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INFORMED BUDGETEER: CBO BASELINE AND THE PRESIDENT'S BUDGET

- This week, the *Bulletin* reprises "compare and contrast" essays from previous years dealing with the Congressional Budget Office's (CBO) baseline report and the President's Budget. Because the two documents usually come out within two weeks of each other, they are often confused.

- CBO's baseline is designed to answer this question: what would the federal government's fiscal position look like if we didn't change current law (except for assuming the continuation of a handful of mandatory programs scheduled to expire)?

- But of course, current law never remains static. Every year, Congress and the President enact hundreds of new laws, many of which have budgetary effects compared to what had previously been current law. Because the President's budget is a picture of what the law would look like in the future if all the proposals in the President's budget were enacted, his budget office (the Office of Management and Budget – OMB) produces a totally different set of numbers that reflect a different fiscal position. To make the comparison even more complicated, OMB has its own baseline estimates that it uses as a starting point for measuring the effects of proposals to change current law.

- On January 24th, CBO released *The Budget and Economic Outlook* for 2008-2017. CBO estimates that if current law remains unchanged, the deficit would be $172 billion for the current fiscal year (2007 – see first line of Table 1 below). (CBO takes pains to note that the 2007 deficit would be $200 billion, or 1.5 percent of GDP, if one assumes the possible enactment of a supplemental appropriations bill similar to the President's request of $100 billion in 2007.

- After this year, deficits would fall to under one percent of GDP for the next three years until 2011, when the budget would essentially be in balance, turning into annual surpluses of about one percent of GDP each year from 2012-2017 (http://www.cbo.gov/ftpdocs/77xx/doc7731/01-24-BudgetOutlook.pdf).

- Surpluses? Can we really count on surpluses if the CBO baseline "leaves out" the budgetary effects of the familiar litany of things that "everyone knows will be changed," such as: continued "fixes" of the alternative minimum tax (AMT), continued funding for the wars, continuation of at least some of the tax cuts scheduled to expire, and continued ad hoc measures to avoid scheduled reductions to physicians' reimbursement under Medicare (see upcoming *Bulletin* for a discussion of this last case).

- Baseline Rules. Relying on a baseline projection as a prediction of the budgetary outcome of future legislative action is not the same thing as having a crystal ball. CBO's baseline (or any baseline) is a starting point, not an end point. For 16 years until it expired on September 30, 2006, Section 257 of the Balanced Budget and Emergency Deficit Control Act (as amended by the Budget Enforcement Act of 1990, or BEA) had mandated to both CBO and OMB the same set of rules for constructing a baseline that was used to enforce the budget agreements laid out in BEA in 1990 (and its successors in 1993 and 1997). Lacking any more recent direction, this latest CBO baseline report continues to adhere to those procedures.

- What are some of these key procedures? The baseline does not allow "guesses" regarding the enactment of future legislation, so the baseline reflects that the temporary tax cuts enacted since 2001 will expire as scheduled, after 2010. In addition, the baseline assumes that the AMT will increase its tax bite each year and does not assume any AMT reforms, fixes, or patches. The baseline must extend all discretionary spending enacted to date for the current fiscal year, regardless of whether it is labeled emergency spending or provided via a supplemental spending bill. Since $70 billion was provided for ongoing operations in Iraq and Afghanistan in the 2007 Defense Appropriations Act, that spending is assumed to continue annually at the $70 billion level (adjusted for inflation) over the 2008-2017 period, just as the all other discretionary spending enacted for 2007 is assumed to continue.

- OMB Baseline. In preparing the President's budget, the Office of Management and Budget (OMB) constructs several alternative baselines. Although section 257 expired five months ago, OMB still prepares its version of the BEA baseline, mostly following the same procedures that CBO follows. (Even when OMB was still required to follow section 257, it had already departed from the requirements with its own "interpretation" of how to prepare the BEA baseline.)

TABLE 1: DIFFERENCES BETWEEN CBO BASELINE AND OMB BASELINE
($ billions)

	2007	2008	2009	2010	2011	2012	2008-2012
CBO BEA baseline deficit(-)/surplus(+)	**-172.1**	**-98.2**	**-116.4**	**-136.9**	**-12.5**	**170.4**	**-193.6**
Revenues (+ reflects revenue increase) (- reflects revenue decrease)	7.2	-5.0	22.9	120.7	131.2	154.9	424.7
Extension of emergencies[1]	-6.4	-10.2	-12.8	-14.6	-15.6	-16.6	-69.8
Discretionary outlays	14.3	-20.7	4.4	7.7	11.6	23.7	26.7
Mandatory outlays	9.9	3.9	11.0	19.4	29.8	39.0	103.1
Net interest	2.8	5.0	7.7	5.1	-2.3	-7.9	7.6
Subtotal outlays[2]	20.6	-22.0	10.4	17.5	23.4	38.2	67.5
Total difference (+ is lower deficit/higher surplus; - is higher deficit/lower surplus)	-13.4	17.0	12.5	103.2	107.8	116.7	357.2
OMB baseline deficit(-)/surplus(+)	**-185.5**	**-81.1**	**-103.9**	**-33.8**	**95.3**	**287.1**	**163.6**

1. CBO extends all emergency appropriations enacted in 2007 in its baseline as directed by section 257(c)(1) of the Balanced Budget and Emergency Deficit Control Act of 1985, while OMB does not extend what it deems as "non-recurring" emergencies, such as appropriations related to hurricane recovery and Avian Flu.
2. Positive numbers reflect more spending.

TABLE 2: CHANGES PROPOSED IN PRESIDENT'S 2008 BUDGET COMPARED TO OMB BASELINE
($ billions)

	2007	2008	2009	2010	2011	2012	2008-2012
OMB baseline deficit(-)/surplus(+)	**-185.5**	**-81.1**	**-103.9**	**-33.8**	**95.3**	**287.1**	**163.6**
Revenues (- reflects revenue decrease)	-9.4	-52.2	-33.8	-66.8	-194.3	-251.9	-599.0
Remove continuation of $70b war "bridge" for 2007	0.0	-41.4	-65.0	-73.2	-77.6	-80.2	-337.4
Discretionary outlays	47.9	151.2	120.4	67.2	34.7	8.7	382.2
Social Security	0.0	0.0	-0.2	-0.6	-1.0	28.0	26.1
Medicare	0.0	-4.3	-9.1	-13.1	-17.5	-21.7	-65.6
Medicaid/SCHIP	0.0	-0.7	-0.8	-1.7	-1.8	-2.0	-7.1
Other mandatory	-0.1	-5.5	-7.9	0.1	-1.4	13.6	-1.1
Net interest	1.5	6.7	12.2	15.1	19.4	27.8	81.2
Subtotal outlays[1]	49.3	106.1	49.4	-6.2	-45.2	-25.8	78.3
Total difference (+ is lower deficit/higher surplus; - is higher deficit/lower surplus)	-58.7	-158.3	-83.2	-60.6	-149.1	-226.1	-677.3
President's budget deficit(-)/surplus(+)	**-244.2**	**-239.4**	**-187.2**	**-94.4**	**-53.8**	**61.0**	**-513.7**

1. Positive numbers reflect more spending.

- The main conceptual difference between OMB's BEA baseline and CBO's is that, while CBO projects all discretionary appropriations currently enacted into future years (regardless of the purpose of the appropriation), OMB does not project what it calls "non-recurring" emergencies. Therefore, appropriations enacted for 2007 for hurricane recovery and avian flu are not continued in OMB's BEA baseline, resulting in $70 billion in lower outlays over the 2008-2012 period (see line 3 of Table 1).

- Other differences between the CBO and OMB baseline stem from what are customarily called economic and technical reasons. The largest difference over the next five years is that OMB projects federal revenues will be $425 billion higher than CBO estimates. Of this total difference, OMB expects $155 billion in higher revenues will occur in 2012 (this is 4.6 percent more than CBO's estimate; see line 2 of Table 1).

- The only other notable difference between the CBO and OMB baselines is actually quite small – OMB expects mandatory spending will be about $100 billion higher over the next five years than does CBO. But this amounts to only a one percent difference between the two baselines because mandatory spending will be about $8.5 trillion over the next five years. (OMB also prepares what it calls an "adjusted" baseline that assumes that certain tax cuts scheduled to expire under current law will continue. But to keep the confusion over baselines to a minimum, the *Bulletin* shows the effects of extending the expiring tax cuts as legislative proposals relative to the OMB's BEA baseline.)

- <u>President's Budget</u>. In 2012, OMB's BEA baseline shows a surplus that is $117 billion higher than the $170 billion surplus projected by CBO (see last line of Table 1 and first line of Table 2). The largest proposal in the President's budget would extend certain expiring tax cuts after 2010, thereby reducing the baseline surplus of $287 billion in 2012 by $252 billion and reducing revenues by nearly $600 billion over the 2008-2012 period (see line 2 of Table 2).

- The next two largest effects nearly offset each other, but are significant individually. First, the President's budget suggests that the $70 billion that has been enacted for warfighting in 2007 should not continue to be appropriated every year into the future (as the baseline assumes), thereby reducing outlays by $337 billion over the next five years (see line 3 of Table 2). But the President does propose significant increases above the base defense budget, seeks an appropriation of another $100 billion in 2007 and $145 billion in 2008 to pay for the costs of the wars, and requests funds to operate the nondefense, discretionary activities of the federal government, resulting in additional outlays of $382 billion (see line 4 of Table 2).

- For mandatory programs, the significant budgetary effects would occur from proposals in the President's budget affecting three programs: Social Security, Medicare, and Medicaid. The key proposal for Social Security would be the creation of private accounts beginning in 2012, which would cost $28 billion in that year (see line 5 of Table 2). The President's set of proposals to slightly reduce the average rate of growth in Medicare from 6.5 percent per year to 5.6 percent per year would save $66 billion over the next five years and reduce the unfunded liability of Medicare by $8 trillion -- from $32 trillion to $24 trillion (see line 6 of Table 2). For Medicaid and the State Children's Health Insurance Program (SCHIP), the President proposes various increases and decreases that would net to $7 billion of savings over the 2008-2012 period.

- According to OMB's estimates, when all the proposals in the Presidents' budget are taken together, the budget would be in approximate balance by 2010 (deficit of 0.6 percent of GDP), and hovering even closer around zero in 2011 and 2012.

- On March 2, CBO will release its own estimate of the effect that the President's budget would have on revenues and spending, and we will have CBO's estimates of resulting deficits or surpluses.

<u>CORRECTION:</u>
The *Budget Bulletins* from January 24 and January 26, 2007 implied that the new House pay-go and reconciliation points of order can be waived if a simple majority votes for an independent motion to waive. This is not the case. The House pay-go and reconciliation points of order can only be waived if the House passes (requiring only a simple majority) a rule that accompanies the bill that waives the points of order. The web versions of the *Budget Bulletin* have been corrected.