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NO END IN SIGHT TO RISING DEFICITS, EXPERTS WARN
Bipartisan Group of Budget Analysts and Former Senior Officials Call for Fiscal Discipline

Washington, D.C. — A bipartisan group of prominent budget analysis organizations, former senior government officials, and business leaders warned today of a "growing mismatch between what Americans are scheduled to pay to government and what they expect government to deliver in return." The group released a new analysis of the expanding federal budget deficit, projecting $5 trillion in total deficits over the coming decade. The group also released a joint statement calling on Congress and the President to develop "a realistic plan for putting the nation's fiscal house in order."

Issuing the statement were the Committee for Economic Development, an organization of business leaders and educators; the Concord Coalition, a bipartisan organization dedicated to sustainable fiscal policy; and the Center on Budget and Policy Priorities, a policy research organization that focuses on fiscal issues and issues affecting low- and moderate-income families. Joining them in releasing the statement were prominent board members of the three organizations, including Robert Rubin, Warren Rudman, Peter Peterson, Robert Reischauer, and William Lewis.

"Many in Washington now argue that escalating deficits do not really matter, that they are self-correcting, that they are unrelated to interest rates or future economic well-being, and that tax cuts will pay for themselves later by spurring economic growth," the statement noted, adding, "It would be wonderful if this were true. It is not." With just a few years remaining before the baby boomers' retirement, the government is on course to squander its final opportunity to prepare for that event by reducing the national debt.

Coming Decade "the Most Fiscally Irresponsible in Our Nation's History"

The three organizations project that combined deficits over the next decade (2004-2013) will total $5 trillion if the nation stays on its current path regarding tax and spending policies.

These projections start with the official Congressional Budget Office projections regarding revenues, expenditures, deficits, and economic growth over the coming decade, but make adjustments to reflect the continuation of current policies. Specifically, they assume that expiring tax cuts will be extended and relief from the Alternative Minimum Tax continued, that a prescription drug benefit costing $400 billion over ten years will become law, that the Administration's future-year defense plan will be fully funded, and that domestic appropriated programs will keep pace with inflation and population growth.

Unless the federal government changes course, this coming decade will be "the most fiscally irresponsible in our nation's history," the organizations stated. The only other period in which the federal government has run deficits of this size (except during times of global depression or full-scale war) was the 1980s and early 1990s, a time when the retirement of the baby-boom generation was still a generation away. Today, with the first baby boomers due to start collecting Social Security in five years, it is just around the corner.

The annual deficit, rather than being cut in half in five years as is suggested by estimates that do not fully reflect the costs of continuing current policies, will grow over the ten-year period under the projections, reaching $610 billion in 2013.

The magnitude of the projected deficits can be seen in the fact that even with a full economic recovery and a decade of economic growth, balancing the budget by 2013 would entail such radical steps as:

- raising individual and corporate income taxes by 27 percent; or
- eliminating Medicare entirely; or
- cutting Social Security benefits by 60 percent; or
- shutting down three-fourths of the Defense Department; or
- cutting all expenditures other than Social Security, Medicare, defense, homeland security, and interest payments on the debt by 40 percent.

$9 Trillion Deterioration in the Budget Outlook in Just 32 Months

The emergence of massive projected deficits has happened in a startlingly short time. In January 2001, the Congressional Budget Office projected that the government would amass trillions of dollars in surpluses over the decade from 2002 to 2011. The organizations project that the budget outlook for this same 2002-2011 period is now $9 trillion worse than it was in January 2001.

More than a third of this $9 trillion decline can be attributed to tax cuts, with this share rising over time. Nearly one-third is attributable to new expenditures, most of which are for defense and homeland security. Changed assumptions about the economy and the amount of revenue generated for a given level of economic activity account for the remaining third.

Even Worse Problems Later, When Baby Boomers Retire

Even larger deficits are forecast for the decades after 2013 as the retirement of the baby-boom generation causes large increases in the cost of retirement programs such as Social Security and Medicare. If current tax and spending policies are continued, deficits will jump from an already high level of 3.4 percent of the nation's Gross Domestic Product in 2013 to 7.8 percent of GDP in 2023, according to the organizations' projections.

Unless brought under control, deficits will lead to slower economic growth by crowding out productive investment. They also will raise the cost of interest payments on the national debt. Annual interest payments will reach $470 billion in 2013 and much more in later years.

Large Deficits Will Not Disappear on Their Own

So large are the projected deficits, the organizations warned, that the economy cannot possibly "grow out of them," a message supported by reports from institutions such as the General Accounting Office and the Congressional Budget Office. The projected deficits are structural rather than cyclical — in other words, they reflect a fundamental mismatch between revenues and expenditures rather than the temporary (and self-correcting) effects of an economic downturn.

If the tax cuts are extended, federal revenues in the coming decade will be lower, as a share of the economy, than their average level in any of the last three decades. And while federal expenditures are not at historically high levels today as a share of the economy, they will be once the baby-boom generation retires in large numbers. The resulting imbalances will be very large.

Neither party is yet willing to make the difficult choices necessary to correct these imbalances, the organizations said. The Administration fails to acknowledge the relationship between its fiscal choices and the nation's long-term future, while Democratic alternatives tend to ignore the fact that existing commitments for retirement, health, and security exceed the revenues available to pay for them.

"In the end, our children will have to face higher taxes, reduced public services, or both," the organizations warned. "But if we wait until the crisis is upon us, the solutions will be more draconian."

As a first step, the organizations said, Congress and the President should "act immediately to stop digging the hole deeper." They also called on policymakers to develop a long-term plan to restore fiscal discipline, including a return to the "pay-as-you-go" budget rules that proved effective during the 1990s.

Joining in presenting the joint statement were:

- Robert E. Rubin, treasury secretary under President Clinton and now a director and chairman of the Executive Committee of Citigroup, Inc.,
- Warren B. Rudman, former Republican senator from New Hampshire and founding co-chairman of the Concord Coalition,
- Peter G. Peterson, secretary of commerce under President Nixon and current president of the Concord Coalition,
- Robert D. Reischauer, former director of the Congressional Budget Office and current president of the Urban Institute, and
- William W. Lewis, trustee of the Committee for Economic Development and director emeritus of the McKinsey Global Institute.

A transcript of the policy briefing will be posted at the groups' web sites. The joint statement, along with a detailed analysis are currently available at the web sites: www.cbpp.org, www.concordcoalition.org, www.ced.org.

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January 16, 2004

Will the Administration Cut the Deficit in Half? and If So, How?

by Richard Kogan and Martha Coven

The Bush Administration has said it has a plan to cut the deficit in half in five years, as a percentage of GDP. However, this plan is likely to be largely a public relations gimmick. The Administration will print a budget that, on paper, has figures for the fifth year (2009) that show the deficit being cut in half. But that will only be possible because, as has been the case with previous Bush budgets, it omits major, costly items that the Administration favors and intends to request — later.[1]

Cutting the Deficit by Smoke and Mirrors

A series of analyses — including analyses by the Brookings Institution, Goldman-Sachs, and a joint analysis by the business-led Committee for Economic Development, the Concord Coalition, and the Center on Budget and Policy Priorities — have all found that official budget projections omit a number of likely costs that must be added back to gain a realistic sense of the budget deficits we face in coming years. *The Administration's forthcoming budget is expected to have approximately $200 billion in missing costs in the fifth year.* Once these missing costs are taken into account, the deficit is seen as being in the range of $500 billion in 2009, or around 3.5 percent of GDP. That is not close to cutting the deficit in half.

Moreover, as many outside observers — most recently including the International Monetary Fund and the Congressional Budget Office — have emphasized, even if the deficit is reduced somewhat in the next few years, deficits will again begin growing substantially after that, and will eventually reach economically unsustainable levels.

Examples of the costs likely to be missing from the President's plan include:

1. Pentagon Buildup. The Administration has published a "future year defense plan" showing its force structure and weapons goals. According to analysis by the Congressional Budget Office and the Center for Strategic and Budgetary Assessments, the figures in the *last* Bush budget were as much as $500 billion short of the Administration's plan over ten years. The coming budget likely will take the same approach of not showing the full costs of the plan in future years.

[1] This issue brief is drawn from Richard Kogan, "Will the President's 2005 Budget Really Cut the Deficit in Half?," Center on Budget and Policy Priorities, January 16, 2002.

2. War on Terrorism. The previous budget showed *zero* costs for fighting terrorism worldwide beyond last September. The new budget may do the same, even though we won't stop the long-term and ongoing international hunt for terrorists.

3. Relief from the Alternative Minimum Tax. The Alternative Minimum Tax was established to make sure wealthy investors don't evade their tax obligations through excessive use of tax shelters and avoidance schemes. But in the years ahead, because of flaws in its structure, the AMT will explode into the middle class. Currently, only 2 to 3 million mostly well-off people are subject to the AMT because Congress has enacted AMT relief through this coming December. If relief is not extended, an estimated 30 million people will be subject to the AMT in 2009, and many of them will be middle class. The Administration has said on the record that it intends to propose permanent AMT relief, but will wait until 2005 to do so. Next year's budget will only show relief for a year or so; it will omit an estimated $70 billion in 2009 costs, as though the Administration really intends 30 million people to be subject to the AMT that year.

4. "Tax extenders." A lot of ostensibly "temporary" tax breaks have been in law for many years and are always extended a few years at a time. The coming budget is likely to pretend most of them will expire before 2009. They won't. This will cost about another $10 billion in that year.

Cutting the Deficit by Cutting Domestic Programs

Suppose instead that the Administration wanted to cut the deficit in half for *real*, while maintaining (and expanding) its tax cuts and maintaining its defense build-up and anti-terrorism spending. The Administration would reflect the missing costs noted above in its budget and then reduce spending enough to cut the deficit in half by 2009. The Administration is unlikely to cut Social Security or Medicare benefits. That means that cutting the deficit in half — to about 2 percent of GDP in 2009 — would require cutting $150 billion from other programs. That amount is equivalent to:

- *Twice* the entire veterans budget; or
- *Twice* the entire education budget; or
- *14 times* the environmental budget.

To put it another way, if we cut all programs *except* defense, homeland security, Social Security, and Medicare by $150 billion in 2009, we'd have to cut all other programs by *15 percent*. This includes education, health research, unemployment benefits, Medicaid, veterans' benefits, military pensions, school lunch, and dozens of others.

If we limited the cuts to the domestic programs funded annually through the appropriations process, such programs — which include education, veterans health, and environmental protection — would have to be cut nearly *one third*.

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Policy Points

IS DOMESTIC SPENDING EXPLODING?

As the Administration prepares to unveil its new budget next month, many news accounts are reporting claims by the Heritage Foundation and other conservative groups that federal domestic spending has exploded in recent years. Careful analysis does not support these claims:

- Federal spending is not exploding. The standard measure of changes in government spending over long periods — the one used by the Congressional Budget Office, the Office of Management and Budget, and other analysts with no ideological ax to grind — is spending as a share of the economy. *In 2003, federal spending was lower, as a share of the economy, than in every year from 1975 through 1996.*

- The overall level of funding for domestic appropriated (i.e., non-entitlement) programs did not rise at all in 2003, after adjusting for inflation, and isn't rising in 2004 either. If the pending omnibus appropriations bill passes, total funding for domestic appropriated programs outside homeland security will be *$6 billion lower* in 2004 than it was in 2002, after adjusting for inflation.

- To be sure, the rate of overall spending growth has increased significantly in the last few years. This is primarily due to two factors: very large increases in defense and anti-terrorism spending, and *temporary* spending increases in entitlement programs like unemployment insurance in response to the economic downturn.

- Spending always rises in economic downturns as more people become eligible for programs like unemployment insurance. But federal spending in 2003 — at 19.9 percent of GDP (the basic measure of the size of the economy) — was *much lower* than during the downturns of both the 1980s and 1990s.

- The bulk of the increase in spending that has resulted from actions that policymakers have taken since the start of 2001 has occurred in defense, homeland security, and international affairs (which includes post-war operations in Iraq and Afghanistan). CBO data show that in 2003, increases in defense, homeland security, and international affairs spending accounted for 63 percent of all spending increases enacted since the start of 2001. A portion of the remaining 37 percent of the spending increases consisted of temporary increases for programs like unemployment insurance; these increases will disappear as the economy rebounds.

- The spending increases continue to be dwarfed by the tax cuts. The CBO data show that in 2003, the revenue lost as a result of tax cuts enacted since January 2001 exceeded the cost of all defense, counter-terrorism, and domestic spending increases *combined*.

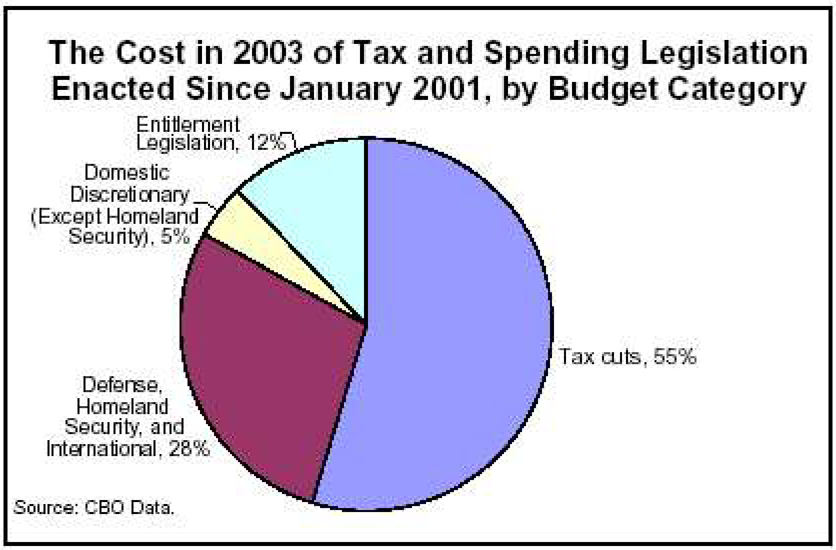
None of this means the nation does not face serious long-term fiscal problems. It does mean that increases in domestic spending are not the principal reason for the unprecedented swing in the past few years from hefty surpluses to large deficits.

These issues are explored in more detail below.

Tax Cuts and Defense-Related Increases Far Outweigh Domestic Spending Increases

Tax cuts made up more than half (55 percent) of the total cost last year of all spending and tax legislation enacted since 2001. Tax cuts cost twice as much as the increased spending on defense, homeland security, and international affairs. Tax cuts cost more than three times as much as the increased spending on domestic appropriated and entitlement programs combined.

If one sets aside tax cuts and considers just the fiscal effects of spending increases, one finds that nearly two-thirds (63 percent) of the increased federal spending in 2003 that resulted from legislation enacted since January 2001 occurred in defense, homeland security, and international affairs.



Part of Domestic Spending Increase Is Temporary Effect of Weak Economy

Domestic spending grew faster between 2001 and 2003 than it had in nearly a decade, as the Heritage Foundation notes. But recessions virtually always trigger a temporary increase in domestic spending: expenditures for unemployment insurance and other benefit programs increase as people lose their jobs and become eligible for various benefit programs. This temporary increase in spending recedes as unemployment declines.

Thus, it is not surprising that domestic spending grew more quickly during the recent downturn than during the preceding economic boom. A more important question is whether domestic spending grew more quickly during the recent downturn than during the previous downturn, in the early 1990s, and it did not: the increases during the two periods were nearly identical.

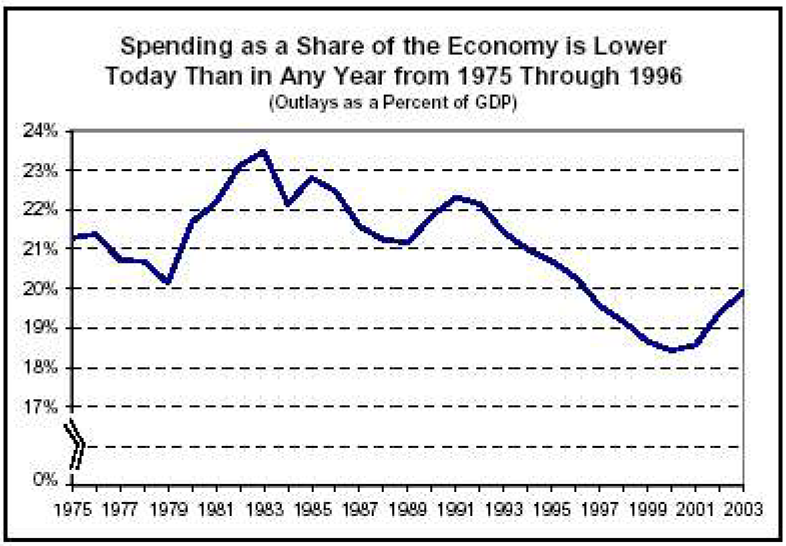
In fact, as the table below shows, fiscal year 2002 was the only year since President Bush took office in which appropriations for domestic appropriated programs outside homeland security increased after adjusting for inflation. *Once budget surpluses disappeared and deficits returned, Congress and the White House stopped increasing the funds for these programs.* If the pending omnibus appropriations bill is enacted, total appropriations for domestic discretionary programs outside homeland security will be *$6 billion lower* in fiscal year 2004 than in fiscal year 2002, after adjusting for inflation.

Funding Levels for Annually Appropriated Programs, Adjusted for Inflation (Assuming enactment of the omnibus appropriations bill; in billions of constant 2004 dollars)				
	2001	**2002**	**2003**	**2004**
Defense, Intl, Homeland	$365	$448	$524	$534
Domestic (outside Homeland)	355	396	390	389
Total	720	844	914	924

Totals may not add due to rounding.

Overall Federal Spending Not at Historic Highs

While federal spending as a whole has risen in the past few years, it remains far below peak levels. In 2003 it equaled 19.9 percent of GDP, lower than in every year from 1975 through 1996, as the graph below shows. The 2003 level is substantially lower than during the downturns of the early 1990s and the early 1980s, when expenditures exceeded 22 percent of GDP in most years and rose as high as 23.5 percent of GDP in 1983.



Federal spending per household is, as a recent Heritage Foundation report claims, at a post-World War II high. This, too, is not surprising — and not very meaningful. Household income has *tripled* since the start of World War II after adjusting for inflation. With higher incomes, both households and the nation can afford more. Increases in federal spending do not pose a problem unless spending consistently grows faster than the economy does. As long as federal spending does not increase as a share of the economy, it consumes no greater share of the nation's income, and no tax increases are needed to finance it. It is for these and other reasons that spending as a share of the economy, not spending per household, is the standard measure that CBO, OMB, and most budget analysts and economists use to measure changes in government spending over time.

The Troubling Budget Outlook

Robert Greenstein
Center on Budget and Policy Priorities

January 20, 2004

Fiscal Outlook

- Center on Budget and Policy Priorities/Concord Coalition/Committee on Economic Development: $5 trillion deficit over next decade
- Brookings: $5.1 trillion
- Decision Economics: $5.4 trillion
- Goldman Sachs: $5.5 trillion

- *After* the next decade, problem becomes worse
  - First baby boomers eligible for Social Security in 2008
  - Eligible for Medicare in 2011

Interest on the National Debt

Ten-year totals, 2002-2011

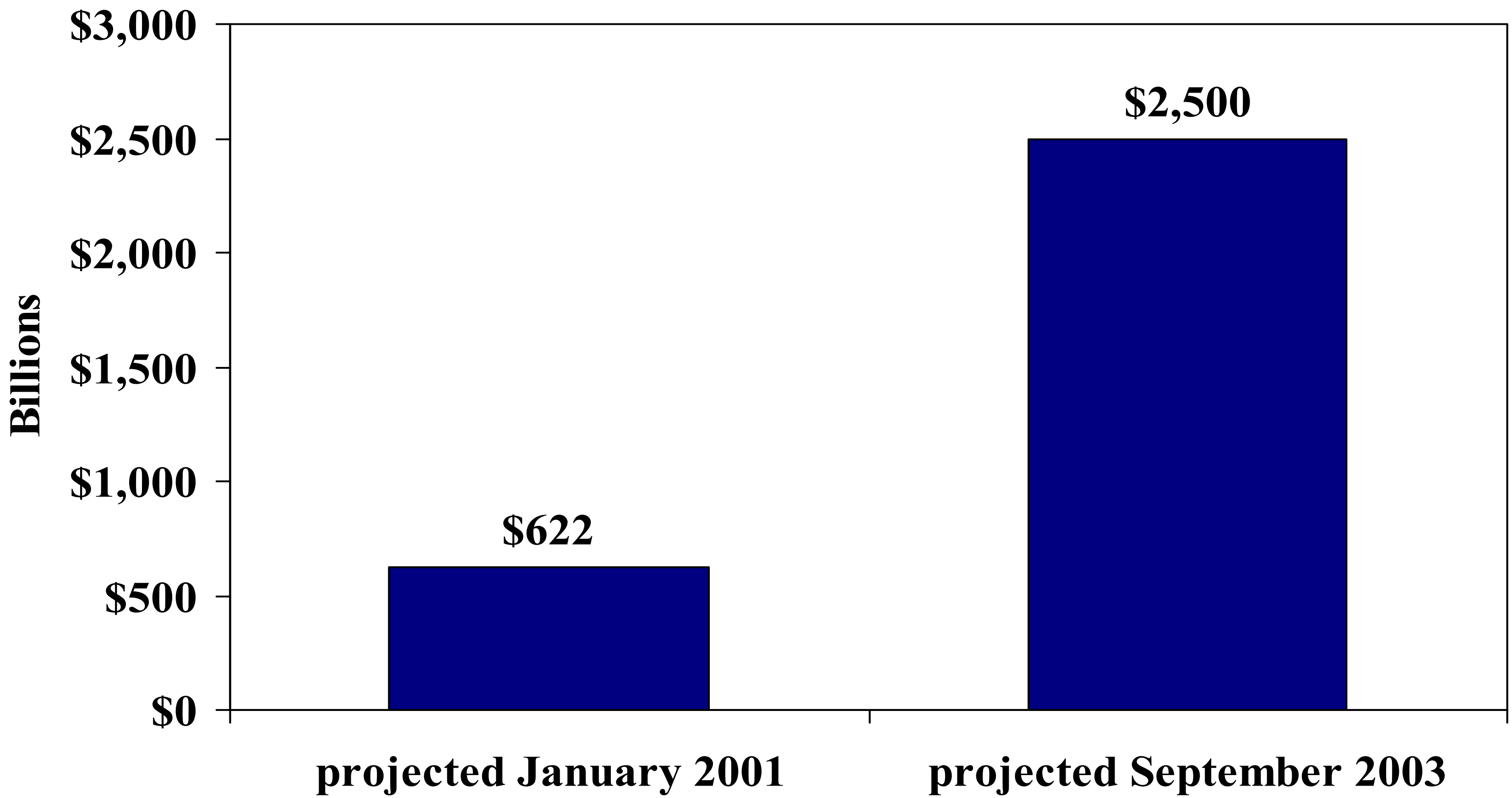
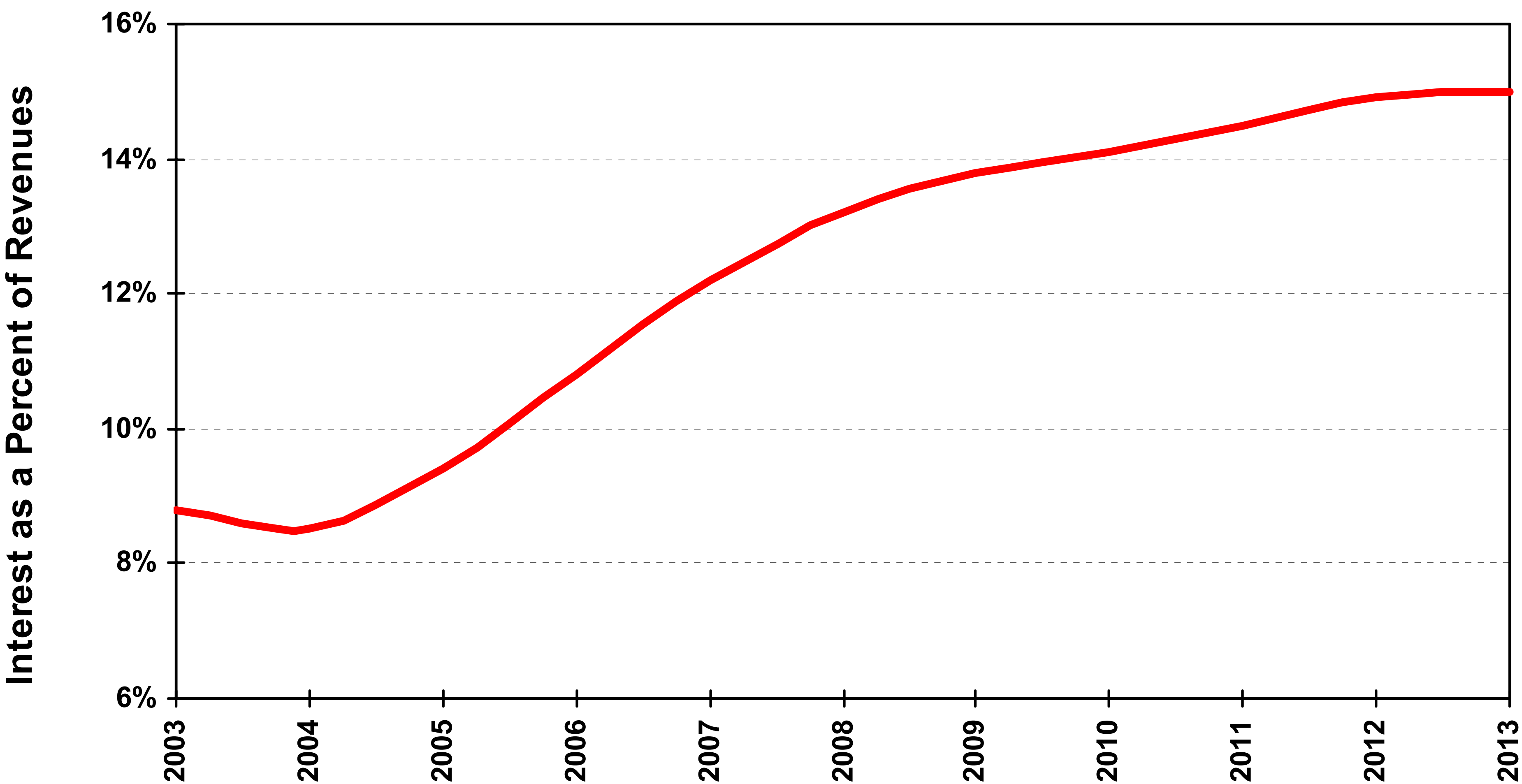


Figure 4:
Interest Payments from 2003-2013



Alarm Bells About U.S. Fiscal Policy

"Prepared by a team of I.M.F. economists, the report sounded a loud alarm about the shaky fiscal foundation of the United States, questioning the wisdom of the Bush administration's tax cuts and warning that large budget deficits pose "significant risks" not just for the United States but for the rest of the world."

--*New York Times*, January 7, 2004, describing a new International Monetary Fund report

"The scale of the nation's projected budgetary imbalances is now so large that the risk of severe adverse consequences must be taken very seriously, although it is impossible to predict when such consequences may occur."

--Robert E. Rubin, Peter R. Orszag, and Allen Sinai, paper presented to the American Economics Association, January 4, 2004

Studies Challenge Assertions that the Recent Tax Cuts Will Boost Long-Term Economic Growth

"But tax legislation will probably have a net negative effect on saving, investment, and capital accumulation over the next 10 years."

--Congressional Budget Office

The tax cut is more likely to reduce than to increase the size of the economy over the long run, because the negative effect of larger deficits will outweigh the positive effect of lower marginal tax rates.

--Brookings Institution study

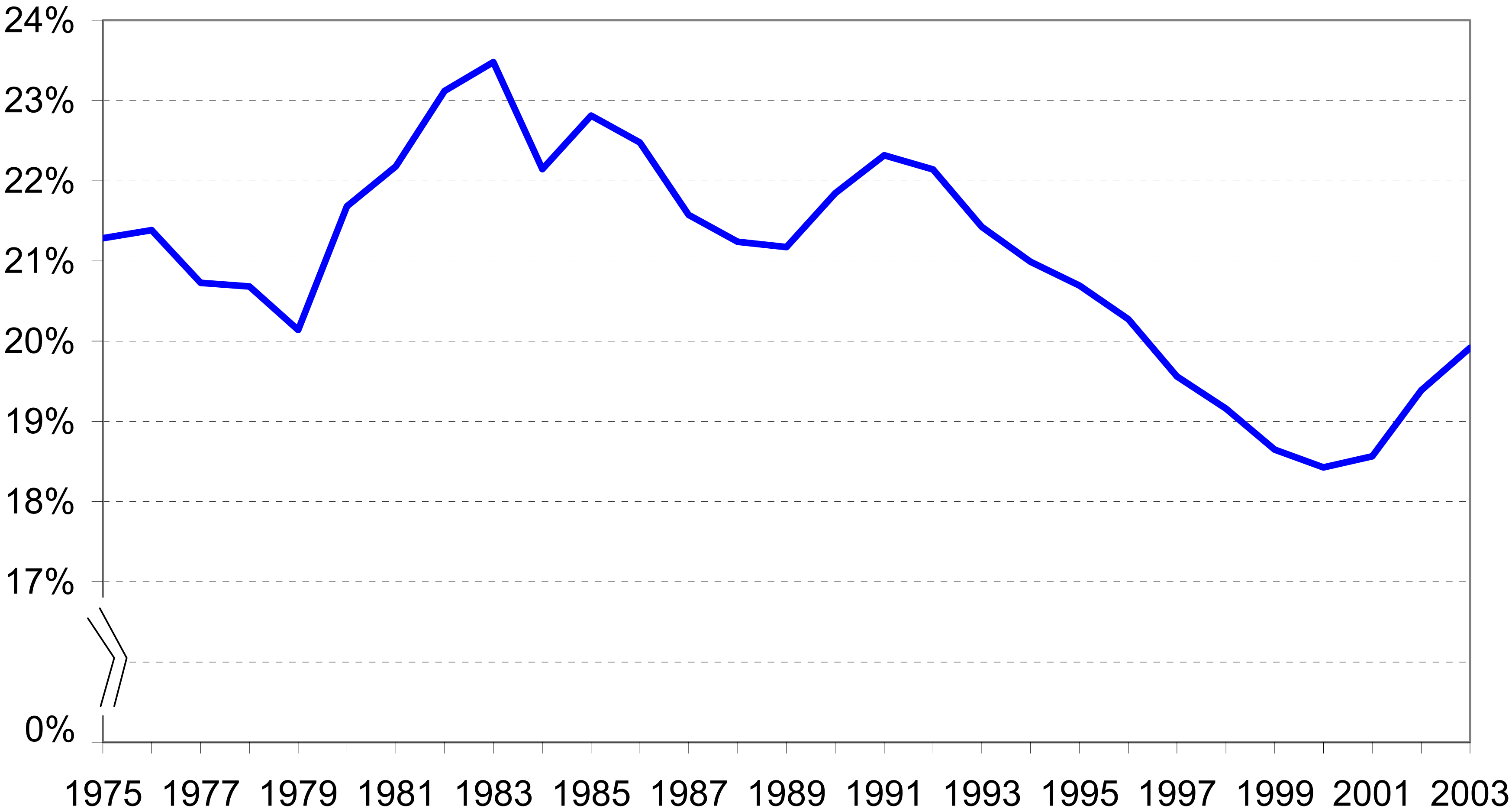
Studies by Federal Reserve economists, the Joint Committee on taxation, and other noted experts have produced similar findings.

Federal Revenues in 2003 As a Share of the Economy--A Historical Comparison

All Federal Revenues	Lowest Since 1959
Federal *Income Tax* Revenues	Lowest since 1942

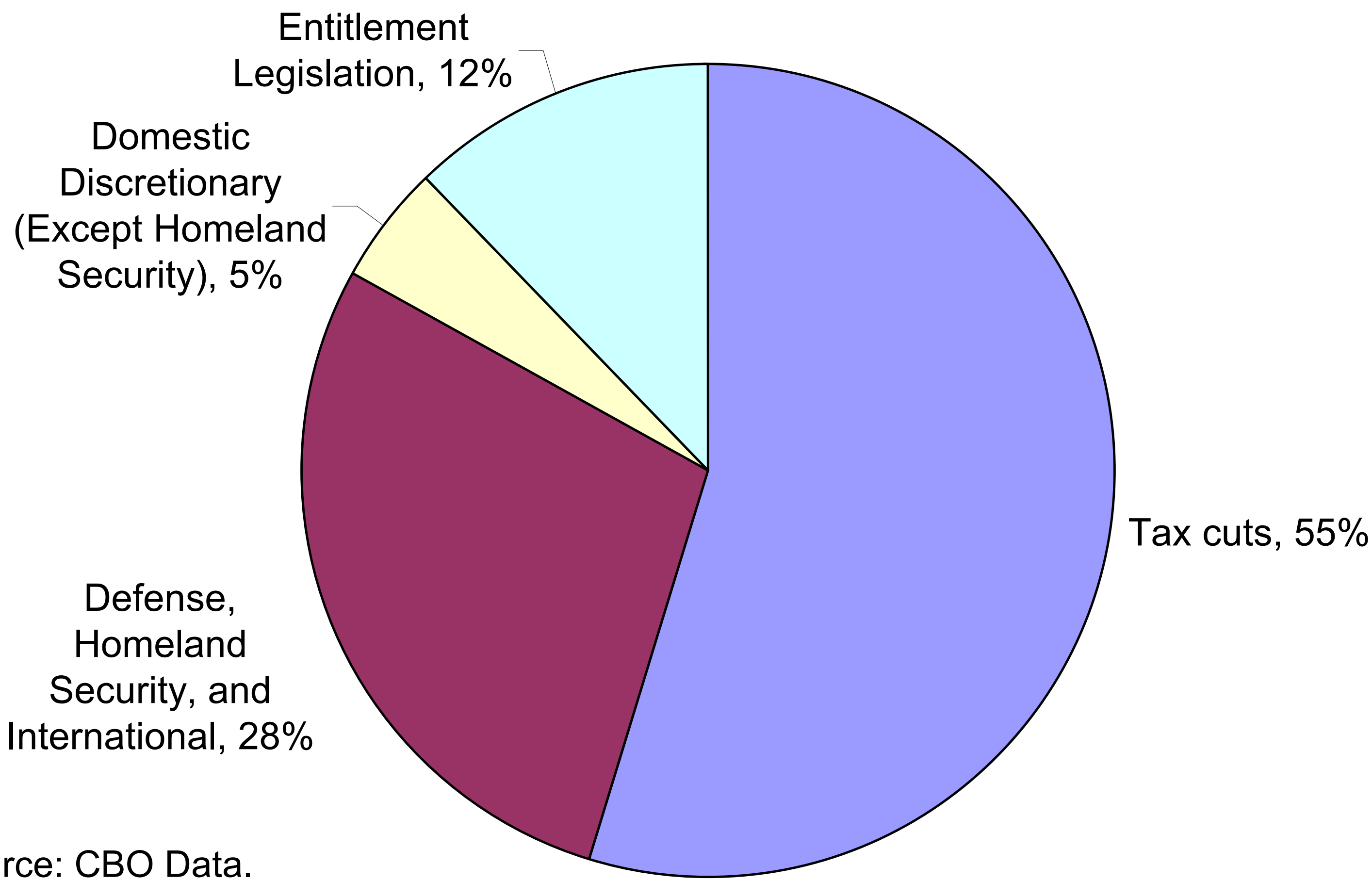
Spending as a Share of the Economy is Lower Today Than in Any Year from 1975 Through 1996

(Outlays as a Percent of GDP)



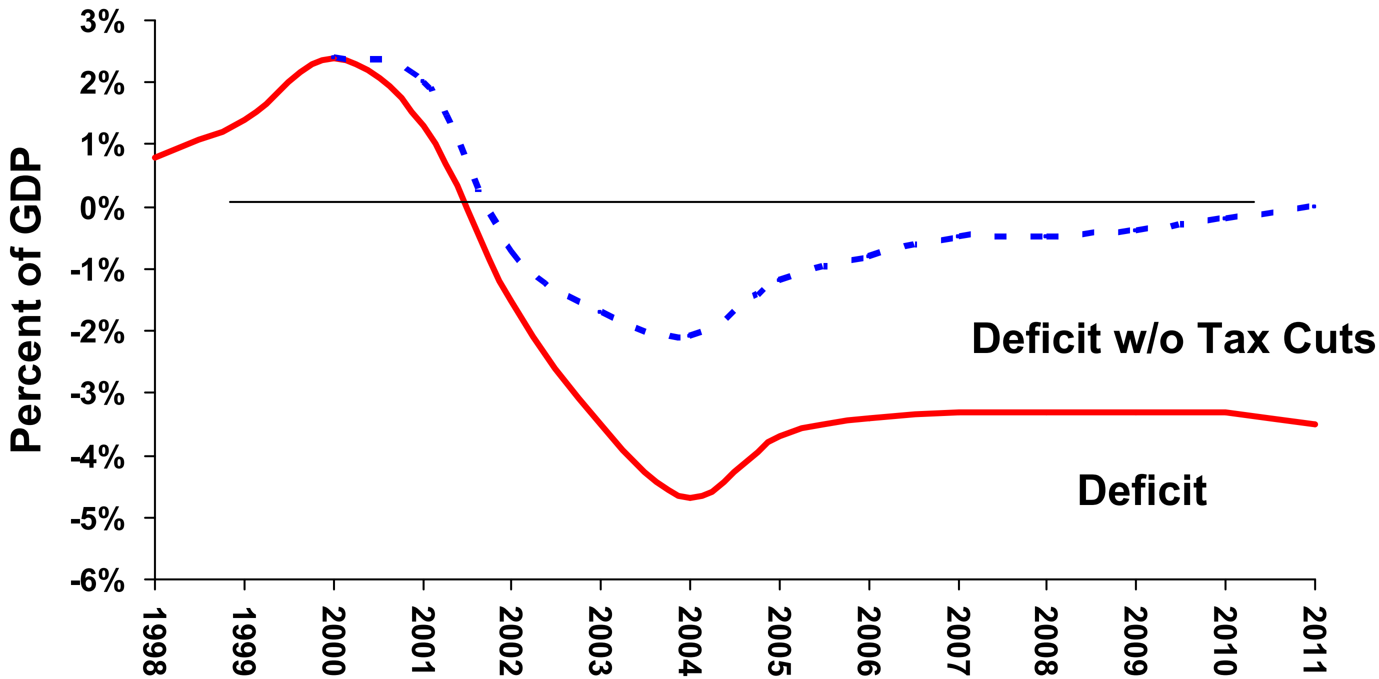
Revenue Reductions Twice as Big a Factor as Spending Increases in Shift from Surpluses to Deficits		
	Change from 2000 to 2003 levels of spending and revenues as a share of GDP	Average annual percentage increase or decrease from 2000 to 2003 in spending and revenues, adjusted for inflation and population growth (i.e., on a real per-person basis)
Expenditures	+1.7% of GDP	+3.5%
Revenues	-4.2% of GDP	-6.8%

In 2003, Tax Cuts Accounted for the Majority of the Cost of Legislation Passed Since 2001



Source: CBO Data.

Deficits Will Remain High Throughout Decade; Tax Cuts are a Major Cause



Deficit projection is a “likely path.” It includes extension of the tax cuts, maintaining AMT relief, a prescription drug benefit, funding for Administration’s defense plan, and non-defense discretionary spending growing at inflation plus population.

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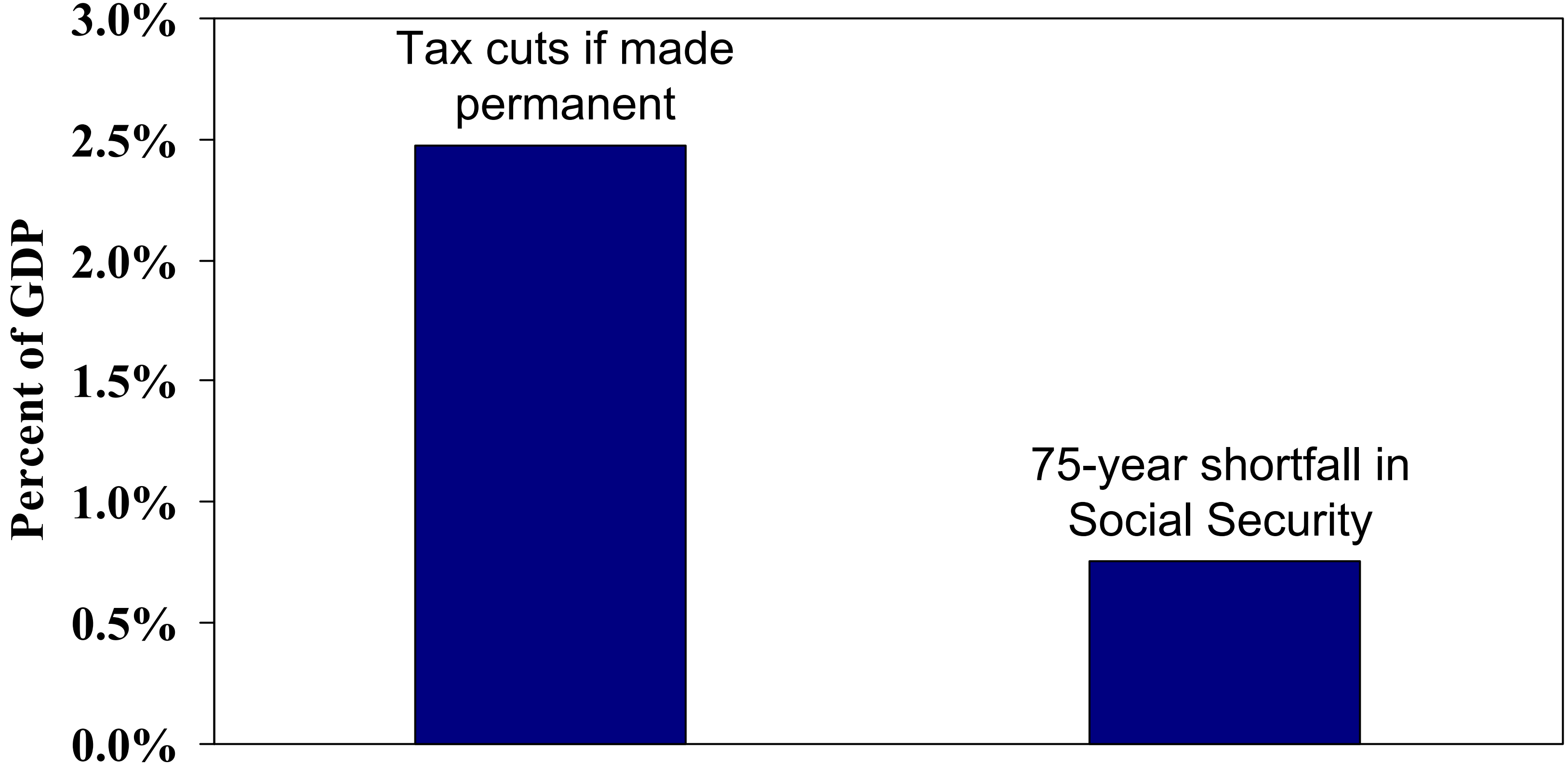
The Tax Cuts and Social Security

Costs over the next 75 years



The figure for the tax cuts represents the costs of the 2001 (EGTRRA), 2002 (JCWA), and 2003 (JGTRRA) tax bills. Estimates of the tax cuts assume all provisions are permanent (including AMT relief) and grow only with the economy after 2013. Social Security estimate is based on the 2003 Trustees Report. All figures are "net present values" of costs from 2004-2078.

Cost in Tenth Year of Extending All Expiring Tax Provisions

Before President Bush

As of January 2001, the cost in 2011 of extending all expiring provisions was $22 billion

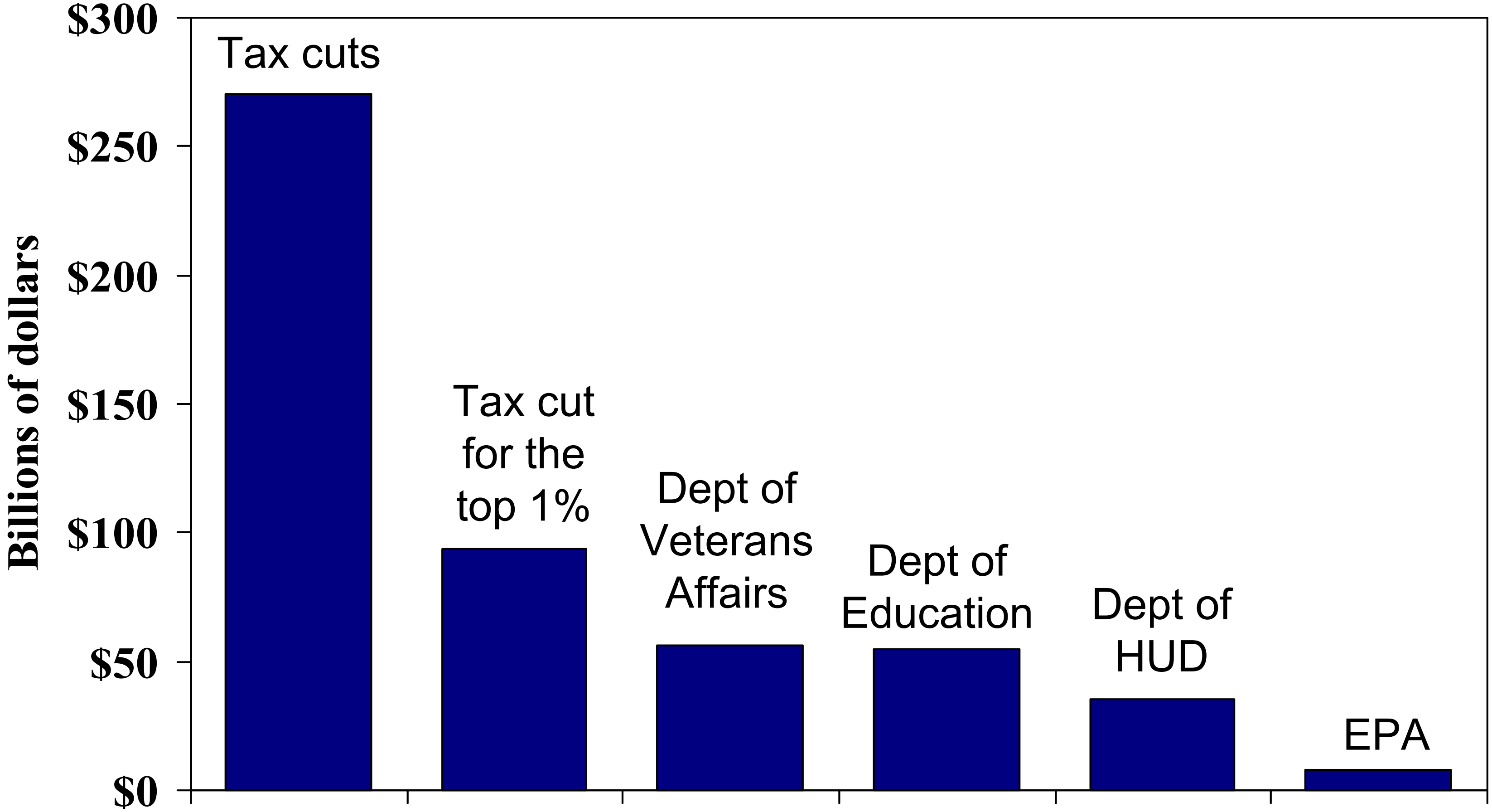
Today

The cost in 2013 of extending all expiring provisions is $430 billion

Source: Bill Gale and Peter Orszag, The Brookings Institution, "Sunsets in the Tax Code," May 26, 2003.

The Tax Cuts and Agency Budgets

Comparable annual costs



Note: The figure for the tax cuts represent the annual cost when fully effective (including AMT relief) of the 2001 (EGTRRA), 2002 (JCWA), and 2003 (JGTRRA) tax bills, scaled to the size of the economy in 2003. Figures for agency budgets represent the annual average, 2002-2004.

Annual Cost of the Tax Cuts Compared to Agency Budgets

When fully in effect, the annual cost of the tax cuts will be:

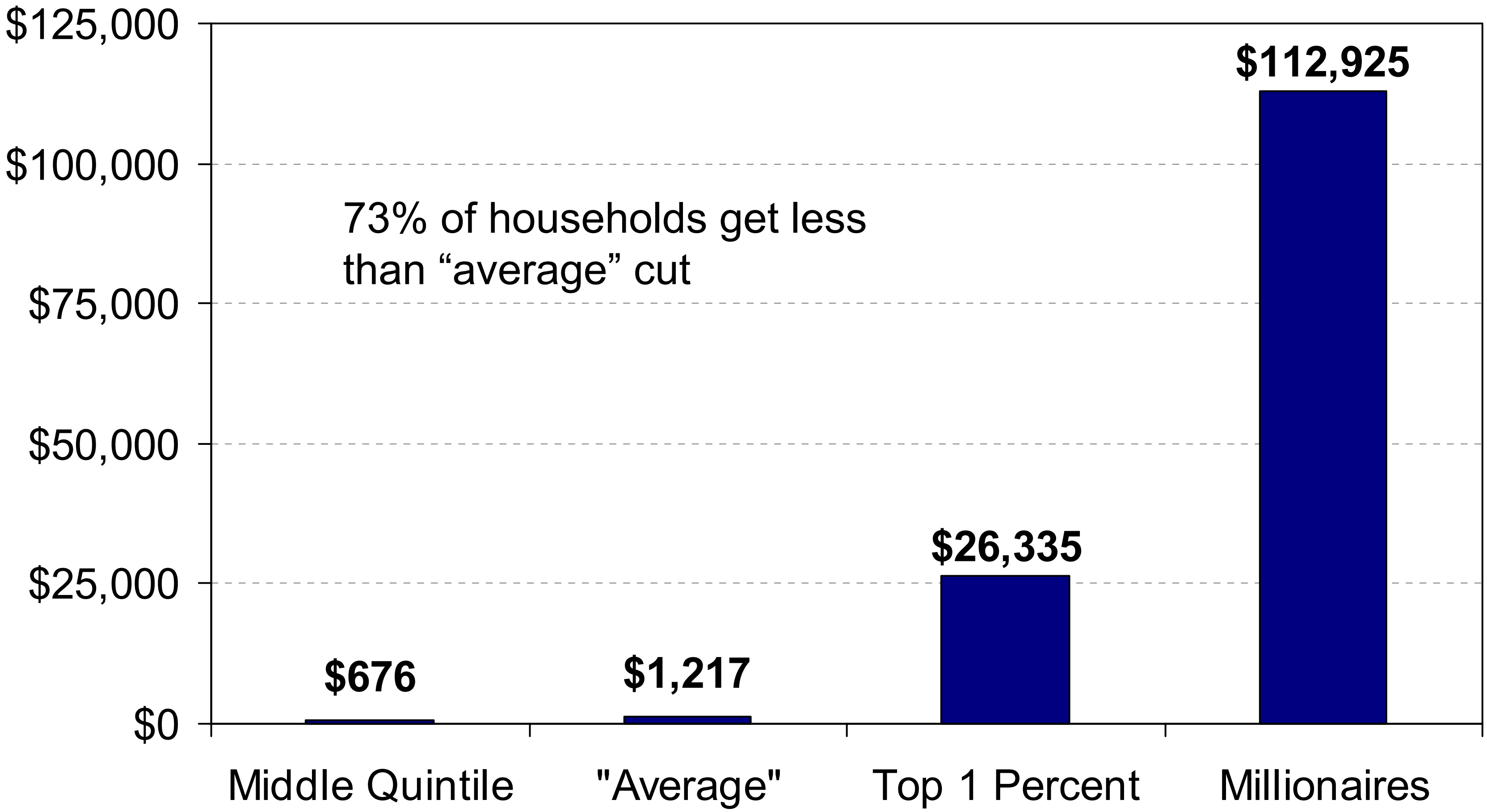
- More than seven times as large as the budget of the Department of Housing and Urban Development
- Nearly five times the budget of the Department of Education
- Nearly five times the Department of Veterans Affairs budget
- Thirty-four times larger than the EPA budget

Annual Cost of the Tax Cuts for the *Top One Percent*, Compared to Agency Budgets

When fully in effect, the annual cost of the tax cuts for the top one percent of filers will be:

- 2 ½ times the budget of the Department of Housing and Urban Development
- More than 1½ times the Department of Education budget
- Also more than 1½ times the Department of Veterans Affairs budget
- Nearly twelve times as large as the EPA budget

"Average" Tax Cuts in 2003 from the 2001 and 2003 Tax Bills



Source: Urban Institute-Brookings Institution Tax Policy Center

Increases in Appropriations Levels for Discretionary Programs

FY 2001 — FY 2004

Adjusted for Inflation

Defense, Homeland, Int'l	46.4%
Domestic outside Homeland	9.8%
Total	28.3%

Growth in Funding for Annually Appropriated Programs

(Assuming enactment of the omnibus appropriations bill; increases shown in percentage terms)

	2002	2003	2004
In current dollars (billions)			
Defense, Int'l, Homeland	24.4%	19.7%	3.8%
Domestic (outside Homeland)	12.9%	0.8%	1.9%
In constant 2004 dollars (billions)			
Defense, Int'l, Homeland	22.8%	17.0%	1.9%
Domestic (outside Homeland)	11.5%	-1.5%	0.0%

Funding Levels for Annually Appropriated Programs in Constant Dollars

(Assuming enactment of the omnibus appropriations bill; in billions of constant 2004 dollars)

	2001	2002	2003	2004
Defense, Int'l, Homeland	$365	$448	$524	$534
Domestic (outside Homeland)	355	396	390	389
Total	720	844	914	924

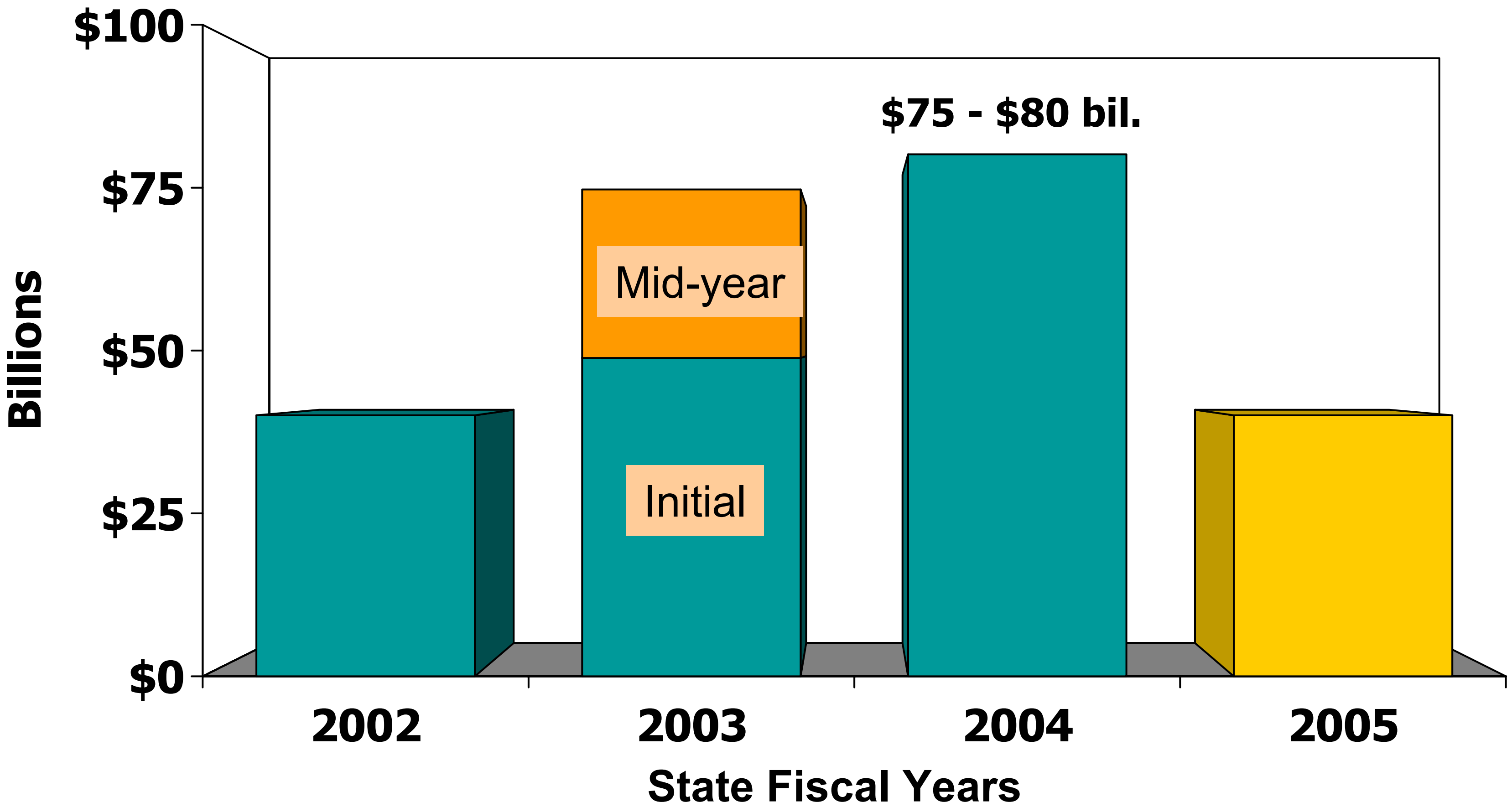
May not add due to rounding.

Cost in FY 2003 of *Spending* Legislation Enacted Since January 2001

	2003 Cost (in billions of dollars)	Share of Spending Increase
Defense, homeland security, and international	**$102**	**63%**
Domestic discretionary (except homeland security)	**$17**	**10%**
Entitlement legislation	**$44**	**26%**
Total Cost of Spending Legislation	**$162**	**100%**

Note: Columns may not add due to rounding. Figures include direct costs and associated increases in the cost of interest payments on the debt.

The State Fiscal Crisis Isn't Over



Note: In most states fiscal years run from July 1 to June 30.
2005 estimate based on CBPP survey.

Federal Policies Expensive for States During State Fiscal Crisis, FY 2002 – 2005