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DON'T POP THE CORKS
CBO Outlook for the Federal Budget Is Still Bleak

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The Congressional Budget Office today released new budget projections showing a deficit of $260 billion for fiscal year 2006, which will end on September 30.[1] Although such a deficit would be $30 billion lower than the Office of Management and Budget estimated on July 11, and just over $100 billion less than CBO projected last March (excluding the effects of legislation enacted since March),[2] the new CBO projections of spending, revenues, and deficits through 2016 are not cause for celebration by those troubled by the bleak federal budget outlook. Among the reasons those concerned with fiscal responsibility should not break out the champagne are:

- CBO is *not* projecting that revenues will be higher in 2006 than the Administration estimated last month — CBO and the Office of Management and Budget both project that revenues will total $2.403 trillion this year.[3] CBO is projecting a lower deficit for 2006 than OMB did because it believes federal agencies will spend less of the funds currently available to them by the end of the fiscal year than the agencies reported to OMB. (In some instances, that simply means that more of the funds will be spent next year.)

- A deficit of $260 billion in 2006 *would represent the largest 6-year deterioration in the budget in 50 years*. In 2000, there was a *surplus* equal to 2.4 percent of Gross Domestic Product.[4] A deficit of $260 billion this year would be equal to an estimated 2.0 percent of GDP. That 4.4 percentage point deterioration in the budget would be the worst 6-year deterioration in half a century (the next worse was from 1998 to 2004, when the deterioration was slightly less than 4.4 percentage points). This

[1] Congressional Budget Office, *The Budget and Economic Outlook: An Update,* August 2006.

[2] See Office of Management and Budget, *Mid-Session Review of the Budget for Fiscal Year 2007*, July 11, 2006, and Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2007*, March 2006. CBO's March baseline projection of the 2006 deficit under then-current policies was $336 billion. Legislation enacted since then (primarily additional funds for the war in Iraq and an extension of alternative minimum tax relief) has added an estimated $30 billion to the deficit. Thus, CBO's March projection implied a deficit of $366 billion under the policies that have actually gone into effect.

[3] That level of revenues is about $100 billion higher than CBO projected in March. CBO assumes that the bulk of this unanticipated increase in revenues is due to temporary factors, such as corporate profits in 2006 that are at historically high levels relative to the size of GDP, and adjusts its projection of revenues for economic and technical factors upward by declining amounts in future years (the adjustment is less than $20 billion in 2016).

[4] Richard Kogan and Matt Fiedler, "Even With New Budget Projections, Budget Deterioration from 2000-2006 Will Be the Largest 6-Year Deterioration in Half a Century," Center on Budget and Policy Priorities, revised August 17, 2006.

deterioration is hardly a reason for jubilation.

- The outlook for the budget over the next 10 years (much less for the following decades, when increasing numbers of baby boomers will retire) remains bleak. CBO's projections show that, if the President's tax cuts are made permanent and relief from the alternative minimum tax is extended, deficits will total nearly $3.5 trillion over the next 10 years (2007-2016), averaging $349 billion a year and never dipping below $284 billion a year even if the costs of the war in Iraq and Afghanistan decline substantially in a few years.[5] This does not represent a significant improvement in the longer-term budget outlook that CBO issued in March. In fact, CBO's report says "…The general fiscal outlook for the coming decade remains about the same as what CBO projected in March."[6]

- Even with revenues now projected to reach a higher level in 2006 than was anticipated earlier this year, revenue growth over the current business cycle has been considerably lower than in comparable periods in the past.[7] In fact, revenue growth in the current business cycle is *near zero* after adjusting for inflation and population growth. That is, real per capita revenues have simply returned to the level they reached *more than five years ago* in 2001, when the last economic recovery peaked (and thus came to an end) and the current business cycle started. In contrast, in previous post-World War II business cycles, real per capita revenue growth over the five and a half years following a business-cycle peak has averaged about 10 percent. The sluggish growth in revenues over the last five and a half years — and the fact that the current economic expansion remains weaker than the average post-World War II economic recovery[8] — do not support Administration claims that the President's tax cuts have boosted economic and revenue growth to remarkable levels.

Total Real Per-Capita Revenue Growth in 22 Quarters after the Last Business Cycle Peak	
Current Business Cycle	0.2%
Average for All Previous Post-World War II Business Cycles	9.7%
1990s Business Cycle	10.7%

CBO's deficit estimate of $260 billion in 2006 illustrates one other reality as well. Based on Joint Committee on Taxation estimates, the total cost of tax cuts enacted since January 2001 in 2006 is $258 billion (including the increased interest costs of the debt that result from the borrowing that is required to cover the lost revenues). This means that even with the spending for the wars in Iraq and Afghanistan and the response to Hurricane Katrina, the federal budget would essentially be in balance this year if the tax cuts had not been enacted, or if they had been offset by either increases in other taxes or cuts in programs, as would have been required under the Pay-As-You-Go rules that tax-cut proponents first ignored and then allowed to expire.

[5] Our adjustments to CBO's current-policy baseline projections (including an adjustment to reflect the assumption that emergency appropriations enacted in 2006 will *not* be repeated in each year through 2016) are based on estimates provided by CBO in Table 1-8 of the *Budget and Economic Outlook: An Update.*

[6] *Budget and Economic Outlook: An Update*, p. ix.

[7] See Aviva Aron-Dine, Joel Friedman, Richard Kogan, and Isaac Shapiro, "The Recent Upturn in Revenues and OMB's Mid-Session Review," Center on Budget and Policy Priorities, revised July 14, 2006.

[8] See Isaac Shapiro, Richard Kogan, and Aviva Aron-Dine, "How Good is the Current Economic Recovery," Center on Budget and Policy Priorities, revised August 4, 2006.