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The Budget for Fiscal Year 2008

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Summary

On February 5, 2007, President Bush presented his fiscal year (FY) 2008 budget to Congress. The President's budget predicted a deficit of $239 billion for FY2008 and a steady improvement of the federal government's fiscal position, including a surplus of $61 billion in FY2012, the last year projected. Major proposals included large defense supplementals for FY2007 and FY2008, extensions of the expiring tax cuts, limited increases in domestic discretionary spending, and limited increases in defense spending after FY2008. The Administration also proposed a temporary halt to the expanding reach of the Alternative Minimum Tax (AMT) in FY2007 and FY2008. Medicare and Medicaid were expected to grow more slowly. The Administration's July 2007 *Mid-Session Review* showed little change in the budget outlook for FY2008 through FY2012, although higher health outlays and war costs increased the expected FY2008 deficit slightly.

The FY2008 budget also discussed long-term fiscal problems. According to the longer-term projections from the Administration, the Congressional Budget Office (CBO), and the Government Accountability Office (GAO), the impending retirement of the baby boom generation and rising health care costs will substantially expand spending over the coming decades on federal programs serving the elderly, such as Medicare, Social Security, and Medicaid. The long-term growth of outlays, if left unchanged or if not offset by new revenues, could overwhelm the government's ability to finance its obligations.

In January 2007, the CBO released baseline projections of future budget outcomes under current law. CBO projected a FY2008 deficit of $98 billion, 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 scheduled, real discretionary spending is fixed, and the Alternative Minimum Tax is unchanged.

The House and Senate adopted separate versions of the FY2008 budget resolution in March 2007, which would allow more domestic spending than the Administration request and extend some expiring tax cuts with conditions. The House and Senate adopted a conference agreement (H.Rept. 110-153) on May 17, with a projected FY2008 deficit of $252 billion. By mid-July, the House and Senate Committees on Appropriations had approved most of the 12 regular appropriations bills. At the end of FY2007, the House had passed all 12 appropriations bills and the Senate had passed four. The Senate passed three more appropriations bills in October. The President had said he would veto other appropriations bills. At the end of FY2007, Congress passed the first (H.J.Res. 52) of four continuing resolutions (H.R. 3222, H.J.Res. 69, H.J.Res. 72), which in sequence, funded government operations until the end of the calendar year. On November 8, Congress approved the Labor-HHS-Education bill (H.R. 3043, S. 1710), which the President vetoed, and Defense bill (H.R. 3222, P.L. 110-116), which he signed. On December 19, Congress passed an omnibus bill (H.R. 2764) that incorporated the 11 remaining regular appropriations bills. On December 26, the President signed the Consolidated Appropriations Act of FY2008 (P.L. 110-161), which provided $555 billion in discretionary budget authority. This report will not be updated.

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The Budget for Fiscal Year 2008

Background and Analysis[1]

The Bush Administration, in accordance with the statutory requirement that the President present a budget proposal by the first Monday in February, released *The Budget of the U.S. Government, Fiscal Year 2008* on February 5, 2007.[2] 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 (known as "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.[3] The budget documents contain general and specific descriptions of the Administration's policy proposals and expectations from FY2007 through FY2012, as well as limited information on budget policies for FY2012 through FY2017. The documents also discuss long-term fiscal issues facing the nation and provide historical data on previously enacted appropriations, past outlays and revenues, and other budget items.

The congressional budget process, which includes the annual budget resolution and appropriations bills, begins once the Administration submits its budget to Congress. As Congress deliberates over the budget, the Administration often revises its proposals as it interacts with Members of Congress and as national and international economic conditions change.

The Current Situation

Congress adopted the conference report (H.Rept. 110-153; S.Con.Res. 21) on the FY2008 budget resolution on May 17, 2007. The House and Senate Appropriation Committees began considering the FY2008 appropriation bills shortly

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[1] Philip Winters, who has retired from CRS, wrote a previous version of this report.

[2] The Budget and Accounting Act of 1921 requires the President to submit a budget to Congress each year. Current law (31 U.S.C. 1105(a)) requires the President to submit a budget no earlier than the first Monday in January, and no later than the first Monday in February.

[3] Current services baseline estimates, and baseline estimates in general, provide a neutral measure against which to compare proposed policy changes and are not designed to predict likely future budget outcomes. 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 and the Congressional Control and Impoundment Act of 1974.

afterwards. By late July, all twelve regular appropriation bills for FY2008 had cleared the House Appropriations Committee and, except for the defense bill, the Senate Appropriation Committee. By August 5, the House had passed all twelve regular appropriations bills. The Senate passed the Homeland Security bill in July and three others in mid-September, but failed to pass the remaining eight by September 30, the end of FY2007. In October, the Senate passed the defense appropriations and Commerce-Justice-Science appropriations bills.

On September 26, the House passed a continuing resolution (H.J.Res. 52) to fund the government until November 16, which the Senate passed the following day. The President signed the continuing resolution on September 29 (P.L. 110-92). On November 8, Congress approved the Labor-HHS-Education bill (H.R. 3043, S. 1710), which the President vetoed, and Defense bill (H.R. 3222, P.L. 110-116) that provided $459 billion in non-emergency budget authority, which he signed. The President had said he would veto nearly all of the appropriation bills that reached the House or Senate floor, either because they exceeded requested funding levels or because of policy disagreements. These veto threats may have complicated the appropriations process.

The defense bill included extended funding for government operations from November 16 until December 14. On December 14, Congress passed another funding continuation (H.J.Res. 69) to December 21, which the President signed. On December 19, Congress passed an omnibus appropriations bill (H.R. 2764) that incorporated 10 remaining regular appropriations bills into the State-Foreign Operations appropriations bill and a fourth continuing resolution (H.J.Res. 72).[4] On the same day, Congress passed a fourth continuing resolution, which the President signed two days later (P.L. 110-149), that funded government operations through the end of the calendar year. On December 26, the President signed the omnibus measure, entitled the Consolidated Appropriations Act of FY2008 (P.L. 110-161), which provided $555 billion in discretionary budget authority.

Budget Totals

Table 1 contains budget estimates for FY2008 from CBO, the Administration (the Office of Management and Budget, OMB), and Congress. Estimated budget totals can vary due to differing underlying economic, technical, and budget-estimating assumptions and techniques, as well as differences in policy assumptions. Minor differences in underlying assumptions, which may generate small short-term discrepancies, can produce wide divergences in projected long-term budget paths. Budget estimates produced by the President, CBO, Congress, or by others, should be expected to change as new data arrive or as economic conditions change.

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[4] For details, see CRS Report RL34298, *Consolidated Appropriations Act for FY2008: Brief Overview*, by Robert Keith.

Table 1. Budget Estimates and Proposals for FY2008
(in billions of dollars)

	Receipts	Outlays	Deficit (-)
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
SBC, Budget Res. 3/16/07	2,678	2,927	-249
CBO Est. of Pres. Budget 3/21/07	2,679	2,905	-226
CBO Baseline, Revised 3/21/07	2,720	2,833	-113
Senate Budget Res., S.Con.Res. 21 3/23/07 [a]	2,678	2,927	-249
House Budget Res., H.Con.Res. 99 3/29/07	2,720	2,933	-213
Conf. Agreement, S.Con.Res. 21 5/17/07	2,685	2,937	-252
Mid-Session Review 7/11/07	2,659	2,918	-258
CBO, Budget Update, 8/23/2007	2,771	2,925	-155

Source: CRS.
Note: Outlays minus receipts may not equal deficit due to rounding.
a. Calculated from the engrossed version of S.Con.Res. 21.
BEO — The *Budget and Economic Outlook*, CBO.
CSB — The Administration's current services baseline.
SBC — Senate Budget Committee.

Budget Estimates and Proposals

CBO Projections. CBO's first budget report for FY2008 contained budget baseline and economic 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. The CBO baseline showed a FY2012 surplus of $170 billion and a projected $249 billion surplus in FY2017.

CBO baseline projections are computed using certain assumptions set by law. These assumptions typically yield higher revenue estimates and projections of slower growth of discretionary spending relative to scenarios that independent forecasters consider likely. Three key assumptions incorporated in CBO baseline projections are that discretionary spending remains constant in inflation-adjusted terms, the 2001 and 2003 tax cuts fully expire after 2010 (as current law specifies), and the "patch" to the alternative minimum tax (AMT), which expired at the end of calendar year 2006, will lapse. After 2010 when most of the tax cuts from 2001 and 2003 expire, according to baseline projections, receipts grow substantially. The assumption that these tax cuts expire and that growth in discretionary spending is zero in real terms explains most of the declining deficit and the surpluses that emerge over the 10-year baseline forecast window. Unless major policy changes are made, federal deficits are expected to grow rapidly beyond the 10-year forecast window. In large part those future deficits would result from the retirement of the baby boom generation and growing health care costs.

CBO's report includes the estimated budgetary effects on revenues and outlays of selected policies omitted from baseline estimates. These include, among a few others, estimates of the budgetary effects of making the 2001 and 2003 tax cuts permanent, indexing the AMT for inflation 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. The first two reduce expected receipts, the third increases expected outlays, and the last reduces outlays.

In March 2007, CBO released its analysis of the President's budget proposals based on its economic and budget models. CBO forecast slightly higher revenues and smaller outlays, implying a FY2008 deficit of $226 billion, somewhat smaller than $239 billion deficit in the President's budget.[5] By FY2012, CBO projected that the President's proposals would produce a deficit of $31 billion, rather than the $61 billion surplus the Administration's expected. This difference in forecasts is largely due to the uncertainty of medium-term projections. For the five years 2008 through 2012, CBO's cumulative deficit estimate based on the President's proposals was $790 billion, while the President's budget had a cumulative net deficit estimate for the same period of $514 billion. Economic forecast and assumptions used in the President's budget yielded larger revenues and somewhat larger outlays than CBO's reestimates of the President's proposals.

Administration Projections and Proposals. President Bush's FY2008 budget called for extending and making permanent most of the 2001 and 2003 tax cuts, as well as extending other expiring tax provisions. The President's proposals would reduce estimated receipts by almost $600 billion between FY2008 and FY2012 relative to the baseline, and by an estimated $1.9 trillion between FY2008 and FY2017, apart from higher debt-service costs resulting from the change.[6]

Administration proposals, according its own estimates, would reduce mandatory spending by $96 billion over five years and by $309 billion over 10 years. Proposed policy changes include both spending reductions and some increases — termed "augmentations" by the Administration. The budget includes a cost estimate of $637 billion over 10 years for proposed personal accounts for Social Security. The Administration estimates its proposals affecting mandatory spending, including indirect effects and the outlay effects of tax proposals, would yield five-year savings of $59 billion and 10-year *increases* of $359 billion. Much of that projected increase is due to the proposed introduction of personal Social Security accounts.

The Administration's budget provided limited information for years beyond FY2012. The budget includes 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 omit data for the individual years after FY2012. Estimates for other components of the budget or for budget totals beyond FY2012 were also omitted.

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[5] The overall small change in revenues obscures much larger increases and decreases in the components of the changes that CBO shows in its report *An Analysis of the President's Budgetary Proposals for Fiscal Year 2008* (see Table 1-4 on p. 7).

[6] 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.

The President proposed eliminating, reducing, or reforming about 141 programs. Many of these proposals, which would affect both discretionary and mandatory spending programs, were also proposed last year.[7] According to Administration estimates, those policy changes would cut $22 billion of budget authority in FY2008 compared to FY2007.

The Administration's *Mid-Session Review* (MSR) released in July featured the same proposals as the President's FY2008 budget issued in February.[8] Administration estimates showed some deterioration in the FY2008 budget outlook since February. In particular, the MSR FY2008 deficit estimate was $19 billion higher than the February estimate. A mix of technical reestimates, economic changes, and minor policy differences account for the changes. Slightly over one-half of the increase in the cumulative five-year deficit estimate, which jumped from $514 billion in the February outlook to $651 billion in the MSR, was due to unexpectedly fast growth in Medicare and Medicaid spending. Rising health care prices and hospital patient volumes were largely responsible for the faster Medicare and Medicaid spending rates.

CBO Scoring of FY2008 Appropriations Bills. CBO estimates the spending totals for discretionary appropriations legislation according to the specifications of budget legislation, a process usually known as "scoring." A summary of the CBO analysis of FY2008 appropriations is presented in **Table 2**.[9] For each category corresponding to a regular appropriations bill, CBO estimates new budget authority and outlays for non-emergency and emergency spending, along with a comparison with 302(b) allocations.[10] Emergency spending is generally treated differently than nonemergency spending in budget legislation.[11]

FY2008 appropriations legislation, according to CBO, provided a total of $932,847 million in nonemergency discretionary budgetary authority, essentially matching the President's request (aside from emergency spending) for $932.8 billion.[12]

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[7] These were issued February 12, 2007, a week after other budget documents were released.

[8] Office of Management and Budget, *Mid-Session Review*, July 11, 2007, available at [http://www.whitehouse.gov/omb/budget/fy2008/pdf/08msr.pdf].

[9] Original CBO table available at [http://www.cbo.gov/budget/approps/approps.pdf].

[10] For an explanation of the role of 302(b) allocations in the budget process, see CRS Report RS20095, *The Congressional Budget Process: A Brief Overview*, by James V. Saturno, and CRS Report 98-721, *Introduction to the Federal Budget Process*, by Robert Keith.

[11] In particular, as CBO notes, "Sec. 204 of the concurrent resolution on the budget for fiscal year 2008 (S.Con.Res. 21), amounts designated as emergencies shall not count for purposes of Sec. 302(b) of the Congressional Budget Act."

[12] CBO, *Analysis of the President's Budgetary Proposals for FY2008*, Mar. 2007, Table 1-6.

Table 2. Final 302(b) Allocations and CBO Estimates for FY2008 Appropriations

(millions of current dollars)

Short Title	House 302(b) Allocation		Senate 302(b) Allocation		Estimated Discretionary Spending					
					Non-Emergencies		Emergencies		Total	
	BA	Outlays	BA	Outlays	BA	Outlays	BA	Outlays	BA	Outlays
Agriculture	18,817	20,027	18,825	20,072	18,093	19,528	1,490	3,086	19,583	22,614
Commerce, Justice, Science	53,551	55,318	54,000	54,500	51,803	53,441	286	432	52,089	53,873
Defense	459,332	475,980	459,332	475,164	459,332	475,164	86,830	76,329	546,162	551,493
Energy and Water	31,603	32,774	32,273	33,229	30,888	32,340	0	559	30,888	32,899
Financial Services	21,434	21,665	21,278	21,243	20,599	20,903	250	-12	20,849	20,891
Homeland Security	36,262	38,247	36,022	40,168	34,852	38,028	5,610	2,012	40,462	40,040
Interior and Environment	27,598	28,513	27,150	28,574	26,555	28,052	800	1,158	27,355	29,210
Labor/HHS	151,748	148,174	150,153	147,683	144,841	146,292	444	560	145,285	146,852
Legislative Branch	4,024	4,042	4,051	4,178	3,970	4,008	0	22	3,970	4,030
Military Construction and Veterans Affairs	64,745	54,832	64,745	55,021	60,213	52,232	3,692	4,060	63,905	56,292
State, Foreign Operations	34,243	33,351	34,243	33,516	32,800	32,841	2,385	3,053	35,185	35,894
Transportation, HUD	50,738	114,528	50,981	115,050	48,901	114,350	3,173	1,388	52,074	115,738
Total	954,095	1,029,097*	953,053	1,028,398	932,847	1,017,179	104,960	92,647	1,037,807	1,109,826
Total Minus Defense	494,763	553,117	493,721	553,234	473,515	542,015	18,130	16,318	491,645	558,333

Source: CBO. See text for notes. Items may not sum to totals due to rounding. *Includes a $1.65 billion 302(b) allocation in outlays for the full committee.

Non-defense discretionary budget authority, which totaled $473,515 million, was slightly higher than the $459,332 million in defense discretionary budget authority provided by FY2008 Defense Appropriations Act. The McConnell Amendment to the Consolidated Appropriations Act for FY2008 included an additional $70 billion in emergency funding for wars in Iraq and Afghanistan.[13]

Congressional Budget Resolutions. On March 16, 2007, the Senate Budget Committee (SBC) reported the Senate budget resolution (S.Con.Res. 21). This resolution specified expenditures and revenues that would yield a FY2008 deficit estimated at $249 billion, $10 billion more than the estimated deficit for the President's proposal.[14] The budget resolution was projected to yield a $132 billion surplus in FY2012. Revenue and outlay levels proposed in the Senate budget resolution differed substantially in some areas from those proposed by the President. In particular, the Senate proposed higher levels of discretionary spending than the President. Yet the resolution would extend tax cuts slated to expire, so long as the revenues lost by their continuation were offset. The FY2008 totals in both the SBC-reported resolution and versions passed by the Senate on March 23 were almost identical, although the amendments adopted by the Senate during its deliberations on the budget resolution reduced the expected FY2012 surplus to $1 billion.

The House Budget resolution (H.Con.Res. 99), reported by the House Budget Committee and passed by the House, was expected to yield a FY2008 deficit of $213 billion and a FY2012 surplus of $153 billion. Like the Senate resolution, the House resolution required offsets to extend the expiring tax cuts.

Projections of a Federal Surplus in FY2012. All of the proposals, the President's, the House, and the Senate, foresee a balanced budget in FY2012, although those forecasts are based on some assumptions that inspire skepticism among independent analysts.[15] The Administration, the House, and the Senate all assume for budgetary scoring purposes that funding for military operations after FY2008 will be minimal or nonexistent. Outlays would be much higher were these war costs included in projections. These proposals also all assume a sharply larger portion of middle-income taxpayers will become subject to the Alternative Minimum Tax (AMT) after FY2008, even though in recent years Congress and the President have agreed to annual fixes to limit the AMT's reach. Assuming that AMT fixes will no longer continue boosts estimated tax revenues. The President's budget assumes little or no growth in discretionary spending over the five years, while historically, discretionary outlays have been more likely to grow at the same rate as the overall economy. The House and Senate budget resolutions assume that the 2001 and 2003

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[13] For additional details regarding the Consolidated Appropriations Act for FY2008, see CRS Report RL34298, *Consolidated Appropriations Act for FY2008: Brief Overview*, by Robert Keith.

[14] The House and Senate Budget Committees generally use CBO budget baseline estimates and economic assumptions in creating the annual budget resolution.

[15] For a detailed independent analysis of the current budget outlook, see Alan Auerbach, Jason Furman, and William Gale, "Still Crazy After All These Years: Understanding the Budget Outlook," working paper, April 27, 2007, available at [http://www.econ.berkeley.edu/~auerbach/AFG%20paper.pdf].

tax cuts will expire unless the cost of extending them is offset through other revenue gains or spending reductions. This provides a large jump in tax revenues after 2010.

Issues Regarding Budget Projections

Budget projections are inherently uncertain. Two measures of the quality of economic forecasts are *statistical unbiasedness*, meaning that average forecast errors over time are close to zero, and *accuracy*, meaning that forecast errors should be small.[16] Budget forecasts, unlike most other types of economic forecasts, are constructed in order to estimate the incremental costs of policy changes (i.e., scoring) in a consistent manner. If policy changes do occur, actual budget outcomes will then differ from baseline estimates. Technical factors and changes in economic conditions also affect budget forecasts. In recent years, OMB and CBO have provided some measures of the accuracy and statistical unbiasedness of their forecasts.

Budget projections depend on models that reflect assumptions about the structure of the economy, expected tax and program changes, and how these interact, along with other factors that affect the budget. Changed economic conditions, such as faster or slower economic growth, higher or lower inflation, or changes in spending and tax policies, affect budget estimates and projections. In addition, technical components of the budget models may change as the structure of the economy evolves and as econometric techniques advance.

Budget estimates depend in part on some stable trends, such as population demographics. For instance, many baby boomers will retire in the next decade, leading to higher spending for Medicare and Social Security. Estimating the growth in these beneficiary populations eligible for these programs is relatively straightforward. Budget estimates also depend on factors that are difficult to predict, such as future productivity growth and business cycles. Some factors that affect the federal revenues, such as financial market trends, can be extremely volatile.

Small changes in economic conditions, such as GDP growth, can produce large changes in the budget estimates. According to CBO estimates, a persistent 0.1% decrease in the real GDP growth rate would increase the deficit, including interest costs, by $61 billion cumulatively over a five-year period and by $273 billion over 10 years. Faster GDP growth would decrease the deficit or increase a surplus. In addition, new government policies also affect budget estimates. For example, extending military operations in Iraq or Afghanistan or allowing tax cuts to lapse would also change the budget outlook.

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[16] There may be a tradeoff between statistical unbiasedness and accuracy because some statistically biased methods may generate forecasts with greater accuracy. Also, other properties of forecasts may be important, such as predicting turning points in economic trends. For a nontechnical discussion of economic forecasting, see Peter Kennedy, *A Guide to Econometrics*, 3rd ed., Boston: MIT Press, 1992, ch. 17, pp. 268-277.

Accuracy and Statistical Bias in Budget Forecasts

The President's FY2008 budget includes some measures of the accuracy and statistical bias of previous forecasts.[17] This analysis examines why Administration February 2005 budget estimates differed from actual results for FY2006.

The accuracy of forecasts generally declines as the forecast window extends to later years because more policy and economic changes can occur in the interim.[18] OMB analyzed a quarter century of February budget estimates of the deficit, and estimated the standard deviation for the current fiscal year was $71 billion. The standard deviation for the corresponding five-years-ahead forecast was estimated at $289 billion, about four times larger. OMB then computed upper and lower bounds for deficit projections using those standard deviations.[19] The gap between these upper and lower bounds at the end of a five-year period was over $1.1 trillion, suggesting that the Administration's $61 billion point estimate for the FY2012 surplus, like all five-years-ahead forecasts of fiscal balance, is very imprecise.

CBO has analyzed the track record of its budget estimates extensively, and now routinely includes information about the forecast accuracy of its baseline projections in its budget publications.[20] CBO also provides detailed explanations of why its projections differ from OMB projections.[21]

Budget Action

The Senate Budget Committee (SBC) reported its version of the FY2008 budget resolution (S.Con.Res. 21) on March 16, 2007. The Senate began its debate on the resolution on March 21 and after adopting some amendments and rejecting others, passed it on March 23. The House Budget Committee (HBC) reported (H.Rept. 110-99) its version of the FY2008 budget resolution on March 23. The House debated the resolution, rejecting three amendments, and passed it on March 29. The general direction outlined in the two resolutions is similar — additional domestic spending and accommodating the Administration's war funding request. Both resolutions

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[17] *Budget of the U.S. Government: Analytical Perspectives*, ch. 20,"Comparison of Actual to Estimated Totals," available at [http://www.whitehouse.gov/omb/budget/fy2008/pdf/apers/dimensions.pdf].

[18] A standard deviation measures the average size of forecast errors. See *Budget of the U.S. Government: Analytical Perspectives*, p. 336.

[19] The upper and lower bounds were computed assuming that forecast errors for different years are statistically independent and are normally distributed. If those assumptions are valid, 90% of forecasts should fall within those bounds on average.

[20] CBO, "*The Uncertainty of Budget Projections: A Discussion of Data and Methods*," March 2006.

[21] CBO, "*Comparing Budget and Accounting Measures of the Federal Government's Fiscal Condition*," December 2006.

would put into place rules requiring offsets to new tax cuts or mandatory spending increases to keep the changes deficit neutral.

After lengthy informal discussions about the FY2008 budget resolution, both the House and Senate appointed conferees in early May to resolve the remaining differences between the House and Senate versions. The conference announced an agreement on May 16, which the House and Senate adopted (H.Rept. 110-153) on May 17, 2007. The conference agreement set FY2008 discretionary spending at $954 billion, which was more than $20 billion above the President's non-emergency discretionary spending request.

The adoption of the conference report on the budget resolution for FY2008 set the level of discretionary spending and was followed by the Appropriations Committees work to draft the FY2008 appropriations bills. The House Appropriations Committee cleared its first (of 12) regular appropriations bills in early June with the Senate Appropriations Committee following in mid-June. By mid-July, the House and Senate Committees on Appropriations had approved most of the 12 regular appropriations bills.

At the end of FY2007, the House had passed all 12 appropriations bills and the Senate had passed four. The Senate passed three more appropriations bills in October. On November 8, Congress approved the Labor-HHS-Education bill (H.R. 3043, S. 1710), which the President vetoed, and Defense bill (H.R. 3222), which the President signed. The President has indicated that he would veto most of the remaining appropriations bills due to policy disagreements and spending levels.

During the last week of FY2007, Congress passed a continuing resolution (H.J. Res 52) to fund government operations until November 16, which the President signed on September 29 (P.L. 110-92). On November 8, Congress approved the Labor-HHS-Education bill (H.R. 3043, S. 1710), which the President vetoed, and the Defense bill (H.R. 3222, P.L. 110-116), which he signed. The Defense Appropriations Act of 2008 contained an extension of funding for government operations from November 16 until December 14. On December 14, Congress passed another continuing resolution (H.J.Res. 69) that extended funding for another week, which the President signed (P.L. 110-137) on the same day.

On December 19, Congress passed an omnibus appropriations bill (H.R. 2764) that incorporated 10 remaining regular appropriations bills into the State-Foreign Operations appropriations bill. On the same day Congress also passed a fourth continuing resolution (H.J.Res. 72), which the President signed two days later (P.L. 110-149), that funded government operations through the end of the calendar year. The President signed the Consolidated Appropriations Act of FY2008 (P.L. 110-161) on December 26, which provided $555 billion in discretionary budget authority.[22]

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[22] For details, see CRS Report RL34298, *Consolidated Appropriations Act for FY2008: Brief Overview*, by Robert Keith.

Outlays

The Administration's budget proposed FY2008 outlays of $2,902 billion, about $84 billion above the CBO baseline. Both the Administration and CBO have issued projections of future federal outlays. In addition, the budget resolutions passed by House and Senate Budget Committees, which reflect Congress's priorities, specify future paths for spending and revenues. **Table 3** summarizes these projections.

Administration Projections

The Administration's FY2008 budget proposed $2,902 billion in outlays, 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, hold most non-defense, non-homeland security discretionary spending to an average 1% annual increase, and slow the growth in some mandatory programs slightly, including Medicare and Medicaid. Total mandatory spending, however, would increase under the proposals. In FY2012, the Administration would raise spending by nearly $30 billion to fund personal accounts for Social Security. [23] The Administration's proposals, if 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% between FY2007 and FY2012.

Table 3. 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 FY08 Budget, 2/07		2,784	2,902	2,985	3,049	3,157	3,246	—
President's FY08 CSB, 2/07		2,735	2,752	2,866	2,973	3,116	3,201	—
SBC, Budget Res. 3/16/07		2,750	2,927	3,041	3,088	3,198	3,229	—
CBO Est. of Pres. Budget 3/21/07		2,747	2,905	3,002	3,046	3,156	3,205	4,094
CBO Baseline, Revised 3/21/07		2,719	2,833	2,944	3,058	3,202	3,250	4,067
Senate Budget Res. 3/23/07		2,745	2,927	3,041	3,093	3,201	3,234	—
House Budget Res. 3/29/07		2,751	2,933	3,051	3,106	3,217	3,252	—
Conf. Agreement S.Con.Res. 21		2,752	2,937	3,052	3,106	3,218	3,255	—
Mid-Session Review 7/11/07		2,779	2,918	3,016	3,078	3,184	3,267	—
CBO Budget & Econ. Update 8/23/07		2,735	2,925	3,071	3,205	3,359	3,415	4,268
Treasury, FY07 Budget Results, 10/07		2,731						

Source: CRS.
a. Actual outlays for FY2006.
CSB — The Administration's current services baseline.
SBC — Senate Budget Committee.

[23] OMB, *Mid-Session Review*, July 11, 2007, Table S-5, p. 26.

The proposed level of outlays, $2,902 billion, exceeds the Administration's FY2008 current services baseline ($2,752 billion) by $150 billion (5.5%).[24] For FY2008, almost all of the increase comes from the Administration's proposed additional funding for the Administration-labeled security activities, which comprise 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 an $8 billion increase (1.8%) for non-security discretionary spending and a $10 billion (0.7%) reduction in mandatory spending compared to baseline levels. The Administration's budget shows a $7 billion (2.8%) increase in net interest payments from baseline levels in FY2008 due to increased federal borrowing.

The overall $118 billion increase in outlays from FY2007 to FY2008 is due to many factors, including automatic cost-of-living adjustments in many federal programs, growth in populations eligible for program benefits, policy changes, and higher costs due to inflation of goods and services bought by the federal government.

The Administration's proposals would reduce outlays from 20.2% of GDP in FY2007 to 20.0% of GDP in FY2008. Between FY1966 and FY2006, outlays averaged 20.6% of GDP. By FY2012, the Administration's projections showed outlays falling to 18.3% of GDP, lower than in any year since FY1960. The Administration projected a fall of 0.7% of GDP in non-defense discretionary spending over the five years. Defense spending was projected to fall 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 are expected by the Administration to grow slightly as percentages of GDP, despite proposals to trim their growth.

The President's budget would increase defense spending by 6.0% from FY2007 ($569 billion) to FY2008 ($603 billion), incorporating the two-year, $140 billion requested supplemental for military actions overseas (which Congress passed and became law on May 25, 2007; P.L.110-28). By FY2012, according to Administration projections, defense spending will drop to $546 billion.

For FY2008, the Administration's proposed level of non-defense discretionary spending exceeds the current services baseline estimate by $19 billion. 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 showed non-defense discretionary spending falling from $511 billion in FY2007 and FY2008 to $493 billion in FY2012. As shares of GDP, the fall is 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

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[24] OMB's 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.

levels are achieved, non-defense discretionary spending would be smaller as a percentage of GDP in FY2012 than in any year since FY1962. How the Administration planned to achieve these reductions was largely unspecified.

Mandatory spending in the President's budget grows by 4.2% ($62 billion) from FY2007 to FY2008. The budget included 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 from baseline levels over the five years by almost $60 billion. By comparison, mandatory spending over the same period is projected to total $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 showed net interest outlays rising by $22.1 billion from FY2007 to FY2008. Federal debt has grown rapidly in recent years, and under the Administration's proposals, will continue to grow. Higher debt, absent sharp drops in interest rates, requires higher net interest payments. Proposed net interest outlays in FY2008 exceed the Administration's FY2008 current services baseline estimate by $7.8 billion. The Administration's policy proposals would raise FY2012 net interest outlays almost $30 billion above its current services net interest outlay estimate. According to Administration estimates, net interest payments as a percentage of GDP will show little change throughout the five years, ranging between 1.6% of GDP and 1.8% of GDP.

CBO Current-Law Baseline Projections

CBO's August 2007 baseline projections for FY2007-FY2017 showed outlays rising from 19.9% of GDP in FY2007 to 20.8% of GDP in FY2008, before easing back to 20.0% of GDP in FY2012. The baseline projections put FY2017 outlays at 20.3% of GDP. Because CBO current-law baseline estimates assume that discretionary spending does not change in real terms as the economy grows, many analysts believe it understates likely future growth in discretionary spending. According to CBO projections, federal outlays would grow by an additional $1.55 trillion over the FY2008-FY2017 period were discretionary spending to grow at the same rate as the economy. On the other hand, if discretionary spending were fixed at FY2007 levels over the same period, federal outlays would drop by $1.65 trillion.

Defense spending, according to CBO baseline estimates, will rise from $547 billion in FY2007 to $599 billion in FY2008. The level of FY2007 defense outlays, which serves as the starting point for baseline projections, includes regular and supplemental funding.[25] CBO's baseline assumptions, in which total discretionary

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[25] The addition of supplemental defense and other appropriations since the March 2007 CBO baseline projections cause an increase of over a trillion dollars in projected discretionary spending over the FY2008-FY2017 period. See CBO, *The Budget and Economic Outlook:*

(continued...)

spending increases at the rate of inflation, show defense spending rising to $684 billion in FY2012 and to $773 billion in FY2017. Defense spending as a percentage of GDP is projected to fall gradually over the 10-year period. CBO's baseline puts defense spending at 4.0% of GDP in FY2007 and 4.2% of GDP in FY2008. It would then fall to 3.9% of GDP in FY2012 and to 3.6% of GDP in FY2017. Alternative scenarios, in which troops would be withdrawn from Iraq and Afghanistan, show lower spending trajectories. CBO projects that withdrawing all but 30,000 troops deployed to Iraq, Afghanistan, and related operations by 2010 would reduce projected discretionary spending and interest costs by about $1.25 trillion over the period FY2008-FY2017. A less drastic reduction, withdrawing all but 75,000 troops deployed to Iraq, Afghanistan, and related operations by 2013, would, according to CBO projections, save about $750 billion in projected discretionary spending and interest costs over the period FY2008-FY2017.

CBO projects non-defense discretionary spending will rise from $495 billion in FY2007 to $521 billion in FY2008, to a projected $555 billion in FY2012, and to $619 billion in FY2017. Non-defense discretionary spending as a percentage of GDP, according to CBO baseline projections, will fall from 3.6% of GDP in FY2007 to 3.2% of GDP in FY2012, and to 2.9% of GDP in FY2017. Because current-law baseline projections are based on the assumption that discretionary spending does not grow in real terms while the economy is projected to continue growing, both the CBO and Administration projections show discretionary spending's relative size shrinking over time.[26]

The CBO mandatory spending baseline projects an increase from $1,457 billion in FY2007 to $1,553 billion in FY2008. Mandatory spending, according to CBO projections, will increase to $1,883 billion by FY2012 and to $2,598 billion by FY2017. Mandatory spending as a share of GDP, according to CBO baseline projections, will remain little changed, moving from 10.6% in FY2007 to 10.8% in FY2012. At the end of the 10-year time frame, CBO projections show mandatory spending reaching 12.1% of GDP in FY2017.

CBO's August 2007 baseline estimates show net interest growing from $235 billion in FY2007 to $253 billion in FY2008, an increase of $18 billion. The CBO baseline projections foresee smaller deficits in later years, which would slow the federal debt's growth. Projected surpluses in FY2012 and after would reduce federal debt, thus lowering net interest payments. Projected net interest payments peak at $292 billion in FY2012, then ease back to $278 billion in FY2017. Net interest as a share of GDP, according to August 2007 CBO projections, will hold nearly steady around 1.7% until FY2012, before falling gradually to 1.3% of GDP in FY2017.

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[25] (...continued)
An Update, August 2007, p. 14.

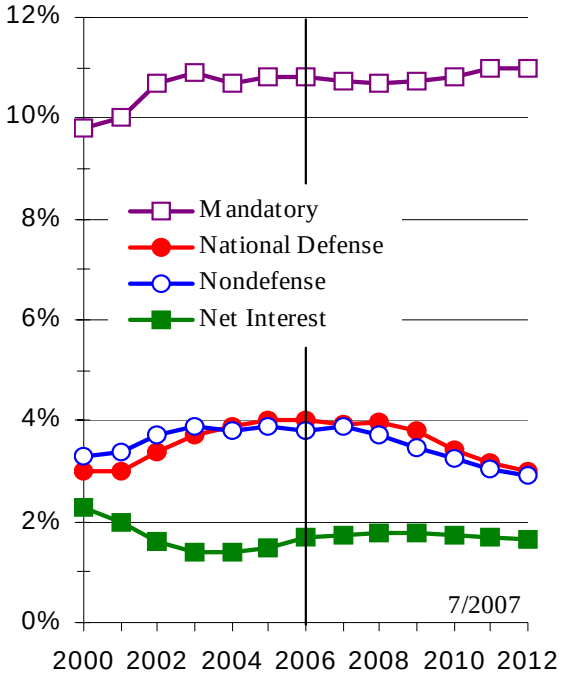
[26] CBO and OMB baselines use different methods to project discretionary spending. In particular, OMB does not extend all discretionary spending. In addition, war expenditures are treated differently by CBO and OMB. For details, see CBO, *The Budget and Economic Outlook: An Update*, August 2007, Box B-1.

Federal Outlays and Congressional Resolutions

The Senate Budget Committee's FY2008 budget resolution (S.Con.Res. 21; March 16) proposed outlays of $2,927 billion for FY2008, which would rise to $3,229 billion in FY2012. This amount included defense funding matching the President's request for FY2008, although the level of domestic spending exceeded the amount the Administration proposed. On March 23, the Senate passed the resolution with several amendments. Outlays over the five years, however, were close to the committee's version. The House Budget Committee reported its version of the FY2008 budget resolution (H.Con.Res. 99) on March 23. The House passed the resolution with no changes on March 29. The resolution would provide $2,933 billion in outlays in FY2008, rising to $3,252 billion in FY2012.

The May 17, 2007, conference agreement included $2,937 billion in FY2008 outlays, including money the President requested for the ongoing military operations overseas. Projected outlays rise to $3,255 billion in FY2012.

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



Trends in Outlays by Category of Spending

Figure 1 shows spending by category as percentages of GDP from the Administration's July 2007 *Mid-Session Review*. These data differ little from those in the President's February 2007 budget.

The figure shows actual outlays for defense, non-defense, mandatory, and net interest spending from FY2000 through FY2006 and the Administration's proposals from FY2007 though FY2012. According to those proposals, defense and non-defense spending as a share of GDP will decline over the five-year period FY2007-FY2012, while mandatory spending is projected to increase.

The downturn in defense and non-defense discretionary spending relative to GDP after FY2008 depends on the Administration's assumptions that non-defense discretionary spending falls after 2007 and that no additional spending is provided for the ongoing military operations overseas after FY2008 beyond the Administration's FY2009 $50 billion "placeholder."

The President's proposed limited reductions in mandatory spending from current service baseline levels keep mandatory spending as a share of GDP stable. The

FY2012 introduction of private Social Security accounts proposed by the President would lift mandatory spending relative to GDP above the current services level.

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

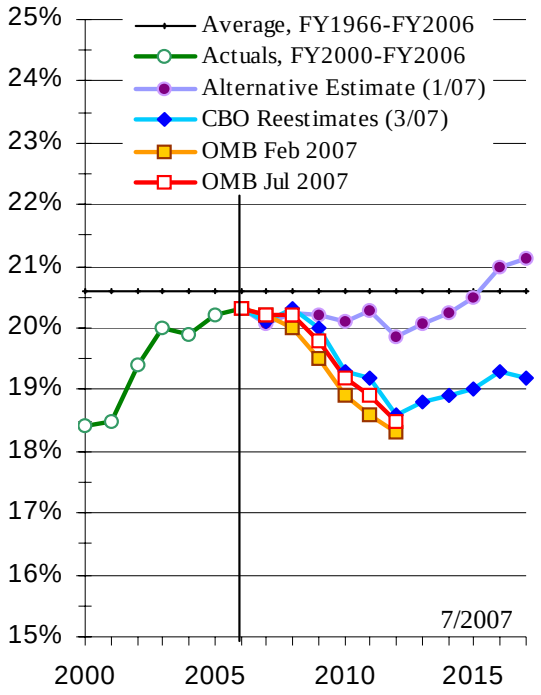


Figure 2 shows four alternative paths for outlays as a percentage of GDP through FY2017:

- the President's FY2008 budget proposal (February 2007),
- the President's revised proposal (*Mid-Session Review*, July 2007),
- an alternative outlook derived from CBO data (March 2007), and
- the March 2007 CBO reestimate of the President's original FY2008 proposals.

The Administration's outlook runs through FY2012, while the CBO outlook runs through FY2017. The figure includes actual outlays as a percentage of GDP for FY2000 through FY2006 and average (FY1966-FY2006) outlays as a share of GDP.

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 to moderate the rate of growth in some mandatory programs. By FY2012, spending would be just below its level as a percentage of GDP in FY2000. Outlays in the *Mid-Session Review* (MSR) are all slightly above those in the February budget, a difference mostly due to reestimation rather than policy changes.

The alternative estimate, based on CBO-estimated policy alternatives to the current-law baseline, incorporates two important assumptions that directly affect outlays. First, discretionary appropriations grow at the same rate as the overall economy, in contrast to the baseline assumption that discretionary spending is constant in real terms. Second, the number of troops deployed in Iraq and Afghanistan as well as other anti-terror activities is assumed to fall to 75,000 by FY2013. Both of these assumptions increase outlays above the baseline projections, increasing the deficit (or reducing a possible future surplus), increasing federal debt and subsequent net interest payments. The alternative estimate includes these higher net interest payments. In addition, the alternative estimate for outlays includes the outlay effects of the changes that occur in the alternative estimate for receipts, which is described in more detail in the next section. These outlay effects, for the most part,

reflect higher net interest payments. According to the alternative estimate, outlays as a percentage of GDP grow over the 10 years, rising to 21.1% of GDP in FY2017.

Receipts

The future path of federal receipts, as projected by the Administration and CBO, is summarized in **Table 4**. Because economic conditions strongly affect federal revenue streams, forecasts of federal receipts beyond the immediate short term are necessarily imprecise.

Table 4. 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 FY08 Budget, 2/07		2,540	2,662	2,798	2,955	3,104	3,307	—
President's FY08 CSB 2/07		2,550	2,714	2,831	3,008	3,151	3,348	—
SBC, Budget Res. 3/16/07		2,538	2,678	2,826	2,959	3,183	3,361	—
CBO Est. of Pres. Budget 3/21/07		2,533	2,679	2,787	2,877	3,007	3,174	4,084
CBO Baseline, Revised 3/21/07		2,542	2,720	2,810	2,901	3,167	3,405	4,284
Senate Budget Res. 3/23/07		2,538	2,678	2,825	2,959	3,130	3,235	—
House Budget Res. 3/29/07		2,542	2,720	2,810	2,901	3,167	3,405	—
Conf. Agreement, S.Con.Res. 21 5/17/07		2,538	2,685	2,817	2,907	3,123	3,296	—
Mid-Session Review 7/11/07		2,574	2,659	2,803	2,954	3,095	3,300	—
CBO Budget & Econ. Update 8/23/07		2,577	2,771	2,855	2,950	3,225	3,477	4,378
Treasury, FY07 Budget Results, 10/07		2,568						

Source: CRS.
a. Actual receipts for FY2006.
CSB — The Administration's current services baseline.
SBC — Senate Budget Committee.

The last few fiscal years have seen unexpectedly rapid growth in receipts (in current dollars) from year to year that neither OMB nor CBO expect to continue. Receipts grew by 5.5% from FY2003 to FY2004, by 14.5% from FY2004 to FY2005, and by 11.8% from FY2005 to FY2006. These increases followed three years of falling receipts, from FY2000 through FY2003. Receipts rose from 16.3% of GDP in FY2004, the lowest level for receipts since FY1959, to 18.4% of GDP in FY2006. OMB's MSR showed little variation in receipts as a share of GDP over the five-year window FY2008-FY2012, ranging between 18.4% of GDP (FY2008) and 18.7% of GDP (FY2012). CBO's baseline showed receipts rising once the 2001 and 2003 tax cuts expire, reaching 19.8% of GDP in FY2012.

Administration Revenue Projections

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

and FY2012. Receipts as a percentage of GDP fall from 18.5% in FY2007 to 18.3% in FY2008 and then remain stable through FY2011. By FY2012 receipts rise to 18.6% of GDP, when the Administration predicts an upward bump in individual and corporate income taxes.

The Administration estimated that making the 2001 and 2003 tax cuts permanent would reduce cumulative receipts by $374 billion from baseline levels 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.[27] The budget included proposed relief from the expanding coverage of the Alternative Minimum Tax (AMT) through FY2008 (at an estimated cost of $48 billion in that year), but not in subsequent years.

Figure 3 shows receipts from the President's July 2007 *Mid-Session Review* by type for FY2007 through FY2012. These estimates are very close to those in the February budget documents. Actual receipts as a percentage of GDP are shown for FY2000 through FY2006.

Excise and other receipts were both less than 1% of GDP for all years 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 stable 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 about 1% of GDP below their FY2000 level.

The Administration's proposals included extending the current relief from the alternative minimum tax (AMT) for FY2007 and FY2008. A growing proportion of middle-class taxpayers will be subject to the AMT unless a sequence of temporary AMT fixes or a permanent change in the structure of the AMT is enacted.[28] The FY2008 budget estimated that temporary AMT "fixes" would cost $9.1 billion in FY2007 and $47.9 billion in FY2008. CBO estimated that indexing AMT thresholds for inflation would cost on average about $55 billion a year over the next 10 years. Although the President's budget called for limiting the growing reach of the AMT, it omitted estimates of the five-year cost of such a fix. Omitting these estimates, in effect, increases the Administration's post-FY2008 estimates of federal receipts by $50 billion to $60 billion a year above what they would be with an AMT fix.[29]

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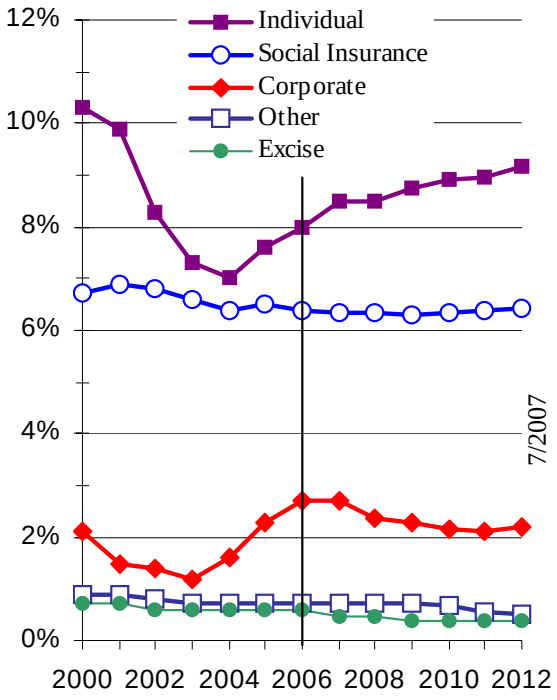
[27] The proposed reductions do not reduce receipts from current levels over time. See **Table 4.**

[28] 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 In The 109th*, both by Gregg A. Esenwein.

[29] See CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back" Effects*, by Gregg A. Esenwein.

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



As shares of GDP, total receipts in the President's budget are expected to remain near their 40-year (FY1966-FY2006) average of 18.3% throughout the five years forecasted. CBO's baseline revenue estimates (revised, March 2007), which exclude the extension of the 2001 and 2003 tax cuts, are larger, rising to over 19.8% of GDP in FY2012 and to 20.1% of GDP in FY2017.

CBO Revenue Projections

CBO's January 2007 budget report estimated that extending the expiring provisions of the major tax cuts passed in 2001 and 2003 would reduce revenues from CBO baseline levels 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, again 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.[30] CBO estimated that limiting the expanding coverage of the AMT alone would reduce revenues by $280 billion over five years and by $570 billion over 10 years excluding additional interest costs.

CBO's March 2007 budget report, which analyzed the President's FY2008 policy proposals, projected slightly lower revenues than the President's budget in all but one (FY2008) of the five years in the budget. Differences in economic assumptions underlying the Administration and CBO estimates produced most of the revenue differences, particularly in the last three years. Technical components of the estimates balanced the effect of economic changes in the first two years of the estimates, producing only small changes in the revenue estimates.

CBO's estimates of the President's revenue policy proposals were cumulatively $479 billion smaller than CBO's cumulative revenue baseline estimates over five years.[31] The President's budget projected cumulative revenues of $14,826 billion

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[30] 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, available at [http://www.cbo.gov/showdoc.cfm?index=7731&sequence=0].

[31] CBO's reestimates allow a comparison of the CBO baseline and the Administration proposals because both are derived from the same underlying economic and budget

(continued...)

over the five years, and CBO's reestimates put cumulative revenues at $14,524 billion, 2% less. CBO's March report presented revised revenue baseline estimates that differed only slightly from CBO's January estimates.

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.[32] AMT reform would interact with the extension of the 2001 and 2003 tax cuts, producing greater revenue losses than the two changes separately.

These policy assumptions show receipts falling as a percentage of GDP to approximately 17.5% by FY2012, where they remain through FY2017. CBO estimates that the alternative revenue assumptions would produce $70 billion less revenue in FY2008 than the baseline. By FY2012, the alternative revenue projection falls $389 billion short of baseline revenues and in FY2017, the alternative lies $560 billion below the baseline projection (all in current dollars).

Federal Revenues and Congressional Resolutions

The House and Senate budget resolutions do not incorporate extending expiring tax provisions without offsetting their cost. The instructions in the budget resolutions by the House and Senate, although different, generally require that revenue changes need offsets, either revenue increases or mandatory spending reductions, to keep the deficit from growing or a surplus from falling. The conference agreement (H.Rept. 110-153; May 17) included the ability to extend some of the expiring tax cuts, if certain conditions are met, and to offset revenue losses relative to baseline levels.

Revenue Projections in Historical Perspective

Figure 4 shows the level of historical and projected federal receipts as a percentage of GDP. Actual receipts are shown for FY2000 through FY2006. Projections are shown for CBO's January and March 2007 budget reports and for the President's February 2007 budget submission for FY2008 and the July *Mid-Session Review* (MSR). Federal receipts averaged 18.3% of GDP over the 41-year period FY1966-FY2006. This level is depicted by a horizontal line.

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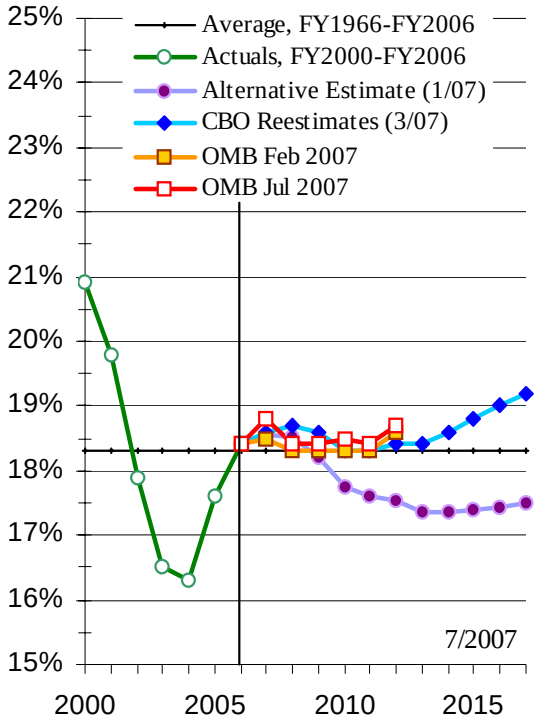
[31] (...continued)
estimating assumptions — only the policy assumptions differ.

[32] CBO analysis of alternative policies includes an estimate of this joint effect.

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



The four estimates shown remain fairly close through FY2009, and three remain close through FY2010. CBO's revenue reestimate and the President's revenue estimates are similar through FY2012. CBO's reestimate extends through FY2017, with receipts rising to slightly above 19% of GDP in FY2017.

The Administration's revenue estimates, in both the February budget and the July MSR, show little variation over the five years covered, with a slight rise in the last year. Over the five years, OMB's MSR projects slightly larger receipts than the February budget. Both of the OMB sets of estimates assume the tax cuts are extended and that an adjustment to the AMT expansion occurs only through FY2008.

The alternative projection, based on CBO data from its January budget report, which assumes the tax cuts are extended and that the expanding coverage of the AMT is limited, shows receipts falling as a share of GDP after FY2008 and remaining fairly constant after FY2011.

Deficits and Surpluses

Deficits occur when Congress and the President enact policies that cause federal spending to exceed federal receipts. Deficits increase government debt held by the public, generally increasing net interest payments. Surpluses occur when federal receipts exceed outlays, which reduces federal debt held by the public.[33] This can, in turn, reduce net interest payments. Many economists believe that running surpluses when economic growth is strong has desirable macroeconomic effects. The federal government last ran a surplus in FY2001, which amounted to $128 billion or 1.3% of GDP. **Table 5** summarizes Administration and CBO projections of federal deficits and surpluses.

The actual FY2007 total deficit, $163 billion, was slightly below CBO's January estimate, and well below the Administration's estimate in the FY2008 budget. The FY2007 on-budget deficit, which excludes a large Social Security surplus and a small Postal Service surplus, was $344 billion.

[33] Very small surpluses might not reduce debt held by the public in some circumstances.

Table 5. 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 FY08 Budget, 2/07		-244	-239	-187	-94	-54	61	—
President's FY08 CSB 2/07		-185	-38	-35	34	35	147	—
SBC, Budget Res. 3/16/07		-212	-249	-215	-129	-14	132	—
CBO Est. of Pres. Budget 3/21/07		-214	-226	-215	-169	-149	-31	-10
CBO Baseline, Revised 3/21/07		-177	-113	-134	-157	-35	155	217
Senate Budget Res. 3/23/07		-212	-249	-216	-134	-71	1	—
House Budget Res. 3/29/07		-209	-213	-241	-205	-50	153	—
Conf. Agreement, S.Con.Res. 21 5/17/07		-214	-252	-235	-199	-95	41	—
Mid-Session Review 7/11/07		-205	-258	-213	-123	-89	33	—
CBO Budget & Econ. Update 8/23/07		-158	-155	-215	-255	-134	62	109
Treasury, FY07 Budget Results, 10/07		-163						

Source: CRS.
a. Actual FY2006 deficit.
CSB — The Administration's current services baseline.
SBC — Senate Budget Committee.

Administration Deficit Projections

The President's February budget proposed a deficit of $239 billion for FY2008, and a small surplus ($61 billion) in FY2012 (-1.6% of GDP and 0.3% of GDP respectively). The Administration's current service baseline estimates, which assume no policy changes, showed surpluses appearing in FY2010, two years earlier than the budget reaches a surplus.

The five-year deficit outlook in the Administration's July 2007 *Mid-Session Review* differed minimally from that put forth in the February budget. The FY2007 deficit fell slightly while the FY2008 deficit grew slightly compared to the estimates in the President's FY2008 budget. The MSR deficit estimates in subsequent years remain slightly larger than those in the original budget. The MSR shows the budget reaching a small surplus in FY2012, just 0.2% of GDP, marginally smaller than the Administration's original estimated surplus of 0.3% of GDP.

Reaching the budget's deficit reduction goals during the next five years, according to the Administration, requires strict limits on the growth in total discretionary spending and slower growth of entitlement spending. 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 opposed using tax increases to reduce the deficit.[34]

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

CBO Deficit Projections

According to CBO's January 2007 baseline estimates, the federal deficit is projected to fall, both in dollar terms and as a percentage of GDP, through FY2011. Surpluses are projected to appear from FY2012 through FY2017. CBO, by law, must use assumptions for baseline projections that some analysts consider optimistic. On the revenue side, the baseline assumes the lack of a fix to the expanding coverage of the AMT and, as required by current law, the expiration of the 2001 and 2003 tax cuts at the end of calendar year 2010. These would boost revenues considerably compared to restricting AMT expansion and extending the tax cuts. On the spending side, discretionary spending is assumed to grow at the rate of inflation, which is at a slower rate than it has grown recently, and mandatory spending grows with eligible populations and cost-of-living adjustments. Some projections using alternative assumptions show a less optimistic fiscal outlook than the path of shrinking deficits and future surpluses depicted by CBO baseline projections.

Substituting a selection of alternative scenarios for policy assumptions used in the January CBO baseline produces a growing deficit from FY2007 through FY2017. These selected alternative policies limit the growing coverage of the AMT, extend the 2001 and 2003 tax cuts, and increase discretionary spending at the rate of GDP growth (see the CBO-based alternative estimate in **Figure 5**). Under these alternative policies, the deficit would increase from an estimated 1.7% of GDP in FY2008 to 2.3% of GDP in FY2012, and to 3.6% of GDP in FY2017.

A March 2007 CBO analysis of the President's policies using CBO's economic and budget-estimating models put the FY2008 deficit at 1.6% of GDP, matching the Administration's February projection. CBO, however, projected larger deficits than the Administration for subsequent years. In FY2012, CBO projected a small deficit (0.3% of GDP), whereas the Administration projected a small surplus.

Deficits in Congressional Budget Legislation

The House- and Senate-passed budget resolutions included FY2008 deficits similar to the deficit in the President's budget (see **Table 5**). By FY2012, the Senate resolution had a surplus of slightly below $1 billion and the House resolution had a surplus of $153 billion. The difference between the surpluses in the two resolutions is due to different assumptions about future policy. The conference agreement on the budget resolution (S.Con.Res. 21; H.Rept. 110-153) had a deficit of $252 billion in FY2008, becoming a surplus of $41 billion in FY2012.

Figure 5 shows deficit or surplus estimates as shares of GDP for FY2007 through FY2017. The actual surpluses and deficits as shares of GDP are shown for FY2000 through FY2006.

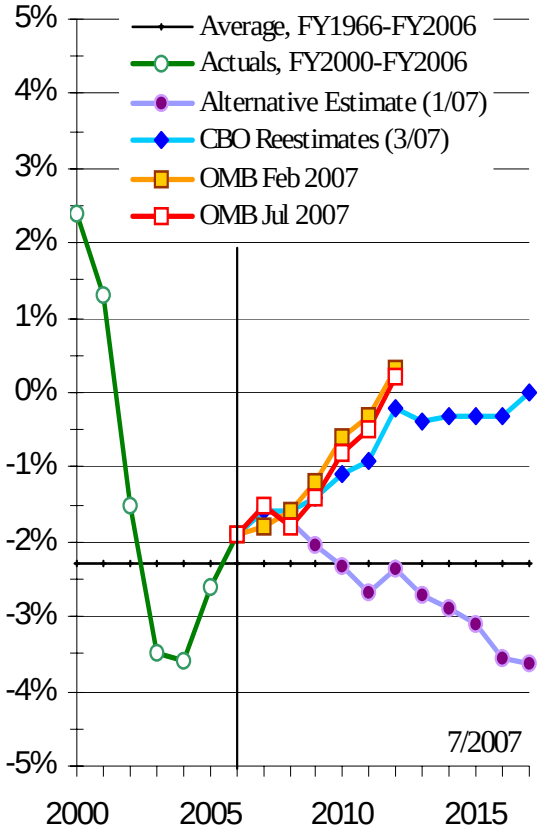
For the years through FY2017, the data are taken from the estimates and projections by CBO and OMB in their budget reports for FY2008. The 40-year (FY1966-FY2006) average deficit (2.3% of GDP) is also shown.

Comparing Projections of Federal Deficits and Surpluses

The President's policy proposals assumed additional spending for defense in FY2007 and FY2008, tight controls on domestic discretionary spending, a slight slowing in the growth of Medicare and Medicaid spending, no additional AMT relief after FY2008, and the creation of personal accounts for Social Security in FY2012.

The proposed defense budget, however, only includes a minimal "placeholder" in FY2009 for the costs of wars in Iraq and Afghanistan, and makes no assumptions about war funding in subsequent years. Administration projections show a rapid decline in the deficit as a share of GDP, with a slight surplus appearing in FY2012.

Figure 5. Deficits(-) or Surpluses, FY2000-FY2017
(percent of GDP)



CBO and OMB deficit projections are shown in **Figure 5**. OMB projections extend through FY2012, while CBO projections extend through FY2017. CBO baseline projections and OMB projections show an improving federal fiscal situation, with projected deficits falling in proportion to the economy.

On the other hand, a CBO projection based on alternative policy assumptions shows a steady deterioration in the federal government's fiscal conditions. Some prominent economists contend that these alternative assumptions provide a more realistic view of future fiscal trends.[35] The alternative CBO deficit projection grows rapidly from FY2012 through FY2017, when the deficit reaches 3.6% of GDP, the same level reached in FY2004. This line moves downward in **Figure 5**, depicting a fiscal outlook less optimistic than OMB and CBO baseline projections.

[35] See Alan Auerbach, Jason Furman, and William Gale, "Still Crazy After All These Years: Understanding the Budget Outlook," working paper, April 27, 2007, available at [http://www.econ.berkeley.edu/~auerbach/AFG%20paper.pdf].

The Longer Run

OMB, CBO, and 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, raises 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."[36]

Keeping future federal outlays at 20% of GDP, approximately its current share, and leaving fiscal policies unchanged, according to CBO projections, would require drastic reductions in all spending other than that for Medicare, Social Security, and Medicaid. A former CBO Acting Director stated that, "by 2030 ... spending for those programs [Medicare, Social Security, and Medicaid] 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" to keep overall spending close to 20% of GDP.[37]

A CBO report on the long-term fiscal outlook concluded that

> 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.... Attaining 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.[38]

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

> 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.[39]

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

[37] 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.

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

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

The Social Security, Medicare, and Medicaid programs present different challenges to the long-term fiscal position of the federal government. Estimates of the long-term fiscal gap between Social Security (OASDI) outlays and revenues as a proportion of long-term GDP are generally much smaller than estimates of long-term fiscal gap between Medicare (HI, Part B, and Part D) outlays and revenues.[40] These long-term estimates of fiscal imbalances are especially sensitive to changes in assumptions regarding productivity growth and interest rates. Some analysts willing to make more felicitous assumptions about productivity growth present a more optimistic long-term outlook for Social Security.[41]

Spending projections for Medicare and Medicaid are sensitive to changes in medical inflation. In past years, many projections that medical inflation would slow have turned out to be overly optimistic.[42]

Unexpected events, such as the hurricanes in 2005 or an economic downturn, can change the short-term budget outlook. The interplay of policy, demographics, and medical care costs, however, will in large part determine the long-term budget outlook. The retirement of the baby boom generation, which will rapidly expand the population eligible for federal programs serving the elderly, along with continuing increase in health care costs 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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[40] For a detailed discussion of long-term projections, see CRS Report RL33623, *Long-Term Measures of Fiscal Imbalance*, by D. Andrew Austin.

[41] Dean Baker, "Social Security Byte: Trustees Assumptions Still More Pessimistic Than CBO," Center for Economic and Policy Research, April 23, 2007. Available at [http://www.cepr.net/index.php?option=com_content&task=view&id=1139&Itemid=138].

[42] The 2004 Technical Review Panel on the Medicare Trustees Reports, "Review of the Assumptions and the Methods of the Medicare Trustees' Financial Projections," December 2004, contended that assuming medical costs per beneficiary will grow 1% a year faster than GDP was reasonable. Actual Medicare costs per beneficiary, however, have risen at a faster pace. See Table V.B1 from *2007 Annual Report of The Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*, available at [http://www.cms.hhs.gov/ReportsTrustFunds/downloads/tr2007.pdf].