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Observations on Budget Estimates from the Mid-Session Review

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The Office of Management and Budget has released its annual Mid-Session Review (MSR) that updates the budget projections from this past February. While the rapid increase in federal revenues shows that the 2003 tax cuts have succeeded, continued runaway spending threatens America's fiscal and economic future.

- The MSR projects a $296 billion budget deficit in fiscal year 2006, down slightly from $318 billion last year. The budget deficit, however, is an overrated economic statistic that does not impact economic performance as much as overall spending and tax policies. To the extent government borrowing matters, most economists consider the debt-to-GDP ratio—which is currently 38 percent, below the level of the 1990s—the key variable.
- The tax cuts are working exactly as intended. Lower tax rates increased the incentives to work, save, and invest, and as a result the economy has grown faster. Tax revenues have always correlated more with economic growth rates than with tax rates.
- Following the 2003 tax cuts, the Congressional Budget Office (CBO) lowered its 2006 revenue projections from $2,370 billion to $2,276 billion. Now, 2006 tax revenues are projected at $2,400 billion. In other words, tax revenues are now above their pre-tax cut baseline.
- Overall, nominal tax revenues are up 11 percent in 2006, and 28 percent over the past two years. The inflation-adjusted 19 percent increase represents the largest two-year revenue surge since 1965-67.
- Tax revenues in 2006 are projected at 18.3 percent of GDP—slightly above the 18.1 percent average for the last 50 years. Americans are now overtaxed by historical standards.
- With a $246 billion revenue increase slightly outpacing a $224 billion spending increase in 2006 alone, 100 percent of the $22 billion deficit reduction has resulted from taxpayers sending more money to Washington. Lawmakers have not cut one dollar from the budget.
- This year's nine percent spending hike is the largest since 1990. This is occurring even though the economy is healthy. Lawmakers should not assume they can continue increasing spending at this rate and be bailed out by equally fast revenue growth.
- Since 2001, federal spending has leaped 45 percent. Defense and homeland security account for less than one-third of this increase.

This paper, in its entirety, can be found at:
www.heritage.org/research/budget/wm1149.cfm

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Education has increased 137 percent, international spending by 111 percent, and health research and regulation by 78 percent. Anti-poverty spending now tops three percent of GDP for the first time ever. Even after a freeze in FY 2007, non-defense discretionary spending will be up 42 percent since 2001—double the increase enacted in President Clinton's first six years in office.[1]

- Spending under President Bush has increased from 18.5 percent of GDP to 20.6 percent. That is the largest increase under any President since Franklin Roosevelt. Had spending remained at 18.5 percent of GDP, this year's budget deficit would be only $27 billion.
- The long-term spending projections remain dire. In only 18 months, the first of 77 million baby boomers will reach early retirement, unleashing an unprecedented avalanche of Social Security, Medicare, and Medicaid costs. Funding all of this spending would require permanently raising taxes by $11,000 per household (adjusted for both inflation and rising incomes) or eliminating every remaining federal program.[2]
- There is no way revenues can cover all of this projected spending. Lawmakers therefore must remain vigilant on spending. They should focus on pursuing long-term entitlement reform and creating a budget process compatible with spending restraint.

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1. Brian M. Riedl "Federal Spending: By the Numbers" Heritage Foundation *Webmemo* No. 989, February 6, 2006, at http://www.heritage.org/Research/Budget/wm989.cfm.
2. Brian Riedl, "Entitlement-Driven Long-Term Budget Substantially Worse Than Previously Projected," Heritage Foundation *Backgrounder* No. 1897, November 30, 2005, at http://www.heritage.org/Research/Budget/bg1897.cfm.