

Harvard Law School
Federal Budget Policy Seminar

Briefing Paper No. 4

**The Role of Estimation
in Budget Procedures:
BASELINES**

Jared Shirck
Francis Shen

Final Draft
May 4, 2005

THE ROLE OF ESTIMATION IN BUDGET PROCEDURES: BASELINES

The baseline in context. In relationship to the budget procedure topics discussed last week, baselines are distinct in at least two ways. First, there is currently no debate over whether we should be using a baseline.¹ The relevant question is thus not “Should we have a baseline?” but “What should the baseline look like?” and “What assumptions should we make?” The second distinction to note is that baselines are not meant to stand alone. Baselines are *tools* for policymakers and analysts, and they become significant when they are put in relationship to some other budget number, e.g. new spending relative to the baseline. Looking to other topics covered in the course, baselines can be thought of both as a tool to be incorporated in designing other budget rules, and as a tool to consider the effects of those rules and procedures. As put by Schick, “CBO’s baseline provides a useful starting point for preparing the [Congressional budget] resolution.”² This briefing paper hopes to provide a better understanding of how we arrive at that starting point.

¹ Historically, the baseline was not always as prominent as it is today. “The use of baselines and long-term projections as the most important aspect of the budgeting process was not automatic and it was not until the 1980s that the baselines ‘gained acceptance in both the executive and legislative branches as the measure of spending cuts, revenue changes, and deficit reductions.’” Puckett, Christopher J. *NOTE: Is the Experiment Over? The OMB’s Decision to Change the Game through a Shortening of the Forecast*, 11 *Geo. J. Poverty Law & Policy* 169 at 176. (2004). Citing: Allen Schick, “The Study of Microbudgeting,” in John F. Cogan, Timothy J. Muris & Allen Schick, eds. *The Budget Puzzle: Understanding Federal Spending* at 104, 116 (1994).

² Schick, Allen. (2000). *The Federal Budget: Politics, Policy, Progress*. p. 118. For other primers on the baseline, see: Timothy J. Muris, “The Uses and Abuses of Budget Baselines,” (1994) in Cogan, Muris & Schick, eds, *supra* note 1. J. D. Foster & James C. Miller III. “Policy Watch: The Tyranny of Budget Forecasts,” in *The Journal of Economic Perspectives*. Vol. 14, No. 3 (Summer, 2000), pp. 205-215.

I. BASELINE BASICS

I.A. General Definitions and Legal Framework for Baselines

I.A.1. The concept of a baseline

Although there is disagreement over how to achieve the goal, there is general consensus over what a baseline should conceptually aim to do: provide an economically sound and politically neutral estimate of what the federal budget would be if the government provided the same types of services and collected the same types of revenue as it currently does.³ The complexities and uncertainties involved in making these estimates are what give way to the political and academic debates in this field.⁴

When discussions of the federal budget process refer to “the baseline” they are most commonly referring to the Congressional Budget Office’s (CBO) “current services baseline”.⁵ The current services baseline is the baseline that this brief will define next and discuss at length, but before presenting that discussion it is important to note that the CBO’s current services baseline is not the only baseline in use. Indeed, the CBO itself presents multiple baselines in its Budget and Economic Outlook report.⁶ The President’s

³ This near-universal agreement can be seen by looking at the similar language in the January 2005 CBO Economic Outlook report, and the President’s Analytical Perspectives on the FY 2006 budget. The CBO, in a section titled, “The Concept Behind CBO’s Baseline Projections” writes that the “baseline can be used as a neutral benchmark against which to measure the effects of proposed changes in tax and spending policies.” Chapter 1, page 5. CBO, *The Budget and Economic Outlook: Fiscal Years 2006 to 2015*. (January 2005). Available on-line at: <http://www.cbo.gov/showdoc.cfm?index=6060&sequence=0>. (Accessed March 2005). The President’s Analytical Perspectives, despite disagreeing with some of the CBO’s methodology, uses similar conceptual language: “Ideally, a current services baseline would provide a projection of estimated receipts, outlays, deficits or surpluses, and budget authority needed to reflect this year’s enacted policies and program for each year in the future.” Chapter 25, page 389. OMB, *Analytical Perspectives, Budget of the United States Government, FY 2006*. Available on-line at: <http://www.whitehouse.gov/omb/budget/fy2006/pdf/spec.pdf>. (Accessed March 2005).

⁴ See: Muris, *supra* note 2.

⁵ 2 USCS § 907. It is also referred to sometimes as the “current law” baseline, and this distinction is discussed in Section I.B.1.

⁶ The CBO also prepares additional baselines in separate reports, using different approaches, e.g. CBO (2004). *The Cyclically Adjusted and Standardized Budget Measures* (May 2004), Available at: <http://www.cbo.gov/showdoc.cfm?index=5163&sequence=0> (Accessed March 2005).

Office of Management and Budget (OMB) presents an alternative baseline, and some policy think tanks offer their own baselines as well.⁷

The baseline is *not* meant to be an accurate prediction about the future.⁸ As observed by Puckett, “The baseline projections of the CBO and OMB are intended to examine what possible effects of long-term expenditures or tax cuts will have on the deficit and mandatory program baselines at a specific point in time for decision-making purposes.”⁹

I.A.2 Current legal definition and legislative history

While there are many potential baselines to choose from, the baseline that receives the most attention is the one that is codified in statute: the Congressional Budget Office’s current services baseline. 2 USCS § 907(a) defines the baseline:

“For any budget year, the baseline refers to a projection of current-year levels of new budget authority, outlays, revenues, and the surplus or deficit into the budget year and the outyears based on laws enacted through the applicable date.”¹⁰

The legislative history leading up to this definition of the baseline is marked by two important dates: the introduction of a baseline in 1974 with the Congressional Budget and

⁷ OMB’s discussion of baselines can be found in the 2005 Analytical Perspectives analysis, *supra* note 3. An example of an alternative baseline is the “no-BS baseline” constructed annually by the Centrists.org think tank. This baseline “attempts to make politically realistic assumptions about technical fixes to the budget that are almost certain to occur.” See: http://www.centrists.org/issue_summaries/budget_tax_baseline.html. (Accessed March 2005). These alternative configurations of the baseline are discussed in greater length in Section II.

⁸ In every Economic Report, the CBO reminds readers of this fact. “The baseline is not intended to be a prediction of future budgetary outcomes. Rather, the projections reflect CBO’s best judgment about how the economy and other factors will affect federal revenues and spending under existing laws and policies.” CBO (2005), *supra* note 3 at 5.

⁹ Puckett, *supra* note 1 at 181.

¹⁰ 2 USCS § 907(a). The CBO, in their 2005 Glossary, provides a similar definition: “A benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending. For purposes of the Deficit Control Act, the baseline is the projection of current-year levels of new budget authority, outlays, revenues, and the deficit or surplus into the budget year and out-years based on current laws and policies, calculated following the rules set forth in section 257 of that act.” CBO (2005), Glossary *supra* note 3 at 2.

Impoundment Act, and its subsequent amendment by the Balanced Budget and Emergency Deficit Control Act of 1985.¹¹ Although budget acts since 1985 have adjusted the baseline rules slightly, the Deficit Control Act remains the primary guide for baseline construction.¹²

Before 1974, “the base used to compare alternative budget proposals was either the levels in the previous year's budget or those proposed by the President.”¹³ §257 of the 1974 Act made a current services baseline a requirement of the federal budget process, and amendments to §257 in the 1985 Deficit Reduction Act provided the CBO with a more detailed rule for baseline construction.¹⁴ Until 1996, the CBO calculated a baseline out for five years. When Congress extended the time horizon to calculate PAYGO in 1996, the CBO began making baseline projections over a ten year time horizon.¹⁵

I.B. How the Baseline is Estimated

Since the baseline is an estimate about the future, the center-piece of the legal rule governing baseline construction is *assumptions*. The law tells us what assumptions the CBO is allowed to make, and provides guidance on how the CBO should set about making those assumptions. Working under these legal constraints, the CBO then engages

¹¹ Congressional Budget and Impoundment Act of 1974. 93 P.L. 344; 88 Stat. 297. (1974). Balanced Budget and Emergency Deficit Control Act of 1985. 99 P.L. 177; 99 Stat. 1037. (1985). Puckett, *supra* note 3, provides a thorough history of the development of the baseline. The discussion here draws in part on Puckett's analysis.

¹² That the 1985 Deficit Control Act is still controlling is evident in the language used by the CBO. In its January 2005 Economic Report, the CBO states that, “CBO constructs its baseline according to rules set forth in law, mainly in the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974.” CBO (2005), *supra* note 3 at 5. More recent legislation has also made minor changes to the rules for constructing baselines. See: Budget Enforcement Act of 1990. 104 Stat. 1388, Pub. Law 101-508 (1990); and Balanced Budget Act of 1997. 105 P.L. 33; 111 Stat. 251. (1997).

¹³ Puckett, *supra* note 1 at 175, citing Muris, *supra* note 3 at 42.

¹⁴ Puckett, *supra* note 1.

¹⁵ Penner R.G. “Dealing with Uncertain Budget Forecasts,” Spring 2002, vol. 22, no. 1, pp. 1-18. The move to ten year horizons was made to prevent gaming between years 5 and 6. Section II discusses the consequences of the baseline time horizon.

in a complex analysis to arrive at its estimates.¹⁶ The law provides two sets of instructions to the CBO. The first concerns direct spending and receipts.¹⁷ The second concerns discretionary spending.¹⁸

I.B.1. Estimating direct spending and receipts in the baseline

The primary assumption in the law is that: “Laws providing or creating direct spending and receipts are assumed to operate in the manner specified in those laws for each such year and funding for entitlement authority is assumed to be adequate to make all payments required by those laws.”¹⁹ With a few enumerated exceptions, then, the CBO is bound under the 1985 Budget Reconciliation Act to estimate the baseline according to current law, no matter how probable it is that current legislation is to be amended or new legislation is to be introduced.²⁰

There are two clauses of the law to consider. The second clause, which instructs CBO to make sure that entitlement programs have enough money to pay their legal obligations, is not difficult to intuit. The baseline provides an estimate of costs/revenues associated with mandatory programs.

The first clause on direct spending is more subtle. It is important to look closely at the language of the first clause and note the distinction between current *law* and current *services*. CBO is directed to assume that that *laws* will “operate in the manner specified.”

¹⁶ For more technical discussions of the CBO procedures, see the set of technical documents released in conjunction with the (more reader-friendly) Economic Report: CBO, *The Uncertainty of Budget Projections: A Discussion of Data and Methods*, February 2005. CBO, *The Cyclically Adjusted and Standardized Budget Measures*, February 2005. CBO, *CBO's Revised Method for Estimating and Projecting Potential TFP*, January 2005.

¹⁷ As defined in the Glossary in the 2005 CBO Budget and Economic Outlook report, “For the purposes of the Deficit Control Act, direct spending includes entitlement authority and the Food Stamp program. In this report, direct spending refers to the outlays that result from budget authority provided in laws other than appropriation acts.” CBO (2005), Glossary, *supra* note 3 at 5.

¹⁸ In the CBO 2005 report, “discretionary spending refers to the outlays that result from budget authority provided in appropriation acts.” CBO (2005), Glossary, *supra* note 3 at 5.

¹⁹ 2 USC § 907(b)(1).

²⁰ *Supra* note 10. 99 P.L. 177; 99 Stat. 1037. See: 2 USC § 907(b)(1).

It is often the case that the *current law* specifies that *future services* be different. Sunset provisions provide an excellent example of this scenario.²¹ If current law says that a tax break will run out in three years, the CBO is to assume that in the fourth year the tax break will disappear. This leads to the result that the “current services” baseline doesn’t actually estimate the costs/revenues of carrying out the same services in future years. The baseline in fact estimates the costs/revenues from sticking with the same statutes as are currently on the books. For direct spending, the CBO baseline is essentially a current law, rather than current services baseline.

Considering a concrete example in the January 2005 CBO report, the rule of baseline construction instructs the CBO to assume that “major provisions of EGTRRA – such as the introduction of the 10 percent tax bracket, increases in the child tax credit, and the repeal of the estate tax – will expire as scheduled at the end of 2010”.²² The CBO cannot, in its official current law baseline, assume that the tax cut will be repealed, nor that it will continue in its present form beyond its sunset provision date.²³

Exceptions to this direct spending and receipts general rule were added in 1985 and in subsequent amendments.²⁴ The exceptions include: no assumption of expiration for direct spending programs with outlays greater than \$50 million²⁵ and “excise taxes dedicated to a trust fund, if expiring, are assumed to be extended at current rates”.²⁶

²¹ See, e.g. Puckett’s (2004) discussion of sunsets. Puckett, *supra* note 1.

²² CBO (2005), *supra* note 3 at 9. EGTRRA refers to Economic Growth and Tax Relief Reconciliation Act of 2001, also referred to by many as the “Bush Tax Cut”.

²³ As discussed in Section I.A.1, the CBO can (and does) present alternative baselines where they make these alternative assumptions.

²⁴ This brief does not discuss all exceptions to the rule. For more on exceptions, see: 2 USCS § 907(b), and discussion in OMB (2005), *supra* note 3.

²⁵ See: 2 USCS § 907(b)(2)(A). The program must also have been established before the enactment of the 1997 Balanced Budget Amendment.

²⁶ 2 USCS § 907(b)(2)(D)

It should also be noted that assumptions are not made about *Supplemental* appropriations, no matter how likely they may be. A recent illustration of this is seen in the fact that CBO's baseline estimates for FY2006 do not include any projections (via supplemental appropriations) for the War on Terrorism.²⁷ The CBO, recognizing this concern, issued an additional report directly on point: "An Alternative Budget Path Assuming Continued Spending for Military Operations in Iraq and Afghanistan and in Support of the Global War on Terrorism."²⁸ Returning to the basic point made at the outset – that the baseline is at core about assumptions – what distinguishes this alternative report is that in this separate report, CBO, "assumes that military operations in Iraq and Afghanistan and other activities related to the global war on terrorism continue at their current levels during 2005 and 2006, but decline after that."²⁹

I.B.2. Estimating direct spending and receipts in the baseline

For discretionary spending, the direct spending "current law" rule is not applied. The reason, as noted by the OMB, is that "absent appropriations of additional funds in the future, discretionary programs would cease to exist after existing balances were spent."³⁰ If the CBO were to follow the same rule for discretionary spending as they did for direct spending, they would not recognize any spending in most future years (because there is no current law authorizing that spending).

To avoid this result, the law instructs the CBO to treat discretionary spending as continuing in future years, "adjusted sequentially and cumulatively" (1) for expiring

²⁷ See: CBO (2005), *supra* note 3.

²⁸ CBO. (2005). "An Alternative Budget Path Assuming Continued Spending for Military Operations in Iraq and Afghanistan and in Support of the Global War on Terrorism," Available online at: <http://www.cbo.gov/ftpdoc.cfm?index=6067&type=1>. CBO references this analysis in Table 1-3 of the Budget & Economic Outlook report.

²⁹ *Id* at 1.

³⁰ OMB (2005), *supra* note 3 at 390.

housing contracts, (2) for social insurance administrative expenses, (3) to offset pay absorption and for pay annualization (4) for inflation, and “to account for changes required by law in the level of agency payments for personnel benefits other than pay”.³¹

I.C. How the Baseline is used in the Appropriations Process

The first step in use of the baseline is its publication. On the CBO side, the CBO publishes its current services baseline three times a year: in January, March, and August. The construction of the baseline is handled by divisions of the CBO permanently dedicated to projections. The task is a formidable one, and the January 2005 required contributions from 81 individuals.³² On the OMB side, the OMB includes its baseline as part of the President’s budget. The President, when submitting his budget, is required to: “include a budget baseline estimate made in accordance with section 251(a)(6) of the Balanced Budget and Emergency Deficit Control Act of 1985 and using economic and technical assumptions consistent with the current services budget submitted under section 1109 for the fiscal year. If such budget baseline estimate differs from the estimate in the current services budget, the President shall explain the differences.”

Once published, the use of the baseline becomes complicated. Former OMB director David Stockman commented that, “None of us really understand what’s going on with all these numbers ... You’ve got so many different budgets out and so many different baselines and such complexity ... People are getting from A to B and it’s not clear how they are getting there.”³³ Picking up on Stockman’s comments, Tomkin

³¹ See 2 USCS § 907(c)(1-6) for the details of these adjustments, as well as analysis in Section II.

³² CBO (2005), Appendix G lists 81 people who contributed to the January 2005 CBO report.

³³ Greider, William. “The education of David Stockman,” *The Atlantic Monthly*, 81 (12), December 1981. Quoted in Widalvsky, *infra* note 34 at 158.

observes that, “it became impossible for those who were not a part of this intricate budgetary game to fathom this baseline parlance.”³⁴

While the complexity of baseline usage cannot be resolved here, at least two general types of baseline usage can be identified. First, the baseline is used in policy discussions and political debates. The baseline becomes important here for framing new policies. In the 1981 Reagan budgets, for instance, the President claimed “deficit reduction” based on a baseline that had been adjusted for “adequate” baseline defense spending – with “adequate defined to exceed the general inflation rate.”³⁵ Section II of this Memo discusses in more detail the extent to which the baseline is used in these debates as a partisan tool.

In addition to its importance in framing debate, a second use of the baseline, however, is its use *within legislation or code*, to determine spending or saving levels. A current example of attempts to write the baseline into legislation are the pieces of “lockbox legislation,” which would restrict Congress from spending baseline budget surpluses.³⁶ Under the currently proposed version of this legislation, H.R. 116, “the term ‘baseline budget surplus’ means the sum of the on- and off-budget surpluses contained in the most recent baseline budget projections made by the Congressional Budget Office at the beginning of the annual budget cycle and no later than the month of March.”³⁷ The aim of the legislation is to prohibit Congress from spending the baseline budget surplus until solvency has been assured for Medicare and social security. The implications for the baseline creation process are striking: the lower the baseline, the greater the surplus, and

³⁴ Tomkin, Shelley Lynne. (1998). *Inside OMB*. M.E. Sharpe, at 159.

³⁵ Muris, *supra* note ____, at 44.

³⁶ The latest incarnation of this proposal in the 109th Congress is H.R. 116, the “Social Security and Medicare Lock-box Act of 2005,” proposed by Rep. Holt.

³⁷ H.R. 116, §3(a)(2).

the more Congress' hands would be tied. Individual departments or programs would have incentives to be "in the baseline" because if they weren't they would automatically become secondary priorities behind Medicare and social security.

I.D. Uncertainties

The CBO recognizes that their estimation procedures involve many uncertainties. They organize uncertainties into three groups: (1) Legislative, (2) Economic, and (3) Technical. Legislative uncertainties arise from the fact that the CBO cannot factor into its baseline any anticipated changes in legislation. Economic uncertainties include CBO's assumptions about interest rates, inflation, and the growth of GDP.³⁸ As discussed in Section II of the Brief, these assumptions provide ample opportunity for political gaming. Technical uncertainties arise from the other (non-economic, non-legislative) assumptions that the CBO has to make. One technical assumption that has given rise to some uncertainty and debate is CBO's set of assumptions of prices "for various agricultural commodities as well as crop yields, all of which are volatile and significantly affect how much the government will pay farmers under price- and income-support programs."³⁹

Rudolph Penner, who served as Chief Economist at the OMB from 1974 to 1977 and chief economist at the CBO from 1983 to 1987 has conducted an extensive analysis of the economic and technical uncertainties involved in the budget forecasting process.⁴⁰ His critiques are considered in Section II, but it is enough to note here that as an

³⁸ The CBO provides a detailed explanation of its economic assumptions, associated uncertainties, and implications for policy in CBO (2005), *Appendix A. How Changes in Economic Assumptions Can Affect Budget Projections*.

³⁹ CBO (2005), *supra* note 3 at 10. For more on the farm price issue, see: Robert Paarlberg; David Orden. "Explaining U.S. Farm Policy in 1996 and beyond: Changes in Party Control and Changing Market Conditions." Vol. 78, No. 5, Proceedings Issue (Dec., 1996), pp. 1305-1313.

⁴⁰ See Penner, *supra* note 15.

empirical matter, “budget forecasts are always wrong, and often they are wrong by a lot.”⁴¹

II. IMPLICATIONS OF THE BASELINE FORMULATION

Former Director of the Office of Management and Budget Richard Darman begins his introduction to the 1991 budget with a revealing quip: “If anything were meant for viewing through proverbial green eyeshades, it would seem to be the Federal budget.”⁴² The concept of a baseline is where the president and Congress begin their agendas for the upcoming fiscal years. It seems a self-evident beginning, since any proposed financial changes requires a reference point from which the repercussions of these changes can be understood. But even this initial reference point beckons one not to displace those “green eyeshades,” for the initial formulation of the baseline, and the way in which it is presented, directly frame the way new numbers will be perceived.⁴³

II.A. General challenges with baselines

A familiar instance of the baseline-perception intersection occurred in 1995, when Congress and the president relied on different baseline predictions while calculating the effects of proposed Medicare cuts. Because the OMB assumed less health care inflation than the corresponding numbers presented by the CBO, President Clinton’s recommendations for altering Medicare appeared, on its face, to call for \$146 billion less in cutbacks. In terms of real spending, the plans entertained by the Republican Congress and by the president, respectively, differed by no more than \$10 billion, but because the

⁴¹ *Id* at 1, citing Aaron, Henry J. (2000) “Presidential Address—Seeing Through the Fog: Policymaking with Uncertain Forecasts” *Journal of Policy Analysis and Management*, 19(2): 193-206.

⁴² Darman, 1991. *The Budget for Fiscal Year 1991*, p. 104.

⁴³ For an interesting description of the way in which the baseline shapes perceptions, see Schick’s (2000), *supra* note 2, pp. 57-58, and “Congressional Budget Office Baseline,” *Congressional Digest*, May 1993, pp. 139, 160.

CBO drew a seven-year baseline that showed Medicare spending rising more precipitously, the proposal offered by congressional Republicans appeared to call for a much heftier axe than would have otherwise been the case. Allen Schick lays down the oft-repeated edifying conclusion:

The moral of this story is that politicians have to be careful in choosing the baselines they use. In a dispute between the president and Congress, the side using the more cautious assumptions (for example, lower economic growth, higher inflation) exposes itself to blame for reducing spending, raising taxes, or doing other unwelcome things to the budget.⁴⁴

Where the baseline begins determines a great deal as to where policy ends up.

II.A.1. Bright lines or loopholes?

Before Section 257 of the 1974 Congressional Budget and Impoundment Act made a “current services” baseline a requirement for the federal budget process, the baseline either reflected the previous year’s budget or the president’s new proposed budget as a beginning reference point.⁴⁵ Complaints abounded. If the latter numbers were used, the president could more easily obscure large policy changes before the figures ever reached Congress; when the former numbers were used, the natural increases in policy funding stemming from uncontrollable demographic and inflationary variables put Congress in the awkward position of always publicly spending more from year to year, even with zero-sum policy shifts.⁴⁶ The 1974 and 1985 budgetary changes were thought by many to correct for these problems, but it did not take long to see how changes bent on creating more politically neutral baseline estimates opened the door to continued disagreements. Because baseline estimates involve assumptions on the future

⁴⁴ Schick, p. 60.

⁴⁵ See *supra* note 13.

⁴⁶ See Puckett, *supra* note 1.

of GDP, interest rates, and inflation, complexities arise immediately. The OMB and CBO not only often disagree about how much weight to place on particular economic variables, but also provide multiple variations of an initial baseline using different combinations of such indicia.⁴⁷ Small movements in initial assumptions often lead to substantial movements in the final form of the baseline, and with no dearth of baseline estimates,⁴⁸ it is not surprising that this complexity affords the president and Congress extra munitions when trying to advance budgetary agendas. It has been said that “President Reagan used a trick with the baseline to claim that the deficit was being reduced when spending actually increased”⁴⁹ simply by using higher estimates of inflation and lower estimates of future GDP than his critics.

II.A.2. Gaming the system

As was noted above in Section I.C., the CBO recognizes three general categories of uncertainty attached to baseline estimates: legislative, economic, and technical.⁵⁰ Sunset provisions obscure financial realities when there is little or no doubt that policy will remain the same. *Unexpected* supplemental funding that is added to baseline estimates distorts the previous fiscal year’s starting point, while *expected* supplemental funding that is not added directly to the initial baseline underestimates governmental costs.⁵¹ And choosing when to represent the revenues and costs of a specific program within the five, seven, or ten-year budgetary baseline horizons provides a generous tool

⁴⁷ Theoretically, this seems sound since the CBO bases its budget predictions on the fiscal stance implied by current policy, whereas the OMB forecast is based on the assumption that all presidential recommendations are adopted. Penner, *supra* note at 15.

⁴⁸ See, e.g., Centrists.org at http://www.centrists.org/issue_summaries/budget_tax_baseline.html or Robert Greenstein, executive director of the Center on Budget and Policy Priorities, at <http://www.senate.gov/~budget/republican/about/hearing2001/greenstein.htm>.

⁴⁹ Puckett, *supra* note 1 at 169, 170.

⁵⁰ CBO, 2005, *Appendix A. How Changes in Economic Assumptions Can Affect Budget Projections*.

⁵¹ For two examples of alternative baseline projections based upon expected policy outcomes, see Centrists.org, *supra* note 40 or Robert Greenstein, *supra* note 40.

for lawmakers to tout short-term benefits while hiding financial costs soon to follow. Just recently in 2003, Director of the OMB Mitch Daniels made an announcement that accompanied the president's 2004 budget. A reporter asked him if "by presenting most of these numbers over five years, rather than ten . . . are you not concerned that you're actually hiding the true extent of the federal deficit in years to come?" Daniels responded quite succinctly:

"No. The experiment, which you probably know is only seven years old, of attempting to pretend that we could roll together thousands of variables and produce some accurate surplus or forecast out six, eight, [ten] years, really needed to come to an end. We made no such pretense for the history of the republic."⁵²

Although many economists agree with Daniels' assessment of the difficulty of accurately, or even realistically, producing direct spending and revenue figures very far into the future, the president's critics often refer to this as "budgetary hide and seek."⁵³

II.A.3. Incrementalism vs. Re-thinking program funding

The nature of the current services baseline, where inflation and demographics raise the direct spending baseline without explicitly acknowledging a spending increase

⁵²"The effects of changing the length of the baseline and projections are significant both practically and politically. Practically, the length of the baseline can increase or decrease the amount of agency work or speculation that goes into creating it. The longer a baseline tries to project the probable future, the more speculative it becomes because of the unpredictability of the economy and the worldwide environment. The political significance of changing the length of the baseline is that the true costs of legislation can be hidden outside the snapshot." Puckett, *supra* note 1, 169,170, citing Daniels, Press Briefing on the Budget, Feb. 3, 2003, http://www.whitehouse.gov/omb/speeches/daniels_04budget.html; see also Office Of Mgmt. & Budget, Budget Of The United States Government, FISCAL YEAR 2004 28, 2003, <http://www.whitehouse.gov/omb/budget/fy2004/budget.html>.

⁵³"*The Administration insists on its practice of budgeting for only five years, masking the full cost of its tax cuts, while it simultaneously insists on using "infinite" or 75-year time horizons in other contexts. A principal reason the Administration cites for providing only a five-year budget is that estimates of the budget beyond the fifth year are too uncertain. Yet the Administration contends that the traditional 75-year test of solvency used by the Social Security actuaries and most social insurance experts is not long enough and that Social Security solvency must be measured into eternity.*" Greenstein, et al., Center on Budget and Policy Priorities, "Assessing President Bush's New Budget Proposal," February 7, 2005.

in that baseline, has placed it within the analytical construct of incrementalism.⁵⁴ “The caricature of incrementalism that has arisen is that of a decision-making process taken up for the most part with negotiations over increases and decreases to an existing ‘base,’ and not with a review of the budget in its entirety.”⁵⁵ This makes sense if you begin from the assumption that voters will not tend to overhaul their opinions from one fiscal year to the next. Others have argued that focusing on budgetary “totals,” rather than what is spent on particular programs, tends to protect funding for areas that might no longer make sense.⁵⁶ In other words, in order to avoid the political whirlwind of cutting funding for a widely accepted governmental project, lawmakers will tend to increase other portions of the project’s spending in order to avoid an overall reduction.

II.A.4. Defenders of the system

Defenders of the current services baseline argue that failing to adjust programs for inflation amounts to cutting them in real terms.⁵⁷ Using last year’s dollars distorts reality and creates an uphill battle for program beneficiaries by requiring them to struggle each year just to stay even. Fully-informed budgeting, it is argued, requires lawmakers to “consider not only the dollars spent, but the impact of those dollars on service levels.”⁵⁸

⁵⁴ Aaron Wildavsky, *The Politics of the Budgetary Process*, Boston: Little, Brown, and Company, 1964.

⁵⁵ Pitsvada and Draper, “Making Sense of the Federal Budget the Old Fashioned Way—Incrementally,” *Public Administration Review*, Vol. 44, No. 5, 401, 402.

⁵⁶ See, for example, Natchez and Bupp, “Policy and Priority in the Budgeting Process,” *American Political Science Review* 67, September 1973.

⁵⁷ Hager, “House Deficit Hawks Propose Changes In Budget Process,” *Congressional Quarterly Weekly Report*, 00105910, 5/21/94, Vol. 52, Issue 20

⁵⁸ Crain and Crain, “Fiscal Consequences of Budget Baselines,” *Journal of Public Economics*, Vol. 67, 1998, 421, 422.

II.B. Critics of the baseline system

II.B.1. Economic arguments

There are three main economic arguments against the use of the current services baseline: (1) inflation and other economic performance-based variables largely lead to incorrect predictions about the future; (2) automatically adjusting the previous fiscal year's budget within the baseline to match inflationary and demographic changes creates an incentive to spend more than lawmakers otherwise would; and (3) the current law approach to baseline estimates inaccurately over or under-estimates the realities of expected policy upon the budget.

First: “[C]hanges in budget projections caused by alterations in economic forecasts and technical assumptions generally far exceed adjustments caused by changes in fiscal policy.”⁵⁹ This is not necessarily a reflection of intentional “missed guesses” for the benefit of lawmakers, but rather emerges initially because economics is not an exact science. The technicians who help compile inferential statistics while preparing a reasonable baseline estimate are “notoriously unreliable at predicting things like the next wave of technological change, the weather, and earth-quakes, all of which can have significant economic and budget implications.”⁶⁰ Rudolph Penner notes that, if the CBO's estimates for current services baselines continues its trend of statistical error, the real dollar alterations made to the current five-year budget forecasts far outweigh any possible policy changes, including the tax cuts President Bush intends to make permanent.⁶¹ Even without the level of gaming that can loom over the process when lawmakers *choose* more favorable estimates of future interest rates, GDP growth, and

⁵⁹ Penner, *supra* note 15, at 1.

⁶⁰ *Id.*, 2.

⁶¹ *Id.*, 4.

inflation, the sheer imprecision of economic variables used to properly “update” the previous fiscal year’s baseline under the current services approach lends weight to the argument that the baseline should begin with the previous budget’s (or previous budgets’) numbers and those numbers alone.⁶²

Second: Several interesting Ordinary Least Squares (OLS) regression analysis studies in the past decade have suggested a secondary effect of using a current services baseline, namely, that there is a slight increase in government spending than would otherwise occur if the baseline solely reflected the previous fiscal year’s budget.⁶³ Crane and Crane use data from state budgetary rules to advance the argument that legislators exhibit loss aversion when voting on budgetary proposals, and as such, spending levels on programs under a current services baseline are more secure than spending levels on programs that use the previous year’s budget as a baseline.⁶⁴ As their empirical evidence suggests, “The present value of programs enacted under a current services regime is...higher than under” a system that uses the previous fiscal year’s spending as a starting point. “This increase in the present value in turn raises the expected return on lobbying resources by pressure groups to secure government programs and thereby fuels an expansion in public sector spending.”⁶⁵

⁶² “The process would be simple, transparent, and immune from political influence and the biases of technical analysts.” Penner, “Forecasting Budget Totals: Why Can’t We Get It Right?,” *The Federal Budget: Economics and Politics*, 1982, 89-110.

⁶³ See, for example, Tversky and Kahneman, “Rational choice and the framing of decisions,” *Journal of Business*, Vol. 59, 1986, 251-284; also see Schelling, “Economic reasoning and the ethics of policy,” *Public Interest*, Vol. 63, 1981, 37-61.

⁶⁴ Currently, 34 states use last year’s spending level as a baseline, while 16 states use a current services baseline similar to the one used by the federal government.

⁶⁵ Their methodological explanation begins with a simple example: Suppose State A is identical to State B in all relevant respects, except State A practices current services budgeting and State B uses last year’s spending as a baseline. Spending on education in the current fiscal period is \$4 billion, and the amount required to maintain the current level of service in the next period is \$4.4 billion. (For example, inflation and population are expected to grow by a combined ten percent.) State A’s budget proposal for education requests increases or decreases from the current services level of \$4.4 billion; State B requests increases or

Third: In many instances, the budget rules distort the reality of expected policy outcomes. Sunset provisions, understated baselines for discretionary spending, and the back loading of program costs into later post-horizon years all allow the president and Congress to “hide” less appealing budget realities. As one pundit has explained recently, “CBO’s projections don’t look that bad under the artificial assumption that tax cuts expire on their sunset dates, health care payments are not fixed, and legislators suddenly downshift the pace of their appropriations.”⁶⁶ The Center on Budget and Policy Priorities’ memo of January 24, 2004 takes to task the CBO’s baseline rule covering annual discretionary appropriations tied to inflation: because the CBO issued January projections based upon fiscal year 2005 appropriations but before Congress had enacted any 2005 supplemental funding for activities in Iraq and Afghanistan, the previous September’s ten-year projection taking into account 2004 defense appropriations and inflation seems to have entirely disappeared—an effect that “reduced” the budget by about \$1.4 trillion.⁶⁷

II.B.2. Political arguments

Self-described “deficit hawks” routinely challenge the way the current services baseline allows lawmakers to increase spending while simultaneously calling this a spending “cut.” A proposal that has come to the Congressional floor four times since 1995 would require beginning with a baseline that starts with last year’s spending, rather

decreases from the last year’s budget, \$4 billion. Suppose the proposed allocation for education in each state is \$4.2 billion. With respect to their reference points, State A proposes a \$200 million cut in spending and State B proposes a \$200 million spending increase. In dollar terms both of the proposals above are equivalent. Yet the loss aversion hypothesis and experimental evidence suggest that by shifting the reference point, the utility value of a \$200 million loss exceeds the utility value of a \$200 million gain. In other words, a loss of less than \$200 million would be the value-equivalent of the \$200 million gain.

⁶⁶ Centrists.org, *supra* note 7.

⁶⁷ Kogan, Center on Budget and Policy Priorities, “Apparent Improvement in CBO’s January Budget Projections is Largely Artificial,” January 24, 2004.

than one that first adjusts for inflation and other factors.⁶⁸ Representatives Stenholm (D-TX), Penny (D-MN) and Kaisch (R-OH) introduced H.R. 4434, entitled the “Common Cents Budget Reform Act,” to reverse what they termed “the bias toward higher spending in the existing budget process.” Although the measure died in committee, the House Republican majority in the 104th and 105th Congresses embraced the effort to eliminate the practice of current services budgeting.

II.C. Reform proposals and options

II.C.1. No-BS baselines

As was discussed above in Part I, the CBO and OMB are not alone in providing baseline estimates. Many think tanks have taken up the considerations discussed in this briefing paper to provide what they consider more realistic and reliable baseline formulations. One detailed by Centrists.Org is particularly revealing. Labeled the “No-BS baseline,” the think tank attempts to account for many of the lopsided effects often propagated by current budgetary rules. In general, the No-BS baseline assumes that most “sunset” provisions in the tax code are extended and that discretionary spending grows faster than the rate of inflation. This revised baseline is updated periodically to reflect probabilistic changes in policy based upon current political support. Although such a method by the CBO might put the cart before the horse of legislation, the No-BS budget baseline does eliminate many of the gaming loopholes that exist solely because of

⁶⁸ See, for example, Hager, “House Deficit Hawks Propose Changes in Budget Process,” *Congressional Quarterly Weekly Report*, 00105910, 5/21/94, Vol. 52, Issue 20; Hager, “House OKs Procedural Change to Spending Comparisons,” *Congressional Quarterly Weekly Report*, 00105910, 8/13/94, Vol. 52, Issue 32; and Forbes Jr., “Truth in Budgeting,” *Forbes*, 12/19/94, Vol. 154, Issue 14.

strategically-timed budget legislation or conscious back loading of budget costs just beyond budgetary horizons.⁶⁹

II.C.2. Dynamic estimation

Another proposal that Congress has considered several times within the last ten years is the adoption of a “dynamic” baseline estimation, which would include the predicted macroeconomic effects of changes in revenue collection or expenditures.⁷⁰ This is a heavily debated baseline method, especially since the current services (or current law) baseline already provokes such heated microeconomic debate on the near-future effects of economic variables with predictive importance. Proponents argue that omitting the macroeconomic “feedback effects” (for instance, of a tax cut spurring economic growth) skews “supply-side” or “growth-oriented” legislation by “counting only the tax revenues lost from such incentives” and not “the salutary effect that they would have on...economic growth and in this way increasing tax revenues.”⁷¹ The hearings have not produced any concrete change, but they do signal that lawmakers are sharply aware of how baseline estimations can further policy agenda or constrain legislative initiatives.

II.C.3. The President’s proposals

The president has proposed several changes to Section 257 of the Budget Enforcement Act as part of his 2006 budget.⁷² Among these, the most notable are as follows:

⁶⁹ For a complete analysis of this method of baseline estimation, see *Centrists.org*, *supra* note 7.

⁷⁰ The first time such a proposal was suggested occurred on January 10, 1995, when the Republican-led budget committees of the Senate and House held a joint meeting to evaluate the ways in which governmental agencies estimate expected tax revenues.

⁷¹ Auerbach, “Dynamic Revenue Estimation,” *Journal of Economic Perspectives*, Vol. 10, No. 1, 141, 145.

⁷² See OMB, *Analytical Perspectives, Budget of the United States Government, FY 2006*, Chs. 15 and 25, 240, 389-392.

- (1) Assuming an extension of all expiring tax provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 and certain provisions in the Jobs and Growth Tax Relief Reconciliation Act of 2003.

What this effectively does is shift the Administration's tax proposals directly into the baseline without having to compute for lost revenue stemming from the 2001 and 2003 tax cuts. The president argues that this proposal is consistent with the Budget Enforcement Act baseline rules for expiring mandatory spending and for excise taxes dedicated to a trust fund. Critics of this proposal highlight that the president's previous budgets had already benefited from sunset provisions that kept future lost revenue from being computed as part of the baseline.⁷³ As one pundit has commented, "This proposal is significant: it would exempt legislation to extend the tax cuts, or make them permanent, from any Congressional budget enforcement."⁷⁴

- (2) Adding a provision to exclude discretionary funding for emergencies from the baseline.

This proposal comes particularly in response to the enormous emergency relief provided to the victims during the last hurricane season. Current budgetary rules require that such appropriated funds from the previous fiscal year be adjusted for inflation and added to the current services (current law) baseline. The Administration views this as an indirect way of padding the baseline in favor of higher discretionary spending.

⁷³ When CBO and OMB are asked to provide estimates of the cost of legislation to extend the tax cuts or make them permanent, they would be required to produce estimates showing the cost to be zero. Greenstein, *et al.*, Center on Budget and Policy Priorities, "Assessing President Bush's New Budget Proposal," February 7, 2005.

⁷⁴ *Id.*, "Budgetary Hide and Seek." But compare Hagstrom, "Ag Panel Wants Emergency Farm Aid in Budget Baseline," *CongressDaily*, 03/15/2001.

- (3) Altering the way pay raise-related costs are related within the budgetary baseline.

Because current law provides for pay raises to take effect on the first day of the new calendar year and not the first day of the new fiscal year, the Administration contends that three months of added costs are inappropriately, but automatically, added to the current services baseline. In effect, the president argues that this inconsistency serves no purpose except to artificially increase the expenditures Congress is authorized to appropriate.

- (4) Eliminating the adjustments for expiring housing contracts and social insurance administrative expenses.

The Administration argues that these are unnecessary cushions to the real dollar growth of the current services baseline, provisions that preferentially call for higher adjustments than similarly situated programs are afforded.

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