

Preparing for CBO's Updated Baseline Projections and the President's New Budget

January 10, 2004

Next on the budget agenda: deciphering the upcoming projections from the Congressional Budget Office (CBO), which will be released on January 27, and the new President's Budget, which is due on February 2. Here are eight points to help policymakers cut through the spin and counter-spin.

1. *Despite the economic recovery, the federal deficit continues to worsen.* According to the latest Monthly Budget Review from the Congressional Budget Office (CBO), the deficit in the first quarter of fiscal year 2004 (last October through December) was \$126 billion, up from \$108 billion in the same quarter of 2003. Income tax revenues were flat in current dollars, and continued to fall as a percent of GDP (mostly due to new tax cuts). Payroll tax receipts were also flat, mostly because wage and salary income under the Social Security tax cap (\$87,000 last year) has been slow to recover. Military outlays soared in the quarter, although entitlement spending grew at a slower-than-normal pace.

2. *The new CBO baseline won't be dramatically different from the projections issued last August.* The new baseline may show stronger revenue growth in 2004 due to the surge in economic activity last summer and fall. However, this won't dramatically change the overall budget trajectory -- CBO will still project a large deficit in fiscal 2004 (probably in the \$450-\$500 billion range) and continued large deficits for several years thereafter. Starting in 2006, any improvement in the deficit due to higher revenues from a stronger-than-expected economy will be swamped by the increase in Medicare spending. (The January 2004 baseline will be the first time the Medicare drug benefit is reflected in CBO's official projections.)

3. *CBO's baseline will assume military spending grows slowly, but from a very high starting point in 2004.* CBO will probably include the recent war-related appropriations in its base levels for projections of defense spending into the future. In other words, the CBO projections will implicitly assume an indefinite continuation of large overseas expenditures. However, this is tempered by their assumption that the natural growth of military spending is the rate of inflation, which is probably too low. Defense outlays are gradually shifting toward services, personnel, software, and so on -- the sorts of items whose replacement cost could reasonably be expected to grow faster than inflation.

4. *By contrast, the President's Budget and Congressional Budget Resolutions will continue to understate likely military spending.* The President's Budget and the House and Senate Budget Resolutions will likely assume that recent supplemental appropriations for Iraq and Afghanistan will not be repeated, and that overseas military and aid spending will drop suddenly to pre-war levels.

5. *CBO's "headline" projections will assume all of the recent personal and business tax cuts expire on their scheduled "sunset" dates.* However, this is very unlikely to happen, at least without a dramatic change in political attitudes. If tax cuts are not allowed to expire -- and the Bush Administration is pushing to make them permanent -- then longer-term pressures on the budget would increase. (Centrists.Org's long-run baseline assumes the tax cuts do not expire, which is a much more likely scenario. The President's Budget will recommend extending some, but not all of the tax cuts past their sunset dates.)

6. *CBO's report will likely include all the information needed to re-compute the baseline*

deficit with more politically realistic assumptions about spending growth and sunset provisions in the tax code. In August 2003, CBO published the cost of several adjustments to the "headline" projections that seem more realistic politically, like extending sunset dates in tax law, preventing the Alternative Minimum Tax (AMT) from negating promised tax cuts, and allowing discretionary (defense and domestic) appropriations to grow at the rate of GDP growth instead of inflation. This information is very helpful in allowing analysts to look at the consequences of those more realistic political assumptions.

7. The President's Budget isn't likely to contain many surprises -- mostly just some wishful thinking on defense and domestic discretionary spending, and some notable omissions. President Bush's budgets have consistently projected a return to surpluses, despite the fact that deficits are getting steadily worse. This year's budget won't stray from that pattern. It will include reasonable economic assumptions and reasonable spending assumptions. However, the Administration won't push very hard to force Congress to actually abide by those spending levels. Moreover, there are enough omissions from the budget -- the AMT fix, the overseas military expenditures, the extensions of some sunset provisions -- to make it appear that the deficit will be reduced, when in reality deficits will probably remain high.

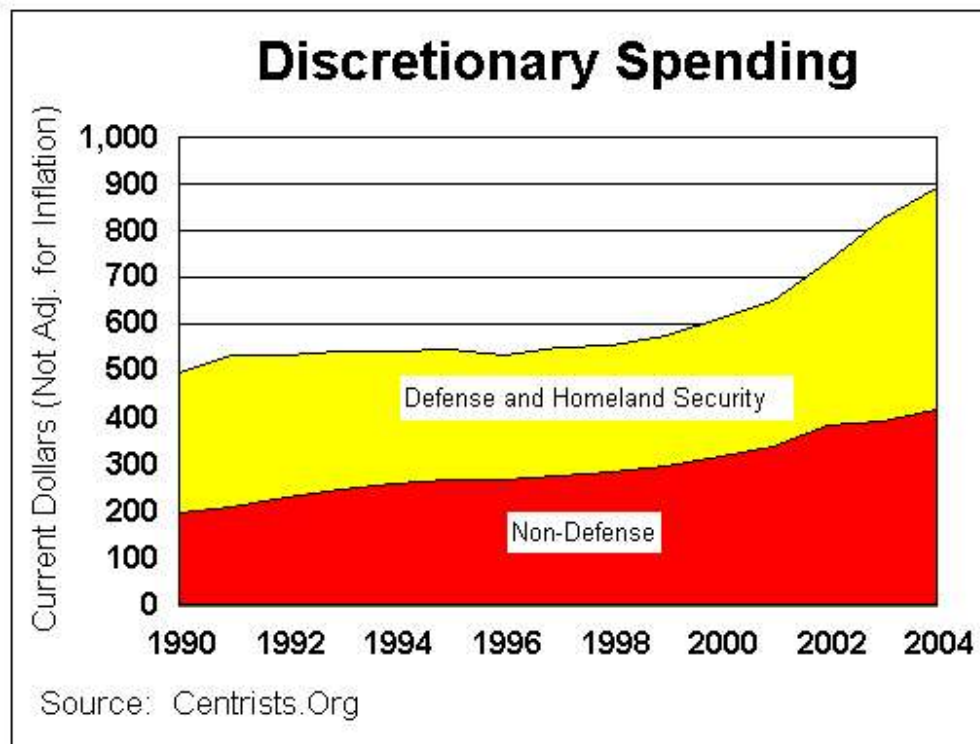
8. Budget analysts should keep their eyes on total spending, not subcategories. Some conservative think tanks are vigorously complaining about the rapid growth of discretionary (non-entitlement) spending (see Figure 1). The liberal Center on Budget and Policy Priorities has responded that within the discretionary spending budget, programs serving the poor are not growing very fast. The Center claims that even within the "non-defense" category, rapid growth in homeland security spending -- not programs for the poor -- is driving the totals up.

There are two problems. First, we should not limit the discussion of "overspending" to discretionary spending. Entitlements -- Social Security, Medicare, Medicaid, certain agriculture subsidies, and so on -- should not be excluded. Those programs may be harder to change, but they are part of the problem and in the past they have grown rapidly even as discretionary outlays declined.

Second, even within the category of discretionary spending, it makes little sense to subtract defense and security spending from the calculations, at least over longer periods of time. What matters to the budget is total spending, regardless of whether we have no choice but to spend a lot to combat terrorism or for other defense purposes.

Extra security spending should lead to tougher prioritization of other needs, either within the entitlement budget or elsewhere in the discretionary spending budget. Defense and homeland security spending should not be excluded from budget calculations -- it may be unavoidable, but it must be "paid for" eventually.

Figure 1.



Links:

[Heritage Foundation Omnibus Spending Bill Hikes Discretionary Spending by 9 Percent in 2004](#)
by Brian M. Riedl (December 16, 2003)

[Center on Budget and Policy Priorities Is Domestic Spending Exploding? An Assessment of Claims by the Heritage Foundation and Others](#) by Robert Greenstein, David Kamin, Richard Kogan, and Joel Friedman (January 7, 2004)

Centrists.Org [No-BS Long-Term Budget Baseline Homepage](#)

Centrists.Org [Issue Summary: Budget and Tax Policy \(Basics\)](#)

Centrists.Org [Issue Summary: Budget Process](#)

Centrists.Org is a non-partisan, non-profit, organization formed under section 501(c)(3) of the tax code, and dedicated to public education on vital public policy matters. Contributions to Centrists.Org are tax deductible.

Centrists.Org
236 Massachusetts Ave, NE, Suite 205
Washington DC, 20002
202-546-4090
202-546-4091 fax