## How we construct the Hutchins Center Fiscal Impact Measure Forecast

The FIM forecast uses the Congressional Budget Office’s (CBO) 10-year economic and budget projections to construct forecasts of government spending, taxes, transfers, GDP, and inflation. Importantly, CBO’s projections of these variables rely on the assumption that current law will remain in place over the projection horizon—an assumption we deviate from in circumstances that we describe here.

The FIM forecast focuses on the near-term outlook for fiscal policies—that is, expected changes over the next two years. While the effects of mandatory spending programs are relatively straightforward to forecast over the medium term, forecasting economic growth and the stance of other fiscal policies would introduce significant uncertainty to any forecast of the FIM beyond a near-term horizon.

### Projecting the federal, state, and local spending FIM components

To get an estimate of future (say, some quarters ahead) federal spending’s contribution to GDP growth, we multiply the projected growth rate in inflation-adjusted federal spending by the projected nominal ratio of federal spending to GDP:

where is the contribution of federal expenditures to real annualized GDP growth, in percentage points, and , , and are the projected values of nominal federal spending, nominal GDP, and the inflation-adjusted annualized growth rate of federal expenditures, respectively.

CBO’s projections for these variables assume that current discretionary spending caps, which were raised by approximately $152 billion in the Bipartisan Budget Act of 2018, will expire and return to the path set under 2011 law at the end of fiscal year 2019. Under this assumption, inflation-adjusted federal spending would rise in the first half of 2019 but decline sharply in subsequent quarters, becoming a drag on GDP growth by the end of 2019. The FIM forecast assumes instead that these caps will remain in place (at a higher level than current law entails), and that discretionary spending will grow in line with CBO’s longer-term budget projections beginning in fiscal 2019. As a result, the FIM sees a more moderate decline in Fiscal Impact from federal spending over the projection period than does a projection that assumes current law will remain in place.

The projected Fiscal Impact from state and local spending is calculated in a manner analogous to that of the federal spending impact. Like the federal component, the projection for future state and local expenditures comes from CBO’s economic projections. State and local spending is projected to increase moderately over the next two years, as broader growth boosts tax revenues and demand for the services those governments provide.

### Taxes and Transfers

Projected Fiscal Impact from taxes and transfers at all levels is calculated in the same way as are historical values of the taxes and transfers FIM, reflecting that aggregate current taxes and transfers equals the sum of those at the federal, state and local levels.

We assume federal taxes and transfers will grow in a manner consistent with CBO’s budget projections for the main categories of federal tax revenues and mandatory spending.[[1]](#footnote-1) CBO projects that transfers under the main federal entitlement programs—Social Security, Medicare, and Medicaid—will rise by 5 percent in 2019 and at a similar rate in subsequent years, providing a steady infusion of spending into the economy. Federal taxes are expected to grow at a rate consistent with the economy, with the exception that corporate taxes are expected to grow slightly faster in the coming years.[[2]](#footnote-2) At the state and local level, we expect that taxes and transfers will grow in line with state and local spending, reflecting that most states operate under rules that require revenues and outlays to remain closely linked. Under these assumptions, tax and transfer policies at the federal, state, and local levels make a small but positive contribution to GDP growth in the coming quarters.

1. We CBO’s budget projections as they appear in the National Income and Product Accounts (NIPAs), which are projections for current taxes and income from transfers on a fiscal year basis and translate them to quarterly growth rates by imputing the fiscal year values to each of the four relevant calendar-year quarters and smoothing them over four quarters. [↑](#footnote-ref-1)
2. CBO offers two explanations. The first is “unexplained weakness” in recent receipts, that CBO expects to dissipate. The second is that some TCJA provisions phase out in 2022, like the full-expensing provisions, and imply a slightly steeper path for corporate tax income. [↑](#footnote-ref-2)