

# WebMemo



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## Obama to CBO Revenue Baseline: Nuts—and He’s Right!

*J. D. Foster, Ph.D.*

Senator Barack Obama (D–IL) has laid out enough of a fiscal blueprint as part of his presidential campaign to allow us to read his intentions: higher taxes on the rich, more spending, slower economic growth, and silence on the critical issues of Medicare and Social Security’s long-term plight. There is little in Obama’s future plans that do not cause conservatives consternation. Surprisingly, though, in one respect his plans should already be causing real heartburn—for congressional Democrats.

The relevant elements of Obama’s fiscal plans are these: He intends to let expire those elements of the 2001 and 2003 tax cuts that benefit taxpayers with over \$250,000 in income; he intends to preserve all the other elements of the tax cuts, plus add a couple more for some low-income workers and working seniors; and he supports the PAYGO budget rules that require new tax cuts and new spending increases to be offset with an equal amount of tax hikes and spending reductions.

Put together, these elements make for a coherent budget policy only if one also abandons the Congressional Budget Office (CBO) revenue baseline against which PAYGO operates. Refusing to be bound by the CBO revenue baseline makes eminent sense because, as aptly described by one of Obama’s economic gurus, Austin Goolsbee, it is “completely unrealistic.”<sup>1</sup> On this point Obama and Goolsbee are right, especially with respect to the CBO revenue baseline. This is why congressional Democrats have a problem, and it provides further justification for CBO to fix its baseline.

**PAYGO, Baselines, and Baseball.** Whether it’s baseball, city driving, or federal budgeting, rules play a central role in determining outcomes. Congress created PAYGO rules many years ago to bring some order and discipline to the budget process. PAYGO rules state that tax cuts or certain spending increases must be matched by an equal amount of tax hikes or spending cuts. Consequently, PAYGO is the grand defender of the status quo as it makes popular changes in tax or spending policy harder to enact.

Making PAYGO operational requires some policy baselines against which to measure change for both revenues and spending. These baselines are provided by the CBO.

Goolsbee’s comment and Obama’s plan tell us that Obama understands full well that the CBO revenue baseline is fundamentally flawed.

**Heads I Win, Tails You Lose.** Sometimes the statute governing spending policy expires. Farm programs expire, as does SCHIP, the highway program, and even annual appropriations. When CBO constructs its *spending* baseline, it sensibly ignores that the statute expires and assumes instead that current policy—and therefore current spending lev-

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(202) 546-4400 • [heritage.org](http://heritage.org)

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els—will continue because CBO assumes the statute will be renewed. CBO's *revenue* baseline, in contrast, is constructed following the statute and assumes those laws will not be renewed. CBO's inconsistency in assuming that the expiring laws governing spending policy will be renewed while those governing tax policy will not be renewed is unfounded in theory and unfair in practice, as it creates an inherent bias in favor of higher taxes and higher spending.

Under the flawed CBO revenue baseline, the expiration of the tax cuts shows up in the baseline as a jump in revenues. This causes two big problems for Obama. On the one hand, under PAYGO, extending most of the tax cuts as he suggests would require either a huge offsetting tax hike or a huge offsetting spending cut. He has proposed neither.

On the other hand, his proposal to let some current provisions affecting the rich expire raises no money for the Treasury and so cannot offset his many spending proposals under PAYGO rules. The CBO revenue baseline puts Obama on the wrong side of a "heads I win, tails you lose" proposition.

Conservatives have few grounds for agreement with Obama's agenda, but on these points we should be in complete agreement:

- The CBO revenue baseline is wrong;
- Preserving current law is not a policy to cut taxes; and
- Allowing any of the current law tax provisions enacted in 2001 or 2003 to expire is a tax hike.

Congressional Democrats, on the other hand, disagree with all three points. And for them, it's a matter not of future policy but of current legislation. Congress is again faced with extending the Alternative Minimum Tax (AMT) patch and a slate of other tax provisions—such as the R&D tax credit—that

periodically expire. Adhering to the CBO revenue baseline, extensions of the AMT patch and the R&D tax credit are shown as tax cuts. Of course, as Obama's position makes plain, preserving current policy means that nothing has changed, so it results in neither a tax cut nor a tax increase.

But congressional Democrats argue that, under the budget rules, in order to avoid a tax hike on some taxpayers, they have to raise taxes on others. This faux fiscal discipline is, of course, nonsense. Congressional Democrats are merely hiding behind the rhetoric of fiscal discipline to try to sneak through a massive tax hike—and then do so again next year and again the year after. If they believe in raising taxes, they should have the courage of their presidential nominee and just say so. They are wrong to try to raise taxes, but they are even more wrong to pretend otherwise by hiding behind a completely unrealistic CBO revenue baseline.

**Joining Forces to Fix the CBO Baseline.** It is said that politics makes for strange bedfellows. Perhaps to his own surprise, Obama has apparently joined forces with conservatives to correct the CBO revenue baseline. Maybe this also demonstrates that Washington is ready to have an honest debate about tax and spending policy. A demonstration of that honesty could start by Congress passing an AMT patch and an R&D tax credit extension without trying to sneak through a massive tax hike in the process.

It is past time for Congress to tell the CBO to fix its revenue baseline methodology. Senator Obama and his people get it. Why don't congressional Democrats?

—J. D. Foster, Ph.D., is Norman B. Ture Senior Fellow in the Economics of Fiscal Policy in the Thomas A. Roe Institute for Economic Policy Studies at The Heritage Foundation.

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1. Richard Rubin, "Candidates' Plans Sketched in Red Ink," *Congressional Quarterly Weekly*, January 13, 2008, quoted in Isabel V. Sawhill, "Candidates on Fiscal Responsibility," Brookings Institution, July 30, 2008, at [http://www.brookings.edu/~/media/Files/rc/papers/2008/0702\\_fiscal\\_responsibility\\_sawhill\\_opp08/0702\\_fiscal\\_responsibility\\_sawhill\\_opp08.pdf](http://www.brookings.edu/~/media/Files/rc/papers/2008/0702_fiscal_responsibility_sawhill_opp08/0702_fiscal_responsibility_sawhill_opp08.pdf) (August 7, 2008).