# HOUSE BUDGET COMMITTEE
## Democratic Caucus
**The Honorable John M. Spratt Jr. ■ Ranking Democratic Member**

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July 11, 2006

# Administration's Mid-Session Review of the Budget

## Key Points

- **2006 is Fourth-Largest Deficit** — The Administration's updated estimate of a $296 billion 2006 deficit makes 2006 one of the four largest in history. When the Social Security surplus is excluded, as it should be, the 2006 deficit is $473 billion.

### Another Record Deficit

*The Four Largest Deficits in History*

| Rank | Year | Deficit |
|---|---|---|
| 1st | 2004 | -$413 Billion |
| 2nd | 2003 | -$378 Billion |
| 3rd | 2005 | -$318 Billion |
| 4th | 2006 | -$296 Billion |

- **Administration Transforms Surpluses to Deficits** — The Bush Administration took office in 2001 with an advantage no administration in recent times has enjoyed: a ten-year projected surplus of $5.6 trillion. The Administration has replaced that surplus with recurring deficits and record debt. When the cost of items omitted from today's figures is included, the deterioration in the budget between 2002 and 2011 is about $8.5 trillion.

- **Future Deficit Forecast Remains Bleak** — Although today's numbers are more positive than the Administration's February forecast, they unfortunately do not represent any significant improvement in the long-term budget picture. Even the Administration's five-year forecast, which omits the cost of certain planned policies, never shows a deficit smaller than $123 billion.

- **Deficit Is Worse than Administration Acknowledges** — The Administration's estimated future deficits fail to include the full costs of items on its agenda, such as the cost of the war beyond 2008, and items that will definitely be addressed, such as the cost of ensuring that the Alternative Minimum Tax does not hit increasing numbers of middle-income Americans, and the cost of rejecting a scheduled cut in Medicare doctor fees. Once likely costs are included, the deficit is never better than $229 billion for the foreseeable future.

- **Deficits Create More Debt and More Debt Service (Interest Payments)** — The large deficits in today's forecast add to a mounting debt that future generations will have to service and repay. During 2007, interest on the national debt will be the fourth largest item in the President's budget, exceeded only by Social Security, Defense, and Medicare. Over the next five years, debt service will be the fastest growing item in the federal budget.

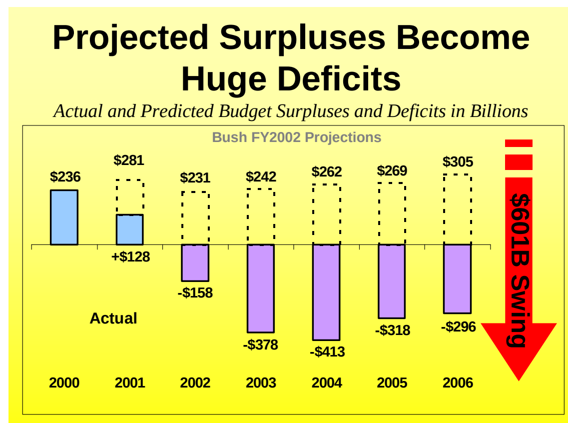
# Today's Report Continues Large Deficits

**Four Largest Deficits in History Have Occurred in Last Four Years** — A 2006 deficit of $296 billion represents an improvement over the 2005 deficit of $318 billion, but still ranks as one of the four largest deficits in history, all racked up by this Administration.

**Social Security Surplus Masks True Size of Deficit** — The Administration's revised estimates of the deficit do not plumb the depth of the government's budget problems because they fold into the calculation the annual surpluses in Social Security. If one excludes the Social Security surplus – all of which is encumbered to secure benefits and which is legally off-budget – the remaining deficit for 2006 is far worse: $473 billion. Over the next five years, Social Security is expected to run surpluses totaling $1.0 trillion. The five-year deficit excluding Social Security is $2.0 trillion, according to Administration estimates.

**Despite Claims, Little Progress Being Made** — The Administration's news release notes that the 2006 estimate shows an improving deficit relative to its February estimate. This marks the third year in a row that the Administration's estimate of the deficit in February has proved pessimistic by at least $108 billion. The new estimate does not represent significant progress; it shows only modest improvement relative to the 2005 deficit of $318 billion.

**Sharp Deterioration Relative to Earlier Predictions** — When the Bush Administration came to office in 2001, it said that after its policies were implemented the budget for 2006 would show a surplus of $305 billion. Even after September 11 and the 2001 recession, the Administration's budget in February 2002 still represented that under its policies the budget would be in surplus in 2006. Instead, the budget for 2006 is in deficit by $296 billion, or $601 billion more than estimated five years ago.



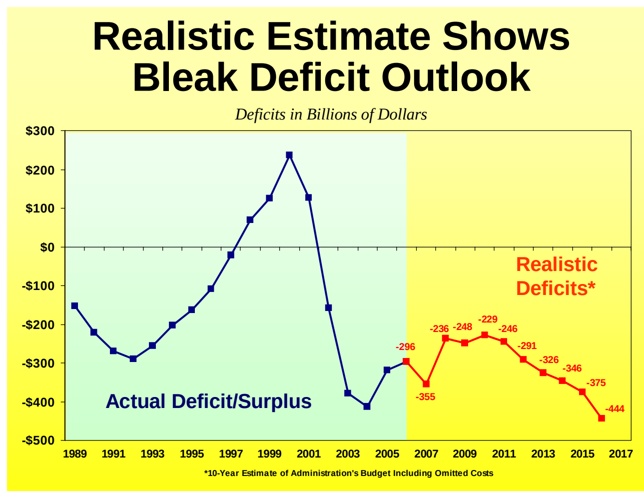

**Long-Term Picture Is Bleak** — The suggestion that the deficit is on track to be cut in half does not mean that the budget is on a trajectory for the deficit to disappear. In fact, the lowest the deficit goes according to the Bush Administration's new forecast is $123 billion, in 2010. Even this is likely to be optimistic, because it fails to account for all of the costs of the Administration's policy agenda, discussed on the next pages. The Administration does not provide ten years of deficit projections, but adding the omitted costs to the Congressional Budget Office's (CBO's) estimate of the President's budget in March of this year shows that the deficit at the end of the ten-year period, in 2016, would be $444 billion under Administration policies.

**Revenue Increase Still Leaves Revenues Behind Projected Levels** — Today's figures reflect an increase in expected revenue in 2006, but still leave revenues far below the levels projected for this year when this Administration first proposed its tax cuts. The Administration estimates that 2006 tax receipts will be higher than their 2005 levels and the level predicted at the beginning of the year, but still $128 billion below the levels predicted under Administration policies by OMB in 2001.

**Tax Cuts Do Not Pay for Themselves** — Today's revenue figures do not support the supply-side claim that tax cuts increase revenues and in time pay for themselves. In the first five years of the Bush tax cuts, revenues were below the levels predicted prior to the tax cuts by a cumulative $2.1 trillion – 18 percent. In fact, revenues from individual income taxes – the primary taxes affected by the Bush tax cuts – for the last complete year are still below their 2000 levels, even before adjusting for inflation and population growth.

**Democrats Balance the Budget** — In 2000, the year before the Bush Administration came to office, the budget was in surplus by $236 billion. The budget has been in deficit since 2002, and since that time this Administration has never submitted a budget that reaches balance. House Democrats have brought to the floor budget resolutions that return the budget to surplus, including a budget this year that reaches balance by 2012. Democrats continue to call for reinstatement of the budget rules that helped turn deficits to record surpluses in the 1990s, particularly the pay-as-you-go rule that Republicans allowed to expire in 2002.

## Deficit Outlook Is Even Worse Than Today's Numbers Show




**Omitted Costs Drive Budget Deterioration Even Deeper** — The true state of the budget is worse than the Administration's forecast depicts because it omits certain costs associated with its agenda, such as fixing the Alternative Minimum Tax and funding ongoing operations in Iraq and Afghanistan. When realistic adjustments are made for omitted items, annual deficits never improve to better than $229 billion for any year over the next decade, and by 2016 the deficit grows to $444 billion.

- **Administration Includes Only Fraction of Cost of Repairing Alternative Minimum Tax (AMT)** — The President's budget acknowledges a need to fix the AMT, because otherwise the AMT would raise taxes for large numbers of middle-income taxpayers in the years ahead. But the Administration's forecast reflects only $33 billion for the first year of the cost of fixing the AMT. When the full ten-year cost (2007-2016) is included, it worsens the ten-year deficit by $832 billion, assuming the President's tax cuts are extended, and by $1.0 trillion if the cost of additional debt service is included.

- **Administration Numbers Omit Cost of War in Iraq and Afghanistan After 2008** — The Administration's new estimates reflect a total of $110 billion for 2007 ($60 billion more than the President's February budget) and a new $50 billion bridge fund for 2008. However, beyond 2008 the Administration provides no further funding for these efforts. Based on a model presented by CBO, costs for military operations in Iraq and Afghanistan could run as much as $371 billion over the next ten years (2007-2016). This CBO calculation is likely conservative given the recent testimony by Army Chief of Staff Peter Schoomaker and Marine Corps Commandant Michael Hagee that reconstitution costs (repairing and replacing worn-out equipment) are running much higher than many anticipated. They testified that Army and Marine Corps equipment reconstitution will cost $29 billion in 2007, nearly triple the amount included in CBO's estimate. Beyond 2007, the Army estimates it alone will need between $12 billion and

$13 billion per year for reconstitution at the current pace of operations until at least two years after operations cease.

- **Administration Omits Long-Term Costs of Its Tax-Cut Agenda** — The President's budget does not show the long-term costs of its tax cuts, which increase rapidly outside the Administration's five-year budget window. The President's tax-cut agenda will cost about $3 trillion over the next ten years, including debt service, with the vast majority of the cost occurring in the second five years.

- **Budget Numbers Understate the Full Deficit Effect of Social Security Privatization —** Today's report estimates that the President's plan to partially privatize Social Security will worsen the unified deficit by $721 billion over the next ten years. This ten-year figure understates the true fiscal effect of the plan because the President's budget assumes implementation of the plan will not begin until 2010, and it will not be fully phased in until 2012. The plan's drain on the budget continues long after the current ten-year budget window. Even with significant benefit cuts, the government will have to increase its borrowing by nearly $5 trillion over the first 20 years of the plan to pay Social Security benefits to current beneficiaries and to those who will start drawing benefits in the near future. Under the President's plan, the level of federal debt held by the public would be higher with the private accounts than without them for the next six decades.

- **Administration Does Not Include Costs of Addressing Medicare Physician Payments —** Under current law, the payment rate to physicians providing services to Medicare beneficiaries is expected to decline by four to five percent each year for the next several years. Congress enacted short-term fixes to prevent such payment rate reductions from taking effect in 2003, 2004, 2005, and 2006. The Administration's budget does not address the issue for 2007 or beyond. A long-term fix could cost from $127 billion to $275 billion over ten years, in the absence of other policy changes.

## Large Deficits Create Debt and Weaken the Economy

**Republican Deficits Create a Growing Burden of Debt** — The deficits created under Republican fiscal policies have generated a growing burden of debt. On the watch of this Administration, debt held by the public has increased by more than one-third, adding $1.2 trillion to $3.4 trillion at the end of 2000, for a total of $4.6 trillion at the end of 2005. As a percentage of Gross Domestic Product, publicly held debt rose from 35.1 percent to 37.4 percent in just five years.

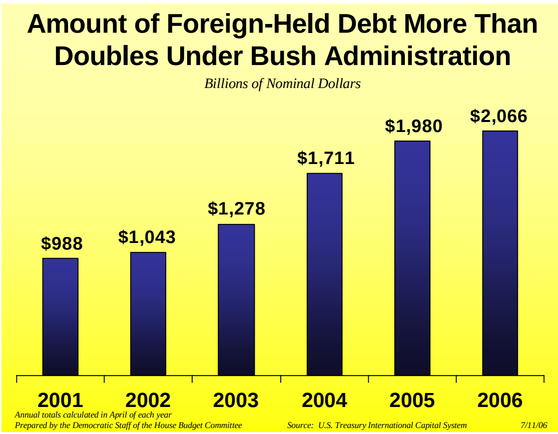
**Republicans Increase the Debt Limit Four Times So Far** — In 2001, this Administration's first budget estimated that its policies would require no increase in the statutory debt ceiling until 2008. In fact, the Administration thus far has requested – and the Republican Congress has granted – four debt ceiling increases, totaling $3.0 trillion, and Republican budgets propose even more increases in the debt ceiling. For example, this year's House-passed budget resolution calls for an additional $653 billion debt ceiling increase.

### Republicans Increase the Debt Limit by $3.7 Trillion

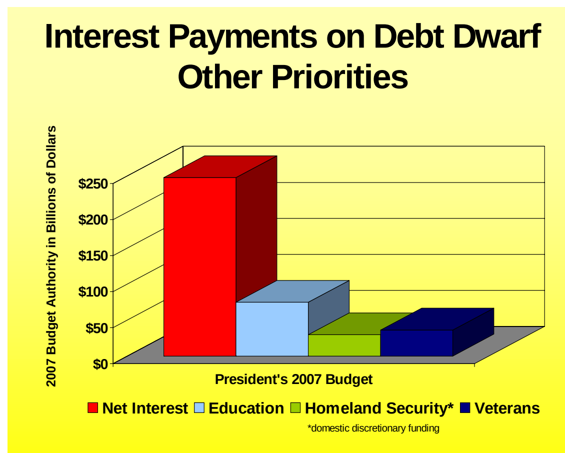
*Debt Limit Increases, Billions of Dollars*

| | |
|---|---|
| June 2002 | **$450** |
| May 2003 | **$984** |
| November 2004 | **$800** |
| March 2006 | **$781** |
| House Budget Res. Level | **$653** |
| **Total Increases** | **$3,668** |

**Foreign-Held Debt Rapidly Increasing** — Since President Bush took office the amount of foreign-held Treasury debt has more than doubled, increasing from $1.0 trillion to $2.1 trillion, meaning that the Bush Administration has already accrued more foreign debt than the previous 42 presidents combined. Unlike deficits in earlier years, current deficits have been primarily financed by foreign investors, with the rise in foreign-held debt equaling three-fourths the increase in publicly held debt since the start of the current Administration. This rise in foreign-held debt is troubling because it makes our economy beholden to foreign creditors and represents another financial burden passed on to future generations. Foreign-held debt is fundamentally different from domestically held debt since the interest payments on foreign-held debt flow outside the United States and reduce Americans' standard of living. The cost of servicing foreign-held debt is high – local, state, and federal government interest payments to foreign investors totaled $114 billion in 2005, an amount that will grow rapidly if the Treasury continues to sell debt to foreign investors at the current rate.




**Deficits Mean Resources Wasted Paying Interest on Debt** — Just like interest payments on a family's credit card, every dollar spent on interest on the national debt is a dollar that doesn't educate a child, build a road, or keep the nation secure. Because of recent record deficits, the government's annual interest payment is the fastest growing category of federal spending over the next five years, and has posted double-digit percentage growth for the past two years. Interest payments dwarf spending on most national priorities, such as homeland security, education, and veterans' health care. By 2011, annual interest payments under the Administration's proposed budget will grow to $302 billion, a 38 percent increase from the current level.




**Deficits Undermine Long-Term Economic Strength** — The Administration claims that its deficits are "manageable," but mainstream economists agree that large, persistent deficits undermine the long-term strength of the economy. Government borrowing raises interest rates and the cost of capital, crowds out private investment, and diminishes sustained economic growth. Former Federal Reserve Chairman Alan Greenspan last year warned that if these large budget deficits are not addressed, "at some point these deficits would cause the economy to stagnate or worse."

**Debate About Economic Impact of Tax Cuts** — Economists argue over the exact impact of the tax cuts on the economy. Bill Gale, an economist with the Brookings Institution, estimated that the 2001 tax cuts would reduce economic growth by 0.3 percent. Similarly, CBO economists estimated that the President's tax policy would result in very small changes to GDP, ranging from a reduction of 0.3 percent to an increase of 0.2 percent over the next five years. Most economic models predict that – contrary to the Administration's claims – tax cuts will reduce economic growth in the long run unless the tax cuts are accompanied by deep cuts to government transfer programs, such as Social Security.

## Bush Economic Policies Fail Working Families

**Job Growth Has Been Weak Under President Bush, Despite Claims to the Contrary —** The economy has added 5.4 million jobs since August 2003, but this growth follows a loss of 2.7 million jobs between January 2001 and August 2003. The net job gain during this Administration is just 2.8 million jobs, far below the net 22.7 million new jobs created during the eight years of the Clinton Administration. Monthly job growth under this Administration has averaged just 42,000 – the lowest since the Eisenhower Administration and far below the monthly average of 237,000 new jobs achieved by the Clinton Administration. About 150,000 new jobs per month are needed to keep pace with the normal growth of the labor force; this Administration's 42,000 average is unfortunately far below this level.

**Americans' Finances Worsen Under the Current Administration's Policies —** Despite large tax cuts and the rapid rise in the national debt, Americans are not seeing higher incomes under current policies. In fact, average annual household income decreased by $2,100, after accounting for inflation, over the course of the Bush Administration. This is in stark contrast to the gains experienced by families under the Clinton Administration, which increased inflation-adjusted average annual household income by $11,400.