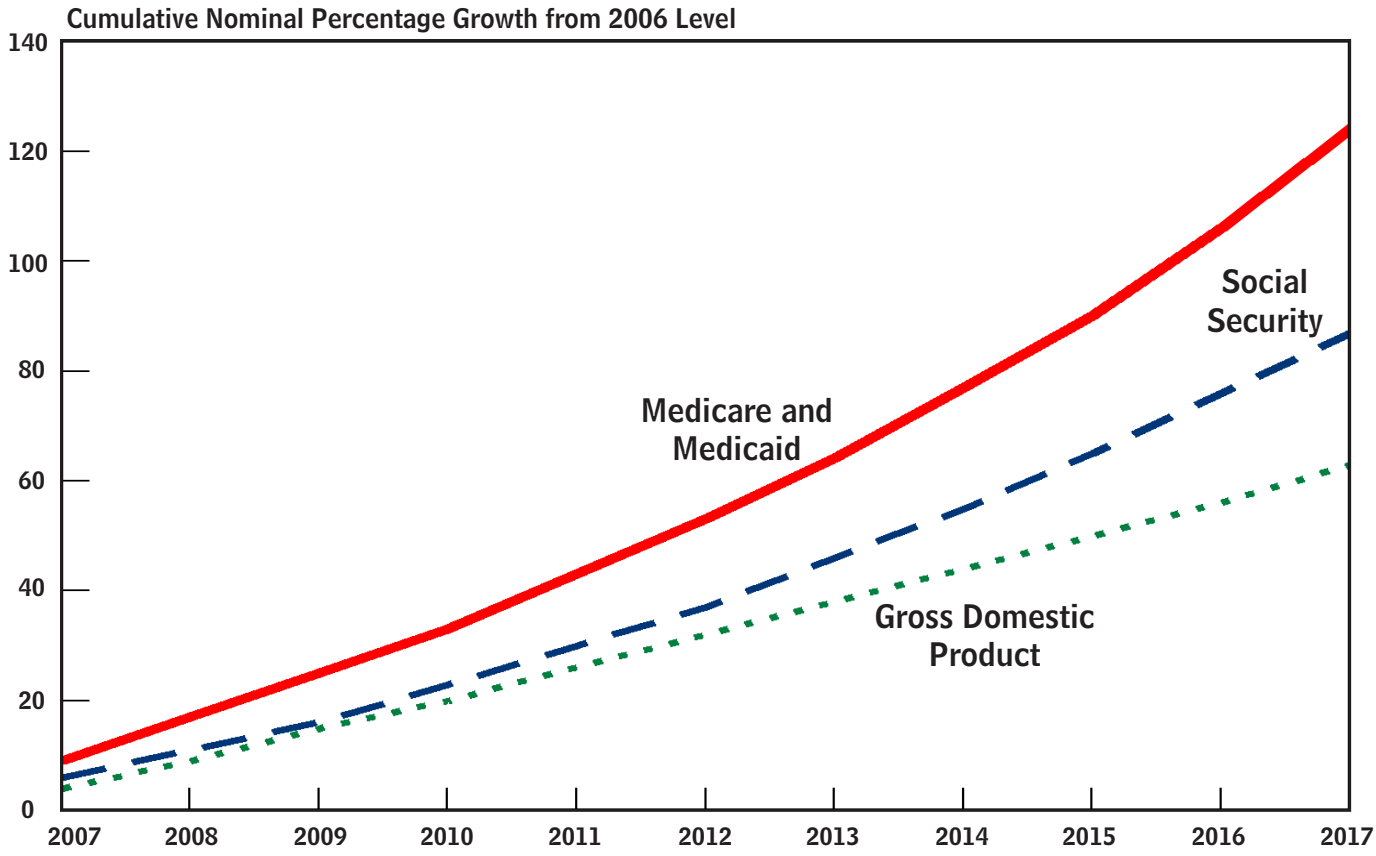
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

# The Budget and Economic Outlook: Fiscal Years 2008 to 2017




**Projected Growth of the U.S. Economy and Federal Spending for Major Mandatory Programs**

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# The Budget and Economic Outlook: Fiscal Years 2008 to 2017

January 2007

The Congress of the United States ■ Congressional Budget Office

# Notes

Unless otherwise indicated, all of the years referred to in describing the economic outlook are calendar years; other years referred to in this report are federal fiscal years (which run from October 1 to September 30).

Numbers in the text and tables may not add up to totals because of rounding.

Some of the figures in Chapter 2 use shaded vertical bars to indicate periods of recession as well as dashed vertical lines to separate actual from projected data. (A recession extends from the peak of a business cycle to its trough.)

Supplemental data for this analysis are available on the home page of the Congressional Budget Office's Web site (www.cbo.gov) under "Current Budget Projections" and "Current Economic Projections."

As of March 14, 2007, updated versions of Table 1-5, "Budgetary Effects of Selected Policy Alternatives Not Included in CBO's Baseline," and Table 4-10, "Effect of Extending Tax Provisions Scheduled to Expire Before 2017," are available under "Current Budget Projections" on the home page of the Congressional Budget Office's Web site, www.cbo.gov. The updates primarily reflect estimates by the Joint Committee on Taxation that were not available at the time of this report's release.

# Preface

This volume is one of a series of reports on the state of the budget and the economy that the Congressional Budget Office (CBO) issues each year. It satisfies the requirement of section 202(e) of the Congressional Budget Act of 1974 for CBO to submit to the Committees on the Budget periodic reports about fiscal policy and to furnish baseline projections of the federal budget. In accordance with CBO's mandate to provide impartial analysis, the report makes no recommendations.

The baseline spending projections were prepared by the staff of CBO's Budget Analysis Division under the supervision of Robert Sunshine, Peter Fontaine, Janet Airis, Thomas Bradley, Kim Cawley, Paul Cullinan, Jeffrey Holland, and Sarah Jennings. The revenue estimates were prepared by the staff of the Tax Analysis Division under the supervision of Thomas Woodward, Mark Booth, and David Weiner, with assistance from the Joint Committee on Taxation. (A detailed list of contributors to the revenue and spending projections appears in Appendix F.)

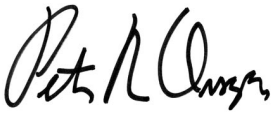
The economic outlook presented in Chapter 2 was prepared by the Macroeconomic Analysis Division under the direction of Robert Dennis, Kim Kowalewski, and John F. Peterson. Robert Arnold and Christopher Williams produced the economic forecast and projections. David Brauer, Ufuk Demiroglu, Richard Farmer (formerly of CBO), Naomi Griffin, Douglas Hamilton, Juann Hung, Kim Kowalewski, Mark Lasky, Angelo Mascaro, Ben Page, and Frank Russek contributed to the analysis. Andrew Gisselquist and Adam Weber provided research assistance.

An early version of CBO's economic forecast was discussed at a meeting of the agency's Panel of Economic Advisers. At that time, members of the panel were Martin Baily, Richard Berner, Dan Crippen, J. Bradford DeLong, Martin Feldstein, Robert J. Gordon, Robert E. Hall, Douglas Holtz-Eakin, Ellen Hughes-Cromwick, Lawrence Katz, Allan H. Meltzer, Laurence H. Meyer,William D. Nordhaus, June E. O'Neill, Rudolph G. Penner, James Poterba, Robert Reischauer, Alice Rivlin, Nouriel Roubini, and Diane C. Swonk. Raj Chetty, Sherry Glied, Daniel Kessler, and David Zion attended the panel's meeting as guests. Although CBO's outside advisers provided considerable assistance, they are not responsible for the contents of this report.

Jeffrey Holland wrote the summary. Barry Blom, with assistance from Mark Booth and Eric Schatten, wrote Chapter 1 (David Newman compiled Box 1-1). John F. Peterson authored Chapter 2. Christina Hawley Anthony wrote Chapter 3, with assistance from Eric Rollins and Eric Schatten. Mark Booth authored Chapter 4, with assistance from Barbara Edwards, Pamela Greene, Andrew Langan, and Emily Schlect. Ann Futrell, with assistance from Mark Booth, wrote Appendix A. Luis Serna wrote Appendix B (Frank Russek wrote the box) and Appendix C. Andrew Gisselquist and Adam Weber compiled

Appendix D, and Ann Futrell prepared Appendix E. Mark Hadley and Eric Schatten produced the glossary.

Christine Bogusz, Christian Howlett, Kate Kelly, Loretta Lettner, Leah Mazade, and John Skeen edited the report. Marion Curry, Denise Jordan-Williams, and Linda Lewis Harris assisted in its preparation. Maureen Costantino designed the cover and prepared the report for publication. Lenny Skutnik printed the initial copies, Linda Schimmel handled the print distribution, and Annette Kalicki and Simone Thomas handled the electronic distribution via CBO's Web site (www.cbo.gov).



Peter R. Orszag
Director

January 2007

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# Summary

If current laws and policies remained the same, the budget deficit would equal roughly 1 percent of gross domestic product (GDP) each fiscal year from 2007 to 2010, the Congressional Budget Office (CBO) projects. Those deficits would be smaller than last year's budgetary shortfall, which equaled 1.9 percent of GDP (see Summary Table 1). Under the assumptions that govern CBO's baseline projections, the budget would essentially be balanced in 2011 and then would show surpluses of about 1 percent of GDP each year through 2017 (the end of the current 10-year projection period).

The favorable outlook suggested by those 10-year projections, however, does not indicate a substantial change in the nation's long-term budgetary challenges. The aging of the population and continuing increases in health care costs are expected to put considerable pressure on the budget in coming decades. Economic growth alone is unlikely to be sufficient to alleviate that pressure as Medicare, Medicaid, and (to a lesser extent) Social Security require ever greater resources under current law. Either a substantial reduction in the growth of spending, a significant increase in tax revenues relative to the size of the economy, or some combination of spending and revenue changes will be necessary to promote the nation's long-term fiscal stability.[1]

CBO's baseline budget projections for the next 10 years, moreover, are not a forecast of future outcomes; rather, they are a benchmark that lawmakers and others can use to assess the potential impact of future policy decisions. The deficits and surpluses in the current baseline are predicated on two key projections (which stem from longstanding procedures that were, until recently, specified in law).[2]

- Revenues are projected to rise from 18.6 percent of GDP this year to almost 20 percent of GDP in 2012 and then remain near that historically high level through 2017. Much of that increase results from two aspects of current law that have been subject to recent policy changes: the growing impact of the alternative minimum tax (AMT) and, even more significantly, various provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and modified by subsequent legislation, which are scheduled to expire by December 31, 2010.

- Outlays for discretionary programs (activities whose spending levels are set anew each year through appropriation acts) are projected to decline from 7.8 percent of GDP last year to 5.8 percent of GDP by 2017—a lower percentage than any recorded in the past 45 years. That projection derives mainly from the assumption in the baseline that discretionary funding will grow at the rate of inflation, which is lower than the growth rate that CBO projects for nominal GDP. The projection for discretionary spending implicitly assumes that no additional funding is provided for the war in Iraq in 2007 and that future appropriations for activities related to the war on terrorism remain equivalent, in real (inflation-adjusted) terms, to the $70 billion appropriated so far this year.

1. For a detailed discussion of the long-term pressures facing the federal budget, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005), *Updated Long-Term Projections for Social Security* (March 2005), and *The Outlook for Social Security* (June 2004).

2. The Balanced Budget and Emergency Deficit Control Act of 1985, which established rules that govern the calculation of CBO's baseline, expired on September 30, 2006. Nevertheless, CBO continues to prepare baselines according to the methodology prescribed in that law.

**Summary Table 1.**

## CBO's Baseline Budget Outlook

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| Total Revenues | 2,407 | 2,542 | 2,720 | 2,809 | 2,901 | 3,167 | 3,404 | 3,550 | 3,717 | 3,896 | 4,084 | 4,284 | 15,001 | 34,531 |
| Total Outlays | 2,654 | 2,714 | 2,818 | 2,926 | 3,038 | 3,179 | 3,234 | 3,391 | 3,533 | 3,687 | 3,892 | 4,034 | 15,194 | 33,731 |
| **Total Deficit (-) or Surplus** | **-248** | **-172** | **-98** | **-116** | **-137** | **-12** | **170** | **159** | **185** | **208** | **192** | **249** | **-194** | **800** |
| On-budget | -434 | -357 | -299 | -332 | -367 | -258 | -85 | -101 | -79 | -57 | -72 | -10 | -1,342 | -1,662 |
| Off-budget[a] | 186 | 185 | 201 | 216 | 230 | 246 | 255 | 261 | 264 | 265 | 264 | 259 | 1,148 | 2,461 |
| Debt Held by the Public at the End of the Year | 4,829 | 4,995 | 5,104 | 5,232 | 5,380 | 5,403 | 5,242 | 5,089 | 4,912 | 4,709 | 4,521 | 4,274 | n.a. | n.a. |
| | | | | | | | As a Percentage of Gross Domestic Product | | | | | | | |
| Total Revenues | 18.4 | 18.6 | 19.0 | 18.7 | 18.4 | 19.2 | 19.8 | 19.8 | 19.8 | 19.9 | 20.0 | 20.1 | 19.1 | 19.5 |
| Total Outlays | 20.3 | 19.9 | 19.7 | 19.5 | 19.3 | 19.3 | 18.8 | 18.9 | 18.8 | 18.8 | 19.1 | 18.9 | 19.3 | 19.1 |
| **Total Deficit (-) or Surplus** | **-1.9** | **-1.3** | **-0.7** | **-0.8** | **-0.9** | **-0.1** | **1.0** | **0.9** | **1.0** | **1.1** | **0.9** | **1.2** | **-0.2** | **0.5** |
| Debt Held by the Public at the End of the Year | 37.0 | 36.6 | 35.7 | 34.8 | 34.2 | 32.8 | 30.5 | 28.3 | 26.2 | 24.0 | 22.1 | 20.1 | n.a. | n.a. |
| **Memorandum:** | | | | | | | | | | | | | | |
| Gross Domestic Product (Billions of dollars) | 13,066 | 13,645 | 14,300 | 15,014 | 15,742 | 16,465 | 17,205 | 17,973 | 18,764 | 19,582 | 20,425 | 21,295 | 78,726 | 176,766 |

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

Policy choices that differed from the assumptions in the baseline would produce different budgetary outcomes. For example, if lawmakers continued to provide relief from the AMT (as they have done on a short-term basis for the past several years) and if the provisions of EGTRRA and JGTRRA that are scheduled to expire were instead extended, total revenues would be almost $3 trillion lower over the next 10 years than CBO now projects. Similarly, if discretionary spending (other than for military operations in Iraq and Afghanistan) grew at the rate of nominal GDP over the next 10 years, total discretionary outlays during that period would be nearly $1.3 trillion higher than in the baseline. Combined, those policy changes—and associated debt-service costs—would produce a deficit of $328 billion (1.9 percent of GDP) in 2012 and a cumulative deficit over the 2008–2017 period of $4.2 trillion (2.4 percent of GDP).

Underlying CBO's baseline projections is a forecast that U.S. economic growth will slow in calendar year 2007 but pick up in 2008. Specifically, CBO anticipates that GDP will grow by 2.3 percent in real terms in 2007, a full percentage point less than the growth recorded last year. For 2008, CBO forecasts that GDP growth will rebound to 3.0 percent. Under the assumptions of the baseline, real GDP growth would continue at a similar rate in 2009 and 2010 and then slow to 2.7 percent in 2011 and 2012. For the rest of the projection period, average growth of real GDP is projected to decrease to 2.5 percent per year as increases in the size of the workforce continue to slow.

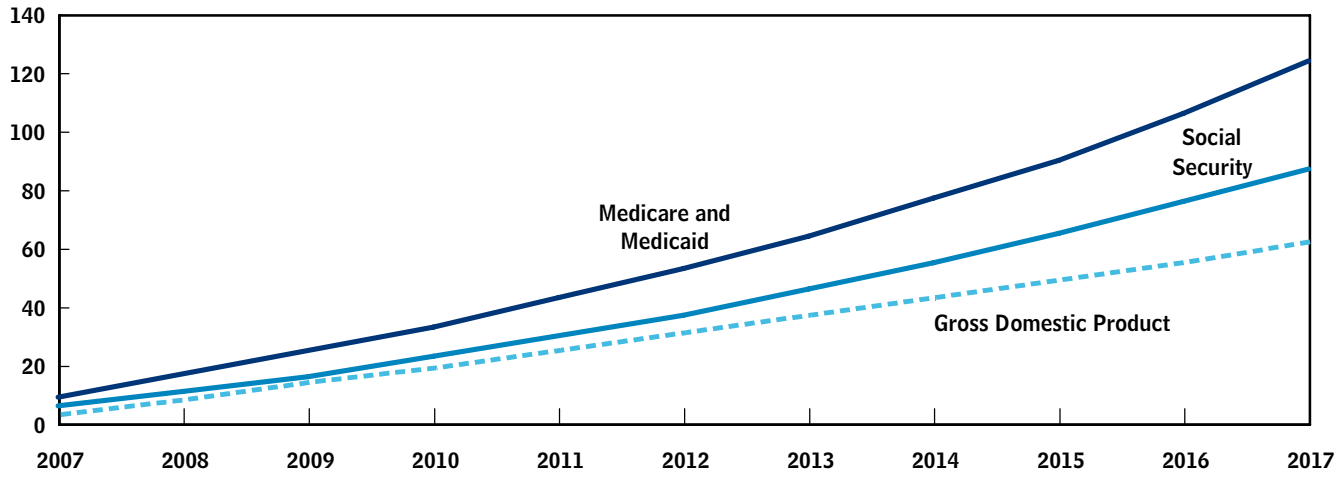
## The Budget Outlook

CBO estimates that if today's laws and policies did not change, federal spending would total $2.7 trillion in

**Summary Figure 1.**

## Projected Growth of the U.S. Economy and Federal Spending for Major Mandatory Programs

(Cumulative nominal percentage growth from 2006 level)




Source: Congressional Budget Office.

2007 and revenues would total $2.5 trillion, resulting in a budget deficit of $172 billion. The additional funding that is likely to be needed to finance military operations in Iraq and Afghanistan would put that deficit in the vicinity of $200 billion. Even so, this year's shortfall would be smaller than the 2006 deficit of $248 billion.

### Baseline Projections for the 2008–2017 Period

Under current laws and policies, the deficit would drop further in 2008, to $98 billion. That decrease results primarily from two factors. On the revenue side of the budget, receipts from the AMT are estimated to increase by about $60 billion next year because of the scheduled expiration of the relief provided through tax year 2006. (In addition, telephone-tax refunds, which totaled $13 billion in 2007, are projected to drop by $10 billion in 2008.) On the spending side of the budget, outlays for operations in Iraq and Afghanistan and for relief and recovery from hurricane damage are about $14 billion lower in 2008 than in 2007 under the assumptions of the baseline.

The baseline deficit is projected to rise modestly over the following two years, 2009 and 2010, as outlays grow by about 3.8 percent annually and revenues increase by about 3.3 percent a year. That projected growth rate for revenues is lower than in recent years, mainly because corporate profits and capital gains realizations are expected to revert to levels that are more consistent with their historical relationship to GDP.

After 2010, spending related to the aging of the baby-boom generation will begin to raise the growth rate of total outlays. The baby boomers will start becoming eligible for Social Security retirement benefits in 2008, when the first members of that generation turn 62. As a result, the annual growth rate of Social Security spending is expected to increase from about 4.5 percent in 2008 to 6.5 percent by 2017.

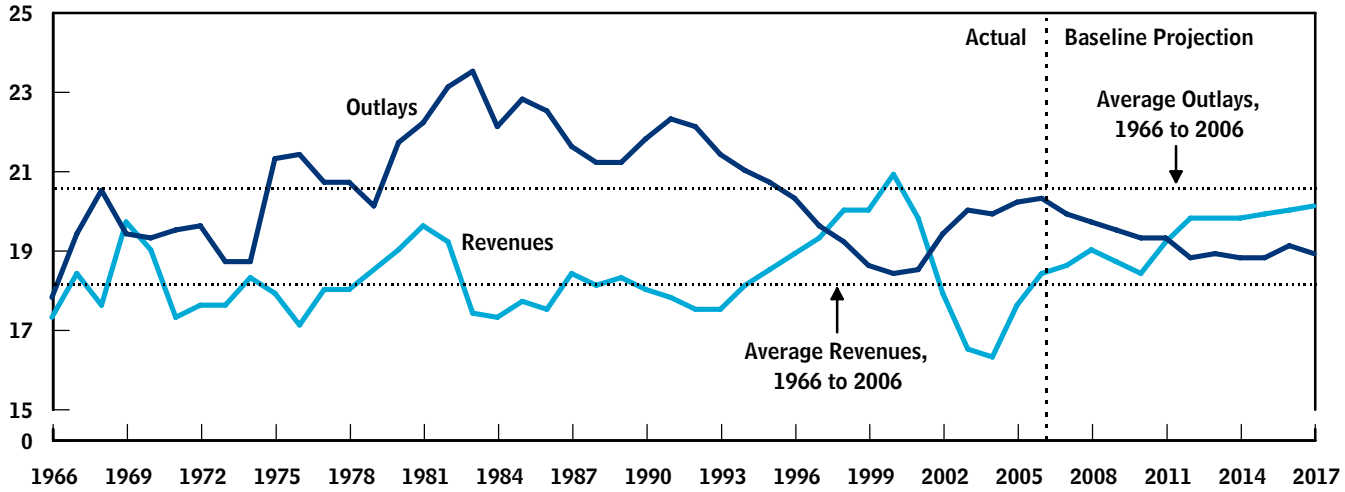
In addition, because the cost of health care is likely to continue rising rapidly, spending for Medicare and Medicaid is projected to grow even faster—in the range of 7 percent to 8 percent annually. Total outlays for those two health care programs are projected to more than double by 2017, increasing by 124 percent, while nominal GDP is projected to grow only half as much, by 63 percent (see Summary Figure 1). Consequently, under the assumptions of CBO's baseline, spending for Medicare, Medicaid, and Social Security will together equal nearly 11 percent of GDP in 2017, compared with a little less than 9 percent this year.

Revenues are projected to increase sharply after 2010 given the assumption that various tax provisions expire as scheduled. In the baseline, total revenues grow by

**Summary Figure 2.**

## Total Revenues and Outlays as a Percentage of Gross Domestic Product, 1966 to 2017

(Percent)




Source: Congressional Budget Office.

9.2 percent in 2011 and by 7.5 percent in 2012, thereby bringing the budget into surplus. Beyond 2012, revenues are projected to grow at about the same pace as outlays (by roughly 4.5 percent a year), keeping the budget in the black through 2017 under baseline assumptions.

Relative to the size of the economy, outlays are projected to range between 18.8 percent and 19.7 percent of GDP during the 2008–2017 period under the assumptions of CBO's baseline—lower than the 20.6 percent average of the past 40 years (see Summary Figure 2). Mandatory spending (funding determined by laws other than annual appropriation acts) is projected to grow by 5.9 percent a year over that period, which is faster than the economy as a whole. By contrast, discretionary appropriations are assumed simply to keep pace with inflation and, to a lesser extent, with the growth of wages. Thus, discretionary outlays are projected to increase by about 2.0 percent a year, on average, or less than half as fast as nominal GDP.

CBO projects that revenues will average 18.7 percent of GDP from 2008 to 2010 (close to the 18.6 percent level expected for this year) before jumping sharply in 2011 and 2012 with the expiration of tax provisions originally enacted in EGTRRA and JGTRRA. After that, revenues are projected to continue growing faster than the overall economy for three reasons: the progressive structure of the tax code combined with increases in total real income, withdrawals of retirement savings as the population ages, and the fact that the AMT is not indexed for inflation. Under the assumptions of the baseline, CBO projects that revenues will equal 20.1 percent of GDP by 2017—a level reached only once since World War II.

Federal government debt that is held by the public (mainly in the form of Treasury securities sold directly in the capital markets) is expected to equal almost 37 percent of GDP at the end of this year. Thereafter, the baseline's projections of smaller annual deficits and emerging surpluses diminish the government's need for additional borrowing, causing debt held by the public to shrink to 20 percent of GDP by 2017.

### Changes in the Baseline Budget Outlook Since August

Although the long-term budgetary picture continues to be worrisome, the baseline outlook for the next 10 years has brightened in the five months since CBO issued its previous projections.[3] Budgetary outcomes have improved for each year from 2007 to 2016 (the period covered by the previous projections), from a reduction

3. Those projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2006).

of $114 billion in the deficit for 2007 to a swing of $285 billion in the bottom line for 2016 (from a deficit of $93 billion to a surplus of $192 billion). In all, those reductions represent a difference of about 1.2 percent of GDP over 10 years.

Those changes overstate the fundamental improvement in the underlying budget outlook, however. Roughly half of the total change stems from the baseline's treatment of previous supplemental appropriations for disaster relief and the irregular pattern of funding for military operations in Iraq and Afghanistan. Consequently, more than half of the improved bottom line is unrelated to changes in the underlying budgetary and economic environment.

Much of the remaining change to the current baseline comes from lower projected spending for Medicare. Total outlays for that program over the 2007–2016 period are nearly 8 percent lower in this baseline than in CBO's August projections. That reduction is largely attributable to new estimates of per capita costs for all Medicare benefits, but it also reflects lower projections of the number of enrollees in the prescription drug benefit program. Those recent changes, however, do not significantly alter the upward trajectory of Medicare spending in the long term.

## The Economic Outlook

The Federal Reserve's shift in monetary policy over the past two and a half years and the recent decline in housing construction are expected to restrain economic growth this year, but the economy is likely to post solid gains next year. CBO forecasts that GDP will grow by 2.3 percent in real terms in calendar year 2007 but by 3.0 percent in 2008 (see Summary Table 2).

Gains in employment, which remained solid in 2006 despite a slowdown in economic growth during the second half of the year, are expected to lessen in 2007. That change may cause unemployment to edge up from the 4.6 percent rate recorded for 2006. As housing construction stabilizes, however, economic growth and employment should start to recover by the middle of 2007.

Last year, robust investment by businesses and solid growth in exports helped the U.S. economy absorb the decline in housing construction. Investment and exports are expected to continue to support the economy in 2007. For many years, businesses' capital stock (the plant, equipment, and software they use for production) grew more slowly than overall demand for U.S. goods and services; as a result, despite the recent growth of investment, the nation's capital stock is still low relative to the level of demand. Investment should therefore continue to increase, even if the growth of demand slows. Similarly, export growth is likely to remain strong because increases in demand for U.S. products overseas are durable enough to withstand a slight slowdown in U.S. demand for other countries' exports.

In the absence of any adverse price shocks to the economy, the core rate of inflation—which excludes prices for food and energy—is expected to ease slightly this year. Overall inflation (as measured by the year-to-year change in the price index for personal consumption expenditures) will fall from last year's rate of 2.8 percent to 1.7 percent in 2007 because of a large drop in prices for motor fuels near the end of last year. The core rate of inflation, however, is expected to decline less rapidly during 2007.

CBO anticipates that the interest rate on three-month Treasury bills will drop slightly this year from the 4.9 percent rate seen at the end of 2006. Further declines are expected during 2008, when that rate will average 4.5 percent. CBO's forecast assumes that long-term interest rates will edge up as short-term interest rates decline. The rate on 10-year Treasury notes, for example, is forecast to rise from 4.8 percent this year to 5.0 percent in 2008.

Beyond the two-year horizon, CBO projects that economic growth (as measured by increases in real GDP) will average 2.7 percent a year from 2009 to 2017. As members of the baby-boom generation begin to retire, the growth of the labor force is expected to slow, pushing down the rate of real GDP growth during the second half of that period. Projected rates of inflation, unemployment, and growth of labor productivity average 2.0 percent, 5.0 percent, and 2.2 percent, respectively, after 2008. Interest rates are projected to average 4.4 percent for three-month Treasury bills and 5.2 percent for 10-year Treasury notes.

## Summary Table 2.

# CBO's Economic Projections for Calendar Years 2007 to 2017

(Percentage change)

| | Estimated | Forecast | | Projected Annual Average | |
|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009-2012 | 2013-2017 |
| Nominal GDP | | | | | |
| Billions of dollars | 13,235 | 13,805 | 14,472 | 17,395 [a] | 21,519 [b] |
| Percentage change | 6.3 | 4.3 | 4.8 | 4.7 | 4.3 |
| Real GDP | 3.3 | 2.3 | 3.0 | 2.9 | 2.5 |
| GDP Price Index | 2.9 | 1.9 | 1.8 | 1.8 | 1.8 |
| PCE Price Index[c] | 2.8 | 1.7 | 1.9 | 2.0 | 2.0 |
| Core PCE Price Index[d] | 2.3 | 2.1 | 1.9 | 2.0 | 2.0 |
| Consumer Price Index[e] | 3.4 | 1.9 | 2.3 | 2.2 | 2.2 |
| Core Consumer Price Index[f] | 2.6 | 2.6 | 2.3 | 2.2 | 2.2 |
| Unemployment Rate (Percent) | 4.6 | 4.7 | 4.9 | 5.0 | 5.0 |
| Interest Rates (Percent) | | | | | |
| Three-month Treasury bills | 4.7 | 4.8 | 4.5 | 4.4 | 4.4 |
| Ten-year Treasury notes | 4.8 | 4.8 | 5.0 | 5.2 | 5.2 |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Notes: GDP = gross domestic product.

Percentage changes are measured from one year to the next.

Economic projections for each year from 2007 to 2017 appear in Appendix D.

a. Level in 2012.

b. Level in 2017.

c. The personal consumption expenditure chained price index.

d. The personal consumption expenditure chained price index excluding prices for food and energy.

e. The consumer price index for all urban consumers.

f. The consumer price index for all urban consumers excluding prices for food and energy.

CHAPTER

1

# The Budget Outlook

The Congressional Budget Office (CBO) projects that if current laws and policies remained the same, the federal budget would show a deficit of $172 billion for 2007 (see Table 1-1). However, that estimate—and the other projections that make up CBO's budget baseline—do not generally include prospective legislation; thus, the current budget outlook omits some likely spending in 2007 for military operations in Iraq and Afghanistan. Supplemental appropriations for such purposes are expected to add about $25 billion to outlays this year, resulting in a deficit in the vicinity of $200 billion. That projected shortfall excludes the effects of other potential changes in spending as well as possible changes to the tax code.

A 2007 deficit of roughly $200 billion would be smaller than the shortfall of $248 billion recorded for 2006. Measured relative to the size of the economy, the deficit would fall from 1.9 percent of gross domestic product (GDP) in 2006 to about 1.5 percent this year—smaller than the average deficit of 2.3 percent of GDP recorded since 1966 (see Figure 1-1).

During the 2008–2017 period, the baseline moves from deficit to surplus. Under the assumptions that govern CBO's projections, the deficit totals $98 billion (0.7 percent of GDP) in 2008, rises slightly in both 2009 and 2010, and then essentially reaches balance in 2011. Thereafter, through 2017, the baseline shows annual surpluses that each equal about 1 percent of GDP.

The favorable pattern of those baseline projections over the next 10 years does not, however, indicate a substantial change in the nation's long-term budgetary challenges. The aging of the population and the expected increases in health care costs are likely to put significant pressure on the budget outside of the current 10-year projection window.

CBO's budget baseline, moreover, is not a forecast of future outcomes but a benchmark that encompasses present laws and policies. It is predicated on two key projections that stem from long-standing statutory procedures for its development.

- Under current law, revenues will increase from 18.6 percent of GDP in 2007 to almost 20 percent of GDP in 2012 and remain near that historically high level through 2017. Much of that increase stems from two factors: the growing impact of the alternative minimum tax (AMT) and, even more significant, the expiration of provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and modified by subsequent legislation.

- Discretionary outlays, measured relative to the economy, will decline from 7.8 percent of GDP in 2006 to 5.8 percent of GDP by 2017, a ratio lower than any recorded in the past 45 years. That projection results primarily from the assumption that discretionary funding grows at the rate of inflation, a pace slower than the estimated rate of growth of GDP.

Although CBO's baseline projections do not incorporate anticipated changes in policy, this chapter shows the implications for the budget over the next 10 years of some alternative policy assumptions. For example, CBO has constructed two possible scenarios for future spending related to military operations in Iraq and Afghanistan and other activities associated with the war on terrorism. Those scenarios incorporate differing assumptions about how rapidly troop levels might be reduced. Under both scenarios, defense outlays would be greater in the near term and smaller in the long term than those in the current baseline.

**Table 1-1.**

## Projected Deficits and Surpluses in CBO's Baseline

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| On-Budget Deficit | -434 | -357 | -299 | -332 | -367 | -258 | -85 | -101 | -79 | -57 | -72 | -10 | -1,342 | -1,662 |
| Off-Budget Surplus[a] | 186 | 185 | 201 | 216 | 230 | 246 | 255 | 261 | 264 | 265 | 264 | 259 | 1,148 | 2,461 |
| **Total Deficit (-) or Surplus** | **-248** | **-172** | **-98** | **-116** | **-137** | **-12** | **170** | **159** | **185** | **208** | **192** | **249** | **-194** | **800** |
| **Memorandum:** | | | | | | | | | | | | | | |
| Social Security Surplus | 185 | 190 | 203 | 218 | 231 | 246 | 255 | 260 | 264 | 265 | 263 | 259 | 1,153 | 2,464 |
| Postal Service Outlays | -1 | 5 | 2 | 2 | 1 | * | * | * | * | * | * | * | 4 | 3 |
| Total Deficit (-) or Surplus as a Percentage of GDP | -1.9 | -1.3 | -0.7 | -0.8 | -0.9 | -0.1 | 1.0 | 0.9 | 1.0 | 1.1 | 0.9 | 1.2 | -0.2 | 0.5 |
| Debt Held by the Public as a Percentage of GDP[b] | 37.0 | 36.6 | 35.7 | 34.8 | 34.2 | 32.8 | 30.5 | 28.3 | 26.2 | 24.0 | 22.1 | 20.1 | n.a. | n.a. |

Source: Congressional Budget Office.

Notes: * = between -$500 million and zero; GDP = gross domestic product; n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

b. Debt held at the end of the year.

Alternative assumptions about tax policy would also change CBO's baseline projections. If all of the tax provisions that are set to expire over the next 10 years were extended and the AMT was indexed for inflation, the budget outlook for 2017 would change from a surplus of $249 billion to a deficit of $476 billion. Debt held by the public at the end of 2017 would climb to 39 percent of GDP, and the 10-year, or cumulative, deficit would total $3.2 trillion.

Throughout the 2008–2017 period, spending for the nation's elderly population is likely to place increasing strains on the federal budget. CBO projects that the annual rate of growth of spending for Medicare will increase from 6.1 percent in 2008 (when the prescription drug benefit is fully phased in) to 8.7 percent in 2017.[1] Similar growth—7.8 percent—is projected for Medicaid spending in 2017. The annual rate of growth of spending for Social Security (excluding administrative expenses) is projected to rise from about 4.5 percent in 2008—the year that the first members of the baby-boom generation reach 62 and become eligible for retirement benefits—to 6.5 percent in 2017. CBO estimates that without changes in law, outlays for those three programs combined will equal 10.7 percent of GDP in 2017, up from 8.8 percent this year.

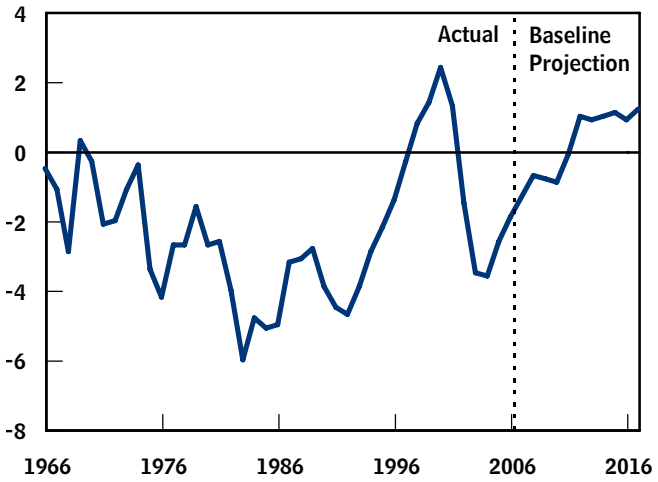
Beyond 2017, those trends will accelerate. The percentage of the population age 65 or older will keep increasing, and health care costs are likely to continue growing faster than GDP—as they have for the past 40 years. Consequently, under current law, spending for Medicare, Medicaid, and Social Security will exert such pressure on the

1. The growth rates for 2008 and 2017 have been adjusted to exclude certain shifts in the timing of payments to managed care providers.

**Figure 1-1.**

## The Total Deficit or Surplus as a Percentage of GDP, 1966 to 2017

(Percent)




Sources: Congressional Budget Office; Office of Management and Budget.

Note: GDP = gross domestic product.

budget as to make the current path of fiscal policy unsustainable.[2]

## A Review of 2006

The budget deficit in 2006 declined for a second consecutive year, dropping from $318 billion in 2005 to $248 billion—$165 billion below its peak in 2004. During the past few years, the deficit, in relation to the size of the economy, has fallen from 3.6 percent of GDP in 2004 to 2.6 percent in 2005 and 1.9 percent in 2006.

### Revenues

The improved budgetary outcome for 2006 was mainly the result of the continued robust growth of federal revenues, which rose by 11.7 percent ($253 billion) above their level in 2005 (see Table 1-2). Revenues measured as a percentage of GDP grew for the second year in a row, increasing from 16.3 percent of GDP in 2004 to 17.6 percent in 2005 and 18.4 percent in 2006. That last figure is slightly higher than the average—18.2 percent—over the past 40 years.

Pushing revenues up in 2006 were substantial increases in receipts from individual and corporate income taxes. Individual income tax receipts, which climbed by almost 13 percent, accounted for nearly half of last year's revenue upturn, a rise that largely reflects the growth in 2005 and 2006 of both wage and nonwage income (such as capital gains income and personal income from partnerships).

Receipts from the corporate income tax remained strong last year, increasing by 27 percent (after growing by about 45 percent in each of the two previous years). Recently, those receipts have grown much faster than the economy as a whole, climbing from 1.2 percent of GDP in 2003 to 2.7 percent in 2006—their highest level since 1977. The strong growth of corporate tax receipts last year can be traced, for the most part, to the growth of corporate profits, which have risen significantly as a percentage of GDP.

Receipts from social insurance (payroll) taxes rose by 5.5 percent in 2006, mainly as a result of increases in wages and salaries. (Chapter 4 provides more information about recent and projected federal revenues.)

### Outlays

Total outlays in 2006 rose by 7.4 percent ($182 billion) and, measured as a share of the economy, reached their highest level since 1995—20.3 percent of GDP. If interest payments (which lawmakers do not directly control and which reflect the impact of previous years' deficits) were excluded, outlays would measure 18.6 percent of GDP, a figure slightly above the average of noninterest outlays over the past 40 years—18.4 percent.

Mandatory outlays grew by slightly less than 7 percent ($92 billion) in 2006, or at about the same pace as in 2005. Spending for Medicare (excluding receipts from premiums) rose by more than 12 percent ($41 billion), largely because of Part D, the new prescription drug program. Yet that percentage increase in outlays understates

2. For a detailed discussion of the long-term pressures facing the federal budget, see Donald B. Marron, "The ABCs of Long-Term Budget Challenges" (opening remarks at the Director's Conference on Budgeting and Accounting for Long-Term Obligations, Congressional Budget Office, Washington, D.C., December 8, 2006), available at www.cbo.gov/ftpdocs/77xx/doc7703/12-08-OpeningRemarks.pdf; and Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005), *Updated Long-Term Projections for Social Security* (March 2005), and *The Outlook for Social Security* (June 2004).

**Table 1-2.**

## Average Annual Growth Rates of Revenues and Outlays

(Percent)

| | Actual | | Estimated | Projected[a] | |
|---|---|---|---|---|---|
| | 1995-2005 | 2005-2006 | 2006-2007 | 2007-2008 | 2008-2017 |
| | | | **Revenues** | | |
| Individual Income Taxes | 4.6 | 12.6 | 9.6 | 10.0 | 6.8 |
| Corporate Income Taxes | 5.9 | 27.2 | 4.1 | 1.4 | * |
| Social Insurance Taxes | 5.1 | 5.5 | 4.4 | 4.5 | 4.5 |
| Other[b] | 2.5 | 10.9 | -9.3 | 11.5 | 5.8 |
| **Total Revenues** | **4.8** | **11.7** | **5.6** | **7.0** | **5.2** |
| | | | **Outlays** | | |
| Mandatory | 6.0 | 6.9 | 3.1 | 5.4 | 5.9 |
| Discretionary | 5.9 | 4.9 | 0.8 | 1.0 | 2.0 |
| Net Interest | -2.3 | 23.2 | 3.7 | 6.4 | -1.0 |
| **Total Outlays** | **5.0** | **7.4** | **2.3** | **3.8** | **4.1** |
| **Memorandum:** | | | | | |
| Consumer Price Index | 2.5 | 3.8 | 1.9 | 2.3 | 2.2 |
| Nominal GDP | 5.3 | 6.5 | 4.4 | 4.8 | 4.5 |

Source: Congressional Budget Office.

Notes: The growth rates in this table do not account for shifts in the timing of certain payments or receipts.

* = between -0.05 percent and zero; GDP = gross domestic product.

a. CBO's baseline budget projections. CBO uses the employment cost index for wages and salaries to inflate discretionary spending related to federal personnel and the gross domestic product deflator to adjust other discretionary spending when constructing its baseline.

b. Includes excise, estate, and gift taxes as well as customs duties.

the growth of Medicare spending because it reflects shifts in the timing of certain payments.[3] Adjusted for those shifts, Medicare benefits jumped by more than 16 percent.

Other areas that saw substantial increases in mandatory outlays in 2006 included education and disaster insurance. Outlays for student loans increased from $15 billion in 2005 to $33 billion in 2006 as a result of significant revisions to previous estimates of credit subsidies and additional subsidy costs for new loan consolidations.[4] Outlays for the flood insurance program also rose, to a net $17 billion in 2006—up from $1 billion in 2005—following damage from Hurricane Katrina and other storms.

From 2005 to 2006, overall discretionary outlays climbed by 4.9 percent ($48 billion). Outlays for defense rose by $26 billion; CBO estimates that about 40 percent of that amount represents increased spending for military operations in Iraq and Afghanistan and for other activities considered part of the war on terrorism. (See Box 1-1 for details about the funding provided for those operations thus far.)

Discretionary outlays not related to defense grew by $21 billion last year. Spending for disaster relief climbed by $14 billion after rising by $9 billion in 2005, with most of the increase in 2006 derived from supplemental

3. A shift in certain payments from October to September 2005 and a legislated delay in payments at the end of 2006 have moved an estimated $9 billion in Medicare outlays from 2006 into 2005 and 2007.

4. The budget records the Administration's estimate of the subsidy costs of consolidation loans as if they are new loans. CBO believes—on the basis of its interpretation of the Credit Reform Act and subsequent guidance from the budget committees—that those costs should be counted as part of the subsidies associated with the original loans.

appropriations that lawmakers provided in response to Hurricanes Katrina, Rita, and Wilma. Outlays related to natural resources and the environment (primarily for flood control) grew by $4 billion, and outlays for ground transportation (mostly for highways and mass transit) rose by $3 billion, with a significant portion of the increase in both spending categories stemming from repairs as a result of the 2005 Gulf Coast hurricanes. Lower spending for international affairs partially offset some of those increases: The slowing down of relief and reconstruction efforts in Iraq largely accounted for a $3 billion drop in outlays for the international affairs category.

In 2006, interest on the public debt rose 23 percent above its level in 2005. Debt held by the public increased by about 5 percent, which led to an upswing in debt-service costs that was further boosted by rising short-term interest rates. (A more detailed discussion of federal spending appears in Chapter 3.)

## The Concept Behind CBO's Baseline Projections

The projections that make up CBO's baseline are not intended to be predictions of future budgetary outcomes—rather, they represent CBO's best judgment of how the economy and other factors would affect federal revenues and spending if current laws and policies remained in place. CBO constructs its baseline in accordance with the provisions set forth in the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974. (Although the provisions in the Deficit Control Act that pertain to the baseline expired at the end of September 2006, CBO continues to follow that law's specifications in preparing its projections.) In general, those provisions spell out how CBO should project federal spending and revenues under current policies. The resulting baseline can then be used as a benchmark against which to measure the effects of proposed changes in tax and spending policies.

For revenues and mandatory spending, the Deficit Control Act required that the baseline be projected under the assumption that present laws continue without change.[5] In many cases, the laws that govern revenues and mandatory spending are permanent. Thus, CBO's baseline projections reflect changes anticipated in the economy, demographics, and other relevant factors that affect the implementation of those laws.

The baseline's treatment of discretionary spending is different. The Deficit Control Act called for projecting discretionary spending by assuming that the most recent year's discretionary budget authority (including any supplemental appropriations) is provided in each future year, with adjustments to reflect projected inflation—as measured in specified indexes—and certain other factors (such as the annual cost of adjustments to federal benefits).

## CBO's Baseline Projections for 2007 to 2017

For 2007, CBO anticipates a budget deficit of $172 billion under current law, with total outlays of $2.7 trillion and revenues of $2.5 trillion. However, additional funding is likely to be needed to finance military activities in Iraq and Afghanistan, which might add about $25 billion to outlays. The net result would be a deficit that approached $200 billion.

In CBO's current baseline, the deficit in 2008 drops further—to $98 billion. That decline results from several factors that affect both revenues and outlays.

- The baseline incorporates the assumption that the relief from the alternative minimum tax that is provided under current law will not continue after this year (it was legislated to expire after December 31, 2006).[6] As a result, revenues in the baseline rise by more than $60 billion in 2008 and by varying amounts thereafter. In addition, refunds of telephone

5. The Deficit Control Act provided some exceptions. For example, it directed that spending programs whose authorizations are set to expire be assumed to continue if they have outlays of more than $50 million in the current year and were established on or before the enactment of the Balanced Budget Act of 1997. Programs established after that law was enacted are not automatically assumed to continue. The Deficit Control Act also required CBO to assume that expiring excise taxes that are dedicated to trust funds will be extended at their current rates. The law did not provide for the extension of other expiring tax provisions, even if they had been extended routinely in the past.

6. The AMT is a parallel income tax system that has fewer exemptions, deductions, and rate categories than the regular income tax has. In general, taxpayers must calculate their tax under both systems and pay whichever amount is larger.

**Box 1-1.**

## Funding for Activities in Iraq and the War on Terrorism

Since September 2001, policymakers have provided $503 billion in budget authority for military and diplomatic operations in Iraq, Afghanistan, and other regions in support of the war on terrorism (see the table on the next page). More than 90 percent of that amount has been appropriated for activities that are categorized in the budget as national defense; the rest has gone to activities that are categorized as international affairs.

Funding for military operations and other defense activities totals $448 billion thus far, nearly all of which has gone to the Department of Defense (DoD). (Funding for intelligence agencies and the Coast Guard accounts for less than 1 percent of that total.) In addition, policymakers have provided $15 billion during the 2005–2007 period to train and equip indigenous security forces in Iraq and Afghanistan. (They provided another $5 billion for Iraqi security forces in 2004, but because that appropriation went to the Department of State's Iraq Relief and Reconstruction Fund, the money was classified as spending for international affairs.) If the $15 billion for indigenous security forces is included, appropriations for defense-related activities in Iraq and Afghanistan and for the war on terrorism since September 2001 total $463 billion.

Determining exactly how much of that budget authority has been spent is difficult. Reports from the Department of the Treasury do not distinguish between outlays from regular appropriations and outlays from supplemental appropriations, nor do they distinguish between spending for peacetime operations and spending associated with the war on terrorism. However, reports from DoD indicate how much of the funding has been obligated.[1]

That information suggests that the department has obligated almost all of the $277 billion in appropriations that it received before 2006 for operations in Iraq and Afghanistan and for antiterrorism activities. Also, according to the reports, as of November 30, 2006, DoD had obligated $95 billion of the $116 billion appropriated for defense in 2006 for the war on terrorism and $16 billion of the $70 billion appropriated for that purpose in 2007. However, the Congressional Budget Office (CBO) cannot precisely estimate the amounts obligated to date because DoD has not provided information about the obligation of funds appropriated for classified activities or for the restructuring of units in the Army and Marine Corps.

DoD reports that it obligated more than $8 billion per month in 2006 for operations in Iraq and Afghanistan—an increase of $1 billion compared with average monthly obligations in 2005. Of those obligations, Operation Iraqi Freedom accounted for approximately 85 percent of all reported obligations; Operation Enduring Freedom (which refers to operations in and around Afghanistan) accounted for another 14 percent. Additional security missions in the United States since the September 11, 2001, attacks—such as combat air patrols over Washington, D.C., and New York City (known as Operation Noble Eagle)—accounted for another 1 percent.

In addition to funding for defense activities, lawmakers since 2001 have appropriated just over $34 billion for diplomatic operations and foreign aid to Iraq, Afghanistan, and other countries that are assisting the United States in the Iraq war and the war on terrorism. If the $5 billion provided in 2004 to the State Department for Iraqi security forces is included, funding for activities related to international affairs since 2001 totals about $40 billion. About half of that amount, or $21 billion, was appropriated for the Iraq Relief and Reconstruction Fund, and almost all of it has been obligated. On the basis of information from the State Department, CBO estimates that most of the other $19 billion has been obligated as well.

1. An obligation is a commitment that creates a legal liability of the government for the payment of goods and services ordered or received. Such payments may be made immediately or in the future.

## Box 1-1.
## Continued

**Estimated Appropriations Provided for Iraq and the War on Terrorism, 2001 to 2007**
(Billions of dollars, by fiscal year)

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | Total, 2001-2007 |
|---|---|---|---|---|---|---|---|---|
| Military Operations and Other Defense Activities | | | | | | | | |
| Iraq[a] | 0 | 0 | 46 | 68 | 53 | 87 | 52 | 306 |
| Other[b] | 14 | 18 | 34 | 21 | 18 | 24 | 14 | 142 |
| Subtotal | 14 | 18 | 80 | 88 | 70 | 111 | 67 | 448 |
| Indigenous Security Forces[c] | | | | | | | | |
| Iraq | 0 | 0 | 0 | 5 | 6 | 3 | 2 | 16 |
| Afghanistan | 0 | 0 | 0 | 0 | 1 | 2 | 2 | 5 |
| Subtotal | 0 | 0 | 0 | 5 | 7 | 5 | 3 | 20 |
| Diplomatic Operations and Foreign Aid | | | | | | | | |
| Iraq | 0 | 0 | 3 | 15 | 1 | 3 | 0 | 22 |
| Other | * | 2 | 5 | 2 | 2 | 1 | 0 | 12 |
| Subtotal | * | 2 | 8 | 17 | 3 | 4 | 0 | 34 |
| **Total[d]** | **14** | **19** | **88** | **111** | **81** | **120** | **70** | **503** |

Source: Congressional Budget Office.

Note: * = between zero and $500 million.

a. CBO estimated how much money has been provided for Operation Iraqi Freedom by allocating funds on the basis of obligations reported by the Department of Defense (DoD). For more information about funding for that operation, see Congressional Budget Office, *Estimated Costs of U.S. Operations in Iraq Under Two Specified Scenarios* (July 13, 2006).

b. Includes Operation Enduring Freedom (in and around Afghanistan), Operation Noble Eagle (homeland security missions, such as combat air patrols, in the United States), the restructuring of Army and Marine Corps units, classified activities other than those funded by appropriations for the Iraq Freedom Fund, and other operations. (For 2005 through 2007, funding for Operation Noble Eagle has been intermingled with regular appropriations for the Department of Defense. That funding is not included in this table because it cannot be separately identified.)

c. Funding for indigenous security forces—which went to accounts for diplomatic operations and foreign aid (budget function 150) in 2004 and, since 2005, has gone to defense accounts (budget function 050)—is used to train and equip local military and police units in Iraq and Afghanistan.

d. At the current rate of military operations, the funding provided to date for 2007 will not be sufficient to pay for all of the costs that will be incurred this year, and additional appropriations will probably be provided.

taxes, which amount to an estimated $13 billion in 2007, are expected to total only $2 billion in 2008.[7]

- Outlays for military operations in Iraq and Afghanistan are about $14 billion higher in CBO's baseline estimate for 2007 than in its projection for 2008. The reason is that the estimate for 2007 includes more outlays resulting from funding provided in prior years than the 2008 estimate does. (Some of the additional funding for such activities that is likely to be requested later this year will be spent in 2007, some in 2008, and some in later years.)

7. For further detail on the refunds, see Box 4-3 on page 96.

## Table 1-3.

# CBO's Baseline Budget Projections

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| Revenues | | | | | | | | | | | | | | |
| Individual income taxes | 1,044 | 1,144 | 1,259 | 1,311 | 1,380 | 1,584 | 1,730 | 1,830 | 1,928 | 2,036 | 2,149 | 2,269 | 7,263 | 17,473 |
| Corporate income taxes | 354 | 368 | 374 | 360 | 336 | 339 | 349 | 333 | 340 | 349 | 360 | 373 | 1,758 | 3,513 |
| Social insurance taxes | 838 | 875 | 914 | 958 | 1,004 | 1,052 | 1,100 | 1,149 | 1,198 | 1,249 | 1,301 | 1,354 | 5,029 | 11,281 |
| Other | 171 | 155 | 173 | 181 | 181 | 192 | 225 | 238 | 250 | 262 | 275 | 288 | 952 | 2,265 |
| **Total** | **2,407** | **2,542** | **2,720** | **2,809** | **2,901** | **3,167** | **3,404** | **3,550** | **3,717** | **3,896** | **4,084** | **4,284** | **15,001** | **34,531** |
| On-budget | 1,798 | 1,905 | 2,051 | 2,106 | 2,163 | 2,394 | 2,596 | 2,706 | 2,838 | 2,979 | 3,129 | 3,290 | 11,311 | 26,252 |
| Off-budget | 608 | 638 | 669 | 703 | 738 | 773 | 808 | 844 | 880 | 917 | 955 | 994 | 3,690 | 8,279 |
| Outlays | | | | | | | | | | | | | | |
| Mandatory spending | 1,411 | 1,455 | 1,533 | 1,620 | 1,708 | 1,821 | 1,866 | 2,001 | 2,123 | 2,258 | 2,438 | 2,568 | 8,548 | 19,937 |
| Discretionary spending | 1,016 | 1,024 | 1,034 | 1,050 | 1,067 | 1,089 | 1,100 | 1,129 | 1,155 | 1,182 | 1,215 | 1,238 | 5,342 | 11,260 |
| Net interest | 227 | 235 | 250 | 255 | 262 | 269 | 268 | 261 | 255 | 248 | 239 | 228 | 1,305 | 2,535 |
| **Total** | **2,654** | **2,714** | **2,818** | **2,926** | **3,038** | **3,179** | **3,234** | **3,391** | **3,533** | **3,687** | **3,892** | **4,034** | **15,194** | **33,731** |
| On-budget | 2,232 | 2,262 | 2,350 | 2,439 | 2,530 | 2,652 | 2,681 | 2,808 | 2,917 | 3,036 | 3,201 | 3,300 | 12,653 | 27,913 |
| Off-budget | 422 | 452 | 468 | 487 | 507 | 527 | 553 | 583 | 616 | 652 | 691 | 735 | 2,542 | 5,818 |
| **Deficit (-) or Surplus** | **-248** | **-172** | **-98** | **-116** | **-137** | **-12** | **170** | **159** | **185** | **208** | **192** | **249** | **-194** | **800** |
| On-budget | -434 | -357 | -299 | -332 | -367 | -258 | -85 | -101 | -79 | -57 | -72 | -10 | -1,342 | -1,662 |
| Off-budget | 186 | 185 | 201 | 216 | 230 | 246 | 255 | 261 | 264 | 265 | 264 | 259 | 1,148 | 2,461 |
| Debt Held by the Public | 4,829 | 4,995 | 5,104 | 5,232 | 5,380 | 5,403 | 5,242 | 5,089 | 4,912 | 4,709 | 4,521 | 4,274 | n.a. | n.a. |
| **Memorandum:** | | | | | | | | | | | | | | |
| Gross Domestic Product | 13,065 | 13,645 | 14,300 | 15,014 | 15,742 | 16,465 | 17,205 | 17,973 | 18,764 | 19,582 | 20,425 | 21,295 | 78,726 | 176,766 |
| | | | | | | | As a Percentage of Gross Domestic Product | | | | | | | |
| Revenues | | | | | | | | | | | | | | |
| Individual income taxes | 8.0 | 8.4 | 8.8 | 8.7 | 8.8 | 9.6 | 10.1 | 10.2 | 10.3 | 10.4 | 10.5 | 10.7 | 9.2 | 9.9 |
| Corporate income taxes | 2.7 | 2.7 | 2.6 | 2.4 | 2.1 | 2.1 | 2.0 | 1.9 | 1.8 | 1.8 | 1.8 | 1.8 | 2.2 | 2.0 |
| Social insurance taxes | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 |
| Other | 1.3 | 1.1 | 1.2 | 1.2 | 1.1 | 1.2 | 1.3 | 1.3 | 1.3 | 1.3 | 1.3 | 1.4 | 1.2 | 1.3 |
| **Total** | **18.4** | **18.6** | **19.0** | **18.7** | **18.4** | **19.2** | **19.8** | **19.8** | **19.8** | **19.9** | **20.0** | **20.1** | **19.1** | **19.5** |
| On-budget | 13.8 | 14.0 | 14.3 | 14.0 | 13.7 | 14.5 | 15.1 | 15.1 | 15.1 | 15.2 | 15.3 | 15.4 | 14.4 | 14.9 |
| Off-budget | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 |
| Outlays | | | | | | | | | | | | | | |
| Mandatory spending | 10.8 | 10.7 | 10.7 | 10.8 | 10.8 | 11.1 | 10.8 | 11.1 | 11.3 | 11.5 | 11.9 | 12.1 | 10.9 | 11.3 |
| Discretionary spending | 7.8 | 7.5 | 7.2 | 7.0 | 6.8 | 6.6 | 6.4 | 6.3 | 6.2 | 6.0 | 5.9 | 5.8 | 6.8 | 6.4 |
| Net interest | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.6 | 1.6 | 1.5 | 1.4 | 1.3 | 1.2 | 1.1 | 1.7 | 1.4 |
| **Total** | **20.3** | **19.9** | **19.7** | **19.5** | **19.3** | **19.3** | **18.8** | **18.9** | **18.8** | **18.8** | **19.1** | **18.9** | **19.3** | **19.1** |
| On-budget | 17.1 | 16.6 | 16.4 | 16.2 | 16.1 | 16.1 | 15.6 | 15.6 | 15.5 | 15.5 | 15.7 | 15.5 | 16.1 | 15.8 |
| Off-budget | 3.2 | 3.3 | 3.3 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.3 | 3.3 | 3.4 | 3.5 | 3.2 | 3.3 |
| **Deficit (-) or Surplus** | **-1.9** | **-1.3** | **-0.7** | **-0.8** | **-0.9** | **-0.1** | **1.0** | **0.9** | **1.0** | **1.1** | **0.9** | **1.2** | **-0.2** | **0.5** |
| On-budget | -3.3 | -2.6 | -2.1 | -2.2 | -2.3 | -1.6 | -0.5 | -0.6 | -0.4 | -0.3 | -0.4 | * | -1.7 | -0.9 |
| Off-budget | 1.4 | 1.4 | 1.4 | 1.4 | 1.5 | 1.5 | 1.5 | 1.5 | 1.4 | 1.4 | 1.3 | 1.2 | 1.5 | 1.4 |
| Debt Held by the Public | 37.0 | 36.6 | 35.7 | 34.8 | 34.2 | 32.8 | 30.5 | 28.3 | 26.2 | 24.0 | 22.1 | 20.1 | n.a. | n.a. |

Source: Congressional Budget Office.

Note: * = between -0.05 percent and zero; n.a. = not applicable.

In both 2009 and 2010, the deficit in the baseline rises to a modest degree. During that time, the growth of outlays will remain steady at about 3.8 percent per year, CBO estimates, and the growth of revenues will slow to about 3.3 percent annually. The slower growth of baseline revenues in those years is mainly due to projected changes in corporate profits and capital gains realizations: CBO expects that during 2009 and 2010, revenues in those income categories will revert to levels that are more consistent with their historical relationship to GDP. The projection of slower revenue growth also reflects CBO's assumption about the possible continuation of the recent high levels of receipts from income taxes (both corporate and individual income). Economic data explain some but not all of that strength; thus, CBO—lacking sufficient information about the sources and causes of the unexplained portion of that growth—has assumed that it will gradually decline.

After 2010, spending tied to the aging of the baby-boom generation pushes baseline projections of the average annual growth of total outlays up to 4.1 percent. Offsetting that rise in spending, however, are sharp increases in projected revenues in 2011 and 2012 (under the assumption that various tax provisions expire as scheduled), which results in a surplus. Beyond 2012, revenues in the baseline grow at roughly the same pace as outlays (about 4.5 percent a year), which keeps the projection of the budget's bottom line "in the black" through 2017.

### Outlays

Over the coming decade, projected outlays in the baseline decline from 20.3 percent of GDP in 2006 and level off at about 19 percent (see Table 1-3). Mandatory spending (which is determined by laws other than annual appropriation acts) grows at an average annual rate between 2008 and 2017 of 5.9 percent—which is faster than CBO's projection of 4.5 percent annual growth for the economy as a whole. Discretionary appropriations, by contrast, simply keep pace with inflation and, to a lesser extent, with the growth of wages. Through 2017, discretionary outlays in the baseline thus increase by about 2.0 percent per year, on average, from their estimated level in 2007—a pace less than half as fast as the projected rate of growth of nominal GDP (4.5 percent) and one significantly slower than the average annual rate of growth of those outlays over the past 20 years (4.3 percent).

### Revenues

Revenues in the baseline, measured as a percentage of the overall economy, range between 18 percent and 19 percent of GDP through 2011; from 2012 through 2017, they measure roughly 20 percent. The 2012 increase in revenues as a percentage of GDP follows from the baseline's underlying assumption that the various tax provisions enacted over the past few years expire as scheduled. (Some of those provisions are set to expire on December 31, 2010; a number are slated to expire before then, the largest being the research and experimentation tax credit.)

Another of the baseline's underlying assumptions is that the relief from the alternative minimum tax that has been in place to a varying degree since 2001 will not continue beyond December 31, 2006. Because of the growth of nominal income as well as provisions enacted during the past few years that reduce regular income tax rates, the number of taxpayers subject to the AMT and the share of total revenues that the AMT represents are projected to rise steadily through 2010.[8] As a result, the impact on revenues and on the budget from modifying the tax so that it does not apply to a broad array of taxpayers (which was not the intent when it was originally enacted) becomes greater over time.

### Debt Held by the Public

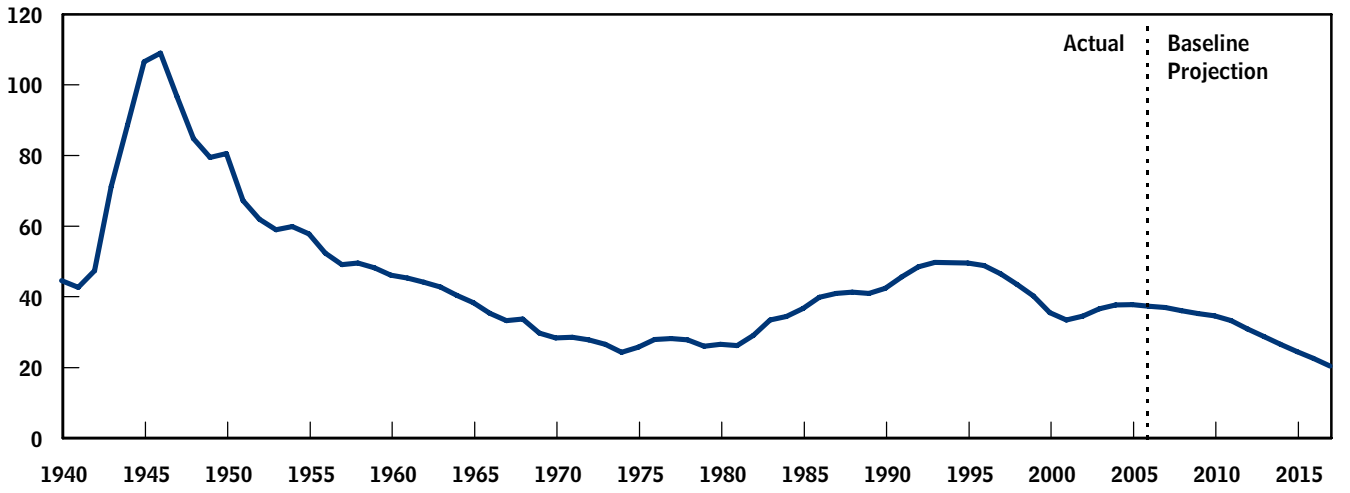
In CBO's baseline, accumulated federal debt held by the public (mainly in the form of Treasury securities sold directly in the capital markets) equals 36.6 percent of GDP in 2007. Thereafter, shrinking annual deficits and emerging surpluses in the baseline diminish the government's anticipated borrowing needs, causing debt held by the public as a percentage of GDP to decline in each year of the 2008–2017 period. By 2017, CBO's projection of public debt has fallen to 20.1 percent of GDP (see Figure 1-2). However, under the alternative assumptions presented later (see Table 1-5 on page 16), the debt-to-GDP ratio in 2017 would differ from that baseline projection.

8. Like the rate structure of the regular income tax, the AMT extracts a greater proportion of overall income as real (inflation-adjusted) income rises. But unlike the regular income tax, the AMT is not indexed for inflation. So as incomes rise each year with the overall price level, a larger number of taxpayers each year find themselves subject to the alternative tax. Box 4-2 on page 88 discusses the increased role of the AMT in CBO's projection.

**Figure 1-2.**

## Debt Held by the Public as a Percentage of Gross Domestic Product, 1940 to 2017

(Percent)




Sources: Congressional Budget Office; Office of Management and Budget.

## The Long-Term Budget Outlook

During the coming decades, the United States will confront immense budgetary challenges. The number of people age 65 or older will more than double by 2050, and the number of adults under age 65 will increase by about 16 percent (see Figure 1-3). As a result, the ratio of people receiving retirement and health care benefits to workers will rise steadily over that period. At the same time, health care costs are likely to continue to grow faster than the economy. (Between 1960 and 2004, the average annual rate of growth of national health expenditures per person exceeded the rate of growth of GDP per capita by 2.6 percentage points.) Without major changes in policy, the combination of an aging population and rising health care costs will cause a dramatic shift in the United States' fiscal situation in the decades beyond 2017.[9]

The growth of spending for Medicare and Medicaid will be a more pressing challenge to address than the growth of outlays for Social Security. CBO anticipates that in 2007, Medicare spending and the federal share of Medicaid outlays together will be slightly greater than outlays for Social Security—measured relative to GDP, 4.5 percent versus 4.3 percent. But because of rapidly rising costs for health care, spending for Medicare and Medicaid will increase to 5.9 percent of GDP in 2017, CBO projects, and outlays for Social Security will grow to 4.8 percent—a difference in nominal terms of about $235 billion.

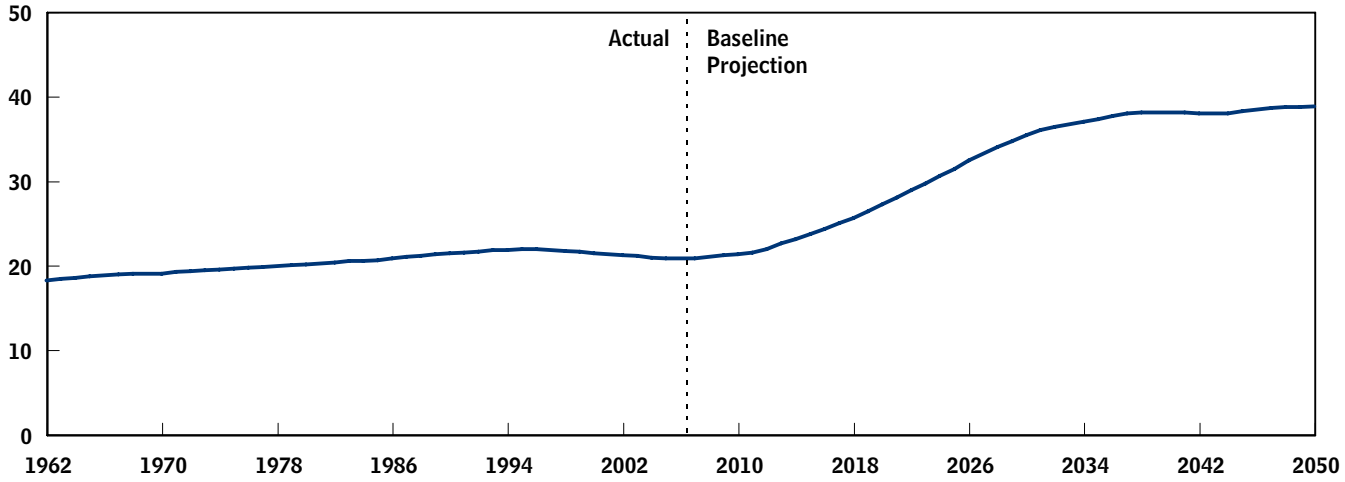
After 2017, if current law remained in place, spending for health care would probably continue to rise faster than income per person. If the growth of annual health care spending per beneficiary continued to exceed the growth of GDP per capita by about 2.5 percentage points, federal spending for Medicare and Medicaid relative to the size of the economy would rise to more than 20 percent in 2050—a share equaling that for all federal spending in 2006 (see Figure 1-4). And even if that growth differential fell to 1 percentage point per year by 2050—an assumption endorsed by the 2004 Technical Review Panel on the Medicare Trustees Reports—federal spend-

9. For a more extensive discussion, see Congressional Budget Office, *The Long-Term Budget Outlook, Updated Long-Term Projections for Social Security,* and *The Outlook for Social Security.*

**Figure 1-3.**

## The Population Age 65 or Older as a Percentage of the Population Ages 20 to 64

(Percent)




Sources: Congressional Budget Office; Social Security Administration.

ing for Medicare and Medicaid would reach more than 10 percent of GDP in that year.[10]

CBO estimates that outlays for Social Security as a share of GDP will grow to about 6.2 percent in 2030 and 6.5 percent in 2050—representing an increase of more than 50 percent above the 2007 level. By contrast, federal revenues credited to the Social Security trust funds during that time are expected to remain close to their current share—about 5 percent—of GDP.

The growing demands for resources by Medicare and Medicaid in particular, and Social Security as well, will exert pressures on the budget that economic growth alone is unlikely to alleviate. Substantial reductions in the projected growth of spending, a sizable increase in taxes as a percentage of the economy, or some combination of changes in policies for spending and revenues is likely to be necessary to achieve fiscal stability in coming decades.

## Changes in CBO's Baseline Since August 2006

Although the long-term budgetary picture continues to be worrisome, CBO's outlook for the budget over the next 10 years has brightened since it published its previous baseline in August 2006.[11] Budgetary outcomes in each year of the 2007–2016 period have improved, starting with a reduction in the deficit for 2007 of $114 billion and growing to an improvement in the bottom line for 2016 of $285 billion—that is, a shift from a deficit of $93 billion to a surplus of $192 billion. In total, those changes represent a difference of about 1.3 percent of GDP (see Table 1-4).

In terms of the underlying budget outlook, however, those changes overstate the improvement. Roughly half of the total projected upturn (about $1.3 trillion including debt service) stems from the treatment in the baseline of previous supplemental appropriations for disaster relief and the irregular pattern of funding for military operations in Iraq and Afghanistan. Consequently, more than half of the baseline's improved balance is unrelated to

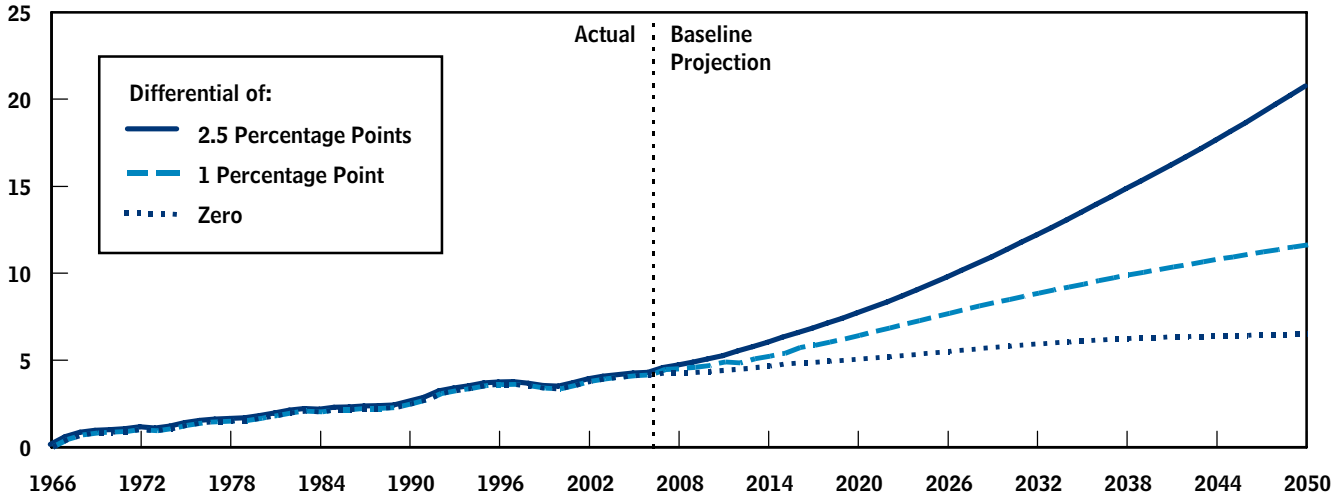
10. The assumption of a 1-percentage-point differential was originally recommended by the review panel that met in 2000; the concept is discussed in Technical Review Panel on the Medicare Trustees Reports, *Review of Assumptions and Methods of the Medicare Trustees' Financial Projection* (December 2000). The Medicare trustees changed the assumption slightly for their 2006 report; they now assume that the differential will gradually decline to zero at the end of the current 75-year projection period. However, under that scenario, total projected health care spending over the next 75 years is the same as it would be under the 1-percentage-point differential assumption. CBO plans to analyze the implications of the new assumption when it updates its long-term budget outlook.

11. Those projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2006).

**Figure 1-4.**

## Total Federal Spending for Medicare and Medicaid Under Different Assumptions About the Health Cost Growth Differential

(Percentage of gross domestic product)




Sources: Congressional Budget Office; Office of Management and Budget.

Note: The health cost growth differential refers to the number of percentage points by which the growth of annual health care spending per beneficiary is assumed to exceed the growth of nominal GDP per capita.

changes in the underlying budgetary and economic environment.

The Deficit Control Act's guidelines for projecting discretionary spending stated that all appropriations provided in the current year are to be extended and inflated throughout the projection period.[12] CBO based its August baseline on appropriations for 2006, which included $120 billion in funding for military and diplomatic operations in Iraq and Afghanistan and $56 billion in other supplemental appropriations (mostly for hurricane relief). Under the guidelines, that funding was extrapolated through 2016.[13]

CBO constructed its most recent baseline by assuming that the funding levels enacted in the current continuing resolution (discussed in Chapter 3) are effective for all of 2007. But so far this year, lawmakers have provided no supplemental appropriations, and funding for military operations in Iraq and Afghanistan has totaled only $70 billion. Extending that smaller amount of enacted appropriations throughout the projection period has reduced both defense and nondefense outlays in the baseline. (The drop is slightly offset by an increase in appropriations for other defense programs; moreover, additional funding is expected.) On balance, the differences between appropriations for 2006 and funding to date for 2007 have reduced outlays through 2016 in CBO's new baseline (compared with those in its previous baseline) by $497 billion in defense discretionary spending and $500 billion in nondefense discretionary spending.

Technical changes—those not directly related to changes in law or in CBO's economic assumptions—have reduced the deficit by $1.1 trillion over the 2007–2016 period. Lower projected outlays for Medicare account for $445 billion of that drop; higher projected revenues and lower projected spending for Medicaid and debt service account for most of the remainder. Much of the reduction since August in CBO's projection of Medicare spending results from new estimates of per capita costs

12. The rules used to project discretionary spending were set by statute in section 257 of the Deficit Control Act. Section 257 expired in September 2006, but CBO continues to follow the methodology prescribed in the law.

13. The amount for other supplemental appropriations excludes a rescission of $23 billion in budget authority provided to the Federal Emergency Management Agency for 2005.

**Table 1-4.**

## Changes in CBO's Baseline Projections of the Deficit or Surplus Since August 2006

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Total, 2007-2011 | Total, 2007-2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Deficit as Projected in August 2006 | -286 | -273 | -304 | -328 | -227 | -54 | -76 | -64 | -56 | -93 | -1,418 | -1,761 |
| Changes | | | | | | | | | | | | |
| Legislative | | | | | | | | | | | | |
| Revenues | -16 | -11 | -4 | -3 | -2 | -1 | -1 | -1 | -1 | -1 | -36 | -42 |
| Outlays[a] | -26 | -71 | -99 | -115 | -128 | -136 | -145 | -154 | -165 | -176 | -438 | -1,212 |
| Subtotal, legislative | 10 | 60 | 94 | 112 | 126 | 134 | 143 | 153 | 164 | 175 | 402 | 1,171 |
| Economic | | | | | | | | | | | | |
| Revenues | -13 | -6 | 3 | -5 | -12 | -16 | -26 | -34 | -42 | -50 | -34 | -201 |
| Outlays[a] | -8 | -7 | -8 | -5 | -3 | -1 | -1 | * | 2 | 3 | -31 | -28 |
| Subtotal, economic | -6 | 1 | 11 | * | -9 | -14 | -25 | -34 | -44 | -53 | -3 | -173 |
| Technical | | | | | | | | | | | | |
| Revenues | 57 | 65 | 36 | 19 | 25 | 24 | 22 | 20 | 17 | 17 | 201 | 300 |
| Outlays[a] | -53 | -50 | -46 | -60 | -72 | -80 | -95 | -111 | -128 | -146 | -281 | -842 |
| Subtotal, technical | 110 | 115 | 82 | 79 | 97 | 104 | 117 | 131 | 145 | 163 | 483 | 1,142 |
| **Total Effect on the Deficit[b]** | **114** | **175** | **188** | **191** | **214** | **224** | **235** | **249** | **265** | **285** | **882** | **2,140** |
| Total Deficit (-) or Surplus as Projected in January 2007 | -172 | -98 | -116 | -137 | -12 | 170 | 159 | 185 | 208 | 192 | -536 | 378 |

Source: Congressional Budget Office.

Notes: For more information on changes in CBO's projections since August, see Appendix A.

* = between -$500 million and $500 million.

a. Includes net interest payments.

b. Positive numbers indicate a decrease in the projected deficit.

for all Medicare benefits. In addition, fewer people enrolled in the prescription drug benefit program than CBO had previously projected. (The new estimates reflect information obtained from the program's first year of operation as well as recently available details about the bids that prescription drug plans submitted to provide coverage in 2007.) Those changes represent a decline of 8 percent in projected Medicare outlays for the 2007–2016 period, but they do not significantly alter the long-term fiscal pressures that the program faces. (For a more detailed discussion of those and other changes made to CBO's baseline since August, see Appendix A.)

CBO's assumptions about the economy over the coming decade, which underlie its baseline projections, have changed little since last August. The updated economic outlook leads to a $173 billion increase in the cumulative 10-year baseline deficit. The changes in assumptions have the biggest impact on projections of revenues, which fall by $201 billion over the period, largely because—relative to the August forecast—nominal GDP is assumed to be slightly lower and, in turn, taxable personal income, particularly wages and salaries, is also projected to be lower.

## Uncertainty and Budget Projections

Actual budgetary outcomes are almost certain to differ from CBO's baseline projections because of future legislative actions, unanticipated changes in conditions affecting the economy and national security, and many other factors that affect federal programs and sources of revenues.

### Uncertainty of Future Legislative Actions

To illustrate how different fiscal policies might affect the baseline, CBO estimated the budgetary impact of some alternative legislative scenarios (see Table 1-5 on page 16). The discussion below focuses on those scenarios' direct effects on revenues and outlays. Their full impact, however, would include their effect on federal debt-service costs, which is shown separately in Table 1-5.

**Activities Related to Iraq and Afghanistan and the War on Terrorism.** CBO's current baseline includes outlays that arise from $70 billion in defense discretionary budget authority already provided for 2007 and $778 billion in budget authority projected under baseline assumptions for military operations in Iraq and Afghanistan during the 2008–2017 period. However, additional funding will be needed in 2007 for those operations.

In subsequent years, the annual funding required for those activities may eventually be less than the amounts in the baseline if the number of troops and pace of operations diminish over time. Because of considerable uncertainty about those future operations, CBO has formulated two budget scenarios involving the deployment of U.S. forces to Iraq, Afghanistan, and elsewhere in support of the war on terrorism. Under both scenarios, the number of active-duty, Reserve, and National Guard personnel would increase to an average of 225,000 in fiscal year 2007, reflecting the President's recently announced plan to increase the number of troops in Iraq. (That number was smaller in the first part of this year and will be larger later in the year.) After 2007, those force levels decline at different rates under the two scenarios and to different sustained levels.

- Under the first scenario, troop levels would be rapidly reduced over a three-year period, with deployed forces declining to roughly 175,000 in 2008. That number would drop further in 2009 and 2010, leaving 30,000 military personnel overseas in support of the war on terrorism through 2017, although not necessarily in Iraq and Afghanistan. Under such a scenario, discretionary outlays for 2007 would be $25 billion higher than the amount in the baseline, but annual outlays would be lower beginning in 2010. In total, over the 2007–2017 period, discretionary outlays would be $280 billion less than the amount in the current baseline.

- Under the second scenario, the number of troops would decline more gradually over a six-year period, dropping to about 210,000 in 2008 and continuing to fall steadily in subsequent years until 75,000 remained overseas in 2013 and each year thereafter. Under such a scenario, discretionary outlays for 2007 would increase by about $25 billion compared with the amount in the current baseline, but annual outlays would be less than the baseline projection beginning in 2013. During the 2007–2017 period, total outlays for military activities related to Iraq, Afghanistan, and the war on terrorism would be greater than the amount in the baseline by $144 billion.

Many other budgetary outcomes—some costing more and some less—are also possible for the operations described in these scenarios.

**Other Discretionary Spending.** Alternative scenarios could also be developed for discretionary spending as a whole. For example, if regular appropriations (other than those for activities in Iraq and Afghanistan) were assumed to grow through 2017 at the same rate as nominal GDP instead of at the rate of inflation, total projected discretionary spending would be $1.3 trillion higher than the amount in the current baseline. In the other direction, if lawmakers did not increase appropriations after 2007 to account for inflation, cumulative discretionary outlays would be $1.3 trillion lower. Under that latter scenario, total discretionary spending would fall from 7.8 percent of GDP in 2006 to less than 5 percent in 2017.

**Mandatory Spending.** Policymakers frequently consider changes in the laws that establish payment rates for providers, eligibility, and other criteria for the federal government's large social insurance programs, such as Medicare and Social Security. Legislation addressing such issues could affect those programs in profound ways. For example, Medicare's payments for physicians' services are currently determined by a formula known as the sustainable

growth rate.[14] (Chapter 3, in the section titled "What Drives Growth in Mandatory Spending," provides more details about how that process works and its budgetary effects.) Because those payments have consistently been above targets set by the formula, current law calls for reductions during the next several years in the rates paid for those services. In the past, the Congress and the President have raised payment rates above those called for by the formula. If lawmakers permanently eliminated the sustainable growth rate mechanism and allowed payment rates for physicians' services to increase in line with medical price inflation (adjusted for productivity), mandatory spending would increase relative to the baseline amount by about $250 billion over the 2008–2017 period.[15]

**Revenues.** The baseline envisions that major provisions of EGTRRA and JGTRRA—such as the introduction of the 10 percent tax bracket, increases in the child tax credit, repeal of the estate tax, and lower rates on capital gains and dividends—will expire as scheduled at the end of 2010. On balance, the tax provisions that are set to expire during the 2008–2017 period reduce revenues; thus, under a scenario in which they were extended, projected revenues would be lower than the amount in the current baseline.[16] For example, if all expiring tax provisions (except those related to the exemption amount for the alternative minimum tax) were extended, total revenues over the 2008–2017 period would be about $2.3 trillion lower than the current baseline projection.[17] That estimate reflects the fact that the effect of lowering the amount of taxpayers' regular tax liabilities would be partially offset by an increase in the number of taxpayers subject to the AMT.

Another change in policy that could affect revenues involves the modification of the AMT, which many observers believe cannot be maintained in its current form. The AMT's exemption amount and brackets are not indexed for inflation, which means that the impact of the tax will grow in coming years as more taxpayers become subject to it. If the AMT was indexed for inflation after 2006 and no other changes were made to the tax code, federal revenues over the next 10 years would be $569 billion lower than the amount in the baseline, according to CBO and the Joint Committee on Taxation.

Because the number of taxpayers who are subject to the AMT will depend on whether the tax provisions originally enacted in EGTRRA and JGTRRA are still in effect, the combination of indexing the AMT for inflation and extending the expiring provisions would reduce revenues by more than indexing alone. The effect of that interaction would lower revenues by an additional $472 billion between 2011 and 2017.

### Other Sources of Uncertainty

In addition to the impact of future legislative actions, the federal budget is sensitive to economic and technical factors that are difficult to forecast. In constructing its baseline, CBO must make assumptions about such economic elements as interest rates, inflation, and the growth of GDP. (CBO's economic assumptions are explained in detail in Chapter 2.) Discrepancies between those assumptions and actual economic conditions can significantly affect the extent to which budgetary outcomes differ from baseline projections. For instance, the baseline reflects an assumption that the real (inflation-adjusted) rate of growth of GDP will average 2.8 percent during the next few years. If the actual rate was 0.1 percentage point higher or lower each year, the cumulative deficit for the 2008–2017 period would differ from CBO's projections by about $270 billion. (For further discussion of the effect of economic assumptions on budget projections, see Appendix B.)

Uncertainty also surrounds technical factors that affect CBO's baseline budget projections. For example, spending per enrollee for both Medicare and Medicaid has generally grown faster than GDP per capita. The future rate of such growth is difficult to forecast, but it will have a large impact on the costs of those programs in coming years. CBO's projections of spending for those programs also depend on assumptions about the growth of their enrollment and, indirectly, general inflation. For

14. For a more extensive discussion, see Congressional Budget Office, *The Sustainable Growth Rate Formula for Setting Medicare's Physician Payment Rates* (September 7, 2006).

15. For a discussion of other policy options that would reduce the growth of mandatory spending in the long term, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2005) and the forthcoming edition of *Budget Options*.

16. In the years before 2011, the provision that contributes the most to the drop in revenues is the research and experimentation tax credit.

17. That estimate does not include any macroeconomic effects—unlike CBO's baseline projections, which incorporate the effects that the tax provisions' expiration would have on the economy. However, such effects are likely to be small relative to GDP.

## Table 1-5.

# The Budgetary Effects of Selected Policy Alternatives Not Included in CBO's Baseline

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Policy Alternatives That Affect Discretionary Spending** | | | | | | | | | | | | | |
| Reduce the Number of Troops Deployed for Military Operations in Iraq and Afghanistan and Other Activities Related to the War on Terrorism to 30,000 by 2010[a] | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | -25 | -53 | -29 | 10 | 33 | 46 | 54 | 59 | 60 | 62 | 63 | 7 | 305 |
| Debt service | -1 | -2 | -4 | -5 | -4 | -3 | -1 | 2 | 5 | 8 | 11 | -19 | 7 |
| Reduce the Number of Troops Deployed for Military Operations in Iraq and Afghanistan and Other Activities Related to the War on Terrorism to 75,000 by 2013[c] | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | -25 | -58 | -64 | -45 | -37 | -15 | 7 | 19 | 22 | 26 | 26 | -219 | -119 |
| Debt service | -1 | -3 | -6 | -8 | -11 | -12 | -13 | -13 | -13 | -12 | -12 | -40 | -103 |
| Increase Regular Discretionary Appropriations at the Rate of Growth of Nominal GDP[d] | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | 0 | -12 | -34 | -59 | -84 | -110 | -137 | -165 | -194 | -224 | -255 | -299 | -1,273 |
| Debt service | 0 | * | -1 | -4 | -7 | -12 | -18 | -26 | -36 | -47 | -61 | -24 | -214 |
| Freeze Total Discretionary Appropriations at the Level Provided for 2007 | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | 0 | 17 | 38 | 61 | 85 | 109 | 134 | 160 | 188 | 216 | 243 | 310 | 1,251 |
| Debt service | 0 | * | 2 | 4 | 8 | 13 | 19 | 27 | 36 | 47 | 60 | 27 | 216 |
| **Policy Alternatives That Affect the Tax Code[e]** | | | | | | | | | | | | | |
| Extend EGTRRA and JGTRRA[f] | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | 0 | -2 | -1 | -9 | -153 | -254 | -280 | -291 | -302 | -315 | -330 | -418 | -1,937 |
| Debt service | 0 | * | * | * | -4 | -14 | -27 | -42 | -58 | -75 | -94 | -19 | -314 |
| Extend Other Expiring Tax Provisions | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | -3 | -11 | -19 | -27 | -35 | -42 | -46 | -50 | -53 | -57 | -59 | -134 | -400 |
| Debt service | * | * | -1 | -2 | -4 | -6 | -8 | -11 | -14 | -17 | -20 | -13 | -83 |
| Index the AMT for Inflation[g] | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | -9 | -59 | -58 | -69 | -58 | -35 | -41 | -49 | -57 | -66 | -77 | -279 | -569 |
| Debt service | * | -2 | -5 | -8 | -11 | -14 | -16 | -19 | -23 | -27 | -31 | -39 | -155 |

Continued

## Table 1-5.

## Continued

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Memorandum:** | | | | | | | | | | | | | |
| Interactive Effect of Extending EGTRRA and JGTRRA and Indexing the AMT[e] | | | | | | | | | | | | | |
| Effect on the deficit or surplus[b] | 0 | 0 | 0 | 0 | -22 | -58 | -65 | -72 | -78 | -85 | -91 | -81 | -472 |
| Debt service | 0 | 0 | 0 | 0 | -1 | -2 | -5 | -9 | -13 | -17 | -22 | -3 | -70 |
| Total Discretionary Outlays in CBO's Baseline | 1,024 | 1,034 | 1,050 | 1,067 | 1,089 | 1,100 | 1,129 | 1,155 | 1,182 | 1,215 | 1,238 | 5,342 | 11,260 |
| Total Outlays for Defense Operations in Iraq and Afghanistan in CBO's Baseline | 93 | 79 | 73 | 74 | 75 | 75 | 77 | 79 | 80 | 82 | 83 | 376 | 776 |
| Total Deficit (-) or Surplus in CBO's Baseline | -172 | -98 | -116 | -137 | -12 | 170 | 159 | 185 | 208 | 192 | 249 | -194 | 800 |

Sources: Congressional Budget Office; Joint Committee on Taxation.

Notes: Positive amounts indicate a reduction in the deficit or an increase in the surplus. "Debt service" refers to changes in interest payments on federal debt resulting from changes in the government's borrowing needs.

* = between -$500 million and $500 million; GDP = gross domestic product; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003; AMT = alternative minimum tax.

a. This alternative does not extrapolate the $70 billion in funding for operations in Iraq and Afghanistan enacted as part of the Department of Defense appropriation act for 2007. However, it incorporates the assumption that an additional $75 billion in budget authority will be provided in 2007 to carry out operations in those countries. Future funding for operations in Iraq, Afghanistan, or elsewhere would total $120 billion in 2008, $75 billion in 2009, $40 billion in 2010, $25 billion in 2011, and then about $20 billion a year from 2012 on—for a total of $377 billion over the 2008–2017 period.

b. Excluding debt service.

c. This alternative does not extrapolate the $70 billion in funding for operations in Iraq and Afghanistan enacted as part of the Department of Defense appropriation act for 2007. However, it incorporates the assumption that an additional $75 billion in budget authority will be provided in 2007 to carry out operations in those countries. Future funding for operations in Iraq, Afghanistan, or elsewhere would total $140 billion in 2008, $130 billion in 2009, $110 billion in 2010, $90 billion in 2011, $70 billion in 2012, and then about $60 billion a year from 2013 on—for a total of $824 billion over the 2008–2017 period.

d. Under this alternative, appropriations for operations in Iraq and Afghanistan that were enacted during 2007 are extrapolated according to baseline rules.

e. The Joint Committee on Taxation's estimates for the tax policy alternatives are preliminary, to be updated later.

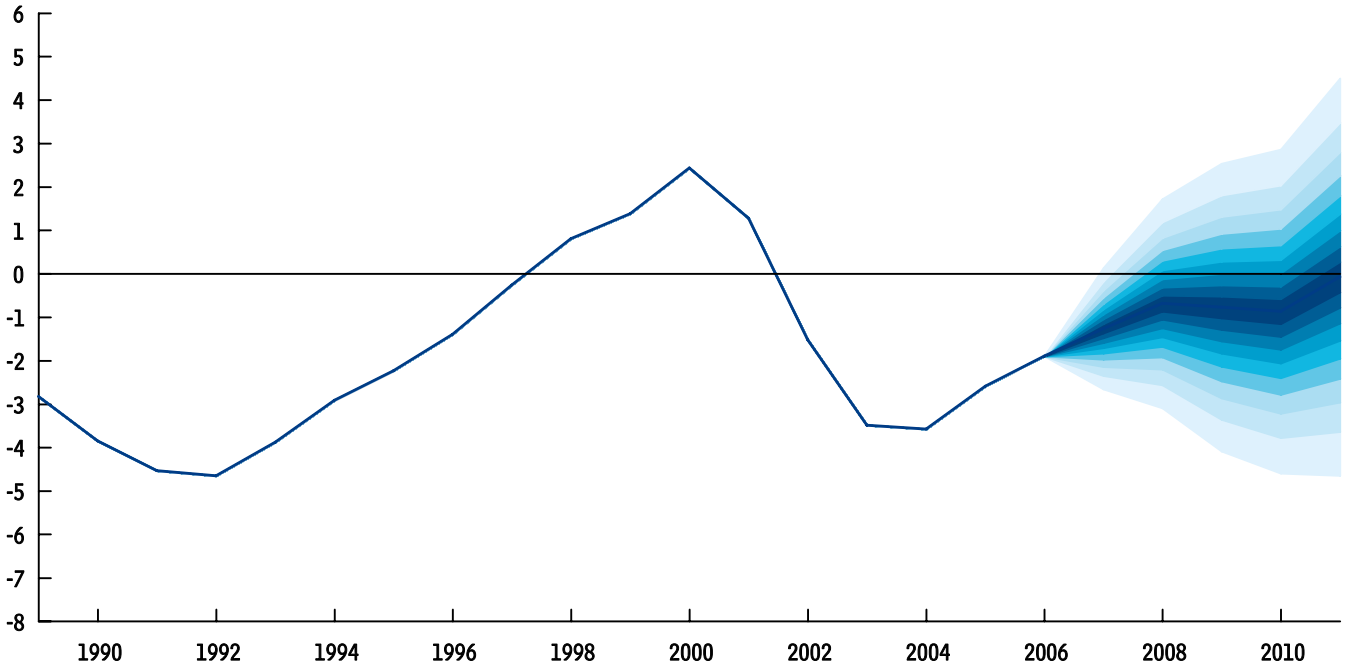
f. These estimates do not include the effects of extending the increased exemption amount or the treatment of personal credits for the AMT that expired at the end of 2006. The effects of that alternative are shown below.

g. This alternative incorporates the assumption that the exemption amount for the AMT (which was increased through 2006 in the Tax Increase Prevention and Reconciliation Act of 2005, or TIPRA) is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2006. In addition, the treatment of personal credits against the AMT (which was extended through the end of 2006 in TIPRA) is assumed to be extended. If this alternative was enacted jointly with the extension of the expiring tax provisions, an interactive effect would occur after 2010 that would make the combined revenue loss over the 2011–2017 period greater than the sum of the two separate estimates (see the memorandum).

**Figure 1-5.**

## Uncertainty of CBO's Projections of the Budget Deficit or Surplus Under Current Policies

(Deficit or surplus as a percentage of gross domestic product)




Source: Congressional Budget Office.

Notes: This figure, calculated on the basis of CBO's track record in forecasting, shows the estimated likelihood of alternative projections of the budget deficit or surplus under current policies. The baseline projections described in this chapter fall in the middle of the darkest area of the figure. Under the assumption that tax and spending policies do not change, the probability is 10 percent that actual deficits or surpluses will fall in the darkest area and 90 percent that they will fall within the whole shaded area.

Actual deficits or surpluses will be affected by legislation enacted in future years, including decisions about discretionary spending. The effects of future legislation are not reflected in this figure.

For an explanation of how CBO calculates the probability distribution underlying this figure, see Congressional Budget Office, *The Uncertainty of Budget Projections: A Discussion of Data and Methods* (February 2006). An updated version of that publication is forthcoming.

example, if inflation during the 2008–2017 period grew 1 percentage point faster or slower than CBO has projected, the impact on Medicare and Medicaid outlays would be about $400 billion.

Other projections are also vulnerable to technical uncertainty. For example, CBO must estimate prices for various agricultural commodities as well as crop yields, all of which are volatile and strongly affect how much the government will pay farmers under price- and income-support programs. Assumptions about revenues are particularly sensitive to technical uncertainty. Although CBO uses its economic projections to estimate overall income from current production, it must make technical assumptions about how much revenue to expect from a given amount of such income. Differences between those expectations and actual revenues can lead to significant deviations from CBO's baseline projections.

Using as a guide the differences between CBO's past baselines and actual budgetary results, Figure 1-5 displays a range of possible outcomes for the total deficit or surplus under current law (that is, excluding the possible impact of future legislation). The current baseline projection of the deficit falls in the middle of the highest-probability area, shown as the darkest part of the figure. But nearby

projections—other paths in that dark portion—have nearly the same probability of occurring. Projections that are increasingly different from the baseline are shown in lighter areas, but they also have a significant likelihood of coming to pass. For example, CBO projects a baseline deficit of 0.9 percent of GDP for 2010. But even with no changes in policy, there is a roughly 20 percent chance that the actual outcome that year will be a deficit equal to almost 3 percent of GDP. Similarly, in the absence of further legislative changes, there is a roughly 5 percent chance that the budget in 2010 will produce a surplus nearly equal to 3 percent of GDP.

## The Outlook for Federal Debt

The federal government's debt falls into two main categories: debt that is held by the public, in the form of marketable and nonmarketable Treasury securities, and debt that is held by government accounts. Debt held by the public is the more meaningful measure in terms of the relationship between federal debt and the economy. It represents debt that the Department of the Treasury issues to raise cash to fund the operations and pay off the maturing liabilities of the federal government. Debt held by government accounts consists of securities that the Treasury issues to various federal agencies. Those securities are used as an accounting device to track cash flows relating to specific federal programs, such as Social Security.

### Debt Held by the Public

When the federal government runs a deficit, the Treasury borrows money from the public by selling securities in the capital markets. That debt is purchased by various domestic buyers, such as mutual funds, state and local governments, Federal Reserve banks, commercial banks, insurance companies, and individuals, as well as by private foreign entities and central banks. Of the $4.8 trillion in outstanding public debt at the end of 2006, domestic investors owned 56 percent ($2.7 trillion), and foreign investors held 44 percent ($2.1 trillion).

Among investors from other nations, those in Japan, China, and the United Kingdom have the biggest holdings of Treasury securities.[18] The central banks and private entities in those countries hold about $1.2 trillion of such debt—roughly 25 percent of the outstanding total. In 2006, foreign investors purchased about $200 billion in Treasury securities, or roughly 80 percent of the year's deficit. In the past five years, investors from abroad have purchased more than $1.1 trillion in securities, or roughly 75 percent of the total increase in public debt during that time. Investors in Japan have purchased about $350 billion of such debt in the past five years, and investors in China and the United Kingdom have added about $270 billion and $165 billion, respectively, to their holdings.

Among domestic investors, Federal Reserve banks, state and local governments, and mutual funds are the largest investors in Treasury securities, holding around $765 billion, $467 billion, and $243 billion, respectively, of debt sold to the public.[19]

Debt held by the public fluctuates according to changes in the government's borrowing needs. In 1993, it equaled nearly 50 percent of GDP, but by 2001, it measured 33 percent (see Figure 1-2 on page 10). Since then, public debt has crept up to 37 percent of GDP. Under the baseline assumption that current law does not change (in particular, that discretionary spending grows at the rate of inflation and tax provisions expire as scheduled), debt held by the public is projected to fall in 2011 to 33 percent of GDP (3 percentage points less than the average debt-to-GDP ratio during the past 40 years). After 2011, it is projected to fall more rapidly, dropping to 20 percent of GDP by 2017 (see Table 1-6). At that time, debt held by the public would total $4.3 trillion, CBO estimates, or roughly $550 billion less than it did at the end of 2006.

Changes in policy, however, such as those shown in Table 1-5 on page 16, would lead to a different amount of public debt. For example, if the number of troops involved in military operations in Iraq, Afghanistan, and elsewhere in support of the war on terrorism declined over the next three years from the 2007 level, debt held by the public in 2017 would fall by $311 billion relative to the amount in the baseline, bringing the total to $4.0 trillion, or 18.6 percent of GDP. By contrast, if those provisions in EGTRRA and JGTRRA set to expire

18. See Department of the Treasury, "Major Foreign Holders of Treasury Securities" (December 15, 2006), available at www.ustreas.gov/tic/mfh.txt. That information should be viewed as approximate because in many cases it is impossible to accurately determine the home country of foreign holders of U.S. securities. (Difficulties arise because intermediaries may be involved in the custody, management, purchase, or sale of the securities.)

19. Department of the Treasury, Financial Management Service, *Treasury Bulletin* (December 2006).

**Table 1-6.**

## CBO's Baseline Projections of Federal Debt

(Billions of dollars)

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Debt Held by the Public at the Beginning of the Year | 4,592 | 4,829 | 4,995 | 5,104 | 5,232 | 5,380 | 5,403 | 5,242 | 5,089 | 4,912 | 4,709 | 4,521 |
| Changes to Debt Held by the Public | | | | | | | | | | | | |
| Deficit or surplus (-) | 248 | 172 | 98 | 116 | 137 | 12 | -170 | -159 | -185 | -208 | -192 | -249 |
| Other means of financing | -11 | -7 | 11 | 11 | 11 | 11 | 9 | 7 | 7 | 6 | 4 | 2 |
| **Total** | **237** | **166** | **110** | **128** | **148** | **23** | **-161** | **-152** | **-178** | **-203** | **-188** | **-247** |
| Debt Held by the Public at the End of the Year | 4,829 | 4,995 | 5,104 | 5,232 | 5,380 | 5,403 | 5,242 | 5,089 | 4,912 | 4,709 | 4,521 | 4,274 |
| Debt Held by Government Accounts | | | | | | | | | | | | |
| Social Security | 1,995 | 2,185 | 2,388 | 2,606 | 2,837 | 3,083 | 3,338 | 3,598 | 3,862 | 4,127 | 4,390 | 4,649 |
| Other government accounts[a] | 1,627 | 1,735 | 1,844 | 1,954 | 2,064 | 2,171 | 2,293 | 2,409 | 2,533 | 2,653 | 2,760 | 2,871 |
| **Total** | **3,622** | **3,920** | **4,232** | **4,560** | **4,901** | **5,253** | **5,631** | **6,007** | **6,395** | **6,780** | **7,151** | **7,521** |
| Gross Federal Debt | 8,452 | 8,915 | 9,336 | 9,792 | 10,281 | 10,656 | 10,873 | 11,097 | 11,307 | 11,489 | 11,671 | 11,795 |
| Debt Subject to Limit[b] | 8,420 | 8,884 | 9,306 | 9,762 | 10,252 | 10,628 | 10,844 | 11,069 | 11,279 | 11,461 | 11,645 | 11,768 |
| **Memorandum:** | | | | | | | | | | | | |
| Debt Held by the Public at the End of the Year as a Percentage of GDP | 37.0 | 36.6 | 35.7 | 34.8 | 34.2 | 32.8 | 30.5 | 28.3 | 26.2 | 24.0 | 22.1 | 20.1 |

Source: Congressional Budget Office.

Note: GDP = gross domestic product.

a. Mainly Civil Service Retirement and Disability, Military Retirement, Medicare, and Unemployment Insurance Trust Funds.

b. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury and the Federal Financing Bank is excluded from the debt limit. The current debt limit is $8,965 billion.

in 2010 were extended and the effects extrapolated under CBO's usual baseline rules, publicly held debt in 2017 would rise by nearly $2.3 trillion relative to the amount in the baseline, bringing the total to $6.5 trillion, or 30.6 percent of GDP.

**The Composition of Debt Held by the Public.** Roughly 90 percent of publicly held debt consists of marketable securities—Treasury bills, notes, bonds, and inflation-indexed issues (called TIPS). The remaining 10 percent comprises nonmarketable securities, such as savings bonds and securities in the state and local government series, which are nonnegotiable, nontransferable debt instruments issued to specific investors.[20]

The Treasury sells marketable securities to brokers in regularly scheduled auctions, whose size varies with changes in the government's cash flow. (Periodically, the Treasury also sells cash-management bills to cover shortfalls in cash balances.) In February 2006, the Treasury began reissuing 30-year bonds, auctioning them semiannually; in February of this year, it will boost the number of such bonds that it issues and start auctioning them quarterly. CBO projects that under the assumptions incorporated in its baseline, those issues will increase the amount of bonds outstanding as a percentage of total marketable debt from 12 percent at the end of 2006 to 13 percent by 2011. The share of marketable debt accounted for by inflation-protected securities is also projected to expand, growing from more than 9 percent at the end of 2006 to 13 percent in 2011. By contrast, the share of Treasury

20. State and local government securities are time deposits that the Treasury sells to the issuers of state and local government tax-exempt debt to help them comply with the arbitrage provisions of the Internal Revenue Code.

bills and notes as a percentage of marketable debt is expected to shrink over the next five years: Bills are expected to decline from a share of 21 percent to 20 percent and notes from a share of 57 percent to 54 percent.

**Why Changes in Debt Held by the Public Do Not Equal Surpluses and Deficits.** In most years, the amount of debt that the Treasury borrows or redeems roughly equals the annual budget deficit or surplus. However, a number of factors—which are broadly labeled "other means of financing"—also affect the government's need to borrow money from the public. For 2007, CBO's projection of debt held by the public shows borrowing to be $7 billion less than the amount of the deficit, mostly because CBO estimates that the Treasury will reduce its cash balance from what it was at the end of 2006. Debt held by the public will grow by more than the cumulative deficit over the 2008–2017 period, CBO projects, because changes in other means of financing will increase the Treasury's borrowing needs (see Table 1-6).

Among such means of financing, the capitalization of financing accounts used for federal credit programs usually has the biggest effect on the government's borrowing. Direct student loans, rural housing programs, loans made by the Small Business Administration, and other credit programs require the government to disburse money up front in anticipation of repayment at a later date. Those initial disbursements are not counted in the budget, which reflects only the programs' estimated costs for subsidies, defaults, and other items. Each year from 2008 to 2017, the amount of loans disbursed will typically be larger than the amount of repayments and interest collected. Thus, the government's annual borrowing needs will, on average, be $8 billion greater than the annual budget deficit or surplus might indicate.

### Debt Held by Government Accounts

Besides selling securities to the public, the Treasury issues securities to various accounts of the federal government; as of the end of 2006, about $3.6 trillion in such securities had been issued. All of the major trust funds in the budget (for example, those for Social Security) as well as many other government funds invest in special, nonmarketable Treasury securities known as the government account series. (Trust funds are described in more detail in the next section.) Those investments are intragovernmental transactions and have no direct effect on the economy. The securities represent credits to the various government accounts and are redeemed as necessary to cover benefit payments or other expenses. In the meantime, the Treasury assigns earnings in the form of interest to the funds that hold the securities, but such payments have no net effect on the total budget.

The largest balances among the government accounts are in the Social Security trust funds ($2.0 trillion at the end of 2006) and the retirement funds for federal civilian employees ($690 billion). CBO projects that if current policies do not change, by 2017, the balance of the Social Security trust funds will rise to $4.6 trillion, and the balance of all government accounts will climb to $7.5 trillion.

### Gross Federal Debt and Debt Subject to Limit

Gross federal debt comprises both debt held by the public and debt issued to government accounts. CBO projects that under current law, gross federal debt will increase in every year of the 2008–2017 period, reaching $11.8 trillion in 2017—nearly 40 percent more than its total of $8.5 trillion at the end of 2006. Most of that increase reflects debt held by government accounts, which by 2017 will represent about 64 percent of the gross federal debt, in CBO's estimation. As a percentage of GDP, the gross federal debt by 2017 will total 55 percent, or 9 percentage points below the debt-to-GDP ratio in 2006.

The Treasury's authority to issue debt is restricted by a statutory ceiling. Although that limit covers both debt held by the public and by government accounts, it does not include debt issued by agencies other than the Treasury (such as the $23 billion in debt issued by the Tennessee Valley Authority and the $14 billion issued by the Federal Financing Bank).[21] The current debt ceiling, which was set in March 2006 by Public Law 109-182, is $8.965 trillion. CBO estimates that under current policies, that ceiling will be reached sometime in the second half of calendar year 2007 (see Figure 1-6).

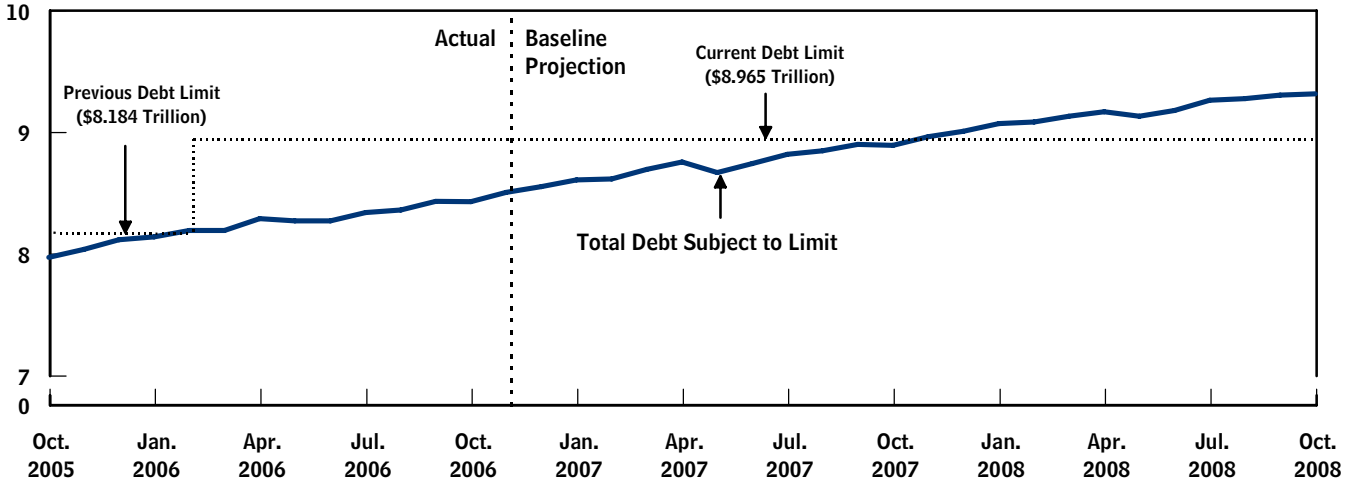
At that time, if policymakers have not enacted a higher debt limit, the Treasury may use several measures to temporarily reduce the government's liabilities that are subject to the limit and continue for a short time to borrow

21. The Federal Financing Bank is a government entity that was established to centralize and reduce the cost of federal borrowing. In 2004, the bank issued $14 billion in securities to the Civil Service Retirement and Disability Fund when the Treasury's borrowing reached the $7.384 trillion ceiling on debt.

**Figure 1-6.**

## Debt Subject to Limit

(Trillions of dollars)




Sources: Congressional Budget Office; Department of the Treasury.

money from the public without going past that boundary. Those options—most of which have been used in the past—include suspending the issuance of certain securities held in the Thrift Savings Plan (a retirement savings plan for federal employees), postponing the issuance of securities in the state and local government series, delaying the issuance of securities to the Civil Service Retirement and Disability Fund, and withdrawing federal securities from the Exchange Stabilization Fund.[22] Such actions normally allow the Treasury to stay within the limit for as much as several months.

## Trust Funds and the Budget

The federal budget includes more than 200 trust funds, although fewer than a dozen account for most of the budget's trust fund dollars. Among the largest are the two Social Security trust funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) and the funds dedicated to civil service retirement, Medicare's Hospital Insurance program (Part A), and military retirement (see Table 1-7). Trust funds function primarily as accounting mechanisms to track receipts and spending for programs that have specific taxes or other revenues earmarked for their use.

When a trust fund receives payroll taxes or other income that is not currently needed to pay benefits, the Treasury credits the fund and uses the excess cash for other purposes. As a result, if other tax and spending policies remain unchanged, the government borrows less from the public than it would in the absence of those excess funds. The process is reversed when revenues for a trust fund program fall short of expenses.

Including in the budget totals the cash receipts and expenditures of trust funds along with those of other federal programs is useful for assessing how federal activities affect the economy and capital markets. Thus, CBO, the Administration's Office of Management and Budget, and many other fiscal analysts focus on the total deficit or surplus rather than on the deficit or surplus with or without particular trust funds.

In CBO's current baseline, trust funds as a whole are projected to run a surplus of $265 billion in 2007. That balance is affected, however, by interest and other sums transferred from other parts of the budget. Such intragovernmental transfers, which are estimated to total $484 billion in 2007, reallocate costs from one section of the budget to another but do not directly change the total deficit or the government's borrowing needs. If intragovernmental transfers are excluded and only income from sources outside the government is counted, the trust funds as a whole are projected to run annual deficits throughout the 2007–2017 period that grow from $218 billion to $583 billion.

22. The Exchange Stabilization Fund, which is part of the Department of the Treasury, buys and sells foreign exchange to promote stability in the currency markets. The fund holds about $15 billion in government account securities.

## Table 1-7.

# CBO's Baseline Projections of Trust Fund Surpluses or Deficits

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | 185 | 190 | 203 | 218 | 231 | 246 | 255 | 260 | 264 | 265 | 263 | 259 |
| Medicare | | | | | | | | | | | | |
| Hospital Insurance (Part A) | 23 | 18 | 17 | 17 | 17 | 10 | 16 | 7 | 1 | -6 | -23 | -29 |
| Supplementary Medical Insurance (Part B) | 15 | 2 | 4 | 5 | 5 | 3 | 7 | 4 | 6 | 7 | 4 | 7 |
| Subtotal, Medicare | 38 | 20 | 22 | 22 | 22 | 13 | 24 | 11 | 7 | 1 | -19 | -22 |
| Military Retirement | 5 | 10 | 12 | 12 | 13 | 14 | 15 | 16 | 18 | 19 | 21 | 22 |
| Civilian Retirement[a] | 29 | 28 | 27 | 27 | 26 | 26 | 26 | 26 | 26 | 26 | 27 | 26 |
| Unemployment Insurance | 12 | 13 | 8 | 4 | 3 | 4 | 5 | 5 | 6 | 6 | 7 | 7 |
| Highway and Mass Transit | -2 | 1 | 1 | * | * | * | * | * | 6 | 2 | 2 | 2 |
| Airport and Airway | * | * | * | 1 | 1 | 2 | 2 | 3 | 3 | 4 | 4 | 5 |
| Other[b] | 11 | 3 | 2 | 2 | 3 | 3 | 3 | 3 | 3 | 4 | 4 | 4 |
| **Total Trust Fund Surplus** | **278** | **265** | **274** | **286** | **299** | **307** | **329** | **325** | **333** | **326** | **309** | **304** |
| Intragovernmental Transfers to Trust Funds[c] | 454 | 484 | 508 | 538 | 570 | 614 | 637 | 686 | 731 | 779 | 845 | 887 |
| **Net Budgetary Impact of Trust Fund Programs** | **-176** | **-218** | **-234** | **-251** | **-271** | **-307** | **-308** | **-361** | **-398** | **-453** | **-537** | **-583** |

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

a. Includes Civil Service Retirement and Disability, Foreign Service Retirement, and several smaller retirement trust funds.

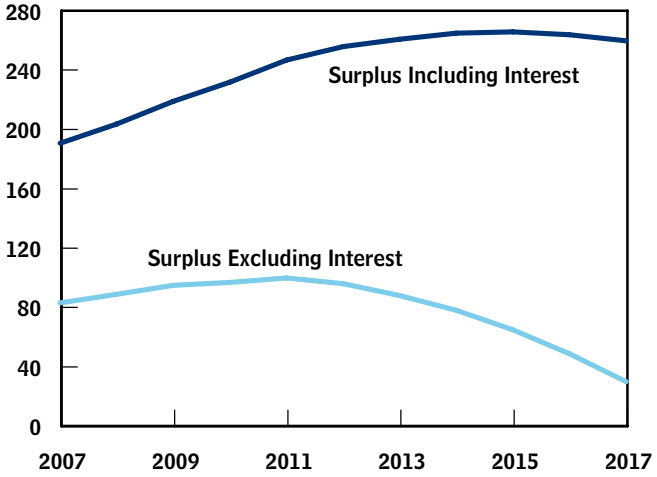
b. Primarily trust funds for Railroad Retirement, federal employees' health and life insurance, Superfund, and various veterans' insurance programs.

c. Includes interest paid to trust funds, payments from the general fund to the Supplementary Medical Insurance program, the employer's share of payments for federal employees' retirement, lump-sum payments to the Civil Service and Military Retirement Trust Funds, taxes on Social Security benefits, and smaller miscellaneous payments.

**Figure 1-7.**

## Projected Social Security Trust Fund Surpluses

(Billions of dollars)




Source: Congressional Budget Office.

Although the full budgetary impact of the aging of the baby-boom generation will not be felt during the 2008–2017 period, CBO's baseline provides an initial indication of those coming budgetary pressures. Examining the differences over the next 10 years between projected receipts and outlays for the Social Security trust funds reveals those strains. Receipts—excluding interest—are projected to exceed expenditures in each year of the period, but under current policies, the amount by which they do so will peak at close to $100 billion in 2011 and then decline steadily to about $30 billion in 2017 (see Figure 1-7). The net surplus of the trust funds—including interest payments—will peak in 2015 and decline thereafter. As a result, the capacity of the Social Security system to offset some of the total deficit in the rest of the budget will begin to dwindle.

CHAPTER

# 2

# The Economic Outlook

The Federal Reserve's shift in monetary policy over the past two and a half years and the recent decline in housing construction will restrain economic growth this year, the Congressional Budget Office expects, but the economy is likely to post solid growth in 2008. Employment gains, which held up in 2006 despite the slowdown in economic growth during the second half of the year, are expected to slow modestly this year, which may cause the unemployment rate to edge up. As housing construction stabilizes, however, economic growth and the labor market should start to recover by the middle of this year. The core rate of inflation—which excludes prices for food and energy—is expected to ease slightly this year, in the absence of any adverse price shocks.

Robust investment by businesses and solid growth of exports last year helped the U.S. economy absorb the decline in housing construction, and investment and exports are expected to continue to support the economy this year. For many years, the growth of businesses' capital stock—their plant, equipment, and software used for production—lagged behind the overall growth in demand for U.S. goods and services. As a result, in spite of the strong growth in investment last year, the nation's capital stock is still low relative to the level of demand. Investment should continue to grow, therefore, even if demand growth slows. Similarly, export growth is likely to remain strong because the growth in demand for U.S. products overseas is durable enough to withstand a slight slowing in U.S. demand for other countries' exports.

Gross domestic product will increase by 2.3 percent after inflation (in "real" terms) this year, CBO forecasts, and rebound to 3.0 percent in 2008 (see Table 2-1). Inflation, as measured by the year-to-year change in the price index for personal consumption expenditures, will fall from last year's estimated rate of 2.8 percent to 1.7 percent this year, because of the large drop in prices for motor fuels near the end of last year. The core rate of inflation in that price index is expected to fall less rapidly than overall inflation during 2007.

Growth in 2007 could be significantly weaker than CBO expects. Although CBO does not anticipate a recession, the recent economic slowdown has increased the risk that a recession might occur in the next two years. Moreover, some economic indicators, particularly the spread between short- and long-term interest rates, are at levels similar to those that have preceded recessions in the past. Housing sales have stabilized in recent months, but they could fall again, further weakening growth. Similarly, the effects of the housing slump on employment or household wealth might be larger than CBO anticipates, which would cause consumer spending to grow by less than CBO expects.

Conversely, growth in 2007 could be significantly stronger than CBO estimates. The economy could rebound from the last half of 2006 to again grow by more than 3 percent in 2007 because a number of factors support an outlook for stronger growth this year: the current strength of financial institutions, worldwide growth, and the general resilience of the U.S. economy in recent years.

CBO's projections beyond the two-year horizon, for 2009 to 2017, indicate real growth averaging 2.7 percent. The rate of real GDP growth declines from an average of 2.9 percent over the 2009–2012 period to 2.5 percent over the 2013–2017 period as members of the baby-boom generation begin to retire, slowing the growth of the labor force. Projected rates of inflation (as measured by changes in the price index for personal consumption expenditures), unemployment, and growth of labor productivity average 2.0 percent, 5.0 percent, and 2.2 percent, respectively, after 2008. Interest rates are projected to average 4.4 percent for three-month Treasury bills and 5.2 percent for 10-year Treasury notes.

**Table 2-1.**

# CBO's Economic Projections for Calendar Years 2007 to 2017

| | Estimated | Forecast | | Projected Annual Average | |
|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009-2012 | 2013-2017 |
| | | | Year to Year (Percentage change) | | |
| Nominal GDP (Billions of dollars) | 13,235 | 13,805 | 14,472 | 17,395 [a] | 21,519 [b] |
| Nominal GDP | 6.3 | 4.3 | 4.8 | 4.7 | 4.3 |
| Real GDP | 3.3 | 2.3 | 3.0 | 2.9 | 2.5 |
| GDP Price Index | 2.9 | 1.9 | 1.8 | 1.8 | 1.8 |
| PCE Price Index[c] | 2.8 | 1.7 | 1.9 | 2.0 | 2.0 |
| Core PCE Price Index[d] | 2.3 | 2.1 | 1.9 | 2.0 | 2.0 |
| Consumer Price Index[e] | 3.4 | 1.9 | 2.3 | 2.2 | 2.2 |
| Core Consumer Price Index[f] | 2.6 | 2.6 | 2.3 | 2.2 | 2.2 |
| | | | Calendar Year Average (Percent) | | |
| Unemployment Rate | 4.6 | 4.7 | 4.9 | 5.0 | 5.0 |
| Three-Month Treasury Bill Rate | 4.7 | 4.8 | 4.5 | 4.4 | 4.4 |
| Ten-Year Treasury Note Rate | 4.8 | 4.8 | 5.0 | 5.2 | 5.2 |
| Tax Bases (Billions of dollars) | | | | | |
| Corporate book profits | 1,795 | 1,775 | 1,787 | 1,763 [a] | 2,126 [b] |
| Wages and salaries | 6,032 | 6,330 | 6,642 | 8,019 [a] | 9,860 [b] |
| Tax Bases (Percentage of GDP) | | | | | |
| Corporate book profits | 13.6 | 12.9 | 12.3 | 10.8 | 9.9 |
| Wages and salaries | 45.6 | 45.9 | 45.9 | 46.1 | 46.0 |
| | | | Fourth Quarter to Fourth Quarter (Percentage change) | | |
| Nominal GDP | 5.3 | 4.8 | 4.9 | 4.7 | 4.3 |
| Real GDP | 2.9 | 2.7 | 3.1 | 2.8 | 2.5 |
| GDP Price Index | 2.3 | 2.0 | 1.8 | 1.8 | 1.8 |
| PCE Price Index[c] | 1.9 | 2.0 | 1.9 | 2.0 | 2.0 |
| Core PCE Price Index[d] | 2.4 | 2.0 | 1.9 | 2.0 | 2.0 |
| Consumer Price Index[e] | 2.2 | 2.5 | 2.2 | 2.2 | 2.2 |
| Core Consumer Price Index[f] | 2.8 | 2.4 | 2.2 | 2.2 | 2.2 |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Notes: GDP = gross domestic product.

Economic projections for each year from 2007 to 2017 appear in Appendix D.

a. Level in 2012.

b. Level in 2017.

c. The personal consumption expenditure chained price index.

d. The personal consumption expenditure chained price index excluding prices for food and energy.

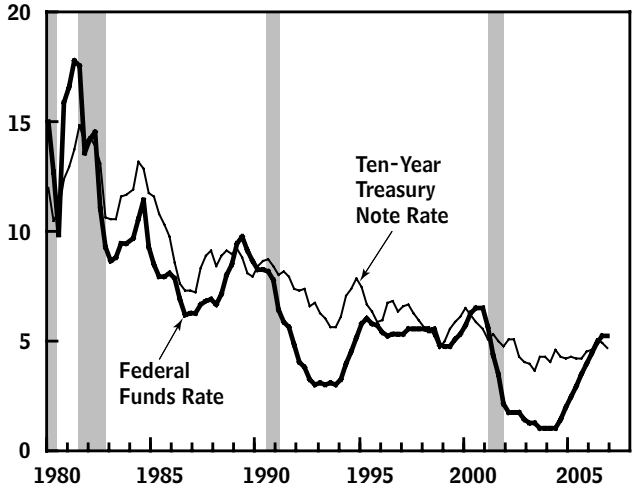
e. The consumer price index for all urban consumers.

f. The consumer price index for all urban consumers excluding prices for food and energy.

**Figure 2-1.**

## Interest Rates

(Percent)




Sources: Congressional Budget Office; Federal Reserve Board.

Note: Data are quarterly and are plotted through the fourth quarter of 2006.

Compared with CBO's August 2006 forecast, this forecast indicates much weaker growth in 2007 and somewhat weaker growth, on average, for the entire 10-year projection period. The change in the near term is largely the result of a decline in housing construction that was more precipitous than expected, but the change in the longer run stems from various factors. Revisions to the historical data for real GDP, business fixed investment, and the size of the country's capital stock since the last forecast was prepared have lowered both the historical estimates of the level of potential GDP and projections of the contribution of the growth of capital to potential GDP. In addition, CBO moderately lowered its projection for the potential growth of total hours worked. Those revisions have resulted in a level of real potential GDP that is about $300 billion, or roughly 2 percent, lower in 2016 than CBO projected last August.

## The Rise in Interest Rates and the Decline in Housing Construction

The two major factors that restrained growth in the second half of 2006 and that will also dampen growth this year are the lagged effects of the increase in short-term interest rates since mid-2004 and the large decline in the housing sector. The decline in housing stems in part from higher interest rates, but a more important contributor appears to be the overbuilding that resulted from the extremely rapid rise in housing prices and construction activity between 2003 and early 2006.

### The Rise in Short-Term Interest Rates

In an effort to forestall inflationary pressures, the Federal Reserve pushed up the federal funds rate, a short-term interest rate that it manages, from 1 percent in mid-2004 to 5¼ percent in mid-2006, where it remains today (see Figure 2-1). In doing so, the Federal Reserve has moved from a stance that clearly stimulated economic growth to one that now appears to be moderately restricting growth. The higher federal funds rate and corresponding increases in other short-term interest rates will tend to curb economic growth as well as inflation.

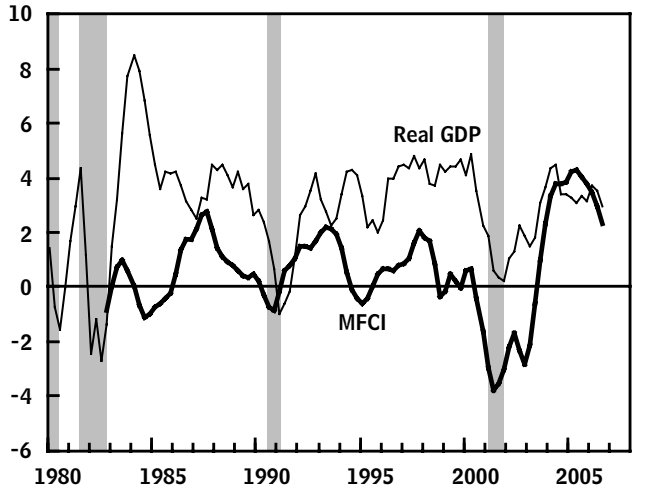
The federal funds rate, though, is not the sole determinant of the degree to which monetary and financial conditions may be suppressing or stimulating growth. Although increases in short-term interest rates tend to depress demand for goods and services, other financial factors, including long-term interest rates, the exchange value of the dollar (a falling dollar stimulates demand for U.S.-produced goods by making them cheaper relative to foreign-produced goods), and changes in wealth from rising or falling stock market prices also affect the demand for goods and services. A broad index that estimates the impact of those monetary and financial conditions on real GDP growth indicates continued support for economic growth in spite of the increase in short-term interest rates (see Figure 2-2). (The effect of changes in housing wealth on the economy, which is not included in the broad index of monetary and financial conditions, is discussed below.) The lagged effects of past stock market gains and the decline in the exchange rate continue to support demand, although those two factors are adding significantly less to demand growth than they were a year ago.

The rise in short-term interest rates has clearly removed some monetary stimulus from the economy, however. Interest rates charged by commercial banks for credit cards and new-car loans have both risen by about 2 percentage points since mid-2004, and corporate borrowing costs have increased for virtually all debt instruments with a term to maturity of fewer than five years. Moreover, the prime rate (a short-term interest rate charged by banks to their most creditworthy customers) rose from 4 percent to 8¼ percent over the past two and a half years.

**Figure 2-2.**

## Monetary and Financial Conditions Index and Real GDP

(Percentage points)




Sources: Congressional Budget Office; Macroeconomic Advisers, LLC; Department of Commerce, Bureau of Economic Analysis.

Notes: The Monetary and Financial Conditions Index (MFCI) estimates how much financial conditions contribute to the one-quarter annualized growth rate of real, or inflation-adjusted, GDP (gross domestic product). It draws on statistical relationships between real GDP and financial variables such as interest rates, exchange rates, and stock market values. When the index is positive, overall conditions in financial markets are conducive to the growth of real GDP; when the index is negative, overall financial market conditions are a drag on growth.

Data are quarterly and are plotted from the first quarter of 1980 through the third quarter of 2006 (for real GDP growth) and from the fourth quarter of 1982 through the third quarter of 2006 (for the MFCI). The percentage change in real GDP is measured from the previous year.

The rise in interest rates, as well as the increase in energy prices that occurred at almost the same time, weakened consumer spending on some durable goods. For example, real consumer spending on new vehicles in 2006 was about 6½ percent lower than in 2004, and some of that decline was because of higher interest rates. The dampening effect of higher short-term rates is likely to persist this year.

Some analysts believe that the increase in short-term interest rates has significantly heightened the risk of a recession. One indication of the greater risk is the relative levels of short- and long-term interest rates. In the past, a negative yield spread—that is, a situation in which short-term rates are higher than long-term rates—has often preceded recessions. This time, however, the yield spread does not appear to be a reliable indicator of a recession (see Box 2-1).

### The Decline in Housing Construction

For three years, from early 2003 to the end of 2005, the increase in housing construction and housing wealth stimulated economic growth. In contrast, the subsequent drop in construction severely undercut economic growth, particularly during the second half of 2006. The portion of GDP directly attributable to residential construction is small, at about 5 percent, but housing activity was so strong during the 2003–2005 period that it directly accounted for about half a percentage point of GDP growth each year (or 15 percent of growth over that period). In addition, the housing boom directly affected other industries, such as appliance manufacturing, and indirectly strengthened consumer spending by boosting household wealth. Acting in reverse, the recent drop in housing construction directly reduced GDP growth during the second half of last year by about a percentage point (at an annual rate), and the drop will have negative secondary effects as well.

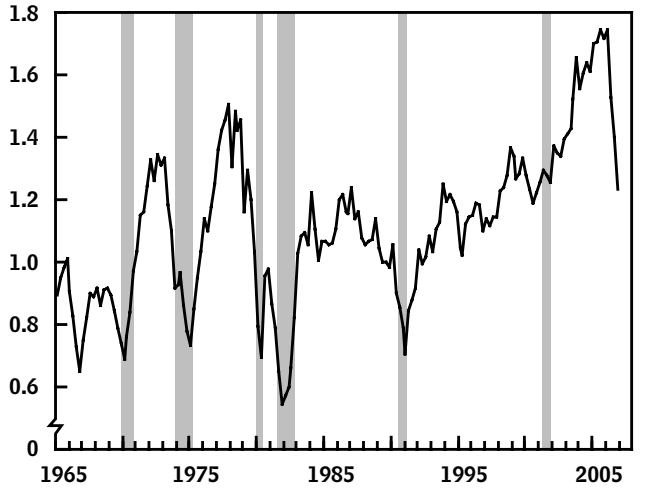
The reversal of the housing sector's performance creates major uncertainties for CBO's economic outlook. Among the questions raised are these: How much more will housing construction decline? How much farther will prices for houses fall? And how large will the secondary effects be of a continued slump in housing?

CBO's short-term forecast assumes that real residential investment will continue to fall during the first half of this year and that, on average, prices for houses will register a small decline during 2007. The forecast for residential fixed investment is based on the slower declines in home sales in recent months and the likelihood that overall economic growth and job creation will be supported by business fixed investment and exports. If home sales decline only slowly for a few more months and housing starts (the number of new houses builders start work on) continue to fall, the inventory of unsold new homes will decrease this year. Because of that projected decline in the inventory of unsold new homes, prices are expected to stabilize later this year. The smaller inventory will encourage a mild rebound in homebuilding during the second half of this year, CBO expects.

**Figure 2-3.**

## Single-Family Housing Starts

(Millions)




Sources: Congressional Budget Office; Department of Commerce, Bureau of the Census.

Note: Data are quarterly and are plotted through the fourth quarter of 2006.

Overall, the secondary effects of the drop in housing activity are estimated to be relatively modest. The growth of housing wealth slowed in 2006 as a result of the combined slowing in the growth of the housing stock and in home prices, and it is expected to grow even less this year. The slowdown in the growth of housing wealth, in turn, is expected to cut growth in personal consumer spending this year by about one-third of a percentage point. Employment growth is also expected to be restrained this year by the loss of jobs in housing and related industries, but again, the direct effect is likely to be small.

**The Boom and Bust in Housing.** The recent boom and bust in housing construction have been unique in many ways, and the causes of the large swings in the recent cycle are not entirely clear. Historically, housing booms and busts have typically been synchronized with the general business cycle, with turns in housing cycles occurring before business-cycle peaks (see Figure 2-3). Housing has not moved in tandem with the general business cycle since 1990, however. Housing starts did not weaken during the recession of 2001, and the current drop in housing is occurring independently of a recession.

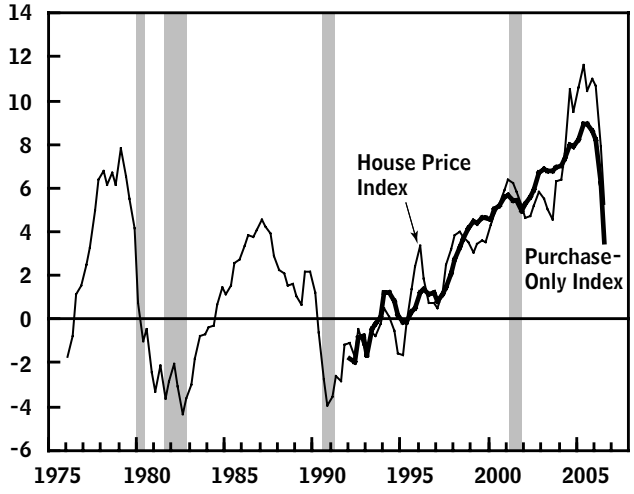
The large upswing in construction in the last housing market cycle appears to be due largely to the combination of extraordinarily low mortgage rates and expectations for rapid growth of housing prices. Rates for 30-year conventional mortgages, which had averaged 7.6 percent from 1995 through 2000, dropped to 5.8 percent in 2003 and generally remained below 6 percent until the third quarter of 2005. Against a background of solid employment and household income growth, the drop in mortgage rates (along with the increase in the use of innovative financing arrangements, such as interest-only loans) made it easier for households to finance housing purchases, which strengthened demand and ultimately bid up prices.

Housing prices grew rapidly from the middle of 2003 to early 2006 (see Figure 2-4). That rapid growth may have

**Figure 2-4.**

## Real Prices of Houses

(Percentage change from previous year)




Sources: Congressional Budget Office; Office of Federal Housing Enterprise Oversight (OFHEO).

Notes: The measures of house prices in this figure are the house price index, which includes purchase price data and refinancings, and the purchase-only house price index, both of which are published by OFHEO. Both house price indexes have been adjusted for inflation by dividing them by the core personal consumption expenditure chained price index.

Data are quarterly and are plotted from the first quarter of 1976 through the third quarter of 2006 (for the house price index) and from the first quarter of 1992 through the third quarter of 2006 (for the house price purchase-only index).

The purchase-only price index fell by 0.7 percent at an annual rate from the second quarter to the third quarter of 2006 (not shown in the figure).

**Box 2-1.**

## The Yield Spread and the Risk of a Recession

Short-term interest rates are normally below long-term interest rates. But the rapid increase in short-term rates since 2004 pushed those rates above long-term rates last year, a situation known as a negative yield spread, or inversion of the yield curve. That situation is often considered an indication of an upcoming recession because it has incorrectly indicated a recession only once since 1955 (see the figure at right). A negative yield spread normally implies a degree of monetary restraint that slows economic activity in general and that particularly dampens growth in sectors of the economy that are sensitive to changes in interest rates, such as consumer durables and housing. Some analysts' estimates of the relationship between the yield curve and recessions suggest that the current yield spread indicates roughly a 35 percent to 50 percent chance that a recession may start late in 2007 or in 2008.[1]

The negative yield spread may not be foreshadowing a recession this time, however. As indicated in the main text, overall financial conditions and other analysis outweigh the signal from the yield curve. Moreover, the yield curve itself may be less reliable as a signal of recession than in the past. The low level of inflation and the relatively low variability of inflation and real (inflation-adjusted) economic activity over the past 10 to 20 years, both in the United States and in other industrialized countries, may have increased the demand for long-term securities. Investors appear to be more confident in central banks' ability and commitment to control inflation in recent years than they were during the 1970s and 1980s. If concerns about the possibility of a sustained increase in inflation have ebbed over the years, the long-term interest rate would tend to be closer to the short-term rate even if no recession was in the offing—that is, long-term rates would not have to reflect as large an "inflation risk premium" as they have in the past. Lower

1. For additional discussion, see Arturo Estrella and Mary R. Trubin, "The Yield Curve as a Leading Indicator: Some Practical Issues," *Current Issues in Economics and Finance*, vol. 12, no. 5 (Federal Reserve Bank of New York, July/August 2006), available at www.newyorkfed.org; and Jonathan H. Wright, *The Yield Curve and Predicting Recessions,* Finance and Economics Discussion Series 2006-07 (Board of Governors of the Federal Reserve System, February 2006), available at www.federalreserve.gov.

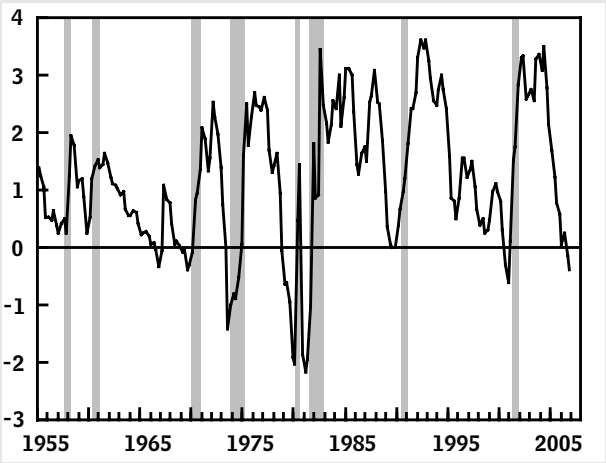
fueled demand by unrealistically inflating some buyers' forecasts of future prices, particularly for houses in areas where employment and income growth were relatively strong. Then, in 2006, increases in housing prices slowed dramatically, from a combination of factors. A slight rise in mortgage rates and the high prices of houses made it more difficult for potential buyers to qualify for mortgages, and houses failed to sell as quickly as they had in the past. In some markets, housing prices fell sharply.

To be sure, it is difficult to determine the "fundamental" or "appropriate" price of a house at the time of purchase, and expectations of future prices are known to be unrealistic only in hindsight. That is why the forecast for housing prices is one of the major uncertainties in this economic outlook. CBO has assumed that the national average price of housing will decline slightly this year but edge up next year. That view is based on CBO's overall economic outlook and the recent indications of some firming in home sales. The declines in sales of both new and existing homes have slowed in recent months, and continued gains in employment and low mortgage rates also imply that the weakness in home sales may bottom out during the first half of this year. If so, the combination of a mild rebound in sales later this year and continued weakness in new-home construction will bring the inventory of unsold homes down and keep housing prices, on average, from falling sharply.

**The Effect of Housing Wealth on Consumer Spending.** Slower growth in housing wealth will dampen growth in consumer spending this year relative to last year, CBO expects. In 2004 and 2005, the increase in housing wealth appears to have added about one-half of a percentage point to the growth of consumer spending nationally; last year, it added about one-third of a percentage point.

## Box 2-1.
## Continued

**Yield Spread**
(Percentage points)




Sources: Congressional Budget Office; Federal Reserve Board.

Notes: Data are quarterly and are plotted through the fourth quarter of 2006.

The spread is calculated as the difference between the rate on the 10-year Treasury note and the bond-equivalent yield on the three-month Treasury bill.

volatility in real economic activity can have a similar effect. Therefore, a slight inversion of the yield curve may be less of a signal of recession now than in the past.

An additional development may also be keeping the yield spread low compared with past business cycles. Many foreign official institutions, primarily central banks, have increased their dollar holdings as they run larger current-account surpluses. The increase in foreign holdings of Treasury securities may hold down long-term interest rates relatively more than short-term rates because short-term rates are more heavily influenced by the Federal Reserve.

Lastly, the negative yield spread is relatively small so far, and a similarly small negative spread occurred in the 1960s without presaging a recession. For those reasons, and because the Congressional Budget Office's overall analysis of the economy indicates significant support from a number of sectors, CBO largely discounts the recession signal of the yield spread, instead forecasting a short period of subpar growth this year.

In contrast, the slower growth in housing wealth will dampen growth in consumer spending this year by about one-third of a percentage point. Some areas of the country will be more adversely affected by the changes in housing wealth, but the overall effects on the economy are likely to be mild.

Traditionally, economists assume that households increase their spending on consumer goods and services each year by a small fraction of the increase in their housing wealth—about 2 to 7 cents for every dollar—with the effects spread over a number of years.[1] Households do not have to convert their housing wealth into cash to increase their spending; they can either reduce the amount of saving they would have done otherwise (that is, hold more of their savings in home equity), or they may increase other forms of debt. A direct consequence of using gains in wealth to increase spending is a lower rate of saving because household spending is higher relative to the flow of household income. Part of the 4½-percentage-point decline in the personal saving rate from 1997 to 2006 stemmed from the increase in housing wealth, although other factors—such as the run-up in energy prices from 2004 to mid-2006—were important as well.

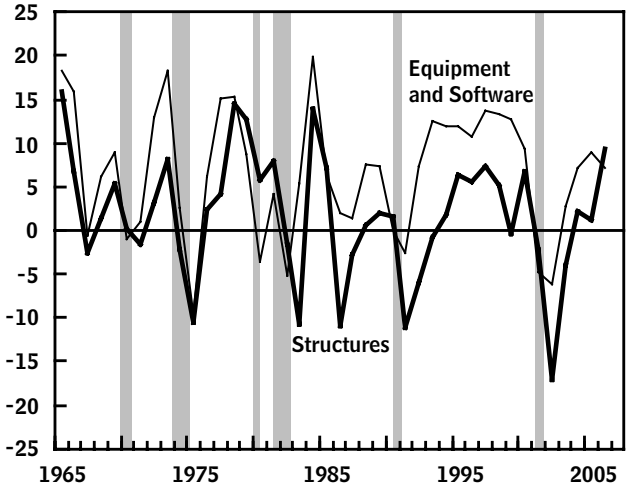
Some analysts maintain that housing wealth has a much larger effect on consumer spending in the short term than the traditional view dictates. They argue that some homeowners would be willing to save less or go further into debt in order to spend more, but their spending is limited by the unwillingness of lenders to extend them additional

1. See Congressional Budget Office, *Housing Wealth and Consumer Spending* (January 2007).

**Figure 2-5.**

## Real Business Fixed Investment

(Percentage change from previous year)




Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Data are annual and are plotted through the estimated value for 2006.

credit. Those homeowners may spend any increase in housing wealth much faster than the traditional wealth effect assumes. For such households, an increase in housing wealth may have a large, but temporary, effect on their spending because it increases their ability to borrow. If much of the increase in consumer spending in recent years has been because of that effect, a significant slowdown in the growth of housing wealth could sharply curtail the growth in consumer spending.

Whether there has been such a large effect on consumer spending from changes in housing wealth is uncertain, however. Analysts who favor that view have focused on the net cash that households withdraw from the value of their homes when they refinance their mortgages or take out home-equity loans. Since the 1990s, there has been a strong inverse relationship between such equity withdrawals and the personal saving rate, supporting the argument that a slight change in the growth of housing wealth will have a large impact on consumer spending. But there could be alternative explanations for the relationship. For example, some third factor, such as households' confidence in their future income growth, could have contributed to both higher consumer spending and higher equity withdrawals. Or, the causality could flow from consumer spending to refinancing, rather than the other way around. Households that are about to make a major purchase will seek out the least expensive way to raise cash for that purchase. In recent years, tapping into home equity has often been the lowest-cost method of financing (which would have been true, even if home prices had not risen so rapidly).

## The Continued Strength in Business Fixed Investment and Net Exports

The shock of the housing decline might have driven the economy into recession were it not for the offsetting strength of business fixed investment and net exports. Businesses' underlying need for more plant and equipment and robust growth in foreign demand for U.S.-produced goods and services are expected to keep economic growth solid this year.

### Business Fixed Investment

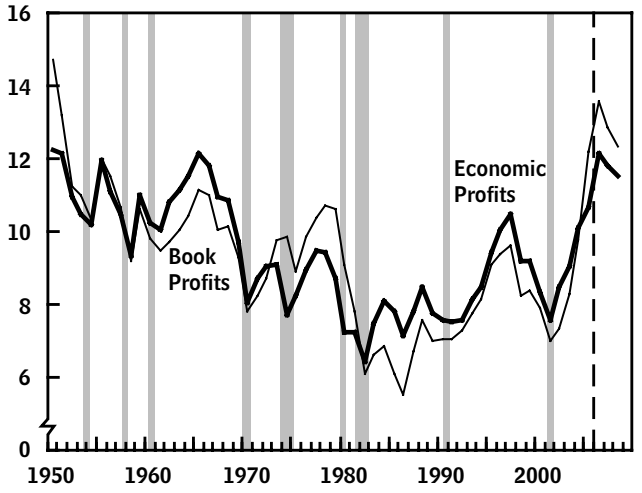
Businesses' investment spending has picked up in recent years. Although real investment in structures, equipment, and software fell sharply during the 2001 recession (and continued to fall during 2002 even as the economy recovered), investment in equipment and software started a strong recovery by mid-2003 (see Figure 2-5). In early 2006, investment in structures also showed signs of a sustained recovery. But the delay in investment growth has left the capital stock still low relative to demand for goods and services, and businesses are seeking to add to their capacity. For that reason, further strength in investment is likely.

Real investment in business structures, which has been a particularly strong category of investment recently, is almost certain to continue to support GDP growth this year. Lags in completing projects already begun, and the fall in vacancy rates for commercial buildings since late 2003, imply continued strength in investment in business structures. The national industrial availability rate, as reported by CB Richard Ellis (a company that measures the supply of available space in large industrial buildings), fell to 9.5 percent in the third quarter of last year from 10.1 percent a year earlier. The national office vacancy rate, as reported by the same source, fell to 13.2 percent in the third quarter from 14.4 percent a year earlier. Those vacancy rates are close to the averages of the past 10 years. But to keep those rates stable, business construction must remain strong.

**Figure 2-6.**

## Corporate Profits

(Percentage of gross domestic product)




Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Data are annual and are plotted through 2008.

Businesses' investment in equipment and software is also likely to support GDP growth this year. Net new orders for nondefense capital goods, a leading indicator of investment in equipment, remain at a high level, even after having retrenched somewhat in October and November 2006. In addition, the increase in the capacity utilization rate in manufacturing over the past year, an indication of the degree to which demand is growing relative to capacity, implies that firms need to invest more given the current level of demand for goods and services.

Corporations in general should be able to finance their additional investment needs relatively easily because profits are high. Both measures of corporate profits—economic profits and book profits—have bounced back in recent years, and economic profits as a share of GDP climbed to a 40-year peak in 2006 (see Figure 2-6). Because profits are quite sensitive to changes in real growth, the temporary slowing of GDP growth for the last half of 2006 and early 2007 is likely to hold down growth in profits this year, although their level will probably remain high. Corporations' strong internal cash flow indicates that financing constraints are not expected to hold back business fixed investment this year, even though long-term interest rates are expected to rise slightly.

### Net Exports and the Current-Account Balance

The decline in the foreign exchange value of the dollar since early 2002 and the recent increase in the average growth of the United States' trading partners relative to domestic growth have helped slow the widening in the trade deficit (see Figure 2-7). The increase in the price of petroleum imports offset those effects during 2005 and early 2006; but the recent decline in petroleum prices is contributing to the current stabilization of the trade deficit. CBO anticipates a decline in the trade deficit as a share of GDP over the next two years, even though the absolute size of the trade deficit for those years is expected to be only slightly less than its 2006 level.

The broader measure of the external accounts of the United States, the current-account balance, indicates a larger deficit than the trade balance alone.[2] The current-account deficit shows the extent to which U.S. residents are borrowing from the rest of the world each year, and the accumulation of deficits over time has increased U.S. net indebtedness to the rest of the world. The magnitude of the increase in the current-account deficit over the past 10 years has raised concerns about a possible disruptive adjustment in the value of the dollar. Some analysts argue that foreigners' willingness to accumulate dollar-denominated assets—that is, to lend to the United States—may suddenly weaken, causing a sharp decline in the value of the dollar and a spike in interest rates and putting upward pressure on inflation. Although economic disruptions because of rapid changes in the dollar's value are possible, CBO's forecast largely discounts such a scenario.

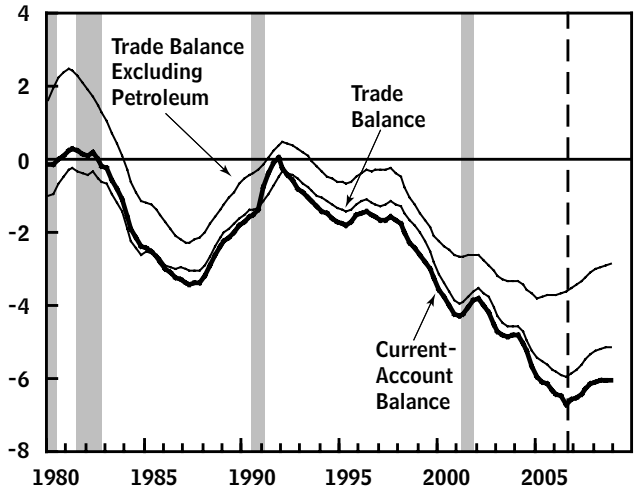
The current-account deficit is unlikely to shrink in the near term, although it will fall as a share of GDP. Net inflows of investment income, which are included in the current account, have been gradually decreasing as net liabilities of U.S. residents to the rest of the world have increased. The net indebtedness of U.S. residents, which is estimated to have been about $2.7 trillion at the end of 2005, or about 21 percent of GDP, is a consequence of many years of current-account deficits. The indebtedness of the United States implies that it will take longer to reduce the current-account deficit than the trade deficit.

2. The current account adds net interest payments, profits, and unilateral transfers (such as U.S. residents' monetary remittances to foreign residents) to the trade balance. Unilateral transfers cause the current-account deficit to be larger than the trade deficit.

**Figure 2-7.**

## Nominal U.S. Trade and Current-Account Balances

(Percentage of gross domestic product)




Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Data are quarterly and are plotted through the fourth quarter of 2008. Additionally, data were smoothed using a four-quarter moving average.

**The Exchange Value of the Dollar.** The downward trend in the value of the dollar over the past five years has tended to raise the prices of imports relative to the prices of domestically produced goods and lower the prices paid by foreigners for U.S.-produced goods, ultimately helping to reduce the trade deficit. The trade-weighted value of the dollar has generally moved downward since 2002, although it rebounded somewhat during 2005. The prices of imported goods excluding petroleum, which had been falling when the dollar was appreciating in value, rose as the value of the dollar fell. Even so, those prices grew by only about 2 percent during 2006, a pace too slow to create significant inflationary pressure.

A drop in the value of the dollar and higher prices for imports initially tend to increase the nominal trade deficit because the volume of goods and services imported and exported are slow to respond to the changes in prices. However, the increase in the relative prices of imports and the reduction in the prices of exports ultimately dampen the growth of the volume of imports and stimulate the growth of exports. After a lag, those changes in imports and exports are large enough that the net effect of a decline in the value of the dollar is a reduction in the nominal trade deficit.

Although the value of the dollar has been trending downward since early 2002, it rebounded briefly in 2005. The shift was a result of several temporary factors. Short-term interest rates rose faster in the United States than in Europe that year, encouraging greater holdings of dollar-denominated assets; rising energy prices initially boosted holdings of dollars by oil-exporting countries; and legislation temporarily favored repatriation to the United States of foreign earnings. Now that those temporary factors have faded—in particular, some oil-exporting nations say that they want to limit the growth of, or reduce absolutely, their dollar holdings—the dollar has resumed its downward trend. CBO's economic outlook assumes that the dollar will continue to fall over the long run, further helping to reduce the trade deficit.

**Exports and the Growth in Foreign Demand.** The drop in the value of the dollar has aided U.S. exports in recent years, but rapid growth in a number of countries that buy U.S.-produced goods and services has also been a major factor in the resurgence of U.S. exports. Real GDP growth in the 12 countries that use the euro averaged less than 1 percent in 2002 and 2003, but growth increased in subsequent years and averaged about 2½ percent last year. The countries of Latin America have also posted solid growth in recent years after slow growth from 2002 to 2003. Similarly, growth in Japan has recovered, climbing from almost zero in 2001 and 2002 to about 2½ percent in 2006.

The growth of domestic demand in those regions—the spending by households, firms, and the government—is promising for U.S. exports. Foreign GDP growth has been increasingly driven by foreign countries' domestic demand, not by their export growth. Consumer spending and business fixed investment in the major export markets for the United States have recovered rapidly since 2003.

**Imports and the Growth in Domestic Demand.** In contrast, the inflation-adjusted growth of consumer demand for goods in the United States is expected to slow. That slower rate of growth will reduce U.S. consumers' desire for imported goods, dampening the growth of imports. Although the pace of spending is slowing, CBO expects that it will still be moderate for much of this year.

## The Slowdown in Consumer Spending

Over the past four years, real growth in consumer spending has been bolstered by solid gains in household employment and income, increases in housing wealth, and, in 2003 and 2004, unusually low interest rates. Those supports to consumer spending were partially undercut by the increase in energy prices from 2004 to mid-2006, but the growth in consumer spending (after inflation) still remained above 3 percent in those years. The factors that affect consumer spending are now partially reversing their roles. The slower growth in employment, household income, and housing wealth is expected to restrain consumer spending, whereas the drop in energy prices that occurred last year will boost it. On balance, inflation-adjusted consumer spending is likely to be slower in 2007 than the 3½ percent pace of growth in 2006, in CBO's estimation, and the personal saving rate is expected to increase slightly. However, that forecast is dependent on the ability of exports and business fixed investment to keep employment growth from slowing too much.

### Employment and Household Income

Employment growth has been healthy, with only a slight easing in net job creation during the fourth quarter of last year. Current data indicate that jobs were added to the economy in the first nine months of 2006 at a pace of about 160,000 per month; that rate ebbed—to about 135,000 per month—during the last three months of the year. CBO anticipates that job growth will slow further, to an average of about 100,000 a month, in the near future.[3] The forecasted slowdown in employment largely reflects the decline in housing activity, as jobs in residential construction and industries related to housing (real estate, mortgage banking, and so forth) fell by about 20,000 per month during the last half of 2006. CBO's forecast assumes further job declines in that sector, averaging about 45,000 per month, through the end of this year.[4]

Even though employment will continue to grow, the unemployment rate is expected to inch up during 2007. The outlook for the growth in demand for goods and services, and therefore for the growth in demand for workers, implies that job growth this year will not quite keep up with the growth of the labor force.

Although it may increase slightly, the unemployment rate is likely to remain low; therefore, wage growth is expected to hold relatively steady this year in spite of the slowdown in employment growth. Hourly wages, as measured by the employment cost index, rebounded to grow by 3 percent during 2006 after a three-year slump during which real gains in total labor compensation (wages plus benefits) trailed productivity gains. Real growth in total labor compensation will probably outpace productivity growth over the next two years because of the low level of unemployment, CBO estimates.

### The Personal Saving Rate and the Financial Condition of Households

The personal saving rate is currently extremely low, and, according to some measures, households' financial position has deteriorated recently. Those measures have prompted concern that a significant percentage of households may be vulnerable to a downturn in employment or income growth. The data do not indicate that households overall are experiencing financial distress, but it is difficult to get up-to-date information about the financial condition of households at various income levels. Therefore, although the overall measures do not imply that the projected slowdown in employment growth will sharply restrain the growth of overall consumer spending, there is a risk that a significant percentage of households are vulnerable to a slowdown in employment or income growth and that such a slowdown could amplify the drop in consumer spending.

Debt-service burdens have continued to rise, although most consumers and homeowners appear to be able to handle their debt load. Although debt service as a percentage of disposable personal income has increased in recent years, delinquency rates do not indicate significant

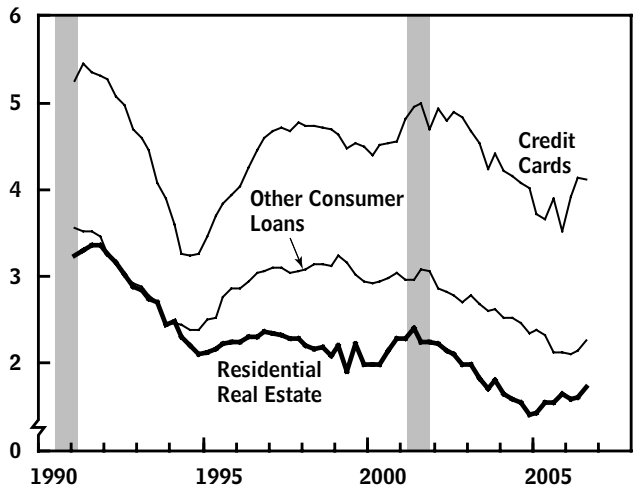
3. In February 2007, the Bureau of Labor Statistics (BLS) will revise the establishment employment data for 2005 and 2006. BLS has indicated that it will revise the growth of employment upward by approximately 800,000 jobs for the period between March 2005 and March 2006, an extraordinarily large revision. The current data indicate that 2,029,000 jobs were created over that period. BLS may also revise the data from March 2006 to the present. (Some analysts believe that there will be a small upward revision to the growth of employment for that period.)

4. For an analysis of the effect of the housing boom on employment, see Matthew Miller, "A Virtual Essay: Post-Recessionary Employment Growth Related to the Housing Market," *Monthly Labor Review* (Department of Labor, Bureau of Labor Statistics, October 2006), available at http://stats.bls.gov/opub/mlr/2006/10/ressum.pdf.

**Figure 2-8.**

## Delinquency Rates at Commercial Banks

(Percent)




Sources: Congressional Budget Office; Federal Reserve Board.

Note: Data are quarterly and are plotted from the first quarter of 1991 through the third quarter of 2006.

financial difficulties overall. Delinquency rates at commercial banks for residential real estate and other consumer loans changed very little last year and remain considerably below previous peaks (see Figure 2-8). The delinquency rate for credit cards moved up noticeably in 2006, bringing it back to where it had been in the first half of 2004, but the rate remains below the level it reached just before the downturn in consumer spending in 2001. Similarly, delinquency rates for adjustable-rate mortgages (ARMs) rose in 2006, particularly for subprime loans, but they have changed little in recent quarters for either prime or subprime fixed-rate mortgages. (The rise in delinquencies for subprime ARM loans—those made to less-creditworthy borrowers—is a particular cause for concern because they constitute a significant percentage of recent loans. They remain a small percentage of all outstanding mortgage loans, however.)

The anticipated slowing of consumer spending this year will allow some households to partially rebuild their savings and slow their accumulation of debt. The drop in gasoline prices that started in September of last year will help, even though those prices remain much higher than they were a few years ago. Households spent less than $400 billion a year (at an annual rate) on energy in the fourth quarter of 2003; by the third quarter of 2006, they were spending about $590 billion.[5] The spending per household for energy—based on a figure of 109 million households in 2006—was about $5,000, up from $3,600 per household in 2003.

## The Steady Growth in Government Purchases

Total government purchases for consumption and investment, as measured by the national income and product accounts (NIPAs), grew by about 2 percent last year (on an inflation-adjusted basis), and they are projected to grow at a similar rate this year.

### State and Local Governments

Revenues of states and localities increased last year faster than their budgets had projected, easing some of their budgetary pressures. The National Conference of State Legislators reports that for the fiscal year ending June 30 (for most states), general fund surpluses plus rainy-day reserves rose from 8.8 percent of general fund spending at the end of 2005 to 10.2 percent in 2006—one of the highest levels in recent decades. No state ended 2006 with a deficit.

That strength in revenues has enabled states and localities to increase funding for programs whose funding had been reduced after the 2001 recession, especially educational programs. Eight states also applied some unexpected funds toward their unfunded pension liabilities, although the problem of funding pensions and other postemployment benefits has not yet gained major prominence in states' budget allocations. The improved fiscal situation allowed state and local purchases to grow by an inflation-adjusted 2 percent in 2006, up from the near-zero real growth experienced during the 2003–2005 period. The current budgetary situation of states and localities suggests real growth in purchases is likely to remain near 2 percent over the next two years.

### Federal Government

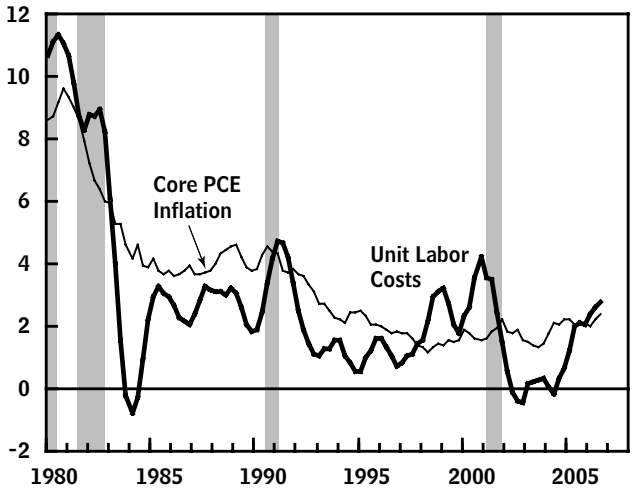
Federal purchases grew at an inflation-adjusted annual rate of less than 2 percent over the past two years; under the rules that govern CBO's baseline projections, they are expected to grow faster this year. Purchases exclude

5. Those figures are based on current estimates from the national income and product accounts. They include consumption of all household energy, motor fuel, electricity, natural gas, and fuel oil. The data, particularly for 2006, are subject to revision.

**Figure 2-9.**

## Core PCE Inflation and Unit Labor Costs

(Percentage change from previous year)




Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics.

Notes: The core PCE price index is the personal consumption expenditure chained price index excluding prices for food and energy.

Data are quarterly and are plotted through the third quarter of 2006. Additionally, data for unit labor costs were smoothed using a four-quarter moving average.

federal transfer payments to individuals (such as Social Security and Medicare) and interest payments, and they therefore account for only about 40 percent of total spending. (The spending outlook is discussed in detail in Chapter 3 and Appendix C.) Changes in all federal spending, as well as changes in tax law and other policies, can affect economic growth in the short run, but changes in purchases often have more-immediate effects on economic growth.

## The Easing of Core Inflation

For three years, the core rate of inflation has been above the upper end of the range that the Federal Reserve considers acceptable, but CBO anticipates that the inflation rate will ease this year. That reduction, in concert with moderate growth, should reduce the Federal Reserve's concerns about future inflation and permit some monetary easing by midyear. Growth of the price index for core personal consumption expenditures was about 2¼ percent near the end of 2006, and CBO expects that rate to fall by the end of this year to 2 percent, the upper end of the Federal Reserve's preferred range of 1 percent to 2 percent.[6] The rate of growth of the consumer price index for all urban consumers (CPI-U), the more commonly cited measure of consumer prices, remains above 2 percent in CBO's forecast. Differences in the way the two consumer price indexes are constructed cause the CPI-U to grow faster than the personal consumption expenditure (PCE) price index, on average.

### Resource Constraints, Productivity Growth, and Import Prices

Even though the slowing of economic growth last year should ease inflationary pressures, other factors—such as the low rate of unemployment, high rates of capacity utilization, slowing productivity growth, and rising prices for nonoil imports—have kept alive concerns about an increase in inflation. For more than a year, the unemployment rate has remained below 5 percent, a rate that many economists contend cannot be sustained for a prolonged period without putting upward pressure on inflation. Moreover, the combination of an increase in the growth of labor compensation and a decrease in the growth of productivity implies higher unit labor costs. In the near term, however, the measure of unit labor costs does not appear to be a reliable indicator of inflation, and resources in general do not appear to be stretched far enough to boost inflation.

**Unit Labor Costs and Capacity Utilization.** The growth of unit labor costs in recent years appears to suggest higher inflation over the short term, but the relationship between unit labor costs and core consumer inflation is too uncertain to put much stock in any one-year change (see Figure 2-9). A rising trend in the growth of unit labor costs has sometimes foreshadowed a slight rise in core PCE inflation, but both the lags and the magnitudes vary. In addition, payments of large year-end bonuses and the cashing in of stock options in 2006 boosted the growth of unit labor costs, but those payments were concentrated in just a few firms—most firms did not face

6. The Federal Reserve does not have an official target range, but 1 percent to 2 percent for the core personal consumption expenditure price index has come to be seen by economists as an implicitly preferred range. See the "Remarks by Ben S. Bernanke at the Finance Committee Luncheon of the Executives' Club of Chicago," Chicago, Ill., March 8, 2005, available at www.federalreserve.gov/boarddocs/speeches/2005/20050308/default.htm.

such increases in costs. Those special payments contributed to the 14 percent increase (at an annual rate) in compensation per hour in the first quarter of 2006, the greatest rate of increase in a quarter since the 15 percent increase seen in the first quarter of 2000, the peak of the stock option boom. Also, the measure of unit labor costs has been subject to large revisions (primarily because of revisions to the measure of compensation per hour), which reduces its usefulness for near-term inflation forecasting. If the employment cost index—an alternative measure of compensation per hour, one that is not subject to such large revisions and which is more closely related to inflation—is used instead, the growth of unit labor costs was about 1½ percent during 2006, not approximately 3 percent as measured by the more commonly used index.

The slowing of productivity growth during 2006 also contributed to the increase in the growth of unit labor costs, but that slowdown is probably temporary. In the short run, productivity growth tends to change in tandem with changes in economic growth, so a recovery of the economy later this year is likely to spur a boost in productivity as well. CBO anticipates that productivity growth will increase to about 2¼ percent by early next year. With compensation per hour expected to climb by less than 4½ percent, growth in unit labor costs would average below 2¼ percent. Such a rate is not a strong indication of upward pressure on inflation.

Some analysts are concerned that the increase in the rate of capacity utilization in manufacturing over the past three years could indicate inflationary pressures. Capacity utilization is relatively high—and this is consistent with the rapid pace of investment in plant and equipment—but the utilization rate does not seem high enough to indicate inflationary pressure. The current rate of 80.4 percent is below the levels that were associated with subsequent increases in inflation during the 1960–1990 period. In addition, since 1990, the capacity utilization index has not been a reliable leading indicator of inflation in consumer prices.

**Inflation in the Rest of the World and U.S. Import Prices.** Low and relatively stable inflation in the rest of the world generally reduces the likelihood of sharp, disruptive increases in the prices of imports, although low foreign inflation could be offset by greater depreciation in the value of the dollar. The moderating of inflation in the United States over the past 20 years has been part of a worldwide trend in the lowering of inflation, as well as a worldwide reduction in its volatility. Over that 20-year span, inflation has slowed even more in many foreign industrialized countries than it has in the United States. Currently, consumer price inflation is averaging below 2½ percent in Europe, Canada, and Asian Pacific countries, and economists generally do not anticipate a significant increase in foreign inflation this year.

Inflation in the prices of imports is only slightly above zero for consumer goods, and it is about 2 percent for all goods excluding petroleum, on average. Although the prices of imports are not restraining inflation in the United States as much as they did in the late 1990s, they also do not appear to be a force for higher inflation.

### Other Inflation Developments During 2006

The core rate of inflation was pushed up by an unusual acceleration in rents in 2006 and the lagged effects of the energy price hikes from 2004 to mid-2006. Those factors are unlikely to be repeated this year, further reducing the prospects of higher inflation, in CBO's estimation.

**Rents.** The core rate of PCE price inflation is influenced by estimates of the growth of rents imputed to homeowners—that is, the rent that homeowners would have to pay to live in their home if they were renting on the open market—as well as tenants' rents. The Bureau of Labor Statistics (BLS) surveys rental units and compiles that data. BLS uses the data from units that are similar to those that are owner-occupied to construct the imputed rent for homeowners, and it uses the data from all units to construct the measure of tenants' rent (called "rent of primary residence").

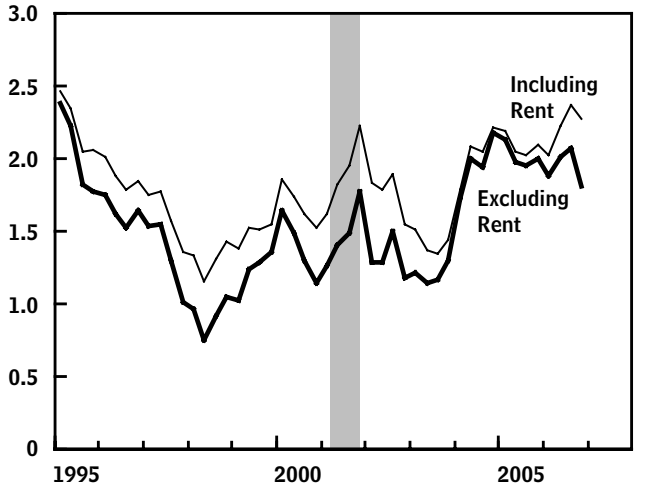
Those rental measures have a large influence on the growth of both the CPI-U and the PCE price indexes. The relative importance or weight of owners equivalent (imputed) rent plus tenants' rent is about 29 percent of the overall CPI-U and 14 percent of the PCE price measures. The corresponding weights for the core measures of inflation are higher, at about 38 percent and 17 percent, respectively.

Higher rents were the main reason that the core rate of PCE price inflation jumped in the spring of 2006 (see Figure 2-10). That jump heightened concerns at the time about a steady upward movement in inflation. Although both measures of rent increased, owners equivalent rent (OER) caused most of the gain in the core PCE price

**Figure 2-10.**

## Core PCE Inflation, Including and Excluding Rent

(Percentage change from previous year)




Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Notes: The core PCE price index is the personal consumption expenditure chained price index excluding prices for food and energy.

Data are quarterly and are plotted through the estimated fourth-quarter value for 2006.

index. The extraordinary increase in the OER measure appears to have occurred, in part, because of the decline in residential natural gas prices in early 2006. That part of the increase in rent inflation (and its contribution to the increase in inflation overall) appears to have been temporary. In constructing the OER measure, the Bureau of Labor Statistics adjusts the raw data in the survey of rents to account for changes in energy costs to ensure that the homeowners rent measure is applied to rental space only. Because natural gas prices were falling in the spring of 2006 from the hurricane-induced highs of late 2005, the removal of the effects of energy prices from the raw data probably caused the OER to grow temporarily faster than its underlying rate. In subsequent months, as residential energy prices stabilized, the growth of the OER measure slowed, better reflecting the underlying growth in rents.

It seems unlikely that rents will increase the measures of inflation over the next two years the way that they did last year. The unique effect of energy prices is not expected to recur. In addition, vacancy rates are still quite high, which should help dampen the growth of rents. In CBO's estimation, the large addition to the housing stock between 2002 and early 2006 will restrain rent increases for single-family housing for some time.

**Energy Prices.** Energy prices appear to have moderately increased nonenergy consumer price inflation in recent years, but they are not expected to have such an effect in the near future. It is difficult to determine how much of the acceleration in the measure of core PCE prices excluding rent between 2003 and 2006 stemmed from the increase in energy prices (see Figure 2-10). Although energy prices probably had some effect in those years, CBO does not anticipate that they will exacerbate inflation over the next two years.

CBO has adopted the consensus view, as reflected in prices for petroleum in the futures markets in December 2006, of only mild increases in petroleum prices this year. The price for West Texas Intermediate petroleum—a commonly cited price—is assumed to average about $63 a barrel this year. (That price was $62 a barrel in December 2006 and dropped in mid-January 2007 below $55 a barrel.) Consumer energy prices in general—for residential natural gas and electricity as well as gasoline and fuel oil—are expected to grow slowly and therefore not contribute to higher core inflation.

### Monetary Policy and Interest Rates in the Short Term

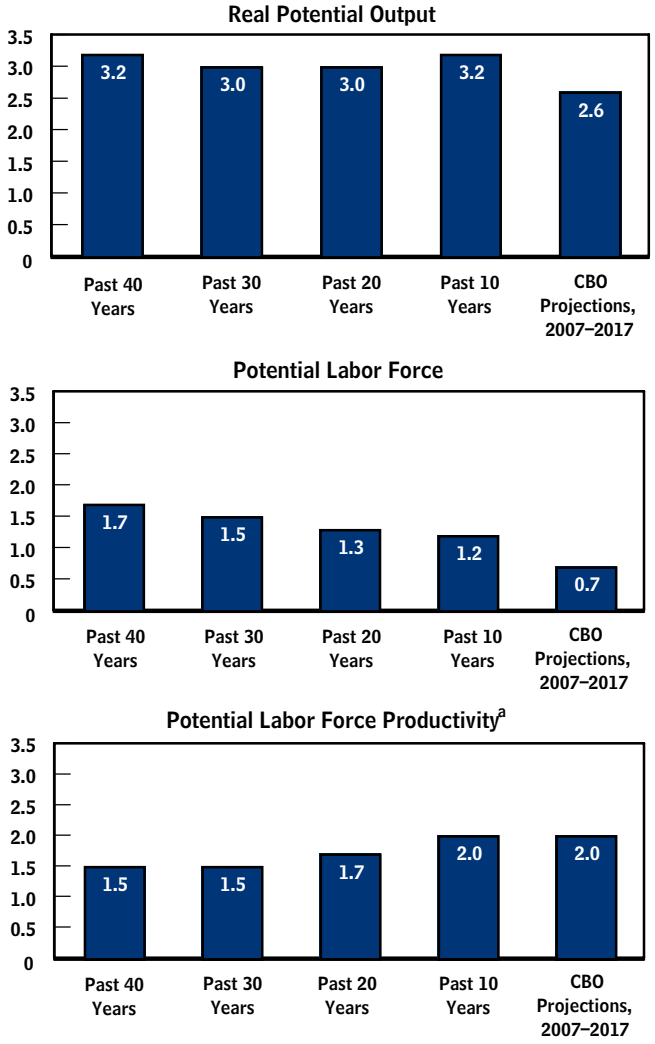
The combination of moderate economic growth and an easing of inflation will reduce the risk of higher inflation over the next two years and alleviate the need for monetary tightening. CBO assumes that the Federal Reserve will lower the federal funds rate marginally later this year and further during 2008 if the economic data evolve as CBO anticipates.

This year, the federal funds rate is likely to remain above the neutral range of 4½ percent to 5 percent—a range that roughly balances the goals of sustainable growth and low inflation in the current financial environment. CBO's outlook for a slightly restrictive monetary policy reflects its view that the Federal Reserve intends to restore core inflation to an acceptably low level as well as maintain the current expectations of low inflation in the future. In early January, the futures market for the federal funds rate indicated that, on balance, financial market participants expected the rate to be lowered by 25 basis

**Figure 2-11.**

## Real Potential Output, Potential Labor Force, and Potential Labor Force Productivity

(Average annual growth rate, in percent)




Source: Congressional Budget Office.

Note: Growth rates are rounded.

a. Potential labor force productivity is the ratio of real potential GDP (the level of inflation-adjusted gross domestic product that corresponds to a high level of resource—labor and capital—use) to the potential labor force (the labor force adjusted for movements in the business cycle).

points around the middle of 2007. (A basis point is one-hundredth of a percentage point.)

CBO's forecast assumes that long-term interest rates will edge up even as short-term interest rates fall. Some of the special factors that appear to be depressing long-term rates relative to short-term rates (as discussed in Box 2-1 on page 30) will probably continue to keep the spread between the two rates lower in the future than the average for the post–World War II period as a whole, but the spread is expected to widen nevertheless. CBO's forecast assumes that the spread between the rate on three-month Treasury bills and that on 10-year Treasury notes—about minus 40 basis points in December 2006—will be positive by the end of this year and increase to a positive 70 basis points by 2010.

## The Outlook Through 2017

CBO's medium-term projections—which this year cover the 2009–2017 period—are based on factors that underlie the potential growth of the economy, such as growth of the labor force, capital input (the productive services provided by the economy's stock of physical assets), and productivity. CBO takes into account the effect that current fiscal policy (as projected by CBO using baseline rules—see Chapter 1) may have on those factors, but it does not project the timing of fluctuations in the business cycle beyond the next two years.

### Potential Output

CBO estimates that potential output for the overall economy will grow at an average annual rate of 2.6 percent for the 2007–2017 period (see Table 2-2). That rate is 0.8 percentage points lower than the historical average growth rate of 3.4 percent, largely because CBO anticipates a sharp slowdown in the growth of the potential labor force during the 10-year projection horizon (see Figure 2-11). The projection for potential growth is also lower than what CBO projected last August, largely because of revisions to historical source data and changes in the projections of national saving and investment.

Growth in the potential labor force will average 0.7 percent annually during the 2007–2017 period, CBO projects. That rate, which is similar to the rate that CBO projected in August, is considerably lower than the historical growth rate of the potential labor force (1.6 percent, on average, during the 1950–2006 period). The slower pace stems from CBO's expectation that labor force participation will decline sharply during the next decade, mainly because the large cohort of workers born during the post–World War II baby boom will begin to retire (see Figure 2-12). Other factors will also contribute to the slowing of labor force growth: Women are not expected to increase their rate of participation in the labor force as much as they did in the past; men's

**Table 2-2.**

## Key Assumptions in CBO's Projection of Potential Output

(By calendar year, in percent)

| | Average Annual Growth | | | | | | Projected Average Annual Growth | | |
|---|---|---|---|---|---|---|---|---|---|
| | 1950-1973 | 1974-1981 | 1982-1990 | 1991-2001 | 2002-2006 | Total, 1950-2006 | 2007-2012 | 2013-2017 | Total, 2007-2017 |
| **Overall Economy** | | | | | | | | | |
| Potential Output | 3.9 | 3.2 | 3.1 | 3.1 | 2.8 | 3.4 | 2.8 | 2.5 | 2.6 |
| Potential Labor Force | 1.6 | 2.5 | 1.6 | 1.2 | 1.1 | 1.6 | 0.8 | 0.5 | 0.7 |
| Potential Labor Force Productivity[a] | 2.3 | 0.7 | 1.4 | 1.9 | 1.7 | 1.8 | 1.9 | 2.0 | 2.0 |
| **Nonfarm Business Sector** | | | | | | | | | |
| Potential Output | 4.0 | 3.6 | 3.3 | 3.5 | 3.1 | 3.7 | 3.1 | 2.9 | 3.0 |
| Potential Hours Worked | 1.4 | 2.3 | 1.7 | 1.1 | 1.1 | 1.5 | 0.8 | 0.6 | 0.7 |
| Capital Input | 3.8 | 4.2 | 4.1 | 4.6 | 2.4 | 3.9 | 3.7 | 3.7 | 3.7 |
| Potential TFP | 1.9 | 0.7 | 0.9 | 1.3 | 1.6 | 1.4 | 1.4 | 1.4 | 1.4 |
| Potential TFP excluding adjustments | 1.9 | 0.7 | 0.9 | 1.3 | 1.3 | 1.4 | 1.3 | 1.3 | 1.3 |
| TFP adjustments | 0 | 0 | 0 | 0.1 | 0.3 | * | 0.1 | 0.1 | 0.1 |
| Price measurement[b] | 0 | 0 | 0 | 0.1 | 0.1 | * | 0.1 | 0.1 | 0.1 |
| Temporary adjustment[c] | 0 | 0 | 0 | * | 0.2 | * | 0 | 0 | 0 |
| Contributions to the Growth of Potential Output (Percentage points) | | | | | | | | | |
| Potential hours worked | 0.9 | 1.6 | 1.2 | 0.8 | 0.8 | 1.0 | 0.6 | 0.4 | 0.5 |
| Capital input | 1.1 | 1.3 | 1.2 | 1.4 | 0.7 | 1.2 | 1.1 | 1.1 | 1.1 |
| Potential TFP | 1.9 | 0.7 | 0.9 | 1.3 | 1.6 | 1.4 | 1.4 | 1.4 | 1.4 |
| Total Contributions | 4.0 | 3.6 | 3.3 | 3.5 | 3.1 | 3.6 | 3.1 | 2.9 | 3.0 |
| **Memorandum:** | | | | | | | | | |
| Potential Labor Productivity in the Nonfarm Business Sector[d] | 2.6 | 1.3 | 1.6 | 2.4 | 2.0 | 2.2 | 2.3 | 2.4 | 2.3 |

Source: Congressional Budget Office.

Note: TFP = total factor productivity; GDP = gross domestic product; * = between zero and 0.05 percent.

a. The ratio of potential output to the potential labor force.

b. An adjustment for a conceptual change in the official measure of the GDP chained price index.

c. An adjustment for the unusually rapid growth of TFP between 2001 and 2003.

d. The estimated trend in the ratio of output to hours worked in the nonfarm business sector.

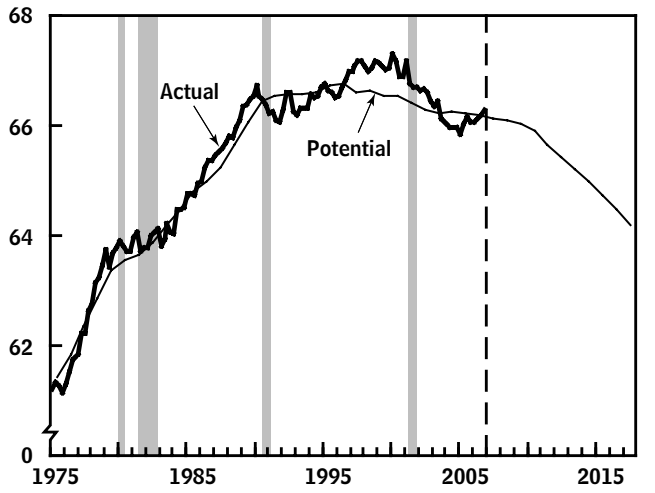
participation rate is likely to resume its slow downward trend; and the increase in marginal personal tax rates in 2011 (after the expiration of provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003) will modestly reduce people's incentive to work.

The primary labor input in CBO's model for potential output, potential hours worked in the nonfarm business sector, is projected to grow at an average annual rate of 0.7 percent through 2017. Like growth in the potential labor force, growth in potential hours worked is projected to slow during the 10-year period and be significantly lower than its long-term historical average. In addition, growth in the projected level of potential hours worked was revised downward since last August because CBO now estimates that the share of total employment in the nonfarm business sector, relative to other sectors of the economy, will rise somewhat more slowly.

**Figure 2-12.**

## Actual and Potential Labor Force Participation

(Percent)




Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

Notes: Labor force participation covers both sexes, ages 16 and older.

The potential labor force participation rate is the rate consistent with full employment. CBO has adjusted it for significant breaks in census population data.

For the actual participation rate, data are quarterly and are plotted through the fourth quarter of 2006. For the potential participation rate, data are annual and are plotted through 2017.

In contrast to the slower rates of growth projected for the potential labor force and potential hours worked, the rates of growth for capital input and potential total factor productivity are expected to be comparable to their historical averages. Capital input, for example, is projected to grow at an average annual rate of 3.7 percent during the 10-year projection period, about two-tenths of a percentage point slower than its average growth rate since 1950. That rate of growth is also about four-tenths of a percentage point lower than CBO projected in August; the change results from a reduction in the projected level of business fixed investment over the 10-year period.

CBO's projection for the growth of potential total factor productivity is slightly lower than it was last August and the same as the trend for the entire postwar period. At an annual rate of 1.4 percent, the trend in this measure of the combined productivity of capital and labor is lower than the 1.6 percent rate of the past few years, a period of unusually strong productivity growth. The corresponding measure of potential labor productivity growth in the nonfarm business sector is projected to be 2.3 percent annually for the 2007–2017 period, about one-tenth of a percentage point higher than its historical rate. Labor productivity in CBO's projection grows faster than its historical average even though the growth of total factor productivity is the same as its historical average because the capital input is expected to grow faster relative to hours worked than in the past. (Providing labor with more capital enhances the growth of labor productivity.)

**Inflation and Interest Rates.** CBO projects that inflation, as measured by the CPI-U, will average 2.2 percent a year from 2009 to 2017; as measured by both the PCE price index and the core PCE price index, it will average 2.0 percent a year. Growth of the GDP price index is expected to average 1.8 percent annually. CBO assumes that an average growth rate of 2.0 percent for the core PCE price index is compatible with the Federal Reserve's preferred range for inflation.

CBO's projection for interest rates in the medium term reflects its projections for inflation and for inflation-adjusted interest rates. Between 2009 and 2017, the rate on three-month Treasury bills is projected to average 4.4 percent, and the rate on 10-year Treasury notes, 5.2 percent. Using projected changes in the CPI-U as a measure of expected inflation, CBO estimates that the real interest rate on three-month Treasury bills will average 2.2 percent and the real rate on 10-year Treasury notes will average 3.0 percent.

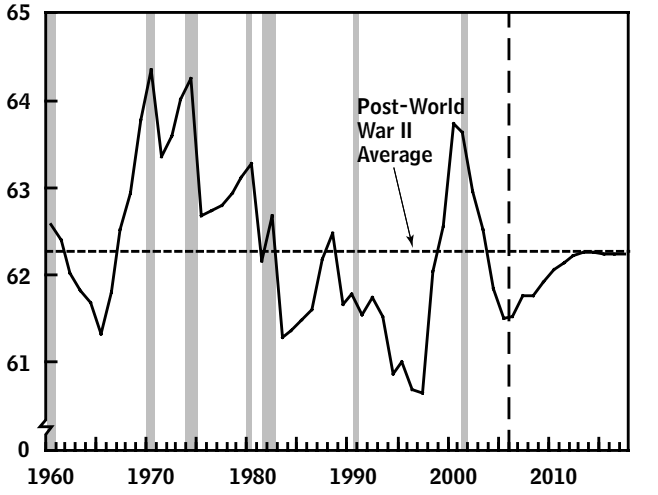
## Projections of Income

CBO's economic projections of various income categories as measured in the national income and product accounts are the basis for its projections of federal revenues. The outlook for revenues is most directly affected by projections of wages and salaries, corporate profits, proprietors' income, interest income, and dividend income. Although the NIPA measures of those income categories do not precisely correspond to the income concepts reported on tax forms for calculating tax liabilities, projections of income as measured in the NIPAs provide the basis for CBO's estimates of tax bases and future federal revenues. (See Chapter 4 for details of CBO's outlook for revenues.)

**Figure 2-13.**

## Labor Income

(Percentage of gross domestic product)




Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Data are annual and are plotted through 2017.

CBO projects the income components as shares of output, or GDP.[7] At the broadest level, GDP can be divided into a share for labor income, a share for capital income, and a share that reflects taxes on production and imports. Although those shares have varied from year to year, the long-term averages in the shares have been stable during the entire postwar period—62.3 percent for labor, 29.9 percent for capital, and 7.8 percent for taxes on production and imports.

Labor income consists of the total compensation that employers pay their employees—that is, the sum of wages and salaries and supplemental benefits (the employer's share of health and other insurance premiums and the employer's contribution to pension funds)—and the employer's share of payroll taxes (for Social Security and Medicare). In addition, CBO assumes that about 65 percent of proprietors' income is part of labor's share of GDP. Capital income consists of domestic corporate profits, depreciation charges, interest and transfer payments made by domestic businesses, rental income, and the remaining 35 percent of proprietors' income.

7. See Congressional Budget Office, *How CBO Forecasts Income* (August 2006).

Recent NIPA data indicate that, despite special bonuses and income from stock options, labor's share of GDP during 2006 was only about 61.5 percent, significantly below the postwar average (see Figure 2-13). CBO assumes that the share of GDP that comes from wages and salaries will increase over the next few years, largely because the low unemployment rate should put upward pressure on wages. Wages and salaries is the single most important category of income for projecting revenues, making up the largest part of the income base that is used to project individual income taxes and to estimate payroll taxes (including contributions by both employers and employees). Other labor income categories are also expected to rise relative to GDP over the projection period. Supplements to wages and salaries are projected to grow because of increases in health insurance contributions by employers. Proprietors' income is also expected to increase slightly. Therefore, labor's total share of GDP is projected to rise, returning to its long-run average by 2013, in CBO's estimation.

Capital's share of GDP moves inversely with labor's share of GDP, in general. But capital's share falls more than labor's share increases because the forecast for the capital share is also affected by the projection of slower growth in total income relative to GDP growth and the decline in net capital income from abroad. Although they should be equal, in theory, there is almost always some discrepancy between the measure of gross domestic income (GDI) and GDP, with the income measure usually smaller than the output measure. NIPA data for 2006 indicate that GDI exceeds GDP; CBO assumes that the difference between the two will return to its long-run average. Therefore, GDI grows at a slower pace in the forecast than GDP does, and part of that slower growth depresses capital's share of GDP.

Net capital income from abroad is also projected to become negative. Despite the growing net indebtedness of U.S. residents to the rest of the world, U.S. residents still receive more capital income from abroad than foreign residents receive from the United States. However, the difference has recently declined, and CBO projects that net capital income from abroad will be negative in coming years.

For those reasons, capital's share of GDP is expected to be lower in CBO's projections than it was last year. Corporate economic profits, which account for roughly a third of the share of capital, are projected to fall even more

than the capital share because both interest payments and depreciation charges by businesses are projected to rise slightly as a share of GDP. The increase in businesses' interest payments stems, in turn, from the need of businesses to increase their debt somewhat to pay for the recent pickup in investment (even though their internal cash flow is adequate to finance much of that increase in investment); from a slight increase in long-term interest rates; and from a greater leveraging (an increase in debt relative to assets) of balance sheets.

Corporate tax liabilities are projected on the basis of book profits, not economic profits. Book profits more closely track the profits that firms report under Internal Revenue Service (IRS) rules for depreciation, inventory valuation, and the like. By contrast, economic profits use economic principles for depreciation and inventory valuation rather than IRS rules. Book profits have deviated sharply from economic profits over the past five years—first lower, and then higher—because the tax laws governing depreciation were temporarily changed under the partial-expensing provisions of the Job Creation and Worker Assistance Act of 2002 and JGTRRA. That legislation permitted much larger depreciation charges than were implied by economic estimates of depreciation during the 2002–2004 period. Since early 2005, however, book depreciation has been smaller than economic depreciation (to make up for the "accelerated" depreciation from 2002 to 2004), and book profits therefore have been higher than economic profits. CBO projects that over the next few years, book depreciation will gradually increase relative to economic depreciation, causing book profits to decline relative to economic profits.

## Changes in the Outlook Since August 2006

Changes in the economic outlook since August 2006 had almost no impact on spending projections and just a slight negative impact on revenue projections—and the overall budget outlook was affected mostly for the last five years of the projection period, 2012 to 2016. Changes in the economic forecast worsened the budget outlook in those years by an average of $34 billion per year. (The specific revisions to the budget outlook that can be attributed to changes in the economic forecast are described in more detail in Chapter 1.)

The decline in housing construction during the second half of 2006 was much more precipitous than CBO anticipated in its August 2006 forecast, causing real GDP growth to be significantly slower during that period than CBO had projected. In addition, the housing sector is now expected to continue to depress economic activity during the first half of this year to a greater extent than CBO had previously anticipated. Real GDP growth in 2006 is now estimated to be 3.3 percent, down from the 3.5 percent that CBO had forecast in August, and growth in 2007 is now expected to be 2.3 percent, compared with the 3.0 percent indicated in the August forecast (see Table 2-3).

Consumer price inflation and interest rates in 2006 generally turned out to be as expected in the August forecast, but the current forecast for those rates in 2007 is significantly lower than last August's. The drop in motor fuel prices that began in September of last year had little effect on the average rate of inflation in 2006, but it is expected to cause the year-over-year growth in inflation in 2007 to be much lower than anticipated.

The forecast for income has also changed substantially, both in the near term and over the longer run. Wages and salaries' share of GDP is projected to be slightly higher over the entire projection period than CBO estimated last August, for two reasons. First, the projection of some employer-provided benefits, such as medical insurance premiums, was lowered because of a downward revision to the historical trend, reducing the share of benefits and increasing the share of wages in labor income. Second, CBO's estimates of the degree to which defined-benefit pension plans are underfunded were lowered, largely because asset returns during 2006 were greater than expected, reducing the need for firms to make additional contributions to those plans over the next few years. However, the increase in wages and salaries' share of GDP is more than offset by the lower level of nominal GDP projected for the 10-year period, so the level of wages and salaries ends up being significantly lower than CBO had previously anticipated. In contrast to the projection of the level of wages and salaries, the level of corporate book profits is higher in this forecast than in last August's. The projected increase in book profits as a share of GDP more than offsets the lower level of GDP.

Beyond 2012, the reduction in the projected level of nominal GDP is the major economic reason that revenues are expected to be lower. The projections for inflation, unemployment, and interest rates for the 2012–2016 period are unchanged from their levels in the

**Table 2-3.**

# CBO's Current and Previous Economic Projections for Calendar Years 2006 to 2016

| | Estimated | Forecast | | Projected Annual Average | |
|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009-2012 | 2013-2016 |
| Nominal GDP (Billions of dollars) | | | | | |
| January 2007 | 13,235 | 13,805 | 14,472 | 17,395 [a] | 20,639 [b] |
| August 2006 | 13,308 | 13,993 | 14,685 | 17,684 [a] | 21,052 [b] |
| Nominal GDP (Percentage change) | | | | | |
| January 2007 | 6.3 | 4.3 | 4.8 | 4.7 | 4.4 |
| August 2006 | 6.6 | 5.1 | 4.9 | 4.8 | 4.5 |
| Real GDP (Percentage change) | | | | | |
| January 2007 | 3.3 | 2.3 | 3.0 | 2.9 | 2.5 |
| August 2006 | 3.5 | 3.0 | 3.1 | 2.9 | 2.6 |
| GDP Price Index (Percentage change) | | | | | |
| January 2007 | 2.9 | 1.9 | 1.8 | 1.8 | 1.8 |
| August 2006 | 3.0 | 2.0 | 1.8 | 1.8 | 1.8 |
| Consumer Price Index[c] (Percentage change) | | | | | |
| January 2007 | 3.4 | 1.9 | 2.3 | 2.2 | 2.2 |
| August 2006 | 3.5 | 2.5 | 2.2 | 2.2 | 2.2 |
| Unemployment Rate (Percent) | | | | | |
| January 2007 | 4.6 | 4.7 | 4.9 | 5.0 | 5.0 |
| August 2006 | 4.7 | 4.8 | 4.9 | 5.0 | 5.0 |
| Three-Month Treasury Bill Rate (Percent) | | | | | |
| January 2007 | 4.7 | 4.8 | 4.5 | 4.4 | 4.4 |
| August 2006 | 4.8 | 5.0 | 4.8 | 4.4 | 4.4 |
| Ten-Year Treasury Note Rate (Percent) | | | | | |
| January 2007 | 4.8 | 4.8 | 5.0 | 5.2 | 5.2 |
| August 2006 | 5.1 | 5.4 | 5.3 | 5.2 | 5.2 |
| Tax Bases (Billions of dollars) | | | | | |
| Corporate book profits | | | | | |
| January 2007 | 1,795 | 1,775 | 1,787 | 1,763 [a] | 2,029 [b] |
| August 2006 | 1,781 | 1,641 | 1,624 | 1,621 [a] | 1,884 [b] |
| Wages and salaries | | | | | |
| January 2007 | 6,032 | 6,330 | 6,642 | 8,019 [a] | 9,471 [b] |
| August 2006 | 5,994 | 6,354 | 6,706 | 8,117 [a] | 9,619 [b] |
| Tax Bases (Percentage of GDP) | | | | | |
| Corporate book profits | | | | | |
| January 2007 | 13.6 | 12.9 | 12.3 | 10.8 | 9.9 |
| August 2006 | 13.4 | 11.7 | 11.1 | 9.6 | 9.0 |
| Wages and salaries | | | | | |
| January 2007 | 45.6 | 45.9 | 45.9 | 46.1 | 46.0 |
| August 2006 | 45.0 | 45.4 | 45.7 | 45.9 | 45.8 |
| **Memorandum:** | | | | | |
| Real Potential GDP (Percentage change) | | | | | |
| January 2007 | 2.7 | 2.8 | 2.8 | 2.7 | 2.5 |
| August 2006 | 3.1 | 3.2 | 3.1 | 2.8 | 2.6 |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: GDP = gross domestic product; percentage changes are measured from one year to the next.

a. Level in 2012.

b. Level in 2016.

c. The consumer price index for all urban consumers.

August forecast. CBO's projection for the growth of real GDP is only slightly lower in the medium term, but the level of real GDP is significantly lower because CBO's estimate of potential GDP was revised downward substantially.

The budgetary effect of the reduction in potential GDP is partially offset in the latter years of the projection period by an increase in the projection of taxable income as a share of GDP. The shares of GDP from wages and salaries and book profits are higher in this outlook than in August's. The taxable income share is higher because the lower level of business fixed investment and the downward revision to the size of the nation's capital stock reduced the projections of interest payments and depreciation charges against profits. Those reductions permitted the profit share to be higher. In addition, the share of nontaxable benefits paid to labor is lower throughout the projection period because of the downward revision to the previously mentioned historical trend in employer-provided benefits.

## How CBO's Forecast Compares with Others

CBO's economic forecast is similar to that of the *Blue Chip* consensus of about 50 private-sector economists, but it indicates somewhat weaker growth than the Administration's most recent forecast (see Table 2-4).

CBO's forecasts for real GDP growth, unemployment, and long-term interest rates over the next two years are close to those of the consensus forecast, but CBO generally indicates slightly lower inflation and short-term interest rates than the consensus does.

The Administration's forecast, which was prepared a month earlier than CBO's and released last November, indicates higher real GDP growth and a slightly lower unemployment rate, both for the near term and for the 2009–2012 period, than CBO's projections. CBO, however, projects lower inflation and a slightly lower long-term interest rate. (The *Blue Chip* consensus forecast does not extend past 2008, and the Administration's forecast does not extend past 2012.)

Although the vast majority of forecasters anticipate healthy growth this year and next, a few believe that the probability of a recession is quite high. The *Blue Chip* reported in January that, of the economists who responded to a question about the odds of a recession within the next 12 months, the average probability cited was 25 percent. Recessions are rarely foreseen, either by businesses or economists, particularly a year ahead. If a recession occurred, it could significantly worsen the budget outlook for the next few years (see Box B-1 on page 122 for a discussion of possible budgetary effects).

**Table 2-4.**

# Comparison of Forecasts by CBO, the Administration, and the *Blue Chip* Consensus for Calendar Years 2007 to 2012

| | Estimated 2006 | Forecast 2007 | Forecast 2008 | Projected Annual Average, 2009-2012 |
|---|---|---|---|---|
| | | Fourth Quarter to Fourth Quarter (Percentage Change) | | |
| Nominal GDP | | | | |
| CBO | 5.3 | 4.8 | 4.9 | 4.7 |
| Administration | 5.9 | 5.5 | 5.5 | 5.1 |
| *Blue Chip* consensus | 5.6 | 5.0 | 5.2 | n.a. |
| Real GDP | | | | |
| CBO | 2.9 | 2.7 | 3.1 | 2.8 |
| Administration | 3.1 | 2.9 | 3.1 | 3.0 |
| *Blue Chip* consensus | 3.1 | 2.7 | 3.0 | n.a. |
| GDP Price Index | | | | |
| CBO | 2.3 | 2.0 | 1.8 | 1.8 |
| Administration | 2.7 | 2.5 | 2.3 | 2.1 |
| *Blue Chip* consensus | 2.4 | 2.2 | 2.1 | n.a. |
| Consumer Price Index[a] | | | | |
| CBO | 2.2 | 2.5 | 2.2 | 2.2 |
| Administration | 2.3 | 2.6 | 2.6 | 2.4 |
| *Blue Chip* consensus | 1.9 | 2.5 | 2.4 | n.a. |
| | | Calendar Year Average (Percent) | | |
| Unemployment Rate | | | | |
| CBO | 4.6 | 4.7 | 4.9 | 5.0 |
| Administration | 4.6 | 4.6 | 4.8 | 4.8 |
| *Blue Chip* consensus | 4.6 | 4.8 | 4.9 | n.a. |
| Three-Month Treasury Bill Rate | | | | |
| CBO | 4.7 | 4.8 | 4.5 | 4.4 |
| Administration | 4.7 | 4.7 | 4.6 | 4.2 |
| *Blue Chip* consensus | 4.8 | 4.9 | 4.8 | n.a. |
| Ten-Year Treasury Note Rate | | | | |
| CBO | 4.8 | 4.8 | 5.0 | 5.2 |
| Administration | 4.8 | 5.0 | 5.1 | 5.3 |
| *Blue Chip* consensus | 4.8 | 4.8 | 5.0 | n.a. |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board; Aspen Publishers, Inc., *Blue Chip Economic Indicators* (January 10, 2007); Council of Economic Advisers, Department of the Treasury, and Office of Management and Budget, "Administration Economic Forecast" (joint press release, November 21, 2006).

Notes: The *Blue Chip* consensus is the average of about 50 forecasts by private-sector economists. The latest *Blue Chip* consensus does not extend past 2008.

GDP = gross domestic product; n.a. = not applicable.

a. The consumer price index for all urban consumers.

CHAPTER

# 3

# The Spending Outlook

The Congressional Budget Office estimates that if current laws governing mandatory programs remained the same and if discretionary appropriations totaled $944 billion, outlays this year would total $2.7 trillion (see Table 3-1). Because appropriations for most government agencies had not been enacted when CBO prepared its baseline projections, CBO built its estimates of discretionary spending for those agencies on funding levels provided for 2007 in the most recent continuing resolution, which expires on February 15, 2007.

As explained in Chapter 1, except for mandatory programs that meet criteria specified in now-expired provisions of the Deficit Control Act, baseline projections of spending do not consider the effects of future legislation.[1] CBO anticipates that the Administration will request additional funding for operations in Iraq and Afghanistan and that such funding, if provided, would boost outlays in 2007 by about $25 billion. With that additional funding, outlays in 2007 would be about 3 percent higher than in 2006. In addition, full-year appropriations that may be enacted later this year could contain additional funding for some programs, which could drive outlays still higher.

Total outlays rose by 7.4 percent in 2006 (see Table 3-2). Adjusted for shifts in the timing of certain payments, spending rose by 8.6 percent—the fastest rate of growth since 1990. The increase was driven primarily by higher interest payments, spending on hurricane relief, the newly instituted Medicare prescription drug benefit, the subsidy cost of student loans, and increased outlays for defense.

In 2006, higher short-term interest rates and accumulating debt pushed net interest outlays 23 percent higher than in 2005. Outlays for flood insurance, along with spending on disaster assistance and other reconstruction efforts, surged after 2005's devastating hurricane season. Adding the drug benefit to Medicare contributed to a sharp rise in the program's outlays; adjusted for a shift in the timing of payments, Medicare spending rose by about 16 percent in 2006. An increase in the volume of loan consolidations and revisions of estimates for subsidy costs drove up outlays for student loans. Defense spending as a whole was up by $26 billion—nearly as much as spending on the new prescription drug program (net of premium payments). In contrast, outlays for Medicaid ended the year slightly lower than in 2005.

Under current law, overall federal spending in 2007 is projected to shrink somewhat relative to the size of the economy. Spending for flood insurance and other disaster relief is anticipated to be much lower in 2007 than in 2006, as is the budgetary impact of student loans. In addition, appropriations enacted to date provide only a portion of the funding necessary for operations in Iraq and Afghanistan. Also, provisions of the continuing resolution hold funding for most government agencies at or below the amount they received in 2006.[2] Under those assumptions, total federal outlays will fall to 19.9 percent of gross domestic product in 2007, down from 20.3 percent in 2006. Once additional appropriations are provided for operations in Iraq and Afghanistan, the 2007 outlays are likely to be around 20.1 percent of GDP, below their average of 20.6 percent between 1966 and 2006.

1. Provisions in the Balanced Budget and Emergency Deficit Control Act of 1985 required that CBO's baseline include the costs of continuing certain large mandatory programs that are not permanently authorized. Although those provisions expired on September 30, 2006, CBO continues to abide by them in producing its baseline estimates.

2. The continuing resolution provides funding at the lower of the amounts in the House- or Senate-passed bills or the amount provided for 2006.

## Table 3-1.

# CBO's Baseline Spending Projections

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| Mandatory Spending | | | | | | | | | | | | | | |
| Social Security | 544 | 582 | 609 | 639 | 675 | 711 | 754 | 801 | 851 | 906 | 964 | 1,027 | 3,388 | 7,937 |
| Medicare | 374 | 428 | 449 | 477 | 508 | 557 | 564 | 623 | 667 | 719 | 806 | 851 | 2,555 | 6,221 |
| Medicaid | 181 | 193 | 208 | 225 | 242 | 261 | 282 | 304 | 327 | 353 | 380 | 410 | 1,219 | 2,993 |
| Other spending | 454 | 419 | 442 | 453 | 465 | 481 | 464 | 484 | 499 | 512 | 537 | 545 | 2,304 | 4,880 |
| Offsetting receipts | -141 | -166 | -174 | -174 | -182 | -190 | -198 | -210 | -221 | -232 | -248 | -265 | -919 | -2,094 |
| Subtotal | 1,411 | 1,455 | 1,533 | 1,620 | 1,708 | 1,821 | 1,866 | 2,001 | 2,123 | 2,258 | 2,438 | 2,568 | 8,548 | 19,937 |
| Discretionary Spending | | | | | | | | | | | | | | |
| Defense | 520 | 534 | 537 | 544 | 555 | 571 | 575 | 593 | 607 | 622 | 642 | 652 | 2,782 | 5,898 |
| Nondefense | 496 | 490 | 497 | 506 | 513 | 519 | 525 | 536 | 548 | 560 | 573 | 586 | 2,560 | 5,362 |
| Subtotal | 1,016 | 1,024 | 1,034 | 1,050 | 1,067 | 1,089 | 1,100 | 1,129 | 1,155 | 1,182 | 1,215 | 1,238 | 5,342 | 11,260 |
| Net Interest | 227 | 235 | 250 | 255 | 262 | 269 | 268 | 261 | 255 | 248 | 239 | 228 | 1,305 | 2,535 |
| **Total** | **2,654** | **2,714** | **2,818** | **2,926** | **3,038** | **3,179** | **3,234** | **3,391** | **3,533** | **3,687** | **3,892** | **4,034** | **15,194** | **33,731** |
| On-budget | 2,232 | 2,262 | 2,350 | 2,439 | 2,530 | 2,652 | 2,681 | 2,808 | 2,917 | 3,036 | 3,201 | 3,300 | 12,653 | 27,913 |
| Off-budget | 422 | 452 | 468 | 487 | 507 | 527 | 553 | 583 | 616 | 652 | 691 | 735 | 2,542 | 5,818 |
| | | | | | | | As a Percentage of GDP | | | | | | | |
| Mandatory Spending | | | | | | | | | | | | | | |
| Social Security | 4.2 | 4.3 | 4.3 | 4.3 | 4.3 | 4.3 | 4.4 | 4.5 | 4.5 | 4.6 | 4.7 | 4.8 | 4.3 | 4.5 |
| Medicare | 2.9 | 3.1 | 3.1 | 3.2 | 3.2 | 3.4 | 3.3 | 3.5 | 3.6 | 3.7 | 3.9 | 4.0 | 3.2 | 3.5 |
| Medicaid | 1.4 | 1.4 | 1.5 | 1.5 | 1.5 | 1.6 | 1.6 | 1.7 | 1.7 | 1.8 | 1.9 | 1.9 | 1.5 | 1.7 |
| Other spending | 3.5 | 3.1 | 3.1 | 3.0 | 3.0 | 2.9 | 2.7 | 2.7 | 2.7 | 2.6 | 2.6 | 2.6 | 2.9 | 2.8 |
| Offsetting receipts | -1.1 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 | -1.2 |
| Subtotal | 10.8 | 10.7 | 10.7 | 10.8 | 10.8 | 11.1 | 10.8 | 11.1 | 11.3 | 11.5 | 11.9 | 12.1 | 10.9 | 11.3 |
| Discretionary Spending | | | | | | | | | | | | | | |
| Defense | 4.0 | 3.9 | 3.8 | 3.6 | 3.5 | 3.5 | 3.3 | 3.3 | 3.2 | 3.2 | 3.1 | 3.1 | 3.5 | 3.3 |
| Nondefense | 3.8 | 3.6 | 3.5 | 3.4 | 3.3 | 3.1 | 3.1 | 3.0 | 2.9 | 2.9 | 2.8 | 2.8 | 3.3 | 3.0 |
| Subtotal | 7.8 | 7.5 | 7.2 | 7.0 | 6.8 | 6.6 | 6.4 | 6.3 | 6.2 | 6.0 | 5.9 | 5.8 | 6.8 | 6.4 |
| Net Interest | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.6 | 1.6 | 1.5 | 1.4 | 1.3 | 1.2 | 1.1 | 1.7 | 1.4 |
| **Total** | **20.3** | **19.9** | **19.7** | **19.5** | **19.3** | **19.3** | **18.8** | **18.9** | **18.8** | **18.8** | **19.1** | **18.9** | **19.3** | **19.1** |
| On-budget | 17.1 | 16.6 | 16.4 | 16.2 | 16.1 | 16.1 | 15.6 | 15.6 | 15.5 | 15.5 | 15.7 | 15.5 | 16.1 | 15.8 |
| Off-budget | 3.2 | 3.3 | 3.3 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.3 | 3.3 | 3.4 | 3.5 | 3.2 | 3.3 |
| **Memorandum:** | | | | | | | | | | | | | | |
| Gross Domestic Product (Billions of dollars) | 13,065 | 13,645 | 14,300 | 15,014 | 15,742 | 16,465 | 17,205 | 17,973 | 18,764 | 19,582 | 20,425 | 21,295 | 78,726 | 176,766 |

Source: Congressional Budget Office.

**Table 3-2.**

## Average Annual Rates of Growth in Outlays Since 1995 and in CBO's Baseline

(Percent)

| | Actual 1995-2005 | Actual 2005-2006 | Estimated 2006-2007 | Projected[a] 2007-2008 | Projected[a] 2008-2017 |
|---|---|---|---|---|---|
| Mandatory Outlays | 6.0 | 6.9 | 3.1 | 5.4 | 5.9 |
| Social Security | 4.5 | 4.9 | 7.0 | 4.5 | 6.0 |
| Medicare | 6.5 | 12.4 | 14.5 | 4.9 | 7.4 |
| Medicaid | 7.4 | -0.6 | 6.6 | 8.0 | 7.8 |
| Other[b] | 7.5 | 9.2 | -19.3 | 5.9 | 0.5 |
| Discretionary Outlays | 5.9 | 4.9 | 0.8 | 1.0 | 2.0 |
| Defense | 6.1 | 5.3 | 2.6 | 0.7 | 2.2 |
| Nondefense | 5.8 | 4.5 | -1.2 | 1.4 | 1.8 |
| Net Interest | -2.3 | 23.2 | 3.7 | 6.4 | -1.0 |
| **Total Outlays** | 5.0 | 7.4 | 2.3 | 3.8 | 4.1 |
| Total Outlays Excluding Net Interest | 6.0 | 6.1 | 2.1 | 3.6 | 4.5 |
| **Memorandum:** | | | | | |
| Consumer Price Index | 2.5 | 3.8 | 1.9 | 2.3 | 2.2 |
| Nominal Gross Domestic Product | 5.3 | 6.5 | 4.4 | 4.8 | 4.5 |
| Discretionary Budget Authority | 7.0 | 0.8 | -5.2 | 2.8 | 2.4 |
| Defense | 6.6 | 11.4 | -6.6 | 2.8 | 2.4 |
| Nondefense[c] | 7.4 | -9.9 | -3.4 | 2.9 | 2.4 |

Source: Congressional Budget Office.

Note: The growth rates shown do not account for shifts in the timing of certain payments or receipts.

a. CBO uses the employment cost index for wages and salaries to inflate discretionary spending related to federal personnel and the gross domestic product deflator to adjust other discretionary spending when constructing its baseline.

b. Includes offsetting receipts.

c. Includes funding provided through supplemental appropriations (and a rescission in 2006 of $23 billion in budget authority originally provided in 2005 to the Federal Emergency Management Agency). Excluding those factors would change the average annual growth rate for nondefense discretionary budget authority from 1995 through 2005 to 5.0 percent and would change the growth in 2006 to 0.03 percent and in 2007 to 3.5 percent.

Under baseline assumptions, CBO estimates that spending will fall to 18.9 percent of GDP by 2017. Those projections assume that discretionary outlays, which grew by an average of 5.9 percent annually from 1995 to 2005 and by 4.9 percent last year, will increase at an average annual rate of just 2.0 percent from 2008 to 2017. (The section of this chapter dealing with discretionary spending discusses additional scenarios for growth in spending governed by the annual appropriation process.) In contrast, over the same period, mandatory spending is projected to grow at nearly three times that rate—5.9 percent per year, which is similar to the rates of the past decade. (See Box 3-1 for descriptions of the various types of federal spending.)

The differences in the projected growth of mandatory and discretionary spending stem, to a significant degree, from longstanding procedures for preparing the baseline estimates. CBO continues to follow now-expired provisions of the Deficit Control Act, which have governed baseline projections for more than 20 years. On that basis, CBO projects spending for mandatory programs according to its estimates of various parameters,

**Box 3-1.**

## Categories of Federal Spending

On the basis of its treatment in the budget process, federal spending can be divided into three broad categories:

**Mandatory spending** consists primarily of benefit programs, such as Social Security, Medicare, and Medicaid. The Congress generally determines spending for those programs by setting rules for eligibility, benefit formulas, and other parameters rather than by appropriating specific amounts each year. In making baseline projections, the Congressional Budget Office (CBO) assumes that existing laws and policies for those programs will remain unchanged and that most expiring programs will be extended. Mandatory spending also includes offsetting receipts—fees and other charges that are recorded as negative budget authority and outlays. Offsetting receipts differ from revenues. Whereas revenues are collected in the exercise of the government's sovereign powers (for example, in the form of income taxes), offsetting receipts generally are collected from other government accounts or from members of the public for business-like transactions (for example, as premiums for Medicare or as rental payments and royalties for oil or gas drilling on public land).

**Discretionary spending** is controlled by annual appropriation acts; policymakers decide each year how much money to provide for given activities. Appropriations fund all manner of government activities, including those involved with defense, law enforcement, and transportation, for example. They also fund the national park system, disaster relief, and foreign aid. Some fees and other charges that are triggered by appropriation action are classified as offsetting collections that offset discretionary spending.

CBO's baseline depicts the path of discretionary spending as directed by the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985. The act states that current spending should be assumed to grow with inflation in the future.[1] Although those provisions (contained in section 257 of the act) expired at the end of September 2006, CBO continues to follow their requirements in preparing its baseline for discretionary spending. CBO estimates that appropriations to date have provided a total of $944 billion in budget authority for fiscal year 2007—$520 billion for defense and $424 billion for nondefense activities. (Most of the nondefense figure as well as some defense spending is an annualization of the sums provided in a continuing resolution that is effective through February 15, 2007).

In addition to spending from those appropriations, the baseline includes discretionary spending for highway infrastructure, highway and motor carrier safety, public transit, and airport infrastructure programs that receive mandatory budget authority from authorizing legislation. Each year, however, the annual appropriation acts control spending for those programs by limiting how much of the budget authority the Department of Transportation can obligate. For that reason, such obligation limitations are treated as a measure of discretionary resources, and the resulting outlays are considered discretionary spending. Under the continuing resolution (which currently governs appropriations for agencies other than the Departments of Defense and Homeland Security), transportation obligation limitations for 2007 total $47 billion.

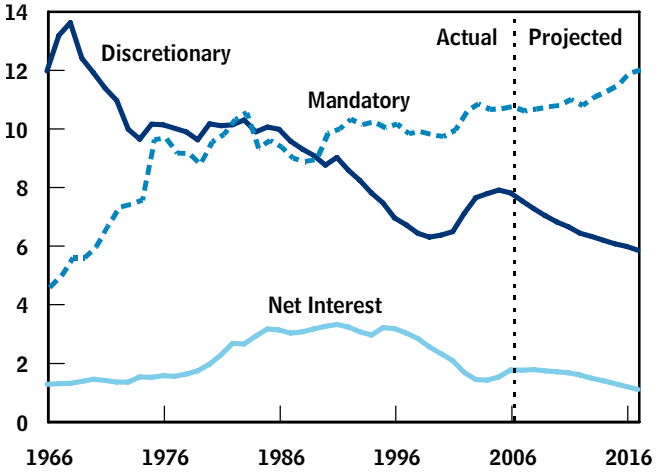
**Net interest** includes interest paid on Treasury securities and other interest the government pays (for example, on late refunds issued by the Internal Revenue Service) minus interest that the government collects from various sources (such as from commercial banks that maintain Treasury tax and loan accounts). Net interest is determined by the size and composition of the government's debt, annual budget deficits or surpluses, and market interest rates.

1. The inflation rates used in CBO's baseline, as specified by the Deficit Control Act, are the employment cost index for wages and salaries (applied to expenditures related to federal personnel) and the gross domestic product deflator (for other expenditures).

**Figure 3-1.**

## Major Components of Spending, 1966 to 2017

(Percentage of gross domestic product)




Sources: Congressional Budget Office; Office of Management and Budget.

Note: Figures for 2007 to 2017 come from CBO's baseline projections.

including caseloads and benefit costs. For discretionary spending, those provisions state that estimates for future discretionary spending should grow with inflation, which is a significantly lower rate of growth than that experienced in recent years. Discretionary outlays have grown by less than inflation in just 2 of the past 10 years and in 14 of the past 40 years.

The share of federal spending categorized as discretionary fell from about 12 percent of GDP in 1966 to 6 percent in 1999. Discretionary outlays began to rise in 2002, reaching 7 percent of GDP that year. By 2006, discretionary outlays were 7.8 percent of GDP (see Figure 3-1). Because projections of discretionary funding are adjusted only to account for inflation, CBO projects that category of spending will fall to 6.4 percent of GDP by 2012 and to 5.8 percent by 2017.

CBO estimates, however, that mandatory spending—which has more than doubled over the past 40 years as a percentage of GDP—will continue to increase over the next 10 years (led by growth in Medicare, Medicaid, and Social Security), climbing from its current GDP share of 10.8 percent to 12.1 percent in 2017. Such growth is driven in part by the rising numbers of the nation's elderly population. Rapid growth in the cost of health care also contributes significantly to the trend.

In 1991, net interest as a percentage of GDP reached a 40-year peak (3.3 percent). It then fell each year from 1995 through 2004 to bottom out at 1.4 percent in 2004 (because of lower interest rates, along with declining deficits or budget surpluses in most of those years). But in 2005, interest payments increased to 1.5 percent of GDP; last year they rose to 1.7 percent of GDP. Under baseline assumptions, net interest will stay constant as a percentage of GDP through 2010, but then it will fall when some tax provisions expire and the additional revenues, in combination with the baseline spending assumptions, change projected deficits to projected surpluses. Between 2007 and 2017, CBO estimates, net interest will average 1.5 percent of GDP.

## Mandatory Spending

Mandatory—or direct—spending makes up more than half of the federal budget. This category includes payments to people and to entities such as businesses, nonprofit institutions, and state and local governments. In general, those payments are governed by statutory criteria and they are not normally constrained by the annual appropriation process. Offsetting receipts (payments that federal agencies receive from the public and from other government agencies) are classified as offsets to mandatory spending. Mandatory outlays were $1.4 trillion in 2006, a figure that CBO projects will rise steadily to reach $2.6 trillion by 2017 (see Table 3-3).

From 1995 to 2005, mandatory spending increased at an average annual rate of 6.0 percent. Increases in the earned income tax credit (EITC) and the child tax credit, rising spending in health care programs, a drop in deposit insurance collections, increases in the subsidy costs of student loans, higher spending for farm programs, and a shift in the timing of payments that raised outlays in 2005 all contributed to strong growth over that period. Buoyed by robust growth in Medicare spending, mandatory outlays increased by 6.9 percent in 2006.

Over the next 10 years, mandatory outlays are expected to climb at a faster rate than the economy—5.9 percent per year, on average—thereby increasing as a share of GDP from 10.8 percent in 2006 to 12.1 percent by 2017. Rapid growth in health care programs factors significantly in that increase. Outlays for some other

mandatory programs, notably the EITC and the child tax credit, are projected to decline in the coming 10 years.

Mandatory spending is dominated by income-support payments and health care subsidies for the elderly, people with disabilities, and the poor. The three largest programs, Medicare, Medicaid, and Social Security, were responsible for more than 70 percent of direct spending in 2006—approximately $1.1 trillion (not including the effects of offsetting receipts). Income-security programs (such as the refundable portions of the EITC and the child tax credit, food assistance, Supplemental Security Income [SSI], and unemployment compensation) made up about 13 percent of direct spending ($199 billion); other retirement and disability programs (including federal civilian and military retirement and veterans' compensation programs) made up just under 10 percent ($149 billion). All other mandatory programs (such as agriculture subsidies, flood insurance, student loans, and other social service programs) made up less than 7 percent of mandatory spending, with outlays of $105 billion in 2006.

### Medicare and Medicaid

Taken together, gross federal outlays for the two major health care programs, Medicare and Medicaid, totaled $554 billion in 2006, or approximately 21 percent of all federal spending—a little more than Social Security. Spending for those programs is projected to grow briskly over the next decade—at an average rate of 7 percent to 8 percent per year. By 2017, CBO estimates, the two programs will cost $1.3 trillion, about 5.9 percent of GDP, up from 4.2 percent in 2006 (and more than double the 1991 level of 2.8 percent).

**Medicare.** The larger of the two major health care programs, Medicare provides subsidized medical insurance for the elderly and some people with disabilities. Medicare has three programs: Part A (Hospital Insurance), Part B (Supplementary Medical Insurance), and Part D (the subsidy for outpatient prescription drugs).[3] Gross outlays for Medicare totaled $374 billion in 2006, about 24 percent of mandatory spending. CBO estimates that Medicare spending will grow by about 15 percent this year—the first full fiscal year of Part D coverage—to $428 billion. In 2008, spending is expected to grow more modestly—by about 5 percent—for two main reasons. First, spending under Part D will no longer be ramping up. Second, under current law, Medicare's payment rates for physicians will be reduced by about 10 percent in 2008, with additional cuts for several years thereafter (as explained later in this chapter).[4] CBO anticipates that growth in Medicare outlays will average 7.4 percent annually from 2008 to 2017, and it estimates that Medicare outlays as a share of GDP will rise from 3.1 percent this year to 4.0 percent in 2017, in spite of the reductions in physicians' fees. In 2017, Medicare outlays will total $851 billion, CBO projects. That estimate does not include the effects of premiums or other payments, which are discussed in the section on offsetting receipts. Those receipts will total $60 billion in 2007 and $132 billion by 2017, CBO projects.

People become eligible for Medicare at age 65, when they are diagnosed with end-stage renal disease (kidney failure), or two years after they become eligible for Social Security Disability Insurance benefits. (The waiting period is waived for people diagnosed with amyotrophic lateral sclerosis [Lou Gehrig's disease].) In 2006, Medicare had about 42 million beneficiaries; it is expected to enroll 54 million by 2017. CBO projects that federal spending per beneficiary for Parts A and B will grow in nominal terms by nearly 50 percent, from about $9,000 in 2007 to $13,400 in 2017.

About 70 percent of Medicare beneficiaries had Part D coverage for prescription drugs for part of 2006; CBO projects that share will grow to about 78 percent of Medicare beneficiaries over the next few years. (Box 3-2 on page 58 discusses CBO's Part D spending estimates.)

**Medicaid.** Medicaid is a federal–state program that funds medical care for many of the nation's poor. The federal government matches state payments for approved services for eligible individuals. The federal government's share varies from state to state, averaging 57 percent nationwide. Federal outlays for Medicaid totaled $181 billion in 2006—about 12 percent of direct spending that year. Like Medicare, Medicaid has a history of rapid cost growth, with annual increases averaging 7.4 percent from 1995 to 2005. Medicaid spending fell slightly in 2006 as

3. Medicare Part C specifies the rules under which private health care plans can assume responsibility for and be paid for providing the benefits covered under Parts A, B, and D.

4. The Tax Relief and Health Care Act of 2006 (Public Law 109-432) modified payment rates for physicians' services in 2007 and specified that those payment rates revert to prior-law levels in 2008. Assuming that occurs, CBO estimates that payment rates for physicians' services will be reduced by about 10 percent in 2008.

**Table 3-3.**

## CBO's Baseline Projections of Mandatory Spending

(Outlays, billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | 544 | 582 | 609 | 639 | 675 | 711 | 754 | 801 | 851 | 906 | 964 | 1,027 | 3,388 | 7,937 |
| Medicare[a] | 374 | 428 | 449 | 477 | 508 | 557 | 564 | 623 | 667 | 719 | 806 | 851 | 2,555 | 6,221 |
| Medicaid | 181 | 193 | 208 | 225 | 242 | 261 | 282 | 304 | 327 | 353 | 380 | 410 | 1,219 | 2,993 |
| Income Security | | | | | | | | | | | | | | |
| Supplemental Security Income | 37 | 36 | 41 | 43 | 44 | 50 | 44 | 49 | 51 | 53 | 59 | 56 | 222 | 489 |
| Earned income and child tax credit | 52 | 53 | 55 | 55 | 55 | 55 | 38 | 38 | 38 | 38 | 39 | 39 | 257 | 449 |
| Unemployment compensation | 31 | 32 | 36 | 40 | 42 | 44 | 46 | 48 | 50 | 52 | 54 | 57 | 207 | 468 |
| Food Stamps | 35 | 35 | 36 | 37 | 37 | 38 | 39 | 40 | 41 | 42 | 43 | 45 | 186 | 396 |
| Family support[b] | 24 | 24 | 24 | 24 | 24 | 24 | 24 | 25 | 25 | 25 | 25 | 25 | 121 | 246 |
| Child nutrition | 14 | 14 | 15 | 15 | 16 | 17 | 17 | 18 | 19 | 20 | 20 | 21 | 80 | 178 |
| Foster care | 6 | 7 | 7 | 7 | 7 | 8 | 8 | 8 | 8 | 9 | 9 | 9 | 37 | 80 |
| Subtotal | 199 | 201 | 214 | 220 | 225 | 234 | 215 | 226 | 232 | 238 | 249 | 252 | 1,109 | 2,305 |
| Other Retirement and Disability | | | | | | | | | | | | | | |
| Federal civilian[c] | 68 | 72 | 74 | 77 | 80 | 83 | 86 | 89 | 92 | 96 | 99 | 102 | 399 | 878 |
| Military | 41 | 44 | 45 | 47 | 49 | 50 | 51 | 53 | 54 | 55 | 57 | 58 | 242 | 519 |
| Veterans[d] | 36 | 35 | 39 | 40 | 41 | 44 | 40 | 44 | 45 | 46 | 50 | 48 | 203 | 436 |
| Other | 5 | 8 | 7 | 7 | 7 | 7 | 8 | 8 | 9 | 10 | 10 | 11 | 37 | 86 |
| Subtotal | 149 | 158 | 166 | 170 | 176 | 185 | 185 | 194 | 200 | 207 | 217 | 221 | 881 | 1,919 |

Continued

new Medicare Part D payments began to assume the costs of prescription drugs for some Medicaid enrollees who qualified for both programs. In addition, lower caseload growth, little growth in rates paid to providers or in utilization of services, and the continuing effects of Hurricane Katrina in the Gulf Coast states contributed to the decline in Medicaid spending in 2006. However, CBO anticipates that the program's annual outlays will grow by about 6.6 percent in 2007 before accelerating to a 7.8 percent average annual growth rate over the remainder of the projection period, as the caseload grows and states respond to providers' demands for rate increases. (Because the federal government shares costs with the states, state spending for Medicaid would rise at similar rates). CBO projects that federal spending for Medicaid as a share of GDP will rise from 1.4 percent in 2007 to 1.9 percent in 2017, reaching $410 billion in that year.

### Social Security

Social Security, which pays cash benefits to the elderly, to people with disabilities, and to their dependents, is the largest federal spending program. Social Security has two programs: Old-Age and Survivors Insurance (OASI) and Disability Insurance. In 2006, Social Security outlays came to $544 billion, about 20 percent of all federal spending and nearly 35 percent of mandatory spending (excluding offsetting receipts). Spending for Social Security currently equals about 4.2 percent of GDP. That share will increase steadily over the next decade (and beyond) as the nation's elderly population increases. CBO expects that, between 2007 and 2017, the pool of recipients will grow by an average of 2.3 percent per year and that outlays will rise by about 6 percent annually. CBO estimates that Social Security will claim 4.8 percent of GDP by 2017.

**Old-Age and Survivors Insurance.** OASI is the larger of the two components, and it pays benefits to workers who reach a specific age (they become eligible for reduced benefits at age 62). It also makes payments to eligible spouses and children and to some survivors (primarily elderly widows and young children) of deceased workers.

## Table 3-3.

## Continued

(Outlays, billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Other Programs | | | | | | | | | | | | | | |
| Commodity Credit Corporation | 18 | 10 | 8 | 8 | 8 | 8 | 8 | 8 | 8 | 9 | 9 | 10 | 39 | 84 |
| Tricare For Life | 7 | 8 | 9 | 10 | 10 | 11 | 12 | 13 | 14 | 16 | 17 | 18 | 53 | 131 |
| Student loans | 33 | 4 | 3 | 4 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 4 | 22 | 45 |
| Universal Service Fund | 7 | 8 | 8 | 9 | 9 | 9 | 9 | 9 | 9 | 9 | 10 | 10 | 43 | 91 |
| SCHIP | 5 | 6 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 27 | 52 |
| Social services | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 25 | 51 |
| Flood insurance | 17 | 3 | 1 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 1 |
| Other | 12 | 17 | 22 | 22 | 21 | 20 | 20 | 19 | 19 | 18 | 19 | 20 | 105 | 200 |
| Subtotal | 105 | 60 | 63 | 62 | 63 | 63 | 64 | 65 | 67 | 67 | 70 | 73 | 315 | 656 |
| Offsetting Receipts | | | | | | | | | | | | | | |
| Medicare[e] | -49 | -60 | -65 | -70 | -75 | -81 | -85 | -92 | -99 | -108 | -120 | -132 | -377 | -929 |
| Employer's share of employee retirement | -47 | -48 | -51 | -53 | -55 | -57 | -60 | -62 | -65 | -68 | -71 | -74 | -275 | -615 |
| Other | -44 | -58 | -58 | -51 | -52 | -52 | -53 | -56 | -57 | -55 | -57 | -58 | -267 | -550 |
| Subtotal | -141 | -166 | -174 | -174 | -182 | -190 | -198 | -210 | -221 | -232 | -248 | -265 | -919 | -2,094 |
| **Total Mandatory Spending** | **1,411** | **1,455** | **1,533** | **1,620** | **1,708** | **1,821** | **1,866** | **2,001** | **2,123** | **2,258** | **2,438** | **2,568** | **8,548** | **19,937** |
| **Memorandum:** | | | | | | | | | | | | | | |
| Mandatory Spending Excluding Offsetting Receipts | 1,552 | 1,622 | 1,708 | 1,794 | 1,890 | 2,011 | 2,064 | 2,211 | 2,344 | 2,489 | 2,687 | 2,833 | 9,466 | 22,031 |
| Medicare Spending Net of Offsetting Receipts | 325 | 367 | 383 | 407 | 433 | 476 | 479 | 531 | 568 | 611 | 685 | 719 | 2,178 | 5,292 |

Source: Congressional Budget Office.

Notes: Spending for the benefit programs shown above generally excludes administrative costs, which are discretionary.

SCHIP = State Children's Health Insurance Program.

a. Excludes offsetting receipts.

b. Includes Temporary Assistance for Needy Families and various programs that involve payments to states for child support enforcement and family support, child care entitlements, and research to benefit children.

c. Includes Civil Service, Foreign Service, Coast Guard, and other, smaller retirement programs as well as annuitants' health benefits.

d. Includes veterans' compensation, pensions, and life insurance programs.

e. Includes Medicare premiums and amounts paid by states from savings on Medicaid prescription drug costs.

OASI benefits totaled $454 billion in 2006, a figure that will climb increasingly rapidly, reaching an estimated $853 billion by 2017. CBO projects that the growth in outlays for OASI will average 5.9 percent a year between 2007 and 2017.

About one-third of the growth in OASI is attributable to a rising caseload. About 40.5 million people received OASI payments in December 2006, and CBO estimates that some 52.5 million people will do so in 2017, an increase of nearly 30 percent. The oldest members of the baby-boom generation (those born in 1946) will qualify for initial OASI benefits in 2008, when they reach age 62. The rate of growth in OASI recipients is projected to jump from about 1.0 percent in 2007 to 1.5 percent in 2008 and to accelerate each year thereafter, rising to 2.1 percent in 2009 and 2.9 percent by 2017.

The rest of the growth in spending for OASI stems from benefit increases, which are projected to average 3.5 percent per year over the coming decade. A retiree's initial benefits are based on lifetime wages, adjusted for overall wage growth in the economy. After a person becomes eligible, benefits also rise each year according to a cost-of-living adjustment (COLA). The January 2007 COLA is 3.3 percent, down from 4.1 percent in 2006. CBO projects that the COLA for Social Security programs will be 1.5 percent in January 2008 and will average 2.2 percent per year through 2017.

**Disability Insurance.** Social Security's disability benefits go to workers who suffer debilitating health conditions before they are old enough for OASI enrollment. (Payments also are made to the eligible spouses and children of those recipients.) In 2006, nearly $91 billion in disability benefits was paid out. That figure will increase to $98 billion in 2007, CBO projects, and rise to $168 billion by 2017. That rate of increase averages 5.5 percent annually, and it is slightly lower than the increase projected for OASI benefits for the same period.

As with OASI, burgeoning caseloads and rising average benefits (as a result of wage growth and COLAs) contribute to the increase in Disability Insurance spending. Another factor is the continuing rise in Social Security's "normal retirement age"—from 65 to 66 and eventually to 67. Because the age increase delays the reclassification of disabled workers as retired workers, older people with disabilities will receive disability benefits for a longer time before making the transition to OASI. In addition, that increase lengthens the period during which workers can apply for those benefits.

### Other Income-Security Programs

The federal government also provides payments to people and to other government entities through programs that assist various populations—people with disabilities, the poor, the unemployed, needy families with children, and children who have been abused and neglected. Federal spending for SSI, unemployment compensation, the EITC and the child tax credit, Food Stamps, family support, and foster care, among others, totaled $199 billion in 2006, or about 1.5 percent of GDP.

In contrast to the rapid growth in Medicare, Medicaid, and Social Security spending, CBO projects, spending for other income-security programs will increase by 2.3 percent per year, on average, and will constitute 1.2 percent of GDP by 2017. Under baseline assumptions, outlays for some programs (SSI, unemployment compensation, Food Stamps, child nutrition, and foster care) will grow more quickly, but spending for family support will barely increase. EITC and child tax credit outlays are projected to decline over the next 10 years with the expiration of several statutory provisions that affect those credits.

**Supplemental Security Income.** SSI provides cash benefits to low-income people who are elderly or have disabilities. SSI outlays totaled $37 billion in 2006 and are projected to fall to $36 billion in 2007, a year in which 11 (rather than 12) monthly payments will be made because October 1, 2006, was a Sunday. After adjusting for that payment shift, SSI outlays are projected to increase at an annual rate of 3.5 percent over the next decade. The program's growth is driven mainly by COLAs and by a rise in the number of people with disabilities.

**Unemployment Compensation.** Outlays for unemployment compensation have fallen dramatically since 2003 as unemployment receded. Outlays fell from $54 billion (including $11 billion in temporary emergency assistance) in 2003 to $31 billion in 2006. CBO estimates that, in 2007, unemployment compensation will total $32 billion and that the unemployment rate will average 4.6 percent. The unemployment rate is projected to rise to 4.9 percent in 2008 and to average 5.0 percent in 2009 and beyond. As the unemployment rate rises, the proportion of people who are eligible for and collect unemployment benefits tends to rise as well. In addition, as the labor force increases, more people become eligible for unemployment compensation. And, although individual states are responsible for setting benefit amounts, benefit growth tends to track the growth in wages. CBO estimates that outlays for unemployment compensation will grow by more than 10 percent a year in 2008 and 2009 and then increase at an annual rate of about 4.5 percent in subsequent years.

**Earned Income and Child Tax Credits.** The EITC and the child tax credit are partially refundable tax credits available to people who earn wages below an established maximum and to qualifying families with dependent children. Either credit can reduce a filer's overall tax liability; if the credit exceeds the liability, the excess may be refunded to the taxpayer, depending on the filer's earnings. The refundable portions (which are categorized as outlays) totaled $52 billion in 2006 and are projected to rise to $53 billion in 2007 and to $55 billion by 2008.

**Box 3-2.**

## Medicare's Prescription Drug Benefit

In January 2006, Medicare began to subsidize prescription drug coverage under its new Part D program. Coverage comes from private prescription drug plans available to all enrollees in a geographic area, to those in managed care plans that participate in the Medicare Advantage program, and to enrollees in employer- or union-sponsored plans. Part D enrollment is voluntary, and subscribers pay premiums to cover a portion of the program's cost. Part D also provides additional federal subsidies to cover the cost of drugs for some low-income Medicare beneficiaries.

During 2006, almost 30 million people—about 70 percent of all Medicare beneficiaries—signed up for the drug benefit, and Part D spent a total of $32 billion on prescription drug coverage. Those costs were partly offset by $1 billion that enrollees paid in premiums and by $4 billion in "clawback" payments from states, leaving a net cost of $28 billion (see the table to the right). The state payments are intended to reflect the savings accruing to states from Medicare's coverage of drug costs previously paid by Medicaid; they are based on historical Medicaid spending on prescription drugs for people who are eligible for both programs.

The Congressional Budget Office (CBO) estimates that payments under Part D for prescription drugs will total $46 billion in 2007 and that they will reach $142 billion by 2017. The 2007 costs will be much higher than those in 2006 because the program will be in effect for the entire fiscal year and most participants will receive benefits for the whole period.

CBO also estimates that the federal government will collect $8 billion in offsetting receipts in 2007 from premiums and clawback payments. CBO projects that amount will rise to $23 billion in 2017. CBO anticipates that net spending for Part D will increase from $38 billion in 2007 to $119 billion in 2017.

The current estimate for Part D spending is significantly lower than CBO's 2006 estimates, for two reasons. First, Medicare's payments for prescription drugs under Part D are largely based on competitive bids that drug plans submit to provide coverage. The bids submitted for calendar year 2007 are much lower than expected—about 15 percent below the 2006 bids, on average. As a result, CBO reduced its projection of the per capita costs of providing drug coverage. In addition, recent information from the

CBO projects that they will remain at about that level until 2012, the first full fiscal year in which tax receipts will reflect the expiration of provisions initially enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001. In 2012, the refundability of the child tax credit will be virtually eliminated, and scheduled higher tax rates will reduce the EITC's refundable portion (because more of the credit will offset tax liability and be reflected as a reduction in revenues). As a result, CBO estimates, outlays for those credits will decline—under current law—to $39 billion in 2017.

**Food Stamps.** For 2007, CBO anticipates that outlays for the Food Stamp program will remain near the 2006 level of $35 billion. Caseloads are projected to drop slightly in 2007, in part because the 2006 caseload included people who received short-term Disaster Food Stamp benefits that were made available after Hurricanes Katrina, Rita, and Wilma devastated the Gulf Coast. (The sharp increase in recipients of those short-term benefits added about 600,000 people to the average monthly caseload in fiscal year 2006.) After several years of steady growth in monthly caseloads, the rate began to slow in 2006. CBO expects annual participation in the Food Stamp program to average 26.1 million between 2007 and 2017. Average monthly benefits are projected to rise by 2.1 percent in 2007 (above 2006) and by 2.4 percent annually through 2017. Overall, CBO estimates, spending for the program will grow by 2.5 percent per year, reaching nearly $45 billion by 2017.

## Box 3-2.
## Continued

**CBO's Projections of Spending for Medicare Part D**
(Billions of dollars)

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross Medicare Part D Outlays | 32 | 46 | 52 | 59 | 66 | 79 | 74 | 90 | 101 | 112 | 137 | 142 |
| Offsetting Receipts | | | | | | | | | | | | |
| Premiums | -1 | -1 | -2 | -2 | -3 | -3 | -3 | -4 | -4 | -5 | -5 | -6 |
| Payments from states | -4 | -7 | -8 | -8 | -9 | -10 | -11 | -12 | -13 | -14 | -16 | -17 |
| Subtotal | -4 | -8 | -10 | -11 | -12 | -13 | -14 | -16 | -17 | -19 | -21 | -23 |
| **Total, Net Medicare Part D outlays** | **28** | **38** | **42** | **48** | **54** | **66** | **60** | **74** | **83** | **94** | **116** | **119** |

Department of Health and Human Services' Centers for Medicare and Medicaid Services indicates that a larger-than-expected number of the Medicare beneficiaries who are not enrolled in Part D have some other form of drug coverage that is comparable to Part D. Because CBO expects that many of those beneficiaries will retain their existing coverage rather than enroll in Part D, it has lowered its estimate of the ultimate participation rate from 87 percent to 78 percent of Medicare beneficiaries.

In its estimate for the Medicare Modernization Act, which established Part D benefits, CBO projected net spending for Part D at $32 billion for 2006 and $518 billion for 2007 to 2013. (CBO's overall estimate that the legislation would cost $395 billion from 2004 to 2013 included savings that would occur elsewhere in the budget that would be attributable to the creation of Part D and to the effects of other provisions unrelated to the drug benefit.) CBO's current estimate of net spending for Part D for 2007 to 2013 is $136 billion lower than the original forecast, a difference of about 26 percent.

**Family Support.** Spending for family support programs—grants to states to help fund welfare programs, child support enforcement, and child care entitlements—is projected to remain fairly flat, rising from $24 billion in 2007 to $25 billion in 2017. The largest program in this category, Temporary Assistance for Needy Families (TANF), is capped by law at roughly $17 billion per year. TANF is authorized through 2010, but in keeping with provisions in the Deficit Control Act, CBO's baseline assumes that TANF funding will continue at its most recently authorized level.

**Child Nutrition and Foster Care.** Spending for child nutrition is projected to rise by about 4 percent annually over the next 10 years. Outlays for child nutrition totaled $14 billion in 2006 and are projected to rise to $21 billion by 2017. Per-meal reimbursements for the school lunch program are projected to rise by 2.3 percent annually during that period. CBO estimates that spending for foster care and adoption assistance, at more than $6 billion in 2006, will increase by 3.6 percent annually, reaching about $9 billion by 2017. Income eligibility standards for federal foster care and adoption assistance are eroding because they were not indexed for inflation in 1996 during welfare reform. CBO anticipates that the average monthly foster care caseload will continue to decline but that the decline will be more than offset by increases in spending on average benefits, administration, and adoption assistance.

### Other Federal Retirement and Disability Programs

Benefits for federal civilian and military retirees and for veterans' retirement and disability totaled $149 billion in 2006—about 10 percent of mandatory spending and

1.1 percent of GDP. Retirement and survivor benefits paid through the federal civilian retirement program (along with several smaller retirement programs for employees of various government agencies and for retired railroad workers) amounted to $68 billion in 2006. Retired military personnel and veterans received benefits totaling $41 billion and $36 billion, respectively. Payments to government retirees and veterans are projected to grow at a rate of about 3.4 percent annually, reaching $221 billion (but falling to 1.0 percent of GDP) by 2017.

Payments to civilian federal retirees will rise from $72 billion in 2007 to $102 billion by 2017, CBO projects, an average increase of about 3.6 percent per year. Growth in federal retirement benefits is attributable primarily to COLAs and to rising federal salaries, which boost future benefits. One factor that restrains growth in retirement programs is the gradual replacement of the Civil Service Retirement System (CSRS) with the Federal Employees Retirement System (FERS). FERS covers employees hired after 1983 and provides a smaller defined benefit than that provided by CSRS. FERS recipients, however, are eligible to receive Social Security benefits through their federal employment (CSRS employees are not), and their contributions to the federal Thrift Savings Plan are matched in part by their employing agencies.

The federal government also provides retirement and disability benefits to retired military personnel and to veterans.[5] Military annuities totaled $41 billion in 2006 and are estimated to grow 3.0 percent each year. Most of the growth in military retirement programs is in COLAs and other benefit increases. Mandatory spending for veterans' benefits—disability compensation, pensions, life insurance, and dependency and indemnity compensation to surviving spouses and children—totaled $36 billion in 2006. Those payments are projected to grow by 3.3 percent annually because of COLAs and other benefit increases. The veterans' disability compensation caseload is projected to grow by 1 percent annually.

### Other Mandatory Spending

Other mandatory spending programs include farm price and income-support programs administered by the Commodity Credit Corporation (CCC), Tricare For Life,[6] student loans, the Universal Service Fund, and the State Children's Health Insurance Program. Unusually high flood insurance claims, CCC payments, and student loan costs caused substantial outlays—$105 billion—in this category for 2006. Spending is projected to drop back to about $60 billion in 2007 (similar to spending before 2006) but to rise to $73 billion by 2017.

Net spending for flood insurance reached an unprecedented amount in 2006 as a result of Hurricane Katrina and other storms. In recent years, the program generally has collected sufficient premiums to cover its outlays: In four of the five years between 2000 and 2004, the program ran cash surpluses that averaged $450 million annually. However, claims exceeded premiums by more than $1 billion in 2005 and by $17 billion in 2006. CBO's baseline projections assume that spending for flood insurance claims and interest on the program's debt to the Treasury will largely be constrained by the program's premium income.

CCC outlays to agricultural producers came to $18 billion in 2006, after varying between $9 billion and $31 billion in the preceding six years. CBO estimates that those outlays will fall to $10 billion in 2007 and will range between $8 billion and $10 billion over the next decade. The reduction in 2007 primarily reflects lower income-support payments to farmers because of historically high crop prices, which are attributable in part to the strong market demand for ethanol. Following directions established by the Deficit Control Act, CBO's baseline assumes that most major farm programs, which are scheduled to expire in 2007, will continue over the 2008–2017 period.

Federal student loan subsidies and administrative costs in 2006 totaled $33 billion, rising largely because of revised estimates of the subsidy costs for loans and loan guarantees made in previous years and because of a record high volume of loan consolidations in 2006. In 2006, the Administration added more than $13 billion to the subsidy costs for previously issued student loans, but it has indicated that such reestimates, on net, will be minor in 2007. The roughly $91 billion in new consolidation loans made in 2006 also added substantial subsidy costs. With less favorable interest rates, the rush to consolidate student loans will likely subside in 2007. Outlays for

5. Veterans also receive education and housing benefits, which are included in other mandatory spending. Veterans' health care is a discretionary program.

6. Tricare For Life provides health care benefits to retirees of the uniformed services (and to their dependents and surviving spouses) who are eligible for Medicare.

**Table 3-4.**

## Sources of Growth in Mandatory Spending

(Outlays, billions of dollars)

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|---|---|---|---|---|
| Estimated Spending in 2007 | 1,622 | 1,622 | 1,622 | 1,622 | 1,622 | 1,622 | 1,622 | 1,622 | 1,622 | 1,622 |
| Sources of Growth | | | | | | | | | | |
| Cost-of-living and other automatic adjustments | | | | | | | | | | |
| Medicare | 4 | 12 | 20 | 29 | 39 | 49 | 61 | 76 | 96 | 118 |
| Social Security | 7 | 19 | 33 | 47 | 62 | 77 | 92 | 107 | 122 | 138 |
| Other programs[a] | 7 | 14 | 22 | 31 | 37 | 46 | 55 | 64 | 74 | 81 |
| Subtotal | 18 | 45 | 75 | 107 | 139 | 173 | 208 | 247 | 293 | 337 |
| Other changes in benefits | | | | | | | | | | |
| Medicare and Medicaid | 22 | 44 | 71 | 100 | 131 | 165 | 200 | 239 | 284 | 333 |
| Social Security | 11 | 18 | 27 | 36 | 48 | 64 | 83 | 105 | 130 | 158 |
| Other programs[a] | 3 | 5 | 7 | 9 | -5 | -1 | 2 | 5 | 10 | 15 |
| Subtotal | 36 | 68 | 105 | 145 | 175 | 228 | 284 | 350 | 423 | 507 |
| Increases in caseload | | | | | | | | | | |
| Medicare and Medicaid | 15 | 30 | 43 | 58 | 76 | 96 | 118 | 140 | 165 | 192 |
| Social Security | 9 | 19 | 33 | 46 | 61 | 77 | 94 | 111 | 129 | 148 |
| Other programs[a] | 6 | 10 | 12 | 13 | 16 | 18 | 20 | 21 | 22 | 24 |
| Subtotal | 29 | 60 | 88 | 117 | 153 | 191 | 231 | 273 | 317 | 364 |
| Shifts in payment dates[b] | 2 | 2 | 2 | 24 | -21 | 2 | 2 | 2 | 34 | 4 |
| Other | 1 | -2 | -2 | -4 | -3 | -4 | -3 | -4 | -2 | -1 |
| **Total** | **86** | **172** | **268** | **390** | **442** | **590** | **722** | **868** | **1,065** | **1,211** |
| Projected Spending | 1,708 | 1,794 | 1,890 | 2,011 | 2,064 | 2,211 | 2,344 | 2,489 | 2,687 | 2,833 |

Source: Congressional Budget Office.

Note: Amounts do not include the effects of offsetting receipts.

a. This category includes unemployment compensation, earned income and child tax credits, military and civilian retirement, veterans' benefits, child nutrition, Food Stamps, and foster care.

b. Represents baseline differences attributable to assumptions about the number of benefit checks that will be issued in a fiscal year. Normally, benefit payments are made once a month. However, Medicare will pay 13 months of benefits in 2011 and 2016, and 11 in 2012. Supplemental Security Income and veterans' benefits will be paid 11 times in 2007 and 2012 and 13 times in 2011 and 2016.

student loans will to fall to $4 billion in 2007, CBO estimates, and the program's costs are projected to be $3 billion to $5 billion per year for the next decade.

### What Drives Growth in Mandatory Spending?

Excluding offsetting receipts, CBO projects, gross mandatory spending will total $1.6 trillion in 2007 and that it will grow faster than the economy over the coming decade. By 2017, $1.2 trillion will be added to annual mandatory spending under baseline assumptions. Several factors account for that growth, including COLAs, other benefit increases, and rising caseloads (see Table 3-4).

**COLAs and Other Automatic Adjustments.** Annual changes in benefits that are pegged to inflation and other automatic adjustments account for more than one-quarter of the projected growth in mandatory spending. All major retirement programs grant automatic COLAs (the 2007 adjustment is 3.3 percent). CBO estimates that the consumer price index (the economic indicator of

inflation to which COLAs are tied) will increase by 1.5 percent in 2008 and by 2.2 percent annually from 2009 through 2017. The Food Stamp program and the EITC are indexed to other measures of inflation. In total, automatic adjustments for inflation in programs other than Medicare are projected to raise mandatory outlays by nearly $14 billion in 2008 and by $219 billion by 2017, accounting for 18 percent of the growth in mandatory spending estimated for the period.

Payment rates for many Medicare services also are adjusted annually to reflect changes in the costs of goods and services used by providers and changes in economic factors such as GDP and productivity. The effect of those automatic increases on Medicare spending is dampened by the sustainable growth rate (SGR) formula, which is used to establish a fee schedule for physicians' services. The SGR formula sets a cumulative spending target for payments to physicians and for services related to medical visits (such as laboratory tests and physician-administered drugs).

Left unaltered, the SGR formula ultimately recoups spending that exceeds the cumulative target by reducing payment rates for physicians' services or by holding increases below inflation (as measured by the Medicare economic index).[7] Under the assumption that current law will remain unchanged, CBO anticipates that the SGR formula will reduce payment rates for physicians' services by about 10 percent in 2008 and 5 percent annually for much of the rest of the 2009–2017 period. By then, CBO estimates, cumulative Medicare spending measured under the SGR will be nearly back in line with the formula's cumulative targets, but payment rates for physicians in 2017 will be less than three-quarters of what they will be in 2007.[8]

When combined, the indexing and the SGR adjustments to Medicare payment rates result in increases of $4 billion in 2008 and $118 billion in 2017, relative to spending in 2007, and make up about 10 percent of projected increases to mandatory spending.[9]

**Other Changes in Benefits.** Other factors that contribute to rising benefits account for more than 40 percent of the increase in mandatory spending over the projection period—$507 billion. About two-thirds of that figure (and nearly 28 percent of all increases in mandatory spending) is attributable to growth in spending for Medicare and Medicaid that cannot be tied to statutory adjustments in payments or to the rising caseload. Increased use of services—more frequent visits to doctors, for example—contributes to growth, as does increased use of costly medical technology. Federal Medicaid costs also rise as states expand coverage of services—for example, by raising limits on the number of home health visits the program will cover.

Benefits for other programs also experience growth beyond the automatic adjustments. Growth in wages, for example, affects Social Security benefits, federal retirement benefits, and unemployment compensation. Wage growth also affects refundable tax credits. Outlays for the EITC and the child tax credit will shrink relative to payments made in 2007, CBO projects, because rising wages will reduce eligibility and increase the proportion of credits that will offset taxes rather than be refunded. Beginning in 2012, expiring provisions first enacted in EGTRRA also will affect outlays for the EITC and the child tax credit by reducing the refundable portion of those credits. If current tax law remains unchanged, outlays for those tax credits in each year from 2012 to 2017 will be less than outlays in 2007.

**Increases in Caseloads.** An increase in the number of people who will be eligible for and claim benefits will add $364 billion to mandatory spending by 2017, CBO estimates. The three largest mandatory programs (Medicare, Medicaid, and Social Security) will be responsible for more than 90 percent of that total—$340 billion. In 2007, CBO estimates, 49 million people will collect Social Security benefits. By 2017, that number will be 62 million. Projected increases in Medicare caseloads are similar, rising from about 43 million in 2007 to

7. The Medicare economic index tracks the costs of physicians' time and operating expenses. Most of the components of the index come from the Bureau of Labor Statistics. Changes in the costs of physicians' time are measured through changes in nonfarm labor costs. Changes in productivity also are factored directly into the index.

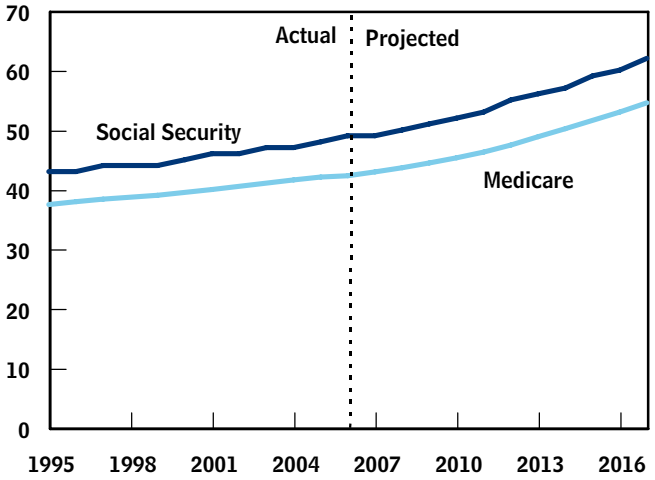
8. For more detail on the SGR, see Congressional Budget Office, *The Sustainable Growth Rate Formula for Setting Medicare's Physician Payment Rates* (September 7, 2006).

9. Amounts discussed for Medicare are gross spending and do not include the offsetting effects of premium payments. Those payments are set to cover about one-quarter of the costs for Part B, the Supplementary Medical Insurance program. Premiums also are paid under Part D.

**Figure 3-2.**

## Caseload Growth in Social Security and Medicare, 1995 to 2017

(Millions of people)




Sources: Congressional Budget Office; Office of Management and Budget.

Notes: Figures for 2007 to 2017 come from CBO's baseline projections.

54 million in 2017 (see Figure 3-2). Changes in caseloads for all major benefit programs will contribute about 30 percent to growth in mandatory spending between 2007 and 2017.

**Shifts in Payment Dates.** The timing of outlays for some mandatory programs depends on whether October 1, the first day of the fiscal year, falls on a weekday or on a weekend. If it falls on a Saturday or a Sunday, some benefits are paid at the end of September, increasing spending for the preceding year but decreasing outlays for the forthcoming year. SSI, veterans' compensation and pension programs, and Medicare payments to managed care plans and Part D plans are affected by such calendar shifts; those programs may make 11, 12, or 13 monthly payments in a fiscal year. Irregular numbers of benefit payments will affect mandatory spending in 2007, 2011, 2012, 2016, and 2017.

**Other Effects.** Growth in other mandatory spending does not significantly affect the overall pattern of mandatory outlays over the coming 10 years. During that time, much of the other mandatory spending will be below 2007 levels. For example, outlays for the CCC are projected to fall by $2 billion from their 2007 level of $10 billion before rising to that amount again in 2017. In addition, outlays for flood insurance are expected to decline from their 2007 level. Those declines are partially offset by increases in spending for other programs, including Tricare For Life and the Universal Service Fund.

### Offsetting Receipts

Offsetting receipts—which the government records as negative spending—are payments made to the federal government by citizens, businesses, or other federal agencies. The receipts include beneficiaries' premiums for Medicare, federal agencies' retirement contributions, and payments for harvesting timber or extracting minerals from federal land. In 2006, offsetting receipts totaled $141 billion—about 9 percent of mandatory spending and 1.1 percent of GDP (see Table 3-5). Offsetting receipts are expected to climb slightly throughout the projection period, primarily because of growth in Medicare Part D premiums. By 2017, offsetting receipts will equal 1.2 percent of GDP, CBO estimates.

**Medicare Premiums and Payments from States.** Offsetting receipts for Medicare totaled $49 billion in 2006—about 35 percent of all offsetting receipts. Over the coming years, those receipts will grow substantially, totaling about $132 billion in 2017. The bulk of those offsetting receipts are from premiums paid by beneficiaries, but they also include payments made by states and recoveries of overpayments made to providers.

Most Medicare premiums currently are paid by people enrolled in Part B, the Supplementary Medical Insurance program, which covers physicians' and outpatient hospital services. Starting in 2007, Part B premiums for some higher-income enrollees will increase above the standard premium, which is designed to cover 25 percent of the program's costs. The government also collects premiums for the new prescription drug program. CBO estimates that Medicare premium payments will rise from $49 billion in 2007 to $106 billion in 2017.

Medicare now pays some of the cost of providing prescription drug coverage for low-income enrollees (previously, Medicaid covered that cost, which was divided between states and the federal government). A portion of the savings accruing to the states from that cost shifting is returned to the federal government and credited to the Part D program. Those payments from states are reflected in the budget as offsetting receipts.

**Table 3-5.**

## CBO's Baseline Projections of Offsetting Receipts

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Medicare[a] | -49 | -60 | -65 | -70 | -75 | -81 | -85 | -92 | -99 | -108 | -120 | -132 | -377 | -929 |
| Employer's Share of Employee Retirement | | | | | | | | | | | | | | |
| Social Security | -12 | -12 | -13 | -14 | -15 | -15 | -16 | -17 | -18 | -19 | -20 | -21 | -73 | -170 |
| Military retirement | -14 | -14 | -16 | -16 | -16 | -17 | -17 | -18 | -18 | -19 | -19 | -20 | -81 | -175 |
| Civil service retirement and other | -22 | -21 | -22 | -23 | -24 | -25 | -26 | -27 | -29 | -30 | -31 | -32 | -120 | -270 |
| Subtotal | -47 | -48 | -51 | -53 | -55 | -57 | -60 | -62 | -65 | -68 | -71 | -74 | -275 | -615 |
| Tricare For Life | -11 | -12 | -12 | -13 | -14 | -15 | -16 | -17 | -18 | -19 | -20 | -21 | -70 | -164 |
| Natural Resources Receipts[b] | -14 | -13 | -16 | -16 | -18 | -18 | -18 | -20 | -19 | -20 | -20 | -20 | -86 | -186 |
| Electromagnetic Spectrum Auctions | * | -14 | -10 | -3 | * | * | * | 0 | 0 | 0 | 0 | 0 | -14 | -14 |
| Other | -19 | -20 | -20 | -19 | -20 | -19 | -19 | -19 | -20 | -17 | -17 | -17 | -97 | -187 |
| **Total** | **-141** | **-166** | **-174** | **-174** | **-182** | **-190** | **-198** | **-210** | **-221** | **-232** | **-248** | **-265** | **-919** | **-2,094** |

Source: Congressional Budget Office.

Notes: Amounts do not include the effects of offsetting collections.

* = between -$0.5 million and zero.

a. Includes Medicare premiums and amounts paid by states from savings on Medicaid prescription drug costs.

b. Includes timber, mineral, and Outer Continental Shelf receipts and proceeds from sales of public land.

CBO expects that those payments will grow from $7 billion in 2007 to $17 billion in 2017.

The addition of new premiums and the payments from states will contribute to the 24 percent jump in offsetting receipts to the Medicare program expected for 2007. CBO estimates that such offsetting receipts will grow by about 8.1 percent annually between 2007 and 2017.

**Other Offsetting Receipts.** Other offsetting receipts involve payments made by federal agencies to employee retirement plans, proprietary receipts from royalties and other charges for oil and natural gas production on federal land, sales arising from harvested timber and minerals extracted from federal land, and various fees paid by users of public property and services.

In 2006, $47 billion in offsetting receipts came in intragovernmental transfers from federal agencies to employee retirement plans (trust funds for Social Security and for military and civil service retirement). CBO estimates that such payments will grow by about 4.5 percent annually, reaching $74 billion by 2017. Intragovernmental transfers also are made to the Uniformed Services Medicare-Eligible Retiree Health Care Fund under the Tricare For Life program; those payments totaled $11 billion in 2006. CBO projects that rising health care costs will cause Tricare For Life payments to rise by about 6 percent each year to $21 billion by 2017, or double current payments, growing at a rate that outstrips the rate of increase in the retiree population.

Receipts from programs to develop federally owned natural resources, particularly oil, natural gas, and minerals, totaled $14 billion in 2006. By 2017, CBO estimates, those receipts will total $20 billion.

Other offsetting receipts include $28 billion over the 2007–2017 period that CBO estimates will come from

Federal Communications Commission auctions of licenses to use the electromagnetic spectrum. Proceeds from the 2006 auction of licenses for advanced wireless services account for nearly $14 billion of that total. Most of the other projected receipts are expected to come from the 2008 auction of licenses to use some of the frequencies currently used for television broadcasts.

### Legislation Assumed in the Baseline

In keeping with precedents established by the Deficit Control Act, CBO's baseline projections assume that certain mandatory programs will be extended when their authorization expires, although the assumptions apply differently to programs created before and after the Balanced Budget Act of 1997. Programs that predate mid-1997 and that have current-year outlays above $50 million are assumed to continue. For programs established after that year, continuation is assessed one case at a time, in consultation with the House and Senate Budget Committees. Smaller programs—those with current outlays of less than $50 million annually—are assumed to expire as authorization lapses. The Deficit Control Act also directed CBO to assume that a cost-of-living adjustment for veterans' compensation is granted each year. The assumption that expiring programs will continue accounts for outlays of $2.3 billion in 2007 and $767 billion between 2008 and 2017 (see Table 3-6).

CBO's baseline projections assume continuance of several social service and welfare programs, including Food Stamps, TANF, the State Children's Health Insurance Program, rehabilitation services, child care entitlement grants to states, federal unemployment benefits and allowances (also known as trade adjustment assistance for workers), child nutrition, and family preservation and support. Most CCC farm subsidies also are assumed to continue. The Food Stamp program, the Trade Adjustment Assistance Program, the State Children's Health Insurance Program, and most CCC subsidies are among the programs scheduled to be reauthorized in 2007.

## Discretionary Spending

Nearly 40 percent of federal spending stems from the budget authority provided in annual appropriation acts. Each year, those acts provide new authority to enter into financial obligations for discretionary programs and activities. That funding translates into outlays once the money is actually spent. Although some funds (for example, those designated for employees' salaries) are spent quickly, others (such as those intended for major construction projects) are disbursed over several years. In any given year, discretionary outlays include spending from new budget authority and from previous appropriations.

When CBO compiled its baseline projections, appropriations under the jurisdiction of the defense and homeland security subcommittees had been enacted, but funding for the rest of the government's operations had not.[10] Instead, those functions were funded temporarily under a continuing resolution, effective through February 15, 2007. CBO's estimates for discretionary spending assume that funding levels enacted in the current continuing resolution are effective for all of fiscal year 2007. That resolution provided funding levels at the lower of those set in the House-passed bill, the Senate-passed bill, or the amount appropriated for fiscal year 2006. CBO used those data for constructing its baseline projections.

As part of the regular defense appropriation act for 2007, the Congress and the President have provided $70 billion for military operations in Iraq and Afghanistan. That sum will cover only a portion of this year's costs; a request for additional funding is anticipated. Chapter 1 has a more detailed discussion of funding for operations in Iraq and Afghanistan.

### Recent Trends in Discretionary Funding and Outlays

In the mid-1980s, discretionary outlays equaled 10.0 percent of GDP; by 1999, they had fallen to 6.3 percent (see Table 3-7 on page 68). In 2001, funding for discretionary programs began to move upward again as a share of the economy. The events of September 11, 2001, and military operations in Iraq and Afghanistan accelerated that trend. Discretionary outlays rose to 7.1 percent of GDP in 2002 and reached 7.9 percent in 2005. In 2006, discretionary spending dipped slightly—to 7.8 percent of GDP. CBO projects that total discretionary outlays as a share of GDP will stay about the same in 2007, assuming that additional funding for operations in Iraq and Afghanistan is provided later this year.

10. The Department of Defense Appropriation Act included funding for much of the Department of Defense. Significant portions of that department, however, fall under the jurisdiction of the House Appropriations Subcommittee on Military Quality of Life and Veterans Affairs and have only temporary funding under the continuing resolution.

## Table 3-6.

# Costs for Mandatory Programs That CBO's Baseline Assumes Will Continue Beyond Their Current Expiration Dates

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Food Stamps | | | | | | | | | | | | | |
| Budget authority | n.a. | 36.1 | 36.6 | 36.9 | 37.6 | 38.7 | 39.8 | 40.9 | 42.1 | 43.3 | 44.6 | 185.9 | 396.7 |
| Outlays | n.a. | 34.5 | 36.6 | 36.9 | 37.6 | 38.6 | 39.8 | 40.9 | 42.1 | 43.3 | 44.5 | 184.2 | 394.7 |
| Temporary Assistance for Needy Families | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | n.a. | n.a. | 16.8 | 16.8 | 16.8 | 16.8 | 16.8 | 16.8 | 16.8 | 33.5 | 117.4 |
| Outlays | n.a. | n.a. | n.a. | n.a. | 11.6 | 16.8 | 16.8 | 16.8 | 16.8 | 16.8 | 16.8 | 28.4 | 112.3 |
| Commodity Credit Corporation[a] | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | 8.0 | 7.8 | 7.7 | 7.9 | 8.1 | 8.4 | 8.8 | 9.3 | 9.6 | 31.4 | 75.5 |
| Outlays | n.a. | n.a. | 8.0 | 7.8 | 7.7 | 7.9 | 8.1 | 8.4 | 8.8 | 9.3 | 9.6 | 31.4 | 75.5 |
| State Children's Health Insurance Program | | | | | | | | | | | | | |
| Budget authority | n.a. | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 25.2 | 50.4 |
| Outlays | n.a. | 2.7 | 4.3 | 5.2 | 5.2 | 5.2 | 5.2 | 5.1 | 5.1 | 5.1 | 5.2 | 22.6 | 48.4 |
| Veterans' Compensation COLAs | | | | | | | | | | | | | |
| Budget authority | n.a. | 0.4 | 1.1 | 1.8 | 2.7 | 3.3 | 4.0 | 4.8 | 5.6 | 6.9 | 7.8 | 9.2 | 38.3 |
| Outlays | n.a. | 0.4 | 1.0 | 1.7 | 2.7 | 3.2 | 3.9 | 4.7 | 5.5 | 6.9 | 7.7 | 9.0 | 37.8 |
| Rehabilitation Services and Disability Research | | | | | | | | | | | | | |
| Budget authority | 2.8 | 2.9 | 3.0 | 3.0 | 3.1 | 3.2 | 3.2 | 3.3 | 3.4 | 3.4 | 3.5 | 15.1 | 31.9 |
| Outlays | 2.2 | 2.8 | 2.8 | 2.9 | 3.0 | 3.0 | 3.1 | 3.2 | 3.3 | 3.3 | 3.4 | 14.5 | 30.8 |
| Child Care Entitlements to States | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | n.a. | n.a. | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 5.8 | 20.4 |
| Outlays | n.a. | n.a. | n.a. | n.a. | 2.1 | 2.8 | 2.9 | 2.9 | 2.9 | 2.9 | 2.9 | 4.9 | 19.5 |
| Federal Unemployment Benefits and Allowances | | | | | | | | | | | | | |
| Budget authority | n.a. | 0.9 | 1.0 | 1.0 | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 | 4.9 | 10.5 |
| Outlays | n.a. | 0.7 | 0.9 | 1.0 | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 | 4.6 | 10.2 |
| Child Nutrition[b] | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | n.a. | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | 0.6 | 0.6 | 1.5 | 4.3 |
| Outlays | n.a. | n.a. | n.a. | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 | 0.6 | 0.6 | 1.4 | 4.2 |

Continued

## Table 3-6.
## Continued

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Ground Transportation Programs Not Subject to Annual Obligation Limitations | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | n.a. | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 1.9 | 5.1 |
| Outlays | n.a. | n.a. | n.a. | 0.2 | 0.4 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 1.2 | 4.3 |
| Family Preservation and Support | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | n.a. | n.a. | n.a. | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 2.1 |
| Outlays | n.a. | n.a. | n.a. | n.a. | n.a. | 0.1 | 0.2 | 0.3 | 0.3 | 0.3 | 0.3 | 0.1 | 1.7 |
| Other Natural Resources | | | | | | | | | | | | | |
| Budget authority | * | 0.5 | 0.9 | 0.9 | 2.5 | 2.9 | 3.3 | 3.7 | 4.0 | 5.6 | 7.0 | 7.7 | 31.4 |
| Outlays | * | 0.3 | 0.8 | 0.9 | 1.5 | 2.3 | 2.8 | 3.4 | 3.6 | 5.4 | 7.0 | 5.7 | 27.8 |
| Ground Transportation Programs Controlled by Obligation Limitations[c] | | | | | | | | | | | | | |
| Budget authority | n.a. | n.a. | n.a. | 42.8 | 42.8 | 42.8 | 42.8 | 42.8 | 42.8 | 42.8 | 42.8 | 128.3 | 342.2 |
| Outlays | n.a. | n.a. | n.a. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Air Transportation Programs Controlled by Obligation Limitations[c] | | | | | | | | | | | | | |
| Budget authority | n.a. | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 3.2 | 15.9 | 31.8 |
| Outlays | n.a. | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total** | | | | | | | | | | | | | |
| **Budget authority** | **2.9** | **49.1** | **58.7** | **103.5** | **126.4** | **129.1** | **131.7** | **134.5** | **137.2** | **141.9** | **145.9** | **466.9** | **1,158.0** |
| **Outlays** | **2.3** | **41.3** | **54.5** | **56.9** | **73.3** | **82.0** | **84.9** | **88.0** | **90.6** | **95.6** | **99.8** | **308.2** | **767.1** |

Source: Congressional Budget Office.

Notes: n.a. = not applicable; COLAs = cost-of-living adjustments.

a. Agricultural commodity price and income supports under the Farm Security and Rural Investment Act of 2002 (FSRIA) generally expire after 2007. Although permanent price support authority under the Agricultural Adjustment Act of 1939 and the Agricultural Act of 1949 would then become effective, CBO continues to adhere to the rule in section 257(b)(2)(iii) of the Deficit Control Act (now expired), which indicates that the baseline should assume that the FSRIA provisions remain in effect.

b. Includes the Summer Food Service program and states' administrative expenses.

c. Authorizing legislation provides contract authority, which is counted as mandatory budget authority. However, because spending is subject to obligation limitations specified in annual appropriation acts, outlays are considered discretionary.

**Table 3-7.**

## Defense and Nondefense Discretionary Outlays, 1985 to 2007

| | Defense Outlays | | | Nondefense Outlays | | | Total Discretionary Outlays | | |
|---|---|---|---|---|---|---|---|---|---|
| | In Billions of Dollars | As a Percentage of GDP | Percentage Change from Previous Year | In Billions of Dollars | As a Percentage of GDP | Percentage Change from Previous Year | In Billions of Dollars | As a Percentage of GDP | Percentage Change from Previous Year |
| 1985 | 253 | 6.1 | 11.0 | 163 | 3.9 | 7.4 | 416 | 10.0 | 9.6 |
| 1986 | 274 | 6.2 | 8.2 | 165 | 3.7 | 1.2 | 439 | 10.0 | 5.5 |
| 1987 | 283 | 6.1 | 3.2 | 162 | 3.5 | -1.8 | 444 | 9.5 | 1.3 |
| 1988 | 291 | 5.8 | 3.0 | 174 | 3.5 | 7.3 | 464 | 9.3 | 4.6 |
| 1989 | 304 | 5.6 | 4.5 | 185 | 3.4 | 6.5 | 489 | 9.0 | 5.3 |
| 1990 | 300 | 5.2 | -1.3 | 200 | 3.5 | 8.5 | 501 | 8.7 | 2.4 |
| 1991 | 320 | 5.4 | 6.5 | 214 | 3.6 | 6.6 | 533 | 9.0 | 6.5 |
| 1992 | 303 | 4.8 | -5.3 | 231 | 3.7 | 8.2 | 534 | 8.6 | 0.1 |
| 1993 | 292 | 4.4 | -3.4 | 247 | 3.8 | 6.8 | 539 | 8.2 | 1.0 |
| 1994 | 282 | 4.1 | -3.5 | 259 | 3.7 | 4.9 | 541 | 7.8 | 0.4 |
| 1995 | 274 | 3.7 | -3.1 | 271 | 3.7 | 4.7 | 545 | 7.4 | 0.6 |
| 1996 | 266 | 3.5 | -2.8 | 267 | 3.5 | -1.7 | 533 | 6.9 | -2.2 |
| 1997 | 272 | 3.3 | 2.1 | 276 | 3.4 | 3.3 | 547 | 6.7 | 2.7 |
| 1998 | 270 | 3.1 | -0.6 | 282 | 3.3 | 2.3 | 552 | 6.4 | 0.9 |
| 1999 | 276 | 3.0 | 2.0 | 296 | 3.2 | 5.2 | 572 | 6.3 | 3.6 |
| 2000 | 295 | 3.0 | 7.1 | 320 | 3.3 | 7.9 | 615 | 6.3 | 7.5 |
| 2001 | 306 | 3.0 | 3.8 | 343 | 3.4 | 7.3 | 649 | 6.5 | 5.6 |
| 2002 | 349 | 3.4 | 14.0 | 385 | 3.7 | 12.3 | 734 | 7.1 | 13.1 |
| 2003 | 405 | 3.7 | 16.0 | 420 | 3.9 | 9.1 | 825 | 7.6 | 12.4 |
| 2004 | 454 | 3.9 | 12.1 | 441 | 3.8 | 5.0 | 895 | 7.8 | 8.5 |
| 2005 | 494 | 4.0 | 8.7 | 475 | 3.9 | 7.6 | 968 | 7.9 | 8.2 |
| 2006 | 520 | 4.0 | 5.3 | 496 | 3.8 | 4.5 | 1016 | 7.8 | 4.9 |
| 2007[a] | 534 | 3.9 | 2.6 | 490 | 3.6 | -1.2 | 1024 | 7.5 | 0.8 |

Sources: Office of Management and Budget for 1985 through 2005 and Congressional Budget Office for 2006 and 2007.

Note: GDP = gross domestic product.

a. Estimated.

Trends in overall discretionary spending have been driven primarily by spending on defense. During the late 1980s and the 1990s, defense outlays declined sharply as a share of the economy, sliding from 6.2 percent in 1986 to a low of 3.0 percent between 1999 and 2001. In 2002, defense outlays rose by 14 percent—to 3.4 percent of GDP—because of operations in Afghanistan, other activities related to the war on terrorism, and defense initiatives that had been planned or funded before the attacks of September 11, 2001. They continued to climb as military operations began in Iraq. After annual increases in outlays of 16 percent in 2003 and 12 percent in 2004, growth in defense outlays slowed to 9 percent in 2005 and to 5 percent in 2006. CBO projects that, under current law, outlays will rise slightly in nominal terms between 2006 and 2007—from $520 billion to $534 billion. Defense outlays in 2007 are expected to be higher than $534 billion, however. Once additional appropriations are enacted to finance operations in Iraq and Afghanistan, defense outlays are likely to be close to $560 billion—or 4.1 percent of GDP. The 2006 amount was 4.0 percent of GDP.

Nondefense discretionary programs encompass such activities as housing assistance, transportation, maintenance of national parks, most homeland security activities, and foreign aid. Spending for such programs has

**Table 3-8.**

## Growth in Discretionary Budget Authority, 2006 to 2007

(Billions of dollars)

| | Actual 2006 | Estimated 2007 | Percentage Change |
|---|---|---|---|
| Defense | | | |
| Enacted appropriations[a] | 556 | 449 | n.a. |
| Continuing resolution | n.a | 71 | n.a. |
| Subtotal, defense | 556 | 520 | -6.6 |
| Nondefense | | | |
| Enacted appropriations[a,b] | 439 | 32 | n.a. |
| Continuing resolution | n.a. | 391 | n.a. |
| Subtotal, nondefense | 439 | 424 | -3.4 |
| **Total** | **995** | **944** | **-5.2** |
| **Memorandum:** | | | |
| Excluding Funding for Iraq and Supplemental Appropriations | | | |
| Defense | 432 | 450 | 4.1 |
| Nondefense[c] | 409 | 424 | 3.5 |
| **Total** | **842** | **874** | **3.8** |

Source: Congressional Budget Office.

Notes: Does not include obligation limitations for certain transportation programs.

n.a. = not applicable.

a. Appropriations have been enacted for programs under the jurisdiction of the defense and homeland security subcommittees. All other discretionary funding is currently being provided through a continuing resolution that expires on February 15, 2007.

b. Budget authority for 2006 includes a rescission of $23 billion in supplemental funding provided in 2005 to the Federal Emergency Management Agency for hurricane relief and recovery.

c. About $9 billion in supplemental appropriations for 2006 has been assumed to continue in CBO's estimate of the effect of the continuing resolution on nondefense spending. In addition, appropriations for the Department of Homeland Security are $4 billion higher than in 2006. Other nondefense appropriations for 2007 under the continuing resolution are about the same as they were in 2006.

remained relatively constant as a share of GDP since the mid-1980s, generally hovering between 3.2 percent and 3.9 percent.

Recent growth in nondefense discretionary outlays has slowed somewhat after a sharp rise in 2002. Since 2004, such growth has been fueled by reconstruction costs in Iraq and, more recently, by costs related to hurricane damage from 2005. Under provisions of the continuing resolution (and the appropriations provided for the Department of Homeland Security), CBO estimates that outlays for nondefense discretionary programs will fall in 2007 to $490 billion (1.2 percent lower than in 2006). Such spending would represent 3.6 percent of GDP (compared with 3.8 percent in 2006).

**Comparison of 2006 and 2007 Budget Authority.** Total discretionary budget authority for 2006 was $995 billion, $51 billion above appropriations provided thus far in 2007 (see Table 3-8). Appropriations for 2007 under the jurisdiction of the defense and homeland security appropriation subcommittees have been enacted, totaling $481 billion; other government operations have been funded under the continuing resolution set to expire on February 15, 2007.

Thus far, 2007 funding for defense is below the amount provided for 2006. However, the 2007 figure includes only a portion of the amount needed for operations in Iraq and Afghanistan. Excluding funding for those operations (and other supplemental funding), discretionary

**Table 3-9.**

## Nondefense Discretionary Funding for 2007

| | Amount of Funding (Billions of dollars) | Percentage of Total |
|---|---|---|
| Education, Training, Employment, and Social Services | 81 | 17 |
| Transportation | 76 | 16 |
| Health | 57 | 12 |
| Income Security | 47 | 10 |
| Administration of Justice | 42 | 9 |
| Natural Resources and Environment | 29 | 6 |
| Veterans' Benefits and Services | 33 | 7 |
| International Affairs | 31 | 7 |
| General Science, Space, and Technology | 24 | 5 |
| General Government | 16 | 3 |
| Community and Regional Development | 14 | 3 |
| Agriculture | 6 | 1 |
| Medicare | 5 | 1 |
| Social Security | 5 | 1 |
| Energy | 4 | 1 |
| Commerce and Housing Credit | 3 | 1 |
| **Total** | **471** | **100** |

Source: Congressional Budget Office.

Note: Includes budgetary resources provided by obligation limitations for certain surface and air transportation programs.

defense appropriations are 4.1 percent higher than the corresponding figure for 2006.[11]

Nondefense discretionary funding for 2007—most of it covered by the continuing resolution—is $15 billion (3.4 percent) less than the amount provided in 2006. That reduction stems from provisions of the continuing resolution, which set 2007 funding levels at the lower of the House- or Senate-passed bills or the level provided for 2006. Most of the supplemental funding provided for 2006 is not continued, however. (About $9 billion in appropriations that had been provided as supplemental authority in 2006 is projected in 2007 under the terms of the continuing resolution.) The Department of Homeland Security appropriation—the only nondefense appropriation enacted at the time CBO prepared its projections—contained funding of $4 billion above the 2006 level. Other nondefense appropriations under the continuing resolution are about the same, in aggregate, as they were in 2006.

**Composition of Nondefense Discretionary Funding.** Four categories account for more than half of the $471 billion in funding provided thus far for nondefense discretionary activities in 2007 (see Table 3-9). Combined, education, training, employment, and social services will receive 17 percent of nondefense discretionary funding ($81 billion). Student loans and several other programs are excluded from that total because they are considered mandatory.

Funding for transportation programs comes to $76 billion, or 16 percent of the total. That sum includes $47 billion in obligation limitations for several surface and air transportation programs, even though those programs receive mandatory budget authority through their authorizing legislation. Because the annual appropriation acts consistently limit how much of that authority the Department of Transportation can obligate, and thereby govern annual spending, the limitations are treated as a measure of discretionary budgetary resources.

Appropriations for health research and public health total $57 billion and make up 12 percent of nondefense discretionary funding in 2007. Finally, at $47 billion, income-security programs (mostly for housing and nutrition assistance) account for 10 percent of nondefense discretionary funding. Other income-security programs, such as unemployment compensation and TANF, are not included in the total because they are part of mandatory spending.

### Discretionary Spending from 2008 Through 2017

Under baseline assumptions, CBO projects that discretionary outlays will remain flat at around $1 trillion in 2007. After that, outlays will increase each year as they follow steadily increasing budget authority. Following the specifications in the Deficit Control Act, CBO assumes that discretionary resources (including supplemental budget authority and obligation limitations for some transportation programs) will keep pace with inflation after

11. Most spending for defense programs is classified as discretionary; however, an additional $3 billion a year in defense spending is classified as mandatory.

2007. Although provisions of that act expired at the end of September 2006, CBO continues to follow its requirements in preparing baseline projections of discretionary spending. As a result, such funding is projected to grow at a rate of 2.0 percent annually through the 10-year projection period. At that rate, CBO projects, discretionary outlays would reach $1.2 trillion by 2017. However, discretionary outlays would decline as a percentage of GDP, falling from about 7.5 percent in 2007 to 5.8 percent of GDP in 2017.[12]

**Alternative Paths for Discretionary Spending.** CBO estimates that total discretionary budget authority in 2007 is about $944 billion and that transportation-related obligation limitations total $47 billion, assuming that the funding provided in the continuing resolution is extended for the whole year. In the projections of baseline spending, both are assumed to grow thereafter with inflation. To illustrate how future funding might differ from those assumptions, CBO presents alternative paths for discretionary spending and shows their budgetary consequences (see Table 3-10).

The first alternative path assumes that most funding will grow at the average annual rate of nominal GDP after 2007 (an average of 4.5 percent a year, almost twice as fast as the rate of growth assumed in the baseline). Funds provided for operations in Iraq and Afghanistan are assumed to grow more slowly—at the rate of inflation—as in baseline projections. Under this scenario, total discretionary outlays would exceed the baseline figures by $1.3 trillion over the projection period. Added debt-service costs would bring the cumulative increase in outlays to $1.5 trillion.

The next two alternatives address possible funding for military operations in Iraq and Afghanistan and other U.S. military activities related to the war on terrorism. CBO has constructed two possible paths of spending for such activities. Both reflect the increase in deployed forces recently announced by the President, bringing the average for the year to 225,000 troops. The first alternative assumes that force levels in 2007 will phase down rapidly over the following three years—falling to about 30,000 by 2010 and remaining at that level thereafter. The force levels assumed over the projection period might be involved in operations in Iraq, Afghanistan, or elsewhere in the world. As described more fully in Chapter 1, that scenario would add about $25 billion to baseline outlays for 2007, but annual outlays would decline relative to the current baseline beginning in 2010. Projected 10-year outlays for that alternative path would be $311 billion lower than the baseline, including debt-service savings.

In the second scenario for operations in Iraq, Afghanistan, and the war on terrorism, funding would still decrease over the coming 10 years, but it would be higher than in the first scenario because troops would return to the United States at a slower pace and more troops (about 75,000) would remain deployed. Like the first alternative, that scenario would add about $25 billion to baseline outlays for 2007, but annual outlays would decline relative to the current baseline beginning in 2013. Projected 10-year outlays for that alternative path would be $222 billion higher than the baseline, including debt-service savings.

The final alternative path for discretionary spending shows lower spending relative to the baseline—it assumes that most discretionary budget authority and obligation limitations are frozen throughout the projection period at the 2007 amount.[13] Total discretionary outlays for the 10-year period would be $1.3 trillion lower than those in the baseline scenario. Debt-service adjustments would reduce spending by another $216 billion for a total of $1.5 trillion. By 2017, total discretionary spending would fall below 5 percent of GDP under this scenario.

## Net Interest

In 2006, interest costs saw the largest growth among the major spending categories in the federal budget. Outlays for net interest increased from $184 billion in 2005 to $227 billion in 2006—a 23 percent rise (see Table 3-11 on page 74). That rate is almost four times faster than the rate of increase for noninterest spending. As a percentage of GDP, net interest has risen to 1.7 percent, up from 1.5 percent in 2005.

12. Assuming that additional funding for operations in Iraq and Afghanistan adds about $25 billion to spending in fiscal year 2007, discretionary outlays would come to 7.7 percent of GDP this year.

13. In this scenario, budget authority for some items (such as offsetting collections and payments made by the Treasury on behalf of the Department of Defense for Tricare For Life) is not held constant at the 2007 amount.

## Table 3-10.

# CBO's Projections of Discretionary Spending Under Selected Policy Alternatives

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Baseline (Discretionary resources grow with inflation after 2007)[a]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 556 | 520 | 534 | 547 | 560 | 573 | 587 | 601 | 615 | 631 | 645 | 661 | 2,801 | 5,954 |
| Nondefense | 439 | 424 | 436 | 448 | 456 | 467 | 478 | 490 | 502 | 514 | 526 | 538 | 2,286 | 4,855 |
| **Total** | **995** | **944** | **970** | **995** | **1,016** | **1,041** | **1,065** | **1,091** | **1,117** | **1,144** | **1,171** | **1,199** | **5,087** | **10,810** |
| Outlays | | | | | | | | | | | | | | |
| Defense | 520 | 534 | 537 | 544 | 555 | 571 | 575 | 593 | 607 | 622 | 642 | 652 | 2,782 | 5,898 |
| Nondefense | 496 | 490 | 497 | 506 | 513 | 519 | 525 | 536 | 548 | 560 | 573 | 586 | 2,560 | 5,362 |
| **Total** | **1,016** | **1,024** | **1,034** | **1,050** | **1,067** | **1,089** | **1,100** | **1,129** | **1,155** | **1,182** | **1,215** | **1,238** | **5,342** | **11,260** |
| **Most Discretionary Resources Grow at the Rate of Nominal Gross Domestic Product After 2007[b]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 556 | 520 | 544 | 569 | 594 | 619 | 645 | 672 | 700 | 729 | 759 | 789 | 2,971 | 6,621 |
| Nondefense | 439 | 424 | 447 | 473 | 496 | 520 | 545 | 571 | 598 | 626 | 655 | 684 | 2,481 | 5,616 |
| **Total** | **995** | **944** | **991** | **1,042** | **1,090** | **1,140** | **1,191** | **1,244** | **1,298** | **1,356** | **1,413** | **1,474** | **5,452** | **12,237** |
| Outlays | | | | | | | | | | | | | | |
| Defense | 520 | 534 | 544 | 561 | 583 | 611 | 627 | 658 | 685 | 713 | 747 | 773 | 2,926 | 6,502 |
| Nondefense | 496 | 490 | 503 | 523 | 543 | 562 | 583 | 608 | 634 | 662 | 691 | 721 | 2,715 | 6,031 |
| **Total** | **1,016** | **1,024** | **1,047** | **1,084** | **1,126** | **1,173** | **1,210** | **1,266** | **1,319** | **1,376** | **1,439** | **1,494** | **5,641** | **12,534** |
| **Costs of Military Operations in Iraq and Afghanistan and for the War on Terrorism Gradually Decrease, Faster Drawdown[c]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 556 | 595 | 583 | 549 | 526 | 523 | 529 | 541 | 554 | 569 | 583 | 597 | 2,709 | 5,553 |
| Nondefense | 439 | 424 | 436 | 448 | 456 | 467 | 478 | 490 | 502 | 514 | 526 | 538 | 2,286 | 4,855 |
| **Total** | **995** | **1,019** | **1,019** | **997** | **982** | **990** | **1,007** | **1,031** | **1,056** | **1,083** | **1,108** | **1,135** | **4,995** | **10,408** |
| Outlays | | | | | | | | | | | | | | |
| Defense | 520 | 559 | 591 | 574 | 545 | 537 | 529 | 539 | 548 | 562 | 580 | 589 | 2,775 | 5,594 |
| Nondefense | 496 | 490 | 497 | 506 | 513 | 519 | 525 | 536 | 548 | 560 | 573 | 586 | 2,560 | 5,362 |
| **Total** | **1,016** | **1,049** | **1,088** | **1,080** | **1,058** | **1,056** | **1,054** | **1,075** | **1,096** | **1,122** | **1,153** | **1,175** | **5,335** | **10,956** |

**Continued**

The recent growth in net interest outlays is attributable mostly to an increase in short-term interest rates and to accumulating debt. Since the beginning of fiscal year 2005, the rate for 91-day Treasury bills almost tripled, from 1.76 percent to more than 4.75 percent. As a result, interest outlays on Treasury bills increased by $17 billion, from $25 billion in 2005 to nearly $42 billion in 2006. Also, an increase in borrowing requirements added $237 billion to the debt, boosting total interest payments by around $12 billion from 2005. Finally, an increase in interest rates tied to Treasury notes, higher inflation, and other technical factors increased 2006 outlays for interest by about $15 billion.

CBO projects that, under baseline assumptions, the growth in interest costs will slow significantly—in large part because the baseline assumptions generate a shift to budget surpluses over the next decade. Interest outlays are

**Table 3-10.**

## Continued

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Costs of Military Operations in Iraq and Afghanistan and for the War on Terrorism Gradually Decrease, Slower Drawdown[c]** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 556 | 595 | 603 | 604 | 596 | 588 | 580 | 582 | 591 | 604 | 619 | 634 | 2,970 | 6,000 |
| Nondefense | 439 | 424 | 436 | 448 | 456 | 467 | 478 | 490 | 502 | 514 | 526 | 538 | 2,286 | 4,855 |
| **Total** | **995** | **1,019** | **1,039** | **1,052** | **1,052** | **1,055** | **1,058** | **1,072** | **1,093** | **1,118** | **1,144** | **1,172** | **5,256** | **10,855** |
| Outlays | | | | | | | | | | | | | | |
| Defense | 520 | 559 | 596 | 609 | 600 | 607 | 590 | 586 | 588 | 600 | 616 | 626 | 3,001 | 6,018 |
| Nondefense | 496 | 490 | 497 | 506 | 513 | 519 | 525 | 536 | 548 | 560 | 573 | 586 | 2,560 | 5,362 |
| **Total** | **1,016** | **1,049** | **1,093** | **1,115** | **1,113** | **1,126** | **1,115** | **1,122** | **1,136** | **1,160** | **1,189** | **1,212** | **5,561** | **11,380** |
| **Discretionary Resources Are Frozen at the 2007 Level** | | | | | | | | | | | | | | |
| Budget Authority | | | | | | | | | | | | | | |
| Defense | 556 | 520 | 521 | 521 | 522 | 523 | 524 | 525 | 526 | 527 | 528 | 529 | 2,611 | 5,247 |
| Nondefense | 439 | 424 | 425 | 426 | 424 | 424 | 423 | 423 | 423 | 422 | 422 | 421 | 2,122 | 4,233 |
| **Total** | **995** | **944** | **945** | **948** | **946** | **947** | **947** | **948** | **949** | **949** | **950** | **951** | **4,733** | **9,479** |
| Outlays | | | | | | | | | | | | | | |
| Defense | 520 | 534 | 527 | 524 | 522 | 526 | 518 | 523 | 524 | 525 | 530 | 527 | 2,618 | 5,246 |
| Nondefense | 496 | 490 | 490 | 489 | 484 | 479 | 473 | 471 | 470 | 470 | 469 | 468 | 2,414 | 4,763 |
| **Total** | **1,016** | **1,024** | **1,017** | **1,012** | **1,007** | **1,004** | **992** | **994** | **994** | **995** | **999** | **995** | **5,032** | **10,009** |

Source: Congressional Budget Office.

Note: Nondefense discretionary outlays are usually higher than budget authority because of spending from the Highway Trust Fund and the Airport and Airway Trust Fund, which is subject to obligation limitations set in appropriation acts. The budget authority for such programs is provided in authorizing legislation and is not considered discretionary.

a. Inflation in CBO's baseline is projected using the inflators that were specified in the Balanced Budget and Emergency Deficit Control Act of 1985: the gross domestic product deflator and the employment cost index for wages and salaries.

b. This alternative assumes that appropriations for operations in Iraq and Afghanistan enacted during 2007 are projected at baseline levels (that is, increased at the rate of inflation).

c. These alternatives assume that deployed forces will average 225,000 troops in 2007 and would gradually decline to 30,000 (in the faster-drawdown option) or to 75,000 (in the slower-drawdown option).

projected to rise by 3.7 percent in 2007 and by 6.4 percent in 2008. Payments are projected to increase by 2.4 percent annually from 2008 to 2011 and then to decline through 2017. Under CBO's baseline projections, interest costs would remain at 1.7 percent of GDP through 2010 and then gradually fall to 1.1 percent of GDP in 2017.

The federal government's interest payments depend primarily on market interest rates and on the amount of outstanding debt held by the public. The Congress and the President can influence the latter through legislation that governs spending and taxes and, thus, the extent of government borrowing.

Interest outlays also are affected by the composition of debt held by the public. For example, the Treasury adjusts the mix of marketable securities (bills with maturities of less than 6 months, notes with maturities of 2–10 years, 30-year bonds, and 5- to 20-year inflation-protected

**Table 3-11.**

## CBO's Baseline Projections of Federal Interest Outlays

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Interest on Treasury Debt Securities (Gross interest)[a] | 406 | 431 | 454 | 472 | 495 | 519 | 537 | 549 | 563 | 576 | 587 | 595 | 2,477 | 5,346 |
| Interest Received by Trust Funds | | | | | | | | | | | | | | |
| Social Security | -98 | -108 | -115 | -124 | -135 | -147 | -160 | -173 | -187 | -201 | -216 | -230 | -681 | -1,688 |
| Other trust funds[b] | -72 | -75 | -74 | -75 | -78 | -80 | -84 | -86 | -90 | -93 | -95 | -96 | -391 | -851 |
| Subtotal | -169 | -182 | -189 | -199 | -213 | -228 | -243 | -260 | -277 | -294 | -310 | -326 | -1,072 | -2,539 |
| Other Interest[c] | -7 | -10 | -13 | -16 | -19 | -21 | -24 | -27 | -30 | -33 | -37 | -40 | -93 | -259 |
| Other Investment Income[d] | -3 | -4 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -1 | -7 | -13 |
| **Total (Net interest)** | **227** | **235** | **250** | **255** | **262** | **269** | **268** | **261** | **255** | **248** | **239** | **228** | **1,305** | **2,535** |

Source: Congressional Budget Office.

a. Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).

b. Mainly the Civil Service Retirement and Disability, Military Retirement, Medicare, and Unemployment Insurance Trust Funds.

c. Primarily interest on loans to the public.

d. Earnings on private investments by the National Railroad Retirement Investment Trust.

securities) in response to market forces. As that mix changes, so does the average maturity of new issues, which has fluctuated significantly in the past several years.[14] For instance, in the late 1990s, average maturity was nearly 90 months; it fell to less than 30 months in 2003. Last year, the Treasury began reissuing 30-year bonds, a practice it had suspended in 2001. As a result, the average maturity of new issues increased from nearly 36 months at the end of 2005 to about 55 months by the end of 2006.

The Treasury issued $24 billion in 30-year bonds in 2006 (exclusive of sales to the Federal Reserve Banks) and is projected to auction slightly more than that in 2007. Although such sales will increase the amount of new issues at the longest end of the debt maturity schedule, they are small relative to the size of the public debt ($4.8 trillion at the end of 2006) and thus will increase the average maturity of the overall stock only slightly. For the next few years, that stock is projected to remain relatively stable, with Treasury notes accounting for more than half of the marketable debt, Treasury bills accounting for around a quarter, and bonds and inflation-protected securities constituting the rest.

The federal government has issued about $3.7 trillion in securities to federal trust funds. However, the interest paid on those securities has no direct net budgetary impact because it is credited to accounts elsewhere in the budget. In 2007, trust funds will be credited with $182 billion of interest, CBO estimates, mostly for the Social Security and Civil Service Retirement and Disability Trust Funds. Over the 10-year baseline period, CBO projects, trust fund interest receipts will total more than $2.5 trillion.

The $10 billion in other interest CBO anticipates the government will receive in 2007 represents the net of many interest payments and interest collections. On balance, the government earns more of that interest than it pays out. Among its expenses are payments for interest on tax refunds that are delayed for more than 45 days after the filing date. On the collections side, one of the larger

14. The average maturity of new issues is a one-year rolling average of the maturities of all the marketable securities the Treasury has issued to the public. See www.treas.gov/offices/domestic-finance/debt-management/qrc/2006/2006-q4-chart-data.pdf.

categories is interest received from the financing accounts of credit programs, such as the direct student loan program. Although other interest is projected to increase rapidly through the period, almost all of that growth will come from interest on the accrued balances credited to the Tricare For Life program. (Because those are intragovernmental payments between the Treasury and the Department of Defense, there is no net effect on the budget.) CBO projects that such receipts will total $259 billion over the next decade.

CBO also estimates that earnings from the National Railroad Retirement Investment Trust will total $4 billion in 2007 and $13 billion between 2008 and 2017.

CHAPTER

# 4

# The Revenue Outlook

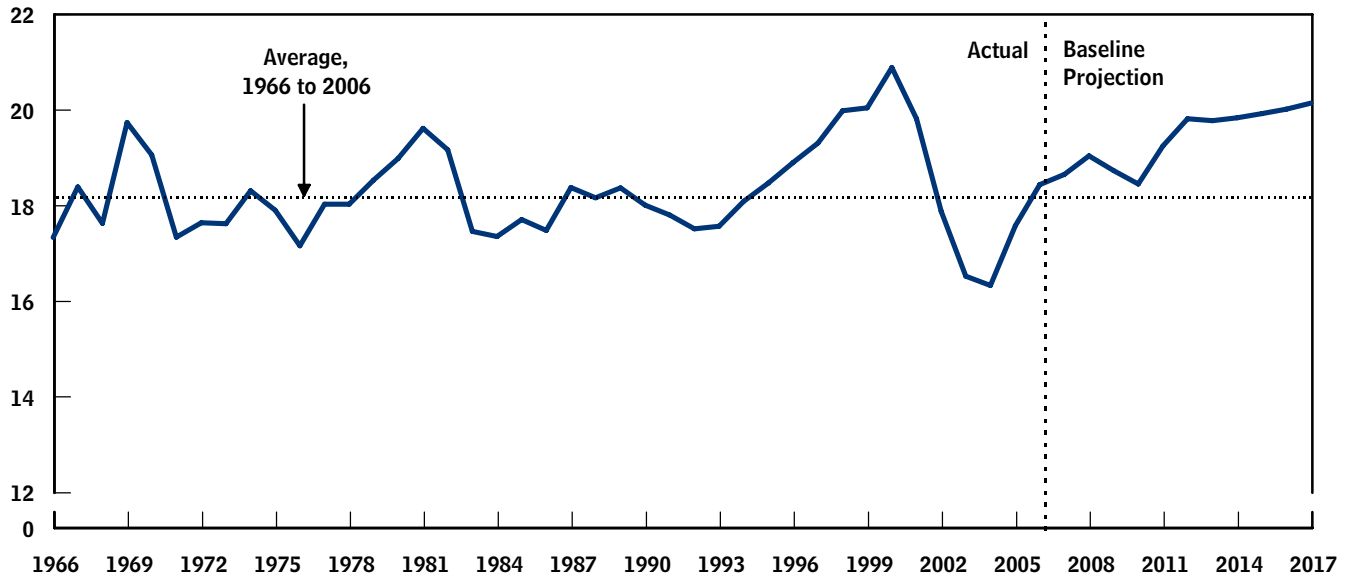
According to Congressional Budget Office projections, under an assumption that current laws and policies remain unchanged, federal revenues will total $2,542 billion in 2007. That amount would be $136 billion (or 5.6 percent) more than revenues totaled in 2006. Although 2007 would be the third consecutive year in which revenues rose faster than gross domestic product, revenue growth would be less than half the rate observed in each of the past two years, when revenues grew at their fastest pace in 25 years. The last time revenues rose that fast was in the early 1980s, when inflation was higher and certain elements of the tax system were not yet indexed for inflation. CBO expects that growth in taxable income will decline, in part, because of slowing growth in the overall economy. In addition, corporate profits are expected to stop expanding after several years of robust growth and to begin to return to more historical levels relative to their share of the economy. Furthermore, the recent termination of most of the telephone excise tax, with one-time refunds, will reduce revenues.

From 2008 to 2010, CBO projects, revenues will first rise and then decline slightly as a share of the economy, averaging 18.7 percent of GDP. That level is greater than both the 18.6 percent share expected in 2007 and the average of 18.2 percent recorded over the past 40 years (see Figure 4-1). CBO estimates that revenues will climb to 19.0 percent of GDP in 2008 largely because, under current law, the higher exemption levels designed to mitigate the effects of the alternative minimum tax will expire. Moreover, distribution of telephone tax refunds,

**Figure 4-1.**

## Total Revenues as a Share of Gross Domestic Product, 1966 to 2017

(Percent)

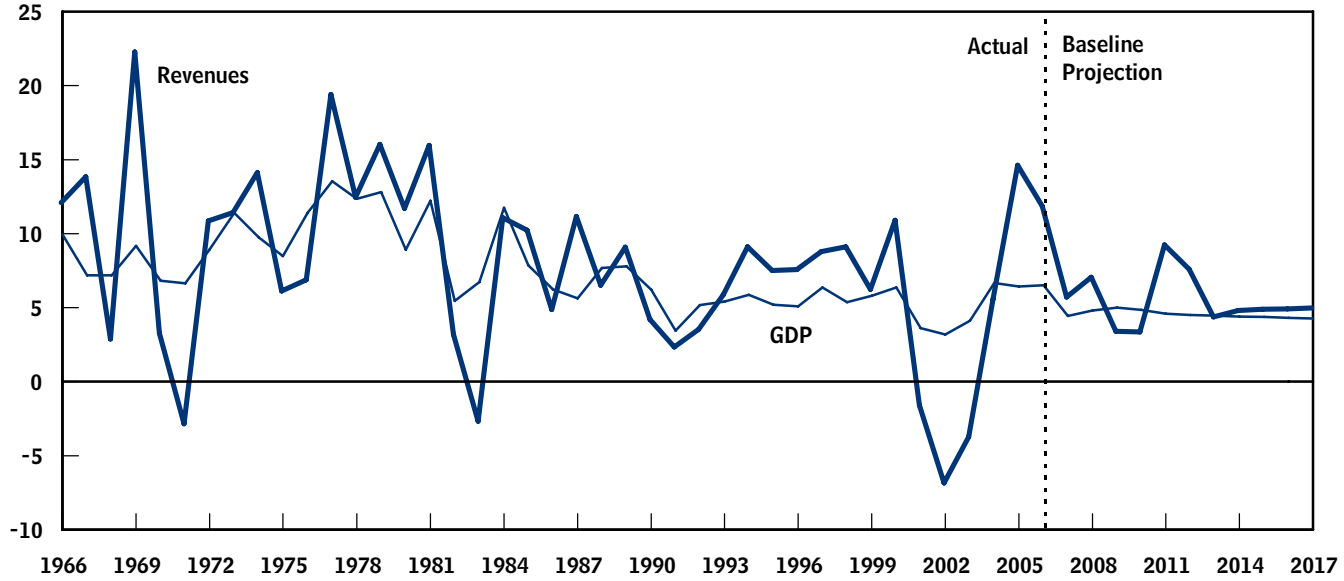



Source: Congressional Budget Office.

**Figure 4-2.**

## Annual Growth of Federal Revenues and Gross Domestic Product, 1966 to 2017

(Percent)




Source: Congressional Budget Office.

slated to begin in 2007, will have neared completion. CBO projects that revenues will then decline to 18.7 percent of GDP in 2009 and to 18.4 percent of GDP in 2010 mainly because corporate profits and capital gains realizations, which have been unusually high relative to GDP, will move back into their historical ranges. Also, CBO's projections incorporate the assumption that those recent gains in corporate and individual income tax receipts that cannot be explained by available economic data will persist for the next year or two and then decline. The stronger-than-expected tax collections suggest that certain taxable income is higher than currently indicated by available economic data, and CBO expects such taxable income to revert to longer-term averages over the projection period.

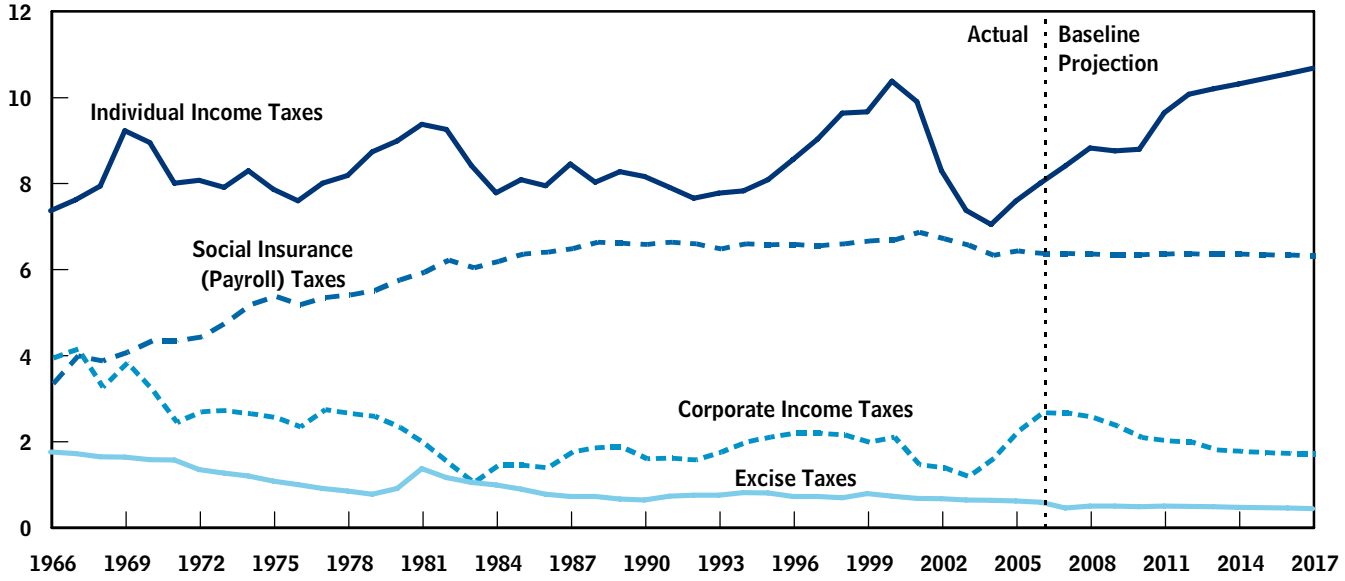
Revenues in CBO's projection jump sharply in 2011 and 2012, upon the expiration of various tax provisions originally enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. In addition, revenues are projected to continue growing faster than GDP because of several factors: "real bracket creep," wherein the growth of real (inflation-adjusted) income causes a greater proportion of taxpayers' income to be taxed in higher brackets; growth in retirement income subject to taxation upon withdrawal; and the increased role of the AMT (see Figure 4-2). Under the assumption that current laws and policies will remain the same, CBO projects that revenues will reach 20.1 percent of GDP in 2017, a level attained only once since World War II, in 2000. By contrast, if the provisions of EGTRRA, JGTRRA, and other laws that are scheduled to expire are extended instead and the AMT is indexed for inflation, revenues will remain near 18 percent of GDP over the next 10 years, CBO projects.

CBO's current revenue projections broadly adhere to those that the agency published in August 2006 in *The Budget and Economic Outlook: An Update*. Over the 2007–2016 period, CBO is now projecting a total of $57 billion more in revenues, or less than 0.2 percent of total revenues expected over the period. For the near term, CBO has increased its revenue projection—by $28 billion in 2007 and by $48 billion in 2008—mostly because tax collections remained stronger than expected last summer and capital gains realizations are expected to be higher than previously anticipated. By contrast, CBO has lowered its projection of economic growth in the near term, which is expected to hold down increases in reve-

**Figure 4-3.**

## Revenues, by Source, as a Share of Gross Domestic Product, 1966 to 2017

(Percent)




Source: Congressional Budget Office.

nues slightly. CBO expects that beyond 2008 and through 2016, slightly higher revenues at the beginning of the period will gradually shift to slightly lower levels by the period's end, when lower projected nominal GDP and taxable income will dominate.

## Revenues by Source

Federal revenues—also referred to as governmental receipts—come from various sources: individual income taxes, social insurance (payroll) taxes, corporate income taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. The level of individual income tax receipts, the largest source of federal revenues, has fluctuated significantly in the past several years, reaching a historical high of 10.3 percent of GDP in 2000, falling to a more-than-50-year low of 7.0 percent in 2004, and then rebounding in the past two years to 8.0 percent of GDP. Between 1966 and the late 1990s, individual income taxes produced nearly half of all federal revenues and typically claimed between 7.5 percent and 9.5 percent of GDP (see Figure 4-3). Social insurance taxes (collected mainly for Social Security and Medicare) represent the second-largest source of revenues. Since 1990, they have generated about one-third or more of federal revenues and measured between 6 percent and 7 percent of GDP. Corporate income taxes, the third-largest source, have typically accounted for about 10 percent of federal revenues since 1980 and have usually amounted to between 1.5 percent and 2 percent of GDP—although strong growth since 2003 boosted those receipts to 2.7 percent of GDP last year, the highest level since the late 1970s. Revenues from other taxes and duties and miscellaneous receipts (including those from the Federal Reserve System) make up the remainder of federal revenues and recently have amounted to a little less than 1.5 percent of GDP.

Since 1966, social insurance taxes have accounted for a growing share of federal revenues, while the share of corporate income taxes and excise taxes has declined. Social insurance taxes contributed almost 20 percent of revenues and amounted to 3.4 percent of GDP in 1966; increases in social insurance taxes boosted revenues substantially through the late 1980s. By contrast, the relative share of corporate income taxes has declined since 1966, when such taxes accounted for about 23 percent of revenues and amounted to about 4 percent of GDP. The contribution of excise taxes also has declined substantially, from about 10 percent of revenues in 1966 to about 3 percent today.

Over the next 10 years, changes in individual and corporate income tax receipts are likely to dominate the movement of overall revenues as a share of the economy. CBO projects that, under current law, receipts from individual income taxes will rise from 8.0 percent of GDP in 2006 to 10.7 percent in 2017, a gain of 2.7 percentage points. That increase more than accounts for the projected rise in total revenues, which are expected to climb by a smaller amount, 1.7 percentage points—from 18.4 percent of GDP in 2006 to 20.1 percent in 2017. Receipts from corporate income taxes are projected to retreat from their recent high levels relative to GDP, declining from 2.7 percent of GDP in 2006 and 2007 to 1.8 percent by 2017.

Of the projected increase in individual receipts relative to GDP, a little over half, or about 1.5 percentage points, results from scheduled changes in tax laws. The changes include a reduced exemption amount for the AMT, beginning in 2007, followed by a variety of changes in 2011, including a change in tax rates on ordinary income, capital gains, and dividends; a lower child tax credit; a reduction in the size of the 15 percent tax bracket for married couples; and changes to other parameters of tax law associated with the expiration of EGTRRA and JGTRRA.

The remainder of the projected increase in individual receipts relative to GDP is largely attributable to the structure of the tax code—wherein effective tax rates rise as personal income rises—and to other factors, such as rapid increases in distributions from tax-deferred 401(k) plans and individual retirement accounts as members of the baby-boom generation reach retirement age.[1] Effective tax rates are projected to rise, in part, because of real bracket creep, which causes revenues as a share of GDP to rise by about 0.6 percentage points from 2007 to 2017. In addition, an increasing number of taxpayers will have to pay the AMT—which is not indexed for inflation. Even without the reductions in exemptions that are scheduled to begin in 2007, the AMT will still claim growing amounts of income in future years. CBO estimates that receipts from the AMT will increase revenue relative to GDP by about 0.3 percentage points over the 10-year budget period. Projected growth in retirement income will lead to an increase in revenues relative to GDP of about 0.4 percentage points.

1. Effective tax rates are the ratio of tax liability to income.

Consistent with an anticipated decline in corporate profits as a share of GDP, receipts from corporate income taxes are projected to fall as a percentage of GDP over the next decade. CBO expects that the decline in profits will begin as a result of slowing economic growth in the second half of 2006 and early 2007. In addition, CBO expects the profit share of GDP to decline in coming years as a result of several factors. First, a discrepancy almost always exists between the historical income and product measures of GDP—with the income measure usually smaller than the output measure. CBO assumes that the discrepancy will return to its long-run average over the projection period, so less total income will be reported relative to GDP. Within that total, profits will be squeezed by smaller income on foreign assets and higher costs. Because of the trade deficit, the United States earns less, on net, from foreign assets. In addition, wages also will return to their long-run share of GDP, and business interest and capital consumption will rise, increasing corporate costs.

CBO anticipates that the amount of revenue arising from the combination of other tax sources will remain relatively stable as a share of GDP, fluctuating between 1.1 percent and 1.4 percent of GDP between 2007 and 2017. However, receipts from excise taxes will most likely drop by more than 0.1 percent of GDP in 2007 with the termination of major parts of the telephone tax and the distribution of associated refunds. Those receipts are projected to bounce back partially in 2008 but then continue their slow, long-term decline relative to GDP. CBO anticipates that receipts from estate and gift taxes will be relatively stable as a share of GDP until 2012, when receipts will jump as scheduled changes in law return the estate and gift tax to the form that existed before the enactment of EGTRRA in 2001. Customs duties and miscellaneous receipts are projected to remain relatively stable as a share of GDP.

## CBO's Current Revenue Projections in Detail

According to CBO's projections, changes in individual and corporate income tax receipts over the next 10 years are likely to dominate the movement of total revenue as a percentage of GDP. By contrast, relative to the size of the economy, receipts from social insurance taxes and from the other, less substantial, revenue sources are expected to vary by comparatively small amounts.

## Table 4-1.

# CBO's Projections of Revenues, by Source

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | In Billions of Dollars | | | | | | | |
| Individual Income Taxes | 1,044 | 1,144 | 1,259 | 1,311 | 1,380 | 1,584 | 1,730 | 1,830 | 1,928 | 2,036 | 2,149 | 2,269 | 7,263 | 17,473 |
| Corporate Income Taxes | 354 | 368 | 374 | 360 | 336 | 339 | 349 | 333 | 340 | 349 | 360 | 373 | 1,758 | 3,513 |
| Social Insurance Taxes | 838 | 875 | 914 | 958 | 1,004 | 1,052 | 1,100 | 1,149 | 1,198 | 1,249 | 1,301 | 1,354 | 5,029 | 11,281 |
| Excise Taxes | 74 | 59 | 69 | 72 | 73 | 78 | 82 | 83 | 85 | 86 | 88 | 90 | 374 | 806 |
| Estate and Gift Taxes | 28 | 24 | 25 | 26 | 21 | 22 | 50 | 56 | 62 | 67 | 73 | 79 | 144 | 480 |
| Customs Duties | 25 | 26 | 28 | 29 | 32 | 34 | 35 | 38 | 40 | 43 | 46 | 50 | 158 | 375 |
| Miscellaneous | 44 | 47 | 52 | 53 | 55 | 57 | 59 | 61 | 63 | 65 | 68 | 70 | 276 | 603 |
| **Total** | **2,407** | **2,542** | **2,720** | **2,809** | **2,901** | **3,167** | **3,404** | **3,550** | **3,717** | **3,896** | **4,084** | **4,284** | **15,001** | **34,531** |
| On-budget | 1,798 | 1,905 | 2,051 | 2,106 | 2,163 | 2,394 | 2,596 | 2,706 | 2,838 | 2,979 | 3,129 | 3,290 | 11,311 | 26,252 |
| Off-budget[a] | 608 | 638 | 669 | 703 | 738 | 773 | 808 | 844 | 880 | 917 | 955 | 994 | 3,690 | 8,279 |
| **Memorandum:** | | | | | | | | | | | | | | |
| Gross Domestic Product | 13,066 | 13,645 | 14,300 | 15,014 | 15,742 | 16,465 | 17,205 | 17,973 | 18,764 | 19,582 | 20,425 | 21,295 | 78,726 | 176,766 |
| | | | | | | | As a Percentage of Gross Domestic Product | | | | | | | |
| Individual Income Taxes | 8.0 | 8.4 | 8.8 | 8.7 | 8.8 | 9.6 | 10.1 | 10.2 | 10.3 | 10.4 | 10.5 | 10.7 | 9.2 | 9.9 |
| Corporate Income Taxes | 2.7 | 2.7 | 2.6 | 2.4 | 2.1 | 2.1 | 2.0 | 1.9 | 1.8 | 1.8 | 1.8 | 1.8 | 2.2 | 2.0 |
| Social Insurance Taxes | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 |
| Excise Taxes | 0.6 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.4 | 0.4 | 0.4 | 0.5 | 0.5 |
| Estate and Gift Taxes | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.2 | 0.3 |
| Customs Duties | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Miscellaneous Receipts | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 | 0.4 | 0.3 |
| **Total** | **18.4** | **18.6** | **19.0** | **18.7** | **18.4** | **19.2** | **19.8** | **19.8** | **19.8** | **19.9** | **20.0** | **20.1** | **19.1** | **19.5** |
| On-budget | 13.8 | 14.0 | 14.3 | 14.0 | 13.7 | 14.5 | 15.1 | 15.1 | 15.1 | 15.2 | 15.3 | 15.4 | 14.4 | 14.9 |
| Off-budget[a] | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 | 4.7 |

Source: Congressional Budget Office.

a. The revenues of the two Social Security trust funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) are off-budget.

### Individual Income Taxes

Over the next 10 years, increases in individual income tax receipts will account for nearly all of the growth that is projected to occur in total revenues as a share of GDP (see Table 4-1). Historically, individual income tax receipts have been the key determinant of movements in total receipts. Between 1992 and 2000, individual income tax receipts recorded an average annual growth rate of nearly 10 percent and reached a historical peak of 10.3 percent of GDP. After 2000, those receipts fell as a share of GDP for four consecutive years, reaching 7.0 percent in 2004, their lowest level since 1951. The downturn in receipts began as a result of the stock market decline and the 2001 recession and was reinforced by the tax cuts enacted in several stages between 2001 and 2004. As the economy recovered, income growth picked up substantially in 2004 and continued at a strong pace through last year. By 2006, receipts as a share of GDP reached 8.0 percent, slightly below their average share of 8.3 percent over the 1966–2006 period.

CBO projects that, relative to GDP, individual income tax receipts will continue to increase for the next two years, then stabilize in 2009 and 2010, and increase every

year thereafter through 2017. Real bracket creep, growth in retirement income subject to taxation upon withdrawal, and the increased effect of the AMT will cause revenues to grow more strongly than output for the 10-year projection period. In addition, CBO anticipates, receipts will be boosted significantly, especially after 2010, when most provisions of EGTRRA and JGTRRA expire. CBO expects that, by 2015, individual income tax receipts will reach a historical peak of 10.4 percent of GDP and will continue to climb thereafter, reaching 10.7 percent of GDP by 2017.

**Receipts in 2006.** Individual income tax receipts grew by a robust 12.6 percent in 2006. The strongest growth in percentage terms occurred in nonwithheld receipts (those not remitted by withholding from paychecks), which increased by about 21 percent over 2005 levels.

Nonwithheld receipts in 2006 were boosted both by final payments that accompanied tax returns for 2005 and by estimated payments that stemmed mostly from economic activity in calendar year 2006. According to early tabulations of tax returns for 2005, several types of nonwage personal income (from sources other than wages and salaries) grew very strongly: Realizations of capital gains grew by about 29 percent; taxable interest income rose by more than 20 percent; and combined income from partnerships and S corporations grew by almost 20 percent. Those income gains may have caused significant increases in final payments when tax returns were filed in 2006. Many taxpayers may not have provided sufficient estimated payments or directed their employers to withhold sufficient funds from their paychecks in 2005 to cover their higher tax liability. Full information from tax returns for 2005, which will include final tabulations of income and deduction amounts and measures of the distribution of income among taxpayers facing different tax rates, should become available in several months.

Estimated payments of income tax also grew strongly in 2006. To some degree, those strong payments may reflect economic activity from calendar year 2005, if taxpayers raised their estimated payments solely because they owed a large amount of tax on their 2005 tax returns. In order to avoid penalties when filing their tax returns, taxpayers must avoid having amounts due that exceed certain levels—which is especially possible for taxpayers with nonwage income that is not subject to automatic tax withholding. Taxpayers can avoid penalties by properly estimating their current income and making adequate estimated tax payments, or they can avail themselves of various "safe harbors" that are not based on current income and accruing tax liability.[2] The high variability from year to year of final payments accompanying tax returns indicates that estimated payments do not necessarily give a good indication of current income.

Receipts from withholding from paychecks grew more slowly than nonwithheld receipts but still recorded solid growth. The Treasury Department estimates that withholding for income taxes rose by about 7.9 percent in 2006. Combined withholding for income and payroll taxes—a more precise measure because it does not include potential misallocations between the two components—grew by 6.9 percent.[3] That increase is consistent with solid growth in wages and salaries, which grew by an estimated 6.3 percent in 2006, according to the latest data from the national income and product accounts. The growth in combined income and payroll withholding in 2006 was about 0.5 percentage points greater than that observed in 2005, registering the highest rate of growth since 2000. From 1995 through 2000, combined withholding grew at an annual rate of just over 8 percent, on average.

**Projected Receipts in 2007 and 2008.** CBO projects that individual income tax receipts will grow by about 10 percent in each of the next two years: by 9.6 percent in 2007 and by 10.0 percent in 2008 (see Table 4-2). That growth would substantially exceed projected growth in taxable personal income—as measured in the NIPAs—of just under 5 percent in both 2007 and 2008. (Taxable personal income includes wages and salaries, dividends, interest, rental income, and proprietors' income. For a description of taxable personal income and other components of the tax base, see Box 4-1.)

2. For example, taxpayers with income below $150,000 can avoid penalties by making estimated payments and withholding amounts equal to their prior year's tax liability. Taxpayers with income in excess of $150,000 must pay 110 percent of their prior year's liability to automatically avoid penalties. Other safe harbors also exist.

3. When employers remit withholding for income and payroll taxes to the Treasury, they are not required to distinguish immediately the amounts of the two components. The Treasury estimates the appropriate division and corrects any resulting error in later years. Because of the different structure of the individual income and payroll taxes, withheld income tax receipts typically grow faster than withheld payroll tax receipts in a growing economy.

**Table 4-2.**

## CBO's Projections of Individual Income Tax Receipts and the NIPA Tax Base

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012[a] | Total, 2008-2017[a] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Individual Income Tax Receipts | | | | | | | | | | | | | | |
| In billions of dollars | 1,044 | 1,144 | 1,259 | 1,311 | 1,380 | 1,584 | 1,730 | 1,830 | 1,928 | 2,036 | 2,149 | 2,269 | 7,263 | 17,473 |
| As a percentage of GDP | 8.0 | 8.4 | 8.8 | 8.7 | 8.8 | 9.6 | 10.1 | 10.2 | 10.3 | 10.4 | 10.5 | 10.7 | 9.2 | 9.9 |
| Annual growth rate | 12.6 | 9.6 | 10.0 | 4.1 | 5.3 | 14.8 | 9.2 | 5.8 | 5.4 | 5.6 | 5.5 | 5.6 | 8.6 | 7.1 |
| Taxable Personal Income | | | | | | | | | | | | | | |
| In billions of dollars | 8,659 | 9,077 | 9,524 | 10,024 | 10,537 | 11,012 | 11,510 | 12,031 | 12,555 | 13,096 | 13,659 | 14,246 | 52,606 | 118,193 |
| As a percentage of GDP | 66.3 | 66.5 | 66.6 | 66.8 | 66.9 | 66.9 | 66.9 | 66.9 | 66.9 | 66.9 | 66.9 | 66.9 | 66.8 | 66.9 |
| Annual growth rate | 6.3 | 4.8 | 4.9 | 5.3 | 5.1 | 4.5 | 4.5 | 4.5 | 4.4 | 4.3 | 4.3 | 4.3 | 4.9 | 4.6 |
| Individual Receipts as a Percentage of Taxable Personal Income | 12.1 | 12.6 | 13.2 | 13.1 | 13.1 | 14.4 | 15.0 | 15.2 | 15.4 | 15.5 | 15.7 | 15.9 | 13.8 | 14.8 |

Source: Congressional Budget Office.

Notes: The tax base in this table (taxable personal income) reflects income as measured in the national income and product accounts (NIPAs) rather than as reported on tax returns. An important difference, therefore, is that it excludes capital gains realizations.

GDP = gross domestic product.

a. Measures expressed in billions of dollars are the cumulative amounts over the period. Measures expressed as a percentage of GDP or taxable personal income are averages over the period. Measures expressed as annual growth rates are the average rates compounded annually over the period, including growth in 2008.

Some of the recent strength in tax collections is expected to carry over into 2007, boosting growth in receipts above growth in income. For example, the strength in the first three quarterly estimated payments for tax year 2006, which were recorded in fiscal year 2006, is expected to continue with the last estimated payment for the tax year, which occurs in January 2007. In addition, final payments due in the upcoming tax filing season are expected to reflect some of the strong collections in 2006. CBO expects that final payments with tax returns will grow by more than 10 percent, roughly in line with expected growth in the sum of withholding and estimated payments for the full 2006 tax year.

In 2008, the expiration of the higher exemptions that mitigated the effects of the AMT on taxpayers is expected to boost receipts sharply. A significant decline in the AMT exemption went into effect in 2007 when, as stipulated by law, a recent extension of higher exemption amounts expired at the end of December 2006 (see Box 4-2 on page 88). As a result, projected tax liability from the AMT in tax year 2007 is expected to jump by about $50 billion.

For several reasons, CBO anticipates that almost all of that additional liability from 2007 will be paid in fiscal year 2008. First, many taxpayers may not be aware of the reduced exemption and may not know that they have incurred substantial AMT liability until they file their tax returns in the spring of 2008; consequently, such taxpayers would not adjust their estimated payments during 2007. Second, even if taxpayers know that they will face substantial AMT liability, they may not have to increase their estimated payments because growth in their income and tax withholding will enable them to avoid penalties through application of one of the safe harbors. Finally, because legislative action to avoid substantial increases in AMT liability has occurred on a temporary basis several times now, taxpayers aware of their higher AMT liability may anticipate such action again. As a result, they may not increase their estimated payments in 2007 under the assumption that they will not incur substantial AMT liability after Congressional action. (CBO's baseline, however, must conform to current law and does not assume any future Congressional action. In CBO's baseline, therefore, many taxpayers with substantial AMT liability in 2007 are assumed to make insufficient estimated

**Box 4-1.**

## Tax Bases and Tax Liability

Tax receipts vary with economic activity, but they do not move in lockstep with gross domestic product (GDP). Although the bases for individual and corporate income taxes and for social insurance taxes are related to GDP, they sometimes grow faster or more slowly than the overall economy. As a result, the ratio of receipts to GDP may change even if tax laws remain the same.

### The Individual Income Tax Base

A rough measure of the individual income tax base includes estimates of wages and salaries, dividends, interest, rental income, and proprietors' income from the national income and product accounts (NIPAs). That measure, referred to here as **taxable personal income,** excludes taxes on businesses (such as corporate income and excise taxes), retained corporate profits, and fringe benefits that workers do not receive in taxable form.

That income measure must be narrowed further to obtain the actual tax base of the income tax. Some of that income accrues to tax-exempt entities such as hospitals, schools, cultural institutions, and foundations; some is earned in a form that is tax-exempt, such as income from state and local bonds; and some is tax-deferred, such as income earned in retirement accounts, on which tax is paid not as the income accrues but when the individual retires and begins to draw down the account. Also, NIPA estimates of personal interest and rental income contain large components of imputed income that are not taxable. (Imputed income is that not earned in a cash transaction, including personal earnings within pension funds and life insurance policies and income from owner-occupied housing.) Consequently, a substantial amount of interest, dividend, and rental income is excluded from the taxable base of the income tax.

Further adjustments, both additions and subtractions, must be made to determine taxpayers' **adjusted gross income,** or AGI. **Capital gains realizations**—the increase in the value of assets between the time they are purchased and sold—are added because NIPA estimates of taxable personal income exclude them as unrelated to current production. Contributions from income that are made to tax-deductible individual retirement accounts and 401(k) plans are subtracted, but distributions to retirees from those plans are added.

A variety of other, smaller adjustments must be made to reflect the various adjustments that taxpayers make. **Exemptions** and **deductions** are subtracted from AGI to yield **taxable income,** to which progressive tax rates—rates that rise as income rises—are applied. (Those rates are known as statutory marginal tax rates; the range of taxable income over which a statutory marginal rate applies is known as an income tax bracket, of which there are now six.)

The tax that results from applying statutory rates to taxable income may then be subject to further adjustments in the form of **credits** (such as the child tax credit for taxpayers with children under age 17), which reduce taxpayers' **tax liability** (the amount of taxes they owe). An important factor in calculating individual tax liability is the **alternative minimum tax** (AMT), which requires some taxpayers to calculate their taxes under a more limited set of exemptions, deductions, and credits (see Box 4-2 on page 88). Taxpayers then pay whichever is higher, the AMT or the regular tax. The ratio of tax liability to AGI is the **effective tax rate on AGI.**

**Box 4-1.**

## Continued

### The Social Insurance Tax Base

Social insurance taxes use payroll as their base. Those taxes largely fund Social Security and the Hospital Insurance program, or HI (Part A of Medicare). Social Security taxes are imposed as a fixed percentage of pay up to an annual **taxable maximum** (currently $97,500) that is indexed for the growth of wages in the economy. HI taxes are not subject to a taxable maximum.

### The Corporate Income Tax Base

Corporate profits form the tax base of the corporate income tax. Profits are measured in a variety of ways in the NIPAs. Several adjustments are made to those measures to better approximate what is taxed by the corporate income tax.

First, different measures of depreciation cause important differences in the measurement of corporate profits. **Economic profits** are measured to include the profit-reducing effects of **economic depreciation**—the dollar value of productive capital assets that is estimated to have been used up in the production process. For tax purposes, however, corporations calculate **book profits,** which include reductions for **book,** or **tax, depreciation.** (Book profits are referred to as profits before tax in the NIPAs). Book depreciation is typically more front-loaded than economic depreciation; that is, the capital is assumed to decline in value at a faster rate than the best estimates of how fast its economic value actually falls, allowing firms to generally report taxable profits that are smaller than economic profits.

Second, the profits of the Federal Reserve System are included in economic and book profits, but they are not taxed under the corporate income tax. (They are instead generally remitted to the Treasury as miscellaneous receipts.)

Third, economic and book profits both include certain foreign-source income of U.S. multinational corporations. Foreign-source income is taxed at very low effective rates, in part, because it is generally taxable only when it is "repatriated," or returned, to the U.S. parent company. In addition, it generates little revenue because corporations can offset their domestic tax by the amount of foreign taxes paid on that income, within limits.

Several other differences exist between book profits and corporations' calculation of their taxable income. In general, only the positive profits of profitable firms, or **gross profits,** are subject to tax. If a corporation's taxable income is negative (that is, if the firm loses money), its loss (within limits) may be carried backward or forward to be netted against previous or future taxable income and thus reduce the firm's taxes in those other years.

A statutory tax rate is applied to the corporation's taxable income to determine its tax liability. A number of credits may pare that liability. The ratio of total corporate taxes to total taxable corporate income (including negative income) is the **average tax rate.**

payments in that year and will face substantial final payments when they file tax returns in 2008.)

CBO anticipates that receipts from the AMT will jump from $25 billion in 2007 to $90 billion in 2008. Not only will taxpayers make the required AMT payments for tax year 2007 when they file their returns in 2008, according to CBO's assumption, but they will also respond in that year by raising their estimated payments to cover their AMT liability for 2008. A portion of the payments made in 2008, therefore, represent a one-time shift in the amounts of tax liability paid across the fiscal year.

**Projected Receipts Beyond 2008.** CBO's projected pattern of revenues for 2008 and beyond reflects steady growth in personal income, punctuated by scheduled changes to tax law in specific years. Receipts are expected

## Table 4-3.

# Actual and Projected Capital Gains Realizations and Taxes

| | Capital Gains Realizations[a] | | Capital Gains Tax Liabilities[a] | | Capital Gains Tax Receipts[b] | | Capital Gains Tax Receipts as a Percentage of Individual Income Tax Receipts |
|---|---|---|---|---|---|---|---|
| | In Billions of Dollars | Percentage Change from Previous Year | In Billions of Dollars | Percentage Change from Previous Year | In Billions of Dollars | Percentage Change from Previous Year | |
| 1990 | 124 | -20 | 28 | -21 | 32 | -14 | 6.8 |
| 1991 | 112 | -10 | 25 | -11 | 27 | -17 | 5.7 |
| 1992 | 127 | 14 | 29 | 16 | 27 | 1 | 5.6 |
| 1993 | 152 | 20 | 36 | 25 | 32 | 20 | 6.3 |
| 1994 | 153 | * | 36 | * | 36 | 12 | 6.7 |
| 1995 | 180 | 18 | 44 | 22 | 40 | 10 | 6.8 |
| 1996 | 261 | 45 | 66 | 50 | 54 | 36 | 8.3 |
| 1997 | 365 | 40 | 79 | 19 | 72 | 33 | 9.8 |
| 1998 | 455 | 25 | 89 | 12 | 84 | 16 | 10.1 |
| 1999 | 553 | 21 | 112 | 26 | 99 | 19 | 11.3 |
| 2000 | 644 | 17 | 127 | 14 | 119 | 20 | 11.8 |
| 2001 | 349 | -46 | 66 | -48 | 100 | -16 | 10.0 |
| 2002 | 269 | -23 | 49 | -25 | 58 | -42 | 6.8 |
| 2003 | 323 | 20 | 51 | 4 | 50 | -14 | 6.3 |
| 2004 | 499 | 54 | 72 | 41 | 61 | 21 | 7.5 |
| 2005 | 643 | 29 | 97 | 34 | 84 | 38 | 9.0 |
| 2006 | 729 | 13 | 110 | 14 | 103 | 23 | 9.9 |
| 2007 | 708 | -3 | 107 | -3 | 109 | 5 | 9.5 |
| 2008 | 699 | -1 | 102 | -4 | 105 | -4 | 8.3 |
| 2009 | 698 | * | 102 | -1 | 102 | -3 | 7.8 |
| 2010 | 796 | 14 | 116 | 14 | 102 | * | 7.4 |
| 2011 | 547 | -31 | 103 | -12 | 116 | 14 | 7.3 |
| 2012 | 649 | 19 | 123 | 20 | 112 | -4 | 6.5 |
| 2013 | 661 | 2 | 125 | 1 | 124 | 11 | 6.8 |
| 2014 | 676 | 2 | 127 | 2 | 126 | 2 | 6.5 |
| 2015 | 694 | 3 | 130 | 2 | 128 | 2 | 6.3 |
| 2016 | 715 | 3 | 133 | 3 | 131 | 2 | 6.1 |
| 2017 | 738 | 3 | 137 | 3 | 135 | 3 | 5.9 |

Source: Congressional Budget Office.

Note: Capital gains realizations represent net positive long-term gains. Data for realizations and liabilities after 2002 and tax receipts in all years are estimated or projected by CBO. Data on realizations and liabilities before 2003 are estimated by the Treasury Department.

* = between zero and 0.5 percent.

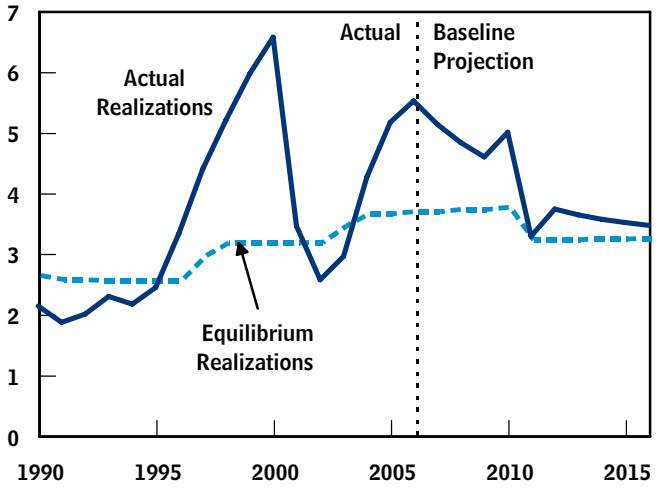
a. Calendar year basis.

b. Fiscal year basis. This measure is CBO's estimate of when tax liabilities are paid to the Treasury.

**Figure 4-4.**

## Capital Gains Realizations as a Share of Gross Domestic Product, Calendar Years 1990 to 2017

(Percent)




Source: Congressional Budget Office.

Note: The equilibrium level of capital gains realizations to gross domestic product (GDP) is measured as the average ratio of gains to GDP from 1954 to 2004, adjusted for the differences between each year's tax rate on capital gains and the average rate over the period. A lower tax rate on capital gains corresponds to a higher equilibrium relationship.

to hold roughly steady as a share of GDP or taxable personal income in 2009 and 2010. Thereafter, they rise in each succeeding year of the projection period. By 2017, they are projected to reach 10.7 percent of GDP, 1.9 percentage points higher than the level expected in 2008.

Increases in receipts as a share of GDP result from two broad factors: scheduled changes in tax legislation and several characteristics inherent in the tax system. Three factors of smaller overall magnitude work in the opposite direction to restrain the growth of revenues: the decline of capital gains realizations relative to GDP; the persistence through 2008, and the decline thereafter, of the recent, unexplained strength in receipts; and, in 2009, the lack of recurrence of the one-time boost in receipts that is expected to arise in 2008 as a result of the AMT. Those factors that restrain the growth of receipts are most significant in the early years of the projection period, explaining the rough stability of the revenue share of GDP in 2009 and 2010.

*Tax Law Changes.* Scheduled changes in tax law—principally from legislation enacted in 2001 (EGTRRA), 2003 (JGTRRA), 2004 (the Working Families Tax Relief Act, or WFTRA), and 2006 (the Tax Increase Prevention and Reconciliation Act, or TIPRA)—will alter the pattern of receipts growth, especially in 2011 and 2012. The scheduled changes almost all tend to increase receipts. Tax revenues are projected to increase sharply in 2011 when provisions initially enacted in EGTRRA and JGTRRA expire. The expiration of those provisions will have various effects: Among other things, tax rates on capital gains and dividends will increase, statutory tax rates on ordinary income will rise, the child tax credit will shrink, and the 15 percent tax bracket and standard deduction for joint filers will contract in size to less than twice those for single taxpayers. Before 2011 only the continued phaseout of restrictions on itemized deductions and personal exemptions for high-income taxpayers—scheduled for completion in tax year 2010—will tend to reduce the growth of individual income tax receipts. (Those restrictions, which were initially enacted in 1990, raise revenue. EGTRRA removed the restrictions in three steps between 2006 and 2010, thereby reducing revenues by increasing amounts through 2010, when the provisions from EGTRRA are set to expire.)

*Characteristics of the Tax System.* According to CBO's projections, effective tax rates will steadily rise over the next 10 years, thereby increasing the receipts generated by the economy. That increase occurs, in part, because of the phenomenon known as real bracket creep, in which the overall growth of real income causes more income to be taxed in higher tax brackets. In addition, as nominal income (measured in current dollars) rises, a growing share will be claimed by the AMT—which is not indexed for inflation. Also pushing up effective rates are taxable distributions from certain tax-deferred retirement accounts, such as traditional individual retirement accounts and 401(k) plans, which are expected to increase as the population ages. Under the tax system, contributions to those accounts are exempt from taxation when they are initially made, which reduces taxable income reported to the IRS in earlier years. As more retirees take distributions from those accounts, the money becomes taxable, thereby increasing tax receipts relative to GDP.

*Capital Gains Realizations.* CBO projects that realizations of capital gains will grow more slowly than GDP after 2006 (see Figure 4-4). Although capital gains plunged between 2000 and 2002, they rebounded strongly from

**Box 4-2.**

## The Growing Significance of the Alternative Minimum Tax in CBO's Projections

With each passing year, the alternative minimum tax (AMT) plays a larger role in the Congressional Budget Office's (CBO's) revenue projections. Revenue effects from recent changes in tax law combined with the growing number of taxpayers qualifying for the AMT have enhanced the AMT's contribution to overall revenue collections. Additional revenue from the AMT is one reason that CBO projects receipts to grow relative to gross domestic product over the next 10 years.

### Characteristics of the AMT

The AMT is a parallel income tax system with fewer exemptions, deductions, and rates than the regular income tax. Lawmakers enacted the AMT to prevent high-income taxpayers from taking advantage of the tax code by using various preferences in the regular code that favor certain activities by taxing the income associated with them at a lower rate. Preferences not allowed under the AMT include personal exemptions and the standard deduction. Thus, the AMT affects some taxpayers not ordinarily thought to be exploiting "loopholes," who might otherwise avoid taxation of their higher income. Taxpayers with potential AMT liability must calculate their taxes under both the AMT and the regular income tax and pay whichever figure is higher. The amount by which a taxpayer's AMT calculation exceeds his or her regular tax calculation is considered the taxpayer's AMT liability.

In tax year 2007, for example, a married couple with three children who earned $90,000 and reported a typical set of deductions would be required to calculate taxes under both the AMT and the regular income tax. In this particular case, the couple's liability would be higher under the AMT.

### The AMT's Growing Importance to Revenues

Because of the nominal income growth reflected by inflation and the effects of recent tax cuts, the AMT's reach is growing both in the number of qualifying taxpayers and in its share of total revenues. As inflation boosts nominal income, more and more taxpayers are becoming subject to the minimum tax.[1] Unlike the regular income tax, the AMT is not indexed to inflation. So as incomes rise with inflation, a larger number of taxpayers find themselves subject to the AMT each year.

Laws enacted between 2001 and 2004—the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), as modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and the Working Families Tax Relief Act of 2004 (WFTRA)—have reduced taxpayer liability under other provisions of the law and thus will add to the number of qualifying AMT taxpayers. Although the tax cuts reduce overall taxpayer liability, many people will still find themselves pushed into the AMT system. By cutting marginal tax rates under the regular tax, EGTRRA, JGTRRA, and WFTRA have reduced regular tax receipts and increased AMT receipts to a partially offsetting degree, and therefore have substantially increased the importance of the AMT to total individual income tax revenues. Temporary provisions have mitigated those AMT effects through 2006.

### The AMT's Impact over the Next 10 Years

With no change in law, the number of taxpayers subject to the AMT is expected to rise from 4 million in 2006 to 39 million by 2017. Revenues from the AMT are projected to increase almost sixfold, from $19 billion last year to about $103 billion in 2017 (see the figure to the right). Compared with levels recorded in 2006, the AMT's contribution to individual income tax receipts is expected to more than double by 2017, rising from 1.8 percent to 4.5 percent of total receipts from the individual income tax.

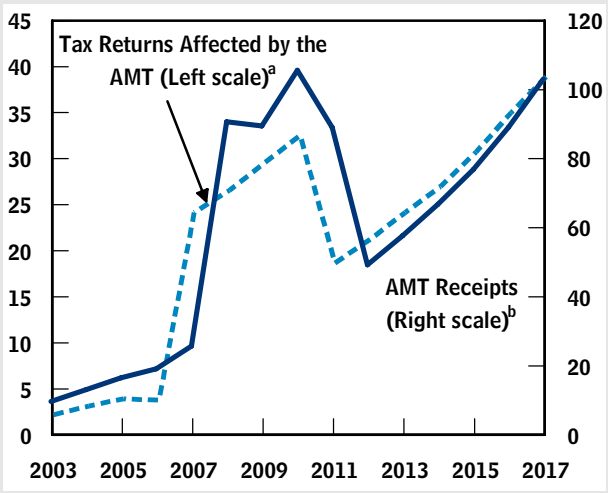
1. Real (inflation-adjusted) growth in income can also subject additional taxpayers to the AMT, but its effects are much smaller.

## Box 4-2.
## Continued

Projections for the AMT rise and fall through that period largely because of expiring tax provisions enacted between 2001 and 2006. The Tax Increase Prevention and Reconciliation Act of 2005, enacted in May 2006, expanded the amount of income exempted under the AMT through 2006. Now that the provision has expired, the number of returns subject to the AMT is expected to rise, from 4 million in 2006 to 24 million in 2007, and, assuming that current law remains unchanged, the resulting AMT liability on those returns is projected to jump from $20 billion in 2006 to $70 billion in 2007. CBO expects that most of the increased liability in 2007 will be paid by taxpayers in fiscal year 2008.

In 2011, when statutory tax rates are scheduled to increase under the regular income tax and other changes in law occur, the number of AMT returns is projected to decline by more than 40 percent: from 33 million in 2010 to 19 million in 2011. Receipts from the AMT are projected to fall from $105 billion in 2010 to $49 billion by 2012. After 2012, the dip in AMT receipts will start to reverse, as inflationary increases in income again make more taxpayers subject to the AMT.

### Projected Baseline Effects of the Individual Alternative Minimum Tax




Source: Congressional Budget Office.

Note: The alternative minimum tax requires some taxpayers to calculate their taxes using a more limited set of exemptions, deductions, and credits than is applicable under the regular individual income tax. Some taxpayers are affected by the AMT but do not have AMT liability because the AMT limits their credits taken under the regular tax.

a. Based on calendar year.

b. Based on fiscal year.

2003 to 2005. Based on recent economic growth and activity in the stock and housing markets, CBO estimates that capital gains increased by a further 13 percent in calendar year 2006 (see Table 4-3 on page 86).

The strong recovery in capital gains realizations since 2002 has pushed them to a level that, relative to the size of the economy, is well above that implied by their past historical relationship to GDP and the rate at which they are taxed. In the past, the ratio of gains realizations to GDP has tended to return to its average level relative to the size of the economy (adjusted for the tax rate on gains). The speed of reversion has been irregular in the past: At times the reversion has been very fast, as in 2001, and at other times it has been more delayed.

Consequently, CBO projects that, beyond 2006, capital gains will rise more slowly than GDP and gradually return to their long-run average level (adjusted for tax rates) relative to the economy. Between 2007 and 2017, capital gains realizations are projected to grow at an average annual rate of less than 0.5 percent per year, substantially lower than the 4.6 percent rate of growth anticipated for GDP. Receipts from gains are expected to grow in step with gains realizations, except when the JGTRRA provisions, as extended in TIPRA, expire in 2011. The higher tax rates that are scheduled to take

**Table 4-4.**

## CBO's Projections of Social Insurance Tax Receipts and the Social Insurance Tax Base

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012[a] | Total, 2008-2017[a] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Insurance Tax Receipts | | | | | | | | | | | | | | |
| In billions of dollars | 838 | 875 | 914 | 958 | 1,004 | 1,052 | 1,100 | 1,149 | 1,198 | 1,249 | 1,301 | 1,354 | 5,029 | 11,281 |
| As a percentage of GDP | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 | 6.4 |
| Annual growth rate | 5.5 | 4.4 | 4.5 | 4.8 | 4.8 | 4.7 | 4.6 | 4.4 | 4.3 | 4.2 | 4.1 | 4.1 | 4.7 | 4.5 |
| Wages and Salaries | | | | | | | | | | | | | | |
| In billions of dollars | 5,946 | 6,254 | 6,559 | 6,902 | 7,249 | 7,588 | 7,930 | 8,284 | 8,637 | 9,001 | 9,376 | 9,761 | 36,228 | 81,288 |
| As a percentage of GDP | 45.5 | 45.8 | 45.9 | 46.0 | 46.0 | 46.1 | 46.1 | 46.1 | 46.0 | 46.0 | 45.9 | 45.8 | 46.0 | 46.0 |
| Annual growth rate | 6.3 | 5.2 | 4.9 | 5.2 | 5.0 | 4.7 | 4.5 | 4.5 | 4.3 | 4.2 | 4.2 | 4.1 | 4.9 | 4.6 |
| Social Insurance Tax Receipts as a Percentage of Wages and Salaries | 14.1 | 14.0 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 | 13.9 |

Source: Congressional Budget Office.

Notes: The tax base in this table (wages and salaries) reflects income as measured in the national income and product accounts rather than as reported on tax returns.

GDP = gross domestic product.

a. Measures expressed in billions of dollars are the cumulative amounts over the period. Measures expressed as a percentage of GDP or wages and salaries are averages over the period. Measures expressed as annual growth rates are the average rates compounded annually over the period, including growth in 2008.

effect in 2011 will reduce the long-run average level of gains relative to the size of the economy because taxpayers tend to realize fewer gains at higher tax rates, although higher rates still increase revenue from capital gains as a share of GDP.

The scheduled return to higher capital gains tax rates in 2011 also will alter the timing of realizations by encouraging taxpayers to speed up the sale of assets that will generate gains from that year to late 2010. Realizations are projected to rise by 14 percent in 2010 (boosted by the speedup in realizations), decline by 31 percent in 2011 (depressed by the earlier speedup and the adjustment to the lower equilibrium level), and rise by 19 percent in 2012 (when they rebound after the one-time speedup). After 2012, realizations are projected to rise by 2 percent to 3 percent annually through 2017.

*Recent Strength in Collections*. As noted earlier, the sources of the strength in collections in 2006 will not be known until information from tax returns becomes fully available. In the absence of that information, CBO assumes that the recent strength in individual receipts that cannot be explained by currently available data will persist through 2008 and then gradually decline over the following several years. CBO makes that assumption because, in the longer term, most forms of taxable income tend to return to their historical relationship to GDP. The effects on projected revenue growth are strongest over the 2009–2010 period but extend through 2013, reducing projected revenues as a share of GDP over the 2009–2013 period by about 0.3 percentage points.

**Changes Since August 2006.** Compared with projections that the agency made five months ago, CBO is anticipating $2 billion more in individual income tax receipts in 2007 and $126 billion less over the 2008–2016 period. From 2007 to 2009, the changes are relatively small as a result of offsetting effects from CBO's updated economic projections and from technical changes to the tax yield for a given economic projection. Beyond 2009, downward reestimates resulting from the new economic projection dominate. Changes resulting from legislation enacted since the summer are relatively small.

**Table 4-5.**

## CBO's Projections of Social Insurance Tax Receipts, by Source

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Social Security | 608 | 638 | 669 | 703 | 738 | 773 | 808 | 844 | 880 | 917 | 955 | 994 | 3,690 | 8,279 |
| Medicare | 177 | 185 | 194 | 204 | 214 | 225 | 235 | 245 | 256 | 267 | 278 | 290 | 1,072 | 2,409 |
| Unemployment Insurance | 43 | 44 | 43 | 43 | 44 | 46 | 49 | 52 | 54 | 57 | 59 | 62 | 224 | 508 |
| Railroad Retirement | 4 | 4 | 4 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 5 | 6 | 23 | 49 |
| Other Retirement | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 4 | 3 | 3 | 3 | 3 | 20 | 36 |
| **Total** | **838** | **875** | **914** | **958** | **1,004** | **1,052** | **1,100** | **1,149** | **1,198** | **1,249** | **1,301** | **1,354** | **5,029** | **11,281** |

Source: Congressional Budget Office.

Changes to CBO's economic projections account for downward reestimates of $23 billion in 2007 and $276 billion over the 2008–2016 period. CBO has lowered its projection of growth in personal income in 2007 and now expects that wages and salaries, the highest-taxed income source, will climb by 5.2 percent in 2007, compared to last summer's projection of 6.0 percent. Because wages and salaries were revised upward in 2006 by $37 billion, this implies a reduction in 2007 of only $11 billion. In addition, CBO has reduced its projections for growth in interest and proprietors' income in 2007. Beyond 2007, CBO has reduced its projected level of wages and salaries by $58 billion in 2008, by an average of $92 billion per year over the 2009–2012 period, and by an average of $123 billion per year over the 2013–2016 period. As a result of those changes, CBO has lowered its projections for income tax receipts by amounts that climb to $48 billion by 2016.

The results of technical changes to CBO's revenue outlook more than offset the effects of the weaker economic outlook projected for 2007 and 2008 but not in later years of the projection period. Stronger collections in recent months and the higher projected levels of capital gains realizations are the main components of the upward changes to projected receipts—$30 billion in 2007 and $38 billion in 2008—that derive from technical sources. Both of those effects are expected to taper off in later years of the projection period. The stronger tax collections suggest that certain taxable income is higher than currently indicated by available economic data, and CBO expects such taxable income to revert to longer-term averages over the projection period. Capital gains are also assumed to revert to their long-term equilibrium share relative to GDP.

CBO lowered its revenue projections by a relatively small amount—$13 billion over the 2007–2016 period—as a result of legislation enacted since the summer. Those reestimates mainly affect 2007 and 2008 and result from two-year extensions of certain expiring tax provisions in the Tax Relief and Health Care Act of 2006.

### Social Insurance Taxes

CBO projects that revenues from social insurance taxes will claim a roughly constant share of gross domestic product—6.4 percent—from 2007 to 2017 (see Table 4-4). In relation to wages and salaries, the approximate base of those payroll taxes, revenues are also projected to be relatively stable, declining from 14.1 percent in 2006 to 13.9 percent by 2008 and remaining almost constant thereafter. This pattern for social insurance taxes results from relatively slower growth in receipts from unemployment taxes, declines in the share of earnings below the taxable maximum amount for Social Security, and waning revenues for other federal retirement programs.

The largest components of payroll tax receipts are taxes for Social Security (called Old-Age, Survivors, and Disability Insurance, or OASDI) and Medicare's Hospital Insurance. A small share of social insurance tax revenues comes from unemployment insurance taxes and contributions to other federal retirement programs (see Table 4-5). The premiums for Medicare Part B (the Supplementary Medical Insurance program) and Part D (the new prescription drug program) are considered off-

**Table 4-6.**

## CBO's Projections of Corporate Income Tax Receipts and Tax Bases

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012[a] | Total, 2008-2017[a] |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Corporate Income Tax Receipts | | | | | | | | | | | | | | |
| In billions of dollars | 354 | 368 | 374 | 360 | 336 | 339 | 349 | 333 | 340 | 349 | 360 | 373 | 1,758 | 3,513 |
| As a percentage of GDP | 2.7 | 2.7 | 2.6 | 2.4 | 2.1 | 2.1 | 2.0 | 1.9 | 1.8 | 1.8 | 1.8 | 1.8 | 2.2 | 2.0 |
| Annual growth rate | 27.2 | 4.1 | 1.4 | -3.6 | -6.8 | 1.1 | 2.9 | -4.6 | 2.3 | 2.4 | 3.2 | 3.7 | -1.1 | 0.1 |
| Corporate Book Profits | | | | | | | | | | | | | | |
| In billions of dollars | 1,752 | 1,766 | 1,789 | 1,773 | 1,744 | 1,739 | 1,758 | 1,792 | 1,848 | 1,922 | 2,007 | 2,102 | 8,804 | 18,474 |
| As a percentage of GDP | 13.4 | 12.9 | 12.5 | 11.8 | 11.1 | 10.6 | 10.2 | 10.0 | 9.8 | 9.8 | 9.8 | 9.9 | 11.2 | 10.5 |
| Annual growth rate | 23.1 | 0.8 | 1.3 | -0.9 | -1.6 | -0.3 | 1.1 | 1.9 | 3.1 | 4.0 | 4.4 | 4.7 | -0.1 | 1.8 |
| Taxable Corporate Profits[b] | | | | | | | | | | | | | | |
| In billions of dollars | 1,380 | 1,350 | 1,339 | 1,291 | 1,234 | 1,198 | 1,186 | 1,186 | 1,204 | 1,238 | 1,282 | 1,336 | 6,247 | 12,493 |
| As a percentage of GDP | 10.6 | 9.9 | 9.4 | 8.6 | 7.8 | 7.3 | 6.9 | 6.6 | 6.4 | 6.3 | 6.3 | 6.3 | 7.9 | 7.1 |
| Annual growth rate | 23.6 | -2.1 | -0.8 | -3.6 | -4.4 | -2.9 | -1.0 | 0.0 | 1.6 | 2.8 | 3.6 | 4.2 | -2.6 | -0.1 |
| Corporate Receipts as a Percentage of Taxable Profits | 25.7 | 27.3 | 27.9 | 27.9 | 27.2 | 28.3 | 29.4 | 28.1 | 28.3 | 28.2 | 28.1 | 27.9 | 28.1 | 28.1 |

Source: Congressional Budget Office.

Notes: The tax bases in this table (corporate book profits and taxable corporate profits) reflect income as measured in the national income and product accounts rather than as reported on tax returns.

GDP = gross domestic product.

a. Measures expressed in billions of dollars are the cumulative amounts over the period. Measures expressed as a percentage of GDP or taxable profits are averages over the period. Measures expressed as annual growth rates are the average rates compounded annually over the period, including growth in 2008.

b. Taxable corporate profits are defined as book profits minus profits earned by the Federal Reserve System, transnational corporations, and S corporations and minus deductible payments of state and local corporate taxes. They include capital gains realized by corporations.

sets to spending and do not appear on the revenue side of the budget.

Social Security and Medicare taxes are calculated as a percentage of covered wages. Unlike the Medicare tax, which applies to all covered wages, the Social Security tax applies only up to a taxable maximum, which is indexed to the growth of wages over time. Consequently, receipts from OASDI taxes tend to remain fairly stable as a proportion of wages as long as covered wages are a stable percentage of GDP and the distribution of income from wages remains relatively unchanged. With the rising share of wages earned above the taxable maximum, the share of wages that is subject to the OASDI tax has declined in recent years.

Between 2007 and 2010, social insurance tax receipts are expected to decline to a slight degree as a fraction of wages and GDP for three reasons. First, receipts from payroll taxes for unemployment insurance—most of which are imposed by the states but yield amounts that are considered to be federal revenues—are projected to decline as a share of wages. (In 2006, all states but one had replenished their unemployment trust funds, which were depleted by the 2001 recession and the aftermath of recent floods and hurricanes.) Second, revenues associated with other federal retirement programs will decline over time as the number of workers covered by Railroad Retirement and the old Civil Service Retirement System declines. Third, the share of wages subject to Social Security tax decreases as a slightly higher fraction of total wage and salary income rises above the taxable maximum.

CBO expects that, with the exception of revenues associated with other federal retirement programs, those revenue sources as a fraction of GDP and of wages and salary income will begin to stabilize by 2010.

In contrast to its projections from August 2006, CBO now anticipates about $81 billion less in social insurance tax receipts for the 2007–2016 period. Changes in CBO's economic forecast—mainly lower projections of wages and salaries—account for $55 billion of that decline. Additional decreases of about $25 billion result from technical factors, primarily the effects in the projection period of new information indicating that amounts of covered wages subject to Social Security and Medicare taxes were lower in 2005 than previously estimated.

## Corporate Income Taxes

Receipts from corporate income taxes have grown sharply in the past three years—to $354 billion in 2006, 27 percent higher than the amount recorded in 2005 and more than 2.5 times higher than that recorded in 2003. As a share of gross domestic product, receipts from corporate income taxes totaled 2.7 percent in 2006, a level last seen in the 1970s. CBO projects that corporate tax revenues will increase by 4.1 percent in 2007, rising to $368 billion (see Table 4-6). However, because profits are expected to grow more slowly than GDP between 2007 and 2017, the sharp increase in receipts as a share of GDP that has been observed in the past three years is expected to reverse. Receipts will remain within about 10 percent of their 2007 level through 2017 in dollar terms, CBO projects, but will fall to 1.8 percent of GDP by 2017, levels similar to those seen in the early 1990s.

**Receipts in Recent Years.** Receipts from corporate income taxes—like those from individual income taxes—rose relative to the size of the economy in the 1990s, fell sharply between 2000 and 2003, and rebounded strongly in recent years (see Figure 4-3 on page 79). The recession in 2001 reduced profits and tax revenues substantially. Business tax incentives enacted in the Job Creation and Worker Assistance Act of 2002 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 further reduced revenues. Those incentives allowed firms to expense (immediately deduct from their taxable income) a portion of any investment made in equipment between September 11, 2001, and December 31, 2004. Prior to 2005, when they expired, those partial expensing provisions both reduced taxable corporate profits and tax payments and increased corporate refunds, thereby reducing net corporate tax receipts. By 2003, corporate receipts as a share of GDP fell to 1.2 percent, their lowest share since 1983. Especially strong profit growth since 2003, combined with expiration of the tax incentives, caused corporate receipts to rise to 2.7 percent of GDP by 2006, their highest share since 1978.

**Projected Receipts.** CBO's projection of corporate tax receipts largely follows its projection of book and taxable profits. The national income and product accounts measure book profits (also called profits before tax) by assuming that depreciation deductions generally follow the rules prescribed in tax law. For that and other reasons, book profits are the NIPA measure that most closely approximates the tax base for the corporate income tax (see Box 4-1 on page 84). CBO makes certain adjustments to book profits to generate a closer approximation of the tax base, called taxable corporate profits.

CBO projects that taxable corporate profits will decline between 2006 and 2012, stabilize in dollar terms, and then grow through 2017, although more slowly than GDP. As previously stated, that profit decline relative to GDP continues throughout the 10-year projection period and occurs for a variety of reasons. (For more detail on CBO's projection of profits, see Chapter 2.)

According to CBO's projections, corporate income tax receipts will rise in 2007 and 2008 even though taxable corporate profits will fall slightly. Much of that expected increase in the average tax rate on profits in 2007 is caused by the delayed effect of strong profits in calendar year 2006, which affects receipts in 2007 when firms file their income tax returns for the 2006 tax year and make the necessary final payments. In addition, some timing effects of the recapture of depreciation deductions taken under partial expensing through 2004 also boost receipts more than profits in 2007, CBO estimates. Furthermore, because of unexpectedly strong collections in the second half of calendar year 2006, some of which occurred in the first quarter of fiscal year 2007, CBO has boosted its projections of receipts for 2007. For the remaining three quarterly payments made by corporations in 2007, CBO expects payments to be near the level of the comparable payments in 2006, on average, consistent with the agency's forecast of profits for those quarters.

In 2008, expirations of tax provisions such as the research and experimentation tax credit contribute to a slight increase in the average tax rate.[4] In addition, increases in profitable firms' earnings relative to taxable corporate profits (which include the negative profits of firms in loss positions) contribute to increases in the average tax rate. Those effects are partially offset by the assumption that the unexpectedly strong collections seen recently will persist through 2007 and then gradually decline over the following three years, which alone would cause receipts to grow more slowly than profits in those years.

CBO expects that, after 2008, corporate tax receipts will move roughly in tandem with taxable corporate profits, with exceptions in specific years. In particular, the enactment in May 2006 of TIPRA results in single-year collection effects, including an additional $5 billion in 2011 collections arising from the initiation of a 3 percent withholding tax on payments made by certain government entities to contractors. That act also shifted corporate tax payment dates in a way that is expected to boost receipts by $14 billion in 2012 from payments that otherwise would have been made both before and after 2012.

As a result of a projected decline in profits as a share of the economy, CBO expects that corporate receipts relative to GDP will weaken steadily, reaching 1.8 percent of GDP between 2014 and 2017. That expected share at the end of the projection period is more in line with the level of receipts recorded in the early 1990s than with the higher amounts recorded in the late 1990s and in 2005 and 2006.

**Changes Since August 2006.** The new outlook for corporate tax receipts is higher by $264 billion over the 2007–2016 period than was estimated in CBO's August 2006 projection. About $176 billion of the increase stems from changes in the economic projection. Although GDP is now expected to be lower than projected in the summer, a higher expected profit share of GDP more than offsets the lower GDP and results in a stronger outlook for corporate profits—and, hence, corporate income tax receipts—throughout the projection period. CBO's updated projection for profits reflects lower estimates of businesses' interest and depreciation costs than were projected last summer.

Technical changes account for an additional $113 billion of CBO's projected increase in corporate tax revenues since the summer. Much of that increase results from higher estimates of corporate capital gains realizations for 2005 and 2006. CBO assumes that those increases will decline gradually over time as capital gains return to historical norms relative to GDP—the same assumption that CBO made for capital gains realized by individuals. In addition, CBO boosted its projections of receipts from 2007 through 2009 because of unexpectedly strong collections in the last four months of calendar year 2006. Recent legislation caused CBO to lower its projection of corporate receipts by $26 billion between 2007 and 2016, mostly because of the extension of the research and experimentation tax credit.

### Excise Taxes

Receipts from excise taxes are expected to continue their long-term decline as a share of GDP, falling from 0.6 percent in 2006 to 0.4 percent toward the end of the 10-year projection period. Most excise taxes—those generating about 80 percent of total excise revenues—are levied per unit of good or per transaction rather than as a percentage of value. Thus, excise receipts tend to grow with real GDP, but they do not rise with inflation and therefore do not grow as fast as nominal GDP does.

Nearly all excise taxes fall into one of four major categories: highway, airport, alcohol, or tobacco taxes (see Table 4-7). More than half of all excise receipts are from highway taxes, primarily on gasoline and diesel fuel. Under current law, those receipts are largely allocated to the Highway Trust Fund. Receipts from highway taxes are projected to remain stable over the 2007–2010 period, climbing by less than 0.3 percent per year, on average. CBO expects that drivers will increase their use of motor fuels—gasoline, ethanol, and diesel—at an average rate of 1.6 percent annually over that period. Receipts rise more slowly than motor fuel use does because a substantial portion of the increased fuel use is attributable to ethanol-blended fuels, which effectively face lower tax rates. Those lower tax rates are scheduled to expire on December 31, 2010, however, at which point ethanol-blended fuels will be taxed at the same rate as gasoline. As a result, highway tax receipts are projected to jump in 2011. Receipts that are transferred to the Highway Trust Fund are not affected by the change in the tax rates on

4. The Tax Relief and Health Care Act of 2006 extended, among other provisions, the research and experimentation tax credit through December 31, 2007, and applied it retroactively to qualifying expenditures made after December 31, 2005.

**Table 4-7.**

## CBO's Projections of Excise Tax Receipts, by Category

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Highway | 37.3 | 37.3 | 37.0 | 37.3 | 37.7 | 42.4 | 44.6 | 45.4 | 46.2 | 46.9 | 47.7 | 48.5 | 199.0 | 433.7 |
| Airport | 10.8 | 11.4 | 12.1 | 12.8 | 13.5 | 14.1 | 14.8 | 15.6 | 16.3 | 17.1 | 17.9 | 18.8 | 67.3 | 153.0 |
| Telephone | 5.0 | -11.0 | -1.3 | 0.5 | 0.2 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | -0.3 | 0.4 |
| Alcohol | 8.8 | 9.0 | 9.2 | 9.5 | 9.7 | 9.9 | 10.2 | 10.4 | 10.7 | 10.9 | 11.2 | 11.5 | 48.5 | 103.2 |
| Tobacco | 8.7 | 8.5 | 8.4 | 8.4 | 8.3 | 8.2 | 8.1 | 8.0 | 8.0 | 7.9 | 7.8 | 7.7 | 41.4 | 80.8 |
| Other Excise | 3.3 | 3.4 | 3.4 | 3.5 | 3.5 | 3.6 | 3.6 | 3.6 | 3.4 | 3.4 | 3.4 | 3.4 | 17.6 | 34.8 |
| **Total** | **74.0** | **58.7** | **68.9** | **71.9** | **72.9** | **78.4** | **81.5** | **83.2** | **84.7** | **86.3** | **88.1** | **90.0** | **373.6** | **805.9** |

Source: Congressional Budget Office.

ethanol-blended fuels because the lower rates only reduce revenues to the general fund.

The airport excise taxes are levied mainly on a percentage basis (usually of ticket prices), so they grow at a faster rate than the other categories do, increasing by an average of 5.1 percent annually between 2006 and 2017. Receipts from alcohol taxes are projected to rise at a little less than the rate of real GDP over the projection period, or by about 2.4 percent annually. Receipts from tobacco taxes are projected to decline by a little more than 1 percent per year as per capita consumption continues to trend downward.

Until recently, the telephone tax had also been one of the major sources of excise tax receipts. In May 2006, after several successful challenges to the validity of elements of the tax in U.S. courts, the IRS opted to cease collecting parts of the telephone excise tax, effective August 1, 2006 (see Box 4-3 for further details). In addition, the IRS plans to refund, with interest, revenue collected under those portions of the telephone tax since April 2003. The refunds—which CBO forecasts will total approximately $13 billion in 2007 and $2 billion in 2008—will offset excise revenue, leading to a substantial drop in the level of overall excise tax receipts in 2007. In light of those decisions and ongoing developments in the communications industry that relieve progressively more telephone services of an excise tax liability, CBO expects telephone excise tax revenue to dwindle quickly to roughly 3 percent of its 2006 level, or less than $150 million annually after 2011.

CBO's current projection of total excise tax receipts for the 2007–2016 period is about $11 billion lower than the estimate it published in August. Changes in CBO's economic forecast increased last August's projection by $4 billion, which, because of technical adjustments, was offset by a decrease of $15 billion over the 2007–2016 period. CBO has lowered its projection for oil prices, which resulted in a higher projection of motor fuels consumption and tax receipts. Decreases in receipts that were attributable to technical changes stemmed from the following factors: Consumption of lower-taxed ethanol blends made up a greater estimated share of fuel consumption; new modeling of the responsiveness of diesel fuel consumption to price yielded updated results; and, on the basis of the IRS's recent announcement about the size of refunds allowed to different types of taxpayers, the forecast of telephone tax refunds was increased.

### Estate and Gift Taxes

If provisions of current law remain in place, CBO projects that receipts from estate and gift taxes will fall from 0.2 percent of GDP in 2006 to 0.1 percent in 2010 and 2011, and then jump to 0.3 percent of GDP in 2012 and nearly 0.4 percent of GDP by 2017. That pattern reflects the phaseout of the estate tax through 2010 as provided by EGTRRA and the subsequent reinstatement of the tax in 2011.

In the past, revenues from estate and gift taxes tended to grow more rapidly than income because the unified credit for the two taxes, which effectively exempts some assets from taxation, is not indexed for inflation. However, under EGTRRA, the estate tax is gradually being

**Box 4-3.**

## Reduced Receipts and Refunds of Telephone Taxes

The telephone excise tax, which raised about $6 billion in revenue each year from 2000 to 2005, is projected to subtract from net receipts in 2007 and 2008 and, thereafter, to raise minimal amounts of revenue. That outlook results because in May 2006, after several successful court cases challenging the validity of parts of the tax, the Internal Revenue Service (IRS) decided to stop collecting telephone excise taxes imposed on long-distance toll calls that were not billed on the basis of both call time and distance. Effective in August 2006, that change covers the vast majority of long-distance phone calls. In addition, the IRS ceased collecting taxes on all telecommunications services "bundled"—or billed as a single item—with such long-distance service. That category includes wireless phone plans (which typically base their prices on minutes of call time, regardless of call distance), certain Internet services, and an increasing number of local phone services in packages that offer multiple telecommunications services covered by one bill.

Furthermore, the IRS plans to refund, with interest, revenue collected since April 2003 under those portions of the telephone tax. Taxpayers may obtain a refund of all telephone tax amounts either by determining from past phone bills the taxes they actually paid or by simply opting to take the IRS's offered "safe harbor" amount, which may be obtained without any documentation. Those safe harbor amounts will vary from $30 to $60 on the basis of the number of personal exemptions claimed by taxpayers on their income tax returns. Individuals will be able to file for the refund on their 2006 income tax returns, which are due to the IRS generally by April 16, 2007. Businesses will be able to claim their refunds on the basis of the number of people they employ and a formula considering the average of two months of phone bills from 2006.

As a result of the changes to the telephone tax, CBO has significantly reduced its projection of telephone excise tax revenue. CBO estimates that the Treasury Department will provide refunds (excluding interest) to taxpayers of approximately $13 billion in 2007 and $2 billion in 2008. Of the total $15 billion in refunds, CBO estimates that $10 billion will be paid to individual taxpayers and $5 billion to businesses, tax-exempt organizations, and public entities. (Businesses will have to claim their refunds as taxable income if they had claimed the telephone taxes as income tax deductions.) CBO also expects that the new tax incentives and the state of communications technology will combine to contract the telephone tax's main remaining tax base—unbundled local service—so that revenue from the telephone tax amounts to only about 3 percent of its 2005 level (or about $130 million) by 2017.

eliminated (albeit temporarily), and the gift tax remains in the tax code but in a modified form. EGTRRA effectively exempted $2.0 million of an estate from taxation in 2006. That amount is scheduled to increase to $3.5 million in 2009. Under EGTRRA, the highest tax rate on estates was reduced incrementally from 50 percent in 2002 to 45 percent in 2007; the tax itself is scheduled to be eliminated in 2010. That year, the gift tax rate is slated to be 35 percent, its lowest rate over the projection period. The law is currently set to reinstate the estate and gift tax at pre–EGTRRA levels in 2011.

Because estate tax liabilities are typically paid after a lag of almost a year, and because the gift tax remains in the tax code, receipts from estate and gift taxes do not disappear completely from CBO's projection but instead reach a trough in 2010 and 2011 (see Table 4-8). The expected receipts in 2011 result largely from taxable gifts that people bestow in 2010 because of the relatively low rate and the legislated reinstatement of the estate tax in 2011. Those gifts would otherwise have been given in earlier or later years and therefore affect the pattern of receipts throughout the 2007–2017 period. CBO estimates that after 2011, estate and gift tax receipts will return to roughly the same share of GDP as that seen in the early

**Table 4-8.**

## CBO's Projections of Other Sources of Revenue

(Billions of dollars)

| | Actual 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Estate and Gift Taxes | 28 | 24 | 25 | 26 | 21 | 22 | 50 | 56 | 62 | 67 | 73 | 79 | 144 | 480 |
| Customs Duties | 25 | 26 | 28 | 29 | 32 | 34 | 35 | 38 | 40 | 43 | 46 | 50 | 158 | 375 |
| Miscellaneous Receipts | | | | | | | | | | | | | | |
| Federal Reserve System earnings | 30 | 32 | 36 | 38 | 40 | 42 | 43 | 45 | 47 | 49 | 51 | 53 | 200 | 446 |
| Universal Service Fund | 8 | 8 | 9 | 9 | 9 | 10 | 10 | 10 | 10 | 10 | 10 | 10 | 46 | 97 |
| Other | 7 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 6 | 30 | 61 |
| Subtotal | 44 | 47 | 52 | 53 | 55 | 57 | 59 | 61 | 63 | 65 | 68 | 70 | 276 | 603 |
| **Total** | **97** | **97** | **104** | **109** | **108** | **113** | **144** | **155** | **165** | **176** | **186** | **198** | **578** | **1,459** |

Source: Congressional Budget Office.

1970s. Receipts as a share of GDP exceed the levels seen immediately before the enactment of EGTRRA mostly because the exemption levels are not indexed for inflation and individuals' wealth has grown faster than inflation in recent years.

### Other Sources of Revenue

Customs duties and miscellaneous sources of revenue yielded only about 3 percent of total revenues in 2006, or about 0.5 percent of GDP. CBO estimates that those sources will remain relatively stable as a share of GDP through 2017.

CBO projects that customs duties will grow over time in tandem with imports. Because the value of imports is projected to grow slightly faster than GDP over the projection period, customs duties will tend to rise slightly relative to GDP. Projections of customs duties over the 2007–2016 period are about $22 billion higher than CBO estimated in its August projections. New analysis indicates that most of the effects of enacted free-trade agreements have been fully phased in, so CBO now projects that the average tariff rate on imports will remain relatively stable rather than falling slightly over the projection period.

Profits of the Federal Reserve System—the largest component of miscellaneous receipts—are counted as revenues when they are remitted to the Treasury. Those profits depend on interest that the Federal Reserve earns on its portfolio of securities and on gains and losses from its holdings of foreign currency. Remittances to the Treasury also depend on the amount that is retained by the Federal Reserve in its surplus account and the amount paid in dividends to member banks. Rising interest rates and other factors affecting earnings in 2005 resulted in a jump of more than 30 percent in reported net income that year. However, in 2004 and 2005, bank merger activity also dampened revenues because the Federal Reserve retained more of its earnings in its surplus account. Receipts in 2006 were much more robust because of further increases in interest rates and the waning of the merger activity that caused retention of Federal Reserve earnings.

CBO expects that, on average, short- and long-term interest rates will remain relatively stable over the 2007–2017 period. As a result, receipts from the Federal Reserve System will rise at nearly the same rate as GDP, roughly the rate at which CBO expects the Federal Reserve's portfolio of securities to increase.

Since August, CBO has decreased its projection of receipts from the Federal Reserve for the 2007–2016 period by about $6 billion. To comply with new accounting rules for pension funding, remittances to the Treasury for the first quarter of 2007 were depressed by about $2 billion. Additional downward revisions in the baseline primarily result from lower interest rate projections over the 2007–2009 period, although lower projected levels of

**Table 4-9.**

## Changes in CBO's Projections of Revenues Since August 2006

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Total, 2007-2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenues in CBO's August 2006 Baseline | 2,515 | 2,672 | 2,775 | 2,890 | 3,156 | 3,398 | 3,555 | 3,733 | 3,922 | 4,118 | 32,733 |
| Legislative Changes | -16 | -11 | -4 | -3 | -2 | -1 | -1 | -1 | -1 | -1 | -42 |
| Other Changes | | | | | | | | | | | |
| Economic | -13 | -6 | 3 | -5 | -12 | -16 | -26 | -34 | -42 | -50 | -201 |
| Technical | 57 | 65 | 36 | 19 | 25 | 24 | 22 | 20 | 17 | 17 | 300 |
| Subtotal | 43 | 59 | 39 | 14 | 13 | 8 | -4 | -15 | -25 | -33 | 99 |
| **Total Changes** | **28** | **48** | **34** | **11** | **11** | **7** | **-5** | **-16** | **-26** | **-34** | **57** |
| Revenues in CBO's January 2007 Baseline | 2,542 | 2,720 | 2,809 | 2,901 | 3,167 | 3,404 | 3,550 | 3,717 | 3,896 | 4,084 | 32,790 |

Source: Congressional Budget Office.

currency and reserves also contribute to the decreases. After 2011, newly enacted legislation—the Financial Services Regulatory Relief Act of 2006—allows the Federal Reserve to pay interest on reserves, which CBO projects will lower receipts by about $2 billion through 2016.

Upward technical revisions in other miscellaneous receipts made since August—mostly to the Universal Service Fund—total about $3 billion between 2007 and 2016. Downward revisions to receipts from countervailing and antidumping duties temporarily reduce the projection of other miscellaneous receipts in 2007 and 2008.

## Changes in CBO's Revenue Projections Since August 2006

CBO's current revenue projections broadly adhere to those that the agency published in August 2006. For the 2007–2016 period, CBO has increased its projections by $57 billion, or less than 0.2 percent, compared with its projection of last summer (see Table 4-9). That net change is attributable to a number of different factors. CBO has reduced its projection for the 10-year baseline period by $201 billion (or 0.6 percent) as a result of changes in the economic outlook, in particular the agency's lower projections for GDP and taxable income, especially wages and salaries. However, CBO has raised its revenue projections by $300 billion (or 0.9 percent) over the 10 years as a result of technical changes, which measure how CBO has adjusted its projection of the amount of revenue that a given economic forecast yields. Changes resulting from legislation enacted since the summer were relatively small, reducing projected receipts by $42 billion, largely over the first several years of the 10-year projection period.

Changes to CBO's revenue projections for the near term are dominated by technical revisions. Because of higher-than-anticipated collections since August and increased estimates of capital gains realizations, CBO has increased its projections for both individual and corporate income tax receipts. For technical reasons, CBO has raised its projections of total receipts by $57 billion in 2007 and $65 billion in 2008 but by smaller and generally declining amounts in subsequent years. The higher-than-expected collections indicate that certain types of taxable income are stronger than currently indicated by available economic data. CBO expects such income to revert to longer-term historical averages, thus building into the forecast the assumption that the unexpectedly high collections will persist for a year or two and then decline over the projection period. CBO makes the same general assumption for capital gains realizations because, in the past, they have tended to return to historical averages (which vary according to the tax rates in effect). CBO increased its projection for 2016 by $17 billion largely

because of revised expectations for capital gains; new information from individual income tax returns for 2004, which led CBO to raise its projections by relatively small and growing amounts; and increases in effective tariff rates.

CBO's economic projection incorporates the assumption of slower economic growth in the first half of calendar year 2007 and a slight reduction in the longer-term potential growth rate of the economy. That has caused CBO to reduce its revenue projections by $13 billion in 2007 and by $6 billion in 2008 and, following a small increase of $3 billion in 2009, by $185 billion over the 2010–2016 period. CBO now projects that nominal GDP will be lower throughout the projection period than projected in last August's outlook, on average by 1.6 percent. Taxable personal income—especially wages and salaries, the highest-taxed income category—is projected to be lower by 1.2 percent. CBO has increased its projection of book profits throughout the projection period, and that change partially offsets the lower revenues from taxes on personal income, most significantly from 2009 to 2010.

Legislation enacted since August has had a smaller effect on the revenue projection, reducing receipts by $42 billion over the 2007–2016 period, with almost two-thirds of that reduction occurring in 2007 and 2008. Nearly all of the revenue effects—$40 billion in lower receipts over the 10-year period—are attributable to the enactment of the Tax Relief and Health Care Act of 2006. That legislation extended and expanded a variety of expiring tax provisions, altered rules for health savings accounts, and made various changes to trade law. The legislation suspended or reduced duties on specific products, extended and altered multiple trade preference programs, and permitted the President to grant permanent normal trade relations with Vietnam. Most of the remaining revenue effects resulted from enactment of the Financial Services Regulatory Relief Act of 2006, which, starting in 2012, permits the Federal Reserve Board to pay interest on reserves out of earnings that it would otherwise pay to the federal treasury.

## The Effects of Expiring Tax Provisions

CBO's revenue projections are based on the assumption that current tax laws will remain unaltered. Thus, the projections assume that provisions currently scheduled to expire will do so. The one exception applies to the expiration of excise taxes that are dedicated to trust funds; under the rules governing the baseline, those taxes are assumed to continue regardless of whether they are scheduled to expire.

The expiration of tax provisions as scheduled has a substantial impact on CBO's projections, especially beyond 2010 when a number of revenue-reducing tax provisions enacted in the past several years are slated to expire. Some of those provisions were enacted many years ago and have been routinely extended. Almost all of the expiring provisions reduce revenues. If the expiring provisions were extended rather than allowed to expire, future revenues would be significantly lower than under the baseline projections that assume current law. This section provides a list of the various tax provisions whose expiration is reflected in CBO's baseline, along with estimates of the revenue effects of extending those provisions (see Table 4-10 on page 102). Most of the revenue effects are based on estimates supplied by the Joint Committee on Taxation (JCT).[5]

The revenue estimates associated with the extensions cited in this section do not include the provisions' potential effects on the macroeconomy. In many instances, macroeconomic feedbacks would be too small to have a substantial effect on the estimates. However, some expiring provisions influence labor supply and economic growth in CBO's baseline economic projection. The full "dynamic" revenue effect of extending various tax provisions would differ from the estimates presented in this section.

5. When this report went to press, JCT's estimates based on the new economic projections were unavailable for certain provisions, including extending various EGTRRA and JGTRRA individual income tax provisions that are scheduled to expire at the end of 2010 and changes to the exemption amount under the alternative minimum tax that expired at the end of 2006. CBO has adjusted JCT's estimates from last year (which were based on CBO's baseline projections from a year ago) to take into account the effects of CBO's updated economic projection; CBO has also extended those results to 2017, the new final year of the projection period. Those adjustments by CBO reduced the estimated loss in revenues from extending the EGTRRA provisions by less than 0.5 percent and from extending the AMT exemption by about 2 percent over the projection period. CBO will make JCT's updated estimates available when they are completed.

### Provisions Scheduled to Expire During the Projection Period

From a budgetary perspective, the most significant expiring provisions are the tax provisions originally enacted in EGTRRA and JGTRRA, as amended by WFTRA, TIPRA, and the Tax Relief and Health Care Act of 2006 (TRHCA). An increased exemption level designed to mitigate the effect of the AMT expired at the end of 2006. The deduction for tuition and other higher-education expenses is scheduled to expire at the end of 2007. The higher level of expensing for investment that is allowed for small businesses expires at the end of 2009. At the end of 2010, a number of provisions that collectively have the most significant budgetary effects are set to expire: reduced tax rates on dividends, capital gains, and ordinary income; a higher child credit; elimination of the estate tax; and an expanded standard deduction and size of the 15 percent tax bracket for married couples. Assuming that those expiring provisions originally enacted in EGTRRA and JGTRRA are extended, CBO and JCT estimate that budgetary surpluses (excluding debt-service effects) would be reduced by about $2.8 trillion from 2007 through 2017. (Those amounts include about $2.7 trillion in lower revenues and $100 billion in higher outlays, excluding debt service.)[6] Over 90 percent of that budgetary effect would occur between 2011 and 2017.

Those estimates of the effects of extending expiring provisions incorporate the assumption that the temporarily higher exemption levels for the AMT would be extended at their 2006 levels. Under that assumption, the exemption levels would not rise with inflation, so a growing number of taxpayers would still become subject to the AMT over time—albeit fewer than if the higher exemption levels were not extended. (See Table 1-5 on page 16 for the budgetary effects of selected policy alternatives not included in CBO's baseline, including the effects of reforming the alternative minimum tax by indexing its higher exemptions and its tax brackets for inflation. That policy change would reduce the number of taxpayers that might become subject to the AMT over time by more than extending the AMT's exemptions at their 2006 levels.)

Another 89 provisions not initially enacted in EGTRRA or JGTRRA are also scheduled to expire between 2007 and 2017; of those, all but four would reduce revenues if extended. Extending the 85 revenue-reducing provisions would decrease receipts by about $425 billion between 2007 and 2017. The provision with the largest effect is the research and experimentation tax credit, which was enacted in 1981 and extended (for the 11th time) through the end of 2007 in TRHCA. Continuing the credit would reduce revenues by about $85 billion over the 2008–2017 period, JCT estimates. The exemption for certain active financing income from the Subpart F rules of the tax law expires at the end of 2008; extending that provision would reduce revenues by $48 billion through 2017. Extending the deduction allowed for state and local general sales taxes, which was enacted in the American Jobs Creation Act of 2004 (AJCA) and extended in TRHCA through 2007, would reduce revenues by $30 billion through 2017, if extended. A new refundable credit allowed for past liabilities under the alternative minimum tax, enacted in TRHCA, expires at the end of 2012. If it is extended, JCT estimates that decreases in revenues and increases in outlays (from refundable credits) would combine to decrease budget surpluses by $1.1 billion, excluding the effects on debt service.

Conversely, four expiring provisions would increase revenues if they were extended. The provision with the largest effect is the Federal Unemployment Tax Act surcharge, which expires on December 31, 2007. Extending it would increase revenues by about $15 billion over the next 10 years, CBO estimates. The other provisions include assessing an excise tax on diesel fuel used for trains and fuel used in barges; allowing employers to transfer excess assets in defined-benefit pension plans to a special account for retirees' health benefits; and allowing the IRS to impose fees on businesses for providing ruling, opinion, and determination letters. Those last three provisions, if extended, would raise about $1 billion altogether through 2017.

### Expiring Provisions That Are Included in CBO's Baseline

Rules enacted in the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, require CBO to include in its projections excise tax receipts earmarked for trust funds, even if those taxes are scheduled to expire. The largest such taxes that are slated to expire over the

6. The outlay effects result from refundable tax credits. Such credits reduce a taxpayer's overall tax liability; if the credit exceeds that liability, the excess may be refunded, in which case it is classified as an outlay in the federal budget.

next 10 years finance the Highway Trust Fund. Some of the taxes for that fund are permanent, but most of them end on September 30, 2011. Extending those taxes contributes about $41 billion to CBO's revenue projections in 2017, or about 45 percent of that year's total excise tax receipts.

Extending other expiring taxes dedicated to trust funds contributes smaller amounts of revenue to CBO's baseline projections in 2017. Taxes dedicated to the Airport and Airway Trust Fund, which are scheduled to expire at the end of September 2007, contribute about $18 billion to revenues in 2017. Taxes for the Leaking Underground Storage Tank Trust Fund, set to end in 2011, add about $300 million to revenues in 2017. The assessment on tobacco manufacturers enacted in AJCA expires on September 30, 2014. Because the receipts from that assessment are dedicated to the Tobacco Trust Fund, baseline rules require CBO to assume that the assessment is extended, which adds $1 billion to revenues in 2017. Finally, the tax on domestic and imported petroleum that is dedicated to the Oil Spill Liability Trust Fund, which was suspended in the early 1990s and then reinstated in the Energy Policy Act of 2005, is set to expire on December 31, 2014. Extending the tax would increase revenues by about $300 million in 2017. No other expiring tax provisions are automatically extended in CBO's baseline.

### Total Effect of Expiring Provisions

If all of the tax provisions that are scheduled to expire were collectively extended, projected levels of revenues would be lower by about $12 billion in 2007 and $68 billion in 2008 (including effects on refundable credits). That loss would grow to $97 billion in 2010, before jumping to $374 billion in 2012 and then reaching $512 billion in 2017. For the entire period from 2008 to 2017, revenues would be reduced by about $3.2 trillion. That estimate includes interactions between extending the higher exemption levels for the AMT and the provisions of EGTRRA and JGTRRA that affect individual income taxes.

## Table 4-10.

# Effect of Extending Tax Provisions Scheduled to Expire Before 2017

(Billions of dollars)

| Tax Provision | Expiration Date | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Provisions That Expired in 2006** | | | | | | | | | | | | | | |
| Credit for Qualified Electric Vehicles | 12/31/06 | * | * | * | * | * | * | * | * | * | * | * | * | * |
| Depreciation for Clean-Fuel Automobiles | 12/31/06 | * | * | * | * | * | * | * | * | * | * | * | * | -0.1 |
| Excise Tax on Fuel for Trains and Barges | 12/31/06 | ** | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.3 | 0.6 |
| Increased AMT Exemption | 12/31/06 | -8.8 | -55.3 | -52.8 | -60.7 | -50.5 | -30.5 | -35.5 | -41.4 | -48.0 | -54.8 | -62.5 | -249.7 | -492.0 |
| Rules for Taxing Certain Life Insurance Dividends | 12/31/06 | * | * | * | * | * | * | * | * | * | * | * | * | * |
| Treatment of Nonrefundable Personal Credits Under the AMT | 12/31/06 | -0.1 | -0.5 | -0.5 | -0.7 | -0.7 | -0.5 | -0.7 | -0.8 | -1.1 | -1.3 | -1.6 | -3.0 | -8.5 |
| Hurricane Relief Provisions | various [a] | -2.3 | -2.3 | -2.8 | -2.8 | -3.3 | -3.5 | -3.6 | -3.7 | -3.9 | -4.0 | -4.1 | -14.7 | -34.0 |
| Tax Incentives for Areas of New York City Damaged on 9/11 | various [b] | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -1.5 | -2.4 |
| **Provisions That Expire Between 2007 and 2017** | | | | | | | | | | | | | | |
| Andean Trade Preference Initiative | 6/30/07 | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.3 | -0.7 |
| American Samoa Economic Development Credit | 12/31/07 | n.a. | * | * | * | * | * | * | * | * | * | * | -0.1 | -0.2 |
| Archer Medical Savings Accounts | 12/31/07 | n.a. | * | * | * | * | * | * | * | * | * | * | * | * |
| Basis Adjustment of S Corporate Stock for Donations | 12/31/07 | ** | * | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.5 |
| Brownfields Remediation Expensing | 12/31/07 | n.a. | -0.2 | -0.4 | -0.4 | -0.4 | -0.3 | -0.3 | -0.3 | -0.3 | -0.2 | -0.2 | -1.7 | -3.0 |
| Combat Pay in Earned Income for Refundable Credits | 12/31/07 | n.a. | 0 | * | * | * | * | * | * | * | * | * | * | -0.1 |
| Contributions of Book Inventory | 12/31/07 | n.a. | * | * | * | * | * | * | * | * | * | -0.1 | -0.1 | -0.4 |
| Contributions of Food Inventory | 12/31/07 | n.a. | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -1.0 | -2.0 |
| Contributions of Real Property for Conservation Purposes | 12/31/07 | n.a. | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.3 | -0.8 |

Continued

## Table 4-10.

## Continued

(Billions of dollars)

| Tax Provision | Expiration Date | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Provisions That Expire Between 2007 and 2017 (Continued)** | | | | | | | | | | | | | | |
| Corporate Contributions of Computers to Schools | 12/31/07 | n.a. | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.3 | -0.3 | -1.0 | -2.2 |
| Credit for Certain Nonbusiness Energy Property | 12/31/07 | n.a. | -0.1 | -0.3 | -0.4 | -0.4 | -0.4 | -0.5 | -0.5 | -0.5 | -0.5 | -0.5 | -1.6 | -4.0 |
| Credit for Maintaining Railroad Tracks | 12/31/07 | n.a. | -0.1 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.7 | -1.6 |
| Credit for Research and Experimentation | 12/31/07 | n.a. | -2.7 | -4.9 | -6.1 | -7.4 | -8.7 | -9.8 | -10.5 | -11.0 | -11.6 | -12.1 | -29.8 | -84.9 |
| Deduction for Domestic Production in Puerto Rico | 12/31/07 | n.a. | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.3 | -0.3 | -0.7 | -1.9 |
| Deduction for Private Mortgage Insurance | 12/31/07 | n.a. | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | ** | 0.1 | 0.1 | 0.2 | -0.5 | -0.3 |
| Deduction for Qualified Education Expenses | 12/31/07 | n.a. | -0.3 | -1.3 | -1.4 | -1.4 | -1.4 | -1.3 | -1.3 | -1.2 | -1.1 | -1.0 | -5.7 | -11.6 |
| Deduction for Teachers' Classroom Expenses | 12/31/07 | n.a. | * | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.8 | -1.9 |
| Deduction of State and Local Sales Taxes | 12/31/07 | n.a. | -0.3 | -1.8 | -2.1 | -2.4 | -3.8 | -3.9 | -3.9 | -3.9 | -4.0 | -4.0 | -10.4 | -30.1 |
| Depreciation for Business Property on Indian Reservations | 12/31/07 | n.a. | -0.1 | -0.4 | -0.4 | -0.4 | -0.4 | -0.3 | -0.2 | -0.2 | -0.1 | 0.2 | -1.8 | -2.4 |
| Depreciation of Leasehold and Restaurant Equipment | 12/31/07 | n.a. | -0.1 | -0.4 | -0.7 | -1.1 | -1.4 | -1.8 | -2.1 | -2.5 | -2.9 | -3.3 | -3.7 | -16.2 |
| Depreciation Period for Motor Tracks | 12/31/07 | n.a. | * | * | * | * | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.4 |
| Dispositions of Electric Transmission Property | 12/31/07 | -0.1 | -0.3 | -0.3 | -0.3 | -0.2 | -0.2 | -0.2 | -0.2 | -0.1 | * | -0.1 | -1.3 | -1.8 |
| Dividends of Mutual Funds | 12/31/07 | n.a. | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.3 | -0.8 |
| FUTA Surtax of 0.2 Percentage Points | 12/31/07 | n.a. | 1.0 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.5 | 1.6 | 1.6 | 7.0 | 14.7 |
| Indian Employment Tax Credit | 12/31/07 | n.a. | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.3 | -0.6 |
| Net Income Limitation for Marginal Oil and Gas Wells | 12/31/07 | n.a. | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.5 | -1.0 |
| Parity in Mental Health Benefits | 12/31/07 | n.a. | * | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.5 |

Continued

## Table 4-10.

## Continued

(Billions of dollars)

| Tax Provision | Expiration Date | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Provisions That Expire Between 2007 and 2017 (Continued)** | | | | | | | | | | | | | | |
| Payments to Controlling Exempt Organizations | 12/31/07 | n.a. | * | * | * | * | * | * | * | * | * | * | -0.1 | -0.3 |
| Qualified Mortgage Bonds for Veterans' Residences | 12/31/07 | n.a. | * | * | * | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.3 |
| Qualified Zone Academy Bonds | 12/31/07 | n.a. | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 | -0.1 | -0.8 |
| Rum Excise Tax Revenue to Puerto Rico and the Virgin Islands | 12/31/07 | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.4 | -0.9 |
| Synthetic or Biomass Fuel Credit | 12/31/07 | n.a. | -4.2 | -4.5 | -4.7 | -4.9 | -5.1 | -5.3 | -5.4 | -5.5 | -5.6 | -5.3 | -23.5 | -50.5 |
| Tax Incentives for Investment in the District of Columbia | 12/31/07 | n.a. | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.5 | -1.4 |
| Tax-Free Distributions from Retirement Plans for Donations | 12/31/07 | n.a. | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.8 | -2.2 |
| Withdrawals from Retirement Plans for Military Personnel | 12/31/07 | n.a. | * | * | * | * | * | * | * | * | * | * | * | * |
| Work Opportunity and Welfare-to-Work Credit | 12/31/07 | n.a. | -0.1 | -0.4 | -0.5 | -0.6 | -0.7 | -0.7 | -0.8 | -0.8 | -0.8 | -0.9 | -2.3 | -6.4 |
| Caribbean Basin Trade Partnership Act | 9/30/08 | n.a. | n.a. | * | * | * | * | * | * | * | * | * | -0.1 | -0.2 |
| Biodiesel Credits | 12/31/08 | n.a. | n.a. | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.5 | -1.6 |
| Carryback Period for Electric Utility Companies | 12/31/08 | n.a. | n.a. | n.a. | -0.1 | * | * | * | * | * | * | * | -0.1 | -0.3 |
| Credit for Business Solar Energy Property | 12/31/08 | n.a. | n.a. | * | -0.1 | * | * | * | * | * | * | * | -0.2 | -0.4 |
| Credit for Electricity Produced from Renewable Resources | 12/31/08 | n.a. | n.a. | -0.2 | -0.6 | -1.2 | -1.7 | -2.0 | -2.4 | -2.9 | -3.4 | -3.5 | -3.6 | -17.9 |
| Credit for Energy Efficient Appliances | 12/31/08 | n.a. | * | * | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | * | * |
| Credit for Energy Efficient Homes | 12/31/08 | n.a. | n.a. | * | * | * | * | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.4 |
| Credit for Residential Solar and Fuel Cells | 12/31/08 | n.a. | n.a. | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.2 | -0.6 |
| Deduction for Energy Efficient Commercial Buildings | 12/31/08 | n.a. | n.a. | -0.1 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.7 | -1.7 |

Continued

## Table 4-10.

## Continued

(Billions of dollars)

| Tax Provision | Expiration Date | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Provisions That Expire Between 2007 and 2017 (Continued)** | | | | | | | | | | | | | | |
| Expensing of Advanced Mine Safety Equipment | 12/31/08 | n.a. | n.a. | * | * | * | * | * | * | * | * | * | -0.1 | -0.1 |
| Expensing of Film and TV Productions | 12/31/08 | n.a. | n.a. | * | -0.1 | -0.1 | -0.1 | * | * | * | * | * | -0.3 | -0.4 |
| Generalized System of Preferences | 12/31/08 | n.a. | n.a. | -0.6 | -0.8 | -0.8 | -0.9 | -0.9 | -1.0 | -1.0 | -1.1 | -1.2 | -3.0 | -8.2 |
| Mine Rescue Team Training Credit | 12/31/08 | n.a. | * | * | * | * | * | * | * | * | * | * | * | * |
| New Markets Tax Credit | 12/31/08 | n.a. | n.a. | -0.1 | -0.3 | -0.4 | -0.6 | -0.8 | -1.0 | -1.2 | -1.3 | -1.3 | -1.5 | -7.2 |
| Payments Between Related Controlled Foreign Corporations | 12/31/08 | n.a. | n.a. | -0.1 | -0.4 | -0.5 | -0.5 | -0.6 | -0.6 | -0.7 | -0.7 | -0.8 | -1.5 | -4.8 |
| Qualified Methanol or Ethanol Fuel from Coal | 12/31/08 | n.a. | n.a. | * | * | * | * | * | * | * | * | * | * | * |
| Renewable Energy Bonds | 12/31/08 | n.a. | n.a. | * | * | * | * | * | * | * | * | * | * | * |
| Subpart F for Active Financing Income | 12/31/08 | n.a. | n.a. | -1.0 | -4.0 | -4.6 | -5.1 | -5.6 | -6.1 | -6.8 | -7.2 | -7.7 | -14.7 | -48.1 |
| Tax Incentives for Alternative Fuels | various [c] | n.a. | n.a. | n.a. | -0.2 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.3 | -0.8 | -2.3 |
| Trade Preferences for Haitian Woven Apparel | 12/19/09 | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * | * |
| Additional IRA Contributions in Bankruptcy | 12/31/09 | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * | -0.1 |
| Alternative Fuel Vehicle Refueling Property | 12/31/09 | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * | * |
| Credit for Certain Diesel Fuel Production | 12/31/09 | n.a. | n.a. | n.a. | * | * | * | * | * | 0 | 0 | 0 | * | * |
| Credit for Coke Production | 12/31/09 | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * | -0.2 |
| Empowerment and Community Renewal Zone Incentives | 12/31/09 | n.a. | n.a. | n.a. | -0.5 | -1.2 | -1.3 | -1.5 | -1.5 | -1.6 | -1.8 | -1.9 | -3.0 | -11.3 |
| Exclusion of Gain on Brownfield Transactions | 12/31/09 | n.a. | n.a. | ** | ** | ** | ** | * | -0.1 | -0.1 | -0.1 | -0.1 | ** | -0.3 |
| Hybrid Heavy Truck Credit | 12/31/09 | n.a. | n.a. | n.a. | * | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.2 | -0.4 | -1.2 |
| Qualified Green Building Bonds | 12/31/09 | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * | * |
| Section 179 Expensing | 12/31/09 | n.a. | n.a. | n.a. | -3.0 | -5.0 | -3.6 | -2.6 | -1.9 | -1.3 | -1.0 | -0.8 | -11.6 | -19.1 |
| Tax Incentives for Diesel Fuel Production | 12/31/09 | n.a. | n.a. | n.a. | * | * | ** | ** | ** | ** | ** | ** | * | * |
| Alcohol Fuel Tax Credit | 12/31/10 | n.a. | n.a. | n.a. | n.a. | -3.5 | -5.2 | -5.8 | -6.5 | -7.3 | -8.2 | -9.2 | -8.7 | -45.8 |
| Alternative Motor Vehicle Credit | 12/31/10 | n.a. | n.a. | n.a. | n.a. | * | -0.1 | * | * | * | * | * | -0.1 | -0.2 |

Continued

## Table 4-10.

## Continued

(Billions of dollars)

| Tax Provision | Expiration Date | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Provisions That Expire Between 2007 and 2017 (Continued)** | | | | | | | | | | | | | | |
| Estate and Gift Tax Changes | 12/31/10 | n.a. | -2.1 | -1.4 | -3.1 | -36.0 | -59.8 | -67.4 | -73.5 | -79.2 | -85.0 | -91.2 | -102.4 | -498.8 |
| Exclusion of Gain on Sale of Residence by Certain Employees | 12/31/10 | n.a. | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * |
| Five-Year Amortization of Music Copyrights | 12/31/10 | n.a. | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * | * |
| Natural Gas Distribution Lines Treated as 15-Year Property | 12/31/10 | n.a. | n.a. | n.a. | n.a. | * | -0.1 | -0.1 | -0.1 | -0.2 | -0.2 | -0.2 | -0.1 | -0.9 |
| Income Tax Provisions of EGTRRA | 12/31/10 | n.a. | n.a. | n.a. | n.a. | -94.9 | -171.9 | -177.0 | -180.4 | -184.6 | -190.5 | -196.8 | -266.8 | -1,196.2 |
| Reduced Tax Rates on Capital Gains | 12/31/10 | n.a. | n.a. | n.a. | -1.9 | -10.1 | 1.2 | -9.6 | -9.9 | -10.1 | -10.4 | -10.8 | -10.8 | -61.4 |
| Reduced Tax Rates on Dividends | 12/31/10 | n.a. | 0.4 | 1.4 | 0.7 | -5.3 | -18.1 | -22.2 | -24.2 | -25.9 | -27.4 | -29.1 | -20.9 | -149.7 |
| Tax Credit for Small Ethanol Producers | 12/31/10 | n.a. | n.a. | n.a. | n.a. | * | * | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.5 |
| Haiti Trade Preferences | 12/19/11 | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | * | * | * | * | * |
| Expensing of Refinery Property | 12/31/11 | n.a. | n.a. | n.a. | n.a. | n.a. | -0.1 | -0.3 | -0.3 | -0.3 | -0.3 | -0.2 | -0.1 | -1.6 |
| African Growth Opportunity Act (Least-Developed Countries) | 9/30/12 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | * | * | n.a. | -0.2 |
| Credit for Past Minimum Tax Liability | 12/31/12 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | -0.2 | -0.3 | -0.2 | -0.2 | -0.2 | n.a. | -1.1 |
| Depreciation of Certain Ethanol Plant Property | 12/31/12 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | * | * | n.a. | -0.1 |
| Transfer of Excess Assets in Defined-Benefit Plans | 12/31/13 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | ** | ** | ** | ** | n.a. | 0.1 |
| IRS User Fees | 9/30/14 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | ** | ** | ** | n.a. | 0.1 |
| Liquefied Hydrogen Fuel Incentives | 9/30/14 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | n.a. | * |
| Automatic Amortization for Certain Pension Plans | 12/31/14 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | n.a. | * |
| Credit for Motor Vehicles with Fuel Cells | 12/31/14 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | n.a. | * |

Continued

## Table 4-10.

## Continued

(Billions of dollars)

| Tax Provision | Expiration Date | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Provisions That Expire Between 2007 and 2017 (Continued)** | | | | | | | | | | | | | | |
| Hydrogen Refueling Property | 12/31/14 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | * | * | * | n.a. | * |
| African Growth Opportunity Act | 9/30/15 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | -0.2 | -0.2 | n.a. | -0.4 |
| **All Expiring Provisions** | | | | | | | | | | | | | | |
| Interaction from Extending All Provisions Together | | 0 | 0 | 0 | 0 | -18.5 | -47.1 | -50.4 | -53.3 | -55.4 | -57.0 | -58.4 | -65.5 | -340.0 |
| **Total** | | **-11.5** | **-68.4** | **-73.6** | **-96.7** | **-257.7** | **-374.1** | **-413.0** | **-436.6** | **-460.2** | **-485.5** | **-511.7** | **-870.4** | **-3,177.5** |

Source: Congressional Budget Office; Joint Committee on Taxation.

Notes: * = between -$50 million and zero; ** = between zero and $50 million; n.a. = not applicable; AMT = alternative minimum tax; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; FUTA = Federal Unemployment Tax Act; IRS = Internal Revenue Service. These estimates assume that the expiring provisions are extended immediately rather than when they are about to expire. The provisions are assumed to be extended at the rates or levels existing at the time of expiration. The estimates include some effects on outlays for refundable tax credits. These estimates do not include debt-service costs.

When this report went to press, JCT's estimates based on the new economic projections were unavailable for certain provisions, including extending various EGTRRA and JGTRRA individual income tax provisions that are scheduled to expire at the end of 2010 and changes to the exemption amount under the alternative minimum tax that expired at the end of 2006. CBO has adjusted JCT's estimates from last year (which were based on CBO's baseline projections from a year ago) to take into account the effects of CBO's updated economic projection; CBO has also extended those results to 2017, the new final year of the projection period. Those adjustments by CBO reduced the estimated loss in revenues from extending the EGTRRA provisions by less than 0.5 percent and from extending the AMT exemption by about 2 percent over the projection period. CBO will make JCT's updated estimates available when they are completed.

a. Provisions of the Katrina Tax Relief Act of 2005 and the Gulf Opportunity Zone Act of 2005 expire at various times between 2006 and 2011.

b. Provisions that increase expensing under Section 179 and allow a five-year lifetime for leasehold improvements expired on 12/31/06. Provisions related to partial expensing for property placed in service either expired on 12/31/06 or expire on 12/31/09.

c. Provisions related to tax incentives for alternative fuels expire on 9/30/09 and 9/30/14.

APPENDIX

# A

# Changes in CBO's Baseline Since August 2006

The Congressional Budget Office (CBO), absent further legislation affecting spending or revenues, projects a deficit of $172 billion for 2007—$114 billion less than the shortfall of $286 billion it projected last August (see Table A-1).[1] Roughly three-quarters of that change results from lower projected spending and the rest from higher anticipated revenues.[2]

For 2008 through 2016, CBO has lowered the projections of deficits in its budget baseline by an average of $225 billion each year. (Most of those changes involve reductions in projected outlays for discretionary programs and Medicare.) However, revisions to the baseline overstate the brightening in the 10-year budget outlook. More than half of the cumulative improvement over the 2007–2016 period (a total of about $1.3 trillion, including debt service) is related to the treatment of previous supplemental appropriations for disaster relief and the irregular pattern of funding for military operations in Iraq and Afghanistan. Thus, it is unrelated to changes in the underlying budgetary and economic environment.

When CBO updates its 10-year baseline projections, it divides the changes into three categories according to their source: enacted legislation; changes to CBO's economic forecast; and other, so-called technical factors.[3]

The largest set of changes in CBO's current baseline is classified as legislative. Such actions trim $10 billion from the estimated deficit for 2007 and nearly $1.2 trillion from the total deficit projected for the 2007–2016 period. Technical changes (those not directly related to changes in law or in CBO's economic outlook) account for almost all of the reduction in the estimated deficit for 2007 and for a substantial portion of the drop in the cumulative 10-year total. Lower projected spending for Medicare and higher projected revenues account for the bulk of the technical changes. Small revisions that can be ascribed to economic factors, which mainly reduced revenues, increased the estimated 2007 deficit by a net amount of $6 billion and the 10-year total by $173 billion.

## The Effects of Recent Legislation

CBO's baseline projections have been greatly affected by the funding provided in 2006 and 2007 for operations in Iraq and Afghanistan and by the supplemental appropriations enacted primarily for hurricane relief and recovery activities. The extrapolation of such spending (and of much smaller differences in regular appropriations) accounts for the vast majority of the $1.2 trillion in cumulative changes in the baseline that is attributable to legislation. By contrast, legislation involving revenues and

1. CBO's previous estimate of the 2007 deficit as well as other baseline projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2006).

2. Some of the reduction in projected outlays for 2007 will probably be eliminated later this year. Because CBO's budget projections do not generally include prospective legislation, the current baseline omits some likely spending in 2007 to finance military operations in Iraq and Afghanistan as well as other defense needs. Supplemental appropriations for such purposes are expected to add about $25 billion to this year's outlays, thereby resulting in a deficit in the vicinity of $200 billion.

3. The categorization of such changes should be viewed with caution. For example, legislative changes represent CBO's best estimates of the future effects of laws enacted since the previous baseline was prepared. If a new law proves to have effects different from the effects that CBO initially estimated, the difference will appear as a technical change in later versions of the baseline. The distinction between economic and technical changes is similarly imprecise. CBO classifies as economic changes those that result directly from alterations in the components of its economic forecast (including interest rates, inflation, and the growth of gross domestic product). Changes in other factors related to the economy (such as capital gains realizations) are shown as technical adjustments.

**Table A-1.**

## Changes in CBO's Baseline Projections of the Deficit Since August 2006

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Total, 2007-2011 | Total, 2007-2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Deficit as Projected in August 2006 | -286 | -273 | -304 | -328 | -227 | -54 | -76 | -64 | -56 | -93 | -1,418 | -1,761 |
| Changes to Revenue Projections | | | | | | | | | | | | |
| Legislative | -16 | -11 | -4 | -3 | -2 | -1 | -1 | -1 | -1 | -1 | -36 | -42 |
| Economic | -13 | -6 | 3 | -5 | -12 | -16 | -26 | -34 | -42 | -50 | -34 | -201 |
| Technical | 57 | 65 | 36 | 19 | 25 | 24 | 22 | 20 | 17 | 17 | 201 | 300 |
| **Total Revenue Changes** | **28** | **48** | **34** | **11** | **11** | **7** | **-5** | **-16** | **-26** | **-34** | **132** | **57** |
| Changes to Outlay Projections | | | | | | | | | | | | |
| Legislative | | | | | | | | | | | | |
| Mandatory outlays | 2 | 1 | -2 | -2 | -2 | -1 | * | * | -1 | -1 | -3 | -6 |
| Discretionary outlays | | | | | | | | | | | | |
| Defense | -14 | -38 | -48 | -51 | -54 | -55 | -57 | -58 | -60 | -61 | -206 | -497 |
| Nondefense | -13 | -31 | -44 | -52 | -56 | -58 | -60 | -61 | -62 | -64 | -196 | -500 |
| Subtotal, discretionary | -27 | -69 | -92 | -103 | -110 | -113 | -116 | -119 | -122 | -125 | -402 | -998 |
| Net interest outlays (Debt service) | * | -2 | -5 | -10 | -16 | -21 | -28 | -35 | -42 | -50 | -33 | -209 |
| **Subtotal, legislative** | **-26** | **-71** | **-99** | **-115** | **-128** | **-136** | **-145** | **-154** | **-165** | **-176** | **-438** | **-1,212** |
| Economic | | | | | | | | | | | | |
| Mandatory outlays | | | | | | | | | | | | |
| Social Security | * | -2 | -3 | -3 | -3 | -3 | -3 | -4 | -5 | -5 | -10 | -31 |
| Other | * | * | * | 1 | 1 | 1 | * | -1 | -1 | -1 | 2 | -1 |
| Subtotal, mandatory | * | -2 | -2 | -2 | -2 | -2 | -3 | -5 | -6 | -7 | -9 | -31 |
| Discretionary outlays | 0 | 3 | 3 | 3 | 3 | 4 | 4 | 4 | 4 | 4 | 12 | 32 |
| Net interest outlays | | | | | | | | | | | | |
| Debt service | * | * | * | * | * | * | 1 | 3 | 5 | 7 | * | 16 |
| Rate effect/inflation | -8 | -8 | -9 | -6 | -4 | -3 | -2 | -2 | -1 | -2 | -35 | -45 |
| Subtotal, net interest | -8 | -7 | -9 | -6 | -5 | -3 | -1 | 1 | 3 | 5 | -35 | -29 |
| **Subtotal, economic** | **-8** | **-7** | **-8** | **-5** | **-3** | **-1** | **-1** | ***** | **2** | **3** | **-31** | **-28** |

**Continued**

mandatory spending has had little effect on CBO's new projections for the 2007–2016 period.

### Discretionary Spending

Since August, CBO's baseline projections of discretionary spending have declined because of revisions attributable to legislation by $27 billion for 2007 and by $998 billion for the 2007–2016 period. The guidelines for projecting discretionary spending state that all appropriations provided in the current year should be extended and inflated throughout the 10-year baseline projection period.[4] Thus, the estimates of discretionary spending

4. The rules used to project discretionary spending were set by statute in section 257 of the Balanced Budget and Deficit Control Act of 1985, which expired in September 2006. CBO continues to follow the methodology that was prescribed in the law.

**Table A-1.**

## Continued

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Total, 2007-2011 | Total, 2007-2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Technical | | | | | | | | | | | | |
| Mandatory outlays | | | | | | | | | | | | |
| Medicare | -17 | -22 | -28 | -34 | -40 | -42 | -50 | -60 | -71 | -82 | -141 | -445 |
| Medicaid | -2 | -5 | -6 | -7 | -7 | -7 | -8 | -9 | -10 | -11 | -27 | -73 |
| Farm programs (CCC) | -4 | -5 | -5 | -4 | -4 | -3 | -2 | -2 | -1 | -1 | -22 | -31 |
| Other | -9 | -3 | 4 | -2 | -5 | -5 | -6 | -5 | -5 | -3 | -15 | -39 |
| Subtotal, mandatory | -33 | -35 | -35 | -47 | -56 | -57 | -66 | -76 | -87 | -97 | -206 | -588 |
| Discretionary outlays | -14 | -5 | 1 | 3 | 4 | 1 | 1 | 1 | * | 1 | -11 | -7 |
| Net interest outlays | | | | | | | | | | | | |
| Debt service | -2 | -9 | -13 | -17 | -21 | -25 | -30 | -36 | -42 | -49 | -61 | -244 |
| Other | -4 | -2 | * | * | 1 | 1 | 1 | * | * | * | -4 | -2 |
| Subtotal, net interest | -6 | -10 | -13 | -17 | -20 | -24 | -30 | -36 | -42 | -50 | -65 | -247 |
| **Subtotal, technical** | **-53** | **-50** | **-46** | **-60** | **-72** | **-80** | **-95** | **-111** | **-128** | **-146** | **-281** | **-842** |
| **Total Outlay Changes** | **-86** | **-127** | **-154** | **-180** | **-203** | **-217** | **-240** | **-265** | **-291** | **-319** | **-750** | **-2,083** |
| **Total Impact on the Deficit**[a] | **114** | **175** | **188** | **191** | **214** | **224** | **235** | **249** | **265** | **285** | **882** | **2,140** |
| Total Deficit (-) or Surplus as Projected in January 2007 | -172 | -98 | -116 | -137 | -12 | 170 | 159 | 185 | 208 | 192 | -536 | 378 |
| **Memorandum:**[a] | | | | | | | | | | | | |
| Total Legislative Changes | 10 | 60 | 94 | 112 | 126 | 134 | 143 | 153 | 164 | 175 | 402 | 1,171 |
| Total Economic Changes | -6 | 1 | 11 | * | -9 | -14 | -25 | -34 | -44 | -53 | -3 | -173 |
| Total Technical Changes | 110 | 115 | 82 | 79 | 97 | 104 | 117 | 131 | 145 | 163 | 483 | 1,142 |

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million; CCC = Commodity Credit Corporation.

a. Positive numbers indicate a decrease in the deficit. For 2012 through 2016, those changes result in projected surpluses.

for the years through 2016 are based on funding provided to date for 2007.

**Defense.** In total, defense outlays in the current baseline relative to those in the previous one have fallen by $497 billion for the years 2007 to 2016, mostly as a result of the way funding for operations in Iraq and Afghanistan is treated. So far this year, the Congress and the President have provided $70 billion for operations in those countries and for other activities related to the war on terrorism; last year, the Department of Defense (DoD) received $116 billion for those purposes. Extrapolating the lower funding appropriated thus far in 2007 reduces projected outlays in the baseline by $15 billion in the current year and by an average of more than $50 billion a year from 2008 to 2016 (see Table A-2).

In 2006, DoD received $8 billion in supplemental appropriations for expenses related to the Gulf Coast hurricanes and for other purposes, and in CBO's August baseline, those appropriations were extended to future years. So far in 2007, however, DoD has not received any supplemental appropriations. Removing that extrapolated funding from the baseline reduces discretionary outlays by $73 billion over the 2007–2016 period.

## Table A-2.

# Changes in CBO's Baseline Projections of Discretionary Outlays Since August 2006

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | Total, 2007-2011 | Total, 2007-2016 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Total Discretionary Outlays as Projected in August 2006 | 1,065 | 1,106 | 1,138 | 1,164 | 1,192 | 1,209 | 1,241 | 1,269 | 1,299 | 1,335 | 5,666 | 12,018 |
| Changes to Outlay Projections | | | | | | | | | | | | |
| Legislative | | | | | | | | | | | | |
| Defense | | | | | | | | | | | | |
| Iraq and Afghanistan | -15 | -39 | -48 | -50 | -52 | -52 | -54 | -55 | -56 | -58 | -204 | -480 |
| Supplemental funding | -2 | -5 | -6 | -7 | -8 | -8 | -9 | -9 | -9 | -9 | -28 | -73 |
| Regular appropriations | 3 | 6 | 6 | 6 | 6 | 5 | 6 | 6 | 6 | 6 | 27 | 56 |
| Subtotal, defense | -14 | -38 | -48 | -51 | -54 | -55 | -57 | -58 | -60 | -61 | -206 | -497 |
| Nondefense | | | | | | | | | | | | |
| Supplemental funding | -10 | -29 | -43 | -51 | -56 | -58 | -59 | -61 | -62 | -63 | -189 | -492 |
| Regular appropriations | -3 | -2 | -1 | -1 | * | * | * | * | * | * | -7 | -8 |
| Subtotal, nondefense | -13 | -31 | -44 | -52 | -56 | -58 | -60 | -61 | -62 | -64 | -196 | -500 |
| **Subtotal, legislative** | **-27** | **-69** | **-92** | **-103** | **-110** | **-113** | **-116** | **-119** | **-122** | **-125** | **-402** | **-998** |
| Economic | | | | | | | | | | | | |
| Defense | 0 | 2 | 2 | 2 | 2 | 2 | 3 | 3 | 3 | 3 | 9 | 22 |
| Nondefense | 0 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 1 | 4 | 10 |
| **Subtotal, economic** | **0** | **3** | **3** | **3** | **3** | **4** | **4** | **4** | **4** | **4** | **12** | **32** |
| Technical | | | | | | | | | | | | |
| Defense | -2 | -1 | * | * | * | * | * | * | * | * | -5 | -6 |
| Nondefense | -12 | -4 | 2 | 4 | 4 | 2 | 1 | 1 | 1 | 1 | -6 | -1 |
| **Subtotal, technical** | **-14** | **-5** | **1** | **3** | **4** | **1** | **1** | **1** | ***** | **1** | **-11** | **-7** |
| **Total Changes to Discretionary Outlays** | **-41** | **-72** | **-87** | **-96** | **-103** | **-108** | **-112** | **-115** | **-117** | **-120** | **-400** | **-973** |
| Total Discretionary Outlays as Projected in January 2007 | 1,024 | 1,034 | 1,050 | 1,067 | 1,089 | 1,100 | 1,129 | 1,155 | 1,182 | 1,215 | 5,265 | 11,046 |
| **Memorandum:** | | | | | | | | | | | | |
| Total Defense Discretionary Changes | -17 | -38 | -46 | -49 | -52 | -53 | -55 | -56 | -57 | -59 | -202 | -481 |
| Total Nondefense Discretionary Changes | -25 | -35 | -41 | -47 | -51 | -55 | -58 | -59 | -60 | -61 | -198 | -492 |

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

Regular appropriations for defense for 2007 total $450 billion, which is about $5 billion more than the amount that CBO projected in its August baseline.[5] When extrapolated to future years, that increase in funding results in $56 billion in additional outlays during the 10-year period.

**Nondefense.** Nondefense spending in the baseline also saw a decrease of $500 billion from 2007 to 2016, mostly because of the large amount of supplemental funding provided last year. In 2006, policymakers provided $53 billion in supplemental appropriations that were primarily for hurricane relief and recovery activities. (A small portion of that funding is covered by the continuing resolution for 2007—Public Law 109-383—and therefore is part of CBO's current baseline.) Removing the extrapolation of all of that 2006 supplemental funding from the baseline leads to a reduction in nondefense discretionary spending of $10 billion for 2007 and $492 billion for 2007 to 2016.

The amount of appropriations currently projected for nondefense programs for 2007—$424 billion—is almost exactly equal to the amount (excluding supplemental appropriations) that CBO projected in its last baseline. Three factors led to that result.

- First, funding for the Department of Homeland Security—the only agency other than the Department of Defense to receive its appropriations for this year—is nearly $4 billion above the amount that CBO previously projected for 2007. Other agencies are currently funded under the continuing resolution, which sets funding levels at the lowest of the House- or Senate-passed bills or the amount provided for 2006.
- Second, the continuing resolution includes $9 billion in funding for 2007 that was enacted through supplemental appropriations in 2006 (mostly for activities related to hurricane relief and avian flu research, preparedness, and response).
- Third, projected funding for all other nondefense programs is $12 billion below the amount for 2007 in the August baseline, which was calculated by adjusting appropriations for 2006 using specified measures of inflation.

The resulting change in the mix of nondefense discretionary spending (excluding supplemental appropriations) causes a slight reduction—about $8 billion—in outlays in the baseline over the 2007–2016 period.

## Mandatory Spending

Recent legislative changes that affect mandatory spending (funding determined by laws other than annual appropriation acts) have had a small effect on CBO's baseline projections—lowering estimated spending during the years 2007 to 2016 by just $6 billion. That decrease reflects the budgetary effects of two laws.

- The Tax Relief and Health Care Act of 2006 (Public Law 109-432) will reduce mandatory outlays by $7 billion over the 10-year period, CBO estimates.[6] That amount includes a reduction of almost $13 billion in projected spending for Parts A and B (Hospital Insurance and Supplementary Medical Insurance) of the Medicare program during the 2007–2016 period. Those changes in Medicare outlays mostly reflect funds that the government expects to recover through a program to audit payments to providers, which are partially offset by increases in payments for physicians' services and in payment rates for dialysis services and by higher costs from extending certain expiring provisions (for example, those associated with therapy services). The legislation also allows for additional oil and gas leasing in the Gulf of Mexico and raises spending for health care benefits for retired miners.

5. Of the $450 billion in total appropriations, about $377 billion was funded by the Department of Defense Appropriations Act, 2007 (Public Law 109-289). However, funding for such areas as military construction, family housing, the National Nuclear Security Administration (which oversees the United States' nuclear weapons program), and portions of DoD's spending for operations and maintenance and military personnel is provided through other appropriation acts and thus is currently subject to the continuing resolution (Public Law 109-383), which sets funding levels at the lowest of the House- or Senate-passed bills or the amount provided for 2006.

6. For more detail, see the Congressional Budget Office's cost estimate for H.R. 6111, the Tax Relief and Health Care Act of 2006 (December 28, 2006). That estimate does not include about $17 billion in expected savings between 2007 and 2016 from funding provided for contractors to audit paid claims and recover overpayments (because a Congressional scorekeeping rule prohibits CBO from scoring an increase in receipts resulting from direct spending for administration or program management).

- The Postal Accountability and Enhancement Act (Public Law 109-435) includes provisions that modify the payments the Postal Service makes for health care and pension benefits for its retired workers. The law increases projected mandatory outlays by a total of $2 billion between 2007 and 2016.

### Revenues

Legislation enacted since August has had a relatively small effect on CBO's 10-year projection of revenues—reducing it by $42 billion—and two-thirds of that decline occurs in 2007 and 2008. Nearly all of the effect—$40 billion over the 2007–2016 period—derives from the enactment of the Tax Relief and Health Care Act of 2006. The most significant reductions in revenues that the legislation would produce, in the estimation of the Joint Committee on Taxation and CBO, stem from extending several tax provisions that were due to expire in 2006 and 2007, including the research and experimentation tax credit, with some modification (which accounts for a drop of $17 billion from 2007 to 2012); the option for taxpayers to deduct state and local sales taxes instead of state and local income taxes on their federal tax form ($6 billion from 2007 to 2009); the 15-year straight-line cost recovery period for qualified restaurant and leasehold improvement property ($5 billion from 2007 to 2016); and the deduction for qualified tuition and other higher education expenses (a total of $3 billion in 2007 and 2008).

The Tax Relief and Health Care Act of 2006 also made various changes to trade law that have minor effects on projected revenues in the baseline (a drop of a little more than $1 billion over the 10-year period). For example, the law extends for two years and alters the Generalized System of Preferences that provides duty-free entry of certain products from 144 countries; allows the President to grant Vietnam permanent normal trade relations status; reduces or suspends the duties on various imported products through 2009; and extends certain provisions of the African Growth and Opportunity Act related to apparel.

### Net Interest

In all, legislative changes have reduced CBO's projection of the cumulative deficit for the 2007–2016 period by an estimated $962 billion. That decrease, in turn, shrinks projected debt-service costs over the period by $209 billion.

## The Effects of Technical Changes

As noted earlier, technical changes comprise revisions to the baseline that are not directly attributable to newly enacted laws or changes in CBO's economic forecast. Such revisions since August have raised projections of revenues and lowered estimates of outlays each year from 2007 to 2016, thereby reducing this year's estimated deficit by $110 billion and the 10-year cumulative deficit by more than $1.1 trillion.

### Mandatory Spending

Technical revisions have reduced CBO's estimate of mandatory outlays in the baseline by $33 billion in 2007 and by a total of $588 billion through 2016. The largest changes involve Medicare, Medicaid, and farm programs.

**Medicare.** CBO's current projections of mandatory spending for Medicare over the 2007–2016 period are $445 billion (8 percent) lower than in the August 2006 baseline. That change consists of a reduction of $181 billion in projected net spending for Hospital Insurance (Medicare Part A) and Supplementary Medical Insurance (Part B) and a drop of $265 billion in projected net spending for the prescription drug program (Part D).

The changes in projected spending for Parts A and B reflect lower-than-expected spending in 2006. Over the past few years, the pace of growth of Medicare spending has exceeded CBO's expectations, and the previous baseline incorporated the assumption that such rapid growth would continue for several years. However, spending did not increase in 2006 by as much as had been expected, and outlays for that year were $9 billion lower than CBO anticipated in March 2006, when it last performed a comprehensive update to its projections of Medicare spending. Consequently, the starting point for the current baseline projections is now lower.

In addition, CBO has reduced its projection of spending for Part D, for two main reasons. First, the competitive bids to provide drug coverage that prescription drug plans submit to Medicare were lower than expected for calendar year 2007; as a result, CBO reduced its projection of the per capita costs of providing drug coverage under Part D. Second, recent information from the Centers for Medicare and Medicaid Services indicates that the number of Medicare beneficiaries who have some other form of drug coverage is larger than previously estimated, and CBO anticipates that many such beneficiaries will

keep their existing coverage rather than enroll in the Part D benefit. Consequently, CBO has lowered its estimate of the number of Medicare beneficiaries who will participate in the program (see Box 3-2 on page 58).

**Medicaid.** CBO has made technical changes that have reduced its projection of Medicaid spending for the 2007–2016 period by $73 billion. On the basis of new data for 2006 about the cost of the major components of the program (including prescription drugs, nursing home care, and hospital services) as well as actual outlays for the year (which were $900 million lower than anticipated in the August baseline), CBO has reduced its projection of spending for Medicaid by a total of $87 billion (3 percent) over the 10-year period. Revisions in the methods used to estimate the growth of nursing home spending further reduced CBO's projections by a cumulative $10 billion. Those changes were offset by a projected increase in enrollment in the program (which raised estimated outlays by $21 billion over the 10 years) and other revisions that increased CBO's estimate of spending by a total of $3 billion between 2007 and 2016.

**Farm Programs.** Projected spending in CBO's baseline for the Commodity Credit Corporation has declined by $31 billion for the 2007–2016 period. That reduction primarily reflects lower income-support payments to farmers for major crops because commodity prices are now expected to be higher than previously anticipated. In particular, CBO has reduced its estimates of support payments to corn producers as a result of stronger demand for ethanol.

**Other Revisions.** Other technical adjustments have reduced CBO's estimate of mandatory spending in the baseline by $9 billion for 2007 and by a total of $39 billion through 2016. The largest of those changes apply to projected spending for Social Security and for the Pension Benefit Guaranty Corporation (PBGC).

Additional information about Social Security recipients and benefits led CBO to slightly revise its baseline projections for the program. Those revisions—chiefly, reductions in the number of expected beneficiaries in Social Security's Old-Age and Survivors Insurance program and in the average payment expected in the Disability Insurance program—reduce the projected amount of benefit payments. On balance, they lower estimates of Social Security outlays by $1 billion per year beginning in 2008, for a total decrease from 2007 to 2016 of $11 billion (less than 0.2 percent of total benefits).

In total, CBO's projection of spending for PBGC over the 2007–2016 period has fallen by $11 billion. Reductions in projected benefit payments, net of reimbursements from PBGC's nonbudgetary fund, and higher projected interest receipts (because of larger estimated balances in PBGC's revolving fund) account for most of that change.

Other technical changes to spending for mandatory programs in 2007 reflect a drop of $3 billion in the estimated subsidy costs for federal loan and loan guarantee programs and a reduction of $2 billion in the estimated net spending of the Postal Service. From 2008 through 2016, technical changes include a cumulative $8 billion increase in estimated receipts from oil and gas leases on the Outer Continental Shelf. That change largely results from anticipated growth in production and from certain contractual changes that will increase the amount of oil and gas royalties paid to the federal government.

### Discretionary Spending

Technical changes to CBO's baseline projections for discretionary programs have decreased outlays by $14 billion for 2007 and by $5 billion for 2008; the remaining years of the projection period—2009 to 2016—show small increases in discretionary spending. In total, technical changes have reduced outlays for discretionary programs in the baseline by $7 billion over the 2007–2016 period.

CBO has lowered its estimate of defense outlays for 2007 by $2 billion (0.4 percent of total defense spending), mainly because some funding for operations and maintenance was expended in 2006 rather than in 2007, as CBO had previously anticipated. Technical revisions to projections of defense spending over the 10-year period are minimal, reducing spending by $6 billion and reflecting relatively small declines in projected outlays for atomic energy activities, military construction, and procurement.

In the nondefense discretionary category of spending, estimated outlays for 2007 for flood control and coastal emergencies have been reduced in the baseline by $2 billion as a result of slower-than-anticipated spending for reconstruction related to the Gulf Coast hurricanes. For similar reasons, outlays for community development pro-

grams have also been reduced, by $2 billion. (Much of the funding that lawmakers provided for hurricane relief and recovery activities has been spent more slowly than CBO had expected.) In addition, on the basis of spending in 2005 and 2006 (the first two years under the current authorization for surface transportation programs), CBO has trimmed its projection of federal spending for highways for 2007 by $2 billion. The remaining reduction in the nondefense discretionary category for 2007—$6 billion—for the most part reflects smaller revisions in many other areas of the federal budget.

### Revenues

Technical changes dominate the revisions to CBO's projections of revenues for the next two years; such changes raise total projected receipts in the baseline by $57 billion in 2007, by $65 billion in 2008, and by declining amounts in subsequent years. Over the 2007–2016 period, the increase in projected revenues as a result of technical factors totals $300 billion.

CBO has increased its projections of individual and corporate income tax receipts as a result of collections that since last summer have been greater than anticipated. In addition, on the basis of new information, CBO has raised its projections of capital gains by individuals and corporations. The stronger collections in recent months may indicate that taxable income, such as corporate profits or wages and salaries, is greater than the amount that the national income and product accounts (NIPAs) currently show or the amount expected under CBO's assumptions about those categories of income and about others (such as capital gains) that are not measured in the NIPAs. CBO expects those categories of income to revert to their longer-term historical averages relative to gross domestic product (GDP) and therefore assumes that the larger collections in 2007 will gradually decline over the 2007–2016 period. CBO has made the same assumption about realizations of capital gains, because in the past they have tended to return to their historical averages relative to GDP (which vary with the tax rates in effect).

Some of the effects of the technical changes persist through the end of the 10-year period. For technical reasons, CBO has increased its projection of revenues for 2016 by $17 billion—a change that largely reflects its revised assumptions about capital gains, new information from individual income tax returns for tax year 2004, and a rise in the effective tariff rate.

### Net Interest

Because technical revisions increase revenues in the baseline by $300 billion and lower outlays by $598 billion from 2007 to 2016, projected debt-service costs decline by $244 billion over those years. Other technical changes to net interest are negligible, totaling $2 billion (0.1 percent) over the 10-year period.

## The Effects of Economic Changes

Changes to CBO's economic assumptions increase the estimated deficit in the baseline for 2007 by $6 billion and reduce the cumulative bottom line by $173 billion over the 2007–2016 period, largely because of reductions in projected revenues. CBO's assessment of the economic outlook has not changed much since last summer. The updates to its economic forecast stem mostly from lower projections of GDP and taxable income, especially wages and salaries—which thereby decrease CBO's estimates of revenues throughout the 10-year period. On the outlay side of the budget, changes are small, averaging about $3 billion per year.

### Revenues

CBO's current outlook for the economy incorporates a slowdown in economic growth in the second half of calendar year 2006 and early 2007 and a slight reduction in the economy's potential rate of growth during the next 10 years. Those assumptions have caused CBO to reduce its projections of revenues for 2007 and 2008 by $13 billion and $6 billion, respectively, and—following a small increase of $3 billion in 2009—to lower projections of revenues over the 2010–2016 period by $185 billion. For the 2007–2016 period, the net result of those changes is a reduction in projected revenues of $201 billion.

CBO now projects that over the 2007–2016 period, GDP will be lower—by about $2.8 trillion, or 1.6 percent—than it estimated last August. CBO also projects that wages and salaries, the category of income under CBO's economic assumptions that faces the highest tax rate, will be lower during the period by more than $900 billion, or 1.2 percent. Slightly offsetting those reductions are increases in projected revenues as a result of higher estimated book profits throughout the 2007–2016

period, with the largest upticks occurring in 2009 and 2010.[7]

### Mandatory Spending

On balance, changes in CBO's economic outlook have had a relatively small effect on its current projections of mandatory spending. Such changes increase CBO's estimate of mandatory outlays in the baseline by a negligible amount in 2007 and lower net spending during the 2007–2016 period by $31 billion.

Most of those economic changes involve the largest mandatory spending program, Social Security, reducing the program's projected outlays by $31 billion from 2007 to 2016. The cost-of-living adjustment (COLA) that Social Security beneficiaries received in January 2007 is slightly higher (0.1 percentage points) than the one that CBO projected last August; as a result, CBO expects a rise in outlays for 2007 of less than $0.5 billion. However, CBO now expects that the COLA in January 2008 will be 0.7 percentage points below its August projection, which will slow the projected growth of benefit payments in the baseline beginning in 2008. Over the 2008–2016 period, the changes in the COLA will lower baseline Social Security outlays by $25 billion, CBO estimates.

In addition, revisions to CBO's projections of the growth of wages and salaries have small effects in both directions from 2007 to 2011. From 2012 to 2016, however, consistently lower growth decreases CBO's projections of Social Security spending—trimming nearly $7 billion from estimated benefits during that period.

### Discretionary Spending

CBO projects discretionary budget authority by using two measures of inflation: the GDP deflator and the employment cost index for wages and salaries. Since the August baseline was published, CBO has increased its estimate of the rate of growth of the GDP deflator by 0.1 percentage point for 2008 and modified certain other calculations used to extrapolate discretionary spending. Those adjustments add $32 billion (0.3 percent) to projected discretionary outlays over the 2007–2016 period.

### Net Interest

Economic revisions to CBO's projections of net interest spending have two parts: the effects of changes in its economic outlook related to interest rates and inflation and changes in debt-service costs resulting from the impact that all other economic changes have on deficits in the baseline. The first factor has reduced projected outlays for net interest, and the second factor has increased them—for a net decline of $29 billion between 2007 and 2016.

In CBO's current economic outlook, the interest rates on three-month Treasury bills and 10-year Treasury notes are lower from 2007 to 2010 than they were in last August's outlook. For those years, the rate projected for three-month bills has dropped by about 20 basis points (a basis point is one-hundredth of a percentage point), and the rate on 10-year notes has fallen by about 40 basis points. As a result, CBO anticipates that interest on the public debt will total $25 billion less during those three years than it projected in its previous baseline. In addition, CBO has lowered its estimate of inflation for 2007 by 0.9 percentage points, which causes projected outlays for the Treasury's inflation-protected securities to fall by $3 billion this year. Overall, revisions to interest rates reduce outlays for net interest in the baseline by $45 billion over the 2007–2016 period.

Finally, changes in the economic outlook (primarily those leading to estimates of lower revenues) have increased the government's projected borrowing needs, thereby raising estimated debt-service costs between 2007 and 2016 by $16 billion.

7. Book profits are calculated by using book (or tax) depreciation. Different from economic profits, book profits are referred to as "profits before tax" in the NIPAs.

APPENDIX

# B

# How Changes in Economic Assumptions Can Affect Budget Projections

The federal budget is highly sensitive to economic conditions. Revenues depend on the amount of taxable income, including wages and salaries, other (nonwage) income, and corporate profits. Those types of income generally move in tandem with overall economic activity. Spending for many mandatory programs is pegged to inflation, either directly (as with Social Security) or indirectly (as with Medicaid). In addition, the Treasury regularly refinances portions of the government's outstanding debt—as well as issuing more debt to finance any new deficit spending—at market interest rates. Thus, the amount that the federal government spends for interest on its debt is directly tied to those rates.

To illustrate how assumptions about the economy can affect federal budget projections, the Congressional Budget Office (CBO) has constructed simplified "rules of thumb." The rules provide rough orders of magnitude for gauging how changes in individual economic variables, taken in isolation, would affect the budget totals. (The rules of thumb are not intended to substitute for a full analysis of an alternative economic forecast.)

Four variables feature in this illustration:

- Real (inflation-adjusted) growth of the nation's gross domestic product (GDP),
- Interest rates,
- Inflation, and
- Wages and salaries as a percentage of GDP.

For real growth, CBO's rule of thumb shows the effects of rates that are 0.1 percentage point lower each year, beginning in January 2007, than the rates assumed for the agency's baseline budget projections. (Those projections are outlined in Chapter 1; the economic assumptions that underpin them are described in Chapter 2.) The rules of thumb for interest rates and inflation assume that those rates are 1 percentage point higher each year than the rates in the baseline, also starting in January 2007. The final rule of thumb assumes that, beginning in January 2007, wages and salaries as a percentage of GDP are 1 percentage point greater each year than projected in the baseline. Correspondingly, corporate profits are assumed to be 1 percentage point lower each year relative to GDP. (The scenario assumes no change in projected levels of nominal or real GDP.)

Each rule of thumb is roughly symmetrical. Thus, if economic growth was higher or interest rates, inflation, or wages and salaries as a percentage of GDP were lower than CBO projects, the effects would be about the same as those shown here, but with the opposite sign.

The calculations that appear in this appendix are merely illustrative of the impact that such changes can have. CBO chose the variations of 0.1 percentage point or 1 percentage point solely for the sake of simplicity. Those changes do not necessarily indicate the extent to which actual economic performance might differ from CBO's assumptions. For example, although the rule of thumb for real GDP shows the effects of a 0.1 percentage point change in the average growth rate over the next 10 years, the standard deviation for real GDP growth over past 10-year periods is roughly five times larger, or about 0.5 percentage points.[1] Extrapolating from small, incremental rule-of-thumb calculations to much larger changes

1. A conventional way to measure past variability is to use the standard deviation. In the case of GDP growth, CBO calculates the extent to which actual growth over 10-year periods differs from the postwar average. The standard deviation is the size of the difference that is exceeded about one-third of the time.

would be inadvisable, however, because the size of the effect of a larger change is not necessarily a multiple of a smaller change.

The other rules of thumb—each of which considers an average change of 1 percentage point from the projection—are much closer to historical deviations for those variables. The standard deviation for the 10-year average of real interest rates is about 1.3 percentage points. Standard deviations for inflation and for wages and salaries as a percentage of GDP are each about 1.9 percentage points, less than twice the change in CBO's rules of thumb.

## Lower Real Growth

Stronger economic growth improves the budget's bottom line, and weaker economic growth worsens it. The first rule of thumb illustrates the impact of slightly weaker-than-expected economic growth on federal revenues and outlays.[1]

CBO's baseline reflects an assumption that real GDP increases by 2.3 percent in calendar year 2007, by 3.0 percent in 2008, and by an average of 2.7 percent annually from 2009 to 2017. Subtracting 0.1 percentage point from each of those growth rates implies that by 2017, GDP would be roughly 1 percent smaller than in CBO's baseline.

Slower GDP growth would have several budgetary implications. For example, it would imply less growth in taxable income and thus lower tax revenues—$1 billion lower in 2007 and $48 billion lower by 2017 (see Table B-1). With a smaller amount of revenues, the federal government would have to borrow more and incur higher interest costs. Payments to service federal debt would be minimally higher during the first few years of the projection period but larger in later years, with the increase reaching $11 billion by 2017. Mandatory spending, however, would be only minimally affected by slower economic growth: Medicare outlays would be slightly lower, but that decrease would be mostly offset by higher outlays for the refundable portions of the earned income and child tax credits.[2]

All told, if the growth of real GDP was 0.1 percentage point lower per year than the rates assumed in CBO's baseline, annual deficits would be higher or surpluses lower by amounts that would climb to $58 billion by 2017. The cumulative surplus for the 2008–2017 period would fall by $273 billion. Those effects differ from the effects of a cyclical change in economic growth, such as a recession, which are usually larger but much shorter-term in nature. (For a discussion of the possible budgetary effects of a recession, see Box B-1.)

## Higher Interest Rates

The second rule of thumb illustrates the sensitivity of the budget to changes in interest rates, which affect the flow of interest payments to and from the federal government. When the budget is in deficit, the Treasury must borrow additional funds from the public to cover any shortfall by selling bonds and other securities. (The Treasury currently issues 1-, 3-, and 6-month bills; 2-, 3-, 5-, and 10-year notes; 5-, 10-, and 20-year inflation-protected securities; and 30-year bonds.) When the budget is in surplus, the Treasury uses some of its income to reduce federal debt held by the public. In either case, the Treasury refinances a portion of federal debt at market interest rates. In addition, those rates affect how much the Federal Reserve Bank earns on its holdings of securities, which in turn affects federal revenues.

If interest rates on all types of Treasury securities were 1 percentage point higher than assumed in the baseline every year through 2017, but all other economic variables were unchanged, the government's interest costs would be about $9 billion higher in 2007 (see Table B-1). That jump would be fueled largely by the extra costs of refinancing Treasury bills, which make up about 21 percent of the government's marketable debt. Roughly $1 trillion of Treasury bills are currently outstanding, all of which mature within the next six months. However, most of the marketable debt is in the form of coupon securities, which consist of medium-term notes, inflation-protected securities, and long-term bonds. As they mature, they will be replaced with new securities. Therefore, the budgetary effects of higher interest rates would mount each year, peaking at an additional $38 billion in 2012 under this

1. A change in the rate of real growth could affect other economic variables, such as inflation and unemployment; however, CBO's rule of thumb does not include such effects.

2. Medicare's payment rates for physicians' services are computed using a formula that compares annual spending with a target amount that partly reflects growth in GDP. The impact of lower real growth would not affect those payment rates until 2015.

**Table B-1.**

# Estimated Effects of Selected Economic Changes on CBO's Baseline Budget Projections

(Billions of dollars)

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | Total, 2008-2012 | Total, 2008-2017 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Growth Rate of Real GDP Is 0.1 Percentage Point Lower per Year** | | | | | | | | | | | | | |
| Change in Revenues | -1 | -4 | -7 | -10 | -15 | -19 | -24 | -30 | -35 | -42 | -48 | -55 | -234 |
| Change in Outlays | | | | | | | | | | | | | |
| Mandatory spending | * | * | * | * | * | * | * | * | * | -1 | -1 | 1 | -1 |
| Debt service | * | * | * | 1 | 1 | 2 | 3 | 5 | 7 | 9 | 11 | 5 | 40 |
| Total | * | * | * | 1 | 2 | 3 | 4 | 5 | 6 | 8 | 10 | 6 | 39 |
| **Change in Deficit or Surplus[a]** | **-1** | **-4** | **-7** | **-11** | **-16** | **-22** | **-28** | **-35** | **-42** | **-50** | **-58** | **-61** | **-273** |
| **Interest Rates Are 1 Percentage Point Higher per Year** | | | | | | | | | | | | | |
| Change in Revenues | 2 | 4 | 6 | 7 | 8 | 8 | 9 | 9 | 10 | 10 | 11 | 32 | 80 |
| Change in Outlays | | | | | | | | | | | | | |
| Higher interest rates | 9 | 21 | 28 | 33 | 37 | 38 | 38 | 37 | 37 | 36 | 35 | 157 | 341 |
| Debt service | * | 1 | 2 | 4 | 5 | 7 | 10 | 12 | 14 | 16 | 19 | 19 | 90 |
| Total | 9 | 22 | 30 | 37 | 42 | 46 | 47 | 49 | 51 | 53 | 54 | 177 | 431 |
| **Change in Deficit or Surplus[a]** | **-7** | **-18** | **-25** | **-30** | **-35** | **-38** | **-39** | **-40** | **-41** | **-43** | **-43** | **-145** | **-351** |
| **Inflation Is 1 Percentage Point Higher per Year** | | | | | | | | | | | | | |
| Change in Revenues | 13 | 40 | 72 | 107 | 146 | 188 | 239 | 292 | 351 | 415 | 486 | 552 | 2,334 |
| Change in Outlays | | | | | | | | | | | | | |
| Discretionary spending | 0 | 6 | 15 | 25 | 37 | 48 | 61 | 74 | 88 | 103 | 118 | 131 | 575 |
| Mandatory spending | 3 | 12 | 26 | 43 | 62 | 81 | 104 | 130 | 158 | 192 | 226 | 224 | 1,033 |
| Higher interest rates[b] | 11 | 26 | 34 | 40 | 44 | 47 | 47 | 48 | 48 | 48 | 48 | 192 | 431 |
| Debt service | * | * | * | 1 | 1 | * | -1 | -3 | -6 | -10 | -15 | 2 | -32 |
| Total | 15 | 45 | 76 | 109 | 143 | 177 | 212 | 249 | 288 | 333 | 377 | 549 | 2,007 |
| **Change in Deficit or Surplus[a]** | **-2** | **-5** | **-4** | **-2** | **2** | **11** | **27** | **43** | **63** | **82** | **109** | **3** | **327** |
| **Wages and Salaries Are 1 Percentage Point Higher per Year as a Percentage of GDP** | | | | | | | | | | | | | |
| Change in Revenues | 13 | 13 | 14 | 16 | 18 | 18 | 19 | 21 | 22 | 23 | 25 | 80 | 191 |
| Change in Outlays (Debt service) | * | -1 | -2 | -2 | -3 | -4 | -5 | -7 | -8 | -9 | -11 | -13 | -53 |
| **Change in Deficit or Surplus[a]** | **13** | **14** | **16** | **19** | **21** | **23** | **25** | **27** | **30** | **33** | **36** | **93** | **243** |
| **Memorandum:** | | | | | | | | | | | | | |
| Deficit (-) or Surplus in CBO's January 2007 Baseline | -172 | -98 | -116 | -137 | -12 | 170 | 159 | 185 | 208 | 192 | 249 | -194 | 800 |

Source: Congressional Budget Office.

Note: GDP = gross domestic product; * = between -$500 million and $500 million.

a. Negative amounts indicate an increase in the deficit or a decrease in the surplus.

b. The change in outlays attributable to higher interest rates in this scenario is different from the estimate in the rule of thumb for interest rates because the principal on the Treasury's inflation-protected securities grows with inflation.

**Box B-1.**

## The Potential Budgetary Impact of a Recession

### Errors in Budget Projections Made Before the Three Most Recent Recessions

| Date of Baseline Projection | Dates of Recession (Peak to trough of cycle) | Error (Percentage of GDP) | | |
|---|---|---|---|---|
| | | For Current Year | For Budget Year | For Budget Year + 1 |
| July 1981 | July 1981–November 1982 | 0.1 (FY 1981) | -1.3 (FY 1982) | -3.7 (FY 1983) |
| January 1990 | July 1990–March 1991 | -1.4 (FY 1990) | -2.4 (FY 1991) | -3.0 (FY 1992) |
| January 2001 | March 2001–November 2001 | -0.7 (FY 2001) | -3.2 (FY 2002) | -3.7 (FY 2003) |
| **Average** | **n.a.** | **-0.7** | **-2.3** | **-3.5** |

Source: Congressional Budget Office.

Notes: GDP = gross domestic product; FY = fiscal year; n.a. = not applicable.

The current year is the fiscal year in which the baseline projection was published. The budget year is the fiscal year for which the federal budget was being considered. (For example, the present budget year is fiscal year 2008.)

The Congressional Budget Office's current economic forecast assumes that growth will slow in 2007 but that the economy will not slip into a recession. If a recession did occur, the budget outlook for the next few years would be worse than CBO's baseline projections indicate.

Forecasting the precise budgetary effects of a future recession is difficult because those effects depend on the size of the recession and its specific characteristics, which could diverge widely. Nevertheless, data that show how budgetary outcomes differed from CBO's baseline projections in the past three recessions offer a rough idea of the possible impact of a future recession (see the table above).

Those three recessions—which began in 1981, 1990, and 2001—resulted in significantly different budgetary outcomes than CBO had projected a few months before the downturns started. CBO's baseline budget projections were inaccurate largely because the economic forecasts underpinning them anticipated continued growth, not recessions. According to measures of error used to construct the "fan chart" shown in Chapter 1 (see Figure 1-5), those baseline projections of the total deficit or surplus proved to be optimistic by an average of 3.5 percent of gross domestic product for the fiscal year two years beyond the one in which the forecast was made.[1] (Put in terms of CBO's current forecast of GDP for 2009, 3.5 percent of GDP translates into roughly $530 billion.)

The varying causes and natures of past recessions have produced different budgetary results, although linking specific economic developments to particular budgetary outcomes is difficult. For example, in the 1981–1982 recession, the high rate of inflation tended to boost revenues in spite of the recession by inflating nominal income and pushing households into tax brackets with higher tax rates. Thus, inflation initially dampened some of the recession's impact on federal revenues (although it may have worsened the recession). Brackets for the individual income tax have since been indexed for inflation, so a downturn today that was similar to the 1981–1982 recession would have a larger negative impact on the budget. In contrast, many aspects of the 2001 recession that caused it to have a sizable effect on the budget are unlikely to recur. A decline in the stock market before and during that recession accentuated its budgetary impact because the normal recessionary drop in personal income was exacerbated by a drop in capital gains, stock options, and bonuses. As a result, revenues from individual income taxes plummeted. A recession this year or next year would be unlikely to have a similar effect on taxable income.

1. That error analysis is based on budget figures that exclude interest payments and discretionary spending. As with the construction of the fan chart, the differences from baseline projections reflect the impact of unexpected economic developments as well as changes in the technical assumptions that underlie projections of revenues and outlays, such as assumptions about effective tax rates and enrollment in Medicare.

scenario. After that, the budget surpluses that are projected in CBO's baseline would reduce projected federal borrowing, thereby slightly lessening the effect of higher interest rates.

As part of its conduct of monetary policy, the Federal Reserve buys and sells Treasury securities in the open market. The interest that it earns on its portfolio of securities helps determine the Federal Reserve's profits, which are counted as revenues when they are turned over to the Treasury. If interest rates were 1 percentage point higher than CBO projects each year, earnings on those securities—and thus revenues—would increase by amounts growing from $2 billion in 2007 to $11 billion in 2017.

In addition, the larger deficits or smaller surpluses that would accompany higher interest rates would require the Treasury to raise more cash than the levels assumed in the baseline. The resulting increase in annual debt-service costs would be as much as $19 billion by 2017.

All told, if interest rates were a full percentage point higher than the rates assumed in CBO's baseline, the budget's bottom line would worsen by increasing amounts over the projection period: by $7 billion in 2007, up to $43 billion by 2017. The cumulative surplus over the 2008–2017 period would drop by $351 billion.

## Higher Inflation

The third rule of thumb shows the budgetary impact of inflation that is 1 percentage point higher than the rates assumed in the baseline. That change has a larger effect on federal revenues and outlays than the other rules of thumb do. For the most part, the effects of inflation on revenues and outlays offset each other, although the impact on revenues is the larger of the two after a few years.

On one hand, higher inflation leads to increases in wages and other income, which translate directly into higher amounts of income taxes and payroll taxes being withheld from people's paychecks. The resulting impact on revenues is dampened (with a lag), however, because the thresholds for various tax rate brackets are indexed to rise with inflation. In addition, faster growth in prices boosts corporate profits, which quickly translates into greater federal revenues from firms' quarterly estimated tax payments.

On the other hand, higher inflation increases spending for many benefit programs and drives growth in projections of discretionary spending. Many mandatory programs automatically adjust benefit levels each year to reflect price increases. Social Security, federal employees' retirement programs, Supplemental Security Income, veterans' disability compensation, Food Stamps, and child nutrition programs, among others, are adjusted (with a lag) for changes in the consumer price index or one of its components. Many Medicare payment rates are also adjusted annually for inflation. Other programs, such as Medicaid, are not formally indexed but grow with inflation nonetheless. In addition, to the extent that the benefit payments that participants in retirement and disability programs initially receive are related to wages, changes in nominal wages will be reflected in future outlays for those programs. Finally, future spending for discretionary programs is projected on the basis of assumed rates of wage and price growth.

Inflation also has an impact on federal net interest outlays because it is one component of nominal long-term interest rates (the other being a real rate of return). For example, if real rates of return remain constant but inflation rises, interest rates will climb, and new federal borrowing will incur higher interest costs. In this rule of thumb, CBO assumes that nominal interest rates rise in step with inflation, thus increasing the cost of financing the government's debt.

If the rate of inflation was 1 percentage point higher than projected each year, total revenues would be about 7 percent larger over the 2008–2017 period, and outlays would be about 6 percent larger. The effects of higher inflation on outlays and revenues in the near term would be very similar, mainly because CBO assumes that interest rates rise with inflation, thus driving up federal interest payments relatively quickly. Mandatory spending would also be boosted by the higher inflation in the short run. As a consequence, from 2007 to 2010, the increase in outlays would slightly exceed the rise in revenues projected under this scenario (see Table B-1).

By 2011, however, the growth in revenues associated with higher inflation would outstrip the growth in outlays; the gap between the two would widen thereafter, reaching $94 billion (plus $15 billion in additional debt-service costs) by 2017. As a result, the cumulative surplus for the 10-year projection period would be $327 billion larger than in CBO's baseline.

## Wages and Salaries as a Higher Percentage of GDP

Because different types of income are taxed at different rates, changes over time in the share of total income that each type represents have contributed to changes in federal tax receipts relative to GDP. Considerable uncertainty exists in projecting those income shares.

Two of the most important categories of income for projecting federal revenues are wages and salaries and corporate profits. Wages and salaries are the most highly taxed type of income because they are subject to the individual income tax as well as to payroll taxes for Social Security (up to a maximum annual amount) and for Medicare. Consequently, CBO estimates that an additional dollar of wages and salaries produces more revenue than an additional dollar of corporate profits does. Thus, higher projections for wages and salaries and correspondingly lower projections for profits would result in higher projected federal revenues.

CBO's baseline incorporates the assumption that total wages and salaries will equal about 46 percent of GDP between 2007 and 2017 and that taxable corporate profits will range from 6.3 percent to 9.9 percent of GDP over that period (see Chapter 4). If, instead, wages and salaries were 1 percentage point larger relative to GDP each year and corporate profits were 1 percentage point smaller, annual revenues would be $13 billion greater in 2007 and $25 billion greater by 2017 (see Table B-1). Those higher revenues would lead to an annual reduction in borrowing costs that would gradually reach $11 billion by 2017. Overall, under this scenario, the budget's bottom line would improve in each year of the projection period, and the cumulative 10-year surplus would be $243 billion larger than in CBO's baseline.

APPENDIX

C

# Budget Resolution Targets and Actual Outcomes

Budget resolutions, which are adopted by both Houses of Congress in most years, specify target levels of revenues and spending for the upcoming fiscal year. The targets in the 2006 concurrent budget resolution, adopted in April 2005, yielded a proposed budget deficit of $383 billion. The deficit for 2006 turned out to be $248 billion—$135 billion less than the deficit target that the budget resolution specified.

In 2006, total outlays were $2,654 billion—$77 billion higher than anticipated, primarily because of spending from supplemental appropriations that were not contemplated in the budget resolution. Revenues were $2,407 billion, about $212 billion higher than expected for the year, largely because of increased revenues from individual and corporate income taxes.

## Elements of the Analysis

The budget resolution—which consists of targets for spending, revenues, the deficit or surplus, and debt held by the public—is a concurrent resolution adopted by both Houses of Congress that sets forth the Congressional budget plan over five or more fiscal years. The resolution does not itself become law; instead, it serves as a blueprint for subsequent legislation. That legislation includes appropriation laws that are subject to limits set for discretionary spending, as well as changes in the laws that affect direct spending and revenues. Sometimes, reconciliation instructions in the resolution direct Congressional committees to make changes in programs under their jurisdiction to achieve direct-spending or revenue targets set in the budget resolution; that was the case for 2006.

For this analysis, the differences between the levels specified in the budget resolution and the actual outcomes are allocated among three categories: policy, economic, and technical. Although those categories help explain the discrepancies, the allocation is inexact and necessarily somewhat arbitrary.

Differences attributed to policy derive from enacted legislation not anticipated in the resolution, legislation anticipated in the resolution that was not enacted, or legislation that was estimated to cost a different amount than the resolution originally assumed. To identify differences arising from legislation, the Congressional Budget Office (CBO) normally uses the cost estimates that it prepared at the time the legislation was enacted. (To the extent that the actual budgetary impact is different from what CBO estimated, that difference is characterized as technical.)

Differences that can be linked directly to discrepancies between the economic assumptions underlying the budget resolution and the actual performance of the economy are labeled economic. Every budget resolution is based on assumptions about numerous economic variables—such as the growth of gross domestic product (GDP), taxable income, unemployment, inflation, and interest rates. Those assumptions are used to estimate revenues, spending for benefit programs, and net interest. Since 1992, the Congress has adopted the most recent economic assumptions published by CBO.[1] CBO's economic forecast for the budget resolution is usually made more than nine months before the fiscal year begins. Furthermore, forecasting the economy is an uncertain endeavor, and almost invariably, the economy's actual performance differs from the estimates, generating what CBO labels as economic differences.

1. The Congress used the Administration's forecast in the resolutions for 1982, 1986, 1989, 1990, and 1992. The budget resolutions for 1983 and 1991 were based on assumptions developed by the staff of the House and Senate Budget Committees.

**Table C-1.**

## Comparison of Budget Resolution Targets and Actual Budget Totals, 2006

(Billions of dollars)

| | Budget Resolution Targets | Actual Budget Totals | Differences (Actual minus resolution) |
|---|---|---|---|
| Revenues | 2,195 | 2,407 | 212 |
| Outlays | 2,577 | 2,654 | 77 |
| Deficit | -383 | -248 | 135 |

Source: Congressional Budget Office using data from H. Con. Res. 95, Concurrent Resolution on the Budget for Fiscal Year 2006 (adopted April 28, 2005).

Notes: The figures include amounts in Social Security trust funds and the net cash flow of the Postal Service, which are off-budget.

These comparisons differ from those in the chapters of this volume, where differences are measured relative to CBO's baseline projections.

Technical differences between the budget resolution targets and actual outcomes are those variations that do not arise directly from policy or economic sources. In the case of revenues, technical differences stem from a variety of factors, including changes in administrative tax rules, differences in the sources of taxable income that are not captured by the economic forecast, and changes in the amounts of income taxed at the various rates. In the case of benefit programs, factors such as an unanticipated change in the number of beneficiaries, unforeseen utilization of health care services, changes in farm commodity prices, or new regulations can produce technical differences.

## Comparing the Budget Resolution and Actual Outcomes for 2006

The budget resolution for 2006 adopted the economic assumptions that CBO published in January 2005, which also underpinned CBO's March 2005 baseline (prepared in conjunction with the agency's analysis of the President's 2006 budget). Using those assumptions and incorporating planned policy changes, the resolution established the following targets for the year: total outlays of $2,577 billion, revenues of $2,195 billion, and a deficit of $383 billion (see Table C-1). Ultimately, outlays were higher by $77 billion, and revenues were higher by $212 billion, resulting in a deficit that was $135 billion lower than the one set forth in the resolution. Technical factors, mostly on the revenue side of the budget, decreased the deficit by $122 billion, and a stronger-than-expected economy lowered the deficit by another $82 billion compared with the target (see Table C-2). Conversely, policy differences—primarily in the form of unanticipated discretionary outlays—raised the deficit by $69 billion relative to the target.

### Differences Arising from Technical Factors

Differences arising from technical factors—that is, differences between budget resolution targets and actual outcomes that cannot be traced to legislation or CBO's economic forecast—caused revenues to be higher by $112 billion (5.1 percent) and outlays to be lower by $10 billion (0.4 percent) than the target levels. On balance, technical factors pushed the deficit $122 billion lower than anticipated in the budget resolution.

The surge in revenues in 2006 exceeded the amount that would ordinarily be expected on the basis of the economy's performance. The reasons for that outcome are still unclear, and a full analysis of the year's results cannot be done now because information from tax returns about sources of individual and corporate income typically does not become available for a couple of years. The information currently available indicates that higher-than-expected noncorporate business income and capital gains (for both individuals and corporations), among other factors, may have boosted revenues.

The decrease in outlays attributable to technical differences resulted from lower-than-expected discretionary spending (a difference of $19 billion) and debt-service costs that were lower (by $5 billion—mostly resulting

**Table C-2.**

## Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, 2006

(Billions of dollars)

| | Differences Arising from | | | |
|---|---|---|---|---|
| | Policy Changes | Economic Factors | Technical Factors | Total Differences |
| Revenues | * | 100 | 112 | 212 |
| Outlays | | | | |
| Discretionary spending | 55 | 1 | -19 | 37 |
| Mandatory spending[a] | 13 | 1 | 14 | 28 |
| Net interest | 1 | 17 | -5 | 12 |
| **Total** | **68** | **18** | **-10** | **77** |
| Effect on the Deficit[b] | -69 | 82 | 122 | 135 |

Sources: Congressional Budget Office using data from H. Con. Res. 95, Concurrent Resolution on the Budget for Fiscal Year 2006 (adopted April 28, 2005); Office of Management and Budget.

Notes: Differences are actual outcomes minus budget resolution targets.

These comparisons differ from those in the chapters of this volume, where differences are measured relative to the Congressional Budget Office's baseline projections.

* = between -$500 million and zero.

a. Includes offsetting receipts.

b. Positive differences denote a reduction in the deficit; negative differences denote an increase.

from the increase in revenues). Those decreases were partially offset by an unexpected $14 billion rise in manda-tory spending. About one-third of the difference in discretionary spending is attributable to defense programs and the other two-thirds to nondefense activities. Much of the deviation in mandatory outlays resulted from adjustments to the estimated subsidy costs for federal credit programs—primarily for student loans.

### Differences Arising from Economic Factors

Overall, the economic assumptions underlying the 2006 budget resolution were somewhat different from actual growth, inflation, and interest rates. Deviations from the forecast led to an increase of $100 billion (or 4.6 percent) in revenues and an increase of $18 billion (or 0.7 percent) in outlays compared with the amounts in the resolution.

The resolution assumed that nominal GDP would grow by 5.9 percent in 2005 and 5.4 percent in 2006, but it actually grew by 6.4 percent and 6.5 percent in those years, respectively. The stronger-than-anticipated growth led to higher personal incomes; thus, economic developments helped increase overall individual income tax revenues by $17 billion. Corporate profits that were larger than expected on the basis of the economic forecast helped increase corporate income tax receipts by $75 billion. Collectively, higher personal incomes and corporate profits accounted for most of the $100 billion overage in revenues attributable to economic factors relative to the amount anticipated in the resolution.

Economic developments resulted in little difference between actual outlays for mandatory programs and spending assumed in the budget resolution. Outlays were lower than projected because of an unanticipated rise in oil and natural gas prices, which boosted government collections from onshore and offshore mineral leases (recorded as negative outlays in the budget). Those receipts were mostly offset by larger-than-anticipated increases in Social Security and Medicare outlays caused by higher-than-expected inflation. Overall, economic factors caused mandatory outlays to be only $1 billion higher than the amount assumed in the resolution.

Higher-than-anticipated interest rates drove projected net interest payments above the level assumed in the budget resolution. Most significantly, the resolution

assumed that short-term interest rates (those on three-month Treasury bills) would average 2.4 percent in 2005 and 3.8 percent in 2006; however, as a result of actions by the Federal Reserve, those rates averaged 2.7 percent and 4.5 percent, respectively. Consequently, outlays for net interest were $17 billion more in 2006 than the amount anticipated in the resolution.

### Differences Arising from Policy Changes

Of the many proposals anticipated in the budget resolution—some from the President's budget for 2006 and some originating in the Congress—a portion were eventually enacted, although sometimes in a different form than originally envisioned. In addition, some legislation was enacted that was not envisioned in the resolution. In total, policy actions taken (or assumed but not taken) after the budget resolution targets were established increased the deficit by $69 billion from the total assumed in the resolution. That net amount reflects $68 billion more in outlays than the resolution assumed and almost no net difference in revenues.

Discretionary outlays were raised by $55 billion because of unanticipated legislation, mostly supplemental appropriations. The resolution assumed total discretionary funding of $893 billion in 2006 (which includes $50 billion in anticipated appropriations for operations in Iraq and Afghanistan)—consistent with the amount requested in the President's budget. In fact, additional supplemental appropriations not envisioned in the resolution raised discretionary budget authority by $103 billion, generating substantial additional outlays. Most of that amount stemmed from costs of the operations in Iraq and Afghanistan and hurricane relief and recovery, which were funded in supplemental appropriation laws in December 2005 (Public Law 109-148) and June 2006 (P.L. 109-234).

Mandatory spending was also altered by legislation not contemplated in the budget resolution. The Congress enacted a series of laws that raised the limit of the National Flood Insurance Program's borrowing authority from $1.5 billion to $20.8 billion following the Gulf Coast hurricanes of 2005. The program spent $16.5 billion in 2006 using that additional authority.

The budget resolution provided reconciliation instructions to various committees in the House and the Senate to prepare legislation that would reduce both mandatory spending and revenues.[2] The instructions called for reductions in mandatory outlays of about $2 billion for 2006 and $35 billion from 2006 to 2010. By CBO's estimate, the resulting Deficit Reduction Act of 2005 (P. L. 109-171) reduced mandatory outlays by $5 billion in 2006—$3 billion more than the reconciliation target for the year. With that $3 billion decrease included, differences arising from policy changes accounted for a total of $13 billion in additional mandatory outlays in 2006.

The reconciliation instructions also sought to reduce revenues by up to $11 billion in 2006 and by as much as $70 billion from 2006 to 2010. When enacted, the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) lowered revenues in 2006 by an estimated $11 billion, the target amount.[3]

Revenues were affected by other legislation as well. According to CBO's and the Joint Committee on Taxation's estimates, the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135) provided $7 billion in tax relief in 2006 to hurricane victims. That amount was equal to a reduction in revenues (other than from reconciliation) that was assumed in the resolution.

## Comparing Budget Resolutions and Actual Outcomes from 1982 to 2006

At the end of each fiscal year, actual outlays and revenues have always differed to varying degrees from budget resolution targets for that fiscal year. Over the past 25 years, the actual deficit has differed from the budget resolution target by an absolute average of $74 billion, or 5 percent of actual outlays (see Table C-3). Of the 22 years in which budget resolutions were adopted, the outcome was worse than anticipated in 14 years and better than expected in 8 years. Over the 1982–1992 period, the deficit consistently exceeded the target in the resolution by amounts ranging from $4 billion in 1984 to $119 billion in 1990. That pattern changed in 1993, in part because spending for deposit insurance was substantially lower than expected. From 1994 to 2000, actual outcomes

2. The resolution also provided for a third bill to raise the limit on the public debt to $8.965 trillion.

3. See the Congressional Budget Office's cost estimate for H.R. 4297, the Tax Increase Prevention and Reconciliation Act of 2005 (June 2, 2006).

**Table C-3.**

## Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, 1982 to 2006

(Billions of dollars)

| | Differences Arising from | | | Total Differences | Total Differences as a Percentage of Actual Outcomes |
|---|---|---|---|---|---|
| | Policy Changes | Economic Factors | Technical Factors | | |
| | | | Revenues | | |
| 1982 | 13 | -52 | -1 | -40 | -6.5 |
| 1983 | -5 | -58 | -3 | -65 | -10.8 |
| 1984 | -14 | 4 | -4 | -13 | -2.0 |
| 1985 | * | -20 | 3 | -17 | -2.3 |
| 1986 | -1 | -23 | -2 | -27 | -3.5 |
| 1987 | 22 | -27 | 7 | 2 | 0.2 |
| 1988 | -11 | 4 | -17 | -24 | -2.6 |
| 1989 | 1 | 34 | -8 | 26 | 2.6 |
| 1990 | -7 | -36 | 9 | -34 | -3.3 |
| 1991[a] | -1 | -31 | -24 | -56 | -5.3 |
| 1992 | 3 | -46 | -34 | -78 | -7.1 |
| 1993 | 4 | -28 | 3 | -20 | -1.7 |
| 1994 | -1 | 12 | 4 | 15 | 1.2 |
| 1995 | * | 16 | 1 | 17 | 1.3 |
| 1996 | -1 | 24 | 12 | 36 | 2.5 |
| 1997 | 20 | 44 | 46 | 110 | 7.0 |
| 1998 | -1 | 62 | 59 | 120 | 7.0 |
| 1999 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2000 | 3 | 78 | 68 | 149 | 7.4 |
| 2001 | -65 | 25 | 26 | -14 | -0.7 |
| 2002 | -9 | -125 | -183 | -317 | -17.1 |
| 2003 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2004 | 9 | 8 | -20 | -3 | -0.2 |
| 2005 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2006 | * | 100 | 112 | 212 | 8.8 |
| Average | -2 | -2 | 3 | -1 | -1.1 |
| Absolute Average[b] | 10 | 39 | 29 | 63 | 4.6 |

Continued

continued to be more favorable than the targets (with the exception of 1999, when there was no conference agreement on a budget resolution). However, in 2001, 2002, and 2004, higher-than-anticipated outlays and lower-than-expected revenues combined to produce a lower surplus or a bigger deficit than what was envisioned in the resolutions for each of those years.[4] In 2006, both revenues and outlays exceeded the amounts assumed in the resolution; the revenue increase was much bigger, and the deficit was lower than expected.

### Differences Arising from Policy Changes

Over the past 25 years, policy action or inaction (for example, the failure to achieve savings called for in a budget resolution) increased the deficit or decreased the surplus by an average of $21 billion a year compared with the target. In only four of those years did policymakers trim the deficit more, or add to it less, than the resolution provided. The largest differences attributable to policy

4. For 2003 and 2005, there was no conference agreement on a budget resolution.

## Table C-3.
## Continued

(Billions of dollars)

| | Differences Arising from | | | Total Differences | Total Differences as a Percentage of Actual Outcomes |
|---|---|---|---|---|---|
| | Policy Changes | Economic Factors | Technical Factors | | |
| | | | Outlays | | |
| 1982 | 1 | 24 | 8 | 33 | 4.4 |
| 1983 | 18 | * | 8 | 26 | 3.2 |
| 1984 | 1 | 7 | -18 | -9 | -1.1 |
| 1985 | 23 | -5 | -13 | 5 | 0.5 |
| 1986 | 14 | -12 | 20 | 22 | 2.2 |
| 1987 | 7 | -12 | 13 | 8 | 0.8 |
| 1988 | -2 | 12 | 12 | 22 | 2.1 |
| 1989 | 17 | 14 | 12 | 43 | 3.8 |
| 1990 | 13 | 13 | 59 | 85 | 6.8 |
| 1991[a] | -19 | 1 | -22 | -40 | -3.0 |
| 1992 | 15 | -21 | -60 | -66 | -4.8 |
| 1993 | 16 | -19 | -90 | -92 | -6.5 |
| 1994 | 10 | -9 | -36 | -35 | -2.4 |
| 1995 | 2 | 17 | -14 | 6 | 0.4 |
| 1996 | 25 | -24 | -29 | -28 | -1.8 |
| 1997 | 15 | 7 | -43 | -21 | -1.3 |
| 1998 | 5 | -9 | -37 | -41 | -2.5 |
| 1999 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2000 | 65 | -1 | -10 | 54 | 3.0 |
| 2001 | 30 | -1 | * | 29 | 1.6 |
| 2002 | 46 | -5 | 18 | 59 | 2.9 |
| 2003 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2004 | 53 | -19 | -10 | 24 | 1.0 |
| 2005 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2006 | 68 | 18 | -10 | 77 | 2.9 |
| Average | 19 | -1 | -11 | 7 | 0.6 |
| Absolute Average[b] | 21 | 12 | 25 | 37 | 2.7 |

Continued

changes decreased the surplus by $61 billion in 2000 and $95 billion in 2001 and increased the deficit by $69 billion in 2006 in comparison with the targets. (By contrast, from 1982 to 1998, the differences ascribed to policy changes averaged $8 billion a year.)

Most of the impact stemming from legislation over the period was on the outlay side of the budget. On average, policy decisions added about $19 billion a year more than anticipated to the spending totals. In fact, 1988 and 1991 were the only years in which legislative action held outlays below the budget resolution targets. The biggest difference due to policy changes was in 2006, when the effects of legislation increased outlays by $68 billion, mostly from higher-than-expected supplemental spending—primarily for military operations in Iraq and Afghanistan as well as hurricane relief and recovery. The difference in 2000 was second largest: a $65 billion increase in outlays, mainly resulting from discretionary appropriations and unanticipated assistance to agricultural producers. On the revenue side of the budget, the largest difference arising from policy changes occurred in

## Table C-3.
## Continued

(Billions of dollars)

| | Differences Arising from | | | Total Differences | Total Differences as a Percentage of Actual Outcomes |
|---|---|---|---|---|---|
| | Policy Changes | Economic Factors | Technical Factors | | |
| | | | Effect on Deficit or Surplus[c] | | |
| 1982 | 12 | -76 | -9 | -73 | -9.8 |
| 1983 | -22 | -59 | -11 | -92 | -11.4 |
| 1984 | -15 | -3 | 14 | -4 | -0.5 |
| 1985 | -23 | -15 | 16 | -22 | -2.3 |
| 1986 | -16 | -11 | -22 | -49 | -4.9 |
| 1987 | 15 | -15 | -6 | -6 | -0.6 |
| 1988 | -9 | -8 | -29 | -46 | -4.3 |
| 1989 | -17 | 20 | -20 | -17 | -1.5 |
| 1990 | -20 | -49 | -50 | -119 | -9.5 |
| 1991[a] | 19 | -32 | -2 | -15 | -1.1 |
| 1992 | -12 | -25 | 26 | -11 | -0.8 |
| 1993 | -12 | -9 | 93 | 72 | 5.1 |
| 1994 | -11 | 21 | 40 | 50 | 3.4 |
| 1995 | -2 | -2 | 15 | 11 | 0.7 |
| 1996 | -25 | 48 | 40 | 63 | 4.0 |
| 1997 | 5 | 37 | 89 | 131 | 8.2 |
| 1998 | -7 | 71 | 97 | 160 | 9.7 |
| 1999 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2000 | -61 | 79 | 77 | 95 | 5.3 |
| 2001 | -95 | 26 | 26 | -43 | -2.3 |
| 2002 | -56 | -119 | -202 | -376 | -18.7 |
| 2003 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2004 | -44 | 27 | -10 | -27 | -1.2 |
| 2005 | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2006 | -69 | 82 | 122 | 135 | 5.1 |
| Average | -21 | -1 | 13 | -8 | -1.2 |
| Absolute Average[b] | 26 | 38 | 46 | 74 | 5.0 |

Source: Congressional Budget Office.

Notes: Differences, which are actual outcomes minus budget resolution targets, are allocated among the three categories soon after the fiscal year ends. Later changes in economic data will not be reflected in those allocations.

* = between -$500 million and $500 million; n.a. = not applicable (there was no budget resolution in 1999, 2003, and 2005).

a. Based on the budget summit agreement for fiscal year 1991 (as assessed by CBO in December 1990).

b. The absolute average disregards whether the differences are positive or negative.

c. Positive differences denote a reduction in the deficit or an increase in the surplus; negative differences denote an increase in the deficit or a decrease in the surplus. Total differences are calculated as a percentage of actual outlays.

2001, when the Economic Growth and Tax Relief Reconciliation Act reduced taxes by $65 billion more than was anticipated by the resolution. The differences in subsequent years were much smaller.

### Differences Arising from Economic Factors

Inaccuracies in the economic forecast from 1982 to 2006 had a small net effect on the cumulative variation between resolution targets and actual outcomes. However, large differences were recorded in many years—deviations that mostly worsened the budgetary outcome occurred before 1994, and ones that improved the budgetary outcome occurred more recently (except for 2002). Until 1993, budget resolutions tended to use short-term economic assumptions that proved optimistic. The largest underestimates of deficits in the 1980s and early 1990s, not surprisingly, were in years marked by recession or the early stages of recovery—namely, in 1982 and 1983 and over the 1990–1992 period. In 2002, the economic assumptions were again too optimistic, resulting in a $119 billion difference between the budget resolution target and the actual outcome—contributing to that year's deficit, although the resolution envisioned a surplus. In contrast, the solid growth of the economy during this past year meant that the economic assumptions underlying the 2006 resolution were not optimistic enough: as a result, economic factors narrowed the deficit by $82 billion relative to what was assumed in the budget resolution.

In absolute terms (disregarding whether the errors were positive or negative), the typical difference in the surplus or deficit attributable to incorrect economic assumptions was about $38 billion a year from 1982 through 2006. Regardless of the direction of the errors in the forecasts, differences between the resolutions' assumptions and what happened in the economy primarily affected revenues.

### Differences Arising from Technical Factors

Technical factors accounted for differences between budget resolution targets and actual deficits or surpluses that averaged $13 billion a year since 1982. In absolute terms, however, such differences caused the targets to be off by an average of $46 billion. Overall, in absolute terms, those deviations were somewhat higher on the revenue side than on the outlay side of the budget.

The magnitude and causes of the differences ascribed to technical factors have varied over the years. On the revenue side, technical misestimates were generally small through 1990, but the budget resolutions significantly overestimated revenues in 1991 and 1992, when tax collections were weaker than economic data suggested. From 1997 through 2001, revenues were much higher than the budget resolution targets, but in 2002, the resolution again overestimated tax collections, by $183 billion. The largest underestimate of revenues that was attributable to technical factors occurred in 2006: $112 billion.

Misestimates arising from technical factors have also shown up on the outlay side of the budget. Through the mid-1980s, discrepancies in estimating receipts from offshore oil leases and spending on farm price supports, defense, and entitlement programs were the dominant technical differences. In the early 1990s, during the savings and loan crisis, outlays for deposit insurance were a major source of discrepancies attributable to technical factors. In recent years, technical differences between the resolutions' estimates of outlays and actual outlays have been relatively small and spread among a variety of programs. In 2006, the difference was $10 billion.

## Differences as a Percentage of Actual Revenues or Outlays

Because the federal budget has grown considerably since 1982, differences between the revenue and spending levels in the budget resolutions and actual outcomes over the 1982–2006 period may be best compared as a percentage of total revenues or outlays. The revenue difference for 2006, at 8.8 percent above the budget resolution target, contrasts with the smaller absolute average of 4.6 percent over the 25-year period (for the 22 years in which there was a conference agreement on the resolution). The total difference for outlays in 2006 was 2.9 percent above the budget resolution target—slightly higher than the 2.7 percent absolute average difference for the 1982–2006 period.

The size of the total difference between actual deficits or surpluses and the deficits or surpluses anticipated in budget resolutions depends in large part on whether the differences in revenues and outlays offset each other. From 1982 through 2006, the differences between estimates of revenues and outlays in the budget resolutions and the actual amounts went in the same direction in terms of their impact on the deficit or surplus in 13 of the 22 years in which a resolution was adopted. In those 13 years, the average difference in absolute terms was 6.9 percent of

actual outlays. In the other 9 years, the discrepancies for both revenues and outlays affected the deficit or surplus in opposite directions. For those years, the average total difference in absolute terms dropped to 2.3 percent of outlays. Although the 2006 outcomes for both revenues and outlays turned out to be higher than expected, the net effect on the deficit (5.1 percent of actual outlays) was close to the absolute average (5.0 percent of actual outlays).

APPENDIX

# D

# CBO's Economic Projections for 2007 to 2017

The tables in this appendix expand on the information in Chapter 2 by showing the Congressional Budget Office's (CBO's) year-by-year economic projections for 2007 to 2017 (by calendar year in Table D-1 and by fiscal year in Table D-2). CBO does not forecast cyclical fluctuations in its projections for years after 2008. Instead, the projected values shown in the tables for 2009 through 2017 reflect CBO's assessment of average values for that period. That assessment takes into account economic and demographic trends as well as the effects of current fiscal policy on those trends but does not attempt to forecast the frequency and magnitude of ups and downs in the business cycle.

## Table D-1.

# CBO's Year-by-Year Forecast and Projections for Calendar Years 2007 to 2017

| | Estimated | Forecast | | Projected | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| Nominal GDP (Billions of dollars) | 13,235 | 13,805 | 14,472 | 15,196 | 15,923 | 16,647 | 17,395 | 18,169 | 18,966 | 19,791 | 20,639 | 21,519 |
| Nominal GDP (Percentage change) | 6.3 | 4.3 | 4.8 | 5.0 | 4.8 | 4.5 | 4.5 | 4.4 | 4.4 | 4.3 | 4.3 | 4.3 |
| Real GDP (Percentage change) | 3.3 | 2.3 | 3.0 | 3.1 | 3.0 | 2.7 | 2.7 | 2.6 | 2.5 | 2.5 | 2.5 | 2.4 |
| GDP Price Index (Percentage change) | 2.9 | 1.9 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| PCE Price Index[a] (Percentage change) | 2.8 | 1.7 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Core PCE Price Index[b] (Percentage change) | 2.3 | 2.1 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 1.9 | 2.0 | 2.0 | 1.9 | 1.9 |
| Consumer Price Index[c] (Percentage change) | 3.4 | 1.9 | 2.3 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Core Consumer Price Index[d] (Percentage change) | 2.6 | 2.6 | 2.3 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Employment Cost Index[e] (Percentage change) | 3.0 | 3.4 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 |
| Unemployment Rate (Percent) | 4.6 | 4.7 | 4.9 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Three-Month Treasury Bill Rate (Percent) | 4.7 | 4.8 | 4.5 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 |
| Ten-Year Treasury Note Rate (Percent) | 4.8 | 4.8 | 5.0 | 5.1 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 |
| Tax Bases (Billions of dollars) | | | | | | | | | | | | |
| Corporate book profits | 1,795 | 1,775 | 1,787 | 1,766 | 1,738 | 1,743 | 1,763 | 1,806 | 1,865 | 1,941 | 2,029 | 2,126 |
| Wages and salaries | 6,032 | 6,330 | 6,642 | 6,989 | 7,335 | 7,673 | 8,019 | 8,372 | 8,727 | 9,094 | 9,471 | 9,860 |
| Tax Bases (Percentage of GDP) | | | | | | | | | | | | |
| Corporate book profits | 13.6 | 12.9 | 12.3 | 11.6 | 10.9 | 10.5 | 10.1 | 9.9 | 9.8 | 9.8 | 9.8 | 9.9 |
| Wages and salaries | 45.6 | 45.9 | 45.9 | 46.0 | 46.1 | 46.1 | 46.1 | 46.1 | 46.0 | 46.0 | 45.9 | 45.8 |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: GDP = gross domestic product; percentage changes are measured from one year to the next.

a. The personal consumption expenditure chained price index.

b. The personal consumption expenditure chained price index excluding prices for food and energy.

c. The consumer price index for all urban consumers.

d. The consumer price index for all urban consumers excluding prices for food and energy.

e. The employment cost index for wages and salaries of workers in private industry.

**Table D-2.**

# CBO's Year-by-Year Forecast and Projections for Fiscal Years 2007 to 2017

| | Actual | Forecast | | Projected | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| Nominal GDP (Billions of dollars) | 13,065 | 13,645 | 14,300 | 15,014 | 15,742 | 16,465 | 17,205 | 17,973 | 18,764 | 19,582 | 20,425 | 21,295 |
| Nominal GDP (Percentage change) | 6.5 | 4.4 | 4.8 | 5.0 | 4.9 | 4.6 | 4.5 | 4.5 | 4.4 | 4.4 | 4.3 | 4.3 |
| Real GDP (Percentage change) | 3.3 | 2.4 | 2.9 | 3.1 | 3.0 | 2.8 | 2.7 | 2.6 | 2.6 | 2.5 | 2.5 | 2.5 |
| GDP Price Index (Percentage change) | 3.1 | 2.0 | 1.9 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 | 1.8 |
| PCE Price Index[a] (Percentage change) | 3.1 | 1.7 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Core PCE Price Index[b] (Percentage change) | 2.2 | 2.2 | 1.9 | 2.0 | 2.0 | 2.0 | 2.0 | 1.9 | 2.0 | 2.0 | 2.0 | 1.9 |
| Consumer Price Index[c] (Percentage change) | 3.7 | 1.9 | 2.3 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Core Consumer Price Index[d] (Percentage change) | 2.4 | 2.7 | 2.3 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Employment Cost Index[e] (Percentage change) | 2.8 | 3.4 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 | 3.3 |
| Unemployment Rate (Percent) | 4.8 | 4.6 | 4.9 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Three-Month Treasury Bill Rate (Percent) | 4.5 | 4.9 | 4.5 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 | 4.4 |
| Ten-Year Treasury Note Rate (Percent) | 4.8 | 4.8 | 5.0 | 5.1 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 | 5.2 |
| Tax Bases (Billions of dollars) | | | | | | | | | | | | |
| Corporate book profits | 1,751 | 1,766 | 1,789 | 1,773 | 1,744 | 1,739 | 1,758 | 1,792 | 1,848 | 1,922 | 2,007 | 2,102 |
| Wages and salaries | 5,948 | 6,254 | 6,559 | 6,902 | 7,249 | 7,588 | 7,930 | 8,284 | 8,637 | 9,001 | 9,376 | 9,761 |
| Tax Bases (Percentage of GDP) | | | | | | | | | | | | |
| Corporate book profits | 13.4 | 12.9 | 12.5 | 11.8 | 11.1 | 10.6 | 10.2 | 10.0 | 9.8 | 9.8 | 9.8 | 9.9 |
| Wages and salaries | 45.5 | 45.8 | 45.9 | 46.0 | 46.0 | 46.1 | 46.1 | 46.1 | 46.0 | 46.0 | 45.9 | 45.8 |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: GDP = gross domestic product; percentage changes are measured from one year to the next.

a. The personal consumption expenditure chained price index.

b. The personal consumption expenditure chained price index excluding prices for food and energy.

c. The consumer price index for all urban consumers.

d. The consumer price index for all urban consumers excluding prices for food and energy.

e. The employment cost index for wages and salaries of workers in private industry.

APPENDIX

E

# Historical Budget Data

This appendix provides historical data for revenues, outlays, and the deficit or surplus—in forms consistent with the projections in Chapters 1, 3, and 4—for fiscal years 1962 to 2006. The data are shown in both nominal dollars and as a percentage of gross domestic product (GDP). Data for 2006 come from the Congressional Budget Office and the Office of Management and Budget. Some of the numbers have been revised since the last time these tables were published, in January 2006.

Federal revenues, outlays, the deficit or surplus, and debt held by the public are shown in Tables E-1 and E-2. Revenues, outlays, and the deficit or surplus have both on-budget and off-budget components. Social Security's receipts and outlays were placed off-budget by the Balanced Budget and Emergency Deficit Control Act of 1985. For the sake of consistency, the tables show the budgetary components of Social Security as off-budget prior to that year. The Postal Service was moved off-budget by the Omnibus Reconciliation Act of 1989.

The major sources of federal revenues (including off-budget revenues) are presented in Tables E-3 and E-4. Social insurance taxes include payments by both employers and employees for Social Security, Medicare, Railroad Retirement, and unemployment insurance, as well as pension contributions by federal workers. Excise taxes are levied on certain products and services, such as gasoline, alcoholic beverages, and air travel. Estate and gift taxes are levied on assets when they are transferred. Miscellaneous receipts consist of earnings of the Federal Reserve System and income from numerous fees and charges.

Total outlays for major categories of spending appear in Tables E-5 and E-6. (Those totals include both on- and off-budget outlays.) Spending controlled by the appropriation process is classified as discretionary. Spending governed by permanent laws, such as those that set eligibility requirements for certain programs, is considered mandatory. Offsetting receipts include the government's contributions to retirement programs for its employees, fees, charges (such as Medicare premiums), and receipts from the use of federally controlled land and offshore territory. Net interest (function 900 of the budget) comprises the interest paid by the government on federal debt offset by its interest income.

Tables E-7 and E-8 divide discretionary spending into its defense, international, and domestic components. Tables E-9 and E-10 classify mandatory spending by the three major entitlement programs—Social Security, Medicare, and Medicaid—and by other categories of mandatory spending. Income-security programs provide benefits to recipients with limited income and assets; those programs include unemployment compensation, Supplemental Security Income, and Food Stamps. Other federal retirement and disability programs provide benefits to federal civilian employees, members of the military, and veterans. The category of other mandatory programs includes the activities of the Commodity Credit Corporation, Tricare For Life (which provides health care benefits to retirees of the uniformed services who are eligible for Medicare), the subsidy costs of federal student loan programs, the Universal Service Fund (which reduces the cost of telecommunications services for selected areas and individuals), the State Children's Health Insurance Program, and the Social Services Block Grant program.

The remaining tables, E-11 through E-13, show estimates of the standardized-budget deficit or surplus and its outlay and revenue components. The standardized-budget deficit or surplus attempts to filter out the effects that cyclical fluctuations in output and unemployment have on revenues and outlays; it also incorporates other adjustments. The change in that deficit or surplus is commonly used to measure the short-term impact of fiscal policy on total demand. Table E-11 also presents estimates of potential and actual GDP.

## Table E-1.

# Revenues, Outlays, Surpluses, Deficits, and Debt Held by the Public, 1962 to 2006

(Billions of dollars)

| | | | Deficit (-) or Surplus | | | | Debt |
|---|---|---|---|---|---|---|---|
| | Revenues | Outlays | On-Budget | Social Security | Postal Service | Total | Held by the Public[a] |
| 1962 | 99.7 | 106.8 | -5.9 | -1.3 | n.a. | -7.1 | 248.0 |
| 1963 | 106.6 | 111.3 | -4.0 | -0.8 | n.a. | -4.8 | 254.0 |
| 1964 | 112.6 | 118.5 | -6.5 | 0.6 | n.a. | -5.9 | 256.8 |
| 1965 | 116.8 | 118.2 | -1.6 | 0.2 | n.a. | -1.4 | 260.8 |
| 1966 | 130.8 | 134.5 | -3.1 | -0.6 | n.a. | -3.7 | 263.7 |
| 1967 | 148.8 | 157.5 | -12.6 | 4.0 | n.a. | -8.6 | 266.6 |
| 1968 | 153.0 | 178.1 | -27.7 | 2.6 | n.a. | -25.2 | 289.5 |
| 1969 | 186.9 | 183.6 | -0.5 | 3.7 | n.a. | 3.2 | 278.1 |
| 1970 | 192.8 | 195.6 | -8.7 | 5.9 | n.a. | -2.8 | 283.2 |
| 1971 | 187.1 | 210.2 | -26.1 | 3.0 | n.a. | -23.0 | 303.0 |
| 1972 | 207.3 | 230.7 | -26.1 | 3.1 | -0.4 | -23.4 | 322.4 |
| 1973 | 230.8 | 245.7 | -15.2 | 0.5 | -0.2 | -14.9 | 340.9 |
| 1974 | 263.2 | 269.4 | -7.2 | 1.8 | -0.8 | -6.1 | 343.7 |
| 1975 | 279.1 | 332.3 | -54.1 | 2.0 | -1.1 | -53.2 | 394.7 |
| 1976 | 298.1 | 371.8 | -69.4 | -3.2 | -1.1 | -73.7 | 477.4 |
| 1977 | 355.6 | 409.2 | -49.9 | -3.9 | 0.2 | -53.7 | 549.1 |
| 1978 | 399.6 | 458.7 | -55.4 | -4.3 | 0.5 | -59.2 | 607.1 |
| 1979 | 463.3 | 504.0 | -39.6 | -2.0 | 0.9 | -40.7 | 640.3 |
| 1980 | 517.1 | 590.9 | -73.1 | -1.1 | 0.4 | -73.8 | 711.9 |
| 1981 | 599.3 | 678.2 | -73.9 | -5.0 | -0.1 | -79.0 | 789.4 |
| 1982 | 617.8 | 745.7 | -120.6 | -7.9 | 0.6 | -128.0 | 924.6 |
| 1983 | 600.6 | 808.4 | -207.7 | 0.2 | -0.3 | -207.8 | 1,137.3 |
| 1984 | 666.5 | 851.9 | -185.3 | 0.3 | -0.4 | -185.4 | 1,307.0 |
| 1985 | 734.1 | 946.4 | -221.5 | 9.4 | -0.1 | -212.3 | 1,507.3 |
| 1986 | 769.2 | 990.4 | -237.9 | 16.7 | * | -221.2 | 1,740.6 |
| 1987 | 854.4 | 1,004.1 | -168.4 | 19.6 | -0.9 | -149.7 | 1,889.8 |
| 1988 | 909.3 | 1,064.5 | -192.3 | 38.8 | -1.7 | -155.2 | 2,051.6 |
| 1989 | 991.2 | 1,143.8 | -205.4 | 52.4 | 0.3 | -152.6 | 2,190.7 |
| 1990 | 1,032.1 | 1,253.1 | -277.6 | 58.2 | -1.6 | -221.0 | 2,411.6 |
| 1991 | 1,055.1 | 1,324.3 | -321.4 | 53.5 | -1.3 | -269.2 | 2,689.0 |
| 1992 | 1,091.3 | 1,381.6 | -340.4 | 50.7 | -0.7 | -290.3 | 2,999.7 |
| 1993 | 1,154.5 | 1,409.5 | -300.4 | 46.8 | -1.4 | -255.1 | 3,248.4 |
| 1994 | 1,258.7 | 1,461.9 | -258.8 | 56.8 | -1.1 | -203.2 | 3,433.1 |
| 1995 | 1,351.9 | 1,515.9 | -226.4 | 60.4 | 2.0 | -164.0 | 3,604.4 |
| 1996 | 1,453.2 | 1,560.6 | -174.0 | 66.4 | 0.2 | -107.4 | 3,734.1 |
| 1997 | 1,579.4 | 1,601.3 | -103.2 | 81.3 | * | -21.9 | 3,772.3 |
| 1998 | 1,722.0 | 1,652.7 | -29.9 | 99.4 | -0.2 | 69.3 | 3,721.1 |
| 1999 | 1,827.6 | 1,702.0 | 1.9 | 124.7 | -1.0 | 125.6 | 3,632.4 |
| 2000 | 2,025.5 | 1,789.2 | 86.4 | 151.8 | -2.0 | 236.2 | 3,409.8 |
| 2001 | 1,991.4 | 1,863.2 | -32.4 | 163.0 | -2.3 | 128.2 | 3,319.6 |
| 2002 | 1,853.4 | 2,011.2 | -317.4 | 159.0 | 0.7 | -157.8 | 3,540.4 |
| 2003 | 1,782.5 | 2,160.1 | -538.4 | 155.6 | 5.2 | -377.6 | 3,913.4 |
| 2004 | 1,880.3 | 2,293.0 | -568.0 | 151.1 | 4.1 | -412.7 | 4,295.5 |
| 2005 | 2,153.9 | 2,472.2 | -493.6 | 173.5 | 1.8 | -318.3 | 4,592.2 |
| 2006 | 2,406.7 | 2,654.3 | -434.0 | 185.2 | 1.1 | -247.6 | 4,829.1 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: n.a. = not applicable; * = between zero and $50 million.

a. End of year.

**Table E-2.**

# Revenues, Outlays, Surpluses, Deficits, and Debt Held by the Public, 1962 to 2006

(Percentage of gross domestic product)

| | | | Deficit (-) or Surplus | | | | Debt |
|---|---|---|---|---|---|---|---|
| | Revenues | Outlays | On-Budget | Social Security | Postal Service | Total | Held by the Public[a] |
| 1962 | 17.6 | 18.8 | -1.0 | -0.2 | n.a. | -1.3 | 43.7 |
| 1963 | 17.8 | 18.6 | -0.7 | -0.1 | n.a. | -0.8 | 42.4 |
| 1964 | 17.6 | 18.5 | -1.0 | 0.1 | n.a. | -0.9 | 40.0 |
| 1965 | 17.0 | 17.2 | -0.2 | * | n.a. | -0.2 | 37.9 |
| 1966 | 17.3 | 17.8 | -0.4 | -0.1 | n.a. | -0.5 | 34.9 |
| 1967 | 18.4 | 19.4 | -1.6 | 0.5 | n.a. | -1.1 | 32.9 |
| 1968 | 17.6 | 20.5 | -3.2 | 0.3 | n.a. | -2.9 | 33.3 |
| 1969 | 19.7 | 19.4 | -0.1 | 0.4 | n.a. | 0.3 | 29.3 |
| 1970 | 19.0 | 19.3 | -0.9 | 0.6 | n.a. | -0.3 | 28.0 |
| 1971 | 17.3 | 19.5 | -2.4 | 0.3 | n.a. | -2.1 | 28.1 |
| 1972 | 17.6 | 19.6 | -2.2 | 0.3 | * | -2.0 | 27.4 |
| 1973 | 17.6 | 18.7 | -1.2 | * | * | -1.1 | 26.0 |
| 1974 | 18.3 | 18.7 | -0.5 | 0.1 | -0.1 | -0.4 | 23.9 |
| 1975 | 17.9 | 21.3 | -3.5 | 0.1 | -0.1 | -3.4 | 25.3 |
| 1976 | 17.1 | 21.4 | -4.0 | -0.2 | -0.1 | -4.2 | 27.5 |
| 1977 | 18.0 | 20.7 | -2.5 | -0.2 | * | -2.7 | 27.8 |
| 1978 | 18.0 | 20.7 | -2.5 | -0.2 | * | -2.7 | 27.4 |
| 1979 | 18.5 | 20.1 | -1.6 | -0.1 | * | -1.6 | 25.6 |
| 1980 | 19.0 | 21.7 | -2.7 | * | * | -2.7 | 26.1 |
| 1981 | 19.6 | 22.2 | -2.4 | -0.2 | * | -2.6 | 25.8 |
| 1982 | 19.2 | 23.1 | -3.7 | -0.2 | * | -4.0 | 28.7 |
| 1983 | 17.4 | 23.5 | -6.0 | * | * | -6.0 | 33.0 |
| 1984 | 17.3 | 22.1 | -4.8 | * | * | -4.8 | 34.0 |
| 1985 | 17.7 | 22.8 | -5.3 | 0.2 | * | -5.1 | 36.3 |
| 1986 | 17.5 | 22.5 | -5.4 | 0.4 | * | -5.0 | 39.5 |
| 1987 | 18.4 | 21.6 | -3.6 | 0.4 | * | -3.2 | 40.6 |
| 1988 | 18.1 | 21.2 | -3.8 | 0.8 | * | -3.1 | 40.9 |
| 1989 | 18.3 | 21.2 | -3.8 | 1.0 | * | -2.8 | 40.6 |
| 1990 | 18.0 | 21.8 | -4.8 | 1.0 | * | -3.9 | 42.0 |
| 1991 | 17.8 | 22.3 | -5.4 | 0.9 | * | -4.5 | 45.3 |
| 1992 | 17.5 | 22.1 | -5.5 | 0.8 | * | -4.7 | 48.1 |
| 1993 | 17.5 | 21.4 | -4.6 | 0.7 | * | -3.9 | 49.4 |
| 1994 | 18.1 | 21.0 | -3.7 | 0.8 | * | -2.9 | 49.3 |
| 1995 | 18.5 | 20.7 | -3.1 | 0.8 | * | -2.2 | 49.2 |
| 1996 | 18.9 | 20.3 | -2.3 | 0.9 | * | -1.4 | 48.5 |
| 1997 | 19.3 | 19.6 | -1.3 | 1.0 | * | -0.3 | 46.1 |
| 1998 | 20.0 | 19.2 | -0.3 | 1.2 | * | 0.8 | 43.1 |
| 1999 | 20.0 | 18.6 | * | 1.4 | * | 1.4 | 39.8 |
| 2000 | 20.9 | 18.4 | 0.9 | 1.6 | * | 2.4 | 35.1 |
| 2001 | 19.8 | 18.5 | -0.3 | 1.6 | * | 1.3 | 33.0 |
| 2002 | 17.9 | 19.4 | -3.1 | 1.5 | * | -1.5 | 34.1 |
| 2003 | 16.5 | 20.0 | -5.0 | 1.4 | * | -3.5 | 36.2 |
| 2004 | 16.3 | 19.9 | -4.9 | 1.3 | * | -3.6 | 37.3 |
| 2005 | 17.6 | 20.2 | -4.0 | 1.4 | * | -2.6 | 37.4 |
| 2006 | 18.4 | 20.3 | -3.3 | 1.4 | * | -1.9 | 37.0 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: n.a. = not applicable; * = between -0.05 percent and 0.05 percent.

a. End of year.

## Table E-3.

# Revenues by Major Source, 1962 to 2006

(Billions of dollars)

| | Individual Income Taxes | Corporate Income Taxes | Social Insurance Taxes | Excise Taxes | Estate and Gift Taxes | Customs Duties | Miscellaneous Receipts | Total Revenues |
|---|---|---|---|---|---|---|---|---|
| 1962 | 45.6 | 20.5 | 17.0 | 12.5 | 2.0 | 1.1 | 0.8 | 99.7 |
| 1963 | 47.6 | 21.6 | 19.8 | 13.2 | 2.2 | 1.2 | 1.0 | 106.6 |
| 1964 | 48.7 | 23.5 | 22.0 | 13.7 | 2.4 | 1.3 | 1.1 | 112.6 |
| 1965 | 48.8 | 25.5 | 22.2 | 14.6 | 2.7 | 1.4 | 1.6 | 116.8 |
| 1966 | 55.4 | 30.1 | 25.5 | 13.1 | 3.1 | 1.8 | 1.9 | 130.8 |
| 1967 | 61.5 | 34.0 | 32.6 | 13.7 | 3.0 | 1.9 | 2.1 | 148.8 |
| 1968 | 68.7 | 28.7 | 33.9 | 14.1 | 3.1 | 2.0 | 2.5 | 153.0 |
| 1969 | 87.2 | 36.7 | 39.0 | 15.2 | 3.5 | 2.3 | 2.9 | 186.9 |
| 1970 | 90.4 | 32.8 | 44.4 | 15.7 | 3.6 | 2.4 | 3.4 | 192.8 |
| 1971 | 86.2 | 26.8 | 47.3 | 16.6 | 3.7 | 2.6 | 3.9 | 187.1 |
| 1972 | 94.7 | 32.2 | 52.6 | 15.5 | 5.4 | 3.3 | 3.6 | 207.3 |
| 1973 | 103.2 | 36.2 | 63.1 | 16.3 | 4.9 | 3.2 | 3.9 | 230.8 |
| 1974 | 119.0 | 38.6 | 75.1 | 16.8 | 5.0 | 3.3 | 5.4 | 263.2 |
| 1975 | 122.4 | 40.6 | 84.5 | 16.6 | 4.6 | 3.7 | 6.7 | 279.1 |
| 1976 | 131.6 | 41.4 | 90.8 | 17.0 | 5.2 | 4.1 | 8.0 | 298.1 |
| 1977 | 157.6 | 54.9 | 106.5 | 17.5 | 7.3 | 5.2 | 6.5 | 355.6 |
| 1978 | 181.0 | 60.0 | 121.0 | 18.4 | 5.3 | 6.6 | 7.4 | 399.6 |
| 1979 | 217.8 | 65.7 | 138.9 | 18.7 | 5.4 | 7.4 | 9.3 | 463.3 |
| 1980 | 244.1 | 64.6 | 157.8 | 24.3 | 6.4 | 7.2 | 12.7 | 517.1 |
| 1981 | 285.9 | 61.1 | 182.7 | 40.8 | 6.8 | 8.1 | 13.8 | 599.3 |
| 1982 | 297.7 | 49.2 | 201.5 | 36.3 | 8.0 | 8.9 | 16.2 | 617.8 |
| 1983 | 288.9 | 37.0 | 209.0 | 35.3 | 6.1 | 8.7 | 15.6 | 600.6 |
| 1984 | 298.4 | 56.9 | 239.4 | 37.4 | 6.0 | 11.4 | 17.1 | 666.5 |
| 1985 | 334.5 | 61.3 | 265.2 | 36.0 | 6.4 | 12.1 | 18.6 | 734.1 |
| 1986 | 349.0 | 63.1 | 283.9 | 32.9 | 7.0 | 13.3 | 20.0 | 769.2 |
| 1987 | 392.6 | 83.9 | 303.3 | 32.5 | 7.5 | 15.1 | 19.5 | 854.4 |
| 1988 | 401.2 | 94.5 | 334.3 | 35.2 | 7.6 | 16.2 | 20.3 | 909.3 |
| 1989 | 445.7 | 103.3 | 359.4 | 34.4 | 8.7 | 16.3 | 23.3 | 991.2 |
| 1990 | 466.9 | 93.5 | 380.0 | 35.3 | 11.5 | 16.7 | 28.1 | 1,032.1 |
| 1991 | 467.8 | 98.1 | 396.0 | 42.4 | 11.1 | 15.9 | 23.7 | 1,055.1 |
| 1992 | 476.0 | 100.3 | 413.7 | 45.6 | 11.1 | 17.4 | 27.3 | 1,091.3 |
| 1993 | 509.7 | 117.5 | 428.3 | 48.1 | 12.6 | 18.8 | 19.5 | 1,154.5 |
| 1994 | 543.1 | 140.4 | 461.5 | 55.2 | 15.2 | 20.1 | 23.3 | 1,258.7 |
| 1995 | 590.2 | 157.0 | 484.5 | 57.5 | 14.8 | 19.3 | 28.7 | 1,351.9 |
| 1996 | 656.4 | 171.8 | 509.4 | 54.0 | 17.2 | 18.7 | 25.6 | 1,453.2 |
| 1997 | 737.5 | 182.3 | 539.4 | 56.9 | 19.8 | 17.9 | 25.6 | 1,579.4 |
| 1998 | 828.6 | 188.7 | 571.8 | 57.7 | 24.1 | 18.3 | 32.8 | 1,722.0 |
| 1999 | 879.5 | 184.7 | 611.8 | 70.4 | 27.8 | 18.3 | 35.1 | 1,827.6 |
| 2000 | 1,004.5 | 207.3 | 652.9 | 68.9 | 29.0 | 19.9 | 43.1 | 2,025.5 |
| 2001 | 994.3 | 151.1 | 694.0 | 66.2 | 28.4 | 19.4 | 38.0 | 1,991.4 |
| 2002 | 858.3 | 148.0 | 700.8 | 67.0 | 26.5 | 18.6 | 34.1 | 1,853.4 |
| 2003 | 793.7 | 131.8 | 713.0 | 67.5 | 22.0 | 19.9 | 34.7 | 1,782.5 |
| 2004 | 809.0 | 189.4 | 733.4 | 69.9 | 24.8 | 21.1 | 32.8 | 1,880.3 |
| 2005 | 927.2 | 278.3 | 794.1 | 73.1 | 24.8 | 23.4 | 33.0 | 2,153.9 |
| 2006 | 1,043.9 | 353.9 | 837.8 | 74.0 | 27.9 | 24.8 | 44.4 | 2,406.7 |

Sources: Congressional Budget Office; Office of Management and Budget.

**Table E-4.**

# Revenues by Major Source, 1962 to 2006

(Percentage of gross domestic product)

| | Individual Income Taxes | Corporate Income Taxes | Social Insurance Taxes | Excise Taxes | Estate and Gift Taxes | Customs Duties | Miscellaneous Receipts | Total Revenues |
|---|---|---|---|---|---|---|---|---|
| 1962 | 8.0 | 3.6 | 3.0 | 2.2 | 0.4 | 0.2 | 0.1 | 17.6 |
| 1963 | 7.9 | 3.6 | 3.3 | 2.2 | 0.4 | 0.2 | 0.2 | 17.8 |
| 1964 | 7.6 | 3.7 | 3.4 | 2.1 | 0.4 | 0.2 | 0.2 | 17.6 |
| 1965 | 7.1 | 3.7 | 3.2 | 2.1 | 0.4 | 0.2 | 0.2 | 17.0 |
| 1966 | 7.3 | 4.0 | 3.4 | 1.7 | 0.4 | 0.2 | 0.2 | 17.3 |
| 1967 | 7.6 | 4.2 | 4.0 | 1.7 | 0.4 | 0.2 | 0.3 | 18.4 |
| 1968 | 7.9 | 3.3 | 3.9 | 1.6 | 0.4 | 0.2 | 0.3 | 17.6 |
| 1969 | 9.2 | 3.9 | 4.1 | 1.6 | 0.4 | 0.2 | 0.3 | 19.7 |
| 1970 | 8.9 | 3.2 | 4.4 | 1.6 | 0.4 | 0.2 | 0.3 | 19.0 |
| 1971 | 8.0 | 2.5 | 4.4 | 1.5 | 0.3 | 0.2 | 0.4 | 17.3 |
| 1972 | 8.0 | 2.7 | 4.5 | 1.3 | 0.5 | 0.3 | 0.3 | 17.6 |
| 1973 | 7.9 | 2.8 | 4.8 | 1.2 | 0.4 | 0.2 | 0.3 | 17.6 |
| 1974 | 8.3 | 2.7 | 5.2 | 1.2 | 0.3 | 0.2 | 0.4 | 18.3 |
| 1975 | 7.8 | 2.6 | 5.4 | 1.1 | 0.3 | 0.2 | 0.4 | 17.9 |
| 1976 | 7.6 | 2.4 | 5.2 | 1.0 | 0.3 | 0.2 | 0.5 | 17.1 |
| 1977 | 8.0 | 2.8 | 5.4 | 0.9 | 0.4 | 0.3 | 0.3 | 18.0 |
| 1978 | 8.2 | 2.7 | 5.5 | 0.8 | 0.2 | 0.3 | 0.3 | 18.0 |
| 1979 | 8.7 | 2.6 | 5.6 | 0.7 | 0.2 | 0.3 | 0.4 | 18.5 |
| 1980 | 9.0 | 2.4 | 5.8 | 0.9 | 0.2 | 0.3 | 0.5 | 19.0 |
| 1981 | 9.3 | 2.0 | 6.0 | 1.3 | 0.2 | 0.3 | 0.5 | 19.6 |
| 1982 | 9.2 | 1.5 | 6.2 | 1.1 | 0.2 | 0.3 | 0.5 | 19.2 |
| 1983 | 8.4 | 1.1 | 6.1 | 1.0 | 0.2 | 0.3 | 0.5 | 17.4 |
| 1984 | 7.8 | 1.5 | 6.2 | 1.0 | 0.2 | 0.3 | 0.4 | 17.3 |
| 1985 | 8.1 | 1.5 | 6.4 | 0.9 | 0.2 | 0.3 | 0.4 | 17.7 |
| 1986 | 7.9 | 1.4 | 6.4 | 0.7 | 0.2 | 0.3 | 0.5 | 17.5 |
| 1987 | 8.4 | 1.8 | 6.5 | 0.7 | 0.2 | 0.3 | 0.4 | 18.4 |
| 1988 | 8.0 | 1.9 | 6.7 | 0.7 | 0.2 | 0.3 | 0.4 | 18.1 |
| 1989 | 8.3 | 1.9 | 6.7 | 0.6 | 0.2 | 0.3 | 0.4 | 18.3 |
| 1990 | 8.1 | 1.6 | 6.6 | 0.6 | 0.2 | 0.3 | 0.5 | 18.0 |
| 1991 | 7.9 | 1.7 | 6.7 | 0.7 | 0.2 | 0.3 | 0.4 | 17.8 |
| 1992 | 7.6 | 1.6 | 6.6 | 0.7 | 0.2 | 0.3 | 0.4 | 17.5 |
| 1993 | 7.7 | 1.8 | 6.5 | 0.7 | 0.2 | 0.3 | 0.3 | 17.5 |
| 1994 | 7.8 | 2.0 | 6.6 | 0.8 | 0.2 | 0.3 | 0.3 | 18.1 |
| 1995 | 8.1 | 2.1 | 6.6 | 0.8 | 0.2 | 0.3 | 0.4 | 18.5 |
| 1996 | 8.5 | 2.2 | 6.6 | 0.7 | 0.2 | 0.2 | 0.3 | 18.9 |
| 1997 | 9.0 | 2.2 | 6.6 | 0.7 | 0.2 | 0.2 | 0.3 | 19.3 |
| 1998 | 9.6 | 2.2 | 6.6 | 0.7 | 0.3 | 0.2 | 0.4 | 20.0 |
| 1999 | 9.6 | 2.0 | 6.7 | 0.8 | 0.3 | 0.2 | 0.4 | 20.0 |
| 2000 | 10.3 | 2.1 | 6.7 | 0.7 | 0.3 | 0.2 | 0.4 | 20.9 |
| 2001 | 9.9 | 1.5 | 6.9 | 0.7 | 0.3 | 0.2 | 0.4 | 19.8 |
| 2002 | 8.3 | 1.4 | 6.8 | 0.6 | 0.3 | 0.2 | 0.3 | 17.9 |
| 2003 | 7.3 | 1.2 | 6.6 | 0.6 | 0.2 | 0.2 | 0.3 | 16.5 |
| 2004 | 7.0 | 1.6 | 6.4 | 0.6 | 0.2 | 0.2 | 0.3 | 16.3 |
| 2005 | 7.6 | 2.3 | 6.5 | 0.6 | 0.2 | 0.2 | 0.3 | 17.6 |
| 2006 | 8.0 | 2.7 | 6.4 | 0.6 | 0.2 | 0.2 | 0.3 | 18.4 |

Sources: Congressional Budget Office; Office of Management and Budget.

## Table E-5.

# Outlays for Major Categories of Spending, 1962 to 2006

(Billions of dollars)

| | | Mandatory Spending | | | |
|---|---|---|---|---|---|
| | Discretionary Spending | Programmatic Spending[a] | Offsetting Receipts | Net Interest | Total Outlays |
| 1962 | 72.1 | 34.7 | -6.8 | 6.9 | 106.8 |
| 1963 | 75.3 | 36.2 | -7.9 | 7.7 | 111.3 |
| 1964 | 79.1 | 38.9 | -7.7 | 8.2 | 118.5 |
| 1965 | 77.8 | 39.7 | -7.9 | 8.6 | 118.2 |
| 1966 | 90.1 | 43.4 | -8.4 | 9.4 | 134.5 |
| 1967 | 106.5 | 50.9 | -10.2 | 10.3 | 157.5 |
| 1968 | 118.0 | 59.7 | -10.6 | 11.1 | 178.1 |
| 1969 | 117.3 | 64.6 | -11.0 | 12.7 | 183.6 |
| 1970 | 120.3 | 72.5 | -11.5 | 14.4 | 195.6 |
| 1971 | 122.5 | 86.9 | -14.1 | 14.8 | 210.2 |
| 1972 | 128.5 | 100.8 | -14.1 | 15.5 | 230.7 |
| 1973 | 130.4 | 116.0 | -18.0 | 17.3 | 245.7 |
| 1974 | 138.2 | 130.9 | -21.2 | 21.4 | 269.4 |
| 1975 | 158.0 | 169.4 | -18.3 | 23.2 | 332.3 |
| 1976 | 175.6 | 189.1 | -19.6 | 26.7 | 371.8 |
| 1977 | 197.1 | 203.7 | -21.5 | 29.9 | 409.2 |
| 1978 | 218.7 | 227.4 | -22.8 | 35.5 | 458.7 |
| 1979 | 240.0 | 247.0 | -25.6 | 42.6 | 504.0 |
| 1980 | 276.3 | 291.2 | -29.2 | 52.5 | 590.9 |
| 1981 | 307.9 | 339.4 | -37.9 | 68.8 | 678.2 |
| 1982 | 326.0 | 370.8 | -36.0 | 85.0 | 745.7 |
| 1983 | 353.3 | 410.6 | -45.3 | 89.8 | 808.4 |
| 1984 | 379.4 | 405.6 | -44.2 | 111.1 | 851.9 |
| 1985 | 415.8 | 448.2 | -47.1 | 129.5 | 946.4 |
| 1986 | 438.5 | 461.8 | -45.9 | 136.0 | 990.4 |
| 1987 | 444.2 | 474.2 | -52.9 | 138.6 | 1,004.1 |
| 1988 | 464.4 | 505.1 | -56.8 | 151.8 | 1,064.5 |
| 1989 | 488.8 | 549.8 | -63.8 | 169.0 | 1,143.8 |
| 1990 | 500.6 | 626.9 | -58.7 | 184.3 | 1,253.1 |
| 1991 | 533.3 | 702.3 | -105.7 | 194.4 | 1,324.3 |
| 1992 | 533.8 | 716.8 | -68.4 | 199.3 | 1,381.6 |
| 1993 | 539.4 | 738.0 | -66.6 | 198.7 | 1,409.5 |
| 1994 | 541.4 | 786.1 | -68.5 | 202.9 | 1,461.9 |
| 1995 | 544.9 | 818.6 | -79.7 | 232.1 | 1,515.9 |
| 1996 | 532.7 | 858.8 | -71.9 | 241.1 | 1,560.6 |
| 1997 | 547.2 | 896.4 | -86.3 | 244.0 | 1,601.3 |
| 1998 | 552.1 | 938.7 | -79.2 | 241.1 | 1,652.7 |
| 1999 | 572.0 | 976.9 | -76.6 | 229.8 | 1,702.0 |
| 2000 | 614.8 | 1,030.0 | -78.6 | 222.9 | 1,789.2 |
| 2001 | 649.3 | 1,094.5 | -86.8 | 206.2 | 1,863.2 |
| 2002 | 734.3 | 1,196.9 | -91.0 | 170.9 | 2,011.2 |
| 2003 | 825.4 | 1,281.8 | -100.2 | 153.1 | 2,160.1 |
| 2004 | 895.5 | 1,346.0 | -108.7 | 160.2 | 2,293.0 |
| 2005 | 968.5 | 1,445.6 | -125.8 | 184.0 | 2,472.2 |
| 2006 | 1,016.2 | 1,552.1 | -140.6 | 226.7 | 2,654.3 |

Sources: Congressional Budget Office; Office of Management and Budget.

a. Excludes offsetting receipts.

**Table E-6.**

# Outlays for Major Categories of Spending, 1962 to 2006

(Percentage of gross domestic product)

| | | Mandatory Spending | | | |
|---|---|---|---|---|---|
| | Discretionary Spending | Programmatic Spending[a] | Offsetting Receipts | Net Interest | Total Outlays |
| 1962 | 12.7 | 6.1 | -1.2 | 1.2 | 18.8 |
| 1963 | 12.6 | 6.0 | -1.3 | 1.3 | 18.6 |
| 1964 | 12.3 | 6.1 | -1.2 | 1.3 | 18.5 |
| 1965 | 11.3 | 5.8 | -1.1 | 1.2 | 17.2 |
| 1966 | 11.9 | 5.7 | -1.1 | 1.2 | 17.8 |
| 1967 | 13.1 | 6.3 | -1.3 | 1.3 | 19.4 |
| 1968 | 13.6 | 6.9 | -1.2 | 1.3 | 20.5 |
| 1969 | 12.4 | 6.8 | -1.2 | 1.3 | 19.4 |
| 1970 | 11.9 | 7.2 | -1.1 | 1.4 | 19.3 |
| 1971 | 11.3 | 8.0 | -1.3 | 1.4 | 19.5 |
| 1972 | 10.9 | 8.6 | -1.2 | 1.3 | 19.6 |
| 1973 | 9.9 | 8.8 | -1.4 | 1.3 | 18.7 |
| 1974 | 9.6 | 9.1 | -1.5 | 1.5 | 18.7 |
| 1975 | 10.1 | 10.9 | -1.2 | 1.5 | 21.3 |
| 1976 | 10.1 | 10.9 | -1.1 | 1.5 | 21.4 |
| 1977 | 10.0 | 10.3 | -1.1 | 1.5 | 20.7 |
| 1978 | 9.9 | 10.3 | -1.0 | 1.6 | 20.7 |
| 1979 | 9.6 | 9.9 | -1.0 | 1.7 | 20.1 |
| 1980 | 10.1 | 10.7 | -1.1 | 1.9 | 21.7 |
| 1981 | 10.1 | 11.1 | -1.2 | 2.2 | 22.2 |
| 1982 | 10.1 | 11.5 | -1.1 | 2.6 | 23.1 |
| 1983 | 10.3 | 11.9 | -1.3 | 2.6 | 23.5 |
| 1984 | 9.9 | 10.5 | -1.2 | 2.9 | 22.1 |
| 1985 | 10.0 | 10.8 | -1.1 | 3.1 | 22.8 |
| 1986 | 10.0 | 10.5 | -1.0 | 3.1 | 22.5 |
| 1987 | 9.5 | 10.2 | -1.1 | 3.0 | 21.6 |
| 1988 | 9.3 | 10.1 | -1.1 | 3.0 | 21.2 |
| 1989 | 9.0 | 10.2 | -1.2 | 3.1 | 21.2 |
| 1990 | 8.7 | 10.9 | -1.0 | 3.2 | 21.8 |
| 1991 | 9.0 | 11.8 | -1.8 | 3.3 | 22.3 |
| 1992 | 8.6 | 11.5 | -1.1 | 3.2 | 22.1 |
| 1993 | 8.2 | 11.2 | -1.0 | 3.0 | 21.4 |
| 1994 | 7.8 | 11.3 | -1.0 | 2.9 | 21.0 |
| 1995 | 7.4 | 11.2 | -1.1 | 3.2 | 20.7 |
| 1996 | 6.9 | 11.2 | -0.9 | 3.1 | 20.3 |
| 1997 | 6.7 | 10.9 | -1.1 | 3.0 | 19.6 |
| 1998 | 6.4 | 10.9 | -0.9 | 2.8 | 19.2 |
| 1999 | 6.3 | 10.7 | -0.8 | 2.5 | 18.6 |
| 2000 | 6.3 | 10.6 | -0.8 | 2.3 | 18.4 |
| 2001 | 6.5 | 10.9 | -0.9 | 2.0 | 18.5 |
| 2002 | 7.1 | 11.5 | -0.9 | 1.6 | 19.4 |
| 2003 | 7.6 | 11.9 | -0.9 | 1.4 | 20.0 |
| 2004 | 7.8 | 11.7 | -0.9 | 1.4 | 19.9 |
| 2005 | 7.9 | 11.8 | -1.0 | 1.5 | 20.2 |
| 2006 | 7.8 | 11.9 | -1.1 | 1.7 | 20.3 |

Sources: Congressional Budget Office; Office of Management and Budget.

a. Excludes offsetting receipts.

## Table E-7.

# Discretionary Outlays, 1962 to 2006

(Billions of dollars)

| | Defense | International | Domestic | Total |
|---|---|---|---|---|
| 1962 | 52.6 | 5.5 | 14.0 | 72.1 |
| 1963 | 53.7 | 5.2 | 16.3 | 75.3 |
| 1964 | 55.0 | 4.6 | 19.5 | 79.1 |
| 1965 | 51.0 | 4.7 | 22.1 | 77.8 |
| 1966 | 59.0 | 5.1 | 26.1 | 90.1 |
| 1967 | 72.0 | 5.3 | 29.1 | 106.5 |
| 1968 | 82.2 | 4.9 | 30.9 | 118.0 |
| 1969 | 82.7 | 4.1 | 30.5 | 117.3 |
| 1970 | 81.9 | 4.0 | 34.4 | 120.3 |
| 1971 | 79.0 | 3.8 | 39.8 | 122.5 |
| 1972 | 79.3 | 4.6 | 44.7 | 128.5 |
| 1973 | 77.1 | 4.8 | 48.5 | 130.4 |
| 1974 | 80.7 | 6.2 | 51.3 | 138.2 |
| 1975 | 87.6 | 8.2 | 62.2 | 158.0 |
| 1976 | 89.9 | 7.5 | 78.2 | 175.6 |
| 1977 | 97.5 | 8.0 | 91.6 | 197.1 |
| 1978 | 104.6 | 8.5 | 105.6 | 218.7 |
| 1979 | 116.8 | 9.1 | 114.1 | 240.0 |
| 1980 | 134.6 | 12.8 | 128.9 | 276.3 |
| 1981 | 158.0 | 13.6 | 136.3 | 307.9 |
| 1982 | 185.9 | 12.9 | 127.2 | 326.0 |
| 1983 | 209.9 | 13.6 | 129.8 | 353.3 |
| 1984 | 228.0 | 16.3 | 135.2 | 379.4 |
| 1985 | 253.1 | 17.4 | 145.3 | 415.8 |
| 1986 | 273.8 | 17.7 | 147.0 | 438.5 |
| 1987 | 282.5 | 15.2 | 146.5 | 444.2 |
| 1988 | 290.9 | 15.7 | 157.8 | 464.4 |
| 1989 | 304.0 | 16.6 | 168.2 | 488.8 |
| 1990 | 300.1 | 19.1 | 181.4 | 500.6 |
| 1991 | 319.7 | 19.7 | 193.9 | 533.3 |
| 1992 | 302.6 | 19.2 | 212.1 | 533.8 |
| 1993 | 292.4 | 21.6 | 225.4 | 539.4 |
| 1994 | 282.3 | 20.8 | 238.3 | 541.4 |
| 1995 | 273.6 | 20.1 | 251.1 | 544.9 |
| 1996 | 266.0 | 18.3 | 248.4 | 532.7 |
| 1997 | 271.7 | 19.0 | 256.6 | 547.2 |
| 1998 | 270.2 | 18.1 | 263.8 | 552.1 |
| 1999 | 275.5 | 19.5 | 277.0 | 572.0 |
| 2000 | 295.0 | 21.3 | 298.5 | 614.8 |
| 2001 | 306.1 | 22.5 | 320.7 | 649.3 |
| 2002 | 349.0 | 26.2 | 359.1 | 734.3 |
| 2003 | 405.0 | 27.9 | 392.5 | 825.4 |
| 2004 | 454.1 | 33.8 | 407.6 | 895.5 |
| 2005 | 493.6 | 39.0 | 435.8 | 968.5 |
| 2006 | 520.0 | 36.0 | 460.2 | 1,016.2 |

Sources: Congressional Budget Office; Office of Management and Budget.

**Table E-8.**

# Discretionary Outlays, 1962 to 2006

(Percentage of gross domestic product)

| | Defense | International | Domestic | Total |
|---|---|---|---|---|
| 1962 | 9.3 | 1.0 | 2.5 | 12.7 |
| 1963 | 9.0 | 0.9 | 2.7 | 12.6 |
| 1964 | 8.6 | 0.7 | 3.0 | 12.3 |
| 1965 | 7.4 | 0.7 | 3.2 | 11.3 |
| 1966 | 7.8 | 0.7 | 3.5 | 11.9 |
| 1967 | 8.9 | 0.7 | 3.6 | 13.1 |
| 1968 | 9.5 | 0.6 | 3.6 | 13.6 |
| 1969 | 8.7 | 0.4 | 3.2 | 12.4 |
| 1970 | 8.1 | 0.4 | 3.4 | 11.9 |
| 1971 | 7.3 | 0.3 | 3.7 | 11.3 |
| 1972 | 6.7 | 0.4 | 3.8 | 10.9 |
| 1973 | 5.9 | 0.4 | 3.7 | 9.9 |
| 1974 | 5.6 | 0.4 | 3.6 | 9.6 |
| 1975 | 5.6 | 0.5 | 4.0 | 10.1 |
| 1976 | 5.2 | 0.4 | 4.5 | 10.1 |
| 1977 | 4.9 | 0.4 | 4.6 | 10.0 |
| 1978 | 4.7 | 0.4 | 4.8 | 9.9 |
| 1979 | 4.7 | 0.4 | 4.6 | 9.6 |
| 1980 | 4.9 | 0.5 | 4.7 | 10.1 |
| 1981 | 5.2 | 0.4 | 4.5 | 10.1 |
| 1982 | 5.8 | 0.4 | 3.9 | 10.1 |
| 1983 | 6.1 | 0.4 | 3.8 | 10.3 |
| 1984 | 5.9 | 0.4 | 3.5 | 9.9 |
| 1985 | 6.1 | 0.4 | 3.5 | 10.0 |
| 1986 | 6.2 | 0.4 | 3.3 | 10.0 |
| 1987 | 6.1 | 0.3 | 3.1 | 9.5 |
| 1988 | 5.8 | 0.3 | 3.1 | 9.3 |
| 1989 | 5.6 | 0.3 | 3.1 | 9.0 |
| 1990 | 5.2 | 0.3 | 3.2 | 8.7 |
| 1991 | 5.4 | 0.3 | 3.3 | 9.0 |
| 1992 | 4.8 | 0.3 | 3.4 | 8.6 |
| 1993 | 4.4 | 0.3 | 3.4 | 8.2 |
| 1994 | 4.1 | 0.3 | 3.4 | 7.8 |
| 1995 | 3.7 | 0.3 | 3.4 | 7.4 |
| 1996 | 3.5 | 0.2 | 3.2 | 6.9 |
| 1997 | 3.3 | 0.2 | 3.1 | 6.7 |
| 1998 | 3.1 | 0.2 | 3.1 | 6.4 |
| 1999 | 3.0 | 0.2 | 3.0 | 6.3 |
| 2000 | 3.0 | 0.2 | 3.1 | 6.3 |
| 2001 | 3.0 | 0.2 | 3.2 | 6.5 |
| 2002 | 3.4 | 0.3 | 3.5 | 7.1 |
| 2003 | 3.7 | 0.3 | 3.6 | 7.6 |
| 2004 | 3.9 | 0.3 | 3.5 | 7.8 |
| 2005 | 4.0 | 0.3 | 3.6 | 7.9 |
| 2006 | 4.0 | 0.3 | 3.5 | 7.8 |

Sources: Congressional Budget Office; Office of Management and Budget.

**Table E-9.**

# Outlays for Mandatory Spending, 1962 to 2006

(Billions of dollars)

| | Social Security | Medicare | Medicaid | Income Security[a] | Other Retirement and Disability | Other Programs | Offsetting Receipts | Total |
|---|---|---|---|---|---|---|---|---|
| 1962 | 14.0 | 0 | 0.1 | 6.1 | 6.7 | 7.7 | -6.8 | 27.9 |
| 1963 | 15.5 | 0 | 0.2 | 6.0 | 7.2 | 7.3 | -7.9 | 28.3 |
| 1964 | 16.2 | 0 | 0.2 | 6.0 | 7.5 | 8.9 | -7.7 | 31.2 |
| 1965 | 17.1 | 0 | 0.3 | 5.4 | 7.9 | 9.0 | -7.9 | 31.8 |
| 1966 | 20.3 | 0 | 0.8 | 5.1 | 8.4 | 8.8 | -8.4 | 35.0 |
| 1967 | 21.3 | 3.2 | 1.2 | 5.1 | 9.3 | 10.9 | -10.2 | 40.7 |
| 1968 | 23.3 | 5.1 | 1.8 | 5.9 | 10.1 | 13.4 | -10.6 | 49.1 |
| 1969 | 26.7 | 6.3 | 2.3 | 6.5 | 11.1 | 11.8 | -11.0 | 53.6 |
| 1970 | 29.6 | 6.8 | 2.7 | 8.2 | 12.4 | 12.8 | -11.5 | 61.0 |
| 1971 | 35.1 | 7.5 | 3.4 | 13.4 | 14.5 | 13.0 | -14.1 | 72.8 |
| 1972 | 39.4 | 8.4 | 4.6 | 16.4 | 16.2 | 15.8 | -14.1 | 86.7 |
| 1973 | 48.2 | 9.0 | 4.6 | 14.5 | 18.5 | 21.3 | -18.0 | 98.0 |
| 1974 | 55.0 | 10.7 | 5.8 | 17.4 | 20.9 | 21.1 | -21.2 | 109.7 |
| 1975 | 63.6 | 14.1 | 6.8 | 28.9 | 26.4 | 29.6 | -18.3 | 151.1 |
| 1976 | 72.7 | 16.9 | 8.6 | 37.6 | 27.7 | 25.6 | -19.6 | 169.5 |
| 1977 | 83.7 | 20.8 | 9.9 | 34.6 | 31.2 | 23.6 | -21.5 | 182.2 |
| 1978 | 92.4 | 24.3 | 10.7 | 32.1 | 33.9 | 34.0 | -22.8 | 204.6 |
| 1979 | 102.6 | 28.2 | 12.4 | 32.2 | 38.7 | 32.9 | -25.6 | 221.4 |
| 1980 | 117.1 | 34.0 | 14.0 | 44.3 | 44.4 | 37.5 | -29.2 | 262.1 |
| 1981 | 137.9 | 41.3 | 16.8 | 49.9 | 50.8 | 42.6 | -37.9 | 301.6 |
| 1982 | 153.9 | 49.2 | 17.4 | 53.2 | 55.0 | 42.1 | -36.0 | 334.8 |
| 1983 | 168.5 | 55.5 | 19.0 | 64.0 | 58.0 | 45.5 | -45.3 | 365.2 |
| 1984 | 176.1 | 61.1 | 20.1 | 51.7 | 59.8 | 36.8 | -44.2 | 361.3 |
| 1985 | 186.4 | 69.7 | 22.7 | 52.3 | 61.0 | 56.3 | -47.1 | 401.1 |
| 1986 | 196.5 | 74.2 | 25.0 | 54.2 | 63.4 | 48.4 | -45.9 | 415.9 |
| 1987 | 205.1 | 79.9 | 27.4 | 55.0 | 66.5 | 40.2 | -52.9 | 421.3 |
| 1988 | 216.8 | 85.7 | 30.5 | 57.3 | 71.1 | 43.7 | -56.8 | 448.2 |
| 1989 | 230.4 | 93.2 | 34.6 | 60.8 | 74.6 | 56.2 | -63.8 | 486.0 |
| 1990 | 246.5 | 107.0 | 41.1 | 68.4 | 76.1 | 87.7 | -58.7 | 568.2 |
| 1991 | 266.8 | 114.2 | 52.5 | 86.6 | 82.2 | 100.0 | -105.7 | 596.6 |
| 1992 | 285.2 | 129.4 | 67.8 | 110.0 | 84.8 | 39.6 | -68.4 | 648.5 |
| 1993 | 302.0 | 143.2 | 75.8 | 116.1 | 87.2 | 13.8 | -66.6 | 671.4 |
| 1994 | 316.9 | 159.6 | 82.0 | 115.3 | 93.2 | 19.0 | -68.5 | 717.6 |
| 1995 | 333.3 | 177.1 | 89.1 | 116.0 | 95.5 | 7.7 | -79.7 | 738.9 |
| 1996 | 347.1 | 191.3 | 92.0 | 121.0 | 96.9 | 10.5 | -71.9 | 786.8 |
| 1997 | 362.3 | 207.9 | 95.6 | 121.9 | 102.3 | 6.5 | -86.3 | 810.1 |
| 1998 | 376.1 | 211.0 | 101.2 | 121.6 | 105.0 | 23.7 | -79.2 | 859.5 |
| 1999 | 387.0 | 209.3 | 108.0 | 128.6 | 105.1 | 38.9 | -76.6 | 900.3 |
| 2000 | 406.0 | 216.0 | 117.9 | 133.5 | 113.8 | 42.7 | -78.6 | 951.4 |
| 2001 | 429.4 | 237.9 | 129.4 | 142.7 | 116.3 | 38.9 | -86.8 | 1,007.7 |
| 2002 | 452.1 | 253.7 | 147.5 | 179.9 | 124.9 | 38.8 | -91.0 | 1,105.9 |
| 2003 | 470.5 | 274.2 | 160.7 | 196.2 | 129.4 | 51.0 | -100.2 | 1,181.6 |
| 2004 | 491.5 | 297.0 | 176.2 | 190.7 | 135.0 | 55.5 | -108.7 | 1,237.3 |
| 2005 | 518.7 | 332.6 | 181.7 | 195.9 | 147.6 | 69.0 | -125.8 | 1,319.8 |
| 2006 | 544.0 | 373.7 | 180.6 | 199.2 | 149.4 | 105.2 | -140.6 | 1,411.5 |

Sources: Congressional Budget Office; Office of Management and Budget.

a. Includes unemployment compensation, Supplemental Security Income, the refundable portion of the earned income and child tax credits, Food Stamps, family support, child nutrition, and foster care.

**Table E-10.**

# Outlays for Mandatory Spending, 1962 to 2006

(Percentage of gross domestic product)

| | Social Security | Medicare | Medicaid | Income Security[a] | Other Retirement and Disability | Other Programs | Offsetting Receipts | Total |
|---|---|---|---|---|---|---|---|---|
| 1962 | 2.5 | 0 | * | 1.1 | 1.2 | 1.4 | -1.2 | 4.9 |
| 1963 | 2.6 | 0 | * | 1.0 | 1.2 | 1.2 | -1.3 | 4.7 |
| 1964 | 2.5 | 0 | * | 0.9 | 1.2 | 1.4 | -1.2 | 4.9 |
| 1965 | 2.5 | 0 | * | 0.8 | 1.2 | 1.3 | -1.1 | 4.6 |
| 1966 | 2.7 | 0 | 0.1 | 0.7 | 1.1 | 1.2 | -1.1 | 4.6 |
| 1967 | 2.6 | 0.4 | 0.1 | 0.6 | 1.1 | 1.3 | -1.3 | 5.0 |
| 1968 | 2.7 | 0.6 | 0.2 | 0.7 | 1.2 | 1.5 | -1.2 | 5.6 |
| 1969 | 2.8 | 0.7 | 0.2 | 0.7 | 1.2 | 1.2 | -1.2 | 5.7 |
| 1970 | 2.9 | 0.7 | 0.3 | 0.8 | 1.2 | 1.3 | -1.1 | 6.0 |
| 1971 | 3.3 | 0.7 | 0.3 | 1.2 | 1.3 | 1.2 | -1.3 | 6.7 |
| 1972 | 3.3 | 0.7 | 0.4 | 1.4 | 1.4 | 1.3 | -1.2 | 7.4 |
| 1973 | 3.7 | 0.7 | 0.4 | 1.1 | 1.4 | 1.6 | -1.4 | 7.5 |
| 1974 | 3.8 | 0.7 | 0.4 | 1.2 | 1.4 | 1.5 | -1.5 | 7.6 |
| 1975 | 4.1 | 0.9 | 0.4 | 1.9 | 1.7 | 1.9 | -1.2 | 9.7 |
| 1976 | 4.2 | 1.0 | 0.5 | 2.2 | 1.6 | 1.5 | -1.1 | 9.7 |
| 1977 | 4.2 | 1.1 | 0.5 | 1.8 | 1.6 | 1.2 | -1.1 | 9.2 |
| 1978 | 4.2 | 1.1 | 0.5 | 1.4 | 1.5 | 1.5 | -1.0 | 9.2 |
| 1979 | 4.1 | 1.1 | 0.5 | 1.3 | 1.5 | 1.3 | -1.0 | 8.8 |
| 1980 | 4.3 | 1.2 | 0.5 | 1.6 | 1.6 | 1.4 | -1.1 | 9.6 |
| 1981 | 4.5 | 1.4 | 0.6 | 1.6 | 1.7 | 1.4 | -1.2 | 9.9 |
| 1982 | 4.8 | 1.5 | 0.5 | 1.6 | 1.7 | 1.3 | -1.1 | 10.4 |
| 1983 | 4.9 | 1.6 | 0.6 | 1.9 | 1.7 | 1.3 | -1.3 | 10.6 |
| 1984 | 4.6 | 1.6 | 0.5 | 1.3 | 1.6 | 1.0 | -1.2 | 9.4 |
| 1985 | 4.5 | 1.7 | 0.5 | 1.3 | 1.5 | 1.4 | -1.1 | 9.7 |
| 1986 | 4.5 | 1.7 | 0.6 | 1.2 | 1.4 | 1.1 | -1.0 | 9.4 |
| 1987 | 4.4 | 1.7 | 0.6 | 1.2 | 1.4 | 0.9 | -1.1 | 9.1 |
| 1988 | 4.3 | 1.7 | 0.6 | 1.1 | 1.4 | 0.9 | -1.1 | 8.9 |
| 1989 | 4.3 | 1.7 | 0.6 | 1.1 | 1.4 | 1.0 | -1.2 | 9.0 |
| 1990 | 4.3 | 1.9 | 0.7 | 1.2 | 1.3 | 1.5 | -1.0 | 9.9 |
| 1991 | 4.5 | 1.9 | 0.9 | 1.5 | 1.4 | 1.7 | -1.8 | 10.1 |
| 1992 | 4.6 | 2.1 | 1.1 | 1.8 | 1.4 | 0.6 | -1.1 | 10.4 |
| 1993 | 4.6 | 2.2 | 1.2 | 1.8 | 1.3 | 0.2 | -1.0 | 10.2 |
| 1994 | 4.6 | 2.3 | 1.2 | 1.7 | 1.3 | 0.3 | -1.0 | 10.3 |
| 1995 | 4.5 | 2.4 | 1.2 | 1.6 | 1.3 | 0.1 | -1.1 | 10.1 |
| 1996 | 4.5 | 2.5 | 1.2 | 1.6 | 1.3 | 0.1 | -0.9 | 10.2 |
| 1997 | 4.4 | 2.5 | 1.2 | 1.5 | 1.2 | 0.1 | -1.1 | 9.9 |
| 1998 | 4.4 | 2.4 | 1.2 | 1.4 | 1.2 | 0.3 | -0.9 | 10.0 |
| 1999 | 4.2 | 2.3 | 1.2 | 1.4 | 1.2 | 0.4 | -0.8 | 9.9 |
| 2000 | 4.2 | 2.2 | 1.2 | 1.4 | 1.2 | 0.4 | -0.8 | 9.8 |
| 2001 | 4.3 | 2.4 | 1.3 | 1.4 | 1.2 | 0.4 | -0.9 | 10.0 |
| 2002 | 4.4 | 2.4 | 1.4 | 1.7 | 1.2 | 0.4 | -0.9 | 10.7 |
| 2003 | 4.4 | 2.5 | 1.5 | 1.8 | 1.2 | 0.5 | -0.9 | 10.9 |
| 2004 | 4.3 | 2.6 | 1.5 | 1.7 | 1.2 | 0.5 | -0.9 | 10.7 |
| 2005 | 4.2 | 2.7 | 1.5 | 1.6 | 1.2 | 0.6 | -1.0 | 10.8 |
| 2006 | 4.2 | 2.9 | 1.4 | 1.5 | 1.1 | 0.8 | -1.1 | 10.8 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: * = between zero and 0.05 percent.

a. Includes unemployment compensation, Supplemental Security Income, the refundable portion of the earned income and child tax credits, Food Stamps, family support, child nutrition, and foster care.

## Table E-11.

# Surpluses, Deficits, Debt, and Related Series, 1962 to 2006

| | Billions of Dollars | | | Percentage of Potential GDP | | | Gross Domestic Product (Billions of dollars) | |
|---|---|---|---|---|---|---|---|---|
| | Deficit (-) or Surplus | Standardized-Budget Deficit (-) or Surplus[a] | Debt Held by the Public | Deficit (-) or Surplus | Standardized-Budget Deficit (-) or Surplus[a] | Debt Held by the Public | Actual[b] | Potential |
| 1962 | -7 | -4 | 248 | -1.2 | -0.7 | 43.1 | 568 | 576 |
| 1963 | -5 | -4 | 254 | -0.8 | -0.6 | 42.0 | 599 | 605 |
| 1964 | -6 | -6 | 257 | -0.9 | -1.0 | 40.3 | 641 | 637 |
| 1965 | -1 | -5 | 261 | -0.2 | -0.7 | 38.7 | 687 | 675 |
| 1966 | -4 | -15 | 264 | -0.5 | -2.0 | 36.7 | 756 | 719 |
| 1967 | -9 | -22 | 267 | -1.1 | -2.8 | 34.3 | 810 | 777 |
| 1968 | -25 | -31 | 290 | -3.0 | -3.7 | 34.5 | 869 | 840 |
| 1969 | 3 | -3 | 278 | 0.4 | -0.3 | 30.4 | 948 | 916 |
| 1970 | -3 | 2 | 283 | -0.3 | 0.2 | 28.2 | 1,013 | 1,004 |
| 1971 | -23 | -10 | 303 | -2.1 | -0.9 | 27.8 | 1,080 | 1,091 |
| 1972 | -23 | -21 | 322 | -2.0 | -1.8 | 27.3 | 1,177 | 1,179 |
| 1973 | -15 | -21 | 341 | -1.2 | -1.6 | 26.8 | 1,311 | 1,273 |
| 1974 | -6 | 3 | 344 | -0.4 | 0.2 | 24.3 | 1,439 | 1,416 |
| 1975 | -53 | 3 | 395 | -3.3 | 0.2 | 24.4 | 1,561 | 1,620 |
| 1976 | -74 | -35 | 477 | -4.1 | -1.9 | 26.6 | 1,739 | 1,794 |
| 1977 | -54 | -21 | 549 | -2.7 | -1.0 | 27.4 | 1,974 | 2,005 |
| 1978 | -59 | -32 | 607 | -2.7 | -1.4 | 27.4 | 2,218 | 2,217 |
| 1979 | -41 | -13 | 640 | -1.6 | -0.5 | 25.8 | 2,502 | 2,482 |
| 1980 | -74 | -10 | 712 | -2.7 | -0.3 | 25.6 | 2,725 | 2,779 |
| 1981 | -79 | -17 | 789 | -2.5 | -0.5 | 25.3 | 3,059 | 3,115 |
| 1982 | -128 | -43 | 925 | -3.7 | -1.3 | 27.0 | 3,226 | 3,419 |
| 1983 | -208 | -112 | 1,137 | -5.7 | -3.0 | 30.9 | 3,443 | 3,677 |
| 1984 | -185 | -143 | 1,307 | -4.7 | -3.6 | 33.3 | 3,847 | 3,928 |
| 1985 | -212 | -179 | 1,507 | -5.1 | -4.3 | 36.0 | 4,149 | 4,191 |
| 1986 | -221 | -212 | 1,741 | -5.0 | -4.8 | 39.3 | 4,407 | 4,434 |
| 1987 | -150 | -156 | 1,890 | -3.2 | -3.3 | 40.3 | 4,654 | 4,694 |
| 1988 | -155 | -128 | 2,052 | -3.1 | -2.6 | 41.1 | 5,012 | 4,995 |
| 1989 | -153 | -117 | 2,191 | -2.9 | -2.2 | 41.0 | 5,402 | 5,344 |
| 1990 | -221 | -122 | 2,412 | -3.9 | -2.1 | 42.2 | 5,737 | 5,710 |
| 1991 | -269 | -150 | 2,689 | -4.4 | -2.5 | 44.2 | 5,934 | 6,087 |
| 1992 | -290 | -188 | 3,000 | -4.5 | -2.9 | 46.9 | 6,241 | 6,398 |
| 1993 | -255 | -193 | 3,248 | -3.8 | -2.9 | 48.4 | 6,578 | 6,706 |
| 1994 | -203 | -145 | 3,433 | -2.9 | -2.1 | 48.8 | 6,964 | 7,034 |
| 1995 | -164 | -146 | 3,604 | -2.2 | -2.0 | 48.8 | 7,325 | 7,386 |
| 1996 | -107 | -96 | 3,734 | -1.4 | -1.2 | 48.2 | 7,697 | 7,753 |
| 1997 | -22 | -80 | 3,772 | -0.3 | -1.0 | 46.4 | 8,187 | 8,139 |
| 1998 | 69 | -38 | 3,721 | 0.8 | -0.4 | 43.7 | 8,626 | 8,514 |
| 1999 | 126 | -1 | 3,632 | 1.4 | * | 40.6 | 9,127 | 8,937 |
| 2000 | 236 | 105 | 3,410 | 2.5 | 1.1 | 36.1 | 9,708 | 9,454 |
| 2001 | 128 | 105 | 3,320 | 1.3 | 1.0 | 33.1 | 10,060 | 10,033 |
| 2002 | -158 | -126 | 3,540 | -1.5 | -1.2 | 33.5 | 10,378 | 10,567 |
| 2003 | -378 | -276 | 3,913 | -3.4 | -2.5 | 35.3 | 10,804 | 11,091 |
| 2004 | -413 | -286 | 4,296 | -3.5 | -2.4 | 36.7 | 11,525 | 11,691 |
| 2005 | -318 | -237 | 4,592 | -2.6 | -1.9 | 37.1 | 12,266 | 12,375 |
| 2006 | -248 | -242 | 4,829 | -1.9 | -1.8 | 36.8 | 13,065 | 13,106 |

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Office of Management and Budget.

Note: * = -0.05 percent and zero.

a. Excludes deposit insurance, receipts from auctions of licenses to use the electromagnetic spectrum, timing adjustments, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

b. CBO calculated fiscal year numbers from seasonally adjusted quarterly national income and product account data from the Bureau of Economic Analysis.

## Table E-12.

# Standardized-Budget Surplus or Deficit and Related Series, 1962 to 2006

(Billions of dollars)

| | Budget Deficit (-) or Surplus | − Cyclical Contributions | + Other Adjustments[a] | = Standardized-Budget Deficit (-) or Surplus | Standardized-Budget Revenues | Standardized-Budget Outlays |
|---|---|---|---|---|---|---|
| 1962 | -7 | -2 | 1 | -4 | 99 | 104 |
| 1963 | -5 | -2 | * | -4 | 106 | 110 |
| 1964 | -6 | 2 | 1 | -6 | 109 | 115 |
| 1965 | -1 | 5 | 1 | -5 | 110 | 115 |
| 1966 | -4 | 13 | 2 | -15 | 115 | 130 |
| 1967 | -9 | 12 | -1 | -22 | 131 | 153 |
| 1968 | -25 | 11 | 5 | -31 | 140 | 171 |
| 1969 | 3 | 14 | 8 | -3 | 170 | 173 |
| 1970 | -3 | 5 | 10 | 2 | 186 | 184 |
| 1971 | -23 | -4 | 9 | -10 | 187 | 197 |
| 1972 | -23 | * | 2 | -21 | 199 | 220 |
| 1973 | -15 | 14 | 8 | -21 | 213 | 234 |
| 1974 | -6 | 10 | 18 | 3 | 251 | 249 |
| 1975 | -53 | -23 | 34 | 3 | 301 | 298 |
| 1976 | -74 | -25 | 14 | -35 | 310 | 344 |
| 1977 | -54 | -14 | 19 | -21 | 358 | 378 |
| 1978 | -59 | 1 | 28 | -32 | 390 | 422 |
| 1979 | -41 | 9 | 36 | -13 | 446 | 459 |
| 1980 | -74 | -21 | 43 | -10 | 523 | 533 |
| 1981 | -79 | -24 | 39 | -17 | 606 | 623 |
| 1982 | -128 | -62 | 23 | -43 | 655 | 698 |
| 1983 | -208 | -89 | 7 | -112 | 653 | 765 |
| 1984 | -185 | -30 | 12 | -143 | 673 | 816 |
| 1985 | -212 | -16 | 17 | -179 | 723 | 902 |
| 1986 | -221 | -11 | -1 | -212 | 747 | 959 |
| 1987 | -150 | -12 | -19 | -156 | 815 | 971 |
| 1988 | -155 | 8 | 36 | -128 | 868 | 996 |
| 1989 | -153 | 21 | 56 | -117 | 937 | 1,054 |
| 1990 | -221 | 10 | 109 | -122 | 992 | 1,113 |
| 1991 | -269 | -48 | 71 | -150 | 1,068 | 1,219 |
| 1992 | -290 | -62 | 40 | -188 | 1,124 | 1,312 |
| 1993 | -255 | -51 | 11 | -193 | 1,165 | 1,358 |
| 1994 | -203 | -28 | 30 | -145 | 1,245 | 1,390 |
| 1995 | -164 | -17 | * | -146 | 1,330 | 1,477 |
| 1996 | -107 | -19 | -8 | -96 | 1,417 | 1,513 |
| 1997 | -22 | 16 | -42 | -80 | 1,494 | 1,574 |
| 1998 | 69 | 42 | -66 | -38 | 1,594 | 1,632 |
| 1999 | 126 | 68 | -58 | -1 | 1,661 | 1,662 |
| 2000 | 236 | 94 | -37 | 105 | 1,820 | 1,715 |
| 2001 | 128 | 17 | -6 | 105 | 1,900 | 1,795 |
| 2002 | -158 | -68 | -36 | -126 | 1,824 | 1,950 |
| 2003 | -378 | -95 | 6 | -276 | 1,797 | 2,073 |
| 2004 | -413 | -56 | 71 | -286 | 1,886 | 2,172 |
| 2005 | -318 | -30 | 51 | -237 | 2,098 | 2,335 |
| 2006 | -248 | -8 | -2 | -242 | 2,314 | 2,556 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: * = between -$500 million and $500 million.

a. Consists of deposit insurance, receipts from auctions of licenses to use the electromagnetic spectrum, timing adjustments, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

## Table E-13.

# Standardized-Budget Surplus or Deficit and Related Series, 1962 to 2006

(Percentage of potential gross domestic product)

| | Budget Deficit (-) or Surplus | − Cyclical Contributions | + Other Adjustments[a] | = Standardized-Budget Deficit (-) or Surplus | Standardized-Budget | |
|---|---|---|---|---|---|---|
| | | | | | Revenues | Outlays |
| 1962 | -1.2 | -0.4 | 0.1 | -0.7 | 17.3 | 18.0 |
| 1963 | -0.8 | -0.3 | -0.1 | -0.6 | 17.5 | 18.1 |
| 1964 | -0.9 | 0.3 | 0.2 | -1.0 | 17.1 | 18.0 |
| 1965 | -0.2 | 0.7 | 0.2 | -0.7 | 16.3 | 17.0 |
| 1966 | -0.5 | 1.8 | 0.3 | -2.0 | 16.0 | 18.0 |
| 1967 | -1.1 | 1.6 | -0.2 | -2.8 | 16.9 | 19.7 |
| 1968 | -3.0 | 1.3 | 0.6 | -3.7 | 16.6 | 20.3 |
| 1969 | 0.4 | 1.5 | 0.9 | -0.3 | 18.6 | 18.9 |
| 1970 | -0.3 | 0.5 | 1.0 | 0.2 | 18.5 | 18.3 |
| 1971 | -2.1 | -0.3 | 0.9 | -0.9 | 17.1 | 18.1 |
| 1972 | -2.0 | * | 0.2 | -1.8 | 16.9 | 18.6 |
| 1973 | -1.2 | 1.1 | 0.6 | -1.6 | 16.8 | 18.4 |
| 1974 | -0.4 | 0.7 | 1.3 | 0.2 | 17.7 | 17.6 |
| 1975 | -3.3 | -1.4 | 2.1 | 0.2 | 18.6 | 18.4 |
| 1976 | -4.1 | -1.4 | 0.8 | -1.9 | 17.3 | 19.2 |
| 1977 | -2.7 | -0.7 | 1.0 | -1.0 | 17.8 | 18.9 |
| 1978 | -2.7 | 0.1 | 1.3 | -1.4 | 17.6 | 19.0 |
| 1979 | -1.6 | 0.4 | 1.5 | -0.5 | 18.0 | 18.5 |
| 1980 | -2.7 | -0.8 | 1.5 | -0.3 | 18.8 | 19.2 |
| 1981 | -2.5 | -0.8 | 1.2 | -0.5 | 19.4 | 20.0 |
| 1982 | -3.7 | -1.8 | 0.7 | -1.3 | 19.2 | 20.4 |
| 1983 | -5.7 | -2.4 | 0.2 | -3.0 | 17.8 | 20.8 |
| 1984 | -4.7 | -0.8 | 0.3 | -3.6 | 17.1 | 20.8 |
| 1985 | -5.1 | -0.4 | 0.4 | -4.3 | 17.3 | 21.5 |
| 1986 | -5.0 | -0.3 | * | -4.8 | 16.9 | 21.6 |
| 1987 | -3.2 | -0.3 | -0.4 | -3.3 | 17.4 | 20.7 |
| 1988 | -3.1 | 0.2 | 0.7 | -2.6 | 17.4 | 19.9 |
| 1989 | -2.9 | 0.4 | 1.0 | -2.2 | 17.5 | 19.7 |
| 1990 | -3.9 | 0.2 | 1.9 | -2.1 | 17.4 | 19.5 |
| 1991 | -4.4 | -0.8 | 1.2 | -2.5 | 17.6 | 20.0 |
| 1992 | -4.5 | -1.0 | 0.6 | -2.9 | 17.6 | 20.5 |
| 1993 | -3.8 | -0.8 | 0.2 | -2.9 | 17.4 | 20.3 |
| 1994 | -2.9 | -0.4 | 0.4 | -2.1 | 17.7 | 19.8 |
| 1995 | -2.2 | -0.2 | * | -2.0 | 18.0 | 20.0 |
| 1996 | -1.4 | -0.2 | -0.1 | -1.2 | 18.3 | 19.5 |
| 1997 | -0.3 | 0.2 | -0.5 | -1.0 | 18.4 | 19.3 |
| 1998 | 0.8 | 0.5 | -0.8 | -0.4 | 18.7 | 19.2 |
| 1999 | 1.4 | 0.8 | -0.7 | * | 18.6 | 18.6 |
| 2000 | 2.5 | 1.0 | -0.4 | 1.1 | 19.3 | 18.1 |
| 2001 | 1.3 | 0.2 | -0.1 | 1.0 | 18.9 | 17.9 |
| 2002 | -1.5 | -0.6 | -0.3 | -1.2 | 17.3 | 18.5 |
| 2003 | -3.4 | -0.9 | 0.1 | -2.5 | 16.2 | 18.7 |
| 2004 | -3.5 | -0.5 | 0.6 | -2.4 | 16.1 | 18.6 |
| 2005 | -2.6 | -0.2 | 0.4 | -1.9 | 17.0 | 18.9 |
| 2006 | -1.9 | -0.1 | * | -1.8 | 17.7 | 19.5 |

Sources: Congressional Budget Office; Office of Management and Budget.

Note: * = between -0.05 percent and 0.05 percent.

a. Consists of deposit insurance, receipts from auctions of licenses to use the electromagnetic spectrum, timing adjustments, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

APPENDIX

F

# Contributors to the Revenue and Spending Projections

The following Congressional Budget Office analysts prepared the revenue and spending projections in this report:

## Revenue Projections

| | |
|---|---|
| Mark Booth | Individual income taxes |
| Paul Burnham | Retirement income |
| Barbara Edwards | Social insurance taxes, Federal Reserve System earnings |
| Pamela Greene | Corporate income taxes, estate and gift taxes, excise taxes |
| Ed Harris | Individual income taxes |
| Andrew Langan | Excise taxes |
| Larry Ozanne | Capital gains realizations |
| Kevin Perese | Tax modeling |
| Emily Schlect | Customs duties, miscellaneous receipts |
| Kurt Seibert | Earned income tax credit, depreciation |
| David Weiner | Individual income taxes |

## Spending Projections

*Defense, International Affairs, and Veterans' Affairs*

| | |
|---|---|
| Sarah Jennings | Unit Chief |
| Kent Christensen | Defense |
| Sunita D'Monte | International affairs (conduct of foreign affairs and information-exchange activities), veterans' housing |
| Raymond Hall | Defense research and development (stockpile sales, atomic energy defense) |
| David Newman | Defense (military construction and family housing, military activities in Iraq and Afghanistan and for the war on terrorism) |
| Sam Papenfuss | International affairs (development, security, international financial institutions) |
| Michelle Patterson | Veterans' health care, military health care |

*Defense, International Affairs, and Veterans' Affairs (Continued)*

| | |
|---|---|
| Matthew Schmit | Defense (military personnel, military activities in Iraq and Afghanistan and for the war on terrorism) |
| Mike Waters | Military retirement, veterans' education |
| Jason Wheelock | Defense (other programs), operations and maintenance, radiation exposure compensation, energy employees' occupational illness compensation |
| Dwayne Wright | Veterans' compensation and pensions |

*Health*

| | |
|---|---|
| Tom Bradley | Unit Chief |
| Julia Christensen | Federal Employees Health Benefits program, Public Health Service |
| Jeanne De Sa | Medicaid, State Children's Health Insurance Program |
| Sarah Evans | Medicare, Public Health Service |
| Geoffrey Gerhardt | Medicare |
| Tim Gronniger | Medicare, Public Health Service |
| Eric Rollins | Medicaid, State Children's Health Insurance Program, Medicare |
| Shinobu Suzuki | Medicare |
| Camile Williams | Medicare, Public Health Service |

*Human Resources*

| | |
|---|---|
| Paul Cullinan | Unit Chief |
| Christina Hawley Anthony | Unemployment insurance, training programs, Administration on Aging, Smithsonian, arts and humanities, report coordinator |
| Chad Chirico | Housing assistance, education |
| Sheila Dacey | Old-Age and Survivors Insurance, Social Security trust funds |
| Kathleen FitzGerald | Food Stamps and nutrition programs |
| Justin Humphrey | Elementary and secondary education, Pell grants |
| Deborah Kalcevic | Student loans, higher education |
| Matthew Kapuscinski | Low Income Home Energy Assistance Program, refugee assistance |
| Craig Meklir | Federal civilian retirement, Pension Benefit Guaranty Corporation, Railroad Retirement |
| Jonathan Morancy | Child Support Enforcement, Temporary Assistance for Needy Families, foster care, Social Services Block Grant program, child care programs, child and family services |
| David Rafferty | Disability Insurance, Supplemental Security Income |

*Natural and Physical Resources*

| | |
|---|---|
| Kim Cawley | Unit Chief |
| Megan Carroll | Energy, conservation and land management, air transportation |
| Mark Grabowicz | Justice, Postal Service |
| Kathleen Gramp | Spectrum auction receipts, energy, deposit insurance, Outer Continental Shelf receipts |
| Greg Hitz | Agriculture |
| Daniel Hoople | Science and space exploration, Bureau of Indian Affairs, justice, community and regional development |
| David Hull | Agriculture |
| James Langley | Agriculture |
| Susanne Mehlman | Pollution control and abatement, Federal Housing Administration and other housing credit programs |
| Julie Middleton | Water resources, Federal Emergency Management Agency, other natural resources |
| Matthew Pickford | General government |
| Deborah Reis | Recreation, water transportation, legislative branch, conservation and land management |
| Gregory Waring | Highways, Amtrak, mass transit |
| Susan Willie | Commerce, Small Business Administration, Universal Service Fund |

*Other*

| | |
|---|---|
| Janet Airis | Unit Chief, Scorekeeping; legislative branch appropriation bill |
| Jeffrey Holland | Unit Chief, Projections |
| Edward Blau | Authorization bills |
| Barry Blom | Federal pay, monthly Treasury data, report coordinator |
| Joanna Capps | Appropriation bills (Interior and the environment, Labor–Health and Human Services) |
| Kenneth Farris | Computer support |
| Mary Froehlich | Computer support |
| Ann Futrell | Other interest, report coordinator |
| Virginia Myers | Appropriation bills (Commerce–State–Justice, energy and water) |
| Jennifer Reynolds | Appropriation bills (Agriculture, foreign relations) |
| Mark Sanford | Appropriation bills (Defense, Homeland Security) |
| Eric Schatten | Interest on the public debt, report coordinator |
| Luis Serna | National income and product accounts, report coordinator |
| Phan Siris | Computer support |
| Esther Steinbock | Appropriation bills (Transportation–Treasury–Housing and Urban Development, military quality of life and veterans' affairs, District of Columbia) |
| Patrice Watson | Database system administrator |

# Glossary

This glossary defines economic and budgetary terms as they apply to *The Budget and Economic Outlook;* it also acts as a general reference for readers. In some cases, the entries sacrifice technical precision for the sake of brevity and clarity. Where appropriate, entries note the sources of data for economic variables as follows:

- (BEA) refers to the Bureau of Economic Analysis in the Department of Commerce,
- (BLS) refers to the Bureau of Labor Statistics in the Department of Labor,
- (CBO) refers to the Congressional Budget Office,
- (FRB) refers to the Federal Reserve Board, and
- (NBER) refers to the National Bureau of Economic Research (a private entity).

**Accrual accounting:** A system of accounting in which revenues are recorded when they are earned and outlays are recorded when goods are received or services are performed, even though the actual receipt of revenues and payment for goods or services may occur, in whole or in part, at a different time. Compare with **cash accounting.**

**adjusted gross income (AGI):** All income that is subject to taxation under the individual income tax after "above-the-line" deductions for such things as alimony payments and certain contributions to individual retirement accounts. Personal exemptions and the standard or itemized deductions are subtracted from AGI to determine taxable income.

**advance appropriation:** Budget authority provided in an appropriation act that is first available for obligation in a fiscal year after the year for which the appropriation was enacted. The amount of the advance appropriation is included in the budget totals for the year in which it will become available. See **appropriation act, budget authority, fiscal year,** and **obligation;** compare with **forward funding, obligation delay,** and **unobligated balances.**

**aggregate demand:** Total purchases of a country's output of goods and services by consumers, businesses, government, and foreigners during a given period. (BEA) Compare with **domestic demand.**

**AGI:** See **adjusted gross income.**

**alternative minimum tax (AMT):** A tax intended to limit the extent to which higher-income people can reduce their tax liability (the amount they owe) through the use of preferences in the tax code. Taxpayers subject to the AMT are required to recalculate their tax liability on the basis of a more limited set of exemptions, deductions, and tax credits than would normally apply. The amount by which a taxpayer's AMT calculation exceeds his or her regular tax calculation is that person's AMT liability.

**appropriation act:** A law or legislation under the jurisdiction of the House and Senate Committees on Appropriations that provides authority for federal programs or agencies to incur obligations and make payments from the Treasury. Each year, the Congress considers regular appropriation acts, which fund the operations of the federal government for the upcoming fiscal year. The Congress may also consider supplemental, deficiency, or continuing appropriation acts (joint resolutions that provide budget authority for a fiscal year until the regular

appropriation for that year is enacted). See **budget authority, fiscal year,** and **obligation.**

**authorization act:** A law or legislation under the jurisdiction of a committee *other than* the House and Senate Committees on Appropriations that establishes or continues the operation of a federal program or agency, either indefinitely or for a specified period of time. An authorization act may suggest a level of budget authority needed to fund the program or agency, which is then provided in a future appropriation act. However, for some programs, the authorization itself may provide the budget authority. See **appropriation act** and **budget authority.**

**Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177):** Referred to in CBO's reports as the Deficit Control Act, it has also been known as Gramm-Rudman-Hollings. Among other changes to the budget process, the law established rules that governed the calculation of CBO's baseline. In addition, it set specific deficit targets as well as sequestration procedures to reduce spending if those targets were exceeded. The targets were changed to discretionary spending limits and pay-as-you-go (PAYGO) controls by the Budget Enforcement Act of 1990. However, the discretionary spending limits and the sequestration procedure to enforce them expired on September 30, 2002. PAYGO and its sequestration procedure were rendered ineffective on December 2, 2002, when P.L. 107-312 reduced all PAYGO balances to zero. The remaining provisions, including the rules that govern the calculation of the baseline, expired on September 30, 2006. CBO, however, continues to follow the methodology prescribed in the law for establishing baselines. See **baseline, discretionary spending limits, pay-as-you-go,** and **sequestration.**

**baseline:** A benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending. For purposes of the Deficit Control Act, the baseline is the projection of current-year levels of new budget authority, outlays, revenues, and the deficit or surplus into the budget year and out-years on the basis of current laws and policies, calculated following the rules set forth in section 257 of that law. Section 257 expired in September 2006, but CBO continues to prepare baselines following the methodology prescribed in the section. Estimates consistent with section 257 are used by the House and Senate Committees on the Budget in implementing the pay-as-you-go (PAYGO) rules in each House. See **Balanced Budget and Emergency Deficit Control Act of 1985, budget authority, deficit, fiscal year, outlays, pay-as-you-go, revenues,** and **surplus.**

**basis point:** One one-hundredth of a percentage point. (For example, the difference between interest rates of 5.5 percent and 5.0 percent is 50 basis points.)

***Blue Chip* consensus forecast:** The average of approximately 50 private-sector economic forecasts compiled and published monthly by Aspen Publishers, Inc.

**book depreciation:** See **depreciation.**

**book profits:** Profits calculated using book (or tax) depreciation and standard accounting conventions for inventories. Different from economic profits, book profits are referred to as "profits before tax" in the national income and product accounts. See **depreciation, economic profits,** and **national income and product accounts.**

**budget authority:** Authority provided by law to incur financial obligations that will result in immediate or future outlays of federal government funds. Budget authority may be provided in an appropriation act or authorization act and may take the form of borrowing authority, contract authority, entitlement authority, or authority to obligate and expend offsetting collections or receipts. Offsetting collections and receipts are classified as negative budget authority. See **appropriation act, authorization act, contract authority, offsetting collections, offsetting receipts,** and **outlays.**

**Budget Enforcement Act of 1990:** Among other changes to the budget process, this law established discretionary spending limits and pay-as-you-go (PAYGO) controls by amending the Balanced Budget and Emergency Deficit Control Act of 1985. See **Balanced Budget and Emergency Deficit Control Act of 1985, discretionary spending limits,** and **pay-as-you-go.**

**budget function:** One of 20 general subject categories into which budgetary resources are grouped so that all budget authority and outlays can be presented according to the national interests being addressed. There are 17 broad budget functions, including national defense, international affairs, energy, agriculture, health, income security, and general government. Three other functions—net interest, allowances, and undistributed offsetting receipts—are included to complete the budget. See **budget authority, net interest, offsetting receipts,** and **outlays.**

**budget resolution:** A concurrent resolution, adopted by both Houses of Congress, that sets forth a Congressional budget plan for the budget year and at least four outyears. The plan consists of targets for spending and revenues; subsequent appropriation acts and authorization acts that affect revenues or direct spending are expected to comply with those targets. The targets are enforced in each House of Congress through procedural mechanisms set forth in law and in the rules of each House. See **appropriation act, authorization act, direct spending, fiscal year,** and **revenues.**

**budget year:** See **fiscal year.**

**budgetary resources:** All sources of authority provided to federal agencies that permit them to incur financial obligations, including new budget authority, unobligated balances, direct spending authority, and obligation limitations. See **budget authority, direct spending, obligation limitation,** and **unobligated balances.**

**business cycle:** Fluctuations in overall business activity accompanied by swings in the unemployment rate, interest rates, and corporate profits. Over a business cycle, real activity rises to a *peak* (its highest level during the cycle) and then falls until it reaches a *trough* (its lowest level following the peak), whereupon it starts to rise again, defining a new cycle. Business cycles are irregular, varying in frequency, magnitude, and duration. (NBER) See **real** and **unemployment rate.**

**business fixed investment:** Spending by businesses on structures, equipment, and software. Such investment is labeled "fixed" to distinguish it from investment in inventories. See **inventories.**

**Capacity utilization rate:** The seasonally adjusted output of the nation's factories, mines, and electric and gas utilities expressed as a percentage of their capacity to produce output. A facility's capacity is the greatest output it can maintain with a normal work pattern. (FRB)

**capital:** Tangible and intangible resources that can be used or invested to produce a stream of benefits over time. *Physical capital*—also known as *fixed capital* or the *capital stock*—consists of land and the stock of products set aside to support future production and consumption, including business inventories and *capital goods* (residential and nonresidential structures and producers' durable equipment). *Human capital* is the education, training, work experience, and other attributes that enhance the ability of the labor force to produce goods and services. The *capital* of a business is the sum advanced and put at risk by the business's owners: for example, *bank capital* is the sum put at risk by the owners of a bank. In an accounting sense, capital is a firm's net worth or equity—the difference between its assets and liabilities. *Financial capital* is wealth held in the form of financial instruments (stocks, bonds, mortgages, and so forth) rather than held directly in the form of physical capital.

**capital gains and losses:** The increase or decrease in the value of an asset that comes from the increase or decrease in the asset's market price since it was purchased. A capital gain or loss is "realized" when the asset is sold.

**capital income:** Income derived from wealth, such as stock dividends, realized capital gains, or the owner's profits from a business. See **capital gains and losses.**

**capital services:** A measure of how much the stock of physical capital contributes to the flow of production.

**cash accounting:** A system of accounting in which revenues are recorded when they are actually received and outlays are recorded when payment is made. Compare with **accrual accounting.**

**central bank:** A government-established agency responsible for conducting monetary policy and overseeing credit conditions. The Federal Reserve System fulfills those functions in the United States. See **Federal Reserve System** and **monetary policy.**

**compensation:** All of the income due to an employee for his or her work during a given period. In addition to wages, salaries, bonuses, and stock options, compensation includes fringe benefits and the employer's share of payroll taxes for social insurance programs, such as Social Security. (BEA)

**constant dollar:** A measure of spending or revenues in a given year that has been adjusted for differences in prices (such as inflation) between that year and a base year. See **inflation** and **real**; compare with **current dollar** and **nominal.**

**consumer confidence:** An index of consumer optimism that is based on surveys of consumers' attitudes about current and future economic conditions. One such measure, the index of consumer sentiment, is constructed by the University of Michigan's Survey Research Center. The Conference Board constructs a similar measure, the consumer confidence index.

**consumer price index (CPI):** An index of the cost of living commonly used to measure inflation. The Bureau of Labor Statistics publishes the CPI-U, an index of consumer prices based on the typical market basket of goods and services consumed by all urban consumers, and the CPI-W, an index of consumer prices based on the typical market basket of goods and services consumed by urban wage earners and clerical workers. (BLS) See **inflation.**

**consumer sentiment index:** See **consumer confidence.**

**consumption:** In principle, the value of goods and services purchased and used up during a given period by households and governments. In practice, the Bureau of Economic Analysis counts purchases of many long-lasting goods (such as cars and clothes) as consumption even though the goods are not used up. Consumption by households alone is also called consumer spending. See **national income and product accounts.**

**contract authority:** Authority provided by law to enter into contracts or incur other obligations in advance of, or in excess of, funds available for that purpose. Although it is a form of budget authority, contract authority does not provide the funds to make payments. Those funds must be provided later, usually in a subsequent appropriation act (called a liquidating appropriation). Contract authority differs from a federal agency's inherent authority to enter into contracts, which may be exercised only within the limits of available appropriations. See **appropriation act, budget authority,** and **obligation**.

**core inflation:** A measure of the rate of inflation that excludes changes in the prices of food and energy. See **consumer price index, inflation,** and **personal consumption expenditure price index.**

**CPI:** See **consumer price index.**

**credit reform:** A system of budgeting and accounting for federal credit activities that focuses on the cost of subsidies conveyed in federal credit assistance. The system was established by the Federal Credit Reform Act of 1990 and took effect at the beginning of fiscal year 1992. See **credit subsidy, financing account, liquidating account,** and **program account.**

**credit subsidy:** The estimated long-term cost to the federal government of a direct loan or loan guarantee. That cost is calculated on the basis of net present value, excluding federal administrative costs and any incidental effects on revenues or outlays. For direct loans, the subsidy cost is the net present value of loan disbursements minus repayments of interest and principal, adjusted for estimated defaults, prepayments, fees, penalties, and other recoveries. For loan guarantees, the subsidy cost is the net present value of estimated payments by the government to cover defaults and delinquencies, interest subsidies, or other payments, offset by any payments to the government, including origination and other fees, penalties, and recoveries. See **outlays** and **present value.**

**current-account balance:** A summary measure of a country's current transactions with the rest of the world, including net exports, net unilateral transfers, and net factor income (primarily the capital income from foreign property received by residents of a country offset by the capital income from property in that country flowing to

residents of foreign countries). (BEA) See **net exports** and **unilateral transfers.**

**current dollar:** A measure of spending or revenues in a given year that has not been adjusted for differences in prices (such as inflation) between that year and a base year. See **inflation** and **nominal;** compare with **constant dollar** and **real.**

**current year:** See **fiscal year.**

**cyclical deficit or surplus:** The part of the federal budget deficit or surplus that results from the business cycle. The cyclical component reflects the way in which the deficit or surplus automatically increases or decreases during economic expansions or recessions. (CBO) See **business cycle, deficit, expansion, recession,** and **surplus;** compare with **cyclically adjusted budget deficit or surplus**

**cyclically adjusted budget deficit or surplus:** The level of the federal budget deficit or surplus that would occur under current law if the influence of the business cycle was removed—that is, if the economy operated at potential gross domestic product. (CBO) See **business cycle, deficit, potential GDP,** and **surplus;** compare with **cyclical deficit or surplus.**

**Debt:** In the case of the federal government, the total value of outstanding notes, bonds, bills, and other debt instruments issued by the Treasury and other federal agencies. That debt is referred to as *federal debt* or *gross debt.* It has two components: *debt held by the public* (federal debt held by nonfederal investors, including the Federal Reserve System) and *debt held by government accounts* (federal debt held by federal government trust funds, deposit insurance funds, and other federal accounts). *Debt subject to limit* is federal debt that is subject to a statutory limit on the total amount issued. The limit applies to gross federal debt except for a small portion of the debt issued by the Treasury and all of the small amount of debt issued by other federal agencies (primarily the Tennessee Valley Authority and the Postal Service).

**debt service:** Payment of scheduled interest obligations on outstanding debt. As used in *The Budget and Economic Outlook,* debt service refers to a change in interest payments resulting from a change in estimates of the deficit or surplus. See **deficit, net interest,** and **surplus.**

**deficit:** The amount by which the federal government's total outlays exceed its total revenues in a given period, typically a fiscal year. The *primary deficit* is that total deficit excluding net interest. See **fiscal year, net interest, outlays,** and **revenues;** compare with **surplus.**

**Deficit Control Act:** See **Balanced Budget and Emergency Deficit Control Act of 1985.**

**deflation:** A drop in price levels that is so broadly based that general indexes of prices, such as the consumer price index, register continuing declines. Deflation is usually caused by a collapse in aggregate demand. See **aggregate demand** and **consumer price index.**

**demand:** See **aggregate demand** and **domestic demand.**

**deposit insurance:** The guarantee by a federal agency that an individual depositor at a participating depository institution will receive the full amount of the deposit (up to $100,000) if the institution becomes insolvent.

**depreciation:** A decline in the value of a currency, financial asset, or capital good. When applied to a capital good, depreciation usually refers to loss of value because of obsolescence, wear, or destruction (as by fire or flood) and is also called *consumption of fixed capital. Book depreciation* (also known as tax depreciation) is the depreciation that the tax code allows businesses to deduct when they calculate their taxable profits. It typically occurs at a faster rate than *economic depreciation,* which is the actual decline in the value of an asset. Both measures of depreciation appear as part of the national income and product accounts. See **book profits** and **national income and product accounts.**

**devaluation:** The act of a government to lower the fixed exchange rate of its currency. The government implements a devaluation by announcing that it will no longer maintain the existing rate by buying and selling its currency at that rate. See **exchange rate.**

**direct spending:** Synonymous with mandatory spending, direct spending is the budget authority provided by laws other than appropriation acts and the outlays that

result from that budget authority. (As used in *The Budget and Economic Outlook,* direct spending refers only to the outlays that result from budget authority provided in laws other than appropriation acts.) See **appropriation act, budget authority,** and **outlays;** compare with **discretionary spending** and **entitlement.**

**discount rate:** The interest rate that the Federal Reserve System charges on a loan it makes to a bank. Such loans, when allowed, enable a bank to meet its reserve requirements without reducing its lending. Alternatively, the discount rate is the interest rate used to compute the present value of future payments (such as for pension plans). See **Federal Reserve System** and **present value.**

**discouraged workers:** Jobless people who are available for work but not actively seeking it because they think they have poor prospects of finding a job. Discouraged workers are not included in measures of the labor force or the unemployment rate. (BLS) See **labor force** and **unemployment rate.**

**discretionary spending:** The budget authority that is provided and controlled by appropriation acts and the outlays that result from that budget authority. See **appropriation act, budget authority,** and **outlays;** compare with **direct spending.**

**discretionary spending limits (or caps):** Statutory ceilings imposed on the amount of budget authority provided in appropriation acts in a fiscal year and on the outlays that are made in that year. The limits were originally established in the Budget Enforcement Act of 1990. Under that law, if the estimated budget authority provided in all appropriation acts for a fiscal year (or the outlays resulting from that budget authority) exceeded the spending limit for that year, a sequestration—a cancellation of budget authority provided for programs funded by appropriation acts—would be triggered. All discretionary spending limits and the sequestration procedure to enforce them expired on September 30, 2002. See **appropriation act, Balanced Budget and Emergency Deficit Control Act of 1985, budget authority, Budget Enforcement Act of 1990, discretionary spending, fiscal year, outlays,** and **sequestration.**

**disposable personal income:** Personal income—the income that individuals receive, including transfer payments—minus the taxes and fees that individuals pay to governments. (BEA) See **transfer payments.**

**domestic demand:** Total purchases of goods and services, regardless of their origin, by U.S. consumers, businesses, and governments during a given period. Domestic demand equals gross domestic product minus net exports. (BEA) See **gross domestic product** and **net exports;** compare with **aggregate demand.**

**ECI:** See **employment cost index.**

**Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16):** This law, also known as EGTRRA, significantly reduced tax liabilities (the amount of tax owed) over the 2001–2010 period by cutting individual income tax rates, increasing the child tax credit, repealing estate taxes, raising deductions for married couples who file joint returns, increasing tax benefits for pensions and individual retirement accounts, and creating additional tax benefits for education. The law phased in many of those changes over time, including some that are not fully effective until 2010. Although some of the law's provisions have been made permanent, most are scheduled to expire on or before December 31, 2010. For legislation that modified provisions of EGTRRA, see **Jobs and Growth Tax Relief Reconciliation Act of 2003, Tax Relief and Health Care Act of 2006,** and **Working Families Tax Relief Act of 2004.**

**economic profits:** Corporations' profits, adjusted to remove distortions in depreciation allowances caused by tax rules and to exclude the effect of inflation on the value of inventories. Economic profits are a better measure of profits from current production than are the book profits reported by corporations. Economic profits are referred to as "corporate profits with inventory valuation and capital consumption adjustments" in the national income and product accounts. (BEA) See **book profits, depreciation, inflation, inventories,** and **national income and product accounts.**

**effective tax rate:** The ratio of taxes paid to a given tax base. For individual income taxes, the effective tax rate is typically expressed as the ratio of taxes paid to adjusted gross income. For corporate income taxes, it is the ratio of

taxes paid to book profits. For some purposes—such as calculating an overall tax rate on all income—an effective tax rate is computed on a base that includes the untaxed portion of Social Security benefits, interest on tax-exempt bonds, and similar items. It can also be computed on a base of personal income as measured by the national income and product accounts. The effective tax rate is a useful measure because the tax code's various exemptions, credits, deductions, and tax rates make actual ratios of taxes paid to income very different from statutory tax rates. See **adjusted gross income** and **book profits;** compare with **marginal tax rate** and **statutory tax rate.**

**EGTRRA:** See **Economic Growth and Tax Relief Reconciliation Act of 2001.**

**employment:** Work performed or services rendered in exchange for compensation. Two estimates of employment are commonly used. One comes from the so-called establishment survey of employers (the Department of Labor's Current Employment Statistics Survey), which measures employment as the estimated number of nonfarm wage and salary jobs. (Thus, a person with more than one job may be counted more than once.) The other estimate comes from the so-called household survey (the Census Bureau's Current Population Survey), which measures employment as the estimated number of people employed. (Thus, someone with more than one job is counted only once.) The household survey is based on a smaller sample than the establishment survey and therefore yields a more volatile estimate of employment. See **compensation** and **unemployment rate.**

**employment cost index (ECI):** An index of the weighted-average cost of an hour of labor—comprising the cost to the employer of wage and salary payments, employee benefits, and payroll taxes for social insurance programs, such as Social Security. The ECI is structured so that it is not affected by changes in the mix of occupations in the labor force or the mix of employment by industry. (BLS)

**entitlement:** A legal obligation of the federal government to make payments to a person, group of people, business, unit of government, or similar entity that meets the eligibility criteria set in law and for which the budget authority is not provided in advance in an appropriation act. Spending for entitlement programs is controlled through those programs' eligibility criteria and benefit or payment rules. The best-known entitlements are the government's major benefit programs, such as Social Security and Medicare. See **appropriation act** and **budget authority;** compare with **direct spending.**

**establishment survey:** See **employment.**

**exchange rate:** The number of units of a foreign currency that can be bought with one unit of the domestic currency, or vice versa.

**excise tax:** A tax levied on the purchase of a specific type of good or service, such as tobacco products or air transportation services.

**expansion:** A phase of the business cycle that begins when gross domestic product exceeds its previous peak and extends until GDP reaches its next peak. (NBER) See **business cycle** and **gross domestic product;** compare with **recession** and **recovery.**

**expenditure account:** An account established within federal funds and trust funds to record appropriations, obligations, and outlays (as well as offsetting collections) that are usually financed from an associated receipt account. See **federal funds, obligation, outlays,** and **trust funds;** compare with **receipt account.**

**Fan chart:** A graphic representation of CBO's baseline projection of the budget deficit or surplus that includes not only a single line representing the outcome expected under the baseline's economic assumptions but also the various possible outcomes surrounding that line, based on the reasonable expectations of error in the underlying economic and technical assumptions. (CBO calculates those reasonable expectations of error on the basis of the accuracy of its own past projections, adjusted for differences in legislation.) See **deficit** and **surplus.**

**federal funds:** In the federal accounting structure, all accounts through which collections of money and expenditures are recorded, except those classified by law as trust funds. Federal funds include several types of funds, one of which is the general fund. See **general fund;** compare with **trust funds.**

**federal funds rate:** The interest rate that financial institutions charge each other for overnight loans of their monetary reserves. A rise in the federal funds rate (compared with other short-term interest rates) suggests a tightening of monetary policy, whereas a fall suggests an easing. (FRB) See **monetary policy** and **short-term interest rate.**

**Federal Open Market Committee:** The group within the Federal Reserve System that determines the stance of monetary policy. The open-market desk at the Federal Reserve Bank of New York implements that policy with open-market operations (the purchase or sale of government securities), which influence short-term interest rates—especially the federal funds rate—and the growth of the money supply. The committee is composed of 12 members, including the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and a rotating group of four of the other 11 presidents of the regional Federal Reserve Banks. See **federal funds rate, Federal Reserve System, monetary policy,** and **short-term interest rate.**

**Federal Reserve System:** The central bank of the United States. The Federal Reserve is responsible for conducting the nation's monetary policy and overseeing credit conditions. See **central bank** and **monetary policy.**

**financing account:** A nonbudgetary account required for a credit program (by the Federal Credit Reform Act of 1990) that holds balances, receives credit subsidy payments from the program account, and records all cash flows with the public that result from obligations or commitments made under the program since October 1, 1991. The cash flow in each financing account for a fiscal year is shown in the federal budget as an "other means of financing." See **credit reform, credit subsidy, means of financing,** and **program account;** compare with **liquidating account.**

**fiscal policy:** The government's tax and spending policies, which influence the amount and maturity of government debt as well as the level, composition, and distribution of national output and income. See **debt.**

**fiscal year:** A yearly accounting period. The federal government's fiscal year begins October 1 and ends September 30. Fiscal years are designated by the calendar years in which they end—for example, fiscal year 2008 will begin on October 1, 2007, and end on September 30, 2008. The *budget year* is the fiscal year for which the budget is being considered; in relation to a session of Congress, it is the fiscal year that starts on October 1 of the calendar year in which that session of Congress began. An *out-year* is a fiscal year following the budget year. The *current year* is the fiscal year in progress.

**foreign direct investment:** Financial investment by which a person or an entity acquires a lasting interest in, and a degree of influence over the management of, a business enterprise in a foreign country. (BEA)

**forward funding:** The provision of budget authority that becomes available for obligation in the last quarter of a fiscal year and remains available during the following fiscal year. This form of funding typically finances ongoing education grant programs. See **budget authority, fiscal year,** and **obligation;** compare with **advance appropriation, obligation delay,** and **unobligated balances.**

**GDI:** See **gross domestic income.**

**GDP:** See **gross domestic product.**

**GDP gap:** The difference between potential and actual gross domestic product, expressed as a percentage of potential GDP. See **gross domestic product** and **potential GDP.**

**GDP price index:** A summary measure of the prices of all goods and services that make up gross domestic product. The change in the GDP price index is used as a measure of inflation in the overall economy. See **gross domestic product** and **inflation.**

**general fund:** One category of federal funds in the government's accounting structure. The general fund records all revenues and offsetting receipts not earmarked by law for a specific purpose and all spending financed by those revenues and receipts. See **federal funds, offsetting receipts,** and **revenues;** compare with **trust funds.**

**GNP:** See **gross national product.**

**grants:** Transfer payments from the federal government to state and local governments or other recipients to help fund projects or activities that do not involve substantial federal participation. See **transfer payments.**

**grants-in-aid:** Grants from the federal government to state and local governments to help provide for programs of assistance or service to the public.

**gross debt:** See **debt.**

**gross domestic income (GDI):** The sum of all income earned in the domestic production of goods and services. In theory, GDI should equal gross domestic product, but measurement difficulties leave a statistical discrepancy between the two. (BEA) See **gross domestic product.**

**gross domestic product (GDP):** The total market value of goods and services produced domestically during a given period. That value is conceptually equal to gross domestic income, but measurement difficulties result in a statistical discrepancy between the two. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports. (BEA) See **consumption, gross investment,** and **net exports.**

**gross investment:** A measure of additions to the capital stock that does not subtract depreciation of existing capital. See **capital** and **depreciation.**

**gross national product (GNP):** The total market value of goods and services produced during a given period by labor and capital supplied by residents of a country, regardless of where the labor and capital are located. That value is conceptually equal to the total income accruing to residents of the country during that period (national income). GNP differs from gross domestic product primarily by including the capital income that residents earn from investments abroad and excluding the capital income that nonresidents earn from domestic investment. See **gross domestic product** and **national income.**

**Home equity:** The value that an owner has in a home, calculated by subtracting the value of any outstanding mortgage (or other loan) secured by the home from the home's current market value.

**household survey:** See **employment.**

**Inflation:** Growth in a general measure of prices, usually expressed as an annual rate of change. See **consumer price index, core inflation, GDP price index,** and **personal consumption expenditure price index.**

**inventories:** Stocks of goods held by businesses for further processing or for sale. (BEA)

**investment:** *Physical investment* is the current product set aside during a given period to be used for future production—in other words, an addition to the capital stock. As measured by the national income and product accounts, *private domestic investment* consists of investment in residential and nonresidential structures, producers' durable equipment, and the change in business inventories. *Financial investment* is the purchase of a financial security, such as a stock, bond, or mortgage. *Investment in human capital* is spending on education, training, health services, and other activities that increase the productivity of the workforce. Investment in human capital is not treated as investment by the national income and product accounts. See **capital, inventories, national income and product accounts,** and **productivity.**

**JCWAA:** See **Job Creation and Worker Assistance Act of 2002.**

**JGTRRA:** See **Jobs and Growth Tax Relief Reconciliation Act of 2003.**

**Job Creation and Worker Assistance Act of 2002 (Public Law 107-147):** This law reduced business taxes by allowing businesses to immediately deduct a portion of the cost of purchases of capital goods, increasing and

extending certain other deductions and exemptions, and expanding the ability of unprofitable corporations to receive refunds of past taxes paid. Those provisions expire on various dates. The law also provided tax benefits for areas of New York City damaged on September 11, 2001, and additional weeks of unemployment benefits to recipients who exhausted their eligibility for regular state benefits. Most of the law's provisions have expired or have been extended in subsequent legislation. See **Jobs and Growth Tax Relief Reconciliation Act of 2003** and **Tax Relief and Health Care Act of 2006.**

**Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108-27):** This law reduced taxes by advancing to 2003 the effective date of several tax reductions previously enacted in EGTRRA. It also increased the exemption amount for the individual alternative minimum tax, reduced the tax rates for income from dividends and capital gains, and expanded the portion of capital purchases that businesses could immediately deduct under JCWAA. Those provisions expire on various dates. The law also provided an estimated $20 billion for fiscal relief to states. See **capital gains and losses, Economic Growth and Tax Relief Reconciliation Act of 2001, Job Creation and Worker Assistance Act of 2002,** and **Working Families Tax Relief Act of 2004.**

**Labor force:** The number of people age 16 or older in the civilian noninstitutional population who have jobs or who are available for work and are actively seeking jobs. (The civilian noninstitutional population excludes members of the armed forces on active duty and people in penal or mental institutions or in homes for the elderly or infirm.) The *labor force participation rate* is the labor force as a percentage of the civilian noninstitutional population age 16 or older. (BLS) See **potential labor force.**

**labor productivity:** See **productivity.**

**liquidating account:** A budgetary account associated with a credit program that records all cash flows resulting from direct loan obligations and loan guarantee commitments made under that program before October 1, 1991. See **credit reform;** compare with **financing account** and **program account.**

**liquidity:** The ease with which an asset can be sold for cash. An asset is highly liquid if it comes in standard units that are traded daily in large amounts by many buyers and sellers. Among the most liquid of assets are U.S. Treasury securities.

**long-term interest rate:** The interest rate earned by a note or bond that matures in 10 or more years.

**Mandatory spending:** See **direct spending.**

**marginal tax rate:** The tax rate that would apply to an additional dollar of a taxpayer's income. Compare with **effective tax rate** and **statutory tax rate.**

**means of financing:** Means by which a budget deficit is financed or a surplus is used. Means of financing are not included in the budget totals. The primary means of financing is borrowing from the public. In general, the cumulative amount borrowed from the public (debt held by the public) will increase if there is a deficit and decrease if there is a surplus, although other factors can affect the amount that the government must borrow. Those factors, known as *other means of financing,* include reductions (or increases) in the government's cash balances, seigniorage, changes in outstanding checks, changes in accrued interest costs included in the budget but not yet paid, and cash flows reflected in credit financing accounts. See **debt, deficit, financing account, seigniorage,** and **surplus.**

**monetary policy:** The strategy of influencing changes in the money supply and interest rates to affect output and inflation. An "easy" monetary policy suggests faster growth of the money supply and initially lower short-term interest rates intended to increase aggregate demand, but it may lead to higher inflation. A "tight" monetary policy suggests slower growth of the money supply and higher interest rates in the near term in an attempt to reduce inflationary pressure by lowering aggregate demand. The Federal Reserve System conducts monetary policy in the United States. See **aggregate demand, Federal Reserve System, inflation,** and **short-term interest rate.**

**National income:** Total income earned by U.S. residents from all sources, including employee compensation (wages, salaries, benefits, and employers' share of payroll taxes for social insurance programs), corporate profits, net interest, rental income, and proprietors' income. See **gross national product.**

**national income and product accounts (NIPAs):** Official U.S. accounts that track the level and composition of gross domestic product, the prices of its components, and the way in which the costs of production are distributed as income. (BEA) See **gross domestic product.**

**national saving:** Total saving by all sectors of the economy: personal saving, business saving (corporate after-tax profits not paid as dividends), and government saving (budget surpluses). National saving represents all income not consumed, publicly or privately, during a given period. (BEA) See **national income, net national saving, personal saving,** and **surplus.**

**natural rate of unemployment:** The rate of unemployment arising from all sources except fluctuations in aggregate demand. Those sources include *frictional unemployment,* which is associated with normal turnover of jobs, and *structural unemployment,* which includes unemployment caused by mismatches between the skills of available workers and the skills necessary to fill vacant positions and unemployment caused when wages exceed their market-clearing levels because of institutional factors, such as legal minimum wages, the presence of unions, social conventions, or employer wage-setting practices intended to increase workers' morale and effort. See **aggregate demand** and **unemployment rate.**

**net exports:** The exports of goods and services produced in a country minus the country's imports of goods and services produced elsewhere; also referred to as the trade balance.

**net federal government saving:** A term used in the national income and product accounts to identify the difference between federal current receipts and federal current expenditures (including consumption of fixed capital). When receipts exceed expenditures, net federal government saving is positive (formerly identified in the national income and product accounts as a federal government surplus); when expenditures exceed receipts, net federal government saving is negative (formerly identified in the NIPAs as a federal government deficit). See **capital** and **national income and product accounts.**

**net interest:** In the federal budget, net interest comprises the government's interest payments on debt held by the public (as recorded in budget function 900) offset by interest income that the government receives on loans and cash balances and by earnings of the National Railroad Retirement Investment Trust. See **budget function** and **debt.**

**net national saving:** National saving minus depreciation of physical capital. See **capital, depreciation,** and **national saving.**

**NIPAs:** See **national income and product accounts.**

**nominal:** A measure based on current-dollar value. The *nominal* level of income or spending is measured in current dollars. The *nominal interest rate* on debt selling at par is the ratio of the current-dollar interest paid in any year to the current-dollar value of the debt when it was issued. The nominal interest rate on debt initially issued or now selling at a discount includes as a payment the estimated yearly equivalent of the difference between the redemption price and the discounted price. The *nominal exchange rate* is the rate at which a unit of one currency trades for a unit of another currency. See **current dollar;** compare with **real.**

**Obligation:** A legally binding commitment by the federal government that will result in outlays, immediately or in the future. See **outlays.**

**obligation delay:** Legislation that precludes the obligation of an amount of budget authority provided in an appropriation act or in some other law until some time after the first day on which that budget authority would normally be available. For example, language in an appropriation act for fiscal year 2007 that precludes obligation of an amount until March 1 is an obligation delay; without that language, the amount would have been available for obligation on October 1, 2006 (the first day of fiscal

year 2007). See **appropriation act, budget authority, fiscal year,** and **obligation;** compare with **advance appropriation, forward funding,** and **unobligated balances.**

**obligation limitation:** A provision of a law or legislation that restricts or reduces the availability of budget authority that would have become available under another law. Typically, an obligation limitation is included in an appropriation act. The limitation may affect budget authority provided in that act, but more often, it affects direct spending that has been provided in an authorization act. Generally, when an appropriation act routinely places an obligation limitation on direct spending, the limitation is treated as a discretionary resource and the associated outlays are treated as discretionary spending. See **appropriation act, authorization act, budget authority, direct spending, discretionary spending,** and **outlays.**

**off-budget:** Spending or revenues sometimes excluded from the budget totals by law. The revenues and outlays of the two Social Security trust funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) and the transactions of the Postal Service are off-budget. See **outlays, revenues,** and **trust funds.**

**offsetting collections:** Funds collected by government agencies from other government accounts or from the public in business-like or market-oriented transactions that are required by law to be credited directly to an expenditure account. Offsetting collections, which are treated as negative budget authority and outlays, are credits against the budget authority and outlays (either direct or discretionary spending) of the account to which they are credited. Collections that result from the government's exercise of its sovereign or governmental powers are ordinarily classified as revenues, although they are classified as offsetting collections when the law requires it. See **budget authority, direct spending, discretionary spending, expenditure account,** and **outlays;** compare with **offsetting receipts** and **revenues.**

**offsetting receipts:** Funds collected by government agencies from other government accounts or from the public in business-like or market-oriented transactions that are credited to a receipt account. Offsetting receipts, which are treated as negative budget authority and outlays, offset gross budget authority and outlays in calculations of total direct spending. Collections that result from the government's exercise of its sovereign or governmental powers are ordinarily classified as revenues, although they are classified as offsetting receipts when the law requires it. See **budget authority, direct spending, outlays,** and **receipt account;** compare with **offsetting collections** and **revenues.**

**other means of financing:** See **means of financing.**

**outlays:** Spending to pay a federal obligation. Outlays may pay for obligations incurred in a prior fiscal year or in the current year; hence, they flow partly from unexpended balances of prior-year budget authority and partly from budget authority provided for the current year. For most categories of spending, outlays are recorded on a cash accounting basis. However, outlays for interest on debt held by the public are recorded on an accrual accounting basis, and outlays for direct loans and loan guarantees (since credit reform) reflect estimated sub sidy costs instead of cash transactions. See **accrual accounting, budget authority, cash accounting, credit reform, debt, fiscal year,** and **obligation.**

**out-year:** See **fiscal year.**

**Pay-as-you-go (PAYGO):** Procedures established in the Budget Enforcement Act of 1990 (statutory PAYGO) and in House and Senate rules that are intended to ensure that all laws that affect direct spending or revenues are budget neutral. Under statutory PAYGO, the budgetary effect of each such law was estimated for a five-year period and entered on the PAYGO scorecard. If, in any budget year, the deficit increased as a result of the total budgetary effects of laws on that scorecard, a PAYGO sequestration—a cancellation of budgetary resources available for direct spending programs—would be triggered. Statutory PAYGO and its sequestration procedure were rendered ineffective on December 2, 2002, when Public Law 107-312 reduced all PAYGO balances to zero. In addition, the House and Senate each have a PAYGO rule enforced by a point of order. Since 1993, the Senate has had a rule against considering legislation affecting direct spending or revenues that is expected to increase (or cause) an on-budget deficit. That rule was adopted in

its current form in the budget resolution for 2004 (H. Con. Res. 95, 108th Congress). The House rule (established by H. Res. 6, 110th Congress) applies to legislation affecting direct spending or revenues that has the net effect of increasing the deficit or decreasing the surplus. Unlike the Senate rule, the House rule applies on a bill-by-bill basis without reference to cumulative effects. See **Balanced Budget and Emergency Deficit Control Act of 1985, Budget Enforcement Act of 1990, deficit, direct spending, fiscal year, point of order, revenues, sequestration,** and **surplus.**

**PCE price index:** See **personal consumption expenditure price index.**

**peak:** See **business cycle.**

**personal consumption expenditure price index:** A summary measure of the prices of all goods and services that make up personal consumption expenditures. It is an alternative to the consumer price index as a measure of inflation. See **consumption, consumer price index,** and **inflation.**

**personal income:** See **disposable personal income.**

**personal saving:** Saving by households. Personal saving equals disposable personal income minus spending for consumption and interest payments. The *personal saving rate* is personal saving as a percentage of disposable personal income. (BEA) See **consumption** and **disposable personal income;** compare with **private saving.**

**point of order:** The procedure by which a member of a legislature (or similar body) questions an action that is being taken, or that is proposed to be taken, as contrary to that body's rules, practices, or precedents.

**potential GDP:** The level of real gross domestic product that corresponds to a high level of resource (labor and capital) use. (Procedures for calculating potential GDP are described in *CBO's Method for Estimating Potential Output: An Update,* August 2001.) See **gross domestic product, potential output,** and **real.**

**potential labor force:** The labor force adjusted for movements in the business cycle. See **business cycle** and **labor force.**

**potential output:** The level of production that corresponds to a high level of resource (labor and capital) use. Potential output for the national economy is also referred to as potential gross domestic product. (Procedures for calculating potential output are described in *CBO's Method for Estimating Potential Output: An Update,* August 2001.) See **potential GDP.**

**present value:** A single number that expresses a flow of current and future income (or payments) in terms of an equivalent lump sum received (or paid) today. The present value depends on the rate of interest used (the discount rate). For example, if $100 is invested on January 1 at an annual interest rate of 5 percent, it will grow to $105 by January 1 of the next year. Hence, at an annual 5 percent interest rate, the present value of $105 payable a year from today is $100.

**primary deficit:** See **deficit.**

**private saving:** Saving by households and businesses. Private saving is equal to personal saving plus after-tax corporate profits minus dividends paid. (BEA) Compare with **personal saving.**

**productivity:** Average real output per unit of input. *Labor productivity* is average real output per hour of labor. The growth of labor productivity is defined as the growth of real output that is not explained by the growth of labor input alone. *Total factor productivity* is average real output per unit of combined labor and capital services. The growth of total factor productivity is defined as the growth of real output that is not explained by the growth of labor and capital. Labor productivity and total factor productivity differ in that increases in capital per worker raise labor productivity but not total factor productivity. (BLS) See **capital services** and **real.**

**program account:** A budgetary account associated with a credit program that receives an appropriation of the subsidy cost of that program's loan obligations or commitments, as well as (in most cases) the program's administrative expenses. From the program account, the subsidy cost is disbursed to the applicable financing account. See **credit subsidy** and **financing account;** compare with **liquidating account.**

**Real:** Adjusted to remove the effects of inflation. *Real output* represents the quantity, rather than the dollar value, of goods and services produced. *Real income* represents the power to purchase real output. *Real data* at the finest level of disaggregation are constructed by dividing the corresponding nominal data, such as spending or wage rates, by a price index. Real aggregates, such as real gross domestic product, are constructed by a procedure that allows the real growth of the aggregate to reflect the real growth of its components, appropriately weighted by the importance of the components. A *real interest rate* is a nominal interest rate adjusted for expected inflation; it is often approximated by subtracting an estimate of the expected inflation rate from the nominal interest rate. See **inflation;** compare with **current dollar** and **nominal.**

**real trade-weighted value of the dollar:** See **trade-weighted value of the dollar.**

**receipt account:** An account established within federal funds and trust funds to record offsetting receipts or revenues credited to that fund. The receipt account typically finances the obligations and outlays from an associated expenditure account. See **federal funds, outlays,** and **trust funds;** compare with **expenditure account.**

**recession:** A phase of the business cycle that extends from a peak to the next trough and that is characterized by a substantial decline in overall business activity—output, income, employment, and trade—for at least several months. As a rule of thumb, though not an official measure, recessions are often identified by a decline in real gross domestic product for at least two consecutive quarters. (NBER) See **business cycle, gross domestic product,** and **real;** compare with **expansion.**

**reconciliation:** A special Congressional procedure often used to implement the revenue and spending targets established in the budget resolution. The budget resolution may contain *reconciliation instructions,* which direct Congressional committees to make changes in laws under their jurisdictions that affect revenues or direct spending to achieve a specified budgetary result. The legislation to implement those instructions is usually combined into a comprehensive *reconciliation bill,* which is considered under special rules. Reconciliation affects revenues, direct spending, and offsetting receipts but usually not discretionary spending. See **budget resolution, direct spending, discretionary spending, offsetting receipts,** and **revenues.**

**recovery:** A phase of the business cycle that lasts from a trough until overall economic activity returns to the level it reached at the previous peak. (NBER) See **business cycle.**

**rescission:** The withdrawal of authority to incur financial obligations that was previously provided by law and has not yet expired. See **budget authority** and **obligation.**

**revenues:** Funds collected from the public that arise from the government's exercise of its sovereign or governmental powers. Federal revenues come from a variety of sources, including individual and corporate income taxes, excise taxes, customs duties, estate and gift taxes, fees and fines, payroll taxes for social insurance programs, and miscellaneous receipts (such as earnings of the Federal Reserve System, donations, and bequests). Federal revenues are also known as federal governmental receipts. Compare with **offsetting collections** and **offsetting receipts.**

**risk premium:** The additional return that investors require to hold assets whose returns are more variable than those of riskless assets. The risk can arise from many sources, such as the possibility of default (in the case of corporate or municipal debt) or the volatility of interest rates or earnings (in the case of corporate stocks).

**S corporation:** A domestically owned corporation with no more than 100 owners who have elected to pay taxes under Subchapter S of the Internal Revenue Code. An S corporation is taxed like a partnership: it is exempt from the corporate income tax, but its owners pay individual income taxes on all of the firm's income, even if some of the earnings are retained by the firm.

**saving rate:** See **national saving** and **personal saving.**

**savings bond:** A nontransferable, registered security issued by the Treasury at a discount and in denominations from $50 to $10,000. The interest earned on savings bonds is exempt from state and local taxation; it is

also exempt from federal taxation until the bonds are redeemed or reach maturity.

**seigniorage:** The gain to the government from the difference between the face value of minted coins put into circulation and the cost of producing them (including the cost of the metal used in the coins). Seigniorage is considered a means of financing and is not included in the budget totals. See **means of financing.**

**sequestration:** An enforcement mechanism established in the Balanced Budget and Emergency Deficit Control Act of 1985 that would result in the cancellation of budgetary resources available for a fiscal year. The mechanism enforced the discretionary spending limits and pay-as-you-go (PAYGO) procedures of that law, as amended. A sequestration of discretionary budget authority would occur in a fiscal year if the budget authority or outlays provided in appropriation acts exceeded the applicable discretionary spending limit for that year. A PAYGO sequestration would occur in a fiscal year if the total budgetary impact of laws affecting direct spending and revenues was not deficit neutral in that year. The discretionary spending limits and the sequestration procedure to enforce them expired on September 30, 2002. PAYGO and its sequestration procedure were rendered ineffective on December 2, 2002, when Public Law 107-312 reduced all PAYGO balances to zero. See **appropriation act, Balanced Budget and Emergency Deficit Control Act of 1985, budget authority,direct spending, discretionary spending limits, fiscal year, outlays, pay-as-you-go,** and **revenues.**

**short-term interest rate:** The interest rate earned by a debt instrument (such as a Treasury bill) that will mature within one year.

**statutory tax rate:** A tax rate specified by law. In some cases, such as with individual and corporate income taxes, the statutory tax rate varies with the amount of taxable income. (For example, under the federal corporate income tax, the statutory tax rate for companies with taxable income below $50,000 is 15 percent, whereas the rate for corporations with taxable income greater than $18.3 million is 35 percent.) In other cases, the statutory tax rate is uniform. (For instance, the statutory federal tax rate on gasoline is 18.4 cents per gallon for all taxpayers.) Compare with **effective tax rate** and **marginal tax rate.**

**Subchapter S corporation:** See **S corporation.**

**subsidy cost:** See **credit subsidy.**

**surplus:** The amount by which the federal government's total revenues exceed its total outlays in a given period, typically a fiscal year. See **fiscal year, outlays,** and **revenues;** compare with **deficit.**

**Tax Increase Prevention and Reconciliation Act of 2005 (Public Law 109-222):** This law extended through 2010 the reduced tax rates on capital gains and dividends originally enacted in JGTRRA, provided relief from the individual alternative minimum tax in tax year 2006, and made other changes to the Internal Revenue Code. See **Jobs and Growth Tax Relief Reconciliation Act of 2003** and **Tax Relief and Health Care Act of 2006.**

**Tax Relief and Health Care Act of 2006 (Public Law 109-432):** This law extended through 2007 the research and experimentation tax credit and the federal tax deduction for state and local sales taxes, added a new credit under the alternative minimum tax, and made other changes to the Internal Revenue Code. It also allowed for additional offshore oil and gas leasing in the Gulf of Mexico and made various modifications to Medicare, the Abandoned Mine Land program, and provisions of tariff and trade law. See **Economic Growth and Tax Relief Reconciliation Act of 2001, Job Creation and Worker Assistance Act of 2002,** and **Tax Increase Prevention and Reconciliation Act of 2005.**

**ten-year Treasury note:** An interest-bearing note issued by the U.S. Treasury that is to be redeemed in 10 years.

**three-month Treasury bill:** A security issued by the U.S. Treasury that is to be redeemed in 91 days. Treasury bills are sold for less than the value paid at redemption but otherwise do not bear interest.

**TIPRA:** See **Tax Increase Prevention and Reconciliation Act of 2005.**

**total factor productivity:** See **productivity.**

**trade balance:** See **net exports.**

**trade-weighted value of the dollar:** The value of the U.S. dollar relative to the currencies of U.S. trading partners, with the weight of each country's currency equal to that country's share of U.S. trade. The *real trade-weighted value of the dollar* is an index of the trade-weighted value of the dollar whose movement is adjusted for the difference between U.S. inflation and inflation among U.S. trading partners. An increase in the real trade-weighted value of the dollar means that the price of U.S.-produced goods and services has increased relative to the price of foreign-produced goods and services. See **inflation.**

**transfer payments:** Payments made to a person or organization for which no current or future goods or services are required in return. Federal transfer payments include Social Security and unemployment benefits. (BEA)

**trough:** See **business cycle.**

**trust funds:** In the federal accounting structure, accounts designated by law as trust funds (regardless of any other meaning of that term). Trust funds record the revenues, offsetting receipts, or offsetting collections earmarked for the purpose of the fund, as well as budget authority and outlays of the fund that are financed by those revenues or receipts. The federal government has more than 200 trust funds. The largest and best known finance major benefit programs (including Social Security and Medicare) and infrastructure spending (such as the Highway Trust Fund and the Airport and Airway Trust Fund). See **budget authority, offsetting collections, offsetting receipts, outlays,** and **revenues;** compare with **federal funds.**

**Unemployment rate:** The number of jobless people who are available for work and are actively seeking jobs, expressed as a percentage of the labor force. (BLS) See **discouraged workers** and **labor force.**

**unified budget:** The entire federal budget, which consolidates all on-budget and off-budget outlays and revenues. See **off-budget, outlays,** and **revenues.**

**unilateral transfers:** Payments from sources within the United States to sources abroad (and vice versa) that are not made in exchange for goods or services. Examples include a private gift sent abroad, a pension payment from a U.S. employer to an eligible retiree living in a foreign country, or taxes paid to the United States by people living overseas.

**unobligated balances:** The portion of budget authority that has not yet been obligated. When budget authority is provided for one fiscal year, any unobligated balances at the end of that year expire and are no longer available for obligation. When budget authority is provided for a specific number of years, any unobligated balances are carried forward and are available for obligation during the years specified. When budget authority is provided for an unspecified number of years, the unobligated balances are carried forward indefinitely, until one of the following occurs: the balances are expended or rescinded, the purpose for which they were provided is accomplished, or no disbursements have been made for two consecutive years. See **budget authority, fiscal year,** and **obligation;** compare with **advance appropriation, forward funding,** and **obligation delay.**

**user fee:** Money that the federal government charges for services or for the sale or use of federal goods or resources that generally provide benefits to the recipients beyond those that may accrue to the general public. The amount of the fee is typically related to the cost of the service provided or the value of the good or resource used. In the federal budget, user fees can be classified as offsetting collections, offsetting receipts, or revenues. See **offsetting collections, offsetting receipts,** and **revenues.**

**WFTRA:** See **Working Families Tax Relief Act of 2004.**

**Working Families Tax Relief Act of 2004 (Public Law 108-311):** This law retained JGTRRA's acceleration of the tax reductions originally phased in under EGTRRA and extended numerous other provisions of the Internal Revenue Code that had expired or were set to expire. Those provisions include the research and experimentation tax credit, parity in the application of certain mental health benefits, and the increased share of revenues from excise tax on rum that is paid to Puerto Rico and the U.S. Virgin Islands. In addition, the law established a uniform

definition of a "qualifying child" for determining taxpayers' filing status and eligibility for certain tax credits and exemptions. See **Economic Growth and Tax Relief Reconciliation Act of 2001** and **Jobs and Growth Tax Relief Reconciliation Act of 2003.**

**Yield:** The average annual rate of return on an investment held over a period of time. For a fixed-income security, such as a bond, the yield is determined by several factors, including the security's interest rate, face value, and purchase price and the length of time that the security is held. The *yield to maturity* is the effective interest rate earned on a fixed-income security if it is held until the date on which it comes due for payment.

**yield curve:** The relationship formed by plotting the yields of otherwise comparable fixed-income securities against their terms to maturity. Typically, yields increase as maturities lengthen. The rate of that increase determines the "steepness" or "flatness" of the yield curve. Ordinarily, a steepening (or flattening) of the yield curve is taken to suggest that short-term interest rates are expected to rise (or fall). See **short-term interest rate** and **yield.**