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

August 27, 2009

NEW OMB AND CBO REPORTS SHOW CONTINUING CURRENT POLICIES WOULD PRODUCE LARGE DEFICITS

President's Proposals Would Produce Lower Deficits Than Continuing Current Policies

By Kathy Ruffing, Paul Van de Water, and James Horney

On August 25, both the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) released updated budget projections. Some observers, comparing OMB's estimate of the deficit over the next ten years under the President's proposed policies ($9.1 trillion) to CBO's "baseline" estimate of the deficit under current law ($7.1 trillion), jumped to the conclusion that the President proposes to increase the deficit dramatically. In fact, the opposite is true. The President's proposals would produce significantly *lower* deficits over the next ten years than continuing current policies.

This and other confusions have occurred because both the OMB and CBO reports are chock-full of numbers that are hard for even seasoned budget-watchers — and almost impossible for ordinary citizens — to interpret. This brief analysis explains what some of the numbers mean, how CBO's official baseline must be adjusted to show what CBO's estimate of deficits would be if it assumed current policies are continued, and why even that adjusted baseline should not be compared with OMB's estimate of deficits under the President's policies.

CBO's Official Baseline Projections Substantially Understate the Deficits That Will Occur if Current Policies Are Extended

A "baseline" is generally supposed to serve 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 originally agreed upon in the Budget Enforcement Act of 1990, which generally require CBO to assume that current laws affecting taxes and mandatory spending will continue without change. If current policies and current law are essentially consistent, the official CBO baseline can be used to determine the difference between deficits under the policies proposed by the President and deficits under a continuation of current policies.

As CBO itself has noted, however, current *law* today diverges substantially from current *policies,* largely because a number of policies currently in effect are scheduled to expire under current law. For instance, under current law, tax cuts enacted in 2001 and 2003 (such as reductions in marginal individual income tax rates and the doubling of the child tax credit), relief from the Alternative Minimum Tax, and other temporary tax breaks are all scheduled to expire at the end of 2010 or subsequent years. The baseline rules require CBO to assume that these tax cuts will expire as scheduled, which would increase revenues in future years relative to what would be paid if current rates, credits, etc. were continued.

The baseline also assumes that the policy prohibiting the reductions in physician fees called for under Medicare's "sustainable growth rate (SGR)" formula — including a 20 percent cut in 2010 — will be allowed to expire at the end of this year, even though Congress has consistently acted to prevent the reductions from going into effect. Finally, the baseline overstates the amounts that will be needed for operations in Iraq and Afghanistan because it assumes that the large appropriations enacted for 2009 will continue indefinitely.[1]

Deficits Under Current Policies Would Total $11 Trillion Over the Next Decade, Using CBO Assumptions

Budget experts have been saying for several years that because of issues such as these, the official baseline departs sharply from reality. In projecting future budgetary costs, deficits, and debt, therefore, such institutions as the Concord Coalition, the Committee for a Responsible Federal Budget, analysts at the Brookings Institution, and the Government Accountability Office — along with the Center on Budget and Policy Priorities — have used more realistic baselines that reflect the continuation of current budget policies.

CBO itself provides the raw material for such exercises by publishing information on the budgetary effects of selected policy alternatives not included in the baseline. Adjusting CBO's figures in that fashion produces deficit projections of $11.1 trillion under current policies — not $7.1 trillion — for the 2010-2019 period (see appendix table for details on the adjustments).

Under the President's Budget, Deficits Would Be Lower Than if Current Policies Were Extended

Unfortunately, it is impossible to state precisely *how much lower* deficits would be under the President's policies than under the baseline described above.

It is tempting to simply subtract the $9.1 trillion in deficits OMB estimates would occur under the President's policies from the estimated $11.1 trillion in deficits under current policies that is based on CBO's new baseline projections. But that would not be appropriate. The difference between the estimates reflects not only the effect of the President's proposed policies, but also the different assumptions OMB and CBO made about the huge number of other factors that will affect federal spending and revenues over the next ten years. These factors include the economy's growth rate, inflation, prices for agricultural products, and the amount and cost of health services that will be provided.

---

[1] The opposite was true early in the year, before the supplemental was enacted.

CBO Projects Slightly Lower Deficit in 2009 than OMB

CBO estimates that the red ink for the fiscal year that ends on September 30 will be $1.587 trillion; OMB cites a figure of $1.580 trillion. These are the "headline numbers" that draw the most attention.

The OMB number, however, assumes that Congress will enact $28 billion in tax cuts for families and businesses this fiscal year — which seems unlikely at this late date. Therefore, readers should focus instead on OMB's baseline projection, or $1.552 trillion.

How can we say that CBO's figure is lower than OMB's? The two agencies differ sharply on the budgetary treatment of Fannie Mae and Freddie Mac, the two Government Sponsored Enterprises (GSEs) that were put into conservatorship last fall in the wake of the housing meltdown. CBO believes that "because of the extraordinary degree of management and financial control that the government now exercises over them, [the] entities should be considered federal operations." Thus, CBO counts $291 billion in outlays for the two GSEs this year. OMB, however, still treats them as if they were outside the government. (That means counting only the amounts that represent current cash infusions.)

Although CBO is on solid conceptual ground, the *Monthly Treasury Statement* — which budget experts and journalists will eagerly await in October — has, so far, followed the OMB treatment. By that measure, CBO expects a deficit of $1.409 trillion, or $143 billion below the comparable OMB figure (see table below). Most of that remaining difference in the two agencies' projections for 2009 is traceable to the Troubled Assets Relief Program (TARP): CBO projects TARP outlays this year of $133 billion, while OMB expects $235 billion.

Fiscal year 2009 (in billions of dollars)	
CBO's projected deficit	1,587
Remove net subsidy costs for Fannie Mae and Freddie Mac	-291
Substitute net cash infusions to Fannie Mae and Freddie Mac	112
Equals MTS-basis deficit	1,409
OMB's baseline deficit	1,552
MTS=Monthly Treasury Statement	
Source: CBO Table 1-1 and Box 1-1.	

Relatively small differences in assumptions about these factors can significantly affect the estimates of the deficits under any given set of policies. For instance, when CBO first analyzed the President's budget for fiscal year 2010, it estimated that deficits would be $2.3 trillion higher under the President's policies over ten years than OMB estimated. This gap largely reflected CBO's somewhat more pessimistic assumptions regarding the amount of revenues that would be collected under current law. (There was relatively little difference between the CBO and OMB estimates of the effects of the President's proposed policy changes.)

CBO has not updated its analysis of the President's budget to reflect its new economic projections and other assumptions (CBO normally does not update its estimate of the President's budget at this point in the budget process). Thus, we do not know precisely what the difference would be between an estimate of deficits under current policies and an estimate of deficits under the President's policies, with both estimates made on the basis of the new CBO assumptions. We can state with confidence, however, that such an estimate would show *lower* deficits under the President's budget than under a continuation of current policies.

In March, when CBO first analyzed the President's budget, we calculated that the deficits CBO estimated would occur over the next ten years under the President's policies were $900 billion lower than under current policies.[2] Subsequent changes in CBO's assumptions — particularly its estimates of the cost of extending tax cuts that are slated to expire — suggest that this figure, if recalculated today, would be somewhat smaller, likely in the range of $600 to $700 billion over ten years.

The President's budget would reduce deficits largely by letting the Bush Administration tax cuts that benefit only those with high incomes expire as scheduled at the end of 2010; while the President proposes some new tax cuts, their cost would be more than offset by other proposals that would increase revenues. The President also proposes that his two major domestic policy initiatives — health care reform and energy and climate legislation — be deficit neutral, so that they do not add to the deficit.

Further Reductions in Future Deficits Will Be Needed

The very high deficits this year and for the next few years result from the deepest economic downturn since World War II and the steps that policymakers took to keep it from growing even worse, including last fall's financial rescue legislation and February's stimulus package. Trying to reduce deficits in the short run — beyond what Congress has already endorsed in its budget resolution for fiscal year 2010 — would be counterproductive, as that could stall or reverse the economic recovery. Deficits will naturally shrink as the economy recovers and the temporary costs associated with stimulus and financial rescues fade.

While the President's policy proposals would reduce deficits relative to what would happen under a continuation of current policies, those deficits will remain unacceptably high after the economy is back on track. The new estimates from OMB and CBO reinforce the message that the current fiscal path is unsustainable over the coming decade. (That was true even before the economic downturn. In fact, the recession — while dramatically swelling deficits in the next few years — adds relatively little to the size of the long-term problem.[3])

Changes in current policies — especially to ensure adequate revenues and to achieve deficit-neutral health care reform while slowing the rapid growth of public and private health care costs — must be made to keep deficits and debt from climbing far past today's levels in coming decades, even if the economy returns to operating at full capacity. While the President's budget takes important steps in the right direction, much larger steps will be needed to put the budget on a sustainable path.

---

[2] Kathy Ruffing and Paul N. Van de Water, "Obama Budget Reduces Deficit by $900 Billion Compared to Current Budget Policies," Center on Budget and Policy Priorities, March 31, 2009.

[3] See Kris Cox, James R. Horney, and Richard Kogan, "The Long-Term Fiscal Outlook Is Bleak," Center on Budget and Policy Priorities," December 16, 2008; and Paul N. Van de Water and Kris Cox, "Economic Recovery Bill Would Add Little to the Long-Run Fiscal Problem," Center on Budget and Policy Priorities, January 16, 2009.

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	Total, 2010-19
CBO baseline deficit	-1,381	-921	-590	-538	-558	-558	-620	-626	-622	-722	-7,137
Extend EGTRRA and JGTRRA	-4	-121	-217	-247	-260	-271	-281	-290	-298	-307	-2.296
Extend other expiring tax provisions (except stimulus)[a]	-8	-26	-33	-37	-42	-46	-49	-53	-57	-61	-410
Index AMT	-7	-69	-31	-34	-37	-41	-46	-53	-60	-70	-448
Interactions among tax provisions	0	-13	-44	-49	-53	-58	-64	-70	-77	-85	-514
Phase down to 75,000 troops in Iraq and Afghanistan by 2014	1	7	29	59	83	97	104	106	111	115	713
Increase Medicare physician payment rates by 1 percent annually	-7	-13	-17	-24	-30	-37	-45	-50	-53	-57	-333
Additional debt-service costs	0	-3	-11	-27	-47	-69	-93	-120	-151	-185	-706
Total adjustments	-25	-238	-324	-358	-387	-425	-473	-529	-585	-648	-3,993
Adjusted deficit	-1,405	-1,159	-914	-896	-945	-983	-1,094	-1,155	-1,207	-1,371	-11,130
Memorandum:											
OMB baseline deficit under current policy	-1,449	-1,173	-939	-938	-955	-925	-988	-1,013	-1,031	-1,145	

Negative numbers indicate a deficit or an increase in the deficit. Positive numbers represent a reduction in the deficit.
EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003; AMT = Alternative Minimum Tax
Sources: CBPP calculations based on CBO projections.