CBO's latest budget and economic outlook once again warns of long-term fiscal pressures

The latest annual projections from the nonpartisan Congressional Budget Office (CBO) assessing the state of the US budget and economy for the next decade show a large and growing mismatch between federal revenues and spending even as the agency sees inflation moderating and economic growth persisting at a pace consistent with pre-pandemic levels.

Revenue, spending projections

CBO's *Budget and Economic Outlook: 2024 to 2034*, released on February 7, represents the agency's first full accounting of the federal fiscal and economic forecast after enactment of the Fiscal Responsibility Act of 2023 (FRA, P.L. 118-5), the budget accord negotiated by President Biden and then-House Speaker Kevin McCarthy, R-Calif., that placed statutory caps on discretionary spending for fiscal years 2024 and 2025 in exchange for suspending the federal debt limit through January 1, 2025.
URL: https://www.cbo.gov/system/files/2024-02/59710-Outlook-2024.pdf
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

The latest report predicts budget deficits will average 5.7 percent of gross domestic product (GDP) over the next decade—more than 150 percent higher than the average 3.7 percent of GDP deficit registered over the past 50 years. This represents a slight improvement over CBO's estimates from last year, which had deficits averaging 6.1 percent of GDP over the decade—a decline which stems mainly from the FRA's discretionary spending caps.

Although deficits have declined recently as the economy has recovered from the COVID-19 pandemic, that trend is coming to a close. CBO projects the deficit for fiscal 2024 (which runs through September 30 of this year) will come in at about $1.5 trillion and remain below $1.7 trillion through fiscal year 2027 as bigger revenue gains (more on those below) help put a damper on rising outlays. During the latter half of the 10-year budget window, however, the agency expects the annual deficit will steadily rise until it reaches almost $2.6 trillion in 2034.

Revenues and spending: CBO sees federal revenues rising from 16.5 percent of GDP last year to 17.5 percent in the current fiscal year. According to CBO, much of that increase is due to the Internal Revenue Service's postponement—from 2023 to 2024—of tax payments for certain individuals and corporations affected by natural disasters. On the corporate side, revenues are also projected to be higher in 2024 on account of the Treasury's penalty relief granted to estimated payments of the corporate alternative minimum tax (CAMT), which the CBO suggests depressed CAMT payments during 2023.

Over the course of the next 10 years, CBO projects revenues will fall about one-half percentage point in 2025, but then recover as major components of the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) are scheduled to expire. After that time, the agency expects receipts will hover within a relatively narrow band and average

17.8 percent of GDP over the full budget window, a bit north of the 17.3 percent of GDP average over the past five decades.
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

As for corporate revenues in particular, CBO actually foresees a decline as a share of the economy over the next decade—a dynamic the agency attributes to the net effect of several factors including the conclusion of payments under the "deemed repatriation" tax enacted in the Tax Cuts and Jobs Act, increased foreign tax credit claims, declining domestic business profits generally, and the offsetting effect of the phase-in of various taxpayer-unfavorable provisions under the TCJA.

Meanwhile, on the spending side of the ledger, outlays—which have fallen sharply from their pandemic-era highs—are expected to resume their steady climb due to pre-existing demographic trends that are projected to increase the ranks of Social Security and Medicare beneficiaries and thus push up spending within those programs. Health care cost growth is also expected to continue to outstrip economic growth, thus pushing up that budgetary component as a share of GDP. By 2034, outlays would exceed 24 percent of the economy—a slight moderation from last year's report due to the FRA's discretionary spending caps which, as noted above, have served to lower CBO's projections of annual appropriations over the next 10 years.

Over the past 50 years, spending has averaged about 21 percent of GDP.

Inflation, interest rates, GDP: On the economic front, CBO forecasts that inflation will continue to moderate, falling from 3.2 percent (actual) in 2023 to 2.5 percent (as measured by growth in the Consumer Price Index) in 2024. By 2026 and for the remainder of budget window, CBO sees inflation returning to a more normal Federal Reserve-targeted level of about 2 percent.

Annual economic growth (adjusted for inflation) is projected to fall by half this year (from 3.1 percent in 2023 to 1.5 percent in 2024) on account of weaker growth in consumer spending and reduced investment in nonresidential real estate, but then bounce back to 2.2 percent in 2025 and average 1.9 percent over the last five years of the budget window. Inherent in these projections is an assumption that the Federal Reserve's recent campaign to raise its key policy-making rate, the Federal Funds Rate, will result in a so-called "soft landing" for the economy that blunts annual price growth without triggering a recession.

Debt service costs: In line with most market observers, CBO projects that the Fed will significantly moderate its short-term, inter-bank lending rate in the coming years. However, CBO also believes that longer-term rates will remain elevated, at least in comparison to their pandemic-era lows. For example, according to CBO, the average rate on 10-year Treasury bonds will remain around 4 percent (its actual average in 2023) over the course of the next decade.

As a result, interest payments on the national debt are projected to average 3.5 percent of GDP over the next decade, up from a 3.1 percent of GDP average in last year's report and 2.6 percent of GDP in the year before. In nominal terms, the agency expects the government will incur $1.6 trillion in debt service costs in 2034 alone—roughly 16 percent of total spending that year.

Publicly held debt: In its January 2020 long-term outlook (published before the pandemic), CBO had projected that debt held by the public—that is, federal debt not held in intragovernmental accounts such as Social Security and Medicare trust funds—would not reach 100 percent of GDP until the early 2030s.

This week's analysis, however, shows that dubious milestone will be reached next year, and that publicly held debt will climb to 116 percent of the economy by the end of the 10-year budget window. (Actually, debt briefly crossed 100 percent of the economy by the end of fiscal year 2020, but then fell again as pandemic-related pressures began to wane).

'Current law' caveat

It is important to note that, by law, CBO is generally required to make its projections on the basis of "current law," or laws as they are currently in effect. (One exception is excise taxes dedicated to trust funds—for example, highway- and aviation-related taxes—which are assumed to be continued beyond any scheduled expiration).

That means this week's analysis does not account for the budget impact of any potential supplemental spending package that some Democrat and Republican lawmakers are currently pursuing.

On the flip side, also inherent in CBO's projections is an assumption that the temporary tax provisions scheduled to expire over the budget window—including nearly all of the individual tax changes and the passthrough deduction under section 199A that were enacted in the TCJA and are set to lapse after 2025—will not be renewed, and revenues will be higher as a result. (For details on a recent report from the nonpartisan Joint Committee on Taxation staff outlining all the temporary provisions that currently are scheduled to expire between 2024 and 2034, see *Tax News & Views*, Vol. 25, No. 3, Jan. 19, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240119_2.html

That assumption similarly applies to certain other TCJA provisions—including those affecting bonus depreciation, the business interest deduction limitation under section 163(j), the timing of research expenditure deductions, and the minimum tax on US multinationals known as the global intangible low-taxed income regime—that, if left untouched by lawmakers, will have (or are already having) the effect of raising revenue under current law.

Any long-term—and unoffset—extensions of expiring TCJA provisions that are adopted by Congress and signed into law would cause the deficit to spike dramatically. CBO estimated in budget projections published in May of 2023 that the 10-year cost (including additional debt service) of renewing all of the expiring individual TCJA provisions is $2.91 trillion, and that maintaining current law on several business provisions—related to foreign profits and profit shifting—that are also due to change would cost another $166 billion.
URL: https://www.cbo.gov/publication/59154

The Tax Relief for American Families and Workers Act of 2024 (H.R. 7024)—which recently cleared the House but is stuck in the Senate—would reinstate the now-expired TCJA provisions related to full expensing, the treatment of research expenditures, and the business interest expense deduction through 2025. CBO estimated in its May 2023 budget projection that a long-term extension of full expensing would cost $384 billion over 10 years. Recent estimates from the Tax Foundation, a Washington-based think tank, peg the 10-year cost of maintaining expensing for research expenditures and the 30 percent limitation on business interest expense deductions at $174.5 billion and $123.1 billion, respectively. (See separate coverage in this issue for an update on the status of that legislation.)

URL: https://www.congress.gov/118/bills/hr7024/BILLS-118hr7024eh.pdf

URL: https://taxfoundation.org/research/all/federal/making-2017-tax-reform-permanent/

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