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# The Budget for Fiscal Year 2007

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## Summary

The Senate passed its version of the fiscal year (FY) 2007 budget resolution (S.Con.Res. 83) on March 16, 2006. After extended delays, the House passed its resolution on May 18. The extensive differences between the Senate and House versions of the FY2007 budget resolution may prevent a House-Senate agreement. Congress has also begun its work on the FY2007 appropriations.

The President's FY2007 budget released in early February 2006 included proposals to make the 2001 and 2003 tax cuts permanent; slow the growth of Medicare spending; hold non-defense, non-homeland security funding to little if any increase; and introduce, in FY2010, private accounts for Social Security. The budget also assumed that relief from the expanding coverage of the alternative minimum tax (AMT) and funding for the war on terror would end after FY2007. The Administration's budget showed the deficit shrinking (in dollars) through FY2010 before rising slightly in FY2011.

The Congressional Budget Office's (CBO's) January 2006 budget report provided baseline estimates and projections through FY2016. The baseline, following required guidelines, assumed that most current policies remain unchanged. The current law expiration of the tax cuts in 2010 leads to small surpluses beginning in FY2012. CBO's March 2006 estimates of the President's proposals (using CBO's underlying assumptions and budget estimating methods) produced deficits that, in most years, were somewhat smaller than those in the Administration's budget.

CBO's January 2006 report included estimates of policy alternatives to those in the baseline. They were used to illustrate how the use of different policy assumptions can change the baseline estimates. Two of the alternative assumptions would extend the tax cuts and maintain AMT relief; their effect on receipts would be enough to eliminate the baseline's expected surplus. The CBO alternative policy, assuming faster discretionary spending growth, would make reducing the deficit and reaching a surplus more difficult.

Over the longer term, the retirement of the baby boom generation will put enormous pressure on the federal budget and the economy. Neither the Administration nor CBO believes that current policies, particularly current federal policies for the elderly, can be sustained. Absent significant policy change, the effect of the growing numbers of recipients for federal programs will disrupt not only the programs themselves, but also the rest of the federal budget, the ability of the government to finance its obligations, and, possibly, the ability of the economy to support the expansion of government spending.

This report will be updated as events warrant.

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# The Budget for Fiscal Year 2007

## Background and Analysis

Presidents submit their budget proposals for the upcoming fiscal year (FY) early in each calendar year. The Bush Administration released its FY2007 budget (*The Budget of the U.S. Government, Fiscal Year 2007*) on February 6, 2006. The multiple volumes contain both general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2006 (still underway) through FY2011. It includes a section on long-term fiscal issues facing the nation and provides limited information on the revenue and mandatory spending changes after 2011. The full set of budget documents (*Budget, Appendix, Analytical Perspectives*, *Historical Tables*, among several other supplemental budget documents) contains extensive and detailed budget information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed budget authority, outlay and receipt data, selected analysis of specific budget related topics, and the Administration's economic forecast.[1] In addition to their presentation of the Administration's proposals, the budget documents are an annual reference source for federal budget information, including enacted appropriations.

The Administration's annual budget submission is followed by congressional action on the budget. This usually includes the annual budget resolution, appropriations, and, possibly, a reconciliation bill (or bills) as required by the budget resolution. Over the course of deliberation on the budget, the Administration often revises its original proposals as it interacts with Congress and as conditions change in the economy and the world.

## The Current Situation

On March 16, 2006, the Senate passed its version of the congressional budget resolution (S.Con.Res.83) for FY2007. The resolution included higher discretionary spending than requested by the President and did not include any reconciliation instructions to reduce mandatory spending or to reduce taxes. The House Budget Committee passed its verison of the congressional budget resolution (H.Con.Res.

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[1] Current services baseline estimates, and baseline estimates in general, are not meant to be predictions of future budget outcomes, but instead are designed to provide a neutral measure against which to compare proposed policy changes. In general, they project current policy, which includes future changes in law, over the next 5 to 10 years. Their construction generally follows instructions provided in the Balanced Budget and Emergency Deficit Control Act of 1985 (DCA) and the Congressional Control and Impoundment Act of 1974.

376) on March 29. Although scheduled for floor action the week of April 3, disagreements within the majority over the resolution put off its consideration until after the Easter break. Continued disagreements within the majority further delayed the House consideration of the budget resolution until mid-May. In the early morning hours of May 18, 2006, the House adopted its version of the budget resolution (218-210). Later that day, the House "deemed" the budget resolution into effect, clearing some procedural issues that otherwise could interfere with the consideration of appropriations. At this time, many analysts believe that the Senate and House are unlikely to resolve the substantial policy differences between their respective budget resolutions. The House has also begun work on the appropriations for FY2007.

# Budget Totals

**Table 1** contains budget estimates for FY2007 from the CBO and the Administration (the Office of Management and Budget, OMB). Differences in totals can result from differing underlying economic, technical, and budget-estimating assumptions and techniques, as well as differences in policy assumptions. At the outset, the *policy*-generated dollar differences for an upcoming fiscal year may be relatively small compared to the budget as a whole. These small differences, however, may grow over time — sometimes substantially — producing widely divergent future budget paths. Budget estimates generally should be expected to change over time from those originally proposed or estimated by the President, CBO, or Congress.

**Table 1. Budget Estimates and Proposals for FY2007**
(in billions of dollars)

| | Receipts | Outlays | Deficit (-)/ Surplus |
|---|---|---|---|
| CBO, BEO Baseline, 1/06 | $2,461 | $2,732 | $-270 |
| OMB, Budget Proposals, 2/06 | 2,416 | 2,770 | -354 |
| OMB, Budget, CSB, 2/06 | 2,444 | 2,701 | -257 |
| CBO Analysis of OMB, 3/06 | 2,431 | 2,766 | -335 |
| Senate Budget Res. (S.Con.Res. 83) 3/06 | 2,433 | 2,795 | -363 |
| House Budget Res. (H.Con.Res. 376) 5/06 | 2,422 | 2,771 | -348 |

BEO — The *Budget and Economic Outlook*, CBO.
CSB — The Administration's current services baseline.

## Budget Estimates and Proposals

CBO's first budget report for FY2007, the *Budget and Economic Outlook: Fiscal Years 2007-2016* (January 2006), contained baseline and economic estimates and projections for FY2006 through FY2016. The report estimated an FY2007 baseline deficit of $270 billion (down from the estimated FY2006 baseline deficit of $337 billion). By FY2011, the CBO baseline deficit estimate had fallen to $114 billion. The next year, FY2012, the increased receipts from the expiration of the

2001 and 2003 tax cuts produce a small baseline surplus estimate of $38 billion. The small surplus estimates (never exceeding $75 billion, or 0.4% of GDP) persist through FY2016.

Under the baseline assumptions, CBO increases discretionary spending at the rate of inflation, assumes that the 2001 and 2003 tax cuts fully expire after 2010 (as required under current law), and allows the recently lapsed alternative minimum tax (AMT) relief to remain lapsed. The effects of these assumptions raise receipts in the near-term and increase receipts by substantial amounts after FY2010 when most of the tax cuts from 2001 and 2003 expire under current law. The declining deficit and appearance of small surpluses over the 10 years in the CBO baseline are largely explained by the baseline construction rules that CBO must follow. The results likely understate the future size and persistence of the deficit, as CBO acknowledges in its report.

CBO's budget reports generally include estimates of the effect on the deficit (or surplus) of selected policies not included in the baseline estimates. These policy alternatives usually reflect policies under discussion or of high interest, such as making the tax cuts permanent, addressing the expanding coverage of the AMT, or assuming a rate of growth other than the inflation rate for discretionary spending. In CBO's January 2006 report, making the tax cuts permanent increases the five-year (FY2007-FY2011) cumulative deficit (including higher debt-service costs) by $372 billion, and by a cumulative $2.3 trillion over the 10-year period (FY2007-FY2016). CBO's estimate of the revenue loss from reforming the AMT produces a $317 billion five-year cumulative increase in the deficit and a $691 billion increase over 10 years. If discretionary spending were to grow at the rate of GDP, rather than at the rate of inflation, the five-year cumulative deficit would increase by an estimated $356 billion, and the 10-year cumulative deficit would increase by an estimated $1.6 trillion. Freezing discretionary appropriations at the FY2006 level would *reduce* the five-year cumulative deficit by $317 billion and the 10-year cumulative deficit by $1.4 trillion.

President Bush's FY2007 budget called for extending and making permanent most of the tax cuts adopted in 2001 and 2003, as well as extending other expiring tax provisions. The budget showed extending the 2001 and 2003 tax cuts would reduce receipts by an estimated $179 billion between FY2007 and FY2011, and by an estimated $1.4 trillion between FY2007 and FY2016 (these estimates do not include the resulting higher debt-service costs resulting from the change).[2] The Administration's total receipt proposals would reduce five-year receipts by $280 billion, and 10-year receipts by $1.7 trillion. Cumulative receipts over the 5- and 10-year periods total approximately $13,823 billion and $32,496 billion respectively, without the proposed changes.

[2] The changes are measured from OMB's current services estimates, its baseline, excluding the proposals assumed in its revenue baseline. OMB included the assumption that the tax cuts would be extended in its baseline. This produces a current services revenue estimate substantially smaller than CBO's baseline revenue estimate, particularly in the second half of the 10-year period.

The Administration's budget provided a limited amount of information for the years beyond FY2011. The budget did include estimates of the cumulative proposed revenue changes and proposed mandatory spending changes for the periods FY2007 through FY2011, and FY2007 through FY2016, but these projections contained no information for the individual years after FY2010. Nor were estimates provided for other components of the budget or for budget totals beyond FY2011.

Although not included in the budget documents (it was made available on February 9, 2006), the President proposed the elimination of, the reduction in, or the reform of approximately 141 discretionary programs. The Administration reports that these changes would produce an estimated $20 billion in budget authority (not outlay) savings in FY2007 compared to FY2006. How much these savings would affect the FY2007 deficit was left unclear.

The budget also proposed reductions (mostly in the rates of increase) in mandatory programs over the next five years. The proposed net savings total $71 billion over five years, but this is only a partial accounting of the President's mandatory proposals. The other proposals include user fee increases ($3 billion in savings), program "augmentations" ($9 billion in increases), Social Security personal accounts ($82 billion in increases in FY2010 and FY2011), the outlay effects of extending the tax cuts ($6 billion in increases), and other mandatory proposals ($1 billion in savings). The net effect increases mandatory outlays by $21 billion over five years. Over the same five years, cumulative mandatory spending, excluding the Administration's proposals, totals an estimated $8,385 billion. The Administration's $21 billion proposed increase raises mandatory spending 0.3% above its baseline estimates.

CBO released its analysis (with contributions from the Joint Committee on Taxation) of the President's budget proposal on March 15 (a preliminary analysis was published on March 3). The analysis involved plugging the Administration's policy proposals into CBO's underlying budget assumptions and budget estimating methods. The results produced smaller deficits in FY2006 and FY2007 than the President's budget, but the deficits were larger than CBO's baseline estimates (see **Table 1**). CBO's reestimates and the Administration's deficits were similar for the subsequent years through FY2011. (CBO extended its reestimates through FY2016, showing the deficit, under the Administration's policies, growing slightly as a percentage of GDP from FY2012 through FY2016.)

## Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial variation over short time periods makes budget estimates and projections susceptible to fairly rapid and dramatic changes.[3] Small changes in economic conditions, particularly the rate of

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[3] Some of the underlying components of budget estimates are known with some certainty. Demographics are one known component. In the next decade, the expected retirements in the baby boom generation will rapidly increase the spending for Medicare and Social (continued...)

GDP growth (from those assumed in the estimates) can produce large changes in the budget estimates. According to CBO, a persistent 0.1% increase in the real growth rate of real GDP would reduce the deficit (including interest costs) by $58 billion cumulatively over a five-year period and by $272 billion over the next 10 years. Reductions in the rate of GDP growth would increase the deficit by similar amounts over the same time periods. Policy changes that are likely, such as supplemental appropriations for operations in Iraq and Afghanistan, but are not included in CBO's baseline, can also change the budget outlook, both for the current budget year and for years in the future.

The President's (FY2007) budget includes a chapter in the *Analytical Perspectives* volume titled "Comparison of Actual to Estimated Totals." The chapter examines the causes of the changes from the initial budget estimates for FY2005 (February 2004) through the actual results for that year. OMB extends its analysis to find upper and lower bounds to the deficit or surplus estimates over a five-year period, based on data going back to FY1982. It found that the upper and lower bounds range over $1.1 trillion at the end of a five-year period. In other words, the Administration's deficit estimate for FY2011, $205 billion, could range from a surplus of approximately $300 billion to a deficit of approximately $700 billion (with a 90% chance of the budget balance falling between those two numbers). Even the Administration's deficit estimate for FY2007 has a 90% chance of being as small as $86 billion or as large as $622 billion.

Budget projections are dependent on the underlying assumptions about the direction of the economy, expected policy and policy changes, and how these interact, along with other factors (such as changing demographics) that affect the budget. Any deviation from the assumptions used in the budget estimates, such as faster or slower economic growth, higher or lower inflation, differences from the expected or proposed spending and tax policies, or changes in the technical components of the budget models can have substantial effects on the budget estimates and projections, particularly over longer periods.

## Budget Action

Congressional committees began hearings on the President's FY2007 budget shortly after it was released. The Senate Budget Committee reported its version of the congressional budget resolution for FY2007 (S.Con.Res. 83) on March 9. After amending the resolution, the Senate passed it on March 16. As passed, the resolution had higher outlays and deficit for FY2007 than proposed by the President, assumed the extension of numerous expiring tax cuts (but did not include a fix, temporary or otherwise, for the Alternative Minimum Tax beyond FY2006), and did not include reductions in mandatory spending. The House Budget Committee passed its version of the FY2007 budget resolution (H.Con.Res. 376) on March 29. The House Budget

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[3] (...continued)
Security as well as other federal activities benefitting the elderly. Because virtually all those who will become eligible for these benefits are alive today, estimating the growth in the populations eligible for these programs is relatively straightforward.

Committee's resolution had smaller discretionary spending caps than the Senate-passed resolution, among other differences. The House, after an extended delay, passed its budget resolution on May 18. The House is also in the early stages of its consideration of the appropriations for FY2007.

## Outlays

The Administration's FY2007 budget proposed $2,770 billion in outlays for FY2007, rising to $3,240 billion in FY2011, the last year shown in the President's budget. The proposals would boost funding for defense and homeland security spending, restrain or cut most other discretionary spending, and make modest growth-slowing changes to Medicare. In FY2010 and FY2011, it would raise spending by tens of billions of dollars to fund private accounts for Social Security. The Administration's proposals, which the budget assumes are adopted, would raise outlays by $61 billion (2.2%) above the Administration's revised FY2006 outlay estimate, and by 17.0% from FY2007 to FY2011.

**Table 2. Outlays for FY2005-FY2011 and FY2016**

(in billions of dollars)

| | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2016 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/05 | *2,472* [a] | $2,649 | $2,732 | $2,857 | $2,984 | $3,105 | $3,252 | $4,046 |
| President's FY06 Budget, 2/05 | | 2,709 | 2,770 | 2,814 | 2,922 | 3,061 | 3,240 | — |
| President's FY06 CSB, 2/05 | | 2,669 | 2,701 | 2,798 | 2,925 | 3,050 | 3,210 | — |
| CBO Analysis of OMB, 3/06 | | 2,675 | 2,766 | 2,820 | 2,906 | 3,017 | 3,167 | 4,044 |
| CBO Revised Baseline, 3/06 | | 2,648 | 2,726 | 2,849 | 2,968 | 3,099 | 3,256 | 3,822 |
| Sen. Bud. Res. (S.Con.Res. 83) 3/06 | | 2,675 | 2,795 | 2,843 | 2,923 | 3,030 | 3,164 | — |
| H. Bud. Res. (H.Con.Res. 376) 5/06 | | 2,675 | 2,771 | 2,825 | 2,914 | 3,022 | 3,157 | — |

a. Actual outlays for FY2005.
CSB — The Administration's current services baseline.
HBC — House Budget Committee

Measured against the Administration's FY2007 current services baseline outlay estimates, the proposed level of outlays grows by $69 billion (2.6%).[4] The difference between the current services baseline outlay estimate and proposed outlays for FY2007 indicates the "cost" of the Administration's proposed policies. The year-to-year change (the $61 billion increase) combines the "costs" of proposed policy changes for FY2007 with the relatively automatic growth in large parts of the budget

[4] The current services baseline estimates, like CBO's baseline estimates, are designed to provide "a neutral benchmark against which policy proposals can be measured." For outlays, the modified baseline used this year by OMB assumes emergencies are one-time only, that federal pay adjustment assumptions reflect the (usual) January 1 start of inflation-adjusted raises rather than October 1, and the debt service (interest payment) changes resulting from these (and revenue-related) modifications are included in the baseline. These modifications reduced the reported current services baseline outlay estimate by approximately $45 billion in FY2007 and by $86 billion in FY2011.

from FY2006 to FY2007. These relatively automatic increases include cost-of-living adjustments in many federal programs, growth in populations eligible for program benefits, and inflation-driven costs of goods and services bought by the government.

From FY2006 to FY2007, the Administration's budget makes a number of assumptions, including the following: a $19 billion increase in undistributed offsetting receipts (that reduce outlays) from proposed sales of a portion of the radio spectrum; a reduction ($23 billion) in disaster and relief spending for hurricane relief efforts that the Administration expects to wind down in FY2007; a $22 billion reduction in federal education funding, mostly for support of higher education; substantial increases in outlays in net interest ($27 billion), as both the debt and interest rates rise; a rise in Social Security spending by an expected $31 billion; and a rise in Medicare spending by an expected $49 billion, including the Administration's proposals to slow its growth.

As shares of gross domestic product (GDP), the Administration's proposals would reduce outlays from 20.8% of GDP in FY2006 to 20.1% of GDP in FY2007. By FY2011, the Administration projects that outlays will have fallen to 19.1% of GDP. CBO's January 2006 baseline estimates showed outlays falling very slowly from 19.8% of GDP in FY2007 to 19.4% of GDP in FY2011 and, after falling slightly in the intervening years, returning to 19.4% of GDP in FY2016. Under a selection of CBO's alternative scenarios for spending — including the assumption that there is a phase-down in activities in Iraq and Afghanistan over a number of years, that total discretionary spending increases at the rate of nominal GDP growth (rather than the rate of inflation), and including higher interest costs from the larger deficits and debt resulting from these changes (and from extending the tax cuts) — outlays would fall from 20.1% of GDP in FY2007 to 20.0% of GDP in FY2011 before rising to 21.2% of GDP in FY2016.

The President's budget indicated that Department of Defense (DOD) spending would increase by 6.9% from FY2006 to FY2007. This increase ($28 billion, from $411 billion to $439 billion) is based on *budget authority* (BA) for those two years and excludes enacted and proposed supplementals for the DOD. The President's budget shows outlays, the actual expenditures of the DOD, dropping from FY2006 ($512 billion) to FY2007 ($505 billion), a 1.4% reduction in spending.[5] (Total outlays, not BA, and total revenues determine a year's surplus or deficit.) With the uncertainty surrounding the financing needs for the war on terror, FY2007 defense outlays seem likely to change. CBO's baseline estimates for defense spending (which include extending supplemental funding) increase BA (by 2.5%) and lower outlays (by less than 1%) between FY2006 and FY2007.[6]

Non-defense discretionary outlays in the President's budget would grow by just under 1% ($5 billion) from FY2006 to FY2007, from $500 billion in FY2006 to $505 billion in FY2007. The President's budget shows non-defense discretionary BA

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[5] These outlay numbers include both discretionary and mandatory outlays for the DOD. Mandatory spending for the DOD is less than $2 billion in both years.

[6] CBO's defense category matches the Budget Enforcement Act (BEA) defense category, a somewhat larger collection of defense related activities than is covered by the DOD alone.

falling by 4.2% ($18 billion) between those two years. Most of that change results from the boost in FY2006 spending resulting from the Administration's proposed $18 billion hurricane relief supplemental. Excluding that amount, non-defense discretionary BA, as a whole, barely changes from FY2006 to FY2007. CBO's baseline non-defense discretionary outlay estimates grow by less than 1% between FY2006 and FY2007, from $499 billion to $502 billion, similar to the change in the President's budget. The President's budget leaves unspecified his called for future year reductions in discretionary spending.

Mandatory spending, federal activities that generally do not need an annual appropriation, grows by 3.9% ($64 billion) from FY2006 to FY2007, including the Administration's proposed $1.7 billion in mandatory spending reductions for FY2007.[7] This raises mandatory spending, the largest category of federal spending, from $1,457 billion in FY2006 to $1,494 billion in FY2007. CBO's baseline estimates of mandatory spending show it rising from $1,432 billion in FY2006 to $1,488 billion in FY2007, a 3.9% increase.

The Administration proposed $36 billion in Medicare savings (from baseline levels) through FY2011, which would slow, slightly, the expected increase in Medicare spending. Medicare spending over the five years totals an estimated $2,207 billion. The Administration's proposed Medicare reduction amounts to a 1.6% cut from total Medicare baseline spending over the five years. The budget also included in its mandatory proposals, personal accounts for Social Security (beginning in FY2010) that would increase spending by $82 billion over the two years, FY2010 and FY2011. The net effect of the Administration's mandatory proposals would increase spending by $21 billion over the five years, FY2007 through FY2011.[8]

The large deficits and rising interest rates have an effect on the interest payments the government must make on its growing debt. Both the President's budget and CBO's baseline estimates show net interest rising by 12% from FY2006 to FY2007. Continued large deficits that rapidly increase the debt, combined with expected higher interest rates, will continue to raise the government's annual interest payment. Net interest as a share of total outlays will have grown from 7.4% in FY2005 to an estimated 8.2% in FY2006, and to an estimated 8.9% of total outlays in FY2007.

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[7] The Administration's reductions include increased user fee offsets as well as reductions in mandatory spending.

[8] The mandatory proposals would increase spending by an estimated $551 billion from FY2007 through FY2016, according to the budget documents.

**Figure 1** shows the Administration's FY2007 budget proposals for spending by category. The data show actual outlays for defense, non-defense, mandatory, and net interest spending for the fiscal years 2000 through 2005 and the President's proposed spending for the fiscal years 2006 though 2011, all as percentages of GDP. The slide in defense and non-defense spending as a share of GDP after FY2006 occurs in both the Administration's proposed and current service baseline estimates and projections. The reductions depend on the Administration's assumptions that non-defense, non-homeland security discretionary spending falls by 1.6% annually (FY2007 through FY2011) and that there is no additional funding for the war on terror after the $50 billion proposed for FY2007 (which means that DOD outlays fall by 0.6% a year). The President proposed some reductions, from current service levels, in mandatory spending, but they have little effect in changing mandatory spending as a share of GDP. By FY2010 and FY2011, the President's proposed private accounts for Social Security raise mandatory spending as a percentage of GDP above the current services level. Mandatory spending grows at an annual rate of 5.2% in the President's budget.

**Figure 1. The President's Proposed Outlays by Type, FY2000-FY2011**

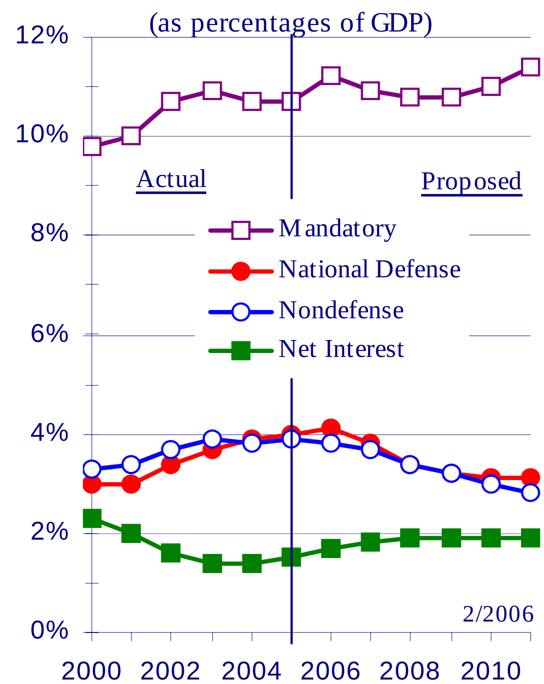
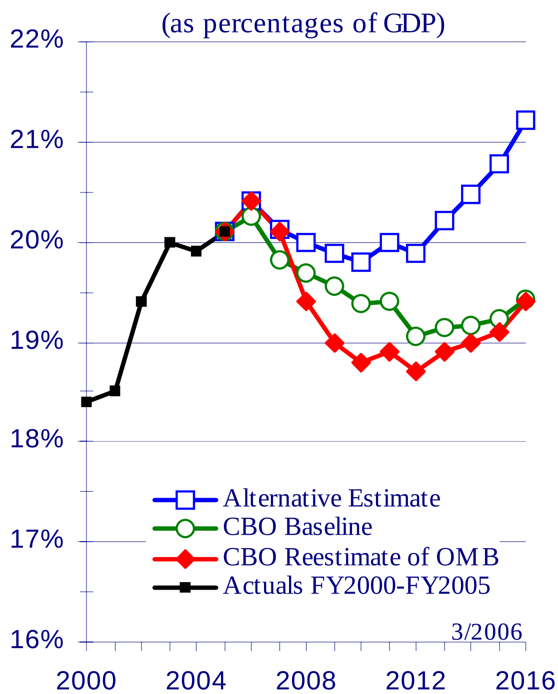



**Figure 2** shows three possible paths for outlays as percentages of GDP through FY2016: the CBO baseline, the President's proposal (as reestimated by CBO), and an alternative estimate derived from CBO data. CBO's baseline falls as a share of GDP through FY2012 before beginning to rise. CBO's reestimate of the President's proposed outlays fall sharply after FY2006, in part the result of the Administration's assumption of reductions in discretionary spending, before beginning a steady rise after FY2012. Future outlays in both estimates remain below FY2006 estimated outlays as a percentage of GDP. The third line, the alternative estimate, is based on selected policy alternatives estimated by CBO that were not included in CBO's baseline. The alternative incorporates several assumptions. One, that discretionary spending grows at the rate of nominal GDP growth (a higher rate of growth than used in the baseline). Two, that instead of annually repeating the recent supplementals for the war on terror and hurricane relief, funding for the military activities in Iraq and Afghanistan are phased down over several years and hurricane relief ends after FY2006. Three, that, because of larger deficits and debt, the government's interest costs are larger than in the baseline. And four, that, as in the baseline, mandatory spending is expected to grow faster than GDP. The lower outlays resulting from the change in the assumption about repeating the supplementals is overwhelmed by the higher outlays resulting from the faster rate of discretionary spending and additional interest costs. Outlays under the alternative estimate fall as a percentage of GDP in

the near future (from 20.1% of GDP in FY2007 to 19.9% of GDP in FY2012) before rising fairly rapidly after FY2012 (from 19.9% of GDP in FY2012 to 21.2% of GDP in FY2016).

**Figure 2. Outlays, FY2000-FY2016**




The Senate-passed budget resolution (S.Con.Res. 83; March 16, 2006) increased outlays by $120 billion (4.5%) between FY2006 and FY2007. The resolution's FY2007 oultays would be $69 billion larger than CBO's FY2007 baseline outlay estimate and $25 billion above the President's FY2007 outlay proposal. Under the Senate resolution, outlays would fall as a percentage of GDP, from 20.3% of GDP in FY2007 to 18.9% of GDP in FY2011.

The House-passed budget resolution (H.Con.Res. 376; May 18, 2006) follows most of the policies of the President's budget proposal. The resolution has a slightly smaller deficit and slightly higher outlays than in the President's proposal for FY2007. Outlays in the resolution increase by $95 billion (3.6%) from FY2006 to FY2007. The outlays are $45 billion higher than CBO's FY2007 baseline outlay estimate and less than $1 billion above the President's FY2007 outlay proposal. In the resolution, outlays would fall from 20.1% of GDP in FY2007 to 18.8% of GDP in FY2011.

## Receipts

Receipts would rise by 5.7% from FY2006 to FY2007 under the Administration's FY2007 budget proposal, including the effect of extending the alternative minimum tax (AMT) relief through FY2007. Over the five years forecast in the President's budget, revenues would rise from $2,416 billion in FY2007 to $3,035 billion in FY2011, a 25.6% increase.

The Administration's proposal to extend and make permanent many of the tax cuts adopted in the Administration's first term has little effect on FY2007 revenues. Most of the budgetary effect of extending the tax cuts would occur after FY2010. (Because the Administration incorporated the effect of making the tax cuts permanent in both its proposed and current services baseline estimates, there is no upward bump in receipts in FY2010 or FY2011. CBO's baseline, which assumes the tax cuts expire, shows a larger increase in receipts between FY2010 and FY2011 than in earlier years. See **Table 3**.) The Administration estimated that making the 2001 and

2003 tax cuts permanent would reduce receipts by $179 billion between FY2007 and FY2011 and by $1.4 trillion between FY2007 and FY2016. The effect of these extensions and the Administration's other proposals for receipts would reduce receipts by $280 billion in the first five years and by $1,667 billion over 10 years. CBO's January 2006 budget report estimated that extending the expiring provisions of the major tax cuts in 2001 and 2003 would reduce revenues by an estimated $346 billion over the first five years and by $1,606 billion over 10 years. Extending *all* the tax cuts that expire over the 10-year period would reduce revenues (from CBO baseline levels) by $582 billion in the first five years and by $2,644 billion over the full 10 years of the forecast.[9]

**Table 3. Receipts for FY2005-FY2011 and FY2016**

(in billions of dollars)

| | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2016 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/05 | *$2,154*[a] | $2,312 | $2,461 | $2,598 | $2,743 | $2,883 | $3,138 | $4,113 |
| President's FY06 Budget, 2/05 | | 2,285 | 2,416 | 2,590 | 2,714 | 2,878 | 3,035 | — |
| President's FY06 CSB 2/05 | | 2,301 | 2,444 | 2,597 | 2,729 | 2,901 | 3,064 | — |
| CBO Analysis of OMB, 3/06 | | 2,304 | 2,431 | 2,585 | 2,712 | 2,852 | 2,964 | 3,794 |
| CBO Revised Baseline, 3/06 | | 2,313 | 2,461 | 2,598 | 2,743 | 2,883 | 3,139 | 4,114 |
| Sen. Bud. Res. (S.Con.Res. 83) 3/06 | | 2,303 | 2,433 | 2,593 | 2,725 | 2,870 | 2,986 | — |
| H. Bud. Res. (H.Con.Res. 376) 3/06 | | 2,303 | 2,422 | 2,590 | 2,723 | 2,869 | 2,994 | — |

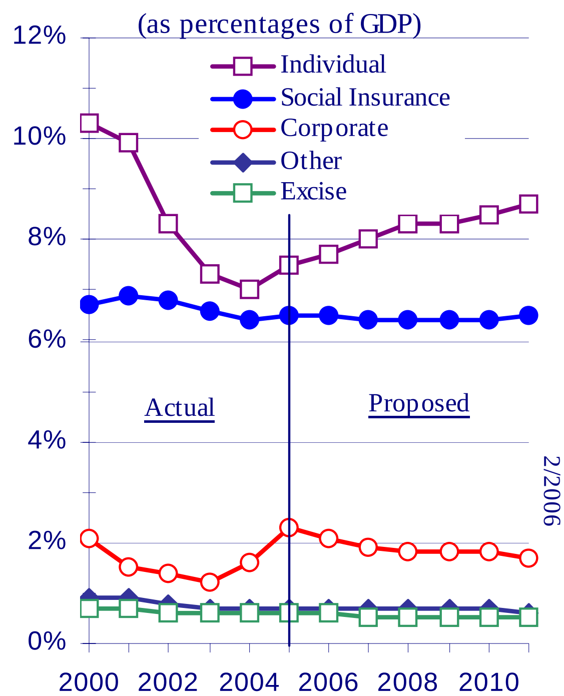
a. Actual receipts for FY2005.
CSB — The Administration's current services baseline.
HBC — House Budget Committee

The estimated reductions in revenues from extending tax cuts do not reduce year-to-year revenues. The Administration projected that receipts would rise from $2,285 billion in FY2006, to $2,416 billion in FY2007, and to $3,035 billion in FY2011 (including the effect of the Administration's proposals). CBO's revised baseline estimates (March 2006) showed revenues increasing from an estimated $2,312 billion in FY2006, to $2,461 billion in FY2007, to $3,139 billion in FY2011, and to $4,114 billion in FY2016.

[9] These amounts from CBO do not include the outlay effects (usually interest costs associated with larger deficits and debt) of the extensions.

**Figure 3** shows the President's budget's proposed receipts, by type, for the fiscal years 2000 through 2011. Actual receipts are shown through FY2005, and the Administration's proposed amounts are shown for FY2006 through FY2011, all as percentages of GDP. Under the Administration's proposals, excise and other receipts remain below 1% of GDP. Corporate income taxes, after rising through FY2005, decline slowly and steadily as a share of GDP under the Administration's projection. Social Insurance receipts remain fairly steady throughout the period shown. Individual income taxes, having fallen over 1.5% of GDP between FY2000 and FY2004, regain some of their lost share under the Administration's proposals, but remain well below their FY2000 level.

**Figure 3. The President's Proposed Receipts by Type, FY2000-FY2011**




The Administration's proposals included extending the current relief from the alternative minimum tax (AMT) for fiscal years 2006 and 2007. Without further extensions of or a permanent fix to the AMT, a growing number of middle-class taxpayers will find themselves subject to the AMT.[10] CBO estimates (January 2006) that providing annual AMT relief would reduce receipts by $236 billion between FY2007 and FY2011, and by $437 billion between FY2007 and FY2016. Without some adjustment to the AMT, it will eventually recapture much of the tax reduction provided in the 2001 and 2003 tax cuts.[11]

As shares of GDP, total receipts are expected to remain near or below their average of 18.2% (between FY1965 and FY2005) throughout the period covered in the Administration's budget. CBO's estimates of the Administration's proposals showed receipts rising slowly from 17.6% of GDP in FY2007, to 17.8% of GDP in FY2011, and to 18.2% of GDP in FY2016 (CBO extended the Administration's policies through FY2016). As one would expect, CBO's revised baseline estimates, which exclude the extension of the tax cuts, are larger, rising from 17.9% of GDP in

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[10] For discussions of the AMT issue, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*; and CRS Report RS22100, *The Alternative Minimum Tax for Individuals: Legislative Initiatives and Their Revenue Effects*, both by Gregg A. Esenwein.

[11] See CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back" Effects*, by Gregg A. Esenwein, for more information on the interaction of the AMT and the tax cuts.

FY2007 to 18.7% of GDP in FY2011. By FY2016, CBO's baseline revenue forecast reaches 19.7% of GDP.[12]

Modifying CBO's baseline revenue estimates and projections by using its alternative policy estimates produces much slower growth in receipts, both in dollars and as shares of GDP, than in CBO's baseline.[13] And although receipts still rise as a percentage of GDP, they do so more slowly than in the President's proposal and much more slowly than in CBO's baseline. By FY2011, the alternative estimates of receipts would rise to $2,925 billion, or 17.4% of GDP. By FY2016, the alternative estimated receipts rise to $3,740 billion, or 17.9% of GDP. This is $400 billion and 2% of GDP below the baseline projections for FY2016.

**Figure 4. Receipts, FY2000-FY2016**

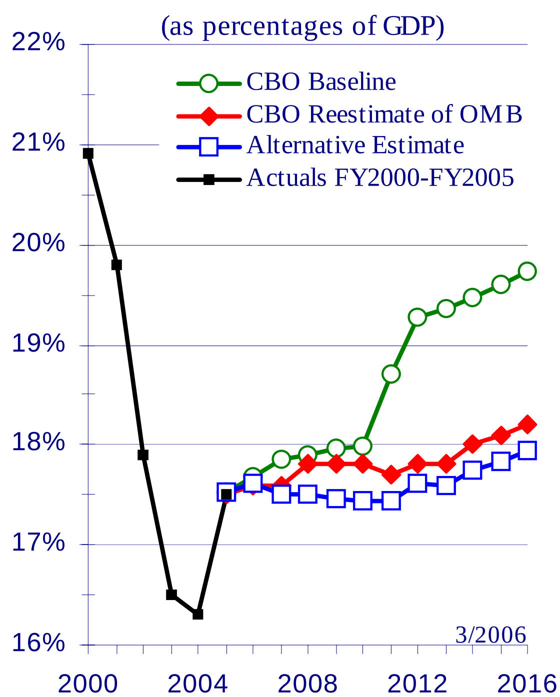


**Figure 4** uses data from the March 2006 CBO budget report analyzing the President's proposed policies. The figure shows receipts as percentages of GDP for fiscal years 2000 through 2016 (projected). Actual receipts are shown for fiscal years 2000 through 2005. CBO's baseline and its reestimate of the Administration proposals follow similar paths through FY2010. CBO's baseline receipt estimates are slightly larger as shares of GDP than those of the Administration. The CBO baseline does not assume the FY2006 and FY2007 AMT relief that is included in the Administration estimate. The similarity in the paths ends in FY2011 when the Administration proposals assume the permanency of the 2001 and 2003 tax cuts and CBO does not. CBO's revised baseline shows a big jump in receipts in FY2011, as its assumptions include the tax increases resulting from the expiration of the 2001 and 2003 tax cuts. CBO's reestimates of the President's tax proposals assumes that the tax cuts are made permanent. Both the reestimates and the alternative estimates in **Figure 4** follow similar paths, although at different levels of GDP, after FY2010. The alternative estimates show receipts staying between 17.5% and 17.9% of GDP throughout the 10-year period.

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[12] The CBO baseline incorporates the assumption of a substantial tax increase after FY2010 when the large 2001 and 2003 tax cuts expire under current law.

[13] CBO indicates that combining the reform of the AMT and the tax extenders produces an interactive effect that makes the combined loss greater than the sum of the two estimates separately.

The Senate-passed budget resolution accommodated over $200 billion in unspecified tax cut extensions over five years. The House-passed budget resolution included a similar amount of tax reductions.

## Deficits (and Surpluses)

Deficits and surpluses are the residuals left after Congress and the President set policies for spending and receipts. Surpluses, in which receipts are greater than outlays, reduce federal debt held by the public, which can lead to lower net interest payments (among other effects). Deficits, in which outlays exceed receipts, increase government debt held by the public, generally increasing net interest payments. The government had its last surplus in FY2001 ($128 billion and 1.3% of GDP).

**Table 4. Surpluses/Deficits(-) for FY2005-FY2011 and FY2016**
(in billions of dollars)

| | FY2005 | FY2006 | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2016 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/05 | *$-318* [a] | $-337 | $-270 | $-259 | $-241 | $-222 | $-114 | $67 |
| President's FY06 Budget, 2/05 | | -423 | -354 | -223 | -208 | -183 | -205 | — |
| President's FY06 CSB 2/05 | | -367 | -257 | -201 | -196 | -149 | -146 | — |
| CBO Analysis of OMB, 3/06 | | -371 | -335 | -236 | -194 | -165 | -204 | -250 |
| CBO Revised Baseline, 3/06 | | -336 | -265 | -250 | -224 | -216 | -117 | 70 |
| Sen. Budget Res. (S.Con.Res. 83) 3/06 | | -372 | -363 | -250 | -197 | -160 | -178 | — |
| H. Budg. Res. (H.Con.Res. 376) 5/06 | | -372 | -348 | -235 | -191 | -153 | -164 | — |

a. Actual deficit for FY2005.
CSB — The Administration's current services baseline.

The President's budget proposed a FY2007 deficit of $354 billion (2.6% of GDP). The Administration's budget showed the deficit shrinking in dollars and as a share of GDP through FY2010 before rising slightly in FY2011. Without policy changes, the deficit is likely to begin rising in subsequent years as the baby boom generation retires in large numbers and raises the demand for federal spending on the elderly, even as revenues remain near or below historical levels.

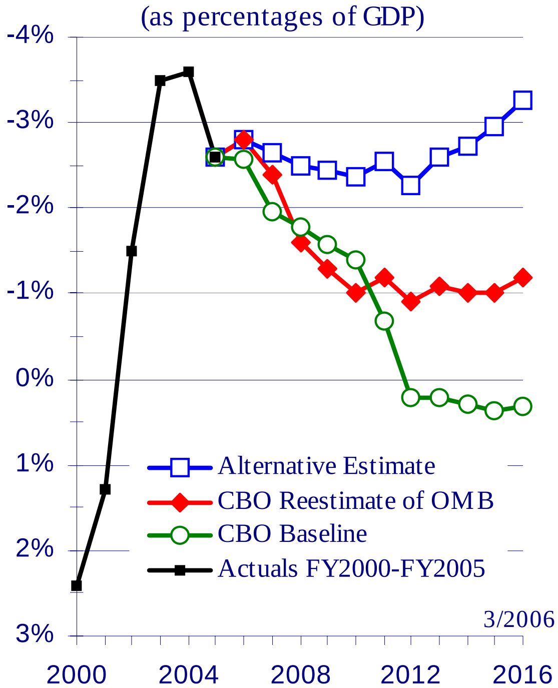
The Administration asserted that the FY2007 budget will further the President's oft-repeated goal of cutting the deficit in half by FY2009. To achieve this goal, the Administration reaches back to its February 2004 deficit estimate for FY2004 ( 4.5% of GDP) as the starting point, which was when it first articulated this goal.[14] The FY2007 budget shows the deficit falling below 2% of GDP by FY2008 and to 1.4% of GDP in FY2009. The goal may be difficult to reach if Congress does not fully adopt the Administration's proposals, if additional AMT relief is implemented beyond FY2007, if additional defense supplementals for the war on terror are adopted

[14] The actual deficit for FY2004 was 3.6% of GDP. Since 2002, the Administration has consistently overestimated the size of the current or the next year's deficit in each year's budget.

after FY2007, or if any number of budget-related events occur over the next several years that raise outlays or reduce receipts.

Achieving the Administration's deficit reduction goals would require, during the next five years, strict limits on the growth in domestic discretionary spending (if not actual reductions), a slowing in the growth rate of some entitlements, and letting AMT relief lapse after 2007. Some of the President's proposals would increase spending or reduce receipts, requiring larger spending reductions in other areas of the budget, since the Administration has steadfastly opposed any tax increases to reduce the deficit.[15] Holding to these spending and revenue levels may prove difficult. Higher than proposed spending or lower than proposed revenues, would result in deficits larger than those expected in the President's budget.

**Figure 5. Surpluses or Deficits, FY2000-FY2016**




CBO's baseline estimates and projections showed the deficit steadily falling in dollars and as a percentage of GDP through FY2011, after which small surpluses appear over the remaining years of the forecast. The requirements and assumptions that CBO must follow in producing the baseline estimates accounts for almost all of this improvement in the deficit/surplus outlook. Under a selection of alternative policies not included in the baseline (as shown in CBO's January 2006 budget report) that may better forecast the future path of fiscal policy, the deficit does not shrink and become a surplus. Instead, it grows throughout the 10-year period in dollars and, after FY2012, grows as a share of GDP (see the CBO-based alternative estimate in **Figure 5**).

**Figure 5** shows deficit estimates as shares of GDP for FY2000 through FY2016.[16] The actual amounts for the surpluses and deficits are shown for FY2000 through FY2005. Subsequent years are based on data from the CBO's January 2006 and March 2006 budget reports. The CBO baseline deficit estimate assumes the expiration of the 2001 and 2003 tax cuts in 2010, no future adjustments to lessen the

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[15] The Administration's current services baseline estimate, which assumes current policy, has smaller deficits throughout the five-year period than the deficits in the President's proposed budget. The cumulative five-year deficit would be smaller without the President's proposed policy changes than with them.

[16] Note that in the chart, larger deficits are at the top; smaller deficits or larger surpluses are towards the bottom.

expanding coverage of the AMT, the adjustment of discretionary spending for inflation, and an annual repetition of the 2005 funding supplemental for the military activities in Iraq and Afghanistan and hurricane relief efforts. The result of these baseline assumptions, as percentages of GDP, is growing receipts, falling outlays, and a rapid fall in the deficit as a share of GDP, reaching a surplus in FY2012. The CBO estimate of the President's policy proposals assumes additional spending for defense in FY2006 and FY2007, additional hurricane relief in FY2006, very tight controls on domestic discretionary spending, a slight slowing in the growth of Medicare, and the creation of personal accounts for Social Security in FY2010 and FY2011. The result is an upward bump in the deficit in FY2006, and a fall until FY2012, after which the deficit remains near 1% of GDP through FY2016.

The alternative estimate in **Figure 5** used selected estimates of alternative policies estimated by CBO (that reflect faster discretionary spending growth, extending the expiring tax cuts, retaining relief from the AMT, and incorporating increased debt servicing costs). Under these assumptions, the deficit estimates, after an upward bump in FY2006, fall slightly through FY2012. At that time, deficits grow fairly rapidly as revenues fall (as a percentage of GDP) and outlays continue growing (as a percentage of GDP).

The Senate budget resolution contained a slightly larger deficit in FY2007 than in the President's budget and is almost $30 billion larger than CBO's reestimate of the President's proposed deficit. Compared with CBO's revised baseline, the Senate's budget resolution deficit is almost $100 billion larger. As shares of GDP, the deficits in the Senate budget resolution fall from 2.6% in FY2007 to 1.0% of GDP in FY2010 before rising to 1.1% of GDP in FY2011.

The House budget resolution for FY2007 had a slightly smaller deficit than the President proposed for FY2007 (by $6 billion) and generally smaller deficits in subsequent years. The House budget resolution deficit is over $80 billion larger than the March 2006 CBO baseline deficit for FY2007 and almost $15 billion larger than CBO's deficit estimate of the President's FY2007 proposal.

## The Longer Run

Both OMB and CBO agree that over a longer time period, one beginning in the next decade and lasting for decades, demographic pressure will so badly distort current policies as to make them unsustainable. The future, under current policies, will lead to growing and persistent deficits. A CBO report on *The Long-Term Budget Outlook* (December 2005) states

> Over the next half-century, the United States will confront the challenge of conducting its fiscal policy in the face of the retirement of the baby-boom generation.... Under current policies, the aging of the population is likely to combine with rapidly rising health care costs to create an ever-growing demand for resources to finance federal spending for mandatory programs, such as Medicare, Medicaid, and Social Security.... [A]ttaining fiscal stability in the coming decades will probably require substantial reductions in the projected

> growth of spending and perhaps also a sizable increase in taxes as a share of the economy.[17]

The Administration indicated similar concerns about the outlook for the budget over the long term in the President's FY2007 budget (February 2006).

> ...the long-term picture presents a major challenge due to the expected growth in spending for major entitlement programs. In only two years, the leading edge of the baby boom generation will become eligible for early retirement under Social Security. In 5 years, these retirees will be eligible for Medicare. The budgetary effects ... will be muted at first. But if we do not take action soon to reform both Social Security and Medicare, the coming demographic bulge will drive Federal spending to unprecedented levels and threaten the Nation's future prosperity.
>
> No plausible amount of cuts to discretionary programs or tax increases can help us avert this major fiscal challenge.... By 2070, if we do not reform entitlement programs to slow their growth, the rate of taxation on the overall economy would need to be more than doubled....[18]

The short-term budget outlook can change when it is buffeted by all types of unexpected events, such as the hurricanes last year or deteriorating economic conditions. The long-term budget outlook, although susceptible to these types of events, will largely be determined by the interplay of current policy and demographics. The retirement of the baby boom generation, rapidly expanding the population eligible for federal programs serving the elderly, will put enormous pressure on the federal budget. Without policy changes, these programs could overwhelm the rest of the budget. Not only will the programs themselves be stressed, but their growth would be likely to impede the government's ability to meet its obligations and the ability of the economy to provide the resources needed.

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[17] CBO, *The Long-Term Budget Outlook*, Dec., 2005, p.1.

[18] OMB, *Budget of the United States Government for Fiscal Year 2007*, Feb. 2006, p.18.

# For Additional Reading


U.S. Congressional Budget Office. *The Budget and Economic Outlook: Fiscal Years 2007-2016*. Washington, January 27, 2006.

——. *The Long-Term Budget Outlook.* Washington, December 2005.

U.S. Council of Economic Advisors. *The Economic Report of the President*. Washington, GPO, February 2006.

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## CRS Products


CRS Report RL32791, *Congressional Budget Actions in 2005*, by Bill Heniff, Jr.

CRS Report RL33132, *Budget Reconciliation Legislation in 2005*, by Robert Keith.

CRS Report RS22322, *Taxes and Fiscal Year 2006 Budget Reconciliation: A Brief Summary*, by David Brumbaugh.

CRS Report RS21992, *Extending the 2001, 2003, and 2004 Tax Cuts*, by Gregg Esenwein.

CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg Esenwein.

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CRS Report RL30239, *Economic Forecasts and the Budget*, by Brian W. Cashell.

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CRS Report 98-720, *Manual on the Federal Budget Process*, by Robert Keith and Allen Schick.

CRS Report RL30708, *Social Security, Saving, and the Economy*, by Brian W. Cashell.