CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Phillip L. Swagel, Director

April 10, 2025

Honorable Jeff Merkley
Ranking Member
Committee on the Budget
United States Senate
Washington, DC 20510

Re: Projections of Deficits and Debt Under an Alternative Scenario for the Budget

Dear Senator:

This letter responds to your request for an analysis of projected deficits and debt under an alternative scenario for the budget that reflects two changes to the Congressional Budget Office's baseline. Specifically, you asked how CBO's projections of deficits and debt would change if certain provisions of the 2017 tax act (Public Law 115-97) were extended permanently.[1] (By statute, estimates of the effects of tax legislation are made by the staff of the Joint Committee on Taxation, or JCT.) You also asked how those projections would change if revenues were reduced by an additional $150 billion in each year of the 10-year budget window and by a fixed percentage of gross domestic product (GDP) thereafter.

In CBO's most recent extended baseline projections, which reflect the assumption that current laws generally remain unchanged, primary deficits (that is, deficits excluding net outlays for interest) average 2.0 percent of GDP over the 2025–2055 period and equal 1.9 percent of GDP in 2055.[2]

[1] For details of those provisions and estimates of the effects of extending them, see Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation, letter to the Honorable Sheldon Whitehouse, the Honorable Ron Wyden, the Honorable Richard E. Neal, and the Honorable Brendan F. Boyle (April 3, 2025), https://tinyurl.com/32y3z95v.

[2] In accordance with statutory requirements, CBO's projections reflect the assumptions that current laws generally remain unchanged, that some mandatory programs are extended after their authorizations lapse, and that spending on Medicare and Social Security continues as scheduled even if the programs' trust funds are exhausted.

Total deficits average 6.3 percent of GDP over that period and reach 7.3 percent of GDP in 2055. Federal debt held by the public increases from 100 percent of GDP to 156 percent of GDP—exceeding any previously recorded level and on track to increase further.[3]

CBO estimates that if provisions of the 2017 tax act were extended, tax revenues were lower by the additional amount you specified, and there were no other changes to fiscal policy, debt held by the public would reach 220 percent of GDP in 2055, 63 percentage points higher than in the long-term baseline projections. Interest rates would also be higher, and real gross national product (GNP) per person—a measure of the resources available to U.S. households—would be lower in that year.[4]

Those estimates incorporate the economic effects that would result from the extension of provisions of the 2017 tax act and the additional reductions in revenues that you specified. Those effects include increases in the supply of labor and investment brought about by lower marginal tax rates on income from labor and capital, increases in output in the short term caused by greater overall demand for goods and services, and decreases in output in the longer term caused by larger federal deficits and debt.

A Scenario With Provisions of the 2017 Tax Act Extended and Additional Reductions in Revenues

You asked CBO to analyze the effects of an alternative budget scenario in which certain provisions of the 2017 tax act that changed the individual income tax continue indefinitely: the lower statutory tax rates, the changes to allowable deductions, the larger child tax credit, the 20 percent deduction for certain business income, and the income levels at which the alternative minimum tax takes effect. CBO's analysis also accounted for the effects of permanently extending the higher estate and gift tax exemptions,

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[3] Congressional Budget Office, *The Long-Term Budget Outlook: 2025 to 2055* (March 2025), www.cbo.gov/publication/61187. CBO's long-term budget projections, referred to as the extended baseline, are based on the demographic, economic, and 10-year budget projections that CBO published in January 2025. The demographic projections reflect information, laws, and policies as of November 15, 2024. The economic projections reflect those demographic projections as well as laws, policies, economic developments, and preliminary budget projections as of December 4, 2024. The 10-year budget projections, which build on those demographic and economic projections, include the effects of legislation enacted as of January 6, 2025. The projections do not reflect the effects of administrative actions taken or judicial decisions made after those respective dates, including actions and decisions affecting immigration, tariffs, and other policy areas.

[4] Unlike GDP, GNP includes income that U.S. residents earn abroad and excludes income that foreigners earn from domestic sources.

permanently extending provisions that allow businesses to immediately deduct the full cost of certain investments, and maintaining more generous rules for several business tax provisions. Many other provisions of the 2017 tax act are permanent and are therefore reflected in CBO's baseline projections as well as in that alternative scenario.

You also asked that revenues in the alternative scenario be reduced by an additional $150 billion in each year of the 10-year budget window and by a fixed percentage of GDP thereafter. Reductions in revenues can occur through many channels. To simplify the analysis, you asked CBO to assume that the reductions occur through a uniform refundable tax credit that leaves incentives to work and invest unchanged.[5]

In that scenario, deficits and debt are larger than they are in CBO's extended baseline (see Figure 1):

- Primary deficits over the first decade of the projection period (fiscal years 2026 to 2035) are about $6 trillion larger. By 2055, the primary deficit equals 3.8 percent of GDP, 1.9 percentage points higher than in CBO's extended baseline.

- The total deficit in 2055 equals 12.0 percent of GDP, 4.7 percentage points higher than in CBO's extended baseline.

- Debt held by the public in 2055 equals 220 percent of GDP, 63 percentage points higher than in CBO's extended baseline.

- The average interest rate on federal debt in 2055 equals 4.0 percent, 0.3 percentage points higher than in CBO's extended baseline.

- Real GNP per person is 3.3 percent lower in 2055 than in CBO's extended baseline (or $4,375 lower, in 2025 dollars).

Economic growth would be faster in the first several years after the extension of the tax provisions, primarily because of the increase in the overall demand for goods and services. It would be slower in the longer term: Although lower marginal tax rates would raise the supply of labor and investment by increasing the incentives to work and invest, larger deficits

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[5] Reductions in tax revenues attributable to refundable tax credits reflect the portions of the credits that exceed taxpayers' liability and are recorded in the budget as increases in mandatory spending.

and debt would reduce the resources available for private investment, eventually offsetting that boost to growth.[6]

Interest rates would be higher in the short term because the Federal Reserve would respond to inflationary pressure from increased demand by either raising interest rates or keeping them higher than they would be otherwise. In the longer term, larger deficits and lower private investment would reduce the amount of capital per worker. That would boost the productivity of capital because each unit would be used by more workers. As a result, returns on capital would rise—along with returns on other assets that compete for investors' resources, including Treasury securities.

How CBO Projected Those Outcomes

CBO's long-term budget projections build on the agency's baseline projections, which are constructed in accordance with a set of rules. Most of those rules are statutory—they are found in the Congressional Budget and Impoundment Control Act of 1974, the Balanced Budget and Emergency Deficit Control Act of 1985, the Federal Credit Reform Act of 1990, the Budget Control Act of 2011, and other laws.

To reflect the budget scenario that you described, CBO employed the methods it used to estimate deficits and debt under several alternative economic and budgetary scenarios in a previous report.[7] CBO used JCT's estimates of the budgetary effects of extending provisions of the 2017 tax act through 2035 and projected those effects through 2055. (Again, by statute, all estimates of the effects of tax legislation are made by the staff of JCT.) CBO then reduced revenues by an additional $150 billion per year for 2026 through 2035 and by about 1.5 percent of GDP in all subsequent years.

In that scenario, tax policies would differ significantly from current law. Those changes would affect the economy in ways that would feed back into

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[6] For more information about the economic effects of extending provisions of the 2017 tax act, see Congressional Budget Office, "How the Expiring Individual Income Tax Provisions in the 2017 Tax Act Affect CBO's Economic Forecast" (December 2024), www.cbo.gov/publication/60986, and "CBO's Model for Estimating the Effects on New Investment of Deductions to Recover the Cost of Capital" (December 2024), www.cbo.gov/publication/60985; and Staff of the Joint Committee on Taxation, "Overview of JCT Methodology for Analyzing the Macroeconomic Effects of Proposed Changes in Tax Law" (December 2024), https://tinyurl.com/4v26ukjt.

[7] Congressional Budget Office, *The Long-Term Budget Outlook Under Alternative Scenarios for the Economy and the Budget* (May 2024), www.cbo.gov/publication/60169.

the budget, further changing spending and revenues. In the simplified analysis presented here, CBO accounted for four of those economic effects:

- Effective marginal tax rates on income from labor would be lower than they are in the extended baseline. Those lower tax rates would encourage people to work and save more and would thus increase output.[8]

- Effective marginal tax rates on income from most types of capital would also be lower. Those lower rates would encourage saving and investment, further boosting output.[9]

- Overall demand for goods and services would be higher. Higher after-tax income would boost consumer spending, leading output to increase.

- Federal debt would be larger. The increase in federal borrowing would draw resources away from investment in capital goods and services, thus reducing the stock of private capital and decreasing output.

In CBO's simplified analysis, the additional $150 billion increases in annual deficits stem from unspecified policy changes that do not affect people's incentives to work and save or businesses' incentives to invest. Many policies that would increase the deficit would strengthen those incentives and would therefore have a positive effect on output that is not captured in the current analysis.

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[8] The effective marginal tax rate on labor income is the share of an additional dollar of such income that is paid in federal individual income taxes and payroll taxes, averaged across taxpayers in proportion to their labor income.

[9] The effective marginal tax rate on capital income is the share of the return on an additional dollar of investment made in a particular year that will be paid in federal taxes over the life of that investment.

I hope this information is helpful to you. Please contact me if you have any questions.

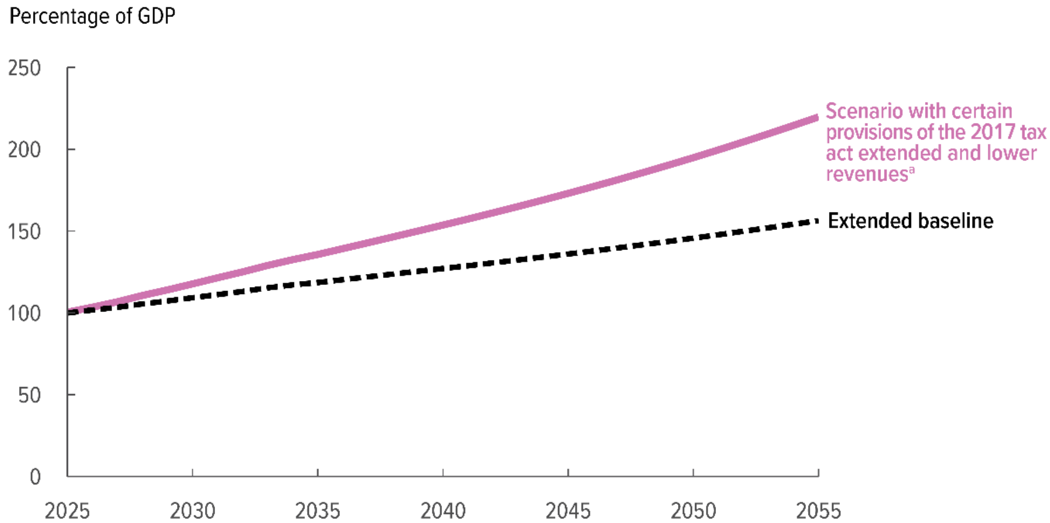
Sincerely,

Phillip L. Swagel
Director

cc: Honorable Lindsey Graham
Chairman

Figure 1.

Federal Debt Under the Extended Baseline and an Alternative Scenario



Data source: Congressional Budget Office.

CBO's long-term budget projections, referred to as the extended baseline, are based on the demographic, economic, and 10-year budget projections that CBO published in January 2025. The demographic projections reflect information, laws, and policies as of November 15, 2024. The economic projections reflect those demographic projections as well as laws, policies, economic developments, and preliminary budget projections as of December 4, 2024. The 10-year budget projections, which build on those demographic and economic projections, include the effects of legislation enacted as of January 6, 2025. The projections do not reflect the effects of administrative actions taken or judicial decisions made after those respective dates, including actions and decisions affecting immigration, tariffs, and other policy areas. Congressional Budget Office, *The Long-Term Budget Outlook: 2025 to 2055* (March 2025), www.cbo.gov/publication/61187.

The 2017 tax act refers to Public Law 115-97.

GDP = gross domestic product.

a. In this scenario, certain provisions of the 2017 tax act are extended permanently, and revenues are reduced by an additional $150 billion in each year of the 10-year budget window and by a fixed percentage of GDP thereafter.