

An hourglass-shaped graphic with a globe inside. The top bulb is dark blue with a lighter blue globe. The neck is a narrow, light blue channel. The bottom bulb is light blue with a darker blue globe. The entire graphic is set against a white background.

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Report RL31784

The Budget for Fiscal Year 2004

Philip D. Winters, Government and Finance Division

November 1, 2004

Abstract. This report provides background and analysis on the FY2004 budget including budget proposals and estimates, budget action outlays, receipts, surpluses and deficits, and more.

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The Budget for Fiscal Year 2004

Updated November 1, 2004

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The Budget for Fiscal Year 2004

Summary

The Administration (Office of Management and Budget; OMB) and the Congressional Budget Office (CBO) released their final official estimates for fiscal year (FY) 2004 on July 30, 2004 and on September 7, 2004 respectively. OMB put the FY2004 deficit estimate at \$445 billion, above the \$307 billion deficit estimate in the original budget (February 2003), but below the FY2004 deficit estimate of \$521 billion included in the FY2005 budget (February 2004). CBO's September 2004 baseline deficit estimate of \$422 billion was larger than its January 2003 estimate of \$145 billion and below its March 2004 estimate of \$477 billion. The actual deficit for the year was \$413 billion (pending revision).

The original proposals from the President (February 2003) included speeding up and making permanent many of the tax cuts enacted over the last two years, along with new tax proposals for economic stimulus, tax incentives, and expiring tax provisions.

CBO's first FY2004 budget report (January 31, 2003) estimated the baseline deficit at \$145 billion deficit for FY2004. The baselines incorporate existing policy; they do not reflect possible or likely policy changes.

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

Both OMB's and CBO's mid-year budget reports (July and August 2003 respectively) showed substantial increases in the deficit estimate for FY2004. Changes in policy, a slowly recovering economy, and other factors produced the growth in the estimated deficit. The Administration's July estimates did "not reflect ... expected but undetermined additional costs arising from ongoing operations in Iraq, extending beyond 2003" (OMB Mid-Session Review, July 15, 2003, p.1). Over 80% of the increase in CBO's baseline deficit estimate resulted from spending bills and tax cuts adopted between March and August 2003.

In the fall of 2003, Congress bogged down in passing the 13 regular appropriation bills. Three had become law at the start of the new fiscal year; another three were enacted by Thanksgiving. The remaining seven were bundled into an omnibus measure, H.R. 2673, which the House passed on December 8 and the Senate adopted on January 22, 2004. It became law (P.L. 108-199) on January 23. Congress passed the fifth in a series of continuing resolutions (CRs) on appropriations (P.L. 108-185; December 16, 2003) that was in effect through January 31, 2004, to fund activities not otherwise funded.

This report will be updated as events warrant.

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The Budget for Fiscal Year 2004

Background and Analysis

Presidents generally submit their budget proposals for the upcoming fiscal year (FY) early in each calendar year. The Bush Administration released its FY2004 budget (*The Fiscal Year 2004 Budget of the U.S. Government*) on February 3, 2003. The multiple volumes contained general and specific descriptions of the Administration's policy proposals and expectations for the budget for FY2004 and for the years through FY2008, with information on the revenue changes through FY2013 and a section on long-term fiscal issues facing the nation. The full set of budget documents (*Budget, Appendix, Analytical Perspectives, Historical Tables*, among several others) contain extensive and detailed budget information, including estimates of the budget without the proposed policy changes (current service baseline estimates), historical budget data, detailed outlay and receipt data, selected analysis of specific budget related topics, and the Administration's economic forecast. In addition to its presentation of the Administration's proposals, the budget documents are an annual basic reference source for federal budget information.

The Administration's annual budget submission is followed by congressional action on the budget. This usually includes the annual budget resolution, appropriations, and, possibly, a reconciliation bill (or bills). During the months of deliberation on budget legislation, the Administration often revises its original proposals because of interactions with Congress and changing circumstances in the economy and the world.

The Current Situation

The Treasury released final budget totals for FY2004 on October 14, 2004, with the release of the *Final Monthly Treasury Statement of Receipts and Outlays of the United States Government*. For FY2004, receipts were \$1,880 billion, outlays were \$2,292 billion, and the deficit was \$413 billion. Receipts in FY2004 were larger than in the previous year for the first time since FY2001. Outlays continued growing, rising 5% above the FY2003 level (\$2,159 billion). The deficit increased from its FY2003 level in dollars (by \$35 billion), and remained almost unchanged as a percentage of gross domestic product (GDP), rising from 3.5% in FY2003 to an estimated 3.6% of GDP in FY2004. These numbers are likely to undergo some revision by the time they appear in the President's FY2006 budget documents, expected to be released in early February 2005.

In the spring of 2004, the President requested a \$25 billion reserve fund to support operations in Afghanistan and Iraq. After amending the request, Congress

adopted it as part of the FY2005 Defense appropriation, making the funds available immediately (in FY2004).

Budget Totals

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

The war on terrorism, the 2001 recession and the slow economic recovery (until it speeded up in the fall of 2003), changes in policies (tax cuts; spending increases), and changes in the technical assumptions underlying budget-economic relationships, have all contributed to the deterioration in the budget outlook since early 2001. Under current policies, and even more so under policies proposed in the President's FY2005 budget, there is little expectation that the budget will reach balance over the next 10 years.

Budget Proposals and Estimates

CBO's first budget report for FY2004, the *Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), contained baseline estimates and projections for FY2003 through FY2013.¹ CBO's report showed that, under baseline assumptions, the budget would remain in deficit through FY2006 (\$16 billion) before showing a small surplus in FY2007. The baseline showed small surpluses beginning in FY2007 and would grow rapidly in FY2011 through FY2013 as revenues increase quickly with the (then) scheduled expiration (by the end of calendar year 2010) of the tax reductions from the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16, June 2001). Extending the expiring tax cuts would delay the return of surpluses, by reducing receipts, until at least FY2008 and would have much slower growth in the surplus over the subsequent years.

¹ Baseline estimates provide a foundation from which to measure proposed policy changes. They extrapolate current policies and other specified conditions into the future based on expectations of future economic conditions, other factors that affect the budget, and rules set by Congress that CBO must follow in creating baseline estimates. They are not meant to predict future budget outcomes. Because they continue existing policy, the baseline estimates repeat spending that was intended for only one year and exclude generally expected but not-yet-enacted policy changes.

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

	Receipts	Outlays	Deficit(-)/ Surplus
<i>Actual for FY2000</i>	\$2,025	\$1,789	\$236
<i>Actual for FY2001</i>	1,991	1,864	127
<i>Actual for FY2002</i>	1,853	2,011	-158
<i>Actual for FY2003</i>	1,782	2,157	-374
CBO B&E Outlook, Baseline, 1/31/03	2,054	2,199	-145
OMB, Budget, 2/3/03	1,922	2,229	-307
OMB, Budget, Current Services, 2/3/03	2,031	2,189	-158
CBO Revised Baseline, 3/7/03	2,024	2,224	-200
CBO Estimates of the President's Policies, 3/7/03	1,907	2,245	-338
House FY2004 Budget Resolution, 3/21/03	1,908	2,232	-324
Senate FY2004 Budget Resolution, 3/26/03	1,958	2,246	-287
Conference FY2004 Budget Resolution, 4/11/03	1,883	2,268	-385
OMB Mid-Session Review, 7/15/03	1,797	2,272	-475
OMB Mid-Session Review, Baseline, 7/15/03	1,794	2,252	-458
CBO Update, Baseline, 8/26/03	1,825	2,305	-480
CBO B&E Outlook, Baseline, 1/26/04	1,817	2,294	-477
OMB, Budget for FY2005, 2/2/04	1,798	2,319	-521
CBO Revised Baseline, 3/8/04	1,817	2,295	-477
CBO Estimate of President's Policies, 3/8/04	1,816	2,295	-478
Senate, FY05 Budget Resolution S.Con.Res. 95, 3/5/04	1,817	2,295	-477
House, FY05 Budget Resolution H.Con.Res. 393, 3/19/04	1,818	2,295	-477
Conf., FY05 Budget Resolution S.Con.Res. 95, 5/19/04*	1,821	2,338	-474
OMB, Mid-Session Rev. 7/30/04	1,874	2,319	-445
CBO Update 9/7/04	1,871	2,293	-422
<i>Actual for FY2004</i>	1,880	2,292	-413

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

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

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

The Administration's budget did not include any cost estimates for the (then future) war in Iraq, expected but unspecified additions to homeland security funding, or for non-war defense related spending. On March 24, 2003, the President asked

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

Congress for a \$75 billion supplemental appropriation for FY2003, some of which would produce outlays in FY2004.

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

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

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

CBO's March report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2004* recalculated the Administration's FY2004 budget proposal using CBO's assumptions and budget estimating methods.⁴ These recalculations produced results similar to those in the President's budget, with little cumulative difference in the projections. CBO estimated a cumulative deficit of \$1.2 trillion under the President's policies over the five years (FY2004-FY2008) compared to the Administration's estimate of \$1.1 trillion.⁵ CBO's 10-year projections of the Administration's proposals (CBO extrapolated the President's policies over the second five years) showed larger deficits (or smaller surpluses) compared to the CBO's own revised (March) baseline in each of the years covered. CBO estimated that about two-thirds of the increases in the deficits in its reestimates of the President's proposals (excluding higher net interest costs) resulted from the lower revenues that would occur from the adoption of the President's tax cut proposals.

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

³ Council of Economic Advisors, *Economic Report of the President*. Feb. 2003. pp. 57-58

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

⁵ *Ibid.*, p. 1.

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

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

The deterioration in the budget outlook between January 2003 and March 2003 resulted in CBO's revised baseline estimate pushing back the budget's return to surplus by one year, from FY2007 to FY2008.

The FY2004 House budget resolution (H.Con.Res. 95; March 21) included the President's request for a \$726 billion economic stimulus tax cut (only a portion of the total tax cut outlined in the resolution was included in reconciliation instructions). The Senate-passed resolution (S.Con.Res. 23; March 26) contained reconciliation instructions for a \$350 billion tax cut. The conference agreement on the resolution (H.Con.Res. 95; H.Rept. 108-71; April 11) included different reconciliation instructions for the relevant House and Senate committees. The House instructions included tax cuts of \$550 billion; the Senate instructions included tax cuts of \$350 billion. The resolution's deficit was \$385 billion in FY2004, becoming a small, \$10 billion surplus in FY2012 and rising to a surplus of \$37 billion in FY2013 (assuming the expiration of the tax cuts by 2010). The reconciliation legislation that Congress passed (the Jobs and Growth Tax Relief Reconciliation Act; P.L. 108-27; May 23, 2003) contained \$350 billion in tax cuts (and a small amount of spending increases) over the period FY2003 through FY2013.

The mid-year budget reports from OMB (July 2003, *Mid-Session Review*) and CBO (August 2003, *The Budget and Economic Outlook: An Update*) projected larger deficits for FY2004 and subsequent years than they had in their respective earlier budget reports in 2003. OMB estimated that the FY2004 deficit would rise to \$475 billion, \$168 billion above its January 2003 estimate.⁷ Policy changes that differed from those originally proposed by the President produced \$73 billion of the change. The largest share, \$95 billion, resulted from differences in the economic and technical assumptions underlying the two projections. These changes raised the estimated cumulative deficit for FY2004 through FY2008 by \$372 billion above the cumulative amount in the earlier estimate.

CBO's August 2003 report raised the FY2004 baseline deficit to \$480 billion, \$280 billion larger than its March estimate. Legislative changes (tax cuts and spending increases) raised the estimated deficit by \$227 billion, while economic and technical revisions raised it by another \$52 billion. The five-year (FY2004-FY2008) projected cumulative deficit increased by \$1,083 billion between CBO's March and August estimates, from \$362 billion to \$1,445 billion. CBO's ten-year projection for

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

⁷ OMB's current services baseline deficit rose from \$158 billion in January to \$458 billion in July. The report showed the cumulative deficit for the five years (FY2004-FY2008) rising to \$949 billion from the cumulative deficit in January of \$114 billion.

FY2004 through FY2013, included a cumulative change in its deficit projections, between March and August, of an estimated \$2,287, moving the budget balance from an estimated cumulative surplus of \$891 billion in March 2003 to an estimated cumulative deficit of \$1,397 billion. The August estimate incorporated (as did the March estimate) the assumed expiration of most of the recently adopted tax cuts. It also included the assumed continuation of all the spending increases adopted since March, including the FY2003 supplementals (P.L. 108-11 and P.L. 108-69), that are unlikely to be repeated annually throughout the forecast period.

Neither OMB's nor CBO's summer 2003 projections reflected, particularly in the years after FY2004, the effect of likely policy changes, such as modifications to the Alternative Minimum Tax (AMT), the costs of the ongoing efforts in Iraq and Afghanistan, the possible repeal of the scheduled expirations of the tax cuts, and the possible adoption of a Medicare drug benefit. The budgetary cost of these policy changes is very large over time and could, according to CBO estimates, add another \$1 trillion to \$3 trillion to the cumulative deficit over the FY2004 through FY2013 period. (See pages 11-14 in the *Update* for CBO's discussion of budget projections under alternative scenarios.) CBO's baseline projections indicated that the budget has a fundamental imbalance that will not be remedied by full economic recovery. The projections imply that only through policy changes that cut spending and/or increase revenues can the deficit be made to shrink and surpluses be restored.

The appropriation process bogged down in the fall of 2003. Three of the 13 regular appropriations were enacted by the start of the fiscal year. Another three became law before Congress recessed for the year (after Thanksgiving 2003). A series of continuing resolutions (CRs) on appropriations were adopted from the beginning of the fiscal year (October 1, 2003) through the fifth (and final) CR, which became law (P.L. 108-84; H.J.Res. 79) on November 22, 2003, and provided funding through January 31, 2004. Congress put together an omnibus appropriation bill of the seven remaining appropriation bills (they were combined in the Agriculture appropriation, H.R. 2673). The House passed the conference report (H.Rept. 108-401) on the appropriation on December 8, 2003; the Senate cleared the conference report on January 22, 2004. It became law (P.L. 108-199) with the President's signature on January 23.

Uncertainty in Budget Projections

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

from the originally proposed or estimated amounts. There is little reason to expect this volatility to be greatly diminished in the current or future budget projections.⁸

Information in chapter 5 (The Uncertainties of Budget Projections) of CBO's budget report, *The Budget and Economic Outlook: Fiscal Years 2004-2013* (January 2003), discussed how significantly the budget outcome can be altered by changes in economic and related technical factors that underpin the budget estimates.⁹ The chapter included optimistic and pessimistic alternative scenarios to its baseline projection. The optimistic scenario assumes that favorable economic and budget conditions continue throughout the forecast, that the increase in productivity persists, and that mandatory spending is lower than in the baseline. The pessimistic scenario assumes that less favorable economic and budget conditions occur, that the economy grows more slowly, and that mandatory spending is higher than in the baseline. The optimistic scenario produces a cumulative surplus \$3 trillion larger than the baseline, while the pessimistic scenario produces a cumulative deficit \$3 trillion below the baseline estimate, both over the FY2004 through FY2013 period.

The President's FY2004 budget (February 2003) includes, in the section, "Charting a Course for the Federal Budget," the statement that "... five-year projections are fraught with uncertainty. The ... error in projecting the surplus or deficit since 1982 ... has been a \$90 billion average absolute forecasting error for the first year alone. A 90-percent confidence range for 2008 would stretch all the way from a \$281 billion surplus to a \$661 billion deficit, a range of nearly \$1 trillion."¹⁰

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

⁸ Some things are known with relative certainty about the direction of future budgets. Demographics can partly determine the shape of future budgets. The upcoming retirement of the baby boom generation will rapidly drive higher the spending for Social Security and Medicare as well as other federal spending or tax breaks for the elderly in the next decade. Because almost all those that will become eligible for these benefits are alive today, estimating the growth in these programs is relatively straightforward.

⁹ CBO's FY2005 budget report (*The Budget and Economic Outlook: Fiscal Years 2005-2014*, Jan. 2004) included a similar chapter in Appendix A.

¹⁰ Office of Management and Budget. *Budget of the U.S. Government for FY2004*, Feb. 3, 2003, p. 28.

Budget Action

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

The Joint Committee on Taxation released its estimates of the revenue effects in the President's proposals on March 4, 2003. They showed 10-year (FY2004-FY2013) revenue reductions of \$1,535 billion. (The President's budget estimated its revenue proposals would reduce receipts by \$1,307 billion over the 10 years.) In mid-March 2003, CBO released its report, *An Analysis of the President's Budgetary Proposals for FY2004*, which used the Joint Committee on Taxation's tax estimates (modified) as the basis for its analysis of the revenue effects of the President's proposals. CBO's estimate showed the proposals reducing receipts by \$1,455 billion over the same 10 years.

The House and Senate Budget Committees adopted their own, differing, versions of the FY2004 budget resolution (H.Con.Res. 95; S.Con.Res. 23) in mid-March 2003. The House, after the Republican leadership had to modify the committee-passed resolution to assure enough support for passage, passed (215-212) its version on March 21. It contained reconciliation instructions for a \$550 billion, multi-year tax cut.

The Senate spent more than a week considering its resolution. After adopting and rejecting numerous amendments, the Senate adopted the resolution on March 26.¹¹ One of the amendments adopted limited the size of the reconciliation tax-cut to \$350 billion over 11 years (from the committee-adopted level of \$698 billion). The resolution moved to a conference committee April 1, 2003. The conference reported its agreement on April 10 (H.Rept. 108-71). The agreement included different tax cut reconciliation instructions for the House and Senate. The House reconciliation instructions included tax cuts (over 11 years) of up to \$550 billion. The Senate reconciliation instructions limited it to tax cuts of \$350 billion. Without other constraints, this would have allowed a \$550 billion tax cut to emerge from a conference on the tax cut legislation. The \$550 billion would have been protected from a Senate filibuster by the reconciliation rules. To make sure the budget resolution conference report could clear the Senate, the Senate leadership agreed that any eventual tax cut legislation would not exceed \$350 billion. The House and Senate passed the conference report on April 11, 2003.

The House Ways and Means Committee reported the reconciliation tax cut legislation (H.R. 2; H.Rept. 108-94) on May 8. The legislation provided for the \$550

¹¹ The Senate substituted the text of its resolution, S.Con.Res. 23, for the text of the House-passed resolution, H.Con.Res. 95.

billion tax cut included in the House version of the conference agreement on the budget resolution. The House passed the bill on May 9.

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

On May 23, after extensive leadership negotiations between the House and Senate, an agreement was reached resolving the differences between the two versions of the tax-cut legislation (the Jobs and Growth Tax Relief Act of 2003). It provided \$350 billion in cumulative tax cuts and small spending increases from FY2004 through FY2013. The agreement was formalized by the conference committee's report (H.Rept. 108-126) on May 22. The House adopted the agreement in the early morning hours of May 23. The Senate adopted it before noon on May 23. The legislation included the automatic expiration of many of the new tax cuts within 1 or 2 years to fit within the \$350 billion 11-year tax cut. The President signed the legislation into law (P.L. 108-27) on May 28, 2003.

On July 7, 2003, the President requested a second supplemental of \$1.9 billion for FY2003. A portion of the request, \$984 million, cleared Congress (H.R. 2859) in late July and became law (P.L. 108-69) on August 8. Most of the spending (outlays) from this legislation would occur in FY2004 and subsequent years.

Work on the appropriations for FY2004 began in the spring of 2003 and continued through the summer. When Congress returned after its summer recess in September 2003, the House had passed 11 of the 13 regular appropriations and the Senate had passed 4. None of the appropriations had become law. By September 9, the House had passed its versions of all the appropriations. The Senate had passed seven of the appropriations by the end of September. Three of the appropriations cleared Congress and were signed into law by the President as the new fiscal year began on October 1, 2003. Congress adopted (on September 25) and the President signed (on September 30) the first in a series of continuing resolutions (CRs) on appropriations (P.L. 108-84; H.J.Res. 69) for FY2004. The CR was necessary to avoid a lapse in funding for the activities in the still-to-be-enacted 10 appropriations. The CR ran through October 31, 2003.

As October progressed, Congress continued its efforts to complete action on the 13 regular appropriations for FY2004. By the end of the month, the Senate had adopted nine appropriations (two more than at the beginning of the month). One more had gone through conference (Interior), but no more had become law.

A second CR, running through November 7 (P.L. 108-104; October 31, 2003), became necessary as Congress' ongoing attempt to finish its work on the FY2004 appropriations continued. As with the second CR, the appropriations work was unfinished as the November 7 deadline approached. A third CR (P.L. 108-107; November 7, 2003), provided funding through November 21.

Again, as time ran out on the third CR, Congress remained mired in conflict over the remaining appropriations. By November 21, the Senate had passed its versions of 12 of the 13 appropriations.¹² A total of four appropriations had become law and two more had been sent to the President. In an effort to assure passage of the remaining appropriations, Congress began working on an omnibus appropriation for the year that was initially expected to contain the 5 remaining regular appropriations. Four that were not expected to pass individually — Commerce, Justice, State; the District; Labor, HHS, Ed; and VA, HUD — were added to Agriculture (H.R. 2673). The omnibus expanded to include the other remaining two, Foreign Operations and Transportation-Treasury, after their enactment as separate bills became less certain. In a post-Thanksgiving session, the House passed the legislation on December 8. The Senate, meeting the next day, deferred its consideration of the omnibus until January 2004. Some members of Congress had suggested that if the omnibus fails to pass the Senate, Congress would have adopted a CR for the rest of the fiscal year, providing FY2003 spending levels for these activities in FY2004.

The ongoing delays in completing the work on appropriations resulted in the need for a fourth CR. On November 21, 2003, Congress passed the fourth CR (H.J.Res. 79), which provided funding through January 31, 2004,. The President signed it into law (P.L. 108-135) on November 22. A fifth CR (P.L. 108-185), containing special provisions for two programs (under the Federal Housing Administration and the Federal Aviation Administration), but otherwise unchanged from the fourth CR and included the same January 31, 2004 end date, became law on December 16.

Earlier, during the second half of October, Congress considered the President's requested \$87 billion supplemental appropriations, mostly for Iraq and Afghanistan. The House and Senate cleared the supplemental (H.R. 3289; S. 1689) on October 17, and sent it to conference. Various contentious provisions in the legislation lengthened the negotiations and prompted a veto threat from the Administration. The differences were resolved, resulting in the \$87.5 billion supplemental appropriation clearing Congress on November 9. The President signed the legislation into law on November 6 (P.L. 108-106).

Just before Congress broke for Thanksgiving, it passed, and the President signed on December 8, changes to Medicare (P.L. 108-173; the Medicare Prescription Drug, Improvement, and Modernization Act of 2003) that would add an estimated (at that time) \$400 billion to the program's cost over the next ten years.

On January 22, 2004, after additional delay, the Senate passed the omnibus appropriation bill, which the President promptly signed on January 23, 2004 (P.L. 108-199).

The January 2004 revised estimates from CBO changed little from the August 2003 estimates, dropping the deficit from \$480 billion in August 2003 to \$477 billion in January 2004. The President's FY2005 budget boosted the estimated deficit for

¹² The House had passed its versions of all the appropriations before mid-September; the Senate had cleared 7 by the end of September and an eighth by the end of October.

FY2004 to \$521 billion from the \$475 billion in the July 2003 *Mid-Session Review*.¹³ CBO's March 2004 budget report (*An Analysis of the President's Budgetary Proposals for Fiscal Year 2005*) left its FY2004 baseline deficit estimate unchanged at \$477 billion.

The FY2005 budget resolutions passed by the House (H.Con.Res. 393) and Senate (S.Con.Res. 95) included revised budget numbers for FY2004. In both resolutions, the deficit had risen to \$477 billion from \$385 billion in the FY2004 budget resolution (H.Con.Res. 95). The conference report on the budget resolution contained a modified deficit target of \$474 billion for FY2004. The House adopted the conference report on the budget resolution (H.Rept. 108-495; S.Con.Res. 95) on May 19, 2004; the Senate did not act on the conference report.

The Administration's May 2004 request for a reserve fund of \$25 billion for Afghanistan and Iraq was eventually incorporated into the FY2005 Defense appropriations. The legislation would allow the funds to be used immediately, if needed. The appropriation cleared Congress on July 22, 2004 and was signed into law by the President on August 5 (P.L.108-287).

Congress also passed (September 7, 2004; H.R. 5005) and the President signed (September 8, 2004; P.L. 108-303) an emergency supplemental appropriation for FY2004 in response to the August and September hurricanes in Florida. (Additional supplemental appropriations for disaster relief were adopted in early FY2005.)

The Treasury released final budget numbers for FY2004 on October 14, 2004, in the *Final Monthly Treasury Statement of Receipts and Outlays of the United States Government*.

Outlays

The Administration's FY2004 budget (February 2003) proposed \$2,229 billion in outlays for FY2004, rising to \$2,711 billion in FY2008, the last year forecast in the President's budget. The current services baseline in the President's budget (estimates of what future outlays would be if policies remained unchanged over the forecast period) showed outlays of \$2,189 billion in FY2004 growing to \$2,541 billion in FY2008.

The Administration's proposals, if adopted as proposed, would have raised outlays \$89 billion above the Administration's proposed FY2003 level and \$40 billion above its FY2004 current services baseline outlay estimate. The difference between the current services baseline outlay estimate and the proposed outlay amount for FY2004 measures the "cost" of the Administration's proposed policies. The year-to-year change (the \$89 billion increase) combines the effects of policy changes from

¹³ The Administration arbitrarily reduced receipts by \$20 billion, thereby increasing the deficit by \$20 billion, in its February 2004 budget for "revenue uncertainty ... and have been made in the interest of cautious and prudent forecasting." OMB, *Budget of the United States Government for FY2005, Analytical Perspectives*, p. 239, February 2004.

year to year with the relatively automatic growth in large parts of the budget. These increases include cost-of-living adjustments, growth in populations eligible for program benefits, and inflation driven increases. The President's budget did not include estimated costs of any (at that time, possible future) conflict with Iraq for either FY2003 or FY2004.

Table 2. Outlays for FY2003-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	\$2,011 ^a	\$2,121	\$2,199	\$2,298	\$2,3878	\$2,4795	\$2,583	\$3,167
President's F04 Budget, 2/3/03		2,140	2,229	2,343	2,464	2,576	2,711	—
President's FY04 Current Services, 2/3/03		2,131	2,189	2,276	2,348	2,440	2,541	—
CBO Revised Baseline, 3/03		2,137	2,224	2,328	2,417	2,513	2,621	3,215
CBO Est. of the President's Policies, 3/03		2,143	2,245	2,370	2,491	2,606	2,739	3,452
House FY2004 Budget Resolution, 3/21/03		2,143	2,232	2,337	2,450	2,556	2,675	3,335
Senate FY2004 Budget Resolution, 3/26/03		2,148	2,246	2,372	2,491	2,607	2,734	3,338
Conference FY2004 Budg. Res. 4/11/03		2,182	2,268	2,375	2,494	2,607	2,737	3,387
OMB MSR 7/15/03		2,212	2,272	2,338	2,452	2,573	2,706	—
OMB MSR, Baseline, 7/15/03		2,210	2,252	2,304	2,377	2,481	2,587	—
CBO Update, Baseline, 8/26/03		2,157 ^a	2,305	2,404	2,501	2,624	2,761	3,422
CBO B&E Outlook, Baseline, 1/26/04		—	2,294	2,411	2,525	2,652	2,783	3,457
OMB, Budget for FY2005, 2/2/04		—	2,319	2,400	2,473	2,592	2,724	—
CBO Revised Baseline, 3/8/04		—	2,295	2,413	2,528	2,659	2,791	3,473
CBO Estimate of Pres's Policies, 3/8/04		—	2,295	2,384	2,482	2,593	2,722	3,429
Senate, FY05 Budget Resolution S.Con.Res. 95, 3/5/04		—	2,295	2,367	2,469	2,582	2,698	—
House, FY05 Budget Resolution H.Con.Res. 393, 3/19/04		—	2,295	2,406	2,492	2,591	2,712	—
Conf., FY05 Budget Resolution S.Con.Res. 95, 5/19/04*		—	2,338	2,405	2,479	2,602	2,725	—
OMB, Mid-Session Rev. 7/30/04		—	2,319	2,423	2,500	2,623	2,762	—
CBO Update 9/7/04		—	2,293	2,442	2,577	2,714	2,849	3,547
Actual for FY2004		—	2,293	—	—	—	—	—

a. Actual outlays for FY2002 and FY2003.

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

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

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

Total outlays, in the President's budget, were projected to grow at an average annual rate of 5.0% between FY2004 and FY2008. Broad categories of spending (budget functions) showed varying rates of growth. The health budget function increased at an annual average rate of 7.9%, the Medicare function increased at an annual average rate of 7.8%, and net interest increased at an annual average rate of 9.6% over these years.^{14,15} These three functions accounted for over 53% of the total

¹⁴ Budget functions combine, "budget data according to the major purpose served" rather than by agency or program. OMB, *Budget of the U.S. Government for FY2004, Analytical Perspectives*, p. 463.

¹⁵ The Energy budget function has an even higher rate of increase, growing by an annual (continued...)

outlay increase in the President's budget during this period. All of the other fifteen budget functions have a lower annual growth rate than that of total outlays.¹⁶ The relatively low growth in some budget functions (agriculture 0.8%, education, training, employment, and social services 1.2%, general government 1.2%, and natural resources and environment 1.5%), growth that is lower than the expected rate of inflation, will reduce these functions' spending, both in real terms and as shares of total spending.

The January 2003 CBO baseline, which, like the Administration's current services baseline estimates, assumed no changes from existing government policy, forecast FY2004 outlays of \$2,199 billion, FY2008 outlays of \$2,583 billion, and, because CBO's estimates extended through FY2013, FY2013 outlays of \$3,167 billion.¹⁷ As should be expected, the CBO baseline estimates were similar to the Administration's current services baseline estimates for the same years (FY2004-FY2008).

The revisions in CBO's March 2003 report raised estimated FY2004 baseline outlays by \$25 billion, to \$2,224 billion (mostly because of the inclusion of the effects of adopting the Consolidated Appropriations Resolution, 2003 (P.L. 108-7)) in February 2003. Each of the subsequent year's outlays were larger in the CBO March estimates than they were in CBO's January baseline.

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

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

¹⁵ (...continued)

average rate of 18.3%, but since it only makes up 0.04% of total outlays in FY2004 and 0.07% of outlays in 2008, it has little effect on the overall change in outlays.

¹⁶ The two budget functions, "allowances," and "undistributed offsetting receipts," were excluded from the total number of functions.

¹⁷ These projections followed very similar rules as those used by the Administration to produce its current services baseline estimates. CBO and OMB used different budget models and a number of different underlying assumptions, which generated much of the difference in the two estimates.

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

The conference report on the FY2004 budget resolution (H.Rept. 108-71) included outlays of \$2,268 billion in FY2004 and \$3,387 billion in FY2013. In addition, the conference agreement required most of the authorizing committees in the House and Senate to report the amount of “waste, fraud, and abuse” within the programs under their jurisdiction to their respective Budget Committees by September 2003 (very few did).

The July 2003 *Mid Session Review* (MSR), reflecting the legislation adopted since the February budget release, raised FY2004 current services baseline outlays to \$2,252 billion from the original baseline outlays of \$2,189 billion, a 3% increase. Outlays under the Administration’s policy proposals, some of which had been modified since the original proposal, grew to \$2,272 billion from the originally proposed \$2,229 billion, a 2% increase. Some of the change resulted from the differences between the legislation adopted by Congress and what the President originally proposed. Outlays under the proposals in the MSR reached \$2,706 billion in FY2008, slightly below the amount originally projected (\$2,711 billion).

CBO’s August 2003 baseline raised estimated baseline outlays by \$81 billion from its March baseline estimates (\$2,224 billion) to \$2,305 billion for FY2004, an almost 4% increase. By FY2008, baseline outlays would rise to \$2,761 billion, \$140 billion above the March estimates. The effects of legislation adopted since March 2003 accounted for \$92 billion of the increases in FY2004 estimated outlays; \$54 billion of the \$92 billion change came from legislated increases in defense spending.

The January 2004 CBO budget report (for FY2005) revised FY2004 baseline outlay estimates, reducing them to \$2,294 billion, \$11 billion below the August 2003 estimates. The expectations of better economic conditions produced most of the improvement. In subsequent years (FY2005-FY2013), the January estimates were slightly larger than the August estimates. The Administration’s FY2005 budget proposal (February 2004) included revised estimates (and proposals) for FY2004 outlays. The budget raised FY2004 outlays to \$2,319 billion, \$65 billion higher than the Administration’s previous estimate in July 2003.

The unfinished appropriations at the time that CBO and OMB released their reports, early in 2004, for FY2005, increased the uncertainty about the level of spending in FY2004 and subsequent years. Senate action was needed on the omnibus appropriation conference report (H.R. 2673; H.Rept. 108-401; the House passed it on December 8, 2003) containing the remaining 7 regular appropriations for FY2004. The activities funded by these 7 appropriations were funded in January 2004 by the fifth (and final) continuing resolution on appropriations (P.L. 108-185; H.J.Res. 82) for FY2004.

Legislation adopted during 2004 had little effect in changing the FY2004 outlay estimates between March 2004 and the release of actual totals in October 2004.

Receipts

The Administration's FY2004 budget included proposals for tax cuts that the Administration claimed would boost the economic recovery, and to speed up and make permanent many of the tax changes enacted over the last two years. The Administration divided its revenue proposals over FY2004-FY2008 period into an economic growth package (\$390 billion in reductions over FY2004-FY2008); tax incentives (\$72 billion); tax simplification (which would increase receipts by \$13 billion); extending expiring tax provisions (\$40 billion); and miscellaneous changes (which would increase receipts by \$2 billion). The total proposal would reduce receipts from current services baseline levels by \$493 billion between FY2004 and FY2008 and by \$1,461 billion between FY2004 and FY2013.¹⁸ According to the Administration's budget, these changes would slow the overall growth in receipts but would not stop them. The President's FY2004 budget showed receipts growing from \$1,922 billion in FY2004 to \$2,521 billion in FY2008.

CBO's January 2003 baseline included FY2004 receipt estimates of \$2,054 billion, using a somewhat different set of underlying assumptions than what the Administration had used for its current service baseline estimates. The CBO estimates also assumed that the automatic expiration of the tax cuts of EGTRRA would occur as scheduled. The reversion to previous tax law under the baseline assumptions, particularly after 2010 (calendar year), produced a large increase in projected revenues in the following fiscal years. In FY2010, extending the tax cuts produces total estimated receipt that are \$32 billion below the baseline estimates; in FY2011, the level of receipts would be an estimated \$156 billion below the baseline estimates; and by FY2013, they would be an estimated \$260 billion below the baseline estimates. CBO estimated that extending all the EGTRRA tax provisions that are set to expire before FY2013 would reduce cumulative revenues over the FY2004-FY2013 period by \$785 billion (from cumulative baseline revenues of \$27,923 billion).¹⁹

CBO's March 2003 revised baseline estimated revenues fell by \$20 billion to \$30 billion below the January baseline for the years FY2004 through FY2006, after which the January and March baseline estimates were very similar. CBO attributed the change to technical factors. The CBO revenue estimates of the President's proposals were somewhat less than the amounts in the President's budget (\$15 billion to \$30 billion) for fiscal years 2004 through 2006. For subsequent years, CBO's

¹⁸ These estimates are from the Treasury's *General Explanations of the Administration's Fiscal Year 2004 Revenue Proposals*. The President's budget showed a \$441 billion revenue reduction (from baseline estimates) for the FY2004-FY2008 period and a \$1,307 billion reduction for the FY2004-FY2013 period. The Treasury's estimates were produced after the release of the President's budget reflecting modifications to the proposals and adjustments to the estimates. See also the CRS Report RS21420, *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, and the CRS Issue Brief IB10110, *Major Tax Issues in the 108th Congress* for more information on the proposals.

¹⁹ This estimate does not include the higher interest payments resulting from the larger deficits or smaller surpluses occurring over this period that increases public debt.

estimates of the President's revenue proposals exceeded the amounts the Administration projected.

Table 3. Receipts for FY2002-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	\$1,853 ^a	\$1,922	\$2,054	\$2,225	\$2,370	\$2,505	\$2,648	\$3,674
President's F04 Budget, 2/3/03		1,836	1,922	2,135	2,263	2,398	2,521	—
President's FY04 Current Services 2/3/03		1,867	2,031	2,235	2,352	2,469	2,593	—
CBO Revised Baseline, 3/7/03		1,891	2,024	2,205	2,360	2,504	2,647	3,674
CBO Est. of the President's Policies, 3/7/03		1,856	1,907	2,100	2,273	2,433	2,573	3,350
House FY2004 Budget Resolution, 3/21/03		1,855	1,908	2,107	2,282	2,444	2,587	3,372
Senate FY2004 Budget Resolution, 3/26/03		1,865	1,959	2,154	2,321	2,479	2,620	3,497
Conference FY2004 Budg. Res. 4/11/03		1,835	1,883	2,082	2,277	2,441	2,586	3,424
OMB MSR 7/15/03		1,756	1,797	2,033	2,215	2,360	2,480	—
OMB MSR, Baseline, 7/15/03		1,756	1,794	2,063	2,267	2,403	2,525	—
CBO Update, Baseline, 8/26/03		1,782 ^a	1,825	2,064	2,276	2,421	2,564	3,634
CBO B&E Outlook, Baseline, 1/26/04		—	1,817	2,049	2,256	2,385	2,506	3,441
OMB, Budget for FY2005, 2/2/04		—	1,798	2,036	2,206	2,351	2,485	—
CBO Revised Baseline, 3/8/04		—	1,817	2,050	2,255	2,384	2,505	3,439
CBO Estimate of Pres's Policies, 3/8/04		—	1,816	2,027	2,211	2,351	2,470	3,151
Senate, FY05 Budget Resolution, 3/12/04		—	1,817	2,026	2,217	2,359	2,481	—
House, FY05 Budget Resolution, 3/25/04		—	1,818	2,030	2,221	2,351	2,477	—
Conf., FY05 Budget Resolution S.Con.Res. 95, 5/19/04*		—	1,821	2,027	2,235	2,383	2,503	—
OMB, Mid-Session Rev. 7/30/04		—	1,874	2,091	2,239	2,391	2,534	—
CBO Update 9/7/04		—	1,871	2,094	2,279	2,406	2,531	3471
<i>Actual for FY2004</i>		—	1,878	—	—	—	—	—

a. Actual receipts for FY2002 and FY2003.

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

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

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

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

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

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

On May 22, after extensive Republican leadership discussions about the reconciliation bill, a compromise was reached on an estimated \$350 billion multi-year tax cut. The conference committee on the legislation endorsed the agreement and reported (H.Rept. 108-126) the modified H.R. 2 on May 22. The House passed the bill in the very early hours of May 23. The Senate passed the bill before noon on May 23. The President signed it into law (P.L. 108-27, the Jobs and Growth Tax Relief Reconciliation Act or JGTRRA) on May 28.²⁰

OMB's July 2003 mid-year budget report (the *Mid-Session Review* — MSR) estimated that the JGTRRA would reduce FY2004 receipts by \$138 billion (from baseline estimates). Over the period FY2004 through FY2008, OMB estimated that the law would actually increase receipts (compared to the Administration's original proposals, since the original proposal included a larger tax cut) by \$48 billion.

The law included the expiration of the tax changes by the end of 2005, with a reversion to previous law. CBO's August 2003 budget report (The *Budget and Economic Outlook: An Update* — Update) estimated that JGTRRA would lower receipts in FY2004 by \$135 billion from CBO's baseline estimate (the law would also increase outlays by \$12 billion). Over the FY2004 through FY2008 period, CBO estimated that JGTRRA would reduce receipts (compared to CBO's baseline, which did not include the Administration's original tax cut proposal) by \$264 billion.²¹

The next budget report from CBO in January 2004 (the *Budget and Economic Outlook: Fiscal Years 2005-2014*) reduced FY2004 baseline receipts slightly below its previous estimate from August 2003 and reduced estimated receipts in subsequent years by larger amounts. The \$8 billion smaller estimate for FY2004 became a \$58 billion smaller estimate by FY2008 and a \$193 billion smaller estimate by FY2013 (compared to the August 2003 estimates). For FY2004, CBO attributed the reduction

²⁰ Most of the major provisions of the legislation are scheduled to expire after calendar year 2004 or after calendar year 2008. These expirations kept the budgetary change from exceeding the \$350 billion limit set by the agreement. Extending the provisions through 2013 would raise the estimated cost of the legislation, compared to the baseline estimates, close to \$1 trillion over the 11 years.

²¹ Because most of the provisions were designed to expire after FY2005, CBO estimated that the 10-year cost of the tax cut would be only slightly larger, by \$7 billion, to \$271 billion, than the five-year cost, \$264 billion.

to underlying technical components of the estimates; for most of the subsequent years, CBO attributed the reductions to changes in the economic outlook.

The President's budget for FY2005 (February 2004) called for extending and making permanent many of the expiring tax changes and had slightly larger receipts (by \$4 billion) for FY2004 than in its previous estimates from July 2003. The February 2004 estimates had smaller receipts for FY2006 through FY2008 than in the July 2003 estimate.

The CBO March 2004 report analyzing the President's FY2005 budget proposals (*An Analysis of the President's Budgetary Proposals for Fiscal Year 2005*) did not change the FY2004 baseline revenue estimate. The baseline revenue estimates and projections in subsequent years were slightly larger than those in CBO's January report.

The tax legislation adopted later in the year to extend at least some of the expiring tax cuts had little or no effect on FY2004 receipts. The July 2004 *Mid-Session Review* (MSR) from OMB and the early September *Budget and Economic Outlook: An Update* from CBO estimated higher receipts for FY2004 (by \$76 billion and \$54 billion respectively) than they had in their previous reports. Both OMB and CBO attributed most of the net change in FY2004 (from their earlier 2004 reports) receipts to changes in underlying economic assumptions and technical reestimates rather than the effects of legislation.

Actual receipts for FY2004 (from the Treasury, October 14, 2004) were \$1,880 billion, less than a \$10 billion increase from either the OMB or CBO estimates in their respective mid-year budget reports. The number is likely to be slightly revised by the time it appears in the President's FY2006 budget, expected in February 2005.

Deficits and Surpluses

Surpluses and deficits are the residuals left after Congress and the President set policies for spending and receipts. Surpluses reduce federal debt held by the public which leads to lower net interest payments; deficits increase government debt held by the public, increasing net interest payments (assuming no change in interest rates). Reducing the deficit and eventually reaching a balanced budget or generating and keeping a surplus (the government had its first surplus in 30 years in FY1998) was a major focus of the budget debates in the late 1980s and throughout the 1990s. The President's FY2004 budget proposals included a deficit of \$307 billion in FY2004. CBO's March 2003 estimates of the President's proposals had a deficit of \$338 billion in FY2004.

CBO's January 2003 baseline estimates showed the budget returning to surplus in FY2007, with it growing through FY2013. CBO's March 2003 revisions increased the near-term deficits and slowed, by one year, the emergence of a surplus. The growth in the surplus, especially after FY2010, would be boosted substantially, in the baseline estimates, by the scheduled expiration of the 2001 tax cut at the end of 2010.

Table 4. Surpluses/Deficits(-) for FY2004-FY2008 and FY2013
(in billions of dollars)

	FY2002	FY2003	FY2004	FY2005	FY2006	FY2007	FY2008	FY2013
CBO Adjusted Baseline, 1/31/03	-\$158 ^a	-\$199	-\$145	-\$73	-\$16	\$26	\$65	\$508
President's F04 Budget, 2/3/03		-304	-307	-208	-201	-178	-190	—
President's FY04 Current Services 2/3/03		-264	-158	-40	5	29	51	—
CBO Revised Baseline, 3/7/03		-246	-200	-123	-57	-9	27	459
CBO Est. of the President's Policies, 3/7/03		-287	-338	-270	-218	-173	-166	-102
House FY2004 Budget Resolution, 3/21/03		-288	-324	-230	-168	-111	-87	37
Senate FY2004 Budget Resolution, 3/26/03		-282	-287	-218	-169	-128	-114	159
Conference FY2004 Budg. Res. 4/11/03		-347	-385	-294	-217	-166	-151	37
OMB MSR 7/15/03		-455	-475	-304	-238	-213	-226	—
OMB MSR, Baseline, 7/15/03		-455	-458	-241	-110	-78	-62	—
CBO Update, Baseline, 8/26/03		-374 ^a	-480	-341	-225	-203	-197	211
CBO B&E Outlook, Baseline, 1/26/04		—	-477	-362	-269	-267	-278	-16
OMB, Budget for FY2005, 2/2/04		—	-521	-364	-268	-241	-239	-237
CBO Revised Baseline, 3/8/04		—	-477	-363	-273	-274	-286	-34
CBO Estimate of Pres's Policies, 3/8/04		—	-478	-358	-271	-242	-252	-278
Senate FY05 Budget Resolution 3/12/04		—	-477	-338	-252	-223	-218	—
House, FY05 Budget Resolution, 3/21/04		—	-477	-377	-271	-240	-235	—
Conf., FY05 Budget Resolution S.Con.Res. 95, 5/19/04*		—	-474	-367	-255	-194	-186	—
OMB, Mid-Session Rev. 7/30/04		—	-445	-331	-261	-233	-228	—
CBO Update 9/7/04		—	-422	-348	-298	-308	-318	-75
<i>Actual for FY2004</i>		—	-413	—	—	—	—	—

a. Actual deficit for FY2002 and FY2003.

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

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

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

Note: The CBO baselines assume, as required by the baseline construction rules, that because it exists in current law, all of the significant tax cuts adopted in the last several years will expire by the end of (calendar) 2010, thereby producing the surpluses in FY2013.

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

The summer 2003 budget reports from OMB (MSR) and CBO (*Update*) raised the expected deficit estimates for FY2004 and subsequent years. The MSR's current services baseline deficit estimate was \$458 billion for FY2004, falling to \$62 billion in FY2008. The baseline had a cumulative deficit (FY2004-FY2008) of \$949 billion. The Administration estimated that under its policies, a deficit of \$475 billion in FY2004, falling to \$226 billion in FY2008 ((the last year in the Administration's estimates). The proposals would create an estimated cumulative deficit of \$1,456 billion (FY2004-FY2008), \$506 billion larger than the sum of the baseline deficit estimates for those years. The Administration's MSR deficit estimates did not

include “what the Administration has previously indicated are expected but undetermined additional costs arising from the ongoing operations in Iraq, extending beyond 2003.”²² (The President asked for and got from Congress, in the fall of 2003, an \$87.5 billion supplemental appropriation mostly for the ongoing operations in Afghanistan and Iraq.) Implementing the President’s proposals would raise each year’s deficit above the baseline and leave very uncertain whether or not the budget would return to surplus after FY2008.

CBO’s summer 2003 baseline estimates raised the deficit estimate to \$480 billion in FY2004, falling to \$197 billion in FY2008 (and becoming a surplus of \$211 billion in FY2013 after the scheduled expiration of various tax cuts at the end of 2010). The cumulative (FY2004-FY2008) baseline deficit was \$1,445 billion in the CBO report. The 10-year period, FY2004-FY2013, had a cumulative baseline deficit of \$1,397 billion (smaller than the five-year cumulative deficit because of the forecast return to surpluses in the second five-year period).

The January 2004 CBO baseline estimates for the FY2005 budget cycle included revised deficit estimates for FY2004 through FY2014. CBO estimated the baseline deficit for FY2004 at \$477 billion. The deficits in subsequent years were larger than CBO had estimated in August 2003, with the budget never returning to surplus throughout the period. (The CBO March 2004 revisions slightly increased deficits throughout the projection period beginning in FY2005.)

The Administration’s FY2005 budget (February 2004) included larger deficit estimates for FY2004 and subsequent years that reflected the effects of the Administration’s policy proposals. The budget included a FY2004 deficit estimate of \$521 billion, up from the \$475 billion level in the July 2003 *Mid-Session Review*. The Administration arbitrarily reduced its FY2004 revenue estimate by \$20 billion in the budget, thereby raising the FY2004 deficit by \$20 billion. CBO’s March 2004 estimates of the President’s proposals produced a deficit of \$477 billion for FY2004. Although the President’s budget estimated that the deficit would fall to \$237 billion in FY2009, half the amount that the Administration expects in FY2004, almost all of the reduction occurs between FY2004 and FY2006. After FY2006, the deficit, in dollars, changes very little through FY2009, the last year of detailed projections in the Administration’s budget.

In addition to the reestimates the President’s proposals, CBO’s March 2004 report included updated baseline estimates. There was no change in CBO’s FY2004 baseline deficit from the one in January 2004. The March baseline deficit estimates for subsequent years were somewhat larger than they had been in CBO’s January 2004 budget report.

The 2004 mid-year reports from OMB (July 30) and CBO (September 7) contained smaller deficit estimates for FY2004 than had their earlier (2004) budget reports. OMB estimated that the deficit would be \$445 billion for FY2004 while CBO estimated that the deficit would be \$422 billion (the actual deficit as reported by the Treasury in October was \$413 billion). CBO attributed much of the deficit

²² OMB, *Mid-Session Review*, July 15, 2003, p.1.

reduction since its March report to higher receipts than expected earlier, mostly from the effect of changed economic conditions and technical changes. Neither legislation nor any changes in outlays had much effect on these final deficit estimates.

CBO's Alternative Policies Not Included in the Baseline

CBO's summer report (August 2003) also included estimates of the "budgetary effects of policy alternatives not included in CBO's baseline." The alternatives include policies that have a high probability of being enacted or seriously debated. They included extending expiring tax provisions, the reform of the alternative minimum tax (AMT), Medicare reform — including a prescription drug benefit (which had not yet been adopted), and increasing discretionary spending at the growth rate of nominal GDP or at the average rate of discretionary spending growth from FY1998 through FY2003. The alternatives are all fairly costly, running from \$112 billion for AMT reform for FY2004 through FY2008 to \$608 billion for increasing discretionary spending at its recent historical growth rate for the same years.

During the 10 years, FY2004-FY2013, these costs become much larger, ranging from \$400 billion for both AMT and Medicare reform, to \$1,564 billion to extend the expiring provisions, to \$2,833 billion for increasing discretionary spending at the recent historical rate. Combining these effects (and excluding the cost of increasing discretionary spending at the rate of nominal GDP growth) with the baseline deficit estimate and projection raises the FY2004 deficit to \$510 billion, the FY2008 deficit to \$577 billion, and, instead of becoming a \$161 billion surplus in FY2012, the alternatives produce a deficit of \$765 billion in that year and a deficit of \$826 billion in FY2013. Under these alternative policies, the cumulative deficit for FY2004 through FY2008 rises from \$1,455 billion in the baseline to \$2,577 billion under the alternatives. For the 10 year period, FY2004 through FY2013, the cumulative deficit rises from \$1,397 billion in the baseline to \$6,193 billion with the alternatives included. Adoption of these alternative policies moves the budget further into deficit with no indications of it moving towards balance.

The Longer Run

Over a longer period, one running decades into this century, the Administration indicated (in its FY2004 budget) that it expects, under existing policies and assumptions, large and continually growing deficits beginning sometime in the next decade. The retirement of the baby boom generation, beginning in large numbers within 15 years, will rapidly drive up spending on Social Security, Medicare, and other programs for the elderly, doubling these collective programs' size as a percentage of GDP. Their growth under current policy will raise the deficit (or reduce the surplus, if there is one) and put a severe strain on both the budget and the economy. The tax cuts and spending increases of the last few years intensified the already existing long-term budget pressure.

The Budget and the Economy

The budget and the economy affect each other unequally. Small economic changes have a more significant effect on the budget than the effect of large policy changes on the economy. The worse-than-expected recent economic conditions that lasted into 2003 played a substantial role, directly or indirectly, in the deterioration of the budget outlook over those years and affected the outlook for FY2004.

After FY2004, the budget projections (from 2003) assumed that the economy has returned to its normal rate of growth. Under policies that are in fiscal balance, a return to normal economic growth should reduce or eliminate a deficit or produce a surplus. The budget balance, using CBO's August 2003 alternative assumptions, does not improve over the next several years. This implies that the budget has an underlying fiscal imbalance, that the current policies of the government are producing outlays that are too large or receipts that are too small to produce a balanced budget or one in surplus during periods of normal economic growth.

The positive budget outlook forecast in early 2001 was substantially based on the favorable future economic conditions that were then expected along with policies that would continue producing surpluses. The outlook continued the overall improvement in the budget situation since the early 1990s. Much of the improvement had come from strong and sustained economic growth (and the rest from policy changes to reduce the deficit). When those favorable economic conditions faltered, as they did in 2001, so did the string of positive forecasts of the budget outlook. What good economic conditions give, bad economic conditions can take away. The unexpectedly lengthy economic weakness into 2003, the start of a recession in March 2001, the lengthy fall in the stock market, the policy responses to the September 2001 terrorist attacks, along with negative changes in the technical components of the budget estimates, raised outlays, reduced receipts (beyond policy changes), and eliminated the previously expected surpluses.

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

For Additional Reading

- U.S. Congressional Budget Office. *The Budget and Economic Outlook: Fiscal Years 2004-2013*. Washington, GPO, January 31, 2003.
- *An Analysis of the President's Budgetary Proposals for Fiscal Year 2004*. Washington, GPO, March 2003.
- *The Budget and Economic Outlook: An Update*, Washington, GPO, August 26, 2003.
- *Budget Options*. Washington, GPO, March 6, 2003.
- *The Budget and Economic Outlook: Fiscal Years 2005-2014*. Washington, GPO, January 26, 2004.
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- U.S. Council of Economic Advisors. *The Economic Report of the President*. Washington, GPO, February 2003.
- *The Economic Report of the President*. Washington, GPO, February 2004.
- U.S. Office of Management and Budget. *The Budget of the United States Government for Fiscal Year 2004*. Washington, GPO, February 3, 2003.
- *Fiscal Year 2004 Mid-Session Review*, Washington, GPO, July 15, 2003.
- *The Budget of the United States Government for Fiscal Year 2005*. Washington, GPO, February 2, 2004.

CRS Products

- CRS Electronic Briefing Book, *Taxation*,
[<http://www.congress.gov/brbk/html/ebt1.r1.shtml>]
- CRS Report RL30973. *2001 Tax Cut: Description, Analysis, and Background*, by David L. Brumbaugh, Jane G. Gravelle, Steven Maguire, Louis Alan Talley, and Bob Lyke.
- CRS Issue Brief IB10110. *Major Tax Issues in the 108th Congress*, Coordinated by David Brumbaugh.
- CRS Report RS21420. *President Bush's 2003 Tax Cut Proposal: A Brief Overview*, by David Brumbaugh.

CRS Report RL31907. *Tax Cut Bills in 2003: A Comparison*, by David Brumbaugh and Don Richards.

CRS Report RS21684. *FY2004 Consolidated Appropriations Act: Reference Guide*, by Robert Keith.

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

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

CRS Report RL31414. *Baseline Budget Projections: A Discussion of Issues*, by Marc Labonte.

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

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

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

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

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

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