COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

The Mid-Session Review
July 26, 2010

Late last week, the Office of Management and Budget (OMB) released its Mid-Session Review, which showed slightly improved deficit and debt projections for FY 2010 but slightly worse projections of the President's Budget over the next few years (for an initial analysis of the President's FY2011 Budget, see http://crfb.org/document/analysis-presidents-fy-2011-budget). Despite some differences from February, these new projections show the same old story: the Federal budget is on an unsustainable path.

Our main points are:

- Under OMB's new estimate of the President's budget, the debt held by the public would grow continuously as a share of the economy, passing 60 percent this year, 70 percent in 2012, and 77 percent in 2020.

- These estimates paint a far better picture than CBO's, which estimate debt held by the public reaching 90 percent of GDP under the President's proposed policies. This is in large part because OMB's economic growth assumptions are notably on the higher-end of consensus ranges. Though we hope OMB's projections are accurate, we should not rely on such assumptions.

- The Administration has not put forward policies that would meet its fiscal goal of bringing the budget into primary balance by 2015 and achieving fiscal sustainability over the longer-term. Instead, the Administration is relying on the fiscal commission to come up with a solution. While CRFB is hopeful that the fiscal commission will succeed, the Administration needs a Plan B in case the commission does succeed or Congress does not heed its recommendations.

- And our main conclusion? It is urgent that we develop a plan to change course soon! Policymakers have to get serious about making changes to the budget path. While we do not have to enact large spending cuts or tax increases immediately as the economy continues to limp along, a plan must be put in place as quickly as possible and the policies can be phased in more gradually, or we risk very severe consequences from our fiscal procrastination.

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Deficits and Debt

OMB now projects a $1.47 trillion (10 percent of GDP) deficit for FY 2010 and a $1.42 trillion (9.2 percent of GDP) deficit for FY 2011. In February, they projected deficits of $1.56 trillion (10.6 percent of GDP) and $1.27 trillion (8.3 percent of GDP), respectively. Over the next decade, OMB now projects deficits total $8.47 trillion, as compared to $8.53 in their previous projections. CBO projects the President's budget would add $9.76 trillion in deficits over the next decade.

Fig. 1: Deficit and Debt Projections under the President's Budget

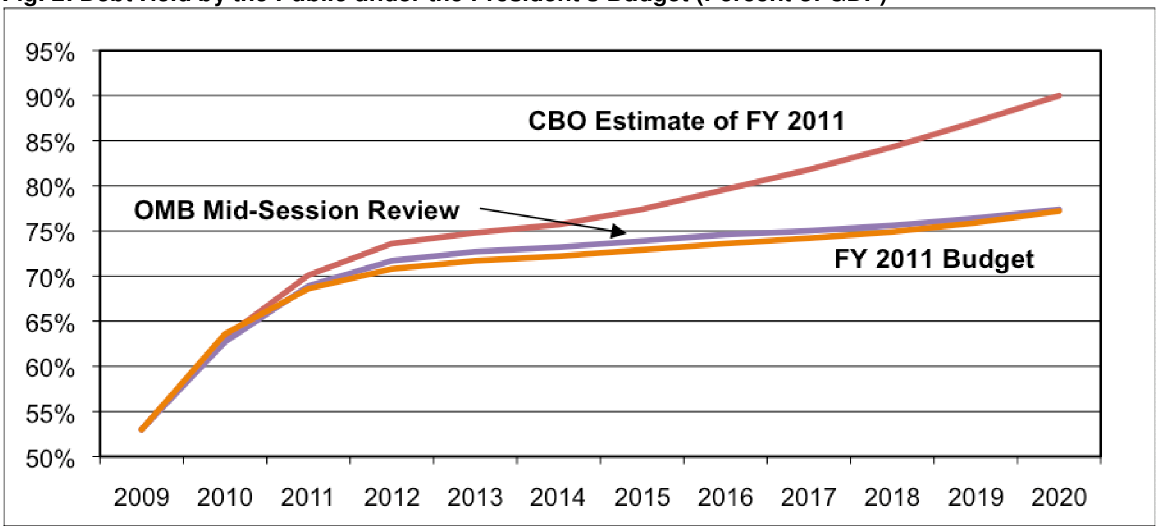
	2010	2011	2012	2013	2014	2015	2011-2020
DEFICITS (Billions of Dollars)							
Mid-Session Review	$1,471	$1,416	$911	$736	$698	$762	$8,474
OMB (February)	$1,556	$1,267	$828	$727	$706	$752	$8,532
CBO (March)	$1,500	$1,342	$914	$747	$724	$793	$9,755
DEBT (Billions of Dollars)							
Mid-Session Review	$9,199	$10,550	$11,602	$12,459	$13,264	$14,134	n/a
OMB (February)	$9,298	$10,498	$11,472	$12,326	$13,139	$13,988	n/a
CBO (March)	$9,221	$10,512	$11,579	$12,467	$13,329	$14,256	n/a
DEFICITS (Percent of GDP)							
Mid-Session Review	10.0%	9.2%	5.6%	4.3%	3.8%	4.0%	4.5%
OMB (February)	10.6%	8.3%	5.1%	4.2%	3.9%	3.9%	4.5%
CBO (March)	10.3%	8.9%	5.8%	4.5%	4.1%	4.3%	5.2%
DEBT (Percent of GDP)							
Mid-Session Review	62.7%	68.9%	71.7%	72.7%	73.2%	73.9%	n/a
OMB (February)	63.6%	68.6%	70.8%	71.7%	72.2%	72.9%	n/a
CBO (March)	63.2%	70.1%	73.6%	74.8%	75.7%	77.4%	n/a

Although deficit projections are smaller for FY2010 – largely due to lower projected spending on unemployment, TARP, and the FDIC – deficits are higher over the next few years than projected in February. Deficits are expected to decline in gross terms starting in 2011 as stimulus spending subsides, the economic recovery leads to greater revenue collection, spending declines for the wars in Iraq and Afghanistan (the Administration assumes a $50 billion placeholder in future years), and the 2001/2003 tax cuts expire for those making over $250,000 a year.

By the middle of the decade, though, deficits will begin to rise again as rising health care costs and population aging push entitlement spending upward and burgeoning debt leads to ever-growing interest payments. By the end of the decade, spending is projected to reach 23.5 percent of GDP, and revenues are projected to reach 19.8 percent of GDP. Both will be above their historical averages (of 21 percent and 18 percent, respectively) and the resulting deficit of 3.8 percent will be much too high and growing.

As a result of this continuing tide of deficits, the debt will continue to grow as a share of the economy under the President's Budget. OMB projects it will exceed 77 percent of GDP by 2020, while CBO project it will reach 90 percent. In either case, the debt trajectory is extremely dangerous both within and beyond the ten-year budget window.

Fig. 2: Debt Held by the Public under the President's Budget (Percent of GDP)



Policy Proposals

Although the debt is scheduled to rise significantly under the President's Budget, it would actually remain relatively stable under current law (albeit at levels that are much too high). We estimate, under this scenario, that debt held by the public would be about 65 percent of GDP in 2020 (as compared to 77 percent under the President's Budget as estimated by OMB or 90 percent as estimated by CBO).

In other words, while it is the built-in growth in the nation's largest programs such as Social Security and Medicare that create the unsustainable situation in the longer-term, it is the assumption of *active changes* in the law that will create an unstable fiscal situation over the medium term. These changes are ones that are supported by the White House and most Members of Congress, including the extension of most of the 2001/2003 tax cuts, the continued patching of the Alternative Minimum Tax, and continued "Doc Fixes." Given the dire fiscal projections in this report—and all the others—we cannot help but point out the obvious: if policymakers want to extend these policies, it is nothing short of fiscal recklessness to do so without paying for them.

Compared to the President's Budget, on a rough apples-to-apples basis, baseline deficits are now projected to be a bit higher while the President's policies are expected to cost a little less. This is despite the fact that two policies in the President's budget – health care reform and higher education financing reform – have since been enacted into law and reduce deficits by about $40 billion more than what was projected in the Budget.

Fig. 3: Policy Proposals in the President's Budget and MSR (Billions of Dollars)

	CBO	Budget	MSR
Pre-PPACA BEA Baseline (Adjusted)*	**$5,990**	**$5,472**	**$5,572**
Health Reform	*($150)*	*($150)*	*($174)*
Education Reform	*$6*	*$20*	*$6*
Post-PPACA BEA Baseline (Adjusted)*	**$5,846**	**$5,342**	**$5,404**
Tax Proposals			
Renew 2001/2003 Tax Cuts for Families Making Under $250,000	$2,465	$2,419	$2,363
Index AMT to Inflation	$577	$659	$633
Limit Itemized Deductions	($289)	($291)	($292)
Reform U.S. International Tax System	($127)	($122)	($117)
Impose Financial Crisis Responsibility Fee	($90)	($90)	($90)
Tax Cuts for Families and Individuals	$154	$143	$127
Tax Cuts for Businesses	$82	$93	$96
Continue Certain Expiring Provisions	$63	$47	$58
Close Tax Gap	($22)	($49)	($35)
Loophole Closers and Other Revenue Raisers	($226)	($207)	($177)
Other~	$25	$15	$9
Subtotal	**$2,612**	**$2,617**	**$2,575**
Spending Proposals			
Stimulus~	$131	$169	$180
Fund Pell Grants	$123	$118	$108
Doc Fixes	$286	$371	$382
Waste, Fraud, and Abuse	N/A@	($132)	($132)
Non-Security Discretionary Changes	($152)	($249)	($259)
Security Discretionary Changes		$284	$279
Overseas Contingency Spending ($50 billion/year placeholder)^		($728)	($731)
Other Changes	$103	$93	$64
Subtotal	**$492**	**($71)**	**($109)**
Debt Service	$803	$643	$604
Total Deficit Under President's Budget	**$9,755**	**$8,532**	**$8,474**

*Baseline adjustments meant to reflect the passage of major health and education reform legislation, which was previously included as a policy in the President's budget. Adjustments for other legislative changes, technical and economic changes, and net interest are not reflected in this adjustment.
~Measures reflect both revenue and outlay changes.
@The CBO cannot score most program integrity savings, since they require appropriations to be achieved.
^ Large variation between CBO and OMB estimates for discretionary and war spending changes reflects different baseline estimates, which create different estimates for discretionary policy changes.

Economic Projections

In light of more recent economic data, the Administration now relies on several improved economic assumptions over the next few years. OMB projects real GDP growth to reach 3.2 percent this year and 3.6 percent in 2011, compared with their estimates of 2.7 percent and 3.8 percent, respectively, in February. CBO has a much more conservative view, estimating that the real economy will grow 2.2 percent this year and 1.9 percent next year, based on their baseline projections. It should be noted that CBO's economic estimates do not incorporate the President's policy changes or proposals, which could have notable effects on the economy, such as various tax cuts extensions and spending proposals.

Although both CBO and OMB project the economy will continue to grow over the coming decade, OMB's projections are notably on the upper-end of consensus ranges. OMB sees the real economy growing by almost 2 percent faster in 2011 than CBO does, and at a significantly faster rate through the second half of the decade. By the end of the decade, as a result, OMB projects nominal GDP will be about $1.4 trillion larger than CBO projects.

Fig. 4: Economic Projections (Calendar Year)

	Actual 2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Real GDP Growth												
Mid-Session Review	-2.4%	3.2%	3.6%	4.2%	4.2%	4.0%	3.6%	3.2%	2.8%	2.5%	2.5%	2.5%
OMB (February)	-2.5%	2.7%	3.8%	4.3%	4.2%	4.0%	3.6%	3.2%	2.8%	2.6%	2.5%	2.5%
CBO (January)	-2.5%	2.2%	1.9%	4.6%	4.8%	3.9%	2.9%	2.5%	2.3%	2.2%	2.2%	2.3%
Blue Chip Consensus		3.1%	3.0%	n/a								
CPI-U												
Mid-Session Review	-0.3%	1.6%	1.3%	1.8%	1.9%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%	2.1%
OMB (February)	-0.3%	1.9%	1.5%	2.0%	2.0%	2.0%	2.0%	2.0%	2.1%	2.1%	2.1%	2.1%
CBO (January)	-0.2%	2.4%	1.3%	1.2%	1.1%	1.3%	1.7%	1.9%	2.0%	2.0%	2.0%	2.0%
Blue Chip Consensus		1.7%	1.5%	n/a								
Unemployment Rate												
Mid-Session Review	9.3%	9.7%	9.0%	8.1%	7.1%	6.3%	5.7%	5.3%	5.2%	5.2%	5.2%	5.2%
OMB (February)	9.3%	10.0%	9.2%	8.2%	7.3%	6.5%	5.9%	5.5%	5.3%	5.2%	5.2%	5.2%
CBO (January)	9.3%	10.1%	9.5%	8.0%	6.3%	5.3%	5.1%	5.0%	5.0%	5.0%	5.0%	5.0%
Blue Chip Consensus		9.6%	9.1%	n/a								

Economic projections play a vital role in both OMB and CBO's budget projections, as a stronger economy reduces automatic spending programs designed to stabilize downturns, increases revenues as wages and employment rise, and increases the denominator for all deficit and debt calculations as a share of the economy. As a result, OMB's slightly rosier economic projections lead to lower debt-to-GDP projections than CBO's. If OMB's assumptions turn out to be overly optimistic, the requisite fiscal adjustments needed to meet the Administration's goals will be that much more difficult.

Conclusion

In creating the National Commission on Fiscal Responsibility and Reform, the Administration committed itself to tackling medium- and long-term fiscal imbalances. Since the fiscal commission will present its findings at the end of this year, the FY 2011 budget must be the last time the Administration presents a dire fiscal outlook without proposals for how to fix the situation. This is nothing short of a most basic requirement of responsible governing.

Both the White House and Congress should be held to a minimum standard of laying out a responsible fiscal objective and presenting detailed proposals of how they would achieve it. While differences in policy preferences will abound, "none of the above" is not an acceptable answer for any U.S. policymaker given the tremendous fiscal challenges we face.   Finding out exactly what a fiscal crisis would look and feel like should not be the path the U.S. follows.