Order Code RL32264

CRS Report for Congress
Received through the CRS Web

The Budget for Fiscal Year 2005

Updated December 12, 2005

Philip D. Winters
Analyst in Government Finance
Government and Finance Division

The Budget for Fiscal Year 2005

Summary

The deficit for fiscal year (FY) 2005 was $318 billion (2.6% of gross domestic product, GDP), below most earlier proposals and estimates from the Administration, Congress, and the Congressional Budget Office (CBO), and smaller than the FY2004 deficit of $412 billion (3.6% of GDP). The President's original budget for FY2005, in February 2004, proposed a deficit of $364 billion. Estimates from July and August 2005 expected a deficit of between $333 billion and $341 billion. Larger than expected receipts, rather than lower spending, produced the reduction in the deficit.

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. 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 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*) provided an FY2005 baseline deficit estimate of $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 estimated deficit would climb slightly after FY2010, moving to $284 billion in FY2014.

The lack of a congressionally passed budget resolution for FY2005 (in 2004) added procedural hurdles to resolving already existing policy disputes and further slowed the passage of the annual appropriations. Congress needed several continuing resolutions on appropriations to complete its work on the FY2005 appropriations. In the second of two after-election sessions, with only four of the 13 regular appropriations passed, 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.

This report will be updated as events warrant.

Contents

List of Figures

List of Tables

The Budget for Fiscal Year 2005

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

FY2005 ended on September 30, 2005. The Treasury released actual budget data for FY2005 in mid-October 2005. Unexpectedly higher receipts reduced the deficit below previously expected levels. For FY2005, the deficit was $318.5 billion, receipts were $2,153.3 billion, and outlays were $2,471.8 billion. As shares of gross domestic product (GDP), the deficit was 2.6% of GDP, receipts were 17.5% of GDP, and outlays were 20.1% of GDP. (These numbers may be revised as more data become available.) The President's original budget for FY2005 (from February 2004) proposed a deficit of $364 billion, receipts of $2,036 billion, and outlays of $2,400 billion.

Budget Totals

Table 1 contains budget estimates and proposals 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 as they become available; and data from congressional budget deliberations.

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 Res., S.Con.Res. 95, 3/12/04	2,026	2,367	-341
House, FY05 Budget Res., H.Con.Res. 393, 3/25/04	2,030	2,406	-377
Conf., FY05 Budget Res., 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
CBO, EPP, 3/05	2,057	2,451	-394
House FY06 Budget Resolution 3/05	2,057	2,451	-394
Senate FY06 Budget Resolution 3/05	2,058	2,455	-397
Conference FY06 Budget Resolution 4/05	2,057	2,455	-398
OMB. *Mid-Session Review* (MSR) July 2005	2,140	2,472	-333
CBO Update, Baseline 8/15/05	2,142	2,473	-331
Actual Totals	**2,153**	**2,472**	**-318**

*The conference report (H.Rept. 108-498) passed the House on May 19, 2004, but was not 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 Control Act directions for producing baselines.
CSB — Current services baseline

Differences in totals result from differing underlying economic, technical, and budget-estimating assumptions and techniques used by OMB and CBO, as well as differences in policy assumptions. Often the *policy*-generated dollar differences among the estimates for an upcoming fiscal year may be relatively small compared to the budget as a whole. These small differences can 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.

Budget Estimates and Proposals

CBO's first budget report for FY2005, the *Budget and Economic Outlook: Fiscal Years 2005-2014* (Outlook; January 2004), contained baseline estimates and projections for FY2004 through FY2014.[1] The report estimated an FY2005 deficit of $362 billion (down from an estimated, at that time, deficit of $477 billion in FY2004; the actual deficit for FY2004 was $412 billion). 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, expected the tax cuts to expire as scheduled, and allowed the alternative minimum tax (AMT) relief to expire as scheduled (which would then boost receipts).

The report also, under baseline assumptions, had the budget in deficit through FY2013 ($16 billion). The baseline estimates produced 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 scheduled expiration of major tax cuts after calendar 2010, producing a large 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. These alternative policies have included the cost of extending expiring tax provisions (in CBO's January 2005 report, this would increase the five-year cumulative deficit by $103 billion, and the 10-year cumulative deficit by $1.4 trillion), reforming the alternative minimum tax (a $147 billion five-year cumulative increase in the deficit and a $430 billion cumulative increase over 10-years). It provided 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) to increasing discretionary spending at the growth rate of gross domestic product (GDP; a $236 billion five-year cumulative increase in the deficit and a $1.3 trillion 10-year cumulative increase).

President Bush's FY2005 (February 2004) 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 billion revenue reduction (from Administration baseline estimates) between FY2005 and

---

[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.

FY2009 and a $1,240 billion revenue reduction 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. Instead of following the traditional method of constructing baseline estimates (as set out in the Balanced Budget and Deficit Control Act of 1985 and the Congressional Control and Impoundment Act of 1974), 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 was $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 little other information for the individual years after FY2009.

In March 2004, CBO released revised baseline estimates, including a $1 billion increase (to $363 billion) in the expected deficit for FY2005. The revised projections also had a deficit (of $15 billion) in FY2014 instead of the surplus expected in the January estimates. The CBO September 2004 revisions had a smaller ($348 billion) FY2005 baseline deficit estimate and a larger FY2014 baseline deficit ($65 billion) estimate than its previous estimates.

The Administration provided 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 estimated receipts between the January and July reports came from changes in underlying economic assumptions and technical reestimates rather than any substantial changes in policy. Most of the increase in outlays between the two estimates came from changes in policy.

In January 2005, CBO included revised baseline budget estimates for FY2005 in its budget report, *The Budget and Economic Outlook: Fiscal Years 2006-2015*. The report had a revised FY2005 baseline deficit ($368 billion) that was similar to the baseline deficit estimate ($362 billion) that CBO had made a year earlier in January 2004.

The President's FY2006 budget request (February 2005) contained revised and re-estimated FY2005 budget data, including a larger deficit estimate for FY2005 ($427 billion) than it had shown in its July 2004 mid-year report ($331 billion). The proposed policy changes combined with changes in underlying assumptions produced smaller receipts, larger outlays and a larger deficit for FY2005 than in the Administration's previous estimates. The President's FY2006 budget included the estimated effects of his proposed defense supplemental for the FY2005 budget. CBO's analysis (March 2005) of the President's FY2006 budget proposals produced a smaller FY2005 deficit ($394 billion), smaller outlays, and similar receipts to those in the Administration forecast (see **Table 1)**.

The Administration's *Mid-Session Review* (MSR; July 2005) and CBO's *Budget and Economic Outlook: An Update* (Update; August 15, 2005) included smaller deficit estimates than in their respective budget reports released earlier in 2005. OMB reduced its FY2005 deficit estimate to $333 billion (2.7% of GDP) from the $427 billion (3.5% of GDP) deficit estimate in February 2005. CBO's FY2005 deficit estimate fell to $331 billion (2.7% of GDP) from its March 2005 baseline deficit estimate of $365 billion (3.0% of GDP).

The reduction in the deficit estimates resulted from higher-than-expected receipts in 2005 that did not result from policy change. The Administration expected the higher receipts to persist (in slightly diminishing amounts) throughout its five-year forecast period; CBO expects the higher receipts to diminish fairly rapidly over the next several years and have little long-term effect on the budget. The cause of the higher receipts remains somewhat uncertain. Additional data, that are not yet available, are needed to determine the cause of the higher receipts. Once the cause is known, whether the higher receipts are temporary or persistent will also likely be known.

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]

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 included, but not separately, a discussion of uncertainty in its January 2005 budget report.) The chapter contains a discussion of 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*.

---

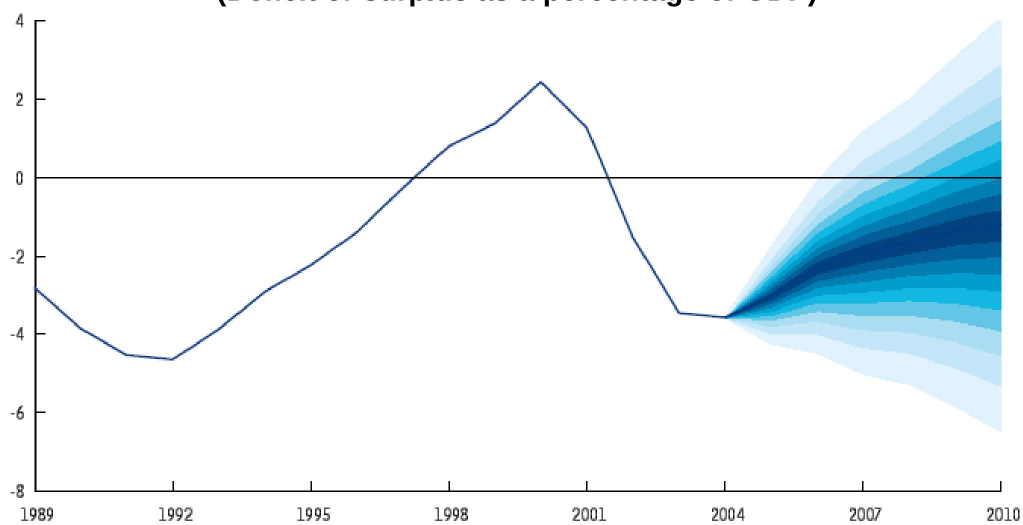
[2] Some things are known with certainty about the direction of future spending and receipts. Demographics can partly determine the shape of future budgets. In the next decade, the beginnings of the retirement of the baby boom generation will rapidly increase the spending for Social Security and Medicare 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.

It shows the most likely deficit or surplus outcomes clustered in the center, in the darkest part, of the figure. The lightest gray represents the less likely outcomes. CBO predicts that the deficit or surplus will have a 90% chance of falling somewhere between the top and bottom of the fan over the five years covered.

The President's (FY2005, February 2004) budget also included information on budget uncertainty 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.

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 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.

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 proposals and 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 its own baseline estimates in the 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 (a $22.9 billion revenue reduction and a $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 needed to 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 never considered the FY2005 budget resolution conference report.

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 was 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 as was being 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 would 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.

The Administration's FY2006 budget's policy proposals, other than a requested supplemental appropriation (see next paragraph), had little effect on the FY2005 budget totals. Changes in the underlying assumption, both economic and technical, produced most of the change in the budget numbers between the July 2004 mid-year Administration budget report and the President's FY2006 budget.

At the same time as the release of the Administration's FY2006 budget proposals (February 2005), it proposed an $82 billion supplemental appropriation for FY2005 to support the military activity in Iraq and Afghanistan, the "global war on terror", tsunami relief, along with other activities. Of the $82 billion in budget authority requested, the Administration expected about $35 billion to become outlays in FY2005 and another $25 billion in outlays in FY2006. The House passed the supplemental appropriations (H.R. 1268), with changes, on March 16, 2005. The Senate passed its version of the legislation on April 21, 2005. The Senate's version differed from the one passed by the House and what the Administration proposed. A conference committee reached agreement on May 3. The agreement provided the $82 billion, but changed numerous allocations and policies (compared to the President's request).[3] The President signed the legislation into law on May 11, 2005 (P.L.109-13).

Congress adopted and the President signed a $10.5 billion emergency supplemental appropriations (H.R. 3645; P.L.109-61) on September 2, 2005, for hurricane Katrina relief. Some of the funding will be spent in the last month of FY2005. Additional substantial funding is expected in the near future, most or all of which will be spent in FY2006 rather than in FY2005.

[3] For additional and detailed information on the supplemental, see CRS Report RL32783, *FY2005 Supplemental Appropriations for Iraq and Afghanistan, Tsunami Relief, and Other Activities*, by Amy Belasco and Larry Nowels.

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 that budget.[4] 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, showed smaller differences caused by policy changes between the proposals 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. CSB 2/2/04		2,319	2,397	2,468	2,583	2,715	2,847	—
Pres.'s FY05 DCA CSB, 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 Budg. Res., 3/12/04		2,295	2,367	2,469	2,582	2,698	2,815	—
House, FY05 Budg. Res., 3/25/04		2,295	2,407	2,492	2,591	2,711	2,845	—
Conf., FY2005 Budg. Res., 5/19/04*		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. CSB, 2/05		—	2,443	2,539	2,650	2,770	2,897	—
CBO, EPP, 3/05		—	2,451	2,542	2,629	2,742	2,872	3,611
House FY06 Budg. Res. 3/05		—	2,451	2,571	2,635	2,743	2,864	—
Senate FY06 Budg. Res. 3/05		—	2,455	2,562	2,658	2,760	2,880	—
Conference FY06 Budg. Res.. 4/05		—	2,455	2,577	2,644	2,750	2,873	—
OMB MSR 7/05		—	2,472	2,613	2,661	2,750	2,888	—
CBO Update, Baseline 8/15/05		—	2,473	2,595	2,721	2,860	2,997	3,726

* 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.

---

[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 to the baselines.

DCA Current Services — Current Service Baseline estimates that follow the Deficit Control Act directions for producing baselines.
Budg. Res. — Budget Resolution.
EPP — CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.
MSR — OMB's *Mid-Session Review*.

The Administration's original proposals, if adopted, would have (under Administration's estimates) raised outlays $81 billion (3.5%) above the Administration's FY2004 outlay estimate and $3 billion (0.1%) above its FY2005 current services baseline outlay estimate.[5] 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 smaller outlay estimates for future years than if these 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 FY2005 Defense appropriation bill (P.L.108-387; August 5, 2005).

As shares of gross domestic product (GDP), the Administration's original (February 2004) proposals showed outlays falling from to 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 20.0% of GDP in FY2004 to 19.7% of GDP in FY2005 to 19.6% of GDP in each of the fiscal years from 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 would grow at the rate of nominal GDP 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 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;

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

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 traditional baseline assumed that all discretionary spending will grow at the rate of inflation. For CBO, the baseline estimates showed that the slow dollar growth in discretionary spending would offset some of the growth in mandatory and net interest spending. The result was a reduction in total outlays as a share of GDP. CBO's *adjusted* baseline, which included a faster rate of growth for discretionary spending, slowly raised outlays as a share of GDP over the 10 years.

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. Different assumptions about discretionary spending between the two reports produced the apparent reduction in outlays. When made comparable, the January 2005 outlay estimates are higher than September 2004 outlays estimates.

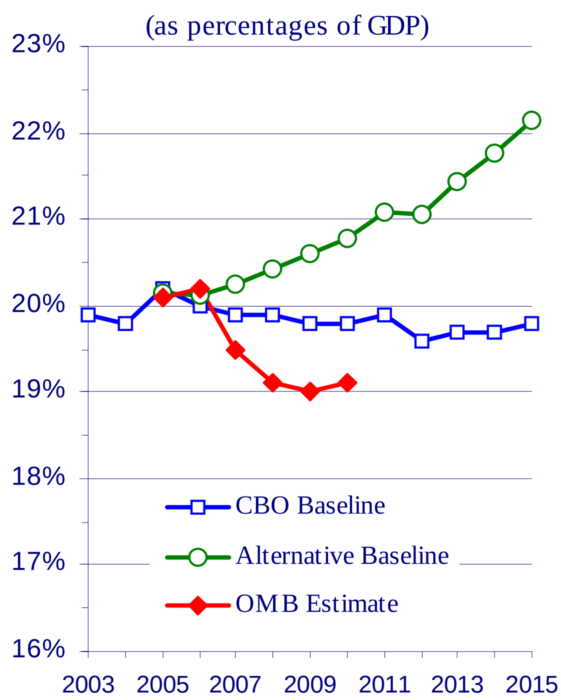
The President's FY2006 budget (February 2005) showed slightly larger outlays for the years FY2005 through FY2009 than it had estimated in July 2004. The Administration's proposed supple-mental appropriation ($82 billion in budget authority; $35 billion in outlays in FY2005) plus some changes in underlying assumptions produced most of the changes between the two estimates. The FY2006 budget contained little additional policy changes for FY2005.

Figure 2 shows outlays as shares of GDP from OMB's July 2005 MSR and CBO's August 2005 budget reports. CBO's outlay baseline estimates decline slightly as shares of GDP over the period shown. The CBO baseline assumes inflation adjustments to discretionary spending, unchanged policies for mandatory spending, and a repeat of the 2005 supplemental in each future year in the projection (as required by baseline rules). The alternative baseline adjusts the CBO baseline to assume that overall discretionary spending growth matches the rate of growth of GDP (rather than the rate of inflation, which is generally smaller) and adds in the higher debt service costs (from larger deficits) for both higher outlays and smaller receipts. These changes produce total outlays that grow as a share of GDP throughout the period, rising to almost 21% of GDP in FY2015. The Administration's policies include slowdowns in mandatory spending growth, close to a freeze (if not actual reductions) in nondefense discretionary spending, a slowing in defense spending growth, and did not include assumptions about future supplementals for Iraq and Afghanistan. The administration's proposals show outlays falling as a share of GDP after FY2006.

OMB's *Mid-Session Review* (July 2005) showed little change, from the Administration's February 2005 estimates in expected outlays for FY2005. Policy changes increased spending by an estimated $1 billion while outlay reestimates due to technical and economic changes (since February 2005) reduced expected outlays by $8 billion. The MSR estimated FY2005 outlays at $2,472 billion, slightly below the $2,479 billion estimated in February.

As part of its efforts to constrain spending, the Administration proposed dollar reductions in discretionary spending, other than defense and homeland security, falling from $460 billion in FY2005 to $450 billion in FY2010 (or from 3.7% of GDP to 2.8% of GDP).

Figure 2. Outlays, FY2003-FY2015



The changes from earlier outlay estimates in the Administration's July 2005 MSR varied over the years included. The May 2005 funding for the war on terror boosted FY2006 outlays and the inclusion of the cost of the Administration's proposed Social Security personal accounts raised outlays by tens of billions of dollars in FY2009 and FY2010 (above the projections in those years in the February 2005 budget documents).

CBO's mid-year estimates for total outlays for FY2005 in the August 2005 Update were $51 billion higher than in its March 2005 report. Two-thirds of the increase resulted from legislation, in particular the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief (P.L.109-13, May 11, 2005). Most of the rest came from technical reestimates. CBO expected outlays to reach $2,142 billion in FY2005.

Unlike the discretionary spending estimates in the Administration's MSR, CBO's mid-year budget report showed non-defense baseline spending growing (by 2.1%) over the FY2005 through FY2010 period. CBO's baseline estimates and projections assume that discretionary spending will grow at the expected rate of inflation. As shares of GDP, CBO projected that non-defense discretionary spending would fall from 3.8% in FY2005 to 3.3% in FY2010 (the expected rate of GDP growth exceeds the expected rate of inflation).

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 estimated (by the Administration) $213 billion over FY2005 to FY2009 period and by $1,240 billion over the FY2005 to FY2014 period.[6] CBO estimated (March 2004) that these proposals would cost $181 billion for the FY2005 through FY2009 period and $1,299 billion for the FY2005 through FY2014 period.[7]

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	—
CBO, EPP, 3/05		—	2,057	2,210	2,350	2,492	2,625	3,540
House FY06 Budget Resolution 3/05		—	2,057	2,195	2,331	2,496	2,635	—
Senate FY06 Budget Resolution 3/05		—	2,057	2,193	2,343	2,483	2,623	—
Conference FY06 Budget Resolution 4/05		—	2,057	2,195	2,331	2,496	2,635	—
OMB MSR 7/05		—	2,140	2,273	2,428	2,588	2,727	—
CBO Update, Baseline 8/15/05		—	2,142	2,280	2,396	2,526	2,675	3,660

* 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.

---

[6] These estimates were 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 CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*.

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

DCA Current Services — Current Service Baseline estimates that follow the Deficit Control Act instructions for producing baselines.
EPP — CBO's estimates of the President's proposals.
CSB — The Administration's current services baseline.
MSR — OMB's *Mid-Session Review*.

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 post World War II 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 lower than in any year since FY1955. In FY2004, receipts grew to $1,880 billion, but fell further as a share of GDP to 16.3% of GDP. The Administration expected receipts in FY2005 to exceed, in dollars (but not as a percentage of GDP), receipts in FY2000.

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. Estimates indicate that the AMT, which affected a little over 600,000 taxpayers in 1997, could affect 33 million taxpayers by 2010.[8] 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 President's budget arbitrarily reduced its FY2004 and FY2005 initial receipt estimates by $20 billion and $15 billion respectively, "in the interest of cautious and prudent forecasting."[9] The downward adjustment increased the resulting estimated deficits by $20 billion (in FY2004) and by $15 billion (in FY2005).

The 2004 mid-year budget reports from both OMB (July 2004) and CBO (September 2004) contained higher receipt estimates than in their earlier 2004 budget reports. Both OMB and CBO attributed these increases mostly to technical reestimates and revisions in the economic outlook rather than to any policy changes.

In early 2005, revised receipt estimates and projections from CBO and OMB were fairly similar for FY2005 through FY2009 (see **Table 3**) and somewhat smaller than the previous budget reports from CBO and OMB. The new receipt estimates were shown rising from 16.3% of GDP in FY2004 to 16.8% in FY2005 and to 17.7% of GDP in FY2009. CBO's baseline (in its January 2005 report) reflected the scheduled expiration of most of the tax cuts and projected receipts through FY2015. These baseline projections of receipts showed them rising rapidly after FY2010 and

---

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

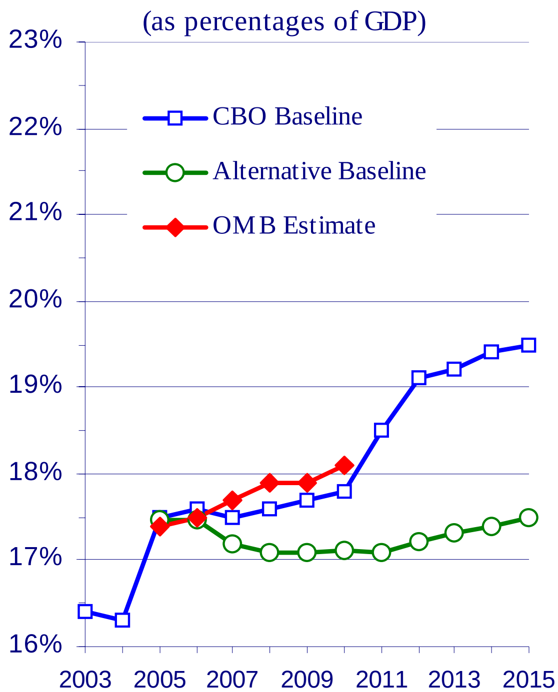
[9] OMB, *Budget of the U.S. Government for Fiscal Year 2003*, February 2004, *Analytical Perspectives*, p. 239.

reaching 19.6% of GDP in FY2015 (assuming that the tax cuts expire as currently scheduled at the end of calendar year 2010 raises receipt estimates rapidly in subsequent years).

Using CBO's August 2005 estimates of alternative revenue policies — making the tax cuts permanent and extending the relief from the alternative minimum tax (AMT) — produces much slower growth in receipts as a share of GDP after FY2010 compared to CBO's baseline (see the alternative baseline in **Figure 3**).[10] Receipts rise as a percentage of GDP through FY2006. They then remain between 17.0% and 17.5% of GDP through FY2015, which is generally below the revenue levels over the last 30 years.

CBO's March 2005 estimates of the President's FY2006 budget proposals produce smaller receipts over the forecast period than CBO's baseline. The CBO estimates of the President's revenue proposals were similar as percentages of GDP to the percentages in the Administration's proposals. The Administration's February 2005 proposals, like the ones from 2004, included making the tax cuts permanent, and like last year, did not propose a multi-year solution to the expanding coverage of the AMT.

Figure 3. Receipts, FY2003-FY2015



OMB's *Mid-Session Review* (July 2005) raised its receipt estimates by $87 billion for FY2005 (and by $95 billion in FY2006) over its February 2005 estimates. The MSR showed the higher receipts persisting over the next five years (in slowly declining amounts). The increase was not due to legislative action, but to higher-than-previously-expected income and payroll taxes. It attributed the increased receipts, in large part, to a stronger economy that, it claimed, resulted from tax relief. (Although the Administration argued that the higher receipts resulted from a stronger economy, the economic data in the MSR differed little from the February 2005 data.) Many analysts disagreed with the Administration's contention. A lack of understanding of the underlying causes for the higher receipts in 2005 and whether they will persist raises uncertainty about any claims to know what receipts will do in the next five years.

[10] CBO indicates in its Update that combining the AMT changes and making the tax cuts permanent produces an interactive effect increasing the combined loss over the sum of the two estimates separately.

CBO's Update also showed receipts $85 billion higher in FY2005 (and $68 billion higher in FY2006) than previously forecast. As with the MSR, the Update attributed most of the increase to higher than expected income and payroll tax collections in 2005. The Update does not expect the surge in receipts to extend at their current levels through the rest of the decade. CBO expects the increases to fade over time, falling to an estimated $10 billion receipt increase in FY2010 above the receipts projected for that year in CBO's March 2005 report. CBO indicated that changes in the economic outlook and technical changes produced the higher receipts. There is a lack of data to fully understand the source for this jump in receipts.

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 (FY1988 saw the first surplus in 30 years; the budget returned to deficit in FY2002) 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. Those projections showed the deficit falling to $237 billion in FY2009. The $237 billion would fulfill the Administration's pledge to reduce the deficit by half (starting from the FY2004 estimated deficit). Most of the deficit's fall would occur from FY2004 to FY2006, after which it showed relatively little change (in dollars) in the original proposals. The February 2004 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 policy proposals and assumptions.

The success of the Administration's deficit reduction efforts, both in its FY2005 and FY2006 budget depended (and depend) on underlying policy assumptions that may prove difficult to maintain. One is the heavy reliance on constraints and reductions in nondefense discretionary spending, which are approximately one-sixth of total outlays. Another is the absence of any estimates for the funding of operations in Afghanistan and Iraq after FY2006. A third is the absence of a cost estimate for a longer-term fix for the expanding coverage of the Alternative Minimum Tax (ATM). The Administration's FY2006 did not include ATM relief after FY2005 (although the Administration's proposal to reform the tax system — in the FY2006 budget — is supposed to address the issue). The continuing growth in entitlements and the likely growth in net interest, along with the Administration's opposition to tax increases, limits the focus of the Administration's deficit reduction proposals to relatively small areas of the budget. (The FY2006 budget proposals included small reductions in mandatory spending.)

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 Curr. Ser., 2/2/04		-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	—
CBO, EPP, 3/05		—	-394	-332	-278	-250	-246	-247
House FY06 Budget Resolution 3/05		—	-394	-376	-304	-247	-229	—
Senate FY06 Budget Resolution 3/05		—	-397	-368	-315	-277	-257	—
Conference FY06 Budget Resolution 4/05		—	-398	-383	-313	-256	-238	—
OMB MSR 7/05		—	-333	-341	-233	-162	-162	—
CBO Update, Baseline 8/15/05		—	-331	-314	-324	-335	-321	-66

* The conference report (H.Rept. 108-498) passed the House on May 19, 2004, but was not considered in the Senate.
a. Actual deficits 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.
MSR — OMB's *Mid-Session Review*.

CBO's January 2004 baseline estimates had the budget returning to surplus in FY2014 ($13 billion), mostly because the baseline assumed the expiration of most of the tax cuts at the end of calendar year 2010. 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 (March 2004) put the FY2005 deficit at an estimated $356 billion and the FY2009 deficit estimated at $258 billion. CBO's revised March baseline showed little change in the near-term from its January estimates. The changes, although not large in dollars, eliminated 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 2004 mid-year budget reports from OMB (July) and CBO (September) 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).

According to the CBO January 2005 budget report, adjusting the September 2004 baseline to make it comparable to the January 2005 baselines, eliminates the appearance of budget improvement. When CBO removed the (required) assumption of annually repeating the cost of the 2004 supplemental appropriation from the September 2004 estimate, the deficit outlook became better in the September estimates than it did in the January 2005 estimates. The adjusted September 2004 numbers produced a cumulative (FY2005 through FY2014) deficit estimate of $861 billion (down from the $2,294 billion originally shown in the September report). 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]...."[11] CBO's January 2005 cumulative deficit estimate for the same fiscal years, 2005 through 2014, was $1,364 billion, $503 billion larger than the adjusted September numbers.[12]

CBO's March 2005 revised baseline estimates included a deficit estimate of $365 billion, for FY2005, $20 billion above CBO's September 2004 estimate. For all subsequent years, CBO's deficit estimates from March 2005, are smaller (leading to a $99 billion surplus in FY2014 and a $122 billion in FY2015) than in its September 2004 estimates. The underlying assumptions in the two estimates differ, requiring some adjustment to make them comparable. Because of the statutory 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 rules exclude the FY2004 supplemental funding from the January and March 2005 estimates.

Figure 4 shows the deficit estimates from CBO's August 2005 Update, an alternative estimate that incorporated selected CBO alternative policy estimates (that reflect faster discretionary spending growth, extension of the tax cuts, extension of AMT relief, and the associated increased debt servicing costs), and OMB's July 2005 MSR, all as percentages of GDP. The scheduled expiration of the tax cuts by the end of 2010 (and the subsequent surge in receipts) produced most of the rapid shrinkage in the CBO baseline deficit projection after FY2010. Even with this rapid rise in receipts, the baseline deficit does not disappear, although it becomes very small. OMB's deficit estimates shrink to just above -1% of GDP by FY2008. OMB's MSR (July 2005) assumptions exclude further adjustments to the AMT and additional

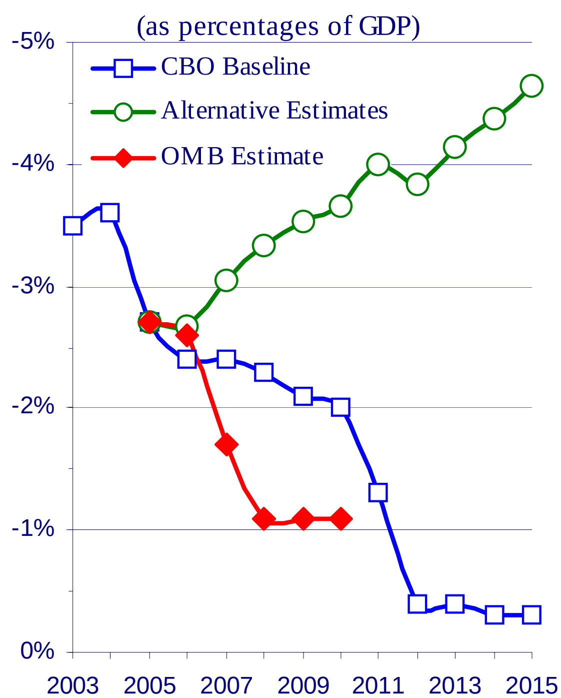
---

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

[12] 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.

funding for the war on terror, and would hold non-defense, non-homeland security funding to no growth. The President's MSR indicated a steady reduction in the deficit from FY2005 through FY2008, after which it stabilized through FY2010. The Administration's MSR did not include future funding for Iraq or Afghanistan, included assumptions about very slow or no growth in nondefense discretionary spending, reductions in the growth rate of selected mandatory spending programs, and did not assume future relief from the expanding coverage of the Alternative Minimum Tax (AMT). The effect of these assumptions provided most of the reduction in OMB's deficit estimate.

Figure 4. Deficits, FY2003-FY2015



The July 2005 MSR reduced the estimated deficit for FY2005 by $94 billion from the deficit estimate in the President's FY2006 budget in February 2005. Higher than expected receipts produced the reduction in the deficit estimate, while relatively unchanged outlays had little effect. As shares of GDP, the FY2005 deficit fell from an estimated 3.5% of GDP in February 2005 to an estimated 2,7% of GDP in July 2005. The Administration expected the deficit to fall over the next five years, to $170 billion (1.1% of GDP) in FY2010, a faster drop than it expected in the February budget release. In making these estimates and projections, the Administration had little analytical support for its assumption that the higher receipts will persist and that spending will be constrained as proposed through FY2010, producing the short-term reduction in the deficit. The MSR had little information on addressing the long-term imbalance in the federal budget.

CBO's August 2005 Update also reduced its baseline estimate of the deficit in FY2005 to $331 billion, a $33 billion reduction from its March 2005 baseline deficit estimate. Not expecting the higher receipts to persist, along with the baseline requirement that discretionary spending grow at the rate of estimated inflation, among other factors, CBO expects *higher* deficits in subsequent years (FY2006 through FY2015) than it did in its March 2005 estimates and projections.

CBO's Alternative Policy Estimates

CBO's January 2004 budget report, and most of its subsequent budget reports, included estimates of the "budgetary effects of policy alternatives not included in CBO's baseline." Some of the alternative policies may more accurately reflect budget experience than allowed by the baseline construction instructions in the Deficit Control Act (DCA) or may estimate policy options with high possibility of adoption. The alternatives have included estimates of extending expiring tax provisions, the reform of or the extension of relief from the alternative minimum tax (AMT), and variations on the future growth rates of discretionary spending. CBO's August 2005 budget report included two alternative estimates of discretionary spending — a freeze at FY2005 levels and an increase at the rate of GDP growth — and an estimate of the cost of a phasedown in military activities in Afghanistan and Iraq and the global war on terrorism. **Table 5** contains the estimates for these policy alternatives.

The alternative policies that cut future taxes or raise future spending would be fairly costly compared to CBO's baseline. Extending the expiring tax provisions would reduce receipts by an estimated $92 billion between FY2005 and FY2009, while letting discretionary spending grow at the expected growth rate of GDP (instead of the rate of inflation) would increase outlays by an estimated $217 billion over the same five years. These estimates do not include the higher interest costs 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 $196 billion for the FY2005 through FY2009 period compared to the baseline estimates.

The costs or savings of the alternatives become substantially larger over the 10 years, FY2005 through FY2014. CBO's August 2005 report estimated that extending expiring tax provisions for the 10-year period would increase the cumulative deficit by $1.3 trillion (with another $157 billion in higher interest costs). Most of that, $1.2 trillion (and $150 billion in higher interest costs), would occur 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.

---

[13] These two policies would produce an estimated $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	$98	$401	$499
Debt service	5	82	87
Increase Total Discretionary Appropriations at the Growth Rate of Nominal GDP[b]			
Effect on the deficit	-217	-925	-1,142
Debt service	-15	-175	-190
Freeze Total Discretionary Appropriations at the Level Provided for 2005[c]			
Effect on the deficit	196	804	1,000
Debt service	14	156	170
Policy Alternatives That Affect the Tax Code			
Extend Expiring Tax Provisions[c]			
Effect on the deficit			
EGTRRA and JGTRRA	-38	-986	-1,024
Other	-54	-201	-235
Total	-92	-1,186	-1,278
Debt service	-7	-150	-157
Reform the Alternative Minimum Tax[d]			
Effect on the deficit	-137	-210	-347
Debt service	-10	-73	-83
Memorandum:			
Cumulative Deficit (-) or Surplus in CBO's Baseline	-1,625	-759	-2,384

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 does not extend the $95 billion in supplemental appropriations enacted during 2005; however, it assumes that about $85 billion in budget authority will be needed in 2006 to maintain activities related to Iraq, Afghanistan, and the war on terrorism. Such budget authority is projected to decline to $65 billion in 2007, $50 billion in 2008, $35 billion in 2009, and about $25 billion per year thereafter (a total of $393 billion over the 10-year period).

b. This alternative assumes that the supplemental appropriation enacted during 2005 are projected at baseline levels (that is, increased at the rate of inflation).

c. This alternative does not include the effects of extending the increased exemption amount for the alternative minimum tax (AMT), which expires in 2005. The effects of that alternative are shown separately.

d. 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. 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.

Increasing discretionary spending at the rate of nominal GDP growth produced a 10-year $1.1 trillion cumulative increase in the deficit (plus another $190 billion in debt service costs) in CBO's August 2005 budget report. Most of the cumulative increase, $925 billion, would take place in the second five years of the10-year period. **Table 5** shows CBO's August 2005 estimates for these alternatives for the five and 10-year periods.

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

> 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. Over the next 30 years, the number of people age 65 or older will double, while the number of adults under age 65 will increase by less than 15 percent....
>
> 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.... By contrast, federal revenues credited to Social Security are expected to remain close to their current level — around 5 percent of GDP — over that period.
>
> 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.[14]

OMB echoed the CBO language in the President's budget documents. The document included a section on the long-term fiscal challenge that stated that unlike the Administration's positive near-term fiscal expectations

> The same cannot be said of the long-term deficit picture as a result of long-standing imbalances between what major entitlement programs currently promise

[14] CBO, *The Budget and Economic Outlook: Fiscal Years 2006-2015*, Jan. 2005, p. 10-11.

> in benefits and the resources expected to be available to meet those promises. Due to a combination of demographic and cost pressures, Social Security's and Medicare's unfunded obligations pose the real fiscal danger to the Federal budget and to our economy in general.[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 be dominated by the 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 difficult 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, results 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 based on CBO estimates, 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 that 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 budget

---

[15] OMB. *Budget of the United States Government for Fiscal Year 2006*, Feb. 2005, p.21.

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

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 along with policy changes cutting taxes and raising spending, 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.

For Additional Reading

U.S. Congressional Budget Office. *The Budget and Economic Outlook: Fiscal Years 2005-2014*. Washington, January 26, 2004.

——*An Analysis of the President's Budgetary Proposals for Fiscal Year 2005*. Washington, March 2004.

——*The Budget and Economic Outlook: An Update*. Washington, September 2004.

——*The Budget and Economic Outlook: Fiscal Years 2006-2015*. Washington, January 27, 2005.

——*An Analysis of the President's Budgetary Proposals for Fiscal Year 2006*. Washington, March 2005.

——*The Budget and Economic Outlook: An Update*. Washington, August 2005.

U.S. Council of Economic Advisors. *The Economic Report of the President*. Washington, GPO, February 2004.

——*The Economic Report of the President*. Washington, GPO, February 2005.

U.S. Office of Management and Budget. *The Budget of the United States Government for Fiscal Year 2005*. Washington, GPO, February 2, 2004.

——*Fiscal Year 2005 Mid-Session Review*. Washington, GPO, July 30, 2004.

——*The Budget of the United States Government for Fiscal Year 2006*. Washington, GPO, February 7, 2005.

——*Fiscal Year 2005 Mid-Session Review*. Washington, GPO, July, 2005.

CRS Products

CRS Report RL30973. *2001 Tax Cut: Description, Analysis, and Background*, by David L. Brumbaugh, Jane G. Gravelle, Steven Maguire, Louis Alan Talley, and Bob Lyke.

CRS Report RS21863. *Recent House Legislation Extending Selected Provisions of the 2001 and 2003 Tax Cuts*, by Gregg Esenwein.

CRS Report RL30149. *The Alternative Minimum Tax for Individuals*, by Gregg Esenwein.

CRS Report RL32502. *What Effects Have the Recent Tax Cuts Had on the Economy?*, by Marc Labonte.

CRS Issue Brief IB95060. *Flat Tax Proposals and Fundamental Tax Reform: An Overview*, by Jim Bickley.

CRS Report 98-560. *Baselines and Scorekeeping in the Federal Budget Process*, by Bill Heniff, Jr.

CRS Report RS20095. *The Congressional Budget Process: A Brief Overview*, by James V. Saturno.

CRS Report RL30297. *Congressional Budget Resolutions: Selected Statistics and Information Guide,* by Bill Heniff Jr.

CRS Report 98-511. *Consideration of the Budget Resolution*, by Bill Heniff, Jr.

CRS Report RL30239. *Economic Forecasts and the Budget*, by Brian W. Cashell.

CRS Report RL31235. *The Economics of the Federal Budget Deficit*, by Brian W. Cashell.

CRS Report 95-543. *The Financial Outlook for Social Security and Medicare*, by Geoffrey Kollmann and Dawn Nuschler.

CRS Report RS21136. *Government Spending or Tax Reduction: Which Might Add More Stimulus to the Economy?*, by Marc Labonte.

CRS Report RS21126. *Tax Cuts and Economic Stimulus: How Effective Are the Alternatives?*, by Jane Gravelle.

CRS Report RL30839. *Tax Cuts, the Business Cycle, and Economic Growth: A Macroeconomic Analysis*, by Marc Labonte and Gail Makinen.

CRS Report 98-720. *Manual on the Federal Budget Process*, by Robert Keith and Allen Schick.

CRS Report RS21756. *The Option of Freezing Non-defense Discretionary Spending to Reduce the Budget Deficit*, by Gregg Esenwein and Philip Winters.

CRS Report RL30708. *Social Security, Saving, and the Economy*, by Brian W. Cashell.

CRS Report RL31134. *Using Business Tax Cuts to Stimulate the Economy*, by Jane Gravelle