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Budget Deficit May Surpass $450 Billion

War Costs, Tax Cut, Slow Economy Are Key Factors

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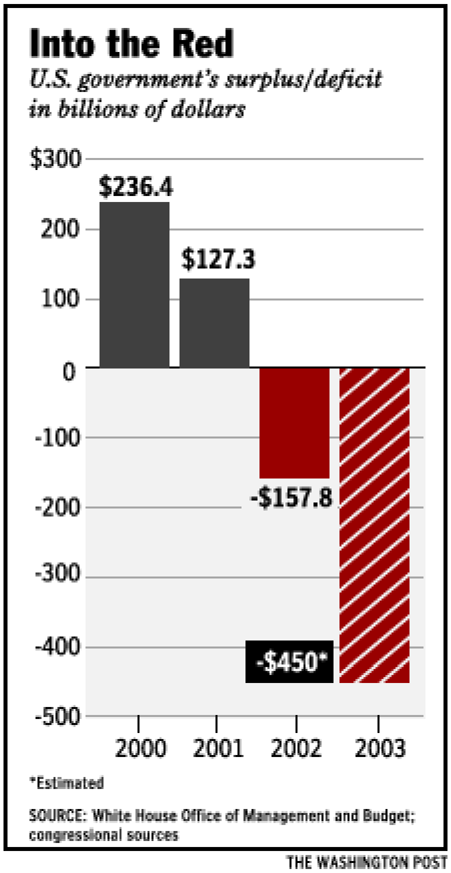
War, tax cuts and a third year of a flailing economy may push this year's budget deficit past $450 billion, according to congressional sources familiar with new White House budget forecasts. That would be 50 percent higher than the Bush administration forecast five months ago.

The deficit projection due out today is nearly $50 billion more than economists anticipated just last week, and it underscores the continuing deterioration of the government's fortunes since 2000, when the Treasury posted a $236 billion surplus. That represents a fiscal reversal exceeding $680 billion.

"It's shock and awe," said a senior Republican Senate aide.

The 2003 forecast -- part of the White House's annual midterm budget update -- easily tops the previous record $290 billion deficit of 1992, even when adjusted for inflation. The red ink now exceeds the entire military budget. Measured against the size of the economy, however, the deficit still has not reached the levels of the Reagan era. It also may prove slightly inflated, because it includes some White House policy proposals that may not be enacted this year.

Still, the political ramifications began to manifest themselves even before the new numbers were officially released. Yesterday, the nonpartisan Concord Coalition, a deficit watchdog group, declared the first six months of this year "the most fiscally irresponsible in recent memory," as Congress and the administration embarked on "a schizophrenic pursuit of small government tax policies and big government spending initiatives. . . . Policymakers need to stop the hemorrhage of red ink, face up to the necessary trade-offs and negotiate a new balanced budget plan."



The 2003 budget deficit -- for the fiscal year ending Sept. 30 -- was exacerbated by the $79.2 billion emergency spending bill enacted at the outset of the Iraq war, which foresees $42 billion in spending in fiscal 2003. It also includes the initial costs of the 10-year, $350 billion tax cut enacted in May. The cost this year of the tax cut plan will exceed the president's initial proposal by more than $30 billion. The White House projection also includes some anticipated costs from the 10-year, $400 billion prescription drug benefit for Medicare still being hashed out in Congress.

But Republicans and many independent economists say the sluggish economy and rising jobless rate remain the largest factors in the worsening fiscal picture. Tax revenue has fallen for three straight years, a streak not seen since the Depression. Through June, tax collection is below the amount of taxes collected in the same period in 1999, according to the Congressional Budget Office.

"I consider this an amazing phenomenon," said CBO Director Douglas Holtz-Eakin.

The White House deficit projection for fiscal 2003 tops a House Democratic forecast that put the year's deficit at $416 billion. The Congressional Budget Office's midyear forecast, due out in August, will put the deficit closer to $400 billion, according to two congressional sources, but that figure will not include the cost of the prescription drug bill if a final agreement has not been reached by then.

For fiscal 2004, the White House and other deficit forecasters may diverge sharply. The White House budget office will project a slightly improved deficit for the fiscal year that begins Oct. 1, although it will likely still top $400 billion. That figure, however, will not include the continuing cost of the occupation of Iraq.

In contrast, private-sector forecasts, which include war cost projections, estimate the deficit will be as high as $475 billion in 2004. The CBO is likely to project a deficit next year close to $500 billion, according to congressional sources.

The rising tide of red ink has put Republicans on the defensive. Asked yesterday about growing war costs and budget deficits, White House spokesman Ari Fleischer cited the terrorist attacks on New York and the Pentagon in 2001, saying: "What was the cost of September 11th? What is the cost of a country that is attacked? What is the price that the American people would have to pay if something like that were ever to happen again?"

Rich Meade, the House Budget Committee's chief of staff, sent out talking points yesterday to gird GOP lawmakers, staff and the press for the deficit figures. They suggested that the deficits are being fueled by excess government spending, not tax cuts, and will be reversed only by the economic growth that three successive years of tax cuts are supposed to fuel.

While Democrats complain about the deficit, House Budget Committee spokesman Sean M. Spicer said, they have pushed for Medicare drug coverage that would cost more than twice the amount that the pending bills envision.

But Senate Budget Committee Democratic aides said yesterday that the $450 billion deficit understates the problems, because it is offset by more than $150 billion in Social Security taxes that are being spent on other programs. If those taxes were not included, the deficit would jump from about 4.2 percent of the gross domestic product to 5.6 percent, a level rivaling the Reagan-era deficits.

The White House budget "is going to put the best face they can on the deficit in the long run, maybe plus it up a little this year to look honest and on the level," said Rep. John M. Spratt (S.C.), the Budget Committee's ranking Democrat. "In truth, as bad as it may seem, it's actually worse."