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The Budget for Fiscal Year 2004

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Summary

The Administration's fiscal year (FY) 2004 *Mid-Session Review* (MSR; July 15, 2003) estimated the FY2004 deficit at $475 billion, up from the $307 billion deficit included in the President's February 2003 budget proposal. Changes in policy, a slowly recovering economy, and other estimating factors produced the growth in the deficit estimate. The Administration's July estimates "do not reflect ... expected but undetermined additional costs arising from ongoing operations in Iraq, extending beyond 2003" (the Office of Management and Budget [OMB] Mid-Session Review, July 15, 2003, p.1). Any increase in outlays (without offsets) will increase the deficit further.

CBO's *Economic and Budget Outlook: An Update* (Update; August 26, 2003) projected an FY2004 baseline deficit of $480 billion, a $280 billion increase from its March 2003 baseline estimate and higher than the $458 billion baseline deficit estimate in OMB's MSR. Over 80% of the increase resulted from appropriations and tax cuts adopted between March and August 2003.

The President's February (2003) FY2004 budget proposals included a deficit of $307 billion, assuming the adoption of those proposals. The proposals included speeding up and making permanent many of the tax cuts enacted over the last two years, along with new tax changes for economic stimulus, tax incentives, and expiring tax provisions.

On January 31, 2003, CBO released the first of its budget reports. CBO's baseline estimates are similar in construction to the current services baseline produced by OMB for the President. CBO's baseline had a $145 billion deficit in FY2004. Because the CBO baseline estimates are constrained by existing policy, they do not incorporate any expected policy changes, even if they are very likely to occur.

In March, CBO released its report analyzing the President's policies, a recasting of the proposals using CBO assumptions and budget estimating methods. CBO's estimates produced an expected deficit of $338 billion for FY2004 under the Administration's proposals. CBO's baseline deficit estimate for FY2004 jumped to $200 billion.

Congress cleared the conference report (H.Rept. 108-71, H.Con.Res. 95) on the FY2004 budget resolution on April 11, containing reconciliation instructions for a tax cut. On May 23, Congress adopted the conference report (H.Rept. 108-126) on H.R. 2, the bill containing an 11-year, $350 billion tax cut that followed the reconciliation instructions. It became law (P.L.108-27) on May 28.

As Congress returns in September, it is expected to resume working its way through the 13 regular appropriations for FY2004. The House had passed 11 and the Senate four of the regular appropriations when Congress recessed in August. None has become law. This report will be updated as events warrant.

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Background and Analysis

Presidents generally submit their budget proposals for the upcoming fiscal year (FY) early in each calendar year. For FY2004, the Bush Administration released its budget (*The Fiscal Year 2004 Budget of the U.S. Government)* on February 3, 2003. The multiple volumes contained general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2004 and for the years through FY2008, with information on the revenue changes through FY2013 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) contain extensive and detailed budget information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed 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 basic reference source for federal budget information.

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. During the months of deliberation on budget legislation, the Administration often revises its original proposals because of interactions with Congress and changing circumstances in the economy and the world.

Budget Totals

Table 1 contains budget estimates and proposals for FY2003 and FY2004 from the Congressional Budget Office (CBO), the Administration (the Office of Management and Budget, OMB), the revisions produced by OMB and CBO throughout the year, and, as they become available, from congressional budget resolutions. Differences in totals occur because of differing underlying economic, technical, and budget-estimating assumptions and techniques as well as differences in policy assumptions. Most *policy* generated dollar differences between the Administration and congressional proposals or assumptions for an upcoming fiscal year are often relatively small compared to the budget as a whole. These small differences may grow, sometimes substantially, producing widely divergent budget paths over time. Budget estimates should be expected to change over time from those originally proposed by the President or Congress.

The war on terrorism, the 2001 recession and the slow economic recovery, changes in policies (tax cuts; spending increases), and changes in the technical assumptions of the underlying budget-economic relationships, have all contributed to the large deterioration in the budget outlook over the last two years.

Table 1. Budget Estimates for FY2003 and FY2004
(in billions of dollars)

	Receipts	Outlays	Deficit(-)/ Surplus
Actual for FY2000	*$2,025*	*$1,789*	*$236*
Actual for FY2001	*1,991*	*1,864*	*127*
Actual for FY2002	*1,853*	*2,011*	*-158*
FY2003 Estimates in 2003			
CBO B&E Outlook, 1/31/03	1,922	2,121	-199
OMB, Budget, 2/3/03	1,836	2,140	-304
OMB, Budget, Current Services, 2/3/03	1,867	2,131	-264
CBO Revised Baseline, 3/7/03	1,891	2,137	-246
CBO Estimates of the President's Policies, 3/7/03	1,856	2,143	-287
House FY2004 Budget Resolution, 3/21/03	1,855	2,143	-288
Senate FY2004 Budget Resolution, 3/26/03	1,865	2,148	-282
Conference FY2004 Budget Resolution, 4/11/03	1,835	2,182	-347
OMB Mid-Session Review, 7/15/03	1,756	2,212	-455
OMB Mid-Session Review, Baseline, 7/15/03	1,756	2,210	-155
CBO Update, Baseline, 8/26/03	1,770	2,170	-401
FY2004 Estimates			
CBO B&E Outlook, Baseline, 1/31/03	2,054	2,199	-145
OMB, Budget, 2/3/03	1,922	2,229	-307
OMB, Budget, Current Services, 2/3/03	2,031	2,189	-158
CBO Revised Baseline, 3/7/03	2,024	2,224	-200
CBO Estimates of the President's Policies, 3/7/03	1,907	2,245	-338
House FY2004 Budget Resolution, 3/21/03	1,908	2,232	-324
Senate FY2004 Budget Resolution, 3/26/03	1,958	2,246	-287
Conference FY2004 Budget Resolution, 4/11/03	1,883	2,268	-385
OMB Mid-Session Review, 7/15/03	1,797	2,272	-475
OMB Mid-Session Review, Baseline, 7/15/03	1,794	2,252	-458
CBO Update, Baseline, 8/26/03	1,825	2,305	-480

B&E Outlook = The *Budget and Economic Outlook,* CBO.

Budget Proposals and Estimates

CBO's first budget report for FY2004, the *Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), contained baseline estimates and projections for FY2003 through FY2013.[1] CBO's report showed that, under current policies, the

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[1] Baseline estimates provide a foundation from which to measure proposed policy changes. They extrapolate current policies into the future based on expectations of future economic conditions, other factors that affect the budget, and rules set by Congress that CBO must follow in creating baseline estimates. They are not meant to predict future budget outcomes. (continued...)

budget would remain in deficit through FY2006 ($16 billion). The baseline projections showed small surpluses beginning in FY2007 and growing rapidly in FY2011 through FY2013 as revenues grow rapidly with the scheduled expiration of the 2001 tax reductions from the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16, June 2001).

President Bush's FY2004 budget called for additional tax cuts and both increased and decreased spending (as measured against OMB's baseline estimates) depending on the activity. The proposed policy changes increased the FY2004 deficit to $307 billion from OMB's baseline deficit estimate of $158 billion. OMB's current service baseline estimates move into a small ($5 billion) surplus in FY2006 while the President's proposals result in a projected deficit of $201 billion in that year. The proposals would keep the budget in deficit (at least) through FY2008, the last year of the Administration's estimates.[2]

The Administration's budget did not include any cost estimates for the (then future) war in Iraq, additions to homeland security funding, or for non-war defense related spending. On March 24, 2003, the President asked Congress for a $75 billion supplemental appropriation for FY2003, of which a large portion will occur as outlays in FY2004.

The Administration argued that the tax cuts are needed to boost the lagging economy and that the acceleration of economic growth resulting from the tax cuts will lead to the recovery of much of the lost revenue over future years. The President's Council of Economic Advisors, in its annual report stated,

> Although the economy grows in response to tax reductions (because of higher consumption in the short run and improved incentives in the long run), it is unlikely to grow so much that lost tax revenue is completely recovered by the higher level of economic activity.[3]

Both OMB's and CBO's FY2004 budget documents were produced prior to the completion of final work on the FY2003 appropriations. This forced both agencies to estimate the (discretionary) spending levels Congress would approve and that the President would agree to for FY2003. This compounded the usual uncertainty in year-to-year budget comparisons.

CBO's March report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2004* (APBP) reestimated the Administration's FY2004 budget proposal

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[1] (...continued)
Because they continue existing policy, the baseline estimates include spending what was intended for one year only and exclude likely but not-yet-enacted changes (such as the existing law requirements that most of the recent tax cuts expire during this decade).

[2] The long-run outlook for government policies existing at the time of the budget submission (that are found in the budget; p. 41), indicate that, without substantial changes from those policies, the budget remains in deficit through much of this century.

[3] Council of Economic Advisers, *Economic Report of the Presiden*t. Feb. 2003. pp. 57-58

using CBO's assumptions and budget estimating methods.[4] These estimates produced results similar to those in the President's budget, with little cumulative difference in the projections. CBO estimated a cumulative deficit of $1.2 trillion under the President's policies over the five years (FY2004-FY2008) compared to the Administration's estimate of $1.1 trillion.[5] CBO's 10-year projections of the Administration's proposals showed larger deficits (or the smaller surpluses) compared to the CBO's own revised (March) baseline in each of the years covered. CBO estimated that about two-thirds of the increases in the deficits in its estimates of the President's proposals (excluding higher net interest costs) resulted from the lower revenues that would occur with the adoption of the President's tax cut proposals.

The March 2003 revised CBO baseline (incorporating the effects of the Consolidated Appropriations Resolution FY2003 (CAR 2003, P.L. 108-7, February 20) increased the projected baseline deficit by $47 billion in FY2003 and by $55 billion in FY2004. CBO attributed $22 billion of the $55 billion increase in the deficit in FY2004 to legislative changes since January (almost all from CAR 2003). The remainder of the increase was attributed to technical changes.

Over the 10-year period covered in the March CBO report, CBO wrote,

> For the 2004-2013 period, CBO has reduced its projection of the cumulative surplus by $446 billion [dropping it from $1,336 billion to $891 billion], nearly three-quarters of which derives from enactment of the omnibus appropriation act in February.[6]

The deterioration in the budget outlook since the January estimates delayed CBO's baseline estimate of the budget's return to surplus by one year, from FY2007 to FY2008.

The House FY2004 budget resolution (H.Con.Res. 95) included the President's request for a $726 billion economic stimulus tax cut (only part of which was put in the reconciliation instructions). The Senate-passed resolution (S.Con.Res. 23) contained reconciliation instructions for a $350 billion tax cut. The conference agreement on the resolution (H.Con.Res. 95; H.Rept. 108-71) included different reconciliation instructions for the relevant House and Senate committees. The reconciliation instructions for the House included tax cuts of $550 billion; the reconciliation instructions for the Senate included tax cuts of $350 billion. The resolution's deficit was $385 billion deficit in FY2004, becoming a small, $9.8 billion surplus in FY2012 and rising to a surplus of $37 billion in FY2013. The reconciliation legislation that Congress passed (the Jobs and Growth Tax Relief

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[4] The CBO report came out before the adoption of the FY2003 supplemental appropriations (P.L.108-11, April 6) and therefore did not include any effect that legislation would have on FY2004's outlays and deficit.

[5] Ibid., p. 1.

[6] Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for FY2004*, March 2003, p. 3.

Reconciliation; P.L. 108-27; May 23, 2003) contained $350 billion in tax cuts (and a small amount of spending increases) over the period FY2003 through FY2013.

The summer budget reports from OMB (July 2003, *Mid-Session Review*) and CBO (August 2003, *The Budget and Economic Outlook: An Update*) projected larger deficits for FY2004 and subsequent years than they had in their earlier budget reports. OMB estimated that the FY2004 deficit would rise to $475 billion, $168 billion above its January 2003 estimate. Policy changes that differed from those originally proposed by the President produced $73 billion of the change. The largest share, $95 billion, resulted from differences in the economic and technical assumptions underlying the two projections. These changes raised the cumulative deficit for FY2004 through FY2008 by $372 billion.

CBO's report pushed the FY2004 baseline deficit to $480 billion, $280 billion larger than its March estimate. Legislative changes (tax cuts and spending increases) raised the deficit by $227 billion, while economic and technical revisions raised it by $52 billion. The five-year (FY2004-FY2008) projected cumulative deficit increased by $1,083 billion between CBO's March and August estimates. For CBO's ten-year projection period, FY2004 through FY2013, the cumulative increase in its deficit projections, between March and August, was $2,287. This August estimate incorporated (as did the March estimate) the assumed expiration of most of the tax cuts adopted over the last several years. It also includes the assumed continuation of all the spending increases adopted since March, including the FY2003 supplementals (P.L. 108-11 and P.L. 108-69), that are unlikely to be repeated throughout the forecast period.

Neither OMB's nor CBO's projections reflect, particularly in the out-years, the effect of likely policy changes, such as modifications to the Alternative Minimum Tax (AMT), the costs of the ongoing efforts in Iraq, and the repeal of the expirations of the tax cuts. The budgetary cost of these policy changes is very large over time and could, according to CBO estimates, add another $1 trillion to $3 trillion to the cumulative deficit over the FY2004 through FY2013 period. (See pages 11-14 in the *Update* for CBO's discussion of budget projections under alternative scenarios.) The projections from CBO indicate that the budget is in a fundamental imbalance that will not be remedied by a return to normal economic growth. The projections imply that the only way to restore surpluses is through large spending cuts or tax increases.

Uncertainty in Budget Projections

All budget estimates and projections are inherently uncertain. Their dependence on assumptions that are themselves subject to substantial variation over relatively short time periods makes budget estimates and projections susceptible to fairly rapid and dramatic changes. The last couple of years have demonstrated this volatility. The original proposals and estimates for FY2002, made in early 2001, changed drastically over the 20 to 21 months of congressional and presidential action on the budget. (The budget estimates for five to 10 years in the future that are included in the OMB and CBO budget documents are subject to even greater variability.) The early 2001 estimates for FY2002 estimated a *surplus* of $231 billion to $313 billion. The year ended on September 30, 2002 with a *deficit* of $158 billion. The September 2001 terrorist attacks on the United States, the legislation adopted in response, the bursting of the stock market bubble, the weak economy, and a shift in critical underlying budget relationships, all contributed to a large change in the year's budget outcome from the originally proposed or estimated amounts. There is little reason to expect this volatility to be greatly diminished in the current or future budget projections.[7]

Information in chapter 5 (The Uncertainties of Budget Projections) of CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), indicates how significantly the budget outcome can be altered by changes in economic and related technical factors that underpin the budget estimates. The chapter contains optimistic and pessimistic alternative scenarios for its baseline projection. The optimistic scenario assumes that the favorable economic and budget conditions of the late 1990s and 2000 recur. The pessimistic scenario assumes that the economy and the budget revert to the unfavorable conditions that prevailed in the 1970s and most of the 1980s.

The numbers in Table 2 are calculated from data in the January 2003 CBO budget report. The results reflect the wide range of possible budget outcomes under the same policies but with different and reasonable underlying assumptions about the economy and the relationship of the budget to the economy.

Table 2. CBO's Alternative Scenarios, Cumulative Surpluses/Deficits(-); FY2004-2008 and FY2004-2013
(in billions of dollars; January 31, 2003)

	FY2004-FY2008	FY2004-FY2013
CBO Optimistic Scenario Cumulative Surplus	$566	$4,490
CBO Baseline 1/31/03	-143	1,336
CBO Pessimistic Scenario Cumulative Deficit	-855	-1,856

Source: CBO, *The Budget and Economic Outlook: Fiscal Years 2004-2013*, Jan. 2003, p.106; CRS calculations.

The President's budget includes, in the section, "Charting a Course for the Federal Budget," the statement that "... five-year projections are fraught with uncertainty. The ... error in projecting the surplus or deficit since 1982 ... has been a $90 billion average absolute forecasting error for the first year alone. A 90-percent

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

confidence range for 2008 would stretch all the way from a $281 billion surplus to a $661 billion deficit, a range of nearly $1 trillion."[8]

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 underlying assumptions used in the budget estimates, such as faster or slower economic growth, higher or lower inflation, differences from the existing or proposed spending and tax policies, or changes in the technical components of the budget models (or substantial policy changes) can, and usually do, have substantial effects on moving the budget outcomes away from the earlier budget estimates and projections.

Budget Action

CBO and the Administration released their first budget reports for the upcoming fiscal year, FY2004, in late January and early February 2003. CBO's report provided baseline estimates for fiscal years 2003 through 2013. OMB's documents provided estimates for FY2004 through FY2008 with a few instances of cumulative estimates for fiscal years 2004 through FY2013 (these are limited to revenues and provide almost no data for the individual fiscal years after FY2008).

The Joint Committee on Taxation put out its estimates of the revenue provisions in the President's budget on March 4, 2003. In mid-March, CBO made available its report, *An Analysis of the President's Budgetary Proposals for FY2004*, which used the tax estimates of the Joint Committee on Taxation in its analysis.

The House and Senate Budget Committees adopted their own, differing, versions of the FY2004 budget resolution (H.Con.Res. 95; S.Con.Res. 23) in mid-March. The House, after the Republican leadership had to modify the committee-passed resolution to assure enough support for passage, passed (215-212) its version on March 21.

The Senate spent more than a week considering its resolution. After adopting and rejecting numerous amendments, the Senate adopted the resolution on March 26.[9] One of the amendments that was adopted limited the size of the reconciliation tax-cut to $350 billion over 11 years (from the committee-adopted level of $698 billion). The resolution moved to a conference committee April 1, 2003. The conference reported its agreement on April 10 (H.Rept. 108-71). The agreement included different tax cut reconciliation instructions for the House and Senate. The House reconciliation instructions would let it cut taxes (over 11 years) by up to $550 billion (down from the $726 billion in the House-passed resolution). The Senate

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[8] Office of Management and Budget. *Budget of the U.S. Government for FY2004*, Feb. 3, 2003, p. 28.

[9] The Senate substituted the text of its resolution, S.Con.Res. 23, for the text of the House-passed resolution, H.Con.Res. 95.

reconciliation instructions limited it to tax cuts of $350 billion. Without other constraints, this would have allowed a $550 billion tax cut to emerge from a conference on the tax cut legislation. The $550 billion would have been protected from a Senate filibuster by the reconciliation rules. To make sure the budget resolution conference report could clear the Senate, the Senate leadership agreed that the eventual tax cut would not exceed $350 billion.

The House Ways and Means Committee reported the reconciliation tax cut legislation (H.R. 2; H.Rept. 108-94) on May 8. The legislation provided for the $550 billion tax cut included in the House version of the conference agreement on the budget resolution. The House passed the bill on May 9.

The Senate Finance Committee reported its *initial* version of the $350 billion reconciliation tax cut (S. 2; no report) on May 9. Rules on reconciliation legislation sent the bill back to the Finance Committee. The Committee re-reported the legislation, now S. 1054 (again, no report) on May 13. The Senate adopted the legislation (with the $350 billion tax cut limit) on May 15, after substituting the text of S. 1054 for that of H.R. 2.

On May 23, after extensive leadership negotiations between the House and Senate, an agreement was reached resolving the differences between the House- and Senate-passed versions of the reconciliation tax cut legislation. It provided $350 billion in tax cuts and small spending increases through FY2013. The agreement was formalized by the conference committee's report (H.Rept. 108-126) on May 22. The House adopted the agreement in the early morning hours of May 23. The Senate adopted it before noon on May 23. The legislation included the automatic expiration of most of the new tax cuts within 1 or 2 years. The President signed the legislation into law (P.L. 108-27) on May 28.

Work on the appropriations for FY2004 began in the spring of 2003 and continued through the summer. When Congress returned in September 2003, the House had passed 11 of the 13 regular appropriations and the Senate had passed 4. None of the appropriations has become law. Congress has less than a month to finish its work on appropriations before the beginning of the new fiscal year (October 1, 2003).

Outlays

The Administration's FY2004 budget proposed $2,229 billion in outlays for FY2004, rising to $2,711 billion in FY2008, the last year forecast in the President's budget. The current services baseline in the President's budget (estimates of what future outlays would be if policies remained unchanged over the forecast period) showed outlays of $2,189 billion in FY2004 growing to $2,541 billion in FY2008, both smaller than the amounts proposed.

The Administration's proposals would raise outlays $89 billion above the Administration's proposed FY2003 level and $40 billion above its FY2004 current services baseline outlay estimate. The difference between the current services baseline outlay estimate and the proposed outlay amount for FY2004 measures the cost of the Administration's proposed policies. The year-to-year change (the $89 billion increase) combines the effects of policy changes from year to year with the relatively automatic growth in large parts of the budget. These increases include cost-of-living adjustments, growth in populations eligible for program benefits, and inflation driven increases. The President's budget did not include estimated costs of any (at that time, possible future) conflict with Iraq for either FY2003 or FY2004.

Table 3. Outlays for FY2003-2008 and FY2013

(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	*$2,011* [a]	$2,121	$2,199	$2,298	$2,3878	$2,4795	$2,583	$3,167
President's F04 Budget, 2/3/03		2,140	2,229	2,343	2,464	2,576	2,711	—
President's FY04 Current Services, 2/3/03		2,131	2,189	2,276	2,348	2,440	2,541	—
CBO Revised Baseline, 3/03		2,137	2,224	2,328	2,417	2,513	2,621	3,215
CBO Est. of the President's Policies,3/03		2,143	2,245	2,370	2,491	2,606	2,739	3,452
House FY2004 Budget Resolution, 3/21/03		2,143	2,232	2,337	2,450	2,556	2,675	3,335
Senate FY2004 Budget Resolution,3/26/03		2,148	2,246	2,372	2,491	2,607	2,734	3,338
Conference FY2004 Budg. Res. 4/11/03		2,182	2,268	2,375	2,494	2,607	2,737	3,387
OMB MSR 7/15/03		2,212	2,272	2,338	2,452	2,573	2,706	—
OMB MSR, Baseline, 7/15/03		2,210	2,252	2,304	2,377	2,481	2,587	—
CBO Update, Baseline, 8/26/03		2,170	2,305	2,404	2,501	2,624	2,761	3,422

a. Actual outlays for FY2002.

Total outlays, in the President's budget, were projected to grow at an average annual rate of 5.0% between FY2004 and FY2008. When broad components of spending are examined, the budget functions showed the health budget function increasing at an annual average rate of 7.9%, the Medicare function increasing at an annual average rate of 7.8%, and net interest increasing at an annual average rate of 9.6% over these years.[10, 11] These three functions account for over 53% of the total outlay increase during this period. All of the other fifteen budget functions have a lower annual growth rate than that of total outlays.[12] The relatively low growth in some budget functions (agriculture 0.8%, education, training, employment, and social services 1.2%, general government 1.2%, and natural resources and environment 1.5%), growth that is lower than the expected rate of inflation, will reduce these functions' spending in real terms and as shares of total spending.

[10] Budget functions group, "budget data according to the major purpose served" rather than by agency or program. OMB, *Budget of the U.S. Government for FY2004, Analytical Perspectives*, p. 463.

[11] The Energy budget function has an even higher rate of increase, growing by an annual average rate of 18.3%, but since it only makes up 0.04% of total outlays in FY2004 and 0.07% of outlays in 2008, it has little effect on the overall change in outlays.

[12] The two budget functions, "allowances," and "undistributed offsetting receipts," were excluded from the total number of functions.

The January 2003 CBO baseline, which assumed no changes from existing government policy, forecast FY2004 outlays of $2,199 billion, FY2008 outlays of $2,583 billion, and, because CBO's estimates extended through FY2013, FY2013 outlays of $3,167 billion.[13] These are similar to the Administration's current services baseline estimates for the same years.

The revisions in CBO's March 2003 report raised estimated FY2004 baseline outlays by $25 billion, to $2,224 billion (mostly because of the inclusion of the effects of adopting the Consolidated Appropriations Resolution, 2003 (P.L. 108-7)) in February. Each of the succeeding year's outlays in the CBO revisions were larger than they were in the January baseline. CBO's March 2003 baseline outlays would grow by an annual average rate of 4.2% between FY2004 and FY2008 (and by the same rate for the FY2004-FY2013 period). Total discretionary spending, including defense and homeland security, would grow by approximately 2.5% a year over both the 5- and 10-year periods.[14] Mandatory spending, including Social Security and Medicare, would grow at average annual rates of 4.7% (FY2004-FY2008) and 5.4% (FY2004-FY2013). Because CBO's baseline shows the budget with a surplus starting in FY2008, net interest declines in the second five years after growing quickly in the first five years. Over the 10 years, net interest grows at an annual average of 1.5% (it grows at an average annual rate of 7.8% over the five years, FY2004-FY2008). If the deficits do not disappear, as they would not under the Administration's proposals, the net interest would continue increasing.

CBO's March estimates of the President's policy proposals resulted in higher outlays under the same policies. The CBO estimates were $16 billion higher in FY2004 than the Administration's proposed amount. For FY2008, CBO's reestimates pushed total outlays to $2,739 billion, $28 billion higher than in the Administration's budget. For the years covered by the President's budget, FY2004-FY2008, CBO's reestimates raised outlays close to $30 billion a year above the Administration's estimates (except in FY2004 when the difference was estimated at $16 billion). By FY2013, the Administration's outlay proposals, under the CBO reestimates, reached $3,279 billion.

The House- and Senate-passed budget resolutions contained different levels of spending for FY2004 and subsequent years and differences in the components of that spending. The House resolution included $2,232 billion in outlays for FY2004, while the Senate amount was $2,246 billion, less than a 1% difference. By FY2013, the House resolution had outlays of $3,289 billion and the Senate resolution had outlays of $3,338 billion, a 1.5% difference. The House included instructions to cut spending in a wide selection of many mandatory programs, stating that there should be enough "waste, fraud, and abuse" in the programs affected to avoid diminishing

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[13] These projections followed very similar rules as those used by the Administration to produce its current services baseline estimates. CBO and OMB used different budget models and a number of different underlying assumptions, which generated much of the difference in the estimates.

[14] Under the rules that CBO must use in producing the baseline estimates, one requires that discretionary spending growth matches the expected rate of inflation over the time period of the projection.

their effectiveness. The Senate resolution tightly constrained growth in non-defense, non-homeland security discretionary spending in the second five years of the period.

The conference report (H.Rept. 108-71) included outlays of $2,268 billion in FY2004 and $3,387 billion in FY2013. In addition, the conference agreement required most of the authorizing committees in the House and Senate to report the amount of "waste, fraud, and abuse" within the programs under their jurisdiction to their respective Budget Committees.

The July 2003 MSR, reflecting the legislation adopted since the February budget release, raised FY2004 baseline outlays to $2,252 billion from the original baseline outlays of $2,189 billion. Outlays under the Administration's policy proposals (some of which have been modified) grew to $2,272 billion from the originally proposed $2,229 billion. Some of the change resulted from the differences between the legislation adopted by Congress and what the President originally proposed. Outlays under the proposals in the MSR reach $2,706 billion in FY2008, slightly below the amount originally projected.

CBO's summer baseline estimates raised outlays by $81 billion from its March baseline estimates to $2,305 billion for FY2004. By FY2008, baseline outlays would be $2,761 billion, up from the $2,621 billion in March. The effects of the consolidated appropriations adopted in March and the supplementals adopted for FY2003 (with many of the outlays occurring in FHY2004) account for much of these increases.

Receipts

The Administration's FY2004 budget included proposals to adopt tax cuts to boost the economic recovery and to speed up and make permanent many of the tax changes enacted over the last two years. The Administration divided its revenue proposals over FY2004-FY2008 period into an economic growth package ($390 billion over FY2004-FY2008); tax incentives ($72 billion); tax simplification (which would raise receipts by $13 billion); extending expiring tax provisions ($40 billion); and miscellaneous changes (which would raise receipts by $2 billion). The total proposal would reduce revenues from current services baseline levels by $493 billion between FY2004 and FY2008 and by $1,461 billion between FY2004 and FY2013.[15] The changes would slow the growth in receipts but would not stop them. They would grow from $1,922 billion in FY2004 to $2,521 billion in FY2008.

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[15] These estimate are from the Treasury's *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals*. The President's budget shows a $441 billion revenue reduction (from baseline estimates) for the FY2004-FY2008 period and a $1,307 billion reduction for the FY2004-FY2013 period. The Treasury's estimates were produced after the release of the President's budget reflecting modifications to the proposals and adjustments to the estimates. See also the CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, and the CRS Issue Brief IB10110, *Major Tax Issues in the 108th Congress* for more information on the proposals.

Table 4. Receipts for FY2002-2008 and FY2013

(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	*$1,853* [a]	$1,922	$2,054	$2,225	$2,370	$2,505	$2,648	$3,674
President's F04 Budget, 2/3/03		1,836	1,922	2,135	2,263	2,398	2,521	—
President's FY04 Current Services 2/3/03		1,867	2,031	2,235	2,352	2,469	2,593	—
CBO Revised Baseline, 3/7/03		1,891	2,024	2,205	2,360	2,504	2,647	3,674
CBO Est. of the President's Policies,3/7/03		1,856	1,907	2,100	2,273	2,433	2,573	3,350
House FY2004 Budget Resolution, 3/21/03		1,855	1,908	2,107	2,282	2,444	2,587	3,372
Senate FY2004 Budget Resolution, 3/26/03		1,865	1,959	2,154	2,321	2,479	2,620	3,497
Conference FY2004 Budg. Res. 4/11/03		1,835	1,883	2,082	2,277	2,441	2,586	3,424
OMB MSR 7/15/03		1,756	1,797	2,033	2,215	2,360	2,480	—
OMB MSR, Baseline, 7/15/03		1,756	1,794	2,063	2,267	2,403	2,525	—
CBO Update, Baseline, 8/26/03		1,770	1,825	2,064	2,276	2,421	2,564	3,634

a. Actual receipts for FY2002.

The Administration claimed that the economic growth tax-cut proposals would speed economic growth by enough to recover some or all of the forgone revenue (a claim countered by CBO's March report that included dynamic macro-economic estimates, estimates that included the effects of the tax cuts on the economy in the budget estimates). None of the three budget models CBO used to calculate the tax-cut's effect on future revenues (or outlays) showed more than a minimal feed-back effect, boosting revenues slightly.

CBO's January 2003 baseline estimates put the FY2004 revenues at $2,054 billion, using a somewhat different set of underlying assumptions than the Administration's current service baseline estimates used. These CBO estimates also assumed that the automatic expiration of the tax cuts of EGTRRA would occur at the end of 2010. The reversion to previous tax law produced a large jump in projected revenues in the fiscal years after FY2010. CBO estimated that extending all the EGTRRA tax provisions that are set to expire before FY2013 would reduce cumulative revenues over the FY2004-2013 period by $785 billion (from cumulative baseline revenues of $27,923 billion).[16] The estimated effect of eliminating the expiring provisions of EGTRRA would be most dramatic after FY2010. In FY2010, the proposed revenue estimates are $32 billion below the baseline estimates for that year; in FY2011 the proposed level of receipts would be $156 billion below the baseline estimates for that year and in FY2013, they would be $260 billion below.

CBO's March 2003 revised estimate baseline revenues were smaller, by $20 billion to $30 billion, than the January baseline between FY2004 and FY2006, after which both estimates were very similar. CBO attributed the change to technical factors. The CBO revenue estimates of the President's proposals were smaller than those proposed by relatively small amounts ($15 billion – $30 billion) for fiscal years

[16] This estimate does not include the larger interest payments resulting from the larger deficits or smaller surpluses occurring over this period that increases public debt.

2004 through 2006. For subsequent years, CBO's estimates of the President's revenue proposals exceeded the amounts in the budget.

The House (H.Con.Res. 95) and Senate (S.Con.Res. 23) budget resolutions included different revenue reduction reconciliation instructions. The House included an estimated $698 billion revenue reduction over 11 years (FY2003-FY2013), closely matching the President's tax cut proposals. The Senate included reconciliation instructions for a tax cut of no more than $350 billion. Additional components of the President's original tax proposals were incorporated in the resolution, but not always in the reconciliation instructions. The conference on the budget resolution produced separate tax cut reconciliation instructions for the House Ways and Means Committee and the Senate Finance Committee. Reconciliation instructions required the Ways and Means Committee to reduce receipts by $550 billion ($535 billion in tax cuts and $15 in increased outlays). The Finance Committee was instructed to reduce taxes by no more than $350 billion.

Soon after the House adopted the conference report (H.Rept. 108-71) on the budget resolution (April 11), the Senate indicated that no eventual tax cut legislation exceeding $350 billion would be presented to the Senate. Many House members, expecting the larger tax cut amount ($550 billion) to eventually emerge from a conference committee on the tax cut legislation, were unhappy with the Senate's internal agreement.

The Committee on Ways and Means reported (H.Rept. 108-94) out the reconciliation bill, H.R. 2 (the Jobs and Growth Reconciliation Tax Act of 2003), costing $550 billion, including some increased outlays, on May 8. The House passed it on May 9. The Committee on Finance reported S. 2 (with no written report), its version of the reconciliation bill, on May 9. It contained revenue reductions of $350 billion (and some increases in outlays). Procedural issues required the Committee on Finance to report (again with no written report) a new bill (S. 1054) containing essentially the same contents as S. 2. The Committee reported the bill on May 13. The Senate, after substituting the text of S. 1054 for the text of H.R. 2, passed the $350 billion reconciliation bill on May 15.

On May 22, after extensive Republican leadership discussions over the reconciliation bill, a compromise was reached on a $350 reconciliation bill. The conference committee on the legislation endorsed the agreement and reported (H.Rept. 108-126) the modified H.R. 2 on May 22. The Housed passed the bill in the very early hours of May 23. The Senate passed the bill before noon on May 23. The President signed it into law (P.L. 108-27, the Jobs and Growth Tax Relief Reconciliation Act or JGTRRA) on May 28.[17]

[17] Most of the major provisions of the legislation are scheduled to expire after calendar year 2004 or, after calendar year 2008. These expirations kept the total budgetary change from exceeding the $350 billion limit set by the agreement. Extending the provisions through 2013 would raise the estimated cost of the legislation, compared to the baseline estimates, close to $1 trillion over the 11 years.

OMB's July 2003 budget report estimated that the JGTRRA would reduce FY2004 receipts by $138 billion (from baseline estimates). Over the period FY2004 through FY2008, OMB estimated that the law would actually increase receipts (compared to the Administration's original proposals) by $48 billion. The law included the expiration of the tax changes by the end of 2005, with a reversion to previous law. CBO's August budget report estimated that JGTRRA would lower receipts in FY2004 by $135 billion from CBO's baseline estimate (the law would also increase outlays by $12 billion). Over the FY2004 through FY2008 period, CBO estimated that JGTRRA would reduce receipts (compared to CBO's baseline, which did not include the Administration's original tax cut proposal) by $264 billion.

Deficits and Surpluses

Surpluses and deficits are the residuals left after Congress and the President set policies for spending and receipts. Surpluses reduce federal debt held by the public which leads to lower net interest payments; deficits increase government debt held by the public, increasing the government's net interest payments. 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 FY2004 budget proposals included a deficit of $307 billion in FY2004. CBO's March 2003 estimates of the President's proposals produced a deficit that would reach $338 billion in FY2004.

Table 5. Surpluses/Deficits(-) for FY2004-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	*-$158* [a]	-$199	-$145	-$73	-$16	$26	$65	$508
President's F04 Budget, 2/3/03		-304	-307	-208	-201	-178	-190	—
President's FY04 Current Services 2/3/03		-264	-158	-40	5	29	51	—
CBO Revised Baseline, 3/7/03		-246	-200	-123	-57	-9	27	459
CBO Est. of the President's Policies,3/7/03		-287	-338	-270	-218	-173	-166	-102
House FY2004 Budget Resolution, 3/21/03		-288	-324	-230	-168	-111	-87	37
Senate FY2004 Budget Resolution, 3/26/03		-282	-287	-218	-169	-128	-114	159
Conference FY2004 Budg. Res. 4/11/03		-347	-385	-294	-217	-166	-151	37
OMB MSR 7/15/03		-455	-475	-304	-238	-213	-226	—
OMB MSR, Baseline, 7/15/03		-455	-458	-241	-110	-78	-62	—
CBO Update, Baseline, 8/26/03		-401	-480	-341	-225	-203	-197	211

a. Actual deficit for FY2002.

CBO's January baseline estimates had the budget returning to surplus in FY2007 which then grew through FY2013. CBO's March 2003 revisions increased the near-term deficits and slowed, by one year, the movement to surplus. The growth in the surplus, especially after FY2010, was boosted dramatically by the scheduled expiration of the 2001 tax cut at the end of 2010.

The House Budget Committee's adopted budget resolution would move the budget into surplus in FY2010; the Senate Budget Committee's resolution would move the budget into surplus in FY2013. Both the House- and Senate-passed budget resolutions amended the two committees' original resolutions and showed the budget moving back into surplus in FY2012. The conference report on the budget resolution (H.Rept. 108-71) had a deficit of $385 billion for FY2004, a $151 billion deficit in FY2008, and a small $10 billion surplus in FY2012.

The summer 2003 budget reports from OMB (MSR) and CBO (*Update*) raised their expected deficit estimates for FY2004 and subsequent years. The MSR's current services baseline deficit estimate was $458 billion for FY2004, falling to $62 billion in FY2008. The baseline had a cumulative deficit (FY2004-FY2008) of $949 billion. The Administration's proposed deficits in the MSR were a deficit of $475 billion in FY2004, falling to $226 billion in FY2008. These proposed deficits summed to a cumulative deficit of $1,456 billion (FY2004-FY2008), $506 billion larger than the cumulative baseline deficit estimate. The Administration's MSR deficit estimates did not include "what the Administration has previously indicated are expected but undetermined additional costs arising from the ongoing operations in Iraq, extending beyond 2003."[18] (In early September 2003, press reports indicated that the Administration would soon ask Congress for at least $60 billion to fund Iraqi operations in FY2004.) Implementing the President's proposals would raise each year's deficit and leave very uncertain any future return to surplus.

CBO's summer estimates raised its baseline deficit to $480 billion in FY2004, falling to $197 billion in FY2008 (and becoming a surplus of $211 billion in FY2013 after the expiration of various tax cuts at the end of 2010). The cumulative (FY2004-FY2008) baseline deficit was $1,445 billion in the CBO report. (The FY2004-FY2013 period had a cumulative baseline deficit of $1397 billion.)

CBO's Alternative Policies Not Included in the Baseline.

CBO's summer report (August 2003) also included estimates of the "budgetary effects of policy alternatives not included in CBO's baseline." The alternatives are policies that have a high probability of being enacted or seriously debated. They included extending expiring tax provisions, the reform of the alternative minimum tax (AMT), Medicare reform – including a prescription drug benefit, and increasing discretionary spending at the growth rate of nominal GDP or at the average rate of discretionary spending growth from FY1998 through FY2003. The alternatives are all fairly costly, running from $112 billion for AMT reform for FY2004 through FY2008 to $608 billion for increasing discretionary spending at its recent historical growth rate for the same years. Over the 10 years, FY2004-FY2013, these costs become much large, ranging from $400 billion for both AMT and Medicare reform, to $1,564 billion to extend the expiring provisions, to $2,833 billion for increasing discretionary spending at the recent historical rate. Combining these effects (and excluding the cost of increasing discretionary spending at the rate of nominal GDP growth) with the baseline deficit estimate and projection raises the FY2004 deficit to $510 billion, the FY2008 deficit to $577 billion, and, instead of becoming a $161

[18] OMB, *Mid-Session Review*, July 15, 2003, p.1.

billion surplus in FY2012, the alternatives produce a deficit of $765 billion in that year and a deficit of $826 billion in FY2013. Under these alternative policies, the cumulative deficit for FY2004 through FY2008 rises from $1,455 billion in the baseline to $2,577 billion under the alternatives. For the 10 year period, FY2004 through FY2013, the cumulative deficit rises from $1,397 billion in the baseline to $6,193 billion with the alternatives included. Under these alternative policies, the budget moves further into deficit and shows no signs of moving towards balance.

Over a longer period, one running far into this century, the Administration indicated (in its budget) that it expects, under existing policies and assumptions, large and continually growing deficits beginning sometime in the next decade. The retirement of the baby boom generation, beginning in large numbers withing 15 years, will rapidly drive up spending on Social Security, Medicare, and other programs for the elderly, doubling their size as a percentage of GDP. Their growth will raise the deficit (or reduce the surplus, if there is one) and put a severe strain on both the budget and the economy. The tax cuts and spending increases of the last few years will intensify these budgetary pressures.

The Budget and the Economy

The budget and the economy affect each other. The relationship is an unequal one, with small economic changes having a more significant effect on the budget than large policy changes have on the economy. The worse-than-expected economic conditions over the last two years played a substantial role, directly or indirectly, in the deterioration of the budget outlook over those years and into FY2004. After FY2004, the budget projections include the assumption that the economy has returned to its normal rate of growth. This implies that the expected continuing deficits result from an imbalance in fiscal policy, that is that the fairly recent changes in policy, the tax cuts and spending increases, will keep the deficit from disappearing.

The positive budget outlook forecast in early 2001 was substantially based on the favorable future economic conditions that were then expected. The positive outlook continued the overall improvement in the budget situation since the early 1990s. Much of this improvement had come from strong and sustained economic growth (and the rest from policy changes to reduce the deficit and other changes). When those favorable economic conditions faltered, so did the string of positive forecasts of 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.

The FY2004 presidential budget documents and CBO’s January 2003 budget report included information of the expected economic outlook and the budget’s sensitivity to changes in selected economic variables. Both reports included tables showing the budget’s sensitivity to changes in selected economic variables (this year, it is found in chapter 2 of the *Analytical Perspectives* volume of the President’s budget and in chapter 5 of CBO's report). The effects of the variables are generally symmetrical. A higher rate of real economic growth (than assumed in the budget proposal) has approximately the same effect on the budget as same-sized lower rate of economic growth has, but in the opposite direction. If a 1% lower rate of economic growth reduces the surplus (or increases the deficit) by $30 billion in FY2004 (from the OMB table; Table 2-6, p. 32, *The Budget of the United States Government*, *Fiscal Year 2004*, *Analytical Perspectives*), a 1% higher than expected rate of economic growth would reduce the deficit (or increase the surplus) by approximately $30 billion. Changes in other variables generally have a smaller effect on the budgetary balance than changes in real GDP. Sustained changes in the underlying economic variables tend to produce larger changes in the budget numbers than the effect of a one or two year change.

Legislation

H.Con.Res. 95

The Concurrent Resolution on the Budget for Fiscal Year 2004. Adopted by the House Budget Committee (H.Rept. 108-37) on March 17, 2002, on a party-line vote after rejecting numerous amendments. It follows many of the proposals of the Administration. After some adjustments by the House leadership to assure passage, it was adopted by the House (215-212) on March 21. A conference agreement (H.Rept. 108-71) on the resolution cleared Congress on April 11.

S.Con.Res. 23

The Concurrent Resolution on the Budget for Fiscal Year 2004. Adopted by the Senate Budget Committee (no report but a committee print, S.Prt. 10-19) on March 14, 2002, on a party-line vote. As passed, the resolution included reconciliation instructions for approximately half of the President's economic stimulus tax cut proposal. The language of S.Con.Res. 23 was substituted for the contents of the House-passed resolution, H.Con.Res. 95.

H.R. 2

The Jobs and Growth Tax Relief Reconciliation Act of 2003. The legislation implemented the reconciliation instructions from the FY2004 budget resolution. It cleared the House on May 9, 2003. A modified version passed the Senate on May 15. After difficult negotiations between the House and Senate leadership, the conference agreement (H.Rept. 108-126) cleared Congress on May 23. The President signed the bill into law (P.L. 108-27) on May 28. The legislation would cut taxes (and includes in that amount small outlay increases) by $350 billion.

For Additional Reading

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CRS Products

CRS Electronic Briefing Book, *Taxation*, [http://www.congress.gov/brbk/html/ebtxr1.shtml]

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