The Federal Budget Situation: Outlook and Options

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Overview

The fiscal outlook

Debt-to-GDP projected to exceed its post-WWII peak by 2030

How we got here

Lower revenue, emergencies, aging and health costs, and a less responsive Congress

Why fiscal sustainability matters

Higher borrowing costs and less room to respond to crises

What it would take to stabilize the debt

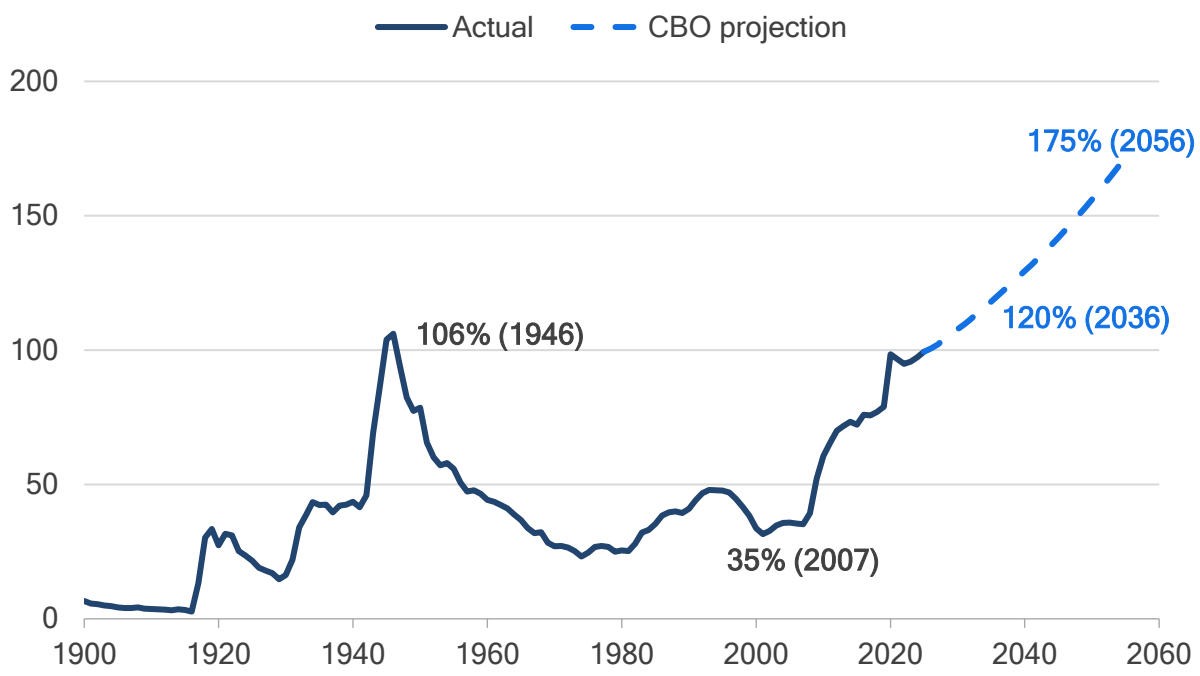
AI is unlikely to fix the problem but policymakers have many options

The debt outlook

Debt is about to exceed its post-war peak

Federal debt held by the public

Percent of GDP, fiscal years 1900-2056



101%

Debt as a share of GDP in 2026

5.8%

Deficit in 2026

Source: CBO, The Budget and Economic Outlook: 2026 to 2036 (Feb. 2026). Projections after 2036 are CBO's extended baseline.

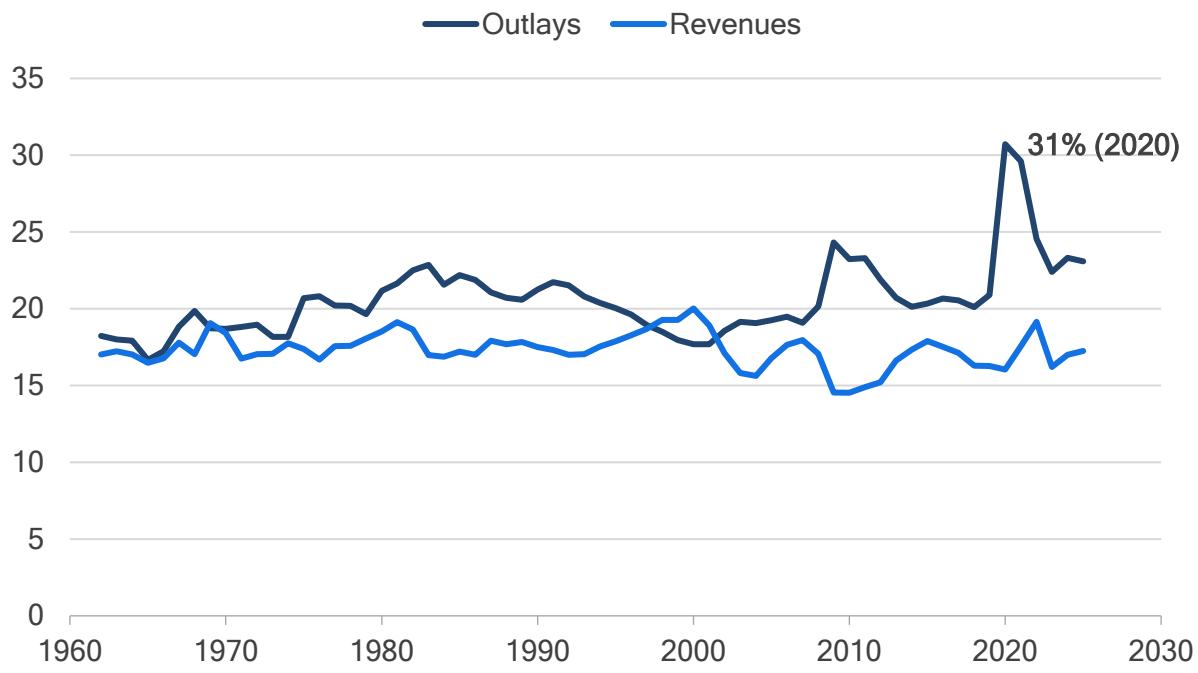
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The budget outlook

Outlays have generally exceeded revenues, and deficits remain large today

Federal outlays and revenues

Percent of GDP, fiscal years 1962-2025



Source: CBO, The Budget and Economic Outlook: 2026 to 2036 (Feb. 2026).

23.1%

Outlays as a share of GDP in 2025

17.2%

Revenues as a share of GDP in 2025

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PART 1

How did we get here?

How did we get here?

Several things are true at the same time

Revenues fell short

Tax cuts in 2001, 2003, 2017, and 2025 reduced revenues below CBO's 2000-vintage projection.

Emergencies added debt

The Iraq and Afghanistan wars, the Great Recession, and COVID-19 boosted deficits temporarily.

Aging and health costs

Social Security and major health programs have driven spending upwards.

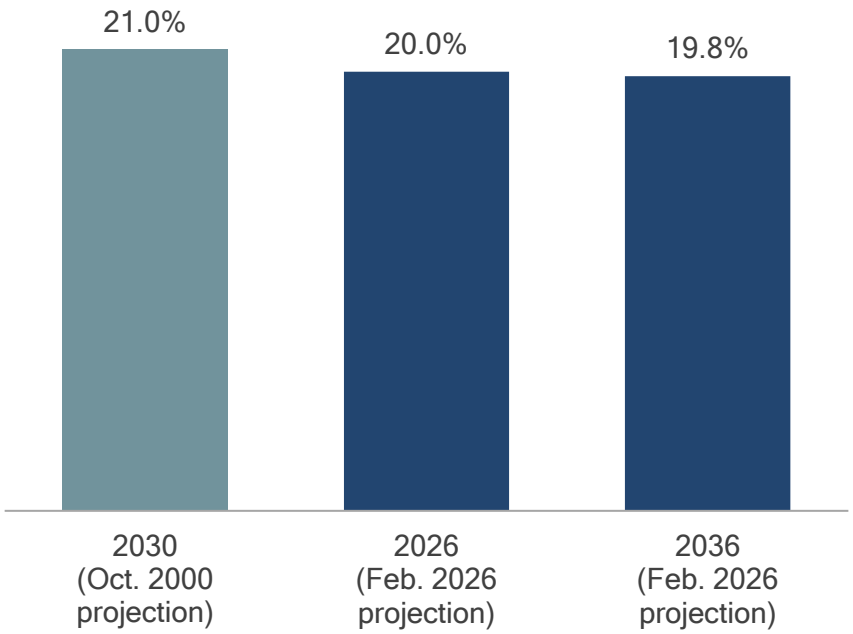
A less responsive Congress

Congress has been much less responsive to rising debt since about 2004.

Compared with 2000 projections…

Noninterest spending is below forecast

Projected noninterest spending
Percent of GDP



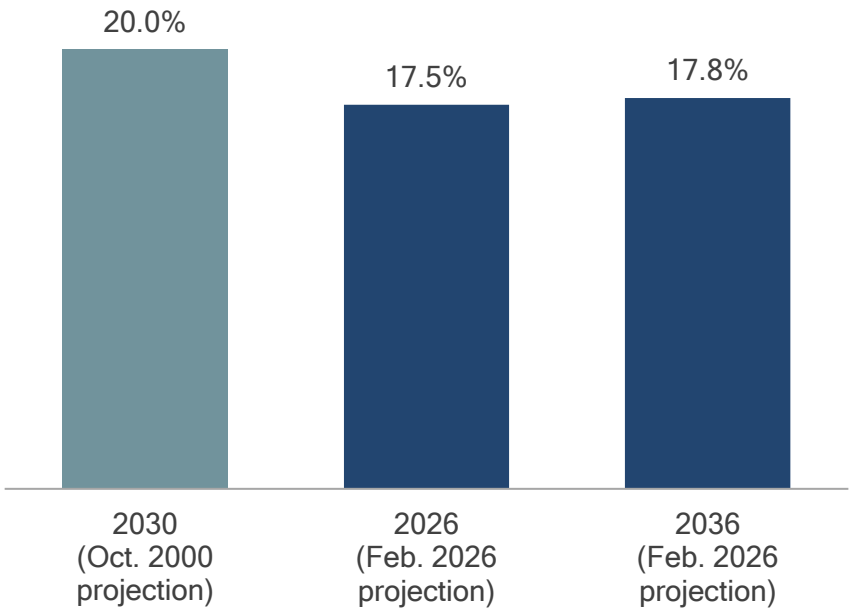
- In late 2000, CBO projected noninterest spending above current levels
- We knew at the time that population aging and healthcare cost growth would raise spending
- *Total* spending now exceeds earlier projections because of interest on accumulated debt

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Compared with 2000 projections…

Revenues are below forecast

Projected revenues
Percent of GDP



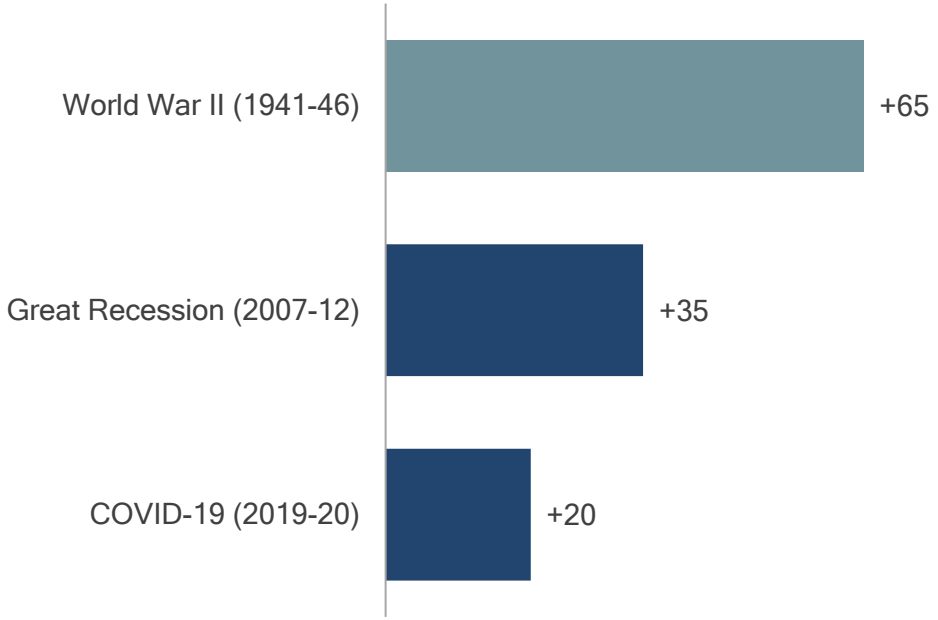
- In late 2000, CBO projected revenues above current levels
- Tax cuts since then have reduced actual revenues below that forecast

Temporary deficit spending

Debt rose because of wars, recessions, and COVID-19

Rise in debt during past episodes

Change in debt held by the public, percentage points of GDP



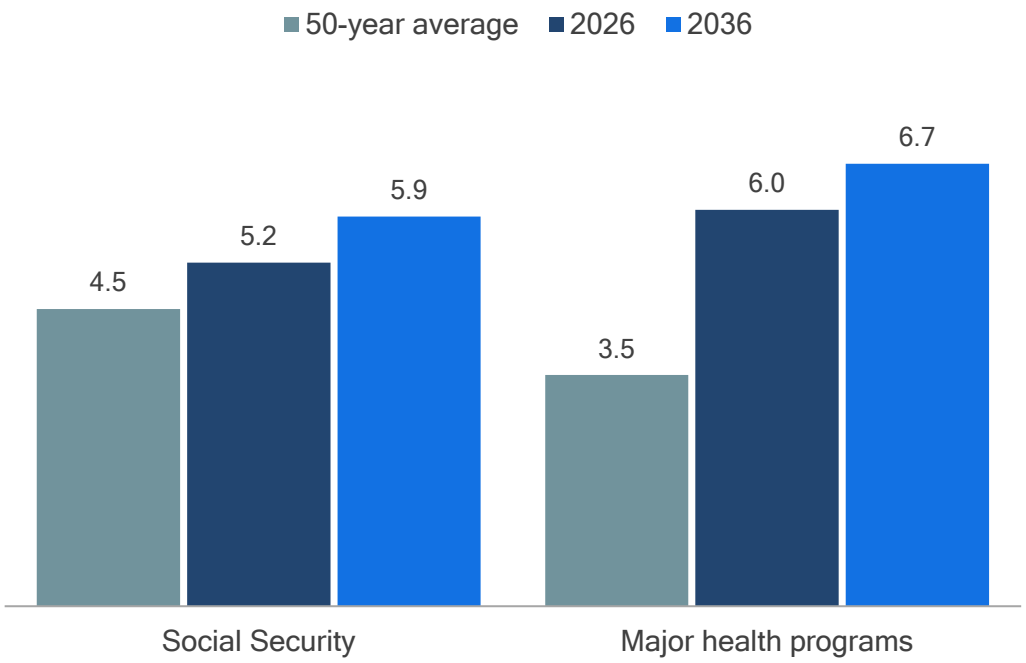
- Policymakers used fiscal capacity to address recessions and other emergencies
- Temporary spending led to higher net interest costs that remain with us

Population aging and health costs

Rising spending on retirees and health care

Federal spending by category

Percent of GDP

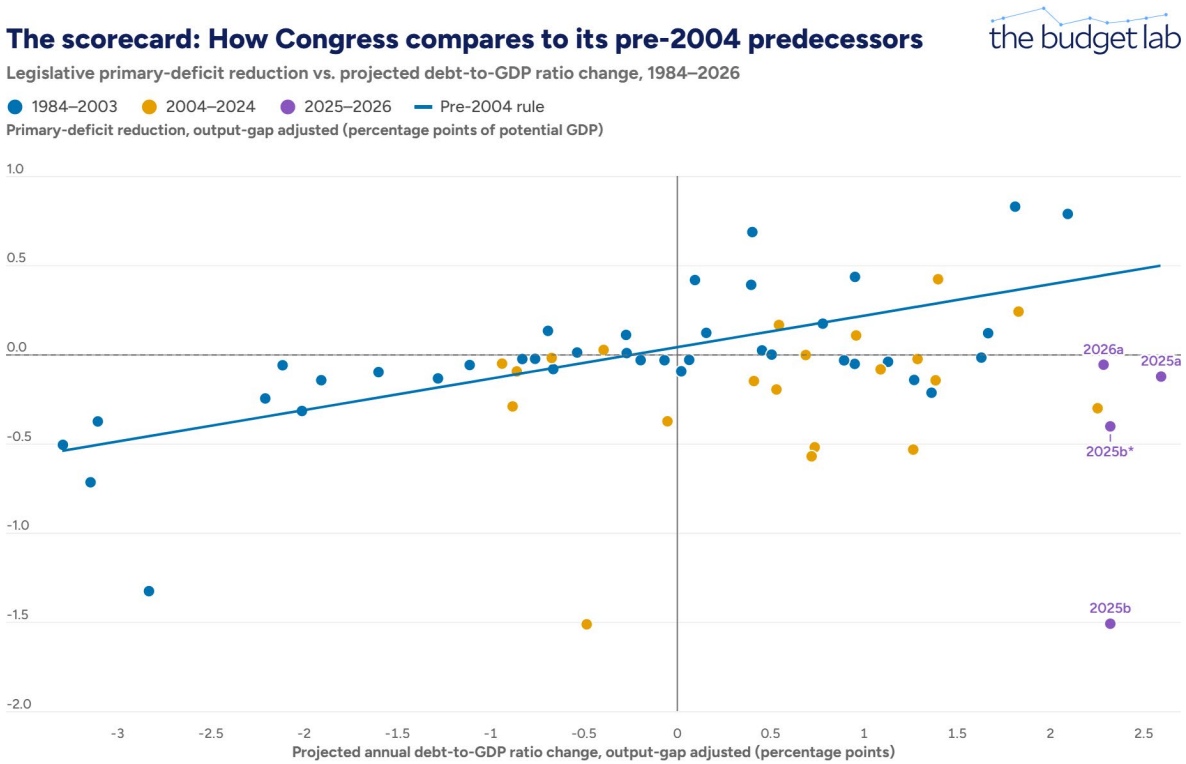


- Population aging has boosted spending on retirees
- Changes in healthcare policy and the rising cost of healthcare have also added

Note: 50-year average is 1976-2025. Major health programs: Medicare, Medicaid, CHIP, and marketplace subsidies.

A less responsive Congress

Congress does less about deteriorating fiscal trends than it used to



The 1984–2003 points are the benchmark era used to estimate the pre-2004 rule, and the 2004–2024 points are the comparison era. Each point represents one half-year, built from the CBO budget outlooks released in that half; "a" denotes the first half-year of a year and "b" the second. The horizontal axis measures CBO's projected average annual change in the debt-to-GDP ratio over the next five years, as of the start of that half-year. The vertical axis measures how much legislation enacted during the half-year reduced the primary deficit over those five years, as a share of potential GDP. Both axes are adjusted for the business cycle using the pre-2004 relationship with the output gap. Points below the line indicate that Congress enacted less deficit reduction than the pre-2004 rule predicts, while points above it indicate that Congress enacted more. Periods of constrained monetary policy (2008b–2016a and 2020b–2022a) are omitted. The 2025b* observation treats projected tariff revenue from executive action as if it were legislated.

Source: Congressional Budget Office and Budget Lab calculations based on Auerbach and Yagan (2026).

PART 2

Why it matters

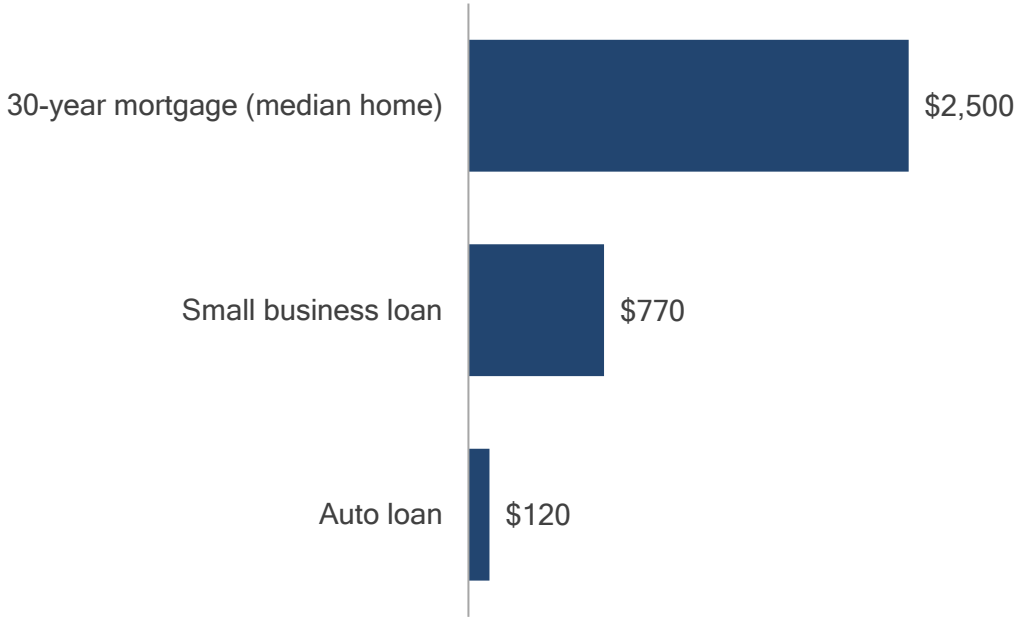
Costs for households, less fiscal space, and a growing interest bill

Household borrowing costs rise when debt rises

Legislation since 2015 has pushed up interest rates

Added annual cost from higher rates through late 2025

Dollars per year, typical loan



~+50 pts

Rise in projected debt-to-GDP from legislation since 2015

~+100 bp

Resulting rise in long-term Treasury yields

$76,000

Added cost over the life of a 30-year mortgage

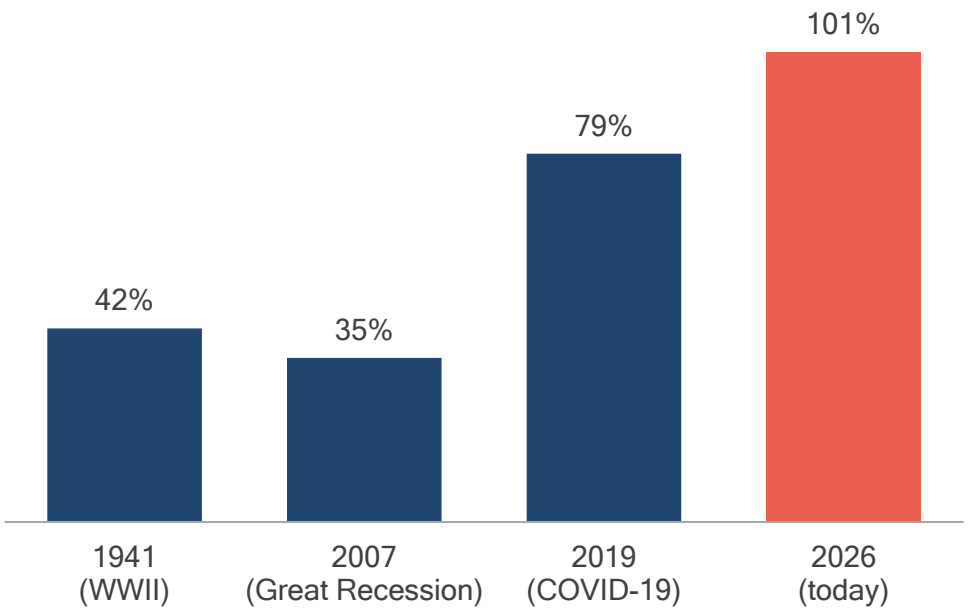
Note: Assumes 2 bp per pt of debt-to-GDP and counts tariff revenue as being due to legislation.

Less fiscal space for crises

Unclear where the upper bound on financial market patience might be

Debt at the onset of past crises

Debt held by the public, percent of GDP



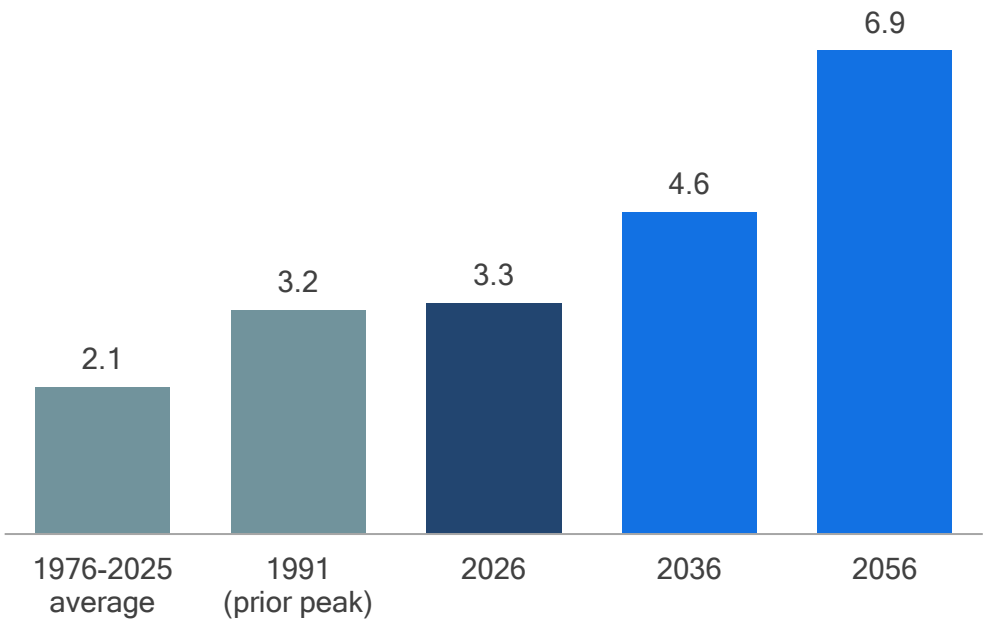
- AI could cause disruption that necessitates extra spending
- International conflict risk is high
- High debt means more exposure to interest rate volatility

A heavier interest burden

Net interest is rising with higher debt and interest rates

Net interest outlays

Percent of GDP; 2026 onward are CBO projections

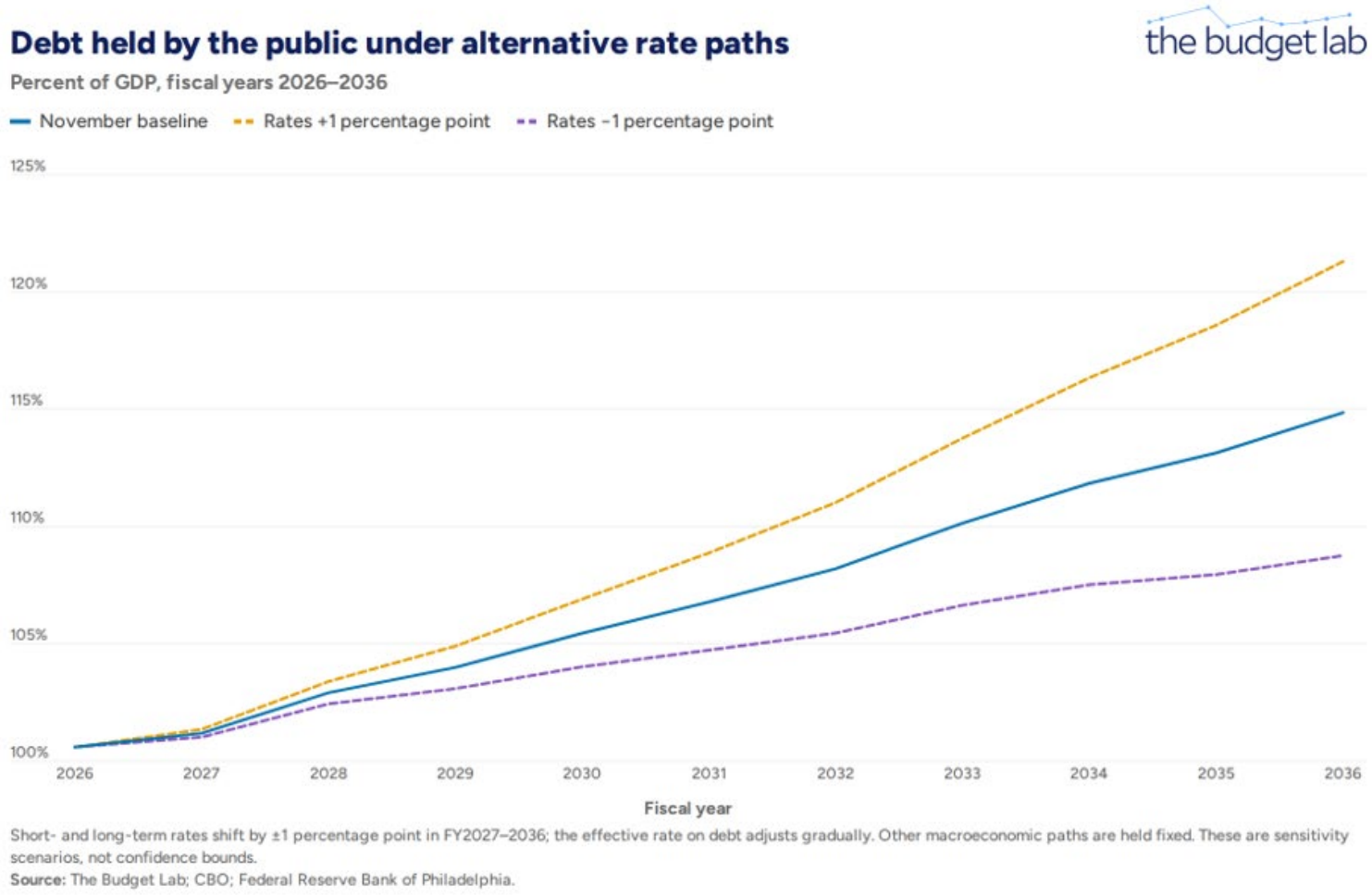


Spending in 2026

Medicare	$1.06T
Net interest	$1.04T
Defense	$0.89T

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The interest rate forecast is important



PART 3

What would it take to stabilize the debt?

Revenue, spending, and growth options

The federal fiscal gap is large

Stabilizing debt requires about 2% of GDP each year

~1.8%

of GDP per year

Permanent cut in primary deficits needed to hold debt at 101% of GDP through 2056 (BLSMM)

~20 bp

of GDP per year

Annual cut in primary deficit for every 5pp increase in the forecasted debt/GDP five years out (Gupta 2026)

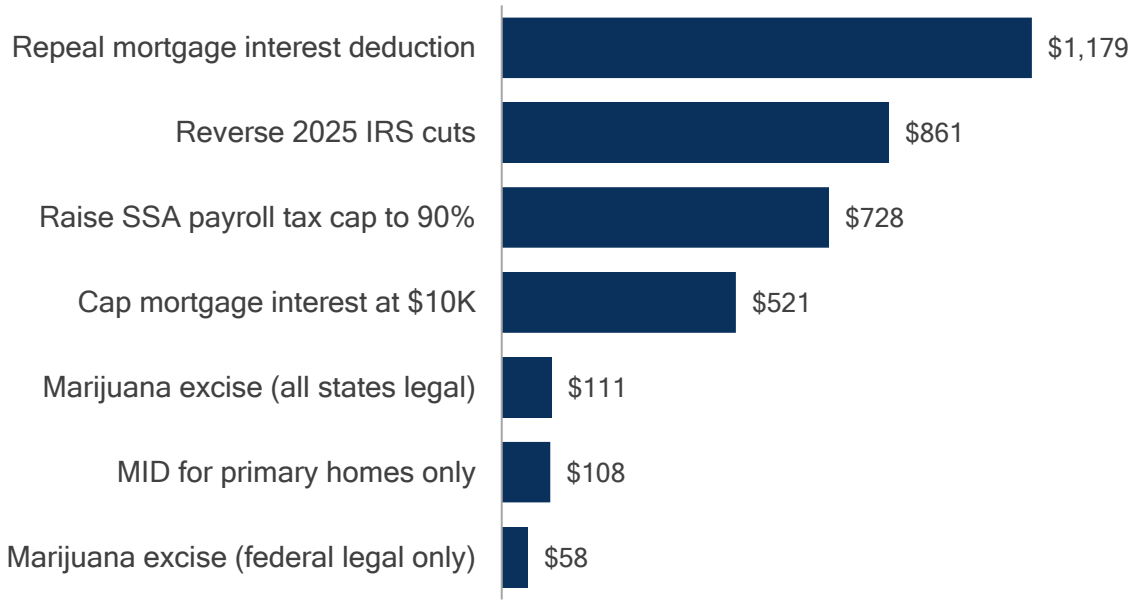
For scale: 1.8% of GDP is $580 billion a year today

Many revenue options

Enforcement, base broadening, and excise taxes

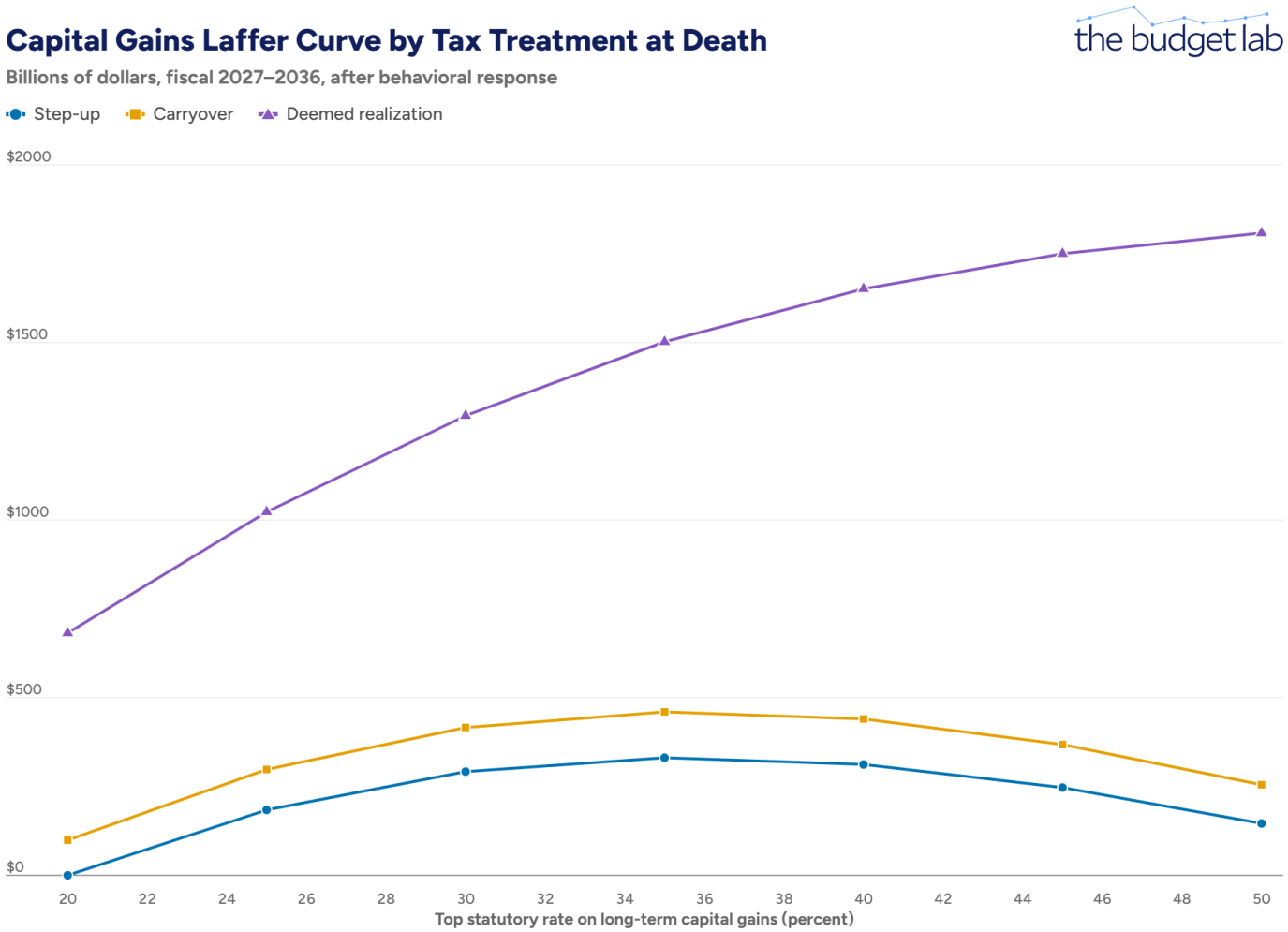
Ten-year revenue, selected options

Billions of dollars



Source: The Budget Lab and CBO, Options for Reducing the Deficit: 2025-34 (Dec. 2024).

Taxing top earners



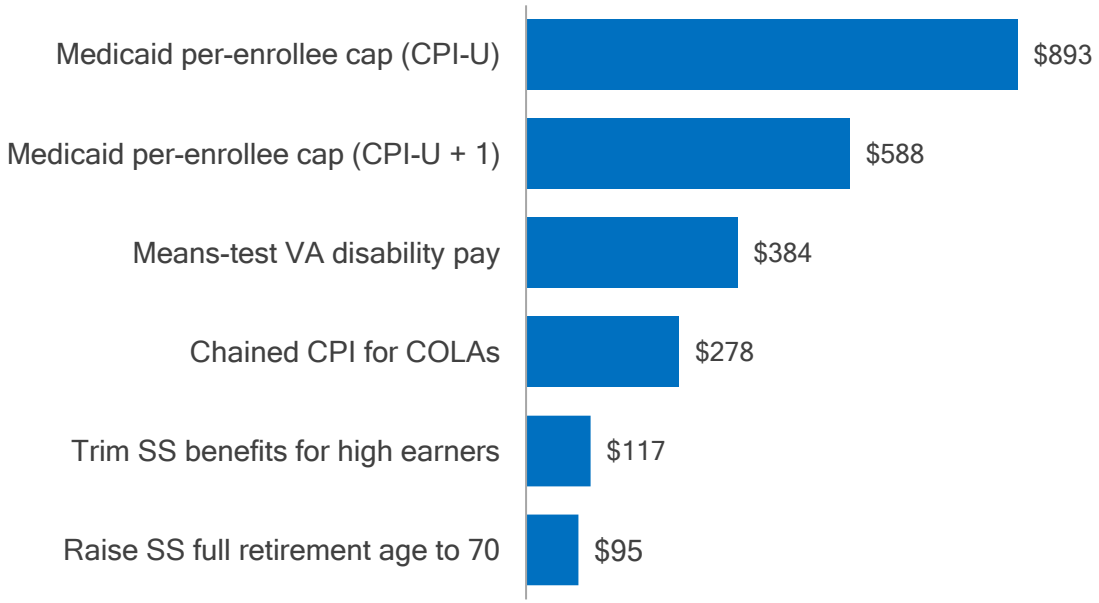
Rate on long-term capital gains only. Carryover and deemed realization include the revenue from the change in treatment at death, shown alone at 20 percent.
Source: The Budget Lab

Spending options

Deficit-reducing options for entitlements

Ten-year deficit reduction, selected CBO options

Billions of dollars, 2025-2034



Source: CBO, Options for Reducing the Deficit: 2025-34 (Dec. 2024).

More economic growth would help

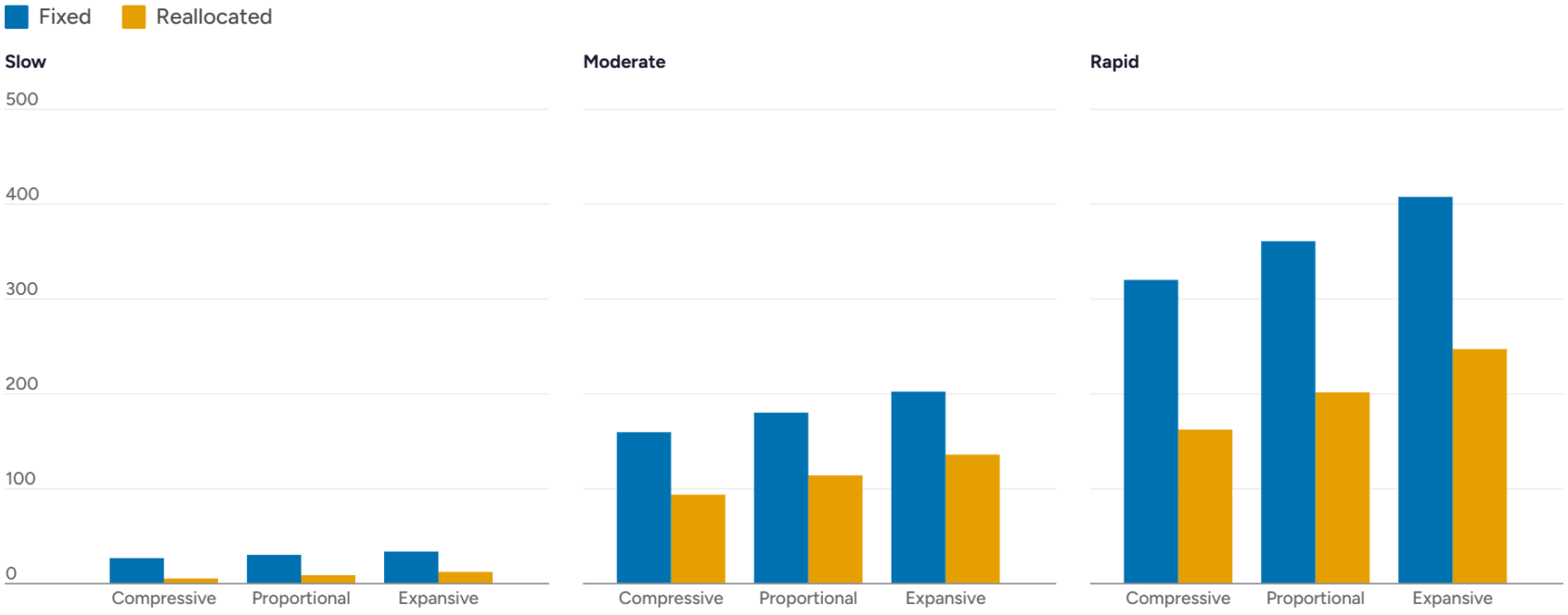
Many options for boosting growth, some of which are inexpensive

- High-skilled immigration
- Streamline housing regulation
- Permitting reform
- Public R&D

Revenue from AI could be less than anticipated

Federal revenue is higher in all scenarios when capital-labor shares are held fixed

Change in federal revenue, including corporate tax wedge, FY 2030, Billions USD



Source: The Budget Lab AI-Revenue Microsimulation Model.

Takeaways

1. Federal debt is on an unsustainable trajectory despite a strong economy

2. Overlapping explanations: lower revenue, higher spending (e.g., aging and health costs), and a less responsive Congress

3. Implications: higher borrowing costs, less room for crises, and a growing interest bill

4. Many policy options for getting some combo of more revenue, lower spending, higher growth

5. AI could help but is highly unlikely on its own to make the fiscal trajectory sustainable