Fact Sheet on CBO Surplus Projections for FY 2001-2011

August 2001 Update

The new budget and economic projections released on August 28 by the Congressional Budget Office[1] have confirmed what budget observers have known for months – the bipartisan commitment to save the Social Security surplus for paying down the national debt has fallen victim to President Bush's tax cut. According to CBO, more than $9 billion of the Social Security surplus will be used to fund other government activities in 2001, the fiscal year that ends just over four weeks from now. Even more troubling is the fact that CBO does not believe that the threat to the Social Security surplus will end when the economy begins to grow at a robust pace once again. CBO projects that real growth will be 2.6 percent in calendar year 2002 (after only 1.7 percent growth this year), 3.3 percent in 2003, and 3.2 percent in 2004. Despite this healthy economic forecast, CBO projects that there will be an non-Social Security surplus[2] of only $2 billion in 2002 and that in 2003 and 2004 we will once again have to use Social Security surplus funds to pay for other government activities (to the tune of $18 billion in 2003 and $3 billion in 2004).

Table 1: CBO August Update – Surplus Projections

($ billions)	2001	2002	2003	2004	2005	2006	2007-11	2002-11
Unified surplus	153	176	172	201	244	289	2,314	3,397
Non-Social Security . . .	-9	2	-18	-3	21	47	799	847
Non-Social Security w/o HI . .	-37	-36	-59	-45	-21	2	601	443

CBO's projections give lie to the Administration's argument that the only threat to Social Security comes from potential increases in spending by the Congress. CBO's report shows that we have a non-Social Security deficit in 2001 because the projected surplus has dropped by almost $130 billion since the Bush Administration took office. Only $7 billion of that reduction is due to new spending, all of which the President supported. Moreover, CBO's projections show that the Social Security surplus will be invaded in 2003 and 2004 without any additional spending at all. CBO's projections assume that there will be no changes in laws governing entitlement programs or taxes and that discretionary spending will be held to the level appropriated for 2001, adjusted for inflation. According to CBO, we will be using surplus Social Security money to fund other activities of government even without the increased spending for defense the President has proposed.

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[1] On August 28 , the Congressional Budget Office (CBO) released the *Budget and Economic Outlook: An Update* for fiscal years 2001-2011. This fact sheet presents some of the key budget data contained in the report. The complete document can be found on CBO's web site at www.CBO.gov.

[2] In this document, the non-Social Security surplus also excludes off-budget Postal Service deficits.

CBO's projections also make clear the extent to which the Bush tax cut will require the use of surplus funds in the Medicare HI Trust Fund to pay the costs of other government activities. In 2002 through 2005, $139 billion of the $162 billion surplus in the Medicare HI Trust Fund will be used for other purposes. According to CBO, the cost of the Bush tax cut over the same period is $344 billion, not counting the additional interest costs stemming from paying down the debt less than would have happened without the tax cut. With a smaller tax cut, that $139 billion, as well as the approximately $21 billion in Social Security surplus that CBO projects will be used to pay for other activities in 2003 and 2004, could have been protected and reserved to pay down the national debt and help prepare for the retirement of the baby-boom population.

The New Projections

For fiscal year 2001. CBO projects a total surplus of $153 billion in fiscal year 2001, and a $9 billion deficit in non-Social Security accounts that exclude the spending and revenues of Social Security. If the totals further exclude the surplus in Medicare's Hospital Insurance (HI) trust fund, the deficit rises to $37 billion.

For fiscal year 2002. The total surplus in 2002 is now estimated to be $176 billion, $128 billion below CBO's May projection. There is a small non-Social Security surplus in 2002 ($2 billion), but a $36 billion deficit if the HI trust funds are also excluded from the surplus totals.

For fiscal years 2002-2011. CBO's estimated cumulative total surplus over the period 2002-2011 is $3.4 trillion - more than $2.2 trillion below the levels projected in May. The non-Social Security surplus totals $847 billion for the ten-year period — $2.3 trillion below the May estimate. If the totals exclude both the Social Security and HI surpluses, the surplus declines to $443 billion.

Debt held by the public. Under its revised baseline assumptions, CBO estimates that debt held by the public will be paid down more slowly than it had previously projected. It now estimates that debt will be reduced to $2.3 trillion by the end of fiscal year 2006 (from $3.4 trillion outstanding at the end of fiscal year 2000). That will leave debt $1 trillion higher in 2006 than the $1.3 trillion CBO projected in May. CBO estimates that interest payments will be nearly $50 billion higher in 2006 alone because of the higher amount of debt outstanding.

Preserving Surpluses and Strengthening Social Security

The Social Security and Medicare Trust Fund surpluses represent the difference between current payroll tax receipts dedicated to the trust funds and current payments to beneficiaries. These surpluses are invested in interest-bearing Treasury securities and will be used to pay benefits in the future, when the baby boom retires and payments to beneficiaries begin to exceed payroll tax receipts.

Some have argued that running a deficit in the non-Social Security, non-Medicare part of the budget doesn't affect Social Security or Medicare in any way. But it does. First, a smaller overall budget surplus today means less national saving and less investment. This, in turn, means a smaller national economy and a lower standard of living in the future. Such an outcome would put a greater strain on our ability to pay future benefits. Second, without any change in the system, the surpluses we are running currently will soon begin to shrink and will eventually turn into ever-widening deficits. Used wisely, today's surpluses could be used to institute reforms that would prevent this outcome and preserve solvency. Reductions in the surplus make such reforms much more difficult.

CBO Projections with Bush Defense and Budget Resolution Policies

The new CBO budget projections assume the continuation of current laws and policies. They do not include the President's request for defense nor do they assume Congressional budget resolution policies that have not yet been enacted. Table 2, below, shows the total raid on Medicare and Social Security if CBO's baseline projections were revised to include the Bush defense request (contained in OMB's Mid-Session Review of the FY 2002 Budget) and budget resolution policies that have not yet been enacted. These policies include $300 billion for a new prescription drug benefit, $14 billion for home health care, $28 billion for expanded health care coverage, $74 billion for agriculture, and $6 billion for veterans programs. Based on CBO's baseline projections, if the President's defense proposal and the budget resolution policies were adopted, Social Security trust funds would be needed to pay for other government activities in each of the next six years, in an amount totaling $203 billion. And, $286 billion of the Medicare Trust Fund would be needed to pay for other activities in 2002 through 2009. Thus, under policies proposed by the President and a Republican-controlled Congress, the President's tax cut will require that $489 billion of trust fund surpluses that were supposed to be reserved to pay down the debt would be used instead to pay for day-to-day operations of the government.

Table 2: CBO August Update with Resolution Policies and President's Defense

($ billions)	2002	2003	2004	2005	2006	2002-06	2007-11	2002-11
"Available" surplus 1/	-36	-59	-45	-21	2	-158	601	443
Bush defense	10	14	15	17	18	74	112	186
Resolution policies	17	24	29	34	38	142	305	447
Interest costs	1	2	5	8	11	27	131	157
Remaining surplus/deficit	-63	-99	-94	-80	-65	-401	54	-347
Raid on Medicare	-38	-41	-42	-42	-45	-206	-80	-286
Raid on Social Security	-26	-58	-52	-38	-20	-194	-9	-203
Total raid	-63	-99	-94	-80	-65	-401	-88	-489

1/ CBO August surplus excluding Social Security and Medicare trust fund surpluses.

What Happened to the Surplus?

One of the least plausible of the Administration's attempts to deflect blame for the incredible shrinking surplus is its effort to convince the public that the deterioration of the budget this year is due to irresponsible new spending enacted last year by the Congress and that more new spending is the only threat to Social Security.

First, the spending enacted last year by a Republican-controlled Congress cannot possibly have anything to do with the deterioration of the budget situation since President Bush took office this past January. Surely, the Administration doesn't expect the public to believe that when it put its budget together it didn't know how much had been appropriated last year? Furthermore, if the President really believes that the spending enacted last year for fiscal year 2001was irresponsible, why did he propose to increase total appropriations for the current year by $5.6 billion. And, why did he propose to rescind only $44 *million* (or less than 1/100 of one percent) of the $635 *billion* appropriated last year?

Nor is new spending passed by the current Congress responsible for the disappearing surplus. CBO's projection of the surplus for 2001 has plunged $122 billion since the President submitted his budget last April. New spending enacted by this Congress – and proposed and signed into law by President Bush – accounts for only $7 billion of the reduction. The Bush tax bill reduced the surplus by an estimated $74 billion (including a $33 billion two-week delay in corporate tax payments that reduced the surplus without providing any economic stimulus). Changes in the economy and technical factors account for the remaining $41 billion reduction in the surplus.

Table 3: Changes in CBO Unified Budget Projections – May to August [1/]

($ billions)	2001	2002	2002-06	2007-11	2002-11	%
CBO May Surplus	**275**	**304**	**2,002**	**3,627**	**5,629**	**---**
Tax bill	74	41	554	1,103	1,657	74%
Defense spending	1	9	41	54	95	4%
Domestic spending	6	1	8	11	18	1%
Economic and technical	41	76	316	144	461	21%
Total changes	122	128	920	1,312	2,232	100%
CBO August surplus/deficit . . .	**153**	**176**	**1,082**	**2,314**	**3,397**	**---**

1/ CBO estimates. Interest costs included in each category.

New spending enacted this year also accounts for a small portion of the total $2.232 trillion reduction in the surplus CBO projects for 2002 through 2011. CBO estimates that supplemental appropriations for defense activities reduced the projected surplus for the next 10 years by $95 billion (including additional interest payments resulting from the new defense spending). Legislation affecting nondefense programs have reduced the surplus by $18 billion over the same period. In contrast, the tax bill reduced the surplus by $1.657 trillion ($1.275 trillion in tax cuts and $382 billion in associated interest payments). The remaining $461 billion in surplus reduction stems from CBO's revised forecast for the economy and changes in technical factors that affect the budget.

The Administration's claim that irresponsible new spending constitutes the real threat to the Social Security surplus is hardly credible in light of CBO's projection that the Social Security surplus has already been invaded this year (fiscal year 2001) and will be required to fund other activities of government in 2003 and 2004 *under current policies*. That is, even without the President's proposed increase for defense or any other new spending or tax cuts, the President's tax cut has caused him to violate his pledge to protect Social Security. (The President has stated that his pledge does not apply during an economic recession, but under both CBO's and the Administration's forecasts, the economy will be growing as fast as is sustainable in 2003 and 2004.)

Economic Outlook

CBO is projecting economic growth of 1.7 percent in 2001 and 2.6 percent in 2002. While the 2001 growth rate is the same as the Administration's and the Blue Chip's, the 2002 growth rate is 0.6 percentage points lower than the Administration's 3.2 percent.

Over the longer-term, once the economy has recovered from its current weakness, CBO and the Administration have fairly similar growth rates (3.2 percent for CBO and 3.1 percent for the Administration). The key difference is that CBO assumes slower growth in nominal GDP and in the tax base than does the Administration. CBO also assumes higher interest rates. The combination of smaller surpluses and higher interest rates means that net interest outlays are higher in the CBO baseline, which further reduces the surplus.

Including adjustments for technical factors made in May, CBO has now revised downward its January baseline surplus by $47 billion in 2001 and $84 billion in 2002 due to economic and technical factors. The weaker economy reduced the 2001 surplus by $25 billion in 2001 and $48 billion in 2002. The latter is much larger than OMB's $21 billion reduction in the surplus stemming from economic factors in 2002.

CBO has not revised its projection of the rate of growth of potential GDP in the 2001-11 period. It remains 3.3 percent. However, the composition of that growth has changed. CBO is projecting faster growth in the labor force (primarily based on new Census data) but slower growth in potential labor productivity (2.5 percent, down from 2.7 percent in January). CBO has not produced a fan chart showing uncertainty in the budget forecast based on its past forecasting record. However, the discussion of economic uncertainty tends to focus on downside risks. For example, a weakening of consumer confidence could hurt growth in the short-term. Investment in information technology, which was so critical to the strength of the economy and productivity in the late 1990s, has collapsed. This has hurt growth in the short term, and it is an open question how much of a revival there will be in this sector. Nevertheless, CBO expects that over the next decade productivity growth will continue to exceed that experienced from 1973-1993.

Comparison of CBO and OMB Baseline Projections

CBO's economic and budget projections are clearly less optimistic than the current services projections released by the Administration on August 22 in OMB's Mid-Session Review of the Budget. CBO estimates that there will be a $9 billion non-Social Security deficit in 2001, while the Administration predicts a $2 billion surplus. The differences are even larger in 2002 and succeeding years.

About half of the difference in 2001 stems from an accounting change the Administration adopted at the last minute, presumably to try to make it appear that the Social Security surplus was not being used to fund other activities of government. The Administration, without the consultation with CBO and the Congressional Budget Committees that is required by the Budget Enforcement Act, changed a 65-year practice of showing adjustments in the amount of payroll taxes attributed in previous years to the Social Security trust funds in the year in which the adjustment is actually made. This change in accounting allowed the Administration to show a non-Social Security surplus for 2001 that is $5.6 billion higher than it would be without the change in accounting. Since even with the accounting change, the Administration estimates the non-Social Security surplus will be less than $1 billion in 2001 (the non-Social Security surplus is smaller than the non-Social Security surplus because it includes the off-budget Postal Service deficit of $1.6 billion), the change made the difference between admitting that the Social Security surplus is being invaded and pretending it isn't. CBO has not gone along with this change in accounting, instead reflecting the adjustment the way it has always been shown (and the way it has already been recorded in the Treasury Department's Monthly Treasury Statements for fiscal year 2001). But, since CBO is projecting a total budget surplus for 2001 that is $5 billion lower than the Administration estimates, CBO would have shown a non-Social Security deficit even if it had gone along with the Administration's accounting change.

CBO projects non-Social Security surpluses for 2002 through 2011 that are $456 billion lower than the current policy projections in OMB's Mid-Session Review. (The Administration's current policy projections, like CBO's baseline projections, are based on the assumption that there will be no changes in laws governing entitlement programs or taxes and that discretionary spending in 2002 through 2011 will remain at the level enacted for 2001, adjusted for inflation.) The differences are particularly noticeable in 2002, 2003, and 2004. CBO projects a $2 billion non-Social Security surplus for 2002, an $18 billion deficit in 2003, and a $3 billion deficit in 2004. OMB projects non-Social Security surpluses for all three years ($18 billion in 2002, $18 billion in 2003, and $39 billion in 2004).

According to CBO, although the economic outlooks of CBO and the Administration are quite similar, the differences between them account for a large part of the difference between CBO's and OMB's budget projections. In general, CBO assumes somewhat slower growth in nominal GDP and the tax base than does the Administration.

Table 4: Comparison of OMB and CBO Baseline Surplus Projections								
($ billions)	2001	2002	2003	2004	2005	2006	2007-11	2002-11
Unified budget surplus								
CBO	153	176	172	201	244	289	2,314	3,397
OMB	158	187	210	250	304	342	2,549	3,842
Difference . . .	-5	-11	-39	-49	-60	-53	-235	-445
Non-Social Security surplus								
CBO	-9	2	-18	-3	21	47	799	847
OMB	2	18	18	39	68	92	1,069	1,304
Difference . . .	-10	-16	-36	-42	-47	-45	-270	-456
Surplus excluding Social Security and HI								
CBO	-37	-36	-59	-45	-21	2	601	444
OMB	-28	-18	-22	-6	20	38	759	770
Difference . . .	-9	-18	-37	-39	-41	-36	-158	-326

Prepared by Senate Budget Committee Majority Staff

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