Congressional Office Forecasts Drop in U.S. Deficit

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WASHINGTON, Jan. 24 — The nonpartisan Congressional Budget Office predicted on Wednesday that the federal budget deficit would shrink again this year and could actually swing into a surplus in 2012 — but only if President Bush's tax cuts expire in 2010.

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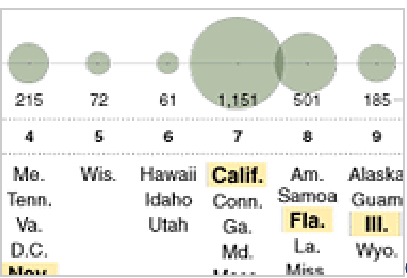

Graphic

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The agency predicted that the deficit for 2007 would decline to about $200 billion. It would be the third big annual decline in a row, and it would come even though spending on the war in Iraq is expected to remain high this year.

The decline of the deficit comes on the heels of unexpectedly large increases in tax revenue over the last two years and slower-than-expected increases in spending on Medicare.

Much of that increased revenue came from taxes on sharply higher corporate profits and big gains in the stock market, even though Congress reduced the tax rate on capital gains and stock dividends in 2003.

The agency's "baseline" estimate, one that assumes current law does not change, is that the deficit will decline to $172 billion this year, from $248 billion in the past fiscal year, which ended Sept. 30, 2006. As a practical matter, officials said, the actual deficit will probably be about $200 billion because of outlays for the war.

It is a rare piece of good news for President Bush, coming as he is struggling to persuade Congress to accept his strategy of sending more troops to Iraq and as his public approval ratings are at an all-time low.

White House officials boasted that the projections validated Mr. Bush's strategy of cutting taxes to stimulate the economy and ultimately generate higher tax revenues.

"Two years ago, the president laid out an ambitious goal to cut the deficit in half by 2009, and we met that goal three years early," said Rob Portman, the White House budget director. "We are now on a solid path toward the president's new goal to achieve a balanced budget by 2012."

But Congressional budget officials cautioned that the projections were not as sunny as they looked, in part because they assume that Congress will let President Bush's tax cuts expire in 2010, along with many corporate tax breaks, and will not try to shield millions of families from a big increase in their tax bills because of the alternative minimum tax.

Mr. Bush and most of his Republican allies in Congress have pushed to make the tax cuts permanent, rather than letting them expire at the end of 2010 as they are scheduled to do. Even some Democrats favor extending the tax cuts that benefit middle-income families.

Extending the tax cuts would cost the Treasury $1.4 trillion in the next 10 years and increase the deficit in 2017 alone by more than $400 billion.

Lawmakers in both parties have wanted to restrain the alternative minimum tax, a parallel tax that was aimed at only the richest families but has not been adjusted for inflation. If left unchanged, the alternative minimum tax is expected to engulf tens of millions of families with annual incomes of $100,000 and less.

Preventing an increase in the alternative tax would cost $1.2 trillion over 10 years and add more than $200 billion to the deficit in 2017, the budget office estimated.

Democrats countered that the fiscal picture remained bleak. "While any improvement in the deficit is a welcome development, today's report from C.B.O. is no cause for a declaration of victory," said Representative John M. Spratt Jr., the South Carolina Democrat who is chairman of the Budget Committee.

After factoring in the cost of tax cuts, Mr. Spratt said, the new report offered a "bleak reminder of how much current policy will need to be changed to return the budget to a fiscally responsible course."

The budget office tried to include costs of the war in its projections. But the baseline projection included only the $70 billion in "bridge" financing that Congress approved last year, and President Bush is expected to submit a supplemental request next month that could be more than $100 billion.

The agency estimated that actual outlays during the 2007 fiscal year would total almost $100 billion and add about $25 billion to the deficit beyond what the baseline estimate indicated. That estimate is consistent with others that war costs are running about $8 billion a month.

Congressional analysts had a more difficult time with war costs in 2008 and beyond. If the United States reduced troops in Iraq to 30,000 in 2010, from more than 130,000 today, the agency estimated, the spending on Iraq would be about $300 billion less than it assumes right now.

Over the long term, the Congressional Budget Office said, the real budget problem will be the surge in spending on Social Security and Medicare as baby boomers retire.

It echoed Ben S. Bernanke, chairman of the Federal Reserve Board, who told Congress last week that the recent improvement in the budget was merely the "calm before the storm" and that the nation would face "draconian" choices between severe cuts in benefits and steep tax increases if it failed to act quickly.

Likewise, the budget office said there had been no "substantial change" to the problems that lie a few years ahead. "Either a substantial reduction in the growth of spending, a significant increase in tax revenues relative to the size of the economy, or some combination of spending and revenue changes will be necessary," it said.

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