BUDGET BULLETIN
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INFORMED BUDGETEER

Let's see…a big snow in DC, the Congressional Budget Office (CBO) releases its annual *Budget and Economic Outlook*, and the President submits his budget request to Congress…it must be the middle of February and the start of the annual congressional budget cycle (which now seems to last for more than a year; indeed, last year's cycle is not over yet as action on the tax reconciliation bill under the 2006 budget resolution has yet to be completed).

This week, the *Bulletin* compares and contrasts the CBO report and the President's Budget, which mark the beginning of the year's budget activities. Because the two documents usually come out within 10 days of each other, they are often confused. For example, some reports have noted that the President's deficit estimate of $423 billion for 2006 is "dramatically" more pessimistic than CBO's estimate of $337 billion, while missing the fact that the two estimates represent totally different concepts.

Congressional budget law mandates that CBO's baseline answer the question: current law is current law, so what would the deficit look like if we didn't change a thing?

But of course, current law never remains static. Every year, Congress and the President enact hundreds of new laws, many of which have budgetary effects compared to what had previously been current law. So in contrast, the President's estimate of deficits in the budget request reflect the new proposals that the President is just now requesting to be enacted and that Congress may or (more likely) may not enact in exactly the same form.

CBO'S BUDGET AND ECONOMIC OUTLOOK

- On January 26th, CBO released *The Budget and Economic Outlook* for 2007-2016. CBO estimates that if current law remains unchanged, the deficit would be $337 billion for the current fiscal year – 2006. It would be $270 billion in 2007 and would continue to decline and then turn to surpluses of $40-$70 billion annually from 2012-2016.http://budget.senate.gov/republican/pressarchive/Analysis.pdf
- Surpluses? But that doesn't sound anything like the grim budget picture that budget experts on both sides of the aisle have been foretelling because of the baby boom generation. There are two reasons that simply looking at a 10-year projection of baseline deficits is not the same thing as having a crystal ball.
- First, the really bleak budget story does not begin until beyond the 10-year budget window in CBO's baseline. This is when Social Security surpluses decline and no longer mask the higher deficit spending of the rest of government. The cost of Medicare, the other massive age-based entitlement program, is also expected to balloon outside the budget window as the aging of the baby boom generation accelerates.
- The second reason for the apparent but temporary return of baseline surpluses is more mechanical: CBO's baseline is a starting point, not an end-point. Construction of the baseline carefully adheres to the requirements laid out in law. Because CBO must follow a particular set of rules about what the baseline must include and what it must leave out, the baseline is not a prediction of the future fiscal position of the federal government.
- For example, because the baseline assumes current law and CBO is not allowed to make guesses on the enactment of future legislation, the baseline reflects that the tax cuts enacted since 2001 will expire as scheduled, largely after 2010. In addition, the baseline assumes that the alternative minimum tax (AMT) will increase its tax bite each year and does not assume any AMT reforms or "patches."
- The baseline must extend all discretionary spending, regardless of whether it is declared emergency spending or provided via a supplemental spending bill. Since $50 billion was provided for ongoing operations in Iraq and Afghanistan in the 2006 Defense Appropriations Act, that spending is assumed to continue annually at the $50 billion level (adjusted for inflation) over the 2007-2016 period.
- The Defense appropriations bill also carried new supplemental funds ($33 billion) in response to the Gulf Coast hurricanes, which are assumed by the baseline to continue in future years. In the near term, this treatment may understate the costs associated with the war and Katrina, but in the long term the costs may be overstated. And finally, the baseline does not reflect the budgetary effects of the spending and revenue reconciliation bills that were pending before Congress at the end of January. (For those who want to construct their own alternative baseline scenarios, CBO includes a table displaying the budgetary effects of certain alternatives not reflected in the baseline; see Table 1-4, pp. 14-15.)
- Given the baseline rules, CBO's deficit estimate for 2006 (compared to the one prepared last August before the hurricanes) includes the spending and revenue effects ($34 billion; see table below) of legislation enacted in both fiscal years 2005 and 2006 to provide relief from the Gulf coast hurricanes. But it does not include the effects of additional relief or other supplemental appropriations the President has indicated he will be requesting in the near future. Partially offsetting the deficit increase from enacted disaster-relief legislation and slightly higher ($21 billion) outlay estimates (for revised technical and economic assumptions) is $39 billion in increased revenues (also because of new economic and technical assumptions).

CBO BASELINE COMPARED TO OMB BASELINE COMPARED TO PRES. REQUEST ($ billions)

	2006
CBO August 2005 Baseline Deficit	-314
Changes from Legislation Enacted Since August:	
Loss of Revenues (Katrina relief)	-7
Increase in Outlays, of which:	34
Discretionary (Katrina relief)	*17*
Mandatory (flood insurance)	*16*
Net Interest	*1*
Changes for Econ. & Technical Reasons	
Increase in Revenue Estimate	39
Increase in Outlay Estimate	21
Total Increase in CBO Deficit Projection	-23
CBO Jan. 2006 Baseline Deficit	**-337**
Difference b/n CBO & OMB Baselines	
OMB revenues < CBO's	-11
OMB mandatory outlays > CBO's	19
OMB Feb. 2006 Baseline Deficit	**-367**
President's Proposals for 2006:	
Defense & Katrina supplemental approps	34
Mandatory outlays	5
Net Interest	1
Revenues - 1-year AMT & other extensions	-16
Subtotal--Deficit increase from Pres. Bud.	-56
Deficit Under President's 2007 Budget Request (OMB Estimate)	**-423**

For revenues, a positive number indicates an increase in revenues and a decrease in the deficit; a negative number(-) indicates a decrease in revenues and an increase in the deficit.
For outlays, a positive number indicates an increase in spending and an increase in the deficit; a negative number (-) indicates a decrease in spending and a decrease in the deficit.

PRESIDENT'S 2007 BUDGET REQUEST

- In preparing the President's budget, the Office of Management and Budget (OMB) is required to follow the same statutory rules for constructing a baseline that apply to CBO. OMB's baseline assumes that revenues in 2006 will be $11 billion less than CBO estimates. As the table on the front page shows, OMB also estimates that outlays for mandatory programs under current law will be $19 billion more than CBO projects (both agencies must have the same estimate for outlays of discretionary appropriations enacted to date), so that OMB estimates a baseline deficit that is only $30 billion higher than CBO's estimate (about 0.6 percent difference on a combined $5 trillion in revenues and outlays).

- Unlike CBO, however, OMB prepares more than a baseline. OMB is allowed to predict what the deficit would look like under a set of changes to current law, and accordingly submits an estimate of the deficit effects of the set of policies that the President proposes in his budget. For 2006, the President has signaled his intention to request additional supplemental appropriations for war and hurricane-response activities. Combining the increased outlays from those impending supplementals with the lost revenue from the President's proposal to extend relief from the AMT into 2006 would increase the deficit by $56 billion (compared to current law), yielding a 2006 deficit estimate of $423 billion.

- Several times in the past decade (except in 2001 and 2002), current-year deficits have been overestimated or surpluses have been underestimated in the annual budget request for the upcoming fiscal year (see table below).

ESTIMATED DEFICIT/SURPLUS COMPARED TO ACTUALS
(in billions of dollars)

	President's Budget (Estimate)	Actual
2006	-423	*
2005	-426	-318
2004	-521	-413
2003	-304	-378
2002	106	-158
2001	281	128
2000	167	236
1999	79	126
1998	-100	69
1997	-126	-22
1996	-146	-107
1995	-193	-164

NOTE: Negative sign indicates a deficit; positive indicates a surplus. * Final not available.
Source: OMB Budget Documents

- Some have been quick to suggest that it is happening again this year with the President's estimate of a $423 billion deficit for 2006. But is it? Let's look at the differences between CBO and OMB's estimates. As the *Bulletin* has noted above, some people incorrectly assume that the CBO baseline should include expenses that "everyone knows are going to happen." It does not. However, the President's budget does. It actually addresses that problem: it reflects the higher outlays, lower revenues, and therefore higher deficits that will occur if the President's supplemental requests and proposals to extend expiring tax provisions are enacted in the next few months.

- Add this $56-billion effect to CBO's baseline deficit of $337 billion, and the resulting $393 billion deficit would not be too far away (a lot closer than spittin' distance) from the financial markets' guesstimate of a $370 billion final deficit for 2006. So where is all the "padding" of OMB's estimate? Must be in the baseline, which the *Bulletin* has already indicated is really just a hair's breadth difference from CBO's baseline.

- A new kind of teeth-gnashing this year has arisen from OMB's failure to include, for the first time, a standard "change table" in the President's budget documents. This table is handy because it summarizes, by basic budget category, the effect on the deficit from the proposals in the President's budget. It essentially provides a road-map or bridge to illustrate how the current-law baseline deficit estimate would change as a result of the President's policies. Such a table is not hard to construct – you subtract the baseline estimates from the President's policy estimates, as the *Bulletin* has in the table below. The table shows that if the President's budget were enacted in full, it would increase the deficit in every year compared to current law (for a more complete version of this table, see Table 3 on p. 43 of the pdf file http://budget.senate.gov/republican/pressarchive/Analysis.pdf)

IMPACT OF PRESIDENT'S BUDGET POLICY ON THE DEFICIT
($ in billions)

	2006	2007	2011
OMB Current Law Baseline Deficit a/	-367.1	-255.7	-26.0
Adjustment for expiring tax relief	--	-1.0	-120.0
OMB Adjusted Baseline Deficit b/	-367.1	-256.7	-146.0
Changes Proposed in President's Budget:			
Discretionary c/			
Defense	30.1	62.7	26.9
Homeland Security	0.0	-0.2	2.3
Other	3.7	4.0	-52.2
Subtotal, Discretionary	33.8	66.5	-23.0
Mandatory c/			
Social Security	0.0	-0.2	56.7
Medicare	0.0	-2.5	-10.7
Medicaid and SCHIP	0.0	0.5	-0.6
Other mandatory proposals d/	5.1	1.4	-3.8
Subtotal, Mandatory e/	5.1	-0.7	41.6
Revenues f/			
Tax incentives to simplify and encourage saving	0.0	4.8	-2.5
Increase expensing for small business	0.0	-2.5	-1.6
Health care tax incentives (revenue effect only)	0.0	-4.8	-13.9
One-year AMT patch	-13.7	-20.5	0.0
Extend expiring provisions (eg R+E tax credit)	-2.2	-4.8	-8.4
Other revenue proposals	-0.1	-0.4	-2.6
Subtotal, Revenues	-16.0	-28.1	-28.9
Net interest	1.3	3.6	11.3
Subtotal Increase in deficit from budget proposals g/	56.1	97.5	58.9
Budget Deficit under President's Budget	-423.2	-354.2	-204.9

a/ The OMB baseline includes the Deficit Reduction Act, which was signed into law on February 8, 2006.
b/ The baseline adjusted reflects the permanent extension of certain of the President's 2001 and 2003 tax cuts.
c/ A positive value in outlays indicates an increase in outlays and the deficit; a negative value indicates a decrease in outlays and a decrease in the deficit.
d/ Includes the outlay effects of proposals for health care tax incentives and the outlay effects of simplification of tax law for families.
e/ Differs from OMB summary table S-6 because OMB figures are net of interest impacts for FHA, PBGC, and FEHB proposals, which are captured as part of the "Net interest" line item above.
f/ A negative value for revenues reflects a decrease in revenues; a positive value reflects a revenue increase.
g/ A positive value indicates an increase in the deficit.
Source: Senate Budget Committee Republican Staff; Office of Management and Budget