CENTER ON BUDGET AND POLICY PRIORITIES

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Revised September 3, 2002

WHY THE SURPLUS HAS DISAPPEARED

> This series of tables and short papers reflect the latest budget estimates, issued by the Congressional Budget Office on August 27, 2002.

- The $5.6 trillion, ten-year surplus projected in January 2001 has declined by $5.3 trillion, or 94 percent.
- Moreover, about 96 percent of the remaining ten-year, $336 billion surplus occurs in 2011. Most of the surplus projected for 2011 is based on the assumption that last year's tax cut will expire at the end of 2010.
- Table 1 shows that last year's tax cut is the largest single reason the ten-year surplus has shrunk since January 2001. The tax cut amounts to 31 percent of the total deterioration, and when the tax cut provisions of the stimulus bill are added in, tax cuts account for about one-third of the total deterioration. (Note: these figures are artificially low because they assume the tax cut will expire at the end of 2010.)

Table 1
Factors Accounting for the Deterioration of the Surplus Since January 2001
Difference between January 2001 baseline and August 2002 baseline,

	2001-2002 avg.		2010		2002-2011 total	
	Reduction in surplus due to various factors, in billions of dollars	Proportion of the deterioration that each factor accounts for	Reduction in surplus due to various factors, in billions of dollars	Proportion of the deterioration that each factor accounts for	Reduction in surplus due to various factors, in billions of dollars	Proportion of the deterioration that each factor accounts for
Surpluses projected in January 2001	**297**		**796**		**5,610**	
Changes in the economic forecast	-73	24%	-46	7%	-793	15%
Changes due to "technical" reestimates	-121	39%	-166	27%	-1,528	29%
Legislation enacted to date:						
Last year's tax cut	-55	18%	-260	42%	-1,648	31%
"Stimulus" bill	-26	8%	+5	-1%	-100	2%
Defense, homeland, and international	-24	8%	-104	17%	-830	16%
Domestic approps (except homeland)	-3	1%	-28	4%	-193	4%
Farm bill	-4	1%	-13	2%	-108	2%
all other legislation	-6	2%	-8	1%	-75	1%
Total reduction in the surplus	-312	100%	-619	100%	-5,274	100%
Surpluses or deficits currently projected	**-15**		**+177**		**+336**	

Source: CBPP calculations from CBO data. Figures may not add due to rounding. All figures include debt service (interest) costs caused by the policy or reestimate in question. This is the same approach taken by OMB in dividing the deterioration of the surplus among its various causes.

- Most of the downward revenue reestimates (outside of those caused by tax cuts) are the result of "technical" factors, rather than because of the recession or a generally less optimistic economic forecast. In other words, the revenue models used a year ago were too optimistic. The recession is responsible only for a modest fraction of the downward revenue reestimates.

- The bulk of spending increases since January 2001 have been for defense, homeland security (including cleanup and reconstruction after the terrorist attacks), and international affairs. Together, they account for 16 percent of the deterioration in the ten-year projected surplus. Increased appropriations for domestic programs outside homeland security account for only 4 percent of the deterioration.

- The bottom-line estimate shown in Table 1 — a projected $336 billion surplus over ten years — itself is likely to prove illusory. It assumes the tax cut will expire at the end of 2010 and omits a range of costs on both the tax and the spending side that are likely or almost certain to be incurred. See Table 6.

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WHAT PART OF THE SHRINKAGE WAS UNDER CONGRESS'S DIRECT CONTROL?

- Congress and the Administration are not directly responsible for revenue shortfalls outside of those caused by tax cuts, although they could have adopted less rosy estimates in January 2001 or left a larger margin for error.
- Of the costs that Congress and the Administration were directly responsible for, tax cuts are the largest factor. They account for 56 percent of the deterioration in the ten-year surplus that Congress and the Administration are responsible for.
- Increases in defense, homeland security, and international programs are the second largest factor, accounting for 28 percent of the deterioration in the ten-year surplus for which Congress and the Administration are responsible.
- Increases in domestic spending (outside of homeland security) account for less than 15 percent of the surplus deterioration Congress and the Administration are responsible for. This figure includes both appropriated (or "discretionary") programs and entitlements such as those covered by the recent farm bill.
- Combined, the first three items listed in Table 2 — last year's tax cut, the stimulus bill, and increases for defense, international affairs, and homeland security — account for 87 percent of the total deterioration in the ten-year surplus for which Congress and the Administration are responsible. They account for a similar percentage in both the short run and the long run, because as the stimulus bill phases out, last year's tax cut phases in. In each of these three areas, the President is calling for additional costs: larger permanent tax cuts, more "stimulus" tax cuts, and larger increases in defense spending.

Table 2
The Contribution of Various Types of Legislation to the Deterioration of the Surplus, Since January 2001
In billions of dollars

	2001-2002 avg.		2010		2002-2011 total	
	Reduction in surplus due to various factors, in billions of dollars	Proportion of the deterioration that each factor accounts for	Reduction in surplus due to various factors, in billions of dollars	Proportion of the deterioration that each factor accounts for	Reduction in surplus due to various factors, in billions of dollars	Proportion of the deterioration that each factor accounts for
Last year's tax cut	55	47%	260	64%	1,648	56%
"Stimulus" bill	26	22%	-5	-1%	100	3%
Defense, homeland, and international	24	20%	104	26%	830	28%
Domestic approps (except homeland)	3	2%	28	7%	193	7%
Farm bill	4	3%	13	3%	108	4%
all other tax and spending legislation	6	5%	8	2%	75	3%
Total cost of legislation to date	117	100%	407	100%	2,953	100%

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REVENUE LOSSES, NOT A SPENDING "EXPLOSION"

- Table 3 shows the combined effects of legislation *and* of economic and technical reestimates from January 2001 through August 2002. As with all tables, we attribute the cost of debt service (payments of increased interest on the debt) to the revenue loss or programmatic spending increase that caused the surplus to shrink.

- Table 3 shows that revenue losses from all causes are the overwhelming reason the ten-year surplus projection has shrunk by $5.3 trillion. Revenue losses account for 82 percent of the deterioration in the surplus.

- Increased costs of defense, homeland security, and international programs account for 16 percent of the deterioration. Domestic spending increases outside of homeland security account for two percent of the deterioration. (Projections of domestic spending have changed since January 2001 both because of legislative increases and because of reestimates of the costs of entitlement programs; some of those reestimates have been downward.)

- The notion in early 2001 was that the government was collecting "excess" revenues that would not be needed to pay off the debt or to finance the education, defense, or health initiatives in the budget the President proposed that February. One argument the Administration and others advanced for last year's tax cut was that without it, the government might pay off the national debt too quickly. The new projections indicate that the revenue projections of January 2001, on which the tax cut was based, substantially overstated revenues.

Table 3
Combined Effect of Legislation and Reestimates on Projected Surpluses:
(Shares of the Surplus Deterioration that are Due to Changes in Revenue and Changes in Spending, January 2001 to August 2002)
In billions of dollars

	2001-2002 avg.	2010	2002-2011 total
Reduced revenues	85%	82%	82%
Increased costs of defense, homeland security, and international	8%	17%	16%
Increased cost of all other programs, net	7%	1%	2%
Total reduction in the surplus	100%	100%	100%

Source: CBPP calculations from CBO data. Figures include the extra interest payments due to each of the causes listed. Figures may not add due to rounding.

The pie chart on the next page depicts the same ten-year data in graph form, dividing the revenue losses (and associated debt service costs) between last year's tax cut and all other causes of revenue losses.

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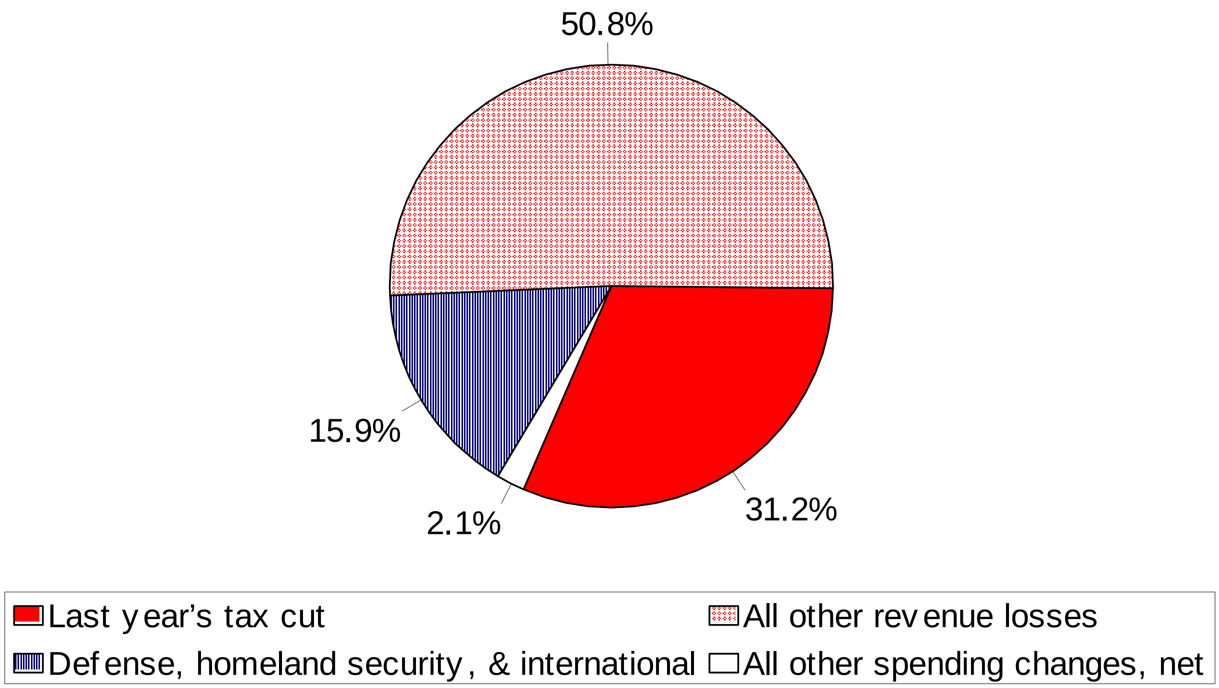
Why projected surpluses have disappeared

Change in CBO's 2002-2011 projections, January 2001 to August 2002



Each amount includes associated interest costs.

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WHAT HAS HAPPENED TO DEBT AND INTEREST ON THE DEBT?

- CBO's projections of publicly held debt and of interest payments on that debt have changed radically since January 2001. In the beginning of 2001, CBO projected the elimination of the publicly held debt before 2011. Now CBO projects that the debt will be $3.2 trillion that year.

- Over the ten-year period 2002-2011, interest payments on the debt are now projected to be $1.3 trillion higher — or more than three times as high — as CBO projected at the start of 2001.

- Some have used the increase in interest costs to buttress their claim that the surplus has shrunk because of a "spending explosion" — they have compared the projection of total federal spending (including interest) issued in January 2001 with the current projection and noted a substantial increase. This is a serious misuse of data; increases in interest costs that are caused by tax cuts and downward reestimates of revenues should not be misrepresented as increases in spending caused by Congressional excesses in increasing funding for defense or other government programs.

- In fact, increases in interest costs caused by tax cuts and by downward reestimates of revenue are *larger* than spending increases for all other reasons combined (i.e., for increased funding for defense, homeland security, international and domestic programs, the farm bill, and the like, plus debt service costs on those pieces of legislation). In other words, the tax cut and revenue shortfalls are responsible for more "spending increases" than all real spending increases combined.

Table 4

	Projected by CBO in January, 2001	Projected by CBO in August, 2002
Level of publicly held Treasury debt in 2011	none*	$3.2 trillion
Net cost of interest payments, 2002 through 2011	$0.6 trillion	$1.9 trillion

* except for a small amount of Treasury debt that could not be conveniently redeemed, such as series E savings bonds.

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Revised September 10, 2002

CBO vs OMB

Previous tables in this series of analyses have covered the ten-year period 2002-2011 because CBO's projection of January 2001 extended only through 2011. Subsequent tables cover the period 2003-2012, which is the projected ten-year period CBO covers in its new report. Through 2012, CBO projects a $1 trillion surplus. But 83 percent of that surplus occurs in the last two years, after the tax cut is scheduled to expire.

- CBO's figures themselves reflect considerable optimism about the economy; CBO assumes that productivity will grow at two percent per year on average, which is almost the average growth rate of the period 1996-2001 and is noticeably higher than the average growth rate from 1991 through 1995. There is a risk that the actual rate of productivity growth will not be this high.

- CBO's new projections suggest that OMB's "mid-session" figures released in July are too optimistic by more than $900 billion over ten years. Some 98 percent of the difference occurs because of OMB's rosier view of future revenue collections. Given CBO's optimism about both short-run and long-run economic growth, it is significant and potentially disquieting that OMB is almost $1 trillion more optimistic than CBO.

Table 5
Differences Between OMB's July Projections and CBO's August Projections
Ten-year totals, 2003-2012

	In billions of dollars
OMB projects higher revenues than CBO under current law	$638
Interest savings resulting from OMB's projection of higher revenues	269
Total effect of OMB's projection of higher revenues	907
OMB projects lower spending and interest (net) under current law	14
Total amount by which OMB is more optimistic than CBO	921

Source: CBPP calculations from CBO data. Figures may not add due to rounding. OMB's July projections were published before enactment of the supplemental appropriations bill and so did not reflect it; this table adjusts the OMB figures to reflect CBO's estimate of the cost of that bill, so that OMB's totals and CBO's totals project the same policies and differ only because of economic and technical estimating differences. Without this adjustment, OMB would appear to be $1.3 trillion more optimistic than CBO.

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WHAT IS MISSING FROM THE PROJECTIONS?

CBO and OMB baseline projections merely reflect current law and therefore understate the likely further deterioration of the budget that is expected to occur as a result of legislation that is highly likely or virtually certain to be enacted.[1]

- Major potential costs not reflected in the baselines include: the extension of tax cuts that are scheduled to expire within the decade; relief from the exploding reach of the individual Alternative Minimum Tax (AMT); the increase in defense funding requested by the President; and a prescription drug benefit. The new CBO baseline essentially assumes that the entire tax cut will expire on schedule, the number of taxpayers subject to the AMT will rise from two million today to 35 million by 2010, defense funding will remain at current levels rather than the increased levels the President has requested, etc.

Table 6
Selected Costs Omitted from CBO and OMB "Baseline" Projections
Ten-year totals, 2003-2012, in trillions of dollars

CBO's projected ten-year surplus under current law, 2003-2012	$1.0 trillion
CBO's projected ten-year deficit (-) outside of Social Security	-1.5
Potential or likely costs not included in CBO's baseline projections:	
Extension of expiring provisions of last year's tax cut	-0.6
Adjustments to alternative minimum tax	at least -0.4
Extension of other expiring tax breaks (primarily "stimulus" bill)	-0.5
Additional tax cuts in Bush budget	-0.2
Additional tax cuts to be proposed by the Administration after Labor Day	-??
Prescription drug benefit and Medicare provider relief	-??
Additional spending for defense, homeland security, and international programs requested by the Administration	-0.4
Domestic appropriations cuts requested by the Administration	+0.3
Additional foreign aid funding (Millennium Fund) the President has pledged	-0.05
Ten-year deficit (-) if all potential costs are incurred	-0.8
Ten-year deficit (-) outside Social Security if all potential costs are incurred	-3.3

Source: CBPP calculations from CBO data. Figures may not add due to rounding. Figures include the additional debt service that would be caused by the policies. For example, extending provisions of last year's tax cut that are scheduled to expire will cost $553 billion in lost revenues according to CBO; with debt service costs, the total reaches $605 billion.

[1] When creating baseline projections, CBO and OMB both follow definitions and rules spelled out in the Balanced Budget and Emergency Deficit Control Act. Those rules establish a baseline against which legislation can be measured for purposes of enforcing the "pay-as-you-go" rule and the discretionary caps established in 1990. While such enforcement is officially due to expire September 30, that Act nonetheless provides the only statutory definition of a baseline. CBO and OMB avoid controversy — and conceptual measurement differences with each other — by following those definitions.