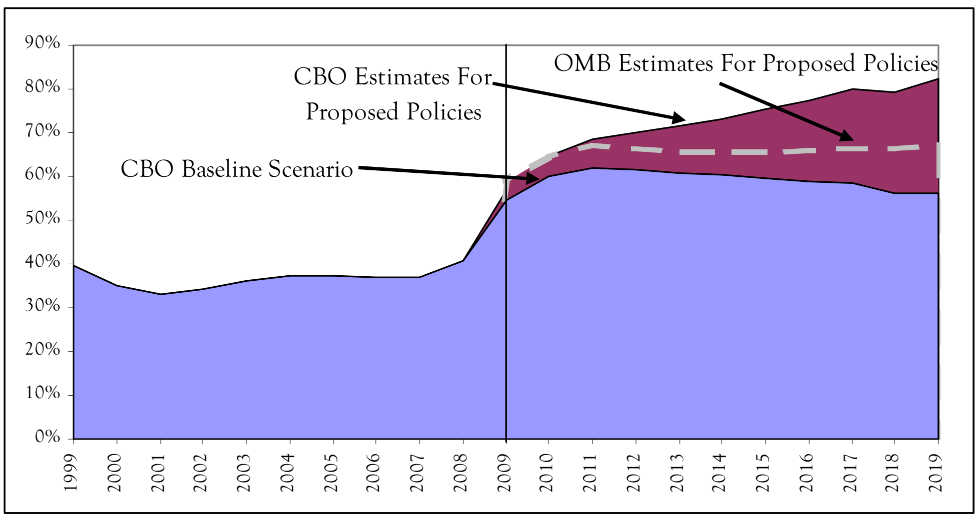
CBO's Analysis of the President's FY2010 Budget Blueprint
March 26, 2009

Last week, the Congressional Budget Office (CBO) released its Preliminary Analysis of the President's Budget. The Committee for a Responsible Federal Budget has warned that the President's budget is not aggressive enough in reducing the medium or long-term deficit (President Obama's FY2010 Budget, More on President Obama's FY2010 Budget), and CBO's analysis projects a significantly worse situation than the Administration does, with the President's Budget plan resulting in larger and continuously rising budget deficits.

The budget proposal would increase the debt held by the public from $5.8 trillion, or 40.8 percent of GDP, in 2008 to $17.3 trillion, or 82.4 percent of GDP, by 2019. This is significantly larger than CBO's baseline estimate of $11.8 trillion, or 56 percent of GDP in 2019. It is also far greater than the debt levels projected by the Administration under its policy proposals of $15.4 trillion or 67 percent of GDP in 2019.

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



Revenue, Spending, and Deficit Projections

Over the next ten years, CBO projects the President's budget plan would result in large and sustained deficits. These deficit projections are considerably higher than those put forward by the Office of Management and Budget (OMB) -- $9.3 trillion over ten years compared to OMB's estimate of roughly $7 trillion. Whereas OMB projects that the deficit will level out after 2013 at around 3 percent of GDP, CBO projects it will simply hit a trough in 2013, at 4.1 percent of GDP, before steadily rising to 5.7 percent of GDP by 2019.

Differences in projections can be seen both in estimates of the budget baseline, and in cost estimates for the President's policy proposal. By and large, these differences are driven by CBO's newer and more pessimistic economic assumptions.

Fig. 2: Projections for the President's Budget Proposal

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-2019
CBO Projections (billions)												
Revenue	$2,159	$2,289	$2,586	$2,917	$3,095	$3,231	$3,387	$3,522	$3,669	$3,807	$3,950	$32,452
Outlays	$4,004	$3,669	$3,556	$3,575	$3,767	$3,979	$4,172	$4,417	$4,619	$4,830	$5,139	$41,723
Deficit	-$1,845	-$1,379	-$970	-$658	-$672	-$749	-$785	-$895	-$949	-$1,023	-$1,189	-$9,270
OMB Projections (billions)												
Revenue	$2,186	$2,381	$2,713	$3,081	$3,323	$3,500	$3,675	$3,856	$4,042	$4,234	$4,446	$35,250
Outlays	$3,938	$3,552	$3,625	$3,662	$3,856	$4,069	$4,258	$4,493	$4,678	$4,868	$5,158	$42,219
Deficit	-$1,752	-$1,171	-$912	-$581	-$533	-$570	-$583	-$637	-$636	-$634	-$712	-$6,969
Deficit as Percent of GDP												
CBO	-13.1%	-9.6%	-6.4%	-4.2%	-4.1%	-4.3%	-4.4%	-4.8%	-4.9%	-5.1%	-5.7%	-5.3%
OMB	-12.3%	-8.0%	-5.9%	-3.5%	-3.0%	-3.1%	-3.0%	-3.2%	-3.0%	-2.9%	-3.1%	-3.9%

Baselines

Included in CBO's analysis is a re-estimation of their budget baseline – the cost of policies under current law. Under this baseline, the deficit hits nearly $1.7 trillion (11.9 percent of GDP) in 2009 and over $1.1 trillion (7.9 percent of GDP) in 2010. As the economy recovers, the stimulus tapers off, and the 2001/2003 tax cuts expire, deficits are reduced, falling to $282 billion in 2015 before rising to $423 billion in 2019. Over that period, deficits would rise from 1.6 to 2 percent of GDP.

The CBO baseline ten-year deficit projection has increased from $3.1 trillion to $4.4 trillion due largely to the costs of the recent stimulus legislation. If OMB's baseline were to be calculated with the same standards as CBO's, (rather than assuming some policies that are not current law) it would show a deficit of $2.8 trillion. In other words, CBO's current policy baseline is substantially worse than OMB's – mainly because of differing economic assumptions.

Fig. 3: Baseline Deficit Projections (billions)

	2010-2014	2010-2019
CBO March Baseline	-$2,773	-$4,441
CBO January Baseline	-$1,972	-$3,135
OMB "Current-Policy" Baseline	-$4,494	-$8,983
OMB BEA Baseline*	-$2,308	-$2,823

*Calculated by CRFB to include the costs of the American Recovery and Reinvestment Act, the recent omnibus appropriations bill, and the interest associated with each.

Policy Changes

While $4.4 trillion in deficits over ten years are projected under its baseline, CBO projects President Obama's policy proposals would add roughly $4.8 trillion to the deficits – resulting in $9.3 trillion in total deficits. The bulk of these costs would come from renewing policies such as the 2001 and 2003 tax cuts for families making under $250,000 a year, patching the Alternative Minimum Tax, and continuing to block reductions in physician payments under Medicare.

Fig. 4: Effect of Policy Changes in the President's Budget (billions)

Policy	*Cost(-)/Savings(+)*	
	CBO	OMB
Renew Most 2001/2003 Tax Cuts	-$2,104	-$2,065
Index Alternative Minimum Tax	-$447	-$576
Making Work Pay Tax Credit	-$537	-$537
Other Tax Changes	-$121	-$29
Medicare Pay Patches	-$285	-$317
Increase Pell Grants*	-$98	-$117
Financial Stability Programs	-$125	$0
Reform Student Loans	$94	$54
Cap-and-Trade Revenue	$629	$646
Health Care Reform^	-$606	-$634
Limit Itemize Dedication Rate	$311	$318
Reduce Medicare/Medicaid Costs	$295	$316
Change in Defense Discretionary Spending+	-$151	$29
Change in Non-Defense Discretionary Spending	-$637	-$487
Other Tax/Spending Changes	-$22	$62
Debt Service Payments	-$1,023	-$779
Total Cost of New Policies	**-$4,829**	**-$4,116**
BEA Baseline	***-$4,441***	***-$2,853***
Total Deficit	**-$9,270**	**-$6,969**

*Includes only the cost of increasing Pell Grants from their projected levels. The President's proposal to re-categorize Pell Grants as Mandatory spending is not reflected in this chart.
^Represents unspecified funding dedicated to health care reform. The Administration has suggested actual costs would be higher, but would be deficit-neutral.
+Includes costs of overseas operations and international emergency spending.

Senator Obama's budget would also increase discretionary spending considerably and undertake major initiatives such as passing a $400 per person Making Work Pay tax credit, reforming the health care system, and increasing the size of Pell Grants. President Obama has also proposed several spending reductions and revenue raisers which would offset the costs of some of his new programs.

CBO's ten-year cost estimate for new policies is about $700 billion larger than those estimated by OMB. $125 billion of the difference is due to timing where OMB accounts for the cost of a $250 billion recovery package in 2009 (which is outside the ten year budget window), and CBO splits these costs between 2009 and 2010. CBO also assumes higher spending on defense, and assumes less tax savings from reducing tax loopholes. Other differences are primarily due to variations in economic and technical assumptions.

Economic Assumptions

The differences between CBO and OMB's projections are due mainly to differing economic assumptions. In large part, CBO's weaker economic estimates stem from new and worse economic data released after OMB undertook its own analysis. Even after accounting for the impact of the stimulus legislation, CBO estimates GDP will decline by 3 percent in 2009 – compared to the 1.2 percent decline projected by the Administration. OMB's estimates, which were made several months ago, are now far more optimistic than most private sector estimates as measured by March Blue Chip Consensus. CBO's estimates tend to be within the range of the Blue Chips, although well on the pessimistic side in 2009 and on the optimistic side in 2010.

Like OMB, CBO forecasts a recovery beginning to take hold in late 2009, and projects similar (although slightly lower) levels of growth between 2010 and 2015 – between 3 and 4 percent annually. Because they never project higher growth than OMB, economic output remains at a permanently lower level under CBO's projections. Additionally, CBO projects a lower rate of growth in the out years (2.3 percent versus 2.6 percent). In this case, it should be noted, the Blue Chip Consensus projects numbers more similar to OMB than to CBO.

Along with smaller overall economic growth, CBO projects higher and more persistent unemployment rates than does the Administration. OMB projects unemployment will peak at 8.1 percent this year, drop to 7.1 percent by 2011, and return to its normal 5 percent range by 2013. CBO, on the other hand, projects unemployment will hit 9 percent next year, drop only to 7.7 percent by 2011, and return to its normal range by 2014 or later. The combination of lower output and higher levels of unemployment results in both greater amounts of spending and less revenue.

Fig. 5: Economic Projections

	2008	2009	2010	2011	2012-2015	2016-2019
Real GDP						
CBO	+1.1%	-3.0%	+2.9%	+4.0%	+3.6%	+2.3%
OMB	+1.3%	-1.2%	+3.2%	+4.0%	+3.6%	+2.6%
CPI						
CBO	+3.8%	-0.7%	+1.4%	+1.2%	+1.2%	+1.9%
OMB	+3.8%	-0.6%	+1.6%	+1.8%	+2.1%	+2.1%
Unemployment						
CBO	5.8%	8.8%	9.0%	7.7%	5.6%	4.8%
OMB	5.8%	8.1%	7.9%	7.1%	5.3%	5.0%
3-Month Treasury Bill Rate						
CBO	1.4%	0.3%	0.9%	1.8%	4.0%	4.7%
OMB	1.4%	0.3%	1.6%	3.4%	4.0%	4.0%
10-Year Treasury Note Rate						
CBO	3.7%	2.9%	3.4%	4.0%	5.1%	5.6%
OMB	3.7%	2.8%	4.0%	4.8%	5.2%	5.2%

Partially offsetting the negative budgetary consequences of slower growth and higher unemployment are CBO's projections for lower inflation and lower interest rates on government bonds through at least 2011. The former reduces the cost of government programs with cost of living adjustments (mainly Social Security), while the latter reduces government interest payments. At the same time, CBO projects higher interest rates after 2016, which results in higher debt service payments in later years.

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CBO's recent analysis of the President's budget paints a dismal fiscal picture, with deficits not only continuing, but increasing, as far as the eye can see, and debt growing to levels not seen since World War II. Although large short-term deficits may be necessary to put the economy on a path to recovery, debt cannot sustainably continue to grow as a percent of GDP over the long-term. If deficits are not eventually reduced to manageable levels, they will threaten long-term economic growth and impair the normal functions and flexibility of government.

The latest projections underline the need for the Administration to put forward a plan for reducing the deficit as soon as the economy has stabilized. This means, to the greatest extent possible, offsetting the costs of all new and renewed policies. Strong budget rules and enforcement mechanisms, including PAYGO and discretionary funding caps, should also be enacted to prevent deficits from getting out of control. More importantly, these numbers should serve as a call for putting long-term deficit reduction – especially tax and entitlement reform – front and center on the agenda.