



## COMMITTEE ON THE BUDGET

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# CBO CONFIRMS DECLINE IN 2006 DEFICIT

## THE BUDGET AND ECONOMIC OUTLOOK: AN UPDATE

17 August 2006

### SUMMARY

The Congressional Budget Office [CBO] today estimated the current year's budget deficit would fall to \$260 billion, a decline of \$76 billion from CBO's projection in March. The figure also is \$36 billion smaller than the administration's deficit estimate, released in July, and \$58 billion lower than the 2005 budget deficit.

The deficit reduction has resulted from faster-than-expected growth in Federal tax revenue, a product of robust economic growth and job creation during the first half of 2006. Although economic growth is projected to moderate – as Blue Chip forecasters have been projecting – CBO estimates a healthy rate of 3.5-percent growth for all of 2006, and 3.0 percent for 2007.

The revenue growth outpaced increases in spending that resulted from higher inflation and energy prices, and emergency spending for war costs and hurricane recovery.

**Table 1: CBO Baseline Budget Estimates**

(By fiscal year in billions of dollars)

|   | 2006  | 2007  | 2008  | 2009  | 2010  | 2011  | 2007-2011 | 2007-2016 |
|---|-------|-------|-------|-------|-------|-------|-----------|-----------|
| Outlays <sup>a</sup>                    | 2,663 | 2,801 | 2,945 | 3,079 | 3,217 | 3,382 | 15,425    | 34,494    |
| Revenue <sup>b</sup>                    | 2,403 | 2,515 | 2,672 | 2,775 | 2,890 | 3,156 | 14,007    | 32,733    |
| Deficit (-) <sup>a,b</sup>              | -260  | -286  | -273  | -304  | -328  | -227  | -1,418    | -1,761    |
| Deficit as a %<br>of GDP <sup>a,b</sup> | -2.0  | -2.1  | -1.9  | -2.0  | -2.0  | -1.4  | n.a.      | n.a.      |

<sup>a</sup> CBO's baseline spending estimates for future years assume the continuation of supplemental and emergency spending amounts, even though these were enacted as temporary spending measures.

<sup>b</sup> Revenue estimates for 2011 and thereafter assume automatic tax increases resulting from the expiration of 2001 and 2003 tax relief provisions.

Source: Congressional Budget Office.

These figures – CBO's "baseline" estimates – are based on commitments and estimated costs embraced in current law, without change. They assume the continuation each year of temporary emergency supplemental spending; no further congressional efforts to restrain spending growth; and no changes in tax laws, including the scheduled expiration of tax relief provisions enacted in 2001 and 2003.

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## KEY POINTS

- **The Budget Deficit.** The deficit for the current year – fiscal year 2006, which ends on 30 September – is estimated at \$260 billion, or 2.0 percent of gross domestic product [GDP]. This is \$76 billion less than the \$336-billion baseline deficit CBO projected in March, and \$36 billion less than the administration’s most recent projection. It is also \$58 billion lower than the deficit for 2005.

The deficit is projected to remain at roughly 2 percent of GDP through 2010. But as noted, these figures assume the continuation each year of supplemental and emergency spending (such as those for operations in Afghanistan and Iraq, and hurricane recovery efforts), even though these were enacted as temporary measures. This adds, for example, \$165 billion in estimated discretionary spending in 2009 alone. The figures also assume no further congressional efforts to restrain the growth of Federal spending.

CBO’s estimates for 2011 and thereafter are unrealistic because they assume automatic tax increases resulting from the expiration of 2001 and 2003 tax relief provisions.

- **Revenue.** As noted, the deficit decline is almost entirely attributable to a significant increase in tax revenue, which is \$90 billion higher than CBO estimated in March. CBO writes: “After growing by 14.5 percent in 2005, total revenues [for 2006] are expected to increase by 11.6 percent – or \$249 billion – this year to just over \$2.4 trillion. Those percentage increases are the highest in the past 25 years.”

Total revenue as a share of the economy also is growing. CBO also notes: “As a share of GDP, revenues are expected to rise from 17.5 percent in 2005 to 18.3 percent this year – slightly higher than the 18.2 percent average of the past four decades.”

- **The Economy and Jobs.** The revenue growth is a product of the economy’s robust performance and substantial job creation so far this year. Although growth is expected to moderate for the next 6 months – as the Blue Chip consensus of private forecasters has indicated since early this year – CBO projects overall growth rates exceeding 3 percent this year and next.
  - *GDP.* CBO estimates annual growth in real (inflation-adjusted) GDP of 3.5 percent in 2006, and 3.0 percent in 2007.
  - *Jobs.* The unemployment rate is estimated at 4.7 percent for this year and 4.8 percent next year.
  - *Inflation.* Inflation as measured by the consumer price index [CPI] is projected at 3.5 percent for 2006 and 2.5 percent next year. CBO acknowledges that this year’s high-than-expected rate is largely due to sharp increases in oil and other energy prices. Although the direct effects of these prices occurs in areas such as transportation, they also ripple throughout the economy, contributing to an overall increase in inflation. CBO estimates these pressures will ease in the

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coming year, but concedes the trend in energy prices remains an important uncertainty for the economic outlook.

- *Interest Rates.* CBO estimates the rate on 3-month Treasury bills to increase from 4.8 percent this year to 5.0 percent next year. The rate on 10-year Treasury notes is projected to rise from 5.1 percent this year to 5.4 percent in 2007.

**Table 2: CBO's Economic Forecast and Projection**  
(calendar year over calendar year)

|                                       | Actual | Forecast |        | Projected Annual Average |                     |
|---------------------------------------|--------|----------|--------|--------------------------|---------------------|
|                                       | 2005   | 2006     | 2007   | 2008-11                  | 2012-16             |
| Nominal GDP (billions of dollars)     | 12,487 | 13,308   | 13,993 | 16,914 <sup>a</sup>      | 21,052 <sup>b</sup> |
| Real GDP (percent change)             | 3.5    | 3.5      | 3.0    | 3.0                      | 2.6                 |
| Consumer Price Index (percent change) | 3.4    | 3.5      | 2.5    | 2.2                      | 2.2                 |
| Unemployment Rate (percent)           | 5.1    | 4.7      | 4.8    | 5.0                      | 5.0                 |
| Ten-Year Treasury Note (percent)      | 4.3    | 5.1      | 5.4    | 5.2                      | 5.2                 |
| Three-Month Treasury Bill (percent)   | 3.1    | 4.8      | 5.0    | 4.5                      | 4.4                 |

<sup>a</sup> Level in 2011.

<sup>b</sup> Level in 2015.

Source: Congressional Budget Office.

- **Spending.** CBO estimates total spending for 2006 at \$14 billion more than estimated in March. The effect is due principally to higher costs for operations in Afghanistan and Iraq, and the effects of higher interest rates.

CBO estimates \$1.4 trillion in mandatory outlays for the year, and \$1.0 trillion in discretionary outlays, for a total of \$2.663 trillion in outlays for the year.

As previously noted, CBO's spending estimates for future years assume the continuation each year of supplemental and emergency amounts, even though these were enacted as temporary spending measures.