



B-71 Cannon House Office Building
Washington, DC 20515
Representative Paul D. Ryan, *Ranking Republican*

REPUBLICAN CAUCUS

THE COMMITTEE ON THE BUDGET

Phone: (202)-226-7270
Fax: (202)-226-7174

Augustine T. Smythe, *Republican Staff Director*

POINTS TO CONSIDER
THE FORTHCOMING MID-SESSION REVIEW

20 August 2009

SUMMARY

The administration's *Mid-Session Review*, scheduled for release next Tuesday (25 August 2009), will provide an update of budget and economic projections. Key issues to consider when evaluating the report include the following:

- *The 2009 Deficit.* Because spending has been higher, and tax revenue lower, the deficit is rising this year to three times the previous record. But if the administration's claims of deficit "reduction" appear to defy reality, consider its handling of its \$250-billion "placeholder" for the Troubled Assets Relief Program: simply removing this "just-in-case" padding from spending estimates does not equate a real reduction in the current-year deficit.
- *Out-Year Deficits.* The Congressional Budget Office [CBO] estimates the President's budget will double the debt in slightly more than 5 years, and nearly triple it in 10 years. CBO also shows the administration's deficits remaining greater than \$600 billion for the duration of the President's budget, with a \$1.2-trillion deficit at the end of the decade. Should the administration continue its claims of "cutting the deficit in half," note this has nothing to do with spending cuts, but rather is a natural reduction from an extraordinarily high starting point (recession, financial bailouts, and so on). Should the administration continue to claim \$2 trillion in "savings," be aware that most of these "savings" were actually a \$1.5-trillion [war funding gimmick](#).
- *The Long-Term Outlook.* Less than 2 months ago, CBO submitted to Congress its report showing further deterioration in the [Long-Term Budget Outlook](#) – primarily due to unsustainable spending growth of Federal health care entitlements. It is worth noting whether the administration's update includes anything concrete (reforms CBO says will actually save money in the long run) to address this worsening crisis.
- *The State of the Economy.* The administration's "stimulus" bill has not performed as advertised: the economy has worsened, the unemployment rate has far exceeded the 8-percent ceiling the administration promised, and most economists today predict a slow, shallow recovery – with future growth burdened by Washington's unprecedented levels of government intervention, spending, deficits, and debt. Hence it is reasonable to view skeptically any exaggerated assessments of economic performance under the administration's continued "stimulus" plan.

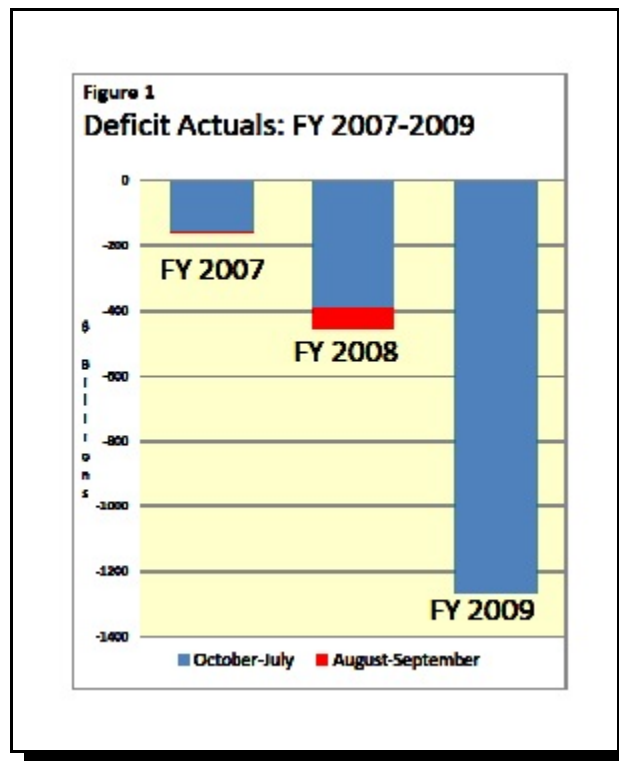
The discussion below elaborates on these points, and offers a context in which to evaluate the administration's updated budget figures. A clear understanding of these developments will be important to determine whether further government expansion – such as a huge new government health entitlement – is fiscally and economically viable.

Note: The Office of Management and Budget [OMB] chose to release the *Mid-Session Review* the same day CBO had scheduled release of its own summer update of *The Budget and Economic Outlook*. Both reports will provide revised budget and economic projections for fiscal years 2009-19. Congress relies on CBO's budget and economic projections. Most of the focus likely will be on revised deficit projections for fiscal year 2009. There will likely be some confusion about projections after 2009. CBO's projections will be built on its own baseline, which is a projection of spending, revenue, and deficit levels under current law, with certain adjustments. CBO will not provide a re-estimate of the President's budget. OMB's focus in the *Mid-Session Review* will be on the budget impact of the President's policies.

THE BUDGET

- CBO's January baseline projected a fiscal year 2009 deficit of \$1.186 trillion, or 8.3 percent of gross domestic product [GDP]. For 2010, CBO projected a baseline deficit of \$703 billion, or 4.9 percent of GDP.
- CBO projected a natural decline from these peak levels over the next 10 years as the economy emerged from recession, revenues rebounded, and spending for unemployment insurance, the Troubled Assets Relief Program, and other programs waned with a strengthening economy. Deficits were projected to decline over the next several years, even with a continuation of the 2001 and 2003 tax relief provisions, the alternative minimum tax [AMT] "patch," and war funding. (See Table 3 at the end of this document.) Whichever baseline one chooses – the January baseline or the adjusted baseline for tax relief and the war – it is the deficit the Obama administration "inherited."
- Two things have happened since January. First, the President submitted his proposed budget for fiscal year 2010. Second, Congress began passing legislation with unprecedented levels of spending, such as the fiscal year 2009 omnibus appropriations bill, and the \$787-billion "stimulus." Since January, the House of Representatives has reported or passed legislation that would add \$3.4 trillion in spending and \$1.9 trillion in deficits, relative to CBO's. [Budget Status Report](#).
- Following a more thorough review, CBO in June provided a full re-estimate of the President's budget, which reflected stunning increases in spending, taxes, deficits, and debt. Nevertheless, the Obama administration has sought to describe its budget as "fiscally responsible": that it will "cut the deficit in half" and reduce baseline deficits by \$2 trillion over the 10-year period. Any objective analysis of these claims calls into question the fiscal path the President has proposed.
 - According to CBO, under the President's budget, deficits never fall below \$600 billion, and they end the decade at \$1.2 trillion, or 5.5 percent of GDP. (See Table 3 at the end of this document.) As a result, the President's budget doubles the debt in just more than 5 years, and nearly triples it in 10 years.

-
- Further, the administration's claim of \$2 trillion in deficit reduction is achieved by projecting a benchmark level of future spending for operations in Iraq and Afghanistan that no one was anticipating. OMB took the peak of funding in fiscal year 2008 for the surge in Iraq and assumed this pace would continue for the next 10 years. Then, by taking credit for a drawdown in Iraq that President Bush had already initiated, the administration claimed \$1.5 trillion in savings. The remaining deficit "reduction" comes from tax increases.
 - Each month, CBO and the Treasury provide data on actual tax collections, spending, and deficits. For the first 10 months of the current fiscal year, Treasury shows the Federal Government running a deficit of \$1.3 trillion, nearly three times the previous record of \$456 billion set in 2008 for the entire fiscal year. Two months remain in the fiscal year, during which the deficit is likely to reach \$1.5 trillion or more. The graph below breaks out the actual deficit levels for the first 10 months of fiscal years 2007, 2008, and 2009. (See Figure 1 below.)



THE TROUBLED ASSETS RELIEF PROGRAM

- It is worth remembering that the Troubled Assets Relief Program [TARP] has expanded in scope from its original mission, which was purchasing toxic assets to prevent a systemic meltdown in the financial services sector. TARP funds have been used for modifying mortgages for at-risk borrowers, buying partial ownership in U.S. auto companies, and rescuing the American International Group.

-
- Although the President’s fiscal year 2010 budget contains a \$250-billion TARP placeholder for “potential additional financial stabilization efforts” – that is, in addition to the \$700 billion in TARP funding already enacted – this funding was not reflected in the congressional budget resolution for fiscal year 2010 (S. Con. Res. 13), and never was requested by the administration. With less than 2 months left in the fiscal year, and the stabilization of financial markets, the administration could drop this \$250-billion placeholder in the *Mid-Session Review*, and then claim it as deficit reduction.
 - The \$250-billion “contingent reserve” represents a credit reform estimate cost. On a cash basis, it reflects about \$750 billion in asset purchases, according to OMB. Thus, if the placeholder were to become a live program, its size would surpass even the original \$700 billion in TARP funding enacted in October 2008.
 - A closer look at the original \$700-billion program reveals that TARP already is costing more than initially anticipated. At the time TARP was enacted, it was noted the program would not cost the full \$700 billion; some even suggested TARP could make a profit. Because of uncertainty about how the administration would use the TARP funds, CBO was unable to provide a cost estimate when the legislation was finalized.
 - CBO did, however, provide an estimate in its January budget projection, projecting TARP would end up costing taxpayers \$189 billion. CBO’s latest estimate, in March, increased the cost of TARP to \$356 billion, with key contributions coming from additional loans to the auto industry (which carry a 73-percent subsidy rate) and the introduction of the administration’s foreclosure mitigation plan (with a 100-percent subsidy rate). Although it appears the net cost of TARP has declined since March – largely due to banks’ \$70-billion repayment of Capital Purchase Program funds and improved market values – the costs to taxpayers nonetheless have increased since January.

ECONOMIC CONDITIONS

Weaker-Than-Predicted GDP Performance

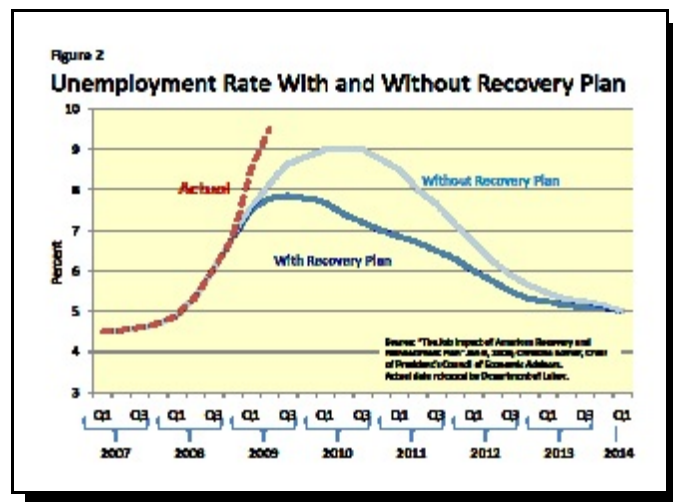
- In February, the administration predicted real GDP would decline by just 1.2 percent this year, which was more optimistic than projections by both CBO and the Blue Chip consensus. The Blue Chip’s subsequent estimate in April increased its estimate of economic contraction to 2.6 percent; and the most recent Blue Chip figures (from 10 August 2009) – which take into account the effects of market stabilization and economic “stimulus” – still see real GDP declining by 2.6 percent. (See Table 1 below.)
- The economic recovery also is likely to be more tepid than the administration has projected. The President’s budget foresaw 3.2-percent real GDP growth in 2010 (see Table 1). That estimate is more optimistic than those of CBO or the Blue Chip, to which the administration compared itself in both February and May. The latest Blue Chip forecast projects a lukewarm 2.3-percent growth in real GDP in 2010; and nearly two-thirds of private-sector forecasters in this month’s Blue Chip report foresee a “U-shaped” recovery – that is, a slow recovery marked by sluggish growth – while only 16 percent expect a speedy return to brisk growth, or what is known as a “V-shaped” recovery.

Table 1: Projections of Real Gross Domestic Product

	2009	2010
Obama Budget (February 2009)	-1.2	3.2
CBO (March 2009)	-3.0	2.9
Blue Chip Consensus (August 2009)	-2.6	2.3

Greater Job Losses, Higher Unemployment

- The administration's employment figures also turned out to be significantly more optimistic than reality.
 - Earlier this year, the administration predicted that its economic stimulus plan would hold the unemployment rate under 8 percent. But the unemployment rate is currently at 9.4 percent (see Figure 2), and although it ticked down in the latest month. Most economists see it continuing to rise in the coming months. The latest Blue Chip forecast (10 August 2009), for instance, still projects the unemployment rate hitting nearly 10 percent next year (see Table 2 below). Since the stimulus was enacted, the economy has lost more than 2.1 million jobs.
 - Even the recent reduction in the unemployment rate is not the "good news" some considered it to be. The decline occurred not because people found jobs, but because more than 400,000 workers dropped out of the labor market. These people are no longer considered part of the official workforce. Economists note that as the economy begins to recover, workers will rejoin the labor force, pushing the unemployment rate upward.

**Table 2: Unemployment Rate Projections (percentages)**

	2009	2010
Obama Budget (February 2009)	8.1	7.9
CBO (March 2009)	8.8	9.0
Blue Chip Consensus (August 2009)	9.3	9.9

-
- The administration's February budget submission projected the unemployment rate would decline to 7.9 percent in 2010. But the Blue Chip consensus sees the rate rising to 9.9 percent next year. In a labor force of roughly 154 million people, the difference between the two rates amounts to more than 3 million unemployed workers.
 - Although the rate of monthly job losses has slowed, it will likely take some time to return to job creation. According to the August economic forecasting survey in *The Wall Street Journal*, the economy will continue to lose a net of 325,000 additional jobs over the next 12 months.

This document was prepared by the Republican staff of the Committee on the Budget, U.S. House of Representatives. It has not been approved by the full committee and may not reflect the views of individual committee members.

Table 3: Budget Deficits (\$ in billions)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2010-2019
CBO January Baseline Deficit	-1,186	-652	-427	-182	-165	-148	-123	-151	-103	-49	-87	-2,087
As a Percent of GDP	-8%	-5%	-3%	-1%	-1%	-1%	-1%	-1%	-1%	0%	0%	
CBO January Baseline Adjusted to Extend Tax Relief and War Funding	-1,217	-834	-723	-584	-621	-653	-704	-767	-778	-790	-898	-7,353
As a Percent of GDP	-9%	-6%	-5%	-4%	-4%	-4%	-4%	-4%	-4%	-4%	-4%	
Obama Budget as Estimated by CBO in June	-1,825	-1,432	-974	-633	-647	-726	-763	-873	-927	-999	-1,163	-9,137
As a Percent of GDP	-13%	-10%	-7%	-4%	-4%	-4%	-4%	-5%	-5%	-5%	-6%	