CBO ramps up deficit projections in latest budget and economic outlook

The nonpartisan Congressional Budget Office (CBO) this week released an updated assessment of the tax, spending, and economic outlook over the next decade which shows a marked increase in budget deficits, both in the current year and over the 10-year budget window, as compared to the prior fiscal and economic projections it published just four months ago.

Revenue lower, spending higher

CBO's *An Update to the Budget and Economic Outlook: 2024 to 2034*, released June 18, anticipates that the budget deficit for fiscal year 2024—which runs through September 30—will clock-in at more than $1.9 trillion, or 6.7 percent of gross domestic product (GDP). That shortfall represents a roughly $400 billion increase relative to the comparable projections released by CBO in February—the net effect of the Biden administration's proposed rule to reduce federal student loan balances for many borrowers, slower than anticipated recoveries by the Federal Deposit Insurance Corporation when resolving recent bank failures, certain newly enacted spending legislation, and higher projected outlays within the Medicaid program.
URL: https://www.cbo.gov/system/files/2024-06/60039-Outlook-2024.pdf

In addition, federal revenues are now projected to be $45 billion, or 1 percent, lower as compared to the agency's prior estimates. (For prior coverage of CBO's previous estimates published this past February, see *Tax News & Views*, Vol. 25, No. 6, Feb. 9, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240209_2.html

This negative trend continues over the 10-year budget window, with cumulative deficits now projected to amount to almost $22.1 trillion, about $2.1 trillion higher than the agency projected earlier this year, with the bulk of that increase attributable to the recently enacted $95 billion foreign aid package benefiting Ukraine, Israel, and Taiwan and the fact that under standard scoring conventions the CBO must assume that amount of discretionary funding is provided on an inflation-adjusted basis over the course of the budget window. (Note that the $95 billion package, structured as an "emergency supplemental" spending bill, is not subject to the statutory appropriations caps for fiscal years 2024 and 2025 put in place by the Fiscal Responsibility Act of 2023 (P.L. 118-5).)
URL: https://www.congress.gov/118/plaws/publ5/PLAW-118publ5.pdf

Digging into the details

CBO sees federal revenues rising from 16.5 percent of GDP last year to 17.2 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 businesses affected by natural disasters. On the corporate side, revenues are also projected to be higher in 2024 on account of the Treasury Department's penalty relief granted to estimated payments of the corporate alternative minimum tax (CAMT), which the CBO suggests depressed CAMT payments during 2023. (See separate coverage in this issue for details on the latest extension of CAMT penalty relief granted by Treasury.)

Over the course of the next 10 years, CBO projects revenues will fall slightly in 2025, to 17 percent of GDP, but then recover as major components of the Tax Cuts and Jobs Act of 2017 (TCJA, P.L. 115-97) are scheduled to expire (more on that below). 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 included in the TCJA, 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.

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

Inflation, interest rates, GDP: On the economic front, CBO's latest forecast suggests that inflation will continue to moderate, falling from 3.2 (actual) in 2023 to 3.0 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 roughly one-third this year (from 3.1 percent in 2023 to 2.0 percent in 2024) on account of weaker growth in consumer spending and an increase in imports relative to domestic demand, and then remain at about that level (or a bit less) over the rest of the decade. 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" that blunts annual price growth without triggering a recession.

Debt service costs: In line with most market observers, the CBO projects that the Fed will significantly moderate its short-term, inter-bank lending rate in the coming years. Specifically, the report anticipates that Fed will begin lowering the Federal Funds Rate in early 2025. However, the 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 3.7 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 $1.7 trillion in debt service costs in 2034 alone—almost 17 percent of total spending that year.

Publicly held debt: In its January 2020 long-term outlook (published before the coronavirus 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 more than 122 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 future supplemental spending packages, or any potential action by lawmakers to relax the Fiscal Responsibility Act's spending cap with respect to upcoming appropriations bills for fiscal year 2025. (A number of Democrats and Republicans have expressed a desire to lift the caps on domestic and defense accounts, respectively.)

On the receipts 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, estate 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 example, this week's report shows individual tax revenues alone jumping by more than 1 percent of GDP, or almost $300 billion, between 2025 and 2026.

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 more revenue when compared to the more generous terms available under current (or prior) law.

A separate report released by the CBO last month pegged the 10-year cost of permanently extending all of the lapsed and lapsing provisions of the TCJA at $4.6 trillion—a $1.1 trillion increase from similar projections the agency issued in 2023. (For prior coverage, see *Tax News & Views*, Vol. 25, No. 17, May 10, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240510_2.html

Implications for 2025 tax debate

This large mismatch between “current law” and “current policy”—and the bleak fiscal outlook in general—is certain to play a major role when the next presidential administration and the next Congress consider the contours of any TCJA-related tax package next year.

Congressional taxwriters have already retreated to their respective partisan corners to mull possible strategies for addressing the pending expiration of TCJA tax-relief provisions affecting individuals, estates, and passthrough entities.

Shortly after a meeting of Senate Finance Committee Democrats on June 20, Chairman Ron Wyden, D-Ore., told reporters that he intends to work with his colleagues to “build a revenue menu to get good ideas” for offsetting the cost of any tax breaks that move through Congress next year. Wyden offered few details of what he and his colleagues discussed in their initial meeting, but Democratic taxwriters generally have made clear that their priority is to pursue tax increases on large corporations and ultrawealthy individuals to pay for family-focused tax cuts, such as an expanded child tax credit.

Finance Committee member Mark Warner, D-Va., told reporters that Democrats will be looking beyond the TCJA as they approach what he called a “Tax Armageddon” in 2025.

“It’s time to suit up and come up with the theories of the case rather than the normal ‘it should be X rate or Y rate,’” he said.

For their part, House Ways and Means Committee Chairman Jason Smith, R-Mo., and Tax Subcommittee Chairman Mike Kelly, R-Pa., announced in late April that they have formed 10 “tax teams“ of GOP taxwriters to “study key tax provisions from the TCJA that are set to expire in 2025 and identify legislative solutions that will continue to help families, workers, and small businesses.” (For prior coverage, see *Tax News & Views*, Vol. 25, No. 16, May 3, 2024.)
URL: https://waysandmeans.house.gov/2024/04/24/ways-means-chairman-smith-and-tax-subcommittee-chairman-kelly-announce-tax-teams-to-avert-2025-tax-cliff/
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240503_6.html

Senate Finance Committee ranking member Mike Crapo, R-Idaho, indicated last month that he has formed TCJA “working groups” of GOP taxwriters in that chamber, although details on the number of groups, leadership and membership assignments, and the specific topics they are expected to cover remain unclear. (For prior coverage, see *Tax News & Views*, Vol. 25, No. 19, May 24, 2024.)
URL: https://dhub.deloitte.com/Newsletters/Tax/2024/TNV/240524_3.html

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