



Testimony

The Budget and Economic Outlook: 2014 to 2024

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Committee on the Budget
United States Senate

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Chairman Murray, Senator Sessions, and Members of the Committee, thank you for inviting me to testify on the Congressional Budget Office's (CBO's) most recent analysis of the outlook for the budget and the economy. My statement summarizes CBO's new economic forecast and baseline budget projections, which cover 2014 to 2024. Those estimates were released last week in the report titled *The Budget and Economic Outlook: 2014 to 2024*.

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 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 increas-

ing 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).

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

Table 1.**CBO's Baseline Budget Projections**

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

the end of 2007, such debt equaled 35 percent of GDP (see 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 Figure 2 on page 6). 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

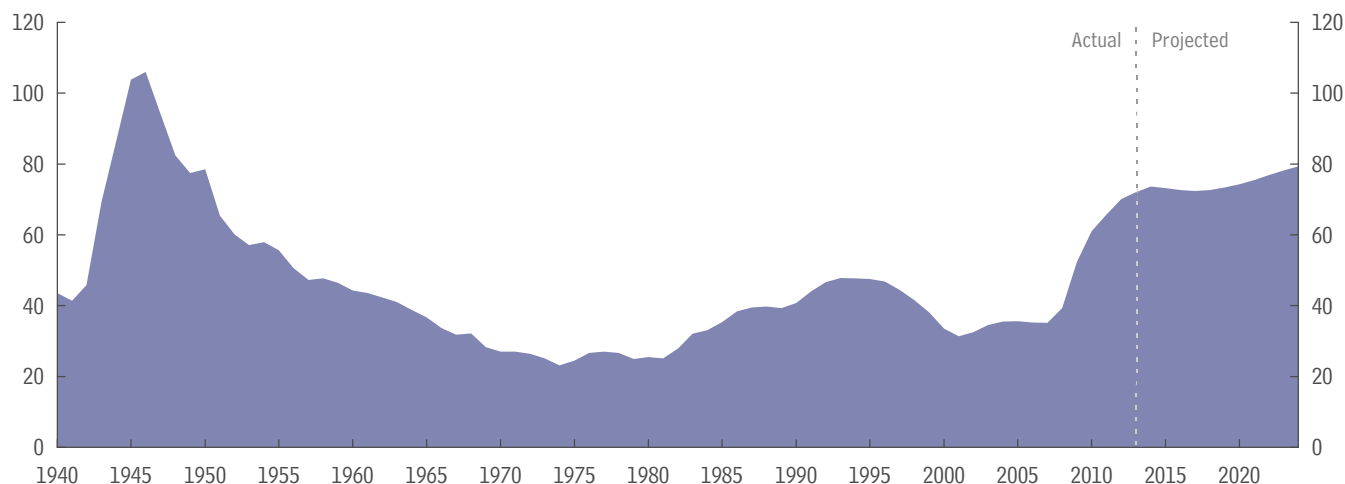
average percentage over the past 40 years. CBO projects that under current law, outlays will grow faster than the economy during the next decade and will equal 22.4 percent of GDP in 2024. With no changes in the applicable laws, spending for Social Security, Medicare (including offsetting receipts), Medicaid, the Children's Health Insurance Program, and subsidies for health insurance 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

Figure 1.**Federal Debt Held by the Public**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

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 Figure 3 on page 7). 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.

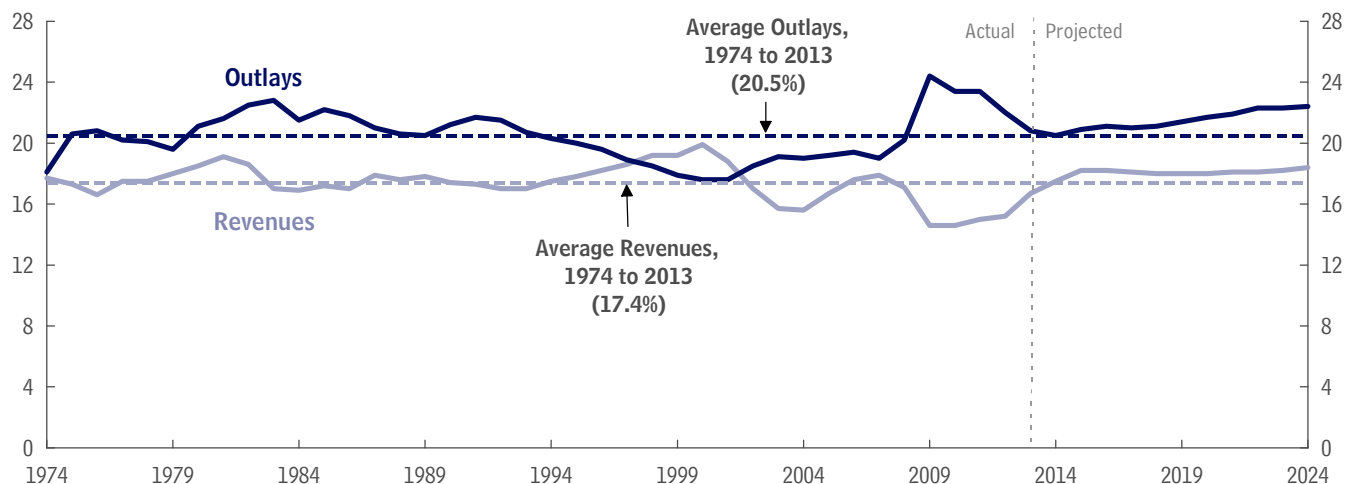
The Economic Outlook Through 2017

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 Table 2 on page 8).¹ CBO expects that those increases in output will spur businesses to hire more workers, pushing down the unemployment rate and

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.

Figure 2.**Total Revenues and Outlays**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

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

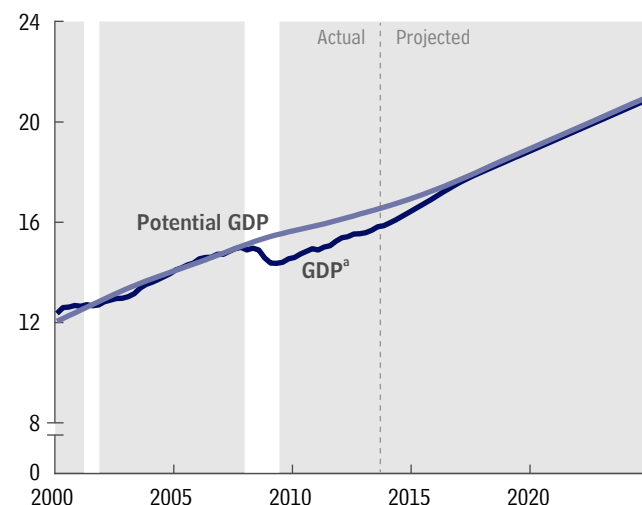
Beginning in 2018, CBO's projections of GDP are based not on forecasts of cyclical movements in the economy but on projections of trends in the factors that underlie potential output, including total hours worked by labor,

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.

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.

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

Table 2.**CBO's Economic Projections for Calendar Years 2014 to 2024**

	Estimated, 2013	Forecast				Projected Annual Average, 2018-2024
		2014	2015	2016	2017	
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.

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.

