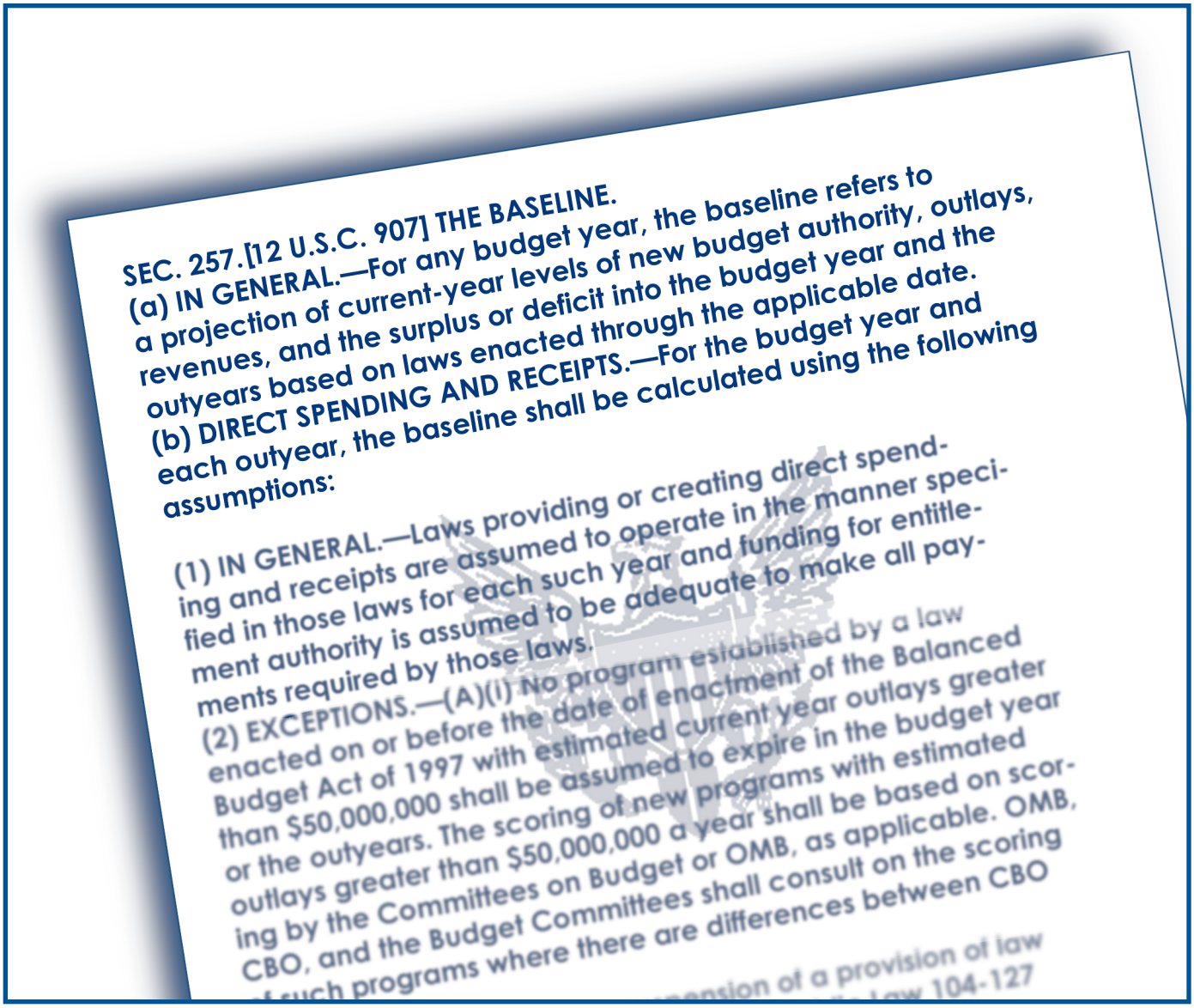
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

The Budget and Economic Outlook: Fiscal Years 2005 to 2014


SEC. 257.[12 U.S.C. 907] THE BASELINE.
(a) IN GENERAL.—For any budget year, the baseline refers to a projection of current-year levels of new budget authority, outlays, revenues, and the surplus or deficit into the budget year and the outyears based on laws enacted through the applicable date.
(b) DIRECT SPENDING AND RECEIPTS.—For the budget year and each outyear, the baseline shall be calculated using the following assumptions:

(1) IN GENERAL.—Laws providing or creating direct spending and receipts are assumed to operate in the manner specified in those laws for each such year and funding for entitlement authority is assumed to be adequate to make all payments required by those laws.
(2) EXCEPTIONS.—(A)(i) No program established by a law enacted on or before the date of enactment of the Balanced Budget Act of 1997 with estimated current year outlays greater than $50,000,000 shall be assumed to expire in the budget year or the outyears. The scoring of new programs with estimated outlays greater than $50,000,000 a year shall be based on scoring by the Committees on Budget or OMB, as applicable. OMB, CBO, and the Budget Committees shall consult on the scoring of such programs where there are differences between CBO

A REPORT TO THE SENATE AND
HOUSE COMMITTEES ON THE BUDGET

JANUARY 2004

A

CBO

STUDY

The Budget and Economic Outlook: Fiscal Years 2005 to 2014

January 2004

The Congress of the United States ■ Congressional Budget Office

Notes

Unless otherwise indicated, the years referred to in this report are federal fiscal years, which run from October 1 to September 30.

Numbers in the text and tables may not add up to totals because of rounding.

Some of the figures in Chapter 2 and Appendix A use shaded vertical bars to indicate periods of recession. A recession extends from the peak of a business cycle to its trough.

Data for real gross domestic product are based on chained 2000 dollars.

Preface

This volume describes the state of the budget and the economy. It is one of a series of reports that the Congressional Budget Office (CBO) issues each year in response to the requirement of section 202(e) of the Congressional Budget Act of 1974 for CBO to submit to the Committees on the Budget periodic reports about fiscal policy and to provide baseline projections of the federal budget. In accordance with CBO's mandate to provide impartial analysis, the report makes no recommendations.

The baseline spending projections were prepared by the staff of CBO's Budget Analysis Division under the supervision of Robert Sunshine, Peter Fontaine, Janet Airis, Tom Bradley, Kim Cawley, Paul Cullinan, Jeffrey Holland, and Jo Ann Vines. The revenue estimates were prepared by the staff of the Tax Analysis Division under the supervision of Thomas Woodward, Mark Booth, and David Weiner, with assistance from the Joint Committee on Taxation. (A detailed list of contributors to the spending and revenue projections appears in Appendix G.)

The economic outlook was prepared by the Macroeconomic Analysis Division under the direction of Robert Dennis. John F. Peterson and Robert Arnold carried out the economic forecast and projections. David Brauer, Ufuk Demiroglu, Tracy Foertsch, Douglas Hamilton, Juann Hung, Kim Kowalewski, Mark Lasky, Angelo Mascaro, Shinichi Nishiyama, Benjamin Page, Frank Russek, Robert Shackleton, John Sturrock, and Christopher Williams contributed to the analysis. Tumi Coker, Brian Mathis, and Amrita Palriwala provided research assistance.

CBO's Panel of Economic Advisers commented on an early version of the economic forecast underlying this report. Members of the panel are Andrew B. Abel, Alan Blinder, Michael J. Boskin, Barry P. Bosworth, Dan Crippen, Robert G. Dederick, William C. Dudley, Martin Feldstein, Robert J. Gordon, Robert E. Hall, Allan H. Meltzer, William D. Nordhaus, June E. O'Neill, Rudolph G. Penner, James Poterba, Robert Reischauer, Alice Rivlin, and Joel Slemrod. John Fernald, Daniel Sichel, and Chris Varvares attended the panel's meeting as guests. Although CBO's outside advisers provided considerable assistance, they are not responsible for the contents of this report.

Jeffrey Holland wrote the summary. Barry Blom, Ann Futrell, and Ellen Hays wrote Chapter 1, with assistance from Tom Bradley, Sandy Davis, and Eric Schatten. Mark Lasky was the lead author for Chapter 2. Gerard Trimarco and Christina Hawley Sadoti wrote Chapter 3, with assistance from Tom Bradley and Eric Schatten. Mark Booth and Thomas Woodward wrote Chapter 4. Frank Russek and Ufuk Demiroglu wrote Appendix A. Ellen Hays wrote Appendix B. Matt Schmit wrote Appendix C. Frank Russek and Barry Blom wrote Appendix D. Tumi Coker prepared Appendix E. Ann Futrell compiled Appendix F. Jennifer Smith produced the glossary.

Christine Bogusz, Juyne Linger, Leah Mazade, John Skeen, and Christian Spoor edited the report. Marion Curry, Linda Lewis Harris, and Denise Williams assisted in its preparation. Maureen Costantino designed the cover and, with assistance from Allan Keaton, prepared the report for publication. Lenny Skutnik and Brian Plummer printed the initial copies. Annette Kalicki, with help from Martina Wojak-Piotrow, produced the electronic versions for CBO's Web site (www.cbo.gov).

Douglas Holtz-Eakin
Director

January 2004

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Summary

The Congressional Budget Office (CBO) projects that under current laws and policies, the federal government will incur a total budget deficit of $477 billion this year and $362 billion in 2005 *(see Summary Table 1).* Such a deficit for this year would set a record in dollar terms, but at 4.2 percent of the nation's gross domestic product (GDP), it would represent a smaller share of the economy than the deficits of the mid-1980s and early 1990s. In the absence of further legislative changes, deficits would diminish after their peak in 2004, although outlays would continue to exceed revenues for most of the next 10 years. Deficits are projected to total $1.4 trillion for the five years after 2004 and $1.9 trillion for the 2005-2014 period.

By statute, CBO's baseline projections must estimate the future paths of federal revenues and spending under current laws and policies. The baseline is therefore not intended to be a prediction of future budgetary outcomes; instead, it is meant to serve as a neutral benchmark that lawmakers can use to measure the effects of proposed changes to taxes and spending.

New legislation can significantly affect the budget outlook. For example, laws enacted since CBO's previous

Summary Table 1.

CBO's Baseline Budget Outlook

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
							In Billions of Dollars							
Total Revenues	1,782	1,817	2,049	2,256	2,385	2,506	2,644	2,786	3,036	3,272	3,441	3,629	11,840	28,004
Total Outlays	2,158	2,294	2,411	2,525	2,652	2,783	2,912	3,047	3,198	3,296	3,457	3,616	13,282	29,897
Total Deficit (-) or Surplus	**-375**	**-477**	**-362**	**-269**	**-267**	**-278**	**-268**	**-261**	**-162**	**-24**	**-16**	**13**	**-1,443**	**-1,893**
On-Budget	-536	-631	-535	-464	-477	-504	-507	-511	-421	-299	-294	-277	-2,487	-4,288
Off-Budget[a]	161	154	174	195	211	226	239	249	259	275	278	290	1,045	2,395
Debt Held by the Public at the End of the Year	3,914	4,393	4,771	5,055	5,338	5,630	5,912	6,185	6,356	6,388	6,409	6,399	n.a.	n.a.
							As a Percentage of GDP							
Total Revenues	16.5	15.8	16.9	17.8	18.0	18.1	18.2	18.3	19.1	19.8	19.9	20.1	17.8	18.7
Total Outlays	19.9	20.0	19.9	19.9	20.0	20.1	20.1	20.1	20.2	19.9	20.0	20.0	20.0	20.0
Total Deficit (-) or Surplus	**-3.5**	**-4.2**	**-3.0**	**-2.1**	**-2.0**	**-2.0**	**-1.8**	**-1.7**	**-1.0**	**-0.1**	**-0.1**	**0.1**	**-2.2**	**-1.3**
Debt Held by the Public at the End of the Year	36.1	38.3	39.5	39.9	40.3	40.6	40.7	40.7	40.1	38.6	37.0	35.4	n.a.	n.a.

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

baseline projections were published in August have increased spending by an estimated $681 billion (0.5 percent of GDP) between 2004 and 2013.[1] Much of that total stems from the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Public Law 108-173). The outlays resulting from that law will steadily increase between 2006 and 2013, totaling nearly $400 billion over the 2004-2013 period (not including debt-service costs).

The baseline projections reflect CBO's forecast of robust economic growth for the next two years. By late 2003, stronger investment by businesses, a weaker dollar, and a rising stock market—augmented by expansionary monetary and fiscal policies—were spurring economic activity. CBO forecasts that real (inflation-adjusted) GDP will grow by 4.8 percent in calendar year 2004 and by 4.2 percent in 2005 and that the unemployment rate will fall to 5.8 percent in 2004 and 5.3 percent in 2005. Between 2006 and 2014, the annual rise in real GDP will average 2.7 percent, CBO projects.

Even if economic growth turns out to be greater than projected, however, significant long-term strains on the budget will start to intensify within the next decade as the baby-boom generation begins to reach retirement age. Federal outlays for the three largest retirement and health programs—Social Security, Medicare, and Medicaid—will consume a growing share of budgetary resources even under moderate assumptions about the programs' growth, rising from over 8 percent of GDP in 2004 to more than 14 percent in 2030. Such increasing demands on spending will exert pressure on the budget that economic growth alone is unlikely to alleviate.

The Budget Outlook

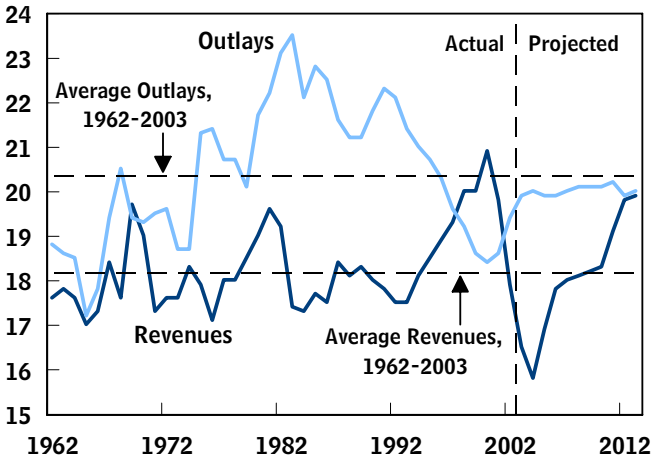
CBO projects that if current laws and policies remain unchanged, federal deficits will begin to decline after this year. In the ensuing years, under CBO's baseline, deficits drop as a percentage of GDP, from 4.2 percent in 2004 to 3.0 percent in 2005 and 1.7 percent in 2010. After 2011—if the tax cuts enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expired as scheduled, growth in discretionary spending continued to be limited to the rate of inflation, and other policies stayed the same—the budget would essentially be in balance.

1. That estimate includes the increased interest payments on federal debt attributable to legislative changes.

Summary Figure 1.

Total Revenues and Outlays as a Share of GDP, 1962 to 2014

(Percentage of GDP)



Sources: Congressional Budget Office (projections); Office of Management and Budget (historical budget data).

Over the 2004-2014 period, outlays are projected to grow at an average annual rate of 4.7 percent and to remain near 20 percent of GDP. That level would be slightly below the average share of the economy devoted to federal spending since 1962 *(see Summary Figure 1).*

The constant share of outlays as a percentage of GDP, however, masks opposing trends in mandatory and discretionary spending. Under the assumption that no changes in policy take place, spending for entitlements and other mandatory programs is projected to grow by 5.5 percent a year—faster than the rate projected for the economy as a whole. Such growth is driven largely by spending for Medicare and Medicaid, which is projected to rise at average rates of 9.0 percent and 7.2 percent a year, respectively, from 2004 through 2014. Toward the end of that period, Social Security spending is also expected to grow faster than the economy as the baby-boom generation begins to retire.

CBO projects discretionary spending as specified in the Balanced Budget and Emergency Deficit Control Act of 1985 (using the GDP deflator and the Employment Cost Index for wages and salaries). The combined rate of growth of those factors is about half of that projected for nominal GDP. As a result, the baseline projection for dis-

cretionary outlays falls from 7.8 percent of GDP in 2004 to 6.4 percent in 2014. If instead such spending kept pace with the growth of GDP (and the other assumptions incorporated in the baseline remained the same), discretionary outlays would maintain a share of about 7.8 percent of GDP throughout the projection period and the deficit in 2014 would be $323 billion, or 1.8 percent of GDP (compared with a small surplus for 2014 under the baseline's assumptions).[2]

Revenues are projected to total 15.8 percent of GDP this year—about 2.5 percentage points below the average since 1962 (18.2 percent). As the economy continues to improve and certain tax provisions expire, revenues will increase to 16.9 percent of GDP in 2005, CBO projects. In 2006 through 2010, rising income and the expiration of more tax provisions will push revenues up to about 18 percent of GDP, by CBO's estimates. In the baseline, projected receipts rise more rapidly after the major provisions of EGTRRA expire at the end of 2010, reaching 20.1 percent of GDP in 2014. If those provisions—together with the expiring provisions of other tax laws—were instead extended and all of the other assumptions underlying the baseline were held constant, receipts would be 18.1 percent of GDP in 2014, and the deficit would total $443 billion, or 2.4 percent of GDP.

Debt held by the public (the most meaningful measure of federal debt in terms of its relationship to the economy) is anticipated to equal 38 percent of GDP at the end of this fiscal year. Under CBO's baseline, that debt will stabilize at around 40 percent of GDP through 2011, at which point the federal government's diminished need to borrow will reduce the growth of such debt.

Since CBO last issued its baseline (in the August 2003 *Budget and Economic Outlook: An Update*), the cumulative deficit over the 2004-2013 period has increased by nearly $1 trillion, or 0.7 percent of GDP *(see Summary Table 2)*. About 70 percent of that total results from new legislation, such as the Medicare law. Another $171 billion stems from economic factors—mainly the decline in CBO's forecast for inflation, which reduces estimates of both revenues and outlays (although the effect on revenues is moderately larger). Changes in projections of the unemployment rate, real GDP, and other variables also play a role. Technical revisions to CBO's baseline—mostly on the revenue side of the budget—account for another $134 billion of the addition to the cumulative deficit over the 2004-2013 period.

The Economic Outlook

CBO's forecast for the next two calendar years anticipates continued robust growth in overall demand. Stronger business investment will lead the way as firms spend more than they have spent in the past few years on their fixed assets (such as buildings and equipment) and switch from drawing down inventories to restocking their shelves. The rapid growth of productivity over the past three years has contributed to the economy's capacity to expand quickly without boosting inflation significantly. Indeed, the unexpected strength of productivity during 2003 has caused CBO to raise its expectation for potential GDP (the level of GDP consistent with a high rate of resource use) and, in turn, for GDP. CBO expects real GDP to expand by 4.8 percent in calendar year 2004 and 4.2 percent in 2005 and then to grow at an average annual rate of 2.7 percent from 2006 to 2014 *(see Summary Table 3)*.

The unemployment rate is forecast to fall from 6.0 percent in 2003 to 5.8 percent in 2004 and 5.3 percent in 2005, reflecting the expected closing of the gap between GDP and potential GDP. After briefly dipping to 5.0 percent in 2006, the unemployment rate will average 5.2 percent from 2007 through 2014, according to CBO's projections.

In CBO's estimates, inflation and nominal interest rates will remain low by historical standards from 2004 to 2014, even though interest rates will rise from current levels. The consumer price index for all urban consumers (CPI-U) will fall from 2.3 percent in 2003 to 1.6 percent in 2004 and then gradually rise to average 2.2 percent from 2006 to 2014. Since its previous forecast in August, CBO has reduced the projected rate of CPI-U growth by 0.7 percentage points for 2005 and by about 0.3 percentage points annually beyond 2006. That outlook reflects CBO's view that the Federal Reserve will act to maintain the underlying rate of CPI-U inflation at between 2.0 percent and 2.5 percent, on average.

2. That projection includes an extrapolation of the $87 billion in supplemental appropriations for 2004 enacted in November 2003 to fund defense spending and reconstruction in Iraq and Afghanistan.

Summary Table 2.

Changes in CBO's Baseline Projections of the Deficit or Surplus Since August 2003

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total, 2004-2008	Total, 2004-2013
Total Deficit (-) or Surplus as Projected in August 2003	-480	-341	-225	-203	-197	-170	-145	-9	161	211	-1,445	-1,397
Changes												
Legislative												
Revenues	*	-1	*	*	*	*	*	*	*	*	-1	*
Outlays[a]	5	17	45	62	70	78	86	95	106	118	199	681
Subtotal, legislative	-5	-17	-45	-62	-70	-78	-86	-95	-106	-117	-200	-681
Economic												
Revenues	7	1	-15	-36	-55	-72	-89	-109	-132	-158	-98	-659
Outlays[a]	-7	-15	-24	-34	-46	-56	-65	-73	-80	-88	-126	-488
Subtotal, economic	14	17	9	-2	-10	-16	-24	-37	-52	-70	28	-171
Technical												
Revenues	-15	-16	-4	1	-3	-7	-5	-20	-25	-35	-38	-130
Outlays[a]	-8	5	3	*	-2	-3	1	1	2	5	-3	4
Subtotal, technical	-7	-20	-7	1	-1	-4	-6	-21	-27	-40	-35	-134
Total Effect on the Deficit or Surplus[b]	3	-21	-43	-64	-81	-98	-117	-153	-185	-227	-207	-986
Total Deficit as Projected in January 2004	-477	-362	-269	-267	-278	-268	-261	-162	-24	-16	-1,652	-2,383

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

a. Includes net interest payments.

b. Negative numbers represent an increase in the deficit or a decrease in the surplus.

The interest rate on three-month Treasury bills for calendar year 2003 was just 1.0 percent. The rate for such bills will remain very low for 2004, CBO anticipates, but will increase to 3.0 percent in 2005. By CBO's projections, the rate will reach 4.6 percent in 2007 and remain at that level through 2014. The yield on 10-year Treasury notes will rise from an average 4.0 percent in 2003 to 4.6 percent in 2004, 5.4 percent in 2005, and 5.5 percent from 2006 through 2014, CBO projects.

Summary Table 3.

CBO's Economic Projections for Calendar Years 2004 Through 2014

	Estimated 2003	Forecast 2004	Forecast 2005	Projected Annual Average, 2006-2014
Nominal GDP (Billions of dollars)	10,980	11,629	12,243	18,266[a]
Nominal GDP (Percentage change)	4.8	5.9	5.3	4.5
Real GDP (Percentage change)	3.2	4.8	4.2	2.7
GDP Price Index (Percentage change)	1.6	1.1	1.1	1.8
Consumer Price Index[b] (Percentage change)	2.3	1.6	1.7	2.2
Unemployment Rate (Percent)	6.0	5.8	5.3	5.2
Three-Month Treasury Bill Rate (Percent)	1.0	1.3	3.0	4.5
Ten-Year Treasury Note Rate (Percent)	4.0	4.6	5.4	5.5

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: Percentage changes are year over year.

a. Level in 2014.

b. The consumer price index for all urban consumers.

CHAPTER

1

The Budget Outlook

The Congressional Budget Office (CBO) projects that under current policies, the federal deficit will total $477 billion in fiscal year 2004 and then decline to $362 billion in 2005 *(see Table 1-1).* Although that 2004 deficit would be a record in nominal dollars, it would represent a smaller share of the economy—4.2 percent of gross domestic product (GDP)—than the deficits recorded in the mid-1980s and early 1990s *(see Figure 1-1).* For the 10 years from 2005 through 2014, CBO projects that current policies would produce a cumulative deficit of $1.9 trillion, or 1.3 percent of total GDP over that period.

Because those baseline projections are predicated on the assumption that present laws and policies remain unchanged, they are not intended to be a prediction of future budgetary outcomes. Rather, CBO's baseline provides a neutral benchmark that lawmakers can use to measure the effects of proposed changes to taxes and spending.

In the current baseline, total outlays are projected to grow at an average rate of 4.7 percent a year and remain near 20 percent of GDP through 2014 *(see Table 1-2).* Within that total, spending for entitlements and other mandatory programs is projected to grow by 5.5 percent annually (faster than the economy as a whole). By contrast, discretionary spending is assumed to keep pace with inflation and wage growth, as the rules that govern the baseline require. Thus, discretionary spending is projected to increase by only 2.5 percent per year (about half the projected growth rate of the economy).

Table 1-1.

Projected Deficits and Surpluses in CBO's Baseline

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
On-Budget Deficit	-536	-631	-535	-464	-477	-504	-507	-511	-421	-299	-294	-277	-2,487	-4,288
Off-Budget Surplus[a]	161	154	174	195	211	226	239	249	259	275	278	290	1,045	2,395
Total Deficit (-) or Surplus	**-375**	**-477**	**-362**	**-269**	**-267**	**-278**	**-268**	**-261**	**-162**	**-24**	**-16**	**13**	**-1,443**	**-1,893**
Memorandum:														
Social Security Surplus	156	152	172	192	208	223	235	245	255	270	273	284	1,030	2,357
Postal Service Outlays	-5	-3	-2	-3	-3	-3	-4	-4	-4	-5	-5	-5	-15	-38
Total Deficit (-) or Surplus as a Percentage of GDP	**-3.5**	**-4.2**	**-3.0**	**-2.1**	**-2.0**	**-2.0**	**-1.8**	**-1.7**	**-1.0**	**-0.1**	**-0.1**	**0.1**	**-2.2**	**-1.3**

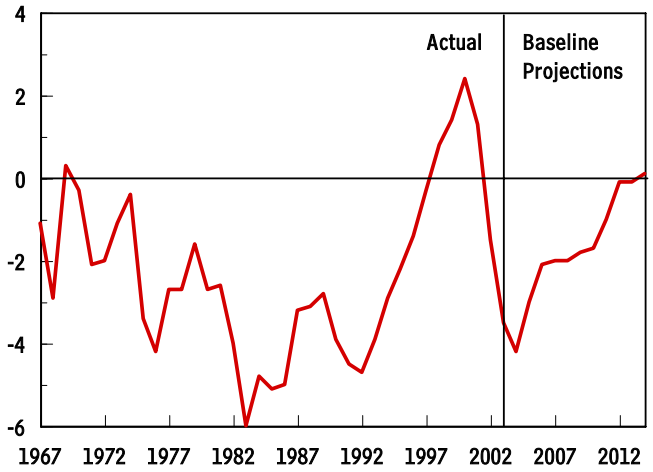
Source: Congressional Budget Office.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

Figure 1-1.

The Total Deficit or Surplus as a Share of GDP, 1967 to 2014

(Percentage of GDP)



Source: Congressional Budget Office.

Revenues are projected to grow from 15.8 percent of GDP this year to 16.9 percent in 2005 as the economy continues to improve. From 2006 through 2010, they are expected to account for about 18 percent of GDP. After that, revenues are projected to rise as the major provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expire. In CBO's baseline, revenues reach 20.1 percent of GDP in 2014.[1]

Federal debt held by the public will equal 38 percent of GDP at the end of this fiscal year, CBO projects. In the baseline, such debt stabilizes at about 40 percent of GDP through 2011, at which point the government's diminished need for borrowing causes debt held by the public to shrink as a share of GDP *(see Figure 1-2).*

Although the baseline projections cannot incorporate anticipated policy changes, this chapter shows the budgetary implications of some alternative policy assumptions over the next 10 years. For example, if the spending funded by the $87 billion supplemental appropriation law enacted in November 2003—mostly for military and reconstruction activities in Iraq—were not assumed to continue each year throughout the projection period, the projected 10-year deficit would shrink from $1.9 trillion to $785 billion. Debt held by the public at the end of 2014 would drop from 35 percent of GDP to 29 percent.

Alternatively, if all of the tax provisions that are set to expire over the next 10 years (except some related to the alternative minimum tax) were extended, the budget outlook for 2014 would change from a surplus of $13 billion to a deficit of $443 billion. Debt held by the public at the end of that year would climb to 48 percent of GDP, and the 10-year deficit would total $4.1 trillion.

Since August 2003, when CBO published its previous projections, revisions to the baseline have added nearly $1 trillion to the cumulative deficit for the 2004-2013 period (the 10 years covered by the earlier baseline).[2] About 70 percent of that increase, or $681 billion, comes from legislation enacted since August—primarily the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Public Law 108-173), which is estimated to boost outlays by almost $400 billion over those 10 years.[3] Revisions that spring from changes in CBO's economic forecast account for another $171 billion of the rise in projected deficits from 2004 through 2013, with the bulk of that increase coming from reductions in CBO's forecast for various measures of inflation. Those reductions lower both projected revenues and spending, but because such changes largely offset each other, they produce only slightly greater deficits (or smaller surpluses). Other, technical revisions—mostly on the revenue side of the budget—boost the cumulative deficit for that 10-year period by a further $134 billion.

Over the longer term, the federal budget will face significant strains, which will begin within the current 10-year projection period and intensify as more of the baby-boom generation reaches retirement age.[4] The annual growth rate of Social Security spending is expected to rise from around 4.6 percent in 2004 to 6.3 percent by 2014. Medicare and Medicaid spending are both projected to increase by 8 percent to 9 percent a year toward the end

1. The expiration of EGTRRA is estimated to reduce economic growth slightly after 2010, an effect that is incorporated in CBO's economic projections (which are presented in *Chapter 2*).

2. The previous projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2003).

3. The estimate for P.L. 108-173 excludes the cost of paying interest on any additional federal debt that results from the higher spending.

4. For an extensive discussion of the pressures facing the budget over the next 50 years, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2003).

Table 1-2.

CBO's Baseline Budget Projections

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
							In Billions of Dollars							
Revenues														
Individual income taxes	794	762	885	997	1,074	1,146	1,237	1,335	1,528	1,684	1,786	1,903	5,339	13,576
Corporate income taxes	132	161	224	264	273	275	276	278	287	297	307	320	1,312	2,801
Social insurance taxes	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732
Other	144	147	151	164	170	178	185	184	190	215	224	234	848	1,895
Total	**1,782**	**1,817**	**2,049**	**2,256**	**2,385**	**2,506**	**2,644**	**2,786**	**3,036**	**3,272**	**3,441**	**3,629**	**11,840**	**28,004**
On-budget	1,258	1,273	1,477	1,655	1,756	1,847	1,954	2,065	2,283	2,486	2,620	2,771	8,688	20,913
Off-budget	524	545	572	601	629	659	690	721	753	786	821	858	3,152	7,091
Outlays														
Discretionary spending	826	896	936	955	972	998	1,021	1,045	1,075	1,091	1,122	1,149	4,882	10,363
Mandatory spending	1,179	1,242	1,295	1,350	1,424	1,504	1,591	1,687	1,796	1,872	2,000	2,129	7,165	16,647
Net interest	153	156	180	219	255	281	300	316	328	334	335	338	1,235	2,886
Total	**2,158**	**2,294**	**2,411**	**2,525**	**2,652**	**2,783**	**2,912**	**3,047**	**3,198**	**3,296**	**3,457**	**3,616**	**13,282**	**29,897**
On-budget	1,795	1,904	2,012	2,118	2,233	2,350	2,461	2,575	2,704	2,785	2,914	3,048	11,175	25,201
Off-budget	363	391	399	406	419	433	451	472	494	512	543	568	2,107	4,696
Deficit (-) or Surplus	**-375**	**-477**	**-362**	**-269**	**-267**	**-278**	**-268**	**-261**	**-162**	**-24**	**-16**	**13**	**-1,443**	**-1,893**
On-budget	-536	-631	-535	-464	-477	-504	-507	-511	-421	-299	-294	-277	-2,487	-4,288
Off-budget	161	154	174	195	211	226	239	249	259	275	278	290	1,045	2,395
Debt Held by the Public	3,914	4,393	4,771	5,055	5,338	5,630	5,912	6,185	6,356	6,388	6,409	6,399	n.a.	n.a.
Memorandum:														
Gross Domestic Product	10,829	11,469	12,091	12,682	13,236	13,862	14,519	15,187	15,862	16,562	17,301	18,070	66,389	149,371
							As a Percentage of GDP							
Revenues														
Individual income taxes	7.3	6.6	7.3	7.9	8.1	8.3	8.5	8.8	9.6	10.2	10.3	10.5	8.0	9.1
Corporate income taxes	1.2	1.4	1.8	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	2.0	1.9
Social insurance taxes	6.6	6.5	6.5	6.5	6.6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
Other	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.2	1.2	1.3	1.3	1.3	1.3	1.3
Total	**16.5**	**15.8**	**16.9**	**17.8**	**18.0**	**18.1**	**18.2**	**18.3**	**19.1**	**19.8**	**19.9**	**20.1**	**17.8**	**18.7**
On-budget	11.6	11.1	12.2	13.0	13.3	13.3	13.5	13.6	14.4	15.0	15.1	15.3	13.1	14.0
Off-budget	4.8	4.7	4.7	4.7	4.8	4.8	4.8	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Outlays														
Discretionary spending	7.6	7.8	7.7	7.5	7.3	7.2	7.0	6.9	6.8	6.6	6.5	6.4	7.4	6.9
Mandatory spending	10.9	10.8	10.7	10.6	10.8	10.9	11.0	11.1	11.3	11.3	11.6	11.8	10.8	11.1
Net interest	1.4	1.4	1.5	1.7	1.9	2.0	2.1	2.1	2.1	2.0	1.9	1.9	1.9	1.9
Total	**19.9**	**20.0**	**19.9**	**19.9**	**20.0**	**20.1**	**20.1**	**20.1**	**20.2**	**19.9**	**20.0**	**20.0**	**20.0**	**20.0**
On-budget	16.6	16.6	16.6	16.7	16.9	17.0	17.0	17.0	17.0	16.8	16.8	16.9	16.8	16.9
Off-budget	3.4	3.4	3.3	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.2	3.1
Deficit (-) or Surplus	**-3.5**	**-4.2**	**-3.0**	**-2.1**	**-2.0**	**-2.0**	**-1.8**	**-1.7**	**-1.0**	**-0.1**	**-0.1**	**0.1**	**-2.2**	**-1.3**
On-budget	-5.0	-5.5	-4.4	-3.7	-3.6	-3.6	-3.5	-3.4	-2.7	-1.8	-1.7	-1.5	-3.7	-2.9
Off-budget	1.5	1.3	1.4	1.5	1.6	1.6	1.6	1.6	1.6	1.7	1.6	1.6	1.6	1.6
Debt Held by the Public	36.1	38.3	39.5	39.9	40.3	40.6	40.7	40.7	40.1	38.6	37.0	35.4	n.a.	n.a.

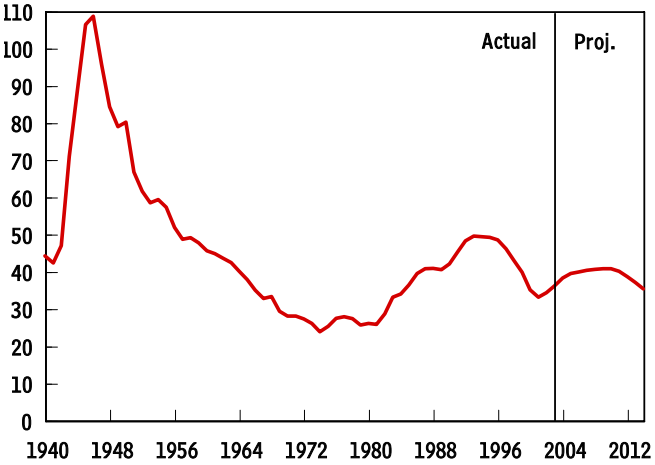
Source: Congressional Budget Office.

Note: n.a. = not applicable.

Figure 1-2.

Debt Held by the Public as a Share of GDP, 1940 to 2014

(Percentage of GDP)



Source: Congressional Budget Office.

of the projection period. Under baseline assumptions, those three entitlement programs together will account for nearly half of all federal outlays by 2014 (up from 40 percent this year).

After 2014, as the percentage of the population age 65 or older continues to increase (from 14 percent in 2014 to 19 percent in 2030), spending on those three programs will claim an even larger share of total outlays. Over the long term, increasing resource demands for major entitlement programs will exert pressure on the budget that economic growth alone is unlikely to alleviate.

A Review of 2003

The budget deficit more than doubled in 2003—growing to $375 billion from $158 billion in 2002. Although last year's deficit was smaller than those of the mid-1980s and early 1990s in relation to the size of the economy, it set a record in nominal dollar terms.

Outlays grew by over 7 percent ($147 billion) in 2003, to a total of almost $2.2 trillion. Excluding net interest, that growth rate was even higher: about 9 percent.[5] Outlays for defense rose by 16 percent ($56 billion) last year—with roughly half of that increase stemming from funds provided for the conflict in Iraq and continuing operations for the war on terrorism. Nondefense discretionary outlays grew by more than 9 percent ($35 billion). That rise was spread among numerous programs, with the largest increases found in transportation ($9 billion),[6] education ($8 billion), and health ($5 billion). In terms of mandatory programs, continued weakness in the job market and legislation that extended emergency benefits for the unemployed pushed up outlays for unemployment compensation by nearly 9 percent, to a record high of $55 billion. Spending on Medicaid also grew by almost 9 percent, reaching $161 billion. (For more information about recent and projected federal spending, see *Chapter 3*.)

While outlays continued to increase in 2003, revenues fell for the third consecutive year, by $71 billion. However, last year's decline (nearly 4 percent) was significantly smaller than the drop the year before (almost 7 percent). The decrease in revenues in 2003 stemmed mostly from weak income growth and changes in tax policies enacted since 2001.

Declines in two major revenue sources—taxes on individual and corporate income—exceeded the overall drop on a percentage basis. Revenues from individual income taxes were almost 8 percent lower in 2003 than in 2002, and corporate income tax receipts were nearly 11 percent lower. Receipts from social insurance (payroll) taxes, by contrast, grew by almost 2 percent. Other sources of revenue fell by roughly 1.5 percent. (Recent and projected revenues are described in more detail in *Chapter 4*.)

The Concept Behind CBO's Baseline Projections

The projections that make up CBO's baseline are not intended to be predictions of future budgetary outcomes but rather CBO's best judgment of how the economy and other factors would affect federal revenues and spending

5. Net interest comprises the government's interest payments on federal debt held by the public minus interest income that the government receives on loans and cash balances and earnings of the National Railroad Retirement Investment Trust.

6. That amount excludes the effects of a $2.75 billion intragovernmental transfer from the Federal Emergency Management Agency to the Department of Transportation.

under current laws and policies. CBO constructs its baseline according to rules set forth in law, mainly in the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget and Impoundment Control Act of 1974. (For further discussion of the federal budget process, *see Box 1-1 on page 8.*) In general, those laws instruct CBO and the Office of Management and Budget to project federal spending and revenues under current policies. Lawmakers can then use the baseline as a neutral benchmark against which to measure the effects of proposed changes in tax and spending policies.

For revenues and mandatory spending, the Deficit Control Act requires that the baseline be projected under the assumption that present laws continue without change.[7] In most cases, the laws that govern revenues and mandatory spending are permanent. The baseline projections reflect anticipated changes in the economy, demographics, and other relevant factors that affect the implementation of those laws.

The baseline rules differ for discretionary spending, which is governed by annual appropriation acts. The Deficit Control Act states that such spending should be projected by adjusting the current year's discretionary budget authority to reflect inflation—using specified indexes—and other factors (such as the cost of annualizing adjustments to federal pay). CBO's baseline for discretionary spending incorporates the omnibus appropriation act (H.R. 2673), which was signed by the President on January 23. That law covers appropriations for the Departments of Agriculture, Commerce, Justice, State, Labor, Health and Human Services, Education, Transportation, the Treasury, Veterans Affairs, and Housing and Urban Development, as well as for the District of Columbia, foreign operations, and a number of federal agencies.

Budget Projections Under Alternative Scenarios

Future legislation will undoubtedly alter the budget outlook in significant ways.[8] To illustrate the potential effects of different fiscal policies on the baseline, CBO has estimated the budgetary impact of some broad legislative options *(see Table 1-3).* The full impact of such options would also include their effect on debt-service costs (changes in projected interest payments resulting from changes in the government's projected borrowing needs).

The future path of discretionary spending has a significant impact on the budget outlook. As noted above, CBO's baseline inflates budget authority for discretionary programs from the level appropriated for the current year and thus projects total discretionary outlays of $10.4 trillion over the 2005-2014 period. For comparison, CBO estimated the budgetary impact of four alternative assumptions about future discretionary funding—two of which would worsen the budget outlook and two of which would improve it.

If current appropriations grow at the same rate as nominal GDP through 2014 instead of at the rate of inflation, total projected discretionary spending will be $1.4 trillion higher. If such appropriations rise by 6.9 percent a year—the average growth rate from 1999 through 2004 (excluding the $87 billion in supplemental appropriations for 2004)—discretionary spending will be $2.7 trillion greater over 10 years than the baseline projects.[9]

7. Under the Deficit Control Act, baseline projections must assume that spending programs that are set to expire will continue if they have outlays of more than $50 million in the current year and were established at the same time as or before the enactment of the Balanced Budget Act of 1997. Programs established after that are not assumed in the baseline to continue automatically. Another requirement of the Deficit Control Act is that expiring excise taxes dedicated to a trust fund be extended at the current rates. However, the law does not provide for the extension of other expiring tax provisions, even if they have routinely been extended in the past.

8. The budget is also sensitive to the state of the economy and to technical assumptions about the impact of tax and spending policies. Uncertainty about such factors is discussed in Appendix A. In addition, Appendix B illustrates the budgetary effects of some alternative economic assumptions.

9. In both of those scenarios, total budget authority for 2004—which includes supplemental appropriations, according to baseline conventions—is extended through 2014.

Table 1-3.

The Budgetary Effects of Policy Alternatives Not Included in CBO's Baseline

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Policy Alternatives That Increase the Deficit or Reduce the Surplus[a]													
Extend Expiring Tax Provisions[b]													
Effect on the deficit or surplus													
EGTRRA and JGTRRA	-1	-14	-32	-35	-34	-40	-48	-175	-275	-285	-295	-155	-1,233
Partial expensing	3	-41	-71	-66	-58	-48	-40	-33	-28	-26	-28	-285	-440
Other	3	-1	-7	-12	-17	-19	-23	-25	-28	-31	-33	-56	-195
Total	6	-56	-110	-113	-108	-108	-110	-233	-331	-341	-356	-496	-1,868
Debt service	*	-1	-5	-11	-17	-24	-31	-41	-57	-77	-99	-57	-363
Reform the Alternative Minimum Tax[c]													
Effect on the deficit or surplus	0	-7	-21	-29	-39	-51	-62	-52	-31	-38	-45	-148	-376
Debt service	0	*	-1	-2	-4	-7	-10	-13	-16	-19	-22	-14	-93
Increase Discretionary Appropriations by the Growth Rate of Nominal GDP After 2004													
Effect on the deficit or surplus	0	-18	-44	-68	-93	-119	-147	-174	-202	-232	-264	-342	-1,360
Debt service	0	*	-2	-5	-9	-15	-23	-32	-43	-57	-72	-31	-258
Increase Discretionary Appropriations by 6.9 Percent a Year After 2004[d]													
Effect on the deficit or surplus	0	-25	-67	-114	-165	-219	-278	-343	-412	-488	-570	-590	-2,682
Debt service	0	*	-3	-7	-15	-26	-40	-58	-80	-107	-139	-51	-475

(Continued)

In the other direction, if the $87 billion in supplemental appropriations for 2004 are excluded from the amount extrapolated for future years, discretionary outlays will be $0.9 trillion lower over 10 years. If appropriations (including the supplemental) are frozen at the current level through 2014, with no adjustments for inflation, the effect will be even larger, reducing cumulative discretionary spending by $1.1 trillion.

For revenues, CBO's baseline projections rest on the assumption that current tax laws are not altered.[10] Therefore, CBO assumes that tax provisions that are scheduled to expire will actually do so. For example, the baseline envisions that major provisions of EGTRRA—such as the introduction of the 10 percent tax bracket, decreases in previously existing tax rates for individuals, increases in the child tax credit, and the repeal of the estate tax—will expire as scheduled at the end of 2010. On balance, the tax provisions that are set to expire reduce receipts; thus, if those provisions are assumed to be extended, projected revenues are lower than the level in the baseline.[11] For example, if all expiring tax provisions were extended (except those related to the exemption amount for the alternative minimum tax), total revenues would be $1.9 trillion lower over the 2005-2014 period.[12]

10. The sole exception involves excise taxes dedicated to trust funds, which, under budget rules, are included in the revenue projections whether or not they are scheduled to expire.

11. In the years before 2011, the largest contributor to the cost of extending those provisions is depreciation deductions that businesses can take for qualifying investments (also known as partial expensing). Other contributors include the research and experimentation tax credit and two provisions of EGTRRA that were modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003: the child tax credit and the 10 percent tax bracket.

12. Extending all expiring tax provisions would probably have a modest positive effect on economic growth, and thus on revenues, but such effects are not included in that estimate.

Table 1-3.

Continued

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Policy Alternatives That Reduce the Deficit or Increase the Surplus													
Increase Discretionary Appropriations (Excluding supplemental appropriations for 2004) by the Rate of Inflation After 2004[e]													
Effect on the deficit or surplus	0	39	72	84	90	93	96	99	100	103	105	379	880
Debt service	0	1	3	8	13	18	24	30	37	44	51	42	227
Freeze Total Discretionary Appropriations at the 2004 Level ($876 billion)													
Effect on the deficit or surplus	0	15	30	48	70	94	119	146	170	198	226	257	1,117
Debt service	0	*	1	3	7	11	17	25	34	45	59	23	203
Memorandum:													
Total Deficit (-) or Surplus in CBO's January 2004 Baseline	-477	-362	-269	-267	-278	-268	-261	-162	-24	-16	13	-1,443	-1,893

Sources: Congressional Budget Office; Joint Committee on Taxation.

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

a. Negative amounts indicate an increase in the deficit or a reduction in the surplus.

b. This estimate does not include the effects of extending the increased exemption amount for the alternative minimum tax, which expires in 2004. See the policy alternative for the alternative minimum tax.

c. This alternative assumes that the exemption amount for the AMT, which was increased through 2004 in JGTRRA, is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2004. The estimates are shown relative to current law. If this alternative was enacted jointly with the extension of expiring tax provisions, an interactive effect would occur that would make the combined revenue loss greater than the sum of the two separate estimates by about $173 billion (plus about $16 billion in debt-service costs) over the 2005-2014 period.

d. The 6.9 percent rate of growth is the historical average from 1999 through 2004, excluding $87 billion in supplemental appropriations for 2004 enacted in November. In this alternative, however, those supplemental appropriations are included in total budget authority for 2004 and are extended through 2014.

e. This alternative does not extend the $87 billion in supplemental appropriations enacted in November but includes the outlays resulting from them.

Another policy change that could affect revenues involves modifying the alternative minimum tax (AMT), a parallel income tax system that has fewer exemptions, deductions, and rates than the regular income tax. Unlike the regular tax, the AMT's exemption amount and brackets are not indexed for inflation. Consequently, its impact will grow in coming years as more taxpayers become subject to it (many of whom were not the intended target of the AMT when it was enacted). If the AMT was indexed for inflation after 2004, federal revenues would be $0.4 trillion lower over the next 10 years, according to CBO and the Joint Committee on Taxation.[13]

13. That estimate assumes that the exemption amount for the AMT (which was increased through 2004 in the Jobs and Growth Tax Relief Reconciliation Act of 2003) is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2004. In addition, if those changes to the AMT were enacted jointly with the extension of expiring tax provisions, an interaction effect would occur, causing revenues to decline by another $173 billion over 10 years.

Box 1-1.

Budget Enforcement Procedures: An Update

At the end of fiscal year 2002, the budget enforcement procedures that originated with the Budget Enforcement Act of 1990 (BEA) expired. Those procedures—annual limits on discretionary appropriations and the pay-as-you-go (PAYGO) requirement for new laws affecting mandatory spending or revenues—were devised as part of a broad agreement reached in 1990 to reduce and then eliminate budget deficits. Initially set to expire in 1995, the procedures were extended twice—in 1993 and 1997—as part of two subsequent budget agreements. The BEA procedures helped control the growth of spending and reduce deficits. Aided by a period of robust economic growth in the 1990s, they also contributed to producing a balanced budget by 1998.[1] Lawmakers are now confronted with the question of whether the BEA framework, or something comparable, should be resurrected.

In the absence of that framework, however, procedures that exist under permanent law provide a means for lawmakers to establish and enforce overall budgetary policies. The President submits an annual budgetary proposal to the Congress, which subsequently sets forth its own budgetary priorities in the form of a concurrent resolution. In general, the budget resolution is enforced through points of order—or procedural objections—that can prohibit the Congress from considering individual spending or revenue bills that are not consistent with the spending or revenue targets specified in the resolution. Budget resolutions may also contain other procedures to impose fiscal discipline. For example, recent resolutions have included broad restrictions on emergency spending and advance appropriations and have set separate discretionary spending limits and PAYGO requirements similar to the BEA procedures that expired in 2002. The points of order that enforce those and other requirements in the Congressional budget process may be waived or set aside, although in the Senate, waivers of major budget enforcement procedures require a three-fifths majority (60 votes) to be approved.

Nevertheless, some lawmakers and other observers assert that the current Congressional budget enforcement procedures are inadequate to control deficits. They argue that an additional framework such as the BEA is needed to strengthen fiscal discipline. However, experience under the BEA—and with the budget process in general—suggests that no procedures to control deficits or impose budgetary restraint will be effective in the absence of an overall political consensus to achieve those goals. Whether or not the BEA framework (or something like it) is renewed, political agreement on fiscal policy objectives is probably the largest single factor in ensuring that budget enforcement procedures and the budget process function smoothly.

1. For more details on the BEA procedures and their expiration, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), Appendix A.

The Long-Term Outlook for the Budget

The aging of the baby-boom generation will cause a historic shift in the United States' fiscal position in the decades beyond CBO's projection period. Over the next 30 years, the number of people ages 65 and older will double, while the number of adults under age 65 will increase by less than 15 percent. In addition to those demographic changes, costs per enrollee in federal health care programs are likely to continue growing much faster than inflation. CBO projects that those pressures will cause federal spending for Social Security, Medicare, and Medicaid combined to increase (even under moderate growth assumptions) by more than two-thirds as a share of the economy—from more than 8 percent of GDP in 2004 to over 14 percent in 2030 and almost 18 percent in 2050.

Those budgetary pressures will ultimately require choices involving some combination of a substantial reduction in the growth of federal spending, an increase in taxation—

possibly to levels unprecedented in the United States—and a dramatic boost in federal borrowing. Responding to that looming situation sooner rather than later, however, can make a significant difference. In particular, policies that encourage economic growth can help by increasing the total amount of resources available for all uses. But economic growth alone is unlikely to bring the nation's longer-term fiscal position into balance—making reform of programs for the elderly or substantial tax increases (or both) necessary. Policymakers face difficult decisions about how best to accomplish that reform, but the sooner such decisions are made, the less disruptive the shifts in policy will be.

Changes to the Budget Outlook Since August 2003

CBO's projection of the cumulative deficit for the 2004-2013 period has grown substantially since its August 2003 baseline *(see Table 1-4).* Revisions to that baseline have reduced the projected deficit for 2004 by $3 billion but increased the 10-year deficit by $986 billion.

CBO categorizes revisions to its baseline by their cause: recently enacted legislation, changes to the agency's outlook for the economy, and other factors that affect the budget (termed "technical" changes).[14] Legislation enacted since August accounts for more than two-thirds of the increase in the cumulative deficit for 2004 through 2013: $681 billion. Changes in the outlook for the economy have large, but mostly offsetting, effects on projected revenues and outlays—on net, they worsen the budget's bottom line by $171 billion. Technical changes add another $134 billion to the cumulative deficit.

Legislative Changes

Laws enacted in the past five months have increased projected deficits for the 2004-2013 period by a total of $681 billion (including $119 billion in additional debt-service costs attributable to that legislation). Virtually all of the increase has occurred on the spending side of the budget.

Discretionary Spending. Legislative changes to CBO's baseline for discretionary spending reflect budget authority for 2004 that is higher than the amounts assumed in the August baseline. Budget authority each year is set in 13 regular appropriation acts. In addition, budget authority for 2004 includes supplemental appropriations that were enacted in November 2003 for reconstruction efforts and ongoing military operations in Iraq and Afghanistan.

CBO estimates that appropriations to date for 2004 total $876 billion, about $4 billion more than the August baseline anticipated. That total reflects a transfer of more than $2 billion in budget authority for education from 2004 back to 2003 and rescissions for housing programs and the Iraqi Freedom Fund; those transfers and rescissions are not continued in the baseline. Extrapolating the remaining budget authority for 2004, CBO's projections of discretionary outlays have risen since the August baseline by $2 billion for 2004 and by a total of $124 billion for the 2004-2013 period.

Mandatory Spending. Legislation enacted since August has increased outlays for mandatory programs by a total of $442 billion between 2004 and 2013, CBO estimates. Most of that amount stems from the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173). That law is estimated to raise net outlays for Medicare by $535 billion, decrease spending for Medicaid by $138 billion, and reduce other health expenditures by $2 billion—for a combined effect of $395 billion over the 2004-2013 period.

Medicare and Medicaid. P.L. 108-173 will create a voluntary, federally subsidized benefit for outpatient prescription drugs under a new Part D of the Medicare program, with additional federal subsidies for drug coverage offered to some low-income Medicare beneficiaries. The law will also change the current Medicare+Choice program; expand and alter the payment structures for Medicare's fee-for-service benefits; increase the deductibles and modify the premiums paid by beneficiaries; and transfer to Medicare the obligation to pay certain costs that, under prior law, would have been paid by the Medicaid program. (For more details about the effects of the Medicare legislation, *see Box 1-2 on pages 12 and 13.*)

14. That categorization should be interpreted with caution. For example, legislative changes represent CBO's best estimates of the future effects of laws enacted since the previous baseline. However, if a new law proves to have different effects than CBO estimated initially, those differences will appear as technical changes (not legislative ones) in later revisions to the baseline. The distinction between economic and technical revisions is similarly imprecise. CBO classifies economic changes as ones that result directly from changes in the components of CBO's economic forecasts. Changes in other factors related to the performance of the economy—such as the amount of capital gains realizations—are classified as technical revisions.

Table 1-4.

Changes in CBO's Baseline Projections of the Deficit or Surplus Since August 2003

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total, 2004-2008	Total, 2004-2013
Total Deficit (-) or Surplus as Projected in August 2003	-480	-341	-225	-203	-197	-170	-145	-9	161	211	-1,445	-1,397
Changes to Revenue Projections												
Legislative	*	-1	*	*	*	*	*	*	*	*	-1	*
Economic	7	1	-15	-36	-55	-72	-89	-109	-132	-158	-98	-659
Technical	-15	-16	-4	1	-3	-7	-5	-20	-25	-35	-38	-130
Total Revenue Changes	**-8**	**-15**	**-20**	**-36**	**-59**	**-79**	**-94**	**-129**	**-158**	**-193**	**-137**	**-790**
Changes to Outlay Projections												
Legislative												
Discretionary												
Defense	*	-1	-2	-1	-1	-1	-1	*	*	*	-5	-8
Nondefense	2	10	13	15	15	15	15	16	16	16	53	132
Subtotal, discretionary	2	9	11	13	13	14	15	15	16	16	48	124
Mandatory												
Medicare and Medicaid	4	6	27	40	44	47	50	53	59	66	121	397
Military retirement	1	2	2	2	3	3	3	4	4	4	9	28
Tanker acquisition	*	1	2	2	2	2	2	2	2	1	7	18
Other	-2	*	1	1	*	*	*	*	*	*	-1	-1
Subtotal, mandatory	3	8	32	45	49	52	56	60	65	72	137	442
Net interest												
Debt service	*	*	2	5	8	12	16	20	25	31	15	119
Other	*	*	*	*	*	*	*	*	*	-1	-2	-4
Subtotal, net interest	*	*	1	4	8	11	15	20	25	30	13	115
Subtotal, legislative	5	17	45	62	70	78	86	95	106	118	199	681
Economic												
Discretionary	*	-1	-6	-11	-14	-17	-20	-22	-25	-28	-33	-144
Mandatory												
Social Security	*	-2	-5	-8	-10	-12	-15	-18	-21	-25	-24	-115
Other COLA programs	*	*	-2	-2	-3	-3	-4	-5	-5	-6	-30	-30
Medicare	*	*	-1	-2	-3	-4	-6	-8	-9	-12	-5	-43
Unemployment insurance	-7	-6	-6	-4	-3	-3	-3	-3	-3	-4	-25	-41
Other	-1	-1	-2	-2	-2	-3	-3	-4	-4	-5	-8	-27
Subtotal, mandatory	-7	-9	-14	-18	-21	-26	-31	-37	-43	-51	-69	-257

(Continued)

Table 1-4.

Continued

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total, 2004-2008	Total, 2004-2013
Changes to Outlay Projections												
Economic (Continued)												
Net interest												
Rate effect	*	-4	-2	-4	-9	-13	-14	-15	-16	-16	-19	-93
Debt service	*	-1	-1	-2	-2	-1	*	2	4	7	-6	6
Subtotal, net interest	*	-5	-3	-6	-11	-13	-14	-13	-12	-9	-25	-87
Subtotal, economic	-7	-15	-24	-34	-46	-56	-65	-73	-80	-88	-126	-488
Technical												
Discretionary	-5	-3	2	2	2	2	2	2	*	1	-3	3
Mandatory												
Medicaid	-2	-2	-2	-2	-2	-2	-2	-3	-3	-4	-9	-23
Medicare	3	2	*	1	1	-1	1	2	1	1	7	11
Farm programs (CCC)	-5	-3	-2	-1	*	*	*	1	1	1	-11	-8
Food Stamps	3	2	2	1	*	*	*	*	*	*	8	7
Spectrum receipts	0	8	3	-2	-3	0	0	0	0	0	6	6
Credit reestimates	5	0	0	0	0	0	0	0	0	0	5	5
Other	-9	-2	-1	*	-2	-2	-2	-4	-2	-2	-13	-26
Subtotal, mandatory	-4	6	*	-4	-6	-6	-3	-4	-4	-4	-7	-28
Net interest												
Debt service	-1	-1	*	*	1	1	2	3	5	7	*	18
Other	2	2	1	2	1	*	1	1	1	1	8	11
Subtotal, net interest	1	1	1	2	2	1	3	3	5	9	7	29
Subtotal, technical	-8	5	3	*	-2	-3	1	1	2	5	-3	4
Total Outlay Changes	**-11**	**6**	**23**	**28**	**22**	**19**	**22**	**24**	**27**	**35**	**69**	**196**
Total Impact on the Deficit or Surplus	**3**	**-21**	**-43**	**-64**	**-81**	**-98**	**-117**	**-153**	**-185**	**-227**	**-207**	**-986**
Total Deficit as Projected in January 2004	-477	-362	-269	-267	-278	-268	-261	-162	-24	-16	-1,652	-2,383
Memorandum:												
Total Legislative Changes	-5	-17	-45	-62	-70	-78	-86	-95	-106	-117	-200	-681
Total Economic Changes	14	17	9	-2	-10	-16	-24	-37	-52	-70	28	-171
Total Technical Changes	-7	-20	-7	1	-1	-4	-6	-21	-27	-40	-35	-134

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million; COLA = cost-of-living adjustment; CCC = Commodity Credit Corporation.

Box 1-2.

Effects of the New Medicare Law on Mandatory Spending

Enactment of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (Public Law 108-173) has increased the Congressional Budget Office's projection of mandatory spending over the 2004-2013 period by $395 billion. That increase reflects a projected $758 billion in new spending for Medicare over 10 years, partly offset by a reduction of $363 billion in outlays because of additional premium payments by Medicare beneficiaries, lower federal costs for Medicaid and other programs, and federal funding withheld from state Medicaid programs.

The Medicare Prescription Drug Program. Beginning in 2006, Medicare's new Part D will subsidize prescription drug coverage that is furnished in various ways: through private prescription drug plans available to all Medicare enrollees in a geographic area, through managed care plans that participate in the Medicare Advantage program, or through employer- or union-sponsored plans. Enrollees in the various plans will be charged premiums to pay for benefits not subsidized by Medicare.[1] The Part D program will provide additional federal subsidies to cover the costs of drugs for some low-income Medicare beneficiaries.

As transitional measures, P.L. 108-173 also established a drug discount card for certain low-income beneficiaries (which will cover up to $600 in prescription drugs per year) and appropriated $1.5 billion for 2004 and 2005 to pay the administrative costs of setting up the drug benefit. Gross Medicare spending for the prescription drug program is expected to total $47 billion in 2006, when the program is fully implemented, and rise to $153 billion in 2014. By that time, CBO estimates, Part D will account for 22 percent of all Medicare spending (not including offsets from premium payments).

Net Medicare outlays for the Part D drug program will total about $640 billion through 2013, CBO estimates—$771 billion in payments to prescription drug plans offset by $131 billion in premium receipts *(see the table at right).* Of that $640 billion cost, $552 billion is estimated to come from the general fund of the Treasury. The other $88 billion will come from withholding part of the government's payments to state Medicaid programs and instead crediting them to the Part D account in Medicare's Supplementary Medical Insurance Trust Fund. (The new law is projected to save states $115 billion over the 2006-2013 period by shifting responsibility for the prescription drug benefits of millions of people who are eligible for both Medicaid and Medicare, so-called dual eligibles, from the joint federal/state Medicaid program to the federal Medicare program. However, the law requires that some of those savings—$88 billion, in CBO's estimate—be transferred to Part D.)

Other Changes in Medicare and Medicaid. P.L. 108-173 will also affect spending for benefits under Parts A (Hospital Insurance) and B (Supplementary Medical Insurance) of Medicare. It will increase payments to managed care plans by an estimated $14 billion through 2013, of which $10 billion will be used to encourage preferred provider organizations to offer services on a regional basis. In addition, the law will increase Medicare payments to rural providers in the fee-for-service sector by about $21 billion.

Other provisions of the law that affect fee-for-service providers will reduce Medicare's payments by $28 billion, CBO estimates—largely through lower payment rates for durable medical equipment, drugs covered under Part B, and services furnished by home health agencies, ambulatory surgical centers, and clinical laboratories. P.L. 108-173 will also shift about $21 billion in spending: some to beneficiaries

1. Beneficiaries will pay those premiums either by having them withheld from their Social Security benefit checks (as is generally done with premiums for Part B of Medicare) or by arranging to pay the plans directly. The discussion above assumes that all participants in the drug benefit—except those enrolled in an employer- or union-sponsored plan—choose to have premiums withheld from their Social Security benefits. To the extent that participants opted to pay plans directly, federal spending for benefits and premium collections would be reduced equally, producing no effect on the net cost of the prescription drug benefit.

Box 1-2

Continued

through a rise in the Part B deductible and some to third-party insurers subject to secondary-payer requirements. Finally, it will increase the Part B premiums collected from beneficiaries by $3 billion over the 2004-2013 period. (That figure reflects a $13 billion increase in premiums paid by Medicare beneficiaries with relatively high income and a $10 billion reduction in premiums paid by all beneficiaries that results from lower Part B costs.)

P.L. 108-173 will also affect federal spending for Medicaid—reducing outlays by $138 billion over 10 years, CBO estimates. Transferring responsibility for the prescription drug benefits of dual eligibles to Medicare will save the federal government an estimated $152 billion in Medicaid spending through 2013. Those savings will be partly offset by an additional $14 billion in Medicaid outlays resulting from the new law—largely, higher spending for administration, increased payments to hospitals serving a disproportionate share of Medicaid beneficiaries, and additional spending on benefits for Medicare beneficiaries who will enroll in Medicaid as a result of applying for the low-income subsidy under the Medicare prescription drug program.

Finally, the Medicare law will reduce mandatory spending for the Federal Employees Health Benefits program and other federal programs that pay for prescription drugs by an estimated $2 billion over the 2006-2013 period.

Effects of the Part D Prescription Drug Benefit and Other Provisions of P.L. 108-173 on Mandatory Spending, 2004 to 2013

(Billions of dollars)

	Part D Provisions[a]	Other Provisions	Total
Medicare			
Part D prescription drug benefit	771	n.a.	771
Payments to managed care plans	n.a.	14	14
Payments to rural providers in fee-for-service sector	n.a.	21	21
Other fee-for-service provisions	n.a.	-28	-28
Spending shifted to beneficiaries	n.a.	-12	-12
Spending shifted to secondary payers	n.a.	-9	-9
Gross Mandatory Outlays for Medicare	771	-14	758
Premium receipts	-131	-3	-134
Transfer of funds withheld from state Medicaid programs	-88	n.a.	-88
Net Mandatory Outlays for Medicare	552	-17	535
Medicaid	-142	3	-138
Other Programs	-2	n.a.	-2
Total Mandatory Spending	**409**	**-14**	**395**

Source: Congressional Budget Office.

Note: n.a. = not applicable.

a. Includes mandatory spending for administration of Part D (in title X of P.L. 108-173) and interactions with the Hatch-Waxman Act and importation provisions in title XI; excludes the interaction of Part D with Medicare spending for benefits under Parts A and B (which is included in "Other fee-for-service provisions"). Those factors account for the difference between the $409 billion for Part D shown above and CBO's $410 billion estimate for title I of H.R. 1.

CBO estimates that the new law will increase net Medicare outlays by $3 billion this year and by $535 billion through 2013. Most of the law's effect on outlays will occur after 2005 because the prescription drug benefit will not be implemented until 2006. The enactment of P.L. 108-173 will also alter Medicaid spending—reducing federal outlays for the joint federal/state program by $138 billion over 10 years, CBO estimates.

Other Programs. The National Defense Authorization Act for 2004 (P.L. 108-136) expands benefits for disabled retirees of the military and other uniformed services whose degree of disability has been rated as 50 percent or higher by the Department of Veterans Affairs (VA). Under prior law, retired veterans could not receive both full retirement annuities and disability compensation from the VA. Beginning in 2014, those retirees will be able to concurrently receive full retirement annuities and veterans' disability benefits; until then, they will receive an increasing portion of their retirement annuities. That legislation also expands the combat-related special compensation program to include retired reservists and to cover all degrees of disability. (In addition, it transfers the obligation for that and another special compensation program for retirees from the military personnel accounts to the Department of Defense's Military Retirement Fund.) Taken together, those provisions will increase spending for military retirement programs by $1 billion in 2004 and $28 billion over the 2004-2013 period, CBO estimates.

P.L. 108-136 also authorized the Air Force to acquire up to 100 KC-767 tankers for aerial refueling through a hybrid acquisition strategy in which the Air Force would lease no more than 20 tankers and purchase as many as 80 additional ones. CBO determined that such transactions, if executed under financing arrangements previously agreed to by the Air Force and Boeing, would obligate the government to acquire the aircraft in advance of the necessary appropriations. Thus, CBO estimates that the legislation provides direct spending authority for tanker acquisition that could result in outlays of $18 billion over the 2004-2013 period.[15]

15. See Congressional Budget Office, *Estimate of Direct Spending and Revenue Effects for H.R. 1588, the National Defense Authorization Act for Fiscal Year 2004* (November 25, 2003) and *Letter to the Honorable Don Nickles regarding the Air Force's plan to acquire 100 Boeing tanker aircraft* (August 26, 2003).

Revenues. Recently enacted laws have had only a minor effect on CBO's revenue projections. Those laws—particularly the Military Family Tax Relief Act of 2003 (P.L. 108-121) and the Medicare legislation—are estimated to reduce revenues by a total of less than $500 million over the 2004-2013 period.

Net Interest. Almost all of the changes since August to CBO's projections of net interest outlays stem from the effects of recently enacted legislation on cumulative deficits. Because that legislation has increased projected deficits or decreased projected surpluses between 2004 and 2013 by $562 billion, debt-service costs will be $119 billion higher during that period, CBO estimates. Thus, the total impact of legislative actions since August is to increase spending by an estimated $681 billion through 2013.

Economic Changes

CBO's underlying assessment of the U.S. economy has not changed much since August. However, CBO has lowered its projections for the consumer price index (CPI), the GDP price index, and other measures of inflation. The current projection for the annual increase in the CPI is 0.7 percentage points lower for 2005 than the August projection, 0.5 percentage points lower for 2006, and 0.3 percentage points lower each year from 2007 through 2013. CBO made similar changes for the GDP price index.

Such changes in the outlook for inflation are responsible for the bulk of the economic revisions to CBO's baseline since August, although changes to the unemployment rate and other effects on interest rates also play a role. Together, those changes reduce projected revenues over the 2004-2013 period by $659 billion *(see Table 1-4).* They also reduce projected outlays, but to a lesser extent: by $488 billion. As a result, the economic revisions increase the projected 10-year deficit by $171 billion. (For more details about how inflation interacts with various components of the federal budget, *see Box 1-3.*)

Discretionary Spending. CBO is required to project future discretionary budget authority using a mix of two economic variables: the GDP price deflator and the employment cost index for wages and salaries. Both measures are now anticipated to be lower than CBO projected last August. Because of those reductions, CBO's projections of discretionary outlays are $144 billion lower over the 2004-2013 period than they would otherwise be.

Box 1-3.

How Inflation Affects the Federal Budget

Both the federal government's revenues and spending are sensitive to increases in the general level of prices, although the effects on the two sides of the budget mostly offset each other. In some cases, components of the budget are keyed directly to measures of inflation, such as the consumer price index; in other cases, the impact of inflation is felt through other measures, such as nominal wages, that affect tax collections or benefit payments. Over the next 10 years, the effects of inflation on revenues are slightly greater than the effects on outlays.[1]

On the revenue side, slower growth in prices results in slower growth in nominal wages, which translates directly into lower amounts of income taxes and payroll taxes withheld from people's paychecks. (The opposite is true for faster growth in prices.) Tax brackets for the individual income tax are indexed for inflation, but the adjustments lag behind actual price increases by more than a year, on average. In addition, lower corporate profits from slower growth in prices quickly reduce receipts from firms' quarterly estimated tax payments.

On the outlay side, three main connections exist between federal spending and inflation. First, many entitlement programs automatically adjust benefit levels each year to reflect price increases. Social Security, federal employee retirement programs, Supplemental Security Income, veterans' pensions, Food Stamps, and child nutrition programs, among others, are adjusted (with a lag) for changes in the consumer price index or one of its components. Many Medicare reimbursement rates are also adjusted annually for inflation. Second, to the extent that the benefit payments that participants in retirement and disability programs initially receive are related to wages, changes in nominal wages will be reflected in future outlays for those programs. Third, future spending for discretionary programs is projected on the basis of assumed rates of wage and price growth, and actual appropriations are often affected by the perception of how allocated resources keep pace with inflation.

Inflation also has an impact on net interest because it is one component of nominal long-term interest rates (the other being a real, or inflation-adjusted, rate of return). For example, if real rates of return remain constant but the inflation rate drops, interest rates will decline and new federal borrowing will incur lower interest costs.

1. For an illustration of how altering projections of inflation affects budget totals, see *Appendix B*.

Mandatory Spending. For many mandatory programs, spending is linked to economic indicators. Changes in CBO's economic outlook decrease projected mandatory spending by $7 billion for 2004 and $257 billion for the 2004-2013 period, mostly because of the decline in projected inflation rates.

The largest economic revision involves the Social Security program. By 2013, cost-of-living adjustments (COLAs), which affect payments to beneficiaries already on the rolls, and nominal wages, which affect new recipients' initial benefits, are both projected to be about 3 percent lower than in CBO's August baseline. As a result, projected outlays for Social Security are also about 3 percent lower in 2013—and $115 billion lower over the entire 2004-2013 period. Projected outlays for other mandatory programs that use COLAs have been reduced by a total of $30 billion over that 10-year period. Those programs include civil service retirement, military retirement, Supplemental Security Income, and some veterans' benefits.

Projected Medicare spending has risen slightly in 2004 and 2005 as a result of CBO's outlook for faster growth of GDP (because expenditure targets for physicians' services are linked to projected GDP growth). After 2005, lower projected inflation begins to offset such spending increases (because payment rates for most services are raised each year to reflect changes in the prices of inputs for those services). As a result, CBO now projects Medicare spending to be lower by $43 billion over 10 years.

Downward revisions to CBO's forecast of the unemployment rate and labor force participation have reduced projected outlays for unemployment compensation by $7 billion for 2004 and $41 billion for the 2004-2013 period. Specifically, CBO has lowered its projections of the unemployment rate in fiscal years 2004 through 2006 by 0.4 to 0.5 percentage points, and the 2007 and 2008 rates by smaller amounts. CBO has also reduced its estimate of the size of the labor force throughout the projection period. The combination of a lower unemployment rate and smaller labor force shrinks CBO's estimate of the number of people drawing unemployment insurance during the 2004-2013 period by about 4 percent. In addition, because CBO has reduced its assumptions for wage growth, average unemployment benefits are projected to be lower.

Revenues. Most of the total decline in CBO's revenue projections since August is attributable to economic changes. Economic reestimates of revenues are slightly positive in 2004 and 2005 but then turn negative and grow steadily through 2013.

The bulk of the change in projected revenues results from CBO's lower outlook for inflation, which generates smaller projected income growth and therefore less tax revenue—roughly $700 billion less over the 2004-2013 period. That reduction is slightly offset, however, by two other effects of the new economic outlook, which together increase projected revenues by about $40 billion over those 10 years. First, CBO has raised its projections for real economic growth in the next two years and for real GDP through 2013. Those revisions result in higher projected revenues from individual and corporate income taxes and payroll taxes. Second, CBO has lowered its projection for the share of GDP earned in the form of wages and salaries (the type of income in CBO's projections that has the highest marginal tax rate). That change reduces projected revenues from individual income and payroll taxes. The two effects nearly offset each other over the 10-year projection period, with the real-growth effect dominating slightly in the early and middle part of the period and the income-share effect dominating slightly in the later part of the period.

Net Interest. Changes to CBO's forecast for interest rates have lowered projected outlays for net interest by $93 billion over 10 years. In the current forecast, interest rates on three-month Treasury bills are 0.3 percentage points lower in 2004 and 0.4 percentage points lower in 2005 than they were in the August forecast. However, CBO's current projections for interest rates on two-year Treasury notes in the near term are higher than they were last summer. As a result, the changes to net interest spending attributable to the new forecast for interest rates are relatively small through 2007. For the years that follow, projected interest rates on three-month bills and 10-year notes have declined by 0.3 percentage points, reducing projected net interest payments by as much as $16 billion a year.

In addition to that rate effect, changes in CBO's economic forecast reduce projected deficits in the near term and thereby decrease estimates of the government's borrowing needs. However, the situation reverses later in the projection period. As a result, additional debt-service costs attributable to economic changes net to just $6 billion over the 2004-2013 period.

Technical Changes

Technical changes represent revisions to the baseline that cannot be ascribed either to recent laws or to changes in CBO's economic forecast. As a whole, technical changes worsen the baseline budget outlook by $7 billion in 2004 and by a total of $134 billion through 2013, largely because of revisions to the revenue projections.

Discretionary Spending. CBO has made small technical adjustments that lower projected discretionary spending by $5 billion this year and $3 billion in 2005 and that increase it thereafter—for a total increase of $3 billion over the 2004-2013 period. Those technical revisions affect nearly all areas of the budget. The largest revision for 2004 and 2005 involves slower projected spending by the Department of Homeland Security's Office for Domestic Preparedness (estimated outlays were reduced by $2 billion for 2004 and $1 billion for 2005).

Mandatory Spending. Overall, technical changes to mandatory programs have a relatively small effect on the budget—amounting to no more than $6 billion in any one year and reducing projected outlays by a total of $28 billion through 2013.

CBO lowered its projections for Medicaid spending over the 2004-2013 period by $23 billion, largely because of lower-than-anticipated spending in 2003. With Medicare, by contrast, new information about the mix of program spending in 2003 has prompted CBO to raise its outlay projections for that period by $11 billion.

Projected outlays by the Commodity Credit Corporation for farm price and income-support payments over the 2004-2013 period have been reduced by $8 billion since the August baseline. Most of the reduction affects the first few years of that period and stems from new information about program participants and the current favorable market for many crops. The Department of Agriculture recently released data from the initial enrollment for benefits under the Farm Security and Rural Investment Act of 2002. Producers reported payment yields and acreage bases that were lower than expected for several major crops. In addition, prices of most major crops are higher than CBO anticipated last summer. Those higher prices result from lower-than-expected production and strong overseas demand for U.S. crops. The federal payments associated with a given year's crop production can span several fiscal years, and the effects of tight supplies and higher prices can last for several years. Consequently, CBO now expects lower federal payments to agricultural producers for the next few years.

Spending for the Food Stamp program is projected to be $7 billion higher during the 2004-2013 period than CBO estimated in August. That change reflects increases in CBO's projections of program participation and of the average benefit over the next few years.

Licenses to use the electromagnetic spectrum are now expected to bring in lower auction receipts through 2013 than previously anticipated. That change increases net federal outlays by an estimated $6 billion over the period. It reflects the likelihood that less spectrum will be auctioned before the Federal Communications Commission's authority to do so expires (at the end of 2007) and a judgment, based on recent trends in the telecommunications industry, that the proceeds from scheduled auctions will be somewhat lower than projected earlier.

Technical reestimates of mandatory spending in 2004 also reflect a net increase in the estimated subsidy cost (the projected net present value of government losses on outstanding loans and guarantees) for a number of federal credit programs. The budget includes the cost of federal programs that guarantee loans made by private financial institutions and the cost of direct federal loans to individuals or businesses. Accurately projecting loan repayments, defaults, and changes in interest rates over the life of a credit program is difficult; as a result, each year, federal agencies revise their estimates of subsidy costs for loans and guarantees that were made in previous years. On the basis of preliminary information from the Administration, CBO has raised its estimate of outlays in 2004 by almost $5 billion to reflect such changes.

The remaining technical changes to projected mandatory spending result from reestimates for a variety of programs, including small reductions in estimated outlays for TRICARE for Life, the Federal Employees Health Benefits program, the Postal Service, and Social Security.

Revenues. CBO has reduced its revenue projections for the 2004-2013 period by $130 billion because of technical factors—specifically, the revenue yield expected from a given amount of income in the economic projections. The downward changes to revenues equal or exceed $15 billion a year for the first two and the last three years of the projection period; they are relatively small for 2006 through 2010. Those changes generally reflect new modeling and information from recent tax collections.

The downward reestimates for 2004 and 2005 are largely based on recent tax revenues and revised estimates of the effects of the past few years' tax cuts. Corporate receipts in recent months have been weaker than analysts had expected given the strong surge in profits indicated by the national income and product accounts. In addition, CBO has revised its estimates of when and to what degree certain provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003 will reduce revenues.

More than 60 percent of CBO's total technical changes to revenue projections affect the 2011-2013 period. The latest information (from 2001 tax returns) indicates that more of the recent shortfall in revenues is likely to be permanent, rather than temporary, than CBO assumed in its August baseline. That information affects every year through 2013 but is especially apparent in the last three years, when offsetting effects are smaller.

Net Interest. The small technical changes to CBO's projections of net interest costs mostly reflect new information about the composition and amount of federal debt. Such changes total $11 billion over the 2004-2013 period.

In total, revisions to the baseline projections that are attributable to technical changes increase the cumulative deficit by $116 billion (excluding debt service) over that 10-year period. CBO estimates that the additional debt-service costs resulting from technical revisions would add $18 billion to interest payments over that period, for a total technical change of $134 billion.

The Outlook for Federal Debt

The federal government's debt falls into two main categories: debt that is held by the public (in the form of marketable and nonmarketable Treasury securities) and debt that is held by government accounts. Debt held by the public is the most meaningful measure of debt in terms of its relationship to the economy; it represents debt that the Treasury issues to raise cash in order to fund the operations of the federal government and pay off its maturing liabilities. Debt held by government accounts consists of securities issued by the Treasury to various federal agencies. Those intragovernmental IOUs are used as an accounting device to track cash flows relating to specific federal programs (such as Social Security).

Debt Held by the Public

When federal revenues are insufficient to finance spending, the Department of the Treasury raises money by selling securities in the capital markets to buyers such as foreign investors (governments, businesses, and individuals), pension funds, mutual funds, state and local governments, commercial banks, insurance companies, and individuals. Of those groups, foreign investors are currently the largest owners of federal debt issued to the public; they hold $1.5 trillion, or more than one-third of the roughly $4 trillion that is now outstanding.

Among foreign investors, those of Japan, China, and the United Kingdom are the largest holders of Treasury securities.[16] The Japanese alone hold about $500 billion in such securities, more than $100 billion of which were bought in 2003—over 25 percent of the size of the 2003 deficit. In all, foreign holdings increased by $260 billion last year. Foreign investors will be important lenders in the future as long as they continue to accumulate dollars and use those funds to buy Treasury securities.

State and local governments and mutual funds are also relatively large investors in Treasury securities. Those governments hold $319 billion in debt held by the public, and mutual funds hold $299 billion.[17]

Debt held by the public fluctuates according to changes in the government's borrowing needs. It reached nearly 50 percent of GDP in 1993, but by 2001, that share had fallen to about 33 percent *(see Figure 1-2 on page 4)*. Over the past two years, debt held by the public has crept up to 36 percent of GDP. If current policies do not change, it will grow to almost 41 percent of GDP by 2008 before falling to 35 percent by 2014 *(see Table 1-5).*

The Composition of Debt Held by the Public. More than 88 percent of publicly held debt consists of marketable securities—Treasury bills, notes, bonds, and inflation-indexed issues. The rest comprises nonmarketable securities, such as savings bonds and state and local government securities, which are nonnegotiable, nontransferable debt instruments issued to specific investors.[18]

The Treasury sells marketable securities in regularly scheduled auctions, whose size varies along with fluctuations in the government's cash flow. (The Treasury also sells cash-management bills periodically to cover shortfalls in cash balances.) In 2003, the Treasury significantly altered its auction schedule because of larger and more volatile borrowing requirements: it introduced a three-year note, which is issued on a quarterly basis, and increased the frequency with which it auctions five-year, 10-year, and inflation-indexed notes.[19] Those changes should enable the Treasury to respond to its large near-term financing requirements. However, increased issuance of notes may boost the average maturity of debt held by the public.

Why Changes in Debt Held by the Public Do Not Equal the Size of Surpluses and Deficits. In most years, the amount that the Treasury borrows or redeems approximates the total budget deficit or surplus. However, a number of factors—which are broadly labeled "other means of financing"—also affect the government's need to borrow money from the public. CBO projects that

16. See Department of the Treasury, *Major Foreign Holdings of Treasury Securities* (January 16, 2004), available at www.ustreas.gov/tic/mfh.txt. That information should be viewed as approximate because the Treasury's data indicate the location where a purchase was made but not necessarily the location of the owner's residence.

17. Department of the Treasury, Financial Management Service, *Treasury Bulletin* (December 2003).

18. State and local government securities are time deposits that the Treasury sells to the issuers of state and local government tax-exempt debt to help them comply with the arbitrage restrictions in the Internal Revenue Code.

19. Five-year notes are now sold monthly instead of quarterly; 10-year notes are sold eight times a year rather than four times a year; and inflation-indexed notes are sold quarterly rather than three times a year.

Table 1-5.

CBO's Baseline Projections of Federal Debt

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Debt Held by the Public at the Beginning of the Year	3,540	3,914	4,393	4,771	5,055	5,338	5,630	5,912	6,185	6,356	6,388	6,409
Changes to Debt Held by the Public												
Surplus (-) or deficit	375	477	362	269	267	278	268	261	162	24	16	-13
Other means of financing	-2	3	16	16	16	15	14	12	10	8	5	2
Total	373	480	377	285	282	292	282	273	171	32	21	-10
Debt Held by the Public at the End of the Year	3,914	4,393	4,771	5,055	5,338	5,630	5,912	6,185	6,356	6,388	6,409	6,399
Debt Held by Government Accounts												
Social Security	1,484	1,636	1,807	2,000	2,207	2,430	2,666	2,911	3,166	3,436	3,709	3,993
Other government accounts[a]	1,362	1,430	1,519	1,627	1,733	1,840	1,949	2,063	2,179	2,303	2,427	2,552
Total	2,846	3,066	3,326	3,626	3,940	4,270	4,615	4,974	5,345	5,739	6,136	6,545
Gross Federal Debt	6,760	7,459	8,097	8,681	9,278	9,900	10,527	11,159	11,701	12,127	12,546	12,944
Debt Subject to Limit[b]	6,738	7,437	8,075	8,659	9,255	9,877	10,503	11,135	11,677	12,102	12,520	12,918
Memorandum:												
Debt Held by the Public at the End of the Year as a Percentage of GDP	36.1	38.3	39.5	39.9	40.3	40.6	40.7	40.7	40.1	38.6	37.0	35.4

Source: Congressional Budget Office.

a. Mainly the Civil Service Retirement, Military Retirement, Medicare, Unemployment Insurance, and Airport and Airway Trust Funds.

b. Differs from gross federal debt primarily because it excludes most debt issued by agencies other than the Treasury. The current debt limit is $7,384 billion.

debt held by the public will increase by more than the cumulative deficit over the 2004-2014 period because other means of financing activities will raise the Treasury's borrowing needs *(see Table 1-5).*

In most years, the largest type of other means of financing is the capitalization of financing accounts used for federal credit programs. Direct student loans, rural housing programs, loans by the Small Business Administration, and other credit programs require the government to disburse money in anticipation of repayment at a later date. Those initial outlays are not counted in the budget, which reflects only the estimated subsidy costs of such programs. From 2004 through 2014, the amount of loans being disbursed will typically be larger than the amount of repayments and interest collected. Thus, the government's annual borrowing needs will be $3 billion to $15 billion greater than the annual budget deficit or surplus would indicate.

In July 2003, the Treasury announced plans to eliminate a program in which interest-free cash balances were held at banks as compensation for their financial services. The withdrawal of those balances throughout the year returned $28 billion to the Treasury, reducing its borrowing needs by that amount. Under the omnibus appropriation act, the Treasury will pay banks directly for their services. Since July, it has compensated banks with interest payments from depositary compensation securities (currently about $20 billion outstanding). CBO's baseline assumes that the Treasury will withdraw those securities, decreasing debt held by the public by $20 billion.

Debt Held by Government Accounts

Besides selling securities to the public, the Treasury has issued more than $2.8 trillion in securities to various accounts of the federal government. All of the major trust funds and many other government funds invest in special, nonmarketable Treasury securities known as the government account series. (Trust funds are described in more detail at the end of this chapter.) Those transactions are intragovernmental and have no direct effect on the economy. The securities represent credits to the various government accounts and are redeemed when benefit payments and other expenses arise. In the meantime, the Treasury assigns interest earnings to the funds holding those securities; such payments have no net effect on the budget.

The largest balances of such debt are in the Social Security trust funds (almost $1.5 trillion at the end of 2003) and the retirement funds for federal civilian employees ($602 billion). If current policies continue, the balance of the Social Security trust funds will rise to $4 trillion by 2014, CBO projects, and the balance of all government accounts will climb to $6.5 trillion *(see Table 1-5).*

Gross Federal Debt and Debt Subject to Limit

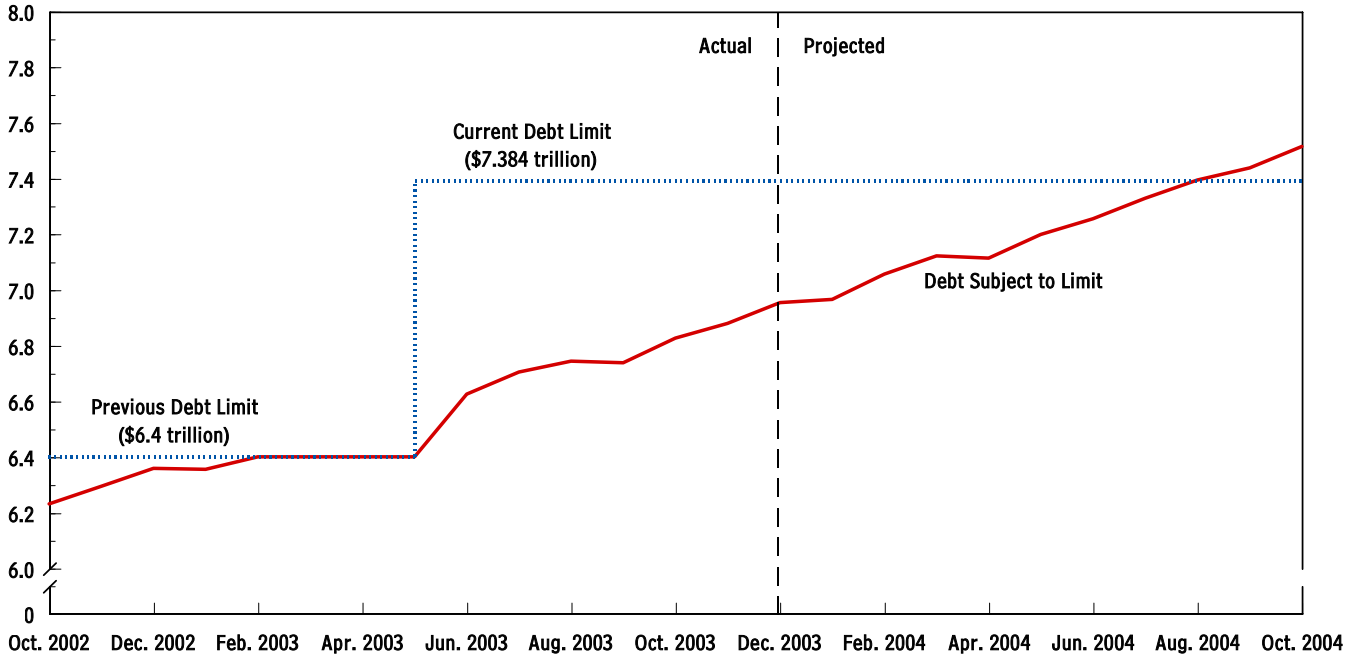
Gross federal debt and its companion measure, debt subject to limit, comprise debt issued to government accounts as well as debt held by the public. The future path of gross federal debt is determined by the sum of those components. CBO projects that gross federal debt will increase in every year of the projection period and reach $12.9 trillion in 2014. That amount is roughly 90 percent greater than the 2003 total of $6.8 trillion. Most of that increase reflects debt held by government accounts.

The Treasury's authority to issue debt is restricted by a statutory ceiling. Although it covers debt held by the public and by government accounts, that ceiling does not apply to debt issued by agencies other than the Treasury (such as the $26 billion of debt issued by the Tennessee Valley Authority). The current debt limit, which was set in May 2003 by P.L. 108-24, is $7.384 trillion. CBO estimates that under current policies, that limit will be reached this year sometime between July and September *(see Figure 1-3).*

Figure 1-3.

Debt Subject to Limit, October 2002 to October 2004

(Trillions of dollars)



Source: Congressional Budget Office.

Table 1-6.

CBO's Baseline Projections of Trust Fund Surpluses

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Social Security	156	152	172	192	208	223	235	245	255	270	273	284
Medicare												
Hospital Insurance (Part A)	22	19	18	24	22	22	22	21	17	20	14	9
Supplementary Medical Insurance (Part B)	-14	-6	*	5	3	1	2	2	1	2	1	-1
Subtotal, Medicare	8	12	17	28	25	24	23	22	19	21	15	8
Military Retirement	10	6	6	6	6	6	6	6	7	7	8	7
Civilian Retirement[a]	28	35	35	36	36	36	37	37	38	39	39	40
Unemployment	-20	-7	4	9	9	6	5	5	5	5	6	7
Highway and Mass Transit	-5	-5	-4	-3	-3	-3	-2	-2	-2	-2	-1	-1
Airport and Airway	*	-1	*	*	1	1	1	2	2	3	3	4
Other[b]	-24	5	4	4	4	4	4	4	5	5	5	5
Total Trust Fund Surplus	**151**	**198**	**235**	**272**	**285**	**297**	**309**	**320**	**328**	**348**	**347**	**355**
Intragovernmental Transfers to Trust Funds[c]	350	369	399	464	514	551	589	630	673	730	779	837
Net Budgetary Impact of Trust Fund Programs	**-198**	**-171**	**-164**	**-192**	**-229**	**-254**	**-280**	**-310**	**-345**	**-382**	**-431**	**-482**

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

a. Includes Civil Service Retirement, Foreign Service Retirement, and several smaller retirement trust funds.

b. Primarily trust funds for Railroad Retirement, federal employees' health and life insurance, Superfund, and various veterans' insurance programs.

c. Includes interest paid to trust funds, payments from the general fund to the Supplementary Medical Insurance program, the employer's share of employee retirement, lump-sum payments to the Civil Service and Military Retirement Trust Funds, taxes on Social Security benefits, and smaller miscellaneous payments.

At that time, if a higher debt limit has not been enacted, the Treasury will have to use accounting measures to remain under the ceiling so it can continue to raise cash to pay for government activities. Those measures—most of which have been used in past debt-limit impasses—could include suspending the issuance of certain securities held in the Thrift Savings Plan, postponing the issuance of state and local government series securities, delaying the issuance of securities to the Civil Service Retirement Trust Fund, and withdrawing federal securities from the Exchange Stabilization Fund. In the most recent impasses, such steps enabled the Treasury to remain below the debt limit for more than three months.

Trust Funds and the Budget

The federal budget includes more than 150 trust funds, although fewer than a dozen account for the vast share of trust fund dollars. Among the largest are the two Social Security trust funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) and those dedicated to civil service retirement, Hospital Insurance (Part A of Medicare), and military retirement *(see Table 1-6).* Trust funds have no particular economic significance. They do not hold separate cash balances; instead, they function primarily as accounting mechanisms to track receipts and spending for programs that have specific taxes or other revenues earmarked for their use.

When a trust fund receives payroll taxes or other income that is not currently needed to pay benefits, the Treasury credits the fund and uses the excess cash for other government purposes. As a result, the government borrows less from the public than it would in the absence of those excess funds. The process is reversed when revenues for a trust fund program fall short of its expenses. In that case, the government raises the necessary cash by borrowing more than it otherwise would.

Including the cash receipts and expenditures of trust funds in the budget totals along with other federal programs is necessary to assess how federal activities affect the economy and capital markets. Thus, CBO, the Office of Management and Budget, and other fiscal analysts focus on the total deficit or surplus.

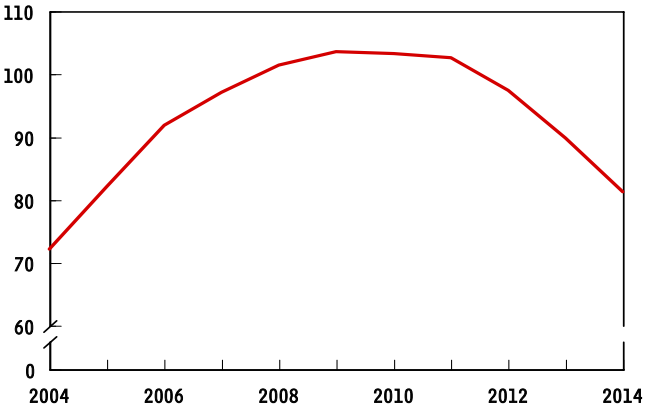
In CBO's current baseline, trust funds as a whole are projected to run a surplus of $198 billion in 2004. That balance is somewhat misleading, however, because trust funds receive much of their income in the form of transfers from other parts of the budget.[20] Such intragovernmental transfers reallocate costs from one part of the budget to another; they do not change the total deficit or the government's borrowing needs. Consequently, they have no effect on the economy or on the government's future ability to sustain spending at the levels indicated by current policies.

For 2004, those intragovernmental transfers are estimated to total $369 billion. The largest of them involve interest credited to trust funds on their government securities ($154 billion in CBO's projections), transfers of federal funds to Medicare for Supplementary Medical Insurance ($95 billion), contributions by government agencies to retirement funds for their current and former employees ($42 billion), and payments from the general fund to Social Security ($13 billion). When intragovernmental transfers are excluded and only income from sources outside the government is counted, the trust funds as a whole are projected to run deficits throughout the projection period, growing from $171 billion in 2004 to $482 billion in 2014.

Figure 1-4.

Social Security Trust Fund Surplus (Excluding interest)

(Billions of dollars)



Source: Congressional Budget Office.

Although the budgetary impact of the aging of the baby-boom generation will not be completely realized during the 2004-2014 period, CBO's current projections provide initial indications of the coming budgetary pressures. Charting the differences over the next 10 years between projected receipts and outlays for the Social Security trust funds (excluding intragovernmental interest payments) illustrates those pressures. Receipts are projected to exceed expenditures throughout the period, but under current policies, the amount by which they do so will decline from over $100 billion between 2008 and 2011 to about $81 billion in 2014 *(see Figure 1-4).* At that point, outlays will be growing by more than 6 percent per year, but non-interest receipts will be growing by less than 5 percent. Thus, in CBO's baseline projections, the capacity of the Social Security trust funds to offset some of the net deficit in the rest of the budget—as they now do—will begin to dwindle during the coming decade. Shortly thereafter, Social Security is projected to begin adding to deficits or reducing surpluses.

20. See Congressional Budget Office, *The Impact of Trust Fund Programs on Federal Budget Surpluses and Deficits,* Long-Range Fiscal Policy Brief No. 5 (November 4, 2002), and *The Impact of Social Security and Medicare on the Federal Budget,* Long-Range Fiscal Policy Brief No. 6 (November 14, 2002).

CHAPTER

2

The Economic Outlook

The economy should continue to grow at a healthy rate over the next two years, for a recovery appears to have taken hold. Stronger investment by businesses will lead the way, as spending on equipment and structures continues to bounce back from the depressed levels of the past few years and firms shift from drawing down their inventories to restocking their shelves. The rapid productivity growth of the past three years has contributed to the economy's capacity to expand without generating significant upward pressure on inflation. Indeed, in light of the unexpected strength of productivity during 2003, the Congressional Budget Office has increased both its two-year forecast and its medium-term projection of the level of potential output (the level of gross domestic product consistent with a high rate of resource use). That increase, in turn, has boosted the forecast and projected levels of real (inflation-adjusted) GDP, which CBO now expects will expand by 4.8 percent in calendar year 2004 and 4.2 percent in 2005 before growing at an average annual rate of 2.7 percent over the medium term, from 2006 to 2014.

A variety of factors could produce growth over the next 10 years that is stronger or weaker than CBO's best estimate. Cyclical factors—those deriving from the ups and downs of the business cycle—are one potential source of risk. The confidence of businesses and investors, the growth of foreign economies, the level of stock prices, the rate of personal saving, and the level of housing activity could each be weaker or stronger than CBO has estimated. Beyond those risks, the accuracy of the forecast is vulnerable as well to the uncertainty that surrounds the economy's response to the war on terrorism, developments in Iraq, and events elsewhere in the world. Looking to the medium term, productivity gains could remain unusually large, buoying income and profits and thus boosting output substantially. Alternatively, productivity could grow at a below-average rate over the next few years, reversing its extraordinary recent gains and resulting in a lower level of GDP than CBO expects.

Overview of the Forecast

Real GDP will grow at above-average rates during 2004 and 2005, CBO estimates, as the economy continues to rebound from the recession of 2001 and its aftermath *(see Table 2-1 and Figure 2-1).* That growth will close the gap between GDP and potential GDP. Indeed, its momentum is anticipated to carry GDP slightly above its potential level in 2005.

CBO does not attempt to forecast cyclical fluctuations after 2005; instead, its medium-term projection (through 2014) reflects where GDP will be, on average, over future business cycles. As a result, the growth of GDP will keep pace with that of potential GDP. Real GDP growth will average 2.8 percent from 2006 to 2009 and 2.5 percent from 2010 to 2014, CBO expects. The slower growth projected for the latter half of the period is due primarily to a lower rate of labor force expansion, as the baby-boom generation begins to retire.

CBO's forecast incorporates the revisions to the national income and product accounts (NIPAs) published in December 2003, as well as the likely macroeconomic effects of provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003, or JGTRRA (Public Law 108-27), including the laws' influence on labor supply and saving.[1] CBO's estimates of such effects incorpo-

1. For an analysis of JGTRRA's likely effects on the economy over the medium term, see Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2003), Box 2-3. The NIPAs, which are maintained by the Bureau of Economic Analysis, are the historical data that form the basis of analysts' views of the economy.

Table 2-1.

CBO's Economic Projections for Calendar Years 2003 Through 2014

	Estimated	Forecast		Projected Annual Average	
	2003	2004	2005	2006-2009	2010-2014
Nominal GDP (Billions of dollars)	10,980	11,629	12,243	14,686[a]	18,266[b]
Nominal GDP (Percentage change)	4.8	5.9	5.3	4.7	4.5
Real GDP (Percentage change)	3.2	4.8	4.2	2.8	2.5
GDP Price Index (Percentage change)	1.6	1.1	1.1	1.8	1.9
Consumer Price Index[c] (Percentage change)	2.3	1.6	1.7	2.2	2.2
Unemployment Rate (Percent)	6.0	5.8	5.3	5.1	5.2
Three-Month Treasury Bill Rate (Percent)	1.0	1.3	3.0	4.5	4.6
Ten-Year Treasury Note Rate (Percent)	4.0	4.6	5.4	5.5	5.5
Tax Bases (Percentage of GDP)					
Corporate book profits	7.7	8.1	10.8	9.9	9.1
Wages and salaries	46.3	45.9	46.1	46.4	46.4
Tax Bases (Billions of dollars)					
Corporate book profits	844	948	1,319	1,359[a]	1,670[b]
Wages and salaries	5,087	5,333	5,639	6,823[a]	8,476[b]

Source: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: Percentage changes are year over year. Year-by-year economic projections for calendar and fiscal years 2004 through 2014 appear in Appendix E.

a. Level in 2009.

b. Level in 2014.

c. The consumer price index for all urban consumers.

rate the assumption that private businesses and households will behave as if they believe that the "sunsets" (scheduled expirations of temporary tax cuts) contained in EGTRRA and JGTRRA will, indeed, occur.

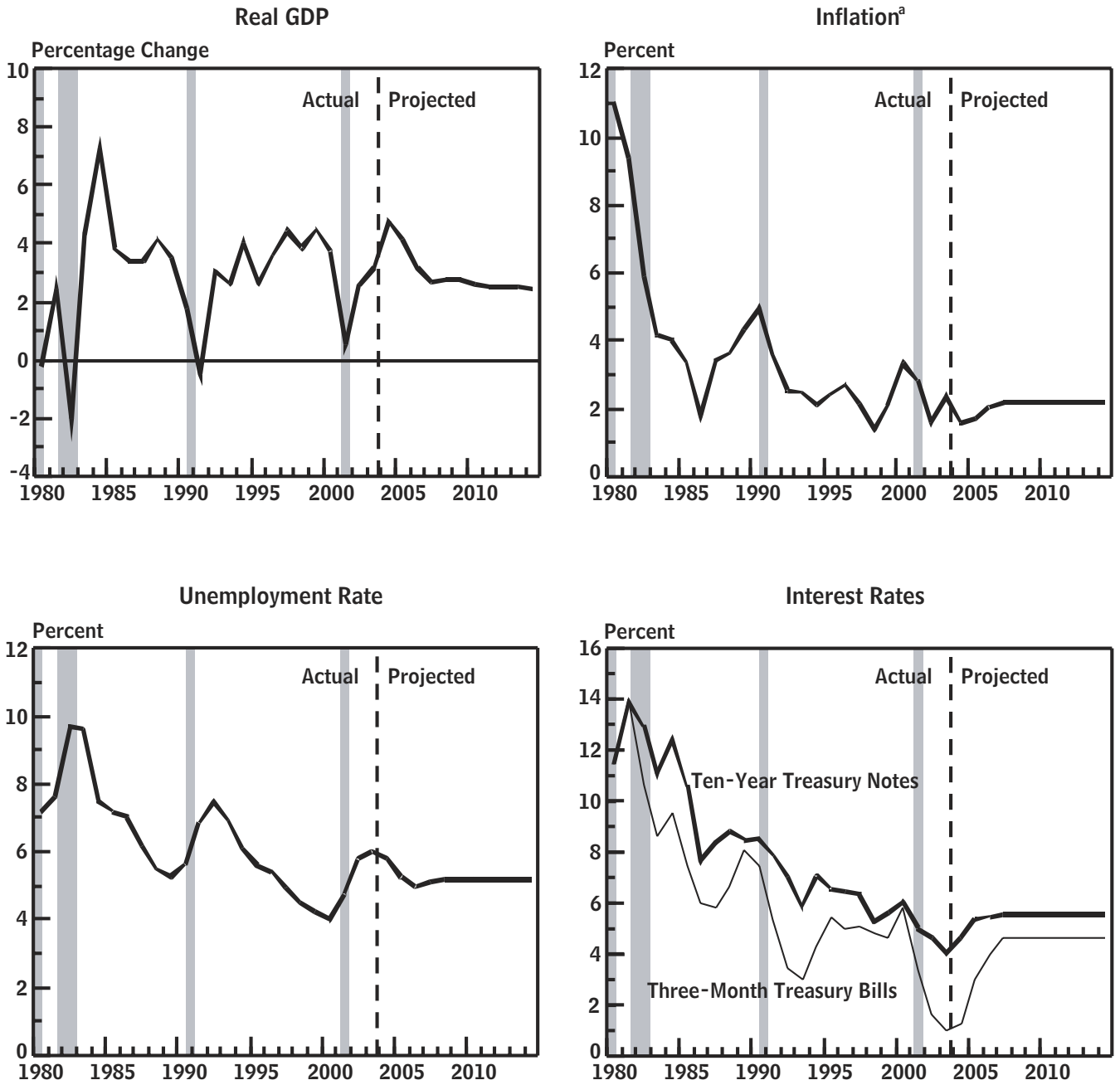
The rate of unemployment in CBO's two-year forecast depends on CBO's estimate of the gap between GDP and potential GDP. As the gap closes, the unemployment rate is expected to fall to 5.8 percent in 2004 and 5.3 percent in 2005. After briefly dipping to 5.0 percent in 2006, the rate will average 5.2 percent from 2007 to 2014.

During the next 10 years, inflation and nominal interest rates are expected to remain low by historical standards, even though interest rates are likely to rise from their current levels. Consumer price inflation, according to CBO's two-year estimates, will fall from 2.3 percent in 2003 to 1.6 percent in 2004 before gradually climbing to an average annual rate of 2.2 percent from 2006 to 2014. The interest rate on three-month Treasury bills is forecast to increase from an average of just 1.0 percent in 2003 to 1.3 percent in 2004, 3.0 percent in 2005, and 4.0 percent in 2006; it is then expected to average 4.6 percent from 2007 to 2014. Yields on 10-year Treasury notes will also follow an upward path, rising from an average of 4.0 percent in 2003 to 4.6 percent in 2004, 5.4 percent in 2005, and 5.5 percent from 2006 to 2014.

Fiscal policy will be expansionary in 2004, in CBO's view, but not as much as it was last year. About two-thirds of the stimulus incorporated in the budget baseline for fiscal year 2004 derives from JGTRRA, but a portion re-

Figure 2-1.

The Economic Forecast and Projections



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: All data are annual values; percentage changes are year over year.

a. The change in the consumer price index for all urban consumers, using the Bureau of Labor Statistics' research series that applies the current methodology to historical price data.

Table 2-2.

Comparison of *Blue Chip*'s and CBO's Forecasts for Calendar Years 2004 and 2005

	Estimated	Forecast	
	2003	2004	2005
Nominal GDP (Percentage change)			
Blue Chip high 10		6.8	6.1
Blue Chip consensus		6.1	5.4
CBO	**4.8**	**5.9**	**5.3**
Blue Chip low 10		5.4	4.7
Real GDP (Percentage change)			
Blue Chip high 10		5.1	4.2
Blue Chip consensus		4.6	3.7
CBO	**3.2**	**4.8**	**4.2**
Blue Chip low 10		4.0	3.1
GDP Price Index (Percentage change)			
Blue Chip high 10		1.9	2.2
Blue Chip consensus		1.4	1.7
CBO	**1.6**	**1.1**	**1.1**
Blue Chip low 10		1.0	1.1
Consumer Price Index[a] (Percentage change)			
Blue Chip high 10		2.3	2.7
Blue Chip consensus		1.7	2.1
CBO	**2.3**	**1.6**	**1.7**
Blue Chip low 10		1.3	1.5
Unemployment Rate (Percent)			
Blue Chip high 10		6.0	5.8
Blue Chip consensus		5.7	5.4
CBO	**6.0**	**5.8**	**5.3**
Blue Chip low 10		5.5	5.1
Three-Month Treasury Bill Rate (Percent)			
Blue Chip high 10		1.7	3.5
Blue Chip consensus		1.3	2.6
CBO	**1.0**	**1.3**	**3.0**
Blue Chip low 10		1.1	1.7
Ten-Year Treasury Note Rate (Percent)			
Blue Chip high 10		5.1	5.9
Blue Chip consensus		4.7	5.4
CBO	**4.0**	**4.6**	**5.4**
Blue Chip low 10		4.3	4.8

Source: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board; Aspen Publishers, Inc., *Blue Chip Economic Indicators* (January 10, 2004).

Note: The *Blue Chip* high 10 is the average of the 10 highest *Blue Chip* forecasts; the *Blue Chip* consensus is the average of the roughly 50 individual *Blue Chip* forecasts; and the *Blue Chip* low 10 is the average of the 10 lowest *Blue Chip* forecasts.

a. The consumer price index for all urban consumers.

flects the supplemental appropriations passed in November 2003. Because the cuts in individual income tax withholding associated with JGTRRA occurred in July 2003, much of the impetus to growth in the 2004 fiscal year actually began in the third quarter of calendar year 2003, which also marked the advanced rebates for the increase in the child tax credits enacted in JGTRRA. CBO expects that fiscal policy will turn moderately contractionary in 2005, mainly because some provisions of JGTRRA expire that had temporarily accelerated or increased various tax cuts originally enacted in EGTRRA and in the Job Creation and Worker Assistance Act of 2002 (JCWAA). By comparison, the unusually easy stance of current monetary policy is expected to gradually give way to a more neutral posture in both 2004 and 2005.

CBO's assessment of the economy's near-term outlook differs little from the latest *Blue Chip* consensus forecast, an average of roughly 50 private-sector forecasts *(see Table 2-2).* CBO expects somewhat stronger growth of real GDP during 2004 and 2005 than the consensus does and also lower inflation. Another point of difference is that CBO's forecast of the rate on three-month Treasury bills for 2005 is somewhat higher than the *Blue Chip* consensus estimate.

Productivity Growth

The most striking economic development of the past three years has been the robust growth of labor productivity (real output per hour of labor). Productivity is crucial in determining CBO's estimate of potential GDP, with which actual GDP is assumed to converge over the medium term. The unexpectedly vigorous growth of productivity in recent years, and especially in 2003, has led CBO to revise its forecast and medium-term projection of the levels of both GDP and potential GDP.

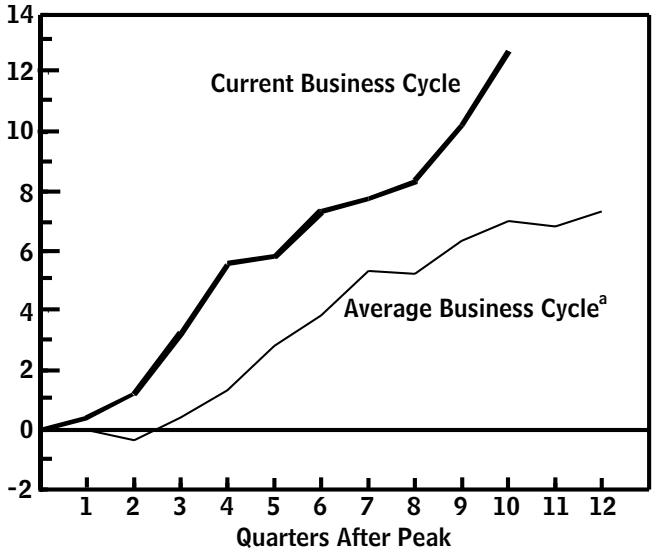
After the rapid rise in productivity in the late 1990s and 2000—itself an unusual phenomenon in the later stages of an expansion—a period of slower-than-average growth might have been expected. Instead, labor productivity has soared, climbing in 2003 at an annual rate of 2.2 percent in the first quarter, 7.1 percent in the second quarter, and 9.3 percent in the third quarter. Moreover, the average rate of growth for the two years ending in the third quarter of 2003—5.6 percent—was higher than the rate for any previous eight-quarter span since 1950.

In the context of the business cycle, productivity growth is typically strong during recoveries and the early part of

Figure 2-2.

Labor Productivity

(Percentage difference from peak value)



Sources: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics.

Note: The peak of the last business cycle was designated by the official arbiter, the National Bureau of Economic Research, as March 2001.

a. Average of the eight recoveries during the 1949-2000 period, excluding the brief 1980 recovery.

expansions, but its pace in recent years has been exceptional, especially for the mild recovery that has followed the 2001 downturn. In the third quarter of 2003, labor productivity was 13 percent above its value at the peak of the previous business cycle, in the first quarter of 2001 *(see Figure 2-2).* That rise was well above the increase (about 7 percent) that might have been expected by that point in an average recovery.

A complete explanation of the sources of such growth is not yet available. However, research suggests that possible hypotheses include the following:

- *Cautiousness of Businesses.* Companies may have been particularly reluctant to hire more workers—as a result of geopolitical uncertainties arising from terrorism or the war in Iraq—and focused instead on improving productivity. (Certainly, the growth of employment, as measured by the Bureau of Labor Statistics' survey of business establishments, has been especially weak during the recovery and expansion that have followed the 2001 recession.) Alternatively, businesses may have been unusually pessimistic about their future prospects or more narrowly focused than usual on increasing profits, perhaps because of the strong foreign competition that many of them are experiencing. By that logic, the rapid growth of productivity is likely to be temporary, lasting only until business confidence picks up, at which point firms will increase their hiring and productivity will return to its pre-2001 trend rate.

- *Adjustment Costs.* Several analysts have suggested that the costs of absorbing the new capital goods and technologies that many firms acquired during the late 1990s may have temporarily suppressed productivity growth at the time (even though it was still strong) and then boosted it after 2001. According to that view, companies diverted resources from production as they integrated the new items into their productive processes. The pause that has occurred in capital spending since 2001 has allowed companies to catch up, and the recent hike in productivity is a delayed payoff to the investments of the 1990s.[2] That hypothesis regarding the strong recent rise in productivity also implies that the increase in growth will be temporary.

- *Diffusion of Technologies.* Another possibility is that computers and other information-related technologies are fundamentally transforming the way the economy works, much as the electric dynamo and the internal combustion engine did in previous eras. If that hypothesis is valid, productivity growth might remain faster than its historical average during a transition period that could last several decades.

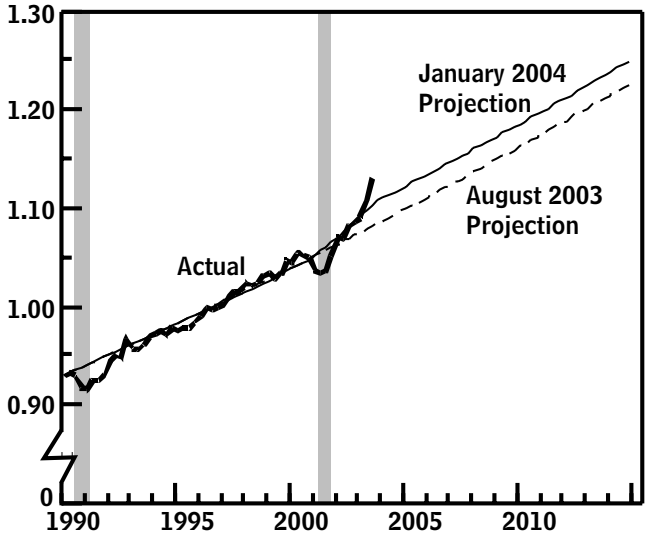
As those various explanations suggest, a key question facing forecasters today is whether the recent spike in labor productivity growth is largely a temporary, one-time event or whether it is generated by a persistent shift in the underlying trend growth of the economy's productive potential. CBO generally discounts short-run surges in productivity; in the past, sudden bursts of growth have tended to be followed by periods of slower gains, and estimates of growth are subject to repeated revision as time goes on. But the recent dramatic upswing in productivity

2. See Susanto Basu, John G. Fernald, and Matthew D. Shapiro, "Productivity Growth in the 1990s: Technology, Utilization, or Adjustment?" *Carnegie-Rochester Conference Series on Public Policy,* vol. 55 (December 2001), pp. 117-165.

Figure 2-3.

Total Factor Productivity: Actual and CBO's Projections

(Index, 1996 = 1.0)



Source: Congressional Budget Office.

Note: Total factor productivity is the increase in production that is not explained by increases in labor or capital inputs.

growth probably indicates at least a temporary rise above the underlying trend that CBO's usual estimating method would have produced.[3] Moreover, evidence suggests that those gains in productive potential are not limited to the computer manufacturing sector, as was previously thought, but are widespread.[4]

Consequently, CBO assumed that the recent surge in productivity reflects a temporary change in the rate of growth over the period from 2001 to 2003, but it did not incorporate in its estimates a change in future growth. Specifically, CBO raised its estimate of the trend growth of total factor productivity (TFP) during the 2001-2003 period by an average annual rate of 0.7 percentage points.[5] From 2004 onward, gains in TFP are expected to revert to the slower pre-2001 rate, although the level of TFP will remain higher than it would have been if growth had not accelerated over the 2001-2003 span *(see Figure 2-3)*. The cumulative adjustment to productivity trend growth accounts for about 40 percent of the deviation of actual TFP from CBO's previous estimate of its trend level in the third quarter of 2003.

The Output Gap and the Composition of Demand Growth

Changes in the gap between the demand for output and the economy's ability to supply it (potential GDP) have influenced the nation's economic fortunes over the past three years and will continue to affect the growth of employment and prices for the next two years. Potential GDP has risen sharply in recent years because of rapid productivity growth, but demand has failed to keep pace, causing a drop in employment and contributing to low inflation.

From 2001 until mid-2003, economic factors that increased demand (in particular, robust growth of consumption and supportive fiscal and monetary policies) were more than offset by factors that curbed it (such as declining investor and business confidence, weak growth of foreign demand, a strong dollar, and a slow rise in pretax income). Focusing on financial influences only, one index of conditions in the financial markets finds that the negative impact on GDP growth of a stronger dollar and lower stock prices overpowered the positive effect of easier monetary policy *(see Figure 2-4)*. The result was an economy that was growing—but too slowly to prevent further declines in employment.

CBO expects that the growth of potential GDP will slow in 2004 and 2005 from its unusually rapid pace between 2001 and 2003, the growth of aggregate demand will pick up, and employment will post solid gains. The change between the fortunes of various sectors of the economy in the recent past and how CBO forecasts they will fare in the coming two years illustrates the factors that are expected to speed growth in the near term. The sectors most buffeted by weakening demand over the past three years—business investment and exports—will probably grow the most rapidly in 2004 and 2005. Those two categories of activity faced downward pressures that

3. For CBO's usual method of estimating potential GDP, see Congressional Budget Office, *CBO's Method for Estimating Potential Output: An Update* (August 2001).

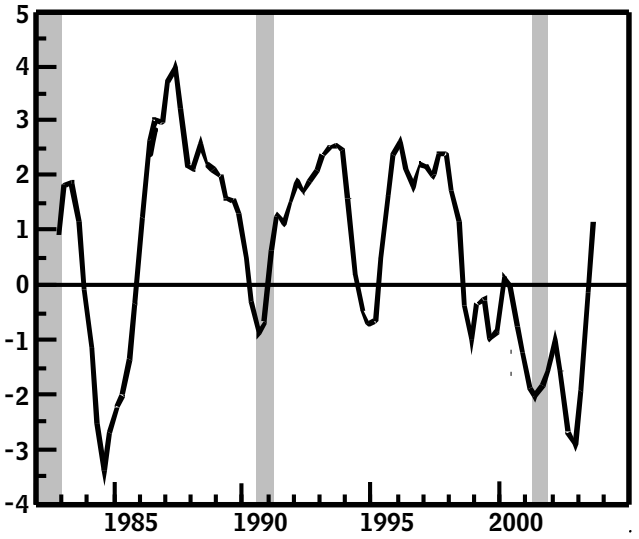
4. See William Nordhaus, "Productivity Growth and the New Economy," *Brookings Papers on Economic Activity,* no. 2 (2002); and Jack E. Triplett and Barry Bosworth, "'Baumol's Disease' Has Been Cured: IT and Multifactor Productivity in U.S. Services Industries" (paper prepared for the Texas A&M conference "The New Economy: How New? How Resilient?" in April 2002).

5. Total factor productivity is the increase in production that is not explained by increases in labor or capital inputs.

Figure 2-4.

Index of Monetary and Financial Conditions

(Percentage points of GDP growth)



Sources: Congressional Budget Office; Macroeconomic Advisers, LLC.

Notes: This index estimates how much financial markets contribute to the rate of growth of real GDP. It draws on statistical relationships between real GDP and financial variables such as interest rates, exchange rates, and equity values. When the index is positive, overall conditions in the financial markets are conducive to the growth of real GDP. When it is negative, overall financial market conditions are a drag on growth.

The last data point is the third quarter of 2003.

dwarfed the benefits of shifts in policy when investor and business confidence collapsed, the growth of foreign demand slackened, and the dollar rose in value. By contrast, consumption and the demand for housing held up well over the 2001-2003 period, aided by fiscal and monetary policies that tended to offset adverse effects from the decline in stock market wealth and the slow growth of pretax income. CBO forecasts that consumption and housing demand will remain at high levels over the next two years but will grow more slowly than the rest of the economy.

The Business Sector

Higher levels of investment by businesses—in equipment, software, structures, and inventories—will provide a significant share of economic growth during 2004 and 2005 (as they did during the second half of 2003). Much of that strength will come from reversal of the forces that prevailed during the previous three years, as growth in the rest of the economy accelerates and confidence among businesses and investors in those businesses remains above the depressed levels of 2002. Also encouraging business fixed investment in 2004 are provisions of JGTRRA that allow more favorable tax treatment of purchases of equipment. Both a rise in demand for their products and the need to restock their relatively empty shelves will help stimulate firms to accumulate new inventories of goods during the next two years.

Business Fixed Investment. The decline in business fixed investment between the third quarter of 2000 and the first quarter of 2003 was unusually steep and long-lasting *(see Figure 2-5).* At least three factors played a role in that slide, the most important of which was that demand for businesses' output grew more slowly than their ability to produce it with their existing capital and labor. Thus, in general, firms cut their payrolls and reduced investment below the levels needed to fully replace all of their depreciating equipment and structures. A second factor was that declining stock prices and higher risk premiums on corporate securities increased the cost of capital—the hurdle that the expected rate of return from a new investment must clear in order for that investment to be considered profitable.[6] A third factor was that the late 1990s witnessed large investments by firms in information technology, especially telecommunications equipment. Investment in those items fell sharply when many businesses found themselves with more capacity than they needed.

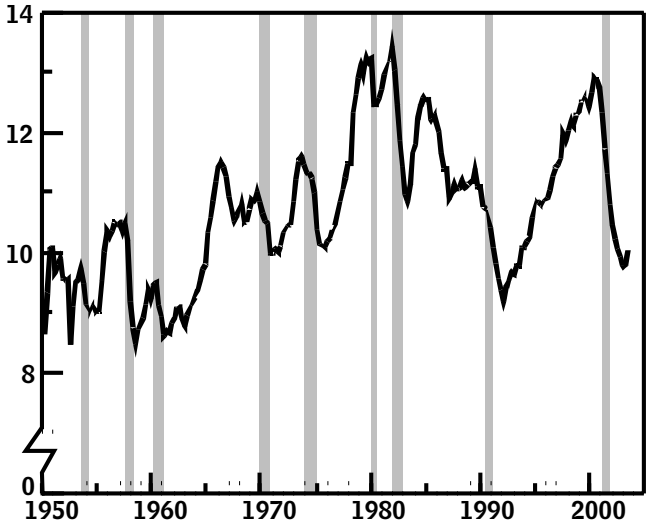
Each of those adverse factors has begun to stabilize or even turn around, suggesting solid gains for the economy from such investment over the next two years. CBO expects that real output will grow faster, on average, than productivity, increasing demand for new structures and equipment. In addition, the cost of capital has fallen since late 2002, increasing the expected profitability of new investments. Between October 2002 and December 2003, stock prices rose by more than 25 percent, and yields on corporate bonds fell by between 0.7 and 1.1 percentage points. Businesses, moreover, have worked off much of the excess capacity in information technology that they built up in the late 1990s and 2000. The remaining portion, the part arising from cyclical weakness in the econ-

6. The risk premium is the additional return that investors require to hold assets whose returns are more variable than those of riskless assets.

Figure 2-5.

Business Fixed Investment

(Percentage of potential GDP)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

omy, will diminish as demand continues to recover and will not hinder investment growth. (In fact, rates of capacity utilization for firms are usually low when investment begins to recover after a downturn.)

Recently enacted changes in tax law will also spur investment in 2004. JCWAA contained incentives to bolster businesses' spending on equipment and structures by temporarily increasing the fraction of new investment that firms can "expense" (deduct from their taxable income immediately rather than over time). JGTRRA expanded those incentives by allowing firms, through the end of 2004, to expense 50 percent of the value of new equipment and of some structures in the tax year in which the property is acquired. In addition, it increased, through 2005, the limit on small businesses' expensing of new depreciable assets. By reducing the cost of capital, those incentives will boost investment in equipment by about 4 percent in 2004, CBO forecasts. In addition, the incentives are likely to induce some firms to take advantage of the expensing provision before it expires by shifting some investment from 2005 to 2004.

Inventory Investment. Inventory investment, like business fixed investment, will benefit from a reversal of the adverse conditions responsible for its slump in recent years. Facing a sharp slowdown in demand, businesses caught with excess inventories cleared their shelves aggressively in 2001, as they had in past recessions *(see Figure 2-6)*. Although inventories rose modestly in 2002, they fell again during the second and third quarters of 2003—the result of faster growth of sales than firms had expected.

The strong growth of output forecast for 2004 and 2005 and firms' currently lean inventory stocks (even after accounting for the historical downward trend in the ratio of inventories to sales) are likely to trigger significant accumulation of inventories. Such investment has frequently been a substantial component of past recoveries: inventory change reached at least 0.5 percent of GDP in the early stages of each of the past four expansions, and it surpassed 1.0 percent of GDP in three of them. CBO forecasts that the swing by businesses from drawing down inventories to rebuilding them will add significantly to GDP growth in 2004 and 2005.

The International Sector

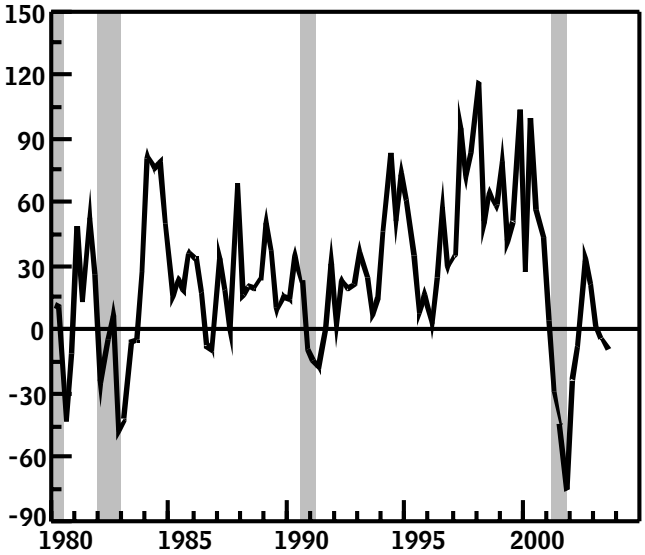
The foreign sector has generally hindered growth in the U.S. economy over most of the past three years, but CBO forecasts that it will cease to have that dampening effect in 2004 and will add to growth in 2005. From the beginning of 2001 through the middle of 2003, lower real net exports of goods and services accounted for an average of 0.5 percentage points of slower real GDP growth—a surprisingly large amount, given that weakness in the U.S. economy usually raises net exports (by holding down imports). Although the level of real imports fell during the 2001 recession, the level of real exports fell by even more, as foreign economies weakened and a rise in the dollar through early 2002 (which made U.S. goods and services relatively more expensive) hurt the United States' ability to compete overseas. Export growth frequently slows when foreign economic growth slows with that of the United States, but the recent deceleration was unusually large *(see Figure 2-7)*. Between the end of 2000 and the middle of 2003, deficits in both the nominal and real U.S. trade balances widened by about $100 billion.

The conditions that influence net exports should improve over the next two years, CBO believes. Growth is expected to pick up in many of the United States' important export markets. In addition, the drop in the dollar against many currencies since early 2002 has improved the price competitiveness of U.S. products. Despite the rise in imports that is likely to occur as economic growth in this country speeds up, CBO expects that the nation's

Figure 2-6.

Change in Businesses' Inventories

(Billions of chained 2000 dollars)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

nominal and real trade deficits will shrink somewhat in 2005.

Foreign Economic Conditions. Economic growth is likely to accelerate in the industrialized countries in 2004. Canada's economy is rebounding from the contraction it experienced in the spring of 2003—caused by news of outbreaks of SARS (severe acute respiratory syndrome) and mad cow disease—and will benefit from growth in its exports to the United States. Japan's economy has embarked on a recovery; improvements have been noted in corporate profits, exports, industrial activity, and the stock market. Most forecasters also expect growth in Western Europe to pick up in 2004, as downturns in France and Germany give way to recovery and economic activity in the United Kingdom quickens. Nevertheless, the appreciation of those countries' currencies against the dollar and the resulting loss of their price competitiveness pose a risk to the anticipated rise in their economic growth, as does the possibility of only weak upticks in those countries' domestic demand.

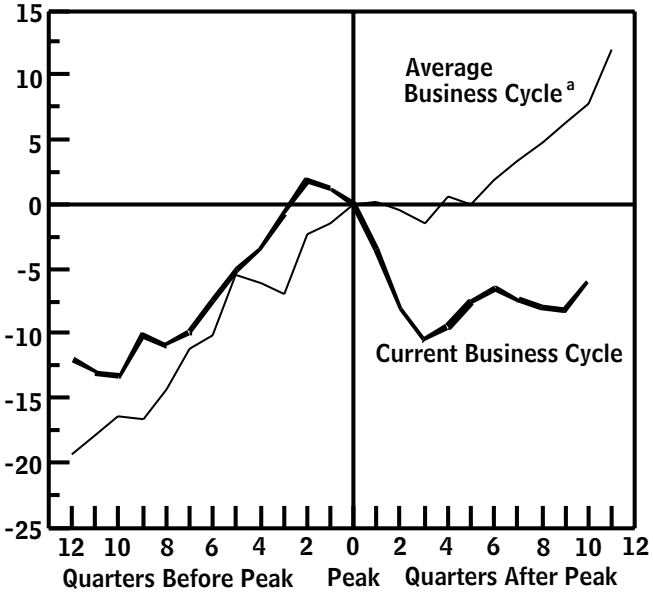
In the developing world, as in the industrialized nations, conditions are also improving. The economies of emerging Asian countries are benefiting from the U.S. recovery and continued rapid growth in China. South Korea's economy—which fell into a recession during the first half of 2003—and those economies of East Asia that contracted during the second quarter of 2003 because of the fallout from the SARS epidemic are all expected to start to grow again. Mexico's economy, which expanded barely at all during 2003, may well strengthen in 2004 along with that of the United States. Economic conditions in Argentina and Brazil have also markedly improved.

The Dollar's Exchange Rate. CBO expects the value of the dollar to continue a fall that began in March 2002 and to gradually decline during 2004 and 2005—because of still-large trade deficits and because a growing level of net foreign indebtedness in the United States may make foreign investors less willing to add to their holdings of U.S. assets. Between the fourth quarter of 2002 and the fourth quarter of 2003, the real trade-weighted value of the dollar dropped by 9 percent, as the nominal value of the dollar fell by 16 percent against the euro, 8 percent against the British pound, 11 percent against the Japa-

Figure 2-7.

Real Exports

(Percentage difference from peak value)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

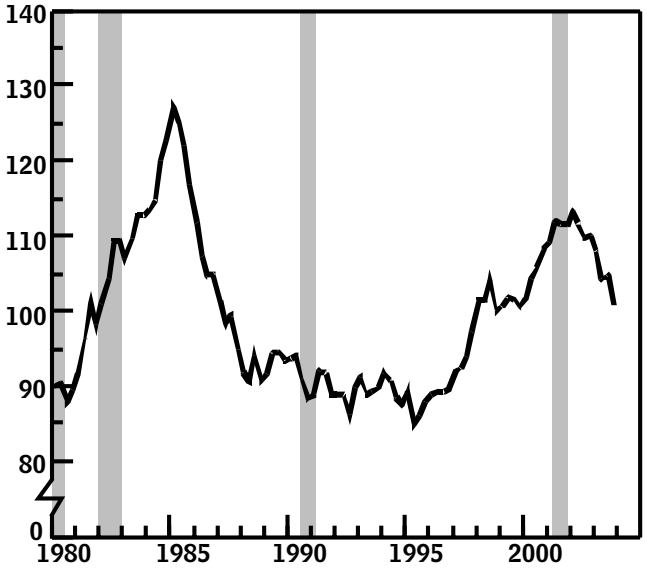
Note: The peak of the last business cycle was designated by the official arbiter, the National Bureau of Economic Research, as March 2001.

a. Average of the eight recoveries during the 1949-2000 period, excluding the brief 1980 recovery.

Figure 2-8.

Real Trade-Weighted Value of the U.S. Dollar

(March 1973=100)



Sources: Congressional Budget Office; Federal Reserve Board of Governors.

Note: The figure shows the real trade-weighted value of the dollar against a broad set of currencies. (For a discussion of the term "real trade-weighted value of the dollar," see footnote 7 below.)

nese yen, and 16 percent against the Canadian dollar *(see Figure 2-8).*[7] The U.S. currency held up better against the currencies of many less developed countries, including Mexico, China, and much of Southeast Asia, in part because many developing countries intervene decisively in currency markets to manage their exchange rates relative to the dollar.

The Current Account. Compared with the trade balance, the current account is a broader measure of U.S. interactions with the rest of the world because it not only includes trade but also net investment income and net unilateral current transfers.[8] The current account indicates, on balance, how much the United States borrows each year from the rest of the world. Cumulative net borrowing from foreigners has brought the United States' net debt to the rest of the world to about 23 percent of GDP. The interest payments resulting from the net debt to foreigners make the current-account deficit harder to eliminate than the trade deficit.

Some analysts are concerned about the level of the current-account deficit and the United States' net debt to foreigners. There is little reason for concern, however, so long as foreign investors find the United States an attractive place to invest. That attraction is tied to the stability of the United States' political and legal systems and its dynamic economy with flexible markets and the expectation of relatively strong growth.

In part, the size of the current-account balance reflects factors that influence saving and investment in the United States, as recent experience shows. In the 1990s, for example, the rate of private saving fell throughout the decade, but overall national saving increased during much of that time because the reduction that was occurring in new federal borrowing more than offset the drop in private saving. Even so, the demand for funds to finance domestic investment outstripped national saving, and the current-account deficit grew. In that period, an important determinant of the deficit seems to have been foreign investors' expectations of attractive returns on investments in the United States.

During the recent recession and its aftermath, foreign investors continued purchasing U.S. assets, perhaps in part because of the dearth of investment opportunities elsewhere as a result of generally weak economic activity abroad. The current-account deficit continued to grow, with only a small interruption in 2001 *(see Figure 2-9).* Imports fell, as they typically do during a recession, but exports were unusually weak, reinforcing the slump in output from low domestic investment. At the same time, the inflows of capital probably helped hold down interest rates. The recent weakness of the dollar suggests that foreign investors' interest in dollar-denominated assets may

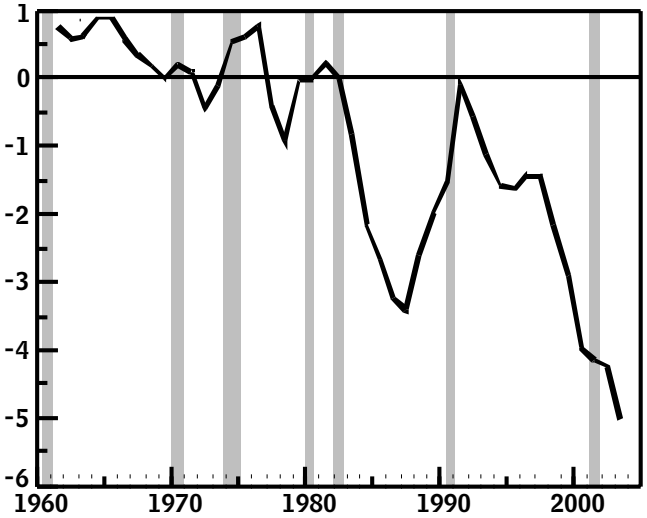
7. The *trade-weighted value of the dollar* is a weighted average of the value of the U.S. dollar relative to the currencies of U.S. trading partners, with the weight of each country's currency equal to that country's share of U.S. trade. The *real trade-weighted value of the dollar* is a measure of the trade-weighted value that takes account of the difference between the U.S. price level relative to the trade-weighted foreign price level. An increase in the dollar's real trade-weighted value means an increase in the price of U.S. goods and services relative to the foreign price.

8. Unilateral transfers are payments from one country to another that are not made in exchange for a good or a service—specifically, gifts or pension payments to foreign residents and grants to foreign governments.

Figure 2-9.

The Current-Account Balance

(Percentage of GDP)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: The current account indicates, on balance, how much the United States borrows each year from the rest of the world.

be diminishing: they are only willing to buy them at a lower price. Nevertheless, the drop in the dollar will ultimately mean a smaller current-account deficit.

The Household Sector

Consumption is likely to grow more slowly than the overall economy during the next two years, whereas real residential investment is likely to contribute little to growth during that time. In contrast to business investment and net exports, consumption and housing continued to expand during the recession and the subsequent two years of slow overall growth; consequently, they will not experience a comparable cyclical rebound. Although real personal income fell during the recession of 2001 and grew only moderately during 2002 and 2003, expansionary fiscal and monetary policies contributed to households' spending by boosting disposable income and holding down borrowing costs.[9] Under current law, tax provisions will tighten somewhat in 2005; at the same time, interest rates will rise, CBO projects. As a result, growth in the household sector will lag behind growth in the rest of the economy.

Income. Expansionary fiscal policy, in the form of tax cuts and higher government transfer payments, boosted disposable (after-tax) income sharply from 2001 to 2003. EGTRRA and JGTRRA both reduced individual income taxes, and JCWAA and subsequent extensions provided additional unemployment benefits. Partly as a result of those changes, taxes paid by individuals to governments (personal income tax payments plus workers' contributions to social insurance programs—mainly Social Security and Medicare) net of transfer payments received from governments fell from 6.3 percent of personal income during the second quarter of 2001 to -0.2 percent by the third quarter of 2003 *(see Figure 2-10).* (One-time rebates subtracted 0.6 percentage points from the third-quarter figure.) Thus, although real personal income grew at an annual rate of just 1.3 percent between the second quarter of 2001 and the third quarter of 2003, real disposable income grew at an annual rate of 3.9 percent.

The slow growth of personal income reflected declining employment and moderate growth of real hourly compensation. Labor compensation's share of GDP fell from 58.8 percent in the second quarter of 2001 to 55.9 percent in the third quarter of 2003 *(see Figure 2-11).* Like labor income, farm proprietors' income also failed to keep pace with GDP during much of 2002 and 2003; however, it rebounded during the second half of the latter year when prices for farm products rose.

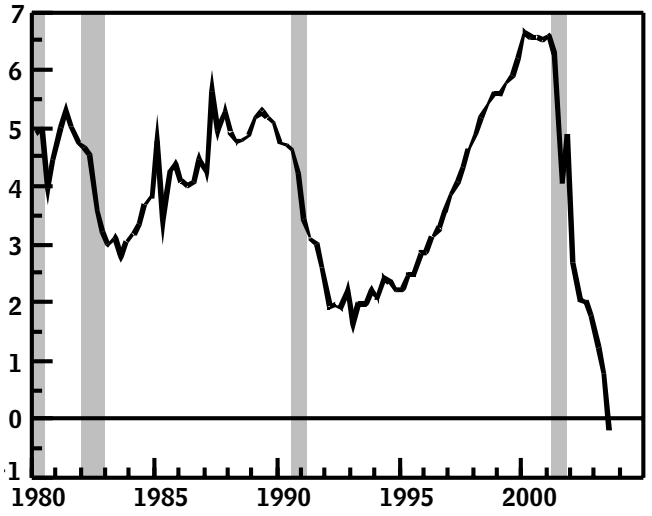
CBO forecasts that over the next two years, disposable income will grow solidly but a bit more slowly than GDP, as higher taxes and slow growth in transfers outweigh faster growth in wages and salaries. Transfer payments will grow more slowly than GDP because of falling unemployment benefits (see Chapter 3). Larger tax refunds are anticipated in 2004—because certain tax cuts in JGTRRA are retroactive to the beginning of 2003—but are not expected to recur in 2005. Also, under JGTRRA, certain tax benefits temporarily diminish, which will raise households' tax burden slightly in 2005 and curb the growth of disposable income. (For example, the child tax credit falls from $1,000 per child in 2004 to $700 per child in 2005 before rising again in later years.) At the same time, total wages and salaries will rise more quickly than will output, CBO estimates, partially reversing the drop over the past three years in the ratio of wages and salaries to GDP.

9. Disposable income equals personal income (the income that individuals receive, including transfer payments) less personal tax payments.

Figure 2-10.

Personal Taxes Less Government Transfers

(Percentage of personal income)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Personal taxes equal personal income taxes plus personal contributions for social insurance.

Households' Finances. After deteriorating in 2001 and 2002, households' finances improved in 2003 and will probably remain stable in 2004 and 2005, thus bolstering consumption. Several indicators support that statement. Between August 2000 and February 2003, the Standard and Poor's 500 index of stock prices fell by 44 percent. By December 2003, however, stock prices had made up some of their losses and were down by only 27 percent from their August 2000 level. According to the Federal Reserve, delinquency rates on consumer loans at commercial banks, after rising during the recession, fell back to levels last seen in the mid-1990s. Another indicator of households' finances, the ratio of household financial obligations to disposable income, remains high but has fallen from its peak in late 2001.

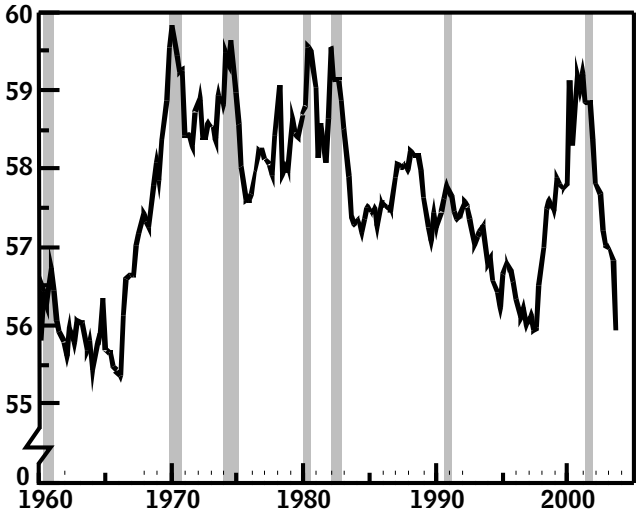
Consumption and Saving. CBO expects that solid income growth will enable real consumption in 2004 and 2005 to expand by slightly more, on average, than it has over the past three years. However, the pace of consumer spending growth over the next two years should be slower than that of GDP—after exceeding GDP growth during most of the previous three years. Much of the growth in consumption from 2001 to 2003 apparently derived from the impact of tax cuts on disposable income, since pretax income grew slowly and stock market wealth fell. Rising prices for homes also contributed to consumption growth. During 2004 and 2005, however, consumption will probably grow more slowly than pretax income, allowing a slight increase in the personal saving rate. That rate is surprisingly low: the sharp drop in households' wealth over the past few years would normally be expected to encourage households to save.

Housing. Residential investment is likely to contribute little to overall economic growth during 2004 and 2005, CBO forecasts. Interest rates on fixed-rate mortgages fell to their lowest level in at least 30 years in June 2003 and have remained low in the months since then. As a result, sales of both new and existing homes hit record levels in 2003, and more housing units were started in that year than in any other since 1986. Real residential construction, after edging up in 2001, grew by 4 percent in 2002 and probably by more than 9 percent in 2003. However, with mortgage rates expected to rise as the economy strengthens, activity in the housing sector is likely to slow by late 2004. Any downturn will be limited, though, by the solid growth in income forecast for the period. Moreover, even if housing activity slows slightly, levels of sales and construction will remain high.

Figure 2-11.

Labor Compensation

(Percentage of GDP)



Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

Note: Labor compensation equals wage and salary disbursements plus supplements to wages and salaries.

The Government's Purchases of Goods and Services

Under current law, real federal purchases of goods and services will contribute less to demand growth during 2004 and 2005 than they did during the previous three years.[10] Such purchases grew by 6.3 percent in 2001 and 10.1 percent in 2002 (measured fourth quarter over fourth quarter); CBO estimates that they grew by 8.1 percent in 2003, as the government increased its purchases of both defense and nondefense goods and services. In 2004, the growth of real federal purchases will slow to less than 5 percent, CBO estimates. For 2005, CBO forecasts flat growth because its budget projections must incorporate the assumption that appropriations after the current budget year will increase only at the rate of inflation (see Chapter 3).

During 2004 and 2005, the growth of real state and local purchases of goods and services is forecast to accelerate from its unusually slow rates in 2003 but still remain slower than the growth of GDP. The rise in such purchases fell to near zero during the first half of 2003, as state and local governments were forced to reduce their large budget deficits. Those imbalances shrank to some extent during early 2003 (because of the drop in spending and some increase in the growth of revenues), and their contraction has eased some but not all of the pressure to restrain spending *(see Box 2-1).* Until those deficits are trimmed further, state and local spending will probably grow more slowly than GDP.

Unemployment, Inflation, and Interest Rates

Today's low rate of price increases together with slack labor markets has set the stage for continued low inflation during CBO's two-year forecast period and over the medium term (through 2014). Strong demand growth will reduce the rate of unemployment, according to CBO's estimates, but not enough to trigger a noticeable acceleration of inflation. Interest rates are projected to rise as the unemployment rate falls, but CBO believes that they will remain relatively low by historical standards, consistent with restrained inflation.

10. Purchases of goods and services, a subset of total federal spending, do not include transfer payments to individuals or foreign governments, grants-in-aid to state and local governments, subsidies, or interest payments.

The Labor Market

From 2001 to 2003, firms more than met the slow growth of demand for goods and services with productivity gains and so triggered a fall in employment and a rise in the unemployment rate. Between the peak in employment in February 2001 and its trough in July 2003, the number of nonfarm employees fell by more than 2.7 million. That drop in employment was concentrated in the manufacturing sector, which lost 2.4 million jobs in the same two-and-a-half-year period.

The unemployment rate rose from 4.2 percent to 6.2 percent over the same interval and would probably have climbed even higher had there not been a sharp drop in the rate of labor force participation. That measure—defined as the share of the population aged 16 and over who are either employed or actively looking for work—fell from 67.1 percent at the beginning of the recession to 66.0 percent in December 2003. The decline in the participation rate for teenagers was particularly large—from 52 percent in 2000 to 44 percent during the fourth quarter of 2003. Labor force participation also fell among young adults but rose for those aged 55 and older.

Since July 2003, the labor market has begun to show some improvement, with the number of nonfarm employees increasing by 278,000 through December, according to the Bureau of Labor Statistics' (BLS's) establishment survey. But the increase since July in the number of people with jobs, as measured independently by the survey of households that BLS also conducts (and that is used to calculate the unemployment rate), was a much stronger 875,000. Adjusting for conceptual differences between the two surveys—the most important is that self-employed workers are included in the household survey but not the establishment survey—reduces the size of the discrepancy during the survey period by about 100,000. (In fact, the household survey has shown considerably stronger growth than the establishment survey has since the recession officially ended in November 2001.)

Although CBO considers the establishment survey's data to be more reliable than the household survey's through early 2003, it is less clear which survey provides a more accurate picture of labor-market conditions in the second half of 2003. Over the past six months, startups of new businesses and expansion among small firms that are not directly measured in the establishment survey may have occurred more frequently than the official data assume. Moreover, recent data on tax withholding, though by no

Box 2-1.

The Fiscal Condition of the States

Since 2001, states have been struggling with sluggish revenues and rising pressures on spending, particularly for health care programs such as Medicaid. They have coped with those pressures by various means: limiting the growth of spending from their general funds (often through midyear budget cuts), increasing taxes and fees, drawing down reserves that had reached record levels in 2000, and employing $20 billion in additional federal assistance. General fund revenues, which had grown at an average annual rate of 6.5 percent over the period from 1997 to 2000, grew by only 3.6 percent from 2000 to 2001;[1] they declined by 1.7 percent in 2002 and returned to positive growth—of 1.6 percent—in 2003 (the result, in part, of legislated increases in taxes and fees). Growth in spending from general funds slowed from 7.6 percent in 2001 to 1.4 percent in 2002 and 0.4 percent in 2003.[2]

The states' fiscal picture is beginning to improve, recent evidence suggests. As states reach the middle of their 2004 fiscal year, national groups representing state budget officers and legislators are reporting signs of an upturn. They caution, however, that the states' fiscal recovery is fragile and continues to lag behind that of the national economy. In its most recent *Fiscal Survey,* the National Association of State Budget Officers (NASBO) notes that spending pressures—particularly for health care—will continue to present states with significant challenges and that revenues overall "remain sluggish," even though a few states appear to be meeting or exceeding their revenue targets in some categories.[3] States are also concerned about covering additional costs associated with homeland security, the Medicaid program, and the No Child Left Behind and Individuals with Disabilities Education Acts.

The National Conference of State Legislatures (NCSL) also cites evidence of an upturn in its *State Budget Update,* noting that only 10 states are reporting budget gaps so far this year compared with 31 states a year ago.[4] (A budget gap is the shortfall that

1. States' general funds account for about 45 percent of total state spending. Revenues flow into the general funds from personal and corporate income taxes, sales taxes, and, to a lesser extent, fees. Those revenues finance a broad range of state programs, including education, Medicaid, public assistance, and public safety. Federal funds support nearly 30 percent of total state spending, and a significant portion of those funds pays for Medicaid costs. The remaining 25 percent of state spending, which includes highway programs, capital projects, and narrower state programs, is supported by fees, specialized taxes, and bond proceeds.

2. Spending from sources other than general funds—for example, federal funds, special state funds, and bond proceeds—increased at a faster pace over the 2000-2003 period than did outlays from general funds.

3. National Governors Association and National Association of State Budget Officers, *Fiscal Survey of States* (Washington, D.C.: National Governors Association and National Association of State Budget Officers, December 2003).

4. National Conference of State Legislatures, *State Budget Update* (Washington, D.C.: National Conference of State Legislatures, November 2003).

means definitive, are consistent with the view that employment growth may have been somewhat stronger during the second half of 2003 than is reflected in the current establishment survey data. Despite the uncertainty about recent job growth, CBO expects employment to grow as the economy expands.

The narrowing of the gap between demand and potential GDP during 2004 and 2005 will help raise employment and reduce the unemployment rate, CBO forecasts. (The measure of the unemployment rate is probably unaffected by the uncertainty about recent job growth.) Jobs are expected to grow more rapidly than the labor force over the next two years, which will push the unemployment rate down; in CBO's forecast, the rate drops from 6.0 percent,

Box 2-1

Continued

states expect at the end of the year, given their most recent projections of revenues and expenditures.) Overall, NCSL projects that state general fund revenues will grow by 1.8 percent in state fiscal year 2004. Spending is budgeted to remain level or slightly decline.

The *State Revenue Report* for December 2003 also notes that state revenues appear to be improving but continue to lag behind national economic growth.[5] The publication notes that for the first time since 2000, collections from all three major tax sources (personal income, corporate income, and sales) are growing; in the July-September quarter of 2003, those three taxes combined grew by 4.5 percent relative to the same period last year. A significant portion of that growth can be attributed to tax increases over the past three years. According to NASBO, more than two-thirds of the states had enacted net tax or fee increases for 2004, which the association estimates will result in additional revenues of $9.6 billion in that year. Growth in tax revenues has also varied among regions. The increase in quarterly tax revenues was greatest in the Far West; after adjustments for inflation and legislative changes, revenues grew by 5.5 percent in the July-September quarter of 2003. Other regions saw much slower (less than 1 percent) or even negative growth.[6]

On the spending side, Medicaid—the second largest spending category for states after education—continues to cause the most concern. NCSL notes that of the 22 states that are reporting spending levels above their estimates, 13 face Medicaid overruns. However, states expect increased matching funds from the federal government to help them cover those expenses, at least for this year. (The Jobs and Growth Tax Relief Reconciliation Act of 2003 [Public Law 108-27] appropriated $10 billion for general aid to the states—$5 billion each in 2003 and 2004—and it authorized a temporary increase in the federal matching rate for Medicaid, which CBO has estimated will provide an additional $10 billion in assistance.) In addition, states will realize some savings in Medicaid costs as a result of the Medicare Prescription Drug, Improvement, and Modernization Act (P.L. 108-173); the law provides Medicare coverage for prescription drugs for individuals eligible for both Medicare and Medicaid. Even though the federal government will recoup most of those savings, CBO has estimated that the states will realize net savings for Medicaid beginning in 2007. Total savings to states as a result of the prescription drug program are estimated to be $18 billion over the 2004-2013 period.

5. Nelson A. Rockefeller Institute of Government, *State Revenue Report,* State University of New York-Albany (December 2003).

6. Nelson A. Rockefeller Institute of Government, *State Fiscal News,* State University of New York-Albany (November 2003).

on average, during 2003 to 5.8 percent for 2004 and 5.3 percent for 2005. The forecast anticipates a rebound in labor force participation for teenagers and young adults as the economy gathers momentum, which will keep the unemployment rate from falling even faster. CBO projects that over the medium term, the unemployment rate will average 5.2 percent from 2007 to 2014.

Inflation

Inflation as measured in the consumer price index for all urban consumers will be lower in 2004 than in 2003, CBO forecasts, providing that the growth of energy prices slows sharply. Consumer energy prices, after rising by about 8 percent during 2003 (measured fourth quarter over fourth quarter), are likely to ease during 2004, as the prices of oil and natural gas decline. Within the core rate of inflation in the CPI (that is, excluding food and en-

ergy), unusually rapid gains in productivity and temporarily slow growth of owners' equivalent rent (the estimated rental rate of owning a home) held down price rises in 2003. In 2004, slack labor markets will continue to exert some downward pressure, but core inflation is expected to accelerate somewhat from its temporarily low 2003 pace. Also likely to push up core inflation in 2004 are higher prices for imports stemming from the falling dollar.

In 2005, according to CBO's forecast, the overall rate of consumer price inflation (including food and energy) will then edge up, boosted not only by higher prices for imports but also by tightening labor markets and increasing utilization of existing productive capacity. Energy prices will also begin to move upward at more normal rates.

Energy prices have the potential to add more to inflation in the first half of 2004 than CBO's forecast indicates, however. Prices for natural gas and petroleum were surprisingly strong in December 2003, highlighting the uncertainty that surrounds such forecasts. Natural gas, which had traded below $5 per million Btu (mmBtu) from August through November, suddenly jumped in price to almost $7 per mmBtu by mid-December. After falling for a short period, natural gas prices climbed again, reaching about $7 per mmBtu briefly in early January. By comparison, the percentage increase in petroleum prices was not as large.

For the medium term, the rise in inflation anticipated in CBO's two-year forecast will taper off, with prices growing at an average annual rate of about 2.2 percent as measured by the CPI-U and 1.9 percent as measured by the GDP price index (the yardstick of inflation in the overall economy). That outlook reflects CBO's view that the Federal Reserve will, on average, maintain the rate of CPI-U inflation between 2.0 percent and 2.5 percent.

The difference that frequently exists between inflation as measured in the CPI-U and the GDP price index's measurement affects the projections of the federal budget. Many spending programs and most income tax brackets are indexed to the CPI-U or the CPI-W (the index of consumer prices for urban wage earners and clerical workers). In contrast, taxable income is more closely related to growth in the GDP price index. CBO expects that the wedge between the projected rates of growth of the CPI-U and the GDP price index will average 0.3 percentage points during the later years of the projection period, a gap equaling the average wedge between the two rates during the 1990-2002 period.[11]

In the first half of 2003, as the recovery seemed to stall, a number of economists feared that the U.S. economy would stagnate and slip into a deflation (generally falling prices) that would be difficult to reverse. Those views, combined with the Federal Reserve's willingness to keep the federal funds rate low (the funds rate is the rate that financial institutions charge each other for overnight loans of monetary reserves), led to the dramatic drop—to below 3.2 percent—in mid-June 2003 in yields on 10-year Treasury notes. As the economy heated up during the summer, however, concerns about stagnation and deflation quickly evaporated. Now analysts feel that deflation is less of a risk, and even those that forecast further slowing of inflation argue that mild deflation is not incompatible with solid economic growth.

Monetary Policy

With idle labor and capital exerting downward pressure on inflation, the Federal Reserve is unlikely to shift soon from its current extremely accommodative stance and tighten monetary policy. Six weeks after cutting its target for the federal funds rate to 1 percent in late June 2003, the Federal Reserve announced that low short-term rates could be "maintained for a considerable period." (Indeed, the futures markets for the federal funds rate in mid-January 2004 did not expect the central bank to begin moving toward a more neutral stance—by boosting rates—until the summer of 2004.) The Federal Reserve will probably begin to raise rates somewhat more in late 2004 and 2005 as the unemployment rate falls toward a level that eliminates its downward effect on inflation.

The rate on three-month Treasury bills is closely tied to the federal funds rate, and CBO forecasts that short-term rates will rise slowly during much of 2004 and then more rapidly in late 2004 and 2005. The rate on those securities is expected to average 1.3 percent in 2004 and 3.0 percent in 2005.

Long-term rates are also expected to rise during the next two years but not by as much as short-term rates will, in part because they have already begun to increase. As the

11. The historical average of the wedge is calculated using the CPI-U research series, which unlike the official CPI incorporates into the entire series most of the methodological improvements made by the Bureau of Labor Statistics since 1978.

prospects for economic growth improved in 2003, the yield on 10-year Treasury notes rose from an average 3.6 percent during the second quarter to an average 4.3 percent during the fourth. CBO expects the yield on 10-year Treasury notes to average 4.6 percent in 2004 and 5.4 percent in 2005.

CBO's projection for interest rates in the medium term, during which the economy is assumed to grow at trend rates, reflects its estimates of CPI-U inflation and real interest rates. During the 2006-2014 period, the rate on three-month Treasury bills will average 4.5 percent, CBO expects, while the rate on 10-year Treasury notes will average 5.5 percent. Thus, the real rates on three-month bills and 10-year notes will average 2.4 percent and 3.3 percent, respectively—close to their historical averages over the 1947-2001 period.

The Outlook for GDP Beyond 2005

CBO projects that real GDP will grow at an average annual rate of 2.7 percent during the 2006-2014 period, about the same pace as the growth of potential GDP. The projected growth rate for potential GDP for 2006 onward is similar to the rate in CBO's August 2003 forecast. The reduction in the projected growth rate of real GDP over that period—0.2 percentage points—is somewhat larger because the faster economic growth now forecast for the 2004-2005 period leaves real GDP above its potential level in 2005. (Last summer's forecast had GDP below its potential for 2005.)

To develop its medium-term projections for 2006 through 2014, CBO projects the factors that underlie the growth of potential GDP, such as the growth of the labor force, productivity, and the capital stock. In doing so, CBO takes into account the effect that current fiscal policy may have on those factors, but it does not attempt to forecast business-cycle fluctuations beyond the next two years.

In CBO's projection, the growth of potential output averages 2.8 percent over the 2004-2014 period *(see Table 2-3)*. That projection implies growth through 2013 that is almost exactly the same as the growth CBO projected in August 2003. But the factors underlying the projection exhibit some differences: the potential labor force is projected to grow by slightly less than CBO had estimated in August, whereas capital accumulation is projected to be slightly higher. The growth of potential TFP after 2006 is unchanged from last August's projection. CBO's current estimate of the level of potential output is 1.2 percent higher in 2003—and remains higher throughout the projection period—than its estimate of last August, mainly because CBO adjusted upward the historical values of potential TFP in its current projection.

Potential total factor productivity will grow at a rate of 1.3 percent over the next 10 years, CBO projects. As noted earlier, productivity growth—both labor productivity and TFP—has been unusually strong since the 2001 recession. That robust growth barely affects CBO's estimate of the trend in TFP because growth in a few recent quarters carries little weight in the estimate of that trend. However, CBO has raised the growth rate of potential TFP by an average of 0.7 percentage points (at an annual rate) during the 2001-2003 period to reflect the strong recent gains in actual productivity. That adjustment boosts the level for 2003 by about 2 percent relative to what it otherwise would have been.

CBO expects growth in the potential labor force to average 0.8 percent during the 2004-2014 period—a reduction of 0.1 percentage points compared with last summer's estimate of growth during the 2004-2013 period. That reduction reflects two factors. First, the growth of the labor force is projected to be lower in 2014 than in preceding years. Second, CBO has reassessed trends in rates of labor force participation, which since the start of the 2001 recession have been much lower than CBO had expected. Although the decline in participation has been most pronounced among the young, participation has also fallen among men and women between the ages of 25 and 54. In contrast, participation among people aged 55 and older is rising. CBO's projection of the potential labor force is subject to many sources of uncertainty, one of the most important being the level of undocumented immigration in the future *(see Box 2-2)*.

Potential hours worked are expected to grow more slowly (about 0.1 percent per year, on average) between 2004 and 2014 than CBO had projected last summer. The downward revision to the growth of projected hours largely reflects the downward revision in the projection for the potential labor force. However, a small fraction of that change stems from the effect that the recent slow growth of employment and hours in the nonfarm business sector has had on the estimated trend.

Capital accumulation will proceed, on average, at a 4.0 percent pace during the 2004-2014 period, slightly faster than CBO had anticipated last summer. Growth in

Table 2-3.

Key Assumptions in CBO's Projection of Potential Output

(By calendar year, in percent)

	Average Annual Growth						Projected Average Annual Growth		
	1950-1973	1974-1981	1982-1990	1991-1995	1996-2003	Total, 1950-2003	2004-2009	2010-2014	Total, 2004-2014
Overall Economy									
Potential Output	3.9	3.3	3.0	2.6	3.4	3.4	3.0	2.6	2.8
Potential Labor Force	1.6	2.5	1.6	1.2	1.3	1.6	1.0	0.6	0.8
Potential Labor Force Productivity[a]	2.3	0.7	1.4	1.3	2.1	1.8	2.0	2.0	2.0
Nonfarm Business Sector									
Potential Output	4.0	3.6	3.1	3.0	3.9	3.7	3.4	2.8	3.1
Potential Hours Worked	1.3	2.2	1.5	1.4	1.5	1.5	1.1	0.7	0.9
Capital Input	3.6	4.4	3.6	2.5	4.5	3.8	4.3	3.7	4.0
Potential Total Factor Productivity	2.0	0.8	0.9	1.2	1.5	1.5	1.3	1.3	1.3
Potential TFP excluding adjustments	2.0	0.7	1.0	1.1	1.1	1.4	1.1	1.1	1.1
TFP adjustments	0	0	0	*	0.4	0.1	0.2	0.1	0.2
Computer quality[b]	0	0	0	*	0.1	*	*	*	*
Price measurement[c]	0	0	0	*	0.1	*	0.1	0.1	0.1
Temporarily faster growth[d]	0	0	0	0	0.2	*	*	0	*
Contributions to Growth of Potential Output (Percentage points)									
Potential hours worked	0.9	1.6	1.1	1.0	1.0	1.1	0.8	0.5	0.7
Capital input	1.1	1.3	1.1	0.8	1.4	1.1	1.3	1.1	1.2
Potential TFP	2.0	0.8	0.9	1.2	1.5	1.5	1.3	1.3	1.3
Total Contributions	4.0	3.6	3.1	2.9	3.9	3.7	3.4	2.8	3.1
Memorandum:									
Potential Labor Productivity[e]	2.7	1.4	1.6	1.5	2.4	2.2	2.2	2.1	2.2

Source: Congressional Budget Office.

Note: * = between zero and 0.05.

a. The ratio of potential GDP to the potential labor force.

b. An adjustment for technological advances in the computer manufacturing sector.

c. An adjustment for a conceptual change in the official measure of the GDP price index.

d. An adjustment for the unusually rapid growth between 2001 and 2003.

e. The estimated trend in the ratio of output to hours worked in the nonfarm business sector.

Table 2-4.

CBO's Current and Previous Economic Projections for Calendar Years 2003 Through 2013

	Estimated	Forecast		Projected Annual Average	
	2003	2004	2005	2006-2009	2010-2013
Nominal GDP (Billions of dollars)					
January 2004	10,980	11,629	12,243	14,686[a]	17,490[b]
August 2003	10,836	11,406	12,025	14,823[a]	17,943[b]
Nominal GDP (Percentage change)					
January 2004	4.8	5.9	5.3	4.7	4.5
August 2003	3.7	5.3	5.4	5.4	4.9
Real GDP (Percentage change)					
January 2004	3.2	4.8	4.2	2.8	2.5
August 2003	2.2	3.8	3.5	3.1	2.6
GDP Price Index (Percentage change)					
January 2004	1.6	1.1	1.1	1.8	1.9
August 2003	1.5	1.4	1.8	2.2	2.2
Consumer Price Index[c] (Percentage change)					
January 2004	2.3	1.6	1.7	2.2	2.2
August 2003	2.3	1.9	2.4	2.5	2.5
Unemployment Rate (Percent)					
January 2004	6.0	5.8	5.3	5.1	5.2
August 2003	6.2	6.2	5.7	5.3	5.2
Three-Month Treasury Bill Rate (Percent)					
January 2004	1.0	1.3	3.0	4.5	4.6
August 2003	1.0	1.7	3.2	4.6	4.9
Ten-Year Treasury Note Rate (Percent)					
January 2004	4.0	4.6	5.4	5.5	5.5
August 2003	4.0	4.6	5.5	5.8	5.8
Tax Bases (Billions of dollars)					
Corporate book profits					
January 2004	844	948	1,319	1,359[a]	1,587[b]
August 2003	742	797	1,210	1,269[a]	1,503[b]
Wages and salaries					
January 2004	5,087	5,333	5,639	6,823[a]	8,120[b]
August 2003	5,128	5,394	5,695	7,029[a]	8,518[b]
Tax Bases (Percentage of GDP)					
Corporate book profits					
January 2004	7.7	8.1	10.8	9.9	9.1
August 2003	6.8	7.0	10.1	9.2	8.4
Wages and salaries					
January 2004	46.3	45.9	46.1	46.4	46.5
August 2003	47.3	47.3	47.4	47.4	47.5
Memorandum:					
Real Potential GDP (Percentage change)					
January 2004	3.4	3.3	3.1	3.0	2.6
August 2003	3.0	3.2	3.0	2.9	2.6

Sources: Congressional Budget Office.

Note: Percentage changes are year over year.

a. Level in 2009.

b. Level in 2013.

c. The consumer price index for all urban consumers.

Box 2-2.

How Undocumented Immigration Affects CBO's Projection of the Labor Force

The Congressional Budget Office's (CBO's) 10-year projection of the labor force is an important component of its estimate of potential gross domestic product (GDP), and potential GDP in turn is a major factor underlying CBO's projections of federal tax bases. But the future growth of the labor force is uncertain, and seemingly small changes in the projection can produce significant differences in the amount of federal revenues expected over the next 10 years. A substantial part of the uncertainty surrounding the size of the future labor force involves undocumented immigration.

CBO projects faster growth of the labor force over the next 10 years than the growth implied by the official population projections of the Bureau of the Census. The decennial population survey of 2000 revealed stronger-than-expected population growth between 1990 and 2000—averaging about 0.2 percent annually over that period—which seems to be attributable to the Census Bureau's previous underestimates of undocumented workers. Although the bureau has incorporated the information from the census into its population estimates for recent years, it has not yet incorporated the new information into any official population projections. Therefore, for its labor-force projection, CBO has assumed that the Census Bureau's forecasts of population continue to understate undocumented immigration. However, it believes that the understatement is less than it was in the 1990s and so has projected that half of the additional average annual growth in the population reported for the 1990s will continue after 2000.

Whether that assumption about additional growth is accurate is unclear. If CBO eliminated from its calculations the assumption that the Census Bureau's projections understate undocumented immigration, its labor-force projection would be lower by 1 percent by 2014. However, if CBO assumed that the Census Bureau's projections understated such immigration by the same amount that they did in the 1990s, the labor force in the projection would be about 1 percent larger by the end of the period.

Uncertainty about the net amount of undocumented immigration arises from both economic and noneconomic factors. Other things being equal, prospective immigrants are more likely to attempt to enter the United States illegally when they believe employ-

the capital stock depends on businesses' investment spending relative to the existing stock. That ratio is higher in CBO's current projection than it was in last August's. The more favorable outlook for capital growth results from a higher forecast for productivity and a reevaluation of trends in investment in the light of unexpectedly fast growth in such spending during the second half of 2003.

Taxable Income

CBO's baseline revenue projections are closely connected to its projections of national income. Because different categories of income are taxed at different rates, and some are not taxed at all, the projected distribution of income among its various components is a central factor in CBO's budget projections.

CBO expects that the sharp drop over the past three years in the share of total income going to employees will be partially reversed over the next 10 years. However, much of the rise in that share will be attributable to higher fringe benefits, CBO believes—specifically, employers' contributions to health insurance and pension plans—rather than to higher wages and salaries. Thus, the share of GDP accounted for by wages and salaries will remain near historically low levels, dropping from 46.3 percent in 2003 to 45.9 percent in 2004, before rising to 46.1 percent in 2005 and an average annual share of 46.4 percent during the 2006-2014 period. Those figures

Box 2-2.

Continued

ment opportunities here are abundant; they are less likely to try when they believe jobs are scarce. (When jobs are scarce, emigration by nonpermanent residents is also likely to be greater.) Conversely, prospective immigrants are less likely to attempt to immigrate when economic conditions in their home countries are favorable than when those conditions are less favorable. In the boom years of the late 1990s, conditions in the United States were especially attractive to prospective immigrants, including illegal ones. However, the extent to which undocumented immigration then was motivated by short-term cyclical factors (such as low unemployment) as opposed to longer-term structural economic features (such as high real wages) is unclear. If the structural component of the United States' economic attraction for undocumented workers proved to be stronger than CBO had anticipated (and thus that strength was not amply reflected in CBO's assumption), the current projection could understate the growth of the U.S. population and labor force over the next 10 years. But it could also overstate that growth if, for example, economic conditions were significantly better than expected in the major countries of origin of undocumented workers.

Noneconomic factors that may affect undocumented immigration over the next 10 years include political conditions in immigrants' home countries and the United States' continuing efforts to improve homeland security. Citizens of repressive governments that have little regard for freedom, democracy, and even human life are likely to want to leave those conditions whenever possible. The political freedoms in the United States are especially appealing to people in such circumstances.

A noneconomic factor that has probably reduced the amount of undocumented immigration into the United States is the efforts to increase homeland security following the terrorist attacks of September 11, 2001. Their downward effect on the number of undocumented workers, however, is probably offset to some extent by a drop in the number of such immigrants temporarily leaving this country to visit their families abroad. Nevertheless, the overall effect is probably a reduction in net immigration, a pattern that is likely to continue. CBO has incorporated in its baseline projections half of the additional population growth reported for the 1990s. If security measures are tightened further, however, population and labor-force growth could be even lower than CBO's current projections assume.

compare with an average annual share of 47.4 percent over the past 20 years.

Two of the various NIPA measures of corporate profits are important for the forecast. Book profits, or before-tax profits, is the measure most closely related to the profits on which corporations pay tax and is affected by changes in the tax code. The law allows corporations to value inventories and depreciate assets at certain rates, and the book measure of profits is designed to reflect those statutory requirements. By contrast, the economic profits measure is not affected by changes in tax law. Rather, it is designed to reflect the valuation of inventories and the rates of depreciation that economists believe more truly represent inventories' current value and the economic usefulness of the capital stock.

Book profits and economic profits will differ sharply over the next decade because of statutory requirements that affect how companies can depreciate their assets for tax purposes. The partial-expensing provisions of JCWAA and JGTRRA that expire at the end of 2004 allow firms to depreciate some of their capital stock much more rapidly than the rate at which the economic usefulness of that capital deteriorates. Those provisions will lower book profits by about $200 billion in 2004, CBO expects, because companies can take extra depreciation in that year. Conversely, from 2005 on, the provisions will increase book profits by about $125 billion in 2005 and declining amounts in subsequent years—because the extra depreciation taken from 2002 to 2004 means that less depreciation will be taken in later years.

Robust growth of GDP will push economic profits up from a 9.7 percent share of GDP in 2003 to a 10.2 percent share in 2004, CBO forecasts. From 2005 to 2007, however, the expanding proportion of total GDP claimed by wages and salaries will reduce the share of GDP going to economic profits, and that drop will roughly offset the rise in the share going to wages and salaries. CBO expects that after 2008, the GDP share of economic profits will average about 9.6 percent, still well above its 20-year average of 8.3 percent.

Changes in the Economic Forecast Since August 2003

CBO has raised its estimates of the growth of real GDP in the near term and lowered its estimates of inflation and nominal interest rates since its forecast last August *(see Table 2-4 on page 41)*. The economy bounced back from its sluggish growth of late 2002 and early 2003 much more forcefully than CBO and many other forecasters had expected. That strong rebound suggests that the economy has more momentum going into 2004 than CBO had previously assumed—which led CBO to raise its forecast for the growth of real GDP in 2004 and 2005 and lower its estimate of the unemployment rate.

The level of real GDP after 2005 in the current forecast is also higher than in last August's, but the rate of growth is slightly lower. CBO views some of the unexpectedly large gains in productivity that accompanied last year's strong output growth as a permanent increase in productivity levels and thus in potential GDP. Even so, the additional GDP growth during 2003 exceeded the upward revision to potential GDP, leaving less room for GDP to grow than in last summer's forecast.

The continued low rates of core inflation last year in the face of stronger growth suggest that inflation will remain tamer during the two-year forecast period than CBO had thought last summer and in turn that nominal interest rates will be as low or lower in the near term than was previously forecast. CBO also now foresees lower inflation and interest rates in the medium term than it did in the summer of 2003.

Compared with its estimates last August, CBO has lowered its outlook for wages and salaries and raised that for corporate profits. Wages and salaries have not recovered as much after the 2001 recession as they typically have after earlier downturns, and they were revised moderately downward in the recent comprehensive revision to the NIPAs (discussed below). In contrast, corporate profits have bounced back strongly in the past year, and the recent revisions to them were noticeably upward.

The 2003 Benchmark Revision to the National Income and Product Accounts

In December 2003, the Bureau of Economic Analysis (BEA) released a comprehensive revision of the NIPAs, as it does about every five years. Such revisions are designed to improve the accuracy and usefulness of the accounts by incorporating new and more complete source data, new definitions of some concepts, and new estimating methods.[12]

In the past, comprehensive revisions have modified economists' views of economic history, particularly for the most recent three or four years. (Those are the years for which new source data are likely to generate significant changes.) By altering historical perspectives, revisions, if substantial, have also affected forecasters' assessment of the economic outlook, both for the near term and for longer periods. The December 2003 revision did not have a major effect on CBO's view of GDP growth or inflation, but it did change recent trends in some important categories of income. CBO's budget baseline and its economic forecast both incorporate BEA's new figures.

Average annual rates of growth of real GDP and of the GDP price index over the past 10 years were unchanged in the revision, although some quarter-to-quarter growth rates were substantially modified. The average growth of real GDP from 1992 through 2002 remained at 3.2 percent, and the average growth of the price index remained at 1.9 percent. Changes in quarterly growth rates, such as the revision in real GDP growth in the third quarter of 2000—from 0.6 percent to -0.5 percent—were offset by opposite changes in adjacent quarters. Thus, the overall trends in real GDP and GDP price growth were not changed.

Some major income categories and saving rates, however, underwent significant revision. The nominal level of profits during the first half of 2003 was revised upward by 14 percent, or $126 billion, even though nominal GDP was revised upward by less than one-half of

12. Details of the revision are given in various issues of the *Survey of Current Business,* published by the Bureau of Economic Analysis, which are available at www.bea.gov.

1 percent. In contrast, the level of overall labor compensation was boosted by only 1 percent, as the wages and salaries component of labor compensation was revised slightly downward, but the estimate of employers' contributions to benefits (such as medical insurance and pensions) was revised significantly upward. Proprietors' income (the income of businesses that are not incorporated) was revised upward by 4 percent in early 2003 because of new source data, and interest income was revised downward, largely because BEA decided it would be more accurate to attribute some of the interest previously imputed to households to businesses.

Both the gross national saving rate and the personal saving rate experienced downward revisions for recent years. The national saving rate was lowered by about 0.4 percentage points for the 1998-2003 period; the personal saving rate was lowered by about 0.5 percentage points in the period 1999 to 2001 and by almost a full percentage point for the period 2002 to early 2003. An upward revision of 1 percent in the level of personal consumption expenditures for 2002 caused the revision in the saving rate for that year.

CHAPTER

3

The Spending Outlook

The Congressional Budget Office expects that federal spending in 2004 will continue to grow at a significant rate but less rapidly than in 2003. Under the assumptions that current laws for mandatory programs remain the same and that discretionary appropriations total about $876 billion, CBO estimates that outlays in 2004 will rise by $137 billion, to $2.3 trillion—a 6.3 percent increase over their level in 2003 *(see Tables 3-1 and 3-2 on pages 50 and 51).* Total spending, excluding net interest, is estimated to rise by 6.7 percent in 2004, compared with an increase of 8.9 percent in 2003.

Fueling the growth in outlays in 2004 are increases in discretionary spending (a portion of which comes from budget authority granted before 2004) and continued growth in entitlement programs. In addition, CBO estimates that net interest payments will rise by 2 percent in 2004, their first increase since 1997. Outlays for defense discretionary programs are estimated to climb by $46 billion (11.5 percent) in 2004; for nondefense discretionary programs, the expected increase is $24 billion (5.8 percent). Spending for entitlements and other mandatory programs—which constitutes more than half of all federal spending—is estimated to grow by $63 billion (5.3 percent) over its level in 2003 *(see Box 3-1* for descriptions of the various types of federal spending).

Total spending as a percentage of gross domestic product fell from a peak of 23.5 percent in 1983 to a low of 18.4 percent in 2000. However, increases in spending and lagging economic growth pushed that figure up to 18.6 percent in 2001, 19.4 percent in 2002, and 19.9 percent in 2003. CBO estimates that outlays will reach 20.0 percent of GDP in 2004 and under current policies will remain at about that level from 2005 through 2014 (the 10-year projection period).

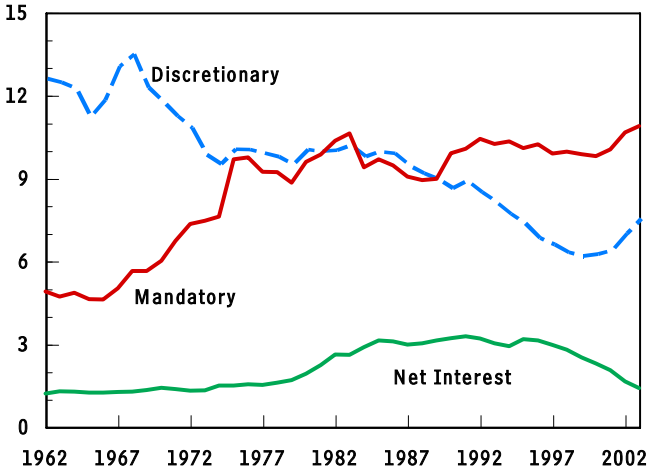
The mix of federal spending has changed significantly over the past several decades. Today, the government spends less—as a proportion of GDP—on discretionary activities and more on entitlement programs than it did in the past. Discretionary spending has declined from 12.7 percent of GDP in 1962 to 7.6 percent in 2003 *(see Figure 3-1).* In contrast, spending for entitlements and other mandatory programs (net of offsetting receipts) has climbed from 4.9 percent to 10.9 percent of GDP over the same period. (For detailed annual data on spending since 1962, *see Appendix F.)*

In 2004, discretionary spending is expected to grow as a percentage of GDP from 7.6 percent to 7.8 percent,

Figure 3-1.

Major Components of Spending, 1962 to 2003

(Percentage of GDP)



Source: Congressional Budget Office based on data from the Office of Management and Budget.

Box 3-1.

Categories of Federal Spending

Federal spending can be divided into categories on the basis of its treatment in the budget process:

Discretionary spending pays for activities such as defense, transportation, national parks, and foreign aid. Discretionary programs are controlled by annual appropriation acts; policymakers decide each year how many dollars to devote to which activities. Certain fees and other charges that are triggered by appropriation action are classified as offsetting collections, which offset discretionary spending. The Congressional Budget Office's (CBO's) baseline depicts the path of discretionary spending in accordance with provisions of the Balanced Budget and Emergency Deficit Control Act of 1985, which state that current spending should be assumed to grow with inflation in the future.[1] CBO estimates that appropriations provided for this fiscal year total $460 billion for defense and about $416 billion for nondefense activities. In addition to the $876 billion in budget authority for discretionary programs for 2004, the baseline reflects about $43 billion in obligation limitations that control spending from the Highway Trust Fund and the Airport and Airway Trust Fund. Such spending is classified as discretionary; however, the budget authority for such programs is provided in authorizing legislation and is not considered discretionary.

Mandatory spending consists overwhelmingly of benefit programs such as Social Security, Medicare, and Medicaid. The Congress generally determines spending for those programs by setting rules for eligibility, benefit formulas, and other parameters rather than by appropriating specific dollar amounts each year. CBO's baseline projections of mandatory spending assume that existing laws and policies remain unchanged and that most expiring programs will be extended. Mandatory spending also includes offsetting receipts—fees and other charges that are recorded as negative budget authority and outlays. Offsetting receipts differ from revenues in that revenues generally are collected as an exercise of the government's sovereign powers, whereas most offsetting receipts are collected from other government accounts or paid by the public for businesslike transactions (such as rents and royalties from leases for oil and gas drilling on the Outer Continental Shelf).

Net interest includes interest paid on Treasury securities and other interest that the government pays (for example, on late refunds issued by the Internal Revenue Service) minus interest that the government collects from various sources (such as from commercial banks, where Treasury tax and loan accounts are maintained). Net interest is determined by the size and composition of the government's debt, annual budget deficits or surpluses, and market interest rates.

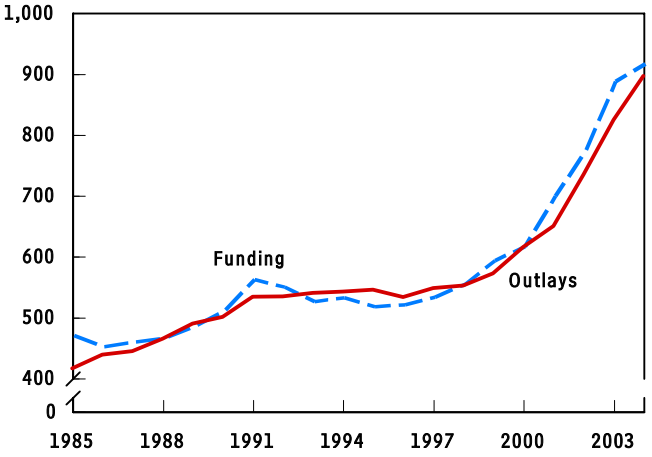
1. The inflation rates used in CBO's baseline, as specified by the Deficit Control Act, are the employment cost index for wages and salaries (applied to expenditures related to federal personnel) and the GDP deflator (for other expenditures).

mandatory spending is expected to drop slightly to 10.8 percent (from 10.9 percent in 2003), and net interest is expected to remain at 1.4 percent. After 2004, under assumptions required by law for the baseline, discretionary outlays are projected to grow roughly half as fast as the economy, or at an average annual rate of 2.5 percent. As a result, discretionary spending's share of GDP is projected to decline gradually, reaching 6.4 percent in 2014. For mandatory spending, the outlook differs. Led by growth in the two major health care programs, Medicare and Medicaid, mandatory outlays (net of offsetting receipts) will grow slightly faster than the economy—or at a rate of 5.5 percent—if current policies remain unchanged. At that rate, those outlays will claim 11.8 percent of GDP

Figure 3-2.

Discretionary Funding and Outlays, 1985 to 2004

(Billions of dollars)



Source: Congressional Budget Office.

Note: Discretionary funding includes both budget authority and obligation limitations. (Spending from the Highway Trust Fund and the Airport and Airway Trust Fund is subject to such limitations. Budget authority for those programs is provided in authorizing legislation and is not considered discretionary.)

by 2014—about a percentage point above their current share. CBO projects that interest payments as a percentage of GDP will increase by one-third—growing to 2.1 percent of GDP in 2009 as a result of continuing deficits and the rising interest rates in CBO's economic forecast *(see Chapter 2* for details of CBO's economic outlook). That percentage will fall slightly toward the end of the 10-year period as the baseline assumptions of restrained growth in discretionary outlays and the scheduled expiration of the tax provisions in the Economic Growth and Tax Relief Reconciliation Act of 2001 lead to diminished borrowing.

Discretionary Spending

Each year, the Congress starts the appropriation process anew. The annual appropriation acts that it passes provide new budget authority (the authority to enter into financial obligations) for discretionary programs and activities. That authority translates into outlays when the money is actually spent. Although some funds (for example, those for employees' salaries) are spent quickly, others (for example, for major construction projects) are disbursed over several years. In any given year, discretionary outlays include spending from both new budget authority and from amounts appropriated previously.

Recent Trends in Discretionary Funding and Outlays

Total discretionary outlays as a share of GDP have been climbing steadily since 2001. That recent upswing reverses a downward trend since the mid-1980s. At that time, discretionary outlays accounted for 10.0 percent of GDP, but they fell to 6.3 percent in 1999 and 2000. Since then, such outlays have moved upward, and they are estimated to account for 7.8 percent of GDP in 2004 *(see Table 3-3 on page 52).*

Defense outlays declined sharply as a share of the economy during the late 1980s and 1990s, decreasing from a peak of 6.2 percent in 1986 to a low of 3.0 percent in 1999, 2000, and 2001. Those outlays then began to rise, reaching 3.4 percent of GDP in 2002 and 3.7 percent of GDP in 2003, an increase in nominal dollar terms of more than one-third from 2000 to 2003. Defense outlays will grow by another 11.5 percent to reach 3.9 percent of GDP this year, CBO estimates, assuming no additional funding for military activity in Iraq and Afghanistan or other defense needs in 2004.

Nondefense discretionary spending has remained relatively constant as a share of GDP since the mid-1980s (hovering between 3.2 percent and 3.9 percent of GDP), although it has grown in nominal dollar terms; such spending is estimated to total 3.9 percent of GDP in 2004. The growth rate of nondefense outlays has slowed significantly since 2002, dropping from 12.3 percent in that year to an estimated 5.8 percent in 2004.

The growth of outlays reflects sizable increases in discretionary funding (which comprises budget authority and obligation limitations) over the past four years *(see Figure 3-2).*[1] Some of the recent increases in funding are attributable to supplemental appropriations for recovery from and response to the terrorist attacks of September 11, 2001; the wars in Afghanistan and Iraq; and disaster

1. In addition to the $876 billion in budget authority for discretionary programs in 2004, the baseline reflects about $43 billion in obligation limitations that control spending from the Highway Trust Fund and the Airport and Airway Trust Fund. Such spending is classified as discretionary; however, the budget authority for such programs is provided in authorizing legislation and is not considered discretionary.

Table 3-1.

CBO's Projections of Spending Under Its Baseline

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
							In Billions of Dollars							
Outlays														
Discretionary Spending														
Defense	405	451	470	476	482	498	510	523	541	545	564	579	2,437	5,189
Nondefense	421	445	466	478	490	500	510	522	533	545	558	571	2,445	5,174
Subtotal	826	896	936	955	972	998	1,021	1,045	1,075	1,091	1,122	1,149	4,882	10,363
Mandatory Spending														
Social Security	471	492	513	533	559	587	618	653	690	732	778	827	2,809	6,490
Medicare	274	294	317	369	418	448	478	515	557	592	645	698	2,029	5,035
Medicaid	161	174	179	186	195	212	230	250	271	295	320	348	1,003	2,487
Other[a]	273	281	287	262	252	258	265	269	277	253	257	256	1,323	2,635
Subtotal	1,179	1,242	1,295	1,350	1,424	1,504	1,591	1,687	1,796	1,872	2,000	2,129	7,165	16,647
Net Interest	153	156	180	219	255	281	300	316	328	334	335	338	1,235	2,886
Total	**2,158**	**2,294**	**2,411**	**2,525**	**2,652**	**2,783**	**2,912**	**3,047**	**3,198**	**3,296**	**3,457**	**3,616**	**13,282**	**29,897**
On-budget	1,795	1,904	2,012	2,118	2,233	2,350	2,461	2,575	2,704	2,785	2,914	3,048	11,175	25,201
Off-budget	363	391	399	406	419	433	451	472	494	512	543	568	2,107	4,696
							As a Percentage of GDP							
Outlays														
Discretionary Spending														
Defense	3.7	3.9	3.9	3.8	3.6	3.6	3.5	3.4	3.4	3.3	3.3	3.2	3.7	3.5
Nondefense	3.9	3.9	3.9	3.8	3.7	3.6	3.5	3.4	3.4	3.3	3.2	3.2	3.7	3.5
Subtotal	7.6	7.8	7.7	7.5	7.3	7.2	7.0	6.9	6.8	6.6	6.5	6.4	7.4	6.9
Mandatory Spending														
Social Security	4.3	4.3	4.2	4.2	4.2	4.2	4.3	4.3	4.4	4.4	4.5	4.6	4.2	4.3
Medicare	2.5	2.6	2.6	2.9	3.2	3.2	3.3	3.4	3.5	3.6	3.7	3.9	3.1	3.4
Medicaid	1.5	1.5	1.5	1.5	1.5	1.5	1.6	1.6	1.7	1.8	1.8	1.9	1.5	1.7
Other[a]	2.5	2.5	2.4	2.1	1.9	1.9	1.8	1.8	1.7	1.5	1.5	1.4	2.0	1.8
Subtotal	10.9	10.8	10.7	10.6	10.8	10.9	11.0	11.1	11.3	11.3	11.6	11.8	10.8	11.1
Net Interest	1.4	1.4	1.5	1.7	1.9	2.0	2.1	2.1	2.1	2.0	1.9	1.9	1.9	1.9
Total	**19.9**	**20.0**	**19.9**	**19.9**	**20.0**	**20.1**	**20.1**	**20.1**	**20.2**	**19.9**	**20.0**	**20.0**	**20.0**	**20.0**
On-budget	16.6	16.6	16.6	16.7	16.9	17.0	17.0	17.0	17.0	16.8	16.8	16.9	16.8	16.9
Off-budget	3.4	3.4	3.3	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.2	3.1
Memorandum:														
Gross Domestic Product (Billions of dollars)	10,829	11,469	12,091	12,682	13,236	13,862	14,519	15,187	15,862	16,562	17,301	18,070	66,389	149,371

Source: Congressional Budget Office.

a. Includes offsetting receipts.

Table 3-2.

Average Annual Rates of Growth in Outlays Under CBO's Baseline

(Percent)

	Actual 1992-2002	Actual 2002-2003	Estimated 2003-2004	Projected[a] 2004-2014
Discretionary	3.2	12.4	8.6	2.5
Defense	1.4	16.0	11.5	2.5
Nondefense	5.2	9.2	5.8	2.5
Mandatory	5.5	6.6	5.3	5.5
Social Security	4.7	4.1	4.6	5.3
Medicare	7.0	8.1	7.3	9.0
Medicaid	8.1	8.9	8.4	7.2
Other[b]	4.3	8.4	2.7	-0.9
Net Interest	-1.5	-10.5	2.0	8.0
Total Outlays	3.8	7.3	6.3	4.7
Total Outlays Excluding Net Interest	4.5	8.9	6.7	4.4
Memorandum:				
Consumer Price Index	2.5	2.3	1.7	2.1
Nominal GDP	5.2	4.4	5.9	4.7
Discretionary Funding[c]	3.4	14.8	3.2	2.4
Defense	1.9	26.1	1.1	2.4
Nondefense	5.0	5.0	5.3	2.4

Source: Congressional Budget Office.

a. As specified by the Deficit Control Act, CBO's baseline uses the employment cost index for wages and salaries to inflate discretionary spending related to federal personnel and the GDP deflator to adjust other spending.

b. Includes offsetting receipts.

c. Comprises budget authority and obligation limitations.

relief. Such appropriations—combined with funding increases for other activities—contributed to annual growth rates for discretionary funding of between 10 percent and 15 percent from 2001 through 2003. Funding thus far for 2004 (including the omnibus appropriation act) represents an increase of 3.2 percent from last year's level—1.1 percent for defense and 5.3 percent for nondefense activities. That increase in nondefense funding stems in large part from spending for the reconstruction of Iraq. Within the nondefense category, funding for homeland security for 2004 is slightly less than it was in 2003, because the 2003 funding included certain one-time costs of the Transportation Security Administration.

Discretionary Spending for 2005 Through 2014

Under baseline assumptions, CBO projects that discretionary outlays will continue rising and remain about evenly divided between defense and nondefense activities for the 2005-2014 period.[2] Outlays for each category of discretionary spending are projected to total about $470 billion in 2005 and to grow by more than $100 billion by 2014.

Homeland Security. An area of spending that includes both defense and nondefense activities is homeland security. The Administration has identified the spending that it considers related to such activities, and in its current baseline, CBO has adopted the Administration's classifi-

2. Most spending for defense programs is classified as discretionary; an additional $2 billion to $4 billion a year in defense spending is classified as mandatory.

Table 3-3.

Defense and Nondefense Discretionary Outlays

	Defense Outlays			Nondefense Outlays			Total Discretionary Outlays		
	In Billions of Dollars	As a Percentage of GDP	Percentage Change from Previous Year	In Billions of Dollars	As a Percentage of GDP	Percentage Change from Previous Year	In Billions of Dollars	As a Percentage of GDP	Percentage Change from Previous Year
1985	253	6.1	11.0	163	3.9	7.5	416	10.0	9.6
1986	274	6.2	8.2	165	3.7	1.2	439	10.0	5.5
1987	283	6.1	3.2	162	3.5	-1.8	444	9.5	1.3
1988	291	5.8	3.0	174	3.5	7.3	464	9.3	4.6
1989	304	5.6	4.5	185	3.4	6.5	489	9.0	5.2
1990	300	5.2	-1.3	200	3.5	8.5	501	8.7	2.4
1991	320	5.4	6.5	214	3.6	6.6	533	9.0	6.5
1992	303	4.9	-5.3	231	3.7	8.2	534	8.6	0.1
1993	292	4.5	-3.4	247	3.8	6.8	539	8.2	1.0
1994	282	4.1	-3.5	259	3.7	4.9	541	7.8	0.4
1995	274	3.7	-3.1	271	3.7	4.7	545	7.4	0.6
1996	266	3.5	-2.8	267	3.5	-1.7	533	6.9	-2.2
1997	272	3.3	2.1	276	3.4	3.3	547	6.7	2.7
1998	270	3.1	-0.5	282	3.2	2.3	552	6.4	0.9
1999	275	3.0	1.9	297	3.2	5.2	572	6.3	3.6
2000	295	3.0	7.1	320	3.3	7.9	615	6.3	7.5
2001	306	3.0	3.8	343	3.4	7.3	649	6.5	5.6
2002	349	3.4	14.0	385	3.7	12.3	734	7.1	13.1
2003	405	3.7	16.0	421	3.9	9.2	826	7.6	12.4
2004[a]	451	3.9	11.5	445	3.9	5.8	896	7.8	8.6

Sources: Office of Management and Budget for 1985 through 2003 and Congressional Budget Office for 2004.

a. Estimated.

cation.[3] *(See Appendix C* for more details on homeland security and trends in spending for that purpose.) Net discretionary budget authority for homeland security is estimated to total about $37 billion in 2004—$11 billion for defense and $26 billion for nondefense programs. CBO estimates that the resulting discretionary outlays for those activities will total $33 billion this year *(see Table 3-4).* In addition, roughly $1 billion a year in net outlays for homeland security is classified as mandatory spending. Under its baseline assumptions, CBO projects that discretionary outlays for homeland security will average about 0.3 percent of GDP and about 1.4 percent of total federal spending over the next 10 years.

Alternative Paths for Discretionary Spending. As specified in the Deficit Control Act, CBO inflates discretionary budget authority (using the factors set forth in law) from the level appropriated in the current year to provide a reference point for assessing policy changes. CBO's baseline assumes that total budget authority for 2004 is about $876 billion and obligation limitations total $43 billion; both grow with inflation thereafter. Under those assumptions, discretionary funding would grow at an annual rate of about 2.5 percent for most of the projection

3. CBO received some preliminary information from the Administration regarding the classification of appropriations for 2004 as homeland security spending. For certain accounts, however, CBO estimated the homeland security spending for 2004 on the basis of the amounts designated for that activity in the President's budget for 2004. Once the Administration releases its 2005 budget proposal in February 2004, CBO will review its homeland security estimates to reflect the Administration's actual classification of those programs.

Table 3-4.

CBO's Baseline Projections of Discretionary Spending for Homeland Security

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Budget Authority													
Defense	11	11	11	11	12	12	12	13	13	13	14	57	121
Nondefense[a]	26	29	27	27	28	31	29	30	31	32	33	141	297
Total	**37**	**39**	**38**	**39**	**39**	**43**	**42**	**43**	**44**	**45**	**46**	**198**	**418**
Outlays (Net)													
Defense	10	11	11	11	11	12	12	12	13	13	13	56	119
Nondefense	23	25	27	28	29	29	30	31	31	32	33	139	295
Total	**33**	**36**	**38**	**40**	**40**	**41**	**42**	**43**	**44**	**45**	**46**	**194**	**414**
Memorandum:													
Net Mandatory Outlays for Homeland Security	1	1	1	1	1	1	1	1	1	1	1	6	12

Source: Congressional Budget Office.

Notes: CBO's classification of homeland security funding is based on designations established by the Administration. Those designations are not limited to the activities of the Department of Homeland Security. In fact, some activities of the department, such as disaster relief, are not included in the definition, whereas nondepartmental activities (such as some defense-related programs and some funding for the National Institutes of Health) fall within the Administration's definition of homeland security. About half of all spending considered to be for homeland security is for activities outside of the Department of Homeland Security. (*See Appendix C.*)

CBO received some preliminary information from the Administration regarding the classification of appropriations for 2004 as homeland security spending. For certain accounts, however, CBO estimated the homeland security spending for 2004 on the basis of the amounts designated for such activity in the President's budget for 2004. When the Administration releases its budget in February 2004, CBO will review its homeland security estimates to reflect the Administration's actual classification of those programs.

The amounts shown in this table reflect the net spending for homeland security activities. About $3 billion to $4 billion a year in spending is offset by fees and other receipts, mostly in the discretionary category.

a. Project BioShield, an initiative to expand the government's arsenal of counter-bioterrorism agents, has appropriations for 2004, 2005, and 2009 in CBO's baseline. Budget authority for all other years is zero.

period. Because actual policies can and probably will differ from those assumptions, CBO presents alternative paths for discretionary spending to show the budgetary consequences of different rates of growth *(see Table 3-5)*.

The first alternative path assumes that discretionary funding increases by 6.9 percent each year after 2004. That rate of growth is the historical average from 1999 through 2004, excluding the $87 billion in supplemental appropriations enacted in November 2003. As the baseline does, however, this path includes those supplemental appropriations in total budget authority for 2004 and extends them through 2014. If discretionary funding increased at that historical rate of growth, discretionary outlays over the 10-year period would total $2.7 trillion more than the baseline figures presented in this report, and debt-service costs would increase by nearly $0.5 trillion.

Table 3-5.

CBO's Projections of Discretionary Spending Under Alternative Paths

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Baseline (Discretionary Funding Grows with Inflation After 2004)[a]													
Budget Authority													
Defense	460	473	481	492	504	517	530	543	557	571	586	2,468	5,255
Nondefense	416	431	436	446	457	470	480	491	503	516	529	2,241	4,760
Total	**876**	**904**	**918**	**939**	**961**	**988**	**1,010**	**1,035**	**1,060**	**1,087**	**1,115**	**4,709**	**10,015**
Outlays													
Defense	451	470	476	482	498	510	523	541	545	564	579	2,437	5,189
Nondefense	445	466	478	490	500	510	522	533	545	558	571	2,445	5,174
Total	**896**	**936**	**955**	**972**	**998**	**1,021**	**1,045**	**1,075**	**1,091**	**1,122**	**1,149**	**4,882**	**10,363**
Discretionary Funding Grows by 6.9 Percent a Year After 2004[b]													
Budget Authority													
Defense	460	496	530	566	605	647	692	739	791	846	904	2,843	6,815
Nondefense	416	452	482	517	553	595	635	680	728	779	835	2,599	6,255
Total	**876**	**948**	**1,012**	**1,083**	**1,158**	**1,242**	**1,326**	**1,419**	**1,518**	**1,625**	**1,739**	**5,442**	**13,070**
Outlays													
Defense	451	484	513	544	585	626	669	720	760	818	875	2,752	6,593
Nondefense	445	477	509	543	577	615	655	697	743	792	845	2,720	6,453
Total	**896**	**961**	**1,022**	**1,087**	**1,162**	**1,240**	**1,323**	**1,417**	**1,503**	**1,610**	**1,720**	**5,472**	**13,046**
Discretionary Funding Grows at the Rate of Nominal GDP After 2004													
Budget Authority													
Defense	460	489	512	535	560	586	613	640	669	699	730	2,682	6,034
Nondefense	416	446	466	487	510	537	560	585	612	640	669	2,447	5,513
Total	**876**	**935**	**978**	**1,022**	**1,070**	**1,124**	**1,173**	**1,226**	**1,281**	**1,339**	**1,399**	**5,129**	**11,547**
Outlays													
Defense	451	480	500	519	547	573	599	631	649	684	714	2,619	5,897
Nondefense	445	474	498	522	544	568	592	617	643	670	699	2,606	5,826
Total	**896**	**954**	**999**	**1,041**	**1,091**	**1,140**	**1,191**	**1,248**	**1,292**	**1,354**	**1,413**	**5,224**	**11,723**
Discretionary Funding, Excluding Supplemental Appropriations, Grows with Inflation After 2004													
Budget Authority													
Defense	460	406	414	423	434	445	456	468	480	492	505	2,123	4,524
Nondefense	416	409	414	423	433	446	455	466	478	490	502	2,125	4,516
Total	**876**	**815**	**827**	**847**	**867**	**891**	**911**	**934**	**958**	**982**	**1,007**	**4,248**	**9,041**
Outlays													
Defense	451	436	418	417	429	440	451	466	470	486	499	2,141	4,513
Nondefense	445	460	464	471	478	488	499	510	521	533	545	2,362	4,970
Total	**896**	**897**	**883**	**888**	**908**	**928**	**949**	**976**	**991**	**1,019**	**1,044**	**4,503**	**9,483**

(Continued)

Table 3-5.

Continued

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Discretionary Funding Is Frozen at the 2004 Level													
Budget Authority													
Defense	460	464	464	464	464	464	464	464	464	464	464	2,318	4,636
Nondefense	416	420	418	418	418	420	418	417	417	417	417	2,094	4,181
Total	**876**	**884**	**881**	**882**	**881**	**883**	**881**	**881**	**881**	**881**	**881**	**4,412**	**8,816**
Outlays													
Defense	451	463	462	458	462	462	463	466	459	463	463	2,308	4,621
Nondefense	445	458	463	466	465	464	463	463	462	461	460	2,317	4,626
Total	**896**	**921**	**925**	**924**	**927**	**927**	**926**	**929**	**921**	**924**	**923**	**4,624**	**9,247**
Memorandum:													
Debt-Service Adjustment on Differences from CBO's Baseline													
Growth at 6.9 percent	*	*	3	7	15	26	40	58	80	107	139	51	475
Growth at nominal GDP	*	*	2	5	9	15	23	32	43	57	72	31	258
Excluding supplementals	*	-1	-3	-8	-13	-18	-24	-30	-37	-44	-51	-42	-227
Frozen at $876 billion	*	*	-1	-3	-7	-11	-17	-25	-34	-45	-59	-23	-203

Source: Congressional Budget Office.

Notes: * = between -$500 million and $500 million.

Discretionary funding comprises both budget authority and obligation limitations. Spending from the Highway Trust Fund and the Airport and Airway Trust Fund is subject to such limitations. Budget authority for those programs is provided in authorizing legislation and is not considered discretionary.

a. Using the inflators specified in the Deficit Control Act (the GDP deflator and the employment cost index for wages and salaries).

b. The 6.9 percent rate of growth is the historical average from 1999 through 2004, excluding $87 billion in supplemental appropriations for 2004 enacted in November 2003. In this alternative, however, those supplemental appropriations are included in total budget authority for 2004 and are extended through 2014.

The second path assumes that the funding for 2004 grows at the average annual rate of nominal GDP after 2004 (4.6 percent a year, or nearly twice as fast as the rate of growth assumed in the baseline). Total discretionary outlays would exceed the baseline figures by almost $1.4 trillion over the projection period under that scenario. Added debt-service costs would bring the cumulative increase in outlays to $1.6 trillion.

The third path considers the impact on the baseline if the $87 billion in supplemental appropriations for 2004 was not extended. Under that assumption, discretionary outlays over the 2005-2014 period would total about $0.9 trillion less than in the baseline, with debt-service savings bringing the difference to $1.1 trillion.

The final path shows less spending: it assumes that most discretionary budget authority (excluding certain rescissions of previous budget authority) and obligation limitations are frozen throughout the projection period at the level provided for 2004. Total discretionary outlays for the 10-year period would be $1.1 trillion lower than those in the baseline scenario. Debt-service adjustments would reduce spending by another $0.2 trillion.

Entitlements and Other Mandatory Spending

More than half of the government's budget supports entitlement programs and other mandatory spending (excluding net interest payments). Most mandatory spend-

ing (also referred to as direct spending) reflects payments to individuals and other entities, such as businesses, nonprofit institutions, and state and local governments. In general, those payments are governed by criteria set in law and are not normally constrained by the annual appropriation process. In addition, offsetting receipts (certain payments that government agencies receive from other agencies or from the public) are classified as offsets to mandatory spending.

Over the past 42 years, direct spending has grown significantly as a share of total federal outlays, climbing from 26 percent in 1962 to 55 percent in 2003. That upward trend is expected to continue, with such spending reaching nearly 59 percent of total outlays in 2014. Expressed as a percentage of GDP, mandatory outlays will increase from 10.9 percent currently to 11.8 percent by 2014 (including the effect of offsetting receipts), CBO projects. That trend primarily results from growth in outlays for the three largest programs—Social Security, Medicare, and Medicaid. Together, those three programs made up 71 percent of mandatory spending in 2003 (excluding payments of premiums that offset a portion of the costs of Medicare). That proportion is likely to continue to rise, reaching 80 percent by 2014, as more people are added to the ranks of beneficiaries and as increases in spending, fueled by cost-of-living adjustments, higher reimbursement rates, newly enacted laws (such as the recent Medicare bill), and other factors, compound throughout the coming decade.

Spending on mandatory programs is dominated by benefits for the nation's elderly. Social Security is by far the largest of all federal programs, paying benefits of nearly $471 billion in 2003 *(see Table 3-6)*. The number of people receiving benefits, already at more than 47 million, is expected to expand to 59 million by 2014, as more baby boomers (the large number of people born between 1946 and 1964) start to collect benefits in the coming years. Most Social Security beneficiaries also participate in Medicare, the program that pays for medical care for seniors and the severely disabled. Beginning in 2006, Medicare also will help defray the cost of their prescription drugs. Those two programs will continue to take up an increasing share of the federal budget. In 2003, combined outlays stood at nearly $745 billion for Social Security and Medicare—over one-third of all federal government spending, or 6.9 percent of GDP. By 2014, spending for those two programs (excluding offsetting receipts) is projected to swell to 42 percent of all federal outlays, or 8.4 percent of GDP.

Social Security

Benefit payments for Social Security are expected to climb at increasingly rapid rates throughout the next decade and beyond. The average growth rate for Social Security is projected to be 4.5 percent per year from 2004 through 2008 and to climb in the following years as baby boomers start to become eligible for benefits, reaching 6.3 percent by 2014. The overall growth rate of 5.3 percent for the 10-year period reflects different rates of growth for Social Security's main programs, Old-Age and Survivors Insurance, or OASI (5.2 percent), and Disability Insurance, or DI (6.3 percent).

Nearly $400 billion in OASI benefits were paid in 2003 to more than 39 million people. The OASI program pays benefits to retired workers, their eligible spouses and children, and some survivors (primarily aged widows and young children) of deceased workers. Because about 60 percent of people ages 62 to 64, and more than 90 percent of people age 65 and over, collect OASI benefits, CBO ties its estimates of OASI beneficiaries chiefly to projections of the elderly population.

During the 1990s, spending on OASI benefits increased at an annual rate of 4.8 percent. That rate dropped to 3.3 percent in 2003, primarily because of low inflation, but it is expected to double—reaching 6.6 percent—by 2014. Although much of the projected growth is attributable to wage inflation and cost-of-living adjustments, growth in the number of people receiving OASI will become increasingly responsible for the rate of increase in OASI spending over the next 10 years, particularly once the leading edge of the baby-boom generation reaches retirement age.

The Social Security program also provides Disability Insurance benefits to qualified workers who have suffered a serious medical impairment before they reach retirement age, and to their eligible spouses and children. DI benefits totaled roughly $70 billion in 2003—or about 15 percent of spending for all Social Security benefits. Payments for DI benefits are expected to grow at a faster clip this year (9.6 percent) than are benefits under OASI (3.8 percent in 2004). That rapid growth is projected to slow to 5.0 percent by 2014, the year in which the youngest of

Table 3-6.

CBO's Baseline Projections of Mandatory Spending, Including Offsetting Receipts

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Social Security	471	492	513	533	559	587	618	653	690	732	778	827	2,809	6,490
Medicare[a]	274	294	317	369	418	448	478	515	557	592	645	698	2,029	5,035
Medicaid	161	174	179	186	195	212	230	250	271	295	320	348	1,003	2,487
Income-Support Programs														
Unemployment compensation	55	45	40	39	41	44	45	47	49	51	52	54	210	463
Supplemental Security Income	33	34	38	36	35	39	41	43	48	42	47	49	189	418
Earned income and child tax credits	38	40	44	41	41	40	40	41	44	31	31	32	207	386
Food Stamps	25	28	28	27	27	27	28	29	29	30	31	32	137	288
Family support[b]	26	26	25	25	25	25	25	25	26	26	26	27	126	256
Child nutrition	12	12	12	13	13	14	14	15	16	16	17	18	66	148
Foster care and adoption assistance	6	7	7	7	7	8	8	9	9	9	10	10	38	84
Subtotal	196	192	195	189	190	197	202	209	220	206	215	221	973	2,043
Other Retirement and Disability														
Federal civilian[c]	58	61	64	66	70	73	76	80	83	86	90	94	348	781
Military	36	38	39	40	41	43	44	46	47	48	49	50	208	448
Veterans' benefits[d]	29	32	37	35	33	36	36	36	40	35	38	39	176	365
Other	7	7	7	7	8	8	8	9	9	9	10	10	38	85
Subtotal	129	137	146	149	151	159	165	170	179	179	187	193	771	1,679
Other Programs														
Commodity Credit Corporation	15	12	14	15	15	14	15	15	15	15	14	14	74	146
TRICARE for Life	4	5	6	6	7	7	8	8	9	10	10	11	34	82
Student loans	8	4	6	6	7	7	7	7	7	7	8	8	33	70
Universal Service Fund	6	6	6	6	6	6	7	7	7	7	7	7	32	68
State Children's Health Insurance	4	5	5	5	5	5	5	5	5	6	6	6	25	53
Social services	5	5	5	5	5	5	5	5	5	5	5	5	24	49
Other	6	23	18	19	17	15	15	15	15	15	13	12	84	154
Subtotal	48	59	60	62	62	61	61	63	63	64	63	63	305	621
Offsetting Receipts	-100	-107	-115	-138	-151	-159	-163	-173	-184	-196	-208	-221	-726	-1,708
Total Mandatory Spending	**1,179**	**1,242**	**1,295**	**1,350**	**1,424**	**1,504**	**1,591**	**1,687**	**1,796**	**1,872**	**2,000**	**2,129**	**7,165**	**16,647**
Memorandum:														
Mandatory Spending Excluding Offsetting Receipts	1,279	1,349	1,409	1,489	1,575	1,664	1,754	1,860	1,980	2,067	2,208	2,349	7,891	18,355

Source: Congressional Budget Office.

Note: Spending for the benefit programs shown above generally excludes administrative costs, which are discretionary.

a. Excludes offsetting receipts.

b. Includes Temporary Assistance for Needy Families and various programs that involve payments to states for child support enforcement and family support, child care entitlements, and research to benefit children.

c. Includes Civil Service, Foreign Service, Coast Guard, and other, smaller retirement programs and annuitants' health benefits.

d. Includes veterans' compensation, pensions, and life insurance programs.

the baby boomers turns 50. Two factors account for much of the projected growth in Disability Insurance. First, the baby-boom generation is aging and more likely to have chronic disabilities. Second, the ongoing rise in Social Security's "normal retirement age" from 65 to 66—and eventually to 67—delays the reclassification of disabled workers as retired workers. As a result, older disabled individuals receive benefits under DI for a longer time before making the transition to OASI.

In addition to OASI and DI benefits, mandatory outlays for Social Security include about another $4 billion a year, the bulk of which reflects an annual transfer to the Railroad Retirement program.

Medicare

Spending for Medicare, the primary program that subsidizes medical benefits for the elderly, is expected to grow rapidly over the coming 10 years. The program currently is about 60 percent as large as Social Security, but by 2014, that proportion is projected to reach 84 percent. By that time, spending for Medicare (including mandatory administrative costs) will total $698 billion, CBO projects, or almost 4 percent of GDP. The program's share of total federal spending will have increased to just over 19 percent from its 13 percent share in 2003.

Medicare currently comprises two main parts—Part A (Hospital Insurance) and Part B (Supplementary Medical Insurance). (Part C lays out the requirements for providers to participate in managed care plans, whose expenses are paid from the trust funds established for Parts A and B.) Under a new Part D of Medicare, beneficiaries will receive coverage for their prescription drugs. Medicare spending overall is estimated to rise by 7 percent in 2004 and by an average of 9 percent yearly through 2014. About half of the upswing in 2004 stems from automatic updates and legislated increases in payment rates for most services in the fee-for-service sector (including hospital care and services provided by physicians, home health agencies, and skilled nursing facilities). Those rates are subject to annual revisions based on changes in input prices as well as in economic factors such as GDP and productivity. Growth in the number of beneficiaries also will account for an increasing share of the rising costs for Medicare—as it will for Social Security—particularly as more baby boomers reach the age at which they qualify for benefits.

Beginning in 2006, a substantial rise in Medicare spending will come from the new prescription drug benefit. Expenses for other provisions in the recently passed Medicare law (the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Public Law 108-173) will be incurred immediately, including increases in payments to health care providers and Medicare+Choice plans and administrative expenses associated with implementing the drug benefit.

Medicare's prescription drug program will subsidize coverage furnished in any of a number of ways: through a private prescription drug plan available to all Medicare enrollees in a geographic region; through a managed care plan participating in the Medicare Advantage program; or through an employer- or union-sponsored plan. Plans will charge beneficiaries premiums to pay for covered benefits not subsidized by Medicare. The program will provide additional federal subsidies to cover the costs of drugs for certain low-income Medicare beneficiaries. Spending for the drug program is expected to begin at $47 billion (not including offsets from premium payments) in 2006, the first year in which the program is implemented, climbing to $153 billion in 2014. By that time, expenditures under Part D will make up 22 percent of all Medicare spending. *(See Box 1-2 in Chapter 1* for a fuller discussion of how the new Medicare law will affect mandatory spending.)

The growth of Medicare spending would be even more rapid were it not for the formula used to establish the fee schedule for physicians' services—the sustainable growth rate (SGR) formula. That formula sets a cumulative spending target for physicians' services and services related to physician visits (such as laboratory services and physician-administered drugs). Left unaltered, the SGR formula ultimately recoups spending above the cumulative target by reducing payment rates for physicians' services or by holding increases below inflation (as measured by the Medicare economic index). If spending falls short of the cumulative target, the SGR formula will provide for increases in payment rates above inflation.

By the end of 2002, spending subject to the SGR formula had exceeded the cumulative target by about $17 billion, CBO estimated, and the amount of spending in excess of the target would have grown by another $10 billion in the next few years. As a result, payment rates for 2003 were scheduled to drop by 4.4 percent (after a reduction of 5.4 percent in 2002). In the Consolidated Appropriations Resolution for 2003 (P.L. 108-7), the Congress responded to that imminent reduction by allowing the Administration to boost the cumulative target—thereby

producing a 1.6 percent increase in payment rates for physicians' services for 2003. But spending through 2003 exceeded that higher target by at least $5 billion, CBO estimates. Therefore, the SGR formula would have again reduced payment rates, this time in 2004. However, P.L. 108-173 replaced that scheduled reduction in payment rates with increases of 1.5 percent in both 2004 and 2005—but left the cumulative target intact. Thus, spending for physicians' services will continue to exceed the cumulative target. Unless it is modified again, the SGR formula will reduce payment rates for several years beginning in 2006, and it will keep updates below inflation through at least 2014.

Medicaid

Federal outlays for Medicaid, the joint federal/state program that pays for the medical care of many of the nation's poor, totaled $161 billion in 2003, making up about 13 percent of mandatory spending (not including offsetting receipts). After growing by 14 percent in 2002, Medicaid outlays rose by 9 percent in 2003, marking the first decline in the program's growth rate in seven years. Growth slowed in 2003 because of smaller increases in enrollment and payment rates, cuts in payments to hospitals that serve a disproportionate share of Medicaid beneficiaries or other low-income people, and restrictions on financing mechanisms that states have used to generate additional federal payments. The drop in spending growth would have been even steeper if not for provisions in the Jobs and Growth Tax Relief Reconciliation Act of 2003 that increased federal matching rates for Medicaid for the last two quarters of 2003, thereby boosting outlays by an estimated $4 billion.

CBO expects that spending for the program will rise by more than 8 percent in 2004, in part because of the increased federal matching rates, which will expire on June 30, 2004. Once those rates expire, spending growth is projected to fall back to roughly 3 percent in 2005. CBO anticipates that spending growth will remain low in 2006 and 2007 because the new Medicare drug benefit will relieve Medicaid of having to provide drug benefits to individuals who are eligible for both programs.

Despite those temporary declines, growth in Medicaid spending for later years is projected to remain robust because of rising prices, greater consumption of services, and, to a lesser extent, increased enrollment. After 2007, spending will increase by an average of nearly 9 percent annually, CBO projects, rising to $348 billion in 2014. As a result, by 2014, the federal government's Medicaid outlays are projected to reach 1.9 percent of GDP, compared with 1.5 percent in 2003.

Other Income-Support Programs

In addition to Social Security, other federal programs provide cash assistance and other income support to people in need—those who cannot find work or whose income and assets fall below certain levels and who meet other criteria set in law. The programs include unemployment compensation, Supplemental Security Income, certain tax credits, and Food Stamps. When compared with the rapid increases in outlays projected for Social Security, Medicare, and Medicaid, spending for other income-support programs will inch upward at an average rate of about 3 percent over the next 10 years, CBO projects. The growth rate varies from year to year, largely because of economic fluctuations, legislated changes in some programs' parameters, and other factors, such as the number of payments in a fiscal year. (Payments for certain programs usually made on the first day of each month are made in the preceding month when that day falls on a holiday or weekend.)

CBO projects that as the pace of economic growth improves, and legislation to temporarily extend benefits for the unemployed expires, outlays for unemployment compensation will start to wane after three years of rapid growth. Spending on unemployment compensation will continue to fall through 2006, CBO estimates, mirroring the expected decline in the unemployment rate over the next few years—dropping from $55 billion in 2003 to $45 billion this year and to $39 billion by 2006. Spending is projected to rise gradually thereafter as a result of increases in benefits and growth in the labor force.

Outlays for the Supplemental Security Income program, which provides cash benefits to low-income disabled children, adults, and the elderly, reached $33 billion in 2003. SSI spending is projected to increase at a rate of just under 4 percent annually. The program's growth is driven mainly by cost-of-living-based increases in benefits and a rising caseload.

In CBO's baseline, estimates for the earned income and child tax credits reflect the scheduled increase in the amounts of such credits, and—in later years—the expiration of provisions in EGTRRA and JGTRRA. Together, the earned income and child tax credits totaled more than $42 billion in 2003. In that year, a small portion of the credits showed up on the revenue side of the budget (as

lower taxes paid), but the majority ($38 billion) was refunded to taxpayers and was reflected on the outlay side of the budget. Annual growth rates for the outlays of those tax credits are somewhat higher in the near term; JGTRRA increased the child tax credit from $700 to $1,000 per child for tax years 2003 and 2004, which will affect outlays in fiscal years 2004 and 2005. In tax year 2005, the credit falls to $700 per child, resulting in a drop in outlays in fiscal year 2006. The credit then reverses course again—to $800 in 2009 and to $1,000 in 2010—resulting in increases in outlays for fiscal years 2010 and 2011. The steep dropoff in 2012 stems from the scheduled expiration of EGTRRA at the end of calendar year 2010, at which time the child tax credit will be refundable on a more limited basis and will be available only to families with three or more children.

In 2004, outlays for the Food Stamp program are anticipated to rise by 10 percent, to $28 billion, following a 15 percent hike in 2003. (Between 1999 and 2001, before the recent economic slowdown, spending on Food Stamps was much lower, hovering between $18 billion and $19 billion a year.) CBO expects that participation in the Food Stamp program will follow its historical pattern (declines in program participation lag behind economic recovery) and will continue to rise over the next year before falling.

Although the authorization for Temporary Assistance for Needy Families (TANF) would have expired at the end of 2002, it was extended at various stages throughout 2003 and now is authorized through March 31, 2004. As required by the Deficit Control Act, CBO assumes that funding for TANF will continue at its most recently authorized level, an annual rate of $17 billion. Spending under TANF, therefore, is projected to remain fairly stable throughout the coming decade. Including TANF, child support enforcement, and other child care entitlements, spending for family support services is estimated to total $26 billion in 2004 and remain at about that level for the next 10 years.

In contrast, spending for child nutrition and for foster care and adoption assistance is projected to rise by about 4 percent a year through 2014. In 2003, outlays for child nutrition programs were $12 billion, while spending for foster care and adoption assistance totaled $6 billion.

Other Federal Retirement and Disability Programs

In 2003, other federal retirement and disability programs incurred outlays of $129 billion. Spending for those programs is projected to grow at about 4 percent per year and to remain at roughly 1 percent of GDP from 2003 through 2014.

The federal government provides benefits to its civilian and military retirees. In 2003, it provided nearly $58 billion in annuities and survivors' benefits through its civilian retirement program, along with several smaller retirement programs. Those payments are expected to grow to almost $94 billion by 2014. The increase is fueled by growth in the number of beneficiaries, cost-of-living adjustments, and rising federal salaries (which boost future benefit levels). One factor that is restraining growth somewhat is the gradual replacement of the Civil Service Retirement System (CSRS) with the less generous defined benefit under the Federal Employees Retirement System (FERS).[4]

Benefits paid to retired military personnel reached $36 billion in 2003, and they are projected to rise to $50 billion by 2014—an increase of about 3 percent per year. Recent enactment of legislation that permits certain disabled military retirees (and retirees of other uniformed services) to receive retirement annuities as well as veterans' disability benefits (referred to as concurrent receipt) will contribute to the rise in outlays.[5]

Spending for income-security-related benefits for veterans, which totaled $29 billion in 2003, is projected to climb to $39 billion in 2014, mainly because of cost-of-living adjustments and caseload increases.

Other Mandatory Spending

After an initial increase of $11 billion in 2004, other mandatory spending is expected to hover between $59 billion and $64 billion a year through 2014. Spending for farm price and income supports administered through the Commodity Credit Corporation will be fairly stable through 2014, CBO projects, ranging from $12 billion to $15 billion annually. In contrast, outlays for the TRICARE for Life program are expected to grow rapidly

4. Beginning in 1984, all newly hired federal civilian employees were enrolled in the FERS program. Although benefits under FERS by itself are less generous than benefits under CSRS, people enrolled in FERS are covered by Social Security and have contributions to the Thrift Savings Plan matched in part by their employers.

5. The National Defense Authorization Act for 2004 (P.L. 108-136) will allow concurrent receipt with no offset beginning on January 1, 2014. Those retirees will begin to receive an increasing portion of their retirement annuities over the 2004-2013 period.

(similar to the rate of growth of other medical expenditures), rising from $5 billion in 2004 to $11 billion by 2014. That program provides health care benefits to retirees of the uniformed services (and their dependents and surviving spouses) who are eligible for Medicare. For the student loan program, CBO estimates that the subsidy and administrative costs will range from $4 billion to $8 billion a year over the next decade.[6]

What Drives the Growth in Mandatory Spending?

Over the past 25 years, mandatory spending has grown at a rapid clip. Growing at a rate of 7.2 percent per year, on average, mandatory spending outpaced nominal growth in the economy as well as inflation. CBO expects that trend to continue far into the future (under current law), with growth in mandatory spending (excluding offsetting receipts) averaging 5.7 percent a year from 2004 through 2014, largely as a result of demographic factors, cost-of-living adjustments, and rising health care costs. The bulk of federal spending supports benefits for the nation's elderly, so as larger portions of the population—particularly the baby-boom generation—reach retirement age, the swelling caseloads will put additional burdens on budgetary resources. Automatic increases in benefit amounts and other factors also will contribute significantly to the projected increases in mandatory spending.

The growing ranks of beneficiaries account for just over one-fourth of the projected growth in mandatory spending over the 2005-2014 period, increasing spending by $19 billion in 2005 and by $263 billion in 2014 relative to outlays in 2004 *(see Table 3-7)*. The majority of that increase—about 79 percent—is concentrated in Social Security and Medicare, the two main programs that will be most affected by the growing number of elderly and disabled people. Programs that provide more benefits when the economy falters (such as unemployment compensation and Food Stamps) are expected to have fewer beneficiaries in coming years, as the economic recovery continues. The dampening effect of such savings is modest, however.

The combined effect of automatic increases in benefits, along with cost-of-living and other adjustments, accounts for about 28 percent of the projected growth in mandatory spending. All of the major retirement programs grant automatic cost-of-living adjustments to their beneficiaries (the adjustment for 2004 is 2.1 percent). CBO estimates that those adjustments, which are pegged to the consumer price index, will be 1.5 percent in 2005, 1.8 percent in 2006, 2.1 percent in 2007, and 2.2 percent thereafter. As a result, cost-of-living adjustments are projected to add $8 billion to total outlays in 2005 and $144 billion in 2014 (accounting for about 14 percent of the growth estimated for the 10-year period).

Several other programs are indexed automatically to changes in prices and other economic factors. Adjustments to Medicare's payments to providers account for more than three-fourths of that type of growth. Those payments are based in part on price indexes for the medical sector and other economic factors, including changes in GDP and productivity. Adjustments to the earned income tax credit and the Food Stamp program also are automatically indexed. (Both the income thresholds above which the earned income tax credit begins to be phased out and the maximum amount of the tax credit are adjusted automatically for inflation using the consumer price index.)[7] The Food Stamp program adjusts its maximum benefit each year according to changes in the Department of Agriculture's Thrifty Food Plan (an adjusted estimate of minimum monthly food costs). The combined effect of indexing for all of those programs is an additional $11 billion in outlays in 2005 and $138 billion more in 2014, accounting for about 14 percent of mandatory spending growth.

The remaining 45 percent of growth in entitlement spending comes from increases that are not attributable to rising enrollment or automatic adjustments to benefit amounts. Other increases in Medicare and Medicaid, the establishment of Medicare Part D, and additional growth in Social Security contribute significantly to the projected increase in mandatory spending.

6. The costs for student loans that are included in the federal budget reflect only a small portion of the $670 billion in loans expected to be made or guaranteed over the 10-year projection period. Under the Credit Reform Act, only the subsidy costs of the loans are treated as outlays. Those outlays are estimated as the future costs in today's dollars for interest subsidies, default costs, and other expected expenses over the life of the loans.

7. Credits for the EITC are administered through the individual income tax. Credits in excess of tax liabilities are recorded as outlays in the federal budget.

Table 3-7.

Sources of Growth in Mandatory Spending

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Estimated Spending for Base Year 2004	1,349	1,349	1,349	1,349	1,349	1,349	1,349	1,349	1,349	1,349
Sources of Growth										
Increases in caseloads	19	31	53	77	101	127	154	188	225	263
Automatic increases in benefits										
Cost-of-living adjustments	8	20	33	48	63	79	95	110	127	144
Other[a]	11	19	29	40	54	69	85	102	120	138
Other increases in Medicare and Medicaid[b]	6	22	39	56	77	101	126	151	178	209
Establishment of Medicare prescription drug benefit[c]	1	40	60	68	74	81	89	98	110	123
Other growth in Social Security[d]	7	11	18	25	34	45	58	74	92	113
Irregular number of benefit payments[e]	9	-3	-6	*	*	*	11	-11	*	*
Other sources of growth	*	*	*	*	1	8	13	6	8	10
Total	**61**	**140**	**226**	**315**	**405**	**511**	**631**	**718**	**859**	**1,000**
Projected Spending	1,409	1,489	1,575	1,664	1,754	1,860	1,980	2,067	2,208	2,349

Source: Congressional Budget Office.

Note: * = between zero and $500 million.

a. Includes automatic increases in the Food Stamp program and child nutrition benefits, certain Medicare reimbursement rates, the earned income tax credit, and other programs.

b. All growth that is not attributed to increased caseloads, automatic increases in reimbursement rates, or new legislation. Excludes most of the new Medicare drug benefit but includes the provider provisions. Excludes offsetting receipts.

c. Excludes premium collections and other offsetting receipts, as well as the effects of legislation that relate to other provisions affecting provider payments.

d. All growth that is not attributed to increased caseloads and cost-of-living adjustments.

e. Represents differences attributable to the number of benefit checks that will be issued in a fiscal year. Normally, benefit payments are made once a month. However, Medicare will make 13 payments of benefits in 2005 and 2011 and 11 payments in 2006 and 2012. Supplemental Security Income and veterans' benefits will be paid 13 times in 2005 and 2011 and 11 times in 2007 and 2012.

CBO anticipates that rising inflation will contribute to increased spending for Medicaid, even though the program is not formally indexed at the federal level. Medicaid payments to providers are determined at the state level, and the federal government matches those payments according to a formula set by law. If states increase their benefits in response to higher prices, federal payments will rise in tandem. In addition, Medicare, Medicaid, and other health programs have faced steadily escalating costs, as participants consume more health services per capita and increasingly use more costly procedures. CBO estimates that growth from those sources will contribute $6 billion more to outlays in 2005 and $209 billion more in 2014.

The new Medicare law will be responsible for about 15 percent of the projected growth in mandatory spending. P.L. 108-173 will add about $1 billion to outlays in 2005, rising to $123 billion by 2014.[8]

The growth of average benefits for Social Security recipients and most federal retirees is faster than the increase provided by cost-of-living adjustments alone. In the case of Social Security, the initial amount available to a newly eligible individual depends on his or her age and past earnings; only after that benefit is set do COLAs adjust it

8. Those amounts do not include premiums and other offsetting receipts, which, if included, would result in a net increase of $81 billion by 2014 compared with the spending level in 2004.

in step with changes in the consumer price index. Because awards to new beneficiaries are indexed to growth in wages, and wage growth typically exceeds inflation, their benefits generally are higher than the monthly check of a longtime beneficiary who has been receiving only cost-of-living adjustments since retiring. Furthermore, because women's participation in the labor force grew dramatically beginning in the mid-1960s, more new retirees receive larger benefits based on their own earnings rather than smaller benefits based on their status as a spouse of a retiree. For Social Security, CBO estimates that the resulting increases in benefits will add $113 billion, or 11 percent, to outlays in 2014. Only one-fourth of that increase depends on the wage growth that CBO projects over the 2004-2014 period; the rest reflects wage growth that has already occurred over the past three decades.

Outlays for mandatory programs also depend on whether the first day of the fiscal year, October 1, falls on a weekday or weekend. If it falls on a weekend, some benefit payments will be made at the end of September, a shift that increases spending in the preceding year and decreases spending for the coming year. Because SSI, veterans' compensation and pension programs, and Medicare payments to health maintenance organizations are affected by such timing shifts, those programs may send out 11, 12, or 13 monthly checks in a fiscal year. (For example, Medicare, SSI, and veterans' benefits will be paid 13 times in 2005.) Irregular numbers of benefit payments will affect mandatory spending in 2005, 2006, 2007, 2011, and 2012.

The remaining growth in mandatory spending comes from a number of factors: rising benefits for new retirees in the civil service and military retirement programs (reflecting the same economic phenomenon as in Social Security); larger average benefits for unemployment compensation (a program that lacks a specific COLA but which pays benefit amounts that generally are linked to the recent earnings of its beneficiaries); and other sources. Offsetting some of those factors is the expiration of emergency benefits for unemployment insurance. The scheduled expiration of EGTRRA at the end of calendar year 2010 also will help hold down growth in this area by returning the earned income and child tax credits to their pre-2002 levels.

Offsetting Receipts

Offsetting receipts are payments from the public or intragovernmental transactions that the federal government records as negative spending—that is, offsets to mandatory spending. Examples of those receipts include payments of premiums for Medicare and agencies' contributions to retirement funds. The collection of offsetting receipts will reduce total mandatory spending by between 8 percent and 10 percent each year through 2014, CBO projects.

Medicare. Over the 10-year projection period, the largest component of offsetting receipts will consist of premiums and other receipts of the Medicare program. In 2003, payments of premiums under Parts A and B of Medicare totaled $28 billion and offset about 10 percent of that program's spending *(see Table 3-8)*. By 2014, with the addition of premiums under Part D and other payments from states' Medicaid programs, Medicare premiums and other receipts are projected to reach $114 billion. At that time, they will finance about 16 percent of the program's costs.

Most of the beneficiaries under Part A of Medicare, the Hospital Insurance program, are not charged a premium. However, Medicare collects premiums for about 400,000 enrollees who were not employed in jobs covered by Medicare payroll taxes long enough to qualify for free enrollment. Medicaid pays the Part A premium for most of those beneficiaries. Those payments, which totaled $2 billion in 2003, are estimated to rise modestly to $3 billion by 2014.

The majority of Medicare premiums are paid by the 39 million people enrolled in Supplementary Medical Insurance (Part B of Medicare), which primarily covers physicians' and outpatient hospital services. By law, those premiums are set to cover one-quarter of the program's costs. The average monthly charge for beneficiaries is $67 in 2004; it is expected to grow to $114 in 2014. (Medicaid pays the Part B premium for certain low-income enrollees.) In addition, the recently enacted Medicare law establishes higher premiums, beginning in 2007, for beneficiaries with relatively high incomes. In 2014, about 6 percent of beneficiaries will be subject to those elevated premiums, CBO estimates, which will be as high as $365 a month. Total Part B premiums are projected to rise from $30 billion in 2004 to $70 billion in 2014.

CBO estimates that the introduction of the premiums for Part D of Medicare will lead total premiums collected

Table 3-8.

CBO's Baseline Projections of Offsetting Receipts

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Medicare[a]	-28	-32	-36	-54	-63	-68	-74	-81	-88	-96	-105	-114	-295	-779
Employer's Share of Employee Retirement														
Social Security	-10	-11	-11	-12	-13	-14	-15	-16	-17	-17	-18	-19	-65	-152
Military retirement	-14	-14	-13	-13	-13	-14	-14	-15	-15	-16	-16	-16	-68	-145
Civil service retirement and other	-18	-19	-20	-21	-21	-22	-23	-24	-25	-26	-27	-28	-108	-236
Subtotal	-41	-44	-45	-46	-48	-50	-52	-54	-57	-59	-61	-62	-240	-533
TRICARE for Life	-8	-9	-12	-13	-13	-14	-15	-16	-17	-18	-19	-20	-67	-157
Energy-Related Receipts[b]	-6	-6	-6	-7	-7	-8	-7	-7	-7	-7	-8	-8	-36	-73
Natural Resources-Related Receipts[c]	-4	-4	-4	-4	-4	-4	-4	-4	-4	-4	-4	-4	-18	-37
Electromagnetic Spectrum Auctions	*	*	*	-5	-5	-5	*	*	*	*	*	*	-15	-15
Other[d]	-12	-12	-12	-10	-11	-11	-11	-11	-11	-12	-12	-12	-54	-112
Total	**-100**	**-107**	**-115**	**-138**	**-151**	**-159**	**-163**	**-173**	**-184**	**-196**	**-208**	**-221**	**-726**	**-1,708**

Source: Congressional Budget Office.

Note: * = between -$500 million and zero.

a. Includes Medicare premiums and amounts withheld from payments to states' Medicaid programs and transferred to the Part D account in the Supplementary Medical Insurance Trust Fund.

b. Includes proceeds from the sale of electricity, various fees, and Outer Continental Shelf receipts.

c. Includes timber and mineral receipts and various fees.

d. Includes asset sales.

under Medicare to increase by 33 percent in 2006, the first year in which the new benefit will be available. Participants in the drug benefit will pay a premium, expected to average about $35 per month in 2006, rising to $58 per month in 2014. Those premiums will cover about one-sixth of the costs of the Part D program, CBO estimates. Those collections are expected to grow steadily—at about 9 percent each year—after the new program is under way, increasing from $9 billion in 2006 to $26 billion in 2014.

The introduction of Part D of Medicare will allow states to spend less on Medicaid benefits, CBO estimates, as the costs of subsidizing prescription drugs for low-income seniors shift from Medicaid (a program for which the states and federal government share the costs) to Medicare. The Medicare legislation required the states to return a portion of those savings to the Treasury. Those funds would be credited to the Medicare Part B trust fund. CBO projects that those transfers will grow from $6 billion in 2006 to $16 billion in 2014.

Other Offsetting Receipts. Currently, the largest component of offsetting receipts is the intragovernmental transfers that federal agencies make to their employees' retirement plans. At $44 billion in 2004, those contributions will constitute about 40 percent of total offsetting receipts in that year. That proportion will fall to about 30 percent by 2014, as rising payments for Medicare premiums take over as the main source of offsetting receipts.

Such intragovernmental transfers will continue to rise, totaling a projected $62 billion in 2014. Agencies' contributions for retirement benefits are paid primarily to the trust funds for Social Security, military retirement, and civil service retirement. They are charged against the agencies' budgets in the same way that other elements of their employees' compensation are: the budget treats them as outlays of the employing agency and records the deposits in the retirement funds as offsetting receipts. The transfers net to zero in budgetary totals, leaving only the funds' disbursements—for retirement benefits and administrative costs—reflected as outlays.

As with their retirement plans, some defense and related agencies make intragovernmental transfers to the Uniformed Services Medicare-Eligible Retiree Health Care Fund under the TRICARE for Life program. That fund pays for certain health care expenses of retirees from the uniformed services, their dependents, and surviving spouses who are eligible for Medicare. Its total receipts are expected to more than double, rising from $9 billion in 2004 to $20 billion in 2014.

Auctions by the Federal Communications Commission of rights to use parts of the electromagnetic spectrum are expected to continue until that authority expires at the end of 2007. CBO estimates that those auctions will bring in about $15 billion over the 2005-2014 period, with most of the receipts being tallied between 2006 and 2008.

Other proprietary receipts come mostly from royalties and charges for oil and natural gas production on federal lands, electricity sales from federal hydroelectric facilities, mineral and timber sales from federal lands, and various fees levied on users of public property and services. Those receipts are expected to total between $10 billion and $12 billion annually.

Legislation Assumed in the Baseline

CBO's projections for mandatory spending follow the general baseline concept of estimating future budget authority and outlays in accordance with current law. However, in the case of certain mandatory programs with outlays of more than $50 million in the current year, the Deficit Control Act directs CBO to assume that the programs will be extended when their authorization expires.[9]

The Food Stamp program, Temporary Assistance for Needy Families, agricultural assistance provided by the Commodity Credit Corporation, and the State Children's Health Insurance Program are examples of programs whose current authorizations are set to expire but in the baseline are assumed to continue. The Deficit Control Act also directs CBO to assume that a cost-of-living adjustment for veterans' compensation is granted each year. The assumption that expiring programs will continue accounts for more than $7 billion in outlays in 2004; that figure increases to nearly $82 billion by 2014 *(see Table 3-9)*.

Net Interest

Interest costs in 2004 will total $156 billion, CBO estimates, $3 billion more than in 2003 *(see Table 3-10 on page 68)*. If that estimate holds, it will mark the first time since 1997 that interest costs have grown from one year to the next. In 1997, net interest costs totaled $244 billion, their record high in nominal dollar terms; over the following six years, however, interest outlays decreased as a result of budget surpluses and declining interest rates. CBO's baseline shows 11 consecutive years of increasing interest costs, in large part the result of accumulating debt as well as rising interest rates in CBO's economic forecast. In 2014, net interest costs will total $338 billion, CBO projects, more than double their level in 2003.

The federal government's interest payments depend mostly on the amount of outstanding debt held by the public and on interest rates. The Congress and the President can influence the former through legislation governing taxes and spending and, thus, the amount of government borrowing. Interest rates are determined by market forces and the Federal Reserve's policies.

Interest costs are also affected by the composition of debt held by the public. The average maturity of outstanding marketable debt has remained fairly constant, fluctuating between roughly five years and six years since 1986, despite some changes in the types of securities issued by the Treasury Department. For example, in 2001, the Treasury stopped issuing 30-year bonds and introduced a four-week bill. As a result, the average maturity of outstanding debt has fallen from five and three-quarters

9. Section 257 of the Deficit Control Act stipulates that programs with current-year outlays of $50 million or more that were established prior to enactment of the Balanced Budget Act of 1997 are assumed in the baseline to continue but that the treatment of programs established after the 1997 law will be decided on a case-by-case basis, in consultation with the House and Senate Budget Committees.

Table 3-9.

Costs for Mandatory Programs That CBO's Baseline Assumes Will Continue Beyond Their Current Expiration Dates

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Food Stamps													
Budget authority	n.a.	n.a.	n.a.	n.a.	27.4	28.0	28.7	29.4	30.1	30.9	31.7	55.4	206.2
Outlays	n.a.	n.a.	n.a.	n.a.	26.0	28.0	28.7	29.4	30.1	30.9	31.7	54.0	204.6
Temporary Assistance for Needy Families													
Budget authority	6.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	84.4	168.9
Outlays	6.2	16.4	17.6	17.4	17.0	16.9	16.9	16.9	16.9	16.9	16.9	85.3	169.7
Commodity Credit Corporation[a]													
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	15.3	15.1	14.9	14.6	14.3	13.7	15.3	87.9
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	15.3	15.1	14.9	14.6	14.3	13.7	15.3	87.9
Veterans' Compensation COLAs													
Budget authority	n.a.	0.4	0.9	1.4	2.1	2.7	3.3	4.1	4.1	5.1	5.7	7.4	29.7
Outlays	n.a.	0.4	0.9	1.4	2.0	2.6	3.2	4.1	4.1	5.0	5.6	7.3	29.3
Child Care Entitlement to States													
Budget authority	0.8	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	13.6	27.2
Outlays	0.8	2.2	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	13.0	26.6
State Children's Health Insurance Program													
Budget authority	n.a.	n.a.	n.a.	n.a.	5.0	5.0	5.0	5.0	5.0	5.0	5.0	10.1	35.3
Outlays	n.a.	n.a.	n.a.	n.a.	1.6	4.3	5.1	5.4	5.5	5.6	5.5	5.9	33.0
Rehabilitation Services and Disability Research													
Budget authority	n.a.	n.a.	n.a.	2.7	2.8	2.9	2.9	3.0	3.0	3.1	3.2	8.4	23.6
Outlays	n.a.	n.a.	n.a.	1.1	2.2	2.8	2.9	2.9	3.0	3.1	3.1	6.1	21.1
Ground Transportation Programs Not Subject to Annual Obligation Limitations													
Budget authority	0.4	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	3.2	6.4
Outlays	0.1	0.3	0.5	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	2.6	5.8
Federal Unemployment Benefits and Allowances													
Budget authority	n.a.	n.a.	n.a.	n.a.	0.9	0.9	0.9	0.9	0.9	0.9	1.0	1.7	6.3
Outlays	n.a.	n.a.	n.a.	n.a.	0.4	0.8	0.9	0.9	0.9	0.9	0.9	1.2	5.7

(Continued)

Table 3-9.

Continued

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Child Nutrition[b]													
Budget authority	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	2.1	4.6
Outlays	0.3	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	2.1	4.6
Family Preservation and Support													
Budget authority	n.a.	n.a.	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.4
Outlays	n.a.	n.a.	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.6	2.1
Health Resources and Services Administration													
Budget authority	0	0	0	0	0	0	0	0	0	0	0	0	0
Outlays	0	0	0	0	0	0	0	0	0	0	0	0	0
Ground Transportation Programs Controlled by Obligation Limitations[c]													
Budget authority	23.5	40.4	40.4	40.4	40.4	40.4	40.4	40.4	40.4	40.4	40.4	201.8	403.7
Outlays	0	0	0	0	0	0	0	0	0	0	0	0	0
Air Transportation Programs Controlled by Obligation Limitations[c]													
Budget authority	3.3	3.5	3.6	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	18.2	36.7
Outlays	0	-0.2	-0.1	*	0.2	0.1	0.1	*	*	*	*	*	*
Total													
Budget authority	**35.4**	**64.9**	**65.6**	**69.2**	**103.2**	**119.8**	**121.0**	**122.5**	**123.0**	**124.5**	**125.4**	**422.6**	**1,038.9**
Outlays	**7.4**	**19.5**	**22.0**	**23.6**	**53.4**	**74.8**	**76.9**	**78.7**	**79.2**	**80.8**	**81.7**	**193.4**	**590.6**

Source: Congressional Budget Office.

Note: * = between zero and $50 million; n.a. = not applicable; COLAs = cost-of-living adjustments.

a. Agricultural commodity price and income supports under the Farm Security and Rural Investment Act of 2002 (FSRIA) generally expire after payments are made for the 2007 crop year. Much of that spending will occur in 2008. Although permanent price support authority under the Agricultural Adjustment Act of 1939 and the Agricultural Act of 1949 would then become effective, section 257(b)(2)(iii) of the Deficit Control Act says that the baseline must assume that the FSRIA provisions continue.

b. Includes the Summer Food Service program and states' administrative expenses.

c. Authorizing legislation provides contract authority, which is counted as mandatory budget authority. However, because spending is subject to obligation limitations specified in annual appropriation acts, outlays are considered discretionary.

Table 3-10.

CBO's Baseline Projections of Federal Interest Outlays

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Interest on Public Debt (Gross interest)[a]	318	321	351	407	460	504	542	578	611	640	664	690	2,264	5,447
Interest Received by Trust Funds														
Social Security	-84	-79	-90	-100	-111	-121	-132	-142	-153	-173	-183	-203	-554	-1,407
Other trust funds[b]	-73	-76	-70	-74	-78	-84	-90	-98	-106	-106	-117	-117	-396	-941
Subtotal	-156	-155	-160	-174	-189	-205	-222	-240	-259	-279	-300	-320	-950	-2,347
Other interest[c]	-7	-9	-11	-13	-15	-17	-19	-21	-24	-26	-28	-31	-75	-205
Other investment income[d]	-2	*	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-4	-8
Total (Net interest)	**153**	**156**	**180**	**219**	**255**	**281**	**300**	**316**	**328**	**334**	**335**	**338**	**1,235**	**2,886**

Source: Congressional Budget Office

Note: * = between -$500 million and zero.

a. Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).

b. Mainly the Civil Service Retirement, Military Retirement, Medicare, and Unemployment Insurance Trust Funds.

c. Primarily interest on loans to the public.

d. Earnings on private investments by the National Railroad Retirement Investment Trust.

years in December 2000 to four and three-quarters years in September 2003. Currently, Treasury bills with a maturity of six months or less account for about 27 percent of all marketable debt (a similar proportion is assumed throughout the 10-year projection period); although such securities generally carry lower interest rates, they will be more sensitive than longer-term maturities to rapid changes in interest rates.

From 2004 to 2008, net interest costs are projected to climb from $156 billion to $281 billion—in large part because of the growth of more than $1.2 trillion in debt held by the public to finance projected deficits and the return to higher short-term interest rates in CBO's economic forecast. By 2008, interest costs in the baseline will consume more than 10 percent of total outlays. As a share of GDP, they are projected to grow to 2.0 percent in 2008 from 1.4 percent in 2004. (By contrast, net interest as a share of the economy ranged between 2.1 percent of GDP and 3.3 percent each year between 1981 and 2001.)

After 2008, projected interest rates stabilize. As a result, the change in baseline net interest will mirror the change in debt held by the public, which continues growing in every year until 2014. Under current policies, CBO projects that net interest will represent 1.9 percent of GDP and 9.3 percent of total outlays by 2014.

The federal government has issued about $2.9 trillion in securities to federal trust funds. Similar to the composition of debt held by the public, those securities consist of bills, notes, bonds, inflation-indexed securities, and zero-coupon bonds. However, unlike such debt, the interest from those securities has no budgetary impact, because it is credited to accounts that exist elsewhere in the budget. In 2004, trust funds will receive $155 billion of interest, CBO estimates—the bulk of which will be credited to the Social Security and Civil Service Retirement Trust Funds.

The $9 billion in other interest that CBO anticipates the government will receive in 2004 represents the net of certain interest payments and interest collections. On balance, the government earns more of such interest than it

pays out. Among its interest expenses are payments for interest on tax refunds that are delayed for more than 45 days after the filing date. On the collections side, the interest received from the financing accounts of credit programs, such as direct student loans, is among the larger categories. Although other interest appears to grow rapidly throughout the projection period, nearly all of that increase is attributable to interest on the accrued balances credited to the TRICARE for Life program. (Interest payments to the program are part of interest on the public debt, and the receipts are recorded in the other-interest category; the net effect on interest outlays is zero.)

CHAPTER

4

The Revenue Outlook

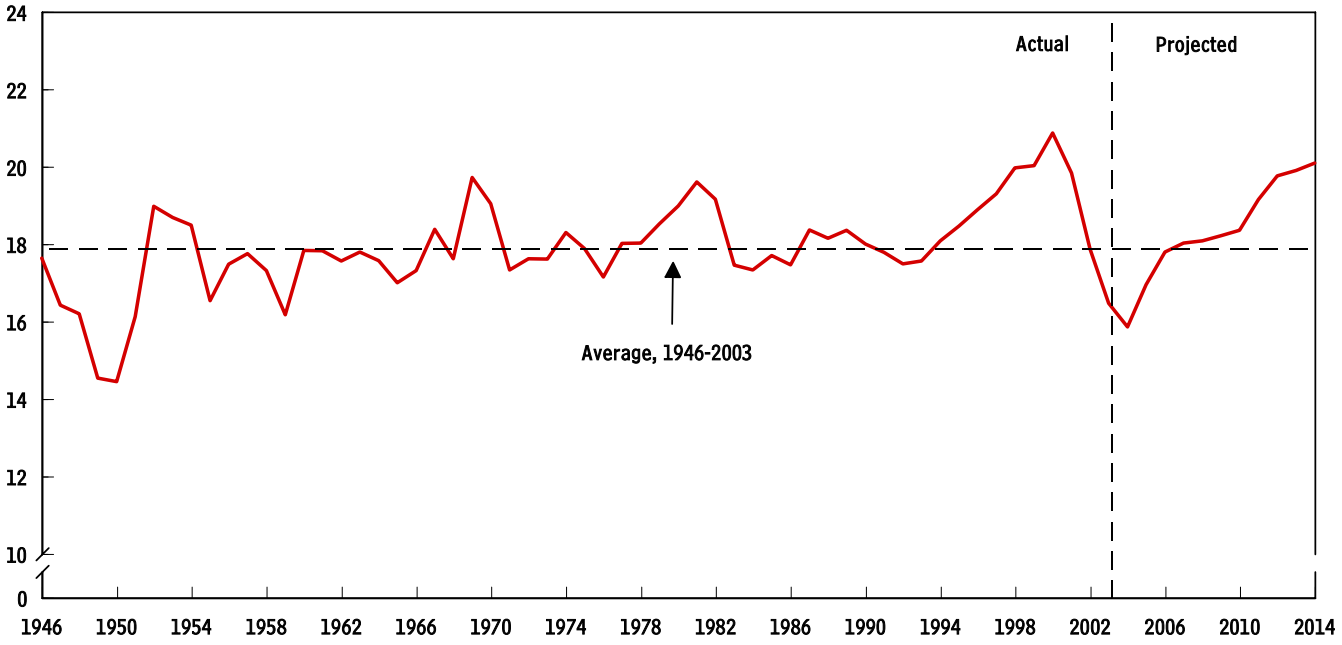
If current policies remain unchanged, the Congressional Budget Office estimates that federal revenues will reach $1,817 billion in 2004. That amount is about $35 billion (or 2 percent) more than revenues in 2003—but still below the amounts collected from 1999 to 2002. As a share of gross domestic product, revenues are expected to equal 15.8 percent this year, lower than in any year since 1950 *(see Figure 4-1).*

Over the coming decade, receipts are projected to rise again, growing faster than GDP in each year after 2004 *(see Figure 4-2).* That ascent is driven mainly by the structure of the tax system, which claims a higher fraction of income in taxes as income grows. The trend of rising receipts is expected to be especially pronounced—first in 2005 and 2006, and then again in 2011—as the tax cuts enacted from 2001 through 2003 expire.

Figure 4-1.

Total Revenues as a Share of GDP, 1946 to 2014

(Percentage of GDP)

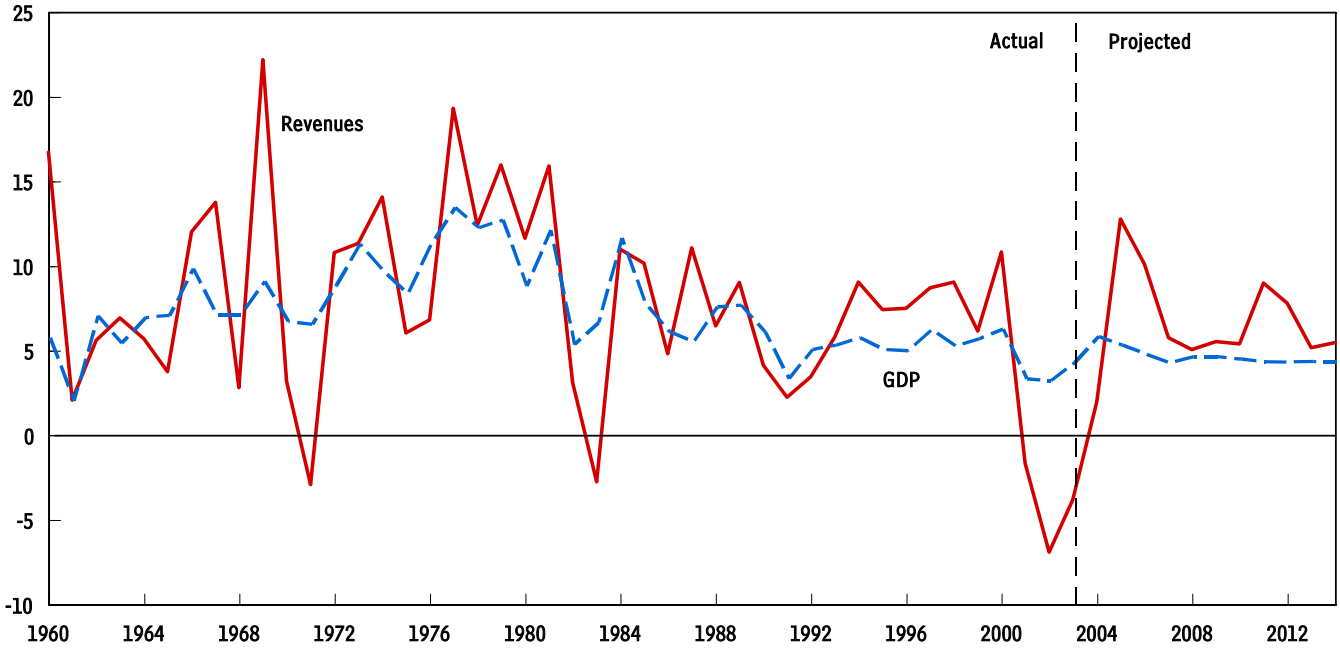


Source: Congressional Budget Office.

Figure 4-2.

Annual Growth of Federal Revenues and GDP, 1960 to 2014

(Percentage change from previous year)



Source: Congressional Budget Office.

CBO's current revenue projections are 3 percent lower, on average, than those it published in August 2003. CBO is now projecting a total of $790 billion less in receipts for the 2004-2013 period than it did last summer. Roughly four-fifths of that reduction stems from changes in CBO's economic forecast, which tend to reduce receipts after 2006 primarily because of lower projected inflation. The remaining reduction can be traced to reestimates of the receipts that would flow from a given level of overall economic activity.

Revenues by Source

Federal revenues come from various sources: individual income taxes, social insurance (payroll) taxes, corporate income taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. In recent years, individual income taxes have typically produced nearly half of all revenues and claimed between 8 percent and 10 percent of GDP *(see Figure 4-3).* Social insurance taxes (mainly for Social Security and Medicare's Hospital Insurance) are the second largest source of receipts. They generate approximately a third of federal revenues and amount to a little less than 7 percent of GDP. Corporate income taxes contribute about one-tenth of overall revenues and have usually represented between 1.5 percent and 2 percent of GDP. Revenues from other taxes, duties, and miscellaneous receipts (including profits from the Federal Reserve System) make up the balance and together constitute about 1.5 percent of GDP.

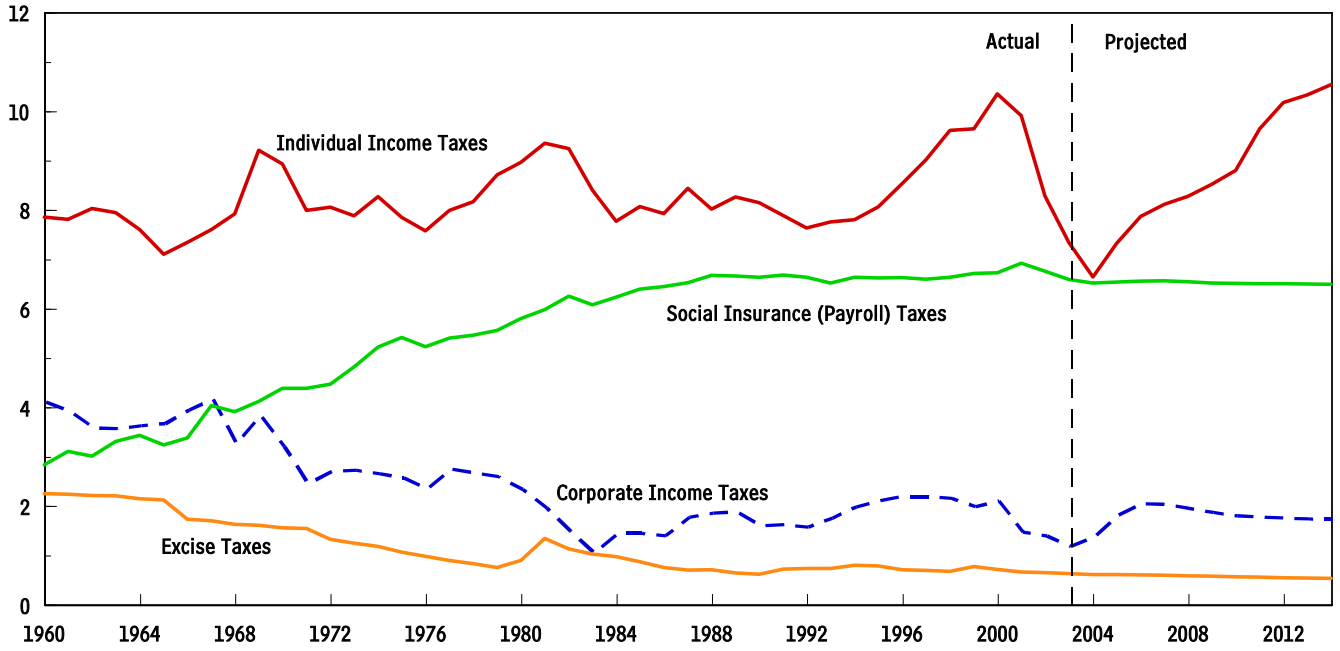
Historically, the post-World War II period has witnessed the declining importance of corporate income and excise taxes and the rising significance of payroll taxes. Since the early 1950s, the former two tax sources combined have declined from nearly half of receipts to less than 15 percent. Over the same period, payroll taxes have increased from slightly more than 10 percent of receipts to more than a third today.

The current composition of tax sources is somewhat unusual—but only temporary. In 2004, receipts from the individual income tax ($762 billion) and from payroll taxes ($747 billion) are expected to be roughly the same. That circumstance, which has not occurred since 1941, can be traced to the sharp decline in individual income tax receipts in the past few years due to both tax law changes and economic events.

Figure 4-3.

Revenues, by Source, as a Share of GDP, 1960 to 2014

(Percentage of GDP)



Source: Congressional Budget Office.

Over the coming decade, the relative contributions of the different revenue sources are expected to shift significantly, and the amount of revenue collected from the economy is projected to increase from its current, unusually low level. Over the next two years, economic recovery and the expiration of certain tax cuts are projected to boost the share of receipts from individual income taxes. After 2006 through the end of the decade, receipts will rise more gradually relative to GDP. And later in the projection period, with the expiration of the Economic Growth and Tax Relief Reconciliation Act at the end of 2010, individual income taxes will increase further relative to GDP and constitute more than half of all receipts. Corporate income taxes are also expected to grow in importance as profits recover from their recent recession lows. But after rising to more than 2 percent of GDP in 2006, they are expected to slip slightly over time as profits fall as a share of the total economy. (For more information on tax bases and tax liability and their relationship to GDP, *see Box 4-1*.) EGTRRA will have a profound effect on the importance of estate and gift taxes—which are expected to drop to historically low levels relative to GDP in 2010 and 2011 before regaining their previous importance after EGTRRA expires. Excise taxes will continue their slow decline in significance as a revenue source.

Those changes—especially the ones associated with the individual income tax—will markedly increase the total taxes collected by the federal government. From the lowest ratio of taxes to GDP in more than half a century—an estimated 15.8 percent of GDP in 2004—receipts in CBO's projection rise to more than 20 percent of GDP in 2014, a level surpassed only once in the same 50-year period.

Revisions to CBO's August Revenue Projections

Last August, CBO projected that receipts would total $27 trillion over the 2004-2013 period *(see Table 4-1 on page 76)*. The current projection for that period is $26.2 trillion, a reduction of 3 percent ($790 billion). The reduction came in the form of lower individual income tax receipts (which have declined by $513 billion), social insurance taxes ($281 billion), and receipts from the Federal Reserve System ($26 billion). Modest increases in the

Box 4-1.

Tax Bases and Tax Liability

Tax receipts vary with economic activity, but they do not move in lockstep with gross domestic product (GDP), or output. Although the bases for taxes on individual and corporate income and for social insurance taxes are related to that economic measure, they differ from GDP in a number of important respects, which means that they sometimes grow faster and sometimes slower than output. As a result, the ratio of receipts to GDP may change even if tax laws remain the same.

The Individual Income Tax Base

The first approximation of the individual income tax base includes dividends, interest, wages and salaries, rent, and proprietors' income. This measure, referred to here as **taxable personal income,** excludes depreciation, taxes on businesses (such as corporate income and excise taxes), retained corporate profits, and employee fringe benefits that are not received by individuals in taxable form.

This income measure must be narrowed further to obtain the tax base of the income tax. Some of this income accrues to tax-exempt entities such as hospitals, schools, cultural institutions, and foundations; some is earned in a form that is tax-exempt, such as income from state and local bonds; and some is tax-deferred, such as income earned in retirement accounts, on which tax is paid not when the income is accrued but when the person retires and begins to draw down the account. Also, personal interest and rental income contain large components of imputed income—income that is not earned in a cash transaction, including personal earnings within pension funds and life insurance policies and income from owner-occupied housing—that are not taxable. Consequently, a substantial amount of interest, dividend, and rental income is excluded from the taxable base of the income tax.

Further adjustments, both additions and subtractions, must be made to derive taxpayers' **adjusted gross income,** or AGI. **Capital gains realizations**—the increase in the value of assets between the time they are purchased and sold—are added to taxable personal income. Contributions from income made to tax-deductible individual retirement accounts and 401(k) plans are subtracted, but distributions to retirees from those plans are added. A variety of other, smaller adjustments must be made to reflect the various adjustments that taxpayers make.

Exemptions and deductions are subtracted from AGI to yield **taxable income,** to which progressive tax rates—rates that rise as income rises—are applied. (Those rates are known as statutory marginal tax rates; the range of taxable income over which a statutory marginal rate applies is known as an income tax bracket, of which there are now six.) The tax that results from applying those rates to taxable income may then be subject to further adjustments in the form of **credits,** such as the child tax credit for taxpayers with children under age 17, which reduce taxpayers' tax liability (the amount of taxes they owe). An important factor in calculating individual **tax liability** is the **alternative minimum tax** (AMT), which requires some taxpayers to calculate their taxes under a more limited set of exemptions, deductions, and credits. Taxpayers then pay the higher of the AMT or the regular tax. The ratio of tax liability to AGI is the **effective tax rate on AGI.**

other revenue sources offset those declines very slightly ($30 billion) over the 10-year period.

Less than $500 million of CBO's revisions was due to legislative changes since the last forecast. Two laws in particular affected receipts in CBO's projection: the Military Family Tax Relief Act of 2003 (Public Law 108-121), enacted in November; and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173), enacted in December. The largest revenue effect from the Military Family Tax Relief Act resulted from providing reservists with a tax deduction for travel ex-

Box 4-1.

Continued

The Social Insurance Tax Base

Social insurance taxes, the second largest source of receipts, use payroll as their base. Those taxes largely fund Social Security and the Hospital Insurance program (Part A of Medicare). Social Security taxes are imposed as a percentage of pay up to a **taxable maximum** that is indexed for the growth of wages in the economy. Hospital Insurance taxes are not subject to a taxable maximum.

The Corporate Income Tax Base

Corporate profits are the tax base of the corporate income tax. Profits are measured in different ways in the national income and product accounts. Several adjustments can be made to the reported profit measures to better approximate what is taxed by the corporate income tax.

First, different depreciation measures cause important differences in the measurement of corporate profits. **Economic profits** are measured on the basis of **economic depreciation**—the dollar value of productive capital assets that is estimated to have been used up in the production process. For tax purposes, however, corporations calculate **book profits,** which are based on **book,** or **tax, depreciation.** Book depreciation is typically more front-loaded than economic depreciation; that is, the capital is assumed to decline in value at a faster rate than the best estimates of how fast its value actually falls, allowing firms to report taxable profits that are smaller than economic profits.

Second, the profits of the Federal Reserve System are included in economic and book profits, but they are not taxed under the corporate income tax (they are instead remitted to the Treasury as miscellaneous receipts).

Third, economic and book profits both include certain foreign-source income of U.S. multinational corporations. Foreign-source income is taxed at very low effective rates in part because it is generally taxable only when it is "repatriated," or returned, to the U.S. parent company. In addition, it is taxed at low rates because corporations can offset their domestic tax by the amount of foreign taxes paid on that income, within limits.

Several other, smaller differences exist between book profits and corporations' calculation of their taxable income for tax purposes. If a corporation's taxable income is negative (that is, if the firm loses money), its loss (within limits) may be carried backward or forward to be netted against previous or future taxable income and thus reduce the firm's taxes in those other years. A statutory tax rate is applied to the corporation's taxable income to determine its tax liability. A number of credits (such as the credit for taxes imposed by other countries on the foreign-source income included in a firm's taxable profits) may further pare that liability. The ratio of aggregate domestic corporate taxes to aggregate taxable corporate income is the **average tax rate.**

Despite many adjustments that must be made to calculate the actual tax bases, a ready approximation is the sum of wages and salaries, nonwage personal income, and corporate book profits. Those items pick up most of the bases of the individual income, corporate income, and social insurance taxes and therefore constitute the bulk of taxed income.

penses without regard to whether they itemize their deductions. The revenue effects of the recently enacted Medicare law were largely offsetting. The legislation reduces revenues by providing qualifying taxpayers with health savings accounts to pay for certain expenses out of pretax income. At the same time, it increases revenues as businesses reduce expenditures on nontaxable health benefits and increase expenditures on taxable wages and pensions.

Most of the revision since August—approximately four-fifths of the change in projected receipts over the 2004-

Table 4-1.

Changes in CBO's Projections of Revenues Since August 2003

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total, 2004-2013
Revenues in CBO's August 2003 Baseline	1,825	2,064	2,276	2,421	2,564	2,723	2,880	3,165	3,430	3,634	26,982
Legislative Changes	*	-1	*	*	*	*	**	**	**	**	*
Other Changes											
Economic	7	1	-15	-36	-55	-72	-89	-109	-132	-158	-659
Technical	-15	-16	-4	1	-3	-7	-5	-20	-25	-35	-130
Subtotal	-8	-14	-20	-36	-59	-79	-94	-129	-158	-193	-789
Total Changes	**-8**	**-15**	**-20**	**-36**	**-59**	**-79**	**-94**	**-129**	**-158**	**-193**	**-790**
Revenues in CBO's January 2004 Baseline	1,817	2,049	2,256	2,385	2,506	2,644	2,786	3,036	3,272	3,441	26,192

Source: Congressional Budget Office.

Notes: * = loss of less than $500 million; ** = gain of less than $500 million.

2013 period—was the result of CBO's revised economic forecast. Changes in the economic forecast had a slightly positive effect on revenues in 2004 and 2005 but an increasingly negative impact on revenues during the remainder of the projection period. The revised economic forecast affected projected receipts in three important ways. First, it lowered inflation, which tended to reduce receipts from all sources. Second, it increased real growth, which tended to raise receipts. And third, it reduced the share of income realized as wages and salaries—the most highly taxed income source—which tended to lessen individual income and payroll taxes. The forecast's lower inflation is greater than its increased real growth, so that it projects lower nominal income, and the net effect of the three changes in the economic forecast was to reduce projected receipts. The effect of real growth is greatest in the earlier years of the projection period, so the downward revision from economic factors is greatest in the later years.

The downward revision of projected receipts attributable to CBO's updated economic forecast is primarily nominal, not real. Measured in constant dollars, there is little change in the 10-year total of receipts attributable to the new economic projection. This is because the negative revenue effect of the change in the wage and salary share was about the same size as the positive revenue effect of higher real growth. Hence, the net decline in receipts due to changes in the economic forecast is roughly that caused by lower inflation.

Nonetheless, the changed economic forecast explains most of the lower ratio of receipts to GDP relative to last August's projection, from 16.2 percent to 15.8 percent in 2004, and by varying amounts in later years. The effects of inflation and real growth on that ratio are relatively small, since they tend to affect both receipts and GDP proportionately. Because the share of income realized as wages and salaries is smaller than in the August projection, however, the ratio of receipts to GDP in CBO's outlook is now lower.

The remaining reduction in projected revenues since August is technical, that is, a result of changes in estimates of how much that income will generate in tax receipts. The downward revision is $15 billion or more in each of the first two years and in the last three years of the projection. The technical revisions in the 2006-2010 period are relatively small.

Most of the technical revisions occur within CBO's projections of the individual income tax. These revisions are primarily due to information from 2001 individual income tax returns that became available recently and has

Table 4-2.

CBO's Projections of Revenues

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
							In Billions of Dollars							
Individual Income Taxes	794	762	885	997	1,074	1,146	1,237	1,335	1,528	1,684	1,786	1,903	5,339	13,576
Corporate Income Taxes	132	161	224	264	273	275	276	278	287	297	307	320	1,312	2,801
Social Insurance Taxes	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732
Excise Taxes	68	70	73	76	78	81	83	85	88	90	93	95	391	842
Estate and Gift Taxes	22	24	23	26	24	25	26	19	20	40	43	47	125	293
Customs Duties	20	21	21	23	24	25	27	28	29	30	30	31	121	269
Miscellaneous Receipts	35	32	34	38	43	47	49	52	54	56	58	60	211	490
Total	**1,782**	**1,817**	**2,049**	**2,256**	**2,385**	**2,506**	**2,644**	**2,786**	**3,036**	**3,272**	**3,441**	**3,629**	**11,840**	**28,004**
On-Budget	1,259	1,273	1,477	1,655	1,756	1,847	1,954	2,065	2,283	2,486	2,620	2,771	8,688	20,913
Off-Budget[a]	524	545	572	601	629	659	690	721	753	786	821	858	3,152	7,091
							As a Percentage of GDP							
Individual Income Taxes	7.3	6.6	7.3	7.9	8.1	8.3	8.5	8.8	9.6	10.2	10.3	10.5	8.0	9.1
Corporate Income Taxes	1.2	1.4	1.8	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	2.0	1.9
Social Insurance Taxes	6.6	6.5	6.5	6.5	6.6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
Excise Taxes	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.6	0.6
Estate and Gift Taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.3	0.2	0.2
Customs Duties	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Miscellaneous Receipts	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total	**16.5**	**15.8**	**16.9**	**17.8**	**18.0**	**18.1**	**18.2**	**18.3**	**19.1**	**19.8**	**19.9**	**20.1**	**17.8**	**18.7**
On-Budget	11.6	11.1	12.2	13.0	13.3	13.3	13.5	13.6	14.4	15.0	15.1	15.3	13.1	14.0
Off-Budget[a]	4.8	4.7	4.7	4.7	4.8	4.8	4.8	4.7	4.7	4.7	4.7	4.7	4.7	4.7

Source: Congressional Budget Office.

a. Social Security.

been incorporated into CBO's current projection models. In preparing its projections last August, CBO had only preliminary summary data tabulated from 2001 individual income tax returns to explain why individual income tax liability in 2001 fell short of projections. Since then, CBO has conducted a detailed analysis of a sample of tax returns, which suggests that some of the decline in receipts—believed to be temporary in August—is likely to be permanent.

Also accounting for some technical revisions, corporate receipts in recent months have been weaker than expected given the strong surge in profits as reported in the national income and product accounts (NIPAs). And CBO has reestimated the timing and amount of revenue losses that result from certain provisions enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27).

Revenue Projection in Detail

Individual Income Taxes

Individual income taxes account for most of the projected change in revenues as a share of GDP over the next 10 years *(see Table 4-2)*. That is not surprising: they were also responsible for most of the rise in that share during the late 1990s and most of the decline since 2000. Individual income tax receipts grew at an average rate of more than 10 percent a year from 1993 to 2000 (except for 1999,

Table 4-3.

CBO's Projections of Individual Income Tax Receipts and the NIPA Tax Base

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Individual Income Tax Receipts														
In billions of dollars	794	762	885	997	1,074	1,146	1,237	1,335	1,528	1,684	1,786	1,903	5,339	13,576
As a percentage of GDP	7.3	6.6	7.3	7.9	8.1	8.3	8.5	8.8	9.6	10.2	10.3	10.5	n.a.	n.a.
Annual growth rate	-7.5	-4.0	16.2	12.7	7.6	6.8	7.9	7.9	14.4	10.2	6.1	6.5	n.a.	n.a.
Taxable Personal Income														
In billions of dollars	7,436	7,792	8,226	8,647	9,045	9,481	9,942	10,392	10,843	11,315	11,821	12,346	45,342	102,059
As a percentage of GDP	68.7	67.9	68.0	68.2	68.3	68.4	68.5	68.4	68.4	68.3	68.3	68.3	n.a.	n.a.
Annual growth rate	1.9	4.8	5.6	5.1	4.6	4.8	4.9	4.5	4.3	4.4	4.5	4.4	n.a.	n.a.
Individual Receipts as a Percentage of Taxable Personal Income	10.7	9.8	10.8	11.5	11.9	12.1	12.4	12.8	14.1	14.9	15.1	15.4	n.a.	n.a.

Source: Congressional Budget Office.

Notes: The tax base in this table (taxable personal income) reflects income as measured by the national income and product accounts (NIPAs) rather than as reported on tax returns. An important difference, therefore, is that it excludes capital gains realizations.

n.a. = not applicable.

when they were reduced by the cuts enacted in the Taxpayer Relief Act of 1997). Their share of GDP reached a historical peak of 10.3 percent in 2000. That trend was halted by the recession that began in March 2001 and, to a lesser extent, by the tax cuts enacted in EGTRRA. Individual income tax receipts fell to 9.9 percent of GDP in 2001, to 8.3 percent in 2002, and—with the help of additional tax cuts enacted in JGTRRA—to 7.3 percent in 2003.

Because some of the factors causing the low level of receipts of the past few years are temporary, and because the design of the income tax system causes revenues to grow faster than output, CBO projects that individual income tax receipts will increase relative to GDP starting in 2005 and lasting throughout the coming decade. They are projected to rise above their post-World War II average of 8.1 percent of GDP by 2008. The rise will continue and become especially pronounced after 2010, when EGTRRA tax cuts expire. Individual income tax receipts are projected to reach a new historical peak of 10.5 percent of GDP in 2014 *(see Table 4-3).*

Taxes in 2004. CBO projects that in both dollar terms and as a percentage of GDP, individual income tax receipts will decline in 2004. The drop will result primarily from the effects of recent legislation. The projected decline in revenues would have been greater if not for expected economic growth in 2004, which should raise revenues.

Recent tax legislation should significantly affect both the growth of tax receipts in 2004 and the distribution of those receipts over the course of the year. CBO expects that the tax legislation enacted in the past three years, especially the legislation enacted in 2003, will reduce receipts of individual income taxes by over $90 billion more in 2004 than it did in 2003, or about 5 percent of total revenue. A substantial portion of the reduced revenues will result from the filing of 2003 income tax returns. The lower final payments and increased refunds will occur primarily during the period from February to May of 2004.

CBO estimates that net final payments with income tax returns will fall by roughly $45 billion in 2004 as a result of the timing of the tax cuts enacted in JGTRRA. The legislation, which was enacted in May 2003, made reductions in tax rates and changes to certain tax brackets effective for the entire calendar year. Although reduced withholding rates incorporating those changes went into effect quickly, they generally applied to income earned

only during the second half of the calendar year. As a result, taxpayers who were employed during the first half of 2003 had taxes withheld from their paychecks at higher tax rates than would now apply. Therefore, when those taxpayers file their returns for tax year 2003, they should either receive larger refunds or pay less in final payments than they would have without the law change. Taxpayers could have had their employers further reduce their withholding during the second half of 2003, but evidence suggests that most taxpayers do not do so in response to tax law changes. A similar effect occurs with estimated payments of taxes for nonwage income; taxpayers probably were slow to adjust their quarterly payments in response to the new tax rates on dividends and other law changes.

Whether the reduced net final payments will occur more in the form of increased refunds or decreased final payments is difficult to predict. That split depends on how closely taxpayers otherwise aligned their withholding and quarterly estimated payments to total liabilities for the year, a relationship that varies from year to year. CBO expects more than half of the reduction in receipts to occur as increased refunds. Because taxpayers with refunds tend to file their tax returns earlier than those with tax due (who generally file near the April 15 deadline), much of the revenue reduction will occur in February and March.

The 2004 revenue reductions from recent tax cuts that are not reflected in net final payments with tax returns occur either as withholding or estimated payments. Those reductions, which subtract about $60 billion from growth in receipts, should occur fairly evenly over the course of the fiscal year. Since withholding and estimated payments together typically account for between 95 percent and 110 percent of total individual income tax liabilities, the effects of recent tax cuts on withholding and estimated payments are disproportionately small. The combination of the $45 billion revenue reduction from net final payments with tax returns and $60 billion from withholding and estimated payments does not represent the full effects of the law change on revenue growth. About $14 billion of that decrease is offset because JGTRRA established one-time advance refunds of child tax credits in July and August of 2003, a provision that will not be in effect this year.

The projected reduction in individual income tax revenues in 2004 will be mitigated by the effects of economic growth. CBO projects that taxable personal income as measured in the national income accounts will grow by 4.8 percent on average in 2004, after a lackluster 1.9 percent growth in 2003. In the second half of calendar year 2003, withholding of individual income and payroll taxes, adjusted to remove the effects of the recent tax cuts, grew in the range of 3 percent to 4 percent from amounts withheld during the comparable period in 2002. That growth is expected to pick up in 2004 consistent with growth in incomes, especially wages and salaries.

The Future Pattern of Individual Income Tax Receipts. In 2005 and 2006, CBO's projected pattern of revenue growth reflects in part the nation's continued recovery from recession. Over that period, individual income tax receipts are expected to increase as economic growth picks up again. Despite the near-term effects of the economic recovery, individual income tax receipts over the 2005-2014 period are influenced primarily by four other factors that cause those receipts to rise faster than either GDP or taxable personal income in every year.

First, changes in tax law—principally those enacted in EGTRRA and JGTRRA—will profoundly alter the pattern of receipts growth. Four major tax provisions—the child tax credit, the expanded 15 percent bracket and standard deduction ("marriage penalty relief"), the expanded 10 percent bracket, and the alternative minimum tax exemption—are reduced in tax year 2005 from the full value they have in tax years 2003 and 2004. This causes a significant jump in projected taxes in fiscal years 2005 and 2006. The first three of these tax provisions are phased back in by tax year 2010; and along with a phase-out of restrictions on itemized deductions and personal exemptions for high-income taxpayers during tax years 2006-2010, they tend to reduce the growth of individual income tax receipts. The lower rates for dividends and capital gains expire after tax year 2008, tending to increase receipts. And all provisions of EGTRRA that are still in effect in 2010 are scheduled to expire at the end of that calendar year, which will cause revenues to climb sharply.

Second, over the 10-year period, several inherent characteristics of the tax system will boost effective tax rates, thereby increasing the receipts generated by the economy. The rise in the effective rate is fueled in part by the phenomenon known as real bracket creep, in which the overall growth of real income pushes more income into higher tax brackets. In addition, the AMT—which is not indexed for inflation—will affect an increasing number of

Box 4-2.

The Growing Significance of the Alternative Minimum Tax in CBO's Projections

The alternative minimum tax (AMT) is becoming an important presence in discussions of tax policy and in the Congressional Budget Office's (CBO's) revenue projections. It is one of the reasons that receipts are projected to grow relative to gross domestic product (GDP) over the next 10 years. With each passing year, the AMT plays a bigger role in revenue projections.

Characteristics of the AMT

The AMT is a parallel income tax system with fewer exemptions, deductions, and rates than the regular income tax. It was enacted to prevent high-income taxpayers from excessively reducing the amount of tax they owe by using the regular code's various preferences—features of the tax code that favor certain activities by taxing the income associated with them at a lower rate. Taxpayers with potential AMT liability must calculate their taxes under both the AMT and the regular income tax and pay whichever figure is higher. (The amount by which a taxpayer's AMT calculation exceeds his or her regular tax calculation is considered the taxpayer's AMT liability.)

Like the rate structure of the regular income tax, the AMT extracts a greater proportion of overall income as real income rises. But unlike the regular income tax, the AMT is not indexed to inflation. Consequently, inflation increases the amount of income to which the AMT applies and the number of taxpayers subject to it each year. Those effects are compounded by reductions in marginal tax rates still scheduled to phase in before 2010. Because those cuts reduce regular tax liability relative to AMT liability, they further increase the AMT's contribution to total revenues.

The preferences not allowed under the AMT include personal exemptions and the standard deduction, so the AMT reaches some taxpayers not ordinarily thought to be exploiting "loopholes" to avoid taxation of high incomes. That situation increases over time as nominal income grows. For example, in tax year 2005, a married taxpayer earning $90,000 who has three children and reports a typical set of deductions would be subject to the AMT.

The AMT's Impact Over the Next 10 Years

Comparing the number of taxpayers subject to the AMT and the amount of revenue it raises in 2003 with the same measures in 2014 (four years after the remaining provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 [EGTRRA] expire) demonstrates how the impact of the AMT increases in part as a result of nominal income growth. CBO estimates that in 2003, 2 million tax returns had AMT liability, and receipts from the tax totaled $11 billion *(see figure at right).* In 2014, about 23 million returns are projected to have AMT liability, and the tax will add an estimated $55 billion in revenues. Over that 12-year span, the AMT's contribution to individual income tax receipts more than doubles, rising from 1.4 percent of those receipts to 2.9 percent.

In the years in between, the rise and fall of the AMT's projected effects also reflect the phasing in

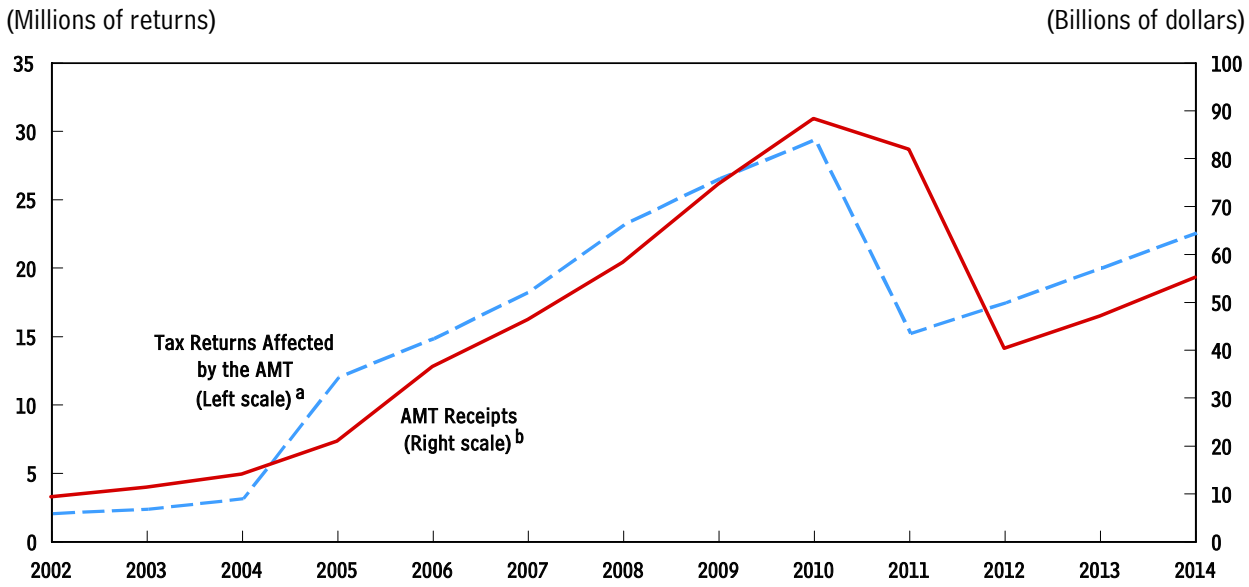
taxpayers and growing amounts of income in future years. (For a more detailed description of the increasing significance of the AMT in CBO's revenue projections, *see Box 4-2.*) Also pushing up the effective rate are taxable distributions from tax-deferred retirement accounts, such as individual retirement accounts and 401(k) plans, which are expected to increase as the population ages. Contributions to those accounts were exempt from taxation when they were made, which reduced taxable income in earlier years. Now, as more retirees take distribu-

Box 4-2.

Continued

and expiration of provisions of EGTRRA and JGTRRA. When a provision in JGTRRA that increased the amount of income exempt from the AMT expires in 2005, the number of returns subject to the AMT is expected to rise, climbing from 3 million in 2004 to 12 million the following year; as a result, AMT revenues are projected to increase from $14 billion in 2004 to $21 billion in 2005. In addition to the effects of nominal income growth, the phasing in of tax cuts in the following years helps drive the number of AMT returns to about 29 million in 2010 (just before EGTRRA's provisions expire), and AMT revenues to nearly $90 billion, or about 7 percent of total individual income tax receipts. The subsequent decline in AMT receipts ($90 billion in fiscal year 2010 versus $40 billion in 2012) and in returns affected (29 million in tax year 2010 versus 15 million in 2011) indicates the degree to which the cuts in marginal tax rates under EGTRRA will have been muted by the AMT.

CBO's Projected Effects of the Individual Alternative Minimum Tax



Source: Congressional Budget Office.

Note: The alternative minimum tax requires some taxpayers to calculate their taxes under a more limited set of exemptions, deductions, and credits than the set applicable under the regular individual income tax. Some taxpayers are affected by the AMT but do not have AMT liability because the AMT limits their credits taken under the regular tax.

a. Calendar year basis.

b. Fiscal year basis.

tions from those accounts, the money becomes taxable, thereby increasing tax receipts relative to GDP.

Third, capital gains realizations—a significant contributor to past movements of receipts—play a much smaller but nonetheless positive role in CBO's projections. Although it estimates that capital gains realizations rose slightly in tax year 2003, CBO expects receipts from capital gains taxes to be lower in fiscal year 2004 because capital gains tax rates have been reduced *(see Table 4-4).* But the declines in realizations of 2001 and 2002 left them well below the level consistent with their historical relationship to GDP *(see Figure 4-4).* Consequently, they

Table 4-4.

Actual and Projected Capital Gains Realizations and Taxes

	Capital Gains Realizations[a]		Capital Gains Tax Liabilities[a]		Capital Gains Tax Receipts[b]		
	In Billions of Dollars	Percentage Change from Previous Year	In Billions of Dollars	Percentage Change from Previous Year	In Billions of Dollars	Percentage Change from Previous Year	Capital Gains Tax Receipts as a Percentage of Total Individual Tax Receipts
1990	124	-20	28	-21	32	-14	6.8
1991	112	-10	25	-11	27	-17	5.7
1992	127	14	29	16	27	1	5.6
1993	152	20	36	25	32	20	6.3
1994	153	0	36	0	36	12	6.7
1995	180	18	44	22	40	10	6.8
1996	261	45	66	50	54	36	8.3
1997	365	40	79	19	72	33	9.8
1998	455	25	89	12	84	16	10.1
1999	553	22	112	26	99	19	11.3
2000	644	16	127	14	119	20	11.8
2001	349	-46	66	-48	100	-16	10.0
2002	256	-27	47	-29	57	-42	6.7
2003	274	7	42	-11	45	-22	5.6
2004	328	20	46	11	44	-2	5.7
2005	363	11	52	13	49	12	5.5
2006	397	9	57	10	54	11	5.5
2007	429	8	62	9	59	9	5.5
2008	531	24	76	22	64	8	5.6
2009	378	-29	68	-10	76	19	6.2
2010	475	26	86	27	76	0	5.7
2011	501	6	93	8	90	17	5.9
2012	528	5	98	5	96	7	5.7
2013	555	5	103	5	100	5	5.6
2014	583	5	108	5	105	5	5.5

Source: Congressional Budget Office.

Note: Capital gains realizations represent net positive long-term gains. Data for realizations and liabilities after 2000 and data for tax receipts in all years are estimated or projected by CBO. Data for realizations and liabilities before 2001 are estimated by the Treasury Department.

a. Calendar year basis.

b. Fiscal year basis. This measure is CBO's estimate of when tax liabilities are paid to the Treasury.

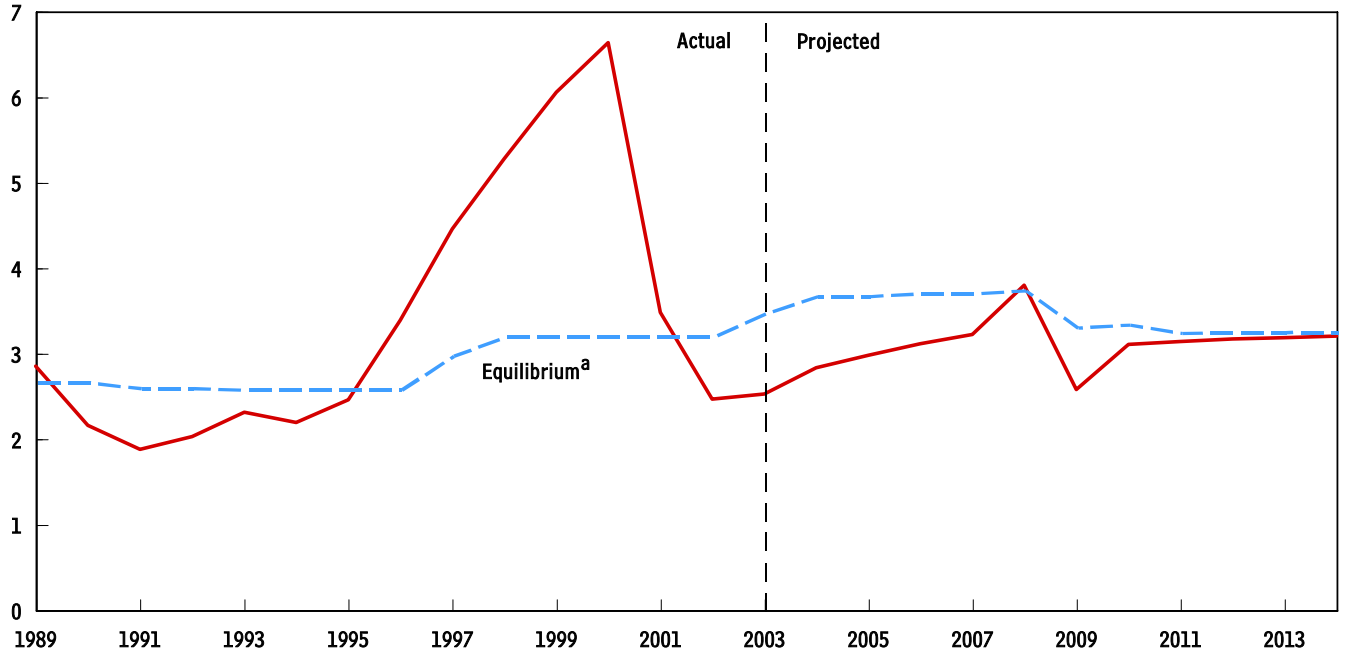
are projected to rise gradually to that level, moderately boosting receipts as a percentage of GDP over the 10-year projection period. That rise is punctuated by a sharp increase in 2008 and a decrease the following year as taxpayers accelerate gains into tax year 2008 before the rate cut expires.

Finally, current collections of individual income taxes are still running below the amounts that would be expected given the level of economic activity, estimated capital gains realizations, retirement distributions, and other factors known to influence the average tax rate. That shortfall is likely to continue for a few years. However, CBO

Figure 4-4.

Capital Gains Realizations as a Share of GDP, Calendar Years 1989 to 2014

(Percentage of GDP)



Source: Congressional Budget Office.

a. The equilibrium relationship of capital gains realizations to GDP is measured as the average ratio of gains to GDP from 1954 to 2002, adjusted for differences between each year's tax rate on capital gains and the average rate over the period. A lower tax rate on capital gains corresponds to a higher equilibrium relationship of gains to GDP, such as between 2003 and 2008. Although the tax rate reductions in those years are scheduled to expire, CBO assumes that realizations approach those rates while the tax rate reductions are in effect.

assumes that it will diminish in later years. Its gradual contraction also tends to increase individual tax receipts relative to GDP over the projection period.

Changes Since August 2003. Compared with the projections it made last August, CBO has reduced its projection of individual income tax receipts by $513 billion. A tiny part of that, about $2.5 billion, was due to legislation. Three-quarters, or $390 billion, was the result of changes in CBO's economic forecast, principally the reduction in inflation and in the share of income received in the form of wages and salaries. The remaining $121 billion of the reduction reflects technical factors.

The technical revision came largely from a combination of reestimates of the effects of the recent tax cut and from information derived from 2001 individual income tax returns that recently became available and has been incorporated into CBO's projection models. Reestimates of the timing and amount of revenue losses from JGTRRA lowered receipts in the shorter term. Information from 2001 returns caused CBO to reduce receipts in the longer term. In August, the shortfall in current receipts that could not be explained by CBO's projection models was assumed to be temporary, and it was not projected to continue beyond the first several years of the forecast period. Information from 2001 tax returns indicates that some of that shortfall is likely to be permanent. Hence, the projection is reduced in the later years of the forecast period.

Social Insurance Taxes

In CBO's projections, revenues from social insurance taxes claim a roughly constant share of GDP, remaining at about 6.5 percent of GDP from 2004 through 2014 *(see Table 4-5).* In relation to wages and salaries—the approximate base of those payroll taxes—revenues decline somewhat, from 14.2 percent in 2004 to 14.0 percent by 2014.

Table 4-5.

CBO's Projections of Social Insurance Tax Receipts and the Social Insurance Tax Base

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Social Insurance Tax Receipts														
In billions of dollars	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732
As a percentage of GDP	6.6	6.5	6.5	6.5	6.6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	n.a.	n.a.
Annual growth rate	1.7	4.7	5.7	5.2	4.6	4.3	4.4	4.5	4.4	4.4	4.4	4.4	n.a.	n.a.
Wages and Salaries														
In billions of dollars	5,051	5,257	5,563	5,859	6,134	6,435	6,744	7,057	7,370	7,693	8,033	8,386	30,735	69,274
As a percentage of GDP	46.6	45.8	46.0	46.2	46.3	46.4	46.5	46.5	46.5	46.5	46.4	46.4	n.a.	n.a.
Annual growth rate	1.9	4.1	5.8	5.3	4.7	4.9	4.8	4.6	4.4	4.4	4.4	4.4	n.a.	n.a.
Social Insurance Tax Receipts as a Percentage of Wages and Salaries	14.1	14.2	14.2	14.2	14.2	14.1	14.0	14.0	14.0	14.0	14.0	14.0	n.a.	n.a.

Source: Congressional Budget Office.

Notes: The tax base in this table (wages and salaries) reflects income as measured by the national income and product accounts rather than as reported on tax returns.

n.a. = not applicable.

The largest generators of payroll tax receipts are taxes for Social Security (officially called Old-Age, Survivors, and Disability Insurance, or OASDI) and Medicare's Hospital Insurance (HI). A small share of social insurance tax revenues comes from unemployment insurance taxes and contributions to other federal retirement programs *(see Table 4-6).*

Social Security and Medicare taxes are calculated as a percentage of covered wages. Unlike the HI tax, which applies to all covered wages, the Social Security tax applies only up to a taxable maximum, which is indexed to the growth of wages over time. Consequently, receipts from OASDI and HI taxes tend to remain fairly stable as a proportion of income as long as covered wages are a stable share of GDP and the distribution of income from wages remains relatively unchanged.

CBO projects that social insurance tax receipts will decrease slightly this year relative to GDP. That decline occurs because the share of total income claimed by wages is expected to fall. As the economy continues to recover, corporate profits are projected to grow rapidly, decreasing the ratio of wages to GDP. That decline is mitigated by factors that are raising social insurance receipts relative to wages, notably a large anticipated increase in state unemployment taxes as states replenish their trust funds following the outflow of funds for unemployment benefits during the recession.

From 2005 onward, payroll tax receipts are expected to increase slightly and then decline very gradually as a share of GDP. CBO projects that as the economy swings back to full employment, the ratio of wage and salary income to total income will increase, boosting social insurance receipts relative to GDP. After that, social insurance receipts will slowly decline as a fraction of both wages and GDP for three reasons: states will have finished replenishing their unemployment trust funds, revenues associated with other federal retirement programs will be lower as the number of workers covered by Railroad Retirement and the old Civil Service Retirement System declines, and a slightly larger fraction of total wage and salary income will be above the maximum level of earnings subject to Social Security taxes.

Table 4-6.

CBO's Projections of Social Insurance Tax Receipts, by Source

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Social Security	524	545	572	601	629	659	690	721	753	786	821	858	3,152	7,091
Medicare	147	155	164	173	181	190	199	208	218	227	238	248	906	2,045
Unemployment Insurance	33	39	45	49	50	50	50	51	53	55	58	60	244	521
Railroad Retirement	4	4	4	4	4	4	4	4	4	4	4	4	19	40
Other Retirement	5	4	4	4	4	4	4	3	3	3	3	3	19	34
Total	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732

Source: Congressional Budget Office.

Compared with its projections last August, CBO is now estimating about $281 billion less in social insurance tax receipts during the 2004-2013 period. Changes in CBO's economic forecast, mainly lower projections of nominal wages and salaries because of the expected slowdown in long-term inflation, account for $266 billion of that change. Nearly all of the rest is due to technical changes resulting primarily from the availability of recent data on wages subject to the payroll tax, which show that corrected receipts for 2002 were lower than the figure used in CBO's August projections. Legislation had little impact.

Corporate Income Taxes

Corporate income taxes contributed to some of the increase in federal revenues in the 1990s as corporate profits surpassed their performance of the previous two decades. But the recent recession has reduced profits—and therefore corporate income tax receipts—substantially. Revenues have been further reduced by the countercyclical tax incentives enacted as part of the Job Creation and Worker Assistance Act of 2002 (JCWAA) and JGTRRA. Those receipts (adjusted to take into account legislated shifts in the timing of collections) fell from 2.1 percent of GDP in 2000 to 1.7 percent in 2001 and 1.2 percent in 2002. They were roughly stable as a share of GDP in 2003, and CBO expects them to increase strongly relative to GDP over the next three years, reaching 2.1 percent in 2006. They will then slip slightly relative to GDP in the remaining years of the projection period.

Corporate income tax revenues have followed much the same pattern as individual income tax receipts, rising markedly in the late 1990s and then falling in recent years. In the case of corporate taxes, however, the peak and decline occurred earlier, and the drop was even more significant. From 1994 through 1998, corporate tax receipts grew more rapidly than the overall economy. That performance was driven largely by very strong corporate profits. But as a percentage of GDP, corporate receipts peaked in 1998 (although they remained relatively strong in 1999 and 2000). After that, corporate receipts dropped even more significantly than individual receipts did. In 2002 and 2003, corporate tax receipts were lower as a percentage of GDP than they had been since the mid-1980s.

That drop was caused almost entirely by the slowing of the economy and the effects of tax legislation enacted in 2002 and 2003. JCWAA and JGTRRA allowed more-rapid write-offs ("partial expensing") of investment undertaken from 2001 through 2004. In addition, JCWAA's expanded "carryback" provision increased firms' ability to use losses from 2001 and 2002 to obtain refunds of taxes paid in previous years. The results of those changes in tax law were a substantial decrease in corporate tax payments, an increase in corporate tax refunds, and a significant fall in net corporate tax receipts. Adjusted for legislated shifts in payment dates, corporate receipts rose in 2003 but remained well below 2001 levels.

Table 4-7.

CBO's Projections of Corporate Income Tax Receipts and Tax Bases

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Corporate Income Tax Receipts														
In billions of dollars	132	161	224	264	273	275	276	278	287	297	307	320	1,312	2,801
As a percentage of GDP	1.2	1.4	1.8	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	n.a.	n.a.
Annual growth rate	-11.0	22.5	38.5	18.2	3.5	0.7	0.1	1.0	3.0	3.5	3.6	4.0	n.a.	n.a.
Corporate Book Profits														
In billions of dollars	819	938	1,215	1,353	1,354	1,358	1,357	1,382	1,435	1,500	1,569	1,645	6,636	14,168
As a percentage of GDP	7.6	8.2	10.0	10.7	10.2	9.8	9.3	9.1	9.0	9.1	9.1	9.1	n.a.	n.a.
Annual growth rate	15.7	14.5	29.5	11.4	0	0.3	-0.1	1.9	3.8	4.5	4.6	4.9	n.a.	n.a.
Taxable Corporate Profits[a]														
In billions of dollars	565	666	926	1,044	1,029	1,015	996	1,000	1,030	1,070	1,113	1,161	5,010	10,385
As a percentage of GDP	5.2	5.8	7.7	8.2	7.8	7.3	6.9	6.6	6.5	6.5	6.4	6.4	n.a.	n.a.
Annual growth rate	21.9	17.9	39.1	12.8	-1.5	-1.3	-1.9	0.5	3.0	3.9	4.0	4.4	n.a.	n.a.
Corporate Receipts as a Percentage of Taxable Profits	23.3	24.3	24.2	25.3	26.6	27.1	27.7	27.8	27.8	27.7	27.6	27.5	n.a.	n.a.
Adjusted Corporate Receipts as a Percentage of Taxable Profits[b]	24.5	24.3	23.5	25.3	26.6	27.1	27.7	27.8	27.8	27.7	27.6	27.5	n.a.	n.a.

Source: Congressional Budget Office.

Notes: The tax bases in this table (corporate book profits and taxable corporate profits) reflect income as measured in the national income and product accounts rather than as reported on tax returns.

n.a. = not applicable.

a. Taxable corporate profits are defined as book profits minus profits earned by the Federal Reserve System, transnational corporations, and S corporations and minus deductible payments of state and local corporate taxes. They include capital gains realized by corporations.

b. Excludes shifts in corporate receipts from 2003 to 2004 enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 and from 2004 to 2005 enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001.

CBO's projection of corporate receipts for the next 10 years reflects a combination of continued recovery from the recession, the effects of the depreciation incentives and their expiration under current law, and longer-term changes in profits as a share of GDP. CBO expects corporate tax receipts in 2004 to rise by two-tenths of a percentage point of GDP and then grow more strongly, so that by 2006, they reach 2.1 percent of GDP. Those receipts will slowly slip from that level to 1.8 percent of GDP by the end of the projection period *(see Table 4-7).*

In CBO's economic forecast, corporate book profits—the underlying base of the corporate income tax—grow very rapidly from 2004 through 2006. (For more details of CBO's outlook for the economy, see Chapter 2.) Profits grew rapidly in 2003 and they are expected to continue to grow faster than GDP through 2006. That growth, particularly in 2004, is caused largely by recovery from the 2001 recession, during which profits were especially depressed. In addition, corporate profits and receipts are affected by provisions of JCWAA and JGTRRA. The partial-expensing provisions are scheduled to expire at the end of 2004. That expiration will raise book and taxable profits sharply in 2005, boosting receipts strongly in 2005 and 2006. Accelerated depreciation has the effect of

Table 4-8.

CBO's Projections of Excise Tax Receipts, by Category

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Highway Taxes	34	35	37	39	40	41	42	43	44	46	47	48	199	427
Airport Taxes	9	10	11	11	12	13	13	14	15	15	16	17	60	137
Telephone Taxes	6	6	7	7	8	8	8	9	9	10	10	11	38	86
Alcohol Taxes	8	8	8	9	9	9	9	9	9	9	10	10	44	91
Tobacco Taxes	8	8	8	8	8	8	8	8	8	8	8	8	41	81
Other Excise Taxes	2	2	2	2	2	2	2	2	2	2	2	2	10	21
Total	**68**	**70**	**73**	**76**	**78**	**81**	**83**	**85**	**88**	**90**	**93**	**95**	**391**	**842**

Source: Congressional Budget Office.

reducing tax liability immediately at the cost of higher liability later. Hence, beginning in 2005, the corporate income tax will begin to recoup some of its earlier loss of receipts.

After 2006, corporate book profits will decline gradually relative to GDP, CBO expects, thereby decreasing corporate tax receipts relative to GDP as well. That effect is somewhat muted by a small rise in receipts as a percentage of taxable profits. As profits decline relative to GDP, losses as a proportion of net profits are higher. Firms pay taxes to the government on the profits they earn, but they do not receive payments from the government if they lose money (except to the extent that they can carry their losses forward or backward to offset profits in other years). Consequently, the overall effective corporate tax rate—receipts divided by net profits—tends to be higher when net corporate profits are lower.

CBO's projection of corporate receipts over the 2004-2013 period is little changed—just $2 billion more—from that of last August. Changes in CBO's economic forecast caused the projection to rise by $14 billion, with the revenue-reducing effects of a lower inflation forecast (reducing nominal GDP and profits) more than offset by the revenue-increasing effects of higher profits as a share of GDP. Technical changes, which mostly reflect weak recent tax collections, reduced the projection by $11 billion.

Excise Taxes

Receipts from excise taxes are expected to continue their long-term decline as a share of GDP, falling from 0.6 percent in 2003 to 0.5 percent toward the end of the 10-year projection period. Most excise taxes—those generating about 80 percent of total excise revenues—are levied per unit of good or per transaction rather than as a percentage of value. Thus, excise receipts grow with real GDP, but they do not rise with inflation and therefore do not grow as fast as nominal GDP does.

Nearly all excise taxes fall into five major categories: highway, airport, telephone, alcohol, and tobacco taxes *(see Table 4-8).* Almost half of all excise receipts are earmarked by law to the Highway Trust Fund; they come primarily from taxes on gasoline and diesel fuel. Most airport and telephone excise taxes are levied on a percentage basis, so they grow at a faster rate than the other categories do. Tobacco and alcohol taxes are expected to remain roughly stable in nominal terms through 2014.

CBO's current projection of total excise tax receipts for the next 10 years is about $15 billion higher than the projection it published in August. Changes in CBO's economic forecast increase last August's projection by $5 billion, and technical adjustments raise projected excise receipts by another $10 billion over the 2004-2013 period. The technical changes reflect higher recent receipts from gasoline taxes, offset partially by a larger share of motor fuel consumption consisting of lower-taxed ethanol blends.

Estate and Gift Taxes

Under current law, estate and gift tax receipts change in importance over CBO's 10-year projection period: their share of GDP is forecast to decline from 0.2 percent in

Table 4-9.

CBO's Projections of Other Sources of Revenue

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Estate and Gift Taxes	22	24	23	26	24	25	26	19	20	40	43	47	125	293
Customs Duties	20	21	21	23	24	25	27	28	29	30	30	31	121	269
Miscellaneous Receipts														
Federal Reserve System earnings	22	21	23	27	32	35	38	40	42	43	45	47	154	372
Universal Service Fund	6	6	6	7	7	7	7	7	7	8	8	8	34	71
Other	7	5	5	5	5	5	5	5	5	5	5	5	23	47
Subtotal	35	32	34	38	43	47	49	52	54	56	58	60	211	490
Total	**76**	**77**	**78**	**88**	**92**	**97**	**102**	**99**	**102**	**125**	**131**	**139**	**457**	**1,052**

Source: Congressional Budget Office.

2003 to 0.1 percent in 2010 and 2011 before jumping back to 0.2 percent of GDP in 2012. That pattern results from the phaseout of the estate tax under EGTRRA and the subsequent reinstatement of the tax when the law expires at the end of 2010.

In the past, revenues from estate and gift taxes tended to grow more rapidly than income because the unified credit for the two taxes, which effectively exempts some assets from taxation, is not indexed for inflation. Under EGTRRA, however, the pattern of receipts over time is quite different. The estate tax is gradually being eliminated; the gift tax remains in the tax code but in a modified form. Today, tax law effectively exempts $1.5 million of an estate from taxation. EGTRRA will raise that amount in steps to $2.0 million in 2006 and $3.5 million in 2009. EGTRRA will also reduce the highest tax rate on estates in steps from 50 percent in 2002 to 45 percent by 2007 and then eliminate the tax in 2010. The law's provisions are scheduled to expire at the end of 2010, however, which means that the estate tax is set to return the following year. Because estate tax liabilities are paid after a lag, and because the gift tax remains in the tax code, receipts from estate and gift taxes do not disappear completely in CBO's projection period but instead reach a trough in 2010 and 2011 *(see Table 4-9).* CBO estimates that after 2011 they will return to roughly their 2002 share of GDP.

The pattern of the phase-in of new provisions and the expiration of the cuts at the end of 2010 produces discrete increases and decreases in revenue from the tax over the 10-year forecast period *(see Figure 4-5).* Not only does the effective exemption rise in steps, reducing revenues, but during the 2002-2005 period, the credit for state death taxes is converted to a less valuable deduction, which tends to raise receipts slightly. Because of the lag in payment, those provisions each have their effects on estate tax revenue in the following years. The changes in law inject greater uncertainty than usual into the projections.

CBO's current projections of estate and gift tax receipts are similar to those it produced last August. Changes in CBO's economic forecast have reduced the projection by $4 billion from 2004 to 2013. Small technical changes—including the impact of the stock market on projected wealth and reestimates of gift tax receipts around the time EGTRRA expires—net to an increase of $8 billion in receipts over 10 years compared with the August projection.

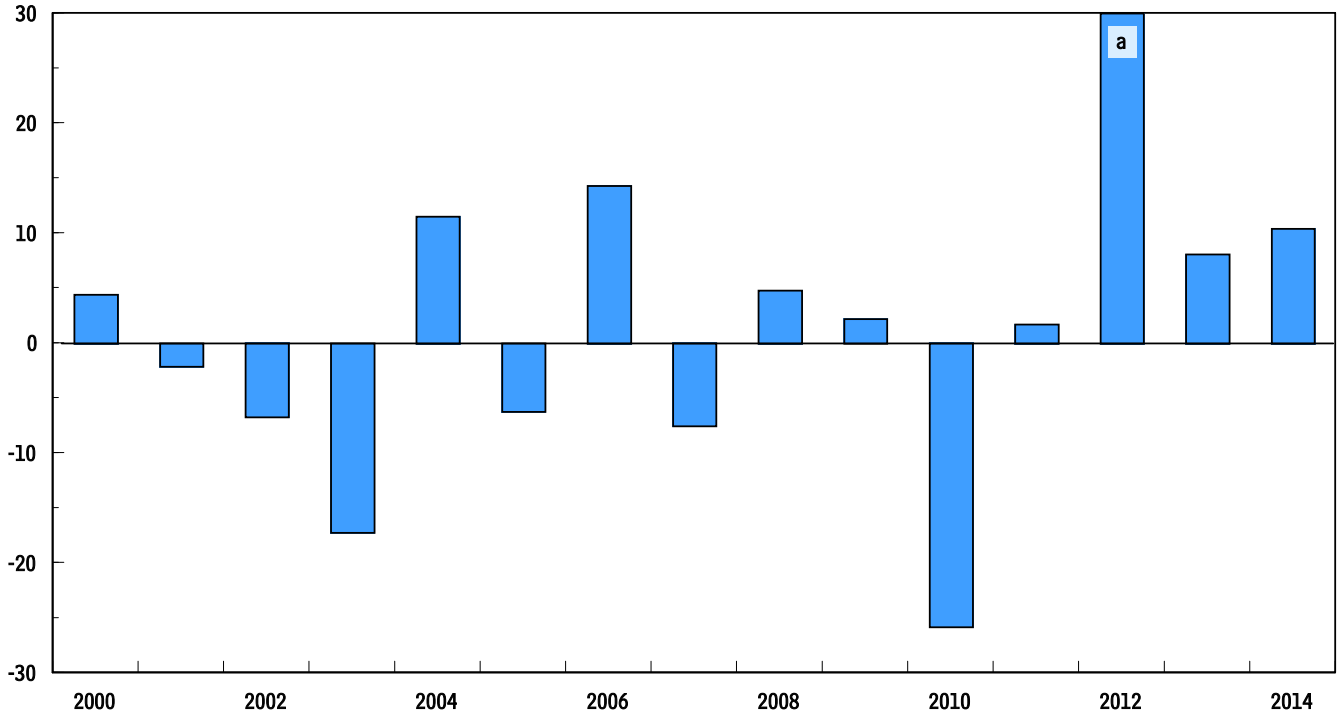
Other Sources of Revenue

Customs duties and numerous miscellaneous receipts bring in much smaller amounts of revenue than the major levies do. CBO estimates that those revenues will remain fairly steady as a share of GDP—at just above 0.5 percent—throughout the projection period. That share will be slightly lower in the first few years, however, because of the effect of low short-term interest rates on the Federal Reserve System's earnings.

Figure 4-5.

Estate and Gift Tax Receipts

(Percentage change from previous year)



Source: Congressional Budget Office.

a. The projected value in 2012 is 102 percent.

CBO projects that customs duties will grow over time in tandem with imports. During the next few years, however, their growth will be curbed as tariff reductions enacted in 1994 are phased in. Some slight decline in customs receipts relative to output occurs because petroleum, an important component of overall imports, is assessed a specific duty that does not rise with price. Projections of customs duties are slightly higher now than in August, due to changes in the economic forecast.

Profits of the Federal Reserve System—the largest component of miscellaneous receipts—are counted as revenues once they are turned over to the Treasury *(see Table 4-9).* Those profits depend on the interest that the Federal Reserve earns on its portfolio of securities and on gains and losses from its holdings of foreign currency. In the past three years, earnings on securities have declined as the Federal Reserve lowered interest rates to stimulate economic growth and counter the economy's downturn. In addition, the recession and slow recovery curbed the growth of the Federal Reserve's portfolio of assets because of slower growth in the public's holdings of U.S. currency. Those factors have led CBO to project that receipts from the Federal Reserve System this year will be substantially below the average of recent years. However, the central bank's income—and therefore the receipts it remits to the Treasury—are expected to return to their previous pattern in 2005 and 2006.

Since August, expectations of lower inflation and interest rates have led CBO to reduce its projection of Federal Reserve receipts by about $26 billion over the 2004-2013 period. Technical revisions in other miscellaneous receipts—largely the result of unexpected recent collections—offset that reduction by about $2 billion.

The Effects of Expiring Tax Provisions

CBO's revenue projections rest on the assumption that current tax laws remain unaltered except for scheduled changes and expirations, which occur on time. The sole exception to that approach is the expiration of excise taxes dedicated to trust funds, which, under budget rules,

are included in the revenue projections whether or not they are scheduled to expire.

The assumption that tax provisions expire as scheduled can have a significant impact on CBO's estimates—even in ordinary circumstances, when those provisions do not include such large changes as the personal tax cuts in EGTRRA and JGTRRA or the partial-expensing rules enacted in JCWAA and extended in JGTRRA. Many expiring provisions are extended almost as a matter of course, and most of them reduce receipts. Thus, revenue projections that assumed the extension of those provisions would be lower than revenue estimates projected under current law. To provide as complete an outlook for revenues as possible, this section details the various tax provisions whose expiration is reflected in CBO's projections, and the revenue effects of extending them.

The estimates of revenue associated with the extensions cited in this section do not include any effects of the provisions on the macroeconomy. In many instances, macroeconomic feedbacks would be too small to have a substantial effect on the estimates. Among the expirations, however, are the EGTRRA and JGTRRA rate cuts that influence labor supply and growth in CBO's baseline economic projection. Hence, the full "dynamic" revenue effect of extending some of these provisions would differ from the estimates presented in this section.

Provisions That Expired in 2003

Seventeen tax provisions expired at the end of 2003, of which 16 reduce revenues *(see Table 4-10 on page 92).* Most of them had been set to expire before and were extended temporarily, in some cases numerous times, even retroactively following expiration. If all 16 of the revenue-reducing provisions were reinstated immediately and made permanent, revenues would be $85 billion lower over the 2005-2014 period.

One other provision that affects revenues also expired at the end of 2003. It is a provision enacted in 2002 that raises the interest rate that firms use to calculate their required contributions to defined-benefit pension plans and their premium payments to the Pension Benefit Guaranty Corporation, both of which are tax-deductible. If the provision were reinstated and made permanent, revenues would rise initially but decline by $7 billion during the 2005-2014 period.

Provisions That Expire During the Projection Period

A number of additional provisions will expire during CBO's current projection period. The most significant of those from a budgetary perspective are the provisions enacted in EGTRRA and JGTRRA. As described previously, several JGTRRA provisions (some of which modify EGTRRA) expire at the end of 2004, and additional provisions expire after 2008. Also, two provisions established by EGTRRA are set to expire by the end of 2006; the rest, which represent the bulk of the law's budgetary effects, expire on December 31, 2010. If all of those measures were extended, revenues would be about $2 trillion lower through 2014, CBO and the Joint Committee on Taxation (JCT) project. About two-thirds of that reduction would occur from 2011 through 2014. Revenue losses from those extensions would increase sharply after 2010, largely as a result of extending the EGTRRA tax cuts that would otherwise expire at the end of 2010. Those cuts include decreases in marginal tax rates for individuals, increases in the child tax credit, and repeal of the estate tax.

About one-third of the revenue loss from extending the expiring provisions of EGTRRA and JGTRRA would occur before 2011. Four major provisions of JGTRRA are reduced in 2005 from their full 2004 value: the child tax credit, the expanded 15 percent tax bracket and standard deduction, the expanded 10 percent tax bracket, and the increased AMT exemption. In addition, the partial-expensing provisions expire after 2004, the Section 179 expensing provisions expire after 2005, and the reduced tax rates on capital gains and dividends expire after 2008. Immediately extending the changes to estate and gift taxes enacted in EGTRRA, which expire at the end of 2010, could reduce revenues as early as this year. The reason is that if taxpayers knew that the repeal of the estate tax would become permanent in 2011, some might postpone taxable gifts that they would otherwise have made during this decade.

CBO's and JCT's estimates of the effects of extending expiring provisions also incorporate the assumption that the higher exemption levels for the AMT, which expire after 2004, are extended at their 2004 levels. Under that assumption, the exemption levels would not rise with inflation, so a growing number of taxpayers would still become subject to the AMT over time—albeit fewer than if the higher exemption levels expired as now scheduled. Two other provisions of EGTRRA expire before 2010—

the deduction for qualified education expenses (in 2005) and the credit for elective deferrals and contributions to individual retirement accounts (in 2006).

Sixteen provisions not related to EGTRRA or JGTRRA end between 2004 and 2009; 11 of them would reduce revenues if extended. The provision with the largest effect is the research and experimentation tax credit, which was enacted in 1981. In 1999, the Congress extended that tax benefit through June of this year, for the ninth and longest time. Continuing the credit through 2014 would reduce revenues by almost $50 billion. In all, extending those 11 revenue-reducing provisions would decrease receipts by $116 billion from 2005 through 2014.

Five provisions that expire over the next decade would increase revenues if they were extended. The provision with the largest effect is the Federal Unemployment Tax Act surcharge, which would increase revenues by $10 billion between 2008 and 2014, if extended. The other provisions include assessing fees for the reclamation of abandoned mines; allowing the Internal Revenue Service (IRS) to impose fees on businesses for providing ruling, opinion, and determination letters; allowing employers to transfer excess assets in defined-benefit pension plans to a special account for retirees' health benefits; and providing authority to the IRS for certain undercover operations. Extending the mine reclamation fees would raise about $250 million per year. The other three provisions would each raise less than $50 million annually.

Expiring Provisions That Are Included in CBO's Baseline

Budget rules require CBO to include in its projections excise tax receipts earmarked for trust funds, even if provisions for those taxes are scheduled to expire. The largest such taxes that are slated to expire during the next 10 years finance the Highway Trust Fund. Some of the taxes for that fund are permanent, but most of them end on September 30, 2005. Extending them at today's rates contributes about $38 billion to CBO's revenue projections in 2014, or about 40 percent of that year's total excise tax receipts.

Other expiring trust fund taxes, if extended, would account for smaller amounts in 2014, CBO estimates. Taxes dedicated to the Airport and Airway Trust Fund, which are scheduled to expire at the end of 2007, would contribute about $16 billion to revenues in 2014. Taxes for the Leaking Underground Storage Tank Trust Fund, set to end on March 31, 2005, would contribute about $275 million. No other expiring tax provisions are automatically extended in CBO's projections.

Total Effect of Expiring Provisions

If all of the expiring tax provisions were extended together, the revenue projection for 2005 would be $65 billion lower. That revenue loss would grow to $134 billion in 2006 and $158 billion in 2010, before jumping to $287 billion in 2011 and then reaching $429 billion in 2014. Over the entire 2005-2014 period, revenues would be reduced by about $2.3 trillion. That estimate of the effects of jointly extending the expiring provisions includes interactions among the provisions. Two AMT provisions in particular—increasing the exemption amount for the AMT and allowing personal credits to reduce AMT liability—interact with each other and with provisions that affect personal tax rates.

A more limited measure of the effects of extending expiring provisions would not include the partial-expensing provision. It expires at the end of 2004 and was not intended to be permanent. If all provisions except partial expensing were extended permanently, federal revenues would be about $1.85 trillion lower through 2014.

Table 4-10.

Effect of Extending Tax Provisions That Will Expire Before 2014

(Billions of dollars)

Tax Provision	Expiration Date	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Provisions That Expired in 2003														
Archer Medical Savings Accounts	12/31/03	*	*	*	*	*	*	*	*	*	*	*	*	*
Brownfields Remediation	12/31/03	-0.1	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	-2.1
Corporate Contributions of Computers to Schools	12/31/03	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.7	-1.7
Credit for Electric Vehicles	12/31/03	*	*	*	*	*	*	*	*	*	*	*	*	*
Credit for Electricity Production from Renewable Sources	12/31/03	*	*	-0.1	-0.2	-0.3	-0.5	-0.8	-1.1	-1.5	-1.9	-2.2	-1.2	-8.7
Deduction for Teachers' Classroom Expenses	12/31/03	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1	-2.2
Deductions for Clean-Fuel Vehicles and Refueling Property	12/31/03	*	-0.1	-0.2	-0.4	-0.5	-0.4	-0.4	-0.4	-0.3	-0.1	-0.1	-1.6	-2.8
Interest Rate for Pension Calculations	12/31/03	4.8	3.7	1.6	0.6	-1.3	-2.2	-2.6	-2.0	-1.9	-2.0	-1.3	2.5	-7.3
Net Income Limitation for Marginal Oil and Gas Wells	12/31/03	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.5
Qualified Zone Academy Bonds	12/31/03	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Reduction in Policy-holder Dividends for Insurance Companies	12/31/03	*	*	*	*	*	*	*	*	*	*	*	-0.2	-0.4
Rum Excise Tax Revenue to Puerto Rico and the Virgin Islands	12/31/03	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.8
Tax Incentives for Investment in the District of Columbia	12/31/03	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.3	-0.5	-1.5
Treatment of Personal Credits Under AMT	12/31/03	-0.1	-0.6	-2.3	-3.6	-4.2	-4.8	-5.5	-6.1	-7.4	-8.5	-9.2	-15.5	-52.1
Welfare-to-Work Tax Credit	12/31/03	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.7
Work Opportunity Tax Credit	12/31/03	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-1.5	-3.7
Tax Incentives for Areas of New York City Damaged on Sept. 11	Various[a]	-0.1	-0.3	-0.3	-0.7	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-3.0	-6.9
Provisions That Expire Between 2004 and 2014														
Credit for Research and Experimentation	06/30/04	-0.5	-2.8	-3.2	-3.7	-4.1	-4.6	-5.1	-5.6	-6.2	-6.7	-7.2	-18.4	-49.2
Abandoned Mine Reclamation Fees	09/30/04	n.a.	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	1.2	2.5
Depreciation for Business Property on Indian Reservations	12/31/04	**	-0.1	-0.4	-0.5	-0.5	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3	-2.1	-3.6
Increased AMT Exemption Amount	12/31/04	n.a.	-7.1	-20.3	-26.8	-34.2	-42.8	-50.5	-42.0	-25.5	-30.6	-35.5	-131.1	-315.2
Indian Employment Tax Credit	12/31/04	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.8
IRS User Fees	12/31/04	n.a.	**	**	**	**	**	**	**	**	**	**	0.2	0.4
Partial Expensing at 50 Percent	12/31/04	3.1	-41.4	-71.1	-66.2	-57.5	-48.4	-39.8	-33.0	-28.2	-26.0	-28.4	-284.6	-440.1

(Continued)

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Authority for Undercover IRS Operations	12/31/05	n.a.	n.a.	**	**	**	**	**	**	**	**	**	**	**
Deduction for Qualified Education Expenses	12/31/05	n.a.	n.a.	-2.6	-3.6	-3.9	-4.2	-4.4	-3.9	-3.9	-4.0	-4.0	-14.4	-34.6
Puerto Rico Business Credits	12/31/05	n.a.	n.a.	-0.6	-1.4	-1.5	-1.6	-1.7	-1.9	-2.0	-2.2	-2.3	-5.1	-15.2
Section 179 Expensing	12/31/05	n.a.	n.a.	-3.6	-6.2	-4.8	-3.9	-3.3	-2.8	-2.6	-2.5	-2.6	-18.5	-32.3
Transfer of Excess Assets in Defined-Benefit Plans	12/31/05	n.a.	n.a.	**	**	**	**	**	**	**	**	**	0.1	0.3
Andean Trade Preference Initiative	12/31/06	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	-0.1	-0.3
Credit for IRA and 401(k)-Type Plans	12/31/06	n.a.	n.a.	n.a.	-0.6	-1.9	-1.7	-1.6	-1.4	-1.4	-1.3	-1.1	-4.1	-10.9
Depreciation for Clean-Fuel Automobiles	12/31/06	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1
Generalized System of Preferences	12/31/06	n.a.	n.a.	n.a.	-0.4	-0.6	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-1.6	-5.3
Subpart F for Active Financing Income	12/31/06	n.a.	n.a.	n.a.	-0.9	-2.8	-3.1	-3.5	-4.0	-4.4	-4.9	-5.3	-6.8	-28.9
Alcohol Fuels Income Credit	12/31/07	n.a.	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*
FUTA Surtax of 0.2 Percentage Points	12/31/07	n.a.	n.a.	n.a.	n.a.	1.0	1.4	1.5	1.5	1.5	1.5	1.5	2.5	9.9
New Markets Tax Credit	12/31/07	n.a.	n.a.	n.a.	n.a.	-0.1	-0.3	-0.4	-0.6	-0.8	-1.0	-1.2	-0.4	-4.6
Reduced Tax Rates on Dividends and Capital Gains	12/31/08	n.a.	n.a.	n.a.	n.a.	-2.3	-12.8	-25.7	-34.9	-39.7	-41.7	-44.0	-15.1	-201.1
Empowerment and Renewal Zones	12/31/09	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.8	-1.6	-1.7	-1.9	-2.0	0	-8.1
Estate and Gift Tax Changes	12/31/10	-0.5	-0.9	-1.1	-1.5	-1.9	-1.7	-2.4	-29.0	-51.0	-55.3	-60.8	-7.2	-205.6
Other Provisions of EGTRRA and JGTRRA[b]	Various[b]	n.a.	-12.9	-25.2	-23.1	-19.0	-15.8	-10.4	-103.3	-176.5	-179.8	-182.2	-96.1	-748.2
All Expiring Provisions														
Interaction from Extending All Provisions Together		0	-1.5	-3.2	-1.8	0.2	2.4	2.9	-11.4	-32.5	-34.6	-37.0	-3.9	-116.5
Total		**6.0**	**-64.9**	**-133.6**	**-141.9**	**-142.1**	**-148.1**	**-157.6**	**-286.7**	**-389.2**	**-406.7**	**-428.6**	**-630.7**	**-2,299.5**

Sources: Joint Committee on Taxation; Congressional Budget Office.

Notes: * = between -$50 million and zero; ** = between zero and $50 million; n.a. = not applicable; AMT = alternative minimum tax; IRS = Internal Revenue Service; IRA = individual retirement account; FUTA = Federal Unemployment Tax Act; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003.

These estimates assume that the expiring provisions are extended immediately rather than when they are about to expire and that provisions that have already expired are reinstated immediately.

The provisions are assumed to be extended at the rates or levels existing at the time of expiration. These estimates do not include debt-service costs.

When this report went to press, JCT's estimates based on the new economic projections were unavailable for most expiring provisions related to EGTRRA's and JGTRRA's individual income tax provisions and the AMT. For the two expiring AMT provisions, CBO updated JCT's previous estimates for the estimated effects of the changed economic projections. Estimates of provisions combined in the entry for "Other Provisions of EGTRRA and JGTRRA" have not been updated, although they were extended to 2014. JCT's updated estimates will be made available when they are completed. JCT has updated the estimates of provisions of EGTRRA and JGTRRA that are shown as separate entries and all other provisions except those for the AMT.

a. The provision that expands the work opportunity credit in New York City expired on 12/31/2003. The provisions that increase expensing under Section 179 and allow a five-year lifetime for leasehold improvements expire on 12/31/2006. The provisions related to partial expensing for property placed in service expire on 12/31/2006 and 12/31/2009.

b. These provisions affect several rates, brackets, credits, and other parameters for individual income taxes: the child tax credit; 10 percent rate bracket; 15 percent rate bracket and standard deduction for joint filers; 25 percent and higher tax rates; the phaseout of limitations on itemized deductions and personal exemptions; and certain education, pension, and other provisions. All of the provisions as enacted in EGTRRA expire at the end of 2010. Modifications enacted in JGTRRA expire at the end of 2004. The estimates do not include the deduction for qualified education expenses, the credit for IRA and 401(k)-type plans, reduced rates on dividends and capital gains, and the exemption amount for the AMT, which are shown in separate entries.

APPENDIX

A

The Uncertainty of Budget Projections

The baseline projections in this report represent the most likely outcomes for the budget and the economy on the basis of current trends and current laws and policies governing taxes and spending. But considerable uncertainty surrounds those projections for two reasons. First, future legislation is likely to alter the paths of federal revenues and spending. The Congressional Budget Office (CBO) does not predict future legislation—indeed, any attempt to incorporate future legislative changes in the baseline would undermine its usefulness as a neutral base against which to measure the effects of legislation. Second, the U.S. economy and the federal budget are affected by many economic and other changes that are difficult to predict. As a result, actual budgetary outcomes will almost certainly differ from CBO's baseline projections, even after adjustments for new legislation.

This appendix explores how the accuracy of the economic and technical assumptions that CBO incorporates in its baseline can affect the accuracy of its budget projections. Looking back, the appendix describes CBO's record of projections and shows how reliable the agency's current and future five-year projections might be if they are as accurate as those of the past. Looking forward, it uses hypothetical scenarios to describe how the 10-year budget outlook might differ from CBO's baseline.

The outlook for the budget deficit or surplus (given current laws and policies) can best be described as a large spread, or fan, of possible outcomes around the single line of numbers expressing CBO's baseline. Moreover, the spread widens as the projections extend into the future. The fan in *Figure A-1* is based on CBO's record of accuracy in its five-year budget projections. The baseline budget projections presented in Chapter 1—the projections with the highest probabilities—fall in the middle of the fan. But nearby projections in the darkest part of the fan have nearly the same probability of occurring as do the baseline projections. Moreover, projections that are quite different from the baseline also have a significant probability of coming to pass. On the basis of the historical record, any budget deficit or surplus for a particular year, in the absence of new legislation, could be expected to fall within the fan about 90 percent of the time and outside the fan about 10 percent of the time. The probability that all of the next five years of deficits or surpluses will fall within the fan is less than 90 percent—closer to 70 percent, according to CBO's record.

While illustrative of the basic issues, Figure A-1 is based on a short historical record. In that short period, the budget may not have experienced all of the sources of uncertainty that it will in the future. Thus, Figure A-1 will continue to evolve with experience, over time becoming a better measure of the true uncertainty of current projections.

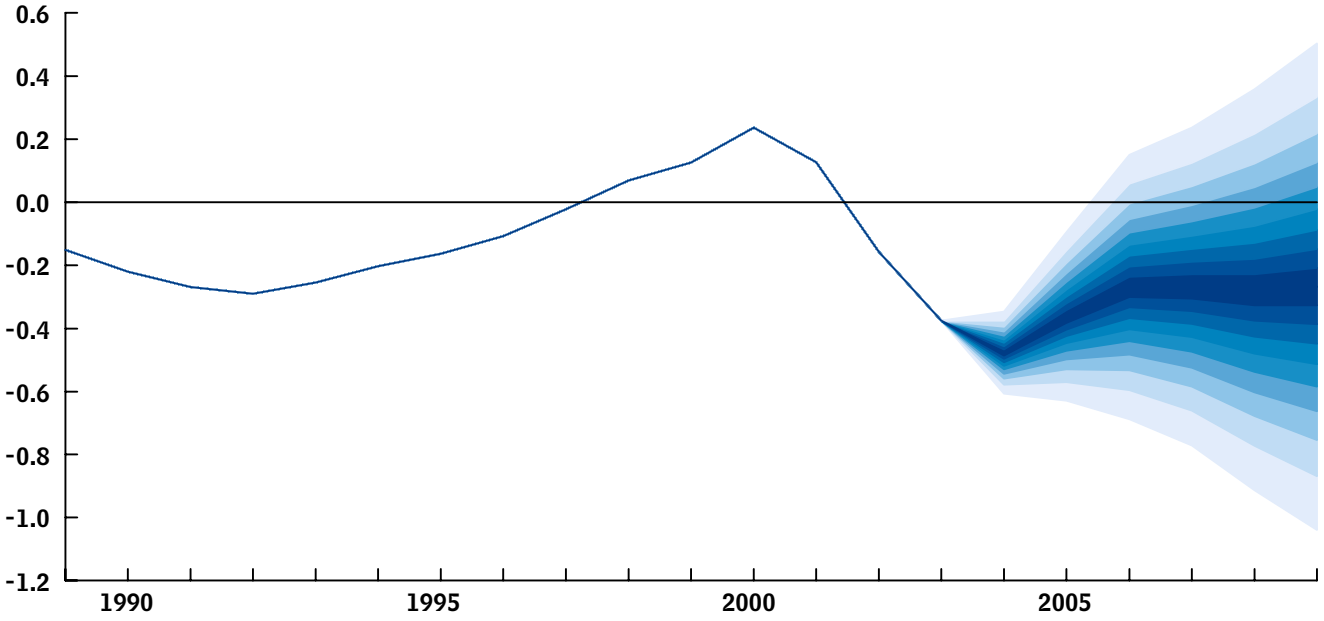
Historically, CBO's projections have been least accurate around cyclical turning points—times when the economy moves from expansion to recession or vice versa—which economists generally have the most difficulty predicting reliably. However, from 1981 (the earliest year for which complete data suitable for this analysis are available) until 2003, the economy experienced just three recessions (in 1981 and 1982, 1990 and 1991, and 2001) and only two long expansions. Thus, CBO has limited information on the uncertainty associated with its projections around turning points.

In addition to the timing and magnitude of cyclical turning points, the longer-run economic and budgetary trends that underlie the 10-year outlook involve uncertainty. For example, measuring and forecasting the potential growth of the economy—an important part of the

Figure A-1.

Uncertainty of CBO's Projections of the Budget Deficit or Surplus Under Current Policies

(Trillions of dollars)



Source: Congressional Budget Office.

Note: Calculated on the basis of CBO's track record, this figure shows the estimated likelihood of alternative projections of the deficit or surplus under current policies. The projections described in Chapter 1 fall in the middle of the darkest area. Under the assumption that tax and spending laws and policies do not change, the probability is 10 percent that the actual deficit or surplus for each year will fall in the darkest area and 90 percent that it will fall within the whole shaded area. The probability that all of the next five years of deficits or surpluses will fall within the fan is less than 90 percent—closer to 70 percent, according to CBO's record.

Actual deficits or surpluses will of course be affected by legislation enacted in coming years, including decisions about discretionary spending. The effects of future legislation are not included in this figure.

For an explanation of how CBO calculates the probability distribution underlying this figure, see *Uncertainties in Projecting Budget Surpluses: A Discussion of Data and Methods* (April 2003), available at www.cbo.gov; an update of that publication will be available shortly.

10-year projections—require making assumptions about many factors that affect the growth of capital, the labor supply, and total factor productivity (which reflects the productivity of both capital and labor combined). Even small changes in the projected growth rate of potential output can have significant budgetary implications over the course of 10 years. Much uncertainty surrounds factors such as the gains in productivity from more efficient use of the capital already acquired, the pace of future technological improvements in IT (information technology) equipment, the impact of changes in the educational status of workers, the effect of undocumented immigration on the size and skills of the labor force, the implications of changes in work and retirement patterns, and developments in the world economy.

In the absence of a sufficient historical record to construct a fan chart, a way to illustrate the uncertainty of 10-year projections is to calculate the effects of specific sets of alternative assumptions on the outlook for the economy and the budget. For that purpose, CBO has assembled two scenarios that differ primarily in their assumptions about cyclical conditions in the next few years, the level of total factor productivity, the revenues arising from a given level of overall economic activity, and the growth of medical costs over the next decade. The range of outcomes is very large for the 10-year projections, and about two-thirds of the effects of uncertainty occur in the last five years of the projection period.

The Accuracy of CBO's Past Budget Projections

Baseline budget projections are bound to deviate from actual outcomes, but assessing the accuracy of previous projections is not a simple matter. As described, baseline projections are meant to serve as a neutral reference point for evaluating policy changes, so they make no assumptions about future legislation that might alter current budget policies. To focus on the accuracy of the baseline as a reference point, this appendix presents inaccuracies in projecting that stem from economic and technical factors and exclude the estimated effects of new legislation.

CBO assessed the accuracy of its past annual projections by comparing them with actual budgetary outcomes and attempted to determine the sources of differences after adjusting for the estimated effects of policy changes *(see Box A-1).* The comparisons included 22 sets of projections for the ongoing fiscal year (the one in which the projections were made), 21 sets for the following fiscal year (referred to as the budget year), and 17 to 20 sets of projections that extend four more years into the future.[1] CBO used only the first five years of projections because its record of 10-year projections is not long enough for drawing conclusions.

On average, the absolute difference (without regard to whether the difference was positive or negative) between CBO's estimate of the federal deficit or surplus and the actual result was 0.5 percent of gross domestic product (GDP) for the ongoing fiscal year and 1.2 percent for the budget year; by the fourth year beyond the budget year, that difference, adjusted for the effects of subsequent legislation, rose to 3.0 percent *(see Table A-1).* If those averages were applied to CBO's current baseline, the actual deficit or surplus could be expected to differ in one direction or the other from the corresponding projection by roughly $60 billion in 2004, $140 billion in 2005, and $440 billion in 2009, aside from the effects of legislative changes.

Misestimates of revenues have generally been larger than misestimates of outlays, reflecting the greater sensitivity of revenues to economic developments. In absolute terms, revenue projections differed from actual outcomes by an average of about 2.1 percent for the current year, 4.9 percent for the budget year, and 10.9 percent for the fourth year beyond the budget year. Inaccuracies in outlay projections were about a third smaller than those in revenue projections for the current year and between a third and a half as large for the budget year and subsequent years. (Those inaccuracies in outlays include misestimates of spending for net interest, which are significantly affected by the misestimates of revenues.)

The misestimates of the budget's bottom line have gone in both directions: sometimes the projections have been too high and at other times too low. On average, CBO's projection of the deficit or surplus has tended to be slightly pessimistic for the current year (that is, CBO overestimated deficits), on the mark for the budget year, and slightly optimistic for the other four years.

Similar conclusions can be drawn from looking at the history of CBO's estimates of the primary surplus—the total budget surplus excluding net interest—for each of the 17 (six-year) baseline projections in the sample period *(see Figure A-2 on page 100).*[2] In each case in Figure A-2, the shaded cone corresponds to an area similar to that shown by the fan in Figure A-1, which is likely to cover the actual outcome about 90 percent of the time for each year in the projections. Both figures reflect a statistical analysis of CBO's past misestimates of revenues and outlays.[3] Misestimates above the center of the cones in Figure A-2 represent instances in which CBO underestimated the primary surplus, whereas misestimates that lie below the center of the cones are times when CBO overestimated

1. The projections are those made in July 1981 and CBO's winter projections (usually published in January) from 1983 through 2003. Insufficient data were available to use projections made before 1981 or the projections made in early 1982. For projections made in 1998 and before, a full five years of estimates could be used. For projections made since that date, progressively shorter spans of estimates were used because the most recent actual data against which they could be compared were for fiscal year 2003. To calculate the role of policy changes, CBO used estimates of the budgetary effects of legislative changes that were made close to the time that the legislation was enacted. (CBO has also examined in detail its record of economic forecasting. See Congressional Budget Office, *CBO's Economic Forecasting Record* [October 2003], available at www.cbo.gov.)

2. CBO's analysis focuses on the primary surplus because including net interest would muddy the comparisons, as the relationship between budget balance and interest costs depends on interest rates, which vary.

3. See Congressional Budget Office, *Uncertainties in Projecting Budget Surpluses: A Discussion of Data and Methods* (April 2003), available at www.cbo.gov. An updated version will be available shortly.

Box A-1.

How CBO Analyzed Its Past Misestimates

This appendix distinguishes inaccuracies in budget projections that are correlated with the business cycle from inaccuracies in assessing trends that are unrelated to the business cycle.[1] That distinction is useful because inaccuracies in the assessment of trends are likely to grow indefinitely as the projection horizon extends, but inaccuracies correlated with the business cycle are not. In fact, according to the Congressional Budget Office's (CBO's) estimates, cyclical inaccuracies are small in the first two years of a projection period (that is, the current year and the budget year); for those two years CBO attempts to reflect its view of the business cycle in its projection. Those inaccuracies plateau for the next three years of the projection period, for which time CBO does not attempt to forecast the business cycle. The remaining inaccuracies grow almost linearly with the projection horizon. According to that decomposition, discrepancies between CBO's budget projections five years out and actual outcomes have consisted in roughly equal parts of discrepancies due to business cycles (which CBO does not attempt to project so far in advance) and inaccuracies in assessing the economic and other trends that underlie the budget.

For the purpose of this appendix, discretionary spending is handled somewhat differently than in CBO's usual analyses of revisions to budget projections. In its analyses of revisions, CBO allots any discrepancies between assumptions and outcomes to three categories: the effects of legislation, economic factors, and technical (estimating) factors. (For more details about those categories, see Chapter 1.) Discretionary spending is appropriated annually through new legislation, and as a result, legislation accounts for the lion's share of the differences between baseline projections and actual outlays for discretionary programs. But the split for discretionary spending is not available consistently throughout all of the historical record that CBO analyzes in this appendix. For that reason, CBO has excluded the small misestimates in discretionary spending for other (nonlegislative) reasons from its discussion of uncertainty here. Because economic and technical assumptions play only a small role in projections of discretionary spending, that omission makes very little difference to the results.

The discussion in this appendix also omits any distinction between economic and technical differences. That distinction is somewhat arbitrary, subject to change as the underlying economic data are revised, and unnecessary for this analysis.

1. A detailed discussion appears in *Uncertainties in Projecting Budget Surpluses: A Discussion of Data and Methods* (April 2003), available at www.cbo.gov. An updated version of that document will be available shortly.

the primary surplus—in all cases, apart from the effects of subsequent legislation.

As Figure A-2 shows, CBO's baseline projections have generally been less accurate for the out-years than in the short run. Although the five-year budget projections made between 1993 and 1998 tended to be too pessimistic, those made earlier tended to be too optimistic. In 13 of the 17 cases (or about three-quarters of the time), all of the misestimates of the primary deficits or surpluses for a particular baseline fell within the fan.

Sources of Past Inaccuracies in Projecting Revenues

Misestimates of revenues are rarely attributable to a single cause, but a few major factors can be identified. Both unexpected recessions and unexpectedly rapid expansions can be a problem for revenue projections—as noted earlier, predicting turning points in the business cycle is one of the most difficult challenges facing economic fore-

Table A-1.

Average Difference Between CBO's Budget Projections and Actual Outcomes Since 1981, Adjusted for Subsequent Legislation

(Percent)

	Year for Which the Projection Was Made					
	Current Year	Budget Year	Budget Year + 1	Budget Year + 2	Budget Year + 3	Budget Year + 4
	Difference as a Percentage of GDP					
Deficit or Surplus						
Average difference[a]	0.2	0	-0.2	-0.2	-0.3	-0.4
Average absolute difference	0.5	1.2	1.7	2.1	2.5	3.0
Revenues						
Average difference	0	-0.1	-0.3	-0.3	-0.4	-0.5
Average absolute difference	0.4	0.9	1.4	1.6	1.8	2.0
Outlays						
Average difference	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1
Average absolute difference	0.3	0.4	0.6	0.7	1.0	1.2
	Difference as a Percentage of Actual Outcome					
Revenues						
Average difference	-0.2	-1.0	-2.2	-2.1	-2.4	-3.4
Average absolute difference	2.1	4.9	7.5	8.5	9.4	10.9
Outlays						
Average difference	-0.9	-0.8	-0.8	-0.9	-0.6	-1
Average absolute difference	1.4	2.1	2.9	3.5	4.7	5.9

Source: Congressional Budget Office.

Notes: This comparison covers the projections that CBO published in July 1981 in *Baseline Budget Projections: Fiscal Years 1982-1986* and the ones it published each winter between 1983 and 2003 in *The Economic and Budget Outlook.*

The current year is the fiscal year in which the projections are made; the budget year is the following fiscal year.

Differences are actual values minus projected values. Unlike the average difference, the average absolute difference indicates the distance between the actual and projected values without regard to whether the projections are overestimates or underestimates.

a. A positive average difference for the deficit or surplus means that, on average, CBO overestimated the deficit or underestimated the surplus; and a negative average difference, the opposite.

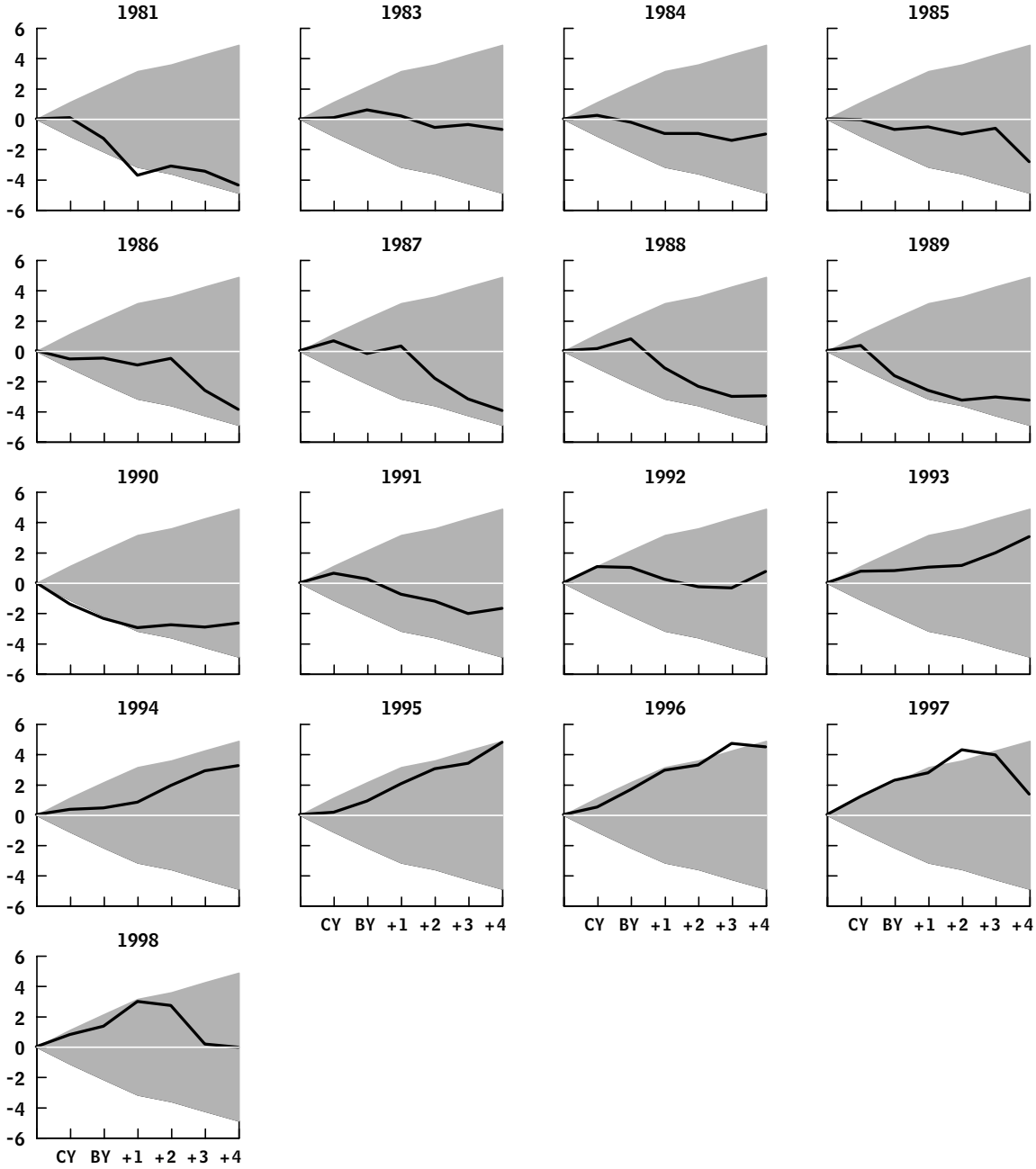
casters. Therefore, revenues tend to be overestimated in projections done just before recessions and underestimated in projections made before rapid expansions. The major source of inaccuracies in revenue projections made during the economic expansion of 1995 through 2000 was the failure to predict the apparent acceleration in the trend of growth in the economy and the economic changes associated with it. In particular, the boom in the stock market boosted tax revenues as investors began to realize their capital gains. At the same time, the income of households in the highest tax brackets grew faster than income did on average, raising effective tax rates.

The unexpected shortfall in receipts from 2001 through 2003 appears to result at least in part from some unwinding of the same factors that pushed receipts up above expectations in the 1995-2000 period. According to the data that are available thus far, capital gains realizations fell sharply in 2001 and 2002, and effective tax rates on income besides capital gains fell in 2001, as high-income taxpayers saw their income grow more slowly than did other taxpayers, who faced lower marginal tax rates. (More information on the sources of the shortfall will become available when data from tax returns for 2002 are tabulated this summer.)

Figure A-2.

Misestimates in CBO's Projections Made from 1981 to 1993

(Percentage of GDP)



Source: Congressional Budget Office.

Notes: CY = current year; BY = budget year.

This figure shows misestimates in CBO's projections of the primary deficit or surplus—the total deficit or surplus excluding net interest—made at different times. Plotted points that lie below the center line reflect instances in which CBO underestimated the primary deficit or overestimated the primary surplus, whereas points above the center line reflect the opposite. In each panel, the shaded cone indicates the estimated 90 percent confidence band; that is, there was a 90 percent chance that CBO's projection would be within the shaded area. CBO estimated that confidence band on the basis of its track record since 1981 (excluding 1982, because of insufficient data).

The figure excludes the effects of legislation enacted after the projections were made.

Sources of Past Inaccuracies in Projecting Mandatory Outlays

CBO often overestimated inflation in its projections in the early 1980s, and more recently, it anticipated an upturn in inflation during the late 1990s that did not occur. Estimates of inflation that are too high result in overestimates not only of cost-of-living adjustments for beneficiaries of many federal programs but also of reimbursements for health care providers. CBO also overestimated unemployment rates in the 1990s, leading to corresponding overstatements of caseloads for means-tested benefit programs (such as the Food Stamp program).

Misestimates of those broad economic trends, however, accounted for only part of the inaccuracies in past projections of mandatory outlays. The remainder came from inaccurate assumptions about such factors as what proportion of eligible individuals and families would participate in benefit programs, how sound financial institutions would be, and how health care providers would behave—factors that can be extremely difficult to predict. For example, along with other analysts, CBO did not fully anticipate the deposit insurance crisis of the 1980s, and the year-by-year costs for its cleanup were highly variable and hard to estimate. Similarly, CBO did not completely foresee the extent of states' use of creative financing mechanisms to obtain federal Medicaid funds between the late 1980s and the late 1990s, or the temporary slowing of the growth of Medicare costs in the late 1990s.

Alternative Economic and Budget Scenarios

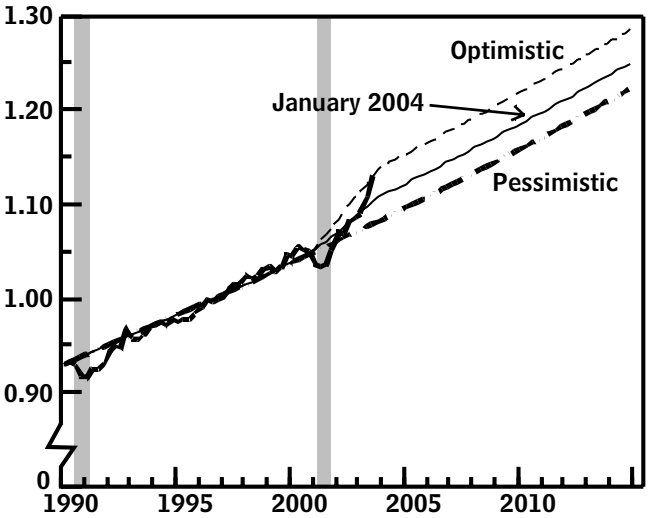
The fan chart is a comprehensive summary of the uncertainty surrounding five-year projections. A way of looking at the uncertainty of today's 10-year projections is to consider how different scenarios could affect the budgetary outcomes. Those alternative scenarios can provide a qualitative, if less comprehensive, understanding of how budget projections can miss the mark, although assigning probabilities to the various outcomes is generally not possible. CBO developed two alternative scenarios that imply significantly different paths for the budget. Each scenario shows the effects of three economic or budgetary developments that occur at the same time. Although each development is plausible in isolation, the chance of all three occurring together is very small.

The alternative economic scenarios primarily reflect opposing views regarding the effect of the recent surge in productivity on the level of potential gross domestic product, or GDP *(see Figure A-3)*. The optimistic scenario used here assumes a level of potential GDP that reflects all of the recent surge in productivity but holds the growth rate of potential output after 2004 at roughly that of CBO's economic baseline projection. As a result, the level of potential GDP is higher throughout the 10-year projection period. By contrast, the pessimistic scenario assumes that none of the recent surge in productivity is permanent, and thus it has no effect on the level of potential GDP. Consequently, the level of potential GDP in the pessimistic scenario is below that of CBO's baseline throughout the projection period, although its growth rate after 2005 is also roughly the same as in the baseline.

Figure A-3.

Total Factor Productivity in the Baseline and Alternative Scenarios

(Index, 1996 = 1.0)



Source: Congressional Budget Office.

The two scenarios also contain different sets of technical assumptions, one for revenues and one for outlays. In particular, the technical assumption for revenues is that the revenue yield for a given set of economic assumptions is either higher (in the optimistic scenario) or lower (in the pessimistic scenario) than that of the baseline. The technical assumption for outlays is that the growth of costs for Medicare and Medicaid will be slower (optimistic) or faster (pessimistic) than in the baseline, for a given set of economic assumptions.

Finally, the alternative scenarios reflect different assumptions about the rate of growth of the GDP price index relative to the consumer price index for all urban consumers (CPI-U), a relationship that is important for budget projections. If the GDP price index grows rapidly in comparison to the CPI-U, projections of revenue growth will be stronger relative to projections of outlay growth. The optimistic scenario assumes that growth of the GDP price index is the same as that of the CPI-U; the baseline assumes that the former will grow relatively more slowly over the medium-term projection; and the pessimistic scenario, that the former will grow even more slowly in relative terms.

The two scenarios show a wide range of possible budgetary outcomes. In comparison with CBO's baseline, the optimistic scenario implies a cumulative surplus that is roughly $4 trillion (or 13 percent of total outlays) greater over the 10 years from 2005 through 2014, whereas the pessimistic scenario implies a cumulative deficit that is about $4 trillion less. In each case, close to two-thirds of the difference occurs in the last five years.

In the optimistic scenario, about half of the improvement over the 2005-2014 period stems from the optimistic economic assumptions, and roughly a third results from the optimistic technical assumptions for revenues that specify a higher revenue yield for a given set of economic assumptions. The rest is attributable to the optimistic assumptions about slower growth of Medicare and Medicaid costs. As would be expected, the budgetary effects of the pessimistic scenario are approximately the opposite of those of the optimistic scenario.

APPENDIX

B

How Changes in Economic Assumptions Can Affect Budget Projections

The federal budget is sensitive to economic conditions. Revenues depend on taxable income—including wages and salaries, other nonwage income, and corporate profits—which generally moves in step with overall economic activity. Spending for the benefits of many entitlement programs is pegged to inflation either directly (as in Social Security) or indirectly (as in Medicaid). In addition, the Treasury regularly refinances portions of the government's debt at market rates, so federal spending for interest on that debt is directly tied to such market rates.

To illustrate how assumptions about the economy can affect federal budget projections, the Congressional Budget Office (CBO) uses key economic variables to construct "rules of thumb." Those rules provide rough orders of magnitude for gauging how changes in individual economic variables, taken in isolation, will affect the budget's totals.

The variables that figure in this illustration are real (inflation-adjusted) growth, interest rates, and inflation. For real growth, CBO's rule of thumb shows the effects of a rate that is 0.1 percentage point lower each year, beginning in January 2004, than the assumed rate of growth underlying the agency's baseline projections (outlined in Chapter 1). The rules of thumb for interest rates and inflation assume an increase of 1 percentage point over the rates in the baseline, also starting in January 2004.

Each rule of thumb is roughly symmetrical. Thus, the effects of higher growth, lower interest rates, or lower inflation would have about the same magnitude as the effects shown in this appendix, but with the opposite sign.

The calculations that appear in this appendix are merely illustrative of the impact that such changes can have. CBO chooses the variations of 0.1 percentage point or 1 percentage point, respectively, for the sake of simplicity alone. Extrapolating from small, incremental "rule-of-thumb" calculations to much larger changes would be inadvisable, because the magnitude of the effect of a larger change is not necessarily a multiple of a smaller change.

Lower Real Growth

Strong economic growth improves the federal budget's bottom line, and weak economic growth worsens it. The first rule of thumb outlines the budgetary impact of economic growth that is slightly weaker than CBO's baseline assumes. CBO's rule of thumb for GDP uses 0.1 percentage point, rather than the full percentage point used in the interest rate and inflation rules. Specifically, the rule illustrates the effects of real gross domestic product (GDP) growth rates that are lower by 0.1 percentage point every year from January 2004 through the end of fiscal year 2014. Those effects differ from the effects of a cyclical change, such as a recession, which are much shorter-term in nature and usually larger in magnitude.

The baseline reflects an assumption that real GDP growth is 4.8 percent in calendar year 2004, 4.2 percent in 2005, and averages 2.7 percent from 2006 to 2014 *(see Chapter 2).* Subtracting 0.1 percentage point from that rate each year means that the level of GDP would fall roughly 1 percent below the level in CBO's baseline by 2014.

A lower rate of growth for GDP would have a number of budgetary implications. For example, it would suggest lower growth in taxable income, leading to losses in revenues that would mount from $1 billion in 2004 to $42

billion in 2014 *(see Table B-1).* Revenue losses would total $201 billion over the 2005-2014 period, or 0.7 percent of the projected revenues over that period.

Lower revenues would mean that the federal government would borrow more and incur greater interest costs. The costs to service that debt would be minimally higher during the first few years of the projection period, but in later years those costs would gradually rise, reaching $11 billion in 2014. Debt-service costs would total $37 billion over the 2005-2014 period, but their impact would be blunted slightly by outlay savings of $2 billion, for a resulting cumulative increase of $35 billion. All told, growth in real GDP that was 0.1 percentage point a year lower than the rate assumed in CBO's baseline would boost deficits by a total of $236 billion over the 2005-2014 period.

Higher Interest Rates

The second rule of thumb illustrates the sensitivity of the budget to changes in interest rates, which affect the flow of interest to and from the federal government. When the budget is in deficit, the Treasury must borrow additional funds from the public to cover any shortfall. When the budget is in surplus, the Treasury uses some of its income to reduce debt held by the public. In either case, the Treasury refinances some debt at market interest rates.

Under the assumption that interest rates are 1 percentage point higher than in the baseline for all maturities—every year—and that all other economic variables are unchanged, interest costs would be approximately $11 billion higher in 2004 *(see Table B-1).* That initial jump in interest costs would be fueled largely by the extra costs of refinancing the government's Treasury bills (securities with maturities of six months or less), which make up about 27 percent of its marketable debt. Roughly $900 billion of Treasury bills is currently outstanding; all of those bills mature within the next six months. The bulk of marketable debt, however, consists of medium-term notes and long-term bonds, which were issued with initial maturities of two to 30 years. As those securities mature, they will be replaced with new securities (the Treasury currently issues two-,three-, five-, and 10-year notes). Thus, the budgetary effects mount; in 2014, the impact of interest rates that are 1 percentage point higher than in the baseline would be $54 billion.

Under this scenario, the Treasury would have to raise additional cash (above the levels assumed in the baseline) to finance the larger outlays for net interest. Such debt-service costs would climb to $32 billion by 2014 and total $142 billion over the 2005-2014 period. All told, if interest rates were a full percentage point higher than the rate assumed in CBO's baseline, interest payments (including the additional debt-service costs) would surpass baseline levels by $592 billion between 2005 and 2014.

That cumulative amount is nearly 60 percent larger than the results of an identical calculation presented in last year's report.[1] Given the deficits and surpluses projected in January 2003, CBO calculated that interest rates 1 percentage point above baseline levels would boost net interest by a total of $374 billion. At that time, however, CBO was projecting a cumulative surplus of $1.3 trillion—in contrast to CBO's current projected cumulative deficit of $1.9 trillion—for the 10-year baseline period. That reversal leads to anticipated levels of borrowing that are significantly higher. Also contributing to the greater effect on interest costs is a level of outstanding debt held by the public that is about $400 billion higher than it was last January.

Higher Inflation

The third rule of thumb shows the budgetary impact of inflation that is 1 percentage point higher than the level assumed in the baseline. The effects of inflation on federal revenues and outlays tend to offset each other, although the impact on revenues is somewhat larger. On the one hand, higher inflation and its effects on wages and other income leads to greater revenues. On the other hand, higher inflation pushes up spending for many benefit programs and drives growth in projections of discretionary spending. In deriving this rule of thumb, CBO also assumes that nominal interest rates rise in step with inflation, thus increasing the cost of financing the government's debt.

An annual increase of 1 percentage point in projected inflation in every year of the baseline period would boost revenues by more than $2.0 trillion, or about 7 percent,

1. See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), Appendix C.

Table B-1.

Estimated Effects of Selected Economic Changes on CBO's Baseline Budget Projections

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Growth Rate of Real GDP Is 0.1 Percentage Point Lower per Year													
Change in Revenues	-1	-3	-6	-9	-12	-16	-20	-25	-31	-36	-42	-47	-201
Change in Outlays													
Net interest (Debt service)	*	*	*	1	1	2	3	4	6	8	11	5	37
Mandatory spending	*	*	*	*	*	*	*	*	*	*	-1	*	-2
Total	*	*	*	1	1	2	3	4	6	8	10	5	35
Change in Deficit or Surplus [a]	-1	-3	-6	-10	-14	-18	-23	-29	-37	-44	-52	-51	-236
Interest Rates Are 1 Percentage Point Higher per Year													
Change in Revenues	0	0	0	0	0	0	0	0	0	0	0	0	0
Change in Outlays													
Higher rates	11	26	33	38	42	47	50	52	54	54	54	186	450
Debt service	*	1	3	5	8	11	14	18	23	27	32	27	142
Total	11	26	36	43	50	58	64	70	76	81	86	213	592
Change in Deficit or Surplus [a]	-11	-26	-36	-43	-50	-58	-64	-70	-76	-81	-86	-213	-592
Inflation Is 1 Percentage Point Higher per Year													
Change in Revenues	11	35	63	93	126	165	206	248	304	361	425	481	2,025
Change in Outlays													
Higher rates	11	26	35	40	45	50	53	56	58	59	60	195	482
Debt service	*	*	1	1	2	2	2	2	1	-1	-4	6	6
Discretionary spending	0	5	13	22	32	43	55	67	80	93	107	116	517
Mandatory spending	1	11	24	38	55	73	93	117	141	171	204	200	925
Total	12	43	72	102	134	168	203	241	279	322	367	518	1,931
Change in Deficit or Surplus [a]	*	-7	-9	-9	-8	-3	3	7	24	39	58	-36	95

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

a. Negative amounts indicate an increase in the deficit or a reduction in the surplus.

from 2005 through 2014—and increase outlays by $1.9 trillion (or about 6 percent) over that same period *(see Table B-1).* In the short run, the net effect is higher deficits—as increases in outlays exceed increases in revenues (in large part because of the impact on interest payments). But by 2010, the revenue increases associated with higher inflation pick up and surpass the increases in outlays. Including debt-service costs, the net effect of this scenario is a reduction in cumulative deficits of $95 billion over the 2005-2014 period.

This rule of thumb roughly corresponds to—but is in the opposite direction of—the economic changes to the baseline described in Chapter 1. Changes to projections of

revenues and outlays since CBO's previous baseline reflect updated projections for a variety of other economic variables as well as inflation, so the rule of thumb for inflation is not directly comparable to the baseline results. Also, the pattern of lower inflation (as measured by the consumer price index) for the baseline projections is not smooth across the 10-year period[2] as it is in the rule-of-thumb estimate for inflation, which leads to differences between the baseline changes and the totals implied by the rule of thumb. Furthermore, other measures of inflation—such as the GDP deflator—affect baseline projections and exhibit different patterns of change across the baseline period. Nevertheless, both the baseline and the rule-of-thumb calculations indicate that the effects of inflation are slightly stronger on the revenue side of the budget, but are mostly offset by the effect on outlays.

2. Compared with CBO's August 2003 projections of the annual increase in the consumer price index, its current projections are lower by 0.7 percentage points in 2005, 0.5 percentage points in 2006, and about 0.3 percentage points each year from 2007 through 2014.

APPENDIX

C

Federal Funding for Homeland Security

The tragic events of September 11, 2001, have focused attention on federal spending for homeland security, but tracking and analyzing that spending have proved difficult. Funding for those activities is split among 200 different appropriation accounts within the federal budget and involves many different functional areas of the government. Furthermore, most of the funding resides within accounts that primarily finance activities not directed at homeland security.

Most of the current data on funding for homeland security are provided in annual reports to the Congress by the Administration's Office of Management and Budget (OMB). Largely on the basis of those reports, CBO estimates that federal resources dedicated to homeland security activities totaled almost $43 billion in 2003—more than double the amount allotted to them before September 11. The Administration requested slightly less funding for 2004—about $41 billion. The total amount provided for homeland security for that year appears to be close to the President's request.

What Is Homeland Security?

Homeland security, as defined by the Administration, represents "a concerted national effort to prevent terrorist attacks within the United States, reduce America's vulnerability to terrorism, and minimize the damage and recover from attacks that do occur."[1] That mission comprises six areas of activity:

- *Intelligence and warning*—Includes efforts to detect and track potential threats before attacks occur within the United States.
- *Border and transportation security*—Encompasses airline security and inspection of cargo at points of entry into the United States to prevent unwanted individuals or weapons from entering the country. Those activities are performed primarily by the Transportation Security Administration (TSA), which was established in November 2001, and by the entities that previously constituted the Immigration and Naturalization Service and the Customs Service.
- *Domestic counterterrorism*—Consists primarily of federal law enforcement and investigative activities that center on tracking and apprehending terrorists. Primary responsibility for those activities rests with the Federal Bureau of Investigation (FBI).
- *Protection of critical infrastructure and key assets*—Includes the physical security of national landmarks and critical infrastructure as well as the physical security of federal government buildings and installations.
- *Defense against catastrophic threats*—Entails efforts to prevent terrorists from obtaining weapons of mass destruction (chemical, biological, or nuclear) and activities to mitigate the effects of such weapons if they are used.
- *Emergency preparedness and response*—Includes efforts to mitigate the effects of future terrorist attacks—including creating federal response plans and providing equipment and training for local "first responders" (in general, local fire, police, and medical personnel who are likely to be first on the scene of a terrorist attack).

1. See Office of Homeland Security, *National Strategy for Homeland Security* (July 2002), available at www.whitehouse.gov/homeland/book/index.html; and Office of Management and Budget, annual *Report to Congress on Combating Terrorism* (September 2003, available at www.whitehouse.gov/omb/inforeg/2003_combat_terr.pdf).

According to OMB, about 38 percent of the $43 billion provided for homeland security in 2003 went toward border and transportation security activities, and another 32 percent was allotted to protecting critical infrastructure and key assets. The remaining funds were used for emergency preparedness and response (14 percent), domestic counterterrorism (9 percent), defense against catastrophic threats (6 percent), and intelligence and warning (1 percent).

The Administration's definition of homeland security focuses only on activities aimed at preventing or responding to terrorist attacks within U.S. borders and not on those devoted to combating terrorism overseas. Overseas activities, such as security at U.S. embassies and military facilities, are classified separately. OMB estimated that for 2003, about $12 billion was allotted to those activities. Of that amount, the Department of Defense and other national security agencies received almost $9 billion, and the Department of State, more than $1 billion. This discussion, however, focuses only on domestic security activities.

Homeland Security and the Federal Budget

Most funding for homeland security is classified as discretionary spending and provided through appropriations, which for 2003 totaled about $41 billion. The collection of fees, mostly by the TSA, offset almost $3 billion of that amount *(see Table C-1).* Mandatory spending finances some additional homeland security activities; for 2003, that funding totaled almost $2 billion.[2] About three-quarters of that amount was used for border protection and immigration enforcement, and most of that spending was offset by immigration and customs user fees, which the budget records as offsetting receipts.

The allocation of homeland security funding to about 200 appropriation accounts within the federal budget substantially complicates efforts to track spending. In addition, although funding levels for homeland security are included in the President's budget request, agencies' accounts do not separate homeland security funding from money appropriated for their other activities. Indeed, much of the money for homeland security activities resides within accounts that fund primarily non-homeland security spending, such as departmental salaries and expenses. That accounting practice makes it difficult to clearly identify homeland security funding on an ongoing basis.

Section 1051 of the National Defense Authorization Act of 1998 directs OMB to produce an annual report on combating terrorism, and that report also contains data on homeland security funding that are collected by federal agencies and updated throughout the year.[3] But classifying and reporting such spending requires judgments about particular projects and activities. Under the current data-collection process, definitions of homeland security and current- and prior-year funding levels are frequently modified and updated. It is particularly hard to reliably compare the $43 billion funding level reported for 2003 with the data collected before 2001 because of the changes in definitions and data-collection methods over the past few years.[4]

The Department of Homeland Security

In response to the terrorist attacks of September 11, the President and the Congress created the Department of Homeland Security in November of 2002, bringing together in one agency activities that were previously spread throughout the federal government. Agencies that are now part of the new department include the Coast Guard, the Federal Emergency Management Agency (FEMA), the Secret Service, and the Transportation Security Administration, as well as activities that were for-

2. Mandatory spending refers to funding that is not subject to annual appropriations.

3. Beginning in 2004, OMB's annual *Report to the Congress on Combating Terrorism* will be replaced by a similar analysis to be included with the President's annual budget request, as required by section 889 of the Homeland Security Act of 2002.

4. Before 2002, OMB's annual reports defined "combating terrorism" as including overseas activities. Beginning in 2002, the reports focused on "homeland security," which expanded the definition to include border enforcement activities of the Immigration and Naturalization Service and the Customs Service but excluded overseas activities. The 2002 report included data for 2001 that had been adjusted to reflect the new definition.

Table C-1.

Total Federal Resources for Homeland Security

(Billions of dollars of budget authority)

	2001	2002	2003
Discretionary Budget Authority			
Regular appropriations	15.0	17.1	32.8
Supplemental appropriations	3.6	12.3	5.3
Fee-funded activities	0.4	1.8	2.7
Mandatory Spending	1.1	1.7	1.8
Gross Budget Authority[a]	**20.1**	**32.9**	**42.5**

Sources: Congressional Budget Office; Office of Management and Budget.

a. Excludes offsetting collections and receipts, which are recorded as negative budget authority. For 2003, negative budget authority totaled about $3.5 billion.

merly part of the Immigration and Naturalization Service (INS) and the Customs Service. Gross budget authority (excluding income from fees and other offsetting receipts) for the new department totaled about $36 billion in 2003. More than $7 billion of that amount came from supplemental appropriations. On the basis of the recently enacted Department of Homeland Security Appropriations Act, 2004 (Public Law 108-90), CBO estimates that gross budget authority for the Department of Homeland Security for 2004 will total about $35 billion.

Despite its name, the Department of Homeland Security's activities are not limited strictly to that mission. Only about $23 billion of its 2003 budget was directed toward purposes that met the executive branch's definition of "homeland security" *(see Figure C-1).* Those activities include, among other things, border and coastal security, immigration enforcement, and grants to first responders. The remaining $13 billion funded non-homeland security functions that were transferred to the new department along with the homeland security activities performed by their original agencies. The Coast Guard, for example, carries out both homeland security (such as coastal defense and port security) and non-homeland security activities (such as marine safety and navigation support). Other examples of non-homeland security duties that are discharged by the new department include disaster relief, which before 2003 was administered by FEMA, and immigration services previously provided by the INS.

Homeland Security Activities in Other Federal Agencies

Other federal agencies also carry out homeland security activities, for which funding in 2003 totaled about $20 billion in gross budget authority *(see Table C-2).* Of that amount, activities within the Department of Defense (such as security at military installations as well as research and development of antiterrorism technologies) accounted for about $9 billion. Homeland security activities of the Departments of Health and Human Services (HHS) and Justice accounted for another $4 billion and $2 billion, respectively. Most of the HHS funds supported research related to the development of methods to detect and vaccinate against possible biological agents. The Department of Justice's homeland security funding includes a portion of the budget of the FBI as well as support for other law enforcement activities to detect and apprehend terrorists.

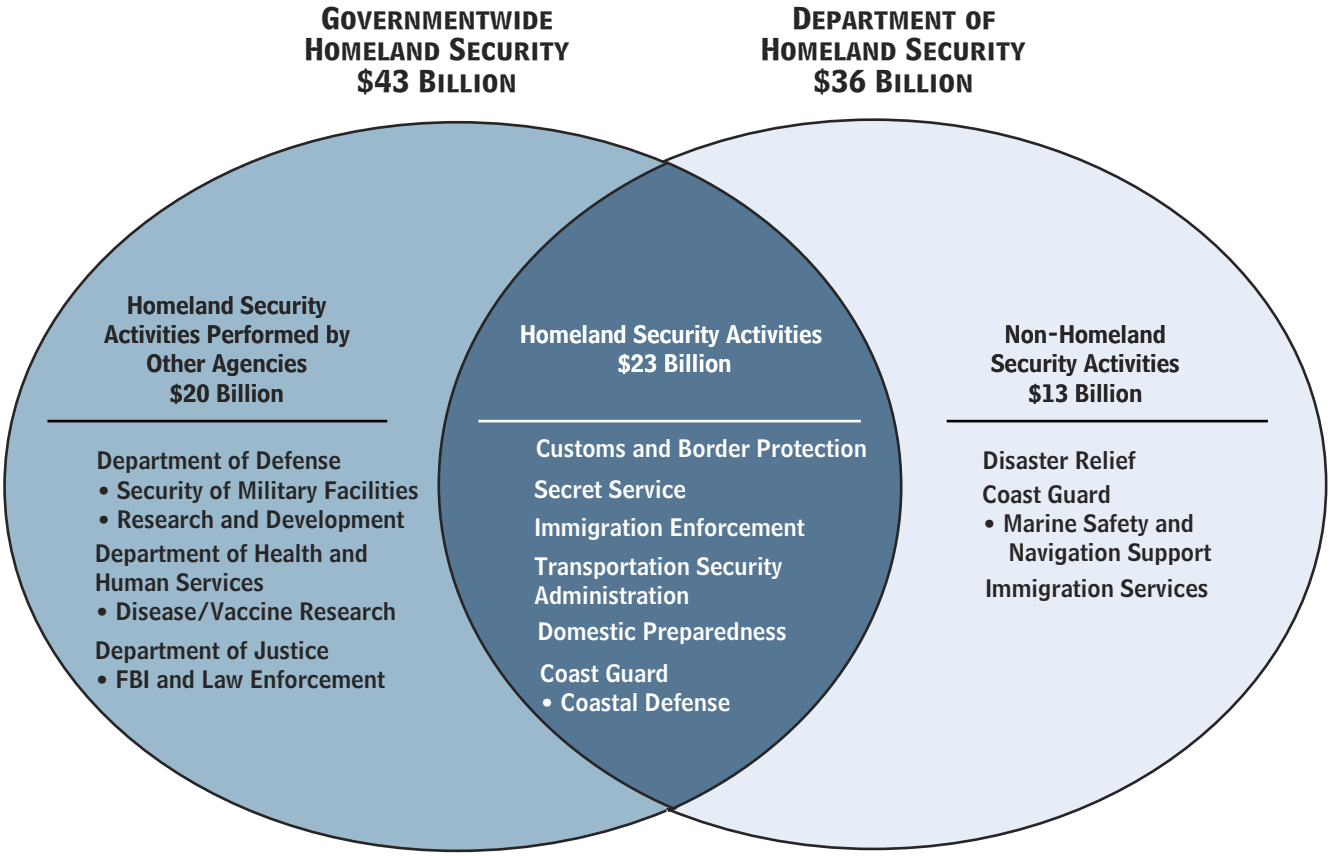
Trends in Homeland Security Funding

Funding for homeland security activities has risen substantially over the past two years. Gross budget authority for those functions, excluding supplemental appropriations enacted immediately after the terrorist attacks, totaled about $16 billion in 2001. Including the supplemental appropriations adds about $4 billion to that figure, bringing total funding for 2001 to $20 billion. The Congress and the President increased that funding to about $33 billion in 2002 and $43 billion in 2003 (including about $5 billion in supplemental appropriations).

Figure C-1.

Funding for the New Department of Homeland Security and for Governmentwide Homeland Security, 2003

(Billions of dollars of gross budget authority)



Source: Congressional Budget Office.

Note: FBI = Federal Bureau of Investigation.

Activities within the new Department of Homeland Security have received the largest portion of the increased funding over the past two years. CBO estimates that before the department was established, its component agencies received about $10 billion in gross budget authority for homeland security activities in 2001, almost $2 billion of which was provided in the post-September 11 supplemental appropriations. In 2003, the new department received gross appropriations of about $23 billion for homeland security activities—more than double the amount provided in 2001. Funding for the Transportation Security Administration (which was established in 2002) accounted for almost $5 billion of the increase. Of the remainder, grants to states and local first responders accounted for $3 billion, and increased funding for border security activities claimed $2 billion.

Funding for homeland security efforts within the Departments of Defense and Justice has nearly doubled since September 2001. Homeland security-related appropriations for the Department of Defense increased from about $5 billion in 2001 (including over $1 billion in supplemental funding) to almost $9 billion in 2003. Much of the additional money has been used to increase security at domestic military installations and conduct combat air patrols over the United States. A portion of that funding—which financed one-time site improvements and new equipment—will not necessarily be re-

Table C-2.

Funding for Homeland Security by Agency

(Billions of dollars of budget authority)

	2001[a]	2002	2003
Department of Homeland Security[b]	10.0	17.4	23.0
Department of Defense	5.4	5.2	8.9
Department of Health and Human Services	0.3	1.9	3.8
Department of Justice	1.0	2.1	2.4
Department of Energy	1.0	1.2	1.4
Department of Agriculture	0.2	0.6	0.5
Department of Transportation	0.4	1.4	0.4
National Science Foundation	0.2	0.3	0.3
Other Agencies	1.5	2.8	1.9
Gross Budget Authority[c]	**20.1**	**32.9**	**42.5**

Sources: Congressional Budget Office; Office of Management and Budget.

a. Includes $3.6 billion in supplemental spending enacted immediately after September 11, 2001.

b. The Department of Homeland Security was established in 2003. Figures for 2001 and 2002 represent budget authority of the agencies that eventually composed the new department.

c. Excludes offsetting collections and receipts, which are recorded as negative budget authority. For 2003, negative budget authority totaled about $3.5 billion.

quired in future years. Homeland security funding for the Department of Justice has increased from about $1 billion in 2001 to more than $2 billion in 2003, with much of that increase going to pay for domestic counterterrorism activities performed by the FBI.

In relative terms, the largest increase in homeland security funding since September 11 has been for activities within the Department of Health and Human Services: those activities claimed about $300 million of HHS's budget in 2001 and almost $4 billion in 2003. About $2 billion of the increase is attributable to additional funding for research by the National Institutes of Health—specifically, to find new ways to detect and combat biological agents. In addition, the Centers for Disease Control and Prevention received an increase of about $1 billion in homeland security funding to help improve local hospitals' responses to catastrophic events.

Funding for 2004

The last regular appropriation laws for fiscal year 2004 have recently been enacted. However, because of the time agencies require to allocate funding and report back to OMB, several weeks may elapse before 2004 budget data on homeland security activities are available. The Administration's budget request for that year included about $41 billion in total funding for such activities (including mandatory spending), which represents about a 3 percent drop in funding relative to the amount provided in 2003 (including $5 billion in supplemental appropriations). Appropriations enacted earlier in the fiscal year, which cover homeland security activities of the Departments of Defense and Homeland Security, have been close to the levels that the President proposed. CBO estimates that net discretionary budget authority for homeland security totals about $37 billion for 2004 *(see Table 3-4 on page 53)*. In addition, CBO anticipates that homeland security activities will receive about $4 billion in mandatory funding and in funding offset by fees and receipts. Gross budget authority for 2004 will thus total about $41 billion, CBO expects.

For 2004, the Congress and the President have created a number of new programs that are classified as homeland security activities. The largest is Project BioShield, which will, among other things, create incentives to increase research for new vaccines. Although the authorizing language has yet to be finalized, the Congress has provided

almost $6 billion in advance appropriations for the program, including $890 million for 2004, as part of the Department of Homeland Security Appropriations Act, 2004.

The Administration and the Congress have also increased funding for a number of existing programs. In particular, policymakers provided an additional $650 million in funding for the Information Analysis and Infrastructure Protection Directorate of the Department of Homeland Security to allow the organization to assess the vulnerability of the nation's critical infrastructure.

For certain categories of homeland security spending, budgeted amounts for 2004 are lower than they were for 2003. For example, the Congress and the President reduced funding for the Department of Defense's homeland security activities from $9 billion in 2003 to $7 billion in 2004, because purchases of force-protection equipment made in 2003 will not be repeated in 2004. Similarly, they reduced total funding for the TSA's homeland security activities from almost $6 billion (including supplemental appropriations) in 2003 to about $4.5 billion in 2004. The higher level in 2003 is explained by the significant one-time startup costs associated with the new agency, such as the purchase of baggage-screening devices and training for new employees.

APPENDIX

D

The Treatment of Federal Receipts and Expenditures in the National Income and Product Accounts

The fiscal transactions of the federal government are reported in two major sets of accounts that are conceptually quite different. The presentation generally discussed in the press and used by executive branch agencies and the Congress (and the one followed in this report) is the *Budget of the United States Government,* as reported by the Office of Management and Budget. It focuses on cash flows—revenues and outlays, or the collection of taxes and fees and the disbursement of cash for the various federal functions. The goal of the budget is to provide information to assist lawmakers in their policy deliberations, to control federal activities, and to help the Department of the Treasury manage its cash balances and determine its borrowing needs.

The national income and product accounts (NIPAs) also report the federal government's transactions, but with different goals. The NIPAs, which are produced by the Bureau of Economic Analysis (BEA) at the Department of Commerce, are intended to provide a comprehensive measure of current production and related income generated by the U.S. economy.[1] A well-known measure of current production in the NIPAs is gross domestic product, or GDP. The accounts, which are used extensively in macroeconomic analysis, divide the economy into four major sectors—business, household, government, and the rest of the world (the foreign sector), each with its own accounts.[2] The federal sector, which is the focus of this appendix, is one component of the government sector (the state and local sector is the other component).[3] Because the goals of the NIPAs differ from those of the budget, the two accounting systems treat some government transactions very differently. The differences, especially those resulting from comprehensive changes in the NIPAs this year, cause the receipts and expenditures in the NIPAs, as projected by the Congressional Budget Office (CBO), to exceed the corresponding budget totals by about 3.5 percent for the 2004-2014 period.

Conceptual Differences Between the NIPAs' Federal Sector and the Federal Budget

The budget of the federal government is best understood as an information and management tool. It focuses mostly on cash flows, recording for each period the in-

1. The discussion of the NIPAs in this appendix generally refers to Table 3.2 in the accounts, "Federal Government Current Receipts and Expenditures," which most closely resembles the presentation in the budget. For other discussions of the NIPAs, see Bureau of Economic Analysis, *Survey of Current Business* (March 2003); and *Budget of the United States Government, Fiscal Year 2004: Analytical Perspectives.*

2. Some accounts in the NIPAs, such as the domestic capital account (which shows saving and investment), focus on components of GDP or gross domestic income, rather than on a specific sector, and bring together relevant information from all four sectors.

3. More formally, BEA regards the federal government and the state and local governments as subsectors. The treatment of state and local governments' transactions in the NIPAs closely resembles that of the federal government's. In large part, the NIPAs rely on state and local budget data collected by the Bureau of the Census, which—like the federal budget data—are currently reported on a cash basis. The Government Accounting Standards Board now requires that state and local governments report transactions on an accrual basis; therefore, accrual-based estimates will appear in the Bureau of the Census's data at some point.

flow of revenues and the outflow of spending.[4] The main period of interest in the budget accounts is the fiscal year, which runs from October through September. There are a few exceptions to the general rule of recording transactions on a cash basis, but they are intended to improve the usefulness of the budget as a tool for making decisions. For example, when the federal government makes direct loans or provides loan guarantees (as with student loans), simply tracking flows of cash would give a misleading view of costs. So (under what is known as credit reform) the budget records the estimated subsidy costs at the time that the loans are made, along with the administrative costs (on a cash basis).

The federal sector of the NIPAs has none of the planning and management goals of the budget. Instead, it is focused on displaying how the federal government fits into a general framework that describes current production and income within specific periods and what happens to that production and income. The main periods of interest for the NIPAs are calendar years and calendar quarters, although approximate totals for fiscal years can be derived from the quarterly estimates.

From the point of view of the NIPAs, the federal government is both a producer and a consumer: its workforce produces government services, and its purchases consume some of the nation's production. In addition, the federal government affects the resources available to the private sector, through its taxes and transfers. The job of the NIPAs is to record all of those activities in a consistent manner.

The federal sector of the NIPAs tracks how much the government spends on consumption purchases, and it records the transfer of resources that occurs through taxes, payments to beneficiaries of federal programs, and federal interest payments. The federal sector's contribution to GDP is presented elsewhere in the NIPAs.[5]

Differences in Accounting for Major Transactions

The accounting differences between the NIPAs and the federal budget stem from the conceptual differences discussed above. In attempting to properly incorporate federal transactions into the framework used to determine GDP, the NIPAs reflect judgments about the best treatment of transactions such as government investment, sales and purchases of existing assets, federal credit, and activities that resemble those of businesses, along with transactions involving U.S. territories. In some cases, the appropriate treatment may be to exclude the transaction entirely from the NIPAs or to move it from the federal sector to another place in the NIPAs. In other cases, the appropriate treatment may involve recording an offsetting (negative) outlay as a receipt instead or adjusting the timing of a federal transaction to better match the timing of related production or income flows.[6]

The Measurement of National Saving

Several conventions in the NIPAs are intended to portray the federal government's contribution to national saving. Two major departures from the budget are the treatment of federal investment spending (for such things as ships, tanks, and office buildings) and the treatment of federal employee retirement programs.

The government's investment spending is not included in the federal sector of the NIPAs but instead is counted along with private investment spending in the domestic capital account, which shows saving and investment. The federal sector of the accounts does, however, record a depreciation charge for the current services of capital created by past government investment. In the budget, depreciation, or consumption of fixed capital, is not

4. Some budget accounts distinguish between on-budget and off-budget transactions and between federal funds and trust funds. Those distinctions do not affect the overall budget balance, have no economic implications, and do not appear in the NIPAs.

5. As part of its comprehensive revisions to the NIPAs (discussed in more detail later), BEA explicitly recognizes the services produced by the government as part of GDP and treats government purchases of goods and services (which are part of the business sector's contribution to GDP) as intermediate inputs to the production of government services. (Thus, the NIPAs now handle transactions in the government sector similarly to those in the business sector.) The changes shift the composition of GDP away from goods and toward services, because the government's purchases of goods are now classified as inputs to a new component of GDP, government services. Although that new treatment changes the relative importance of different components of GDP, it does not change the level of GDP or the transactions reported in the NIPAs' federal sector.

6. The resulting differences between the numbers in the NIPAs and the budget are sometimes divided into three groups: coverage, netting, and timing differences. While all three can affect total revenues or outlays, netting differences have no impact on the federal deficit or surplus because they affect revenues and outlays equally.

tracked. In *Table D-1,* this difference in coverage by the NIPAs and the budget is shown under "Treatment of investment and depreciation."[7]

The transactions of federal employee retirement programs are also handled very differently in the budget and the NIPAs. In the budget, federal employees' contributions to their retirement are recorded as revenues, whereas agencies' contributions on behalf of their employees (as well as interest payments from the Treasury to trust funds) have no overall budgetary effect because they are simply transfers of funds between two government accounts.[8] Benefit payments to retirees are recorded as outlays in the budget. By contrast, in the NIPAs, the aim is to make the measurement of saving by the federal government consistent with that by the private sector. Therefore, the NIPAs treat some of the transactions of federal retirement plans, except for the Railroad Retirement Fund, as part of the household sector.[9] The receipts from federal employers' and employees' retirement contributions (and the interest earned by retirement accounts) are considered part of the personal income of workers and thus are not recorded as federal transactions (receipts or negative expenditures).

On the outlay side, pension benefit payments to retirees are not recorded as federal expenditures in the NIPAs because they are treated as transfers from pension funds within the household sector. Some transactions, however, remain part of federal expenditures even though the corresponding receipts are recorded in the household sector. Namely, as part of compensation, the government's payments to its workers' retirement are counted as federal expenditures, as is the interest paid to federal retirement accounts. The different treatment of retirement contributions by federal employees shows up in Table D-1 under "Receipts"; the different treatment of contributions by federal employers, interest earnings, and benefit payments is shown under "Expenditures."

Capital Transfers and Exchanges of Existing Assets

The NIPAs measure current production and income rather than transactions involving existing assets. Thus, the NIPAs exclude capital transfers and asset exchanges, although the budget generally includes them. Capital transfers in the NIPAs include estate and gift taxes (which are taxes on private capital transfers), investment subsidies to businesses, and investment grants to state and local governments (for highways, transit, air transportation, and water treatment plants). Exchanges of existing assets include federal transactions for deposit insurance and sales and purchases of government assets (including assets that are not produced, such as land and the radio spectrum). In Table D-1, those differences between the NIPAs' federal sector and the budget accounts show up on the revenue side as estate and gift taxes and on the outlay side as capital transfers and lending and financial adjustments.

Credit Programs

The budget is not affected by all of the transactions associated with federal loans and loan guarantees—just the administrative costs and the estimated cost of subsidies. Loan disbursements, loan repayments, and interest are reported in what are termed financing accounts, which have no effect on revenues or outlays.

Like the budget, the NIPAs record administrative costs and generally exclude other cash flows considered exchanges of existing assets or financial and lending transactions unrelated to current production. Unlike the budget, however, the NIPAs do not record subsidy costs. Also, unlike the budget, the NIPAs include the interest receipts from credit programs (as part of federal receipts). Those differences in the treatment of credit programs are recorded in two places. Under "Expenditures" in Table D-1, the lending and financial adjustments show the differences in handling the loan subsidies, and under "Receipts," the difference in treating loan interest is captured as income receipts on assets.

7. The estimates and presentation of the reconciliation between the NIPAs and the budget in Table D-1 are based on CBO's interpretation of the revised methodology for the accounts, as presented in Bureau of Economic Analysis, *Survey of Current Business* (June 2003). The Administrations's budget will include a revised reconciliation table that will form the basis for CBO's future presentations.

8. In the budget, contributions by an agency for its employees' retirement are outlays for that agency and are offsetting receipts (negative outlays) for the trust funds. Thus, those intragovernmental transfers result in no net outlays or receipts for the total budget. That treatment is the same for Social Security and Medicare contributions by the federal government for its employees.

9. Social Security contributions and benefit payments for both private and government employees are kept in the federal sector as receipts and expenditures rather than moved to the household sector.

Table D-1.

Relationship of the Budget to the Federal Sector of the National Income and Product Accounts

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Receipts												
Revenues (Budget)[a]	1,782	1,817	2,049	2,256	2,385	2,506	2,644	2,786	3,036	3,272	3,441	3,629
Differences												
Coverage												
Contributions for government employees' retirement	-5	-4	-4	-4	-4	-4	-4	-3	-3	-3	-3	-3
Estate and gift taxes	-22	-24	-23	-26	-24	-25	-26	-19	-20	-40	-43	-47
Geographic adjustments	-4	-4	-4	-4	-5	-5	-5	-5	-5	-6	-6	-6
Universal Service Fund receipts	-6	-6	-6	-7	-7	-7	-7	-7	-7	-8	-8	-8
Subtotal, coverage	-36	-39	-38	-41	-39	-41	-42	-35	-36	-56	-59	-64
Timing shift of corporate estimated tax payments	6	*	-7	0	0	0	0	0	0	0	0	0
Netting												
Medicare	28	32	36	54	63	68	74	81	88	96	105	114
Deposit insurance premiums	*	*	*	1	1	1	1	2	2	2	2	2
Government contributions for OASDI and HI for employees	13	14	15	16	17	18	19	20	21	22	23	24
Income receipts on assets	18	19	20	21	23	25	25	26	27	28	29	31
Surpluses of government enterprises	-2	-3	-4	-3	-3	-3	-3	-3	-3	-3	-4	-4
Other	18	20	20	19	20	20	20	21	21	21	22	22
Subtotal, netting	76	82	87	108	120	129	136	146	156	166	177	189
Other adjustments	14	28	-7	-6	1	3	-1	-2	1	-4	1	1
Total Differences	61	71	36	61	81	90	94	109	122	106	119	126
Receipts in the NIPAs	1,843	1,888	2,085	2,317	2,467	2,596	2,738	2,895	3,158	3,378	3,560	3,755
Expenditures												
Outlays (Budget)[a]	2,158	2,294	2,411	2,525	2,652	2,783	2,912	3,047	3,198	3,296	3,457	3,616
Differences												
Coverage												
Treatment of investment and depreciation	-8	-10	-12	-14	-17	-20	-24	-28	-33	-38	-42	-47
Contributions for government employees' retirement	32	37	38	38	38	39	41	41	42	43	44	45
Capital transfers	-42	-46	-47	-49	-51	-51	-52	-53	-53	-54	-55	-56
Lending and financial adjustments	21	21	19	22	22	23	16	16	16	16	17	18
Geographic adjustments	-13	-14	-14	-14	-15	-16	-16	-17	-18	-19	-20	-21
Universal Service Fund receipts	-6	-6	-6	-6	-6	-6	-6	-7	-7	-7	-7	-7
Other	9	-4	2	2	4	6	8	11	12	14	17	19
Subtotal, coverage	-6	-21	-21	-21	-24	-25	-33	-37	-41	-43	-46	-49

(Continued)

Table D-1.

Continued

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Timing adjustments	0	0	-12	3	10	0	0	0	-15	15	0	0
Netting												
Medicare	28	32	36	54	63	68	74	81	88	96	105	114
Deposit insurance premiums	*	*	*	1	1	1	1	2	2	2	2	2
Government contributions for OASDI and HI for employees	13	14	15	16	17	18	19	20	21	22	23	24
Income receipts on assets	18	19	20	21	23	25	25	26	27	28	29	31
Surpluses of government enterprises	-2	-3	-4	-3	-3	-3	-3	-3	-3	-3	-4	-4
Other	18	20	20	19	20	20	20	21	21	21	22	22
Subtotal, netting	76	82	87	108	120	129	136	146	156	166	177	189
Total Differences	**70**	**61**	**54**	**89**	**107**	**103**	**103**	**109**	**100**	**138**	**131**	**140**
Expenditures in the NIPAs	2,228	2,355	2,465	2,614	2,759	2,886	3,015	3,156	3,298	3,434	3,588	3,756
Net Federal Government Saving												
Budget Deficit (-) or Surplus[a]	-375	-477	-362	-269	-267	-278	-268	-261	-162	-24	-16	13
Differences												
Coverage												
Treatment of investment and depreciation	8	10	12	14	17	20	24	28	33	38	42	47
Contributions for government employees' retirement	-37	-41	-42	-42	-42	-43	-44	-44	-45	-46	-47	-48
Estate and gift taxes	-22	-24	-23	-26	-24	-25	-26	-19	-20	-40	-43	-47
Capital transfers	42	46	47	49	51	51	52	53	53	54	55	56
Lending and financial adjustments	-21	-21	-19	-22	-22	-23	-16	-16	-16	-16	-17	-18
Geographic adjustments	9	10	10	10	10	11	11	12	12	13	14	14
Universal Service Fund payments	*	*	*	*	-1	-1	-1	-1	-1	-1	-1	-1
Other	-9	4	-2	-2	-4	-6	-8	-11	-12	-14	-17	-19
Subtotal, coverage	-30	-18	-17	-20	-16	-16	-9	2	5	-13	-13	-15
Timing adjustments	6	*	6	-3	-10	0	0	0	15	-15	0	0
Other adjustments	14	28	-7	-6	1	3	-1	-2	1	-4	1	1
Total Differences	**-10**	**10**	**-19**	**-29**	**-25**	**-13**	**-9**	*****	**22**	**-32**	**-12**	**-14**
Net Federal Government Saving	-385	-467	-380	-297	-292	-290	-278	-261	-140	-56	-28	-2

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million; OASDI = Old-Age, Survivors, and Disability Insurance; HI = Hospital Insurance.

a. Includes Social Security and the Postal Service.

Geographic Coverage

The NIPAs exclude all government transactions with Puerto Rico and the U.S. territories, whose current production is, by the NIPAs' definition, not part of U.S. GDP. Since federal transfers dominate those transactions, their exclusion tends to increase the NIPAs' depiction of the federal surplus (which the accounts now term net federal government saving) or decrease its depiction of the deficit, in comparison with that in the budget. That difference in coverage is shown as geographic adjustments in Table D-1.

Universal Service Fund

The budget, but not the NIPAs' federal sector, records the business activity of the Universal Service Fund, which provides resources to promote access to telecommunications. The fund receives federally required contributions from providers of interstate and international telecommunications service and disburses those funds to local providers that serve high-cost areas, low-income households, libraries, and schools, as well as to rural health care providers. The fund is administered by an independent nonprofit corporation (the Universal Fund Administration Company), which is regulated by the Federal Communications Commission.

Because of the limited role played by the government, the fund's receipts and payments are classified in the NIPAs as intracorporate transfers (from one business to another) and are not recorded in the federal sector of the accounts. The fund's revenues and outlays appear in the federal budget but have little net impact on the deficit or surplus. The difference in treatment of the Universal Service Fund is so labeled in Table D-1.

Timing Differences

The NIPAs attempt to measure income flows as much as possible on an accrual basis (when income is earned as opposed to when it is received) rather than on a cash basis.[10] That approach makes sense in an integrated system of accounts that is tracking both production and income, because on an accrual basis the value of what is produced in a period should (measurement problems aside) match the total income generated. For example, BEA attributes corporate tax payments to the year in which the liabilities are incurred rather than to the time when the payments are actually made. However, the NIPAs are not entirely consistent in this respect: personal tax payments are counted as they are made and are not attributed back to the year the liabilities were incurred. Currently, BEA is engaged in research to develop methods for preparing accrual-based estimates of personal tax payments.

Because the budget is mostly on a cash basis and the NIPAs' federal sector is much more on an accrual basis, differences exist in a number of areas in the timing for recording transactions.

Corporate Taxes. Tax legislation sometimes temporarily shifts the timing of corporate tax payments (usually from the end of one fiscal year to the beginning of the next one). The NIPAs exclude such timing shifts, which are not consistent with accrual accounting. The timing adjustments for the effects of the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108-27) are shown as the timing shift of corporate estimated tax payments in Table D-1.

Although corporations make estimated tax payments throughout the year, any shortfalls (or overpayments) are corrected in the form of final payments (or refunds) in subsequent years. The NIPAs shift those final payments back to the year in which the corporate profits that gave rise to the tax liabilities actually were generated, while the budget records them on a cash basis. The results of that difference are difficult to identify for recent history and thus appear under "Other adjustments" under "Receipts" in Table D-1.[11]

Personal Taxes. Although personal taxes are not recorded on an accrual basis in the NIPAs, nevertheless BEA attempts to avoid large, distorting upward or downward spikes in personal disposable income due to timing quirks. Such quirks occur, for example, in April of each

10. See United Nations, *System of National Accounts* (1993), section 3.19, which emphasizes reporting transactions on an accrual basis. Many of the conceptual changes to the NIPAs over time have been based on the guidelines enumerated in that U.N. document.

11. "Other adjustments" includes timing differences not shown elsewhere in Table D-1, plus discrepancies between figures in the NIPAs and the budget that may become much smaller after BEA makes its annual revisions in July 2004, at which time estimates of federal receipts for the past three years will be open to revision. Such revisions, which can be large at times, often reflect the effects on receipts of economic developments (such as lower-than-expected growth in profits) that do not show up until a year or more later when the Internal Revenue Service's tax data on corporate liabilities become available.

year, when most final settlements for the previous year's personal taxes are paid. In the NIPAs, therefore, those settlements are evenly spread over the four quarters of the calendar year in which they are paid. (That treatment avoids spikes, as would accrual accounting, but differs from accrual accounting in that it does not move payments back to the year in which the liabilities were incurred.) The smoothing can alter the relationship of the NIPAs and the budget accounts for fiscal years because it moves some receipts into the last quarter of the calendar year and thus into the following fiscal year. Those adjustments are difficult to identify for recent history and thus are not shown separately in Table D-1, but appear in the "Other adjustments" category under "Receipts."

Transfers and Military Compensation. Timing adjustments are needed on the spending side of the NIPAs to align military compensation and government transfer payments—for example, veterans' benefits, Supplemental Security Income (SSI) payments, and Medicare's payments to HMOs (health maintenance organizations)—with income that is reported on an accrual basis in the NIPAs. Misalignments can occur because of quirks in the calendar.

For example, although SSI payments are usually sent out on the first day of each month, the checks are sometimes mailed a day or more in advance. That typically occurs when the first of the month falls on a weekend or holiday. If that situation occurs for the October payments, the payments will be pushed into the previous fiscal year in the budget. In such cases, the NIPAs introduce a timing adjustment that effectively puts the payments back on the first day of the month. Hence, the NIPAs' adjustment always ensures that there are exactly 12 monthly SSI payments in a year, whereas in the budget, there can be 11 in some years and 13 in others.

For military compensation, which is paid twice a month (at the beginning and the middle), the adjustment in the NIPAs always ensures 24 payments in the year, whereas in the budget, there can be 23 in some years and 25 in others. The timing adjustments for expenditures in Table D-1 reflect that regularizing for transfers and for military pay.

Business Activities

The NIPAs and the federal budget both treat certain revenues as offsetting receipts (negative outlays) when they result from voluntary transactions with the public that resemble business activities, such as the proceeds from the sale of postage stamps or government publications. However, the NIPAs generally have a stricter view of what resembles a business transaction. In particular, Medicare premiums, deposit insurance premiums, rents, royalties, and regulatory or inspection fees are deemed equivalent to business transactions in the budget but not in the NIPAs. Consequently, those transactions (negative outlays in the budget) are treated in the NIPAs as government receipts (contributions for government social insurance and current transfers from business—fines and fees). Those differences are recorded under "Netting" in Table D-1. Because they affect total current receipts and total current expenditures by exactly the same amounts, they have no effect on the NIPAs' measure of federal saving.

Newly Revised Treatment of Federal Transactions in the NIPAs

As mentioned, BEA recently introduced comprehensive revisions to the NIPAs. Those changes align the accounts more consistently with international accounting guidelines, provide new information, and improve the measurement of the federal sector's contribution to GDP. The changes that affect the translation from the budget to the NIPAs are mostly timing changes and the reclassification of some items that previously were recorded as offsets to expenditures so that they now are deemed receipts. Medicare payments are now recorded on an accrual basis rather than on a cash basis, and taxes from the rest of the world, interest receipts, and the surpluses of government enterprises are now shown as part of federal receipts rather than as offsets to federal expenditures. Except for the timing change for Medicare's expenditures, the revisions do not alter federal saving because they affect receipts and expenditures by exactly the same amounts. That also is the case for a change in the treatment of in-kind military assistance that shifts some portion of GDP from the federal sector to the international sector (rest of world).

Medicare Payments

In the NIPAs, the shift from cash to accrual accounting for Medicare payments was made possible by new data. So now the NIPAs better show the link between the underlying economic activity (the medical services provided) and the associated federal transaction (payment for those services), which can be several months apart. That timing adjustment has only a small effect on the NIPAs' measure of federal saving.

Taxes from the Rest of the World

Previously, federal taxes from resident aliens and from U.S. citizens living abroad for more than a year were netted against federal transfers to the rest of the world on the expenditure side of the NIPAs' federal sector. BEA now reports those receipts and transfers separately, and those receipts now appear with other federal receipts rather than as offsets to expenditures. The new treatment is consistent with international accounting guidelines, under which taxes and transfers are reported separately. It also matches the treatment of such taxes in the federal budget, although the budget does not attempt to separately identify taxes paid by the rest of the world. The reclassification has no effect on the NIPAs' measurement of federal saving.

Interest Receipts

Previously in the NIPAs, interest received by the federal government from loans and other financial assets was netted against federal interest payments. As a result, federal interest costs were reported on a net basis in the NIPAs, as they are in the federal budget.[12] That treatment, however, is not consistent with international accounting practices, under which interest receipts and payments are reported separately and interest receipts are grouped with other types of government receipts. BEA now follows that international practice. The new treatment raises both federal expenditures and receipts in the NIPAs by the same amounts and thus has no effect on the accounts' measure of federal saving.

Surpluses of Government Enterprises

Under BEA's previous practices, the surpluses of government enterprises, such as the Postal Service, were combined with federal subsidies paid to government enterprises. As a result, the amount of such subsidies was not apparent. The new treatment provides more information by shifting the surpluses of government enterprises to a separate line on the receipts side of the federal sector in the NIPAs. That revision brings the NIPAs more in line with international accounting standards, which generally advocate reporting spending on a gross rather than a net basis. By contrast, surpluses of government enterprises are treated as negative outlays in the federal budget.

12. Small amounts of interest receipts, mainly interest penalties on late tax payments, are recorded as revenues in the federal budget.

Military Assistance in Kind

The NIPAs attempt to identify contributions to GDP by sector and therefore no longer classify military purchases of equipment and services for delivery to foreign governments as part of federal consumption. Instead, those transactions are now part of net exports in the NIPAs' foreign transactions account. The level of GDP for all of the NIPAs' sectors combined is unaffected, because the decline in federal consumption is exactly offset by more net exports. Within the federal sector, in-kind military assistance is now recorded as part of transfers to the rest of the world.

Presentation of the Federal Government's Receipts and Expenditures in the NIPAs

Like the budget, the federal sector of the NIPAs classifies receipts by type, but the categories differ *(see Table D-2).* The NIPAs' classifications help to determine measures of such things as disposable income and corporate profits after taxes. There are five major categories of current receipts. The largest one, current tax receipts, includes taxes on personal income, taxes on corporate income, taxes on production and imports, and taxes from the rest of the world. The next largest category is contributions for government social insurance, which consists of contributions and premiums for Social Security, Medicare, and unemployment insurance. The remaining categories are current transfer receipts (fines and fees), income receipts on assets (interest, rents, and royalties), and current surpluses of government enterprises (such as the Postal Service). As discussed above, those surpluses, as well as interest and some other receipts, previously were recorded on the expenditure side of the NIPAs' federal sector as offsetting (negative) expenditures.

In the NIPAs, the government's expenditures are classified according to their purpose. The major groups, which are much fewer than those in the federal budget, are consumption expenditures, or purchases of goods and services (broken out for defense and nondefense purchases); transfer payments (to persons, governments, and the rest of the world); interest payments; and subsidies to government enterprises.

Defense and nondefense consumption of goods and services consists of purchases made by the government for its immediate use in production. (The largest portion of such consumption is the compensation of military and

Table D-2.

Projections of Baseline Receipts and Expenditures as Measured by the National Income and Product Accounts

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Receipts												
Current Tax Receipts												
Personal current taxes	775	763	858	969	1,051	1,123	1,208	1,303	1,495	1,642	1,747	1,860
Taxes on corporate income	171	186	232	284	296	303	305	309	320	332	343	357
Taxes on production and imports	88	91	95	99	103	106	110	113	117	120	123	126
Taxes from the rest of the world	7	6	7	8	9	10	10	11	13	14	15	16
Subtotal	1,040	1,046	1,193	1,361	1,459	1,541	1,633	1,737	1,945	2,108	2,229	2,359
Contributions for Government Social Insurance[a]	755	790	838	897	946	989	1,036	1,087	1,139	1,192	1,249	1,309
Current Transfer Receipts	26	28	29	30	32	33	35	37	39	41	43	45
Income Receipts on Assets	23	27	28	31	33	35	36	38	39	41	42	44
Current Surplus of Government Enterprises	-2	-3	-4	-3	-3	-3	-3	-3	-3	-3	-4	-4
Current Receipts	**1,843**	**1,888**	**2,085**	**2,317**	**2,467**	**2,596**	**2,738**	**2,895**	**3,158**	**3,378**	**3,560**	**3,755**
Expenditures												
Consumption Expenditures												
Defense												
Consumption	365	412	428	439	448	459	471	483	495	507	519	531
Consumption of fixed capital	61	62	63	63	63	63	62	61	60	59	57	56
Nondefense[b]												
Consumption	200	208	215	219	224	229	233	239	244	249	255	260
Consumption of fixed capital	24	25	26	27	29	30	32	34	35	37	39	41
Subtotal	650	707	731	748	764	781	798	816	834	851	870	888
Current Transfer Payments												
Government social benefits												
To persons	956	996	1,040	1,114	1,189	1,250	1,315	1,393	1,474	1,553	1,651	1,758
To the rest of the world	3	3	3	3	3	3	4	4	4	4	4	5
Subtotal	959	998	1,043	1,118	1,192	1,253	1,318	1,397	1,478	1,557	1,655	1,762
Other transfer payments												
Grants-in-aid to state and local governments[b]	330	351	355	364	375	394	415	438	463	490	519	551
To the rest of the world	23	25	33	37	39	40	42	43	44	44	45	46
Subtotal	353	376	388	401	414	434	456	480	506	534	564	597
Interest Payments[b]	221	229	256	300	341	372	396	417	434	446	452	461
Subsidies	46	45	47	47	47	46	46	46	46	46	46	47
Current Expenditures	**2,228**	**2,355**	**2,465**	**2,614**	**2,759**	**2,886**	**3,015**	**3,156**	**3,298**	**3,434**	**3,588**	**3,756**
Net Federal Government Saving												
Net Federal Government Saving	-385	-467	-380	-297	-292	-290	-278	-261	-140	-56	-28	-2

Source: Congressional Budget Office.

a. Includes Social Security taxes, Medicare taxes and premiums, and unemployment insurance taxes.

b. Includes Social Security and the Postal Service.

civilian federal employees.) Among the consumption expenditures, the consumption of fixed capital—depreciation—corresponds to the services that the government receives from its stock of fixed assets, such as buildings or equipment.

Transfer payments (cash payments made directly to individuals and the rest of the world and grants to state and local governments or foreign nations) constitute another grouping. Most of the transfers to individuals are for social benefits. Grants-in-aid are payments that the federal government makes to state or local governments, which generally use them for transfers (such as benefits provided by the Temporary Assistance for Needy Families program) and consumption (such as the hiring of additional police officers). Grants-in-aid to foreigners include federal purchases of military equipment for delivery to foreign governments.

The NIPAs' category for federal interest payments shows only payments and thus differs from the budget, which contains a category labeled "net interest." In the NIPAs, federal interest receipts are classified with other federal receipts.

The NIPAs' category labeled subsidies primarily consists of grants paid by the federal government to businesses, including state and local government enterprises such as public housing authorities. Federal housing assistance dominates that category. Formerly, this category of expenditures was reduced by the inclusion of government enterprises' surpluses.

APPENDIX

E

CBO's Economic Projections for 2004 Through 2014

Year-by-year economic projections for 2004 through 2014 are shown in the accompanying tables *(by calendar year in Table E-1 and by fiscal year in Table E-2).* The Congressional Budget Office did not try to explicitly incorporate cyclical fluctuations into its projections for years after 2005. Instead, the projected values shown here for 2006 through 2014 reflect CBO's assessment of average values for that period—which take into account potential ups and downs in the business cycle.

Table E-1.

CBO's Year-by-Year Forecast and Projections for Calendar Years 2004 Through 2014

	Estimated	Forecast		Projected								
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Nominal GDP (Billions of dollars)	10,980	11,629	12,243	12,814	13,389	14,023	14,686	15,354	16,034	16,743	17,490	18,266
Nominal GDP (Percentage change)	4.8	5.9	5.3	4.7	4.5	4.7	4.7	4.5	4.4	4.4	4.5	4.4
Real GDP (Percentage change)	3.2	4.8	4.2	3.2	2.7	2.8	2.8	2.6	2.5	2.5	2.5	2.5
GDP Price Index (Percentage change)	1.6	1.1	1.1	1.5	1.8	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Consumer Price Index[a] (Percentage change)	2.3	1.6	1.7	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Employment Cost Index[b] (Percentage change)	2.9	2.4	2.5	2.7	3.2	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Unemployment Rate (Percent)	6.0	5.8	5.3	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	1.0	1.3	3.0	4.0	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	4.0	4.6	5.4	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Tax Bases (Billions of dollars)												
Corporate book profits	844	948	1,319	1,358	1,356	1,356	1,359	1,393	1,451	1,516	1,587	1,670
Wages and salaries	5,087	5,333	5,639	5,926	6,208	6,511	6,823	7,134	7,449	7,777	8,120	8,476
Tax Bases (Percentage of GDP)												
Corporate book profits	7.7	8.1	10.8	10.6	10.1	9.7	9.3	9.1	9.0	9.1	9.1	9.1
Wages and salaries	46.3	45.9	46.1	46.2	46.4	46.4	46.5	46.5	46.5	46.4	46.4	46.4

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: Percentage change is year over year.

a. The consumer price index for all urban consumers.

b. The employment cost index for wages and salaries only, private-industry workers.

Table E-2.

CBO's Year-by-Year Forecast and Projections for Fiscal Years 2004 Through 2014

	Estimated	Forecast		Projected								
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Nominal GDP (Billions of dollars)	10,829	11,469	12,091	12,682	13,236	13,862	14,519	15,187	15,862	16,562	17,301	18,070
Nominal GDP (Percentage change)	4.4	5.9	5.4	4.9	4.4	4.7	4.7	4.6	4.4	4.4	4.5	4.4
Real GDP (Percentage change)	2.8	4.7	4.3	3.5	2.6	2.8	2.8	2.7	2.5	2.5	2.5	2.5
GDP Price Index (Percentage change)	1.5	1.2	1.1	1.3	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Consumer Price Index[a] (Percentage change)	2.4	1.7	1.6	2.0	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Employment Cost Index[b] (Percentage change)	2.8	2.5	2.5	2.6	3.1	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Unemployment Rate (Percent)	6.0	5.9	5.4	5.0	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	1.1	1.1	2.6	3.8	4.5	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	3.9	4.5	5.3	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5	5.5
Tax Bases (Billions of dollars)												
Corporate book profits	819	938	1,215	1,353	1,354	1,358	1,357	1,382	1,435	1,500	1,569	1,645
Wages and salaries	5,051	5,257	5,563	5,859	6,134	6,435	6,744	7,057	7,370	7,693	8,033	8,386
Tax Bases (Percentage of GDP)												
Corporate book profits	7.6	8.2	10.0	10.7	10.2	9.8	9.3	9.1	9.0	9.1	9.1	9.1
Wages and salaries	46.6	45.8	46	46.2	46.3	46.4	46.5	46.5	46.5	46.5	46.4	46.4

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

Note: Percentage change is year over year.

a. The consumer price index for all urban consumers.

b. The employment cost index for wages and salaries only, private-industry workers.

APPENDIX

F

Historical Budget Data

This appendix provides historical data for revenues, outlays, and the deficit or surplus—in forms consistent with the projections in Chapters 1, 3, and 4—for fiscal years 1962 through 2003. The data are shown in both nominal dollars and as a percentage of gross domestic product (GDP). Data for 2003 come from the Congressional Budget Office and the Office of Management and Budget. Some of the historical data and the way in which mandatory spending is categorized have been revised since January 2003, when these tables were previously published.

Federal revenues, outlays, the surplus or deficit, and debt held by the public are shown in *Tables F-1 and F-2.* Revenues, outlays, and the surplus or deficit have both on-budget and off-budget components. Social Security's receipts and outlays were placed off-budget by the Balanced Budget and Emergency Deficit Control Act of 1985;[1] the Postal Service was moved off-budget by the Omnibus Budget Reconciliation Act of 1989.

The major sources of federal revenues (including off-budget revenues) are presented in *Tables F-3 and F-4.* Social insurance taxes include payments by both employers and employees for Social Security, Medicare, Railroad Retirement, and unemployment insurance, as well as pension contributions by federal workers. Excise taxes are levied on certain products and services, such as gasoline, alcoholic beverages, and air travel. Estate and gift taxes are levied on property when it is transferred. Miscellaneous receipts consist of earnings of the Federal Reserve System and income from numerous fees and charges.

Total outlays for major categories of spending appear in *Tables F-5 and F-6.* (Those totals include both on- and off-budget outlays.) To allow comparison of historical outlays with the projections in this report, the historical data have been divided into the same spending categories as the projections. Spending controlled by the appropriation process is classified as discretionary. Spending governed by permanent laws, such as those that set eligibility requirements for certain programs, is considered mandatory. Offsetting receipts include the government's contributions to retirement programs for its employees, fees, charges such as Medicare premiums, and receipts from the use of federally controlled land and offshore territory. Net interest (function 900 of the budget) comprises the government's interest payments on federal debt offset by its interest income.

Tables F-7 and F-8 divide discretionary spending into its defense, international, and domestic components. *Tables F-9 and F-10* classify mandatory spending by the three major entitlement programs—Social Security, Medicare, and Medicaid—and other mandatory spending. Income-support programs provide benefits to recipients with limited income and assets; those programs include unemployment compensation, Supplemental Security Income, and Food Stamps. Other federal retirement and disability programs provide benefits to federal civilian employees, members of the military, and veterans. The category of other mandatory programs includes the activities of the Commodity Credit Corporation, TRICARE for Life (which provides health care benefits to retirees of the uniformed services who are eligible for Medicare), the subsidy costs of federal student loan programs, the Universal Service Fund, the State Children's Health Insurance Program, and Social Services Block Grants.

1. For consistency, Tables F-1 and F-2 show Social Security as off-budget before 1985 as well as afterward.

The remaining tables in this appendix, *F-11 through F-13,* show estimates of the standardized-budget surplus or deficit and its revenue and outlay components. The standardized-budget surplus or deficit (also called the structural surplus or deficit) attempts to exclude the effects that cyclical fluctuations in output and unemployment have on revenues and outlays and also incorporates other adjustments. The change in that surplus or deficit is commonly used to measure the short-term impact of fiscal policy on aggregate demand. *Table F-11* also presents estimates of potential and actual GDP and debt held by the public.

Table F-1.

Revenues, Outlays, Surpluses, Deficits, and Debt Held by the Public, 1962 to 2003

(Billions of dollars)

			Surplus or Deficit (-)				Debt
	Revenues	Outlays	On-Budget	Social Security	Postal Service[a]	Total	Held by the Public[b]
1962	99.7	106.8	-5.9	-1.3	n.a.	-7.1	248.0
1963	106.6	111.3	-4.0	-0.8	n.a.	-4.8	254.0
1964	112.6	118.5	-6.5	0.6	n.a.	-5.9	256.8
1965	116.8	118.2	-1.6	0.2	n.a.	-1.4	260.8
1966	130.8	134.5	-3.1	-0.6	n.a.	-3.7	263.7
1967	148.8	157.5	-12.6	4.0	n.a.	-8.6	266.6
1968	153.0	178.1	-27.7	2.6	n.a.	-25.2	289.5
1969	186.9	183.6	-0.5	3.7	n.a.	3.2	278.1
1970	192.8	195.6	-8.7	5.9	n.a.	-2.8	283.2
1971	187.1	210.2	-26.1	3.0	n.a.	-23.0	303.0
1972	207.3	230.7	-26.4	3.1	n.a.	-23.4	322.4
1973	230.8	245.7	-15.4	0.5	n.a.	-14.9	340.9
1974	263.2	269.4	-8.0	1.8	n.a.	-6.1	343.7
1975	279.1	332.3	-55.3	2.0	n.a.	-53.2	394.7
1976	298.1	371.8	-70.5	-3.2	n.a.	-73.7	477.4
1977	355.6	409.2	-49.8	-3.9	n.a.	-53.7	549.1
1978	399.6	458.7	-54.9	-4.3	n.a.	-59.2	607.1
1979	463.3	504.0	-38.7	-2.0	n.a.	-40.7	640.3
1980	517.1	590.9	-72.7	-1.1	n.a.	-73.8	711.9
1981	599.3	678.2	-73.9	-5.0	n.a.	-79.0	789.4
1982	617.8	745.7	-120.0	-7.9	n.a.	-128.0	924.6
1983	600.6	808.4	-208.0	0.2	n.a.	-207.8	1,137.3
1984	666.5	851.9	-185.6	0.3	n.a.	-185.4	1,307.0
1985	734.1	946.4	-221.7	9.4	n.a.	-212.3	1,507.3
1986	769.2	990.4	-237.9	16.7	n.a.	-221.2	1,740.6
1987	854.4	1,004.1	-169.3	19.6	n.a.	-149.7	1,889.8
1988	909.3	1,064.5	-194.0	38.8	n.a.	-155.2	2,051.6
1989	991.2	1,143.6	-205.2	52.4	0.3	-152.5	2,190.7
1990	1,032.0	1,253.2	-277.8	58.2	-1.6	-221.2	2,411.6
1991	1,055.0	1,324.4	-321.5	53.5	-1.3	-269.3	2,689.0
1992	1,091.3	1,381.7	-340.5	50.7	-0.7	-290.4	2,999.7
1993	1,154.4	1,409.5	-300.4	46.8	-1.4	-255.1	3,248.4
1994	1,258.6	1,461.9	-258.9	56.8	-1.1	-203.3	3,433.1
1995	1,351.8	1,515.8	-226.4	60.4	2.0	-164.0	3,604.4
1996	1,453.1	1,560.5	-174.1	66.4	0.2	-107.5	3,734.1
1997	1,579.3	1,601.3	-103.3	81.3	*	-22.0	3,772.3
1998	1,721.8	1,652.6	-30.0	99.0	0.2	69.2	3,721.1
1999	1,827.5	1,701.9	1.9	124.7	-1.0	125.6	3,632.4
2000	2,025.2	1,788.8	86.6	151.8	-2.0	236.4	3,409.8
2001	1,991.2	1,863.8	-33.3	163.0	-2.3	127.4	3,319.6
2002	1,853.2	2,011.0	-317.5	159.0	0.7	-157.8	3,540.4
2003	1,782.3	2,157.6	-536.1	155.6	5.2	-375.3	3,913.6

Source: Congressional Budget Office.

Note: n.a. = not applicable; * = between zero and $50 million.

a. From 1962 through 1988, the Postal Service was on-budget.

b. End of year.

Table F-2.

Revenues, Outlays, Surpluses, Deficits, and Debt Held by the Public, 1962 to 2003

(Percentage of GDP)

			Surplus or Deficit (-)				Debt
	Revenues	Outlays	On-Budget	Social Security	Postal Service[a]	Total	Held by the Public[b]
1962	17.5	18.8	-1.0	-0.2	n.a.	-1.3	43.6
1963	17.8	18.5	-0.7	-0.1	n.a.	-0.8	42.3
1964	17.5	18.5	-1.0	0.1	n.a.	-0.9	40.0
1965	17.0	17.2	-0.2	*	n.a.	-0.2	37.9
1966	17.3	17.8	-0.4	-0.1	n.a.	-0.5	34.8
1967	18.3	19.4	-1.6	0.5	n.a.	-1.1	32.8
1968	17.6	20.5	-3.2	0.3	n.a.	-2.9	33.3
1969	19.7	19.3	-0.1	0.4	n.a.	0.3	29.3
1970	19.0	19.3	-0.9	0.6	n.a.	-0.3	27.9
1971	17.3	19.4	-2.4	0.3	n.a.	-2.1	28.0
1972	17.6	19.6	-2.2	0.3	n.a.	-2.0	27.4
1973	17.6	18.7	-1.2	*	n.a.	-1.1	26.0
1974	18.3	18.7	-0.6	0.1	n.a.	-0.4	23.8
1975	17.9	21.3	-3.5	0.1	n.a.	-3.4	25.3
1976	17.2	21.4	-4.1	-0.2	n.a.	-4.2	27.5
1977	18.0	20.7	-2.5	-0.2	n.a.	-2.7	27.8
1978	18.0	20.7	-2.5	-0.2	n.a.	-2.7	27.4
1979	18.5	20.1	-1.5	-0.1	n.a.	-1.6	25.6
1980	18.9	21.6	-2.7	*	n.a.	-2.7	26.1
1981	19.6	22.2	-2.4	-0.2	n.a.	-2.6	25.8
1982	19.1	23.1	-3.7	-0.2	n.a.	-4.0	28.6
1983	17.4	23.5	-6.0	*	n.a.	-6.0	33.0
1984	17.3	22.1	-4.8	*	n.a.	-4.8	34.0
1985	17.7	22.9	-5.4	0.2	n.a.	-5.1	36.4
1986	17.5	22.5	-5.4	0.4	n.a.	-5.0	39.6
1987	18.4	21.6	-3.6	0.4	n.a.	-3.2	40.6
1988	18.1	21.2	-3.9	0.8	n.a.	-3.1	40.9
1989	18.3	21.2	-3.8	1.0	*	-2.8	40.5
1990	18.0	21.8	-4.8	1.0	*	-3.9	42.0
1991	17.8	22.3	-5.4	0.9	*	-4.5	45.4
1992	17.5	22.2	-5.5	0.8	*	-4.7	48.2
1993	17.6	21.5	-4.6	0.7	*	-3.9	49.5
1994	18.1	21.0	-3.7	0.8	*	-2.9	49.4
1995	18.5	20.7	-3.1	0.8	*	-2.2	49.2
1996	18.9	20.3	-2.3	0.9	*	-1.4	48.5
1997	19.3	19.5	-1.3	1.0	*	-0.3	46.0
1998	20.0	19.2	-0.3	1.1	*	0.8	43.1
1999	20.0	18.6	*	1.4	*	1.4	39.8
2000	20.9	18.4	0.9	1.6	*	2.4	35.1
2001	19.8	18.6	-0.3	1.6	*	1.3	33.1
2002	17.9	19.4	-3.1	1.5	*	-1.5	34.1
2003	16.5	19.9	-5.0	1.4	*	-3.5	36.1

Source: Congressional Budget Office.

Note: n.a. = not applicable; * = between -0.05 percent and 0.05 percent.

a. From 1962 through 1988, the Postal Service was on-budget.

b. End of year.

Table F-3.

Revenues by Major Source, 1962 to 2003

(Billions of dollars)

	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Excise Taxes	Estate and Gift Taxes	Customs Duties	Miscellaneous Receipts	Total Revenues
1962	45.6	20.5	17.0	12.5	2.0	1.1	0.8	99.7
1963	47.6	21.6	19.8	13.2	2.2	1.2	1.0	106.6
1964	48.7	23.5	22.0	13.7	2.4	1.3	1.1	112.6
1965	48.8	25.5	22.2	14.6	2.7	1.4	1.6	116.8
1966	55.4	30.1	25.5	13.1	3.1	1.8	1.9	130.8
1967	61.5	34.0	32.6	13.7	3.0	1.9	2.1	148.8
1968	68.7	28.7	33.9	14.1	3.1	2.0	2.5	153.0
1969	87.2	36.7	39.0	15.2	3.5	2.3	2.9	186.9
1970	90.4	32.8	44.4	15.7	3.6	2.4	3.4	192.8
1971	86.2	26.8	47.3	16.6	3.7	2.6	3.9	187.1
1972	94.7	32.2	52.6	15.5	5.4	3.3	3.6	207.3
1973	103.2	36.2	63.1	16.3	4.9	3.2	3.9	230.8
1974	119.0	38.6	75.1	16.8	5.0	3.3	5.4	263.2
1975	122.4	40.6	84.5	16.6	4.6	3.7	6.7	279.1
1976	131.6	41.4	90.8	17.0	5.2	4.1	8.0	298.1
1977	157.6	54.9	106.5	17.5	7.3	5.2	6.5	355.6
1978	181.0	60.0	121.0	18.4	5.3	6.6	7.4	399.6
1979	217.8	65.7	138.9	18.7	5.4	7.4	9.3	463.3
1980	244.1	64.6	157.8	24.3	6.4	7.2	12.7	517.1
1981	285.9	61.1	182.7	40.8	6.8	8.1	13.8	599.3
1982	297.7	49.2	201.5	36.3	8.0	8.9	16.2	617.8
1983	288.9	37.0	209.0	35.3	6.1	8.7	15.6	600.6
1984	298.4	56.9	239.4	37.4	6.0	11.4	17.1	666.5
1985	334.5	61.3	265.2	36.0	6.4	12.1	18.6	734.1
1986	349.0	63.1	283.9	32.9	7.0	13.3	20.0	769.2
1987	392.6	83.9	303.3	32.5	7.5	15.1	19.5	854.4
1988	401.2	94.5	334.3	35.2	7.6	16.2	20.3	909.3
1989	445.7	103.3	359.4	34.4	8.7	16.3	23.3	991.2
1990	466.9	93.5	380.0	35.3	11.5	16.7	28.0	1,032.0
1991	467.8	98.1	396.0	42.4	11.1	15.9	23.6	1,055.0
1992	476.0	100.3	413.7	45.6	11.1	17.4	27.3	1,091.3
1993	509.7	117.5	428.3	48.1	12.6	18.8	19.5	1,154.4
1994	543.1	140.4	461.5	55.2	15.2	20.1	23.2	1,258.6
1995	590.2	157.0	484.5	57.5	14.8	19.3	28.6	1,351.8
1996	656.4	171.8	509.4	54.0	17.2	18.7	25.5	1,453.1
1997	737.5	182.3	539.4	56.9	19.8	17.9	25.5	1,579.3
1998	828.6	188.7	571.8	57.7	24.1	18.3	32.7	1,721.8
1999	879.5	184.7	611.8	70.4	27.8	18.3	34.9	1,827.5
2000	1,004.5	207.3	652.9	68.9	29.0	19.9	42.8	2,025.2
2001	994.3	151.1	694.0	66.2	28.4	19.4	37.8	1,991.2
2002	858.3	148.0	700.8	67.0	26.5	18.6	33.9	1,853.2
2003	793.7	131.8	713.0	67.5	22.0	19.9	34.5	1,782.3

Source: Congressional Budget Office.

Table F-4.

Revenues by Major Source, 1962 to 2003

(Percentage of GDP)

	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Excise Taxes	Estate and Gift Taxes	Customs Duties	Miscellaneous Receipts	Total Revenues
1962	8.0	3.6	3.0	2.2	0.4	0.2	0.1	17.5
1963	7.9	3.6	3.3	2.2	0.4	0.2	0.2	17.8
1964	7.6	3.7	3.4	2.1	0.4	0.2	0.2	17.5
1965	7.1	3.7	3.2	2.1	0.4	0.2	0.2	17.0
1966	7.3	4.0	3.4	1.7	0.4	0.2	0.2	17.3
1967	7.6	4.2	4.0	1.7	0.4	0.2	0.3	18.3
1968	7.9	3.3	3.9	1.6	0.4	0.2	0.3	17.6
1969	9.2	3.9	4.1	1.6	0.4	0.2	0.3	19.7
1970	8.9	3.2	4.4	1.5	0.4	0.2	0.3	19.0
1971	8.0	2.5	4.4	1.5	0.3	0.2	0.4	17.3
1972	8.0	2.7	4.5	1.3	0.5	0.3	0.3	17.6
1973	7.9	2.8	4.8	1.2	0.4	0.2	0.3	17.6
1974	8.3	2.7	5.2	1.2	0.3	0.2	0.4	18.3
1975	7.8	2.6	5.4	1.1	0.3	0.2	0.4	17.9
1976	7.6	2.4	5.2	1.0	0.3	0.2	0.5	17.2
1977	8.0	2.8	5.4	0.9	0.4	0.3	0.3	18.0
1978	8.2	2.7	5.5	0.8	0.2	0.3	0.3	18.0
1979	8.7	2.6	5.5	0.7	0.2	0.3	0.4	18.5
1980	8.9	2.4	5.8	0.9	0.2	0.3	0.5	18.9
1981	9.3	2.0	6.0	1.3	0.2	0.3	0.5	19.6
1982	9.2	1.5	6.2	1.1	0.2	0.3	0.5	19.1
1983	8.4	1.1	6.1	1.0	0.2	0.3	0.5	17.4
1984	7.8	1.5	6.2	1.0	0.2	0.3	0.4	17.3
1985	8.1	1.5	6.4	0.9	0.2	0.3	0.4	17.7
1986	7.9	1.4	6.5	0.7	0.2	0.3	0.5	17.5
1987	8.4	1.8	6.5	0.7	0.2	0.3	0.4	18.4
1988	8.0	1.9	6.7	0.7	0.2	0.3	0.4	18.1
1989	8.2	1.9	6.6	0.6	0.2	0.3	0.4	18.3
1990	8.1	1.6	6.6	0.6	0.2	0.3	0.5	18.0
1991	7.9	1.7	6.7	0.7	0.2	0.3	0.4	17.8
1992	7.7	1.6	6.6	0.7	0.2	0.3	0.4	17.5
1993	7.8	1.8	6.5	0.7	0.2	0.3	0.3	17.6
1994	7.8	2.0	6.6	0.8	0.2	0.3	0.3	18.1
1995	8.1	2.1	6.6	0.8	0.2	0.3	0.4	18.5
1996	8.5	2.2	6.6	0.7	0.2	0.2	0.3	18.9
1997	9.0	2.2	6.6	0.7	0.2	0.2	0.3	19.3
1998	9.6	2.2	6.6	0.7	0.3	0.2	0.4	20.0
1999	9.6	2.0	6.7	0.8	0.3	0.2	0.4	20.0
2000	10.3	2.1	6.7	0.7	0.3	0.2	0.4	20.9
2001	9.9	1.5	6.9	0.7	0.3	0.2	0.4	19.8
2002	8.3	1.4	6.8	0.6	0.3	0.2	0.3	17.9
2003	7.3	1.2	6.6	0.6	0.2	0.2	0.3	16.5

Source: Congressional Budget Office.

Table F-5.

Outlays for Major Spending Categories, 1962 to 2003

(Billions of dollars)

		Entitlements and Other Mandatory Spending			
	Discretionary Spending	Programmatic Spending[a]	Offsetting Receipts	Net Interest	Total Outlays
1962	72.1	34.7	-6.8	6.9	106.8
1963	75.3	36.2	-7.9	7.7	111.3
1964	79.1	38.9	-7.7	8.2	118.5
1965	77.8	39.7	-7.9	8.6	118.2
1966	90.1	43.4	-8.4	9.4	134.5
1967	106.5	50.9	-10.2	10.3	157.5
1968	118.0	59.7	-10.6	11.1	178.1
1969	117.3	64.6	-11.0	12.7	183.6
1970	120.3	72.5	-11.5	14.4	195.6
1971	122.5	86.9	-14.1	14.8	210.2
1972	128.5	100.8	-14.1	15.5	230.7
1973	130.4	116.0	-18.0	17.3	245.7
1974	138.2	130.9	-21.2	21.4	269.4
1975	158.0	169.4	-18.3	23.2	332.3
1976	175.6	189.1	-19.6	26.7	371.8
1977	197.1	203.7	-21.5	29.9	409.2
1978	218.7	227.4	-22.8	35.5	458.7
1979	240.0	247.0	-25.6	42.6	504.0
1980	276.3	291.2	-29.2	52.5	590.9
1981	307.9	339.4	-37.9	68.8	678.2
1982	326.0	370.8	-36.0	85.0	745.7
1983	353.3	410.6	-45.3	89.8	808.4
1984	379.4	405.6	-44.2	111.1	851.9
1985	415.8	448.2	-47.1	129.5	946.4
1986	438.5	461.8	-45.9	136.0	990.4
1987	444.2	474.2	-52.9	138.6	1,004.1
1988	464.4	505.0	-56.8	151.8	1,064.5
1989	488.8	548.6	-63.8	169.0	1,143.6
1990	500.6	626.9	-58.7	184.3	1,253.2
1991	533.3	702.3	-105.7	194.4	1,324.4
1992	533.8	716.8	-68.4	199.3	1,381.7
1993	539.4	738.0	-66.6	198.7	1,409.5
1994	541.4	786.1	-68.5	202.9	1,461.9
1995	544.9	818.5	-79.7	232.1	1,515.8
1996	532.7	858.7	-71.9	241.1	1,560.5
1997	547.2	896.3	-86.3	244.0	1,601.3
1998	552.1	938.6	-79.2	241.1	1,652.6
1999	572.0	976.8	-76.6	229.8	1,701.9
2000	614.8	1,029.8	-78.8	223.0	1,788.8
2001	649.3	1,095.2	-86.8	206.2	1,863.8
2002	734.4	1,196.6	-91.0	171.0	2,011.0
2003	825.7	1,279.0	-100.2	153.1	2,157.6

Source: Congressional Budget Office.

a. Excludes offsetting receipts.

Table F-6.

Outlays for Major Spending Categories, 1962 to 2003

(Percentage of GDP)

		Entitlements and Other Mandatory Spending			
	Discretionary Spending	Programmatic Spending[a]	Offsetting Receipts	Net Interest	Total Outlays
1962	12.7	6.1	-1.2	1.2	18.8
1963	12.5	6.0	-1.3	1.3	18.5
1964	12.3	6.1	-1.2	1.3	18.5
1965	11.3	5.8	-1.1	1.2	17.2
1966	11.9	5.7	-1.1	1.2	17.8
1967	13.1	6.3	-1.3	1.3	19.4
1968	13.6	6.9	-1.2	1.3	20.5
1969	12.4	6.8	-1.2	1.3	19.3
1970	11.9	7.2	-1.1	1.4	19.3
1971	11.3	8.0	-1.3	1.4	19.4
1972	10.9	8.6	-1.2	1.3	19.6
1973	9.9	8.8	-1.4	1.3	18.7
1974	9.6	9.1	-1.5	1.5	18.7
1975	10.1	10.9	-1.2	1.5	21.3
1976	10.1	10.9	-1.1	1.5	21.4
1977	10.0	10.3	-1.1	1.5	20.7
1978	9.9	10.2	-1.0	1.6	20.7
1979	9.6	9.9	-1.0	1.7	20.1
1980	10.1	10.7	-1.1	1.9	21.6
1981	10.1	11.1	-1.2	2.2	22.2
1982	10.1	11.5	-1.1	2.6	23.1
1983	10.3	11.9	-1.3	2.6	23.5
1984	9.9	10.5	-1.2	2.9	22.1
1985	10.0	10.8	-1.1	3.1	22.9
1986	10.0	10.5	-1.0	3.1	22.5
1987	9.5	10.2	-1.1	3.0	21.6
1988	9.3	10.1	-1.1	3.0	21.2
1989	9.0	10.2	-1.2	3.1	21.2
1990	8.7	10.9	-1.0	3.2	21.8
1991	9.0	11.8	-1.8	3.3	22.3
1992	8.6	11.5	-1.1	3.2	22.2
1993	8.2	11.2	-1.0	3.0	21.5
1994	7.8	11.3	-1.0	2.9	21.0
1995	7.4	11.2	-1.1	3.2	20.7
1996	6.9	11.2	-0.9	3.1	20.3
1997	6.7	10.9	-1.1	3.0	19.5
1998	6.4	10.9	-0.9	2.8	19.2
1999	6.3	10.7	-0.8	2.5	18.6
2000	6.3	10.6	-0.8	2.3	18.4
2001	6.5	10.9	-0.9	2.1	18.6
2002	7.1	11.5	-0.9	1.6	19.4
2003	7.6	11.8	-0.9	1.4	19.9

Source: Congressional Budget Office.

a. Excludes offsetting receipts.

Table F-7.

Discretionary Outlays, 1962 to 2003

(Billions of dollars)

	Defense	International	Domestic	Total
1962	52.6	5.5	14.0	72.1
1963	53.7	5.2	16.3	75.3
1964	55.0	4.6	19.5	79.1
1965	51.0	4.7	22.1	77.8
1966	59.0	5.1	26.1	90.1
1967	72.0	5.3	29.1	106.5
1968	82.2	4.9	31.0	118.0
1969	82.7	4.1	30.5	117.3
1970	81.9	4.0	34.4	120.3
1971	79.0	3.8	39.8	122.5
1972	79.3	4.6	44.6	128.5
1973	77.1	4.8	48.5	130.4
1974	80.7	6.2	51.3	138.2
1975	87.6	8.2	62.2	158.0
1976	89.9	7.5	78.2	175.6
1977	97.5	8.0	91.5	197.1
1978	104.6	8.5	105.5	218.7
1979	116.8	9.1	114.1	240.0
1980	134.6	12.8	128.9	276.3
1981	158.0	13.6	136.3	307.9
1982	185.9	12.9	127.1	326.0
1983	209.9	13.6	129.8	353.3
1984	228.0	16.3	135.1	379.4
1985	253.1	17.4	145.3	415.8
1986	273.8	17.7	147.0	438.5
1987	282.5	15.2	146.5	444.2
1988	290.9	15.7	157.8	464.4
1989	304.0	16.6	168.2	488.8
1990	300.1	19.1	181.4	500.6
1991	319.7	19.7	193.9	533.3
1992	302.6	19.2	212.1	533.8
1993	292.4	21.6	225.4	539.4
1994	282.3	20.8	238.3	541.4
1995	273.6	20.1	251.2	544.9
1996	266.0	18.3	248.4	532.7
1997	271.7	19.0	256.6	547.2
1998	270.2	18.1	263.8	552.1
1999	275.5	19.5	277.0	572.0
2000	295.0	21.3	298.6	614.8
2001	306.1	22.5	320.8	649.3
2002	348.9	26.2	359.2	734.4
2003	404.9	27.9	392.8	825.7

Source: Congressional Budget Office.

Table F-8.

Discretionary Outlays, 1962 to 2003

(Percentage of GDP)

	Defense	International	Domestic	Total
1962	9.2	1.0	2.5	12.7
1963	8.9	0.9	2.7	12.5
1964	8.6	0.7	3.0	12.3
1965	7.4	0.7	3.2	11.3
1966	7.8	0.7	3.4	11.9
1967	8.9	0.7	3.6	13.1
1968	9.4	0.6	3.6	13.6
1969	8.7	0.4	3.2	12.4
1970	8.1	0.4	3.4	11.9
1971	7.3	0.3	3.7	11.3
1972	6.7	0.4	3.8	10.9
1973	5.9	0.4	3.7	9.9
1974	5.6	0.4	3.6	9.6
1975	5.6	0.5	4.0	10.1
1976	5.2	0.4	4.5	10.1
1977	4.9	0.4	4.6	10.0
1978	4.7	0.4	4.8	9.9
1979	4.7	0.4	4.6	9.6
1980	4.9	0.5	4.7	10.1
1981	5.2	0.4	4.5	10.1
1982	5.8	0.4	3.9	10.1
1983	6.1	0.4	3.8	10.3
1984	5.9	0.4	3.5	9.9
1985	6.1	0.4	3.5	10.0
1986	6.2	0.4	3.3	10.0
1987	6.1	0.3	3.1	9.5
1988	5.8	0.3	3.1	9.3
1989	5.6	0.3	3.1	9.0
1990	5.2	0.3	3.2	8.7
1991	5.4	0.3	3.3	9.0
1992	4.9	0.3	3.4	8.6
1993	4.5	0.3	3.4	8.2
1994	4.1	0.3	3.4	7.8
1995	3.7	0.3	3.4	7.4
1996	3.5	0.2	3.2	6.9
1997	3.3	0.2	3.1	6.7
1998	3.1	0.2	3.1	6.4
1999	3.0	0.2	3.0	6.3
2000	3.0	0.2	3.1	6.3
2001	3.0	0.2	3.2	6.5
2002	3.4	0.3	3.5	7.1
2003	3.7	0.3	3.6	7.6

Source: Congressional Budget Office.

Table F-9.

Outlays for Entitlements and Other Mandatory Spending, 1962 to 2003

(Billions of dollars)

	Social Security	Medicare	Medicaid	Income Support[a]	Other Retirement and Disability	Other Programs	Offsetting Receipts	Total
1962	14.0	0	0.1	6.1	6.7	7.7	-6.8	27.9
1963	15.5	0	0.2	6.0	7.2	7.3	-7.9	28.3
1964	16.2	0	0.2	6.0	7.5	8.9	-7.7	31.2
1965	17.1	0	0.3	5.4	7.9	9.0	-7.9	31.8
1966	20.3	*	0.8	5.1	8.4	8.8	-8.4	35.0
1967	21.3	3.2	1.2	5.1	9.3	10.9	-10.2	40.7
1968	23.3	5.1	1.8	5.9	10.1	13.4	-10.6	49.1
1969	26.7	6.3	2.3	6.5	11.1	11.8	-11.0	53.6
1970	29.6	6.8	2.7	8.2	12.4	12.8	-11.5	61.0
1971	35.1	7.5	3.4	13.4	14.5	13.0	-14.1	72.8
1972	39.4	8.4	4.6	16.4	16.2	15.8	-14.1	86.7
1973	48.2	9.0	4.6	14.5	18.5	21.3	-18.0	98.0
1974	55.0	10.7	5.8	17.4	20.9	21.1	-21.2	109.7
1975	63.6	14.1	6.8	28.9	26.4	29.6	-18.3	151.1
1976	72.7	16.9	8.6	37.6	27.7	25.6	-19.6	169.5
1977	83.7	20.8	9.9	34.6	31.2	23.6	-21.5	182.2
1978	92.4	24.3	10.7	32.1	33.9	34.0	-22.8	204.6
1979	102.6	28.2	12.4	32.2	38.7	32.9	-25.6	221.4
1980	117.1	34.0	14.0	44.3	44.4	37.6	-29.2	262.1
1981	137.9	41.3	16.8	49.9	50.8	42.7	-37.9	301.6
1982	153.9	49.2	17.4	53.2	55.0	42.1	-36.0	334.8
1983	168.5	55.5	19.0	64.0	58.0	45.6	-45.3	365.2
1984	176.1	61.0	20.1	51.7	59.8	37.0	-44.2	361.3
1985	186.4	69.6	22.7	52.3	61.0	56.3	-47.1	401.1
1986	196.5	74.2	25.0	54.2	63.4	48.4	-45.9	415.9
1987	205.1	79.9	27.4	55.0	66.5	40.2	-52.9	421.3
1988	216.8	85.7	30.5	57.3	71.1	43.7	-56.8	448.2
1989	230.4	94.3	34.6	60.8	74.6	54.9	-63.8	485.8
1990	246.5	107.4	41.1	68.4	76.1	87.4	-58.7	568.2
1991	266.8	114.2	52.5	86.6	82.2	100.0	-105.7	596.6
1992	285.2	129.4	67.8	110.0	84.8	39.6	-68.4	648.5
1993	302.0	143.1	75.8	116.1	87.2	13.8	-66.6	671.4
1994	316.9	159.5	82.0	115.3	93.2	19.0	-68.5	717.5
1995	333.3	177.1	89.1	116.0	95.5	7.6	-79.7	738.8
1996	347.1	191.3	92.0	121.0	96.9	10.5	-71.9	786.8
1997	362.3	207.9	95.6	121.9	102.3	6.4	-86.3	810.0
1998	376.1	211.0	101.2	121.6	105.0	23.6	-79.2	859.4
1999	387.0	209.3	108.0	128.6	105.1	38.8	-76.6	900.1
2000	406.0	216.0	117.9	133.5	113.8	42.6	-78.8	951.0
2001	429.4	237.9	129.4	142.7	116.3	39.6	-86.8	1,008.4
2002	452.1	253.7	147.5	179.9	124.9	38.6	-91.0	1,105.7
2003	470.6	274.2	160.7	196.4	129.4	47.8	-100.2	1,178.9

Source: Congressional Budget Office.

Note: * = between zero and $50 million.

a. Includes unemployment compensation, Supplemental Security Income, the refundable portion of the earned income and child tax credits, Food Stamps, family support, child nutrition, and foster care.

Table F-10.

Outlays for Entitlements and Other Mandatory Spending, 1962 to 2003

(Percentage of GDP)

	Social Security	Medicare	Medicaid	Income Support[a]	Other Retirement and Disability	Other Programs	Offsetting Receipts	Total
1962	2.5	0	*	1.1	1.2	1.4	-1.2	4.9
1963	2.6	0	*	1.0	1.2	1.2	-1.3	4.7
1964	2.5	0	*	0.9	1.2	1.4	-1.2	4.9
1965	2.5	0	*	0.8	1.1	1.3	-1.1	4.6
1966	2.7	*	0.1	0.7	1.1	1.2	-1.1	4.6
1967	2.6	0.4	0.1	0.6	1.1	1.3	-1.3	5.0
1968	2.7	0.6	0.2	0.7	1.2	1.5	-1.2	5.6
1969	2.8	0.7	0.2	0.7	1.2	1.2	-1.2	5.6
1970	2.9	0.7	0.3	0.8	1.2	1.3	-1.1	6.0
1971	3.2	0.7	0.3	1.2	1.3	1.2	-1.3	6.7
1972	3.3	0.7	0.4	1.4	1.4	1.3	-1.2	7.4
1973	3.7	0.7	0.4	1.1	1.4	1.6	-1.4	7.5
1974	3.8	0.7	0.4	1.2	1.4	1.5	-1.5	7.6
1975	4.1	0.9	0.4	1.9	1.7	1.9	-1.2	9.7
1976	4.2	1.0	0.5	2.2	1.6	1.5	-1.1	9.8
1977	4.2	1.1	0.5	1.8	1.6	1.2	-1.1	9.2
1978	4.2	1.1	0.5	1.4	1.5	1.5	-1.0	9.2
1979	4.1	1.1	0.5	1.3	1.5	1.3	-1.0	8.8
1980	4.3	1.2	0.5	1.6	1.6	1.4	-1.1	9.6
1981	4.5	1.3	0.6	1.6	1.7	1.4	-1.2	9.9
1982	4.8	1.5	0.5	1.6	1.7	1.3	-1.1	10.4
1983	4.9	1.6	0.6	1.9	1.7	1.3	-1.3	10.6
1984	4.6	1.6	0.5	1.3	1.6	1.0	-1.2	9.4
1985	4.5	1.7	0.5	1.3	1.5	1.4	-1.1	9.7
1986	4.5	1.7	0.6	1.2	1.4	1.1	-1.0	9.5
1987	4.4	1.7	0.6	1.2	1.4	0.9	-1.1	9.1
1988	4.3	1.7	0.6	1.1	1.4	0.9	-1.1	8.9
1989	4.3	1.7	0.6	1.1	1.4	1.0	-1.2	9.0
1990	4.3	1.9	0.7	1.2	1.3	1.5	-1.0	9.9
1991	4.5	1.9	0.9	1.5	1.4	1.7	-1.8	10.1
1992	4.6	2.1	1.1	1.8	1.4	0.6	-1.1	10.4
1993	4.6	2.2	1.2	1.8	1.3	0.2	-1.0	10.2
1994	4.6	2.3	1.2	1.7	1.3	0.3	-1.0	10.3
1995	4.6	2.4	1.2	1.6	1.3	0.1	-1.1	10.1
1996	4.5	2.5	1.2	1.6	1.3	0.1	-0.9	10.2
1997	4.4	2.5	1.2	1.5	1.2	0.1	-1.1	9.9
1998	4.3	2.4	1.2	1.4	1.2	0.3	-0.9	9.9
1999	4.2	2.3	1.2	1.4	1.1	0.4	-0.8	9.8
2000	4.2	2.2	1.2	1.4	1.2	0.4	-0.8	9.8
2001	4.3	2.4	1.3	1.4	1.2	0.4	-0.9	10.1
2002	4.4	2.5	1.4	1.7	1.2	0.4	-0.9	10.7
2003	4.3	2.5	1.5	1.8	1.2	0.4	-0.9	10.9

Source: Congressional Budget Office.

Note: * = between -0.05 percent and 0.05 percent.

a. Includes unemployment compensation, Supplemental Security Income, the refundable portion of the earned income and child tax credits, Food Stamps, family support, child nutrition, and foster care.

Table F-11.

Surpluses, Deficits, Debt, and Related Series, 1962 to 2003

	Billions of Dollars			Percentage of Potential GDP			GDP (Billions of dollars)	
	Surplus or Deficit (-)	Standardized-Budget Surplus or Deficit (-)[a]	Debt Held by the Public	Surplus or Deficit (-)	Standardized-Budget Surplus or Deficit (-)[a]	Debt Held by the Public	Actual[b]	Potential
1962	-7	-4	248	-1.2	-0.7	43.6	569	576
1963	-5	-4	254	-0.8	-0.6	42.3	600	605
1964	-6	-7	257	-0.9	-1.0	40.0	642	637
1965	-1	-5	261	-0.2	-0.8	37.9	688	675
1966	-4	-15	264	-0.5	-2.1	34.8	757	720
1967	-9	-21	267	-1.1	-2.8	32.8	812	777
1968	-25	-32	290	-3.0	-3.7	33.3	870	842
1969	3	-11	278	0.4	-1.2	29.3	949	917
1970	-3	-6	283	-0.3	-0.6	27.9	1,014	1,004
1971	-23	-10	303	-2.1	-0.9	28.0	1,082	1,091
1972	-23	-20	322	-2.0	-1.7	27.4	1,178	1,180
1973	-15	-22	341	-1.2	-1.7	26.0	1,314	1,275
1974	-6	1	344	-0.4	0.1	23.8	1,442	1,416
1975	-53	2	395	-3.3	0.1	25.3	1,559	1,617
1976	-74	-36	477	-4.1	-2.0	27.5	1,736	1,788
1977	-54	-22	549	-2.7	-1.1	27.8	1,975	2,001
1978	-59	-34	607	-2.7	-1.5	27.4	2,219	2,213
1979	-41	-18	640	-1.6	-0.7	25.6	2,505	2,473
1980	-74	-11	712	-2.7	-0.4	26.1	2,732	2,777
1981	-79	-13	789	-2.5	-0.4	25.8	3,060	3,130
1982	-128	-38	925	-3.7	-1.1	28.6	3,231	3,438
1983	-208	-109	1,137	-5.6	-3.0	33.0	3,442	3,685
1984	-185	-143	1,307	-4.7	-3.6	34.0	3,847	3,932
1985	-212	-178	1,507	-5.1	-4.3	36.4	4,142	4,186
1986	-221	-211	1,741	-5.0	-4.8	39.6	4,398	4,425
1987	-150	-157	1,890	-3.2	-3.4	40.6	4,654	4,692
1988	-155	-128	2,052	-3.1	-2.6	40.9	5,017	4,995
1989	-152	-121	2,191	-2.9	-2.3	40.5	5,407	5,343
1990	-221	-124	2,412	-3.9	-2.2	42.0	5,738	5,704
1991	-269	-148	2,689	-4.4	-2.4	45.4	5,928	6,086
1992	-290	-186	3,000	-4.5	-2.9	48.2	6,222	6,402
1993	-255	-188	3,248	-3.8	-2.8	49.5	6,561	6,713
1994	-203	-142	3,433	-2.9	-2.0	49.4	6,949	7,033
1995	-164	-147	3,604	-2.2	-2.0	49.2	7,323	7,381
1996	-107	-96	3,734	-1.4	-1.2	48.5	7,700	7,750
1997	-22	-83	3,772	-0.3	-1.0	46.0	8,194	8,151
1998	69	-32	3,721	0.8	-0.4	43.0	8,628	8,545
1999	126	12	3,632	1.4	0.1	39.7	9,127	8,962
2000	236	108	3,410	2.5	1.1	35.1	9,708	9,464
2001	127	106	3,320	1.3	1.1	33.1	10,041	10,038
2002	-158	-146	3,540	-1.5	-1.4	34.3	10,373	10,519
2003	-375	-313	3,914	-3.4	-2.8	36.1	10,829	11,052

Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

a. Excludes deposit insurance, receipts from auctions of licenses to use the electromagnetic spectrum, timing adjustments, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

b. CBO calculated fiscal year numbers from quarterly national income and product account data from the Bureau of Economic Analysis.

Table F-12.

Standardized-Budget Surplus or Deficit and Related Series, 1962 to 2003

(Billions of dollars)

	Budget Surplus or Deficit (-)	-	Cyclical Surplus or Deficit (-)	+	Other Adjustments[a]	=	Standardized-Budget Surplus or Deficit (-)	Revenues	Outlays
1962	-7		-2		1		-4	99	104
1963	-5		-2		*		-4	106	110
1964	-6		2		1		-7	108	115
1965	-1		5		1		-5	110	115
1966	-4		14		3		-15	115	130
1967	-9		13		*		-21	132	153
1968	-25		11		5		-32	139	171
1969	3		15		*		-11	162	173
1970	-3		6		2		-6	178	184
1971	-23		-4		9		-10	187	197
1972	-23		*		4		-20	200	220
1973	-15		15		8		-22	212	234
1974	-6		10		18		1	251	249
1975	-53		-23		32		2	300	297
1976	-74		-24		14		-36	309	345
1977	-54		-12		20		-22	356	378
1978	-59		3		29		-34	388	422
1979	-41		13		35		-18	442	460
1980	-74		-19		43		-11	521	532
1981	-79		-28		38		-13	610	623
1982	-128		-67		23		-38	661	698
1983	-208		-91		7		-109	657	766
1984	-185		-31		12		-143	674	816
1985	-212		-17		17		-178	724	902
1986	-221		-11		-1		-211	747	958
1987	-150		-12		-20		-157	815	972
1988	-155		10		37		-128	867	995
1989	-152		23		55		-121	934	1,055
1990	-221		12		109		-124	989	1,113
1991	-269		-51		70		-148	1,071	1,219
1992	-290		-68		36		-186	1,127	1,313
1993	-255		-57		10		-188	1,171	1,359
1994	-203		-32		30		-142	1,249	1,391
1995	-164		-17		*		-147	1,330	1,477
1996	-107		-17		-6		-96	1,415	1,511
1997	-22		16		-45		-83	1,493	1,576
1998	69		34		-67		-32	1,598	1,630
1999	126		62		-52		12	1,679	1,667
2000	236		93		-35		108	1,823	1,714
2001	127		10		-11		106	1,908	1,802
2002	-158		-55		-42		-146	1,816	1,962
2003	-375		-70		-8		-313	1,789	2,101

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million.

a. Consists of deposit insurance, receipts from auctions of licenses to use the electromagnetic spectrum, timing adjustments, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

Table F-13.

Standardized-Budget Surplus or Deficit and Related Series, 1962 to 2003

(Percentage of potential GDP)

	Budget Surplus or Deficit (-)	-	Cyclical Surplus or Deficit (-)	+	Other Adjustments[a]	=	Standardized-Budget Surplus or Deficit (-)	Revenues	Outlays
1962	-1.2		-0.4		0.1		-0.7	17.3	18.0
1963	-0.8		-0.3		-0.1		-0.6	17.5	18.1
1964	-0.9		0.3		0.2		-1.0	17.0	18.0
1965	-0.2		0.8		0.2		-0.8	16.2	17.0
1966	-0.5		1.9		0.4		-2.1	15.9	18.0
1967	-1.1		1.7		*		-2.8	16.9	19.7
1968	-3.0		1.4		0.6		-3.7	16.5	20.3
1969	0.4		1.6		*		-1.2	17.7	18.9
1970	-0.3		0.6		0.2		-0.6	17.8	18.4
1971	-2.1		-0.3		0.9		-0.9	17.1	18.1
1972	-2.0		*		0.3		-1.7	16.9	18.6
1973	-1.2		1.2		0.6		-1.7	16.7	18.4
1974	-0.4		0.7		1.3		0.1	17.7	17.6
1975	-3.3		-1.4		2.0		0.1	18.5	18.4
1976	-4.1		-1.4		0.8		-2.0	17.3	19.3
1977	-2.7		-0.6		1.0		-1.1	17.8	18.9
1978	-2.7		0.1		1.3		-1.5	17.5	19.1
1979	-1.6		0.5		1.4		-0.7	17.9	18.6
1980	-2.7		-0.7		1.6		-0.4	18.8	19.2
1981	-2.5		-0.9		1.2		-0.4	19.5	19.9
1982	-3.7		-2.0		0.7		-1.1	19.2	20.3
1983	-5.6		-2.5		0.2		-3.0	17.8	20.8
1984	-4.7		-0.8		0.3		-3.6	17.1	20.8
1985	-5.1		-0.4		0.4		-4.3	17.3	21.6
1986	-5.0		-0.3		*		-4.8	16.9	21.7
1987	-3.2		-0.3		-0.4		-3.4	17.4	20.7
1988	-3.1		0.2		0.7		-2.6	17.4	19.9
1989	-2.9		0.4		1.0		-2.3	17.5	19.7
1990	-3.9		0.2		1.9		-2.2	17.3	19.5
1991	-4.4		-0.8		1.1		-2.4	17.6	20.0
1992	-4.5		-1.1		0.6		-2.9	17.6	20.5
1993	-3.8		-0.9		0.1		-2.8	17.4	20.2
1994	-2.9		-0.4		0.4		-2.0	17.8	19.8
1995	-2.2		-0.2		*		-2.0	18.0	20.0
1996	-1.4		-0.2		-0.1		-1.2	18.3	19.5
1997	-0.3		0.2		-0.6		-1.0	18.3	19.3
1998	0.8		0.4		-0.8		-0.4	18.7	19.1
1999	1.4		0.7		-0.6		0.1	18.7	18.6
2000	2.5		1.0		-0.4		1.1	19.3	18.1
2001	1.3		0.1		-0.1		1.1	19.0	18.0
2002	-1.5		-0.5		-0.4		-1.4	17.3	18.6
2003	-3.4		-0.6		-0.1		-2.8	16.2	19.0

Source: Congressional Budget Office.

Note: * = between -0.05 percent and 0.05 percent.

a. Consists of deposit insurance, receipts from auctions of licenses to use the electromagnetic spectrum, timing adjustments, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

APPENDIX

G

Contributors to the Revenue and Spending Projections

The following Congressional Budget Office analysts prepared the revenue and spending projections in this report:

Revenue Projections

Mark Booth	Unit Chief
David Weiner	Unit Chief
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Paul Burnham	Retirement income
Barbara Edwards	Individual income taxes
Ed Harris	Social insurance taxes, corporate income taxes
Robert McClelland	Estate and gift taxes
Larry Ozanne	Capital gains realizations
Kurt Seibert	Earned income tax credit, social insurance taxes
Andrew Shaw	Excise taxes
Thomas Woodward	Federal Reserve System earnings

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Jo Ann Vines	Unit Chief
Kent Christensen	Defense
Sunita D'Monte	International affairs (conduct of foreign affairs and information-exchange activities), veterans' housing
Raymond Hall	Defense (Navy weapons, missile defenses, stockpile sales, atomic energy defense)
Sarah Jennings	Military retirement, veterans' education
David Newman	Defense (infrastructure and procurement)

Sam Papenfuss	Veterans' health care, military health care
Michelle Patterson	Defense (military personnel)
Matt Schmit	Defense (operations and maintenance), homeland security, intelligence programs, radiation exposure compensation
Joseph Whitehill	International affairs (development, security, international financial institutions)
Dwayne Wright	Veterans' compensation and pensions

Health

Tom Bradley	Unit Chief
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Shawn Bishop	Medicare, Federal Employees Health Benefits program
Niall Brennan	Medicare, Public Health Service
Julia Christensen	Medicare, Public Health Service
Anna Cook	Pharmaceuticals
Jeanne De Sa	Medicaid, State Children's Health Insurance Program
Philip Ellis	Medicare
Lyle Nelson	Medicare
Robert Nguyen	Medicare
Margaret Nowak	Medicare, Public Health Service, pharmaceuticals
Eric Rollins	Medicaid, State Children's Health Insurance Program
Shinobu Suzuki	Medicare, Public Health Service
Christopher Topoleski	Medicare, Public Health Service

Human Resources

Paul Cullinan	Unit Chief
Michael Carson	Low Income Home Energy Assistance Program, refugee assistance
Chad Chirico	Housing assistance
Sheila Dacey	Child Support Enforcement, Temporary Assistance for Needy Families, Social Services Block Grants
Kathleen FitzGerald	Food Stamps, nutrition programs
Geoffrey Gerhardt	Federal civilian retirement, Pension Benefit Guaranty Corporation, Supplemental Security Income
Deborah Kalcevic	Education
Kathy Ruffing	Social Security
Christina Hawley Sadoti	Unemployment insurance, training programs, Administration on Aging, foster care
Donna Wong	Elementary and secondary education, Pell grants, child care, child and family services, arts and humanities

Natural and Physical Resources

Kim Cawley	Unit Chief
Megan Carroll	Conservation and land management, air transportation
Lisa Cash Driskill	Energy, Outer Continental Shelf receipts
Mark Grabowicz	Justice, Postal Service
Kathleen Gramp	Spectrum auction receipts, energy, science, space, deposit insurance
Greg Hitz	Agriculture
David Hull	Agriculture
James Langley	Agriculture
Susanne Mehlman	Pollution control and abatement, Federal Housing Administration and other housing credit programs
Julie Middleton	Water resources, Federal Emergency Management Agency
Rachel Milberg	Highways, Amtrak, mass transit
Matthew Pickford	General government
Deborah Reis	Recreation, water transportation, community development, natural resources, legislative branch
Lanette Walker	Justice, regional development, Bureau of Indian Affairs
Melissa Zimmerman	Commerce, Small Business Administration, Universal Service Fund

Other

Janet Airis	Unit Chief, Scorekeeping
Theresa Gullo	Unit Chief, State and Local Government Cost Estimates
Jeffrey Holland	Unit Chief, Projections
Edward Blau	Authorization bills
Barry Blom	National income and product accounts, monthly Treasury data
Joanna Capps	Appropriation bills (Agriculture, Interior)
Kenneth Farris	Computer support
Mary Froehlich	Computer support
Ann Futrell	Other interest
Ellen Hays	Federal pay
Leo Lex	State and local finances
Catherine Little	Appropriation bills (VA-HUD, Transportation-Treasury)
Marjorie Miller	State and local finances
Virginia Myers	Appropriation bills (Commerce-Justice-State, foreign operations)
Eric Schatten	Interest on the public debt
Robert Sempsey	Appropriation bills (Labor-HHS, Homeland Security, military construction)
Gerard Trimarco	Other interest
Patrice Watson	Computer support
Jason Wheelock	Appropriation bills (Defense, energy and water)

Glossary

This glossary defines economic and budgetary terms as they relate to the Congressional Budget Office's annual *Budget and Economic Outlook* and for the general information of readers. Some entries sacrifice precision for the sake of brevity and clarity to the lay reader. Where appropriate, entries note the sources of data as follows:

(BEA) refers to the Bureau of Economic Analysis in the Department of Commerce;

(BLS) refers to the Bureau of Labor Statistics in the Department of Labor;

(CBO) refers to the Congressional Budget Office;

(FRB) refers to the Federal Reserve Board; and

(NBER) refers to the National Bureau of Economic Research (a private entity).

accrual accounting: A system of accounting in which revenues are recorded when earned and outlays are recorded when goods are received or services performed, even though the actual receipt of revenues and payment for goods or services may occur, in whole or in part, at a different time. Compare with **cash accounting.**

adjusted gross income (AGI): All income subject to taxation under the individual income tax after subtracting "above-the-line" deductions, such as alimony payments and certain contributions for individual retirement accounts. Personal exemptions and the standard or itemized deductions are subtracted from AGI to determine taxable income.

advance appropriation: Budget authority provided in an appropriation act that is first available for obligation in a fiscal year after the year for which the appropriation was enacted. The amount of the advance appropriation is included in the budget totals for the fiscal year in which it will become available. See **appropriation act, budget authority, fiscal year,** and **obligation;** compare with **forward funding** and **obligation delay.**

aggregate demand: Total purchases of a country's output of goods and services by consumers, businesses, government, and foreigners during a given period. (BEA) Compare with **domestic demand.**

AGI: See **adjusted gross income.**

alternative minimum tax (AMT): A tax intended to limit the extent to which higher-income taxpayers can reduce their tax liability (the amount they owe) through the use of preferences in the tax code. Taxpayers subject to the AMT are required to recalculate their tax liability on the basis of a more limited set of exemptions, deductions, and tax credits than would normally apply. The amount by which a taxpayer's AMT calculation exceeds his or her regular tax calculation is that taxpayer's AMT liability.

appropriation act: Legislation under the jurisdiction of the House and Senate Committees on Appropriations that provides budget authority for federal programs or agencies. By law, such an act has a particular style and title—for example, "An act making appropriations for the Department of Defense for the year ending September 30, 2004." Generally, 13 regular appropriation acts are considered annually to fund the operations of the federal government; the Congress may also consider supplemental or continuing appropriation acts, but each follows the statutory style and title. See **budget authority.**

authorization act: Legislation under the jurisdiction of a committee other than the House and Senate Committees on Appropriations that establishes or continues the operation of a federal program or agency, either indefinitely or for a specified period of time. An authorization act may suggest a level of budget authority needed to fund the program or agency, which is then provided in a future appropriation act. However, for some programs, the autho-

rization itself may provide the budget authority. See **budget authority.**

Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177): Referred to in CBO's reports as the Deficit Control Act, it was originally known as Gramm-Rudman-Hollings. Among other changes to the budget process, the law established specific deficit targets and a sequestration procedure to reduce spending if those targets were exceeded. The Deficit Control Act has been amended and extended several times—most significantly by the Budget Enforcement Act of 1990 (BEA). The BEA established one type of control, the pay-as-you-go procedure, for legislation affecting direct spending and revenues and another type of control, annual spending limits, for discretionary spending. The sequestration procedure—originally applicable to overall deficit targets—was restructured to enforce the discretionary spending limits and pay-as-you-go process separately. However, on September 30, 2002, the discretionary spending caps and the sequestration procedure to enforce those caps expired, and the Office of Management and Budget and CBO were no longer required to record the five-year budgetary effects of legislation affecting direct spending or revenues. Although sequestration under the pay-as-you-go procedure would have continued through 2006 on the basis of laws enacted before September 30, 2002, Public Law 107-312 eliminated that possibility by reducing to zero all pay-as-you-go balances. See **direct spending, discretionary spending, discretionary spending limits (or caps), pay-as-you-go, revenues,** and **sequestration.**

baseline: A benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending. For purposes of the Deficit Control Act, the baseline is the projection of current-year levels of new budget authority, outlays, revenues, and the surplus or deficit into the budget year and out-years based on current laws and policies, calculated following the rules set forth in section 257 of that act. See **fiscal year.**

basis point: One-hundredth of a percentage point. (For example, the difference between interest rates of 5.5 percent and 5.0 percent is 50 basis points.)

***Blue Chip* consensus forecast:** The average of about 50 private-sector economic forecasts compiled and published monthly by Aspen Publishers, Inc.

book depreciation: See **depreciation.**

book profits: Profits calculated using book (or tax) depreciation and standard accounting conventions for inventories. Different from economic profits, book profits are referred to as "profits before tax" in the national income and product accounts. See **depreciation, economic profits,** and **national income and product accounts.**

budget authority: Authority provided by law to incur financial obligations that will result in immediate or future outlays of federal government funds. Budget authority may be provided in an appropriation act or authorization act and may take the form of borrowing authority, contract authority, or authority to obligate and expend offsetting collections or receipts. Offsetting collections and receipts are classified as negative budget authority. See **appropriation act, authorization act, contract authority, offsetting collections, offsetting receipts,** and **outlays.**

Budget Enforcement Act of 1990 (BEA): See **Balanced Budget and Emergency Deficit Control Act of 1985.**

budget function: One of 20 broad categories into which budgetary resources are grouped so that all budget authority and outlays can be presented according to the national interests being addressed. There are 17 broad budget functions, including national defense, international affairs, energy, agriculture, health, income security, and general government. Three other functions—net interest, allowances, and undistributed offsetting receipts—are included to complete the budget. See **budget authority, net interest, offsetting receipts,** and **outlays.**

budget resolution: A concurrent resolution, adopted by both Houses of Congress, that sets forth a Congressional budget plan for the budget year and at least four out-years. The plan consists of spending and revenue targets with which subsequent appropriation acts and authorization acts that affect revenues and direct spending are expected to comply. The targets established in the budget resolution are enforced in each House of Congress through procedural mechanisms set out in law and the rules of each House. See **appropriation act, authorization act, direct spending, fiscal year,** and **revenues.**

budget year: See **fiscal year.**

budgetary resources: All sources of authority provided to federal agencies that permit them to incur financial obligations, including new budget authority, unobligated balances, direct spending authority, and obligation limitations. See **budget authority, direct spending, obligation limitation,** and **unobligated balances.**

business cycle: Fluctuations in overall business activity accompanied by swings in the unemployment rate, interest rates, and corporate profits. Over a business cycle, real activity rises to a peak (its highest level during the cycle), then falls until it reaches a trough (its lowest level following the peak), whereupon it starts to rise again, defining a new cycle. Business cycles are irregular, varying in frequency, magnitude, and duration. (NBER) See **real.**

business fixed investment: Spending by businesses on structures, equipment, and software. Such investment is labeled "fixed" to distinguish it from investment in inventories.

capacity utilization rate: The seasonally adjusted output of the nation's factories, mines, and electric and gas utilities expressed as a percentage of their capacity to produce output. The capacity of a facility is the greatest output it can maintain with a normal work pattern. (FRB)

capital: *Physical capital* is land and the stock of products set aside to support future production and consumption. In the national income and product accounts, *private capital* consists of business inventories, producers' durable equipment, and residential and nonresidential structures. *Financial capital* is funds raised by governments, individuals, or businesses by incurring liabilities such as bonds, mortgages, or stock certificates. *Human capital* is the education, training, work experience, and other attributes that enhance the ability of the labor force to produce goods and services. *Bank capital* is the sum advanced and put at risk by the owners of a bank; it represents the first "cushion" in the event of loss, thereby decreasing the willingness of the owners to take risks in lending. See **consumption** and **national income and product accounts.**

capital input: A measure of the flow of services available for production from the stock of capital goods. Growth in the capital input differs from growth in the capital stock because different types of capital goods (such as equipment, structures, inventories, or land) contribute differently to production.

cash accounting: A system of accounting in which revenues are recorded when actually received and outlays are recorded when payment is made. Compare with **accrual accounting.**

central bank: A government-established agency responsible for conducting monetary policy and overseeing credit conditions. The Federal Reserve System fulfills those functions in the United States. See **Federal Reserve System** and **monetary policy.**

civilian unemployment rate: Unemployment as a percentage of the civilian labor force—that is, the labor force excluding armed forces personnel. (BLS) See **labor force** and **unemployment rate.**

compensation: All income due to employees for their work during a given period. In addition to wages, salaries, bonuses, and stock options, compensation includes fringe benefits and the employer's share of contributions to social insurance programs, such as Social Security. (BEA)

consumer confidence: An index of consumer optimism based on surveys of consumers' attitudes about current and future economic conditions. One such index—the Index of Consumer Sentiment—is constructed by the University of Michigan Survey Research Center. The Conference Board constructs a similar index—the Consumer Confidence Index.

consumer price index (CPI): An index of the cost of living commonly used to measure inflation. The Bureau of Labor Statistics publishes the CPI-U, an index of consumer prices based on the typical market basket of goods and services consumed by all urban consumers during a base period, and the CPI-W, an index of consumer prices based on the typical market basket of goods and services consumed by urban wage earners and clerical workers during a base period. (BLS) See **inflation.**

consumer sentiment index: See **consumer confidence.**

consumption: In principle, the value of goods and services purchased and used up during a given period by households and governments. In practice, the Bureau of Economic Analysis counts purchases of many long-lasting goods (such as cars and clothes) as consumption even though the goods are not used up. Consumption by households alone is also called *consumer spending.* See **national income and product accounts.**

contract authority: Authority in law to enter into contracts or incur other obligations in advance of, or in excess of, funds available for that purpose. Although it is a form of budget authority, contract authority does not provide the funds to make payments. Those funds must be provided later, usually in a subsequent appropriation act (called a liquidating appropriation). Contract authority differs from a federal agency's inherent authority to enter into contracts, which may be exercised only within

the limits of available appropriations. See **appropriation act, budget authority,** and **obligation.**

CPI: See **consumer price index.**

credit reform: A system of budgeting for federal credit activities that focuses on the cost of subsidies conveyed in federal credit assistance. The system was established by the Federal Credit Reform Act of 1990. See **credit subsidy.**

credit subsidy: The estimated long-term cost to the federal government of a direct loan or loan guarantee. That cost is calculated on the basis of net present value, excluding federal administrative costs and any incidental effects on revenues or outlays. For direct loans, the subsidy cost is the net present value of loan disbursements minus repayments of interest and principal, adjusted for estimated defaults, prepayments, fees, penalties, and other recoveries. For loan guarantees, the subsidy cost is the net present value of estimated payments by the government to cover defaults and delinquencies, interest subsidies, or other payments, offset by any payments to the government, including origination and other fees, penalties, and recoveries. See **outlays, present value,** and **revenues.**

current-account balance: The net revenues that arise from a country's international sales and purchases of goods and services plus net international transfers (public or private gifts or donations) and net factor income (primarily capital income from foreign property owned by residents of that country minus capital income from domestic property owned by nonresidents). The current-account balance differs from net exports in that it includes international transfers and net factor income. (BEA) See **net exports.**

current dollar: A measure of spending or revenues in a given year that has not been adjusted for differences in prices (such as inflation) between that year and a base year. See **nominal;** compare with **real.**

current year: See **fiscal year.**

cyclical surplus or deficit: The part of the federal budget surplus or deficit that results from cyclical factors rather than from underlying fiscal policy. This cyclical component reflects the way in which the surplus or deficit automatically increases or decreases during economic expansions or recessions. (CBO) See **deficit, fiscal policy,** and **surplus;** compare with **standardized-budget surplus or deficit.**

debt: The total value of outstanding securities issued by the federal government is referred to as *federal debt* or *gross debt.* It has two components: *debt held by the public* (federal debt held by nonfederal investors, including the Federal Reserve System) and *debt held by government accounts* (federal debt held by federal government trust funds, deposit insurance funds, and other federal accounts). *Debt subject to limit* is federal debt that is subject to a statutory limit on its issuance. The current limit applies to almost all gross debt, except a small portion of the debt issued by the Department of the Treasury and the small amount of debt issued by other federal agencies (primarily the Tennessee Valley Authority and the Postal Service). *Unavailable debt* is debt that is not available for redemption, or the amount of debt that would remain outstanding even if surpluses were large enough to redeem it. Such debt includes securities that have not yet matured (and will be unavailable for repurchase) and nonmarketable securities, such as savings bonds.

debt service: Payment of scheduled interest obligations on outstanding debt. As used in CBO's *Budget and Economic Outlook,* debt service refers to a change in interest payments resulting from a change in estimates of the surplus or deficit.

deficit: The amount by which the federal government's total outlays exceed its total revenues in a given period, typically a fiscal year. See **outlays** and **revenues;** compare with **surplus.**

Deficit Control Act: See **Balanced Budget and Emergency Deficit Control Act of 1985.**

deflation: A drop in general price levels so broadly based that general indexes of prices, such as the consumer price index, register continuing declines. Deflation is usually caused by a collapse of aggregate demand. See **aggregate demand** and **consumer price index**.

deposit insurance: The guarantee by a federal agency that an individual depositor at a participating depository institution will receive the full amount of the deposit (up to $100,000) if the institution becomes insolvent.

depreciation: Decline in the value of a currency, financial asset, or capital good. When applied to a capital good, depreciation usually refers to loss of value because of obsolescence, wear, or destruction (as by fire or flood). *Book depreciation* (also known as tax depreciation) is the depreciation that the tax code allows businesses to deduct when they calculate their taxable profits. It is typically faster

than *economic depreciation,* which represents the actual decline in the value of the asset. Both measures of depreciation appear as part of the national income and product accounts. See **book profits** and **national income and product accounts.**

devaluation: The act of a government to lower the fixed exchange rate of its currency. The government implements a devaluation by announcing that it will no longer maintain the existing rate by buying and selling its currency at that rate. See **exchange rate.**

direct spending: Synonymous with mandatory spending. Direct spending is budget authority provided and controlled by laws other than appropriation acts and the outlays that result from that budget authority. For the purposes of the Deficit Control Act, direct spending includes entitlement authority and the Food Stamp program. See **appropriation act, budget authority, entitlement,** and **outlays;** compare with **discretionary spending.**

discount rate: The interest rate that the Federal Reserve System charges on a loan it makes to a bank. Such loans, when allowed, enable a bank to meet its reserve requirements without reducing its loans.

discouraged workers: Jobless people who are available for work but who are not actively seeking it because they think they have poor prospects for finding a job. Discouraged workers are not counted as part of the labor force or as being unemployed. (BLS) See **labor force** and **unemployment rate.**

discretionary spending: Budget authority that is provided and controlled by appropriation acts and the outlays that result from that budget authority. See **appropriation act** and **outlays;** compare with **direct spending.**

discretionary spending limits (or caps): Statutory ceilings imposed on the amount of budget authority provided in appropriation acts in a fiscal year and on the outlays that are made in that fiscal year. The limits were first established in the Budget Enforcement Act of 1990 and enforced through sequestration. On September 30, 2002, all discretionary spending limits, and the sequestration process to enforce them, expired. See **Balanced Budget and Emergency Deficit Control Act of 1985, budget authority, discretionary spending, outlays,** and **sequestration.**

disposable personal income: *Personal income*—the income that individuals receive, including transfer payments—minus the personal taxes and fees that they pay to governments. (BEA) See **transfer payments.**

domestic demand: Total purchases of goods and services, regardless of origin, by U.S. consumers, businesses, and governments during a given period. Domestic demand equals gross domestic product minus net exports. (BEA) See **gross domestic product** and **net exports;** compare with **aggregate demand.**

ECI: See **employment cost index.**

Economic and Monetary Union (EMU): A currency union consisting of most of the members of the European Union, who in January 1999 aligned their monetary policies under the European Central Bank and adopted a common currency, the euro.

Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16): Referred to in CBO reports as EGTRRA, it was signed into law on June 7, 2001. The law significantly reduces tax liabilities (the amount of tax owed) over the 2001-2010 period by cutting individual income tax rates, increasing the child tax credit, repealing estate taxes, raising deductions for married couples, increasing tax benefits for pensions and individual retirement accounts, and creating additional tax benefits for education. The law phases in many of those changes over time, including some that are not fully effective until 2010. All of the law's provisions are now scheduled to expire on or before December 31, 2010.

economic profits: Profits of corporations, adjusted to remove the distortions in depreciation allowances caused by tax rules and to exclude the effect of inflation on the value of inventories. Economic profits are a better measure of profits from current production than are the book profits reported by corporations. Economic profits are referred to as "corporate profits with inventory valuation and capital consumption adjustments" in the national income and product accounts. (BEA) See **book profits, depreciation,** and **national income and product accounts.**

effective tax rate: The ratio of taxes paid to a given tax base. For individual income taxes, the effective tax rate is typically expressed as the ratio of taxes to adjusted gross income. For corporate income taxes, it is the ratio of taxes to book profits. For some purposes—such as calculating an overall tax rate on all income sources—an effective tax rate is computed on a base that includes the untaxed portion of Social Security benefits, interest on tax-exempt bonds, and similar items. It can also be computed on a

base of personal income as measured by the national income and product accounts. The effective tax rate is a useful measure because the tax code's various exemptions, credits, deductions, and tax rates make actual ratios of taxes to income very different from statutory tax rates. See **adjusted gross income** and **book profits.**

EGTRRA: See **Economic Growth and Tax Relief Reconciliation Act of 2001.**

employment cost index (ECI): An index of the weighted-average cost of an hour of labor—comprising the cost to the employer of wage and salary payments, employee benefits, and contributions for social insurance programs. The ECI is structured so that it is not affected by changes in the mix of occupations or changes in employment by industry. (BLS)

entitlement: A legal obligation of the federal government to make payments to a person, group of persons, business, unit of government, or similar entity that is not controlled by the level of budget authority provided in an appropriation act. The Congress generally controls spending for entitlement programs by setting eligibility criteria and benefit or payment rules. The source of funding to liquidate the obligation may be provided in either the authorization act that created the entitlement or a subsequent appropriation act. The best-known entitlements are the major benefit programs, such as Social Security and Medicare. See **appropriation act, authorization act, budget authority,** and **direct spending.**

exchange rate: The number of units of a foreign currency that can be bought with one unit of the domestic currency, or vice versa.

excise tax: A tax levied on the purchase of a specific type of good or service, such as tobacco products or telephone services.

expansion: A phase of the business cycle extending from the date that gross domestic product exceeds its previous peak to the next peak. (NBER) See **business cycle, gross domestic product,** and **recovery;** compare with **recession.**

expenditure account: An account established within federal funds and trust funds to record appropriations, obligations, and outlays that is usually financed from the associated receipt account. See **federal funds, receipt account,** and **trust funds.**

fan chart: A graphic representation of CBO's baseline projections that includes not only a single line representing the outcome expected under the baseline's economic assumptions but also the various possible outcomes surrounding that line based on the reasonable expectations of error in the underlying assumptions.

federal funds: Part of the budgeting and accounting structure of the federal government. Federal funds are all funds that make up the federal budget except those classified by law as trust funds. Federal funds include several types of funds, one of which is the general fund. See **general fund;** compare with **trust funds.**

federal funds rate: The interest rate that financial institutions charge each other for overnight loans of their monetary reserves. A rise in the federal funds rate (compared with other short-term interest rates) suggests a tightening of monetary policy, whereas a fall suggests an easing. (FRB) See **monetary policy** and **short-term interest rate.**

Federal Open Market Committee: The group within the Federal Reserve System that determines the direction of monetary policy. The open market desk at the Federal Reserve Bank of New York implements that policy with open market operations (the purchase or sale of government securities), which influence short-term interest rates—especially the federal funds rate—and the growth of the money supply. The committee is composed of 12 members, including the seven members of the Board of Governors of the Federal Reserve System, the president of the Federal Reserve Bank of New York, and a rotating group of four of the other 11 presidents of the regional Federal Reserve Banks. See **federal funds rate, Federal Reserve System, monetary policy, money supply,** and **short-term interest rate.**

Federal Reserve System: The central bank of the United States. The Federal Reserve is responsible for conducting the nation's monetary policy and overseeing credit conditions. See **central bank, monetary policy,** and **short-term interest rate.**

financing account: A nonbudgetary account associated with a credit program that holds balances, receives credit subsidy payments from the program account, and includes all cash flows resulting from obligations or commitments made under the credit program since October 1, 1991. The transactions reflected in the financing account are considered a means of financing. See **credit subsidy, means of financing,** and **program account;** compare with **liquidating account.**

fiscal policy: The government's choice of tax and spending programs, which influences the amount and maturity of government debt as well as the level, composition, and distribution of national output and income. Many summary indicators of fiscal policy exist. Some, such as the budget surplus or deficit, are narrowly budgetary. Others attempt to reflect aspects of how fiscal policy affects the economy. For example, a decrease in the *standardized-budget surplus* (or increase in the *standardized-budget deficit*) measures the short-term stimulus of demand that results from higher spending or lower taxes. The *fiscal gap* measures whether current fiscal policy implies a budget that is close enough to balance to be sustainable over the long term. The fiscal gap represents the amount by which taxes would have to be raised, or spending cut, to keep the ratio of debt to GDP from rising forever. Other important measures of fiscal policy include the ratios of total taxes and total spending to GDP. See **debt, deficit, gross domestic product, national income, standardized-budget surplus or deficit**, and **surplus.**

fiscal year: A yearly accounting period. The federal government's fiscal year begins October 1 and is designated by the calendar year in which it ends—for example, fiscal year 2005 begins October 1, 2004, and ends September 30, 2005. The *budget year* is the fiscal year for which the budget is being considered; in relation to a session of Congress, it is the fiscal year that starts on October 1 of the calendar year in which that session of Congress begins. An *out-year* is a fiscal year following the budget year. The *current year* is the fiscal year in progress.

foreign direct investment: Financial investment by which a person or an entity acquires a lasting interest in, and a degree of influence over, the management of a business enterprise in a foreign country. (BEA)

forward funding: The provision of budget authority that becomes available for obligation in the last quarter of a fiscal year and remains available during the following fiscal year. This form of funding typically finances ongoing education grant programs. See **budget authority** and **fiscal year;** compare with **advance appropriation** and **obligation delay.**

GDI: See **gross domestic income.**

GDP: See **gross domestic product.**

GDP gap: The difference between potential and actual GDP, expressed as a percentage of potential GDP. See **potential GDP.**

GDP price index: A summary measure of the prices of all of the goods and services that make up gross domestic product. The change in the GDP price index is used as a measure of inflation in the overall economy. See **gross domestic product** and **inflation.**

general fund: One type of federal fund whose receipt account is credited with federal revenues and offsetting receipts not earmarked by law for a specific purpose and whose expenditure account records amounts provided in appropriation acts or other laws for the general support of the federal government. See **expenditure account, federal funds,** and **receipt account;** compare with **trust funds.**

GNP: See **gross national product.**

grants: Transfer payments from the federal government to state and local governments or other recipients to help fund projects or activities that do not involve substantial federal participation. See **transfer payments.**

grants-in-aid: Grants from the federal government to state and local governments to help provide for programs of assistance or service to the public.

gross debt: See **debt.**

gross domestic income (GDI): The sum of all income earned in the domestic production of goods and services. In theory, GDI should equal GDP, but measurement difficulties leave a statistical discrepancy between the two. (BEA)

gross domestic product (GDP): The total market value of goods and services produced domestically during a given period. The components of GDP are consumption (both household and government), gross investment (both private and government), and net exports. (BEA) See **consumption, gross investment,** and **net exports.**

gross investment: A measure of additions to the capital stock that does not subtract depreciation of existing capital. See **capital** and **depreciation.**

gross national product (GNP): The total market value of goods and services produced during a given period by labor and capital supplied by residents of a country, regardless of where the labor and capital are located. GNP differs from GDP primarily by including the capital income that residents earn from investments abroad and excluding the capital income that nonresidents earn from domestic investment.

inflation: Growth in a general measure of prices, usually expressed as an annual rate of change. See **consumer price index** and **GDP price index.**

infrastructure: Capital goods that provide services to the public, usually with benefits to the community at large as well as to the direct user. Examples include schools, roads, bridges, dams, harbors, and public buildings. See **capital.**

inventories: Stocks of goods held by businesses for further processing or for sale. (BEA)

investment: *Physical investment* is the current product set aside during a given period to be used for future production—in other words, an addition to the stock of capital goods. As measured by the national income and product accounts, private domestic investment consists of investment in residential and nonresidential structures, producers' durable equipment, and the change in business inventories. *Financial investment* is the purchase of a financial security, such as a stock, bond, or mortgage. *Investment in human capital* is spending on education, training, health services, and other activities that increase the productivity of the workforce. Investment in human capital is not treated as investment by the national income and product accounts. See **capital, inventories,** and **national income and product accounts.**

JCWAA: See **Job Creation and Worker Assistance Act of 2002.**

JGTRRA: See **Jobs and Growth Tax Relief Reconciliation Act of 2003.**

Job Creation and Worker Assistance Act of 2002 (Public Law 107-147): Referred to in CBO reports as JCWAA, it was signed into law on March 9, 2002. The law reduced business taxes by providing immediate deduction of a portion of capital purchases, increasing and extending certain other deductions and exemptions, and expanding the ability of unprofitable corporations to receive refunds of past taxes paid. The act also provided certain tax benefits for areas of New York City damaged on September 11, 2001, and additional weeks of unemployment benefits to recipients who exhausted their eligibility for regular state benefits. The tax provisions contained varying expiration dates.

Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108-27): Referred to in CBO reports as JGTRRA, it was signed into law on May 28, 2003. The law reduced taxes by advancing to 2003 the effective date of several tax reductions previously enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001. The act also increased the exemption amount for the individual alternative minimum tax (AMT), decreased the tax rates for income from dividends and capital gains, and expanded the portion of capital purchases that could be immediately deducted by businesses under the Job Creation and Worker Assistance Act of 2002. The tax provisions contained varying expiration dates. The legislation also provided an estimated $20 billion for fiscal relief to states. See **Economic Growth and Tax Relief Reconciliation Act of 2001** and **Job Creation and Worker Assistance Act of 2002.**

labor force: The number of people who have jobs or who are available for work and actively seeking jobs. The *labor force participation rate* is the labor force as a percentage of the noninstitutional population age 16 or older. (BLS)

labor productivity: See **productivity.**

liquidating account: A budgetary account associated with certain credit programs that includes all cash flows resulting from all direct loan obligations and loan guarantee commitments made under those programs before October 1, 1991. See **credit reform;** compare with **financing account.**

liquidity: The ease with which an asset can be sold for cash. An asset is highly liquid if it comes in standard units that are traded daily in large amounts by many buyers and sellers. Among the most liquid of assets are U.S. Treasury securities.

long-term interest rate: The interest rate earned by a note or bond that matures in 10 or more years.

mandatory spending: See **direct spending.**

marginal tax rate: The tax rate that applies to an additional dollar of income.

means of financing: Means by which a budget deficit is financed or a surplus is used. Means of financing are not included in the budget totals. The primary means of financing is borrowing from the public. In general, the cumulative amount borrowed from the public (debt held by the public) will increase if there is a deficit and decrease if there is a surplus, although other factors can affect the amount that the government must borrow. Those factors, known as other means of financing, include reductions (or increases) in the government's cash balances, seigniorage, changes in outstanding checks, changes in accrued

interest costs included in the budget but not yet paid, and cash flows reflected in credit financing accounts. See **debt, deficit, financing account, seigniorage,** and **surplus.**

monetary policy: The strategy of influencing movements of the money supply and interest rates to affect output and inflation. An "easy" monetary policy suggests faster growth of the money supply and initially lower short-term interest rates in an attempt to increase aggregate demand, but it may lead to higher inflation. A "tight" monetary policy suggests slower growth of the money supply and higher interest rates in the near term in an attempt to reduce inflationary pressure by lowering aggregate demand. The Federal Reserve System conducts monetary policy in the United States. See **aggregate demand, Federal Reserve System, inflation, money supply,** and **short-term interest rate.**

money supply: Private assets that can readily be used to make transactions or are easily convertible into assets that can. The money supply includes currency and demand deposits and may also include broader categories of assets, such as other types of deposits and securities.

NAIRU (nonaccelerating inflation rate of unemployment): The unemployment rate hypothetically consistent with a constant inflation rate. An unemployment rate higher than the NAIRU indicates downward pressure on inflation, whereas an unemployment rate lower than the NAIRU indicates upward pressure on inflation. Estimates of the NAIRU are based on the historical relationship between inflation and the unemployment rate. (CBO's procedures for estimating the NAIRU are described in Appendix B of *The Economic and Budget Outlook: An Update,* August 1994.) See **inflation** and **unemployment rate.**

national income: Total income earned by U.S. residents from all sources, including employee compensation (wages, salaries, benefits, and employers' contributions to social insurance programs), corporate profits, net interest, rental income, and proprietors' income.

national income and product accounts (NIPAs): Official U.S. accounts that track the level and composition of gross domestic product, the prices of its components, and the way in which the costs of production are distributed as income. (BEA) See **gross domestic product.**

national saving: Total saving by all sectors of the economy: personal saving, business saving (corporate after-tax profits not paid as dividends), and government saving (the budget surplus). National saving represents all income not consumed, publicly or privately, during a given period. (BEA) See **national income, net national saving,** and **personal saving.**

natural rate of unemployment: The rate of unemployment arising from all sources except fluctuations in aggregate demand. Those sources include *frictional unemployment,* which is associated with normal turnover of jobs; *structural unemployment,* which includes unemployment caused by mismatches between the skills of available workers and the skills necessary to fill vacant positions; and unemployment caused by institutional factors such as legal minimum wages, the presence of unions, and social conventions. See **aggregate demand** and **unemployment rate.**

net exports: Exports of goods and services produced in a country minus the country's imports of goods and services produced elsewhere (sometimes referred to as a trade surplus when net exports are positive or a trade deficit when net exports are negative).

net federal government saving: A term used in the national income and product accounts (NIPAs) to identify the difference between federal current receipts and federal current expenditures (including consumption of fixed capital). When receipts exceed expenditures, net federal government saving is positive (formerly identified in the NIPAs as a federal government surplus); when expenditures exceed receipts, net federal government saving is negative (formerly identified in the NIPAs as a federal government deficit). See **national income and product accounts.**

net interest: In the federal budget, net interest comprises the government's interest payments on debt held by the public (as recorded in budget function 900) offset by interest income that the government receives on loans and cash balances and by earnings of the National Railroad Retirement Investment Trust.

net national saving: National saving minus depreciation of physical capital. See **capital, depreciation,** and **national saving.**

NIPAs: See **national income and product accounts.**

nominal: A measure based on current-dollar value. The nominal level of income or spending is measured in current dollars. The *nominal interest rate* on debt selling at

par is the ratio of the current-dollar interest paid in any year to the current-dollar value of the debt when it was issued. The nominal interest rate on debt initially issued or now selling at a discount includes as a payment the estimated yearly equivalent of the difference between the redemption price and the discounted price. The *nominal exchange rate* is the rate at which a unit of one currency trades for a unit of another currency. See **current dollar;** compare with **real.**

obligation: A legally binding commitment by the federal government that will result in outlays immediately or in the future.

obligation delay: Legislation that precludes the obligation of an amount of budget authority provided in an appropriation act or in some other law until some time after the first day on which that budget authority would normally be available. For example, language in an appropriation act for fiscal year 2005 that precludes obligation of an amount until March 1 is an obligation delay; without that language, the amount would have been available for obligation on October 1, 2004 (the first day of fiscal year 2005). See **appropriation act** and **fiscal year;** compare with **advance appropriation** and **forward funding.**

obligation limitation: Legislation that reduces existing authority to incur obligations.

off-budget: Spending or revenues excluded from the budget totals by law. The revenues and outlays of the two Social Security trust funds (the Old-Age and Survivors Insurance Trust Fund and the Disability Insurance Trust Fund) and the transactions of the Postal Service are off-budget. As a result, they are excluded from the totals and other amounts in the budget resolution and from any calculations necessary under the Deficit Control Act. See **Balanced Budget and Emergency Deficit Control Act of 1985, budget resolution, outlays, revenues,** and **trust funds.**

offsetting collections: Funds collected by the government that are required by law to be credited directly to an expenditure account. Offsetting collections are accounted for as negative budget authority and outlays; they offset budget authority and outlays (either direct or discretionary spending) at the program or account level. Offsetting collections generally result from businesslike or market-oriented activities with the public or from intragovernmental transactions. Collections that result from the government's exercise of its sovereign or governmental powers are ordinarily classified as revenues, but will be classified as offsetting collections when the law requires that treatment. See **budget authority, direct spending, discretionary spending, expenditure account,** and **outlays;** compare with **offsetting receipts** and **revenues.**

offsetting receipts: Funds collected by the government that are credited to a receipt account. Offsetting receipts are accounted for as negative budget authority and outlays; they offset gross budget authority and outlays for direct spending programs in calculations of total direct spending. Offsetting receipts generally result from businesslike or market-oriented activities with the public or from intragovernmental transactions. Collections that result from the government's exercise of its sovereign or governmental powers are ordinarily classified as revenues, but will be classified as offsetting receipts when the law requires that treatment. See **budget authority, direct spending, outlays,** and **receipt account;** compare with **offsetting collections** and **revenues.**

other means of financing: See **means of financing.**

outlays: Spending made to pay a federal obligation. Outlays may pay for obligations incurred in previous fiscal years or in the current year; therefore, they flow in part from unexpended balances of prior-year budget authority and in part from budget authority provided for the current year. For most categories of spending, outlays are recorded when payments are made or when cash is disbursed from the Treasury. However, outlays for interest on debt held by the public are recorded when the interest is earned, and outlays for direct loans and loan guarantees (since credit reform) reflect estimated subsidy costs instead of cash transactions. See **budget authority, credit subsidy, debt,** and **fiscal year.**

out-year: See **fiscal year.**

pay-as-you-go (PAYGO): A procedure established in the Budget Enforcement Act of 1990 that was intended to ensure that all legislation affecting direct spending or revenues was budget neutral in each fiscal year. Under the procedure, the Office of Management and Budget and CBO estimated the five-year budgetary impact of all such legislation enacted into law. If the total of those estimates in the budget year increased the deficit or reduced the surplus for that year, a PAYGO sequestration—a cancellation of budgetary resources available for direct spending programs—would be triggered. Since September 30, 2002, the Office of Management and Budget and CBO

are no longer required to provide five-year estimates of laws affecting direct spending and revenues. Although sequestration under the pay-as-you-go procedures would have continued through 2006 on the basis of laws enacted before September 30, 2002, Public Law 107-312 eliminated that possibility by reducing to zero all pay-as-you-go balances. See **Balanced Budget and Emergency Deficit Control Act of 1985, direct spending, fiscal year, revenues,** and **sequestration.**

peak: See **business cycle.**

personal income: See **disposable personal income.**

personal saving: Saving by households. Personal saving equals disposable personal income minus spending for consumption and interest payments. The personal saving rate is personal saving as a percentage of disposable personal income. (BEA) See **disposable personal income.**

point of order: Procedure by which a member of a legislature (or similar body) questions an action being taken, or that is proposed to be taken, as contrary to that body's rules, practices, or precedents.

potential GDP: The level of real gross domestic product that corresponds to a high level of resource (labor and capital) use. (CBO's procedure for estimating potential GDP is described in *CBO's Method for Estimating Potential Output: An Update,* August 2001.) See **gross domestic product, inflation, potential output,** and **real.**

potential labor force: The labor force adjusted for movements in the business cycle. See **business cycle** and **labor force.**

potential output: The level of production that corresponds to a high level of resource (labor and capital) use. Potential output for the national economy is also referred to as potential GDP. (CBO's procedure for estimating potential output is described in *CBO's Method for Estimating Potential Output: An Update,* August 2001.) See **inflation** and **potential GDP.**

present value: A single number that expresses a flow of current and future income (or payments) in terms of an equivalent lump sum received (or paid) today. The calculation of present value depends on the rate of interest. For example, if $100 is invested on January 1 at an annual interest rate of 5 percent, it will grow to $105 by January 1 of the next year. Hence, at an annual 5 percent interest rate, the present value of $105 payable a year from today is $100.

primary surplus: See **surplus.**

private saving: Saving by households and businesses. Private saving is equal to personal saving plus after-tax corporate profits minus dividends paid. (BEA) See **personal saving.**

productivity: Average real output per unit of input. *Labor productivity* is average real output per hour of labor. The growth of labor productivity is defined as the growth of real output that is not explained by the growth of labor input alone. *Total factor productivity* is average real output per unit of combined labor and capital inputs. The growth of total factor productivity is defined as the growth of real output that is not explained by the growth of labor and capital. Labor productivity and total factor productivity differ in that increases in capital per worker raise labor productivity but not total factor productivity. (BLS) See **capital input.**

program account: Any budgetary account associated with a credit program that receives an appropriation of the subsidy cost of that program's loan obligations or commitments as well as, in most cases, the program's administrative expenses. From the program account, the subsidy cost is disbursed to the applicable financing account. See **credit subsidy** and **financing account.**

real: Adjusted to remove the effects of inflation. *Real output* represents the quantity, rather than the dollar value, of goods and services produced. *Real income* represents the power to purchase real output. *Real data* at the finest level of disaggregation are constructed by dividing the corresponding nominal data, such as spending or wage rates, by a price index. Real aggregates, such as real GDP, are constructed by a procedure that allows the real growth of the aggregate to reflect the real growth of its components, appropriately weighted by the importance of the components. A *real interest rate* is a nominal interest rate adjusted for expected inflation; it is often approximated by subtracting an estimate of the expected inflation rate from the nominal interest rate. Compare with **current** and **nominal dollar.**

real trade-weighted value of the dollar: See **trade-weighted value of the dollar.**

receipt account: An account established within federal funds and trust funds to record offsetting receipts or revenues credited to the fund. See **federal funds, offsetting receipts, revenues,** and **trust funds.**

recession: A phase of the business cycle extending from a peak to the next trough and characterized by a substantial decline in overall business activity—output, income, employment, and trade—of at least several months' duration. As a rule of thumb, though not an official measure, recessions are often identified by a decline in real gross domestic product for at least two consecutive quarters. (NBER) See **business cycle, gross domestic product,** and **real;** compare with **expansion.**

reconciliation: A special Congressional procedure often used to implement the revenue and spending targets established in the budget resolution. The budget resolution may contain *reconciliation instructions,* which direct Congressional committees to make changes in existing revenues or direct spending programs under their jurisdiction to achieve a specified budgetary result. The legislation to implement those instructions is usually combined into one comprehensive *reconciliation bill,* which is then considered under special rules. Reconciliation affects revenues, direct spending, and offsetting receipts but usually not discretionary spending. See **budget resolution, direct spending, discretionary spending, offsetting receipts,** and **revenues.**

recovery: A phase of the business cycle that lasts from a trough until overall economic activity returns to the level it reached at the previous peak. (NBER) See **business cycle.**

revenues: Funds collected from the public through the government's exercise of its sovereign or governmental powers. Federal revenues consist of individual and corporate income taxes, excise taxes, and estate and gift taxes; contributions to social insurance programs (such as Social Security and Medicare); customs duties; fees and fines; and miscellaneous receipts, such as earnings of the Federal Reserve System, gifts, and contributions. Federal revenues are also known as federal governmental receipts. Compare with **offsetting collections** and **offsetting receipts.**

risk premium: The additional return that investors require to hold assets whose returns are more variable than those of riskless assets. The risk can arise from many sources, such as the possibility of default (in the case of corporate or municipal debt), the volatility of earnings (in the case of corporate equities), or changes in interest rates.

S corporation: A domestically owned corporation with no more than 75 owners who have elected to pay taxes under Subchapter S of the Internal Revenue Code. An S corporation is taxed like a partnership: it is exempt from the corporate income tax, but its owners pay income taxes on all of the firm's income, even if some of the earnings are retained by the firm.

saving rate: See **national saving** and **personal saving.**

savings bond: A nontransferable, registered security issued by the Treasury at a discount and in denominations from $50 to $10,000. The interest earned on savings bonds is exempt from state and local taxation; it is also exempt from federal taxation until the bonds are redeemed.

seigniorage: The gain to the government from the difference between the face value of minted coins put into circulation and the cost of producing them (including the cost of the metal used in the coins). Seigniorage is considered a means of financing and is not included in the budget totals. See **means of financing.**

sequestration: The cancellation of budgetary resources available for a fiscal year in order to enforce the discretionary spending limits or pay-as-you-go procedures in that year. The process was first established in the Balanced Budget and Emergency Deficit Control Act of 1985. A discretionary spending sequestration would be triggered if the Office of Management and Budget determined that budget authority or outlays provided in appropriation acts exceeded the applicable discretionary spending limits. Spending in excess of the limits would cause the cancellation of budgetary resources within the applicable category of discretionary programs. A pay-as-you-go sequestration would be triggered if OMB determined that recently enacted legislation affecting direct spending and revenues increased the deficit or reduced the surplus. An increase in the deficit or reduction of the surplus would cause the cancellation of budgetary resources available for direct spending programs not otherwise exempt by law. On September 30, 2002, the discretionary spending caps and the sequestration procedure to enforce those caps expired, and OMB (and CBO) were no longer required to record the five-year budgetary effects of legislation affecting direct spending or revenues. Although sequestration under the pay-as-you-go procedure would have continued through 2006 on the basis of laws enacted before September 30, 2002, Public Law 107-312 eliminated that possibility by reducing to zero

all pay-as-you-go balances. See **direct spending, discretionary spending limits,** and **pay-as-you-go.**

short-term interest rate: The interest rate earned by a debt instrument (such as a Treasury bill) that will mature within one year.

standardized-budget surplus or deficit: The level of the federal budget surplus or deficit that would occur under current law if the economy operated at potential GDP. The standardized-budget surplus or deficit provides a measure of underlying fiscal policy by removing the influence of cyclical factors. (CBO) See **deficit, fiscal policy, potential GDP,** and **surplus;** compare with **cyclical surplus or deficit.**

structural surplus or deficit: Same as **standardized-budget surplus or deficit.**

Subchapter S corporation: See **S corporation.**

subsidy cost: See **credit subsidy.**

surplus: The amount by which the federal government's total revenues exceed its total outlays in a given period, typically a fiscal year. The *primary surplus* is that total surplus excluding net interest. See **outlays** and **revenues;** compare with **deficit.**

10-year Treasury note: An interest-bearing note issued by the U.S. Treasury that is to be redeemed in 10 years.

three-month Treasury bill: An interest-bearing security issued by the U.S. Treasury that is to be redeemed in 91 days.

total factor productivity: See **productivity.**

trade deficit: See **net exports.**

trade-weighted value of the dollar: The value of the U.S. dollar relative to the currencies of U.S. trading partners, with the weight of each country's currency equal to that country's share of U.S. trade. The *real trade-weighted value of the dollar* is the trade-weighted value of the dollar that takes account of the difference between U.S. price inflation and price inflation among U.S. trading partners. An increase in the real trade-weighted value of the dollar means that the price of U.S.-produced goods and services has increased relative to the price of foreign-produced goods and services.

transfer payments: Payments made to an individual or organization for which no current or future goods or services are required in return. Federal transfer payments include Social Security and unemployment benefits. (BEA)

trough: See **business cycle.**

trust funds: Government funds that are designated by law as trust funds (regardless of any other meaning of that term). Trust funds display the revenues, offsetting receipts or offsetting collections, and outlays that result from implementation of the law that designated the fund as a trust fund. The federal government has more than 200 trust funds. The largest and best known finance major benefit programs (including Social Security and Medicare) and infrastructure spending (the Highway and the Airport and Airway Trust Funds). See **offsetting collections, offsetting receipts, outlays,** and **revenues;** compare with **federal funds** and **general fund.**

underlying rate of inflation: The rate of inflation of a modified consumer price index for all urban consumers that excludes from its market basket the components with the most volatile prices: food and energy. See **consumer price index** and **inflation.**

unemployment gap: The difference between the nonaccelerating inflation rate of unemployment (NAIRU) and the unemployment rate. See **NAIRU.**

unemployment rate: The number of jobless people who are available for work and are actively seeking jobs, expressed as a percentage of the labor force. (BLS) See **discouraged workers** and **labor force.**

unilateral transfers: Payments from one country to another that are not made in exchange for goods or services—for instance, gifts or pension payments to foreign residents.

unobligated balances: The portion of budget authority that has not yet been obligated. When budget authority is provided for one fiscal year, any unobligated balances at the end of that year expire and are no longer available for obligation. When budget authority is provided for a specific number of years, any unobligated balances are carried forward and are available for obligation during the years specified. When budget authority is provided for an unspecified number of years, the unobligated balances are carried forward indefinitely, until either they are rescinded, the purpose for which they were provided is accomplished, or no disbursements have been made for two consecutive years. See **budget authority;** compare with

advance appropriation, forward funding, and **obligation delay.**

user fee: A fee charged by the federal government to recipients of its goods or services. User fees generally apply to activities that provide special benefits to identifiable recipients, and the amount of the fee is usually related to the cost of the good or service provided. In the federal budget, user fees can be classified as offsetting collections, offsetting receipts, or revenues. See **offsetting collections, offsetting receipts,** and **revenues.**

yield: The average annual rate of return on a security, including interest payments and repayment of principal, if it is held to maturity.

yield curve: The relationship formed by plotting the yields of otherwise comparable fixed-income securities against their terms to maturity. Typically, yields increase as maturities lengthen. The rate of that increase determines the "steepness" or "flatness" of the yield curve. Ordinarily, a steepening (or flattening) of the yield curve is taken to suggest that short-term interest rates are expected to rise (or fall). See **short-term interest rate.**