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**The Economics and Politics
of Long-Term Budget Projections**

Budget projections can provide a valuable look at what the world will look like if current laws remain in place, but they cannot tell us how or when to act in the face of projected imbalances, argues Henry Aaron, the Bruce and Virginia MacLaury Chair and Senior Fellow in Economic Studies at The Brookings Institution.

Aaron notes that budget projections are only as useful as they are objective. All projections are based on assumptions around some set of variables and are vulnerable to error, or the variability in factors that can be expressed as a probability distribution, as well as uncertainty stemming from advances in medical technology, natural disasters, wars, and other unforeseeable circumstances. Because error and uncertainty grow as the projection horizon is lengthened, Aaron suggests that in some cases, lengthening the window is not useful and can degrade decision making.

Aaron reviews the utility of four sets of projections: long-term budget projections by the Congressional Budget Office, 75-year projections for Social Security, 75-year projections for Medicare, and generational accounts. The CBO regularly releases 75-year budgetary projections, but has recently shifted attention towards the first 25 years, a welcome change, as the later years are based on unrealistic assumptions. In contrast, the 75-year Social Security projections are very useful, as the variables that the projections are based upon can be reliably predicted. Because Medicare costs depend heavily on advancements in medical technology, which is subject to vast uncertainty, a 75-year projection window makes little sense, and focus should be shifted to the initial 25-year period. Infinite horizon generational account projections provide little new information after the 75th year, as the underlying variables are simply frozen at their 75th year value and then extrapolated.

Aaron concludes by arguing that whether and when action should be taken based on a projection depends not just on the uncertainty surrounding a projection, but also on the political options available at a particular time. Recommending action now rather than later assumes that the sum of the expected values from action is higher today than they would be in the future, which is not necessarily the case. Taking action now can raise the cost of, or even preclude, future action. If political constraints only allow for less-than-optimal policy action, it may be beneficial to wait for political or economic conditions to change.

CBO's long-term budget projections depend heavily on underlying assumptions				
<i>Projected debt (+) or surplus (-) as percent of GDP; 2005 projections</i>				
Revenue assumption	Spending assumption	2010	2030	2050
Low	High	43.5	137.9	449.4
Low	Intermediate	42.1	96.9	256
Low	Low	40.9	38.6	34.3
High	High	43.1	91.2	286.4
High	Intermediate	41.7	50.3	95.9
High	Low	40.5	-9.7	-123.7

Source: Congressional Budget Office