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# CRS Report for Congress

## The Budget for Fiscal Year 2009

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# The Budget for Fiscal Year 2009

## Summary

On February 4, 2008, President Bush sent his fiscal year (FY) 2009 budget to Congress. The President's budget predicted a deficit of $407 billion for FY2008 and $410 billion for FY2009, up from $162 billion in FY2007 due to falling federal revenues and rising security expenditures. The Congressional Budget Office (CBO) estimates the FY2008 deficit would total $396 billion if the President's proposals are enacted, about $39 billion more than the current-law baseline. The projected FY2009 deficit under the President's proposals was $342 billion. Tax rebates and business investment incentives enacted in the Economic Stimulus Act of 2008 (P.L. 110-185), which passed in January, will push up the FY2008 deficit by an estimated $152 billion. The on-budget deficit, which excludes Social Security surpluses, for the President's budget proposals, would reach $592 billion in FY2008 and $525 billion in FY2009 according to CBO estimates.

The Administration foresees a steady improvement of the federal government's fiscal position, including a surplus of $29 billion in FY2013, the last year projected, although the FY2013 on-budget deficit is projected at $201 billion. These projections omit all costs of wars in Afghanistan and Iraq beyond FY2008 aside from a pending $70 billion supplemental request. Federal deficits are projected to rise rapidly after FY2020. Major Administration proposals include extending expiring tax cuts, limiting domestic discretionary spending, and halting the expanding reach of the Alternative Minimum Tax (AMT) for calendar 2008, but not for later years. Medicare and Medicaid were expected to grow more slowly than in recent years.

The FY2009 budget also discusses long-term fiscal problems. According to the longer-term projections from the Administration, 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.

March 2008 CBO current-law baseline projections, which incorporate costs of the Economic Stimulus Act, show a $357 billion deficit in FY2008, a $70 billion surplus in FY2013, and a $202 billion surplus in FY2018. CBO baseline projections assume that key tax cuts enacted in 2001 and 2003 (as well as some others) expire as scheduled, real discretionary spending is fixed, and the Alternative Minimum Tax is unchanged. CBO estimated the President's budget proposals would yield a $396 billion deficit in FY2008. The revised baseline projection of the FY2009 deficit was $207 billion, much smaller than the $342 billion FY2009 deficit that the President's budget had been projected to generate.

On March 7, 2008, the House and Senate Budget Committees introduced budget resolutions (S.Con.Res. 70 and H.Con.Res. 312). The House passed its budget resolution on March 13 by a 212 to 207 vote, and the Senate passed its version in the early hours of March 14 by a 51 to 44 vote. This report will be updated as legislative conditions warrant.

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# The Budget for Fiscal Year 2009

## Background and Analysis

The Bush Administration released *The Budget of the U.S. Government, Fiscal Year 2009* on February 4, 2008.[1] The full set of budget documents (*Budget, Appendix, Analytical Perspectives, Historical Tables*, as well as several other supplemental budget documents) contains 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.[2] The budget documents outline the Administration's policy proposals and expectations from FY2008 through FY2013. 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 Administration foresees a steady improvement of the federal government's fiscal position, including a surplus of $29 billion in FY2013, the last year projected, although the FY2013 on-budget deficit is projected at $201 billion. These projections omit all costs of wars in Afghanistan and Iraq beyond FY2008 aside from a pending $70 billion supplemental request. Federal deficits are projected to rise rapidly after FY2020. Major Administration proposals include extensions of the expiring tax cuts, limited increases in domestic discretionary spending, and halting the expanding reach of the Alternative Minimum Tax (AMT) for calendar 2008, but not for later years. Medicare and Medicaid were expected to grow more slowly than in recent years.

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.

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[1] 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.

[2] 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 5 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.

On March 7, 2008, the House and Senate Budget committees reported budget resolutions (S.Con.Res. 70 and H.Con.Res. 312). The House passed its budget resolution on March 13 by a 212 to 207 vote, and the Senate passed its version in the early hours of March 14 by a 51 to 44 vote. In each chamber, a large number of amendments were considered before adoption to budget resolutions. Both resolutions include a one-year Alternative Minimum Tax (AMT) fix.

## Budget Totals

**Table 1** contains budget estimates for FY2009 from CBO, the Administration (the Office of Management and Budget, OMB), and Congress (House and Senate Budget Committees). 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.

**Table 1. Budget Estimates and Proposals for FY2009**
(in billions of dollars)

| | Receipts | Outlays | Deficit (-) |
|---|---|---|---|
| CBO, BEO Baseline, 1/08 | 2,817 | 3,015 | -198 |
| OMB, FY08 Budget Proposals, 2/08 | 2,700 | 3,107 | -407 |
| OMB, Budget, CSB, 2/08 | 2,815 | 2,993 | -178 |
| CBO Analysis of FY09 Budget, 3/08[a] | 2,699 | 3,041 | -342 |
| CBO Rev. Baseline, 3/08[a] | 2,792 | 2,999 | -207 |
| HBC, 3/07/08 | 2,723 | 3,063 | -340 |
| SBC, 3/07/08 | 2,710 | 3,076 | -366 |

**Source:** OMB, CBO, HBC, SBC.
**Note:** Outlays minus receipts may not equal deficits due to rounding.
a. Letter to Sen. Byrd, Mar. 3, 2008.
BEO — *The Budget and Economic Outlook*, CBO.
CSB — The Administration's Current Services Baseline.
HBC — House Budget Committee
SBC — Senate Budget Committee

## Outlays and Budget Authority

Spending in **Table 1** is shown in terms of outlays, which are federal funds disbursed in a given time period. Many budget documents also report spending in amounts of budget authority, which reflects the amount of money federal agencies are legally allowed to spend. Budget authority has been compared to funds deposited into a checking account, which then can be used for federal purposes. Outlay data are more convenient for assessing the macroeconomic effects of the federal budgets, while analysts focusing on specific federal programs typically rely on budget authority figures. Appropriations legislation is generally framed in terms of budget authority, because Congress can control the amount of funds made available for

specific purposes. The timing of federal outlays, on the other hand, often depends on administrative decisions of federal program officials, made within bounds set by Congress. This report focuses on outlays, rather than budget authority, in order to highlight broader effects of the federal budget on the economy.

## Budget Estimates and Proposals

**CBO Baseline Projections.** CBO's first budget report for the FY2009 budget cycle, released in January 2008, contained current-law budget baseline and economic projections for FY2008 through FY2018.[3] This report projected a FY2009 current-law baseline deficit of $198 billion, up slightly from the FY2007 deficit of $162 billion. This projection, however, assumes that AMT relief will lapse and that FY2009 costs of wars in Iraq and Afghanistan will be a little less than costs in FY2008. That CBO baseline projection showed a surplus of $87 billion emerging in FY2012 that was expected to rise to $223 billion in FY2018.

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), currently slated to expire at the end of calendar year 2007, will in fact 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. Nonetheless, unless major policy changes are made, federal deficits are expected to grow rapidly beyond the 10-year forecast window, largely because of rapidly growing health care costs and the retirement of the baby boomers.

CBO's January report also included estimated budgetary effects of selected policies on revenues and outlays.[4] These include estimates of the costs of making the 2001 and 2003 tax cuts permanent and indexing the AMT for inflation to limit its expanding coverage. CBO also presented projections based on assumptions that differ from current-law baseline assumptions. One alternate projection assumed that discretionary appropriations increase at the rate of growth of gross domestic product (GDP), which leads to faster growth of outlays relative to the baseline, and another assumed that total discretionary appropriations would be frozen at FY2008 levels, which yields slower growth in outlays relative to the baseline.

Estimated cost savings for troop reductions are also reported: reducing troops deployed to Iraq, Afghanistan, and other Global War on Terror postings to 75,000 by

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[3] CBO, *The Budget and Economic Outlook: Fiscal Years 2008 to 2018*. Jan. 2008, available at [http://www.cbo.gov/ftpdocs/89xx/doc8917/01-23-2008_BudgetOutlook.pdf]. CBO calls totals for the current fiscal year "estimates" and calls totals for future years "projections."

[4] Ibid., Table 1-5.

FY2013 would reduce outlays (including borrowing costs) by $250 billion over the FY2009-FY2013 period relative to baseline levels.

In February 2008, CBO issued an update of its economic projections due to new evidence of slower economic activity, interest rate cuts and other actions taken by the Federal Reserve, and the economic stimulus package.[5] The revised estimates showed slightly faster economic growth in FY2008 due to fiscal stimulus measures, but slightly slower growth in FY2009, when those measures lapse. The cost of the economic stimulus package and slower economic growth imply increases in federal budget deficits in the short-run.

**CBO Analysis of the President's Budget.** At the beginning of March 2008, CBO published a preliminary analysis of the President's FY2009 Budget.[6] This estimate included the effects of the Economic Stimulus Act of 2008 (P.L. 110-185), projected to raise the FY2008 budget deficit by $152 billion and the FY2009 deficit by $16 billion. In addition, forecasts reflected lower interest rates, which helped increase projected economic growth rates and reduce borrowing costs. CBO estimates smaller short-run deficits than OMB, largely to lower estimates of defense costs. On the other hand, CBO projects slightly higher deficits in later years.

**Administration Projections and Proposals.** President Bush's FY2009 budget proposes a permanent extension of most of the 2001 EGTRRA and 2003 JGTRRA tax cuts, as well as extending other expiring tax provisions.[7] When borrowing costs are included, the President's proposals would raise the deficit by a projected $692 billion between FY2009 and FY2013 relative to the baseline, and by $2.7 trillion between FY2009 and FY2017, according to Administration estimates.[8]

The Administration's proposals, according to its own estimates, would reduce mandatory spending by $96 billion over 5 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 5-year savings of $59 billion and a 10-year *increase* in spending of $359 billion. The proposed introduction of personal Social Security accounts is responsible for most of that projected increase.

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[5] CBO, Letter to Sen. Kent Conrad, Chairman of the Senate Budget Committee, Feb. 15, 2008, available at [http://www.cbo.gov/ftpdocs/89xx/doc8979/EconForecast_ConradLetter.1.1.shtml]

[6] CBO, Letter to Sen. Robert Byrd, Mar. 3, 2008, available at [http://www.cbo.gov/ftpdocs/90xx/doc9015/03-03-Byrd_Letter.pdf].

[7] Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) and Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27).

[8] 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 effects of the Administration's proposals in this report are estimated by CBO.

The Administration's budget provided limited information for years beyond FY2013. The budget includes estimates of the cumulative proposed revenue changes and proposed mandatory spending changes for the periods FY2009 through FY2013 and FY2009 through FY2018, but these projections omit data for the individual years after FY2013. Estimates for other components of the budget or for budget totals beyond FY2013 were also omitted.

The President proposed elimination or major reductions in 151 programs, which the Administration maintains would save $18 billion of budget authority in FY2009 compared to FY2008. Many of these proposals, affecting both discretionary and mandatory spending programs, were also proposed last year, when elimination or major reductions were proposed for 141 programs.

**CBO Scoring of FY2009 Appropriations Bills.** CBO estimates the spending totals for discretionary appropriations legislation according to the specifications of budget legislation, a process usually known as "scoring." 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.[9] Emergency spending is generally treated differently than non-emergency spending in budget legislation.[10]

**Projections of a Federal Surplus in FY2012.** Both the CBO baseline projections and Administration forecasts show a budget surplus in FY2012, which would be the first surplus since FY2001. Independent analysts note these forecasts are based on assumptions chosen for the specific purpose of budgetary scorekeeping, rather than on assumptions meant to generate predictions of likely future outcomes.[11] For example, funding for military operations after FY2009 is omitted for budgetary scoring purposes. Projected future outlays would be far 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 calendar 2007, even though in recent years Congress and the President have agreed to annual fixes to limit the AMT's reach. Assuming that AMT fixes lapse boosts estimated tax revenues. The President's budget proposes no real 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.

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[9] 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.

[10] 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."

[11] 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].

## Issues Regarding Budget Projections

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 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 information about how past forecasts have varied from actual results.

CBO has analyzed the track record of its budget estimates extensively and now routinely includes information about its forecast record of baseline projections in its budget publications.[12] CBO also provides detailed explanations of why its projections differ from OMB projections.[13] CBO routinely provides a breakdown of economic, legislative, and technical factors responsible for divergences between past forecasts and actual outcomes. The FY2009 budget documents contain an OMB analysis of the divergence between the Administration's February 2006 budget estimates and actual results for FY2007. Differences are decomposed into (1) legislative and administrative changes, (2) changed economic conditions, and (3) technical factors.

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 effect 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 a deficit, including interest costs, by $61 billion cumulatively over a 5-year period and by $273 billion over 10 years. Faster GDP growth would decrease a 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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[12] CBO, "*The Uncertainty of Budget Projections: A Discussion of Data and Methods*," March 2006.

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

## Accuracy and Statistical Bias in Budget Forecasts

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.[14] An unbiased forecasting method may be of little use if forecast errors are large. On the other hand, some forecasting methods may sacrifice unbiasedness in order to gain greater accuracy. Most forecasters try to produce projections that are both unbiased and accurate, as far as possible.

The President's FY2009 budget includes measures that can be used to assess the accuracy and statistical bias of previous forecasts.[15] 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.[16] OMB analyzed February budget estimates of the deficit since FY1982 and estimated the standard deviation of $70 billion for the current fiscal year and $140 billion for the budget year estimate. The standard deviation of Administration budget year deficit/surplus estimates for the period FY1994-FY2001was $77 billion and $237 billion for the period FY2002-FY2007.[17] The standard deviation for the corresponding four-years-ahead forecast was $284 billion, about four times larger.

OMB used its standard deviation estimate to compute upper and lower bounds for deficit projections.[18] 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 $29 billion point estimate for the FY2013 surplus, like all five-years-ahead forecasts of fiscal balance, is imprecise.

# Congressional Budget Action

On March 7, 2008, the House and Senate Budget Committees reported budget resolutions (S.Con.Res. 70 and H.Con.Res. 312). The House passed an amended version of its budget resolution on March 13 by a 212 to 207 vote, and the Senate approved its version, also including amendments, in the early hours of March 14 by a 51 to 44 vote. In both chambers, a large number of amendments were considered.

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[14] 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.

[15] *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].

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

[17] CRS calculation based on OMB data.

[18] 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, about 90% of forecasts should fall within those bounds on average.

Both budget resolutions include a one-year fix for the AMT in tax year 2008. The House resolution includes reconciliation instructions that would offset the cost of the AMT fix, while the Senate resolution did not include offsets for the AMT fix. According to media reports, the House resolution would spend $25.4 billion more (including cap adjustments and advance funding) in non-emergency discretionary budget authority than the $991.6 billion figure requested by the President for FY2009.

The Senate budget resolution called for $21.8 billion in non-emergency discretionary budget authority above the level requested by the President. The Senate version presumes the key 2001 and 2003 tax cuts, including the 10% tax bracket and the child tax credit, would be extended beyond their scheduled 2010 expiration date. The Senate resolution also includes a $35 billion economic stimulus package. Approval of House and Senate budget resolutions clears the way for negotiations for a conference agreement.

# Outlays

The Administration's budget proposed FY2009 outlays of $3,107 billion, about $92 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 2** summarizes these projections.

**Table 2. Outlays for FY2007-FY2013 and FY2018**

(in billions of dollars)

| | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 | FY2013 | FY2018 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/08 | 2,731[a] | 2,873 | 3,015 | 3,148 | 3,299 | 3,355 | 3,524 | 4,325 |
| President's FY09 Budget, 2/08 | | 2,931 | 3,107 | 3,091 | 3,171 | 3,222 | 3,399 | — |
| President's FY09 CSB, 2/08 | | 2,900 | 2,993 | 3,065 | 3,207 | 3,289 | 3,464 | — |
| CBO Analysis of FY09 Budget, 3/08[b] | | 2,933 | 3,041 | 3,082 | 3,169 | 3,215 | 3,363 | 4,224 |
| CBO Rev. Baseline, 3/08b | | 2,903 | 3,000 | 3,130 | 3,294 | 3,358 | 3,530 | 4,354 |
| HBC, 3/07/08 | | 2,933 | 3,063 | 3,148 | 3,263 | 3,301 | 3,459 | — |
| SBC, 3/07/08 | | 2,947 | 3,076 | 3,143 | 3,255 | 3,289 | 3,441 | — |

**Source:** OMB, CBO, HBC, SBC.

a. Actual outlays for FY2007. Receipts for later years are estimated or projected.

b. Letter to Sen. Byrd, Mar. 3, 2008.

CSB — Administration's Current Services Baseline.

HBC — House Budget Committee

SBC — Senate Budget Committee

## CBO Current-Law Baseline Projections

CBO's January 2008 baseline projections for FY2008-FY2018 showed outlays rising from 20.2% of GDP in FY2008 to 20.4% of GDP in FY2009, before falling to 19.3% of GDP in FY2013. Revised baseline projections issued in March 2008

estimated FY2008 outlays would be 20.4% of GDP and that FY2009 outlays would be 20.3% of GDP.

CBO's baseline assumptions, in which total discretionary spending increases at the rate of inflation, imply that projected discretionary spending falls as a percentage of GDP over time. 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. **Table 3** summarizes the costs of discretionary spending under different assumptions. According to CBO projections, federal outlays would grow by an additional $350 billion over the FY2009-FY2013 period were discretionary spending to grow at the same rate as the economy. On the other hand, if discretionary spending were fixed at FY2008 levels over the same period, federal outlays would drop by $344 billion relative to baseline trends.

Baseline projections start with the level of FY2008 discretionary defense outlays, including regular and supplemental funding.[19] The CBO current-law baseline projection of future spending, because it is based on current expenditure levels, can be sensitive to new supplemental funding. The funding of the bulk of the costs of the Iraq and Afghanistan wars through supplemental appropriations presents challenges to baseline forecasting methods.

**Table 3. Discretionary Spending Projections Under Alternative Assumptions**

| Policy Alternative | Estimated Total Cost, FY2009-FY2013 (billions of current dollars) | |
|---|---|---|
| | Effect on Deficit/Surplus Before Debt Costs | Debt Service Costs |
| Increase Regular Discretionary Appropriations at the Rate of Nominal GDP Growth | -324 | -26 |
| Freeze Total Discretionary Appropriations at FY2008 Level | 316 | 28 |

**Source:** CBO, *Budget and Economic Outlook*, Jan. 2008.
**Note:** Negative numbers indicate larger deficits.

**Discretionary Defense Outlays.** Discretionary defense spending, according to January 2008 CBO baseline estimates, will rise from $549 billion in FY2007 to $572 billion in FY2008. These CBO projections show discretionary defense spending rising to $645 billion in FY2013 and to $723 billion in FY2018. Discretionary defense spending, 4.0% of GDP in FY2007, would fall to 3.6% of GDP in FY2013 and to 3.2% of GDP in FY2018 according to CBO baseline projections.

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[19] The addition of supplemental defense and other appropriations since the March 2007 CBO baseline projections causes an increase of over a trillion dollars in projected discretionary spending over the FY2008-FY2017 period. See CBO, *The Budget and Economic Outlook: An Update*, August 2007, p. 14.

Alternative scenarios, in which troops would be withdrawn from Iraq and Afghanistan, show lower spending trajectories, in part because not all of the FY2008 funding for those operations is extrapolated forward. 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 relative to the current-law baseline by about $425 billion over the period FY2009-FY2018. Withdrawing forces more slowly — taking out all but 75,000 troops deployed to Iraq, Afghanistan, and related operations by 2013 — would add about $225 billion in projected discretionary spending and interest costs over the period FY2009-FY2018 relative to the current-law baseline.

**Non-defense Discretionary Spending.** CBO projects non-defense discretionary spending will rise from $493 billion in FY2007 to $520 billion in FY2008, to a projected $571 billion in FY2013, and to $637 billion in FY2018. 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 FY2013, and to 2.8% of GDP in FY2018. 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 shrinking over time relative to GDP.[20]

**Mandatory Spending.** The March 2008 CBO mandatory spending baseline projects an increase from $1,577 billion in FY2008 to $1,664 billion in FY2009. Mandatory spending, according to CBO projections, will increase to $2,031 billion by FY2013 and to $2,725 billion by FY2018. Mandatory spending as a share of GDP, according to CBO baseline projections, will change little, moving from 11.1% in FY2008 to 11.2% in FY2013. At the end of the 10-year time frame, CBO projections show mandatory spending edging up to 12.2% of GDP in FY2018.

## Administration Projections

The Administration's FY2009 budget proposed $3,107 billion in outlays, rising to $3,399 billion in FY2013, the last year shown in the President's budget.

The proposals would boost funding for defense and homeland security spending in FY2008 and FY2009 and would hold growth in non-defense, non-homeland security discretionary spending below 1% a year, implying a slight decrease in real terms. The Administration proposed measures to slow the growth of Medicare and Medicaid and other mandatory programs slightly. Total mandatory spending, however, would increase under the proposals. The Administration also proposes spending $30 billion in FY2013 to fund personal Social Security accounts.[21]

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[20] 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.

[21] *Budget of the U.S. Government*, Feb. 2008, Table S-6, p. 154

The proposed level of FY2009 outlays, $3,015 billion, exceeds the Administration's FY2009 current services baseline ($2,993 billion) by $114 billion (3.8%).[22] Proposed FY2009 mandatory spending would be $18 billion below baseline. The Administration's budget shows net interest payments increasing from $260 billion in FY2009 to $300 billion in FY2009 due to increased federal borrowing.

The Administration's proposals would increase outlays to 20.7% of GDP in FY2009. By contrast, FY2007 outlays were 20.0% of GDP. Between FY1966 and FY2006, outlays averaged 20.6% of GDP. By FY2012, the Administration's projections show outlays falling to 18.5% of GDP, lower than in any year since FY1966.

The overall $176 billion increase in outlays from FY2008 to FY2009 is due to many factors, including automatic cost-of-living adjustments in many federal programs, growth in populations eligible for program benefits, increased spending on military and veterans' programs, policy changes, and higher costs due to inflation of goods and services bought by the federal government.

**Spending on Defense and Security.** For FY2009, almost all of the increase in discretionary spending comes from what the Administration calls "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. Medium-term projections, however, show a decrease in defense spending, mostly due to the omission of post-FY2009 war costs. National defense spending, which OMB projects will reach 4.0% of GDP in FY2009, is projected to fall to 3.2% of GDP in FY2013.[23]

Congress approved $86.8 billion in supplemental funding for FY2008. An additional $102.5 billion requested by the Administration has not been approved.[24] In addition, the Administration has requested $70 billion in emergency supplemental

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[22] 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 assumptions used by OMB reflects that federal pay raises and adjustments begin with the first full pay period in January, as has been usual in recent years, rather than October 1 date reflected in the Budget Enforcement Act (BEA), and that emergency spending is not extended (as opposed to the BEA assumption that it is). These modifications lowered the FY2009 current services baseline outlay estimate by $54 billion and FY2013 projection by $114 billion.

[23] General Mike Mullen, Chairman of the Joint Chiefs of Staff, noted in an interview that the defense budget was now "just under 4% of GDP," and stated that "I would see that in the future as an absolute floor." *New York Times*, Oct. 22, 2007. Transcript available at [http://www.nytimes.com/2007/10/22/washington/22mullen-text.html]

[24] U.S. Dept. of Defense, Office of the Assistant Secretary for Defense (Public Affairs), Press Release 90-08, "FY2009 Department of Defense Budget Released," available at [http://www.defenselink.mil/comptroller/defbudget/fy2009/2009_Budget_Rollout_Release.pdf].

funding for FY2009.[25] Some analysts also note that while the Department of Defense accounts for the bulk of spending in the functional category of national defense, that category includes some Department of Energy programs as well as certain mandatory spending, such as contributions to military retirement programs.[26] The Administration estimates spending on the national defense function will total $603.7 billion in FY2008 and proposes spending $670.7 in FY2009.

**Non-defense or "Non-Security" Discretionary Spending.** The Administration proposes $393.0 billion in net "non-security" discretionary budget authority for FY2009 and for subsequent years until FY2013, just slightly above the enacted FY2008 level of $392.7 billion (not counting $104.4 billion in supplemental and emergency funds enacted for FY2008). [27] Holding "non-security" discretionary budget authority constant implies a proposed cut in real terms equal to the inflation rate, which CBO projects to run about 2% from FY2009 through FY2013.[28]

The Administration proposes $482 billion in "non-security" discretionary outlays, just slightly above the estimated FY2008 level of $481 billion. According to Administration projections, "non-security" discretionary spending will decline sharply after FY2009, reaching $429 billion in FY2013.

Future federal health care spending is expected to remain close to the 5.3% of GDP projected for FY2009, although many analysts expect health care prices and costs to rise faster than GDP in the future. Federal spending on Medicare (net of beneficiary premiums) and Medicaid accounted for 4% of GDP in 2007. CBO current-law projections show that share rising to 7% in 2025, 12% in 2050, and 19% in 2082.[29] Thus, federal spending on Medicare and Medicaid in 2082 is projected to take up about roughly the same proportion of GDP as total federal government spending took up in the late 1990s.

**Mandatory Spending.** Mandatory spending in the President's budget grows by 5.5% ($1,551 billion) from FY2008 to FY2009 ($1,636 billion). According to the Administration, mandatory programs will increase from $1,636 billion in FY2009 (10.9% of GDP) to $2,034 billion in FY2013 (11.2% of GDP). The budget included proposals to reduce mandatory outlays from baseline levels by $17.1 billion in

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[25] Testimony of Secretary of Defense Robert M. Gates, in U.S. Congress, House Armed Services Committee, 110th Cong., 2nd sess., Feb. 6, 2008, available at [http://armedservices.house.gov/pdfs/FC020608/Gates_Testimony020608.pdf]

[26] Fred Kaplan, "What's Really in the U.S. Military Budget? Much More Than the Oft-Cited $515.4 Billion," *Slate*, Feb. 4, 2008, available at [http://www.slate.com/id/2183592/].

[27] The Administration defines "Security" funding as spending for the Department of Defense, Government-wide Homeland Security activities, and International Affairs.

[28] CBO projects an average percentage change in the GDP price index just less than 2% per year and an average percentage change in the Consumer Price Index just over 2% per year over the FY2009-FY2013 period. See CBO Letter to Sen. Byrd, Mar. 3, 2008, Table 6.

[29] CBO, *The Long-Term Outlook for Health Care Spending*, Nov. 2007, available at [http://www.cbo.gov/ftpdocs/87xx/doc8758/11-13-LT-Health.pdf].

FY2009, with larger reductions in later years. The reductions would be achieved by slowing the growth of selected mandatory spending activities such as Medicare and Medicaid, among others. The Administration estimates that these measures would reduce total mandatory spending from baseline levels over the five-year period FY2009-FY2013 by $178 billion. By comparison, mandatory spending over the same period is projected to total over $9 trillion. The Administration's mandatory spending reductions would thus cut about 2% from mandatory spending over FY2009-FY2013. Even if those cuts were enacted, mandatory spending would remain the largest broad category of federal spending.

**Net Interest.** The President's FY2009 budget showed net interest outlays rising from $244 billion in FY2008 to $260 billion in FY2009, as growing federal debt outweighs the effects of lower interest rates. Federal debt has grown rapidly in recent years, and under the Administration's proposals, will continue to grow. Higher debt, even with lower interest rates, is projected to require higher net interest payments in the future. Proposed net interest outlays in FY2009 exceed the Administration's FY2009 current services baseline estimate by $3 billion. The Administration's policy proposals would raise FY2013 net interest outlays $18 billion above their current services estimate. According to Administration estimates, net interest payments will run about 1.7% of GDP over the five-year period.

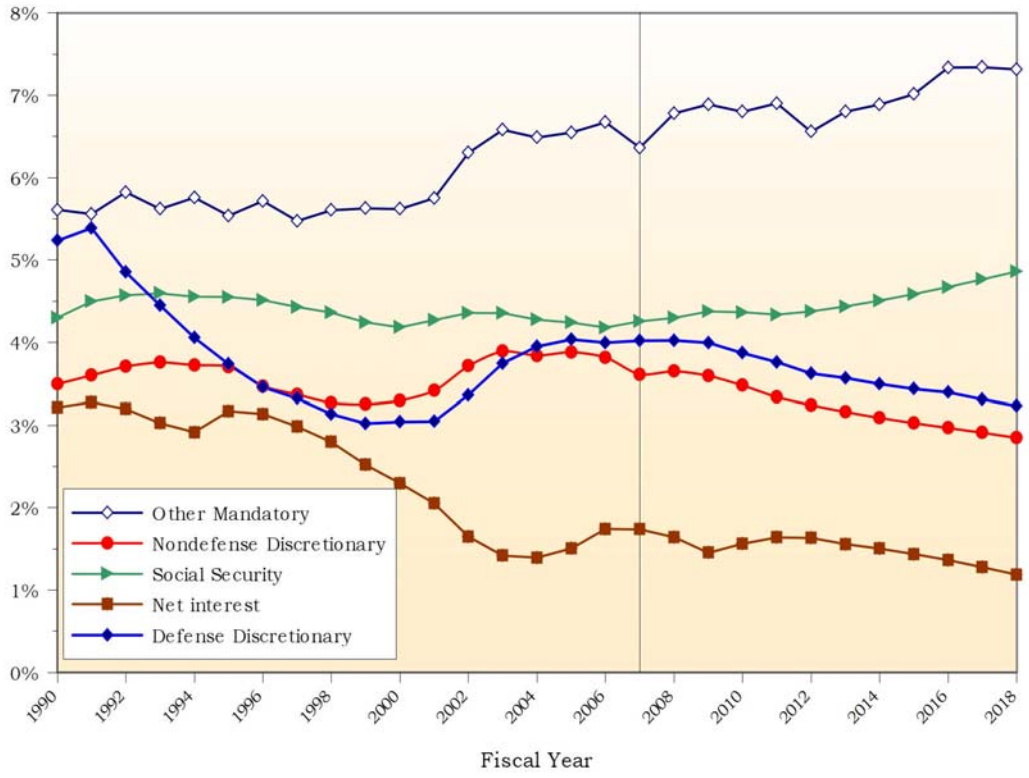
## Trends in Outlays by Category of Spending

**Figure 1** shows spending trends by category as percentages of GDP. The figure shows actual outlays for defense, non-defense, mandatory, and net interest spending from FY2000 through FY2007; estimated amounts for FY2008; and the Administration's proposals from FY2009 though FY2013. According to those proposals, defense and non-defense discretionary spending as a share of GDP will decline over the five-year period FY2008-FY2013, while mandatory spending is projected to increase.

The downturn in defense and non-defense discretionary spending relative to GDP after FY2009 depends on the Administration's assumptions that non-defense discretionary spending falls after 2008 and that no additional spending is provided for the ongoing military operations overseas after FY2009.

The President's proposed limited reductions in mandatory spending from current service baseline levels keep mandatory spending as a share of GDP stable. The proposed introduction of private Social Security accounts in FY2013 would lift mandatory spending relative to GDP above the current services level.

**Figure 1. Outlays By Type As Percentage of GDP, FY1990-FY2018**




**Source:** OMB and CBO.
**Notes:** Data on the right of the vertical line represent CBO current-law baseline estimates or projections. Vertical axis shows percentage of GDP.

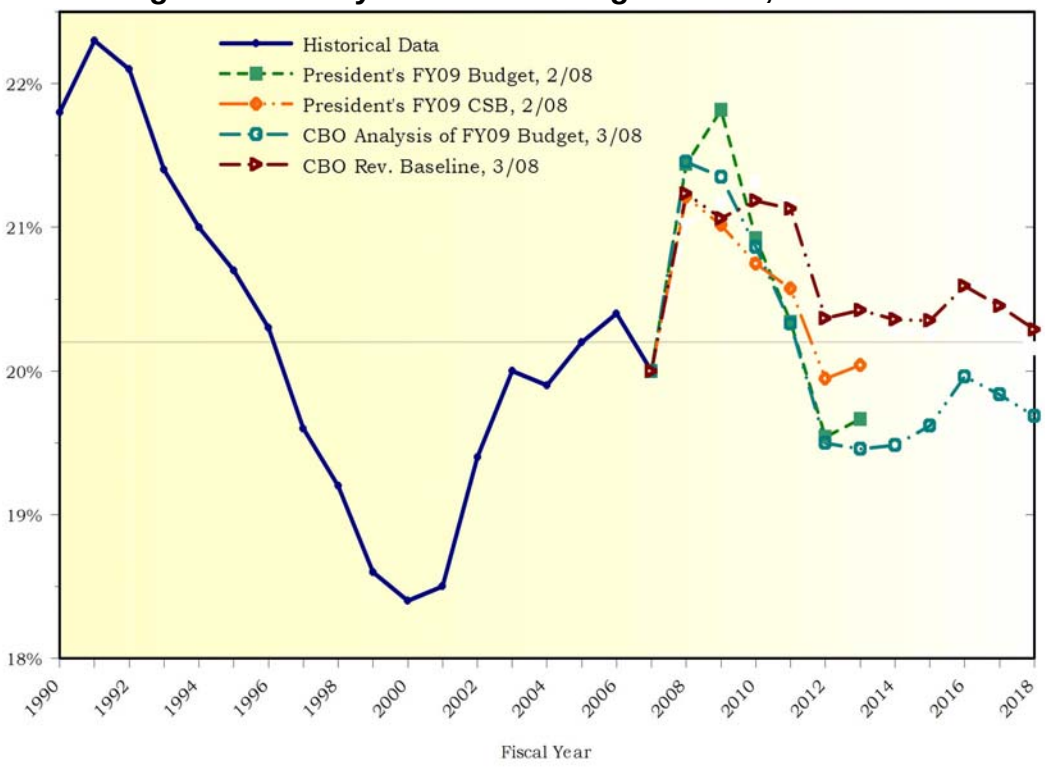
**Figure 2** shows historical data on outlays since FY1990 and five sets of projections of outlays as a percentage of GDP through FY2018:

- the President's FY2009 budget proposal (February 2008),
- OMB's Current Service Baseline (February 2008),
- a March 2008 preliminary CBO analysis of the President's FY2009 proposals, and
- the January 2008 and March 2008 CBO baselines.

The Administration's outlook runs through FY2013, while the CBO outlook runs through FY2018. The figure includes actual outlays as a percentage of GDP for FY2000 through FY2007 and average (FY1966-FY2007) outlays as a share of GDP.

The President's proposed outlays fall sharply after FY2009, 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 as a percentage of GDP would be at the same level as in FY2001. In FY2011 and later years, according to CBO projections, the President's spending levels (which omit war costs in those years) run about 1% of GDP lower than current-law baseline projections.

**Figure 2. Outlays As a Percentage of GDP, FY1990-FY2018**




**Source:** OMB and CBO. Points for FY2008-FY2018 are projections.
**Notes:** Horizontal line at 20.2% represents average over FY1990-FY2007.
Vertical axis shows percentage of GDP.

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.

## Outlays By Function

Federal spending can be classified by superfunction, function, and subfunction of government. Superfunctions are National Defense, Human Resources, Physical Resources, and Other Functions. Functional breakdowns of federal spending reflect resources directed towards particular goals and cut across usual bureaucratic boundaries. For example, the National Defense function (and superfunction) includes spending by parts of the Department of Energy as well as the Department

of Defense outlays, which comprise the bulk of National Defense outlays. Other Department of Energy outlays fall within the Physical Resources superfunction. In some cases, such as spending on Coast Guard patrols in major ports that support commerce, recreation, and national security, outlays are not easily and neatly divided between subfunction.

**Figure 3** shows FY2008 outlays by function as estimated by the Administration. National defense, at an estimated 22.4% of FY2008 outlays, accounts for the largest share of federal spending. Social Security and Medicare are the next largest functional categories.

## Receipts

Administration and CBO projections of the future path of federal receipts are 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 FY2007-FY2013 and FY2018

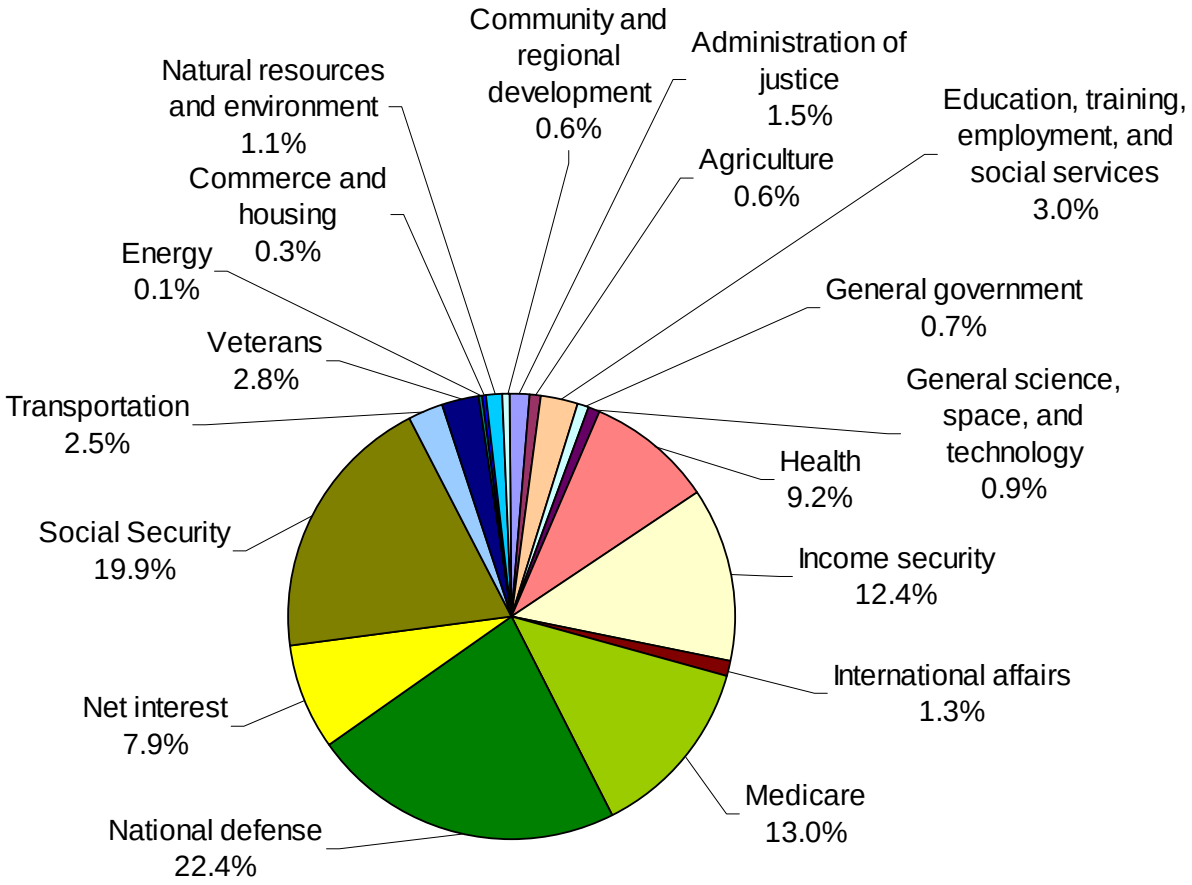
(billions of current dollars)

| | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 | FY2013 | FY2018 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/08 | 2,568[a] | 2,654 | 2,817 | 2,907 | 3,182 | 3,442 | 3,585 | 4,548 |
| President's FY09 Budget, 2/08 | | 2,521 | 2,700 | 2,931 | 3,076 | 3,270 | 3,428 | — |
| President's FY09 CSB 2/08 | | 2,662 | 2,815 | 2,954 | 3,110 | 3,301 | 3,454 | — |
| CBO Est. of Pres. Budget 3/3/08[b] | | 2,537 | 2,699 | 2,900 | 3,040 | 3,215 | 3,342 | 4,297 |
| HBC, 3/7/08 | | 2,546 | 2,723 | 2,939 | 3,214 | 3,479 | 3,617 | — |
| SBC, 3/07/08 | | 2,539 | 2,710 | 2,934 | 3,205 | 3,466 | 3,600 | — |

**Source:** OMB, CBO, HBC, SBC.
a. Actual outlays for FY2007. Receipts for later years are estimated or projected.
b. Letter to Sen. Byrd, Mar. 3, 2008.
CSB — Administration's Current Services Baseline.
HBC — House Budget Committee
SBC — Senate Budget Committee

The last few fiscal years have seen unexpectedly rapid growth in receipts, in part due to strong economic growth. After three years of falling receipts from FY2000 through FY2003, federal receipts grew by 5.5% from FY2003 to FY2004, by 14.5% from FY2004 to FY2005, and by 11.8% from FY2005 to FY2006. Receipts, according to OMB, rose from 16.4% of GDP in FY2004, the lowest level for receipts since FY1959, to 18.8% of GDP in FY2007.

**Figure 3. Estimated FY2008 Federal Outlays by Function as Share of Total**



Recent indications of slower economic growth are expected to slow the growth of federal receipts, at least in the short run. Corporate tax receipts and capital gains receipts can be especially sensitive to cyclical economic conditions. In addition, tax provisions of the Economic Stimulus Act of 2008 will temporarily reduce federal revenues' share of GDP. Both CBO and OMB estimate that federal revenues as a share of GDP will drop in FY2008 and will then gradually rise in the following years.

## Administration Revenue Projections

Receipts rise, in current dollars, by 7.1% ($179 billion) from FY2008 to FY2009 under the Administration's FY2009 budget proposal. Over the five-year forecast, receipts in nominal terms rise by $907 billion, a 36% increase over FY2008. The President's proposals would extend and make permanent most of the tax cuts slated to expire at the end of calendar 2010 or before. Tax reductions in the Administration's economic stimulus proposals, according to OMB, will push federal receipts, as a share of GDP, to 17.6% in FY2008. The share is then projected to rise to 18.8% in FY2013.

Excise and other receipts were both less than 1% of GDP for all years shown. The Administration projects that corporate income taxes, which rose to 2.7% of GDP in FY2006 and FY2007, will decline slowly to 2.1% of GDP in FY2013. Social insurance receipts, at 6.4% of GDP in FY2008, remain stable through FY2013. The Administration projects that individual income taxes, having fallen from 10.3% of GDP in FY2000 to 7.0% of GDP in FY2004, will rise to 9.4% of GDP in FY2013, about 1% of GDP below their FY2000 level.

**Administration Revenue Proposals.** The Administration estimated that making the 2001 and 2003 tax cuts permanent would reduce cumulative receipts by $635 billion from baseline levels between FY2009 and FY2013 and by $2,076 billion between FY2008 and FY2017.[30] The effect of all Administration revenue proposals, apart from proposals incorporated in the Administration baseline, would reduce receipts by an estimated $228 billion in the first 5 years and by $233 billion over 10 years.

The budget also proposes a one-year fix to limit expansion of the Alternative Minimum Tax's (AMT) coverage through calendar 2008 at an estimated cost of $46.7 billion. The AMT will cover a rapidly growing proportion of middle-class taxpayers unless a sequence of temporary AMT fixes or a permanent change in the AMT's structure is enacted.[31] No fix for subsequent years is proposed, although

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[30] For details, see *FY2009 Budget of the U.S. Government, Analytic Perspectives*, ch. 17, Table 17-3.

[31] For discussions of the AMT issue, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire; and CRS Report RL34382, *The Alternative Minimum Tax for Individuals: Legislative Activity in the 110th Congress*, by Steven Maguire (continued...)

Congress has enacted and the President has signed AMT fixes each year in recent years.

CBO estimates that indexing AMT thresholds for inflation would cost on average $72.4 billion a year over the next 10 years, plus another $18.9 billion in debt financing costs. 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-FY2009 estimates of federal receipts substantially above what they would be with an AMT fix.

As shares of GDP, total receipts in the President's budget are expected to remain near their 40-year (FY1966-FY2007) average of 18.3% throughout the five-year budget horizon. CBO's baseline revenue estimates (revised, March 2008), which exclude the extension of the 2001 and 2003 tax cuts, are larger, rising to 20.0% of GDP in FY2012.

## CBO Revenue Projections

The March 2008 CBO preliminary analysis of the President's FY2009 policy proposals projects slightly lower revenues in FY2008 than the President's budget, in part because the CBO estimate reflected recent fiscal stimulus legislation. In later years, CBO revenue estimates of the Administration's budget were very close to or slightly above OMB projections.[32] CBO baseline revenue estimates released in March 2008 were lower than January estimates, in large part due to the passage of the Economic Stimulus Act of 2008. To a lesser extent, baseline revenue projections changed due to changing economic conditions. CBO baseline revenue projection shows receipts rising once the 2001 and 2003 tax cuts expire, rising from 18.6% of GDP in FY2010 to 20.0% of GDP in FY2012.

CBO's modification of its baseline revenue estimates and projections using 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.[33] AMT reform would interact with the extension of the 2001 and 2003 tax cuts, producing greater revenue losses than the two changes separately.

CBO estimates of the five-year costs of selected revenue policies are summarized in **Table 5**. Were the costs of the permanent extension of the EGTRRA and JGTRRA tax cuts that the Administration has proposed included in the baseline, a projected future deficit would be larger by $692 billion, aside from financing costs,

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[31] (...continued)
and Jennifer Teefy.

[32] 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-estimating assumptions — only the policy assumptions differ.

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

over the five-year period FY2009-FY2013.[34] Similarly, indexing the AMT for inflation, which Congress has done on a temporary basis in recent years, would raise the five-year deficit projection by $313 billion. The costs of indexing the AMT and of extending EGTRRA and JGTRRA tax cuts interact in important ways.[35] Costs of the EGTRRA and JGTRRA tax cuts would be much larger if the AMT did not cover as many households.

### Table 5. Estimated Costs of Selected Revenue Policy Alternatives

| Policy Alternative | Estimated Total Cost, FY2009-FY2013 (billions of current dollars) | |
|---|---|---|
| | Effect on Deficit/Surplus Before Debt Costs | Debt Service Costs |
| Extend EGTRRA and JGTRRA | -692 | -46 |
| Extend Other Expiring Tax Provisions | -149 | -16 |
| Index AMT for Inflation | -313 | -45 |
| Interactive Effect of EGTRRA and JGTRRA and Index AMT for Inflation | -148 | -9 |

**Source:** CBO, *Budget and Economic Outlook*, Jan. 2008, Table 1-5.
**Note:** Negative numbers indicate larger deficits.

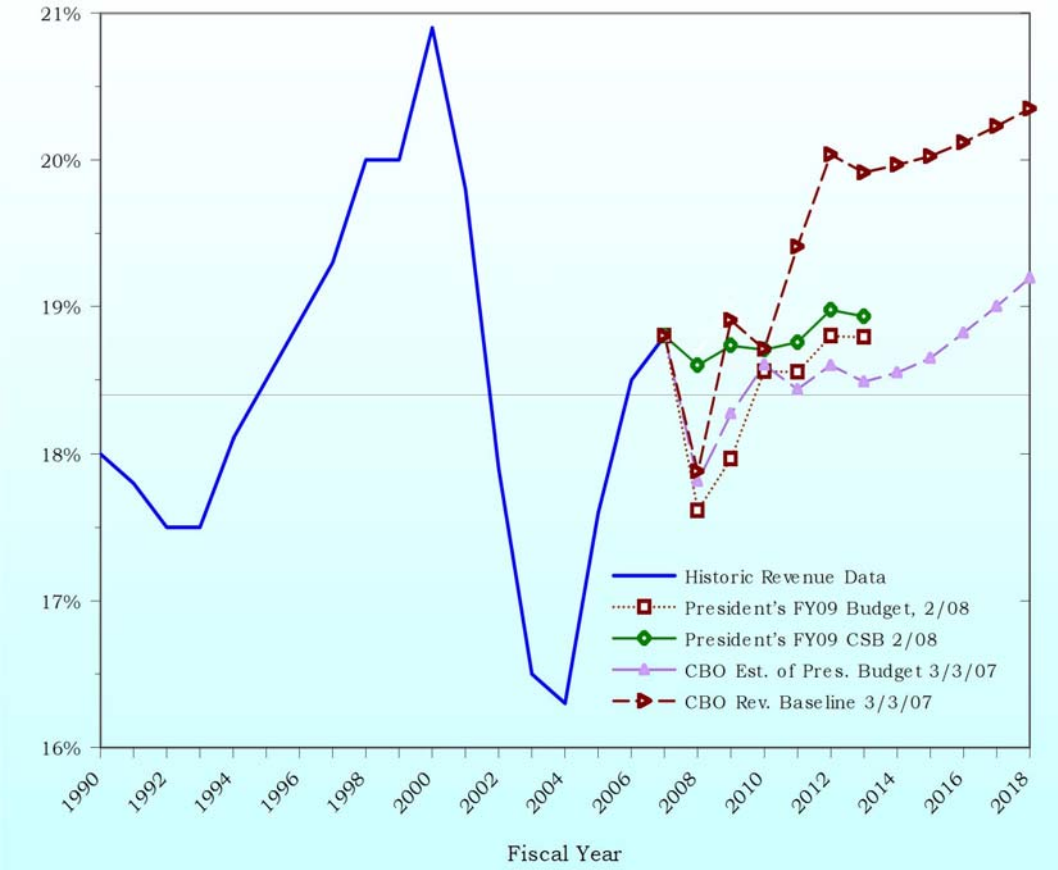
## Revenue Projections in Historical Perspective

**Figure 4** shows the level of historical and projected federal receipts as a percentage of GDP. Historical receipts are shown for FY2000 through FY2007. The figure shows CBO baseline revenue projections from January and March 2008 budget reports, the President's February 2008 budget submission for FY2009, a March 2008 analysis of the President's revenue proposals, and the OMB Current Service baseline. Federal receipts averaged 18.4% of GDP over the period FY1990-FY2006, indicated by the horizontal line.

[34] If there were surpluses after the JGTRRA and EGTRRA extension, they would either be smaller or would become deficits.

[35] See CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back" Effects*, by Steven Maguire.

**Figure 4. Revenue Data and Projections As a Percentage of GDP, FY1990-FY2018**




**Source:** OMB and CBO.
**Note:** Vertical axis shows percentage of GDP.

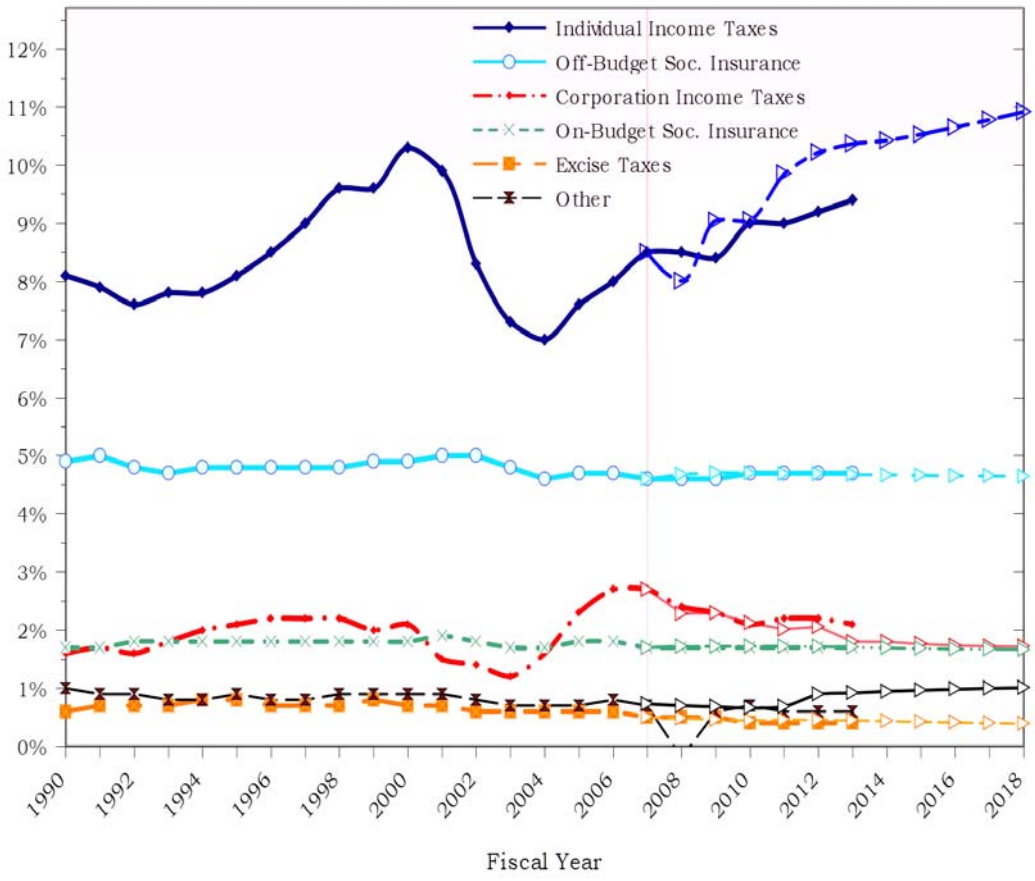
Revenue projections for OMB Current Service baseline and the CBO current-law baseline remain close through FY2010. Baseline projections for FY2008 computed before passage of the Economic Stimulus Act of 2008 show higher revenues, of course, than projections computed afterwards. CBO baseline estimates for FY2011 and later years are substantially higher than projections of future revenue for the President's budget. CBO projects that receipts will rise to 20.3% of GDP in FY2018.

## Federal Revenues By Type

**Figure 5** shows trends in federal revenue sources as a percentage of GDP since FY1990 as well as OMB projections, which extend until FY2013, and CBO baseline projections, which extend until FY2018. Federal revenue sources strongly affected by cyclical economic conditions and major legislative changes, such as individual and corporate income taxes, have varied sharply over time. Other revenue sources, such as social insurance taxes, have been stable as a share of the economy. Individual income taxes are the largest revenue source for the federal government,

followed by off-budget social insurance taxes. Social Security payroll (OASDI) taxes comprise nearly all of the off-budget social insurance tax category.

**Figure 5. Federal Revenues By Type As a Percentage of GDP, FY1990-FY2018**




**Source:** OMB and CBO.
**Notes:** Points to the right of vertical line represent projections. Trends with hollow triangles represent CBO baseline projections. Vertical axis shows percentage of GDP.

## 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.[36] This can, in turn, reduce net interest payments. Many economists believe that running surpluses when economic growth is strong and deficits when the economy is weak

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

helps dampen macroeconomic fluctuations. The federal government last ran a surplus in FY2001, which amounted to $128 billion or 1.3% of GDP.

Long-term CBO and OMB projections both show substantial increases in budget deficits in the years after FY2020. These deficits result from a projected gap between rising federal outlays and revenues. The growth of health care spending, as well as demographic changes, plays an important part of those fiscal trends.

**Table 6** summarizes Administration and CBO projections of total federal deficits and surpluses. The FY2007 total deficit, $162 billion, was slightly below CBO's January estimate, and well below the Administration's estimate in the FY2008 budget.

**Table 6. Total Surpluses/Deficits(-), FY2007-FY2013 and FY2018**

(in billions of current dollars)

| | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 | FY2013 | FY2018 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/08 | -162[a] | -219 | -198 | -241 | -117 | -87 | 61 | 223 |
| President's FY09 Budget, 2/08 | | -410 | -407 | -160 | -95 | 48 | 29 | — |
| President's FY09 CSB 2/08 | | -238 | -231 | -200 | -50 | 136 | 136 | — |
| CBO Rev. Baseline 3/08[b] | | -357 | -207 | -213 | -93 | 105 | 70 | 202 |
| CBO Prelim. Est. of Pres. Budget 3/07[b] | | -396 | -342 | -182 | -129 | 0 | -21 | 73 |
| HBC, 3/7/08 | | -583 | -536 | -416 | -275 | -60 | -86 | — |
| SBC, 3/07/08 | | -408 | -366 | -209 | -49 | 177 | 160 | — |

**Source:** OMB, CBO, HBC, SBC.
a. Actual FY2007 total deficit.
b. CBO Letter to Sen. Byrd
CSB — The Administration's Current Services Baseline.
HBC — House Budget Committee, SBC — Senate Budget Committee

## On-Budget Deficits

The total federal deficit (or surplus) is the sum of the off-budget and on-budget deficits or surpluses. The U.S. Postal Service net profits or losses and Social Security revenues net of beneficiary payments are by law considered off-budget entities. Since FY1985, Social Security surpluses have led to growing off-budget surpluses, which has reduced the size of the total deficit. **Table 7** summarizes projections of on-budget deficits. No projection shows a surplus within the next 5 or 10 years. The FY2007 on-budget deficit, which excludes a large Social Security surplus and a small Postal Service surplus, was $344 billion.

**Table 7. On-Budget Deficits, FY2007-FY2013 and FY2018**

(in billions of current dollars)

| | FY2007 | FY2008 | FY2009 | FY2010 | FY2011 | FY2012 | FY2013 | FY2018 |
|---|---|---|---|---|---|---|---|---|
| CBO Baseline, 1/08 | -343.5[a] | -414 | -396 | -450 | -343 | -151 | -184 | -27 |
| President's FY09 Budget, 2/08 | | -602 | -611 | -384 | -335 | -203 | -201 | — |
| President's FY09 CSB 2/08 | | -431 | -382 | -344 | -336 | -236 | -267 | — |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| CBO Rev. Baseline 3/08[b] | -592 | -525 | -375 | -346 | -236 | -269 | -121 |
| CBO Prelim. Est. of Pres. Budget 3/07[b] | -553 | -403 | -421 | -320 | -133 | -174 | -44 |
| HBC, 3/7/08 | -583 | -536 | -416 | -275 | -60 | -86 | — |
| SBC, 3/07/08 | -605 | -562 | -416 | -276 | -61 | -84 | — |

a. Actual FY2007 on-budget deficit.
b. CBO Letter to Sen. Byrd
CSB — The Administration's Current Services Baseline.
HBC — House Budget Committee, SBC — Senate Budget Committee

## Administration Deficit Projections

The President's February budget estimated the FY2008 deficit at $410 billion (1.6% of GDP) and a small surplus of $29 billion in FY2013. 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 dramatic increase in the FY2008 and FY2009 deficits compared to the FY2007 deficit is largely due to fiscal stimulus measures enacted to respond to weakening economic conditions.

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.[37] If war costs, which are omitted for post-FY2009 years in the President's budget, continue at high levels, deficit reduction efforts will face additional challenges.

## CBO Deficit Projections

In March 2008, CBO released revised current-law baseline projections, which incorporated costs of the Economic Stimulus Act and superceded projections issued in January. The revised CBO current-law baseline projections showed a FY2008 deficit of $357 billion, a $70 billion surplus in FY2013, and a $202 billion surplus in FY2018. CBO current-law baseline projections show the federal deficit falling after FY2010, both in dollar terms and as a percentage of GDP, through the end of the budget window in FY2018. Surpluses are projected to appear from FY2012 through FY2017.

The March 2008 CBO analysis estimated that the President's budget proposals would lead to a FY2008 deficit of $396 billion, $39 billion above the baseline level. The CBO also projected that the President's budget would generate a FY2009 deficit of $342 billion, well above the revised baseline projection of a $207 billion FY2009 deficit.

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[37] 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, by law, must use assumptions for current-law baseline projections that some analysts consider optimistic. Baseline revenue projections assume temporary fixes to halt the expanding coverage of the AMT expire at the end of 2008, as current law specifies, and that the 2001 and 2003 tax cuts expire at the end of 2010. These assumptions boost revenues considerably compared to restricting AMT expansion and extending the tax cuts. Baseline outlay projections assume that discretionary spending will grow at the rate of inflation, which is at a slower rate than it has grown recently, and that mandatory spending grows with eligible populations and cost-of-living adjustments.

Some projections based on alternative assumptions depict more pessimistic fiscal outlook than the path of shrinking deficits and future surpluses indicated by CBO current-law baseline projections.[38]

## 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 rising costs per beneficiary for health care 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 compounding federal debt burden. CBO has concluded that "under any plausible scenario, the federal budget is on an unsustainable path."[39]

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.[40]

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

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[38] See Auerbach, Furman, and Gale (2007) referenced at footnote 11.

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

[40] 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.[41]

The Administration indicated similar concerns about the outlook for the budget over the long term in the President's FY2009 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.[42]

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 Social Security revenues as a proportion of long-term GDP are generally much smaller than estimates of the -term fiscal gap between Medicare (HI, Part B, and Part D) outlays and revenues.[43] 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.[44]

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.[45]

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 increases 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

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[41] CBO, *The Long-Term Budget Outlook*, December 2007, p. 1.

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

[43] For a detailed discussion of long-term projections, see CRS Report RL33623, *Long-Term Measures of Fiscal Imbalance*, by D. Andrew Austin.

[44] 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].

[45] 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].

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.