Center on Budget and Policy Priorities

820 First Street NE, Suite 510
Washington, DC 20002

Tel: 202-408-1080
Fax: 202-408-1056

center@cbpp.org
www.cbpp.org

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OBAMA BUDGET REDUCES DEFICIT BY $1.3 TRILLION OVER NEXT DECADE COMPARED TO CURRENT POLICIES

But Much More Action Will Be Needed

By Kathy A. Ruffing and James R. Horney

Despite claims that President Obama's policies will generate big increases in deficits, his 2011 budget would actually reduce deficits by about $1.3 trillion over ten years, based on a Congressional Budget Office (CBO) estimate of his budget and a realistic assessment of what deficits would be if policymakers continued to follow current tax and spending policies.

Deficits will total $9.8 trillion in 2011 through 2020 under the President's budget, according to CBO. But these deficits overwhelmingly reflect the policies that Obama inherited, not new policies that he is proposing.

In fact, if policymakers simply extend current policies, deficits will total *more than $11 trillion* over the same period. The difference between that figure and the $9.8 trillion under the President's budget is the $1.3 trillion in savings that the President proposes.

The current policies that Obama inherited include, among others, the Bush tax cuts of 2001 and 2003 (all of which are due to expire at the end of 2010), relief from the alternative minimum tax (which Congress routinely provides so that the AMT does not ensnare tens of millions of middle-class taxpayers), and relief from a deep cut in physician fees under Medicare's sustainable growth rate (SGR) formula (which Congress regularly provides to try to ensure that payments are adequate to maintain beneficiaries' access to care).

In calculating how President Obama's policies affect future deficits, we start with a "baseline" – one that employs CBO's projections and estimates but assumes that the aforementioned policies will continue. This is the standard approach that most independent budget analysts and institutions (including the Brookings Institution, Concord Coalition, and several recent panels or commissions) use in whole or in large part in assessing the budget outlook. (For more on how the Center's assumptions compare to those of other leading budget analysts, see the box on p. 5.) Compared with this baseline, CBO's figures show that the President's policies will reduce the deficits by $1.3 trillion over 10 years.

Despite this deficit reduction, the President's budget does not do enough to put the nation's finances on a sound footing, as the President himself acknowledges. Even if Congress enacted his budget in full, the federal government would still generate huge and ultimately unsustainable deficits in coming decades, risking a debt explosion and, with it, serious damage to the economy.

Consequently, policymakers will have to take far more aggressive action in the future to stabilize the federal debt as a percentage of gross domestic product (GDP). That will require policymakers to reduce annual deficits to about 3 percent of GDP in the second half of this decade — essentially the goal the President has set for the new fiscal commission that will begin work shortly — compared to the 5.6 percent of GDP that CBO estimates the deficit will total in 2020 under the President's budget proposals.

Official Baseline Is Unrealistic

Discussions of the budget outlook typically begin with the "baseline," which serves as a benchmark against which to compare the spending and revenue effects of proposed legislation. In building the baseline, CBO follows rules that the Administration and Congress agreed upon in 1990. The rules generally state that the baseline should reflect current laws that govern taxes and mandatory spending and should assume continued funding for discretionary (appropriated) programs at this year's level, adjusted for inflation.

Sometimes, however, current laws fail to reflect current policies. That has been especially true in recent years because of Congress's growing tendency to enact legislation on a temporary or stopgap basis. In those cases, CBO generally must assume in its baseline that such provisions will expire on schedule, even if Congress never intended them to expire and is very likely to extend them.

As a result, CBO's latest baseline assumes that Congress will allow all of the 2001 and 2003 tax cuts and other temporary tax provisions to expire. It also assumes that the alternative minimum tax (AMT) — which affected about 4 million tax returns in 2009 — will snare about 27 million tax filers in 2010 and over 35 million by 2020, a result that Congress has repeatedly prevented with a series of temporary "patches."[1] The baseline assumes that the reductions in physician fees called for under Medicare's SGR formula — including the 21 percent reduction that occurred on April 1— will take effect, even though Congress has stepped in to prevent or overturn such reductions repeatedly since 2003. Finally, the baseline extrapolates the defense appropriations enacted for 2010, and thus omits the supplemental funding that will be needed to finance continued operations in Iraq and Afghanistan. (The President has requested such funding and asked Congress to approve it this spring.)

Budget experts have been saying for a number of years that the official baseline departs sharply from reality. This analysis continues CBPP's longstanding practice of producing a baseline that reflects current policies in order to assess more accurately the effects of proposed changes in those policies. Most other analysts similarly use adjusted baselines that reflect the continuation of current budget policies.

In January 2010, CBO showed how assuming the continuation of various policies that are slated to expire under current law affects the budget outlook. We have used these CBO estimates, as applied to CBO's March 2010 baseline, to project the deficit under current budget policies. Specifically, we adjust the official CBO baseline to reflect:

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[1] Congressional Budget Office, "The Individual Alternative Minimum Tax" (issue brief, January 15, 2010).

- extension of the 2001 and 2003 tax cuts and other expiring tax provisions (except for the explicitly temporary provisions of last year's recovery act), and the indexing of the AMT for inflation;

- cancellation of the scheduled cuts in Medicare fees paid to participating physicians, with future modest increases in step with the Medicare Economic Index (on average, slightly over 1 percent annually); and

- full funding of operations in Iraq and Afghanistan in 2010, with an orderly phasedown to a level of 60,000 troops by 2015.

These adjustments are detailed in the appendix table. With these realistic adjustments, deficits of $11 trillion are projected over the next ten years under current policies. This is our starting point for measuring the impact of President Obama's budget proposals.

Budget Reduces Projected Deficits Compared to Realistic Baseline

Compared with the current-policy baseline sketched above, the President would reduce deficits by over $500 billion in the 2011-2015 period and by $1.3 trillion over the next decade. (See Table 1.) The President's budget:

- assumes that health care reform will reduce deficits modestly, by $150 billion over ten years (a placeholder inserted before passage of the final legislation);[2]

- rolls back tax breaks for families earning over $250,000 a year, reforms the U.S. international tax system, and otherwise selectively raises revenues by $1.6 trillion over ten years;

TABLE 1:
President Would Reduce Deficits by $1.3 Trillion Over Next Ten Years
(in billions of dollars)

	2011-15 (five years)	2011-20 (ten years)
Deficit under current policies	5,033	11,035
Effects of President's proposals:		
Health care reform	-127	-150
Tax proposals[a]	-576	-1,645
Pell grants	157	374
Other mandatory outlays[a]	103	82
Defense discretionary	-43	210
Nondefense discretionary	-21	16
Net interest	-8	-167
Total deficit reduction	-514	-1,280
Deficit under President's policies	4,519	9,755

a. Excludes revenues and mandatory outlays associated with health care reform. Revenue increases are shown with a negative sign to depict their effect on the deficit. "Tax proposals" include those affecting refundable credits, which appear on the outlay side of the budget.

Source: CBPP calculations based on CBO projections.

[2] CBO and the staff of the Joint Committee on Taxation (JCT) estimate that the pair of health-care reform measures just passed by the Congress would reduce the deficit by $143 billion over the 2010-2019 period. That figure comprises $124 billion from the health-care and revenue provisions, and $19 billion from the education provisions. See "Cost estimate for the amendment in the nature of a substitute for H.R. 4872, incorporating a proposed manager's amendment made public on March 20, 2010" (available at www.cbo.gov).

- makes Pell grants for needy students — currently a discretionary program — mandatory and expands them;[3]

- includes other mandatory changes, chiefly in the near term, amounting to less than $100 billion over ten years;

- proposes additional discretionary funding of about $200 billion over ten years, almost wholly in defense; and

- saves over $150 billion in net interest from slowing the growth of the debt.

Although the President's budget would reduce the deficit compared to the current-policy baseline in the medium term, it would slightly increase deficits in 2010 and 2011 because of the President's jobs initiatives. Those initiatives — which include the proposed extension of certain provisions of last year's American Recovery and Reinvestment Act plus some new tax cuts and spending — are a response to continued economic weakness.[4]

While any budget that a President submits may include policies that Congress may not go along with, it is important that the budget reflect the costs of all policies the President supports or does not propose to change. From a transparency standpoint, President Obama's budget is superior to those of the previous administration; the budgets submitted by President George W. Bush routinely omitted costs associated with extending AMT relief or continuing operations in Iraq and Afghanistan even though his administration supported those policies.[5] Such costs are not omitted from the Obama budget, which makes an assessment of its effects more meaningful.

Much More Needs to Be Done

By itself, the budget does not do enough to put the nation on a sound fiscal footing, as the President has acknowledged. According to CBO, the President's proposals would shrink the deficit to 4.1 percent of gross domestic product (GDP) by 2014, but the gap between spending and revenues would then worsen again — reaching 5.6 percent of GDP in 2020. Many analysts have coalesced around 3 percent of GDP as a reasonable target for the deficit in the second half of the decade; the President's proposals would not accomplish that.

The United States has previously faced stubborn deficits of that magnitude and successfully reduced them. In the mid-1980s and again in the early 1990s, deficits peaked at about 5 percent to 6 percent of GDP. By dint of hard work, policymakers substantially reduced the deficit — notably through the Tax Equity and Fiscal Responsibility Act of 1982, the reconciliation acts that followed the "budget summits" between the Administration and congressional leaders in 1987 and 1990, and the reconciliation act of 1993. (Together with the strong performance of the economy in the 1990s

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[3] Of the $374 billion shown for Pell grant costs over ten years, $177 billion represents a reclassification of current discretionary spending and the remainder represents an expansion in funding.
[4] Kris Cox, "President's Budget Requests $266 Billion to Support Economic Recovery" (Center on Budget and Policy Priorities, February 5, 2010).
[5] Kris Cox, "Administration's Budget Does Not Reflect Administration Policies" (Center on Budget and Policy Priorities, March 5, 2008); Aviva Aron-Dine and Robert Greenstein, "Why The Cost of AMT Relief Should Be Included in Estimates of the Cost of Extending the President's Tax Cuts" (Center on Budget and Policy Priorities, February 20, 2007).

Many Analysts and Institutions Adjust CBO Baseline to Present More Realistic Picture

Many budget-watchers besides CBPP have presented current-policy baselines that produce much higher deficits than CBO's standard baseline. These baselines are broadly similar in approach but differ in some details. For example, some analysts assume extension of *all* expiring tax cuts. (CBPP's baseline, in contrast, assumes that the explicitly temporary provisions of the American Recovery and Reinvestment Act of 2009 expire on schedule.) Similarly, several assume that discretionary spending in the near term will keep pace with GDP or with inflation plus population — either of which leads to higher spending than CBPP assumes. (CBPP adopts the CBO baseline — that is, inflation adjustments only — for non-war-related discretionary spending for the ten-year period, and adopts an inflation plus population convention after that.[a]). Some posit a permanent freeze in Medicare physician fees, while others (including CBPP) incorporate modest increases. Some assume that tax cuts for families making more than $250,000 a year will expire or that the estate tax will stay at 2009 levels — although, in CBPP's view, such assumptions are more accurately characterized as *proposed* policies rather than *current* policies.

Among the organizations that have presented current-policy projections along lines broadly similar to the projections outlined here are:

- The **Concord Coalition**;
- The **Peterson-Pew Commission** (a collaboration of the Peter G. Peterson Foundation, the Pew Charitable Trusts, and the Committee for a Responsible Federal Budget);
- The **Brookings Institution** scholars Alan Auerbach and William Gale; and
- A recent **National Academy of Sciences** panel.

In its long-run budget projections, CBO itself presents an "alternative fiscal scenario," which diverges from its standard baseline because it incorporates some policy changes (such as extensions of expiring tax cuts and cancellation of Medicare physician-fee reductions) that, in CBO's words, "are widely expected to occur and that policymakers have regularly made in the past." Because of its scrupulously nonpartisan role and its obligation to follow current law as written, CBO cannot make such assumptions in its standard baseline.

In sum, most serious budget analysts modify the CBO baseline to reflect the continuation of various current policies, and CBPP's adjustments are firmly in the mainstream.

Sources: "The Concord Coalition Plausible Baseline" (www.concordcoalition.org/concord-coalition-plausible-baseline, last updated January 2010); Peterson-Pew Commission on Budget Reform, *Red Ink Rising: A Call to Action to Stem the Mounting Federal Debt* (December 2009); Alan J. Auerbach and William G. Gale,"The Economic Crisis and the Fiscal Crisis: 2009 and Beyond — :An Update" (September 2009, available at www.brookings edu); National Academy of Sciences, Choosing the Nation's Fiscal Future (January 2010, available at www.nas.edu); Congressional Budget Office, *The Long-Term Budget Outlook* (June 2009, available at www.cbo.gov).

[a] Kathy Ruffing, Kris Cox, and James Horney, "The Right Target: Stabilize the Federal Debt" (Center on Budget and Policy Priorities, January 12, 2010).

expansion these steps helped produce balanced budgets in 1998 through 2001.) The largest of those packages trimmed deficits by about 2 percent of GDP. Over the 2013-2020 period, we will need savings about one-and-a-half to two times as large. Accomplishing this at the same time that the baby boom generation — the huge cohort born between 1946 and 1964 — begins to retire in large numbers, and without the "peace dividend" that permitted reductions in defense spending in the 1990s, will be a daunting task.

The President has established a bipartisan National Commission on Fiscal Responsibility and Reform to recommend additional policy changes to reduce deficits to about 3 percent of GDP. It remains to be seen whether the commission will come up with a credible package to reduce the deficit to sustainable levels and secure congressional passage.

APPENDIX TABLE

Federal Budget Deficit Under Current Policies
(by fiscal year, in billions of dollars)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Total, 2011-20
CBO baseline	1,368	996	642	525	463	472	513	521	534	641	684	5,990
Adjustments:												
Extend tax laws[a]	11	139	247	279	300	318	331	344	356	369	382	3,064
Continue AMT relief[b]	7	82	75	83	92	103	115	129	144	162	181	1,164
Cancel physician-fee cuts	5	14	18	25	31	38	46	51	55	60	66	403
Adjust Iraq and Afghanistan[d]	8	21	21	-3	-36	-66	-85	-95	-101	-104	-106	-555
Additional debt service	0	3	11	26	47	70	97	127	161	195	234	970
Total adjustments	31	258	372	410	434	462	503	555	615	681	755	5,045
Current–policy baseline	1,399	1,254	1,013	935	896	934	1,016	1,076	1,149	1,322	1,439	11,035
Addendum:												
President's budget (as estimated by CBO)	1,500	1,342	914	747	724	793	894	940	996	1,152	1,254	9,755
President's budget versus CBPP baseline	101	88	-99	-189	-173	-142	-122	-136	-153	-170	-186	-1,280

Sources: CBPP calculations based on Congressional Budget Office, *An Analysis of the President's Budget Request for 2011* (March 2010); *The Economic and Budget Outlook* (January 2010); and "Estimated Changes in Net Federal Outlays from Alternative Proposals for Changing Physician Payment Rates" (May 2009).

a. This assumes that the 2001 and 2003 tax cuts (EGTRRA and JGTRRA) and the regular "tax extenders" are continued. It does *not* assume that expiring tax provisions originating in the American Recovery and Reinvestment Act of 2009 are extended.

b. This assumes that the 2009 AMT thresholds and brackets are indexed for inflation, and includes the interaction with extension of the 2001 and 2003 tax cuts.

c. These amounts assume that troops deployed in Iraq and Afghanistan decrease to 60,000 by 2015, as in one of CBO's alternative paths. This line also includes the effects of removing a small amount (less than $1 billion a year) of nondefense emergency funding, which CBO's standard baseline includes because it assumes the continuation in future years of the 2010 level to date of such funding.

Note: CBO=Congressional Budget Office, AMT=Alternative Minimum Tax.