Order Code RL33915

CRS Report for Congress

The Budget for Fiscal Year 2008

March 12, 2007

Philip D. Winters
Analyst in Government Finance
Government and Finance Division

Prepared for Members and
Committees of Congress

Congressional
Research
Service

The Budget for Fiscal Year 2008

Summary

President Bush presented his fiscal year (FY) 2008 budget to Congress on February 5, 2007. For FY2008, the budget shows a deficit of $239 billion, which would become a surplus of $61 billion in FY2012, the last year projected. The proposals include large defense supplementals for FY2007 and FY2008, extending the expiring tax cuts, constraining domestic discretionary spending (and, after FY2008, doing the same to defense spending), slightly slowing the growth of Medicare and Medicaid, and stopping the expanding coverage of the Alternative Minimum Tax (AMT) in FY2007 and FY2008 (but not in subsequent years).

Although the budget proposes a positive outlook over the next five years, it also discusses the long-term fiscal problems facing the nation. According to the longer-term projections from the Administration, the Congressional Budget Office (CBO), and the Government Accountability Office (GAO), the soon-to-begin retirement of the baby boom generation will increase the demand for resources from the federal programs for the elderly (in particular, Medicare, Social Security, and Medicaid). Under any responsible set of projections, the expanding eligible populations and continued growth in medical care costs (in particular) will drive the growth in these programs in the next decades. If overall federal spending is not allowed to grow as a share of gross domestic product (GDP), the growth in these programs will require reductions in most other federal activities. The consequences of unchecked growth in these programs could, at some future date, disrupt the economy's ability to provide the resources needed for the programs.

Earlier in the year (January 24, 2007), the CBO released its annual budget report (*The Budget and Economic Outlook: Fiscal Years 2008-2017*). The report's baseline estimates and projections attempt to show what happens to the budget with no changes from current policy. CBO makes certain assumptions (and certain assumptions have been provided in law in the past) to generate a baseline. CBO's report projects a deficit of $98 billion for FY2008, becoming a $170 billion surplus in FY2012 and a $249 billion surplus in FY2017. The baseline assumes the large tax cuts enacted in the first half of the decade expire as currently scheduled, discretionary spending grows more slowly than its historical trend, relief from the Alternative Minimum Tax (AMT) is not provided, and there is no further funding for the wars in Iraq and Afghanistan. The baseline is designed to be a benchmark against which policy changes can be measured, rather than a prediction of likely outcomes.

Congress has held hearings (and, more are anticipated) on various components of the President's budget proposals. The House and Senate Budget Committees have begun work to produce their respective budget resolutions for FY2008.

This report will be updated as events warrant.

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The Budget for Fiscal Year 2008

Background and Analysis

The law requires that Presidents submit their budget proposals for the upcoming fiscal year (FY) on or before the first Monday in February. The Bush Administration released its FY2008 budget (*The Budget of the U.S. Government, Fiscal Year 2008*) on February 5, 2006. The multiple volumes contain both general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2007 (still underway) through FY2012. It provides limited information on the Administration's proposed revenue and mandatory spending policies after 2012 through FY2017. The documents include discussion of the long-term fiscal issues facing the nation. The full set of budget documents (*Budget*, *Appendix*, *Analytical Perspectives*, *Historical Tables*, as well as 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 previously 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 Congressional Budget Office (CBO) released its annual budget report, *The Budget and Economic Outlook: Fiscal Years 2008-2017* (BEO), on January 24, 2007. The report included CBO's baseline estimates (estimates of the budget without changes from current policy), along with the effects of selected alternative policies,

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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 five 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.

and the economic forecast. The report included detailed estimates of federal revenues, spending, and the economic outlook.

The President sent his FY2008 budget to Congress on February 5, 2007. Various congressional committees held hearings on the budget during that same week. The congressional budget committees have indicated a desire to produce their respective budget resolution for FY2008 by mid-March 2007.

Budget Totals

Table 1 contains budget estimates for FY2008 from 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. Small differences in underlying assumptions may have small effects early in the projection period, but can grow over time — sometimes substantially — producing widely divergent future budget paths. Generally, budget estimates 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 FY2008
(in billions of dollars)

	Receipts	Outlays	Deficit (-)/ Surplus
CBO, BEO Baseline, 1/07	2,720	2,818	-98
OMB, FY08 Budget Proposals, 2/07	2,662	2,902	-239
OMB, Budget, CSB, 2/07	2,714	2,752	-38

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

Budget Estimates and Proposals

CBO's first budget report for FY2008 contained baseline and economic estimates and projections for FY2007 through FY2017. The report estimated an FY2008 baseline deficit of $98 billion (down from the estimated FY2007 baseline deficit of $172 billion). By FY2012, the CBO baseline shows a surplus of $170 billion, which grows to $249 billion in FY2017.

CBO's baseline assumes discretionary spending grows at the rate of inflation, the 2001 and 2003 tax cuts fully expire after 2010 (as required under current law), and the "patch" to the alternative minimum tax (AMT), which expired at the end of calendar year 2006, is not revived. The effects of these assumptions raise receipts and slow discretionary spending growth. Receipts would grow substantially after calendar year 2010, when most of the tax cuts from 2001 and 2003 expire, which, along with sluggish growth in discretionary spending, explains most of the declining deficit and the emerging surpluses over the 10 years in the CBO baseline. As CBO warns, the 10-year baseline results understate the longer-term size and persistence of the deficit.

CBO's report includes the estimated budgetary effects on revenues and outlays of selected policies not included in the baseline estimates. These include policy choices that may be more or less likely to occur than the policies assumed to produce the baseline. CBO's January 2007 report includes estimates of alternative policies that, among a few others, estimate the budgetary effects of making the 2001 and 2003 tax cuts permanent, indexing the AMT to limit its expanding coverage, increasing discretionary appropriations at the rate of growth of gross domestic product (GDP), and freezing total discretionary appropriations at the level provided in FY2007.

President Bush's FY2008 budget calls for extending and making permanent most of the tax cuts adopted in 2001 and 2003, as well as extending other expiring tax provisions. The President's proposals would reduce receipts by almost $600 billion between FY2008 and FY2012, and by an estimated $1.9 trillion between FY2008 and FY2017 (these estimates do not include the resulting higher debt-service costs resulting from the change).[2]

The President also proposes changes to some mandatory programs, in particular Medicare and Medicaid, to slow their growth. The changes would save, according to Administration estimates, $59 billion over five years and $359 billion over 10 years. This overall reduction reflects increases such as a new tax credit for health care, personal accounts for Social Security (beginning in FY2012), and increases in need-based grants for higher education.

The Administration's budget provided a limited amount of information for the years beyond FY2012. The budget does include estimates of the cumulative proposed revenue changes and proposed mandatory spending changes for the periods FY2008 through FY2012, and FY2008 through FY2017, but these projections contained no information for the individual years after FY2012. No estimates are provided for other components of the budget or for budget totals beyond FY2012.

Although not included in the budget documents (they were made available on February 12, 2007), the President, as he had last year, proposed the elimination of, the reduction in, or the reform of approximately 141 programs, both discretionary and mandatory. Many of the proposals are the same as last year's. This set of policy changes will, according to Administration estimates, save an estimated $22 billion in budget authority (not outlays) in FY2008 compared to FY2007 levels.

Uncertainty in Budget Projections

All budget projections are inherently uncertain (albeit, some more than others). Their dependence on assumptions that are themselves subject to substantial variation over short time periods makes budget estimates and projections susceptible to fairly

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[2] The Administration's current services baseline estimates incorporate some of the Administration's policy proposals, such as the extension of the 2001 and 2003 tax cuts. The effect of the Administration's proposals in this report are taken from OMB tables measuring the full effect of the policy changes.

rapid and dramatic changes.[3] Small changes in economic conditions (from those assumed in the estimates), particularly the rate of GDP growth, can produce large changes in the budget estimates. According to CBO estimates, a persistent 0.1% decrease in the growth rate of real GDP would increase the deficit (including interest costs) by $61 billion cumulatively over a five-year period and by $273 billion over 10 years. Increases in the rate of GDP growth would decrease the deficit or increase a surplus by similar amounts over the same time periods. In addition to budget changes resulting from economic variations, the adoption of policies that differ from those assumed in the baseline, such as supplemental appropriations for operations in Iraq and Afghanistan or extending the expiring tax provisions, would also change the budget outlook.

The President's (FY2008) 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 Administration budget estimates for FY2006 (from February 2005) through the actual results for that year. OMB extends the 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 finds that the upper and lower bounds, based on the Administration's statistical analysis of past experience, ranges over $1.1 trillion at the end of a five-year period. In other words, the Administration's projected surplus for FY2012, $61 billion, could range from a surplus of approximately $600 billion to a deficit of approximately $500 billion (with a 90% chance of the budget balance falling between those two numbers). Even the Administration's $239 billion FY2008 deficit estimate has a 90% chance of falling between a $28 billion deficit and a $516 billion deficit.

Budget projections depend on underlying assumptions about the direction of the economy, expected tax and program 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 — will change the budget estimates and projections.

Budget Action

Various congressional committees began hearings on the President's FY2008 budget shortly after its release. The House and Senate Budget Committees have begun their hearings on the FY2008 budget in preparation for producing their respective budget resolutions.

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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 from 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.

Outlays

The Administration's FY2007 budget proposed $2,902 billion in outlays for FY2008, rising to $3,246 billion in FY2012, the last year shown in the President's budget. The proposals would boost funding for defense and homeland security spending (in FY2007 and FY2008), keep most other discretionary spending to an average 1% annual increase, and slightly slow the growth in some mandatory programs including Medicare and Medicaid. In FY2012, 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 $118 billion (4.2%) above the Administration's revised FY2007 outlay estimate, and would increase total outlays by 16.6% from FY2007 to FY2012.

Table 2. Outlays for FY2006-FY2012 and FY2017

(in billions of dollars)

	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2017
CBO Baseline, 1/07	2,655 [a]	2,714	2,818	2,926	3,038	3,179	3,234	4,034
President's FY06 Budget, 2/07		2,784	2,902	2,985	3,049	3,157	3,246	—
President's FY06 CSB, 2/07		2,735	2,752	2,866	2,973	3,116	3,201	—

a. Actual outlays for FY2006
CSB — The Administration's current services baseline.

Measured against the Administration's FY2008 current services baseline ($2,752 billion), the proposed level of outlays ($2,902 billion) is $150 billion (5.5%) higher than the baseline.[4] This difference represents the "cost" of the Administration's proposed policies. For FY2008, almost all of the increase comes from the Administration's proposed additional funding for "security" activities (which comprise the combined spending for defense, homeland security, and foreign affairs). Most of the proposed additional security funding is for the wars in Iraq and Afghanistan. The budget also proposes, compared to baseline levels, an increase ($8 billion, 1.8%) for "non-security" discretionary spending and a $10 billion (0.7%) reduction in mandatory spending. The Administration's budget shows a net interest increase of $7 billion (2.8%) from baseline levels in FY2008.

The year-to-year change in outlays (the $118 billion increase in outlays from FY2007 to FY2008) is composed of all the factors that make outlays change from one year to the next. These include automatic cost-of-living adjustments in many federal programs, growth in populations eligible for program benefits, policy changes

[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 that federal pay adjustment assumptions reflect the (usual) first full pay period in January start of pay-compatibility-adjusted raises rather than October 1, that emergency spending is not extended, and that the debt service (interest payment) changes are included in the baseline. These modifications reduced the reported current services baseline outlay estimate by approximately $41 billion in FY2008 and by $84 billion in FY2012.

from year-to-year, and inflation-driven costs of goods and services bought by the federal government.

As a share of gross domestic product (GDP), the Administration's proposals would reduce outlays from 20.2% of GDP in FY2007 to 20.0% of GDP in FY2008 (it averaged 20.6% of GDP between FY1966 and FY2006). By FY2012, the Administration's projections show that outlays will have fallen to 18.3% of GDP (lower than in any year since FY1960). The Administration shows non-defense discretionary spending falling by 0.7% of GDP over these five years. Defense spending falls by 1.1% of GDP over the same period. Mandatory programs increase their share of GDP by 0.3%, while net interest falls by 0.2% of GDP. Both Medicare and Medicaid grow slightly as percentages of GDP, despite the Administration proposals to trim their growth.

The President's budget showed defense spending increasing by 6.0% from FY2007 ($569 billion) to FY2008 ($603 billion), including the $140 billion proposed supplemental for military actions overseas. By FY2012, the Administration's projections drop defense spending to $546 billion.

For FY2008, the Administration's proposed level of non-defense discretionary outlays is larger than the current services baseline estimates (by $19 billion) in the Administration's budget. Over the five years, the current services estimates for non-defense discretionary outlays grows by an average 0.7% annually, while the Administration's proposed levels fall by an average 0.7% annually. The Administration's budget shows non-defense discretionary spending falling from $511 billion in FY2007 and FY2008 to $493 billion in FY2012. As shares of GDP, the fall is more substantial, dropping from 3.7% of GDP in FY2007 to 3.5% of GDP in FY2008 to 2.8% of GDP in FY2012. If these levels are achieved, non-defense discretionary spending would be smaller as a percentage of GDP in FY2012 than in any year since at least FY1962. How the Administration plans to achieve these reductions, particularly after FY2008, is not illuminated in the budget.

Mandatory spending in the President's budget grows by 4.2% ($62 billion) from FY2007 to FY2008. The budget includes proposals to reduce, from baseline levels, mandatory outlays by $10 billion in FY2008. The reductions would be achieved by slowing the growth of selected mandatory spending activities such as Medicare and Medicaid, among others. The effort would reduce total mandatory spending over the five years by almost $60 billion (out of total mandatory spending over the period of approximately $1,100 billion). Mandatory spending would remain the largest broad category of federal spending, growing from $1,465 billion in FY2007 to $1,527 billion in FY2008 and to $1,923 billion in FY2012. The budget showed it growing from 10.5% of GDP in FY2008 to 10.8% of GDP in FY2012.

The President's FY2008 budget shows net interest outlays rising by $22.1 billion from FY2007 to FY2008. The growth in federal debt in the recent past, and its continued growth under the Administration's proposals (at least in the very short term), leads to the higher net interest outlays. The proposed net interest outlays in FY2008 are $7.8 billion larger than the Administration's current services baseline estimate for FY2008. The Administration's policy proposals would raise FY2012 net interest outlays almost $30 billion above its current services net interest outlay estimate. The Administration's estimates show net interest changing very little as a percentage of GDP throughout the five years (ranging between 1.6% of GDP to 1.8% of GDP).

CBO's January 2007 baseline estimates show outlays falling over its projection period (FY2007-FY2017), from 19.9% of GDP in FY2007 to 19.7% of GDP in FY2008 to 18.8% of GDP in FY2012 and remaining near that level through FY2017 (18.9% of GDP). Under a selection of CBO provided alternative policies that would increase outlays above baseline levels, with outlays rising over the 10-year period from 20.2% of GDP in FY2008 to 21.2% of GDP in FY2017. One of the alternative policies that CBO estimates, freezing total discretionary appropriations at the level provided for FY2007, would reduce outlays as a percentage of GDP faster than what CBO shows occurring under the baseline.

The CBO baseline estimates for defense spending (which excluded any new supplemental funding) increases outlays by $7 billion (from $490 billion to $497 billion) between FY2007 and FY2008. CBO's baseline assumptions, which increase total discretionary spending by the rate of inflation, show defense spending rising to $575 billion in FY2012 (and to $652 billion in FY2017). As percentages of GDP, defense spending falls slowly throughout the 10-year projection. CBO estimates that it will be 3.9% of GDP in FY2007 and 3.8% of GDP in FY2008. It would then fall to 3.3% of GDP in FY2012 and to 3.1% of GDP in FY2017 in CBO's projections. CBO's non-defense discretionary spending rises from an estimated $490 billion in FY2007 to $497 billion in FY2008, to a projected $525 billion in FY20012, and to $586 billion in FY2017. Under the CBO baseline projections, non-defense discretionary spending falls as a percentage of GDP, from 3.6% of GDP in FY2007 to 3.5% of GDP in FY2008, to 3.1% of GDP in FY2012, and to 2.8% of GDP in FY2017. These latter numbers, like the ones from the Administration, are very low by historical standards.

The mandatory spending baseline estimates from CBO rises from $1,455 billion in FY2007 to $1,533 billion in FY2008, a 5.4% increase. By FY2012, CBO's projections increases mandatory spending to $1,866 billion and to $2,568 billion by FY2017. As shares of GDP, CBO's projections raise mandatory spending slowly early in the period and faster later in the period from 10.7% in both FY2007 and FY2008 to 10.8% in FY2012 and to 12.1% of GDP in FY2017.

CBO's baseline estimates show net interest growing by $15 billion from FY2007 to FY2008 (from $235 billion to $250 billion). The smaller deficits in subsequent years in the CBO baseline projections reduce the growth in the debt, slowing the rise and then reversing the rise, in net interest payments. They peak at approximately $270 billion in FY2011 and FY2012 before sliding to $228 billion in FY2017. As shares of GDP, the CBO January 2007 projections show net interest holding fairly steady or falling throughout the ten-year period (from approximately 1.7% of GDP in FY2007 and FY2008 to 1.1% of GDP in FY2017.

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

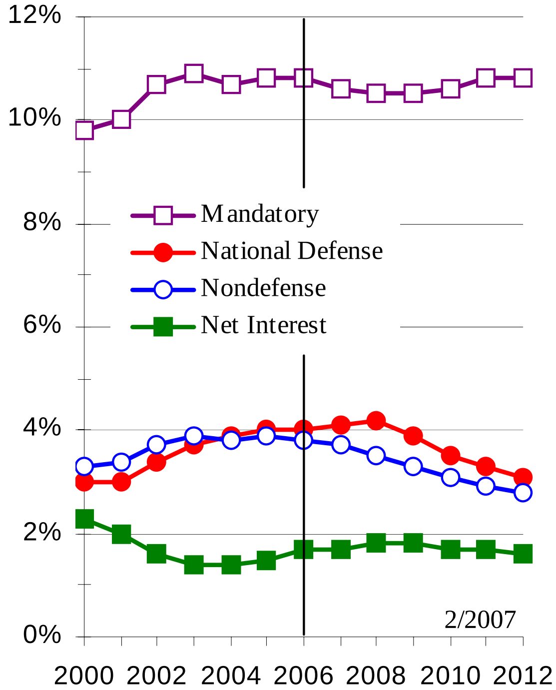


Figure 1 shows spending by category as percentages of GDP from the Administration's February 2007 budget. The data show actual outlays for defense, non-defense, mandatory, and net interest spending for the fiscal years 2000 through 2006 and the estimates and projections for the fiscal years 2007 though 2012. The slide in defense and non-defense discretionary spending as shares of GDP after FY2007 and FY2008 depend on the Administration's assumptions that non-defense discretionary spending falls annually (FY2008 through FY2012) and that there is limited additional funding for the war on terror after FY2008 (the Administration includes a $50 billion "placeholder' in its FY2009 estimates for additional war funding). The President proposes some reduction in mandatory spending from current service levels, but they do little to keep mandatory spending from rising slightly later in the decade, as a share of GDP. By FY2012, the President's proposed private accounts for Social Security help raise mandatory spending as a percentage of GDP above the current services level.

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

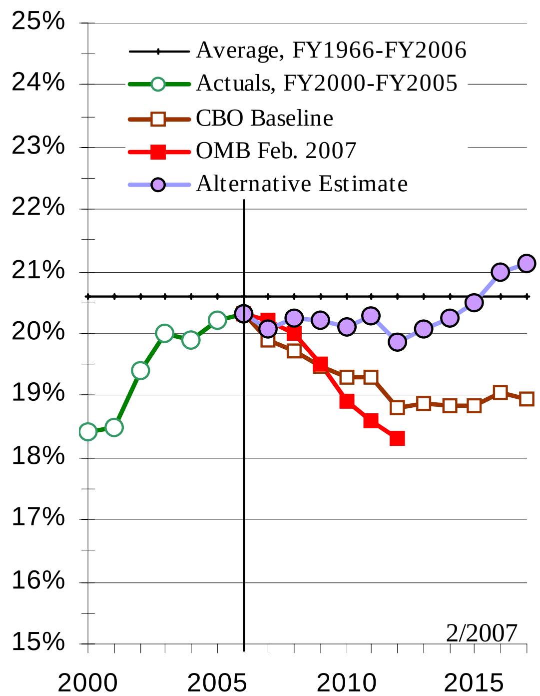


Figure 2 shows three possible paths for outlays (as percentages of GDP) through FY2017: the CBO January 2007 baseline; the President's proposal in his FY2008 budget (February 2007); and an alternative estimate derived from CBO data. CBO's baseline outlays fall as a share of GDP through FY2012 and then remain relatively stable through FY2017.

The President's proposed outlays fall sharply after FY2007, a result of the Administration's proposals to reduce discretionary spending, both defense and non-defense, and moderate the rate of growth in some mandatory programs. By FY2012, spending would be just below its percentage of GDP in FY2000.

The alternative estimate is based on selected policy alternatives from CBO that are not included in its baseline. The alternative estimate incorporates two of several available assumptions directly affecting outlays. The first has discretionary appropriations growing at the rate of nominal GDP growth (rather than at the rate of inflation). The second reduces the number of troops deployed in Iraq and Afghanistan as well as other anti-terror activities to 75,000 by FY2013. Both of these assumptions increase outlays above the baseline projections, increasing the deficit (or reducing a surplus), increasing federal debt and subsequent net interest payments. These higher net interest payments are included in the alternative estimate. In addition, the alternative estimate for outlays includes the outlay effects of the changes to the deficit and debt that occur in the alternative estimate for receipts (see the next section). The outlay effects are mostly higher net interest. The alternative estimate grows over the 10 years as a percentage of GDP, rising to 21.1% in FY2017.

Receipts

Receipts rise by 4.8% ($122 billion) from FY2007 to FY2008 under the Administration's FY2008 budget proposal. Over the five years forecast, receipts rise by $767 billion, over 30%. The proposal would extend and make permanent most of the tax cuts scheduled to expire between now and FY2012.

Table 3. Receipts for FY2006-FY2012 and FY2017

(in billions of dollars)

	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2017
CBO Baseline, 1/07	2,407[a]	2,542	2,720	2,809	2,901	3,167	3,404	4,284
President's FY06 Budget, 2/07		2,540	2,662	2,798	2,955	3,104	3,307	—
President's FY06 CSB 2/07		2,550	2,714	2,831	3,008	3,151	3,348	—

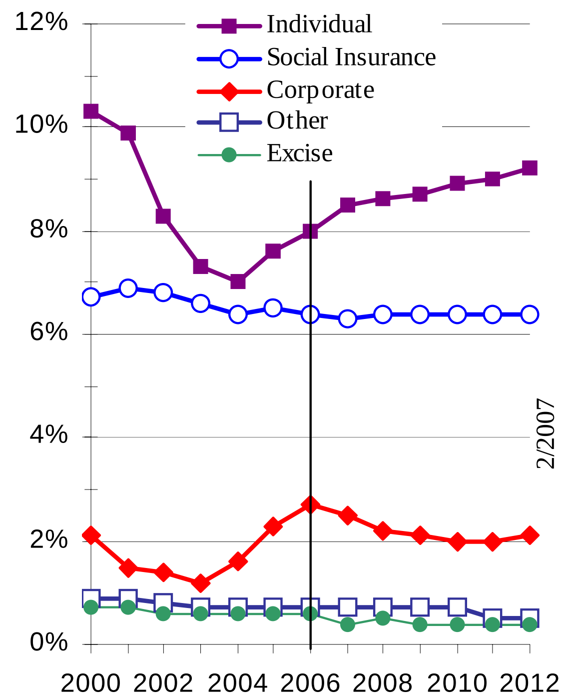
a. Actual receipts for FY2006.
CSB — The Administration's current services baseline.

The Administration estimates that making the 2001 and 2003 tax cuts permanent will reduce cumulative receipts by $374 billion between FY2008 and FY2012 and by $1,617 billion between FY2008 and FY2017. The effect of these and the other Administration proposals for receipts would reduce receipts, from baseline levels, by an estimated $599 billion in the first five years and by $1,854 billion over 10 years (as can be seen in **Table 3**, the proposed reductions do not reduce receipts in dollars over time).

CBO's January 2007 budget report estimates that extending the expiring provisions of the major tax cuts passed in 2001 and 2003 would reduce revenues by an estimated $418 billion over the first five years and by $1,937 billion over 10 years. Extending *all* the tax cuts that expire over the 10-year period would reduce revenues (from CBO baseline levels) by $870 billion in the first five years and by $3,178 billion over the full 10 years of the forecast.[5]

Figure 3 shows the President's January receipt estimates by type for the fiscal years 2000 through 2012. Actual receipts are shown for FY2000 through FY2006. All are shown as percentages of GDP. Excise and other receipts each remain at or below 1% of GDP for the period shown. Corporate income taxes, after rising through FY2006, decline slowly and stabilize near 2% of GDP under the Administration's projection. Social Insurance receipts remain fairly steady from FY2006 through FY2012. Individual income taxes, having fallen from over 10% of GDP in FY2000 to 7% of GDP in FY2004, regain some of their lost share under the Administration's proposals, but remain 1% of GDP below their FY2000 level.

Figure 3. OMB Receipts FY2000-FY2012
(in percentages of GDP)



The Administration's proposals includes extending the current relief from the alternative minimum tax (AMT) for fiscal years 2007 and 2008. Without further extensions of or a permanent fix to the AMT, a growing number of middle-class taxpayers will be subject to it.[6] The FY2008 budget estimates that "fixing" the AMT for the two years will cost $9.1 billion in FY2007 and $47.9 billion in FY2008. CBO estimates that it would cost on average about $55 billion a year over the next 10 years to index the AMT for inflation. Although the President's budget calls for fixing the AMT expansion, it does not include the five-year cost of doing so. This, in effect, increases the Administration's receipt estimates by $50 to $60 billion a year (after FY2008) above what they would be if they included an AMT fix.[7]

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[5] CBO lists almost 100 expiring provisions between FY2007 and FY2017. Almost all of them would reduce revenues. See table 4-10 in CBO's report, *The Budget and Economic Outlook: Fiscal Years 2008-2017*, January 2007, [http://www.cbo.gov/showdoc.cfm?index=7731&sequence=0].

[6] 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.

[7] 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.

As shares of GDP, total receipts in the President's budget are expected to remain near their average (between FY1966 and FY2006) of 18.3% throughout the five years. CBO's baseline estimates (January 2007), which exclude the extension of the 2001 and 2003 tax cuts, are larger, rising to over 20% of GDP by FY2017.

The last two years (FY2006, FY2007) saw unexpectedly rapid growth in receipts. Neither OMB nor CBO expects the rapid growth to continue. Receipts rose from 16.3% of GDP in FY2004 to 18.4% of GDP in FY2006. OMB shows very little change in receipts as a share of GDP over the budget's five years, rising to 18.6% in FY2012. CBO's baseline shows receipts jumping to 19.8% of GDP in FY2012 once the 2001 and 2003 tax cuts expire, but not because of continued revenue growth under current tax law.

Modifying CBO's baseline revenue estimates and projections by using its alternative policy estimates produces slower growth in receipts, both in dollars and as shares of GDP, than in CBO's baseline. The alternative estimate assumes the extensions of all expiring tax cuts, an annual adjustment to the AMT to halt its expanding coverage, and the interaction effect of the extensions and the AMT.[8] The alternative estimate for receipts shows them falling as a percentage of GDP to approximately 17.5% by FY2012, where they remain through FY2017. In FY2008, CBO estimates that the alternative revenue assumptions would produce $70 billion less revenue than the baseline. By FY2012, the alternative revenue estimate is $389 billion smaller than baseline revenues and in FY2017, the alternative has fallen $560 billion below the baseline projection.

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

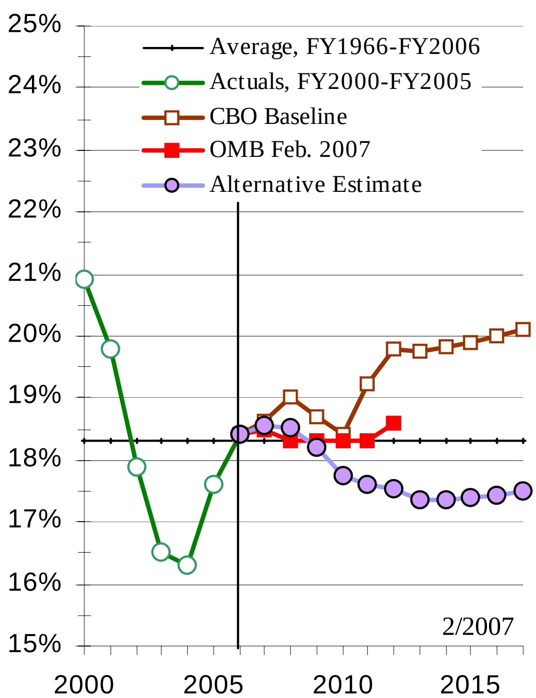

Figure 4 uses data from the January 2007 CBO budget report and from the President's FY2008 budget. The 40-year average of receipts as a percentage of GDP (18.3%) is also shown. The figure shows receipts as percentages of GDP for fiscal years 2000 through 2017 (projected). Actual receipts are shown for fiscal years 2000 through 2006. The three estimates shown remain fairly close through FY2009 or FY2010, and then separate by fairly large amounts. In CBO's baseline, receipt estimates are larger as shares of GDP than those of the Administration's proposals or the alternative estimate. The CBO baseline does

[8] The interactions of AMT reform and the extension of the 2001 and 2003 tax cuts produces greater revenue losses than the two changes separately. CBO includes in its alternative policies an estimate of this effect.

not include the FY2007 and FY2008 AMT relief that is included in the Administration estimate and the alternative estimate. The separation in the estimates accelerates in FY2011, when the Administration proposal and the alternative estimate assume the permanency of the 2001 and 2003 tax cuts and CBO's baseline does not. CBO's baseline shows a large jump in receipts in FY2011, as the 2001 and 2003 tax cuts expire (as required by current law). It then climbs slowly to just above 20% of GDP in FY2017. The Administration's revenue estimates show little variation over the five-years in the FY2008 budget, with only a slight rise in the last year. The alternative estimate shows receipts rising slightly (as shares of GDP) in FY2007 before falling through FY2012, and remaining relatively constant after that.

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 or 1.3% of GDP).

The President's FY2008 budget has a deficit of $239 billion for FY2008, and a small surplus ($61 billion) in FY2012. The Administration's current service baseline estimates show the budget reaching a surplus in FY2010, two years prior to the budget reaching a surplus. This implies that if the Administration's proposals were not implemented, a surplus would arrive sooner.

Table 4. Surpluses/Deficits(-) for FY2006-FY2012 and FY2017

(in billions of dollars)

	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2017
CBO Baseline, 1/07	-248 [a]	-172	-98	-116	-137	-12	170	249
President's FY06 Budget, 2/07		-244	-239	-187	-94	-54	61	—
President's FY06 CSB 2/07		-185	-38	-35	34	35	147	—

a. Actual deficit for FY2006.
CSB — The Administration's current services baseline.

Achieving the Administration's deficit reduction goals during the next five years would require strict limits on the growth in total discretionary spending (both defense and domestic), a slowing in the growth rate of some entitlements, and allowing AMT relief to lapse after 2008. 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.[9]

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[9] The Administration's current services baseline estimate, which assumes current policy, has smaller deficits and a quicker move to surplus than the deficits and surplus in the President's proposed budget. The cumulative five-year deficit would be smaller without the President's

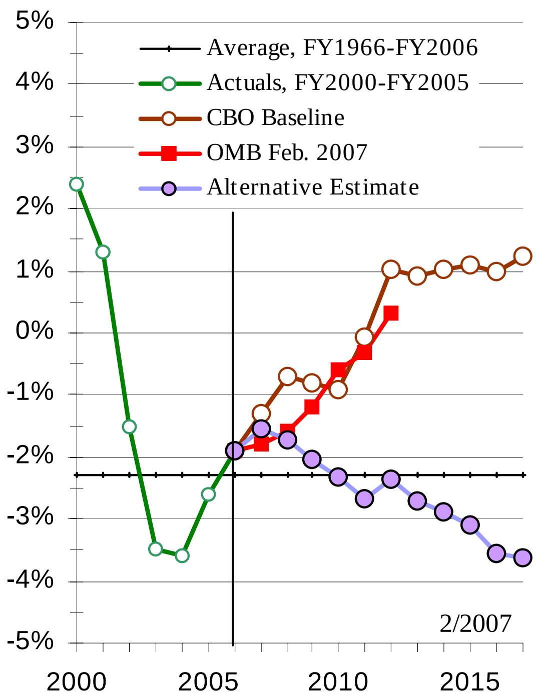
(continued...)

CBO's January 2007 baseline estimates and projections show the deficit falling in dollars and as a percentage of GDP through FY2011, after which surpluses appear through the end of the projections in FY2017. The assumptions that CBO follows to produce the baseline generated the deficit reduction and surpluses. On the revenue side, the baseline assumes the lack of a fix to the expanding coverage of the AMT and the expiration of the 2001 and 2003 tax cuts at the end of calendar year 2010 (as required by current law). Both boost revenues considerably compared to including an AMT fix and extending the tax cuts. On the spending side, discretionary spending is assumed to grow at the rate of inflation, which is a slower rate than it has grown recently.

The result of substituting a selection of the CBO alternative policies not included in its baseline for the policy assumptions used in the baseline, produced a growing deficit from FY2007 through FY2017. The alternative estimate, as discussed in the previous sections, limits the growing coverage of the AMT, extends the 2001 and 2003 tax cuts, and increases discretionary spending at the rate of GDP growth (see the CBO-based alternative estimate in **Figure 5**). Under these alternative policies, the deficit would grow from an estimated 1.5% of GDP in FY2007 to 3.6% of GDP in FY2017.

Figure 5 shows deficit estimates as shares of GDP for FY2000 through FY2017. The actual shares of GDP for the surpluses and deficits are shown for FY2000 through FY2006. For the years through FY2017, the data are taken from the estimates and projections by CBO and OMB in their first budget reports for FY2008, early in 2007. The average deficit (2.3% of GDP) for FY1966 through FY2006 is also shown. The 40-year average is shown for comparison.

Figure 5. Surplus/Deficit(-) FY2000-FY2017
(in percentages of GDP)



The CBO baseline deficit estimate assumes the expiration of the 2001 and 2003 tax cuts in 2010, no future adjustments to lessen the expanding coverage of the AMT, and the adjustment of discretionary spending for inflation. 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 and the emergence of surpluses after FY2011 (the line moves upward in the figure). The President's policy

[9] (...continued)
proposed policy changes than with them.

proposals assume additional spending for defense in FY2007 and FY2008 (and a minimal "placeholder" in FY2009, with no assumptions about additional defense funding in subsequent years), tight controls on domestic discretionary spending, a slight slowing in the growth of Medicare and Medicaid, no additional AMT relief after FY2008, and the creation of personal accounts for Social Security in FY2012. The estimates show a rapid decline in the deficit as a percentage of GDP, with a slight surplus appearing in FY2012.

The alternative estimate in **Figure 5** uses selected estimates of alternative policies estimated by CBO. Under these assumptions, the deficit estimates, after a reduction in FY2007, grows almost steadily through FY2017, when the deficit reaches 3.6% of GDP, the same level reached in FY2004 (this line moves downward in **Figure 5**).

The Longer Run

OMB, CBO, and the Government Accountability Office (GAO) agree that over a longer time period, one beginning in this decade and lasting far into the century, the current mix of federal fiscal policies is unsustainable. The nation's aging population combined with health care costs that seem likely to continue rising faster than per capita GDP raise spending in federal programs for the elderly to such an extent that the government faces constantly rising deficits and, "a federal debt burden that ultimately spirals out of control.... Although the timing of deficits and resulting debt build up varies depending on the assumptions used, ... we are on an unsustainable fiscal path."[10] According to CBO projections, keeping future outlays at current levels of GDP (approximately 20%) and fiscal policies unchanged could easily lead to drastic reductions in all spending other than those for Medicare, Social Security, and Medicare. The Acting Director of CBO stated that, "By 2030 ... spending for those programs [Medicare, Social Security, and Medicare] is projected to reach roughly 15 percent of GDP .... If that increase happened ..., the rest of the budget would have to be cut by more than half."[11] to keep overall spending close to 20% of GDP

In addition, a CBO report on *The Long-Term Budget Outlook* (December 2005) stated

> 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

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[10] GAO. *The Nation's Long-Term Fiscal Outlook: January 2007 Update*. GAO-07-510R. p.1.

[11] CBO. *The ABCs of Long-Term budget Challenges*, Director's Conference on Budget and Accounting for Long-Term Obligations, Opening Remarks by Donald B. Marron, Acting Director, December 8, 2006. p.2.

> growth of spending and perhaps also a sizable increase in taxes as a share of the economy.[12]

The Administration indicated similar concerns about the outlook for the budget over the long term in the President's FY2008 budget (February 2007).

> ...the current structure of the Federal Government's major entitlement programs will place a growing and unsustainable burden on the budget in the long-term....By 2050, spending on these three entitlement programs [Social Security, Medicare, and Medicaid] is projected to be more than 15 percent of GDP, or more than twice as large as spending on all other programs combined, excluding interest on the public debt.[13]

The short-term budget outlook can change when it is buffeted by all types of unexpected events, such as the hurricanes in 2005 or deteriorating economic conditions. The long-term budget outlook, although susceptible to these types of events, will largely be determined by the interplay of policy and demographics. The retirement of the baby boom generation and a rapidly expanding 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 could easily limit the government's flexibility in meeting its obligations or new needs as well as overwhelm the economy's ability to provide the resources needed for the expanded programs.

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

[13] OMB, *Budget of the United States Government for Fiscal Year 2008*, Feb. 2007, p.16.

For Additional Reading

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