COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

To: Interested Parties
From: Maya MacGuineas, President, The Committee for a Responsible Federal Budget, at the New America Foundation

Date: January 25, 2005

Re: January 2005 CBO Baseline

The January 2005 CBO Baseline

The Congressional Budget Office released its January 2005 baseline today. (http://www.cbo.gov/showdoc.cfm?index=6060&sequence=0). Assuming current laws and policies, the CBO projects that in FY2005 revenues will total $2.1 trillion, expenditures will be $2.4 trillion, the deficit will be $368 billion and the on-budget deficit will be $541 billion. As a share of GDP, revenues will be 16.8%, expenditures will be 19.8%, the deficit will be 3.0% and the on-budget deficit will be 4.4%.

2005 Baseline:

	2005 Projection	Last Sept.'s 2005 Projection (Change)	Last Jan.'s 2005 Projection (Change)	2004 Actual (Change)
Revenues	**2,057**	**2,094**	**2,049**	**1,880**
		(-37)	*(8)*	*(177)*
Expenditures	**2,425**	**2,442**	**2,411**	**2,292**
		(-17)	*(14)*	*(133)*
Deficit	**-368**	**-348**	**-362**	**-412**
		(-20)	*(-6)*	*(44)*
On-Budget Deficit	**-541**	**-521**	**-535**	**-567**
		(-20)	*(-6)*	*(26)*
Debt Held by the Public	**4,665**	**4,694**	**4,771**	**4,296**
		(-29)	*(-106)*	*(369)*

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CBO estimates that the deficit will decline to $295 billion in 2006 and will continue to decline thereafter until 2012, when a budget surplus of $71 billion is projected. (Not counting Social Security surpluses, the budget will continue to run a deficit throughout the projected time period.)

Of course, the baseline does not incorporate policies other than current law. Therefore, the Administration's supplemental requests for the Iraq war and tsunami relief is not reflected in the numbers, nor are plans to reform Social Security, extend the tax cuts, or slow the growth of spending for a number of government programs. The President's budget will be released on February 7, 2005.

Ten-Year Projections:

	Current Projection 2006-2015	**Current Projection 2005-2014**	**Last Sept.'s 2005-2014 Projection**
Deficit	**-855**	**-1,364**	**-2,294**
On-Budget Deficit	**-3,469**	**-3840**	**-4,712**

The 10-year estimates improved by $1.4 trillion from a 10-year deficit of $2.3 trillion last fall to a 10-year deficit of $855 billion today. (Looking at the numbers over the same time period, 2005 to 2014, the change would be a $930 billion improvement.) The 10-year $930 billion improvement ($2.3 trillion to $1.4 trillion) is due to:

- The inflated baseline based on previous supplemental appropriations for operations in Iraq and Afghanistan. - $1.4 trillion.
- Legislative changes - $-371 billion (the extension of some tax cuts, including the 10 percent tax bracket, relief from the marriage penalty, and the increase in the child tax credit and supplemental appropriations)
- Economic changes - $41 billion
- Technical changes - $-173 billion

CBO's Economic Projections:

(Last September's Projections)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Nominal GDP	**12,396** *(12,464)*	**13,059** *(13,058)*	**13,766** *(13,682)*	**14,486** *(14,340)*	**15,210** *(15,016)*	**15,940** *(15,697)*	**16,680** *(16,397)*	**17,437** *(17,111)*	**18,221** *(17,856)*	**19,031** *(18,628)*	**19,861** *(NA)*
Real GDP %	**3.8** *(4.1)*	**3.7** *(3.2)*	**3.7** *(3.1)*	**3.4** *(3.0)*	**3.1** *(2.9)*	**2.9** *(2.7)*	**2.8** *(2.6)*	**2.7** *(2.5)*	**2.7** *(2.5)*	**2.6** *(2.5)*	**2.5** *(NA)*
CPI %	**2.4** *(2.0)*	**1.9** *(2.0)*	**2.1** *(2.2)*	**2.2** *(2.2)*	**2.2** *(2.2)*	**2.2** *(2.2)*	**2.2** *(2.2)*	**2.2** *(2.2)*	**2.2** *(2.2)*	**2.2** *(2.2)*	**2.2** *(NA)*
Unemployment Rate	**5.2** *(5.2)*	**5.2** *(5.1)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(5.2)*	**5.2** *(NA)*

Major Points

- There is no unexpected bad news in the numbers and the economy looks to be moving along solidly. That said, the bulk of the improvements in the deficit numbers are due to technicalities, while there are still many costly items on the national agenda that have not been counted.

- The 10-year baseline improved from dropping the assumptions included in last fall's projections based on defense supplemental spending. If the assumptions are dropped from the last baseline to make an apples-to-apples comparison, the total deficit projected for the 2005-2014 has actually increased by more than $500 billion.

- Social Security surpluses will increase from roughly $173 billion in 2005 to $310 billion in 2015. Most often the deficit numbers cited include the Social Security surpluses.

- Unquestionably, defense spending will be higher than in the baseline to pay for costs of operations in Iraq and Afghanistan. Incorporating more realistic defense spending increases the 2005 deficit to $400 billion, or 3.3% of GDP. The 2006-2015 numbers would increase from $855 billion to $1.4 trillion.

- The baseline assumes that the President's tax cuts will expire as scheduled on December 31, 2010. Extending the tax provisions would have no effect in 2005 and would decrease revenues from 2006-2015 by $1.6 trillion. Reform of the Alternative Minimum Tax would cost another $395 billion.

Going Forward

On the same day CBO released its numbers, the Administration warned that additional spending for Iraq is likely to push the deficit up to $427 billion in FY2005 – higher than CBO suggested. This would be the largest deficit, in dollar terms, ever. It is a pretty safe bet that we will achieve that inauspicious benchmark this year.

It remains unclear how the Administration will be able to accomplish its goal of cutting the deficit in half by 2009. Even if one allows, as the starting point, the 2004 estimated deficit of $521 billion rather than the actual $412 billion, (which is like losing 20 pounds off of a starting point of 180 when you only weigh 165) it will take a Herculean effort to accomplish the goal. Going forward, the projections will depend greatly on growth in spending. The President's budget is likely to be very tight on discretionary spending and some areas of mandatory spending as well. Controlling spending could reduce – potentially significantly – the deficit in the short and long-run.

Still, there are a number of items on the agenda that are not reflected in the baseline. The real story will be how the Administration balances its many new and on-going priorities – from reforming Social Security, to extending the tax cuts, to paying for the ongoing operations in Iraq – while also cutting the deficit in half. Some of the proposals, such as reforming Social Security, could create long-term savings, but the dreadful fiscal environment creates a real roadblock in paying for them.

The elephant in the room continues to be the long-term fiscal issues. The numbers only get worse looking into the future. In order to get ahead of the entitlements train wreck, a number of things need to be addressed including, Social Security (which is on the table), health care spending (which is not), and deficit reduction (which is receiving lip service but no real action). Borrowing is an unsustainable policy and financial markets will not tolerate loading on the debt indefinitely. Inaction now will cost the country greatly down the road.