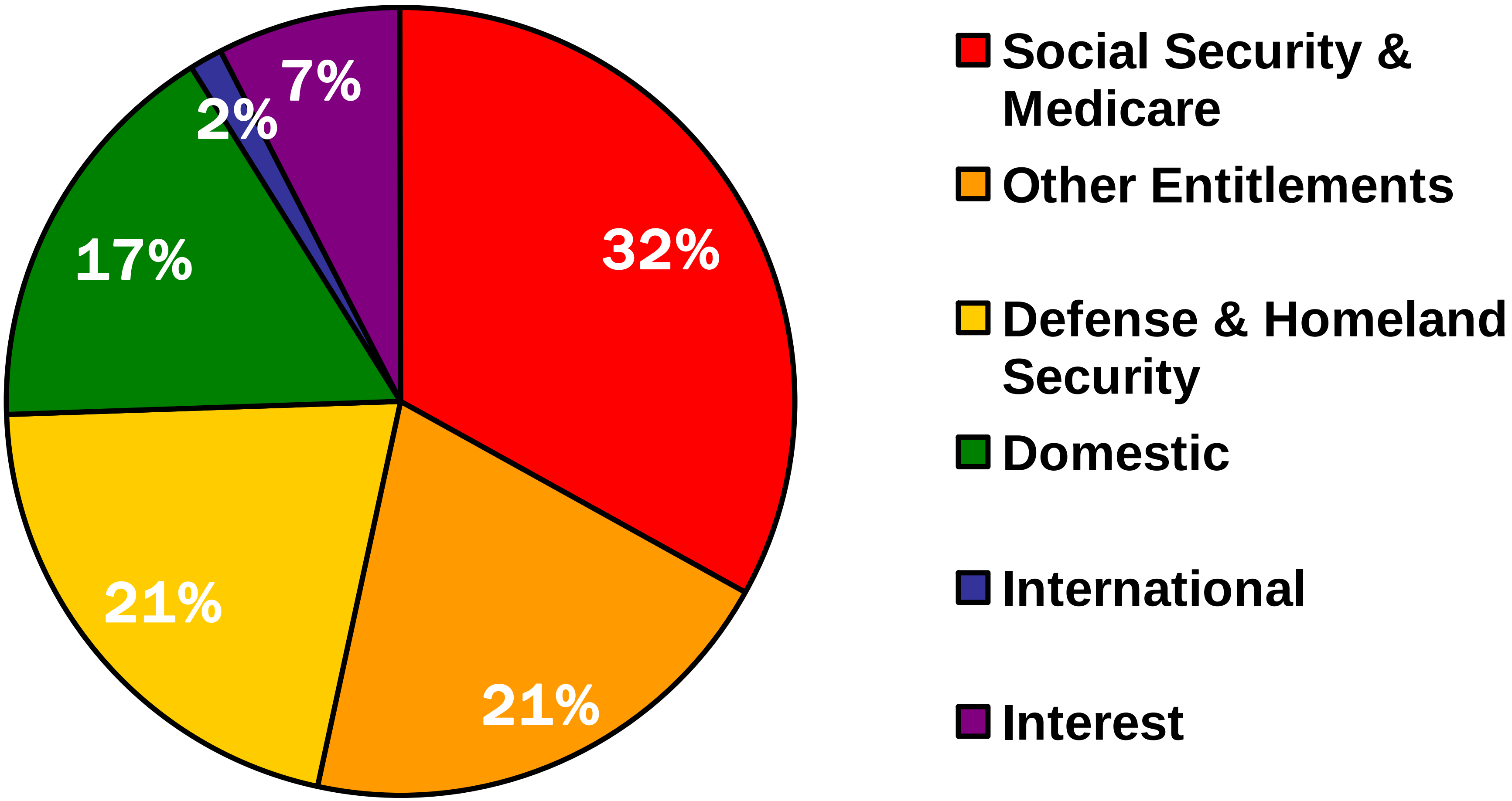
I. Background on the Federal Budget and the Return of Budget Deficits

Composition of the Federal Budget in 2005



Source: Congressional Budget Office

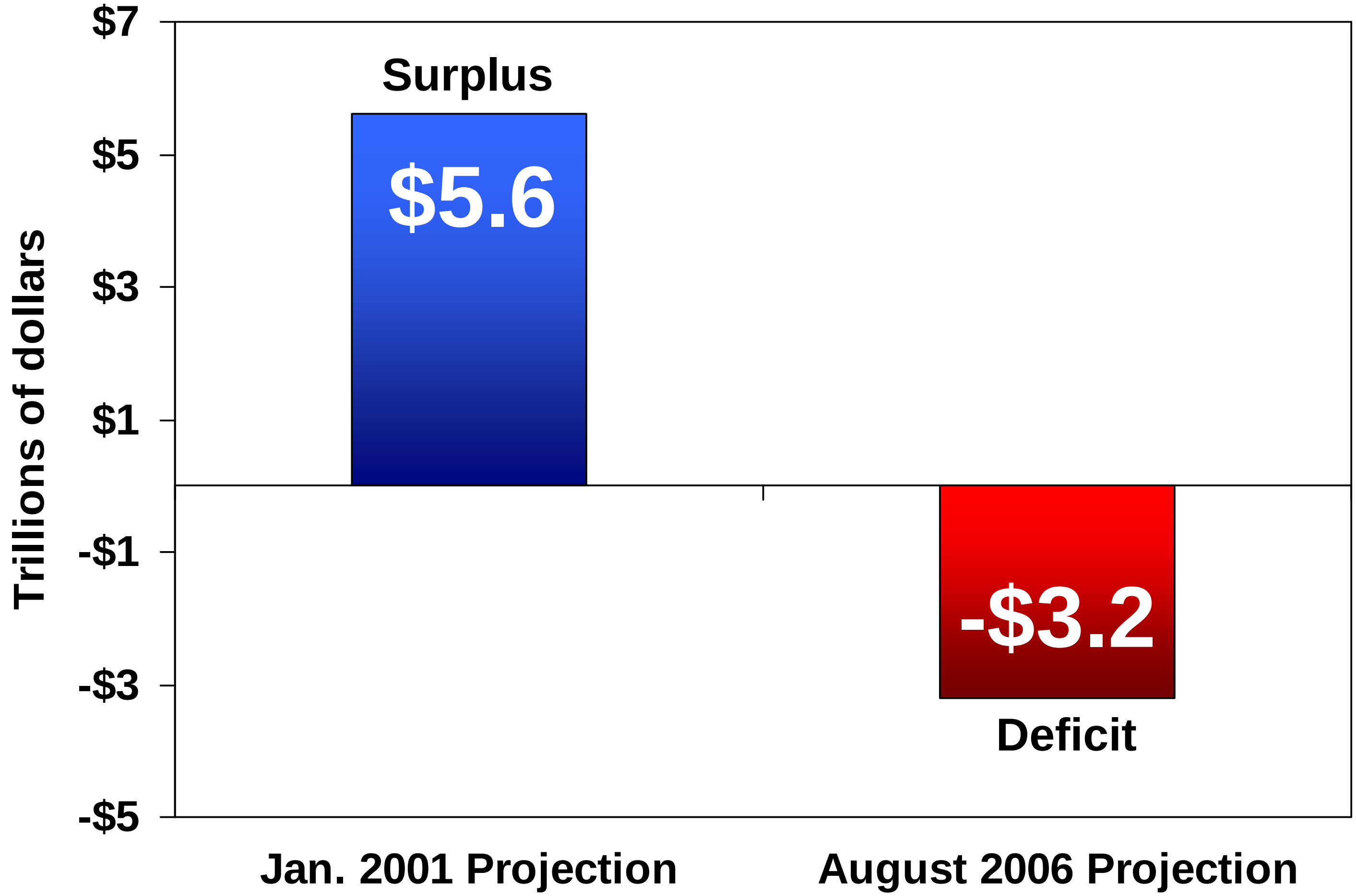
The Federal Budget in 2006

Revenues	$2.407 trillion
Expenditures	$2.654 trillion
Deficit	$ 248 billion

Source: Treasury Department

FROM LARGE SURPLUSES TO LARGE DEFICITS IN JUST 5 YEARS

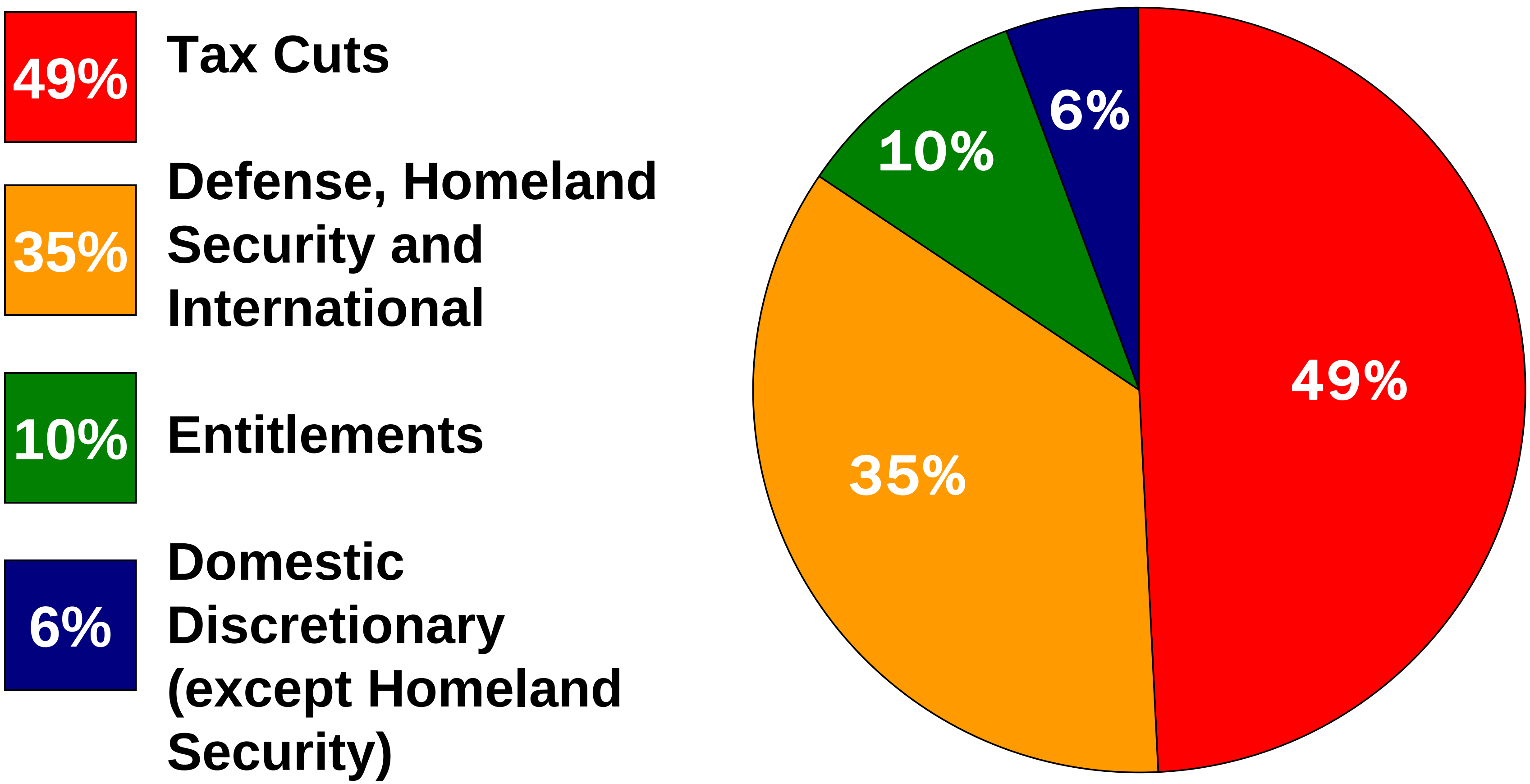
Cumulative Surpluses/Deficits, 2002-2011



Source: CBPP calculations based on Congressional Budget Office data.

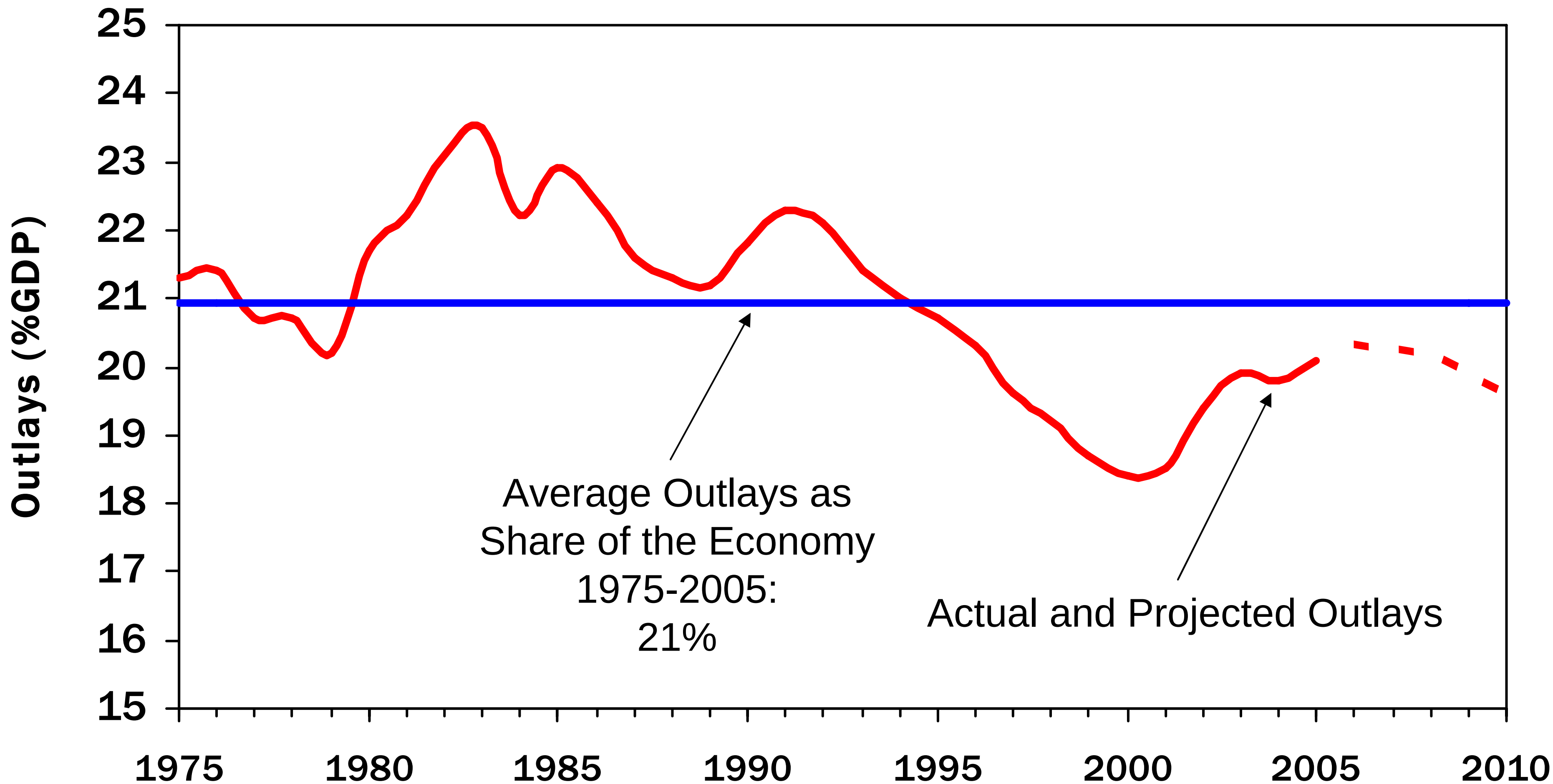
LEGISLATION ADDING TO DEFICITS: MOSTLY TAX CUTS AND DEFENSE

Cost, 2002-2011, of policy changes since January 2001



Source: CBPP calculations based on Congressional Budget Office data. Assumes extension of the President's tax cuts, continuation of Alternative Minimum Tax relief, a gradual phasedown of operations in Iraq and Afghanistan, and funding of the defense requests in the President's FY 2007 budget.

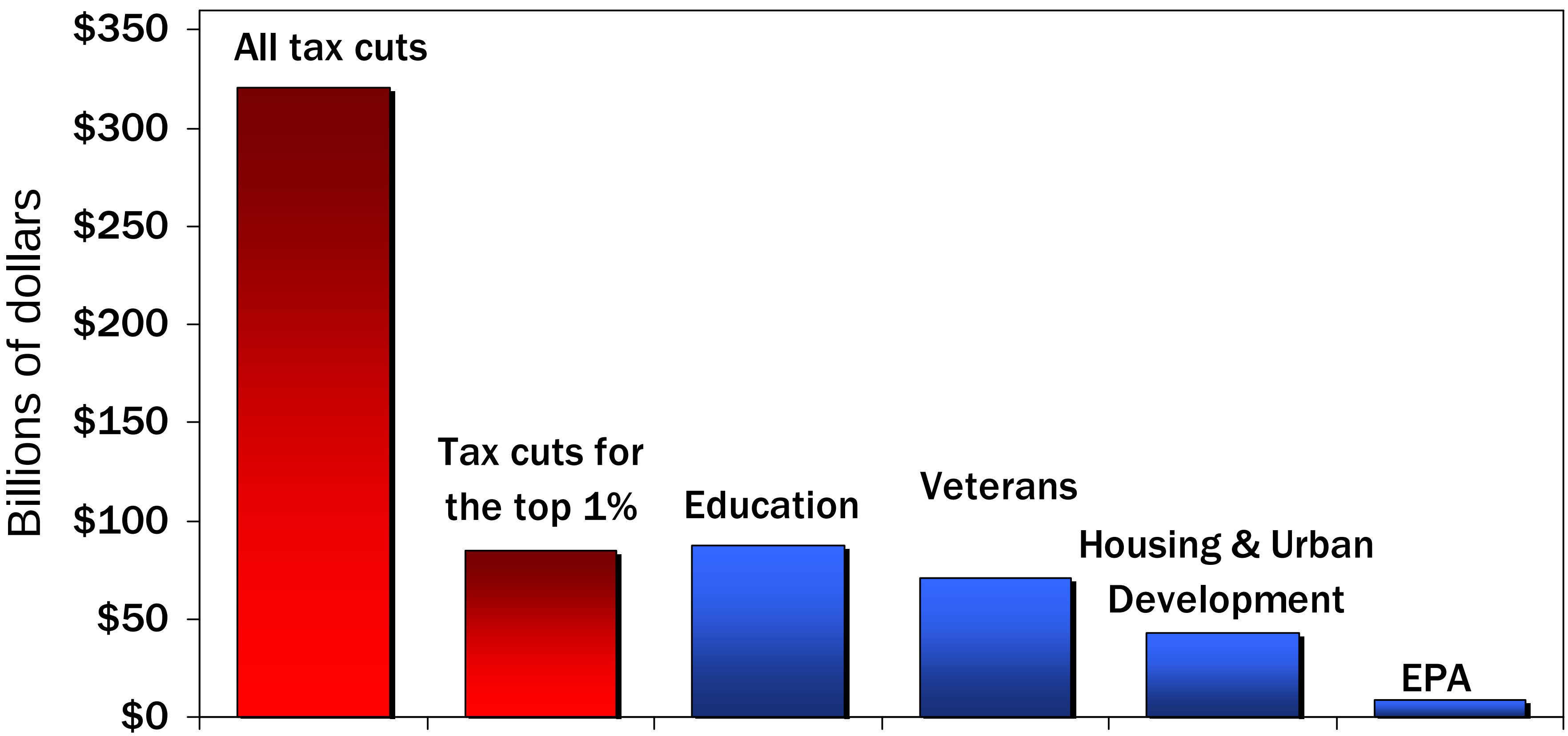
EVEN WITH IRAQ AND KATRINA, FEDERAL SPENDING IS BELOW AVERAGE FOR RECENT DECADES



Source: CBPP calculations based on Congressional Budget Office data.

Tax Cuts Cost More Than Most Agency Budgets

2006 Agency Budgets, Tax Cuts if Fully in Effect in 2006



Source: CBPP calculations based on Congressional Budget Office, Joint Committee on Taxation, and Urban-Brookings Tax Policy Center data.

WHAT WOULD IT TAKE TO BALANCE THE BUDGET WHILE PRESERVING THE TAX CUTS?

To balance the budget by 2016 while making the tax cuts permanent, policy makers would have to:

- **Cut Social Security benefits by.................................... 43%**
- **Or cut defense spending by 67%**
- **Or cut Medicare by.. 54%**
- **Or cut every other program except Social Security, Medicare, defense by.. 30%**

Source: CBPP calculations based on Congressional Budget Office data.

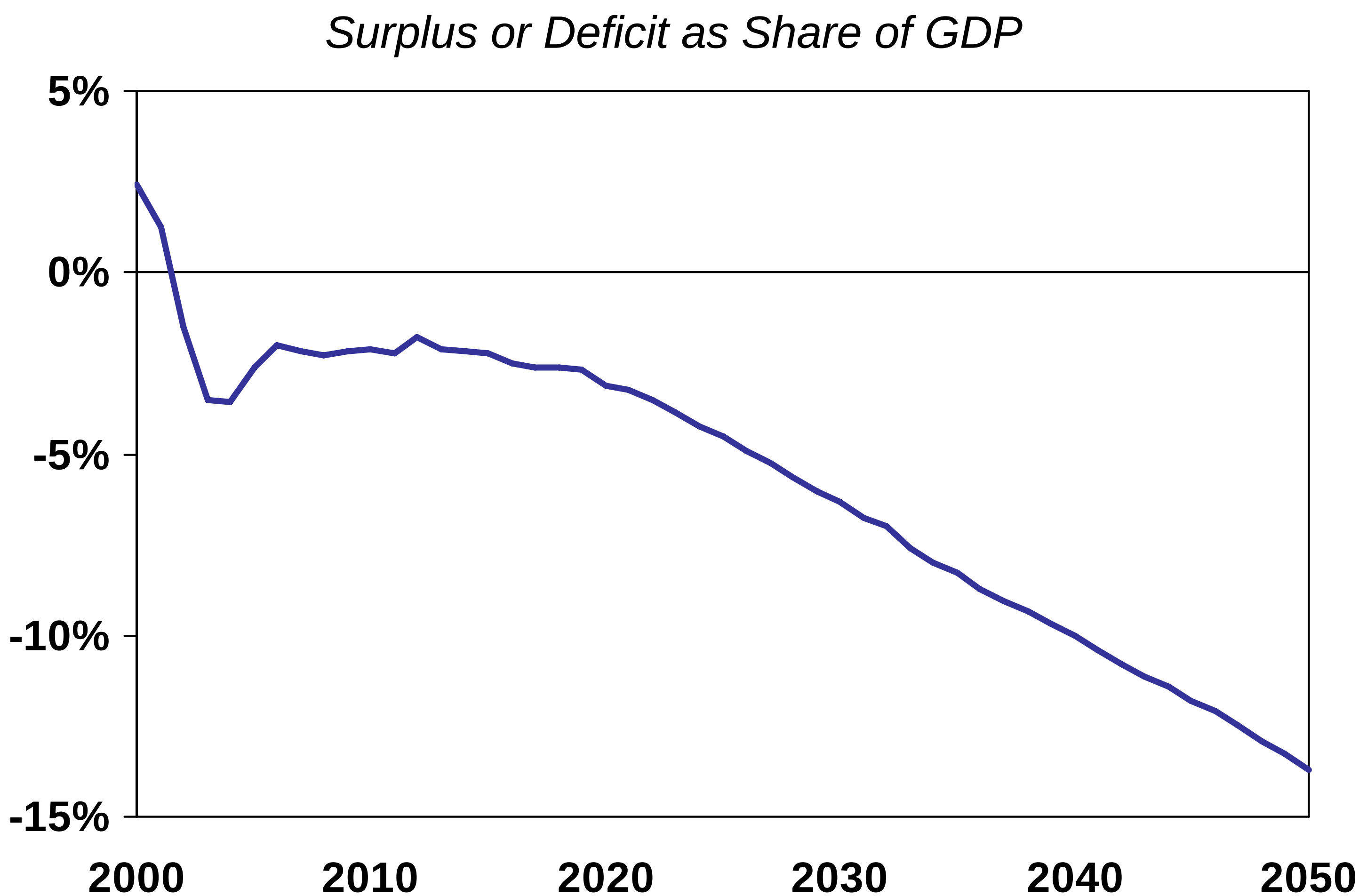
II. Drivers of the Long-Term Fiscal Problem

- Rising health care costs in the private and public sectors alike.

- Large tax cuts.

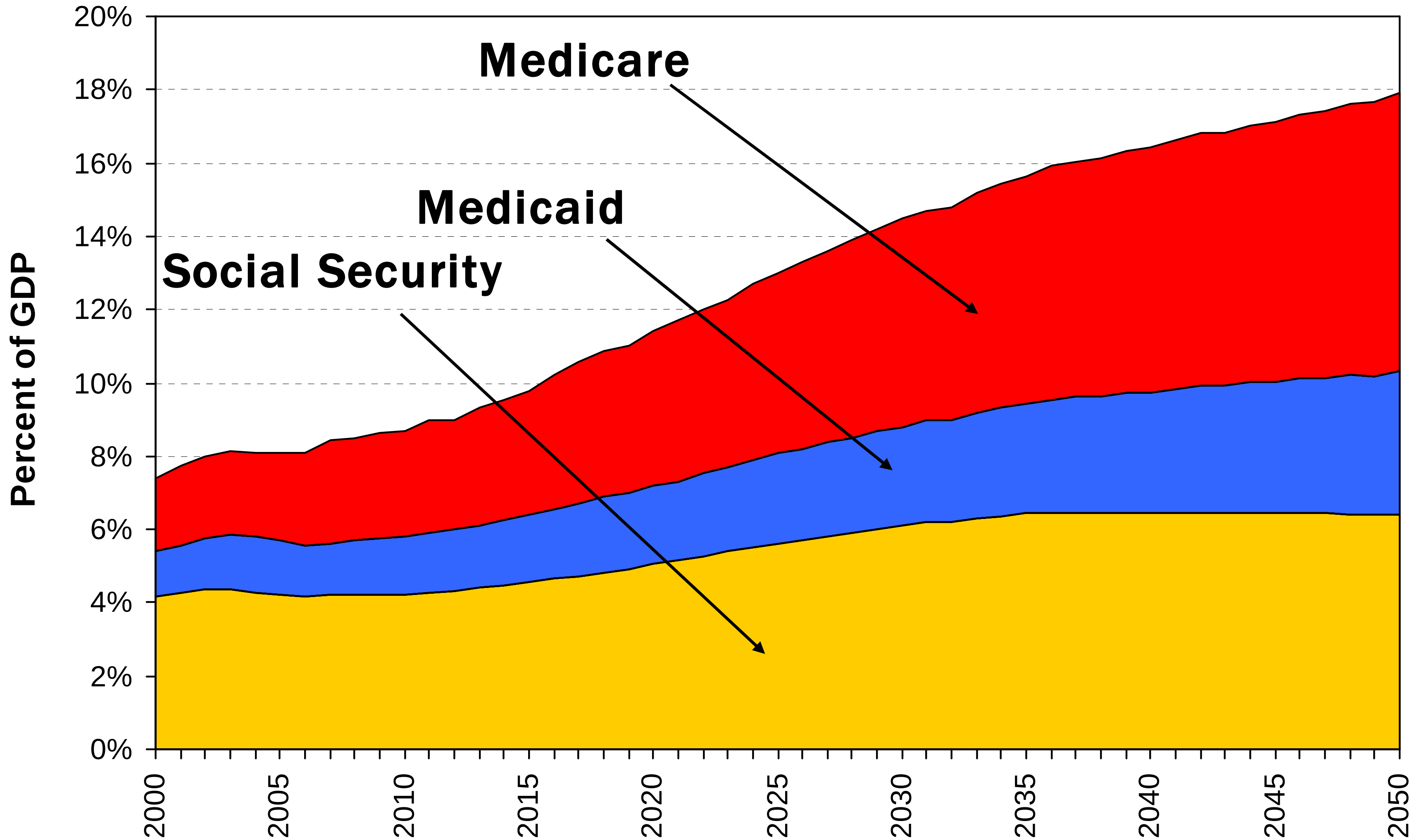
- The aging of the population, which raises the costs of Social Security, Medicare, and Medicaid.

Under Current Policy, Deficits Will Grow Dramatically Deeper in Coming Decades



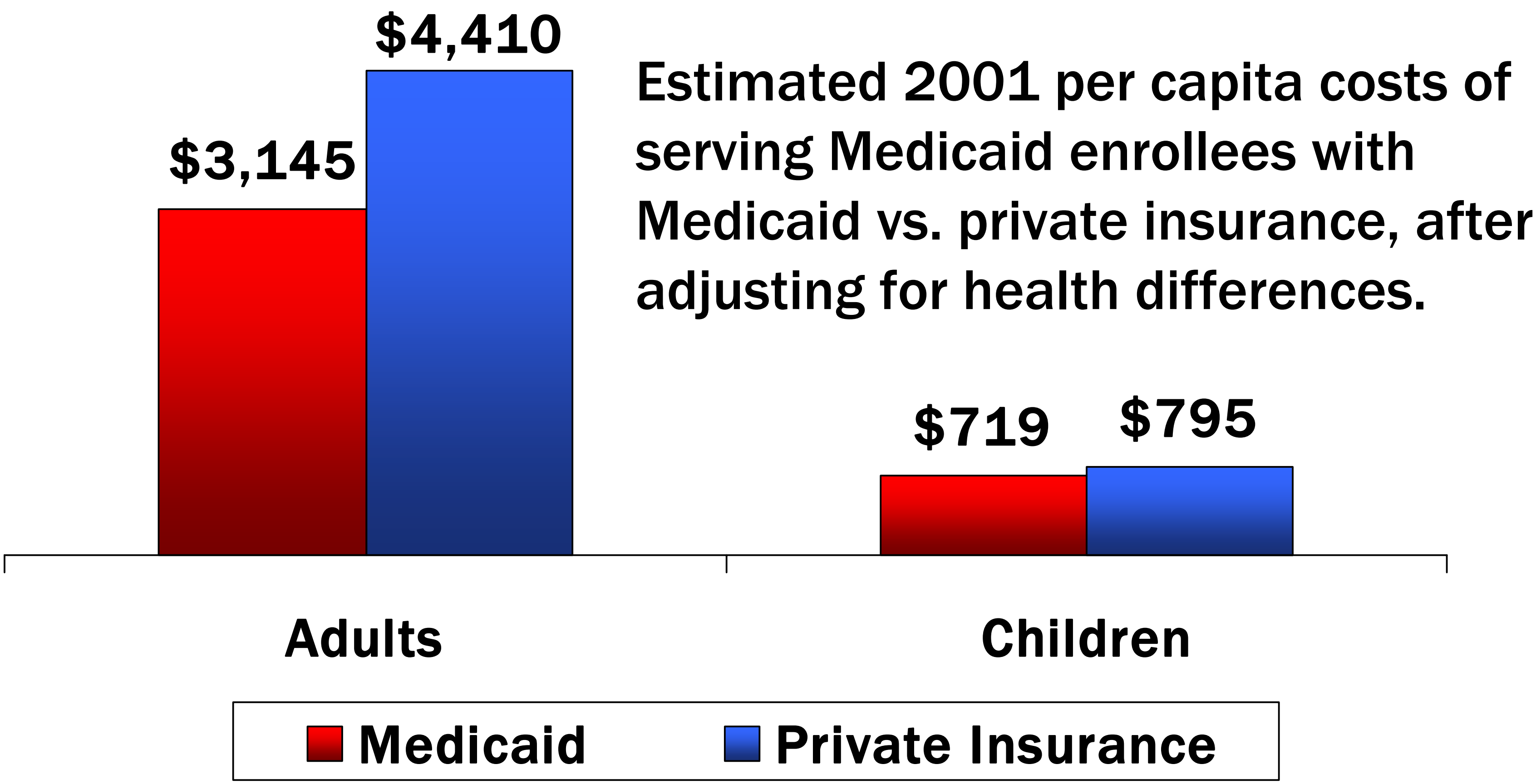
Source: CBPP calculations based on Congressional Budget Office and Census Bureau data.

MEDICARE, MEDICAID, AND SOCIAL SECURITY EXPECTED TO RISE RAPIDLY



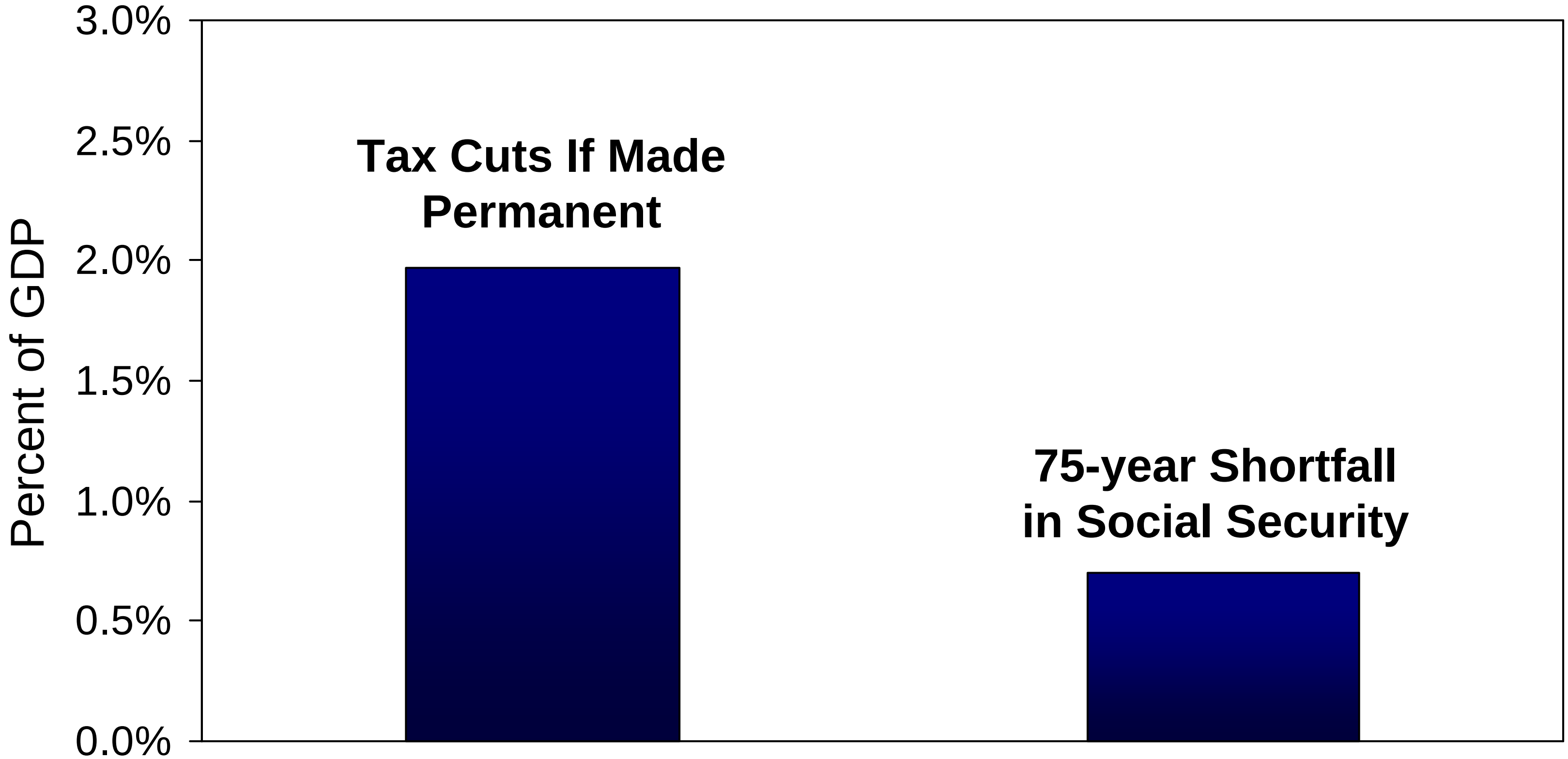
Source: CBPP calculations based on Congressional Budget Office data.

Medicaid Costs Less Than Private Health Insurance



Source: Hadley and Holahan, *Inquiry,* 2004

THE TAX CUTS AND SOCIAL SECURITY:
Costs through the next 75 years



Source: Social Security Trustees Report estimate of Social Security shortfall, CBPP calculation of tax cut costs based on Joint Committee on Taxation estimates

III. Congress's Major Budget Decisions Over the Past Year

Budget Changes Recently Enacted

Congress approved cuts in many programs important to low-income families, but subsequently passed even larger tax cuts. The net effect of these actions was to increase deficits. Congress enacted:

- ✂ **Reductions of $100 billion over ten years in "entitlement" programs, such as: Medicaid, which provides health care to low-income and elderly people, children, and people with disabilities; children's programs, including child support enforcement and foster care; and student loans.**

- ✂ **Tax cuts of about $135 billion over ten years, including extension of lower rates on capital gains and dividends, continuation of relief from the Alternative Minimum Tax, and extension of various tax breaks for retirement savings.**

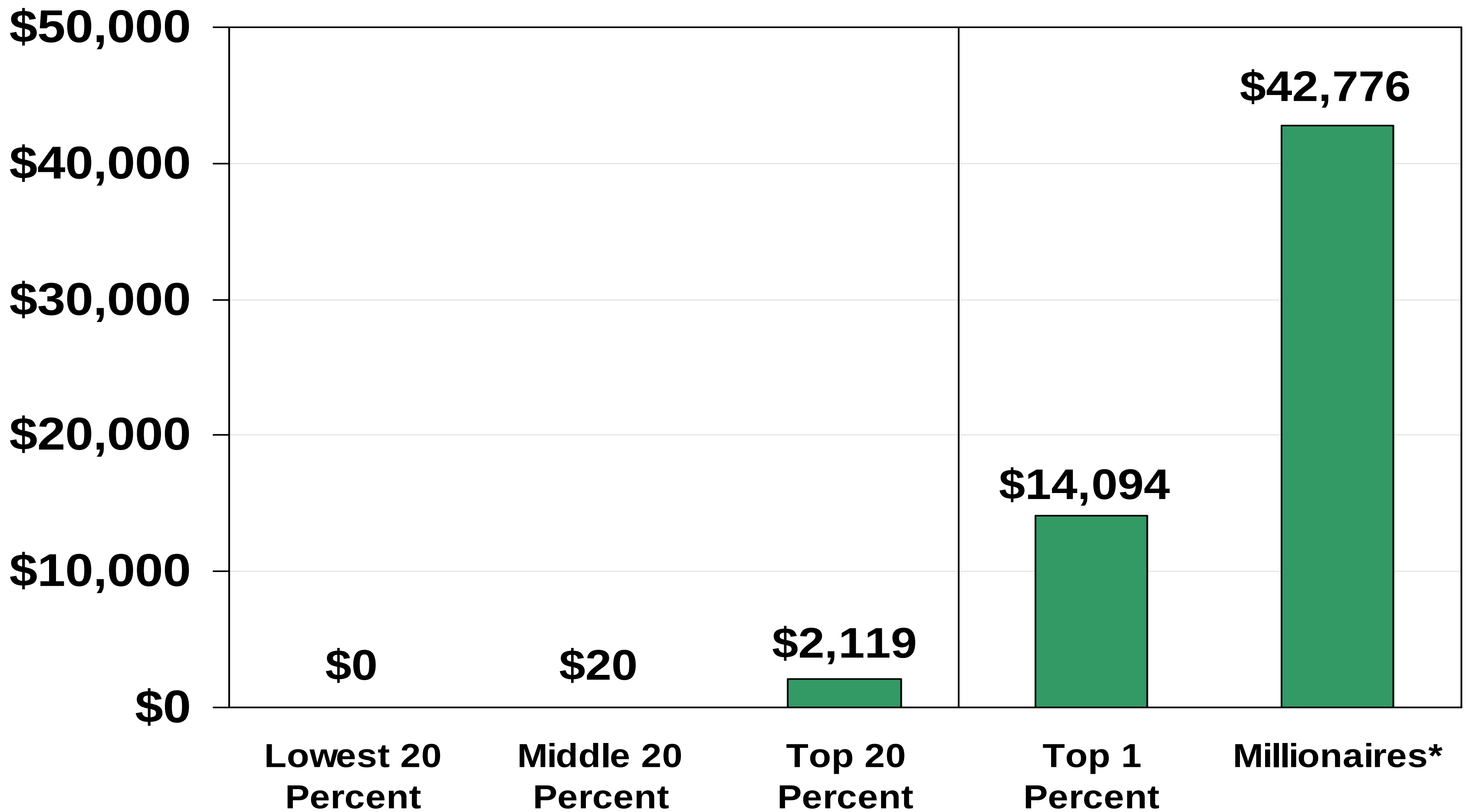
Effects of Recent Program Cuts

Analysis by the Congressional Budget Office indicates the law will:

- Cause many low-income people eligible for Medicaid to forgo needed health care because of increased co-payments and premiums.
- Result in $8 billion in child support going uncollected over 10 years due to cuts in child support enforcement.
- Shift billions of dollars in costs for welfare reform and child care assistance to the states.

AVERAGE VALUE OF TAX CUTS IN THE LARGE TAX-CUT BILL ENACTED THIS YEAR

Assuming Tax Cuts Were Fully in Effect in 2006



*Millionaires are households with an annual income above $1 million.

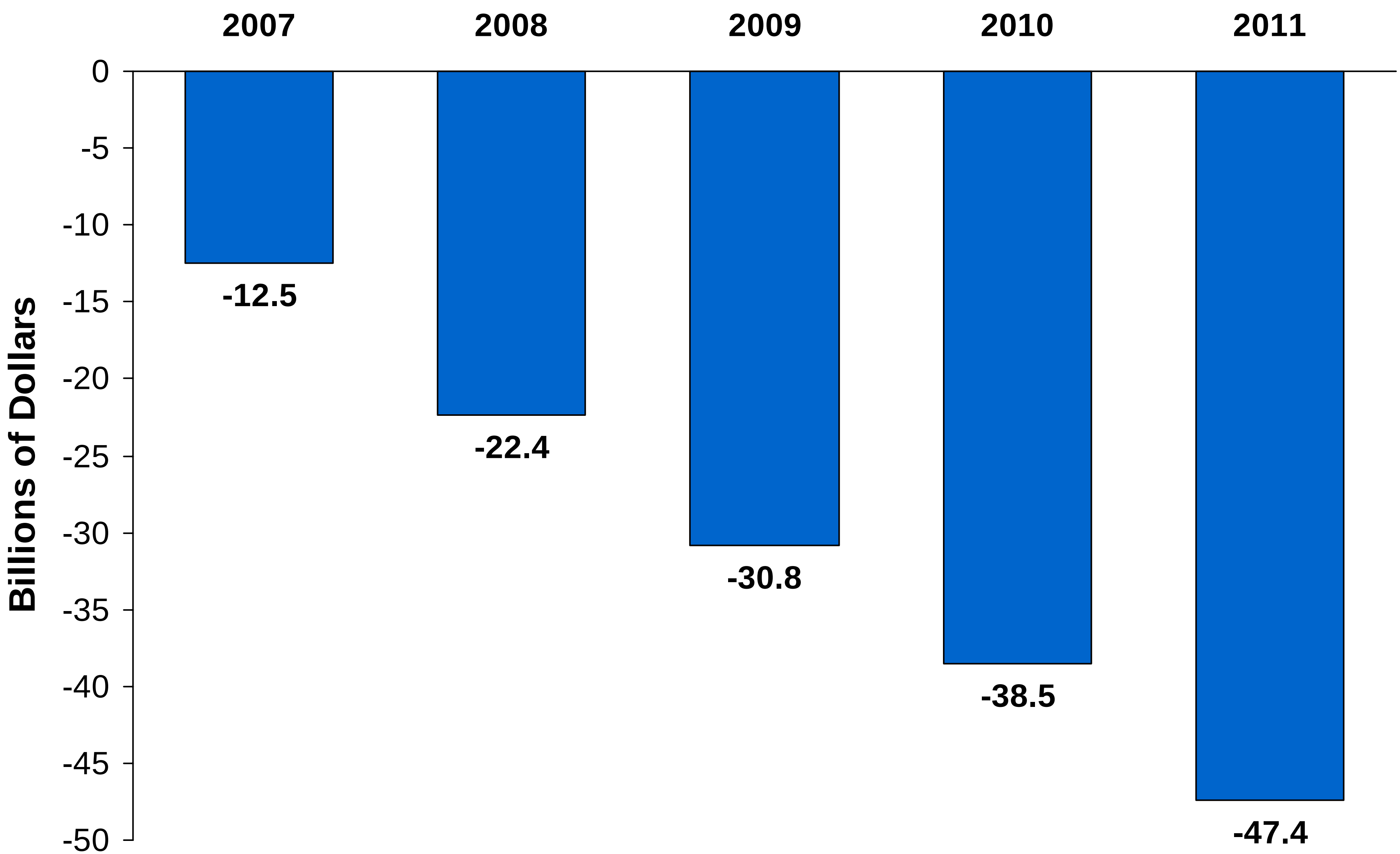
Source: Tax Policy Center

IV. This Year's Budget Debate

KEY ELEMENTS OF THE PRESIDENT'S FISCAL YEAR 2007 BUDGET PROPOSAL

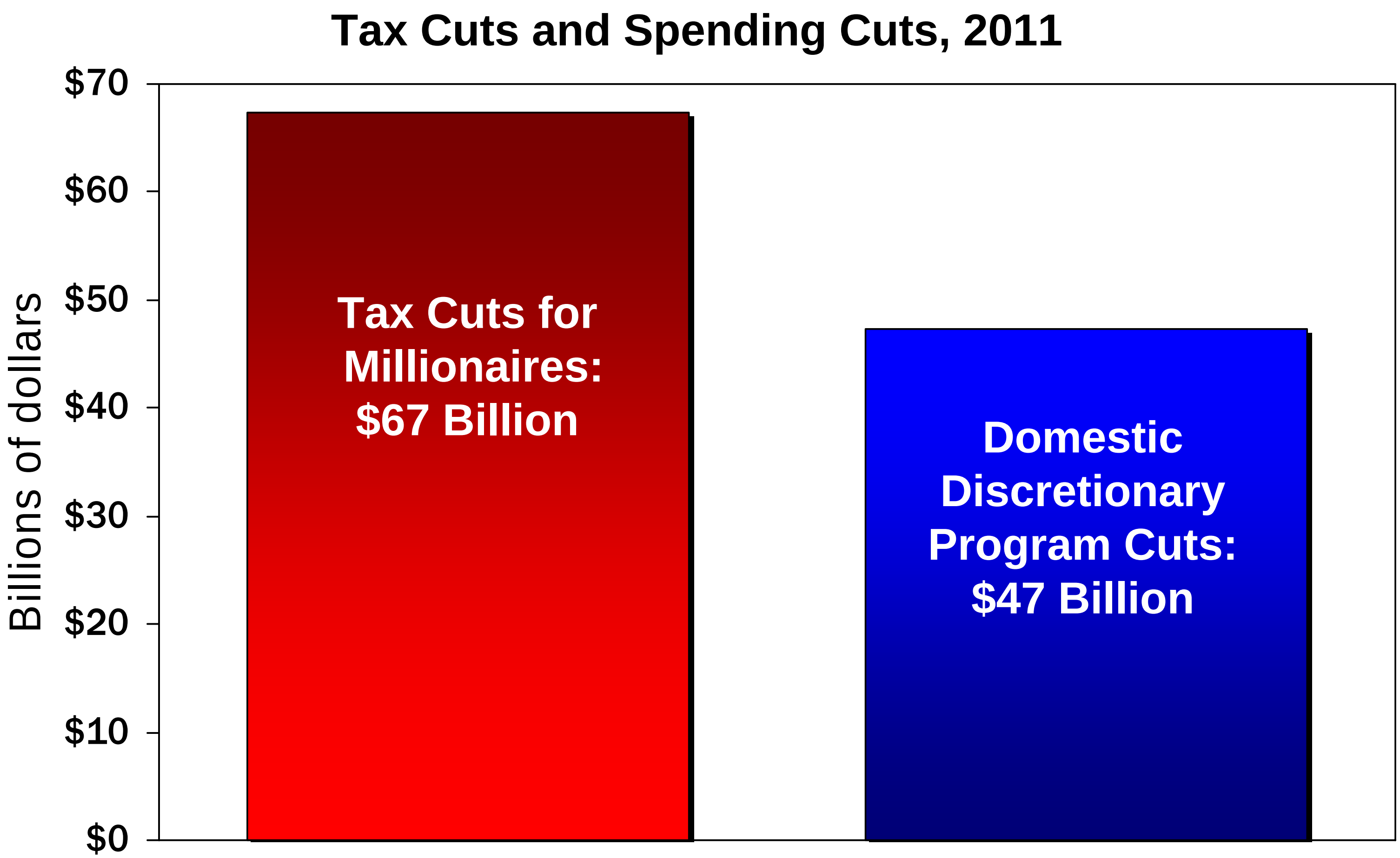
- Large cuts in domestic discretionary programs, with cuts growing deeper over time, this on top of cuts in 2005 and 2006
- Cuts in Medicaid that shift significant costs to states
- Makes 2001 and 2003 tax cuts permanent
- Expands health tax cuts that are worth most to people with high incomes
- New budget rules that make it easier to pass tax cuts and force significant spending cuts in the future
- Net Effect: Increase deficits by $281 billion over 5 years, according to CBO documents

President's Proposed Cuts in Domestic Discretionary Funding Grow Deeper Over Time



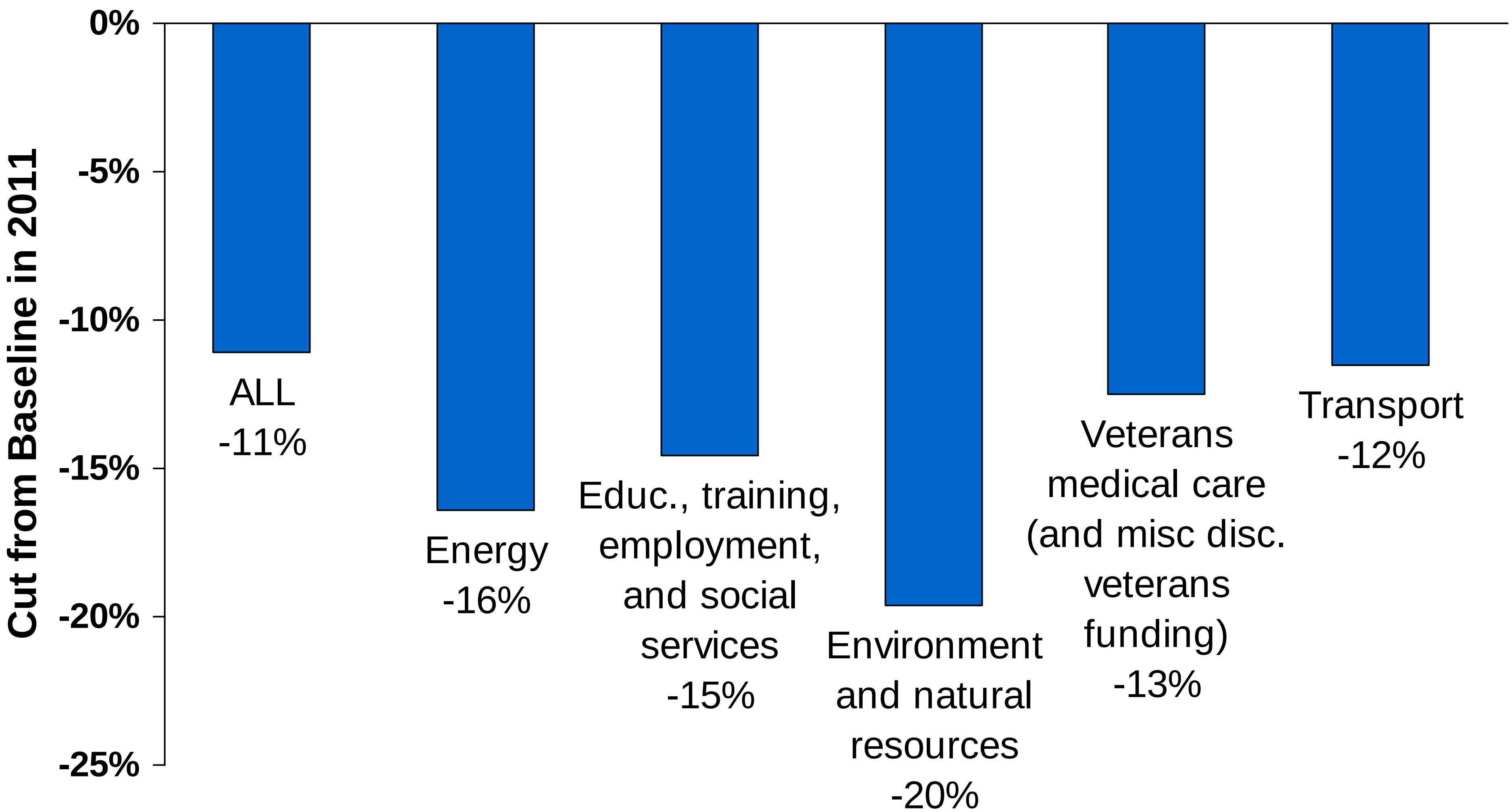
Source: CBPP calculations based on Congressional Budget Office data.

Tax Cuts for People With Incomes Over $1 Million Cost More Than All of the Cuts in Domestic Discretionary Programs Would Save



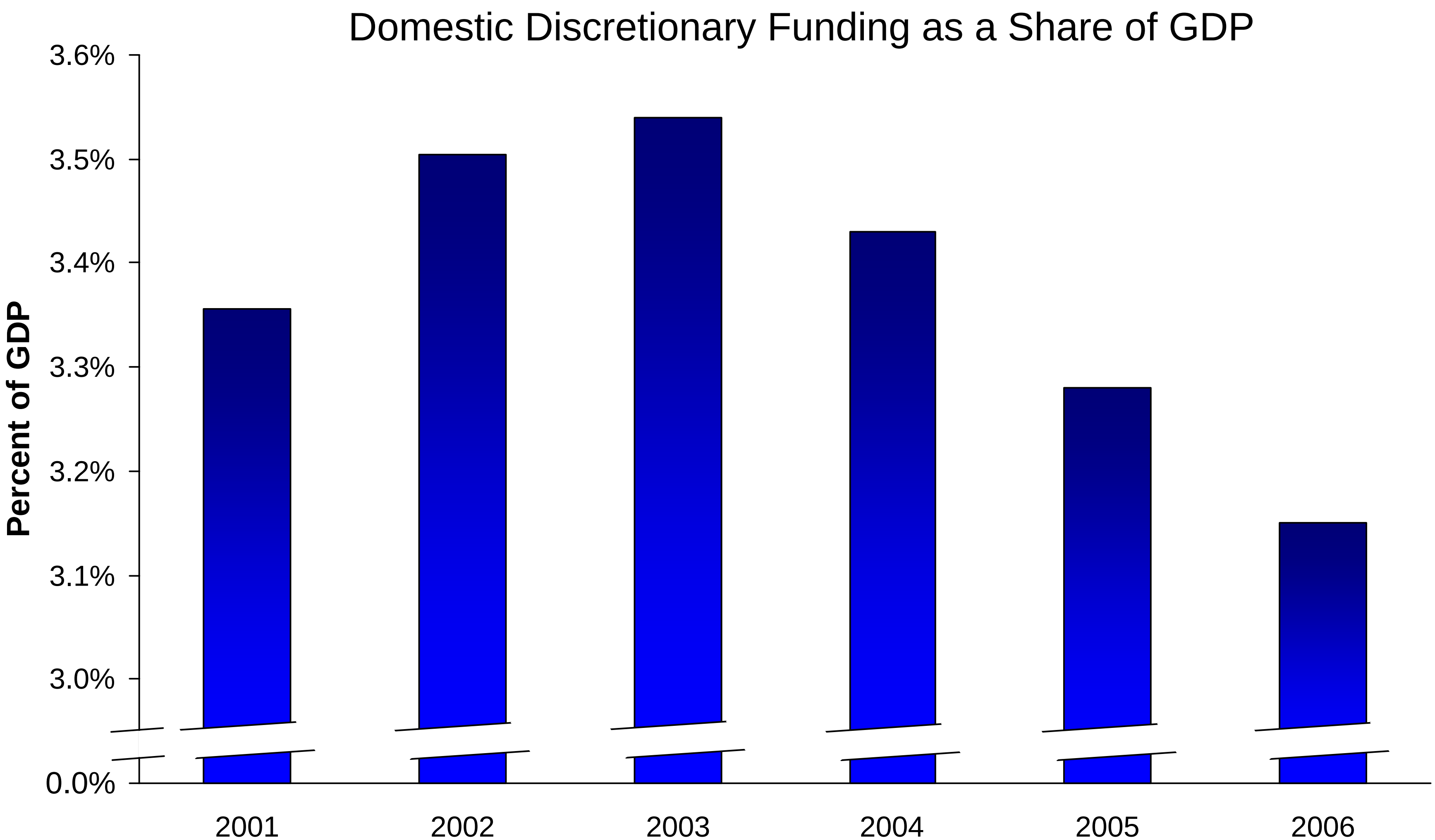
Source: CBPP calculations from Congressional Budget Office, Joint Committee on Taxation, and Urban-Brookings Tax Policy Center data.

President's Budget Calls for Large Cuts to Broad Range of Domestic Programs



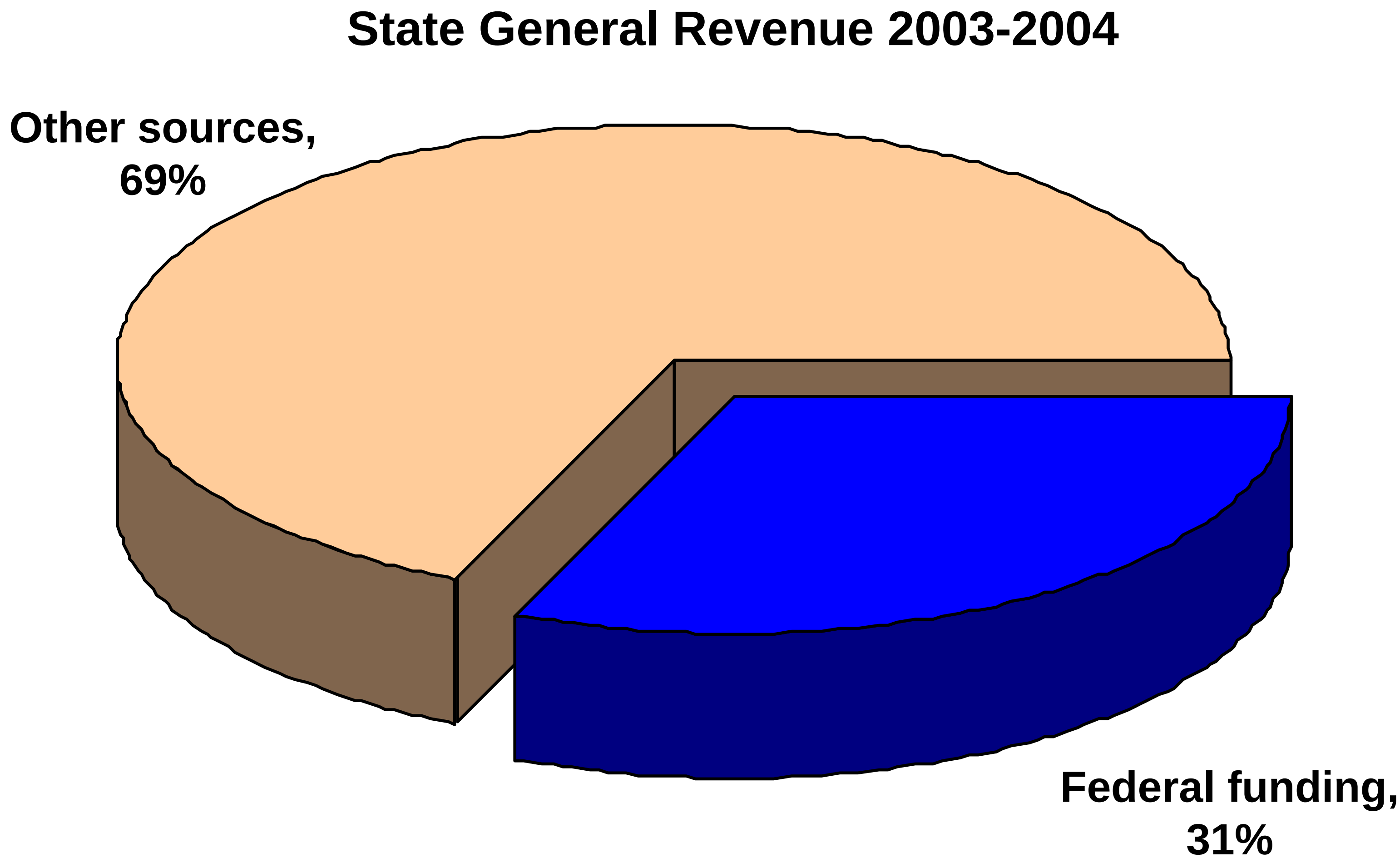
Source: CBPP calculations based on CBO data.

Since 2001, Funding for Domestic Discretionary Programs Has Fallen as a Share of the Economy



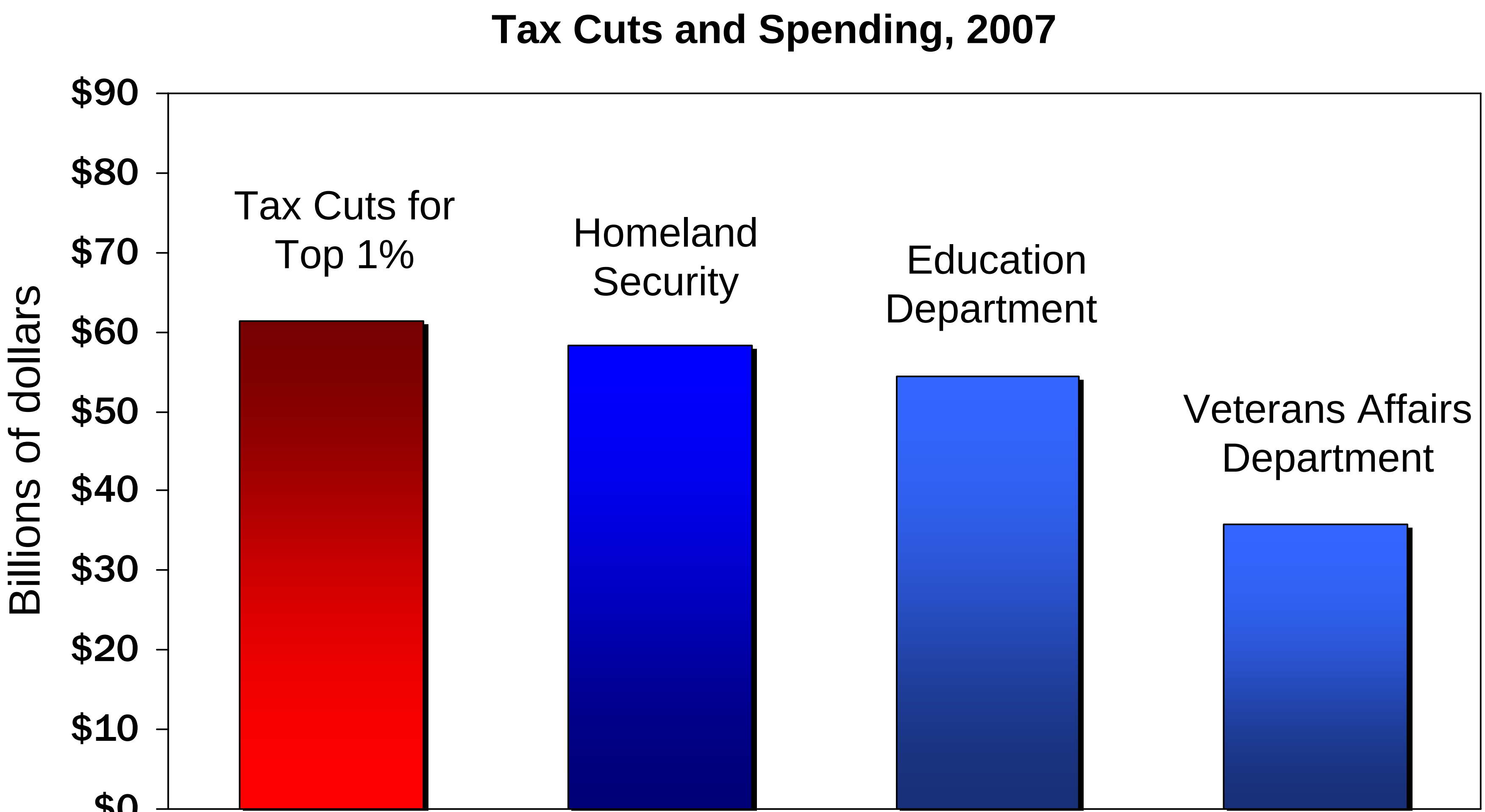
Source: CBPP calculations based on CBO data. To avoid distortions, figures do not include funding for homeland security or hurricane relief.

STATES DEPEND ON FEDERAL FUNDING



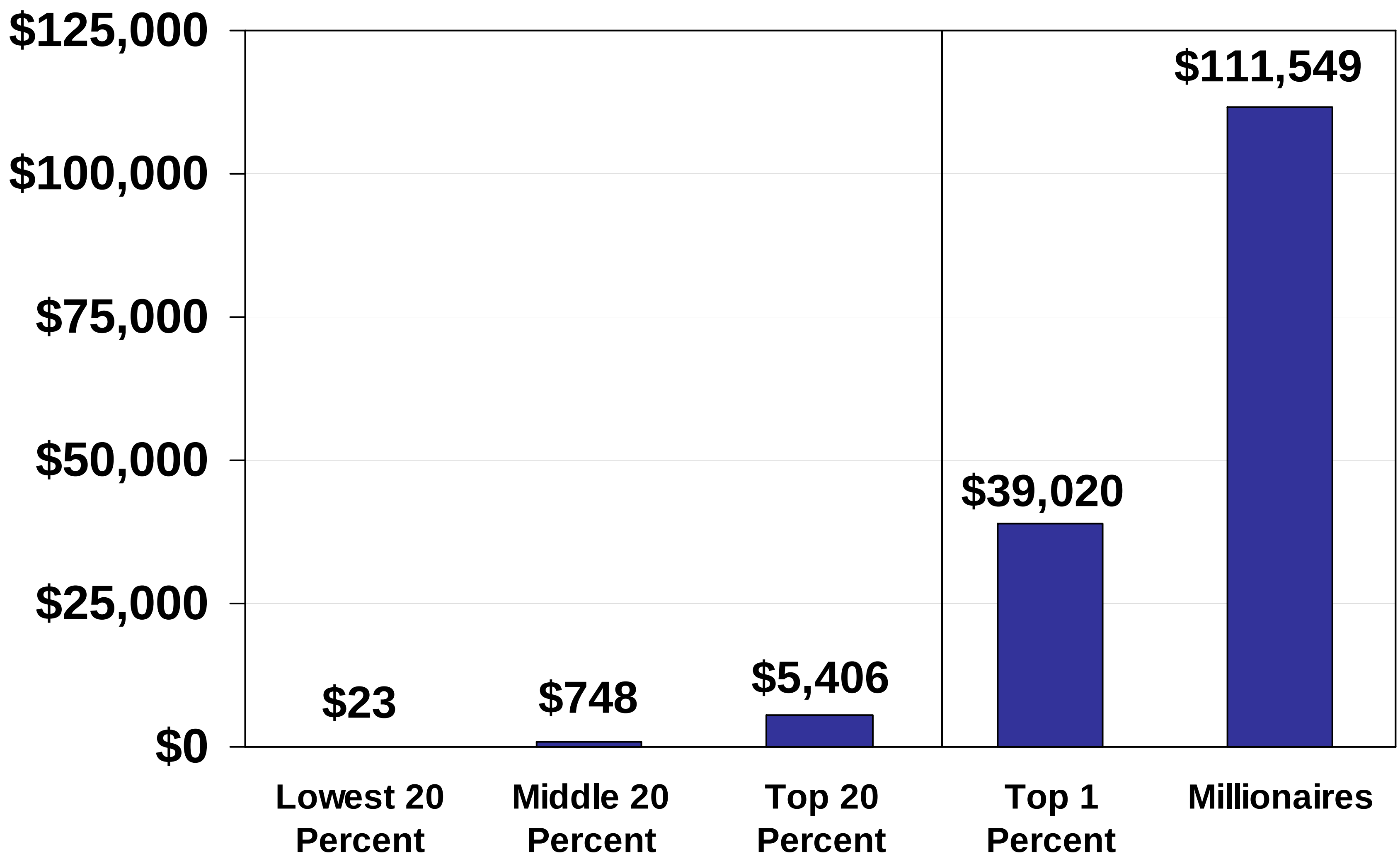
Source: CBPP calculations based on Census data.

Tax Cuts for Highest-Income 1 Percent of Households Compared with Spending on Administration's Stated Priorities



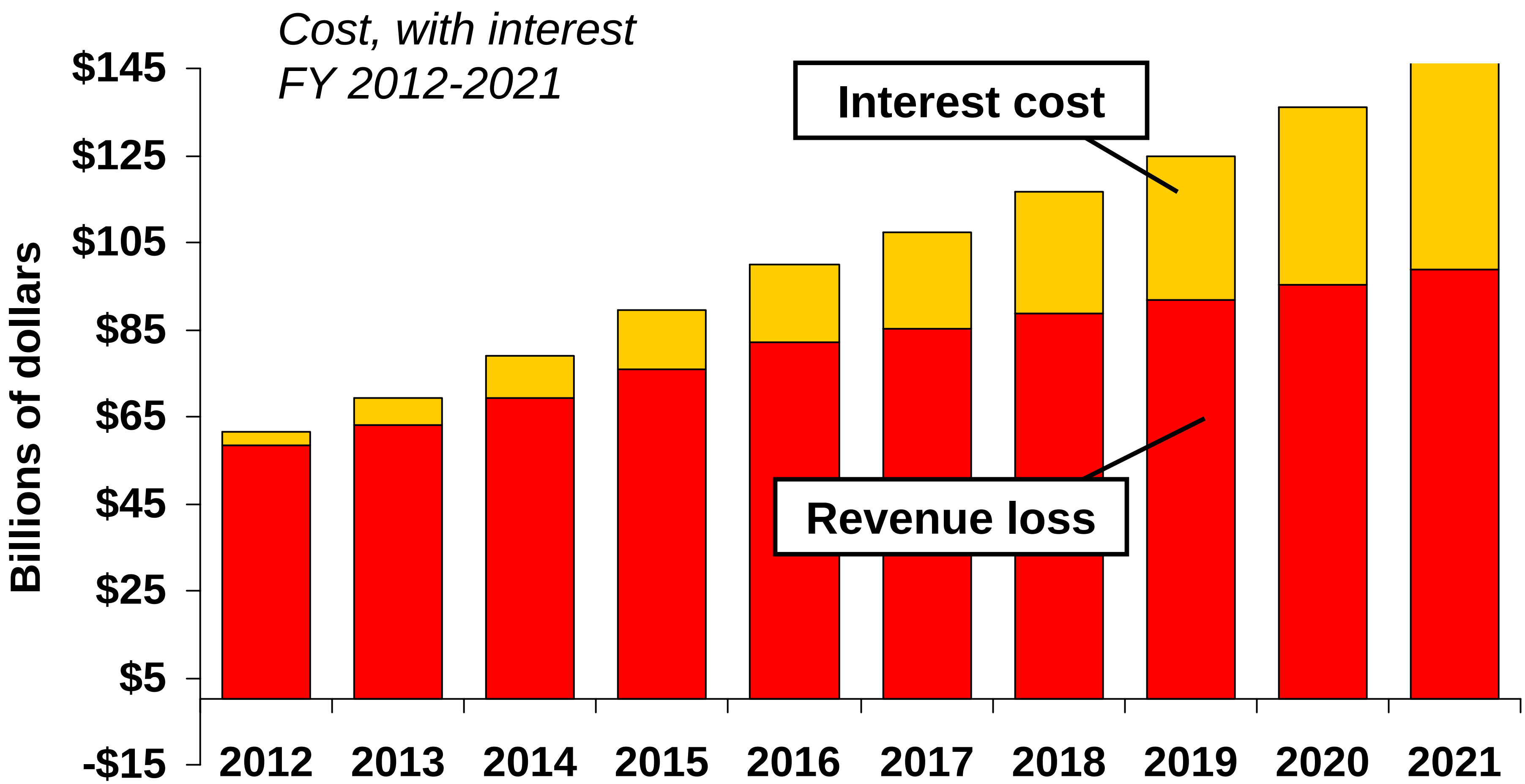
Source: CBPP calculations from Office of Management and Budget, Joint Committee on Taxation, and Urban-Brookings Tax Policy Center data. Funding levels are those requested in the President's budget.

AVERAGE VALUE IN 2006 OF TAX CUTS ENACTED SINCE 2001



Source: Urban-Brookings Tax Policy Center

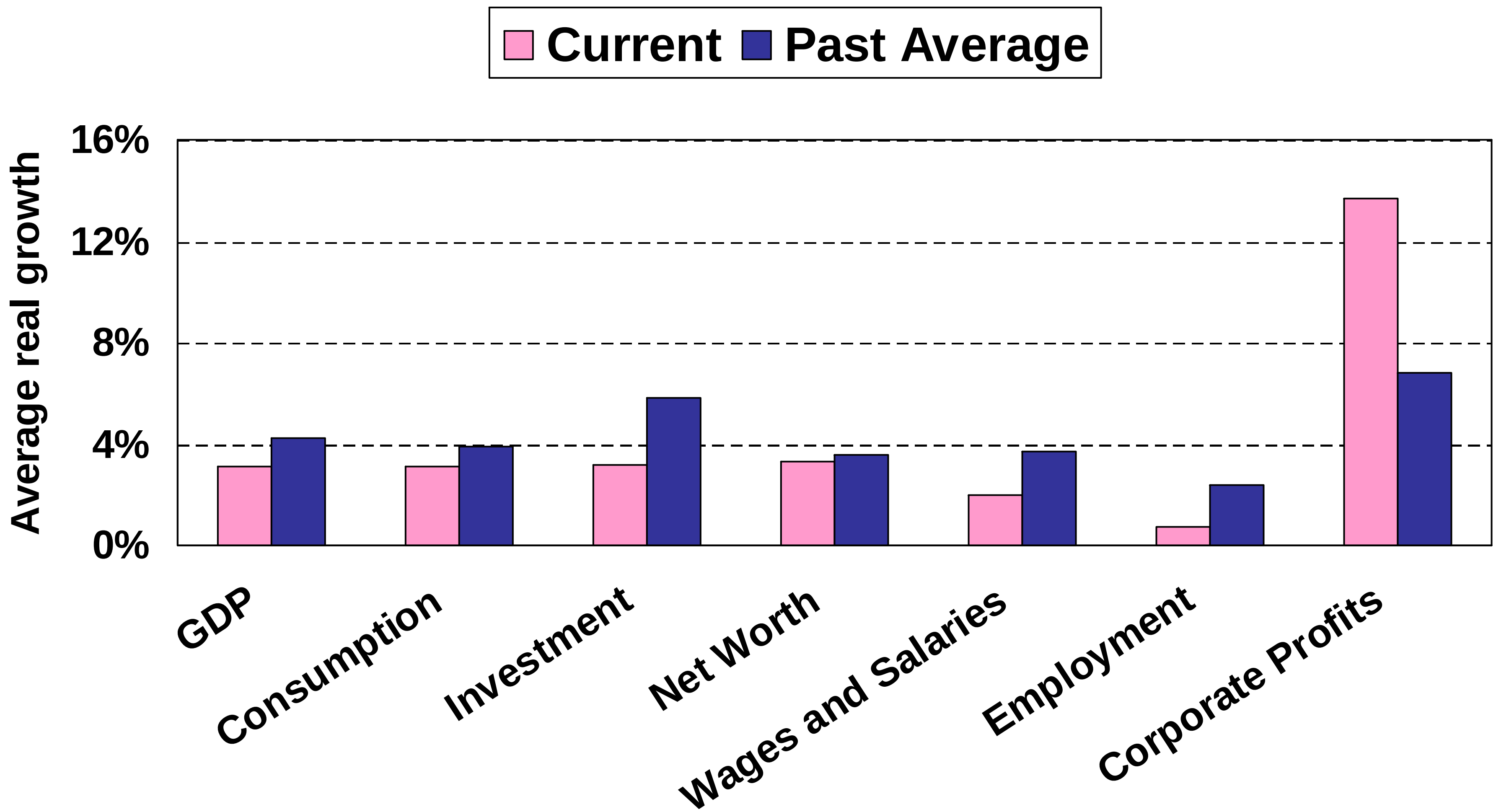
Estate Tax Repeal Costs Nearly $1 Trillion Over 10 Years



Source: CBPP calculations based on Joint Committee on Taxation and Congressional Budget Office data.

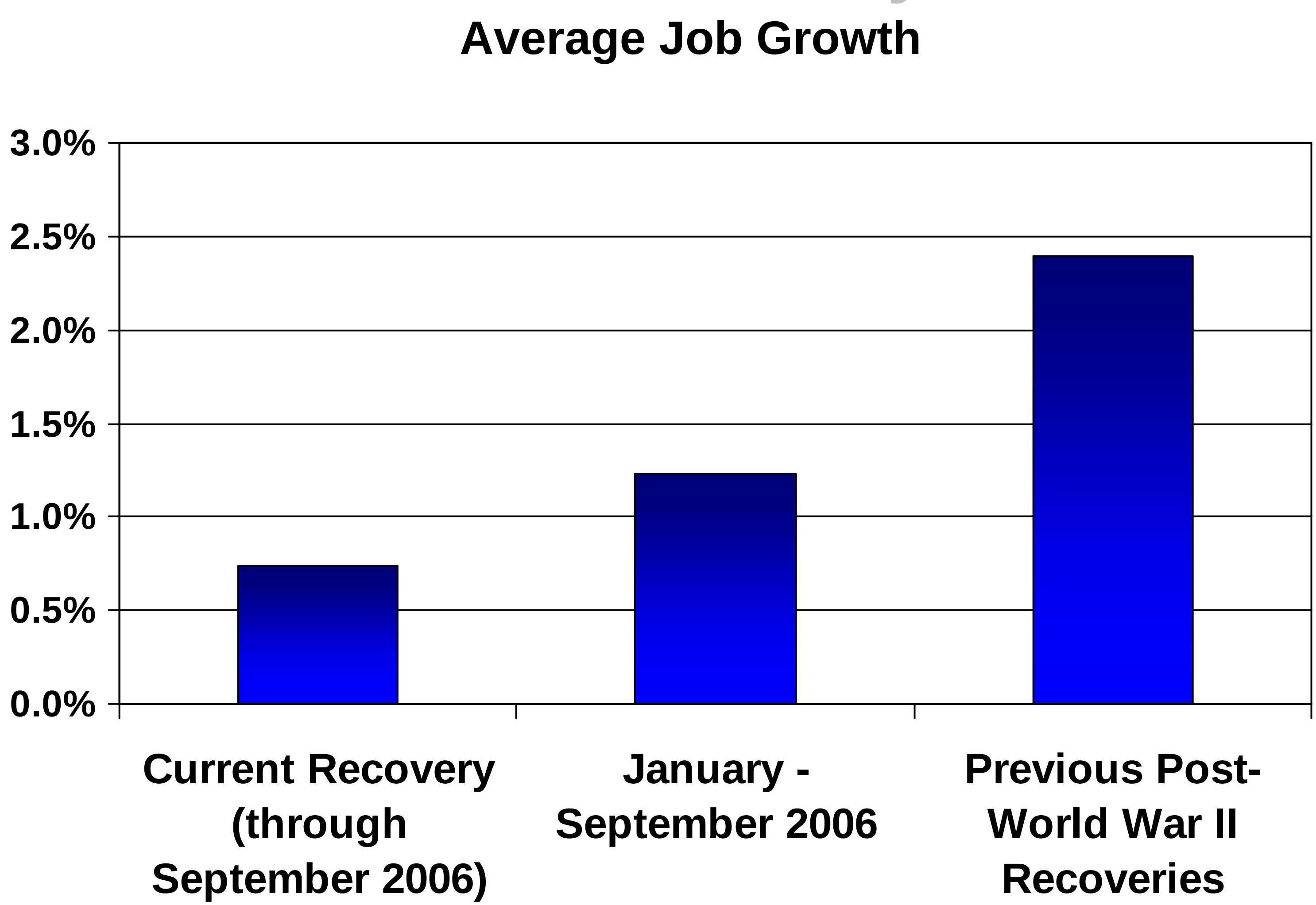
V. Where Do We Go From Here?

The Current Recovery Has Been Weaker Than Average; Only Corporate Profits Have Grown Rapidly



Source: CBPP calculations based on Commerce Department, Labor Department, and Federal Reserve data. Employment data through August 2006. All other data through the first quarter of 2006.

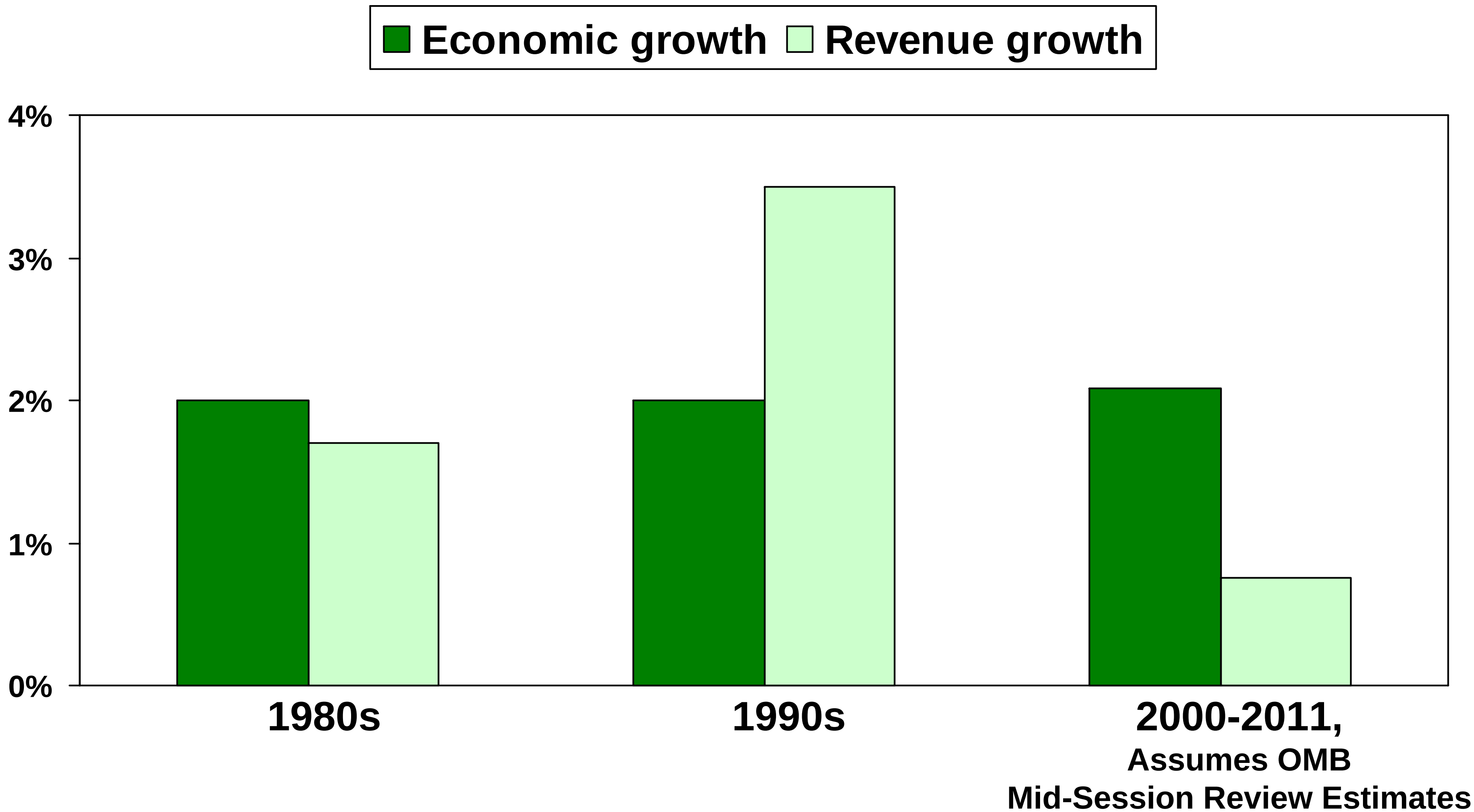
Job Growth Has Been Especially Weak in This Recovery



Source: CBPP calculations based on Labor Department data.

Economic and Revenue Growth Following 1980s and Recent Tax Cuts and 1990s Tax Increases

Growth Rates, Adjusted for Inflation and Population Growth



Source: CBPP calculations based on Commerce Department and Office of Management and Budget data.

Studies Find Recent Tax Cuts, If Not Offset, Are at Least as Likely to Reduce Long-Term Economic Growth as to Increase It

"Nearly all of the simulations [done of the tax cuts' effects on the economy] showed that the tax cuts would have positive effects in the short run and negative effects in the long run. Often, the long-run effects did not entirely materialize by the end of the traditional 10-year forecast window."

-- Congressional Research Service

"making the 2001 and 2003 tax cuts permanent would raise the cost of capital for new investments, reduce long-term investment, and reduce economic growth."

--William Gale and Peter Orszag,
Brookings Institution economists

Studies by **Federal Reserve economists, the Congressional Budget Office, the Joint Committee on Taxation**, and other noted experts have produced similar findings regarding the effects of unpaid for tax cuts.

Likely Consequences of *Un*balanced Approach to Deficit Reduction

- Large cuts over time in programs for the poor.
- Increases in number of uninsured Americans.
- Federal government may be unable to fulfill some core functions.
- More costs shifted to states.

The Goal: *Balanced* Approach To Deficit Reduction

- Balanced approach would include revenue increases as well as spending cuts, especially since the recent tax cuts are a main reason we have deficits.

- Cuts would not fall disproportionately on low-income programs and would focus on "weak claims," not "weak clients."

- Balanced approach was taken in 1990 and 1993 by Presidents Bush and Clinton.

Some First Steps Under a Balanced Approach to Deficit Reduction

- Restore “Pay As You Go” rules requiring both tax cuts and increases in entitlement programs to be paid for.
- Shelve tax cuts not yet fully in effect; do not extend expiring tax cuts unless they are paid for.
- Adopt recommendations from congressional Medicare commission to curb excessive Medicare payments to health-care providers.
- Adopt President’s farm subsidy reforms.
- Pare back earmarks in appropriations bills.
- Adopt Joint Tax Committee proposals to curb unproductive tax breaks and shelters and reduce tax avoidance.
- Use better inflation measure for everything from Social Security cost-of-living adjustments to indexing of the tax code.