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OFFICIAL TREASURY REPORT SHOWS FOURTH YEAR OF DEFICIT GROWTH, DESPITE ECONOMIC RECOVERY

This Marks First Time Since World War II that Deficit Grew for Four Straight Years

by Richard Kogan and Robert Greenstein

Fiscal Year 2004 ended on September 30, and today the Treasury Department reported that the deficit for 2004 was $413 billion, or 3.6 percent of Gross Domestic Product.[1]

- At 3.6 percent of GDP, the 2004 deficit marks the fourth consecutive year of fiscal deterioration, the first time this has happened since the U.S. entered World War II.

- At 3.6 percent of GDP, the 2004 deficit is up from the 2003 level of 3.5 percent of GDP and is the highest level since 1993.

- The deficit increased in 2004 even though the recession officially ended in November 2001. This is the first time since *before* the Depression of the 1930s that the deficit has continued to increase this far into a recovery.

- At $413 billion, the 2004 deficit was $36 billion higher than the 2003 deficit, which stood at $377 billion.

- The growth of deficits has largely reflected stunning revenue declines. Federal tax revenues this year are at their lowest level, measured as a share of the Gross Domestic Product, since 1959. In contrast, federal spending in 2004, measured as a share of GDP, is slightly *below* its average level of the last four decades.

The Administration's "Good News" Claim Is Based on Gamesmanship about Expectations

The Administration claims that a $413 billion deficit reflects an "improvement in the nation's budget picture."[2] Such a claim is misleading at best. The Administration's claim comes about only because the deficit *did not increase as much* in 2004 as the Administration earlier predicted it would. This is like a football coach predicting his team will go from a record of 6

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[1] U.S. Treasury, "Monthly Treasury Statement," issued October 14, 2004, available at http://www.fms.treas.gov/mts/index.html.

[2] "The improvement in the Nation's budget picture since the President's budget was released last February is a clear reflection of our strengthening economy and improving fiscal performance." OMB Director Joshua B. Bolton, in "Joint Statement of John W. Snow, Secretary of the Treasury, and Joshua B. Bolton, Director of the Office of Management and Budget, on Budget Results for Fiscal Year 2004," Treasury and OMB, October 14, 2003.

wins and 10 losses to a 4-12 record the next year, and then celebrating when the team "improves" to 5-11.

Moreover, both of the Administration's earlier deficit forecasts appear to have been deliberately overstated, perhaps in anticipation of a desire to spin the straw of a rising deficit into the gold of "good news." In February of this year, when the Administration first overestimated the 2004 deficit (and predicted it would reach $521 billion), we issued a report explaining that its deficit figure appeared to have been purposely overstated.[3] We made this point again in July, when the Administration officially estimated the 2004 deficit at $445 billion, even as Treasury data was quietly being issued showing the deficit would, in fact, be about $418 billion.[4] (Just three days after OMB's $445 billion deficit estimate was released, the Treasury reported that it expected to borrow an additional $91 billion by the end of the fiscal year. That, plus the deficit of $327 billion for the fiscal year to date — as reported in a different Treasury document — equals $418 billion for 2004.)

Budget Deterioration of 6.0 Percent of GDP Is Very Large by Historical Standards

In fiscal year 2000, the surplus stood at 2.4 percent of GDP. The shift to a deficit of 3.6 percent of GDP in 2004 represents a deterioration of 6.0 percent of GDP over four years.

Few occasions in U.S. history have produced budget deteriorations this large over a four-year period. Deteriorations of this size occurred only during the Civil War, World War I, the Great Depression, and World War II.

Of the 6.0-percent-of-GDP deterioration over the last four years, less than one percentage point can be attributed to the wars in Afghanistan and Iraq. Moreover, spending increases of all sorts totaled 1.4 percent of GDP over this period, thereby accounting for about one quarter of the deterioration. In contrast, revenues have fallen by 4.6 percent of GDP over the last four years, accounting for three-quarters of the deterioration. Only once before in U.S. history, when taxes were cut after World War II, have revenues fallen this sharply.

Sources: GAO for historical data; Treasury for 2004 data budget data, CBO for 2004 GDP.

Economic Growth Has *Not* Exceeded Expectations

Finally, the fact that the 2004 deficit did not grow as much as the Administration predicted does not mean the economy is exceeding expectations and thus that the "the President's tax relief initiative are having the intended effects."[5] The simple fact is that *the economy grew no faster in 2004 than OMB and CBO projected last winter when they issued higher deficit forecasts*. Last winter, CBO and apparently OMB each projected that the economy

[3] Richard Kogan, "Does the Administration's Budget Overstate the Likely 2004 Deficit?" CBPP, February 2, 2004, available at http://www.cbpp.org/2-2-04bud2.pdf.

[4] David Kamin, Richard Kogan, and Robert Greenstein, "Deficits and the Mid-Session Review: The Administration's Efforts to Make Harmful Deficits Appear Benign," CBPP, originally issued July 30, 2004, revised October 1, 2004, available at http://www.cbpp.org/7-30-04bud.pdf. See also Richard Kogan, "Administration's Latest 2004 Deficit Projection Appears Overstated; Will Final Deficit Figure Be Presented as Progress in Deficit Reduction?" CBPP, August 10, 2004, available at http://www.cbpp.org/8-10-04bud.pdf.

[5] Treasury Secretary John W. Snow, in Joint Statement, op. cit.

Cutting the Deficit in Half?

In the press statement announcing the $413 billion deficit figure, Treasury Secretary John Snow said the Administration was on track "to reach the President's goal of cutting the budget deficit in half in five years, bringing it to a level that will be low by historical standards at less than 2 percent of GDP."

As we have discussed in previous analyses of the Administration's budget plans,* such deficit projections cannot be taken seriously; they substantially understate likely deficits in future years for at least three reasons. First, in projecting deficits beyond 2005, the Administration fails to count the substantial cost of continuing to provide relief from the Alternative Minimum Tax (which currently is slated to expire at the end of 2005) even though the Administration has repeatedly said it plans to propose such relief and virtually all observers expect such relief to be enacted. (Without such relief, the number of filers subject to the AMT will soar from three million today to 27 million by 2009 and hit increasing numbers of middle-class families.) Second, the Administration has failed to include in its budget projections any funding for operations in Iraq and Afghanistan — or even for the international war on terrorism in general — beyond the end of the current year. Third, the budget projections the Administration is using significantly understate the cost of the Administration's own defense plans. CBO has found that the costs of the Administration's "Future-Year Defense Plan" — the Administration's official multi-year budget blueprint — will substantially exceed the amounts included in the budget projections the Administration cites.

On September 23, CBO reported to Rep. John Spratt that when the Administration's budget proposals are adjusted to reflect the costs of continuing to provide AMT relief and the costs of operations in Iraq and Afghanistan (that are assumed to scale down over time), the deficit does *not* fall in half. Earlier analyses by other budget analysts, including ourselves, have found the same result.

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* See Kamin, Kogan, and Greenstein, "Deficits and the Mid-Session Review," Center on Budget and Policy Priorities, October 1, 2004, and Kogan, Friedman, and Springer, "Does the Administration's Budget Really Cut the Deficit in Half?" Center on Budget and Policy Priorities, February 3, 2004.

would grow at an annual average rate of 4.8 percent in the first three quarters of the fiscal year. According to the latest GDP estimates, that is exactly what the economy has done. That the deficit did not climb as much in 2004 as earlier projected appears to reflect factors such as higher-than-expected inflation and an increased concentration of income at the top of the income scale. It cannot be explained by stronger-than-expected economic growth because stronger-than-expected growth did not occur.[6]

[6] Moreover, the Treasury report shows that the improvement between OMB's July estimate of a $445 billion deficit and today's report of $413 billion deficit has occurred primarily because expenditures are $27 billion lower than projected in July; revenues are only $5 billion higher. Individual income tax receipts are actually lower than projected in July, indicating that there is no widespread improvement in incomes relative to the estimates that the administration made in July.