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Creating a Consistent, Commonsense Benchmark Through a Current Policy Baseline

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Each January, the Congressional Budget Office (CBO) completes a projection of a budget baseline. This figure gives lawmakers an estimate of spending and revenue levels over the next ten years, and is used as a benchmark against which to compare policy changes being considered in Congress. But as Congress moves forward with the first comprehensive reform of the tax code in over thirty years, there are legitimate concerns that the way CBO develops its baseline presents an inaccurate portrayal of federal receipts and expenditures.

CBO's baseline is nominally constructed on current law. It generally assumes that spending programs will continue to grow with inflation. On the other hand, it assumes that taxes will follow exactly what is enacted in law, no more and no less, including scheduled expirations and phase-outs of key provisions. But Congress, of course, routinely extends policies otherwise scheduled to expire, rendering a "current law baseline" misleading from the moment it is produced. This stands in contrast to a "current policy baseline," which takes into account the most likely course of expenditures and taxes in an attempt to more accurately predict fiscal impacts.

Which baseline Congress uses can have tremendous impact in a debate as consequential as fundamental tax reform. While no estimate can be perfect, a reformed baseline that is based on current policy would provide a more rational - and honest - benchmark for policymakers.

Current law baseline assumes too much revenue

By blindly reflecting what is written in law rather than what is likely to happen, CBO is required to produce a current law baseline provides Congress with an inaccurate view of the future. Perhaps the most notable example can be found in CBO's treatment of so-called "tax extenders." Congress routinely provides short-term extensions of these tax relief provisions, but those extensions don't appear in a current law baseline. This means that CBO's ten-year projection assumes higher revenue than what is actually brought in as a result of enacted policy.

Over the past few years, several previous extenders were finally made permanent to address this problem and protect taxpayers. For example, in 2013, a deal was struck to permanently index the exemption for the dreaded Alternative Minimum Tax (AMT), putting an end to repeated passage of AMT patches to shield households from becoming subject to the double-filing system. In 2015, the Protecting Americans from Tax Hikes (PATH) Act made permanent several previously temporary tax provisions, including the tax credit for research and experimentation which provided tax relief of $113.2 billion over

10 years. The credit had been established as a temporary measure in 1981 and was extended over a dozen times and modified six times until the PATH Act.

With regard to today's tax reform debate, there are many tax extenders remaining that will cause the revenues in the current law baseline to be higher than they would be under a baseline that reflects the actual policy Congress is likely to enact. A January report from the Joint Committee on Taxation included a list of 36 federal tax provisions set to expire at the end of 2016 (many of which were subsequently extended) and another 22 by 2026.

One example, bonus depreciation for business expenses, was originally established in the Job Creation and Worker Assistance Act of 2002, and subsequently extended eight times. The PATH Act extension gradually phased the bonus down to 30 percent in 2019, after which it is again scheduled to expire. Relative to CBO's current law baseline, reinstating and extending 50 percent bonus depreciation for ten years would reduce revenues by $247 billion, while a straight extension of 30 percent bonus depreciation would drop them by $152 billion over ten years. These revenue impacts are nowhere to be found in a current law baseline, despite the overwhelming likelihood that complicated depreciation schedules are unlikely to return.

Another example, the New Markets Tax Credit was temporarily established in 2000 to provide incentives for capital investments in low-income communities. The PATH Act extended the program through 2019 with a cap of $3.5 billion per year. Other remaining extenders with a long lineage include various energy credits, Airport and Airway Trust Fund excise taxes, and the Oil Spill Liability Trust Fund.

Current law baseline is inconsistent in its treatment of spending

If a current law baseline was simply a 100 percent accurate depiction of the budgetary path under existing laws, it would be an understandable and worthwhile tool even with its obvious flaws. The truth, however, is that CBO's current law baseline makes several deviations from the path dictated by the letter of the law, primarily as it relates to spending, thus muddling its utility.

Perhaps most notably, the current law baseline constructed by CBO is inconsistent in its treatment of spending and revenues. Unlike the tax extenders, discretionary spending programs whose authorizations periodically expire are assumed in the current law baseline to continue and to grow with inflation.

Likewise, entitlement spending is generally assumed to continue to provide for full benefit payments to recipients, even beyond the level of funding available in the dedicated trust funds. As the Hoover Institute's Charles Blahous explains, "CBO is instructed to assume that Social Security and Medicare will make full benefit and insurance payments far beyond the amounts the programs are permitted by law to spend from their limited trust fund resources."

The same is true with regard to war funding, or so-called "overseas contingency operations" (OCO). CBO is instructed to assume that current OCO funding levels will continue and rise along with inflation. This practice persists even though war-related spending commitments are likely to decrease in the near future. The effect is to inflate the long-term discretionary spending outlook and to create a gimmick used by some Members to skirt caps on baseline defense funding, allowing Congress to assume implausibly high levels of OCO outlays.

The OCO account was originally intended to separate war funding from the regular defense budget. But because OCO is exempt from budget caps and sequestration, it has turned into a convenient slush fund to sidestep spending limits. Last fall, the Department of Defense acknowledged that nearly half of its OCO budget is used to pad its base budget rather than for war-related costs. The gimmick extends beyond the defense budget: foreign policy funding has declined in the base and increased significantly through OCO appropriations.

Oftentimes lawmakers game this system when drafting legislation, by front-loading savings and backloading higher costs, or even including savings that never materialize. The tortuous process through which the Affordable Care Act was ultimately passed provides some egregious examples of this game, including the Independent Payment Advisory Board and the CLASS Act to project savings under the law but which have not emerged as actual policy.

Building a better baseline

Congress should have the most realistic revenue and spending projections at hand. This is especially important as progress proceeds on fixing our broken tax system. But the current law baseline against which tax reform is now measured includes phantom revenues. The House Republicans' "A Better Way" blueprint on tax reform rightly argues:

> … [T]he current law baseline is not the proper standard for determining whether tax reform is revenue neutral. Because an assumption that Congress, in fact, will continue to extend current policy more closely resembles historical experience, House Republicans measure revenue neutrality by reference to a "current policy baseline"– i.e., achieving a level of Federal revenues that is approximately $400 billion less over the ten-year window than the current law baseline.

A current policy baseline would provide a more accurate projection of future budgetary inflows and outflows, and a more rational benchmark against which to analyze proposals. Establishing a consistent budget baseline is not, as some have argued, a way to "hide" tax cuts. Rather, it provides honest numbers based on practice and policy.

CBO's projections with the current law baseline almost always underestimate the actual level of federal debt that actually occurs. A current policy baseline would reflect lower revenues, and as the Committee for Responsible Federal Budget has pointed out in the past, current law projections for discretionary spending are "probably unrealistically low." A better baseline will provide a better benchmark and provide a basis for necessary reforms.