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CONGRESSIONAL BUDGET OFFICE SEES NO SIGNIFICANT IMPROVEMENT IN BUDGET OUTLOOK

By James R. Horney

The Congressional Budget Office today released updated economic and budget projections.[1] CBO's projections confirm that the deficit for the current year will be smaller than had been anticipated earlier this year (CBO now projects it will be $158 billion, or 1.2 percent of Gross Domestic Product) but offer no support for the claim that the President's tax cuts are boosting the economy and significantly improving the budget outlook for coming years. In fact, the accompanying report makes clear that:

- The outlook for the economy and the budget in 2008 through 2017 has not improved significantly since the beginning of this year. In fact, CBO states that "the general fiscal outlook for the coming decade remains about the same as what CBO projected in March."[2] The modest improvements in CBO's projections of revenues and deficits for years after 2007 (excluding the effects of supplemental appropriations, primarily for the war in Iraq, enacted since CBO released its last projections in March) were due to factors that cannot be attributed to the President's tax cuts, notably higher-than-anticipated inflation this year, a slightly larger projected labor force, and an increase in the projected share of GDP represented by corporate profits.

- Under CBO's new projections, if expiring tax cuts are made permanent, Alternative Minimum Tax relief is extended, and future costs for the wars in Iraq and Afghanistan follow CBO's most optimistic scenario, the deficit will climb to $245 billion (1.7 percent of GDP) in 2008 and to $409 billion (1.9 percent of GDP) in 2017 while never falling below $219 billion over the next 10 years (see figure and table below).[3] As a result of these deficits, debt will rise slightly as a percent of GDP during this period.

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- CBO also sees no real improvement in the longer-term budget outlook. The CBO report states that, "Over the long term, the budget remains on an unsustainable path." Further emphasizing that continuing current policies is not a viable option, CBO concludes that "Attaining fiscal stability in the coming decades will almost certainly require some combination of reductions in

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[1] Congressional Budget Office, "Budget and Economic Outlook: An Update," August 23, 2007.
[2] Ibid, p. ix.
[3] CBO's estimates of the cost of these alternative policies are provided in Table 1-8 of the new report. The future costs of the war in Iraq and Afghanistan are based on CBO's scenario that assumes the number of troops deployed will be reduced to 30,000 by 2010.

growth of spending and increases in taxes as a share of the economy."

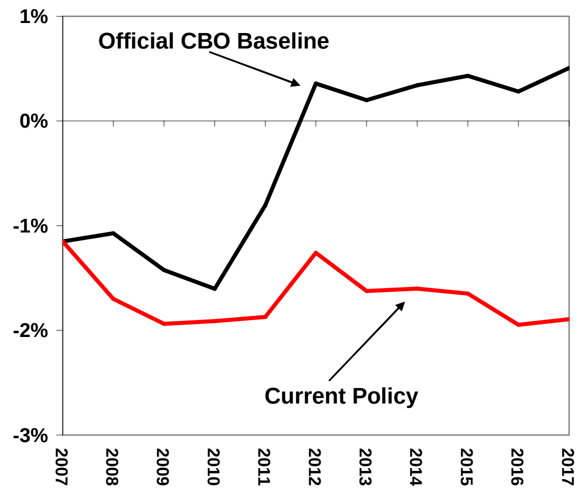
- Far from boosting the economy and reducing the deficit as the White House has claimed, the tax cuts enacted since 2001 have turned a would-be surplus into a deficit. CBO projects that the deficit will be $158 billion this year. Based on Joint Committee on Taxation estimates, the tax cuts enacted since January 2001 will cost $300 billion in 2007 alone (including increased interest costs resulting from the additional borrowing required to finance the tax cuts). If the tax cuts had not been enacted — or if they had been paid for, as is required by the newly reinstated Pay-As-You-Go rules — there would be a *surplus* of nearly $150 billion this year instead of a deficit.[4]

- In contrast, if the estimated $120 billion in military and foreign affairs expenditures in 2007 related to the wars in Iraq and Afghanistan and the war on terrorism had not been incurred[5], there would still be a modest deficit in 2007. In 2007 alone, tax cuts enacted since January 2001 are costing more than twice as much as the wars.

FIGURE 1

Under Current Policies, Next Ten Years Will See Persistent Deficits

Surplus(+)/Deficit (-) as a Percent of GDP



Source: CBPP calculations based on CBO data. CBO's official baseline assumes that war costs grow with inflation and that recent tax cuts and Alternative Minimum Tax (AMT) relief expire. The current policy line, in contrast, assumes that war costs gradually phase down but that the tax cuts are extended and the AMT is indexed to inflation. See Table 1 for details.

It would be unfortunate if good news about a lower-than-anticipated deficit in 2007 were to be misinterpreted and used to justify maintaining unsustainable budget policies. A careful reading of CBO's new report, however, offers no support for the claims by the White House and others that the lower deficit this year shows that the President's tax cuts "are working" — that is, boosting the economy and revenues — and should be made permanent without being paid for. Instead, CBO's report makes clear that the economic and budget outlook in years after 2007 has not meaningfully improved and tough choices will have to be made in order to achieve long-term fiscal stability.

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[4] In assessing claims by the White House and others that the tax cuts have significantly boosted the economy and, therefore, cost substantially less in 2007 than the JCT estimates show, CBO has concluded that "At this point in time (several years after enactment), … the overall impact of the tax legislation on the economy is likely to be modest." CBO letter to House Budget Committee Chairman John M. Spratt, Jr., July 20, 2007, p. 2.

[5] This estimate of war-related costs was included in testimony delivered by CBO's Assistant Director for Budget Analysis, Robert A. Sunshine, to the House Budget Committee on July 31, 2007, p. 3.

TABLE 1

Bridge from CBO Baseline Deficits to Deficits under Current Policies

	Billions of Dollars										
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Total 2008-2017
CBO Official Baseline Surplus/Deficit (+/-)	-155	-215	-255	-134	62	36	65	85	58	109	-343
Use lower CBO alternative war funding scenario[a]	-3	10	67	113	142	158	173	187	201	213	1,261
Index AMT for inflation	-71	-65	-79	-72	-53	-63	-75	-88	-104	-121	-791
Extend 2001/2003 tax cuts[b]	-2	-2	-6	-177	-322	-370	-404	-440	-479	-521	-2,725
Extend other expiring tax provisions	-14	-21	-30	-40	-49	-56	-64	-71	-80	-88	-513
Current Policy Deficits (-)	-245	-293	-304	-311	-219	-296	-305	-327	-403	-409	-3,111
Memorandum Current Policy Deficits (-) as a Percentage of GDP	-1.7	-1.9	-1.9	-1.9	-1.3	-1.6	-1.6	-1.6	-1.9	-1.9	N/A

Note: The budgetary effects of the alternative policy assumptions listed above include both the direct effects of the policies on outlays and revenues and the indirect effects on interest costs.

a. CBO's official baseline is consistent with baseline rules that require that CBO mechanically project the same level of emergency discretionary funding that was provided in 2007 (adjusted for inflation), or approximately $189 billion, in each of the next 10 years. This line reflects the net effect of removing the funding for operations in Iraq and Afghanistan mechanically included in the baseline and replacing it with the lower of the two alternative funding scenarios that CBO describes in Table 1-8 (which assumes that the number of troops deployed in Iraq and Afghanistan declines to 30,000 by 2010).

b. The cost of extending the 2001 and 2003 tax cuts reflects the cost of extending the tax cuts under current law (shown in the main text of Table 1-8 of the CBO report) plus the "interactive effect" that results from simultaneously indexing the Alternative Minimum Tax (AMT) to inflation and extending the tax cuts (shown as a memorandum in Table 1-8).