

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue, and the bottom bulb is light blue. The globe is a darker shade of blue. The hourglass is centered on the page.

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February 2, 2009

Congressional Research Service

Report RL31414

*Baseline Budget Projections: A Discussion of Issues*

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February 7, 2008

**Abstract.** In January 2001, the Congressional Budget Office (CBO) projected budget surpluses of \$2.6 trillion from 2002-2007. Instead, deficits over that time combined to equal \$1.7 trillion. For the current 2009-2018 budget window, CBO projects a cumulative 10-year surplus of \$0.3 trillion, with the budget returning to surplus in 2012. But will actual deficits in the future turn out as differently from this projection as was the case in the last five years? What lessons can be drawn from this turn of events, and what role should budget projections play in policy decisions?

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# CRS Report for Congress

## Baseline Budget Projections: A Discussion of Issues

Updated February 7, 2008

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Prepared for Members and  
Committees of Congress

# Baseline Budget Projections: A Discussion of Issues

## Summary

In January 2001, the Congressional Budget Office (CBO) projected budget surpluses of \$2.6 trillion from 2002-2007. Instead, deficits over that time combined to equal \$1.7 trillion. Although large by historical standards, this dramatic revision in surplus projections should not come as a surprise. Baselines are meant to project the future budgetary path of current policy; they are not meant to be a “best guess” of future budgetary outcomes. Without a baseline projection, policymakers would be in the dark when planning the budget. Nevertheless, an overriding focus on the baseline projection will lead to conclusions that can be radically misleading for three reasons.

First, baseline projections are only as accurate as the assumptions underlying them. Arguably, a “better guess” of the probable path of the budget under current policy might be achieved by modifying three assumptions in the CBO baseline. One, that discretionary spending will remain constant as a share of GDP rather than growing at the rate of inflation. Two, that current troop levels will be maintained abroad in 2007. Three, that recent tax reductions and relief from the alternative minimum tax (AMT) will not be allowed to expire. Modifying these baseline assumptions (and accounting for the additional debt service required to finance these policies) yield an estimate that federal budget deficits would be \$7 trillion more over FY2009 through FY2018 period than that shown by the baseline projection. While the baseline shows the budget returning to surplus by 2012, the budget remains in deficit throughout the 10-year budget window if these alternative assumptions are used instead. The effects of the alternative assumptions grow over time: by 2018, the alternative baseline deficit is \$1 trillion, compared to a baseline surplus of \$223 billion.

Second, budget baseline estimates and projections are highly sensitive to small changes in underlying assumptions and economic factors. Economic forecasts remain subject to extremely large margins of error, even over short time periods. Thinking of the baseline projection as a certain outcome distorts the policymaking process. Although the baseline predicts the budget would return to surplus by 2012 under current law, projection uncertainty means that there is a 42% chance it will still be in deficit that year.

Third, baseline projections are limited to a 10-year period, and thus give no indication of the unique situation the United States faces beyond that horizon: the retirement of the baby boomers. Under current policy, their retirement and rising medical costs are likely to place an unsustainable strain on government finances.

This report will be updated annually.

## Contents

What Baselines Can Do .....	1
What Baselines Cannot Do .....	2
Discretionary Spending .....	2
Supplemental Spending on Military Operations and Disasters .....	5
Expiring Provisions .....	6
Alternative Minimum Tax (AMT) .....	6
Accuracy of Forecasts .....	7
Troubles on the Horizon — Social Security, Medicare, and Medicaid .....	9
Conclusion: The Sensitivity of the Baseline to Alternative Assumptions .....	11

## List of Figures

Figure 1. Discretionary Spending as a % of GDP, 1962-2007 .....	4
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## List of Tables

Table 1. Probability Distribution of Deficit Outcomes Based on Historical Projection Errors .....	8
Table 2. Long-Term Projected Federal Outlays, as a % of GDP .....	10
Table 4. Baseline Deficit Under Alternative Assumptions .....	12

# Baseline Budget Projections: A Discussion of Issues

In January 2001, the Congressional Budget Office (CBO) projected budget surpluses of \$2.6 trillion from 2002-2007. Instead, deficits over that time combined to equal \$1.7 trillion. For the current 2009-2018 budget window, CBO projects a cumulative 10-year surplus of \$0.3 trillion, with the budget returning to surplus in 2012.<sup>1</sup> But will actual deficits in the future turn out as differently from this projection as was the case in the last five years? What lessons can be drawn from this turn of events, and what role should budget projections play in policy decisions?

## What Baselines Can Do

Both CBO and the Office of Management and Budget (OMB) produce baseline projections of the budget semi-annually. The purpose of the baseline is to project revenues and outlays under current policy over the next 10 years. A concise definition of the baseline comes from CBO:

The baseline is intended to provide a neutral, nonjudgmental foundation for assessing policy options. It is not “realistic,” because tax and spending policies will change over time. Neither is it intended to be a forecast of future budgetary outcomes. Rather, the projections ... reflect CBO’s best judgment about how the economy and other factors will affect federal revenues and spending under existing policies.<sup>2</sup>

Thus, headlines such as “CBO baseline predicts that the budget will be balanced by 2012” or “Changes in the baseline projections prove policy change was unaffordable” are a misuse of the baseline. As indicated in the CBO quote, the baseline is not a “best guess” of future policy outcomes.

The proper way to use a baseline is as a rule-of-thumb estimate for the budgetary ramifications of current policy. This offers the policymaker a means to measure the relative effects of proposed legislation in the context of the overall budget. Current policy is very narrowly defined in these projections. It does not

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<sup>1</sup> Congressional Budget Office, *The Budget and Economic Outlook*, January 2001-January 2008. Similar projections were made by the administration in Office of Management and Budget, *Budget of the United States Government*, FY2002-FY2009. All estimates come from these documents unless otherwise noted. The figures cited in this report have not been revised to take into account policy changes made since January 2007.

<sup>2</sup> CBO, *The Budget and Economic Outlook*, January 2001, p. 7. Instructions for creating the baseline estimates are contained in the Budget Enforcement Act (BEA) as amended.

include proposals made in adopted budget resolutions, bills passed by only one chamber, or even bills passed by both chambers but not yet signed into law.

## What Baselines Cannot Do

Without a baseline projection, policymakers would be in the dark when planning the budget. Nevertheless, an overriding focus on the baseline projection can lead to radically misleading conclusions. This is true for three reasons.

First, baseline projections are only as accurate as the assumptions underlying them. Critics have argued that several of the underlying assumptions or rules followed by CBO and OMB in making the budget baselines are not as realistic as they could be. Applying alternative assumptions to the baseline could significantly increase the projected size of the deficit. As discussed more fully below, the baseline treatment of discretionary spending, supplemental spending on military operations in Iraq and Afghanistan, expiring tax provisions, and the alternative minimum tax are four assumptions that have been criticized.

Second, budget estimates and projections are highly sensitive to relatively small changes in the underlying assumptions and economic factors. These changes can have substantial effects on the deficit projection, and the effect on the projection compounds when extrapolated into the future. In particular, our understanding of the economy remains limited and economic forecasts remain subject to extremely large margins of error, even over short time periods. Thinking of the baseline projection as a certain outcome can distort the policymaking process.

Third, baseline projections are limited to current-year expenditures (for 10 years). Although one would expect 10 years to be a more than adequate time horizon to assess the course of future policy, the United States faces a unique situation beyond that horizon: the retirement of the baby boomers. Under current policy, their retirement, coupled with rising medical costs, would lead to a large expansion in funds dedicated to Social Security and Medicare that is likely to place an unsustainable strain on government finances. Because their retirement will mostly occur outside the 10-year window, the baseline does not reflect this problem. In a narrow sense, it should not reflect the problem, for the baseline is not supposed to advocate policy changes. Nevertheless, to the extent that the baseline frames the budget debate, critics argue that a baseline that makes unsustainable policy appear sustainable is misleading.

All three of these issues are discussed in detail below.

## Discretionary Spending

Discretionary spending presents a special problem to budget estimators. Accounting for about one-third of total outlays, it includes most spending in policy areas such as the military, transportation, education, and the environment. Unlike entitlements, there are few legal determinants of its levels; instead it is determined annually at the “discretion” of legislators. Because almost all discretionary funding

comes through annual appropriations, Congress has significant control over the amounts involved and there is no easy way to distinguish between “new policies” and the extension of “current policy.” This means that there is no obvious growth rate of discretionary spending to use in baseline budget forecasts. Arguably, the most useful rate of baseline discretionary growth for policymakers is whatever rate is most realistic.

Although the Budget Enforcement Act (BEA) as amended requires that OMB and CBO assume discretionary spending will stay constant in inflation-adjusted terms in their respective baselines, such an adjustment is not the only reasonable one. For example, assuming discretionary spending grew at an average historical rate, remained constant on a per-person inflation-adjusted basis, or remained constant as a percentage of GDP would each produce different budget results for total discretionary spending, total outlays, and the deficit than does the inflation-adjustment requirement. A smaller rate of increase would slow overall outlay growth, reducing the size of future deficit projections. A higher rate of increase would speed total outlay growth, increasing future deficit projections.

The baseline assumption that overall discretionary spending will stay constant in real, or inflation adjusted, terms has two implications. First, although discretionary spending is assumed to keep up with inflation, there is no adjustment for expected population growth. Under the baseline, therefore, future discretionary spending can buy the same amount of roads or military equipment or government services, but there will be fewer of them per person.

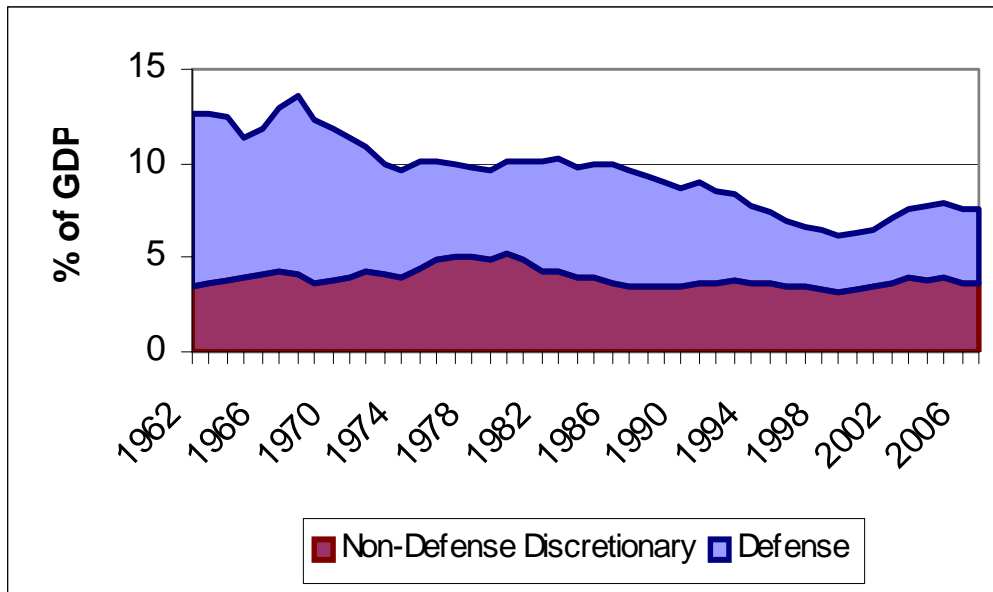
Second, since the economy, as measured by gross domestic product (GDP), is assumed to grow in real terms over the next 10 years, but real discretionary spending is assumed to remain constant, discretionary spending would fall as a percentage of GDP. This implies that as society becomes wealthier, it will not want to spend any of its additional wealth on government-provided discretionary goods and services. Although there are undoubtedly some government-provided goods and services on which people may not wish to spend their additional wealth, it is not obvious why this would be true of total discretionary spending, as implied by the baseline.

Over 10 years, the alternate assumption that non-supplemental discretionary spending stays constant as a percentage of GDP would increase cumulative outlays by \$1.4 trillion over the baseline levels. (Supplemental spending will be discussed in the next section.) If outlays are increased then, absent other policy changes, there will be a larger national debt and higher outlay for debt service. In addition to raising discretionary outlays by \$1.4 trillion, assuming discretionary spending stays constant as a share of GDP increases debt service costs by \$0.2 trillion. The cost of this alternative assumption grows over time — in 2018, it adds \$280 billion (plus \$70 billion in debt service) to the deficit. Assuming higher rates of discretionary spending growth is not inconsistent with the baseline’s purpose, to project current policy.

The baseline is not meant to make value judgments about, say, what future rate of discretionary spending growth is most desirable. Its goal is to make the most accurate projections of current policy. One way to determine what assumption is most accurate is by looking at what has happened to discretionary spending growth

historically.<sup>3</sup> As seen in **Figure 1**, total discretionary spending has, in fact, fallen slowly as a percentage of GDP for decades. Much of the decline in the 1990s came from a decline in military spending as a result of the “peace dividend” following the end of the cold war. Non-defense discretionary spending rose slightly as a percentage of GDP in the 1970s, fell in the early 1980s, then stayed relatively constant through the 1990s. From 2001 to 2005, defense spending grew faster than GDP. Since then, it has held approximately steady as a share of GDP. From 2001 to 2003, non-defense discretionary spending grew faster than GDP. Since then, it has held approximately steady as a share of GDP. (Discretionary spending was lower than originally planned in FY2007 because of the decision to operate on a continuing resolution for the entire year.)

**Figure 1. Discretionary Spending as a % of GDP, 1962-2007**



**Source:** CBO.

Although discretionary spending fell as a percentage of GDP, it grew more quickly than the rate of inflation in all but one year between FY1975 and FY1989. Thus, using the baseline assumption would have underestimated discretionary spending throughout this period. In the 1990s, discretionary spending fell in real terms from FY1990 to FY1995, but then grew more quickly than the rate of inflation from FY1996 to the present. Removing the fall in defense spending, non-defense discretionary spending grew more quickly than inflation throughout the 1990s and 2000s, with the exception of 1996.

At least for non-defense discretionary spending, assuming spending would stay constant as a percentage of GDP is the only assumption that would not consistently underpredict spending levels historically. For better or worse, the baseline

<sup>3</sup> Of course, some of the historical change in discretionary spending is due to policy changes, which would not be reflected in a baseline. But for discretionary spending, there is no objective way to disentangle the policy changes from the policy already in place.



assumption that discretionary spending will stay constant in inflation-adjusted terms through FY2018 would reduce total discretionary spending as a share of GDP to its lowest level ever since data has been collected.

## Supplemental Spending on Military Operations and Disasters

Supplemental discretionary spending, which includes military activities in Iraq and Afghanistan and natural disaster relief, outside of the normal appropriation process poses a particular problem for the baseline. The baseline extends whatever budget authority was granted for the current fiscal year at the time the baseline was projected and adjusts it for inflation over the next 10 years.<sup>4</sup> Supplemental spending for the current year that is passed after the baseline is released will not be included in the baseline. As of January 2008, Congress had authorized \$88 billion for supplemental spending in Iraq and Afghanistan,<sup>5</sup> which has been included (adjusted for inflation) in each year of the 10-year baseline.

It is difficult to say what assumption about supplemental spending best represents current policy for baseline purposes. On the one hand, the baseline underestimates military spending in FY2008 unless troop levels abroad are dramatically reduced immediately; CBO estimates that at least \$30 billion more is expected to be spent before FY2008 ends, which will increase the deficit relative to the baseline. On the other hand, assuming that the government will continue to spend \$115 billion a year in real terms for the next 10 years is probably an overestimate, although including anything less could reasonably be defined as a policy change in the baseline context. (Remember, the baseline is not meant to be a best guess of the future.)

If the \$30 billion is added to the baseline in 2008 and extended (adjusted for inflation) throughout the 10-year projection, then spending over 10 years would rise by \$332 billion (plus \$103 billion in debt service). This assumption is not current policy in the sense that it would still not be sufficient funding to maintain current troop levels over 10 years. Alternatively, if troops were gradually reduced to 30,000 by 2010, the deficit would be reduced by \$305 billion (plus \$35 billion in debt service) over 10 years.

Besides military spending, Congress routinely authorizes unplanned supplemental spending in response to emergencies. In some years, such as 2005 (following Hurricane Katrina), supplemental spending is quite large; in other years, it is much smaller. The baseline extends whatever level of supplemental spending occurred in the last year. Because non-military supplemental spending varies from year to year, in some years extending the current year amount would be too high over the baseline window, and in others too low.

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<sup>4</sup> See CBO, *The Budget and Economic Outlook*, January 2001, p. 9.

<sup>5</sup> CBO estimates supplemental outlays of \$115 in 2008 based on \$88 billion of budget authority granted in 2008 and unused budget authority from prior fiscal years.

## Expiring Provisions

Some government spending and tax provisions, especially tax credits, have expiration dates. CBO is required to assume in their baseline estimates that all tax measures (unless earmarked to a trust fund) and small spending programs will expire as scheduled, since that represents current policy according to the law.<sup>6</sup> The baseline reflects this assumption by increasing revenues when the measure is due to expire, or reducing outlays when the program is due to expire. But most of these expiring provisions have proven very durable and are routinely extended. The 10-year cost of extending these provisions is \$438 billion (plus \$97 billion in debt service). Some examples of expiring tax provisions include credits or deductions for fuel cell vehicles, qualified zone academy bonds, welfare-to-work, medical savings accounts, research and experimentation, and economic development empowerment zones.<sup>7</sup>

The routine renewal of minor tax provisions has made the proper baseline treatment of expiring provisions tricky for years. But baseline treatment of expiring provisions became particularly difficult after the decision to make the major tax cuts of 2001, the Economic Growth and Tax Relief Reconciliation Act (EGTRRA, P.L. 107-16), and 2003, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA, P.L. 108-27), both of which expire in 2010 due to congressional budget rules. Clearly, expiration of the tax cut was not a goal of its proponents, and there have already been several proposals to make it permanent, including the President's FY2007 budget proposal. Few would say that policy had not changed if tax cuts received in 2010 disappeared in 2011.

CBO estimates that if EGTRRA and JGTRRA were renewed, the deficit would rise by \$2.3 trillion (plus \$0.4 trillion in debt service) over 10 years. Almost all of the cost comes after 2010, and grows over time. In 2018, making EGTRRA and JGTRRA permanent would reduce revenues by \$344 billion (not including resulting debt service). These estimates do not include expiring provisions related to the alternative minimum tax, which, if allowed to expire, would "take back" some of the tax cuts. The problem for the baseline posed by the AMT is discussed in the next section.

## Alternative Minimum Tax (AMT)

The alternative minimum individual income tax (AMT) is a parallel tax system that is meant to ensure that all taxpayers accrue at least some minimum tax liability.<sup>8</sup> Because of the reduction in regular income tax rates and because the AMT is not

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<sup>6</sup> Until 2005, OMB made similar assumptions to construct its baseline. In 2005, the baseline was changed to incorporate certain policy changes, such as extending expiring tax cuts and not extending "emergency" spending. To compare CBO and OMB baseline estimates, use the OMB "BEA baseline deficit," found in OMB, *Analytical Perspectives*, February 2007.

<sup>7</sup> For more information, see CRS Report RL33641, *Tax Expenditures: Trends and Critiques*, by Thomas L. Hungerford.

<sup>8</sup> For more information, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg Esenwein.

indexed for inflation, more and more people fall under it each year. JGTRRA increased the AMT exemption and changed its treatment of tax credits temporarily. In recent years, the changes made in JGTRRA have been extended for one year at a time, and the changes are currently due to expire at the end of 2008. As a result, under current law the number of households falling under the AMT would rise from 4 million in 2006 to nearly 50 million in 2016. The baseline assumes that the JGTRRA changes will be allowed to expire as scheduled. Many critics have argued that this is not a realistic baseline assumption since the AMT was originally intended to affect only a few very wealthy individuals.

Alternative scenarios that prevent the number of AMT taxpayers from growing rapidly would result in significantly larger deficit projections. For example, if the higher exemption and treatment of tax credits under the AMT that recently expired were extended and adjusted for inflation, the deficit would increase by an estimated \$724 billion (and increase interest payments by \$189 billion) over 10 years.

Critics argue that the interaction of the AMT under current law with the major tax cuts also misrepresents the cost of current policy. For example, a married couple with two children claiming the standard deduction and earning \$80,000 a year in 2008 will find that about 60% of their EGTRRA/JGTRRA tax cut has been “taken back” by the AMT.<sup>9</sup> Revenue estimates of the recent tax cuts, including the baseline, assume that this would occur; if they did not, the revenue estimates of the tax cuts would be much higher. If expiring AMT provisions were extended when all other expiring tax provisions were made permanent, then the deficit would increase by \$1.3 trillion plus debt service costs of \$0.3 trillion over 10 years. This is \$598 billion more than the sum of the estimates of the two policy changes in isolation.

## Accuracy of Forecasts

The baseline is inherently uncertain because it rests on a number of unpredictable assumptions about the future. Indeed, it should be viewed not as a precise estimate, but rather as the midpoint on a continuum of highly uncertain outcomes. Even in the very near future, uncertainty looms large: between January and the end of the fiscal year, revisions in economic and technical assumptions reduced the surplus in 2001 by \$72 billion.

**Table 1** shows the probability distribution for the deficit based on economic and technical errors — not policy changes — to historical projections. Three months into the fiscal year, CBO projects that the baseline deficit would equal 1.5% of GDP in FY2008. If the economic and technical errors in CBO’s January baseline projection are equal to the historical average, there is a 25% chance that nine months later the actual deficit will be above 2.2% of GDP and a 25% chance it will be below 0.8% of GDP. As the projection moves further into the future, the errors get larger. Although CBO projects a baseline surplus for 2012, it predicts a 42% chance of a deficit instead. In 2012, there is a 25% chance that the budget will be back in surplus equal to 2.4% of GDP under current policy — and a 25% chance that the deficit will

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<sup>9</sup> CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and “Take Back” Effects*, by Gregg Esenwein.

have grown to 1.4% of GDP, 1.9 percentage points more than the baseline projection. With margins of error that large, baseline projections, particularly in out years, cannot be counted on for accuracy, and like other economic projections reaching that far out, they are not, by themselves, a meaningful basis for policy decisions.

**Table 1. Probability Distribution of Deficit Outcomes Based on Historical Projection Errors**  
(% of GDP)

	2008	2009	2010	2011	2012
25% Chance That Baseline Deficit Will Exceed:	-2.2	-2.3	-2.9	-2.2	-1.4
Current Baseline Deficit:	-1.5	-1.3	-1.5	-0.7	0.5
25% Chance That Baseline Deficit Will Be Smaller Than (or Surplus Will Exceed):	-0.8	-0.3	-0.2	0.8	2.4
Probability of a Deficit Under Current Policy (%)	97	83	79	62	42

**Source:** CBO, *The Budget and Economic Outlook*, Jan. 2008; CRS calculations based on CBO, *The Uncertainty of Budget Projections*, March 2007.

**Note:** These projections are based on current policy, as defined by the official baseline.

The historical errors in CBO's projections stem from two sources: errors in CBO's economic forecasts and "technical" errors, which refer to all changes in budgetary outcomes that cannot be attributed to policy or economic changes. For example, projections can prove inaccurate because entitlement program participation rates turn out to be different or taxable income rises faster or slower than projected.

The economic errors imply no shortcoming on the part of CBO; the accuracy of their forecasts has typically been comparable to private sector forecasters. Historically, economic forecasts have been particularly inaccurate at spotting turning points in the business cycle, and the most recent recession was no exception. In January 2001, CBO, the Administration, the Federal Reserve, and virtually all major private forecasts predicted growth between 2.0% and 3.1% for the year. In reality, the economy grew by 0.8%. Many economists are worried that the economy may enter a recession in 2008. On average, recent recessions have increased the budget deficit by 1.6% of GDP, absent policy changes. Over the 10-year budget window, recessions have relatively small effects on the baseline projections, and small changes in assumptions about growth in the labor force and productivity have large effects.

Since 2001, economic changes to the baseline have been significant only in 2002 and 2003. By contrast, technical changes have been a major factor each year.<sup>10</sup> Much of the downward revision in the baseline forecast in 2001 was attributable to the fact that tax revenues fell even more quickly than CBO predicted given the rate

<sup>10</sup> See CRS Report RS22550, *The Federal Budget: Sources of the Movement from Surplus to Deficit*, by Marc Labonte.

of economic growth following the recession. For example, the stock market crash created a larger than expected decline in capital gains revenues. If a policy change or tax cut cost more in reality than its original “score,” this would also appear as a technical error.

What does this uncertainty imply for policymaking? It implies that half of the time policymakers will find themselves with more money than anticipated, half the time they will find themselves with less. Setting goals such as balancing the budget or reducing the deficit by half by changing policy according to the amount needed under the baseline does not ensure they will occur; in fact, the probability that they will occur is only 50%.

This section has discussed uncertainty caused by technical and economic factors. There is also policy uncertainty — for example, spending on unanticipated future wars and natural disasters — which is not budgeted for in baseline projections.

## Troubles on the Horizon — Social Security, Medicare, and Medicaid

Unlike corporations, the government considers only current-year liabilities in its budget for two reasons. First, it is typically assumed that only the current budget surplus or deficit affects aggregate demand in the current economy. Second, unlike corporations, the government has the power to alter its revenue (taxes) or spending levels as necessary to meet almost any future funding need. Critics have argued that since the baseline projects the budget for only the next ten years, it is unable to guide policymakers on longer term policy issues under the current accounting system. Long-range projections indicate that the government faces very large liabilities in its Social Security, Medicaid (which covers long-term care), and Medicare programs beginning in the second decade of this century under current policy. The retirement of the baby boom generation, rising medical costs, and longer life expectancy will put enormous pressure on government finances. If the government used accrual-basis accounting like corporations, then unfunded liabilities would be recorded in the current year deficit as they were accrued, and current deficit projections would be much larger.<sup>11</sup> To fund these liabilities when they accrue would require large budget surpluses using today’s cash-flow accounting. One study has placed the government’s total unfunded liabilities at \$71 trillion in present value terms.<sup>12</sup>

Benefits paid under these “pay as you go” programs are financed through payroll taxes on current workers. Over the next 30 years, the ratio of workers per beneficiary is expected to fall from 3.4 to about 2. **Table 2** illustrates the projected path of future government outlays under current policy. In 2000, total spending on Social Security,

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<sup>11</sup> For a brief explanation, see CRS Report RL33623, *Long-Term Measures of Fiscal Imbalance*, by D. Andrew Austin. In testimony before the House Financial Services Committee on Feb. 12, 2003, Federal Reserve Chairman Alan Greenspan proposed that the government adopt accrual-basis accounting, like corporations, in order to take into account the implicit liabilities of the entitlement programs.

<sup>12</sup> Jagdeesh Gokhale and Kent Smetters, “Fiscal and Generational Imbalances: An Update,” *Tax Policy and the Economy*, vol. 20, National Bureau of Economic Research, 2006, p. 193.

Medicaid, and Medicare equaled 7.4% of GDP. The share of national income devoted to those programs is projected to double shortly after 2040. The difference between future spending on these programs and the government's future tax revenue is the "unfunded liability" that can only be financed through higher taxes, lower benefits than promised under current law, or the issuance of debt. The liabilities cannot be financed solely through debt issuance, however, because the size and persistence of the shortfall would quickly lead to unsustainably large budget deficits. As shown in the table, under current revenue policy, total outlays would rise from 20.3% in 2006 to 38.9% in 2080. This large rise occurs under the assumption that all spending outside Social Security, Medicare, and Medicaid would fall to 6.7% by 2020, its lowest level in the post-war period, and continue to fall to 5.9% of GDP by 2080. Budget deficits would become unsustainably large at some point, probably by the 2060s. To balance the budget each year under these spending assumptions, taxes would need to rise continually, to 24.7% of GDP in 2080 from 18.4% of GDP in 2006. Otherwise, already promised benefits could not be paid. Yet there is no hint of these developments found in the baseline since it occurs beyond the 10-year window.<sup>13</sup>

**Table 2. Long-Term Projected Federal Outlays, as a % of GDP**

Fiscal Year	Social Security, Medicare, and Medicaid	Other Spending (Excluding Interest)	Total Outlays (Including Interest)	Budget Surplus/ Deficit(-)
2000 (act.)	7.4	8.7	18.4	2.4
2007 (act.)	8.9	9.4	20.0	-1.9
2020	10.4	6.7	18.4	-0.1
2030	13.7	6.4	20.8	-2.5
2040	14.7	6.2	23.5	-5.2
2060	16.8	6.0	29.8	-11.5
2080	18.8	5.9	38.9	-20.6

**Source:** OMB, *Analytical Perspectives of the U.S. Government*, FY2008, p. 188.

**Note:** Table assumes that current revenue stays a constant 18.3% of GDP from 2020 on.

Critics can reasonably argue that although these problems are important, the baseline is not the proper forum for raising them. A short-term tool cannot accommodate the evaluation of long-term problems, they argue; longer term forecasts already in existence are a more appropriate forum for this debate.<sup>14</sup> With margins of error so large even five years ahead, it would arguably be impractical to give, say, 75-

<sup>13</sup> For more information, see CRS Report RL32747, *Social Security and Medicare: The Economic Implications of Current Policy*, by Marc Labonte.

<sup>14</sup> CBO's long-term forecasts are presented in CBO, *Long-Term Budget Outlook*, December 2007.

year projections the institutional role in the budget debate that the baseline currently occupies. And incorporating long-term liabilities into the baseline could be seen as favoring this issue over other policy issues that people may believe to be equally or more important, perhaps altering the baseline's role from one of neutrality to advocacy. Nevertheless, it can be argued that to the extent that the baseline frames the budget debate and makes unsustainable policy appear sustainable, it is also misleading in this case.

## Conclusion: The Sensitivity of the Baseline to Alternative Assumptions

The budget baseline is meant to be a projection of current policy. This gives lawmakers a means of evaluating how policy proposals affect the budget. The baseline is not meant to be a prediction of the future. For a baseline to be useful, it should give as accurate a description of current policy as possible. Unfortunately, there is no obvious definition of "current policy," so some arbitrary assumptions must be made to construct a baseline. Critics have questioned whether some of these assumptions could be altered to be more realistic.

Arguably, a "better guess" of the probable path of the federal budget under current policy extended might be achieved by modifying five assumptions in the CBO baseline. First, that non-supplemental discretionary spending will remain constant as a share of GDP rather than growing at the rate of inflation. Second, that supplemental military spending will be increased so that current troop levels in Iraq and Afghanistan can be maintained in 2008, and (following baseline conventions) that spending level will be extended throughout the budget window. Third, that expiring tax provisions ("extenders") that are routinely extended will not be allowed to expire in the future. Fourth, that recent tax cuts (EGTRRA and JGTRRA) will be extended rather than allowed to expire. Fifth, that the alternative minimum tax (AMT) relief will be extended and adjusted for inflation rather than allowing the AMT to "take back" most of the income tax cuts. Modifying these baseline assumptions (and accounting for the additional debt service required to finance these policies) yield an estimate that the federal budget deficit would equal \$6.7 trillion over FY2009 through FY2018 period rather than the \$0.3 trillion surplus projected in the official baseline. These changes are illustrated in **Table 4**. The effects of the alternative assumptions grow over time: by 2018, the alternative baseline deficit is \$1 trillion, compared to an official baseline surplus of \$223 billion. (The table is meant to serve as a technical illustration rather than a recommended alternative. It indicates, as CBO notes, that the baseline is an inevitably arbitrary yardstick.)

**Table 4. Baseline Deficit Under Alternative Assumptions**  
(\$ in billions)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total 2009- 2018
CBO baseline surplus/deficit	-219	-198	-241	-117	87	61	96	117	95	151	223	274
Discretionary appropriations constant as % of GDP <sup>a</sup>	0	-9	-33	-64	-95	-125	-154	-184	-214	-246	-280	-1,404
Current troops levels abroad maintained in 2008	-30	-31	-32	-33	-33	-34	-34	-35	-35	-35	-36	-332
Extend EGTRRA/JGTRRA	0	-3	-6	-147	-254	-281	-292	-304	-316	-329	-344	-2,276
Other tax extenders	-6	-14	-22	-31	-38	-44	-49	-53	-58	-63	-67	-439
Extend AMT <sup>b</sup>	-6	-75	-76	-89	-103	-118	-134	-151	-170	-191	-215	-1,322
<i>Debt service</i>	-1	-6	-12	-26	-50	-79	-113	-152	-197	-247	-301	-1,183
Total modifications	-43	-137	-180	-389	-572	-680	-776	-878	-989	-1112	-1243	-6,956
Modified baseline surplus/deficit	-262	-335	-421	-506	-485	-619	-680	-761	-894	-961	-1020	-6,682

**Source:** CRS calculations based on CBO data.

**Notes:** See text for details. Columns may not be additive due to rounding. The table does not include legislative changes made since January 2007.

a. Supplemental spending is excluded from this category.

b. For the purposes of this table, the cost of extending the AMT includes the interactive effects when the AMT and tax cuts are extend jointly.

Another conceptual mistake sometimes made in reference to the baseline is to treat the underlying assumptions as highly predictable. The baseline is the midpoint in an wide array of possible outcomes. Because our understanding of the demand for government services, the growth rate of taxable income, and the economy in general — and causes of the business cycle in particular — is limited, there is a high degree of uncertainty surrounding these estimates, even over short time intervals. Over longer time periods, uncertainty grows, which is an argument counseling against policy changes whose budgetary effect grows over time. Although the baseline projects that the budget will be back in surplus in 2011, there is a 42% chance it will remain in deficit that year.

Reasonable changes in baseline assumptions, made in **Table 4** suggest that under current policy the budget deficit will rise rather than fall throughout the 10-year window. Outside the 10-year window, budget deficits get larger and current policy becomes unsustainable because of the budgetary pressures associated with the retirement of the baby boomers. Current deficits exacerbate these pressures.