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## **Beyond the Baseline: 10 Year Deficits Likely to Reach \$5.5 Trillion**

**Deficits not “cut in half” in 5 years.**

by John S. Irons

### **Deficit Projections**

The Congressional Budget Office's (CBO) September 2004 report “The Budget and Economic Outlook: An Update” shows a baseline projection of a \$422 billion deficit for 2004, and \$348 billion for 2005. The 10-year baseline projections show a \$2.3 trillion deficit over the next ten years; however, as the report notes, the baseline is not intended to be a good predictor of actual budgetary outcomes. A better predictor of budget deficits under “current policy” would put the deficit for 2005 at \$405 billion and the 10-year deficit over \$5.5 trillion.

The lower, baseline figures that are reported by the CBO are due to the fact that, by law, the CBO baseline must estimate future revenues and expenditures under *current law*. A more realistic prediction of the 10-year deficits would include legislative changes that are likely to occur. In addition, estimates of deficits under *current policy* must include budget provisions that are intended to be extended, such as the 2001 and 2003 tax cuts. The CBO's report does contain estimates of the cost for a few likely changes. The legislative options included in the CBO report are:

1. Extension of expiring tax provisions;
2. Reforming the Alternative Minimum Tax to index 2004 levels to inflation;
3. Including a slowdown, or elimination of supplemental appropriations; and
4. Two different assumptions about the growth of discretionary spending
  - o Freeze at 2004 levels,
  - o Increase at the rate of total output (nominal GDP).

Using the numbers produced by the CBO, we can construct a more realistic prediction of deficits under current economic policy, rather than under current law. Table 1 and Figure 1 show the projections under the CBO baseline as well as under the *OMB Watch's* “current policy” baseline, which assumes that policy options 1-2 from above are in place, that discretionary spending will grow at the same rate as total output, and that supplemental appropriations slow down, but do not stop altogether under current policy. At no point in the next 10 years will deficits be significantly reduced.

Historically, discretionary spending has grown faster than the overall economy, so projecting an increase at the rate of GDP is a conservative assumption, and will likely cause an underestimate in the size of the deficit. Given the recent frequent use of supplemental budget requests, especially for defense spending, eliminating this category altogether would not be appropriate, so we instead use CBO's slowdown scenario to create our current policy baseline.

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1742 Connecticut Ave NW  
Washington, DC 20009



tel: 202.234.8494  
fax: 202.234.8584



email: [ombwatch@ombwatch.org](mailto:ombwatch@ombwatch.org)  
web: <http://www.ombwatch.org>

The inclusion of these provisions gives us a better measure of deficit projections under current policy priorities, as well as a better predictor of actual deficits.

When these provisions and the additional debt service are included, the deficit for 2005 is projected to be \$405 billion. Over the next 10 years, the estimate of the total deficit rises to \$5.5 trillion, and there is no significant improvement in the budget situation as currently estimated under the CBO baseline. In addition, when the Social Security trust fund is removed from the calculations, the deficit for 2005 will reach \$576 billion, and the 10-year deficit rises to \$7.9 trillion (see Table 2.) Figure 2 shows that the budget situation under the likely policy scenario will continue to deteriorate through 2014.

With the increase in retirees necessitating increased Social Security and Medicare expenditures, the situation is not projected to improve after 2014 either, unless, of course, the direction of current policy is significantly changed. The CBO's report demonstrates that freezing discretionary spending will not solve the deficit problem; and that not extending the Bush tax cuts helps more, but also will not completely solve the longer-term problem.

As the CBO put it, "[e]ven if the economy grows more rapidly than projected, significant long-term strains on the budget will start to intensify within the next decade as the baby-boom generation begins to reach retirement age."

#### **What is a baseline?**

Simply put, a baseline projection is a starting point for budget analyses. It gives a reference path for the current situation, against which a new policy proposal can be judged. Future policy proposals can then be measured as a deviation from an established baseline. A baseline is not necessarily the best, or even an accurate, prediction of actual budget outcomes.

The CBO, according to the law, must produce a baseline that is derived from the exact letter of the current law – and is explicitly not allowed to take into account likely or proposed legislation when determining the baseline.

The most recent CBO Budget and Economic Update from August 2003 put it this way:

*“Actual budget totals, however, will almost certainly differ from those baseline projections. By statute, CBO's baseline must estimate the future paths of federal revenues and spending under current laws and policies. The baseline is therefore not intended to be a prediction of future budgetary outcomes; instead, it is meant to serve as a neutral benchmark that lawmakers can use to measure the effects of proposed changes to taxes and spending.*

*Such changes can significantly affect the budget outlook. ... In addition to policy changes, factors beyond lawmakers' direct control--such as unexpected economic developments--can affect the budget outlook positively or negatively.”*

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John S. Irons is a Senior Economic Research and Policy Analyst and Staff Economist, OMB Watch.  
Send comments and questions to [jsirons@ombwatch.org](mailto:jsirons@ombwatch.org).

**Table 1. Projected Deficits (-) and Surpluses (+) (\$ billions)**

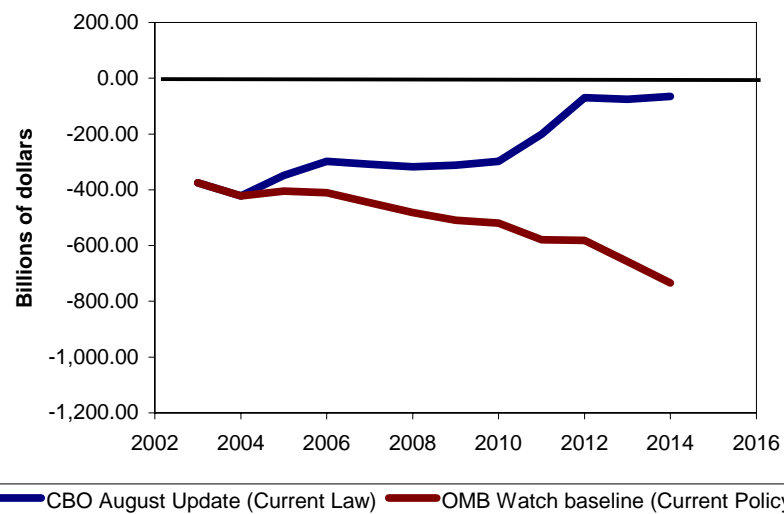
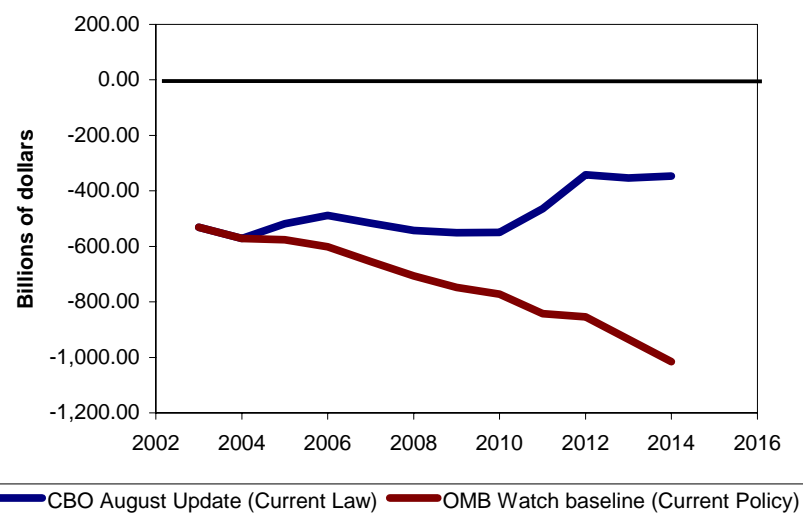
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005- 2009	2005- 2014
CBO August Update (Current Law)	-375	-422	-348	-298	-308	-318	-312	-298	-200	-70	-75	-65	-1,584	-2,294
Adjustments, including debt service														
Extend Tax Changes	-	0	-59	-115	-123	-124	-130	-128	-271	-393	-425	-469	-549	-2,237
Reform AMT	-	0	-7	-21	-29	-40	-52	-65	-59	-42	-50	-60	-149	-425
Discretionary Spending	-	0	9	23	14	0	-15	-29	-49	-77	-107	-140	31	-370
Total <sup>1</sup>	-	0	-57	-113	-138	-164	-197	-222	-379	-512	-582	-669	-667	-3,209
<b>OMB Watch baseline (Current Policy)</b>	<b>-375</b>	<b>-422</b>	<b>-405</b>	<b>-411</b>	<b>-446</b>	<b>-482</b>	<b>-509</b>	<b>-520</b>	<b>-579</b>	<b>-582</b>	<b>-657</b>	<b>-734</b>	<b>-2,251</b>	<b>-5,503</b>

Source: Congressional Budget Office, The Budget and Economic Outlook: An Update, September 2004

<sup>1</sup> The 10-year total includes \$177 billion due to the interaction between the AMT and the tax extensions.

**Table 2. Projected Deficits (-) and Surpluses (+) (Excluding Social Security Surplus, \$ billions)**

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2005- 2009	2005- 2014
Social Security Surplus	156	149	171	190	208	225	239	252	264	272	278	282	1,033	2,381
CBO August Update (Current Law)	-531	-571	-519	-488	-516	-543	-551	-550	-464	-342	-353	-347	-2,617	-4,675
<b>OMB Watch baseline (Current Policy)</b>	<b>-531</b>	<b>-571</b>	<b>-576</b>	<b>-601</b>	<b>-654</b>	<b>-707</b>	<b>-748</b>	<b>-772</b>	<b>-843</b>	<b>-854</b>	<b>-935</b>	<b>-1,016</b>	<b>-3,284</b>	<b>-7,884</b>

**Figure 1. CBO Baseline and Current Policy Baseline (2003-2014)****Figure 2. CBO Baseline and Current Policy Baseline Excluding Social Security Surplus (2003-2014)**

Data source: Congressional Budget Office