



Squeezing the Budget Balloon

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Wednesday is the last day of the worst fiscal year in America's history. If the economic recession is over, someone forgot to tell the federal budget. The Congressional Budget Office's latest estimates are that the 2009 federal deficit will total \$1.6 trillion. Amazingly, that is an \$80 billion improvement from March estimates. However, latest estimates also show this "improvement" is outweighed 30 to 1 by increased future deficits. The illusion of improvement is similar to the effect of squeezing a balloon: while it is flattened in one place, it is fattened in another.

The hope for a happier fiscal new year is understandable. During this fiscal year, revenues fell 17% and outlays surged 24% from 2008 levels. At \$1.6 trillion, the resulting 2009 deficit is just a quarter less than the previous eight years' combined deficits (\$2 trillion). Even when measured against the economy, at 11.2% of GDP, it is the largest federal deficit since WWII.

And the next ten years' deficit news is even worse. Over the next decade, CBO estimates the federal deficit will be \$2.7 trillion higher than had been projected in March and total just over \$7 trillion. What caused such deterioration? Spending. According to CBO, falling revenues account for just 13.8% (\$372 billion) of the estimated deficit increases. The rest is all due to higher estimated spending.

In budgeting these days trillion is the new billion. Even so, these figures are hard to handle. To bring such sums into mental reach, compare them to America's economy.

CBO estimates revenues will average 19.3% of GDP over the next ten years. Over the last 40 years, revenues averaged 18.3%. Outlays, on the other hand, are estimated to average 23.4% of GDP. That compares a 40-year average of 20.7%.

Once again, spending proves the culprit. Even though revenues will beat their 40-year average, outlays will exceed their 40-year average by a far greater proportion over the next decade.

This spending surge translates into a long-term structural deficit – high level deficits become a fixture throughout future year projections. CBO estimates deficits to average 4% of GDP during the coming decade – versus a 2.4% average over the last 40 years.

Only twice in the next ten years does the deficit fall as low as 3.1% of GDP (2015 and 2018). Why is that figure important? Last year, the current recession's first year, the deficit was 3.2% of GDP. So although the economy is projected to recover (as early as this year's second half), the budget will not: its deficits remain at recession levels over the next decade!

Of course, CBO's projections are just that, not the future itself. These are just estimates that assume today's economic, technical, and legislative assumptions occur. And change they certainly will. For example, almost \$1.1 trillion of CBO's increased spending projections comes from this year's \$106 billion supplemental. By CBO's baseline procedures, it must assume such spending continues annually.

But CBO also does not include likely spending increases -- such as assuming future annual appropriations are not increased for inflation. As CBO states, such an assumption results "in projections of discretionary spending that would be low, relative to GDP, by historical standards." CBO revenue estimates are also likely high -- it assumes all the 2001 tax cuts expire and the AMT's impact on the middle class is not negated.

Such assumptions largely offset themselves in the deficit picture. That picture's are likely to be directionally and depressingly accurate, even if the elements shift somewhat.

The small compression in this year's deficit from earlier estimates has sprung up even bigger over the next decade. The ballooning deficit is acting like, well, a balloon. Looking only at the compression, it is easy to imagine the air has gone. But looking at the whole balloon, it is clear: squeezed here, it pops up there. However,

like a balloon, the federal budget can take only so much pressure -- in this case, deficit pressure -- before it explodes. Happy fiscal new year indeed.

J.T. Young served in the Department of Treasury and the Office of Management and Budget from 2001 -2004 and as a Congressional staff member from 1987-2000.

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