INFORMED BUDGETEER:

@ End of 106th Congress Countdown @

Calendar Days to Sine Die: October 6

(From September 11)

Total Days	27
Less:	
Scheduled Non-Leg. Periods (0 days)	27
Fridays & Mondays before/after Non-Leg. Periods (0)	27
Remaining Saturdays & Sundays (8)	19
Mondays & Fridays in Leg. Periods (8) ; =	11

MALTHUSIAN BUDGET WARNINGS

- There has been a growing chorus of voices warning that current surplus projections are rosy and will not materialize due to unrealistic outlay assumptions. President Clinton joined the foray, stating: "And, by the way, the $2 trillion surplus is just an estimate, anyway. And anybody who knows anything abut the federal budget will tell you that there are just three or four technical reasons it is grossly overestimated." Well, the *Bulletin* knows something about budget matters, and we beg to differ.

- These critiques have a Malthusian element to them. Malthus famously predicted massive food shortages because world population would grow sharply and outstrip growth in food production, but he failed to take into account advances in technology which would lead to surging farm output.

- In a similar vein, recent authors have fixated on the fact that spending may come in above CBO and OMB's 10 year projections, while they have ignored the possibility that revenues may continue to greatly exceed official expectations.

Recent History

- Indeed, if one looks over the last five years, CBO and OMB have systematically over-estimated outlays and underestimated revenues. (Ironically, higher revenues were an important reason why outlays came in below what they had been projected to do because debt service savings resulted from higher revenues themselves).

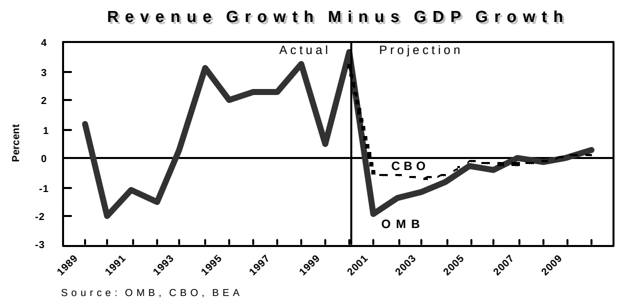
- Based on their January 1995 forecasts, both CBO and OMB underestimated cumulative FY 1995-2000 revenues by $800 billion. (Absent 1997's Taxpayer Relief Act that cut taxes, the miss would have been even greater).

- Professor Alan Auerbach of the University of California, Berkeley has found that surplus revisions are correlated over time– i.e., if surpluses were revised higher in the last update, there is a better than average chance that the next revision will also be to the upside. This suggests that estimates will likely rise again in January, 2001.

- This seems particularly likely in light of OMB's and CBO's conservative assumptions regarding: 1) the pace of revenue growth for a given GDP growth rate and 2) GDP growth rates themselves.

Revenue-GDP Growth Spread

- We begin with the revenue-GDP growth spread. For the last eight years, annual revenue growth has topped GDP growth by 2 percentage points on average. Despite this, OMB looks for current services revenue growth to lag GDP growth in every year between 2001-2008. Indeed, they expect revenues to lag by a notable 1.5 percentage points on average for each of the next three years. (CBO also believes that revenue growth will lag GDP growth from 2001-2008, although by a somewhat lesser degree than OMB).



- The last time revenue growth lagged GDP growth by 1.5 percentage points annually was during the 1990/1991 recession. **Thus, the spread component of OMB's revenue forecasts is consistent with what one might expect during a recession, even though there are no such adverse economic signs on the horizon (nor is this reflected in their economic assumptions.)**

- What might be a more realistic assumption? Over the last 40 years, revenues have grown 0.8 percentage points faster than nominal GDP growth on average. If one assumes this spread for the next ten years, CBO's and OMB's revenue forecasts would be $1.8 to $2.5 trillion higher respectively.

- However, this 0.8% historic spread has been held down by one important factor – each time the ratio of revenues to GDP approached record highs, taxes were cut. With the present Administration's opposition to tax relief, this does not look likely. Thus, it is not inconceivable that revenues could continue to grow at their current 2 % pace in excess of GDP growth.

- Such growth could continue to be driven by i) real bracket creep due to stronger productivity gains and BLS technical reductions to CPI growth; ii) higher capital gains & options realizations as households continue to lock in recent gains; and iii) increasing realization of tax-deferred gains as the baby boomers approach retirement. If this were to occur, CBO and OMB's 10-year revenue projections could be $3.7 to $4.5 trillion higher respectively – in other words the current surplus estimates could be this much higher!

The Role of GDP Growth

- The above analysis merely looked at the spread of revenue growth to GDP growth – it did not look at the role of GDP growth itself. If GDP growth were to come in above OMB's and CBO's projections, surpluses would be even higher than discussed above.

- Indeed, OMB and CBO's forecasts of underlying trend growth may also be conservative. Based on public comments, it appears that the Fed believes that the US economy's potential growth rate for the next 18 months is between 4.0 - 4.5%. In contrast, CBO estimates that trend growth is 3.4% over this same period, falling to 2.9% by 2009. (We do not have enough specifics of OMB's assumptions to gauge their precise near-term assumption, however, it would appear to be similar to CBO's.)

- It is important to stress that the Fed's apparent trend assumptions can not be extrapolated over 10 years – population growth will slow over this period and somewhat slower capital stock accumulation may be seen. However, since the deceleration in trend growth is likely to be relatively smooth, it seems fair to assume that if trend growth is indeed between 4.0-4.5% today, it would exceed CBO's assumptions for a number of years even if it eases back gradually.

- For sake of example, we look at a case where trend growth is 0.5 percentage points above CBO's 10-year assumptions. This would generate an additional $700 billion in revenues and $150 billion in debt service savings. In other words, again, the surplus estimate would be $850 billion higher.

Net Revenue Effects

- The combined effect of OMB's and CBO's conservative revenue and economic assumptions should more than offset any purported "overly optimistic" assumptions on outlays in CBO's and OMB's present baselines. (Some analysts have argued that discretionary spending would be $850 billion higher including interest costs if CBO assumed that discretionary spending grows with the economy - - a policy decision not a baseline issue! We also should note that these analysts have ignored other aspects of the outlay projections which are pessimistic – ie, OMB and CBO both assume Treasury yields remain near 6% even as the supply of Treasury debt dwindles to zero in the baseline.)

- If one were to assume revenue growth in line with historical precedent and somewhat faster trend GDP growth, CBO's and OMB's 10 year surpluses could be $3.1 - 4.0 trillion higher respectively.

- Furthermore, if one were to assume that revenue growth continues its pace over the last 8 years and that trend growth were somewhat faster, CBO and OMB's 10-year surpluses could in fact be understated by $5.4 - 6.4 trillion. These are staggering figures which would easily cover a discretionary overage and/or passage of AMT relief/tax extenders that some have argued will inevitably occur.

Effect of Alternate Revenue Assumptions on CBO & OMB's 10 Year Surplus Projections
($ in trillions)

	10-yr revenue increase	Debt service savings	10-yr surplus increase
Revenue growth minus GDP growth = 0.8% *(Hist. 40 yr avg.)*	1.8-2.5	0.4-0.6	2.2-3.1
Revenue growth minus GDP growth = 2.0% *(Avg of Last 8 Yrs)*	3.7-4.5	0.8-1.0	4.5-5.5
Trend growth 0.5% faster	0.7	0.15	0.85

NOTE: First entry in cell relates to CBO baseline, second to OMB baseline.

- Lest readers misunderstand, we are not predicting that surpluses will materialize exactly as we have laid out. And in fact we can state positively that they won't. We are very familiar with the vagaries of budget forecasting. An unforeseen recession could hit that disrupts the calculations made above. Thus, it is understandable & desirable that OMB and CBO do use conservative assumptions.

- However, if analysts are going to examine the risks to OMB and CBO's spending projections, it is only fair to examine the risks to revenues as well. We believe official forecasts already assume a sharp deterioration in revenue performance. Hence, given the absence of dark clouds on the horizon, the risks to the surplus appear to be on the upside.

- If our Malthusian friends are determined to argue otherwise, they at least owe it to their readers to devote more than a line of text to the revenue side of the surplus equation and explain why they believe revenue growth will slow so markedly from its recent experience as assumed in official projections.

WHILE YOU WERE GONE PART II.... PLAN COLOMBIA RACES FORWARD

- Plan Colombia became a reality when President Clinton signed the FY2000 Supplemental Appropriations bill on July 13, 2000. The plan provides $1.3 billion to aid Colombian President Andres Pastrana in his war against narcotrafficking, but Congress required that before any funds could be disbursed, the Secretary of State was to certify in advance that Colombia had met several conditions. They were, in summary:

  - Colombian armed forces personnel who had committed human rights violations or aided paramilitary groups were to be suspended from duty and brought to justice in the civilian courts;

  - Leaders and members of paramilitary groups were to be vigorously prosecuted in civilian courts;

  - The Government of Colombia was to develop and implement a strategy to eliminate Colombia's total coca and opium poppy production by 2005; and

  - The Colombian Armed Forces was to develop and deploy in their field units a Judge Advocate General Corps to investigate armed forces personnel for misconduct.

- However, a provision was included in the legislation whereby the President could waive the certification requirements if he deemed it in the interest of national security. **While you were gone,** President Clinton did that on August 22, despite the fact that Colombian President Pastrana has met only one condition (he issued a statement warning the military that soldiers accused of human rights abuses will be tried in civilian courts).

- President Clinton justified the waiver by saying Colombia is improving on human rights and the situation is too precarious to wait. Colombia's main rebel group has responded to the U.S. aid through a series of attacks and killings, calling the plan "a threat to the peace process."

BUDGET QUIZ

- On June 6, the House passed the Death Tax Elimination Act (H.R. 8) by an overwhelming vote of 279-136. The Senate followed suit on July 14 by a vote of 59-39. The President vetoed this $105 billion ten-year tax cut on August 31, and the House failed to override the veto on September 7 by a vote of 274-157 (290 yea votes were needed to override the veto).

Question: How much death tax relief has Vice President Gore proposed?

Answer: The Gore-Lieberman economic plan says that it contains $11 billion (over ten years) of death tax relief for small businesses and family farms. But let's take a closer look. The Gore plan also accepts the Clinton-Gore 2001 budget "loophole closers," which include $9.2 billion in death tax increases. So, on net, the Gore budget proposes only $1.8 billion in death tax relief over ten years.

For more information about Vice President Gore's proposals see the SBC analysis at: www.senate.gov/~budget/Republican.

CALENDAR

September 12: GAO staff brief of debt managment strategies used by the U.S. and other selected nations with budget surpluses. The GAO briefing will focus on governments in Australia, New Zealand, Norway, Sweden and the United Kingdom. Dirksen 608, 10:00am.

September 14: SBC Hearing,"Budgeting for Defense: Maintaining Today's Forces". Witness: CBO Director Dan Crippen. Dirksen 608, 10:00 am.

@ BUDGET MILESTONE @

- On September 7, the now infamous "Debt Clock" in New York's Times Square was turned off. After 11 years of counting the national debt, a red, white and blue banner was lowered over the clock on the birthday of New York real estate developer Seymour Durst, the man who invented and bankrolled the clock. Earlier this year the clock began counting downward as the debt decreased, but Mr. Durst's son is leaving the clock in place "just in case".