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CBO PROJECTIONS UNDERSTATE POTENTIAL DEFICITS BECAUSE THEY LEAVE OUT LARGE COSTS THAT ARE VERY LIKELY TO OCCUR

by Richard Kogan

> *"Rarely have the policies underlying the baseline projections been as disconnected from the policy makers' agendas as they are today."*
> *-- Robert Reischauer*[1]

On January 29, the Congressional Budget Office issued a new set of budget estimates. These "baseline" projections are considerably too optimistic because they omit costs of at least $2 trillion and as much as $4 trillion over the next ten years, which will result from legislation that Congress is very likely — and in many cases, virtually certain — to enact.[2] The most likely estimate of the omitted costs is somewhere in the range of $3 trillion.

The CBO baseline projections, which show deficits through 2006 and surpluses after that, show an overall net surplus of $1.3 trillion over the ten-year period from 2004 through 2013. When the roughly $3 trillion in omitted costs are taken into account, however, the picture changes, and the budget is seen to be in deficit by something on the order of $1.7 trillion over the decade. This estimate is very similar to one issued by the Concord Coalition this week; Concord notes that a more realistic estimate of the deficit is $1.6 trillion over the ten-year period.[3]

Moreover, these deficits of $1.6 or $1.7 trillion include within them a surplus of $2.6 trillion in the Social Security trust fund. Both this analysis and the Concord analysis estimate that deficits outside Social Security are likely to exceed $4 trillion over the next ten years.

CBO baseline estimates are a projection of future expenditures and revenues that are calculated according to a set of rules that are based on current law and thus assume, among other things, that all tax cuts scheduled to expire will indeed terminate on schedule, even when such tax measures are routinely renewed. These projections are the basic benchmark against which analysts assess the costs of proposed and actual changes in policy. These projections do not necessarily provide a realistic assessment of the future fiscal outlook and are not intended to do so. Because they are based on these rules, the new CBO projections present a much rosier picture of the future than is likely to occur.

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[1] Robert D. Reischauer, President of the Urban Institute and former Director of the Congressional Budget Office, "Framing the Budget Debate for the Future," testimony before the Senate Budget Committee, January 29, 2002.

[2] CBO's projection is also subject to considerable uncertainty with respect to the future course of the economy and of such "technical" factors as capital gains realizations and cost increases in the health care industry.

[3] Concord Coalition Warns Against Growing Complacent With Deteriorating Long-Term Budget Outlook," January 29, 2003, available at http://www.concordcoalition.org/releases/030128release.htm.

The CBO projections are unrealistically rosy because they: understate the costs of appropriated programs, especially for defense and homeland security; omit the cost of extending tax breaks that are scheduled to expire but that Congress always renews; omit the cost of the Administration's tax-cutting agenda, including extending the 2001 tax cut beyond its scheduled 2010 expiration and providing relief from the mushrooming alternative minimum tax; do not include the costs of responding to major natural disasters such as hurricanes or floods; and do not include the costs of a war with Iraq and the aftermath of such a war.

Specifically:

- Because the CBO baseline projections assume discretionary (or non-entitlement) programs will grow only by enough to cover inflation, the baseline projections do not account for the increases in defense and homeland security funding that are certain to be proposed and enacted. As noted, the baseline also does not include the cost of a war with Iraq. The omitted costs in these areas are likely to amount to a minimum of $150 billion over the decade even if war is avoided, including the costs of the increased interest payments on the debt that will result.[4]

- CBO's projection of revenue collections is based on current laws, regardless of whether provisions of law that are scheduled to expire are virtually certain to be renewed. If a tax provision that is scheduled to expire has very strong bipartisan support, has repeatedly been extended in the past, and is virtually certain to be extended again, CBO will nevertheless assume that the provision will expire. The cost of extending expiring tax benefits that have always been routinely renewed is likely to be about $160 billion over the next ten years, including interest.

- CBO's projections likewise assume that the large 2001 tax cut will expire on schedule in 2010. The President has proposed making that tax cut permanent. Doing so would cost an estimated $690 billion over the next ten years, including interest, with almost all the 10-year costs occurring in 2011, 2012, and 2013.[5]

- The baseline also does not include the cost of the President's proposed "growth" package. The Administration says the tax cuts in that package would cost $670 billion through 2013; counting interest, the cost totals approximately $920 billion.

- In addition, the Administration has made clear that its agenda includes the provision of relief from the individual Alternative Minimum Tax, without which the number of taxpayers subject to the AMT will explode from about 2½ million

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[4] When a budget increase or tax cut is enacted, this causes deficits to be higher or surpluses to be lower than CBO projected in its baseline. As a result, the debt is high than projected, and the cost of paying interest on the debt increases.

[5] For a discussion of this presidential proposal and its costs, as well as the President's new tax-cut proposal and the President's likely agenda to provide tax relief from the Alternative Minimum Tax, see Center on Budget and Policy Priorities, "Full Cost Of Administration's Agenda For New Tax Cuts Is At Least $2.3 Trillion Through 2013," revised January 31, 2003, available at http://www.cbpp.org/1-22-03bud.pdf.

today to 35 million by the end of the decade. Virtually all observers consider AMT relief inevitable. The Administration has said that it plans to address the AMT issue in 2005. The cost of the most modest of the possible relief options the Administration is expected to consider amounts to more than $685 billion through 2013, counting interest.[6]

- Under the baseline rules, CBO also projects entitlement costs based on current law. Public demand for a prescription drug benefit for the elderly has increased considerably, making the enactment of some such benefit very likely during the next few years. Such a benefit could cost anywhere from $350 billion to $750 billion over the decade, counting interest, depending on how many of the elderly are covered and how comprehensive the benefit is. The President's proposal is reported to cost approximately $400 billion over ten years, a figure that grows larger when the increased interest payments that would result are included in the cost.

- In addition, because few natural disasters have occurred so far in 2003, there is little funding for disaster relief in the CBO baseline. Yet hurricanes, floods, or earthquakes are likely to occur at some point over the decade. It is inconceivable there will be virtually no such events for 10 years, as the baseline implicitly assumes. If history is a guide, disaster relief may cost $50-$100 billion over the period, including interest.

- Finally, as noted, CBO projects that total discretionary funding will grow only to cover inflation. In 10 of the last 14 years, funding for domestic appropriations has grown faster than inflation *and* population growth combined. Although the Administration is unlikely to propose increasing domestic appropriations faster than inflation, over a decade the historical funding pattern may reassert itself. If non-defense funding simply grows with inflation and the rise in the U.S. population (rather than only with inflation), and thus stays even in real per-capita terms, budget costs will be approximately $230 billion higher over ten years than the baseline will show.

[6] This AMT option would index the AMT exemption, tax bracket thresholds, and exemption phase-out threshold for inflation beginning in 2002. These indexed levels would become effective starting in 2006, after the temporary relief proposed by the Administration has expired. The cost of this option through 2012 was estimated by the Urban Institute-Brookings Institution Tax Policy Center; our estimate extends that estimate one additional year, through 2013. (See Leonard Burman, William Gale, Jeffery Rohaly, and Benjamin Harris, "The Individual AMT: Problems and Potential Solutions," Urban-Brookings Tax Policy Center Discussion Paper No. 5, September 2002.) This AMT option is used here to illustrate the likely cost of the Administration's agenda because indexing the AMT parameters at 2002 levels produces an exemption amount in 2005 similar to the Administration's recent proposal for that year (2005 is the final year of AMT relief under the Administration's new tax-cut plan). The Tax Policy Center has also designed an option to provide AMT relief by restructuring the AMT in a cost-neutral manner; this option frees large numbers of middle-class taxpayers from the AMT and offsets the cost by making the AMT tougher on high-income taxpayers (especially very high income taxpayers, who currently are generally not affected much by the AMT). There is virtually no chance the Administration will propose such a cost-neutral approach.

Potential Budget Costs Omitted from CBO's Adjusted Baseline (in billions)	Possible Cost Through 2013, including interest
Defense and homeland security increases in 2004 and future years	$150 - $250
Possible war with Iraq	$100 - $200
Expiring tax breaks	$160
Extending 2001 tax cut after 2010	$690
New package of tax cuts proposed by the Administration	$920
Relief from the Alternative Minimum Tax	$685
Prescription drug benefit	$350 - $750
Natural disasters (at or below historical average)	$50 - $100
Inflation *and* population adjustments for domestic appropriations	$230

The list of likely costs not reflected in the CBO baseline thus is both lengthy and costly. The list exceeds $2 trillion even if no "growth" or "stimulus" package is enacted this year, domestic appropriations rise no faster than inflation for a decade, and the low end of the cost range is assumed for every remaining item. As a result, the $2 trillion figure likely understates the magnitude of the omitted costs. A more likely estimate for the omitted costs is in the neighborhood of $3 trillion, and the figure could reach as high as $4 trillion.