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CBO PROJECTS NEAR-TERM DEFICITS OUTSIDE SOCIAL SECURITY
CBO "Baseline" Estimates Exclude Substantial Pressures on the Federal Budget

by Joel Friedman and Richard Kogan

The Congressional Budget Office's new report on the federal budget confirms that the surplus is considerably smaller than previously assumed and that, in some years, the budget outside Social Security will be in deficit. CBO now shows a total surplus between 2002 and 2011 that is $2.2 trillion less than it estimated in May; about three-quarters of this decline was caused by the impact of the recently enacted tax-cut package. These CBO estimates are less rosy than those released by the Administration last week as part of its Mid-Session Review.

- Unlike the Administration, CBO shows a *deficit* in the budget outside of the Social Security trust fund in 2001, 2003, and 2004.

- Over the ten years between 2002 and 2011, CBO is projecting a non-Social Security surplus that is about $460 billion smaller than the Administration's estimate.

The new CBO figures, while highlighting the impact on the surplus of the recently enacted tax cuts and the slowdown in the economy, still do not capture all of the likely pressures on the federal budget. The CBO estimates assume continuation of current law, following the traditional budget "baseline" rules. Thus they reflect none of the policy proposals under consideration by Congress or advocated by the Administration. Similarly, the CBO estimates assume that dozens of tax provisions, including those in the tax-cut package, will expire at some point over the next ten years rather than be extended. Yet Congress will find it difficult to reject all of these policies, as many are supported by large bipartisan majorities in Congress and by the President. A more realistic assessment of the ten-year budget outlook should identify these likely costs that are not currently assumed in the CBO projections. Two obvious examples are:

- The nearly $400 billion the Joint Committee on Taxation estimates it would cost to continue all of the tax provisions scheduled to expire over the next decade, including a number of popular tax credits such as the research and experimentation credit.

- The $460 billion of additional entitlement spending called for in the Congressional budget plan, including $300 billion for a Medicare prescription drug benefit and $70 billion for farm price support payments.

There are other examples, as well. For instance, the CBO baseline assumes that annually appropriated programs — both defense and non-defense — grow with inflation. Yet the Administration has placed a high priority on additional funds for defense, noting that the extra $200 billion that it added to its budget in the Mid-Session Review represents only a "first installment" of the funds it believes will be needed to accommodate its plans for a missile-defense system and force modernization. For appropriated non-defense programs, growth limited to the rate of inflation is unlikely to be sustainable over a ten-year period. Many budget experts maintain that it is more realistic to assume a rate of growth equal to inflation *and* population growth combined, a rate that is more consistent with past experience and that would still result in these programs falling as a share of the economy to the lowest level on record by the end of the decade. Similarly, Congress will likely face pressure to take costly action to ensure that millions of middle-class taxpayers are not subject to the Alternative Minimum Tax for the first time.

If these additional costs (as shown in the table on page 5) are taken into account, the surplus would be reduced by $1.1 trillion to $1.9 trillion over the next decade — amounts that are far larger than the $846 billion non-Social Security surplus that CBO projects for the coming decade. These additional costs would produce deficits outside of Social Security in every year. Moreover, these additional costs do not include any funds to address the long-term solvency problems of the Social Security and Medicare HI trust funds. Overall, the new CBO projections highlight the difficult choices, following the enactment of large tax cuts, that Congress will face if it hopes to avoid using the Social Security trust fund surpluses to fund other government programs in the years ahead.

Comparison of CBO and Administration Projections

The CBO update of its baseline estimates shows a total budget surplus of $3.4 trillion between 2002 and 2011, or $2.2 trillion less than the $5.6 trillion surplus that CBO projected in May. About three-quarters of this decline reflects the impact of the enacted tax-cut package. Only 13 percent represents the effects of the economic slowdown — with much of the impact affecting the projections in the next few years — and the remainder results primarily from revisions to various technical assumptions. Of this $3.4 trillion total surplus, $2.5 trillion represents the surplus in the Social Security trust fund and $404 billion reflects the surplus in the Medicare Hospital Insurance trust fund.

- For the budget outside the Social Security trust fund, CBO estimates a ten-year surplus of $846 billion (including the surplus in the Medicare HI trust fund), but predicts deficits in 2001, 2003, and 2004.[1] (The non-Social Security surplus in 2002 is projected to be a mere $0.5 billion.)

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[1] As a proxy for the non-Social Security surplus, the term "on-budget" surplus is often used. The on-budget surplus excludes not only the Social Security trust fund but also the Postal Service fund. CBO projects an on-budget surplus of $2 billion in 2002 and $847 billion over ten years. The difference between the non-Social Security surplus and the on-budget surplus is due entirely to the small deficit in the Postal Service fund.

- For the budget outside both the Social Security and Medicare HI trust funds, CBO projects a ten-year surplus of $442 billion, but anticipates a deficit in each year from 2001 through 2005.

These CBO estimates do *not* reflect CBO's best judgment of likely expenditures and revenues over the decade, but rather represent a far more mechanical calculation that follows a set of rules specified in law. Following these rules, for instance, CBO projects that a tax provision scheduled to expire during the decade will in fact expire, even if the provision has strong bipartisan support, has been extended in previous years prior to its expiration, and is virtually certain to be extended again in the future. The mechanical projections — known as "baseline" or "current services" estimates — provide a useful benchmark for assessing policy proposals, but do not necessarily provide the most accurate assessment of the future fiscal situation, as the following section explains.

Unlike the CBO figures, the projections highlighted in the Administration's Mid-Session Review are not baseline estimates, since they include the effects of the policies that the Administration supports.[2] The Administration did, however, prepare estimates that follow the same baseline rules used by CBO, but that reflect the Administration's economic assumptions. The Administration's baseline estimates show a $1.3 trillion surplus outside of the Social Security trust fund over the decade; this is comparable to the $846 billion non-Social Security surplus presented in the CBO update. Over the ten-year budget window, therefore, CBO estimates a non-Social Security surplus that is $460 billion — or 35 percent — smaller than the Administration is projecting. Moreover, CBO figures indicate that the budget outside the Social Security trust fund will slip into deficit in several years over the decade, while the more optimistic estimates from the Administration show a non-Social Security surplus in each year.

The differences between these baseline estimates primarily reflect the Administration's more positive projections of economic growth over the period. Over ten years, CBO also projects higher levels of Medicare spending than the Administration as well as higher interest costs, consistent with its smaller surplus estimates. In addition, in 2001 the Administration used new accounting procedures that helped it to avoid projecting a deficit in the budget outside Social Security; CBO did not adopt the Administration's approach.

Adjusting the CBO Estimates to Incorporate Potential Costs

As noted, CBO follows specified rules when preparing its baseline estimates and, as a result, excludes both policy proposals under consideration by Congress and the cost of extending

[2] The most widely reported ten-year figures from the Administration's Mid-Session Review are a projected total budget surplus of $3.1 trillion and a projected non-Social Security surplus of $575 billion. Although these estimates reflect the impact of Administration policies, the Administration chose to exclude a variety of costs from these estimates, including some associated with policies for which it indicated support in the Mid-Session Review. See Joel Friedman, "Administration Mid-Session Estimates Exclude Likely Costs, Inflating Ten-Year Surplus Estimates by $800 Billion or More," Center on Budget and Policy Priorities, August 22, 2001.

various tax provisions that are scheduled to expire during the decade. CBO notes the uncertainty surrounding its projections, stating that "the outlook for the budget can best be described not as a single set of numbers but as a range of possible outcomes around those numbers." When assessing the budget outlook over the next decade, it is therefore prudent to take into account likely costs that are excluded from the baseline projections. These costs are discussed in more detail below.

Expiring tax provisions — The Joint Committee on Taxation has identified several dozen tax provisions that will expire at some point over the course of the decade, ranging from the handful of tax credits that will expire in 2001 to all of the provisions of the recently enacted tax-cut package, which sunsets in 2010.[3] The cost of permanently extending all of these tax provisions is $397 billion between 2002 and 2011, according to the Joint Tax Committee. While extension of several provisions that are part of the tax-cut package may be controversial — such as repeal of the estate tax — past experience indicates that most of these tax provisions will be extended on a bipartisan basis. The Joint Tax Committee's estimates show it will cost:

- $112 billion over ten years to extend all the provisions of the recently enacted tax-cut package that expire in 2010.

- $148 billion to extend provisions in the tax-cut package that expire *before* 2010, including $113 billion to maintain the increase in the exemption for the Alternative Minimum Tax ($2,000 for singles and $4,000 for couples) that expires in 2004.

- $138 billion to extend about three dozen other tax provisions scheduled to expire between 2001 and 2010. This total includes $47 billion for the research and experimentation tax credit, which expires in 2004, and $39 billion to allow certain credits, such as the Hope and Lifetime Learning credits, to offset AMT liability after 2001, when the current authority expires.

Congressional budget resolution — The Congressional budget resolution is the plan that Congress adopted to guide its work on spending and tax policies. The largest policy change in the resolution has already been enacted — namely, the tax-cut package. However, the resolution allocates $460 billion over ten years for entitlement initiatives. The largest of these proposals include:

- $300 billion for a Medicare prescription drug benefit;

- $70 billion for farm price supports and the reauthorization of farm programs; and

- $36 billion to expand health coverage for the uninsured.

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[3] Joint Committee on Taxation, "Estimated Revenue Effects of a One-Year Extension of Federal Tax Provisions Scheduled to Expire in 2001 and Permanent Extension of Federal Tax Provisions Scheduled to Expire in 2001-2010," JCX-66-01, August 3, 2001.

Potential Costs That Have Not Been Accounted For in the CBO Update
in billions of dollars

	Ten-year total 2002-2011
Extend expiring tax provisions:	
Recently enacted tax-cut package (P.L. 107-16)	260
All other tax provisions expiring between 2001 and 2011	140
Subtotal, expiring tax provisions	400
Entitlement initiatives in the Congressional budget resolution:	
Medicare prescription drugs	300
Farm price supports	70
Other	90
Subtotal, budget resolution entitlements	460
Further potential costs:	
AMT relief*	80-180
Non-defense appropriations	0-180
Administration anticipated defense requests, including missile defense	0-370
Subtotal, further potential costs	80-730
Interest on all of the above	170-310
Total, potential costs not accounted for in the CBO baseline	1,110-1,900
Addendum: CBO baseline estimate of the non-Social Security surplus	846

Note: Totals exclude any funds to address the solvency of the Social Security and Medicare HI trust funds. Figures in the table are rounded, and thus may not add.

*When combined with the other AMT provisions in the table, the low estimate reflects the cost of reducing the number of taxpayers affected by the AMT to the levels projected before enactment of the tax cuts (i.e., to about 21 million taxpayers in 2011); the high estimate reflects a rough approximation of the additional funding needed to reduce the number AMT taxpayers to a more acceptable level than 21 million. See Joint Tax Committee analysis for Rep. Rangel, June 14, 2001.

There are, of course, no guarantees that the policies assumed in the budget resolution will be enacted into law. Nevertheless, some of these costs may be difficult for Congress to avoid. For instance, even if no multi-year authorization for farm programs is enacted, the costs in the budget resolution are still likely to be incurred, as past experience has shown that Congress will act on an annual, ad hoc basis to provide farmers with additional price support payments.

Other potential costs — Although extension of expiring tax provisions and popular initiatives in the budget resolution provide a useful indicator of additional costs that should be taken into account when assessing the budget outlook, there are other likely costs as well.

- **Alternative Minimum Tax —** Under the enacted tax-cut package, the number of taxpayers subject to the AMT will jump from about 1 million today to more than 35 million by the end of the decade. Such dramatic growth in the reach of the

AMT would be unprecedented, and it would transform the AMT from a narrow tax aimed at preventing high-income taxpayers from avoiding income taxes through excessive use of tax shelters to a burdensome tax that affects a broad cross-section of taxpayers. Congress will surely act to prevent this outcome and the higher taxes that it would force upon millions of middle-class taxpayers. Extending the AMT relief provided in the tax-cut package but scheduled to expire after 2004 and continuing the authority to allow certain tax credits to offset AMT liability (both of which are discussed above under expiring tax provisions) are unlikely to be sufficient to address the problem. Indeed, the Joint Tax Committee estimates that it would require another $84 billion beyond the cost of extending these two provisions — for a total cost of $247 billion over ten years — just to limit the increase in the number of taxpayers affected by the AMT from 1.4 million today to 20.5 million in 2011, essentially the level projected for 2011 before enactment of the tax-cut package. Even having 20.5 million taxpayers subject to the AMT would likely be unacceptable; Congress will face significant pressure to reduce the growth in the number of AMT taxpayers to more moderate levels, at a potential cost of another $100 billion or so.

- **Non-defense Appropriations** — The CBO baseline assumes that expenditures for non-defense programs subject to the annual appropriations process will simply keep pace with inflation. While this year's budget resolution assumes that funding for these programs will be set *below* these inflation-adjusted levels, that is unlikely to occur; both the President and a bipartisan majority in Congress are calling for increases in education and health research. Further, history suggests that these budget resolution levels are not likely to be sustainable over a longer period. A more prudent and realistic assumption for decade-long projections is that non-defense appropriations will at least stay even with inflation and more likely will keep pace with both inflation and the increase in the size of the U.S. population — that is, that the real per-capita level of funding will remain constant. Holding the real per-capita level of funding constant for non-defense appropriations would add about $180 billion to the ten-year costs reflected in the CBO baseline. Assuming that funding is set at this level could itself prove to be a conservative assumption, as it would result in spending on these programs that, as a share of GDP, would fall to 3.0 percent by 2011, the lowest level on record. It also is worth noting that for 12 of the last 14 years, real per-capita funding for these programs has increased, even though most of that period was one of substantial deficits.

- **Defense** — The inflation-adjusted levels for defense in the CBO baseline will also be difficult to maintain. In the Mid-Session Review, the Administration requested an additional $18 billion of funding in 2002 beyond the levels in its initial budget and an equivalent amount each year, adjusted for inflation, throughout the rest of the decade, for a total of $209 billion over ten years. Moreover, the Administration made it clear that it intends to request even more funds for defense, referring to the Mid-Session request as "the first installment, totaling

> $209 billion, of investment in restoring our national defense capabilities..." The Administration plans to request additional amounts to accommodate a missile-defense system and its force modernization program. While we do not know the ultimate size of the additional defense increases the Administration will advocate, it could reach $100 billion to $200 billion over ten years beyond the figures in the Administration's Mid-Session Review — which means that defense expenditures could reach $360 billion above the levels in the CBO baseline.

Finally, the CBO projections include no funds to address the solvency of the Social Security or Medicare HI trust funds. Nearly all recent proposals to restore or significantly enhance Social Security solvency — by Republicans and Democrats alike — have relied in part on resources from the general fund to help mitigate the severity of the problem; without such resources, the magnitude of the benefit cuts or payroll tax increases needed to restore long-term solvency is likely to be too great for any solvency plan to survive. (In the past, we have suggested that $500 billion over ten years might be devoted to these purposes and noted that such an amount would go only 30 percent of the way to bringing 75-year solvency to Social Security and Medicare.)

Conclusion

The new estimates by both the Administration and CBO confirm that the surpluses projected earlier in the year have shrunk considerably, reflecting the impact of tax cuts and a slowing economy. The CBO figures show that in 2001, 2003, and 2004, the budget outside the Social Security trust fund is expected to be in deficit — a conclusion the Administration was able to avoid only through the use of accounting maneuvers and rosy assumptions about economic growth. In addition, over the next ten years, CBO forecasts a non-Social Security surplus that is $460 billion smaller than the Administration projects.

Even these less optimistic CBO figures do not tell the whole story. Under the rules that CBO follows to construct its projections, it leaves out certain costs even if there is a strong likelihood that they will be incurred. A more realistic assessment of the ten-year budget outlook would recognize some of these anticipated costs. If these costs are taken into account, the projected non-Social Security surplus shrinks by $1.1 trillion to $1.9 trillion, exceeding what remains of the projected non-Social Security surplus and placing the non-Social Security budget into deficit status in every year.