Testimony of OMB Director Joshua B. Bolten
Mid Session Review of the
President's FY 2006 Budget Request
Committee on the Budget
United States House of Representatives

July 14, 2005

I am pleased today to report on the Office of Management and Budget's Mid Session Review of the Budget of the U.S. Government.

Since last February, when we released the 2006 Budget, the Nation's fiscal outlook has improved dramatically. The U.S. budget deficit is falling, and it is falling fast. The 2005 shortfall will be $94 billion less than we projected just five months ago. We are seeing what happens when you have a strong economy – more businesses investing, more people working, and more income, so that Americans can spend and invest as they see fit.

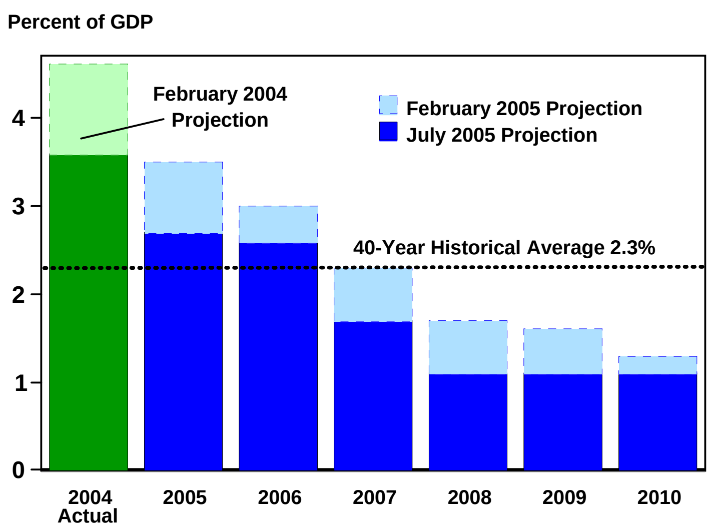
And with all those economic gains, we are also seeing more revenues coming into the Federal Treasury. We have arrived at this point largely because of this President's and this Congress' pro-growth policies, especially tax relief. Those policies have strengthened the economy, which is now producing better-than-expected tax revenues.

Of the $94 billion decline in the deficit from last February, $87 billion comes from stronger receipts; $7 billion comes from lower-than-expected outlays.

Even as the Nation devotes the substantial resources needed to fight and win the War on Terror, the deficit is now forecast to fall from $412 billion, or 3.6 percent of GDP, in 2004 to $333 billion, or 2.7 percent, in 2005.

At its currently forecast level, the U.S. budget deficit for 2005 would be smaller than the deficits in 15 of the last 25 years and only slightly above the 40-year historical average of 2.3 percent.

Cutting the Deficit in Half



Under the President's fiscal policies, the budget deficit is forecast to continue to fall, to $162 billion in 2009, or 1.1 percent of GDP – less than half the size of the average deficit over the last 40 years.

That would significantly surpass President Bush's goal of cutting the deficit in half from its projected 2004 peak of $521 billion, or 4.5 percent of GDP.

This rapid improvement in the budget picture demonstrates the significance of policies that contribute to sustained economic growth. The implementation of the Administration's pro-growth agenda, especially tax relief, restored growth and investment to the economy after multiple shocks, including a stock market collapse, corporate scandals, and the terrorist attacks of September 11, 2001.

Tax relief proposed by the President and enacted by Congress in each year from 2001 through 2004 reduced income tax rates, raised incentives for small businesses to invest in new equipment, dramatically reduced the tax rate on dividends and capital gains, and phased out the death tax.

Once fully in place, tax relief produced the desired results: The economy has grown by 12.4 percent since the recession ended in November, 2001. Employment is up by 3.7 million jobs since May of 2003, and the unemployment rate has fallen to 5 percent, lower than the average unemployment rate of each of the last three decades. Both inflation and interest rates have remained low, and business investment is strong.

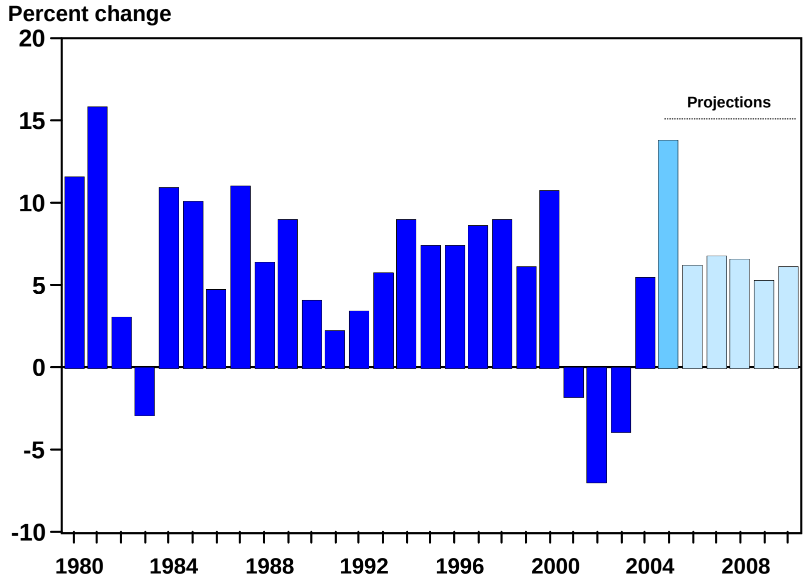
Our improved budget outlook is largely a product of collections of tax revenue, which have grown significantly faster than projected five months ago. After three straight years of declines due to economic weakness, tax receipts will have risen two consecutive years. This Mid-Session Review projects that tax receipts will rise 14 percent from last year – the largest such year-over-year increase since 1981. Federal receipts as a share of the economy are projected to continue rising in future years as well.

We cannot yet identify with certainty the composition of income that yielded this greater-than-expected surge in tax receipts; detailed data that would permit such an analysis will not be available for many months.

The data so far do show, however, that all major categories of receipts – corporate income taxes, payroll taxes, and individual income taxes – are outpacing forecasts. This experience of the Federal Treasury generally has been matched at the state level, as nearly all states are reporting income tax collections above forecasts.

Our improved deficit picture in the budgetary window does not rely on assumptions that receipts will continue to grow at this year's rate. Rather, these forecasts are well within the range of experience in times of solid economic growth.

Strong Economy = Strong Receipts



With these future gains, federal receipts are expected to rise to 17.4 percent of GDP in 2005. By 2010, the ratio is projected at 18.1 percent, just about the historical average, even assuming full extension of the President's tax relief program.

Tax relief has had a significant positive impact on the economy, and that stronger economy is the source of the improved tax receipts that are reported today. To sustain economic growth, it is critical that Congress make tax relief permanent. Allowing this tax relief to expire would endanger the economy's prospects, placing into doubt gains in job creation and business investment that contribute to increases in tax revenues and further reductions in the size of the deficit.

Maintaining this growing economy will also require other pro-growth policies. The President's agenda for economic growth includes passing a national energy bill, opening markets abroad through accords such as CAFTA, instituting regulatory reforms, and limiting lawsuit abuse.

In this and future years, spending discipline will play a vital role in deficit reduction. Each year of President Bush's administration, he and Congress have brought down the rate of growth in discretionary spending unrelated to defense and homeland security.

This Committee has demonstrated a continued focus on spending restraint. I'm grateful for the partnership we have with you, Mr. Chairman, and other members of this Committee; I know the President appreciates your hard work on behalf of the American people to restrain spending and strengthen our economy.

Thanks to your work, Congress passed a 2006 Budget Resolution that holds overall discretionary spending to an increase below the projected rate of inflation, and assumes an actual reduction in non-security related discretionary spending compared to last year's levels.

I am grateful, too, for the Committee's leadership in seeking mandatory savings through the Reconciliation process. This Committee produced a Resolution agreeing to $70 billion in savings, and ultimately, the entire Congress agreed to $35 billion in savings. This is the first time since 1997 that Congress will have employed the expedited Reconciliation process to reduce mandatory spending.

The House Appropriations Committee has demonstrated a similar resolve. Under the leadership of Chairman Lewis, the appropriations bills have been completed in the House on schedule, all within the limit set by the Budget Resolution. We also appreciate the House's support during the appropriations process to help meet our goals for halting spending on poorly performing programs. Through this work, the House has agreed to terminate or reduce nearly two-thirds of programs proposed for termination or reduction in the President's Budget, achieving more than $6 billion in savings.

Even so, much work remains to be done. The Administration looks forward to cooperating with the Congress to produce a final set of spending bills that remain within the President's overall request, and achieve a reduction in non-security spending while meeting the Nation's priorities.

The Mid Session Review we are presenting today contains some items not included in the 2006 Budget. The Budget Resolution passed by the Congress assumes an additional $50 billion in 2006 for the continuing costs of operations in Iraq and Afghanistan. This Review assumes enactment of this funding, which would increase outlays by $37 billion in 2006 and $13 billion in 2007 and beyond. The Administration expects to request additional 2006 funding from the Congress when requirements for these operations can be estimated more reliably. This Review does not reflect the effect of undetermined but anticipated supplemental requests for operations beyond 2006.

This update also includes the estimated budget impact from the creation of personal accounts under the President's Social Security reform proposal. Transition financing for these accounts would not begin to take effect until 2009, and is easily accommodated within the President's deficit reduction goal.

Although transition financing is incorporated into our deficit projections, it should not have the same effect on capital markets as traditional federal borrowing. First, such financing would essentially bring forward obligations already owed in the form of promised future benefits, and as a result, would reduce existing future obligations by a roughly equal amount. Second, unlike debt issued to fund government spending, there would be no impact on net national savings, because every dollar of transition financing would be saved in a personal account and invested in the capital markets.

As the nation's near-term fiscal outlook improves, we have the opportunity and responsibility to confront the real fiscal threat: a long-term budgetary picture of steadily rising deficits from mandatory spending programs. President Bush has proposed to address Social Security's long-term insolvency while offering a better deal for today's younger workers.

As we continue to address the nation's long-term fiscal challenges, spending discipline and pro-growth policies, especially sustained tax relief, will be essential to our success.