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INFORMED BUDGETEER

CBO'S SUMMER UPDATE

- Last month, CBO revised its March estimates of baseline federal spending and revenues in its summer update (http://www.cbo.gov/ftpdocs/74xx/doc7492/08-17-BudgetUpdate.pdf). Like OMB's mid-session review, CBO projects stronger revenues than previously projected and a resulting lower deficit for 2006: $260 billion (2% of GDP). This is $58 billion lower than the actual recorded for 2005 and $112 billion lower than the 2006 deficit figure that CBO estimated in March.

- Despite the improvement in the deficit outlook for 2006, CBO's *Budget and Economic Outlook: An Update* takes pains to observe that there is not a whiff of change in the long-term budget outlook: "under current law, spending for Social Security, Medicare, and Medicaid will eventually exert such pressure on the budget as to make the current path of fiscal policy unsustainable."

- As for the outlook over the next 10 years, it has not changed materially in recent months. In the very near term, CBO projects the 2007 deficit to rise slightly from the expected 2006 level – to $286 billion – and then stay at roughly $300 billion, or about 2% of GDP. CBO's report notes that this excess of spending over revenues "is smaller than the average budgetary outcome recorded since 1965: a deficit of 2.3 percent of GDP."

- By extension, if deficits were to really remain at the 2% of GDP level as projected in the CBO baseline for the next five years (note that CBO's baseline are mere projections; actual results are guaranteed to be different because of future legislation yet to be enacted and because of changes in the economy and how federal spending and tax programs work), that would perpetuate a level of deficits that appear to be within the tolerance of the US and global economy, if the last 40 years of economic data mean anything.

- The table to the right shows that at 2.0% of GDP, the projected 2006 deficit is lower than the deficit was in 21 of the previous 29 years (with the stock-market boom of the late 1990s through 2001 responsible for seven of the eight years in which the deficit was less than 2% of GDP or there was a surplus).

- It was not uncommon in the 1980s and early 1990s to run deficits in the 4-6% of GDP range. From 1977 to 2005, the average deficit, as a percentage of GDP (including the surplus years in the late 1990s), was 2.6%, which was more than 0.5 percentage points higher (or at least 25 percent higher) than any of the annual deficits projected in CBO's baseline through 2016.

- Despite some annual deficits several times greater than the deficits projected for the next several years, the economy did not collapse throughout the 1980s and 1990s. Why? Because, over time, the economy grew at least as fast as the debt that the annual deficits were adding to the economy, so the economy was able to digest the deficits over the long-haul (even if not so easily in particular years)

- Some have argued, however, that the federal government's debt should be a more important focus of attention than its deficit. Forty years ago the debt held by the public was in the 35-40% range as a percentage of GDP. After falling to almost 25% and rising as high as nearly 50%, the debt held by the public today is back at about 38% of GDP. CBO pointed out in its December 2005, paper *The Long-Term Budget Outlook*: "The simple fact that federal debt grows over time is not necessarily a problem. If the economy is growing just as fast, the ratio of debt to gross domestic product (GDP) – and the share of GDP devoted to paying interest on that debt – will remain stable."
(http://www.cbo.gov/ftpdocs/69xx/doc6982/12-15-LongTermOutlook.pdf)

Deficit/Surplus and debt as a % of GDP

FY	Deficit(-) or Surplus(+)	Debt held by public	Gross debt	Gross – publicly held debt
1977	**-2.7**	**27.8**	**35.8**	**8.0**
1978	**-2.7**	**27.4**	**35.0**	**7.6**
1979	-1.6	25.6	33.2	7.6
1980	**-2.7**	**26.1**	**33.3**	**7.2**
1981	**-2.6**	**25.8**	**32.6**	**6.8**
1982	**-4.0**	**28.6**	**35.2**	**6.6**
1983	**-6.0**	**33.1**	**39.9**	**6.8**
1984	**-4.8**	**34.0**	**40.7**	**6.7**
1985	**-5.1**	**36.4**	**43.9**	**7.5**
1986	**-5.0**	**39.4**	**48.1**	**8.7**
1987	**-3.2**	**40.7**	**50.5**	**9.8**
1988	**-3.1**	**41.0**	**51.9**	**10.9**
1989	**-2.8**	**40.6**	**53.1**	**12.5**
1990	**-3.9**	**42.0**	**55.9**	**13.9**
1991	**-4.5**	**45.3**	**60.6**	**15.3**
1992	**-4.7**	**48.1**	**64.1**	**16.0**
1993	**-3.9**	**49.4**	**66.2**	**16.8**
1994	**-2.9**	**49.3**	**66.7**	**17.4**
1995	**-2.2**	**49.2**	**67.2**	**18.0**
1996	-1.4	48.5	67.3	18.8
1997	-0.3	46.1	65.6	19.5
<u>1998</u>	<u>0.8</u>	<u>43.1</u>	<u>63.5</u>	<u>20.4</u>
<u>1999</u>	<u>1.4</u>	<u>39.8</u>	<u>61.4</u>	<u>21.6</u>
<u>2000</u>	<u>2.4</u>	<u>35.1</u>	<u>58.0</u>	<u>22.9</u>
<u>2001</u>	<u>1.3</u>	<u>33.0</u>	<u>57.4</u>	<u>24.4</u>
2002	-1.5	34.1	59.7	25.6
2003	**-3.5**	**36.2**	**62.6**	**26.4**
2004	**-3.6**	**37.2**	**63.7**	**26.5**
2005	**-2.6**	**37.4**	**64.3**	**26.9**
2006	-2.0	37.0	64.6	27.6
2007	-2.1	37.3	65.5	28.2
2008	-1.9	37.5	66.5	29.0
2009	-2.0	37.7	67.5	29.8
2010	-2.0	38.1	68.5	30.4
2011	-1.4	37.8	68.9	31.1
2012	-0.3	36.5	68.3	31.8
2013	-0.4	35.4	67.7	32.3
2014	-0.3	34.2	67.1	32.9
2015	-0.3	33.1	66.4	33.3
2016	-0.4	32.2	65.7	33.5

SOURCES: 1977-2005 actuals taken from OMB historical tables; 2006-2016 projections from 2006 CBO summer update (baseline)
NOTE: Years with deficits above the 2% of GDP forecast for 2006 in **bold**. Surplus years <u>underlined</u>.

- Gross debt, which adds the amount the federal government owes to itself (for trust funds such as Social Security) to the debt held by the public, has not been as relatively stable as debt held by the public. Gross debt has risen (after fluctuations) from about 50% of GDP forty years ago to about 66% today. The rise in gross debt is not attributable to rising debt held by the public – which is the same 35-40% range as forty years ago – gross debt has increased because of the requirement that the Social Security surpluses, which have been accruing since the last Social Security reform in 1983, be invested in Treasury securities.

- Those invested surpluses represent a debt we owe to ourselves. Our ability to make good on that debt is only as good as our economy's ability to make good on any of the commitments we have made to future beneficiaries or to make good on often national responsibilities, as long as those commitments do not demand too great a portion of the economic output of the country.

- A collapsed economy is exactly the fear that economists have regarding the level of resources that Social Security, Medicare, and Medicaid will demand to extract from the economy if the current projected growth of those demographically-driven programs is left unchecked.

- CBO's long-term projections for Social Security, Medicare, and Medicaid in its most recent *Long-Term Budget Outlook* (pp. 10-12) indicate that those three programs will consume increasing bites of the economy: from 8.2% of GDP to 9.2% in 2010, 15.2% in 2030, and 19% in 2050 (see table below). If everything else remains equal, then the federal government would increase the amount of the economy it consumes from about 20% today to 25% in 2030 and then 30% in 2050, meaning the government's size would increase by 50%.

- Assuming revenues remained unchanged, the federal deficit would grow from 2% of GDP today to about 7% of GDP in 2030 to about 12% of GDP in 2050. Deficits at those levels have not been seen since World War II, which lasted only about five years. The federal government's demand on the economy through Social Security, Medicare, and Medicaid would last much longer, severely testing the economy's ability to either borrow or tax the resources to deliver those program benefits.

Social Security, Medicare, and Medicaid Make Fiscal Policy Unsustainable

As a % of GDP

Year	Soc. Sec., Medicare, Medicaid	Total Spending	Revenues	Deficit
2006	8.4%	20.3%	18.3%	-2.0%
2010	9.2%	20.1%	18.1%	-2.0%
2030	15.2%	25.0%	18.3%	-6.7%
2050	19.0%	30.0%	18.3%	-11.7%

Source: CBO Long-Term Budget Outlook and SBC Staff. 2006 and 2010 revenues from CBO summer update, 2030 and 2050 revenues based on historical averages.

BUDGET ENFORCEMENT BACK-UP PLAN

- The Senate and the House have both debated and passed a 2007 Budget Resolution, but the prospects for a conference agreement appear to have evaporated in the waning days of the 109th Congress. In the little legislative time that remains, the appropriation bills for 2007 are considered the must-do legislation.

- Will there be a fiscal free-for-all in the absence of a 2007 budget resolution conference agreement? The answer is they need not be, if members decide they want to avail themselves of the enforcement tools that are still at their disposal. While enforcement would be tighter and more meaningful under a 2007 Budget Resolution, the spending and revenue allocations and paygo balances set in the 2006 Budget Resolution remain applicable in the Senate.

- Informed budgeteers know that section 7035 of P.L. 109-234 (the 2006 Iraq-Hurricane Relief Supplemental) deemed a 302(a) allocation to the Senate Appropriations Committee, and the Appropriations Committee in turn set their 302(b) subcommittee allocations. (http://budget.senate.gov/republican/analysis/2006/bb05-2006.pdf) Vigilant senators are now able to protect each 2007 appropriations bill from amendments that exceed each bill's allocation. Such spending amendments, if they are not offset, are subject to a 302(f) point of order, requiring 60 votes to waive.

- How will the Senate evaluate other legislation that it might consider at the end of this session and the beginning of the next? The 2006 Budget Resolution, agreed to more than 16 months ago on April 28, 2005, remains in effect (and will remain in effect until a new budget resolution conference report is agreed to).

- Under that Budget Resolution, the Senate Budget Committee will continue to measure the budget authority and outlay totals for direct spending legislation for 2006 and for the 2006-2010 five-year total. (Once FY2006 is over, there will be no first-year enforcement.) As the table below shows, few Senate committees have room to create new direct spending, unless it is offset by reductions in other direct spending. The current allocations to Senate authorizing committees represent the allocation agreed to in the 2006 Budget Resolution, plus or minus the direct spending impacts of enacted legislation within each committee's jurisdiction. Bills or amendments that violate the committee allocations set in the 2006 budget resolution (as adjusted for enacted legislation) will be subject to a 302(f) point of order.

Senate Authorizing Committees with Allocations Remaining Under the 2006 Budget Resolution

($ millions)

Committee	2006 BA	2006 Outlays	2006-2010 BA	2006-2010 Outlays
Armed Services	23	24	57	64
Environment and Public Works	472	0	0	0
Finance	4,708	0	6,292	1,540
Foreign Relations	25	0	27	12
Judiciary	6	6	6	6
HELP	0	0	336	1,558

Source: SBC Staff

- The Budget Committee also will continue to track the revenue aggregate for the 2006-2010 period. Under the 2006 Budget Resolution, there remains room to reduce revenues by $24 billion (over the 2006-2010 period), although there is only $22 billion of room left on the paygo scorecard (see next bullet). Bills or amendments that violate the revenue aggregate set in the 2006 Budget Resolution will be subject to a 311(a)(2)(B) point of order, requiring 60 votes to waive.

- Paygo enforcement continues to be available as well. Under the 2006 Budget Resolution, there is $22 billion left for 2006-2010 and $268 billion left for 2011-2015 on the paygo scorecard. (There is a big balance in the second five years because of the 2006 budget resolution assumption of a permanent estate tax repeal.) Bills or amendments that increase the deficit by more than the amounts left on the paygo scorecard will be subject to a paygo point of order (under sec. 505 of H.Con.Res. 95, the 2004 Budget Resolution).