CENTER ON BUDGET AND POLICY PRIORITIES
820 First Street, NE, Suite 510, Washington, DC 20002
Tel: 202-408-1080 Fax: 202-408-1056 center@cbpp.org www.cbpp.org

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$401 BILLION vs $455 BILLION: GOOD NEWS, BAD NEWS, OR NO NEWS?

By Richard Kogan

On July 15, the Office of Management and Budget (OMB) estimated that the federal budget deficit for the current fiscal year will be $455 billion. In its Summer Update released on August 26, the Congressional Budget Office (CBO) estimated it will be $401 billion. Is CBO's estimate of a $401 billion deficit good news, bad news, or no news at all?

The difference between CBO and OMB is related to different estimates of spending rather than of revenues. Essentially, CBO projects that certain defense and other expenditures that OMB assumed would occur in 2003 will occur instead in 2004 or subsequent years. The CBO estimate does not reflect a more sanguine view of the economy or of revenue collections. Both the CBO and OMB official "baselines" agree that the federal deficit will continue its rapid rise through the next fiscal year. They project that the deficit should hit even higher levels in fiscal year 2004, with CBO forecasting a deficit of $480 billion and OMB forecasting one of $475 billion.

CBO vs OMB

On the surface, CBO's lower deficit estimate for fiscal year 2003 may appear to be good news. Some will infer that CBO's lower estimate means that CBO foresees better economic growth and more robust revenue collections than does OMB.[1] But that is not the case. Rather, CBO sees lower *spending* in the current fiscal year than OMB does, primarily for defense purchases.

OMB's estimate of a $455 billion deficit in fiscal year 2003 includes a "downward revenue adjustment" of $15 billion "in the interest of cautious and prudent forecasting."[2] Without that adjustment, OMB's deficit estimate would be $440 billion and its revenue estimate would be $1,771 billion. CBO's revenue estimate is $1,770 billion (i.e., $1.77 trillion), essentially identical to OMB's. CBO and OMB thus do not differ in their short-term view of revenue collections or the economy.

The estimating differences between CBO and OMB lie on the spending side of the budget. The three largest differences are in defense (CBO estimates $18 billion less spending in 2003 than does OMB), international affairs (CBO is $5 billion lower), and homeland security (CBO is $4 billion lower).

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[1] Both OMB and CBO now foresee significantly lower revenue collections in 2003 *and all future years* than they projected in February and March, even adjusting for the recent tax cut.

[2] OMB, *Mid-Session Review*, July 15, 2003, page 51.

These expenditures are from funds already appropriated. Lower expenditures in these areas in fiscal year 2003 simply mean that, for example, CBO expects the Department of Defense to replenish its munitions somewhat more slowly than OMB assumed. All of the funds appropriated for the Defense Department (or these other agencies) will ultimately be spent, if not in 2003 then in 2004 or subsequent years. CBO's lower estimate of 2003 expenditures thus is unlikely to mean lower expenditures going forward. This is not good news (or, for that matter, bad news either) for the federal budget.

What does CBO's $401 billion estimate portend for the future?

Based on CBO's recent budget forecast, the Center on Budget and Policy Priorities has issued an alternative and more realistic projection of future deficits. Our analysis explains that official budget projections paint too rosy a picture because they omit costs that are likely or nearly certain to occur. For example, CBO's August "baseline" projection reflects laws currently in place. CBO consequently assumes that the various tax breaks enacted in 2001, 2002, and 2003 would expire on schedule. Likewise, CBO omits relief from the Alternative Minimum Tax after tax-year 2004 and does not include the likely enactment of a Medicare prescription drug benefit. Our report concludes that if these and other likely costs occur, deficits over the ten-year period from 2004 through 2013 will total approximately $5.1 trillion, will not fall below $400 billion in any year, and will reach $650 billion, or 3.6 percent of GDP, by 2013.[3]

Other analysts, such as Goldman Sachs and the Concord Coalition, similarly paint a grim picture of future deficits and demonstrate that a deficit below $455 billion in 2003 should not be interpreted as good news. On June 17, Goldman Sachs projected a $425 billion deficit for 2003 and a $4.5 trillion deficit over the ten-year period 2004-2013, while the Concord Coalition earlier projected a deficit of about $420 billion for 2003 and $4.0 trillion over the decade.[4] These forecasts were made before the release of CBO's August baseline, which showed further deterioration in the mid-term budget outlook. When revised to reflect the most recent CBO figures, both estimates will likely be higher and in line with our projection of deficits totaling $5.1 over the next ten years.

In short, it now appears that OMB's July figures both overstate the deficit in fiscal year 2003, while seriously understating the long-term deficit. The OMB estimates understate the long-term deficits because they omit some costs that are very likely or nearly certain to occur in years after 2004.

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[3] See Richard Kogan, *Deficit Picture Even Grimmer Than New CBO Projections Suggest*, Center on Budget and Policy Priorities, August 26, 2003, at http://www.cbpp.org/8-26-03bud.pdft.

[4] Goldman Sachs, *Daily Financial Market Comment*, June 17, 2003 and Testimony of Peter G. Peterson, President of the Concord Coalition, before the House Financial Services Committee, April 30, 2003. Peterson's testimony included the $4.0 trillion ten-year total; the figure for 2003 was not cited in the testimony but was supplied by the Concord Coalition.

Why Did OMB Overestimate the 2003 Deficit?

It is not clear why OMB overestimated the 2003 deficit.

One possibility is that OMB overestimated the 2003 deficit out of caution and prudence. This possibility is consistent with OMB's inclusion of a $15 billion "adjustment for revenue uncertainty" in its 2003 figures and a $30 billion adjustment in its 2004 figure. Prudence, however, would also have dictated including a similar adjustment for the costs of Iraq and Afghanistan in 2004. The Administration's July budget projections show these costs as zero, which is surely incorrect. The United States is not going to withdraw from both countries at the end of September 2003.

Another possibility is that OMB's higher deficit estimate for 2003 represents no more than the normal estimating differences that occur between objective analysts. As noted before, since the estimating differences between OMB and CBO for 2003 mostly represent differences in how long it will take various supplemental appropriations to "spend out," there is no long-term significance to such a difference.

A third possibility is that the White House is attempting to "spin" the discussion of the deficit. Under this theory, the White House has purposefully overestimated the 2003 and 2004 deficits, perhaps so that subsequent reports of high deficits will be portrayed as good news to the extent that they are "improvements" relative to OMB's July 2003 forecast. In addition, overestimating the 2003 and 2004 deficits — and then underestimating the 2007 and 2008 deficits, as OMB apparently also has done — could enable the Administration to point to a downward trajectory of deficits between 2004 and 2008 that appears much steeper than it will likely be in reality.

The Administration's budget projections show deficits of $455 billion in 2003 and $226 billion in 2008. Administration officials have cited these figures in recent weeks in claiming that their plan will "cut the deficit in half" over the next five years. In fact, our more realistic ten-year projection shows the deficit *rising* by 15 percent over this period despite an improving economy, from $401 billion in 2003 to $460 billion in 2008, and then climbing to $650 billion by 2013.

In addition, as Stan Collender, managing director of the federal budget consulting group at Fleischman-Hilliard, has pointed out, the Administration's budget does not constitute a plan to reduce the deficit but rather a plan to increase it.[5] OMB's own estimates show that if Congress enacts no further spending increases or tax cuts (and allows existing tax cuts to expire on schedule), the deficit will fall to $62 billion by 2008. According to OMB's own figures, the President's budget proposes additional tax cuts and additional spending for defense and prescription drugs that would increase the deficit in 2008 from this $62 billion level to $226 billion.

[5] Stan Collender, *Budget Battles*, July 29, 2003. Also see *Mid-Session Review*, op cit, page 41.