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APPARENT IMPROVEMENT IN CBO'S JANUARY BUDGET PROJECTIONS IS LARGELY ARTIFICIAL

By Richard Kogan

The most recent ten-year "baseline" projection of the federal budget, issued by the Congressional Budget Office in September 2004, showed deficits totaling \$2.3 trillion over ten years. When CBO issues a new baseline projection tomorrow morning, the official ten-year deficit will appear to be substantially lower. However, approximately \$1.7 trillion of this apparent improvement in the budget outlook will be artificial — \$1.7 trillion of the decline will not indicate any fundamental improvement in CBO's view of future economic growth, future revenue collections, or future budgetary outcomes. There are two primary reasons that about \$1.7 trillion of the decline will not be real.

- **Iraq costs were included in the previous projection but will not be included in the new one.** Under the mechanical baseline rules that CBO employs, annual "discretionary" appropriations are assumed to grow with inflation. In September 2004, when CBO issued its most recent projections, no appropriations for fiscal year 2005 had yet been enacted, so CBO based its projections on fiscal year 2004 appropriations. Those 2004 appropriations included \$115 billion in "supplemental" funding for the wars in Iraq and Afghanistan. Thus, CBO's ten-year projection, covering 2005-2014, assumed that this \$115 billion in funding (plus inflation) would be repeated in each of the following ten years. The ten-year projection consequently included more than \$1 trillion in funding (and almost as much in expenditures), as well as the higher interest costs that the resulting higher deficits and debt would generate. All told, the mechanical continuation of the 2004 supplemental appropriations level added \$1.4 trillion to CBO's ten-year projection.

In contrast, the new projections that CBO will issue on January 25 will be based on fiscal year 2005 appropriations. And since Congress has not yet enacted any 2005 funding for activities in Iraq or Afghanistan, CBO's projection will include *no such funding* for the coming ten-year period.¹ The Administration is expected in February to request a supplemental 2005 appropriation of between \$75 billion and \$100 billion for costs in Iraq and Afghanistan, and additional costs in fiscal year 2006 and subsequent years seem very likely. But CBO's official baseline will not include any such costs.

¹ CBO will project forward approximately \$11 billion in supplemental 2005 funding for the fall hurricanes, but this is a marked reduction from the \$115 billion per year, plus inflation, in supplemental funding included in the September projection.

In short, approximately \$1.4 trillion in "improvement" in the CBO baseline will represent the fact that the September baseline overstated Iraq costs by including \$115 billion plus inflation in *every* year, while the new January baseline will understate Iraq costs by including *no* funding for Iraq in *any* year. Clearly, none of this apparent "improvement" represents a more favorable ten-year economic forecast, a more favorable view of revenue collections over the next ten years, or even more favorable prospects for Iraq. (CBO's baseline might portray some improvement in economics or revenue collections, but if it does, that will be in addition to the \$1.4 trillion in artificial improvement that will result from the elimination of Iraq costs from the new baseline.)

- **Change in ten-year period.** CBO's September projection of \$2.3 trillion in cumulative deficits covered the ten-year period 2005-2014. The new January projections will cover the ten-year period 2006-2015. Thus, the projected deficit for 2005 will drop out of the total, while the projected deficit for 2015 will be added. Even if the deficits for every intervening year are unchanged (which they won't be), the ten-year cumulative deficit will decline by about \$300 billion because the official baseline will, for artificial reasons, show a much lower deficit in 2015 than in 2005.

Effect of changing the ten-year period

Subtract previously projected 2005 deficit from 10-year total	- .348 trillion
Add projected 2015 deficit to 10-year total (rough guess)	+ .070 trillion
Net effect of changing the 10-year period	- .278 trillion

In short, the ten-year projection will improve by roughly \$300 billion solely because of the change in the years covered by the projection.

Yet this "improvement" of \$300 billion is as artificial as the "improvement" resulting from the omission of any Iraq costs. The reason is that CBO's official baseline follows mechanical rules under which tax cuts scheduled to expire in the future are assumed to do so. The official projection for 2015 will assume that all of the 2001 and 2003 tax cuts will have expired, and also that relief from the Alternative Minimum Tax will have ended, with millions of additional Americans falling under the AMT as a result. If CBO instead assumed that the 2001 and 2003 tax cuts (and AMT relief) were extended, the deficit in 2015 would likely be larger than the deficit in 2005, and all of this apparent \$300 billion improvement would disappear.

Together, the \$1.4 trillion shift in projections because of the removal of Iraq funding and the \$0.3 trillion shift from the change in the ten-year period mean that approximately \$1.7 trillion of the *apparent* decline in ten-year deficits will represent no *actual* change in the underlying budget picture.