Order Code RL32264

CRS Report for Congress
Received through the CRS Web

The Budget for Fiscal Year 2005

Updated February 14, 2005

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Summary

CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2006-2015* (January 25, 2005), included revised baseline estimates (assuming current policies) for fiscal year (FY) 2005. The estimates included a $368 billion deficit for FY2005, larger than CBO's previous (September 2004) estimate. CBO's baseline estimates do not include assumptions about future legislation that may increase spending or decrease receipts in FY2005. The President presented his FY2006 budget, containing revised proposals and estimates for FY2005, on February 7, 2005, including a deficit estimate of $427 billion. The estimate includes the Administration's estimates of additional War-On-Terror funding in FY2005.

The President's original FY2005 budget (February 2004) included, among many policy proposals, extending and making permanent many of the tax cuts adopted in 2001 and 2003. The budget contained a FY2005 deficit of $364 billion. On May 12, 2004, the Administration requested an additional $25 billion for the ongoing operations in Afghanistan and Iraq. The budget did not include estimates for the cost of the war on terror beyond FY2004, provided limited information on the costs of extending the tax cuts past FY2009 (which is the period in which most of their budget effects would occur), and did not propose providing relief from the expanding middle-class coverage of the alternative minimum tax (AMT) after FY2005.

The Congressional Budget Office's (CBO) January 2004 budget report for FY2005 (the *Budget and Economic Outlook: Fiscal Years 2005-2014*) estimated the FY2005 baseline deficit at $362 billion. CBO's report provided estimates of the costs of selected alternative policies (measured from the baseline), such as estimates of the cost of extending the tax cuts, reforming the AMT, and alternative assumptions about discretionary spending growth.

In March 2004, CBO released its estimates of the Administration's proposals using CBO's underlying assumptions and budget estimating methods. These produced a deficit of $358 billion in FY2005, falling to $258 billion in FY2009. By extending the effect of the Administration's policies past FY2009, the deficit would climb slightly after FY2010, moving to $284 billion in FY2014.

The Senate did not clear the FY2005 budget resolution (S.Con.Res. 95; H.Rept. 108-498), adding procedural hurdles to already existing policy disputes and further slowing the passage of the annual appropriations. With only one of the 13 regular appropriations enacted as the new fiscal year began, Congress passed the first of three continuing resolutions on appropriations (H.J.Res. 107) on September 29. Congress adopted three more appropriations during October 2004. In the second after-election session, Congress passed and the President signed an omnibus appropriation for FY2005 (The Consolidated Appropriations Act, 2005; P.L.108-447; H.R. 4818) containing the remaining nine regular appropriations. In early 2005, the Administration indicated that it will request an $80 billion supplemental appropriation for FY2005 early in the new year.

This report will be updated as events warrant.

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Background and Analysis

Presidents generally submit their budget proposals for the upcoming fiscal year (FY) early in each calendar year. The Bush Administration released its FY2005 budget (*The Budget of the U.S. Government, Fiscal Year 2005)* on February 2, 2004. The multiple volumes contained general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2005 through FY2009. It contained limited information on the revenue and mandatory spending changes after 2009, and a section on long-term fiscal issues facing the nation. The full set of budget documents (*Budget, Appendix, Analytical Perspectives, Historical Tables*, among several others) contains extensive and detailed budget information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed budget authority, outlay and receipt data, selected analysis of specific budget related topics, and the Administration's economic forecast. In addition to its presentation of the Administration's proposals, the budget documents are an annual reference source for federal budget information, including enacted appropriations.

The Administration's annual budget submission is followed by congressional action on the budget. This usually includes the annual budget resolution, appropriations, and, possibly, a reconciliation bill (or bills) as required by the budget resolution. Over the course of deliberation on the budget, the Administration often revises its original proposals as it interacts with Congress and as conditions change in the economy and the world.

The Current Situation

Congress and the President completed action on the FY2005 regular appropriations on November 20, 2004, and December 7, 2004, after the presidential election. On those dates respectively, Congress passed and the President signed the Consolidated Appropriations Act, 2005, containing nine of the 13 regular appropriations for FY2005. Only one regular appropriation had become law before the start (on October 1, 2004) of the new fiscal year. Congress passed and the President signed three more during deliberations in October.

The new budget cycle for FY2006 is expected to produce changes to the FY2005 budget. In late January 2005, the Administration indicated that it would propose an $80 billion supplemental appropriation for FY2005 (much of which will be spent in subsequent years). An estimated $30 billion to $35 billion would become outlays in FY2005. This additional spending would raise the year's deficit to approximately $427 billion, according to the Administration.

Budget Totals

Table 1 contains budget estimates for FY2005 from the Congressional Budget Office (CBO) and the Administration (the Office of Management and Budget, OMB); revisions produced by both the CBO and OMB during the year, as they become available; and data from congressional budget deliberations. Differences in totals result from differing underlying economic, technical, and budget-estimating assumptions and techniques, as well as differences in policy assumptions. Often the *policy*-generated dollar differences between Administration and congressional proposals for an upcoming fiscal year are relatively small compared to the budget as a whole. These small differences may grow over time, sometimes substantially, producing widely divergent future budget paths. Budget estimates should be expected to change over time from those originally proposed or estimated by the President, CBO, or Congress.

Table 1. Budget Estimates for FY2005

(in billions of dollars)

	Receipts	Outlays	Deficit (-)/ Surplus
CBO, BEO Baseline, 1/04	$2,049	$2,411	$-362
OMB, Budget Proposals, 2/04	2,036	2,400	-364
OMB, Budget, Current Services Baseline, 2/04	2,037	2,397	-360
OMB, Budget DCA Current Services Baseline, 2/04	2,048	2,442	-393
CBO, Revised Baseline, 3/8/04	2,050	2,414	-363
CBO, EPP, 3/8/04	2,029	2,384	-356
Senate, FY05 Budget Resolution S.Con.Res. 95, 3/12/04	2,026	2,367	-341
House, FY05 Budget Resolution H.Con.Res. 393, 3/25/04	2,030	2,406	-377
Conf., FY05 Budget Resolution S.Con.Res. 95, 5/19/04*	2,027	2,405	-367
OMB, Mid-Session Rev. 7/30/04	2,091	2,423	-331
OMB, Mid-Session Rev. CSB 7/30/04	2,108	2,400	-292
CBO Update 9/7/04	2,094	2,442	-348
CBO, BEO Baseline, 1/25/05	2,057	2,425	-368
OMB, Budget Proposals, 2/05	2,053	2,479	-427
OMB, Budget, Current Services Baseline, 2/05	2,053	2,443	-390

*The conference report (H.Rept. 108-498) passed the House on May 19, 2004, but has yet to be considered in the Senate.

BEO — The *Budget and Economic Outlook*, CBO.

EPP — CBO's estimates of the President's proposals.

DCA Current Services Baseline — Current Service Baseline estimates that follow the Deficit Conttrol Act directions for producing baselines.

The war on terrorism, the 2001 recession, the slow economic recovery from that recession, changes in policies (tax cuts; spending increases), and changes in the technical assumptions in the underlying budget-economic relationships contributed to the deterioration in the budget outlook since the expectations of large and growing surpluses from early in 2001.

Budget Estimates and Proposals

CBO's first budget report for FY2005, the *Budget and Economic Outlook: Fiscal Years 2005-2014* (January 2004), contained baseline estimates and projections for FY2004 through FY2014.[1] The report estimated a FY2005 deficit of $362 billion (down from an estimated $477 billion in FY2004). By FY2009, the baseline deficit estimate had fallen to $268 billion. Under the baseline assumptions, the CBO estimates increased discretionary spending at the rate of inflation, did not include extending the tax cuts, and allowed the alternative minimum tax (AMT) relief to expire as scheduled (which would then boost receipts).

The report also showed that under baseline assumptions the budget would remain in deficit through FY2013 ($16 billion). The baseline estimates showed a small surplus ($13 billion) in FY2014. The reduction in the deficit after calendar year 2010, leading to the small surplus, was largely explained by the expiration of major tax cuts (under the baseline assumptions) after calendar 2010, producing a revenue surge.

In March 2004, CBO released slightly revised baseline estimates that showed a small change to the FY2005 deficit (to $363 billion). The revised projections also showed a deficit of $15 billion in FY2014 instead of a surplus. The CBO September 2004 revisions showed a smaller ($348 billion) FY2005 baseline deficit and a larger FY2014 baseline deficit ($65 billion) than its earlier estimates.

CBO's budget reports generally include the estimated budgetary costs (including higher or lower debt service costs) of selected policies not included in the baseline estimates. These alternative policies have included the cost of extending expiring tax provisions, including interest costs (in CBO's January 2005 report estimates that this would increase the five-year (FY2005-FY2009) cumulative deficit by $103 billion, and by a cumulative $1.4 trillion over the 10-year period, FY2005-FY2014), reforming the alternative minimum tax (a $147 billion five-year cumulative increase in the deficit and by $430 billion over 10-years, FY2005-FY2014), and several alternative assumptions about the growth rate of discretionary spending (including defense) that ranged from a freeze in appropriations (a $184 billion cumulative five-year *decrease* in the deficit and a cumulative $1.0 trillion *decrease* in the deficit between FY2005 and FY2014) to increasing discretionary spending at the growth rate of nominal gross domestic product (GDP; a $236 billion five-year cumulative increase in the deficit and by $1.3 trillion for the full 10 years).

President Bush's FY2005 budget called for extending and making permanent a large number of the tax cuts adopted in 2001 and 2003. The Treasury's estimates (at that time) of the tax proposals produced a $213.3 billion revenue reduction (from Administration baseline estimates) between FY2005 and FY2009 and a $1,240.2 billion revenue reduction between FY2005 and FY2014. The Joint Committee on Taxation (JCT) estimated (March 3, 2004) that the President's tax proposals would reduce receipts by $226.7 billion between FY2005 and FY2009 and by $1,402.4

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[1] Baseline estimates are not meant to be predictions of future budget outcomes but instead are designed to provide a neutral measure against which to compare proposed policy changes. In general, they project current policy into the future. Discretionary spending is increased by the rate of inflation. Their construction generally follows instructions in the Balanced Budget and Emergency Deficit Control Act of 1985 (DCA) and the Congressional Control and Impoundment Act of 1974.

billion between FY2005 and FY2014. Most of the cost of extending the tax cuts would fall on the budget after FY2009.

The Administration modified its presentation of the current services baseline estimates (a change in the baseline estimates changes the reported size of the proposed policy changes). Instead of following the traditional method of constructing baseline estimates, the Administration's FY2005 current services baseline assumed the extension of certain tax provisions (that by current law are scheduled to expire), excluded the future cost of one time events, such as FY2004 emergency funding, and included a timing adjustment to the calculation of federal pay increases. For FY2005, the Administration's modified current services deficit estimate was $33 billion smaller than the traditional baseline estimate. By FY2009, the Administration's modified estimated baseline deficit is $60 billion smaller than the traditional baseline deficit estimate.

The Administration's budget provided a minimum amount of information beyond FY2009. The budget did include estimates of the cumulative proposed revenue changes and proposed mandatory spending changes for the periods FY2005 through FY2009 and FY2005 through FY2014, but it contained no information for the individual years after FY2009.

The Administration released revised estimates of the President's budget in the *Mid-Session Review* (July 30, 2004). In general, the revisions showed improvement in the budget outlook, with smaller deficits, a recovery in receipts, and somewhat higher outlays through FY2009. The net increase in receipts between the January and July estimates came from changes in economic assumptions and technical reestimates; most of the increase in outlays between the two estimates came from changes in policy. The President's FY2006 budget request (February 7, 2005) contained re-estimated FY2005 budget data. The revised deficit for FY2005 was larger (by $96 billion) than in its July 2004 mid-year report.

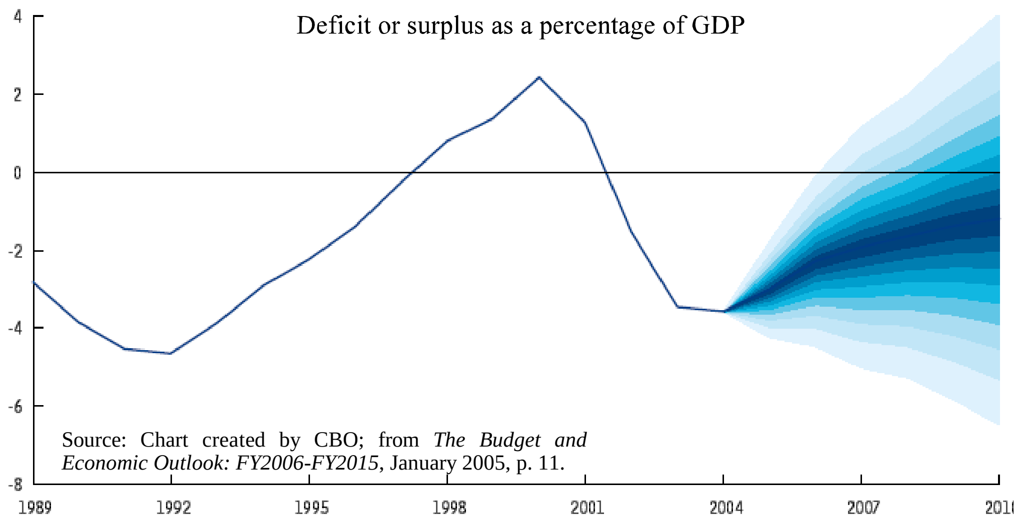
CBO included revised baseline budget estimates for FY2005 in its January 2005 budget report, *The Budget and Economic Outlook: Fiscal Years 2006-2015*. Both receipts and outlays are smaller and the deficit is larger than in CBO's September 2004 budget report (see Table 1). The baseline estimates do not reflect the Administration's January 2005 supplemental proposal for funds for Afghanistan and Iraq.

Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial variation over short time periods makes budget estimates and projections susceptible to fairly rapid and dramatic changes. The last couple of years have demonstrated this volatility. The original proposals and estimates for FY2002, made in early 2001, dramatically changed over the 20 to 21 months of congressional and presidential action on the budget. (The budget estimates in the OMB and CBO budget documents for five to 10 years in the future are subject to even greater variability.)

The early 2001 estimates for FY2002 estimated a *surplus* of $231 billion to $313 billion. The year ended on September 30, 2002 with a *deficit* of $158 billion. The September 2001 terrorist attacks on the United States, the legislation adopted in response, the bursting of the stock market bubble, the weak economy, and a shift in underlying budget relationships, all contributed to a large change in the year's budget outcome from the originally proposed or estimated amounts. There is little reason to expect this uncertainty to diminish substantially in current or future budget projections.[2]

Figure 1. Uncertainty in CBO's Projections of the Surplus or Deficit Under Current Policies



Note: 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.

Information in appendix A (The Uncertainties of Budget Projections) of CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2005-2014* (January 2004), indicated how greatly the budget outcome can be altered, especially over time (in this case over five years), by changes in economic and the related technical factors that underpin the budget estimates (CBO did not include a separate discussion of uncertainty in its January 2005 budget report.) The chapter contains a discussion of

[2] Some things are known with certainty about the direction of future spending and receipts. Demographics can partly determine the shape of future budgets. In the next decade, the beginnings of the retirement of the baby boom generation will rapidly drive higher the spending for Social Security and Medicare as well as other federal spending or tax breaks for the elderly. Because virtually all those who will become eligible for these benefits are alive today, estimating the growth in the populations eligible for these programs is relatively straightforward.

optimistic and pessimistic alternative scenarios for CBO's baseline projection. The optimistic scenario assumes more favorable economic and budget conditions than the baseline, while the pessimistic scenario assumes less favorable conditions than the baseline. CBO estimated that the 10-year cumulative optimistic and pessimistic baseline surpluses or deficits would be $8 trillion apart. According to CBO, two-thirds of the growth in the difference occurs in the last five years of the estimates. **Figure 1** is from CBO's January 2005 *Budget and Economic Outlook.* It represents the most likely budget outcomes clustered in the center, in the darkest part, of the figure. The lightest gray represents the less likely outcomes. The entire fan in FY2010 represents the range within which CBO predicts that the deficit or surplus will have a 90% chance of falling.

The President's (FY2005) budget included similar information in the chapter, "Comparison of Actual to Estimated Totals," in the *Analytical Perspectives* volume of the budget. The Administration used budget data from FY1982 to FY2003 to produce statistical measures of the differences between the estimated and actual surpluses or deficits over these years. According to the Administration's (February 2004) calculations, there would be a 90% chance that the FY2009 budget will have a deficit or a surplus that would fall within $500 billion above or below the Administration's (then) currently estimated deficit for that year. This produced a range of outcomes from a deficit of approximately $740 billion to a surplus of approximately $260 billion, within which the deficit or surplus has a 90% chance of falling.

Budget projections are very dependent on the underlying assumptions about the direction of the economy and expected future government policy and how these interact along with other factors (such as changing demographics) that affect the budget. Any deviation from the assumptions used in the budget estimates, such as faster or slower economic growth, higher or lower inflation, differences from the expected or proposed spending and tax policies, or changes in the technical components of the budget models can have substantial effects on moving the eventual budget outcomes away from the previous budget estimates and projections.

Budget Action

CBO and the Administration released their first budget reports for FY2005, in late January and early February 2004. CBO's report provided baseline estimates for fiscal years 2004 through 2014. OMB's documents provided estimates for FY2004 through FY2009 with a few instances of cumulative estimates for fiscal years 2004 through FY2014 (these were limited to revenues and mandatory spending and provided no data for the individual fiscal years after FY2009). The budget also lacked detailed data on program or account spending beyond FY2005. The *Analytical Perspectives* volume of the President's budget provided the Administration's current services baseline estimates for the years through FY2009.

On March 8, 2004, CBO released its estimates of the President's proposals and slightly revised baseline estimates in its report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2005*. The report recalculated the

Administration's proposals using CBO's underlying assumptions and estimating techniques. CBO also extended its projections of the Administration's proposals through FY2014. The CBO reestimates produced smaller deficits in FY2004 and FY2005 than in the President's budget.

By late February and early March 2004, the House and Senate Budget Committees began discussing the budget resolution for FY2005. The Senate Budget Committee (SBC) reported its version of the FY2005 budget resolution on March 5 (without a numbered report). The Senate considered the resolution (S.Con.Res. 95) the week of March 8 and, after amending the committee-adopted resolution, approved it on March 12.

The House Budget Committee (HBC) approved its version of the FY2005 budget resolution (H.Con.Res. 393; H.Rept. 108-441) on March 19, a week later than originally planned. Disagreements within the committee majority over components of the resolution delayed its consideration. The House approved the resolution, after rejecting several proposed alternatives, on March 25. The House substituted the text of H.Con.Res. 393 for the text of S.Con.Res. 95 on March 29 to facilitate the conference on the resolution.

A conference committee began its efforts to resolve the resolutions' differences on March 31. The most difficult issue became the differing pay-go requirements in the House and Senate resolutions. The House resolution required offsets for proposed increases in mandatory spending; the Senate resolution required offsets for both mandatory spending increases and revenue reductions. After a month and a half of efforts, the conference committee reported (H.Rept. 108-498) an agreement. The agreement reduced the resolution's coverage to one year from the five-year coverage in the resolutions adopted by the House and Senate. The pay-go rules were limited to the one year of the resolution and would expire on May 15, 2005. The reconciliation instructions in the agreement incorporated the cost ($22.9 billion revenue reduction and $4.6 billion in outlay increases) of extending three popular tax cuts — the marriage penalty relief, the increased child care credit, and the expanded 10% tax bracket that expire this year. The resolution accommodated another $27.7 billion in additional tax cuts that were not included in the reconciliation instructions.

The House passed the conference resolution on May 19. The House Rules Committee resolution allowing consideration of the conference resolution (H.Res. 649) included a provision putting the budget resolution, once adopted by the House, in effect for the House. This provided guidance to the Appropriations and other committees that must adopt legislation to implement the FY2005 budget.

Unsure that it had enough votes to adopt the resolution, the Senate leadership delayed Senate consideration of the conference agreement until early June. As June came and went and the summer recess (beginning July 24, 2004) approached, the conference report on the resolution remained unconsidered by the Senate. The Senate had still not considered the conference report as of the start of FY2005 on October 1, 2004.

The lack of a budget resolution for the year altered the way budget legislation (appropriations, tax cuts) moves through Congress. The House put in place instructions (through H.Res. 649) to treat the budget resolution conference agreement, once it passed the House, as if it had passed Congress. This provided a cap for discretionary spending ($821 billion, excluding a $50 billion reserve for Afghanistan and Iraq) and allocations of that amount among the 13 appropriation subcommittees.

In the Senate, the lack of a resolution initially left the appropriators working from the discretionary spending cap ($814 billion) for FY2005 included in last year's (FY2004) budget resolution (H.Con.Res. 95). In addition, without the tax-cut reconciliation instructions from an adopted budget resolution, tax cut legislation is open to amendment in the Senate. This difficulty was resolved with the enactment of the first appropriation (Defense) for FY2005 (see the next paragraph).

Congress passed the first of the 13 regular appropriations on June 22, 2004. The Defense appropriation (H.R. 4613; H.Rept. 108-622) provided $417.5 billion for the new fiscal year, including the Administration-requested $25 billion for operations in Afghanistan and Iraq (this $25 billion became immediately available for FY2004 upon enactment). The legislation, signed into law (P.L. 108-287) by the President on August 5, 2004, included a provision setting the discretionary spending limit at $821.4 billion in the Senate, the same amount used by the House.

Speculation began in July 2004 that a continuing resolution on appropriations (CR) or an omnibus appropriation would be needed before the start of FY2005. Either would provide funding for federal activities not other wise funded by a regular appropriation or by permanent funding. As time ran out in September, Congress passed (H.J.Res. 107) a CR on appropriations to fund otherwise unfunded federal activities at FY2004 levels (minus supplementals) through November 20, 2004. The President signed it into law (P.L. 108-309) on September 30.

Congress passed three more of the 13 regular appropriation bills during October 2004, but was unable to pass the remaining nine individually. Two more CRs (P.L. 108-416, November 11, 2004; P.L. 108-434, December 3, 2004) were adopted to provide Congress with the time needed to complete action on the FY2005 appropriations. In an after-elections session, Congress combined the remaining nine regular appropriations into one omnibus bill, using the Foreign Operations appropriation legislation (H.R. 4818) as the vehicle. The legislation passed Congress on November 20, 2004, and was signed by the President (P.L. 108-447; The Consolidated Appropriations Act, 2005) on December 8, 2004. The appropriations will provide approximately $837 billion in budget authority for FY2005.

Earlier, on September 23, Congress adopted legislation (H.R. 1308) extending over 20 expiring tax provisions. Most of the extensions run through December 2005, while several extend further into the future. The 10-year estimated cost of the bill was put at $146 billion. The President signed the legislation into law (P.L. 108-311) on October 4, 2004.

Outlays

The Administration's FY2005 budget (February 2004) proposed $2,400 billion in outlays for FY2005, rising to $2,853 billion in FY2009, the last year forecast in the President's budget. The Administration modified its method of calculating its current services baseline in this year's budget.[3] Under its modified assumptions, FY2005 baseline outlays would be $2,397 billion, rising to $2,847 billion in FY2009. Under the traditional method of calculating the baseline, current services baseline outlay estimates would rise from $2,442 billion in FY2005 to $2,952 billion in FY2009. The Administration's modified current services baseline estimates, when compared to the proposals, show smaller changes than the difference between the proposal and the traditional current services baseline estimates.

Table 2. Outlays for FY2004-FY2009 and FY2014

(in billions of dollars)

	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2014
CBO Baseline, 1/26/04	*$2,158* [a]	2,294	2,411	2,525	2,652	2,783	2,912	3,616
President's FY05 Budget, 2/2/04		2,319	2,400	2,473	2,592	2,724	2,853	—
President's FY05. Current Services, 2/2/04		2,319	2,397	2,468	2,583	2,715	2,847	—
Pres.'s FY05 DCA Current Services, 2/2/04		2,319	2,442	2,550	2,676	2,815	2,952	—
CBO, Revised Baseline, 3/8/04		2,296	2,414	2,528	2,658	2,791	2,924	3,635
CBO, EPP, 3/8/04		2,295	2,384	2,482	2,593	2,722	2,853	3,600
Senate, FY05 Budget Resolution, 3/12/04		2,295	2,367	2,469	2,582	2,698	2,815	—
House, FY05 Budget Resolution, 3/25/04		2,295	2,407	2,492	2,591	2,711	2,845	—
Conf., FY2005 Budget Resolution,		2,338	2,405	2,479	2,602	2,725	2,853	—
OMB, Mid-Session Rev. 7/30/04		2,319	2,423	2,500	2,623	2,762	2,895	—
OMB, Mid-Session Rev. CSB 7/30/04		2,319	2,400	2,489	2,611	2,749	2,886	—
CBO Update 9/04		2,293	2,442	2,577	2,714	2,849	2,985	3,713
CBO Baseline 1/25/05		*2,292* [a]	2,425	2,507	2,618	2,743	2,869	3,706
President's FY06 Budget, 2/05		—	2,479	2,568	2,656	2,758	2,883	—
President's FY06. Current Services 2/05		—	2,443	2,539	2,650	2,770	2,897	—

* The conference report (H.Rept. 108-498) passed the House on May 19, 2004, but was not considered in the Senate.
a. Actual outlays for FY2003 and FY2004.
DCA Current Services — Current Service Baseline estimates that follow the Deficit Control Act directions for producing baselines.
EPP — CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

The Administration's original proposals, if adopted, would have (under Administration estimates) raised outlays $81 billion (3.5%) above the Administration's FY2004 outlay estimate and $3 billion (0.1%) above its FY2005

[3] The current services baseline estimates like CBO's baseline estimates are designed to provide "a neutral benchmark against which policy proposals can be measured." For outlays, the modified baseline used this year assumes emergencies are one-time only, that federal pay adjustment assumptions reflect the (usual) January 1 start of inflation adjusted raises rather than October 1, and the debt service (interest payment) changes resulting from these (and revenue related) modifications to the baselines.

current services baseline outlay estimate.[4] The difference between the current services baseline outlay estimate and proposed outlays for FY2005 measures the "cost" of the Administration's proposed policies. The year-to-year change (the $81 billion increase) combines the effects of policy changes from year to year with the relatively automatic growth in large parts of the budget. These automatic increases include cost-of-living adjustments, growth in populations eligible for program benefits, and inflation driven cost of goods and services bought by the government. The President's budget did not include estimated costs of action in Afghanistan or Iraq after the end of FY2004, which produced a smaller initial outlay estimate than if estimates of these costs had been included. On May 12, 2004, the Administration requested $25 billion in additional defense funding for continuing operations in Afghanistan and Iraq. The amount requested was included in the enacted Defense appropriations (P.L.108-387; August 5, 2005).

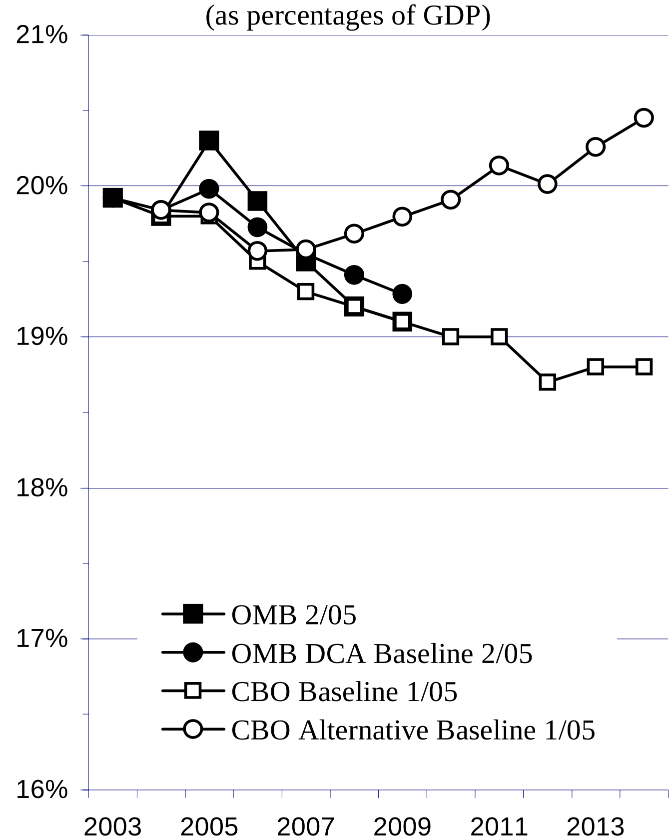
As shares of gross domestic product (GDP), the Administration's proposals showed outlays falling from 19.9% of GDP in FY2005 to 19.4% of GDP in FY2009. CBO's March 2004 estimate of the President's outlay proposals showed the shares falling from 19.7% of GDP in FY2005 to 19.6% of GDP for the fiscal years 2006 through 2010, before rising to 19.9% of GDP in FY2014. These outlays-as-shares-of-GDP are below both the average from FY1980 through FY2003 (21.1% of GDP) or the average from FY1990 through FY2003 (20.2% of GDP).

CBO's March 2004 revised *baseline* estimates showed outlays rising from 20.0% of GDP in FY2005 to 20.1% of GDP in FY2009 and remaining at that level through FY2014. Using one of CBO's alternative scenarios for spending, one that assumes discretionary outlays grow at the rate of nominal GDP growth rather than the lower rate of inflation, outlays would equal 20.1% of GDP in FY2005, rising to 21.0% of GDP in FY2009 and to 21.9% of GDP in FY2014.

OMB's *Mid-Session Review* (MSR; July 2004) indicated a modest increase

Figure 2. Outlays, FY2003-FY2014

(as percentages of GDP)



[4] The FY2005 outlay proposals would be $42 billion (1.7%) *below* the traditional formulation of the baseline.

in outlays for the five years forecast. Policy changes accounted for most of the increase in the estimate for FY2005, while reestimates of underlying policy produced most of the increases in subsequent years. Outlays as a share of GDP would fall from 19.8% in FY2005 to 19.1% in FY2009. Under the proposals in the MSR, combined outlays for defense and homeland security would grow by $26 billion over five years; nondefense, non-homeland security discretionary spending would fall by $1 billion over the same period; total mandatory spending would grow by $352 billion; and net interest would increase by $112 billion, over the same five years.

CBO's revised baseline estimates in its September 2004 *Update*, showed larger outlays than in the March baseline estimate for each of the 10 years in the forecast. Most of the change resulted from legislation adopted after the March report. The revisions did little to alter relative growth in the components of spending. Discretionary spending would increase the least, while mandatory and net interest outlays would increase the most, for both the FY2005-FY2009 and the FY2005-FY2014 periods.

The Administration's original proposals envisioned holding to almost zero growth (if not actual reductions) the non-defense, non-homeland security discretionary spending throughout the five year forecast. The OMB DCA baseline assumes that all discretionary spending will grow at the rate of inflation. For CBO, the baseline indicates that the slow dollar growth in discretionary spending will counter, to some extent, the growth in mandatory and net interest spending, and will reduce total outlays as a share of GDP. The CBO adjusted baseline adopts the assumption that discretionary spending will grow at the rate of GDP growth (faster) rather than the rate of inflation (slower), raising outlays as a share of GDP over the 10 years covered in the CBO report.

The January 2005 CBO budget report reduced, slightly (from $2,442 billion to $2,425 billion), estimated baseline outlays compared to its September 2004 estimates. CBO's new report estimated that outlays through FY2014 would be slightly smaller in each year than it had expected in its previous report. The President's FY2006 budget (February 2005) showed slightly larger outlays for the years FY2005 through FY2009 than it had estimated in July 2004. **Figure 2** shows OMB outlay estimates, both its proposals and its Deficit Control Act (DCA) baseline estimates, as percentages of GDP from the FY2006 budget through FY2009. The figure also includes CBO's baseline estimates (from January 2005) and its adjusted baseline that includes the assumption that discretionary spending grows at the rate of nominal GDP growth rather than at the rate of inflation. This adjusted baseline shows outlays, after FY2006, growing as a share of GDP. The other 3 estimates all show outlays declining as a share of GDP to levels below its recent historical average.

Receipts

The Administration's original FY2005 budget (February 2004) proposed extending and making permanent many of the tax cuts adopted in 2001 and 2003 that otherwise would expire (as scheduled) between now and 2010. These plus other proposals would reduce receipts by an Administration estimated $213 billion over FY2005 to FY2009 period and by $1,240 billion over the FY2005 to FY2014 period.[5] CBO's estimate of these proposals put the cost at $181 billion for the FY2005 through FY2009 period and $1,299 billion for the FY2005 through FY2014 period.[6]

Table 3. Receipts for FY2003-FY2009 and FY2014
(in billions of dollars)

	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2014
CBO Baseline, 1/31/03	*$1,782* [a]	$1,817	$2,049	$2,256	$2,385	$2,506	$2,644	$3,629
President's F005 Budget, 2/2/04		1,798	2,036	2,206	2,351	2,485	2,616	—
President's FY05 Current Services 2/2/04		1,791	2,037	2,215	2,354	2,497	2,636	—
Pres.'s FY05 DCA Current Services, 2/2/04		1,791	2,048	2,245	2,384	2,527	2,681	—
CBO, Revised Baseline, 3/8/04		1,817	2,050	2,255	2,384	2,505	2,643	3,620
CBO, EPP, 3/8/04		1,817	2,029	2,212	2,351	2,469	2,595	3,311
Senate, FY05 Budget Resolution, 3/12/04		1,817	2,026	2,217	2,359	2,481	2,615	—
House, FY05 Budget Resolution, 3/25/04		1,817	2,029	2,220	2,350	2,476	2,609	—
Conf., FY05 Budget Resolution, 5/19/04*		1,821	2,027	2,235	2,383	2,503	2,640	—
OMB, Mid-Session Rev. 7/30/04		1,874	2,091	2,239	2,391	2,534	2,665	—
OMB, Mid-Session Rev. Adj CSB 7/30/04		1,875	2,108	2,255	2,394	2,546	2,683	—
CBO Update 9/04		1,871	2,094	2,279	2,406	2,531	2,673	3,648
CBO Baseline 1/25/05		*1,880* [a]	2,057	2,212	2,357	2,508	2,662	3,847
President's F006 Budget, 2/2/04		—	2,053	2,178	2,344	2,507	2,650	—
President's FY06 Current Services 2/2/04		—	2,053	2,178	2,347	2,518	2,668	—

* The conference report (H.Rept. 108-498) passed the House on May 19, 2004, but was not considered in the Senate.
a. Actual receipts for FY2003 and FY2004.
DCA Current Services — Current Service Baseline estimates that follow the Deficit Control Act directions for producing baselines.
EPP = CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

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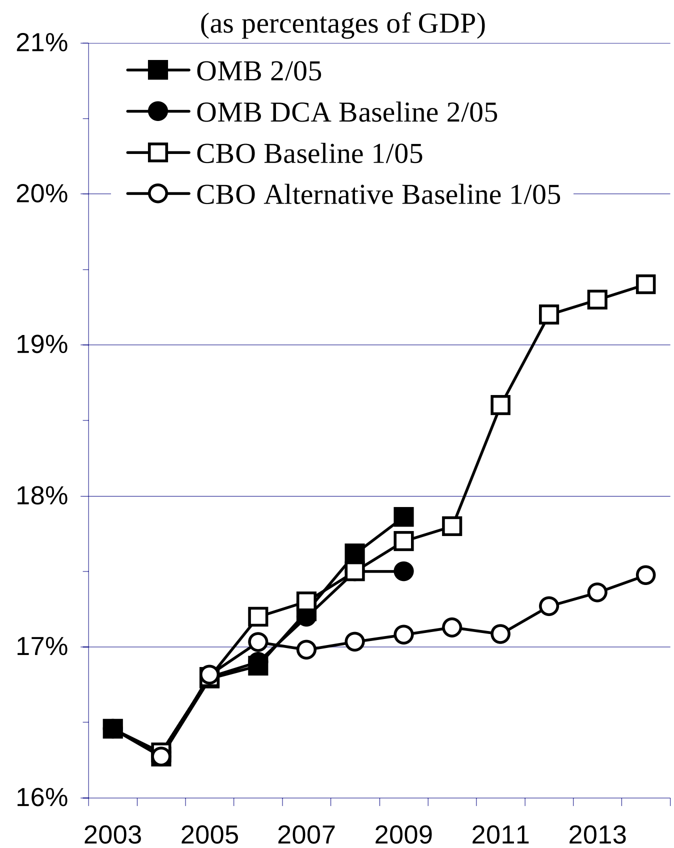
[5] These estimates are from the Treasury's *General Explanations of the Administration's Fiscal Year 2005 Revenue Proposals*. The President's budget showed a $175 billion revenue reduction (from baseline estimates) for the FY2005-FY2009 period and a $1,122 billion reduction for the FY2005-FY2014 period. The Treasury's estimates were produced after the release of the President's budget reflecting modifications to the proposals and adjustments to the estimates. See also the CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, and the CRS Issue Brief IB10110, *Major Tax Issues in the 108th Congress* for more information on the proposals.

[6] These amounts from CBO do not include the outlay effects of the extensions or other proposals.

Under the initial request, receipts would grow from an estimated $2,036 billion in FY2005 to $2,616 billion in FY2009. These increases would reverse the slump in receipts over the years FY2001 through FY2003. Receipts had reached their highest level both in dollars ($2,025 billion) and as a percentage of GDP (20.9% of GDP) in FY2000. By FY2003, receipts had fallen for three years in a row in both dollars (to $1,782 billion) and as a percentage of GDP (to 16.4%), with that share of GDP being the lower than in any year since FY1955. Receipts grew to $1,880 billion, but fell to 16.3% of GDP in FY2004. The Administration expected receipts in FY2005 to exceed, in dollars (but not as a percentage of GDP), receipts in FY2000..

Figure 3. Receipts, FY2003-FY2014



The Administration's proposals would extend the current middle class relief from the alternative minimum tax (AMT) for one year. Without a further extension, a growing number of middle class taxpayers will find themselves subject to the AMT. If further adjustments are not made, estimates indicate that the AMT, which affected a little over 600,000 taxpayers in 1997, could grow to 33 million taxpayers in 2010.[7] CBO estimated (September 2004) that providing extended or permanent AMT relief would reduce receipts by $136 billion between FY2005 and FY2009 and by $340 billion between FY2005 and FY2014.

The Administration reduced its FY2004 and FY2005 initial receipt estimates by $20 billion and $15 billion respectively, "in the interest of cautious and prudent forecasting."[8] The downward adjustment increased the resulting estimated deficits by $20 billion (in FY2004) and by $15 billion (in FY2005).

The CBO baseline and OMB's proposed and baseline estimates from early 2005 are fairly similar from FY2005 through FY2009 (see **Figure 3**). Receipts rise from

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[7] See CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg A. Esenwein, for a discussion of the AMT issue.

[8] OMB, *Budget of the U.S. Government for Fiscal Year 2003*, February 2004, *Analytical Perspectives*, p. 239.

a little over 16% of GDP in FY2004 to between 17.5% and 18.0% of GDP in FY2009. CBO's baseline, which incorporated the scheduled expiration of the tax cuts, extended the projections through FY2014. In the CBO baseline, receipts rise rapidly after FY2010 and reach 19.5% of GDP in FY2014 (generally from the effect on total receipts of the baseline assumption that the tax cuts will expire as currently required by law).

Using CBO's estimates of alternative revenue policies to remove the expiration of the tax cuts and to reform the alternative minimum tax (AMT) results in a much slower growth in receipts as a share of GDP (see the CBO alternative baseline in **Figure 3**).[9] Receipts still rise as a percentage of GDP, but by much less than the other three estimates. By FY2009, receipts are just over 17% of GDP, a level below most years since the 1950s (when the role of the government was quite different). By FY2014, the adjusted receipts rise to 17.5% of GDP, below most years since the mid-1970s (except for recession years).

The 2004 mid-year budget reports from both OMB and CBO contained higher receipt estimates than in their earlier budget reports. Mostly these increases resulted from technical reestimates and changes in the economic outlook rather than any changes in policy. CBO's January 2005 baseline receipt estimates are similar over the FY2005 through FY2014 to those in its mid-year (September 2004) baseline estimates. OMB's FY2006 budget's receipt estimates are slightly smaller in each year, between FY2005 and FY2009 than it estimated in its July 2004 report.

Deficits (and Surpluses)

Deficits and surpluses are the residuals left after Congress and the President set policies for spending and receipts. Surpluses, in which receipts are greater than outlays, reduce federal debt held by the public which can lead to lower net interest payments (among other effects); deficits, in which outlays exceed receipts, increase government debt held by the public, generally increasing net interest payments (assuming no change in interest rates). Reducing the deficit and eventually reaching a balanced budget or generating and keeping a surplus (the government had its first surplus in 30 years in FY1998) was a major focus of the budget debates in the late 1980s and throughout the 1990s.

The President's FY2005 budget proposals included an estimated deficit of $521 billion in FY2004 falling to $364 billion in FY2005. The deficit would fall to an estimated $237 billion in FY2009, which would fulfill the Administration's pledge of reducing the deficit by half (starting from the FY2004 estimated deficit). Most of the deficit's fall would occur between FY2004 to FY2006, after which it shows relatively little change (in dollars). The February budget showed the deficit falling from 4.5% of GDP in FY2004, to 3.0% of GDP in FY2005, and to 1.6% of GDP in FY2009, under the Administration's policies and assumptions.

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[9] CBO indicates in its *Update* that combining the reform of the AMT and the tax extenders produces an interactive effect that makes the combined loss greater than the sum of the two estimates separately.

The success of the Administration's deficit reduction efforts depended (and depends) heavily on what many observers consider unrealistic constraints and reductions in nondefense discretionary spending. The continuing growth in entitlements and net interest, along with the limits on taxation, have left nondefense discretionary spending, approximately one-sixth of the budget, bearing much of the Administration's and Congress's deficit reduction burden.

Table 4. Surpluses/Deficits(-) for FY2005-FY2009 and FY2014

(in billions of dollars)

	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2014
CBO Baseline, 1/26/04	*-375* [a]	-477	-362	-269	-267	-278	-268	13
President's F05 Budget, 2/2/04		-521	-364	-268	-241	-239	-237	—
President's FY05 Current Services 2/2/04		-528	-360	-253	-229	-218	-211	—
Pres.'s FY05 DCA Current Services,		-528	-393	-305	-292	-288	-271	—
CBO Revised Baseline 3/8/04		-477	-363	-273	-274	-286	-281	-15
CBO EPP 3/8/04		-478	-356	-270	-242	-252	-258	-289
Senate, FY05 Budget Resolution, 3/12/04		-477	-341	-252	-223	-217	-200	—
House, FY05 Budget Resolution, 3/25/04		-478	-378	-272	-240	-236	-235	—
Conf., FY05 Budget Resolution, 5/19/04*		-474	-367	-255	-194	-186	-174	—
OMB, Mid-Session Rev. 7/30/04		-445	-331	-261	-233	-228	-229	—
OMB, Mid-Session Rev. CSB 7/30/0		-444	-292	-234	-217	-204	-202	—
CBO Update 9/04		-422	-348	-298	-308	-318	-312	-65
CBO Baseline 1/25/05		*-412* [a]	-368	-295	-261	-235	-207	141
President's FY06 Budget, 2/05		—	-427	-390	-312	-251	-233	—
President's FY06 Current Services 2/05		—	-390	-361	-303	-251	-229	—

* The conference report (H.Rept. 108-498) passed the House on May 19, 2004, but was not considered in the Senate.
a. Actual receipts for FY2003 and FY2004.
DCA Current Services — Current Service Baseline estimates that follow the Deficit Control Act directions for producing baselines.
EPP — - CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

CBO's January 2004 baseline estimates had the budget returning to surplus in FY2014 ($13 billion). CBO's baseline revisions in March 2004 showed a slight slowing in the budget's improvement (because of technical factors) and eliminated the forecast of a small surplus in FY2014, leaving instead a small deficit of $15 billion.

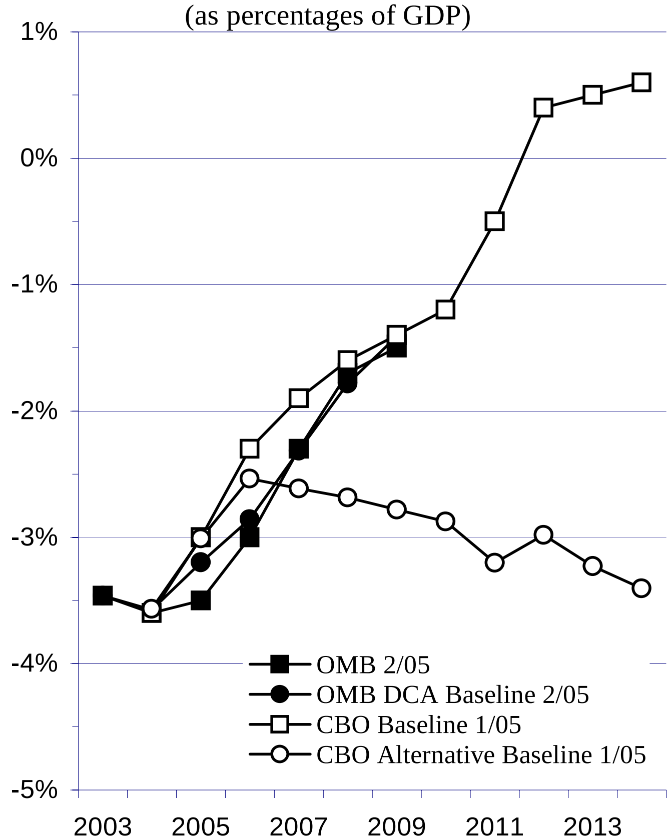
CBO's estimates of the President's proposals put the FY2004 deficit at an estimated $478 billion and the FY2005 deficit at an estimated $356 billion. The reestimates had a FY2009 deficit of an estimated $258 billion, somewhat less than the 50% reduction in the deficit claimed by the Administration. CBO's revised March baseline had little change in the near-term, in FY2004 and FY2005, from its January estimates. The changes, although not large in dollars, for the final years of the projections (FY2011 through FY2014) were large enough to eliminate the possibility of the earlier projected baseline surplus in FY2014. The March revisions forecast the deficit falling from 4.2% of GDP in FY2004 to 3.0% of GDP in FY2005, to 1.9% of GDP in FY2009, and to 0.1% of GDP in FY2014.

The mid-year budget reports from OMB (July 2004) and CBO (September 2004) reduced the deficit estimates between FY2004 and FY2009, but increased CBO's baseline estimates between FY2010 and FY2014 (see **Table 4**). OMB's July 2004 deficit estimates as shares of GDP fell below the February estimates by greater amounts in FY2004 and FY2005 than in subsequent years. CBO's September 2004 baseline deficit estimates, as shares of GDP, were smaller than its March estimates for FY2004 through FY2007 and larger for the remaining years in its projection (through FY2014).

Incorporating selected CBO alternative policies (to reflect faster discretionary spending growth, extending the tax cuts, reforming the AMT, and incorporating the increased debt servicing costs), results in deficit estimates that increase as a percentage of GDP after FY2006 and through FY2014. **Figure 4** shows the deficit estimates from OMB (policy and baseline) and CBO (baseline and alternative) from their early 2005 reports as percentages of GDP. The scheduled expiration of many of the tax cuts by or before 2010 produces the rapid shrinkage in the CBO baseline deficit projection after FY2009. OMB's policy and baseline forecasts are similar to each other over their five years.

Figure 4. Deficit(-)/Surpluses, FY2003-FY2014

(as percentages of GDP)



CBO's January 2005 budget report raised its deficit estimate to $368 billion, for FY2005, $20 billion above its September 2004 estimate. For all subsequent years, CBO's deficit estimates from January 2005, are smaller (leading to a $141 billion surplus in FY2014) than in its September 2004 estimates. The comparison between these two CBO estimates is misleading. Because of the rules that CBO must follow in constructing its baseline, the September 2004 baseline estimates included, in each year in the forecast, an extrapolation of the supplemental funding provided for FY2004. The January 2005 estimates did not include the FY2004 supplemental funding and with no supplemental funding for FY2005, so far, the new estimates show smaller outlays and a smaller deficit throughout the forecast period. According to CBO, including the supplementals in the September forecast raised the cumulative deficit by $1.4 billion. CBO adjusted the September and January estimates to make them comparable. The result lowered the cumulative (FY2005 through FY2014) deficit estimate by $500 billion in the September estimates. This change indicates that, instead of showing an improvement in the budget outlook from the September to January estimates, the outlook has actually deteriorated (see Figure 5).[10]

Compared to the September 2004 CBO budget report, the January 2005 CBO budget report showed smaller deficits through FY2011, followed by growing surpluses through FY2015. Part of the changed outlook came from the change in the year on which the baseline is built. The change moved the base year from FY2004 for the September report to FY2005 in January report. Supplemental appropriations for defense for FY2004 were included in the baseline estimates for FY2005 through FY2014 in CBO's September 2004 budget report. In CBO's January 2005 report, with no defense supplementals yet adopted for FY2005, the baseline estimates are based on the regular appropriations adopted for FY2005 in during 2004 (calendar year). The difference between the assumptions produced a smaller 10-year cumulative deficit, by $1.4 trillion, in January 2005 compared to the September 2004 baseline estimates..[11] As CBO notes in its January 2005 budget report, the January baseline estimates may appear to be an improvement over CBO's previous baseline from September 2004. Once the differences in certain policy assumptions are removed, there is no improvement in the budget outlook. According to CBO (in its January 2005 report — see pages 1-2), "under identical assumptions about spending on Iraq, Afghanistan, and other activities related to the war on terrorism, the current baseline outlook [January 2005] is less favorable than the one presented in September [2004]..." [12] This is illustrated in Figure 5. The line labeled CBO Baseline Excluding Supplementals 9/04 represents the September 2004 estimates reformulated to match the war on terror assumptions in the January 2005 baseline. The January baseline estimate has a larger deficit in each year in the forecast than does the reformulated September baseline estimate, indicating a slight worsening in the budget outlook, according to CBO.

CBO's Alternative Policies Not Included in the Baseline

CBO's January 2004 budget report included estimates of the "budgetary effects of policy alternatives not included in CBO's baseline." Some of the alternatives policies were those that may have been considered or may have more accurately reflected budget experience than the Deficit Control Act (DCA) baseline instructions that CBO must follow. They include extending expiring tax provisions, the reform of the alternative minimum tax (AMT), and four variations on the growth of discretionary spending.

Most of the alternative policies would be fairly costly when compared to CBO's baseline, running from $96 billion in lower receipts extending expiring tax provisions from FY2005 through FY2009 to $220 billion in higher outlays for increasing discretionary spending at the rate of GDP growth. These amounts do not include the higher interest costs

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[10] See Table 1-1 in CBO's January 2005 report, *The Budget and Economic Outlook: FY2006-FY2015.* The beginning of chapter 1 in this report discusses this adjustment.

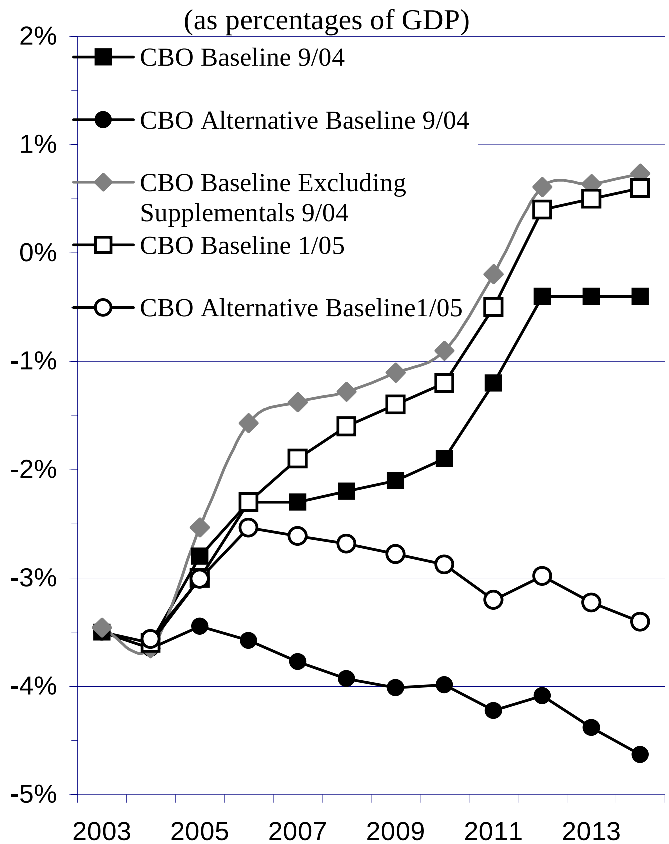
[11] The baseline statutes require that CBO extrapolate all discretionary funding from the most recent fiscal year in creating its baseline estimates. The September 2004 CBO report (produced near the end of FY2004) used FY2004 funding, including supplemental funding for Afghanistan and Iraq; the January 2005 report used already adopted funding for FY2005, which does not yet include any supplemental funding for Afghanistan and Iraq.

[12] CBO, *The Budget and Economic Outlook: FY2006-FY2015*, January 2005, pp. 1-2.

associated with larger deficits and debt.[13] The same report indicated that freezing discretionary spending at the FY2005 level would *reduce* spending by an estimated $172 billion for the FY2005 through FY2009 period compared to the baseline estimates over the same years. **Figure 5** shows the CBO baseline deficit and incorporating the costs of alternative policies for extending the tax cuts, reforming the AMT, and increasing discretionary spending at the rate of GDP growth (as percentages of GDP) from CBO's January 2005 and September 2004 budget reports.

The costs or savings of the alternatives become substantially larger over the 10 years, FY2005 through FY2014, rather than the five years, FY2005 through FY2009. CBO's January 2005 report estimated that extending expiring tax provisions for the 10-year period would increase the cumulative deficit by $1.3 trillion (with another $156 billion in higher interest costs). Most of that, $1.2 trillion (and $149 billion in higher interest costs), occurs in the second five years, FY2010 through FY2014. Reforming the alternative minimum tax over the 10 years would cost an estimated $347 billion plus another $83 billion in interest costs. Of the total 10 year cost, $210 billion (plus $73 billion in interest costs) falls in the second five years.

Figure 5. Alternative Deficits(-)/Surpluses, FY2003-FY2014



Increasing discretionary spending at the rate of nominal GDP growth produced a 10-year $1.2 trillion cumulative increase in the deficit (plus another $191 billion in debt service costs) in CBO's January 2005 report. Most of the cumulative increase, $934 billion, would take place in the second five years of the10-year period. The amounts for these alternatives for the five and ten-year periods from the January 2005 CBO report are shown in **Table 5**.

[13] These two policies would produce an estimated e $7 billion and $16 billion in interest costs respectively.

Table 5. The Cumulative Effects of CBO's Policy Alternatives Not Included in CBO's Baseline for Selected Time Periods

(In Billions of Dollars)

	Total, 2005-2009	Total, 2010-2014	Total, 2005-2014
Policy Alternatives That Affect Discretionary Spending			
Assume Phasedown of Activities in Iraq and Afghanistan and Continued Spending for the Global War on Terrorism[a]			
Effect on the deficit	-285	-135	-420
Debt service	-35	-109	-144
Increase Total Discretionary Appropriations at the Growth Rate of Nominal GDP			
Effect on the deficit	-220	-934	-1,154
Debt service	-16	-175	-191
Freeze Total Discretionary Appropriations at the Level Provided for 2005			
Effect on the deficit	172	726	898
Debt service	12	137	149
Policy Alternatives That Affect the Tax Code			
Extend Expiring Tax Provisions[b]			
Effect on the deficit			
EGTRRA and JGTRRA	-41	-988	-1,029
Other	-52	-190	-242
Total	-96	-1,178	-1,274
Debt service	-7	-149	-156
Reform the Alternative Minimum Tax[c]			
Effect on the deficit	-137	-210	-347
Debt service	-10	-73	-83
Memorandum:			
Cumulative Deficit (-) or Surplus in CBO's Baseline	-1,366	2	-1364

Sources: Congressional Budget Office; Joint Committee on Taxation.

Notes: EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003; * = between -$500 million and $500 million.

Positive amounts indicate a reduction in the deficit or an increase in the surplus. "Debt service" refers to changes in interest payments on federal debt resulting from changes in the government's borrowing needs.

a. This alternative assumes an eventual slowdown of U.S. activities in Iraq and Afghanistan but continued spending for the global war on terrorism throughout the 10-year period. It also includes funding for domestic military operations for homeland security.

b. This estimate does not include the effects of extending the increased exemption amount for the alternative minimum tax, which expires in December 2005. The effects of that alternative are shown below.

c. This alternative assumes 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, is indexed for inflation after 2005. The estimates are shown relative to current law. If this alternative was enacted jointly with the extension of expiring tax provisions, an interactive effect would occur that would make the combined revenue loss greater than the sum of the two separate estimates by about $247 billion (plus $24 billion in debt-service costs) over the 2006-2015 period.

The Longer Run

Over a longer time period, one beginning in the next decade and lasting for decades into future, both CBO and the Administration indicate (in their respective budget documents) that they expect, under existing policies and assumptions, that demographic pressures will produce large and persistent deficits. CBO states

> The aging of the baby-boom generation will cause a historic shift in the United States' fiscal position in the decades beyond CBO's projection period. Over the next 30 years, the number of people ages 65 and older will double... costs per enrollee in federal health care programs are likely to continue growing much faster than inflation. CBO projects that [these factors] will cause federal spending for Social Security, Medicare, and Medicaid combined to increase (even under moderate growth assumptions) by more than two-thirds as a share of the economy — from more than 8 percent of GDP in 2004 to over 14 percent in 2030 and almost 18 percent in 2050.
>
> Those budgetary pressures will ultimately require choices involving some combination of a substantial reduction in the growth of federal spending, an increase in taxation — possibly to levels unprecedented in the United States — and a dramatic boost in federal borrowing.... economic growth alone is unlikely to bring the nation's longer-term fiscal position into balance — making reform of programs for the elderly or substantial tax increases (or both) necessary.[14]

OMB echoed the CBO comments in the President's budget documents. The document included the comments that

> Social Security and Medicare are critical programs for ensuring the financial security and health of elderly Americans ... Unless these programs are reformed however, over the long run they will overwhelm the rest of the budget and place an unsustainable burden on future generations.
>
> Although projections of the budget over the next few decades and beyond are subject to enormous uncertainty, fundamental forces are at work that will create serious fiscal problems if left unaddressed.
>
> The main source of the long-run fiscal problem is demographics. As Americans live longer and the birth rate falls, the ratio of workers to retirees is decreasing....
>
> Because the Nation's two largest entitlement programs, Social Security and Medicare, are based in large part on the principle that current workers pay the benefits of retirees, these programs are heavily influenced by this decline in the ratio of workers to retirees.... In the next several decades, however, the impact of lower birth rates and longer life expectancy will begin to take a visible toll on both Social Security and Medicare....
>
> The result of this demographic shift is a steady worsening of the finances of the Social Security and Medicare programs....[15]

The short-term budget outlook can change when it is buffeted by economic or policy changes. As indicated by both CBO and OMB, the long-term budget outlook is expected to

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[14] CBO, *The Budget and Economic Outlook: Fiscal Years 2005-2014*, Jan. 2004, p. 8-9.

[15] OMB. *Budget of the United States Government for Fiscal Year 2005*, Feb. 2004, p.38-39.

be dominated by the rapid spending growth for Social Security, Medicare, Medicaid, and other programs for the elderly, as the baby boom generation begins retiring in large numbers in the next decade. Not only will these programs be affected, but their constant growth will put great stress on the rest of the budget, the government's ability to finance its obligations, and the ability of the economy to provide the resources needed. The tax cuts and spending increases of the last few years have not produced the grim fiscal future, but they appear to have made a solution more difficult.

The Budget and the Economy

The budget and the economy affect each other unequally. Small economic changes have a more significant effect on the budget than the effect large policy changes have on the economy. The worse-than-previously-expected economic conditions that lasted from 2001 into 2003, played a substantial role, directly and indirectly, in the deterioration of the budget outlook over those years. The rebound from that slower-than-normal growth results, according to CBO, in expectations of faster than normal growth in 2004 and 2005. For the period 2006 through 2014, CBO projects that real gross domestic product (GDP) will grow about as fast as potential GDP.[16]

Under governmental policies that are in fiscal balance, a return to economic growth that is close to the growth of potential GDP should reduce or eliminate a deficit or produce a surplus. In both the President's budget and in CBO's budget reports, the budget under current policies experiences a shrinking deficit and, under CBO's January 2005 baseline, moves into surplus in FY2012. Under the CBO alternative policies, the deficit grows as a percentage of GDP; it does not shrink or disappear, during a period of expected normal economic growth. This result implies that the budget has a basic fiscal imbalance that cannot be eliminated by economic growth. To produce a balanced budget or one in surplus will require spending reductions or tax increases.

The last, extremely positive budget outlook was forecast in early 2001 and was substantially based on the favorable future economic conditions that were then expected, along with government policies that were in approximate balance if not favoring surpluses. That outlook expected a continuation in the overall improvement of the budget situation that had occurred since the early 1990s. Much of the improvement in the 1990s had come from strong and sustained economic growth (and the rest from policy changes to reduce the deficit). When those favorable economic conditions faltered, so did the string of positive forecasts for the budget outlook. What good economic conditions give, bad economic conditions can take away. The unexpectedly lengthy economic weakness (into 2003), the start of a recession in March 2001, the lengthy fall in the stock market, the policy responses to the September 2001 terrorist attacks, along with negative changes in the technical components of the budget estimates, raised outlays, reduced receipts (beyond policy changes), and eliminated the previously expected surpluses.

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[16] Potential GDP represents an estimate of what GDP would be if both labor and capital were as fully employed as is possible.

For Additional Reading

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