's projections for various reasons. Unforeseen changes in businesses' confidence, the economies of other countries, interest rates, stock prices, and the availability of mortgage credit could cause economic outcomes to differ substantially, in one direction or the other, from those CBO has projected.

For example, the economy could grow considerably faster than CBO has forecast if the forces that have restrained the recovery faded more rapidly than the agency anticipates. One possibility would be a rapid easing of borrowing constraints in mortgage markets, which could support stronger residential investment, accelerating the recovery in the housing market and further boosting house prices. Households' increased wealth could then buttress consumer spending.

Outcomes that are worse than those in CBO's forecast are also quite possible. For instance, if investment by businesses failed to improve as CBO expects (perhaps because of unforeseen increases in interest rates, decreases in stock prices or businesses' confidence, or tightening of the availability of credit resulting from disruptions in financial markets), then production would rise more slowly than the agency expects, and hiring would probably be weaker as well. That outcome could lead to greater restraint in consumer spending and diminish the recovery in the housing market, which would, in turn, reinforce the weakness in investment by businesses.

16. For a discussion of some unusual features of the current business cycle, see Congressional Budget Office, *What Accounts for the Slow Growth of the Economy After the Recession?* (November 2012), www.cbo.gov/publication/43707.

## The Economic Outlook for 2018 to 2024

CBO's projections for 2018 and later years are based not on forecasts of cyclical movements in the economy but on projections of trends in the factors that underlie potential output, namely, the total hours worked by labor, capital services (the flow of services available for production from the stock of capital goods), and the productivity of those factors. Those projections take into account federal fiscal policies under current law and the agency's estimates of the effects of the recession and slow economic recovery. On the basis of historical experience, CBO expects that, on average, output will be slightly short of its potential level—and, as a result, unemployment will be slightly above its natural rate.

In CBO's projections, the growth of real GDP averages 2.2 percent a year between 2018 and 2024, and the unemployment rate declines from 5.8 percent at the end of 2017 to 5.5 percent in 2024. Both inflation and core inflation as measured by the PCE price index average 2.0 percent over the period; inflation as measured by the CPI-U is a little higher. The interest rates on 3-month Treasury bills and 10-year Treasury notes are projected to be 3.7 percent and 5.0 percent, respectively, during those years.

### Potential Output

CBO projects annual growth of real potential output averaging 2.2 percent during the 2018–2024 period, up from 2.0 percent in the 2014–2017 period, primarily reflecting a pickup in the growth of capital services due to higher investment (including residential investment). Although that rate of growth in the latter part of the upcoming decade is similar to the rate over the past decade, it is substantially lower than the average growth during the 1980s and 1990s (see Table 2-2).

The projected growth rate for potential output between 2018 and 2024 is slower than that during previous economic expansions for several reasons. The first is slower growth in the potential labor force (the labor force adjusted for variations caused by the business cycle), resulting from long-term demographic trends, namely, the aging of the population and retirement of the baby-boom generation. Second, changes in the rates of labor force participation *within* some demographic groups will also hold back the growth of the potential labor force; in particular, CBO projects that the labor force participation rate of women in the prime working years (ages 25 to 54) will remain roughly stable, after rising rapidly from the 1960s to the mid-1990s. A third factor is that slower-than-average growth of the potential labor force will attenuate the growth of capital services in the economy, because smaller increases in the stock of structures, equipment, and intellectual property products will be needed to equip the workforce with the same amount of capital per worker; as a result, investment by businesses will be less than would otherwise occur.

In addition, changes in people's economic incentives caused by federal tax and spending policies set in current law are expected to reduce the number of hours worked such that aggregate compensation of labor will be almost 1½ percent lower in 2024 than what would occur in the absence of those changes. That estimate largely reflects changes in labor hours worked owing to the ACA. Given the greater subsidies for health insurance to people with lower earnings and the higher taxes on some people under the ACA, some people will choose to work fewer hours, yielding a net reduction in aggregate labor compensation of roughly 1 percent over the period from 2017 to 2024, CBO estimates.[17] Separately, rising incomes will push some taxpayers into higher tax brackets over time, which will reduce their incentive to work and trim aggregate compensation by almost one-half percent by 2024, according to CBO's analysis.

CBO also expects that the recession and slow recovery will have lingering negative effects on potential output. Persistently weak conditions in the labor market have led some workers to permanently leave the labor force, and the lasting effects of high long-term unemployment have boosted the natural rate of unemployment relative to its prerecession level. In addition, the low level of investment during the past several years has held down the growth of capital services, and, despite CBO's projection of brisk growth in investment in coming years, the agency does not expect the capital stock in 2024 to be as large as it would have been in the absence of the recession. Also, CBO estimates that the protracted weakness in demand and large amount of slack in the labor market have lowered potential total factor productivity (the average real

17. For further discussion of the effects of the ACA on the labor market, see Appendix C.

**Table 2-2.**

## Key Assumptions in CBO's Projection of Potential GDP

(By calendar year, in percent)

| | Average Annual Growth | | | | | | Projected Average Annual Growth | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1950-1973 | 1974-1981 | 1982-1990 | 1991-2001 | 2002-2013 | Total, 1950-2013 | 2014-2017 | 2018-2024 | Total, 2014-2024 |
| **Overall Economy** | | | | | | | | | |
| Potential GDP | 4.0 | 3.3 | 3.2 | 3.2 | 2.2 | 3.3 | 2.0 | 2.2 | 2.1 |
| Potential Labor Force | 1.6 | 2.5 | 1.6 | 1.3 | 0.8 | 1.5 | 0.6 | 0.5 | 0.5 |
| Potential Labor Force Productivity[a] | 2.4 | 0.8 | 1.5 | 1.9 | 1.5 | 1.8 | 1.4 | 1.7 | 1.6 |
| **Nonfarm Business Sector** | | | | | | | | | |
| Potential GDP | 4.0 | 3.7 | 3.3 | 3.6 | 2.5 | 3.5 | 2.4 | 2.6 | 2.5 |
| Potential Hours Worked | 1.4 | 2.4 | 1.6 | 1.2 | 0.5 | 1.3 | 0.5 | 0.6 | 0.6 |
| Capital Services | 3.9 | 4.1 | 4.0 | 4.3 | 2.5 | 3.8 | 2.9 | 3.2 | 3.1 |
| Potential TFP | 1.9 | 0.8 | 1.0 | 1.4 | 1.5 | 1.5 | 1.2 | 1.2 | 1.2 |
| Potential TFP excluding adjustments | 1.9 | 0.8 | 1.0 | 1.4 | 1.2 | 1.4 | 1.2 | 1.2 | 1.2 |
| Adjustments to TFP (Percentage points)[b] | 0 | 0 | 0 | 0.1 | 0.2 | * | ** | 0 | ** |
| Contributions to the Growth of Potential GDP (Percentage points) | | | | | | | | | |
| Potential hours worked | 0.9 | 1.7 | 1.1 | 0.9 | 0.3 | 0.9 | 0.4 | 0.4 | 0.4 |
| Capital input | 1.2 | 1.2 | 1.2 | 1.3 | 0.8 | 1.1 | 0.9 | 1.0 | 0.9 |
| Potential TFP | 1.9 | 0.8 | 1.0 | 1.4 | 1.5 | 1.5 | 1.2 | 1.2 | 1.2 |
| Total Contributions | 4.0 | 3.7 | 3.3 | 3.6 | 2.5 | 3.5 | 2.4 | 2.6 | 2.5 |
| Potential Labor Productivity[c] | 2.7 | 1.3 | 1.7 | 2.4 | 2.1 | 2.2 | 1.9 | 2.0 | 2.0 |

Source: Congressional Budget Office.

Notes: Potential GDP is CBO's estimate of the maximum sustainable output of the economy.

GDP = gross domestic product; TFP = total factor productivity; * = between zero and 0.05 percentage points; ** = between -0.05 percentage points and zero.

a. The ratio of potential GDP to the potential labor force.

b. The adjustments reflect CBO's estimate of the effects of the 2007–2009 recession on potential GDP (over and above its impact on capital services and potential hours worked) as well as the unusually rapid growth of TFP between 2001 and 2003.

c. The ratio of potential GDP to potential hours worked in the nonfarm business sector.

output per unit of combined labor and capital services) by reducing the speed with which resources are being reallocated to their most productive uses, slowing the rate at which workers are gaining new skills, and restraining businesses' spending for research and development. Combining those effects, CBO estimates that the 2007–2009 recession and the ensuing weak recovery will reduce the level of potential output through the 2017–2024 period by roughly 1¾ percent—0.7 percentage points from fewer potential hours worked, 0.6 percentage points from lower capital services, and 0.5 percentage points from lower total factor productivity.[18]

### The Nonfarm Business Sector

As with the economy as a whole, the projected growth rate of 2.6 percent for real potential output in the nonfarm business sector (which produces about three-quarters of the total output of the economy) during the 2018–2024 period is about 0.7 percentage points lower than the average rate during the 1980s and 1990s but similar to the experience of the last decade.

**Potential Hours Worked.** In CBO's projections, growth of potential hours worked in the nonfarm business sector averages 0.6 percent annually during the 2018–2024 period, well below the average growth rate in the 1980s and 1990s but close to the average since 2002. The lower growth relative to that in earlier decades primarily reflects the aging of the population and the leveling off of the labor force participation rate of women in their prime working years.

**Capital Services.** Capital services in nonfarm business are projected to grow at an average rate of 3.2 percent a year in the 2018–2024 period. That rate is lower than the average rate during the 1980s and 1990s. However, it is higher than the average rate from 2002 to 2013 because investment during the recession and first part of the recovery was especially low and, CBO expects, businesses will still be making up for some of the investment they did not undertake during that period. Nonetheless, the lingering effects of the recession, including reductions in potential labor hours and productivity, will probably deter businesses from making up all of the investment that did not occur earlier, so the amount of capital services in 2024 is projected to be less than would have occurred in the absence of the recession.

**Productivity.** In CBO's projections, the growth rate of potential total factor productivity in the nonfarm business sector averages 1.2 percent per year from 2018 through 2024, somewhat higher than its average growth during the 1980s and 1990s but somewhat lower than the growth rate since 2002. The faster average growth during the past dozen years was generated, in large part, by a surge in productivity during a few years early in that period whose source is unclear and which CBO thinks is unlikely to be repeated.

### Sectors Outside of the Nonfarm Business Sector

Real potential output in sectors of the economy other than nonfarm business—government, households (primarily the services from owner-occupied housing), nonprofit institutions serving households, and farms—is projected to grow more slowly than overall potential output, as has generally been true historically. Growth in the 2018–2024 period is projected to be considerably lower than the average rate since World War II because of lower projected growth in the household and nonprofit sectors, as well as lower growth in federal, state, and local governments' spending.

## Unemployment, Inflation, and Interest Rates

In CBO's projections, the rate of unemployment declines from 5.8 percent at the end of 2017 to 5.5 percent in 2024. CBO's estimate of the natural rate of unemployment declines similarly—with corresponding values of 5.5 percent and 5.2 percent. Those improvements reflect diminishing effects of structural factors associated with long-term unemployment (namely, the stigma of being unemployed for a long time and the erosion of skills that occurs), which contribute about one-quarter of a percentage point to the projected natural rate in 2024, down from about one-half of a percentage point in 2017. Those effects will fade as some of the people unemployed for a long time retire (or otherwise permanently withdraw from the labor force) and as others eventually obtain stable jobs.

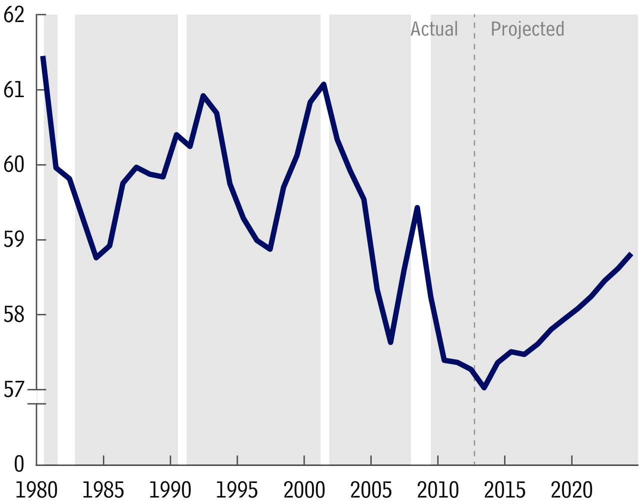
CBO projects an unemployment rate about one-quarter of a percentage point above the natural rate in the 2018–2024 period. That projection is not based on a forecast of

18. CBO's current estimate of the effect of the recession and slow recovery on potential hours worked is more negative than the estimate in the February 2013 *Budget and Economic Outlook* because the agency has increased its estimate of the effect on labor force participation. Since 2007, CBO has lowered its projection of potential output in 2017—the end of the projection period for the estimates made in 2007—by 7.3 percent, much more than the 1¾ percent reduction that the agency attributes to the recession and ensuing economic weakness. (That comparison excludes the effects of changes BEA made to the definition of GDP, which are described in Box 2-1 on page 29.) The bulk of the difference is attributable to CBO's reassessment of long-term trends that were already under way before the recession. To a lesser extent, the downward revision is attributable to revisions of historical data, changes in CBO's methods for estimating potential output and the effect of higher federal debt in "crowding out" additional capital investment in the long term. For analysis of those revisions, see Congressional Budget Office, *The Revisions to CBO's Projections of Potential Output Since 2007* (forthcoming, February 2014), www.cbo.gov/publication/45012.

**Figure 2-9.**

## Labor Income

(Percentage of gross domestic income)




Sources: Congressional Budget Office; Bureau of Economic Analysis.

Notes: Labor income is defined as the sum of employees' compensation and CBO's estimate of the share of proprietors' income that is attributable to labor. Gross domestic income is the sum of all income earned in the production of gross domestic product.

Data are annual. Actual data are plotted through 2012; the value for 2013 reflects CBO's estimates for the third and fourth quarters and does not incorporate data released by the Bureau of Economic Analysis since early December 2013. Projections are plotted through 2024.

specific cyclical movements in the economy. Instead, it is based on CBO's estimate that, on average, the unemployment rate has been roughly that much higher than the natural rate since the end of World War II and, in fact, higher than the natural rate during each of the past five business cycles. That difference has arisen because the shortfalls in output relative to CBO's estimate of its potential during and after economic downturns have been larger and have lasted longer than the excesses of output over its potential during economic booms. Consistent with that pattern, CBO projects, real GDP will be about one-half percent below potential GDP, on average, during the 2018–2024 period.

In CBO's projections, inflation, as measured by the PCE price index and the core PCE price index, averages 2.0 percent annually during the 2018–2024 period, which is in line with the Federal Reserve's goal. As measured by the CPI-U and core CPI-U, projected inflation is higher during that period, at 2.4 percent and 2.3 percent, respectively. Differences in the way that the two price indexes are calculated cause the CPI-U to grow faster than the PCE price index, on average.

In CBO's forecast, the interest rates on 3-month Treasury bills and 10-year Treasury notes are 3.7 percent and 5.0 percent, respectively, from 2018 to 2024. Those projections are broadly consistent with the historical relationships among interest rates, inflation, federal borrowing, the gap between actual and potential GDP, and the factors that underlie the growth of potential GDP. The projected rate on 10-year Treasury notes adjusted for inflation as measured by the CPI-U equals 2.6 percent in those years, a little higher than its historical average. That difference is the net effect of a number of factors—in particular, the higher-than-average ratio of federal debt to GDP during that period (which would tend to increase interest rates) and the more slowly growing labor force and shortfall of GDP relative to its potential (which would tend to reduce them).

## Projections of Income

Economic activity and federal tax revenues depend not only on the amount of total income in the economy but also on how that income is divided among its constituent parts: wages and salaries, domestic economic profits, proprietors' income, interest and dividend income, and other categories. CBO projects various categories of income by estimating their shares of total gross domestic income (GDI). (In principle, GDI equals GDP because each dollar of production produces a dollar of income; in practice, they differ because of difficulties in measuring both quantities.)

CBO expects labor income as a share of GDI to increase during the projection period after declining since the recession (see Figure 2-9).[19] By CBO's estimates, labor's share of income averaged about 57 percent in 2013, down from over 59 percent in 2008. Much of that decline reflects slower growth in wages and salaries (the largest component of labor income) than in the other components of GDI. Historically, labor's share of income tends to decline early in recoveries and to rise later. In CBO's projections, labor income grows faster than GDI

19. CBO defines labor income as the sum of employees' compensation and a percentage of proprietors' income (that percentage being employees' compensation as a share of the difference between GDI and proprietors' income).

over the next decade, bringing its share back to almost 59 percent in 2024—about half a percentage point below its average since 1980. The projected increase in labor's share of income stems primarily from faster growth in real hourly labor compensation, which picks up during the first part of the projection period in response to stronger demand for labor and then remains solid during the latter years of the period. However, CBO does not expect labor's share of income to reach its post-1980 average because factors that have depressed it in recent years, such as technological change and globalization, will continue during the coming decade.[20]

In CBO's projections, domestic economic profits as a percentage of GDI fall to 7 percent in 2024 from about 10 percent of GDI in 2013. That percentage falls mainly because, by CBO's expectations, rising interest rates will increase corporate interest payments, depreciation will increase as a share of GDI as robust growth in business fixed investment speeds the growth of the capital stock, and the growth of labor compensation will pick up.

## Comparison With CBO's February 2013 Projections

CBO's current economic projections differ in some important respects from the projections it issued in February 2013 (see Table 2-3). In particular, projected growth of real GDP is now lower in each year than it was last February, and the projected level of real GDP in 2023 is 2 percent lower.[21] (That comparison and the others discussed here exclude the effects of changes that BEA made to the definition of GDP in its comprehensive revision in July 2013, which are described in Box 2-1 on page 29.)[22]

Of that downward revision of 2 percent to output in 2023, 1½ percentage points stems from a reduction in CBO's estimate of potential output, both for recent years and for the next decade, and one-half of a percentage point owes to a gap between actual and potential output that CBO now incorporates. The agency's current estimate of potential output in 2013 is one-half percent lower than its previous estimate, primarily because of newly available data released in BEA's comprehensive revision to the national income and product accounts (leaving aside definitional changes). And for 2013 to 2023, CBO's projection for the growth of potential GDP is about 0.1 percentage point lower per year than its previous estimate, resulting in an additional downward revision to potential output of about 1 percent at the end of the projection period. The revision to projected growth of potential output over the next decade is the net result of several factors:

- A downward revision to the projected growth of potential total factor productivity (reflecting a reassessment of historical trends); that measure of productivity is now projected to grow by an average of 1.2 percent per year, compared with the 1.3 percent projected previously.
- A downward revision to the projected growth of the capital stock (reflecting new data and lower projected investment resulting primarily from higher federal debt); the capital stock is now projected to grow by an average of 3.1 percent per year, compared with the 3.4 percent projected previously.
- Little net change to projected growth of potential hours worked, as revisions to historical data that suggest a stronger trend were roughly offset by more negative estimated effects from the recession and weak recovery and from the ACA.

In addition, CBO now projects that, on average, a gap between GDP and potential GDP will remain during the

20. For further discussion of the labor share of income, see Congressional Budget Office, *How CBO Projects Income* (July 2013), www.cbo.gov/publication/44433.

21. CBO revised downward its projection of the growth of GDP in 2014 despite the enactment of the Bipartisan Budget Act of 2013. That act lessened the restraint embodied in federal fiscal policy for 2014 by allowing more discretionary spending in the near term than the amount under prior law, thereby adding about one-quarter of a percentage point to growth in 2014 (measured in the fourth quarter from the fourth quarter of the previous year), CBO estimates.

22. Specifically, in making its comparisons, CBO adjusted the previous projection of nominal output upward by 3.2 percent in order to roughly account for the change in the definition of GDP in the comprehensive revision. That adjustment is approximately equal to the average upward revision to nominal GDP between 1950 and 2012 resulting from the comprehensive revision. In addition, because the comprehensive revision changed the reference year for calculating inflation-adjusted values from 2005 to 2009, CBO recalculated its previous projections of real output in 2009 dollars using those adjusted nominal measures of output.

**Table 2-3.**

## Comparison of CBO's Current and Previous Economic Projections for Calendar Years 2013 to 2023

| | Estimated, 2013 | Forecast | | | | Projected Annual Average, 2018-2023 |
|---|---|---|---|---|---|---|
| | | 2014 | 2015 | 2016 | 2017 | |
| | Fourth Quarter to Fourth Quarter (Percentage change) | | | | | |
| Real Gross Domestic Product | | | | | | |
| February 2014 | 2.1 | 3.1 | 3.4 | 3.4 | 2.7 | 2.2 |
| February 2013 | 1.4 | 3.4 | 4.4 | 4.3 | 3.2 | 2.3 |
| Nominal Gross Domestic Product | | | | | | |
| February 2014 | 3.5 | 4.7 | 5.2 | 5.3 | 4.7 | 4.2 |
| February 2013 | 2.9 | 5.3 | 6.5 | 6.4 | 5.4 | 4.4 |
| PCE Price Index | | | | | | |
| February 2014 | 0.9 | 1.5 | 1.7 | 1.8 | 1.9 | 2.0 |
| February 2013 | 1.3 | 1.8 | 1.9 | 1.9 | 2.0 | 2.0 |
| Consumer Price Index[a] | | | | | | |
| February 2014 | 1.2 [b] | 1.9 | 2.1 | 2.1 | 2.3 | 2.4 |
| February 2013 | 1.5 | 2.0 | 2.1 | 2.1 | 2.3 | 2.3 |
| GDP Price Index | | | | | | |
| February 2014 | 1.4 | 1.6 | 1.7 | 1.9 | 1.9 | 2.0 |
| February 2013 | 1.5 | 1.9 | 2.1 | 2.1 | 2.1 | 2.0 |
| Employment Cost Index[c] | | | | | | |
| February 2014 | 2.1 | 2.6 | 3.3 | 3.6 | 3.9 | 3.7 |
| February 2013 | 2.2 | 3.3 | 4.0 | 4.0 | 4.2 | 3.7 |
| Real Potential GDP | | | | | | |
| February 2014 | 1.7 | 1.8 | 2.0 | 2.2 | 2.4 | 2.2 |
| February 2013 | 1.8 | 2.0 | 2.1 | 2.3 | 2.5 | 2.3 |
| | Calendar Year Average | | | | | |
| Unemployment Rate (Percent) | | | | | | |
| February 2014 | 7.4 [b] | 6.8 | 6.5 | 6.1 | 5.9 | 5.6 |
| February 2013 | 7.9 | 7.8 | 7.1 | 6.3 | 5.6 | 5.4 |
| Interest Rates (Percent) | | | | | | |
| Three-month Treasury bills | | | | | | |
| February 2014 | 0.1 [b] | 0.2 | 0.4 | 1.8 | 3.3 | 3.7 |
| February 2013 | 0.1 | 0.2 | 0.2 | 1.5 | 3.4 | 4.0 |
| Ten-year Treasury notes | | | | | | |
| February 2014 | 2.4 [b] | 3.1 | 3.7 | 4.3 | 4.8 | 5.0 |
| February 2013 | 2.1 | 2.7 | 3.5 | 4.3 | 5.0 | 5.2 |
| Tax Bases (Percentage of GDP) | | | | | | |
| Wages and salaries | | | | | | |
| February 2014 | 42.6 | 42.6 | 42.5 | 42.5 | 42.6 | 43.1 |
| February 2013 | 43.5 | 43.9 | 44.0 | 44.1 | 44.2 | 44.9 |
| Domestic economic profits | | | | | | |
| February 2014 | 9.9 | 9.5 | 9.5 | 9.5 | 9.0 | 7.7 |
| February 2013 | 9.3 | 9.7 | 9.9 | 10.2 | 9.8 | 7.9 |

Source: Congressional Budget Office.

Notes: Estimated values for 2013 do not reflect the values for GDP and related series released by the Bureau of Economic Analysis since early December 2013.

PCE = personal consumption expenditures; GDP = gross domestic product.

a. The consumer price index for all urban consumers.

b. Actual value for 2013. (Actual values come from the Bureau of Labor Statistics and the Federal Reserve.)

c. The employment cost index for wages and salaries of workers in private industry.

2018–2024 period. In the agency's current projections, real GDP is one-half percent below potential GDP, on average, during that period. That projection is based on CBO's estimate that, on average, GDP has been that much lower than potential GDP since the end of World War II and, in fact, lower than potential GDP during each of the past five business cycles. In contrast, last year CBO projected that GDP would equal potential GDP in the later years of the projection period.

CBO's projection of GDP growth for the coming decade is revised down not only because of the downward revision to GDP at the end of the decade, but also because of an upward revision to GDP in 2013 stemming from last summer's comprehensive revision of the national income and product accounts (leaving aside definitional changes).

Compared with last February's estimates, CBO's current projection for the unemployment rate is lower for the next few years but then higher. In the near term, the projection is lower because of unanticipated declines in the unemployment rate and the rate of labor force participation last year. Later in the coming decade, the projection is higher, as CBO anticipates that the rate will, on average, exceed the natural rate by about one-quarter of a percentage point; last year, CBO projected a return to the natural rate.

CBO currently projects higher long-term interest rates in 2014 and 2015 and higher short-term interest rates in 2015 and 2016 than it estimated a year ago. Those increases reflect in part a more rapid rebound in long-term rates during the past year than the agency had anticipated. They also reflect a somewhat faster projected recovery in the labor market, implying that the Federal Reserve is likely to start raising the federal funds rate slightly sooner than CBO previously expected. CBO also currently projects lower short-term and long-term interest rates in 2017 and later years than it estimated previously. Those decreases primarily reflect the new projection that real GDP will be slightly below its potential, on average.

The current forecast also includes a lower rate of inflation, as measured by the price indexes for personal consumption expenditures and GDP, over the next few years. Both overall and core inflation in the PCE price index in 2013 were lower than had been anticipated in CBO's previous forecast. Core inflation rates tend to be fairly persistent, probably because observed inflation affects workers' and businesses' expectations for inflation, and those expectations influence workers' bargaining for wages and businesses' decisions about prices. So CBO has dampened its near-term projection to reflect the expected persistence of those recent lower-than-anticipated rates of inflation. In addition, BEA's comprehensive revision of the national income and product accounts lowered estimates of historical inflation rates in the PCE and GDP price indexes. (As a consequence of that revision, CBO projects a slightly larger difference between inflation as measured by the CPI and the PCE price index than what it estimated previously.)

Given the downward revisions to both historical and projected inflation in the GDP price index, CBO has revised down its projection of the level of the GDP price index in 2023. In addition to lowering estimates of historical inflation rates, the comprehensive revision also adjusted the reference year for the GDP price index to 2009 from 2005. Therefore, in order to compare the current projection of inflation in the GDP price index with the previous projection, CBO adjusted the previous projection to reflect 2009 dollars. With that adjustment, the level of the GDP price index in CBO's current projection for 2023 is 1.7 percent lower than the level that was projected a year ago. Coupled with CBO's 2.0 percent downward revision to its projection of real GDP in 2023, the 1.7 percent downward revision to the level of prices in 2023 puts CBO's current projection of nominal GDP in that year 3.6 percent lower than it was before.

## Comparison With Other Economic Projections

CBO's projections differ only slightly from the *Blue Chip* consensus forecast published in January 2014 and from the Federal Reserve's forecasts presented at the December 2013 meeting of the Federal Open Market Committee (see Table 2-4). The Federal Reserve reports two sets of forecasts: a range (reflecting the forecasts of the members of the Board of Governors and the presidents of the Federal Reserve Banks) and a central tendency (the range excluding the three highest and three lowest projections). CBO's current projection for the growth of real GDP in 2014 and 2015 is somewhat higher than that of the *Blue Chip* consensus but is within the central tendency of the range of Federal Reserve forecasts for both years. CBO's projection for the unemployment rate is slightly above both that of the *Blue Chip* consensus and the central

**Table 2-4.**

## Comparison of Economic Projections by CBO, the *Blue Chip* Consensus, and the Federal Reserve

(By calendar year)

| | Estimated, 2013 | Forecast 2014 | 2015 | 2016 | Longer Run[a] |
|---|---|---|---|---|---|
| | Fourth Quarter to Fourth Quarter (Percentage Change) | | | | |
| Real Gross Domestic Product | | | | | |
| CBO | 2.1 | 3.1 | 3.4 | 3.4 | 2.0 |
| *Blue Chip* | 2.4 | 2.8 | 3.0 | n.a. | n.a. |
| Federal Reserve | | | | | |
| Range | 2.2 to 2.4 | 2.2 to 3.3 | 2.2 to 3.6 | 2.1 to 3.5 | 1.8 to 2.5 |
| Central tendency | 2.2 to 2.3 | 2.8 to 3.2 | 3.0 to 3.4 | 2.5 to 3.2 | 2.2 to 2.4 |
| PCE Price Index | | | | | |
| CBO | 0.9 | 1.5 | 1.7 | 1.8 | 2.0 |
| Federal Reserve | | | | | |
| Range | 0.9 to 1.2 | 1.3 to 1.8 | 1.4 to 2.3 | 1.6 to 2.2 | 2.0 |
| Central tendency | 0.9 to 1.0 | 1.4 to 1.6 | 1.5 to 2.0 | 1.7 to 2.0 | 2.0 |
| Core PCE Price Index[b] | | | | | |
| CBO | 1.1 | 1.6 | 1.8 | 1.9 | 2.0 |
| Federal Reserve | | | | | |
| Range | 1.1 to 1.2 | 1.3 to 1.8 | 1.5 to 2.3 | 1.6 to 2.2 | n.a. |
| Central tendency | 1.1 to 1.2 | 1.4 to 1.6 | 1.6 to 2.0 | 1.8 to 2.0 | n.a. |
| Consumer Price Index[c] | | | | | |
| CBO | 1.2[d] | 1.9 | 2.1 | 2.1 | 2.4 |
| *Blue Chip* | 1.2[d] | 1.9 | 2.1 | n.a. | n.a. |
| GDP Price Index | | | | | |
| CBO | 1.4 | 1.6 | 1.7 | 1.9 | 2.0 |
| *Blue Chip* | 1.3 | 1.8 | 2.0 | n.a. | n.a. |

**Continued**

tendency of the range of Federal Reserve forecasts in 2014 and 2015. CBO's estimates of the unemployment rate later in the projection period are close to the mid-point of the range of forecasts of the "longer run" rate in the Federal Reserve forecasts. CBO's projections for inflation are similar to those of the other forecasters: Growth in the PCE price index is within the central tendency of Federal Reserve forecasts, and the projected growth in the CPI-U is equal to the projections of the *Blue Chip* consensus in 2014 and 2015. In contrast, CBO's projections of growth in the GDP price index in 2014 and 2015 are slightly below the projections of the *Blue Chip* consensus.

The differences between CBO's projections and those of the outside forecasters probably stem from a variety of factors, including varying assumptions about the government's future tax and spending policies (other forecasters may be assuming changes to current law), the economic news available when the forecasts were completed, and differences in the economic and statistical models used.

**Table 2-4.** **Continued**

## Comparison of Economic Projections by CBO, the *Blue Chip* Consensus, and the Federal Reserve

(By calendar year)

| | Estimated, 2013 | Forecast 2014 | 2015 | 2016 | Longer Run[a] |
|---|---|---|---|---|---|
| | | | Fourth-Quarter Level (Percent) | | |
| Unemployment Rate | | | | | |
| CBO | 7.0[d] | 6.7 | 6.3 | 6.0 | 5.5 |
| *Blue Chip* | 7.0[d] | 6.6 | 6.1 | n.a. | n.a. |
| Federal Reserve | | | | | |
| Range | 7.0 to 7.1 | 6.2 to 6.7 | 5.5 to 6.2 | 5.0 to 6.0 | 5.2 to 6.0 |
| Central tendency | 7.0 to 7.1 | 6.3 to 6.6 | 5.8 to 6.1 | 5.3 to 5.8 | 5.2 to 5.8 |
| Interest Rates | | | | | |
| Three-month Treasury bills | | | | | |
| CBO | 0.1[d] | 0.2 | 0.8 | 2.4 | 3.7 |
| *Blue Chip* | 0.1[d] | 0.1 | 0.8 | n.a. | n.a. |
| Ten-year Treasury notes | | | | | |
| CBO | 2.7[d] | 3.4 | 3.9 | 4.5 | 5.0 |
| *Blue Chip* | 2.7[d] | 3.4 | 3.9 | n.a. | n.a. |

Sources: Congressional Budget Office; Aspen Publishers, *Blue Chip Economic Indicators* (January 10, 2014); Board of Governors of the Federal Reserve System, "Economic Projections of Federal Reserve Board Members and Federal Reserve Bank Presidents, December 2013" (December 18, 2013).

Notes: The *Blue Chip* consensus is the average of about 50 forecasts by private-sector economists. The range of estimates from the Federal Reserve reflects the forecasts of the members of the Board of Governors and the presidents of the Federal Reserve Banks. The central tendency is that range without the three highest and three lowest projections.

The *Blue Chip* consensus does not provide forecasts of the PCE or core PCE price indexes. The Federal Reserve does not provide forecasts of the consumer price index, the GDP price index, or interest rates.

Estimated values for 2013 do not reflect the values for GDP and related series released by the Bureau of Economic Analysis since early December 2013.

n.a. = not applicable; PCE = personal consumption expenditures; GDP = gross domestic product.

a. For CBO, numbers are for 2024. For the Federal Reserve, numbers represent assessments of the value at which each variable would settle under appropriate monetary policy.

b. Excludes prices for food and energy.

c. The consumer price index for all urban consumers.

d. Actual value for 2013. (Actual values come from the Bureau of Labor Statistics and the Federal Reserve.)

CHAPTER

3

# The Spending Outlook

Under the provisions of current law, federal outlays in 2014 will total $3.5 trillion, the Congressional Budget Office (CBO) estimates, about $90 billion (or 2.6 percent) higher than the amount spent in 2013. Mandatory spending, which makes up about 60 percent of the federal budget, accounts for most of that increase: Such spending is projected to rise by about $85 billion, from $2.0 trillion last year to $2.1 trillion this year (see Table 3-1). In contrast, discretionary spending, which accounts for about one-third of the budget and totaled $1.2 trillion in 2013, is projected to edge down by $7 billion in 2014. Payments for net interest are expected to rise by $12 billion this year to $233 billion. (See Box 3-1 for descriptions of the three major types of federal spending.) All together, federal outlays in 2014 will equal 20.5 percent of gross domestic product (GDP), CBO estimates, which is below last year's total of 20.8 percent. As a percentage of GDP, spending in 2014 is projected to be lower than it has been since 2008 and the same as the average percentage during the past 40 years.

Over the next decade, total outlays in CBO's baseline projections rise relative to GDP, reaching 22.4 percent by 2024. That 1.8 percentage-point increase over the share projected for 2014 reflects growth in spending for Social Security, major health care programs, and net interest, and a decline (relative to GDP) in other mandatory outlays and discretionary spending. Specifically, according to CBO's baseline, federal spending is projected to take the following path:

- Outlays for the largest federal program, Social Security, are expected to rise from 4.9 percent of GDP in 2014 to 5.6 percent in 2024, as the retirement of the baby boomers helps boost the number of people collecting Social Security benefits by one-third.

- Federal outlays for major health care programs—Medicare, Medicaid, the Children's Health Insurance Program (CHIP), and subsidies offered through health insurance exchanges—are projected to increase more rapidly than outlays for Social Security, from 4.8 percent of GDP in 2014 to 6.1 percent in 2024 (net of offsetting receipts for Medicare). That increase is driven by the increasing number of retirees, the expansion of federal subsidies for health insurance, and rising health care spending per beneficiary.

- Outlays for all other mandatory programs (net of other offsetting receipts) are expected to decline from 2.5 percent of GDP in 2014 to 2.2 percent in 2024 because per-beneficiary spending for many of those programs grows with inflation (which is projected to increase at a lower rate than the overall economy) and because the number of beneficiaries of some of those programs is expected to drop as the economy improves.

- Over the next decade, discretionary spending is projected to rise at an average annual rate of less than 2 percent, largely because appropriations are constrained through 2021 by the caps originally established by the Budget Control Act of 2011 (Public Law 112-25) and modified in limited ways by subsequent legislation. As a result, both defense and nondefense discretionary outlays are projected to fall by more than 20 percent relative to the size of the economy over the next 10 years, from 6.9 percent of GDP in 2014 to 5.2 percent in 2024.

- Net interest payments are expected to rise from 1.3 percent of GDP in 2014 to 3.3 percent of GDP in 2024. Such outlays are projected to increase rapidly, by an average of roughly 14 percent per year, as interest rates return to more typical levels and federal debt continues to mount.

**Table 3-1.**

## Outlays Projected in CBO's Baseline

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | In Billions of Dollars | | | | | | | | | | | | | |
| Mandatory | | | | | | | | | | | | | | |
| Social Security | 808 | 846 | 886 | 933 | 989 | 1,050 | 1,116 | 1,188 | 1,263 | 1,341 | 1,422 | 1,506 | 4,975 | 11,694 |
| Medicare | 585 | 603 | 613 | 660 | 680 | 715 | 786 | 839 | 899 | 995 | 1,031 | 1,087 | 3,453 | 8,304 |
| Medicaid | 265 | 298 | 328 | 368 | 393 | 413 | 437 | 461 | 487 | 515 | 543 | 574 | 1,940 | 4,520 |
| Other spending | 679 | 658 | 712 | 768 | 791 | 794 | 805 | 827 | 855 | 894 | 901 | 911 | 3,870 | 8,259 |
| Offsetting receipts | -306 | -289 | -217 | -227 | -239 | -250 | -267 | -276 | -291 | -307 | -324 | -341 | -1,199 | -2,739 |
| Subtotal | 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 | | | | | | | | | | | | | | |
| Defense | 625 | 604 | 603 | 611 | 616 | 624 | 642 | 657 | 673 | 695 | 707 | 719 | 3,096 | 6,546 |
| Nondefense | 576 | 590 | 589 | 581 | 578 | 586 | 596 | 609 | 620 | 634 | 650 | 664 | 2,930 | 6,107 |
| Subtotal | 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 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** |
| 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 |
| **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 | | | | | | | | | | | | | |
| Mandatory | | | | | | | | | | | | | | |
| Social Security | 4.9 | 4.9 | 4.9 | 4.9 | 4.9 | 5.0 | 5.1 | 5.2 | 5.3 | 5.4 | 5.5 | 5.6 | 5.0 | 5.2 |
| Medicare | 3.5 | 3.5 | 3.4 | 3.5 | 3.4 | 3.4 | 3.6 | 3.7 | 3.8 | 4.0 | 4.0 | 4.1 | 3.4 | 3.7 |
| Medicaid | 1.6 | 1.7 | 1.8 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.1 | 2.1 | 2.1 | 2.1 | 1.9 | 2.0 |
| Other spending | 4.1 | 3.8 | 3.9 | 4.0 | 3.9 | 3.8 | 3.7 | 3.6 | 3.6 | 3.6 | 3.5 | 3.4 | 3.9 | 3.7 |
| Offsetting receipts | -1.8 | -1.7 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.3 | -1.3 | -1.2 | -1.2 |
| Subtotal | 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 | | | | | | | | | | | | | | |
| Defense | 3.8 | 3.5 | 3.3 | 3.2 | 3.1 | 3.0 | 2.9 | 2.9 | 2.8 | 2.8 | 2.7 | 2.7 | 3.1 | 2.9 |
| Nondefense | 3.5 | 3.4 | 3.2 | 3.0 | 2.9 | 2.8 | 2.7 | 2.7 | 2.6 | 2.6 | 2.5 | 2.5 | 2.9 | 2.7 |
| Subtotal | 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 Outlays** | **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 |

Source: Congressional Budget Office.

a. Off-budget outlays stem from transactions related to the Social Security trust funds and the net cash flow of the Postal Service.

**Box 3-1.**

## Categories of Federal Spending

On the basis of its treatment in the budget process, federal spending can be divided into three broad categories:

**Mandatory spending** consists primarily of spending for benefit programs, such as Social Security, Medicare, and Medicaid. The Congress generally determines funding for those programs by setting rules for eligibility, benefit formulas, and other parameters rather than by appropriating specific amounts each year. In making baseline projections, the Congressional Budget Office (CBO) generally assumes that existing laws and policies governing those programs will remain unchanged. Mandatory spending also includes offsetting receipts—fees and other charges that are recorded as negative budget authority and outlays. Offsetting receipts differ from revenues in that revenues are collected in the exercise of the government's sovereign powers (for example, in the form of income taxes), whereas offsetting receipts generally are collected from other government accounts or from members of the public for businesslike transactions (for example, as premiums for Medicare or as rental payments and royalties for the drilling of oil or gas on public lands).

**Discretionary spending** is controlled by annual appropriation acts; policymakers decide each year how much money to provide for given activities. Appropriations fund a broad array of government activities, including defense, law enforcement, and transportation. They also fund the national park system, disaster relief, and foreign aid. Some fees and other charges that are triggered by appropriation action are classified as offsetting collections, which are credited against discretionary spending for the particular accounts affected.

For individual discretionary accounts, CBO's baseline depicts the path of that spending as directed by the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985. That act stated that current appropriations should be assumed to grow with inflation in the future. However, the Budget Control Act of 2011 (Public Law 112-25) imposed caps on discretionary appropriations through 2021, and the baseline incorporates the assumption that such funding, in total, will not exceed those caps as amended.

The caps can be adjusted upward for certain appropriations, however—specifically, those for war-related activities known as overseas contingency operations, certain disaster assistance purposes, specified "program integrity" initiatives, or designated emergencies. As a result, CBO's baseline projections use the most recent appropriations for those categories, with increases for inflation, to account for future adjustments to the caps.

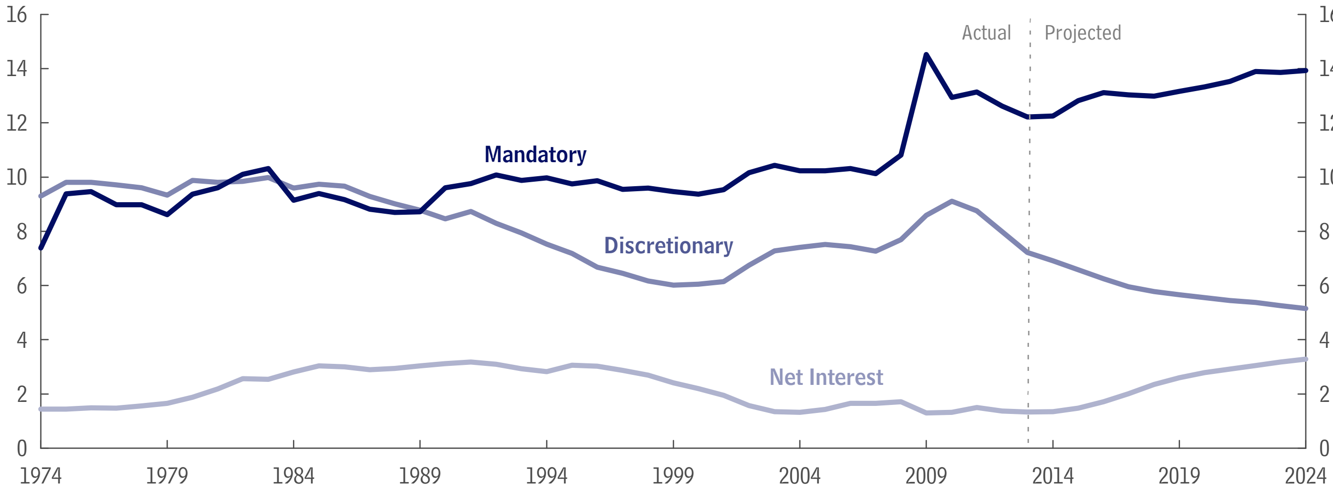
In addition to spending from appropriations subject to the caps, the baseline includes discretionary spending for highway infrastructure, highway and motor carrier safety, public transit, and airport infrastructure programs that receive mandatory budget authority from authorizing legislation. Each year, however, the annual appropriation acts control spending for those programs by limiting how much of the budget authority the Department of Transportation can obligate. For that reason, such obligation limitations are treated as a measure of discretionary resources, and the resulting outlays are considered discretionary spending. Thus far in 2014, transportation obligation limitations total $53 billion.

**Net interest** includes interest paid on Treasury securities and other interest the government pays (for example, on late refunds issued by the Internal Revenue Service) minus interest that the government collects from various sources (for example, some states are required to pay the federal unemployment trust fund interest on advances they received when their state unemployment accounts were insolvent). Net interest is determined by the size and composition of the government's debt, annual budget deficits or surpluses, and market interest rates.

**Figure 3-1.**

## Outlays, by Category

(Percentage of gross domestic product)




Source: Congressional Budget Office.

In developing its baseline projections, CBO generally assumes that the provisions of current law governing federal taxes and spending will remain unchanged, consistent with the rules established by the Balanced Budget and Emergency Deficit Control Act of 1985 (referred to as the Deficit Control Act). Therefore, when projecting spending for mandatory programs, CBO assumes that existing laws will not be altered and that future outlays will depend on changes in caseloads, benefit costs, and other factors. When projecting spending for discretionary programs, CBO assumes that most discretionary appropriations provided between 2014 and 2021 will be constrained by the statutory caps enacted in the Budget Control Act and that appropriations in subsequent years will equal those in the prior year, with adjustments for inflation.[1]

1. CBO developed its projections of discretionary spending through 2021 by inflating the appropriations provided for specific activities in 2014 and then reducing total projected funding for defense and nondefense activities by the amounts necessary to achieve compliance with the caps. Certain appropriations are not constrained by the caps—those for overseas contingency operations (that is, war-related spending), activities receiving emergency designations, disaster relief, and spending designed to enhance program integrity by reducing overpayments in certain benefit programs—and are assumed to grow with inflation from the amounts provided in 2014.

## Mandatory Spending

Mandatory—or direct—spending includes spending for benefit programs and certain other payments to people, businesses, nonprofit institutions, and state and local governments. It is generally governed by statutory criteria and is not normally constrained by the annual appropriation process.[2] Certain types of payments that federal agencies receive from the public and other government agencies are classified as offsetting receipts and offset gross mandatory spending.

Relative to the size of the economy, mandatory spending peaked in 2009 at 14.5 percent of GDP. Since then, spending that increased because of the financial crisis and economic downturn and because of policymakers' response to those developments—outlays for unemployment insurance, for example—has declined, and total mandatory spending dropped to 12.2 percent of GDP in 2013 (see Figure 3-1). Over the next 10 years, however, the aging of the population, the expansion of health insurance subsidies, and rising health care costs per beneficiary will boost spending for federal programs that

2. Each year, some mandatory programs are modified by provisions contained in annual appropriation acts. Such changes may decrease or increase spending for the affected programs (for just one year or for multiple years). In addition, provisions of the Deficit Control Act and the Balanced Budget Act of 1997 govern how CBO projects spending for mandatory programs whose authorizations have expired.

serve the elderly and subsidize health care. As a result, CBO projects, mandatory spending will reverse its recent decline relative to GDP and resume its long-term upward trend.

If no laws are enacted that affect mandatory spending, such spending will rise by 4 percent in 2014, to $2.1 trillion, or 12.3 percent of GDP, in CBO's estimation. Mandatory spending will then rise to $2.3 trillion in 2015, CBO projects, and increase thereafter at an average rate of close to 6 percent per year, reaching $3.7 trillion, or 13.9 percent of GDP, in 2024 (see Table 3-2). By comparison, mandatory spending has averaged 11.7 percent of GDP during the past 10 years and 10.0 percent during the past 40 years.

Mandatory outlays are affected by the timing of certain payments. Specifically, monthly payments for Medicare, veterans' benefits, Supplemental Security Income (SSI), and military retirement are shifted to the previous month if the payment date—normally the first of the month—falls on a weekend or holiday. If the first day of the fiscal year, October 1, falls on a weekend, the shift would result in payments being made in the previous fiscal year. Because October 1, 2022, and October 1, 2023, both fall on weekends, certain payments that ordinarily would be made on those days will instead be made at the end of September, thus shifting them into the previous fiscal year. If not for the effects of those timing shifts, mandatory spending would be 14.1 percent of GDP in 2024.[3]

At $1.8 trillion in 2014, federal outlays for Social Security and for Medicare, Medicaid, and other major health care programs will make up nearly three-quarters of mandatory spending (not including offsetting receipts) and equal 10.3 percent of GDP. Under current law, CBO projects, spending for those programs will rise by $1.6 trillion from 2014 to 2024—accounting for nearly all of the growth in mandatory spending over that period. By 2024, spending for those programs will represent more than half of the federal budget and 12.4 percent of GDP.[4]

Programs that are designed to provide income security—such as certain refundable tax credits, the Supplemental Nutrition Assistance Program (SNAP), and unemployment compensation—will account for about 13 percent of mandatory spending and 1.8 percent of GDP in 2014.[5] By 2024, though, outlays for those programs will shrink to 9 percent of mandatory spending and 1.3 percent of GDP, primarily because the expected economic expansion will allow spending for many of those programs to recede to more typical levels.

Additional mandatory spending programs include retirement benefits for federal civilian and military employees, benefits for veterans, student loans, and support for agriculture. Under current law, CBO projects, such spending will equal 1.7 percent of GDP in 2014 and 1.3 percent of GDP in 2024. Civilian and military retirement benefits account for about half of those amounts. In addition, CBO estimates, offsetting receipts will reduce mandatory outlays by 1.7 percent of GDP in 2014—including payments to the Treasury by Fannie Mae and Freddie Mac equaling 0.5 percent of GDP—and by an average of about 1.2 percent of GDP in ensuing years (when CBO does not record such payments by those two entities).

### Social Security

Social Security, which is the largest federal spending program, provides cash benefits to the elderly, people with disabilities, and their dependents and survivors. Social Security comprises two main parts: Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI). Social Security outlays grew by about 5 percent in 2013 because of increases in caseloads and average benefits.

CBO estimates that, under current law, outlays for Social Security in 2014 will total $846 billion, or 4.9 percent of GDP. Over the next decade, spending for Social Security benefits will climb steadily (by an average of about 6 percent per year) as the nation's elderly population grows and as average benefits rise (see Figure 3-2 on page 56). By 2024, CBO estimates, Social Security outlays will total $1.5 trillion, or 5.6 percent of GDP, if current laws are unchanged.

**Old-Age and Survivors Insurance.** OASI, the larger of Social Security's two components, pays full benefits to

3. Pay for active-duty military personnel is also affected by shifts in the timing of payments, but such spending is classified as discretionary.

4. Including offsetting receipts for Medicare, net outlays for those programs would rise from 9.7 percent of GDP in 2014 to 11.7 percent in 2024.

5. Tax credits reduce a taxpayer's overall income tax liability; if a refundable credit exceeds a taxpayer's other income tax liabilities, the excess may be refunded to the taxpayer, in which case that payment is recorded as an outlay in the budget.

**Table 3-2.**

## Mandatory Outlays Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | | | | | | | | | | | | | | |
| Old-Age and Survivors Insurance | 668 | 703 | 738 | 780 | 831 | 886 | 946 | 1,011 | 1,076 | 1,145 | 1,216 | 1,290 | 4,182 | 9,920 |
| Disability Insurance | 140 | 144 | 148 | 153 | 158 | 164 | 170 | 177 | 186 | 196 | 206 | 216 | 793 | 1,774 |
| Subtotal | 808 | 846 | 886 | 933 | 989 | 1,050 | 1,116 | 1,188 | 1,263 | 1,341 | 1,422 | 1,506 | 4,975 | 11,694 |
| Major Health Care | | | | | | | | | | | | | | |
| Medicare[a] | 585 | 603 | 613 | 660 | 680 | 715 | 786 | 839 | 899 | 995 | 1,031 | 1,087 | 3,453 | 8,304 |
| Medicaid | 265 | 298 | 328 | 368 | 393 | 413 | 437 | 461 | 487 | 515 | 543 | 574 | 1,940 | 4,520 |
| Health insurance subsidies and related spending | 1 | 18 | 62 | 95 | 118 | 121 | 127 | 135 | 143 | 150 | 158 | 166 | 523 | 1,275 |
| Children's Health Insurance Program | 9 | 14 | 15 | 7 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 40 | 68 |
| Subtotal[a] | 861 | 933 | 1,018 | 1,129 | 1,197 | 1,255 | 1,356 | 1,442 | 1,535 | 1,665 | 1,738 | 1,832 | 5,956 | 14,167 |
| Income Security | | | | | | | | | | | | | | |
| Earned income, child, and other tax credits[b] | 84 | 87 | 89 | 92 | 93 | 94 | 78 | 80 | 81 | 82 | 84 | 85 | 446 | 858 |
| Supplemental Nutrition Assistance Program | 83 | 80 | 80 | 79 | 78 | 76 | 76 | 75 | 75 | 74 | 74 | 74 | 388 | 761 |
| Supplemental Security Income | 53 | 54 | 55 | 61 | 59 | 55 | 62 | 64 | 66 | 74 | 71 | 67 | 293 | 634 |
| Unemployment compensation | 69 | 46 | 41 | 41 | 42 | 44 | 47 | 50 | 53 | 55 | 58 | 61 | 215 | 491 |
| Family support and foster care[c] | 32 | 31 | 31 | 32 | 32 | 32 | 32 | 32 | 33 | 33 | 33 | 33 | 159 | 323 |
| Child nutrition | 20 | 21 | 22 | 23 | 23 | 24 | 25 | 26 | 27 | 28 | 30 | 31 | 117 | 259 |
| Subtotal | 340 | 319 | 318 | 327 | 326 | 326 | 320 | 327 | 334 | 347 | 349 | 351 | 1,618 | 3,327 |
| Federal Civilian and Military Retirement | | | | | | | | | | | | | | |
| Civilian[d] | 92 | 94 | 97 | 100 | 103 | 106 | 109 | 113 | 117 | 121 | 125 | 128 | 515 | 1,120 |
| Military | 54 | 55 | 57 | 62 | 59 | 56 | 62 | 64 | 65 | 72 | 69 | 66 | 296 | 633 |
| Other | 7 | 8 | 8 | 8 | 8 | 8 | 9 | 9 | 10 | 9 | 9 | 9 | 41 | 88 |
| Subtotal | 152 | 158 | 161 | 170 | 170 | 171 | 180 | 186 | 192 | 202 | 204 | 204 | 852 | 1,840 |
| Veterans[e] | | | | | | | | | | | | | | |
| Income security | 66 | 70 | 73 | 82 | 79 | 75 | 83 | 85 | 86 | 94 | 87 | 81 | 392 | 825 |
| Other | 14 | 14 | 15 | 16 | 16 | 17 | 18 | 19 | 20 | 22 | 22 | 22 | 81 | 186 |
| Subtotal | 80 | 85 | 88 | 98 | 95 | 91 | 101 | 104 | 105 | 115 | 109 | 104 | 473 | 1,010 |
| Other Programs | | | | | | | | | | | | | | |
| Agriculture | 24 | 15 | 14 | 17 | 15 | 15 | 15 | 15 | 15 | 15 | 15 | 16 | 76 | 152 |
| Deposit insurance | 4 | -10 | -9 | -11 | -11 | -12 | -17 | -17 | -12 | -13 | -14 | -15 | -60 | -133 |
| MERHCF | 8 | 9 | 9 | 10 | 10 | 11 | 12 | 12 | 13 | 14 | 15 | 16 | 52 | 123 |
| Higher education | -26 | -7 | -9 | -8 | -4 | -1 | -1 | -2 | -2 | -3 | -3 | -3 | -24 | -37 |
| Other | 85 | 57 | 63 | 64 | 66 | 66 | 62 | 61 | 60 | 61 | 62 | 68 | 321 | 633 |
| Subtotal | 96 | 64 | 68 | 72 | 76 | 79 | 70 | 69 | 75 | 74 | 75 | 81 | 365 | 738 |

Continued

workers who start collecting those benefits at a specified normal retirement age, which depends on a worker's year of birth (normal retirement is currently defined as occurring at age 66 but is slated to rise to age 67); however, workers can choose to start collecting reduced benefits as early as age 62. The program also makes payments to eligible spouses and children of deceased workers. OASI spending totaled $668 billion in 2013, accounting for more than 80 percent of Social Security's outlays.

About 46 million people received OASI benefits in 2013. Over the 2014–2024 period, as more baby boomers become eligible to receive benefits under the program, the number of people collecting those benefits will increase by an average of about 3 percent per year, CBO

Table 3-2. Continued

## Mandatory Outlays Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Offsetting Receipts | | | | | | | | | | | | | | |
| Medicare[f] | -93 | -98 | -100 | -105 | -113 | -122 | -131 | -138 | -149 | -161 | -174 | -189 | -570 | -1,381 |
| Federal share of federal employees' retirement | | | | | | | | | | | | | | |
| Social Security | -16 | -17 | -17 | -18 | -18 | -19 | -20 | -20 | -21 | -22 | -23 | -24 | -91 | -201 |
| Military retirement | -21 | -20 | -20 | -20 | -21 | -21 | -22 | -23 | -24 | -25 | -26 | -27 | -103 | -227 |
| Civil service retirement and other | -29 | -29 | -30 | -30 | -33 | -34 | -35 | -36 | -37 | -39 | -40 | -41 | -162 | -355 |
| Subtotal | -66 | -66 | -66 | -68 | -72 | -74 | -77 | -80 | -82 | -85 | -88 | -92 | -357 | -784 |
| Receipts related to natural resources | -15 | -14 | -14 | -14 | -14 | -15 | -19 | -18 | -18 | -18 | -19 | -21 | -76 | -170 |
| MERHCF | -9 | -8 | -8 | -8 | -8 | -9 | -9 | -10 | -11 | -11 | -12 | -13 | -43 | -99 |
| Other | -123 | -103 | -29 | -32 | -32 | -30 | -30 | -31 | -31 | -31 | -31 | -27 | -154 | -306 |
| Subtotal | -306 | -289 | -217 | -227 | -239 | -250 | -267 | -276 | -291 | -307 | -324 | -341 | -1,199 | -2,739 |
| **Total Mandatory Outlays** | **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** |
| **Memorandum:** | | | | | | | | | | | | | | |
| Mandatory Spending Excluding Offsetting Receipts | 2,338 | 2,405 | 2,540 | 2,729 | 2,853 | 2,972 | 3,144 | 3,315 | 3,504 | 3,744 | 3,897 | 4,077 | 14,238 | 32,777 |
| Medicare Spending Net of Offsetting Receipts | 492 | 505 | 513 | 555 | 567 | 593 | 655 | 701 | 750 | 833 | 858 | 898 | 2,883 | 6,923 |
| Spending for Major Health Care Programs Net of Offsetting Receipts[g] | 768 | 835 | 918 | 1,025 | 1,084 | 1,133 | 1,225 | 1,303 | 1,386 | 1,504 | 1,564 | 1,643 | 5,385 | 12,786 |

Source: Congressional Budget Office.

Notes: Data on spending for benefit programs in this table generally exclude administrative costs, which are discretionary.

MERHCF = Department of Defense Medicare-Eligible Retiree Health Care Fund (including TRICARE for Life).

a. Excludes offsetting receipts.

b. Includes outlays for the American Opportunity Tax Credit and other credits.

c. Includes the Temporary Assistance for Needy Families program, the Child Support Enforcement program, the Child Care Entitlement program, and other programs that benefit children.

d. Includes Civil Service, Foreign Service, Coast Guard, and other, smaller retirement programs as well as annuitants' health care benefits.

e. Income security includes veterans' compensation, pensions, and life insurance programs. Other benefits are primarily education subsidies. The costs of veterans' health care are classified as discretionary spending and thus are not shown in this table.

f. Includes premium payments, recoveries of overpayments made to providers, and amounts paid by states from savings on Medicaid's prescription drug costs.

g. Consists of outlays for Medicare (net of offsetting receipts), Medicaid, health insurance subsidies and related spending, and the Children's Health Insurance Program.

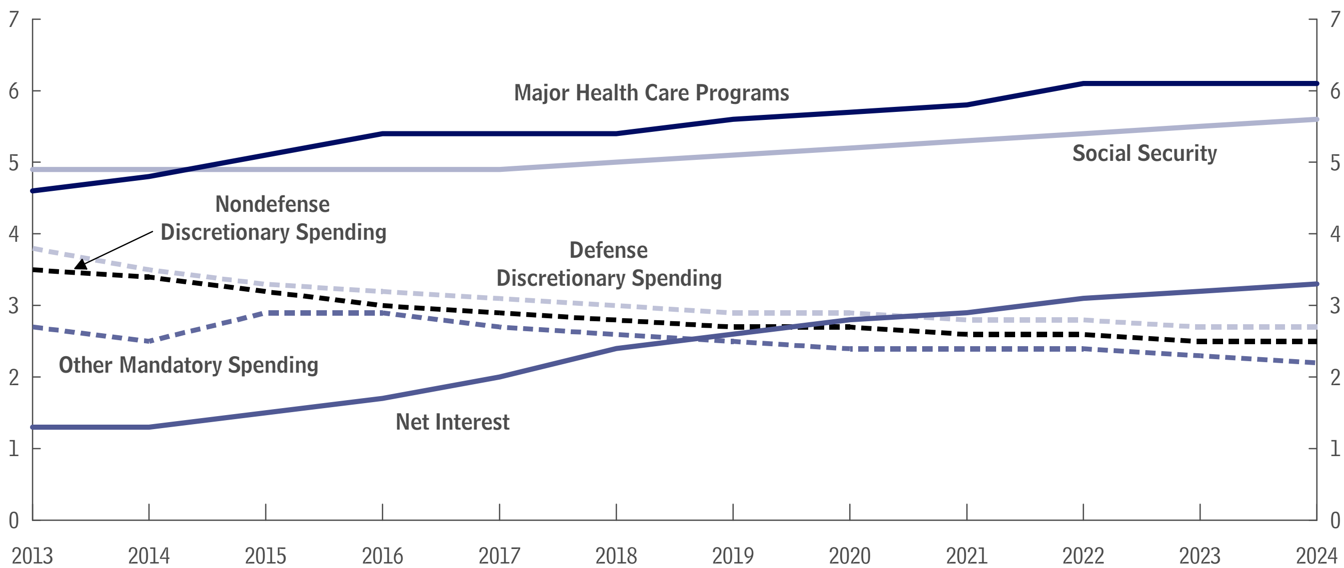
estimates, reaching 63 million by 2024, 38 percent more than the number of recipients in 2013.

Average benefits will also rise over time because beneficiaries generally receive annual cost-of-living adjustments (COLAs) and because initial benefits are based on people's lifetime earnings, which tend to increase over time. OASI beneficiaries received a COLA of 1.5 percent in January 2014. CBO anticipates that beneficiaries will receive a COLA of 1.6 percent in 2015 and that COLAs will average 2.3 percent annually from 2016 through 2024. All told, the average benefit will rise by 3 percent

**Figure 3-2.**

## Projected Spending in Major Budget Categories

(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.

per year over the 2014–2024 period, according to CBO's estimates. The increasing average benefit, in combination with the growing number of beneficiaries, is projected to boost outlays for OASI by an average of about 6 percent per year over that period.

**Disability Insurance.** Social Security's disability benefits are paid to workers who suffer debilitating health conditions before they reach OASI's full retirement age. Payments also are made to the eligible spouses and children of those recipients. In 2013, the federal government paid $140 billion in DI benefits.

The number of people receiving those benefits rose by about 2 percent in 2013, to 11 million, after increasing by 4 percent per year, on average, between 2007 and 2012. The growth in the DI caseload is expected to slow further in 2014 and in subsequent years, as the improving economy leads fewer people to seek disability benefits and as a greater portion of the population qualifies for benefits under OASI. Like OASI beneficiaries, those receiving benefits under DI received a COLA of 1.5 percent for 2014. Including COLAs that will be paid in future years, average DI benefits under current law will grow by just under 3 percent per year, on average, from 2014 through 2024, and the program's outlays will rise by an average of about 4 percent annually during those years, CBO estimates.

### Medicare, Medicaid, and Other Major Health Care Programs

At $861 billion, gross federal outlays for Medicare, Medicaid, and other major programs related to health care accounted for 37 percent of mandatory spending in 2013 and 5.2 percent of GDP. Under current law, CBO estimates, gross federal outlays for those programs in 2014 will jump to $933 billion, or 5.4 percent of GDP. In CBO's baseline projections, gross federal spending for major health care programs nearly doubles between 2014 and 2024, rising by an average of about 7 percent per year, and in 2024 reaches $1.8 trillion, or 6.8 percent of GDP. Net of offsetting receipts (mostly from premiums paid by Medicare beneficiaries), spending for the government's major health care programs is projected to constitute about one-quarter of all federal spending throughout the 10-year projection period.

In CBO's baseline, gross spending for Medicare rises by about 80 percent over the coming decade, but spending for the combination of Medicaid and other health care programs more than doubles, largely because the Affordable Care Act (ACA) is expanding eligibility for Medicaid and providing subsidies for health insurance purchased through exchanges.

**Medicare.** Medicare provides subsidized medical insurance to the elderly and to some people with disabilities. The program has three principal components: Part A (Hospital Insurance), Part B (Medical Insurance, which covers doctors' services, outpatient care, home health services, and other medical services), and Part D (which covers outpatient prescription drugs).[6] People generally become eligible for Medicare at age 65 or two years after they qualify for Social Security disability benefits.

Gross spending for Medicare will total $603 billion in 2014, CBO estimates, or 3.5 percent of GDP, the same share recorded in 2013. By 2024, the program's spending will reach nearly $1.1 trillion, or 4.1 percent of GDP. Medicare also collects substantial offsetting receipts, mostly in the form of premiums paid by beneficiaries, which rise from $98 billion in 2014 to $189 billion in 2024 under CBO's baseline projections. (See the section of this chapter on offsetting receipts for further details.) Including those offsetting receipts, net spending for Medicare will be 2.9 percent of GDP in 2014 and 3.3 percent in 2024, CBO estimates.[7]

Under current law, spending for Medicare is expected to grow by an average of 6 percent per year over the next 10 years. That growth can be attributed in roughly equal parts to increasing caseloads and rising costs per beneficiary. CBO projects that Medicare caseloads will expand at an average rate of 3 percent per year, as growing numbers of baby boomers become eligible for benefits at age 65. In 2013, Medicare had about 51 million beneficiaries; that number is expected to climb to 71 million in 2024.

CBO projects that spending per beneficiary will also grow at an average rate of 3 percent per year over the coming decade—much more slowly than it has grown historically. In particular, CBO projects that after adjusting for inflation, Medicare spending per beneficiary will increase at an average annual rate of 1.5 percent between 2014 and 2024, compared with average annual growth of 4 percent between 1985 and 2007 (excluding the jump in spending that occurred in 2006 with the implementation of Part D, the prescription drug program).

The comparatively slow growth in per-beneficiary spending that CBO projects for the next decade results from a combination of factors. First, the anticipated influx of beneficiaries when they turn 65 will bring down the average age of Medicare beneficiaries, which in turn will reduce average health care costs per beneficiary, holding all else equal.

Second, the slowdown in Medicare cost growth during the past several years has been sufficiently broad and persistent to lead CBO to project that growth will be slower than usual for some years to come. Markedly lower growth rates for Medicare spending in recent years have extended across all types of services, beneficiaries, and major regions.[8] As spending has fallen short of CBO's projections, the agency has made a series of downward adjustments to those projections. For example, since March 2010, CBO has reduced its projection of Medicare outlays in 2020 (the last year included in the March 2010 projection) by $109 billion, or about 12 percent, based on analysis by CBO and other analysts of data on Medicare spending. (CBO has also made other revisions to its projections for Medicare spending in response to legislative action and revisions to CBO's economic outlook.)

The third factor leading to slow projected growth in Medicare spending per beneficiary for the coming decade is the constraints on payment rates for most services that are built into current law:

6. Medicare Part C (known as Medicare Advantage) specifies the rules under which private health care plans can assume responsibility for, and be compensated for, providing benefits covered under Parts A, B, and D.

7. Because October 1, 2023—the first day of fiscal year 2024—falls on a weekend, certain payments to private plans in Medicare will be shifted to the end of fiscal year 2023. Without that shift in timing, net spending for Medicare would be 3.5 percent of GDP in 2024.

8. See Michael Levine and Melinda Buntin, *Why Has Growth in Spending for Fee-for-Service Medicare Slowed?* Working Paper 2013-06 (Congressional Budget Office, August 22, 2013), www.cbo.gov/publication/44513.

- Payment rates for physicians' services are set according to the sustainable growth rate mechanism, or SGR. Under current law, payment rates for those services will be reduced by 24 percent in April 2014 and will increase by small amounts in most subsequent years, CBO projects. However, if future legislation overrides the scheduled reductions (as has happened in every year since 2003), spending for Medicare will be greater than the amount that is projected in CBO's baseline. For example, if payment rates for physicians' services remained at the current level through 2024, net Medicare outlays through 2024 would be about $115 billion (or roughly 2 percent) higher than in CBO's baseline projections. If those payment rates were increased over time, the impact on Medicare outlays would be even greater.

- Payments to other types of providers are limited by provisions of the ACA that hold annual increases in payment rates for Medicare services—apart from those provided by physicians—to about 1 percentage point less than inflation. Under CBO's economic projections, those payment rates are expected to increase by about 1 percent per year on average.[9]

Despite the relatively slow rates of growth projected over the next 10 years, federal spending per beneficiary for Parts A and B is projected to grow by 35 percent; federal spending per beneficiary for Part D, which accounts for a small share of total Medicare spending, will grow much more—by 101 percent—largely because of a combination of rising drug costs and provisions in the ACA that expanded the extent of coverage for some prescription drugs.

**Medicaid.** Medicaid is a joint federal and state program that funds medical care for certain low-income, elderly, and disabled people. The federal government shares costs with states for approved services and administrative costs; that share varies from state to state but has averaged about 57 percent in most years. Federal outlays for Medicaid totaled $265 billion in 2013—nearly 6 percent above the previous year's amount, mostly because of higher per-person spending.

CBO projects that, under current law, federal spending for Medicaid will rise by about 9 percent per year between 2013 and 2018, as states expand coverage under the provisions of the ACA. (See Appendix B for more information on the insurance coverage provisions of the ACA.) After that, spending growth is expected to return to near its historical rate of about 6 percent annually.

Beginning in 2014 and continuing through 2018, states are expected to gradually take up the coverage option made available under the ACA. Many states are likely to take up that option because, of the costs that states incur for newly eligible enrollees under the ACA, the federal government will pay 100 percent from 2014 through 2016, a declining share during the next few years, and 90 percent in 2020 and thereafter.[10] Enrollment in Medicaid is expected to rise from 69 million people at some point in 2013 to 73 million in 2014, because CBO estimates that about 25 states (with about 40 percent of the potential newly eligible population) will expand their programs. CBO anticipates that additional states will expand coverage during the next few years so that by 2018 about 80 percent of the eligible population will be in states that have extended coverage and enrollment in Medicaid will be about 87 million. By 2024, about 89 million people will be enrolled in Medicaid at some point during the year, CBO projects.

Under current law, federal outlays for Medicaid are expected to total $574 billion by 2024, more than twice the amount spent in 2013; spending will equal about 2.1 percent of GDP, compared with 1.6 percent last year, CBO estimates.

**Health Insurance Subsidies and Related Spending.** Individuals and families can now purchase private health insurance coverage through marketplaces known as exchanges that are operated by the federal government or state governments. Certain participants in the exchanges

9. One other factor affecting payments to Medicare providers—but not growth rates over the 2015–2024 period—is a provision of the Budget Control Act of 2011, as amended by the Bipartisan Budget Act of 2013 (P.L. 113-67), that reduces payment rates for most Medicare services by 2 percent. That reduction will apply to payments for services furnished through March 2023; the reduction will be greater—2.9 percent—for services furnished from April 2023 through September 2023, and it will fall to 1.1 percent for services furnished from October 2023 through April 2024.

10. Taking into account the enhanced federal matching rates for populations made eligible under the ACA, the average federal share of spending for Medicaid is expected to be between 58 percent and 61 percent in 2014 and later years, compared with a historical average of 57 percent.

will be eligible for subsidies to cover a portion of their health insurance premiums and additional subsidies to reduce cost-sharing amounts (out-of-pocket payments under their insurance policies). "Related spending" consists of grants to states for establishing health insurance exchanges and outlays for risk adjustment, reinsurance, and risk corridor programs.[11] Outlays for those premium and cost-sharing subsidies combined with related spending are expected to total $18 billion in 2014 and to rise to $166 billion in 2024.

CBO estimates that about 5 million people will receive exchange subsidies in 2014. After a couple of years of rapid increases in enrollment as more people respond to the new coverage choices, roughly 19 million will receive subsidies in 2016, the agency projects. (Other people will purchase health insurance coverage through the exchanges but will not be eligible for subsidies.) After that, enrollment is expected to remain fairly steady. According to CBO's estimates, outlays for exchange subsidies will total $15 billion in 2014 and will rise to $143 billion by 2024. (Additional subsidies will be provided in the form of reductions in people's tax payments.)[12]

CBO estimates that outlays for grants to states for exchange operations will be about $2 billion in 2014. Spending of those grants is winding down because funds for new grants must be obligated by the end of 2014. In CBO's baseline, outlays associated with those grants gradually decline to zero by 2018.

Under the ACA, payments to health insurance plans for risk adjustment (amounts paid to plans that attract less healthy enrollees), reinsurance (amounts paid to plans that enroll individuals who end up with high costs), and risk corridors (amounts paid to health insurance plans whose actual costs for medical claims exceed expected costs) became effective in 2014. Outlays are expected to begin in 2015 and total $20 billion in that year. Over the 2015–2024 period, CBO projects, outlays for those programs will total $208 billion; however, those payments will be more than offset by associated revenues. The three programs are intended to spread more widely—either to other insurance plans or to the federal government—some of the risk that health insurers face when selling health insurance through new exchanges or in the individual or small group markets outside the exchanges. Under current law, the reinsurance and risk corridor programs are authorized for three years (although spending associated with the programs is expected to extend a little beyond those years), and the risk adjustment program is permanent.

By law, risk adjustment payments and reinsurance payments will be offset by collections from health insurance plans of equal magnitudes; those collections will be recorded as revenues. As a result, those payments and collections can have no net effect on the budget deficit. In contrast, risk corridor collections (which will be recorded as revenues) will not necessarily equal risk corridor payments, so that program can have net effects on the budget deficit. CBO projects that the government's risk corridor payments will be $8 billion over three years and that its collections will be $16 billion over that same period (see Appendix B for further discussion).

**Children's Health Insurance Program.** The Children's Health Insurance Program provides health insurance coverage to children in families whose income, although modest, is too high for them to qualify for Medicaid. The program is jointly financed by the federal government and the states and is administered by the states within broad federal guidelines. Total federal spending for CHIP was approximately $9 billion in 2013. Such spending is expected to increase by nearly 50 percent in 2014, rising to $14 billion—largely as a result of the ACA, which added funding to the allotments for states in 2014 and 2015, required that all individuals have health coverage, and increased publicity about the availability of insurance coverage, all of which are expected to increase enrollment in CHIP.

Annual spending for CHIP is projected to reach $15 billion in 2015—the year in which the program is scheduled to expire. Under the rules governing baseline projections for expiring programs, funding for CHIP

11. In previous reports, CBO combined outlays for risk adjustment, reinsurance, and risk corridor payments in the category labeled "Other" under "Health Care Programs" in its table showing mandatory outlays projected in the baseline. In Table 3-2 on page 54 of this report, outlays for all three of those programs are included in "Health insurance subsidies and related spending."

12. The subsidies for health insurance premiums are structured as refundable tax credits; the portions of such credits that exceed taxpayers' other income tax liabilities are classified as outlays, whereas the portions that reduce tax payments appear in the budget as reductions in revenues. The cost-sharing subsidies for enrollees in insurance plans offered through exchanges also are categorized as outlays.

after 2015 is set at an annualized level of about $6 billion; outlays are projected to fall to that amount a few years later.[13] About 8 million people will be enrolled in CHIP at some point in 2014, CBO estimates. Enrollment drops later in the decade, according to baseline projections, mostly because funding is assumed to decline after 2015.

### Income-Security Programs

The federal government makes various payments to people and government entities to assist the poor, the unemployed, and others in need. Federal spending for the refundable portions of the earned income tax credit (EITC) and the child tax credit, SNAP, Supplemental Security Income (SSI), unemployment compensation, family support, foster care, and other services peaked in 2010 at $438 billion, more than twice the $202 billion spent for them in 2007, before the severe recession. The surge in spending occurred partly because outlays for many of those programs tend to rise automatically when the economy falters (and ebb later as the economy recovers) and partly because lawmakers responded to the weak economy by enacting temporary measures to increase the number of people eligible or the benefits payable for some of the programs. As the economy improved, spending for those programs fell; such spending in 2013 totaled $340 billion, or 2.0 percent of GDP.

Under current law, spending on income-security programs is projected to decline by another 6 percent in 2014, reflecting the anticipated further improvement in the economy and the expiration of certain provisions of law. CBO projects that such spending will remain below the 2013 amount until 2022. By 2024, outlays for those programs are anticipated to be 1.3 percent of GDP—about the same as the average during the past 40 years.

**Earned Income, Child, and Other Tax Credits.** Refundable tax credits reduce a filer's overall income tax liability; if the credit exceeds the rest of the filer's income tax liability, the government may pay that excess to the taxpayer. Those payments—the refundable portions of the EITC, child tax credit, American Opportunity Tax Credit (AOTC), and other, much smaller credits—are categorized as outlays. The EITC is a fully refundable credit available primarily to people with earnings and income that fall below established maximums. The child tax credit is a partially refundable credit (limited to 15 percent of earnings over a predetermined threshold) available to qualifying families with dependent children. The AOTC allows certain individuals (including those who owe no taxes) to claim a credit for college expenses. Outlays for those credits totaled $84 billion in 2013.

Such outlays are projected to reach $94 billion in 2018 but drop to $78 billion in 2019 following the expiration, under current law, of the AOTC and of the temporary expansions in the child tax credit and EITC that were enacted at the beginning of January 2013. By 2024, outlays for refundable tax credits will total $85 billion, CBO projects.

**Supplemental Nutrition Assistance Program.** Outlays for SNAP (formerly known as the Food Stamp program) have risen significantly over the past few years. In 2008, spending for SNAP was $39 billion, with enrollment (as measured by the average monthly caseload) of roughly 28 million; in 2013, spending for SNAP was $83 billion, with enrollment of almost 48 million. CBO estimates that the program's spending will decline to $80 billion this year, in part because of the expiration of temporary provisions that increased the maximum benefit amount. As the economy continues to improve, CBO expects that the number of people collecting SNAP benefits will gradually diminish. However, average per-person benefits will increase each year because of adjustments for inflation in prices for food. By 2024, CBO projects, SNAP enrollment will be 34 million and outlays will total $74 billion. On January 27, 2014, the Congress completed a conference agreement for a new farm bill that would reauthorize and make other changes to SNAP. CBO estimates that those changes would reduce outlays by $8 billion over the 2014–2023 period, relative to the agency's May 2013 baseline projections, but that effect is not included in the February 2014 baseline.[14]

13. In projecting spending for certain expiring mandatory programs, the Deficit Control Act calls for CBO to extrapolate such funding at the end of its authorization. Under current law, funding for the Children's Health Insurance Program in 2015 consists of two semiannual allotments of $2.85 billion—amounts that are much smaller than the allotments made in the four preceding years. (The first semiannual allotment in 2015 will be supplemented by $15.4 billion in one-time funding for the program.) Following the rules prescribed by the Deficit Control Act, CBO extrapolates the $2.85 billion provided for the second half of the year to arrive at projected annual funding of $5.7 billion.

14. For details, see CBO's cost estimate for the conference agreement for H.R. 2642, the Agricultural Act of 2014 (January 28, 2014), www.cbo.gov/publication/45049.

**Supplemental Security Income.** SSI provides cash benefits to people with low income who are elderly or disabled. Outlays for SSI rose by nearly 13 percent in 2013 to $53 billion, mostly because a shift of the October 2012 benefit payments into September resulted in one fewer payment in that year; absent that shift, the increase would have been 4 percent. According to CBO's estimates, outlays for SSI will increase by 2 percent in 2014 and at the same rate, on average, over the coming decade. Spending for SSI benefits will be close to $70 billion in the last few years of the 10-year projection period, CBO estimates.

**Unemployment Compensation.** In 2013, outlays for unemployment compensation were $69 billion, 25 percent below the amount spent in 2012. However, outlays for that program remained significantly higher than the $33 billion spent in 2007, before the severe recession, because of persistently high unemployment and the availability of emergency benefits for the long-term unemployed (people without a job for more than 26 consecutive weeks). Since late 2008, spending for unemployment compensation has been boosted significantly by changes in law that temporarily provided additional benefits to people who have been out of work for more than 26 weeks; those emergency benefits expired at the end of December 2013.[15] Assuming there are no changes to current law, outlays will drop again in 2014, CBO estimates, to $46 billion.

As the economic recovery continues, CBO expects that the number of people receiving first-time payments of regular unemployment benefits will continue to decline, generating further declines in outlays for unemployment benefits. Beginning in 2017, outlays for unemployment compensation are projected to rise gradually, pushed up by growth in the labor force and wages (which serve as the basis for benefits). By 2024, CBO projects, outlays for unemployment compensation will amount to $61 billion, or 0.2 percent of GDP, roughly the same share of the economy that they were in 2007.

15. If those expiring provisions that allowed for additional benefits were extended through December 2014, total spending for unemployment compensation would be $17 billion higher in 2014 and $6 billion higher in 2015, CBO estimates. That estimate differs slightly from previous estimates that CBO has prepared, which were based on baseline projections that the agency issued in May 2013.

**Family Support and Foster Care.** Spending for family support programs—grants to states that help fund welfare programs, foster care, child support enforcement, and the Child Care Entitlement—is expected to remain close to last year's level, about $32 billion, throughout the coming decade. Funding for two major components of family support are capped: The primary Temporary Assistance to Needy Families (TANF) program is limited to roughly $17 billion annually (although some additional funding is available if states' unemployment rates or SNAP caseloads exceed certain thresholds); funding for the Child Care Entitlement is capped at just under $3 billion per year. Under current law, the regular TANF program and the Child Care Entitlement are funded only through the end of this fiscal year, but CBO's baseline reflects the assumption (as specified in the Deficit Control Act) that such funding will continue throughout the projection period.

Outlays for federal grants to states for foster care and adoption assistance are expected to remain near last year's level—at about $7 billion—in 2014. CBO estimates that such spending will increase slightly over the coming decade and amount to $8 billion in 2024.

**Child Nutrition.** CBO projects that federal spending for child nutrition—which provides cash and commodities for meals and snacks in schools, day care settings, and summer programs—will rise by 4 percent in 2014, to $21 billion, spurred by increased participation and reimbursement rates in the free-lunch program. CBO anticipates that growth in the number of meals provided and their reimbursement rates will continue over the next decade. As a result, spending for child nutrition is projected to climb at an average annual rate of 4 percent and reach $31 billion in 2024.

### Civilian and Military Retirement

Retirement and survivors' benefits for federal civilian employees (along with benefits provided through several smaller retirement programs for employees of various government agencies and for retired railroad workers) amounted to $92 billion in 2013. Such outlays will grow by about 3 percent annually over the next 10 years, CBO projects, reaching $128 billion in 2024.

Growth in federal civil service retirement benefits is attributable primarily to cost-of-living adjustments for retirees and to increases in federal salaries, which boost benefits for people entering retirement. (CBO's projections reflect the assumption that federal salaries will continue to rise in accordance with the employment cost index for wages and salaries of workers in private industry.) One factor that is restraining growth in spending for retirement benefits is the ongoing, gradual replacement of the Civil Service Retirement System (CSRS) with the Federal Employees Retirement System (FERS). FERS covers employees hired after 1983 and provides a smaller benefit than that provided by CSRS. FERS recipients, however, are eligible for Social Security benefits on the basis of their federal employment (CSRS employees are not). In addition, their contributions to the federal Thrift Savings Plan are matched in part by their employing agencies (but those matching funds are categorized as discretionary costs, not mandatory).

The federal government also provides annuities to personnel who retire from the military and their survivors. Outlays for those annuities totaled $54 billion in 2013. Most of the annual growth in those outlays results from COLAs and increases in basic pay.[16] Outlays for military retirement annuities are projected to grow over the next 10 years, reaching $66 billion in 2024 (reflecting the effect of one fewer monthly payment in that year because of a shift in the payment date).

### Veterans' Benefits

Mandatory spending for veterans' benefits—including housing, readjustment benefits, life insurance, disability compensation, pensions, and burial benefits—has increased rapidly over the past few years, averaging about 13 percent annually since 2008. Outlays for those benefits totaled $80 billion in 2013, an amount that does not include the significant spending for veterans' health care, which is funded by discretionary appropriations. The rapid growth in spending in recent years has resulted from increased use of benefits available under the Post-9/11 Veterans Educational Assistance Act of 2008 (commonly referred to as the Post-9/11 GI Bill), which greatly expanded education benefits available to veterans, reservists, and active-duty service members. Also, in 2013, the Department of Veterans Affairs significantly reduced the backlog of older disability claims, resulting in a jump in disability compensation benefits.

As a result of the reduction in the backlog of older disability claims and CBO's expectation that use of the Post-9/11 GI Bill is leveling off, growth in veterans' benefits is expected to moderate in the future, averaging about 3 percent a year between 2014 and 2024. CBO estimates that spending in 2024 will total $104 billion.[17]

### Other Mandatory Spending

Other mandatory spending includes spending for agricultural support, net outlays for deposit insurance, health care benefits for military retirees, subsidy costs for student loans, and other payments. Outlays in some of those categories can fluctuate markedly from year to year and may be either positive or negative.

**Agricultural Support.** Mandatory spending for agricultural support totaled $24 billion in 2013. Spending was relatively high in 2013, primarily because of substantial crop insurance payments necessitated by significant weather-related crop losses in 2012 and 2013.

Such spending would average $15 billion in each year between 2014 and 2024, if the farm programs authorized in the Food, Conservation, and Energy Act of 2008 (commonly referred to as the 2008 Farm Bill) were reauthorized. Most of those programs expired at the end of September 2013. On January 27, 2014, the Congress completed a conference agreement for a new farm bill that would reauthorize and make other changes to agricultural support programs. On balance, CBO estimates that those changes would reduce such outlays by about $9 billion over the 2014–2023 period, relative to CBO's May 2013 baseline projections, but that effect is not included in the February 2014 baseline.

**Deposit Insurance.** Net outlays for deposit insurance were $4 billion last year. Those outlays reflect the cost of

16. The Bipartisan Budget Act of 2013 reduced the annual COLAs for most military retirees under the age of 62 by 1 percentage point, lowering outlays by about $1 billion per year by 2024, CBO estimates. (The Consolidated Appropriations Act, 2014 [P.L. 113-76] later reversed that change in COLAs for disabled retirees only.) The Bipartisan Budget Act also made a change to civil service retirement: As of January 1, 2014, most new employees must contribute 4.4 percent of their salary toward their future retirement benefit, which represents an increase of 1.3 percentage points over the previous contribution rate for new employees; those additional payments will be recorded as revenues. The act made no modifications to the program that affect spending for civil service retirement benefits.

17. That amount reflects 11 payments during the year because one payment will be shifted into 2023. If 12 payments were made during 2024, outlays for that year would total $111 billion, CBO estimates.

resolving failed institutions minus the net receipts from premiums paid by financial institutions. Beginning in 2014, premium payments will exceed amounts spent on failed institutions, CBO projects, and net outlays for deposit insurance will be negative, ranging from -$9 billion to -$17 billion annually over the coming decade.

**Medicare-Eligible Retiree Health Care Fund.** The Department of Defense's Medicare-Eligible Retiree Health Care Fund (MERHCF) provides health care benefits through the TRICARE for Life program to retirees of the uniformed services (and to their dependents and surviving spouses) who are eligible for Medicare. Outlays for those benefits totaled $8 billion in 2013. Over the coming decade, spending from MERHCF is projected to rise at an average annual rate of roughly 6 percent, reaching $16 billion in 2024.

**Higher Education.** Mandatory outlays for higher education were -$26 billion in 2013. That figure includes the budget impact of student loans originated in 2013, which amounted to -$27 billion (on a present-value basis); and a reduction in the estimated cost of direct and guaranteed loans originated in previous years, which amounted to -$15 billion (also on a present-value basis).[18] The budgetary effects of student loans were offset somewhat by mandatory spending for Pell grants, which totaled $16 billion in 2013.[19] CBO estimates that subsidies for student loans made in 2014 will be -$22 billion and that mandatory spending for the Federal Pell Grant Program will be $15 billion this year, resulting in net mandatory outlays for higher education of -$7 billion. (Those projected outlays do not include any potential revision to the estimated subsidy costs of loans or guarantees made before 2014.)

In 2013, lawmakers enacted legislation governing student loans that will set interest rates for new borrowers based on the 10-year Treasury note rate determined by the last auction in May of each year. Before that change, loans were made at a fixed rate stated in the Higher Education Act of 1965, as amended. For the coming decade, CBO's forecast of rising interest rates will increase the present-value cost to the government of outstanding loans for this program, but the student loan program will continue to have negative subsidy costs through 2024, CBO estimates. Over the 2015–2024 period, net mandatory outlays for higher education will total -$37 billion, in CBO's estimation.

### Offsetting Receipts

Offsetting receipts are funds collected by government agencies from other government accounts or from the public in businesslike or market-oriented transactions that are recorded as negative outlays (that is, credits against direct spending). Such receipts include beneficiaries' premiums for Medicare; intragovernmental payments made by federal agencies for their employees' retirement benefits; royalties and other charges for the production of oil and natural gas on federal lands; proceeds from sales of harvested timber and minerals extracted from federal lands; and various fees paid by users of public property and services. In 2013, offsetting receipts totaled $306 billion (see Table 3-2 on page 54).

**Medicare.** Offsetting receipts for Medicare in 2013 reached $93 billion, constituting a little more than 30 percent of all offsetting receipts. Over the coming years, those receipts will rise at about the same rate as spending for Medicare, totaling $189 billion in 2024 under CBO's baseline projections. Such receipts are

18. CBO's calculations of subsidy costs for student loans follow the procedures specified in the Federal Credit Reform Act of 1990 (FCRA). Under FCRA, the discounted present value of expected income from federal student loans made during the 2014–2024 period is projected to exceed the discounted present value of the government's costs. (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—known as the discount rate—that is used to translate future cash flows into current dollars.) Credit programs that produce net income rather than net outlays are said to have "negative subsidy rates," which result in negative outlays. The original subsidy calculation for a set of loans or loan guarantees may be increased or decreased by a "credit subsidy reestimate" in subsequent years, on the basis of updated valuations of the present-value costs of the cash flows associated with the outstanding loans and loan guarantees.

    FCRA accounting, however, does not consider some costs borne by the government. In particular, it omits the risk taxpayers face because federal receipts from interest and principal payments on student loans tend to be low when economic and financial conditions are poor and resources therefore are more valuable. Fair-value accounting methods account for such risk and, as a result, the program's savings are less (or its costs are greater) under fair-value accounting than they are under FCRA's rules.

19. Under current law, most of the funding for the Pell grant program is from discretionary appropriations.

primarily premiums paid by Medicare beneficiaries, but they also include recoveries of overpayments made to providers and payments made by states to cover a portion of the prescription drug costs for low-income beneficiaries.

**Federal retirement.** In 2013, $66 billion in offsetting receipts consisted of intragovernmental transfers from federal agencies to the federal funds from which employees' retirement benefits are paid (mostly trust funds for Social Security and for military and civilian retirement). Those intragovernmental payments from agencies' operating accounts to the funds have no net effect on federal outlays. Such payments will grow by nearly 3 percent per year, on average, CBO estimates, reaching $92 billion in 2024.

**Natural resources.** Receipts stemming from the extraction of natural resources—particularly oil, natural gas, and minerals—from federally owned lands totaled $15 billion in 2013. By 2024, CBO estimates, those receipts will be $21 billion.

**Medicare-Eligible Retiree Health Care Fund.** Intragovernmental transfers also are made to the Department of Defense's MERHCF, which pays for the health care costs of Medicare-eligible retirees of the uniformed services (including the TRICARE for Life benefit). Contributions to the fund are made on an accrual basis: The services contribute an amount each year sufficient to cover the future costs of their current service members who will eventually retire and draw benefits from the fund. Such payments totaled $9 billion in 2013 and, because of rising health care costs, are projected to grow to $13 billion by 2024.

**Fannie Mae and Freddie Mac.** In September 2008, the government placed Fannie Mae and Freddie Mac, two institutions that facilitate the flow of funding for home loans nationwide, into conservatorship as a result of their mounting losses.[20] Because the Administration considers Fannie Mae and Freddie Mac to be nongovernmental entities for federal budgeting purposes, it records the Treasury's payments to those entities as outlays in the budget, and payments by those entities to the Treasury as offsetting receipts. In 2013, the Treasury made no payments to those entities and received payments totaling $97 billion from them. Specifically, Fannie Mae made a one-time payment to the Treasury of about $50 billion because revaluation of certain deferred tax assets significantly increased the company's net worth, and both Fannie Mae and Freddie Mac made quarterly payments to the Treasury in amounts related to their net worth. CBO estimates that net payments from those entities to the Treasury will amount to $81 billion in 2014 (which includes a payment of $24 billion made by Freddie Mac at the end of December 2013, to recognize a revaluation of its deferred tax assets, similar to the one-time payment made by Fannie Mae in fiscal year 2013).

In contrast to the Administration's approach, CBO projects the budgetary impact of the two entities' operations in future years as if they were being conducted by a federal agency because of the degree of management and financial control that the government exercises over them.[21] Therefore, CBO estimates the net lifetime costs—that is, the subsidy costs adjusted for market risk—of guarantees that will be issued by as well as loans that will be held by the entities and counts those costs as federal outlays in the year of issuance. For the 2015–2024 period, CBO projects, the costs for new guarantees and loans held by the entities will be $19 billion.

### Legislation Assumed in the Baseline

In keeping with the rules established by the Deficit Control Act, CBO's baseline projections incorporate the assumption that some mandatory programs will be extended when their authorization expires, although the assumption applies differently to programs created before and after the Balanced Budget Act of 1997. All direct spending programs that predate that act and have current-year outlays greater than $50 million are assumed to continue in CBO's baseline projections. For programs established after 1997, continuation is assessed program by program, in consultation with the House and Senate Budget Committees.

CBO's baseline projections therefore incorporate the assumption that the following programs whose authorization expires within the current projection period will continue: SNAP, TANF, CHIP, rehabilitation services,

20. Conservatorship is the legal process in which an entity is appointed to establish control and oversight of a company to put it in a sound and solvent condition.

21. See Congressional Budget Office, *Fannie Mae, Freddie Mac, and the Federal Role in the Secondary Mortgage Market* (December 2010), www.cbo.gov/publication/21992; and Congressional Budget Office, *CBO's Budgetary Treatment of Fannie Mae and Freddie Mac* (January 2010), www.cbo.gov/publication/41887.

the Child Care Entitlement, trade adjustment assistance for workers, child nutrition, family preservation and support, and most farm subsidies. In addition, the Deficit Control Act directed CBO to assume that a cost-of-living adjustment for veterans' compensation would be granted each year. In CBO's projections, the assumption that expiring programs will continue accounts for $12 billion in mandatory outlays for 2014 and about $1.3 trillion between 2015 and 2024 (see Table 3-3). Almost two-thirds of that amount over the next 10 years is attributable to the Supplemental Nutrition Assistance Program.[22]

## Discretionary Spending

Roughly one-third of federal outlays stem from budget authority provided in annual appropriation acts.[23] That funding—referred to as discretionary—translates into outlays when the money is spent. Although some appropriations (for example, those designated for employees' salaries) are spent quickly, others (such as those intended for major construction projects) are disbursed over several years. In any given year, discretionary outlays include spending from new budget authority and from budget authority provided in previous appropriations.

Several transportation programs have an unusual budgetary treatment: Their budget authority is provided in authorizing legislation, rather than in appropriation acts, but their spending is constrained by *obligation limitations* imposed by appropriation bills. Consequently, their budget authority is considered mandatory, but their outlays are discretionary. (The largest of those programs is the Federal-Aid Highway program, which is funded from the Highway Trust Fund.) As a result, total discretionary outlays in the budget are greater than total discretionary budget authority. In some cases, the amounts of those obligation limitations are added to discretionary budget authority to produce a measure of the total *funding* provided for discretionary programs.

In CBO's baseline projections, most appropriations for the 2014–2021 period are assumed to be constrained by the caps and automatic enforcement procedures put in place by the Budget Control Act and subsequent legislation; CBO developed those projections by inflating the appropriations provided for specific activities in 2014 and then reducing total projected defense and nondefense funding by the amounts necessary to achieve compliance with the caps. For the period from 2022 through 2024, CBO assumes that those appropriations would grow at the rate of inflation from the amounts estimated for 2021. Funding for certain purposes is not constrained by the caps: for military operations in Afghanistan and related activities (also known as overseas contingency operations, or OCO), programs receiving emergency designations, disaster relief, and spending designed to enhance program integrity by reducing overpayments in some benefit programs. CBO developed projections for such funding by assuming that it would grow at the rate of inflation from the amount appropriated for 2014.

Because discretionary funding grows much more slowly than the economy under those assumptions, discretionary outlays in CBO's baseline projections fall from 6.9 percent of GDP in 2014 to 5.2 percent of GDP in 2024, a smaller share than in any year since 1962 (the first year for which comparable data are available).

### Trends in Discretionary Outlays

Discretionary outlays declined from about 10 percent of GDP during much of the 1970s and 1980s to 6.0 percent in 1999 (see Figure 3-3 on page 70). Those outlays then began to increase relative to the size of the economy, reaching 6.7 percent of GDP in 2002 and 7.7 percent in 2008. That rise occurred in part because of actions taken in response to the terrorist attacks of September 11, 2001, and subsequent military operations in Afghanistan and Iraq. (Funding for those operations from 2001 to 2014 is examined in Box 3-2 on page 68.) In 2009 and 2010, discretionary outlays jumped to 8.6 percent and 9.1 percent of GDP, respectively, in part because of $281 billion in discretionary funding provided by the American Recovery and Reinvestment Act of 2009 (ARRA; P.L. 111-5). In 2013, discretionary outlays declined to 7.2 percent of GDP, mostly because of the

22. CBO constructed Table 3-3 before enactment of the Agricultural Act of 2014. The authorizations provided in that legislation would change the expiration dates of SNAP and certain agricultural programs and therefore affect some of the numbers presented in that table.

23. Budget authority is the authority provided by law to incur financial obligations that will result in immediate or future outlays of federal funds. Budget authority may be provided in an appropriation act or authorization act and may take the form of a direct appropriation of funds from the Treasury, borrowing authority, contract authority, entitlement authority, or authority to obligate and expend offsetting collections or receipts. Offsetting collections and receipts are shown as creating negative budget authority.

**Table 3-3.**

## Costs for Mandatory Programs That Continue Beyond Their Current Expiration Date in CBO's Baseline

(Billions of dollars)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Supplemental Nutrition Assistance Program | | | | | | | | | | | | | |
| Budget authority | 0 | 80 | 79 | 78 | 76 | 76 | 75 | 75 | 74 | 74 | 74 | 388 | 761 |
| Outlays | 0 | 80 | 79 | 78 | 76 | 76 | 75 | 75 | 74 | 74 | 74 | 388 | 761 |
| Temporary Assistance for Needy Families | | | | | | | | | | | | | |
| Budget authority | 12 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 87 | 173 |
| Outlays | 10 | 16 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 17 | 85 | 171 |
| Commodity Credit Corporation[a] | | | | | | | | | | | | | |
| Budget authority | * | 7 | 11 | 10 | 9 | 9 | 10 | 10 | 11 | 11 | 12 | 47 | 101 |
| Outlays | * | 6 | 10 | 9 | 9 | 9 | 10 | 10 | 11 | 11 | 12 | 43 | 97 |
| Children's Health Insurance Program | | | | | | | | | | | | | |
| Budget authority | 0 | 0 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 23 | 51 |
| Outlays | 0 | 0 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 23 | 51 |
| Veterans' Compensation COLAs | | | | | | | | | | | | | |
| Budget authority | 0 | 1 | 3 | 4 | 5 | 7 | 9 | 11 | 13 | 14 | 14 | 21 | 83 |
| Outlays | 0 | 1 | 3 | 4 | 5 | 7 | 9 | 11 | 13 | 14 | 14 | 21 | 83 |
| Rehabilitation Services and Disability Research | | | | | | | | | | | | | |
| Budget authority | 0 | 3 | 3 | 3 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 17 | 37 |
| Outlays | 0 | 2 | 3 | 3 | 3 | 4 | 4 | 4 | 4 | 4 | 4 | 15 | 34 |
| Child Care Entitlements to States | | | | | | | | | | | | | |
| Budget authority | 2 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 15 | 29 |
| Outlays | 2 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 14 | 29 |
| Trade Adjustment Assistance for Workers | | | | | | | | | | | | | |
| Budget authority | 0 | * | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 4 | 9 |
| Outlays | 0 | * | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 4 | 9 |
| Child Nutrition[b] | | | | | | | | | | | | | |
| Budget authority | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 3 | 8 |
| Outlays | 0 | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 3 | 8 |

Continued

constraints put in place by the Budget Control Act to limit new discretionary budget authority and decreased spending from funding for OCO and from ARRA.

Discretionary outlays for defense declined from 6.0 percent of GDP in 1986 to a low of 2.9 percent of GDP between 1999 and 2001. In part boosted by funding for operations in Afghanistan and Iraq, outlays for defense rose to 3.8 percent of GDP in 2004 and to 4.7 percent of GDP in 2010. Since then, outlays have fallen to 3.8 percent of GDP in 2013, owing mostly to a reduction in funding for overseas military operations. As a whole,

**Table 3-3.** **Continued**

## Costs for Mandatory Programs That Continue Beyond Their Current Expiration Date in CBO's Baseline

(Billions of dollars)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ground Transportation Programs Not Subject to Annual Obligation Limitations | | | | | | | | | | | | | |
| Budget authority | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 3 | 6 |
| Outlays | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 3 | 6 |
| Family Preservation and Support | | | | | | | | | | | | | |
| Budget authority | 0 | 0 | 0 | * | * | * | * | * | * | * | * | 1 | 3 |
| Outlays | 0 | 0 | 0 | * | * | * | * | * | * | * | * | 1 | 2 |
| Ground Transportation Programs Controlled by Obligation Limitations[c] | | | | | | | | | | | | | |
| Budget authority | 0 | 50 | 50 | 50 | 50 | 50 | 50 | 50 | 50 | 50 | 50 | 251 | 501 |
| Outlays | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Air Transportation Programs Controlled by Obligation Limitations[c] | | | | | | | | | | | | | |
| Budget authority | 0 | 0 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 3 | 13 | 30 |
| Outlays | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Natural Resources | | | | | | | | | | | | | |
| Budget authority | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Outlays | 0 | * | * | * | * | * | * | * | * | * | * | * | * |
| **Total** | | | | | | | | | | | | | |
| **Budget authority** | **15** | **163** | **178** | **177** | **177** | **178** | **180** | **182** | **184** | **186** | **187** | **873** | **1,793** |
| **Outlays** | **12** | **108** | **123** | **122** | **122** | **124** | **126** | **128** | **131** | **132** | **134** | **599** | **1,250** |

Source: Congressional Budget Office.

Notes: This table was constructed before the enactment of the Agricultural Act of 2014. The authorizations provided in that law would change the expiration dates for the Supplemental Nutrition Assistance Program and certain agricultural programs and thus would affect some of the numbers shown here.

COLAs = cost-of-living adjustments; * = between -$500 million and $500 million.

a. Agricultural commodity price and income supports under the Food, Conservation, and Energy Act of 2008 generally expired at the end of September 2013. CBO has included an extension of its May 2013 baseline in this report because that baseline was used to evaluate the costs of the conference report on the Agricultural Act of 2014 (see U.S. House of Representatives, *Agricultural Act of 2014: Conference Report to Accompany H.R. 2642,* House Report 113-333, January 27, 2014.). The estimated costs of that act are not included here because the legislation had not yet been enacted when this report was completed.

b. Includes the Summer Food Service program and states' administrative expenses.

c. Authorizing legislation for those programs provides contract authority, which is counted as mandatory budget authority. However, because the programs' spending is subject to obligation limitations specified in annual appropriation acts, outlays are considered discretionary.

**Box 3-2.**

## Funding for Operations in Afghanistan and Iraq and for Related Activities

Since September 2001, lawmakers have provided almost $1.6 trillion in budget authority for operations in Afghanistan and Iraq and for related activities (see the table). That amount includes funding for military and diplomatic operations in Afghanistan, Iraq, and certain other regions; for some veterans' benefits and services; and for related actions of the Department of Justice. Appropriations specifically designated for those purposes averaged about $70 billion a year from 2001 through 2006, rose to $170 billion in 2007 and to $187 billion in 2008, and then declined to an average of $150 billion over the 2009–2012 period. For 2013, lawmakers appropriated $99 billion in the Consolidated and Further Continuing Appropriations Act, 2013 (Public Law 113-6), an amount that was reduced by $5.6 billion as a result of sequestration (a cancellation of budgetary resources). Almost $92 billion has been provided for 2014.

Funding to date for military operations and other defense activities totals $1.4 trillion, most of which has gone to the Department of Defense (DoD)—about $860 billion for operation and maintenance costs, $300 billion for procurement, and another $190 billion for military personnel costs. Lawmakers have also provided $86 billion to train and equip indigenous security forces in Afghanistan and Iraq.[1] In addition, $81 billion has been provided for diplomatic operations and foreign aid to Afghanistan, Iraq, and other countries that are assisting the United States in those efforts. The majority of those funds have been appropriated to the Economic Support Fund ($21 billion), diplomatic and consular programs ($18 billion), and the Iraq Relief and Reconstruction Fund ($16 billion).

DoD reports that in fiscal year 2013, obligations for operations in Afghanistan and Iraq and for related activities averaged $6.7 billion per month. That monthly average is about $2.7 billion less than the amount reported for 2012. Operation Enduring Freedom (in and around Afghanistan) accounted for 96 percent of those obligations in 2013. Operation New Dawn (formerly known as Operation Iraqi Freedom) accounted for the remaining 4 percent.

Because most appropriations for operations in Afghanistan and Iraq and for related activities appear in the same budget accounts as appropriations for DoD's other functions, it is impossible to determine precisely how much has been spent on those activities. The Congressional Budget Office (CBO) estimates that the $1.5 trillion appropriated for military operations, other defense activities, and indigenous security forces in those two countries has resulted in outlays of about $1.3 trillion through 2013; about $115 billion of that spending occurred in 2013. Of the $81 billion appropriated for international affairs activities related to the war efforts, about $60 billion was spent through 2013, CBO estimates, including $7 billion in 2013. In total, outlays for all of those activities amounted to about $125 billion last year. On the basis of sums appropriated for 2014, CBO estimates that outlays will total about $105 billion this year.

1. That $86 billion includes $5 billion provided for Iraqi security forces in 2004 in an appropriation for the State Department's Iraq Relief and Reconstruction Fund.

Continued

funding for defense declined by 3.5 percent in nominal terms, or 13 percent in real terms, between 2007 and 2013. That change was heavily influenced by reductions in funding for OCO. Excluding those amounts, funding for defense increased by 13 percent in nominal terms, or 1.9 percent in real terms, over that period.

Nondefense discretionary programs encompass such activities as transportation, education grants, housing assistance, health-related research, veterans' health care, most homeland security activities, the federal justice system, foreign aid, and environmental protection. Between 1990 and 2008, nondefense outlays represented a fairly stable share of GDP, ranging between 3.1 percent and

Box 3-2. Continued

## Funding for Operations in Afghanistan and Iraq and for Related Activities

### Estimated Appropriations Provided for U.S. Operations in Afghanistan and Iraq and for Other War-Related Activities Since 2001

(Billions of dollars of budget authority)

| | 2001-2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013[a] | 2014 | Total, 2001-2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| Military Operations and Other Defense Activities[b] | | | | | | | | | | |
| Iraq | 256 | 113 | 133 | 90 | 59 | 42 | 10 | 3 | 1 | 707 |
| Afghanistan | 56 | 24 | 29 | 38 | 87 | 98 | 89 | 65 | 74 | 560 |
| Other[c] | 66 | 15 | 13 | 13 | 5 | 6 | 6 | 10 | 6 | 139 |
| Subtotal | 378 | 152 | 175 | 140 | 151 | 146 | 104 | 78 | 81 | 1,405 |
| Indigenous Security Forces[d] | | | | | | | | | | |
| Iraq | 14 | 6 | 3 | 1 | 1 | 2 | 0 | 0 | 0 | 26 |
| Afghanistan | 3 | 7 | 3 | 6 | 9 | 12 | 11 | 4 | 5 | 60 |
| Subtotal | 17 | 13 | 6 | 7 | 10 | 13 | 11 | 4 | 5 | 86 |
| Diplomatic Operations and Foreign Aid[e] | | | | | | | | | | |
| Iraq | 22 | 3 | 3 | 2 | 2 | 0 | 4 | 4 | 2 | 41 |
| Afghanistan | 4 | 1 | 1 | 5 | 2 | 0 | 5 | 5 | 1 | 24 |
| Other | 7 | * | * | 1 | * | 0 | 2 | 2 | 3 | 16 |
| Subtotal | 33 | 4 | 5 | 7 | 4 | 0 | 11 | 11 | 7 | 81 |
| Other Services and Activities[f] | | | | | | | | | | |
| Iraq | * | 1 | 1 | * | 0 | 0 | 0 | 0 | 0 | 2 |
| Afghanistan | * | * | * | * | 0 | 0 | 0 | 0 | 0 | * |
| Other | * | * | * | * | 0 | 0 | 0 | 0 | 0 | 1 |
| Subtotal | * | 1 | 2 | * | 0 | 0 | 0 | 0 | 0 | 3 |
| **Total** | **428** | **170** | **187** | **154** | **165** | **159** | **127** | **93** | **92** | **1,575** |

Source: Congressional Budget Office.

Note: * = between zero and $500 million.

a. Amounts for 2013 are net of reductions implemented in response to the Administration's sequestration order of March 1, 2013.

b. CBO estimated the funding provided for operations in Afghanistan and Iraq by allocating funds on the basis of information in budget justification materials from the Department of Defense and in the department's monthly reports on its obligations. Some allocations for prior years have been adjusted to reflect more recent information.

c. Includes Operation Noble Eagle (homeland security missions, such as combat air patrols, in the United States), additional personnel and other restructuring efforts for Army and Marine Corps units, classified activities other than those funded by appropriations for the Iraq Freedom Fund, and other operations. (From 2005 through 2014, funding for Operation Noble Eagle was intermingled with regular appropriations for the Department of Defense; that funding is not included in this table.)

d. Funding for indigenous security forces is used to train and equip local military and police units in Afghanistan and Iraq. That funding was appropriated in accounts for diplomatic operations and foreign aid (budget function 150) in 2004 and in accounts for defense (budget function 050) starting in 2005.

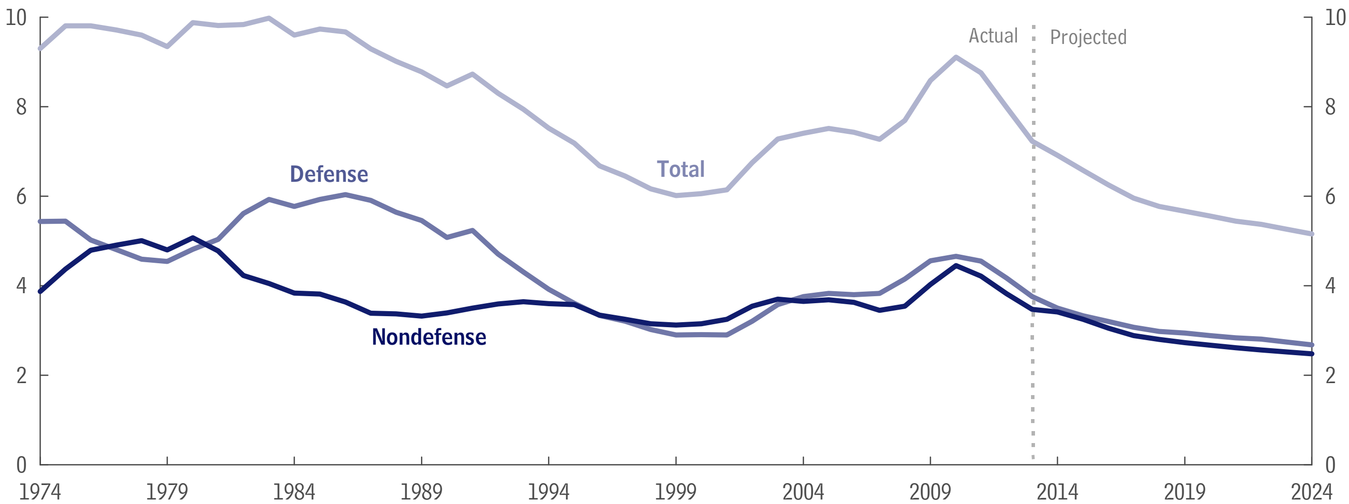
e. In 2010 and 2011, most funding for diplomatic operations in, and foreign aid to, countries helping the United States fight terrorism was provided in regular appropriations and cannot be separated from appropriations for activities unrelated to those operations.

f. Includes funding for some veterans' benefits and services and for certain activities of the Department of Justice. Excludes about $23 billion in spending by the Department of Veterans Affairs for the incremental costs of medical care, disability compensation, and survivors' benefits for veterans of operations in Afghanistan and Iraq and the war on terrorism. That amount is based on CBO's estimates of spending from regular appropriations for the Department of Veterans Affairs and was not explicitly appropriated for war-related expenses.

**Figure 3-3.**

## Discretionary Outlays, by Category

(Percentage of gross domestic product)




Source: Congressional Budget Office.

3.7 percent. Funding from ARRA helped push that share to 4.0 percent of GDP in 2009 and 4.5 percent in 2010. However, by 2013, more than 90 percent of discretionary funding from ARRA had been spent; and as caps on budget authority reduced funding levels, nondefense discretionary outlays fell as a share of GDP, reaching 3.5 percent in 2013. Although funding for nondefense discretionary activities in 2013 was only slightly above its share of GDP for 2007, it was higher by 21 percent in nominal terms and by 9 percent in real terms. Excluding OCO and hurricane relief, funding for nondefense discretionary activities was higher in 2013 than in 2007, by 11 percent in nominal terms and by 0.2 percent in real terms.

### Discretionary Appropriations and Outlays in 2014

For 2014, discretionary budget authority provided to date totals $1,130 billion, roughly 1 percent less than the $1,145 billion provided for fiscal year 2013 (see Table 3-4).[24] Funding for relief and recovery from Hurricane Sandy amounted to $48 billion last year, but no additional funding has been provided for this year. Other appropriations increased by $34 billion (or 3.4 percent).

The caps on budget authority for 2014 are set at $1,012 billion—$520 billion for defense programs and $492 billion for nondefense programs. However, those limits on funding are adjusted when appropriations are provided for certain purposes. Specifically, budget authority designated as an emergency requirement or provided for OCO would lead to an increase in the caps, as would budget authority provided for some types of disaster relief or for certain “program integrity” initiatives.[25] To date, such adjustments to the caps on discretionary budget authority for 2014 have totaled $98 billion; most of that amount, $92 billion, resulted from funding for OCO. In addition, the amount of budget authority in CBO’s baseline is about $20 billion more than the caps, primarily because savings from changes to mandatory programs that were included in the Continuing Appropriations Act, 2014 (P.L. 113-76) were credited against discretionary spending when the legislation was enacted; those savings appear as reductions in mandatory spending in CBO’s baseline.

In the absence of additional appropriations for 2014, CBO projects that discretionary outlays will decrease slightly from $1,201 billion in 2013 to $1,194 billion in 2014. Although appropriations for defense are up slightly

24. In addition, obligation limitations for transportation programs in 2014 total $53 billion, about $1 billion above the amount legislated for 2013.

25. Such initiatives are aimed at reducing improper benefit payments in Disability Insurance, Supplemental Security Income, Medicare, Medicaid, and the Children’s Health Insurance Program.

**Table 3-4.**

## Changes in Discretionary Budget Authority From 2013 to 2014

(Billions of dollars)

| | Actual, 2013 | Estimated, 2014 | Percentage Change |
|---|---|---|---|
| Defense | | | |
| Overseas contingency operations | 82 | 85 | 3.7 |
| Hurricane Sandy | * | 0 | -100.0 |
| Other | 518 | 520 | 0.5 |
| Subtotal | 600 | 606 | 0.9 |
| Nondefense | | | |
| Overseas contingency operations | 11 | 7 | -39.9 |
| Hurricane Sandy | 48 | 0 | -100.0 |
| Other | 486 | 517 | 6.4 |
| Subtotal | 545 | 524 | -3.8 |
| Total Discretionary Budget Authority | | | |
| Overseas contingency operations | 93 | 92 | -1.4 |
| Hurricane Sandy | 48 | 0 | -100.0 |
| Other | 1,004 | 1,038 | 3.4 |
| **Total** | **1,145** | **1,130** | **-1.3** |

Source: Congressional Budget Office.

Notes: Excludes budgetary resources provided by obligation limitations for certain ground and air transportation programs.

* = between zero and $500 million.

in 2014, defense spending is expected to drop by $21 billion in 2014 because funding has been lower over the past few years. Funding for defense programs this year is $104 billion lower than the amount provided for 2011; about three-quarters of that drop reflects a decline in OCO funding. In contrast, appropriations for nondefense activities are lower in 2014 than they were in 2013 (because of the large disaster relief appropriation in 2013), but nondefense outlays in 2014 are expected to be $14 billion higher, largely because of a drop in receipts credited to the Federal Housing Administration's mortgage insurance program ($7 billion) and an increase in estimated spending from the appropriations in 2013 related to Hurricane Sandy ($5 billion). As a percentage of GDP, total discretionary outlays are estimated to fall from 7.2 percent in 2013 to 6.9 percent in 2014.

**Defense Discretionary Funding.** Budget authority provided for defense discretionary programs in 2014 is expected to be about 1 percent more than it was in 2013, rising from $600 billion to $606 billion. Three major categories of funding within the Department of Defense account for 83 percent of the defense appropriation in 2014: operation and maintenance ($262 billion), military personnel ($144 billion), and procurement ($99 billion). Appropriations for research and development ($63 billion) account for another 10 percent of total funding for defense. The rest of the appropriation, about 6 percent, is made up of funding for military construction, family housing, and other Department of Defense programs ($12 billion); funding for atomic energy activities, primarily within the Department of Energy ($17 billion); and funding for various defense-related programs in other departments and agencies ($8 billion).

**Nondefense Discretionary Funding.** Seven broad budget categories (referred to as budget functions) account for more than 75 percent of the $577 billion in resources appropriated in 2014 for nondefense discretionary activities (see Table 3-5). Activities related to education, training, employment, and social services have received $92 billion, claiming 16 percent of total nondefense discretionary funding.[26] Transportation programs have received $85 billion, or 15 percent, of the total, which

26. Spending for student loans and several other federal programs in the category of education, training, employment, and social services is not included in that total because their funding is considered mandatory.

**Table 3-5.**

## Changes in Nondefense Discretionary Funding From 2013 to 2014

(Billions of dollars)

| Budget Function | Actual, 2013 | Estimated, 2014 | Change |
|---|---|---|---|
| Education, Training, Employment, and Social Services | 89 | 92 | 3 |
| Transportation[a] | 96 | 85 | -11 ** |
| Income Security | 60 | 65 | 5 |
| Veterans' Benefits and Services | 62 | 64 | 2 ** |
| Health | 53 | 56 | 3 |
| Administration of Justice | 49 | 52 | 3 |
| International Affairs | 52 | 51 | -2 |
| Natural Resources and Environment | 39 | 34 | -4 |
| General Science, Space, and Technology | 28 | 29 | 1 |
| Community and Regional Development | 45 | 17 | -28 |
| General Government | 17 | 17 | * |
| Medicare | 6 | 6 | * |
| Agriculture | 6 | 6 | * |
| Social Security | 5 | 6 | * |
| Energy | 4 | 5 | 1 |
| Commerce and Housing Credit | -12 | -7 | 5 |
| **Total** | **597** | **577** | **-20** |

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million. [**Values corrected on February 20, 2014]

a. Includes budgetary resources provided by obligation limitations for certain ground and air transportation programs.

includes $53 billion in obligation limitations for several ground and air transportation programs. Income-security programs and veterans' benefits and services each account for 11 percent of the total nondefense funding, totaling $65 billion and $64 billion, respectively.[27] Health programs account for 10 percent of the nondefense funding, totaling $56 billion, and administration of justice ($52 billion) and international affairs ($51 billion) each account for 9 percent of the total. All told, funding for nondefense programs in 2014 is expected to be $20 billion lower than the total amount provided in 2013; however, excluding funding related to Hurricane Sandy (most of which had appeared last year in the budget functions for transportation and for community and regional development), nondefense discretionary funding is $28 billion higher than last year's total.

### Projections for 2015 Through 2024

The Budget Control Act of 2011 established limits on discretionary budget authority for 2012 through 2021; in addition, that legislation also provided for automatic procedures that, if triggered, would reduce the limits that were originally set. The Bipartisan Budget Act of 2013 canceled the automatic spending reductions related to discretionary funding that were set to occur in 2014 and 2015 under the Budget Control Act; for 2015, the Bipartisan Budget Act established new caps of $521 billion for defense programs and $492 billion for nondefense programs. According to CBO's estimates, those caps are $9 billion higher for both defense and nondefense programs than the caps in place under prior law.

In CBO's baseline projections, discretionary outlays total about the same amount in 2015, 2016, and 2017 that they do in 2014 (see Table 3-6). Such outlays are expected to start slowly increasing again in 2018 and to grow by about 2 percent per year thereafter, reaching nearly $1.4 trillion by 2024. As a share of GDP, they are projected to fall markedly, from 6.6 percent in 2015 to 5.2 percent in 2024.

### Alternative Paths for Discretionary Spending

Total funding for discretionary activities in 2014 will amount to about $1,183 billion on an annualized basis,

27. Some significant income-security programs, such as unemployment compensation and TANF, are not reflected in the total because they are included in mandatory spending.

CBO estimates—$1,130 billion in budget authority and $53 billion in transportation-related obligation limitations. In CBO's baseline projections, discretionary funding is projected for subsequent years on the basis of the amounts and procedures prescribed in the Budget Control Act. However, if the policies governing discretionary appropriations changed, funding could differ greatly from the baseline projections. To illustrate such differences, CBO has estimated the budgetary consequences of several alternative paths for discretionary funding (see Table 3-6).

The first alternative path addresses spending for operations in Afghanistan and related activities. 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 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).[28]

In coming years, the funding required for overseas contingency operations—in Afghanistan or other countries—might be smaller than the amounts projected in the baseline if the number of deployed troops and the pace of operations diminished over time. For that reason, 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 levels could represent various allocations of forces among Afghanistan and other regions.) Under that scenario, and assuming that the related funding for diplomatic operations and foreign aid declines at a similar rate, total discretionary outlays over the 2015–2024 period would be $572 billion less than the amount in the baseline.[29]

For the second policy alternative, CBO assumed that discretionary funding would grow at the rate of inflation after 2014. If that occurred, discretionary outlays would surpass CBO's baseline projections by $735 billion over the 2015–2024 period. In that scenario, discretionary outlays would increase by an average of 2.2 percent a year over the next decade.

The third scenario reflects the assumption that most discretionary budget authority and obligation limitations would be frozen at the 2014 level for the entire projection period.[30] In that case, total discretionary outlays for the 10-year period would be $688 billion lower than those projected in the baseline, and total discretionary spending would fall to 4.5 percent of GDP by 2024.

For the final alternative scenario, CBO projected what would occur if lawmakers canceled the automatic enforcement procedures for discretionary spending specified in the Budget Control Act. Those automatic procedures will reduce discretionary (and mandatory) spending over the 2016 through 2021 period (the automatic spending reductions for 2014 and 2015 were canceled by the Bipartisan Budget Act and new caps were set). If, instead, lawmakers chose to prevent those automatic cuts to discretionary spending each year, outlays would be $747 billion (or about 6 percent) higher over the 2015–2024 period than the amount projected in CBO's baseline.

28. 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.

29. 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.

30. Some items, such as offsetting collections and payments made by the Treasury on behalf of the Department of Defense's TRICARE for Life program, would not be held constant.

**Table 3-6.**

## CBO's Projections of Discretionary Spending Under Selected Policy Alternatives

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **CBO's February 2014 Baseline (Spending caps in effect through 2021)** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 600 | 606 | 608 | 611 | 626 | 641 | 656 | 672 | 688 | 706 | 723 | 742 | 3,143 | 6,674 |
| Nondefense | 545 | 524 | 506 | 506 | 518 | 530 | 545 | 558 | 571 | 586 | 601 | 617 | 2,605 | 5,538 |
| Total | 1,145 | 1,130 | 1,114 | 1,118 | 1,144 | 1,171 | 1,201 | 1,230 | 1,259 | 1,291 | 1,324 | 1,358 | 5,748 | 12,212 |
| Outlays | | | | | | | | | | | | | | |
| Defense | 625 | 604 | 603 | 611 | 616 | 624 | 642 | 657 | 673 | 695 | 707 | 719 | 3,096 | 6,546 |
| Nondefense | 576 | 590 | 589 | 581 | 578 | 586 | 596 | 609 | 620 | 634 | 650 | 664 | 2,930 | 6,107 |
| Total | 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 |
| **Reduce the Number of Troops Deployed for Overseas Contingency Operations to 30,000 by 2017[a]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 600 | 606 | 579 | 566 | 569 | 579 | 592 | 606 | 621 | 637 | 654 | 671 | 2,885 | 6,073 |
| Nondefense | 545 | 524 | 504 | 503 | 514 | 526 | 540 | 553 | 566 | 581 | 596 | 611 | 2,586 | 5,493 |
| Total | 1,145 | 1,130 | 1,083 | 1,068 | 1,083 | 1,105 | 1,131 | 1,160 | 1,187 | 1,218 | 1,249 | 1,282 | 5,470 | 11,566 |
| Outlays | | | | | | | | | | | | | | |
| Defense | 625 | 604 | 593 | 577 | 569 | 568 | 582 | 593 | 607 | 628 | 640 | 651 | 2,889 | 6,008 |
| Nondefense | 576 | 590 | 589 | 580 | 575 | 582 | 593 | 605 | 616 | 630 | 645 | 660 | 2,919 | 6,073 |
| Total | 1,201 | 1,194 | 1,181 | 1,156 | 1,145 | 1,151 | 1,174 | 1,198 | 1,223 | 1,257 | 1,285 | 1,311 | 5,807 | 12,081 |
| **Increase Discretionary Appropriations at the Rate of Inflation After 2014[b]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 600 | 606 | 618 | 633 | 649 | 667 | 684 | 702 | 721 | 740 | 760 | 780 | 3,251 | 6,954 |
| Nondefense | 545 | 524 | 536 | 549 | 564 | 581 | 597 | 616 | 632 | 649 | 666 | 683 | 2,827 | 6,072 |
| Total | 1,145 | 1,130 | 1,154 | 1,182 | 1,213 | 1,247 | 1,281 | 1,318 | 1,353 | 1,389 | 1,426 | 1,462 | 6,078 | 13,025 |
| Outlays | | | | | | | | | | | | | | |
| Defense | 625 | 604 | 609 | 627 | 636 | 647 | 668 | 685 | 704 | 728 | 741 | 755 | 3,187 | 6,801 |
| Nondefense | 576 | 590 | 606 | 613 | 617 | 631 | 646 | 662 | 678 | 694 | 712 | 728 | 3,112 | 6,587 |
| Total | 1,201 | 1,194 | 1,215 | 1,239 | 1,254 | 1,278 | 1,314 | 1,348 | 1,381 | 1,422 | 1,454 | 1,484 | 6,300 | 13,388 |

**Continued**

## Net Interest

In 2013, outlays for net interest were $221 billion, very close to the amount spent in 2012. As a share of GDP, net interest was 1.3 percent in 2013 and is expected to be about the same in 2014 because of continued historically low interest rates (see Table 3-7).

Net interest payments are dominated by the interest paid to holders of the debt that the Department of the Treasury issues to the public. The Treasury also pays interest on debt issued to trust funds and other government accounts, but such payments are intragovernmental transactions that have no effect on the budget deficit. In addition, other federal accounts pay and receive interest for various reasons.[31]

The federal government's interest payments depend primarily on market interest rates and the amount of debt held by the public; however, other factors, such as the rate of inflation and the maturity structure of outstanding

31. For additional information, see Congressional Budget Office, *Federal Debt and Interest Costs* (December 2010), www.cbo.gov/publication/21960.

**Table 3-6.** **Continued**

## CBO's Projections of Discretionary Spending Under Selected Policy Alternatives

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Freeze Most Discretionary Appropriations at the 2014 Amount[c]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 600 | 606 | 607 | 609 | 612 | 614 | 617 | 619 | 622 | 624 | 627 | 630 | 3,059 | 6,181 |
| Nondefense | 545 | 524 | 526 | 527 | 528 | 529 | 530 | 532 | 532 | 532 | 533 | 531 | 2,640 | 5,301 |
| Total | 1,145 | 1,130 | 1,134 | 1,136 | 1,139 | 1,143 | 1,147 | 1,151 | 1,154 | 1,157 | 1,160 | 1,161 | 5,699 | 11,482 |
| Outlays | | | | | | | | | | | | | | |
| Defense | 625 | 604 | 602 | 608 | 605 | 603 | 609 | 611 | 613 | 620 | 618 | 617 | 3,026 | 6,106 |
| Nondefense | 576 | 590 | 600 | 596 | 587 | 585 | 584 | 584 | 582 | 581 | 581 | 579 | 2,952 | 5,859 |
| Total | 1,201 | 1,194 | 1,202 | 1,204 | 1,192 | 1,188 | 1,193 | 1,195 | 1,195 | 1,201 | 1,199 | 1,196 | 5,978 | 11,965 |
| **Remove the Effect on Discretionary Spending of the Automatic Enforcement Procedures Specified in the Budget Control Act[d]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 600 | 606 | 608 | 665 | 680 | 695 | 710 | 726 | 742 | 761 | 780 | 800 | 3,359 | 7,168 |
| Nondefense | 545 | 524 | 506 | 544 | 555 | 567 | 581 | 593 | 605 | 621 | 637 | 653 | 2,752 | 5,861 |
| Total | 1,145 | 1,130 | 1,114 | 1,209 | 1,235 | 1,262 | 1,291 | 1,319 | 1,347 | 1,382 | 1,417 | 1,453 | 6,110 | 13,029 |
| Outlays | | | | | | | | | | | | | | |
| Defense | 625 | 604 | 603 | 644 | 662 | 674 | 694 | 710 | 726 | 749 | 762 | 776 | 3,277 | 7,000 |
| Nondefense | 576 | 590 | 589 | 602 | 608 | 619 | 631 | 644 | 654 | 669 | 684 | 700 | 3,049 | 6,400 |
| Total | 1,201 | 1,194 | 1,192 | 1,246 | 1,270 | 1,293 | 1,325 | 1,354 | 1,381 | 1,417 | 1,447 | 1,476 | 6,326 | 13,400 |

Source: Congressional Budget Office.

Note: Nondefense discretionary outlays are usually higher than budget authority because of spending from the Highway Trust Fund and the Airport and Airway Trust Fund that is subject to obligation limitations set in appropriation acts. The budget authority for such programs is provided in authorizing legislation and is not considered discretionary.

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 a year from 2017 on—for a total of $380 billion over the 2015–2024 period.

b. These estimates reflect the assumption that appropriations will not be constrained by caps 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.

c. This option reflects the assumption that appropriations other than those for overseas contingency operations would generally be frozen at the 2014 level through 2024.

d. 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 (with some limited changes made by later legislation) and generally 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.

**Table 3-7.**

## Federal Interest Outlays Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Interest on Treasury Debt Securities (Gross interest)[a] | 416 | 425 | 468 | 533 | 625 | 732 | 825 | 905 | 977 | 1,046 | 1,116 | 1,184 | 3,184 | 8,412 |
| Interest Received by Trust Funds | | | | | | | | | | | | | | |
| Social Security | -106 | -102 | -99 | -99 | -101 | -104 | -109 | -112 | -114 | -114 | -113 | -111 | -511 | -1,075 |
| Other[b] | -51 | -50 | -57 | -61 | -68 | -75 | -82 | -87 | -92 | -93 | -95 | -99 | -344 | -810 |
| Subtotal | -157 | -152 | -156 | -160 | -168 | -179 | -191 | -199 | -206 | -207 | -208 | -210 | -855 | -1,884 |
| Other Interest[c] | -35 | -38 | -44 | -48 | -53 | -59 | -65 | -70 | -76 | -82 | -88 | -94 | -268 | -678 |
| NRRIT Investment Income (Non-Treasury holdings)[d] | -3 | -2 | * | * | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -3 | -7 |
| **Net Interest Outlays** | **221** | **233** | **268** | **326** | **404** | **493** | **569** | **635** | **694** | **755** | **819** | **880** | **2,059** | **5,842** |

Source: Congressional Budget Office.

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

a. Excludes interest costs on debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).

b. Mainly the Civil Service Retirement, Military Retirement, Medicare, and Unemployment Insurance Trust Funds.

c. Primarily interest on loans to the public.

d. Earnings on investments by the National Railroad Retirement Investment Trust (NRRIT), an entity created to manage and invest assets of the Railroad Retirement program.

securities, also affect interest costs. (For example, longer-term securities generally pay higher interest than do shorter-term securities.) Interest rates are determined by a combination of market forces and the policies of the Federal Reserve System. Debt held by the public is determined mostly by cumulative budget deficits, which depend on policy choices about spending and revenues and on economic conditions and other factors. At the end of 2013, debt held by the public reached nearly $12 trillion, and in CBO's baseline, it is projected to total $21.3 trillion in 2024. (For detailed projections of debt held by the public, see Table 1-3 on page 17.)

Although debt held by the public surged in the past few years to its highest levels relative to GDP since the early 1950s, outlays for net interest have remained low relative to GDP because interest rates on Treasury securities have been remarkably low. Rates on 3-month Treasury bills plummeted from an average of nearly 5 percent in 2007 to 0.1 percent in 2010; those rates averaged 0.1 percent in 2013 as well. Similarly, rates on 10-year Treasury notes dropped from an average of nearly 5 percent in 2007 to a low of 1.9 percent in 2012; those rates picked up only slightly in 2013, to an average of 2.1 percent. As a result, even though debt held by the public rose dramatically—climbing from 35 percent of GDP at the end of 2007 to 72 percent at the end of 2013—outlays for net interest as a percentage of GDP fell from 1.7 percent in 2007 to 1.3 percent in 2013. By comparison, such outlays averaged about 3 percent of GDP in the 1980s and 1990s.

### Baseline Projections of Net Interest

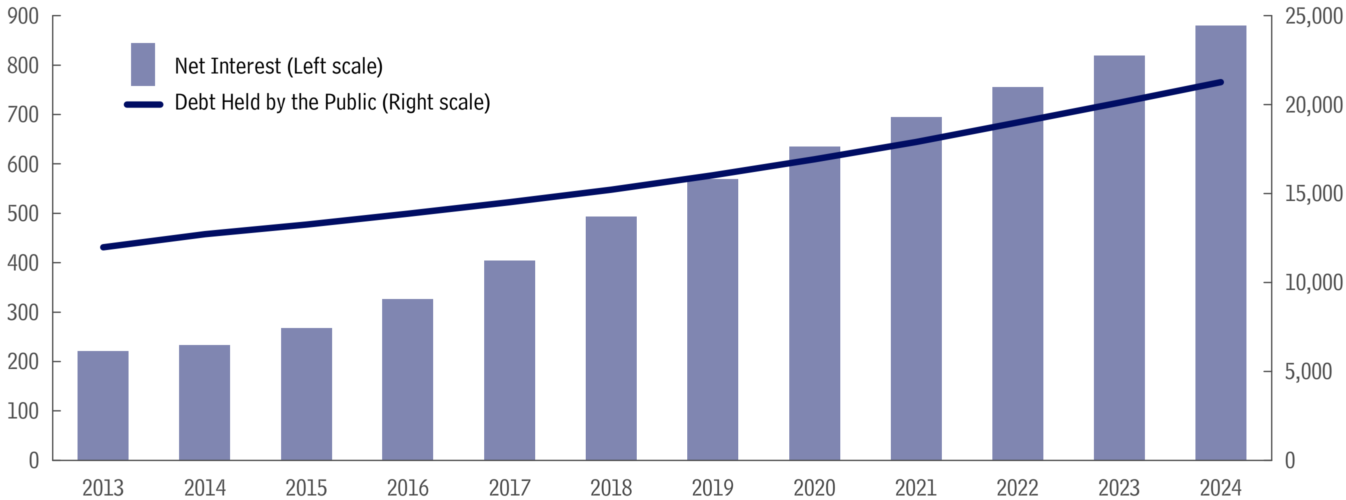
Under CBO's baseline assumptions, net interest costs are projected to nearly quadruple from 2014 through 2024, from $233 billion in 2014 to $880 billion in 2024. Debt held by the public is projected to increase by nearly 70 percent (in nominal terms) over the next 10 years, reaching $21.3 trillion in 2024 (see Figure 3-4 on page 77).[32] In addition, CBO estimates, the interest rate paid on 3-month Treasury bills will rise from 0.1 percent in 2013 to 3.7 percent in 2018 and subsequent years, and the rate on 10-year Treasury notes will increase from 2.1 percent in 2013 to 5.0 percent. As a result, under current law, net interest is projected to reach 3.3 percent of GDP in 2024.

32. Debt held by the public does not include securities issued by the Treasury to federal trust funds and other government accounts. Those securities are included as part of the measure of gross debt. (For further details, see Chapter 1.)

**Figure 3-4.**

## Projected Debt Held by the Public and Net Interest

(Billions of dollars)




Source: Congressional Budget Office.

### Gross Interest

In 2013, interest paid by the Treasury on all of its debt issuances totaled $416 billion. Nearly 40 percent of that total, $157 billion, represents payments to other entities (such as trust funds) within the federal government; the remainder is paid to owners of Treasury debt issued to the public. In CBO's baseline, gross interest payments from 2015 through 2024 total $8.4 trillion. Almost 75 percent of that amount reflects interest paid on debt held by the public.

### Interest Received by Trust Funds

The Treasury has issued more than $4.7 trillion in securities to federal trust funds and other government accounts. Trust funds are the dominant holders of such securities, owning more than 90 percent of them. The interest paid on those securities has no net impact on federal spending because it is credited to accounts elsewhere in the budget. In 2014, trust funds will be credited with $152 billion of such intragovernmental interest, CBO estimates, mostly for the Social Security, Military Retirement, and Civil Service Retirement and Disability trust funds. Over the 2015–2024 period, the intragovernmental interest received by trust funds is projected to total $1.9 trillion.

### Other Interest

The net payments of $38 billion in other interest that CBO anticipates the government will receive in 2014 represent the net result of many transactions, including both interest collections and interest payments.

The largest interest collections come from the government's credit financing accounts, which have been established to record the cash transactions related to federal direct loan and loan guarantee programs. For those programs, net subsidy costs are recorded in the budget, but the cash flows that move through the credit financing accounts are not. Credit financing accounts pay interest to and receive interest from Treasury accounts that appear in the budget; but, on net, they pay more interest to the Treasury than they receive from it. CBO estimates that net receipts from the credit financing accounts will total $30 billion in 2014 and steadily increase to $66 billion in 2024. Interest payments associated with the direct student loan program dominate the annual totals.

Among the interest outflows from the government are payments for interest on tax refunds issued more than 45 days after the date on which the corresponding tax returns were filed and interest payments made for certain bonds that were issued to finance the resolution of the savings and loan crisis of the 1980s. Together, those payments are expected to total nearly $6 billion in 2014 and to average about that amount each year through 2024.

The government also receives investment income from the financial assets held by the National Railroad Retirement Investment Trust. CBO estimates that net receipts from the trust will be $2 billion in 2014 and total $7 billion for the rest of the 10-year period.

CHAPTER

# 4

# The Revenue Outlook

The Congressional Budget Office (CBO) projects that, if current laws generally do not change, the federal government's revenues will increase by 9 percent in 2014 and by another 9 percent in 2015, reaching $3.3 trillion in 2015—about $530 billion more than receipts in 2013. As a share of gross domestic product (GDP), revenues are projected to rise from 16.7 percent in 2013 to 17.5 percent (about the average for the past 40 years) in 2014 and to 18.2 percent in 2015. Because of the recent recession, revenues had fallen to 14.6 percent of GDP in both 2009 and 2010 (see Figure 4-1).

More than half of the projected growth in revenues relative to GDP between 2013 and 2015 comes from changes in provisions of law that have already occurred or are scheduled to occur. The largest contributors are the following:

- The expiration, at the end of calendar year 2013, of a number of tax provisions that reduced corporate and individual income taxes, especially one that allowed businesses to immediately deduct a significant portion of their investment in equipment.

- A number of changes that, because they took effect in January 2013, will increase revenues more in fiscal year 2014, the first full fiscal year they are in effect, than they did in fiscal year 2013. Those changes include the expiration of a two-year reduction in Social Security payroll tax rates, as well as increases in income tax rates and a new surtax on investment income that apply to certain high-income individuals.

- New taxes, fees, and fines related to health insurance coverage under the Affordable Care Act, although those additional revenues will be partially offset by new tax credits to subsidize the purchase of health insurance.

Revenues are also projected to rise relative to GDP this year and next year for reasons other than changes in law. The factors that significantly reduced corporate income tax revenues during the recession have since diminished, and CBO expects them to wane further as the economy continues to recover. In addition, CBO projects that growth in people's real (inflation-adjusted) income will push more of their income into higher tax brackets, a phenomenon called real bracket creep. Moreover, CBO expects that taxable distributions from tax-deferred retirement accounts will increase faster than GDP, in part because the balances in those accounts have been boosted in the past two years by a rapid increase in equity prices, which will allow people to make larger withdrawals.

After this year and next, revenues in CBO's baseline projections remain between 18.0 percent and 18.4 percent of GDP from 2016 through 2024, largely because of offsetting movements in three sources of revenue:

- Individual income tax receipts are projected to increase as a share of GDP, mostly as a result of real bracket creep and increases in withdrawals from tax-deferred retirement accounts as baby boomers retire.

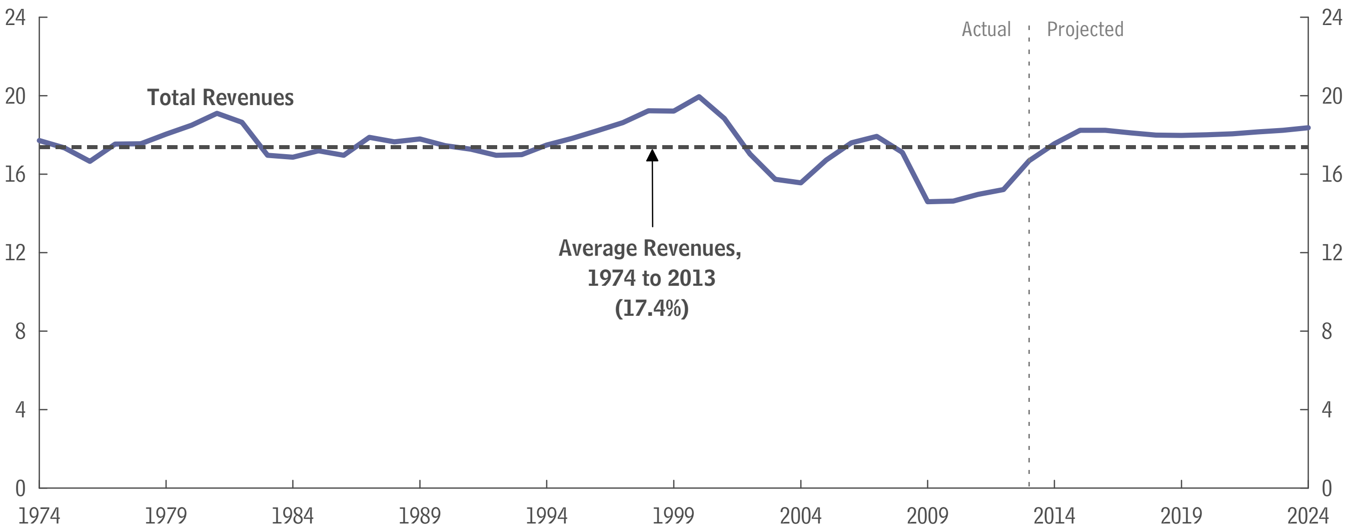
- Corporate income tax receipts are projected to decline relative to the size of the economy because of an expected drop in domestic economic profits relative to GDP, a result of rising interest payments on businesses' debt, growing labor costs, and increasing depreciation deductions on the larger stock of business capital.

- Remittances to the Treasury from the Federal Reserve—which have been very large in the past four years because of changes in the size and composition of the central bank's portfolio—are projected to decline to more normal levels.

**Figure 4-1.**

## Total Revenues

(Percentage of gross domestic product)




Source: Congressional Budget Office.

Last May, CBO published revenue projections for the period from 2013 to 2023; the projections in this chapter cover the period from 2014 to 2024. For the overlapping period—2014 to 2023—the current projections are lower than the previous ones by a total of $1.6 trillion (or 4 percent). That reduction largely reflects slower GDP growth in CBO's updated economic forecast. (For more information on changes to the revenue projections since May, see Appendix A.)

The tax rules on which CBO's projections are based include the tax rates that apply to different types of income; they also include an array of exclusions, deductions, preferential rates, and credits, which reduce revenues, for any given level of tax rates, in both the individual and corporate income tax systems. Some of those provisions are called tax expenditures because, like government spending programs, they provide financial assistance to particular activities, entities, or groups of people. The tax expenditures that have the largest effect on revenues are the following:

- The exclusion from workers' taxable income of employers' contributions for health care, health insurance premiums, and long-term-care insurance premiums;
- The exclusion of contributions to and earnings of pension funds (minus pension benefits that are included in taxable income);
- Preferential tax rates on dividends and long-term capital gains; and
- The deduction of interest that homeowners pay on mortgages for their residences.

On the basis of estimates prepared by the staff of the Joint Committee on Taxation (JCT), CBO expects that under current law, those and other tax expenditures will total $1.4 trillion in 2014—an amount equal to 8.2 percent of GDP, or nearly half of the revenues projected for the year.[1] Most of that amount arises from the 12 largest tax expenditures, which CBO estimates will total about 6.0 percent of GDP in 2014 and 6.5 percent of GDP from 2015 to 2024.

## How the Composition of Revenues Is Evolving

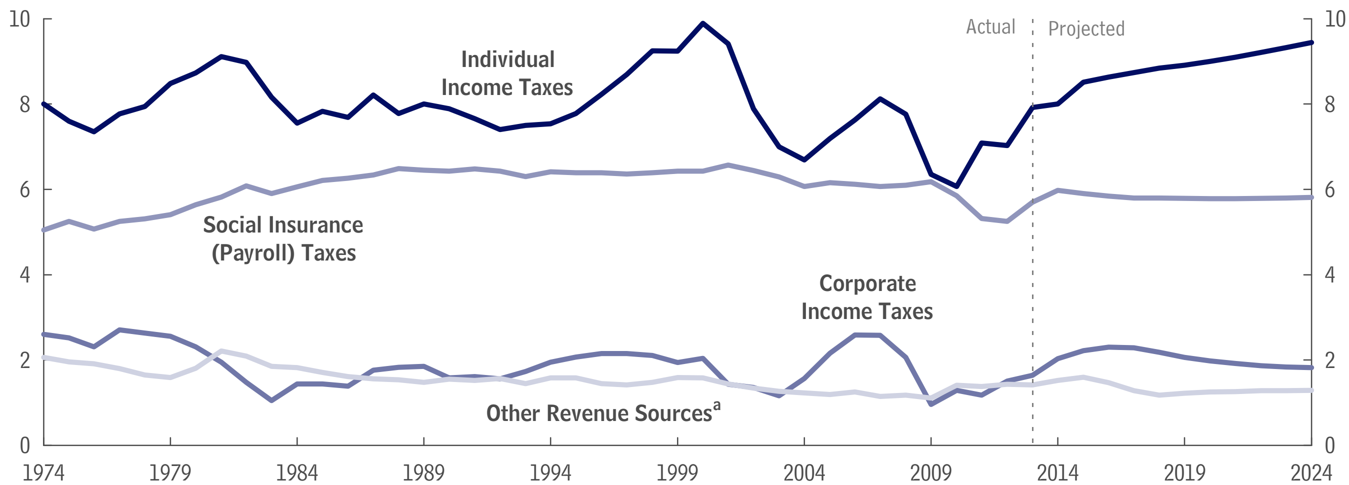
Federal revenues come from various sources: individual income taxes; payroll taxes, which are dedicated to certain social insurance programs; corporate income taxes; excise taxes; earnings of the Federal Reserve System, which are remitted to the Treasury; customs duties; estate and

1. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), http://go.usa.gov/ZHCz. CBO used its economic forecast to extrapolate the estimates beyond 2017 and included projected effects on payroll taxes.

**Figure 4-2.**

## Revenues, by Major Source

(Percentage of gross domestic product)




Source: Congressional Budget Office.

a. Excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

gift taxes; and miscellaneous fees and fines. Individual income taxes are the largest source of federal revenues, having contributed, on average, about 45 percent of total revenues (and equaled about 8 percent of GDP) over the past 40 years. Social insurance taxes—mainly for Social Security and for Medicare's Hospital Insurance program—are the second-largest source of receipts, averaging about 35 percent of total revenues (or 6 percent of GDP) over the same period. Corporate income taxes have contributed roughly 10 percent of total revenues (or 2 percent of GDP), as have all of the other revenue sources combined.

Although that broad picture has remained the same over the past four decades, the details have varied. Receipts from individual income taxes have fluctuated more than the other major types of revenues, ranging from 42 percent to 50 percent of total revenues (and from 6.1 percent to 9.9 percent of GDP) but showing no clear trend over that period (see Figure 4-2). Receipts from social insurance taxes rose as a share of revenues in the 1970s—largely because of legislated increases in tax rates and in the amount of income to which those taxes applied—and reached about 36 percent of total revenues (and just over 6 percent of GDP) in the mid-1980s. Since 2001, those receipts have fallen slightly relative to GDP; in addition, a sharper, temporary reduction took place in 2011 and 2012 as a result of a two-year reduction in the employees' share of the Social Security payroll tax. Revenues from corporate income taxes fell substantially relative to total revenues and GDP in the early 1980s, mainly because of declining profits and legislation that accelerated depreciation deductions. Those revenues have fluctuated since then with no evident trend. Revenues from the remaining sources, particularly excise taxes, have slowly trended downward over the past 40 years relative to total revenues and GDP.

Under current law, CBO projects, individual income taxes will generate a growing share of revenues over the next decade; by 2021, they will account for more than half of total revenues (for the first time in history), and by 2024, they will rise to more than 9 percent of GDP, well above the historical average. Receipts from social insurance taxes are projected to remain stable at about 5.8 percent of GDP, though their share of total revenues is projected to decline slightly as revenues from individual income taxes grow more quickly. Corporate income taxes are expected to make roughly the same contribution that they have in the past three decades, supplying about 11 percent of total revenues and averaging 2 percent of GDP. Taken together, the remaining revenue sources are expected to diminish slightly as a share of total revenues, though they will remain roughly stable relative to GDP.

**Table 4-1.**

## Revenues Projected in CBO's Baseline

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| 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 | | | | | | | | | | | | | | |
| Excise taxes | 84 | 91 | 96 | 98 | 102 | 105 | 107 | 108 | 111 | 114 | 117 | 120 | 507 | 1,076 |
| Federal Reserve remittances | 76 | 93 | 89 | 56 | 14 | 8 | 21 | 30 | 36 | 42 | 45 | 51 | 188 | 391 |
| Customs duties | 32 | 33 | 36 | 38 | 41 | 43 | 45 | 47 | 50 | 53 | 57 | 60 | 202 | 469 |
| Estate and gift taxes | 19 | 19 | 20 | 23 | 25 | 26 | 27 | 28 | 29 | 31 | 32 | 33 | 120 | 273 |
| Miscellaneous fees and fines | 26 | 27 | 49 | 65 | 75 | 66 | 69 | 72 | 74 | 77 | 80 | 82 | 323 | 708 |
| Subtotal | 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 |
| **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 | | | | | | | |
| 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 | | | | | | | | | | | | | | |
| Excise taxes | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 | 0.5 | 0.5 |
| Federal Reserve remittances | 0.5 | 0.5 | 0.5 | 0.3 | 0.1 | * | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Customs duties | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Estate and gift taxes | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Miscellaneous fees and fines | 0.2 | 0.2 | 0.3 | 0.3 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Subtotal | 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 |

Source: Congressional Budget Office.

Note: * = between zero and 0.05 percent.

a. Receipts from Social Security payroll taxes.

# Individual Income Taxes

If current laws do not change, individual income taxes are expected to rise markedly relative to GDP over the next 10 years, as a result of structural features of the tax system (such as real bracket creep), recent changes in tax provisions, the ongoing economic recovery, and other factors. CBO projects that individual income tax receipts will increase as a percentage of GDP from 7.9 percent in 2013 to 8.5 percent in 2015; they will then rise by about 0.1 percentage point per year, reaching 9.4 percent of GDP in 2024 (see Table 4-1).

### Significant Growth in Receipts Relative to GDP From 2013 to 2015

After declining by 23 percent between 2007 and 2010, receipts from individual income taxes grew in each of the past three years. They continue to grow in CBO's baseline projections—by 5 percent in 2014 and by 12 percent in 2015. They are projected to total over $1.5 trillion, or 8.5 percent of GDP, in 2015, the highest percentage since 2001 and also greater than the 40-year average of 7.9 percent.

Part of the projected increase in individual income tax receipts in 2014 and 2015 results from projected growth in taxable personal income, as measured in the national income and product accounts (NIPAs) produced by the Bureau of Economic Analysis. That measure of income includes wages, salaries, dividends, interest, rental income, and proprietors' income; its expected growth this year and next roughly corresponds to expected growth in GDP. However, several factors cause receipts from individual income taxes in CBO's baseline to rise relative to both taxable personal income and GDP—boosting revenues relative to GDP by 0.6 percentage points from 2013 to 2015. Those factors include growth in taxable income that is *not* included in the NIPAs, real bracket creep, and recent changes in tax provisions.

**Increases in Certain Kinds of Taxable Income.** The most significant increase in taxable income not included in the NIPAs consists of taxable distributions from tax-deferred retirement accounts, such as individual retirement accounts and 401(k) plans. Those distributions are projected to rise quickly in 2014 and 2015 because higher asset values, resulting especially from the rapid increase in equity prices over the past two years, have enlarged the balances in retirement accounts, allowing retirees to make larger withdrawals. The expected increase in distributions from retirement accounts raises CBO's projections of revenues as a percentage of GDP by 0.2 percentage points between 2013 and 2015.

Capital gains realizations are likewise not included in income in the national income and product accounts. CBO projects that, excluding the effects of tax law changes (which are considered separately and discussed below), capital gains realizations will increase from 2013 to 2015 as the economy continues to recover. That increase will raise revenues as a share of GDP over the two-year period by about 0.1 percentage point, CBO estimates.

**Real Bracket Creep.** CBO expects that average tax rates—that is, total taxes as a percentage of total income—will increase this year and in 2015 for a few reasons. The most significant of those reasons is real bracket creep. That phenomenon occurs because the income tax brackets and exemptions under both the regular income tax and the alternative minimum tax (AMT) are indexed only to inflation.[2] When real economic growth occurs, total income grows faster than the inflation-indexed tax brackets do, pushing more income into higher tax brackets. That factor causes projected revenues as a share of GDP to rise by between 0.1 and 0.2 percentage points during the 2013–2015 period.

**Changes in Tax Provisions.** Average tax rates will also increase this year and next because of recent changes in tax law. The American Taxpayer Relief Act of 2012 (Public Law 112-240), which was enacted in early January 2013, permanently extended some lower tax rates and other tax provisions that had expired at the end of calendar year 2012 and limited the reach of the AMT. Nonetheless, some high-income taxpayers started to face higher tax rates—including rates applicable to ordinary income, capital gains, and dividends—at the beginning of 2013. In addition, 2013 saw the beginning of a surtax (enacted in the Affordable Care Act) of 3.8 percent on certain types of investment income for taxpayers with income over $200,000 (for single filers) or $250,000 (for joint filers).

Those higher tax rates were in effect for only three quarters of fiscal year 2013 (which began in October 2012), but they will be in effect for all four quarters of fiscal year 2014, boosting receipts in that year relative to receipts in 2013. However, the boost in 2014 will be smaller than it might have been, CBO estimates, because taxpayers responded to the higher tax rates by shifting some income—especially capital gains realizations—from calendar year 2013 to 2012. That shift raised receipts in fiscal year 2013, when taxpayers filed their tax returns for calendar year 2012, but will reduce receipts in fiscal year 2014, according to CBO's projections.

In addition, certain other tax provisions that reduced tax revenues expired at the end of 2013, including many provisions that were extended routinely in previous years (sometimes retroactively). Most notably, rules allowing accelerated depreciation deductions for certain business investments expired at the end of last year. That expiration does not affect corporations alone; it also affects noncorporate businesses, whose owners' income is subject

2. The alternative minimum tax is a parallel income tax system with fewer exemptions, deductions, and rates than the regular income tax. Households must calculate the amount that they owe under both the alternative minimum tax and the regular income tax, and then pay the larger of the two amounts.

to the individual income tax. The expiration will therefore increase individual income tax liabilities starting in calendar year 2014—liabilities that mostly will be paid by taxpayers starting in fiscal year 2015, CBO estimates.

Offsetting some of the revenue increases that will result from changes in tax provisions, new tax credits for individuals' purchases of health insurance through exchanges have gone into effect this year. CBO estimates that those tax credits will reduce revenues by $2 billion in 2014 and by $6 billion in 2015.[3] On balance, however, the changes in tax provisions will cause individual income tax receipts as a share of GDP to increase by about 0.2 percentage points from 2013 to 2015.

### Slower but Steady Growth in Receipts Relative to GDP After 2015

CBO projects that under current law, individual income tax receipts will rise from $1.5 trillion in 2015 to $2.5 trillion in 2024, for an average annual increase of about 6 percent; that would represent an increase of 0.9 percentage points of GDP, from 8.5 percent to 9.4 percent. Real bracket creep and growing distributions from tax-deferred retirement accounts will cause most of that increase.

**Real Bracket Creep.** Real bracket creep will raise individual income tax receipts as a share of GDP by about 0.5 percentage points between 2015 and 2024, CBO projects.

**Distributions From Tax-Deferred Retirement Accounts.** In coming years, as the population ages, taxable distributions from tax-deferred retirement accounts are expected to grow more rapidly than GDP. By CBO's estimate, the taxation of distributions from such accounts will cause revenues as a share of GDP to rise by about 0.2 percentage points from 2015 through 2024.

**Other Factors.** Other factors are expected to raise individual income tax receipts as a share of GDP by about 0.2 percentage points between 2015 and 2024. Wages and salaries—which have fallen sharply relative to GDP since 2008—are expected to increase as a percentage of GDP (for more details, see Chapter 2). In addition, the wages and salaries of higher-income taxpayers are projected to grow faster than those of other taxpayers, increasing total taxes as a percentage of total income.

## Social Insurance Taxes

From fiscal year 2012 to fiscal year 2013, receipts from payroll taxes, which fund social insurance programs, increased by about 12 percent—to 5.7 percent of GDP—primarily because of the expiration of a 2 percentage-point reduction in employees' share of the Social Security tax that was in effect during calendar years 2011 and 2012. Under current law, CBO projects, social insurance tax receipts will increase further as a percentage of GDP this year, to 6.0 percent, largely because this is the first full fiscal year after the tax rate reduction expired. Thereafter, social insurance tax receipts are projected to decline slightly as a percentage of GDP under current law—in 2015, to 5.9 percent, and in 2016, to 5.8 percent, where they are expected to remain through 2024.

### Sources of Social Insurance Tax Receipts

By far the largest sources of social insurance tax receipts are payroll taxes for Social Security and payroll taxes for Part A of Medicare (the Hospital Insurance program). Much smaller sources are payroll taxes for unemployment insurance (whose revenues are classified as federal, even though most of the taxes are imposed by states); employers' and employees' contributions to the Railroad Retirement system, which functions for railroad employees the way Social Security does for most workers; and contributions to other federal retirement programs, mainly those made by federal employees (see Table 4-2). The premiums that Medicare enrollees pay for Part B (the Medical Insurance program) and Part D (prescription drug coverage) are voluntary payments and thus are not counted as tax revenues; rather, they appear on the spending side of the budget as offsetting receipts.

Social Security and Medicare payroll taxes are calculated as percentages of a worker's earnings. The Social Security tax is 12.4 percent of earnings, half paid by the employer and half by the employee. It does not apply to annual earnings above a certain amount, called the taxable maximum (currently $117,000); that amount is indexed to grow over time at the same pace as average earnings for all workers. The Medicare tax is 2.9 percent of earnings for

3. Those tax credits are refundable, which means that any portion that exceeds an individual's tax liability is paid to that person and recorded in the budget not as a reduction in revenues but as an outlay. In this case, an additional $13 billion in 2014 and $33 billion in 2015 will be recorded in the budget as outlays, CBO estimates.

**Table 4-2.**

## Social Insurance Tax Revenues Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | 673 | 743 | 771 | 805 | 842 | 880 | 918 | 955 | 994 | 1,034 | 1,076 | 1,119 | 4,215 | 9,392 |
| Medicare | 209 | 227 | 238 | 251 | 264 | 278 | 291 | 304 | 318 | 333 | 349 | 365 | 1,321 | 2,991 |
| Unemployment Insurance | 57 | 54 | 52 | 49 | 48 | 47 | 47 | 46 | 48 | 51 | 55 | 59 | 243 | 502 |
| Railroad Retirement | 5 | 5 | 5 | 5 | 5 | 6 | 6 | 6 | 6 | 6 | 7 | 7 | 27 | 60 |
| Other Retirement[a] | 4 | 4 | 4 | 4 | 5 | 5 | 5 | 6 | 7 | 7 | 8 | 8 | 23 | 59 |
| Total | 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 |

Source: Congressional Budget Office.

a. Consists primarily of federal employees' contributions to the Federal Employees Retirement System and the Civil Service Retirement System.

most workers, with the employer and employee each paying half. In contrast with the Social Security tax, there is no taxable maximum for the Medicare tax. Moreover, since 2013, an additional Medicare tax of 0.9 percent, paid entirely by the employee, has been levied on an individual's earnings over $200,000 (or on joint filers' total earnings over $250,000), bringing the total Medicare tax for such people to 3.8 percent.

### Slight Decline in Projected Receipts Relative to GDP

Relative to GDP, social insurance tax receipts are projected to decline slightly from 2014 to 2016 for two reasons. First, a growing share of earnings is anticipated to be above Social Security's taxable maximum.[4] Second, receipts from unemployment insurance taxes are expected to decline in dollar terms (and therefore as a share of GDP). Those receipts grew rapidly from 2009 to 2012, as states raised their tax rates and tax bases and also made payments to replenish unemployment insurance trust funds that had been depleted because of high unemployment and consequently high unemployment insurance benefits. As trust fund balances improved in 2013, those receipts fell, and CBO expects them to continue to fall to more typical levels in coming years.

The same two factors are projected to continue pushing down social insurance revenues relative to GDP between 2016 and 2024—but they will be largely offset by other factors. The most important is that wages and salaries, the main component of the social insurance tax base, will increase as a share of GDP, CBO projects. Another factor boosting revenues from Medicare taxes relative to GDP is that, over time, a greater share of earnings will become subject to the additional 0.9 percent tax.

4. However, because of the progressive rate structure of the individual income tax, the increase in the share of earnings above the Social Security taxable maximum is projected to produce an increase in individual income tax receipts that will more than offset the decrease in social insurance tax receipts.

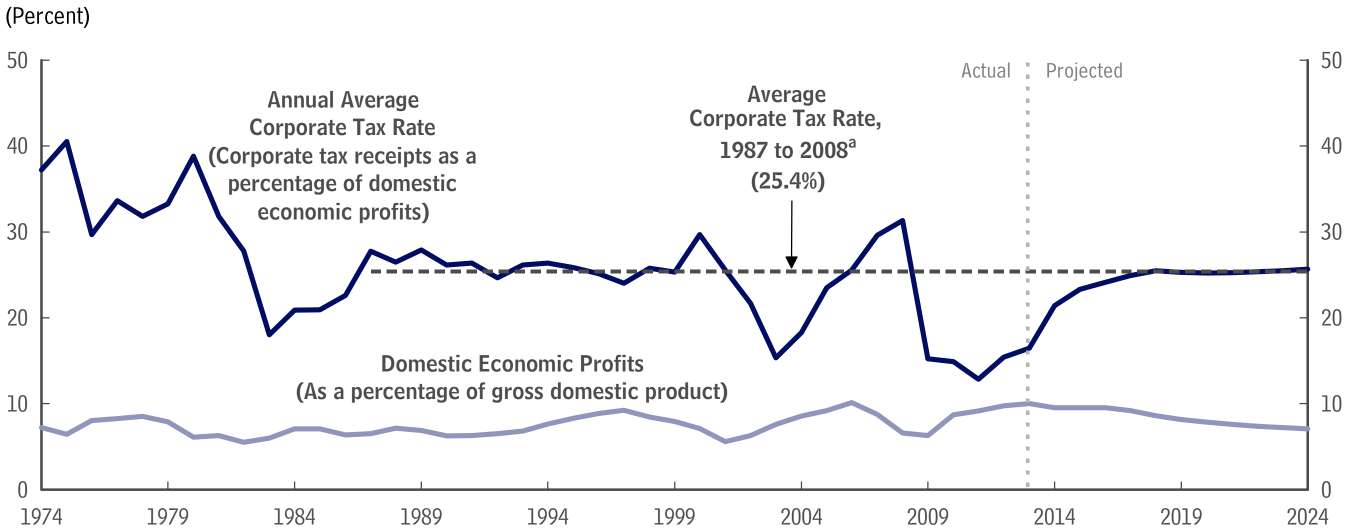
## Corporate Income Taxes

In 2009, receipts from corporate income taxes fell to 1.0 percent of GDP, the lowest percentage in more than 70 years, as a result of a drop in taxable corporate profits during the recession and the government's policy responses to that economic downturn.[5] Those receipts have rebounded to some extent since then—to 1.6 percent of GDP in 2013—but remain below the 40-year average of 1.9 percent. Under current law, CBO expects corporate income tax receipts to rise sharply relative to GDP during the next few years because of a continuing increase in the average corporate tax rate (that is, receipts as a percentage of domestic economic profits), the result of expiring tax provisions and other factors. In CBO's baseline, corporate income tax receipts reach 2.3 percent of GDP in 2016 and then decline gradually as a percentage of GDP, reaching roughly the historical average after 2020.

5. In particular, the American Recovery and Reinvestment Act of 2009 (P.L. 111-5) contained a number of provisions that temporarily reduced corporate income taxes.

**Figure 4-3.**

## Average Corporate Tax Rate and Corporations' Domestic Economic Profits




Source: Congressional Budget Office.

Note: Domestic economic profits, as measured in the national income and product accounts, are the profits that U.S. and foreign corporations earn from current production activities carried out within the United States. They exclude certain income of U.S.-based multinational corporations that is derived from foreign sources, most of which does not generate corporate income tax receipts in the United States.

a. The measure represents the average of the annual amounts from 1987 to 2008. CBO uses a comparison period that begins in 1987 because the Tax Reform Act of 1986 put in place corporate tax rates and a tax base that, though modified in some ways by later legislation, still closely resemble the rates and base scheduled to be in effect over the 2014–2024 period.

### Sharp Increase in Receipts Relative to GDP From 2013 Through 2016

CBO expects domestic economic profits—an approximation of the base on which corporate income taxes are paid—to decline by about 1 percent from 2013 to 2014 and to remain fairly stable relative to GDP for the following two years. Nevertheless, receipts from corporate income taxes are expected to climb by almost 30 percent from 2013 to 2014—from 1.6 percent of GDP to 2.0 percent—and then to grow by an additional 25 percent over the following two years, to 2.3 percent of GDP in 2016. The reason for the apparent discrepancy is that the average corporate tax rate will increase, according to CBO's projections, to nearly the average rate seen over the period from 1987 to 2008 (see Figure 4-3).[6] That increase occurs in CBO's projections both because certain revenue-reducing tax provisions expired at the end of 2013 and because other factors that have held down the average corporate tax rate since the recession ended are expected to continue to wane.

**Expiration of Tax Provisions.** A number of tax provisions that had been holding down corporate tax receipts expired at the end of 2013; those expirations boost revenues as a share of GDP in CBO's baseline by about 0.3 percentage points between 2013 and 2016. The most significant of those provisions, accounting for about half of the total effect from expiring provisions, involves the rate at which firms that bought equipment could deduct its costs from their taxable income to reflect depreciation in the equipment's value. In 2013, companies with large amounts of investment could expense—that is, immediately deduct—50 percent of the cost of their investments in equipment.[7] This year, under current law, tax depreciation has reverted to the rules generally in effect before

6. CBO uses a comparison period that begins in 1987 because the Tax Reform Act of 1986 (P.L. 99-514) put in place corporate tax rates and a tax base that, though modified in some ways by later legislation, still closely resemble the rates and base scheduled to be in effect over the 2014–2024 period.

7. By contrast, businesses with relatively small amounts of investment in new equipment were allowed to fully deduct those costs in the year in which the equipment was placed in service. That has been the case since 1982 and remains so today, although the maximum amount of such investments allowed to be deducted has changed over time.

**Table 4-3.**

## Smaller Sources of Revenues Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Excise Taxes | | | | | | | | | | | | | | |
| Highway | 35 | 37 | 37 | 38 | 38 | 38 | 38 | 38 | 38 | 38 | 38 | 38 | 190 | 381 |
| Tobacco | 16 | 16 | 15 | 15 | 15 | 15 | 15 | 14 | 14 | 14 | 14 | 13 | 75 | 145 |
| Aviation | 13 | 13 | 14 | 14 | 15 | 16 | 16 | 17 | 18 | 18 | 19 | 20 | 76 | 168 |
| Alcohol | 10 | 10 | 10 | 10 | 10 | 10 | 11 | 11 | 11 | 11 | 11 | 12 | 51 | 108 |
| Health insurance providers | 0 | 7 | 10 | 11 | 13 | 13 | 14 | 15 | 16 | 17 | 18 | 18 | 62 | 145 |
| Other | 10 | 9 | 9 | 9 | 10 | 12 | 13 | 13 | 14 | 15 | 17 | 19 | 53 | 130 |
| Subtotal | 84 | 91 | 96 | 98 | 102 | 105 | 107 | 108 | 111 | 114 | 117 | 120 | 507 | 1,076 |
| Federal Reserve Remittances | 76 | 93 | 89 | 56 | 14 | 8 | 21 | 30 | 36 | 42 | 45 | 51 | 188 | 391 |
| Customs Duties | 32 | 33 | 36 | 38 | 41 | 43 | 45 | 47 | 50 | 53 | 57 | 60 | 202 | 469 |
| Estate and Gift Taxes | 19 | 19 | 20 | 23 | 25 | 26 | 27 | 28 | 29 | 31 | 32 | 33 | 120 | 273 |
| Miscellaneous Fees and Fines | | | | | | | | | | | | | | |
| Universal Service Fund fees | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 11 | 11 | 11 | 11 | 11 | 50 | 105 |
| Other fees and fines | 16 | 17 | 39 | 55 | 65 | 55 | 59 | 61 | 63 | 66 | 69 | 71 | 273 | 603 |
| Subtotal | 26 | 27 | 49 | 65 | 75 | 66 | 69 | 72 | 74 | 77 | 80 | 82 | 323 | 708 |
| **Total** | **236** | **263** | **290** | **280** | **256** | **246** | **268** | **285** | **300** | **316** | **330** | **347** | **1,340** | **2,919** |

Source: Congressional Budget Office.

Note: This table shows all projected sources of revenues other than individual and corporate income taxes and social insurance taxes.

2008, which usually require businesses to deduct their equipment investments over a number of years. Other recently expired provisions include tax credits for research and experimentation and tax incentives for certain types of foreign-earned income, both of which had been in effect for many years.

**Other Factors Boosting Receipts.** The average corporate tax rate fell sharply during the recession. The main factors behind that decline, other than changes in tax law, were a sharp drop in capital gains realizations by corporations and a sharp increase in deductions of bad debts from corporate income. Since the recession ended, the average corporate tax rate has recovered only partially and remains very low by historical standards. The sources of that slow recovery will not be known with certainty until information from tax returns becomes available in the future, but CBO expects that whatever factors have been at work will gradually dissipate as the economy continues to recover. The resulting higher average tax rate is projected to boost corporate receipts as a share of GDP by about 0.4 percentage points between 2013 and 2016.

### Falling Receipts Relative to GDP After 2016

In CBO's baseline projections, corporate income tax receipts decline from 2.3 percent of GDP in 2016 to 1.8 percent in 2024. That decrease is attributable mainly to a projected drop in corporations' domestic economic profits as a share of GDP—from 9.2 percent in 2017 to 7.1 percent in 2024—which is expected to result primarily from rising interest payments on businesses' debt, growing labor costs, and increasing depreciation deductions on a growing stock of business capital. In CBO's projections, those factors are offset only slightly by a continued increase in the average corporate tax rate to about its historical average.

## Smaller Sources of Revenues

The remaining sources of federal revenues are excise taxes, remittances from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines. Revenues from those sources totaled $236 billion in 2013, or 1.4 percent of GDP (see Table 4-3). CBO's baseline projection shows such revenues increasing to $263 billion in 2014, or 1.5 percent of GDP, and ranging between 1.2 percent and 1.6 percent of GDP over the period from 2015 to 2024. The types of revenues that are projected to change the most from their current amounts are miscellaneous fees and fines (which increase, mostly because of new fees and fines enacted in the Affordable Care Act) and remittances from the Federal Reserve System (which decline over the next several years, as the size of the Federal Reserve's portfolio and its earnings return to a more typical relationship to GDP).

## Excise Taxes

Unlike taxes on income, excise taxes are levied on the production or purchase of a particular type of good or service. Almost 90 percent of excise tax receipts over the coming decade will come from taxes related to highways, tobacco and alcohol, aviation, and health insurance. Receipts from excise taxes are expected to decrease slightly as a share of GDP over the next decade, from 0.5 percent in 2015 to 0.4 percent in 2024, largely because of declines in gasoline and tobacco taxes.

**Highway Taxes.** More than 40 percent of excise tax receipts come from highway taxes, primarily taxes on the consumption of gasoline, diesel fuel, and blends of those fuels with ethanol, as well as on the retail sale of trucks. Annual receipts from highway taxes, which are largely dedicated to the Highway Trust Fund, are projected to stay at $37 billion or $38 billion between 2014 and 2024 and to fall as a percentage of GDP.

That pattern is the net effect of falling receipts from taxes on gasoline and rising receipts from taxes on diesel fuel and trucks. Gasoline consumption is expected to decline because improvements in vehicles' fuel economy (resulting largely from increases in the government's fuel economy standards) will probably more than offset increases in the number of miles that people drive. Increasing fuel economy will likewise reduce the consumption of diesel fuel per mile driven—but not by enough, according to CBO's projections, to offset an increase in the total number of miles driven by diesel-powered trucks as the economy continues to expand.

Under current law, most of the federal excise taxes used to fund highways are scheduled to expire on September 30, 2016. In general, CBO's baseline incorporates the assumption that expiring tax provisions will follow the schedules set forth in current law. However, the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177) specifies that CBO's baseline should incorporate the assumption that expiring excise taxes dedicated to trust funds (including most of the highway taxes) will be extended.

**Tobacco and Alcohol Taxes.** Taxes on tobacco products will generate $16 billion in revenues in 2014, CBO projects. That amount is expected to decrease by 1 percent to 2 percent a year over the next decade, as the decline in tobacco consumption that has been occurring for many years continues. By contrast, receipts from taxes on alcoholic beverages, which are expected to total $10 billion in 2014, are projected to rise at an average rate of almost 2 percent a year through 2024, the result of expected increases in alcohol consumption.

**Aviation Taxes.** CBO projects that receipts from taxes on airline tickets, aviation fuels, and various aviation-related transactions will increase from $13 billion in 2014 to $20 billion in 2024, yielding an average annual rate of growth of about 4 percent. That growth is close to the projected increase of GDP over that period, in part because the largest component of aviation excise taxes (a passenger ticket tax) is levied not on the number of units transacted (as gasoline taxes are, for example) but as a percentage of the dollar value of transactions—which causes receipts to increase as real economic activity and prices increase. Under current law, most aviation-related taxes are scheduled to expire on September 30, 2015, but CBO's baseline projections are required to incorporate the assumption that they, like the highway taxes described above, will be extended.

**Tax on Health Insurance Providers.** Under the Affordable Care Act, health insurers are subject to a new excise tax starting this year. The law specifies the total amount of tax to be assessed, and that total will be divided among insurers according to their share of total premiums charged. However, several categories of health insurers (such as self-insured plans, federal and state governments, and tax-exempt providers) are fully or partially exempt from the tax. Revenues from the tax are projected to total $7 billion in 2014 and rise to $18 billion by 2024.

**Other Excise Taxes.** Other excise taxes are projected to generate a total of about $9 billion in revenues this year and $130 billion in revenues between 2015 and 2024. About three-quarters of that $130 billion stems from three charges instituted by the Affordable Care Act, each of which is estimated to yield excise tax revenue of about $31 billion over the 2015–2024 period: an annual fee charged on manufacturers and importers of brand-name drugs; a 2.3 percent tax on manufacturers and importers of certain medical devices; and a tax, beginning in 2018, on certain high-cost employment-based health insurance plans.[8]

### Remittances From the Federal Reserve System

The income produced by the various activities of the Federal Reserve System, minus the cost of generating that income and the cost of the system's operations, is remitted to the Treasury and counted as revenues. The largest component of such income is what the Federal Reserve earns as interest on its holdings of securities. Over the past six years, the central bank has more than quadrupled the size of its asset holdings through significant purchases of Treasury securities and mortgage-backed securities issued by Fannie Mae, Freddie Mac, and the Government National Mortgage Association (Ginnie Mae). Those purchases raised remittances from the Federal Reserve from 0.2 percent of GDP in 2009 to about 0.5 percent of GDP between 2010 and 2013; the remittances totaled $76 billion in 2013. CBO expects those remittances to increase in 2014 and 2015 to roughly $90 billion per year (still about 0.5 percent of GDP) as a result of further increases in the size of the Federal Reserve's portfolio.

Beyond 2015, CBO expects remittances from the Federal Reserve to decline sharply, falling to less than 0.1 percent of GDP between 2017 and 2019. That drop largely reflects a projected increase in the rate at which the Federal Reserve pays interest to the financial institutions that hold deposits on reserve with it, which would increase the central bank's interest expense. Higher interest rates would also boost earnings for the Federal Reserve—but much more slowly, because the Federal Reserve would only gradually purchase new securities earning the higher yields.

After 2019, CBO anticipates, the size and composition of the Federal Reserve's portfolio, along with its remittances to the Treasury, will gradually return to amounts roughly in line with historical experience. According to CBO's projections, remittances over the 2022–2024 period will average about 0.2 percent of GDP, roughly what they averaged from 2000 through 2009.

### Customs Duties

Customs duties, which are assessed on certain imports, have totaled about 0.2 percent of GDP in recent years, amounting to $32 billion in 2013. CBO projects that under current law, those receipts will continue at that level relative to GDP throughout the next decade.

### Estate and Gift Taxes

Receipts from estate and gift taxes totaled about 0.1 percent of GDP in 2012 and 2013 (amounting to $14 billion and $19 billion, respectively), and CBO projects that under current law, those receipts will remain at about 0.1 percent of GDP from 2014 to 2024. That projection reflects provisions of the American Taxpayer Relief Act of 2012, which permanently extended most estate and gift tax provisions in place in 2012 (including the effective exemption amount, equal to $5.34 million in 2014 and indexed annually for inflation) but raised the top marginal tax rate by 5 percentage points (to 40 percent).

### Miscellaneous Fees and Fines

Miscellaneous fees and fines totaled $26 billion in 2013 (or just under 0.2 percent of GDP) and will total $27 billion in 2014 under current law, CBO projects. After 2014, those receipts will rise substantially (again, under current law), mainly because of provisions of the Affordable Care Act. The receipts in that category include penalties on employers that do not provide health insurance and fees paid to the government as part of the risk adjustment process for insurers under that act; according to that process, health insurance plans whose enrollees are expected to have below-average health care costs are required to make payments to the government, which distributes those sums to plans whose enrollees are expected to have above-average health care costs.[9] After 2014, miscellaneous fees and fines will total about 0.3 percent of GDP, according to CBO's projections.

## Tax Expenditures

A number of exclusions, deductions, preferential rates, and credits in the individual income tax, social insurance

8. The excise tax on high-cost health plans also increases CBO's projections of revenues from individual income and payroll taxes, because firms are expected to respond to the tax by shifting to lower-cost insurance plans—thereby reducing nontaxable labor compensation and increasing taxable compensation.

9. Miscellaneous receipts related to the Affordable Care Act also include collections for the reinsurance and risk corridor programs, which will expire after 2016 and generate receipts through 2017. See Appendix B for further details.

tax, and corporate income tax systems cause revenues to be much lower than they would be otherwise for any given structure of tax rates. Some of those provisions are called tax expenditures because they resemble federal spending by providing financial assistance to particular activities, entities, or groups of people.

Tax expenditures, like traditional forms of federal spending, contribute to the federal budget deficit; influence how people work, save, and invest; and affect the distribution of income. The Congressional Budget and Impoundment Control Act of 1974 defines tax expenditures as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[10] That law requires that a list of tax expenditures be included in the federal budget, and each year the Treasury's Office of Tax Analysis and the staff of the Congress's Joint Committee on Taxation publish estimates of individual and corporate income tax expenditures.[11]

Tax expenditures are more similar to the largest benefit programs than to discretionary spending programs: They are not subject to annual appropriations, and any person or entity that meets the legal requirements can receive the benefits. Because of their budgetary treatment, however, tax expenditures are much less transparent than spending on benefit programs.

### The Magnitude of Tax Expenditures

Tax expenditures have a major impact on the federal budget. On the basis of the estimates prepared by JCT, CBO projects that the more than 200 tax expenditures in the individual and corporate income tax systems will total roughly $1.4 trillion in fiscal year 2014—or 8.2 percent of GDP—if their effects on social insurance taxes as well as on income taxes are included.[12] That amount equals nearly half of all federal revenues projected for 2014 and exceeds projected spending on Social Security, defense, or Medicare (see Figure 4-4).

However, the total amount of tax expenditures does not represent the increase in revenues that would occur if all tax expenditures were eliminated, because repealing a tax expenditure would change incentives and lead taxpayers to modify their behavior in ways that would mute the revenue impact of the repeal. For example, if preferential tax rates on capital gains realizations were eliminated, taxpayers would reduce the amount of capital gains they realized; as a result, the amount of additional revenues that would be produced by eliminating the preferential rates would be smaller than the estimated size of the tax expenditure.

Furthermore, a simple total of the estimated revenue effects of repealing various tax expenditures would not account for the interactions that would arise if multiple expenditures were repealed at the same time. For instance, the effect of eliminating all itemized deductions would be smaller than the sum of the effects of eliminating each deduction, because with all of the deductions gone, more taxpayers would claim the standard deduction (instead of itemizing deductions) than would be the case if any single deduction was repealed. However, the structure of tax brackets and marginal rates ensures that the opposite would be the case with income exclusions; that is, the effect of eliminating all exclusions would be greater than the sum of the effects of eliminating each separate exclusion. As it turns out, however, the effect in fiscal year 2014 of eliminating *all* individual income tax expenditures would be roughly equal to the sum of the effects of eliminating each of those tax expenditures.

10. Section 3(3) of the Congressional Budget and Impoundment Control Act of 1974, P.L. 93-344 (codified at 2 U.S.C. §622(3) (2006)).

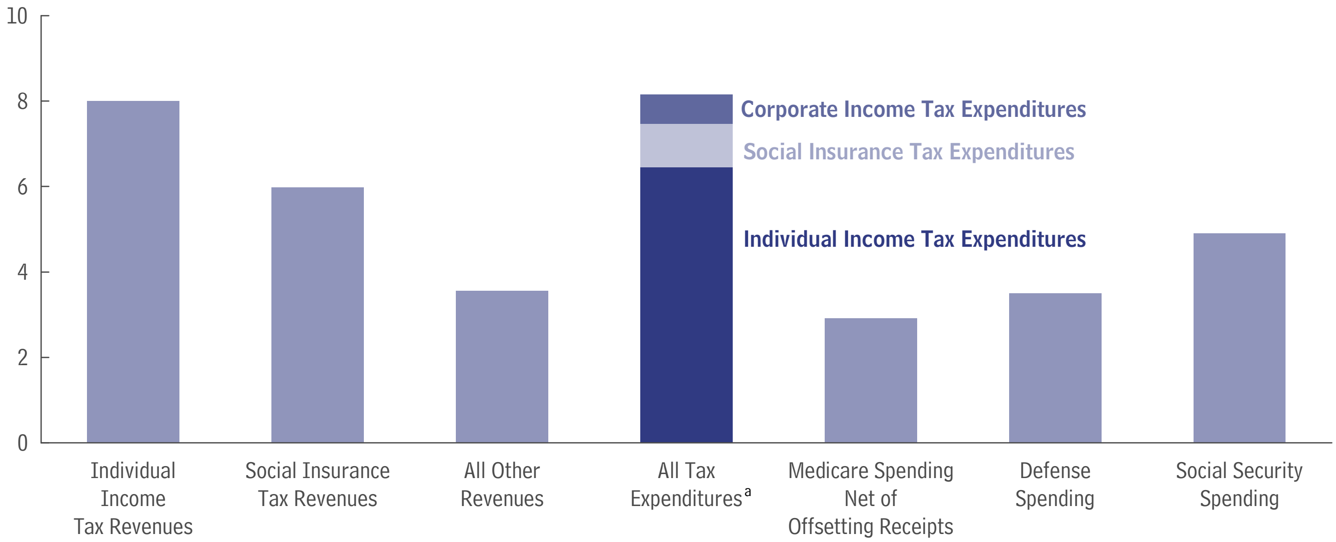
11. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), http://go.usa.gov/ZHCz; and Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2014: Analytical Perspectives* (April 2013), pp. 241–277, http://go.usa.gov/BC4Q.

12. Most estimates of tax expenditures include only their effects on individual and corporate income taxes. However, tax expenditures can also reduce the amount of income subject to payroll taxes. JCT has previously estimated the effect on payroll taxes of the provision that excludes employers' contributions for health insurance premiums from their workers' taxable income. See Joint Committee on Taxation, *Background Materials for Senate Committee on Finance Roundtable on Health Care Financing*, JCX-27-09 (May 8, 2009), http://go.usa.gov/ZJcx. Tax expenditures that reduce the tax base for payroll taxes will eventually decrease spending for Social Security by reducing the wage base on which Social Security benefits are calculated.

**Figure 4-4.**

## Revenues, Tax Expenditures, and Selected Components of Spending in 2014

(Percentage of gross domestic product)




Source: Congressional Budget Office based on estimates by the staff of the Joint Committee on Taxation.

a. This total is the sum of the estimates for all of the separate tax expenditures and does not account for any interactions among them. However, CBO estimates that in 2014, the effect of eliminating all tax expenditures would be roughly equal to the sum of the effects of eliminating each of the tax expenditures separately. Because estimates of tax expenditures are based on people's behavior with the tax expenditures in place, the estimates do not reflect the amount of revenue that would be raised if those provisions of the tax code were eliminated and taxpayers adjusted their activities in response to the changes.

### Economic and Distributional Effects of Tax Expenditures

Tax expenditures are generally designed to further societal goals. For example, the tax expenditures for health insurance costs, pension contributions, and mortgage interest payments may help to promote a healthier population, adequate financial resources for retirement and greater national saving, and stable communities of homeowners. However, tax expenditures have a broad range of effects that may not always further societal goals. They may lead to an inefficient allocation of economic resources by encouraging more consumption of goods and services receiving preferential treatment; they may also subsidize activity that would have taken place without the tax incentives. Moreover, by providing benefits to particular activities, entities, or groups of people, tax expenditures increase the size and scope of federal involvement in the economy. Tax expenditures also reduce the amount of revenue that is collected for any given set of statutory tax rates—and therefore require higher rates to collect any chosen amount of revenue. All else being equal, those higher tax rates lessen people's incentives to work and save, decreasing output and income.

Tax expenditures are distributed unevenly across the income scale. When measured in dollars, tax expenditures benefit higher-income households much more than lower-income households. As a percentage of people's income, tax expenditures benefit the highest-income and lowest-income households to a greater extent than they benefit households in the middle of the income distribution.[13]

### The Largest Tax Expenditures

CBO estimates that the 12 largest tax expenditures will account for almost three-quarters of the total budgetary effects of all tax expenditures in fiscal year 2014 and will total about 6.5 percent of GDP over the period from

13. For a detailed analysis of the distribution of tax expenditures, see Congressional Budget Office, *The Distribution of Major Tax Expenditures in the Individual Income Tax System* (May 2013), www.cbo.gov/publication/43768.

2015 to 2024.[14] Those 12 tax expenditures fall into four categories: exclusions from taxable income, itemized deductions, preferential tax rates, and tax credits.

**Exclusions From Taxable Income.** Exclusions from taxable income account for the greatest share of total tax expenditures. The largest items in that category are employers' contributions for their employees' health care, health insurance premiums, and long-term-care insurance premiums; contributions to and earnings of pension funds (minus pension benefits that are included in taxable income); Medicare benefits (net of premiums paid); profits earned abroad, which certain corporations may exclude from their taxable income until those profits are returned to the United States; and capital gains from assets that are transferred at the owner's death.

The exclusion of employers' health insurance contributions is the single largest tax expenditure in the individual income tax code; including effects on payroll taxes, it is projected to equal 1.6 percent of GDP over the 2015–2024 period (see Figure 4-5). The exclusion of pension contributions and earnings has the next-largest impact, generating net tax expenditures, including effects on payroll taxes, estimated to total 0.9 percent of GDP over the same period.[15] The tax expenditures for the exclusion of Medicare benefits, for the deferral of corporate profits earned abroad, and for unrealized capital gains at death are projected to equal about 0.5 percent, 0.3 percent, and 0.3 percent of GDP over the coming decade, respectively.

**Itemized Deductions.** Itemized deductions for spending on certain items allow taxpayers to further reduce their taxable income. The tax expenditures for deductions for state and local taxes (on nonbusiness income, sales, real estate, and personal property) and for interest paid on mortgages for owner-occupied residences are each projected to equal about 0.5 percent of GDP between 2015 and 2024. The tax expenditures for deductions for charitable contributions are projected to equal 0.3 percent of GDP over that period.

**Preferential Tax Rates.** Under the individual income tax, preferential tax rates apply to some forms of income, including dividends and long-term capital gains.[16] Tax expenditures for the preferential tax rates on dividends and long-term capital gains are projected to total 0.6 percent of GDP between 2015 and 2024.[17]

**Tax Credits.** Tax credits reduce eligible taxpayers' tax liability. Nonrefundable tax credits cannot reduce a taxpayer's income tax liability below zero; refundable tax credits, by contrast, may provide direct payments to taxpayers who do not owe any income taxes. Beginning in 2014, the Affordable Care Act provides refundable tax credits, called premium assistance credits, to help low- and moderate-income people purchase health insurance through exchanges (see Appendix B). Because CBO and JCT project that participation in exchanges will increase considerably during the next few years, the tax

14. Those 12 tax expenditures are the ones whose budgetary effects, according to JCT's estimates, will equal more than 0.25 percent of GDP over the 2014–2017 period. CBO combined the components of certain tax expenditures that JCT reported separately, such as tax expenditures for different types of charitable contributions. CBO also extrapolated JCT's estimates for the 2012–2017 period through 2024. (Those extrapolated estimates would not precisely match estimates produced by JCT.) JCT defines tax expenditures as deviations from an individual income tax structure that incorporates the existing regular tax rates, standard deduction, personal exemptions, and deduction of business expenses. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), http://go.usa.gov/ZHCz.

15. That total includes amounts from defined benefit and defined contribution plans offered by employers; it does not include amounts from self-directed individual retirement arrangements or from Keogh plans that cover partners and sole proprietors, though contributions to and earnings in those plans are also excluded from taxable income.

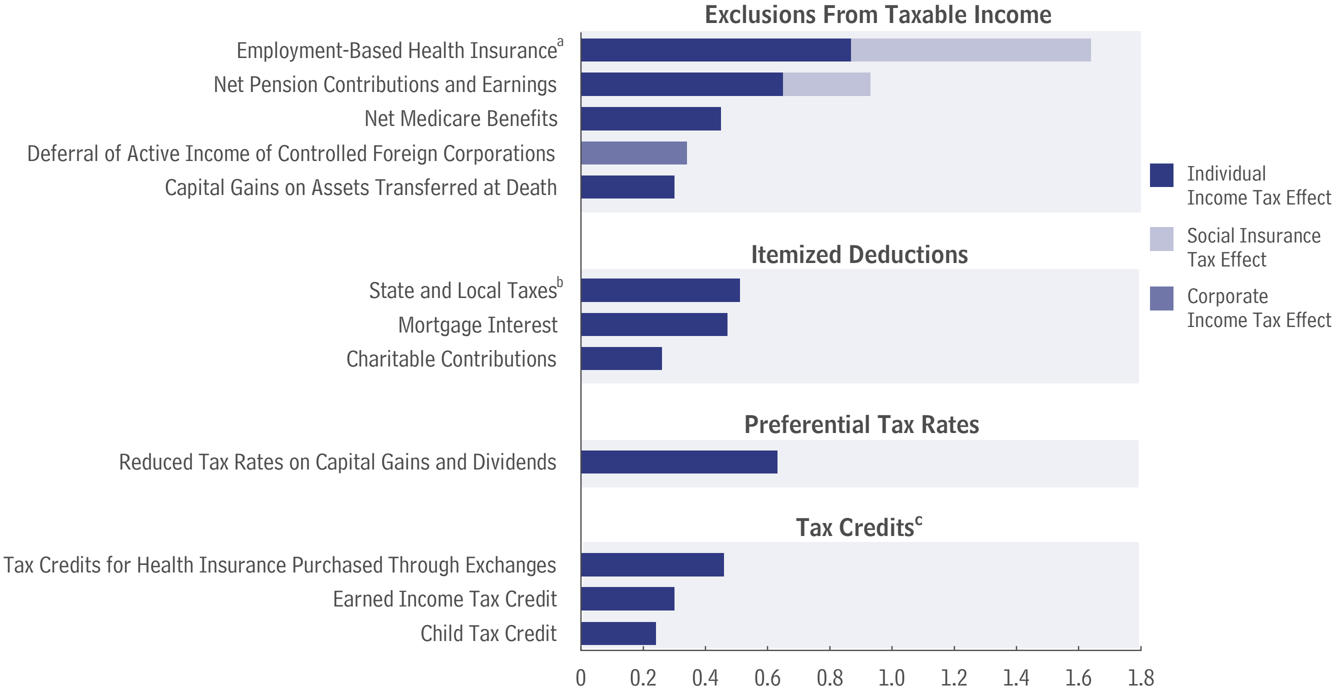
16. Not all analysts agree that those lower tax rates on investment income constitute tax expenditures. Although those tax preferences would be tax expenditures relative to a pure income tax, they would not be relative to a pure consumption tax, because investment income generally would be excluded from taxation under a consumption tax.

17. Taxpayers with income over certain thresholds—$200,000 for single filers and $250,000 for joint filers—face a surtax equal to 3.8 percent of their investment income (including capital gains and dividend income, as well as interest income and some passive business income). That surtax effectively reduces the preferential tax rate on dividends and capital gains. JCT treats the surtax as a *negative* tax expenditure—that is, a deviation from the tax system that increases rather than decreases taxes—and it is not included in the figures presented here.

**Figure 4-5.**

## Budgetary Effects of the Largest Tax Expenditures From 2015 to 2024

(Percentage of gross domestic product)




Source: Congressional Budget Office based in part on estimates by the staff of the Joint Committee on Taxation.

Note: These effects are calculated as the sum of the tax expenditures over the 2015–2024 period divided by the sum of gross domestic product over the same 10 years. Because estimates of tax expenditures are based on people's behavior with the tax expenditures in place, the estimates do not reflect the amount of revenue that would be raised if those provisions of the tax code were eliminated and taxpayers adjusted their activities in response to the changes.

a. Includes employers' contributions for health care, health insurance premiums, and long-term-care insurance premiums.

b. Consists of nonbusiness income, sales, real estate, and personal property taxes paid to state and local governments.

c. Includes effect on outlays.

expenditure for premium assistance credits (including the refundable portion) is projected to grow from 0.2 percent of GDP in 2015 to 0.5 percent of GDP in 2017, where it is expected to remain from 2018 through 2024. The next-largest refundable credits are the earned income tax credit (for which tax expenditures, including the refundable portion, are projected to be 0.3 percent of GDP between 2015 and 2024) and the child tax credit (0.2 percent of GDP over the same period, also including the refundable portion). Both of those credits were significantly expanded in 2001 and again in later years, but the expansions enacted since 2008 are scheduled to expire at the end of December 2017; thus, under current law, the budgetary effect of those two credits will decline modestly in the future.

APPENDIX

# A

# Changes in CBO's Baseline Since May 2013

The Congressional Budget Office (CBO) anticipates that in the absence of further legislation affecting spending and revenues, the budget deficit for fiscal year 2014 will total $514 billion—$46 billion less than CBO projected in May 2013, when it released its previous set of baseline projections (see Table A-1).[1] The decrease in the projected deficit for 2014 mostly reflects the Administration's accounting for large payments to the Treasury from the mortgage finance institutions Fannie Mae and Freddie Mac; that revision is partially offset by other changes that, on net, increased this year's projected deficit.

By contrast, CBO now estimates that the cumulative deficit for the 2014–2023 period under current law would be about $1.0 trillion greater than it projected in May, $7.3 trillion rather than $6.3 trillion.[2] The increase for the 2014–2023 period as a whole stems mainly from lower projections of revenues, mostly because CBO has reduced its projections of the growth of the nation's economic output, or gross domestic product (GDP).

For 2014, CBO currently estimates that revenues will be $13 billion (or 0.4 percent) less than it previously projected, and outlays will be $59 billion (or 1.6 percent) less. For the 2014–2023 period, CBO estimates that under current law, revenues would be $1.6 trillion (or 4.0 percent) less, and outlays $600 billion (or 1.3 percent) less, than it projected in May.

## Changes to Projections of Revenues

The reduction in estimated revenues for the current fiscal year is the net result of two types of revisions to the baseline. Technical factors (those not related to legislative activity or changes in the economic forecast) have caused CBO to decrease its estimate of 2014 revenues by $91 billion. Mostly offsetting that reduction, changes to CBO's economic forecast have increased the 2014 revenue estimate by $77 billion. For the 2014–2023 period, economic factors—particularly lower projections of GDP—account for $1.4 trillion of the $1.6 trillion reduction in projected revenues.

### Economic Changes

CBO's current economic forecast incorporates updated projections of GDP, the unemployment rate, interest rates, inflation, and other variables that affect federal spending and revenues (see Chapter 2 for details). Those revisions have caused the agency to increase its revenue

1. Those projections were published in Congressional Budget Office, *Updated Budget Projections: Fiscal Years 2013 to 2023* (May 2013), www.cbo.gov/publication/44172. CBO constructs its baseline projections in accordance with provisions of the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974. To project revenues and mandatory spending, CBO assumes that current laws, with only a few exceptions, will remain unchanged throughout the 10-year projection period. To project discretionary spending, CBO assumes that annual appropriations through 2021 will adhere to the caps and automatic spending reductions originally established in the Budget Control Act of 2011 (Public Law 112-25) and that appropriations for 2022 through 2024 will grow from the 2021 amount at the rate of inflation. The resulting baseline projections are not intended to be a prediction of future budgetary outcomes; rather, they serve as a current-law benchmark against which to measure the potential effects of tax or spending proposals.

2. This appendix focuses on the 2014–2023 period, rather than the 2015–2024 period emphasized in the rest of the report, because the earlier 10-year span was the one covered by the May 2013 baseline.

**Table A-1.**

## 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 2014-2018 | Total 2014-2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Deficit in CBO's May 2013 Baseline | -560 | -378 | -432 | -482 | -542 | -648 | -733 | -782 | -889 | -895 | -2,394 | -6,340 |
| **Changes to Revenue Projections** | | | | | | | | | | | | |
| Legislative Changes | * | * | * | * | 1 | 1 | 1 | 1 | 1 | 1 | 2 | 7 |
| Economic Changes | | | | | | | | | | | | |
| Individual income taxes | 45 | 23 | -14 | -58 | -83 | -100 | -117 | -135 | -150 | -162 | -87 | -749 |
| Corporate income taxes | 16 | -10 | -26 | -43 | -49 | -44 | -39 | -36 | -34 | -31 | -111 | -297 |
| Social insurance taxes | 14 | 3 | -13 | -29 | -38 | -44 | -52 | -59 | -64 | -67 | -63 | -349 |
| Other | 2 | * | -13 | -6 | 2 | 1 | * | -1 | -2 | -2 | -16 | -20 |
| Subtotal | 77 | 16 | -66 | -136 | -168 | -187 | -209 | -231 | -249 | -262 | -276 | -1,415 |
| Technical Changes | | | | | | | | | | | | |
| Individual income taxes | -44 | -39 | -30 | -16 | -7 | -3 | * | 5 | 6 | 4 | -137 | -125 |
| Corporate income taxes | -45 | -43 | -24 | -10 | -6 | -3 | -2 | -1 | -1 | * | -128 | -135 |
| Social insurance taxes | -1 | 1 | 1 | 1 | * | * | 2 | 3 | 3 | * | 2 | 10 |
| Other | -1 | -29 | -7 | 13 | 8 | 22 | 32 | 19 | -1 | -2 | -15 | 55 |
| Subtotal | -91 | -110 | -59 | -13 | -6 | 16 | 32 | 25 | 7 | 3 | -278 | -196 |
| **Total Revenue Changes** | **-13** | **-94** | **-125** | **-148** | **-173** | **-171** | **-176** | **-205** | **-242** | **-257** | **-553** | **-1,604** |
| **Changes to Outlay Projections** | | | | | | | | | | | | |
| Legislative Changes | | | | | | | | | | | | |
| Mandatory outlays | | | | | | | | | | | | |
| Medicare | 4 | 3 | 1 | * | * | * | * | * | -8 | -15 | 8 | -16 |
| Student loans | 10 | 8 | 2 | -3 | -5 | -6 | -6 | -5 | -5 | -5 | 13 | -14 |
| Transportation | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -2 | -2 | -2 | -6 | -13 |
| Other | -1 | -3 | -3 | -2 | 2 | -2 | -2 | -3 | -10 | -15 | -7 | -39 |
| Subtotal | 13 | 7 | -1 | -6 | -5 | -10 | -10 | -10 | -24 | -37 | 7 | -83 |
| Discretionary outlays | | | | | | | | | | | | |
| Defense | 14 | 12 | 5 | 2 | 2 | 1 | 1 | 1 | * | * | 34 | 37 |
| Nondefense | 18 | 2 | -13 | -29 | -37 | -42 | -45 | -47 | -49 | -51 | -60 | -294 |
| Subtotal | 31 | 13 | -8 | -27 | -35 | -41 | -44 | -47 | -49 | -51 | -25 | -258 |
| Net interest outlays (Debt service) | * | 1 | 1 | 1 | -1 | -2 | -4 | -7 | -10 | -14 | 2 | -35 |
| All Legislative Changes | 45 | 21 | -8 | -33 | -41 | -53 | -59 | -63 | -84 | -101 | -16 | -376 |
| Economic Changes | | | | | | | | | | | | |
| Mandatory outlays | | | | | | | | | | | | |
| Medicare | -1 | -7 | -14 | -18 | -12 | -16 | -18 | -20 | -24 | -24 | -53 | -154 |
| Medicaid | -2 | -5 | -6 | -6 | -7 | -7 | -8 | -8 | -9 | -10 | -26 | -67 |
| Other | -5 | -7 | -8 | -4 | -3 | -2 | -1 | 1 | 2 | 3 | -26 | -22 |
| Subtotal | -8 | -19 | -27 | -29 | -22 | -25 | -26 | -27 | -30 | -30 | -104 | -243 |
| Discretionary outlays | * | -1 | -1 | -1 | -2 | -2 | -2 | -2 | -2 | -2 | -5 | -14 |
| Net interest outlays | | | | | | | | | | | | |
| Debt service | -1 | -1 | -1 | 1 | 6 | 12 | 18 | 26 | 34 | 44 | 3 | 136 |
| Effect of rates and inflation | -1 | 4 | 11 | 5 | -8 | -14 | -20 | -25 | -29 | -31 | 10 | -109 |
| Subtotal | -2 | 2 | 9 | 6 | -2 | -3 | -2 | 1 | 5 | 13 | 14 | 28 |
| All Economic Changes | -10 | -17 | -19 | -24 | -25 | -29 | -30 | -28 | -27 | -19 | -95 | -229 |

**Continued**

**Table A-1.** **Continued**

## 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 2014-2018 | Total 2014-2023 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Changes to Outlay Projections (Continued)** | | | | | | | | | | | | |
| Technical Changes | | | | | | | | | | | | |
| Mandatory outlays | | | | | | | | | | | | |
| Fannie Mae and Freddie Mac | -88 | -1 | -1 | * | * | -1 | * | * | -1 | * | -90 | -92 |
| Earned income tax credit | 3 | 4 | 5 | 5 | 5 | 4 | 4 | 4 | 3 | 3 | 21 | 39 |
| Veterans' benefits and services | 2 | 3 | 3 | 4 | 4 | 4 | 4 | 4 | 5 | 5 | 15 | 37 |
| Social Security | -2 | -7 | -9 | -8 | -6 | -4 | -3 | -1 | 1 | 3 | -32 | -36 |
| Medicaid | 2 | 5 | 5 | 4 | 2 | 4 | 3 | 3 | 3 | 3 | 18 | 34 |
| Civil Service Retirement | 1 | 2 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 4 | 10 | 24 |
| SNAP | 2 | 2 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 2 | 10 | 23 |
| Other | -5 | 1 | 4 | 7 | 3 | 7 | 9 | 8 | 5 | 4 | 10 | 44 |
| Subtotal | -85 | 9 | 12 | 16 | 12 | 19 | 22 | 24 | 22 | 23 | -37 | 73 |
| Discretionary outlays | -6 | -8 | -4 | -7 | -5 | -4 | -4 | -6 | -6 | -6 | -29 | -55 |
| Net interest outlays | | | | | | | | | | | | |
| Debt service | * | * | 1 | 2 | 2 | 2 | 2 | 1 | 1 | 1 | 6 | 13 |
| Other | -3 | 1 | 1 | -3 | -4 | -2 | -4 | -3 | -5 | -4 | -8 | -26 |
| Subtotal | -3 | 1 | 2 | -1 | -1 | * | -2 | -2 | -4 | -3 | -2 | -13 |
| All Technical Changes | -94 | 2 | 10 | 8 | 6 | 15 | 16 | 16 | 12 | 14 | -69 | 5 |
| **Total Outlay Changes** | **-59** | **7** | **-18** | **-49** | **-60** | **-67** | **-73** | **-75** | **-99** | **-106** | **-180** | **-600** |
| **All Changes** | | | | | | | | | | | | |
| **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 |
| **Memorandum:** | | | | | | | | | | | | |
| Total Legislative Changes[a] | -45 | -21 | 9 | 33 | 41 | 54 | 60 | 64 | 85 | 102 | 18 | 382 |
| Total Economic Changes[a] | 87 | 33 | -47 | -111 | -143 | -158 | -179 | -203 | -222 | -242 | -181 | -1,186 |
| Total Technical Changes[a] | 3 | -112 | -69 | -21 | -11 | 1 | 17 | 8 | -5 | -11 | -210 | -200 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: * = between -$500 million and $500 million; SNAP = Supplemental Nutrition Assistance Program.

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

estimates for 2014 and 2015 but to decrease them for each year thereafter through 2023. CBO raised its revenue projections for the first two years of the 10-year period because it now anticipates higher individual income (including wages, salaries, and proprietors' income) from 2013 through 2015, and higher domestic corporate profits in 2013 and 2014, than it did last year.[3] (Those revisions were more than offset by technical changes, as described in the section below.)

The main reason for the decrease in projected revenues over the 2016–2023 period is that CBO now expects slower growth in nominal GDP through 2023 than

3. Wages and salaries are now estimated to be a smaller share of GDP in 2013 and 2014, and domestic economic profits a smaller share of GDP in 2014, than CBO previously forecast (see Table 2-3 on page 45). Nevertheless, the agency's projections of GDP have increased, and its estimates of the total amount of wages and salaries and domestic economic profits have risen.

previously forecast.[4] That change reflects lower projections for the growth of real (inflation-adjusted) GDP and for inflation. As a result, CBO now projects smaller amounts of wages, salaries, and corporate profits throughout that period.

Most significantly, CBO has reduced its projections of the total amount of wages and salaries over the 2015–2023 period by about $3.2 trillion (or 3.6 percent) since last year. That decrease is the key factor that caused CBO to lower its projections of receipts from individual income taxes by about $820 billion—and its projections of receipts from social insurance taxes by about $370 billion—for the period from 2016 through 2023.

In addition, corporations' domestic economic profits are now projected to be about $650 billion (or 3.9 percent) lower over the 2015–2023 period than previously estimated. The effective decrease in such profits—the decrease for the purpose of projecting tax revenues—is greater than that because the Bureau of Economic Analysis revised the definition of profits in the national income and product accounts to include some types of income that had been excluded. (By itself, that change would have increased domestic economic profits relative to CBO's previous projections without altering CBO's projections of corporate tax revenues because it did not affect how companies report taxable profits to the Internal Revenue Service.) To reflect changes to the outlook for profits, CBO has lowered its projections of receipts from corporate income taxes over the 2015–2023 period by about $310 billion.

### Technical Changes

CBO has reduced its projections of revenues by $91 billion (or 3 percent) for 2014 and by $196 billion (or 0.5 percent) for the 2014–2023 period for reasons unrelated to new legislation or changes to the economic outlook. The largest of those technical changes involve projected receipts from corporate income taxes (reduced by $135 billion over 10 years) and individual income taxes (reduced by $125 billion), although technical changes have boosted projected receipts from other sources.

The technical revisions to revenue projections are greatest for the years 2014 to 2016. They reflect the fact that collections of both corporate and individual income taxes were lower in 2013 than CBO had projected, although the main types of income on which those taxes are levied (wages and salaries, proprietors' income, and corporate profits) were higher than expected. Consequently, the average tax rates on those types of income—taxes as a percentage of income—were lower than previously projected. CBO has decreased its near-term projections of revenues from those taxes accordingly, but by a smaller amount for each successive year. The agency continues to expect, as it did in May, that the average corporate tax rate will rise to a percentage more in keeping with the long-term historical average. CBO also expects that after 2014, the average individual income tax rate will return almost to the percentage projected in May.

Technical factors affecting other sources of revenues largely derive from revisions to CBO's projections of the earnings of the Federal Reserve System, which are remitted to the Treasury as revenues. CBO has reduced its estimate of Federal Reserve remittances over the next few years to reflect a lower projected average yield on the central bank's portfolio of assets. That lower projection results from recent information from the Federal Reserve about how much its purchases of securities at amounts above their face value are expected to reduce the central bank's earnings. In contrast, CBO has increased its projections of remittances from 2017 to 2021 to reflect fewer projected asset sales by the Federal Reserve—sales that would generate capital losses as interest rates rise. CBO made that change to reflect statements made last year by the Chairman of the Federal Reserve that the central bank is unlikely to sell mortgage-backed securities issued by Fannie Mae, Freddie Mac, and the Government National Mortgage Association during the process of normalizing monetary policy.

### Legislative Changes

Legislation enacted since May has prompted CBO to raise its revenue projections by $54 million for 2014

4. Since CBO issued its previous forecast, the Bureau of Economic Analysis (BEA) has made several conceptual changes to the national income and product accounts that have boosted the nominal amount of GDP in past years (see Box 2-1 on page 29). The higher historical amount of GDP does not stem primarily from higher taxable income but from higher amounts of depreciation of capital assets. To compare its current and previous economic forecasts on a consistent basis, CBO adjusted its previous forecast for nominal GDP in 2023 upward by 3.2 percent, which is roughly equal to BEA's average revision to nominal GDP for the 1950–2012 period. With that historical revision accounted for, CBO's current projection of GDP in 2023 is 3.6 percent less than its previous projection.

and by about $7 billion (or less than 0.02 percent) for the 2014–2023 period. Most of those changes result from provisions in the Bipartisan Budget Act of 2013 (Public Law 113-67) that increase the rate at which federal employees hired after December 31, 2013, will contribute to their future retirement benefits. (Such contributions are considered revenues to the Treasury.)

## Changes to Projections of Outlays

CBO has trimmed its estimate of outlays in 2014 by $59 billion (or 1.6 percent), mainly because of technical updates—notably, higher reported receipts to the Treasury from Fannie Mae and Freddie Mac. For the 2014–2023 period, CBO has reduced its projections of outlays by $600 billion, primarily because appropriations to date for 2014 are lower than total appropriations for 2013 and because of revisions to the agency's economic forecast.

### Legislative Changes

Laws enacted since May have increased projected outlays in 2014 by $45 billion (or 1.3 percent) but reduced projected outlays over the 2014–2023 period by $376 billion (or 0.8 percent). Changes to estimates of discretionary spending are responsible for most of those increases. Two changes account for the bulk of the difference: the removal from CBO's baseline of projected spending for disaster relief that was based on 2013 funding for recovery from Hurricane Sandy, and adjustments to discretionary spending caps for 2014 and 2015 made by the Bipartisan Budget Act.

**Discretionary Spending.** On net, legislative changes to discretionary programs have added $31 billion to estimated outlays in the current year but cut $258 billion from projected outlays over the 2014–2023 period.

The substantial reduction over the 10-year period is related to the $48 billion that was appropriated in 2013 for relief and recovery efforts after Hurricane Sandy. (That amount includes the reduction resulting from the sequestration of discretionary resources in 2013.) In accordance with the statutory rules that govern its projections of discretionary spending, CBO assumed for its May 2013 baseline that similar amounts (adjusted for inflation) would be appropriated in future years. However, no additional funding has been provided in 2014. Hence, in accordance with those rules, CBO's new baseline includes no projection of future funding for such disaster relief. That change has reduced baseline projections of discretionary outlays over the 2014–2023 period by about $365 billion.

Other legislative changes have increased projected discretionary outlays through 2023 by $107 billion. Most of that increase stems from changes to the caps on discretionary spending for 2014 and 2015 that were enacted in the Bipartisan Budget Act; that law raised the caps for 2014 by a total of $45 billion and the caps for 2015 by a total of $18 billion (see Box 1-1 on page 20 for details).

**Mandatory Spending.** Legislative activity since May has raised CBO's estimate of mandatory outlays in 2014 by $13 billion, mostly because of changes to the student loan program. For the 2014–2023 period, however, recent legislation has reduced CBO's projections of mandatory outlays by $83 billion; almost 40 percent of that decrease comes from extending the automatic spending cuts set to expire after 2021 for two more years.[5]

*Medicare*. On net, legislative changes to Medicare have raised estimated outlays for the program this year by $4 billion but have reduced projected outlays over the 2014–2023 period by $16 billion. The Pathway for SGR Reform Act of 2013 (part of P.L. 113-67) increased Medicare's payment rates for physicians' services by 0.5 percent for three months (rather than allowing them to drop by nearly 24 percent, as scheduled, at the end of December 2013). That change will increase outlays for Medicare by $4 billion in 2014 and by $3 billion in 2015, CBO estimates. The two-year extension of the automatic spending reductions will decrease Medicare outlays by a total of $21 billion in 2022 and 2023, according to CBO's estimates. P.L. 113-67 made several other, smaller changes to the Medicare program that together trim $2 billion from projected outlays through 2023.

*Student Loans.* As a result of two new laws, CBO has reduced its projections of outlays for federal student loans

5. Under the Bipartisan Budget Act, automatic spending reductions will apply to certain mandatory spending accounts in 2022 and 2023. The law requires that the sequestration percentage applied to those accounts in 2021 be continued and applied in the same manner in 2022 and 2023. (However, the Pathway for SGR Reform Act revised the sequestration percentage that will be applied to Medicare accounts in 2023.) CBO estimates that extending those spending reductions for two additional years will decrease mandatory spending in 2022 and 2023 by a total of $31 billion.

over the 2014–2023 period by $14 billion. The Bipartisan Student Loan Certainty Act of 2013 (P.L. 113-28) changed the interest rates on all new subsidized, unsubsidized, and PLUS loans made to students or parents beginning on July 1, 2013. Those rates, which had been fixed by statute, are now based on the interest rate on 10-year Treasury notes in the academic year in which a loan is made. Relative to the May 2013 baseline projections, CBO estimates that the law will increase federal outlays for student loans by $24 billion between 2014 and 2016 but decrease outlays in later years, for a net reduction of $9 billion over the 2014–2023 period.

The Bipartisan Budget Act also reduced estimated outlays for student loans, by $5 billion over the 10-year period. That law decreased the amount of funds that loan guaranty agencies can keep on loans that were in default but were later restructured and sold back to lenders; as a result, the government will receive a larger share of the funds obtained from selling those loans. The law also eliminated some mandatory loan-servicing payments—although CBO expects that most of those payments will have to be covered through discretionary appropriations instead.

*Transportation.* The Bipartisan Budget Act increased security-related fees paid by airline passengers (while eliminating other fees paid by air carriers) and repealed a requirement that the Department of Transportation supplement federal payments to shippers of food aid. Together, those provisions will reduce mandatory spending (net of offsetting receipts) by $13 billion over the 2014–2023 period, CBO estimates.

**Net Interest.** All told, the changes that CBO made to its projections of revenues and outlays because of recently enacted legislation reduce the cumulative deficit projected for the 2014–2023 period by $347 billion (excluding interest costs). The resulting decrease in federal borrowing reduces projected outlays for interest payments on federal debt by $35 billion through 2023.

## Economic Changes

Updates to CBO's economic projections led the agency to lower its estimates of outlays by $10 billion for 2014 and by $229 billion for the 2014–2023 period. That 10-year change reflects the following reductions: $243 billion to projected spending for mandatory programs (mainly Medicare and Medicaid), $109 billion to projected net interest outlays (because of the effects of changes in projections for interest rates and inflation), and $14 billion to projected discretionary outlays (to account for revised measures of inflation).[6] Those changes are partly offset by an increase of $136 billion in projected debt-service costs because of all of the other changes to CBO's revenue and spending projections resulting from the revised economic forecast.

**Medicare and Medicaid.** The government's two largest health care programs account for a decrease of $221 billion in projected outlays through 2023. Under current law, payment rates for most services in the fee-for-service sector of Medicare (such as hospital care and services provided by physicians, home health agencies, and skilled nursing facilities) are subject to automatic, inflation-based updates. Those updates are tied to changes in the prices of the labor, goods, and services that health care providers offer, coupled with an adjustment for gains in productivity throughout the economy (the ability to produce the same output using fewer inputs, such as hours of labor, than before). CBO's current projections of productivity are slightly higher than those in the agency's previous forecast, and its projected prices for goods and services (including the cost of both labor and nonlabor inputs) are lower. Consequently, CBO now anticipates lower payment rates for Medicare services than it did in May—a change that reduces projected outlays over the 2014–2023 period by $154 billion (or about 2 percent). In the Medicaid program, lower projected prices for medical services and for labor are also expected to reduce spending—by a total of $67 billion between 2014 and 2023.

**Net Interest.** Economic revisions to CBO's projections of spending for net interest have two components: the effects of changes in the agency's forecast for interest rates and inflation, and the effects of changes in the government's borrowing that result from the impact on projected revenues and outlays of changes in the economic outlook.

Updates to CBO's projections of interest rates and inflation have raised estimates of net interest costs by a total of

6. CBO assumes that certain discretionary appropriations not constrained by the caps, such as those for overseas contingency operations (military operations and related activities in Afghanistan and other countries), will grow in future years at the rate of inflation. Also, CBO assumes that total discretionary spending will grow at the rate of inflation after the caps expire in 2021.

$19 billion from 2015 through 2017 but lowered them by $127 billion from 2018 through 2023. CBO now projects that interest rates on most securities will be higher in 2015 and 2016 than previously projected (by between 2 basis points and 56 basis points) but lower starting in 2017 (by 5 basis points to 45 basis points).[7] Overall, those and other changes to CBO's economic forecast since last year have reduced projected outlays for net interest over the 2014–2023 period by $109 billion.

All told, changes to CBO's economic projections have increased deficit projections for the 2014–2023 period by $1,050 billion, mostly because of the decrease in projected revenues. As a result of the added borrowing, CBO has increased its projections of debt-service costs between 2014 and 2023 by $136 billion.

### Technical Changes

As a result of technical updates to the outlook for various mandatory and discretionary programs, CBO has lowered its estimate of outlays in 2014 by $94 billion. That change stems almost entirely from a reduction of $88 billion in estimated net outlays for Fannie Mae and Freddie Mac related to the budgetary treatment of transactions by the two entities. For the 2014–2023 period, technical changes to spending projections largely offset each other; on net, those changes raise total projected outlays over the 10-year period by $5 billion.

**Mandatory Spending.** Technical revisions related to mandatory programs have reduced the amount of spending projected for the current year by $85 billion, mostly because of receipts from the Treasury's transactions with Fannie Mae and Freddie Mac. For the 2014–2023 period, technical updates to projections for a number of programs have increased the total amount of projected mandatory spending by $73 billion.

*Fannie Mae and Freddie Mac.* Because the government placed these two entities into conservatorship in 2008 and now controls their operations, CBO considers the activities of Fannie Mae and Freddie Mac to be governmental. Therefore, for the 10-year period that follows the current fiscal year, CBO projects the subsidy costs of the entities' new activities using procedures similar to those specified in the Federal Credit Reform Act of 1990 for determining the costs of federal credit programs, but with adjustments to reflect the market risk associated those activities. The Administration, in contrast, considers Fannie Mae and Freddie Mac to be outside the federal government for budgetary purposes and records cash transactions between them and the Treasury as federal outlays or receipts. (In CBO's view, those transactions are intragovernmental.)

Nevertheless, to provide CBO's best estimate of what the Treasury will ultimately report as the federal deficit for 2014, CBO's current baseline includes an estimate of the cash receipts from the two entities to the Treasury for this year (while retaining its risk-adjusted projections of subsidy costs for later years). CBO estimates that payments from Fannie Mae and Freddie Mac to the Treasury will total $81 billion in 2014 (on the basis of the entities' most recent quarterly financial releases); those payments are recorded in the budget as offsets to outlays (offsetting receipts). By comparison, CBO's May 2013 baseline showed an estimated subsidy cost—that is, outlays—of about $7 billion for the entities' activities in 2014. In all, that swing reduces CBO's estimate of outlays by $88 billion for 2014.

For 2015 through 2023, CBO's baseline follows its customary approach of showing the estimated subsidy costs of mortgage guarantees provided, and loans purchased, by Fannie Mae and Freddie Mac. Those estimates are calculated on a fair-value basis, reflecting the market risk associated with the activities of the two institutions. For the 2015–2023 period, CBO now estimates that those subsidy costs will total $18 billion—about $4 billion less than it projected in May, mostly because Fannie Mae and Freddie Mac are now charging higher fees to guarantee mortgages.

*Earned Income Tax Credit.* CBO has increased its estimate of outlays resulting from the refundable earned income tax credit (EITC) over the 2014–2023 period by $39 billion. That change largely results from a revised assessment of the effects that provisions of the Affordable Care Act (ACA) will have on the wages of recipients of the credit. Relative to the previous baseline, CBO now estimates that the wages earned by recipients of the EITC will be lower, which will raise both the total amount of the tax credit and the portion that is refundable.

*Veterans' Benefits and Services.* CBO has raised its baseline projections of spending for veterans' benefits and services

7. A basis point is one one-hundredth of a percentage point. (For example, the difference between interest rates of 5.5 percent and 5.0 percent is 50 basis points.)

over the 2014–2023 period by $37 billion, mainly to reflect continued growth in spending for education benefits under the Post-9/11 Veterans Educational Assistance Act of 2008 (commonly referred to as the Post-9/11 GI Bill) and growth in disability compensation payments. In 2013, the number of people receiving payments from the Post-9/11 GI Bill program rose by 17 percent, far exceeding the number of beneficiaries projected in the previous baseline. Reflecting that increase, CBO raised its spending projections for that program by about $21 billion through 2023. CBO also increased its spending projections for disability compensation over that period by almost $14 billion. That rise reflects the fact that in 2013, average benefit payments grew by almost 5 percent and the number of new beneficiaries rose by 12 percent, following an initiative by the Department of Veterans Affairs to reduce its backlog of applications.

*Social Security.* CBO has reduced its projections of outlays for Social Security over the 2014–2023 period by $36 billion (or 0.3 percent). Those reductions reflect updated information about participation and average benefits in the Old-Age and Survivors Insurance (OASI) program and the Disability Insurance (DI) program, as well as new population projections from the Social Security Administration. CBO now estimates that the number of people who will receive benefits from the OASI and DI programs will be slightly smaller than it projected in May.

*Medicaid.* CBO's current projections of spending for Medicaid between 2014 and 2023 are $34 billion (or about 1 percent) higher than its May 2013 estimates. That increase mostly reflects newly available information about Medicaid spending in 2013: Spending was higher for some faster-growing categories of Medicaid benefits (such as payments for hospital services) and lower for some slower-growing categories (such as payments for physicians' services) than CBO previously projected.

CBO has also made a small offsetting reduction to its estimate of Medicaid spending in 2014 to reflect challenges that the Department of Health and Human Services and states have been facing in enrolling newly eligible people in Medicaid through health insurance exchanges. CBO has reduced its projection of new Medicaid enrollment resulting from the ACA's expansion of Medicaid coverage by about 1 million people for 2014 (see Appendix B for details). As a result, CBO has lowered its estimate of Medicaid spending for 2014 and 2015 by about $2 billion. (CBO has not revised its projections of enrollment in Medicaid under the ACA for subsequent years.)

*Civil Service Retirement.* CBO's current projections of outlays for the Civil Service Retirement System and the Federal Employees Retirement System are $24 billion higher through 2023 than its previous projections, mainly because of a significant reduction in the backlog of outstanding applications for retirement. That reduction caused the number of applications processed in 2013 to be significantly higher than expected, which led CBO to increase its estimate of the number of retirees in the system and thus its estimate of benefit payments during the projection period.

*Supplemental Nutrition Assistance Program.* Technical revisions have increased projected outlays for SNAP over the 2014–2023 period by about $23 billion. (That increase is largely offset, however, by a $20 billion decrease in projected SNAP outlays because of changes to CBO's economic forecast.) The technical updates primarily involve an increase to CBO's estimate of the average monthly SNAP benefit per person.

*Other Mandatory Programs.* Other technical changes to estimates of mandatory spending include a $6 billion decrease in CBO's projections of outlays for premium and cost-sharing subsidies provided through health insurance exchanges over the 2014–2023 period. That decrease largely reflects lower expected enrollment in 2014 in plans sold through the exchanges, and lower premiums for those plans, than previously projected. In addition, CBO's current projections include newly estimated payments (and collections) for the risk corridor program, a system of profit and loss sharing to limit the risks that insurers will face during their first few years of operating under the ACA. The government's outlays for that program are estimated to total $8 billion between 2015 and 2017, and its revenue collections from the program are expected to total $16 billion during that period. (See Appendix B for a more extensive discussion of the changes in CBO's estimates of the effects of the ACA's insurance coverage provisions.)

**Discretionary Spending.** Technical adjustments to CBO's projections for a variety of discretionary programs have the net effect of reducing estimated discretionary outlays by $6 billion for 2014 and by $55 billion for the 2014–2023 period. The largest reductions to projections of discretionary spending over the 10-year period are for the Disaster Relief Fund ($26 billion, because CBO expects such spending to occur more slowly than it previously projected) and for certain categories of military spending (mainly military personnel and operations and maintenance).

**Net Interest.** As a result of technical updates to its spending and revenue projections, CBO's estimate of net interest outlays has declined by $3 billion for 2014 and by $13 billion for the 2014–2023 period. Those decreases are mainly attributable to new information about the Treasury's auctions of securities: Interest rates at recent auctions of the Treasury's inflation-protected securities were lower than CBO had projected, and future auctions will include a new type of Treasury security, floating-rate notes.[8] In addition to those changes, CBO is now projecting lower receipts from the financing accounts associated with the government's credit programs than it estimated in May. Together, those changes reduce projected outlays for net interest over the 2014–2023 period by $26 billion. In the opposite direction, CBO projects that higher debt-service costs related to technical changes in other areas of the budget will add $13 billion to net interest outlays over the same period.

8. The Treasury held the first auction of floating-rate notes on January 29, 2014. Interest payments on those notes will rise and fall according to the interest rates generated in auctions of three-month Treasury bills. For more information about the new securities, see Department of the Treasury, "Floating Rate Notes (FRNs)" (January 6, 2014), www.treasurydirect.gov/indiv/products/prod_frns_glance.htm.

APPENDIX

# B

# Updated Estimates of the Insurance Coverage Provisions of the Affordable Care Act

In preparing the February 2014 baseline budget projections, the Congressional Budget Office (CBO) and the staff of the Joint Committee on Taxation (JCT) have updated their estimates of the budgetary effects of the provisions of the Affordable Care Act (ACA) that relate to health insurance.[1] The new baseline estimates rely on analyses completed by the early part of December 2013 and account for administrative actions that were taken before then. The estimates, however, do not reflect CBO's updated economic projections, the most recent data on enrollment through insurance exchanges or the plans that have been offered through exchanges, and any federal administrative actions or decisions by states about expanding Medicaid coverage that have occurred since that time. Hence, these updates are both partial and preliminary.

CBO typically revises its baseline budget projections after the Administration releases its proposed budget for the coming year (in part because that release includes data on federal spending that has occurred during the previous year); CBO and JCT expect to incorporate into those revised baseline projections new information and additional data about the ACA that become available before that time. Although such revisions could be substantial, CBO and JCT cannot predict either their direction or their magnitude. Even at that point, however, information about the effects of the ACA in 2014 will be limited, and little more will be known about how the law will unfold over the next several years.

1. As referred to in this report, the Affordable Care Act comprises the Patient Protection and Affordable Care Act (Public Law 111-148); the health care provisions of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152); and the effects of subsequent judicial decisions, statutory changes, and administrative actions.

In the current, interim projections, CBO and JCT estimate that the ACA's coverage provisions will result in a net cost to the federal government of $41 billion in 2014 and $1,487 billion over the 2015–2024 period. Compared with last year's projections, which spanned the 2014–2023 period, the new estimate represents a downward revision of $9 billion in the net costs of those provisions over that 10-year period.[2] This appendix first describes the insurance coverage provisions of the ACA and provides more detail on CBO and JCT's current estimates of the budgetary effects of those provisions. That discussion is followed by an explanation of how and why those estimates differ from the estimates in CBO's May 2013 baseline.

The estimated net costs in 2014 stem almost entirely from spending for subsidies that will be provided through exchanges and from an increase in spending for Medicaid (see Table B-1). For the 2015–2024 period, the projected net costs consist of the following:

- Gross costs of $2,004 billion for Medicaid, the Children's Health Insurance Program (CHIP), subsidies and related spending for insurance obtained through exchanges, and tax credits for small employers; and
- Receipts of $517 billion from penalties on certain uninsured people and certain employers, an excise tax on high-premium insurance plans, and other budgetary effects—mostly increases in tax revenues.

2. For CBO and JCT's previous estimate of the budgetary effects of the insurance coverage provisions of the ACA, see Congressional Budget Office, "Effects on Health Insurance and the Federal Budget for the Insurance Coverage Provisions in the Affordable Care Act—May 2013 Baseline" (supplemental material for *Updated Budget Projections: Fiscal Years 2013 to 2023*, May 2013), www.cbo.gov/publication/44190.

**Table B-1.**

## Effects on the Deficit of the Insurance Coverage Provisions of the Affordable Care Act

(Billions of dollars, by fiscal year)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total, 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Exchange Subsidies and Related Spending[a] | 20 | 47 | 85 | 104 | 118 | 123 | 129 | 137 | 143 | 151 | 159 | 1,197 |
| Medicaid and CHIP Outlays[b] | 19 | 41 | 62 | 70 | 76 | 80 | 83 | 87 | 92 | 98 | 103 | 792 |
| Small-Employer Tax Credits[c] | 1 | 2 | 1 | 1 | 1 | 1 | 1 | 2 | 2 | 2 | 2 | 15 |
| Gross Cost of Coverage Provisions | 40 | 90 | 148 | 175 | 195 | 205 | 214 | 226 | 237 | 250 | 263 | 2,004 |
| Penalty Payments by Uninsured People | 0 | -2 | -4 | -5 | -5 | -5 | -5 | -6 | -6 | -6 | -7 | -52 |
| Penalty Payments by Employers[c] | 0 | 0 | -11 | -14 | -15 | -16 | -17 | -18 | -19 | -20 | -21 | -151 |
| Excise Tax on High-Premium Insurance Plans[c] | 0 | 0 | 0 | 0 | -5 | -9 | -11 | -14 | -18 | -22 | -28 | -108 |
| Other Effects on Revenues and Outlays[d] | 1 | 1 | -6 | -14 | -20 | -23 | -24 | -26 | -28 | -31 | -34 | -206 |
| **Net Cost of Coverage Provisions** | **41** | **88** | **127** | **142** | **151** | **151** | **156** | **161** | **166** | **170** | **173** | **1,487** |
| **Memorandum:** | | | | | | | | | | | | |
| Changes in Mandatory Spending | 37 | 103 | 156 | 186 | 196 | 207 | 217 | 229 | 241 | 254 | 267 | 2,056 |
| Changes in Revenues[e] | -4 | 15 | 29 | 44 | 45 | 55 | 61 | 68 | 75 | 84 | 94 | 570 |

Sources: Congressional Budget Office; staff of the Joint Committee on Taxation.

Notes: These numbers exclude effects on the deficit of provisions of the Affordable Care Act that are not related to insurance coverage. They also exclude federal administrative costs subject to appropriation. (CBO has previously estimated that the Internal Revenue Service would need to spend between $5 billion and $10 billion over the 2010–2019 period to implement the Affordable Care Act and that the Department of Health and Human Services and other federal agencies would also need to spend $5 billion to $10 billion over that period.) In addition, the Affordable Care Act included explicit authorizations for spending on a variety of grant and other programs; that funding is also subject to future appropriation action.

Unless otherwise noted, positive numbers indicate an increase in the deficit, and negative numbers indicate a decrease in the deficit.

CHIP = Children's Health Insurance Program.

a. Includes spending for exchange grants to states and net collections and payments for risk adjustment, reinsurance, and risk corridors.

b. Under current law, states have the flexibility to make programmatic and other budgetary changes to Medicaid and CHIP. CBO estimates that state spending on Medicaid and CHIP over the 2015–2024 period will be about $70 billion higher because of the coverage provisions of the Affordable Care Act than it would be otherwise.

c. These effects on the deficit include the associated effects of changes in taxable compensation on revenues.

d. Consists mainly of the effects of changes in taxable compensation on revenues. CBO estimates that outlays for Social Security benefits will increase by about $8 billion over the 2015–2024 period and that the coverage provisions will have negligible effects on outlays for other federal programs.

e. Positive numbers indicate an increase in revenues, and negative numbers indicate a decrease in revenues.

Those estimates address only the insurance coverage provisions of the ACA; they do not constitute all of the act's budgetary effects. Many other provisions, on net, are projected to reduce budget deficits. Considering all of the coverage provisions and the other provisions together, CBO and JCT estimated in July 2012 (the most recent comprehensive estimates) that the total effect of the ACA would be to reduce federal deficits.[3]

## The Insurance Coverage Provisions and Their Effects on People's Coverage

The key elements of the insurance coverage provisions of the ACA that are encompassed by the estimates discussed here include the following:

3. See Congressional Budget Office, letter to the Honorable John Boehner providing an estimate for H.R. 6079, the Repeal of Obamacare Act (July 24, 2012), www.cbo.gov/publication/43471.

- Many individuals and families will be able to purchase subsidized insurance through exchanges operated either by the federal government or by a state government,
- States are permitted to significantly expand eligibility for Medicaid but may decline to do so,
- Most legal residents of the United States must either obtain health insurance or pay a penalty tax for not doing so,
- Certain employers that decline to offer minimum health insurance coverage to their employees will be assessed penalties,
- A federal excise tax will be imposed on some health insurance plans with high premiums, and
- Insurers may not deny coverage to people on the basis of their health status or charge enrollees in poor health higher insurance premiums.

The ACA also made other changes to rules governing health insurance coverage that are not listed here.

CBO and JCT estimate that the insurance coverage provisions of the ACA will markedly increase the number of nonelderly people who have health insurance—by about 13 million in 2014, 20 million in 2015, and 25 million in each of the subsequent years through 2024 (see Table B-2). Still, according to estimates by CBO and JCT, about 31 million nonelderly residents of the United States are likely to be without health insurance in 2024, roughly one out of every nine such residents. Of that group, about 30 percent are expected to be unauthorized immigrants and thus ineligible for most Medicaid benefits and for the exchange subsidies; about 20 percent will be eligible for Medicaid but will choose not to enroll; about 5 percent will be ineligible for Medicaid because they live in a state that has chosen not to expand coverage; and about 45 percent will not purchase insurance even though they have access through an employer, an exchange, or directly from an insurer.

## Enrollment in and Subsidies for Coverage Through Exchanges

Subsidies and related spending for insurance obtained through exchanges constitute the largest share of the costs of the coverage provisions of the ACA. CBO and JCT project that, under current law, 6 million people in 2014 will receive insurance coverage through the new exchanges. Over time, more people are expected to respond to the new coverage options, so enrollment is projected to increase sharply in 2015 and 2016. Starting in 2017, between 24 million and 25 million people are expected to obtain coverage each year through exchanges, and roughly 80 percent of those enrollees are expected to receive subsidies for purchasing that insurance.

CBO and JCT estimate that, under current law, exchange subsidies and related spending will total $20 billion in 2014. Over the 2015–2024 period, such spending is projected to total $1.2 trillion, as follows:

- Outlays of $899 billion and a reduction in revenues of $137 billion for premium assistance tax credits, which cover a portion of eligible individuals' and families' health insurance premiums, summing to $1,036 billion (see Table B-3);[4]
- Outlays of $167 billion for cost-sharing subsidies (which reduce out-of-pocket payments for low-income enrollees);
- Outlays of $2 billion for grants to states for operating exchanges; and
- Outlays of $208 billion and revenues of $215 billion related to payments and collections for risk adjustment, reinsurance, and risk corridors—summing to net receipts of $8 billion.

Although the government's net cash flow associated with the risk adjustment, reinsurance, and risk corridor programs is estimated to be small, those programs play a significant role in the new insurance system. All three programs, which take effect in 2014, reduce the likelihood that particular health insurers will bear especially high costs to cover the expenses of a disproportionate share of less healthy enrollees. Thus, those programs encourage insurers to offer coverage under the new

4. The subsidies for health insurance premiums are structured as refundable tax credits; the portions of such credits that exceed taxpayers' other income tax liabilities are classified as outlays in the federal budget, and the portions that reduce tax payments appear in the budget as reductions in revenues.

**Table B-2.**

## Effects of the Affordable Care Act on Health Insurance Coverage

(Millions of nonelderly people, by calendar year)

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Insurance Coverage Under Prior Law[a] | | | | | | | | | | | |
| Medicaid and CHIP | 34 | 34 | 33 | 33 | 33 | 33 | 34 | 34 | 34 | 34 | 35 |
| Employment-based coverage | 157 | 159 | 161 | 164 | 165 | 166 | 167 | 167 | 168 | 169 | 169 |
| Nongroup and other coverage[b] | 25 | 26 | 26 | 27 | 27 | 27 | 27 | 28 | 28 | 28 | 28 |
| Uninsured[c] | 57 | 57 | 56 | 56 | 55 | 55 | 56 | 56 | 56 | 56 | 57 |
| Total | 274 | 276 | 277 | 279 | 281 | 282 | 284 | 285 | 286 | 288 | 289 |
| Change in Insurance Coverage Under the ACA | | | | | | | | | | | |
| Insurance exchanges | 6 | 13 | 22 | 24 | 25 | 25 | 24 | 25 | 24 | 24 | 24 |
| Medicaid and CHIP | 8 | 12 | 12 | 12 | 12 | 12 | 13 | 13 | 13 | 13 | 13 |
| Employment-based coverage[d] | * | -2 | -6 | -6 | -7 | -7 | -7 | -7 | -7 | -7 | -7 |
| Nongroup and other coverage[b] | -2 | -3 | -4 | -5 | -5 | -5 | -5 | -5 | -5 | -5 | -5 |
| Uninsured[c] | -13 | -20 | -25 | -25 | -25 | -25 | -25 | -25 | -25 | -25 | -25 |
| Uninsured Under the ACA | | | | | | | | | | | |
| Number of uninsured nonelderly people[c] | 45 | 37 | 31 | 30 | 30 | 30 | 30 | 31 | 31 | 31 | 31 |
| Insured as a percentage of the nonelderly population | | | | | | | | | | | |
| Including all U.S. residents | 84 | 86 | 89 | 89 | 89 | 89 | 89 | 89 | 89 | 89 | 89 |
| Excluding unauthorized immigrants | 86 | 89 | 91 | 92 | 92 | 92 | 92 | 92 | 92 | 92 | 92 |
| **Memorandum:** | | | | | | | | | | | |
| Exchange Enrollees and Subsidies | | | | | | | | | | | |
| Number with unaffordable offer from employer[e] | * | * | * | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 |
| Number of unsubsidized exchange enrollees[f] | 1 | 2 | 4 | 4 | 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| Average exchange subsidy per subsidized enrollee (Dollars) | 4,700 | 5,330 | 5,350 | 5,590 | 5,990 | 6,240 | 6,720 | 7,060 | 7,460 | 7,900 | 8,370 |

Sources: Congressional Budget Office; staff of the Joint Committee on Taxation.

Notes: Figures for the nonelderly population include residents of the 50 states and the District of Columbia who are younger than 65.

CHIP = Children's Health Insurance Program; ACA = Affordable Care Act; * = between -500,000 and 500,000.

a. Figures reflect average enrollment over the course of a year and include spouses and dependents covered under family policies; people reporting multiple sources of coverage are assigned a primary source. To illustrate the effects of the Affordable Care Act, which is part of current law, changes in coverage are compared with coverage projections in the absence of that legislation, or "prior law."

b. The effects are almost entirely for nongroup coverage; "other" includes Medicare.

c. The number of uninsured people includes unauthorized immigrants as well as people who are eligible for, but not enrolled in, Medicaid.

d. The change in employment-based coverage is the net result of projected increases and decreases in offers of health insurance from employers and changes in enrollment by workers and their families. For example, in 2019, an estimated 11 million people who would have had an offer of employment-based coverage under prior law will lose their offer under current law, and an estimated 3 million people who would have enrolled in employment-based coverage will still have such an offer but will choose to no longer enroll in that coverage. Those decreases in employment-based coverage will be partially offset by an estimated 7 million people who will newly enroll in employment-based coverage under the Affordable Care Act.

e. Workers who would have to pay more than a specified share of their income (9.5 percent in 2014) for employment-based coverage could receive subsidies through an exchange.

f. Excludes coverage purchased directly from insurers outside of an exchange.

**Table B-3.**

## Enrollment in, and Budgetary Effects of, Health Insurance Exchanges

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total, 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Exchange Enrollment (Millions of nonelderly people, by calendar year)[a]** | | | | | | | | | | | |
| Individually Purchased Coverage | | | | | | | | | | | | |
| Subsidized | 5 | 11 | 19 | 20 | 20 | 20 | 20 | 20 | 19 | 19 | 19 | n.a. |
| Unsubsidized[b] | 1 | 2 | 4 | 4 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | n.a. |
| **Total** | **6** | **13** | **22** | **24** | **25** | **25** | **24** | **25** | **24** | **24** | **24** | **n.a.** |
| Employment-Based Coverage Purchased Through Exchanges[b] | 2 | 2 | 3 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | n.a. |
| | **Budgetary Effects (Billions of dollars, by fiscal year)** | | | | | | | | | | | |
| Changes in Mandatory Spending | | | | | | | | | | | | |
| Premium credit outlays | 13 | 33 | 63 | 79 | 88 | 92 | 97 | 103 | 109 | 115 | 121 | 899 |
| Cost-sharing subsidies | 3 | 8 | 13 | 15 | 16 | 17 | 17 | 18 | 19 | 21 | 22 | 167 |
| Exchange grants to states | 2 | 1 | * | * | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 |
| Payments for risk adjustment, reinsurance, and risk corridors | 0 | 20 | 19 | 23 | 17 | 19 | 21 | 21 | 22 | 23 | 23 | 208 |
| **Total** | **18** | **62** | **95** | **118** | **121** | **127** | **135** | **143** | **150** | **158** | **166** | **1,275** |
| Changes in Revenues | | | | | | | | | | | | |
| Premium credit revenues | -2 | -6 | -11 | -13 | -14 | -15 | -15 | -15 | -15 | -16 | -16 | -137 |
| Collections for risk adjustment, reinsurance, and risk corridors | 0 | 21 | 21 | 27 | 17 | 19 | 21 | 21 | 22 | 23 | 23 | 215 |
| **Total** | **-2** | **14** | **10** | **14** | **3** | **4** | **6** | **6** | **7** | **7** | **7** | **78** |
| Net Increase in the Deficit From Exchange Subsidies and Related Spending | 20 | 47 | 85 | 104 | 118 | 123 | 129 | 137 | 143 | 151 | 159 | 1,197 |
| **Memorandum:** | | | | | | | | | | | | |
| Total Exchange Subsidies (Billions of dollars, by calendar year) | 25 | 57 | 100 | 112 | 121 | 124 | 132 | 139 | 145 | 153 | 162 | 1,244 |
| Average Exchange Subsidy per Subsidized Enrollee (Dollars) | 4,700 | 5,330 | 5,350 | 5,590 | 5,990 | 6,240 | 6,720 | 7,060 | 7,460 | 7,900 | 8,370 | n.a. |

Sources: Congressional Budget Office; staff of the Joint Committee on Taxation.

Note: n.a. = not applicable; * = between zero and $500 million.

a. Figures reflect average enrollment over the course of a year and include spouses and dependents covered under family policies. Figures for the nonelderly population include residents of the 50 states and the District of Columbia who are younger than 65.

b. Excludes coverage purchased directly from insurers outside of an exchange.

federal rules and curtail their incentives to avoid accepting high-cost enrollees. Although those programs apply to different segments of the insurance market, all serve to spread risk either among the insurers or between the insurers and the federal government, as follows:

- Risk adjustment is a permanent program that transfers resources from health insurance plans that attract a relatively small proportion of high-risk enrollees (people with serious chronic conditions, for example) to plans that attract a relatively large proportion of such people. Payments will be made to insurance companies in the individual and small-group markets to the extent that those companies attract some enrollees who are not as healthy as some others and therefore would be expected to have higher medical claims. Similarly, risk adjustment collections are paid by companies whose plans attract a disproportionate share of healthier enrollees in those same markets. The risk adjustment system is facilitated by the federal government, but, by law, essentially entails transfers between insurance companies with no net budgetary effect. Risk adjustment payments and collections apply to plans sold within or outside of exchanges but not to plans that do not comply with the market and benefit standards established by the ACA. Under the ACA, the risk adjustment process will be a permanent feature of the health insurance system.

- The reinsurance program applies to insurance issued in the first three years, 2014 through 2016, to facilitate a stable individual insurance market during the transition to the new insurance system under the ACA. (Although risk adjustment can help compensate plans that enroll high-risk individuals, that process generally cannot fully compensate plans for unusually high claims if the individual market as a whole enrolls more high-risk individuals than insurers anticipated.) Reinsurance payments will be made by the federal government to all plans that operate in the individual insurance market (within or outside of exchanges, excluding plans that do not comply with the ACA's market and benefit standards) whose enrollees incur particularly high costs for medical claims—that is, costs above a specified threshold and up to a certain maximum. To cover those costs, the government will collect a per-enrollee assessment ($63 in 2014) from most private insurance plans, including self-insured plans and plans that are offered in the large-group market.[5] As in the case of the risk adjustment process, the payments to and from the government are specified to be equal and so will have no net budgetary effect over the course of the program.

- The risk corridor program also will reduce the risks faced by insurers during the first few years of the new system. Risk corridor payments are made by the government to individual and small-group plans sold in exchanges whose actual costs for medical claims exceed their expected costs by certain percentages. (Those percentages are the "corridors.") At the same time, risk corridor collections are paid to the government by those individual and small-group plans whose actual costs for medical claims fall short of their expected costs by certain percentages. Risk corridor calculations are based on insurers' costs after accounting for risk adjustment and reinsurance payments and collections. Risk corridors also apply to certain plans sold outside an exchange if the plans are the same as (or substantially the same as) plans sold by the same carrier within an exchange. The risk corridor program is temporary, applying only to insurance issued from 2014 through 2016. In contrast to the risk adjustment and reinsurance programs, payments and collections under the risk corridor program will not necessarily equal one another: If insurers' costs exceed their expectations, on average, the risk corridor program will impose costs on the federal budget; if, however, insurers' costs fall below their expectations, on average, the risk corridor program will generate savings for the federal budget.

For all three programs, payments will be recorded in the budget as outlays and collections will be recorded as revenues. CBO projects that risk adjustment payments and collections will each total $179 billion over the 2015–2024 period and that reinsurance payments and collections will each total $20 billion over that same 10-year period; thus the flows from those programs will have no net budgetary effect.[6] CBO now projects that, over the 2015–2024 period, risk corridor payments from the federal government to health insurers will total $8 billion and the corresponding collections from insurers will amount to $16 billion, yielding net savings for the federal government of $8 billion. The analysis underlying those latter figures is described below in the section on changes from the previous estimate.

5. According to a recent proposed regulation, the Department of Health and Human Services plans to exempt self-insured, self-administered plans from reinsurance assessments in 2015 and 2016.

6. Collections and payments for the risk adjustment, reinsurance, and risk corridor programs will occur after the close of a benefit year. Therefore, collections and payments for insurance provided in 2014 will occur in 2015, and so forth. Under the reinsurance program, an additional $5 billion will be collected from health insurance plans and deposited into the general fund of the U.S. Treasury. That amount is the same as that appropriated for the Early Retiree Reinsurance Program (which was in operation before 2014) and is not included here as part of the budgetary effects of the ACA's insurance coverage provisions.

## Enrollment in and Costs for Medicaid and CHIP

CBO and JCT project that the number of people enrolled in Medicaid and CHIP will be substantially higher—by 8 million in 2014 and by 12 million to 13 million people every year between 2015 and 2024—than would have been the case in the absence of the ACA (see Table B-2 on page 108). The increase anticipated after 2014 reflects the expectation that more people in states that have already expanded Medicaid will enroll in the program and that more states will expand eligibility for Medicaid (although those increases will be partially offset by fewer people enrolling in CHIP starting in 2016—funding projected for that program in CBO's baseline is reduced in that year).[7]

CBO and JCT estimate that the added costs to the federal government for Medicaid and CHIP attributable to the ACA will be $19 billion in 2014 and will grow to $70 billion in 2017. For the 2015–2024 period, they are projected to total $792 billion (see Table B-1 on page 106).

## Tax Credits for Small Employers

Under the ACA, certain small employers are eligible to receive tax credits to reduce the cost of providing health insurance to their employees. CBO and JCT project that those tax credits will total $15 billion over the 2015–2024 period.

## Penalty Payments and Excise Taxes

Certain employers of more than 50 full-time-equivalent workers will be assessed penalties by the federal government if they decide not to offer health insurance coverage that meets an affordability standard under the ACA. CBO and JCT estimate that payments of those penalties will total $151 billion over the 2015–2024 period. Some people who do not obtain health insurance coverage also will face penalties. CBO and JCT estimate that those payments will total $52 billion over the 10-year period. In addition, the excise tax on high-premium insurance plans is projected to boost federal revenues by $108 billion over the 2015–2024 period.[8]

## Other Effects on Revenues and Outlays

CBO and JCT project that, as a result of the ACA, between 6 million and 7 million fewer people will have employment-based insurance coverage each year from 2016 through 2024 than would be the case in the absence of the ACA. That change is the net result of projected increases and decreases in offers of health insurance from employers and changes in enrollment by workers and their families. For example, in 2019, an estimated 11 million people who would have had an offer of employment-based coverage in the absence of the ACA will lose their offer under current law, and about 3 million people who would have enrolled in employment-based coverage will still have such an offer but will choose not to enroll in that coverage. Those decreases in employment-based coverage will be partially offset by an estimated 7 million people who will newly enroll in employment-based coverage under the ACA.

Because of the net reduction in employment-based coverage, the share of people's compensation that takes the form of nontaxable benefits (such as health insurance premiums) will be smaller—and the share that takes the form of taxable wages will be larger—than would otherwise be the case. That shift will boost net federal receipts. Partially offsetting the federal savings will be an estimated $8 billion increase in Social Security benefits that will arise from the higher wages paid to workers. All told, CBO and JCT project, those changes will reduce federal budget deficits by $206 billion over the 2015–2024 period.

## Changes From the Previous Estimates of the Effects of the Insurance Coverage Provisions of the ACA

CBO and JCT's current, interim projections of the effects of the insurance coverage provisions of the ACA reflect administrative actions and certain other information available through early December 2013. The current projections do not differ substantially from the previous

7. Annual spending for CHIP is projected to reach $15 billion in 2015—the year in which the program is scheduled to expire. Under the rules governing baseline projections for expiring programs, CBO projects funding for CHIP after 2015 at an annualized amount of about $6 billion. (For more details about the CHIP baseline, see Chapter 3.)

8. That estimated increase in federal revenues over the 2015–2024 period consists of about $31 billion in excise tax receipts and about $77 billion in higher net revenues from the associated effects of changes in employees' taxable compensation.

ones, which were released in May 2013.[9] In all, the revisions incorporated in the current baseline decrease by $9 billion the projected cost of the ACA's insurance coverage provisions over the 2014–2023 period (the period covered by the previous baseline), from $1,363 billion to $1,354 billion (see Table B-4): $2 billion of that amount is a net decrease in outlays and $7 billion is a net increase in revenues. Nearly all of the change is for the 2014–2017 period.

Relative to the May 2013 projections, CBO and JCT now estimate that, in 2014, about 1 million fewer people will obtain coverage through exchanges, about 1 million fewer people will enroll in Medicaid and CHIP as a result of the ACA, and about 1 million more people will be uninsured. Those changes primarily reflect the significant technical problems that have been encountered in the initial phases of implementing the ACA. Also, estimated premiums for 2014 have been reduced on the basis of a preliminary analysis of premiums for plans offered through exchanges. The limited information available in early December regarding enrollment and premiums for insurance coverage in exchanges in 2014 does not provide a sound basis for changing estimates of enrollment or premiums for future years; however, CBO and JCT are monitoring such information and may make more substantial changes in their estimates for 2014 and later years for subsequent baseline projections.

Several factors explain the various changes in the budgetary flows stemming from the ACA's coverage provisions, including lower estimates for enrollment and exchange premiums, new estimates for the effects of risk corridors, and the effects of recent administrative actions:

- Taken together, the downward revisions to the estimates of enrollment and premiums reduced the cost projected for the ACA's insurance coverage provisions—including spending for Medicaid, CHIP, and exchange subsidies as well as effects on taxable compensation—by roughly $11 billion, on net, for fiscal years 2014 and 2015.
- CBO and JCT also incorporated into the updated baseline projections some new estimates of payments and collections for the risk corridor program, which had previously been projected to have no net budgetary effect; collections are now projected to exceed payments by $8 billion for the 2015–2017 period.
- The updated estimates include the budgetary effects of two administrative actions, which added, on net, $12 billion to projected deficits for the 2014–2016 period.

Those three sets of changes, together with a shift of roughly $1 billion in spending from "exchange subsidies and related spending" to other parts of the budget, account for the $9 billion reduction in the estimated net cost of the coverage provisions over the 2014–2023 period.[10]

### Lower Enrollment in the Exchanges, Medicaid, and CHIP

In light of technical problems that impeded many people's enrollment in exchanges in the first months of the open enrollment period, CBO and JCT have reduced their estimate of enrollment for the current year from 7 million to 6 million people. Between October and late December 2013, about 2 million people selected a health insurance plan through an exchange.[11] That figure is significantly below the total that CBO and JCT estimate will enroll in 2014. However, the open enrollment period

9. For CBO and JCT's previous estimate of the budgetary effects of the insurance coverage provisions of the ACA, see Congressional Budget Office, "Effects on Health Insurance and the Federal Budget for the Insurance Coverage Provisions in the Affordable Care Act—May 2013 Baseline" (supplemental material for *Updated Budget Projections: Fiscal Years 2013 to 2023*, May 2013), www.cbo.gov/publication/44190. For a discussion of previous updates to CBO's estimates, see Congressional Budget Office, "CBO's Estimate of the Net Budgetary Impact of the Affordable Care Act's Health Insurance Provisions Has Not Changed Much Over Time," *CBO Blog* (May 14, 2013), www.cbo.gov/publication/44176.

10. CBO's May 2013 estimate of the budgetary effects of the insurance coverage provisions of the ACA included an estimated $1 billion in spending for high-risk pools, premium-review activities, and loans to consumer-operated and -oriented plans for the 2014–2023 period. A similar amount is included elsewhere in CBO's February 2014 baseline projections.

11. See Department of Health and Human Services, *Health Insurance Marketplace: January Enrollment Report* (January 2014), http://go.usa.gov/BccV (PDF, 3392 KB). More recent reports indicate that the number of enrollees has risen since December 2013.

**Table B-4.**

## Comparison of CBO's Current and Previous Estimates of the Effects of the Insurance Coverage Provisions of the Affordable Care Act

| | May 2013 Baseline | February 2014 Baseline | Difference |
|---|---|---|---|
| | **Change in Insurance Coverage Under the ACA in 2014 (Millions of nonelderly people, by calendar year)[a]** | | |
| Insurance Exchanges | 7 | 6 | -1 |
| Medicaid and CHIP | 9 | 8 | -1 |
| Employment-Based Coverage[b] | * | * | * |
| Nongroup and Other Coverage[c] | -2 | -2 | * |
| Uninsured[d] | -14 | -13 | 1 |
| | **Effects on the Cumulative Federal Deficit, 2014 to 2023[e] (Billions of dollars)** | | |
| Exchange Subsidies and Related Spending[f] | 1,075 | 1,058 | -16 |
| Medicaid and CHIP Outlays | 710 | 708 | -2 |
| Small-Employer Tax Credits[g] | 14 | 14 | ** |
| Gross Cost of Coverage Provisions | 1,798 | 1,780 | -18 |
| Penalty Payments by Uninsured People | -45 | -45 | ** |
| Penalty Payments by Employers[g] | -140 | -130 | 10 |
| Excise Tax on High-Premium Insurance Plans[g] | -80 | -80 | 0 |
| Other Effects on Revenues and Outlays[h] | -171 | -171 | -1 |
| **Net Cost of Coverage Provisions** | **1,363** | **1,354** | **-9** |
| **Memorandum:** | | | |
| Net Collections and Payments for Risk Adjustment, Reinsurance, and Risk Corridors[i] | 0 | -8 | -8 |

Sources: Congressional Budget Office; staff of the Joint Committee on Taxation.

Note: ACA = Affordable Care Act; CHIP = Children's Health Insurance Program; * = between -500,000 and 500,000; ** = between -$500 million and $500 million.

a. Figures for the nonelderly population include residents of the 50 states and the District of Columbia who are younger than 65.

b. The change in employment-based coverage is the net result of projected increases and decreases in offers of health insurance from employers and changes in enrollment by workers and their families.

c. The effects are almost entirely for nongroup coverage; "other" includes Medicare.

d. The number of uninsured people includes unauthorized immigrants as well as people who are eligible for, but not enrolled in, Medicaid.

e. Positive numbers indicate an increase in the deficit; negative numbers indicate a decrease in the deficit. They also exclude effects on the deficit of other provisions of the Affordable Care Act that are not related to insurance coverage. They also exclude federal administrative costs subject to appropriation.

f. Includes spending for exchange grants to states and net collections and payments for risk adjustment, reinsurance, and risk corridors (see Memorandum). CBO's May 2013 baseline also included an estimated $1 billion in spending for high-risk pools, premium review activities, and loans to consumer-operated and -oriented plans over the 2014–2023 period. A similar total is included elsewhere in CBO's February 2014 baseline.

g. These effects on the deficit include the associated effects of changes in taxable compensation on revenues.

h. Consists mainly of the effects of changes in taxable compensation on revenues.

i. These effects are included in "Exchange Subsidies and Related Spending."

lasts through March, and CBO and JCT anticipate that, similar to initial enrollment patterns for other new health care programs, the number of people who sign up will increase sharply toward the end of the period. In particular, people who choose to enroll primarily to avoid a penalty for being uninsured may wait until the end of the open enrollment period to choose a plan. Thus, it is possible that the number of enrollees will reach the 7 million originally projected for 2014, just as it is possible that the number will fall short of the current estimate of 6 million. In any event, CBO and JCT estimate that enrollment in exchanges will rise sharply in the next few years—reaching 22 million by 2016—as people become more familiar with the new insurance options and subsidies.

CBO and JCT expect that lower projected enrollment in 2014 and lower estimated premiums for that year (discussed below) will reduce the subsidies that are provided through exchanges by $10 billion for fiscal years 2014 and 2015 relative to the previous estimates. That reduction is partly offset by other small factors that add, on net, $3 billion to projected subsidies. In addition, CBO and JCT now estimate that the risk corridor program will have net receipts of $8 billion over the 2015–2017 period, compared with the previous estimate of no net budgetary effect (a revision that also is discussed below). All together, including the change in the definition of related spending discussed earlier, those revisions led to a net $16 billion reduction in the projection for exchange subsidies and related spending over the 2014–2023 period compared with the estimate published in May 2013 (see Table B-4 on page 113).

CBO also has reduced, from 9 million to 8 million, its estimate of the number of people who will enroll in Medicaid and CHIP in 2014 as a result of the ACA. That reduction reflects the greater-than-expected technical problems in implementing the ACA; for example, the exchanges operated by the federal government have struggled to transfer application information to state agencies for people who might be eligible for Medicaid or CHIP. Additional Medicaid and CHIP enrollment to date is lower than the 8 million currently projected by CBO and JCT. However, because people can enroll in either program at any time during the year and because CBO and JCT expect that many people who apply for subsidies through the exchanges by the end of March 2014 will discover that they are eligible for Medicaid or CHIP, the agencies expect enrollment in those two programs to continue to rise throughout 2014. Nevertheless, as a result of lower projected enrollment in 2014, CBO and JCT now anticipate that outlays for Medicaid and CHIP will be $2 billion less in fiscal years 2014 and 2015 than the agencies projected in May 2013.

### Lower Premiums for Policies Purchased Through Exchanges

CBO and JCT lowered their estimate of average premiums for insurance coverage through exchanges in 2014 by about 15 percent on the basis of a preliminary analysis of plans offered through exchanges. Because the information about premiums and enrollment is still limited, however, CBO and JCT have not adjusted their projections of premiums for years after 2014. As more information becomes available, CBO and JCT will undertake additional analyses of observed premiums and of factors that affect premiums or change the attractiveness of insurance plans offered through exchanges compared with plans available from other sources. Those factors include the intensity of management of health care services, the payments to providers for those services, the breadth of provider networks, and the characteristics and expected health care costs of people who enroll through exchanges. Future revisions to CBO and JCT's projections of premiums and of other characteristics of plans offered through exchanges could affect estimates of exchange enrollment and subsidies. (The previous section discusses the combined budgetary effects of reducing projections for premiums and enrollment in 2014.)

### New Estimates for the Risk Corridor Program

CBO now projects that, over the 2015–2017 period, risk corridor payments from the federal government to health insurers will total $8 billion and that the corresponding collections from insurers will amount to $16 billion, yielding net savings for the federal government of $8 billion. By contrast, in its baseline projections published in May 2013, the agency estimated that payments and collections for risk corridors would roughly offset one another. The current projection reflects the net effect of two changes. First, a revised assessment of how the risk corridor program is likely to operate increased the amount estimated for collections and reduced the amount estimated for payments, thereby generating net savings of about $8.5 billion. Second, an analysis of the effect that a recent administrative action will have on risk corridor payments reduced the amount estimated for collections and increased the amount estimated for payments, thereby reducing the projection of net savings by less than $1 billion.

Whether insurers pay into or receive payments from the risk corridor system for 2014 will depend on how their actual health care claims compare with their expected claims, as reflected in the premium bids they submitted to exchanges in mid-2013 and after accounting for payments and collections for risk adjustment and reinsurance. To inform its projections, CBO analyzed recent data from the Medicare drug benefit (Part D), which established competitive marketplaces for coverage that are analogous to the ACA's insurance exchanges, and included similar provisions for risk adjustment, reinsurance, and risk corridors. Under Part D's risk corridors, collections from insurers have exceeded payments to insurers, yielding net collections that have averaged about $1 billion per year—between 2 percent and 3 percent of total covered costs for drugs under Part D. In CBO's judgment, that experience suggests that plans' premium bids in the ACA's exchanges will probably exceed their costs by a few percent. Despite the technical problems that have impeded enrollment in exchanges—and the resulting reduction in CBO and JCT's projection of enrollment for 2014—CBO expects that premium bids will still exceed costs and, as a result, collections from insurers for the risk corridor program will exceed payments.

The net savings of $8.5 billion from this program that CBO would have projected in the absence of the recent administrative action exceeds average net receipts under Part D for a few reasons, including the greater amount of expenses encompassed by the ACA's risk corridor system and the smaller percentages (narrower corridors) used in the ACA's system that minimize potential gains and losses alike for insurers in the first few years. However, the government has only limited experience with this type of program, and there are many uncertainties about how the market for health insurance will function under the ACA and how various outcomes would affect the government's costs or savings for the risk corridor program. In its estimate, CBO aims to be in the middle of the distribution of possible outcomes.

### Administrative Actions

Under the ACA, certain large employers that do not offer health insurance coverage that meets the affordability standard set in that law will be subject to penalties. In addition, insurers and certain other health coverage providers (primarily employers that self-insure) will be required to report the names of those receiving coverage, and certain large employers will be required to report the health insurance coverage offered to their full-time employees. In July 2013, the Administration announced a delay of one year in the penalties for certain large employers that do not provide affordable coverage and in certain reporting requirements for insurers and employers. As a result of those changes, CBO and JCT reduced by $10 billion their estimate of revenues arising from penalties to be paid by employers in 2015 (because penalties assessed for 2014 would have been collected in 2015). Other effects from the one-year delay in penalties as well as small effects from certain final rules announced by the summer of 2013 added another $2 billion, on net, to estimated costs.[12]

In November 2013, the Administration announced that state insurance commissioners could give health insurers the option of allowing individuals and small businesses to re-enroll in coverage that did not comply with certain market and benefit rules, such as the prohibition against adjusting premiums based on health status, that were scheduled to take effect in January 2014. CBO and JCT estimate that, as a result, roughly 1½ million people in the individual and small-group markets will renew policies in 2014 that are not compliant with those rules. In addition, because subscribers may renew such coverage between January and October of 2014, CBO and JCT estimate that half a million people will continue to be enrolled in noncompliant policies in 2015.

CBO and JCT estimate that the November announcement will reduce spending for exchange subsidies only slightly, for two reasons. First, in 2014, exchanges are new and many people may not yet be aware of their eligibility for subsidies and therefore would not have signed up for the subsidies even in the absence of the announcement. Second, most people who are eligible for and enroll in subsidized coverage through an exchange will face lower costs for that coverage than for unsubsidized coverage in a noncompliant plan. Most of the people who renew enrollment in noncompliant plans will probably be those who would have bought an unsubsidized ACA-compliant plan either within or outside of exchanges or who would

12. See Congressional Budget Office, letter to the Honorable Paul Ryan concerning an analysis of the Administration's announced delay of certain requirements under the Affordable Care Act (July 30, 2013), www.cbo.gov/publication/44465.

have enrolled in an ACA-compliant plan through their small employer. They will probably pay lower premiums for noncompliant plans, on average, than they would have paid otherwise; as a result, some of those people will generate a small amount of additional tax revenue. Specifically, those who are self-employed will deduct a smaller amount from their taxable income for health insurance premiums, and those who receive insurance through the small-group market will receive a greater share of their compensation in the form of taxable wages and salaries rather than nontaxable benefits.

However, the small budgetary savings attributable to that announcement will be more than offset, in CBO and JCT's judgment, by changes the Administration is planning for the risk corridor program that are intended to help mitigate losses that insurers might incur as a result of the November announcement.[13] People who renew noncompliant policies are expected to be generally healthier than people who enroll in ACA-compliant plans, thereby leading to slightly higher medical claims per enrollee among ACA-compliant plans. Because the Administration's action was taken after insurers had set their premiums for 2014, insurers could not change their current premiums to reflect that increase in expected medical claims; some of those added costs will be borne by the government under the risk corridor program. Hence, the November announcement and the Administration's proposed changes to the risk corridor program led CBO to reduce its projection of net receipts under that program by a little less than $1 billion.

13. The Administration also announced changes to the reinsurance program; however, those changes did not affect CBO's projection of reinsurance payments because CBO had previously projected that all collections under that program would be spent.

APPENDIX

# C

# Labor Market Effects of the Affordable Care Act: Updated Estimates

## Overview

The baseline economic projections developed by the Congressional Budget Office (CBO) incorporate the agency's estimates of the future effects of federal policies under current law. The agency updates those projections regularly to account for new information and analysis regarding federal fiscal policies and many other influences on the economy. In preparing economic projections for the February 2014 baseline, CBO has updated its estimates of the effects of the Affordable Care Act (ACA) on labor markets.[1]

The ACA includes a range of provisions that will take full effect over the next several years and that will influence the supply of and demand for labor through various channels. For example, some provisions will raise effective tax rates on earnings from labor and thus will reduce the amount of labor that some workers choose to supply. In particular, the health insurance subsidies that the act provides to some people will be phased out as their income rises—creating an implicit tax on additional earnings—whereas for other people, the act imposes higher taxes on labor income directly. The ACA also will exert conflicting pressures on the quantity of labor that employers demand, primarily during the next few years.

### How Much Will the ACA Reduce Employment in the Longer Term?

The ACA's largest impact on labor markets will probably occur after 2016, once its major provisions have taken full effect and overall economic output nears its maximum sustainable level. CBO estimates that the ACA will reduce the total number of hours worked, on net, by about 1.5 percent to 2.0 percent during the period from 2017 to 2024, almost entirely because workers will choose to supply less labor—given the new taxes and other incentives they will face and the financial benefits some will receive. Because the largest declines in labor supply will probably occur among lower-wage workers, the reduction in aggregate compensation (wages, salaries, and fringe benefits) and the impact on the overall economy will be proportionally smaller than the reduction in hours worked. Specifically, CBO estimates that the ACA will cause a reduction of roughly 1 percent in aggregate labor compensation over the 2017–2024 period, compared with what it would have been otherwise. Although such effects are likely to continue after 2024 (the end of the current 10-year budget window), CBO has not estimated their magnitude or duration over a longer period.

The reduction in CBO's projections of hours worked represents a decline in the number of full-time-equivalent workers of about 2.0 million in 2017, rising to about 2.5 million in 2024. Although CBO projects that total employment (and compensation) will increase over the coming decade, that increase will be smaller than it would have been in the absence of the ACA. The decline in full-time-equivalent employment stemming from the ACA will consist of some people not being employed at all and other people working fewer hours; however, CBO has not tried to quantify those two components of the overall effect. The estimated reduction stems almost entirely from a net decline in the amount of labor that workers choose to supply, rather than from a net drop in businesses' demand for labor, so it will appear almost entirely as a reduction in labor force participation and in hours worked relative to what would have occurred otherwise

1. As referred to in this report, the Affordable Care Act comprises the Patient Protection and Affordable Care Act (Public Law 111-148); the health care provisions of the Health Care and Education Reconciliation Act of 2010 (P.L. 111-152); and the effects of subsequent judicial decisions, statutory changes, and administrative actions.

rather than as an increase in unemployment (that is, more workers seeking but not finding jobs) or underemployment (such as part-time workers who would prefer to work more hours per week).

CBO's estimate that the ACA will reduce employment reflects some of the inherent trade-offs involved in designing such legislation. Subsidies that help lower-income people purchase an expensive product like health insurance must be relatively large to encourage a significant proportion of eligible people to enroll. If those subsidies are phased out with rising income in order to limit their total costs, the phaseout effectively raises people's marginal tax rates (the tax rates applying to their last dollar of income), thus discouraging work. In addition, if the subsidies are financed at least in part by higher taxes, those taxes will further discourage work or create other economic distortions, depending on how the taxes are designed. Alternatively, if subsidies are not phased out or eliminated with rising income, then the increase in taxes required to finance the subsidies would be much larger.

CBO's estimate of the ACA's impact on labor markets is subject to substantial uncertainty, which arises in part because many of the ACA's provisions have never been implemented on such a broad scale and in part because available estimates of many key responses vary considerably. CBO seeks to provide estimates that lie in the middle of the distribution of potential outcomes, but the actual effects could differ notably from those estimates. For example, if fewer people obtain subsidized insurance coverage through exchanges than CBO expects, then the effects of the ACA on employment would be smaller than CBO estimates in this report. Alternatively, if more people obtain subsidized coverage through exchanges, then the impact on the labor market would be larger.

### Why Will Those Reductions Be Smaller in the Short Term?

CBO estimates that the ACA will cause smaller declines in employment over the 2014–2016 period than in later years, for three reasons. First, fewer people will receive subsidies through health insurance exchanges in that period, so fewer people will face the implicit tax that results when higher earnings reduce those subsidies. Second, CBO expects the unemployment rate to remain higher than normal over the next few years, so more people will be applying for each available job—meaning that if some people seek to work less, other applicants will be readily available to fill those positions and the overall effect on employment will be muted. Third, the ACA's subsidies for health insurance will both stimulate demand for health care services and allow low-income households to redirect some of the funds that they would have spent on that care toward the purchase of other goods and services—thereby increasing overall demand. That increase in overall demand while the economy remains somewhat weak will induce some employers to hire more workers or to increase the hours of current employees during that period.

### Why Does CBO Estimate Larger Reductions Than It Did in 2010?

In 2010, CBO estimated that the ACA, on net, would reduce the amount of labor used in the economy by roughly half a percent—primarily by reducing the amount of labor that workers choose to supply.[2] That measure of labor use was calculated in dollar terms, representing the approximate change in aggregate labor compensation that would result. Hence, that estimate can be compared with the roughly 1 percent reduction in aggregate compensation that CBO now estimates to result from the act. There are several reasons for that difference: CBO has now incorporated into its analysis additional channels through which the ACA will affect labor supply, reviewed new research about those effects, and revised upward its estimates of the responsiveness of labor supply to changes in tax rates.

## Effects of the ACA on the Supply of Labor

CBO anticipates that the ACA will lead to a net reduction in the supply of labor. In the agency's judgment, the effects will be most evident in some segments of the workforce and will be small or negligible for most categories of workers. (The ACA also will slightly affect employers' demand for labor, as discussed below, and the total effect on labor use will consist of the combined effects on supply and on demand.) In CBO's view, the ACA's effects on labor supply will stem mainly from the following provisions, roughly in order of importance:

2. See Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2010), Box 2-1, www.cbo.gov/publication/21670.

- The subsidies for health insurance purchased through exchanges;
- The expansion of eligibility for Medicaid;
- The penalties on employers that decline to offer insurance; and
- The new taxes imposed on labor income.

Some of those provisions will reduce the amount of labor supplied by some workers; other provisions will increase the amount of labor supplied by other workers. Several provisions also will combine to affect retirement decisions.

The ACA also could alter labor productivity—the amount of output generated per hour of work—which in turn would influence employment (for example, by affecting workers' health or firms' investments in training of workers). The effects on productivity could be positive or negative, however, and their net impact is uncertain, so they are not reflected in CBO's estimates of labor supply or demand. Because the ACA could affect labor markets through many channels, with substantial uncertainty surrounding the magnitude of the effects and their interactions, CBO has chosen not to report specific estimates for each of the channels encompassed by its analysis.

## Effects of Insurance Subsidies on the Supply of Labor

Beginning in 2014, many people who purchase insurance through exchanges will be eligible for federal tax credits to defray the cost of their premiums, and some also will be eligible for cost-sharing subsidies to reduce out-of-pocket expenditures for health care. Those subsidies are largest for people whose income is near the federal poverty guideline (also known as the federal poverty level, or FPL), and they decline with rising income.[3]

In 2014, for example, a single person or a family whose income is 150 percent of the FPL and is eligible for subsidies will pay 4 percent of their income for a certain "silver" health care plan purchased through an exchange; if their income is 200 percent of the FPL, they will pay 6.3 percent of their income for that plan.[4] An increase in income thus raises the enrollee premium (and reduces the subsidy) both because the percentage-of-income formula applies to a larger dollar amount and because that percentage itself increases. People whose income exceeds 400 percent of the FPL are ineligible for premium subsidies, and for some people those subsidies will drop abruptly to zero when income crosses that threshold. Cost-sharing subsidies also phase out in steps with rising income, declining sharply at 150 percent, 200 percent, and 250 percent of the FPL.

CBO's estimate of the impact that the subsidies will have on labor supply has three components: the magnitude of the incentive, the number and types of people affected, and the degree of responsiveness to the incentive among those who are affected.

**The Magnitude of the Incentive to Reduce Labor Supply.** For some people, the availability of exchange subsidies under the ACA will reduce incentives to work both through a substitution effect and through an income effect. The former arises because subsidies decline with rising income (and increase as income falls), thus making work less attractive. As a result, some people will choose not to work or will work less—thus substituting other activities for work. The income effect arises because subsidies increase available resources—similar to giving people greater income—thereby allowing some people to maintain the same standard of living while working less. The magnitude of the incentive to reduce labor supply thus depends on the size of the subsidies and the rate at which they are phased out.

**The Number and Types of Workers Likely To Be Affected.** Subsidies clearly alter recipients' incentives to work and can certainly influence the labor supply of those who would gain eligibility by working and earning slightly less. But most full-time workers do not confront that particular choice—either their income is well above 400 percent of the FPL or they are offered employment-based health insurance and thus are generally ineligible for subsidies regardless of their income. Even so, one line of research indicates that the subsidies will affect the labor supply of many full-time workers with health insurance

3. In 2013, the FPL (which is indexed to inflation) was $11,490 for a single person and $23,550 for a family of four. Calculations of exchange subsidies for 2014 use the 2013 FPL schedule.

4. A silver plan pays about 70 percent of covered health costs, on average. For the second-least-expensive silver plan offered on the exchanges, the premium, net of subsidies, for a family of four in 2014 would be $1,413 at 150 percent of the FPL ($35,325) but would rise to $2,967 at 200 percent of the FPL ($47,100).

from their employer—precisely because they effectively forgo exchange subsidies when they take or keep a job with health insurance.[5] If instead a worker switched to a part-time job, which typically does not offer health insurance, that worker could become eligible for exchange subsidies. In that view, exchange subsidies effectively constitute a tax on labor supply for a broad range of workers.

In CBO's judgment, however, the cost of forgoing exchange subsidies operates primarily as an implicit tax on employment-based insurance, which does not imply a change in hours worked. Instead, the tax can be avoided if a worker switches to a different full-time job without health insurance (or possibly two part-time jobs) or if the employer decides to stop offering that benefit. The consequences of that implicit tax are incorporated into CBO's estimate of the ACA's effect on employment-based coverage—which is projected to decline, on net, by about 4 percent because of the ACA (see Appendix B).[6] Correspondingly, the negative effects of exchange subsidies on incentives to work will be relevant primarily for a limited segment of the population—mostly people who have no offer of employment-based coverage and whose income is either below or near 400 percent of the FPL.

Nonetheless, another subgroup that has employment-based insurance does seem likely to reduce their labor supply somewhat. Specifically, those people whose income would make them eligible for subsidies through exchanges (or for Medicaid), and who work less than a full year (roughly 10 to 15 percent of workers in that income range in a typical year), would tend to work somewhat less because of the ACA's subsidies. For those workers, the loss of subsidies upon returning to a job with health insurance is an implicit tax on working (and is equivalent to an average tax rate of roughly 15 percent, CBO estimates). That implicit tax will cause some of those workers to lengthen the time they are out of work—similar to the effect of unemployment benefits.

**Responsiveness of Affected Groups.** The implicit taxes that arise from the phaseout of the subsidies have effects on net income that are similar to the effects of direct taxes. With tax changes, however, the income and substitution effects typically work in opposite directions, whereas with the insurance subsidies the income and substitution effects work in the same direction to decrease labor supply.[7] CBO's estimate of the response of labor supply to the subsidies is based on research concerning the way changes in marginal tax rates affect labor supply and on studies analyzing how labor supply responds to changes in after-tax income.[8]

### Effects of the Medicaid Expansion on Labor Supply

The ACA significantly increases eligibility for Medicaid for residents of states that choose to expand their programs. In states that adopt the expansion, Medicaid eligibility is extended to most nonelderly residents whose income is below 138 percent of the FPL—including childless adults who previously were ineligible for Medicaid in most states regardless of their income. In states that have not expanded Medicaid, people whose income is between 100 percent and 138 percent of the FPL become eligible for subsidies through the exchanges; in those states, subsidies could decline abruptly if an enrollee's income fell from just above the FPL to just below it (and vice versa). By 2018, CBO expects that around 80 percent of the potentially eligible population will live in states that have expanded Medicaid.

5. See Casey B. Mulligan, *Average Marginal Tax Rates Under the Affordable Care Act*, Working Paper 19365 (National Bureau of Economic Research, August 2013), www.nber.org/papers/w19365, and *Is the Affordable Care Act Different From Romneycare? A Labor Economics Perspective*, Working Paper 19366 (National Bureau of Economic Research, August 2013), www.nber.org/papers/w19366.

6. See Congressional Budget Office, *CBO and JCT's Estimates of the Effects of the Affordable Care Act on the Number of People Obtaining Employment-Based Health Insurance* (March 2012), www.cbo.gov/publication/43082.

7. To see how the substitution and income effects can create counteracting pressures on people's willingness to work when tax rates change, consider the case of an increase in tax rates. The resulting reduction in take-home pay for an additional hour of work makes work less valuable relative to other uses of time and encourages people to work less. Reduced after-tax income from a given amount of work, however, encourages people to work more to limit the decline in their standard of living.

8. See Congressional Budget Office, *How the Supply of Labor Responds to Changes in Fiscal Policy* (October 2012), www.cbo.gov/publication/43674; Robert McClelland and Shannon Mok, *A Review of Recent Research on Labor Supply Elasticities*, Working Paper 2012-12 (Congressional Budget Office, October 2012), www.cbo.gov/publication/43675; and Felix Reichling and Charles Whalen, *Review of Estimates of the Frisch Elasticity of Labor Supply*, Working Paper 2012-13 (Congressional Budget Office, October 2012), www.cbo.gov/publication/43676.

**Incentives to Change Labor Supply and Groups Affected.** For some people, the ACA's expansion of Medicaid will reduce the incentive to work—but among other people it will increase that incentive. As with exchange subsidies, access to Medicaid confers financial benefits that are phased out with rising income or (more commonly) eliminated when income exceeds a threshold; some people will thus work fewer hours or withdraw from the labor force to become or remain eligible (the substitution effect). Moreover, those financial benefits will lead some people to work less because the increase in their available resources enables them to reduce work without a decline in their standard of living (the income effect).

At the same time, some people who would have been eligible for Medicaid under prior law—in particular, working parents with very low income—will work more as a result of the ACA's provisions. In 2013, the median income threshold for that group's Medicaid eligibility was 64 percent of the FPL (albeit with substantial state-to-state variation). The incentives and groups affected depend on whether a state has adopted the Medicaid expansion (and, in both cases, those incentives are intertwined with the effects of the exchange subsidies):

- In states that have chosen to expand Medicaid, the ACA now allows parents to qualify for Medicaid with income up to 138 percent of the FPL. And if their income rises above that threshold, those parents would generally be eligible for premium tax credits and cost-sharing subsidies for insurance purchased through the exchanges unless they are offered qualified employment-based health insurance. The subsidies will cover a smaller share of enrollees' medical costs than Medicaid would, but under prior law those participants ultimately would have become ineligible for Medicaid and lost all benefits. As a result, some people who would have curtailed their hours of work in order to maintain access to Medicaid under prior law will now be able to increase their hours and income while remaining eligible for subsidized insurance.

- In states that choose not to expand Medicaid, the availability of exchange subsidies also will lead some people to work more. Specifically, some people who would otherwise have income below the FPL will work more so that they can qualify for the substantial exchange subsidies that become available when income is equal to or just above the FPL

**Responses of Affected Groups.** A number of studies examining the impact of changes in Medicaid eligibility for parents and children have shown either no effects or small effects on the labor supply of single mothers; effects on two-parent households appear to be somewhat larger, in part because health insurance has stronger effects on the labor supply of secondary earners.[9]

More recently, several studies have examined changes in state policies that affect childless adults—who constitute the majority of those gaining coverage through the Medicaid expansion—and larger effects have been reported. Some reductions in employment are reported among people who have gained Medicaid eligibility, although the findings differ regarding the magnitude and statistical significance of that effect.[10] Similarly, other research shows a rise in employment rates with the withdrawal of Medicaid coverage from childless adults who had previously been turned down for private insurance.[11] Because those studies examined state-level policy initiatives affecting program eligibility—instead of changes in eligibility attributable to income changes, which could merely reflect changes in employment—the results provide some useful insights into the potential effects of the ACA (even though other aspects of the studies raise questions about their applicability to an analysis of the ACA).

Taking that research into account, CBO estimates that expanded Medicaid eligibility under the ACA will, on balance, reduce incentives to work. That effect has a relatively modest influence on total labor supply, however, because the expansion of eligibility for Medicaid primarily affects a relatively small segment of the total population—both because most people's income will

9. See Jonathan Gruber and Brigitte C. Madrian, *Health Insurance, Labor Supply, and Job Mobility: A Critical Review of the Literature*, Working Paper 8817 (National Bureau of Economic Research, February 2002), www.nber.org/papers/w8817.

10. See Katherine Baicker and others, *The Impact of Medicaid on Labor Force Activity and Program Participation: Evidence from the Oregon Health Insurance Experiment*, Working Paper 19547 (National Bureau of Economic Research, October 2013), www.nber.org/papers/w19547; and Laura Dague, Thomas DeLeire, and Lindsey Leininger, "The Effect of Public Insurance Coverage for Childless Adults on Labor Supply" (draft, March 2013), www.uh.edu/~achin/conference/dague.pdf (950 KB).

11. Craig Garthwaite, Tal Gross, and Matthew J. Notowidigdo, *Public Health Insurance, Labor Supply, and Employment Lock*, Working Paper 19220 (National Bureau of Economic Research, July 2013), www.nber.org/papers/w19220.

significantly exceed the cutoff for Medicaid eligibility and because some low-income people live in states that are not expected to expand Medicaid.

### Effects of the Employer Penalty on Labor Supply

Under the ACA, employers with 50 or more full-time-equivalent employees will face a penalty if they do not offer insurance (or if the insurance they offer does not meet certain criteria) and if at least one of their full-time workers receives a subsidy through an exchange. Originally scheduled to take effect in 2014, that penalty is now scheduled to be enforced beginning in 2015. In CBO's judgment, the costs of the penalty eventually will be borne primarily by workers in the form of reductions in wages or other compensation—just as the costs of a payroll tax levied on employers will generally be passed along to employees.[12] Because the supply of labor is responsive to changes in compensation, the employer penalty will ultimately induce some workers to supply less labor.

In the next few years, however, when wages probably will not adjust fully, those penalties will tend to reduce the demand for labor more than the supply. In the longer run, some businesses also may decide to reduce their hiring or shift their demand toward part-time hiring—either to stay below the threshold of 50 full-time-equivalent workers or to limit the number of full-time workers that generate penalty payments. But such shifts might not reduce the overall use of labor, as discussed below.

### Effects of Higher Marginal Tax Rates on Labor Supply

To cover part of the cost of the expansion of coverage, the ACA also imposes higher taxes on some people.[13] In particular, the payroll tax for Medicare's Hospital Insurance program has increased by 0.9 percentage points for workers whose earnings are above $200,000 ($250,000 for those filing a joint return).[14] As with other tax increases, those changes will exert competing pressures on labor supply: Lower after-tax compensation will encourage people to work more to make up for the lost income, but the decline in after-tax hourly compensation also will reduce the return on each additional hour of work, thus tending to reduce the incentive to work. On net, CBO anticipates, the second effect will be larger than the first, and the tax will yield a small net reduction in labor supply.

In addition, beginning in 2018, the ACA imposes an excise tax on certain high-cost health insurance plans. CBO expects that the burden of that tax will, over time, be borne primarily by workers in the form of smaller after-tax compensation. Some firms may seek to avoid or limit the amount of the excise tax they pay by switching to less expensive health plans, and in that case workers' wages should rise by a corresponding amount. Those wages will be subject to income and payroll taxes, however, so total tax payments by those workers will be higher than they would have been in the absence of the ACA. After-tax compensation will thus fall whether firms pay the excise tax or take steps to avoid it, and the resulting increases in average and marginal tax rates will cause a slight decline in the supply of labor, CBO estimates.

Under certain circumstances, the ACA also imposes a penalty tax on people who do not have qualified health insurance. That tax is to be phased in over time; by 2016, it will generally be the greater of $695 annually per adult or 2.5 percent of taxable income (each subject to a cap).[15] For people who are subject to the percentage-of-income penalty, that tax discourages work—but CBO estimates

12. By contrast, if employers add health insurance coverage as a benefit in response to the penalty or drop coverage despite it, CBO estimates that their workers' wages will adjust by roughly the employers' cost of providing that coverage—so total compensation would stay about the same and labor supply would not be affected by the change in employer coverage.

13. CBO and the staff of the Joint Committee on Taxation have estimated that, on balance, the ACA will reduce the cumulative deficit over the 2013–2022 period because cuts in other spending more than offset the rest of the cost of the expansion in coverage. Therefore, repealing the ACA would increase budget deficits by a corresponding amount over that period; see Congressional Budget Office, letter to the Honorable John Boehner providing an estimate for H.R. 6079, the Repeal of Obamacare Act (July 24, 2012), www.cbo.gov/publication/43471.

14. The ACA has also raised the tax rate on capital income for some higher-income households and imposed taxes on certain goods and services (such as medical devices), but CBO does not expect those provisions to have a noticeable effect on the overall labor market.

15. For families who are subject to the dollar penalty, the penalty per child is one-half the adult penalty, and in 2016 the payment is capped at $2,085; for people who are subject to the percentage-of-income penalty, the tax payment is capped at the average cost of a "bronze" insurance plan (which, on average, covers 60 percent of enrollees' health costs) offered through the exchanges. After 2016, the dollar penalty is indexed to general inflation.

that a relatively small number of workers will be affected. About 6 million workers and dependents will be subject to the penalty tax in 2016, and among the workers who pay it, a large share will be subject to the dollar penalty rather than the percentage-of-income penalty.[16] As a result, CBO estimates that its impact on aggregate labor supply will be negligible.

### Effects on Retirement Decisions and Disabled Workers

Changes to the health insurance market under the ACA, including provisions that prohibit insurers from denying coverage to people with preexisting conditions and those that restrict variability in premiums on the basis of age or health status, will lower the cost of health insurance plans offered to older workers outside the workplace. As a result, some will choose to retire earlier than they otherwise would—another channel through which the ACA will reduce the supply of labor.

The new insurance rules and wider availability of subsidies also could affect the employment decisions of people with disabilities, but the net impact on their labor supply is not clear. In the absence of the ACA, some workers with disabilities would leave the workforce to enroll in such programs as Disability Insurance (DI) or Supplemental Security Income (SSI) and receive subsidized health insurance. (SSI enrollees also receive Medicaid; DI enrollees become eligible for Medicare after a two-year waiting period.) Under the ACA, however, they could be eligible for subsidized health insurance offered through the exchanges, and they cannot be denied coverage or charged higher premiums because of health problems. As a result, some disabled workers who would otherwise have been out of the workforce might stay employed or seek employment. At the same time, those subsidies and new insurance rules might lead other disabled workers to leave the workforce earlier than they otherwise would. Unlike DI applicants who are ineligible for SSI, they would not have to wait two years before they received the ACA's Medicaid benefits or exchange subsidies—making it more attractive to leave the labor force and apply for DI.

16. See Congressional Budget Office, *Payments of Penalties for Being Uninsured Under the Affordable Care Act* (September 2012), www.cbo.gov/publication/43628.

### Possible Effects on Labor Supply Through Productivity

In addition to the effects discussed above, the ACA could shape the labor market or the operations of the health sector in ways that affect labor productivity. For example, to the extent that increases in insurance coverage lead to improved health among workers, labor productivity could be enhanced. In addition, the ACA could influence labor productivity indirectly by making it easier for some employees to obtain health insurance outside the workplace and thereby prompting those workers to take jobs that better match their skills, regardless of whether those jobs offered employment-based insurance.

Some employers, however, might invest less in their workers—by reducing training, for example—if the turnover of employees increased because their health insurance was no longer tied so closely to their jobs. Furthermore, productivity could be reduced if businesses shifted toward hiring more part-time employees to avoid paying the employer penalty and if part-time workers operated less efficiently than full-time workers did. (If the dollar loss in productivity exceeded the cost of the employer penalty, however, businesses might not shift toward hiring more part-time employees.)

Whether any of those changes would have a noticeable influence on overall economic productivity, however, is not clear. Moreover, those changes are difficult to quantify and they influence labor productivity in opposing directions. As a result, their effects are not incorporated into CBO's estimates of the effects of the ACA on the labor market.

Some recent analyses also have suggested that the ACA will lead to higher productivity in the health care sector—in particular, by avoiding costs for low-value health care services—and thus to slower growth in health care costs under employment-based health plans.[17] Slower growth in those costs would effectively increase workers' compensation, making work more attractive. Those effects could increase the supply of labor (and could increase the demand for labor in the near term, if some of the savings were not immediately passed on to workers).

17. See Council of Economic Advisers, *Trends in Health Care Cost Growth and the Role of the Affordable Care Act* (November 2013), http://go.usa.gov/ZJFJ; and David Cutler and Neeraj Sooj, *New Jobs Through Better Health Care* (Center for American Progress, January 2010), http://tinyurl.com/oc2zdta.

Whether the ACA already has or will reduce health care costs in the private sector, however, is hard to determine. The ACA's reductions in payment rates to hospitals and other providers have slowed the growth of Medicare spending (compared with projections under prior law) and thus contributed to the slow rate of overall cost growth in health care since the law's enactment. Private health care costs (as well as national health expenditures) have grown more slowly in recent years as well, but analysts differ about the shares of that slowdown that can be attributed to the deep recession and weak recovery, to provisions of the ACA, and to other changes within the health sector. Moreover, the overall influence of the ACA on the cost of employment-based coverage is difficult to predict—in part because some provisions could either increase or decrease private-sector spending on health care and in part because many provisions have not yet been fully implemented or evaluated.[18] Consequently, CBO has not attributed to the ACA any employment effects stemming from slower growth of premiums in the private sector.

## Effects of the ACA on the Demand for Labor

The ACA also will affect employers' demand for workers, mostly over the next few years, both by increasing labor costs through the employer penalty (which will reduce labor demand) and by boosting overall demand for goods and services (which will increase labor demand).

### Effects of the Employer Penalty on the Demand for Labor

Beginning in 2015, employers of 50 or more full-time-equivalent workers that do not offer health insurance (or that offer health insurance that does not meet certain criteria) will generally pay a penalty. That penalty will initially reduce employers' demand for labor and thereby tend to lower employment. Over time, CBO expects, the penalty will be borne primarily by workers in the form of reduced wages or other compensation, at which point the penalty will have little effect on labor *demand* but will reduce labor *supply* and will lower employment slightly through that channel.

Businesses face two constraints, however, in seeking to shift the costs of the penalty to workers. First, there is considerable evidence that employers refrain from cutting their employees' wages, even when unemployment is high (a phenomenon sometimes referred to as sticky wages).[19] For that reason, some employers might leave wages unchanged and instead employ a smaller workforce. That effect will probably dissipate entirely over several years for most workers because companies that face the penalty can restrain wage growth until workers have absorbed the cost of the penalty—thus gradually eliminating the negative effect on labor demand that comes from sticky wages.

A second and more durable constraint is that businesses generally cannot reduce workers' wages below the statutory minimum wage.[20] As a result, some employers will respond to the penalty by hiring fewer people at or just above the minimum wage—an effect that would be similar to the impact of raising the minimum wage for those companies' employees. Over time, as worker productivity rises and inflation erodes the value of the minimum wage, that effect is projected to decline because wages for fewer jobs will be constrained by the minimum wage. The effect will not disappear completely over the next 10 years, however, because some wages are still projected to be constrained (that is, wages for some jobs will be at or just above the minimum wage).

Businesses also may respond to the employer penalty by seeking to reduce or limit their full-time staffing and to hire more part-time employees. Those responses might occur because the employer penalty will apply only to businesses with 50 or more full-time-equivalent employees, and employers will be charged only for each full-time employee (not counting the first 30 employees). People are generally considered full time under the ACA if they work 30 hours or more per week, on average, so

18. Before the ACA was enacted, CBO estimated that the provisions of a similar proposal might cause a small increase or decrease in premiums for employment-based coverage, although that analysis did not take into account the effects of the excise tax on certain high-cost employment-based plans. See Congressional Budget Office, *An Analysis of Health Insurance Premiums Under the Patient Protection and Affordable Care Act* (November 2009), www.cbo.gov/publication/41792.

19. See, for example, Peter Gottschalk, "Downward Nominal Wage Flexibility: Real or Measurement Error?" *Review of Economics and Statistics*, vol. 87, no. 3 (August 2005), pp. 556–568, http://tinyurl.com/k9bcxss; and Alessandro Brattieri, Susanto Basu, and Peter Gottschalk, *Some Evidence on the Importance of Sticky Wages*, Working Paper 16130 (National Bureau of Economic Research, June 2010), www.nber.org/papers/w16130.

20. As of January 2014, the federal minimum wage was $7.25 per hour. Roughly half of all workers, however, live in states or communities where the minimum wage is higher.

employers have an incentive, for example, to shift from hiring a single 40-hour, full-time employee to hiring two, 20-hour part-time employees to avoid bearing the costs of the penalty.

Such a change might or might not, on its own, reduce the total number of hours worked. In the example just offered, the total amount of work is unaffected by the changes. Moreover, adjustments of that sort can take time and be quite costly—in particular, because of the time and costs that arise in dismissing full-time workers (which may involve the loss of workers with valuable job-specific skills); the time and costs associated with hiring new part-time workers (including the effort spent on interviewing and training); and, perhaps most important, the time and costs of changing work processes to accommodate a larger number of employees working shorter and different schedules. The extent to which people would be willing to work at more than one part-time job instead of a single full-time job is unclear as well; although hourly wages for full-time jobs might be lower than those for part-time jobs (once wages adjust to the penalty), workers also would incur additional costs associated with holding more than one job at a time.

In CBO's judgment, there is no compelling evidence that part-time employment has increased as a result of the ACA. On the one hand, there have been anecdotal reports of firms responding to the employer penalty by limiting workers' hours, and the share of workers in part-time jobs has declined relatively slowly since the end of the recent recession. On the other hand, the share of workers in part-time jobs generally declines slowly after recessions, so whether that share would have declined more quickly during the past few years in the absence of the ACA is difficult to determine.[21] In any event, because the employer penalty will not take effect until 2015, the current lack of direct evidence may not be very informative about the ultimate effects of the ACA.

More generally, some employers have expressed doubts about whether and how the provisions of the ACA will unfold. Uncertainty in several areas—including the timing and sequence of policy changes and implementation procedures and their effects on health insurance premiums and workers' demand for health insurance—probably has encouraged some employers to delay hiring. However, those effects are difficult to quantify separately from other developments in the labor market, and possible effects on the demand for labor through such channels have not been incorporated into CBO's estimates of the ACA's impact.

### Effects of Changes in the Demand for Goods and Services on the Demand for Labor

CBO estimates that, over the next few years, the various provisions of the ACA that affect federal revenues and outlays will increase demand for goods and services, on net. Most important, the expansion of Medicaid coverage and the provision of exchange subsidies (and the resulting rise in health insurance coverage) will not only stimulate greater demand for health care services but also allow lower-income households that gain subsidized coverage to increase their spending on other goods and services—thereby raising overall demand in the economy. A partial offset will come from the increased taxes and reductions in Medicare's payments to health care providers that are included in the ACA to offset the costs of the coverage expansion.

On balance, CBO estimates that the ACA will boost overall demand for goods and services over the next few years because the people who will benefit from the expansion of Medicaid and from access to the exchange subsidies are predominantly in lower-income households and thus are likely to spend a considerable fraction of their additional resources on goods and services—whereas people who will pay the higher taxes are predominantly in higher-income households and are likely to change their spending to a lesser degree. Similarly, reduced payments under Medicare to hospitals and other providers will lessen their income or profits, but those changes are likely to decrease demand by a relatively small amount.

The net increase in demand for goods and services will in turn boost demand for labor over the next few years, CBO estimates.[22] Those effects on labor demand tend to be especially strong under conditions such as those now prevailing in the United States, where output is so far below its maximum sustainable level that the Federal Reserve has kept short-term interest rates near zero for several years and probably would not adjust those rates to

21. See Congressional Budget Office, *The Slow Recovery of the Labor Market* (February 2014), www.cbo.gov/publication/45011.

22. For further discussion of CBO's analysis of the economic effects of budgetary policies, see Congressional Budget Office, *Economic Effects of Policies Contributing to Fiscal Tightening in 2013* (November 2012), pp. 2–5, www.cbo.gov/publication/43694.

offset the effects of changes in federal spending and taxes. Over time, however, those effects are expected to dissipate as overall economic output moves back toward its maximum sustainable level.

## Why Short-Term Effects Will Be Smaller Than Longer-Term Effects

CBO estimates that the reduction in the use of labor that is attributable to the ACA will be smaller between 2014 and 2016 than it will be between 2017 and 2024. That difference is a result of three factors in particular—two that reflect smaller negative effects on the supply of labor and one that reflects a more positive effect on the demand for labor:

- The number of people who will receive exchange subsidies—and who thus will face an implicit tax from the phaseout of those subsidies that discourages them from working—will be smaller initially than it will be in later years. The number of enrollees (workers and their dependents) purchasing their own coverage through the exchanges is projected to rise from about 6 million in 2014 to about 25 million in 2017 and later years, and most of those enrollees will receive subsidies. Although the number of people who will be eligible for exchange subsidies is similar from year to year, workers who are eligible but do not enroll may either be unaware of their eligibility or be unaffected by it and thus are unlikely to change their supply of labor in response to the availability of those subsidies.

- CBO anticipates that the unemployment rate will remain high for the next few years. If changes in incentives lead some workers to reduce the amount of hours they want to work or to leave the labor force altogether, many unemployed workers will be available to take those jobs—so the effect on overall employment of reductions in labor supply will be greatly dampened.

- The expanded federal subsidies for health insurance will stimulate demand for goods and services, and that effect will mostly occur over the next few years. That increase in demand will induce some employers to hire more workers or to increase their employees' hours during that period.

CBO anticipates that output will return nearly to its maximum sustainable level in 2017 (see Chapter 2). Once that occurs, the net decline in the amount of labor that workers choose to supply because of the ACA will be fully reflected in a decline in total employment and hours worked relative to what would otherwise occur.

## Differences From CBO's Previous Estimates of the ACA's Effects on Labor Markets

CBO's estimate that the ACA will reduce aggregate labor compensation in the economy by about 1 percent over the 2017–2024 period—compared with what would have occurred in the absence of the act—is substantially larger than the estimate the agency issued in August 2010.[23] At that time, CBO estimated that, once it was fully implemented, the ACA would reduce the use of labor by about one-half of a percent. That measure of labor use was calculated in dollar terms, representing the change in aggregate labor compensation that would result. Thus it can be compared with the reduction in aggregate compensation that CBO now estimates to result from the act (rather than with the projected decline in the number of hours worked).

The increase in that estimate primarily reflects three factors:

- The revised estimate is based on a more detailed analysis of the ACA that incorporates additional channels through which that law will affect labor supply. In particular, CBO's 2010 estimate did not include an effect on labor supply from the employer penalty and the resulting reduction in wages (as the costs of that penalty are passed on to workers), and it did not include an effect from encouraging part-year workers to delay returning to work in order to retain their insurance subsidies.

- CBO has analyzed the findings of several studies published since 2010 concerning the impact of provisions of the ACA (or similar policy initiatives) on labor markets. In particular, studies of past expansions or contractions in Medicaid eligibility for childless adults have pointed to a larger effect on labor supply than CBO had estimated previously.

23. See Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2010), Box 2-1, www.cbo.gov/publication/21670.

- CBO made an upward revision in its estimates of the impact that changes in after-tax wages have on labor supply, reflecting a broad review of the tax literature that has informed several of CBO's estimates and analyses.[24]

CBO's updated estimate of the decrease in hours worked translates to a reduction in full-time-equivalent employment of about 2.0 million in 2017, rising to about 2.5 million in 2024, compared with what would have occurred in the absence of the ACA. Previously, the agency estimated that if the ACA did not affect the average number of hours worked per employed person, it would reduce household employment in 2021 by about 800,000.[25] By way of comparison, CBO's current estimate for 2021 is a reduction in full-time-equivalent employment of about 2.3 million.

The current estimate of the ACA's impact on hours worked and full-time-equivalent employment is considerably higher for two significant reasons.[26] First, as described above, CBO has boosted its estimate of the ACA's effect on aggregate labor compensation in the economy from about 0.5 percent to about 1 percent. Second, CBO has increased its estimate of the effect of a given reduction in aggregate compensation under the ACA on hours worked. CBO's earlier estimate was based on a simplifying assumption that affected workers would have average earnings—in which case the percentage reductions in compensation and hours worked would be roughly the same. However, people whose employment or hours worked will be most affected by the ACA are expected to have below-average earnings because the effects of the subsidies that are available through exchanges and of expanded Medicaid eligibility on the amount of labor supplied by lower-income people are likely to be greater than the effects of increased taxes on the amount of labor supplied by higher-income people. According to CBO's more detailed analysis, the 1 percent reduction in aggregate compensation that will occur as a result of the ACA corresponds to a reduction of about 1.5 percent to 2.0 percent in hours worked.

The reduction in full-time-equivalent employment that CBO expects will arise from the ACA includes some people choosing not to work at all and other people choosing to work fewer hours than they would have in the absence of the law; however, CBO has not tried to quantify those two components of the overall effect. Because some people will reduce the amount of hours they work rather than stopping work altogether, the number who will choose to leave employment because of the ACA in 2024 is likely to be substantially less than 2.5 million. At the same time, more than 2.5 million people are likely to reduce the amount of labor they choose to supply to some degree because of the ACA, even though many of them will not leave the labor force entirely.

24. See Congressional Budget Office, *How the Supply of Labor Responds to Changes in Fiscal Policy* (October 2012), www.cbo.gov/publication/43674.

25. See testimony of Douglas W. Elmendorf, Director, Congressional Budget Office, before the Subcommittee on Health of the House Energy and Commerce Committee, *CBO's Analysis of the Major Health Care Legislation Enacted in 2010* (March 30, 2011), pp. 31–33, www.cbo.gov/publication/22077.

26. The estimates also differ in that the first estimate was presented in terms of household employment and the current estimate is presented in terms of full-time-equivalent employment. However, that difference is relatively small when comparing CBO's previous estimate with the current one.

APPENDIX

# D

# How Changes in Economic Projections Might Affect Budget Projections

The federal budget is highly sensitive to economic conditions. Revenues depend on the amount of taxable income, including wages and salaries, other (nonwage) income received by individuals, and corporate profits. Those types of income generally rise or fall with overall economic activity, although not necessarily in proportion. Spending for many mandatory programs depends on inflation, either through explicit cost-of-living adjustments or in other ways. In addition, the U.S. Treasury regularly refinances portions of the government's outstanding debt—and issues more debt to finance new deficits—at market interest rates. Thus, the amount that the federal government spends for interest on its debt is directly tied to those rates.

To show how projections for the economy can affect projections of the federal budget, the Congressional Budget Office (CBO) has constructed simplified "rules of thumb." The rules provide a rough sense of how differences in individual economic variables, taken in isolation, would affect the budget totals; however, those rules of thumb are not intended to substitute for a full analysis of the implications of alternative economic forecasts.

The rules of thumb have been developed for three variables:

- Growth of real (inflation-adjusted) gross domestic product (GDP),
- Interest rates, and
- Inflation.

All three rules of thumb are assumed to begin in January 2014.

CBO's rule of thumb for the growth of real GDP shows the effects of growth rates that are 0.1 percentage point lower each year than the rates that underlie the agency's baseline budget projections. (The budget projections are summarized in Chapter 1, and the economic projections are described in Chapter 2.) The rule of thumb for interest rates shows the effects of rates that are 1 percentage point higher each year than the rates used in the baseline; because inflation is held equal to its baseline projection in this rule of thumb, the results show the effects of higher *real* interest rates. Finally, the rule of thumb for inflation shows the effects of inflation that is 1 percentage point higher each year than is inflation in the baseline.

Each rule of thumb is roughly symmetrical. Thus, if economic growth was correspondingly higher or interest rates or inflation were correspondingly lower than CBO projects, the effects would be about the same as those shown here, but with the opposite sign.[1]

CBO chose variations of 0.1 percentage point and 1 percentage point solely for simplicity. Those differences do not necessarily indicate the extent to which actual economic performance might differ from CBO's projections. For example, although the rule of thumb for real GDP growth shows the effects of a difference of 0.1 percentage point, the standard deviation of the 10-year average of growth rates for real GDP is roughly seven times larger, or 0.7 percentage points.[2] And although the rules of

1. Interest rates on short-term Treasury securities could not be much lower in the near term. Those rates are currently near zero, and CBO does not project them to rise much until fiscal year 2016.

2. Standard deviation is a conventional measure of variability. In the case of real GDP growth, CBO calculated the extent to which actual growth over 10-year periods differed from the post–World War II average. The standard deviation is the size of the difference that was exceeded about one-third of the time.

thumb for real interest rates and inflation show the effects of a difference of 1 percentage point, the standard deviations of the 10-year averages of real interest rates for 10-year Treasury notes and inflation are 1.5 and 2.1 percentage points, respectively.

## Lower Real Growth

Stronger economic growth improves the budget's bottom line, and weaker growth worsens it. The first rule of thumb illustrates the effects of economic growth that is slightly weaker than expected.[3]

CBO's baseline includes growth of real GDP of 2.7 percent in calendar year 2014, an average of 3.2 percent from 2015 to 2017, and an average of 2.2 percent from 2018 to 2024. If 0.1 percentage point was subtracted from each of those rates, by 2024 GDP would be roughly 1 percent smaller than the amount underlying CBO's baseline.

Slower GDP growth would have several effects on the budget. It would result in less growth in taxable income and thus lower tax revenues—$1 billion less in 2014 and $55 billion less in 2024 (see Table D-1). With a smaller amount of revenues, the federal government would need to borrow more and thus would incur higher interest costs. Additional payments to service federal debt would be very small during the first few years of the projection period but larger in later years, reaching $11 billion by 2024. Mandatory spending, however, would be only marginally affected by a decline of 0.1 percentage point in economic growth: Medicare outlays would be slightly lower, but that decrease would be partially offset by higher outlays for the refundable portions of the earned income and child tax credits.[4]

3. A change in the rate of real economic growth could affect inflation and unemployment; however, CBO's rule of thumb does not include the effects of changes in those variables.

4. Medicare's payment rates for physicians' services are computed using a formula that compares annual spending with a target amount that partly reflects the growth of GDP. Slower GDP growth leads to a lower target and thereby smaller Medicare payments to physicians. Tax credits reduce a taxpayer's income tax liability; if a refundable credit exceeds a taxpayer's other liability, the excess may be refunded to the taxpayer, and that payment is recorded as an outlay in the budget.

All told, if growth of real GDP each year was 0.1 percentage point lower than in CBO's baseline projections, annual deficits would be larger by amounts that would climb to $66 billion by 2024. The cumulative deficit for 2015 through 2024 would be $311 billion higher.

## Higher Interest Rates

The second rule of thumb illustrates the sensitivity of the budget to changes in interest rates, which affect the flow of interest payments to and from the federal government. When the budget is in deficit, the Treasury must borrow additional funds from the public to cover the shortfall. Moreover, the Treasury refinances a substantial portion of the nation's debt each year at market interest rates. Those rates also help determine how much the Federal Reserve remits to the Treasury.

If interest rates on all types of Treasury securities were 1 percentage point higher each year through 2024 than projected in the baseline, and all other economic variables were unchanged, the government's interest costs would be substantially larger. The difference would amount to only $12 billion in 2014 (see Table D-1). However, most marketable government debt is in the form of Treasury notes, bonds, and inflation-protected securities, which have maturities greater than one year. As the Treasury replaced securities as they matured, the budgetary effects of higher interest rates would mount, climbing to an additional $174 billion in 2024 under this scenario.

As part of its conduct of monetary policy, the Federal Reserve buys and sells Treasury securities and other securities, including, recently, a large amount of mortgage-backed securities. The Federal Reserve also pays interest on reserves. The interest that the Federal Reserve earns on its portfolio of securities and the interest that it pays on reserves affect the Federal Reserve's remittances to the Treasury, which are counted as revenues. If all interest rates were 1 percentage point higher for the coming decade than CBO projects, the Federal Reserve's remittances would be lower for a number of years because higher interest payments on reserves would outstrip additional interest earnings on its portfolio. However, over time, the current holdings in the portfolio would mature and be replaced with higher-yielding investments; CBO projects that by 2022 the Federal Reserve's remittances would be higher if projected interest rates were higher. Overall, between 2015 and 2024, those higher rates would reduce revenues by $105 billion.

**Table D-1.**

## How Selected Economic Changes Might Affect CBO's Baseline Budget Projections

(Billions of dollars)

| | | | | | | | | | | | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2015-2019 | 2015-2024 |
| | | | | | **Growth Rate of Real GDP Is 0.1 Percentage Point Lower per Year** | | | | | | | | |
| Change in Revenues | -1 | -5 | -8 | -13 | -18 | -23 | -28 | -34 | -41 | -48 | -55 | -66 | -272 |
| Change in Outlays | | | | | | | | | | | | | |
| Mandatory spending | * | * | * | * | * | * | * | * | * | * | * | * | -1 |
| Debt service | * | * | * | 1 | 1 | 2 | 3 | 5 | 7 | 9 | 11 | 5 | 40 |
| Total | * | * | * | 1 | 2 | 2 | 3 | 5 | 6 | 9 | 11 | 5 | 40 |
| **Change in the Deficit[a]** | **-1** | **-5** | **-9** | **-14** | **-19** | **-25** | **-32** | **-39** | **-47** | **-56** | **-66** | **-71** | **-311** |
| | | | | | **Interest Rates Are 1 Percentage Point Higher per Year** | | | | | | | | |
| Change in Revenues | -18 | -26 | -24 | -21 | -17 | -13 | -7 | -3 | * | 2 | 3 | -100 | -105 |
| Change in Outlays | | | | | | | | | | | | | |
| Higher interest rates | 12 | 38 | 57 | 74 | 90 | 106 | 119 | 134 | 147 | 160 | 174 | 365 | 1,099 |
| Debt service | * | 1 | 5 | 10 | 16 | 24 | 31 | 40 | 49 | 60 | 72 | 56 | 308 |
| Total | 13 | 40 | 62 | 84 | 106 | 129 | 150 | 173 | 196 | 221 | 246 | 421 | 1,407 |
| **Change in the Deficit[a]** | **-30** | **-66** | **-85** | **-105** | **-123** | **-142** | **-157** | **-176** | **-197** | **-219** | **-242** | **-521** | **-1,512** |
| | | | | | **Inflation Is 1 Percentage Point Higher per Year** | | | | | | | | |
| Change in Revenues | -3 | 19 | 57 | 99 | 146 | 197 | 254 | 316 | 381 | 451 | 526 | 517 | 2,446 |
| Change in Outlays | | | | | | | | | | | | | |
| Discretionary spending[b] | 0 | 1 | 1 | 2 | 4 | 5 | 6 | 7 | 15 | 26 | 39 | 13 | 106 |
| Mandatory spending | 3 | 17 | 40 | 63 | 89 | 122 | 156 | 193 | 239 | 281 | 327 | 331 | 1,528 |
| Higher interest rates[c] | 23 | 53 | 74 | 94 | 114 | 132 | 149 | 169 | 185 | 202 | 220 | 468 | 1,393 |
| Debt service | * | 1 | 4 | 7 | 12 | 16 | 19 | 24 | 28 | 33 | 38 | 40 | 181 |
| Total | 27 | 72 | 120 | 167 | 218 | 274 | 331 | 394 | 467 | 542 | 623 | 851 | 3,208 |
| **Change in the Deficit[a]** | **-30** | **-53** | **-63** | **-69** | **-72** | **-77** | **-76** | **-77** | **-86** | **-91** | **-97** | **-334** | **-762** |
| **Memorandum:** | | | | | | | | | | | | | |
| Deficit in CBO's February 2014 Baseline | -514 | -478 | -539 | -581 | -655 | -752 | -836 | -912 | -1,031 | -1,047 | -1,074 | -3,005 | -7,904 |

Source: Congressional Budget Office.

Note: GDP = gross domestic product; * = between -$500 million and $500 million.

a. Negative amounts indicate an increase in the deficit.

b. Most discretionary spending through 2021 is governed by caps established by the Budget Control Act of 2011; in CBO's baseline, that spending would not be affected by changes in projected inflation.

c. The change in outlays attributable to higher interest rates in this scenario differs from the estimate in the scenario for interest rates because the principal of inflation-protected securities issued by the Treasury grows with inflation.

The larger deficits generated by the increase in interest rates would require the Treasury to borrow more than is projected in the baseline. That extra borrowing would raise the cost of servicing the debt by amounts that would reach $72 billion in 2024.

All together, if interest rates were 1 percentage point higher than projected in CBO's baseline, the budget's bottom line would worsen by amounts that would rise over the projection period, climbing from $30 billion in 2014 to $242 billion in 2024. The cumulative deficit would be $1.5 trillion higher over the 2015–2024 period.

## Higher Inflation

The third rule of thumb shows the budgetary effects of inflation that is 1 percentage point higher than is projected in the baseline. Although higher inflation increases both revenues and outlays, the net effect would be substantially larger budget deficits.

Larger increases in prices generally lead to greater wages, profits, and other income, which in turn generate larger collections of individual income taxes, payroll taxes, and corporate income taxes. The parameters in the individual income tax system that affect most taxpayers—including the income thresholds for both the regular and alternative minimum tax brackets, the standard deduction, and personal exemptions—are indexed for inflation. Therefore, the share of taxpayers' incomes taxed at certain rates does not change very much when incomes are higher because of higher inflation, so tax collections tend to rise roughly proportionally with incomes under those circumstances. However, some parameters of the individual income tax system are not indexed for inflation: For example, the income thresholds for the surtax on investment income are fixed in nominal dollars, so if incomes were higher because of higher inflation, the surtax would apply to a larger share of taxpayers' incomes.

For the payroll tax, rates are mostly the same across income levels, and the maximum amount of earnings subject to the Social Security tax rises with average wages in the economy, which generally rise more when inflation is higher; therefore, higher inflation leads to an increase in revenues that is roughly proportional to the increase in earnings. Also, although the tax brackets under the corporate income tax are not indexed for inflation, most profits are taxed at the top tax rate, so again higher inflation generates an increase in revenues that is roughly proportional to the increase in corporate profits.

Higher inflation also increases the cost of many mandatory spending programs. Benefits for many mandatory programs are automatically adjusted each year to reflect increases in prices. Specifically, benefits paid for Social Security, federal employees' retirement programs, Supplemental Security Income, disability compensation for veterans, the Supplemental Nutrition Assistance Program (formerly known as Food Stamps), and child nutrition programs, among others, are adjusted (with a lag) for changes in the consumer price index or one of its components. Many of Medicare's payment rates also are adjusted annually for inflation. Spending for some other programs, such as Medicaid, is not formally indexed to price changes but tends to grow with inflation because the costs of providing benefits under those programs increase as prices rise. In addition, to the extent that initial benefit payments to participants in retirement and disability programs are linked to wages, increases in nominal wages as a result of higher inflation will boost future outlays for those programs.

In CBO's baseline, higher inflation would raise projections of future spending for discretionary programs by a fairly small amount. The Budget Control Act of 2011 (Public Law 112-25), as modified by subsequent legislation, imposes caps on most discretionary budget authority through 2021, and CBO's baseline incorporates the assumption that appropriations for most purposes will be equal to those caps. Higher inflation would not alter those caps and thus would have no effect on CBO's projections of those appropriations.

However, higher inflation would raise other projected appropriations in two ways. First, the law specifies that the caps may be adjusted to accommodate appropriations for certain purposes. In 2014, those adjustments include $92 billion designated for overseas contingency operations (such as the war in Afghanistan), $6 billion in funding provided for disaster relief, and $1 billion for "program integrity" initiatives aimed at reducing improper benefit payments in the Disability Insurance and Supplemental Security Income programs. CBO's baseline extrapolates the funding provided for those purposes in 2014 with adjustments for inflation; if inflation was 1 percentage point higher, projected outlays from such funding would increase by $56 billion between 2015 and 2024. Second, CBO's baseline projections incorporate the assumption that discretionary funding that is capped through 2021 increases with inflation in 2022, 2023, and 2024 from the amount of the cap in 2021; inflation that was 1 percentage point higher would boost projected outlays in those years by a total of $50 billion.

Although the caps on discretionary appropriations are not indexed for inflation, higher inflation would gradually diminish the amount of goods that could be acquired and the benefits and services that could be provided under those fixed caps. If, over time, higher inflation led lawmakers to adjust the discretionary caps, the impact on spending would be greater and the net impact on the deficit would be even worse.

Inflation also has an impact on outlays for net interest because it affects interest rates. If inflation was 1 percentage point higher than CBO projects, for example, then interest rates would be 1 percentage point higher (all else being equal). As a result, new federal borrowing would incur higher interest costs, and outstanding inflation-indexed securities would be more costly for the federal government. In addition, higher interest rates would first reduce and then increase revenues from the Federal Reserve's remittances to the Treasury.

If inflation each year was 1 percentage point higher than the rate underlying CBO's baseline, total revenues and outlays over the 10-year period would be about 6 percent and 7 percent greater, respectively, than in the baseline. Over the 2015–2024 period, the deficit would be $762 billion higher (see Table D-1 on page 131).

APPENDIX

# E

# The Effects of Automatic Stabilizers on the Federal Budget as of 2014

During recessions, federal tax liabilities and, therefore, revenues decline automatically with the reduction in output and income. In addition, some federal outlays—to pay unemployment insurance benefits, for example—automatically increase. Such reductions in revenues and increases in outlays—known as automatic stabilizers—help bolster economic activity during downturns, but they also temporarily increase the federal budget deficit. Conversely, when real (inflation-adjusted) gross domestic product (GDP) moves up closer to the maximum sustainable output of the economy (termed potential GDP), revenues automatically rise and outlays automatically fall. Under those circumstances, automatic stabilizers provide a smaller boost to economic activity. (Those effects of automatic stabilizers are in addition to the effects of any legislated changes in tax and spending policies.)

The Congressional Budget Office (CBO) uses statistical techniques to estimate the automatic effects of the business cycle on federal revenues and outlays and, thus, on federal budget deficits. According to CBO's estimates, automatic stabilizers added significantly to the budget deficit—and thereby substantially strengthened economic activity relative to what it would have been otherwise—in fiscal years 2009 through 2013. On the basis of CBO's economic and budgetary projections under current law, the agency expects that automatic stabilizers will continue to add significantly to the budget deficit and to support economic activity in 2014 but that their effects on the budget and the economy will decline substantially from 2015 through 2017 in response to improving economic conditions. For the period from 2018 to 2024, CBO projects that GDP will fall slightly short of potential GDP, on average, after the economy has recovered from the recent economic downturn. (For discussion of CBO's economic projections, see Chapter 2.) As a result, CBO projects that automatic stabilizers will slightly lower revenues and raise federal spending during that period, providing a small boost to demand for goods and services but also raising budget deficits (and thereby crowding out some private investment).

## How Large Were the Budgetary Effects of Automatic Stabilizers Last Year?

In fiscal year 2013, CBO estimates, automatic stabilizers added $277 billion to the federal budget deficit, an amount equal to 1.6 percent of potential GDP (see Table E-1 and Table E-2).[1] That outcome marked the fifth consecutive year that automatic stabilizers added to the deficit by an amount equal to or exceeding 1.6 percent of potential GDP, a magnitude that had previously been equaled or exceeded only twice in the past 50 years, in fiscal years 1982 and 1983 (see Figure E-1 on page 140). (Those historical calculations, as well as the

1. CBO's estimates of the automatic stabilizers reflect the assumption that discretionary spending and interest payments do not respond automatically to the business cycle. For a description of a methodology for estimating automatic stabilizers that is similar to CBO's methodology, see Darrel Cohen and Glenn Follette, "The Automatic Fiscal Stabilizers: Quietly Doing Their Thing," *Economic Policy Review*, Federal Reserve Bank of New York, vol. 6, no. 1 (April 2000), pp. 35–68, http://tinyurl.com/pcxcohz. See also Glenn Follette and Byron Lutz, *Fiscal Policy in the United States: Automatic Stabilizers, Discretionary Fiscal Policy Actions, and the Economy*, Finance and Economics Discussion Series Paper 2010–43 (Board of Governors of the Federal Reserve System, June 2010), http://tinyurl.com/nl6qc6e.

**Table E-1.**

## Deficit or Surplus With and Without Automatic Stabilizers, and Related Series, in Billions of Dollars

| | Deficit (-) or Surplus With Automatic Stabilizers | – | Automatic Stabilizers | = | Deficit (-) or Surplus Without Automatic Stabilizers | Revenues and Outlays Without Automatic Stabilizers: Revenues | Revenues and Outlays Without Automatic Stabilizers: Outlays | GDP Gap[a] | Unemployment Gap (Percent)[b] |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Actual | | | |
| 1964 | -6 | | 1 | | -7 | 112 | 119 | 3 | -0.1 |
| 1965 | -1 | | 4 | | -5 | 114 | 119 | 11 | -0.7 |
| 1966 | -4 | | 11 | | -15 | 121 | 136 | 37 | -1.7 |
| 1967 | -9 | | 12 | | -21 | 139 | 160 | 36 | -2.0 |
| 1968 | -25 | | 11 | | -36 | 145 | 181 | 33 | -2.0 |
| 1969 | 3 | | 14 | | -11 | 176 | 187 | 38 | -2.4 |
| 1970 | -3 | | 6 | | -9 | 190 | 198 | 15 | -1.9 |
| 1971 | -23 | | -3 | | -20 | 191 | 211 | -7 | -0.2 |
| 1972 | -23 | | -2 | | -22 | 209 | 231 | * | -0.1 |
| 1973 | -15 | | 12 | | -27 | 221 | 247 | 40 | -0.9 |
| 1974 | -6 | | 10 | | -16 | 256 | 272 | 25 | -1.2 |
| 1975 | -53 | | -20 | | -33 | 296 | 329 | -62 | 1.2 |
| 1976 | -74 | | -24 | | -49 | 317 | 366 | -59 | 1.8 |
| 1977 | -54 | | -14 | | -40 | 366 | 406 | -36 | 1.1 |
| 1978 | -59 | | -1 | | -59 | 400 | 459 | -6 | ** |
| 1979 | -41 | | 7 | | -48 | 458 | 506 | 10 | -0.4 |
| 1980 | -74 | | -21 | | -53 | 535 | 588 | -68 | 0.6 |
| 1981 | -79 | | -33 | | -46 | 627 | 673 | -77 | 1.2 |
| 1982 | -128 | | -70 | | -58 | 678 | 736 | -215 | 3.0 |
| 1983 | -208 | | -89 | | -119 | 679 | 798 | -253 | 4.1 |
| 1984 | -185 | | -35 | | -151 | 698 | 849 | -95 | 1.8 |
| 1985 | -212 | | -17 | | -195 | 747 | 943 | -49 | 1.2 |
| 1986 | -221 | | -11 | | -210 | 777 | 987 | -34 | 1.0 |
| 1987 | -150 | | -15 | | -135 | 869 | 1,004 | -49 | 0.4 |
| 1988 | -155 | | 4 | | -159 | 908 | 1,066 | 8 | -0.3 |
| 1989 | -153 | | 19 | | -171 | 975 | 1,147 | 51 | -0.7 |
| 1990 | -221 | | 9 | | -230 | 1,024 | 1,254 | 21 | -0.5 |
| 1991 | -269 | | -55 | | -214 | 1,105 | 1,318 | -171 | 0.8 |
| 1992 | -290 | | -70 | | -220 | 1,150 | 1,371 | -179 | 1.7 |
| 1993 | -255 | | -61 | | -194 | 1,208 | 1,402 | -169 | 1.5 |
| 1994 | -203 | | -47 | | -156 | 1,302 | 1,457 | -126 | 0.9 |
| 1995 | -164 | | -39 | | -125 | 1,389 | 1,514 | -118 | 0.3 |
| 1996 | -107 | | -39 | | -68 | 1,491 | 1,559 | -111 | 0.2 |
| 1997 | -22 | | -8 | | -14 | 1,588 | 1,602 | -15 | ** |
| 1998 | 69 | | 24 | | 45 | 1,702 | 1,657 | 63 | -0.5 |
| 1999 | 126 | | 73 | | 53 | 1,761 | 1,708 | 193 | -0.7 |

**Continued**

**Table E-1.** **Continued**

## Deficit or Surplus With and Without Automatic Stabilizers, and Related Series, in Billions of Dollars

| | Deficit (-) or Surplus With Automatic Stabilizers | − | Automatic Stabilizers | = | Deficit (-) or Surplus Without Automatic Stabilizers | Revenues and Outlays Without Automatic Stabilizers: Revenues | Revenues and Outlays Without Automatic Stabilizers: Outlays | GDP Gap[a] | Unemployment Gap (Percent)[b] |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | **Actual (Continued)** | | | | |
| 2000 | 236 | | 118 | | 118 | 1,916 | 1,797 | 299 | -1.0 |
| 2001 | 128 | | 54 | | 74 | 1,940 | 1,866 | 105 | -0.7 |
| 2002 | -158 | | -44 | | -114 | 1,888 | 2,002 | -130 | 0.7 |
| 2003 | -378 | | -87 | | -290 | 1,859 | 2,149 | -250 | 1.0 |
| 2004 | -413 | | -42 | | -371 | 1,917 | 2,288 | -108 | 0.6 |
| 2005 | -318 | | -1 | | -318 | 2,154 | 2,471 | 4 | 0.2 |
| 2006 | -248 | | 26 | | -274 | 2,385 | 2,659 | 63 | -0.3 |
| 2007 | -161 | | 6 | | -166 | 2,568 | 2,734 | -8 | -0.5 |
| 2008 | -459 | | -67 | | -391 | 2,583 | 2,974 | -220 | 0.3 |
| 2009 | -1,413 | | -329 | | -1,083 | 2,371 | 3,455 | -1037 | 3.5 |
| 2010 | -1,294 | | -373 | | -922 | 2,467 | 3,389 | -1024 | 4.6 |
| 2011 | -1,300 | | -342 | | -957 | 2,586 | 3,544 | -963 | 3.9 |
| 2012 | -1,087 | | -281 | | -806 | 2,688 | 3,494 | -800 | 3.0 |
| 2013 | -680 | | -277 | | -403 | 3,019 | 3,422 | -806 | 2.2 |
| | | | | | **Projected** | | | | |
| 2014 | -514 | | -261 | | -253 | 3,268 | 3,521 | -723 | 1.4 |
| 2015 | -478 | | -198 | | -281 | 3,485 | 3,766 | -498 | 1.1 |
| 2016 | -539 | | -111 | | -428 | 3,581 | 4,009 | -267 | 0.7 |
| 2017 | -581 | | -51 | | -529 | 3,675 | 4,204 | -119 | 0.4 |
| 2018 | -655 | | -38 | | -617 | 3,803 | 4,419 | -102 | 0.3 |
| 2019 | -752 | | -40 | | -712 | 3,967 | 4,679 | -106 | 0.3 |
| 2020 | -836 | | -43 | | -793 | 4,141 | 4,933 | -111 | 0.3 |
| 2021 | -912 | | -45 | | -867 | 4,327 | 5,194 | -116 | 0.3 |
| 2022 | -1,031 | | -47 | | -984 | 4,531 | 5,515 | -120 | 0.3 |
| 2023 | -1,047 | | -49 | | -997 | 4,745 | 5,742 | -125 | 0.3 |
| 2024 | -1,074 | | -52 | | -1,022 | 4,971 | 5,993 | -131 | 0.3 |

Sources: Congressional Budget Office; Office of Management and Budget.

Notes: Automatic stabilizers are automatic changes in revenues and outlays that are attributable to cyclical movements in real (inflation-adjusted) output and unemployment.

GDP = gross domestic product; * = between -$500 million and zero; ** = between -0.05 percent and 0.05 percent.

a. The GDP gap equals actual or projected GDP minus potential GDP (CBO's estimate of the maximum sustainable output of the economy).

b. The unemployment gap equals the actual or projected rate of unemployment minus the underlying long-term rate of unemployment.

**Table E-2.**

## Deficit or Surplus With and Without Automatic Stabilizers, and Related Series, as a Percentage of Potential Gross Domestic Product

| | Deficit (-) or Surplus With Automatic Stabilizers | − | Automatic Stabilizers | = | Deficit (-) or Surplus Without Automatic Stabilizers | Revenues and Outlays Without Automatic Stabilizers | | GDP Gap[a] | Unemployment Gap (Percent)[b] |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | Revenues | Outlays | | |
| | | | | | | Actual | | | |
| 1964 | -0.9 | | 0.1 | | -1.0 | 17.0 | 18.0 | 0.5 | -0.1 |
| 1965 | -0.2 | | 0.5 | | -0.7 | 16.3 | 17.0 | 1.6 | -0.7 |
| 1966 | -0.5 | | 1.5 | | -2.0 | 16.3 | 18.3 | 4.9 | -1.7 |
| 1967 | -1.1 | | 1.5 | | -2.6 | 17.4 | 19.9 | 4.5 | -2.0 |
| 1968 | -2.9 | | 1.2 | | -4.2 | 16.7 | 20.9 | 3.8 | -2.0 |
| 1969 | 0.3 | | 1.5 | | -1.1 | 18.7 | 19.8 | 4.0 | -2.4 |
| 1970 | -0.3 | | 0.6 | | -0.9 | 18.3 | 19.2 | 1.4 | -1.9 |
| 1971 | -2.0 | | -0.3 | | -1.7 | 17.0 | 18.7 | -0.6 | -0.2 |
| 1972 | -1.9 | | -0.1 | | -1.8 | 17.1 | 18.9 | * | -0.1 |
| 1973 | -1.1 | | 0.9 | | -2.0 | 16.8 | 18.8 | 3.0 | -0.9 |
| 1974 | -0.4 | | 0.7 | | -1.1 | 17.5 | 18.6 | 1.7 | -1.2 |
| 1975 | -3.2 | | -1.2 | | -2.0 | 17.7 | 19.7 | -3.7 | 1.2 |
| 1976 | -4.0 | | -1.3 | | -2.7 | 17.2 | 19.8 | -3.2 | 1.8 |
| 1977 | -2.6 | | -0.7 | | -1.9 | 17.7 | 19.7 | -1.7 | 1.1 |
| 1978 | -2.6 | | * | | -2.6 | 17.5 | 20.1 | -0.2 | * |
| 1979 | -1.6 | | 0.3 | | -1.9 | 17.9 | 19.8 | 0.4 | -0.4 |
| 1980 | -2.6 | | -0.7 | | -1.9 | 18.7 | 20.5 | -2.4 | 0.6 |
| 1981 | -2.5 | | -1.0 | | -1.4 | 19.5 | 20.9 | -2.4 | 1.2 |
| 1982 | -3.6 | | -2.0 | | -1.6 | 19.2 | 20.9 | -6.1 | 3.0 |
| 1983 | -5.5 | | -2.3 | | -3.1 | 17.9 | 21.0 | -6.7 | 4.1 |
| 1984 | -4.6 | | -0.9 | | -3.7 | 17.2 | 21.0 | -2.3 | 1.8 |
| 1985 | -4.9 | | -0.4 | | -4.5 | 17.3 | 21.8 | -1.1 | 1.2 |
| 1986 | -4.8 | | -0.2 | | -4.6 | 17.0 | 21.6 | -0.7 | 1.0 |
| 1987 | -3.1 | | -0.3 | | -2.8 | 18.0 | 20.8 | -1.0 | 0.4 |
| 1988 | -3.0 | | 0.1 | | -3.1 | 17.6 | 20.7 | 0.1 | -0.3 |
| 1989 | -2.8 | | 0.3 | | -3.1 | 17.7 | 20.8 | 0.9 | -0.7 |
| 1990 | -3.8 | | 0.2 | | -3.9 | 17.4 | 21.3 | 0.4 | -0.5 |
| 1991 | -4.3 | | -0.9 | | -3.4 | 17.6 | 21.0 | -2.7 | 0.8 |
| 1992 | -4.4 | | -1.1 | | -3.3 | 17.4 | 20.7 | -2.7 | 1.7 |
| 1993 | -3.7 | | -0.9 | | -2.8 | 17.3 | 20.1 | -2.4 | 1.5 |
| 1994 | -2.8 | | -0.6 | | -2.1 | 17.8 | 19.9 | -1.7 | 0.9 |
| 1995 | -2.1 | | -0.5 | | -1.6 | 18.0 | 19.7 | -1.5 | 0.3 |
| 1996 | -1.3 | | -0.5 | | -0.8 | 18.4 | 19.3 | -1.4 | 0.2 |
| 1997 | -0.3 | | -0.1 | | -0.2 | 18.7 | 18.9 | -0.2 | * |
| 1998 | 0.8 | | 0.3 | | 0.5 | 19.1 | 18.6 | 0.7 | -0.5 |
| 1999 | 1.3 | | 0.8 | | 0.6 | 18.9 | 18.3 | 2.1 | -0.7 |

Continued

**Table E-2.** **Continued**

## Deficit or Surplus With and Without Automatic Stabilizers, and Related Series, as a Percentage of Potential Gross Domestic Product

| | Deficit (-) or Surplus With Automatic Stabilizers | − | Automatic Stabilizers | = | Deficit (-) or Surplus Without Automatic Stabilizers | Revenues and Outlays Without Automatic Stabilizers: Revenues | Revenues and Outlays Without Automatic Stabilizers: Outlays | GDP Gap[a] | Unemployment Gap (Percent)[b] |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | | **Actual (Continued)** | | | |
| 2000 | 2.4 | | 1.2 | | 1.2 | 19.4 | 18.2 | 3.0 | -1.0 |
| 2001 | 1.2 | | 0.5 | | 0.7 | 18.5 | 17.8 | 1.0 | -0.7 |
| 2002 | -1.4 | | -0.4 | | -1.0 | 17.2 | 18.2 | -1.2 | 0.7 |
| 2003 | -3.3 | | -0.8 | | -2.5 | 16.0 | 18.6 | -2.2 | 1.0 |
| 2004 | -3.4 | | -0.3 | | -3.0 | 15.7 | 18.8 | -0.9 | 0.6 |
| 2005 | -2.5 | | * | | -2.5 | 16.7 | 19.2 | * | 0.2 |
| 2006 | -1.8 | | 0.2 | | -2.0 | 17.5 | 19.5 | 0.5 | -0.3 |
| 2007 | -1.1 | | * | | -1.2 | 17.9 | 19.1 | -0.1 | -0.5 |
| 2008 | -3.1 | | -0.4 | | -2.6 | 17.2 | 19.9 | -1.5 | 0.3 |
| 2009 | -9.1 | | -2.1 | | -7.0 | 15.3 | 22.4 | -6.7 | 3.5 |
| 2010 | -8.2 | | -2.4 | | -5.8 | 15.6 | 21.4 | -6.5 | 4.6 |
| 2011 | -7.9 | | -2.1 | | -5.9 | 15.8 | 21.7 | -5.9 | 3.9 |
| 2012 | -6.4 | | -1.7 | | -4.8 | 15.9 | 20.7 | -4.7 | 3.0 |
| 2013 | -3.9 | | -1.6 | | -2.3 | 17.3 | 19.6 | -4.6 | 2.2 |
| | | | | | | **Projected** | | | |
| 2014 | -2.9 | | -1.5 | | -1.4 | 18.2 | 19.6 | -4.0 | 1.4 |
| 2015 | -2.6 | | -1.1 | | -1.5 | 18.7 | 20.2 | -2.7 | 1.1 |
| 2016 | -2.8 | | -0.6 | | -2.2 | 18.5 | 20.7 | -1.4 | 0.7 |
| 2017 | -2.9 | | -0.3 | | -2.6 | 18.2 | 20.8 | -0.6 | 0.4 |
| 2018 | -3.1 | | -0.2 | | -2.9 | 18.1 | 21.0 | -0.5 | 0.3 |
| 2019 | -3.4 | | -0.2 | | -3.2 | 18.1 | 21.3 | -0.5 | 0.3 |
| 2020 | -3.6 | | -0.2 | | -3.5 | 18.1 | 21.5 | -0.5 | 0.3 |
| 2021 | -3.8 | | -0.2 | | -3.6 | 18.1 | 21.8 | -0.5 | 0.3 |
| 2022 | -4.1 | | -0.2 | | -4.0 | 18.2 | 22.2 | -0.5 | 0.3 |
| 2023 | -4.0 | | -0.2 | | -3.8 | 18.3 | 22.2 | -0.5 | 0.3 |
| 2024 | -4.0 | | -0.2 | | -3.8 | 18.4 | 22.2 | -0.5 | 0.3 |

Sources: Congressional Budget Office; Office of Management and Budget.

Notes: Automatic stabilizers are automatic changes in revenues and outlays that are attributable to cyclical movements in real (inflation-adjusted) output and unemployment.

GDP = gross domestic product; * = between -0.05 percent and 0.05 percent.

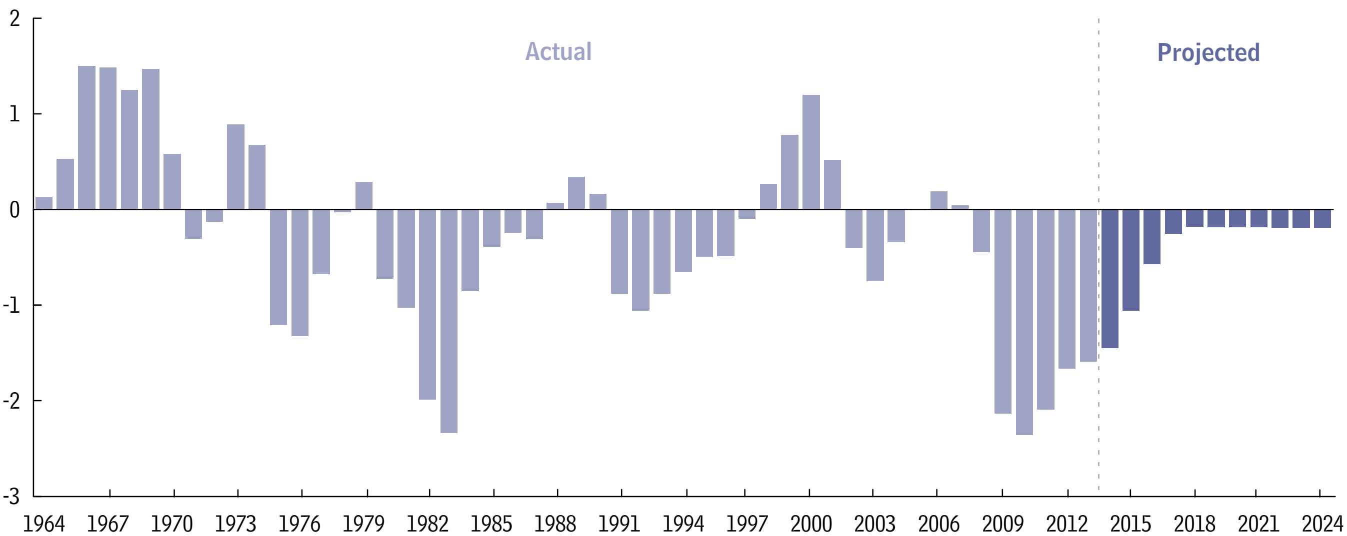
a. The GDP gap equals actual or projected GDP minus potential GDP (CBO's estimate of the maximum sustainable output of the economy).

b. The unemployment gap equals the actual or projected rate of unemployment minus the underlying long-term rate of unemployment.

**Figure E-1.**

## Contribution of Automatic Stabilizers to Budget Deficits and Surpluses

(Percentage of potential gross domestic product)




Sources: Congressional Budget Office; Office of Management and Budget.

Notes: Automatic stabilizers are automatic changes in revenues and outlays that are attributable to cyclical movements in real (inflation-adjusted) output and unemployment.

Potential gross domestic product is CBO's estimate of the maximum sustainable output of the economy.

projections presented below, involve potential GDP rather than actual GDP because potential GDP excludes fluctuations that are attributable to the business cycle.)[2]

## How Large Will the Budgetary Effects of Automatic Stabilizers Be Over the Next Decade?

According to CBO's projections under current law, the contribution of automatic stabilizers to the federal budget deficit, measured as a share of potential GDP, will fall slightly in fiscal year 2014, to 1.5 percent. That contribution accounts for a bit more than half of the estimated deficit this year. The contribution will decline to 1.1 percent of potential GDP in 2015, accounting for less than half of the projected deficit.

CBO expects that the budgetary effects of automatic stabilizers will remain significant this year, largely because of the continued—albeit diminishing—weakness in the economy. Specifically, CBO projects that the gap between actual and potential GDP will amount to about 4 percent of potential GDP in fiscal year 2014, compared with gaps of roughly 4½ percent in 2012 and 2013.

The contribution of the automatic stabilizers to the budget deficit is projected to decline significantly in 2015, 2016, and 2017, as the output gap narrows. That contribution is then projected to flatten at 0.2 percent of potential GDP in 2018 and later years. On the basis of historical experience, CBO projects that GDP will be one-half percent below potential GDP, on average, after the economy has recovered from the recent economic downturn (although in any particular year the gap could be larger or smaller than one-half percent). As a result,

2. CBO's previous estimates of the automatic stabilizers were published in March 2013. Revisions to CBO's estimates since last March stem from the July 2013 comprehensive revisions of the national income and product accounts by the Bureau of Economic Analysis, changes to the agency's economic projections, and technical improvements in the agency's estimating approach. Those revisions are generally small before 2001 and larger after that; the revisions for 2012 through 2015 are especially large because the comprehensive revision led CBO to significantly reduce its estimate of the shortfall of actual GDP relative to potential GDP in 2012 and 2013, and thereby to its projection of that shortfall during the next few years.

CBO projects that the automatic stabilizers will continue to raise budget deficits through the 10-year projection period.[3]

## How Large Will Budget Deficits Without Automatic Stabilizers Be Over the Next Decade?

The federal budget deficit or surplus with the effects of automatic stabilizers filtered out is an estimate of what the deficit or surplus would be if GDP was at its potential, the unemployment rate was at a corresponding level, and all other factors were unchanged. (The "budget deficit without automatic stabilizers" has also been referred to as the "cyclically adjusted deficit" or "structural deficit.") That measure, when compared with the budget deficit with automatic stabilizers, helps analysts evaluate the extent to which changes in the budget deficit or surplus are caused by cyclical developments in the economy and thus are likely to prove temporary rather than enduring.

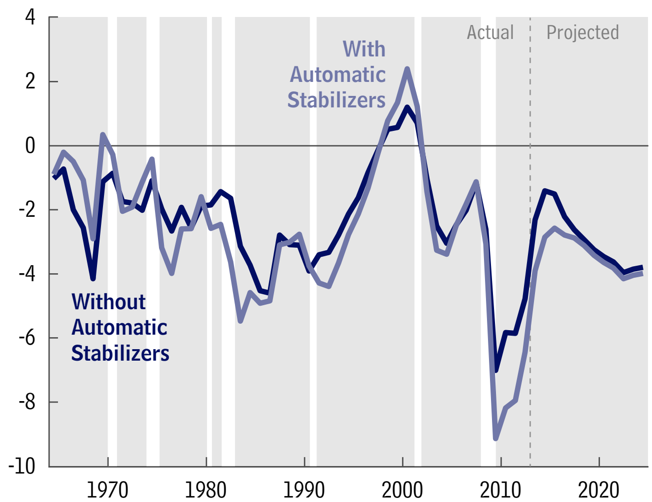
Under current law, CBO projects, the budget deficit without automatic stabilizers will equal 1.4 percent of potential GDP in fiscal year 2014, down from 2.3 percent in 2013 and much larger values in 2009 through 2012 (see Figure E-2). Essentially all of the drop between 2013 and 2014 results from a projected rise in revenues. The largest increase is in corporate income tax receipts, because certain revenue-reducing tax provisions expired at the end of 2013 and, in CBO's estimation, other factors that have held down corporate tax receipts since the recession will continue to wane (see Chapter 4 for more discussion of those factors).

After 2014, the projected budget deficit without automatic stabilizers rises, on balance, over the subsequent decade. The slight increase in 2015, from 1.4 percent to 1.5 percent of potential GDP, is due to a rise in spending that is slightly larger than the rise in revenues (both with the effects of automatic stabilizers excluded). Between 2015 and 2024, the projected budget deficit without automatic stabilizers rises to 3.8 percent of GDP (a figure that would be 0.2 percentage points larger were it not for shifts in the timing of certain payments that would otherwise occur on a weekend). Most of that increase can be attributed to an increase in spending, with a smaller role played by a decline in revenues (again, both without automatic stabilizers and measured as a percentage of potential GDP). The increase in spending reflects growth in interest payments and mandatory spending without automatic stabilizers that more than offsets a decline in discretionary spending (all expressed relative to potential GDP). The decline in revenues is due largely to a combination of decreases in corporate taxes and remittances from the Federal Reserve, which is mostly offset by an increase in individual income taxes (all without automatic stabilizers and expressed relative to potential GDP).

**Figure E-2.**

### Budget Deficits and Surpluses With and Without Automatic Stabilizers

(Percentage of potential gross domestic product)




Sources: Congressional Budget Office; Office of Management and Budget.

Notes: Automatic stabilizers are automatic changes in revenues and outlays that are attributable to cyclical movements in real (inflation-adjusted) output and unemployment.

Potential gross domestic product is CBO's estimate of the maximum sustainable output of the economy.

3. The estimated budgetary impact of automatic stabilizers in fiscal year 2017 is slightly larger than in subsequent years because CBO projects that the gap between GDP and potential GDP will not narrow to one-half percent of potential GDP until the last part of that year.

## Why Do Budget Deficits Appear Cyclical Even After the Estimated Effects of Automatic Stabilizers Are Filtered Out?

Despite adjustments to revenues and outlays for the estimated effects of the business cycle, the estimated deficit without automatic stabilizers exhibits movements that appear to be correlated with the business cycle. In particular, the estimated deficit without automatic stabilizers tends to increase during times of recession and early in a recovery.

That pattern probably reflects several factors. One factor is that estimates of the budgetary impact of automatic stabilizers may only partly remove the effects of certain changes (such as large fluctuations in the stock market) that have not had a sufficiently regular relationship to business cycles to be viewed as mostly cyclical. Another factor is that policymakers often choose to support a weak economy by cutting taxes or increasing federal spending, both of which increase the deficit (or reduce the surplus). Such responses to recessions and high unemployment require legislation, so their budgetary effects are not automatic, and they are not viewed as automatic stabilizers. During the past several years, for example, lawmakers have enacted the American Taxpayer Relief Act of 2012 (Public Law 112-240); the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (P.L. 111-312); the American Recovery and Reinvestment Act of 2009 (P.L. 111-5); the Emergency Economic Stabilization Act of 2008 (P.L. 110-343); and the Housing and Economic Recovery Act of 2008 (P.L. 111-289).

APPENDIX

# F

# Trust Funds

The federal government uses several accounting mechanisms to link earmarked receipts—money designated for a specific purpose—with corresponding expenditures. Those mechanisms include trust funds (such as the Social Security trust funds), special funds (such as the fund that the Department of Defense uses to finance its health care program for military retirees), and revolving funds (such as the Federal Employees' Group Life Insurance fund). When the receipts designated for those funds exceed the amounts needed for expenditures, the funds are credited with nonmarketable debt instruments, known as Government Account Series (GAS) securities, that are issued by the Treasury. At the end of fiscal year 2013, about $4.7 trillion in such securities was outstanding, more than 90 percent of which was held by trust funds.[1]

The federal budget has numerous trust funds, although most of the money credited to such funds goes to fewer than a dozen of them. By far the largest trust funds are the two for Social Security (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund), Medicare's Hospital Insurance Trust Fund, and the funds dedicated to the government's retirement programs for its military and civilian personnel (see Table F-1).

Ordinarily, when a trust fund receives cash that is not needed immediately to pay benefits or cover other expenses, the Treasury issues GAS securities in that amount to the fund and then uses the extra income to reduce the amount of new federal borrowing that is necessary to finance the governmentwide deficit. In other words, in the absence of changes to other tax and spending policies, the government borrows less from the public than it would without that extra net income. The reverse happens when revenues for a trust fund program fall short of expenses.

The balance of a trust fund at any given time is a measure of the historical relationship between the related program's receipts and expenditures. That balance (in the form of GAS securities) is an asset for the individual program, such as Social Security, but a liability for the rest of the government. The resources to redeem a trust fund's GAS securities—and thereby pay for benefits or other spending—in some future year must be generated through taxes, income from other government sources, or borrowing from the public in that year. Trust funds have an important legal meaning in that their balances are a measure of the amounts that the government has the legal authority to spend for certain purposes under current law, but they have little relevance in an economic or budgetary sense.

To assess how all federal activities, taken together, affect the economy and financial markets, it is useful to include the cash receipts and expenditures of trust funds in the budget totals along with the receipts and expenditures of other federal programs. Therefore, the Congressional Budget Office (CBO), the Office of Management and Budget, and other fiscal analysts generally focus on the total deficit in that "unified budget," which includes the transactions of trust funds.

According to CBO's current baseline projections, the value of securities held by federal trust funds will increase by $225 billion in fiscal year 2014. About half of that increase is attributable to investments made to the Civil Service Retirement and Disability Fund last October that normally would have been made in fiscal year 2013 but were not because of debt limit constraints.[2] CBO projects

1. Debt issued in the form of GAS securities is included in a measure of federal debt called gross debt. Because such debt is intragovernmental in nature, however, it is not included in the measure of debt held by the public. (For a discussion of different measures of federal debt, see Chapter 1.)

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

**Table F-1.**

## Trust Fund Balances Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | | | | | | | | | | | | |
| Old-Age and Survivors Insurance | 2,656 | 2,725 | 2,783 | 2,832 | 2,868 | 2,890 | 2,892 | 2,868 | 2,818 | 2,738 | 2,626 | 2,475 |
| Disability Insurance[a] | 101 | 70 | 39 | 6 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Subtotal | 2,756 | 2,795 | 2,821 | 2,838 | 2,868 | 2,890 | 2,892 | 2,868 | 2,818 | 2,738 | 2,626 | 2,475 |
| Medicare | | | | | | | | | | | | |
| Hospital Insurance (Part A) | 206 | 196 | 194 | 190 | 196 | 197 | 188 | 173 | 153 | 114 | 79 | 32 |
| Supplementary Medical Insurance (Part B) | 67 | 72 | 77 | 65 | 68 | 88 | 96 | 92 | 87 | 67 | 66 | 91 |
| Subtotal | 273 | 268 | 271 | 255 | 264 | 285 | 284 | 266 | 240 | 181 | 144 | 123 |
| Military Retirement | 421 | 475 | 542 | 610 | 688 | 777 | 868 | 966 | 1,070 | 1,177 | 1,297 | 1,430 |
| Civilian Retirement[b] | 738 | 871 | 886 | 900 | 915 | 932 | 949 | 966 | 985 | 1,003 | 1,023 | 1,044 |
| Unemployment Insurance | 29 | 31 | 28 | 33 | 37 | 39 | 38 | 35 | 27 | 21 | 15 | 7 |
| Highway and Mass Transit[a] | 2 | 3 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Airport and Airway | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 | 12 |
| Railroad Retirement (Treasury holdings)[c] | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 | 2 |
| Other[d] | 101 | 103 | 105 | 107 | 109 | 111 | 114 | 117 | 119 | 122 | 125 | 128 |
| **Total Trust Fund Balance** | **4,335** | **4,560** | **4,667** | **4,756** | **4,896** | **5,048** | **5,158** | **5,232** | **5,273** | **5,256** | **5,243** | **5,221** |
| **Memorandum:** | | | | | | | | | | | | |
| Railroad Retirement (Non-Treasury holdings)[c] | 25 | 25 | 24 | 23 | 22 | 21 | 20 | 19 | 18 | 17 | 17 | 16 |

Source: Congressional Budget Office.

Note: These balances are for the end of the fiscal year and include securities invested in Treasury holdings, unless otherwise noted.

a. In keeping with the rules in section 257 of the Deficit Control Act of 1985, CBO's baseline incorporates the assumption that payments will continue to be made after the trust fund has been exhausted, although there is no legal authority to make such payments. Because the manner by which those payments would continue would depend on future legislation, CBO shows zero rather than a cumulative negative balance in the trust fund after the exhaustion date.

b. Includes Civil Service Retirement, Foreign Service Retirement, and several smaller retirement trust funds.

c. The Railroad Retirement and Survivors' Improvement Act of 2001 established an entity, the National Railroad Retirement Investment Trust, that is allowed to invest in non-Treasury securities, such as stocks and corporate bonds.

d. Consists primarily of trust funds for federal employees' health and life insurance, Superfund, and various insurance programs for veterans.

that, in total, income credited to the trust funds will exceed outlays in each year from 2015 through 2020; however, spending from the trust funds is projected to exceed income in each year thereafter. All told, CBO projects a cumulative net surplus of $171 billion over the 2015–2024 period (see Table F-2). But that surplus would result, in part, from interest payments on the funds' GAS securities and other sums transferred from elsewhere in the budget. Such intragovernmental transfers—which are projected to total $646 billion in 2014 and to reach $1.1 trillion in 2024—reallocate costs from one category of the budget to another, but they do not directly change the total deficit or the government's borrowing needs. With those intragovernmental transfers excluded and only income from sources outside the government (such as payroll taxes) counted, the trust funds will add to federal deficits throughout the 2015–2024 period by amounts that grow from $572 billion in 2015 to $1.2 trillion in 2024, CBO projects.

Without legislative action, two trust funds are projected to be exhausted during that period: Social Security's Disability Insurance Trust Fund and the Highway Trust Fund.

**Table F-2.**

## Trust Fund Surpluses or Deficits Projected in CBO's Baseline

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | | | | | | | | | | | | | | |
| Old-Age and Survivors Insurance | 69 | 69 | 58 | 49 | 37 | 21 | 2 | -23 | -50 | -80 | -112 | -151 | 167 | -250 |
| Disability Insurance[a] | -32 | -30 | -32 | -33 | -34 | -35 | -36 | -37 | -40 | -44 | -48 | -52 | -169 | -389 |
| Subtotal | 37 | 39 | 26 | 17 | 2 | -14 | -33 | -60 | -91 | -124 | -160 | -203 | -2 | -639 |
| Medicare | | | | | | | | | | | | | | |
| Hospital Insurance (Part A) | -22 | -10 | -2 | -3 | 6 | 1 | -9 | -14 | -21 | -39 | -35 | -47 | -8 | -164 |
| Supplementary Medical Insurance (Part B) | -2 | 4 | 5 | -12 | 3 | 20 | 8 | -4 | -5 | -21 | -1 | 26 | 24 | 20 |
| Subtotal | -24 | -6 | 3 | -16 | 9 | 21 | -2 | -18 | -26 | -59 | -36 | -22 | 16 | -145 |
| Military Retirement | 45 | 53 | 67 | 68 | 78 | 89 | 91 | 98 | 104 | 107 | 120 | 133 | 394 | 956 |
| Civilian Retirement[b] | -107 | 133 | 14 | 14 | 16 | 16 | 17 | 18 | 18 | 19 | 19 | 21 | 77 | 173 |
| Unemployment Insurance | 9 | 2 | -3 | 5 | 4 | 2 | -1 | -3 | -7 | -7 | -6 | -7 | 6 | -24 |
| Highway and Mass Transit[a] | -8 | 1 | -16 | -16 | -15 | -16 | -17 | -17 | -18 | -19 | -20 | -20 | -80 | -174 |
| Airport and Airway | 1 | * | * | * | * | * | * | * | * | * | * | * | * | * |
| Other[c] | 4 | 3 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 3 | 3 | 3 | 11 | 25 |
| **Total Trust Fund Surplus or Deficit** | **-42** | **225** | **93** | **74** | **96** | **102** | **58** | **19** | **-17** | **-81** | **-80** | **-93** | **423** | **171** |
| Intragovernmental Transfers to Trust Funds[d] | 643 | 646 | 665 | 690 | 722 | 760 | 813 | 862 | 916 | 980 | 1,021 | 1,057 | 3,651 | 8,486 |
| **Net Budgetary Impact of Trust Fund Programs** | **-685** | **-421** | **-572** | **-617** | **-626** | **-659** | **-755** | **-842** | **-933** | **-1,061** | **-1,101** | **-1,150** | **-3,228** | **-8,316** |

Source: Congressional Budget Office.

Notes: Negative numbers indicate that the trust fund transactions add to total budget deficits.

* = between -$500 million and $500 million.

a. CBO projects that this trust fund will be exhausted during the 2015–2024 period. However, in keeping with the rules in section 257 of the Deficit Control Act of 1985, CBO's baseline incorporates the assumption that payments will continue to be made after the trust fund has been exhausted, although there is no legal authority to make such payments. The manner by which those payments would continue would depend on future legislation.

b. Includes Civil Service Retirement, Foreign Service Retirement, and several smaller retirement trust funds.

c. Consists primarily of trust funds for railroad workers' retirement, federal employees' health and life insurance, Superfund, and various insurance programs for veterans.

d. Includes interest paid to trust funds, payments from the Treasury's general fund to the Supplementary Medical Insurance Trust Fund, the government's share of payments for federal employees' retirement, lump-sum payments to the Civil Service and Military Retirement Trust Funds, taxes on Social Security benefits, and smaller miscellaneous payments.

# Social Security Trust Funds

Social Security provides benefits to retired workers, their families, and some survivors of deceased workers through the Old-Age and Survivors Insurance (OASI) program; it also provides benefits to some people with disabilities and their families through the Disability Insurance (DI) program. Those benefits are financed mainly through payroll taxes collected on workers' earnings, at a rate of 12.4 percent—6.2 percent of which is paid by the worker and 6.2 percent by the employer.

## Old-Age and Survivors Insurance

The OASI trust fund is by far the largest of all federal trust funds, with nearly $2.7 trillion in holdings of GAS securities at the end of 2013. CBO projects that the fund's annual income, excluding interest on those

**Table F-3.**

## Balances Projected in CBO's Baseline for the OASI, DI, and HI Trust Funds

(Billions of dollars)

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | Total 2015-2019 | Total 2015-2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Old-Age and Survivors Insurance Trust Fund** | | | | | | | | | | | | | | |
| Beginning-of-Year Balance | 2,587 | 2,656 | 2,725 | 2,783 | 2,832 | 2,868 | 2,890 | 2,892 | 2,868 | 2,818 | 2,738 | 2,626 | n.a. | n.a. |
| Income (Excluding interest) | 640 | 677 | 703 | 736 | 770 | 807 | 842 | 878 | 915 | 954 | 994 | 1,032 | 3,859 | 8,633 |
| Expenditures | -671 | -705 | -741 | -783 | -834 | -889 | -949 | -1,014 | -1,080 | -1,148 | -1,219 | -1,294 | -4,196 | -9,951 |
| Noninterest Deficit | -31 | -28 | -38 | -47 | -63 | -82 | -107 | -136 | -164 | -194 | -225 | -261 | -338 | -1,318 |
| Interest Received | 100 | 98 | 95 | 97 | 100 | 104 | 109 | 112 | 114 | 114 | 113 | 111 | 505 | 1,069 |
| Total Surplus or Deficit | 69 | 69 | 58 | 49 | 37 | 21 | 2 | -23 | -50 | -80 | -112 | -151 | 167 | -250 |
| **End-of-Year Balance** | **2,656** | **2,725** | **2,783** | **2,832** | **2,868** | **2,890** | **2,892** | **2,868** | **2,818** | **2,738** | **2,626** | **2,475** | **n.a.** | **n.a.** |
| **Disability Insurance Trust Fund[a]** | | | | | | | | | | | | | | |
| Beginning-of-Year Balance | 132 | 101 | 70 | 39 | 6 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | n.a. | n.a. |
| Income (Excluding interest) | 106 | 112 | 116 | 121 | 127 | 133 | 138 | 144 | 150 | 156 | 162 | 169 | 635 | 1,415 |
| Expenditures | -143 | -146 | -151 | -156 | -162 | -167 | -174 | -181 | -190 | -200 | -210 | -220 | -810 | -1,810 |
| Noninterest Deficit | -37 | -35 | -35 | -35 | -35 | -35 | -36 | -37 | -40 | -44 | -48 | -52 | -175 | -395 |
| Interest Received | 6 | 4 | 3 | 2 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 6 | 6 |
| Total Surplus or Deficit | -32 | -30 | -32 | -33 | -34 | -35 | -36 | -37 | -40 | -44 | -48 | -52 | -169 | -389 |
| **End-of-Year Balance** | **101** | **70** | **39** | **6** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **n.a.** | **n.a.** |
| **Hospital Insurance Trust Fund** | | | | | | | | | | | | | | |
| Beginning-of-Year Balance | 228 | 206 | 196 | 194 | 190 | 196 | 197 | 188 | 173 | 153 | 114 | 79 | n.a. | n.a. |
| Income (Excluding interest) | 245 | 267 | 280 | 295 | 311 | 328 | 344 | 361 | 379 | 398 | 418 | 437 | 1,559 | 3,553 |
| Expenditures | -277 | -287 | -292 | -308 | -315 | -336 | -363 | -384 | -408 | -444 | -459 | -487 | -1,615 | -3,797 |
| Noninterest Deficit | -32 | -20 | -12 | -13 | -4 | -9 | -19 | -23 | -29 | -46 | -41 | -51 | -56 | -245 |
| Interest Received | 10 | 10 | 10 | 10 | 10 | 10 | 9 | 9 | 8 | 7 | 5 | 4 | 48 | 80 |
| Total Surplus or Deficit | -22 | -10 | -2 | -3 | 6 | 1 | -9 | -14 | -21 | -39 | -35 | -47 | -8 | -164 |
| **End-of-Year Balance** | **206** | **196** | **194** | **190** | **196** | **197** | **188** | **173** | **153** | **114** | **79** | **32** | **n.a.** | **n.a.** |

Source: Congressional Budget Office.

Note: Balances shown are invested in Treasury Government Account Series securities; n.a. = not applicable.

a. In keeping with the rules in section 257 of the Deficit Control Act of 1985, CBO's baseline incorporates the assumption that payments will continue to be made after the trust fund has been exhausted, although there is no legal authority to make such payments. Because the manner by which those payments would continue would depend on future legislation, CBO shows zero rather than a cumulative negative balance in the trust fund after the exhaustion date.

securities, will amount to $677 billion in 2014 and increase to more than $1.0 trillion by 2024 (see Table F-3).[3] Annual expenditures from the fund are projected to be greater and to grow faster than non-interest income, rising from $705 billion in 2014 to about $1.3 trillion in 2024. As a result, the annual cash flows of the OASI program, excluding interest credited to the trust fund, will add to federal deficits in every year of the coming decade by amounts that will grow to $261 billion in 2024, CBO estimates. With interest receipts included, the OASI trust fund will show a

3. Although it is an employer, the federal government does not pay taxes. However, it makes an intragovernmental transfer from the general fund of the Treasury to the OASI and DI trust funds to cover the employer's share of the Social Security payroll tax for federal workers. That transfer is included in the income line in Table F-3.

surplus in every year through 2019, but by amounts that will decline over that period. By 2020, even taking into account interest receipts, the trust fund is projected to start recording deficits that will reach about $150 billion in 2024 (see Figure F-1).

### Disability Insurance

Because the DI program is much smaller than OASI, the DI trust fund is much smaller than the OASI fund, with a balance of $101 billion at the end of 2013. In its current baseline, CBO projects that, excluding interest, the DI fund will have yearly income of $112 billion in 2014, which will increase to $169 billion in 2024 (see Table F-3). As with the OASI fund, annual expenditures from the DI fund are expected to be higher than non-interest income, totaling $146 billion in 2014 and rising steadily to $220 billion in 2024. Thus, the annual cash flows of the DI program, excluding interest, will also add to federal deficits in each year of the projection period, by amounts ranging from $35 billion to $52 billion, CBO estimates. Even with interest receipts included, the DI trust fund is expected to run a yearly deficit throughout that period (see Figure F-1). In the absence of legislative action, the balance of the DI fund will be exhausted in 2017, CBO projects (the same year projected in the agency's previous baseline, published in May 2013).

## Medicare Trust Funds

Cash flows for payments to hospitals and payments for other services covered by Medicare are accounted for in two trust funds. The Hospital Insurance (HI) Trust Fund accounts for payments made to hospitals and providers of post-acute care services under Part A of the Medicare program, and the Supplementary Medical Insurance (SMI) Trust Fund accounts for payments made for outpatient services, prescription drugs, and other services under Parts B and D of Medicare.[4]

### Hospital Insurance

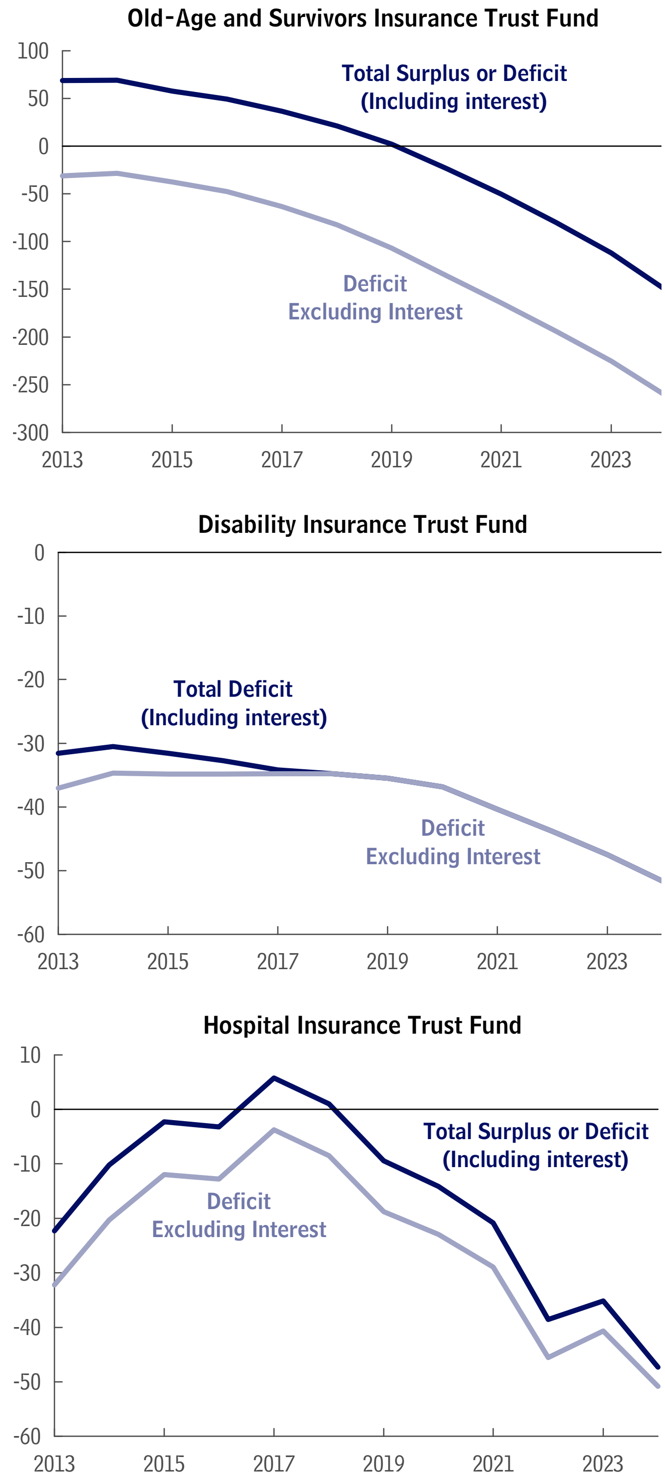
The HI fund is the larger of the two Medicare trust funds, with a balance of $206 billion at the end of 2013. The fund's income is derived largely from the Medicare payroll tax (2.9 percent of workers' earnings, divided equally between the worker and the employer); in 2013 those taxes accounted for 87 percent of the $245 billion

4. Part C of Medicare (known as Medicare Advantage) specifies the rules under which private health care plans can assume responsibility for, and be compensated for, providing benefits covered under Parts A, B, and D.

**Figure F-1.**

**Annual Surpluses or Deficits Projected in CBO's Baseline for the OASI, DI, and HI Trust Funds**

(Billions of dollars)




Source: Congressional Budget Office.

in noninterest income credited to the HI trust fund.[5] Another 6 percent came from part of the income taxes on Social Security benefits collected from beneficiaries with relatively high income. The remaining 7 percent of non-interest income credited to the HI trust fund consisted largely of premiums paid by beneficiaries; amounts paid to providers and later recovered; fines, penalties, and other amounts collected by the Health Care Fraud and Abuse Control program; and other transfers and appropriations. In addition, the trust fund is credited with interest on its balances; that interest amounted to $10 billion in 2013.

The fund's noninterest income is projected to increase from $267 billion in 2014 to $437 billion in 2024. Annual expenditures from the HI fund are projected to grow from $287 billion in 2014 to $487 billion in 2024. CBO expects expenditures to outstrip income, excluding interest, throughout the 2014–2024 period, producing annual deficits that reach a low of $4 billion in 2017 but rise thereafter to $51 billion in 2024. Including interest receipts, the trust fund is expected to run deficits in most years during the baseline period (see Table F-3 on page 146 and Figure F-1 on page 147). By 2024, CBO projects, the fund's balance will be down to $32 billion.

### Supplementary Medical Insurance

The SMI trust fund contains two separate accounts: one that pays for physicians' services and other health care provided on an outpatient basis under Part B of Medicare (Medical Insurance) and one that pays for prescription drug benefits under Part D. The funding mechanisms used for the two accounts differ slightly:

- The Part B portion of the SMI fund is financed primarily through transfers from the general fund of the Treasury and through monthly premium payments from Medicare beneficiaries. The basic monthly premium for the SMI program is set to cover approximately 25 percent of the program's spending (with adjustments to maintain a contingency reserve to cover unexpected spikes in spending); an additional premium is assessed on beneficiaries with relatively high income. The amount transferred from the general fund equals about three times the amount expected to be collected from basic premiums minus the amount collected from the income-related premiums and fees from drug manufacturers.
- The Part D portion of the SMI fund is financed mainly through transfers from the general fund, monthly premium payments from beneficiaries, and transfers from states (which are based on the number of people in a state who would have received prescription drug coverage under Medicaid in the absence of Part D). The basic monthly premium for Part D is set to cover 25.5 percent of the program's estimated spending, under the assumption that all participants would pay it. However, people who receive low-income subsidies available under Part D are not required to pay Part D premiums, so receipts are projected to cover less than 25.5 percent of the program's costs. Higher-income participants in Part D pay an income-related premium. The amount transferred from the general fund is set to cover total expected spending for benefits and administrative costs, net of the amounts transferred from states and collected from basic and income-related premiums.

Unlike the HI trust fund, the accounts in the SMI fund are not dependent solely on a specified set of revenues collected from the public. The amounts credited to those accounts from the general fund of the Treasury are automatically adjusted to cover the differences between program spending and specified revenues. Thus, the SMI fund cannot be exhausted.

The Part B account of the SMI fund currently holds $67 billion in GAS securities. Including the contingency reserve that is maintained to cover unanticipated increases in spending, the balance in the fund is expected to reach $91 billion in 2024.

## Highway Trust Fund

The Highway Trust Fund comprises two accounts: the highway account, which funds construction of highways and highway safety programs, and the transit account, which funds mass transit programs. Revenues credited to those accounts are derived mostly from excise taxes on gasoline and certain other motor fuels, which account for more than 85 percent of all receipts to the trust fund.[6]

5. As it does with the Social Security payroll tax, the federal government makes an intragovernmental transfer from the general fund of the Treasury to the HI trust fund to cover the employer's share of the Medicare payroll tax for federal workers.

6. The other revenues credited to the Highway Trust Fund come from excise taxes on trucks and trailers, on truck tires, and on the use of certain kinds of vehicles.

Almost all spending from the fund is controlled by limitations on obligations set in appropriation acts. Over the past seven years, that spending has exceeded the fund's revenues by $49 billion. In addition, CBO expects spending to exceed revenues by $14 billion in 2014. Consequently, from 2008 through 2014—including amounts transferred in accordance with the most recent authorization for highway and transit programs—lawmakers authorized a series of transfers to the Highway Trust Fund to keep that fund from being exhausted. Those transfers totaled more than $54 billion, mostly from the general fund of the Treasury.

For its baseline spending projections, CBO assumes that future limitations on obligations will be equal to amounts set for 2014, adjusted annually for inflation. Under those circumstances, and without other legislative action, the two accounts would be unable to meet obligations in a timely manner at some point in 2015, although it is possible that the highway account will have to delay certain payments during the latter half of 2014.

## Other Trust Funds

Among the remaining trust funds in the federal budget, the largest balances are held by various civilian retirement funds (a total of $738 billion at the end of 2013) and by the Military Retirement Trust Fund ($421 billion).[7] In its current baseline, CBO projects that the balances of those funds will increase steadily over the coming decade, reaching $1.0 trillion for the civilian funds and $1.4 trillion for the military retirement fund in 2024, about the same size in total as the balance of the OASI trust fund (see Table F-1 on page 144). Unlike the Social Security and Medicare trust funds, these funds are projected to run surpluses throughout the coming decade; in 2024, the surplus for the military retirement fund will reach $133 billion and that for the civilian funds will total $21 billion.

7. Those civilian retirement funds include the Civil Service Retirement Trust Fund, the Foreign Service Retirement Trust Fund, and several smaller retirement funds.

APPENDIX

G

# CBO's Economic Projections for 2014 to 2024

The tables in this appendix expand on the information in Chapter 2 by showing the Congressional Budget Office's (CBO's) economic projections for each year from 2014 to 2024 (by calendar year in Table G-1 and by fiscal year in Table G-2). For years after 2017, CBO did not attempt to forecast the frequency or size of fluctuations in the business cycle. Instead, the values shown in these tables for 2018 to 2024 reflect CBO's assessment of the effects in the medium term of economic and demographic trends, federal tax and spending policies under current law, the 2007–2009 recession, and the slow economic recovery since then.

**Table G-1.**

## CBO's Economic Projections, by Calendar Year

| | Estimated, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | Year to Year (Percentage change) | | | | | | | |
| Gross Domestic Product | | | | | | | | | | | | |
| Real | 1.7 | 2.7 | 3.3 | 3.4 | 3.0 | 2.4 | 2.3 | 2.2 | 2.2 | 2.1 | 2.1 | 2.0 |
| Nominal | 3.2 | 4.2 | 5.1 | 5.3 | 4.9 | 4.4 | 4.3 | 4.2 | 4.2 | 4.2 | 4.1 | 4.1 |
| Inflation | | | | | | | | | | | | |
| PCE price index | 1.1 | 1.3 | 1.7 | 1.8 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Core PCE price index[a] | 1.2 | 1.4 | 1.8 | 1.9 | 1.9 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Consumer price index[b] | 1.5 [c] | 1.7 | 2.0 | 2.1 | 2.2 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Core consumer price index[a] | 1.8 [c] | 1.8 | 2.1 | 2.2 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| GDP price index | 1.4 | 1.5 | 1.7 | 1.8 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Employment Cost Index[d] | 1.9 | 2.3 | 3.0 | 3.5 | 3.8 | 3.9 | 3.8 | 3.8 | 3.7 | 3.7 | 3.6 | 3.6 |
| | | | | | Calendar Year Average | | | | | | | |
| Unemployment Rate (Percent) | 7.4 [c] | 6.8 | 6.5 | 6.1 | 5.9 | 5.8 | 5.7 | 5.7 | 5.6 | 5.6 | 5.5 | 5.5 |
| Payroll Employment (Monthly change, in thousands)[e] | 190 [c] | 164 | 160 | 141 | 124 | 85 | 58 | 56 | 61 | 71 | 68 | 67 |
| Interest Rates (Percent) | | | | | | | | | | | | |
| Three-month Treasury bills | 0.1 [c] | 0.2 | 0.4 | 1.8 | 3.3 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 |
| Ten-year Treasury notes | 2.4 [c] | 3.1 | 3.7 | 4.3 | 4.8 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Tax Bases (Percentage of GDP) | | | | | | | | | | | | |
| Wages and salaries | 42.6 | 42.6 | 42.5 | 42.5 | 42.6 | 42.8 | 42.9 | 43.0 | 43.1 | 43.2 | 43.3 | 43.5 |
| Domestic economic profits | 9.9 | 9.5 | 9.5 | 9.5 | 9.0 | 8.5 | 8.1 | 7.8 | 7.5 | 7.3 | 7.2 | 7.0 |
| Tax Bases (Billions of dollars) | | | | | | | | | | | | |
| Wages and salaries | 7,141 | 7,438 | 7,807 | 8,220 | 8,648 | 9,072 | 9,479 | 9,899 | 10,336 | 10,801 | 11,280 | 11,777 |
| Domestic economic profits | 1,657 | 1,667 | 1,740 | 1,837 | 1,829 | 1,791 | 1,782 | 1,788 | 1,809 | 1,833 | 1,874 | 1,905 |
| Nominal GDP (Billions of dollars) | 16,769 | 17,472 | 18,357 | 19,329 | 20,281 | 21,180 | 22,097 | 23,035 | 23,998 | 25,000 | 26,036 | 27,095 |

Source: Congressional Budget Office.

Notes: Estimated values for 2013 do not reflect the values for GDP and related series released by the Bureau of Economic Analysis since early December 2013.

PCE = personal consumption expenditures; GDP = gross domestic product.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. Actual value for 2013. (Actual values come from the Bureau of Labor Statistics and the Federal Reserve.)

d. The employment cost index for wages and salaries of workers in private industry.

e. Calculated as the monthly average of the fourth-quarter-to-fourth-quarter change in the quarterly average level of payroll employment.

**Table G-2.**

## CBO's Economic Projections, by Fiscal Year

| | Actual, 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Year to Year (Percentage change) | | | | | | | | | | | |
| Gross Domestic Product | | | | | | | | | | | | |
| Real | 1.7 | 2.4 | 3.3 | 3.4 | 3.1 | 2.5 | 2.3 | 2.2 | 2.2 | 2.1 | 2.1 | 2.1 |
| Nominal | 3.3 | 3.9 | 4.9 | 5.3 | 5.1 | 4.5 | 4.4 | 4.3 | 4.2 | 4.2 | 4.2 | 4.1 |
| Inflation | | | | | | | | | | | | |
| PCE price index | 1.3 | 1.2 | 1.6 | 1.8 | 1.8 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Core PCE price index[a] | 1.4 | 1.3 | 1.7 | 1.9 | 1.9 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Consumer price index[b] | 1.6 | 1.5 | 1.9 | 2.1 | 2.2 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 | 2.4 |
| Core consumer price index[a] | 1.8 | 1.8 | 2.0 | 2.2 | 2.2 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| GDP price index | 1.5 | 1.5 | 1.6 | 1.8 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Employment Cost Index[c] | 1.8 | 2.2 | 2.9 | 3.4 | 3.8 | 3.9 | 3.8 | 3.8 | 3.8 | 3.7 | 3.6 | 3.6 |
| | Fiscal Year Average | | | | | | | | | | | |
| Unemployment Rate (Percent) | 7.6 | 6.9 | 6.6 | 6.2 | 5.9 | 5.8 | 5.7 | 5.7 | 5.6 | 5.6 | 5.5 | 5.5 |
| Payroll Employment (Monthly change, in thousands)[d] | 187 | 172 | 160 | 147 | 126 | 101 | 58 | 57 | 58 | 70 | 69 | 68 |
| Interest Rates (Percent) | | | | | | | | | | | | |
| Three-month Treasury bills | 0.1 | 0.1 | 0.2 | 1.4 | 3.0 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 | 3.7 |
| Ten-year Treasury notes | 2.1 | 3.0 | 3.6 | 4.2 | 4.7 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Tax Bases (Percentage of GDP) | | | | | | | | | | | | |
| Wages and salaries | 42.7 | 42.6 | 42.5 | 42.5 | 42.6 | 42.8 | 42.9 | 43.0 | 43.0 | 43.2 | 43.3 | 43.4 |
| Domestic economic profits | 10.0 | 9.5 | 9.5 | 9.5 | 9.2 | 8.6 | 8.1 | 7.8 | 7.6 | 7.4 | 7.2 | 7.1 |
| Tax Bases (Billions of dollars) | | | | | | | | | | | | |
| Wages and salaries | 7,102 | 7,359 | 7,708 | 8,115 | 8,540 | 8,967 | 9,378 | 9,792 | 10,225 | 10,683 | 11,159 | 11,651 |
| Domestic economic profits | 1,661 | 1,642 | 1,724 | 1,819 | 1,842 | 1,797 | 1,781 | 1,785 | 1,804 | 1,826 | 1,864 | 1,899 |
| Nominal GDP (Billions of dollars) | 16,632 | 17,273 | 18,126 | 19,083 | 20,052 | 20,954 | 21,867 | 22,799 | 23,755 | 24,746 | 25,774 | 26,830 |

Sources: Congressional Budget Office; Bureau of Economic Analysis; Bureau of Labor Statistics; Federal Reserve.

Note: PCE = personal consumption expenditures; GDP = gross domestic product.

a. Excludes prices for food and energy.

b. The consumer price index for all urban consumers.

c. The employment cost index for wages and salaries of workers in private industry.

d. Calculated as the monthly average of the fourth-quarter-to-fourth-quarter change in the quarterly average level of payroll employment.

APPENDIX

# H

# Historical Budget Data

This appendix provides historical data on revenues, outlays, and the deficit or surplus—in forms consistent with the projections in Chapters 1, 3, and 4—for fiscal years 1974 to 2013. The data, which come from the Congressional Budget Office and the Office of Management and Budget, are shown both in nominal dollars and as a percentage of gross domestic product (GDP). Some of the numbers have been revised since August 2013, when these tables were previously published on CBO's website (www.cbo.gov). The percentages of GDP shown in these tables (and in those published in August) reflect the comprehensive revision of the national income and product accounts that the Bureau of Economic Analysis released in July 2013. The net effect of that revision was to increase the value of nominal GDP throughout the 1974–2013 period. (For a description of that revision, see Box 2-1 on page 29.)

Federal revenues, outlays, the deficit or surplus, and debt held by the public are shown in Table H-1. Revenues, outlays, and the deficit or surplus have both on-budget and off-budget components. Social Security's receipts and outlays were placed off-budget by the Balanced Budget and Emergency Deficit Control Act of 1985. For the sake of consistency, Table H-1 shows the budgetary components of Social Security as off-budget before that year. The Postal Service was classified as off-budget by the Omnibus Budget Reconciliation Act of 1989.

The major sources of federal revenues (including off-budget revenues) are presented in Table H-2 on page 158. Social insurance taxes include payments by employers and employees for Social Security, Medicare, Railroad Retirement, and unemployment insurance, as well as pension contributions by federal workers. Excise taxes are levied on certain products and services, such as gasoline, alcoholic beverages, and air travel. Estate and gift taxes are levied on assets when they are transferred. Miscellaneous receipts consist of earnings of the Federal Reserve System and income from numerous fees and charges.

Total outlays for major categories of spending (including off-budget outlays) appear in Table H-3 on page 160. Spending controlled by the appropriation process is classified as discretionary. Spending governed by laws other than appropriation acts, such as laws that set eligibility requirements for certain programs, is considered mandatory. Offsetting receipts include the government's contributions to retirement programs for its employees, as well as fees, charges (such as Medicare premiums), and receipts from the use of federally controlled land and offshore territory. Net interest (function 900 of the budget) consists mostly of the government's interest payments on federal debt offset by its interest income.

Table H-4 on page 162 divides discretionary spending into its defense and nondefense components. Table H-5 on page 164 shows mandatory outlays for three major benefit programs—Social Security, Medicare, and Medicaid—and for other categories of mandatory spending. Income security programs provide benefits to recipients with limited income and assets; those programs include unemployment compensation, Supplemental Security Income, and the Supplemental Nutrition Assistance Program (formerly known as Food Stamps). Other federal retirement and disability programs provide benefits to federal civilian employees, members of the military, and veterans. The category of other mandatory programs includes the activities of the Commodity Credit Corporation, the Medicare-Eligible Retiree Health Care Fund, the subsidy costs of federal student loan programs, the Children's Health Insurance Program, and programs related to the federal government's response to problems in the housing and financial markets.

**Table H-1.**

## Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public Since 1974

| | Revenues | Outlays | Deficit (-) or Surplus: On-Budget | Deficit (-) or Surplus: Social Security | Deficit (-) or Surplus: Postal Service | Deficit (-) or Surplus: Total | Debt Held by the Public[a] |
|---|---|---|---|---|---|---|---|
| | | | In Billions of Dollars | | | | |
| 1974 | 263.2 | 269.4 | -7.2 | 1.8 | -0.8 | -6.1 | 343.7 |
| 1975 | 279.1 | 332.3 | -54.1 | 2.0 | -1.1 | -53.2 | 394.7 |
| 1976 | 298.1 | 371.8 | -69.4 | -3.2 | -1.1 | -73.7 | 477.4 |
| 1977 | 355.6 | 409.2 | -49.9 | -3.9 | 0.2 | -53.7 | 549.1 |
| 1978 | 399.6 | 458.7 | -55.4 | -4.3 | 0.5 | -59.2 | 607.1 |
| 1979 | 463.3 | 504.0 | -39.6 | -2.0 | 0.9 | -40.7 | 640.3 |
| 1980 | 517.1 | 590.9 | -73.1 | -1.1 | 0.4 | -73.8 | 711.9 |
| 1981 | 599.3 | 678.2 | -73.9 | -5.0 | -0.1 | -79.0 | 789.4 |
| 1982 | 617.8 | 745.7 | -120.6 | -7.9 | 0.6 | -128.0 | 924.6 |
| 1983 | 600.6 | 808.4 | -207.7 | 0.2 | -0.3 | -207.8 | 1,137.3 |
| 1984 | 666.4 | 851.8 | -185.3 | 0.3 | -0.4 | -185.4 | 1,307.0 |
| 1985 | 734.0 | 946.3 | -221.5 | 9.4 | -0.1 | -212.3 | 1,507.3 |
| 1986 | 769.2 | 990.4 | -237.9 | 16.7 | * | -221.2 | 1,740.6 |
| 1987 | 854.3 | 1,004.0 | -168.4 | 19.6 | -0.9 | -149.7 | 1,889.8 |
| 1988 | 909.2 | 1,064.4 | -192.3 | 38.8 | -1.7 | -155.2 | 2,051.6 |
| 1989 | 991.1 | 1,143.7 | -205.4 | 52.4 | 0.3 | -152.6 | 2,190.7 |
| 1990 | 1,032.0 | 1,253.0 | -277.6 | 58.2 | -1.6 | -221.0 | 2,411.6 |
| 1991 | 1,055.0 | 1,324.2 | -321.4 | 53.5 | -1.3 | -269.2 | 2,689.0 |
| 1992 | 1,091.2 | 1,381.5 | -340.4 | 50.7 | -0.7 | -290.3 | 2,999.7 |
| 1993 | 1,154.3 | 1,409.4 | -300.4 | 46.8 | -1.4 | -255.1 | 3,248.4 |
| 1994 | 1,258.6 | 1,461.8 | -258.8 | 56.8 | -1.1 | -203.2 | 3,433.1 |
| 1995 | 1,351.8 | 1,515.7 | -226.4 | 60.4 | 2.0 | -164.0 | 3,604.4 |
| 1996 | 1,453.1 | 1,560.5 | -174.0 | 66.4 | 0.2 | -107.4 | 3,734.1 |
| 1997 | 1,579.2 | 1,601.1 | -103.2 | 81.3 | * | -21.9 | 3,772.3 |
| 1998 | 1,721.7 | 1,652.5 | -29.9 | 99.4 | -0.2 | 69.3 | 3,721.1 |
| 1999 | 1,827.5 | 1,701.8 | 1.9 | 124.7 | -1.0 | 125.6 | 3,632.4 |
| 2000 | 2,025.2 | 1,789.0 | 86.4 | 151.8 | -2.0 | 236.2 | 3,409.8 |
| 2001 | 1,991.1 | 1,862.8 | -32.4 | 163.0 | -2.3 | 128.2 | 3,319.6 |
| 2002 | 1,853.1 | 2,010.9 | -317.4 | 159.0 | 0.7 | -157.8 | 3,540.4 |
| 2003 | 1,782.3 | 2,159.9 | -538.4 | 155.6 | 5.2 | -377.6 | 3,913.4 |
| 2004 | 1,880.1 | 2,292.8 | -568.0 | 151.1 | 4.1 | -412.7 | 4,295.5 |
| 2005 | 2,153.6 | 2,472.0 | -493.6 | 173.5 | 1.8 | -318.3 | 4,592.2 |
| 2006 | 2,406.9 | 2,655.1 | -434.5 | 185.2 | 1.1 | -248.2 | 4,829.0 |
| 2007 | 2,568.0 | 2,728.7 | -342.2 | 186.5 | -5.1 | -160.7 | 5,035.1 |
| 2008 | 2,524.0 | 2,982.5 | -641.8 | 185.7 | -2.4 | -458.6 | 5,803.1 |
| 2009 | 2,105.0 | 3,517.7 | -1,549.7 | 137.3 | -0.3 | -1,412.7 | 7,544.7 |
| 2010 | 2,162.7 | 3,457.1 | -1,371.4 | 81.7 | -4.7 | -1,294.4 | 9,018.9 |
| 2011 | 2,303.5 | 3,603.1 | -1,366.8 | 68.0 | -0.8 | -1,299.6 | 10,128.2 |
| 2012 | 2,450.2 | 3,537.1 | -1,148.9 | 64.6 | -2.7 | -1,087.0 | 11,281.1 |
| 2013 | 2,774.0 | 3,454.3 | -719.8 | 37.6 | 1.9 | -680.3 | 11,981.9 |

Continued

**Table H-1.** **Continued**

## Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public Since 1974

| | | | Deficit (-) or Surplus | | | | |
|---|---|---|---|---|---|---|---|
| | Revenues | Outlays | On-Budget | Social Security | Postal Service | Total | Debt Held by the Public[a] |
| | | | As a Percentage of Gross Domestic Product | | | | |
| 1974 | 17.7 | 18.1 | -0.5 | 0.1 | -0.1 | -0.4 | 23.1 |
| 1975 | 17.3 | 20.6 | -3.4 | 0.1 | -0.1 | -3.3 | 24.5 |
| 1976 | 16.6 | 20.8 | -3.9 | -0.2 | -0.1 | -4.1 | 26.7 |
| 1977 | 17.5 | 20.2 | -2.5 | -0.2 | ** | -2.6 | 27.1 |
| 1978 | 17.5 | 20.1 | -2.4 | -0.2 | ** | -2.6 | 26.6 |
| 1979 | 18.0 | 19.6 | -1.5 | -0.1 | ** | -1.6 | 24.9 |
| 1980 | 18.5 | 21.1 | -2.6 | ** | ** | -2.6 | 25.5 |
| 1981 | 19.1 | 21.6 | -2.4 | -0.2 | ** | -2.5 | 25.2 |
| 1982 | 18.6 | 22.5 | -3.6 | -0.2 | ** | -3.9 | 27.9 |
| 1983 | 17.0 | 22.8 | -5.9 | ** | ** | -5.9 | 32.1 |
| 1984 | 16.9 | 21.5 | -4.7 | ** | ** | -4.7 | 33.1 |
| 1985 | 17.2 | 22.2 | -5.2 | 0.2 | ** | -5.0 | 35.3 |
| 1986 | 17.0 | 21.8 | -5.2 | 0.4 | ** | -4.9 | 38.4 |
| 1987 | 17.9 | 21.0 | -3.5 | 0.4 | ** | -3.1 | 39.5 |
| 1988 | 17.6 | 20.6 | -3.7 | 0.8 | ** | -3.0 | 39.8 |
| 1989 | 17.8 | 20.5 | -3.7 | 0.9 | ** | -2.7 | 39.3 |
| 1990 | 17.4 | 21.2 | -4.7 | 1.0 | ** | -3.7 | 40.8 |
| 1991 | 17.3 | 21.7 | -5.3 | 0.9 | ** | -4.4 | 44.0 |
| 1992 | 17.0 | 21.5 | -5.3 | 0.8 | ** | -4.5 | 46.6 |
| 1993 | 17.0 | 20.7 | -4.4 | 0.7 | ** | -3.8 | 47.8 |
| 1994 | 17.5 | 20.3 | -3.6 | 0.8 | ** | -2.8 | 47.7 |
| 1995 | 17.8 | 20.0 | -3.0 | 0.8 | ** | -2.2 | 47.5 |
| 1996 | 18.2 | 19.6 | -2.2 | 0.8 | ** | -1.3 | 46.8 |
| 1997 | 18.6 | 18.9 | -1.2 | 1.0 | ** | -0.3 | 44.5 |
| 1998 | 19.2 | 18.5 | -0.3 | 1.1 | ** | 0.8 | 41.6 |
| 1999 | 19.2 | 17.9 | 0.0 | 1.3 | ** | 1.3 | 38.2 |
| 2000 | 19.9 | 17.6 | 0.9 | 1.5 | ** | 2.3 | 33.6 |
| 2001 | 18.8 | 17.6 | -0.3 | 1.5 | ** | 1.2 | 31.4 |
| 2002 | 17.0 | 18.5 | -2.9 | 1.5 | ** | -1.5 | 32.5 |
| 2003 | 15.7 | 19.1 | -4.8 | 1.4 | ** | -3.3 | 34.5 |
| 2004 | 15.6 | 19.0 | -4.7 | 1.2 | ** | -3.4 | 35.5 |
| 2005 | 16.7 | 19.2 | -3.8 | 1.3 | ** | -2.5 | 35.6 |
| 2006 | 17.6 | 19.4 | -3.2 | 1.4 | ** | -1.8 | 35.3 |
| 2007 | 17.9 | 19.0 | -2.4 | 1.3 | ** | -1.1 | 35.1 |
| 2008 | 17.1 | 20.2 | -4.3 | 1.3 | ** | -3.1 | 39.3 |
| 2009 | 14.6 | 24.4 | -10.8 | 1.0 | ** | -9.8 | 52.3 |
| 2010 | 14.6 | 23.4 | -9.3 | 0.6 | ** | -8.8 | 61.0 |
| 2011 | 15.0 | 23.4 | -8.9 | 0.4 | ** | -8.4 | 65.8 |
| 2012 | 15.2 | 22.0 | -7.1 | 0.4 | ** | -6.8 | 70.1 |
| 2013 | 16.7 | 20.8 | -4.3 | 0.2 | ** | -4.1 | 72.1 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: * = between -$50 million and $50 million; ** = between -0.05 percent and 0.05 percent.

a. End of year.

**Table H-2.**

## Revenues, by Major Source, Since 1974

| | Individual Income Taxes | Social Insurance Taxes | Corporate Income Taxes | Excise Taxes | Estate and Gift Taxes | Customs Duties | Miscellaneous Receipts | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | In Billions of Dollars | | | | |
| 1974 | 119.0 | 75.1 | 38.6 | 16.8 | 5.0 | 3.3 | 5.4 | 263.2 |
| 1975 | 122.4 | 84.5 | 40.6 | 16.6 | 4.6 | 3.7 | 6.7 | 279.1 |
| 1976 | 131.6 | 90.8 | 41.4 | 17.0 | 5.2 | 4.1 | 8.0 | 298.1 |
| 1977 | 157.6 | 106.5 | 54.9 | 17.5 | 7.3 | 5.2 | 6.5 | 355.6 |
| 1978 | 181.0 | 121.0 | 60.0 | 18.4 | 5.3 | 6.6 | 7.4 | 399.6 |
| 1979 | 217.8 | 138.9 | 65.7 | 18.7 | 5.4 | 7.4 | 9.3 | 463.3 |
| 1980 | 244.1 | 157.8 | 64.6 | 24.3 | 6.4 | 7.2 | 12.7 | 517.1 |
| 1981 | 285.9 | 182.7 | 61.1 | 40.8 | 6.8 | 8.1 | 13.8 | 599.3 |
| 1982 | 297.7 | 201.5 | 49.2 | 36.3 | 8.0 | 8.9 | 16.2 | 617.8 |
| 1983 | 288.9 | 209.0 | 37.0 | 35.3 | 6.1 | 8.7 | 15.6 | 600.6 |
| 1984 | 298.4 | 239.4 | 56.9 | 37.4 | 6.0 | 11.4 | 17.0 | 666.4 |
| 1985 | 334.5 | 265.2 | 61.3 | 36.0 | 6.4 | 12.1 | 18.5 | 734.0 |
| 1986 | 349.0 | 283.9 | 63.1 | 32.9 | 7.0 | 13.3 | 19.9 | 769.2 |
| 1987 | 392.6 | 303.3 | 83.9 | 32.5 | 7.5 | 15.1 | 19.5 | 854.3 |
| 1988 | 401.2 | 334.3 | 94.5 | 35.2 | 7.6 | 16.2 | 20.2 | 909.2 |
| 1989 | 445.7 | 359.4 | 103.3 | 34.4 | 8.7 | 16.3 | 23.2 | 991.1 |
| 1990 | 466.9 | 380.0 | 93.5 | 35.3 | 11.5 | 16.7 | 28.0 | 1,032.0 |
| 1991 | 467.8 | 396.0 | 98.1 | 42.4 | 11.1 | 15.9 | 23.6 | 1,055.0 |
| 1992 | 476.0 | 413.7 | 100.3 | 45.6 | 11.1 | 17.4 | 27.2 | 1,091.2 |
| 1993 | 509.7 | 428.3 | 117.5 | 48.1 | 12.6 | 18.8 | 19.4 | 1,154.3 |
| 1994 | 543.1 | 461.5 | 140.4 | 55.2 | 15.2 | 20.1 | 23.1 | 1,258.6 |
| 1995 | 590.2 | 484.5 | 157.0 | 57.5 | 14.8 | 19.3 | 28.5 | 1,351.8 |
| 1996 | 656.4 | 509.4 | 171.8 | 54.0 | 17.2 | 18.7 | 25.5 | 1,453.1 |
| 1997 | 737.5 | 539.4 | 182.3 | 56.9 | 19.8 | 17.9 | 25.4 | 1,579.2 |
| 1998 | 828.6 | 571.8 | 188.7 | 57.7 | 24.1 | 18.3 | 32.6 | 1,721.7 |
| 1999 | 879.5 | 611.8 | 184.7 | 70.4 | 27.8 | 18.3 | 34.9 | 1,827.5 |
| 2000 | 1,004.5 | 652.9 | 207.3 | 68.9 | 29.0 | 19.9 | 42.8 | 2,025.2 |
| 2001 | 994.3 | 694.0 | 151.1 | 66.2 | 28.4 | 19.4 | 37.7 | 1,991.1 |
| 2002 | 858.3 | 700.8 | 148.0 | 67.0 | 26.5 | 18.6 | 33.9 | 1,853.1 |
| 2003 | 793.7 | 713.0 | 131.8 | 67.5 | 22.0 | 19.9 | 34.5 | 1,782.3 |
| 2004 | 809.0 | 733.4 | 189.4 | 69.9 | 24.8 | 21.1 | 32.6 | 1,880.1 |
| 2005 | 927.2 | 794.1 | 278.3 | 73.1 | 24.8 | 23.4 | 32.7 | 2,153.6 |
| 2006 | 1,043.9 | 837.8 | 353.9 | 74.0 | 27.9 | 24.8 | 44.6 | 2,406.9 |
| 2007 | 1,163.5 | 869.6 | 370.2 | 65.1 | 26.0 | 26.0 | 47.5 | 2,568.0 |
| 2008 | 1,145.7 | 900.2 | 304.3 | 67.3 | 28.8 | 27.6 | 50.0 | 2,524.0 |
| 2009 | 915.3 | 890.9 | 138.2 | 62.5 | 23.5 | 22.5 | 52.1 | 2,105.0 |
| 2010 | 898.5 | 864.8 | 191.4 | 66.9 | 18.9 | 25.3 | 96.8 | 2,162.7 |
| 2011 | 1,091.5 | 818.8 | 181.1 | 72.4 | 7.4 | 29.5 | 102.8 | 2,303.5 |
| 2012 | 1,132.2 | 845.3 | 242.3 | 79.1 | 14.0 | 30.3 | 107.0 | 2,450.2 |
| 2013 | 1,316.4 | 947.8 | 273.5 | 84.0 | 18.9 | 31.8 | 101.5 | 2,774.0 |

Continued

**Table H-2.** **Continued**

## Revenues, by Major Source, Since 1974

| | Individual Income Taxes | Social Insurance Taxes | Corporate Income Taxes | Excise Taxes | Estate and Gift Taxes | Customs Duties | Miscellaneous Receipts | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | As a Percentage of Gross Domestic Product | | | | |
| 1974 | 8.0 | 5.1 | 2.6 | 1.1 | 0.3 | 0.2 | 0.4 | 17.7 |
| 1975 | 7.6 | 5.2 | 2.5 | 1.0 | 0.3 | 0.2 | 0.4 | 17.3 |
| 1976 | 7.4 | 5.1 | 2.3 | 0.9 | 0.3 | 0.2 | 0.4 | 16.6 |
| 1977 | 7.8 | 5.2 | 2.7 | 0.9 | 0.4 | 0.3 | 0.3 | 17.5 |
| 1978 | 7.9 | 5.3 | 2.6 | 0.8 | 0.2 | 0.3 | 0.3 | 17.5 |
| 1979 | 8.5 | 5.4 | 2.6 | 0.7 | 0.2 | 0.3 | 0.4 | 18.0 |
| 1980 | 8.7 | 5.6 | 2.3 | 0.9 | 0.2 | 0.3 | 0.5 | 18.5 |
| 1981 | 9.1 | 5.8 | 1.9 | 1.3 | 0.2 | 0.3 | 0.4 | 19.1 |
| 1982 | 9.0 | 6.1 | 1.5 | 1.1 | 0.2 | 0.3 | 0.5 | 18.6 |
| 1983 | 8.2 | 5.9 | 1.0 | 1.0 | 0.2 | 0.2 | 0.4 | 17.0 |
| 1984 | 7.5 | 6.1 | 1.4 | 0.9 | 0.2 | 0.3 | 0.4 | 16.9 |
| 1985 | 7.8 | 6.2 | 1.4 | 0.8 | 0.2 | 0.3 | 0.4 | 17.2 |
| 1986 | 7.7 | 6.3 | 1.4 | 0.7 | 0.2 | 0.3 | 0.4 | 17.0 |
| 1987 | 8.2 | 6.3 | 1.8 | 0.7 | 0.2 | 0.3 | 0.4 | 17.9 |
| 1988 | 7.8 | 6.5 | 1.8 | 0.7 | 0.1 | 0.3 | 0.4 | 17.6 |
| 1989 | 8.0 | 6.5 | 1.9 | 0.6 | 0.2 | 0.3 | 0.4 | 17.8 |
| 1990 | 7.9 | 6.4 | 1.6 | 0.6 | 0.2 | 0.3 | 0.5 | 17.4 |
| 1991 | 7.7 | 6.5 | 1.6 | 0.7 | 0.2 | 0.3 | 0.4 | 17.3 |
| 1992 | 7.4 | 6.4 | 1.6 | 0.7 | 0.2 | 0.3 | 0.4 | 17.0 |
| 1993 | 7.5 | 6.3 | 1.7 | 0.7 | 0.2 | 0.3 | 0.3 | 17.0 |
| 1994 | 7.5 | 6.4 | 2.0 | 0.8 | 0.2 | 0.3 | 0.3 | 17.5 |
| 1995 | 7.8 | 6.4 | 2.1 | 0.8 | 0.2 | 0.3 | 0.4 | 17.8 |
| 1996 | 8.2 | 6.4 | 2.2 | 0.7 | 0.2 | 0.2 | 0.3 | 18.2 |
| 1997 | 8.7 | 6.4 | 2.1 | 0.7 | 0.2 | 0.2 | 0.3 | 18.6 |
| 1998 | 9.3 | 6.4 | 2.1 | 0.6 | 0.3 | 0.2 | 0.4 | 19.2 |
| 1999 | 9.2 | 6.4 | 1.9 | 0.7 | 0.3 | 0.2 | 0.4 | 19.2 |
| 2000 | 9.9 | 6.4 | 2.0 | 0.7 | 0.3 | 0.2 | 0.4 | 19.9 |
| 2001 | 9.4 | 6.6 | 1.4 | 0.6 | 0.3 | 0.2 | 0.4 | 18.8 |
| 2002 | 7.9 | 6.4 | 1.4 | 0.6 | 0.2 | 0.2 | 0.3 | 17.0 |
| 2003 | 7.0 | 6.3 | 1.2 | 0.6 | 0.2 | 0.2 | 0.3 | 15.7 |
| 2004 | 6.7 | 6.1 | 1.6 | 0.6 | 0.2 | 0.2 | 0.3 | 15.6 |
| 2005 | 7.2 | 6.2 | 2.2 | 0.6 | 0.2 | 0.2 | 0.3 | 16.7 |
| 2006 | 7.6 | 6.1 | 2.6 | 0.5 | 0.2 | 0.2 | 0.3 | 17.6 |
| 2007 | 8.1 | 6.1 | 2.6 | 0.5 | 0.2 | 0.2 | 0.3 | 17.9 |
| 2008 | 7.8 | 6.1 | 2.1 | 0.5 | 0.2 | 0.2 | 0.3 | 17.1 |
| 2009 | 6.4 | 6.2 | 1.0 | 0.4 | 0.2 | 0.2 | 0.4 | 14.6 |
| 2010 | 6.1 | 5.8 | 1.3 | 0.5 | 0.1 | 0.2 | 0.7 | 14.6 |
| 2011 | 7.1 | 5.3 | 1.2 | 0.5 | * | 0.2 | 0.7 | 15.0 |
| 2012 | 7.0 | 5.3 | 1.5 | 0.5 | 0.1 | 0.2 | 0.7 | 15.2 |
| 2013 | 7.9 | 5.7 | 1.6 | 0.5 | 0.1 | 0.2 | 0.6 | 16.7 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: * = between zero and 0.05 percent.

**Table H-3.**

## Outlays, by Major Category, Since 1974

| | | Mandatory | | | |
|---|---|---|---|---|---|
| | Discretionary | Programmatic Outlays[a] | Offsetting Receipts | Net Interest | Total |
| | | | In Billions of Dollars | | |
| 1974 | 138.2 | 130.9 | -21.2 | 21.4 | 269.4 |
| 1975 | 158.0 | 169.4 | -18.3 | 23.2 | 332.3 |
| 1976 | 175.6 | 189.1 | -19.6 | 26.7 | 371.8 |
| 1977 | 197.1 | 203.7 | -21.5 | 29.9 | 409.2 |
| 1978 | 218.7 | 227.4 | -22.8 | 35.5 | 458.7 |
| 1979 | 240.0 | 247.0 | -25.6 | 42.6 | 504.0 |
| 1980 | 276.3 | 291.2 | -29.2 | 52.5 | 590.9 |
| 1981 | 307.9 | 339.4 | -37.9 | 68.8 | 678.2 |
| 1982 | 326.0 | 370.8 | -36.0 | 85.0 | 745.7 |
| 1983 | 353.3 | 410.6 | -45.3 | 89.8 | 808.4 |
| 1984 | 379.4 | 405.5 | -44.2 | 111.1 | 851.8 |
| 1985 | 415.8 | 448.2 | -47.1 | 129.5 | 946.3 |
| 1986 | 438.5 | 461.7 | -45.9 | 136.0 | 990.4 |
| 1987 | 444.2 | 474.2 | -52.9 | 138.6 | 1,004.0 |
| 1988 | 464.4 | 505.0 | -56.8 | 151.8 | 1,064.4 |
| 1989 | 488.8 | 546.1 | -60.1 | 169.0 | 1,143.7 |
| 1990 | 500.6 | 625.6 | -57.6 | 184.3 | 1,253.0 |
| 1991 | 533.3 | 702.0 | -105.5 | 194.4 | 1,324.2 |
| 1992 | 533.8 | 717.7 | -69.3 | 199.3 | 1,381.5 |
| 1993 | 539.8 | 736.8 | -65.9 | 198.7 | 1,409.4 |
| 1994 | 541.3 | 786.0 | -68.5 | 202.9 | 1,461.8 |
| 1995 | 544.8 | 817.5 | -78.7 | 232.1 | 1,515.7 |
| 1996 | 532.7 | 857.6 | -70.9 | 241.1 | 1,560.5 |
| 1997 | 547.0 | 895.5 | -85.4 | 244.0 | 1,601.1 |
| 1998 | 552.0 | 942.9 | -83.5 | 241.1 | 1,652.5 |
| 1999 | 572.1 | 979.4 | -79.4 | 229.8 | 1,701.8 |
| 2000 | 614.6 | 1,032.5 | -81.2 | 222.9 | 1,789.0 |
| 2001 | 649.0 | 1,097.1 | -89.5 | 206.2 | 1,862.8 |
| 2002 | 734.0 | 1,196.5 | -90.5 | 170.9 | 2,010.9 |
| 2003 | 824.3 | 1,283.4 | -100.9 | 153.1 | 2,159.9 |
| 2004 | 895.1 | 1,346.4 | -108.9 | 160.2 | 2,292.8 |
| 2005 | 968.5 | 1,448.1 | -128.7 | 184.0 | 2,472.0 |
| 2006 | 1,016.6 | 1,556.1 | -144.3 | 226.6 | 2,655.1 |
| 2007 | 1,041.6 | 1,627.9 | -177.9 | 237.1 | 2,728.7 |
| 2008 | 1,134.9 | 1,780.3 | -185.4 | 252.8 | 2,982.5 |
| 2009 | 1,237.5 | 2,287.8 | -194.6 | 186.9 | 3,517.7 |
| 2010 | 1,347.2 | 2,110.2 | -196.5 | 196.2 | 3,457.1 |
| 2011 | 1,347.1 | 2,234.9 | -209.0 | 230.0 | 3,603.1 |
| 2012 | 1,285.3 | 2,259.7 | -228.3 | 220.4 | 3,537.1 |
| 2013 | 1,201.2 | 2,337.8 | -306.1 | 221.3 | 3,454.3 |

Continued

**Table H-3.** **Continued**

## Outlays, by Major Category, Since 1974

| | Discretionary | Mandatory: Programmatic Outlays[a] | Mandatory: Offsetting Receipts | Net Interest | Total |
|---|---|---|---|---|---|
| | **As a Percentage of Gross Domestic Product** | | | | |
| 1974 | 9.3 | 8.8 | -1.4 | 1.4 | 18.1 |
| 1975 | 9.8 | 10.5 | -1.1 | 1.4 | 20.6 |
| 1976 | 9.8 | 10.6 | -1.1 | 1.5 | 20.8 |
| 1977 | 9.7 | 10.0 | -1.1 | 1.5 | 20.2 |
| 1978 | 9.6 | 10.0 | -1.0 | 1.6 | 20.1 |
| 1979 | 9.3 | 9.6 | -1.0 | 1.7 | 19.6 |
| 1980 | 9.9 | 10.4 | -1.0 | 1.9 | 21.1 |
| 1981 | 9.8 | 10.8 | -1.2 | 2.2 | 21.6 |
| 1982 | 9.8 | 11.2 | -1.1 | 2.6 | 22.5 |
| 1983 | 10.0 | 11.6 | -1.3 | 2.5 | 22.8 |
| 1984 | 9.6 | 10.3 | -1.1 | 2.8 | 21.5 |
| 1985 | 9.7 | 10.5 | -1.1 | 3.0 | 22.2 |
| 1986 | 9.7 | 10.2 | -1.0 | 3.0 | 21.8 |
| 1987 | 9.3 | 9.9 | -1.1 | 2.9 | 21.0 |
| 1988 | 9.0 | 9.8 | -1.1 | 2.9 | 20.6 |
| 1989 | 8.8 | 9.8 | -1.1 | 3.0 | 20.5 |
| 1990 | 8.5 | 10.6 | -1.0 | 3.1 | 21.2 |
| 1991 | 8.7 | 11.5 | -1.7 | 3.2 | 21.7 |
| 1992 | 8.3 | 11.2 | -1.1 | 3.1 | 21.5 |
| 1993 | 7.9 | 10.8 | -1.0 | 2.9 | 20.7 |
| 1994 | 7.5 | 10.9 | -1.0 | 2.8 | 20.3 |
| 1995 | 7.2 | 10.8 | -1.0 | 3.1 | 20.0 |
| 1996 | 6.7 | 10.7 | -0.9 | 3.0 | 19.6 |
| 1997 | 6.4 | 10.6 | -1.0 | 2.9 | 18.9 |
| 1998 | 6.2 | 10.5 | -0.9 | 2.7 | 18.5 |
| 1999 | 6.0 | 10.3 | -0.8 | 2.4 | 17.9 |
| 2000 | 6.1 | 10.2 | -0.8 | 2.2 | 17.6 |
| 2001 | 6.1 | 10.4 | -0.8 | 2.0 | 17.6 |
| 2002 | 6.7 | 11.0 | -0.8 | 1.6 | 18.5 |
| 2003 | 7.3 | 11.3 | -0.9 | 1.4 | 19.1 |
| 2004 | 7.4 | 11.1 | -0.9 | 1.3 | 19.0 |
| 2005 | 7.5 | 11.2 | -1.0 | 1.4 | 19.2 |
| 2006 | 7.4 | 11.4 | -1.1 | 1.7 | 19.4 |
| 2007 | 7.3 | 11.4 | -1.2 | 1.7 | 19.0 |
| 2008 | 7.7 | 12.1 | -1.3 | 1.7 | 20.2 |
| 2009 | 8.6 | 15.9 | -1.3 | 1.3 | 24.4 |
| 2010 | 9.1 | 14.3 | -1.3 | 1.3 | 23.4 |
| 2011 | 8.8 | 14.5 | -1.4 | 1.5 | 23.4 |
| 2012 | 8.0 | 14.0 | -1.4 | 1.4 | 22.0 |
| 2013 | 7.2 | 14.1 | -1.8 | 1.3 | 20.8 |

Sources: Congressional Budget Office; Office of Management and Budget.

a. Excludes offsetting receipts.

**Table H-4.**

## Discretionary Outlays Since 1974

| | Defense | Nondefense | Total |
|---|---|---|---|
| | | In Billions of Dollars | |
| 1974 | 80.7 | 57.5 | 138.2 |
| 1975 | 87.6 | 70.4 | 158.0 |
| 1976 | 89.9 | 85.7 | 175.6 |
| 1977 | 97.5 | 99.6 | 197.1 |
| 1978 | 104.6 | 114.1 | 218.7 |
| 1979 | 116.8 | 123.2 | 240.0 |
| 1980 | 134.6 | 141.7 | 276.3 |
| 1981 | 158.0 | 149.9 | 307.9 |
| 1982 | 185.9 | 140.0 | 326.0 |
| 1983 | 209.9 | 143.4 | 353.3 |
| 1984 | 228.0 | 151.4 | 379.4 |
| 1985 | 253.1 | 162.7 | 415.8 |
| 1986 | 273.8 | 164.7 | 438.5 |
| 1987 | 282.5 | 161.6 | 444.2 |
| 1988 | 290.9 | 173.5 | 464.4 |
| 1989 | 304.0 | 184.8 | 488.8 |
| 1990 | 300.1 | 200.4 | 500.6 |
| 1991 | 319.7 | 213.6 | 533.3 |
| 1992 | 302.6 | 231.2 | 533.8 |
| 1993 | 292.4 | 247.3 | 539.8 |
| 1994 | 282.3 | 259.1 | 541.3 |
| 1995 | 273.6 | 271.2 | 544.8 |
| 1996 | 266.0 | 266.8 | 532.7 |
| 1997 | 271.7 | 275.4 | 547.0 |
| 1998 | 270.3 | 281.7 | 552.0 |
| 1999 | 275.5 | 296.7 | 572.1 |
| 2000 | 295.0 | 319.7 | 614.6 |
| 2001 | 306.1 | 343.0 | 649.0 |
| 2002 | 349.0 | 385.0 | 734.0 |
| 2003 | 405.0 | 419.4 | 824.3 |
| 2004 | 454.1 | 441.0 | 895.1 |
| 2005 | 493.6 | 474.9 | 968.5 |
| 2006 | 520.0 | 496.7 | 1,016.6 |
| 2007 | 547.9 | 493.7 | 1,041.6 |
| 2008 | 612.4 | 522.4 | 1,134.9 |
| 2009 | 656.7 | 580.8 | 1,237.5 |
| 2010 | 688.9 | 658.3 | 1,347.2 |
| 2011 | 699.4 | 647.7 | 1,347.1 |
| 2012 | 670.5 | 614.8 | 1,285.3 |
| 2013 | 624.9 | 576.3 | 1,201.2 |

Continued

**Table H-4.** **Continued**

## Discretionary Outlays Since 1974

| | Defense | Nondefense | Total |
|---|---|---|---|
| | | As a Percentage of Gross Domestic Product | |
| 1974 | 5.4 | 3.9 | 9.3 |
| 1975 | 5.4 | 4.4 | 9.8 |
| 1976 | 5.0 | 4.8 | 9.8 |
| 1977 | 4.8 | 4.9 | 9.7 |
| 1978 | 4.6 | 5.0 | 9.6 |
| 1979 | 4.5 | 4.8 | 9.3 |
| 1980 | 4.8 | 5.1 | 9.9 |
| 1981 | 5.0 | 4.8 | 9.8 |
| 1982 | 5.6 | 4.2 | 9.8 |
| 1983 | 5.9 | 4.1 | 10.0 |
| 1984 | 5.8 | 3.8 | 9.6 |
| 1985 | 5.9 | 3.8 | 9.7 |
| 1986 | 6.0 | 3.6 | 9.7 |
| 1987 | 5.9 | 3.4 | 9.3 |
| 1988 | 5.6 | 3.4 | 9.0 |
| 1989 | 5.5 | 3.3 | 8.8 |
| 1990 | 5.1 | 3.4 | 8.5 |
| 1991 | 5.2 | 3.5 | 8.7 |
| 1992 | 4.7 | 3.6 | 8.3 |
| 1993 | 4.3 | 3.6 | 7.9 |
| 1994 | 3.9 | 3.6 | 7.5 |
| 1995 | 3.6 | 3.6 | 7.2 |
| 1996 | 3.3 | 3.3 | 6.7 |
| 1997 | 3.2 | 3.2 | 6.4 |
| 1998 | 3.0 | 3.1 | 6.2 |
| 1999 | 2.9 | 3.1 | 6.0 |
| 2000 | 2.9 | 3.1 | 6.1 |
| 2001 | 2.9 | 3.2 | 6.1 |
| 2002 | 3.2 | 3.5 | 6.7 |
| 2003 | 3.6 | 3.7 | 7.3 |
| 2004 | 3.8 | 3.6 | 7.4 |
| 2005 | 3.8 | 3.7 | 7.5 |
| 2006 | 3.8 | 3.6 | 7.4 |
| 2007 | 3.8 | 3.4 | 7.3 |
| 2008 | 4.2 | 3.5 | 7.7 |
| 2009 | 4.6 | 4.0 | 8.6 |
| 2010 | 4.7 | 4.5 | 9.1 |
| 2011 | 4.5 | 4.2 | 8.8 |
| 2012 | 4.2 | 3.8 | 8.0 |
| 2013 | 3.8 | 3.5 | 7.2 |

Sources: Congressional Budget Office; Office of Management and Budget.

**Table H-5.**

## Mandatory Outlays Since 1974

| | Social Security | Medicare | Medicaid | Income Security[a] | Other Retirement and Disability | Other Programs | Offsetting Receipts | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | In Billions of Dollars | | | | |
| 1974 | 55.0 | 10.7 | 5.8 | 17.4 | 20.9 | 21.1 | -21.2 | 109.7 |
| 1975 | 63.6 | 14.1 | 6.8 | 28.9 | 26.4 | 29.6 | -18.3 | 151.1 |
| 1976 | 72.7 | 16.9 | 8.6 | 37.6 | 27.7 | 25.6 | -19.6 | 169.5 |
| 1977 | 83.7 | 20.8 | 9.9 | 34.6 | 31.2 | 23.6 | -21.5 | 182.2 |
| 1978 | 92.4 | 24.3 | 10.7 | 32.1 | 33.9 | 34.0 | -22.8 | 204.6 |
| 1979 | 102.6 | 28.2 | 12.4 | 32.2 | 38.7 | 32.9 | -25.6 | 221.4 |
| 1980 | 117.1 | 34.0 | 14.0 | 44.3 | 44.4 | 37.5 | -29.2 | 262.1 |
| 1981 | 137.9 | 41.3 | 16.8 | 49.9 | 50.8 | 42.6 | -37.9 | 301.6 |
| 1982 | 153.9 | 49.2 | 17.4 | 53.2 | 55.0 | 42.1 | -36.0 | 334.8 |
| 1983 | 168.5 | 55.5 | 19.0 | 64.0 | 58.0 | 45.5 | -45.3 | 365.2 |
| 1984 | 176.1 | 61.1 | 20.1 | 51.7 | 59.8 | 36.7 | -44.2 | 361.3 |
| 1985 | 186.4 | 69.7 | 22.7 | 52.3 | 61.0 | 56.2 | -47.1 | 401.1 |
| 1986 | 196.5 | 74.2 | 25.0 | 54.2 | 63.4 | 48.4 | -45.9 | 415.8 |
| 1987 | 205.1 | 79.9 | 27.4 | 55.0 | 66.5 | 40.2 | -52.9 | 421.2 |
| 1988 | 216.8 | 85.7 | 30.5 | 57.3 | 71.1 | 43.7 | -56.8 | 448.2 |
| 1989 | 230.4 | 93.2 | 34.6 | 62.9 | 57.3 | 67.6 | -60.1 | 485.9 |
| 1990 | 246.5 | 107.0 | 41.1 | 68.7 | 60.0 | 102.3 | -57.6 | 568.1 |
| 1991 | 266.8 | 114.2 | 52.5 | 86.9 | 64.4 | 117.1 | -105.5 | 596.5 |
| 1992 | 285.2 | 129.4 | 67.8 | 110.8 | 66.5 | 58.0 | -69.3 | 648.4 |
| 1993 | 302.0 | 143.2 | 75.8 | 117.1 | 68.3 | 30.4 | -65.9 | 670.9 |
| 1994 | 316.9 | 159.6 | 82.0 | 116.1 | 72.3 | 39.1 | -68.5 | 717.5 |
| 1995 | 333.3 | 177.1 | 89.1 | 116.6 | 75.2 | 26.2 | -78.7 | 738.8 |
| 1996 | 347.1 | 191.3 | 92.0 | 121.6 | 77.3 | 28.4 | -70.9 | 786.7 |
| 1997 | 362.3 | 207.9 | 95.6 | 122.5 | 80.5 | 26.8 | -85.4 | 810.1 |
| 1998 | 376.1 | 211.0 | 101.2 | 122.1 | 82.5 | 49.8 | -83.5 | 859.3 |
| 1999 | 387.0 | 209.3 | 108.0 | 129.0 | 85.3 | 60.8 | -79.4 | 900.0 |
| 2000 | 406.0 | 216.0 | 117.9 | 133.9 | 87.8 | 70.8 | -81.2 | 951.4 |
| 2001 | 429.4 | 237.9 | 129.4 | 143.1 | 92.7 | 64.7 | -89.5 | 1,007.6 |
| 2002 | 452.1 | 253.7 | 147.5 | 180.3 | 96.1 | 66.8 | -90.5 | 1,106.0 |
| 2003 | 470.5 | 274.2 | 160.7 | 196.2 | 99.8 | 82.1 | -100.9 | 1,182.5 |
| 2004 | 491.5 | 297.0 | 176.2 | 190.6 | 103.6 | 87.4 | -108.9 | 1,237.5 |
| 2005 | 518.7 | 335.1 | 181.7 | 196.9 | 109.7 | 105.9 | -128.7 | 1,319.4 |
| 2006 | 543.9 | 376.8 | 180.6 | 200.0 | 113.1 | 141.6 | -144.3 | 1,411.8 |
| 2007 | 581.4 | 436.1 | 190.6 | 203.1 | 122.4 | 94.2 | -177.9 | 1,450.0 |
| 2008 | 612.1 | 456.0 | 201.4 | 260.7 | 128.9 | 121.3 | -185.4 | 1,594.9 |
| 2009 | 677.7 | 499.9 | 250.9 | 350.2 | 137.7 | 371.4 | -194.6 | 2,093.2 |
| 2010 | 700.8 | 520.5 | 272.8 | 437.3 | 138.4 | 40.5 | -196.5 | 1,913.7 |
| 2011 | 724.9 | 559.6 | 275.0 | 404.1 | 144.2 | 127.2 | -209.0 | 2,026.0 |
| 2012 | 767.7 | 551.2 | 250.5 | 353.6 | 143.5 | 193.2 | -228.3 | 2,031.4 |
| 2013 | 807.8 | 585.3 | 265.4 | 339.9 | 152.5 | 187.0 | -306.1 | 2,031.8 |

Continued

**Table H-5.** **Continued**

## Mandatory Outlays Since 1974

| | Social Security | Medicare | Medicaid | Income Security[a] | Other Retirement and Disability | Other Programs | Offsetting Receipts | Total |
|---|---|---|---|---|---|---|---|---|
| | | | | As a Percentage of Gross Domestic Product | | | | |
| 1974 | 3.7 | 0.7 | 0.4 | 1.2 | 1.4 | 1.4 | -1.4 | 7.4 |
| 1975 | 3.9 | 0.9 | 0.4 | 1.8 | 1.6 | 1.8 | -1.1 | 9.4 |
| 1976 | 4.1 | 0.9 | 0.5 | 2.1 | 1.5 | 1.4 | -1.1 | 9.5 |
| 1977 | 4.1 | 1.0 | 0.5 | 1.7 | 1.5 | 1.2 | -1.1 | 9.0 |
| 1978 | 4.1 | 1.1 | 0.5 | 1.4 | 1.5 | 1.5 | -1.0 | 9.0 |
| 1979 | 4.0 | 1.1 | 0.5 | 1.3 | 1.5 | 1.3 | -1.0 | 8.6 |
| 1980 | 4.2 | 1.2 | 0.5 | 1.6 | 1.6 | 1.3 | -1.0 | 9.4 |
| 1981 | 4.4 | 1.3 | 0.5 | 1.6 | 1.6 | 1.4 | -1.2 | 9.6 |
| 1982 | 4.6 | 1.5 | 0.5 | 1.6 | 1.7 | 1.3 | -1.1 | 10.1 |
| 1983 | 4.8 | 1.6 | 0.5 | 1.8 | 1.6 | 1.3 | -1.3 | 10.3 |
| 1984 | 4.5 | 1.5 | 0.5 | 1.3 | 1.5 | 0.9 | -1.1 | 9.1 |
| 1985 | 4.4 | 1.6 | 0.5 | 1.2 | 1.4 | 1.3 | -1.1 | 9.4 |
| 1986 | 4.3 | 1.6 | 0.6 | 1.2 | 1.4 | 1.1 | -1.0 | 9.2 |
| 1987 | 4.3 | 1.7 | 0.6 | 1.2 | 1.4 | 0.8 | -1.1 | 8.8 |
| 1988 | 4.2 | 1.7 | 0.6 | 1.1 | 1.4 | 0.8 | -1.1 | 8.7 |
| 1989 | 4.1 | 1.7 | 0.6 | 1.1 | 1.0 | 1.2 | -1.1 | 8.7 |
| 1990 | 4.2 | 1.8 | 0.7 | 1.2 | 1.0 | 1.7 | -1.0 | 9.6 |
| 1991 | 4.4 | 1.9 | 0.9 | 1.4 | 1.1 | 1.9 | -1.7 | 9.8 |
| 1992 | 4.4 | 2.0 | 1.1 | 1.7 | 1.0 | 0.9 | -1.1 | 10.1 |
| 1993 | 4.4 | 2.1 | 1.1 | 1.7 | 1.0 | 0.4 | -1.0 | 9.9 |
| 1994 | 4.4 | 2.2 | 1.1 | 1.6 | 1.0 | 0.5 | -1.0 | 10.0 |
| 1995 | 4.4 | 2.3 | 1.2 | 1.5 | 1.0 | 0.3 | -1.0 | 9.7 |
| 1996 | 4.3 | 2.4 | 1.2 | 1.5 | 1.0 | 0.4 | -0.9 | 9.9 |
| 1997 | 4.3 | 2.5 | 1.1 | 1.4 | 0.9 | 0.3 | -1.0 | 9.5 |
| 1998 | 4.2 | 2.4 | 1.1 | 1.4 | 0.9 | 0.6 | -0.9 | 9.6 |
| 1999 | 4.1 | 2.2 | 1.1 | 1.4 | 0.9 | 0.6 | -0.8 | 9.5 |
| 2000 | 4.0 | 2.1 | 1.2 | 1.3 | 0.9 | 0.7 | -0.8 | 9.4 |
| 2001 | 4.1 | 2.3 | 1.2 | 1.4 | 0.9 | 0.6 | -0.8 | 9.5 |
| 2002 | 4.2 | 2.3 | 1.4 | 1.7 | 0.9 | 0.6 | -0.8 | 10.2 |
| 2003 | 4.2 | 2.4 | 1.4 | 1.7 | 0.9 | 0.7 | -0.9 | 10.4 |
| 2004 | 4.1 | 2.5 | 1.5 | 1.6 | 0.9 | 0.7 | -0.9 | 10.2 |
| 2005 | 4.0 | 2.6 | 1.4 | 1.5 | 0.9 | 0.8 | -1.0 | 10.2 |
| 2006 | 4.0 | 2.8 | 1.3 | 1.5 | 0.8 | 1.0 | -1.1 | 10.3 |
| 2007 | 4.1 | 3.0 | 1.3 | 1.4 | 0.9 | 0.7 | -1.2 | 10.1 |
| 2008 | 4.1 | 3.1 | 1.4 | 1.8 | 0.9 | 0.8 | -1.3 | 10.8 |
| 2009 | 4.7 | 3.5 | 1.7 | 2.4 | 1.0 | 2.6 | -1.3 | 14.5 |
| 2010 | 4.7 | 3.5 | 1.8 | 3.0 | 0.9 | 0.3 | -1.3 | 12.9 |
| 2011 | 4.7 | 3.6 | 1.8 | 2.6 | 0.9 | 0.8 | -1.4 | 13.2 |
| 2012 | 4.8 | 3.4 | 1.6 | 2.2 | 0.9 | 1.2 | -1.4 | 12.6 |
| 2013 | 4.9 | 3.5 | 1.6 | 2.0 | 0.9 | 1.1 | -1.8 | 12.2 |

Sources: Congressional Budget Office; Office of Management and Budget.

a. Includes unemployment compensation, Supplemental Security Income, the refundable portion of the earned income and child tax credits, the Supplemental Nutrition Assistance Program, family support, child nutrition, and foster care.

# List of Tables and Figures

## Tables

## Tables (Continued)



## Figures

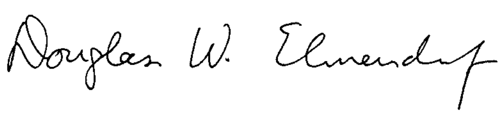
## Figures (Continued)

# About This Document

This volume is one of a series of reports on the state of the budget and the economy that the Congressional Budget Office (CBO) issues each year. It satisfies the requirement of section 202(e) of the Congressional Budget Act of 1974 for CBO to submit to the Committees on the Budget periodic reports about fiscal policy and to provide baseline projections of the federal budget. In keeping with CBO's mandate to provide objective, impartial analysis, this report makes no recommendations.

CBO's Panel of Economic Advisers commented on an early version of the economic forecast underlying this report. Members of the panel are Rosanne Altshuler, Raj Chetty, Dan L. Crippen, Steven J. Davis, Kristin J. Forbes, Robert E. Hall, Jan Hatzius, Simon Johnson, Charles I. Jones, Anil Kashyap, Lawrence Katz, Donald Kohn, N. Gregory Mankiw, June E. O'Neill, Adam S. Posen, James Poterba, Joel Prakken, Carmen M. Reinhart, Robert Shimer, Matthew Slaughter, and Mark Zandi. Andrew Haughwout and Thomas Laubach attended the panel's meeting as guests. Although CBO's outside advisers provided considerable assistance, they are not responsible for the contents of this report.

The CBO staff members who contributed to this report—by preparing the economic, revenue, and spending projections; writing the report; editing and publishing it; compiling the supplemental materials posted along with it on CBO's website (www.cbo.gov/publication/45010); and providing other support—are listed on the following pages.



Douglas W. Elmendorf
Director

February 2014

## Economic Projections

The economic projections were prepared by the Macroeconomic Analysis Division, with contributions from analysts in other divisions. That work was supervised by Wendy Edelberg, Kim Kowalewski, Robert Arnold, and Benjamin Page.

| | |
|---|---|
| Alexander Arnon | Model and data management |
| David Brauer | Inflation, labor markets |
| Gabriel Ehrlich | Interest rates, monetary policy, energy prices, house prices |
| Daniel Fried | Net exports, exchange rates |
| Ronald Gecan | Energy prices |
| Mark Lasky | Business investment, housing |
| Leah Loversky | Motor vehicle sector, research assistance |
| Frank Russek | Federal, state, and local government spending and revenues |
| Robert Shackleton | Potential output, productivity |
| Christopher Williams | Consumer spending, incomes |

## Revenue Projections

The revenue projections were prepared by the Tax Analysis Division, supervised by David Weiner, Mark Booth, and Janet Holtzblatt. In addition, the staff of the Joint Committee on Taxation provided valuable assistance.

| | |
|---|---|
| Paul Burnham | Retirement income |
| Barbara Edwards | Federal Reserve System earnings, customs duties, miscellaneous receipts |
| Jennifer Gravelle | International taxation |
| Pamela Greene | Corporate income taxes, estate and gift taxes |
| Edward Harris | Individual income taxes, social insurance taxes, tax modeling |
| Robert McClelland | Capital gains realizations |
| Shannon Mok | Estate and gift taxes |
| Kevin Perese | Tax modeling, Federal Reserve System earnings |
| Kurt Seibert | Social insurance taxes, refundable tax credits, depreciation, tax modeling |
| Joshua Shakin | Individual income taxes |
| Logan Timmerhoff | Excise taxes |

## Spending Projections

The spending projections were prepared by the Budget Analysis Division, with contributions from analysts in other divisions; that work was supervised by Peter Fontaine, Theresa Gullo, Holly Harvey, Janet Airis, Tom Bradley, Kim Cawley, Jean Hearne, Jeffrey Holland, Sarah Jennings, and Sam Papenfuss of the Budget Analysis Division, as well as by Jessica Banthin of the Health, Retirement, and Long-Term Analysis Division and Damien Moore of the Financial Analysis Division.

*Defense, International Affairs, and Veterans' Affairs*

| | |
|---|---|
| Kent Christensen | Defense (projections, working capital funds, procurement, scorekeeping) |
| Sunita D'Monte | International affairs |
| Ann Futrell | Veterans' health care, international food assistance |
| Raymond Hall | Defense (research and development, stockpile sales, atomic energy, other programs) |
| William Ma | Veterans' readjustment benefits, reservists' education benefits |
| David Newman | Defense (military construction and family housing, military activities in Afghanistan), veterans' housing |
| Dawn Sauter Regan | Defense (military personnel) |
| Matthew Schmit | Military retirement, military health care |
| Jason Wheelock | Defense (operation and maintenance, compensation for radiation exposure, compensation for energy employees' occupational illness, other programs) |
| Dwayne Wright | Veterans' compensation and pensions |

*Health*

| | |
|---|---|
| Kirstin Blom | Medicaid, Children's Health Insurance Program |
| Julia Christensen | Food and Drug Administration, prescription drugs |
| Philip Ellis | Health insurance coverage |
| Lori Housman | Medicare |
| Paul Jacobs | Health insurance coverage |
| Paul Masi | Medicare |
| Sarah Masi | Health insurance exchanges, other programs |
| Jamease Miles | Medicare, Public Health Service |
| Alexandra Minicozzi | Health insurance coverage |
| Julia Mitchell | Federal Employees Health Benefits program |
| Andrea Noda | Medicaid prescription drugs, long-term care, Public Health Service |
| Allison Percy | Health insurance coverage |
| Lisa Ramirez-Branum | Medicaid, health insurance coverage, Public Health Service |
| Lara Robillard | Medicare |

| | |
|---|---|
| ***Health (Continued)*** | |
| Robert Stewart | Medicaid, Children's Health Insurance Program, Indian Health Service |
| Andrew Stocking | Health insurance coverage |
| Santiago Vallinas | Medicare, Public Health Service |
| Ellen Werble | Health insurance coverage, other programs |
| Rebecca Yip | Medicare Part D, prescription drugs |
| ***Income Security and Education*** | |
| Christina Hawley Anthony | Unemployment insurance, training programs, Administration on Aging, Smithsonian Institution, arts and humanities |
| Chad Chirico | Housing assistance, Fannie Mae and Freddie Mac, Troubled Asset Relief Program, Pension Benefit Guaranty Corporation |
| Sheila Dacey | Old-Age and Survivors Insurance, Social Security trust funds, Pension Benefit Guaranty Corporation |
| Elizabeth Cove Delisle | Social Services Block Grant, Children and Families Services, child nutrition and other nutrition programs |
| Kathleen FitzGerald | Supplemental Nutrition Assistance Program and other nutrition programs |
| Justin Humphrey | Elementary and secondary education, Pell grants, student loans |
| Deborah Kalcevic | Student loans, higher education |
| David Rafferty | Temporary Assistance for Needy Families, Child Support Enforcement, foster care, child care programs, Low Income Home Energy Assistance Program, Supplemental Security Income, refugee assistance |
| Emily Stern | Disability Insurance |
| ***Natural and Physical Resources*** | |
| Megan Carroll | Energy, air transportation |
| Mark Grabowicz | Administration of justice, Postal Service |
| Kathleen Gramp | Energy, Outer Continental Shelf receipts, spectrum auction receipts |
| Daniel Hoople | Community and regional development, Federal Emergency Management Agency, deposit insurance |
| David Hull | Agriculture |
| Jeff LaFave | Conservation and land management, other natural resources |
| James Langley | Agriculture |

*Natural and Physical Resources (Continued)*

| | |
|---|---|
| Susanne Mehlman | Pollution control and abatement, Federal Housing Administration and other housing credit programs |
| Matthew Pickford | General government, legislative branch |
| Sarah Puro | Highways, Amtrak, water transportation |
| Aurora Swanson | Water resources, Fannie Mae and Freddie Mac |
| Martin von Gnechten | Administration of justice, science and space exploration, Bureau of Indian Affairs, recreation |
| Susan Willie | Mass transit, commerce, Small Business Administration, Universal Service Fund |

*Other Areas and Functions*

| | |
|---|---|
| Janet Airis | Appropriation bill (Legislative Branch) |
| Shane Beaulieu | Computer support |
| Edward Blau | Authorization bills |
| Barry Blom | Federal pay, monthly Treasury data |
| Jared Brewster | Interest on the public debt |
| Joanna Capps | Appropriation bills (Labor, Health and Human Services, and Education; State and Foreign Operations) |
| Gabriel Ehrlich | Fannie Mae and Freddie Mac, Federal Housing Administration |
| Mary Froehlich | Computer support |
| Avi Lerner | Troubled Asset Relief Program, automatic budget enforcement and sequestration, other interest |
| Amber Marcellino | Federal civilian retirement, historical data |
| Virginia Myers | Appropriation bills (Commerce, Justice, and Science; Financial Services and General Government) |
| Jeffrey Perry | Fannie Mae and Freddie Mac, Federal Housing Administration |
| Mitchell Remy | Fannie Mae and Freddie Mac, Federal Housing Administration |
| Mark Sanford | Appropriation bills (Agriculture and Food and Drug Administration; Defense) |
| Esther Steinbock | Appropriation bills (Transportation and Housing and Urban Development; Military Construction and Veterans Affairs; Energy and Water Development) |
| Santiago Vallinas | Various federal retirement programs, national income and product accounts, federal pay |
| Patrice Watson | Database system administrator |
| Adam Wilson | Appropriation bills (Homeland Security; Interior) |

## Writing

Christina Hawley Anthony wrote the summary. Barry Blom wrote Chapter 1, with assistance from Mark Booth and Jared Brewster; Jeffrey Holland wrote Box 1-1. Mark Lasky and Charles Whalen wrote Chapter 2. Christina Hawley Anthony, Jared Brewster, Amber Marcellino, and Santiago Vallinas wrote Chapter 3. Mark Booth and Joshua Shakin wrote Chapter 4. Amber Marcellino wrote Appendix A, with assistance from Mark Booth. Sarah Masi wrote Appendix B, with assistance from Jessica Banthin, Philip Ellis, Holly Harvey, and Jean Hearne. Devrim Demirel, Philip Ellis, and Benjamin Page wrote Appendix C, with assistance from Wendy Edelberg, Edward Harris, Janet Holtzblatt, Jonathan Huntley, Shannon Mok, Felix Reichling, and David Weiner. Avi Lerner wrote Appendix D, with assistance from Barbara Edwards. Frank Russek wrote Appendix E; and Jared Brewster, Appendix F. Alexander Arnon compiled Appendix G, and Amber Marcellino did the same for Appendix H.

## Editing and Publishing

The editing and publishing of the report were handled by CBO's editing and publishing group, supervised by John Skeen, and the agency's web team, supervised by Deborah Kilroe.

Christine Bogusz, Christian Howlett, Kate Kelly, Loretta Lettner, Benjamin Plotinsky, and John Skeen edited the report. Maureen Costantino and Jeanine Rees prepared the report for publication, and Leigh Angres, Robert Dean, Annette Kalicki, and Simone Thomas published the report on CBO's website.

Chad Chirico coordinated the preparation of tables of baseline projections for selected programs, and Leah Loversky and Logan Timmerhoff compiled supplemental economic and tax data—all posted with this report on the agency's website. Jeanine Rees and Simone Thomas coordinated the presentation of those materials.