

Are Estimates for Years to Come Merely Science Fiction?

C. Eugene Steuerle

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It wasn't that long ago that tax and expenditure estimates were made only for the next year's budget. Spurred especially by budgetary fights since the mid-1970s, three-, five-, and 10-year estimates eventually came to be adopted either by law, procedure, or convention. Meanwhile, attempts to project the status of the social security trust funds go out for 75 years while Medicare estimates have been expanded from 25 to 75 years.

The arguments against these longer-term projections are many. How can we predict decades into the future? Could anyone in 1930 have predicted the world of today, or even that of 1940 or 1950? At some point do estimates merely represent science fiction? Moreover, it doesn't appear that policymaking has become much better due to longer budget projections. Some would argue it's worse, although a quick review of history quickly dispels the notion that there was ever some golden era of public-interest policymaking.

Although the objections of those who protest longer-term budget estimating may be perfectly valid at one level, they seldom place today's budgetary dilemma into context. Never before in our history have the statutes tried to pre-ordain so much of the future. If our elected officials are going to try to order the direction of spending over the next several decades—indeed, the next few centuries if we study the statutes closely—then budget systems are going to be compelled to try to account, however crudely, for those actions.

It is a well-known statistical fact that projection error, or the probability of being in error by a given percentage of the projection, normally increases over time. For example, if one is trying to project national income for next year, there is a very high probability that the error would be less than 2 or 3 percent of the projected amount. Barring a severe depression, the error would almost never exceed 10 percent. On the other hand, if one projects out 10 years, there is a very high probability that the error will be in excess of 5 or 10 percent. Carried out 75 years, the estimator is likely to understate income by one-half or overstate it by 100 percent.

Therefore, if the protest is against relying too much on any set of forecasts as predictions of the future, then it is well-founded. However, if it is against making the projections or using them as guides for policymaking, then the case is weak or nonexistent.

Occasionally, long-term projections have been useful in forcing Congress to adopt needed reform. It has long been a tradition to provide estimates on the status of social security that stretch many years into the future. In one sense, the actuaries of social security are only doing what actuaries in the private sector do when they try to count up all the liabilities of their clients. We wouldn't dream of telling private pension actuaries that they should project costs only a few years into the future, so why would it be different for the public sector? Indeed, some private actuaries complain that the government does not go far enough when it takes into account only 75 years of social security projections.

Although we do not know the future perfectly, some things are more well-known than others. When it comes to demographics, for instance, we know with a fair degree of certainty the number of people born in the past. By aging them over time and taking into account mortality rates that change only gradually, we have a fairly accurate picture of the number of 75 year-olds there will be for each of the next 75 years. New births aren't going to change that calculation. Nor are new births going to have much impact on the size of the labor force for at least 20 years, and it will take 30 or more years before persons born after today make up any substantial portion of the labor force.

When one looks at long-term projections of social security and Medicare, a substantial chunk of the projected actuarial deficits derive from these very predictable demographic trends. Sensitivity analysis, moreover, indicates that different economic assumptions usually don't have a substantial impact on those deficits.

Crudely speaking, these programs are scheduled to grow faster when the economy grows faster, and slower when the economy grows slower. Although there are some lags, this close relationship between economic and program growth makes taxes and expenditures grow more or less in line and, hence, the difference between the two is not affected so much by changes in economic growth.

One reason why we have come to expect long-term projections for social security and Medicare, however, is not because of what we know about demographics, but simply because the programs make promises way into the future. This logic can be applied to the budget as a whole. The demand for longer-term projections can be seen simply as a response to the longer-term commitments made by elected officials.

Forty years ago, the federal budget was largely discretionary. Each year's budget actions had a substantial effect on what could be done and not done. Certainly, some obligations were multi-year in nature. A battleship, for instance, might take years to complete. The built-in tendency to provide new military equipment at the same pace year after year led in part to President Eisenhower's protest against the military-industrial complex. But, as we can see with hindsight, military spending had a built-in control mechanism in the annual appropriations process, and it has declined since the end of the Korean War from about 14 percent of the gross domestic product to about 3 percent today.

Entitlement spending, on the other hand, is not required to go through an appropriations process. Most of it is never reviewed from year to year. Neither are most of the tax breaks and expenditures that are put into the tax code. They are expected to remain forever as part of the federal tax and expenditure system. But more important than the supposed permanency of these various entitlement provisions is the built-in growth that many have acquired. For a variety of reasons, such as failure to account for life expectancy, programs such as social security and Medicare have been scheduled essentially to grow forever faster than the economy. Regardless of its unfeasibility as an economic matter, it does reflect the promises of current law.

If one wants to reduce reliance on long-term and highly uncertain projections, therefore, one must simultaneously reduce the extent to which these past commitments absorb future revenues. With more discretionary policy, long-term estimates would be less necessary and less influential on the policy process. Entitlement government of the type we have now dodges periodic review of programs, bypasses the appropriations process, and attempts to deny to current voters and their representatives the power to spend the taxes they pay in the way they best see fit.

Long-term projections will always be required to try to get some handle on the nature of long-term obligations that have been made. What deserves criticism is not the accuracy of the projections as much as the hubris of those who have made so many extraordinary promises for the future. Until government is restored to the discretion of voters in each age, long-term estimates will serve less as predictors of the future than observations on the extent to which policymakers have tried to foreordain the future.

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