

INFORMED BUDGETEER: BACK-TO-SCHOOL SAVINGS ??

As the 108th Congress returns for the remainder of its 1st session, CBO has just released its summer update to its *Budget and Economic Outlook*. With each round of legislation and each successive snapshot of the budget outlook, CBO estimates larger deficits, raising the question: When do deficits become large enough to require action? In spite of such news, Congress and the Administration are addressing other priorities, such as new airplanes for the military's midair refueling needs. However, policymakers are attempting to meet some of these priorities through contorted means that would cost more than is necessary, thereby increasing the deficit to unnecessarily high levels (see below).

CBO UPDATES OUTLOOK

- Though CBO is well into its third decade of issuing its periodic baseline report, the press and public's misunderstanding of the limits and special use of this product is so obstinate that it is daunting to try to correct.
- Most of the press on CBO's update leads with two common, but incorrect, claims. One is that these latest deficit estimates are "record" deficits. Deficits of \$400 billion now are no more a record than are the current levels of gasoline prices, which the press also reports as being at record highs. It is simply wrong to argue that something is a record when the units (in this case dollars, as opposed to, say, inches) used to measure the data change their meaning and value over time. (To be fair, some accounts have gone to the trouble to also provide the deficit figures in context of the size of the economy to control for the value of the dollar, but most cannot resist the "record" claim.)
- The other lazy tack is taken when press accounts characterize CBO's estimates as predictions or forecasts or when they say something like: "CBO says the federal deficit will be \$480 billion in 2004." As CBO repeatedly goes to great pains to point out, its 10-year baseline work (or even its baseline for 2004) at best constitutes a projection of a scenario that CBO promises *will never be realized*.
- Since the CBO baseline, as a matter of law, describes the budget outlook as it would appear only if current law were to remain unchanged, it cannot be a prediction or forecast of what *will* happen, because legislation always intervenes. Only CBO's estimate of a \$401 billion deficit for 2003 can be considered a prediction, since it was made with only one month left in the year, with very little opportunity for the Congress to enact legislation this month that could still affect the books over the next 28 days. Still, it somehow comes as a surprise to many – who say CBO "got it wrong" – when CBO points out how different its current estimates are from those it made 6 or 12 months ago because of legislation that has been enacted in the interim.
- So, what is interesting as well as true about CBO's latest deficit estimates? Are they record highs? No. Are they getting high? The trend has been on the upswing with little to suggest that they've approached the ceiling. The table below shows how CBO's base case has changed since March and why.
- Three-fourths of the increase in the estimated deficit for 2003 and 2004 stems from changes in law. Over 65 percent of these legislative effects result from the Jobs and Growth Tax Relief Reconciliation Act enacted in May. Further, the deficit is estimated to increase by \$114 billion over 2003-2004 because of other legislation increasing outlays, with the largest effect by far coming from the 2003 supplemental.
- One criticism frequently levied at CBO's baseline is that it is not realistic, as it leaves out changes in law that "everybody knows" are going to happen later. Interestingly, although the Administration appears content to ignore the long-term costs of our commitments in

CHANGES IN CBO'S BASELINE ESTIMATES (\$ in billions)								
	2003		2004		2003-2004		2004-2013	
	\$	As % of the total change	\$	As % of the total change	\$	As % of the total change	\$	As % of the total change
Deficit (-)/Surplus (+)								
CBO March 2003 Baseline	-246		-200		-446		+891	
Economic Downturn Enacted Policy (including debt service):	-56	36%	-53	19%	-108	25%	-665	29%
2003 Tax Relief (with related spending impacts)	-62	40%	-150	54%	-213	49%	-465	20%
Enacted Spending Legislation	-37	24%	-77	27%	-114	26%	-1158	51%
Enacted Subtotal	-99	64%	-227	81%	-326	75%	-1622	71%
CBO August 2003 Baseline	-401		-480		-880		-1397	

Source: Senate Budget Committee Republican Staff, CBO

Iraq and elsewhere (preferring instead to nickel and dime the Congress with repeated last-minute supplemental requests – with two more rumored for this Fall), the CBO baseline serendipitously incorporates a place holder for such costs. CBO does so because the law requires that all current year appropriations be inflated in the baseline; curiously, OMB purposely flouts the law and removes the effects of supplementals from its baseline, pretending that such costs will not reoccur in 2004 or later years. By inflating the cost of supplementals into future years, the CBO baseline reflects the resources that would be necessary to continue current activities.

- As for other expected, but not-yet-enacted, increases in the deficit (which are therefore not reflected in the statutory baseline estimates), CBO preempts the usual criticism by providing supplemental information (cost estimates as well as associated debt service cost) for the following proposals: provide a Medicare prescription drug benefit, extend expiring tax provisions, reform the alternative minimum tax, increase discretionary spending by historical rates of growth or limit it to less than the inflation rate. Most plausible combinations of these scenarios – many of which are explicit public policy goals of the Administration and many members of Congress – would produce higher deficits than reflected in CBO's baseline.

WHY SHOULD TAXPAYERS PAY LESS, WHEN THEY CAN PAY MORE?

- This week, CBO is scheduled to testify before both the Senate Commerce Committee and the Senate Armed Services Committee on the budgetary impact of the Air Force's proposed contract with Boeing to lease 100 airplanes to perform midair refueling. Baffled budgeteers may ask: why are hearings being held at this 11th hour, almost two years after Congress gave the Air Force all the authority it needs to enter into such a contract?
- Legislative History. As of December 2001, the Air Force had never requested money in the budget for replacing refueling aircraft or even identified problems with the existing fleet as a priority (despite GAO's urging since 1996 that it focus on this emerging problem). Despite the Air Force's inaction, a provision (Section 8159) was added to the 2002 Defense appropriations bill (as reported by the Senate Appropriations Committee) to authorize the Air Force to lease up to 100 Boeing 767 aircraft.
- The only limitation on the leasing authority was that the Air Force had to report to the congressional defense committees (the House and Senate Armed Services Committees and the House and Senate Appropriations subcommittees on defense) on its lease plans and then wait 30 days. A subsequent provision (Section 133, enacted in the 2003 Defense authorization bill) added the requirement that either (1) the Air Force submit to the committees a new start notification (using existing appropriations) or (2) an appropriation is enacted to enter into the lease. On July 10 and 11, 2003, the Air Force submitted the required report and the notification, respectively. No other legislative action is necessary to proceed with the lease at this point.

- Since those notices, three out of four of the defense committees have acquiesced to the lease, with the Senate Armed Services Committee waiting to hold its hearing (Sept. 4) before entering an opinion. Legally, none of the four committees can single-handedly hold up the lease if the Air Force wants to proceed with it. The authority was fully granted nearly two years ago and cannot be second-guessed except by a change in law. Practically speaking, the Air Force appears to acknowledge in its July 11th letter that it would be foolhardy to proceed with the lease if even one of the four committees were to object by offering to abide by the following constraint: “We will not award a contract until you have approved this new start request.”
- Constructing the Straw Man. So why might someone want to revisit the Air Force’s authority to lease 100 planes that it now insists (in its July report) are the *sine qua non* of our entire military power?: “In short, our national security strategy is unexecutable without air refueling tankers.”
- Good question. Two years ago, this concern with the then 41-year old KC-135 tanker fleet was not on the Air Force’s radar screen. But 9/11, combined with Boeing’s subsequent misfortunes, made this advanced age a concern for some in Congress. The leasing authority provided since then apparently has galvanized the Air Force into examining the need. The Air Force’s July report shows it now has religion: “Tanker dependence in recent wars and the advanced age of the nation’s air refueling aircraft fleet drive the Air Force’s urgency to recapitalize as soon as possible.” The recent conflicts, which the military is always supposed to be prepared to fight, are, according to the Air Force, unexpectedly “stressing our tanker fleet, especially our oldest and least capable tankers. . . . [so] the Department must begin to replace the KC-135 as soon as possible. . . . [r]ecapitalization can no longer be deferred.”
- The threshold question of whether new planes are needed was decided after the procurement method was already selected! So assume going forward that there is no cost-effective alternative to replacing 100 of the existing refueling fleet (though a CRS report released last weeks points out that despite their old age, the KC-135s “have only used approximately half their flying hours”) and that there is consensus that the Air Force must get the new planes just as it says – “as soon as possible.” Then what is the best way for the federal government to acquire such planes?
- The Air Force has decided that the “dominant reason for proposing the lease [instead of a purchase] is the advantage it affords for quickly delivering needed tankers to our warfighters without requiring significant upfront funding.” The rest of its rationalization is crucial: “If we were to purchase these aircraft in a traditional buy on the same delivery schedule, *while maintaining our financial top-line*, we would have to take billions of dollars out of other important programs. The adverse impact to our combat capability would be traumatic.” (Emphasis added.)
- What financial top line? For the entire federal budget, or even just the defense budget, there is no such thing as a top line for the next five years. It’s true that the Air Force has a Future Years Defense Plan (FYDP), which it argues cannot absorb a purchase of these tankers now (but that’s because the plan was designed to procure planes that may not be needed as much as the Air Force now argues it needs the tankers). That is why the Air Force claims it could not begin a “traditional buy” for the tankers until later this decade, making the lease option appear more expeditious. But the FYDP constraint is artificial. Congress and the President can appropriate whatever they deem necessary for defense, or for anything else for that matter (for example, \$40 billion enacted in the months after 9/11, and \$79 billion enacted for the 2003 supplemental, none of which was in the FYDP).
- So the “constraint” of a financial top line is not as binding as advertised. And even if there was such an inflexible constraint, the Air Force rationale is nonsensical. The Air Force logically says that refueling planes are a prerequisite for all other military activities: No fuel, no fly. But the Air Force says it wouldn’t reduce other planned procurement if that was necessary to pay for tankers, because capability would be harmed. So the Air Force would have other new planes instead of tankers, just no way to refuel them. It’s not clear how that helps combat capability.
- It doesn’t take a budgeteer to wonder: Do those who designed the lease really expect anyone to believe that Boeing would build and deliver aircraft **more slowly** if the federal government paid Boeing all cash on the barrelhead. Put differently, will Boeing really build planes more quickly only if the federal government pays for them piecemeal over time (with a buyout price at the end)?
- CBO’s Analysis. CBO’s recent report and testimony this week debunks this notion. CBO’s analysis demonstrates that there is nothing special about purchasing planes that lengthens the amount of time it takes to build them. On the contrary, 100 planes may be acquired by purchase on the exact same delivery schedule as the Air Force’s proposed lease option, but a purchase would cost significantly less. CBO concludes that leasing (at \$22 billion) instead of simply buying (at \$16 billion) 100 planes would cost 35% more over the next 14 years. (CBO’s more analytically correct way to make the comparison – using net present value calculations, which seem to scare or bore some “should-be” budgeteers too much to be bothered – reveals that the lease approach costs “10% to 15% more than an outright purchase.”) Even the Air Force grudgingly admits that it cannot construct a scenario in which “leases cost less than a purchase.” Though the Air Force claims its lease costs only 1 percent more than purchase, CBO’s analysis reveals many errors in the Air Force’s calculations.
- So whether it’s 35%, 15%, 1%, or just \$1 dollar more, why is it OK for the federal government to go out of its way to spend more than necessary for something policymakers have already decided we absolutely cannot go one more day without? Consider this: If the last year is any guide, would-be home buyers and refinancers have shopped around at least a few mortgage brokers to get the lowest interest rate. Does the federal government mirror this rational behavior? It knows it is going to buy planes by increasing the deficit and therefore by borrowing the money, and it knows it has the best shopper around in the Treasury, which goes out and gets the lowest interest rate possible from lenders.
- But under the terms of the lease that is about to be signed, the federal government instead is going to create a new shopper (a “Trust”) outside of Treasury that will be the middleman in the lease between Boeing and the Air Force. Only, this middleman will charge a higher interest rate, which is why leasing costs so much more than a purchase. To save taxpayers from this unnecessary \$6 billion addition to the deficit, Congress simply could enact appropriations for a direct purchase of the refueling planes instead.