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FIVE KEYS TO UNDERSTANDING NEW 2009 DEFICIT ESTIMATES

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Next week, the President's Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) will update their economic and budget projections for fiscal year 2009, which ends on September 30, and the next ten fiscal years.[1] Some analysts and pundits will try to use the new projections to support their arguments that the February stimulus package is (or is not) working, that Congress must (or must not) proceed with health care reform, and that any number of other policies should (or should not) be pursued. In fact, however, it will be extremely hard to draw any reasonable conclusions about such questions. Instead, the new estimates are likely to provide more evidence that we are in a highly uncertain economic and budgetary environment, in which the estimates can fluctuate significantly for a variety of reasons that have little to do with the desirability of undertaking new policy actions such as health care reform.

1. Both reports will undoubtedly show that this year's deficit will be the largest since the end of World War II, relative to the size of the economy. This is no surprise, since CBO and OMB projected a post-war record deficit for this year as long ago as January and February. The new projections almost certainly also will continue to show deficits improving over the next few years as the economy recovers, although the projected improvement will likely be slower than in previous recoveries and deficits will remain troublingly high.

2. There will be no simple answer to the question of whether the new projections are bigger or smaller than was expected earlier this year. This is because OMB and CBO have each produced at least four different sets of projections over the last eight months, ranging from $1.19 trillion (CBO's estimate in January if current policies were continued) to $1.84 trillion (estimated by CBO in March and OMB in May). Those estimates vary according to which organization produced them, what policies it assumed in making them, and when it made them. (See Appendix for a description of the various deficit estimates made by OMB and CBO since January.)

The new estimates for 2009 will certainly be higher than $1.19 trillion. The Department of the Treasury reported earlier this month that in the first ten months of fiscal year 2009 (through July), the deficit already totaled $1.27 trillion. Although the federal government normally runs a surplus in

[1] News reports cited a "senior White House official" as saying OMB will report a 2009 deficit of $1.58 trillion for 2009. See Philip Elliot and Jim Kuhnhenn, "AP source: Deficit to be $1.58 trillion this year," Associated Press, August 20, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/08/19/AR2009081903690_pf.html.

September because of quarterly income tax payments, it is unlikely to do so this year, and it is inconceivable that any September surplus would be enough to offset more than a fraction of the likely large addition to the deficit in August.

It is not clear whether the new estimates will exceed $1.84 trillion (although as noted in footnote 1, it has been reported that OMB's estimate will be $1.58 trillion). Some observers have suggested that recent data revisions showing the economy was weaker in 2008 and in the first quarter of this year than previously reported indicate that the fiscal year 2009 deficit will be higher than earlier projections. But the actual performance of the economy through March has already been reflected in the revenues collected and expenditures made to date, which will be the primary basis for OMB's and CBO's new deficit estimates. Thus, the revisions themselves are likely to have little effect on any changes made in this round of estimates of the 2009 deficit.

3. Whether the new estimates exceed $1.84 trillion will likely depend on the amounts recorded for a particularly volatile category of spending: assistance to troubled financial institutions. CBO's March estimate of a $1.84 trillion deficit included more than $330 billion in spending for the Troubled Asset Relief Program (TARP) enacted last fall,[2] plus $125 billion from legislation the President was seeking to provide additional authority for TARP activities.[3] However, Congress has not considered the legislation providing new authority for TARP, and through July the Treasury Department had recorded only $169 billion in TARP costs under existing authorities for 2009.

Similarly, the costs recorded for the federal government's support of two ailing government-sponsored enterprises — the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) — will substantially affect the deficit for 2009. Government-sponsored enterprises are privately owned organizations that generally are not considered part of the federal government; their transactions with the public are not included in the budget. CBO believes, however, that the decision last year to put Fannie Mae and Freddie Mac into conservatorship under the control of the Federal Housing Finance Agency essentially represents a federal takeover of the two organizations. CBO argues that the activities of the two organizations should now appear in the budget and that the long-term costs related to Fannie's and Freddie's commitments as of the takeover, as well as the full costs of their ongoing activities, should be recorded in the budget as a cost in 2009. CBO estimates these costs exceed $290 billion.

OMB, in contrast, continues to treat Fannie Mae and Freddie Mac as private entities that are not fully reflected in the budget. It includes only direct payments from the Treasury to Fannie and Freddie as a budget expense. So far this year, the Department of the Treasury has recorded just over $80 billion in such costs.

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[2] The net cash transactions related to TARP are expected to exceed that amount, but TARP costs are appropriately recorded in the budget on a net present value basis since, similar to direct loan programs that are recorded on the same basis, the government expects to get back some portion of funds paid out when assets obtained in the transactions are ultimately sold.

[3] CBO estimated that the legislation would cost another $125 billion in 2010. OMB's May estimate of a $1.84 trillion deficit in 2009 also assumed the new TARP legislation would cost $250 billion, but with all of the costs in 2009.

4. The new projections won't provide any evidence about whether the stimulus legislation is working or whether Congress and the President should continue to pursue health care reform. Not only will it be hard to say whether the projections clearly show an improvement or worsening in the fiscal outlook (better or worse than what?), but the factors that are likely to determine the final size of the deficit in 2009 — the costs recorded for TARP and for Fannie Mae and Freddie Mac — have nothing to do with questions that some are hoping the new projections will answer.

Lower-than-anticipated costs for TARP may indicate that the problems in the financial system have stabilized, but they will not provide any evidence one way or the other about the impact of the stimulus legislation. In fact, it is hard to know in general what a bigger or smaller deficit would mean about the stimulus. On the one hand, a bigger deficit might mean that the stimulus package's tax cuts and spending increases are taking effect faster than expected — repudiating claims that the stimulus bill is not working because it is taking too long to implement. On the other hand, some could regard a bigger deficit as an indication that the stimulus is not producing the intended improvement in the economy.

5. The only clear conclusion that should be drawn from the new deficit estimates is the continued need for action on *long-term* deficits. The new estimates should not spur efforts to reduce deficits in the next few years beyond what Congress has already endorsed in its budget resolution for fiscal year 2010. The extremely high deficits projected for 2009 and the next few years largely result from the most serious economic downturn since the Great Depression and the steps taken to keep it from becoming even worse. Trying to reduce deficits in the short run would be counterproductive to those efforts and could stall or reverse the economic recovery.

The estimates should, however, reinforce the message that the current fiscal path is unsustainable over coming decades. (The policy path was unsustainable before the economic downturn; in fact, the downturn will add relatively little to the size of the long-term problem.[4]) Changes in current policies — such as to ensure adequate revenues and help slow the rapid growth of public and private health care costs — must be made to keep deficits from growing rapidly in coming decades to levels substantially higher than this year's, even if the economy is operating at full capacity. The President and Congress should begin immediately to demonstrate they are serious about bringing deficits in the medium term (five to ten years from now) down to reasonable levels and avoiding an explosion of deficits in the longer term.

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[4] See Kris Cox, James R. Horney, and Richard Kogan, "The Long-Term Fiscal Outlook is Bleak," Center on Budget and Policy Priorities," December 16, 2008; and Paul N. Van de Water and Kris Cox, "Economic Recovery Bill Would Add Little to the Long-Run Fiscal Problem," Center on Budget and Policy Priorities, January 16, 2009.

Appendix: History of Fiscal Year 2009 Deficit Estimates Since January

As shown in Table 1, CBO projected in January that the deficit would total $1.19 trillion in 2009 under current policies (that is, *if the policies then in place remained unchanged*).[5] When President Obama submitted his preliminary budget on February 26, OMB estimated that the current-policy deficit for 2009 would be $1.5 trillion.[6] That current-policy estimate included the effects of legislation that CBO had not included in its January estimate because the legislation had not yet been enacted, such as the American Recovery and Reinvestment Act (ARRA), enacted on February 17. The OMB current-policy deficit estimate also anticipated the costs of the omnibus appropriations bill that provided full-year appropriations for fiscal year 2009 (enacted on March 11) and additional supplemental appropriations for the wars in Iraq and Afghanistan (enacted on June 26). If one were to exclude the effects of legislation that OMB's March projection included but CBO's January projection did not, the OMB estimate would have been $1.21 trillion, almost the same as CBO's.

While it included an estimate of the deficit under then-current policies, OMB's February document focused on estimates of the deficit under the President's proposed policies. Under those policies — which included ARRA, the omnibus appropriations act for 2009, and supplemental appropriations for the wars in Iraq and Afghanistan (at a somewhat different level than OMB assumed under a continuation of current policies), as well as legislation providing additional funding for financial stabilization efforts and tax cuts for families and businesses — OMB estimated that the deficit would be $1.75 trillion in 2009.[7] (The increase from OMB's $1.5 trillion current policy estimate largely reflected the Administration's anticipation of an additional $250 billion request for potential financial rescues in 2009, which the Administration and Congress appear unlikely to pursue.)

In March, CBO revised its baseline projections of deficits under current policies, taking into account the enactment of ARRA, the omnibus appropriations bill for 2009, and other legislation, as well as new information about the economy and the course of federal spending and revenue collections through the first four months of fiscal year 2009. CBO's revised estimate of the current-policy deficit for 2009 (including the effects of the legislation enacted since its January estimate) was $1.67 trillion.[8] CBO also estimated that, under the policies proposed in the President's preliminary budget, the deficit for 2009 would be $1.84 trillion.[9]

When the President submitted his detailed budget in May, OMB updated its estimates of the effects of enacted legislation and made certain other "technical' revisions to its estimates (but did not update its economic assumptions), and revised its estimate of the deficit for 2009 under policies

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[5] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2009 to 2019,* January 2009, Table 4, p. 15.

[6] Office of Management and Budget, *A New Era of Responsibility: Renewing America's Promise*, February 26, 2009, Table S-3, p. 117.

[7] *A New Era of Responsibility*, Table S-2, p. 115.

[8] Congressional Budget Office, A Preliminary Analysis of the President's Budget and an Update of CBO's Budget and Economic Outlook, Table 1-1, p.2.

[9] Ibid.

then in effect to $1.54 trillion and the deficit under the President's policies to $1.84 trillion.[10] Finally, based on the detailed information provided in the President's full budget submission, CBO estimated that the deficit under the President's policies would be $1.825 trillion in 2009.[11] CBO did not update its current policy projections or its economic assumptions.

TABLE 1:
Estimates of the Deficit for Fiscal Year 2009 Since January 2009
(in trillions of dollars)

	Current Policies	President's Policies
CBO January	1.19	NA
OMB February		
Same current policies as CBO	1.21	NA
With ARRA, Omnibus, and Supplemental	1.51	1.75
CBO March	1.67	1.84
OMB May	1.54	1.84
CBO June	1.67	1.82

NA= Not applicable

[10] Office of Management and Budget, *Budget of the U.S. Government: Fiscal Year 2010*, "Updated Summary Tables," May 2009, Table S-7, p. 15 ("BEA baseline deficit") and Table S-1, p. 3.

[11] Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2010*, June 2009, Table 1-1, p. 2.