

INFORMED BUDGETEER

CBO'S ECONOMIC AND BUDGET OUTLOOK, 2003-2012

- The Director of the Congressional Budget Office testified last week before both the Senate and House Budget Committees in advance of its annual report (to be released on January 31) outlining CBO's latest economic assumptions and budget projections based on all legislation enacted through the end of last month.

CBO Baseline Projections - January 2002 (\$ in Billions)				
	2001	2002	2003	2003-2012
Revenues	1,991	1,983	2,070	27,030
Outlays	1,864	2,003	2,085	24,767
Surplus/Deficit (-)	127	-21	-14	2,263

Source: CBO

- Under this latest baseline and absent any new legislation, CBO expects the federal budget to be in slight deficit for this year and next, with surpluses reemerging in 2004. Cumulative surpluses would total \$2.3 trillion over the 2003-2012 period, with almost half that surplus projected to occur in the last two years of that period.
- The "shocking" news from CBO's latest estimates is that the surplus (for 2002-2011) is \$4 trillion less than projected in last January's baseline. Several Senators whistled in amazement at what they termed CBO's "error." Even National Public Radio boggled it by reporting that CBO testified its estimate was "wrong" by \$4 trillion.
- It is **essential** that policy makers understand what most budgeteers already "get" – that CBO's baseline this year, as it was last year and in all other years, is "intended to serve as a neutral benchmark against which to measure the effects of possible changes in tax and spending policies." The baseline is a starting point against which anticipated and unanticipated events are measured. Thus, no one should rely on CBO's baseline to predict the country's precise fiscal position in the future.
- CBO's \$5.6 trillion surplus estimate from last year was not a prediction of where we'd be even a year later. In fact, critics of CBO's estimate last year endlessly observed that those estimates omitted (as baselines are designed by law to do) plenty of legislative events that Congress was almost certain to enact later, such as emergency spending, extension of expiring tax credits, a rewrite of the farm bill, and reform of the Alternative Minimum Tax, to name a few.
- Indeed, most of the \$4 trillion reduction in baseline surpluses over the past year has occurred because of things the Congress **meant to do on purpose**, whether they were anticipated (such as the tax relief bill proposed by the President, or even as proposed by Senate Democrats; see following *Bulletin* article) or unanticipated but deemed necessary (such as spending to respond to the terrorist attacks). To the extent that CBO (in good company along with Blue Chip forecasters) was "wrong" on its baseline surplus estimates, it is that CBO did not anticipate the drop in revenues from the recession that few predicted.
- Nonetheless, some of the discussants during CBO's testimony dwelled on the effect of last year's tax cut on the surplus projection. As the table below shows, for 2002, the tax relief and associated debt service accounted for 12 percent of the change in the surplus. Over ten years, tax relief accounted for 41 percent of the reduction. Increased spending and associated debt service was responsible for 15 percent of the reduction in 2002 and 19 percent over ten years.
- Economic and technical changes were responsible for 72 percent of the reestimate in 2002, and 40 percent over ten years. The economic and technical categories of changes were combined in the table below because distinguishing between them is rather difficult. CBO classifies changes in some factors that are related to the performance

of the economy as technical reestimates only because those changes are not directly driven by components of CBO's economic forecast.

Changes in CBO Baseline Projections of the Surplus Since January 2001 (\$ in Billions)				
	2002	02-11	% 2002	% 02-11
Total Surplus Projected in Jan. 2001	313	5,610	—	—
Changes ^a :				
Legislative:				
Tax Act ^b	-41	-1,657	12%	41%
Discretionary	-45	-714	14%	18%
Other	-5	-49	1%	1%
Subtotal	-91	-2,420	27%	60%
Economic and Technical ^c	-242	-1,588	72%	40%
Total	-333	-4,008	100%	100%
Total Surplus or Deficit (-) as Projected in Jan. 2002	-21	1,602	—	—
Legislative Changes due to discretionary spending:				
Defense	-34	-396	10%	10%
Nondefense	-11	-318	3%	8%

Source: CBO

Note: totals may not add due to rounding

^a These estimates include the interest effects of changes assumed.

^b CBO cost estimate for the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16). The estimate includes both a reduction in taxes and an increase in outlays.

^c Changes not directly driven by new legislation or by changes in the components of CBO's economic forecast are considered technical.

- The figures shown here include the interest impacts of the legislative, economic or technical change. CBO, in its testimony January 23, listed the interest impact of legislative changes separately. Without interest effects, the tax relief bill accounted for 32 percent of the surplus reduction over ten years, and new spending accounted for 15 percent of the surplus reduction over ten years.
 - The *Bulletin* finds it curious that some gasp at the reduction in the surplus due to enacted tax relief. Congress passed a budget resolution last year that instructed the tax writing committees, through reconciliation, to produce legislation that reduced revenues. With bipartisan support, Congress passed and the President signed the bill. The numbers reflecting the effect of tax relief this year are the same as expected last year; that tax relief (or other enacted legislation for that matter) reduced the surplus exactly as planned should come as a surprise to no one in Congress.
- ### SO WHAT WAS THE DEMOCRATIC POSITION ON TAX CUTS?
- The Chairman of the Budget Committee has of late reminded us of his alternative tax relief plan - the one that would have reduced the surplus by \$900 billion over ten years (\$750 billion of tax cuts plus \$150 billion of additional interest expense). He states that his alternative, which he calls the "Democratic Tax Alternative", would have used much less of the available surplus, and he is correct about the latter.
 - However, the Conrad alternative tax relief plan was never introduced as a free-standing plan nor offered as an amendment to the tax cut enacted last year. Instead, the real Democratic substitute tax relief plan (amendment #674) was offered by Senators Carnahan and Daschle.
 - The Democratic substitute tax relief plan was designed, like the Bush tax relief plan, to return a substantial amount of the projected surplus to the taxpayer.
 - Amendment #674 received 48 aye votes - all Democratic Senators

(except for Senators Baucus and Miller), plus Senator McCain. Senator Inouye voted present. All Democratic Senators on the Budget Committee voted for the Carnahan-Daschle amendment.

- Since enactment of the tax relief bill, and especially since the first of the year, many Democratic Senators have characterized the enacted tax relief bill as the evil monster that ate away much of the surplus.
- The tax bill critics might have a point to make if they had not supported (every one of them) the Carnahan-Daschle alternative. The following table shows what the new budget baseline picture would look like, assuming Carnahan-Daschle had been enacted instead.

Changes in CBO Baseline Projections of the Surplus Since January 2001 Substituting Carnahan-Daschle Tax Cut for Enacted Tax Act				
(\$ in Billions)				
	2002	02-11	% 2002	% 02-11
Total Surplus Projected in Jan. 2001	313	5,610	—	—
Changes^{/a}				
Legislative				
Carnahan-Daschle ^b	-67	-1,581	19%	40%
Discretionary	-45	-714	13%	18%
Other	-5	-49	1%	1%
Subtotal	-116	-2,343	32%	60%
Economic and Technical ^c	-242	-1,588	68%	40%
Total	-359	-3,932	100%	100%
Total Surplus or Deficit (-) as Projected in Jan. 2002	-46	1,678	—	—
Legislative Changes due to discretionary spending:				
Defense	-34	-396	9%	10%
Nondefense	-11	-318	3%	8%

Source: CBO Note: totals may not add due to rounding

^{/a} These estimates include the interest effects of changes assumed.

^{/b} JCT estimate for Senate amendment #674. The estimate includes both a reduction in taxes and an increase in outlays.

^{/c} Changes not directly driven by new legislation or by changes in components of CBO's economic forecast are considered technical.

- The picture is essentially the same as in the similar, previous table. If Carnahan-Daschle had been enacted in place of the Economic Growth and Tax Relief Reconciliation Act, the 10-year surplus estimate would have been virtually the same as under CBO's latest baseline. Further, the Carnahan-Daschle package would have accounted for 19 percent of the reduction in the 2002 surplus (vs. 12 percent under EGTRRA) and 40 percent of the reduction in the ten-year surplus (vs. 41 percent under EGTRRA).

- Critics who live in glass houses should not throw stones.

BUDGET QUIZ

Question: All of the \$40 billion promised in P.L. 107-38 to respond to the terrorist attacks of September 11th has been allocated. Last fall, the *Bulletin* highlighted the Administration's seven separate releases of funding from the Emergency Response Fund, which totaled \$19.7 billion out of the first \$20 billion provided in response to the attacks. (Congress also passed, and the President signed into law, the Defense and Emergency Supplemental Appropriations Act that included the

second tranche of \$20 billion for the Emergency Response Fund.) When did the eighth release covering the last \$0.3 million of emergency response funding occur?

Answer: There was no eighth release of emergency response funding by the Administration. Rather, the Congress directed in Section 305(b) of the final Defense and Emergency Supplemental Appropriations bill that \$300 million from unobligated and uncommitted funds appropriated to the President in P.L. 107-38 be transferred "to finance the simultaneous construction and hardening of military command centers at the Pentagon." This is a change to the overall Pentagon renovation plan in direct response to the terrorist attacks that will add an estimated \$800 million to the overall cost of the project.

A total of \$1.6 billion has been made available for the reconstruction of the Pentagon – \$780 million out of the first \$20 billion in emergency response funding; \$475 million out of the second \$20 billion in the Defense/Supplemental bill; and the \$300 million in unobligated funding transferred in the Defense/Supplemental bill.

Bonus Question: Will there be a ninth release of funds?

Answer: Possibly. The actual total out of the first \$20 billion in the Emergency Response Fund is \$19.673 billion, so technically there is \$27 million remaining that could be released.

CALENDAR

Unless otherwise noted, all hearings will be held in Dirksen 608 at 10:00 AM. Additional hearings and witnesses will be scheduled.

January 29 - HEARING: The Budget and the Economy. Brian Wesbury, Griffin, Kubik, Stephens & Thompson, Inc.; Robert D. Reischauer, The Urban Institute; Peter R. Orszag, The Brookings Institution.

February 4 - President's budget released(morning), and the SBC Republican staff "A Brief Overview" by COB (available on-line).

February 5 - HEARING: The President's FY 2003 Budget. OMB Director, Mitch Daniels.

February 12 - HEARING: The President's FY 2003 Budget. Secretary of State, Collin Powell.

February 13 - HEARING: The President's FY 2003 Budget. Deputy Secretary of Defense, Paul Wolfowitz.

February 14 - HEARING: The President's FY 2003 Budget. Health and Human Services Secretary, Tommy Thompson.

February 27 - HEARING: Long Term Budget Projections. Comptroller General, GAO, David Walker.

EDITOR'S NOTE

Departing from usual practice, the *Budget Bulletin* will not appear on February 4th because of the release of the President's 2003 budget on that day. Look for the next *Bulletin* on February 11th.

The *Budget Bulletin* and many other budget related items can be found on the recently updated website of the Budget Committee

(Republican Staff). The new and improved site can be found at:
<http://www.senate.gov/~budget/republican/index.html>.