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The Budget for Fiscal Year 2006

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Summary

CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2006-2015* (January 25, 2005), included baseline estimates (assuming current policies) for FY2005 through FY2015. Under the baseline assumptions, CBO estimates a FY2006 deficit of $295 billion (2.3% of gross domestic product — GDP). This is smaller than CBO's FY2005 baseline deficit estimate ($368 billion, 3.0% of GDP). CBO's baseline estimates do not include assumptions about possible future legislation that may increase or decrease spending or receipts, and therefore change the deficit. The baseline assumptions assume the continuation of current law, including that laws changing the level of future revenues or outlays, will go into effect as scheduled. Therefore, CBO's revenue estimates include the assumption that the tax cuts of 2001 and 2003 will expire as scheduled in 2010, reverting the tax code to pre-tax cut levels.

The President presented his FY2006 budget, containing proposals and estimates for FY2006 through FY2010, on February 7, 2005. It included a deficit estimate of $390 billion (3.0% of GDP) in FY2006, and steadily declining deficits through FY2010. The budget did not include estimates of the cost of the war on terror beyond FY2005. It did not include cost estimates of the Administration's proposals for Social Security change. It did include proposals that, over five years would: reduce spending among the nondefense domestic discretionary programs in inflation adjusted terms; slow the growth in defense spending and make some cuts in specific parts of defense; slow the growth in selected areas of mandatory spending, including Medicaid; and further cut taxes and make permanent the 2001 and 2003 tax cuts, the effects of which do not appear in a significant way within the years covered by the budget.

CBO's preliminary estimate of the President's policy proposals includes a smaller deficit ($332 billion, 2.6% of GDP) and slightly larger revenues and slightly smaller receipts than in the President's budget. Although the pattern of spending and receipts varies some between the Administration and CBO reestimates, their cumulative amounts for receipts, outlays, and the deficit for the FY2006 through FY2010 period are very similar.

Both the House and Senate Budget Committees (HBC, SBC) adopted their respective budget resolutions for FY2006 during the week of March 7, 2005. They generally followed the Administration's lead, but differences exist between the two resolutions and between the resolutions and the President's budget. The HBC proposes a deficit of $376 billion for FY2006; the SBC proposes a deficit of $362 billion. Both fall below the $390 billion deficit in the President's budget.

This report will be updated as events warrant.

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Background and Analysis

Presidents submit their budget proposals for the upcoming fiscal year (FY) early in each calendar year. The Bush Administration released its FY2006 budget (*The Budget of the U.S. Government, Fiscal Year 2006)* on February 7, 2005. The multiple volumes contain general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2006 through FY2010. It contained limited information on the revenue and mandatory spending changes after 2010, 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

CBO released its baseline budget report (*The Budget and Economic Outlook: Fiscal Years 2006-2015*) on January 25, 2005. The baseline estimates, according to statute, incorporate current government policy, including any already-enacted future policy changes — such as the expiration of many of the 2001 and 2003 tax cuts at the end of the decade. The baseline estimates are *not* meant to be CBO's estimate concerning the budget in the future, since they are constrained by current policy assumptions.[1] The Administration, through the Office of Management and Budget

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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 and enacted future changes into the future. Discretionary spending is increased by the rate of inflation. Their construction generally (continued...)

(OMB), presented the President's budget to Congress and the public on February 7, 2005. The President's budget incorporates most of the President's proposals, but does not contain the details of his proposals to change Social Security and future costs of the war on terror. The House and Senate Budget Committees adopted their versions of the budget resolution for FY2006, during the week of March 7.

Budget Totals

Table 1 contains budget estimates for FY2006 from the Congressional Budget Office (CBO) and the Administration (the Office of Management and Budget, OMB); revisions produced by both 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 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 are generally expected to change over time from those originally proposed or estimated by the President, CBO, or Congress.

Table 1. Budget Estimates for FY2006

(in billions of dollars)

	Receipts	Outlays	Deficit (-)/ Surplus
CBO, BEO Baseline, 1/05	$2,212	$2,507	$-295
OMB, Budget Proposals, 2/05	2,178	2,568	-390
OMB, Budget, Current Services Baseline, 2/05	2,178	2,539	-361
CBO, Revised Baseline, 3/05	2,212	2,510	-298
CBO, Preliminary EPP 3/05	2,210	2,542	-332
House Budget Committee, 3/05	2,195	2,571	-376
Senate Budget Committee, 3/05	2,197	2,552	-362

BEO — The *Budget and Economic Outlook,* CBO.
EPP — CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

Budget Estimates and Proposals

CBO's first budget report for FY2006, the *Budget and Economic Outlook: Fiscal Years 2006-2015* (January 2005), contained baseline estimates and projections for FY2005 through FY2015. The report estimated a FY2006 deficit of $295 billion (down from an estimated $368 billion in FY2005). By FY2010, the baseline deficit estimate had fallen to $189 billion. Under the baseline assumptions, the CBO

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[1] (...continued)
follows instructions in the Balanced Budget and Emergency Deficit Control Act of 1985 (DCA) and the Congressional Control and Impoundment Act of 1974.

estimates increase discretionary spending at the rate of inflation, do not include extending the 2001 and 2003 tax cuts after 2010, and allow the alternative minimum tax (AMT) relief to expire as currently scheduled. The effects of these assumptions increase receipts because of the reversion of the AMT to previous law in the near-term and by substantial amounts after FY2010 with the current law expiration of most of the tax cuts from 2001 and 2003. The baseline estimates have historically understated the growth in discretionary outlays and, similarly, this year, are likely to understate the size of the deficit and its persistence.

The CBO baseline assumptions show the budget remaining in deficit through FY2011 ($80 billion) with surpluses through FY2015 ($141 billion). The reduction in the deficit after calendar year 2010, leading to the surpluses, is largely explained by the required inclusion of the expiration of major tax cuts after calendar 2010 in the baseline estimates, producing a rapid increase in revenues.

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 that may better represent actual future policy, such as making the tax cuts permanent and fixing the AMT problem. In CBO's report, making the tax cuts permanent increases the five-year (FY2006-FY2010) cumulative deficit (including higher debt service costs) by $156 billion, and by a cumulative $1.9 trillion over the 10-year period, FY2006-FY2015). CBO's estimate of reforming the alternative minimum tax is a $218 billion five-year cumulative increase in the deficit and a $503 billion increase over 10 years, (FY2006-FY2015). If discretionary spending grows at the rate of GDP, rather than at the rate of inflation, the five-year cumulative deficit increases by $378 billion and the 10-year cumulative deficit increases by $1.7 trillion. Freezing discretionary appropriations at the FY2005 level would *reduce* the five-year cumulative deficit by $294 billion and the 10-year cumulative deficit by $1.3 trillion.

President Bush's FY2006 budget called for extending and making permanent most of the tax cuts adopted in 2001 and 2003. The budget showed this reducing receipts by $53 billion between FY2006 and FY2010 and by $1.1 trillion between FY2006 and FY2015 (these estimates do not include the resulting higher debt service costs resulting from the change). The Administration's total receipt proposals would reduce five-year receipts by $106 billion and 10-year receipts by $1.3 trillion.

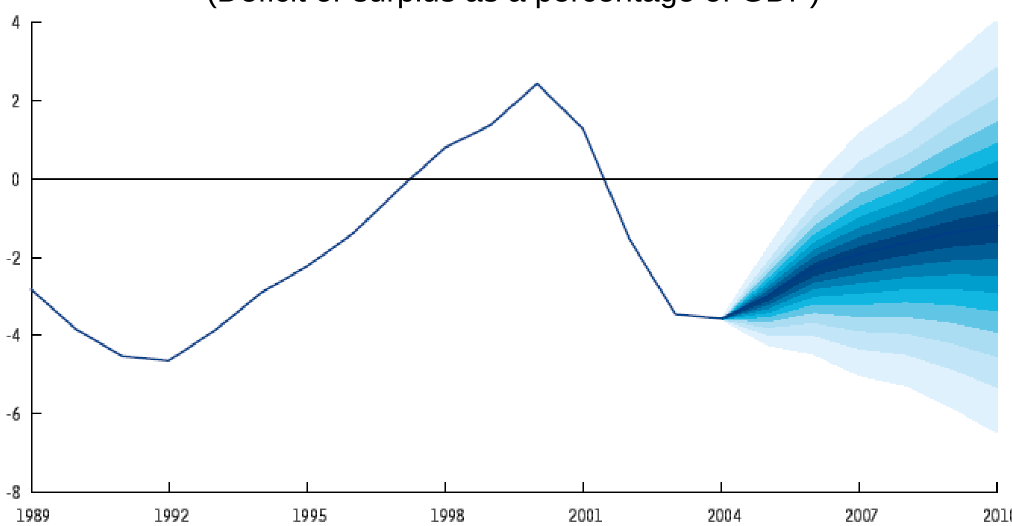
The Administration again this year, used a slightly modified set of assumptions to produce the OMB current services baseline estimates, moving the estimates closer, by a very small amount, to the proposed budget levels. Instead of following the traditional method of constructing baseline estimates, the Administration's FY2006 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, and included a timing adjustment to the calculation of federal pay increases. For FY2006, the differences produced an Administration current services baseline deficit estimate $9 billion smaller than the traditional baseline estimate. By FY2010, the Administration's estimated baseline deficit is $16 billion smaller than the traditional baseline deficit estimate.

The Administration's budget provided a limited amount of information beyond FY2010. The budget did include estimates of the cumulative proposed revenue changes and proposed mandatory spending changes for the periods FY2006 through FY2010 and FY2006 through FY2015, but it contained no information for the individual years after FY2010.

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.[2] Small changes in economic conditions, particularly the rate of GDP growth, from those used in the estimates, can have large changes on the budget estimates. A persistent 0.5% increase in the growth rate of real GDP would reduce the deficit (including interest costs) by $575 billion cumulatively over a five-year period. This change would reduce the cumulative deficit by $1.3 trillion over the next 10 years. Reductions in the rate of growth would increase the deficit by similar amounts over the same time periods.

Figure 1. Uncertainty in CBO's Projections of the Surplus or Deficit Under Current Policies
(Deficit or surplus as a percentage of GDP)



Source: Chart created by CBO; from The Budget and Economic Outlook: FY2006-FY2015, January 2005, p. 11.

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

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[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 growing retirements in 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.

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% that actual deficits or surpluses will fall in the darkest area and 90% 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.

Figure 1 (on the previous page) is from CBO's January 2005 *Budget and Economic Outlook*. CBO indicates that the most likely deficit or surplus outcomes (as percentages of GDP), through FY2010, are clustered in the center of the figure, in the darkest area. The lighter shades indicate the less likely outcomes. The distance from the top to the bottom of the image in the chart (the fan) represents the range within which CBO predicts that the deficit (or surplus) has a 90% chance of occurring. In FY2010 this ranges from a surplus of 4% of GDP to a deficit of 5% of GDP.

The President's (FY2006) budget included a chapter in the *Analytical Perspectives* volume titled "Comparison of Actual to Estimated Totals." The chapter examines the causes of the changes from the initial budget estimates for FY2004 through the actual results for that year. Like the CBO information, this provides another example of the uncertainty surrounding budget estimates. The chapter includes a chart based on historical experience, that indicates the possible range of budget balance (surplus or deficit) outcomes with a 90% certainty. The range for the current and following year (which the Administration calls the budget year) rise from $256 billion to $548 billion.[3] By five years beyond the current year, the range exceeds $1 trillion.

Budget projections are very dependent on the underlying assumptions about the direction of the economy, 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 the budget estimates and projections.

Budget Action

CBO and the Administration released their first budget reports for FY2006, in late January and early February 2005, respectively. CBO's report provided baseline estimates for fiscal years 2005 through 2015. The CBO baseline estimates, following the instructions mandated by law, did not include any estimated cost for ongoing operations in Afghanistan and Iraq after FY2005 or any estimates of the Administration's proposed, but undefined change in Social Security. The estimates assumed that the tax cuts adopted over the Administration's first term will expire in 2010 as required by current law and that the Alternative Minimum Tax (AMT) will

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[3] The current year is the fiscal year we are in, 2005. The budget year is the year that the President has proposed a budget for, 2006, and which Congress will pass legislation to implement.

revert to its previous incarnation when the temporary relief provisions expire at the end of FY2005. Some alternative assumptions about likely future policy might produce a more accurate estimate of the budget's future than the straight baseline estimates.

OMB's documents provided estimates for FY2005 through FY2010 with a few instances of cumulative estimates for FY2006 through FY2015 (these were limited to revenues and mandatory spending and provided no data for the individual fiscal years after FY2010). 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 FY2010.

On March 4, 2005, CBO provided its preliminary estimates of the President's 2006 budget. CBO takes the policies in the Administration's budget and recalculates the effect of those policies using CBO's underlying assumptions and budget estimating methods. CBO's estimates produced smaller deficits than the Administration for FY2005 through FY2007. They were essentially the same in FY2008 and were larger than the Administration's proposals in FY2009 and FY2010.

During the week of March 7, 2005, both the House and Senate Budget Committees' adopted their respective versions of the budget resolution for FY2006, on party-line votes. Both resolutions follow the general outline of the Administration's proposals: to constrain discretionary spending; to cut the growth of some entitlement programs; and to further reduce some taxes. The resolutions are currently scheduled to be on the House and Senate floors during the week of March 14, 2005.

Outlays

The Administration's FY2006 budget proposed $2,568 billion in outlays for FY2006, rising to $3,028 billion in FY2010, the last year shown in the President's budget. As it did in last year's budget, the Administration modified some of the underlying policy assumptions in creating its current services baseline for FY2006.[4] The modifications had a minor effect on the current services estimates this year.

The Administration's proposals, if adopted, would raise outlays by $83 billion (3.6%) above the Administration's FY2005 outlay estimate and $29 billion (1.1%) above its FY2006 current services baseline outlay estimate. The difference between the current services baseline outlay estimate and proposed outlays for FY2006 measures the "cost" of the Administration's proposed policies. The year-to-year

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[4] 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 are included in the baseline.

change (the $83 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.

Table 2. Outlays for FY2004-FY2010 and FY2015

(in billions of dollars)

	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2015
CBO Baseline, 1/05	*$2,292* [a]	$2,425	$2,507	$2,618	$2,743	$2,869	$2,996	$3,706
President's FY06 Budget, 2/05		2,479	2,568	2,656	2,758	2,883	3,028	—
President's FY06 CSB, 2/05		2,443	2,539	2,650	2,770	2,897	3,048	—
CBO, Revised Baseline, 3/05		2,444	2,538	2,621	3,731	2,860	2,987	3,777
CBO, Preliminary EPP 3/05		2,451	2,542	2,629	2,742	2,872	2,999	3,796
House Budget Committee, 3/05		2,451	2,571	2,635	2,743	2,864	2,987	—
Senate Budget Committee, 3/05		2,455	2,559	2,651	2,755	2,874	2,999	—

a. Actual outlays for FY2004.
EPP — CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

The President's budget did not include estimated costs of the ongoing action in Afghanistan or Iraq after the end of FY2005. Although unknown, the amount will not be zero. This implies that the Administration's initial outlay estimate is smaller than actual outlays will be, even if the remaining parts of the budget are accurate in other respects. A week after the budget became available, the Administration proposed , on February 14, 2005, an $82 billion supplemental appropriation (budget authority) mostly for these costs. A portion of the appropriation would produce outlays in both FY2005, FY2006, and several subsequent years.

As shares of gross domestic product (GDP), the Administration's proposals showed outlays falling from 19.9% of GDP in FY2006 to 19.0% of GDP in FY2010. CBO's preliminary estimate of the President's outlay proposals (March 2004) showed the shares falling from 19.7% of GDP in FY2006 to 19.0% of GDP in FY2010, before rising to 19.3% of GDP in FY2015. 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 FY2004 (20.2% of GDP).

CBO's *baseline* estimates showed outlays falling from 19.5% of GDP in FY2006 to 19.0% of GDP in FY2010 and sliding slightly to 18.9% of GDP FY2015. Using two of CBO's alternative scenarios for spending — assuming the phase-down of activities in Iraq and Afghanistan and continued spending for the global war on terrorism plus increasing total discretionary spending at the rate of nominal GDP growth (rather than the rate of inflation) — both of which increase outlays, outlays as shares of GDP would rise from 20.1% of GDP in FY2006 to 21.0% of GDP in FY2015.

Receipts

The Administration's FY2006 budget proposed extending and making permanent many of the tax cuts adopted in the first term that otherwise would expire (as required by law) mostly in 2010. The change, incorporated in the Administration's receipt proposals, had little effect on the numbers in the President's budget, with the budget numbers generally running through FY2010. The Administration estimated that making the cuts permanent would reduce receipts by $53 billion between FY2006 and FY2010 and by $1.0 trillion between FY2011 and FY2015. CBO's estimate of these proposals put the cost at $143 billion for the FY2006 through FY2010 period and $1.5 trillion for the FY2011 through FY2015 period.[5]

Table 3. Receipts for FY2004-FY2010 and FY2015

(in billions of dollars)

	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2015
CBO Baseline, 1/05	*$1,880* [a]	$2,057	$2,212	$2,357	$2,508	$2,662	$2,806	$3,847
President's FY06 Budget, 2/05		2,053	2,178	2,344	2,507	2,650	2,821	—
President's FY06 CSB 2/05		2,053	2,178	2,347	2,518	2,668	2,841	—
CBO, Revised Baseline, 3/05		2,057	2,209	2,350	2,492	3,625	2,769	2,546
CBO, Preliminary EPP 3/05		2,057	2,210	2,350	2,492	2,625	2,770	3,540
House Budget Committee, 3/05		2,057	2,195	2,331	2,496	2,635	2,784	—
Senate Budget Committee, 3/05		2,057	2,197	2,352	2,496	2,638	2,792	—

a. Actual receipts for FY2004.
EPP = CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

Under the initial request, receipts would grow from an estimated $2,178 billion in FY2006 to $2,821 billion in FY2010. The increases continue the dollar growth in receipts that began in FY2005, following three years of dollar declines in receipts (FY2001 to 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 estimates receipts of $2,053 billion (16.8% of GDP in FY2005, exceeding FY2000 receipts in dollars and $2,178 billion (16.9% of GDP) in 2006.

The Administration's proposals did not include any extension of the relief from the alternative minimum tax (AMT), that expires at the end of FY2005. Without a further extension, a growing number of middle class taxpayers will find themselves

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[5] These amounts from CBO do not include the outlay effects (usually interest costs associated with larger deficits) of the extensions.

subject to the AMT.[6] CBO estimated (January 2005) that providing extended or permanent AMT relief would reduce receipts by $198 billion between FY2006 and FY2010 and by $395 billion between FY2006 and FY2015. Without some adjustment to the AMT, it will recapture much of the tax reduction provided in the 2001 and 2003 tax cuts.[7]

The CBO baseline and OMB's proposed and baseline estimates are fairly similar from FY2006 through FY2010. Under both baselines, receipts rise from 16.8% of GDP in FY2005 to between 17.8% (CBO) and 17.7% of GDP (OMB) in FY2010. CBO's baseline, which assumes the scheduled expiration of the tax cuts, extended the projections through FY2015. In the CBO baseline, receipts rise rapidly after FY2010 (the year the tax cuts expire) and reach 19.6% of GDP in FY2015.

Using CBO's estimates of alternative revenue policies, to extend the tax cuts and to reform the alternative minimum tax (AMT), results in a much slower growth in receipts in dollars and as shares of GDP.[8] Receipts still rise as a percentage of GDP, but much more slowly than in the President's proposal or CBO's baseline. By FY2010, receipts have risen to $2,727 billion and 17.3% of GDP. By FY2015, the adjusted receipts rise to $3,508 billion and 17.9% of GDP.

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 FY2006 budget proposals include an estimated deficit of $427 billion in FY2005 falling to $390 billion (3.0% of GDP) in FY2006. The deficit would fall to an estimated $207 billion (1.3% of GDP) in FY2010, which would fulfill the Administration's pledge to reduce the deficit by half (starting from the FY2005 estimated deficit).

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

[7] See CRS Report RS21817, *The Alternative Minimum Tax (AMT): Income Entry Points and "Take Back" Effects*, by Gregg A. Esenwein, for more information of the interaction of the AMT and the tax cuts.

[8] 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 Administration's deficit reduction proposals require strict limits on the growth in domestic discretionary spending, a modest reduction (from baseline estimates) in some entitlements, slowing defense spending growth, and revenue-reducing tax cuts, including making permanent the 2001 and 2003 tax cuts. An inability to hold spending growth to the levels in the budget, a task that may prove difficult, could affect the significant budget reduction projected in the President's budget. The success of the Administration's deficit reduction efforts depend heavily on what many observers consider unrealistic spending constraints and reductions in nondefense discretionary spending. The continuing growth in entitlements and net interest, along with the ongoing efforts to cut taxes and the need to continue the efforts against terrorism, could effectively narrow the focus of deficit reduction efforts by Congress and the President to one-fifth of total spending, nondefense discretionary spending.

Table 4. Surpluses/Deficits(-) for FY2004-FY2010 and FY2015

(in billions of dollars)

	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2015
CBO Baseline, 1/05	*$-412* [a]	$-368	$-295	$-261	$-235	$-207	$-189	$141
President's FY06 Budget, 2/05		-427	-390	-312	-251	-233	-207	—
President's FY06 CSB 2/05		-390	-361	-303	-251	-229	-207	—
CBO Revised Baseline 3/05		-365	-298	-268	-246	-219	-201	122
CBO Preliminary EPP 3/05		-394	-332	-278	-250	-246	-229	-256
House Budget Committee,		-394	-376	-304	-247	-229	-203	—
Senate Budget Committee, 3/05		-397	-362	-299	-258	-236	-208	—

a. Actual deficit for FY2004.
EPP — - CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.

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 do not fall below 2.5% of GDP throughout the forecast period (FY2005-FY2015). If the President's proposal to make the tax cuts permanent succeeds, the budget might remain in deficit for at least the next 10 years.

CBO's estimates of the President's proposals put the FY2005 deficit at an estimated $394 billion (3.2% of GDP) and the FY2006 deficit at an estimated $332 billion (2.6% of GDP). Both are below the deficits for those years in the budget. The reestimated deficits are below the Administration's deficits through FY2008 and then larger than the Administration's deficit estimates in FY2009 and FY2010. CBO extended the reestimates through FY2015, beyond the FY2010 endpoint of the President's budget. CBO projects that the Administration's policies will produce deficits each year between FY2006 and FY2015, sliding slowly from 2.6% of GDP in FY2006 to 1.5% of GDP in FY2010 to 1.3% of GDP in FY2015.

CBO's Alternative Policies Not Included in the Baseline

CBO's January 2005 budget report included estimates of the "budgetary effects of policy alternatives not included in CBO's baseline." The alternative policies are those that may better reflect future policy than CBO's baseline. One of the alternative policies makes the 2001 and 2003 tax cuts permanent and adjusts the alternative minimum tax to reduce its expansion among middle class taxpayers. Another of alternative policy freezes discretionary spending at FY2005 levels instead of growing at the rate of inflation as baseline rules require. The costs of these alternatives are measured against CBO's regular baseline calculation.

Table 5, on the next page, contains data from the CBO budget report and calculated by CRS for the three time periods, FY2006-FY2010, FY2010-FY2015, and FY2011-FY2015. The alternative policies would substantially increase or decrease the cumulative deficit over these periods. Freezing discretionary spending produces larger estimated surpluses sooner than in CBO's baseline estimates. Increasing discretionary spending at the rate of GDP increases the cumulative deficit estimate by almost $350 billion between FY2006 and FY2010. It would increase the cumulative deficit by $1.4 trillion between FY2011 and FY2015. Making the tax cuts permanent and fixing the AMT would increase the cumulative deficit estimate by $374 billion from FY2006 through FY2010. The subsequent five-year period sees an estimated cumulative increase in the deficit of $2.4 trillion.

Table 5. The Budgetary Effects of Selected Policy Alternatives Not Included in CBO's Baseline

(Billions of dollars)

	Total, 2006-2010	Total, 2011-2015	Total, 2006-2015
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	-133	-418
Debt service	-51	-121	-172
Increase Total Discretionary Appropriations at the Growth Rate of Nominal GDP			
Effect on the deficit	-347	-1,090	-1,437
Debt service	-31	-237	-268
Freeze Total Discretionary Appropriations at the Level Provided for 2005			
Effect on the deficit	269	849	1,118
Debt service	25	183	208
Policy Alternatives That Affect the Tax Code			
Extend Expiring Tax Provisions[b]			
Effect on the deficit			
EGTRRA and JGTRRA	-60	-1,261	-1,321
Other	-83	-212	-295
Total	-143	-1,473	-1,616
Debt service	-13	-225	-238
Reform the Alternative Minimum Tax[c]			
Effect on the deficit	-198	-197	-395
Debt service	-20	-88	-108
Memorandum:			
Total Deficit (-) or Surplus in CBO's Baseline	-1,188	333	-855

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.

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. The details are described in *An Alterative Budget Path Assuming Continued Spending for Military Operations in Iraq and Afghanistan and in Support of the Global War on Terrorism* (February 2005).

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, CBO indicates (in its January 2005 budget documents) that it expects, under existing policies and assumptions, that demographic pressures will produce large and persistent deficits. CBO states

> In the decades beyond CBO's projection period, the aging of the baby-boom generation, combined with rising health care costs, will cause a historic shift in the United States' fiscal situation....
>
> Driven by rising health care costs, spending for Medicare and Medicaid is increasing faster than can be explained by the growth of enrollment and general inflation alone. If excess cost growth continued to average 2.5 percentage points in the future, federal spending for Medicare and Medicaid would rise from 4.2 percent of GDP today to about 11.5 percent of GDP in 2030....
>
> Outlays for Social Security as a share of GDP are projected to grow by more than 40 percent in the next three decades under current law: from about 4.2 percent of GDP to more than 6 percent....
>
> Together, the growing resource demands of Social Security, Medicare, and Medicaid will exert pressure on the budget that economic growth alone is unlikely to alleviate. Consequently, policymakers face choices that involve reducing the growth of federal spending, increasing taxation, boosting federal borrowing, or some combination of those approaches.[9]

[9] CBO, *The Budget and Economic Outlook: Fiscal Years 2006-2015*, Jan. 2004, p.10-11.

The Administration indicated similar concerns about the outlook for the budget over the long term, but tied much of its discussion to the President's proposed reforms to Social Security. Less was said about Medicare and Medicaid.

The short-term budget outlook can change when it is buffeted by economic or policy changes. The long-term budget outlook is expected to be dominated by the expansion of the population eligible for Social Security, Medicare, Medicaid, and other programs for the elderly as the baby boom generation begins retiring in large numbers. The steady price increases experienced by the health programs, if unchanged, could begin to dominate future budget debates. 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, spending increases, and policy changes of the last few years have not produced the difficult fiscal future, but they appear to have made an already difficult situation 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 generally have on the economy. The worse-than-previously-expected economic conditions that lasted from 2001 into 2003, played a role, directly and indirectly, in the deterioration of the budget outlook over those years. CBO expects continued economic growth during calendar years 2005 and 2006, which should result in higher revenues and lower spending (than would occur if the economy was growing at a slower rate). Because there is no way of predicting the timing of economic ups and downs, especially as estimates run into the future, CBO projects that GDP will grow at a rate close to potential GDP for the period 2007 through 2015.[10]

Under governmental policies that are in fiscal balance, a return to normal economic growth (growth close to that 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 2006 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, using the alternative assumptions, has a basic fiscal imbalance that cannot be eliminated by economic growth. To produce a balanced budget or one in surplus under those policy conditions would require spending reductions or tax increases.

[10] 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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