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The Budget for Fiscal Year 2007

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August 23, 2007

Abstract. The House and Senate, in late March, passed differing versions of a supplemental appropriation (H.R. 1591) providing, as requested by the President, over $90 billion for the ongoing military conflicts overseas, unrequested funds for domestic spending, and a withdrawal timetable for troops in Iraq. The House and Senate agreed to a conference report (H.Rept. 110-107; on April 25 and 26). The President vetoed (as he had indicated he would do) the bill on May 1. On May 2, an attempt to override the veto failed in the House. A new supplemental (H.R. 2206), without Iraq withdrawal timetables, passed Congress on May 24, 2007. The President signed it on May 25 (P.L. 110-28) The President's original 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 did not extend relief from the expanding coverage of the alternative minimum tax (AMT) or fund current military actions overseas after FY2007. Both the Senate (S.Con.Res. 83; March 16, 2006) and House (H.Con.Res. 376; May 18) passed differing versions of the FY2007 budget resolution. An agreement on the resolutions was not reached. Both the House and Senate adopted (separately) deeming resolutions, setting the FY2007 dollar amount for appropriations.

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CRS Report for Congress

The Budget for Fiscal Year 2007

Updated August 23, 2007

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Prepared for Members and
Committees of Congress

Congressional
Research
Service

The Budget for Fiscal Year 2007

Summary

The Administration's *Mid-Session Review* (for fiscal year (FY) 2008, July 2007) provided updated budget estimates for FY2007. Higher than previously expected receipts reduced the estimated deficit for FY2007 to $205 billion from the estimated $244 billion in February 2007.

In the fall of 2006, Congress passed three continuing resolutions (CRs) on appropriations to fund the nine (of 11) regular appropriations for FY2007 that had not cleared Congress. Congress passed H.J.Res. 20 (Revised Continuing Appropriations Resolution) on February 14, 2007 (a day before the third CR expired), providing funding for those nine regular appropriations for the rest of FY2007. The President signed the legislation on February 15, 2007 (P.L. 110-5).

The Congressional Budget Office (CBO) provided new baseline estimates (January 2007) showing improvement in the FY2007 budget outlook (the baseline estimates do not assume any policy changes). The baseline deficit estimate fell to $172 billion from an estimated $286 billion in August 2006. The President's FY2008 budget (February 2007) included a FY2007 deficit of $244 billion (including a substantial military supplemental).

The House and Senate, in late March, passed differing versions of a supplemental appropriation (H.R. 1591) providing, as requested by the President, over $90 billion for the ongoing military conflicts overseas, unrequested funds for domestic spending, and a withdrawal timetable for troops in Iraq. The House and Senate agreed to a conference report (H.Rept. 110-107; on April 25 and 26). The President vetoed (as he had indicated he would do) the bill on May 1. On May 2, an attempt to override the veto failed in the House. A new supplemental (H.R. 2206), without Iraq withdrawal timetables, passed Congress on May 24, 2007. The President signed it on May 25 (P.L. 110-28)

The President's original 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 did not extend relief from the expanding coverage of the alternative minimum tax (AMT) or fund current military actions overseas after FY2007.

Both the Senate (S.Con.Res. 83; March 16, 2006) and House (H.Con.Res. 376; May 18) passed differing versions of the FY2007 budget resolution. An agreement on the resolutions was not reached. Both the House and Senate adopted (separately) deeming resolutions, setting the FY2007 dollar amount for appropriations.

This report will be updated as events warrant.

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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 contained both general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2006 through FY2011. It included a section on long-term fiscal issues facing the nation and provided 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) contained 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

The final budget estimates for FY2007 from the Administration, in the *Mid-Session Review* for FY2008 (July 11, 2007) included further reductions in the expected deficit (to $205 billion from $244 billion in February 2007) and continued unexpected increases in receipts. CBO's July monthly budget report indicated that

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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.

the deficit may be closer to $150 billion than $200 billion (its mid-year budget report will be released later in August).

Earlier in 2007, Congress adopted supplemental appropriations for FY2007. Congress responded to President Bush's request for additional funding for the ongoing military conflicts and a few other needs by passing a $124 billion funding bill (H.R. 1591). The House passed the conference report on April 25, with the Senate following on April 26, 2007 (H.Rept. 110-107). The bill included about $100 billion in military funding and approximately $24 billion in domestic spending, much of which the President had not requested. It also included a timetable for the withdrawal of American troops from Iraq beginning later this year. The President had threatened a veto because of the withdrawal timetable and the additional spending as the bill was taking shape in the House and Senate. On May 1, the President vetoed the bill. The House failed to override the veto on May 2.

The House passed a second supplemental appropriations bill (H.R. 2206) on May 10, 2007. It contained the funding for the war without the withdrawal deadline, along with most of the additional domestic spending. The Senate amended the bill and passed it on May 17. Discussions between the House and Senate led to further changes. These were incorporated into the bill, which Congress passed on May 24, 2007. The President signed the bill on May 25 (P.L. 110-28).

Budget Totals

Table 1 (below) contains budget estimates for FY2007 from the CBO, the Administration (the Office of Management and Budget, OMB), and Congress. Differences in totals can result from differing underlying economic, technical, and budget-estimating assumptions and techniques, as well as differences in policy assumptions. The dollar differences in the budget outlook resulting from underlying policy differences in the President's proposals or those from Congress are often relatively small for the upcoming fiscal year compared to the budget as a whole. These small differences, however, may grow over time — sometimes substantially — potentially 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.

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 (smaller than 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 scheduled (in current law) expiration of the 2001 and 2003 tax cuts produced a small baseline surplus estimate of $38 billion. The small surplus estimates (never exceeding $75 billion, or 0.4% of GDP) persisted 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 follows. The results likely understate the near-term future size and persistence of the deficit, as CBO acknowledges in its report.

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
OMB MSR 7/06	2,459	2,798	-339
CBO Update Baseline 8/06	2,515	2,801	-286
CBO BEO Baseline, 1/07	2,542	2,714	-172
OMB, Budget Proposals, 2/07	2,540	2,784	-244
OMB, Budget, CSB, 2/07	2,550	2,735	-185
CBO Analysis of OMB 3/21/07	2,533	2,747	-214
Sen. Budget Res. (S.Con.Res 21) 3/23/07	2,538	2,750	-212
House Budget Res. (H.Con.Res. 99) 3/29/07	2,542	2,751	-209
OMB MSR 7/11/07	2,574	2,779	-205

BEO — The *Budget and Economic Outlook*, CBO.
CSB — The Administration's current services baseline.
MSR — *Mid-Session Review*, OMB
Update — *The Budget and Economic Outlook: An Update*, CBO

CBO's annual 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 2001, 2003, and other expiring tax cuts permanent; addressing the expanding coverage of the AMT; assuming a rate of growth other than the inflation rate for discretionary spending; and assuming additional expenditures for military activities overseas beyond the next year.

In CBO's January 2006 report, making the tax cuts permanent increased 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 produced 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 (in CBO's report) by an estimated $356 billion, and the 10-year cumulative deficit would increase by an estimated $1.6 trillion. CBO estimated that 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 (February 2006) 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.

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 FY2007 budget also proposed reductions (mostly in the rates of increase) in mandatory programs over the next five years. The proposed net savings totaled $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, totaled an estimated $8,385 billion. The Administration's mandatory proposals would have increased it 0.3% above the mandatory spending baseline estimates.

[2] The changes are measured from OMB's current services baseline estimates, excluding policy proposals the Administration included in its revenue baseline. OMB included the extensions of expiring tax cuts in its baseline. This set of assumptions produced a current services revenue estimate substantially smaller than CBO's baseline revenue estimate, particularly in the second half of the 10-year period.

CBO released its analysis (with contributions from the Joint Committee on Taxation) of the President's budget proposal on March 15, 2006 (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 larger than CBO's baseline deficit estimates (see **Table 1**). CBO's reestimates and the Administration's deficits were similar for the remaining years projected (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.)

The Administration provided its annual *Mid-Session Review* (for the FY2007 budget; MSR) on July 11, 2006. The report updated the Administration's budget and economic estimates for FY2006 through FY2011. For FY2007, the changes from the February budget estimates were relatively small. The deficit fell by 4.2% (to $339 billion), receipts grew by 1.8% (to $2,459 billion), and outlays grew by 1.0% (to $2,798 billion). As shares of GDP (the estimates of GDP also were revised), the deficit fell from 2.6% of GDP in February 2006 to 2.4% of GDP in July. Receipts fell by 0.1% of GDP to 17.6% of GDP. Outlays remained unchanged at 20.1% of GDP.

The somewhat improved short-term budget outlook in the Administration's MSR had little effect on the long-term budget imbalance facing the country. The rapid growth in receipts then expected in FY2006 was not necessarily going to continue in future years. The Administration's assumption about future spending restraint is also not assured. Even if the Administration's short-term assumptions prove correct — without substantial changes to the programs that will expand rapidly as the baby boom retires or other large policy changes occur — the long-term budget imbalance remained (and remains) in place.

CBO's August 2006 release of *The Budget and Economic Outlook: An Update* also showed fairly dramatic improvement in the deficit for FY2006, but showed little change for the other years from its earlier budget reports (January and March 2006). The adoption of a FY2006 supplemental appropriation in the spring of 2006 — which CBO, under the baseline rules it follows, includes in its baseline estimates for subsequent years — generated much of the baseline outlay estimate increase for FY2007 in the *Update*. Revisions showing higher receipts in FY2007 limited the effect of the increased outlays on the deficit, with the combined changes raising the deficit by $21 billion above CBO's March 2006 baseline estimate.

CBO's August revisions showed a slightly worsened long-term budget outlook under its baseline assumptions, even with the improved expectations for FY2006. The cumulative deficit in CBO's August baseline ($34.5 trillion) was $1.3 trillion larger than CBO's March baseline estimates ($33.2 trillion).

The initial FY2008 budget documents from CBO and OMB in January and February 2007, respectively, contained an improved outlook for the FY2007 budget. CBO's report (*The Budget and Economic Outlook: FY2008-2017*) had a FY2007 baseline deficit estimate of $172 billion (1.3% of GDP), over $100 billion below

CBO's August 2006 baseline estimate.[3] The President's FY2008 budget (February 5, 2007), with a FY2007 deficit estimate of $244 billion (1.8% of GDP), included a request that would result in an estimated additional $37 billion in outlays (from about $100 billion in requested budget authority) for the ongoing war efforts.

CBO's March 2007 *Analysis of the President's Budget Proposals for Fiscal Year 2008* contained CBO's estimates of the Administration's proposals and reestimates of CBO's January 2007 baseline estimates. CBO estimated that the FY2007 deficit would be $214 billion using the President's policy proposals, $30 billion smaller than OMB's February 2007 estimate. CBO's baseline deficit estimate for FY2007 grew slightly (by $5 billion) from its January 2007 estimate to $177 billion.

The President's FY2008 *Mid-Session Review* (July 11, 2007) included updated estimates for FY2007 showing a continuing decline in the expected deficit. The Administration attributed the fall to higher-than-expected receipts, which were primarily due to higher corporate income tax and excise tax collections. The faster-than-expected growth in receipts tapers off in the estimates for subsequent years. The budget report hinted that the actual deficit for FY2007 could be lower than indicated in the report. A subsequent CBO monthly budget report (from July 2007) expected the deficit to be closer to $150 billion for FY2007. The improvements in the deficit outlook and in receipts are not the result of policy changes, but mostly the result of changes in economic assumptions and technical changes in the estimates.

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.[4] Small changes in economic conditions, particularly the rate of 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 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 which are not included in

[3] According to CBO's January 2007 budget report, outlays for FY2007 fell by $86 billion and receipts increased by $28 billion since CBO's and OMB's summer 2006 respective budget reports. About half of the revenue changes and 60% of the outlay changes were technical in nature, having nothing to do with policy changes adopted during the fall of 2006.

[4] 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 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.

CBO's baseline, can also change the budget outlook, both for the current budget year and for future years.

The President's (FY2007) budget included a chapter in the *Analytical Perspectives* volume titled "Comparison of Actual to Estimated Totals." The chapter examined the causes of the changes from the initial budget estimates for FY2005 (February 2004) through the actual results for that year. OMB extended 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 ranged 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 a larger deficit for FY2007 than proposed by the President. It 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 Committee's resolution had smaller discretionary spending caps than the Senate-passed resolution, among other differences. The House, after an extended delay, passed the Budget Committee's version of the budget resolution on May 18. The House resolution had budget totals for FY2007 that were in most respects similar to those proposed in the President's budget.

Substantial differences between the House- and Senate-passed budget resolutions, along with the relatively late adoption of the House resolution in an election-year-shortened legislative session, may have reduced the chances of a successful conference. In the expectation of a very difficult-to-achieve House-Senate agreement on a FY2007 budget resolution, both the House and Senate adopted deeming resolutions.[5] The deeming resolutions established the discretionary spending levels for FY2007 (the House and Senate both used $873 billion) for use by the Appropriation Committees in both chambers. The House adopted its deeming resolution shortly after it passed its version of the budget resolution; the Senate attached its deeming resolution to the Emergency Supplemental Appropriations for FY2006 (H.R. 4939), which became law (P.L. 109-234) on June 15, 2006. The discretionary level in the Senate deeming resolution was almost $16 billion below the discretionary level in the Senate-passed budget resolution.

Following the adoption of the deeming resolutions, the Appropriation Committees in the House and Senate began considering and reporting the annual appropriation bills for FY2007. When Congress left in August, no regular appropriation had passed. The House had passed 10 of its 11 appropriations; the House Committee on Appropriations had cleared all 11 of the appropriations. The Senate had yet to pass any of its 12 appropriations; the Senate Committee on Appropriations had cleared all 12. Congress passed the Defense (H.R. 5631) and Homeland Security (H.R. 5441) appropriations at the end of September 2006 in advance of the October 2006 start of FY2007, but none of the others. The Defense appropriation included a continuing resolution on appropriations (a CR) that funded all the activities *not* in the two adopted appropriations, through November 17, 2006. Funding under the CR would be at either the House-passed, Senate-passed, or last year's (FY2006) funding levels, whichever was the lowest. (Because the Senate had only passed the Defense and Homeland Security appropriations, the funding level chosen was the lower of the House-passed or FY2006 levels.)

Congress returned after the election on November 13, with little time to adopt the remaining appropriations for FY2007. Action on the remaining appropriations in the Senate bogged down quickly. To avoid a possible lapse in funding, Congress adopted a second CR (P.L. 109-369; H.J.Res. 100) on November 15, 2006. The new CR provided funding through December 8, 2006.

In its post-Thanksgiving session, Congress adopted a third CR (P.L.109-383; H.J.Res. 102) very late on December 8, 2006, extending the existing CR through February 15, 2007. Congress also passed legislation that included an extension of numerous regularly extended tax breaks (H.R. 6111) and also included trade and health savings account modifications among other provisions.

On January 31, 2007, the House passed H.J.Res. 20, which would fund the remaining FY2007 appropriations for the rest of the year (9 of the 11 regular appropriations for FY2007 did not clear Congress before the 109th Congress ended in December 2006). Most activities, with numerous exceptions, would be funded at or near FY2006 funding levels. The Senate passed the legislation without amendment on February 14. The President signed it on February 15 (P.L. 110-5).

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[5] The deeming resolutions serve as an annual budget resolution to establish enforceable budget levels in the absence of an actual congressionally adopted budget resolution. For additional information, see the CRS Report RL31443, *The "Deeming Resolution": A Budget Enforcement Tool*, by Robert Keith.

Along with his FY2008 budget, the President requested $103 billion in supplemental appropriations for the wars in Iraq and Afghanistan and for additional hurricane recovery on the Gulf Coast. The 2007 supplemental (most of which was for defense and international affairs ($99 billion) would be spent in both FY2007 and FY2008. The House passed its version of the legislation (H.R. 1591) on March 23, 2007. In addition to the funding requested by the President, the bill contained an additional $20 billion for domestic purposes. It also included instructions to remove U.S. troops from Iraq (under certain conditions) during 2008. The Senate approved its version of the legislation on March 29, 2007. It contained $21 billion in spending for domestic programs not requested by the President. It also included instructions to remove troops from Iraq in 2008. The President threatened to veto the bills in their current forms because of the requirements for troop withdrawal and the additional unrequested domestic spending.

A conference on the bill reached agreement (H.Rept. 110-107) on April 24, 2007. The agreement included the additional domestic funding and the withdrawal timetables, as well as the funding for the military. The House passed the agreement on April 25 and the Senate passed it on April 26. The President received the bill on May 1 and, as promised, vetoed it. The House failed in its attempt to override the veto.

The House and Senate began discussions about a new supplemental shortly after the veto. The House passed a new supplemental appropriations bill (H.R. 2206) funding military and domestic spending on May 10. The bill did not contain a timetable for withdrawal from Iraq. The Senate amended the legislation with a "place-holder" to facilitate a conference, on May 17. After leadership discussions, an agreement was reached that passed the House and Senate on May 24. The President signed the bill on May 25 (P.L.110-28).

Outlays

The Administration's FY2007 budget (February 2006) 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.

Measured against the Administration's FY2007 current services baseline outlay estimates, the proposed level of outlays would grow by $69 billion (2.6%).[6] The

[6] 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) first full pay period in (continued...)

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 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.

Table 2. Outlays for FY2005-FY2011 and FY2016

(in billions of dollars)

	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2016
CBO Baseline, 1/06	*2,472* [a]	2,649	2,732	2,857	2,984	3,105	3,252	4,046
President's FY07 Budget, 2/06		2,709	2,770	2,814	2,922	3,061	3,240	—
President's FY07 CSB, 2/06		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
S. 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	—
OMB, MSR 7/06		2,696	2,798	2,847	2,929	3,053	3,224	—
CBO Update Baseline 8/06		2,663	2,801	2,945	3,079	3,217	3,382	4,211
CBO Baseline, 1/07		2,654 [a]	2,714	2,818	2,926	3,038	3,179	3,892
President's FY08 Budget, 2/07		—	2,784	2,902	2,985	3,049	3,157	—
President's FY08 CSB, 2/07		—	2,735	2,752	2,866	2,973	3,166	—
CBO Analysis of OMB 3/21/07		—	2,747	2,905	3,002	3,046	3,156	3,943
S. Bud. Res. (S.Con.Res 21) 3/23/07		—	2,750	2,927	3,041	3,093	3,201	—
H. Bud. Res. (H.Con.Res. 99) 3/29/07		—	2,751	2,933	3,051	3,106	3,217	—
OMB, MSR 7/11/07		—	2,779	2,918	3,016	3,078	3,184	—

a. Actual outlays for FY2005 and FY2006.
CSB — The Administration's current services baseline (not strictly comparable to CBO's baseline).
MSR — *Mid-Session Review*
Update — *The Budget and Economic Outlook: An Update*, CBO

From FY2006 to FY2007, the Administration's original FY2007 budget made a number of assumptions, including the following: a $19 billion increase in undistributed offsetting receipts (that reduce outlays) resulting from the 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, which included 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

[6] (...continued)
January 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.

GDP in FY2006 to 20.1% of GDP in FY2007. By FY2011, the Administration projected that outlays would 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 excluded enacted and proposed supplementals for the DOD. The President's budget showed outlays, the actual expenditures of the DOD, dropping from FY2006 ($512 billion) to FY2007 ($505 billion), a 1.4% reduction in spending.[7] (Total outlays, not BA, and total revenues determine a year's surplus or deficit.) With the uncertainty surrounding the financing needs for the ongoing military action in Iraq and Afghanistan, FY2007 defense outlays seem unlikely to match the proposals. CBO's baseline estimates for defense spending (which include extending previously adopted supplemental funding) increase BA (by 2.5%) and lower outlays (by less than 1%) between FY2006 and FY2007.[8]

Non-defense discretionary outlays in the President's FY2007 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 showed non-defense discretionary BA falling by 4.2% ($18 billion) between those two years. Most of that change resulted 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, would barely change from FY2006 to FY2007. CBO's January 2006 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 left unspecified his called-for future year reductions in discretionary spending.

Mandatory spending, federal activities that generally do not need an annual appropriation, would grow by 3.9% ($64 billion) from FY2006 to FY2007, including the Administration's proposed $1.7 billion in mandatory spending reductions for

[7] 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.

[8] 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.

FY2007 under the President's original proposals.[9] This would raise mandatory spending, the largest broad category of federal spending, from $1,457 billion in FY2006 to $1,494 billion in FY2007. CBO's January 2006 baseline estimates of mandatory spending showed 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 totaled 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 (no legislation to reduce Medicare spending was adopted in 2006). 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, which included both increases and decreases, would increase spending by $21 billion over the five years, FY2007 through FY2011.[10]

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

In the early spring of 2006, the Senate passed its verison of the FY2007 budget resolution (S.Con.Res. 83; March 16, 2006). If followed, it would have increased the proposed level of outlays by $120 billion (4.5%) between FY2006 and FY2007. The resolution's FY2007 outlays were $69 billion larger than CBO's FY2007 baseline outlay estimate and $25 billion above the President's proposed FY2007 outlays. 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 version of the FY2007 budget resolution (H.Con.Res. 376; May 18, 2006) followed most of the policies of the President's budget proposal. The resolution had a slightly smaller deficit and slightly higher outlays than in the President's proposal for FY2007. Outlays in the resolution would increase by $95 billion (3.6%) from FY2006 to FY2007. The outlays were $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. (Congress did not adopt a budget resolution for FY2007.)

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

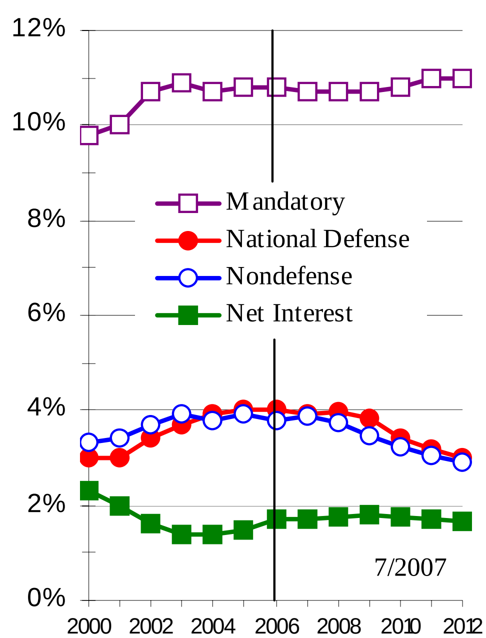
[10] The mandatory proposals would increase spending by an estimated $551 billion over the 10-year period, FY2007 through FY2016, according to the budget documents.

The Administration's July 2006 *Mid-Session Review* (MSR) increased the FY2007 outlay estimate by $28 billion. Most of the increase came from higher estimates for the Administration's global war on terror and the effect of the FY2006 supplemental (P.L. 109-234) on outlays in FY2007. Somewhat lower spending estimates in a variety of other programs moderated the overall increase. Over the five years covered in the MSR, the changes in estimates between February 2006 and July 2006 would raise cumulative outlays by $45 billion, a barely noticeable amount given that cumulative outlays approach a projected $12 trillion over the five years.

CBO's August 2006 mid-year budget report (*The Budget and Economic Outlook: An Update),* reflecting budget legislation adopted to that point along with economic and technical adjustments to the underlying budget estimates, boosted baseline outlays for FY2007 by $75 billion (to $2,801 billion) over its January 2006 baseline estimates. Much of the increase reflected legislation that increased spending for the war effort and hurricane recovery.

The January 2007 CBO budget report (*The Budget and Economic Outlook: FY2008-FY2017)* reduced expected FY2007 outlays by $87 billion (to $2,714 billion)below its August 2006 budget estimates. About 30% of the reported change came from legislative actions taken since the August 2006 estimates. The remaining change came from technical reestimates and shifts in the underlying economic forecast. The President's FY2008 budget (February 2007) also lowered the expected FY2007 outlays (by $14 billion) compared to OMB's July 2006 *Mid-Session Review*.

Figure 1. Outlays by Type, FY2000-FY2012
(in percentages of GDP)



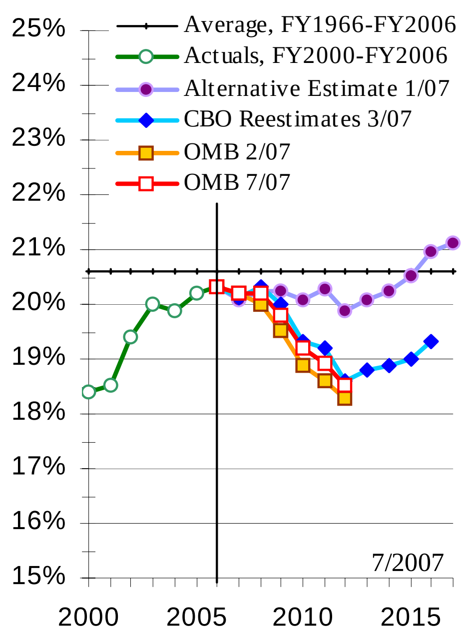
The Administration's July 2007 MSR slightly lowered (by $5.6 billion) the FY2007 outlay estimate below the FY2007 outlay estimate in the President's FY2008 budget proposal (February 2007). Reestimates reducing discretionary spending were responsible for most of the change (legislation adopted since February 2007 raised outlays slightly while other reestimates both raised and reduced outlays from the February levels).

Figure 1 shows the Administration's estimates for spending by category as revised in the July 2007 MSR. The actual outlays are shown for the fiscal years 2000 through 2006 and the July 2007 estimates are shown for the fiscal years 2007 through 2012, all as percentages of GDP. The general slide in nondefense discretionary spending after FY2005 reflects the Administration's efforts to limit its growth (in dollars) over its time in office and beyond. Defense spending begins falling as a percentage of GDP (and in dollars) after FY2008, when the Administration no longer includes full funding estimates for the ongoing overseas military operations.

The proposed reductions in some mandatory programs in the President's FY2008 budget have little to no effect on FY2007 mandatory spending, but could, if enacted, moderate the near-term growth in mandatory spending as a share of GDP.[11] Longer-term, mandatory spending begins growing again as a percentage of GDP as the baby boom generation begins retiring in large numbers. The President's FY2008 budget had mandatory spending growing at an annual rate of 5.4% (from FY2007 to FY2012). Over the same period, total spending would grow by 3.1% annually.

Figure 2 shows several possible paths for total outlays as percentages of GDP for FY2007 through FY2013 or FY2017 (actual outlays are shown for FY2000 through FY2006). The paths include the President's FY2008 budget proposal, an alternative outlay path derived from CBO data, CBO's March 2007 reestimate of the President's proposal, and the Administration's July 2007 *Mid-Session Review*. Average outlays for the FY1966 through FY2006 period (20.6% of GDP) are also shown in the figure.

Figure 2. Outlays, FY2000-FY2017
(in percentages of GDP)



The alternative estimate shown here is based on selected policy alternatives estimated by CBO (in its January 2007 budget report, *The Budget and Economic Outlook: Fiscal Years 2008-20017)* that were not included in CBO's baseline. It incorporates several assumptions that may better reflect future budget policy than the policy assumptions used to produce the baseline. One is that discretionary spending grows at the rate of nominal GDP growth (a higher rate of growth than the inflation adjustment used in the baseline). The second is that funding for the military activities in Iraq and Afghanistan are phased down more rapidly than the baseline assumes. The third is that, because of larger deficits and debt resulting from other alternative assumptions, the government's interest costs are larger than in the baseline. And the fourth is that, as in the baseline, mandatory spending is expected to grow faster than GDP. Outlays under the alternative estimate wander a bit as a percentage of GDP in the near future (from 20.1% of GDP in FY2007 to 20.3% of GDP in FY2011 and to 19.9% of GDP in FY2012) before rising steadily to 21.1% of GDP in FY2017.

[11] FY2006 mandatory spending was boosted, temporarily, by spending on hurricane recovery.

Receipts

Receipts would rise 5.7% from FY2006 to FY2007 in the Administration's original FY2007 budget proposal (February 2006), including the effect of extending the alternative minimum tax (AMT) relief through FY2007. (The most recent Administration budget estimate from July 2007 shows receipts rising by 6.9% from FY2006 to FY2007.) Over the five years forecast in the President's budget, receipts would rise from $2,416 billion in FY2007 to $3,035 billion in FY2011, a 25.6% increase.

Table 3. Receipts for FY2005-FY2011 and FY2016

(in billions of dollars)

	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2016
CBO Baseline, 1/06	*2,154*[a]	2,312	2,461	2,598	2,743	2,883	3,138	4,113
President's FY07 Budget, 2/06		2,285	2,416	2,590	2,714	2,878	3,035	—
President's FY07 CSB 2/06		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
S. 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	—
OMB, MSR 7/06		2,400	2,459	2,659	2,772	2,930	3,098	—
CBO Update Baseline, CBO 8/06		2,403	2,515	2,672	2,775	2,890	3,156	4,118
CBO Baseline, 1/07		2,407 [a]	2,542	2,720	2,809	2,901	3,167	4,084
President's FY08 Budget, 2/07		—	2,540	2,662	2,798	2,955	3,104	—
President's FY08 CSB, 2/07		—	2,550	2,715	2,833	3,022	3,297	—
CBO Analysis of OMB 3/21/07		—	2,533	2,679	2,787	2,877	3,007	3,873
S. Bud. Res. (S.Con.Res 21) 3/23/07		—	2,538	2,678	2,825	2,959	3,130	—
H. Bud. Res. (H.Con.Res. 99) 3/29/07		—	2,542	2,720	2,810	2,901	3,167	—
OMB, MSR 7/11/07		—	2,574	2,659	2,803	2,954	3,095	—

a. Actual receipts for FY2005 and FY2006.
CSB — The Administration's current services baseline (not strictly comparable to CBO's baseline).
MSR — *Mid-Session Review*
Update — *The Budget and Economic Outlook: An Update*, CBO

The Administration's proposal to extend and make permanent many of the tax cuts adopted in the Administration's first term would have 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 the current services receipt estimates in FY2010 or FY2011.)

The Administration estimated that making the 2001 and 2003 tax cuts permanent would reduce cumulative 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 (from baseline levels) 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 passed 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.[12] CBO's baseline estimates, following current law, assume that the 2001 and 2003 tax cuts expire in 2010 as scheduled.

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. The Administration's MSR (July 2006), with revised receipt estimates, also showed total receipts rising over this period, from $2,400 billion in FY2006, to $2,459 billion in FY2007, to $3,098 billion in FY2011. (The Administration's FY2002 budget documents, published in April 2001, projected total receipts of $2,643 billion for FY2007, almost $200 billion more than estimated in the MSR.)

Figure 3. Receipts by Type, FY2000-FY2012
(in percentages of GDP)

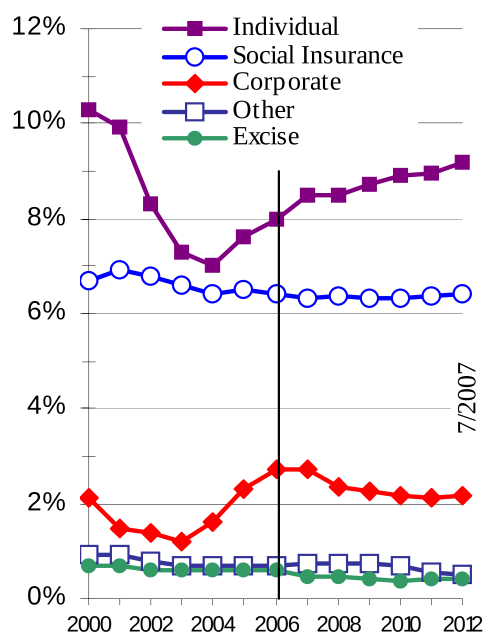


Figure 3 shows the President's July 2007 receipt estimates and projections by type (from the FY2008 *Mid-Session Review*) for the fiscal years 2000 through 2012. Actual receipts are shown for FY2000 through FY2006. All are shown as percentages of GDP. In the revised estimates, as in the original FY2007 budget, excise and other receipts remain near or below 1% of GDP. Corporate income taxes, after rising through FY2006, decline slowly and steadily as a share of GDP under the Administration's projection. Social insurance receipts vary little throughout the period. Individual income tax receipts, having fallen over 3.3% of GDP between FY2000 and FY2004, are shown regaining some of their lost share, but remain below their FY2000 level.[13]

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

[13] Individual income tax receipts fell from 10.3% of GDP in FY2000, the highest level on record, to 7.0% of GDP in FY2004, the lowest level since FY1951. Individual income tax receipts averaged 8.3% of GDP between FY1966 and FY2006.

The Administration's original proposals (February 2006) 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 would find themselves subject to the AMT.[14] CBO estimated (January 2007) that providing annual AMT relief would reduce receipts by $279 billion between FY2008 and FY2012, and by $569 billion between FY2008 and FY2017. Without adjustment to the AMT, it will eventually recapture much of the tax reduction provided in the 2001 and 2003 tax cuts.[15]

The Administration's July 2006 MSR showed a jump in receipts as a share of GDP in FY2006 (to 18.3% of GDP from 17.5% of GDP in the President's February 2006 budget), but the two sets of estimates are relatively close in the other years. The large increase in receipts expected (at that time) in FY2006 and possibly into FY2007 (mostly from corporate income and non-withheld individual income taxes) appeared to be limited and had little effect on receipts in subsequent years.

The CBO August 2006 Update also reflected the expected jump in FY2006 receipts (from 17.7% of GDP in CBO's March 2006 budget report to 18.3% of GDP), an increase that dissipates over the 10-year forecast. By FY2011, the August 2006 baseline receipt estimate was 0.2% of GDP larger than CBO's March 2006 baseline receipt estimate (18.9% of GDP versus 18.7% of GDP). The expected jump in FY2007 receipts was smaller, rising from 17.9% of GDP in the January 2006 estimates to 18.2% of GDP in the August 2006 estimates.

The revised estimates for FY2007 in the CBO January 2007 budget report and the OMB FY2008 budget both showed still higher receipts in FY2007 (18.6% and 18.5% of GDP respectively). A large component of the increase, as with the outlay estimate changes, was technical. Revisions to underlying assumptions by both OMB and CBO produced much of the change in the revenue estimates for FY2007, not legislation or changes in the economic outlook. The increase in near-term receipts, as shares of GDP, persisted, but generally diminishes over time.

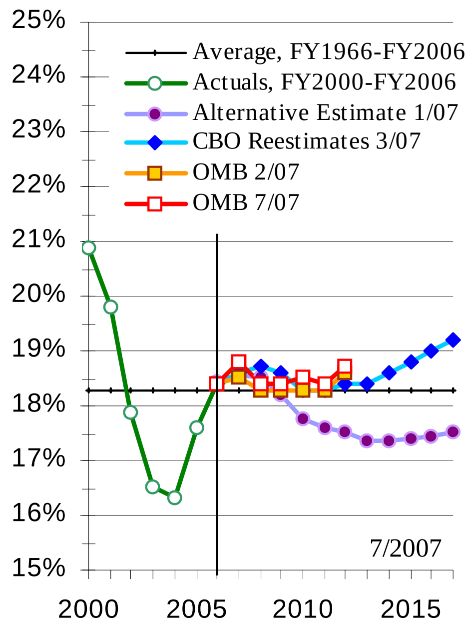
The Administration revised receipt estimates in its July 2007 MSR. The revisions raised expected receipts as percentages of GDP above the February 2007 Administration receipt estimates. In dollars, the July estimates were below those from February. The Administration revised its estimates of GDP over the next five years, reducing it in each of the years. This produced the somewhat unusual result of receipts rising as a percentage of GDP while falling in dollars (in the same years — receipts continue rising from year-to-year).

[14] 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.

[15] 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.

Figure 4 uses data from the January 2007 CBO budget report, the President's FY2008 budget documents (February 2007), and the Administration's July 2007 *Mid-Session Review* to show a variety of paths that receipts might follow in the next decade. The figure shows receipts as percentages of GDP for fiscal years 2000 through 2017 (projected). Actual receipts are shown for fiscal years 2000 through 2006, as are average receipts (18.3% of GDP) for FY1966 through FY2006.

Figure 4. Receipts, FY2000-FY2017
(in percentages of GDP)



The Administration's February 2007 estimates showed receipts remaining relatively stable over its five-year forecast, near the long-term average of 18.3% of GDP. They then rise to 18.6% of GDP in FY2012. The Administration's revenue estimates include a one-year AMT patch (for FY2007) and the assumption that many expiring tax provisions, particularly from the 2001 and 2003 tax cuts, will be extended. This has the effect of reducing revenues below what they would have been without these policy proposals.

CBO's March 2007 reestimates of the Administration's proposals show higher receipts early in the FY2007-FY2012 period, then closely track the President's budget estimates. Beyond FY2012, the extension of the reestimates shows receipts rising through FY2017 as percentages of GDP.

The alternative estimate, based on data provided in CBO's January 2007 budget report, showed receipts falling to near 17.5% of GDP by FY2011 and rising slowly after that. The alternative assumes that the AMT is adjusted to eliminate its growing coverage and that most expiring tax provisions, as in the Administration's estimate, are extended. This last adjustment to the baseline is most apparent after FY2010. Under these assumptions, the alternative path for receipts remains below the 40-year (FY1966-FY2006) average for receipts as a percentage of GDP (18.3% of GDP).

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).

The President's original FY2007 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. (Since that proposal, the expected deficit for FY2007 has fallen to near $200 billion.)

Table 4. Surpluses/Deficits(-) for FY2005-FY2011 and FY2016

(in billions of dollars)

	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2016
CBO Baseline, 1/06	*-318* [a]	-337	-270	-259	-241	-222	-114	67
President's FY07 Budget, 2/06		-423	-354	-223	-208	-183	-205	—
President's FY07 CSB 2/06		-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
S. 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	—
OMB, MSR 7/06		-296	-339	-188	-157	-123	-127	—
CBO, Update Baseline 8/06		-260	-286	-273	-304	-328	-227	-93
CBO Baseline, 1/07		-248 [a]	-172	-98	-116	-137	-12	192
President's FY08 Budget, 2/07		—	-244	-239	-187	-94	-54	—
President's FY08 CSB, 2/07		—	-186	-80	-33	95	288	—
CBO Analysis of OMB 3/21/07		—	-214	-226	-215	-169	-149	-70
S. Bud. Res. (S.Con.Res 21) 3/23/07		—	-212	-249	-216	-134	-71	—
H. Bud. Res. (H.Con.Res. 99) 3/29/07		—	-209	-213	-241	-205	-50	—
OMB, MSR 711//07		—	-205	-258	-213	-123	-89	—

a. Actual deficit for FY2005 and FY2006.
CSB — The Administration's current services baseline, Budget Enforcement Act basis.
MSR — Mid-Session Review
Update — *The Budget and Economic Outlook: An Update*, CBO

The Administration asserted that the FY2007 budget would further the President's oft-repeated goal of cutting the deficit in half by FY2009. To achieve this result, the Administration reached 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.[16] The FY2007 budget showed the deficit falling below 2% of GDP by FY2008 and to 1.4% of GDP in FY2009.

Achieving the Administration's deficit reduction goals would require, during the five years in the budget, 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 to reduce the deficit, since the Administration has steadfastly

[16] 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.

opposed the use of tax increases to reduce the deficit.[17] Holding to these spending and revenue levels may prove difficult. The President's FY2008 budget (February 2007) repeated many of these proposals. Higher-than-expected receipts in FY2006 and during much of FY2007 and somewhat slower outlay growth in both years improved the deficit outlook for FY2007. The last Administration budget estimate before the end of FY2007, the July 2007 *Mid-Session Review* (MSR), reduced the expected deficit in FY2007 to $205 billion (1.5% of GDP). (The MSR showed the budget reaching a small surplus, $33 billion, in FY2012.)

CBO's January 2007 baseline estimates and projections showed the deficit steadily falling in dollars and as a percentage of GDP through FY2011, after which small surpluses appeared over the remaining years of the projection. The requirements and assumptions that CBO follows in producing the baseline estimates accounts for almost all of this improvement in the deficit/surplus outlook. These assumptions included the expiration of the tax cuts as currently scheduled and the expanding coverage of the alternative minimum tax (AMT)

Under a selection of alternative policies not included in the baseline (but included in CBO's January 2007 budget report) the deficit does not shrink and a surplus does not appear. Instead, the deficit grows almost continuously throughout the 10-year period in dollars and, after FY2012, grows as a share of GDP (see the alternative estimate in **Figure 5**).

Figure 5. Deficits(-)/Surpluses, FY2000-FY2017
(in percentages of GDP)

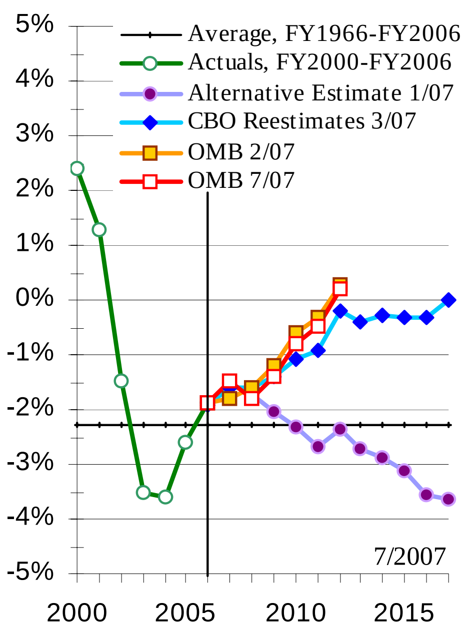


Figure 5 shows deficit or surplus estimates as shares of GDP for FY2000 through FY2017. The actual surpluses or deficits are shown for FY2000 through FY2006. For the future years, the figure shows the President's February 2007 proposals (from the FY2008 budget), the alternative estimate based on data in the CBO January 2007 budget report, CBO's reestimates (from its March 2007 budget report) of the President's February 2007 budget proposals, and the estimates and projections from the Administration's July 2007 MSR. The figure also shows the average deficit (2.3% of GDP) for FY1966 through FY2006.

The President's proposals (from February and July 2007) show a steady reduction in the deficit (it moves upward in **Figure 5**) over the five years covered by

[17] 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.

the reports. CBO's reestimates of the Administration's proposals follow the same pattern through FY2012, then show little reduction in the deficit through FY2017.

The alternative estimate in **Figure 5** is based on the alternative policies estimated by CBO (that reflected faster-than-the-baseline-assumed discretionary spending growth, extension of the expiring tax cuts, continuation of the existing relief for the middle class from the expanding coverage of the alternative minimum tax (AMT), and incorporation of the increased debt servicing costs). Under these assumptions, the deficit estimates, after a slight fall in FY2007 (to -1.3% of GDP), increase to -3.6% of GDP in FY2017.

Although not shown in **Figure 5**, the CBO baseline deficit estimate (January 2007) assumed the expiration of the 2001 and 2003 tax cuts in 2010, no future adjustments to lessen the expanding coverage of the AMT, an annual inflation adjustment to discretionary spending, along with a number of other assumptions. The result was growing receipts, falling outlays, and a rapid fall in the deficit as a share of GDP after FY2010 that would reach a surplus in FY2012. CBO put the FY2007 baseline deficit estimate at $177 billion (-1.3% of GDP) in its March 2007 estimates. This was $5 billion higher than its January estimates, but over $100 billion smaller than its August 2006 baseline deficit estimate of $286 billion (-2.1% of GDP).

Previous budget reports during the FY2007 budget cycle tended to show shrinking deficit estimates for FY2007 (with less improvement, if any, in the surplus-deficit outlook for subsequent years) compared to the President's original budget proposal (see **Table 4**). A combination of higher-than-expected revenues and somewhat lower levels of spending produced much of the change.

The Senate's FY2007 budget resolution (S.Con.Res. 83; March 2006) contained a slightly larger proposed deficit in FY2007 than in the President's budget and was $30 billion larger than CBO's March 2006 reestimate of the President's proposed deficit. Compared with CBO's revised March 2006 baseline, the Senate's budget resolution deficit is almost $100 billion larger, implying that no policy changes would produce a smaller deficit than the policy change assumptions included in the budget resolution. 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 (H.Con.Res. 376: May 2006) for FY2007 had a slightly smaller proposed deficit than the President originally proposed (by $6 billion) and generally smaller deficits in subsequent years. Compared to the March 2006 CBO estimates, the House budget resolution deficit for FY2007was$80 billion larger than CBO's baseline deficit and almost $15 billion larger than CBO's reestimate of the President's FY2007 proposal. As with the Senate resolution, making no policy changes would produce a smaller deficit in FY2007 than adopting the policy changes assumed in the House budget resolution. (Congress did adopt a budget resolution for FY2007.)

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.[18]

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....[19]

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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[18] CBO, *The Long-Term Budget Outlook*, December 2005, p. 1.

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

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