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CBPP STATEMENT

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STATEMENT OF JAMES HORNEY, DIRECTOR OF FEDERAL FISCAL POLICY, ON CBO'S NEW BUDGET ESTIMATES

Correction: We have revised this statement to correct numbers in the third bullet.

The Congressional Budget Office's new report on the budget and economic outlook suggests three important points that might be lost in the current cacophony of calls to slash federal domestic programs immediately. A careful reading of the CBO report makes it clear that:

- The economic recovery remains anemic, with the unemployment rate expected to remain above 8 percent through 2012. Thus, implementing big cuts in federal spending (or big increases in broad-based taxes) *now* would weaken the economy and further slow the already sluggish pace of economic growth, sacrificing many jobs.
- Policymakers could significantly reduce the real risk that rising deficits and debt will pose later this decade *simply by following current law* and allowing the 2001 and 2003 tax cuts to expire at the end of 2012, as scheduled.
- While CBO's projection of the 2011 deficit is higher than its projection last August, this change does *not* reflect "runaway spending." The $475 billion cost in 2011 of December's bipartisan tax cut-unemployment insurance deal and small business legislation enacted in September account for more than the entire $414 billion increase in CBO's 2011 deficit projection. These two bills consisted overwhelmingly of tax cuts; spending provisions account for only $67 billion (14 percent) of their cost.[i]

CBO forecasts that the economy will grow at about 3 percent this year and next, much slower than in previous recoveries and less than is needed to bring unemployment down quickly. CBO believes unemployment will remain above 9 percent through the end of this year and not fall close to its "natural rate" of 5.2 percent until 2016.

While everyone wishes the pace of the recovery would pick up, calls to "boost the economy by slashing federal spending immediately" are entirely at odds with mainstream economic thinking and basic economic theory. As Pulitzer Prize-winning business columnist Steve Pearlstein wrote in today's *Washington Post*, the "Republicans now offer 'cut-and-grow,' which will take its place beside 'government ownership of the means of production' and 'tax cuts that pay for themselves' in the Pantheon of Economic Nonsense."

CBO Director Doug Elmendorf reflects mainstream economic thinking in writing in his blog post today that, while substantial restraint in the growth of spending, significant

increases in revenues, or both will be necessary to prevent unsustainable increases in debt, "Congress may wish to implement them gradually so as to avoid a sudden negative impact on the economy, particularly as it recovers from the severe recession, and so as to give families, businesses, and state and local governments time to plan and adjust."

As Elmendorf suggests, it will take significant changes in current policies on both the revenue and spending sides of the budget to put the budget on a sustainable path. Based on information provided in the new CBO report and highlighted in Elmendorf's blog post, if current tax and spending policies are continued, deficits will decline over the next few years but then begin to rise again, growing to nearly $1.5 trillion (or 6.1 percent of GDP) by 2021. In contrast, the official CBO baseline shows that if current law were maintained — that is, if the tax cuts (including the 2001 and 2003 tax cuts), relief from the Alternative Minimum Tax, and relief from Medicare Sustainable Growth Rate cuts in physician payments were allowed to expire as scheduled under current law — deficits would be much smaller, shrinking to 3.2 percent of GDP by 2021.

It might seem impossible to allow *all* of these provisions to expire: lawmakers are unlikely, for instance, to allow more than 40 million taxpayers to be forced on to the AMT. But simply allowing the 2001 and 2003 tax cuts to expire on schedule at the end of 2012 — as economists such as Martin Feldstein and Peter Orszag have suggested — would reduce the deficit in 2021 by more than $600 billion, from 6.1 percent to 3.6 percent of GDP. And debt held by the public would be reduced from 95 percent of GDP at the end of 2021 (the level it would reach under a continuation of current policy) to 80 percent of GDP.

The 2001 tax cuts were enacted at a time when large surpluses were projected and President Bush and Federal Reserve Board Chairman Alan Greenspan warned that the federal government was in danger of running overly large surpluses (and paying off the entire national debt) if substantial tax cuts were not enacted. It is now clear, however (as many budget experts warned in 2001), that we could not afford those tax cuts. Returning to the tax laws in place in the late 1990s, when the economy was vibrant, would be far preferable to the drain on the economy that ultimately will occur if no action is taken on deficits, and to the program cuts of unprecedented depth that House Republican leaders are proposing.

To be sure, letting the tax cuts expire as scheduled (or paying for any of them that policymakers want to retain) would not be sufficient *by itself* to put the budget on a sustainable path. But it would represent a big step in the right direction, would buy time to allow full consideration and gradual implementation of other deficit reduction measures, and would make it unnecessary to enact spending cuts so severe that the government could not meet the needs of the American people.

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The Center on Budget and Policy Priorities is a nonprofit, nonpartisan research organization and policy institute that conducts research and analysis on a range of government policies and programs. It is supported primarily by foundation grants.

[i] These figures were revised on January 28, 2011.