Sunday News Journal, Wilmington, Del. Sept. 5, 1999 ••• Section H

Perspective

Beware of pols bearing surplus

It seldom materializes if it is tied to a prediction

By SHELDON D. POLLACK

Estimates by the Congressional Budget Office of a $120 billion surplus for the current fiscal year and a $2.9 trillion surplus over 10 years have stimulated politicians to devise new ways to "spend" the money. Congressional Republicans just approved $792 billion of tax cuts, while the White House proposes dedicating hundreds of billions to Social Security and Medicare. But before rushing to enact massive tax cuts or expand entitlement programs, a few words of caution are in order.

First, understand what the budget is — and is not! The budget is a compilation of spending authorized by Congress for the coming fiscal year and expected revenue. The budget measures only the government's projected cash-flow for the coming year. Politicians are acting as if the federal government just got a whole lot richer because of predictions of future surpluses. This is not the case. Furthermore, important items do not appear in the budget — for instance, unfunded long-term liabilities, such as the $3 trillion revenue shortfall that the Social Security system faces over the next 75 years. Take this "off-budget" liability into account and the surplus vanishes!

Second, the numbers can be misleading. CBO's prediction of a $2.9 trillion surplus is based on the consolidated budget, which includes an extra $100-$200 billion or so generated annually by the Social Security wage tax. This is how budget surpluses (and deficits) must be calculated under current law. Nevertheless, it presents a highly distorted and deceptively favorable picture of the government's cash-flow.

Finally, reports of surpluses are nothing more than predictions of future spending and government receipts based on certain economic assumptions — such as the direction of interest rates, inflation, tax receipts, and governmental expenditures. While these assumptions may be perfectly reasonable when made, they often turn out to be inaccurate over the long-term. Very slight technical adjustments in the economic assumptions of the revenue forecasters can produce tens of billions of extra revenue that show up in long-term budget projections, dramatically affecting predictions of future surpluses.

For instance, the revenue forecasts assume that because the economy is strong today, future tax receipts will pour into the Treasury over the next 10 years at the current historic rates — a feat that is next to impossible. Unless the law of business cycles has been effectively repealed, a recession will eventually arrive, and with it tax revenues will decline precipitously. Unexpected events such as the deployment of U.S. military personnel in Kosovo (funded through $15 billion in "emergency" funds) can put an end to predicted surpluses for any given year.

CBO's 10-year budget estimates also are premised on certain highly dubious political assumptions — for example, that Congress will keep spending under the statutory budget caps that apply to discretionary expenditures. This is highly unlikely, as Congress has continually relied on emergency authorizations to push spending beyond the budget caps. It has been difficult to reach agreement on budget appropriations that conform to the spending limits. So far this year, Congress has been unable to pass the 13 annual appropriations bills required for fiscal year 2000 — mainly because of the austere budget caps. To the extent that the budget caps are exceeded, government spending will be higher and the projected surplus for fiscal year 2000 will be that much lower!

So don't bet the house on the predicted $2.9 trillion surplus ever being realized — just as predictions earlier in the 1990s of decades of deficits never materialized. One-year budget forecasts are subject to considerable error — as witnessed by CBO's continual revising and updating of its projections. If CBO can be wrong by tens of billions of dollars in a three-month estimate, imagine the magnitude of error in a 10-year projection. The danger is in policy makers relying on such long-term budget projections to guide contemporary decisions. Tax cuts, as well as expansions of domestic programs such as Medicare and Social Security, become fixed in law. If the future revenue does not materialize (for instance, because of a recession), we run the risk of major deficits returning.

It should not be surprising that reports of decades of surpluses totaling in the trillions have thrown policymakers into a tizzy. Perhaps we are entitled to a moment of celebration, as we are getting our fiscal house in order. But until we deal with the $3 trillion unfunded liability of Social Security and pay off a significant chunk of our $5.6 trillion national debt, we shouldn't make too many demands on future budget surpluses.

►Sheldon D. Pollack is associate professor in the College of Business and Economics at the University of Delaware.