

# WebMemo



Published by The Heritage Foundation

No. 3479  
February 1, 2012

## CBO Baseline: A Few Quirks Do Not Distract from a Dismal Picture

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The Congressional Budget Office (CBO) released its baseline budget outlook through fiscal year 2022 on January 31. The analysis is as creditable to the CBO as its message is daunting to the nation. After squandering three years in which the signal consequences have been persistent high unemployment coupled with an unprecedented increase in the national debt, President Obama has left the nation facing a budget deficit exceeding \$1.1 trillion for 2012 and averaging almost as much each year for the 10-year forecast. Assuming, as most do, that Congress and the President will spend the coming year largely inert on fiscal matters, whoever is in the White House next year will face a fiscal calamity of epic proportions.

Producing a budget baseline is an act requiring professional skill, judgment, and some guesswork. Thus it should not surprise that a few specific oddities appear in the CBO baseline that ought to be kept in mind as policymakers prepare to construct a budget resolution for the coming year, and they merit inquiry of the CBO for clarification. Three that are especially apparent deal with the definition of the baseline itself, the economic forecast for the alternative baseline, and the production of the alternative baseline.

**A Generally Sensible Baseline.** The circumstances under which CBO produced the baseline forecast are extraordinary by any measure. The economy is sputtering with high unemployment. Spending on two wars is winding down. New, tem-

porary budget procedures are in effect. A longstanding and growing anomaly with respect to Medicare remains unresolved, and enormous portions of the tax code are slated to expire next year. Producing a credible baseline forecast under these conditions is nearly impossible, and yet the CBO made a fair effort at producing not one, but two.

The CBO baseline budget outlook should provide a policy-judgment-free perspective on the budget outlook. It cannot be entirely judgment-free, because judgment must be exercised in crafting the economic forecast underneath the budget outlook. There are two possible rigorous approaches the CBO can take to developing such a baseline in addition to providing an explicitly judgment-based approach. The CBO can:

1. Construct a baseline reflecting current law so that the outlook adjusts as the law changes; or
2. Construct a current policy baseline that reflects the extension of current policy regardless of whether certain tax or spending policies expire under the law.

This paper, in its entirety, can be found at:  
<http://report.heritage.org/wm3479>

Produced by the Thomas A. Roe Institute  
for Economic Policy Studies

Published by The Heritage Foundation  
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Many might incorrectly conclude that the starting point, the baseline budget outlook, reflects the first of these—a strictly current law baseline. However, as the CBO explains, the baseline outlook assumes “that current laws *generally* remain unchanged [italics added].” The import of the word *generally* is that the CBO has decided to assume that some—but only some—of the current law that expires will continue.

Thus, for example, the Federal Aviation Administration and the highway transportation program are assumed to continue in practice, even though they expire in law. In short, under the baseline outlook, all current law is followed with respect to taxes, and some current law is followed with respect to spending. This mixed approach is confusing and debases the rigor of the baseline.

Unfortunately, the second option—a current policy baseline—is entirely missing in the CBO analysis. Providing a rigorous current law baseline alongside a rigorous current policy baseline would be useful to Congress and the nation in honestly bracketing the possible outcomes based on known policies.

A third option, in which the CBO is explicit about its chosen deviations from current law, is presented in the budget as the “Alternative Fiscal Scenario.” The Alternative Fiscal Scenario assumes that the Medicare anomaly known as “doc fix” is resolved, expiring tax provisions (other than the payroll tax reduction, a.k.a. the “payroll tax holiday”) are extended, the Alternative Minimum Tax is indexed for inflation, and automatic spending reductions under the Budget Control Act are set aside.

**Economic Forecasts Under the Baselines.** By and large, the economic forecast that the CBO uses for its baseline outlook appears reasonable. Projected growth for 2012 of about 2 percent is certainly in the ballpark of other estimates. As the baseline assumes a massive tax hike in 2013, a resulting decline in growth in 2013 is appropriate whether one is a Keynesian or a supply-sider, though the CBO forecast of 1.1 percent growth under those circumstances seems very optimistic.

Another peculiarity is that there appears to be no reflection in the forecast for interest rates of the massive increase in national debt effected thus far under President Obama or projected in either base-

line. If deficits matter, they matter first and foremost through higher interest rates, but these consequences seem to be wholly missing.

The greater curiosity is in the economic forecast under the Alternative Fiscal Scenario. Here, the CBO offers not point estimates (as with the budget baseline) but ranges, and in the case of the forecast for real GDP in 2013, the range is an ungainly 2.7 percentage points. In short, the CBO is able to provide a point forecast for the economic variables in the scenario that varies substantially from current policy and is highly unlikely to transpire, but it cannot provide similar point estimates for the more likely scenario reflecting economically modest changes in policy from what is in effect today. This is most peculiar. One would expect it to be easier to forecast a familiar over an unfamiliar policy scenario.

**An Inconsistent Alternative Budget Baseline.** The basic order and process of building a budget baseline is to assume a set of policies, use these policies to inform the economic forecast, and then use this economic forecast to shape the budget outlook—for example, producing the baseline budget outlook as follows:

Baseline policies—Baseline economic forecast—  
Baseline budget outlook

Producing the Alternative Fiscal Scenario budget outlook would proceed in a similar fashion, with the word *alternative* replacing the word *baseline* in the string.

The CBO appears to have lost its way in constructing the outlook under the Alternative Fiscal Scenario. It identified the alternative set of policies and then produced an alternative economic forecast. Though the CBO described the alternative forecast in terms of ranges, it could have chosen the midpoint in each range for its point forecasts for budget calculations. Then, it appears, the CBO produced its alternative budget outlook using the alternative policies but the economic forecast from the baseline policies. Diagrammatically, this would appear as:

Alternative policies—Baseline economic forecast—  
Alternative budget outlook

It is possible the discussion of the Alternative Fiscal Scenario baseline outlook was simply unclear,

and the result is internally consistent after all. If not, then, unfortunately, interpreting the more relevant budget outlook—that reflecting the Alternative Fiscal Scenario—is as unnecessarily murky as it is internally inconsistent.

**One More Chance.** The CBO budget outlook is a very important contribution whatever quirks may arise in its production, and it has reaffirmed the dismal state of the nation's finances. President Obama has one more opportunity in the upcoming

release of his budget proposals to begin to get spending under control and turn the fiscal ship from the waiting shoals. Unfortunately, his State of the Union address offered little hope that the President would lead in this election year, but one can hope.

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