



JOINT ECONOMIC COMMITTEE

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Budget Deficit \$56 Billion Less than Previously Projected

In March, the Congressional Budget Office (CBO) projected that the federal budget deficit would reach \$477 billion this fiscal year. This week, CBO released an update of its budget outlook and is now projecting the fiscal year 2004 budget deficit to be \$422 billion, or roughly \$56 billion less than previously estimated. This downward revision, which is largely the product of a higher-than-anticipated inflow of revenues into federal coffers, is consistent with the Office of Management and Budget's (OMB) *Mid-Session Review* released in July. Even though this year's federal budget deficit is the highest in dollar terms, when compared to the size of the economy it remains below the peak levels reached in the 1980s and 1990s.

Strong economic policies lead to higher revenues and lower deficits

As Federal Reserve Board Chairman Alan Greenspan has noted in congressional testimony, the pro-growth tax cuts enacted by Congress over the last three years have contributed to the recovery of the American economy. As one can intuitively infer, stronger growth in national income (or gross domestic product (GDP), the broadest measure of the nation's output) due to sound economic policies expands the tax base, thereby increasing the amount of federal revenues pouring into the Treasury. This growth in revenue, in turn, contributes to lower federal deficits.

Since March, CBO has reduced its deficit projection for fiscal year 2004 by \$56 billion. According to CBO, "Virtually all of that improvement is attributable to higher-than-expected revenues collected so far this year."

Deficits should be measured relative to the size of the economy, not in dollar terms

In order to compare deficits across different years, it is important to account for the economy's capacity to absorb the deficits and the government's ability to finance them. Both of these factors depend on the size of the economy. For this reason, economists typically measure deficits relative to GDP. As can be seen in the chart, the annual budget deficit is projected to be 3.6% of GDP this year and then decline to 2.8% of GDP next year. These deficits are not small, but they are lower relative to the size of the economy than many of the deficits experienced in the United States in the 1980s and early 1990s and should be manageable in the short term. At \$422 billion, this year's deficit would be the largest ever in nominal terms (i.e., in current dollars), but relative to GDP, it is below recent historical peaks.

