CBO: Long-term budget outlook remains bleak

The nonpartisan Congressional Budget Office (CBO) on March 20 released an update of its Long-Term Budget Outlook, which continues to paint a sobering picture of the nation's projected fiscal condition over the next 30 years.
URL: https://www.cbo.gov/publication/59711

The report, which extrapolates CBO's typical 10-year current-law "baseline" projections through 2054, predicts the federal debt held by the public (that is, debt not held in intragovernmental accounts such as the Social Security trust fund) will reach 166 percent of gross domestic product (GDP) by the end of the 30-year window. (For coverage of CBO's most recent 10-year baseline, see *Tax News & Views*, Vol. 25, No. 6, Feb. 9, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240209_2.html

The largest debt-to-GDP level in recorded US history—106 percent—was reached in 1946 in the wake of World War II.

Those increasing debt levels are the product of large and growing annual budget deficits that would more or less consistently rise from about 5.6 percent of GDP in the current fiscal year to about 8.5 percent of GDP in 2054. Over the past five decades, budget deficits have averaged 3.7 percent annually.

Revenue and spending mismatch

As it has many times in recent years, CBO once again attributes those large and growing deficits to a fundamental mismatch between revenues and spending driven in part by the continuing retirement of the Baby Boom generation (which is resulting in a greater number of Medicare and Social Security beneficiaries), as well as lower birth rates and growth in health care costs.

Revenues: In CBO's estimation, revenues will rise gradually over the next few decades—from about 17.5 percent of GDP in the current fiscal year (that is, fiscal year 2024) to 18.8 percent of GDP by 2054—as temporary tax cuts expire, scheduled tax increases take effect, and more income is taxed at higher rates due to what's known as "bracket creep" (the tendency of revenues to naturally rise over time as wage growth exceeds the inflation index to which the individual tax brackets are tied). Accelerating distributions from tax-deferred retirement plans by Baby Boomers exiting the workforce also plays a role.

Over the past five decades, revenues have averaged roughly 17.3 percent of the economy.

Spending and debt service: On the spending side of the ledger, a notable metric in this week's report—and a large contributor to future deficits, along with growing outlays for Social Security and Medicare due to the aging population and growing health care expenses—relates to the government's projected debt service costs.

Though interest rates hit historic lows during the coronavirus pandemic—a function of both Federal Reserve policy and continued strong demand for US Treasury bills and bonds—which caused the CBO to significantly write down its estimates of what the government will spend on interest over the medium term, that trend appears to be over. In fact, over the next three decades, the agency projects the government's net interest costs will more than double from 3.1 percent of GDP this year to 6.3 percent of GDP in 2054 as interest rates remain elevated (at least in comparison to their pandemic-era lows) and are applied to a large and growing federal debt load.

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 taxes—which are assumed to be continued beyond any scheduled expiration).

That means that inherent in CBO's projections is an assumption that most expiring tax provisions—including, most notably, nearly all of the individual tax changes in the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) as well as the TCJA's passthrough deduction under section 199A, which are scheduled to lapse after 2025—will not be renewed, and revenues will be higher as a result. That assumption similarly applies to recent taxpayer-unfavorable changes that have occurred pursuant to the TCJA that have affected 100 percent bonus depreciation, the business interest deduction limitation under section 163(j), and the timing of research expenditure deductions—policies that many Republicans and Democrats would like to see reversed, but which CBO assumes will remain in their present state in perpetuity (or, in the case of bonus depreciation, will continue to phase out as scheduled).
URL: https://www.congress.gov/115/plaws/publ97/PLAW-115publ97.pdf

Thus, if additional tax cuts or spending increases are enacted into law, or if temporary tax provisions are instead made permanent or otherwise extended beyond their scheduled expiration, future deficits may be higher than this week's CBO projections unless those policies are offset by other budgetary changes.

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