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## **“FORECASTING” DEFICIT SPENDING IN THE UNITED STATES: A LOOK AT PROJECTIONS FROM THE CONGRESSIONAL BUDGET OFFICE**

**DENNIS W. JANSEN and AARON ROSS**

Deficit spending has long been an issue that raises concerns and disagreements among the American people and among their elected representatives. Members of Congress, needing to balance fiscal responsibility along with responsibilities to their constituents, are simultaneously faced with limited federal government financial resources and seemingly unlimited demands on those resources. In considering legislation and budgeting, members of Congress – and members of the public - consider the impact on current and future deficits. The importance of accurate information on current and future projected deficits cannot be overemphasized. The agency responsible for reporting budget projections to the Congress is the Congressional Budget Office or CBO. This article examines the 10-year deficit projections of the Congressional Budget Office from 2000 to 2017, comparing them to subsequent actual levels of deficit spending.

### **THE CONGRESSIONAL BUDGET OFFICE**

Created in 1975, the Congressional Budget Office (CBO) conducts analysis of budgetary and economic issues, providing cost estimates and analytical reports to legislators. The CBO is independent, nonpartisan and does not provide policy recommendations.

The CBO publishes their report “The Budget and Economic Outlook” several times a year. The report includes projections of budgetary and economic outcomes over the next 10-year period. In these reports, the CBO updates their earlier projections of deficit spending and GDP growth. These projections, known as baseline projections, are based on a detailed understanding of federal programs and tax codes, current relevant research literature, extensive analysis, and consultation with outside experts. The CBO functions under the assumption that current government laws will remain in place, meaning that it cannot consider future changes in policy in their projections (although they do account for changes indicated by current law).

The CBO stresses that their baseline projections should not be used as a forecast of economic outcomes, but instead as a “neutral benchmark against which Members of Congress can measure the effects of proposed legislation.”

## PROJECTIONS VERSUS FORECASTS

In the CBO's own words, it would be 'grossly negligent' to interpret their projections as forecasts.

"Projections will almost certainly differ from actual budget totals: the economy may not follow the path that [the] CBO projects, and lawmakers are likely to alter the nation's tax and spending policies. Therefore, [the] CBO's baseline should be viewed not as a forecast or prediction of future budgetary outcomes but simply as the agency's best judgment of how the economy and other factors will affect federal revenues and spending under current law." (Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2003-2012* (January 2002), p. xiii)

The difference between what the CBO defines as a forecast and what it defines as a projection is subtle. Basically CBO projections are based on forecasts of underlying economic drivers (GDP, potential GDP, and demographic variables) and assumptions regarding current laws, largely that they remain in effect into the future. This means that CBO projections are conditional forecasts, conditional on a set of assumptions. CBO releases talk about projections using language that would be appropriate for forecasts, as in "CBO's baseline estimate of the 2017 deficit is \$449 billion, or 2.9 percent of GDP – less than the \$587 billion deficit posted in 2016." (Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2017-2027* (January 2017), p. 1)

This leads to a problem, as CBO projections are treated by the media as forecasts. The nature of these conditional forecasts that are based on assumptions about current law and forecasts of economic drivers makes these projections more accurate when economic conditions are stable and when CBO assumptions about current law are largely correct. When economic conditions are changing, such as during recessions, and when current law is changing, the CBO deficit projections can be strikingly at variance with actual deficits.

## DEFICIT PROJECTIONS

We compare the actual deficit with the CBO's projections made over the period 2000 - 2017. Since the CBO makes several projections during any given calendar year, the first projection of the year is used to compare to subsequent realizations of the actual deficit. The first projections for the year are typically published in January. All data is taken from the CBO's website, either from their compiled datasets or directly from their "Budget and Economic Outlook" reports. For the periods where the CBO's projections differ significantly from the actual deficit, there is an accompanying description of how they differ along with a description of economic and budgetary factors that were not taken into account. All data on deficits, both CBO projections and the actual deficit data, are for federal government fiscal years, which run from October 1 until September 30.

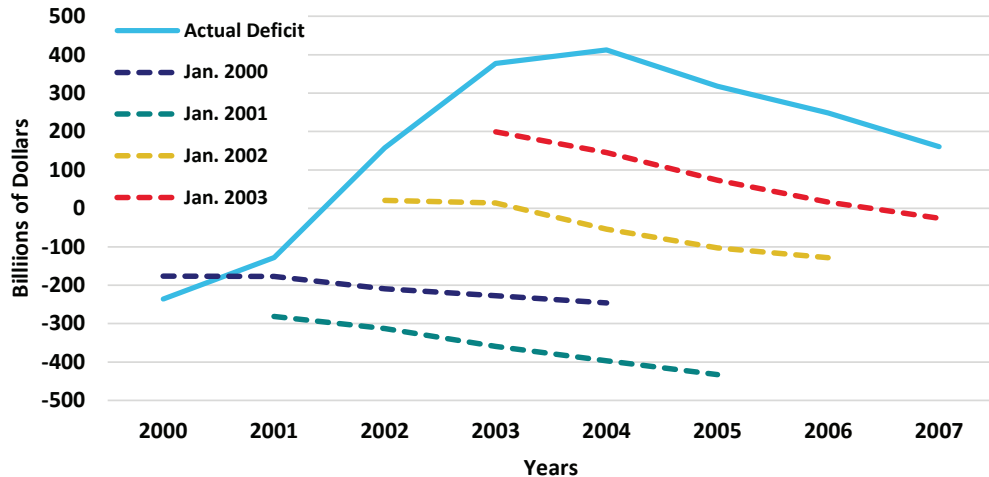
## 2000-2003 PROJECTIONS

The first graph shows the CBO projections made in the years 2000 through 2003. The vertical axis displays the size of the deficits, with positive numbers indicating budget deficits and negative numbers indicating budget surpluses. On the horizontal axis, we indicate the years from 2000 through 2006. We graph the actual deficits for each year. We also graph the CBO's projections made in the year 2000, 2001, 2002, and in 2003. For these projections, we graph the projection for the current year of the projection, for example, the year 2000, and for subsequent years. Thus, in the year 2000 projection, the January projection was for a surplus in 2000 of \$176 billion, while the actual 2000 surplus turned out to be \$236 billion. This same budget projection, made in January 2000, was for a budget surplus in 2002 of \$209 billion, while in actuality, the 2002 budget was in deficit by \$157 billion. Thus, the projection made in January 2000, while fairly accurate for the year 2000, was far too optimistic in the years 2001 – 2006. The projection showed continuing surpluses, while the reality was that we ended up with large deficits from 2002 – 2006.

This pattern continues for projections made in 2001, 2002, and in 2003. The CBO's deficit projections during this time were all markedly optimistic, with all projections showing a path that involved either an increase in the

surplus or a decrease in the deficit. The deficit was continuously underestimated. Even in 2002 and 2003, when the actual budget surplus had disappeared, the CBO projections indicated a future improvement in the budget balance.

### Actual Deficits Versus CBO Projected Deficits 2000 - 2003 Projections

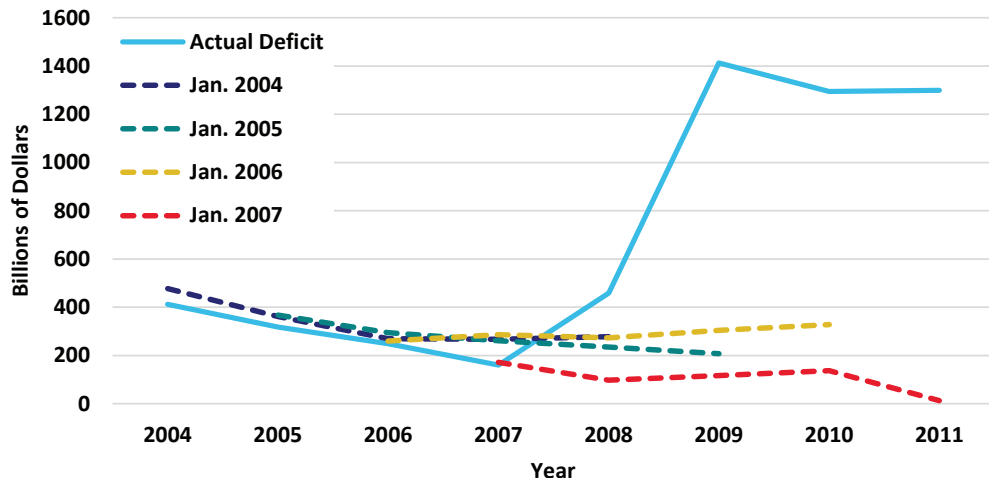


Congressional Budget Office, Budget and Economic Outlook and Updates (2000-2003)

The underestimation of the 2000 and 2001 projections can be explained by Congressional action to pass one of the so-called “Bush tax cuts,” as well as the beginning of the War on Terror. Neither of these were taken into consideration by the CBO in their 2000 and 2001 projections. From 2001 to 2002, the future 10-year projected total of surpluses decreased by 4 trillion dollars. (At the time, the CBO attributed the 60% decline to a change in legislature, such as passing of the Economic Growth and Tax Relief Reconciliation Act of 2001, and 40% to changes in economic conditions and technical changes.) The underestimation of the 2002 and 2003 projections can be partially attributed to the beginning of the Iraq war and the passing of the second so-called “Bush tax cut,” more formally known as the Jobs and Growth Tax Relief Reconciliation Act of 2003. This Congressional action was not considered in the projections made in 2002 and 2003.

### 2004-2007 PROJECTIONS

### Actual Deficits Versus CBO Projected Deficits 2004 - 2007 Projections



Congressional Budget Office, Budget and Economic Outlook and Updates (2004-2007)

The projections made in the years 2004-2007 are significantly less optimistic than those in the preceding period. We can see that projections during this period are close to the actual deficit, at least until the financial crisis of 2008. During these years, the CBO projected that the deficit would gradually decline or continue flat through 2010. However, the financial crisis in 2008 rendered these projections obsolete. In a single year, 2009, the actual deficit differed from every single one of the CBO's projections by more than a trillion dollars.

### 2008-2010 PROJECTIONS

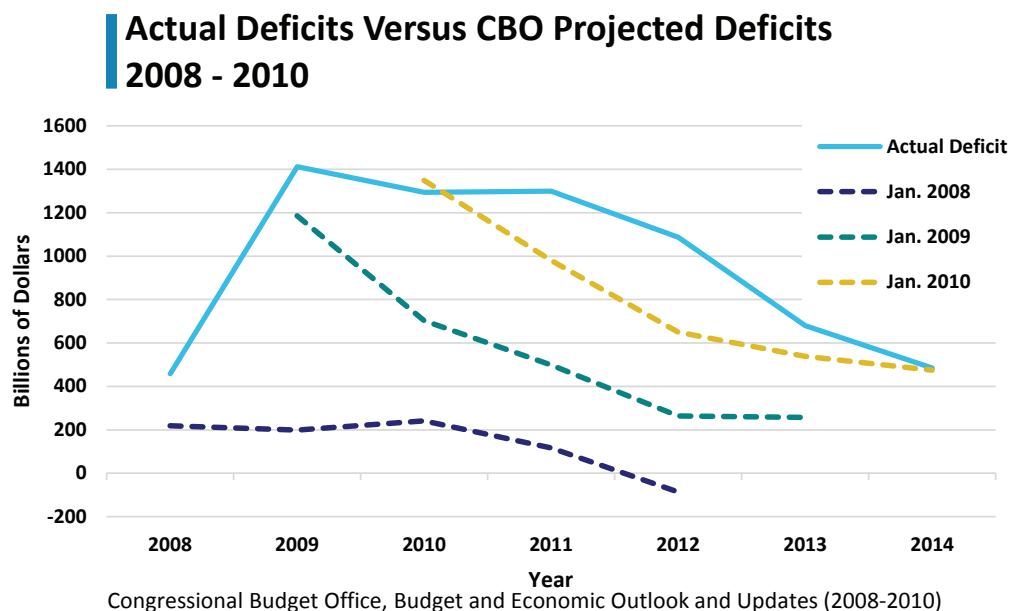
The deficit projections during the 2008-2010 periods are characterized by a significant underestimation of the deficits in the very short term. In January 2008, the CBO projections show the deficit flat at \$250 billion through 2010 and in surplus by 2012. The reality was of course different, with deficits of \$458 billion in 2008, and deficits well over \$1 trillion per year for 2009, 2010, 2011 and 2012.

In January 2009, the CBO had the current magnitude of the deficit nearly correct at over \$1 trillion, but the projected path had the deficit declining steadily to a level of about \$300 billion by 2012. Here too, the CBO was much too optimistic, as the actual deficits remained over \$1 trillion for each of these years.

The January 2010 projection again had the current magnitude of the deficit nearly correct, but again, the projected path show the deficits declining too quickly. The projected path for the 2010 projection missed the 2012 actual deficit by \$500 billion.

In January 2008, the CBO opined that “Although recent data suggest that the probability of a recession in 2008 has increased, CBO does not expect the slowdown in economic growth to be large enough to register as a recession.” While not unique in holding such an opinion, subsequent events proved this expectation to be far from reality.

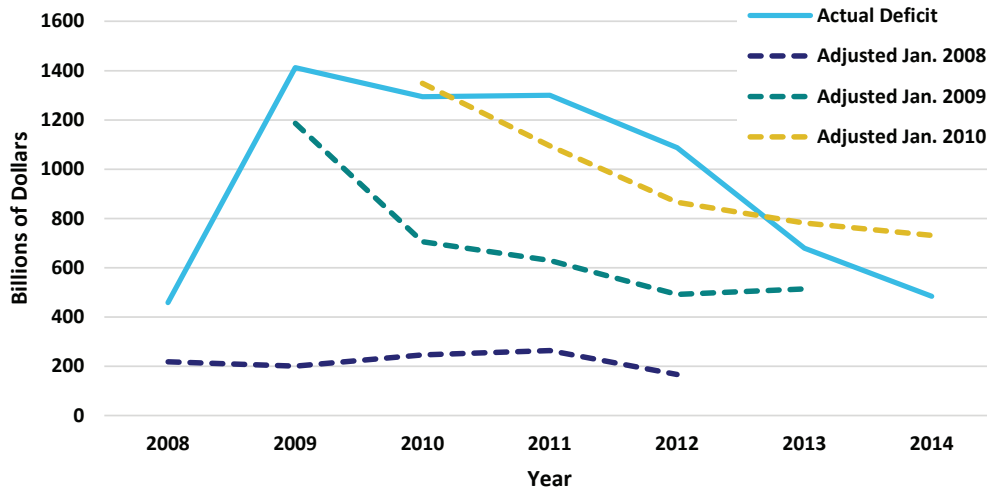
One year later, in January 2009, the CBO was writing that “The sharp downturn in housing markets across the country, which undermined the solvency of major financial institutions and severely disrupted the functioning of financial markets, has led the United States into a recession that will probably be the longest and the deepest since World War II.” Yet even saying that, the CBO projections of the path of future deficits proved much too optimistic.



A partial explanation for the discrepancies between the projected paths of the deficits made in January 2009 and in January of 2010 is due to legislation including the American Recovery and Reinvestment Act and the Troubled

Asset Relief Program (TARP). Here, the consistent underestimation of the deficit can also be partially attributed to the CBO's assumption that the Bush tax cuts (the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Growth Tax Relief Reconciliation Act of 2003) would be allowed to expire by the end of 2010. In reality, the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act in December 2010 extended these tax cuts. However, clearly the CBO did not anticipate the severity of Great recession.

### Actual Deficits Versus CBO Projected Deficits 2008 - 2010 Projections Including Bush Tax Cuts

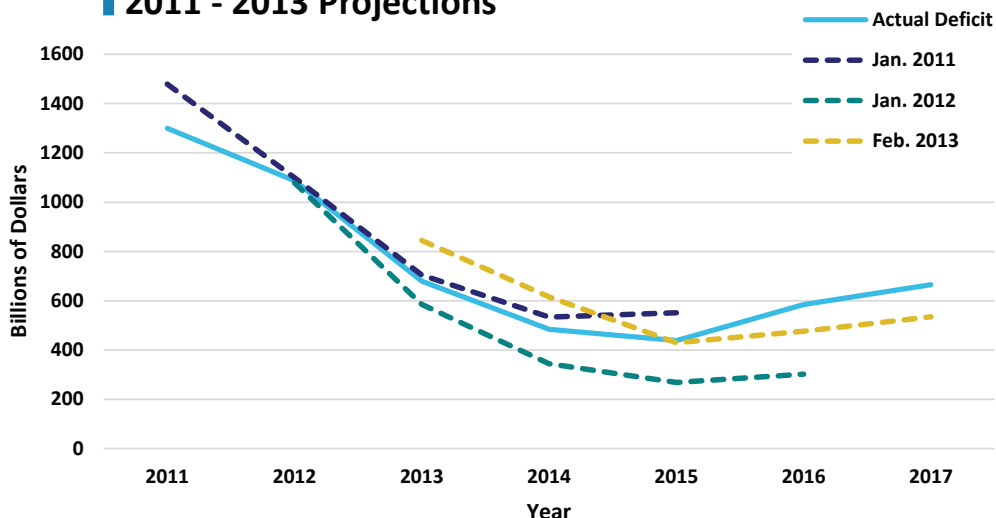


Congressional Budget Office, Budget and Economic Outlook and Updates (2008-2010)

In their 2008-2010 reports, the CBO included estimates of the effect that extending the Bush tax cuts would have on the deficit. The following graph incorporates these alternative projections for 2009, 2010 and 2011. These alternative projections makes the 2010 projection look better, but the 2008 and 2009 projections still have deficits that are drastically lower than the subsequent reality. Even after accounting for the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act, the 2008 and 2009 deficit projections are still more than one trillion and 500 billion dollars less than the actual deficit with continuing under-projections through 2012.

### 2011-2013 PROJECTIONS

### Actual Deficit Versus CBO Projected Deficits 2011 - 2013 Projections

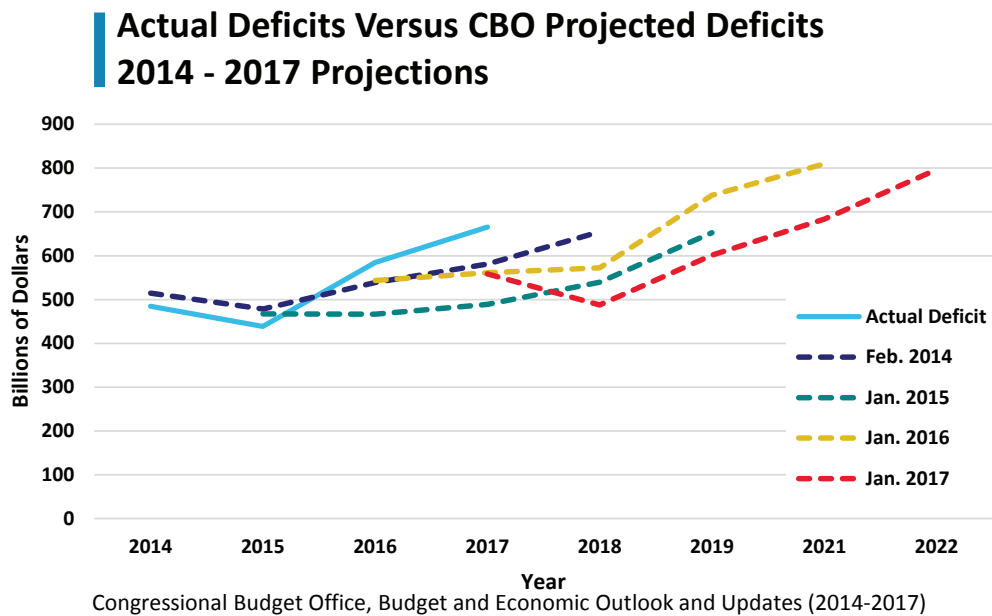


Congressional Budget Office, Budget and Economic Outlook and Updates (2011-2013)

The projections from 2011, 2012 and 2013 show a return to accuracy, with deficit projections fairly close to the subsequent actual path of the deficits. By this time, the Great Recession was long over, and it appears that the CBO projections were not rendered problematic by any unforeseen changes in economic conditions or unforeseen legislative changes to federal revenues and expenditures.

### 2014-2017 PROJECTIONS

The projections made in 2014, 2015 and 2016 show a similar pattern to those for 2011 – 2013, with deficit projections fairly close to the subsequent actual path of the deficits. Our actual deficit data extends only through 2017, limiting the time period available to compare projections made in these years. We can say that at least the initial year projections and the immediate out years correspond to the actual deficit path, indicating again that the CBO projections match subsequent reality during this period when there were no large unforeseen changes in the economy or legislative actions.



### CONCLUSION

The CBO provides projections of costs and revenues to Congress and to the public. It is widely considered to be a reliable non-partisan source. In particular, CBO deficit projections are used to provide a framework for considering the future path of deficits without changes in current law, and subject to CBO projections of economic activity. Here, we have shown that the CBO projections can be wildly different from subsequent realized values of the deficit when the economy changes, and when there are big legislative actions that impact the budget. The purpose of this paper is not to attack the CBO, but to show that their projections have sometimes significantly underestimated the level and path of deficits, while they have not over this period significantly overestimated the level and path of deficits. The public should be aware that CBO projections are, in this sense, an optimistic projection of future events.

## AUTHORS

Dennis W. Jansen is Director of the Private Enterprise Research Center and Mary Julia and George R. Jordan Professor in Economics at Texas A&M University.

Aaron Ross is an Undergraduate Research Fellow at the Private Enterprise Research Center and is a junior major in Economics at Texas A&M University.

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