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Blue-Ribbon Business Group Issues Stern Warning on Deficits And Advises Against Further Tax Cuts

On March 5, 2003, the Committee for Economic Development issued a major analysis and policy statement on the federal budget, entitled *Exploding Deficits, Declining Growth: The Federal Budget and the Aging of America*. The CED document examines the long-term budget outlook, sets forth principles for federal budget policy, and includes specific policy recommendations based on its findings.

The report from CED — a highly respected research and policy organization that consists of 250 corporate CEO's, university presidents, and similar officials — strongly opposes the Administration's proposals to institute further tax cuts and to make the 2001 tax cut permanent, because of the effects that such actions would have on long-term deficits. CED warns that if no action is taken, projected long-term deficits will reach dangerous levels and reduce national income and standards of living for future generations. CED calls for a combination of spending restraint, Social Security and Medicare reforms, and tax increases to meet the very serious long-term fiscal challenges the nation faces.

The CED report includes the following findings:

- **Realistic budget projections show large and sustained long-term deficits.** Official CBO baseline estimates understate future deficits, CED warns, because they do not include the costs of making the 2001 tax cuts permanent, reforming the Alternative Minimum Tax, providing increases in defense and homeland security spending, the Administration's new budget proposals, or a war and reconstruction in Iraq. A more realistic projection shows a deficit of about $2 trillion over ten years, and that is *before* any new tax cuts, a prescription drug benefit, or a war are taken into account.

  CED notes that under the policies the Administration has proposed, deficits would be several trillion dollars larger than this $2 trillion ten-year estimate. The report explains that the nation faces deficits "as far as the eye can see" and projects that these deficits would reach $500 billion to $575 billion a year by 2013 under Administration policies. "A decade of these growing deficits will leave America ill-prepared for the arrival of the baby-boomers' retirement," the report concludes.

- **Deficits reduce long-term economic growth.** The report notes that deficits reduce national saving and "leave less money behind to finance investments in plant and equipment, research and technology, and human capital that make us more productive." Deficits also can increase the nation's international debts and "divert our future income to service those debts." As a result, the report states, "Deficits matter — they lead to less investment, less productivity, and a lower future standard of living."

- **Demographic trends will exacerbate future fiscal problems.** The ratio of retirees to workers will increase as a result of lower fertility rates and longer life spans. The slowdown in workforce growth that will occur as the population ages, along with the accompanying increases in retirement and health care costs for the elderly, will increase budget deficits further, reduce national savings and investment, and lower long-term economic growth.

- **With these considerations in mind, policymakers should first "do no harm."** As a basic principle, the government should not adopt policies that will increase future deficits and make the nation's fiscal problems even more dire. The CED opposes the Administration's "economic growth" package because it ignores the need for long-term budget balance and would have "a destructive long-term fiscal impact." CED also notes that current policies — including the 2001 tax cut — have been a major factor in the sharp deterioration of the budget over the past two years.

- **The nation is unlikely to "grow its way out of deficits" with tax cuts.** The report dismisses the claim that tax cuts will spur sufficient economic growth to balance the budget. Economic studies find that work and savings incentives from tax cuts are generally modest, CED explains, and tend to be outweighed by the negative long-term economic impacts from reduced national savings. The report concludes that it is unrealistic to expect tax cuts to increase productivity sufficiently to return the budget to balance at any time in the next 50 years.

- **Dynamic scoring should not be used in official cost estimates.** CED warns that "as a practical matter, dynamic scoring is extremely problematic." The report cautions that while changes in tax policy do have economic effects, such effects cannot be forecast in a credible fashion. "First, such effects are extremely sensitive to future fiscal and monetary policy decisions, which cannot be predicted. Second, the size — and even direction — of such effects are highly uncertain; different models and assumptions produce very different results. But the most important problem is that the application of dynamic scoring would inevitably be extremely political….We therefore oppose the use of dynamic scoring for official CBO cost estimates of policy proposals."

The report concludes that a realistic analysis of the future budget outlook suggests that: "...it is extremely unlikely that the long-term budget problem can be solved without additional revenues. We therefore urge the Administration and Congress to forgo at this time any additional tax reductions (including the permanent extension of The Economic Growth and Tax Relief Reconciliation Act) that would further reduce long-term revenues." The CED's call to avoid further revenue reductions in light of the nation's fiscal problems stands in stark contrast to the Administration's proposal to enact large new tax cuts and accelerate and make permanent the 2001 tax cuts.

Several aspects of the CED report are discussed further below.

Realistic Budget Accounting Shows Serious Long-Term Deficits

The CED report states that current policy decisions must recognize the serious fiscal problems the nation will face in the future. It explains that the fiscal outlook is considerably worse than what official CBO baseline projections suggest and that under realistic projections, the nation faces deficits that total about $2 trillion over the next ten years and that extend "as far as the eye can see."

The Administration's "economic growth" package and its other budget proposals would make this problem more acute. CED notes that these policies would worsen the fiscal outlook by $2.7 trillion over ten years, with the nation facing deficits of $500 billion or more per year by 2013. (The Congressional Budget Office similarly projects that the Administration's policies would cause projected deficits to increase by $2.7 trillion over the next ten years.) Moreover, these projections do not include the possible large costs of war and reconstruction in Iraq.

"Deficits Do Matter"

Although the Administration has argued that the deficits under its budget proposals are manageable, the CED report finds otherwise and warns that the long-term deficits currently projected will undermine future economic growth. The report notes that growing productivity drives long-term economic growth and that productivity gains are based on technological progress, investment, and reorganizing production to capture the gains of innovation. Federal budget deficits reduce growth because they "usurp the national savings otherwise available for investment." The report explains: "By reducing private investment at home, higher deficits leave the nation with a smaller capital stock, giving our workforce fewer tools with which to work — whether computers and software, machines, transportation equipment, or buildings and other structures. This slows the growth in the productivity of our workers, which, in turn, leads to slower growth in living standards." The report explains that deficits also can adversely affect long-term growth by reducing the funds available for "productivity-enhancing public investments such as basic scientific research, improved public schools, and expanded access to quality pre-school education."

Future Fiscal Problems Compounded by the Aging of America

The report finds that demographic trends will place pressure both on the long-term economic outlook and on the budget outlook. The combination of low fertility rates and increasing life spans means that the population of retirees will increase steadily, while growth in the working-age population will slow dramatically. As a result, growth in the workforce — a key factor in economic growth — will nearly cease, while the large increase in the size of the elderly population will cause a greater share of the economy to be devoted to health care expenditures, a development likely to reduce national savings. As a result, the momentous demographic shifts that lie ahead threaten to slow long-term economic growth and exert downward pressure on future standards of living.

CED's long-term budget projections are stunning. CED estimates that if the nation stays on its present course, the deficit will rise from its current level of 3 percent of the Gross National Product to an extraordinary 29 percent of the Gross National Product by 2050, and that reduced national investment will lower the growth rate of real GNP per capita nearly to zero by 2040.

Policymakers Should "Do No Harm"

Within the context of this challenging fiscal outlook, the report declares that a basic principle is to "do no harm." The report declares: "The first step in climbing out of a hole is to stop digging. We cannot afford economic policy decisions today that further raise deficits tomorrow."

The Administration's proposals would increase future deficits and thus fail to address the serious fiscal challenges that lie ahead. In the section on policy recommendations, the report states:

> "CED strongly opposes any short-term stimulus program that is not combined with a plan to restore longer-term budget balance. We are specifically concerned that the Jobs and Growth Package proposed by the Administration, which would raise the cumulative 2004-2013 deficit by about $920 billion (including interest) and raise the annual deficit ten years from now by about $100 billion, does not meet this test."

The report is highly skeptical of assertions that the Administration's tax cuts would enable the nation to "grow its way out of long-term deficits." CED states: "...the critical question is whether tax cuts will have long-term 'supply-side' effects on productive capacity that outweigh the negative effects produced by the larger deficits they entail. Economic studies of these conflicting effects indicate that, while lower marginal tax rates do increase work and saving incentives for some individuals, the positive effects of these incentives are relatively modest and in the long term will be more than offset by the growth-reducing effects of the larger deficits they create." CED's analysis finds that productivity growth would have to be 50 percent higher just to produce a balanced budget by the year 2050. CED notes: "We know of no reputable analysis finding that tax cuts would raise long-term productivity growth by anything close to 50 percent."

In addition to its commentary on deficits and taxes, the report also examines how changes in the budget process and in government spending could help facilitate a return to long-term fiscal balance. CED concludes that what is required is a "war on many fronts" involving changes in both revenues and expenditures — including changes in Social Security and Medicare, "rationalizing defense and homeland security spending," reducing the growth in discretionary spending, raising additional tax revenues, and "reject[ing] any short-term stimulus that adds to future deficits and slows growth later." CED continues: "None of these actions are pleasant. But all of them must be taken to secure our nation's economic future."