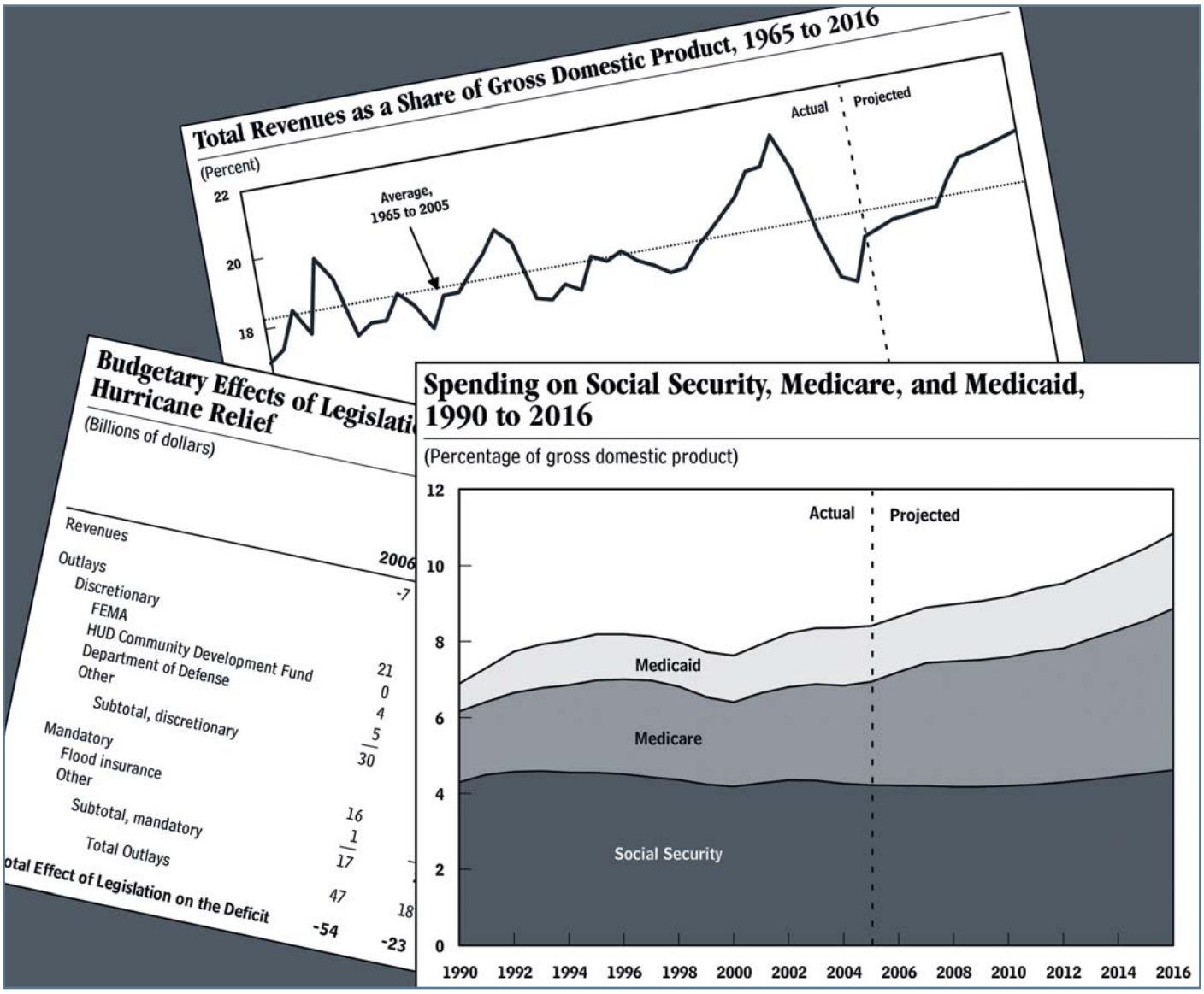
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

The Budget and Economic Outlook: Fiscal Years 2007 to 2016



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The Budget and Economic Outlook: Fiscal Years 2007 to 2016

January 2006

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; otherwise, the years 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 and dashed vertical lines to separate actual from projected data. (A recession extends from the peak of a business cycle to its trough.)

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 provide 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 Jo Ann Vines. 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 C.)

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

CBO's Panel of Economic Advisers commented on an early version of the economic forecast underlying this report. Members of the panel are Richard Berner, Dan Crippen, J. Bradford DeLong, Martin Feldstein, Robert J. Gordon, Robert E. Hall, Robert Glenn Hubbard, Ellen Hughes-Cromwick, Lawrence Katz, Catherine L. Mann, Allan H. Meltzer, Laurence H. Meyer, William D. Nordhaus, June E. O'Neill, Rudolph G. Penner, Robert Reischauer, and Alice Rivlin. Arthur Alexander, Ernst Berndt, Robert Giffin, and Andrew Lyon 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, Mark Booth, and Eric Schatten wrote Chapter 1 (David Newman and Kent Christensen compiled Box 1-1). Frank Russek was the lead author for Chapter 2 (David Brauer wrote Box 2-2). Christina Hawley Sadoti and Ellen Hays wrote Chapter 3, with assistance from Thomas Bradley and Eric Schatten (Shinobu Suzuki and Eric Rollins wrote Box 3-2). Mark Booth and Thomas Woodward were the lead authors for Chapter 4. Barry Blom wrote Appendix A; Ann Futrell and Mark Booth, Appendix B; Ellen Hays, Appendix C; and Frank Russek and Barry Blom, Appendix D. Frank

Russek also compiled Appendix E; and Ann Futrell, Appendix F. Jennifer Smith produced the glossary.

Christine Bogusz, Janey Cohen, Loretta Lettner, Leah Mazade, John Skeen, and Christian Spoor 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, with assistance from Allan Keaton. Lenny Skutnik printed the initial copies.

An electronic version of this report appears on CBO's Web site: www.cbo.gov.

Donald B. Marron
Acting Director

January 2006

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Summary

The Congressional Budget Office (CBO) projects that under current laws and policies, the federal budget will report a deficit of $337 billion in 2006 (see Summary Table 1). That estimate is somewhat higher than the $318 billion shortfall recorded in 2005 but about the same in comparison to the size of the nation's economy. At 2.6 percent of gross domestic product (GDP), this year's deficit would be slightly larger than the 2.3 percent average recorded since 1965.

Because of the statutory rules that govern baseline projections, CBO's current estimates omit a significant amount of spending that is likely to occur later this year. In particular, additional funding will probably be necessary in 2006 to pay for military activities in Iraq and Afghanistan and for flood insurance claims. If that funding is provided, CBO expects that outlays will grow by another $20 billion to $25 billion this year, resulting in a deficit in the vicinity of $360 billion, or about 2.8 percent of GDP.

CBO's baseline includes spending from the $50 billion that the Congress has appropriated this year for military activities in Iraq and Afghanistan, but more resources are likely to be necessary within a few months. The baseline also includes the effect of legislation dealing with disaster relief, flood insurance, and other programs that were funded in the aftermath of Hurricane Katrina and other storms. Such legislation will add an estimated $47 billion in outlays during 2006; hurricane-related tax relief will reduce revenues by an estimated $7 billion this year. But paying all claims expected under the federal flood insurance program could require a few billion dollars of additional funding for that program. Furthermore, the pending spending reconciliation act, if signed into law, would reduce the deficit by about $5 billion in 2006.

Under the assumptions incorporated in CBO's baseline—in particular, that various tax increases occur as scheduled and that discretionary spending grows at the rate of inflation—the budget deficit totals $270 billion (2.0 percent of GDP) in 2007 and continues to fall thereafter, essentially reaching balance in 2012. After that, the budget remains close to balance in the baseline, showing small surpluses ranging from $40 billion to $73 billion through 2016 (the end of the current projection period).

By statute, CBO's baseline must project the future paths of federal spending and revenues under current laws and policies. The baseline is therefore not intended to be a prediction of future budgetary outcomes; instead, it is meant to serve as a neutral benchmark that lawmakers can use to measure the effects of proposed changes to spending and taxes.

Underlying CBO's baseline projections is a forecast that the U.S. economy will continue growing at a healthy pace throughout calendar years 2006 and 2007. CBO forecasts that GDP will grow by 3.6 percent (in real, inflation-adjusted, terms) this year and by 3.4 percent next year. That rate of growth is projected to slow to an average of 3.1 percent from 2008 through 2011 and 2.6 percent from 2012 through 2016.

Over the longer term, the aging of the U.S. population combined with rapidly rising health care costs will put significant strains on the federal budget, which begin to be evident within the projection period. When the first members of the baby-boom generation reach age 62 in 2008, they will become eligible for Social Security benefits. As a result, the annual rate of growth of Social Security spending is expected to increase from about 4.8 percent in 2008 to 6.5 percent in 2016.

In addition, because the cost of health care is likely to continue rising rapidly, the annual rate of growth of Medicare spending is projected to increase from 7.4 percent in 2008 to about 8.9 percent in 2016. (Medicare

Summary Table 1.

CBO's Baseline Budget Outlook

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
							In Billions of Dollars							
Total Revenues	2,154	2,312	2,461	2,598	2,743	2,883	3,138	3,378	3,546	3,724	3,912	4,113	13,823	32,496
Total Outlays	2,472	2,649	2,732	2,857	2,984	3,105	3,252	3,340	3,506	3,666	3,839	4,046	14,930	33,328
Total Deficit (-) or Surplus	**-318**	**-337**	**-270**	**-259**	**-241**	**-222**	**-114**	**38**	**40**	**57**	**73**	**67**	**-1,107**	**-832**
On-budget	-494	-518	-466	-476	-474	-473	-380	-238	-243	-230	-218	-226	-2,269	-3,424
Off-budget[a]	175	181	196	217	233	250	266	276	283	288	291	293	1,162	2,592
Debt Held by the Public at the End of the Year	4,592	4,925	5,204	5,477	5,732	5,967	6,092	6,064	6,032	5,981	5,912	5,848	n.a.	n.a.
							As a Percentage of GDP							
Total Revenues	17.5	17.7	17.9	17.9	18.0	18.0	18.7	19.3	19.4	19.5	19.6	19.7	18.1	18.9
Total Outlays	20.1	20.3	19.8	19.7	19.5	19.4	19.4	19.1	19.1	19.2	19.2	19.4	19.6	19.4
Total Deficit (-) or Surplus	**-2.6**	**-2.6**	**-2.0**	**-1.8**	**-1.6**	**-1.4**	**-0.7**	**0.2**	**0.2**	**0.3**	**0.4**	**0.3**	**-1.4**	**-0.5**
Debt Held by the Public at the End of the Year	37.4	37.6	37.8	37.7	37.5	37.2	36.3	34.6	32.9	31.3	29.6	28.1	n.a.	n.a.
Memorandum:														
Gross Domestic Product (Billions of dollars)	12,293	13,082	13,781	14,508	15,264	16,021	16,768	17,524	18,311	19,121	19,963	20,839	76,343	172,101

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.

spending is anticipated to rise by 17 percent this year and 14 percent in 2007 as the new prescription drug program gets under way.) Rapid growth is also projected for Medicaid spending—an average of 8.3 percent annually from 2008 to 2016. Under the assumptions in CBO's baseline, Social Security, Medicare, and Medicaid together will account for 56 percent of all federal spending by the end of the projection period (up from 43 percent in 2006). Measured as a share of the economy, spending for the three programs will equal 10.8 percent of GDP in 2016, up from 8.7 percent this year (see Summary Figure 1).

Beyond 2016, those trends are projected to continue. The percentage of the population age 65 or older will continue to increase (from 14 percent in 2016 to more than 19 percent in 2030). In addition, no evidence suggests that the growth of health care costs, which have risen faster than GDP over the past four decades, is likely to slow significantly in the future. As a result, spending for Social Security, Medicare, and Medicaid will exert pressures on the budget that economic growth alone is unlikely to alleviate. A substantial reduction in the growth of spending and perhaps a sizable increase in taxes as a share of the economy will be necessary for fiscal stability to be at all likely in the coming decades.[1]

The Budget Outlook

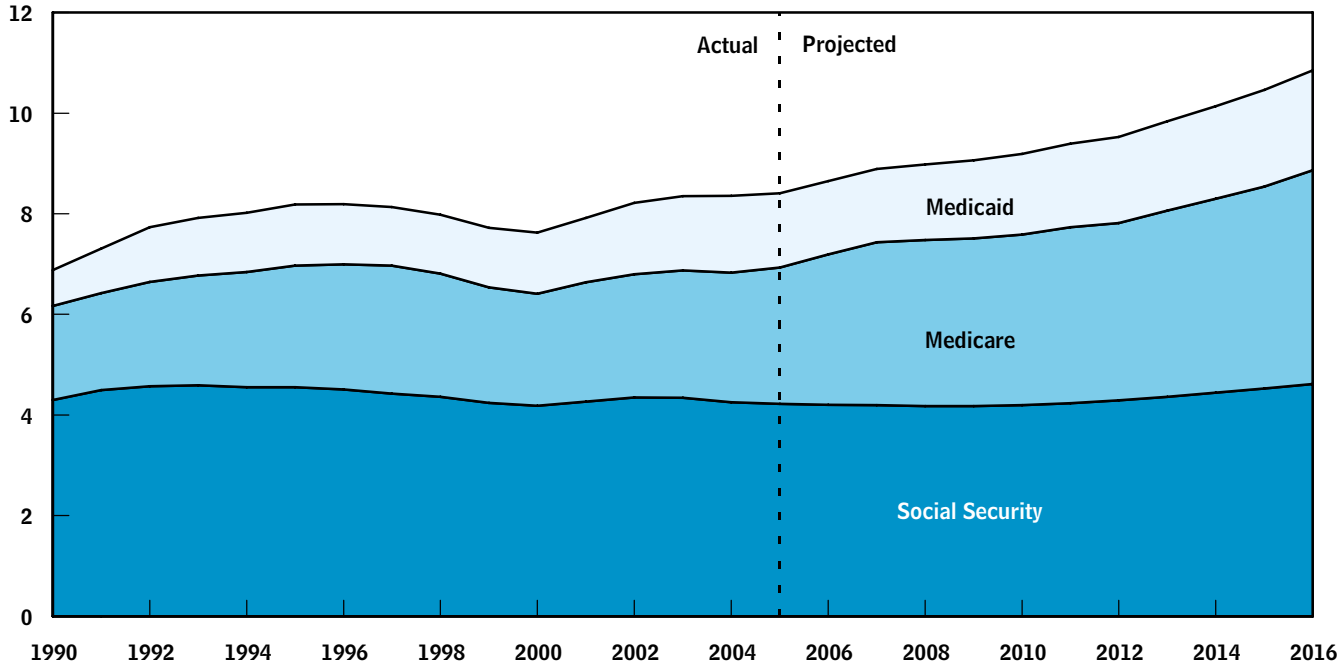
In CBO's current baseline, deficits decline gradually through 2010, as outlays increase at an average annual rate of 4.0 percent and revenues rise by 5.7 percent a year. Beyond 2010, spending related to the aging of the baby-boom generation raises projections of the average annual

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).

Summary Figure 1.

Spending on Social Security, Medicare, and Medicaid, 1990 to 2016

(Percentage of gross domestic product)



Source: Congressional Budget Office.

growth of total outlays to 4.5 percent. However, revenues increase sharply in 2011 and 2012, growing by 8.9 percent and 7.6 percent, respectively—under the assumption that various tax increases occur as scheduled—and thereby bring the baseline projection of the budget near balance. Beyond 2012, revenues grow at about the same pace as outlays (roughly 5 percent a year), which keeps the bottom line showing small surpluses through 2016.

From 2007 through 2016, outlays are projected to remain between 19 percent and 20 percent of GDP under the assumptions in CBO's baseline (see Summary Figure 2). Mandatory spending (funding determined by laws other than annual appropriation acts) is projected to grow by 5.8 percent a year—faster than the economy as a whole. Discretionary appropriations, by contrast, are assumed simply to keep pace with inflation and, to a lesser extent, with wage growth. Thus, discretionary outlays are projected to increase by about 2.0 percent per year, on average—a pace less than half as fast as the projected rate of growth of nominal GDP and significantly slower than the average annual rate of 4.3 percent over the past 20 years.

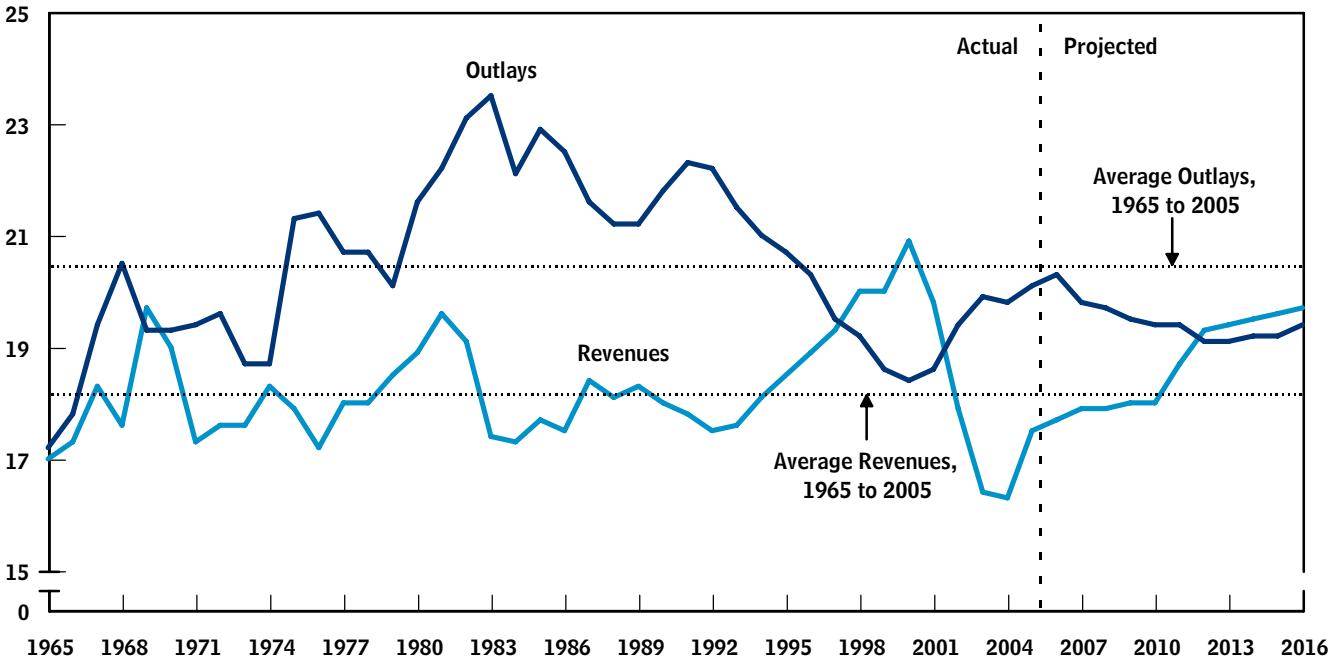
According to CBO's projections, the structure of the tax code and rapid growth in retirement income will cause revenues to increase faster than the overall economy in each year of the projection period. In addition, CBO assumes—as rules for the baseline require—that the various tax provisions enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and by the Working Families Tax Relief Act of 2004 (WFTRA) will expire as scheduled. Many of those provisions are set to expire at the end of December 2010, but some have an earlier expiration date. As a result, revenues as a percentage of GDP are projected to rise slightly through 2010, from 17.7 percent to 18.0 percent, and to increase more rapidly over the following two years, to 19.3 percent of GDP in 2012. By 2016, revenues are projected to reach 19.7 percent of GDP.

In CBO's baseline, accumulated federal debt held by the public (mainly in the form of Treasury securities sold in the capital markets) equals about 38 percent of GDP through 2009. Thereafter, projections of shrinking

Summary Figure 2.

Total Revenues and Outlays as a Percentage of Gross Domestic Product, 1965 to 2016

(Percent)



Source: Congressional Budget Office.

annual deficits and small surpluses diminish the government's anticipated borrowing needs, causing debt held by the public to decline to about 28 percent of GDP by 2016.

Relative to its previous baseline projections, which were published last August, CBO's estimate of the deficit for 2006 has increased by $22 billion and its projections of deficits in 2007 through 2015 have declined by an average of about $100 billion per year.[2] Those revisions reflect no fundamental change in the budgetary and economic environment. Indeed, when viewed as a percentage of the economy, they represent a difference of just 0.5 percent of GDP over the 2006-2015 period.

Most of the changes in CBO's new baseline stem from changes in economic factors that affect revenues and net interest, which cause the projection of the deficit for the 2006-2015 period to decline by a cumulative $736 billion. CBO's projected rates of economic growth are about the same as those underlying its previous baseline. However, higher inflation in the second half of calendar year 2005, combined with an upward revision to past measures of GDP, causes CBO to project higher levels of GDP and revenues throughout the projection period. In addition, CBO anticipates slightly lower interest rates from 2008 through 2015, reducing projected net interest outlays during that time.

Differences attributed to legislation also have reduced CBO's projection of the cumulative deficit, by $157 billion. The irregular timing and varying amounts of supplemental appropriations together with the treatment of such appropriations under the rules for the baseline explain most of that adjustment. Other, technical adjustments to the baseline have had a minimal effect—upward changes to both revenues ($151 billion) and outlays ($170 billion) nearly offset each other and increase the projected deficit by $19 billion over the 2006-2015 period.

2. See Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2005).

The Economic Outlook

Economic activity had considerable momentum last year, some of which will carry into calendar year 2006. CBO forecasts that real GDP will grow by 3.6 percent this year and by 3.4 percent in 2007 (see Summary Table 2).

Despite an anticipated weakening in the housing market, economic growth will be driven by forces already set in motion—firms' continued need to expand productive capacity, solid increases in household income and wealth, and the lagged effects of declines in the value of the dollar since 2002. The housing market is expected to cool because potential buyers are likely to be deterred by concerns about the future growth of home prices and by higher interest rates. Business investment, however, will continue its recent strength because it has not yet fully caught up with the acceleration in the growth of demand in 2004 and 2005. The increases in employment and wages seen last year are also expected to continue, with the unemployment rate remaining near 5 percent, underpinning consumer spending. In addition, the lower value of the dollar combined with somewhat stronger economic growth abroad will cause exports to increase faster than imports (in real terms), CBO forecasts, bolstering the economy and keeping the U.S. trade deficit near its current level.

Along with healthy growth in demand and output, the growth of labor productivity (which usually slows in the later stages of economic expansions) will remain strong, CBO expects, though not as rapid as the extraordinary pace of the past five years. Overall inflation (as measured by the consumer price index) is likely to be lower this year than in 2005, when rising energy prices boosted it. According to CBO's forecast, the growth of the consumer price index will decline from the 3.4 percent recorded last year to 2.8 percent in 2006 and 2.2 percent in 2007. But the core rate of inflation—which excludes food and energy prices—will increase slightly in the near term, from 2.2 percent in 2005 and 2006 to 2.3 percent in 2007. Short-term interest rates are expected to rise in the first half of 2006, reaching 4.5 percent. Long-term interest rates are also anticipated to rise—to more than 5 percent, widening the spread between the rates on three-month Treasury bills and 10-year Treasury notes that existed in mid-January (when that spread was very small).

Hurricanes Katrina and Rita interrupted the economy's momentum temporarily. They reduced economic growth in the second half of 2005 by about 0.5 percentage points, in part by pushing up energy prices, which had already risen sharply since 2003. The impact of those natural disasters on the overall economy is expected to be relatively brief, however. This year, the recovery of energy production, rebuilding, and related activities are likely to boost growth by an amount similar to the reduction in 2005.

Beyond 2007, the pace of economic growth will probably slow somewhat. The main reason is that the labor force is projected to grow less quickly as members of the baby-boom generation begin to retire and as the scheduled expiration of various tax provisions in 2011 discourages work by raising marginal tax rates. Real GDP is projected to grow at an average annual rate of 3.1 percent between 2008 and 2011 and at 2.6 percent between 2012 and 2016. The rate of inflation is assumed to average 2.2 percent after 2007; and the unemployment rate, 5.2 percent. Interest rates on three-month and 10-year Treasury securities are projected to average 4.4 percent and 5.2 percent, respectively.

Summary Table 2.

CBO's Economic Projections for Calendar Years 2006 to 2016

	Estimated	Forecast		Projected Annual Average	
	2005	2006	2007	2008-2011	2012-2016
Nominal GDP (Billions of dollars)	12,494	13,262	13,959	16,954 [a]	21,064 [b]
Nominal GDP (Percentage change)	6.5	6.1	5.3	5.0	4.4
Real GDP (Percentage change)	3.6	3.6	3.4	3.1	2.6
GDP Price Index (Percentage change)	2.7	2.4	1.8	1.8	1.8
Consumer Price Index[c] (Percentage change)	3.4	2.8	2.2	2.2	2.2
Core Consumer Price Index[d] (Percentage change)	2.2	2.2	2.3	2.2	2.2
Unemployment Rate (Percent)	5.1	5.0	5.0	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	3.2	4.5	4.5	4.4	4.4
Ten-Year Treasury Note Rate (Percent)	4.3	5.1	5.2	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: Percentage changes are year over year.

Year-by-year economic projections for calendar years 2006 to 2016 appear in Appendix E.

a. Level in 2011.

b. Level in 2016.

c. The consumer price index for all urban consumers.

d. 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 government would run a deficit of $337 billion in 2006 (see Table 1-1). The baseline deficit for this year would be somewhat larger than the deficit of $318 billion in 2005, but it would be roughly the same relative to the size of the nation's economy. At 2.6 percent of the gross domestic product (GDP), this year's baseline deficit would be slightly above the average deficit of 2.3 percent of GDP recorded since 1965 (see Figure 1-1).

Because of the statutory rules that govern CBO's budget projections, the current baseline omits a significant amount of spending that is likely to occur this year to finance military activities in Iraq and Afghanistan and to pay flood insurance claims resulting from Hurricane Katrina. Additional outlays for such purposes in 2006 are expected to total between $20 billion and $25 billion, resulting in a deficit in the vicinity of $360 billion, or about 2.8 percent of GDP. Another potential factor in 2006 is the pending spending reconciliation act; if enacted, it will reduce the projected deficit for this year by about $5 billion, CBO estimates.[1]

Under the assumptions incorporated in CBO's baseline—in particular, that various tax increases occur as scheduled and discretionary spending rises at the rate of inflation—the budget deficit totals $270 billion (2.0 percent of GDP) in 2007 and continues falling thereafter, essentially reaching balance in 2012. Thereafter in the baseline, the budget remains close to balance through 2016 (the end of the current projection period), showing small surpluses that range between $40 billion and $73 billion. Such a pattern is not a forecast of future outcomes but rather a neutral benchmark that describes the path of the budget if present laws and policies remain unchanged.

CBO's outlook for the budget as described above is not fundamentally different from its outlook in August 2005.[2] Although CBO has increased its baseline estimate of the 2006 deficit by $22 billion and reduced projected deficits in subsequent years by an average of about $100 billion annually, those changes are relatively small, representing an overall difference of just 0.5 percent of GDP (see Table 1-2 on page 4). Furthermore, those adjustments are mostly unrelated to changes in the underlying budgetary and economic environment.

The small increase in CBO's projection of the baseline deficit for 2006 is due primarily to legislative actions taken last September in response to hurricane damage, particularly from Hurricanes Katrina and Rita. Those events occurred after CBO's August baseline was published, so those previous estimates include no spending providing relief related to those storms. Since that report was issued, however, the Congress and the President have enacted several measures to provide assistance to those affected—such legislation has added about $47 billion to projected outlays for this year. Hurricane-related supplemental appropriations enacted thus far will increase discretionary outlays by about $30 billion in 2006, CBO estimates. In addition, increased borrowing authority for the flood insurance program will boost outlays to pay

1. The budget resolution for 2006 instructed certain Congressional committees to recommend legislation that would reduce mandatory spending and revenues by specified amounts. That process is known as reconciliation.

2. Those projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2005).

Table 1-1.

Projected Deficits and Surpluses in CBO's Baseline

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
On-Budget Deficit	-494	-518	-466	-476	-474	-473	-380	-238	-243	-230	-218	-226	-2,269	-3,424
Off-Budget Surplus[a]	175	181	196	217	233	250	266	276	283	288	291	293	1,162	2,592
Total Deficit (-) or Surplus	**-318**	**-337**	**-270**	**-259**	**-241**	**-222**	**-114**	**38**	**40**	**57**	**73**	**67**	**-1,107**	**-832**
Memorandum:														
Social Security Surplus	173	180	195	214	231	246	262	271	278	282	286	287	1,148	2,552
Postal Service Outlays	-2	-2	-1	-3	-2	-4	-4	-5	-5	-5	-6	-6	-14	-40
Total Deficit (-) or Surplus as a Percentage of GDP	-2.6	-2.6	-2.0	-1.8	-1.6	-1.4	-0.7	0.2	0.2	0.3	0.4	0.3	-1.4	-0.5
Debt Held by the Public as a Percentage of GDP	37.4	37.6	37.8	37.7	37.5	37.2	36.3	34.6	32.9	31.3	29.6	28.1	n.a.	n.a.

Source: Congressional Budget Office.

Note: 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.

flood insurance claims this year by about $16 billion.[3] Also, tax relief provided in response to the storms will reduce federal revenues by $7 billion this year, CBO forecasts. (For more information on the budgetary effects of hurricane relief, see Appendix A.)

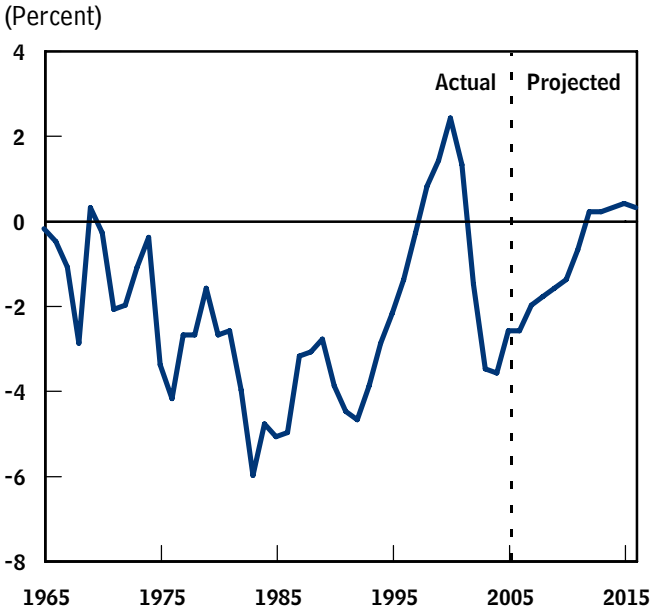
CBO's economic outlook for the coming decade, which underlies its baseline projections, has not changed much since last August. Nevertheless, the largest differences between CBO's current and August baselines are classified as economic changes. Those differences occur because of revisions to historical data for certain economic variables and economic developments during 2005. Specifically, recent revisions to the national income and product accounts, as well as the spurt in inflation that occurred during the second half of last year, increased the base from which CBO projects future revenues. As a result of that larger base, roughly the same assumptions for growth in future years produced higher estimates of revenues and lower estimates of outlays (because of changes in debt service) in the current baseline than in the previous one. One difference in the current baseline's economic assumptions involves lower interest rates beyond 2007: that change reduced baseline outlays during the 10-year projection period (2007 to 2016) by an additional $113 billion.

The irregular pattern of funding for military activities in Iraq and Afghanistan, combined with statutory rules governing baseline estimates, also produced some changes in CBO's projections relative to last August's. According to those rules, all appropriations provided in the current year are extended and inflated throughout the projection period. By August 2005, supplemental appropriations had provided nearly $76 billion for military activities in Iraq and Afghanistan for the 2005 fiscal year. Thus far in 2006, however, such appropriations total only about $50 billion (although more funding is expected). Extending that lower amount throughout the projection period has led to a reduction in defense outlays in the baseline, but that drop is partially offset by an increase in appropriations for other defense programs. On net, such legislative actions have reduced defense outlays in CBO's new baseline—compared with those in its previous baseline—by

3. Combined with the program's prior authority, flood insurance spending under current law is likely to total about $18 billion for 2006. Additional spending for flood insurance is likely to be needed, but further legislation would be necessary to provide funding for it.

Figure 1-1.

The Total Deficit or Surplus as a Percentage of GDP, 1965 to 2016



Source: Congressional Budget Office.

Note: GDP = gross domestic product.

$236 billion through 2015.[4] (Appendix B provides a more detailed discussion of changes to the baseline since August.)

Although by law CBO's baseline projections may not incorporate anticipated changes in policy, this chapter illustrates the estimated budgetary implications over the next 10 years of some alternative policy assumptions. For example, outlays for military operations in Iraq and Afghanistan and for other activities related to the war on terrorism could be assumed to total about $90 billion in 2006 and then to gradually decline to around $27 billion to $30 billion a year (about half the level now in the baseline). Incorporating such a phasedown of military activities and assuming that no supplemental appropriations are continued after 2006 would reduce the total projected deficit for the 2007-2016 period from $832 billion to $330 billion. Under that scenario, debt held by the public at the end of 2016 would fall to 25.7 percent of GDP.

Similarly, if all of the tax provisions that are set to expire over the next 10 years were extended, the budget outlook for 2016 would change from a surplus of $67 billion to a deficit of $584 billion. Debt held by the public at the end of 2016 would climb to 44.3 percent of GDP, and the cumulative 10-year deficit would total $4.2 trillion.

Over the longer term, the aging of the population combined with rapidly rising health care costs will put significant strains on the federal budget. When the first members of the baby-boom generation reach age 62 in 2008, they will become eligible for Social Security benefits. As a result, the annual rate of growth of Social Security spending is expected to increase from about 4.8 percent in 2008 to 6.5 percent in 2016. In addition, because the cost of health care is likely to continue to rise rapidly, the annual rate of growth of Medicare spending is projected to increase from 7.4 percent in 2008 (when the prescription drug benefit is fully phased in) to about 8.9 percent in 2016.[5] Similar growth—8.3 percent a year—is projected for Medicaid spending in 2016. Under the assumptions incorporated in the baseline, those three programs together will account for 56 percent of all federal spending by the end of the projection period (up from 43 percent in 2006) and 10.8 percent of GDP (up from 8.7 percent this year).

Beyond 2016, those trends are projected to continue. The percentage of the population age 65 or older will continue to increase (from 14 percent in 2016 to more than 19 percent in 2030). In addition, there is no evidence that the growth of health care costs, which has risen faster than GDP over the past four decades, is likely to slow significantly in the near future. As a result, spending for Social Security, Medicare, and Medicaid under current law is expected to claim an even larger share of total outlays. Over the long term, if those trends are maintained, the increasing resource demands of those programs will exert such pressure on the budget as to make current fiscal policy unsustainable.[6]

4. Changes to nondefense appropriations, including supplemental appropriations related to Hurricanes Katrina and Rita as well as to the avian flu, increased nondefense discretionary outlays in the baseline by about $59 billion over the 10-year period.

5. The calculation for 2016 excludes the extra payment to managed care providers scheduled to occur that year. Such payments are ordinarily made on the first day of the month but are made a day or two earlier when the first day of the month falls on a weekend.

6. 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).

Table 1-2.

Changes in CBO's Baseline Projections of the Deficit Since August 2005

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Total Deficit as Projected in August 2005	-314	-324	-335	-321	-317	-218	-78	-80	-66	-57	-1,612	-2,110
Changes												
Legislative												
Revenues	-7	-6	-1	*	*	*	*	*	*	*	-14	-15
Outlays	34	-8	-14	-18	-22	-24	-26	-29	-32	-34	-28	-172
Subtotal, legislative	-41	2	13	18	22	24	26	28	31	34	14	157
Economic												
Revenues	29	47	50	50	52	51	50	51	52	54	229	488
Outlays	9	3	-9	-17	-25	-31	-37	-42	-47	-51	-39	-248
Subtotal, economic	21	44	59	67	77	82	87	93	100	106	268	736
Technical												
Revenues	10	24	23	17	13	13	15	14	12	10	87	151
Outlays	12	15	21	23	18	15	13	16	20	19	88	170
Subtotal, technical	-2	8	3	-5	-5	-2	2	-2	-8	-9	*	-19
Total Effect on the Deficit or Surplus[a]	**-22**	**54**	**75**	**80**	**94**	**104**	**115**	**120**	**123**	**130**	**282**	**874**
Total Deficit (-) or Surplus as Projected in January 2006	-337	-270	-259	-241	-222	-114	38	40	57	73	-1,330	-1,236

Source: Congressional Budget Office.

Notes: * = between -$500 million and zero.

For more information on changes to the baseline since August, see Appendix B.

a. Negative numbers represent an increase in the deficit.

A Review of 2005

The budget deficit declined in 2005, dropping from a $412 billion shortfall in 2004 to $318 billion. Relative to the size of the economy, the deficit measured 2.6 percent of GDP in 2005 versus 3.6 percent in 2004.

Revenues

The improved budgetary outcome for 2005 stemmed from the robust growth of federal revenues, which rose 14.6 percent ($274 billion) above their level in 2004. Revenues as a share of GDP rose for the first time since 2000—from 16.3 percent of GDP in 2004 to 17.5 percent in 2005. That percentage is slightly below the average over the past 40 years of 18.2 percent but well below the post-World War II high of 20.9 percent reached in 2000. The growth of revenues in 2005 derived from several sources:

- Individual income tax receipts accounted for more than 40 percent of last year's boost in revenues, increasing by almost 15 percent. That rise largely reflects growth in 2004 and 2005 in nonwage income (such as capital gains) and changes in tax law that caused a reduction in receipts in 2004 but not in 2005.

- Receipts from the corporate income tax were 47 percent higher last year, following similar growth in 2004.

Those receipts in recent years have grown faster than the economy as a whole, increasing from 1.2 percent of GDP in 2003 to 2.3 percent in 2005—their largest share of the economy since 1980. Most of the strong growth in 2005 probably stems from solid economic activity in both 2004 and 2005. Another likely contributor is the expiration at the end of 2004 of provisions enacted in 2002 and 2003 that allowed additional depreciation deductions during the first year of service for businesses' investments in equipment.

- Receipts from social insurance (payroll) taxes rose by more than 8 percent in 2005 as a result of increases in wages and salaries. (Chapter 4 provides more information about recent and projected federal revenues.)

Outlays

Total outlays rose last year by almost 8 percent ($179 billion); only once in the past 15 years has the rate of spending growth been higher. Over the 2001-2005 period, spending grew at an average annual rate of about 7 percent, or twice as fast as in the previous five years.

Mandatory outlays in 2005 grew by slightly less than 7 percent ($83 billion). Programs experiencing rapid growth included agriculture spending, which more than doubled as a result of lower prices for commodities, and spending for education, which grew by 37 percent last year (excluding credit subsidy reestimates). Outlays for veterans' programs increased by 27 percent. (However, part of that increase occurred because veterans' compensation and pension payments for October 2005 were made in September—which shifted them from fiscal year 2006 to fiscal year 2005. Without that shift, the rise in outlays would have been 18 percent.) Spending for Medicare (excluding receipts from premiums) grew by 12 percent.

Overall, discretionary outlays increased by just over 8 percent ($73 billion) from 2004 to 2005. Outlays for defense rose by $39 billion; CBO estimates that about 40 percent of that amount represented a boost in 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 $33 billion last year. Spending for disaster relief and insurance rose by $10 billion—which brought the total for such spending in 2005 to almost three times its average annual level over the previous five years. Most of the increase stemmed from supplemental appropriations provided in response to the hurricanes that struck Florida and South Carolina in the late summer and early fall of 2004; very little of it was for relief efforts following Hurricanes Katrina, Rita, and Wilma. Outlays related to international affairs grew by $6 billion, with reconstruction funds for Iraq accounting for $4 billion of that increase. Other large boosts in outlays were recorded for education ($4 billion) and health programs ($3 billion).

In 2005, interest on the public debt rose almost 15 percent above its level in 2004. Debt held by the public grew by about 7 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 the same. CBO constructs its baseline according to rules set forth in law, mainly in the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974. In general, those laws spell out how CBO should project federal spending and revenues under current policies. The resulting baseline can then be used as a neutral benchmark against which to measure the effects of proposed changes in tax and spending policies.

Box 1-1.

Appropriations for the War on Terrorism

Since September 2001, the Congress and the President have provided about $323 billion in appropriations for military operations in Iraq and Afghanistan and for other Department of Defense (DoD) activities in support of the war on terrorism (see the table on the next page). Determining exactly how much of that budget authority has been spent is difficult because reports by the Department of the Treasury do not distinguish between outlays from regular appropriations and those from supplemental appropriations, nor do they distinguish between spending for peacetime operations and spending associated with the war on terrorism. Information from DoD indicates that the department has obligated almost all of the $171 billion appropriated before August 2004 for operations in Iraq and Afghanistan and for other, terrorism-related activities. Additionally, DoD reported that through September 2005, it had obligated $20.4 billion of the $26.8 billion appropriated in August 2004 as part of Public Law 108-287 and another $63.2 billion of the $75.6 billion appropriated in May 2005 as part of Public Law 109-13. Total obligations by the end of last September had thus reached about $254 billion.[1]

In 2005, DoD obligated a total of $83.6 billion—or almost $7 billion per month—for Operations Iraqi Freedom, Enduring Freedom (in Afghanistan), and Noble Eagle (antiterrorism activities in the United States). Of that total, 85 percent was dedicated to Operation Iraqi Freedom, 13 percent went to Operation Enduring Freedom, and 2 percent was provided for Operation Noble Eagle. (Outlays for those activities in 2006 could total roughly $90 billion, the Congressional Budget Office estimates.) In all, 45 percent of the amount obligated in 2005 covered operation and support costs (for example, costs for training, fuel, supplies, repair parts, maintenance of facilities, communications, and contract services). Personnel costs accounted for another 26 percent of the total, 8 percent went toward transporting troops and supplies, and the remaining 21 percent paid for new equipment and for construction projects.

1. That amount does not include obligations for classified activities or for coalition support, which are not included in DoD's obligation reports.

For revenues and mandatory spending, the Deficit Control Act requires that the baseline be projected under the assumption that present laws continue without change.[7] In most cases, the laws that govern revenues and mandatory spending are permanent. Thus, CBO's baseline projections reflect anticipated changes in the economy, demographics, and other relevant factors that affect the implementation of those laws.

7. The Deficit Control Act makes some exceptions. For example, mandatory spending programs that are set to expire must 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 are not automatically assumed to continue. Similarly, the law requires CBO to assume that expiring excise taxes that are dedicated to trust funds will be extended at their current rates. The Deficit Control Act does not provide for the extension of other expiring tax provisions, even if they have been extended routinely in the past.

The baseline rules differ for discretionary spending. The Deficit Control Act states that such spending should be projected by assuming that the most recent year's discretionary budget authority is provided in each future year, with adjustments to reflect projected inflation—using specified indexes—and certain other factors (such as the cost, calculated on an annual basis, of adjustments to federal pay). If the current year's discretionary budget authority includes funds provided through supplemental appropriations, those funds are also adjusted for inflation and assumed to continue throughout the baseline period.

The frequency of supplemental appropriations and the irregular pattern of funding for military operations in Iraq and Afghanistan have significantly affected CBO's baseline projections in recent years. Through last August, policymakers had provided a total of nearly $95 billion in supplemental appropriations for 2005—about $76 bil-

Box 1-1.

Continued

Appropriations for Military Operations in Support of the War on Terrorism, Including Operations in Iraq and Afghanistan

(Billions of dollars of budget authority)

Public Law	Title	2001	2002	2003	2004	2005	2006	Total
107-38 (Sept. 2001)	2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States	13.6						
107-117 (Jan. 2002)	Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002		3.4					
107-206 (Aug. 2002)	2002 Supplemental Appropriations Act for Further Recovery from and Response to Terrorist Attacks on the United States		13.8					
107-248 (Oct. 2002)	Department of Defense Appropriations Act, 2003			6.4 [a]				
108-7 (Feb. 2003)	Consolidated Appropriations Resolution, 2003			10.0				
108-11 (April 2003)	Emergency Wartime Supplemental Appropriations Act, 2003			62.2				
108-87 (Sept. 2003)	Department of Defense Appropriations Act, 2004				-3.5 [b]			
108-106 (Nov. 2003)	Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004				64.8			
108-287 (Aug. 2004)	Department of Defense Appropriations Act, 2005				26.8 [c]			
109-13 (May 2005)	Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005					75.6 [d]		
109-148 (Dec. 2005)	Department of Defense, Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico, and Pandemic Influenza Act, 2006						49.9 [e]	
Total		**13.6**	**17.2**	**78.6**	**88.1**	**75.6**	**49.9**	**323.0**

Source: Congressional Budget Office.

Note: The numbers in this table are amounts identified in appropriation acts as funding for Department of Defense activities in response to the terrorist attacks of September 11, 2001, and in support of the war on terrorism, including military operations in Iraq. Those amounts represent funding directed to the Department of Defense (subfunction 051 of the federal budget).

a. This figure is an estimate based on conference report language for Public Law (P.L.) 107-248.

b. Rescission of funds appropriated in P.L. 108-11.

c. Of this amount, $25 billion was funding requested by the President for 2005 that was largely to be used to cover costs incurred in that year, and $1.8 billion was funding restored by the repeal of a previous rescission. The Congress appropriated the funds in 2004 and made them available upon enactment, so the appropriation was counted as budget authority for 2004.

d. This amount includes $5.0 billion for Army "modularity" but excludes $0.2 billion for the Pentagon's costs arising from tsunami relief efforts and $6.3 billion for activities of other departments and agencies.

e. Excludes $0.1 billion provided to the Coast Guard for operating expenses.

lion for military operations in Iraq and Afghanistan (plus another $6 billion provided in the same act for other activities, mostly for the State Department and international assistance programs) and smaller amounts for disaster relief ($11 billion) and veterans' health care ($1.5 billion). In its August baseline, in accordance with the statutory rules, CBO extrapolated all of those appropriations for each future year—even though such spending, especially for activities in Iraq and Afghanistan, may be unlikely to continue at the 2005 level throughout the 10-year projection period. CBO's current projections are based on appropriations for 2006 and therefore do not include an extrapolation of the 2005 supplemental appropriations. However, CBO's current baseline includes—and extrapolates—the $50 billion in appropriations that have been provided thus far in 2006 for military activities in Iraq and Afghanistan. The resulting projections probably understate such costs for the near term and may overstate them for later years.

In addition, the baseline extrapolates funding, provided in 2006, for relief and reconstruction related to last fall's hurricanes in the Gulf of Mexico. Public Law 109-148 provided a total of $29 billion for the hurricane-related activities of a number of agencies. It also rescinded $23 billion previously directed to the Federal Emergency Management Agency (FEMA), but that rescission is not extended into the future. Also extrapolated in the current baseline is $3.8 billion in supplemental appropriations for avian flu research, preparedness, and response.

CBO's Baseline Projections for 2006 Through 2016

For 2006, CBO estimates a budget deficit of $337 billion under current law, with outlays totaling $2.6 trillion and revenues measuring $2.3 trillion. However, additional funding is likely to be needed to finance military activities in Iraq and Afghanistan (perhaps adding about $20 billion to outlays) and to pay flood insurance claims resulting from hurricane damage (requiring another $4 billion, according to FEMA's current estimates). The net result would be a deficit of somewhere near $360 billion. If the spending reconciliation act became law—the act contains a package of adjustments to mandatory spending—it would reduce outlays for 2006 by an estimated $5 billion.[8] (For more information about the spending reconciliation legislation, see Box 1-2.).

The deficit for 2006 is likely to be higher than the 2005 shortfall of $318 billion for two main reasons. First, the additional spending and the losses in revenues stemming from last fall's hurricanes are estimated to add more than $50 billion to the 2006 deficit. Second, net outlays for Medicare's new prescription drug benefit are projected to amount to another $30 billion.

In CBO's current baseline, deficits decline gradually through 2010 as outlays increase at an average annual rate of 4.0 percent and revenues rise by 5.7 percent a year. Beyond 2010, spending related to the aging of the baby-boom generation raises projections of the average annual growth of total outlays to 4.5 percent. However, revenues are projected to climb sharply in 2011 and 2012, growing by 8.9 percent and 7.6 percent, respectively (under the assumption that various tax increases occur as scheduled), and thereby bringing the baseline projection of the budget near balance. Beyond 2012, baseline revenues grow at about the same pace as outlays (about 5 percent a year), which keeps the bottom line showing small surpluses through 2016.

Outlays

From 2007 through 2016, outlays are projected to remain between 19 percent and 20 percent of GDP (see Table 1-3). Mandatory spending (which is determined by laws other than annual appropriation acts) is projected to grow by 5.8 percent per year—faster than the economy as a whole. Discretionary appropriations, by contrast, are assumed simply to keep pace with inflation and, to a lesser degree, with wage growth. Through 2016, discretionary outlays are thus projected to increase by about 2.0 percent per year, on average, from the baseline level for 2006—a pace less than half as fast as the projected rate of nominal GDP and one significantly slower than the average annual growth (4.3 percent) of discretionary outlays over the past 20 years.

Revenues

CBO projects that the structure of the tax code and rapid growth in retirement incomes will cause revenues to increase faster than the overall economy in each year of the projection period. In addition, CBO assumes—as baseline rules require—that the various tax provisions enacted

8. The House and Senate each passed a tax reconciliation act (H.R. 4297 and S. 2020), but the two acts contain some provisions that are quite different, and a conference version of the legislation has not yet been agreed upon.

Table 1-3.

CBO's Baseline Budget Projections

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
							In Billions of Dollars							
Revenues														
Individual income taxes	927	1,003	1,108	1,190	1,281	1,374	1,572	1,724	1,824	1,930	2,043	2,164	6,525	16,210
Corporate income taxes	278	302	296	300	303	305	309	317	326	335	346	360	1,513	3,197
Social insurance taxes	794	838	882	925	970	1,017	1,064	1,112	1,161	1,212	1,264	1,319	4,857	10,926
Other	154	169	176	183	189	187	193	225	235	246	259	271	928	2,163
Total	**2,154**	**2,312**	**2,461**	**2,598**	**2,743**	**2,883**	**3,138**	**3,378**	**3,546**	**3,724**	**3,912**	**4,113**	**13,823**	**32,496**
On-budget	1,576	1,704	1,819	1,921	2,031	2,135	2,356	2,561	2,693	2,834	2,985	3,145	10,263	24,482
Off-budget	577	608	642	676	712	747	782	817	853	890	928	968	3,559	8,014
Outlays														
Mandatory spending	1,320	1,432	1,488	1,572	1,667	1,755	1,866	1,935	2,071	2,205	2,350	2,527	8,348	19,437
Discretionary spending	968	999	1,000	1,022	1,040	1,060	1,087	1,103	1,132	1,159	1,186	1,219	5,209	11,009
Net interest	184	217	244	263	277	289	299	303	303	302	302	300	1,372	2,882
Total	**2,472**	**2,649**	**2,732**	**2,857**	**2,984**	**3,105**	**3,252**	**3,340**	**3,506**	**3,666**	**3,839**	**4,046**	**14,930**	**33,328**
On-budget	2,070	2,222	2,286	2,397	2,505	2,608	2,736	2,799	2,936	3,065	3,203	3,372	12,532	27,906
Off-budget	402	427	446	460	479	497	516	541	570	602	636	675	2,398	5,422
Deficit (-) or Surplus	**-318**	**-337**	**-270**	**-259**	**-241**	**-222**	**-114**	**38**	**40**	**57**	**73**	**67**	**-1,107**	**-832**
On-budget	-494	-518	-466	-476	-474	-473	-380	-238	-243	-230	-218	-226	-2,269	-3,424
Off-budget	175	181	196	217	233	250	266	276	283	288	291	293	1,162	2,592
Debt Held by the Public	4,592	4,925	5,204	5,477	5,732	5,967	6,092	6,064	6,032	5,981	5,912	5,848	n.a.	n.a.
Memorandum:														
Gross Domestic Product	12,293	13,082	13,781	14,508	15,264	16,021	16,768	17,524	18,311	19,121	19,963	20,839	76,343	172,101
							As a Percentage of GDP							
Revenues														
Individual income taxes	7.5	7.7	8.0	8.2	8.4	8.6	9.4	9.8	10.0	10.1	10.2	10.4	8.5	9.4
Corporate income taxes	2.3	2.3	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.7	1.7	2.0	1.9
Social insurance taxes	6.5	6.4	6.4	6.4	6.4	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.4	6.3
Other	1.3	1.3	1.3	1.3	1.2	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.2	1.3
Total	**17.5**	**17.7**	**17.9**	**17.9**	**18.0**	**18.0**	**18.7**	**19.3**	**19.4**	**19.5**	**19.6**	**19.7**	**18.1**	**18.9**
On-budget	12.8	13.0	13.2	13.2	13.3	13.3	14.1	14.6	14.7	14.8	15.0	15.1	13.4	14.2
Off-budget	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.6	4.6	4.7	4.7
Outlays														
Mandatory spending	10.7	10.9	10.8	10.8	10.9	11.0	11.1	11.0	11.3	11.5	11.8	12.1	10.9	11.3
Discretionary spending	7.9	7.6	7.3	7.0	6.8	6.6	6.5	6.3	6.2	6.1	5.9	5.9	6.8	6.4
Net interest	1.5	1.7	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.6	1.5	1.4	1.8	1.7
Total	**20.1**	**20.3**	**19.8**	**19.7**	**19.5**	**19.4**	**19.4**	**19.1**	**19.1**	**19.2**	**19.2**	**19.4**	**19.6**	**19.4**
On-budget	16.8	17.0	16.6	16.5	16.4	16.3	16.3	16.0	16.0	16.0	16.0	16.2	16.4	16.2
Off-budget	3.3	3.3	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.2	3.2	3.1	3.2
Deficit (-) or Surplus	**-2.6**	**-2.6**	**-2.0**	**-1.8**	**-1.6**	**-1.4**	**-0.7**	**0.2**	**0.2**	**0.3**	**0.4**	**0.3**	**-1.4**	**-0.5**
On-budget	-4.0	-4.0	-3.4	-3.3	-3.1	-3.0	-2.3	-1.4	-1.3	-1.2	-1.1	-1.1	-3.0	-2.0
Off-budget	1.4	1.4	1.4	1.5	1.5	1.6	1.6	1.6	1.5	1.5	1.5	1.4	1.5	1.5
Debt Held by the Public	37.4	37.6	37.8	37.7	37.5	37.2	36.3	34.6	32.9	31.3	29.6	28.1	n.a.	n.a.

Source: Congressional Budget Office.

Note: n.a. = not applicable.

Box 1-2.

Reconciliation Legislation for Spending

The budget resolution for 2006 contained reconciliation instructions to Congressional committees to reduce both spending and revenues. Eight House and Senate committees were instructed to recommend spending changes, and those recommendations were combined into an omnibus bill by the House and Senate Budget Committees. The House Ways and Means and the Senate Finance Committees were instructed to report legislation covering revenue changes. The bills were considered by the House and Senate under special rules expediting their movement through the legislative process.

As of the end of December, a conference agreement on the spending reconciliation bill had been approved by the House and—in a slightly modified form—by the Senate. (Certain points of order in the Senate led to minor changes in the legislation.) As a result, final action on the bill is pending in the House. The House and the Senate each passed a version of the tax reconciliation bill, but the two versions contained some provisions that were quite different, and as yet, a conference agreement has not been reached.

The spending reconciliation act—the Deficit Reduction Act of 2005 (S. 1932)—would reduce mandatory outlays by an estimated $39 billion between 2006 and 2010 and a total of $99 billion from 2006 through 2015 (see the table on the next page).[1] Those totals reflect apparent drafting errors in the education and judiciary provisions. If those errors were corrected in subsequent legislation, estimated savings would increase by $700 million from 2006 to 2010 and by about $2 billion over the 2006-2015 period. The largest savings from the legislation would accrue in five areas of the budget: education, Medicare, Medicaid and other health programs, auctions of licenses for use of the electromagnetic spectrum, and pension insurance.

Education

The reconciliation act contains various provisions related to student loan programs that would result in net savings of $11.9 billion over the next five years and $29.0 billion through 2015. Spending over the 2006-2015 period would be reduced by $52 billion, primarily by decreasing payments to lenders, increasing the interest rate charged on loans to parents of students, mandating the payment of certain fees by guaranty agencies, reducing lenders' insurance reimbursements, and eliminating mandatory funding for administrative costs. Offsetting about $23 billion of those 10-year savings would be additional spending to increase loan limits, reduce borrowers' origination fees, create two new grant programs to supplement the Federal Pell Grants Program (which awards grants to undergraduate students on the basis of financial need), and fulfill other purposes.

Medicare

The reconciliation act would reduce net Medicare spending by $6.4 billion through 2010 and $22.4 billion through 2015, CBO estimates. Those 10-year savings would be achieved in part by reducing payments for certain imaging services—such as magnetic resonance imaging, or MRIs—($8.1 billion) and for home health services ($5.7 billion) and by improving the accuracy of the process by which payments to managed care plans are adjusted for differences in expected costs stemming from differences in patients' health status ($4.1 billion). In addition, the reconciliation act would temporarily raise and then lower payment rates for physicians' services, which would add $7.3 billion to outlays from 2006 to 2010 but reduce them by $0.4 billion over the 10-year period.

Medicaid and Other Health Programs

In total, changes to Medicaid and other health programs would reduce mandatory outlays by $4.7 billion between 2006 and 2010 and $26.4 billion from 2006 through 2015, CBO estimates. The largest savings would come from provisions in the reconciliation act that would permit state Medicaid programs to require beneficiaries to pay higher premiums and a greater share of their health care costs and to reduce the level of coverage of certain beneficiaries. Those provisions would save $16 billion through 2015. The reconciliation act would also lower payments by Medicaid for outpatient prescription drugs, saving another $12 billion over the 10-year period.

1. Savings from reconciliation were calculated relative to the baseline that CBO prepared in March 2005. CBO used that baseline, which underlies the Congressional budget resolution, to evaluate all legislation proposed after the resolution was passed.

Box 1-2.

Continued

Spectrum Auctions and Related Spending

In CBO's estimation, changes in the collection and expenditure of proceeds from the Federal Communications Commission's (FCC's) auctions of licenses to use the electromagnetic spectrum would lower total federal spending from 2006 through 2015 by $7.6 billion. Provisions that extend the FCC's auction authority and change the statutory requirements for the transition from analog to digital television broadcasts would increase auction proceeds by an estimated $10.3 billion from 2006 to 2015. Balanced against that increase would be additional spending by the Departments of Commerce, Homeland Security, and Transportation totaling an estimated $2.7 billion. Most of those expenditures would go for two purposes: about $1.4 billion would subsidize equipment needed by consumers for viewing digital signals on analog television. Another $1.0 billion would be used to purchase equipment that would enable public safety agencies to communicate with one another more effectively.

Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation (PBGC) is a wholly owned government corporation that insures the pension benefits of more than 44 million people. Changes in the premiums paid by firms to PBGC would lower federal outlays by $3.6 billion over the 2006-2010 period and $0.5 billion from 2006 through 2015. Receipts from premiums, which are recorded as offsets to mandatory spending, would increase as a result of boosting rates per participant for single-employer and multiemployer defined-benefit pension plans and imposing premiums on former sponsors whose pension plans had been terminated by PBGC. That additional premium income is estimated to total $7.9 billion. Higher premium receipts would allow the PBGC's on-budget revolving fund to defer some reimbursements from the nonbudgetary funds it has obtained from firms whose plans have been terminated. Because those reimbursements appear as receipts in the budget, the deferral would effectively increase net outlays in the 2013-2015 period, thus offsetting some of the savings that had accrued in earlier years.

Estimated Impact of Budget Reconciliation on Mandatory Outlays
(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Education[a]	-3.5	-1.9	-2.2	-2.2	-2.1	-2.4	-3.3	-3.6	-3.8	-4.1	-11.9	-29.0
Medicare	-3.4	6.2	-1.2	-3.0	-5.0	-3.7	-3.9	-3.2	-2.8	-2.4	-6.4	-22.4
Medicaid and Other Health Care Programs	2.2	-0.6	-1.7	-2.0	-2.7	-3.1	-3.7	-4.3	-4.9	-5.7	-4.7	-26.4
Spectrum Auctions and Related Spending	*	1.4	2.5	-11.4	0.2	-0.1	-0.1	0	0	0	-7.4	-7.6
Pension Benefit Guaranty Corporation	-0.4	-0.6	-0.7	-0.9	-1.0	-0.9	-0.9	0.3	2.3	2.3	-3.6	-0.5
Other[a]	0.3	-1.0	-1.1	-1.3	-1.7	-1.6	-1.7	-1.7	-1.8	-1.7	-4.8	-13.4
Total Changes	**-4.8**	**3.6**	**-4.5**	**-20.8**	**-12.3**	**-11.7**	**-13.6**	**-12.6**	**-11.0**	**-11.5**	**-38.8**	**-99.3**

Source: Congressional Budget Office.

Notes: The conference agreement was reported in the House as House Report 109-362 and was passed on December 19, 2005. The Senate passed S. 1932 after adopting Senate Amendment No. 2691 on December 21, 2005.

* = between -$500 million and zero.

a. These numbers reflect the language contained in the conference agreement. However, that language includes apparent drafting errors in the education and judiciary provisions. If those errors were corrected in subsequent legislation, estimated savings would increase by $700 million over the 2006-2010 period and about $2 billion over the 2006-2015 period.

in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and by the Working Families Tax Relief Act of 2004 will expire as scheduled. Many of those provisions are set to expire on December 31, 2010, but some have earlier expiration dates. As a result, revenues as a percentage of GDP are projected to rise slightly through 2010—from 17.7 percent in 2006 to 18.0 percent—and grow more rapidly over the following two years, reaching 19.3 percent of GDP in 2012. By 2016, CBO projects, revenues will account for 19.7 percent of GDP.

Budgetary Impact of Hurricane Relief

Since September 2005, the Congress and the President have enacted several measures to address the damage caused by last fall's hurricanes. CBO estimates that as of this writing, disaster relief and other hurricane-related effects will add at least $54 billion to the deficit for 2006, $23 billion for 2007, $13 billion for 2008, and smaller amounts thereafter. The largest budgetary impact has resulted from supplemental appropriations, which CBO estimates will increase outlays by about $30 billion in 2006. In addition, lawmakers have boosted mandatory outlays for this year by $17 billion, mostly by increasing the borrowing authority for the flood insurance program. Last, the hurricanes will lower total federal receipts (by about $7 billion) as a result of the various forms of tax relief that have been provided. The storms' impact on the overall economy and delays in the payment of taxes will also affect revenues, although probably not significantly. (For more information on the budgetary effects related to hurricane relief, see Appendix A. For a discussion of the hurricanes' effects on the economy, see Chapter 2.)

Debt Held by the Public

In CBO's baseline, accumulated federal debt held by the public (mainly in the form of Treasury securities sold in the capital markets) equals about 38 percent of GDP through 2009. Thereafter, projections of shrinking annual deficits and small surpluses diminish the government's anticipated borrowing needs, causing debt held by the public to decline to about 28 percent of GDP by 2016 (see Figure 1-2).

Uncertainty and Budget Projections

Actual budgetary outcomes are almost certain to differ from CBO's baseline projections, both because of future legislative actions and because of unanticipated changes in economic and security-related conditions and in other factors that affect federal programs and sources of revenues.

The 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 1-4). The discussion below focuses on those scenarios' direct effects on revenues and outlays. However, their full impact would include their effect on federal debt-service costs, which is shown separately in Table 1-4.

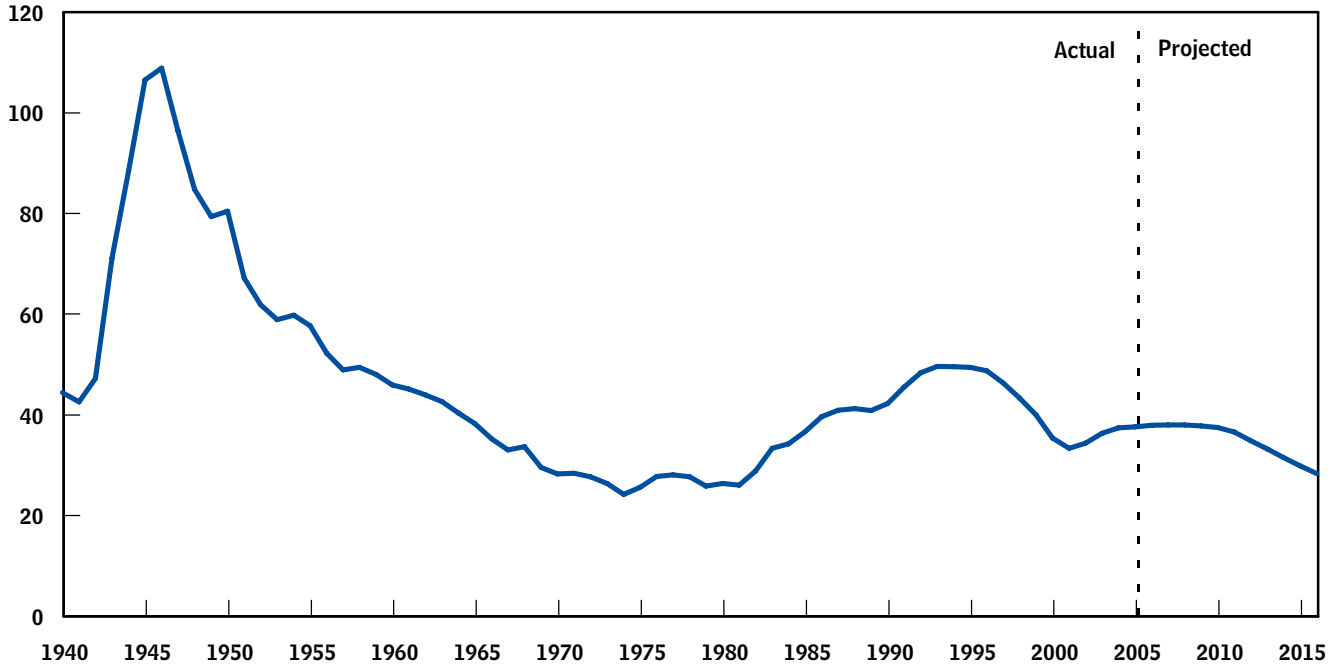
Activities Related to Iraq and Afghanistan and Supplemental Appropriations. As noted above, CBO's baseline inflates budget authority for discretionary programs—which includes appropriations for military activities in Iraq and Afghanistan—from the 2006 level, a method that leads to total projected discretionary outlays of $11 trillion for the 2007-2016 period. However, different assumptions about spending for operations in Iraq and Afghanistan or about the rate of growth of other discretionary appropriations would produce a different total. For example, if the $33 billion provided thus far in 2006 through supplemental appropriations (primarily for hurricane relief) and the $50 billion in funding for military activities in Iraq and Afghanistan were excluded from the amount extrapolated for future years, total discretionary outlays from 2007 to 2016 would be $827 billion lower than in CBO's current projections.

The current baseline includes outlays arising from the $50 billion in discretionary budget authority already provided for 2006 and $557 billion in budget authority over the 2007-2016 period that has been projected under baseline assumptions for military activities in Iraq and Afghanistan. Additional funding will probably be needed in 2006 if the number of U.S. forces involved in those activities remains at or near its current level through the end of the year. Beyond 2008, however, funding requirements may be less than baseline amounts if the number of forces and the pace of operations diminish over time.

Figure 1-2.

Debt Held by the Public as a Percentage of Gross Domestic Product, 1940 to 2016

(Percent)



Source: Congressional Budget Office.

Thus, CBO has formulated another budget scenario that considers eventual reductions in the scale of military activities in Iraq and Afghanistan as well as in other operations related to the war on terrorism. To illustrate the effect of such a scenario on the baseline, CBO constructed a possible spending path for military activities that incorporates the assumption that force levels and operations will decline somewhat in 2007 relative to 2006 and then continue to decrease gradually over several years. Such a scenario might involve keeping about 185,000 active-duty, Reserve, and National Guard personnel deployed overseas to support operations through 2006; in 2007, the number of those forces would drop to about 158,000. Over the longer term, the scenario could involve reducing the level of U.S. military involvement in those activities to about 50,000 troops (not necessarily in Iraq and Afghanistan) and curtailing domestic military operations related to homeland security.

Under such a scenario, discretionary outlays for 2006 would rise by about $20 billion, but annual outlays would decline relative to the current baseline beginning in 2009. Outlays for military activities related to the war on terrorism under the assumptions of this alternate path would be about $140 billion lower between 2007 and 2016. Under the assumptions that supplemental appropriations are not extrapolated and that such a phasedown in military activities occurs, total discretionary outlays would fall relative to the baseline by $440 billion over the 10-year period. Many other outcomes—some costing more and some costing less—are also possible for the activities covered in this scenario.

Other Discretionary Spending. Alternative assumptions can also be made about discretionary spending as a whole. For example, if regular appropriations (other than those for activities in Iraq and Afghanistan and supplemental appropriations) were assumed to grow through 2016 at the same rate as nominal GDP instead of with inflation, total projected discretionary spending would be $1.4 trillion higher than in the current baseline. In the other direction, if lawmakers did not increase appropriations after 2006 to account for inflation, cumulative discretionary outlays would be $1.2 trillion lower.

Table 1-4.

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

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
						Policy Alternatives That Affect Discretionary Spending							
Remove the Extension of Supplemental Appropriations and Funding for Military Activities in Iraq and Afghanistan from the Baseline After 2006[a]													
Effect on the deficit	0	42	64	77	84	88	90	93	94	96	99	355	827
Debt service	0	1	4	7	11	16	21	26	32	38	44	39	199
Remove the Extension of Supplemental Appropriations and Assume the Phasing Down of Military Activities in Iraq and Afghanistan Instead of the Extension of Current Appropriations for Such Activities[b]													
Effect on the deficit	-20	-23	4	27	49	58	61	64	65	66	69	115	440
Debt service	*	-2	-2	-1	*	3	6	9	13	16	20	-2	62
Increase Discretionary Appropriations—Except Supplementals and Funding for Military Activities in Iraq and Afghanistan—at the Rate of Growth of Nominal GDP[c]													
Effect on the deficit	0	-15	-38	-64	-92	-121	-149	-178	-207	-238	-271	-329	-1,372
Debt service	0	*	-2	-4	-8	-13	-20	-29	-39	-52	-66	-27	-234
Freeze Total Discretionary Appropriations at the Level Provided for 2006													
Effect on the deficit	0	15	35	57	80	105	128	154	180	207	236	292	1,199
Debt service	0	*	2	4	7	12	18	25	35	45	58	25	206

Continued

Mandatory Spending. Three mandatory programs—Social Security, Medicare, and Medicaid—dominate federal spending. In 2005, outlays for those programs totaled more than $1 trillion (excluding offsetting receipts from Medicare premiums) and accounted for 42 percent of federal spending. Legislation affecting such large programs could have substantial budgetary impacts. Some recent proposals to change aspects of Social Security, for example, could have a significant effect on budgetary totals both during the baseline period and well beyond. Likewise, changes in the laws that set payment rates, eligibility, and other criteria for Medicare and Medicaid are proposed and considered every year. For example, in each year between 2003 and 2005, Medicare's payments for physicians' services (which are set by a procedure known as the sustainable growth rate formula) have been raised above the levels previously set by law, and the Congress and the President are poised to do so again this year as part of the spending reconciliation legislation. Further actions of that kind would lift outlays for Medicare noticeably above baseline levels over the coming 10 years.[9]

The Congress is currently considering changes to Medicare as well as to other mandatory programs in the pending reconciliation act. CBO estimates that, if enacted, that legislation would save $99 billion between 2006 and 2015 (see the table in Box 1-2 on page 11).

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

Table 1-4.

Continued

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
						Policy Alternatives That Affect the Tax Code							
Extend Expiring Tax Provisions[d]													
Effect on the deficit													
EGTRRA and JGTRRA	*	-4	-9	-20	-18	-154	-257	-270	-282	-290	-301	-206	-1,606
Other	-5	-15	-22	-28	-34	-41	-45	-49	-53	-57	-61	-140	-406
Total	-6	-18	-31	-49	-53	-195	-302	-319	-335	-347	-362	-346	-2,012
Debt service	*	-1	-2	-4	-6	-13	-25	-41	-58	-77	-97	-26	-324
Reform the Alternative Minimum Tax[e]													
Effect on the deficit	-7	-46	-48	-58	-70	-59	-36	-43	-50	-60	-72	-282	-544
Debt service	*	-1	-4	-6	-10	-13	-16	-19	-22	-26	-30	-35	-147
Memorandum:													
Total Discretionary Outlays in CBO's Baseline	999	1,000	1,022	1,040	1,060	1,087	1,103	1,132	1,159	1,186	1,219	5,209	11,009
Total Deficit (-) or Surplus in CBO's Baseline	-337	-270	-259	-241	-222	-114	38	40	57	73	67	-1,107	-832

Sources: Congressional Budget Office; Joint Committee on Taxation.

Notes: Positive amounts indicate a reduction in the deficit. "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.

a. This alternative does not extrapolate the appropriations for military activities in Iraq and Afghanistan or the supplemental appropriations enacted so far during fiscal year 2006.

b. This alternative does not extend the $50 billion in appropriations provided thus far in 2006 for military activities in Iraq and Afghanistan and the war on terrorism, nor does it extend any supplemental appropriations (for example, those for hurricane relief). However, it incorporates the assumption that an additional $45 billion in budget authority will be provided in 2006 for operations in Iraq and Afghanistan. Such budget authority is projected to total $75 billion in 2007, $55 billion in 2008, and $40 billion in 2009, and then to decline to about $30 billion a year from 2010 on. Additional budget authority over the 2006-2016 period is assumed to total $416 billion.

c. This alternative incorporates the assumption that the appropriations for military activities in Iraq and Afghanistan and the supplemental appropriations enacted during 2006 are projected according to statutory baseline rules (at the rate of projected inflation).

d. These estimates do not include the effects of extending the increased exemption amount for the alternative minimum tax (AMT) that expires in 2005. The effects of that alternative are shown below.

e. This alternative incorporates the assumption that the exemption amount for the AMT (which was increased through December 2005 in the Working Families Tax Relief Act of 2004) is extended at its higher level and, together with the AMT tax brackets, indexed for inflation after 2005. The estimates shown are relative to current law. If this alternative was enacted jointly with the extension of the expiring tax provisions, an interactive effect would occur that would make the combined revenue loss over the 2007-2016 period greater than the sum of the two separate estimates by about $321 billion (plus $35 billion in debt-service costs).

Revenues. The baseline envisions (as the statutory rules require) 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 by the end of 2010. On balance, the tax provisions that are set to expire during the projection period reduce revenues; thus, in a scenario in which the provisions were extended, projected revenues would be lower than they are in the current baseline.[10] For example, if all expiring tax provisions (except those related to the exemption amount for the alternative minimum tax, or AMT) were extended, total revenues over the 2007-2016 period would be $2.0 trillion lower.[11]

Another change in policy that could affect revenues involves modifying 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; that 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 2005, federal revenues would be $544 billion lower between 2007 and 2016, according to CBO and the Joint Committee on Taxation.

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 creating 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 have a significant effect on 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 slowly fall from 3.6 percent in calendar year 2006 to 2.5 percent in 2016. If the actual rate was 0.1 percent higher (or lower) each year, the cumulative deficit for the 2007-2016 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 C.)

Uncertainty also arises from technical factors—those not directly related to changes in law or in CBO's economic forecast—that affect budget projections. For example, spending per enrollee in past decades for both Medicare and Medicaid has been growing faster than GDP per capita. The level of such "excess cost growth" in the future is difficult to forecast, but it will have a large impact on the costs of those programs. Other assumptions on which CBO's projections of those costs depend include assumptions about growth of enrollment in the programs and, indirectly, general inflation.

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 significantly affect how much the government will pay farmers under price- and income-support programs. Assumptions about revenues are particularly sensitive to technical uncertainty. Although the overall level of income is determined by economic projections, CBO must make technical assumptions about how much revenue to expect from a given amount of income. Differences between expected and actual revenue yields 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 1-3 displays a range of possible outcomes for the total deficit or surplus under current law (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 the darkest part of the figure—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 0.7 percent of GDP for 2011. Under current law, however, there is a roughly 5 percent chance that the actual outcome that year will be a deficit greater than 6 percent of GDP. Similarly, in the absence of further legislative changes, there is a roughly 40 percent chance that the budget will be in balance or in surplus in 2011.

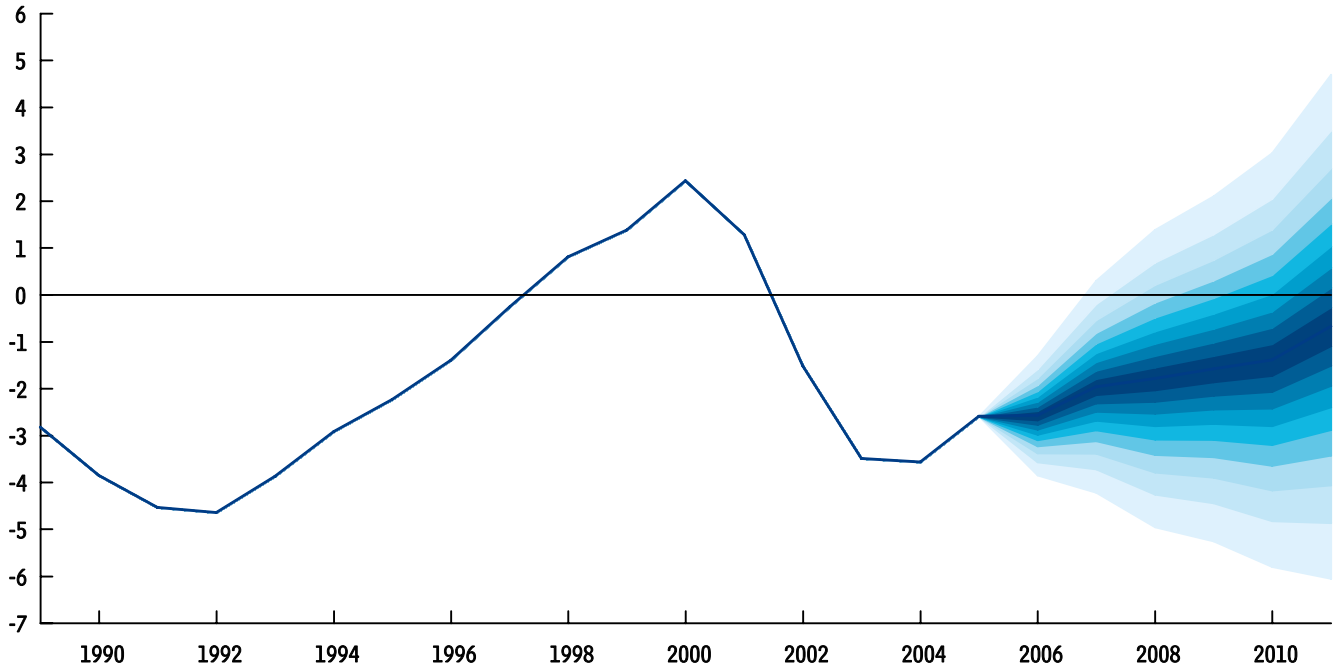
10. In the years before 2011, the provisions that contribute the most to the drop in revenues are the research and experimentation tax credit and the current tax rates on capital gains and dividends.

11. 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 overall GDP.

Figure 1-3.

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 forecasting track record, 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 will 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 2005). (An updated version of that publication is forthcoming.)

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 intragovernmental IOUs 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 buyers, including foreign investors, mutual funds, state and local governments, commercial banks, insurance companies, and individuals. Of those groups, foreign investors (governments, businesses, and individuals) currently own 45 percent of all federal debt issued to the

public—or nearly $2.1 trillion of the roughly $4.6 trillion that is now outstanding.

Among investors from other nations, those in Japan, China, and the United Kingdom have the biggest holdings of Treasury securities.[12] The central bank and private entities in those countries purchased about $1.1 trillion of such debt—roughly 25 percent of the outstanding total. In 2005, investors from the United Kingdom were the largest purchasers of Treasury securities from abroad, buying roughly $115 billion of debt. (However, a significant amount of those acquisitions are probably held by investors residing outside the United Kingdom who executed their orders through British brokers.) In all, investors from other countries purchased about $235 billion in Treasury securities last year.

State and local governments and mutual funds in the United States are also large investors in Treasury securities, respectively holding $431 billion and $249 billion of debt sold to the public.[13]

Debt held by the public fluctuates according to changes in the government's borrowing needs. It equaled nearly 50 percent of GDP in 1993 but had fallen to about 33 percent by 2001 (see Figure 1-2 on page 13). Over the past four years, debt held by the public 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 remain at about that level until 2009 and then decline to 28 percent of GDP by 2016 (see Table 1-5).

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 approximately 10 percent comprises nonmarketable securities, such as savings bonds and state and local government securities, which are nonnegotiable, nontransferable debt instruments issued to specific investors.[14]

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 will add a new security to its auction calendar when it will again issue 30-year bonds on a semiannual basis. That move will somewhat reduce the Treasury's exposure to losses from rapid swings in interest rates. Initially, however, it is also likely to increase the Treasury's interest costs—because such securities normally carry higher interest rates than other, shorter-term marketable instruments. An advantage of again issuing the 30-year bond is that it could diversify the Treasury's investment base by attracting new investors who seek long-term securities that have the highest credit ratings.

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. CBO projects that debt held by the public will increase by more than the cumulative deficit over the 2006-2016 period because changes in other means of financing will raise the Treasury's borrowing needs (see Table 1-5).

Among such means, 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 outlays are not counted in the budget, which reflects only the programs' estimated subsidy costs. From 2007 through 2016, the amount of loans being disbursed every year will typically be larger than the amount of repayments and interest being collected each year. Thus,

12. See Department of the Treasury, "Major Foreign Holders of Treasury Securities" (January 18, 2006), available at www.ustreas.gov/tic/mfh.txt. That information should be viewed as approximate because in many cases it is not possible to accurately determine the home country of foreign holders of U.S. securities. (That difficulty arises because intermediaries may be involved in the custody, management, purchase, or sale of the securities.)

13. Department of the Treasury, Financial Management Service, *Treasury Bulletin* (December 2005).

14. 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.

Table 1-5.

CBO's Baseline Projections of Federal Debt

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Debt Held by the Public at the Beginning of the Year	4,296	4,592	4,925	5,204	5,477	5,732	5,967	6,092	6,064	6,032	5,981	5,912
Changes to Debt Held by the Public												
Surplus (-) or deficit	318	337	270	259	241	222	114	-38	-40	-57	-73	-67
Other means of financing	-22	-4	8	14	14	13	11	10	8	6	4	3
Total	**297**	**333**	**279**	**273**	**255**	**235**	**125**	**-28**	**-32**	**-51**	**-69**	**-64**
Debt Held by the Public at the End of the Year	4,592	4,925	5,204	5,477	5,732	5,967	6,092	6,064	6,032	5,981	5,912	5,848
Debt Held by Government Accounts												
Social Security	1,809	1,989	2,184	2,398	2,629	2,875	3,137	3,408	3,686	3,968	4,254	4,541
Other government accounts[a]	1,504	1,601	1,700	1,797	1,892	1,987	2,078	2,183	2,285	2,388	2,492	2,569
Total	**3,313**	**3,590**	**3,884**	**4,195**	**4,521**	**4,862**	**5,215**	**5,591**	**5,971**	**6,356**	**6,746**	**7,110**
Gross Federal Debt	7,905	8,515	9,088	9,671	10,253	10,829	11,307	11,655	12,003	12,337	12,658	12,959
Debt Subject to Limit[b]	7,871	8,482	9,055	9,640	10,222	10,799	11,278	11,627	11,976	12,311	12,632	12,934
Memorandum:												
Debt Held by the Public at the End of the Year as a Percentage of GDP	37.4	37.6	37.8	37.7	37.5	37.2	36.3	34.6	32.9	31.3	29.6	28.1

Source: Congressional Budget Office.

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.

under baseline assumptions, the government's annual borrowing needs will, on average, be $9 billion greater than the annual budget deficit or surplus might indicate.

In 2005, the relationship between the change in accumulated debt and the amount of the deficit went in the other direction—compared with the deficit, debt held by the public rose by $22 billion less. About half of that amount can be attributed to payments to financing accounts for loan guarantee programs. Most of the rest stems from a reduction in the Treasury's reserves at the International Monetary Fund. For 2006, CBO's projection shows borrowing by the Treasury to be $4 billion less than the amount of the deficit.

Debt Held by Government Accounts

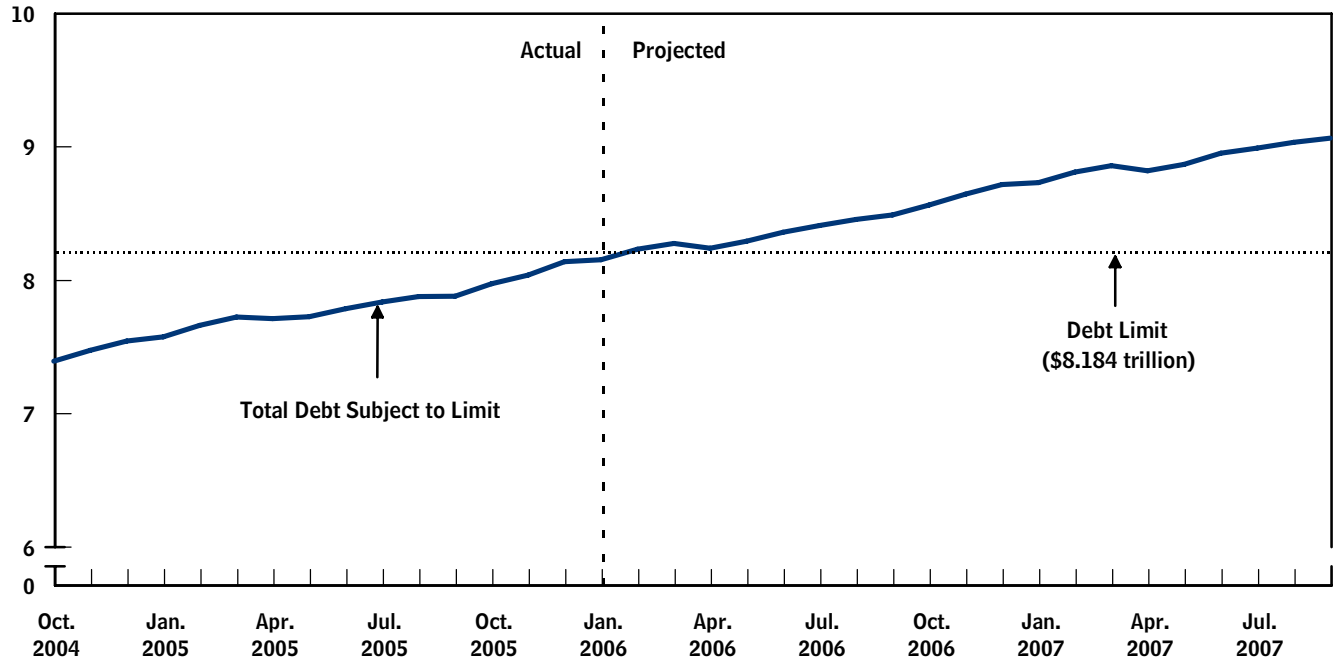
Besides selling securities to the public, the Treasury issues securities to various accounts of the federal government—as of the end of 2005, about $3.3 trillion. All of the major trust funds in the budget and many other government funds invest in special, nonmarketable Treasury securities known as the 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 when necessary to cover benefit payments or other expenses. In the meantime, the Treasury assigns interest earnings to the funds that hold those securities, but such payments have no net effect on the budget.

The largest balances among the government accounts are in the Social Security trust funds (more than $1.8 trillion at the end of 2005) and the retirement funds for federal civilian employees ($662 billion). If current policies do not change, the balance of the Social Security trust funds

Figure 1-4.

Debt Subject to Limit, October 2004 to September 2007

(Trillions of dollars)



Source: Congressional Budget Office.

will rise to $4.5 trillion by 2016, CBO projects, and the balance of all government accounts will climb to $7.1 trillion.

Gross Federal Debt and Debt Subject to Limit

Gross federal debt and its companion measure, debt subject to limit, comprise debt issued to government accounts as well as debt held by the public. The future path of gross federal debt is determined by the sum of those two components. CBO projects that under current law, gross federal debt will increase in every year of the 2007-2016 period, reaching almost $13 trillion in 2016, or 64 percent more than its total of $7.9 trillion at the end of 2005. Most of that increase reflects debt held by government accounts. At the end of the projection period, more than half of the gross federal debt would be held by government accounts—that is, more than half would be money owed by the government to itself.

The Treasury's authority to issue debt is restricted by a statutory ceiling. Although that limit covers debt held both 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).[15] The current debt ceiling, which was set in November 2004 in Public Law 108-415, is $8.184 trillion. CBO estimates that under current policies, that ceiling will be reached sometime in February 2006 (see Figure 1-4).

At that time, if policymakers have not enacted a higher debt limit, the Treasury will have to use accounting measures to remain under the debt ceiling so it can continue to raise cash to pay for government activities. Those accounting measures—most of which have been used in the past—could 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

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

Table 1-6.

CBO's Baseline Projections of Trust Fund Deficits or Surpluses

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Social Security	173	180	195	214	231	246	262	271	278	282	286	287
Medicare												
Hospital Insurance (Part A)	14	16	13	15	15	14	9	15	6	*	-8	-35
Supplementary Medical Insurance (Part B)	*	10	3	4	4	4	2	4	5	4	6	1
Subtotal, Medicare	14	25	17	19	19	17	10	19	11	4	-2	-33
Military Retirement	10	9	9	9	9	9	10	11	12	13	14	16
Civilian Retirement[a]	30	30	30	30	30	30	30	31	31	31	32	32
Unemployment	9	13	13	8	4	2	2	3	4	4	5	6
Highway and Mass Transit	-2	3	-1	-4	-6	-6	-7	-7	-7	-7	-7	-7
Airport and Airways	*	-1	*	*	1	1	2	2	3	3	4	5
Other[b]	-8	4	4	5	5	5	5	5	5	5	5	5
Total Trust Fund Surpluses	**226**	**265**	**266**	**279**	**293**	**305**	**314**	**334**	**335**	**337**	**337**	**310**
Intragovernmental Transfers to Trust Funds[c]	392	449	490	527	561	596	636	678	733	786	846	907
Net Budgetary Impact of Trust Fund Programs	**-165**	**-184**	**-224**	**-247**	**-268**	**-291**	**-322**	**-343**	**-397**	**-450**	**-508**	**-597**

Source: Congressional Budget Office.

Notes: Negative numbers represent deficits.

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

a. Includes Civil Service Retirement, 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 employee retirement, lump-sum payments to the Civil Service and Military Retirement Trust Funds, taxes on Social Security benefits, and smaller miscellaneous payments.

Retirement and Disability Fund, and withdrawing federal securities from the Exchange Stabilization Fund. In recent years, when the Treasury's borrowing reached the debt ceiling, the department has been able to use such accounting mechanisms to remain below the limit for one to three months. (However, unlike the past two instances in which its borrowing rose to the level of the ceiling, the Treasury next time will be unable to make significant room by swapping securities with the Federal Financing Bank. The bank can issue only $15 billion of its own debt, and, as noted earlier, it has already issued $14 billion.)

Trust Funds and the Budget

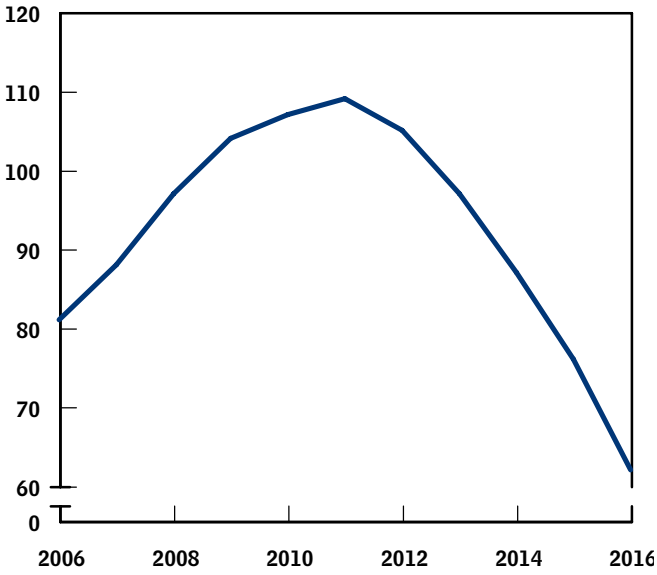
The federal budget includes more than 200 trust funds, although fewer than a dozen account for most of the trust fund dollars. Among the largest are the two Social Security trust funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) and the funds dedicated to civil service retirement, Hospital Insurance (Part A of Medicare), and military retirement (see Table 1-6). Trust funds have no particular economic significance. They do not hold separate cash balances; instead, they 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, the government borrows less from the public than it would in the absence of those excess funds.

Figure 1-5.

Social Security Trust Fund Surpluses, Excluding Interest, 2006 to 2016

(Billions of dollars)



Source: Congressional Budget Office.

The process is reversed when revenues for a trust fund program fall short of expenses. In that case, the government raises the necessary cash by increasing taxes, reducing spending, or borrowing more than it otherwise would.

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 2006. That balance is somewhat misleading, however, because trust funds receive much of their income in the form of transfers from other parts of the budget. Such intragovernmental transfers reallocate costs from one section of the budget to another but do not change the total deficit or the government's borrowing needs. Consequently, they have no effect on the economy or on the government's future ability to sustain spending at the levels indicated by current policies.

For 2006, those intragovernmental transfers are estimated to total $449 billion. The largest involve interest credited to trust funds on their government securities ($172 billion, by CBO's estimate), transfers of general funds to Medicare for Supplementary Medical Insurance ($126 billion) and Part D ($31 billion), government agencies' contributions to retirement funds for their current and former employees ($50 billion), and payments from the general fund to Social Security ($10 billion). With intragovernmental transfers excluded and only income from sources outside the government counted, the trust funds as a whole are projected to run a deficit throughout the 2006-2016 period that grows from $184 billion to $597 billion.

Although the full budgetary impact of the aging of the baby-boom generation will not be felt during the current projection period, CBO's baseline provides initial indications of the coming budgetary pressures. Charting the differences over the next 10 years between projected receipts and outlays for the Social Security trust funds (excluding intragovernmental interest payments) reveals those strains. Receipts are projected to exceed expenditures in each year of the period, but under current policies, the amount by which they do so will decline from more than $100 billion between 2009 and 2012 to about $62 billion in 2016 (see Figure 1-5). In the decade following 2016, Social Security outlays are projected to grow by an average of about 6 percent per year, but noninterest receipts for the program are projected to rise at an average annual rate of 4 percent. That difference means that the capacity of the Social Security trust funds to offset some of the net deficit in the rest of the budget—as they do now—will begin to dwindle. Soon after the baseline period, Social Security is projected to begin adding to deficits or reducing surpluses.

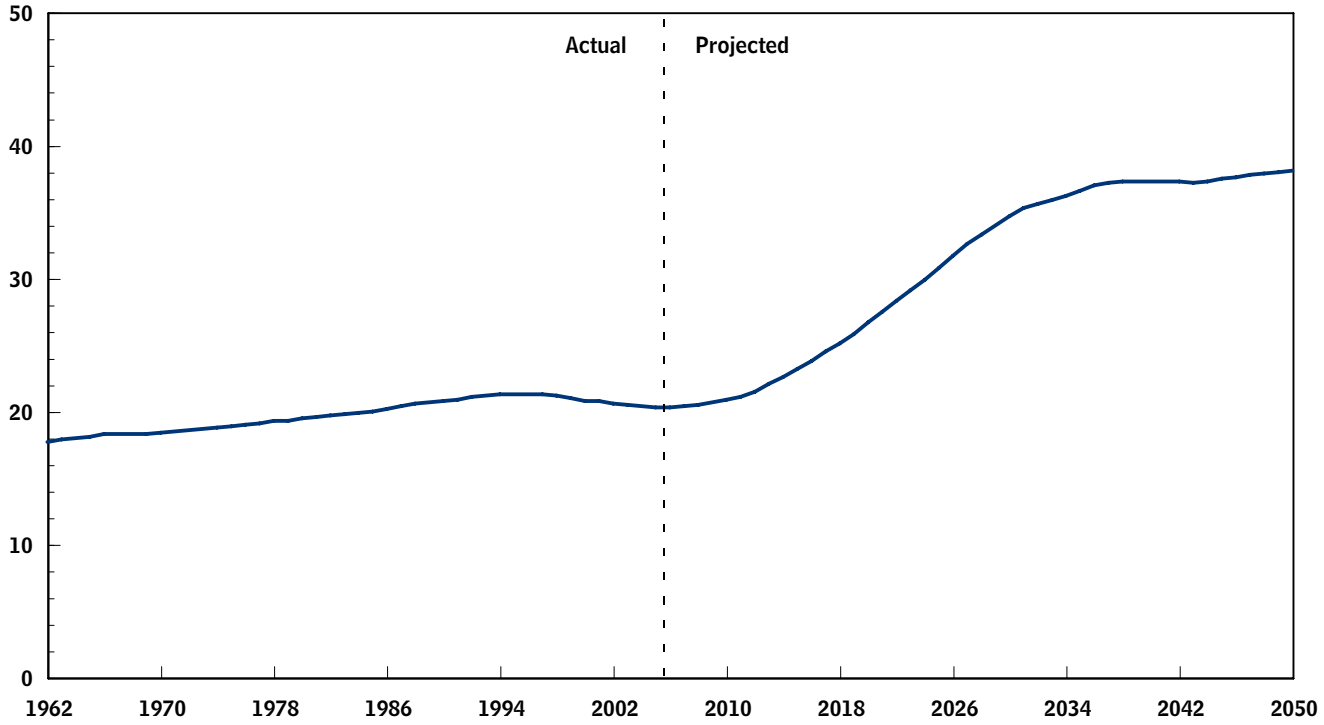
The Long-Term Budget Outlook

Over the next half-century, the United States will confront significant budgetary challenges. The number of people age 65 or older will double, and the number of adults under age 65 will increase by just 12 percent. As a result, the ratio of people who receive retirement and health care benefits to workers will increase steadily over that period. (Figure 1-6 shows the population age 65 or older as a percentage of the population ages 20 to 64.) At the same time, health care costs are likely to continue to grow faster than the economy. (Between 1960 and 2003, the average annual rate of growth of national health expenditures exceeded the rate of growth of GDP—the

Figure 1-6.

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

(Percent)



Source: Congressional Budget Office.

phenomenon known as excess cost growth—by 2.6 percent.) Taken together, an aging population and rising health care costs will cause a historic shift in the United States' fiscal situation in the decades beyond CBO's projection period.[16]

If the excess cost growth in national health expenditures in the future continued to average about 2.5 percent annually, federal spending for Medicare and Medicaid would rise from 4.4 percent of GDP today to about 8 percent in 2020 and 22 percent in 2050 (see Figure 1-7). However, the trustees who oversee the Medicare program assume that the health care system will experience significant pressures to curb the rate of excess cost growth, in part because of their belief that the current rate is unsustainable and ultimately will be reduced to 1 percent. At that pace, by 2050, federal spending for Medicare and Medicaid would reach almost 13 percent of GDP.[17]

Outlays for Social Security as a share of GDP are projected to grow from 4.2 percent today to 6.0 percent in 2030 and 6.4 percent in 2050—an increase of more than 50 percent. By contrast, federal revenues credited to Social Security over that period are expected to remain close to their current level—about 5 percent of GDP. CBO projects that under current law, Social Security outlays will first exceed revenues from payroll taxes and taxation of benefits in 2020.

Together, the growing resource demands of Social Security, Medicare, and Medicaid will exert pressures on the budget that economic growth alone is unlikely to alleviate. Substantial reductions in the projected growth of spending and perhaps also a sizable increase in taxes as a share of the economy will be necessary to provide a significant likelihood of fiscal stability in the coming decades.

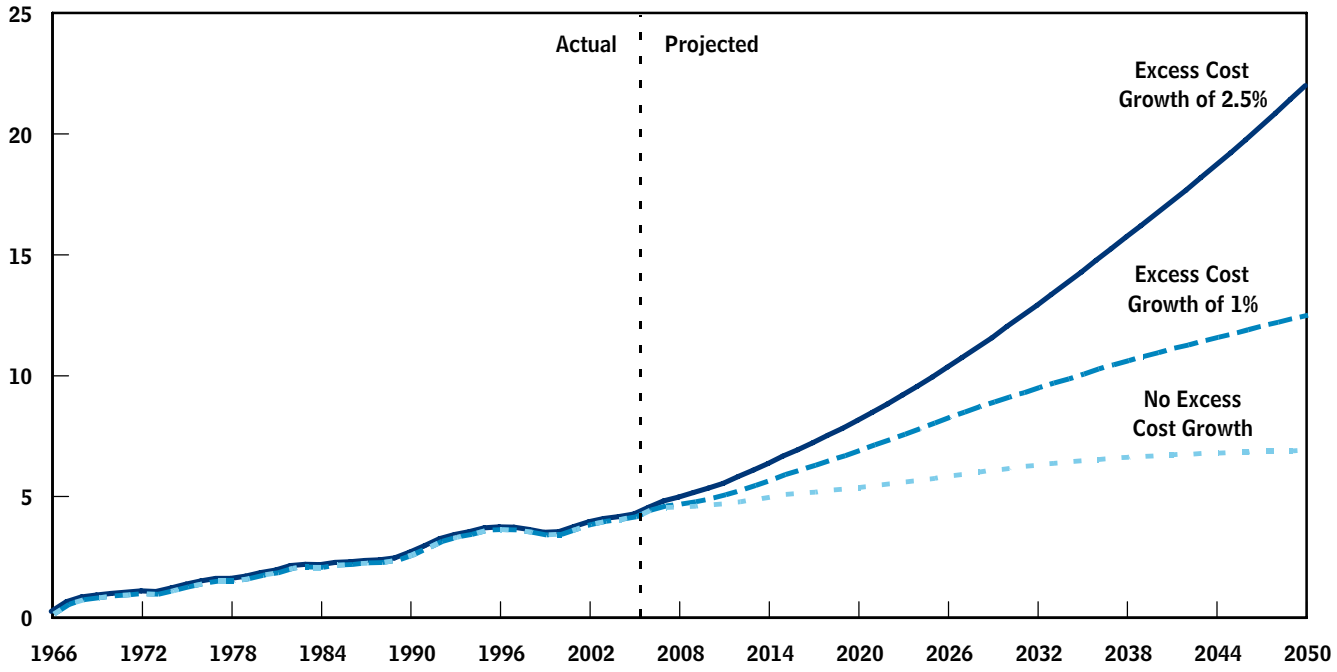
16. For a more extensive discussion, see Congressional Budget Office, *The Long-Term Budget Outlook, Updated Long-Term Projections for Social Security,* and *The Outlook for Social Security.*

17. See Technical Review Panel on the Medicare Trustees Reports, *Review of Assumptions and Methods of the Medicare Trustees' Financial Projections* (December 2000).

Figure 1-7.

Total Federal Spending for Medicare and Medicaid Under Different Assumptions About Excess Cost Growth, 1966 to 2050

(Percentage of gross domestic product)



Source: Congressional Budget Office.

CHAPTER

2

The Economic Outlook

Despite large increases in energy prices over the past two years and damage caused by major hurricanes in 2005, the U.S. economy is expected to continue growing at a healthy pace throughout 2006 and 2007. The Congressional Budget Office forecasts that gross domestic product will grow by 3.6 percent after inflation (in "real" terms) this year and by 3.4 percent next year (see Table 2-1).

Economic activity had a considerable amount of momentum last year, which was interrupted only mildly and temporarily by Hurricanes Katrina and Rita (see Box 2-1 on page 28). Some of that momentum will carry over into 2006, CBO forecasts. Despite an anticipated weakening in the housing market, the growth of GDP will be driven by forces already set in motion—businesses' continued need to expand productive capacity, solid growth in household income and wealth, and the lagged effects of declines in the value of the dollar since 2002. The housing market is expected to cool because potential buyers are likely to be deterred by concerns about the future growth of home prices and by higher interest rates. Business investment, however, is expected to continue its recent strength because it has not fully caught up with acceleration in the growth of demand in 2004 and 2005. The growth in employment and wages seen last year is also likely to continue, with the unemployment rate remaining near 5 percent, underpinning consumer spending. In addition, CBO forecasts that a lower value of the dollar combined with somewhat stronger economic growth abroad will cause real exports to increase faster than imports, bolstering the U.S. economy and holding the trade deficit near its current level.[1]

Along with healthy growth in demand and output, CBO expects the growth of labor productivity (which usually slows in the later stages of economic expansions) to remain strong, although not as rapid as the extraordinary pace of the past five years. Overall inflation, as measured by the consumer price index, is likely to be lower this year than in 2005, when it was boosted by rising energy prices. However, the core rate of inflation—which excludes food and energy prices—is expected to increase slightly in the next two years (the period covered by CBO's near-term forecast). As the Federal Reserve continues to reduce its stimulus to short-term growth, short-term interest rates are expected to rise in the first half of 2006. A larger increase in long-term interest rates is expected this year, as those rates move toward the levels projected for the medium term (2008 to 2016). As a result, the spread between long-term and short-term interest rates is forecast to widen. (In mid-January, that spread was quite small.)

Beyond 2007, the pace of economic growth is likely to slow somewhat. The main reason is that the labor force is expected to grow less quickly over time as members of the baby-boom generation begin to retire and as the scheduled expiration of various tax provisions in 2011 discourages work by increasing marginal tax rates. Consequently, CBO projects that real GDP will increase at average rates of 3.1 percent between 2008 and 2011 and 2.6 percent between 2012 and 2016. Rates of inflation, unemployment, and growth of labor productivity are assumed to average 2.2 percent, 5.2 percent, and 2.2 percent, respectively, after 2007. Interest rates are projected to average 4.4 percent for three-month Treasury bills and 5.2 percent for 10-year Treasury notes.

The medium-term outlook for real growth, inflation, and the unemployment rate has not changed materially since August 2005, when CBO published its previous economic projections. However, recent revisions to historical

1. The trade deficit indicates the extent to which the total value of exports of goods and services produced in the United States is lower than the total value of U.S. imports of goods and services produced elsewhere.

Table 2-1.

CBO's Economic Projections for Calendar Years 2006 to 2016

	Estimated	Forecast		Projected Annual Average	
	2005	2006	2007	2008-2011	2012-2016
Nominal GDP (Billions of dollars)	12,494	13,262	13,959	16,954 [a]	21,064 [b]
Nominal GDP (Percentage change)	6.5	6.1	5.3	5.0	4.4
Real GDP (Percentage change)	3.6	3.6	3.4	3.1	2.6
GDP Price Index (Percentage change)	2.7	2.4	1.8	1.8	1.8
Consumer Price Index[c] (Percentage change)	3.4	2.8	2.2	2.2	2.2
Core Consumer Price Index[d] (Percentage change)	2.2	2.2	2.3	2.2	2.2
Unemployment Rate (Percent)	5.1	5.0	5.0	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	3.2	4.5	4.5	4.4	4.4
Ten-Year Treasury Note Rate (Percent)	4.3	5.1	5.2	5.2	5.2
Tax Bases (Billions of dollars)					
Corporate book profits	1,434	1,451	1,438	1,555 [a]	1,901 [b]
Wages and salaries	5,723	6,050	6,383	7,785 [a]	9,647 [b]
Tax Bases (Percentage of GDP)					
Corporate book profits	11.5	10.9	10.3	9.4	9.0
Wages and salaries	45.8	45.6	45.7	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.

Notes: Percentage changes are year over year.

Year-by-year economic projections for calendar years 2006 to 2016 appear in Appendix E.

a. Level in 2011.

b. Level in 2016.

c. The consumer price index for all urban consumers.

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

data for nominal GDP and profits, along with higher inflation in the second half of 2005, have substantially raised the projected level of several important types of taxable income (including wages and salaries and corporate profits). Those changes have significantly increased projected federal revenues but have had relatively little effect on projected spending other than for debt service. A decline in CBO's projection of interest rates for the 2008-2015 period as a whole, however, has helped lower the projection of federal interest costs. As discussed in Chapter 1, changes in the economic outlook have reduced CBO's projection of the cumulative budget deficit for the 2006-2015 period by $736 billion.

A number of factors could cause future economic growth to differ from CBO's projections. The major factors that might lead to lower growth in the next two years are the possibility of another shock to energy prices; unexpected, delayed effects from the recent increases in those prices; a large drop in housing prices; adverse economic or financial developments in other countries; or a flu pandemic.

Conversely, unexpected positive developments could result in better economic performance in the near term. Oil prices might fall significantly below the level that CBO projects, for example, or the growth of labor productivity could remain at the exceptionally high rates of recent years. In addition, the housing market might stay

strong, and economic growth in the rest of the world could turn out to be more robust than anticipated.

After 2007, the average growth rate of the economy could be faster or slower than CBO's medium-term projection because of unexpected gains or losses in productivity, unanticipated changes in labor force participation, or higher or lower rates of national saving and capital formation.

A Resilient Economy

The U.S. economy has weathered recent increases in energy prices remarkably well. Those prices have doubled in the past two years, making energy more expensive compared with other goods and services and reducing the resources that consumers have available to pay for other things. In the past, such a large shift in relative prices resulted in costly adjustments for the economy—as happened with the energy price shocks of the 1973-1974 and 1979-1980 periods. The increase in energy prices relative to other prices since 2003 is roughly equivalent to those earlier shocks, but it does not appear to have significantly disrupted growth or increased core inflation. Real GDP continued to record solid gains in both 2004 and 2005, with annual growth exceeding 3.6 percent (measured on a fourth-quarter-to-fourth-quarter basis). Moreover, core consumer price inflation remained low in both years at 2.1 percent (measured on the same basis).

Analysts have suggested various reasons why the economy does not appear to have undergone major disruptions as a result of rising energy prices over the past two years. Those explanations include a service-oriented economy that uses less energy than in the past to produce a dollar of output, the presence of very high rates of productivity growth for several years, and a low-inflation environment. Nevertheless, considerable uncertainty remains about the causes of the recent resilience.

Increases in Energy Prices Since 2003

Strong worldwide demand and various supply problems boosted energy prices sharply in 2004 and 2005 (see Figure 2-1 on page 30). In December 2003, West Texas crude oil sold for $32.15 a barrel; in August 2005, it cost more than twice that—$64.97 a barrel. The hurricanes helped bring the price to a monthly peak of $65.57 in September, after which it declined to $59.43 a barrel by December. The rise in the price of crude oil since 2003 reflects pressures that were largely unrelated to last year's hurricanes—sharp increases in global demand in 2004 (especially by U.S. and Chinese consumers) and concerns about the sufficiency of global supplies (because of limited excess capacity in OPEC, investment problems in Russia, and lost oil production from Hurricane Ivan in 2004).

Gasoline prices generally followed world crude oil prices in 2004 and 2005. But closures of refineries and pipelines after the hurricanes caused gasoline prices to jump relative to oil prices, from about $2.50 a gallon in August 2005 to more than $3.00 a gallon for a short time in September. By November, however, the retail price of regular-grade gasoline had fallen to $2.34 a gallon. (By comparison, it was $1.49 a gallon at the end of 2003.)

Prices for natural gas delivered to major interstate pipelines have jumped even more over the past two years than crude oil prices have. Before the hurricanes, the price of natural gas rose mainly with domestic demand, especially demand by electric utilities. Despite high levels of exploration for natural gas, domestic production has had trouble keeping pace with demand, and opportunities for importing natural gas are limited. As with gasoline, the most recent price increases resulted mainly from hurricane-related supply losses. In the last quarter of 2003, the average price of natural gas (at the Henry Hub in Louisiana) was $5.22 per 1,000 cubic feet (mcf). In the fourth quarter of 2005, it averaged more than twice that—$12.57 per mcf. The average monthly price peaked at $13.77 per mcf in October 2005 (up from $9.71 in August), dipped close to its pre-Katrina level in November, then rebounded to $13.39 per mcf by the end of 2005.

Explanations for Continued Strong Economic Activity

At least two plausible explanations exist for why the growth of output has remained robust since 2003 despite the rise in energy prices. The two explanations are not mutually exclusive.

The first possibility is that economic activity would have been even stronger in the absence of the energy price increases. In other words, those increases merely brought growth down to more-normal rates of 3.5 percent to 4.0 percent. If energy prices had not risen, U.S. spending on oil imports during 2004 and 2005 would have been lower, and spending on domestically produced goods and services would have been greater. The additional spending could have added as much as half a percentage point to the growth of GDP in those years. That explanation

Box 2-1.

The Macroeconomic Effects of Hurricanes Katrina and Rita

Besides causing loss of life and property damage in the Gulf Coast region, Hurricanes Katrina and Rita disrupted economic activity outside the immediately affected area. Unlike previous storms, those hurricanes had a national effect because the destruction of facilities for energy extraction, processing, and shipping suddenly curtailed energy production and drove up prices. The storms probably slowed the real growth of gross domestic product (GDP) in the second half of 2005 by roughly half a percentage point. During the first half of 2006, GDP growth is likely to be boosted by a similar amount as energy production comes back online and rebuilding stimulates the economy.[1]

Regional Losses of Jobs, Capital Stock, and Energy Production

According to the Labor Department's unofficial tabulation of unemployment insurance claims, 570,000 or more people lost jobs at least temporarily because of the hurricanes. However, data on the number of people who received unemployment insurance suggest that many of those people either returned to their old jobs or found new employment within a few months. Total employment declined by about 250,000 jobs in the directly affected region between mid-August and mid-November—by about 220,000 jobs in Louisiana and about 30,000 in Mississippi.

The loss of physical capital from the storms was substantial. The Bureau of Economic Analysis estimates that more than $90 billion in damage occurred to private-sector structures and equipment—such as homes, office buildings, drilling rigs, manufacturing equipment, motor vehicles, and household durable goods. Damage to capital stock owned by local, state, and federal governments may have amounted to another $20 billion. Although rebuilding has begun in some areas, complete replacement of the lost capital stock could take three or more years.

Initially, Katrina halted all oil and gas production from the Gulf of Mexico, disrupted the operations of nearly 20 percent of the nation's refinery capacity, and closed oil and gas pipelines. Crude oil from the Gulf normally accounts for almost 30 percent of U.S. production (and 2 percent of world production); natural gas from the Gulf usually makes up 20 percent of the U.S. gas supply. Production was starting

1. The Congressional Budget Office issued preliminary analyses of the probable macroeconomic effects of the hurricanes on September 29, 2005, and October 6, 2005. This box reflects revised data since those analyses.

suggests that the rise in energy prices has already had the bulk of its impact on the rate of economic growth.

A second possibility is that many consumers adjusted to the price increases by reducing their saving rather than by cutting their purchases of nonenergy goods and services. That explanation suggests that the impact of higher energy prices may still be ahead, for the most part. Personal saving, which was close to 2 percent of personal disposable income in 2003 and 2004, seems likely to have been negative in 2005, meaning that consumers spent more than they earned, on average.[2] To the extent that energy prices remain high and consumers try to rebuild their savings more than CBO assumes, they may need to lower their future spending on nonenergy goods and services. Such an adjustment by consumers would slow growth below the levels that CBO projects, probably over several years.

Explanations for Continued Low Core Inflation

Driven by rising energy prices, the consumer price index increased by roughly 3½ percent in 2004 and 2005, compared with less than 2 percent in 2003 (on a fourth-quarter-to-fourth-quarter basis). The core rate of inflation rose from 1.2 percent in 2003 to 2.1 percent in 2004

2. That statement refers to income as measured in the national income and product accounts, which does not include items such as capital gains and distributions from pension plans and thus does not correspond to what many observers might consider income.

Box 2-1.

Continued

to recover after Katrina when Hurricane Rita caused another halt and even greater damage. At the end of 2005, roughly one-quarter of crude oil production and one-fifth of natural gas production from the Gulf remained shut down, and 2 percent of the nation's refinery capacity was still not operating.

National Economic Effects

Last year's hurricanes curtailed national GDP growth not only through direct losses in production in the affected areas but also through the impact of higher energy prices. Gasoline prices jumped to more than $3 a gallon, causing consumers to cut back on the amount of gasoline they bought and on other purchases as well. Some households could draw down savings or borrow to cover other purchases as they paid more for gasoline, but some households reduced their nonenergy spending. By November, gasoline prices had fallen back below prehurricane levels, but natural gas and electricity prices, as measured in the consumer price index for urban consumers (CPI-U), remained high. They are likely to constrain nonenergy spending moderately in the near future.

Primarily because of the spike in gasoline prices, the CPI-U jumped by 1.2 percentage points in September 2005—the largest one-month increase since 1980. Consumer prices for natural gas and electricity rose less sharply that month than gasoline prices did, but because of lags in passing cost increases on to consumers, they will continue to rise in early 2006. However, given the drop in gasoline prices since September and the likelihood that heating-fuel prices will decline somewhat, CPI-U inflation will be lower this year than in 2005.

Production losses in the Gulf region and nationwide because of the hurricanes were partly offset by increased private and government recovery and rebuilding efforts.[2] Nevertheless, the storms appear to have cut about half a percentage point from real GDP growth during the second half of 2005. If energy production and consumer spending largely recover by the middle of this year, and if the pace of investment spending picks up to replace even a small part of the destroyed capital stock by that time, GDP growth will bounce back. In essence, the storms will have shifted economic growth from the second half of 2005 to the first half of 2006.

2. For details about the effects of the 2005 hurricanes on the federal government's budget, see Appendix A.

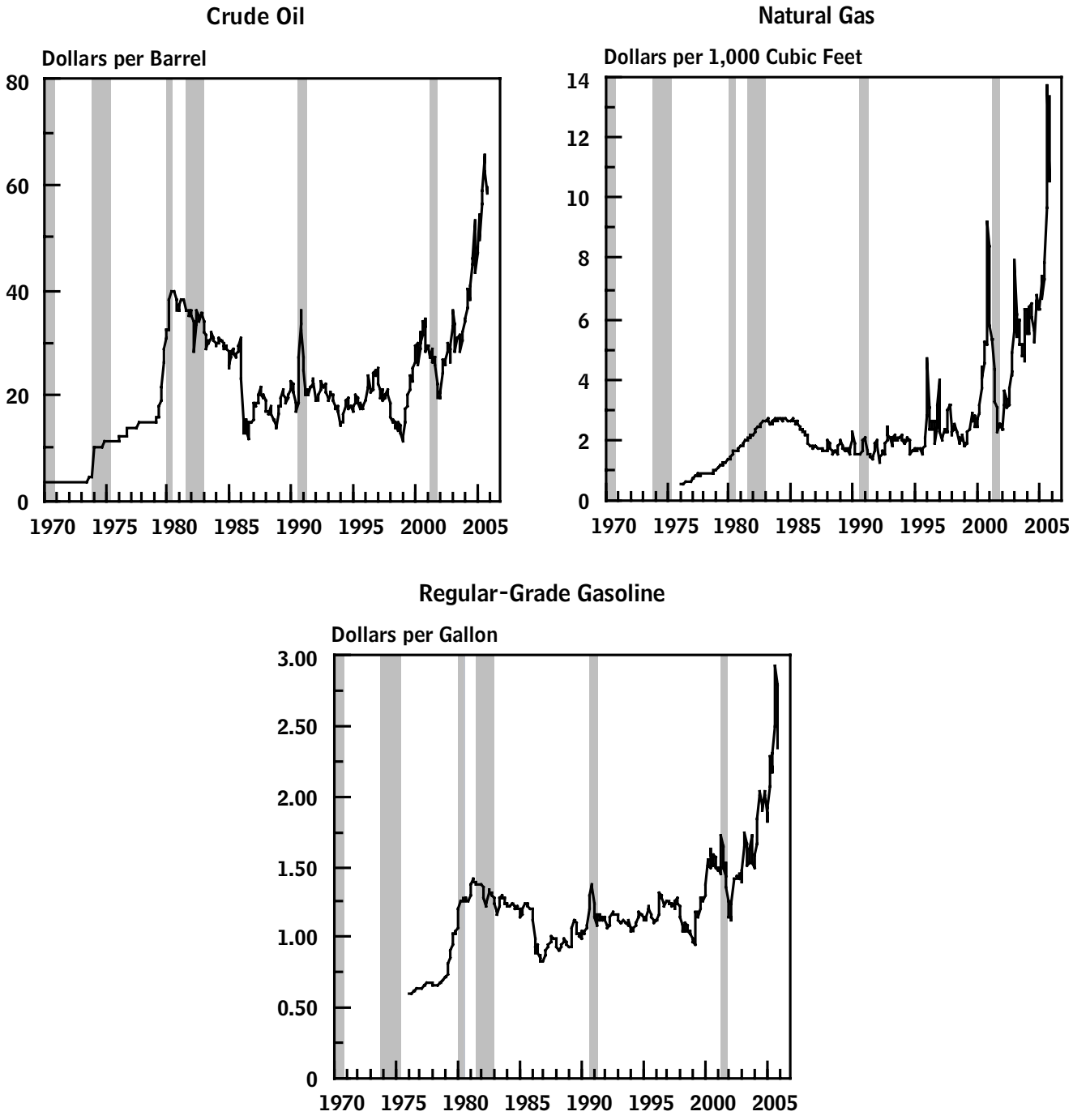
and 2005, but that increase was driven by shelter and used-car prices, which are not closely related to energy prices. One possible explanation for the absence of any apparent "pass-through" of energy prices to core inflation is that core inflation would otherwise have been much lower than the roughly 2.1 percent rate seen over the past two years.

Another possibility is that the relative increase in energy prices has been partly offset by lower growth in other prices, profit margins, or labor compensation. As consumers spent more of their income on energy, spending on nonenergy goods and services may have grown more slowly than would otherwise have been the case, reducing the growth of prices for those goods and services. The economic environment of recent years—including more global competition, a significant amount of excess capacity, and the Federal Reserve's success in fostering low expectations for inflation—has encouraged firms to respond to higher costs by trying to increase productivity growth rather than by raising prices. That environment, plus the limited amount of inflation indexing that exists in labor contracts, has also kept workers from immediately pushing for raises to match the growth of overall consumer prices.

If the economy remains vibrant, however—as CBO expects—some of the relative increase in energy prices is likely to show up in core measures of consumer inflation. That is one reason CBO is forecasting slightly higher core inflation for 2006 (measured from fourth quarter to fourth quarter).

Figure 2-1.

Prices of Crude Oil, Natural Gas, and Gasoline, 1970 to 2005



Sources: Congressional Budget Office; Department of Energy, Energy Information Administration; *Wall Street Journal.*

Note: The price of crude oil is for West Texas intermediate. Before 1982, it refers to the posted price; after 1982, it refers to the spot price. The price of natural gas refers to the wellhead price before May 1994 and the Henry Hub, LA, price (converted to dollars per 1,000 cubic feet) after that. The figures for oil and natural gas are scaled to show changes in comparable dollars per British thermal unit. The price of gasoline is the average retail price, including taxes, for regular unleaded. The final data points are $59.43 (December) for crude oil, $13.39 (December) for natural gas, and $2.34 (November) for gasoline.

The Economic Outlook Through 2007

CBO's economic forecast for 2006 and 2007 reflects its best judgments about short-term developments, including changes in the business cycle. In its projection for later years, by contrast, CBO does not forecast business-cycle movements.

Despite growth in energy prices and disruptions from the recent hurricanes, CBO expects the economy's momentum—which stems from healthy consumer spending and strong investment—to continue this year and next year. Much-higher-than-average growth of investment by businesses is expected to drive overall economic growth, offsetting a downturn in demand for residential investment. The nation's trade deficit is likely to stay near current levels. Core inflation is expected to remain low, despite some small increase during 2006. Interest rates are likely to rise in the first half of the year but are assumed to remain stable in the second half of 2006 and through 2007.

The Business Sector

Most decisions about investment and production are made in the business sector. Although business investment accounts for only about 11 percent of GDP, it varies more than do the other major components of total demand, and it usually dominates the pattern of economic growth in the near term.

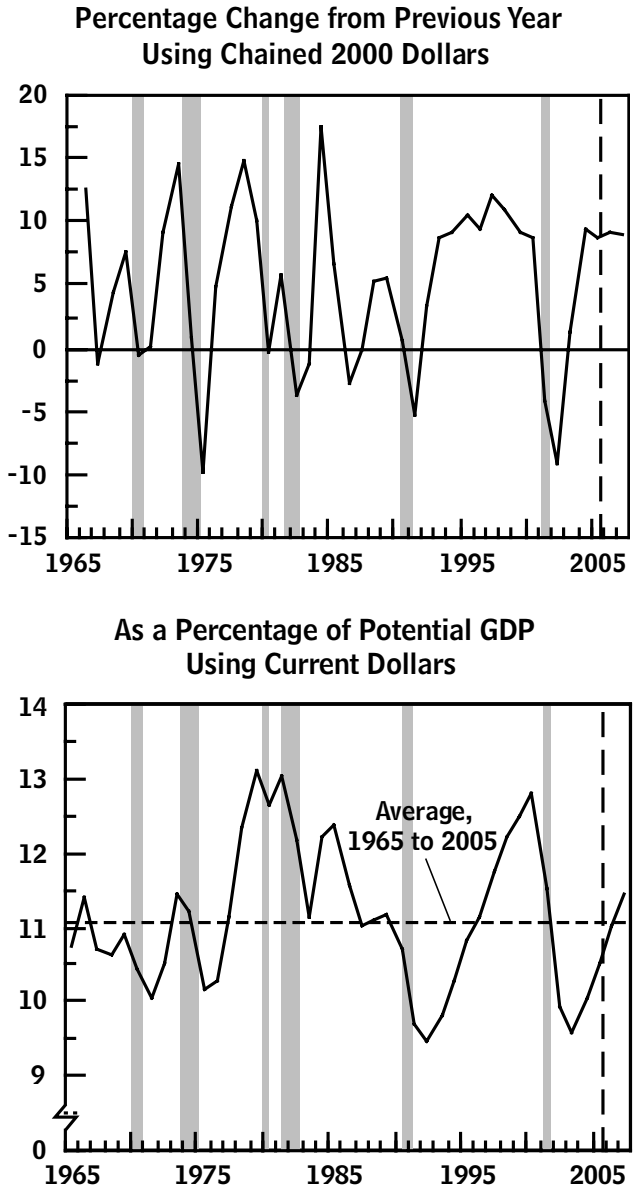
CBO expects that business investment will continue to boost growth. Although companies' spending on equipment, software, and structures—known as business fixed investment (BFI)—has increased rapidly in the past two years, more capacity will be needed to satisfy growing demand for goods and services. In addition, businesses' investment in inventories is likely to rebound after a weak showing in 2005.

Business Fixed Investment. Real BFI grew by roughly 9 percent in each of the past two years, and CBO forecasts similar growth for 2006 and 2007 (see Figure 2-2). The rebuilding of business capital after the 2005 hurricanes will add to investment this year. The pace of investment is likely to slow by 2008, however, as the capital stock expands relative to the total demand for goods and services.

The primary factor underlying CBO's forecast of strong growth in real BFI is that businesses need to increase their plant and equipment to satisfy rising demand for goods and services. They cannot meet that demand simply through gains in productivity—as they did from 2001 to 2003—because productivity is no longer growing at such an unusually rapid pace and demand is growing more quickly. Businesses have increased employment since 2003 to meet greater demand, but there are limits to how many workers they can hire before they need to expand

Figure 2-2.

Business Fixed Investment, 1965 to 2007



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

their investment in new plant and equipment beyond replacement levels. Because businesses adjust stocks of plant and equipment more slowly than they adjust employment, those stocks have not yet fully responded to the accelerated growth of demand in 2004 and 2005. That response is expected to continue in 2006 and 2007, leading to another two years of strong growth in investment. Moreover, even with the increases of the past two years, nominal BFI is still below its 1965-2005 average as a percentage of potential GDP, suggesting little reason for a slowdown.[3]

Rising capacity utilization is one factor supporting the view that current rates of investment are not yet sufficient to keep supply growing with demand. That rise is evident both in manufacturing and in vacancy rates at commercial and industrial buildings. Capacity utilization in manufacturing was higher in December 2005 than it had been a year earlier. Moreover, the national industrial availability rate—which measures the supply of space available in large industrial buildings—declined to 10.1 percent in the third quarter of 2005 from 11.2 percent a year earlier. And the national office vacancy rate fell to 14.4 percent in the third quarter of 2005 from 16.3 percent in the third quarter of 2004.[4]

In terms of the components of BFI, CBO expects some acceleration in the growth of structures relative to that of equipment and software. Because of the long lags between increased demand for goods and services, on the one hand, and investment in new structures, on the other hand, very little of the latter's eventual response to the more rapid growth of demand in recent years had occurred by the end of 2005. Most of that response is still to come. In addition, reconstruction in the aftermath of Hurricanes Katrina and Rita will add to construction spending.

Other factors that are likely to support increases in BFI are the recent growth of corporate profits and the relatively low real cost of funds for corporations in stock and bond markets. Economic profits rose by 12 percent in the first quarter of 2005 and by roughly 16 percent in the second and third quarters (measured from the corresponding quarter a year earlier).[5] In addition, corporations' real cost of funds—about 5 percent in the fourth quarter of 2005—was low both for recent years and for the period since 1970. CBO does not expect a significant increase in firms' real cost of funds over the next two years.

The main uncertainty about the outlook for business fixed investment is how fast the demand for goods and services will grow relative to the ability to produce them. Unexpected changes in domestic demand by consumers or in demand from abroad could cause investment to grow more or less quickly than CBO forecasts. A secondary risk is that financial markets' confidence will decline, causing stock market prices to fall and interest rates to rise and thus raising the cost of capital for businesses. Of course, investor confidence could increase rather than decline.

Business Inventories. CBO expects businesses to accumulate inventories more rapidly this year and next year than they did in 2005, reflecting continued strong growth in demand for goods and services. After increasing from $16 billion in 2003 to $52 billion in 2004 in real terms, inventory accumulation fell back to an estimated $18 billion in 2005, partly because of strong vehicle sales. The need to adjust overall stocks of inventories to higher sales should raise inventory accumulation in 2006 and 2007.

The Household Sector

The household sector accounts for the largest share of total demand for goods and services. Consumer spending by individuals and families currently amounts to 70 percent of GDP, and residential investment by households accounts for another 6 percent. Households also make decisions about how much to work and how much to invest in education and training in preparation for employment. Those decisions affect the potential output and productivity of the economy in ways similar to that of business investment.

The fundamental factors are in place for consumer spending to remain healthy in the near term. Those fac-

3. Potential GDP is the level of real gross domestic product that corresponds to a high level of resource (labor and capital) use.

4. The national industrial availability rate and the national office vacancy rate are reported by CB Richard Ellis, a private real estate service company.

5. Economic profits are corporate profits adjusted to remove distortions in depreciation allowances caused by tax rules and to exclude the effects of inflation on the value of inventories. They are considered a better measure of profits from current production than are the book profits reported by corporations.

tors include continuing momentum in the growth of employment and income, gains in households' net wealth, good financial health for households, and still-favorable borrowing conditions. The major risk to that positive outlook is that the housing market will weaken more than anticipated and thus temper the growth of consumer spending more than CBO forecasts.

Consumer Spending. Real consumer spending rose rapidly before last year's hurricanes, at an annual rate of almost 3¾ percent in 2003, 2004, and the first half of 2005. Because of weak vehicle sales in the fourth quarter and the spike in energy prices, that growth slowed to an estimated 2.4 percent annual pace in the second half of 2005, but it was still healthy for the year as a whole at 2.9 percent. The weakness in sales of vehicles and parts mostly resulted from a reduction in sales incentives in the fourth quarter; such incentives had contributed to a 15 percent increase in motor vehicle sales in the third quarter.

CBO forecasts that real consumer spending will grow at a 3½ percent rate this year and in 2007. The impact on consumer spending of hurricane-related increases in energy prices is expected to dissipate quickly this year as prices return to near their pre-Katrina levels.

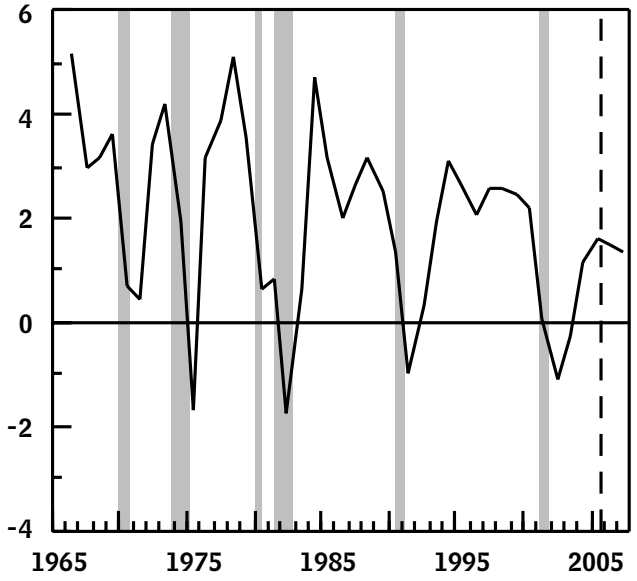
Labor Markets. Strong growth in output last year was accompanied by solid growth in employment: the U.S. economy added roughly 2 million new jobs in 2005. The hurricanes lowered the level of employment in the third and fourth quarters as businesses in the Gulf region were damaged or destroyed and workers had to relocate for an extended period. Outside the directly affected area, however, the labor market remains healthy. New claims for unemployment insurance, which surged for a few weeks because of the storms, have fallen below the prehurricane level of roughly 320,000 per week. Moreover, in the first half of 2006, new hiring related to reconstruction in the Gulf area is expected to offset some of the hurricane-related losses in employment.

CBO projects that total nonfarm payroll employment will grow by roughly 1½ percent over the four quarters of this year—about the same as in 2005—before slowing slightly in 2007 (see Figure 2-3). The unemployment rate is forecast to average 5.0 percent over the next two years—just above its current level of 4.9 percent but slightly below its projected long-term average rate of 5.2 percent. The labor force participation rate (the percentage of adults in the civilian, noninstitutionalized population who have jobs or are actively looking for them) fell from 67.1 percent in the 1997-2000 period to a low of 65.8 percent in early 2005 before rebounding to 66.0 percent by the end of last year. Nonetheless, the participation rate remains below the rate that would be consistent with an economy at full employment: about 66.5 percent, in CBO's estimate. As a result, CBO forecasts that the actual labor force will grow by 1.4 percent in 2006 (on a fourth-quarter-to-fourth-quarter basis)—further narrowing the gap between the actual and potential labor force—and will grow by 1.1 percent in 2007.[6]

Figure 2-3.

Nonfarm Payroll Employment, 1965 to 2007

(Percentage change from previous year)



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

Total labor compensation increased by 3.7 percent in 2005 in real terms, compared with 3.1 percent in 2004.[7] CBO projects significantly higher growth in 2006, but that rise includes a doubling of corporations' payments to their defined-benefit pension plans, which is required under current law (see Box 2-2 for details). Nevertheless,

6. The potential labor force is the actual labor force adjusted for movements in the business cycle.

7. Real total compensation is the sum of wages, salaries, and other labor income, deflated by the price index for personal consumption expenditures.

Box 2-2.

Contributions to Defined-Benefit Pension Plans

Between 2001 and 2004, private employers' contributions to defined-benefit pension plans tripled—from $36 billion to $108 billion—according to the national income and product accounts. Although such contributions appear to have declined slightly last year, the Congressional Budget Office (CBO) projects that under current law, they will rise sharply in 2006 to about $185 billion. Contributions have grown so much since 2001 because many defined-benefit plans have become underfunded, in some cases by substantial amounts—meaning that the value of their assets is currently insufficient to meet the plans' projected liabilities (the pensions owed to current workers and retirees and their survivors).[1]

One critical factor in determining a pension plan's liabilities is the interest rate, or discount rate, used to compute the present value of future payments (the value in today's dollars). The higher the discount rate, the lower the value of liabilities for future payments will be in today's dollars—and thus the smaller the possible degree of underfunding. According to the Employment Retirement Income Security Act of 1974 (ERISA), which set minimum standards for funding pension plans in private industry, the discount rate used to calculate liabilities must be no more than 105 percent of a weighted average of the interest rates on 30-year Treasury securities over the previous four years.

1. For details of how the underfunding situation arose, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2006 to 2015* (January 2005), Appendix D.

In recent years, however, lawmakers have enacted legislation to give firms that sponsor defined-benefit plans temporary relief from declining long-term interest rates. The Pension Funding Equity Act (PFEA) of 2004 stipulated that in 2004 and 2005, the maximum applicable discount rate would be higher than that specified under ERISA, thus lowering firms' contributions. One consequence of that temporary provision is that the gap between the values of the liabilities and assets of defined-benefit pension plans is now wider than it would be otherwise—meaning that companies' future contributions will probably have to be larger.

PFEA expired at the end of 2005. Under current law, the maximum applicable discount rate in 2006 will again be based on the yield on 30-year Treasury securities. Using that rate, about 5.15 percent, CBO projects that private employers' contributions to defined-benefit plans will have to roughly double this year to about $185 billion. (Had PFEA's discount-rate provision been extended for another year, the maximum applicable rate would have been about 5.75 percent, and contributions in 2006 would total about $135 billion).[2]

2. Both the House and Senate have passed legislation that would alter the defined-benefit pension system. (Those acts are H.R. 2830, the Pension Protection Act of 2005, and S. 1783, the Pension Security and Transparency Act of 2005.) If enacted, both versions would extend PFEA's discount-rate provisions through 2006 and phase in new rules for calculating required contributions beginning in 2007.

CBO also projects solid growth in real wages and salaries, which do not include employers' contributions to pension plans and other benefits.

Households' Financial Positions. Despite the risk that housing prices could decline significantly, most measures point to healthy finances for households. Net wealth—households' assets minus their liabilities—continued to rise faster than disposable personal income through the third quarter of 2005 (the latest data available). The ratio of net wealth to income reached 5.6 in that quarter, the highest level in more than four years and higher than for most of the past four decades (see Figure 2-4 on page 36). Much of that increase sprang from gains in real estate; stock market gains played a smaller role. Hurricane-related losses did not have a significant effect on the net-wealth-to-income ratio.

Box 2-2.

Continued

Although CBO is forecasting a large increase in defined-benefit contributions under current law, its current projection for 2006 is far lower than the $335 billion it projected in August 2005. The August forecast was based on a funding gap of about $600 billion for defined-benefit plans at the end of 2004, as reported by the Pension Benefit Guaranty Corporation (PBGC). That figure, however, reflected the concept of "termination liability"—the liability that applies when a pension plan is terminated and taken over by PBGC. By contrast, the basis for determining what, if any, catch-up payments are required for a plan is "current liability," which is essentially based on the number of active workers, retirees, and beneficiaries in the plan, their current pay rates, and their length of service.[3]

Analysis of company-level data indicates that the total underfunding of defined-benefit plans was about one-third the size on a current-liability basis as on a termination-liability basis through the middle of 2005. Given PBGC's updated estimate that the funding gap had grown to at least $650 billion by the end of fiscal year 2005, those calculations imply that on a current-liability basis, the funding gap is now approximately $215 billion (before taking into account changes in the discount rate). In addition, recent gains in the stock market that were larger than CBO anticipated in August have boosted the value of plans' assets, further reducing the contributions required in 2006.

CBO projects that private employers' contributions to defined-benefit plans will decline to about $162 billion in 2007, $140 billion in 2008, and $114 billion by 2010. They will rise gradually thereafter, reaching $136 billion by 2016. That pattern reflects a projected increase in the applicable discount rate under current law—to about 5.3 percent in 2007, 5.45 percent in 2008, and ultimately 5.7 percent in 2010—as well as a slowing in the rate at which liabilities are accrued (compared with the recent average). That slowdown results from freezes that many companies, including large corporations such as IBM and Verizon, have recently imposed on their defined-benefit pension plans. (When a plan is frozen, it does not accrue any further liabilities. However, many of the frozen plans have been replaced by new or enhanced defined-contribution plans.) In its forecast, CBO assumes that existing plans will continue to operate unless forced to default.

3. See Congressional Budget Office, *A Guide to Understanding the Pension Benefit Guaranty Corporation* (September 2005).

Gains in wealth and withdrawals of home equity helped boost consumer spending relative to personal disposable income in 2005, reducing the personal saving rate. Those withdrawals were spurred by continued gains in housing prices and low mortgage interest rates (by historical standards). Through the first three quarters of 2005, the personal saving rate was negative, on average, meaning that consumers were spending more than their disposable income. The saving rate is likely to have been negative through the entire year—the first time that has happened since the Depression. CBO expects that solid growth in real disposable personal income this year will permit both a rise in the personal saving rate and growth in consumer spending.

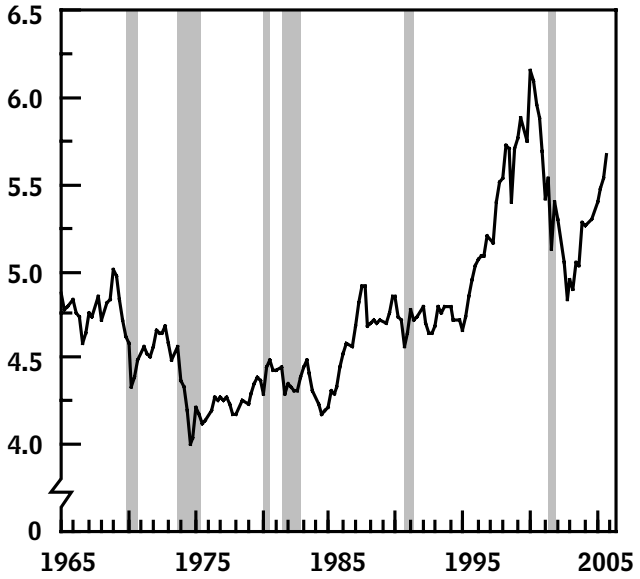
Continued large increases in mortgage debt contributed to a sharp rise in households' financial obligations last year. As a percentage of disposable personal income, those obligations rose to 18.6 percent by the third quarter of 2005 from 17.9 percent in the fourth quarter of 2004. Mortgage debt obligations might begin to put some restraint on consumer spending—depending on future increases in interest rates and housing prices—particularly through higher interest payments on adjustable-rate mortgages.

So far, households have had little trouble meeting their growing financial obligations, however. The delinquency rate on residential real estate loans at commercial banks

Figure 2-4.

Households' Net Wealth, 1965 to 2005

(Ratio to disposable personal income)



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

Note: Data are plotted through the third quarter of 2005.

changed little over the past year. The delinquency rate on credit card loans edged up recently, but it remained lower in the third quarter of last year than at any time in 2004. The rate on other (non-credit-card) consumer loans was at its lowest level in the third quarter of 2005 since 1991, when those data were first collected.

Housing. CBO expects the housing market to cool, resulting in a decline in housing investment this year and next year (see Figure 2-5). After rising by 7 percent in both 2004 and 2005, real residential investment will fall by about 5 percent in both 2006 and 2007 (measured on a fourth-quarter-to-fourth-quarter basis), CBO forecasts. That drop reflects concerns about a significant slowdown in the growth of housing prices and higher interest rates.

Although the housing market remains strong, it is showing some faint signs of weakening. Sales of new and existing single-family homes appear to be slowing, and mortgage applications are declining. However, data on housing prices do not yet indicate a cooling of the market on either a national or a regional basis.

Uncertainties. If housing prices begin to fall substantially and the drop becomes widespread enough to have a noticeable effect on households' net wealth, consumers are likely to reduce their spending plans. With less real estate wealth, households could decide to save more of their current income or to borrow less (including getting smaller home-equity loans). In either case, the growth of consumer spending could be slower than CBO projects.

Other factors could cause the growth of households' spending to be lower or higher than CBO forecasts. For example, a decline in consumer confidence could reverse post-hurricane gains and cause consumers to cut back, whereas an increase in consumer confidence would have the opposite effect. Likewise, unexpected growth in jobs and income or lower interest rates would boost consumer spending above CBO's expectations, whereas slower growth in employment and earnings or higher-than-expected interest rates would slow consumer spending.

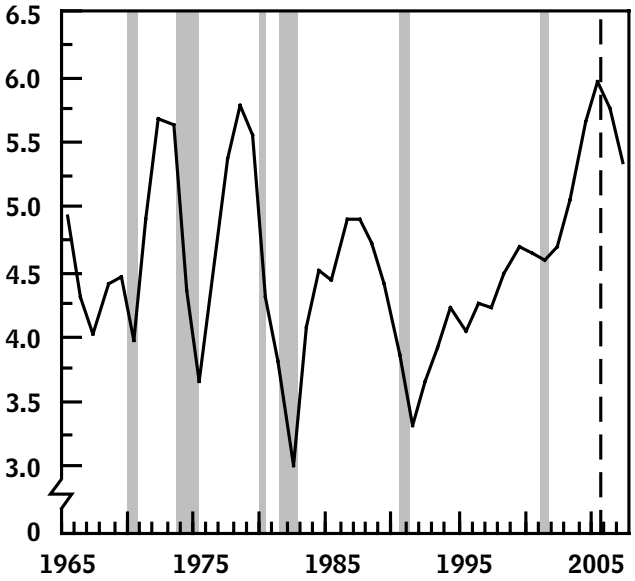
The Government Sector

The government sector also affects the total demand for goods and services. Purchases by the federal government currently account for about 7 percent of GDP, and state and local governments account for another 12 percent. In addition, government policies about taxes and spending

Figure 2-5.

Residential Investment, 1965 to 2007

(Percentage of potential gross domestic product)



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

influence the demand for goods and services by households and businesses.

Real purchases for current consumption and investment by all levels of government combined rose by about 2 percent in 2005, compared with an average of 3.1 percent for the post-World War II period. CBO projects that if current laws and policies do not change, such spending will grow by another 2 percent in 2006 and then slow in 2007. This year, rebuilding and related activities to recover from the recent hurricanes is expected to add to spending by all levels of government. In 2007, federal military purchases are expected to slow, under current law, reducing the growth of total purchases by the government sector. However, additional funds for defense could be appropriated later this year.

CBO's baseline projection of federal government purchases reflects recent appropriations for operations in Iraq and Afghanistan (and the extrapolation of such funding), which add about $33 billion to budget outlays in fiscal year 2006 and $46 billion in 2007, as well as recent appropriations for hurricane recovery, which add about $30 billion to outlays this year and $23 billion next year. The baseline does not include defense- or hurricane-related spending that might result from additional requests later in 2006. (For more details about CBO's projections of federal spending, see Chapters 1 and 3.)

At the state and local level, real gains in revenues have helped ease the budgetary pressures that most states and localities experienced in the aftermath of the 2001 recession. As a result, employment and investment by state and local governments grew more quickly last year. CBO expects those governments' spending to rise by roughly 2 percent in 2006 and 2007, in small part because of recovery efforts from last year's hurricanes.

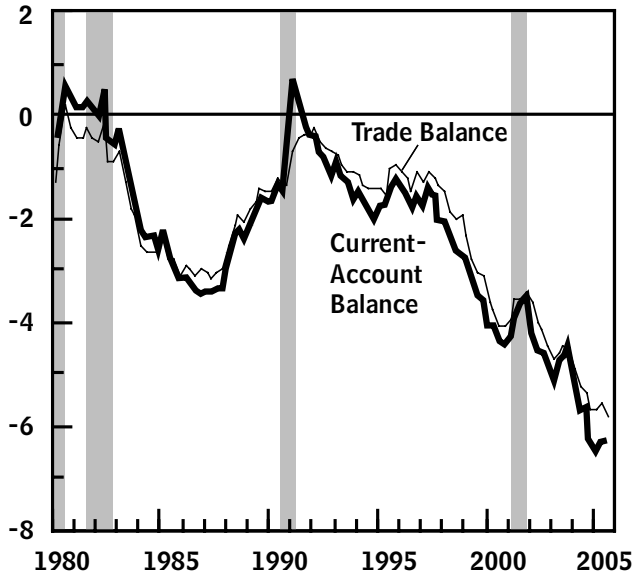
The International Sector

The U.S. trade deficit increased further during 2005, from an annual rate of $685 billion in the fourth quarter of 2004 to approximately $725 billion in the fourth quarter of last year. The nation's current-account deficit —the trade deficit plus net flows of investment income and unilateral transfers—also increased, from $753 billion to more than $800 billion. However, both deficits were stable relative to GDP (see Figure 2-6). CBO anticipates that the trade and current-account deficits will level off this year and then decline as a share of GDP over the medium term, if the value of the U.S. dollar resumes its downward trend and economic growth abroad remains relatively strong.

Figure 2-6.

The U.S. Trade and Current-Account Balances, 1980 to 2005

(Percentage of gross domestic product)



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

Note: Data are plotted through the third quarter of 2005.

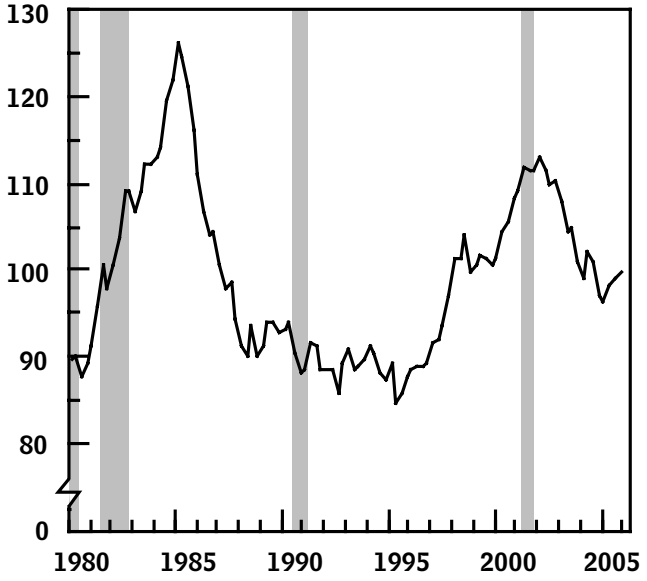
The Exchange Value of the Dollar. After declining by roughly 13 percent from the end of 2002 to the end of 2004, the real trade-weighted value of the dollar rose by 4 percent during 2005 (see Figure 2-7). Most of that gain reflected a 14 percent appreciation against the yen and about a 13 percent appreciation against the euro. Many analysts believe the large U.S. current-account deficit has put downward pressure on the dollar in recent years, so the strength of the dollar last year was generally unanticipated. It resulted from a number of factors, including a widening of the difference between short-term interest rates in the United States and those in Japan and the euro countries,[8] a surge in the demand for U.S. assets stemming from a rise in the oil revenues of oil-producing

8. In the past year, the Federal Reserve has raised the federal funds rate from 2.25 percent to 4.25 percent. By contrast, the European Central Bank has raised rates only once, to 2.25 percent, and Japan's interest rate has stayed near zero.

Figure 2-7.

The Real Trade-Weighted Value of the U.S. Dollar, 1980 to 2005

(Index, March 1973 = 100)



Sources: Congressional Budget Office; Federal Reserve Board.

Note: The real trade-weighted value of the U.S. dollar is a weighted average of the foreign exchange values of the dollar against the currencies of a large group of major U.S. trading partners, adjusted for relative inflation rates. The index weights, which change over time, are based on a country's share of U.S. imports and exports.

countries, and a temporary increase in the repatriation of overseas profits. Those effects are likely to weaken in 2006 and 2007.

CBO assumes that the current-account deficit—and the rapid accumulation of debt owed by the United States to foreign investors—cannot continue to grow faster than GDP over the long run. Although average economic growth among U.S. trading partners is likely to exceed growth in the United States over the next 10 years (partly because of economic growth in China), the current-account deficit is likely to stabilize during that period only if the dollar also trends downward.

For the United States to continuously run a current-account deficit of $800 billion, governments and private investors abroad must be able and willing to buy an additional $800 billion worth of dollar-denominated assets every year. How willing investors abroad will be to continue doing that is unknown. Their investment decisions will depend on their expectations about rates of return and the riskiness of dollar assets versus assets held in other currencies. CBO assumes that the exchange value of the dollar will decline gradually over the next 10 years because the current-account deficit will remain large in dollar terms (though not keep widening) and will add to the supply of dollar assets for investors. That decline in the value of the dollar, in turn, will help the current-account deficit shrink as a percentage of GDP.

Although CBO expects the dollar to depreciate over the next decade, a sharp depreciation is not likely. Risk-adjusted returns on assets in the United States are still higher than those in most other countries. Demand for dollar assets is also supported by the dollar's position as a major reserve currency used for international transactions. Some governments have an incentive to prevent the dollar from falling too sharply to minimize the potential damage to their own economies. In addition, some governments (such as those of Japan, China, South Korea, and Taiwan) have a limited ability to keep their exchange rates stable by buying—or at least not selling—dollar assets should the dollar fall rapidly. Finally, a decline in the dollar is unlikely to be self-reinforcing. The reason is that such a decline will not only help improve the ability of U.S. firms to compete profitably in world markets (and thus increase U.S. exports) but also enhance the dollar value of U.S.-owned assets abroad (and thus the net international asset position of the United States).

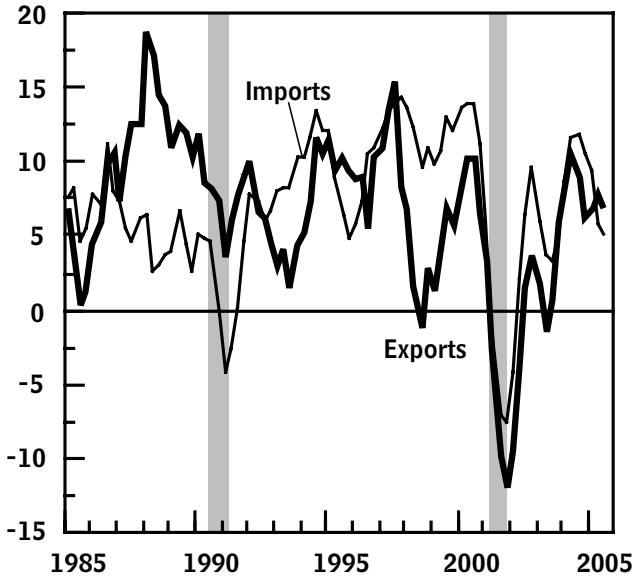
The Trade Deficit. The recent pattern in the growth of real exports and imports suggests that the trade deficit may be relatively stable in the near term. In a departure from the pattern of the past few years, the growth of U.S. exports (adjusted for price changes) recently surpassed the growth of imports (see Figure 2-8).[9] Both the overall decline in the dollar since 2002 and the solid growth, on average, of U.S. trading partners contributed to that turnaround. The fall in the dollar caused prices of U.S. exports in foreign-currency terms to ease during 2003 and remain relatively low, while contributing to a steady rise in the price of imports (even with oil imports

9. When imports are significantly larger than exports (as they are now), the trade deficit can still widen even if the growth of exports exceeds the growth of imports. In particular, since imports are about 1.5 times as large as exports, exports would have to grow 1.5 times as fast as imports merely to keep the trade deficit from widening.

Figure 2-8.

Real U.S. Exports and Imports, 1985 to 2005

(Percentage change from previous year)



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

Note: Data are plotted through the third quarter of 2005.

excluded). Although it often takes a few years for changes in relative prices to affect real exports and imports, those price changes since 2002 have encouraged the growth of real exports relative to the growth of imports. The recent rebound in the value of the dollar would undercut that pattern only if it persisted, but CBO anticipates that the dollar will resume depreciating.

Although real exports grew faster than real imports over the past year, the nominal trade deficit increased, largely because of petroleum imports. Those imports declined in quantity during the year, but their value increased by about $55 billion between the fourth quarter of 2004 and the third quarter of 2005. CBO expects relative stability in petroleum prices over the next two years to help stabilize the nominal trade deficit.

Economic Conditions and Prospects Abroad. The economies of the United States' major trading partners are continuing to gain strength. Still-accommodative macroeconomic policies and generally benign financial conditions have fostered more optimism that those nations will continue to recover from the worldwide slowdown of 2001. Nevertheless, growth in Japan and most countries of the euro zone is expected to remain slower than U.S. growth this year and in 2007.

Growth in Asia exceeds that in the rest of the world, and growth in China leads that in the rest of Asia. The Chinese economy continues to expand by more than 9 percent per year, and new data indicate that the economy was much larger in past years than previously reported. Japan's growth, though still subdued, is picking up more strength. The nation appears to have embarked on a self-sustaining path of economic growth, with domestic spending playing a stronger and more reliable role in upholding growth.

Among other U.S. trading partners, Canada and most Latin American countries are likely to keep experiencing healthy rates of economic growth, but growth in Europe is expected to remain lackluster. Real GDP in the euro zone increased more strongly than expected in the third quarter of 2005 (by 1.6 percent from a year ago), and recent indicators show signs that the recovery there is gaining more momentum. However, many obstacles to growth persist in the largest member countries (Germany, Italy, and France). *Consensus Forecasts*, a survey of financial and economic forecasters, expects that real GDP in the euro zone will continue to grow by less than 2 percent in 2006.[10]

Inflation

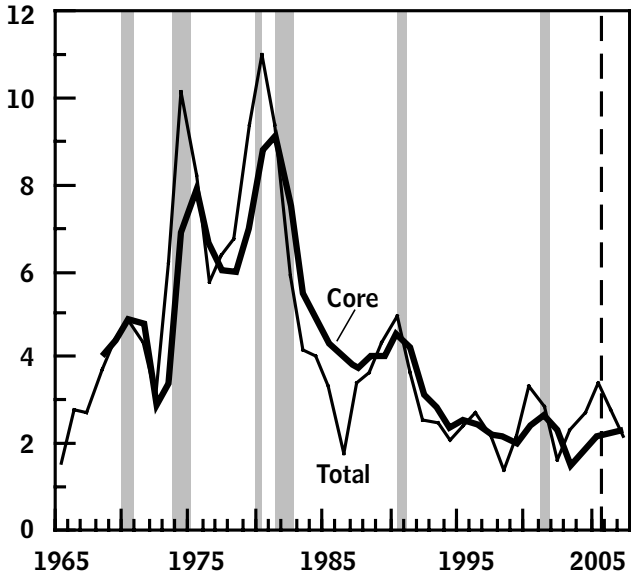
Overall, the prices that consumers pay for goods and services are expected to increase less this year and next year than they did in 2005. CBO forecasts that the change in the consumer price index for urban consumers (CPI-U) will slow to slightly more than 2 percent by 2007, compared with a 3.4 percent rise in 2005 (see Figure 2-9). In large part, the slower growth reflects a stabilizing of energy prices. Increases in the prices of goods and services excluding food and energy were somewhat weaker than expected in 2005. That core consumer inflation is forecast to edge up slightly this year as some of last year's increase in energy prices is reflected in nonenergy prices and as inflation accelerates for some categories of goods and services whose prices grew unusually slowly in 2005.

10. Consensus Economics, *Consensus Forecasts: A Digest of International Forecasts* (London: Consensus Economics, Inc., December 12, 2005).

Figure 2-9.

Total and Core Measures of the Consumer Price Index, 1965 to 2007

(Percentage change from previous year)



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

Notes: The core consumer price index is the consumer price index for all urban consumers (CPI-U) excluding food and energy. The figure uses the research series of the total and core CPI-Us, which approximately apply current methods for calculating the CPI-U to historical data.

Data are plotted through the third quarter of 2005.

Core Inflation and Energy Prices. The large rise in petroleum and natural gas prices since 2003 (relative to the prices of other goods and services) has been reflected in consumer prices for energy goods and services, such as gasoline and home heating. However, the pass-through of higher energy prices into higher prices for other consumer goods and services (which use energy as an input) is not readily apparent in data on prices through the end of 2005. Consumer prices excluding food and energy rose by just 2.1 percent in 2004 and 2005. If the energy price increases of those years had been passed through to the prices of other goods and services, core consumer inflation would have been higher.

It appears either that core inflation has been restrained by other factors affecting prices or that the energy price increases have been permanently or temporarily absorbed by the producers of other goods and services, or both. Inflation for some categories of the CPI-U eased unexpectedly in 2005, possibly for reasons unrelated to general price pressures. Those reasons may include greater competition in the market for apparel imports following a change in textile agreements in 2005, the effect of rising home prices on rental rates, or the impact of shifting financial market conditions on insurance rates or banks' charges to customers. In addition, it is possible that increases in energy prices have dampened the growth of profits and labor compensation for nonenergy businesses and that companies will try to raise prices in the future to cover their higher costs. Uncertainty about the extent of the pass-through of energy prices so far is a major source of uncertainty about the near-term outlook for consumer prices.

CBO's economic forecast assumes that the likelihood of a future pass-through of energy prices—combined with the probability of greater price growth for those categories of consumer spending that unexpectedly slowed in 2005—raises the chance that core inflation will be slightly higher this year than last year (measured on a fourth-quarter-to-fourth-quarter basis). By 2007, however, those pressures are no longer assumed to be adding to the core inflation rate. Thus, core CPI-U inflation is forecast to be about 2.2 percent in 2007 (measured on the same basis).

Uncertainties. Energy prices are a significant source of uncertainty in the forecast for inflation. There is uncertainty not only about a greater lagged effect of energy prices than CBO anticipates but also about whether another shock to energy supplies will occur in the next two years and whether global demand for energy will grow more strongly than expected. Further energy supply shocks could result from political turmoil in oil-producing countries or another round of severe hurricanes. A significant increase in global demand for energy (to the extent that it reflected demand outside the United States) could have effects on energy prices in the United States similar to those of a supply shock.

Another area of uncertainty is whether continuing strength in the growth of demand for goods and services will push up inflation as unused capacity shrinks. On the one hand, most measures do not indicate high levels of resource use in the economy. For example, the capacity utilization rate in manufacturing, which was 79.6 percent in December, is still below its historical average of 81.2 percent, a level near which inflation has tended to accelerate in the past. Moreover, although the economy has

posted two years of strong growth, the estimated gap between actual and potential GDP (as estimated by CBO) remains large because actual hours worked appear to be low for this point in the business cycle. That large GDP gap lessens the chance of a sudden increase in core inflation because of demand pressures.

On the other hand, the gap between the actual and natural rates of unemployment (unlike the GDP gap) suggests that little or no slack remains in the economy.[11] At 4.9 percent in December, the actual unemployment rate is below most current estimates of the natural rate.

The employment gap may not be a reliable indicator of slack in the labor market, however. Some analysts believe that estimates of the natural rate of unemployment are too high and should be lowered. Others believe that the concept of the natural rate is flawed and should be abandoned as a benchmark. Moreover, the actual unemployment rate may be an incomplete measure of conditions in labor markets. The rate of labor force participation still appears low, suggesting that there may be more slack in the labor market than the unemployment rate implies. In addition, average weekly hours of work—which are usually a fairly sensitive indicator of tightness in the labor market—have not rebounded as much as they usually do during an expansion (even adjusted for a shift in the composition of industries toward those with shorter-than-average workweeks).

Monetary Policy and Financial Market Conditions

Although the Federal Reserve has raised the federal funds rate significantly and steadily since mid-2004, conditions in financial markets last year were very supportive of real economic growth.[12] That support is likely to recede slightly this year if interest rates rise further, as CBO and other forecasters expect. With some additional increase in the federal funds rate by the Federal Reserve in the first half of this year, the interest rate on three-month Treasury bills is projected to rise to 4.5 percent in 2006. At the same time, the rate on 10-year Treasury notes is expected to increase to 5.2 percent. That upward movement in interest rates will widen the spread between the 10-year Treasury note and three-month Treasury bill rates from the level of mid-January, when the spread was very narrow. Both Treasury interest rates are expected to remain stable in the second half of 2006 and throughout 2007.

Monetary Policy. The Federal Reserve has continued to pursue its monetary policy of gradually raising its target for the federal funds rate until that rate reaches a level that neither adds to nor subtracts from economic growth and that keeps inflation low (a level commonly referred to as the neutral rate). At the end of 2005, the target federal funds rate was 4.25 percent, up from 2.25 percent at the end of 2004. Most participants in financial markets generally believe that the neutral federal funds rate lies somewhere between 4 percent and 5 percent. At the end of last year, the consensus of participants (as reflected in the futures market for federal funds) was that the Federal Reserve would increase the target rate to 4.75 percent by mid-2006 and possibly reduce it to 4.5 percent by mid-2007.

Financial Market Conditions. A broad index that measures the impact of monetary and financial conditions—including such factors as interest rates, stock market wealth, and the exchange rate—indicates that those conditions made a very positive contribution to the growth of real GDP last year (see Figure 2-10). However, increases in interest rates in the second half of the year made financial market conditions less favorable, though still accommodative to growth, at the end of 2005.

The interest rate on three-month Treasury bills rose from 3.0 percent to 3.9 percent between June and December last year, while the rate on 90-day commercial paper issued by nonfinancial corporations increased from 3.5 percent to 4.5 percent. Over the same period, the interest rate on 10-year Treasury notes rose by 0.5 percentage points to 4.5 percent, and the rate on AAA-rated corporate bonds increased by about 0.4 percentage points to 5.4 percent. The interest rate on conventional 30-year mortgages rose by about 0.7 percentage points to 6.3 percent. Even with the increases, however, those levels of long-term interest rates are still attractive to borrowers, compared with rates over the past 10 years.

Finally, stock market wealth has been a strong contributor to favorable financial conditions. Total domestic

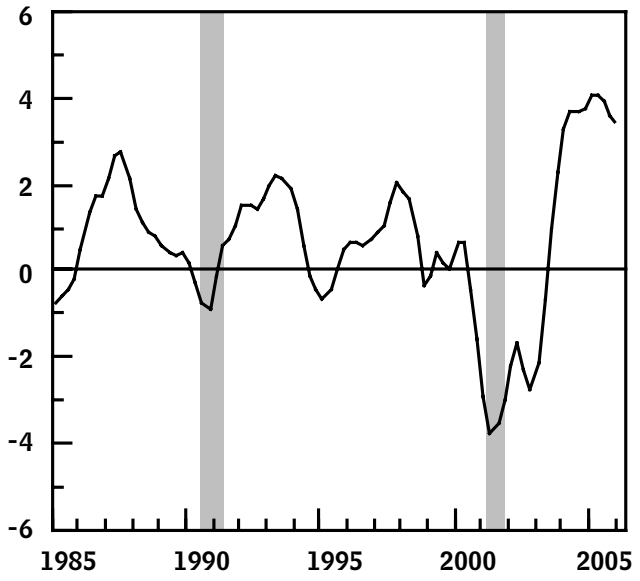
11. The natural rate of unemployment is the rate of unemployment arising from all sources except cyclical fluctuations in the demand for goods and services.

12. The federal funds rate is the interest rate that financial institutions charge each other for overnight loans of their monetary reserves at the Federal Reserve. The Federal Reserve implements monetary policy by setting a specified target level for the federal funds rate. A rise in that rate suggests a less accommodative stance of monetary policy, whereas a fall suggests a more accommodative stance.

Figure 2-10.

Index of Monetary and Financial Conditions, 1985 to 2005

(Percentage points of GDP growth)



Sources: Congressional Budget Office; Macroeconomic Advisers, LLC.

Note: This index estimates how much financial markets contribute to the growth rate of real gross domestic product (GDP). 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 it is negative, overall financial market conditions are a drag on growth.

holdings of U.S. corporate stock increased by $1.6 trillion between the end of 2003 and the third quarter of 2005, according to the Federal Reserve's flow-of-funds accounts.

The Spread Between Treasury Interest Rates. The difference between the interest rates on 10-year Treasury notes and three-month Treasury bills continued to narrow last year, declining to a level similar to that of the late 1990s (see Figure 2-11). Because that spread has been close to zero or even negative before every recession in the post-World War II era, the small spread at the end of 2005 raised some concerns that the economy was heading toward a slowdown.

The unusual way in which the spread has narrowed, however, may suggest that such concerns are premature and perhaps misplaced. In the past, the spread has typically narrowed because both the three-month and 10-year rates have risen but the three-month rate has risen more. In the past year and a half, however—for the first time since the early 1960s—the three-month rate has increased while the 10-year rate has not. In particular, the three-month Treasury bill rate grew from 1.1 percent in the second quarter of 2004 (just before the Federal Reserve began raising the federal funds rate) to 3.9 percent in the fourth quarter of 2005, while the 10-year Treasury note rate stayed basically unchanged at roughly 4½ percent.[13]

Observers have offered several explanations for why long-term Treasury rates have not moved up, none of which suggest that the chances of a recession in the next few years are significant:

- Large purchases of Treasury securities by governments and private investors abroad have presumably dampened the increase in Treasury and other long-term interest rates. According to the Federal Reserve's flow-of-funds data, investors from other countries added $177 billion in Treasury securities to their portfolios during the first three quarters of 2005—compared with the $196 billion increase in the stock of Treasury securities (excluding savings bonds) during that period. Those purchases reflect an excess of domestic saving over domestic investment in the rest of the world, including emerging economies. That excess saving appears to have arisen from a combination of factors, most notably insufficient demand for investment in many other industrial economies, some emerging countries' efforts to guard against future financial crises, and the sharp rise in revenues of oil-exporting nations.

- Increased demand for long-term Treasury securities by long-term investors such as insurance and pension funds may have played a role, but estimates of the amounts added by those investors (only $18 billion in the first three quarters of 2005) seem too small to have had much effect on interest rates.

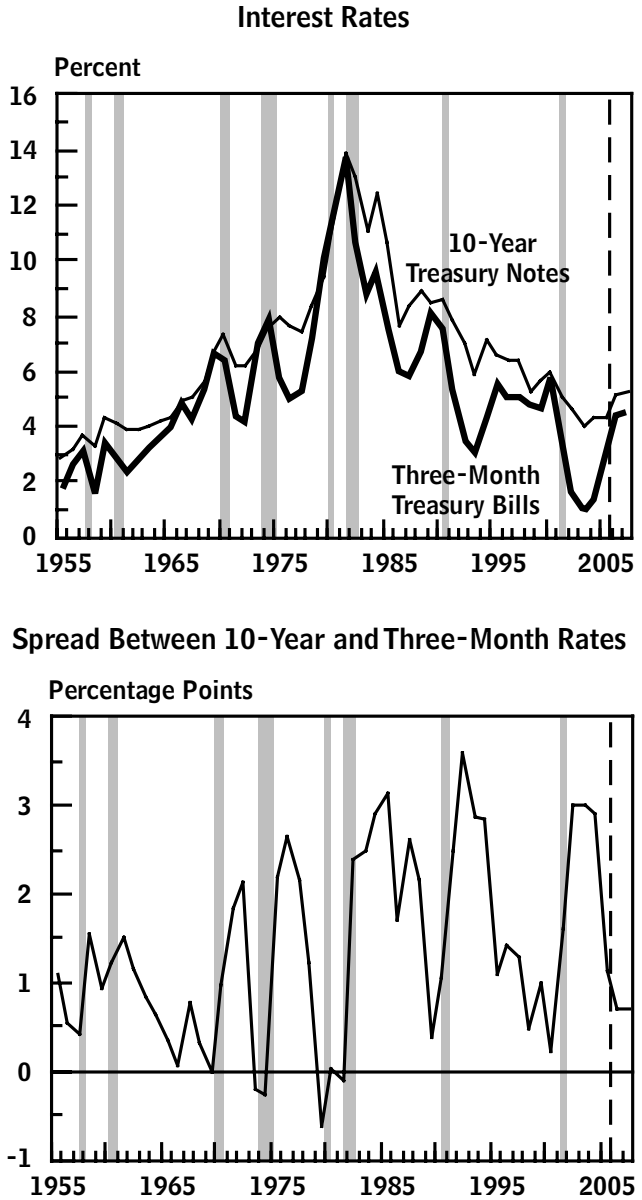
- Investors' confidence in continued low inflation may have grown, thus reducing the risk premium that investors demand in return for holding long-term Treasury securities.

13. In mid-January, the three-month Treasury bill rate was 4.2 percent, and the 10-year Treasury note rate was 4.4 percent.

- Some observers believe that the addition of China, India, and countries of the former Soviet Union to the world marketplace has had favorable effects on productive capacity and inflation in the United States, thus reducing the risk premium in rates on Treasury securities.

Figure 2-11.

Three-Month and Ten-Year Treasury Interest Rates, 1955 to 2007



Sources: Congressional Budget Office; Federal Reserve Board.

- People may expect that the U.S. economy will eventually slow more than CBO anticipates. The consensus of economists recently polled by the *Wall Street Journal* is that growth will slow to 3¼ percent in 2006 and inflation will decline.[14]

The Economic Outlook Through 2016

To develop its medium-term projections—which this year cover 2008 through 2016—CBO projects levels and rates for the factors that underlie potential GDP, such as the growth of the labor force, capital services (the productive services provided by the economy's existing stock of physical assets), and productivity. CBO takes into account the effect that current fiscal policy may have on those factors, but it does not forecast fluctuations in the business cycle beyond the next two years.

CBO projects that real GDP will grow slightly faster than potential GDP during the 2008-2016 period—at a rate are very similar to what CBO projected in August 2005. In addition, inflation (as measured by the CPI-U) averages 2.2 percent in the current medium-term projection, and the unemployment rate averages 5.2 percent, equal to CBO's estimate of the natural rate of unemployment. Interest rates during the 2008-2016 period are projected to average 4.4 percent for three-month Treasury bills and 5.2 percent for 10-year Treasury notes.

Potential GDP

Potential output will grow at an average rate of 2.8 percent annually between 2006 and 2016, CBO projects (see Table 2-2). That rate is about 0.6 percentage points lower than the historical average growth rate of 3.4 percent. The primary reason for the difference is that CBO is anticipating a sharp slowdown in the growth of the potential labor force.

Whereas the potential labor force has expanded by 1.6 percent per year, on average, since 1950, CBO projects that it will grow at an average annual rate of just 0.7 percent through 2016 (roughly the same rate as in CBO's August 2005 economic projection). The slower pace stems from CBO's expectation that labor force participation will decline sharply during the next decade, mainly

14. Rafael Gerena-Morales and Tim Annett, "Growth May Slow in 2006 as Market for Housing Cools," *Wall Street Journal*, January 3, 2006, p. 1.

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	1991-1995	1996-2005	Total, 1950-2005	2006-2011	2012-2016	Total, 2006-2016
Overall Economy									
Potential Output	3.9	3.3	3.0	2.7	3.3	3.4	3.1	2.6	2.8
Potential Labor Force	1.6	2.5	1.6	1.2	1.2	1.6	0.9	0.5	0.7
Potential Labor Force Productivity[a]	2.3	0.8	1.4	1.5	2.1	1.8	2.1	2.1	2.1
Nonfarm Business Sector									
Potential Output	4.0	3.6	3.1	3.1	3.8	3.7	3.4	2.9	3.2
Potential Hours Worked	1.4	2.4	1.5	1.2	1.2	1.5	0.9	0.6	0.8
Capital Input	3.8	4.3	4.1	2.7	4.4	3.9	4.6	3.6	4.1
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	*	0.3	0.1	0.1	0.1	0.1
Price measurement[b]	0	0	0	*	0.1	*	0.1	0.1	0.1
Temporary adjustment[c]	0	0	0	0	0.2	*	0	0	0
Contributions to the Growth of Potential Output (Percentage points)									
Potential hours worked	1.0	1.7	1.0	0.9	0.9	1.0	0.7	0.4	0.5
Capital input	1.1	1.3	1.2	0.8	1.3	1.2	1.4	1.1	1.2
Potential TFP	1.9	0.7	0.9	1.3	1.6	1.4	1.4	1.4	1.4
Total Contributions	4.0	3.7	3.1	3.0	3.8	3.7	3.5	2.9	3.2
Memorandum:									
Potential Labor Productivity in the Nonfarm Business Sector[d]	2.6	1.2	1.6	1.8	2.5	2.2	2.5	2.3	2.4

Source: Congressional Budget Office.

Note: TFP = total factor productivity; * = 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 price index.

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

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

because the large cohort of workers born during the postwar baby boom will begin to retire. Other factors are also projected to slow the growth of the potential labor force during the 2008-2016 period:

- The rate of men's participation in the labor force is likely to continue its downward trend;
- Women are not expected to increase their rate of participation as much as they did in the past; and
- Tax provisions enacted in 2001 and 2003 are scheduled to expire in 2011, which will raise the marginal tax rate on labor by roughly 1.5 percentage points, thus lessening the incentive to work.

Unlike the potential labor force, the capital stock and productivity are projected to grow over the next 10 years at rates that approximate their historical averages. CBO estimates that the growth in capital services (services derived from the use of the capital stock) will average 4.1

percent a year through 2016. That rate is similar to the average pace since 1950—3.9 percent—and is almost identical to the estimate in CBO's August projection, although the pattern of growth differs from the previous projection. Growth in capital services is slightly slower during the first two years of the 10-year projection, and slightly faster during the remaining years, relative to the growth rates that CBO assumed in August.

Potential total factor productivity (TFP) will grow at an average annual rate of 1.4 percent over the next 10 years, CBO projects.[15] That rate—which is nearly identical both to the historical average and to the rate that CBO projected last August—results from two offsetting changes since the August estimate. First, revisions to the national income and product accounts (NIPAs) released by the Bureau of Economic Analysis in August revealed that the growth of TFP during the past three years was sharply lower than had been previously thought. According to the data available last summer, TFP grew at an average annual rate of 3.2 percent between the beginning of 2002 and the first quarter of 2005; according to the most recent data, the growth rate was 2.9 percent. By itself, that change would tend to lower CBO's projection of potential TFP. However, data since August indicate that total factor productivity grew strongly in the second and third quarters of 2005; the addition of those data improve the outlook for potential TFP, in large part offsetting the effects of the NIPA revision.

Inflation and Interest Rates

CBO projects that inflation, as measured by the CPI-U, will average 2.2 percent a year during the 2008-2016 period and that the GDP price index will grow at an average annual rate of 1.8 percent. Both rates are unchanged from CBO's August projection. In general, CBO assumes that the Federal Reserve's monetary policy will result in a rate of core CPI-U inflation that averages between 2 percent and 2½ percent.[16]

CBO's projection for interest rates in the medium term reflect its projections for inflation and for real (inflation-adjusted) interest rates. Between 2008 and 2016, the rate on three-month Treasury bills will average 4.4 percent, CBO projects, and the rate on 10-year Treasury notes will average 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 over that period, and the real rate on 10-year Treasury notes will average 3.0 percent. The current projection for the real 10-year Treasury rate is about 0.2 percentage points below the level that CBO projected in August, bringing it in line with the consensus of private-sector forecasters.

Types of Income Important for Revenue Projections

The portions of CBO's economic projections that most directly affect the outlook for federal revenues are the projections of various categories of income as measured in the NIPAs: specifically, wages and salaries, corporate profits, proprietors' income, and personal interest and dividend income. Although those income categories do not directly correspond to the income on which tax liabilities are based, projections of them are important for the projection of revenues. (CBO's outlook for revenues is described in Chapter 4.)

NIPA income categories are projected as shares of GDP. Broadly speaking, GDP can be divided into a share that goes to labor and a share that goes to capital. Labor's share is the sum of wages and salaries, payments made by employers on behalf of workers (such as the employer's portion of health insurance premiums and contributions to pension funds, as well as payroll taxes for Social Security and Medicare), and about 70 percent of the income of proprietors.[17] The rest of GDP is capital's share. The shares attributable to labor and capital have varied since World War II, averaging 62.7 percent of GDP for labor and 37.3 percent for capital.

15. Total factor productivity is the average real output per unit of combined labor and capital inputs. The growth of TFP is defined as the growth of real output that is not explained by the growth of labor and capital.

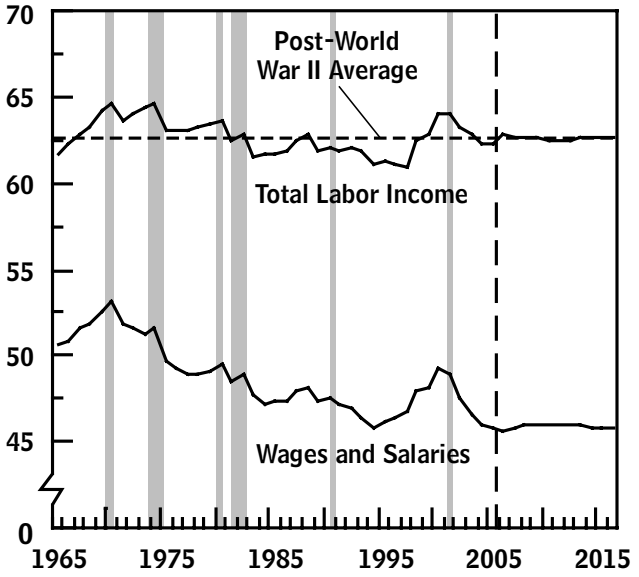
16. An alternative measure of inflation can be computed using the price index for personal consumption expenditures (PCE). The Federal Reserve uses that measure in its projections of inflation. Growth of the PCE price index is likely to be about one-quarter of a percentage point lower, on average, than growth of the CPI-U during the next 10 years.

17. How much of the income earned by proprietors represents a return on capital (the equipment and structures that self-employed workers use) and how much represents a return on labor is unclear. However, 70 percent of total proprietors' income is generally assumed to be the return on labor. See, for example, Douglas Gollin, "Getting Income Shares Right," *Journal of Political Economy*, vol. 110, no. 2 (April 2002), pp. 458-474.

Figure 2-12.

Labor Income and Wages and Salaries, 1965 to 2016

(Percentage of gross domestic product)



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

The single most important category of income for revenue projections is wages and salaries. They form the tax base for social insurance payroll taxes and are the largest component of the tax base for individual income taxes. CBO projects that wages and salaries will edge up from an estimated 45.8 percent of GDP last year to 46.0 percent in 2009 and then decline slightly as the share of compensation paid in the form of benefits increases. That projection is based on the assumption that total labor income will move upward to its postwar average share of GDP (see Figure 2-12). Labor compensation as a percentage of GDP will rise slightly in the near term, CBO projects, consistent with the low anticipated unemployment rate. Part of that increase stems from employer-paid benefits, such as the projected rise in contributions for defined-benefit pensions under current law (see Box 2-2 on page 34).

Corporate book profits are expected to decline in 2006 and 2007 because of an increase in depreciation charges against income, a rise in companies' defined-benefit contributions, and a decline in net capital income from abroad as a percentage of GDP.

CBO assumes that depreciation for tax purposes will increase between 2005 and 2007 because the low level of depreciation in 2005 resulted from the expiration of partial-expensing provisions enacted in 2002 and 2003. Those provisions allowed firms to shift some of the depreciation of their capital expenditures from 2005 and beyond back to 2001 through 2004. That shift kept book profits low in those years, but profits jumped in 2005 when the provisions expired. As depreciation for tax purposes returns to normal levels, book profits will decline as a share of GDP.

Changes in the Economic Outlook Since August 2005 and Their Implications for Budget Projections

Recent changes to CBO's economic forecast have increased revenue projections and reduced spending projections. (The specific revisions to the budget outlook that can be attributed to changes in the economic forecast are described in more detail in Appendix B).[18]

Many of the changes in the economic forecast stem from two factors: recent revisions to the NIPAs and the spurt in inflation that occurred during the second half of 2005. The growth rate of real GDP projected for 2006 to 2015 is virtually the same now as it was in August, but the projected level of real GDP is slightly lower because recent data on real GDP were revised downward after CBO completed its August forecast. However, that revision increased the level of nominal GDP in early 2005—which, together with recent higher inflation, caused CBO to raise its projection of the dollar level of nominal GDP through 2016. The growth rate of nominal GDP, by contrast, has changed little for 2007 and beyond (see Figure 2-13).

In dollar terms, all of the income tax bases that drive revenue projections are higher in the current forecast after 2006 because of the higher levels of nominal GDP. Corporate profits are higher for other reasons as well:

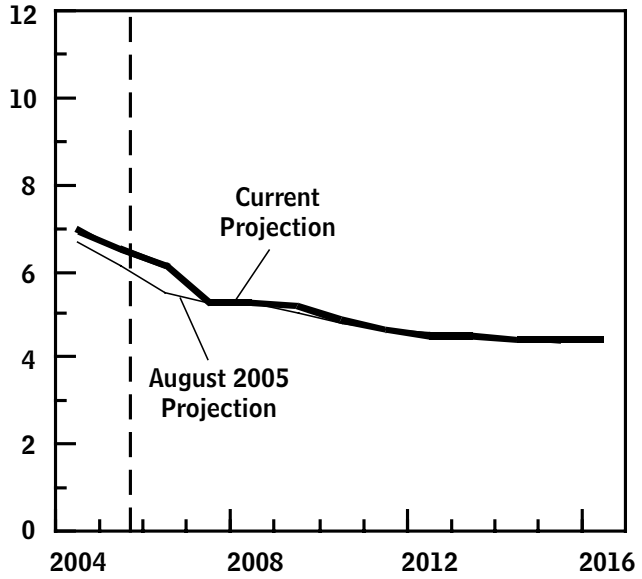
- The NIPA revisions substantially increased corporate book profits as share of GDP in early 2005;

18. Changes in the macroeconomic outlook are only one factor that alters the outlook for the budget. New legislation and other, so-called technical changes also affect the budget outlook.

Figure 2-13.

Current and Previous Projections of the Growth of Nominal Gross Domestic Product, 2004 to 2016

(Percentage change from previous year)



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

- By reducing the shares of GDP attributed to businesses' interest payments and proprietors' income, the revisions also indicated that corporate profits will tend to have a higher share of GDP throughout the projection period; and
- CBO lowered its estimate of companies' required contributions to defined-benefit pension plans in the near term (see Box 2-2 on page 34).

Compared with the August forecast, the current forecast anticipates higher interest rates in 2006, about the same rates in 2007, and lower rates thereafter (see Table 2-3). Those lower rates bring CBO's projection of real long-term interest rates close to the average of private-sector forecasts. The lower interest rates in turn reduce projected outlays by decreasing the interest costs of servicing federal debt.

Conversely, the current forecast's higher rates of CPI-U and GDP inflation in 2006 raise projected outlays by increasing cost-of-living adjustments and inflation indexing in various federal programs for fiscal year 2006. CBO's projections of inflation in later years have not changed, but the higher spending levels from cost-of-living adjustments and inflation indexing in the near term are built into the levels for certain mandatory programs for the rest of the projection period.

Comparison with Other Forecasts

CBO's economic forecast differs in some ways from those of the Administration and the *Blue Chip* consensus of about 50 private-sector forecasters (see Table 2-4). In general, however, those differences are not large.

Compared with the Administration, CBO expects a higher level of real growth and less inflation during 2006 and 2007 but the same unemployment rate. CBO also anticipates more real growth, less inflation, and slightly higher rates of unemployment than does the *Blue Chip* consensus forecast. CBO's estimate of interest rates on three-month Treasury bills is higher than the Administration's for both years, as is its estimate of the rate on 10-year Treasury notes in 2006. By contrast, CBO expects a lower interest rate on 10-year notes in 2007 than the Administration does. CBO's forecast of the interest rate on 10-year Treasury notes is higher than the *Blue Chip* consensus for both years, but its estimate of the rate on three-month Treasury bills is the same.

For the 2008-2011 period, CBO and the Administration both project that real GDP will grow at an average annual rate of 3.1 percent, but CBO projects lower inflation and a higher unemployment rate. (The *Blue Chip* consensus forecast does not extend past 2007.) CBO's projection of the average interest rate on three-month Treasury bills over the 2008-2011 period is slightly higher than the Administration's, but its projection of the rate on 10-year Treasury notes is 0.4 percentage points lower.

Table 2-3.

CBO's Current and Previous Economic Projections for Calendar Years 2005 to 2015

	Estimated	Forecast		Projected Annual Average	
	2005	2006	2007	2008-2011	2012-2015
Nominal GDP (Billions of dollars)					
January 2006	12,494	13,262	13,959	16,954 [a]	20,178 [b]
August 2005	12,450	13,137	13,832	16,768 [a]	19,946 [b]
Nominal GDP (Percentage change)					
January 2006	6.5	6.1	5.3	5.0	4.4
August 2005	6.1	5.5	5.3	4.9	4.4
Real GDP (Percentage change)					
January 2006	3.6	3.6	3.4	3.1	2.6
August 2005	3.7	3.4	3.4	3.1	2.6
GDP Price Index (Percentage change)					
January 2006	2.7	2.4	1.8	1.8	1.8
August 2005	2.3	2.0	1.8	1.8	1.8
Consumer Price Index[c] (Percentage change)					
January 2006	3.4	2.8	2.2	2.2	2.2
August 2005	3.1	2.5	2.2	2.2	2.2
Unemployment Rate (Percent)					
January 2006	5.1	5.0	5.0	5.2	5.2
August 2005	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)					
January 2006	3.2	4.5	4.5	4.4	4.4
August 2005	3.0	3.7	4.4	4.7	4.7
Ten-Year Treasury Note Rate (Percent)					
January 2006	4.3	5.1	5.2	5.2	5.2
August 2005	4.3	4.7	5.3	5.4	5.4
Tax Bases (Billions of dollars)					
Corporate book profits					
January 2006	1,434	1,451	1,438	1,555 [a]	1,818 [b]
August 2005	1,308	1,158	1,181	1,389 [a]	1,655 [b]
Wages and salaries					
January 2006	5,723	6,050	6,383	7,785 [a]	9,246 [b]
August 2005	5,750	6,055	6,366	7,705 [a]	9,132 [b]
Tax Bases (Percentage of GDP)					
Corporate book profits					
January 2006	11.5	10.9	10.3	9.4	9.0
August 2005	10.5	8.8	8.5	8.3	8.3
Wages and salaries					
January 2006	45.8	45.6	45.7	45.9	45.9
August 2005	46.2	46.1	46.0	46.0	45.9
Memorandum:					
Real Potential GDP (Percentage change)					
January 2006	3.0	3.2	3.2	3.0	2.6
August 2005	3.2	3.3	3.3	3.0	2.6

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

Note: Percentage changes are year over year.

a. Level in 2011.

b. Level in 2015.

c. The consumer price index for all urban consumers.

Table 2-4.

Comparison of CBO, Administration, and *Blue Chip* Economic Forecasts for Calendar Years 2006 to 2011

	Estimated 2005	Forecast 2006	Forecast 2007	Projected Annual Average, 2008-2011
		Fourth Quarter to Fourth Quarter (Percentage Change)		
Nominal GDP				
CBO	6.7	5.6	5.2	4.9
Administration	6.4	5.6	5.6	5.3
Blue Chip consensus	6.6	5.6	5.3	n.a.
Real GDP				
CBO	3.6	3.6	3.4	3.1
Administration	3.5	3.4	3.3	3.1
Blue Chip consensus	3.6	3.3	3.1	n.a.
GDP Price Index				
CBO	2.9	2.0	1.8	1.8
Administration	2.8	2.2	2.2	2.1
Blue Chip consensus	2.9	2.2	2.2	n.a.
Consumer Price Index[a]				
CBO	3.7	2.1	2.2	2.2
Administration	3.8	2.4	2.4	2.4
Blue Chip consensus	3.8	2.2	2.4	n.a.
		Calendar Year Average (Percent)		
Unemployment Rate				
CBO	5.1	5.0	5.0	5.2
Administration	5.1	5.0	5.0	5.0
Blue Chip consensus	5.1	4.9	4.9	n.a.
Three-Month Treasury Bill Rate				
CBO	3.2	4.5	4.5	4.4
Administration	3.2	4.2	4.2	4.3
Blue Chip consensus	3.2	4.5	4.5	n.a.
Ten-Year Treasury Note Rate				
CBO	4.3	5.1	5.2	5.2
Administration	4.3	5.0	5.4	5.6
Blue Chip consensus	4.3	4.9	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, 2005); Council of Economic Advisers, Department of the Treasury, and Office of Management and Budget, "Administration Economic Forecast" (joint press release, December 1, 2005).

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 2007.

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 $902 billion—the amount provided thus far for fiscal year 2006—outlays this year would exceed $2.6 trillion (see Table 3-1). Spending would grow by $177 billion—a 7.2 percent increase over the total in 2005 (see Table 3-2). As discussed in Chapter 1, those estimates do not include the effects of legislation pending at the end of December 2005 or of any other future legislation, except as specified by law.[1] Outlays for 2006 are likely to be between $20 billion and $25 billion higher once additional funding is provided for ongoing operations in Iraq and Afghanistan and for further payments of flood insurance claims resulting from the recent hurricanes. The pending reconciliation bill—if enacted—would reduce spending by about $5 billion this year, CBO estimates.

Total spending rose by 7.8 percent in 2005, resulting from double-digit growth in outlays for net interest (14.8 percent) and for Medicare (12.0 percent). CBO projects even higher growth in those areas for 2006—about 18 percent for net interest and 17 percent for Medicare. Net interest is currently the fastest-growing category of spending in the federal budget, spurred on both by accumulating debt and rising interest rates. Rapidly rising health care costs continue to drive up Medicare outlays. In addition, those outlays will grow significantly in the short term as the new prescription drug benefit takes effect and, in later years, as the leading edge of the baby-boom generation becomes eligible for benefits.

Under current law, spending is projected to grow somewhat faster than the economy in 2006: as a percentage of gross domestic product, total outlays will rise to 20.3 percent, up from 20.1 percent in 2005. At that level, federal spending will be close to its long-run average (from 1965 to 2005) of 20.5 percent of GDP. In subsequent years, spending is projected to grow more slowly than the economy until 2012; after that year, growth in spending will outstrip growth in GDP. As a result, CBO estimates that—under baseline assumptions—spending as a percentage of GDP will fall to 19.1 percent in 2012 before rising to 19.4 percent by 2016.

In CBO's baseline, discretionary outlays, which grew by an average of 5.2 percent annually from 1994 to 2004 and by 8.1 percent last year, increase at an average annual rate of just 2.0 percent from 2006 to 2016. In contrast, mandatory spending is projected to grow at nearly three times that rate—5.8 percent per year. (See Box 3-1 on page 54 for descriptions of the various types of federal spending.) A significant reason for the differences in growth of mandatory and discretionary spending comes from their treatment in the baseline projections. CBO projects the spending for mandatory programs according to its estimates of various parameters—including projected caseloads and benefit costs. As required by law, however, CBO projects that discretionary spending grows with inflation, which has been significantly lower than the historical growth of such spending.[2] Discretionary outlays have grown by less than 2 percent in just 10 of the past 40 years.

Since 1965, discretionary spending has declined significantly relative to the size of the economy, although it resumed an upward trend beginning in 2001. In contrast, mandatory spending has more than doubled (see Figure 3-1 on page 55). In 2005, discretionary outlays totaled

1. As required by the Balanced Budget and Emergency Deficit Control Act of 1985, CBO's baseline includes the costs of continuing certain large mandatory programs that are not permanently authorized.

2. The section of this chapter dealing with discretionary spending addresses alternative scenarios for growth in spending governed by the annual appropriation process.

Table 3-1.

CBO's Projections of Spending Under Baseline Assumptions

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
							In Billions of Dollars							
Outlays														
Mandatory spending														
Social Security	519	550	579	606	638	673	709	752	799	850	904	962	3,204	7,472
Medicare	333	391	445	478	509	543	587	616	677	737	802	885	2,562	6,280
Medicaid	182	191	201	219	237	257	278	301	325	352	382	413	1,192	2,966
Other spending	413	447	429	443	457	466	484	468	488	501	511	532	2,280	4,780
Offsetting receipts	-126	-147	-166	-175	-174	-183	-193	-203	-219	-234	-248	-266	-891	-2,061
Subtotal	1,320	1,432	1,488	1,572	1,667	1,755	1,866	1,935	2,071	2,205	2,350	2,527	8,348	19,437
Discretionary spending														
Defense	494	500	498	509	519	531	548	552	570	584	599	618	2,605	5,528
Nondefense	474	499	502	513	521	529	539	550	562	575	588	601	2,605	5,480
Subtotal	968	999	1,000	1,022	1,040	1,060	1,087	1,103	1,132	1,159	1,186	1,219	5,209	11,009
Net interest	184	217	244	263	277	289	299	303	303	302	302	300	1,372	2,882
Total	**2,472**	**2,649**	**2,732**	**2,857**	**2,984**	**3,105**	**3,252**	**3,340**	**3,506**	**3,666**	**3,839**	**4,046**	**14,930**	**33,328**
On-budget	2,070	2,222	2,286	2,397	2,505	2,608	2,736	2,799	2,936	3,065	3,203	3,372	12,532	27,906
Off-budget	402	427	446	460	479	497	516	541	570	602	636	675	2,398	5,422
							As a Percentage of GDP							
Outlays														
Mandatory spending														
Social Security	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.3	4.4	4.4	4.5	4.6	4.2	4.3
Medicare	2.7	3.0	3.2	3.3	3.3	3.4	3.5	3.5	3.7	3.9	4.0	4.2	3.4	3.6
Medicaid	1.5	1.5	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8	1.9	2.0	1.6	1.7
Other spending	3.4	3.4	3.1	3.1	3.0	2.9	2.9	2.7	2.7	2.6	2.6	2.6	3.0	2.8
Offsetting receipts	-1.0	-1.1	-1.2	-1.2	-1.1	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2	-1.3	-1.2	-1.2
Subtotal	10.7	10.9	10.8	10.8	10.9	11.0	11.1	11.0	11.3	11.5	11.8	12.1	10.9	11.3
Discretionary spending														
Defense	4.0	3.8	3.6	3.5	3.4	3.3	3.3	3.2	3.1	3.1	3.0	3.0	3.4	3.2
Nondefense	3.9	3.8	3.6	3.5	3.4	3.3	3.2	3.1	3.1	3.0	2.9	2.9	3.4	3.2
Subtotal	7.9	7.6	7.3	7.0	6.8	6.6	6.5	6.3	6.2	6.1	5.9	5.9	6.8	6.4
Net interest	1.5	1.7	1.8	1.8	1.8	1.8	1.8	1.7	1.7	1.6	1.5	1.4	1.8	1.7
Total	**20.1**	**20.3**	**19.8**	**19.7**	**19.5**	**19.4**	**19.4**	**19.1**	**19.1**	**19.2**	**19.2**	**19.4**	**19.6**	**19.4**
On-budget	16.8	17.0	16.6	16.5	16.4	16.3	16.3	16.0	16.0	16.0	16.0	16.2	16.4	16.2
Off-budget	3.3	3.3	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.2	3.2	3.1	3.2
Memorandum:														
Gross Domestic Product (Billions of dollars)	12,293	13,082	13,781	14,508	15,264	16,021	16,768	17,524	18,311	19,121	19,963	20,839	76,343	172,101

Source: Congressional Budget Office.

Table 3-2.

Average Annual Rates of Growth in Outlays Under CBO's Baseline

(Percent)

	Actual 1994 to 2004	Actual 2004 to 2005	Estimated 2005 to 2006	Projected[a] 2006 to 2016
Mandatory Outlays	5.6	6.7	8.5	5.8
Social Security	4.5	5.5	6.0	5.8
Medicare	6.4	12.0	17.3	8.5
Medicaid	7.9	3.1	5.2	8.0
Other[b]	5.5	5.3	4.8	-1.2
Discretionary Outlays	5.2	8.1	3.3	2.0
Defense	4.9	8.7	1.4	2.1
Nondefense	5.5	7.5	5.2	1.9
Net Interest	-2.3	14.8	18.2	3.3
Total Outlays	4.6	7.8	7.2	4.3
Total Outlays Excluding Net Interest	5.4	7.3	6.3	4.4
Memorandum:				
Consumer Price Index	2.4	3.3	3.2	2.2
Nominal GDP	5.2	6.5	6.4	4.8
Discretionary Budget Authority	5.9	8.7	-8.5	2.7
Defense	6.4	2.9	-2.4	2.5
Nondefense	5.3	15.4	-14.7	2.9

Source: Congressional Budget Office.

a. As specified by the Deficit Control Act, CBO's baseline uses the employment cost index for wages and salaries to inflate discretionary spending related to federal personnel and the GDP deflator to adjust other discretionary funding.

b. Includes offsetting receipts.

7.9 percent of GDP. Because projections of future discretionary spending are adjusted only to account for inflation, CBO's baseline assumes that discretionary spending will continue to fall as a percentage of GDP, dropping to 6.5 percent by 2011 and 5.9 percent by 2016.

Mandatory spending, however, led by growth in Social Security, Medicare, and Medicaid, is expected to continue increasing over the next 10 years, climbing from its current share of 10.7 percent of GDP to 11.1 percent in 2011 and 12.1 percent in 2016, CBO estimates. Such growth is driven by rapidly rising health care costs and the expansion of the nation's elderly population, which will increase in size and as a share of the total population. The Social Security Administration projects that the number of Americans ages 65 and older will grow from 37.2 million this year to 47.3 million by 2016, rising from 12.2 percent of the population to 14.4 percent.[3]

Net interest as a percentage of GDP topped out at 3.3 percent in 1991. It has fallen each year since 1995 until last year, bottoming out at 1.4 percent in 2004. In 2005, it began to rise again, inching up to 1.5 percent. Under baseline assumptions, net interest will rise initially as a percentage of GDP—as the debt continues to grow—but then will fall as scheduled tax increases take effect and the additional revenues bring the budget closer to balance. Over the 2007-2016 period, CBO estimates, net interest will average 1.7 percent of GDP.

3. Data are from the single-year tables consistent with the *2005 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Trust Funds* (March 23, 2005), Social Security Table V.A2, Intermediate Assumptions.

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 dollar amounts each year. The Congressional Budget Office's (CBO's) baseline projections of mandatory spending assume that existing laws and policies 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 in that revenues are collected as an exercise of the government's sovereign powers, whereas offsetting receipts generally are collected from other government accounts or paid by the public for business-like transactions (such as premiums collected under Medicare and rental payments and royalties from leases for oil and gas drilling on the Outer Continental Shelf).

Discretionary spending is controlled by annual appropriation acts; policymakers decide each year how many dollars to provide and to which activities. Appropriations fund a wide variety of governmental activities, including defense, transportation, national parks, law enforcement, disaster relief, and foreign aid. Certain fees and other charges that are triggered by appropriation action are classified as offsetting collections, which offset discretionary spending. CBO's baseline depicts the path of discretionary spending in accordance with provisions of the Balanced Budget and Emergency Deficit Control Act of 1985, which state that current spending should be assumed to grow with inflation in the future.[1] CBO estimates that appropriations to date have provided a total of $902 billion in budget authority for fiscal year 2006—$488 billion for defense and $414 billion for nondefense activities.

In addition to spending from those appropriations, the baseline includes discretionary spending from programs for highway infrastructure, highway and motor carrier safety, public transit, and airport infrastructure. Many of those transportation programs receive mandatory budget authority from authorizing legislation; however, each year, 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 limitations (known as obligation limitations) are treated as a measure of discretionary resources, and the resulting outlays are considered discretionary spending. Appropriations for 2006 set obligation limitations for transportation programs that total $48 billion.

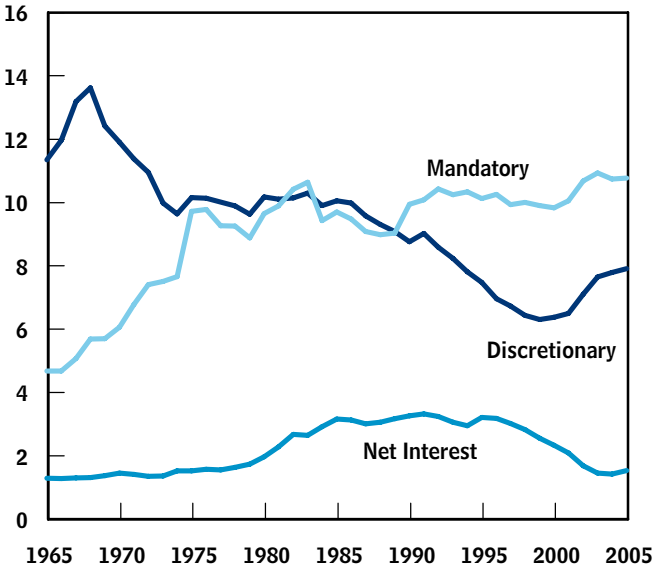
Net interest includes interest paid on Treasury securities and other interest that the government pays (for example, on late refunds issued by the Internal Revenue Service) minus interest that the government collects from various sources (such as from commercial banks, where Treasury tax and loan accounts are maintained). 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 GDP deflator (for other expenditures).

Figure 3-1.

Major Components of Spending, 1965 to 2005

(Percentage of gross domestic product)



Source: Congressional Budget Office based on data from the Office of Management and Budget.

Mandatory Spending

Mandatory—also called direct—spending makes up over half of the federal budget. In 2005, mandatory outlays were $1.3 trillion, a figure that will nearly double by 2016 under CBO's projections (see Table 3-3). From 1994 to 2004, mandatory spending increased at an average annual rate of 5.6 percent. It grew by 6.7 percent in 2005. Over the next 10 years, it is expected to climb at a faster rate than the economy—5.8 percent per year, on average—thereby increasing as a share of GDP from 10.7 percent in 2005 to 12.1 percent by 2016. The spending in this category involves payments to individuals and other entities, such as businesses, nonprofit institutions, and state and local governments. In general, those payments are governed by criteria set in law and are not normally constrained by the annual appropriation process. Offsetting receipts (certain payments that federal agencies receive from the public and from other governmental agencies) are classified as offsets to mandatory spending.

Mandatory spending is dominated by income-support payments and health care subsidies for the elderly, disabled, and the poor. The three largest programs, Social Security, Medicare, and Medicaid, were responsible for more than 70 percent of direct spending in 2005—approximately $1 trillion (not including the effects of offsetting receipts). Other income-security programs (such as Supplemental Security Income, unemployment compensation, and the refundable portions of the earned income and child tax credits) made up about 14 percent of direct spending ($196 billion), while other retirement and disability programs (including federal civilian and military retirement and veterans' compensation programs) made up about 10 percent ($148 billion). All other mandatory programs (agriculture subsidies, student loans, and other social service programs, among others) made up less than 5 percent of mandatory spending, with outlays of $69 billion in 2005.

What Drives Growth in Mandatory Spending?

Excluding offsetting receipts, gross mandatory spending is estimated to total $1.6 trillion in 2006 and to grow faster than the economy over the coming decade. By 2016, $1.2 trillion will be added to annual mandatory spending under baseline assumptions. A number of factors account for that growth, including cost-of-living adjustments (COLAs) and other benefit increases, rising caseloads, and the establishment of Medicare Part D (see Table 3-4).

COLAs and Other Automatic Adjustments. COLAs (annual cost-of-living adjustments in benefit amounts that are pegged to inflation) and other automatic adjustments account for close to one-quarter of the projected growth in mandatory spending. All of the major retirement programs grant automatic COLAs to their beneficiaries (the adjustment for 2006 is 4.1 percent). CBO estimates that the consumer price index (the economic indicator of inflation to which COLAs are tied) will increase by 2.2 percent each year from 2007 through 2016. Programs such as Food Stamps and the earned income tax credit (EITC) are indexed to other measures of inflation. In total, adjustments for inflation in the Social Security, other income-support, federal retirement, disability, and social service programs are projected to add $16 billion to mandatory outlays in 2007 and $214 billion by 2016, accounting for 18 percent of the growth in mandatory spending estimated for the 10-year period.

Payment rates for many Medicare services also are adjusted annually on the basis of changes in the prices of goods and services used by providers as well as changes in economic factors such as GDP and productivity.

Table 3-3.

CBO's Baseline Projections of Mandatory Spending

(Outlays, in billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Social Security	519	550	579	606	638	673	709	752	799	850	904	962	3,204	7,472
Medicare[a]	333	391	445	478	509	543	587	616	677	737	802	885	2,562	6,280
Medicaid	182	191	201	219	237	257	278	301	325	352	382	413	1,192	2,966
Income Security														
Supplemental Security Income	38	38	36	41	42	44	49	43	49	50	52	58	211	463
Unemployment compensation	32	32	33	36	40	43	45	47	49	52	54	56	197	456
Earned income and child tax credits	49	51	52	52	52	52	52	36	36	37	37	37	260	443
Food Stamps	33	35	35	35	36	37	38	38	39	40	41	42	180	381
Family support[b]	24	24	24	24	24	24	25	25	25	25	25	25	122	247
Child nutrition	13	14	14	15	15	16	17	17	18	19	20	20	77	172
Foster care	6	7	7	7	7	8	8	8	8	9	9	9	36	80
Subtotal	196	200	200	210	217	223	233	215	225	232	238	248	1,084	2,242
Other Retirement and Disability														
Federal civilian[c]	64	68	71	74	77	80	84	87	90	94	97	101	386	855
Military	39	41	43	45	46	48	49	50	52	53	54	55	231	495
Veterans'[d]	36	36	35	38	39	40	44	39	43	44	45	50	197	419
Other	9	8	8	8	9	9	10	11	11	12	9	10	45	97
Subtotal	148	153	157	166	172	178	187	187	196	203	206	216	858	1,866
Other Programs														
Commodity Credit Corporation Fund	19	18	18	14	13	12	11	11	10	10	10	10	68	119
TRICARE For Life	6	7	8	9	9	10	11	12	12	13	14	15	47	113
Student loans	15	18	7	7	7	7	8	8	8	8	8	8	36	76
Universal Service Fund	6	7	7	7	7	8	8	8	8	8	8	8	37	77
State Children's Health Insurance	5	5	5	5	5	5	5	5	5	5	5	5	26	52
Social services	5	5	5	5	5	5	5	5	5	5	5	5	24	50
Flood insurance	1	18	1	0	0	0	0	0	0	0	0	0	1	1
Other	12	17	22	20	21	18	17	18	17	17	16	16	98	183
Subtotal	69	94	72	67	68	65	65	66	66	67	67	68	337	671
Offsetting Receipts	-126	-147	-166	-175	-174	-183	-193	-203	-219	-234	-248	-266	-891	-2,061
Total Mandatory Spending	**1,320**	**1,432**	**1,488**	**1,572**	**1,667**	**1,755**	**1,866**	**1,935**	**2,071**	**2,205**	**2,350**	**2,527**	**8,348**	**19,437**
Memorandum:														
Mandatory Spending Excluding Offsetting Receipts	1,446	1,579	1,654	1,747	1,840	1,938	2,060	2,138	2,289	2,439	2,598	2,793	9,239	21,497

Source: Congressional Budget Office.

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

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 small retirement programs and annuitants' health benefits.

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

Table 3-4.

Sources of Growth in Mandatory Spending

(Outlays, in billions of dollars)

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Estimated Spending in 2006	1,579	1,579	1,579	1,579	1,579	1,579	1,579	1,579	1,579	1,579
Sources of Growth										
Cost-of-living and other automatic adjustments										
Social Security	9	22	35	48	62	76	90	104	118	133
Medicare	3	7	10	14	20	28	38	48	58	67
Other programs [a]	7	15	22	30	39	45	54	63	71	82
Subtotal	19	43	67	93	121	150	182	214	247	282
Other changes in benefits										
Social Security	11	17	24	33	42	57	74	94	117	144
Medicare and Medicaid	21	43	70	101	132	165	204	247	296	350
Other programs [a]	2	3	3	5	6	-8	-6	-3	-1	2
Subtotal	34	63	98	138	180	214	272	337	411	495
Increases in caseloads										
Social Security	8	17	29	42	55	70	86	102	119	136
Medicare and Medicaid	8	18	27	36	47	59	74	89	105	122
Other programs [a]	3	6	10	13	14	17	18	19	20	21
Subtotal	19	41	66	91	116	146	177	210	244	279
Establishment of Medicare Part D [b]	29	44	52	62	73	86	101	119	139	161
Shifts in payment dates [c]	-2	4	4	4	19	-11	4	4	4	23
Other effects	-24	-27	-26	-29	-28	-26	-26	-25	-26	-25
Total	**75**	**168**	**262**	**359**	**481**	**559**	**711**	**860**	**1,019**	**1,214**
Projected Spending	1,654	1,747	1,840	1,938	2,060	2,138	2,289	2,439	2,598	2,793

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. Amounts shown for Medicare Part D do not include savings realized by Medicaid and other federal programs because Medicare will now be paying some of the prescription drug costs of those programs' beneficiaries.

c. 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 make 13 payments to managed care plans 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.

The effect of those automatic increases on Medicare spending is dampened, however, by a formula used to establish a fee schedule for physicians' services, known as the sustainable growth rate (SGR) formula. That formula sets a cumulative spending target for physicians' services and other services related to physicians' 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).[4] If spending falls short of the cumulative target, the SGR formula provides for increases in payment rates above inflation. CBO estimates that spending subject to the SGR will exceed the cumulative target by about $37 billion by the end of 2006. As a result, should the SGR formula remain unchanged, physicians' payment rates would be reduced by 4.4 percent in 2006 and by similar amounts in future years, thereby holding down growth in spending for Medicare. When combined, indexing and SGR adjustments to Medicare payment rates result in estimated increases of $3 billion in 2007 and $67 billion in 2016 and will make up about 6 percent of projected increases to mandatory spending.[5]

Other Changes in Benefits. Other factors that contribute to rising benefit levels account for more than 40 percent of the increase in mandatory spending over the projection period—about $495 billion. One of those factors, growth in wages, affects the amounts paid to individuals collecting Social Security and federal retirement benefits, as well as those who receive unemployment compensation. Wage growth also affects refundable tax credits. Outlays for the EITC and child tax credit will shrink relative to payments made in 2006 because growth in wages will reduce the number of eligible tax filers and increase the portion of the credits that will offset taxes rather than be refunded. Expiring provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 also will affect the EITC and child tax credit significantly by reducing the refundable portion of those credits beginning in 2012. From 2012 to 2016, outlays for those tax credits will be below their 2006 level.

CBO projects large increases in benefits for Medicare and Medicaid. Growth in spending for those programs that is not attributable to statutory adjustments in payments or to rising caseloads will be responsible for nearly 30 percent of all the increases in mandatory spending (around $350 billion by 2016). More-frequent use of services, such as increased visits to the doctor on a per capita basis, contributes to that high growth, as does greater use of costly medical technologies. In addition, federal costs for Medicaid rise when states provide broader coverage of services, such as raising the limit on the number of home health visits allowed under the program.

Increases in Caseloads. Changes in the number of individuals who will be eligible for and claim benefits will add $279 billion to mandatory spending by 2016, CBO estimates. Programs most affected by the rising numbers of elderly individuals, Social Security and Medicare, will be responsible for $230 billion of that total (over 80 percent). In 2006, CBO estimates, 48 million people will collect Social Security benefits. By 2016, that number will grow to 60 million. Projected increases in Medicare caseloads are similar, rising from about 42 million people in 2006 to 53 million in 2016. Growth as a result of changes in caseloads for all major benefit programs will contribute to about 23 percent of all growth in mandatory spending from 2006 to 2016.

Establishment of Medicare Part D. Beginning this year, Medicare Part D will subsidize outpatient prescription drugs for the elderly. CBO estimates that outlays for the drug benefit will total $41 billion in 2006. In 2007 (the program's first full year), Medicare Part D will cost $70 billion, or $29 billion more than in 2006. By 2016, spending for Part D is estimated to cost $202 billion—an increase of $161 billion over the cost in 2006 and representing 13 percent of all growth in mandatory outlays over the 10-year period (see Box 3-2 for further discussion of Medicare Part D). Those amounts do not include the offsetting effects of premiums and certain payments by states to the federal government, which will reduce the net costs of the Part D program by about 25 percent. They also do not include savings realized by Medicaid and other federal programs resulting from the shift of

4. The Medicare economic index measures changes in 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.

5. 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.

Box 3-2.

The Budgetary Effects of the Medicare Drug Benefit

Starting on January 1, Medicare began subsidizing prescription drug coverage under a new Part D of the program. Medicare furnishes coverage through a combination of private prescription drug plans available to all Medicare enrollees in a geographic area, managed care plans that participate in the Medicare Advantage program, and employer- or union-sponsored plans. Enrollment in the drug benefit is voluntary, and enrollees are charged premiums to pay for benefits not subsidized by Medicare. Part D also provides additional federal subsidies to cover the cost of drugs for some low-income Medicare beneficiaries.

The Congressional Budget Office (CBO) estimates that Medicare payments for prescription drugs will total $41 billion in 2006 and will reach $202 billion by 2016. Those costs will be partly offset by the receipt of premiums paid by enrollees and "clawback" payments from states based on their historical Medicaid spending on prescription drugs for individuals eligible for both programs. CBO estimates that the federal government will collect $11 billion in offsetting receipts in 2006, rising to $47 billion in 2016 from those two sources. On net, Part D will increase Medicare spending by $30 billion in 2006 and by $155 billion in 2016 (see the table below).

The increases in Medicare spending will be offset, in part, elsewhere in the federal budget. Medicare will now be responsible for providing coverage of prescription drugs for enrollees who had previously received coverage through other programs such as Medicaid and the Department of Defense's TRICARE For Life program. Such savings are not separately identifiable in budget figures.

In its estimate for the Medicare Modernization Act, which established the Part D prescription drug benefit, CBO projected that the legislation would cost $395 billion over the 2004-2013 period. That estimate reflected net Medicare spending of $552 billion for Part D, offset, in part, by savings in Medicaid and other programs and by other changes to the Medicare program. CBO's current estimate of net Medicare spending for Part D exceeds its original forecast by $42 billion over the 2004-2013 period, a difference of about 8 percent. (Those changes are discussed in Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2006* [March 2005], Appendix A.) The program is just starting, however, and there is little basis for judging what its actual cost will be.

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

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Gross Medicare Part D Outlays	41	70	85	93	103	114	128	142	161	180	202
Offsetting Receipts											
Premiums	-5	-9	-11	-11	-13	-14	-16	-18	-21	-24	-27
Payments from states	-5	-9	-10	-11	-11	-12	-13	-15	-16	-17	-19
Subtotal	-11	-17	-20	-22	-24	-27	-30	-33	-37	-42	-47
Total, Net Medicare Part D Outlays	**30**	**53**	**65**	**71**	**79**	**87**	**98**	**109**	**123**	**139**	**155**

some of the prescription drug costs of their beneficiaries to the Medicare program.

Shifts in Payment Dates. The timing of outlays for certain mandatory programs depends on whether the first day of the fiscal year, October 1, falls on a weekday or weekend. If it falls on a weekend, some benefit payments will be made at the end of September—which increases spending for the preceding year and decreases spending for the forthcoming year. Supplemental Security Income (SSI), veterans' compensation and pension programs, and Medicare payments to managed care plans all 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, and 2016. In Medicare, $4 billion in payments to managed care plans were shifted from 2006 to 2005; that shift results in a $4 billion difference between 2006 outlays and the outlays in each subsequent year.

Other Effects. Overall, mandatory outlays for a number of programs are projected to be lower than they were in 2006. Significantly, payments made on flood insurance claims are estimated to total at least $18 billion in 2006 but are projected to return to historic spending levels ($1 billion per year or less) thereafter. In 2006, the Department of Education expects to make revisions of $11 billion to the estimated subsidy cost of outstanding student loans. Such adjustments may incorporate changes to the estimated cost of loans made as far back as 1992 and reflect the actual interest rates, defaults, and repayments of loans, including loan consolidations. (CBO does not forecast revisions to credit subsidy estimates beyond the budget year.) As a result of those changes, projected outlays for student loans in 2007 and beyond are $11 billion per year lower than in 2006.

Social Security

The largest single federal spending program is Social Security, which pays cash benefits to the elderly and disabled. Outlays for Social Security amounted to $519 billion in 2005, about 21 percent of all federal spending and nearly 36 percent of mandatory spending (excluding offsetting receipts). Spending for Social Security benefits currently equals about 4.2 percent of GDP. That share will increase steadily over the coming 10 years (and beyond) in tandem with the increase in the nation's elderly population. CBO expects that over the 2006-2016 period, the number of people receiving Social Security benefits will grow by an average of 2.3 percent per year and that the program's outlays will rise by an average of 5.8 percent annually. By 2016, Social Security will claim 4.6 percent of GDP, CBO estimates.

Old-Age and Survivors Insurance. The larger of the two main components of Social Security is Old-Age and Survivors Insurance (OASI). That program pays benefits to workers who reach a specified age, to their eligible spouses and children, and to some survivors (primarily aged widows and young children) of deceased workers. OASI benefits totaled $430 billion in 2005, a figure that will climb at an increasingly rapid rate each year, reaching an estimated $794 billion by 2016.

About one-third of the growth in OASI is attributable to a rising caseload. Whereas just over 40 million individuals received OASI payments in December 2005, CBO estimates that 50 million people will do so in 2016, an increase of about 25 percent. The oldest members of the baby-boom generation (those born in 1946) will turn 62 in 2008 and thus will qualify for initial OASI benefits in that year. The rate of growth in the number of OASI recipients is projected to jump from about 1.1 percent in 2006 and 2007 to 1.7 percent in 2008. It will accelerate each year thereafter, rising to 2.2 percent in 2009 and reaching 2.9 percent by 2016.

The rest of the growth in spending for OASI stems from benefit increases, which are projected to average 3.3 percent per year over the coming decade. Increases in wages earned by an individual throughout his or her lifetime have the result of increasing an individual's initial benefit. In addition, benefits are increased each year according to a cost-of-living adjustment. As noted earlier, the COLA in January 2006 is 4.1 percent, up from 2.7 percent the previous year, mostly because of rising energy costs. CBO projects that the COLA for Social Security programs will be 2.2 percent per year thereafter.

Disability Insurance. The Social Security program also provides disability insurance (DI) benefits to workers who experience severe health conditions prior to becoming eligible for OASI and to the eligible spouses and children of those workers. Nearly $84 billion in disability benefits were paid in 2005. That figure will increase to $91 billion in 2006, CBO estimates, and will rise to $163 billion by 2016, an average rate of 6.0 percent annually—slightly faster than benefits under OASI.

As with OASI, rising caseloads and increased average benefits (from both wage growth and COLAs) contribute to the increase in DI spending. Another factor contributing to growth in DI spending is the ongoing rise in Social Security's "normal retirement age"—from 65 to 66 and eventually to 67. That increase delays the reclassification of disabled workers as retired workers; as a result, older disabled individuals will receive benefits under DI longer before making the transition to OASI.

Medicare and Medicaid

Taken together, federal outlays for the two major health programs, Medicare and Medicaid, totaled $515 billion in 2005—about as much as Social Security's spending—or approximately 21 percent of all federal spending (including offsetting receipts). Spending for those health programs is projected to grow briskly over the next 10 years at an average annual rate of 8.5 percent for Medicare and 8.0 percent for Medicaid.[6] By 2016, CBO estimates, the two programs will cost $1.3 trillion, or more than 30 percent of all federal spending and 6.2 percent of GDP, up from 4.2 percent of GDP in 2005.

Medicare. The larger of the two major health care programs, Medicare, provides subsidized medical insurance for the elderly and certain disabled individuals. Medicare comprises three main parts—Part A (the Hospital Insurance program), Part B (Supplementary Medical Insurance), and beginning in 2006, Part D, which subsidizes the cost of outpatient prescription drugs.[7] Excluding the effect of offsetting receipts, outlays for Medicare totaled $333 billion in 2005, about 23 percent of mandatory spending.

CBO estimates that spending for the program will soar this year—by about 17 percent, to $391 billion. That rate of increase reflects some calendar-related shifts in payment dates; excluding those shifts, the expected growth rate is 20 percent. The bulk of that growth, 12 percentage points, is from the establishment of the prescription drug benefit under Part D, which CBO estimates will result in Medicare outlays of $41 billion in 2006. The remaining 8 percent stems from underlying growth in Parts A and B. As a result of the new prescription drug benefit, a rising caseload, and other cost increases, Medicare outlays as a share of GDP will rise from 3.0 percent this year to 4.2 percent in 2016, CBO estimates. Such costs do not include the effects of premiums and certain payments from states, which are discussed in the section on offsetting receipts. Those payments will total $55 billion in 2006 and $141 billion by 2016, CBO estimates.

Medicaid. Medicaid is a joint federal-state program that funds medical care for many of the nation's poor, wherein the federal government matches state dollars to cover certain approved services for eligible individuals. The federal government's share of costs varies from state to state, averaging 57 percent nationwide. Federal outlays for Medicaid totaled $182 billion in 2005—about 13 percent of direct spending that year. Like Medicare, Medicaid has a history of strong cost growth, with increases averaging 7.9 percent annually from 1994 to 2004. Growth slowed somewhat in 2005 as a result of the expiration of temporary enhanced matching rates.[8] CBO estimates that growth rates will continue to be relatively low in the near term because the new prescription drug benefit provided under Medicare Part D will replace Medicaid payments for some individuals who qualify for both programs. As a result, CBO anticipates that the program's outlays will grow by about 5 percent per year in 2006 and 2007 before accelerating to an 8.3 percent average annual rate of growth over the remainder of the projection period. CBO projects that spending for Medicaid as a share of GDP will rise from 1.5 percent in 2006 to 2.0 percent in 2016.

Other Income-Security Programs

In addition to Social Security and the health care subsidy programs already discussed, the federal government provides payments to individuals and to other governmental entities through programs aimed at assisting various populations—disabled individuals, the unemployed, needy families with children, the poor, and abused and neglected children. Federal spending on programs such as Supplemental Security Income, unemployment compensation, the earned income and child tax credits, Food

6. After an adjustment for shifts in the timing of payments to managed care providers that affect Medicare outlays in 2006 and 2016, CBO's projection of the 10-year average growth rate for that program is 8.3 percent.

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

8. The Jobs and Growth Tax Relief Reconciliation Act of 2003 temporarily increased federal matching rates under Medicaid. As a result, outlays for 2004 were about $6 billion higher than they would have been without the enhanced rates.

Stamps, family support, and foster care totaled $196 billion in 2005, or about 1.6 percent of GDP.

In contrast to the rapid growth in Social Security, Medicare, and Medicaid, spending for those other income-security programs is projected to increase by just 2.2 percent per year, on average, and will comprise 1.2 percent of GDP by 2016 under CBO's projections. Outlays for some of the programs, such as SSI, unemployment compensation, child nutrition, and foster care, will grow at a faster rate, while other programs (Food Stamps and family support) are expected to grow more slowly. Outlays for the earned income and child tax credits are projected to decline after 2011 as certain provisions of law affecting those credits expire.

Supplemental Security Income. The Supplemental Security Income program provides cash benefits to low-income individuals who are aged or disabled. Outlays for SSI totaled $38 billion in 2005, a year in which 13 payments were made because October 1, 2005, fell on a weekend. For 2006—a 12-payment year—SSI benefits are estimated to remain at $38 billion. The final year in CBO's projection period, 2016, also is a 13-payment year, so outlays for that year ($58 billion) are higher than they otherwise would be. Excluding the extra payment in 2016, spending for the program is estimated to grow at 3.9 percent annually. The program's growth is driven mainly by COLAs and a rising caseload.

Unemployment Compensation. Outlays for unemployment compensation have fallen dramatically over the past few years, dropping from $55 billion in 2003 (which included $11 billion in temporary emergency assistance) to $32 billion in 2005. CBO estimates that the unemployment rate will average 5.0 percent in 2006 and 2007 and then rise slightly to 5.1 percent in 2008 and to 5.2 percent in 2009 and beyond. As the unemployment rate rises, the proportion of unemployed who are eligible for and collect unemployment benefits also tends to rise. As a result, CBO estimates that outlays for unemployment compensation will grow by about 10 percent a year in 2008 and 2009 and then grow at an annual rate of about 5 percent in subsequent years.

Earned Income and Child Tax Credits. The earned income and child tax credits are partially refundable tax credits available to individuals who earn wages below an established maximum and to qualifying families with dependent children. Those credits reduce a filer's overall tax liability; if the credits exceed that liability, the excess may be refunded to the taxpayer, depending on the filer's earnings. The refundable portions of such credits (which are categorized as outlays) totaled $49 billion in 2005 and are estimated to rise to $52 billion by 2007. 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. At that time, the refundability of the child tax credit will be virtually eliminated, and scheduled higher tax rates will reduce the refundable portion of the earned income tax credit (because more of the credit will offset tax liability and be reflected as a reduction in revenues). As a result, outlays for those credits will decline to $37 billion in 2016, CBO estimates.

Food Stamps. CBO anticipates that outlays for the Food Stamp program will rise by 9 percent—to $35 billion—in 2006. Over the past four years, outlays have grown by 14 percent a year, on average, largely as a result of steady growth in participation. Food Stamp caseloads rose from 17.3 million people in 2001 to 25.7 million in 2005, an average increase of 10 percent per year. Caseloads initially grew in reaction to the economic downturn. In addition, a simplified application process, additional outreach efforts, and expanded eligibility could all be contributing to persistently high participation. CBO projects that participation will remain at a high level—an average of 25.6 million people annually—throughout the coming years. Overall, CBO estimates that spending for the program will change little over the next three years and then grow by an average of 2.3 percent per year after that, reaching more than $42 billion by 2016.

Family Support. Spending for family support programs—grants to states to help fund welfare programs, child support enforcement, and other child care entitlements—is projected to remain fairly flat, rising modestly from $24 billion in 2006 to $25 billion in 2016. The largest program in this category, Temporary Assistance for Needy Families (TANF), currently is capped by law at roughly $17 billion per year. TANF is authorized through March 31, 2006, but as specified in the Deficit Control Act, CBO's baseline assumes that funding for that program will continue at its most recently authorized level.

Child Nutrition and Foster Care. Spending for both child nutrition and the foster care and adoption assistance programs is projected to rise by about 4 percent annually

through 2016. Outlays for child nutrition totaled $13 billion in 2005 and are estimated to rise to $20 billion by 2016. Spending for foster care and adoption assistance totaled more than $6 billion in 2005 and is projected to increase to about $9 billion by 2016.

Other Federal Retirement and Disability Programs

Benefits for federal civilian and military retirees and for veterans totaled $148 billion in 2005—about 10 percent of mandatory spending and 1.2 percent of GDP. Annuities and survivor benefits paid through the federal civilian retirement program (along with several smaller retirement programs for employees of various government agencies) amounted to $64 billion in 2005. Retired military personnel and veterans received benefits of $39 billion and $36 billion, respectively. Payments to government retirees and veterans are projected to grow at a rate of about 3.5 percent annually, reaching $216 billion (but falling to 1.0 percent of GDP) by 2016.

Payments to civilian retirees from the federal government are projected to rise from $68 billion in 2006 to $101 billion by 2016, an average of about 4 percent per year. Growth in federal retirement benefits results primarily from COLAs and from rising federal salaries, which boost future benefit levels. One factor that restrains growth in those programs is the gradual replacement of the Civil Service Retirement System (CSRS) with the Federal Employees' Retirement System (FERS). The FERS program covers employees hired after 1983 and provides a smaller defined benefit than that under CSRS. Employees covered by FERS, however, also are eligible to receive Social Security benefits and have contributions to the Thrift Savings Plan—a savings vehicle for federal employees that is not unlike a 401(k) plan—matched in part by their employing agencies.

The federal government also provides benefits to retired military personnel and to veterans. Annuities paid to retired military personnel totaled $39 billion in 2005 and are estimated to grow at an average annual rate of 2.9 percent. Most of the growth in military retirement programs stems from COLAs and other benefit increases. Mandatory spending for veterans' benefits—disability compensation, pensions, dependency and indemnity compensation to surviving spouses and children, and life insurance programs—totaled $36 billion in 2005. Under current law, such payments are projected to grow at a rate of 3.3 percent annually as a result of COLAs and other caseload and benefit increases.

Other Mandatory Spending

Other programs in the mandatory spending category include the price and income support for farmers provided by the Commodity Credit Corporation (CCC), TRICARE For Life,[9] student loans, the Universal Service Fund,[10] and the State Children's Health Insurance program. Bolstered by relatively high outlays for the CCC and for student loans, outlays for other mandatory spending totaled $69 billion in 2005. Spending in that category is expected to jump to at least $94 billion in 2006, mostly because of increased outlays for flood insurance claims as a result of Hurricane Katrina and other hurricanes. After 2007, spending for other mandatory programs is projected to drop back to pre-2006 levels, totaling $68 billion by 2016.

Net spending for flood insurance is expected to reach an unprecedented amount in 2006 as a result of Hurricane Katrina. In recent years, the program generally has collected sufficient premiums to cover costs: in four of the five years over the 2000-2004 period, the program ran cash surpluses that averaged about $450 million annually. Net spending increased to more than $1 billion in 2005 and is expected to reach at least $18 billion in 2006 before declining in subsequent years. (Payment of flood insurance claims related to Hurricane Katrina may result in outlays of more than $20 billion in 2006, but paying such claims will require additional funding or borrowing authority for the program.)

Projected outlays of the Commodity Credit Corporation for price and income-support payments start at $18 billion in 2006 and decline to $10 billion near the end of the projection period. Current spending is relatively high because of low prices for major crops, the result of record or near-record production for several major crops, and somewhat weakened demand. Over time, commodity production covered by the federal assistance program is expected to return to average levels while demand will continue to grow (partly as a result of domestic economic growth and demand from other countries and partly because of an increase in demand for grains resulting from

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

10. The Universal Service Fund helps defray the cost of telecommunications services in high-cost areas; for schools, libraries, and rural health providers; and for low-income consumers.

Table 3-5.

CBO's Baseline Projections of Offsetting Receipts

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Medicare[a]	-38	-55	-65	-70	-74	-80	-87	-94	-103	-115	-127	-141	-375	-955
Employers' Share of Employees' Retirement														
Social Security	-11	-12	-12	-13	-14	-15	-16	-16	-17	-18	-19	-20	-70	-161
Military retirement	-15	-14	-14	-15	-15	-15	-16	-16	-17	-17	-18	-18	-75	-160
Civil service retirement and other	-21	-22	-23	-23	-24	-25	-26	-27	-28	-29	-30	-32	-122	-269
Subtotal	-47	-48	-49	-51	-53	-55	-58	-60	-62	-65	-67	-70	-266	-591
TRICARE For Life	-10	-11	-12	-12	-13	-14	-15	-16	-17	-18	-19	-20	-67	-157
Natural Resources-Related Receipts[b]	-12	-15	-16	-17	-17	-16	-17	-16	-18	-18	-18	-18	-82	-170
Electromagnetic Spectrum Auctions	0	0	-8	-8	0	0	0	0	0	0	0	0	-15	-15
Other	-18	-18	-17	-17	-17	-17	-17	-18	-18	-19	-16	-16	-85	-172
Total	**-126**	**-147**	**-166**	**-175**	**-174**	**-183**	**-193**	**-203**	**-219**	**-234**	**-248**	**-266**	**-891**	**-2,061**

Source: Congressional Budget Office.

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.

the renewable-fuel standard established in last summer's energy legislation). As a result, prices for supported crops generally are expected to rise over time, resulting in reduced spending.

Subsidy and administrative costs for student loans totaled $15 billion in 2005 and are estimated to reach $18 billion in 2006, largely because of revisions in the estimated subsidy costs for loans and guarantees made in previous years. In the following years, the program's costs are projected to be $7 billion to $8 billion per year.

Offsetting Receipts

Offsetting receipts are payments from the public or from other federal agencies that, for budgetary purposes, the government records as negative spending. Those receipts include beneficiaries' premium payments for Medicare, federal agencies' contributions to retirement funds, and payments made to the government for the harvesting of timber and the extraction of minerals on federal lands. In 2005, offsetting receipts totaled $126 billion—about 9.0 percent of mandatory spending and 1.0 percent of GDP (see Table 3-5). Offsetting receipts will climb throughout the projection period, primarily because of additional premium payments for Medicare Part D. By 2016, offsetting receipts will equal 1.3 percent of GDP, CBO estimates.

Medicare Premiums and Payments from States. Premiums from Medicare beneficiaries totaled $38 billion in 2005—about 30 percent of all offsetting receipts. Over the coming years, those receipts will grow substantially, totaling an estimated $141 billion in 2016.

The bulk of Medicare premiums currently are paid by individuals enrolled in Part B, the Supplementary Medical Insurance program, which covers physicians' and outpatient hospital services. Beginning this year, the government also will collect premiums from beneficiaries enrolled in Medicare Part D, the new prescription drug program. Also with the introduction of Part D, some of the costs of providing prescription drug coverage to low-income Medicare enrollees will shift to that program from the Medicaid program. A portion of the savings ac-

cruing to the states from that cost shifting will be returned to the federal government and credited to the Medicare Part B trust fund. Those credits will be reflected in the budget as offsetting receipts. The addition of new premiums and the payments from states will contribute to the 45 percent jump in offsetting receipts to the Medicare program expected for 2006. CBO estimates that once Part D is fully operational, offsetting receipts for Medicare will grow by about 10 percent annually.

Other Offsetting Receipts. Other sources of offsetting receipts involve payments made by federal agencies to employee retirement plans; receipts from royalties and other charges for oil and natural gas production on federal lands; sales arising from the harvesting of timber and extraction of minerals on federal land; and various fees levied on users of public property and services.

Intragovernmental transfers from federal agencies to employee retirement plans (paid to the trust funds for Social Security and military and civil service retirement) made up the largest component of offsetting receipts in 2005, totaling $47 billion. CBO estimates that those payments will grow at a rate of about 4 percent annually, reaching $70 billion by 2016. Intragovernmental transfers also are made to the Uniformed Services Medicare-Eligible Retiree Health Care Fund under the TRICARE For Life program; those payments totaled $10 billion in 2005. As a result of rising health care costs, payments to the TRICARE For Life program will grow more rapidly than the retiree population—at an annual rate of about 6 percent—and are expected to double to $20 billion by 2016.

Natural resource-related receipts include proceeds from programs to develop federally owned resources, particularly oil, natural gas, and other minerals. Those receipts totaled $12 billion in 2005. Although oil and gas extraction from the Outer Continental Shelf is projected to be somewhat depressed in 2006 as a result of Hurricanes Katrina and Rita, total natural resource-related receipts are projected to rise this year to $15 billion, largely as a result of increases in oil and gas prices. By 2016, those receipts will total $18 billion, CBO estimates.

Further, CBO estimates that over the 2007-2016 period, $15 billion in offsetting receipts will come from the Federal Communications Commission's (FCC's) auctions of licenses to use the electromagnetic spectrum. Most of those proceeds will result from an auction of licenses to use 90 megahertz for advanced wireless services, which is expected to occur before the FCC's auction authority expires at the end of 2007. CBO considers it unlikely that licenses made available by the transition to digital television—which would be affected by the pending reconciliation legislation—will be auctioned under current law.

Legislation Assumed in the Baseline

In keeping with provisions of the Deficit Control Act, CBO's baseline projections assume that certain mandatory programs will be extended when their authorization expires. That rule applies differently to mandatory programs created before and after the enactment of the Balanced Budget Act of 1997. In the case of programs in existence prior to 1997, those with current-year outlays exceeding $50 million are assumed to continue. For programs established after that year, continuation is determined on a case-by-case basis in consultation with the House and Senate Budget Committees. Smaller programs—those with outlays in the current year of less than $50 million—are assumed to expire when their authorization lapses. In addition, the Deficit Control Act directs CBO to assume that a cost-of-living adjustment for veterans' compensation is granted each year. The assumption that expiring programs continue accounts for outlays of nearly $12 billion in 2006 and outlays of $757 billion over the 2007-2016 period (see Table 3-6).

Major programs that are assumed to continue in CBO's baseline projections include social service and welfare programs such as Food Stamps, TANF, State Children's Health Insurance, rehabilitation services, child care entitlements to states, federal unemployment benefits and allowances (also known as trade adjustment assistance for workers), child nutrition, and family preservation and support. Most of the farm assistance provided by the CCC also is assumed to continue.

Discretionary Spending

Each year, the Congress starts the appropriation process anew. The annual appropriation acts that it passes provide new budget authority—the 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 (for example, those intended for major construction projects) are disbursed over several years. In any given year, discretionary outlays include spending

Table 3-6.

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

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Food Stamps													
Budget authority	n.a.	n.a.	35.0	35.9	36.8	37.7	38.5	39.5	40.3	41.3	42.1	145.4	347.0
Outlays	n.a.	n.a.	33.4	35.9	36.7	37.7	38.4	39.4	40.2	41.2	42.1	143.7	345.1
Temporary Assistance for Needy Families													
Budget authority	6.9	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8	84.7	169.4
Outlays	5.2	14.2	16.1	16.8	16.8	16.8	16.8	16.8	16.8	16.8	16.8	82.0	166.7
Commodity Credit Corporation[a]													
Budget authority	n.a.	n.a.	n.a.	13.2	11.8	11.3	10.9	10.4	10.1	10.0	9.6	36.4	87.3
Outlays	n.a.	n.a.	n.a.	13.2	11.8	11.3	10.9	10.4	10.1	10.0	9.6	36.4	87.3
State Children's Health Insurance Program													
Budget authority	n.a.	n.a.	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	20.2	45.4
Outlays	n.a.	n.a.	2.3	4.0	5.0	5.3	5.4	5.2	5.1	5.1	5.2	16.6	42.5
Veterans' Compensation COLAs													
Budget authority	n.a.	0.5	1.2	2.0	2.7	3.8	4.0	5.1	6.0	6.8	8.3	10.3	40.5
Outlays	n.a.	0.5	1.2	1.9	2.7	3.7	4.0	5.1	5.9	6.8	8.2	10.0	40.0
Rehabilitation Services and Disability Research													
Budget authority	2.7	2.8	2.9	2.9	3.0	3.1	3.1	3.2	3.3	3.4	3.4	14.7	31.2
Outlays	1.1	2.2	2.8	2.8	2.9	3.0	3.0	3.1	3.2	3.2	3.3	13.7	29.5
Child Care Entitlements to States													
Budget authority	0.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	13.6	27.2
Outlays	0.5	2.2	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	13.3	26.9
Federal Unemployment Benefits and Allowances													
Budget authority	n.a.	n.a.	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0	3.7	8.7
Outlays	n.a.	n.a.	0.6	0.9	0.9	0.9	1.0	1.0	1.0	1.0	1.0	3.4	8.3
Child Nutrition[b]													
Budget authority	0	0	0	0	0.5	0.5	0.5	0.5	0.6	0.6	0.6	1.0	3.8
Outlays	0	0	0	0	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.9	3.7

Continued

Table 3-6.

Continued

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Ground Transportation Programs Not Subject to Annual Obligation Limitations													
Budget authority	n.a.	n.a.	n.a.	n.a.	0.6	0.6	0.6	0.6	0.6	0.6	0.6	1.3	4.5
Outlays	n.a.	n.a.	n.a.	n.a.	0.2	0.4	0.6	0.6	0.6	0.6	0.6	0.6	3.6
Family Preservation and Support													
Budget authority	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.5	3.1
Outlays	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.2	2.7
Other Natural Resources													
Budget authority	0	0	0	0	0	0	0	0	0	0.3	0.3	0	0.5
Outlays	0	0	0	0	0	0	0	0	0	0.2	0.2	0	0.4
Ground Transportation Programs Controlled by Obligation Limitations[c]													
Budget authority	n.a.	n.a.	n.a.	n.a.	42.8	42.8	42.8	42.8	42.8	42.8	42.8	85.6	299.8
Outlays	n.a.	n.a.	n.a.	n.a.	0	0	0	0	0	0	0	0	0
Air Transportation Programs Controlled by Obligation Limitations[c]													
Budget authority	0	0	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	14.8	33.3
Outlays	0	0	0	0	0	0	0	0	0	0	0	0	0
Total													
Budget authority	**16.4**	**23.3**	**68.7**	**83.7**	**127.9**	**129.5**	**130.2**	**131.9**	**133.3**	**135.4**	**137.4**	**433.1**	**1,101.4**
Outlays	**11.6**	**20.2**	**59.5**	**78.7**	**80.6**	**82.9**	**83.7**	**85.2**	**86.6**	**88.7**	**90.8**	**321.8**	**756.8**

Source: Congressional Budget Office.

Note: 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, section 257(b)(2)(iii) of the Deficit Control Act says that the baseline must 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 2006

	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	7.5	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	-0.5	282	3.3	2.3	552	6.4	0.9
1999	275	3.0	1.9	297	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	4.9	895	7.8	8.5
2005	494	4.0	8.7	474	3.9	7.5	968	7.9	8.1
2006[a]	500	3.8	1.4	499	3.8	5.2	999	7.6	3.3

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

Note: GDP = gross domestic product.

a. Estimated. Defense outlays do not include any further funding for military activities in Iraq and Afghanistan.

both from new budget authority and from amounts previously appropriated.

Recent Trends in Discretionary Funding and Outlays

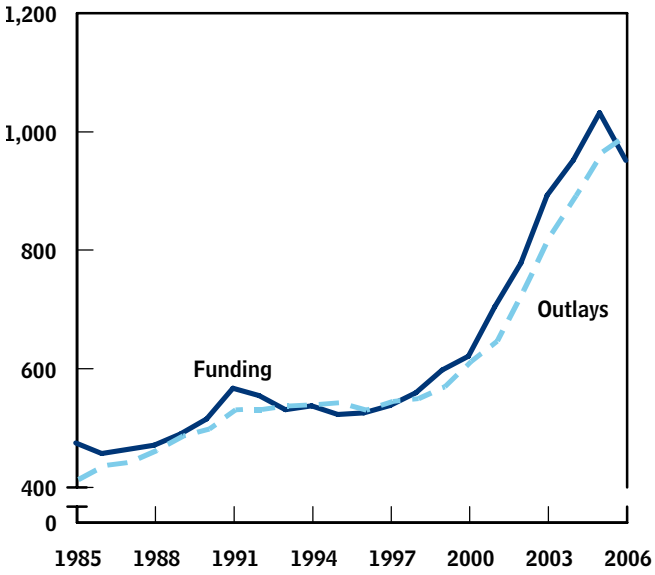
In the mid-1980s, discretionary outlays equaled 10.0 percent of GDP, but by 1999 they had fallen to 6.3 percent (see Table 3-7). In 2001, funding for discretionary programs began moving upward again as a share of the economy. The events of September 11, 2001, and the war in Iraq accelerated that trend; discretionary outlays jumped to 7.1 percent of GDP in 2002 and reached 7.9 percent in 2005. CBO projects that total discretionary outlays as a share of GDP will fall to 7.6 percent in 2006 if no further funding is provided this year.

Trends in overall discretionary spending have been driven primarily by spending on defense. During the late 1980s and the 1990s, such 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, in part because of operations in Afghanistan. They continued to climb as military operations began in Iraq. Following annual outlay increases of 16 percent in 2003 and 12 percent in 2004, growth in defense outlays slowed in 2005. CBO estimates that outlays for defense programs under current law will rise slightly in nominal terms between 2005 and 2006—from $494 billion to $500 billion—but

Figure 3-2.

Discretionary Funding and Outlays, 1985 to 2006

(Billions of dollars)



Source: Congressional Budget Office.

Notes: Eventual discretionary funding is expected to be higher than $902 billion for 2006. A request for additional supplemental budget authority for the costs of military operations in Iraq and Afghanistan is expected.

The figure includes both budget authority and obligation limitations. (Spending from the Highway Trust Fund and the Airport and Airway Trust Fund is subject to such limitations. Budget authority for those programs is provided in authorizing legislation and is not considered discretionary.)

decline slightly as a percentage of GDP (from 4.0 percent to 3.8 percent).[11]

Nondefense discretionary programs encompass such activities as housing assistance, transportation, maintenance of national parks, most homeland security operations, and foreign aid. Spending for such programs has remained relatively constant as a share of GDP since the mid-1980s, ranging between 3.2 percent and 3.9 percent.

Recent growth in nondefense discretionary outlays has slowed somewhat since a sharp uptick in 2002. Since 2004, such growth has been fueled by the costs of reconstruction activities in Iraq and, more recently, by costs related to Hurricanes Katrina and Rita. CBO estimates that outlays for nondefense discretionary pro-grams will continue to rise in 2006, reaching $499 billion (a 5.2 percent increase over 2005) and representing 3.8 percent of GDP (compared with 3.9 percent of GDP in 2005).

Total discretionary spending has risen dramatically in recent years. In 1990, both funding and outlays stood at about $500 billion. By 2000, they exceeded $600 billion and grew rapidly from there, reaching about $1 trillion in 2005; they will be near that level in 2006, CBO estimates (see Figure 3-2).

Supplemental Appropriations. The growth in outlays described above stems from two types of funding: regular and supplemental appropriations. Regular appropriation acts provide funding for the continued operation of federal departments, agencies, and various government activities and are considered annually. Supplemental appropriations typically provide budget authority in response to problems or priorities that were not anticipated in the regular budget cycle. However, in recent years, supplemental funding also has been used to fund activities such as ongoing military activity in Iraq and Afghanistan that were not unanticipated.

Since the mid-1980s, supplemental appropriations have been provided in every year. For about 15 years, virtually all supplemental appropriations (with the exception of funding for the Persian Gulf War in 1991 and 1992 and peacekeeping missions in Bosnia and Kosovo in 1999 and 2000) were provided in response to natural disasters such as hurricanes, earthquakes, and floods.[12] Following the attacks of September 11, 2001, the Congress and the President provided funding for recovery and response through supplemental funding.

Since 2003, the use of supplemental appropriations has expanded as the President has requested and the Congress

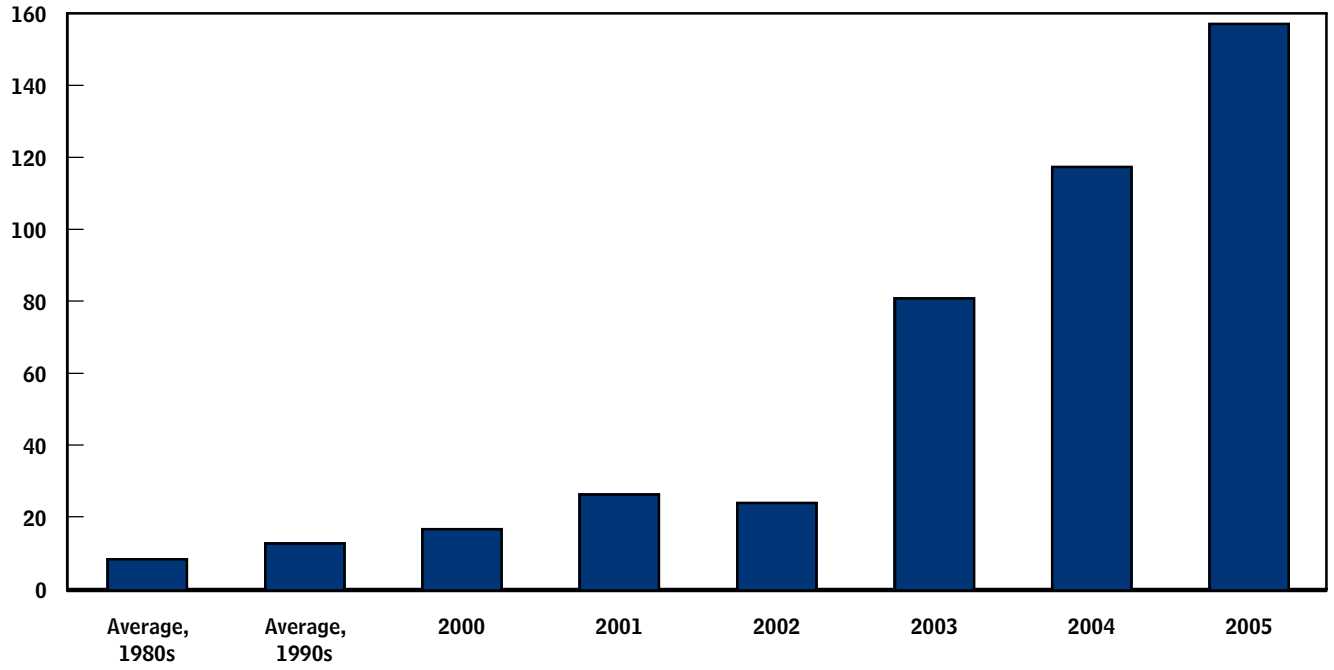
11. Defense outlays for 2006 are expected to be higher than $500 billion. The $50 billion in funding provided for ongoing operations in Iraq and Afghanistan is intended to cover costs only for part of the fiscal year. A request for additional budget authority for 2006 is expected for such operations.

12. Supplemental appropriations affected defense funding each year. Except for the years noted, however, the new budget authority was for a relatively small amount and was largely offset by rescissions. See Congressional Budget Office, *Supplemental Appropriations in the 1990s* (March 2001), and *Supplemental Appropriations in the 1980s* (February 1990) for more information.

Figure 3-3.

Budget Authority Provided Through Supplemental and Additional Appropriations

(Billions of dollars)



Source: Congressional Budget Office.

Note: Funding shown for 2004 includes $27 billion in additional appropriations provided by the Congress at the end of that year for military operations in Iraq and Afghanistan.

has provided funds for military operations in Iraq and Afghanistan largely through such means. That approach has substantially boosted the amount of supplemental funding enacted each year: in 2003, such appropriations totaled $81 billion, and in 2004, they reached $118 billion (see Figure 3-3).

In 2005, the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005, provided $82 billion in supplemental funding, mostly for war-related activities. In addition, the response to Hurricanes Katrina and Rita added another $62 billion in supplemental appropriations just before the end of the fiscal year (see Appendix A). Along with previous funding for disaster relief and veterans' medical care, supplemental appropriations totaled $157 billion in 2005.

The Congress and the President have enacted $50 billion in funding for military activities in Iraq and Afghanistan as part of the regular defense appropriation act for 2006. That sum will cover only a portion of this year's costs for such activities; a request for additional funding is anticipated. Supplemental appropriations thus far in 2006 include about $29 billion in new budget authority ($23 billion for nondefense programs and $6 billion for defense) that has been appropriated for relief and recovery activities related to hurricane damage. At the same time, policymakers rescinded $23 billion from previous appropriations provided to the Federal Emergency Management Agency. A further $3.8 billion has been appropriated for avian flu research, preparedness, and response, and $125 million for workers' compensation claims and health services related to the terrorist attacks on New York on September 11, 2001.

Comparison of 2005 and 2006 Budget Authority. Total discretionary budget authority for 2005 was $985 billion, $83 billion above appropriations provided thus far in 2006 (see Table 3-8). However, that comparison is distorted by the amount of funding provided for activities in Iraq and Afghanistan and supplemental appropriations.

Table 3-8.

Growth in Discretionary Budget Authority, 2005 to 2006

(Billions of dollars)

	Actual 2005	Estimated 2006	Percentage Change
Budget Authority			
Defense	500	488	-2.4
Nondefense			
Homeland security[a]	31	28	-11.6
Other nondefense	454	386	-14.9
Subtotal, nondefense	485	414	-14.7
Total	**985**	**902**	**-8.5**
Budget Authority Excluding Additional Funding for Activities in Iraq and Afghanistan and Supplemental Appropriations[b]			
Defense	421	432	2.7
Nondefense			
Homeland security[a]	31	28	-10.2
Other nondefense	376	383	1.8
Subtotal, nondefense	407	411	0.9
Total Excluding Supplementals	**827**	**842**	**1.8**

Source: Congressional Budget Office.

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

a. CBO received preliminary information from the Administration regarding the classification of homeland security activities for 2006 from appropriation bills enacted through mid-December. For the two bills not enacted until later in December—Defense and Labor-Health and Human Services-Education—CBO estimated the homeland security spending for 2006 on the basis of the amounts designated for such activities in the Office of Management and Budget's *2005 Mid-Session Review* (July 2005). Once the Administration releases its 2007 budget proposal in February 2006, CBO will revise its homeland security estimates to reflect the Administration's classification of those programs in the budget. In addition, CBO has not classified any supplemental funding for 2006 as funding for homeland security.

b. In 2005, the Congress and the President provided $82 billion in supplemental funding primarily for activities in Iraq and Afghanistan, $62 billion in supplemental appropriations in response to Hurricanes Katrina and Rita, and $13 billion in other supplemental funding (mostly for disaster relief from hurricanes in 2004 and for veterans' benefits). Thus far in 2006, about $59 billion has been provided for activities in Iraq and Afghanistan and for supplemental appropriations, net of rescissions.

Excluding such funding, regular appropriations for 2006 have grown slightly from the levels enacted for 2005—rising from $827 billion to $842 billion. Defense discretionary appropriations have grown by 2.7 percent, and nondefense discretionary budget authority has increased by 0.9 percent. About three-quarters of the increase ($11 billion) is in defense funding.

Nondefense discretionary funding provided through regular appropriations grew by just $4 billion in 2006. Some activities in that category received increases, whereas others received a cut in funding. The programs that received the largest funding increases include veterans' medical programs, border and transportation security, and housing assistance. Each of those areas received funding increases of about $1 billion or more. In contrast, no 2006 funding was provided for Project BioShield, which received an appropriation of $2.5 billion in 2005.[13] Additionally, the Office of Elementary and Secondary Education, the Federal Bureau of Investigation (FBI), and the Employment and Training Administration all had their funding reduced by $500 million or more.

13. Project BioShield received an appropriation of $885 million for 2004 and $2.5 billion for 2005 but is not scheduled to receive additional funding until 2009 (for which it has already received an advance appropriation of $2.2 billion).

Table 3-9.

Nondefense Discretionary Funding for 2006

	Amount of Funding (Billions of dollars)	Percentage of Total
Education, Training, Employment, and Social Services	81	18
Transportation	76	16
Health	55	12
Income Security	48	10
Administration of Justice	41	9
Natural Resources and Environment	34	7
Veterans' Benefits and Services	34	7
International Affairs	32	7
General Science, Space, and Technology	25	5
General Government	16	4
Agriculture	6	1
Medicare	5	1
Social Security	5	1
Energy	4	1
Commerce and Housing Credit	2	1
Community and Regional Development	2	*
Multiple Functions[a]	-4	-1
Total	**462**	**100**

Source: Congressional Budget Office.

Notes: Includes supplemental budget authority and budgetary resources provided by obligation limitations for certain surface and air transportation programs.

* = between zero and 0.5 percent.

a. Includes savings from the 1 percent across-the-board cut, which affected all accounts except for certain veterans' benefits. Those savings have not been distributed among individual accounts or budget functions, except for those for Defense and International Affairs in CBO's baseline.

Composition of Nondefense Discretionary Funding. Four categories together account for over half of the $462 billion in funding provided thus far for nondefense discretionary activities in 2006 (see Table 3-9).[14] The education, training, employment, and social services category will receive 18 percent of nondefense discretionary funding ($81 billion) in 2006. Student loans, unemployment compensation, and a number of other programs are not included in those totals because they are considered mandatory programs.

Funding for transportation programs (ground, air, and water) totals $76 billion and accounts for 16 percent of nondefense discretionary funding in 2006. That estimate includes $48 billion of obligation limitations for certain surface and air transportation programs. Even though those programs receive mandatory budget authority through their authorizing legislation, annual appropriation acts consistently limit how much of that authority the Department of Transportation can obligate and thereby govern annual spending. For that reason, such limitations are treated as a measure of discretionary budgetary resources.

Appropriations for health research and public health total $55 billion and make up 12 percent of nondefense discretionary funding in 2006. At $48 billion, income-security programs (mostly for housing assistance and food and nutrition assistance) will claim 10 percent of nondefense discretionary funding.

Discretionary Spending for 2007 Through 2016

Under baseline assumptions, CBO projects that discretionary outlays will remain flat at around $1.0 trillion in 2006 and 2007, mostly because large amounts of supplemental funding enacted in 2005 and prior years boost 2006 outlays but have a smaller effect in 2007. Furthermore, baseline outlays for military activities in Iraq and Afghanistan are substantially higher in 2006 than in 2007.

Beyond 2007, outlays in the baseline increase each year as they follow steadily increasing budget authority. As specified in the Deficit Control Act, CBO assumes that discretionary resources—including supplemental budget authority—keep pace with inflation after 2006. As a result, such funding is projected to grow at a rate of 2.7 percent annually through the 10-year projection period. At that rate, CBO projects, discretionary outlays will reach $1.2 trillion by 2016—evenly split between defense and nondefense spending.[15] Discretionary outlays will shrink as a percentage of GDP, however, falling from an estimated 7.6 percent of GDP in 2006 to 5.9 percent in 2016.

14. Nondefense discretionary funding includes obligation limitations for certain transportation activities.

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

Table 3-10.

CBO's Baseline Projections of Discretionary Spending for Homeland Security

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Budget Authority														
Defense	12	12	13	13	13	14	14	15	15	15	16	16	67	144
Nondefense[a]														
Department of Homeland Security														
Border and transportation security	11	12	12	12	13	13	13	14	14	14	15	15	63	135
Other activities	12	9	9	9	12	10	10	10	10	10	11	11	49	101
Subtotal, Department of Homeland Security	23	21	21	21	24	23	23	24	24	25	25	26	112	237
Other departments	8	7	7	7	7	8	8	8	8	8	9	9	37	79
Total Nondefense	31	28	28	29	32	30	31	32	32	33	34	35	150	316
Total Budget Authority	**43**	**40**	**41**	**42**	**45**	**44**	**45**	**46**	**47**	**49**	**50**	**51**	**217**	**460**
Outlays														
Defense	11	12	12	13	13	14	14	14	15	15	16	16	66	142
Nondefense[a]														
Department of Homeland Security														
Border and transportation security	11	12	13	13	13	13	13	14	14	14	15	15	64	135
Other activities	7	9	10	10	10	10	10	10	11	11	11	11	50	104
Subtotal, Department of Homeland Security	18	21	22	23	23	23	23	24	24	25	26	26	114	239
Other departments	8	9	8	7	7	7	8	8	8	8	8	9	38	79
Total Nondefense	26	29	30	30	30	30	31	32	32	33	34	35	152	318
Total Outlays	**38**	**42**	**43**	**43**	**43**	**44**	**45**	**46**	**47**	**48**	**49**	**51**	**218**	**460**
Memorandum:														
Mandatory Outlays for Homeland Security	*	*	*	*	*	*	*	*	*	*	2	2	1	4

Source: Congressional Budget Office.

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

CBO's classification of homeland security funding is based on designations established by the Administration. Those designations are not limited to the activities of the Department of Homeland Security. In fact, some activities of the department, such as disaster relief, are not included in the definition, whereas nondepartmental activities (such as some defense-related programs and some funding for the National Institutes of Health) fall within the Administration's definition of homeland security. About half of all spending considered to be for homeland security is for activities outside of the Department of Homeland Security.

The amounts shown in this table reflect the net spending for homeland security activities. About $3 billion to $4 billion a year in spending is offset by fees and other receipts.

The designation of funding as homeland security is based on preliminary information from the Administration. CBO will update such designations after the Administration releases its 2007 budget proposal in February 2006.

a. Project BioShield, an initiative to expand the government's arsenal of counterbioterrorism agents, has received appropriations for 2005 and 2009. Budget authority for all other years is zero.

Homeland Security. Spending for homeland security encompasses both defense and nondefense activities.[16] CBO's classification of homeland security funding is based on the Administration's designations. About half of all spending considered to be for homeland security is for activities conducted by agencies other than the Department of Homeland Security, including the Department of Defense (see Table 3-10).

Net discretionary budget authority for homeland security is estimated to total about $40 billion for 2006. Of that sum, $12 billion is classified as defense and includes funding for security at military installations. Nondefense programs receive $28 billion, of which $21 billion is appropriated to the Department of Homeland Security for border and transportation security and other intelligence and warning activities. The remaining $7 billion is allocated to other agencies and is primarily for domestic counterterrorism activities conducted by the FBI. CBO estimates that the resulting discretionary outlays for homeland security will total $42 billion in 2006. In addition, an average of less than $1 billion a year in net outlays for homeland security is classified as mandatory spending.

Alternative Paths for Discretionary Spending. Thus far, discretionary budget authority for 2006 totals about $902 billion and transportation-related obligation limitations, about $48 billion; in projecting baseline spending, both are assumed to grow with inflation thereafter. To illustrate how future funding might differ from those assumptions, CBO presents alternative paths for discretionary spending to show the budgetary consequences of using different assumptions concerning growth (see Table 3-11).

The first alternative path assumes that most funding will grow at the average annual rate of nominal GDP after 2006 (an average of 4.8 percent a year, almost twice as fast as the rate of growth assumed in the baseline). Funds provided for ongoing activities in Iraq and Afghanistan and funds provided by supplemental appropriations thus far in 2006 grow more slowly, at the rate of inflation. Under this scenario, total discretionary outlays would exceed the baseline figures by nearly $1.4 trillion over the projection period. Added debt-service costs would bring the cumulative increase in outlays to $1.6 trillion.

The second alternative path assumes that 2006 appropriations for activities in Iraq and Afghanistan, as well as supplemental appropriations that have been provided for other purposes in 2006, are not extended in future years. Such 2006 appropriations total $83 billion (excluding a rescission of $23 billion in funds previously provided to FEMA that is not extended in the baseline)—primarily to conduct military activities in Iraq and Afghanistan but also to respond to avian flu and to provide additional funds for hurricane relief and recovery. If such budget authority is not repeated in future years, total discretionary outlays would be lower than the baseline figures by $0.8 trillion from 2007 through 2016. Lower debt-service costs would bring the cumulative decrease in outlays to $1.0 trillion compared with the baseline, CBO projects.

The third alternative assumes additional funding in 2006 for anticipated military activities in Iraq and Afghanistan in 2006 above the $50 billion provided to date and a gradual phase-down of operations in years beyond. CBO has constructed a possible path of spending for such activities that assumes force levels and operations will decrease somewhat in 2007 relative to 2006 and continue to decline gradually over several years. As described more fully in Chapter 1, that scenario would add about $20 billion to baseline discretionary outlays for 2006 but reduce baseline outlays by $140 billion between 2007 and 2016. In addition, that scenario would remove the extension of supplemental appropriations (for example, those for hurricane relief) from the baseline; in total, that scenario would lower projected 10-year outlays by $0.5 trillion (including debt-service savings).

The fourth path also shows less spending relative to the baseline—it assumes that most discretionary budget authority and obligation limitations are frozen throughout the projection period at the level provided in 2006. (In this scenario, some funding, such as offsetting collections and payments made by the Treasury on behalf of the Department of Defense for the TRICARE For Life program, is not held constant at its 2006 level.) Total discretionary outlays for the 10-year period would be $1.2 trillion lower than those in the baseline scenario. Debt-service adjustments would reduce spending by another $0.2 trillion for a total of $1.4 trillion.

16. For a discussion of homeland security activities and funding, see Congressional Budget Office, *Federal Funding for Homeland Security: An Update* (July 20, 2005).

Net Interest

Under baseline assumptions, over the next five years, interest costs will grow significantly faster than noninterest spending in the federal budget. CBO projects that interest costs will increase by 57 percent during this time, compared with 23 percent for noninterest outlays. Interest payments are projected to grow from $184 billion in 2005 to $289 billion in 2010; as a share of GDP, interest outlays are projected to increase from 1.5 percent to 1.8 percent during that period (see Table 3-12). By contrast, net interest as a share of the economy ranged from 2.0 percent of GDP to 3.3 percent each year between 1981 and 2001. As a share of total outlays, interest costs are projected to rise from 7.4 percent in 2005 to 9.3 percent in 2010.

The increase in interest payments is attributable to accumulating debt as well as the rising interest rates in CBO's economic forecast. The baseline assumes that tax increases will occur as specified in current law. As a result, net interest costs stop growing in 2012 as the Treasury is projected to begin paying down debt; by 2016, net interest costs are projected to total $300 billion, or 1.4 percent of GDP—slightly less than the share of GDP recorded in 2005.

In general, the federal government's interest payments depend primarily on 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 rates are determined predominately by market forces and the Federal Reserve's policies, although fiscal policy may also have some influence.

Interest costs in 2006 will total $217 billion, CBO estimates, $33 billion more than in 2005. About half of that increase is attributable to recent actions by the Federal Reserve to raise short-term rates and to expected future increases in those rates during this year. The other half stems from the accumulating debt that has financed recent deficits.

Interest outlays are also affected by both the size and composition of debt held by the public. The average maturity of new issues has fluctuated significantly in the past several years. For instance, it was nearly seven-and-a-half years in the late 1990s but decreased to less than two-and-a-half years in 2002. Those fluctuations stem from changes in the amounts and types of securities issued by the Department of the Treasury. For example, beginning in February 2006, the Treasury will begin reissuing 30-year bonds. As a result, the average maturity of new issues is projected to increase from three years in 2005 to more than four years in 2006.

The Treasury is expected to issue about $30 billion in 30-year bonds annually. Because that amount is small relative to the overall stock of debt held by the public ($4.6 trillion), those issues will not significantly alter the composition of the public debt. For example, Treasury notes (with maturities of two, three, five, and 10 years) currently make up half of the public debt and are projected to remain a similar proportion through 2016. Treasury bills, with a maturity of six months or less, account for about 22 percent of all marketable debt and are likewise projected to remain at that level throughout the projection period.

The federal government has issued about $3.3 trillion in securities to federal trust funds and other governmental accounts. Similar to the composition of debt held by the public, those securities consist of bills, notes, bonds, inflation-indexed securities, and zero-coupon bonds. However, the interest paid on those securities has no net budgetary impact because it is credited to accounts elsewhere in the budget. In 2006, trust funds will be credited with $172 billion of interest, CBO estimates—mostly for the Social Security and Civil Service Retirement trust funds.

The $7 billion in other interest that CBO anticipates the government will receive in 2006 represents the net of certain interest payments and interest collections. On balance, the government earns more of such interest than it pays out. Among its interest expenses are payments for interest on tax refunds that are delayed for more than 45 days after the filing date. On the collections side, interest received from the financing accounts of credit programs, such as direct student loans, is one of the larger categories. Although other interest increases rapidly through the projection period, almost all of that growth is attributable to interest on the accrued balances credited to the TRICARE For Life program. (Because those are intragovernmental payments, there is no net effect on the budget.) In addition, CBO estimates that earnings from the Railroad Retirement Investment Trust in 2006 will total $1.5 billion.

Table 3-11.

CBO's Projections of Discretionary Spending Under Alternative Paths

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Baseline (Discretionary Resources Grow with Inflation After 2006)[a]													
Budget Authority													
Defense	488	500	512	525	538	550	564	578	592	607	622	2,626	5,588
Nondefense	414	450	460	473	482	493	504	516	528	541	553	2,358	5,000
Total	**902**	**951**	**972**	**998**	**1,019**	**1,043**	**1,069**	**1,094**	**1,120**	**1,147**	**1,175**	**4,983**	**10,588**
Outlays													
Defense	500	498	509	519	531	548	552	570	584	599	618	2,605	5,528
Nondefense	499	502	513	521	529	539	550	562	575	588	601	2,605	5,480
Total	**999**	**1,000**	**1,022**	**1,040**	**1,060**	**1,087**	**1,103**	**1,132**	**1,159**	**1,186**	**1,219**	**5,209**	**11,009**
Most Discretionary Resources Grow at the Rate of Nominal Gross Domestic Product After 2006[b]													
Budget Authority													
Defense	488	512	537	563	590	616	642	670	698	728	759	2,818	6,316
Nondefense	414	463	487	514	540	566	592	620	648	677	708	2,569	5,814
Total	**902**	**975**	**1,024**	**1,077**	**1,130**	**1,181**	**1,235**	**1,290**	**1,346**	**1,405**	**1,466**	**5,388**	**12,130**
Outlays													
Defense	500	506	528	552	577	607	624	655	683	712	748	2,768	6,191
Nondefense	499	509	532	552	576	601	627	655	683	712	742	2,770	6,189
Total	**999**	**1,014**	**1,060**	**1,104**	**1,153**	**1,208**	**1,251**	**1,310**	**1,366**	**1,425**	**1,490**	**5,539**	**12,381**
Extension of Supplemental Appropriations and Funding for Activities in Iraq and Afghanistan Is Removed from the Baseline After 2006[c]													
Budget Authority													
Defense	488	443	454	466	477	489	501	514	527	540	554	2,329	4,965
Nondefense	414	423	432	445	453	463	474	486	497	509	521	2,216	4,703
Total	**902**	**866**	**887**	**910**	**930**	**952**	**976**	**999**	**1,024**	**1,049**	**1,075**	**4,546**	**9,668**
Outlays													
Defense	500	462	459	464	473	487	491	507	520	533	551	2,345	4,947
Nondefense	499	496	499	499	504	512	522	533	544	557	569	2,510	5,235
Total	**999**	**958**	**958**	**963**	**976**	**999**	**1,012**	**1,040**	**1,064**	**1,090**	**1,121**	**4,854**	**10,182**
Costs of Military Operations in Iraq and Afghanistan and for the War on Terrorism Gradually Decrease[d]													
Budget Authority													
Defense	533	518	509	506	504	516	529	543	556	570	585	2,553	5,336
Nondefense	414	423	432	445	453	463	474	486	497	509	521	2,216	4,703
Total	**947**	**941**	**942**	**950**	**957**	**979**	**1,004**	**1,028**	**1,053**	**1,079**	**1,106**	**4,770**	**10,039**
Outlays													
Defense	520	527	519	514	508	517	520	536	549	563	581	2,585	5,334
Nondefense	499	496	499	499	504	512	522	533	544	557	569	2,510	5,235
Total	**1,019**	**1,023**	**1,018**	**1,013**	**1,011**	**1,029**	**1,041**	**1,069**	**1,093**	**1,120**	**1,151**	**5,094**	**10,569**

Continued

Table 3-11.

Continued

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
						Discretionary Resources Are Frozen at the 2006 Level							
Budget Authority													
Defense	488	489	489	490	491	492	493	494	495	496	497	2,450	4,923
Nondefense	414	440	439	441	439	439	439	438	438	437	437	2,198	4,388
Total	**902**	**928**	**929**	**931**	**930**	**930**	**931**	**932**	**932**	**933**	**934**	**4,648**	**9,310**
Outlays													
Defense	500	489	490	490	490	494	487	492	493	494	499	2,452	4,916
Nondefense	499	495	497	494	491	488	487	486	486	485	484	2,465	4,894
Total	**999**	**985**	**987**	**983**	**980**	**982**	**974**	**978**	**978**	**979**	**983**	**4,918**	**9,810**
Memorandum:													
Obligation Limitations in CBO's January 2006 Baseline	48	49	49	50	51	52	53	54	55	56	57	252	528

Source: Congressional Budget Office.

Note: Discretionary resources include both budget authority and obligation limitations. Spending from the Highway Trust Fund and the Airport and Airway Trust Fund is subject to such limitations. Budget authority for those programs is provided in authorizing legislation and is not considered discretionary.

a. Using the inflators specified in the Balanced Budget and Emergency Deficit Control Act of 1985 (the GDP deflator and the employment cost index for wages and salaries).

b. This alternative assumes that supplemental appropriations and appropriations for operations in Iraq and Afghanistan enacted during 2006 are projected at baseline levels (that is, increased at the rate of inflation).

c. This alternative does not extrapolate appropriations for operations in Iraq and Afghanistan, disaster relief and recovery related to hurricane damage, avian flu research and prevention, and other funding attached to the defense appropriation bill.

d. This alternative does not extend the $50 billion in appropriations provided thus far in 2006 for military activities in Iraq and Afghanistan and the war on terrorism, nor does it extend any supplemental appropriations (for example, those for hurricane relief). However, it incorporates the assumption that an additional $45 billion in budget authority will be provided in 2006 to maintain activities in Iraq and Afghanistan. Such budget authority is projected to total $75 billion in 2007, $55 billion in 2008, and $40 billion in 2009, and then to decline to about $30 billion a year from 2010 on. Additional budget authority over the 2006-2016 period is assumed to total $416 billion.

Table 3-12.

CBO's Baseline Projections of Federal Interest Outlays

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Interest on Treasury Debt Securities (Gross interest)[a]	352	398	438	473	503	533	561	584	603	624	644	662	2,507	5,624
Interest Received by Trust Funds														
Social Security	-92	-99	-107	-117	-128	-139	-152	-166	-180	-195	-210	-226	-643	-1,620
Other trust funds[b]	-69	-73	-76	-80	-83	-86	-90	-93	-96	-99	-102	-104	-415	-910
Subtotal	-161	-172	-183	-196	-211	-226	-242	-259	-276	-294	-312	-330	-1,058	-2,529
Other Interest[c]	-4	-7	-10	-12	-14	-17	-19	-21	-23	-26	-29	-32	-72	-202
Other Investment Income[d]	-3	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-5	-10
Total (Net interest)	**184**	**217**	**244**	**263**	**277**	**289**	**299**	**303**	**303**	**302**	**302**	**300**	**1,372**	**2,882**

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, 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.

CHAPTER

4

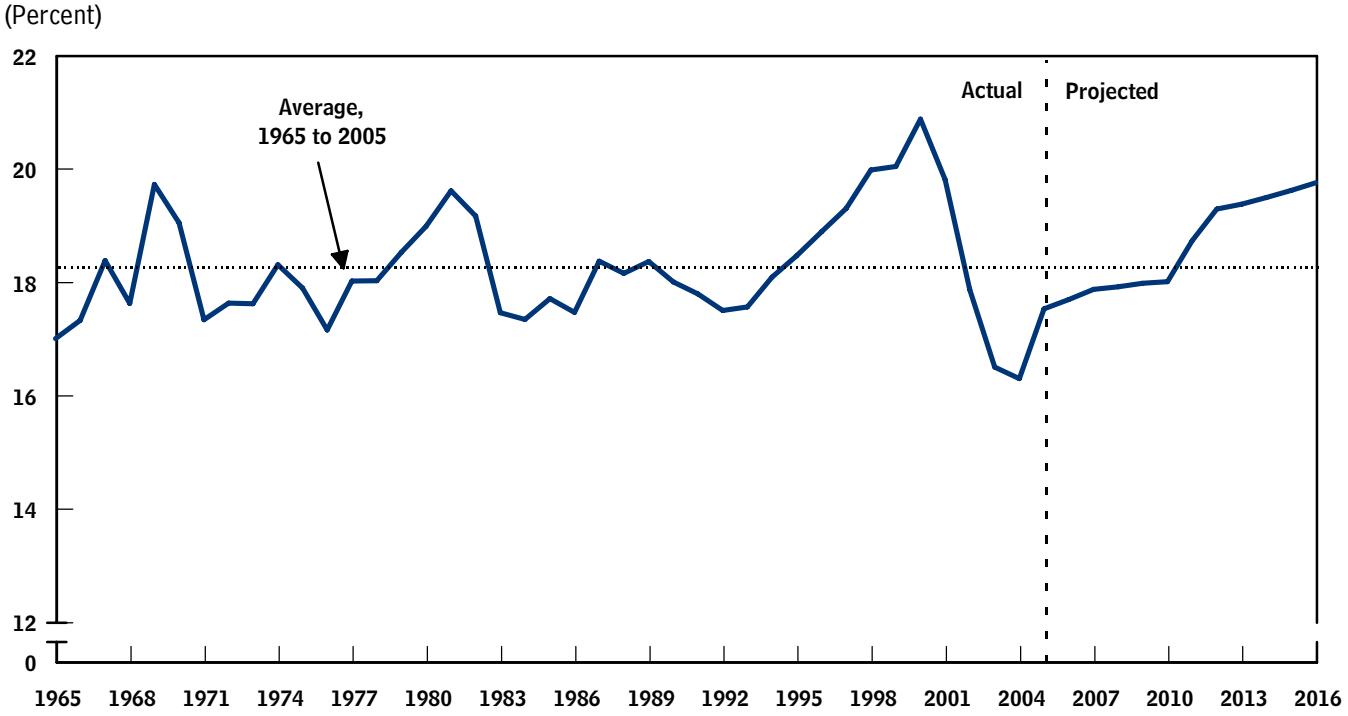
The Revenue Outlook

The Congressional Budget Office projects that if current policies remain the same, revenues will exceed $2.3 trillion in 2006. That amount would be 7.3 percent (or $158 billion) higher than the revenues recorded in 2005 and would make 2006 the second consecutive year in which revenues grew faster than the economy. As a share of gross domestic product, revenues are projected to increase from 17.5 percent in 2005 to 17.7 percent in 2006, slightly below the average level of 18.2 percent since 1965 (see Figure 4-1).

In each of the ensuing 10 years of the baseline period, revenues are projected to grow faster than GDP (see Figure 4-2). Revenues jump sharply in 2011 and 2012, after scheduled increases in various taxes. In addition, revenues continue to grow somewhat faster than GDP throughout the projection period because of the structure of the individual income tax system, which causes revenues to claim a higher fraction of income each year as income grows. Under the assumption that current laws and policies remain the same, CBO projects that revenues will reach 19.7 percent of GDP in 2016, a level that has been equaled or exceeded only five times since 1946.

Figure 4-1.

Total Revenues as a Share of Gross Domestic Product, 1965 to 2016

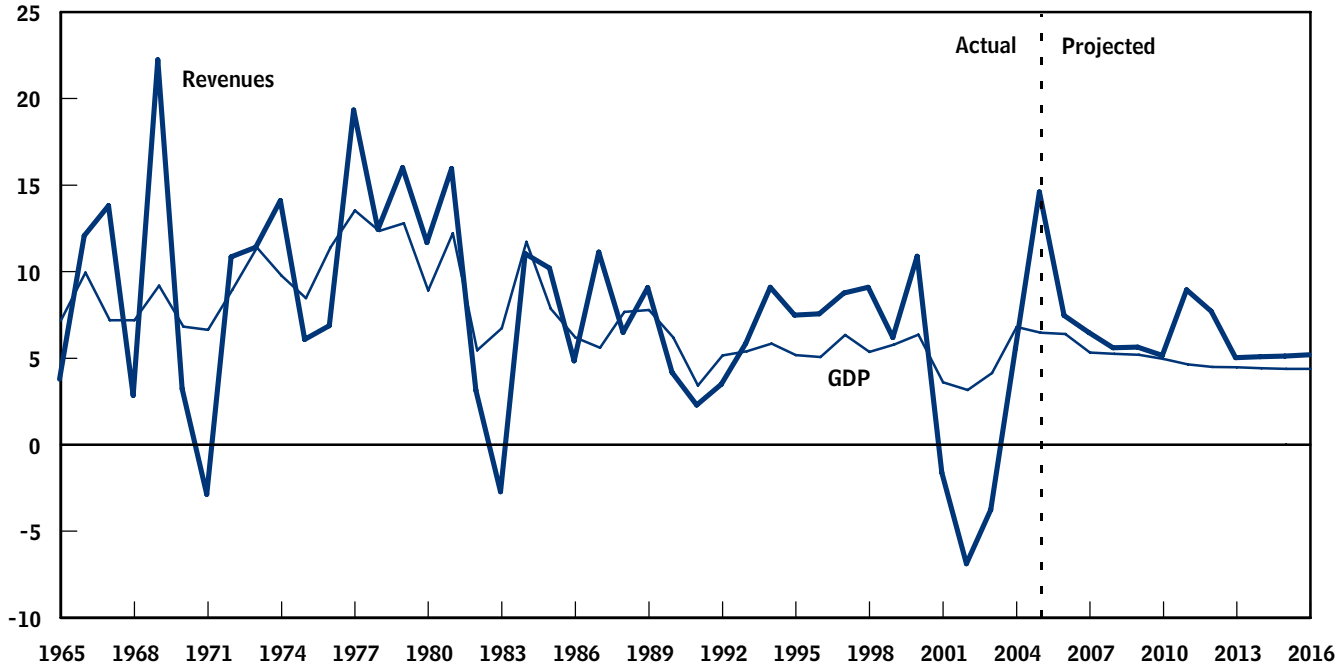


Source: Congressional Budget Office.

Figure 4-2.

Annual Growth of Federal Revenues and Gross Domestic Product, 1965 to 2016

(Percent)



Source: Congressional Budget Office.

CBO's current revenue projections are somewhat higher than those that the agency published in August 2005. Primarily as a result of higher projected nominal GDP—driven by higher prices rather than an increase in real (inflation-adjusted) economic activity—CBO is now projecting a total of $625 billion more in revenues for the 2006-2015 period, about 2 percent more than last summer's projection. A spurt in inflation in the second half of 2005, largely as a result of higher energy prices, combined with an upward revision to past measures of GDP to raise projected GDP and, therefore, taxable income throughout the projection period. Additional increases in projected corporate profits and capital gains realizations (above those amounts implied by the higher GDP alone) also contribute to the higher outlook for revenues.

Revenues by Source

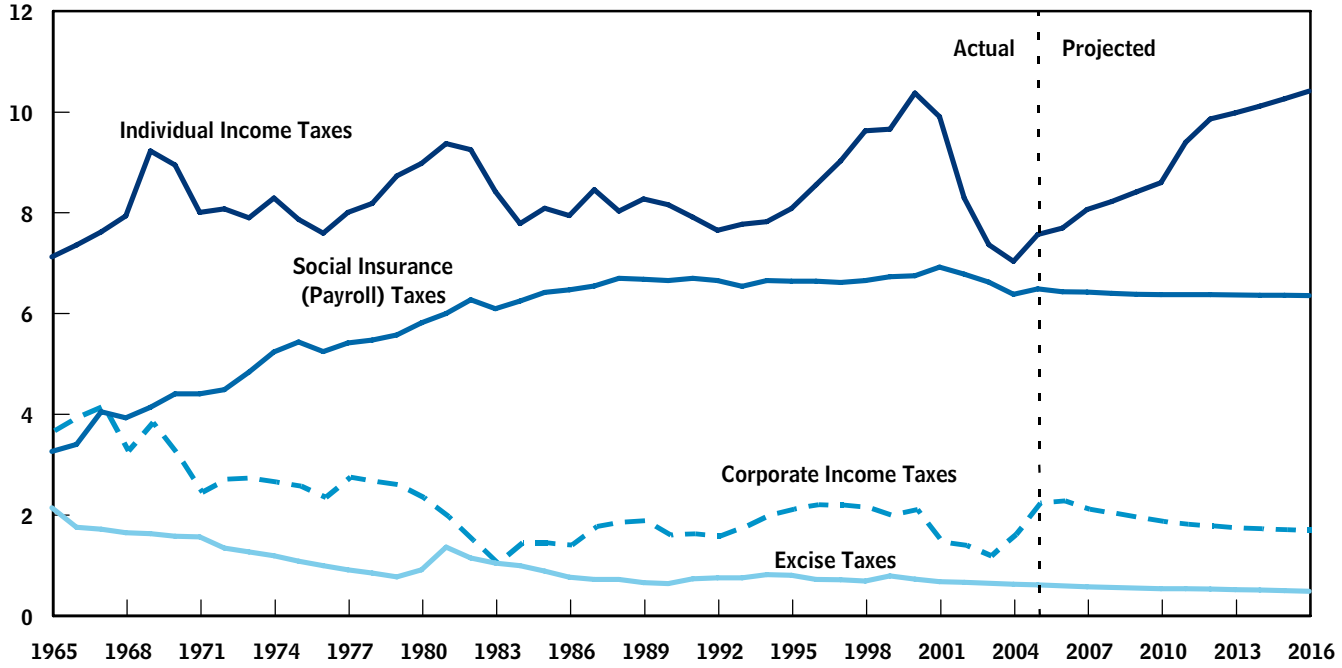
Federal revenues—also referred to as governmental receipts or receipts—derive from various sources: individual income taxes, social insurance (payroll) taxes, corporate income taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. The level of individual income tax receipts—the largest source of federal revenues—has fluctuated significantly in the past several years, from a historical high of 10.3 percent of GDP in 2000 to a more-than-50-year low of 7.0 percent in 2004. Between 1965 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 accounted for about 10 percent of federal revenues since 1980 and typically have amounted to between 1.5 percent and 2 percent of GDP—although they exceeded that level in 2005 when they reached a 25-year high of 2.3 percent of GDP. 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 about 1.5 percent of GDP.

Since 1965, 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

Figure 4-3.

Revenues, by Source, as a Share of Gross Domestic Product, 1965 to 2016

(Percent)



Source: Congressional Budget Office.

insurance taxes contributed about 19 percent of revenues and amounted to 3.2 percent of GDP in 1965; increases in social insurance taxes and the establishment of the Medicare program in 1965 (with its taxes starting in 1966) boosted revenues substantially through the late 1980s. The relative share of corporate income taxes has declined since 1965, when such taxes accounted for about 22 percent of revenues and amounted to 3.7 percent of GDP. The contribution of excise taxes also has declined substantially, from 12.5 percent of revenues in 1960 to less than 4 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 7.5 percent of GDP in 2005 to 10.4 percent in 2016, a gain of 2.8 percentage points. That increase more than accounts for the projected rise in total revenues, which are expected to climb by a smaller amount, 2.2 percentage points, from 17.5 percent of GDP in 2005 to 19.7 percent in 2016. Receipts from corporate income taxes are projected to retreat from their recent high levels relative to GDP, declining from 2.3 percent of GDP in 2005 and 2006 to 1.7 percent by 2016.

About half of the projected increase in individual receipts relative to GDP that occurs over the 2007-2016 period results from scheduled changes in tax laws. The changes include a reduced exemption amount for the alternative minimum tax (AMT) beginning in 2006; higher statutory tax rates on capital gains and dividends starting in 2009; and a host of changes to statutory tax rates, the child tax credit, tax brackets, and other parameters of tax law in 2011.[1] The tax law changes scheduled to take place in 2011 will have the most significant effect on revenues.

The other half of the projected increase in individual receipts relative to GDP is attributable to the structure of the tax code—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 (IRAs).[2] Effective tax rates are projected to rise in part because of the phenomenon known as "real bracket creep," in which the growth of real in-

1. Statutory tax rates—those specified in law—apply to taxable income in a given year.

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

Table 4-1.

Changes in CBO's Projections of Revenues Since August 2005

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2015
Revenues in CBO's August 2005 Baseline	2,280	2,396	2,526	2,675	2,817	3,075	3,312	3,481	3,660	3,848	30,071
Legislative Changes	-7	-6	-1	*	*	*	*	*	*	*	-15
Other Changes											
Economic	29	47	50	50	52	51	50	51	52	54	488
Technical	10	24	23	17	13	13	15	14	12	10	151
Subtotal	39	71	73	68	65	64	66	65	64	64	639
Total Changes	**32**	**65**	**72**	**67**	**65**	**64**	**66**	**65**	**64**	**64**	**625**
Revenues in CBO's January 2006 Baseline	2,312	2,461	2,598	2,743	2,883	3,138	3,378	3,546	3,724	3,912	30,695

Source: Congressional Budget Office.

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

come causes a greater proportion of a taxpayer's income to be taxed in higher brackets. In addition, an increasing number of taxpayers will have to pay the AMT—which is not indexed for inflation. Even without the reduced exemption scheduled to begin in 2006, the AMT will claim growing amounts of income in future years.

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 anticipates that the profit share of GDP will decline in the near term because of increased employer contributions to defined-benefit pension plans (see Box 2-2 on page 34). That profit share will likely continue to decline in later years of the projection period because of a gradual increase in allowable depreciation deductions.

CBO expects that over the coming decade, the amount of revenue arising from other sources combined will remain relatively stable as a share of GDP, although some of those sources will increase or decrease slightly as a share of GDP. In contrast with levels observed at the beginning of the baseline period, receipts from estate and gift taxes are expected to be higher as a percentage of GDP at the end of the projection period, although those receipts will dip substantially in 2010 and 2011 with the full phaseout of the estate tax. With the reinstatement of the tax in 2011, receipts from estate and gift taxes are projected to return to the higher shares observed in the late 1990s. Receipts generated by excise taxes are projected to continue their slow, long-term decline relative to GDP. Miscellaneous receipts from the Federal Reserve are projected to increase slightly relative to GDP as a result of near-term, sustained increases in interest rates.

Changes to CBO's Revenue Projections Since August 2005

CBO has increased its projection of revenues over the 2006-2015 period by $625 billion, or 2.1 percent, compared with its projection of last summer (see Table 4-1). About three-quarters of the increase, or $488 billion, results from changes in CBO's economic outlook, in particular higher projections for GDP and for corporate profits as a percentage of GDP. About one-quarter of the increase, or $151 billion, results from technical changes, which measure how CBO has adjusted its projection of the amount of revenue that a given economic forecast yields. Legislation enacted since August has had a relatively small effect on the revenue projection, reducing receipts by $15 billion over the 2006-2015 period, with most of that reduction concentrated in 2006 and 2007

Box 4-1.

Effects of Recent Legislation on the Revenue Outlook

Since the Congressional Budget Office (CBO) released its previous budget projections in August 2005, policymakers have enacted several laws that affect revenues; those laws have only a small effect on the overall revenue outlook, however. The changes result primarily from legislation that provides tax relief to taxpayers harmed by Hurricane Katrina. The Katrina Emergency Tax Relief Act of 2005 (Public Law 109-73) is estimated to reduce receipts by $3 billion in both 2006 and 2007. The bulk of the reduction stems from three provisions: suspending thresholds on the deductibility of personal casualty losses, extending the period in which insurance proceeds are not subject to tax if they are invested in certain replacement property, and temporarily suspending certain limitations on the deductibility of charitable donations. In addition, the Gulf Opportunity Zone Act of 2005 (P.L. 109-135) is estimated to reduce revenues by $4 billion in 2006, by $3 billion in 2007, and then by $2 billion over the 2008-2015 period. Most of that reduction comes from providing tax incentives to a newly designated "Gulf Opportunity Zone" that covers areas hardest hit by Hurricane Katrina. The act also provides tax reductions for taxpayers in areas hit by Hurricanes Rita and Wilma. (For more details, see Appendix A.)

Other enacted legislation had even smaller effects on revenues. CBO estimates that the United States-Bahrain Free Trade Agreement Implementation Act (P.L. 109-169) will reduce receipts by more than $300 million over the 2006-2015 period. The QI, TMA, & Abstinence Programs Extension & Hurricane Katrina Unemployment Relief Act of 2005 (P.L. 109-91) transfers amounts to the unemployment insurance trust funds of Louisiana, Mississippi, and Alabama, allowing them to reduce their unemployment insurance receipts, which are recorded in the federal budget, by about $400 million over the 2006-2015 period. CBO estimates that a one-year extension of mandated parity in lifetime health insurance limits for mental and physical health (enacted in P.L. 109-151) will reduce revenues by $58 million over the 2006-2008 period.

One new law is estimated to increase revenues. The Terrorism Risk Insurance Extension Act of 2005 (P.L. 109-144) extends for two years, through 2007, the requirement that certain insurance companies offer coverage for damages caused by terrorist attacks. In the event of losses that exceeded set amounts, the companies and policyholders would be levied assessments based on the premiums paid for insurance coverage. Those assessments would be federal revenues. CBO projects that such assessments have an expected value of roughly $700 million over the 2008-2015 period.

and resulting from tax relief related to Hurricane Katrina (see Box 4-1).

Changes in CBO's economic projection since August have increased projections of revenues by relatively stable amounts across the baseline period: between $47 billion and $54 billion per year from 2007 through 2015. Those increases occur mainly because of a rise in projected GDP, which derives from higher prices in the economy, not real economic activity. The higher projected level of GDP means that taxable sources of income, especially wages and salaries and corporate profits, are projected to be higher than anticipated in August. Expected profits are boosted further in the near term because of downward reestimates of contributions to defined-benefit plans and in the longer term because of downward reestimates in proprietors' income (mainly from partnerships and sole proprietorships) and business interest payments. Lower projections of proprietors' income and personal interest income, however, result in lower projections of individual income tax receipts and offset some of the effects of the higher projected profits on revenues.

CBO has increased its revenue projections for other, technical reasons by $10 billion in 2006, by $24 billion in 2007, and by amounts thereafter that gradually decrease

Table 4-2.

CBO's Projections of Revenues, by Source

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
							In Billions of Dollars							
Individual Income Taxes	927	1,003	1,108	1,190	1,281	1,374	1,572	1,724	1,824	1,930	2,043	2,164	6,525	16,210
Corporate Income Taxes	278	302	296	300	303	305	309	317	326	335	346	360	1,513	3,197
Social Insurance Taxes	794	838	882	925	970	1,017	1,064	1,112	1,161	1,212	1,264	1,319	4,857	10,926
Excise Taxes	73	75	76	78	80	82	87	89	91	93	95	97	403	870
Estate and Gift Taxes	25	28	26	28	29	22	20	45	49	55	61	67	124	402
Customs Duties	23	25	26	28	29	30	31	33	35	37	39	41	145	329
Miscellaneous Receipts	33	41	47	49	51	53	55	57	59	61	63	66	255	562
Total	**2,154**	**2,312**	**2,461**	**2,598**	**2,743**	**2,883**	**3,138**	**3,378**	**3,546**	**3,724**	**3,912**	**4,113**	**13,823**	**32,496**
On-budget	1,576	1,704	1,819	1,921	2,031	2,135	2,356	2,561	2,693	2,834	2,985	3,145	10,263	24,482
Off-budget[a]	577	608	642	676	712	747	782	817	853	890	928	968	3,559	8,014
Memorandum:														
Gross Domestic Product	12,293	13,082	13,781	14,508	15,264	16,021	16,768	17,524	18,311	19,121	19,963	20,839	76,343	172,101
							As a Percentage of Gross Domestic Product							
Individual Income Taxes	7.5	7.7	8.0	8.2	8.4	8.6	9.4	9.8	10.0	10.1	10.2	10.4	8.5	9.4
Corporate Income Taxes	2.3	2.3	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.7	1.7	2.0	1.9
Social Insurance Taxes	6.5	6.4	6.4	6.4	6.4	6.3	6.3	6.3	6.3	6.3	6.3	6.3	6.4	6.3
Excise Taxes	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Estate and Gift Taxes	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.3	0.3	0.3	0.3	0.3	0.2	0.2
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	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total	**17.5**	**17.7**	**17.9**	**17.9**	**18.0**	**18.0**	**18.7**	**19.3**	**19.4**	**19.5**	**19.6**	**19.7**	**18.1**	**18.9**
On-budget	12.8	13.0	13.2	13.2	13.3	13.3	14.1	14.6	14.7	14.8	15.0	15.1	13.4	14.2
Off-budget[a]	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.6	4.6	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.

to $10 billion by 2015. Those changes mainly reflect higher projections of capital gains realizations by individuals and corporations, especially in the near term. Those reestimates gradually wane over the projection period because CBO continues to project that gains realizations will revert to their longer-term averages relative to the economy. The technical changes are smaller in 2006 than in subsequent years in part because CBO has reduced its estimates of the amount of tax liability arising from the AMT in tax year 2006 that will be paid in fiscal year 2006 and has raised the amount that will be paid in 2007.

CBO's Current Revenue Projections in Detail

Individual Income Taxes

Increases in individual income tax receipts account for the projected increase in total revenues as a share of GDP over the next 10 years (see Table 4-2). Historically, individual income tax receipts have been the key determinant of movements in total receipts. Between 1992 and 2000, individual income tax receipts more than doubled in nominal dollars, recording an average annual growth rate of nearly 10 percent and reaching a historical peak of 10.3 percent of GDP. After 2000, individual income tax

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. Income growth picked up substantially in 2004 and 2005, and revenues rose to 7.5 percent of GDP in 2005. CBO expects that income tax receipts from individuals will rise further in 2006 to about 7.7 percent of GDP.

According to CBO's projections, individual income tax receipts will continue to increase relative to GDP throughout the coming decade (see Table 4-2). The structure of the income tax system will cause revenues to grow more strongly than output for the entire 10-year projection period. In addition, receipts are projected to be boosted significantly, especially after 2010, by scheduled increases in statutory tax rates and other changes in tax law. As a share of GDP, individual income tax receipts are projected to rise steadily between 2006 and 2010, reaching 8.6 percent. Over the subsequent two years, receipts are projected to increase substantially, reaching 9.8 percent of GDP in 2012. Thereafter, CBO projects, those receipts will continue to increase faster than the overall economy, reaching a historical peak of 10.4 percent of GDP in 2016.

Receipts in 2005. Individual income tax receipts grew by a robust 14.6 percent in 2005. Most of the growth occurred in nonwithheld receipts (those not remitted by withholding from paychecks), which increased by 32 percent over 2004 levels. That substantial increase reflects strong growth in 2004 and 2005 in nonwage personal income (income other than wages and salaries) as well as changes in tax laws that caused a reduction in receipts in 2004 but not in 2005. Income taxes withheld from paychecks increased by 4.4 percent, reflecting growth in wages and salaries.

According to early tabulations from 2004 tax returns, capital gains realizations grew by about 50 percent in 2004, contributing to the strong boost in nonwithheld receipts when taxpayers filed their tax returns in 2005. In addition to those and other income gains recorded, the strong growth in nonwithheld receipts reflected the timing of tax reductions enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). The reduction in tax rates enacted midway through 2003 was made retroactive to the beginning of the year. Although automatic changes to withholding took effect shortly after enactment for wages earned from that point forward, people did not fully adjust their withholding downward to reflect the lower tax rates on wages earned in the first half of the year. As a result, individuals received larger refunds or made smaller payments than usual when they filed their tax returns in the spring of 2004, and tax collections rebounded in 2005.

Projected Receipts in 2006 and 2007. CBO projects that individual income tax receipts will grow by 8.2 percent in 2006 and by 10.4 percent in 2007 (see Table 4-3). That growth in receipts will be driven in part, CBO projects, by growth in taxable personal income—as measured in the national income and product accounts (NIPAs)—of 6.1 percent in 2006 and 2007, slightly stronger than the growth rate recorded in 2005 and the largest increase since 2000. (Taxable personal income includes wages and salaries, dividends, interest, rent, and proprietors' income. For a description of taxable personal income and other components of the tax base, see Box 4-2 on page 88.) The growth of individual income tax receipts typically exceeds the growth of personal income by roughly a percentage point in an expanding economy because of real bracket creep. However, CBO projects that receipts in 2006 and 2007 will grow between 2 and 4 percentage points faster than taxable personal income. That outlook derives from projections of strong increases in certain types of nonwage income, along with added liabilities from the alternative minimum tax.

Under CBO's baseline projections, receipts in 2006 will be boosted by strong growth in tax year 2005 of profits of S corporations, distributions from IRAs, and realizations of capital gains. Because those forms of nonwage income are not included in the NIPA measure of taxable personal income, they cause receipts to grow faster than taxable personal income. Increases in those forms of income in tax year 2005 contribute to the growth in receipts both in fiscal year 2005 (to the degree that taxpayers adjusted their quarterly estimated payments) and in fiscal year 2006 (when taxpayers file their tax returns for 2005). According to CBO's estimates, profits from S corporations increased significantly in 2005, in part because of the expiration at the end of 2004 of the tax incentive for investment called partial expensing (described in more detail below). In addition, CBO estimates that both withdrawals from IRAs and capital gains realizations grew by nearly 13 percent in 2005.

Table 4-3.

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

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Individual Income Tax Receipts														
In billions of dollars	927	1,003	1,108	1,190	1,281	1,374	1,572	1,724	1,824	1,930	2,043	2,164	6,525	16,210
As a percentage of GDP	7.5	7.7	8.0	8.2	8.4	8.6	9.4	9.8	10.0	10.1	10.2	10.4	n.a.	n.a.
Annual growth rate	14.6	8.2	10.4	7.4	7.7	7.3	14.4	9.6	5.8	5.8	5.8	5.9	n.a.	n.a.
Taxable Personal Income														
In billions of dollars	8,121	8,613	9,135	9,649	10,154	10,658	11,155	11,652	12,162	12,687	13,236	13,812	50,752	114,301
As a percentage of GDP	66.1	65.8	66.3	66.5	66.5	66.5	66.5	66.5	66.4	66.4	66.3	66.3	n.a.	n.a.
Annual growth rate	5.9	6.1	6.1	5.6	5.2	5.0	4.7	4.4	4.4	4.3	4.3	4.4	n.a.	n.a.
Individual Receipts as a Percentage of Taxable Personal Income	11.4	11.6	12.1	12.3	12.6	12.9	14.1	14.8	15.0	15.2	15.4	15.7	n.a.	n.a.

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; n.a. = not applicable.

The scheduled significant decline in the AMT exemption under current law in tax year 2006 leads CBO to project substantial increases in AMT receipts in 2006 and, especially, in 2007.[3] Projected tax liability from the AMT in tax year 2006 is expected to jump by more than $35 billion. For several reasons, CBO anticipates that most of that additional liability will be paid in fiscal year 2007. First, with the reduced exemption, many taxpayers may be surprised when they file their 2006 tax returns in the spring of 2007 and find that they have incurred substantial AMT liability. Those taxpayers will pay their AMT liability with their tax returns in fiscal year 2007 and, in addition, may be subject to penalties for not paying enough of their taxes earlier through withholding and estimated payments. 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 incomes and tax withholding will enable them to avoid penalties through application of one of the currently available "safe harbors."[4] Finally, up to the time that tax forms for 2006 are published late that year, policymakers can change the AMT exemption retroactively. Since the Congress has given indications that it will act this year to avoid the imminent AMT hit, taxpayers may anticipate such action and decide not to adjust their estimated tax payments. (CBO's baseline projection, however, must conform to current law and does not assume any Congressional action.)

Projected Receipts Beyond 2007. In 2008 and beyond, CBO's projected pattern of revenues reflects steady growth in personal income, punctuated by scheduled changes to tax law in specific years. Receipts are expected to continue to rise faster than either GDP or taxable personal income in each year of the projection period, influenced by two broad factors: changes in tax legislation and several characteristics inherent in the tax system. Excluding the effects of changes in tax law, CBO's projection of capital gains realizations works in the opposite direction,

3. The exemption drops from $58,000 in 2005 to $45,000 in 2006 for married taxpayers filing jointly, and from $40,250 to $33,750 for single taxpayers. In late 2005, the House of Representatives and the Senate passed different provisions for 2006 that either maintained the exemption at its 2005 levels or increased it, but no such provision has yet been enacted into law.

4. For example, taxpayers with income below $150,000 can avoid penalties by making estimated payments and withholding 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 penalty. Other safe harbors also exist.

slightly reducing the growth of receipts relative to growth of GDP over most of the projection period.

Tax Law Changes. Scheduled changes in tax law—principally from legislation enacted in 2001, 2003, and 2004—will alter the pattern of receipts growth, especially in 2011 and 2012. The scheduled changes largely tend to increase receipts. For instance, the tax rates on dividends and capital gains will rise in 2009, returning to the rates that existed before 2003. Most important, taxes are projected to increase sharply in 2011 when, among other things, statutory tax rates rise, the child tax credit declines, and tax brackets and standard deductions for joint filers contract in size to less than twice those for single taxpayers. Only the phaseout of restrictions on itemized deductions and on personal exemptions for high-income taxpayers during tax years 2006 to 2010 will tend to reduce the growth of individual income tax receipts.

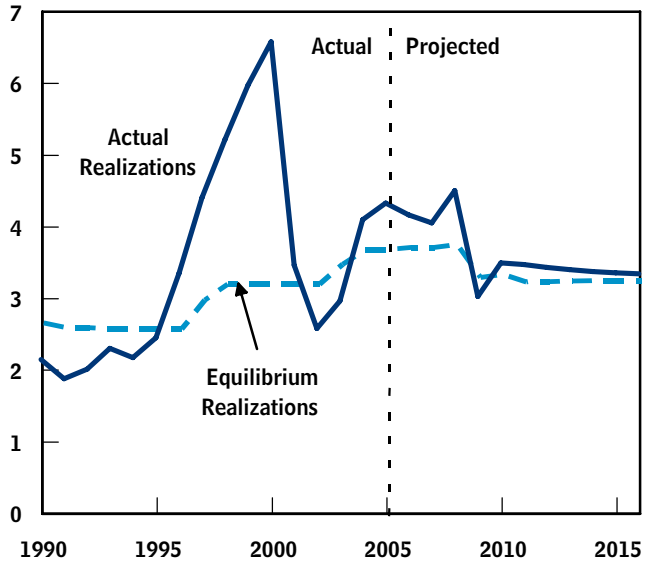
Characteristics of the Tax System. CBO projects that effective tax rates will steadily rise over the next 10 years, thereby increasing the receipts generated by the economy. That rise occurs partly because of real bracket creep and partly because the AMT—which is not indexed for inflation—will be paid by an increasing number of taxpayers and affect growing amounts of income in future years. (For a more detailed description of the increasing significance of the AMT in CBO's revenue projections, see Box 4-3 on page 91.) Also pushing up effective rates are taxable distributions from tax-deferred retirement accounts, such as IRAs and 401(k) plans, which are expected to increase as the population ages. Contributions to those accounts were exempt from taxation when they were initially made, which reduced taxable income reported to the Internal Revenue Service (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 2007. Although capital gains plunged between 2000 and 2002, they rebounded strongly in 2003 and 2004. According to early tabulations from 2004 tax returns, capital gains realizations grew by about 50 percent from 2003 levels. Based on recent economic growth and stock market activity, CBO estimates that capital gains increased by a further 13 percent in 2005, boosting them to just about double their 2002 trough (see Table 4-4 on page 92).

Figure 4-4.

Capital Gains Realizations as a Share of Gross Domestic Product, Calendar Years 1990 to 2016

(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 2002, 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.

The strong recovery in capital gains realizations since 2002 has pushed them to a level that, relative to the size of the economy, is above that implied by their past historical relationship (see Figure 4-4). Consequently, CBO projects that, beyond 2005, capital gains will rise a bit more slowly than GDP. As it has tended to do in the past, the ratio of gains realizations to GDP is expected to gradually approach its long-run average level relative to the economy. Between 2007 and 2016, capital gains realizations are projected to grow by an average of 2.5 percent annually, lower than the 4.7 percent growth rate of both GDP and taxable personal income. Receipts from gains are expected to grow in step with gains realizations, except when tax rates increase in 2009.

Box 4-2.

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

As a first approximation, the individual income tax base includes estimates of dividends, interest, wages and salaries, rent, 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 when the income is accrued 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 (income that is not earned in a cash transaction, including personal earnings within pension funds and life insurance policies and income from owner-occupied housing) that are not taxable. 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. Contributions from income made to tax-deductible individual retirement accounts (IRAs) 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. Taxpayers then pay the higher of the AMT or the regular tax. The ratio of tax liability to AGI is the **effective tax rate on AGI.**

The scheduled return to higher capital gains tax rates in 2009 is expected to alter the timing of realizations by encouraging taxpayers to speed up the sale of assets that will generate gains from that year to late 2008. In addition, realizations will be depressed after 2008 because the projected long-term equilibrium level of gains will be slightly lower as a result of the higher tax rates. Realizations are projected to rise by 17 percent in 2008 (boosted by the speedup in realizations), decline by 29 percent in 2009 (held down by the speedup and the adjustment to the lower equilibrium level), and rise by 21 percent in 2010 (when they rebound after the onetime speedup). After 2010, realizations are projected to rise by 3 percent to 4 percent annually through 2016.

Box 4-2.

Continued

The Social Insurance Tax Base

Social insurance taxes, the second-largest source of receipts, use payroll as their base. Those taxes largely fund Social Security and the Hospital Insurance program (Part A of Medicare). Social Security taxes are imposed as a percentage of pay up to an annual **taxable maximum** (currently $94,200) that is indexed for the growth of wages in the economy. Hospital Insurance 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 different ways in the NIPAs. Several adjustments are made to those reported 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 on the basis 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 are based on **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 value actually falls, allowing firms to 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 for tax purposes. 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**.

The Total Tax Base

Despite the many adjustments that must be made to calculate actual tax bases, a ready approximation is the sum of wages and salaries, nonwage personal income, and corporate book profits. Those items comprise most of the bases of the individual income, corporate income, and social insurance taxes and therefore constitute the bulk of taxed income.

Changes Since August 2005. Compared with the projections that the agency made five months ago, CBO is anticipating $9 billion less in individual income tax receipts in 2006 and $144 billion more over the 2007-2015 period. Changes to CBO's economic projections account for just over half of the increases. Specifically, CBO boosted its projection of individual income tax revenues by $5 billion for 2007 and by a total of $73 billion for 2008 through 2015—mainly as a result of higher projected GDP and personal income. Certain legislative changes, primarily the enactment of tax initiatives related to recent hurricanes, especially Hurricane Katrina, caused

Box 4-3.

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 (GDP) 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 reaches 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 2006, 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 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] Like the rate structure of the regular income tax, the AMT extracts a greater proportion of overall income as real income rises. But unlike the regular income tax, the AMT is not indexed for 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 have reduced overall taxpayer liability and 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, the recent legislation has reduced regular tax receipts and therefore enlarged the AMT share and subsequently its importance to total individual income tax revenues.

The AMT's Impact in the Next 10 Years

The number of AMT qualifiers is expected to rise from 4 million in 2005 to 33 million by 2016 and revenues from the AMT to increase almost six-fold, from $14 billion last year to about $81 billion in 2016 (see the figure at right). Compared with fiscal year 2005, the AMT's contribution to individual income tax receipts is expected to more than double by 2016, rising from 1.5 percent to 3.8 percent of total receipts from the individual income tax.

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

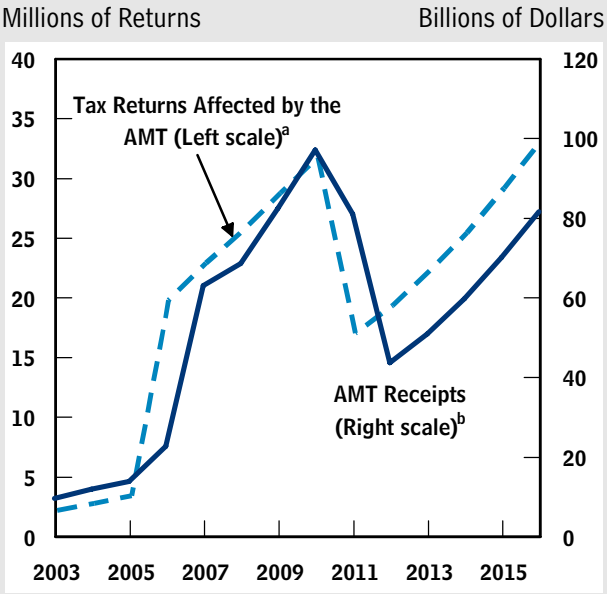
Box 4-3.

Continued

Projections for the AMT rise and fall through that period largely because of the phasing in and out of tax changes enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001, the Jobs and Growth Tax Relief Reconciliation Act of 2003, and the Working Families Tax Relief Act of 2004. For example, the 2004 law expanded the amount of income exempted under the AMT through 2005. Now that the provision has expired, the number of returns subject to the AMT is expected to rise, from 4 million in 2005 to 20 million in 2006, and the resulting AMT liability on those returns is projected to jump from $15 billion to $51 billion. CBO expects that much of that increased liability will be paid by taxpayers in fiscal year 2007. (In late 2005, the House and Senate passed different one-year increases in the exemption amount, but no such provision has yet been enacted into law.)

In 2011, when statutory tax rates are scheduled to increase under the regular income tax and other law changes occur, the number of AMT returns is projected to decline almost by half: from 32 million in 2010 to 17 million in 2011. Receipts from the AMT are projected to fall from $97 billion in 2010 to $43 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 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. Calendar year basis.

b. Fiscal year basis.

CBO to reduce its projection of revenues over the 2006-2015 period by $11 billion, with most of the reduction affecting 2006 and 2007.

The remainder of the changes to receipts derive from other, technical factors. CBO reduced its projection of receipts by $5 billion in 2006 and raised its projection by $14 billion in 2007; it raised its projection by $59 billion over the 2008-2015 period to account for such effects. The upward reestimates largely reflect new information on capital gains realizations. CBO's current expectation for growth of capital gains realizations in 2004 (about 50 percent) is roughly double the 23 percent growth anticipated in the August projection; gains are also expected to have grown more rapidly in 2005 than previously projected. As a result, CBO has raised its estimates of liabilities resulting from capital gains, with that effect tapering off in the later years of the projection period as gains are assumed to revert to their long-term equilibrium share relative to GDP.

The upward revision to projected receipts from capital gains is anticipated to be offset in 2006 by a shifting of receipts between fiscal years 2006 and 2007. As noted above, CBO has increased its estimate of the portion of tax liabilities generated by the AMT in tax year 2006 that will actually be paid in fiscal year 2007.

Table 4-4.

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	22	112	26	99	19	11.3
2000	644	16	127	14	119	20	11.8
2001	349	-46	66	-48	100	-16	10.0
2002	269	-23	49	-25	58	-41	6.8
2003	323	20	51	4	50	-14	6.3
2004	479	48	71	39	60	20	7.4
2005	539	13	80	13	75	25	8.1
2006	550	2	82	2	81	8	8.1
2007	564	2	84	2	83	2	7.4
2008	660	17	96	15	84	2	7.1
2009	465	-29	86	-11	97	15	7.5
2010	564	21	104	22	94	-3	6.8
2011	586	4	111	6	107	14	6.8
2012	605	3	114	3	112	5	6.5
2013	627	4	118	3	116	3	6.3
2014	650	4	122	4	120	3	6.2
2015	674	4	126	4	124	4	6.1
2016	701	4	131	4	129	4	5.9

Source: Congressional Budget Office.

Notes: Capital gains realizations represent net positive long-term gains. Data for realizations and liabilities after 2002 and data for 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.

Table 4-5.

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

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Social Insurance Tax Receipts														
In billions of dollars	794	838	882	925	970	1,017	1,064	1,112	1,161	1,212	1,264	1,319	4,857	10,926
As a percentage of GDP	6.5	6.4	6.4	6.4	6.4	6.3	6.3	6.3	6.3	6.3	6.3	6.3	n.a.	n.a.
Annual growth rate	8.3	5.5	5.2	4.9	4.9	4.8	4.6	4.5	4.4	4.4	4.3	4.3	n.a.	n.a.
Wages and Salaries														
In billions of dollars	5,652	5,970	6,299	6,652	7,015	7,362	7,701	8,044	8,400	8,767	9,149	9,545	35,029	78,934
As a percentage of GDP	46.0	45.6	45.7	45.9	46.0	46.0	45.9	45.9	45.9	45.9	45.8	45.8	n.a.	n.a.
Annual growth rate	6.7	5.6	5.5	5.6	5.5	5.0	4.6	4.5	4.4	4.4	4.4	4.3	n.a.	n.a.
Social Insurance Tax Receipts as a Percentage of Wages and Salaries	14.1	14.0	14.0	13.9	13.8	13.8	13.8	13.8	13.8	13.8	13.8	13.8	n.a.	n.a.

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; n.a. = not applicable.

Social Insurance Taxes

According to CBO's projections, revenues from social insurance (payroll) taxes will claim a roughly constant share of GDP—between 6.3 percent and 6.4 percent—from 2006 through 2016 (see Table 4-5). In relation to wages and salaries—the approximate base of those payroll taxes—revenues are also projected to be relatively stable, declining slightly from 14.0 percent in 2006 to 13.8 percent by 2009. That small decline occurs because of slower growth in receipts derived from unemployment taxes, declines in revenues for other federal retirement programs, and declines in the share of earnings below the taxable maximum amount for Social Security.

The largest components of social insurance tax receipts are taxes collected for Social Security (officially Old-Age, Survivors, and Disability Insurance, or OASDI) and Medicare's Part A (which covers Hospital Insurance, or HI). A small share of social insurance tax revenues comes from unemployment insurance taxes and contributions to other federal retirement programs (see Table 4-6). The premiums for Medicare Part D, the new prescription drug program, are considered offsets to spending and do not show up on the revenue side of the budget; the same treatment is accorded premiums for Medicare Part B, the Supplementary Medical Insurance program.

Social Security and Medicare taxes are calculated as a percentage of covered wages. Unlike the HI tax, which applies to all covered wages, the Social Security tax applies only up to the 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 share of GDP and the distribution of income from wages remains relatively unchanged. In recent years, with a rising share of wages earned above the taxable maximum, the share of wages that is subject to the OASDI tax has declined.

From 2006 onward, social insurance tax receipts are expected to decline very gradually as a fraction of both 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, the states will largely finish replenishing unemployment trust funds that were depleted by the 2001 recession and its aftermath. Second, revenues

Table 4-6.

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

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Social Security	577	608	642	676	712	747	782	817	853	890	928	968	3,559	8,014
Medicare	166	176	186	197	207	218	228	238	249	260	272	284	1,036	2,339
Unemployment Insurance	42	45	45	43	43	44	46	49	52	55	57	60	221	493
Railroad Retirement	4	4	4	4	4	4	4	5	5	5	5	5	22	45
Other Retirement	4	4	4	4	4	4	4	3	3	3	3	2	20	34
Total	**794**	**838**	**882**	**925**	**970**	**1,017**	**1,064**	**1,112**	**1,161**	**1,212**	**1,264**	**1,319**	**4,857**	**10,926**

Source: Congressional Budget Office.

associated with other federal retirement programs will be lower as the number of workers covered by Railroad Retirement and the old Civil Service Retirement System declines. Last, the share of wages subject to the Social Security tax will continue to decrease as a slightly higher fraction of total wage and salary income rises above the taxable maximum.

Compared with its projections last August, CBO now anticipates about $33 billion more in social insurance tax receipts for the 2006-2015 period. Changes in CBO's economic forecast—mainly higher projections of nominal wages and salaries in the later years of the baseline period—account for $40 billion of that increase. Offsetting that amount by about $6 billion are reductions in revenue projections because of technical factors, primarily the effects of changes in unemployment benefits on state unemployment trust funds and small changes in the projections of the share of wages subject to social insurance taxes.

Corporate Income Taxes

Receipts from corporate income taxes have grown sharply in the past two years—to $278 billion in 2005, more than twice the amount recorded in 2003. They totaled 2.3 percent of GDP in 2005, a level just slightly above the 2.2 percent observed in the late 1990s. CBO projects that corporate tax revenues will increase by 8.6 percent in 2006, to $302 billion (see Table 4-7). Because profits are expected to grow more slowly than GDP after 2006, however, the sharp increase in receipts as a share of GDP observed in the past two years is expected to reverse. Receipts will remain near their 2006 level through 2011 in dollar terms, CBO projects, but will fall to 1.7 percent of GDP by 2016, 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 have rebounded strongly in recent years. Corporate receipts peaked at about 2.2 percent of GDP during the 1996-1998 period, earlier than the peak for individual income taxes, and then dipped just slightly by 2000, to 2.1 percent of GDP. The recession in 2001 reduced profits and tax revenues substantially. Business tax incentives enacted in the Job Creation and Worker Assistance Act of 2002 (JCWAA) and JGTRRA further reduced revenues. Corporate profits rebounded strongly in 2003, but corporate tax receipts as a share of GDP fell to 1.2 percent, their lowest share since 1983. Profits again grew strongly in 2004, and with the expiration of the tax incentives at the end of 2004, corporate receipts reached 2.3 percent of GDP in 2005, their highest share since 1980.

Tax provisions enacted after 2001, especially the business tax cuts in JCWAA and JGTRRA, have had a substantial effect on recent corporate tax liabilities and receipts. Combined, JCWAA and JGTRRA allowed firms to expense (immediately deduct from their taxable income) between 30 percent and 50 percent 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. The American Jobs Creation Act of 2004 (AJCA) also

Table 4-7.

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

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Corporate Income Tax Receipts														
In billions of dollars	278	302	296	300	303	305	309	317	326	335	346	360	1,513	3,197
As a percentage of GDP	2.3	2.3	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.7	1.7	n.a.	n.a.
Annual growth rate	47.0	8.6	-2.2	1.5	1.0	0.5	1.6	2.5	2.7	3.0	3.3	3.8	n.a.	n.a.
Corporate Book Profits														
In billions of dollars	1,328	1,476	1,438	1,439	1,459	1,501	1,543	1,596	1,658	1,724	1,800	1,876	7,380	16,034
As a percentage of GDP	10.8	11.3	10.4	9.9	9.6	9.4	9.2	9.1	9.1	9.0	9.0	9.0	n.a.	n.a.
Annual growth rate	28.4	11.2	-2.6	*	1.5	2.9	2.8	3.4	3.9	4.0	4.4	4.2	n.a.	n.a.
Taxable Corporate Profits[a]														
In billions of dollars	1,020	1,115	1,064	1,053	1,054	1,073	1,091	1,117	1,150	1,186	1,231	1,282	5,335	11,301
As a percentage of GDP	8.3	8.5	7.7	7.3	6.9	6.7	6.5	6.4	6.3	6.2	6.2	6.2	n.a.	n.a.
Annual growth rate	34.1	9.3	-4.5	-1.1	0.1	1.8	1.7	2.3	2.9	3.1	3.8	4.2	n.a.	n.a.
Corporate Receipts as a Percentage of Taxable Profits	27.3	27.1	27.8	28.5	28.7	28.4	28.4	28.4	28.3	28.3	28.2	28.0	n.a.	n.a.

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; n.a. = not applicable; * = increase of less than 0.05 percent.

a. 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.

affected corporate tax receipts in 2005. AJCA repealed the exclusion on a portion of income earned by exporters (called extraterritorial income), allowed a deduction for income attributable to production in the United States, and altered numerous other tax provisions for both domestic and foreign corporations, including temporarily reducing the tax rate on repatriated foreign income, thus inducing firms to repatriate foreign earnings in 2005. The Gulf Opportunity Zone Act of 2005 provided tax incentives for various investments, which are expected to reduce corporate tax receipts in 2006 and 2007.

Projected Receipts. CBO's projection of corporate tax receipts depends critically on its projection of book 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 measure in the national income and product accounts that most closely approximates the tax base for the corporate income tax (see Box 4-2 on page 88). CBO makes certain adjustments to book profits to generate a closer approximation, called taxable corporate profits.

CBO's projection of book profits is heavily influenced by assumptions about depreciation deductions and, especially in the near term, contributions to underfunded pension plans (see Box 2-2 on page 34). CBO projects that taxable corporate profits will decline slightly in 2007 and 2008, stabilize in 2009, and then grow through 2016, although more slowly than GDP. In the near term, increases in contributions to defined-benefit pension plans will reduce profits relative to GDP. In the longer term, the strength of businesses' investment in equipment over the 2004-2007 period is expected to generate increased depreciation deductions for several years after the investment strength dissipates, thereby reducing profits relative to GDP. Expiration of the partial-expensing pro-

visions at the end of 2004 also contributes to the projected decline in profits relative to GDP after 2006. Profits were held down by the partial-expensing provisions in 2004, but for the same reason they will be higher for several years after 2004 than they otherwise would have been. Those higher profits result because the partial expensing provisions allowed firms to take their deductions earlier than they otherwise would have, leaving fewer deductions, and correspondingly higher profits, for later years. The largest increases in profits that are projected to result from partial expensing occur in 2006, with the increases diminishing thereafter.

According to CBO's projections, corporate income tax receipts will increase slightly faster than corporate profits over the 2007-2009 period. Much of that increase in the average tax rate on profits will be caused by the recapture of depreciation deductions taken under partial expensing through 2004, as well as by the effects of other legislation discussed above. Some of the increase also stems from the relationship between gross taxable profits (a measure that includes only the profits of profitable firms) and net taxable profits (a measure that also includes losses of unprofitable firms). Because only profitable corporations pay taxes, gross profits are a better measure of the tax base than are net profits. The ratio of gross profits to net profits varies with the ratio of (net) profits to GDP. If the ratio of profits to GDP falls substantially, as is projected to occur between 2007 and 2009, some of the weakness in profitability will occur in firms in a loss position rather than in those with profits, dampening the impact on corporate tax liabilities. After 2009, when CBO anticipates that the profit share of GDP will decline at a much slower rate, the projection for the average tax rate (which measures taxes relative to net taxable profits) becomes more stable and receipts closely follow the profits projection.

The Longer-Term Implications of the Recent Increase in Profits and Receipts. The latest historical data on profits and CBO's estimates of other relevant measures are now roughly consistent with the strong level of corporate tax receipts paid in 2005. In January 2005, CBO projected that receipts would total $216 billion that year, about $62 billion less than the amount actually paid. Since then, taxable profits have been revised upward by about $160 billion for 2004 and by about $140 billion for 2005. Some of those reestimates reflect upward revisions to profits as reported in the national income and product accounts for 2004 and early 2005. Furthermore, CBO has increased its projection of corporations' capital gains realizations based on movements in capital gains of individuals, which are now known to have grown robustly in 2004. CBO also has increased its estimates of the amount of gross profits recorded relative to net profits.

CBO considers the substantial increase in corporate receipts relative to GDP that occurred in 2005 to be mostly temporary because the factors driving it are mainly temporary. Most important, CBO projects that the NIPA measure of book profits relative to GDP peaked in 2005 and will steadily decline throughout the projection period.

In addition, corporate capital gains are projected to decline slightly relative to GDP as they return to their historical norms. Further, any boost to receipts in 2005 from repatriations of foreign earnings is expected to be temporary as well as relatively small. As a result of those factors, CBO projects that corporate receipts relative to GDP will decline steadily to 1.7 percent by 2016, more in line with receipts recorded in the early 1990s than with the higher amounts recorded in the late 1990s and in 2005.

Changes Since August 2005. The new outlook for corporate receipts is larger by about $467 billion over the 2006-2015 period than CBO's projection from August 2005. About $396 billion of the increase reflects changes in the economic projection. Corporate profits are expected to be higher in all years partly because projected GDP is higher and a portion of that additional GDP is expected to accrue to profits. In addition, the profit share of GDP is projected to be higher than CBO projected in the summer. For the near term, CBO has raised its projection of the level of profits to reflect lower estimates of employers' contributions to defined-benefit pension plans. For the longer term, it has raised its projection of the profit share of GDP to reflect lower shares allocated to business interest costs and proprietors' income.

Technical changes account for an additional $74 billion of CBO's increase in projected corporate tax revenues since the summer. Most of that increase results from a raised estimate of capital gains realizations for 2004, which persists to a diminishing degree over time in the projection.

Table 4-8.

CBO's Projections of Excise Tax Receipts, by Category

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Highway Taxes	36.6	38.1	38.9	39.7	40.6	41.4	44.8	46.7	47.7	48.6	49.6	50.6	205.4	448.7
Airport Taxes	10.2	10.9	11.6	12.3	13.0	13.8	14.5	15.3	16.1	16.9	17.7	18.6	65.2	149.7
Telephone Taxes	5.9	5.3	4.6	4.9	5.2	5.3	5.3	5.3	5.4	5.4	5.5	5.5	25.3	52.4
Alcohol Taxes	8.6	8.8	9.0	9.2	9.5	9.7	9.9	10.2	10.4	10.7	10.9	11.2	47.3	100.7
Tobacco Taxes	8.7	8.9	8.7	8.6	8.5	8.4	8.4	8.3	8.2	8.1	8.0	7.9	42.6	83.1
Other Excise Taxes	3.1	3.2	3.4	3.4	3.5	3.6	3.6	3.7	3.7	3.4	3.4	3.4	17.5	35.1
Total	**73.1**	**75.2**	**76.2**	**78.2**	**80.3**	**82.2**	**86.6**	**89.5**	**91.4**	**93.1**	**95.1**	**97.1**	**403.5**	**869.7**

Source: Congressional Budget Office.

Excise Taxes

Receipts from excise taxes are expected to continue their long-term decline as a share of GDP over the 10-year projection period, falling from 0.6 percent last year to 0.5 percent in 2008 and through the end of 2016. 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 grow with real GDP, but they do not grow as fast as nominal GDP does.

Nearly all excise taxes fall into five major categories: highway, airport, telephone, alcohol, and tobacco taxes (see Table 4-8). Almost half of excise receipts are earmarked by law for the Highway Trust Fund; they come primarily from taxes on gasoline and diesel fuel. Those and other highway receipts are projected to grow at an average annual rate of 2.9 percent between 2006 and 2016, boosted a bit in 2011 when reduced tax rates on ethanol-blended fuels expire. (They would average about 2.0 percent annual growth without that change in law.) Most airport excise taxes are levied as a percentage of ticket prices, so they tend to grow at a faster rate than the other categories do, increasing by an average of 5.6 percent annually between 2006 and 2016. Receipts from alcohol taxes are projected to rise at about the rate of real GDP over the projection period. As per capita use of tobacco products continues to decline, receipts from tobacco taxes are expected to decline slowly through 2016 and to be only partially offset by increases in population.

The telephone tax is projected to decline in the near term and then slowly increase, ending the projection period at about 7 percent below its level in 2005. The telephone tax is a 3 percent levy on the value of local, toll (long distance), and wireless phone services. Recently, the component of the tax derived from toll services has been challenged in court on the basis that most such charges no longer meet the statutory definition of taxable toll services. The IRS has lost numerous cases defending the toll tax, including three in federal courts of appeal. The agency continues to collect the tax and is appealing decisions in other courts. CBO's projections assume that there is a significant likelihood—about 75 percent—that the IRS will acquiesce or lose those cases by 2007 and the tax on toll services will be terminated. However, CBO's projection also assumes that there is about a 25 percent likelihood that the tax on toll services will continue. The other components of the telephone tax are expected to continue, although the tax on wireless services also could be challenged and subject to legal action in coming years.

IRS termination of the toll tax would require the agency to issue refunds, if requested by taxpayers, on toll service payments made for about three years prior to the date of termination. Those refund payments, which CBO assumes would be requested primarily by businesses with large phone bills, would significantly reduce projected revenues from the telephone tax over the next few years; in the long term, however, the decline would be much smaller. Toll services are projected to represent a declining component of the overall telephone tax base, even if the tax on toll services stays in place, because of continued

Table 4-9.

CBO's Projections of Other Sources of Revenue

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Estate and Gift Taxes	25	28	26	28	29	22	20	45	49	55	61	67	124	402
Customs Duties	23	25	26	28	29	30	31	33	35	37	39	41	145	329
Miscellaneous Receipts														
Federal Reserve System earnings	19	27	32	35	37	39	41	42	44	46	48	50	182	414
Universal Service Fund	7	7	8	8	8	8	8	8	8	8	9	9	39	81
Other	6	7	8	7	6	6	6	6	7	7	7	7	34	67
Subtotal	33	41	47	49	51	53	55	57	59	61	63	66	255	562
Total	**81**	**94**	**99**	**105**	**108**	**105**	**106**	**135**	**143**	**153**	**164**	**173**	**524**	**1,293**

Source: Congressional Budget Office.

declines in prices and the increasing prevalence of wireless services. Telephone tax revenues overall are projected to increase in the longer term because of growth in the wireless component.

CBO's current projection of total excise tax receipts for the baseline period is about $3 billion lower than the projection it published in August. Changes in CBO's economic forecast raised the earlier projection by $1 billion, which is offset by a downward technical adjustment of $5 billion over the 10-year period. The decreases attributable to technical factors reflect a larger portion of lower-taxed ethanol blends in motor-fuel consumption than previously expected and a drop in receipts derived from the telephone tax.

Estate and Gift Taxes

If provisions of current law remain in place, CBO projects, receipts from estate and gift taxes will fall from 0.2 percent of GDP in 2005 to 0.1 percent in 2010 and 2011, and then jump to 0.3 percent of GDP in 2012 and thereafter. That pattern reflects the phaseout of the estate tax through 2010 as provided by the Economic Growth and Tax Relief Reconciliation Act of 2001 (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 pattern of receipts over time has changed dramatically. The estate tax under current law is gradually being eliminated (albeit temporarily), and the gift tax remains in the tax code but in a modified form. EGTRRA effectively exempted $1.5 million of an estate from taxation in 2005. That amount increases to $2.0 million this year and will rise again in 2009 to $3.5 million. EGTRRA is also reducing the highest tax rate on estates incrementally from 50 percent in 2002 to 45 percent in 2007 and then will eliminate the tax 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 paid after a lag, and because the gift tax remains in the tax code, receipts from estate and gift taxes do not disappear completely in CBO's projection but instead reach a trough in 2010 and 2011 (see Table 4-9). 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 2006-2016 period. CBO estimates that after 2011, estate and gift tax receipts will return to roughly their 2002 share of GDP.

Since August, CBO has raised its projections of estate and gift receipts over the 2006-2015 period by $12 billion. More than $4 billion of that increase is attributable to changes in CBO's economic forecast and almost $8 billion results from technical reestimates. The technical reestimates stem partly from the stronger-than-expected growth in the value of assets, especially owner-occupied housing, in the second half of calendar year 2005, which boosts the size of taxable estates and generates increased tax receipts. Based on new data indicating that the level of gift tax receipts in 2005 was higher than had been expected, CBO also increased its estimates of gift tax receipts between 2006 and 2010. For 2011 alone, CBO has slightly reduced its projection of gift tax receipts as a result of reducing its estimates of the amount of gifts that are expected to be shifted from other years into 2010, just before the expiration of the reduced rate of tax on gifts and reinstatement of the estate tax.

Other Sources of Revenue

Customs duties and numerous miscellaneous sources yield much smaller amounts of revenue than the major levies do. CBO estimates that those revenues will remain fairly steady as a share of GDP—at about 0.5 percent—throughout the projection period.

CBO further 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. However, the effect is offset in part as various tariff reductions take effect. Projections of customs duties over the 2006-2015 period are about $17 billion lower compared with the August projections. The reduction in collections is more significant in the later years of the projection period and is attributable primarily to lower projected imports.

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 the interest that the Federal Reserve earns on the portfolio of securities that it owns 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. Federal Reserve earnings have declined each year since 2001. Interest rates generally declined through early 2004, especially on short-term securities that make up most of the Federal Reserve's portfolio. Additionally, in the past two years, some bank merger activity substantially increased the assets of member banks, and the Federal Reserve, following its longstanding policy, responded by retaining more of its earnings in its surplus account. That addition to its surplus account caused a reduction in federal revenues. For the projection period, CBO expects that, on average, short- and long-term interest rates will rise through the first half of calendar year 2006 and remain relatively stable thereafter, which will increase receipts from the Federal Reserve System between 2007 and 2016 to a level that is more consistent with the relationship to GDP that existed in the 1990s.

Since August, CBO has increased its projection of receipts from the Federal Reserve for the 2006-2008 period by about $3 billion and reduced it for the 2009-2015 period by about $13 billion. Interest rates are projected to be slightly higher in the near term and lower in the longer term than projected in August. CBO also has made upward technical adjustments to its projection of other miscellaneous receipts—mostly to immigration, passport, and consular fees—totaling about $7 billion between 2006 and 2015.

The Effect of Expiring Tax Provisions

CBO's revenue projections rest on the assumption that current tax laws remain unaltered by future legislative changes. Thus, the projections assume that provisions that are currently scheduled to expire will do so. The sole exception to that approach is the expiration of excise taxes dedicated to trust funds; under the rules that govern the baseline, those taxes are assumed to continue regardless of whether they are scheduled to expire.

The assumption that tax provisions will expire as scheduled has a significant impact on CBO's projections. Many of the expiring provisions were enacted many years ago but are routinely extended, and most reduce receipts. Others that were instituted within the past few years also act to reduce revenues; their expiration implies substantial increases in taxes over the projection period. If those provisions were extended rather than allowed to expire, future revenues would be lower (and not consistent with the baseline projections that assume current law). To provide as complete an outlook for revenues as possible, this section lists the various tax provisions whose expiration is reflected in CBO's baseline. The Joint Committee on Taxation (JCT) provided the estimates of the revenue

effects of extending most of the provisions (see Table 4-10 on page 102).

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

Provisions Scheduled to Expire During the Projection Period

A number of tax law provisions either just expired at the end of 2005 or are scheduled to expire between 2006 and 2016. From a budgetary perspective, the most significant of those are the tax provisions enacted in EGTRRA, as modified by JGTRRA and the Working Families Tax Relief Act of 2004 (WFTRA). The higher amount of income exempt from the individual AMT expired at the end of 2005, along with the deduction allowed for qualified education expenses.[5] The credit allowed for certain contributions to IRA and 401(k) plans expires at the end of 2006, and the higher amount of expensing of investment allowed for small businesses expires after 2007. The lower tax rates on dividends and capital gains enacted in JGTRRA expire at the end of 2008. The rest of the provisions addressed by those three laws—which represent the bulk of the budgetary effect—expire on December 31, 2010. Those provisions include decreases in statutory tax rates for individuals, increases in the child tax credit, and repeal of the estate tax.

Assuming that the expiring provisions enacted in EGTRRA, JGTRRA, and WFTRA were extended, CBO and the Joint Committee on Taxation estimate that revenues will be about $2.0 trillion lower through 2016. Almost 90 percent of that reduction will occur between 2011 and 2016. However, extending the changes to estate and gift taxes, which expire at the end of 2010, could reduce revenues as early as 2007 because some taxpayers might postpone taxable gifts that they otherwise would have made during this decade if they knew that the repeal of the estate tax would become permanent in 2011.

Those estimates of the effects of extending expiring provisions incorporate the assumption that the higher exemption levels for the AMT, which expired after 2005, would be extended (retroactively) at their 2005 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. Although the higher levels expired at the end of 2005, the estimates assume that they are extended retroactively.

Another 65 provisions not initially enacted in EGTRRA, JGTRRA, or WFTRA also expired at the end of 2005 or are scheduled to expire between 2006 and 2016; of those, all but five would reduce revenues if extended. Extending the 60 revenue-reducing provisions would decrease receipts by $445 billion between 2007 and 2016. The provision with the largest effect is the research and experimentation tax credit, which was enacted in 1981. WFTRA extended that provision for the 10th time, through the end of 2005. Continuing the credit would reduce revenues by about $81 billion over the 2007-2016 period. The provision that allows individuals to claim nonrefundable personal credits against the AMT, first enacted in 1998, also is set to expire after 2005. Extending that provision would reduce revenues by about $74 billion through 2016, according to JCT. The reduced tax rate on repatriated dividends, enacted in AJCA in 2004, expires in 2006, and JCT estimates that extending it would reduce revenues by $57 billion over the next 10 years. Extending the exemption for certain active financing income from the Subpart F rules of the tax law, which expires at the end of 2006, would reduce revenues by $45 billion through 2016. Extending the deduction allowed for state and local general sales taxes, which was also enacted in AJCA in 2004 and expired at the end of 2005, would reduce revenues by about $42 billion through 2016. Last year, policymakers enacted about 12 new expiring provisions in the Energy Policy Act of 2005, providing tax incentives for various types of activities. If extended, those provisions would reduce revenues by an estimated $9 billion from 2007 through 2016.

Conversely, five provisions that are set to expire over the next decade would increase revenues if they were extended. The provision with the largest effect is the Federal Unemployment Tax Act surcharge, which would

5. In late 2005, the House and Senate passed separate temporary extensions of many provisions that expired at the end of 2005, but those extensions have not yet become law. Several times in the past, expiring provisions have been extended retroactively.

boost revenues by about $13 billion between 2008 and 2016 if extended. The other provisions include assessing fees for the reclamation of abandoned mines; allowing the IRS to impose fees on businesses for providing ruling, opinion, and determination letters; allowing employers to transfer excess assets in defined-benefit pension plans to a special account for retirees' health benefits; and providing a reduction in required contributions to defined-benefit plans of the steel, airline, and certain other industries. Extending the mine reclamation fees would raise almost $2 billion from 2007 to 2016. The other three provisions, if extended, would raise about $160 million altogether through 2016.

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 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 $42 billion to CBO's revenue projections in 2016, or about 43 percent of that year's total excise tax receipts.

Other expiring trust fund taxes, if extended, would account for smaller amounts of revenue in 2016, CBO estimates. 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 2016. Taxes for the Leaking Underground Storage Tank Trust Fund, set to end in 2011, add about $300 million to revenues in 2016. In addition, the new 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 nearly $1 billion to revenues in 2016. Finally, the tax on domestic and imported petroleum that is dedicated to the Oil Spill Liability Trust Fund, which was established in the Energy Policy Act of 2005, is set to expire on December 31, 2014. Extending the tax would increase revenues by $415 million in 2016. 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 extended together, the revenue projection for 2006 would be about $11.5 billion lower. That revenue loss would grow to $57 billion in 2007 and to $106 billion in 2010, before jumping to $254 billion in 2011 and then reaching $455 billion in 2016. For the entire 2007-2016 period, projected revenues would be reduced by about $2.64 trillion. That estimate includes interactions among the provisions. In particular, two AMT provisions—increasing the exemption amount for that tax and allowing certain personal credits to reduce AMT liability—interact with each other and with provisions that affect individual income tax rates.

Table 4-10.

Effects of Extending Tax Provisions Scheduled to Expire Before 2016

(Billions of dollars)

Tax Provision	Expiration Date	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
							Provisions That Expired in 2005							
Reduce Pension Contributions of Certain Industries	12/27/05	**	**	**	*	*	*	*	*	*	*	*	**	**
Archer Medical Savings Accounts	12/31/05	*	*	*	*	*	*	*	*	*	*	*	*	*
Brownfields Remediation Expensing	12/31/05	-0.2	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.3	-2.3
Corporate Contributions of Computers to Schools	12/31/05	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.8	-1.9
Credit for Electric Vehicles	12/31/05	*	*	*	*	*	*	*	*	*	*	*	*	*
Credit for Research and Experimentation	12/31/05	-2.1	-4.4	-5.7	-6.8	-7.7	-8.3	-8.7	-9.2	-9.7	-10.2	-10.7	-32.8	-81.2
Deduction for Qualified Education Expenses	12/31/05	-0.4	-1.7	-1.8	-1.9	-2.0	-2.0	-1.7	-1.8	-1.8	-1.8	-1.8	-9.5	-18.5
Deduction of State and Local Sales Taxes	12/31/05	-1.3	-2.6	-2.7	-2.9	-3.5	-4.2	-4.6	-4.8	-5.1	-5.4	-5.6	-16.0	-41.5
Deduction for Teachers' Classroom Expenses	12/31/05	*	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0	-2.1
Depreciation for Business Property on Indian Reservations	12/31/05	-0.1	-0.4	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.1	-1.8	-2.6
Depreciation of Leasehold and Restaurant Equipment	12/31/05	-0.1	-0.3	-0.6	-1.0	-1.3	-1.6	-2.0	-2.3	-2.6	-3.0	-3.3	-4.8	-18.0
Increased AMT Exemption Amount	12/31/05	-6.5	-42.0	-42.0	-49.0	-56.3	-47.1	-29.6	-34.1	-39.3	-45.6	-52.3	-236.4	-437.5
Indian Employment Tax Credit	12/31/05	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.6
Interest Rate for Pension Plan Liability and Benefits Calculations	12/31/05	0.3	1.5	1.0	-0.9	-0.6	-0.5	-0.3	-0.2	-0.2	-0.1	-0.1	0.6	-0.4
Net Income Limitation for Marginal Oil and Gas Wells	12/31/05	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.9
Qualified Zone Academy Bonds	12/31/05	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.8
Rum Excise Tax Revenue to Puerto Rico and the Virgin Islands	12/31/05	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.9
Special Rules for Pension Plans of Bus Companies	12/31/05	**	**	*	*	*	*	*	*	*	*	*	*	*
Tax Incentives for Investment in the District of Columbia	12/31/05	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.5	-1.7

Continued

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Provisions That Expired in 2005 (Continued)														
Treatment of Personal Credits Under AMT	12/31/05	-0.3	-3.8	-3.9	-4.2	-4.6	-5.6	-8.7	-9.6	-10.4	-11.2	-11.9	-22.2	-73.9
Welfare-to-Work Tax Credit	12/31/05	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.9
Work Opportunity Tax Credit	12/31/05	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.6	-0.6	-1.8	-4.5
Hurricane Relief Provisions	Various[a]	-0.9	-1.8	-2.6	-3.2	-3.3	-3.3	-3.4	-3.5	-3.6	-3.7	-3.8	-14.3	-32.2
Provisions That Expire Between 2006 and 2016														
Abandoned Mine Reclamation Fees	06/30/06	**	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.9
Reduced Tax Rate on Repatriated Dividends	10/20/06	*	-0.3	-2.6	-3.5	-4.6	-5.3	-6.1	-7.0	-8.1	-9.3	-10.1	-16.3	-57.0
Andean Trade Preference Initiative	12/31/06	n.a.	*	*	*	*	*	*	*	*	-0.1	-0.1	-0.2	-0.4
Combat Pay in Earned Income for Refundable Credits	12/31/06	n.a.	0	*	*	*	*	*	*	*	*	*	*	-0.1
Credit for IRA and 401(k)-Type Plans	12/31/06	n.a.	-0.5	-1.4	-1.3	-1.2	-1.1	-0.9	-0.8	-0.8	-0.7	-0.7	-5.6	-9.5
Depreciation for Clean-Fuel Automobiles	12/31/06	n.a.	*	*	*	*	*	*	*	*	*	*	*	-0.1
Generalized System of Preferences	12/31/06	n.a.	-0.3	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-1.0	-3.1	-7.5
Parity in Mental Health Benefits	12/31/06	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.7
Reduction in Policyholder Dividends for Insurance Companies	12/31/06	n.a.	*	*	*	*	*	*	*	*	*	*	*	*
Subpart F for Active Financing Income	12/31/06	n.a.	-0.8	-2.3	-2.6	-4.0	-4.6	-5.1	-5.6	-6.1	-6.8	-7.2	-14.4	-45.2
Tax Incentives for Areas of New York City Damaged on 9/11	Various[b]	*	-0.2	-0.4	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-1.6	-2.7
Treatment of Income of Electric Cooperatives	12/31/06	n.a.	*	*	*	*	*	*	*	*	*	*	-0.1	-0.3
African Growth Opportunity Act—Least Developed Countries	09/30/07	n.a.	n.a.	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.2	-0.4
Credit for Alternative Fuel Stations	12/31/07	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*	-0.1
Credit for Business Solar Equipment	12/31/07	n.a.	n.a.	0	*	*	*	*	*	*	*	*	*	-0.2

Continued

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
						Provisions That Expire Between 2006 and 2016 (Continued)								
Credit for Electricity Production from Renewable Sources	12/31/07	n.a.	n.a.	-0.1	-0.3	-0.5	-0.9	-1.3	-1.8	-2.4	-3.0	-3.4	-1.8	-13.8
Credit for Energy Efficient Appliances	12/31/07	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*	*
Credit for Energy Efficient Homes	12/31/07	n.a.	n.a.	-0.1	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-1.2	-3.5
Credit for Fuel Cells	12/31/07	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*	-0.1
Credit for Residential Solar Equipment	12/31/07	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1	-0.2
Deduction for Energy Efficient Buildings	12/31/07	n.a.	n.a.	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.7	-1.8
Depreciation Period for Motor Tracks	12/31/07	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1	-0.3
Disposition of Electric Transmission Property	12/31/07	n.a.	-0.1	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.1	*	-1.2	-1.8
Dividends of Mutual Funds	12/31/07	n.a.	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.7
FUTA Surtax of 0.2 Percentage Points	12/31/07	n.a.	n.a.	1.0	1.5	1.5	1.5	1.5	1.5	1.5	1.6	1.6	5.5	13.3
New Markets Tax Credit	12/31/07	n.a.	n.a.	-0.1	-0.3	-0.4	-0.6	-0.8	-1.0	-1.2	-1.3	-1.4	-1.5	-7.3
Renewable Energy Bonds	12/31/07	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*	*
Section 179 Expensing	12/31/07	n.a.	n.a.	-2.4	-4.0	-2.8	-1.9	-1.4	-1.0	-0.8	-0.8	-0.8	-11.1	-15.9
Tax Credit for Maintaining Railroad Tracks	12/31/07	n.a.	n.a.	*	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-1.2
Caribbean Basin Trade Partnership Act	09/30/08	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	-0.1	-0.2
Biodiesel Credits	12/31/08	n.a.	n.a.	n.a.	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.4	-1.5
Expensing of Film and TV Productions	12/31/08	n.a.	n.a.	n.a.	*	-0.1	-0.1	-0.1	*	*	*	*	-0.2	-0.4
Reduced Tax Rates on Dividends	12/31/08	n.a.	n.a.	-0.2	-2.9	-10.9	-15.3	-17.1	-18.8	-20.3	-21.5	-22.8	-29.3	-129.7
Reduced Tax Rates on Capital Gains	12/31/08	n.a.	n.a.	-1.5	-8.4	1.0	-8.7	-8.6	-8.9	-9.2	-9.4	-9.7	-17.6	-63.4
Use of Losses by Electric Companies	12/31/08	n.a.	n.a.	n.a.	n.a.	-0.1	*	*	*	*	*	*	-0.1	-0.3
Tax Credit on Alternative Fuels	09/30/09	n.a.	n.a.	n.a.	n.a.	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.5	-2.0
Sustainable Design Project Bonds	09/30/09	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*
Empowerment and Renewal Zones	12/31/09	n.a.	n.a.	n.a.	n.a.	-0.7	-1.5	-1.6	-1.8	-1.9	-2.0	-2.2	-2.1	-11.7
Exclusion of Gain on Brownfield Transactions	12/31/09	n.a.	n.a.	n.a.	**	**	**	**	*	-0.1	-0.1	-0.1	**	-0.2
Nonconventional Fuel Credit	12/31/09	n.a.	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	-0.2
Tax Incentives for Certain Diesel Fuel Production	12/31/09	n.a.	n.a.	n.a.	n.a.	*	*	**	**	**	**	**	*	*
Alcohol Fuel Tax Credit	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-1.9	-2.6	-2.7	-2.8	-2.8	-2.9	-1.9	-15.7

Continued

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
Provisions That Expire Between 2006 and 2016 (Continued)														
Authority to Postpone Certain Tax Payments	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*
Child Credit at $1,000	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-6.9	-34.7	-35.0	-35.6	-36.0	-36.6	-6.9	-184.8
Earned Income Credit Modification	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	0.2	-2.8	-2.8	-2.9	-2.8	-2.9	0.2	-14.1
EGTRRA Education Provisions	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-1.1	-2.6	-2.7	-2.9	-3.1	-3.3	-1.1	-15.7
EGTRRA Pension Provisions	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-2.6	-4.6	-5.3	-6.0	-6.8	-7.6	-2.6	-32.9
Estate and Gift Tax Changes	12/31/10	n.a.	-1.6	-2.1	-1.8	-2.5	-29.8	-54.2	-59.6	-64.8	-68.7	-72.9	-37.8	-357.9
Expanded 10 Percent Bracket	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-32.5	-46.7	-46.4	-46.1	-45.3	-44.9	-32.5	-261.8
Income Tax Rates of 25, 28, 33, and 35 Percent	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-41.6	-62.3	-66.0	-69.2	-71.0	-74.8	-41.6	-384.8
Itemized Deduction and Personal Exemption Phaseout	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-6.2	-13.1	-14.4	-15.7	-16.4	-17.2	-6.2	-83.1
Joint Filers' 15 Percent Bracket and Standard Deduction	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-4.3	-5.8	-5.4	-4.9	-4.5	-4.2	-4.3	-29.1
Other Provisions of EGTRRA[c]	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	-0.2	-0.8	-0.8	-0.9	-0.9	-0.9	-0.2	-4.6
Small Ethanol Producer Credit	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	*	*	*	*	-0.1	-0.1	*	-0.2
Expensing for Liquid Fuel Refining Equipment	12/31/11	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.2	-0.3	-0.2	-0.1	-0.1	n.a.	-1.0
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.	**	**	**	n.a.	0.1
IRS User Fees	09/30/14	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	**	**	n.a.	0.1
African Growth Opportunity Act	09/30/15	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.1	n.a.	-0.1
All Expiring Provisions														
Interaction from Extending All Provisions Together		0.6	3.5	3.1	3.2	3.3	-11.4	-32.6	-34.1	-35.2	-35.5	-34.8	1.6	-170.5
Total		**-11.5**	**-56.9**	**-70.3**	**-94.4**	**-105.9**	**-254.3**	**-368.1**	**-391.3**	**-414.1**	**-433.5**	**-455.2**	**-581.8**	**-2,644.1**

Sources: 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; IRS = Internal Revenue Service; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001. 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.

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

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

c. Includes provisions related to the adoption credit, dependent care credit, and the employer-provided child care credit.

APPENDIX

A

The Budgetary Effects of Hurricane Relief

In the aftermath of Hurricanes Katrina and Rita, which struck the Gulf Coast in August and September of last year, the Congress and the President have enacted several measures to address the damage that those natural disasters caused. Such actions affect both discretionary and mandatory spending as well as federal revenues. Overall, as of this writing, the Congressional Budget Office (CBO) estimates that additional spending for hurricane-related disaster assistance together with various forms of tax relief will add at least $54 billion to the deficit for 2006, $23 billion for 2007, $13 billion for 2008, and smaller amounts thereafter (see Table A-1).

Discretionary Spending

Thus far, the hurricane-related legislation with the largest effect on the federal budget has been supplemental appropriations for disaster relief. Those appropriations initially provided a total of $62.3 billion in budget authority—almost all of which (nearly $60 billion) went to the Federal Emergency Management Agency (FEMA). Subsequently, the Congress rescinded $23.4 billion of the funding for FEMA and appropriated that amount, plus another $5.2 billion, to other agencies for specific activities.

All told, FEMA has received about $36 billion in budget authority for relief operations for individuals and for assistance to state and local governments. As of the beginning of January, it had obligated about $21 billion of that funding: approximately 40 percent was designated for housing and other assistance to victims of Hurricane Katrina, and most of the rest was allocated for such operations as debris cleanup and relief coordination and support. As of that time, the agency had disbursed a total of about $8 billion.

In addition to the funds provided to FEMA, approximately $31 billion was made available to other agencies. Of that amount, policymakers allocated $11.5 billion to the Community Development Fund of the Department of Housing and Urban Development. That money is to be used for longer-term economic development and public works projects. The Department of Defense received $7.6 billion, primarily for costs associated with the deployment of military personnel in support of relief efforts, repairs to military facilities, and repairs to shipyards that build Navy vessels. In addition, the Army Corps of Engineers received $3.3 billion, most of which will be used to repair flood-protection structures in areas affected by the hurricanes. Another $2.75 billion in funding went to rebuild highways, and $1.4 billion was designated to assist affected elementary and secondary schools in reopening and to make payments to schools that are serving displaced students. The remaining $4 billion in budget authority was spread among various other agencies.

Not all of the supplemental funding will be spent during 2006; instead, outlays will continue over a number of years. CBO estimates that about $30 billion will actually be expended this year, with another $16 billion in outlays in 2007, $12 billion in 2008, and smaller amounts in the following years. (About $3 billion was spent in 2005 for disaster assistance after Hurricanes Katrina and Rita, some of which came from the recently enacted supplemental funding and some from previous appropriations.)

Mandatory Spending

The unprecedented number of flood insurance claims resulting from Hurricane Katrina has dwarfed the ability of FEMA's flood insurance program to cover such payments with premiums. As a result, the program needed legislative authority to borrow funds from the Treasury to pay those claims. In recent months, the Congress and the President have twice raised the borrowing authority for the program (by a cumulative $17 billion), bringing its total available borrowing authority to $18.5 billion.

Table A-1.

Budgetary Effects of Legislation Related to Hurricane Relief

(Billions of dollars)

	2006	2007	2008	2009	2010	Total, 2006-2010
Revenues	-7	-5	-1	*	*	-14
Outlays						
Discretionary						
FEMA	21	8	4	2	1	36
HUD Community Development Fund	*	4	5	2	1	11
Department of Defense	4	1	1	1	*	7
Other	5	3	2	1	*	12
Subtotal, discretionary	30	16	12	5	2	65
Mandatory						
Flood insurance	16	1	0	0	0	17
Other	1	1	*	-1	*	1
Subtotal, mandatory	17	2	*	-1	*	18
Total Outlays	47	18	12	4	2	83
Total Effect of Legislation on the Deficit	**-54**	**-23**	**-13**	**-5**	**-2**	**-97**

Source: Congressional Budget Office.

Notes: The estimates in this table do not include interest costs on additional borrowing or the effect of the hurricanes on the economy. Negative amounts indicate an increase in the deficit.

* = between -$500 million and $500 million; FEMA = Federal Emergency Management Agency; HUD = Department of Housing and Urban Development.

Through December, FEMA had already provided reimbursement for claims totaling more than $10 billion, and CBO estimates that almost all of the current borrowing authority for flood insurance will be expended during 2006. FEMA estimates that flood insurance claims will ultimately total about $23 billion, so another $4 billion to $5 billion in borrowing authority may be necessary to quickly resolve all such claims.

The Congress and the President also enacted the TANF Emergency Response and Recovery Act of 2005 (Public Law 109-68) to provide additional funds for benefits to needy people. That money will go to states that sustained damage from Hurricane Katrina or that are hosting evacuees from the storm. The legislation will provide about $400 million, CBO estimates, most of which will be spent in 2006.

Other hurricane-related legislation has had a small net impact on mandatory spending. Such laws include the Natural Disaster Student Aid Fairness Act (P.L. 109-86), the Community Disaster Loan Act of 2005 (P.L. 109-88), and the QI, TMA, and Abstinence Programs Extension and Hurricane Katrina Unemployment Relief Act of 2005 (P.L. 109-91).

The total cost of hurricane relief, however, is greater than the sum of the legislative actions taken in direct response to the storms. Besides the additional outlays resulting from legislation, some federal programs (such as Medicaid) may experience temporary increases in spending as evacuees become eligible for benefits that they would not normally collect. Also, workers unemployed as a result of the hurricanes may receive unemployment benefits (or disaster unemployment assistance, which is provided by FEMA).

Revenues

The hurricanes will affect federal revenues through their impact on the economy and through such mechanisms as delays in the payment of taxes and other tax relief. The

temporary reduction in economic growth that can be traced to the hurricanes may lower receipts but probably not significantly; the changes are likely to be very small relative to total federal tax collections.[1] As economic growth picks up, in part because of the recovery and reconstruction of storm-damaged areas, the negative effect on tax receipts should dissipate.

The Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73), which was enacted on September 23, provides several types of tax relief to businesses and individuals. The Joint Committee on Taxation estimates that the law will reduce revenues by about $6 billion, almost entirely during 2006 and 2007. The provisions with the largest effects on revenues allow taxpayers to deduct more in personal property losses from their taxable income and to take more time to replace damaged property without being assessed income taxes on the insurance proceeds. Those provisions also allow businesses and individuals to deduct larger amounts of charitable donations from their income.

The Gulf Opportunity Zone Act of 2005 (P.L. 109-135) is estimated to reduce revenues by $4 billion in 2006, $3 billion in 2007, and $2 billion over the years from 2008 to 2015. Most of the drop in revenues comes from providing tax incentives to a newly designated "Gulf Opportunity Zone" comprising areas that were hardest hit by Hurricane Katrina. The incentives include additional authority to issue certain tax-preferred bonds; new investment incentives for businesses, such as earlier depreciation deductions for some business property; and additional tax credits for investing in low-income housing. The law also provides tax incentives for taxpayers located in the paths of Hurricanes Rita and Wilma, incentives that in some cases mirror the tax reductions provided to victims of Hurricane Katrina.

In addition to the effects of legislation, delays in the payment of taxes could affect the timing of several billion dollars or more of receipts. As a result of rules implemented by the Internal Revenue Service shortly after Hurricane Katrina struck and provisions in recent legislation, victims of the hurricane may delay all federal tax payments until February 28, 2006. Taxpayers whose records were in the disaster areas and relief workers also qualify for a delay. Because of those provisions, some tax payments—including estimated payments of corporate and individual income taxes and withheld income and employment tax payments—may be held up for a number of months. Some of that delay will lead to a shift in receipts from 2005 to 2006, but the total amount shifted is not likely to be more than a few billion dollars.

1. For more information about the effects of the 2005 hurricanes on the economy, see Box 2-1 on page 28.

APPENDIX

B

Changes to the Budget Outlook Since August 2005

Relative to its previous baseline projections, which were published last August, the Congressional Budget Office (CBO) has increased its estimate of the deficit for 2006 by $22 billion and reduced its projections of deficits from 2007 through 2015 by an average of about $100 billion per year (see Table B-1).[1] Those adjustments reflect no fundamental changes in the budgetary and economic environment. When considered in relation to the size of the economy, they represent a difference of just 0.5 percent of gross domestic product (GDP) over the 2006-2015 period.

When CBO periodically updates its 10-year baseline projections, it divides the changes into three categories: enacted legislation, changes to CBO's outlook for the economy, and other, so-called technical factors that affect the budget.[2] Most of the changes in CBO's new baseline stem from changes in economic factors, which led CBO to reduce its projection of the deficit for the 2006-2015 period by a cumulative $736 billion. The effects of enacted legislation, including the timing and treatment of appropriations to fund military activities in Iraq and Afghanistan, have also reduced that projection—by $157 billion. Technical adjustments have had a minimal effect—upward changes to projections of both revenues ($151 billion) and outlays ($170 billion) nearly offset each other and increase the projected deficit by $19 billion over the 10 years from 2006 to 2015.

The Effects of Economic Changes

The economic changes to CBO's projections affect mainly revenues and interest costs. CBO's assessment of the economic outlook has not changed much since last August; the updates made to its economic forecast stem largely from revisions to historical data and higher inflation in the latter half of 2005. Those factors boosted estimates of nominal GDP for last year, from which CBO projects future GDP and wages, and reduced the estimated level of businesses' interest payments in 2005—thereby increasing CBO's estimates of revenues throughout the 10-year period. In addition, CBO's baseline projections now incorporate an assumption of slightly lower interest rates from 2008 through 2015, which reduce projected net interest outlays during that time.

Revenues

Changes in the economic outlook have increased CBO's projection of revenues over the 2006-2015 period by $488 billion—$29 billion in 2006 and between $47 billion and $54 billion per year over the remainder of the period. The increases result from CBO's higher estimates of the level of GDP and, in particular, from a boost in projected corporate profits. Receipts from the corporate income tax account for more than 80 percent of the total upward adjustment to projected revenues that is attributable to changes in the economic outlook.

The higher levels of nominal GDP that CBO now foresees stem from higher prices rather than from changes in underlying economic activity. An upward revision to the Bureau of Economic Analysis's (BEA's) estimates of nom-

1. Those earlier projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2005).

2. The categorization of such changes should be interpreted 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 different effects from the ones in CBO's initial estimate, the differences will appear as technical reestimates in later versions of the baseline. The distinction between economic and technical changes is similarly imprecise. CBO classifies economic changes as those resulting directly from alterations in the components of CBO's economic forecast (GDP growth, interest rates, inflation, and so on). Changes in other factors related to the performance of the economy (such as the amount of capital gains realizations) are shown as technical adjustments.

Table B-1.

Changes in CBO's Baseline Projections of the Deficit Since August 2005

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Total Deficit as Projected in August 2005	-314	-324	-335	-321	-317	-218	-78	-80	-66	-57	-1,612	-2,110
Changes to Revenue Projections												
Legislative	-7	-6	-1	*	*	*	*	*	*	*	-14	-15
Economic	29	47	50	50	52	51	50	51	52	54	229	488
Technical	10	24	23	17	13	13	15	14	12	10	87	151
Total Revenue Changes	**32**	**65**	**72**	**67**	**65**	**64**	**66**	**65**	**64**	**64**	**302**	**625**
Changes to Outlay Projections												
Legislative												
Mandatory												
Flood insurance	16	1	0	0	0	0	0	0	0	0	17	17
Other	*	1	1	1	*	*	*	*	*	*	2	2
Subtotal, mandatory	16	2	1	1	*	*	*	*	*	*	19	19
Discretionary	17	-11	-16	-20	-22	-23	-23	-25	-26	-27	-52	-177
Net interest (Debt service)	1	2	1	1	*	-1	-2	-4	-5	-6	5	-14
Subtotal, legislative	**34**	**-8**	**-14**	**-18**	**-22**	**-24**	**-26**	**-29**	**-32**	**-34**	**-28**	**-172**
Economic												
Mandatory												
Social Security	3	3	3	3	2	2	2	2	2	2	14	23
Oil and gas receipts	-2	-2	-2	-2	-2	-2	-2	-2	-2	-2	-10	-20
Other	*	-3	-1	1	1	1	1	1	*	*	-3	*
Subtotal, mandatory	*	-2	-1	1	2	1	1	*	*	*	1	3
Discretionary	0	0	0	0	0	0	0	0	0	0	0	0
Net interest												
Debt service	*	-2	-4	-7	-11	-14	-18	-22	-27	-32	-25	-138
Rate effect/inflation	9	7	-4	-11	-16	-18	-20	-20	-20	-20	-15	-113
Subtotal, net interest	9	5	-9	-19	-26	-32	-38	-42	-47	-51	-40	-251
Subtotal, economic	**9**	**3**	**-9**	**-17**	**-25**	**-31**	**-37**	**-42**	**-47**	**-51**	**-39**	**-248**

Continued

Table B-1.

Continued

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Technical												
Mandatory												
Medicare[a]	6	7	13	14	13	10	8	10	12	13	52	107
Medicaid	*	-1	-1	-2	-2	-3	-3	-3	-4	-4	-7	-23
Food Stamps	3	3	3	3	3	3	3	3	3	3	13	27
Credit reestimates	10	0	0	0	0	0	0	0	0	0	10	10
Other	2	3	1	1	-2	-3	-2	-3	-2	-5	4	-11
Subtotal, mandatory	20	12	15	15	11	8	6	7	9	7	73	111
Discretionary	-9	3	6	8	7	6	6	6	7	7	14	46
Net interest												
Debt service	*	-1	-1	-1	-1	*	*	*	*	1	-4	-4
Other	1	1	1	1	1	1	2	3	4	4	4	18
Subtotal, net interest	*	*	*	*	*	1	2	3	4	5	*	14
Subtotal, technical	**12**	**15**	**21**	**23**	**18**	**15**	**13**	**16**	**20**	**19**	**88**	**170**
Total Outlay Changes	**55**	**11**	**-3**	**-13**	**-29**	**-41**	**-50**	**-55**	**-59**	**-66**	**21**	**-249**
Total Impact on the Deficit	**-22**	**54**	**75**	**80**	**94**	**104**	**115**	**120**	**123**	**130**	**282**	**874**
Total Deficit (-) or Surplus as Projected in January 2006	-337	-270	-259	-241	-222	-114	38	40	57	73	-1,330	-1,236
Memorandum:												
Total Legislative Changes	-41	2	13	18	22	24	26	28	31	34	14	157
Total Economic Changes	21	44	59	67	77	82	87	93	100	106	268	736
Total Technical Changes	-2	8	3	-5	-5	-2	2	-2	-8	-9	*	-19

Source: Congressional Budget Office.

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

a. Includes offsetting receipts.

inal GDP in early 2005 and higher inflation in the second half of that year, combined with anticipated rates of economic growth that are about the same as those underlying CBO's previous projections, cause the estimated level of GDP to be higher throughout the 2006-2015 period. As a result, projections of taxable income—most important, those for wages, salaries, and corporate profits—are also higher than in the previous baseline. In the near term, profits are boosted further relative to the previous projection because CBO now estimates that firms will make smaller contributions to their defined-benefit pension plans. CBO also projects higher corporate book profits as a share of GDP to reflect smaller shares allocated to businesses' interest payments and proprietors' income throughout the 10-year period.[3]

Net Interest

Changes to CBO's projections of federal spending for net interest that can be attributed to economic factors have two components: the effects of changes in projected in-

3. 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 national income and product accounts.

terest rates and inflation and the effects of additions to (or reductions in) debt. Those changes increase CBO's previous projections of interest costs for 2006 and 2007 and reduce them for subsequent years.

In CBO's current economic forecast, the rate for three-month Treasury bills is higher for 2006 and 2007 than it was in the previous forecast; the rate for 10-year Treasury notes is higher as well for 2006. As a result, CBO anticipates that interest on the public debt will total $16 billion more during those two years than it did in the previous baseline. Starting in 2008, forecasts of those short- and long-term interest rates are lower than CBO's previous estimates—by roughly 0.3 and 0.2 percentage points, respectively. Consequently, projected interest outlays from 2008 through 2015 are $129 billion lower than they were in the last baseline.

Furthermore, changes in the economic outlook (primarily, those leading to estimates of higher revenues) reduce CBO's projections of deficits over the 10-year period, thus shrinking debt-service costs by $138 billion during those years. All told, changes in the baseline related to economic factors lead to cumulative net interest payments that are $251 billion lower than those projected last August.

Mandatory Spending

On net, changes in CBO's economic outlook have had a relatively small effect on projections of mandatory spending (that is, funding determined by laws other than annual appropriation acts). Such changes increase CBO's estimate of mandatory outlays by a negligible amount in 2006 and by a total of $3 billion over the 2006-2015 period.

Higher inflation in late 2005 boosted the cost-of-living adjustment (COLA) that Social Security beneficiaries received in January 2006 to 4.1 percent, the highest level since 1990 and 0.7 percentage points above the level that CBO projected for the COLA last August. That increase raises benefit payments in 2006 and beyond; over the 2006-2015 period, the larger COLA will add $29 billion to Social Security outlays, CBO estimates. Those higher outlays are slightly offset in the baseline by lower projected growth of wages in the near term, which decreases future benefit payments by an estimated $6 billion over the 10-year period. On balance, changes in the economic outlook raise CBO's projections of outlays for Social Security by $23 billion from 2006 through 2015.

CBO now anticipates that throughout that 10-year period, higher oil and natural gas prices will increase the amount that the government collects from its onshore and offshore mineral leases. (Those collections are considered offsets to mandatory spending.) CBO estimates that prices for oil will exceed those it had previously projected by about 10 percent for each year of the 2006-2015 period, and prices for natural gas will exceed previous estimates by about 27 percent per year. For example, CBO's previous forecast for refiners' average acquisition costs per barrel of oil in 2007 was $47.90; its new forecast is for costs of $53.50 per barrel. CBO previously forecast that natural gas prices would average $6.90 per thousand cubic feet in 2007; its new estimate is $8.60 per thousand cubic feet. As a result, through 2015, additional collections from onshore and offshore leases will total $20 billion, in CBO's estimation.

The changes in CBO's economic outlook have little effect on its projections for other mandatory programs. The outlook's lower unemployment rates for the near future coupled with a slight reduction in the estimated size of the labor force decrease projected spending for unemployment compensation. Revisions to various price indexes have a relatively small effect on estimates of spending for Medicare and Medicaid.

Discretionary Spending

CBO has made no changes to its baseline for discretionary spending as a result of economic factors. The statutory rules for constructing the baseline require CBO to project discretionary spending by assuming that the current year's discretionary budget authority is provided in each future year of the projection period together with an adjustment to reflect projected inflation. Since the previous baseline, CBO has made no changes for years after 2006 to the two measures of inflation used for its projections: the GDP deflator (which covers the changes in price of all goods and services that contribute to GDP) and the employment cost index for wages and salaries.

The Effects of Enacted Legislation

On balance, legislative activity since last August has raised CBO's projection of the deficit for 2006 by $41 billion. Measures enacted in response to hurricane damage, mostly related to Hurricanes Katrina and Rita, have raised estimated outlays in the baseline by $47 billion and reduced revenues by $7 billion, for a net increase of $54 billion in the deficit for this year. But thus far in

2006, appropriations are lower than the amount provided in 2005, offsetting some of the increase in spending related to the hurricanes.[4] For 2006 to 2015, the extrapolation of those lower current appropriations, particularly those for military activities in Iraq and Afghanistan, largely accounts for a projected reduction in the cumulative deficit—relative to that in the previous baseline—of $157 billion attributable to legislative changes.

Discretionary Spending

The irregular timing and varying amounts of supplemental appropriations together with the treatment of such appropriations under baseline rules account for most of the $177 billion decrease in baseline projections of discretionary outlays over the 2006-2015 period. Reductions in defense outlays of $236 billion are partially offset by a cumulative increase of $59 billion in nondefense outlays (see Table B-2).

Defense Outlays. By law, CBO is required in constructing its baseline to extend all current discretionary funding, with adjustments for inflation, into future years. Applying that treatment to funding for activities in Iraq and Afghanistan pushes defense outlays $279 billion lower over the 10-year period than CBO had projected last August. So far this year, the Congress and the President have provided $50 billion for such activities; last year, the Department of Defense (DoD) received $76 billion.[5] Extrapolating the lower funding appropriated thus far in 2006 reduces projected outlays by $8 billion for 2006 and by an average of about $30 billion a year from 2007 through 2015.

Nearly $6 billion in supplemental funding has been provided to DoD thus far in 2006 for hurricane-related activities. By comparison, about $1 billion was provided last year for activities related to disaster relief. Extrapolating the difference between those two amounts through 2015 generates an additional $43 billion in defense discretionary outlays over the 2006-2015 period.

Regular appropriations for defense programs for 2006—$432 billion—are almost exactly equal to the amount that CBO projected in its August baseline. As a result, very little of the change in projections of discretionary spending is attributable to such funding.

Nondefense Outlays. Regular appropriations for nondefense programs ($411 billion) are down slightly this year—by about $7 billion—relative to the amount projected last August. Extending that difference through 2015 reduces projected nondefense outlays by a total of $57 billion.

However, supplemental funding for 2006 for nondefense programs is greater than the amount provided through August 2005, mostly as a result of appropriations for hurricane relief and recovery efforts. As a result, projections of nondefense outlays are higher by $116 billion over the 2006-2015 period.

The August baseline included and extrapolated $18 billion in supplemental funding that was provided in 2005 for nondefense programs (primarily for relief from natural disasters occurring in calendar year 2004 and for operations of the State Department).[6] For 2006, about $23 billion in new budget authority has been appropriated for relief and recovery activities related to Hurricanes Katrina and Rita. (At the same time, policymakers rescinded $23 billion from previous appropriations provided to the Federal Emergency Management Agency, or FEMA, but that rescission does not affect the amount of budget authority projected in the baseline for subsequent years.) In addition, nearly $4 billion has been appropriated for avian flu research, preparedness, and response and for additional assistance to New York City related to the terrorist attacks of September 11, 2001.

Mandatory Spending

In response to an unprecedented volume of claims presented to the National Flood Insurance Program following Hurricanes Katrina and Rita, two laws were enacted to increase the amount that FEMA may borrow from the Treasury for payment of those claims. Public Law (P.L.) 109-65, the National Flood Insurance Program Enhanced Borrowing Authority Act of 2005, increased

4. Additional funding for military activities in Iraq and Afghanistan is likely to be necessary later this year.

5. In addition to the $76 billion of budget authority provided in 2005, DoD also received $27 billion at the end of 2004 to cover costs that would largely be incurred in 2005. That additional funding, however, was counted as budget authority in 2004, when it was made available.

6. In September, lawmakers appropriated $62.3 billion for relief and recovery efforts in the aftermath of Hurricanes Katrina and Rita. Such appropriations were not included in CBO's August baseline.

Table B-2.

Changes in CBO's Baseline Projections of Discretionary Outlays Since August 2005

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Total Discretionary Outlays as Projected in August 2005	991	1,008	1,032	1,052	1,075	1,104	1,120	1,151	1,179	1,207	5,159	10,920
Changes to Outlay Projections												
Legislative												
Defense												
Iraq and Afghanistan	-8	-22	-27	-29	-30	-31	-31	-33	-33	-34	-116	-279
Supplemental funding	3	2	3	4	5	5	5	5	5	5	17	43
Regular appropriations	2	1	*	*	*	*	*	-1	-1	-1	2	-1
Subtotal, defense	-4	-19	-24	-25	-26	-27	-27	-28	-29	-30	-96	-236
Nondefense												
Supplemental funding	21	11	12	11	11	10	10	10	10	10	66	116
Regular appropriations	*	-4	-5	-6	-7	-7	-7	-7	-7	-8	-21	-57
Subtotal, nondefense	21	7	7	5	4	4	3	3	2	2	45	59
Subtotal, legislative	**17**	**-11**	**-16**	**-20**	**-22**	**-23**	**-23**	**-25**	**-26**	**-27**	**-52**	**-177**
Economic	0	0	0	0	0	0	0	0	0	0	0	0
Technical												
Defense	-4	3	3	3	2	3	2	3	3	3	6	21
Nondefense	-5	*	3	5	4	4	3	3	3	4	8	25
Subtotal, technical	**-9**	**3**	**6**	**8**	**7**	**6**	**6**	**6**	**7**	**7**	**14**	**46**
Total Changes to Discretionary Outlays	**8**	**-8**	**-10**	**-12**	**-15**	**-17**	**-18**	**-19**	**-20**	**-20**	**-37**	**-131**
Total Discretionary Outlays as Projected in January 2006	999	1,000	1,022	1,040	1,060	1,087	1,103	1,132	1,159	1,186	5,122	10,789
Memorandum:												
Total Defense Discretionary Changes	-8	-16	-21	-22	-24	-24	-24	-25	-26	-26	-90	-216
Total Nondefense Discretionary Changes	16	8	10	10	9	7	6	6	6	6	53	85

Source: Congressional Budget Office.

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

FEMA's borrowing authority from $1.5 billion to $3.5 billion; that amount was subsequently increased to $18.5 billion by the National Flood Insurance Program Further Enhanced Borrowing Authority Act of 2005 (P.L. 109-106). CBO estimates that mandatory outlays resulting from that increased authority will total $16 billion in 2006 and $1 billion in 2007.

Other legislative actions will have a small effect on mandatory programs, increasing projections of outlays by about $2 billion over the 2006-2015 period. Most of those changes result from the TANF and Child Care Continuation Act of 2005 (P.L. 109-161), which reauthorizes the Temporary Assistance for Needy Families and child care programs through March 31, 2006; and

the Terrorism Risk Insurance Extension Act of 2005 (P.L. 109-144), which extends that program through December 31, 2007.

Revenues

Legislative changes have had a relatively small effect on CBO's projections of revenues, reducing them by $13 billion for 2006 and 2007 combined and by a total of $15 billion over the 2006-2015 period. Almost all of that reduction can be ascribed to the Katrina Emergency Tax Relief Act of 2005 (P.L. 109-73) and the Gulf Opportunity Zone Act of 2005 (P.L. 109-135).

Three provisions account for the bulk of the decline in revenues attributable to the Katrina Emergency Tax Relief Act of 2005: suspending the thresholds on the deductibility of personal casualty losses, extending the period during which insurance proceeds are not taxable if they are invested in certain replacement property, and temporarily suspending certain limitations on the deductibility of charitable donations. The Gulf Opportunity Zone Act of 2005 provides tax incentives related to a newly designated "Gulf Opportunity Zone," which comprises the areas hardest hit by Hurricane Katrina. Those incentives include additional authority to issue certain tax-advantaged bonds; new investment incentives for businesses, such as earlier depreciation deductions for certain business property; and additional tax credits for construction of low-income housing. The act also provides tax incentives for residents and business owners located in areas struck by Hurricanes Rita and Wilma—in some cases, the same tax relief provided to victims of Hurricane Katrina under P.L. 109-73.

Net Interest

In all, legislative changes lower the projection of the cumulative deficit for the 2006-2015 period by an estimated $143 billion. In turn, that decrease shrinks projected debt-service costs over the period by $14 billion.

The Effects of Technical Changes

Technical changes represent all other adjustments to the baseline that are not directly attributable to enacted laws or changes in the economic outlook. In the current baseline, net technical adjustments are minimal because the changes to revenues and outlays largely offset each other. In total, such changes increase the projected deficit by $19 billion over the 2006-2015 period.

Mandatory Spending

Technical adjustments have raised CBO's estimate of mandatory spending for each year from 2006 through 2015, adding $20 billion for 2006 and a total of $111 billion (0.6 percent) over the 10-year period.

Medicare and Medicaid. CBO has boosted its projection of spending for the Medicare program by $107 billion (2 percent) over the 2006-2015 period. That change reflects an increase in the rates at which spending in the next several years is expected to grow. CBO raised those projected rates both because there was a surge in spending (12 percent) in 2005—the first time in a decade that spending grew at a double-digit rate—and because the broad-based nature of that surge suggests that rapid growth is likely to persist for several years. (Analysis of preliminary data indicates that spending for nearly all types of Medicare services experienced unusually rapid growth in 2005.) Actual spending for the Medicaid program last year was roughly $3 billion lower than had been anticipated in the previous baseline. CBO has therefore reduced baseline spending for that program by a total of $23 billion over the 10-year period.

Food Stamps. The outlays projected for the Food Stamp program over the 2006-2015 period have grown by $27 billion since August because CBO has boosted its estimate of participation in the program. Rates of participation have been persistently higher than expected for the past few years, despite falling rates of unemployment and a slight slowing in the growth rate for participation in 2005. As a result, CBO now expects that the decline in participation stemming from lower unemployment will not be as sharp as it had previously anticipated. Increased outreach to eligible households and recent legislative changes that have expanded eligibility and eased the application process are also likely to play a part in that trend. Participation in the program will rise to 26.9 million people in 2006, CBO estimates—in part because of the large number of people receiving short-term benefits through the Disaster Food Stamp Program in the wake of the recent hurricanes in the Gulf of Mexico. CBO anticipates that participation from 2007 to 2015 will average 25.6 million people.

Credit Programs. Technical adjustments to mandatory spending also reflect a net increase in the estimated subsidy costs for various federal loan and loan guarantee programs. Under the Credit Reform Act of 1990, the costs of loans and guarantees are initially recorded as the present

value of the expected expenses and receipts to the government resulting from those transactions. Accurately projecting loan repayments, defaults, and changes in interest rates over the life of a credit program is difficult, however. As a result, federal agencies annually reestimate costs for loans and guarantees made in previous years. On the basis of preliminary information from the Office of Management and Budget, CBO has raised its estimates of mandatory outlays for 2006 by $10 billion to reflect such revisions—largely stemming from reestimates of costs for the student loan program. However, the reestimates affect a variety of programs besides student loans, including the Federal Housing Administration's (FHA's) Mutual Mortgage Insurance program, activities of the Export-Import Bank, and veterans' housing loans.

Other Programs. Technical changes related to other mandatory programs lower projections of spending over the 2006-2015 period by $11 billion, in CBO's estimation. Those other changes include downward adjustments to estimated spending for the agriculture price- and income-support program of the Commodity Credit Corporation and for unemployment benefits, and upward adjustments to projected collections from oil and gas leases (recorded in the budget as negative outlays). Those changes are partially offset in the baseline by an increase in projected outlays for Social Security benefits, veterans' compensation, and the net transactions of the Postal Service.

Discretionary Spending

Technical changes to the baseline have reduced CBO's estimate of discretionary outlays for 2006 by $9 billion but have increased projected outlays over the 10-year period by $46 billion (0.4 percent).

Defense Outlays. Defense spending accounts for about $21 billion of the cumulative change in the projections of discretionary outlays. For 2006, CBO has lowered its estimate of defense outlays by $4 billion (0.8 percent of defense spending), mainly because some funding for operations and maintenance was expended in 2005 rather than in 2006, as CBO had previously anticipated. Over the 2007-2015 period, however, technical changes raise projections of defense spending by $25 billion (0.5 percent of cumulative defense spending). Nearly half of those changes result from an adjustment to CBO's projections of accrual payments for military retirees' health care.

Nondefense Outlays. The largest adjustment to projected spending for nondefense discretionary programs stems from a reduction in projected receipts (negative outlays, in the budget) generated by FHA's Mutual Mortgage Insurance program. CBO has reduced its projection of such receipts—that is, it has increased projected outlays—by $14 billion over the 2006-2015 period for two reasons. First, the volume of FHA's business has declined in recent years, and CBO expects lower levels in subsequent years as well. Second, the estimated collections (in this case, the negative subsidy) from FHA's loan guarantee program are smaller in the current baseline than they were in the previous one.[7] The remaining upward change of $11 billion over the 10-year period reflects smaller technical adjustments that apply to many other areas of the federal budget.

Revenues

CBO has increased its projections of revenues over the 2006-2015 period by $151 billion as a result of technical changes. The adjustments—which mainly reflect higher near-term projections of capital gains realizations by individuals and corporations—are largest, at $24 billion, for 2007; they then gradually fall, to $10 billion, by 2015. (The effect of such changes gradually wanes over the 10-year period because CBO expects gains realizations to revert to longer-term averages.) Technical changes to revenues for 2006 ($10 billion) are smaller than in most subsequent years, in part because CBO has reduced its estimate of the amount of tax liabilities from the alternative minimum tax that will be paid to the Treasury in 2006 and raised its estimate of the amount to be paid in 2007.

Net Interest

Technical revisions have prompted an $18 billion increase in net interest outlays in the baseline (excluding debt service) over the 2006-2015 period. Projections of lower interest collections from the financing accounts of federal loan programs account for most of that difference. Federal debt-service costs are projected to fall by a total of $4 billion over that period as a result of technical changes.

7. Guarantee fees for new mortgages more than offset the costs of anticipated defaults, resulting in net collections from the loan guarantee program—or a negative credit subsidy.

APPENDIX

C

How Changes in Economic Assumptions Can Affect Budget Projections

The federal budget is sensitive to economic conditions. Revenues depend on taxable income—including wages and salaries, other (nonwage) income, and corporate profits—which generally moves with overall economic activity. Spending for many mandatory programs is pegged to inflation either directly (as in Social Security) or indirectly (as in Medicaid). In addition, the Treasury regularly refinances portions of the government's debt at market interest rates, so the amount of federal spending for interest on that debt is directly tied to such rates.

To illustrate how assumptions about the economy can affect federal budget projections, the Congressional Budget Office (CBO) traditionally shows those relationships by constructing simplified "rules of thumb." Those rules provide rough orders of magnitude for gauging how changes in individual economic variables, taken in isolation, would affect the budget's totals. They are not intended to substitute for a full analysis of an alternative economic forecast.

Four variables that figure in this illustration are real (inflation-adjusted) growth, interest rates, inflation, and wages and salaries as a percentage of the economy. For real growth, CBO's rule of thumb shows the effects of a rate that is 0.1 percentage point lower each year, beginning in January 2006, than the assumed rate of economic growth underlying the agency's baseline budget projections (outlined in Chapter 1). The rules of thumb for interest rates and inflation assume an increase of 1 percentage point over the rates in the baseline, also starting in January 2006.

The rule of thumb for wages and salaries assumes that, beginning in January 2006, wages and salaries are 1 percentage point higher as a share of gross domestic product (GDP) than the share assumed in the baseline and that they continue to be that much higher for every year of the projection period. Correspondingly, corporate profits are assumed to be 1 percentage point lower each year. This scenario assumes no change in projected levels of nominal or real GDP.

Each rule of thumb is roughly symmetrical. Thus, the effects of higher growth, lower interest rates, lower inflation, or lower wages and salaries as a share of GDP would have about the same magnitude as the effects shown in this appendix, but with the opposite sign. The calculations that appear in this appendix are merely illustrative of the impact that such changes can have. CBO chooses the variations of 0.1 percentage point and 1 percentage point for the sake of simplicity alone. Extrapolating from small, incremental "rule-of-thumb" calculations to much larger changes would be inadvisable, because the magnitude of the effects of a larger change is not necessarily a simple multiple of a smaller change.

The rules of thumb describe effects of alternative assumptions but do not directly indicate the size of deviations that might be expected in individual variables. For example, CBO's 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; however, the standard deviation for growth rates of real GDP over 10-year periods in the past is about 0.6 percentage points, which is about six times the deviation in the rules of thumb.[1] The other rules of thumb—each of which considers an average change of 1.0 percentage point from the projection—are much closer to historical deviations for those variables.

1. A conventional way to measure past variability is to use the standard deviation. In the case of GDP growth, CBO calculates how much actual growth over 10-year periods differs from the postwar average. The standard deviation is the size of the deviation that is exceeded about one-third of the time.

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 share of GDP are both about 1.9 percentage points.

Lower Real Growth

Stronger economic growth improves the federal budget's bottom line, and weaker economic growth worsens it. The first rule of thumb outlines the budgetary impact of economic growth that is slightly weaker than CBO's baseline assumes. Specifically, the rule illustrates the effects of growth rates for real GDP that are lower by 0.1 percentage point every year from January 2006 through the end of fiscal year 2016. Those effects differ from the effects of a cyclical change, such as a recession, which are much shorter-term in nature and usually larger in magnitude.

The baseline reflects an assumption that real GDP growth is 3.6 percent in calendar year 2006 and 3.4 percent in 2007 and averages 2.8 percent from 2008 to 2016 (see Chapter 2). Subtracting 0.1 percentage point from those growth rates each year—over the 10-year projection period—implies that GDP would be roughly 1 percentage point below the level in CBO's baseline by 2016.

A lower rate of growth for GDP would have a number of budgetary implications. For example, it would imply lower growth in taxable income, leading to decreases in revenues that would mount from $1 billion in 2006 to $47 billion in 2016 (see Table C-1 on page 123).

If revenues were lower, the federal government would have to borrow more and incur higher interest costs. The payments to service the debt would be minimally higher during the first few years of the projection period, but in later years, those annual costs would gradually increase by amounts that reach $14 billion by 2016. Mandatory spending would be only minimally affected—Medicare outlays would be slightly reduced (because of the formula used to calculate payment rates for physicians), but marginally higher outlays for the refundable portions of the earned income and child tax credits would offset that decrease. All told, growth in real GDP that was 0.1 percentage point a year lower than the rate assumed in CBO's baseline would increase deficits by amounts that would climb to $60 billion a year by 2016. The cumulative deficit over the 2007-2016 period would increase by $272 billion, or 0.8 percent of projected revenues over that period.

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. When the budget is in surplus, the Treasury uses some of its income to reduce debt held by the public. In either case, the Treasury refinances a portion of its debt at market interest rates. In addition, revenues are affected as a result of changes in the earnings of securities held by the Federal Reserve.

Under the assumption that interest rates are 1 percentage point higher than in the baseline for all maturities every year and that all other economic variables are unchanged, interest costs would be approximately $10 billion higher in 2006 (see Table C-1). That initial jump in interest costs would be fueled largely by the extra costs of refinancing the government's Treasury bills (securities with maturities of six months or less), which make up about 22 percent of its marketable debt. Roughly $1 trillion of Treasury bills is currently outstanding; all of those bills mature within the next six months. Most of the marketable debt, however, is in coupon securities—which consist of medium-term notes, inflation-protected securities, and long-term bonds ranging in maturity from two to 30 years. As they mature, they will be replaced with new securities. (The Treasury currently issues two-, three-, five-, and 10-year notes and five-, 10-, and 20-year inflation-protected securities and will begin reissuing 30-year bonds in February 2006.) Therefore, the budgetary effects mount; by 2016, interest rates that are 1 percentage point higher than those in the baseline would increase outlays by $50 billion.

The Federal Reserve holds Treasury securities to help manage its conduct of monetary policy. Profits depend on the interest that the Federal Reserve earns on its portfolio of securities; those profits are counted as revenues once they are turned over to the Treasury. If interest rates were 1 percentage point higher than projected each year, earnings on those securities would increase each year by amounts ranging from $2 billion in 2006 to $10 billion in 2016.

Under this scenario, the Treasury would have to raise additional cash (above the levels assumed in the baseline) to finance the larger deficits resulting from higher interest

rates. Such debt-service costs would climb to $24 billion by 2016. All in all, if interest rates were a full percentage point higher than the rates assumed in CBO's baseline, interest payments (including additional debt-service costs) would surpass baseline levels by increasing amounts, reaching $75 billion by 2016. Additional revenues would offset about $10 billion of that total. Over the 10-year period, the cumulative deficit would rise by $461 billion.

Higher Inflation

The third rule of thumb shows the budgetary impact of inflation that is 1 percentage point higher than the rate assumed in the baseline. The effects of inflation on federal revenues and outlays tend to offset each other, although the impact on revenues is somewhat larger.

On the one hand, higher inflation, because of its effects on wages and other income, translates directly into higher amounts of income taxes and payroll taxes withheld from people's paychecks. The impact of the higher personal incomes on revenues is reduced, with a lag, by the indexation of tax brackets for inflation. In addition, higher corporate profits from faster growth in prices quickly boost receipts from firms' quarterly estimated tax payments. Those results reduce projected deficits or increase projected surpluses.

On the other hand, higher inflation pushes up 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 reimbursement rates are also adjusted annually for inflation. Other programs, such as Medicaid, are not formally indexed but grow with inflation nonetheless. 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 net interest 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 deriving 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.

An annual increase of 1 percentage point in projected inflation in every year of the baseline period would boost revenues by about 7 percent from 2007 through 2016 and increase baseline outlays by about 6 percent over that same period. In the near term, the net effect would be slightly higher deficits—as increases in outlays exceeded the higher revenues (see Table C-1). In large part, the effect derives from CBO's assumption that interest rates rise with inflation, thus driving up interest payments relatively quickly. Mandatory spending would be boosted by the higher inflation in the short run as well. As a consequence, from 2007 through 2011, increases in outlays would exceed the boost in revenues projected under this scenario.

By 2012, however, the increased revenues associated with higher inflation would overcome the higher outlays. By the end of the projection period, added revenues would exceed the increase in outlays by $54 billion (excluding debt-service costs). Over the 2007-2016 period, the net effect of the scenario, including debt-service costs, would be a reduction of $121 billion in the cumulative deficit.

Wages and Salaries as a Higher Percentage of GDP

Because different types of income are taxed at different rates, the variation in income shares over time has contributed to changes in tax receipts relative to GDP. Considerable uncertainty exists in projections of the income shares.

Two of the most important types of income for projecting federal revenues are wages and salaries and corporate profits. Wages and salaries are the most highly taxed component of income, being subject to the individual income tax as well as payroll taxes for Social Security (up to a maximum annual amount) and Medicare. Consequently, CBO estimates that an additional dollar of corporate profits produces less revenue than an additional dollar of

wages and salaries. Thus, higher projections for wages and salaries and correspondingly lower projections for profits result in higher projected budget receipts.

CBO estimates that a shift of 1 percentage point of GDP from corporate profits to wages and salaries would lead to gains in revenues of $11 billion in 2007, rising to $24 billion in 2016 (see Table C-1). Higher revenues would lead to an annual reduction in borrowing costs that would gradually reach $12 billion by 2016. Overall, under this scenario, the 2016 deficit would be $37 billion lower than that in the baseline. The cumulative deficit over the 2007-2016 period would be $231 billion lower—roughly 0.7 percent of projected revenues over the decade.

Table C-1.

Estimated Effects of Selected Economic Changes on CBO's Baseline Budget Projections

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	Total, 2007-2011	Total, 2007-2016
						Growth Rate of Real GDP Is 0.1 Percentage Point Lower per Year							
Change in Revenues	-1	-4	-6	-10	-13	-18	-23	-28	-34	-40	-47	-52	-224
Change in Outlays													
Debt service	*	*	*	1	2	3	4	6	8	11	14	6	48
Mandatory spending	*	*	*	*	*	*	*	*	*	*	*	*	*
Total	*	*	*	1	2	3	4	6	8	10	13	6	48
Change in Deficit or Surplus[a]	**-1**	**-4**	**-7**	**-11**	**-15**	**-21**	**-27**	**-34**	**-42**	**-50**	**-60**	**-58**	**-272**
						Interest Rates Are 1 Percentage Point Higher per Year							
Change in Revenues	2	4	5	6	7	8	8	9	9	10	10	30	77
Change in Outlays													
Higher rates	9	23	32	37	43	46	48	48	49	50	50	181	426
Debt service	*	1	2	4	6	9	12	15	18	21	24	23	112
Total	10	24	34	42	49	55	59	63	67	71	75	204	538
Change in Deficit or Surplus[a]	**-8**	**-20**	**-29**	**-35**	**-42**	**-47**	**-51**	**-54**	**-57**	**-61**	**-64**	**-173**	**-461**
						Inflation Is 1 Percentage Point Higher per Year							
Change in Revenues	12	37	67	100	137	180	225	276	332	395	462	521	2,211
Change in Outlays													
Higher rates[b]	12	27	35	41	47	51	51	54	54	55	56	201	472
Debt service	*	*	1	1	2	2	2	1	*	-2	-5	6	1
Discretionary spending	*	6	14	24	35	47	59	72	85	99	114	126	555
Mandatory spending	1	12	26	43	62	83	105	133	163	197	237	225	1,061
Total	12	44	77	109	146	182	217	260	303	350	403	557	2,090
Change in Deficit or Surplus[a]	*****	**-7**	**-10**	**-9**	**-9**	**-2**	**8**	**16**	**29**	**45**	**59**	**-36**	**121**
						Wage and Salaries' Share of GDP Is 1 Percentage Point Higher per Year							
Change in Revenues	10	11	12	14	15	17	18	19	21	22	24	69	173
Change in Outlays													
Debt service	*	-1	-2	-2	-3	-5	-6	-7	-9	-11	-12	-13	-58
Change in Deficit or Surplus[a]	**10**	**12**	**13**	**17**	**19**	**21**	**24**	**27**	**30**	**33**	**37**	**82**	**231**

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million; GDP = gross domestic product.

a. Negative amounts indicate an increase in the deficit or a decrease in the surplus.

b. The change in outlays attributable to higher 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.

APPENDIX

D

The Treatment of Federal Receipts and Expenditures in the National Income and Product Accounts

The fiscal transactions of the federal government are recorded in two major sets of accounts that are conceptually quite different. The presentation generally used by executive branch agencies and the Congress and typically discussed in the press (and the one followed in this report) is the *Budget of the United States Government,* as reported by the Office of Management and Budget. The budget focuses on cash flows—revenues and outlays, or the collection of taxes and fees and the disbursement of cash for the various federal functions. The objectives of the budget are to provide information that can assist lawmakers in their policy deliberations; to facilitate the management and control of federal activities; and to help the Department of the Treasury manage its cash balances and determine its borrowing needs.

The national income and product accounts (NIPAs) also record the federal government's transactions, but with different objectives. The NIPAs, which are produced by the Bureau of Economic Analysis (BEA), an agency within the Department of Commerce, are intended to provide a comprehensive measure of current production and related income generated by the U.S. economy.[1] A well-known measure of current production in the NIPAs is gross domestic product (GDP). The accounts, which are used extensively in macroeconomic analysis, divide the economy into four major sectors—business, government, household, and the rest of the world (the foreign sector), each with its own set of accounts.[2] The federal sector, which is the focus of this appendix, is one component of the government sector (the state and local sector is the other component).[3] Because the aims of the NIPAs differ from those of the budget, the two accounting systems treat some government transactions very differently. On average, the differences cause receipts and expenditures in the NIPAs, as projected by the Congressional Budget Office (CBO), to be about 3 percent higher than the corresponding budget totals for the 2007-2016 period.

Conceptual Differences Between the NIPAs' Federal Sector and the Federal Budget

The budget of the federal government is best understood as an information and management tool. It focuses primarily on cash flows, recording for each fiscal period the inflow of revenues and the outflow of spending. The period of foremost interest in the budget is the federal fiscal year, which runs from October 1 through September 30. There are a few exceptions to the general rule of recording transactions on a cash basis, but they are designed to improve the usefulness of the budget as a decisionmaking tool. For example, when the federal government makes direct loans or provides loan guarantees (as with student loans), tracking cash flows would give a misleading view of costs; under what is termed credit reform, the budget

1. The discussion of the national income and product accounts in this appendix generally refers to Table 3.2 in the accounts, "Federal Government Current Receipts and Expenditures," which most closely resembles the presentation in the budget. For other discussions of the NIPAs, see Department of Commerce, Bureau of Economic Analysis, "Federal Budget Estimates for Fiscal Year 2006," *Survey of Current Business* (March 2005); and *Budget of the United States Government, Fiscal Year 2006: Analytical Perspectives*.

2. Some accounts in the NIPAs, such as the domestic capital account (which shows saving and investment), focus on components of gross domestic product or income rather than on a specific sector and bring together relevant information from all four sectors.

3. More formally, BEA regards the federal government and state and local governments as subsectors. The treatment of state and local governments' transactions in the NIPAs closely resembles that of the federal government's transactions.

records the estimated subsidy costs and federal administrative expenses at the time the loans are made.

The federal sector of the NIPAs possesses none of the planning and management goals of the budget. Instead, it focuses on displaying how the federal government fits into a general economic framework that describes current production and income within specific periods and what happens to that production and income. The main periods of interest for the NIPAs are calendar years and calendar quarters, although approximate totals for fiscal years can be derived from the quarterly estimates. (The tables in this appendix show fiscal year numbers.)

From the perspective of the NIPAs, the federal government is both a producer and a consumer: its workforce produces government services, and its purchases consume some of the nation's production. In addition, through its taxes and transfers, the federal government affects the resources available to the private sector. The purpose of the NIPAs is to record all of those activities in a consistent manner.

The federal sector of the NIPAs tracks how much the government spends on consumption purchases, and it records the transfer of resources that occurs through taxes, payments to beneficiaries of federal programs, and federal interest payments. The federal sector's contribution to GDP is presented elsewhere in the NIPAs.

Differences in Accounting for Major Transactions

The accounting differences between the NIPAs and the federal budget stem from the conceptual differences discussed above. In attempting to properly incorporate federal transactions into the framework used to determine GDP, the NIPAs reflect judgments about the best treatment of such transactions as government investment, sales and purchases of existing assets, federal credit, and federal activities that resemble those of businesses, along with transactions involving U.S. territories. In some cases, the appropriate treatment may be to move a transaction from the federal sector to another place in the NIPAs or to exclude the transaction from the NIPAs entirely. In other cases, the appropriate treatment may involve recording as a receipt in the NIPAs an item that the federal budget reports as an offsetting (negative) budget outlay, or adjusting the timing of a federal transaction to better match the timing of related production or income flows.[4]

The Measurement of National Saving

Several conventions in the NIPAs are intended to show the federal government's contribution to the NIPA measure of national saving. Two major departures from the budget are the treatment of federal investment spending (for such things as ships, computers, and office buildings) and the treatment of federal employees' retirement programs.

In the federal budget, outlays for investment purchases are treated like other cash outlays and thus are subtracted from budget revenues to determine the size of the federal deficit or surplus. By contrast, in the NIPAs, federal investment is not counted as federal spending for the purpose of measuring net federal government saving (current receipts minus current expenditures)—because new purchases of federal capital (investments) do not measure the current inputs from the existing stock of capital used to provide government services.[5] To approximate the cost of those capital inputs, the NIPAs include in current federal expenditures an estimate of the depreciation (consumption of fixed capital) of the stock of federal capital.[6] The treatment is conceptually similar to that applied to the corporate business sector, which uses depreciation rather than investment purchases to compute net corporate saving (retained earnings). In the federal budget, deprecia-

4. The resulting differences between the numbers in the NIPAs and the budget are sometimes divided into three groups: coverage, timing, and netting. Although all three types of differences can affect total revenues or outlays, netting differences have no impact on the federal deficit or surplus because they affect revenues and outlays equally.

5. Federal investment is shown elsewhere in the NIPAs, along with private investment spending in the domestic capital account, which shows saving and investment (Table 5.1 in the accounts).

6. The destruction of business capital by Hurricanes Katrina and Rita was recorded in the NIPAs as a large increase in the consumption of fixed capital (CFC) by the business sector. For the government sector, however, BEA did not follow that treatment. Because CFC is captured in the accounts as "value added" by the government, a surge in CFC to reflect the catastrophic loss of capital would increase GDP—which is inconsistent with actual events. Consequently, the loss of federal capital resulting from the hurricanes was not recorded in the NIPAs when it occurred. However, BEA will remove the lost capital from the stock of government-owned fixed assets, and future estimates of federal CFC will be reduced correspondingly.

tion is not tracked. In Table D-1, which provides a crosswalk between the budget and the NIPAs, that difference in coverage is shown under "Treatment of investment and depreciation."[7]

The transactions of federal employees' retirement programs are also handled differently in the budget and the NIPAs. In the budget, federal employees' contributions for their retirement are recorded as revenues, whereas agencies' contributions on behalf of their employees (as well as interest payments from the Treasury to trust funds) have no overall budgetary effect because they are simply transfers of funds between two government accounts.[8] Benefit payments to retirees are recorded as outlays in the budget. By contrast, in the NIPAs, the aim is to make the measurement of saving by the federal government consistent with that of the private sector. Therefore, the NIPAs treat some of the transactions of federal retirement plans, except for the Railroad Retirement Fund, as part of the household sector.[9] The receipts from federal employers' and employees' retirement contributions (and the interest earned by retirement accounts) are considered part of the personal income of workers and thus are not recorded as federal transactions (receipts or negative expenditures).

On the outlay side, pension benefit payments to retirees are not recorded as federal expenditures in the NIPAs because they are treated as transfers from pension funds within the household sector. Some transactions, however, are treated as part of federal expenditures even though the corresponding receipts are recorded in the household sector. The government's contributions to its workers' retirement are counted as federal expenditures (as part of employees' compensation), as is the interest paid to federal retirement accounts. The different treatment of retirement contributions by federal employees shows up in Table D-1 under "Receipts"; the different treatment of contributions by federal employers, interest earnings, and benefit payments is shown under "Expenditures."

Capital Transfers and Exchanges of Existing Assets

The NIPAs measure current production and income rather than transactions that involve existing assets. Therefore, the NIPAs do not count capital transfers or asset exchanges as part of federal receipts or expenditures, although the budget generally does include those transactions. The NIPAs define as capital transfers—and thus exclude—estate and gift taxes (which are taxes on private capital transfers), investment subsidies to businesses, and investment grants to state and local governments (for air transportation, highways, transit, and water treatment plants).[10] Exchanges of existing assets include federal transactions for deposit insurance and sales and purchases of government assets (including assets that are not produced, such as land and the radio spectrum). In Table D-1, those differences between the NIPAs' federal sector and the budget accounts show up on the revenue side as estate and gift taxes and on the outlay side as capital transfers and lending and financial adjustments.

Credit Programs

The budget is not affected by all of the transactions related to federal loans and loan guarantees—just by the estimated cost of subsidies and federal administrative costs. Loan disbursements, loan repayments, and interest are reported in what are termed financing accounts, which have no effect on revenues or outlays.

7. The estimates and the presentation of the reconciliation between the budget and the NIPAs in Table D-1 are based on CBO's interpretation of the methodology for the accounts as detailed in Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* (June 2003), and in BEA's reconciliation of the Administration's budget for fiscal year 2006, published in the *Survey of Current Business* (March 2005).

8. In the budget, contributions by an agency for its employees' retirement are considered outlays for that agency and offsetting receipts (negative outlays) for the trust funds. Thus, those intragovernmental transfers result in no net outlays or receipts for the total budget. That treatment is the same for Social Security and Medicare contributions by the federal government for its employees.

9. Social Security contributions and benefit payments for both private and government employees are recorded in the federal sector as receipts and expenditures rather than moved to the household sector.

10. Another type of capital transfer excluded by the Bureau of Economic Analysis in the national income and product accounts is the annual lump-sum payment from the Treasury to the Uniformed Services Retiree Health Care Fund—a trust fund begun in 2003 to pay for benefits received by retired members of the armed forces who are Medicare-eligible and their dependents. Those payments to the trust fund are for accrued but unfunded liabilities for benefits attributable to work performed before 2003, and BEA excludes those payments from federal expenditures because they are not related to current production. In the budget, those annual payments are recorded as outlays by the Treasury but as offsetting receipts (negative outlays) by the trust fund. Because those annual payments have no net impact on federal spending in either the NIPAs or the budget, there is no corresponding reconciliation item in Table D-1.

Table D-1.

Relationship of the Budget to the Federal Sector of the National Income and Product Accounts

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
						Receipts						
Revenues (Budget)[a]	2,154	2,312	2,461	2,598	2,743	2,883	3,138	3,378	3,546	3,724	3,912	4,113
Differences												
Coverage												
Contributions for government employees' retirement	-4	-4	-4	-4	-4	-4	-4	-3	-3	-3	-3	-2
Estate and gift taxes	-25	-28	-26	-28	-29	-22	-20	-45	-49	-55	-61	-67
Geographic adjustments	-4	-4	-4	-4	-5	-5	-5	-5	-5	-6	-6	-6
Universal Service Fund receipts	-7	-7	-8	-8	-8	-8	-8	-8	-8	-8	-9	-9
Subtotal, coverage	-40	-44	-42	-44	-45	-38	-36	-62	-66	-72	-79	-84
Timing shift of corporate estimated tax payments	-5	0	0	0	0	0	0	0	0	0	0	0
Netting												
Medicare premiums	38	55	65	70	74	80	87	94	103	115	127	141
Deposit insurance premiums	*	1	1	1	1	2	2	2	2	2	2	2
Government contributions for OASDI and HI for employees	14	15	16	17	18	19	20	20	22	23	24	25
Income receipts on assets	14	14	17	19	19	20	20	20	22	22	23	23
Surpluses of government enterprises	-3	-4	-5	-5	-5	-5	-5	-5	-6	-6	-6	-6
Other	21	25	25	25	26	26	26	27	27	28	26	26
Subtotal, netting	85	107	119	127	132	140	149	157	170	183	195	210
Other adjustments[b]	-36	3	-4	1	-1	-2	-4	-6	1	1	2	3
Total Differences	**4**	**66**	**72**	**84**	**86**	**100**	**109**	**89**	**105**	**112**	**118**	**129**
Receipts in the NIPAs	2,157	2,378	2,533	2,681	2,829	2,983	3,248	3,467	3,651	3,836	4,030	4,243
						Expenditures						
Outlays (Budget)[a]	2,472	2,649	2,732	2,857	2,984	3,105	3,252	3,340	3,506	3,666	3,839	4,046
Differences												
Coverage												
Treatment of investment and depreciation	-14	-18	-22	-23	-24	-25	-26	-27	-28	-29	-30	-31
Contributions for government employees' retirement	36	36	35	35	35	36	37	38	40	41	43	45
Capital transfers	-47	-50	-53	-56	-57	-58	-59	-60	-61	-62	-63	-64
Lending and financial adjustments	13	14	21	23	15	16	15	16	17	18	18	18
Geographic adjustments	-13	-14	-15	-16	-16	-17	-18	-18	-19	-20	-21	-22
Universal Service Fund payments	-6	-7	-7	-7	-7	-7	-7	-7	-8	-8	-8	-8
Other	-8	-7	-2	2	2	5	7	8	9	11	16	19
Subtotal, coverage	-40	-46	-44	-42	-53	-50	-51	-50	-49	-48	-45	-43
Timing adjustments	-15	5	4	0	0	0	-20	20	0	0	0	-26

Continued

Table D-1.

Continued

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
						Expenditures (Continued)						
Differences (Continued)												
Netting												
Medicare premiums	38	55	65	70	74	80	87	94	103	115	127	141
Deposit insurance premiums	*	1	1	1	1	2	2	2	2	2	2	2
Government contributions for OASDI and HI for employees	14	15	16	17	18	19	20	20	22	23	24	25
Income receipts on assets	14	14	17	19	19	20	20	20	22	22	23	23
Surpluses of government enterprises	-3	-4	-5	-5	-5	-5	-5	-5	-6	-6	-6	-6
Other	21	25	25	25	26	26	26	27	27	28	26	26
Subtotal, netting	85	107	119	127	132	140	149	157	170	183	195	210
Flood insurance adjustment[c]	0	-18	-1	0	0	0	0	0	0	0	0	0
Total Differences	**30**	**48**	**79**	**85**	**80**	**91**	**79**	**127**	**121**	**136**	**150**	**141**
Expenditures in the NIPAs	2,503	2,697	2,811	2,942	3,063	3,196	3,331	3,467	3,627	3,802	3,989	4,188
						Net Federal Government Saving						
Budget Deficit (-) or Surplus[a]	-318	-337	-270	-259	-241	-222	-114	38	40	57	73	67
Differences												
Coverage												
Treatment of investment and depreciation	14	18	22	23	24	25	26	27	28	29	30	31
Contributions for government employees' retirement	-41	-40	-39	-39	-39	-40	-40	-42	-43	-44	-46	-47
Estate and gift taxes	-25	-28	-26	-28	-29	-22	-20	-45	-49	-55	-61	-67
Capital transfers	47	50	53	56	57	58	59	60	61	62	63	64
Lending and financial adjustments	-13	-14	-21	-23	-15	-16	-15	-16	-17	-18	-18	-18
Geographic adjustments	10	10	10	11	12	12	13	13	14	14	15	16
Universal Service Fund	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Other	8	7	2	-2	-2	-5	-7	-8	-9	-11	-16	-19
Subtotal, coverage	-1	3	*	-2	8	11	14	-12	-17	-25	-34	-41
Timing adjustments	10	-5	-4	0	0	0	20	-20	0	0	0	26
Flood insurance adjustment[c]	0	18	1	0	0	0	0	0	0	0	0	0
Other adjustments[b]	-36	3	-4	1	-1	-2	-4	-6	1	1	2	3
Total Differences	**-27**	**18**	**-7**	**-1**	**7**	**9**	**31**	**-38**	**-16**	**-24**	**-32**	**-12**
Net Federal Government Saving	-345	-319	-277	-261	-234	-213	-83	*	24	34	41	55

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million; OASDI = Old-Age, Survivors, and Disability Insurance; HI = Hospital Insurance.

a. Includes Social Security and the Postal Service.

b. The figure for 2005 includes netting adjustments for Hurricanes Katrina and Rita.

c. Reflects netting and timing adjustments for Hurricanes Katrina and Rita.

As in the budget, the NIPAs record administrative costs and generally exclude loan disbursements and repayments and other cash flows considered exchanges of existing assets or financial and lending transactions unrelated to current production. By contrast, however, the NIPAs do not record subsidy costs. In another departure from the budget, the NIPAs include the interest receipts from credit programs (as part of federal receipts). Those differences in the treatment of credit programs are recorded in two places: under "Expenditures" in Table D-1, the lending and financial adjustments show the differences in handling the loan subsidies; and under "Receipts," the difference in treating loan interest is captured as part of income receipts on assets.

Geographic Coverage

The NIPAs exclude all government transactions with Puerto Rico and the U.S. territories, whose current production, according to the NIPAs' definition, is not part of U.S. GDP. Because federal transfers dominate those transactions, their exclusion tends to increase the NIPAs' depiction of net federal government saving in comparison with the budget's measure of saving—the federal deficit or surplus. That difference in coverage is shown as geographic adjustments in Table D-1.

Universal Service Fund

The business activity of the Universal Service Fund, which provides resources to promote access to telecommunications, is recorded in the budget, but not in the NIPAs' federal sector. The Universal Service Fund receives federally required payments from providers of interstate and international telecommunications services and disburses those funds to local providers that serve high-cost areas, low-income households, libraries, and schools, as well as to rural health care providers. The fund is administered by an independent nonprofit corporation (the Universal Service Administrative Company), which is regulated by the Federal Communications Commission.

Although the Universal Service Fund's revenues and outlays appear in the federal budget, they have little net impact on the deficit or surplus. In the NIPAs, the fund's receipts and payments are classified as intracorporate transfers (from one business to another). The difference in treatment of the Universal Service Fund is so labeled in Table D-1.

Interest Receipts

In the NIPAs, federal interest receipts are grouped with other types of federal receipts (in the category designated "Income receipts on assets") rather than netted against federal interest payments, as they are in the federal budget.[11] BEA's treatment is consistent with international accounting practices, under which interest receipts and payments are reported separately. That difference in the treatment of interest receipts in the NIPAs and in the federal budget raises the NIPAs' measure of government receipts relative to federal budget revenues and increases the NIPAs' measure of federal spending relative to budget outlays. However, because the difference in treatment affects receipts and expenditures in the NIPAs by exactly the same amount, it has no impact on the NIPAs' measurement of net federal government saving.

Surpluses of Government Enterprises

In the NIPAs, the surpluses of government enterprises, such as the Postal Service, are shown on a separate line as current receipts of the federal government. That treatment accords with international accounting standards, which generally advocate reporting spending on a gross, rather than a net, basis. By contrast, surpluses of government enterprises are treated as offsetting receipts (negative outlays) in the federal budget.

Military Sales and Assistance in Kind

The NIPAs attempt to identify contributions to GDP by sector. Therefore, they do not classify as part of federal consumption military purchases of equipment and services that are intended for sale or as gifts to foreign governments. Instead, those transactions are considered net exports in the NIPAs' foreign transactions account (Table 4.1 in the accounts). In the case of gifts, the transactions are also recorded in the federal sector of the NIPAs as a portion of transfers to the rest of the world—a classification that parallels their treatment as outlays in the federal budget. By contrast, military sales to foreign governments are recorded in the federal budget as outlays, while the proceeds from those sales are recorded as offsetting receipts (negative outlays).

11. About half of the NIPAs' interest receipts, mainly from penalties on late tax payments, are recorded as revenues in the federal budget.

National Flood Insurance Program

In the federal budget, payments to beneficiaries covered by the National Flood Insurance Program (NFIP) are recorded as outlays. In the NIPAs, though, insurance losses by that federal government enterprise are normally recorded as offsets to current receipts (and thus a reduction in the current surpluses of government enterprises). In Table D-1, that difference is captured under netting for both receipts and expenditures, and it is usually relatively small.

The flood-related damages caused by Hurricanes Katrina and Rita were catastrophic rather than normal, so BEA is treating the NFIP's insurance losses differently, in two important ways.[12] First, an estimate of the increased liabilities of the NFIP is recorded for the fiscal year that the destruction occurred—that is, on an accrual basis—not for the fiscal years that the benefit payments will be made. Second, the increased liabilities do not show up in the NIPAs as a reduction in the surplus of government enterprises, but as offsets to current transfer receipts from businesses (such as certain fees paid to the government)—because private insurance companies make the payments to policyholders, and the federal government reimburses the private companies.

In the federal budget, however, there is no difference in the treatment of normal losses and catastrophic losses: the costs are recorded when payments are actually made. Because the bulk of the payments for the recent hurricanes will be made in fiscal year 2006, the federal budget will record most of the outlays in that year. In Table D-1, the netting and timing differences for those payments are part of "Other adjustments" under "Receipts" and are shown as the adjustment for flood insurance under "Expenditures."

12. The treatment parallels that in the business sector of the NIPAs, which makes a distinction between catastrophic and normal insurance losses, because insurance premiums are generally set to cover normal losses, while catastrophic losses are covered by reserve funds or reinsurance. See Brent R. Moulton and Eugene P. Seskin, "Preview of the 2003 Comprehensive Revision of the National Income and Product Accounts: Changes in Definitions and Classifications," *Survey of Current Business* (Department of Commerce, Bureau of Economic Analysis, June 2003), pp. 17-34; and Baoline Chen and Dennis J. Fixler, "Measuring the Services of Property-Casualty Insurance in the NIPAs," *Survey of Current Business* (Department of Commerce, Bureau of Economic Analysis, October 2003), pp. 10-26.

Timing Differences

As much as possible, the NIPAs attempt to measure income flows when income is earned (on an accrual basis) rather than when income is received (on a cash basis).[13] That approach makes sense in an integrated system of accounts that tracks both production and income because, on an accrual basis, the value of what is produced in a given period should—measurement problems aside—match the total income generated. For example, BEA attributes corporate tax payments to the year in which the liabilities are incurred rather than to the time when the payments are actually made. However, the NIPAs are not entirely consistent in that respect: personal tax payments are counted as they are made and are not attributed retroactively to the year in which the liabilities were incurred. Currently, BEA is engaged in research to develop methods for preparing accrual-based estimates of personal tax payments.

Because the budget is recorded mostly on a cash basis and the NIPAs' federal sector is recorded largely on an accrual basis, differences exist in a number of areas in the timing of recorded transactions.

Corporate Taxes. Tax legislation sometimes temporarily shifts the timing of corporate tax payments (usually from the end of one fiscal year to the beginning of the next). The NIPAs exclude such timing shifts, which are not consistent with accrual accounting. The timing adjustments for the effects of the Economic Growth and Tax Relief Reconciliation Act of 2001 are shown as the timing shift of corporate estimated tax payments in Table D-1.

Although corporations make estimated tax payments throughout the year, any shortfalls (or overpayments) are corrected in the form of final payments (or refunds) in subsequent years. The NIPAs shift those final payments back to the year in which the corporate profits that gave rise to the tax liabilities were actually generated, whereas the budget records them on a cash basis. The results of that difference are difficult to identify for recent history

13. See United Nations, *System of National Accounts* (1993), paragraph 3.19, which emphasizes reporting transactions on an accrual basis. Many of the conceptual changes to the national income and product accounts over time have been based on guidelines enumerated in that U.N. document. See also Department of Commerce, Bureau of Economic Analysis, "The NIPAs and the System of National Accounts," *Survey of Current Business* (December 2004), pp. 17-32.

and thus appear as part of "Other adjustments" under "Receipts" in Table D-1.[14]

Personal Taxes. Although personal taxes are not recorded on an accrual basis in the NIPAs, BEA nevertheless attempts to avoid large, distorting upward or downward spikes in personal disposable income that result from timing quirks. Such quirks occur in April of each year, for example, when most final settlements for the previous year's personal taxes are paid. In the NIPAs, therefore, those settlements are evenly spread over the four quarters of the calendar year in which they are paid. (As with accrual accounting, that treatment avoids spikes. Unlike accrual treatment, however, it does not move payments back to the year in which the liabilities were incurred.) Such "smoothing" can alter the relationship of the NIPAs and the budget accounts for fiscal years because it shifts some receipts into the last quarter of the calendar year and thus into the following fiscal year.[15] Those adjustments are difficult to identify for recent history and thus are not shown separately in Table D-1; they appear instead in the "Other adjustments" category under "Receipts."

Transfers and Military Compensation. Timing adjustments are needed on the spending side of the NIPAs to align military compensation and government transfer payments—for example, veterans' benefits, Supplemental Security Income (SSI) payments, and Medicare's payments to providers—with income that is reported on an accrual basis in the NIPAs. Misalignments can occur because of delays in payments or quirks in the calendar.

For example, although SSI payments are usually made on the first day of each month, they are sometimes made a day or more in advance. That situation typically occurs when the first day of the month falls on a weekend or holiday. If it occurs for the October benefits, the payments will be pushed into the previous fiscal year in the budget. In such cases, the NIPAs introduce a timing adjustment that effectively moves the payments back to the first day of the month. Hence, the NIPAs' adjustment always ensures that there are exactly 12 monthly SSI payments in a year, whereas in the budget, there can be 11 in some years and 13 in others.

For military compensation, which is paid at the beginning and middle of each month, the adjustment in the NIPAs always ensures 24 payments in a year. In the budget, by contrast, there can be 23 payments in some years and 25 in others. The timing adjustments for expenditures in Table D-1 reflect that regularizing for transfers and for military pay.

In another contrast with the federal budget, the NIPAs record Medicare payments on an accrual basis rather than on a cash basis. That treatment better illustrates the link between the underlying economic activity (the medical services provided) and the associated federal transactions (payment for those services), which can be several months apart. The timing adjustment, however, has only a small effect on the NIPAs' measure of net federal government saving.

Business Activities

The federal budget and the NIPAs both treat certain revenues as offsetting receipts (negative outlays) when they result from voluntary transactions with the public that resemble business activities, such as proceeds from the sale of government publications. However, the NIPAs generally have a stricter view of what resembles a business transaction. In particular, Medicare premiums, deposit insurance premiums, rents, royalties, and regulatory or inspection fees are deemed equivalent to business transactions in the budget but not in the NIPAs. Consequently, those transactions (negative outlays in the budget) are treated in the NIPAs as government receipts (contributions for government social insurance and current transfers from business—fines and fees). Those differences are recorded under "Netting" in Table D-1. Because they affect total current receipts and total current expenditures by exactly the same amounts, they have no effect on the NIPAs' measure of net federal government saving.

Presentation of the Federal Government's Receipts and Expenditures in the NIPAs

As in the budget, the federal sector of the NIPAs classifies receipts by type, but the categories differ (see Table D-2). The NIPAs' classifications help to determine measures

14. "Other adjustments" include timing differences not shown elsewhere in Table D-1, plus discrepancies between figures in the NIPAs and the budget that may diminish when BEA makes subsequent revisions.

15. A change in the relationship between receipts in the budget and in the NIPAs is projected to occur following certain changes in tax laws, such as the increases in tax rates and other changes scheduled to take effect in 2011 and assumed in CBO's baseline for receipts.

Table D-2.

Projections of Baseline Receipts and Expenditures as Measured by the National Income and Product Accounts

(Billions of dollars)

	Actual 2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
						Receipts						
Current Tax Receipts												
Personal current taxes	903	993	1,081	1,167	1,253	1,344	1,535	1,681	1,785	1,888	1,997	2,114
Taxes on corporate income	280	314	319	324	331	333	341	350	360	372	385	401
Taxes on production and imports	97	102	104	108	111	115	120	125	129	133	134	138
Taxes from the rest of the world	10	10	11	12	13	14	16	18	19	20	21	22
Subtotal	1,289	1,419	1,516	1,612	1,708	1,805	2,012	2,174	2,293	2,412	2,537	2,676
Contributions for Government Social Insurance[a]	841	905	959	1,008	1,058	1,112	1,168	1,224	1,283	1,347	1,413	1,482
Current Transfer Receipts	7	33	35	36	37	38	40	42	44	47	49	52
Income Receipts on Assets	23	25	28	31	31	32	33	33	36	37	37	39
Current Surpluses of Government Enterprises	-3	-4	-5	-5	-5	-5	-5	-5	-6	-6	-6	-6
Total Current Receipts	**2,157**	**2,378**	**2,533**	**2,681**	**2,829**	**2,983**	**3,248**	**3,467**	**3,651**	**3,836**	**4,030**	**4,243**
						Expenditures						
Consumption Expenditures												
Defense												
Consumption	443	455	454	459	468	479	489	502	513	525	538	551
Consumption of fixed capital	67	68	68	69	71	74	76	79	82	85	88	90
Nondefense[b]												
Consumption	226	232	237	244	252	258	264	270	277	284	292	299
Consumption of fixed capital	25	25	26	26	26	27	27	28	28	29	29	30
Subtotal	760	780	783	798	818	838	857	878	900	923	947	970
Current Transfer Payments												
Government social benefits												
To persons	1,064	1,170	1,246	1,321	1,388	1,462	1,540	1,619	1,724	1,839	1,962	2,097
To the rest of the world	3	3	3	4	4	4	4	5	5	5	5	6
Subtotal	1,068	1,174	1,249	1,325	1,392	1,466	1,544	1,624	1,729	1,844	1,968	2,103
Other transfer payments												
Grants-in-aid to state and local governments[b]	357	383	393	413	431	453	478	504	532	563	597	633
To the rest of the world	29	28	25	24	25	25	25	25	26	26	27	27
Subtotal	385	411	418	437	456	477	503	529	558	589	624	660
Interest Payments[b]	239	280	309	333	350	367	381	390	394	399	404	407
Subsidies	51	53	51	50	48	47	46	46	46	47	47	47
Total Current Expenditures	**2,503**	**2,697**	**2,811**	**2,942**	**3,063**	**3,196**	**3,331**	**3,467**	**3,627**	**3,802**	**3,989**	**4,188**
						Net Federal Government Saving						
Net Federal Government Saving	**-345**	**-319**	**-277**	**-261**	**-234**	**-213**	**-83**	*****	**24**	**34**	**41**	**55**

Source: Congressional Budget Office.

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

a. Includes Social Security taxes, Medicare taxes and premiums, and unemployment insurance taxes.

b. Includes Social Security and the Postal Service.

such as disposable income and corporate profits after taxes. There are five major categories of current receipts. The largest one, current tax receipts, includes taxes on personal income, taxes on corporate income, taxes on production and imports, and taxes from the rest of the world. The next-largest category is contributions for government social insurance, which consists of Social Security taxes, Medicare taxes and premiums, and unemployment insurance taxes. The remaining categories are current transfer receipts (fines and fees), income receipts on assets (interest, rents, and royalties), and current surpluses of government enterprises (such as the Postal Service).

In the NIPAs, the government's expenditures are classified according to their purpose. The major groups, which are much fewer than those in the federal budget, are consumption expenditures, or purchases of goods and services (broken out for defense and nondefense purchases); transfer payments (to individuals, governments, and the rest of the world); interest payments; and subsidies to businesses and to government enterprises.

Consumption of goods and services (for both defense and nondefense purposes) consists of purchases made by the government for its immediate use in production. (The largest portion of such consumption is the compensation of military and civilian federal employees.) Among the government's consumption expenditures, the consumption of fixed capital—depreciation—represents a partial measure of the services that the government receives from its stock of fixed assets, such as buildings or equipment.

Transfer payments (cash payments made directly to individuals and the rest of the world as well as grants to state and local governments or foreign nations) constitute another grouping. Most of the transfers to individuals are for social benefits. Grants-in-aid are payments that the federal government makes to state or local governments, which generally use them for transfers (such as benefits provided by the Medicaid program) and consumption (such as the hiring of additional police officers). Grants-in-aid to foreigners include federal purchases of military equipment for delivery to foreign governments.

The NIPAs' category for federal interest payments shows only payments and thus differs from the budget, which contains a category labeled "net interest." In the NIPAs, federal interest receipts are classified with other federal receipts.

The NIPAs' category labeled "subsidies" primarily consists of grants paid by the federal government to businesses, including state and local government enterprises such as public housing authorities. Federal housing and agricultural assistance have long dominated that category.

Net federal government saving in the NIPAs is the difference between the current receipts and the current expenditures of the federal sector.[16] It is a component of net national saving (which also includes net saving by the state and local government sector, personal saving, and corporate retained earnings) and thus is a partial measure of how much of the nation's income earned from current production is not consumed in the current period. Net federal saving (or dissaving) is not a good indicator of federal borrowing requirements because, unlike the budget deficit or surplus, it is not a measure of cash flows.[17]

16. Gross federal saving—a component of gross national saving—equals net federal saving plus depreciation (consumption of fixed capital).

17. As an addendum to the NIPAs' Table 3.2, BEA publishes a measure labeled "net lending or net borrowing," which is closer to a cash or financial measure in several ways. Like the budget, it includes investment purchases as expenditures because those purchases must be financed from current receipts or from federal borrowing. At the same time, it excludes consumption of fixed capital because those accounting charges are not a drain on current financial resources. In addition, it includes receipts from the sale of assets that are not produced, as well as capital transfer receipts (for example, estate and gift taxes) and capital transfer payments (for example, investment grants to state and local governments), which are not part of current receipts or expenditures in the NIPAs but do affect cash flows. Despite those adjustments, net federal lending or borrowing in the NIPAs differs from the budget deficit or surplus because of all of the other differences in timing and coverage that distinguish the NIPAs from the budget. BEA presents those differences in Table 3.18, which is similar to Table D-1 presented here.

APPENDIX

E

CBO's Economic Projections for 2006 to 2016

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 2006 to 2016 (by calendar year in Table E-1 and by fiscal year in Table E-2). CBO does not forecast cyclical fluctuations in its projections for years after 2007. Instead, the projected values shown in the tables for 2008 through 2016 reflect CBO's assessment of average values for that period—which takes into account the potential ups and downs of the business cycle.

Table E-1.

CBO's Year-by-Year Economic Forecast and Projections for Calendar Years 2006 to 2016

	Estimated	Forecast		Projected								
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Nominal GDP (Billions of dollars)	12,494	13,262	13,959	14,696	15,455	16,208	16,954	17,718	18,512	19,329	20,178	21,064
Nominal GDP (Percentage change)	6.5	6.1	5.3	5.3	5.2	4.9	4.6	4.5	4.5	4.4	4.4	4.4
Real GDP (Percentage change)	3.6	3.6	3.4	3.4	3.3	3.0	2.8	2.7	2.6	2.6	2.6	2.5
GDP Price Index (Percentage change)	2.7	2.4	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Consumer Price Index[a] (Percentage change)	3.4	2.8	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Core Consumer Price Index[b] (Percentage change)	2.2	2.2	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Employment Cost Index[c] (Percentage change)	2.4	3.0	3.2	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Unemployment Rate (Percent)	5.1	5.0	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	3.2	4.5	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)	4.3	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Tax Bases (Billions of dollars)												
Corporate book profits	1,434	1,451	1,438	1,439	1,468	1,511	1,555	1,611	1,675	1,742	1,818	1,901
Wages and salaries	5,723	6,050	6,383	6,745	7,103	7,447	7,785	8,132	8,491	8,861	9,246	9,647
Tax Bases (Percentage of GDP)												
Corporate book profits	11.5	10.9	10.3	9.8	9.5	9.3	9.2	9.1	9.0	9.0	9.0	9.0
Wages and salaries	45.8	45.6	45.7	45.9	46.0	45.9	45.9	45.9	45.9	45.8	45.8	45.8

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

Note: Percentage changes are year over year.

a. The consumer price index for all urban consumers.

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

c. The employment cost index for wages and salaries of workers in private industry.

Table E-2.

CBO's Year-by-Year Economic Forecast and Projections for Fiscal Years 2006 to 2016

	Actual	Forecast		Projected								
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Nominal GDP (Billions of dollars)	12,293	13,082	13,781	14,508	15,264	16,021	16,768	17,524	18,311	19,121	19,963	20,839
Nominal GDP (Percentage change)	6.5	6.4	5.3	5.3	5.2	5.0	4.7	4.5	4.5	4.4	4.4	4.4
Real GDP (Percentage change)	3.7	3.7	3.4	3.4	3.3	3.1	2.8	2.7	2.6	2.6	2.6	2.5
GDP Price Index (Percentage change)	2.7	2.6	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Consumer Price Index[a] (Percentage change)	3.3	3.2	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Core Consumer Price Index[b] (Percentage change)	2.2	2.2	2.3	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Employment Cost Index[c] (Percentage change)	2.3	2.9	3.2	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Unemployment Rate (Percent)	5.2	5.0	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	2.7	4.3	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)	4.2	5.0	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Tax Bases (Billions of dollars)												
Corporate book profits	1,328	1,476	1,438	1,439	1,459	1,501	1,543	1,596	1,658	1,724	1,800	1,876
Wages and salaries	5,652	5,970	6,299	6,652	7,015	7,362	7,701	8,044	8,400	8,767	9,149	9,545
Tax Bases (Percentage of GDP)												
Corporate book profits	10.8	11.3	10.4	9.9	9.6	9.4	9.2	9.1	9.1	9.0	9.0	9.0
Wages and salaries	46.0	45.6	45.7	45.9	46.0	46.0	45.9	45.9	45.9	45.9	45.8	45.8

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

Note: Percentage changes are year over year.

a. The consumer price index for all urban consumers.

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

c. The employment cost index for wages and salaries of workers in private industry.

APPENDIX

F

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 2005. The data are shown in both nominal dollars and as a percentage of gross domestic product (GDP). Some of the numbers have been revised since the last time these tables were published, in January 2005.

Federal revenues, outlays, the deficit or surplus, and debt held by the public are shown in Tables F-1 and F-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 Budget Reconciliation Act of 1989.

The major sources of federal revenues (including off-budget revenues) are presented in Tables F-3 and F-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 F-5 and F-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 F-7 and F-8 divide discretionary spending into its defense, international, and domestic components. Tables F-9 and F-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 subsidizes telecommunications services for selected areas and individuals), the State Children's Health Insurance Program, and the Social Services Block Grant program.

The remaining tables, F-11 through F-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 F-11 also presents estimates of potential and actual GDP.

Table F-1.

Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public, 1962 to 2005

(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

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

Note: n.a. = not applicable (the Postal Service was not an independent agency until 1972); * = between -$50 million and $50 million.

a. End of year.

Table F-2.

Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public, 1962 to 2005

(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	37.2
2005	17.5	20.1	-4.0	1.4	*	-2.6	37.4

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

Note: n.a. = not applicable (the Postal Service was not an independent agency until 1972); * = between -0.05 percent and 0.05 percent.

a. End of year.

Table F-3.

Revenues by Major Source, 1962 to 2005

(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

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

Table F-4.

Revenues by Major Source, 1962 to 2005

(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	7.5	2.3	6.5	0.6	0.2	0.2	0.3	17.5

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

Table F-5.

Outlays for Major Spending Categories, 1962 to 2005

(Billions of dollars)

	Discretionary Spending	Mandatory Spending: Programmatic Spending[a]	Mandatory Spending: 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	895.3	1,346.2	-108.7	160.2	2,293.0
2005	967.9	1,446.1	-125.8	184.0	2,472.2

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

a. Excludes offsetting receipts.

Table F-6.

Outlays for Major Spending Categories, 1962 to 2005

(Percentage of gross domestic product)

	Discretionary Spending	Mandatory Spending: Programmatic Spending[a]	Mandatory Spending: 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	20.1

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

a. Excludes offsetting receipts.

Table F-7.

Discretionary Outlays, 1962 to 2005

(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	31.0	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	44.6	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	91.5	197.1
1978	104.6	8.5	105.5	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	127.1	326.0
1983	209.9	13.6	129.8	353.3
1984	228.0	16.3	135.1	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	251.2	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	298.6	614.8
2001	306.1	22.5	320.8	649.3
2002	348.9	26.2	359.2	734.3
2003	404.9	27.9	392.6	825.4
2004	454.1	33.8	407.5	895.3
2005	493.6	39.0	435.3	967.9

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

Table F-8.

Discretionary Outlays, 1962 to 2005

(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	3.5	7.9

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

Table F-9.

Outlays for Mandatory Spending, 1962 to 2005

(Billions of dollars)

	Social Security	Medicare	Medicaid	Income Support[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	297.2	176.2	190.7	135.0	55.6	-108.7	1,237.5
2005	518.7	333.1	181.7	195.9	147.6	69.1	-125.8	1,320.3

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 F-10.

Outlays for Mandatory Spending, 1962 to 2005

(Percentage of gross domestic product)

	Social Security	Medicare	Medicaid	Income Support[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	10.6
2003	4.3	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	10.7

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 F-11.

Deficits, Surpluses, Debt, and Related Series, 1962 to 2005

	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	575
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	38.6	687	675
1966	-4	-14	264	-0.5	-2.0	36.6	756	720
1967	-9	-22	267	-1.1	-2.8	34.3	810	777
1968	-25	-31	290	-3.0	-3.7	34.4	869	841
1969	3	-3	278	0.4	-0.3	30.4	948	916
1970	-3	1	283	-0.3	0.1	28.2	1,013	1,003
1971	-23	-10	303	-2.1	-0.9	27.8	1,080	1,090
1972	-23	-21	322	-2.0	-1.7	27.3	1,177	1,180
1973	-15	-20	341	-1.2	-1.6	26.8	1,311	1,274
1974	-6	2	344	-0.4	0.1	24.3	1,439	1,416
1975	-53	3	395	-3.3	0.2	24.4	1,561	1,616
1976	-74	-36	477	-4.1	-2.0	26.7	1,739	1,790
1977	-54	-21	549	-2.7	-1.1	27.4	1,974	2,003
1978	-59	-33	607	-2.7	-1.5	27.4	2,218	2,214
1979	-41	-18	640	-1.6	-0.7	25.9	2,502	2,472
1980	-74	-11	712	-2.7	-0.4	25.7	2,725	2,774
1981	-79	-12	789	-2.5	-0.4	25.2	3,059	3,132
1982	-128	-38	925	-3.7	-1.1	26.9	3,226	3,437
1983	-208	-109	1,137	-5.6	-3.0	30.8	3,443	3,687
1984	-185	-141	1,307	-4.7	-3.6	33.2	3,847	3,936
1985	-212	-179	1,507	-5.1	-4.3	36.0	4,149	4,190
1986	-221	-213	1,741	-5.0	-4.8	39.3	4,407	4,428
1987	-150	-158	1,890	-3.2	-3.4	40.3	4,654	4,691
1988	-155	-127	2,052	-3.1	-2.5	41.1	5,012	4,995
1989	-153	-118	2,191	-2.9	-2.2	41.0	5,402	5,345
1990	-221	-122	2,412	-3.9	-2.1	42.2	5,737	5,708
1991	-269	-152	2,689	-4.4	-2.5	44.2	5,934	6,083
1992	-290	-188	3,000	-4.5	-2.9	46.9	6,241	6,399
1993	-255	-192	3,248	-3.8	-2.9	48.4	6,578	6,711
1994	-203	-145	3,433	-2.9	-2.1	48.8	6,964	7,038
1995	-164	-146	3,604	-2.2	-2.0	48.8	7,325	7,389
1996	-107	-93	3,734	-1.4	-1.2	48.1	7,697	7,756
1997	-22	-81	3,772	-0.3	-1.0	46.3	8,187	8,144
1998	69	-37	3,721	0.8	-0.4	43.7	8,626	8,523
1999	126	3	3,632	1.4	*	40.6	9,127	8,948
2000	236	108	3,410	2.5	1.1	36.0	9,708	9,469
2001	128	106	3,320	1.3	1.1	33.0	10,060	10,047
2002	-158	-120	3,540	-1.5	-1.1	33.4	10,378	10,600
2003	-378	-276	3,913	-3.4	-2.5	35.1	10,810	11,152
2004	-413	-288	4,296	-3.5	-2.4	36.5	11,545	11,765
2005	-318	-226	4,592	-2.6	-1.8	36.9	12,293	12,450

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

Note: * = between zero and 0.05 percent.

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 F-12.

Standardized-Budget Deficit or Surplus and Related Series, 1962 to 2005

(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	-14	115	130
1967	-9	12	-1	-22	131	153
1968	-25	11	5	-31	140	171
1969	3	14	8	-3	171	173
1970	-3	5	10	1	186	184
1971	-23	-4	9	-10	187	197
1972	-23	*	2	-21	199	220
1973	-15	13	8	-20	214	234
1974	-6	10	18	2	251	249
1975	-53	-22	35	3	300	297
1976	-74	-24	14	-36	308	345
1977	-54	-13	20	-21	357	378
1978	-59	3	29	-33	389	422
1979	-41	12	35	-18	443	460
1980	-74	-20	43	-11	521	532
1981	-79	-29	38	-12	611	623
1982	-128	-68	23	-38	661	699
1983	-208	-91	7	-109	657	766
1984	-185	-32	12	-141	675	816
1985	-212	-16	17	-179	723	902
1986	-221	-9	-1	-213	745	958
1987	-150	-11	-20	-158	814	972
1988	-155	8	37	-127	868	995
1989	-153	20	55	-118	937	1,055
1990	-221	10	109	-122	991	1,113
1991	-269	-47	70	-152	1,067	1,220
1992	-290	-62	41	-188	1,125	1,313
1993	-255	-52	11	-192	1,167	1,359
1994	-203	-29	30	-145	1,247	1,391
1995	-164	-18	*	-146	1,331	1,477
1996	-107	-20	-6	-93	1,418	1,511
1997	-22	15	-44	-81	1,496	1,576
1998	69	40	-67	-37	1,597	1,634
1999	126	66	-57	3	1,665	1,662
2000	236	91	-38	108	1,825	1,718
2001	128	15	-7	106	1,904	1,798
2002	-158	-73	-35	-120	1,833	1,953
2003	-378	-101	*	-276	1,811	2,087
2004	-413	-63	62	-288	1,901	2,189
2005	-318	-42	50	-226	2,120	2,346

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 F-13.

Standardized-Budget Deficit or Surplus and Related Series, 1962 to 2005

(Percentage of potential gross domestic product)

	Budget Deficit (-) or Surplus	−	Cyclical Contributions	+	Other Adjustments[a]	=	Standardized-Budget Deficit (-) or Surplus	Standardized-Budget Revenues	Standardized-Budget 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		1.5		-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		0.1	18.5	18.4
1971	-2.1		-0.3		0.9		-0.9	17.1	18.1
1972	-2.0		*		0.2		-1.7	16.9	18.6
1973	-1.2		1.1		0.6		-1.6	16.8	18.4
1974	-0.4		0.7		1.3		0.1	17.7	17.6
1975	-3.3		-1.3		2.1		0.2	18.6	18.4
1976	-4.1		-1.3		0.8		-2.0	17.2	19.3
1977	-2.7		-0.6		1.0		-1.1	17.8	18.9
1978	-2.7		0.1		1.3		-1.5	17.6	19.1
1979	-1.6		0.5		1.4		-0.7	17.9	18.6
1980	-2.7		-0.7		1.6		-0.4	18.8	19.2
1981	-2.5		-0.9		1.2		-0.4	19.5	19.9
1982	-3.7		-2.0		0.7		-1.1	19.2	20.3
1983	-5.6		-2.5		0.2		-3.0	17.8	20.8
1984	-4.7		-0.8		0.3		-3.6	17.2	20.7
1985	-5.1		-0.4		0.4		-4.3	17.3	21.5
1986	-5.0		-0.2		*		-4.8	16.8	21.6
1987	-3.2		-0.2		-0.4		-3.4	17.3	20.7
1988	-3.1		0.2		0.7		-2.5	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		1.1		-2.5	17.5	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		-0.3		-0.1		-1.2	18.3	19.5
1997	-0.3		0.2		-0.5		-1.0	18.4	19.4
1998	0.8		0.5		-0.8		-0.4	18.7	19.2
1999	1.4		0.7		-0.6		*	18.6	18.6
2000	2.5		1.0		-0.4		1.1	19.3	18.1
2001	1.3		0.1		-0.1		1.1	19.0	17.9
2002	-1.5		-0.7		-0.3		-1.1	17.3	18.4
2003	-3.4		-0.9		*		-2.5	16.2	18.7
2004	-3.5		-0.5		0.5		-2.4	16.2	18.6
2005	-2.6		-0.3		0.4		-1.8	17.0	18.8

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

G

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
Laura Hanlon	Excise taxes
Ed Harris	Individual income taxes
Larry Ozanne	Capital gains realizations
Monisha Primlani	Individual income taxes
Emily Schlect	Customs duties, miscellaneous receipts
Kurt Seibert	Earned income tax credit
David Weiner	Individual income taxes

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Jo Ann Vines	Unit Chief
Kent Christensen	Defense
Sunita D'Monte	International affairs (conduct of foreign affairs and information-exchange activities), veterans' housing
Dan Frisk	Defense (military activities in Iraq and Afghanistan and for the war on terrorism)
Raymond Hall	Defense (stockpile sales, atomic energy defense)
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Michelle Patterson	Veterans' health care, military health care
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Kathleen FitzGerald	Food Stamps and nutrition programs, child and family services
Justin Humphrey	Elementary and secondary education, Pell grants
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Matthew Kapuscinski	Low Income Home Energy Assistance Program, refugee assistance
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Kathy Ruffing	Social Security, Supplemental Security Income
Christina Hawley Sadoti	Unemployment insurance, training programs, Administration on Aging, foster care, Smithsonian, arts and humanities, report coordinator

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Julie Middleton	Water resources, Federal Emergency Management Agency
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Matthew Pickford	General government
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Gregory Waring	Justice, community and regional development
Michael Waters	Science and space exploration, Bureau of Indian Affairs
Melissa Zimmerman	Commerce, Small Business Administration, Universal Service Fund

Other

Janet Airis	Unit Chief, Scorekeeping (legislative branch, Homeland Security appropriations)
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Edward Blau	Authorization bills
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Joanna Capps	Appropriation bills (Interior and the environment, Labor-HHS)
Kenneth Farris	Computer support
Mary Froehlich	Computer support
Ann Futrell	Other interest, report coordinator
Ellen Hays	Federal pay, report coordinator
Virginia Myers	Appropriation bills (Commerce-State-Justice, energy and water)
Jennifer Reynolds	Appropriation bills (Agriculture, foreign relations)
Eric Schatten	Interest on the public debt, report coordinator
Phan Siris	Computer support
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Patrice Watson	Database system administrator

Glossary

This glossary defines economic and budgetary terms as they apply to *The Budget and Economic Outlook* and also acts as a general reference for readers. Some 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 research organization.

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 (such as alimony payments and certain contributions to individual retirement accounts) are subtracted. 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 fiscal 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 taxpayers 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 taxpayer'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 **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 was originally known as Gramm-Rudman-Hollings. Among other changes to the budget process, the law establishes rules that govern the calculation of the baseline. It also set specific deficit targets and a sequestration procedure 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 Public Law 107-312 reduced all PAYGO balances to zero. 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 based on current laws and policies, calculated following the rules set forth in section 257 of that act. See **fiscal year.**

basis point: 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: See **Balanced Budget and Emergency Deficit Control Act of 1985.**

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 out-years. The plan consists of spending and revenue targets with which subsequent appropriation acts and authorization acts that affect revenues and direct spending are expected to comply. 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.

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. The capacity of a facility is the greatest output it can maintain with a normal work pattern. (FRB)

capital: *Physical capital* is land and the stock of products set aside to support future production and consumption. In the national income and product accounts, *private capital* consists of business inventories, producers' durable equipment, and residential and nonresidential structures. *Financial capital* is monetary resources that governments, individuals, or businesses raise by issuing securities such as bonds, mortgages, or stock certificates. *Human capital* is the education, training, work experience, and other attributes that enhance the ability of the labor force to produce goods and services. *Bank capital* is the sum advanced and put at risk by the owners of a bank; it represents the first "cushion" in the event of loss, thereby decreasing the owner's willingness to take risks in lending. See **consumption** and **national income and product accounts.**

capital services: A measure of the flow of services available for production from the stock of capital goods. Growth in capital services differs from growth in the capital stock because different types of capital goods (such as equipment, structures, inventories, or land) contribute to production in different ways.

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 employees for their work during a given period. In addition to wages, salaries, bonuses, and stock options, compensation includes fringe benefits and the employer's share of the contributions to social insurance programs, such as Social Security. (BEA)

consumer confidence: An index of consumer optimism based on surveys of consumers' attitudes about current and future economic conditions. One such index, the Index of Consumer Sentiment, is constructed by the University of Michigan's Survey Research Center. The Conference Board constructs a similar index, 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 in 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: The rate of inflation that excludes changes in food and energy prices. See **consumer price index** and **inflation.**

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. See **credit subsidy.**

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, present value,** and **revenues.**

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 against the capital income from property in that country flowing to residents of a foreign country). (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 **real.**

current year: See **fiscal year.**

cyclical deficit or surplus: The portion 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;** 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—in other words, if the economy operated at potential GDP. (CBO) See **business cycle** and **potential GDP;** compare with **cyclical deficit or surplus.**

Debt: The total value of outstanding notes, bonds, bills, and other debt instruments issued by the federal government 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 its issuance. The limit applies to federal debt, excluding a small portion of the debt issued by the Department of 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 CBO's *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 **net interest.**

deficit: The amount by which the federal government's total outlays exceed its total revenues in a given period, typically a fiscal year. See **outlays** and **revenues;** compare with **surplus.**

Deficit Control Act: See **Balanced Budget and Emergency Deficit Control Act of 1985.**

deflation: A drop in general 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). *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 the 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 budget authority provided by laws other than appropriation acts and the outlays that result from that budget authority. (As used in CBO's *Budget and Economic Outlook*, direct spending refers only to the outlays that result from budget authority provided in laws other than appropriation acts). For the purposes of the Deficit Control Act, direct spending includes entitlement authority and the Food Stamp program. See **appropriation act, budget authority, entitlement,** and **outlays;** compare with **discretionary spending.**

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 **present value.**

discouraged workers: Jobless people who are available for work but who are not actively seeking it because they think they have poor prospects of finding a job. Discouraged workers are not counted as part of the labor force or as being unemployed. (BLS) See **labor force** and **unemployment rate.**

discretionary spending: Budget authority that is provided and controlled by appropriation acts and the outlays that result from that budget authority. See **appropriation act** 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 fiscal year. The limits were originally established in the Budget Enforcement Act of 1990. Under the law, if the estimated budget authority provided in all appropriation acts for a fiscal year (or the outlays that resulted 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, discretionary spending, outlays,** and **sequestration.**

disposable personal income: Personal income—the income that individuals receive, including transfer payments—minus the taxes and fees that they 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.**

E

ECI: See **employment cost index.**

Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16): This law significantly reduces 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 filing jointly, increasing tax benefits for pensions and individual retirement accounts, and creating additional tax benefits for education. The law phases in many of those changes over time, including some that are not fully effective until 2010. Although one provision has been made permanent, the remainder of the law's provisions are scheduled to expire on or before December 31, 2010. See **Jobs and Growth Tax Relief Reconciliation Act of 2003** and **Job Creation and Worker Assistance Act of 2002.**

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,** 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 to adjusted gross income. For corporate income taxes, it is the ratio of taxes to book profits. For some purposes—such as calculating an overall tax rate on all income sources—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 to income very different from statutory tax rates. See **adjusted gross income** and **book profits.**

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: those from the *establishment survey*, which is based on a survey of employers (the Current Employment Statistics Survey), and from the *household survey*, which is based on a survey of households (the Current Population Survey). The establishment survey measures employment as the estimated number of nonfarm wage and salary jobs (so a person with more than one job may be counted more than once). That survey does not include the unincorporated self-employed, unpaid family workers, agriculture and related workers (except in the area of logging), private household workers, and workers who are temporarily absent from their jobs (for instance, those on leave without pay or on strike). The household survey measures employment as the estimated number of employed people (so a person with more than one job is counted only once). The household survey is based on a smaller sample than the establishment survey and thus 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 contributions for social insurance programs, such as Social Security. The ECI is structured so that it is not affected by changes in the population's mix of occupations or 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 the eligibility criteria and benefit or payment rules. The best-known entitlements are the major benefit programs,

such as Social Security and Medicare. See **appropriation act, budget authority,** and **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 telephone services.

expansion: A phase of the business cycle extending from the date that gross domestic product exceeds its previous peak to the next peak. (NBER) See **business cycle, gross domestic product,** and **recovery;** compare with **recession.**

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** and **trust funds;** compare with **receipt account.**

Fan chart: A graphic representation of CBO's baseline projections 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 assumptions.

federal funds: In the federal accounting structure, federal funds are 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 associated with a credit program that holds balances, receives credit subsidy payments from the program account, and includes all cash flows resulting from obligations or commitments made under the program since October 1, 1991. The transactions reflected in the financing account are considered a means of financing. See **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.

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 2007 will begin on October 1, 2006, and end on September 30, 2007. 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 begins. 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** and **fiscal year;** compare with **advance appropriation, obligation delay,** and **unobligated balances.**

G

DI: See **gross domestic income.**

GDP: See **gross domestic product.**

GDP gap: The difference between potential and actual GDP, expressed as a percentage of potential GDP. See **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 GDP, but measurement difficulties leave a statistical discrepancy between the two. (BEA)

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 GDP 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.**

H

ome 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,** and **GDP price index.**

infrastructure: Capital goods that provide services to the public, usually with benefits to the community at large as well as to the direct user. Examples include schools, roads, bridges, dams, harbors, and public buildings. See **capital.**

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 stock of capital goods. 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,** and **national income and product accounts.**

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 capital purchases, 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 varying 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. See **Economic Growth and Tax Relief Reconciliation Act of 2001** and **Jobs and Growth Tax Relief Reconciliation Act of 2003.**

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. The tax provisions expire on varying dates. (The law also provided an estimated $20 billion for fiscal relief to states.) See **Economic Growth and Tax Relief Reconciliation Act of 2001** and **Job Creation and Worker Assistance Act of 2002.**

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 certain credit programs that includes all cash flows resulting from all direct loan obligations and loan guarantee commitments made under those programs before October 1, 1991. See **credit reform;** compare with **financing 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 applies to an additional dollar of income.

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 in an attempt 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 reducing 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' contributions to 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 (the budget surplus). National saving represents all income not consumed, publicly or privately, during a given period. (BEA) See **national income, net national saving,** and **personal saving.**

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; *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 by such institutional factors 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: 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 NIPAs 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 **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 2006 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, 2005 (the first day of fiscal year 2006). See **appropriation act** and **fiscal year;** 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 provision of law. Typically, an obligation limitation is included in an appropriation act. The limitation may affect budget authority provided in that act, but more often, the limitation affects direct spending that has been provided in an authorization act. Generally, when it becomes routine for an appropriation act to place 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 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. As a result, they are excluded from the totals and other amounts in the budget. See **budget resolution, outlays, revenues,** and **trust funds.**

offsetting collections: Funds collected by government agencies from other government accounts or from the public in businesslike or market-oriented transactions that are required by law to be credited directly to an expenditure account. Offsetting collections, 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 the collections are credited. Collections that result from the government's exercise of its sovereign or governmental powers are ordinarily classified as revenues but will be classified as offsetting collections when the law requires that treatment. 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 businesslike or market-oriented transactions that are credited to a receipt account. Offsetting receipts, 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 but will be classified as offsetting receipts when the law requires that treatment. 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; therefore, they flow in part from unexpended balances of prior-year budget authority and in part 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 subsidy costs instead of cash transactions. See **accrual accounting, budget authority, cash accounting, credit reform, debt,** and **fiscal year**.

out-year: See **fiscal year**.

Pay-as-you-go (PAYGO): A procedure established in the Budget Enforcement Act of 1990 that was intended to ensure that all laws enacted before September 30, 2002, that affected direct spending and revenues were budget neutral. The budgetary effect of each direct spending and revenue law was estimated over 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. PAYGO and its sequestration procedure were rendered ineffective on December 2, 2002, when Public Law 107-312 reduced all PAYGO balances to zero. See **Balanced Budget and Emergency Deficit Control Act of 1985, direct spending, fiscal year, revenues,** and **sequestration.**

peak: See **business cycle.**

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, disposable personal income,** and **private saving.**

point of order: The procedure by which a member of a legislature (or similar body) questions an action 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. (CBO's procedure for estimating potential GDP is 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 GDP. (CBO's procedure for estimating potential output is 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 surplus: See **surplus**.

private saving: Saving by households and businesses. Private saving is equal to personal saving plus after-tax corporate profits minus dividends paid. (BEA) See **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.**

program account: Any 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.**

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 GDP, 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** 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—of at least several months' duration. 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 revenue or direct-spending laws under their jurisdictions to achieve a specified budgetary result. The legislation to implement those instructions is usually combined into one comprehensive *reconciliation bill*, which is then 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, contributions 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 stock).

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.

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 resulted 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 act, 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 effect of direct spending and revenue laws 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, budget authority, direct spending, discretionary spending limits, 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.

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. The *primary surplus* is that total surplus excluding net interest. See **net interest, outlays,** and **revenues;** compare with **deficit.**

Ten-year Treasury note: An interest-bearing note issued by the Treasury that is to be redeemed in 10 years.

three-month Treasury bill: An interest-bearing security issued by the Treasury that is to be redeemed in 91 days.

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 the trade-weighted value of the dollar that takes account of the difference between U.S. price inflation and price 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.

transfer payments: Payments made to an individual 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, trust funds are 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, and budget authority and outlays of that fund 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 (the Highway and the Airport and Airway Trust Funds). See **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.**

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, such as a private gift sent abroad, a pension payment from a U.S. employer to an eligible person 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 either they 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** and **obligation;** compare with **advance appropriation, forward funding,** and **obligation delay.**

user fee: Money charged by the federal government for federal 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 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, including the research and experimentation tax credit, parity in the application of certain mental health benefits, and the increased share of rum excise tax revenues 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 the security is held. The *yield to maturity* is the effective interest rate earned on a fixed-income security if it is held to the date on which the security comes due for payment. See **interest rate.**

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.**