COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

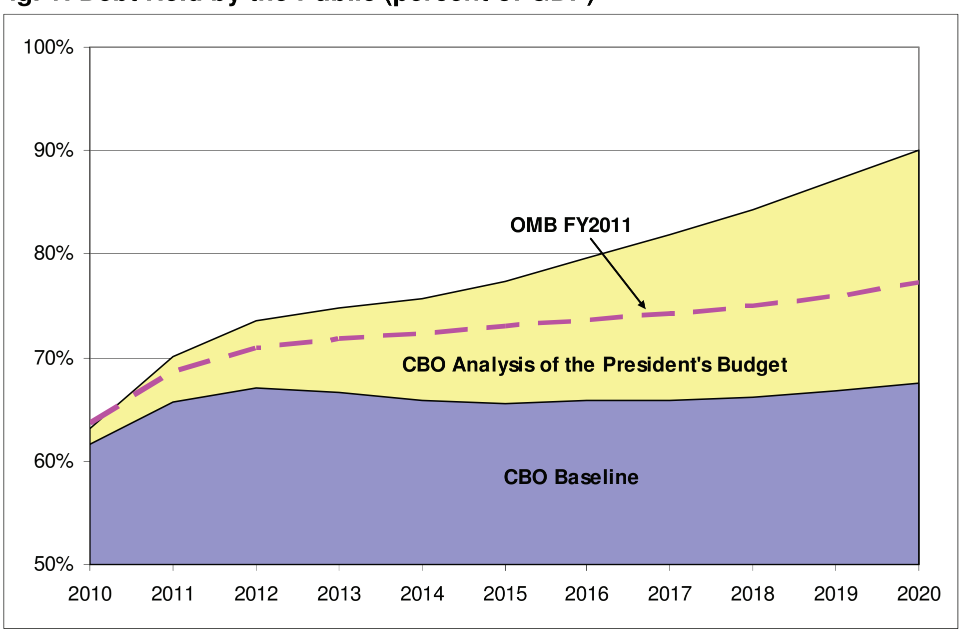


# CBO's Analysis of the President's FY 2011 Budget
## March 25, 2010

Yesterday, the Congressional Budget Office (CBO) released its analysis of the President's FY 2011 budget. The President's budget would increase deficits by $9.8 trillion over ten years, or by $3.8 trillion above current law. The public debt would increase from $7.5 trillion in 2009 (53 percent of GDP), to $20.3 trillion (90 percent of GDP), by 2020 — 13 percentage points higher than what OMB estimated, and 22 percentage points higher than in CBO's baseline. That level of debt is extremely problematic, particularly, given the upward debt path beyond the ten-year budget window.

The President has chosen a fiscal target of a $571 billion deficit in 2015, though his proposed budget would not achieve that goal and relies on an outside Commission to come up with a plan for achieving it. The President's budget includes a few hard policy choices that would reduce the deficit, but as CBO's report clearly shows, the proposed budget is woefully insufficient to achieve the President's fiscal goal or the important fiscal goal of stabilizing the debt at a reasonable level in the medium and long-term.

**Fig. 1: Debt Held by the Public (percent of GDP)**



## Revenue, Spending, and Deficit Projections

CBO projects the government will run a record $1.5 trillion deficit (10.3 percent of GDP) in 2010, and continue to run large deficits thereafter. Although increasing revenues will reduce the deficit to a low of $724 billion (4.1 percent of GDP) in 2014, the deficit will increase in subsequent years, reaching close to $1 trillion (4.8 percent of GDP) in 2018 and close to $1.3 trillion (5.6 percent of GDP) by 2020. In total, CBO projects deficits of $9.8 trillion (5.2 percent of GDP) over the next decade. This is far worse than the $8.5 trillion (4.5 percent of GDP) in deficits projected by OMB.

**Fig. 2: Differences in Projections for the President's Budget Proposal (billions)**

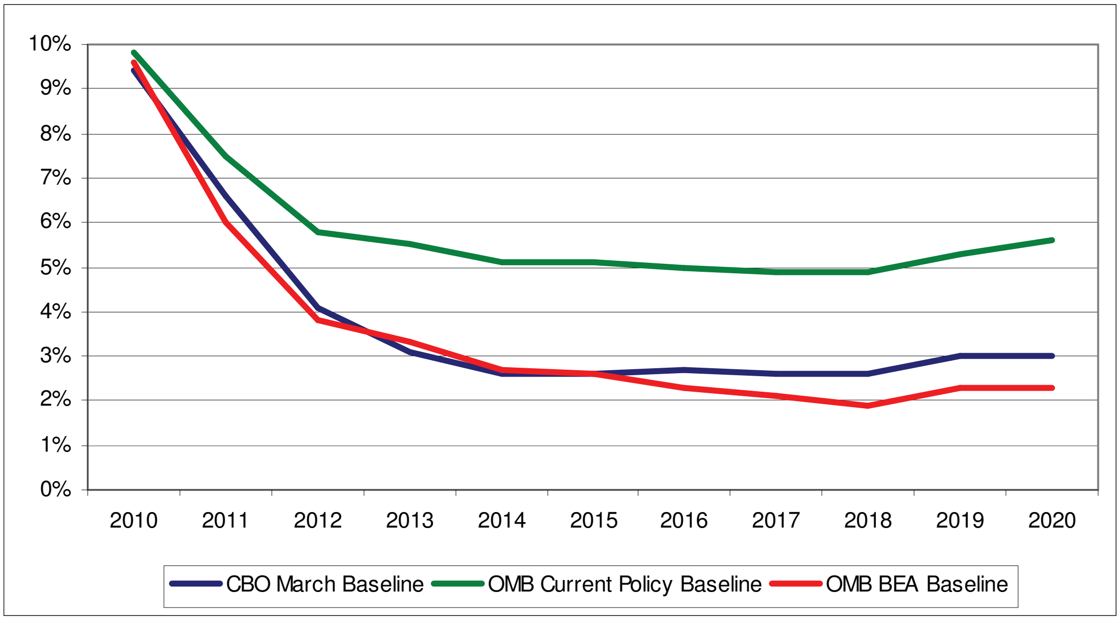
| Fiscal Year | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2011-2020 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **RECEIPTS** | | | | | | | | | | | | |
| CBO Analysis of Budget | $2,118 | $2,460 | $2,808 | $3,095 | $3,341 | $3,504 | $3,693 | $3,869 | $4,036 | $4,211 | $4,416 | $35,434 |
| OMB Analysis of Budget | $2,165 | $2,567 | $2,926 | $3,188 | $3,455 | $3,634 | $3,887 | $4,094 | $4,299 | $4,507 | $4,710 | $37,268 |
| CBO Baseline | $2,176 | $2,673 | $2,967 | $3,221 | $3,469 | $3,629 | $3,818 | $4,000 | $4,174 | $4,355 | $4,567 | $36,872 |
| **OUTLAYS** | | | | | | | | | | | | |
| CBO Analysis of Budget | $3,618 | $3,802 | $3,722 | $3,842 | $4,065 | $4,297 | $4,587 | $4,808 | $5,032 | $5,364 | $5,670 | $45,189 |
| OMB Analysis of Budget | $3,721 | $3,834 | $3,755 | $3,915 | $4,161 | $4,386 | $4,665 | $4,872 | $5,084 | $5,415 | $5,713 | $45,800 |
| CBO Baseline | $3,545 | $3,668 | $3,609 | $3,746 | $3,931 | $4,101 | $4,331 | $4,521 | $4,708 | $4,996 | $5,251 | $42,862 |
| **DEFICIT** | | | | | | | | | | | | |
| CBO Analysis of Budget | $1,500 | $1,342 | $914 | $747 | $724 | $793 | $894 | $940 | $996 | $1,152 | $1,254 | $9,755 |
| OMB Analysis of Budget | $1,556 | $1,267 | $828 | $727 | $706 | $752 | $778 | $778 | $785 | $908 | $1,003 | $8,532 |
| CBO Baseline | $1,368 | $996 | $642 | $525 | $463 | $472 | $513 | $521 | $534 | $641 | $684 | $5,990 |
| **DEFICIT (percent of GDP)** | | | | | | | | | | | | |
| CBO Analysis of Budget | 10.3% | 8.9% | 5.8% | 4.5% | 4.1% | 4.3% | 4.7% | 4.7% | 4.8% | 5.3% | 5.6% | 5.2% |
| OMB Analysis of Budget | 10.6% | 8.3% | 5.1% | 4.2% | 3.9% | 3.9% | 3.9% | 3.7% | 3.6% | 3.9% | 4.2% | 4.5% |
| CBO Baseline | 9.4% | 6.6% | 4.1% | 3.1% | 2.6% | 2.6% | 2.7% | 2.6% | 2.6% | 3.0% | 3.0% | 3.2% |

These differences result from three broad projection differences. First, CBO projects higher current law baseline deficits than OMB -- $6 trillion as opposed $5.5 trillion (the OMB BEA baseline). In addition, CBO estimates the President's policies would have a larger net cost -- $3.8 trillion for CBO as opposed to $3.1 trillion for OMB. And finally, CBO projects a lower nominal GDP than does OMB, affecting the denominator of the deficit-to-GDP ratios.

## Baselines

Included in CBO's analysis is an update of their current law baseline from January (see our previous analysis here http://crfb.org/document/crfb-analysis-cbo-january-2010-baseline). Under the new baseline, CBO projects the deficits will total $5.99 trillion, down slightly from $6.05 trillion under the January baseline. This small decrease is due to several technical changes in CBO's models; they have not updated their economic assumptions since January. Notably, CBO's baseline excludes the effect of the health care reform legislation signed by the President this weekend – which would reduce the deficit by about $120 billion (deficit reduction would increase to about $140 billion if the reconciliation bill becomes law).

**Fig. 3: Baseline Deficit Projections (percent of GDP)**




Rather than comparing its policies to what is written into law, OMB measure its policies relative to a "current policy" baseline, which assumes many expiring policies, such as the 2001/2003 tax cuts, the AMT patches, and the Medicare "doc fix", are continued and not paid for. Under these policy assumptions, OMB projects baseline deficits of $10.6 trillion (compared to $5.5 trillion under their current law baseline). CRFB has constructed its own "current policy baseline" based upon CBO numbers, which projects that extending certain policies would lead to cumulative deficits of over $13 trillion over the coming decade (see http://crfb.org/blogs/costs-current-policies).

## Policy Changes

Relative to its current law baseline (which excludes the just-passed health care legislation), CBO projects the net effect of President Obama's policy proposals would be to add $3.8 trillion to those deficits in ten years. The most expensive proposal is the renewal of the 2001/2003 tax cuts for families making under $250,000 a year, at a cost of $2.5 trillion. Other deficit-increasing policies include a patch for the Alternative Minimum Tax (AMT), the Medicare physician payment (doc fix), new stimulus spending, an expansion of Pell Grants, and a number of middle-class tax cuts. CBO also assumes the President's budget will result in a large increase in non-war discretionary spending (despite the non-security "freeze" he proposes) due largely to different baseline estimates.

**Fig. 4: Ten Year Deficit Impact of Policy Changes in the President's Budget**

| | OMB | CBO |
|---|---|---|
| **BEA Baseline deficit** | **$5,472** | **$5,990** |
| **Tax Proposals** | | |
| Renew 2001/2003 Tax Cuts for Families Making Under $250,000 | $2,419 | $2,465 |
| Index AMT to Inflation | $659 | $577 |
| Limit Itemized Deductions | ($291) | ($289) |
| Reform U.S. International Tax System | ($122) | ($127) |
| Impose Financial Crisis Responsibility Fee | ($90) | ($90) |
| Tax Cuts for Families and Individuals | $143 | $154 |
| Tax Cuts for Businesses | $93 | $82 |
| Continue Certain Expiring Provisions | $47 | $63 |
| Close Tax Gap | ($49) | ($22) |
| Loophole Closers and Other Revenue Raisers | ($207) | ($226) |
| Other* | $15 | $25 |
| **Subtotal** | **$2,617** | **$2,612** |
| **Spending Proposals** | | |
| Stimulus* | $169 | $131 |
| Health Care Placeholder* | ($150) | ($150) |
| Modify Pell Grants~ | $187 | $197 |
| Medicare Physician Payment Update | $371 | $286 |
| Student Loan Reform | ($49) | ($67) |
| Waste, Fraud, and Abuse | ($132) | N/A@ |
| Discretionary Changes (including placeholder for reduced war spending)^ | ($693) | ($152) |
| Other Changes | $93 | $103 |
| **Subtotal** | **($201)** | **$348** |
| Debt Service | $643 | $803 |
| **Total Deficit Under President's Budget** | **$8,532** | **$9,755** |

Note: Some numbers are based on JCT's earlier estimates of the President's budget, although we do not expect their final estimates to differ substantially; numbers may not add due to rounding.
*measures reflect both revenue and outlay changes.
~Cost reflects net policy changes and not the transfer of Pell grant funding from mandatory to discretionary.
@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.

The President's budget includes a number of measures to reduce the deficit, including limiting itemized deductions for higher earners, as well as other tax changes. The President's budget also assumes changes to student loans and health reform. (Health care reform of a similar magnitude was signed into law last weekend, and additional health reform, along with student loan and Pell Grant reform similar to what is in the President's budget, is expected to pass soon.)

On the whole, CBO projects the President's proposals will increase the deficit substantially more than OMB does – about $1.2 trillion more over ten years. Much of this difference is due to discretionary spending projections, since President Obama's non-security spending freeze saves a lot less relative to CBO's baseline than OMB's (although savings from reduced spending on the Iraq war remain significant). The other large chunk of the difference occurs because CBO estimates significantly less deficit reduction than OMB does from closing the tax gap and reducing waste, fraud, and abuse. In part, this may be because some of these changes may not considered "scoreable," but it may also be the case the OMB's estimates are overly optimistic in these areas.

## Economic Assumptions

Economic forecasts have a large impact on budgetary projections, and since CBO's estimates tend to be more pessimistic than OMB's, the result is higher deficits. Since CBO has not updated its economic projections from January, a comparison of CBO and OMB economic assumptions can be found on page 5 of this document: http://crfb.org/document/crfb-analysis-cbos-january-2010-baseline.

The different economic assumptions are responsible for about $350 billion (nearly 30%) of the difference between CBO's and OMB projections. Given the importance of the state of the economy to the overall fiscal picture, CBO attempts to take into account the economic effect of the President's proposals based on economic assumptions from the January outlook, and then the secondary budgetary effects of those changing conditions.

Using their "overall effect" models, which take into account both supply- and demand-side effects, CBO estimates the President's budget would tend to improve GDP over the next five years by between 0.9 and 1.2 percent (1.05 percent on average). This is largely due to the short-term stimulative effects of deficits. Yet the same deficits which CBO projects could stimulate demand in the short-term would tend to damage the economy over the long-term. In the second decade, this could reduce GDP by anywhere from 0.2% to 1.4%, depending on the model.

**Fig. 5: Average Economic Effects of the President's Budget Under Different Models**

| | Effect on Real GDP | | Indirect Effect on Deficit (billions) | |
|---|---|---|---|---|
| | 2011-2015 | 2016-2020 | 2011-2015 | 2016-2020 |
| Overall (Supply-Side and Demand-Side) Effect Models | +1.05% | n/a | +$115 | n/a |
| Supply-Side Effect Models Without Forward Looking Behavior | -0.45% | n/a | -n/a | n/a |
| Textbook Model | -0.15% | -0.6% | -$17 | -$92 |
| Closed-Economy Life-Cycle Model | +0.15% | -0.35% | +$22 | -$43 |
| Open-Economy Life-Cycle Model | -0.4% | -1.15% | +$4 | -$7 |
| Infinite-Horizon Model | +0.1% | -0.25% | +$21 | -$4 |

## Conclusion

The warning coming out of this analysis of the President's budget could not be clearer: the country is on an unsustainable fiscal path. Despite the inclusion of some deficit-reducing policies, the President's budget would make the situation far worse. The budget would increase the public debt to 90 percent of GDP by 2020—a dangerous rise that would be completely irresponsible during a time of economic growth, which the budget assumes will occur.

Absent major structural policy changes to address the medium-term debt situation, the nation's economy is at real risk from excessive borrowing. The Administration thus far is leaving the work of addressing this threat to its newly formed fiscal commission. While we support the effort and are hopeful it will be successful, early signs are not promising that it will be.

It is therefore <u>critical</u> that the Administration develop a "Plan B," that focuses on reforming spending, the tax code, and budget enforcement procedures. If the commission does not succeed in its effort, the White House will have to take the lead in championing a credible debt reduction plan. The federal government will need to make changes one way or another. We can either enact reforms on our own terms, or wait for the markets to force changes upon us—an act of fiscal procrastination that would have damaging effects on our economy and standard of living for decades to come.