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THE NEW CONGRESSIONAL BUDGET OFFICE FORECAST AND THE REMARKABLE DETERIORATION OF THE SURPLUS

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> The material in this summary is discussed in somewhat greater detail and with additional data in "An Examination of Recent Budget and Economic Projections by the Congressional Budget Office," available at http://www.cbpp.org/8-29-02bud.pdf.

In January 2001, the Congressional Budget Office projected a surplus for the ten-year period 2002 through 2011 of $5.6 trillion. Some 20 months later, on August 27, 2002, CBO issued its latest ten-year forecast. CBO now projects substantial deficits in the near term and a net surplus over the same ten-year period of only $336 billion.

- The $5.6 trillion, ten-year surplus that was projected last January has declined by $5.3 trillion, or 94 percent. Moreover, the remaining $336 billion projected surplus is largely illusory. Some 96 percent of it occurs in 2011. Most of the 2011 projected surplus is based on the unrealistic assumption that last year's tax cut will expire at the end of 2010.

- In addition, the $336 billion surplus projection does not include a number of virtually inevitable costs, such as the President's proposed defense and homeland security increases or the cost of preventing the number of taxpayers subject to the Alternative Minimum Tax from climbing from two million today to 35 million by 2010. Because CBO (and OMB) baseline projections merely reflect current law, they exclude these costs.

- Accordingly, the CBO baseline assumes the entire tax cut will die at the end of 2010, the number of taxpayers subject to the AMT will balloon to 35 million, funding for defense and homeland security will remain at current levels rather than rise to the levels the President has requested, and no prescription drug benefit will be provided for the next decade. Costs likely to be incurred but not reflected in the baseline — including extending the tax cut, AMT relief, the President's defense and homeland security increases, and a prescription drug benefit — amount to approximately $1.5 trillion to $2 trillion over ten years.

Why the Surplus Has Shrunk by $5.3 Trillion Since January 2001

There has been considerable public confusion about the relative roles that last year's tax cut, increases in spending, and the downturn in the economy have played in causing the disappearance of surpluses and the reemergence of deficits. The table on page 2 presents the causes of the deterioration of the surplus, based on the new CBO data.

Change in Projected Surpluses since January 2001

	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 for 2002-2011	**5,610**	
Changes in the actual or projected economy*	-793	15%
Changes due to reestimates of “technical” factors*	-1,528	29%
Cost of legislation enacted to date:		
Last year’s tax cut	-1,648	31%
Defense, homeland security, and international programs	-830	16%
Domestic appropriations (except homeland security)	-193	4%
Farm bill	-108	2%
“Stimulus” bill	-100	2%
all other tax and spending legislation	-75	1%
Total reduction in the projected surplus	**-5,274**	**100%**
Surpluses currently projected for 2002-2011	**336**	

Source: CBPP calculations from CBO data. Figures may not add due to rounding. All figures include debt service costs caused by the policy change or reestimate in question. (See box on page 3.)

- As the table shows, last year’s tax cut is the largest single reason for the deterioration in the surplus since January 2001. The CBO data show the tax cut accounts for 31 percent of the $5.3 trillion deterioration over ten years. When the tax-cut provisions of the stimulus bill are added in, tax cuts account for about one-third of the overall deterioration. (Note: these figures are artificially low because they assume the entire tax cut will expire at the end of 2010. Also of note, the proportion of the surplus deterioration that is due to the tax cut rises with each passing year. In 2010, the tax cut accounts for 42 percent of the deterioration of the surplus.)

- “Technical” reestimates (changes in estimates that are caused *neither* by legislation nor by changes in the actual or expected performance of the economy) account for 29 percent of the deterioration over ten years. Changes in the economic forecast are responsible for 15 percent of the shrinkage.

- Increased spending for defense, homeland security, and international affairs is responsible for another 16 percent of the deterioration in the ten-year surplus.

- By contrast, increased appropriations for domestic programs outside homeland security account for only four percent of the deterioration. Total increases in domestic spending outside homeland security, including the farm bill, account for about eight percent of the shrinkage. These figures indicate that claims that a domestic spending explosion contributed heavily to the deterioration are unfounded.

As these figures indicate, a large share of the deterioration of the surplus stems from economic and technical reestimates. Virtually all of the deterioration that is represented by these reestimates results from lower estimates of projected revenues. The technical and economic reestimates consist almost entirely of downward reestimates of revenues, not upward reestimates of spending for government programs.

The Treatment of Interest Payments in This Analysis

Whenever Congress enacts a tax cut or a program increase, or whenever costs increase for other reasons (such as an unexpected revenue shortfall), the surplus will be smaller than previously projected. As a result, the debt will be higher than projected, and the Treasury will consequently have to pay more interest on the debt than previously projected.

In this analysis, we follow the standard practice of attributing CBO's estimate of increased interest payments to the events that caused those increased payments, such as the tax cut, program funding increases, and the downward revenue reestimates made for technical or economic reasons. The Office of Management and Budget used the same approach in its July Mid-Session review in estimating the costs of last year's tax cut.

The bulk of these downward revenue reestimates are reestimates for "technical" rather than economic reasons and are not a result of the recession. CBO now projects that for any given level of the U.S. economy, the amount of federal tax revenue that the economy will generate is significantly lower than CBO previously thought. The revenue forecasting methods that underlay last year's budget projections — and last year's budget and tax decisions —are now considered to have been decidedly too optimistic.

The Role of Congress and the Administration

Congress and the Administration are not directly responsible for the deterioration in the surplus caused by economic and technical factors, although they could have adopted less rosy estimates last year or left a larger margin for error. Congress and the Administration do bear responsibility, however, for the deterioration caused by legislation.

- Of the costs for which Congress and the Administration were responsible, tax cuts are the largest factor. The CBO data show that last year's tax cut accounts for 56 percent of the deterioration in the ten-year surplus that was caused by legislation.

- Increases in defense, homeland security, and international programs are the second largest such factor. They account for 28 percent of the deterioration in the ten-year surplus that legislation caused.

  In the two areas that together account for 84 percent of the deterioration for which Congress and the Administration are responsible — the tax cut and the increases in spending for defense, homeland security, and international programs — the Administration is currently proposing additional action. The Administration has requested further tax cuts and spending increases in these areas.

- Increases in domestic spending outside of homeland security account for less than 15 percent of the surplus deterioration for which Congress and the Administration are responsible.

- It is instructive to examine the combined effects of legislation *and* economic and technical reestimates. CBO data show that total revenue losses, as a result of all factors, account for 82 percent of the $5.3 trillion surplus deterioration.

Policymakers believed last year that the government's revenue collections would be so robust that there would be plenty of revenue to pay off the debt and finance the President's education, defense, and health initiatives, with ample revenue left over for the tax cut that was enacted. In retrospect, it is evident that the revenue projections on which those beliefs were based overstated revenues by a substantial margin.

Interest Payments and the National Debt

CBO's projections of the publicly held debt and interest payments on the debt also have changed radically since January 2001.

- At the beginning of 2001, CBO projected the publicly held debt would be eliminated by 2011. CBO now projects the debt will be $3.2 trillion that year.

- Over the ten-year period from 2002 to 2011, interest payments on the debt now are projected to total $1.9 trillion. This is $1.3 trillion — or more than three times — higher than CBO projected at the start of 2001.

	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.

Most of the increases in government spending that CBO now projects, relative to its projections of January 2001, represent increases in expenditures for interest payments on the debt that are a result of the sharp reductions in projected revenue collections. Since revenue collections will be lower, the surpluses will be smaller, and less debt will be paid off. And since the amount of debt on which interest payments must be made consequently will be higher, the interest payments will be significantly larger.

Some have sought to use the increase in interest costs to support claims that the surplus has shrunk because of a "spending explosion;" they have compared the projection of total federal spending — including interest payments — that CBO issued in January 2001 to the current projection and noted a substantial increase. This, however, is a serious misuse of data; increases in interest costs that are due to tax cuts and downward reestimates of revenues cannot be represented as being increases in spending caused by Congressional action to boost funding for government programs. In fact, increases in interest costs caused by tax cuts and downward revenue reestimates are responsible for *more of the overall increase in federal "spending" since January 2001 than all of the increases in federal programs combined,* including the increases in defense, homeland security, domestic appropriations, and farm programs.

Finally, CBO's new projections suggest that OMB's "mid-session" budget estimates released in July 2002 are too optimistic. The CBO projections differ from OMB's by more than $900 billion over ten years. Some 98 percent of the difference stems from OMB's rosier view of future revenue collections.