COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

Memo to: Board and Members
From: Carol Wait
Date: January 23, 2002

SUBJECT: New Numbers from the Congressional Budget Office Preview of the President's Budget and other Issues

THE PARTY IS OVER

In 1997 President Clinton and Congress struggled mightily to reach agreement on a deal to balance the budget by 2002. By January 1998 the Congressional Budget Office (CBO) was projecting a very small deficit for FY 1998. In August of that year CBO projected the first surplus in 30 years. Between August 1998 and summer 2001 surplus projections grew, and grew and grew. Congresses, Presidents and voters were sorely tempted to believe that we could have it all—

- Tax cuts;
- Expanded health care benefits for children from low-income families, and prescription drug coverage for the elderly;
- Increased spending for virtually every Department and Agency and every function in the budget; and
- Balanced budgets—even without counting Social Security surpluses.

Between August 1998 and January 2002 CBO estimates show legislative actions that increased outlays by about $1.3 trillion and cut taxes by about $1.4 trillion (FY 1998—FY 2011). CBO estimates of debt service costs increased by a total of $776 billion over the same period.

Why choose that time period? Because it represents policy changes enacted during the halcyon days when it seemed we could increase spending and cut taxes, and the "new economy" would somehow bail us out. Somehow we could pay the bills without even dipping into Social Security Trust Fund surpluses. (See table at attachment 1.) This illustrates the very real difficulty of maintaining any kind of fiscal discipline against a backdrop of budget surpluses.

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It's the Economy

As CBO director Dan Crippen pointed out in his testimony last week, about 60 percent of the decline in surplus projections over the last year is due to changes in economic assumptions and technical re-estimates.

You must go back to the 1981-1982 period to find a similar alignment of large, concurrent changes in the economy and fiscal policy. If you compare that period to FY 2002 you find a remarkable similarity between the relative contributions of policy change and economics and technicals to the differences between budget projections and budget outcomes.

In 1981 the budget was in structural deficit going into the recession. Policy change (largely tax cuts and defense increases) widened the deficit. Last year the budget was in structural surplus going into the recession. CBO projects a return to surplus—given no further changes in laws or policy—in FY 2004. Surpluses will be smaller due to policy change (primarily tax cuts) they are still more than 2 trillion over ten years.

The President's Budget will propose substantial further spending increases and tax cuts. As a result, the President's Budget likely will project a deficit in excess of $100 billion for FY 2003 (compared to the CBO projection of a $14 billion deficit that year.) Recent news stories also suggest that the Administration will not project a return to budget surpluses until sometime after FY 2005.

Of course, the budget outlook could get much better or worse depending whether and how soon the economy actually begins to grow—and how robust that growth is once it begins. But Federal Reserve Chairman Alan Greenspan suggested in testimony before Congress last week that he thinks the recovery is imminent. Dr. Greenspan changed his prescription for fiscal policy. He said that stimulus legislation might not be such a good thing after all—and more focus on balancing the budget and retiring debt held by the public may be in order

The new CBO Outlook shows the budget in deficit until FY 2004. It does not predict a return to triple-digit surpluses until FY 2005. It does not anticipate budget balance excluding Social Security until FY 2010. And this CBO outlook is based on current policy. The President's Budget could prove to be the low-watermark for post-policy deficits and the most optimistic projection of budget outcomes. Congress very well might accept the President's proposed hikes for defense and related expenditure and demand domestic spending substantially higher than the President proposes. Even if Congress rejects the Administration's stimulus proposals, some of the tax extenders for business may be enacted in another form. The table on the next page illustrates the CBO analysis of changes in surplus projections since last January. The table at the top of page 4 contains the CBO budget projections for FY 2003 and beyond.
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Changes in CBO's Baseline Projections of the Surplus Since January 2001 (fiscal years, $ in billions)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2006	Total, 2002-2011
Total Surplus as Projected in January 2001	313	359	397	433	505	573	635	710	796	889	2,007	5,610
Changes to Revenue Projections												
Legislative												
Tax[a]	-38	-91	-108	-107	-135	-152	-160	-168	-187	-130	-479	-1,275
Discretionary Spending	-44	-49	-52	-54	-56	-57	-58	-59	-60	-61	-255	-550
Other	-4	-6	-5	-3	-4	-2	-2	-2	-2	-2	-23	-33
Debt Service[b]	-5	-12	-22	-32	-44	-57	-72	-88	-106	-124	-114	-562
Subtotal	-91	-158	-186	-197	-238	-268	-293	-317	-355	-317	-870	-2,420
Economic	-148	-131	-95	-81	-75	-75	-76	-79	-82	-88	-530	-929
Technicals[c]	-94	-84	-62	-51	-64	-64	-65	-64	-65	-45	-356	-660
	0	0	0	0	0	0	0	0	0	0	0	0
Total Changes	-333	-373	-343	-330	-377	-406	-433	-460	-502	-450	-1,757	-4,008
Total Surplus or Deficit (-) as Projected in January 2002	-21	-14	54	103	128	166	202	250	294	439	250	1,602
Memorandum												
Changes in Surplus by Type Of Discretionary Spending												
Defense	-33	-29	-29	-29	-29	-29	-30	-30	-31	-32	-149	-301
Nondefense	-11	-20	-23	-25	-26	-28	-28	-29	-29	-30	-106	-249

Source: Congressional Budget Office , Testimony January 23, 2002, Table 1

Note: for purposes of comparison, this table shows projections for 2002 through 2001 because that was the period covered by the CBO's January 2001 baseline. The current projection period extends from 2003 through 2012.

[a] The Economic Growth and Tax Relief Reconciliation Act of 2001, which was estimated at the tie of enactment to reduce revenues by $1,186 billion and increase outlays by $88 billion between 2002 and 2011.

[b] Reflects only the change in debt-service costs that results from legislative actions. Other effects on debt-service costs are included under economic and technical changes.

[c] Technical changes are revisions that are not attributable to new legislation or to changes in the components of CBO's economic forecast.

Congressional Budget Office Budget Outlook under Current Policies
(fiscal years--$ in billions)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total 2003-07	Total 2003-12
On-Budget Surplus/Deficit (-)	-33	-181	-193	-141	-108	-99	-76	-56	-23	4	131	319	-617	-242
Off Budget Surplus[a]	161	160	178	195	212	227	242	258	274	290	307	322	1,054	2,505
Total Surplus/Deficit (-)	127	-21	-14	54	103	128	166	202	250	294	439	641	437	2,263
Debt held by the Public (Ed of Year-$ in trillions)	3.3	3.4	3.4	3.4	3.3	3.2	3.0	2.8	2.6	2.3	1.9	1.3	n	na
Memorandum														
Total Surplus/Deficit (-) as a percent of GDP	1.3	-0.2	-0.1	0.5	0.8	1.0	1.2	1.4	1.7	1.9	2.7	3.7	0.7	1.6
Debt held by the public (End of Year) as a percent of GDP	32.7	32.8	31.3	29.2	27.0	24.8	22.5	20.0	17.5	14.8	11.5	7.4	na	na

SOURCE: Congressional Budget Office Testimony—January 23, 2002—Table 2

NOTE: na=not applicable

[a] Off-budget surpluses comprise surpluses in the Social Security trust funds and the net cash flow of the Postal Service

These projections assume—

- No stimulus legislation;
- None of the President's proposals to increase funding for defense and homeland security;
- No money for prescription drug coverage for seniors, nor the farm bill, nor for education nor any other high priority programs and priorities;
- No tax cuts. And that includes the so-called "extenders" for business" and continuation of popular provisions in last year's tax bill that expire during the forecast period under current law, e.g., amelioration of the impact of the alternative minimum tax for individuals.

In other words, this outlook understates very substantially the difficulty that Congress and the President will face as they seek to meet multiple and pressing needs and also balance the budget.

In the late 1970's President Carter made a commitment to our NATO allies that the U.S. would increase defense spending 3% per year in real terms. There was broad consensus in Congress (on both sides of the aisle and on both sides of the Hill) that defense increases should be offset by domestic reductions. They had the benefit of cutting from economic stimulus spending. For example, much the largest single reduction was in CETA public service jobs.

Today the nation is at war, but there is no similar consensus to fund wartime defense and related spending from domestic cuts (not for that matter from tax increases).

The budget is in structural surplus. That means we almost certainly will return to substantial surpluses sometime in the forecast period.. The question is: will it matter to policymakers when we return to surplus or how large future surpluses may be. Total surplus projections of more than two trillion dollars over the next decade are not likely to impose rigid discipline on budgetary decisions.

Budget Process concerns.

The baseline projections do not distinguish between on-going commitments to ongoing government programs and services and what surely should be one-time expenditures to replace arms used in Afghanistan, repair the Pentagon, assist victims of 9/11, etc. The effect is to understate the cost of continuing current tax laws (because some popular provisions expire and are not included in the base for the entire ten years) and to overstate current policy spending, so that simply keeping programs constant would look like a cut. CBO is not perverse. This is the way the law requires them to construct the baseline. But it surely will confuse the budget debate and make matters much more difficult than they need to be.

Virtually all existing rules that govern budget enforcement are due to expire this year. We agree with Alan Greenspan: Congress should adopt a regimen that forces trade-offs between specific priorities and aggregate fiscal policy objectives. And policymakers must do something to sort out this baseline confusion.

Exercise in Hard Choices^{sm}

We continue to work toward a real-time, on-line, interactive version of the ***Exercise***. This year we are working with the University of Akron and our next live ***Exercise*** will be on their campus on February 20th. If you want to attend, please contact us for registration and meeting materials.

We are working hard to update the ***Exercise*** to reflect the changed budget debate just as soon as we can. We will have a CD-ROM version available soon after we complete that revision.

Reductions in Projected Surpluses due to Policy Change--1998-2002

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	**Totals 1998-2001**
CBO 08/01/1998															
Program Outlays	1	3	4	4	4	3	2	1	1	a	1				
Revenues				1	1	1	1								
Interest															
CBO 01/01/1999															
Program Outlays		17	7	2	2	2	1	1	1	1	1				
Revenues					1		1	1	1						
Interest			1	1	1	2	2	2	2	2	2				
CBO 07/01/1999															
Program Outlays		4	7	3	2	2	2	2	2	2	2	2			
Revenues				1	1	1	1	1	1	2	2	2			
Interest															
CBO 01/01/2000															
Program Outlays			32	7	6	6	6	2	2	3	2	2			
Revenues				6	8	2	2	1	1						
Interest			1	2	3	4	4	5	5	6	6	7			
CBO 07/01/2000															
Program Outlays			10	6	6	5	5	4	3	3	2	2	1		
Revenues															
Interest				1	1	2	2	2	3	3	3	4	4		
CBO 01/01/2001															
Program Outlays				12	38	44	41	45	46	49	50	52	54		
Revenues				2	2	3	3	3	4	4	5	6	5		
Interest					2	4	7	10	13	17	21	25	30		
CBO 08/01/2001															
Program Outlays				11	17	15	15	18	18	18	18	21	21	21	
Revenues				70	31	84	101	100	126	142	151	158	176	117	
Interest					4	9	16	23	31	41	53	65	79	92	
CBO 01/01/2002															
Program Outlays					38	45	47	47	49	50	50	51	51	53	
Revenues						2	2	3	3	2	2	2	2	2	
Interest					1	3	6	9	12	16	20	23	28	32	
Totals															
Program Outlays	1	24	60	45	113	122	119	120	122	126	126	130	127	74	**1309**
Revenues				80	44	93	111	109	136	150	160	166	183	119	**1351**
Interest			2	3	12	24	37	51	66	85	105	126	141	124	**776**

Source: CBO Economic and Budget Updates corresponding with dates above