Insight

CBO’s January Baseline: Closer to Reality

GORDON GRAY | JANUARY 21, 2016

On Tuesday, the Congressional Budget Office (CBO), released a precis of its annual January baseline, which provides policymakers with the agency’s latest economic and budgetary projections for the next ten years. There was very little in the way of surprises, economically or budgetarily. Instead, the latest projections reflect the passage of legislation that made permanent a number of temporary measures, as well as relief from spending caps imposed by the Budget Control Act (BCA). These developments mark the further convergence of current policy, that is to say what Congress does “temporarily,” with current law, which is what Congress enacts permanently, and thus moves budget projections closer to reality.

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The Budget Outlook

Over the next decade, deficits will average over $900 billion, as spending outpaces revenue and economic growth, driving the debt up to 86 percent of GDP. Entitlement spending will increase due to the rising costs of Social Security and major health care programs. Discretionary spending will also rise due to the Bipartisan Budget Act of 2015, which increased statutory limits on discretionary funding, and subsequent appropriations. Net interest spending will also increase because of rising interest rates and a larger federal debt.

The Economic Outlook

CBO expects that in the next two years, real growth will pick up to 2.7 percent in 2016 and 2.5 percent in 2017, settling to an average of 2 percent thereafter. Unemployment is expected to continue to fall to 4.5 percent before normalizing at slightly above the normal rate of unemployment for the next ten years. As noted by CBO, the longer-term growth rate is down from the average trend growth rate that was observed during the 1980s, 1990s, and early 2000s. This tepid growth is attributable to slower projected labor force growth, driven by demographics and public policy, such as the Affordable Care Act. CBO projects that interest rates will increase above current rates, but owing to lower projected inflation and growth, are expected to remain below the average of rates observed in the 25 years preceding the financial crisis.

What Changed?

CBO last updated its budget and economic estimates in August. The January budget estimates reflect a $1.5 trillion increase in cumulative projected deficits since the August estimates. Despite the large swing, the balance of this change has been entirely predictable, with half of that projected increase attributable to legislation enacted since August – specifically the increase in discretionary spending and the enactment of permanent and extended tax policies. These Acts enshrined what has become common practice by Congress, providing relief from sequestration and annual passage of temporary extensions of dozens of tax policies. In providing a few years' relief under the BCA caps, and more significantly, making permanent $559 billion worth of tax policies that Congress routinely extends, Congress essentially owned up to the costs of policies it was in the habit of enacting but only on a short term basis. This continues the march to aligning "current policy" with "current law," and one casualty may be CBO's alternative fiscal scenario and tables of budget alternatives that more closely matched budget reality. The remaining changes from the August estimates reflect slightly weaker projected growth (in part owing to historical revisions) and technical changes. CBO's interest rate forecast has also been marked down from August's estimate.