COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

CBO's Analysis of the President's FY 2015 Budget
April 17, 2014

The Congressional Budget Office (CBO) released its official analysis of the President's FY 2015 budget today using its own economic assumptions and methodologies to estimate the budget's fiscal impact. As is often the case, CBO finds a less optimistic outlook than the President's Office of Management and Budget (OMB) with debt on a modest upward path in the latter part of the ten-year window, up to 74.3 percent of GDP in 2024 as opposed to OMB's projection of debt on a downward path toward 69.0 percent of GDP.

Both projections represent an improvement from CBO's current law baseline, which projects debt trending upward to 78 percent of GDP by 2024. However, most of the $1.04 trillion difference based on CBO's estimates – about $775 billion (3 percent of GDP) – arises because the President's budget reflects the war drawdown currently under way while the CBO baseline is required to assume war spending grows with inflation. Setting this drawdown aside, CBO estimates about $260 billion of net deficit reduction over ten years in the President's budget, compared to $750 billion using OMB's estimates.

Although the budget includes both spending cuts and revenue increases, the spending cuts are smaller than the proposed spending increases (including sequester relief and increased spending as a result of immigration reform). As a result, net deficit reduction would come entirely from higher revenue levels. Indeed, spending and revenue levels would both grow over the course of the decade, and deficits would be slightly higher in the second half of the projection window than in the first.

Differences between CBO and OMB estimates largely reflect different economic and technical assumptions. For example, OMB projects GDP to be $700 billion higher by 2024. Of the 5.3 percent difference in the projected 2024 debt ratio, about two thirds is due to different *baseline* projections and the remaining third due to different estimates of the impact of the President's policy proposals.

The President deserves credit for fully offsetting the cost of all his new initiatives. However, CBO's projection that current record-high debt levels will continue to grow as a share of the economy under the President's budget, is discouraging. This outcome would leave little flexibility to respond to new needs and priorities and would hinder long-term economic growth. The President's budget would be an improvement from current law, but CBO's analysis confirms that it does not go nearly far enough, particularly on entitlement reforms, to put debt on a sustainable downward path.

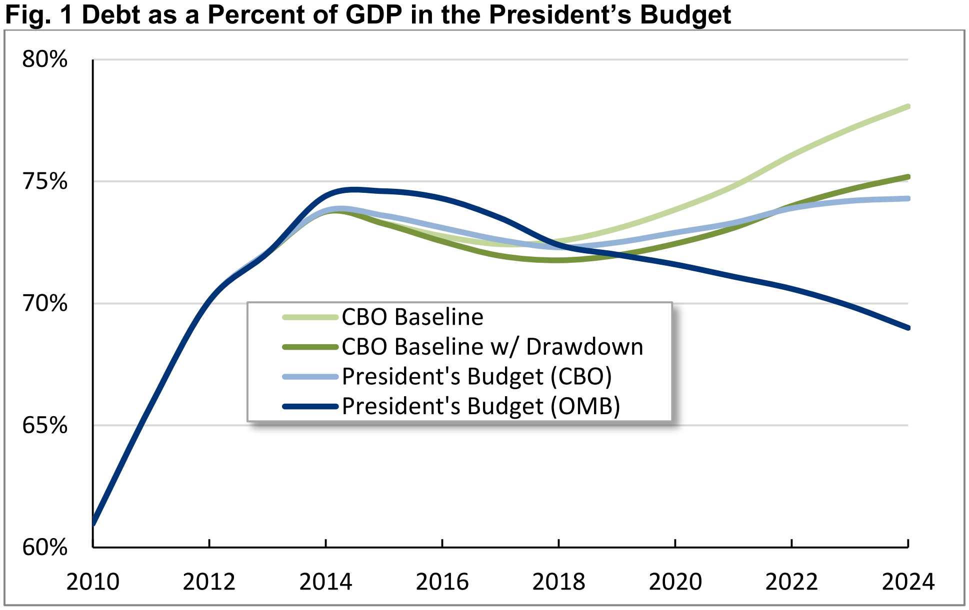
1899 L Street NW • Suite 225 • Washington, DC 20036 • Phone: 202-596-3597 • Fax: 202-478-0681 • www.crfb.org

Budget Projections

Under the President's budget, CBO estimates debt levels would fall from 73.8 percent of GDP in 2014 to 72.3 percent by 2018, before rising to 74.3 percent by 2024. In nominal dollars, debt held by the public will rise from $12.6 trillion today to $19.9 trillion by 2024.

The President's budget would be an improvement over current law, under which CBO projects debt would rise to above 78 percent of GDP (75 percent with the President's war drawdown). However, it is significantly worse than OMB's estimates that show debt declining throughout the decade to a low of 69 percent by 2024.

Fig. 1 Debt as a Percent of GDP in the President's Budget



Source: CBO, OMB, CRFB calculations
Note: "CBO Baseline w/ Drawdown" includes the budgetary effects of the President's war drawdown

Debt accumulation is the result of continued deficits throughout the decade. CBO projects deficits falling from 4.1 percent of GDP ($680 billion) in 2013 to 2.9 percent ($506 billion) in 2014, and then stabilizing around 3 percent of GDP for the following ten years. In 2024, the deficits would total 2.8 percent of GDP, or $746 billion. By comparison, CBO's baseline estimates a deficit of 3.7 percent of GDP ($1 trillion) in 2024, while OMB estimated the President's budget would produce a deficit of only 1.6 percent of GDP ($434 billion) that year.

Outlays, under the President's budget, are projected to rise from 20.5 percent of GDP in 2014 to 21.5 percent by 2019 and 22.0 percent by 2024. Revenue, meanwhile, would grow from 17.6 percent of GDP in 2014 to 19.2 percent by 2024. By comparison, spending and revenue levels have averaged 20.5 and 17.4 percent of GDP over the last four decades, respectively. Under CBO's baseline, outlays would rise to 22.1 percent of GDP by 2024 (slightly above the President) and revenues to 18.3 percent (almost a percentage point below the President).

Fig. 2 Budget Metrics in CBO's Analysis of the President's Budget

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-2024
Revenue											
2015 Budget (CBO)	18.4%	18.5%	18.6%	18.6%	18.6%	18.6%	18.7%	18.9%	19.0%	19.2%	18.7%
2015 Budget (OMB)	18.3%	18.6%	18.9%	19.0%	19.0%	19.2%	19.4%	19.6%	19.8%	19.9%	19.2%
CBO Baseline	18.2%	18.2%	18.1%	18.0%	18.0%	18.0%	18.0%	18.1%	18.2%	18.3%	18.1%
Outlays											
2015 Budget (CBO)	21.2%	21.4%	21.3%	21.2%	21.5%	21.7%	21.8%	22.1%	22.0%	22.0%	21.7%
2015 Budget (OMB)	21.4%	21.4%	21.1%	20.9%	21.3%	21.4%	21.5%	21.7%	21.6%	21.5%	21.4%
CBO Baseline	20.8%	21.0%	20.9%	21.0%	21.3%	21.5%	21.7%	22.2%	22.1%	22.1%	21.5%
Deficits											
2015 Budget (CBO)	-2.8%	-2.9%	-2.7%	-2.6%	-3.0%	-3.1%	-3.1%	-3.3%	-3.0%	-2.8%	-2.9%
2015 Budget (OMB)	-3.1%	-2.8%	-2.3%	-1.9%	-2.3%	-2.2%	-2.1%	-2.1%	-1.8%	-1.6%	-2.2%
CBO Baseline	-2.6%	-2.8%	-2.9%	-3.0%	-3.3%	-3.5%	-3.7%	-4.0%	-3.9%	-3.7%	-3.4%
Debt											
2015 Budget (CBO)	73.6%	73.1%	72.6%	72.3%	72.5%	72.9%	73.3%	73.9%	74.2%	74.3%	N/A
2015 Budget (OMB)	74.6%	74.3%	73.5%	72.4%	72.0%	71.6%	71.1%	70.6%	69.9%	69.0%	N/A
CBO Baseline	73.3%	72.8%	72.4%	72.5%	73.1%	73.8%	74.8%	76.1%	77.1%	78.1%	N/A

Source: CBO, OMB

A number of factors account for these growing levels of revenue and spending. On the revenue side, increases can be mostly be attributed to the economic recovery, tax increases from the Affordable Care Act and American Taxpayer Relief Act, new tax increases proposed in the President's budget, and the increased number of taxpayers resulting from the President's immigration reform proposal. On the spending side, increases are due to a combination of rising health costs, the aging of the population, the continued implementation of the Affordable Care Act, new spending from proposed immigration reform, modest net spending increases in the President's budget, and projections of rising interest rates back to more traditional levels.

Policy Changes

Excluding the President's war drawdown – which does not represent real savings since it largely reflects the policy already in place – the budget saves $260 billion relative to CBO's baseline. This is significantly lower than the $750 billion in savings that OMB projected.

This net deficit reduction reflects spending and revenue changes in both directions. The President's budget proposes a number of new investments and sequester relief but also offers offsets meant to pay for these initiatives and contributes modestly to deficit reduction.

New Initiatives and Sequester Relief

The budget includes a number of new investments and initiatives, many of which have designated offsets. It increases surface transportation spending ($70 billion), expands the Earned Income Tax Credit for childless workers ($60 billion), provides funding for universal preschool and related programs ($75 billion), and increases discretionary spending by $55 billion in 2015. These changes, along with the current shortfall in the highway trust fund, are offset for in a number of ways, including increasing the cigarette tax ($80 billion), dedicating $150 billion of transition revenue from corporate tax reform to the highway trust fund (which CBO does not count due to lack of specificity), reducing crop insurance subsidies along with other spending cuts ($25 billion), closing various tax loopholes such as carried interest ($45 billion), and limiting the size of tax-preferred retirement accounts ($5 billion). According to CBO, these offsets would fall more than $100 billion short of what is needed (before accounting for the highway fund shortfall), mainly because they do not include the $150 billion of transition revenue.

In addition to increasing discretionary spending in 2015, the budget partially repeals the sequester for both defense and non-defense spending in future years, costing roughly $500 billion in total. It also includes a number of new spending such as extended unemployment benefits and a national infrastructure bank, as well as savings from increasing user fees, reducing fraud, and making other changes.

Health Care Reforms

The budget includes $360 billion of gross health care savings, which is about $235 billion net of a permanent "doc fix" ($125 billion) and $135 billion net of repealing the Medicare sequester ($100 billion). The budget would reduce Medicare spending on prescription drugs ($155 billion), reduce payments for post-acute care providers ($85 billion), and increase means-tested premiums ($50 billion), among other changes. In addition, the budget includes four cost-sharing reforms that would save $35 billion. Three of those grandfather current beneficiaries, so they would save more over the longer term than their ten-year score indicates.

Revenue Changes

In total, the budget includes about $615 billion of net tax increases, excluding the dedicated offsets for the initiatives described above or revenue stemming from immigration reform. The largest proposal would limit the value of deductions and certain exclusions to 28 percent, raising nearly $500 billion. In addition, the budget would increase and expand the estate tax ($95 billion), enact a 30 percent "Buffett Rule" minimum tax on the very highest earners ($70 billion), and impose a fee on large financial institutions ($50 billion). In addition, the budget includes a reserve fund for business tax reform, which includes reforms to the international tax system ($255 billion), repeal of fossil fuel tax preferences ($50 billion), and repeal of last-in first-out accounting ($105 billion). The reserve fund raises $225 billion of net revenue dedicated to rate reductions or other tax reforms. The budget also extends the 2009 refundable tax credit expansions, costing $175 billion, and enacts $60 billion of tax cuts for families and infrastructure.

Immigration Reform

The President's budget assumes the enactment of immigration reform similar to the bill that passed the Senate last year (S. 744). In lieu of an updated score of that bill, CBO uses the Administration's placeholder of $160 billion of ten-year deficit reduction, which is the net effect of $300 billion in new spending and nearly $460 billion in new revenue. These effects are almost entirely due to projections of a larger labor force – which CBO would not ordinarily count but does in this case. CBO's estimates do not incorporate the effects of reform on the economy as a whole, though past estimates have suggested GDP could be more than 3 percent higher by 2024.

Fig. 3 Policy Changes as Estimated by CBO and OMB

	CBO Estimate	OMB Estimate
Investments and Initiatives with/ Dedicated Offsets	**$80 billion**	**-$80 billion**
Fund and Increase Highway and Related Spending	*$70 billion*	*$70 billion*
Raise Transition Revenue from Tax Reform	#	*-$150 billion*
Fund Universal Pre-School and Related Spending	*$75 billion*	*$75 billion*
Increase and Index Cigarette Tax	*-$80 billion*	*-$80 billion*
Expand Earned Income Tax Credit	*$60 billion*	*$60 billion*
Close Various Tax Loopholes	*-$45 billion*	*-$60 billion*
Sequester Relief, Dedicated Offsets, and Other Spending Changes	**$665 billion**	**$610 billion**
Increase FY2015 Discretionary Spending	*$55 billion*	*$55 billion*
Reduce Farm Subsidies and Other Cuts	*-$25 billion`*	*-$30 billion*
Limit Size of Tax Preferred Retirement Accounts	*-$5 billion*	*-$30 billion*
Reduce Future Sequestration Cuts and Set Future Discretionary Levels	*$380 billion*	*$365 billion*
Repeal Mandatory Sequester Cuts	*$120 billion*	*$180 billion*
Increase PBGC Premiums	*-$10 billion*	*-$20 billion*
Other Non-Health Mandatory Spending Changes	*$150 billion*	*$90 billion*
Health Care Reforms	**-$235 billion**	**-$300 billion**
Reform the Sustainable Growth Rate ("Doc Fixes")	*$125 billion*	*$100 billion*
Reduce Spending on Prescription Drugs	*-$155 billion*	*-$155 billion*
Reduce Spending on Post-Acute Care	*-$85 billion*	*-$110 billion*
Increase Means-testing of Medicare Premiums	*-$50 billion*	*-$55 billion*
Modify Cost Sharing in Medicare	*-$35 billion*	*-$15 billion*
Reduce Other Health Care Spending	*-$35 billion*	*-$65 billion*
Revenue Changes	**-$615 billion**	**-$780 billion**
Extend Expiring Refundable Tax Credits	*$175 billion*	*$155 billion*
Enact Tax Breaks for Families, Jobs, Infrastructure	*$60 billion*	*$85 billion*
Limit Value of Tax Preferences to 28%	*-$500 billion*	*-$600 billion*
Enact "Buffett Rule" to Set Minimum Tax	*-$70 billion*	*-$55 billion*
Reform and Increase Estate Tax	*-$95 billion*	*-$130 billion*
Reduce the Tax Gap	*-$60 billion*	*-$70 billion*
Impose Financial Responsibility Tax	*-$50 billion*	*-$55 billion*
Reform Unemployment Insurance Financing	*-$20 billion*	*-$60 billion*
Enact Other Revenue Raisers	*-$55 billion*	*-$55 billion*
Enact Immigration Reform	**-$160 billion**	**-$160 billion**
Spending Impact	*$300 billion*	*$300 billion*
Revenue Impact	*-$455 billion*	*-$455 billion*
Net Interest	**$5 billion**	**-$45 billion**
Total Net Deficit Reduction	**-$260 billion**	**-$750 billion**
Reduce War Spending from Baseline	*-$660 billion*	*-$695 billion*
Net Interest	*-$115 billion*	*-$120 billion*
Deficit Reduction with War Drawdown	**-$1,035 billion**	**-$1,565 billion**

Source: CBO, OMB, CRFB calculations

The Administration proposes dedicating $150 billion of temporary corporate revenue toward transportation funding. The Administration also identifies about $225 billion of net business reform revenue which could be used for tax reform; however because it does not offer specificity as to where the transportation revenue is coming from, the CBO assumes no net revenue from corporate tax reform.

` Partially estimated based on OMB scores

Economic Projections

As mentioned in the introduction, a key difference between CBO's and OMB's estimates of the President's budget is their economic assumptions. CBO is more pessimistic than OMB on unemployment, interest rates, and economic growth. According to CBO, macroeconomic differences are responsible for $1.3 trillion of the more than $1.6 trillion difference in deficit estimates between CBO and OMB.

On average, OMB projects annual economic growth 0.2 percentage points higher over the next ten years than CBO (2.7 versus 2.5 percent). As a result of compounding over a decade, OMB projects GDP will be $700 billion, or 2.6 percent, higher in 2024. The difference in the denominator alone (leaving aside any effects from higher tax revenue) results in a 2 percentage point difference in the debt-to-GDP ratio in 2024.

In addition, OMB projects a sharper decline in the unemployment rate. The agency forecasts a steady decline in the unemployment rate to 5.4 percent by 2018, where it remains through 2024. By contrast, CBO projects a decline in unemployment to 5.8 percent by 2018 and a very gradual decline to 5.5 percent by 2024.

While both agencies have similar longer-term projections for interest rates on Treasury securities, CBO projects a quicker reversion to those rates than OMB. As a result, ten-year Treasury rates are between 0.3 and 0.5 percentage points higher in the 2016-2019 period, and three-month T-bill rates are between 0.5 and 1 percentage point higher in 2016-2018 in CBO's forecast.

Fig. 4 Economic Assumptions (Calendar Year)

	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	Average
Real GDP Growth											
CBO	3.3%	3.4%	3.0%	2.4%	2.3%	2.2%	2.2%	2.1%	2.1%	2.0%	2.5%
OMB	3.4%	3.3%	3.2%	2.8%	2.5%	2.4%	2.3%	2.3%	2.3%	2.3%	2.7%
Unemployment Rate											
CBO	6.5%	6.1%	5.9%	5.8%	5.7%	5.7%	5.6%	5.6%	5.5%	5.5%	5.8%
OMB	6.4%	6.0%	5.6%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.4%	5.6%
Ten-Year Treasury Note											
CBO	3.7%	4.3%	4.8%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	4.8%
OMB	3.5%	4.0%	4.3%	4.6%	4.7%	4.9%	5.0%	5.1%	5.1%	5.1%	4.6%
Three-Month T-Bill											
CBO	0.4%	1.8%	3.3%	3.7%	3.7%	3.7%	3.7%	3.7%	3.7%	3.7%	3.1%
OMB	0.3%	1.2%	2.3%	3.2%	3.6%	3.7%	3.7%	3.7%	3.7%	3.7%	2.9%

Source: CBO, OMB

Importantly, CBO and OMB rely on different conventions. CBO makes economic projections based on current law while OMB does so based on assuming the President's policies were enacted. The fact that recent estimates find immigration reform could increase GDP by more than 3 percent suggest that these different conventions could explain a portion of the differences.

Conclusion

The President some deserves credit for proposing a budget that fully abides by PAYGO rules so as to not make the debt situation any worse than it's already projected to be, and for proposing a number of important tax and health reforms. However, the $260 billion of net deficit reduction estimated by CBO is not nearly enough to put the debt on a sustainable downward path as would be necessary in a responsible budget.

Whereas the President's budget suggested debt levels might fall to 69 percent of GDP by the end of the decade, CBO estimates the debt would instead grow to above 74 percent. Although these differences may appear small, the differences are likely to grow over time as the population continues to age and health care costs continue to grow. Whereas a falling debt-to-GDP ratio represents a move toward sustainability, growing debt levels represent a threat to flexibility, sustainability, and economic growth.

Given these latest estimates, the President would be wise to re-introduce some of the policies left out of this year's budget - like switching to the more accurate chained CPI – as well as propose or embrace some new reforms. More aggressive entitlement reforms would make room for the President's investments while putting debt on a truly sustainable path.