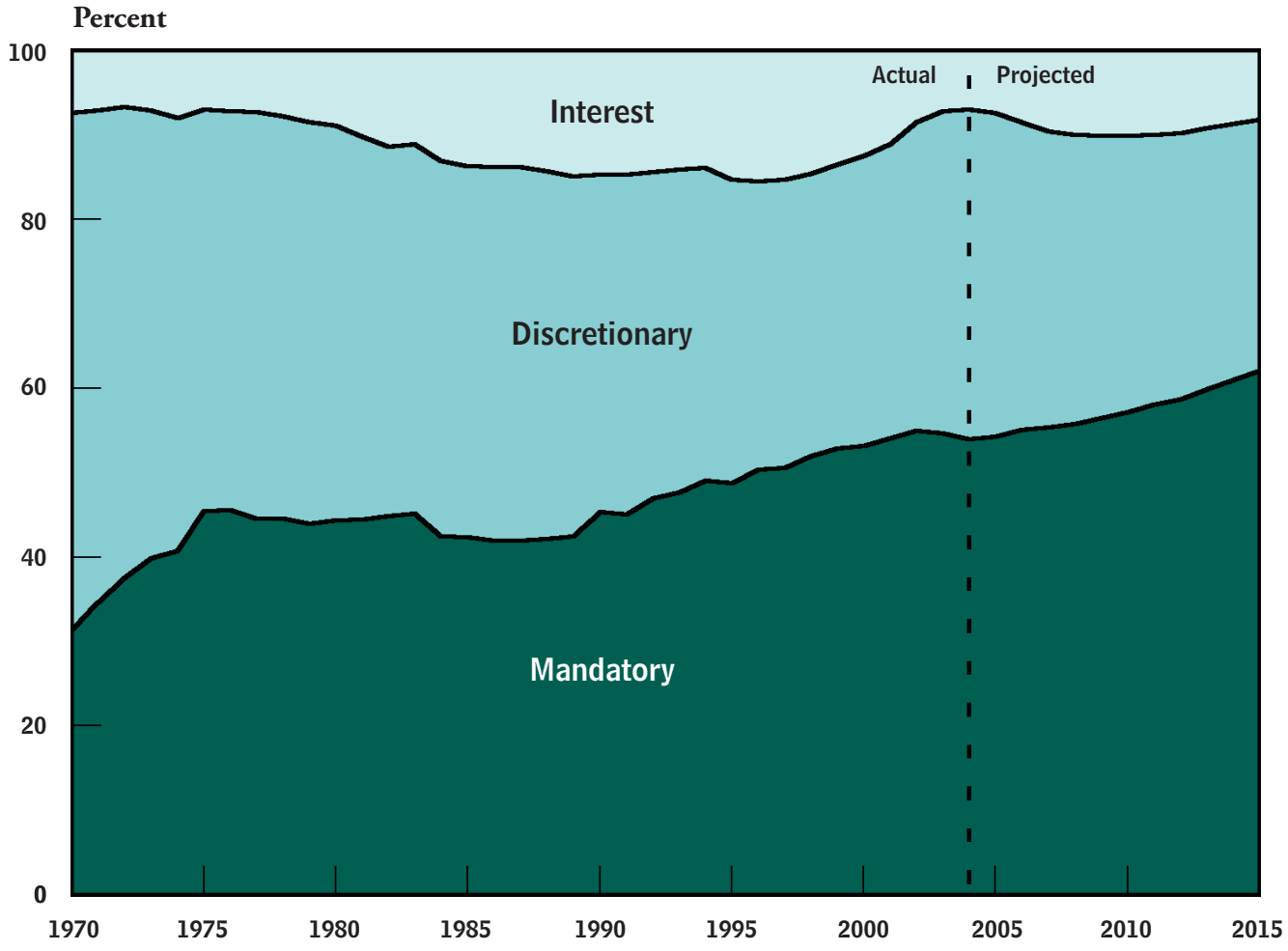
CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

The Budget and Economic Outlook: Fiscal Years 2006 to 2015

Type of Spending as a Share of Total Outlays



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The Budget and Economic Outlook: Fiscal Years 2006 to 2015

January 2005

The Congress of the United States ■ Congressional Budget Office

Notes

Unless otherwise indicated, all years referred to in describing the economic outlook are calendar years; otherwise, the years 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 D 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 (inflation-adjusted) gross domestic product are based on chained 2000 dollars.

Preface

This volume is one of a series of reports on the state of the budget and the economy that the Congressional Budget Office (CBO) issues each year. It satisfies 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, Thomas 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 presented in Chapter 2 was prepared by the Macroeconomic Analysis Division under the direction of Robert Dennis. John F. Peterson, Robert Arnold, and Christopher Williams carried out the economic forecast and projections. David Brauer, Ufuk Demiroglu, Tracy Foertsch, Eva de Francisco, Douglas Hamilton, Juann Hung, Kim Kowalewski, Mark Lasky, Angelo Mascaro, Shinichi Nishiyama, Benjamin Page, Frank Russek, Robert Shackleton, and Sven Sinclair contributed to the analysis. Adam Gordon, 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, Dan Crippen, William C. Dudley, Martin Feldstein, Robert J. Gordon, Robert E. Hall, Robert Glenn Hubbard, Lawrence Katz, Catherine L. Mann, Allan H. Meltzer, Laurence H. Meyer, William D. Nordhaus, June E. O'Neill, Rudolph G. Penner, James Poterba, Robert Reischauer, and Alice Rivlin. Martin Baily, Nada Eissa, Paul Fronstin, and Casey Mulligan 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, Mark Booth, Ann Futrell, and Eric Schatten wrote Chapter 1 (David Newman wrote Box 1-1). Robert Arnold was the lead author for Chapter 2. Gerard Trimarco and Christina Hawley Sadoti authored Chapter 3, with assistance from Thomas Bradley and Eric Schatten. Mark Booth and Thomas Woodward were the lead authors for Chapter 4. Ellen Hays wrote Appendixes A and C; Frank Russek and Barry Blom, Appendix B; and David Brauer, Appendix D. Robert Arnold prepared Appendix E, and Ann Futrell compiled Appendix F. Jennifer Smith produced the glossary.

Christine Bogusz, Janey Cohen, Loretta Lettner, Leah Mazade, John Skeen, and Christian Spoor edited the report. Marion Curry, Linda Lewis Harris, and Denise Jordan-Williams

assisted in its preparation. Maureen Costantino designed the cover and prepared the report for publication. Lenny Skutnik and Carter Campbell printed the initial copies, and Annette Kalicki and Simone Thomas, with assistance from Martina Wojak-Piotrow, produced the electronic versions for CBO's Web site (www.cbo.gov).

Douglas Holtz-Eakin
Director

January 2005

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Summary

The Congressional Budget Office (CBO) projects that if current laws and policies remained the same, the federal government would run budget deficits of $368 billion in 2005 and $295 billion in 2006 (see Summary Table 1). However, because of the statutory rules that govern such baseline projections, those estimates omit a significant amount of spending that will occur this year—and conceivably for some time in the future—for U.S. military operations in Iraq and Afghanistan and for other efforts in the war on terrorism.

Additional appropriations for such purposes are expected to add about $30 billion to the deficit this year and possibly more next year. Thus, the 2005 deficit is likely to total around $400 billion and the 2006 deficit well over $300 billion. With that extra spending included, the deficit in 2005 would amount to about 3.3 percent of gross domestic product (GDP)—compared with last year's deficit of 3.6 percent of GDP.

The absence of further appropriations for activities in Iraq and Afghanistan also masks a deterioration in budget projections over the 10 years in CBO's baseline. Since September 2004, when CBO last made projections,[1] the cumulative deficit projected for the 2005-2014 period (the 10 years covered by the previous baseline) has declined from $2.3 trillion to $1.4 trillion. However, following rules set forth in law, CBO's September baseline extrapolated supplemental funding for 2004—provided mostly for activities in Iraq and Afghanistan—throughout the 10-year period, thereby increasing projected outlays by more than $1.4 trillion (including the additional interest payments on federal debt). CBO's current baseline does not include appropriations for those activities because the funds have not been provided yet this year. If the baselines are made comparable by removing that extrapolation of supplemental funding from the preceding baseline, the outlook has actually become less favorable: the total deficit projected for the 2005-2014 period has grown by more than $500 billion, or 0.3 percent of GDP (see Summary Table 2). New legislation accounts for about three-quarters of that increase, most of it from recent laws that extend certain tax provisions and provide funding for disaster relief.

By statute, CBO's baseline projections must estimate the future paths of federal spending and revenues 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 spending and taxes.

Underlying CBO's baseline projections is a forecast that the U.S. economy will continue to grow at a healthy pace in 2005 and 2006. Although real (inflation-adjusted) GDP grew rapidly during the past two years, output remained considerably below the economy's potential. Therefore, by CBO's expectations, GDP will grow at an average annual rate of about 3.8 percent in the next two years to close most of that gap, before slowing to a pace of 2.9 percent for the 2007-2015 period.

Over the longer term, the federal budget will be strained significantly by demographic changes that will begin within the current 10-year projection period and intensify as members of the baby-boom generation age. In particular, the rising cost of health care will contribute to the growth of programs for elderly and low-income beneficiaries. As a result, under current law, total federal spending for Social Security, Medicare, and Medicaid is projected to grow by about 25 percent over the next 10 years relative to the size of the economy—from 8.4 percent of GDP in 2004 to 10.4 percent of GDP in 2015.

After 2015, if the growth of health care costs continues to exceed that of the economy, outlays for Social Security, Medicare, and Medicaid will claim an even larger share of federal spending as the percentage of the population age

1. See Congressional Budget Office, *The Budget and Economic Outlook: An Update* (September 2004).

Summary Table 1.

CBO's Baseline Budget Outlook

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
							In Billions of Dollars							
Total Revenues	1,880	2,057	2,212	2,357	2,508	2,662	2,806	3,062	3,303	3,474	3,657	3,847	12,545	29,888
Total Outlays	2,292	2,425	2,507	2,618	2,743	2,869	2,996	3,142	3,232	3,389	3,542	3,706	13,733	30,743
Total Deficit (-) or Surplus	**-412**	**-368**	**-295**	**-261**	**-235**	**-207**	**-189**	**-80**	**71**	**85**	**115**	**141**	**-1,188**	**-855**
On-budget	-567	-541	-484	-471	-464	-453	-451	-357	-217	-212	-190	-169	-2,323	-3,469
Off-budget[a]	155	173	190	210	229	246	262	277	288	298	305	310	1,136	2,614
Debt Held by the Public at the End of the Year	4,296	4,665	4,971	5,246	5,494	5,716	5,919	6,012	5,955	5,884	5,784	5,658	n.a.	n.a.
							As a Percentage of GDP							
Total Revenues	16.3	16.8	17.2	17.3	17.5	17.7	17.8	18.6	19.2	19.3	19.4	19.6	17.5	18.5
Total Outlays	19.8	19.8	19.5	19.3	19.2	19.1	19.0	19.0	18.7	18.8	18.8	18.9	19.2	19.0
Total Deficit (-) or Surplus	**-3.6**	**-3.0**	**-2.3**	**-1.9**	**-1.6**	**-1.4**	**-1.2**	**-0.5**	**0.4**	**0.5**	**0.6**	**0.7**	**-1.7**	**-0.5**
Debt Held by the Public at the End of the Year	37.2	38.1	38.6	38.6	38.4	38.0	37.6	36.5	34.5	32.6	30.7	28.8	n.a.	n.a.
Memorandum:														
Gross Domestic Product (Billions of dollars)	11,553	12,233	12,888	13,586	14,307	15,029	15,757	16,494	17,245	18,023	18,826	19,652	71,566	161,806

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.

65 or older continues to rise (from 14 percent in 2015 to 19 percent in 2030). Thus, over the long term, the increasing resources needed for such programs will exert pressure on the federal budget that will make current fiscal policy unsustainable.

The Budget Outlook

Under the assumption that current laws and policies remain unchanged, CBO projects that federal deficits will begin to decline this year. In CBO's baseline, deficits drop as a percentage of GDP, from the 3.6 percent recorded in 2004 to 1.2 percent in 2010. Beginning in 2012—if taxes increased as scheduled under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), discretionary spending continued to grow no faster than inflation, and other policies stayed the same—the budget would shift to small annual surpluses.

Over the 2005-2015 period, outlays are projected to grow at an average annual rate of 4.3 percent and to gradually diminish from 19.8 percent of GDP this year to 18.9 percent in 2015 (see Summary Figure 1). That downward drift of total outlays as a percentage of GDP is driven by the treatment of discretionary spending under rules set forth in law. CBO projects growth in 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, CBO's baseline projection for discretionary outlays falls from 7.6 percent of GDP in 2005 to 5.6 percent in 2015. Including future costs for activities in Iraq and Afghanistan (and for other such activities) would probably not affect that trend significantly.

Summary Table 2.

Changes Since September 2004 in CBO's Estimate of the Cumulative Deficit for 2005 to 2014

(Billions of dollars)

	10-Year Total
September 2004	
Projected deficit	-2,294
Less the effect of extending supplemental appropriations for 2004	1,433
Adjusted projected deficit	-861
Other Changes to the Baseline Since September 2004	
Legislative	-371
Economic	41
Technical	-173
Total	**-504**
January 2005	
Projected deficit	-1,364

Source: Congressional Budget Office.

Note: According to rules set forth in law, CBO's September 2004 baseline extrapolated through 2014 supplemental appropriations of $115 billion provided in 2004 (mostly for operations in Iraq and Afghanistan). CBO's January 2005 baseline does not include appropriations for those operations because the funds have not been provided yet this year. Hence, for the purpose of making a consistent comparison between the September 2004 and January 2005 baselines, this table removes the extension of such supplemental appropriations from the previous baseline. The 10-year totals include changes in projected debt-service costs (interest payments on federal debt) resulting from projected changes in the government's borrowing.

Negative numbers in this table represent deficits or increases to deficits.

In the current baseline, which covers 2006 through 2015, the cumulative deficit totals $855 billion.

Mandatory spending continues to account for a rising share of federal outlays; such spending is projected to grow from 54 percent of total outlays in 2004 to 62 percent in 2015 (see Summary Figure 2). Under the assumption that no changes in policy take place, spending for mandatory programs is projected to grow by 5.7 percent a year—faster than the rate projected for the economy as a whole. Such growth is driven largely by outlays for Medicare and Medicaid, which are projected to rise at average annual rates of 9.0 percent and 7.8 percent, respectively, through 2015. By the middle of the projection period, Social Security spending is also expected to grow faster than the economy, as the baby-boom generation begins to collect benefits.

Revenues are projected to total 16.8 percent of GDP this year—nearly 1.5 percentage points below the average since 1962 (18.2 percent). Over the coming decade, revenues are expected to continue increasing, growing faster than GDP in every year of the projection period. That ascent is driven by the structure of the tax system, which causes revenues to claim a higher fraction of income in taxes every year as income grows. In addition, a large boost in revenues occurs in CBO's baseline after the major provisions of EGTRRA expire at the end of 2010. By 2015, such receipts are projected to reach 19.6 percent of GDP.

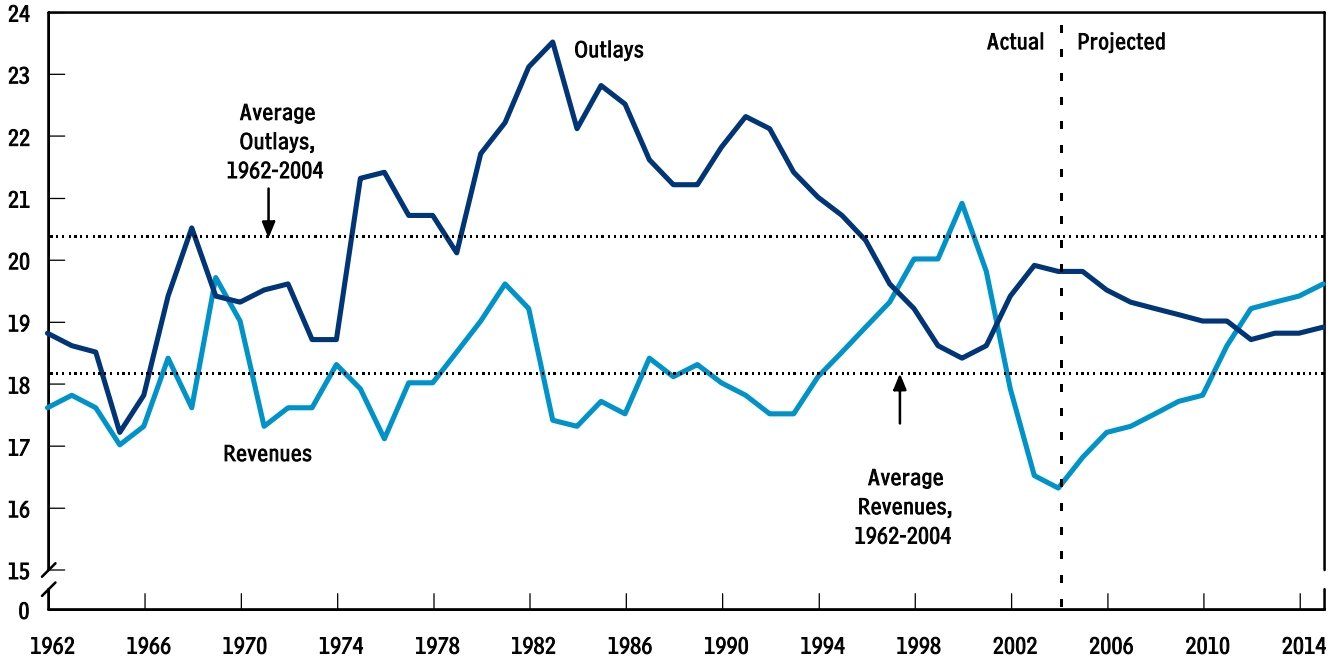
Debt held by the public (the most meaningful measure of federal debt in terms of its relationship to the economy) is anticipated to equal 38.1 percent of GDP at the end of this fiscal year. In CBO's baseline, that debt stabilizes at around its current level of GDP through 2010, at which point the federal government's diminished need to borrow reduces the growth of such debt.

Since September, when CBO issued its previous baseline, changes unrelated to the treatment of spending for activities in Iraq and Afghanistan have increased the cumulative deficit projected for 2005 to 2014 by more than $500 billion. Among the legislation that contributed to that increase was the Working Families Tax Relief Act of 2004. That law extended several tax provisions, including the 10 percent tax bracket, relief from the marriage penalty, and the increase in the child tax credit—thereby adding $146 billion to the 10-year deficit (excluding debt-service costs). In addition, supplemental appropriations for 2005 provide $11.5 billion in disaster relief for hurricane victims; extrapolating that budget authority through 2014 (following rules for the baseline) adds $94 billion to discretionary spending. Revisions to the baseline caused by changes in CBO's economic forecast were fairly small, reducing the projected 10-year deficit by $41 billion. Other, so-called technical revisions to the baseline—mostly involving revenues—increased that cumulative deficit by $173 billion.

Summary Figure 1.

Total Revenues and Outlays as a Percentage of GDP, 1962 to 2015

(Percentage of GDP)



Source: Congressional Budget Office.

The Economic Outlook

According to CBO's forecast, in 2005 and 2006, the U.S. economy continues to grow at a healthy pace. Although investment by businesses is not expected to grow as rapidly as in 2004, such spending will probably still lead the economy's continuing expansion. Moreover, the caution that has characterized firms' decisions over the past three years appears to be dissipating, and businesses seem to be having greater difficulty meeting increases in demand with their current workforce; as a result, hiring should accelerate. Growth of productivity, which has been exceptionally strong since 2001, is expected to slow relative to its rate in the recent past but to continue at a pace similar to the long-run average. Thus, CBO expects that real GDP will grow by 3.8 percent in calendar year 2005 and 3.7 percent in 2006, before slowing to a pace of 2.9 percent for the 2007-2015 period (see Summary Table 3).

The rate of unemployment is forecast to decline from 5.4 percent at the end of 2004 to 5.2 percent in 2005 and 2006. During the 2007-2015 period, the rate of unemployment is expected to average 5.2 percent.

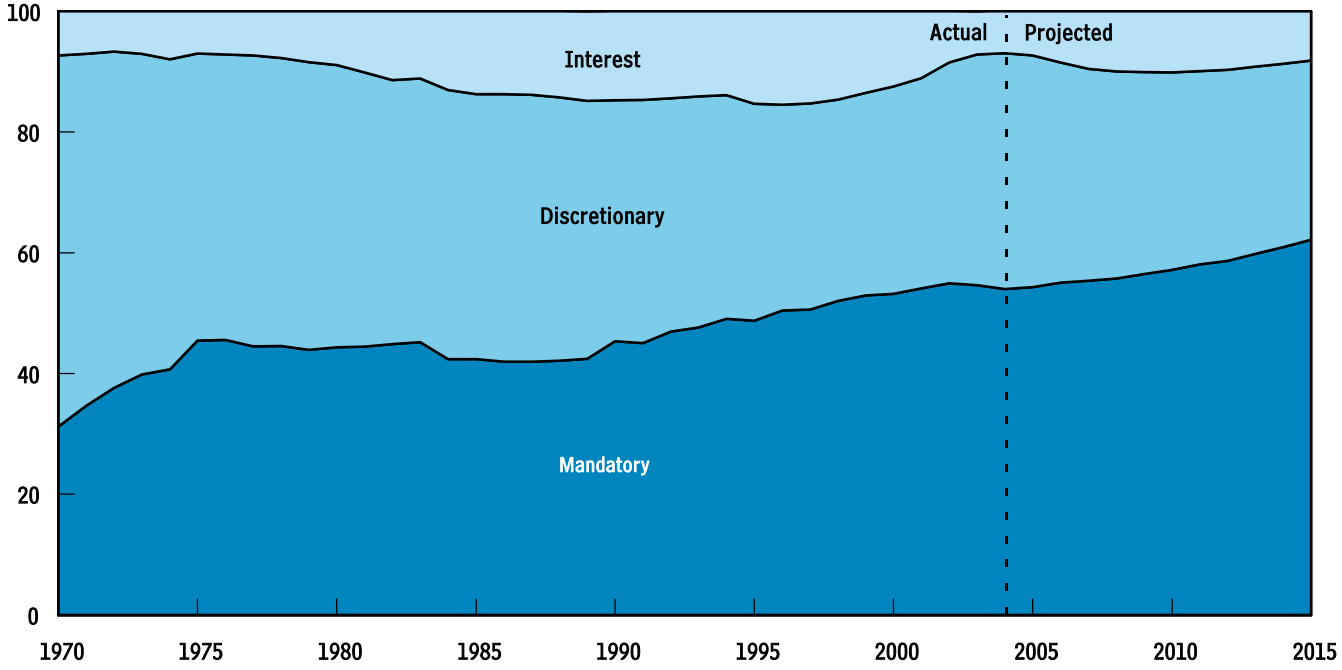
According to CBO's forecast, inflation is lower in 2005 and 2006 than in 2004. A surge in energy prices, along with an acceleration in the cost of shelter and in used car prices, caused a spike in inflation in 2004, as measured by the consumer price index for all urban consumers. That increase is not expected to feed into core inflation (inflation excluding changes in prices for food and energy). CBO projects that consumer prices will rise by 2.4 percent in 2005 and 1.9 percent in 2006; during the 2007-2015 period, CBO anticipates growth averaging 2.2 percent.

Interest rates are expected to move upward during the next two years, as the economy grows and the Federal Reserve continues to move toward a more neutral monetary policy. CBO forecasts that the three-month Treasury bill rate will rise to about 2.8 percent in 2005 and 4 percent in 2006; thereafter, it will average 4.6 percent, which is relatively low by historical standards. In the forecast, the rise in the rate for the 10-year Treasury note is somewhat smaller; it averages 4.8 percent in 2005 and 5.4 percent in 2006, then inches up to average 5.5 percent from 2007 to 2015.

Summary Figure 2.

Type of Spending as a Share of Total Outlays, 1970 to 2015

(Percent)



Source: Congressional Budget Office.

Summary Table 3.

CBO's Economic Projections for Calendar Years 2005 to 2015

	Estimated	Forecast		Projected Annual Average	
	2004	2005	2006	2007-2010	2011-2015
Nominal GDP (Billions of dollars)	11,730	12,396	13,059	15,940 [a]	19,861 [b]
Nominal GDP (Percentage change)	6.6	5.7	5.3	5.1	4.5
Real GDP (Percentage change)	4.4	3.8	3.7	3.3	2.7
GDP Price Index (Percentage change)	2.1	1.8	1.5	1.8	1.8
Consumer Price Index[c] (Percentage change)	2.7	2.4	1.9	2.2	2.2
Unemployment Rate (Percent)	5.5	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	1.4	2.8	4.0	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	4.3	4.8	5.4	5.5	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 2010.

b. Level in 2015.

c. The consumer price index for all urban consumers.

CHAPTER

1

The Budget Outlook

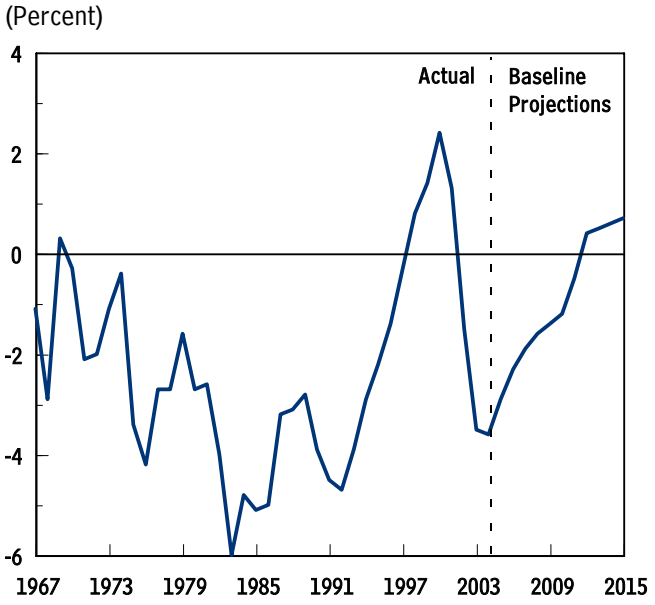
The Congressional Budget Office's (CBO's) new baseline projections indicate that if current laws and policies did not change, the federal budget would run a deficit of $368 billion in 2005 and a smaller deficit, $295 billion, next year. After that, annual deficits would gradually decline, turning into a small surplus by 2012, assuming that various tax increases occurred as scheduled. Relative to the size of the economy, the deficit would equal 3.0 percent of the nation's gross domestic product (GDP) this year and 2.3 percent of GDP in 2006. By 2015, the end of CBO's 10-year projection period, the baseline surplus would equal 0.7 percent of GDP (see Figure 1-1).

At first glance, the current baseline budget outlook may appear to have improved relative to CBO's previous projections, which were issued last September.[1] The cumulative deficit projected for the 2005-2014 period (the 10 years covered by the previous baseline) has declined from $2.3 trillion to $1.4 trillion. However, because of the statutory rules that govern baseline projections, the current baseline omits a significant amount of spending that will occur this year—and possibly for some time to come—for U.S. military operations in Iraq and Afghanistan and for other activities related to the global war on terrorism. Likewise, those rules may have led the September 2004 baseline to overstate such costs.

Under the Balanced Budget and Emergency Deficit Control Act of 1985, discretionary spending (spending controlled by annual appropriation acts) is projected by assuming that the most recent year's funding is continued in each subsequent year with adjustments for projected inflation. In 2004, supplemental appropriations provided $115 billion for operations in Iraq and Afghanistan (and for other activities); in CBO's September baseline, that sum was extrapolated for each future year.[2] But so far in 2005, no appropriations have been provided for those operations. As a result, unlike the preceding projections, the

Figure 1-1.

The Total Deficit or Surplus as a Percentage of GDP, 1967 to 2015



Source: Congressional Budget Office.

1. Those projections were published in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (September 2004).

2. That $115 billion, which included a small amount of funding unrelated to activities in Iraq and Afghanistan, comprised funding from two laws that provided supplemental appropriations for 2004. The first, enacted in November 2003, provided $87 billion. The second, the Department of Defense Appropriations Act, 2005, provided another $28 billion for 2004 (including $1.8 billion from reversing a rescission that had previously been enacted but not yet applied). In addition, $2 billion in supplemental funding for hurricane relief was provided in September, after CBO published its baseline.

Table 1-1.

Comparison of CBO's January 2005 and September 2004 Baseline Deficits or Surpluses

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2014
Baseline Deficit (-) or Surplus as Projected in January 2005[a]	-368	-295	-261	-235	-207	-189	-80	71	85	115	-1,364
Deficit (-) or Surplus as Projected in September 2004 and Adjusted to Exclude the Extension of Supplemental Appropriations[b]	-310	-202	-187	-183	-166	-142	-32	108	115	138	-861
Memorandum:											
Baseline Deficit as Projected in September 2004[b]	-348	-298	-308	-318	-312	-298	-200	-70	-75	-65	-2,294

Source: Congressional Budget Office.

a. Does not include additional funding for operations in Iraq and Afghanistan, which has not yet been requested for 2005.

b. CBO's September 2004 baseline extrapolated $115 billion in supplemental funding (mostly for activities in Iraq and Afghanistan) throughout the 2005-2014 period. Excluding the extension of such funding reduces outlays over that period by $1.4 trillion (including debt-service costs).

current baseline includes only outlays for such activities that result from appropriations enacted for previous years.

Once further appropriations for those operations are provided, they are likely to add about $30 billion to the deficit this year and possibly more next year. (For a discussion of one plausible path for future spending on military operations in Iraq and Afghanistan and the global war on terrorism, see page 9.) Thus, the 2005 deficit is likely to total around $400 billion and the 2006 deficit well over $300 billion. With that extra spending for military operations included, the 2005 deficit would amount to about 3.3 percent of GDP—compared with the deficit in 2004 of 3.6 percent of GDP.

Under identical assumptions about spending on Iraq, Afghanistan, and other activities related to the war on terrorism, the current baseline outlook is less favorable than the one presented in September: the total deficit projected for the 2005-2014 period has grown from $861 billion to $1.3 trillion—a rise of more than $500 billion, or 0.3 percent of GDP (see Table 1-1). A number of factors account for that increase. The Working Families Tax Relief Act of 2004 (WFTRA)—which extended several tax provisions, including the 10 percent tax bracket, marriage-penalty relief, and the increase in the child tax credit—added $146 billion to the 10-year deficit, mostly by decreasing projected revenues.[3] In addition, supplemental appropriations for 2005 provide $11.5 billion in disaster relief for hurricane victims; extrapolating that budget authority through 2014 added $94 billion to projected discretionary outlays. Revisions to the baseline caused by changes in CBO's economic forecast were fairly small, reducing the cumulative deficit by $41 billion. Other, technical revisions to the baseline—mostly involving revenues—had a greater effect on the 10-year deficit, increasing it by $173 billion.

In the current baseline, total outlays grow at an average rate of 4.3 percent a year and remain around 19 percent to 20 percent of GDP through 2015 (see Table 1-2). Within that total, mandatory spending (funding determined by laws other than annual appropriation acts) is projected to grow by 5.7 percent a year—faster than the

3. That estimate excludes additional debt-service costs (interest payments on federal debt) that result from the increase in projected deficits.

Table 1-2.

CBO's Baseline Budget Projections

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
							In Billions of Dollars							
Revenues														
Individual income taxes	809	899	986	1,082	1,172	1,265	1,362	1,561	1,718	1,822	1,932	2,048	5,867	14,947
Corporate income taxes	189	216	226	226	237	246	249	254	261	270	281	292	1,184	2,542
Social insurance taxes	733	790	833	876	918	962	1,009	1,054	1,102	1,151	1,202	1,253	4,598	10,360
Other	148	153	167	173	181	188	187	192	221	231	243	255	896	2,038
Total	**1,880**	**2,057**	**2,212**	**2,357**	**2,508**	**2,662**	**2,806**	**3,062**	**3,303**	**3,474**	**3,657**	**3,847**	**12,545**	**29,888**
On-budget	1,345	1,484	1,607	1,719	1,836	1,956	2,066	2,287	2,494	2,629	2,775	2,928	9,184	22,297
Off-budget	535	573	605	638	672	706	740	774	809	845	882	919	3,361	7,591
Outlays														
Discretionary spending	895	930	914	919	940	959	980	1,006	1,022	1,050	1,075	1,101	4,713	9,966
Mandatory spending	1,237	1,317	1,380	1,450	1,529	1,620	1,713	1,824	1,896	2,028	2,159	2,303	7,692	17,902
Net interest	160	178	213	249	274	289	303	311	314	311	308	303	1,328	2,875
Total	**2,292**	**2,425**	**2,507**	**2,618**	**2,743**	**2,869**	**2,996**	**3,142**	**3,232**	**3,389**	**3,542**	**3,706**	**13,733**	**30,743**
On-budget	1,913	2,024	2,092	2,190	2,300	2,409	2,517	2,644	2,711	2,841	2,965	3,097	11,508	25,766
Off-budget	380	401	415	428	443	460	479	497	521	548	577	609	2,225	4,977
Deficit (-) or Surplus	**-412**	**-368**	**-295**	**-261**	**-235**	**-207**	**-189**	**-80**	**71**	**85**	**115**	**141**	**-1,188**	**-855**
On-budget	-567	-541	-484	-471	-464	-454	-451	-357	-217	-212	-190	-169	-2,324	-3,469
Off-budget	155	173	190	210	229	246	262	277	289	298	305	310	1,136	2,614
Debt Held by the Public	4,296	4,665	4,971	5,246	5,494	5,716	5,919	6,012	5,955	5,884	5,784	5,658	n.a.	n.a.
Memorandum:														
Gross Domestic Product	11,553	12,233	12,888	13,586	14,307	15,029	15,757	16,494	17,245	18,023	18,826	19,652	71,566	161,806
							As a Percentage of GDP							
Revenues														
Individual income taxes	7.0	7.3	7.7	8.0	8.2	8.4	8.6	9.5	10.0	10.1	10.3	10.4	8.2	9.2
Corporate income taxes	1.6	1.8	1.8	1.7	1.7	1.6	1.6	1.5	1.5	1.5	1.5	1.5	1.7	1.6
Social insurance taxes	6.3	6.5	6.5	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4
Other	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	1.3
Total	**16.3**	**16.8**	**17.2**	**17.3**	**17.5**	**17.7**	**17.8**	**18.6**	**19.2**	**19.3**	**19.4**	**19.6**	**17.5**	**18.5**
On-budget	11.6	12.1	12.5	12.7	12.8	13.0	13.1	13.9	14.5	14.6	14.7	14.9	12.8	13.8
Off-budget	4.6	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7
Outlays														
Discretionary spending	7.7	7.6	7.1	6.8	6.6	6.4	6.2	6.1	5.9	5.8	5.7	5.6	6.6	6.2
Mandatory spending	10.7	10.8	10.7	10.7	10.7	10.8	10.9	11.1	11.0	11.3	11.5	11.7	10.7	11.1
Net interest	1.4	1.5	1.7	1.8	1.9	1.9	1.9	1.9	1.8	1.7	1.6	1.5	1.9	1.8
Total	**19.8**	**19.8**	**19.5**	**19.3**	**19.2**	**19.1**	**19.0**	**19.0**	**18.7**	**18.8**	**18.8**	**18.9**	**19.2**	**19.0**
On-budget	16.6	16.5	16.2	16.1	16.1	16.0	16.0	16.0	15.7	15.8	15.8	15.8	16.1	15.9
Off-budget	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0	3.1	3.1	3.1	3.1
Deficit (-) or Surplus	**-3.6**	**-3.0**	**-2.3**	**-1.9**	**-1.6**	**-1.4**	**-1.2**	**-0.5**	**0.4**	**0.5**	**0.6**	**0.7**	**-1.7**	**-0.5**
On-budget	-4.9	-4.4	-3.8	-3.5	-3.2	-3.0	-2.9	-2.2	-1.3	-1.2	-1.0	-0.9	-3.2	-2.1
Off-budget	1.3	1.4	1.5	1.5	1.6	1.6	1.7	1.7	1.7	1.7	1.6	1.6	1.6	1.6
Debt Held by the Public	37.2	38.1	38.6	38.6	38.4	38.0	37.6	36.5	34.5	32.6	30.7	28.8	n.a.	n.a.

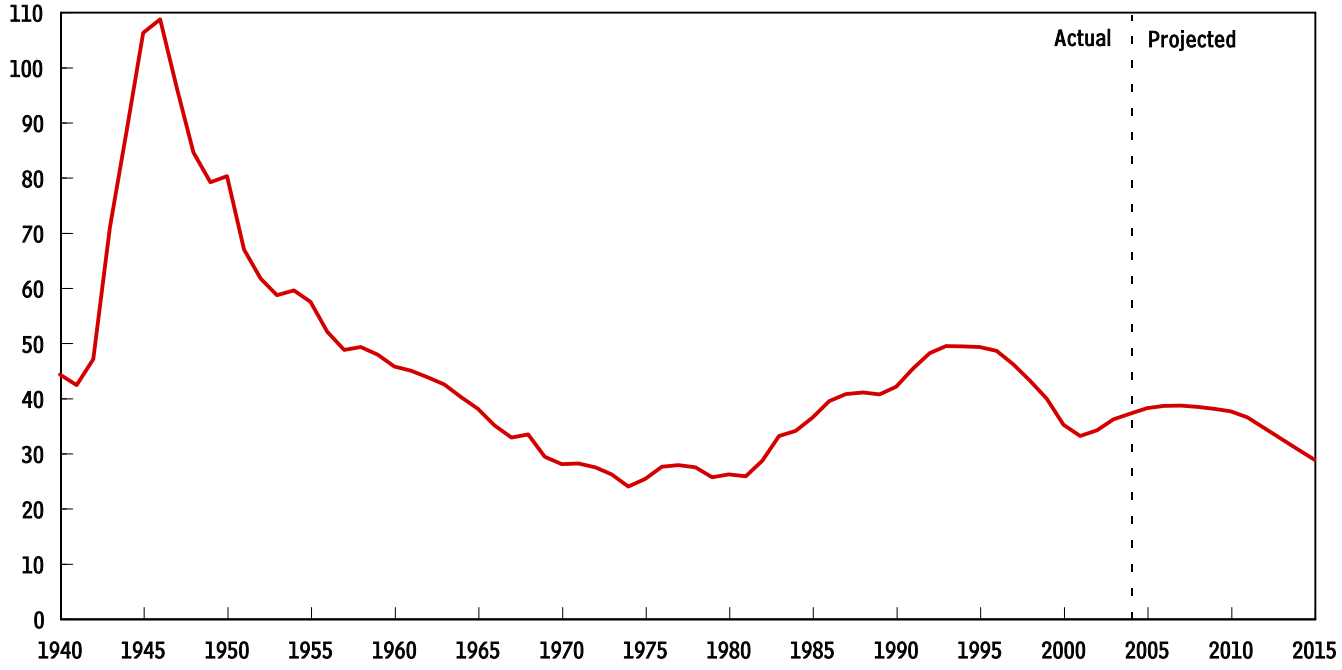
Source: Congressional Budget Office.

Note: n.a. = not applicable.

Figure 1-2.

Debt Held by the Public as a Percentage of GDP, 1940 to 2015

(Percent)



Source: Congressional Budget Office.

economy as a whole. Discretionary appropriations, by contrast, are assumed simply to keep pace with inflation and, to a lesser extent, with wage growth. As explained above, however, the baseline does not include additional funding for military operations in Iraq and Afghanistan and for the global war on terrorism; thus, discretionary outlays are projected to increase by only 1.7 percent a year, on average, from the baseline level for 2005.

For revenues, CBO assumes—as baseline rules require—that the various tax provisions enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and by WFTRA will expire as scheduled on December 31, 2010. As a result, revenues as a percentage of GDP are projected to rise slowly through 2010, from 16.8 percent to 17.8 percent, and then increase more rapidly in 2011 and 2012, reaching 19.6 percent of GDP by 2015.

Accumulated federal debt held by the public (mainly in the form of Treasury bonds) equals about 38 percent of GDP through 2010 in CBO's baseline. Thereafter, projections of shrinking annual deficits diminish the government's need to borrow, causing debt held by the public to decline to less than 29 percent of GDP by 2015 (see Figure 1-2).

Although the baseline projections are prohibited from incorporating anticipated policy changes, this chapter shows the budgetary implications of some alternative policy assumptions over the next 10 years. For example, if military operations in Iraq and Afghanistan and other activities related to the global war on terrorism were assumed to continue (but slow gradually) for the next few years rather than being excluded from the baseline altogether, the total deficit projected for the 2006-2015 period would increase from $855 billion to $1.4 trillion. Debt held by the public at the end of 2015 would equal almost 32 percent of GDP instead of less than 29 percent.

Similarly, if all of the tax provisions that are set to expire over the next 10 years (except for one related to the alternative minimum tax) were extended, the budget outlook for 2015 would change from a surplus of $141 billion to

a deficit of $282 billion.[4] Debt held by the public at the end of 2015 would equal 38 percent of GDP, and the 10-year deficit would total $2.7 trillion.

Over the longer term, demographic changes will put significant strains on the federal budget. Those strains are set to begin within the current 10-year projection period and intensify as members of the baby-boom generation age. In addition, the cost of health care for the elderly is likely to keep growing rapidly. As a result, the annual growth rate of Medicare spending is projected to increase from 6.2 percent in 2008 (after the prescription drug benefit has been fully phased in) to 8.3 percent in 2015. Spending for Medicaid also is estimated to grow by more than 8 percent a year at the end of the projection period. The annual growth of Social Security spending is expected to accelerate from around 4.5 percent in 2006 to 6.4 percent in 2015. Under baseline assumptions, those three programs together will account for 55 percent of all federal spending by 2015, up from 42 percent this year.

After 2015, as the percentage of the population age 65 or older continues to increase (from 14 percent in 2015 to 19 percent in 2030), spending on Social Security, Medicare, and Medicaid will claim an even larger share of total outlays, assuming that health care costs keep growing faster than the economy. Over the long term, the increasing resource demands of such programs will exert pressure on the budget that will make current fiscal policy unsustainable.[5]

A Review of 2004

The budget deficit continued to increase in 2004—growing to $412 billion from the $378 billion recorded for 2003. In relation to the size of the economy, the deficit was slightly bigger last year than in the previous year—3.6 percent of GDP versus 3.5 percent—but was smaller than the deficits of the mid-1980s and early 1990s (see Figure 1-1 on page 1).

Spending rose by more than 6 percent (or $132 billion) in 2004, totaling almost $2.3 trillion. Mandatory outlays grew by 5 percent ($56 billion), with Medicaid spending rising by almost 10 percent and Medicare outlays growing by more than 8 percent. Discretionary spending increased by 8 percent ($70 billion), led by outlays for defense, which rose by more than 12 percent ($49 billion). Roughly half of that increase resulted from spending for military operations in Iraq and Afghanistan and for other activities considered part of the war on terrorism (see Box 1-1 for details about the funding provided for those operations thus far). Discretionary outlays not related to defense grew only half as fast in 2004 as they did in 2003: by less than 5 percent (almost $20 billion). That growth was spread among numerous programs, with the largest increases occurring in the areas of international affairs ($6 billion), education ($4 billion), and health ($3 billion). (Recent federal spending and projections through 2015 are discussed in detail in Chapter 3.)

After declining for three years, revenues increased in 2004 by 5.5 percent (or $98 billion). Taxes on corporate income accounted for roughly 60 percent of that growth; receipts from those taxes were almost 44 percent higher last year than in 2003. Receipts from social insurance taxes rose by about 2.9 percent, and receipts from taxes on individual income grew by almost 2 percent. Taken as a whole, other sources of revenue grew by about 3 percent. (Chapter 4 provides more information about recent and projected federal revenues.)

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—rather, they represent CBO's best judgment of how the economy and other factors would affect federal revenues and spending if current laws and policies remained the same. 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. In general, those laws spell out how CBO should project federal spending and revenues under current policies. The resulting baseline can be used as a neutral benchmark against which to measure the effects of proposed changes in tax and spending policies.

4. That calculation does not assume extension of the higher exemption amounts for the alternative minimum tax that were established by JGTRRA through 2004 and extended by WFTRA through December 2005. Also, that calculation does not incorporate any impact on the overall economy.

5. For an detailed discussion of the long-term pressures facing the federal budget, see Congressional Budget Office, *The Long-Term Budget Outlook* (December 2003) and *The Outlook for Social Security* (June 2004).

Box 1-1.

Appropriations for the Global War on Terrorism

Since September 2001, the Congress has provided about $197 billion in supplemental appropriations for military operations in Iraq and Afghanistan and for other activities in support of the global war on terrorism (see the table at right). Determining exactly how much of that budget authority has been spent is impossible because reports by the Department of the Treasury do not distinguish between outlays from regular appropriations and those from supplemental appropriations, nor do they distinguish between spending for peacetime operations and spending associated with the war on terrorism. Information from the Department of Defense (DoD) indicates that the department has obligated almost all of the $171 billion appropriated before August 2004 for operations in Iraq and Afghanistan and for other activities in the war on terrorism. Additionally, DoD reported that through September 2004, it had obligated $1.9 billion of the $26.8 billion appropriated in August as part of Public Law 108-287.

In fiscal year 2004, DoD obligated a total of $71.3 billion—or almost $6 billion per month—for Operations Iraqi Freedom, Enduring Freedom (in Afghanistan), and Noble Eagle (antiterrorism activities in the United States). Of that total, 80 percent was dedicated to Operation Iraqi Freedom, 14 percent to Operation Enduring Freedom, and 6 percent to Operation Noble Eagle. In all, half of the amount obligated in 2004 covered operation and support costs, such as for training, fuel, supplies, repair parts, maintenance of facilities, communications, and other contract services. Personnel costs accounted for another 31 percent of the total, 9 percent went for transporting troops and supplies, and the remaining 10 percent paid for new equipment and for construction projects.

For revenues and mandatory spending, the Deficit Control Act requires that the baseline be projected under the assumption that present laws continue without change.[6] In most cases, the laws that govern revenues and mandatory spending are permanent. Thus, 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. The Deficit Control Act states that such spending should be projected by assuming that the most recent year's discretionary budget authority is provided in each future year, with adjustments to reflect projected inflation—using specified indexes—and other factors (such as the cost of annualizing adjustments to federal pay). If the current year's discretionary budget authority includes funds provided through supplemental appropriations, those funds are also adjusted for inflation and assumed to continue throughout the baseline period. As explained above, that rule—coupled with the timing of supplemental appropriations for operations in Iraq and Afghanistan—is a major source of the differences between CBO's current and previous baseline projections.

Uncertainty and Budget Projections

Actual budgetary outcomes are almost certain to differ from CBO's baseline projections, both because of future legislative actions and because of unanticipated changes in economic conditions and in other factors that affect federal programs and revenue sources.

The Budgetary Effects of Some Alternative Policies

To illustrate the potential effects of different fiscal policies on the baseline, CBO has estimated the budgetary impact of some alternative scenarios (see Table 1-3). The discussion below focuses on those scenarios' direct effects on revenues and outlays. However, their full impact would

6. Some exceptions exist under the Deficit Control Act. For example, spending programs that are set to expire must be assumed to continue if they have outlays of more than $50 million in the current year and were established on or before the enactment of the Balanced Budget Act of 1997. (Programs established after that are not automatically assumed to continue.) Similarly, expiring excise taxes that are dedicated to trust funds are assumed to be extended at the current rates. (The Deficit Control Act does not provide for the extension of other expiring tax provisions, even if they have routinely been extended in the past.)

Box 1-1.

Continued

Appropriations Provided for Military Operations in Support of the Global War on Terrorism

		Budget Authority (Billions of dollars)				
Public Law	Title	2001	2002	2003	2004	Total
107-38 (Sept. 2001)	2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States	13.6				
107-117 (Jan. 2002)	Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002		3.4			
107-206 (Aug. 2002)	2002 Supplemental Appropriations Act for Further Recovery from and Response to Terrorist Attacks on the United States		13.8			
107-248 (Oct. 2002)	Department of Defense Appropriations Act, 2003			6.4 [a]		
108-7 (Feb. 2003)	Consolidated Appropriations Resolution, 2003			10.0		
108-11 (April 2003)	Emergency Wartime Supplemental Appropriations Act, 2003			62.2		
108-87 (Sept. 2003)	Department of Defense Appropriations Act, 2004				-3.5 [b]	
108-106 (Nov. 2003)	Emergency Supplemental Appropriations Act for Defense and for the Reconstruction of Iraq and Afghanistan, 2004				64.8	
108-287 (Aug. 2004)	Department of Defense Appropriations Act, 2005				26.8 [c]	
	Total	**13.6**	**17.2**	**78.6**	**88.1**	**197.4**

Source: Congressional Budget Office.

Note: The numbers in this table are amounts identified in appropriation acts as funding for Department of Defense activities in response to the terrorist attacks on September 11, 2001, and in support of the global war on terrorism, including military operations in Afghanistan and Iraq. They do not include funds for reconstruction activities in Iraq. (P.L. 108-11 provided $2.5 billion for that purpose, and P.L. 108-106 provided another $18.4 billion.) The amounts shown here represent funding directed to the Department of Defense (subfunction 051 of the federal budget).

a. This figure is an estimate based on conference report language for P.L. 107-248.

b. Rescission of funds appropriated in P.L. 108-11.

c. Of this amount, $25 billion is funding requested by the President for 2005 that will largely be used to cover costs incurred in that year, and $1.8 billion is funding restored from the repeal of a previous rescission. The Congress appropriated the funds in 2004 and made them available upon enactment, so the appropriation is counted as budget authority in 2004. As of September 2004, $1.9 billion of it had been obligated.

Table 1-3.

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

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
						Policy Alternatives That Affect Discretionary Spending							
Assume Phasedown of Activities in Iraq and Afghanistan and Continued Spending for the Global War on Terrorism[a]													
Effect on the deficit	-30	-70	-75	-65	-45	-30	-25	-26	-27	-27	-28	-285	-418
Debt service	*	-3	-7	-11	-14	-17	-19	-22	-24	-27	-29	-51	-172
Increase Total Discretionary Appropriations at the Growth Rate of Nominal GDP													
Effect on the deficit	0	-15	-40	-68	-97	-126	-156	-186	-217	-249	-283	-347	-1,437
Debt service	0	*	-2	-5	-9	-15	-23	-33	-45	-59	-76	-31	-268
Freeze Total Discretionary Appropriations at the Level Provided for 2005													
Effect on the deficit	0	14	32	52	74	97	121	144	169	195	221	269	1,118
Debt service	0	*	1	4	7	12	18	26	35	46	59	25	208
						Policy Alternatives That Affect the Tax Code							
Extend Expiring Tax Provisions[b]													
Effect on the deficit													
EGTRRA and JGTRRA	0	-3	-4	-11	-23	-19	-160	-259	-269	-281	-292	-60	-1,321
Other	*	-2	-11	-19	-22	-28	-34	-39	-43	-46	-50	-83	-295
Total	*	-5	-16	-30	-45	-47	-194	-298	-312	-327	-342	-143	-1,616
Debt service	*	*	-1	-2	-4	-6	-13	-26	-43	-61	-82	-13	-238
Reform the Alternative Minimum Tax[c]													
Effect on the deficit	0	-12	-34	-41	-50	-60	-50	-27	-33	-40	-47	-198	-395
Debt service	0	*	-1	-3	-6	-9	-12	-15	-17	-20	-23	-20	-108
Memorandum:													
Total Deficit (-) or Surplus in CBO's Baseline	-368	-295	-261	-235	-207	-189	-80	71	85	115	141	-1,188	-855

Sources: Congressional Budget Office; Joint Committee on Taxation.

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

Positive amounts indicate a reduction in the deficit or an increase in the surplus. "Debt service" refers to changes in interest payments on federal debt resulting from changes in the government's borrowing needs.

a. This alternative assumes an eventual slowdown of U.S. activities in Iraq and Afghanistan but continued spending for the global war on terrorism throughout the 10-year period. It also includes funding for domestic military operations for homeland security.

b. This estimate does not include the effects of extending the increased exemption amount for the alternative minimum tax, which expires in December 2005. The effects of that alternative are shown below.

c. This alternative assumes that the exemption amount for the AMT (which was increased through December 2005 in the Working Families Tax Relief Act of 2004) is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2005. The estimates are shown relative to current law. If this alternative was enacted jointly with the extension of expiring tax provisions, an interactive effect would occur that would make the combined revenue loss greater than the sum of the two separate estimates by about $247 billion (plus $24 billion in debt-service costs) over the 2006-2015 period.

include their effect on federal debt-service costs, which is shown separately in the table.

Since military activities in Iraq and Afghanistan and other operations related to the global war on terrorism will continue in 2005 and for some unknown period thereafter, CBO has constructed a possible path of spending for such activities. It assumes that force levels and operations will remain at about the same levels in 2005 and 2006 as they did in 2004 and then will decline gradually over several years. Such a scenario might involve keeping about 200,000 active-duty, Reserve, and National Guard personnel deployed overseas to support those activities through fiscal year 2006. But over the longer term, it could involve reducing U.S. military involvement in those activities to about four brigades (40,000 troops) and decreasing domestic military operations for homeland security. Such a scenario would add about $30 billion to baseline discretionary outlays for 2005 and $418 billion for the 2006-2015 period.[7] Many other outcomes —some costing more and some costing less—are also possible for such activities.

In addition, alternative assumptions could be made about discretionary spending as a whole. For example, if current appropriations were assumed to grow at the same rate as nominal GDP through 2015 instead of at the rate of inflation, total projected discretionary spending would be $1.4 trillion higher. In the other direction, if lawmakers did not increase appropriations after 2005 to account for inflation, cumulative discretionary outlays would be $1.1 trillion lower.

Three mandatory programs—Social Security, Medicare, and Medicaid—dominate federal spending. In 2004, outlays for those programs totaled $965 billion (excluding offsetting receipts from Medicare premiums) and accounted for 42 percent of federal spending. Legislation could affect such large programs in significant ways. For example, the Administration is considering broad changes to the Social Security program, including allowing workers to divert part of their tax payments into private investments. No details are yet available, but such a plan could affect budgetary totals during the baseline period and well beyond. Likewise, changes in the laws that set payment rates, eligibility, and other criteria for Medicare and Medicaid are proposed and considered every year. For example, for each year since 2003, Medicare's payment rates for physicians' services (which are set by a procedure known as the sustainable growth rate formula) have been raised above the levels previously set by law. Further actions of that kind would lift outlays for Medicare considerably above baseline levels over the coming 10 years.

For revenues, CBO's baseline projections rest on the assumption that current tax laws do not change. For example, the baseline envisions that major provisions of EGTRRA—such as the introduction of the 10 percent tax bracket, 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 during the projection period reduce revenues; thus, if they were assumed to be extended, projected revenues would be lower than the level in the baseline.[8] For example, if all expiring tax provisions (except those related to the exemption amount for the alternative minimum tax, or AMT) were extended, total revenues over the 2006-2015 period would be $1.6 trillion lower.[9]

Another policy change that could affect revenues involves modifying the AMT, which many observers believe cannot be maintained in its current form. The AMT's exemption amount and brackets are not indexed for inflation, which means that the impact of the tax will grow in coming years as more taxpayers become subject to it. If the AMT was indexed for inflation after 2005, federal revenues would be $395 billion lower over the next 10 years, according to CBO and the Joint Committee on Taxation.

Other Sources of Uncertainty

Aside from the impact of future legislative actions, the federal budget is also sensitive to economic and technical factors that are difficult to forecast. In creating its baseline, CBO must make assumptions about such economic factors as interest rates, inflation, and the growth of GDP.

7. The scenario assumes that the military services would need to replace equipment that was destroyed, damaged, or worn out in those operations.

8. In the years before 2011, the largest contributors to the cost of extending those provisions are the research and experimentation tax credit and the reduced tax rates on dividends and capital gains.

9. Unlike CBO's baseline projections, which incorporate the effects that the expiration of tax provisions would have on the economy, that estimate does not include any macroeconomic effects. Such effects are likely to be small relative to the overall economy.

(CBO's economic assumptions are explained in detail in Chapter 2.) Discrepancies between those assumptions and actual economic conditions can have a significant impact on the extent to which budgetary outcomes differ from baseline projections. For instance, the baseline reflects an assumption that the real (inflation-adjusted) growth rate of GDP will slowly fall from 3.8 percent in calendar year 2005 to 2.5 percent in 2015. If the actual growth rate of GDP was 0.1 percent higher or lower per year, the cumulative deficit for the 2006-2015 period would differ from CBO's projections by about $260 billion. (For a further discussion of the effect of economic assumptions on budget projections, see Appendix A.)

Uncertainty also exists about technical factors—those not directly related to changes in law or in CBO's economic forecast—that affect budget projections. For example, spending per enrollee for both Medicare and Medicaid has been growing faster than per capita GDP. The future level of such "excess cost growth" is difficult to forecast, but it will have a large impact on the costs of those programs. In addition, projections of those costs depend on assumptions about the growth of enrollment in the programs and, indirectly, about general inflation. Similarly, CBO must estimate prices for various agricultural commodities as well as crop yields, all of which are volatile and significantly affect how much the government will pay farmers under price- and income-support programs.

Revenue projections too are vulnerable to technical uncertainty. Although the overall level of income is determined by economic projections, CBO must make technical assumptions about how much revenue to expect from a given amount of income. Differences between expected and actual revenue yields can lead to significant deviations from CBO's baseline projections.

Using the difference between past CBO baselines and actual budgetary results as a guide, Figure 1-3 displays a range of possible outcomes for the total deficit or surplus under current law (excluding the possible impact of future legislation). The current baseline projection of the deficit falls in the middle of the highest-probability area, shown as the darkest part of the figure. But nearby projections—other paths in the darkest part of the figure—have nearly the same probability of occurring that the baseline projection does. Projections that are increasingly different from the baseline are shown in lighter areas, but they also have a significant probability of coming to pass. For example, CBO projects a baseline deficit of 1.2 percent of GDP for 2010. However, under current law, there is roughly a 5 percent chance that the actual outcome that year will be a deficit greater than 6 percent of GDP. Similarly, in the absence of further legislative changes, there is a 35 percent chance that the budget will be in balance or surplus in 2010.

The Long-Term Outlook

In the decades beyond CBO's projection period, the aging of the baby-boom generation, combined with rising health care costs, will cause a historic shift in the United States' fiscal situation. Over the next 30 years, the number of people age 65 or older will double, while the number of adults under age 65 will increase by less than 15 percent.[10] Moreover, health care costs are likely to continue to grow faster than the economy. (Between 1960 and 2001, the average annual growth rate of national health expenditures exceeded the growth rate of GDP by 2.5 percentage points.)

Driven by rising health care costs, spending for Medicare and Medicaid is increasing faster than can be explained by the growth of enrollment and general inflation alone. If excess cost growth continued to average 2.5 percentage points in the future, federal spending for Medicare and Medicaid would rise from 4.2 percent of GDP today to about 11.5 percent of GDP in 2030 (see Figure 1-4). The Medicare trustees assume that excess cost growth will decline to 1 percentage point, on average; however, even at that rate, federal spending for Medicare and Medicaid would double to 8.4 percent of GDP by 2030.[11]

Outlays for Social Security as a share of GDP are projected to grow by more than 40 percent in the next three decades under current law: from about 4.2 percent of GDP to more than 6 percent. Such costs are likely to creep up gradually thereafter. By contrast, federal revenues credited to Social Security are expected to remain close to their current level—around 5 percent of GDP—over that period.

Together, the growing resource demands of Social Security, Medicare, and Medicaid will exert pressure on the

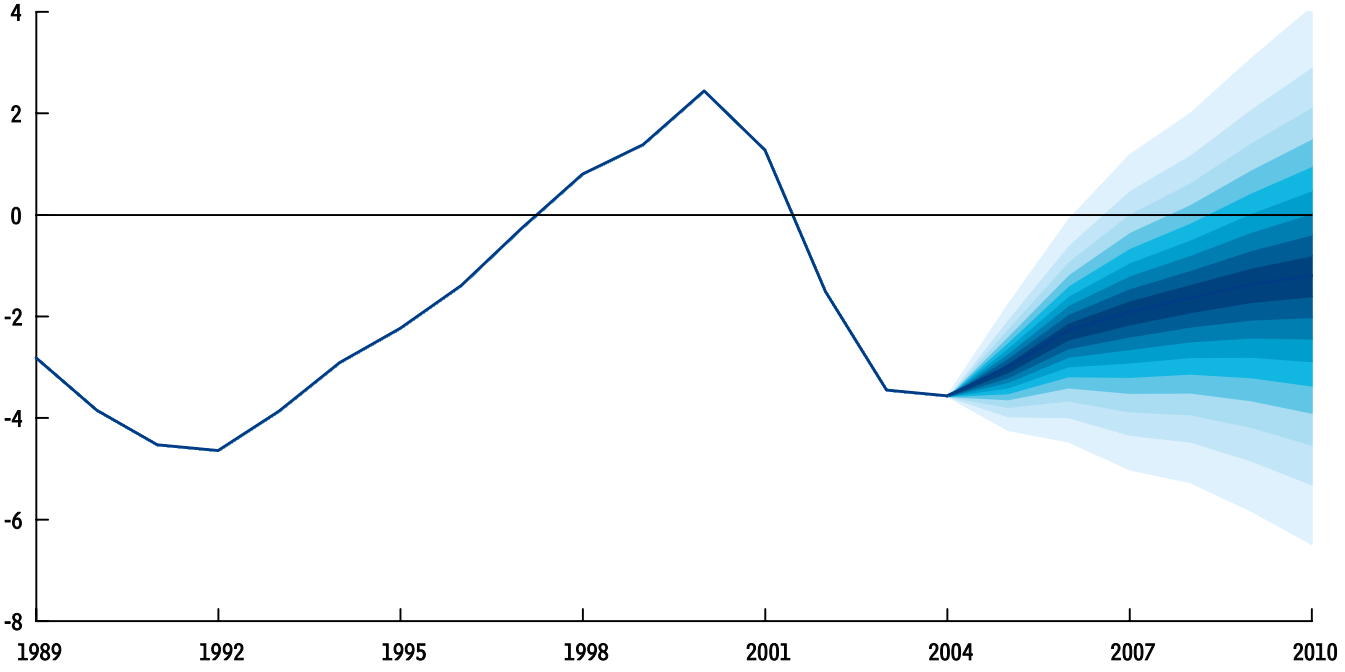
10. For a more extensive discussion, see CBO, *The Long-Term Budget Outlook* and *The Outlook for Social Security.*

11. See Technical Review Panel on the Medicare Trustees Reports, *Review of Assumptions and Methods of the Medicare Trustees' Financial Projections* (December 2000).

Figure 1-3.

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

(Deficit or surplus as a percentage of GDP)



Source: Congressional Budget Office.

Notes: This figure, calculated on the basis of CBO's forecasting track record, shows the estimated likelihood of alternative projections of the budget deficit or surplus under current policies. The baseline projections described in this chapter fall in the middle of the darkest area of the figure. Under the assumption that tax and spending policies will not change, the probability is 10 percent that actual deficits or surpluses will fall in the darkest area and 90 percent that they will fall within the whole shaded area.

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

For an explanation of how CBO typically calculates the probability distribution underlying figures such as this one, see Congressional Budget Office, *The Uncertainty of Budget Projections: A Discussion of Data and Methods* (April 2004).

budget that economic growth alone is unlikely to alleviate. Consequently, policymakers face choices that involve reducing the growth of federal spending, increasing taxation, boosting federal borrowing, or some combination of those approaches.

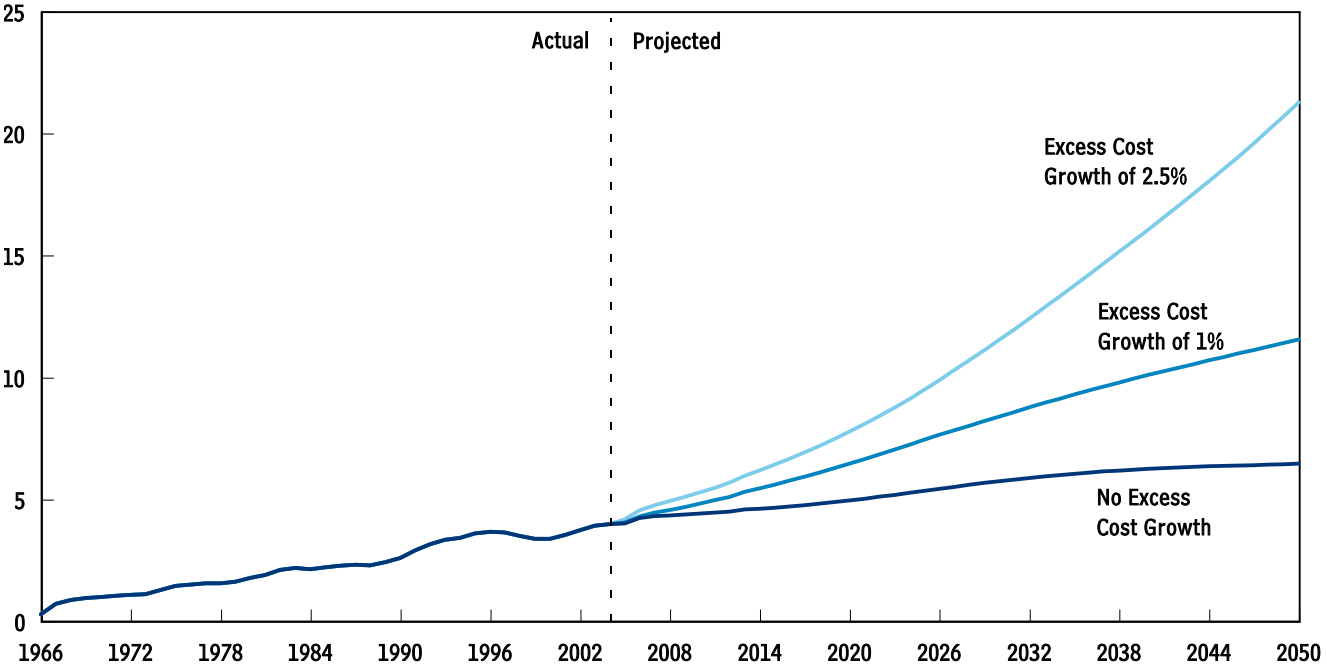
Changes to the Budget Outlook Since September 2004

CBO's projection of the cumulative deficit for the 2005-2014 period has declined by $930 billion since last September, when the agency published its previous baseline. But that figure gives a misleading picture of changes to the underlying budget outlook. As illustrated in Table 1-1 on page 2, the apparent improvement in the projected 10-year deficit derives largely from the treatment of spending for operations in Iraq and Afghanistan. Because the statutes that govern the baseline require that all discretionary budget authority for the most recent year be extrapolated through the projection period, CBO's September baseline contained about $1.4 trillion in outlays (including debt-service costs) that are not in the current baseline, since no supplemental funding for Iraq and Afghanistan has yet been provided for 2005. Revisions to the baseline that are unrelated to the treatment of such funding partially offset that change, increasing projected deficits over the 2005-2014 period by more than $500 billion.

Figure 1-4.

Total Federal Spending for Medicare and Medicaid Under Different Assumptions About Excess Cost Growth

(Percentage of GDP)



Source: Congressional Budget Office.

Note: "Excess cost growth" refers to the degree to which the annual growth rate of federal spending for Medicare and Medicaid exceeds the annual rate of gross domestic product.

When CBO revises its baseline projections, it divides the changes into three categories according to their cause: recently enacted legislation, changes to CBO's outlook for the economy, and technical factors that affect the budget.[12] Legislative changes have reduced the 10-year deficit by more than $1 trillion, primarily because of the treatment of supplemental funding for military operations. Changes to economic and technical assumptions have had a relatively small effect on the projections, combining to boost the cumulative deficit by $132 billion (less than 0.1 percent of GDP).

Outlay projections have declined by $17 billion for this year and by a total of $1.1 trillion (including debt-service costs) for the 2005-2014 period (see Table 1-4 on page 14). Removal from the baseline of the extrapolated $115 billion in supplemental appropriations enacted in 2004, which CBO categorizes as a legislative change, accounts for most of that decline. Changes in CBO's economic assumptions (particularly about inflation) and various technical changes have had a minor offsetting effect on projected outlays, increasing them by a total of $52 billion over 10 years.

CBO's revenue projections have declined by $37 billion for 2005 and by $209 billion for the 2005-2014 period. Together, laws enacted since September and technical changes have reduced projected revenues over the 10-year period by $281 billion, whereas revisions to economic

12. The categorization of revisions 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. If a new law proves to have different effects from the ones in CBO's initial estimate, the differences will appear as technical reestimates in later revisions to the baseline. The distinction between economic and technical revisions is similarly imprecise. CBO classifies economic changes as those resulting directly from changes in the components of CBO's economic forecast (interest rates, inflation, GDP growth, and so on). Changes in other factors related to the performance of the economy (such as the amount of capital gains realizations) are shown as technical reestimates.

assumptions have increased projected revenues by $72 billion.

The Effects of Recent Legislation

Legislative changes to CBO's baseline since last September have increased this year's projected deficit by $6 billion but lowered the cumulative deficit through 2014 by more than $1 trillion. As noted above, most of that change results from differences in the treatment of spending for operations in Iraq and Afghanistan. In addition, laws enacted in the past five months have raised projected outlays by $242 billion and reduced projected revenues by $129 billion through 2014.

Mandatory Spending. Legislative changes since September have had little effect on the outlook for mandatory programs. Projected outlays for those programs have risen by $5 billion (excluding debt-service costs) for 2005, by $9 billion for 2006, and by a total of $12 billion for the 2005-2014 period.

One of the largest legislative changes to mandatory spending comes from the Ronald W. Reagan National Defense Authorization Act for Fiscal Year 2005 (Public Law 108-375). That law prohibits the Air Force from leasing any tanker aircraft and repeals the authority that would have allowed the service to sign a contract to acquire 100 KC-767 tankers without regard to whether sufficient funds were available to pay the full costs of the contract. Because P.L. 108-375 prevents the Air Force from leasing or purchasing tankers without having an appropriation for the full cost of those aircraft, CBO estimates that the law will reduce mandatory spending for KC-767s by $18.5 billion over the 2005-2014 period relative to CBO's September baseline.

P.L. 108-375 also includes provisions that affect outlays for military retirement. On net, CBO estimates that those provisions will increase mandatory spending for military retirement over the 2005-2014 period by about $8 billion. Most of that increase comes from revisions to the survivor benefit plan (SBP) that phase out, over three-and-a-half years, the reduction in the SBP annuity that occurs when survivors become eligible for Social Security survivor benefits at age 62. The law also eliminates the 10-year phase-in for concurrent receipt of military retirement and veterans' disability compensation for retirees who are rated by the Department of Veterans Affairs as 100 percent disabled—a change that is projected to increase spending by nearly $1 billion through 2014.

The Military Construction Appropriations and Emergency Hurricane Supplemental Appropriations Act, 2005 (P.L. 108-324) is projected to add $2.6 billion to mandatory spending this year. That law provides emergency assistance to farmers who lost crops or livestock because of damaging weather.

The tobacco buyout provisions in the American Jobs Creation Act of 2004 (P.L. 108-357) will add an estimated $1.5 billion to spending in 2005 and roughly $1 billion each year from 2006 through 2014. That law also extends customs user fees through September 30, 2014—creating more than $20 billion in additional offsetting receipts (negative spending) over the 2005-2014 period.

The Working Families Tax Relief Act of 2004 (P.L. 108-311) contains several provisions that affect refundable tax credits. Most important, WFTRA raises the child tax credit to $1,000 through 2009. (It also increased the refundability of the credit in 2004.) Such changes are projected to add about $2 billion to outlays this year and nearly $24 billion over the 2005-2014 period.

The Commercial Spectrum Enhancement Act (P.L. 108-494) affects the timing of certain Federal Communications Commission (FCC) auctions of licenses to use the electromagnetic spectrum. It also creates new direct spending authority for agencies that currently use the frequencies due to be auctioned. The law sets an 18-month waiting period before the start of those auctions, which will delay the collection of $5 billion in receipts relative to CBO's previous baseline projections but will have no net effect on the budget over time. After purchasers pay for the licenses—which is now expected to occur in 2007 and 2008—the proceeds will be available to agencies without further appropriation to pay for any costs incurred to relocate federal services to other frequencies. CBO estimates that agencies will spend about $2.5 billion over the 2007-2014 period for those costs.

Finally, various smaller legislative changes to mandatory programs are projected to boost spending by about $5 billion over 10 years.

Discretionary Spending. Since September, CBO's baseline projections of discretionary spending have declined by $31 billion for 2005 and by more than $1 trillion for the 2005-2014 period because of revisions attributable to legislation.

Table 1-4.

Changes in CBO's Baseline Projections of the Deficit Since September 2004

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Total Deficit as Projected in September 2004	-348	-298	-308	-318	-312	-298	-200	-70	-75	-65	-1,584	-2,294
Changes to Revenue Projections												
Legislative	-32	-46	-25	-14	-6	-6	*	1	*	-1	-122	-129
Economic	-14	-25	-23	-9	3	14	18	28	37	43	-68	72
Technical	9	4	-2	-1	-8	-22	-33	-33	-34	-33	3	-152
Total Revenue Changes	**-37**	**-67**	**-49**	**-23**	**-11**	**-15**	**-15**	**-5**	**3**	**10**	**-187**	**-209**
Changes to Outlay Projections												
Legislative												
Discretionary												
Defense	-33	-76	-89	-93	-95	-97	-100	-101	-104	-106	-386	-895
Nondefense	1	-6	-12	-14	-15	-15	-15	-15	-14	-14	-46	-119
Subtotal, discretionary	-31	-82	-101	-107	-110	-112	-115	-116	-119	-121	-432	-1,014
Mandatory	5	9	1	1	3	2	-2	-2	-2	-2	19	12
Net interest (Debt service)	*	*	-3	-7	-13	-19	-25	-33	-40	-49	-23	-189
Subtotal, legislative	-26	-74	-103	-114	-119	-130	-142	-151	-161	-171	-436	-1,191
Economic												
Discretionary	0	2	2	2	2	2	2	2	2	1	8	18
Mandatory	-1	4	5	2	9	-1	1	*	-1	-11	20	8
Net interest												
Debt service	*	1	3	4	4	4	4	3	2	-1	12	24
Rate effect/inflation	-1	-4	-4	-3	-2	-2	-1	-1	-1	-1	-14	-18
Subtotal, net interest	-1	-3	-1	1	2	3	3	2	1	-1	-2	5
Subtotal, economic	-3	3	6	6	13	4	6	4	2	-11	26	31

Continued

As noted above, no supplemental funding for activities in Iraq and Afghanistan has yet been provided in 2005 (the current base year used to project discretionary spending), although about $115 billion was provided in 2004 (the base year for the September projections). Because of that difference, CBO has had to decrease its projections of discretionary spending relative to the September baseline by $38 billion for 2005 and by more than $1.1 trillion (not including associated debt-service costs) through 2014.

Increases in other appropriations have offset that decrease slightly. The 2005 Military Construction Appropriations and Emergency Hurricane Supplemental Appropriations Act provides $11.5 billion in supplemental appropriations for relief from natural disasters and other purposes. Extrapolating that budget authority through 2014 adds $94 billion in outlays to the baseline. Also, $2 billion in supplemental funding for disaster relief was provided in September (after CBO's baseline had been completed); those outlays are anticipated to occur during the 2005-2008 period.

In addition, regular appropriations for 2005 for agencies other than the Department of Defense are slightly higher, overall, than the amounts assumed in the September baseline. Although funding has risen for most areas of the budget, the largest increases are in the general categories of transportation, federal law enforcement, and veterans'

Table 1-4.

Continued

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Changes to Outlay Projections (Cont'd)												
Technical												
Discretionary	-3	-6	-2	*	-2	-3	-4	-5	-5	-5	-13	-34
Mandatory												
Medicaid	3	4	4	4	4	4	4	3	2	1	19	33
Food Stamps	3	3	3	3	3	3	3	3	3	3	15	30
Unemployment Insurance	-4	-5	-3	-3	-3	-3	-2	-2	-1	*	-19	-26
Farm programs (CCC)	8	6	3	*	-1	-1	-1	-2	-2	-1	15	8
Credit reestimates	7	0	0	0	0	0	0	0	0	0	7	7
Other	-2	-2	-2	*	-8	3	*	-3	-4	4	-14	-14
Subtotal, mandatory	14	7	5	4	-6	6	3	*	-1	7	25	39
Net interest												
Debt service	*	-1	-1	-1	*	*	2	3	5	7	-2	16
Other	1	-1	-2	-1	-2	-1	*	1	2	2	-4	1
Subtotal, net interest	1	-1	-2	-1	-2	-1	2	5	7	10	-6	16
Subtotal, technical	11	*	1	2	-10	2	1	*	1	11	5	21
Total Outlay Changes	**-17**	**-70**	**-96**	**-106**	**-116**	**-124**	**-135**	**-146**	**-158**	**-171**	**-405**	**-1,139**
Total Impact on the Deficit	**-20**	**4**	**47**	**83**	**104**	**109**	**120**	**142**	**161**	**180**	**218**	**930**
Total Deficit (-) or Surplus as Projected in January 2005	-368	-295	-261	-235	-207	-189	-80	71	85	115	-1,366	-1,364
Memorandum:												
Total Legislative Changes	-6	28	79	100	113	123	142	151	161	170	314	1,062
Total Economic Changes	-11	-28	-29	-15	-10	10	12	24	35	54	-94	41
Total Technical Changes	-2	4	-3	-3	1	-24	-34	-33	-35	-44	-2	-173

Source: Congressional Budget Office.

Note: * = between -$500 million and $500 million; CCC = Commodity Credit Corporation.

health care. Extrapolating all of the changes in 2005 regular appropriations through 2014 raises projected outlays by a total of $32 billion over the 10-year period.

Revenues. Legislative changes have reduced projected receipts by $129 billion over the 2005-2014 period, with virtually all of that reduction occurring before 2011. By far the most significant change—accounting for $122 billion of the reduction—results from the enactment of WFTRA, which extends a number of expiring provisions first enacted in the Economic Growth and Tax Relief Reconciliation Act and then modified in the Jobs and Growth Tax Relief Reconciliation Act. Under EGTRRA, the amounts of the increased child credit, the expanded 10 percent tax bracket, and marriage-penalty relief had been set to phase in over time; JGTRRA accelerated that timing so all of the amounts were fully phased in by 2004, but only for that year. WFTRA maintains those amounts at their fully phased-in levels through 2010, after which all of the provisions enacted in EGTRRA are due to expire. The decline in revenues from that change is concentrated in the next few years, before the higher amounts would have been fully phased in under prior law. Other changes in WFTRA also contribute to reducing revenues early in the projection period. The law extends through 2005 the higher exemption amount for the

alternative minimum tax as well as a number of tax provisions (such as the research and experimentation credit) that had regularly been extended temporarily over the years but had already expired.

In addition, the recently enacted American Jobs Creation Act makes numerous changes to tax law, such as replacing an exclusion of income earned by exporters with a deduction of income from domestic production. That law has reduced projected revenues by a total of $7 billion through 2014.

Net Interest. Together, revisions to the September baseline that are classified as legislative decrease the cumulative deficit for the 2005-2014 period by $873 billion (excluding debt service). In turn, that reduction in the need to borrow is projected to lessen the government's debt-service costs through 2014 by a total of $189 billion. As a result, legislative revisions reduce the projected cumulative deficit by more than $1 trillion in all.

The Effects of Economic Changes

Updates to CBO's economic assumptions since September have had a relatively minor effect on the budget outlook. Such changes increase this year's projected deficit by $11 billion (almost entirely on the revenue side of the budget) but decrease the total deficit projected for the 2005-2014 period by $41 billion (through raising projected revenues by $72 billion and projected outlays by $31 billion). CBO is now forecasting slightly lower levels of nominal GDP and wages in the next few years, and slightly higher levels in later years, than it did last September (see Chapter 2), which reduces estimated revenues in the near term and raises them thereafter. In addition, CBO's new forecast envisions a higher rate of inflation this year and a slightly lower rate next year than the previous forecast did.

Mandatory Spending. Food Stamps, Medicaid, and Social Security are the three mandatory programs most affected by changes to the economic forecast. Those changes have increased projections of mandatory spending by $20 billion for 2005 through 2009 and lowered them by about $12 billion for the following five years—on net, adding $8 billion to projected mandatory outlays for the 2005-2014 period.

Since September, CBO has raised its near-term forecast of the consumer price index for the cost of food purchased for consumption at home. As a result, average Food Stamp benefits are projected to increase, boosting outlays for the program by $12 billion over 10 years.

In the Medicaid program, payment rates for services are generally not linked to specific price factors. Nevertheless, CBO anticipates that changes in its economic outlook will affect spending for the program. In particular, the decline in projected medical inflation will reduce Medicaid spending for hospital and physicians' services, CBO projects. To a lesser extent, lower projected wage growth will reduce spending for long-term care, which is influenced by labor costs. Because of those changes to the economic forecast, CBO currently estimates that federal Medicaid spending will be $8 billion lower over the next 10 years than previously projected.

The cost-of-living adjustment (COLA) that Social Security beneficiaries will receive in January 2006 is now expected to be 0.5 percentage points higher than CBO projected in September, increasing benefit payments in 2006 and beyond. Changes to projections of nominal wages also affect Social Security spending by changing projections of initial benefits for new recipients. In all, such economic revisions increase projected Social Security spending over the 2005-2014 period by $5 billion.

The COLA reestimate also produces a small increase in projected spending for other programs, including civil service retirement, military retirement, Supplemental Security Income, and some veterans' benefits.

Discretionary Spending. As explained above, most of the revisions to projections of discretionary spending result from legislative changes. But changes in CBO's assumptions about two measures of inflation—the GDP price deflator (which covers the changes in prices of all goods and services that contribute to GDP) and the employment cost index for wages and salaries—cause a small net increase ($18 billion) in projected discretionary spending through 2014.

Revenues. Changes in CBO's economic outlook have had a relatively minor effect on revenue projections, lowering them through 2008 and raising them thereafter—for a net increase of $72 billion over the 2005-2014 period. CBO has reduced its forecasts of the growth of GDP and personal income for this year and raised them for later years. By 2007, personal income is projected to exceed the amount projected in September. That pattern reduces projected receipts from individual income and payroll

taxes through 2006 and boosts them thereafter. CBO is also anticipating lower corporate profits throughout the projection period than it did last September, which reduces projected receipts from corporate income taxes, mostly in the near term.

Net Interest. Economic revisions to projected spending for net interest have two components: the effects of changes in projected interest rates and inflation and the effects of additional (or reduced) debt service. In the current economic forecast, interest rates on 10-year Treasury notes are about half a percentage point lower in 2005 and marginally lower in 2006 than previously anticipated. However, savings from those lower long-term rates are partially offset by increased outlays resulting from higher projections of short-term rates in those two years. Overall, such changes in CBO's economic forecast reduce projected outlays for net interest by $18 billion over 10 years.

In addition, changes in the economic outlook increase projected deficits between 2005 and 2009, adding a total of $12 billion to debt-service costs during those years. The growth of such costs reverses later in the projection period: economic revisions lower projected deficits, causing additional debt-service charges to decline each year (from a cost of $4 billion in 2010 to a savings of less than $1 billion in 2014).

The Effects of Technical Changes

Technical changes represent all other revisions to the baseline not directly related to recent laws or to changes in the components of CBO's economic forecast. Over the 2005-2014 period, technical revisions increase the cumulative deficit by $173 billion, mainly by reducing projected revenues.

Mandatory Spending. Because of technical adjustments, CBO is projecting an additional $14 billion in mandatory spending this year and $39 billion (or 0.2 percent) over the 2005-2014 period relative to the previous baseline. Most of the increase results from higher projected spending for the Medicaid and Food Stamp programs, partly offset by reductions in projected unemployment insurance payments.

A variety of technical revisions have added $33 billion (or 1.3 percent) to CBO's projection of federal spending for Medicaid over 10 years. Those revisions reflect the fact that Medicaid spending in 2004 was higher than anticipated and that the number of people expected to enroll in the program has increased. The impact of those changes on spending is largely offset by lower estimates of growth in per capita spending.

Projected outlays for the Food Stamp program over the 2005-2014 period have grown by $30 billion since the September baseline because CBO's estimate of participation in the program has increased. Rates of participation have persistently been higher than expected for the past few years, despite falling unemployment rates. The magnitude of the increase has led CBO to conclude that there is a slightly longer lag between declines in the unemployment rate and declines in Food Stamp participation than previously believed. In addition, legislative changes to the program in recent years have led to an increase in outreach efforts, an expansion of eligibility, and some simplification of the application process. For all of those reasons, more people appear to be applying for benefits than was the case in the past.

Outlays for unemployment compensation over the 10-year projection period are $26 billion lower in the current baseline than in the previous baseline. More than half of that change comes from a reduction in the number of people expected to claim benefits (based on recent and historical rates of insured unemployment). About 8.7 million people received unemployment compensation in 2004; CBO expects that number to decline to about 8.4 million this year. In addition, about 40 percent of the change in estimated outlays is attributable to lower projected average benefits. States are responsible for setting the parameters under which people can claim benefits, with maximum amounts generally tied to some measure of average wages. The average benefit in 2004 grew little from the previous year, thus creating a lower base for projecting benefits for coming years.

Prices of some major agricultural commodities—especially feed grains, cotton, and soybeans—have experienced sharp declines. That and other factors have led CBO to raise its estimates of spending by the Commodity Credit Corporation (CCC) for farm price-support and income-support payments in 2005 through 2007 by a total of $17 billion. Projections of CCC spending in later years have declined slightly, for a net increase of $8 billion over the 2005-2014 period.

CBO's projection of mandatory spending in 2005 reflects another technical change: a net increase in the estimated subsidy cost for a number of federal programs that make

loans directly to individuals or businesses or that guarantee loans made by private financial institutions. The budget records the cost of such credit programs as the projected net present value of government losses on outstanding loans and guarantees. Accurately projecting loan repayments, defaults, and changes in interest rates over the life of a credit program is difficult, however. As a result, federal agencies annually revise their estimates of costs for loans and guarantees made in previous years. On the basis of preliminary information from the Administration, CBO has raised its estimate of mandatory outlays in 2005 by $7 billion to reflect such revisions. The reestimates affect a variety of programs, including the Federal Housing Administration's Mutual Mortgage Insurance program, the FCC's spectrum auctions, the Small Business Administration's business loan programs, and federal student loan programs.

Discretionary Spending. Technical revisions to the baseline have reduced projections of discretionary outlays by $3 billion for 2005 and by a total of $34 billion (or 0.3 percent) for the 2005-2014 period. Those revisions affect nearly all areas of the budget, but the largest change involves the program that provides housing vouchers for low-income renters. CBO has adopted a new estimating method that will better align the baseline for that program with the intent of the Deficit Control Act and will treat the program's accounts in the same way as other discretionary accounts. The Deficit Control Act's procedure for producing a baseline for that program reflects the fact that when the law was enacted, the voucher program featured many multiyear contracts, which received all of their funding at the beginning of the contract period. That is no longer the case; today, most contracts are for only one year. As a result, CBO now projects budget authority for the voucher program the same way that it does for most other discretionary programs (by inflating the current year's budget authority) and then includes an add-on for expiring multiyear contracts. That new approach reduces projected outlays for the program by $24 billion over 10 years.

Revenues. CBO has lowered its revenue projections for the 2005-2014 period by $152 billion as a result of technical changes. Most of those changes apply to receipts from individual income taxes and occur in the second half of the projection period (totaling $155 billion between 2010 and 2014). Technical changes are quite small for 2005 through 2009.

The main changes in the later years of the projection derive from two sources: information that is now available from 2002 tax returns, and new estimates of the effects of asset accumulations in tax-deferred retirement accounts, such as individual retirement accounts and 401(k) accounts. Tax returns for 2002 show lower amounts of taxable income than CBO anticipated, and CBO expects that the causes of that shortfall will continue through the later years of the projection period, thereby reducing receipts. In addition, new estimates of activity in retirement accounts indicate that accrual of dividend and interest income in taxable accounts is likely to be smaller than CBO projected earlier. Those two factors also reduce revenues in the first five years of the projection, but the reduction is largely offset by a change in CBO's estimate of the effects of a cut in the tax rates on dividends (which will expire in 2009). CBO now believes that the cut will not lower revenues as much as previously thought.

Net Interest. New information about the composition and amount of federal debt and additional details about federal interest payments and receipts have led CBO to increase its projections of net interest outlays by $1 billion (excluding debt service) over the 2005-2014 period. In addition, because technical changes to the baseline increase the cumulative deficit over that period by $157 billion, federal debt-service costs are projected to rise by a total of $16 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 more meaningful measure in terms of the relationship between federal debt and the economy. It represents debt that the Department of the Treasury issues to raise cash to fund the operations and pay off the maturing liabilities of the federal government. Debt held by government accounts consists of securities that the Treasury issues 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 the federal government runs a deficit, the Treasury borrows money from the public by selling securities in the capital markets to various buyers, such as foreign in-

vestors, mutual funds, state and local governments, commercial banks, insurance companies, and individuals. Of those groups, foreign investors (governments, businesses, and individuals) are currently the largest owners of federal debt issued to the public. They hold nearly $1.9 trillion—or more than 43 percent—of the roughly $4.3 trillion that is now outstanding.

Among foreign countries, investors in Japan, China, and the United Kingdom have the largest holdings of Treasury securities.[13] The central bank and private entities in Japan alone hold about $715 billion in such securities, more than $229 billion of which were bought in 2004—equal to roughly 55 percent of the U.S. deficit that year. In all, foreign investors purchased nearly $399 billion in Treasury securities last year—just $13 billion less than the size of the 2004 deficit.

State and local governments and mutual funds in the United States are also large investors in Treasury securities. Those governments hold $368 billion in debt held by the public, and mutual funds hold $258 billion.[14]

Debt held by the public fluctuates according to changes in the government's borrowing needs. It equaled nearly 50 percent of GDP in 1993 but fell to about 33 percent of GDP by 2001 (see Figure 1-2 on page 4). Over the past three years, debt held by the public has crept up to 37 percent of GDP. Under the baseline assumption that current law does not change (for example, that no further funding is provided for operations in Iraq and Afghanistan and that taxes rise as scheduled), debt held by the public is projected to peak at 39 percent of GDP in 2007 and then fall steadily to 29 percent of GDP in 2015 (see Table 1-5).

The Composition of Debt Held by the Public. Roughly 90 percent of publicly held debt consists of marketable securities—Treasury bills, notes, bonds, and inflation-indexed issues (called TIPS). The remaining 10 percent comprises nonmarketable securities, such as savings bonds and state and local government securities, which are nonnegotiable, nontransferable debt instruments issued to specific investors.[15]

The Treasury sells marketable securities to brokers in regularly scheduled auctions, whose size varies along with changes in the government's cash flow. (The Treasury also sells cash-management bills periodically to cover shortfalls in cash balances.) In 2004, the Treasury changed its mix of marketable securities to meet investors' growing demand for assets that protect against inflationary risks: it introduced a 20-year TIPS bond, which is issued on a semiannual basis, and began issuing five-year TIPS notes semiannually in October. Those changes could attract new investors, and the addition of a TIPS security with a longer maturity will diversify the Treasury's portfolio. However, those changes could increase the Treasury's exposure to inflationary risks.

Why Changes in Debt Held by the Public Do Not Equal the Size of Deficits and Surpluses. In most years, the amount of debt that the Treasury borrows or redeems approximates the annual 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 debt held by the public will increase by more than the cumulative deficit over the 2005-2015 period because changes in other means of financing will raise the Treasury's borrowing needs (see Table 1-5).

In most years, the largest of the 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 up front 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 2006 through 2015, the amount of loans being disbursed will typically be larger than the amount of repayments and interest being collected. Thus, the government's annual borrowing needs will be $11 billion to $15 billion greater than the annual budget deficit or surplus would indicate.

13. See Department of the Treasury, "Major Foreign Holders of Treasury Securities" (December 15, 2004), available at www.ustreas.gov/tic/mfh.txt. That information should be viewed as approximate because the Treasury's data indicate the country where a purchase was made, which is not necessarily the purchaser's home country.

14. Department of the Treasury, Financial Management Service, *Treasury Bulletin* (December 2004).

15. State and local government securities are time deposits that the Treasury sells to the issuers of state and local government tax-exempt debt to assist in the restriction of arbitrage provisions in the Internal Revenue Code.

Table 1-5.

CBO's Baseline Projections of Federal Debt

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Debt Held by the Public at the Beginning of the Year	3,913	4,296	4,665	4,971	5,246	5,494	5,716	5,919	6,012	5,955	5,884	5,784
Changes to Debt Held by the Public												
Deficit or surplus (-)	412	368	295	261	235	207	189	80	-71	-85	-115	-141
Other means of financing	-30	2	11	14	13	14	14	13	14	14	15	16
Total	382	370	306	275	249	222	203	93	-58	-71	-100	-126
Debt Held by the Public at the End of the Year	4,296	4,665	4,971	5,246	5,494	5,716	5,919	6,012	5,955	5,884	5,784	5,658
Debt Held by Government Accounts												
Social Security	1,635	1,804	1,989	2,194	2,419	2,661	2,919	3,191	3,475	3,768	4,068	4,372
Other government accounts[a]	1,424	1,505	1,605	1,707	1,813	1,927	2,047	2,169	2,301	2,442	2,582	2,725
Total	3,059	3,310	3,594	3,901	4,232	4,588	4,965	5,361	5,776	6,210	6,650	7,097
Gross Federal Debt	7,355	7,975	8,565	9,146	9,726	10,304	10,884	11,373	11,731	12,094	12,434	12,755
Debt Subject to Limit[b]	7,333	7,939	8,529	9,111	9,690	10,268	10,847	11,336	11,693	12,056	12,395	12,716
Memorandum:												
Debt Held by the Public at the End of the Year as a Percentage of GDP	37.2	38.1	38.6	38.6	38.4	38.0	37.6	36.5	34.5	32.6	30.7	28.8

Source: Congressional Budget Office.

a. Mainly the Civil Service Retirement, Military Retirement, Medicare, and Unemployment Insurance 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 $8,184 billion.

In 2004, the relationship between the change in accumulated debt and the size of the deficit went in the other direction—debt held by the public grew by $30 billion less than the size of the deficit. The elimination of a program that allowed the Treasury to withdraw certain nonmarketable securities (called depositary compensation securities) and interest-free loans (called compensating balances) from financial institutions that had provided services to the Treasury accounted for about $22 billion of that difference ($14 billion from depositary compensation securities and $8 billion from compensating balances). The program ended after the Treasury received an appropriation in the Consolidated Appropriations Act, 2004 (P.L. 108-199) to pay those financial institutions directly. In addition, the government's borrowing requirements were lowered by $5 billion in 2004 when the International Monetary Fund repaid a portion of the Treasury's reserve assets.

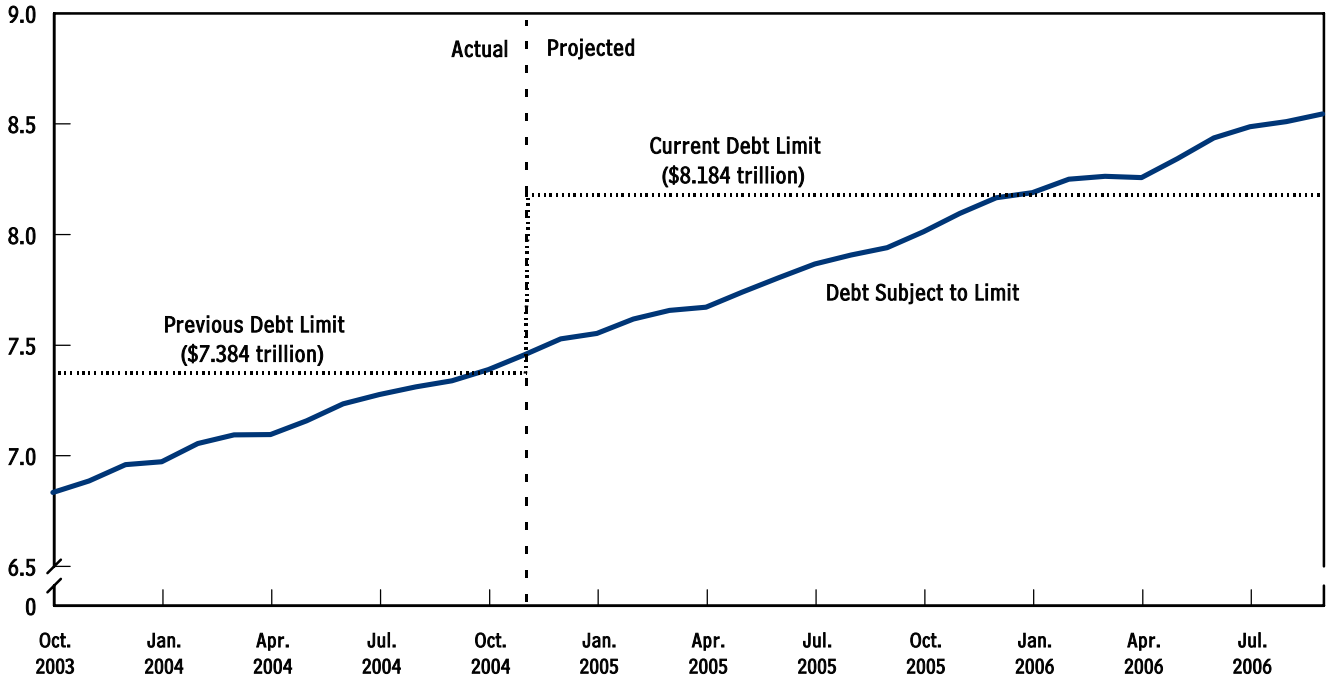
Debt Held by Government Accounts

Besides selling securities to the public, the Treasury has issued about $3.1 trillion in securities to various accounts of the federal government (as of the end of fiscal year 2004). All of the major trust funds in the budget 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 investments are intragovernmental transactions and have no direct effect on the economy. The securities represent credits to the various government accounts and are redeemed when necessary to cover benefit payments and other expenses. In the meantime, the Treasury assigns interest earnings to the

Figure 1-5.

Debt Subject to Limit, October 2003 to September 2006

(Trillions of dollars)



Source: Congressional Budget Office.

funds that hold those securities; such payments have no net effect on the budget.

The largest balances of such debt are in the Social Security trust funds (more than $1.6 trillion at the end of 2004) and the retirement funds for federal civilian employees ($632 billion). If current policies do not change, the balance of the Social Security trust funds will rise to $4.4 trillion by 2015, CBO projects, and the balance of all government accounts will climb to $7.1 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 two components. CBO projects that under current law, gross federal debt will increase in every year of the projection period and reach almost $12.8 trillion in 2015—roughly 73 percent more than the 2004 total of nearly $7.4 trillion. Most of that increase reflects debt held by government accounts. Under current law, more than half of the gross federal debt in 2015 would be held by government accounts—that is, money owed by the government to itself.

The Treasury's authority to issue debt is restricted by a statutory ceiling. Although that limit covers debt held by the public and by government accounts, it does not include debt issued by agencies other than the Treasury (such as the $26 billion in debt issued by the Tennessee Valley Authority and the $14 billion issued by the Federal Financing Bank). The current debt ceiling, which was set in November 2004 in P.L. 108-415, is $8.184 trillion (see Figure 1-5). CBO estimates that under current policies, that ceiling will be reached between November 2005 and February 2006.

At that time, if a higher debt limit has not been enacted, the Treasury will have to use accounting measures to remain under the debt ceiling so it can continue to raise cash to pay for government activities. Those accounting measures—most of which have been used in the past—could include suspending the issuance of certain securities held in the Thrift Savings Plan, postponing the issu-

Table 1-6.

CBO's Baseline Projections of Trust Fund Surpluses

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Social Security	151	169	185	205	225	242	258	273	284	293	300	304
Medicare												
Hospital Insurance (Part A)	13	13	16	22	24	27	29	30	27	33	28	25
Supplementary Medical Insurance (Part B)	-8	3	3	1	2	4	5	2	9	6	4	5
Subtotal, Medicare	5	17	18	23	27	31	34	32	36	39	32	30
Military Retirement	10	11	10	10	10	10	11	12	13	14	14	15
Civilian Retirement[a]	30	32	31	31	32	32	32	32	32	33	33	34
Unemployment	-3	11	12	9	6	4	3	3	4	4	4	5
Highway and Mass Transit	-3	-2	-3	-3	-3	-2	-2	-2	-1	-1	-1	*
Airport and Airways	*	1	1	1	2	2	3	3	4	4	5	5
Other[b]	-1	4	4	4	4	6	5	5	5	5	5	5
Total Trust Fund Surplus	**189**	**242**	**259**	**280**	**302**	**325**	**343**	**358**	**376**	**391**	**393**	**398**
Intragovernmental Transfers to Trust Funds[c]	380	406	449	496	532	571	615	662	713	767	824	885
Net Budgetary Impact of Trust Fund Programs	**-192**	**-164**	**-190**	**-216**	**-230**	**-246**	**-272**	**-304**	**-337**	**-377**	**-431**	**-487**

Source: Congressional Budget Office.

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

a. Includes the 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, employers' 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.

ance of state and local government series securities, delaying the issuance of securities to the Civil Service Retirement Trust Fund, or withdrawing federal securities from the Exchange Stabilization Fund. In recent years, when the Treasury has bumped into the debt ceiling, such accounting maneuvers have enabled it to remain below the debt limit for one to three months. (However, unlike in the past two instances, the Treasury will be unable next time to clear significant room under the debt ceiling by swapping securities with the Federal Financing Bank. The bank is limited to issuing $15 billion of its own debt; it has already issued $14 billion, which is currently held by the Civil Service Retirement and Disability Fund.)

Trust Funds and the Budget

The federal budget includes nearly 175 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 the funds 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 otherwise. 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 increasing taxes, reducing spending, or borrowing more than it would otherwise.

Including the cash receipts and expenditures of trust funds as well as of other federal programs in the budgetary totals is useful for assessing how federal activities affect the economy and capital markets. Thus, CBO, the Office of Management and Budget, and many other fiscal analysts focus on the total deficit or surplus rather than on the deficit or surplus without particular trust funds.

In CBO's current baseline, trust funds as a whole are projected to run a surplus of $242 billion in 2005. 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. Such intragovernmental transfers reallocate costs from one section 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.

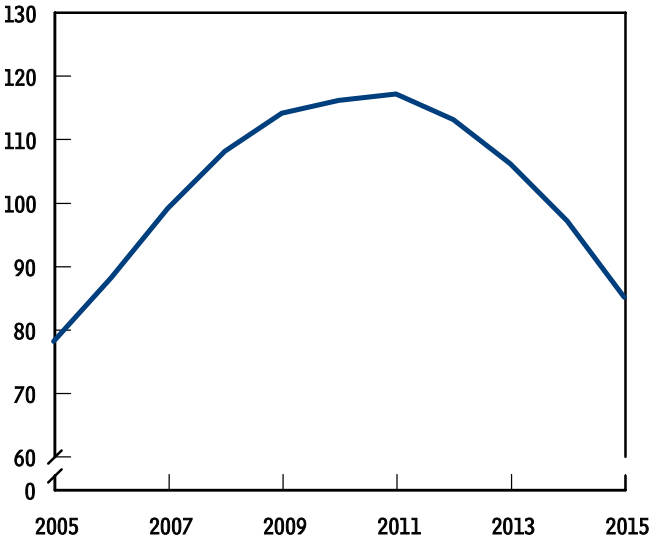
For 2005, those intragovernmental transfers are estimated to total $406 billion. The largest involve interest credited to trust funds on their government securities ($161 billion in CBO's projections), transfers of federal funds to Medicare for Supplementary Medical Insurance ($114 billion), contributions by government agencies to retirement funds for their current and former employees ($48 billion), and payments from the general fund to Social Security ($14 billion). With intragovernmental transfers excluded and only income from sources outside the government counted, the trust funds as a whole are projected to run a deficit throughout the projection period, growing from $164 billion in 2005 to $487 billion in 2015.

Although the budgetary impact of the aging of the baby-boom generation will not be fully felt during the current projection period, CBO's baseline provides 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 in each year of the period, but under current policies, the amount by which they do so will decline from more than $100 billion between 2008 and 2013 to about $85 billion in 2015 (see Figure 1-6). At that point, Social Security outlays will be growing by about 6 percent per year, but noninterest receipts will be growing by about 4.5 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 do now—will begin to dwindle during the coming decade. Shortly thereafter, Social Security is projected to begin adding to deficits or reducing surpluses.

Figure 1-6.

Annual Social Security Trust Fund Surpluses, Excluding Interest

(Billions of dollars)



Source: Congressional Budget Office.

CHAPTER

2

The Economic Outlook

The Congressional Budget Office forecasts that in 2005 and 2006, the U.S. economy will continue to expand at a healthy pace. Although investment by businesses is not expected to grow as rapidly as it did in 2004, such spending will probably still lead the economy's continuing expansion. Moreover, the caution that has characterized firms' decisionmaking over the past three years appears to be dissipating, and businesses seem to be having greater difficulty meeting increases in demand with their current workforce. As a result, hiring should accelerate. Productivity growth, which has been exceptionally strong since 2001, is expected to slow relative to its rate in the recent past; nevertheless, CBO anticipates that such growth will continue at a pace that is similar to its long-run average. Over the 2005-2015 period, real (inflation-adjusted) gross domestic product is expected to expand at an average annual rate of 3.1 percent.

A variety of factors, however, could lead to growth over the next 10 years that differs from CBO's best estimate. Cyclical factors—those deriving from the business cycle—are one potential source of risk to the outcomes that CBO envisions. Others include the confidence of businesses and investors, the growth of foreign economies, and the level of stock prices, each of which could be more or less buoyant than CBO expects. Beyond those risks, the accuracy of CBO's forecast of conditions over the next two years is subject to the uncertainty that surrounds the economy's response to world energy prices, the war on terrorism, the exchange value of the dollar, and events elsewhere in the world.

Looking to the medium term (from 2007 to 2015), productivity could continue to grow rapidly, permitting greater growth of output, income, and profits. Alternatively, productivity could grow at a below-average rate over the next few years, reversing its extraordinary recent advances and resulting in a lower level of GDP and income than CBO now anticipates.

Overview of CBO's Two-Year Forecast

The economy is in the midst of a business-cycle expansion with solid gains expected in output, employment, and income. Growth of real GDP was an estimated 3.9 percent in 2004 (measured on a fourth-quarter-over-fourth-quarter basis), slightly slower than the 4.4 percent rate posted in 2003. But businesses appear to have thrown off some of the caution that marked the recovery from the 2001 recession and the subsequent expansion, and in the latter part of 2004, the growth of employment in particular picked up noticeably. In addition, investment by businesses swelled, rising from its 9 percent annual rate of increase in 2003 to a pace of nearly 12 percent in 2004. Those trends portend further growth during the near-term forecast period.

Although real GDP during the past two years grew at a rate faster than its historical trend, a considerable amount of "slack," or excess capacity, remained in the economy at the end of 2004, leaving room for further growth without increasing inflationary pressures. Thus, CBO expects that during the forecast period, GDP will grow faster than potential GDP, rising at a rate of about 3.8 percent, on average, before slowing during the 2007-2015 period to a pace of 2.9 percent (see Table 2-1).[1] In that projection, the gap that exists between GDP and CBO's estimate of potential GDP is largely closed by the end of 2007. CBO does not attempt to predict the course of the business cycle beyond the two-year forecast horizon. Consequently, once that output gap has closed, GDP is projected to grow at the same rate as potential GDP.

As the gap between GDP and potential GDP is eliminated, the rate of unemployment will decline from

1. Potential GDP is an estimate of GDP that excludes business-cycle fluctuations. It is the level of real GDP that corresponds to a high rate of resource (labor and capital) use.

Table 2-1.

CBO's Economic Projections for Calendar Years 2004 to 2015

	Estimated	Forecast		Projected Annual Average	
	2004	2005	2006	2007 to 2010[a]	2011 to 2015[b]
Nominal GDP (Billions of dollars)	11,730	12,396	13,059	15,940	19,861
Nominal GDP (Percentage change)	6.6	5.7	5.3	5.1	4.5
Real GDP (Percentage change)	4.4	3.8	3.7	3.3	2.7
GDP Price Index (Percentage change)	2.1	1.8	1.5	1.8	1.8
Consumer Price Index[c] (Percentage change)	2.7	2.4	1.9	2.2	2.2
Unemployment Rate (Percent)	5.5	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	1.4	2.8	4.0	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	4.3	4.8	5.4	5.5	5.5
Tax Bases (Percentage of GDP)					
Corporate book profits	8.4	10.7	9.4	8.7	8.3
Wages and salaries	45.6	45.7	45.8	45.9	45.9
Tax Bases (Billions of dollars)					
Corporate book profits	984	1,331	1,222	1,349	1,635
Wages and salaries	5,346	5,665	5,979	7,317	9,096

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

Notes: Percentage changes are year over year.

Year-by-year economic projections for calendar years 2005 through 2015 appear in Appendix E.

a. For projections in billions of dollars, the level is that in 2010.

b. For projections in billions of dollars, the level is that in 2015.

c. The consumer price index for all urban consumers.

5.4 percent at the end of 2004 to 5.2 percent in 2005 and 2006, CBO forecasts. During the 2007-2015 period, the rate of unemployment is expected to average 5.2 percent.

According to CBO's forecast, inflation will be lower in 2005 and 2006 than it was in 2004. A surge in energy prices, along with an acceleration in the cost of shelter and in used car prices, caused a spike in inflation in 2004 as measured by the consumer price index for all urban consumers (CPI-U); CBO, however, does not expect that increase to feed into core inflation (inflation excluding changes in prices for food and energy). In fact, energy prices are likely to fall this year, according to many analysts. CBO projects that consumer prices will rise by 2.4 percent in 2005 and 1.9 percent in 2006; during the 2007-2015 period, CBO anticipates growth averaging 2.2 percent.

Interest rates are expected to move upward during the next two years, as the economy continues to grow and the Federal Reserve continues to move toward a more neutral monetary policy. CBO forecasts that the three-month Treasury bill rate will rise to about 2.8 percent in 2005 and 4 percent in 2006; thereafter, it is projected to average 4.6 percent, which is relatively low by historical standards. The estimated rise in the 10-year Treasury note's rate is somewhat smaller. That rate is projected to average 4.8 percent in 2005 and 5.4 percent in 2006 and then inch up to average 5.5 percent from 2007 to 2015.

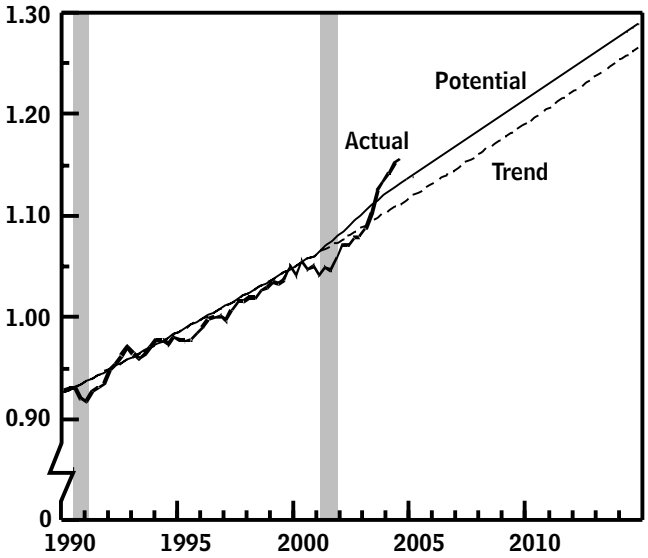
The Importance of Productivity Growth for Economic and Budget Projections

Productivity has grown at an extraordinarily rapid pace in the past three years. Labor productivity, or output per

Figure 2-1.

Total Factor Productivity

(Index, 1996 = 1.0)



Source: Congressional Budget Office

Notes: Total factor productivity is the average real output per unit of combined labor and capital inputs.

The data are adjusted to exclude the effects of methodological changes in the measurement of prices.

hour worked, rose at an average annual rate of 4.4 percent during the three-year period ending in the third quarter of 2004, well above its post-World War II average of 2.3 percent. Similarly, total factor productivity (TFP), or output per unit of labor and capital combined, grew at an average annual rate of 3.5 percent during the same period—which is about 2.2 percentage points above its trend rate of growth (see Figure 2-1).

The future course of productivity plays an important role in CBO's economic outlook, largely because it underlies CBO's estimate of the potential output of the economy. That estimate is important in two ways: it indicates how long the current relatively rapid growth of GDP can continue without running into capacity constraints, and it drives CBO's projections of GDP and tax bases over the next 10 years. Indeed, each increase of a tenth of a percentage point in the growth rate for labor productivity or TFP, if cumulated over that period, would raise the level of GDP in 2015 by roughly 1 percent, or about $200 billion.

Rapid productivity growth also has implications for the outlook for near-term inflation and employment through its effect on the output gap and excess capacity. The output gap (the percentage difference between GDP and potential GDP) is a summary indicator of the slack that exists in the economy. Strong productivity growth since 2001 has boosted CBO's estimate of potential output, which has, in turn, prevented the moderate growth of real GDP from shrinking the output gap by as much as might have been expected on the basis of historical patterns. Hence, a fair amount of slack—1.6 percent—still existed during 2004, which has kept inflation tame and allowed the Federal Reserve to keep interest rates lower than would otherwise have been the case.

Fast growth of productivity also explains how solid growth of output has been possible even though the rise in employment during the current business-cycle expansion has been unusually small. After declining modestly during the recession, real GDP has grown since 2001 at an average annual rate of 3.3 percent, a fairly typical pace in past business cycles. Apparently, however, firms were reluctant to hire workers (and purchase structures and equipment) during that period and focused instead on increasing efficiency. As a result, businesses have been able to meet modest increases in demand with existing labor and capital, and productivity growth has surged.

Going forward, it is difficult to project confidently whether the faster pace of productivity growth will continue because analysts have no compelling explanation for the acceleration. A number of hypotheses have been suggested to explain the speedup in growth; they include the possibility that businesses might have hesitated to hire more workers, perhaps because of geopolitical uncertainties arising from the threat of terrorism or because of strong competition from abroad, and focused instead on improving productivity. Other possibilities center on the idea that the surge in productivity is a delayed payoff to the investments that firms made in information technologies (IT) and other capital goods during the late 1990s. (Analysts suggest that the delay might have ensued either because there were unmeasured costs for absorbing new capital goods or because IT investments are fundamentally—but gradually—transforming the way that the economy works.) To decisively accept or reject any such conjecture is impossible, given the limited amount of data available from such a brief period of observation.[2]

2. For more discussion of the speedup in productivity growth, including possible causes, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005-2014* (January 2004).

In CBO's view, three broad outcomes are possible:

- The productivity surge might be reversed. In that scenario, a period of below-trend (or negative) growth would ensue, bringing the level of productivity back to the path it had been following before the period of faster growth. (That is what happened after surges in productivity in 1983 and 1992.)

- The gains thus far might persist as an upward shift in the future path of productivity, but productivity growth would return to its previous pace. The faster growth from the recent period would not be reversed, but going forward, productivity would "jump off" from the new higher level.

- Future rates of productivity growth might continue to exceed CBO's previous estimate of growth based on productivity's historical trend. In that case, productivity levels in future years would exceed CBO's previous projection by an ever-widening margin. Roughly speaking, that scenario mirrors what happened between the early 1970s and the mid-1990s but moves in the opposite direction. (Starting in about 1973, productivity growth slipped from the 2.8 percent average pace it had posted during the 1950s and 1960s and grew at an average annual rate of 1.4 percent until about 1995.)

Also possible, of course, is that productivity growth during the period since 2001 will look entirely different after the underlying data have been revised in the future—a common occurrence as more information becomes available. Growth could be revised upward or, as happened with the data for the late 1990s, downward (see Box 2-1).

CBO has chosen to adopt the middle ground—that the recent upturn in productivity growth reflects a transition to a permanently higher level of productivity in the economy. As a result, CBO has raised its estimate of the growth of potential TFP during the 2001-2003 period by an average annual rate of 0.6 percentage points. That adjustment to potential TFP growth accounts for about half of the deviation during 2004 of actual TFP from CBO's estimate of the trend level.[3] In the future, TFP growth is assumed to revert to the slower pre-2001 rate, leaving the level of potential TFP permanently higher than it would have been had its growth not accelerated during the 2001-2003 period.

The Outlook for 2005 and 2006

CBO forecasts that during 2005 and 2006, the economy will continue to expand at a healthy pace. Businesses are expected to respond to stronger demand by increasing their spending on capital assets and by hiring more workers, which should in turn support further boosts in demand. Productivity growth over the same period is likely to abate somewhat and interest rates to climb gradually, while inflation will moderate, in CBO's estimation, after the spike in 2004 induced in part by the jump in energy prices.

The Business Sector

The business sector comprises firms that produce goods and services. Firms decide which workers (and how many of them) to hire, how much investment in capital goods to undertake, whether to pursue sales in other countries, and how to most efficiently combine their labor and capital to maximize their profits. Of those decisions, investment spending—firms' expenditures on equipment, software, structures, and inventories—has the most direct effect on the growth of output. Although such investment makes up a relatively small share of GDP—roughly 11 percent in recent years—it is quite volatile and therefore disproportionately affects changes in GDP growth.

Higher levels of investment by businesses will be an important source of growth during the next two years, in CBO's estimation. Firms will probably be unable to meet increases in demand by cutting costs and increasing efficiency. Instead, they are expected to expand capacity by purchasing capital assets and hiring more workers.

Business Fixed Investment. After a prolonged decline between the end of 2000 and the beginning of 2003, businesses' spending on structures and equipment grew robustly during the final three quarters of 2003 and in 2004 and should continue to contribute strongly to economic growth as the expansion continues. During the second half of 2004, real business fixed investment

3. CBO began including this adjustment in January 2004. For more details, see Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2005 to 2014*.

Box 2-1.

Data Revisions and the Productivity Boom of the Late 1990s

During the late 1990s, economic growth in the United States was robust, the stock market was booming, investment by businesses surged, and the rise in productivity appeared to be so strong that many observers declared that a new era of productivity growth had dawned. Since 2000, a number of revisions to the data used to calculate productivity have changed the view of its growth during the late 1990s—in particular, by trimming the pace of productivity expansion during the 1995-1999 period.

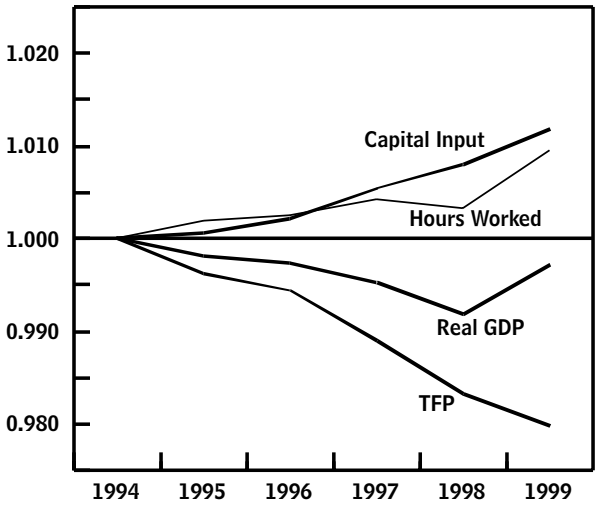
For example, when CBO estimates total factor productivity (TFP) during that period on the basis of currently available data, TFP grows at an average annual rate of 1.3 percent. However, when CBO calculates TFP using data that were available when it prepared its *Budget and Economic Outlook* for January 2000, the rate is 1.7 percent. Pushing the estimate lower have been revisions to the three data series that are used to compute TFP: specifically, growth in the number of hours worked and in capital services (the productive services provided by the economy's capital stock) has been revised upward, and growth of real GDP has been revised downward (see the figure).

Those revisions were made gradually, none was especially large, and the cumulative effect of all of the revisions was to lower the level of TFP by 2 percent in 1999. The biggest revision to real GDP occurred between the publication of CBO's January 2001 and January 2002 *Budget and Economic Outlook* reports, when the Bureau of Economic Analysis released the results of its annual revision to the national income and product accounts. That revision reduced the average annual rate of growth of real GDP in the nonfarm business sector during the 1995-1999 period by nearly a tenth of a percentage point. The largest upward revision to the category of labor hours worked in the economy occurred last August—too late to be incorporated in CBO's economic forecast for the September update of its January 2004 outlook. The Bureau of Labor Statistics released a data series that reflected new estimates of hours worked by nonproduction and supervisory workers and boosted the pace of labor-hour growth during the 1995-1999 period by more than a tenth of a percentage point.

Although the revisions to the data underlying the productivity statistics are significant, there is still a substantial step-up in growth for TFP during the late 1990s when compared with the preceding period. The growth rate calculated for TFP during the 1995-1999 period—1.3 percent—is considerably higher than the average growth rate for the 1974-1994 period, when TFP grew at an average annual pace of 0.8 percent. The revisions to hours worked and real GDP described above also affect labor productivity. When calculated using data that were available in January 2000, labor productivity grows at an average annual rate of 2 percent during the 1995-1999 period, down from 2.2 percent using currently available data. Like TFP, labor productivity growth picks up during the late 1990s, even after the revisions: average annual growth during the 1995-1999 period is about 0.6 percentage points faster than it was from 1974 to 1994.

Revisions to Late 1990s Data for Key Inputs to Potential Output

(Index, 1994 = 1.0)

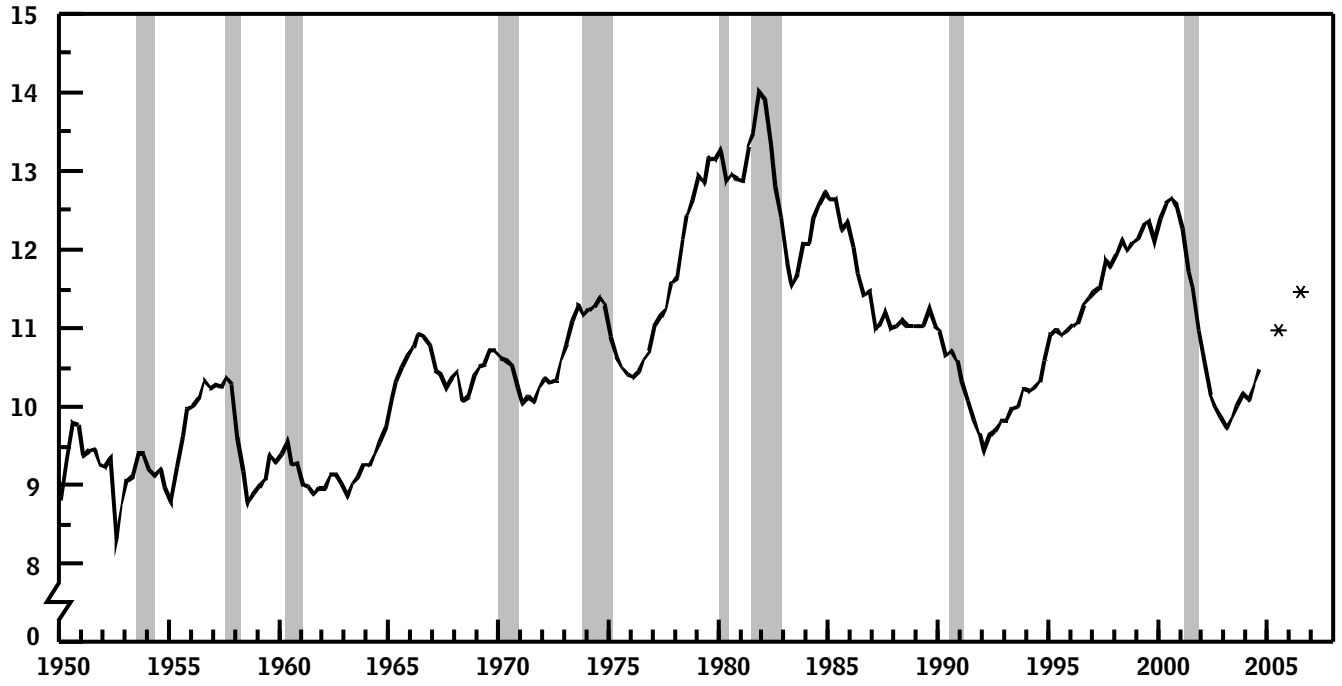


Sources: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics.

Figure 2-2.

Business Fixed Investment

(Percentage of potential GDP)



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

Note: * = CBO's forecast for 2005 and 2006.

climbed at an estimated rate of more than 15 percent measured on an annual basis—well above its postwar average of 5 percent or its average annual rate of 9 percent during the boom in investment of the late 1990s. Yet despite that vigorous growth, real business fixed investment at the end of 2004 had only just regained the ground it had lost during the 2001 recession and the sluggish recovery that followed. Consequently, CBO expects that during the next two years, the pace of firms' investment spending will remain above its long-run rate.

Real business fixed investment fell by 15.1 percent between the beginning of the recession (in the first quarter of 2001) and the first quarter of 2003. As a share of potential GDP, that drop was sharper and more long-lasting than such declines in past business cycles (see Figure 2-2). In the first quarter of 2003, eight quarters after the business cycle's peak, real investment in equipment, software, and structures was still 14 percent below its peak value. On the basis of past patterns, it would have been expected by then to have recovered all of its losses.

As the economy recovered from the 2001 recession, however, demand for goods and services expanded less rapidly than businesses' ability to produce them. The reason, for the most part, was that the growth rate of total factor productivity was exceptionally high, which allowed firms to meet increased demand without the hiring or capital expenditures that would be typical during the early phase of a business-cycle expansion. In addition, a surge in investment spending during the late 1990s, especially for telecommunications equipment, apparently left many industries with more capacity than they needed. Consequently, even though real GDP grew at moderate rates in 2002 and 2003, firms' spending for capital equipment and the growth of employment lagged behind the rise in output.

Both investment and hiring improved in 2004, indicating that the factors tending to restrain firms' spending had weakened. Real business fixed investment grew by an estimated 11 percent last year, suggesting that businesses were concerned about their ability to meet expected increases in demand with existing capacity and expected productivity growth. Although labor productivity rose at

a fairly brisk pace in 2004—about 3 percent—CBO expects that labor productivity growth will slow toward its long-term trend in 2005 and 2006. At the same time, a steady rise in consumption by households and governments will encourage businesses to spend more on investment, which CBO estimates will grow by about 10 percent in real terms during 2005 and 2006.

A variety of indicators other than business investment suggest that the confidence of businesses improved during 2004. For example, the Business Roundtable, an association of chief executive officers of leading U.S. corporations, surveyed up to 160 member companies about the economic prospects for the next six months and reported an overall index averaging 98 in 2004 (a value above 50 indicates expansionary conditions) compared with a value of 68 in 2003. In a key portion of the survey that measures confidence, an average of 88 percent of respondents to the association's four quarterly surveys of 2004 expected their firm to increase sales in the next six months—compared with 72 percent during 2003.

Another measure, based on work by the Conference Board, showed similar results but also some divergence. (The Conference Board is a global business membership organization that conducts research and forecasts and assesses economic trends.) The measure, which used the board's CEO Confidence Survey, was also stronger in 2004 than in 2003, averaging 67 last year versus 62 in the previous year. Unlike the Business Roundtable's survey, however, the Conference Board's measure suggests that confidence waned over the course of 2004 after a robust first quarter.

Changes in tax laws aided investment in 2004 but will no longer do so in 2005 and beyond. The Job Creation and Worker Assistance Act of 2002 (JCWAA) contained incentives to bolster businesses' spending on equipment and structures by temporarily increasing the fraction of new investment that firms could "expense" (deduct from their taxable income immediately rather than over time). The Jobs and Growth Tax Relief Reconciliation Act of 2003 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 was acquired. JGTRRA also increased, through 2005, the limit on small businesses' expensing of new depreciable assets—and that limit was extended through 2007 by the American Jobs Creation Act of 2004. On balance, those incentives boosted investment in equipment slightly in 2004 but will have little effect in 2005 and 2006.

Current financial conditions are favorable for businesses that seek to invest. Firms' high levels of corporate profits and retained earnings (the portion of profits that is not paid to shareholders as dividends) since the recession's end in 2001 should help businesses finance their capital spending from internal funds. Aided in part by the accelerated expensing provided by JCWAA and JGTRRA, firms' retained earnings reached an estimated 4 percent of potential GDP during 2004, a share not matched since the 1960s (see Figure 2-3). Corporate profits and retained earnings are not expected to remain at such elevated levels, though—partly because almost all of the expensing provisions in JGTRRA expired at the end of 2004 and partly because employers are expected to increase their contributions to their defined-benefit pension plans, especially in 2006 (see Appendix D).

In the near term, firms will continue to use retained earnings to underpin their investment spending. And if they need to turn to outside sources of financing, they will find that their costs for securing external capital will not have increased dramatically. Short-term interest rates rose somewhat during the second half of 2004, but businesses' spending on structures and equipment responds more to changes in long-term than in short-term rates, and long-term rates changed little over the year. Moreover, gains in the stock market last year mean that equity financing has become cheaper than it was in 2002 and 2003.

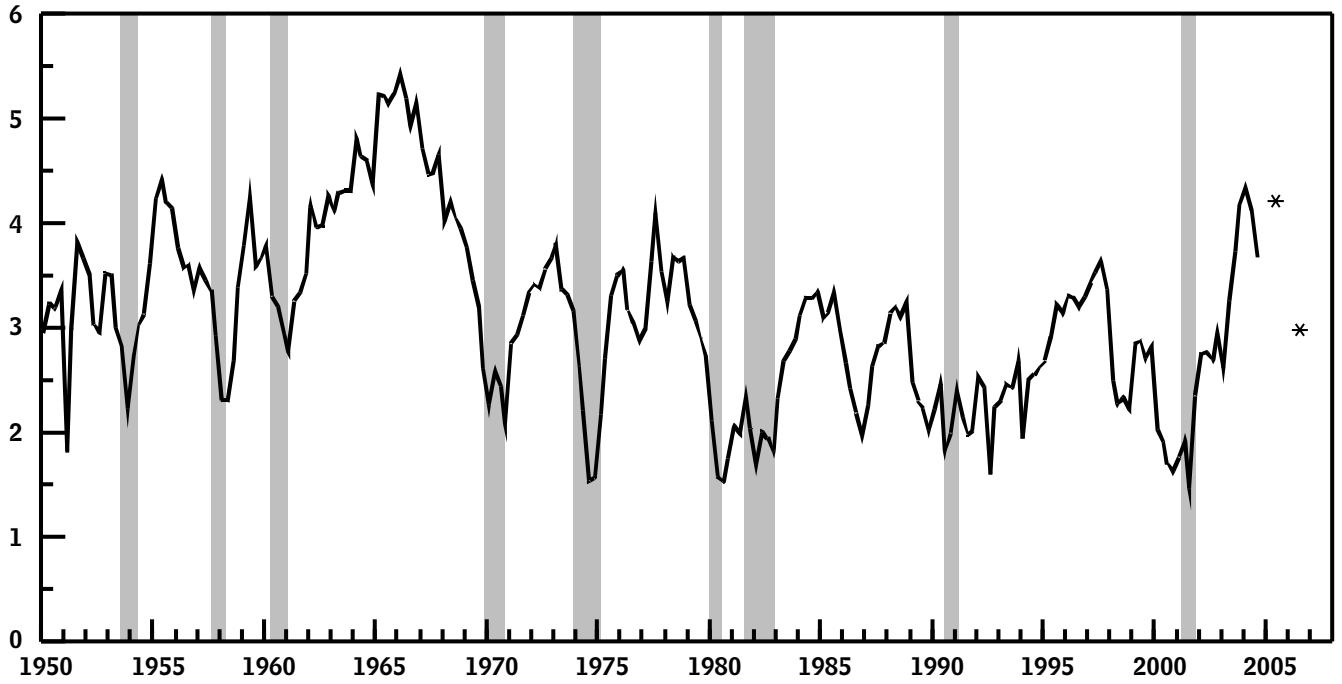
CBO expects that solid growth in the demand for output, combined with healthy financial conditions, will allow businesses' investment spending to continue to grow at a relatively fast pace during 2005 and 2006. In CBO's forecast, real investment in producers' durable equipment and software grows at an average annual rate of 10 percent during 2005 and 2006, whereas firms' spending for nonresidential structures, which began to rise in 2004, is slated to grow at an average annual rate of 4 percent during the two-year forecast period.

Despite the signs that businesses appear ready to invest more, however, actual outcomes remain uncertain. If, for example, the rate of growth of productivity continues to exceed its potential rate, firms could decide to meet future increases in demand with existing capacity and thus would not need to boost investment by as much as CBO

Figure 2-3.

Corporate Retained Earnings

(Percentage of potential GDP)



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

Notes: Retained earnings are the portion of profits not paid to shareholders as dividends.

* = CBO's forecast for 2005 and 2006.

envisions. Alternatively, other components of demand could grow more or less vigorously than CBO has forecast, which would lead to a correspondingly stronger or weaker course for investment. Another possibility is that future innovations may require firms to make new investments. (One example of such a change was the commercial development of the Internet, which required substantial investments by firms during the 1990s.) If such circumstances arise, investment spending by businesses may be much greater than CBO has foreseen.

Inventory Investment. The recent pattern of investment in inventories also suggests that businesses have become more confident about their economic prospects. As demand has picked up, so too has the building of inventories. Accumulation accelerated in 2004—inventories rose by an estimated $40 billion—after a period of sluggishness in 2003, when firms drew down their stocks. As with fixed investment, the pickup in spending on inventories has lagged behind economic growth during the past three years. Now, though, the strong demand forecast for 2005 and 2006, combined with a fairly lean stock of inventories, is expected to propel inventory investment to about $80 billion in 2005 and $70 billion in 2006.

The Household Sector

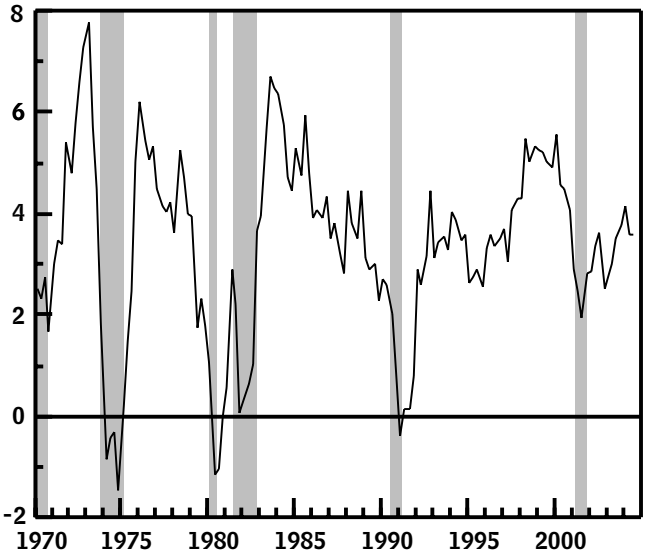
The household sector consists mainly of individuals and families who supply labor and decide how to divide their income between consumption and spending—and then choose which goods and services to purchase. Households' spending composes a large share of GDP—about 70 percent, on average, during the past five years. Households are also the main force behind residential investment, which makes up another 5 percent of GDP.

Spending by the household sector was a bright spot during the 2001 recession and subsequent recovery, supporting overall growth when other sectors, such as business investment and net exports, did not. Real consumer spending, for example, slowed but did not decline during the recession: it grew at an estimated average annual rate

Figure 2-4.

Real Personal Consumption Expenditures

(Percentage change from previous year)



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

of 3.3 percent during the 2002-2004 period, which is not too different from its long-run average rate of 3.6 percent (see Figure 2-4). Real housing investment was also relatively robust in the past recession, as compared with previous downturns, and remained quite strong during the recovery. Policy actions contributed to those healthy outcomes, as the Federal Reserve's accommodative monetary policy lowered financing costs for housing and durable goods and expansionary fiscal policy cut personal taxes. Last year, real consumer spending grew by an estimated 3.6 percent (measured on a fourth-quarter-over-fourth-quarter basis), and real residential investment grew at a solid 5.5 percent rate.

CBO believes that the household sector will continue to support the growth of real GDP in the next two years. The fundamental elements for an ongoing rise in consumer spending are in place: households' net worth has continued to improve; the recent gains seen in employment and income are likely to continue; and the household sector as a whole faces few financial difficulties. Nevertheless, an expected upturn in interest rates is likely to slow the growth of real consumer spending a bit this year and cause a modest decline in real residential investment.

The main risk to the prospect of continued robust spending by households is a stalling of employment and hence of growth in incomes. Another risk is the possibility of a sharp decline in the prices of houses, which are at a high level relative to incomes (and the general price level). However, a broad-based decline in housing prices seems unlikely.

Employment. CBO expects that conditions in the labor market will continue to improve as the economy expands in 2005 and 2006. Growth of the labor force is likely to accelerate, in CBO's view, and hiring to expand at an even faster rate, because firms will be unable to meet expected increases in demand through productivity growth. But the growth of employment is likely to remain slower than it would typically be in an expansion, and CBO forecasts that the unemployment rate will fall only slightly—to 5.2 percent—in 2005.

The level of employment dipped from the end of the 2001 recession until mid-2003, when it bottomed out and began a rebound that continued in 2004. Businesses added more than 2.1 million jobs last year, as measured by the Bureau of Labor Statistics' (BLS's) payroll survey, boosting employment by 1.6 percent over the four quarters of 2004. Employment as measured by BLS's household survey presents a slightly more optimistic picture of the labor market. According to the household survey, employment started growing earlier than the payroll measure indicated, and it increased steadily over the past two years, climbing by 1.0 million jobs in 2003 and about 2.2 million in 2004.[4]

The stronger gains in employment last year are reflected in the drop in the unemployment rate, which declined by 0.5 percentage points to 5.4 percent. Ordinarily, that low a rate would suggest that the labor market had tightened appreciably. However, the rate probably understates the market's current degree of slack because the rate of labor force participation—the share of the population ages 16 and older who are either employed or looking for work—has been falling since 2000. After a long-running rise that started in the early 1960s, the labor force participation rate peaked at 67 percent of the civilian population in the first quarter of 2000 and has since declined to 66 percent. That drop implies that the labor force has 2.2 million

4. Those figures were adjusted by BLS to smooth out the effects of revisions to the underlying population estimates in January 2003 and January 2004.

fewer workers than it would have had if the participation rate had not declined. CBO anticipates that in the coming years, the participation rate will recover somewhat as the continuing creation of jobs draws many of those workers back into the labor force.

Some indicators of businesses' plans for hiring suggest that firms are likely to continue to add jobs at a rate similar to the average since 1970. An index of hiring demand calculated by the Internet-based employment agency Monster.com, although too new to interpret with any precision, indicates that the availability of jobs is greater than it was a year ago. Moreover, the BLS's Job Openings and Labor Turnover Survey shows recent gains in both the rate of hiring and the number of job openings. In addition, a recent survey of employers' hiring plans by Manpower, Incorporated, a provider of temporary workers, suggests that hiring gains will continue in early 2005.

Income. CBO expects that more substantial growth in employment will provide—as it did last year—the basis for a solid rise in wages and salaries in 2005 and 2006 (see Figure 2-5). In 2004, real wages and salaries grew by an estimated 2.6 percent after inching up 0.6 percent in 2003; the pace of growth this year is expected to pick up to about 4 percent before tapering off slightly next year. Also boosting real incomes slightly this year, in CBO's view, is a modest decline in energy prices, which will lower the overall rate of inflation in consumer prices.

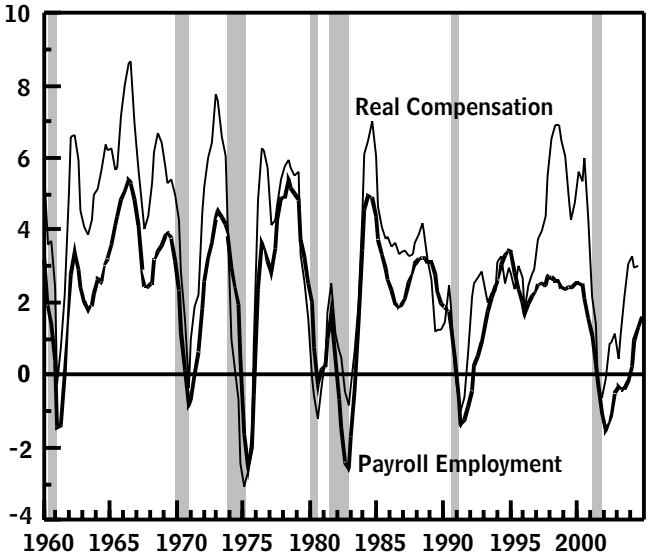
Although the growth of wages and salaries is expected to quicken in 2005, the growth of disposable (after-tax) personal income is likely to remain relatively steady. During the past few years, cuts in personal taxes raised disposable income, even though the growth of wages and salaries was fairly listless. By contrast, the source of growth in disposable income in the future is likely to be a moderate rise in employment growth.

In CBO's estimation, a modest decline in energy prices will boost real disposable personal income this year by a small amount. Increases in the price of both crude oil and natural gas contributed to the hike in consumer energy prices last year, which reduced the rate of growth of real disposable income. After rising only slightly in the second half of 2003, the price index for consumer energy products shot up at an average annual rate of more than 26 percent in the first half of 2004; in the third quarter, it climbed by an additional 4 percent. This year, CBO assumes, refiners' acquisition cost of crude oil will fall from about $45 per barrel in the fourth quarter of 2004 to just under $40 by the fourth quarter of 2005.

Figure 2-5.

Payroll Employment and Real Labor Compensation

(Percentage change from previous year)



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

Households' Financial Health. Households' finances are in good shape, having turned around in 2003 and strengthened in 2004. Consequently, they should not hinder spending. Despite a flat stock market for most of the year, the net wealth of households essentially rose at the same rate as disposable income during 2004 because their real estate wealth posted a strong advance. Moreover, the household sector as a whole does not appear to be suffering from financial stress. Although households' borrowing grew rapidly last year, the share of disposable income they used to service debts rose only slightly, and the share claimed by financial obligations declined through the third quarter of last year. In addition, delinquency rates at commercial banks on credit cards, other consumer loans, and residential real estate all declined during 2004.

Housing. Investment in housing, propelled by historically low interest rates on home mortgages, has been an important source of strength in the economy in the past few

years. Now, however, in CBO's view, the housing market is likely to cool in 2005 and 2006 in the face of a rise in mortgage interest rates. During 2004, housing investment surged to near-record levels, reaching 5.7 percent of GDP in the middle of the year; single-family housing starts and sales of new and existing homes also reached record highs. But mortgage interest rates are likely to rise as the economy keeps expanding and the Federal Reserve continues to push the federal funds interest rate, its main policy tool, back toward a more neutral level.[5]

The prices of houses registered another strong advance last year. According to the Office of Federal Housing Enterprise Oversight (OFHEO), the price index for single-family homes rose by 13 percent in the year ending in the third quarter of 2004, a jump that is considerably above the average annual rise of about 7 percent posted during the previous two years. According to OFHEO, a part of the step-up in growth last year may reflect the fact that appraised values for houses that were undergoing refinancing have "caught up" with previous price increases in the real estate market.[6] Apparently, appraisals for refinancings may not have kept pace with market prices during the previous one or two years, when refinancing activity was at record levels. Now that such activity has abated, appraisals for refinancings better reflect current market prices, in OFHEO's view.

Some analysts worry that the continued rise in the prices of houses reflects a market that has been seized by a speculative frenzy that could lead to a price collapse. Such an outcome would hurt household wealth and hence spending. Research indicates, however, that the rise in housing prices in recent years for the nation as a whole reflects positive fundamental factors, such as rising personal income and declines in mortgage interest rates, rather than speculative expectations of future increases in prices.[7] In CBO's estimation, a general collapse of prices for houses is unlikely because stronger income growth in the next two years will probably counteract the anticipated rise in mortgage interest rates. Prices could fall in some areas—particularly parts of the Middle Atlantic, New England, and Pacific regions—where prices have risen much faster than in other parts of the country. However, any such declines are unlikely to present a serious risk for the nation as a whole.

Imports, Exports, and the Value of the Dollar

In 2004, the United States increased its imports by more than it increased its exports, so the nominal balance of trade—U.S. exports minus imports—worsened. During the past three years, that imbalance has widened by an estimated $230 billion in nominal terms, or about 2 percent as a share of GDP. However, in CBO's estimation, the decline will reverse in the near future. By 2006, the growth of exports is likely to outpace that of imports, and the balance of trade should begin to improve.

The projected improving trend in the trade balance largely reflects the expected decline of the dollar relative to the currencies of the United States' trading partners, especially those of Asian economies. The dollar has been falling for three years; since its peak in the first quarter of 2002, it has lost almost 14 percent of its value (see Figure 2-6). Such a decline should eventually improve the trade balance by making U.S. exports cheaper (in terms of foreign currency) and U.S. imports more expensive (in dollars). Nevertheless, the trade balance has continued to fall over the past three years despite the dollar's decline, for two reasons.

First, declines in the exchange value of the dollar typically take two to three years to exert their full effect on the trade balance. Initially, the dollar's decline will worsen the nominal trade balance because it raises the dollar price of imports, most of which are priced in foreign currencies, faster than it reduces the quantity of imports. Over time, however, the trade balance will improve as the increase in the value of exports and the decline in the quantity of imports dominate the rise in the price of imports. Thus, the lack of response of the trade balance to the dollar's decline since early 2002 partly reflects a continued adjustment to the rapid rise in the dollar's value during the 1995-2001 period.

Second, the fall of the U.S. currency has increased the dollar prices of imported goods by less than analysts had expected on the basis of past relationships. Although the dollar fell by about 14 percent during the past three years, import prices (other than for oil and computers) rose by

5. The federal funds rate is the interest rate that financial institutions charge each other for overnight loans of their monetary reserves.

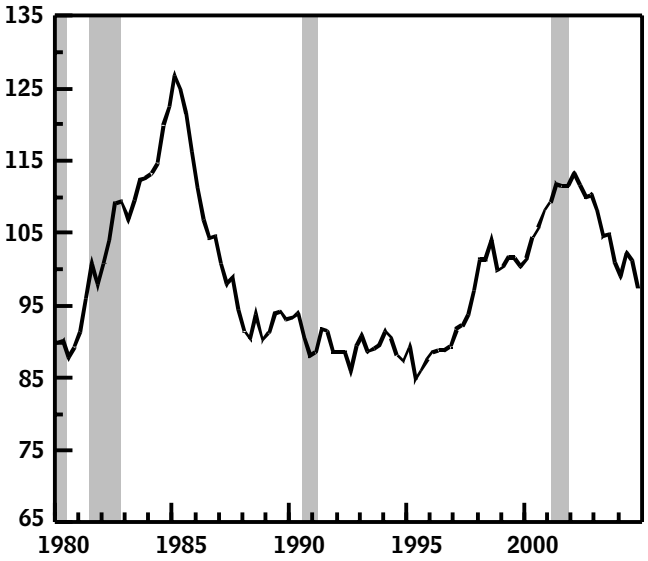
6. See Office of Federal Housing Enterprise Oversight, "OFHEO House Price Index: House Price Gains Continue to Accelerate" (news release, December 1, 2004), available at www.ofheo.gov.

7. Jonathan McCarthy and Richard W. Peach, "Are Home Prices the Next 'Bubble'?" *Economic Policy Review*, Federal Reserve Bank of New York (December 2004), pp. 1-17.

Figure 2-6.

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

(Index, March 1973 = 100)



Sources: Congressional Budget Office; Federal Reserve Board.

Note: The real trade-weighted value of the U.S. dollar is a weighted average of the foreign exchange values of the dollar against the currencies of a large group of major U.S. trading partners. The index weights, which change over time, are derived from U.S. export shares and from U.S. and foreign import shares.

only 5 percent, which implies that producers abroad must have absorbed more of the effect of the exchange rate change than in the past. Presumably, the underlying reason is an increase in competition for the U.S. market. Over the past several years, the lackluster domestic demand in many industrialized nations suggests that the U.S. market has grown in importance for firms in other countries at the same time that the surge in U.S. productivity growth has boosted the competitiveness of U.S. products. Exporters in those industrialized countries may also be afraid that if they raise their dollar prices by too much, they will lose some of their share of the market to producers in the United States and to the Chinese, whose currency has not appreciated against the dollar.

Imports and exports also reflect other factors, notably the price of oil and the growth of incomes. (Income growth in the United States helps determine the demand for imports; income growth in countries that the United States trades with helps determine exports.) The sharp rise in oil prices since late 2003 slowed the decline in the trade deficit by raising the value of U.S. oil imports. CBO expects that oil prices will continue to fall from their peak in late 2004, which will help reduce the cost of such imports. Another factor that has been contributing to the trade balance's decline—stronger growth in the United States than in the countries that purchase its exports—is expected to play less of a role in the next few years, as the difference between the pace of growth here and abroad diminishes.

CBO's forecast of an improving trade balance, however, is subject to considerable uncertainty. If the economies of the United States' trading partners should falter or oil prices fail to decline as expected, the improvement in the trade balance could be delayed. CBO's forecast also incorporates the assumption that international investors (including governments) will continue to increase their holdings of U.S. assets. If, instead, those investors decided to reduce or simply not increase their holdings of dollar assets, the U.S. currency could fall more quickly than CBO anticipates—which would tend to raise both inflation and interest rates, at least temporarily, and slow economic activity. It would also, however, improve the trade balance more quickly, implying that foreign countries would bear some of the costs of that adjustment.

Economic Conditions Abroad. Forecasters in the private sector anticipate that the overseas economic recovery will continue, with solid growth and generally low inflation and interest rates. Among the United States' trading partners, economic growth picked up in 2004; during 2005 and 2006, it is expected to nearly keep pace with its long-run rate of roughly 4 percent. *Consensus Forecasts*, a survey of financial and economic forecasters, expects that growth among the countries that use the euro will equal 1.7 percent in 2005 and 2 percent in 2006.[8] Japan's economic recovery, which has been helped considerably by exports to China, should also continue. Canada, although fighting the drag caused by an appreciating currency, is also helped by high prices for commodities (including oil) and is expected to keep growing at a moderate rate.

Major developing countries have also grown at healthy rates. China, though it imports little from the United

8. Consensus Economics, Inc., *Consensus Forecasts, A Digest of International Forecasts*, published by Consensus Economics, Inc., (London: U.K., Consensus Economics, Inc., January 10, 2005).

States, makes a substantial contribution to regional economic activity, having grown 9 percent in real terms during 2003 and 2004. In Latin America as well, economies have rebounded. Mexico's has benefited from rapid economic growth in the United States, its largest trading partner, and from the increase in the price of oil. Brazil's economy, the largest in South America, expanded at an estimated rate of 5 percent during 2004 and is expected to grow by nearly 4 percent in 2005.

The Current Account and the Exchange Value of the Dollar. Although exchange rates are notoriously difficult to forecast, CBO expects that the exchange value of the dollar will decline during the next two years, largely because continued deficits in the nation's current account will raise net liabilities to foreigners to new highs. (The current account is a broad measure of U.S. transactions with the rest of the world. It includes not only the trade balance but also net investment income and net unilateral transfers.)[9] In CBO's view, investors will be less willing to add to their holdings of dollar assets at current exchange rates and interest rates.

Persistent current-account deficits have led to more-rapid accumulation of foreign-owned assets in the United States than of U.S.-owned assets abroad. Net liabilities to foreigners—the difference between U.S.-owned assets abroad and foreign-owned assets in this country—declined to an estimated -24 percent of GDP during 2004. By the end of 2006, such liabilities will have fallen to about -30 percent of GDP, CBO expects, even though the current-account deficit is forecast to stabilize during that time.

Investors may not be willing to hold that increased volume of dollar assets unless the rate of return they expect on those assets goes up. In principle, the expected rate of return can increase either as the dollar return on those assets (interest rates or the return on equities) goes up or as the dollar falls, making the assets cheaper. CBO anticipates that most of the adjustment will come as the dollar falls.

Assessing the Risk of a Sharp Decline in the Dollar. The extent of the U.S. current-account deficit and of the United States' net liabilities to foreigners has prompted concerns on the part of some analysts about the risk of a sudden and significant decline in the dollar. In that scenario, a sharp drop in the demand for assets denominated in dollars could cause an abrupt tumble in the dollar's value, which could disrupt the global economy by sharply raising inflation and interest rates in the United States, slashing the foreign-currency value of dollar-denominated assets that are owned by people in other countries, and crippling the competitiveness of foreign producers relative to manufacturers in the United States. More likely, however, in CBO's view, is an orderly decline in the dollar and little disruption to the U.S. economy, for the following reasons:

- The returns expected on investments in the United States remain higher than those available abroad, especially after adjusting for the risk of default. In part, that is because the outlook for the U.S. economy is brighter than the prospects for Japan and the countries that use the euro, which suggests that the return on U.S. portfolio assets, such as stocks and bonds, will exceed the return available in those countries. The expected rate of return on portfolio assets in some developing economies may surpass that in the United States, but it is also subject to much greater risk.

- Many countries that export to the United States have a strong incentive to minimize the potential damage to their own economies by preventing the dollar from falling too sharply. A large decline in the dollar's exchange rate would cut the value of many countries' reserves of foreign exchange—which are held largely in dollars—and it could also dampen the rate of economic growth in countries that send a large share of their exports to the United States. Moreover, as the major international reserve currency, the dollar's exchange value receives steady support from demand arising from its use as a medium of exchange for international transactions and from those who hold it as a precaution against the devaluation of their own currency.

- A plunge in the dollar's exchange rate would not tend to feed on itself as has sometimes occurred in past episodes involving depreciations of the currencies of developing countries. Most foreign assets owned by U.S. citizens, companies, and governments are denominated in the relevant local currency, whereas almost all U.S. liabilities to foreigners are denominated in dol-

9. Unilateral transfers are official and private payments from the United States to sources abroad and from sources abroad to the United States, in which the payments are not made in exchange for goods and services.

lars. Consequently, the dollar's depreciation automatically shrinks the value of U.S. net liabilities to foreigners, thereby removing some of the pressure for further depreciation. By contrast, many of the international liabilities of other countries, especially those of developing countries, are denominated in the currencies of their creditors. Hence, a decline in the exchange value of the countries' currencies increases the value of their net liabilities to foreigners—which, in turn, further depresses their currencies.

- The depreciation of the dollar will, over time, help boost U.S. net exports and thus economic growth. That positive aspect of a drop in the dollar's value also helps limit the extent of its fall.

Monetary Policy and Financial Market Conditions

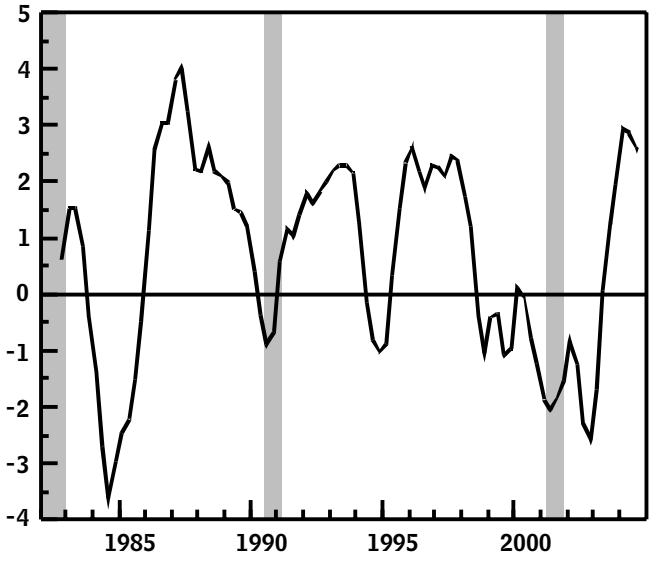
CBO expects that during the next two years, the Federal Reserve will continue to shift monetary policy away from the accommodative stance it has maintained since the 2001 recession and toward a more neutral position by raising its target for the federal funds rate, its primary policy instrument. Before the central bank began to boost the rate in June, it had been kept for a full year at the historically low level of 1 percent, a policy that was designed to achieve economic growth that could sustain itself without policy actions. Now that the economy appears to have found its footing, Federal Reserve officials have stated that they will raise the target rate at a measured pace and move monetary policy toward a neutral stance—one that is balanced between supporting economic growth and maintaining low inflation. That approach is seen by participants in the financial markets as allowing room for the Federal Reserve to quicken the pace of policy tightening if inflation surges or to delay interest rate increases if the economy stumbles. At the time that CBO's forecast was completed, the consensus among financial market participants was that the federal funds rate would reach 3.25 percent by August 2005. (In late December 2004, the target rate was 2.25 percent.)

An index of monetary and financial conditions compiled by the consulting firm Macroeconomic Advisers indicates that financial conditions are still adding a considerable degree of upward momentum to the growth of GDP, even after the hikes in short-term interest rates that occurred in 2004 (see Figure 2-7). At year's end, rates on corporate bonds, though slightly higher than the low levels (about 5.3 percent) seen briefly in early 2004, were still sufficiently low (about 5.5 percent) to encourage investment. Like other long-term rates, those on corporate bonds had weathered midyear jitters over whether the pace of the Federal Reserve's tightening would be rapid or relatively deliberate. (Rates rose to 6 percent before falling back.) Conditions have also continued to improve in the stock market, which is helping to restore household wealth. New public stock offerings by corporations have been one result of that more favorable climate, providing another source of funds for businesses' expansion.

Figure 2-7.

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.

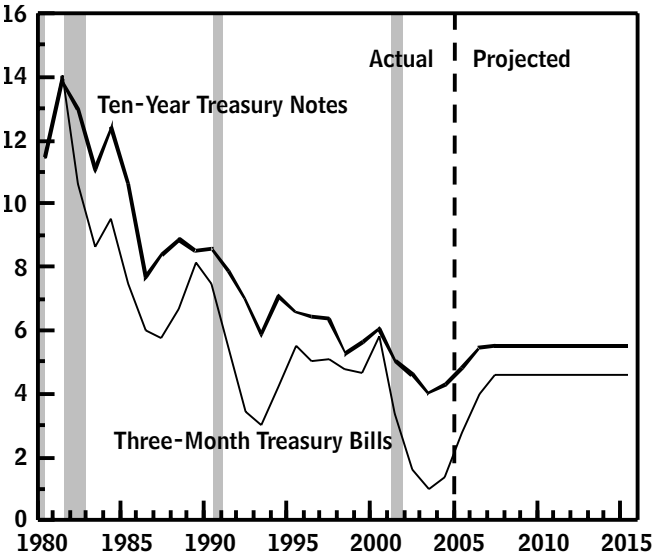
The last data point is the third quarter of 2004.

CBO forecasts that the rate on three-month Treasury bills will continue to climb as the federal funds rate rises. The rate on three-month bills, which stood at 2.2 percent at the end of 2004, is expected to average 2.75 percent and 4 percent in 2005 and 2006, respectively (see Figure 2-8). That forecast is on a par with expectations in financial

Figure 2-8.

Interest Rates

(Percent)



Sources: Congressional Budget Office; Federal Reserve Board.

Note: All data are annual values.

markets about the direction of monetary policy. (Typically, the Treasury bill rate tends to rise and fall with the funds rate.)

The rate on 10-year Treasury notes also rises in CBO's forecast but to a lesser degree than the rate on short-term securities. To a certain extent, the near-term outlook for monetary policy affects day-to-day and month-to-month changes in rates on long-term financial instruments. The path of those rates, however, tends to be governed by the long-term outlook for inflation and the potential for real returns from capital investment. CBO thus forecasts that the rate on 10-year Treasury notes will average 4.8 percent and 5.4 percent in 2005 and 2006, respectively.

Government Spending

The growth of real consumption and total investment spending by all levels of government slowed for a second year in 2004, rising by about 2 percent. Most of the slowdown in growth occurred in the spending of state and local governments; by contrast, real federal spending climbed by about 4¾ percent. That growth was buoyed by a strong increase in defense spending (over 7 percent) that reflected supplemental appropriations for activities in Iraq and Afghanistan and for other activities related to the war on terrorism. Real federal nondefense spending declined slightly in 2004. As in 2003, real spending by state and local governments grew by less than 1 percent.

CBO projects that during the next two years, the growth of real consumption plus investment in the government sector overall will continue to slow, despite a small rise anticipated in spending by states and localities. That slowdown stems from a projected weakening in defense spending, which largely results from the procedures that CBO is required to use to project defense and other discretionary spending (see Chapter 1).

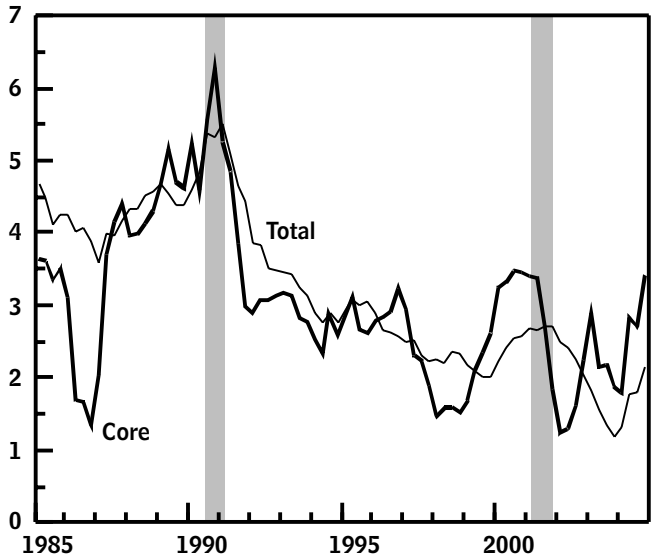
Most analysts expect that spending for Iraq and Afghanistan and for other activities related to the war on terrorism will be greater than the amount CBO has projected under the rules that govern its baseline projections. Consequently, CBO has developed an illustrative alternative for such spending (see Table 1-3 on page 8). The alternative incorporates the assumption that outlays are higher than in the current baseline by $30 billion in fiscal year 2005, $70 billion in 2006, and $75 billion in 2007; thereafter, outlays steadily decline. Additional outlays for the 2005-2015 period total $620 billion (including $172 billion in debt service).

If that spending path were incorporated in CBO's baseline, the forecast for real growth of GDP would be slightly faster in the near term but slightly slower, on average, over the 10-year projection horizon. Because roughly two-thirds of those outlays might be spent in the United States rather than abroad, the additional spending would boost economic growth slightly in the short term by adding to the demand for U.S. goods and services. For the next 10 years as a whole, however, the additional defense spending under that alternative path (plus the associated increase in interest payments) would produce larger federal deficits than those projected in the current baseline and would slightly reduce the growth of the economy's potential supply of output by crowding out some private investment. To a certain extent, increased private saving and more borrowing from abroad would offset the effect of those larger deficits. Nevertheless, investment during the 2005-2015 period would be lower than it would otherwise have been, and the resulting fall in national income would be greater, as payments to people in other countries increased to service the additional debt owed to them.

Figure 2-9.

The Consumer Price Index: Total and Core Measures

(Percentage change from previous year)



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

Note: The core consumer price index is the consumer price index for all urban consumers excluding food and energy.

Inflation

Special factors last year, such as the surge in oil prices and upturns in the cost of shelter and used cars, caused inflation as measured by the CPI-U to rise sharply, from 1.8 percent during 2003 to 3.4 percent during 2004 (see Figure 2-9). That increase, however, is not necessarily a harbinger of generally higher inflation. During the next two years, CBO forecasts, the growth in prices will be close to 2 percent. Some analysts believe that the long period of accommodative monetary policy, the solid economic growth of the past several quarters, and a falling dollar will drive inflation higher. Yet although CBO in its forecast acknowledges that there is some risk of inflation's being higher than it has assumed, it basically maintains that falling oil prices and an excess of productive capacity, both here and abroad, are likely to keep inflation low during the 2005-2006 period.

Energy and Food Prices. Prices for both energy and food grew rapidly during 2004, but CBO does not expect that price rises in either of those categories will exacerbate inflation in 2005 and 2006. An anticipated reversal in energy prices is the primary reason that CBO's forecast incorporates an assumption of lower inflation in 2005 than in 2004, a view strongly shared by many analysts. Indeed, CBO expects oil prices to be more than 10 percent lower in the fourth quarter of this year than they were in the fourth quarter of 2004 (see Box 2-2 on page 42). In addition, CBO expects a smaller rise during the next two years in the CPI-U for food and beverages—a category that accounts for 18 percent of the price index. Because of unusual weather and an upturn in beef prices (caused in part by a shift to the consumption of more protein), the food and beverages component of the CPI-U rose by 3.3 percent last year. CBO anticipates that during the forecast period, inflation in food prices will revert to its average of the past 15 years of about 2.5 percent.

Core Inflation. Hikes in energy and food prices were not the only reason for the spurt in growth of the price index in 2004. The core CPI-U—the CPI-U excluding the energy and food categories—grew by 2.2 percent over the course of the year, compared with a rise of 1.1 percent in 2003. Some analysts cite the 2004 increase as evidence of rapidly building inflationary pressures. However, only a small portion of the quickened pace of core inflation in 2004—the increase in import prices—implies a continuing upward push on prices during the next two years.

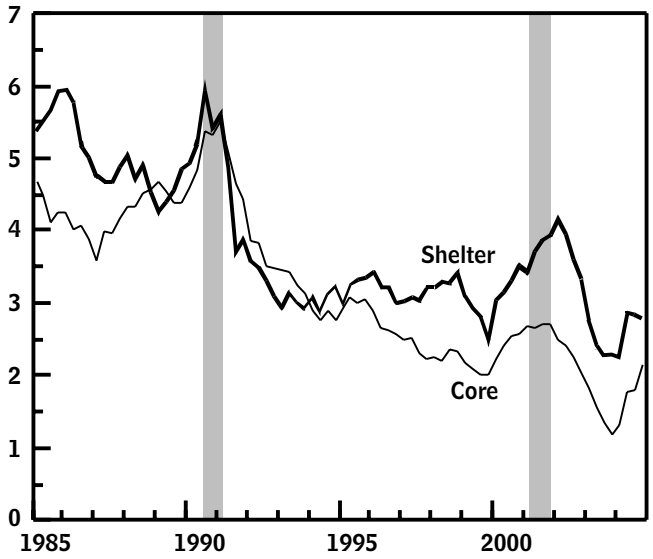
Bolstering CBO's belief that inflation will not surge in the near term is that most of the increase in the core rate in 2004 was simply a rebound from the unusually low rate of growth of prices in 2003. A little less than half of the acceleration in 2004 can be traced to the shelter price index in the CPI-U. That measure, which primarily comprises rental prices and has a total relative importance in the core CPI-U of about 42 percent, grew by 3.1 percent in 2002. During 2003, its rate of growth slumped, registering only 2.2 percent; then in 2004, it climbed again, to 2.7 percent (see Figure 2-10). A significant part of the acceleration in the core CPI-U during 2004, therefore, was caused by the rebound in the growth of prices for shelter. Although CBO forecasts that shelter prices will not accelerate further, that outlook is particularly uncertain, largely because the wide variation in the growth of the shelter price index over the past four years has not yet been satisfactorily explained.

Used car prices also contributed to the increase in inflation in 2004—but only because they were bouncing back from an unusually steep fall (12 percent) in 2003. Last year, the prices of used cars rose moderately, a reversal

Figure 2-10.

The Consumer Price Index: Shelter and Core Measures

(Percentage change from previous year)



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

Note: The core consumer price index is the consumer price index for all urban consumers excluding food and energy.

that accounted for a significant part of the increase in core inflation. Nevertheless, that moderate amount of growth in such prices is more likely to prevail over the two-year forecast period than is another jump to higher inflation.

Excess Capacity Versus the Risks of Higher Inflation. The outlook for overall inflation during the next two years is favorable because excess productive capacity apparently exists both in the United States and abroad. Therefore, the long span of the Federal Reserve's accommodative monetary policy and the recent years of solid economic growth are not likely to push up inflation precipitately in the near term. In that environment, price shocks in the commodities markets (such as last year's surge in oil prices) may boost the overall price level, but they are unlikely to lead to sustained inflation. The drop in the dollar, together with the resulting hikes in the prices of imported goods and services, appears to be the single biggest risk for higher inflation.

At the end of 2004, the economy still had a considerable amount of excess capacity, largely because productivity growth had been so strong during the 2002-2004 period. CBO's estimate of potential GDP was about 1¼ percent higher than actual GDP at the end of 2004; annual growth of potential output in the near term is forecast to be about 3¼ percent. Thus, it appears that the economy could grow by about 4 percent annually for two years before some sectors would start to experience strains in their productive capacity. Indeed, in CBO's forecast, real GDP does not fully merge with potential GDP until the end of 2007.

Of course, the economy may have more or less excess capacity than CBO has forecast. Its current estimates, for example, indicate slightly more slack at the end of 2004 than was suggested in its update, in September 2004, of last January's *Budget and Economic Outlook*. However, those measures are subject to considerable uncertainty. Developing estimates of trends in the growth of productivity and labor force participation has been particularly difficult in recent years. Nevertheless, other indicators of capacity, such as measures of the manufacturing sector's capacity utilization, the percentage of the adult population who are employed, and the pace of core price inflation, support the view that the economy currently has a significant amount of slack.

The rise that is occurring in import prices as a result of the fall of the dollar is causing some inflationary pressure, but again, CBO expects that the excess supply in the economy will keep overall inflation mild throughout the two-year forecast period. The growth of import prices has mirrored the ups and downs in the value of the dollar. For example, during the 1995-2001 period, when the dollar was generally rising, the prices of imports fell. By contrast, since early 2002 and the beginning of the dollar's fall, import prices have been rising. CBO anticipates that the dollar will fall further, causing import prices to continue to rise for several years. However, in CBO's estimation, the growth of prices for imported non-oil goods is likely to be contained during 2005 and 2006 and should not result in higher inflation.

The Economic Outlook Through 2015

CBO projects that real GDP will grow at an average annual rate of 2.9 percent during the 2007-2015 period, or slightly faster than potential GDP during the same span. Growth of real GDP, though fast during 2005 and 2006, is not expected to fully close the gap between real and

Box 2-2.

Is the Price of Oil Going to Fall?

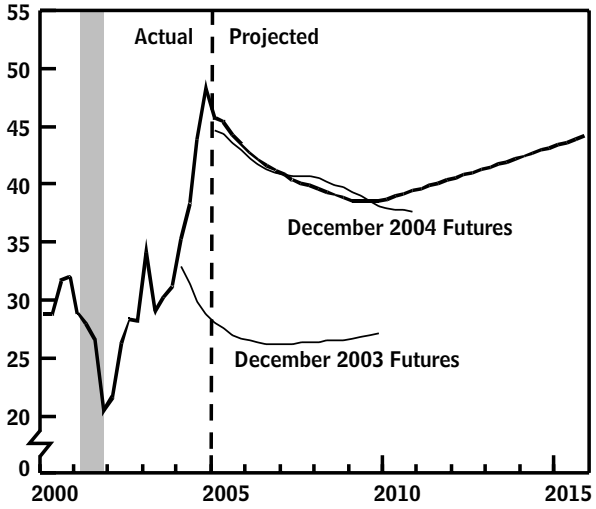
The price of high-quality oil in the U.S. spot market (the market dealing in oil for immediate delivery) stood at $43 per barrel in December 2004. At the same time, prices in the futures market for oil (for delivery in later months) were somewhat lower—about $40 for delivery in December 2006, for example (see the figure below). That disparity seems to suggest that the futures market expects the spot price of oil to fall. Partly on the basis of the downward-trending path suggested by prices in the New York Mercantile Exchange's (NYMEX's) oil-futures market, the Congressional Budget Office (CBO) has assumed for the purposes of its economic forecast that, through 2009, oil prices will fall from their current peak levels. Thereafter, prices are projected to rise through 2015 at the same rate as overall inflation.

Utilizing prices in the futures market raises questions about whether such indicators are a reliable guide to longer-term spot prices. Futures prices are often below spot prices—including, for instance, the period in early 2004 when spot prices were rising from less than $35 per barrel to more than $50. Yet users of futures-market forecasts know that such predictions, though unlikely to precisely delineate the path that spot prices will eventually follow, may nevertheless be among the best methods available to predict the future price of oil.

For example, the Bank of England's monetary policy committee, in its quarterly *Inflation Report* of November 2000, noted that it "has maintained the assumption that the futures market provides the best guide to the outlook for the oil price" (p. 50). The Federal Reserve Board has also used information on prices in futures markets to gauge inflationary pressures.[1] Participation in the oil futures market is quite extensive: in late 2004, for example, contracts for future delivery of oil amounted to more than 700 million barrels at NYMEX. (That figure rises to more than 1 billion barrels, if contracts at the London International Petroleum Exchange are included.) By comparison, world production of oil through most of 2004 averaged just over 72 million barrels per day, implying that current futures contracts cover almost 15 days of production.

Price of Oil

(Dollars per barrel)



Sources: Congressional Budget Office; New York Mercantile Exchange; *Wall Street Journal.*

1. For a recent example, see the remarks of Ben Bernanke, Governor of the Federal Reserve Board, on "Oil and the Economy," Distinguished Lecture Series, Darton College, Albany, Georgia, October 21, 2004, available at www.federalreserve.gov/boarddocs/speeches/2004/20041021/default.htm.

Box 2-2.

Continued

Although projections based on futures-market prices are subject to large errors, they do not appear to have a significant bias. Oil prices in the futures market reflect the consensus of the market's participants about the evolution of future demand and supplies—but that consensus can certainly be wrong. For example, futures-market predictions of the price of oil for delivery in December 2004 ranged from as low as $16 per barrel (in March 1999) to as high as $56 (in late October 2004). Presumably, the variation in December delivery prices during that period reflected emerging changes in actual and predicted demand as well as supplies that had not previously been taken into account.

Forecasters might be concerned about a bias in the futures market if, for example, participants whose beliefs underlay the consensus futures price were more affected by the potential for losses than by the prospect of gains. Aversion to the risk of losses could distort the course of oil prices as projected by the market. Available research into such a distortion has not uncovered strong evidence of it. For example, calculations by Federal Reserve Board economists indicate that average forecasting errors from a comparison of 12-month futures prices with subsequent spot prices from April 1989 to December 2003 were insignificant.[2]

Several possible contributing factors have been suggested to explain why futures-market prices indicate a drop from current levels in the spot market. For example, currently tight market conditions may be creating temporary bottlenecks, which market participants expect will be gradually resolved. Recent indications of such constrictions include strong growth in world demand amid low levels of inventories; threatened or actual disruptions in supplies from some countries (such as Nigeria, Venezuela, and Russia); production by other major suppliers (such as Saudi Arabia) that may be near short-term capacity; and world oil transport systems that are also temporarily operating at almost their full potential. (A report in London's *Financial Times* of November 3, 2004, cited a "20-fold rise in tanker rates in the last two years.")

Another likely reason for the drop in oil prices indicated by the futures market is heightened uncertainty about longer-term market conditions and prices. With the possibility that prices might be substantially higher in the future, some producers may have been induced to curtail current production by the prospect of bigger profits down the road—a plan that, if followed, would push up spot prices. Such producers, of course, would also run the risk of encountering unusually low prices in the future and earning lower-than-expected profits, but they would have the option of limiting production then as well and waiting for more profitable conditions to emerge. The existence of that option implies that current prices may have to be higher than prices in futures markets to induce producers to sell now instead of later, and current prices may have to be higher still in the presence of heightened uncertainty about the future.[3]

2. See Sergey V. Chernenko, Krista B. Schwarz, and Jonathan H. Wright, *The Information Content of Forward and Futures Prices: Market Expectations and the Price of Risk*, International Finance Discussion Paper No. 808 (Board of Governors of the Federal Reserve System, June 2004).

3. The option effect on the relation between spot and futures prices is discussed in Robert Litzenberger and Nir Rabinowitz, "Backwardation in Oil Futures Markets: Theory and Empirical Evidence," *Journal of Finance*, vol. 50, no. 5 (December, 1995), pp. 1517-1545.

potential GDP by the end of 2006. As a result, real GDP is projected to grow nearly two-tenths of a percentage point faster than potential GDP in 2007 and 2008 but then to rise at the same rate thereafter. From 2007 through 2015, in CBO's view, CPI-U inflation will average 2.2 percent and the unemployment rate, 5.2 percent. The rate on three-month Treasury bills is estimated to average 4.6 percent over the medium term, and the rate on 10-year Treasury notes, 5.5 percent.

To develop its medium-term projections for 2007 through 2015, CBO projects levels and rates for the factors that underlie potential GDP, such as growth of the labor force, capital services (the productive services provided by the economy's capital stock), and productivity. In so doing, CBO takes into account the effect that current fiscal policy may have on those variables, but it does not attempt to forecast business-cycle fluctuations beyond the next two years.

Potential Output

CBO's projection of potential output during the 2005-2015 period shows output growing at an average annual rate of 2.9 percent, or about six-tenths of a percentage point slower than its long-run average pace of 3.5 percent (see Table 2-2). That slower projected growth is almost entirely due to a dramatic slowdown expected in the rate of expansion of the potential labor force, as the large cohort of workers born during the postwar baby boom begins to reach the traditional age for retirement. By contrast, capital accumulation and productivity growth are projected to grow at rates that approximate their long-run averages. Although in CBO's estimation, potential GDP will grow more slowly than its historical average, its estimated rate of growth will still be about a tenth of a percentage point faster than the rate CBO projected in September 2004. CBO's new, higher projection stems from its expectation of slightly faster growth of total factor productivity and from an upward revision in its projection of the growth of capital services.

The Potential Labor Force. CBO's projection of growth in the potential labor force between 2005 and 2015 (0.8 percent, on average—the same rate that CBO forecast last September) is slower than its historical rate of growth of 1.6 percent during the 1950-2003 period. The slower projected pace stems from CBO's expectation that labor force participation will decline sharply during the next 10 years. That decline occurs largely because the leading edge of the baby-boom generation reaches the traditional retirement age, but it is also spurred by other factors: the rate of men's labor force participation is likely to continue its historical downward trend; women are not expected to increase their rate of participation as much as they did in the past; and the tax cuts in the Economic Growth and Tax Relief Reconciliation Act of 2001 and JGTRRA are scheduled to expire in 2011, which will raise the marginal tax rate on labor (the rate on the last dollar of income) and lessen the incentive to work. The slowdown in the growth of the potential labor force is reflected in CBO's estimate of potential hours worked—that factor is projected to grow at an annual average rate of 0.9 percent during the period (a growth rate similar to that reported last September in CBO's update of its January 2004 outlook).

Capital Services. Capital services during the 2005-2015 period are now expected to grow by 4.2 percent per year, on average, or about 0.5 percentage points faster than CBO envisioned last September. That revision did not result from a new projection for investment spending—the share of potential GDP that such spending makes up is about the same in CBO's current outlook (12 percent, on average) as it was in last September's. Instead, the revised outlook for capital accumulation results from the combination of revisions to data on the capital stock by the Bureau of Economic Analysis (including data for 2003) and a revised weighting scheme for different types of capital. Those changes led to estimates of a faster pace of growth in capital services during recent years and in the 10-year projection period.

Total Factor and Labor Productivity. Over the next 10 years, total factor productivity is likely to rise at an average annual rate of 1.4 percent, in CBO's estimation—which is roughly equal to the average rate of growth of potential TFP during the 1950-2004 period and almost identical to the rate that CBO projected last September. Since September, however, CBO has changed its method for calculating and projecting potential TFP in response to changes in the data underlying that estimate (see Box 2-1 on page 29). A series of revisions in recent years has reduced the estimated rate of growth of TFP during the 1990-1999 period. As a result, a special adjustment to the TFP estimate—associated with improvements in computer quality—is no longer necessary, and CBO has discontinued it.[10] That change raised the growth of poten-

10. CBO provides more information about its method on its Web site (www.cbo.gov); see "CBO's Revised Method for Estimating and Projecting Potential TFP."

Table 2-2.

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	1996-2004	Total, 1950-2004	2005-2010	2011-2015	Total, 2005-2015
Overall Economy									
Potential Output	3.9	3.3	3.0	2.7	3.4	3.5	3.2	2.7	2.9
Potential Labor Force	1.6	2.5	1.6	1.2	1.2	1.6	1.1	0.6	0.8
Potential Labor Force Productivity[a]	2.3	0.8	1.4	1.5	2.2	1.8	2.1	2.1	2.1
Nonfarm Business Sector									
Potential Output	4.0	3.6	3.1	3.1	3.9	3.7	3.5	3.0	3.3
Potential Hours Worked	1.4	2.4	1.4	1.4	1.4	1.5	1.2	0.6	0.9
Capital Input	3.8	4.2	3.9	2.7	4.6	3.9	4.5	3.7	4.2
Potential Total Factor Productivity	1.9	0.7	0.9	1.3	1.6	1.4	1.4	1.4	1.4
Potential TFP excluding adjustments	1.9	0.7	1.0	1.3	1.3	1.4	1.3	1.3	1.3
TFP adjustments	0	0	0	*	0.3	*	0.1	0.1	0.1
Price measurement[b]	0	0	0	*	0.1	*	0.1	0.1	0.1
Temporary adjustment[c]	0	0	0	0	0.2	*	0	0	0
Contributions to Growth of Potential Output (Percentage points)									
Potential hours worked	1.0	1.7	1.0	1.0	0.9	1.1	0.8	0.4	0.6
Capital input	1.1	1.3	1.2	0.8	1.4	1.2	1.4	1.1	1.2
Potential TFP	1.9	0.7	0.9	1.3	1.6	1.4	1.4	1.4	1.4
Total Contributions	4.0	3.7	3.1	3.0	3.9	3.7	3.6	2.9	3.3
Memorandum:									
Potential Labor Productivity[d]	2.6	1.2	1.7	1.7	2.5	2.2	2.4	2.3	2.4

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 a conceptual change in the official measure of the GDP price index.

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

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

tial TFP very slightly (by a few hundredths of a percentage point) during the period since 1990.

Inflation, Unemployment, and Interest Rates

Between 2006 and 2015, inflation as measured by the CPI-U is expected to average 2.2 percent, and the GDP price index is projected to grow at an average annual rate of 1.8 percent. Both rates are identical to those projected in September 2004. In general, CBO assumes that the Federal Reserve's monetary policy will result in an underlying rate of CPI-U inflation that averages between 2 percent and 2.5 percent.[11] The unemployment rate during the period, in CBO's view, will average 5.2 percent—

11. The Federal Reserve's preferred measure of core inflation is the price index for personal consumption expenditures (PCE) excluding food and energy prices. Growth of the core PCE price index over the 10-year projection period is likely to be about a quarter of a percentage point slower, on average, than the growth of the core CPI-U.

which is identical to CBO's estimate of the nonaccelerating inflation rate of unemployment, or NAIRU.[12]

CBO's medium-term projections of interest rates (which it estimates by adding its projection for inflation to its projection for real interest rates) have not altered since last September. Using the CPI-U as a measure of price changes, CBO estimates that the real rate on three-month Treasury bills will average 2.4 percent during the 2007-2015 period and that the real rate on 10-year Treasury notes will average 3.3 percent. Combined with the projected rates of CPI-U inflation, those real rates imply nominal rates over the medium term of 4.6 percent for three-month Treasury bills and 5.5 percent for 10-year Treasury notes.

Taxable Income

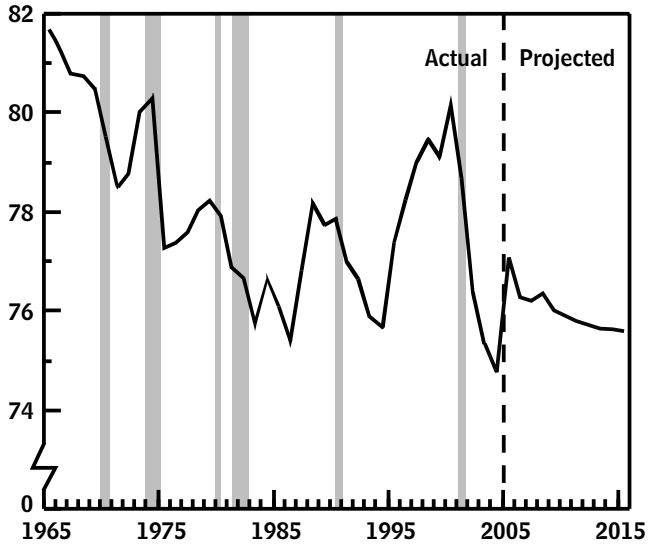
Forecasts of the growth of specific categories of income (such as wages and salaries, corporate profits, and proprietors' income) drive projections of revenues.[13] In CBO's two-year forecast, the share of GDP reflecting income categories that affect revenue projections bounces up in 2005, falls back in 2006, and drifts downward thereafter (see Figure 2-11). The rise in 2005 stems largely from the expiration of tax provisions that have allowed firms to deduct from their profits a larger-than-usual percentage of their expenditures on equipment and structures. Once those provisions expire, profits subject to tax are expected to rise in 2005 relative to 2004.

The drop in the share of taxable income that CBO projects for 2006 stems from its expectation that, under current law, firms will have to make larger-than-usual contributions to defined-benefit pension plans that year (see Appendix D). Those contributions are not considered part of a firm's taxable income; as a result, the profits share of GDP is likely to be smaller than it would otherwise be. The reduction in profits accounts for the bulk of the drop in the taxable income share forecast for 2006.

Figure 2-11.

Total Share of GDP for Income Categories That Affect Revenue Projections

(Percentage of GDP)



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

Note: Income categories include the following, measured on a national income and product accounts basis: wages and salaries, book profits, proprietors' income, rental income, personal dividend income, and personal interest income.

Broadly speaking, GDP can be divided into a share that goes to labor and a share that goes to capital. Labor's share is the sum of the following categories: wages and salaries; payments made by employers on behalf of workers (such as the employer's share of health insurance premiums and contributions to pension funds, as well as payments for Social Security and Medicare); and about 70 percent of the income of proprietors.[14] The rest of GDP is capital's share. Although the shares of labor and capital have varied over the postwar period, labor's share has averaged 62.7 percent of GDP and capital's, 37.3 percent.

Wages and salaries, the category of income that is most important for revenue projections, is forecast to rise from an estimated 45.6 percent of GDP in 2004 to 45.8 per-

12. The NAIRU is the unemployment rate consistent with a constant rate of inflation. 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.

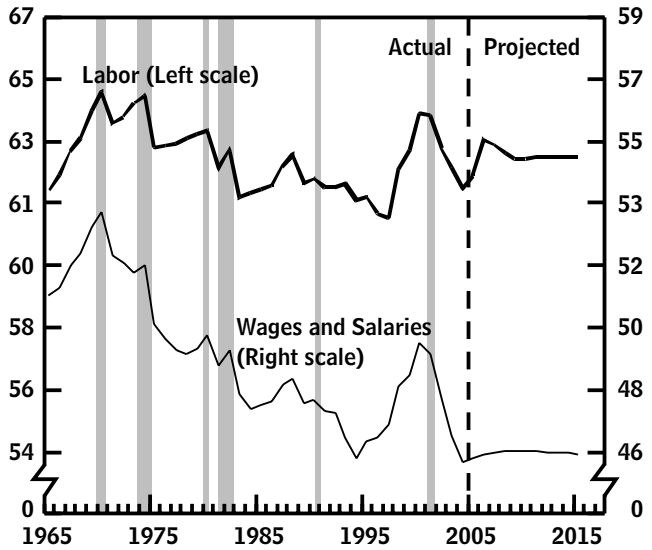
13. Proprietors' income is the income of self-employed workers.

14. Exactly how much of the income earned by proprietors is a return to capital (the equipment and structures that self-employed workers use) and how much is a return to labor is unclear. However, 70 percent of total proprietors' income is generally assumed to be the return to labor.

Figure 2-12.

Labor Income and Wages and Salaries

(Percentage of GDP)



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

cent in 2006; it is then expected to average 45.9 percent during the remainder of the 10-year projection period. Since the mid-1960s, that share has shrunk (see Figure 2-12); however, labor's overall share of output has not declined, and CBO projects that it will remain high for a few years, bolstered by firms' higher-than-usual contributions to their defined-benefit plans. Later, CBO expects, labor's share of GDP will remain close to its postwar average of 62.7 percent.[15]

The difference since 1980 between the trends in labor's share of total income and in the share of wages and salaries has arisen primarily because of the increase in the shares of GDP claimed by health benefits, pensions, and proprietors' income. CBO estimates that over the next 10 years, the share of income claimed by proprietors will level off, the share attributable to health benefits will steadily increase, and the portion of income that represents pension payments will initially rise sharply and then fall. On balance, the overall share of GDP that those categories constitute does not increase over the 10-year period, so the share of labor's income that is attributable to wages and salaries does not trend downward.

Uncertainty about the path of the shares of income that affect revenue projections has been a source of error in CBO's budget projections in the past and is a major risk to the accuracy of the current forecast. Even though CBO's annual estimates of nominal GDP during the late 1990s were quite accurate, CBO consistently understated the increase in revenues occurring during that period because it failed to anticipate growth in some of the categories of income—in particular, an extraordinary increase in the share of wages and salaries—that are important in estimating revenues. (The wages and salaries share jumped in part because of stock options that were exercised during the late-1990s boom in the stock market.) Conversely, CBO underestimated the speed of the drop in that share during the early 2000s, which led to budget projections that were too optimistic. The variability in income shares during the 1995-2002 period was extremely unusual, but it is certainly possible that such shares will be significantly greater or smaller over the next 10 years than CBO is currently projecting.

Changes in CBO's Outlook Since September 2004

CBO's current view of the economy is broadly similar to its outlook in September 2004, though with some notable differences (see Table 2-3). The growth of real GDP in CBO's current estimates is slightly slower for 2004 and 2005, reflecting, in part, slightly higher prices for oil and lower assumed government spending for defense. For 2006 and thereafter, the growth of real GDP is faster, reflecting a brighter outlook for growth of potential GDP in the medium term than CBO had projected in September. Revisions to the outlook for the unemployment rate mirror those to the forecast of GDP growth: for 2006, the rate is slightly higher than last September's but then, for the medium term, falls back to 5.2 percent—CBO's estimate of the NAIRU.

In CBO's current estimates, inflation as measured by the CPI-U grows at about the same rate in 2005 and 2006 as it did in CBO's September forecast. The year-over-year growth rate for 2005 of 2.4 percent, as reported in Table 2-3, contains some residual effect of the spike in energy prices that actually occurred in 2004. For 2005, the CPI-U is forecast to grow by 1.9 percent (measured on a fourth-quarter-over-fourth-quarter basis); for the

15. CBO assumes that most of those contributions come from profits and not from any form of labor compensation.

Table 2-3.

CBO's Current and Previous Economic Projections for Calendar Years 2004 to 2014

	Estimated	Forecast		Projected Annual Average	
	2004	2005	2006	2007 to 2010[a]	2011 to 2014[b]
Nominal GDP (Billions of dollars)					
January 2005	11,730	12,396	13,059	15,940	19,031
September 2004	11,753	12,464	13,058	15,697	18,628
Nominal GDP (Percentage change)					
January 2005	6.6	5.7	5.3	5.1	4.5
September 2004	6.8	6.1	4.8	4.7	4.4
Real GDP (Percentage change)					
January 2005	4.4	3.8	3.7	3.3	2.7
September 2004	4.5	4.1	3.2	2.9	2.6
GDP Price Index (Percentage change)					
January 2005	2.1	1.8	1.5	1.8	1.8
September 2004	2.2	1.8	1.5	1.7	1.8
Consumer Price Index[c] (Percentage change)					
January 2005	2.7	2.4	1.9	2.2	2.2
September 2004	2.6	2.0	2.0	2.2	2.2
Unemployment Rate (Percent)					
January 2005	5.5	5.2	5.2	5.2	5.2
September 2004	5.6	5.2	5.1	5.2	5.2
Three-Month Treasury Bill Rate (Percent)					
January 2005	1.4	2.8	4.0	4.6	4.6
September 2004	1.3	2.6	4.0	4.6	4.6
Ten-Year Treasury Note Rate (Percent)					
January 2005	4.3	4.8	5.4	5.5	5.5
September 2004	4.6	5.4	5.5	5.5	5.5
Tax Bases (Billions of dollars)					
Corporate book profits					
January 2005	984	1,331	1,222	1,349	1,566
September 2004	1,045	1,455	1,430	1,447	1,710
Wages and salaries					
January 2005	5,346	5,665	5,979	7,317	8,721
September 2004	5,370	5,703	6,003	7,238	8,592
Tax Bases (Percentage of GDP)					
Corporate book profits					
January 2005	8.4	10.7	9.4	8.7	8.3
September 2004	8.9	11.7	11.0	9.6	9.1
Wages and salaries					
January 2005	45.6	45.7	45.8	45.9	45.9
September 2004	45.7	45.8	46.0	46.1	46.1
Memorandum:					
Real Potential GDP (Percentage change)					
January 2005	3.2	3.2	3.3	3.1	2.7
September 2004	3.1	3.1	3.2	2.9	2.6

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. For projections in billions of dollars, the level is that in 2010.

b. For projections in billions of dollars, the level is that in 2014.

c. The consumer price index for all urban consumers.

medium term, growth is expected to average 2.2 percent, the same rate that CBO projected last September. Changes to CBO's view of the GDP price index since last fall are modest, with slightly faster growth anticipated in the near term and little change in the medium term. CBO's outlook for short-term and long-term interest rates in the medium term has remained virtually unchanged since September. However, CBO now anticipates that for 2005 and 2006, short-term interest rates will be slightly higher than it envisioned in September, and long-term rates will be lower.

A Comparison of Forecasts

Comparing the estimates of CBO, the Administration, and a consensus of private-sector forecasters reveals some differences, but in general, the three outlooks are similar (see Table 2-4). CBO's forecast for inflation during the next two years is lower, and its estimate of real GDP growth slightly higher, than those of the Administration and the *Blue Chip* consensus forecast. (The *Blue Chip* forecast is an average of the estimates of about 50 private-sector forecasters.) Otherwise, CBO's outlook for the two-year horizon is similar to both the *Blue Chip*'s and the Administration's. CBO's estimates of the unemployment rate, nominal GDP growth, and interest rates differ little from those of the other forecasts, reflecting the widespread view that growth over the next two years will be higher than its historical trend rate, interest rates will rise slightly, and the unemployment rate will ease slowly downward.

CBO's forecast for real GDP growth over the longer term is the same as that of the Administration. For the 2007-2010 period (the Administration's forecast does not extend beyond 2010), both agencies foresee real GDP growth averaging 3.2 percent, and there is little difference between their estimates of the unemployment rate and the long-term interest rate. CBO envisions lower inflation, however—notably for the GDP price index—and higher short-term interest rates. Therefore, real short-term interest rates are significantly higher in CBO's forecast than in the Administration's.

Table 2-4.

Comparison of CBO, *Blue Chip*, and Administration Forecasts for 2004 to 2010

	Estimated 2004	Forecast 2005	Forecast 2006	Projected Annual Average, 2007 to 2010
	Fourth Quarter to Fourth Quarter (Percentage Change)			
Nominal GDP				
Blue Chip consensus	6.3	5.5	5.3	n.a.
CBO	6.3	5.5	5.4	5.0
Administration	6.3	5.5	5.6	5.3
Real GDP				
Blue Chip consensus	3.9	3.5	3.3	n.a.
CBO	3.9	3.7	3.8	3.2
Administration	3.9	3.5	3.4	3.2
GDP Price Index				
Blue Chip consensus	2.4	1.9	2.0	n.a.
CBO	2.2	1.7	1.5	1.8
Administration	2.3	1.9	2.0	2.1
Consumer Price Index[a]				
Blue Chip consensus	3.4	2.3	2.4	n.a.
CBO	3.4	1.9	2.0	2.2
Administration	3.4	2.0	2.3	2.4
	Calendar Year Average			
Unemployment Rate (Percent)				
Blue Chip consensus	5.5	5.3	5.2	n.a.
CBO	5.5	5.2	5.2	5.2
Administration	5.5	5.4	5.2	5.1
Three-Month Treasury Bill Rate (Percent)				
Blue Chip consensus	1.4	3.0	3.8	n.a.
CBO	1.4	2.8	4.0	4.6
Administration	1.4	2.7	3.5	4.1
Ten-Year Treasury Note Rate (Percent)				
Blue Chip consensus	4.3	4.7	5.3	n.a.
CBO	4.3	4.8	5.4	5.5
Administration	4.3	4.6	5.2	5.5

Source: Congressional Budget Office; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board; Aspen Publishers, Inc., Blue Chip Economic Indicators (January 10, 2005); Council of Economic Advisers, Department of the Treasury, and Office of Management and Budget, "Administration Economic Forecast" (joint press release, December 17, 2004).

a. The consumer price index for all urban consumers.

CHAPTER

3

The Spending Outlook

The Congressional Budget Office estimates that if current laws governing mandatory programs remain the same and discretionary appropriations total $840 billion, the amount provided thus far for 2005, outlays this year will rise by $133 billion to $2.4 trillion—a 5.8 percent increase over their level in 2004 (see Tables 3-1 and 3-2). However, no funding has yet been provided this year for activities in Iraq and Afghanistan. Such funding—when provided—is likely to add about $30 billion to outlays this year, raising growth in total outlays in 2005 to 7.1 percent, higher than the 6.1 percent growth experienced from 2003 to 2004.

Total spending as a percentage of gross domestic product dropped slightly between 2003 and 2004, from 19.9 percent to 19.8 percent. Under baseline projections, CBO estimates that outlays will remain at that level of GDP in 2005; once additional funding is provided for operations in Iraq and Afghanistan, that figure is likely to rise to at least 20.1 percent.

Fueling the growth in outlays projected for 2005 is continued expansion of both mandatory and discretionary spending (a significant portion of which stems from budget authority granted before 2005). In addition, CBO estimates that net interest payments will increase by 10.8 percent in 2005, the result of rising interest rates and accumulating federal debt. Outlays for mandatory programs—which account for more than half of all federal spending—are expected to grow by $80 billion (6.5 percent) over their level in 2004. In the absence of further appropriations, outlays for discretionary defense activities are projected to climb by $10 billion, or 2.2 percent, in 2005. Once operations in Iraq and Afghanistan are fully funded, that rate of increase will most likely grow to about 8.9 percent. For nondefense discretionary programs, outlays are expected to increase by $25 billion (5.8 percent). (See Box 3-1 on page 54 for descriptions of the various types of federal spending.)

The mix of federal spending has changed significantly over the past several decades. Today the government spends less—as a percentage of GDP—on discretionary activities and more on mandatory programs. Discretionary spending declined from 12.7 percent of GDP in 1962 to 6.3 percent in 1999 and 2000 before rebounding to 7.7 percent in 2004 (see Figure 3-1 on page 55). By contrast, mandatory spending—net of offsetting receipts—has climbed from 4.9 percent of GDP to 10.7 percent over the same period. Net interest has remained between 1.2 percent and 3.3 percent of GDP since 1962. In 2005, the share of the economy represented by each of the three major spending categories is expected to remain close to the share recorded in 2004. (For detailed annual data on spending since 1962, see Appendix F.)

Outlays in CBO's baseline are projected to grow at an average annual rate of 4.3 percent over the next 10 years—declining to 18.7 percent of GDP in 2012, before climbing to 18.9 percent of GDP in 2015 as mandatory spending accelerates. If current policies remain unchanged, mandatory outlays, led by growth in Medicare and Medicaid, will grow by about 5.7 percent. At that rate, those outlays will claim 11.7 percent of GDP by 2015—a percentage point above their share in 2004. CBO projects that interest payments as a share of GDP will increase to 1.9 percent by 2008 as a result of continuing deficits and the rising interest rates discussed 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 projection period, to 1.5 percent of GDP, as the baseline assumptions of restrained growth in discretionary outlays and the scheduled rise in taxes under current law lead to diminished borrowing needs.

After 2005, under assumptions required by law for the baseline, discretionary outlays are projected to grow at an average annual rate of 1.7 percent and to gradually de-

Table 3-1.

CBO's Projections of Spending Under Baseline Assumptions

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
							In Billions of Dollars							
Outlays														
Discretionary spending														
Defense	454	464	438	435	447	457	468	484	488	504	516	529	2,245	4,765
Nondefense	441	466	476	485	493	502	511	523	534	546	559	572	2,468	5,202
Subtotal	895	930	914	919	940	959	980	1,006	1,022	1,050	1,075	1,101	4,713	9,966
Mandatory spending														
Social Security	492	517	540	564	592	623	659	697	739	785	835	888	2,978	6,922
Medicare	297	325	380	426	453	484	520	565	598	654	708	766	2,263	5,554
Medicaid	176	186	193	205	223	241	262	284	307	333	361	392	1,124	2,802
Other spending	381	412	408	413	428	440	451	470	454	473	487	500	2,140	4,523
Offsetting receipts	-109	-122	-140	-159	-167	-168	-179	-191	-203	-217	-231	-244	-813	-1,899
Subtotal	1,237	1,317	1,380	1,450	1,529	1,620	1,713	1,824	1,896	2,028	2,159	2,303	7,692	17,902
Net interest	160	178	213	249	274	289	303	311	314	311	308	303	1,328	2,875
Total	**2,292**	**2,425**	**2,507**	**2,618**	**2,743**	**2,869**	**2,996**	**3,142**	**3,232**	**3,389**	**3,542**	**3,706**	**13,733**	**30,743**
On-budget	1,913	2,024	2,092	2,190	2,300	2,409	2,517	2,644	2,711	2,841	2,965	3,097	11,508	25,766
Off-budget	380	401	415	428	443	460	479	497	521	548	577	609	2,225	4,977
							As a Percentage of GDP							
Outlays														
Discretionary spending														
Defense	3.9	3.8	3.4	3.2	3.1	3.0	3.0	2.9	2.8	2.8	2.7	2.7	3.1	2.9
Nondefense	3.8	3.8	3.7	3.6	3.4	3.3	3.2	3.2	3.1	3.0	3.0	2.9	3.4	3.2
Subtotal	7.7	7.6	7.1	6.8	6.6	6.4	6.2	6.1	5.9	5.8	5.7	5.6	6.6	6.2
Mandatory spending														
Social Security	4.3	4.2	4.2	4.2	4.1	4.1	4.2	4.2	4.3	4.4	4.4	4.5	4.2	4.3
Medicare	2.6	2.7	2.9	3.1	3.2	3.2	3.3	3.4	3.5	3.6	3.8	3.9	3.2	3.4
Medicaid	1.5	1.5	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8	1.9	2.0	1.6	1.7
Other spending	3.3	3.4	3.2	3.0	3.0	2.9	2.9	2.8	2.6	2.6	2.6	2.5	3.0	2.8
Offsetting receipts	-0.9	-1.0	-1.1	-1.2	-1.2	-1.1	-1.1	-1.2	-1.2	-1.2	-1.2	-1.2	-1.1	-1.2
Subtotal	10.7	10.8	10.7	10.7	10.7	10.8	10.9	11.1	11.0	11.3	11.5	11.7	10.7	11.1
Net interest	1.4	1.5	1.7	1.8	1.9	1.9	1.9	1.9	1.8	1.7	1.6	1.5	1.9	1.8
Total	**19.8**	**19.8**	**19.5**	**19.3**	**19.2**	**19.1**	**19.0**	**19.0**	**18.7**	**18.8**	**18.8**	**18.9**	**19.2**	**19.0**
On-budget	16.6	16.5	16.2	16.1	16.1	16.0	16.0	16.0	15.7	15.8	15.8	15.8	16.1	15.9
Off-budget	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0	3.1	3.1	3.1	3.1
Memorandum:														
Gross Domestic Product (Billions of dollars)	11,553	12,233	12,888	13,586	14,307	15,029	15,757	16,494	17,245	18,023	18,826	19,652	71,566	161,806

Source: Congressional Budget Office.

Table 3-2.

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

(Percent)

	Actual 1993-2003	Actual 2003-2004	Estimated[a] 2004-2005	Projected[b] 2005-2015
Discretionary	4.3	8.4	4.0	1.7
Defense	3.3	12.1	2.2	1.3
Nondefense	5.5	4.9	5.8	2.1
Mandatory	5.8	4.7	6.5	5.7
Social Security	4.5	4.5	5.1	5.6
Medicare	6.7	8.5	9.3	9.0
Medicaid	7.8	9.7	5.3	7.8
Other[c]	6.3	-1.6	6.7	-1.2
Net Interest	-2.6	4.7	10.8	5.5
Total Outlays	4.4	6.1	5.8	4.3
Total Outlays Excluding Net Interest	5.2	6.2	5.4	4.2
Memorandum:				
Consumer Price Index	2.5	2.3	2.8	2.2
Nominal GDP	5.1	6.6	5.9	4.9
Discretionary Budget Authority	5.3	6.7	-7.3	2.4
Defense	5.1	6.7	-13.3	2.4
Nondefense	5.4	6.6	-0.3	2.3

Source: Congressional Budget Office.

a. CBO's baseline does not include estimates of future funding for operations in Iraq, Afghanistan, and the global war on terrorism (which have previously been funded through supplemental appropriations). As a result, budget authority provided thus far in 2005 for both defense and nondefense discretionary programs is lower than the amount provided in 2004. Excluding all supplemental appropriations (including those for disaster relief) in both years, total budget authority has grown by 5.1 percent in 2005 (6.6 percent for defense programs and 3.5 percent for nondefense programs).

b. 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 discretionary funding.

c. Includes offsetting receipts.

cline as a share of GDP. That rate of growth is relatively low because 2005 outlays include some spending for operations in Iraq and Afghanistan that resulted from previous years' appropriations, but the years toward the end of the projection period do not include any such spending. Discretionary spending's share of the economy is projected to fall to 5.6 percent of GDP in 2015—about 2 percentage points below the current level.

Mandatory Spending

Mandatory spending—also known as direct spending—has continued to grow as a share of federal outlays. Currently, such spending (net of offsetting receipts) stands at just over half of all federal spending. Most of the spending in this category involves 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. Offsetting receipts (certain payments that federal agencies receive from other governmental agencies or from the public) are classified as offsets to mandatory spending.

By 2015, direct spending is projected to constitute more than twice the share of federal outlays that it represented

Box 3-1.

Categories of Federal Spending

On the basis of its treatment in the budget process, federal spending can be divided into three broad categories:

Mandatory spending consists primarily 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. The Congressional Budget Office's (CBO's) baseline projections of mandatory spending assume that existing laws and policies will 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 are collected as an exercise of the government's sovereign powers, whereas offsetting receipts are generally collected from other government accounts or paid by the public for business transactions (such as rent payments and royalties from leases for oil and gas drilling on the Outer Continental Shelf).

Discretionary spending is controlled by annual appropriation acts; policymakers decide each year how many dollars to devote and to which activities. Appropriations fund a wide variety of governmental activity, including defense, transportation, national parks, law enforcement, disaster relief, and foreign aid. Certain fees and other charges that are triggered by appropriation action are classified as offsetting collections, which offset discretionary spending. 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 to date total $840 billion for 2005—$421 billion for defense and $419 billion for nondefense activities. In addition, the baseline includes about $45 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, although the budget authority for such programs is provided in authorizing legislation and is considered mandatory.

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).

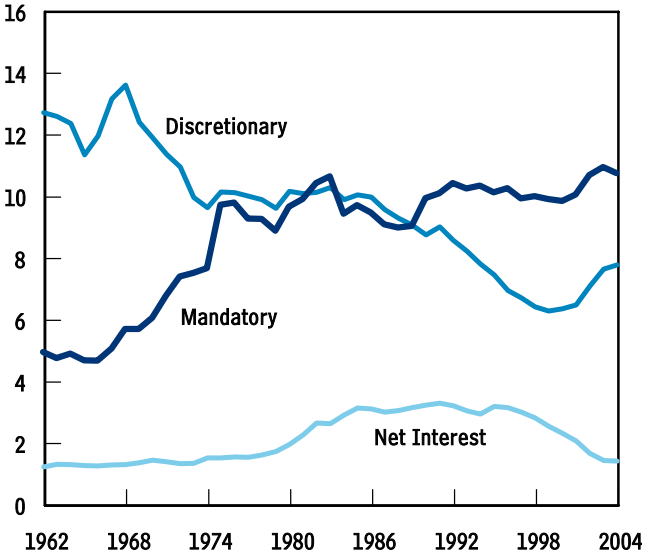
in 1962. At that time, direct spending accounted for 26 percent of outlays; by 2015, CBO estimates that such spending will make up 62 percent of outlays. Expressed as a percentage of GDP, mandatory outlays are projected to rise from 10.7 percent in 2004 to 11.7 percent by 2015. The corresponding figure for 1962 was only 4.9 percent of GDP.

Driving the projected increase in mandatory spending are mounting costs for health care and income support for the elderly, the disabled, and low-income populations. The largest of those programs—Social Security, Medicare, and Medicaid—accounted for 72 percent of mandatory spending in 2004 (excluding offsetting receipts). Buoyed by the rapidly rising costs of health care and an increase in the elderly population, that share will grow steadily over the next 10 years. Under CBO's baseline projections, those three programs will constitute 80 percent of all mandatory spending by 2015—an increase of about 7 percent each year.

Figure 3-1.

Major Components of Spending, 1962 to 2004

(Percentage of GDP)



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

Medicare and Medicaid

Significant federal resources are devoted to health care benefits for the nation's elderly, poor, and disabled. Combined, the Medicare program and the federal government's share of Medicaid currently approach Social Security in size. However, because Medicare and Medicaid will grow much more rapidly—by about 8.5 percent annually, compared with 5.6 percent for Social Security—they are projected to overtake that income-support program by next year. Their cost to the federal government will reach 130 percent of Social Security spending by 2015, CBO estimates (see Table 3-3).

Medicare. Spending for Medicare, the primary program that subsidizes medical care for the elderly and certain disabled individuals, is expected to grow rapidly over the next 10 years. The program is currently about 60 percent as large as Social Security (not including the effect of premium collections), but, by 2015, that proportion is projected to reach 86 percent. By then, spending for Medicare will total $766 billion, CBO projects, or almost 4 percent of GDP.

Medicare currently comprises two main parts—Part A (Hospital Insurance) and Part B (Supplementary Medical Insurance). However, the program will undergo a major expansion of benefits in 2006 when it begins to pay for outpatient prescription drugs under the recently approved Part D.[1] Expenditures for Part D will total $47 billion (not including income from premium payments and other offsetting receipts) in 2006, climbing to $174 billion in 2015, CBO estimates.[2] By that time, Part D expenditures will make up 23 percent of spending for Medicare. Overall, spending for Medicare is expected to rise by 9 percent in 2005 and by a similar annual average through 2015. About 40 percent of the upswing in 2005 stems from automatic updates and legislated increases in payment rates for most types of care 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 the prices of goods and services used by providers, as well as on changes 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, particularly as more baby boomers reach the age at which they qualify for benefits, beginning in 2011.

The projected acceleration of Medicare spending would be even more dramatic were it not for the formula used to establish a fee schedule for physicians' services—the sustainable growth rate (SGR) formula. That formula sets a cumulative spending target for physicians' services and other services related to physician visits (such as laboratory tests and physician-administered drugs). Left unaltered, the SGR formula ultimately recoups spending that exceeds the cumulative target by reducing payment rates for physicians' services or by holding increases below in-

1. Part C of Medicare specifies the rules under which certain private health care plans can assume responsibility, and get paid, for providing the benefits covered under Parts A, B, and D.

2. The transitional Part D program will expire when the outpatient prescription drug program is implemented in January 2006. Spending on the transitional program will total less than $200 million in 2006; spending on the outpatient prescription drug program will total $47 billion during the last three quarters of that fiscal year, CBO estimates.

Table 3-3.

CBO's Baseline Projections of Mandatory Spending

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Social Security	492	517	540	564	592	623	659	697	739	785	835	888	2,978	6,922
Medicare[a]	297	325	380	426	453	484	520	565	598	654	708	766	2,263	5,554
Medicaid	176	186	193	205	223	241	262	284	307	333	361	392	1,124	2,802
Income Security														
Unemployment compensation	43	33	35	38	41	42	45	47	49	51	54	56	200	457
Supplemental Security Income	34	39	37	35	40	42	43	49	42	48	50	52	198	439
Earned income and child tax credits	42	48	48	48	48	48	48	48	33	33	34	34	240	421
Food Stamps	29	32	32	32	32	33	33	34	35	36	37	38	162	342
Family support[b]	25	25	25	25	25	25	25	25	25	26	26	26	124	252
Child nutrition	12	13	13	14	14	15	16	16	17	18	18	19	71	159
Foster care	6	7	7	7	8	8	8	9	9	9	10	10	38	84
Subtotal	191	196	197	199	207	212	218	228	211	221	228	234	1,033	2,155
Other Retirement and Disability														
Federal civilian[c]	60	64	67	70	73	76	80	83	86	89	93	96	365	813
Military	37	39	41	43	44	46	47	49	50	51	52	53	221	476
Veterans'[d]	31	35	34	32	34	35	35	38	34	37	38	38	170	355
Other	7	7	8	8	8	9	9	10	10	11	11	12	43	97
Subtotal	135	145	149	152	160	166	171	180	180	188	194	200	799	1,741
Other Programs														
Commodity Credit Corporation Fund	9	22	19	17	15	15	15	14	14	14	14	13	81	149
TRICARE For Life	5	6	7	7	8	8	9	10	10	11	12	13	39	96
Student loans	8	10	6	7	7	7	7	7	8	8	8	8	34	74
Universal Service Fund	3	6	7	7	7	7	7	7	8	8	8	8	35	73
State Children's Health Insurance	5	5	5	5	5	5	5	5	5	5	5	5	26	52
Social services	5	5	5	5	5	5	5	5	5	5	5	5	24	49
Other	20	17	13	14	14	14	14	13	13	12	12	13	69	133
Subtotal	55	71	62	61	61	62	62	63	64	63	65	65	308	627
Offsetting Receipts	-109	-122	-140	-159	-167	-168	-179	-191	-203	-217	-231	-244	-813	-1,899
Total Mandatory Spending	**1,237**	**1,317**	**1,380**	**1,450**	**1,529**	**1,620**	**1,713**	**1,824**	**1,896**	**2,028**	**2,159**	**2,303**	**7,692**	**17,902**
Memorandum:														
Mandatory Spending Excluding Offsetting Receipts	1,346	1,439	1,521	1,608	1,696	1,788	1,892	2,015	2,099	2,245	2,390	2,546	8,505	19,801

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 small retirement programs and annuitants' health benefits.

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

flation (as measured by the Medicare economic index).[3] If spending falls short of the cumulative target, the SGR formula provides for increases in payment rates above inflation.

Application of the SGR formula resulted in a 5.4 percent reduction in payment rates in 2002 and would have resulted in a 4.4 percent reduction in 2003 if not for legislative intervention. In the Consolidated Appropriations Resolution for 2003 (Public Law 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. Application of the SGR formula would have again resulted in reduced payment rates in 2004. However, in the Medicare Prescription Drug, Improvement, and Modernization Act (P.L. 108-173), the Congress specified that payment rates would increase by 1.5 percent in both 2004 and 2005. CBO estimates that spending subject to the SGR formula will exceed the cumulative target by about $20 billion at the end of 2005. As a result, unless it is once again modified, the SGR formula will reduce payment rates for several years, beginning in 2006, and it will keep updates below inflation through at least 2015.

Medicaid. Federal outlays for Medicaid, the joint federal-state program that subsidizes the medical care of many of the nation's poor, totaled $176 billion in 2004, making up about 13 percent of mandatory spending (not including offsetting receipts). In the past two years, Medicaid outlays grew at an annual rate of between 9 percent and 10 percent, reflecting continued increases in enrollment and payment rates, and increases in payments to hospitals that serve a disproportionate share of Medicaid beneficiaries or other low-income people. Some of the growth in 2004 was the result of an additional three fiscal quarters of increased federal matching rates established by the Jobs and Growth Tax Relief Reconciliation Act of 2003. Those enhancements boosted 2004 outlays by about $6 billion. (Increased matching funds in 2003 accounted for an estimated $4 billion in spending in the last two quarters of that year.)

Growth in Medicaid outlays in 2005 will be slower than in the program's recent history, CBO estimates, in large part because the temporarily enhanced matching rates expired on June 30, 2004. Spending increases will remain lower through 2007 because the new Medicare drug benefit will replace Medicaid payments for individuals who are eligible for both programs.

Despite those temporary declines, Medicaid spending increases in later years are projected to return to historic levels as a result of rising prices, greater consumption of services, and, to a lesser extent, increased enrollment. After 2007, spending will increase by an average of 8.4 percent annually, CBO projects, rising to $392 billion in 2015. Consequently, the federal government's Medicaid outlays are projected to reach 2.0 percent of GDP by 2015, compared with 1.5 percent in 2004.

Social Security

Social Security is currently the largest of all federal programs. Its two major components—Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI)—provided benefits of over $487 billion to the elderly and the disabled in 2004. The number of people receiving benefits, already at more than 47 million, is expected to reach 60 million by 2015. Most Social Security beneficiaries also participate in Medicare. Because about 60 percent of people ages 62 to 64, and more than 90 percent of people age 65 and over, collect Social Security benefits, CBO ties its estimates of Social Security beneficiaries primarily to projections of the elderly population.

In the next 10 years and beyond, benefit payments for Social Security are expected to rise at increasingly rapid rates, starting with growth of 5.1 percent in 2005 and climbing to 6.4 percent by 2015.[4] The program's rate of growth will accelerate in the latter half of the 10-year projection period. While both OASI and DI will continue to be affected by the aging of the nation's workforce, DI will realize more growth earlier because aging workers may become disabled before they qualify for OASI.

3. The Medicare economic index measures changes in the costs of physicians' time and operating expenses; it is a weighted sum of the price of inputs in those two categories. Most of the components of the index come from the Bureau of Labor Statistics. Changes in the costs of physicians' time are measured through changes in nonfarm labor costs. Changes in productivity are also factored directly into the index.

4. A discussion of long-term projections for Social Security is presented in Congressional Budget Office, *The Outlook for Social Security* (June 2004).

Old-Age and Survivors Insurance. About $411 billion in OASI benefits were paid in 2004 to just under 40 million people. The OASI program pays benefits to workers who reach a defined age of retirement, to their eligible spouses and children, and to some survivors (primarily aged widows and young children) of deceased workers.

Over the past 10 years, outlays for OASI benefits increased at an annual rate of 4.1 percent. The OASI growth rate fell below that average in recent years, chiefly because of low inflation (cost-of-living adjustments—or COLAs—for Social Security benefits are based on inflation), but it is expected to increase considerably, reaching 6.7 percent by 2015.[5] Although much of the projected growth is attributable to wage increases (which raise initial retirement benefits) and COLAs, growth in the number of people receiving OASI will become increasingly responsible for the surge in OASI spending over the next 10 years, particularly once the leading edge of the baby-boom generation begins to collect benefits in 2008.[6] By 2015, CBO projects, nearly 50 million people will be receiving OASI benefits, 25 percent more than in 2004.

Disability Insurance. The Social Security program also provides Disability Insurance benefits to qualified workers who have suffered a serious medical impairment that restricts their ability to work before they reach retirement age. DI benefits are also paid to those workers' eligible spouses and children. In 2004, DI benefits totaled roughly $76 billion or about 16 percent of spending for all Social Security benefits. Payments for DI benefits are expected to grow at a rapid clip this year (nearly 10 percent), moderating to around 6 percent in 2006. The marked growth in 2005 continues the rapid pace of recent years, which results partially from unusually large payments for retroactive claims. CBO projects slower growth in DI outlays in 2006, mainly because the backlog of pending cases is expected to shrink in 2005. (Retroactive claims will continue to be made throughout the next 10 years, but with a reduction in the backlog, amounts paid are likely to be smaller.) The lower COLA expected in December 2005—2.3 percent, compared with 2.7 percent in December 2004—also will slow the rate of benefit increases. CBO estimates that growth in DI will taper off to about 5.3 percent by 2015. By that time, the last of the baby boomers will have entered the age category in which disabilities are more likely to occur. Another factor contributing to much of the projected growth in Disability Insurance is the ongoing rise in Social Security's "normal retirement age"—from 65 to 66 and eventually to 67. That increase delays the reclassification of disabled workers as retired workers, and, as a result, older disabled individuals receive benefits under DI for a longer time before making the transition to OASI.

Other Income-Security Programs

In contrast to the rapid increases in outlays for Social Security, Medicare, and Medicaid, spending for other income-security programs will grow modestly at an average annual rate of 1.8 percent, CBO estimates. (Those programs include unemployment compensation, Supplemental Security Income, the refundable portion of certain tax credits, and Food Stamps.) As a result, those programs will make up a declining share of GDP—falling from about 1.7 percent in 2004 to 1.2 percent by 2015. Some of the drop over time is the result of provisions in law that affect the child tax credit, which is scheduled to expire in 2010. (The amount of the child tax credit that exceeds an individual's tax liability is treated as an outlay in the budget.) Moreover, some major benefit programs (for example, Temporary Assistance for Needy Families, or TANF) are capped by law and thus do not adjust according to increases in inflation or for changing caseloads. Still other programs, such as the refundable portion of the earned income tax credit (EITC), are projected to remain at roughly the same nominal amount over the next 10 years, though they are not capped. Consequently, as the economy expands, spending on those programs will drop relative to GDP.

Unemployment Compensation. Following the expiration of a temporary increase in the availability of unemployment benefits in 2004, and with the improving labor market, CBO expects that outlays for unemployment compensation in 2005 will be significantly lower than in recent years. Spending on unemployment compensation will fall to $33 billion this year, CBO estimates, dropping from $55 billion in 2003 and $43 billion in 2004. CBO projects that benefits will gradually rise thereafter as a re-

5. The cost-of-living adjustment for calendar year 2005 is 2.3 percent. CBO estimates that those adjustments, which are pegged to the consumer price index, will be 2.0 percent in 2006 and 2.2 percent in 2007 and thereafter.

6. The oldest members of the baby-boom generation—those born in 1946—will turn 62 in 2008 and thus will qualify for reduced OASI benefits beginning that year. The age at which those individuals can receive full Social Security benefits (the "normal retirement age") is 66.

sult of increases in the amount of average benefits and growth in the labor force.

Supplemental Security Income. Outlays for the Supplemental Security Income program, which provides cash benefits to low-income people with disabilities, reached nearly $34 billion in 2004. SSI spending is projected to increase at an average rate of 3.0 percent annually during the 2006-2015 period, though spending in a given year can fluctuate according to the number of payments made in that year. The program's growth is driven mainly by cost-of-living adjustments and a rising caseload.

Earned Income and Child Tax Credits. Taxpayers who earn wages below an established maximum, and those with dependent children, are eligible for federal tax credits. While a portion of those credits reduces filers' overall tax liability, the portion that exceeds that tax liability may be refunded to them in the form of a cash payment and thus is categorized as an outlay in the federal budget. The refundable portions of the earned income and child tax credits totaled $42 billion in 2004. About $33 billion of that amount represented the refundable portion of the earned income tax credit, while $9 billion was attributable to the child tax credit. CBO estimates that much of the recent growth in participation in those programs will persist and that outlays for the credits will total $48 billion in 2005. Under the Working Families Tax Relief Act of 2004, the child tax credit was increased to $1,000 for calendar years 2005 through 2009 (matching the amount of the credit in 2004 and 2010). As a result, CBO expects that outlays for the two credits will remain steady at about $48 billion until fiscal year 2012. By then, the child tax credit will be virtually eliminated under current law, and scheduled higher taxes will reduce the refundable portion of the EITC. Consequently, outlays for those credits will drop to about $33 billion annually.

Food Stamps. CBO anticipates that outlays for the Food Stamp program will rise by 12 percent—to $32 billion—in 2005 following a similar jump in 2004. In recent years, participation in the Food Stamp program has increased much faster than expected. CBO projects that participation in the program will continue at a higher level throughout the coming years and that spending for the program will remain well above its prerecession range of $18 billion to $19 billion per year.

Family Support Services. The federal government provides grants to states to help fund services to families. Outlays for those family support services—Temporary Assistance for Needy Families, child support enforcement, and other child care entitlements—totaled $25 billion in 2004 and are estimated to remain at about the same level in 2005. Because the largest of those programs—TANF—is capped, spending in this category is expected to stay fairly flat throughout the next 10 years. Authorization for TANF originally was scheduled to expire at the end of 2002, but the program was extended at various points in the past two years and now is authorized through March 31, 2005. As required by the Deficit Control Act, CBO assumes that funding for TANF will continue at its most recently authorized level of nearly $17 billion per year.

Child Nutrition and Foster Care. Spending for both child nutrition and for foster care and adoption assistance (neither of which is capped) is projected to rise by about 4 percent a year through 2015. In 2004, outlays for child nutrition programs were $12 billion. They are expected to rise to $13 billion in 2005. Spending for foster care and adoption assistance totaled a little over $6 billion in 2004 and is estimated to be about $7 billion in 2005.

Other Federal Retirement and Disability Programs

Benefits for federal retirees—both civilian and military—totaled $135 billion in 2004 and are estimated to reach $145 billion in 2005. Between 2006 and 2015, funding for those programs is projected to grow steadily at about 3.3 percent per year and to remain at roughly 1 percent of GDP.

In 2004, the federal government funded nearly $60 billion in annuities and survivors' benefits through its civilian retirement program, along with several smaller retirement programs for employees of various government agencies. Those payments are expected to grow to more than $96 billion by 2015. The increase is fed by growth in the number of beneficiaries, cost-of-living adjustments, and rising federal salaries (which, in turn, boost future benefit levels). One factor that restrains growth somewhat is the gradual replacement of the Civil Service Retirement System (CSRS) with the smaller defined ben-

efit provided under the Federal Employees' Retirement System (FERS).[7]

In addition, the government offers benefits to retired military personnel and veterans. Annuities paid to retired military personnel reached $37 billion in 2004. They are estimated to total $39 billion in 2005 and are expected to rise to $53 billion by 2015—an increase of about 3.2 percent a year. Mandatory spending for veterans' benefits—including disability compensation, pensions, and dependency and indemnity compensation to surviving spouses and children—totaled $31 billion in 2004 and is projected to climb to $38 billion by 2015, mainly because of cost-of-living adjustments and caseload increases.

Other Mandatory Spending

After an initial increase in 2005, other mandatory spending is expected to stay between $61 billion and $65 billion a year through 2015. Spending for farm price and income supports administered through the Commodity Credit Corporation (CCC) is projected to jump from $9 billion in 2004 to $22 billion in 2005. Because of near-record-high crop prices in 2004, the CCC paid out relatively little in federal subsidies. However, with a rapid drop in crop prices evident for 2005, CBO estimates that federal spending will increase significantly before returning to levels of $13 billion to $15 billion annually.

By contrast, outlays for the TRICARE For Life program—which provides health care benefits to retirees of the uniformed services who are eligible for Medicare (and to their dependents and surviving spouses)—are expected to grow rapidly each year, rising from $6 billion in 2005 to $13 billion by 2015. (At about 8 percent, the program's rate of growth parallels that of other medical expenditures.) Other mandatory spending is not expected to change significantly. For example, CBO estimates that, from 2006 to 2015, the subsidy and administrative costs of student loan programs will range from $6 billion to $8 billion a year.[8]

Offsetting Receipts

Offsetting receipts are payments from the public or from intragovernmental transactions that, for budgetary purposes, the federal government characterizes and records as negative spending. In other words, those payments offset mandatory spending. Examples of such receipts include beneficiaries' premium payments for Medicare, federal agencies' contributions to retirement funds, and the government's receipts for the harvesting of timber and extraction of minerals on federal lands. The collection of offsetting receipts reduces total mandatory spending by between 8 percent and 10 percent each year.

Medicare Premiums and Related Receipts. Over the 10-year projection period, premiums for the Medicare program make up the largest component of offsetting receipts (see Table 3-4). In 2004, those payments totaled $32 billion and offset Medicare spending by about 11 percent. By 2015, when such premiums and other payments to Medicare are projected to reach $130 billion, they will reduce the program's overall costs by about 17 percent. Most of the increase over the coming 10 years is attributable to the prescription drug premiums and other collections provided under the new Medicare Part D.

Only a small portion of Medicare premiums—about 5 percent—are collected under Part A, the Hospital Insurance program. That proportion will fall to 3 percent by 2015 as premiums collected under Part D become a more significant source of receipts.

The majority of Medicare premiums are paid by the 39 million people enrolled in Supplementary Medicare Insurance (Medicare Part B), which covers physicians' and outpatient hospital services. By law, those premiums are set to cover one-quarter of that program's costs. In 2005, the average monthly premium is $78; it is expected to grow to $125 by 2015. Beginning in 2007, beneficiaries with relatively high incomes will be charged higher premiums. By 2015, CBO estimates, about 6 percent of beneficiaries will have annual incomes that are subject to those higher premiums, which will be as high as $365 a month. Total Part B premiums are projected to rise from $36 billion in 2005 to about $80 billion in 2015.

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

8. The costs that are included in the federal budget for student loans are the present value of the net costs associated with the $765 billion in direct and guaranteed loans expected 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.

Table 3-4.

CBO's Baseline Projections of Offsetting Receipts

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Medicare[a]	-32	-38	-55	-64	-69	-75	-82	-90	-98	-107	-118	-130	-346	-890
Employers' Share of Employees' Retirement														
Social Security	-11	-11	-12	-12	-13	-14	-15	-16	-17	-18	-19	-21	-67	-159
Military retirement	-14	-16	-16	-15	-16	-16	-17	-17	-18	-18	-18	-18	-80	-169
Civil service retirement and other	-20	-19	-20	-21	-22	-23	-24	-25	-26	-27	-28	-29	-110	-244
Subtotal	-45	-47	-48	-49	-51	-53	-56	-59	-61	-63	-66	-68	-257	-573
TRICARE For Life	-8	-10	-11	-12	-12	-13	-14	-15	-16	-17	-18	-19	-62	-145
Electromagnetic Spectrum Auctions	0	0	0	-8	-8	0	0	0	0	0	0	0	-15	-15
Energy-Related Receipts[b]	-6	-8	-8	-8	-8	-8	-8	-9	-9	-10	-10	-10	-41	-88
Natural-Resources-Related Receipts[c]	-5	-5	-5	-4	-4	-4	-4	-4	-4	-4	-4	-4	-22	-43
Other[d]	-12	-14	-14	-14	-14	-14	-15	-15	-15	-15	-16	-13	-70	-145
Total	**-109**	**-122**	**-140**	**-159**	**-167**	**-168**	**-179**	**-191**	**-203**	**-217**	**-231**	**-244**	**-813**	**-1,899**

Source: Congressional Budget Office.

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.

Beginning in 2006, premium payments for Medicare Part D will total $9 billion. CBO estimates that those payments will cover about one-sixth of the program's costs. Part D collections are expected to grow steadily—by about 9 percent each year—after the new prescription drug benefit is underway, rising to $29 billion in 2015.

With the introduction of Medicare Part D, some of the costs of providing prescription drug coverage to low-income Medicare enrollees will shift from the Medicaid program (which the states and the federal government both fund) to Medicare. Current law requires a portion of the resulting savings to be withheld from federal payments to state Medicaid programs and credited to the Medicare Part B trust fund. CBO projects that those transfers will grow from $6 billion in 2006 to $18 billion in 2015.

Other Offsetting Receipts. In 2004, intragovernmental transfers from federal agencies to employee retirement plans made up the largest component of offsetting receipts. Those payments will total about $47 billion in 2005, constituting about 38 percent of total offsetting receipts that year. Those intragovernmental transfers will continue to rise, totaling a projected $68 billion in 2015. Agencies' retirement contributions are primarily paid 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 they do with their retirement plans, the Department of Defense and certain other agencies make intragovernmental transfers to the Uniformed Services Medicare-Eligible Retiree Health Care Fund under the TRICARE For Life program. Its receipts are expected to almost double, rising from about $10 billion in 2005 to nearly $19 billion in 2015.

The auction of rights to use portions of the electromagnetic spectrum constitutes another source of offsetting receipts. Such auctions are expected to continue until the Federal Communications Commission's (FCC's) authority expires at the end of 2007. CBO assumes that the FCC will auction at least 90 megahertz of spectrum for advanced wireless services sometime in 2006 and 2007. Those auctions will bring in about $15 billion through 2015, with the receipts being tallied in 2007 and 2008.

Other sources of proprietary receipts include royalties from and charges for oil and natural-gas production on federal lands; sales from federal hydroelectric facilities; sales arising from the harvesting of timber and extraction of minerals on federal lands; and various fees levied on users of public property and services. Energy-related receipts are expected to come to between $8 billion and $10 billion per year, while those dealing with natural resources will bring in about half as much, CBO estimates. A variety of other receipts are expected to average about $14 billion annually through 2015.

What Drives the Growth in Mandatory Spending?

Mandatory spending has a history of rapid growth. For example, over the past 10 years, mandatory spending (excluding offsetting receipts) grew at a rate of 5.5 percent per year, which outpaced nominal growth in the economy. CBO expects that trend to continue well into the future, with growth between 2005 and 2015 reaching levels slightly above the recent average. Overall, CBO estimates that, by 2015, spending on mandatory programs will exceed the amount projected for 2005 by $1.1 trillion. The bulk of that increase—75 percent—is attributable to rising per-beneficiary costs. Expanding caseloads will account for about one-fourth of the increase between 2006 and 2015 (see Table 3-5).

Increases in Spending per Recipient. CBO anticipates that most mandatory programs will continue to see increases in per-beneficiary costs. Such spending is frequently required by factors set in law (COLAs and other automatic adjustments, for instance). Other contributing factors include rising wages (which are used as a basis for determining benefit levels in several programs); increases in the intensity of benefit utilization; the addition of more-costly medical procedures; and the expansion of benefits. CBO estimates that, by 2015, those increases will boost spending by $830 billion—a 58 percent jump. Thus, those factors account for average annual growth of about 4.7 percent in mandatory spending—more than twice the projected rise in the consumer price index. Just over 60 percent of such increases—about $500 billion—will be attributable to funding for Medicare and Medicaid (not accounting for the offsetting receipts that reduce the net cost of those programs). A significant portion of that increase can be ascribed to the addition of the outpatient prescription drug program, Medicare Part D.

Increases in average benefits for Social Security account for another $251 billion in rising per-beneficiary costs. Average benefits for Social Security recipients (and for most federal retirees) grow faster than the increase provided by COLAs alone because initial awards to new beneficiaries are indexed to growth in wages, and wage growth typically exceeds inflation.

Increases in Caseload. About one-quarter of the growth in mandatory spending over the 2006-2015 period can be attributed to the rising ranks of beneficiaries. Even if average benefits did not rise, adding beneficiaries to the rolls under current eligibility rules would increase spending by $17 billion in 2006 and by $288 billion by 2015, CBO projects, relative to outlays in 2005. That growth amounts to an average of about 2 percent per year. Just over half of the increase in costs from expanding caseloads will occur in the Medicare and Medicaid programs. About 40 percent of the growth in caseloads over the next 10 years will take place in Social Security. CBO estimates that the annual increases in the number of OASI beneficiaries will be about 1 percent at the beginning of the period and then will escalate rapidly, reaching almost 3 percent by 2015.

Shifts in Payment Dates. 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—which increases spending for the preceding year and decreases spending for the forthcoming year. Because SSI, veterans' compensation and pension programs, and Medicare payments to health maintenance

Table 3-5.

Sources of Growth in Mandatory Spending

(Billions of dollars)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Estimated Spending for Base Year 2005	1,439	1,439	1,439	1,439	1,439	1,439	1,439	1,439	1,439	1,439
Sources of Growth										
Medicare and Medicaid										
Establishment of Medicare Part D[a]	45	73	83	91	100	110	122	136	153	172
Other increases in spending per recipient	14	34	57	88	122	160	199	239	283	331
Increases in caseload	8	18	29	41	52	66	84	104	126	149
Social Security										
Increases in spending per recipient	16	33	52	73	96	121	149	180	214	251
Increases in caseload	7	14	23	34	46	59	73	88	104	120
Income security, federal retirement, disability, and social services[b]										
Increases in spending per recipient	8	15	24	33	41	51	45	56	66	76
Increases in caseload	2	6	8	10	12	13	15	16	18	19
Shifts in payment dates[c]	-8	-15	-9	-9	-9	3	-21	-9	-9	-9
Other effects	-10	-9	-10	-10	-8	-6	-6	-4	-3	-2
Total	**82**	**169**	**257**	**349**	**453**	**576**	**660**	**806**	**951**	**1,107**
Projected Spending	1,521	1,608	1,696	1,788	1,892	2,015	2,099	2,245	2,390	2,546
Memorandum:										
Total Increases in Spending per Recipient	83	155	216	283	359	441	515	611	715	830
Total Increases in Caseload	17	39	60	85	111	139	172	209	248	288

Source: Congressional Budget Office.

Note: Amounts do not include the effects of offsetting collections.

a. Gross Part D spending is substantially larger than the effect on the federal budget of establishing the Medicare prescription drug benefit because gross Part D spending includes some costs that, under prior law, would have been incurred by Medicaid and other federal health programs. It does not, however, include offsetting receipts of the Medicare program from new premiums and payments by states.

b. This category includes unemployment compensation, earned income and child tax credits, military and civilian retirement, veterans' benefits, child nutrition, Food Stamps, and foster care.

c. Represents baseline differences attributable to assumptions about the number of benefit checks that will be issued in a fiscal year. Normally, benefit payments are made once a month. However, Medicare will pay 13 months of benefits in 2005 and 2011 and 11 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.

organizations all are affected by such calendar shifts, those programs may send out 11, 12, or 13 monthly checks in a fiscal year. Irregular numbers of benefit payments will affect mandatory spending in 2005, 2006, 2007, 2011, and 2012. Those effects reduce outlays in most later years relative to those in 2005, in large part because 2005 is a 13-payment year.

Other changes to mandatory programs will reduce outlays over the 2006-2015 period. Those changes are largely attributable to spending by the Commodity Credit Corporation, which CBO projects will decline after this year. Also, CBO has recorded outlays of $7 billion in 2005 to adjust for revised estimates of the costs of credit programs; such costs are not included in future years.

Legislation Assumed in the Baseline

CBO's projections for mandatory spending follow the general baseline concept of estimating future budget au-

thority 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, the agricultural price and income-support programs of the Commodity Credit Corporation, rehabilitation services and disability research, and the State Children's Health Insurance Program are examples of programs whose current authorization is set to expire but in the baseline is 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 nearly $6 billion in outlays in 2005. As authorization for various programs expires throughout the next 10 years, that figure climbs to $87 billion by 2015 (see Table 3-6).

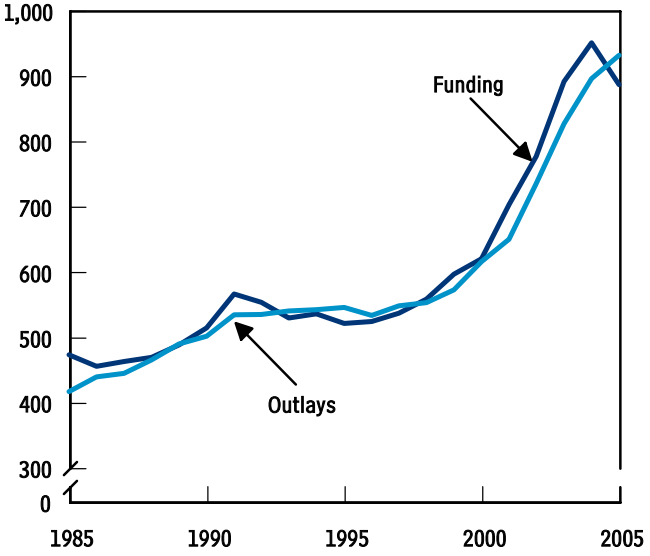
Discretionary Spending

Each year, the Congress starts the appropriation process anew. The annual appropriation acts that it passes provide new budget authority (authority to enter into financial obligations) for discretionary programs and activities. That authority translates into outlays once the money is actually spent. Although some funds (for example, those designated for employees' salaries) are spent quickly, others (for example, those intended 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 previously appropriated.

Figure 3-2.

Discretionary Funding and Outlays, 1985 to 2005

(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.)

Recent Trends in Discretionary Funding and Outlays

In the mid-1980s, discretionary outlays accounted for 10.0 percent of GDP, but by 1999 they had fallen to 6.3 percent (see Table 3-7 on page 69). With the advent of budget surpluses in the late 1990s, funding for discretionary programs began moving upward again, thereby reversing the decline in outlays as a share of the economy (see Figure 3-2). The events of September 11, 2001, accelerated that trend, with discretionary outlays jumping to 7.1 percent of GDP ($734 billion) in 2002 and 7.6 percent ($825 billion) in 2003.

Under baseline assumptions, total discretionary outlays as a share of GDP drop slightly—from 7.7 percent ($895 billion) in 2004 to 7.6 percent ($930 billion) in 2005. However, anticipated additional funding for activities in Iraq and Afghanistan will most likely add about $30 billion to outlays this year. Assuming such funding is enacted, total discretionary outlays would account for about

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. For example, the Budget Committees decided not to continue the recently enacted tobacco-buyout payments, which have been authorized through fiscal year 2014 and were estimated to cost about $1 billion annually.

7.9 percent of GDP—the highest level since 1993—and would have a growth rate in 2005 of 7.3 percent.

Trends in overall discretionary spending have generally been greatly influenced by spending on defense. During the late 1980s and the 1990s, such outlays declined sharply as a share of the economy, sliding from a peak of 6.2 percent in 1986 to a low of 3.0 percent between 1999 and 2001. In 2002, those outlays rose to 3.4 percent of GDP and then continued to climb, reaching 3.7 percent in 2003 and 3.9 percent in 2004. Without additional funding for Iraq and Afghanistan, CBO estimates that defense outlays would account for 3.8 percent of GDP in 2005. Additional funding could boost defense outlays by about 8.9 percent over the 2004 level, growing to about 4.0 percent of GDP. Excluding supplemental funding appropriated in 2004 (mostly for activities in Iraq and Afghanistan) and in 2005 (mostly for disaster relief related to hurricane damage), discretionary budget authority for defense programs grew from $394 billion in 2004 to $420 billion in 2005, a 6.7 percent increase (see Table 3-8 on page 70).

Nondefense discretionary programs encompass such activities as housing assistance, transportation, maintenance of national parks, and foreign aid. Spending for such programs has remained relatively constant as a share of GDP since the mid-1980s (generally hovering between 3.2 percent and 3.9 percent of GDP), although it has grown steadily in nominal dollar terms. Such spending is estimated to total 3.8 percent of GDP in 2005. The growth rate of nondefense discretionary outlays slowed significantly in the past two years, dropping from 12.3 percent in 2002 to 4.9 percent in 2004. However, in 2005, CBO projects that growth rate to increase to 5.8 percent, partially as a result of outlays from previous appropriations. Nearly half of the $466 billion in outlays projected for 2005 in the nondefense discretionary category stems from funding granted before this year. Also contributing to the increase in outlays for nondefense discretionary programs is spending for reconstruction activities in Iraq—such outlays are expected to rise from $3 billion in 2004 to $6 billion this year.

Excluding all supplemental funding in 2004 and 2005, appropriations for nondefense discretionary activities have grown by 3.5 percent since last year. Spending on homeland security activities has been among the fastest-growing components of the nondefense discretionary category: excluding supplemental funding, budget authority for such programs jumped by nearly 15 percent in 2005, CBO estimates (see Table 3-8). Appropriations for other nondefense activities have risen by 2.6 percent over the previous year's levels. Areas of growth include Project BioShield (which received an advance appropriation of $2.5 billion last year for fiscal year 2005), hospital and medical care for veterans, and programs to battle HIV/AIDS overseas.[10] A large decrease in funding occurred for election reform programs. (Those programs were not funded in 2005, but about $1 billion in previous funding remains to be spent.)

The distribution of the $464 billion in funding for nondefense discretionary activities for 2005 (including $45 billion in obligation limitations) is shown in Figure 3-3 on page 68. The education, training, employment, and social services category will constitute 17 percent of nondefense discretionary funding ($80 billion) in 2005, CBO projects. That budget function includes all discretionary federal programs related to education and employment, as well as social services for children, families, the elderly, and the disabled. (Student loans, unemployment compensation, and a number of other programs are not included in these totals, because they are considered mandatory programs.) Funding for transportation programs (ground, air, and water)—which includes obligation limitations set in appropriation bills—will total $71 billion and account for 15 percent of nondefense discretionary funding in 2005, CBO estimates. Health research and public health expenditures will reach $54 billion—and make up 12 percent of nondefense discretionary funding—in 2005. According to CBO's calculations, at $46 billion, the income-security category will claim 10 percent of nondefense discretionary funding, mostly for housing assistance and food and nutrition assistance programs. Those four categories together account for over half of all nondefense discretionary funding.

10. Project BioShield also received an advance appropriation of $2.2 billion for 2009.

Table 3-6.

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

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Food Stamps													
Budget authority	n.a.	n.a.	n.a.	32.0	32.6	33.4	34.2	35.1	35.9	36.9	37.8	98.0	278.0
Outlays	n.a.	n.a.	n.a.	30.6	32.6	33.3	34.2	35.1	35.9	36.8	37.8	96.5	276.3
Temporary Assistance for Needy Families													
Budget authority	7.1	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	84.6	169.2
Outlays	5.2	15.2	17.2	17.2	16.9	16.9	16.9	16.9	16.9	16.9	16.9	83.5	168.2
Commodity Credit Corporation[a]													
Budget authority	n.a.	n.a.	n.a.	n.a.	15.0	14.6	14.4	14.0	13.9	13.9	12.7	29.6	98.4
Outlays	n.a.	n.a.	n.a.	n.a.	15.0	14.6	14.4	14.0	13.9	13.9	12.7	29.6	98.4
Veterans' Compensation COLAs													
Budget authority	n.a.	0.6	1.1	1.7	2.4	3.0	3.9	4.0	4.9	5.6	6.2	8.7	33.3
Outlays	n.a.	0.5	1.0	1.7	2.3	2.9	3.9	3.9	4.9	5.5	6.2	8.5	32.9
Child Care Entitlement to States													
Budget authority	0.9	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	0.6	2.2	2.6	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	12.9	26.5
State Children's Health Insurance Program													
Budget authority	n.a.	n.a.	n.a.	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	15.1	40.3
Outlays	n.a.	n.a.	n.a.	2.0	4.0	4.9	5.3	5.3	5.4	5.2	5.1	10.9	37.2
Rehabilitation Services and Disability Research													
Budget authority	n.a.	n.a.	2.8	2.8	2.9	3.0	3.0	3.1	3.2	3.2	3.3	11.5	27.2
Outlays	n.a.	n.a.	1.1	2.2	2.8	2.8	2.9	3.0	3.0	3.1	3.2	9.0	24.2
Ground Transportation Programs Not Subject to Annual Obligation Limitations													
Budget authority	0.2	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	2.5	5.7
Federal Unemployment Benefits and Allowances													
Budget authority	n.a.	n.a.	n.a.	0.9	0.9	0.9	0.9	1.0	1.0	1.0	1.0	2.7	7.6
Outlays	n.a.	n.a.	n.a.	0.4	0.8	0.9	0.9	0.9	1.0	1.0	1.0	2.1	7.0

Continued

Table 3-6.

Continued

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Child Nutrition[b]													
Budget authority	0	0	0	0	0	0.5	0.5	0.5	0.5	0.5	0.6	0.5	3.1
Outlays	0	0	0	0	0	0.4	0.5	0.5	0.5	0.5	0.6	0.4	3.0
Family Preservation and Support													
Budget authority	n.a.	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.2	2.7
Outlays	n.a.	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.9	2.4
Other Natural Resources													
Budget authority	0	0	0	0	0	0	0	0	0	0	0.3	0	0.3
Outlays	0	0	0	0	0	0	0	0	0	0	0.2	0	0.2
Ground Transportation Programs Controlled by Obligation Limitations[c]													
Budget authority	14.2	41.3	41.3	41.3	41.3	41.3	41.3	41.3	41.3	41.3	41.3	206.7	413.3
Outlays	0	0	0	0	0	0	0	0	0	0	0	0	0
Air Transportation Programs Controlled by Obligation Limitations													
Budget authority	0	0	0	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	11.1	29.6
Outlays	0	0	0	0	0	0	0	0	0	0	0	0	0
Total													
Budget authority	**22.4**	**62.2**	**65.8**	**108.1**	**124.4**	**126.0**	**127.6**	**128.3**	**130.0**	**131.7**	**132.5**	**486.5**	**1,136.6**
Outlays	**5.8**	**18.2**	**22.5**	**57.6**	**78.1**	**80.5**	**82.6**	**83.4**	**85.1**	**86.6**	**87.3**	**256.9**	**681.8**

Source: Congressional Budget Office.

Notes: 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 2007. 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.

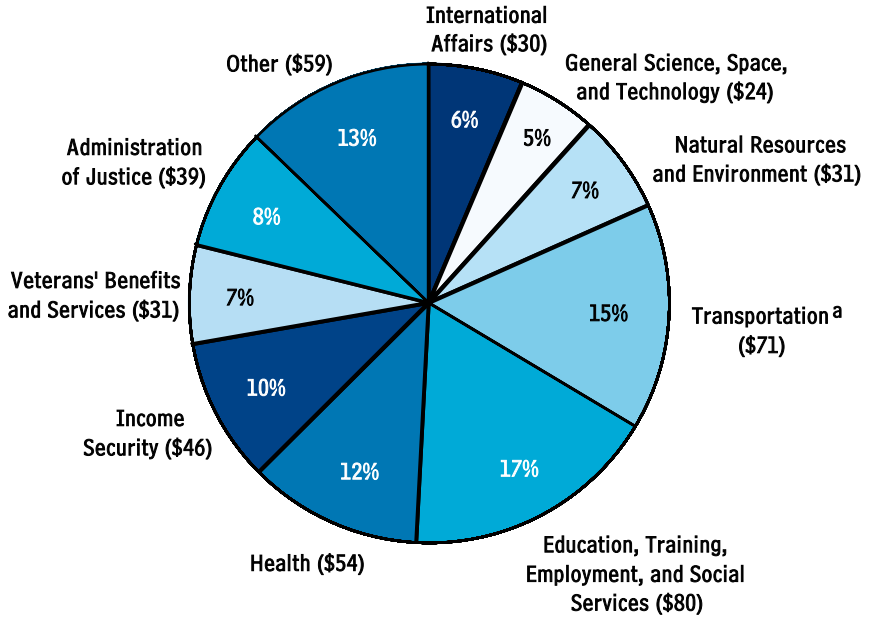
b. Includes the Summer Food Service program and state administrative expenses.

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.

Figure 3-3.

Nondefense Discretionary Funding, by Budget Function, 2005

(Billions of dollars)



Source: Congressional Budget Office.

a. Includes $45 billion in obligation limitations.

Discretionary Spending for 2006 Through 2015

Under baseline assumptions, CBO projects that discretionary outlays will drop from $930 billion in 2005 to $914 billion in 2006, before steadily rising for the remainder of the 10-year projection period, reaching $1.1 trillion in 2015. The initial drop-off can be attributed to a projected decline in defense spending in 2006 and 2007 as outlays for Iraq and Afghanistan taper off under the baseline assumption of no additional appropriations for those operations. In 2008, outlays for defense are projected to begin rising again; by 2015, such outlays would total $529 billion.[11] CBO projects that, under baseline assumptions, nondefense discretionary outlays would continue rising steadily throughout the 2006-2015 period, growing from $476 billion in 2006 to $572 billion in 2015—an average rate of 2.1 percent per year.

Homeland Security. One type of spending that encompasses both defense and nondefense activities is homeland security.[12] The Administration has identified the spending that it considers related to such activities, and, in its current baseline, CBO has adopted the Administration's classification.[13] Net discretionary budget authority for homeland security is estimated to total about $42 billion in 2005—$11 billion for defense and $31 billion for nondefense programs. CBO estimates that the resulting discretionary outlays for those needs will total $37 billion this year (see Table 3-9 on page 71). In addition, roughly $1 billion in net outlays for homeland security is classified as mandatory spending in 2005. Under its baseline

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

12. For a discussion of homeland security activities and funding, see Congressional Budget Office, *Federal Funding for Homeland Security,* Economic and Budget Issue Brief (April 30, 2004).

13. CBO received some preliminary information from the Administration regarding the classification of appropriations for 2005 for the Department of Homeland Security. For homeland security activities outside of the Department, CBO estimated homeland security spending for 2005 on the basis of the amounts designated for that activity in OMB's 2004 *Mid-Session Review.* Once the Administration releases its 2006 budget proposal in February 2005, CBO will revise its homeland security estimates to reflect the Administration's classification of those programs.

Table 3-7.

Defense and Nondefense Discretionary Outlays, 1985 to 2005

	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	4.8	-5.3	231	3.7	8.2	534	8.6	0.1
1993	292	4.4	-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	3.3	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	420	3.9	9.1	825	7.6	12.4
2004	454	3.9	12.1	441	3.8	4.9	895	7.7	8.4
2005[a]	464	3.8	2.2	466	3.8	5.8	930	7.6	4.0

Sources: Office of Management and Budget for 1985 through 2004 and Congressional Budget Office for 2005.

a. Estimated. Excludes the effect on outlays of additional funding for operations in Iraq and Afghanistan, which has not yet been enacted for 2005.

assumptions, CBO projects that discretionary outlays for homeland security will average about 0.3 percent of GDP and about 1.5 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 in 2005 is about $840 billion and that obligation limitations total $45 billion, the amounts appropriated to date; both grow with inflation thereafter. Under those assumptions, discretionary funding would grow at an annual rate of about 2.4 percent for most of the projection period. Because funding can and probably will differ from those assumptions, CBO presents alternative paths for discretionary spending to show the budgetary consequences of using different rates of growth (see Table 3-10 on page 72).

The first alternative path assumes that funding will grow at the average annual rate of nominal GDP after 2005 (4.9 percent a year, or twice as fast as the rate of growth assumed in the baseline). Under this scenario, total discretionary outlays would exceed the baseline figures by $1.4 trillion over the projection period. Added debt-service costs would bring the cumulative increase in outlays to $1.7 trillion.

Table 3-8.

Growth in Discretionary Budget Authority, 2004 to 2005

(Billions of dollars)

	Actual 2004	Estimated 2005	Percentage Change
Budget Authority			
Defense	486	421	-13.3
Nondefense			
Homeland security[a]	27	31	14.3
Other nondefense	393	388	-1.4
Subtotal, nondefense	420	419	-0.3
Total	**906**	**840**	**-7.3**
Budget Authority Excluding Supplementals[b]			
Defense	394	420	6.7
Nondefense			
Homeland security[a]	27	31	14.7
Other nondefense	368	377	2.6
Subtotal, nondefense	395	409	3.5
Total Excluding Supplementals	**789**	**829**	**5.1**

Source: Congressional Budget Office.

a. CBO received some preliminary information from the Administration regarding the classification of appropriations for 2005 for the Department of Homeland Security. For homeland security activities outside of the department, CBO estimated homeland security spending for 2005 on the basis of the amounts designated for such activity in OMB's 2004 *Mid-Session Review.* Once the Administration releases its 2006 budget proposal in February 2005, CBO will revise its homeland security estimates to reflect the Administration's actual classification of those programs. About $9 billion of defense funding for 2004 and $11 billion of funding for 2005 is also classified as homeland security; those funds are shown in the defense category.

b. Supplemental appropriations in 2004 totaled $117 billion. Funding, primarily for activities in Iraq and Afghanistan, was contained in two acts. The first, enacted in November 2003, provided $87 billion. The second, the Department of Defense Appropriations Act, 2005, provided another $28 billion for 2004 (including $1.8 billion from reversing a rescission that had previously been enacted but not yet applied). In addition, $2 billion in supplemental funding for hurricane relief was provided in September 2004. Supplemental funding of $11.5 billion in 2005 has been provided for hurricane disaster assistance.

The second path assumes that discretionary resources are provided in 2005 and thereafter to continue activities in Iraq and Afghanistan and, more broadly, for the global war on terrorism. This policy alternative assumes an eventual slowdown of such activities and includes funding for domestic military operations for homeland security. Under that scenario, discretionary outlays over the 10-year period would total $418 billion more than the baseline figures presented in this report, and debt-service costs would increase by $172 billion.

The final path shows less spending: it assumes that most discretionary budget authority and obligation limitations are frozen throughout the projection period at the level provided in 2005. 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.

Net Interest

In the next eight years, interest outlays will be one of the fastest growing components of the federal budget. CBO's baseline shows interest costs nearly doubling during this time, growing from $160 billion in 2004 to $314 billion in 2012; as a share of GDP, interest outlays are projected to total between 1.4 percent and 1.9 percent during that period (see Table 3-11 on page 74). By contrast, net interest as a share of the economy ranged from 2.0 percent

Table 3-9.

CBO's Baseline Projections of Discretionary Spending for Homeland Security

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Budget Authority														
Defense	9	11	11	11	12	12	12	13	13	13	14	14	58	124
Nondefense[a]														
Department of Homeland Security														
Border and transportation security	10	11	11	11	11	11	11	12	12	12	13	13	55	118
Other activities	9	11	8	9	9	11	9	9	10	10	10	10	46	95
Subtotal, Department of Homeland Security	19	21	19	20	20	22	21	21	22	22	23	23	101	213
Other departments	8	10	10	10	11	11	11	11	12	12	12	13	53	112
Subtotal, nondefense	27	31	29	30	30	33	32	33	33	34	35	36	154	326
Total Budget Authority	**36**	**42**	**40**	**41**	**42**	**45**	**44**	**45**	**46**	**47**	**49**	**50**	**212**	**449**
Outlays														
Defense	9	11	11	11	11	12	12	12	13	13	13	14	57	122
Nondefense[a]														
Department of Homeland Security														
Border and transportation security	9	10	11	11	11	11	11	12	12	12	13	13	55	116
Other activities	5	7	9	10	10	10	10	10	10	10	10	10	48	97
Subtotal, Department of Homeland Security	15	17	19	20	21	21	21	21	22	22	23	23	102	214
Other departments	7	9	10	10	11	11	11	11	12	12	12	12	53	112
Subtotal, nondefense	21	26	29	31	31	31	32	33	33	34	35	36	155	325
Total Outlays	**30**	**37**	**40**	**42**	**43**	**43**	**44**	**45**	**46**	**47**	**48**	**49**	**212**	**448**
Memorandum:														
Mandatory Outlays for Homeland Security	1	*	*	*	*	*	*	*	*	*	*	2	1	2

Source: Congressional Budget Office.

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

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.

CBO received some preliminary information from the Administration regarding the classification of appropriations for 2005 for the Department of Homeland Security. For homeland security activities outside of the department, CBO estimated homeland security spending for 2005 on the basis of the amounts designated for such activity in OMB's 2004 *Mid-Session Review.* Once the Administration releases its 2006 budget proposal in February 2005, CBO will revise 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 $4 billion to $5 billion a year in spending is offset by fees and other receipts.

a. Project BioShield, an initiative to expand the government's arsenal of counterbioterrorism agents, has received appropriations for 2005 and 2009. Budget authority for all other years is zero.

Table 3-10.

CBO's Projections of Discretionary Spending Under Alternative Paths

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Baseline (Discretionary Resources Grow with Inflation After 2005)[a]													
Budget Authority													
Defense	421	432	441	452	463	474	486	498	510	523	536	2,263	4,817
Nondefense	419	428	438	448	460	469	480	491	503	514	526	2,242	4,756
Total	**840**	**859**	**879**	**900**	**923**	**943**	**966**	**989**	**1,013**	**1,038**	**1,063**	**4,505**	**9,573**
Outlays													
Defense	464	438	435	447	457	468	484	488	504	516	529	2,245	4,765
Nondefense	466	476	485	493	502	511	523	534	546	559	572	2,468	5,202
Total	**930**	**914**	**919**	**940**	**959**	**980**	**1,006**	**1,022**	**1,050**	**1,075**	**1,101**	**4,713**	**9,966**
Discretionary Resources Grow at the Rate of Nominal GDP After 2005													
Budget Authority													
Defense	421	444	467	492	517	542	567	594	621	649	678	2,462	5,570
Nondefense	419	439	463	488	514	537	562	588	614	642	670	2,441	5,516
Total	**840**	**883**	**931**	**980**	**1,031**	**1,078**	**1,129**	**1,181**	**1,235**	**1,291**	**1,348**	**4,903**	**11,087**
Outlays													
Defense	464	446	455	481	504	529	558	576	606	634	663	2,415	5,452
Nondefense	466	483	505	528	552	577	604	632	660	690	721	2,645	5,951
Total	**930**	**929**	**959**	**1,009**	**1,057**	**1,106**	**1,162**	**1,208**	**1,267**	**1,324**	**1,383**	**5,059**	**11,403**
Appropriations Are Provided for Activities in Iraq and Afghanistan and for the Global War on Terrorism													
Budget Authority													
Defense	486	517	506	502	498	499	511	524	537	550	564	2,523	5,210
Nondefense	419	428	438	448	460	469	480	491	503	514	526	2,242	4,756
Total	**905**	**944**	**944**	**950**	**958**	**968**	**991**	**1,015**	**1,040**	**1,065**	**1,091**	**4,765**	**9,966**
Outlays													
Defense	494	508	510	512	502	498	509	514	531	543	557	2,530	5,183
Nondefense	466	476	485	493	502	511	523	534	546	559	572	2,468	5,202
Total	**960**	**984**	**994**	**1,005**	**1,004**	**1,010**	**1,031**	**1,048**	**1,077**	**1,102**	**1,129**	**4,998**	**10,384**

Continued

of GDP to 3.3 percent each year between 1981 and 2001. As a share of total outlays, interest costs are projected to rise from 7.0 percent in 2004 to 9.7 percent in 2012.

The increase in interest payments is attributable to accumulating debt as well as the rising interest rates in CBO's economic forecast. Assuming that certain tax provisions expire as specified in current law, net interest costs begin to decline after 2012 as deficits revert to surpluses under the baseline; by 2015, net interest costs are projected to total $303 billion, or 1.5 percent of GDP—the same percentage as in 2005.

Interest costs in 2005 will total $178 billion, CBO estimates, $17 billion more than in 2004. Most of that increase is attributable to recent action by the Federal Reserve to raise short-term rates and to expected future in-

Table 3-10.

Continued

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
						Discretionary Resources Are Frozen at the 2004 Level							
Budget Authority													
Defense	421	421	421	421	421	421	421	421	421	421	421	2,106	4,211
Nondefense	419	418	418	418	420	417	417	416	416	415	415	2,091	4,169
Total	**840**	**839**	**839**	**839**	**841**	**838**	**838**	**837**	**837**	**836**	**836**	**4,196**	**8,381**
Outlays													
Defense	464	430	418	420	420	420	423	416	420	420	420	2,108	4,205
Nondefense	466	470	470	468	466	463	462	462	461	461	460	2,336	4,643
Total	**930**	**900**	**887**	**888**	**885**	**883**	**885**	**878**	**881**	**880**	**880**	**4,444**	**8,848**
Memorandum:													
Obligation Limitations in CBO's September 2004 Baseline	45	46	47	48	49	49	50	51	52	53	54	239	500

Source: Congressional Budget Office.

Note: Discretionary resources include 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).

creases in those rates during the year. Increased borrowing requirements to finance recent deficits will also boost net interest outlays in 2005.

The federal government's interest payments depend primarily 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 that governs spending and taxes and, thus, the extent of government borrowing. Interest rates are determined by market forces and the Federal Reserve's policies.

Interest outlays are also affected by the composition of debt held by the public. The average maturity of outstanding marketable debt has remained fairly constant since 1986, ranging from four years to six years. That stability, however, masks 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-quarter years in December 2000 to about four and a half years in September 2004. Currently, Treasury bills with a maturity of six months or less account for about 25 percent of all marketable debt (a similar proportion is assumed to continue throughout the 10-year projection period). Although such securities generally carry lower interest rates, they are riskier obligations for the Treasury than securities with longer-term maturities because their financing costs are subject to rapid fluctuations in interest rates.

The federal government has issued about $3.1 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, the interest paid on those securities has no net budgetary impact because it is credited to accounts elsewhere in the budget. In 2005, trust funds will be credited with $161 billion in interest, CBO estimates—mostly for the Social Security and Civil Service Retirement trust funds.

The $6 billion in other interest that CBO anticipates the government will receive in 2005 represents the net of certain interest payments and interest collections. On bal-

Table 3-11.

CBO's Baseline Projections of Federal Interest Outlays

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Interest on Public Debt (Gross interest)[a]	322	347	392	446	489	523	556	585	609	629	650	668	2,405	5,546
Interest Received by Trust Funds														
Social Security	-86	-91	-96	-106	-117	-129	-142	-156	-171	-186	-203	-219	-589	-1,524
Other trust funds[b]	-68	-70	-72	-77	-82	-86	-90	-94	-98	-103	-107	-113	-407	-921
Subtotal	-154	-161	-168	-183	-198	-215	-232	-250	-269	-289	-310	-332	-996	-2,446
Other Interest[c]	-4	-6	-10	-13	-15	-18	-20	-23	-25	-28	-31	-33	-76	-215
Other Investment Income[d]	-3	-2	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-5	-10
Total (Net interest)	**160**	**178**	**213**	**249**	**274**	**289**	**303**	**311**	**314**	**311**	**308**	**303**	**1,328**	**2,875**

Source: Congressional Budget Office.

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.

ance, 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, interest received from the financing accounts of credit programs, such as direct student loans, is one of the larger categories. Although other interest appears to increase rapidly through the projection period, almost all of that growth is attributable to interest on the accrued balances credited to the TRICARE For Life program. (Because those are considered intragovernmental payments, the net effect on interest outlays is zero.) In addition, CBO estimates that earnings from the Railroad Retirement Investment Trust in 2005 will total about $2 billion.

CHAPTER

4

The Revenue Outlook

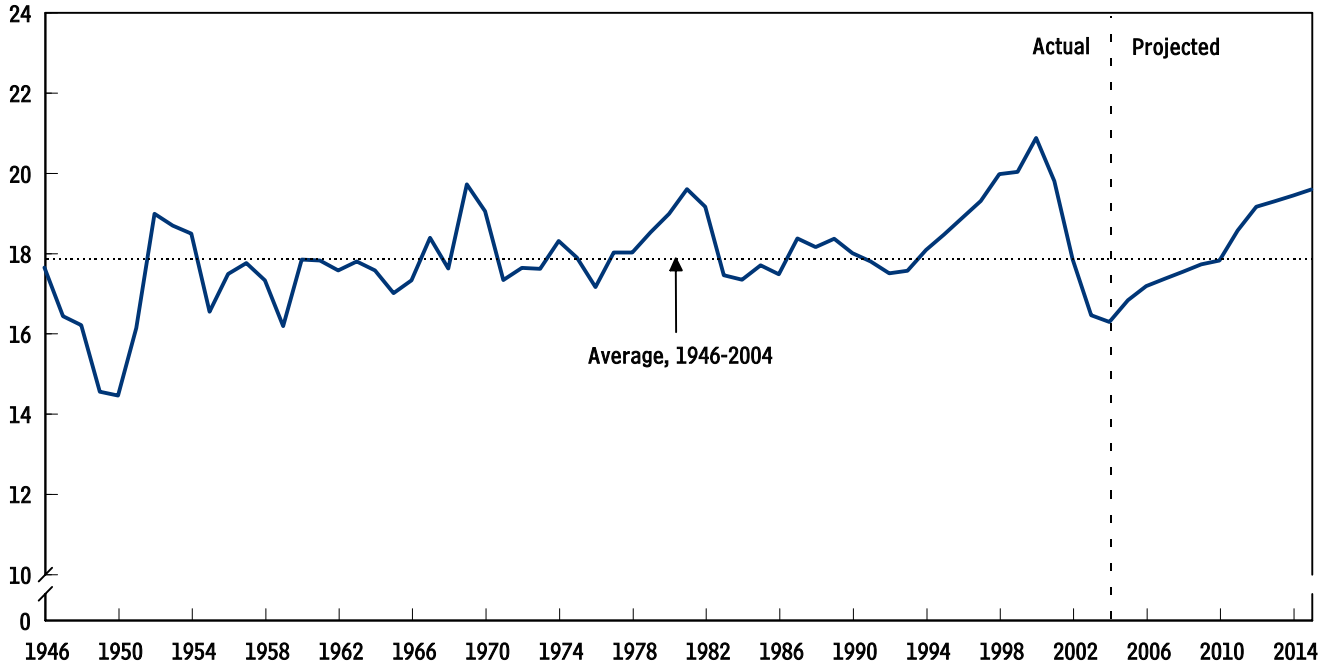
The Congressional Budget Office estimates that federal revenues will reach $2.1 trillion in 2005 if current policies remain the same. That amount is about 9 percent (or $177 billion) higher than revenues in 2004. As a share of gross domestic product, revenues are projected to rise from 16.3 percent in 2004 to 16.8 percent this year, below the postwar average of 17.9 percent but the first increase since 2000 (see Figure 4-1).

Over the following 10 years through 2015, receipts are expected to continue increasing, growing faster than GDP in every year (see Figure 4-2). That increase is driven partly by the structure of the tax system, which causes revenues to claim a higher fraction of income every year as income grows. An even larger part of the rise is concentrated in specific years, with the biggest jump in 2011, when various taxes are scheduled to increase under current law. By 2015, revenues are projected to reach 19.6 percent of GDP.

Figure 4-1.

Total Revenues as a Share of GDP, 1946 to 2015

(Percentage of GDP)

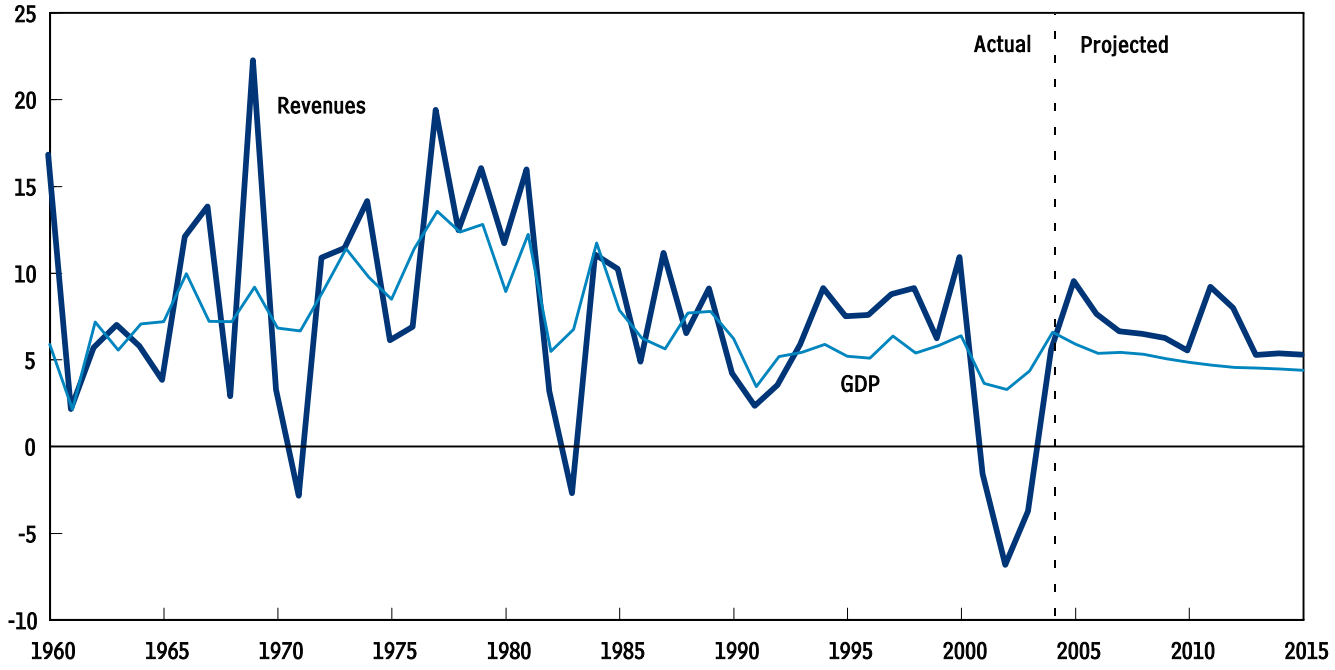


Source: Congressional Budget Office.

Figure 4-2.

Annual Growth of Federal Revenues and GDP, 1960 to 2015

(Percentage change from previous year)



Source: Congressional Budget Office.

CBO's current revenue projections are, on average, very close to those it published in September 2004. CBO is now projecting a total of $209 billion less in receipts for the 2005-2014 period—less than 1 percent of its projections last summer. Roughly three-fifths of that reduction stems from new legislation.

Revenues by Source

Federal revenues derive 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.

During the post-World War II period, corporate income and excise taxes have declined in importance and payroll taxes have become more significant. Since the early 1950s, corporate income and excise taxes together 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 revenues to more than one-third.

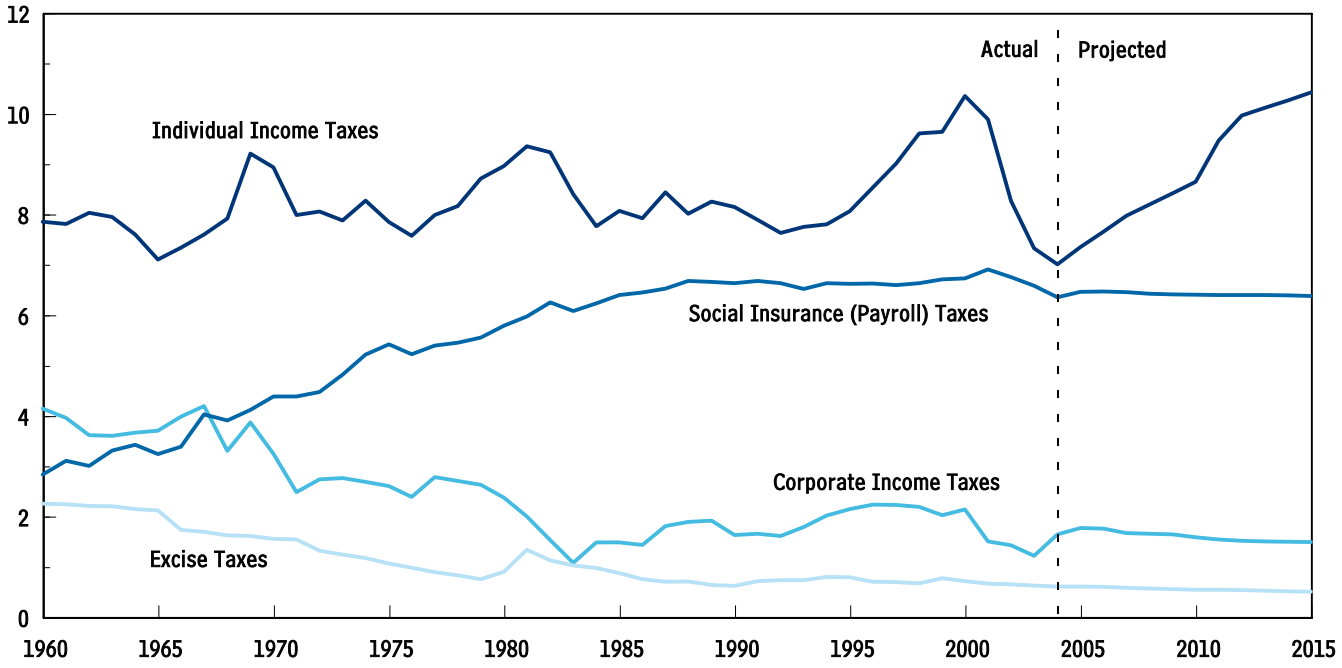
In 2004, receipts of individual income taxes equaled 7 percent of GDP—1 percentage point below their postwar average of 8 percent. The level of those receipts in 2004 was lower as a percentage of GDP than in any year since 1951. The level projected for 2005, although higher, is still unusually low by postwar standards.

Over the coming decade, the path of total receipts will be primarily driven by individual income taxes. Receipts from those taxes, measured relative to GDP, are projected to rise by 3.4 percentage points from 2004 to 2015, more than accounting for the projected increase of 3.3

Figure 4-3.

Revenues, by Source, as a Share of GDP, 1960 to 2015

(Percentage of GDP)



Source: Congressional Budget Office.

percentage points for total receipts relative to GDP over that period.

About half of the growth in individual receipts will result from changes in tax law including a lower alternative minimum tax (AMT) exemption beginning in 2006; higher tax rates on dividends and capital gains starting in 2009; and an increase in statutory tax rates, reduction in child credit amounts, contraction of joint filers' tax brackets, and other changes in 2011 that will increase taxes. The other half of the growth results from the structure of the tax code, which causes tax rates effectively to rise as income grows, and from other factors, such as a rapid increase in distributions from tax-deferred retirement accounts.

Other revenue sources will change somewhat during the baseline period but with little net effect over that decade. Corporate income taxes are also expected to grow in importance for the next few years as the investment incentives enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and the Job Creation and Worker Assistance Act of 2002 (JCWAA) expire. But after rising to 1.8 percent of GDP in 2005 and 2006, corporate income taxes are expected to slip back to their current levels and then below by 2009. Estate and gift taxes are expected to drop to historically low levels relative to GDP in 2010 and 2011 as a result of the phaseout of the estate tax and then regain their previous importance after the tax is reinstated in 2011. 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 tax revenues collected by the federal government. From the lowest ratio of revenues to GDP in nearly 50 years—16.3 percent in 2004—receipts in CBO's projection rise to 19.6 percent of GDP in 2015, a level matched or exceeded only a half-dozen times since 1945.

Revenue Projections in Detail

Individual Income Taxes

Individual income taxes account for most of the projected increase in revenues as a share of GDP over the next 10

Table 4-1.

CBO's Projections of Revenues

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
							In Billions of Dollars							
Individual Income Taxes	809	899	986	1,082	1,172	1,265	1,362	1,561	1,718	1,822	1,932	2,048	5,867	14,947
Corporate Income Taxes	189	216	226	226	237	246	249	254	261	270	281	292	1,184	2,542
Social Insurance Taxes	733	790	833	876	918	962	1,009	1,054	1,102	1,151	1,202	1,253	4,598	10,360
Excise Taxes	70	74	77	79	81	83	85	89	92	94	96	98	405	874
Estate and Gift Taxes	25	24	27	25	26	27	21	19	43	46	52	58	126	344
Customs Duties	21	21	23	25	27	28	29	30	31	33	35	37	133	299
Miscellaneous Receipts	33	34	39	44	47	50	52	54	56	58	60	62	231	521
Total	**1,880**	**2,057**	**2,212**	**2,357**	**2,508**	**2,662**	**2,806**	**3,062**	**3,303**	**3,474**	**3,657**	**3,847**	**12,545**	**29,888**
On-budget	1,345	1,484	1,607	1,719	1,836	1,956	2,066	2,288	2,494	2,629	2,775	2,928	9,184	22,297
Off-budget[a]	535	573	605	638	672	706	740	774	809	845	882	919	3,361	7,591
Memorandum:														
Gross Domestic Product	11,553	12,233	12,888	13,586	14,307	15,029	15,757	16,494	17,245	18,023	18,826	19,652	71,566	161,806
							As a Percentage of GDP							
Individual Income Taxes	7.0	7.3	7.7	8.0	8.2	8.4	8.6	9.5	10.0	10.1	10.3	10.4	8.2	9.2
Corporate Income Taxes	1.6	1.8	1.8	1.7	1.7	1.6	1.6	1.5	1.5	1.5	1.5	1.5	1.7	1.6
Social Insurance Taxes	6.3	6.5	6.5	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4
Excise Taxes	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.5
Estate and Gift Taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.3	0.3	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	**16.3**	**16.8**	**17.2**	**17.3**	**17.5**	**17.7**	**17.8**	**18.6**	**19.2**	**19.3**	**19.4**	**19.6**	**17.5**	**18.5**
On-budget	11.6	12.1	12.5	12.7	12.8	13.0	13.1	13.9	14.5	14.6	14.7	14.9	12.8	13.8
Off-budget[a]	4.6	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7	4.7

Source: Congressional Budget Office.

a. Social Security.

years (see Table 4-1). That is not surprising because they represent about half of all federal receipts and they were responsible for most of the movement in total receipts relative to the economy—first up, then down—over the past decade. Individual income tax receipts more than doubled in nominal dollars between 1992 and 2000, recording an average annual growth rate of nearly 10 percent and reaching a historical peak of 10.3 percent of GDP. Since then, individual income tax receipts have fallen as a share of GDP for four consecutive years, reaching 7.0 percent in 2004, their lowest level since 1951. The downturn in receipts resulted in large part from the substantial stock market decline of 2000 through 2002 and the 2001 recession; it was reinforced by the tax cuts enacted in several stages between 2001 and 2004. After the recession ended in late 2001, the slow pace of recovery in personal income held down growth in tax receipts. In 2004, receipts grew in dollar terms for the first time since 2000, but they remained nearly 20 percent below their dollar peak in 2000.

Because some of the factors that weakened revenues over the past four years are temporary, and because the design of the income tax system causes revenues to grow more strongly than output, CBO projects that individual income tax receipts will increase relative to GDP starting in 2005 and continue throughout the next 10 years. By 2008, receipts are projected to rise above their post-World War II average of 8.0 percent of GDP. The rise will become especially pronounced after 2010, following

Table 4-2.

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

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Individual Income Tax Receipts														
In billions of dollars	809	899	986	1,082	1,172	1,265	1,362	1,561	1,718	1,822	1,932	2,048	5,867	14,947
As a percentage of GDP	7.0	7.3	7.7	8.0	8.2	8.4	8.6	9.5	10.0	10.1	10.3	10.4	n.a.	n.a.
Annual growth rate	1.9	11.1	9.8	9.8	8.3	7.9	7.6	14.6	10.0	6.1	6.0	6.0	n.a.	n.a.
Taxable Personal Income														
In billions of dollars	7,676	8,132	8,610	9,128	9,646	10,132	10,625	11,126	11,633	12,152	12,689	13,243	48,141	108,984
As a percentage of GDP	66.4	66.5	66.8	67.2	67.4	67.4	67.4	67.5	67.5	67.4	67.4	67.4	n.a.	n.a.
Annual growth rate	4.6	5.9	5.9	6.0	5.7	5.0	4.9	4.7	4.6	4.5	4.4	4.4	n.a.	n.a.
Individual Receipts as a Percentage of Taxable Personal Income	10.5	11.0	11.5	11.9	12.1	12.5	12.8	14.0	14.8	15.0	15.2	15.5	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.

scheduled increases in statutory tax rates along with other changes in tax law. Individual income tax receipts are projected to reach 10.0 percent of GDP in 2012 and to hit a new historical peak of 10.4 percent of GDP in 2015.

Projecting Receipts in 2005. CBO projects that individual income tax receipts will grow by a strong 11 percent in 2005 (see Table 4-2). That growth in receipts is partly driven by CBO's projection that taxable personal income—as measured by the national income and product accounts—will grow by 5.9 percent in 2005, the largest increase since 2000. (Taxable personal income includes wages and salaries, dividends, interest, rent, and proprietors' income. See Box 4-1 for a description of taxable personal income and other components of various tax bases.) Although growth in receipts of individual income taxes typically exceeds growth in personal income by roughly a percentage point in an expanding economy (the phenomenon of "real bracket creep" described below), receipts growth in 2005 is expected to substantially outstrip growth in taxable personal income by more than 5 percentage points. That growth is expected to occur because of past legislative changes and strong increases in profits of S corporations, personal realizations of capital gains, and pension distributions.[1]

The implementation and expiration of tax provisions enacted in JCWAA and JGTRRA are projected to contribute about $30 billion, or 3.5 percentage points, to revenue growth in 2005. First, the partial-expensing provision, which was first enacted in JCWAA in 2002 and then expanded a year later in JGTRRA, expired at the end of calendar year 2004. The provision allowed businesses to reduce taxes by taking an additional first-year depreciation deduction of 50 percent of qualifying fixed investments, with the rest of the investment depreciated under normal rules, effectively backloading tax liability. As a result, taxes generated by business activity were reduced in 2004 and increased in 2005. Although most of the provision's effect is on corporate receipts, a substantial share of qualifying investments are made by S corporations, partnerships, and sole proprietorships, which are all taxed under the individual income tax.

1. S corporations are domestically owned corporations with no more than 100 shareholders that elect to be taxed like partnerships. An S corporation is exempt from the corporate income tax, but its owners pay income taxes on all of the firm's income, even if the income is retained by the firm.

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 individual and corporate income taxes and for social insurance taxes are related to GDP, they differ from it 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. That measure, referred to here as **taxable personal income**, excludes depreciation, taxes on businesses (such as corporate income and excise taxes), retained corporate profits, and employees' fringe benefits that are not received by individuals in taxable form.

That income measure must be narrowed further to obtain the tax base of the income tax. Some of that 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. Such income is 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 statutory marginal 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 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**.

Second, the timing of the cuts in individual income taxes enacted in JGTRRA caused a bunching of revenue losses in 2004. JGTRRA was enacted in May 2003, and its provisions were generally made effective as of January 1 of that year. Reduced withholding rates consistent with the new law went into effect shortly after enactment, but the new rates applied only to income earned after the change. Taxpayers who earned income before the withholding rates were changed saw a reduction in their tax liabilities that was not matched by reductions in withholding (unless they acted on their own to reduce their withholding). It appears that relatively few taxpayers took such actions,

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 generates little revenue 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. If the loss is carried forward, it is called a "carryforward deduction." 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 total domestic corporate taxes to total 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.

so when taxpayers filed their tax returns in the spring of 2004, refunds were boosted and final payments were smaller than would otherwise have been the case. That overwithholding effect was moderated by advance refunds of the increased child tax credit, which were distributed in the summer of 2003 (a phenomenon not repeated in 2004). Nonetheless, the net effect is believed to be relatively low receipts in 2004, causing this year's growth to be higher than it otherwise would be.

CBO projects that profits of S corporations are growing substantially faster than taxable personal income as mea-

sured in the national income accounts. That growth, coupled with similarly more rapid growth in capital gains realizations by individuals and distributions from pensions and individual retirement accounts (IRAs), will boost receipts in 2005 by about $15 billion, or almost 2 percentage points, relative to what receipts would be if those types of income grew at the same rate as taxable personal income. CBO projects that in tax year 2004, S corporation profits, capital gains realizations, and retirement distributions all increased in excess of 10 percent, boosting tax liabilities in that year and contributing to a strong increase in final payments that is expected when tax returns for that year are filed in 2005.

Projected growth in individual income tax receipts is reduced by about $10 billion, or more than 1 percentage point, to reflect changes to the official accounting for individual income and social insurance receipts for 2004. When payroll tax receipts are remitted to the Treasury, they are not distinguished from income tax withholding. The Treasury estimates the appropriate division and corrects any resulting error in later years. In 2004, the Treasury lowered social insurance receipts in the official data by about $10 billion and raised individual income taxes by the same amount to correct previous years' misestimates.[2] In producing its estimate for the level of receipts in 2005, CBO estimates actual receipts for 2004 before the Treasury makes its final determination. In CBO's history and forecast for social insurance receipts, the opposite effect occurs, so overall receipts are not affected.[3]

Projecting Receipts Beyond 2005. From 2006 through 2015, CBO's projected pattern of revenues reflects steady growth in personal income punctuated by changes in tax law scheduled to take place in specific years. Wage and salary income is expected to rise slightly faster than GDP through 2009, with its growth held down by an increased share of overall labor compensation expected to be paid in the form of health insurance benefits and contributions to pension plans. Taxable personal income is also expected to grow slightly faster than GDP in each year through 2012. Receipts are expected to continue to rise faster than either GDP or taxable personal income in every year because of three major factors.

First, changes in tax law—principally those enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001(EGTRRA) and JGTRRA—will alter the pattern of growth in receipts. As a result of legislation enacted in 2004, fewer provisions of tax law are now scheduled to change in the future than was the case under prior law. What remain of the scheduled changes are principally ones that cause taxes to increase. The alternative minimum tax (AMT) exemption is reduced in tax year 2006 from the value it has in tax years 2003 through 2005. That causes a significant jump in projected taxes in fiscal years 2006 and 2007. Tax rates on dividends and capital gains rise in 2009, returning to the rates that existed before 2003 and thus increasing receipts. And most important, taxes increase sharply in 2011 when various changes in law are scheduled to occur: statutory tax rates rise, the child tax credit amount declines, joint filers' tax brackets contract, and other changes take place. Only the phase-out of restrictions on itemized deductions and personal exemptions for high-income taxpayers during tax years 2006 to 2010 tends to reduce the growth of individual income tax receipts.

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 generated in part by the phenomenon known as real bracket creep, in which the overall growth of real income causes more income to be taxed in higher tax brackets. In addition, the AMT—which is not indexed for inflation—will affect an increasing number of 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 on page 86.) 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, thus reducing taxable income in earlier years. Now, as more retirees take distributions from those accounts, the accu-

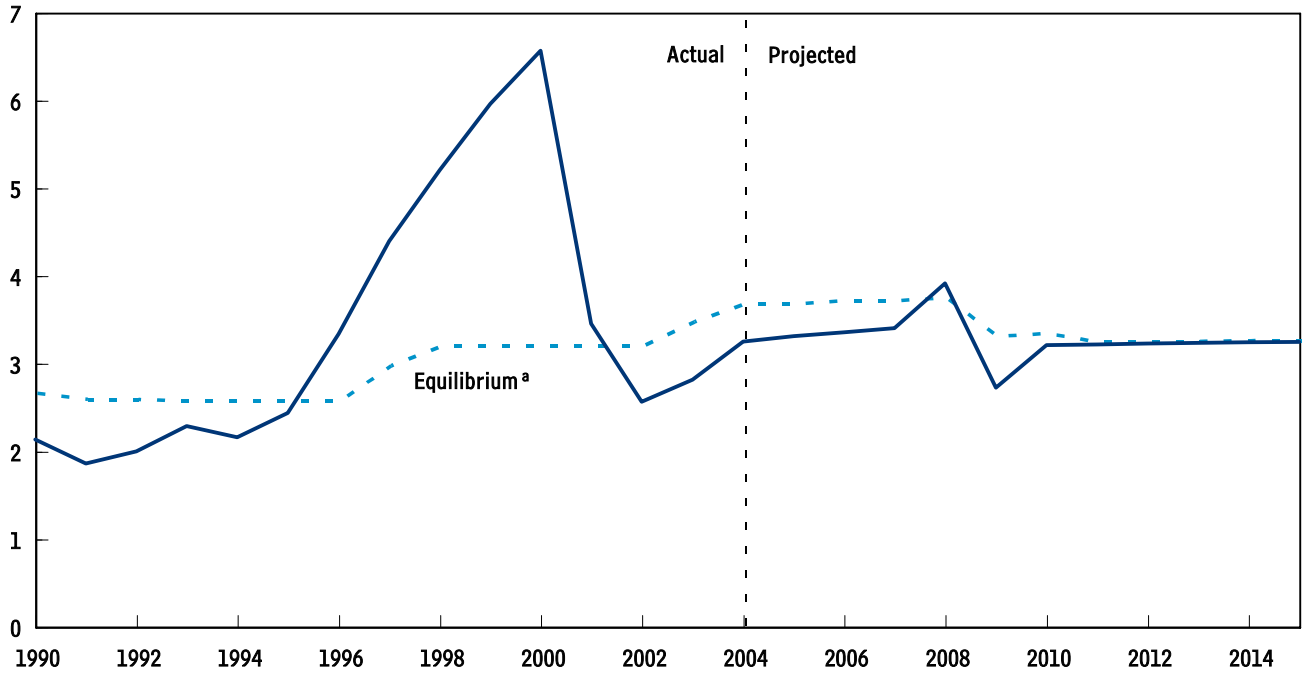
2. The Treasury Department uses that procedure rather than revising the official measures of receipts for the years before 2004 to which the misestimates applied.

3. CBO reports the official historical data in its tables, thus showing a reduced growth rate for receipts of individual income taxes and an increased growth rate for receipts of social insurance taxes in 2005. The growth rate of total receipts for 2005 is not affected.

Figure 4-4.

Capital Gains Realizations as a Share of GDP, Calendar Years 1990 to 2015

(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.

mulations become taxable, thereby increasing tax receipts relative to GDP.[4]

Finally, CBO projects that realizations of capital gains will exert a positive effect on receipts relative to income (see Table 4-3). According to CBO's forecast for 2004, capital gains have not quite recovered to their average level relative to the size of the economy after their plunge between 2000 and 2002. CBO assumes that capital gains will tend to return to a level consistent with their historical relationship to GDP, as they have in the past. As a result, CBO's projection of gains grows moderately faster than GDP through 2007 as gains approach their average, or equilibrium (see Figure 4-4). Receipts grow in step with gains. The scheduled return to higher capital gains tax rates in 2009 is likely to encourage taxpayers to speed up the sale of assets with gains from that year to late 2008 and depress realizations thereafter. CBO projects that by 2012, realizations of capital gains will have roughly reached their equilibrium relative to output and then grow with output through 2015. Overall, the positive effect of capital gains on projected revenue growth over the next decade is modest—much less than their significant contributions to receipts in recent years.

Changes Since September 2004. Compared with the projections it made last September, CBO has reduced its projection of individual income tax receipts by $24 billion for 2005 and by an additional $160 billion for the 2006-2014 period. Legislative changes, mainly from enactment of the Working Families Tax Relief Act of 2004 (WFTRA), caused CBO to reduce its projection of revenues by $126 billion over the full 10-year period, with $103 billion of that amount occurring for 2005 through 2008. CBO reduced its projection of revenues by $11 billion for 2005 through 2007 as a result of slightly lower projected growth in the near term in GDP and personal

4. See Congressional Budget Office, *Tax-Deferred Retirement Savings in Long-Term Revenue Projections* (May 2004).

Table 4-3.

Actual and Projected Capital Gains Realizations and Taxes

	Capital Gains Realizations[a]		Capital Gains Tax Liabilities[a]		Capital Gains Tax Receipts[b]		Capital Gains Tax Receipts as a Percentage of Individual Income Tax Receipts
	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	
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	*	36	*	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	269	-23	49	-26	58	-41	6.8
2003	310	15	47	-4	51	-13	6.4
2004	381	23	54	14	48	-7	5.9
2005	410	8	58	8	56	17	6.2
2006	438	7	63	8	60	8	6.1
2007	468	7	67	7	65	7	6.0
2008	567	21	81	20	69	6	5.9
2009	414	-27	74	-8	82	20	6.5
2010	511	24	95	28	84	2	6.1
2011	537	5	100	5	97	16	6.2
2012	562	5	104	5	102	5	5.9
2013	589	5	109	5	106	5	5.8
2014	617	5	114	5	111	5	5.8
2015	645	5	120	5	117	5	5.7

Source: Congressional Budget Office.

Notes: 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 on realizations and liabilities before 2001 are estimated by the Treasury Department.

*= less than 0.5 percent.

a. Calendar year basis.

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

Table 4-4.

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

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Social Insurance Tax Receipts														
In billions of dollars	733	790	833	876	918	962	1,009	1,054	1,102	1,151	1,202	1,253	4,598	10,360
As a percentage of GDP	6.3	6.5	6.5	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	n.a.	n.a.
Annual growth rate	2.9	7.7	5.5	5.1	4.8	4.8	4.8	4.5	4.6	4.4	4.4	4.2	n.a.	n.a.
Wages and Salaries														
In billions of dollars	5,279	5,584	5,900	6,225	6,562	6,898	7,233	7,570	7,912	8,265	8,629	9,002	32,818	74,197
As a percentage of GDP	45.7	45.7	45.8	45.8	45.9	45.9	45.9	45.9	45.9	45.9	45.8	45.8	n.a.	n.a.
Annual growth rate	4.5	5.8	5.6	5.5	5.4	5.1	4.9	4.7	4.5	4.5	4.4	4.3	n.a.	n.a.
Social Insurance Tax Receipts as a Percentage of Wages and Salaries	13.9	14.1	14.1	14.1	14.0	14.0	13.9	13.9	13.9	13.9	13.9	13.9	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.

income, and increased its projection of receipts by $119 billion for the 2008-2014 period as assumed faster GDP growth eventually pushes personal income above the amounts projected in September. In addition, CBO raised its projection of receipts by $6 billion for 2005 and reduced its projection by $171 billion for the 2006-2014 period as a result of technical factors that affect the revenue yield for a given economic projection of income, with $159 billion of that reduction occurring after 2009.

The downward technical revisions in the second half of the projection period reflect new information from tax returns and new estimates of the effects of asset accumulations in IRAs and 401(k)s. Individual income tax returns filed for tax year 2002 indicate that personal income, especially wages and salaries and interest income, was lower than CBO had expected on the basis of growth in comparable measures from the national income and product accounts. CBO has incorporated a portion of that weakness into its long-term projection by reducing taxable income relative to comparable measures in the economic projection. In addition, CBO has reduced its projection of the share of overall interest and dividend income that is earned in taxable accounts.

Those lower estimates are considered to be more consistent with CBO's projection for earnings in tax-deferred 401(k) and IRA accounts, which are expected to accumulate rapidly over the projection period. Total revenue reductions from the new tax return data and new estimates of the effects of asset accumulation are partially offset through 2009 by reductions in the estimated loss in revenues from the reduced rates of taxation on dividends. Those reduced rates were enacted in JGTRRA and apply through December 31, 2008.

Social Insurance Taxes

In CBO's projections, revenues from social insurance taxes claim a roughly constant share of GDP, remaining between 6.4 percent and 6.5 percent of GDP from 2005 through 2015 (see Table 4-4). In relation to wages and salaries—the approximate base of those payroll taxes—revenues are projected to decline somewhat, from 14.1 percent in 2005 to 13.9 percent by 2015, as a result of relatively slower growth in receipts from unemployment taxes, declines in the share of earnings below the taxable maximum amount for Social Security, and declines in revenues for other federal retirement programs.

The largest components of payroll tax receipts are taxes for Social Security (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

Box 4-2.

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

With each passing year, the alternative minimum tax (AMT) plays a larger role in the Congressional Budget Office's (CBO's) revenue projections. Revenue effects from recent changes in tax law combined with the growing number of taxpayers qualifying for the AMT have enhanced the AMT's contribution to overall revenue collection. Additional revenue from the AMT is one reason that CBO projects receipts to grow relative to gross domestic product (GDP) over the next 10 years.

Characteristics of the AMT

The AMT is a parallel income tax system with fewer exemptions, deductions, and rates than the regular income tax. The Congress enacted the AMT to prevent high-income taxpayers from taking advantage of the tax code by using the various preferences in the regular tax code that favor certain activities by taxing the income associated with them at a lower rate. Preferences not allowed under the AMT include personal exemptions and the standard deduction. Thus, the AMT reaches some taxpayers, not ordinarily thought to be exploiting "loopholes," who might otherwise avoid taxation of their high income. 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.

For example, in tax year 2006, a married taxpayer with three children who earned $90,000 and reported a typical set of deductions would be required to calculate taxes under both the AMT and the regular income tax. In this case, the taxpayer's liability would be higher under the AMT.

The AMT's Growing Importance to Revenues

Because of the nominal income growth reflected by inflation and the effects of recent tax cuts, the AMT is growing in terms of both the number of qualifying taxpayers and the tax's share of total revenues.

As inflation boosts nominal income, more taxpayers are becoming subject to the minimum tax.[1] 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. So as incomes rise with inflation, a larger number of taxpayers find themselves subject to the AMT each year.

Laws enacted over the past four years—the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), as modified by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) and the Working Families Tax Relief Act of 2004 (WFTRA)—have cut taxpayer liability and will add to the number of qualifying AMT taxpayers. Although the tax cuts still reduce overall taxpayer liability, many people will find themselves pushed into the AMT system. By cutting tax rates under the regular tax, EGTRRA, JGTRRA, and WFTRA have reduced regular tax receipts and therefore enlarged the AMT's share and consequently its importance to total individual income tax revenues.

1. Real (inflation-adjusted) growth in income can also subject additional taxpayers to the AMT, but its effects are much smaller.

contributions to other federal retirement programs (see Table 4-5).

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.

Box 4-2.

Continued

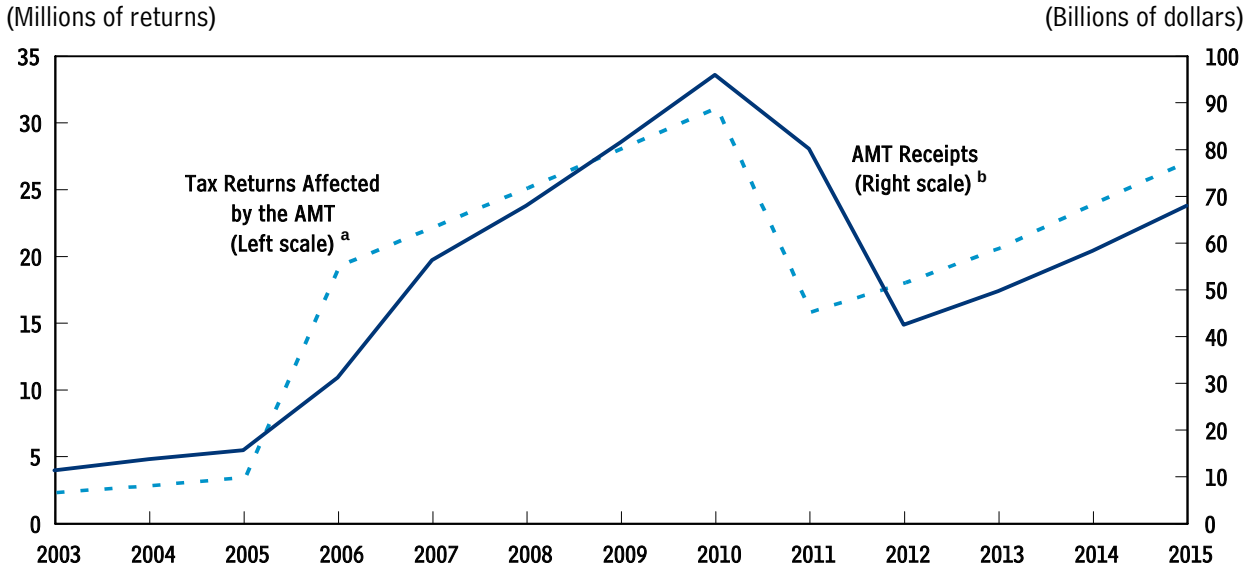
The AMT's Impact in the Next 10 Years

By 2015, the number of AMT qualifiers is expected to reach 27 million, providing approximately $68 billion in revenues (see the figure below). Compared with fiscal year 2004, AMT contributions to individual income tax receipts are expected to almost double by 2015, rising from 1.7 percent of those receipts to 3.3 percent.

During those years, AMT projections rise and fall largely because of the phasing in and out of changes in tax law enacted in EGTRRA, JGTRRA, and WFTRA. For example, WFTRA expands the amount of income exempted under the AMT through 2005. When that provision ends, the number of returns subject to the AMT is expected to rise, jumping from 4 million returns in 2005 to 19 million the following year. As a result, AMT revenues are projected to increase from $15 billion in fiscal year 2005 to $31 billion in 2006.

In 2011, when statutory tax rates are scheduled to increase under the regular income tax and other law changes occur, the number of AMT returns is projected to decline, dropping from 31 million in 2010 to 16 million. Projected revenues from the AMT decline from $96 billion in fiscal year 2010 to $80 billion in 2011 and $42 billion in 2012. Similarly, the AMT's share of total income tax revenues drops from 7.0 percent in 2010 to 5.1 percent in 2011 and 2.5 percent in 2012. After 2012, the dip in AMT receipts because of increases in regular taxes starts to reverse. As inflation pushes more taxpayers to qualify for the AMT, receipts begin climbing again, so that by the end of the 10-year span, AMT revenues are more than four times higher than revenues in fiscal year 2005.

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.

Table 4-5.

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

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Social Security	535	573	605	638	672	706	740	774	809	845	882	919	3,361	7,591
Medicare	151	164	174	183	193	203	214	224	234	245	256	267	967	2,192
Unemployment Insurance	39	44	47	47	45	45	47	49	52	54	57	60	232	504
Railroad Retirement	4	4	4	4	4	4	4	4	4	4	4	5	20	42
Other Retirement	5	4	4	4	4	4	3	3	3	3	3	2	19	32
Total	733	790	833	876	918	962	1,009	1,054	1,102	1,151	1,202	1,253	4,598	10,360

Source: Congressional Budget Office.

CBO projects that social insurance tax receipts will increase slightly relative to GDP in 2005. That increase primarily reflects changes in the accounting for individual income tax and social insurance receipts, as in the analysis of income tax receipts discussed above. In producing its estimate for the level of receipts in 2005, CBO estimates actual receipts for 2004 before the Treasury makes its final determination. In CBO's history and forecast for individual income tax receipts, the opposite effect occurs, so overall receipts are not affected. The increase in payroll tax receipts in 2005 is augmented by other factors, notably an anticipated increase in state unemployment taxes as states replenish their trust funds following the outflow of funds for unemployment benefits during the 2001 recession.

From 2005 onward, payroll tax receipts are expected to decline very gradually as a fraction of both wages and GDP for three reasons: states will largely finish replenishing their unemployment trust funds this year, 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. Another factor offsets a portion of the decline: CBO expects that wages and salaries as a share of GDP will rise slightly from 2006 through 2010, boosting social insurance receipts relative to GDP.

Compared with its projections last September, CBO is now estimating about $59 billion more in social insurance tax receipts for the 2005-2014 period. Changes in CBO's economic forecast—mainly higher projections of nominal wages and salaries in the later years—account for $60 billion of that change. Reestimates because of technical factors and recent legislation were very small.

Corporate Income Taxes

Receipts from corporate income taxes—like those from individual income taxes—rose relative to the size of the economy in the 1990s and then fell sharply between 2000 and 2002. Corporate receipts peaked at about 2.2 percent of GDP for the 1996-1998 period, earlier than the peak for individual income taxes, and then dipped just slightly by 2000 to 2.1 percent of GDP. The recession in 2001 reduced profits and revenues substantially, and business tax incentives enacted in the Job Creation and Worker Assistance Act of 2002 (JCWAA) reinforced the revenue decline. Corporate tax revenues as a share of GDP fell sharply—to 1.7 percent of GDP in 2001 and 1.2 percent in 2002 (adjusted to account for legislative shifts in the timing of collections). A second round of business tax cuts was enacted in 2003 in JGTRRA. But profits began rebounding strongly that year, so the net effect was a slight uptick in receipts as a share of GDP in 2003 (to 1.3 percent). In 2004, profits grew strongly and revenue rose to 1.6 percent of GDP. CBO projects that with the expiration of business tax incentives, corporate tax revenues will rise in the near term and peak at about 1.8 percent of GDP in 2005 and 2006, followed by a gradual decline to 1.5 percent of GDP in 2011 and thereafter (see Table 4-6).

Table 4-6.

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

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Corporate Income Tax Receipts														
In billions of dollars	189	216	226	226	237	246	249	254	261	270	281	292	1,184	2,542
As a percentage of GDP	1.6	1.8	1.8	1.7	1.7	1.6	1.6	1.5	1.5	1.5	1.5	1.5	n.a.	n.a.
Annual growth rate	43.7	14.0	4.9	-0.2	4.7	4.2	1.0	2.0	2.9	3.5	3.9	3.8	n.a.	n.a.
Corporate Book Profits														
In billions of dollars	970	1,257	1,247	1,223	1,264	1,311	1,342	1,378	1,426	1,483	1,549	1,614	6,387	13,837
As a percentage of GDP	8.4	10.3	9.7	9.0	8.8	8.7	8.5	8.4	8.3	8.2	8.2	8.2	n.a.	n.a.
Annual growth rate	15.9	29.6	-0.8	-1.9	3.3	3.8	2.4	2.7	3.5	4.0	4.5	4.2	n.a.	n.a.
Taxable Corporate Profits[a]														
In billions of dollars	601	879	868	836	857	885	899	918	947	982	1,024	1,064	4,345	9,280
As a percentage of GDP	5.2	7.2	6.7	6.1	6.0	5.9	5.7	5.6	5.5	5.4	5.4	5.4	n.a.	n.a.
Annual growth rate	14.3	46.1	-1.2	-3.7	2.6	3.3	1.6	2.1	3.1	3.7	4.3	3.8	n.a.	n.a.
Corporate Receipts as a Percentage of Taxable Profits	31.5	24.6	26.1	27.0	27.6	27.8	27.7	27.7	27.6	27.5	27.4	27.4	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.

The business tax cuts enacted in 2002 and 2003 have had a substantial effect on recent corporate tax liabilities and receipts. JCWAA allowed firms to expense (immediately deduct from taxable income) 30 percent of their investment in equipment made between September 11, 2001, and September 10, 2004. (See Box 4-3 for more details.) In addition, JCWAA allowed firms to use losses generated in 2001 and 2002 to obtain greater refunds of previous taxes paid. JGTRRA increased the partial-expensing allowance from 30 percent to 50 percent and allowed partial expensing to be extended slightly longer, until the end of calendar year 2004. Over the past three years, those changes in JCWAA and JGTRRA reduced taxable corporate profits and tax payments and increased corporate refunds, thereby reducing net corporate tax receipts.

CBO's projection of corporate tax receipts depends critically on its projection of book profits. The national income and product accounts measure book profits (called "profits before tax") by assuming that depreciation deductions generally follow the rules prescribed in tax law. For that and other reasons, book profits are the measure in the national income and product accounts that most closely approximates the tax base for the corporate income tax (see Box 4-1 on page 80). CBO makes certain adjustments to book profits to generate a closer approximation to the tax base, called "taxable corporate profits."

Book profits will jump by 30 percent in 2005, CBO projects, and taxable corporate profits will surge by 46 percent, contributing to an increase in corporate receipts of 14 percent this year. That increase is predominantly a result of the expiration of the partial-expensing provision at the end of 2004. The immediate effect of accelerated depreciation is increased deductions and reduced pro-

Box 4-3.

Special Factors in the Projections for Corporate Profits and Receipts

Two special factors, the expiration of the partial-expensing provision and substantial employer contributions to defined-benefit pension plans, cause significant fluctuations in the outlook for corporate profits and receipts over the next several years. Forecasts of profits are always subject to much uncertainty because profits vary widely during the business cycle. Because uncertainty also exists about those special factors, the Congressional Budget Office (CBO) considers the overall uncertainty surrounding the projections for corporate profits and receipts to be magnified.

Partial Expensing

Partial expensing is a method of capital-cost recovery that allows firms to deduct immediately from taxable income a portion of their investments in qualifying fixed assets. The Job Creation and Worker Assistance Act of 2002 instituted partial expensing for business equipment and software investment undertaken between September 11, 2001, and September 10, 2004. It allowed an additional first-year deduction against income of 30 percent of the value of the asset, with normal depreciation rules applying to the remaining 70 percent—a part of which would also be depreciated in the first year. The Jobs and Growth Tax Relief Reconciliation Act of 2003 increased the additional first-year deduction to 50 percent and extended the expiration date to investments undertaken by December 31, 2004. Normal depreciation rules are typically those prescribed by the Modified Accelerated Cost Recovery System established in 1986, which provide accelerated depreciation (generally twice the straight-line rate) over an assumed asset lifetime that is generally shorter than the true lifetime. Full expensing would allow all of the asset's value to be depreciated in the first year and none thereafter; hence, the term "partial expensing" applies to the provision that was enacted.

Although the partial-expensing provision is referred to as "bonus depreciation" in the tax code, it is not a "bonus" in the usual sense of the term. The provision allows depreciation deductions to be taken earlier than otherwise, but the same amount of depreciation deductions—generally the purchase price of the asset—is allowed over the lifetime of the asset. Nonetheless, up-front deductions are more valuable than later deductions because they result in an immediate reduction in taxes and corresponding increase in after-tax profits, which can be invested and over time earn a return. As a result, most firms with qualifying assets would elect to partially expense them.

The combination of the front-loading of deductions and the expiration of the provision causes expected

fits—with the reverse effect in later years. Combined with the sharp increase in depreciation deductions in 2004, the swing in depreciation deductions from the partial-expensing provision accounts for almost three-quarters of the projected $287 billion growth in book profits in 2005.

CBO expects that corporate receipts in 2005 will climb more slowly than profits, thereby pushing down corporate receipts as a percentage of taxable profits. The slower growth in receipts occurs partly because tax payments typically lag slightly behind the earning of profits. In addition, greater deductions for net-operating-loss carryforwards—by firms that had negative profits (losses) in recent years—are expected to slow the growth in the corporate tax base and receipts relative to taxable profits. The decline in corporate receipts as a percentage of taxable profits also reflects provisions of the American Jobs Creation Act of 2004 (AJCA) and WFTRA that are expected to reduce corporate receipts in 2005. AJCA repealed the exclusion for a portion of income earned by exporters (so-called extraterritorial income), allowed a deduction for income attributable to production in the United States, and altered numerous other tax provisions for both domestic and foreign corporations. Finally, corporate receipts in 2004 were higher than indicated by CBO's estimates and the most recent information on

Box 4-3.

Continued

depreciation deductions to plummet in calendar year 2005, boosting corporate profits and receipts.[1] First, for partially expensed assets, fewer deductions will typically be available in 2005. In addition, starting in 2005, firms will no longer be able to use the partial-expensing provision and must revert to using the normal rules. Because most equipment investment is depreciated over a five- or seven-year lifetime, the net effect of the provision is that it takes seven years before depreciation deductions roughly return to the level that would have existed without enactment of partial expensing. In the intervening years, depreciation deductions will be lower—and profits correspondingly higher—than they would have been if partial expensing had not been instituted, with the amount diminishing over time starting in 2007.

Because it has already expired and is not a provision that has ever been extended retroactively, partial expensing is not included in CBO's list of expiring tax provisions (see Tables1-3 and 4-10).

1. Individual income and tax receipts are also affected because the partial-expensing provision may be used by partnerships, sole proprietorships, and S corporations, all of which are taxed under the individual income tax.

Employers' Contributions to Defined-Benefit Plans

Largely as a result of the stock market decline that began in 2000 and the recession of 2001, many pension plans that pay a defined benefit have become underfunded. CBO expects that employers will need to make significant contributions to such plans in coming years. Because the contributions that employers make to their defined-benefit plans are a deductible business expense when computing profits, those contributions will be a drag on profit growth.

The Job Creation and Worker Assistance Act allowed firms to reduce their required payments to defined-benefit plans through 2003, and the Pension Funding Equity Act of 2004 generally extended that relief through 2005 (see Appendix D for a more complete discussion). CBO's baseline is required to assume that no further law changes are enacted; therefore, CBO assumes that in 2006, firms will be required to make very large contributions to their plans, which will depress profits. After 2006, contributions are expected to retreat to more normal levels as many firms eliminate their pension-funding shortfalls. Although CBO expects that factor to reduce profit growth substantially in 2006, the reduction is offset in part that year by an increase in profit growth from the partial-expensing provision.

profits, and in CBO's projection, that unexplained strength phases out quickly.

Beyond 2005, CBO's projection for receipts closely follows its profits forecast, which is heavily influenced by assumptions about depreciation deductions and contributions to underfunded pension plans. CBO projects that book and taxable profits will both fall slightly in 2006 and 2007 and then average more than 3 percent growth annually through 2015. Profits are expected to decline as a share of GDP after 2005. In 2006, CBO expects a large increase in employers' contributions to underfunded defined-benefit plans, which will reduce profits (see Appendix D). In the longer term, CBO projects that strong recovery in business fixed investment will increase depreciation deductions and reduce corporate profits relative to GDP during the projection period. Expiration of partial expensing also will contribute to the decline in profits relative to GDP after 2006 by decreasing depreciation deductions and thereby boosting profits—mostly in 2006 and by shrinking amounts thereafter.

CBO projects that corporate receipts will climb in 2006, despite a decline in profits, because of the delayed effect of the partial-expensing expiration. CBO expects receipts to be roughly stable in 2007 and to grow by an average 3.2 percent annually through 2015. Corporate tax

Table 4-7.

CBO's Projections of Excise Tax Receipts, by Category

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Highway Taxes	35	37	39	40	42	43	44	47	48	49	51	52	207	454
Airport Taxes	10	11	11	12	13	13	14	15	15	16	17	18	63	143
Telephone Taxes	6	6	6	6	7	7	7	7	7	7	7	7	32	68
Alcohol Taxes	8	8	9	9	9	9	9	9	9	10	10	10	45	93
Tobacco Taxes	8	9	9	9	9	9	9	9	9	9	9	9	45	91
Other Excise Taxes	2	2	3	2	2	2	3	3	3	3	3	3	12	25
Total	70	74	77	79	81	83	85	89	92	94	96	98	405	874

Source: Congressional Budget Office.

receipts are projected to peak at 1.8 percent of GDP in 2005 and 2006 and then decline to about 1.5 percent of GDP by 2015.

The new outlook for corporate receipts is smaller by about $124 billion over the 2005-2014 period than CBO's projection from September 2004. About $100 billion of the decrease reflects changes in the economic projection. CBO has lowered its projection for profits, especially in the first half of the projection period. Legislative changes account for an additional $30 billion drop in the estimate for corporate receipts. About two-thirds of that comes from enactment of AJCA. The rest comes from enactment of WFTRA, mainly through extending the research and experimentation tax credit through 2005. Minimal technical reestimates raised receipts by $5 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 2004 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 4-7). 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 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 2015.

CBO's current projection of total excise tax receipts for the next 10 years is about $25 billion higher than the projection it published in September. Changes in CBO's economic forecast have increased projected receipts by $5 billion over the 2005-2014 period, but technical adjustments to the baseline have decreased them by $8 billion. The technical decreases reflect lower recent receipts from gasoline taxes as well as the growing share of lower-taxed ethanol blends in motor-fuel consumption.

The most significant change in CBO's projection of excise tax receipts over the 2005-2014 period comes from enactment of AJCA, which has increased that projection by $27 billion. About $10 billion of the increase results from new assessments on manufacturers of tobacco products—effectively raising taxes on such products—to fund an equal amount of direct payments to domestic tobacco growers and owners of the rights to produce and market specific amounts of tobacco. About $8 billion of the added revenue comes from the scheduled elimination of the tax subsidy associated with ethanol-blended fuels after calendar year 2010. The subsidy had been scheduled to expire under prior law, but in previous baselines CBO had assumed that the subsidy would be extended under baseline rules governing expiring excise taxes dedicated to trust funds. Now that AJCA provides for the subsidy to be paid out of the general fund, baseline rules require

CBO to assume that the subsidy will expire as scheduled. The remaining increase in projected excise tax receipts, about $9 billion from 2005 to 2014, comes from compliance initiatives in AJCA. Most of those initiatives are associated with provisions intended to reduce evasion of fuel taxes, such as modifying the point of taxation for aviation fuel, altering the tax rates on heavy vehicles, and imposing fines on unregistered transporters of taxable fuels.

AJCA also affected trust fund revenues in ways that do not affect overall excise tax receipts. As a result of the law, revenues dedicated to the Highway Trust Fund will be higher by an estimated $31.5 billion over the 2005-2014 period, and general fund revenues will be correspondingly lower. That change stems mostly from provisions in AJCA that require trust fund accounting to apply all tax credits on ethanol-blended fuels (which reduce revenue) to the general fund rather than to the Highway Trust Fund.

Estate and Gift Taxes

Under current law, receipts from estate and gift taxes change in importance over the first half of CBO's 10-year projection period: their share of GDP is forecast to decline from 0.2 percent in 2004 to 0.1 percent in 2010 and 2011 before jumping back to 0.2 percent of GDP in 2012 and 0.3 percent of GDP thereafter through 2015. That pattern results from the phaseout of the estate tax through 2010 under EGTRRA and the subsequent reinstatement of the tax in 2011.

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 has changed dramatically. The estate tax is gradually being eliminated, and 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 two 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 in 2007 and then eliminate the tax in 2010. The law is currently set to reinstate the estate tax in 2011. 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 4-8). CBO estimates that after 2011, those receipts will return to roughly their 2002 share of GDP.

Since September, CBO has raised its projections of estate and gift receipts over the 2005-2014 period by $14 billion. About half of that increase results from changes in CBO's economic forecast and about half from technical reestimates. The technical reestimates stem largely from the stronger-than-expected stock market in the second half of calendar year 2004, which boosts the size of taxable estates and generates increased tax receipts. For 2011 alone, CBO has reduced its projection of taxable gifts slightly as a result of reestimating the amount of gifts that are shifted from other years into 2010, just before expiration of both the reduced rate of gift taxation and repeal of the estate tax.

Other Sources of Revenue

Customs duties and numerous miscellaneous sources 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 about 0.5 percent—throughout the projection period. That share will be slightly lower in 2005 and 2006, however, because of the effect of low short-term interest rates on the Federal Reserve System's earnings.

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 several tariff reductions, which began with enactment of the North American Free Trade Agreement in 1994, continue to phase in. Some slight decline in customs receipts relative to GDP occurs because petroleum, an important component of overall imports, is assessed a specific duty that does not rise with price. Projections of customs duties over the next 10 years are about $7 billion lower now than in the September projections. Most of that change affects the 2010-2014 period and reflects lower expectations of imports over that period than CBO projected in September.

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 4-8). 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 four years, earnings on securities declined as

Table 4-8.

CBO's Projections of Other Sources of Revenue

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Estate and Gift Taxes	25	24	27	25	26	27	21	19	43	46	52	58	126	344
Customs Duties	21	21	23	25	27	28	29	30	31	33	35	37	133	299
Miscellaneous Receipts														
Federal Reserve System earnings	20	21	26	30	34	37	39	41	43	45	47	49	165	388
Universal Service Fund	7	7	7	7	7	8	8	8	8	8	8	8	37	78
Other	6	6	7	6	5	5	5	5	5	5	5	5	29	55
Subtotal	33	34	39	44	47	50	52	54	56	58	60	62	231	521
Total	**79**	**79**	**90**	**94**	**100**	**105**	**102**	**103**	**130**	**137**	**147**	**157**	**490**	**1,164**

Source: Congressional Budget Office.

the Federal Reserve lowered interest rates to stimulate economic growth and counter the economy's downturn. 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. CBO expects that, on average, short- and long-term interest rates will rise through 2007, increasing receipts from the Federal Reserve System to a level that is more consistent with the relationship to GDP that existed in the 1990s.

Since September, CBO has made little change to its projection of receipts from the Federal Reserve. CBO has made technical changes to projections of other miscellaneous receipts—mainly for receipts that finance the Universal Service Fund—that raise revenues by about $8 billion over the 2005-2014 period.

Uncertainty in the Revenue Baseline

The projection of revenues in the baseline represents the most likely path of receipts under current law. Nonetheless, even if policies remain unchanged, much uncertainty exists in the projections of economic circumstances that underlie the revenue projection. Thus, misestimates are inherent in forecasting.

The factors most likely to generate misestimates of revenues in the projection can be identified by examining past revisions to CBO's revenue projections. Those revisions are typically categorized into changes caused by legislation, economics, or technical factors.

All nonlegislative factors that affect revenues are ultimately economic in nature. The economic and technical categories used to identify the sources of baseline revisions distinguish revisions that result from changes in CBO's macroeconomic forecast from those linked to other causes. Economic revisions are changes stemming from new projections of variables typically generated as part of a standard macroeconomic forecast. Technical revisions are those that affect how much revenue is generated by a given macroeconomic forecast. Capital gains realizations and retirement distributions are examples of items that are important for determining tax liability but that are not part of a macroeconomic projection.

Although past revisions have been based on a number of different sources, a few major factors have tended to have more influence than others. Among factors usually designated as economic, the most significant is the level of wages and salaries in the economy. Of those that are technical, capital gains and changes in the growth of income among the nation's highest earners stand out. Two other technical factors also merit mention: the behavior of contributions and distributions associated with tax-deferred retirement savings and unexplained deviations in current collections of receipts. In general, revisions to the projection for the near term have tended to be technical, while those for the longer term have tended to be economic.

Among economic factors, projections of wage and salary income have the greatest potential to generate misestimates in the revenue projection because such income is, on average, taxed at a higher rate than other income sources. Further, because wages and salaries are such a large component of income, even small errors can produce relatively large effects. (See Appendix A for a discussion of the sensitivity of receipts to wages and salaries and other selected macroeconomic variables.)

Among technical factors, realizations of capital gains are among the most difficult to predict of all of the items that go into the revenue forecast. Estimates of capital gains realizations are subject to large errors even when the forecaster has access to most of the information on GDP, the stock market, tax rates, and other variables—and that difficulty is compounded in looking beyond the current year, when those variables are not known. As a consequence, swings in realizations have produced errors in the forecast. Over the next few years, however, gains are a smaller risk factor for the projection because of the lower tax rate imposed on them.

Another difficult-to-predict determinant of tax receipts is growth of income among the most highly taxed households relative to income growth among all households. A substantial proportion of income tax receipts is generated by a small percentage of earners because of the tax system's progressivity and the skewed distribution of income. Even if total wage and salary income is accurately projected, a shift in its distribution among households will alter the average rate at which it is taxed. If very high income earners experience income growth significantly faster or slower than that of all households, the tax yielded by a given level of overall income will be higher or lower. That phenomenon is unlikely to generate very large errors in any one year. However, if the differential growth of income persists, errors can accumulate.

Although not a significant source of revision in the past, projections of distributions from tax-deferred retirement accounts offer another potential source of error, largely because of their growing importance in the projection. The baby-boom generation has accumulated large amounts in tax-deferred retirement accounts and will soon begin to take larger distributions from them. In addition, because of the total size of tax-deferred retirement accounts, significant amounts of interest and dividend income are exempt from taxation. Errors in projecting contributions, distributions, or account earnings may all affect the accuracy of the projection.

Finally, determining the sources of current collections is difficult. Detailed information about sources of tax liability are only available about two years after receipts come into the Treasury. Consequently, forecasters know how much is coming in as withholding, estimated taxes, and so forth, but they cannot know until much later which activities generated the liability giving rise to those receipts. Thus, at any given time, current receipts will exceed or fall short of what the projection models say they will be. Even after those differentials are attributed to their most likely sources, some residual remains, and a determination must be made about whether that amount will continue into the future and how far.

Revisions to CBO's September 2004 Revenue Projections

In September, CBO projected that receipts would total $28.3 trillion over the 2005-2014 period (see Table 4-9). The current projection for that period is nearly unchanged: $28.1 trillion, less than 1 percent ($209 billion) lower. Legislative changes since September accounted for $129 billion of that reduction. Virtually all of the changes in the 10-year total resulting from legislation were from the Working Families Tax Relief Act, which extended several provisions of EGTRRA and JGTRRA, extended a number of other expired or expiring tax provisions, and made other changes to the tax code. The American Jobs Creation Act, which replaced an extraterritorial income exclusion with a deduction for income from domestic production and made numerous other tax-law changes, reduced receipts modestly in the first five years of the projection and raised them slightly less in the second five years. Small reductions in projected receipts resulted from the Miscellaneous Trade and Technical Corrections Act, which made minor changes to U.S. trade law, and from the Thrift Savings Plan Open Elections Act of 2004, which affected the frequency with which federal employees could make contributions to their tax-deferred retirement accounts. In addition, a series of continuing resolutions (Public Laws 108-309, -416, and -434) extended mine reclamation fees for brief periods last autumn, and the Consolidated Appropriations Act, 2005 (P.L. 108-447) extended those fees

Table 4-9.

Changes in CBO's Projections of Revenues Since September 2004

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2014
Revenues in CBO's September 2004 Baseline	2,094	2,279	2,406	2,531	2,673	2,821	3,077	3,308	3,471	3,648	28,308
Legislative Changes	-32	-46	-25	-14	-6	-6	*	1	*	-1	-129
Other Changes											
Economic	-14	-25	-23	-9	3	14	18	28	37	43	72
Technical	9	4	-2	-1	-8	-22	-33	-33	-34	-33	-152
Subtotal	-5	-21	-24	-10	-5	-8	-14	-5	3	10	-80
Total Changes	**-37**	**-67**	**-49**	**-23**	**-11**	**-15**	**-15**	**-5**	**3**	**10**	**-209**
Revenues in CBO's January 2005 Baseline	2,057	2,212	2,357	2,508	2,662	2,806	3,062	3,303	3,474	3,657	28,099

Source: Congressional Budget Office.

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

through June 2005 as well as fees on satellite companies for use of copyrighted programming through 2010.[5]

The effects of legislative revisions to the baseline are concentrated in the first five years. Most of the tax reductions in WFTRA extend only through 2010; consequently, the law does little to reduce taxes after that date. In addition, AJCA is structured to generate revenue losses in the first five years that are largely offset by gains in the second. As a result, about 95 percent of the revenue loss from all recent legislation occurs in the 2005-2009 period.

The remaining $80 billion decrease in projected revenues since September is the result of technical revisions that reduce receipts by $152 billion partly offset by economic revisions that increase them by $72 billion. The positive economic effects on revenues are concentrated in the later years of the projection period and stem principally from higher projections of economic growth after 2005. However, in the first four years of the projection period, the effect of economic revisions is to reduce the forecast of revenues, mainly because taxable income is projected to represent a smaller share of GDP than was expected in September. Technical changes are also largely concentrated in the later years of the projection period. They mainly reflect new information from tax returns and new estimates of the effects of rapid accumulations in IRAs and 401(k)s.

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. 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

5. One law with relatively small revenue effects was enacted after CBO had prepared its estimates and is therefore not included. Public Law 109-1 allows certain taxpayers to deduct charitable contributions to tsunami relief from their 2004 taxable income. The tax would reduce receipts by $11 million in 2005 and increase them by $9 million in 2006, according to estimates by the Joint Committee on Taxation.

revenues as possible, this section details the various tax provisions whose expiration is reflected in CBO's baseline 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, JGTRRA, and WFTRA 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 Expire During the Projection Period

A number of provisions are scheduled to expire between 2005 and 2015 (see Table 4-10). The most significant of those from a budgetary perspective are tax provisions enacted in EGTRRA, as modified by JGTRRA and WFTRA. First, the higher amount of income exempt from the individual AMT is set to expire at the end of 2005, along with the deduction allowed for qualified education expenses. The credit allowed for certain contributions to IRA and 401(k) plans expires at the end of 2006, and the higher amount of expensing of investment allowed for small businesses expires after 2007. The lower tax rates on dividends and capital gains enacted in JGTRRA expire at the end of 2008. The rest of the provisions from those laws—which represent the bulk of the budgetary effect—expire on December 31, 2010. Those provisions include decreases in marginal tax rates for individuals, increases in the child tax credit, and repeal of the estate tax.

Assuming that the expiring provisions enacted in EGTRRA, JGTRRA, and WFTRA were extended, CBO and the Joint Committee on Taxation (JCT) estimate that revenues would be about $1.66 trillion lower through 2015. About six-sevenths of that reduction would occur from 2011 through 2015. However, extending the changes to estate and gift taxes, which expire at the end of 2010, could reduce revenues as early as 2006 because some taxpayers might postpone taxable gifts that they would otherwise have made during this decade if they knew that the repeal of the estate tax would become permanent in 2011.

CBO's and JCT's estimates of the effects of extending expiring provisions incorporate the assumption that the higher exemption levels for the AMT, which expire after 2005, are extended at their 2005 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.

Fifty-three provisions not initially enacted in EGTRRA, JGTRRA, or WFTRA are due to end between 2005 and 2015; of those, 47 would reduce revenues if extended. The provision with the largest effect is the research and experimentation tax credit, which was enacted in 1981. WFTRA extended that provision for the 10th time, through the end of 2005. Continuing the credit through 2015 would reduce revenues by about $73 billion. The provision that allows individuals to claim nonrefundable personal credits against the AMT, first enacted in 1998, expires after 2005. Extending that provision would reduce revenues by about $50 billion through 2015, according to JCT. The reduced tax rate on repatriated dividends, enacted in AJCA in 2004, expires in 2006, and JCT estimates that extending it would reduce revenues by $47 billion over the next 10 years. Extending the exemption for certain active financing income from the Subpart F rules of the tax law, which expires at the end of 2006, would reduce revenues by $38 billion through 2015. Extending the deduction allowed for state and local general sales taxes, also enacted in AJCA in 2004 and set to expire at the end of 2005, would reduce revenues by $26 billion through 2015. In all, extending those 47 revenue-reducing provisions would decrease receipts by $322 billion from 2006 through 2015.

In the opposite direction, six provisions that are set to 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 boost revenues by about $11 billion between 2008 and 2015 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; providing authority to the IRS for certain undercover operations; and allowing defined-benefit plans with multiple employers to defer a portion of charges for net experience losses. Extending the mine

reclamation fees would raise about $200 million per year. The other four provisions, if extended, would raise about $100 million altogether through 2015.

Expiring Provisions That Are Included in CBO's Baseline

Budget rules enacted in the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, require CBO to include in its projections excise tax receipts earmarked for trust funds, even if 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 those taxes at today's rates contributes about $42 billion to CBO's revenue projections in 2015, or about 43 percent of that year's total excise tax receipts.

Other expiring trust fund taxes, if extended, would account for smaller amounts in 2015, CBO estimates. Taxes dedicated to the Airport and Airway Trust Fund, which are scheduled to expire at the end of September 2007, would contribute about $15 billion to revenues in 2015. Taxes for the Leaking Underground Storage Tank Trust Fund, set to end on March 31, 2005, are assumed to continue in CBO's baseline, contributing about $300 million to revenues in 2015. In addition, the new assessment on tobacco manufacturers enacted under AJCA expires on September 30, 2014. Because the receipts are dedicated to the Tobacco Trust Fund, baseline rules require CBO to assume that the assessment is extended, adding $1 billion in revenues to the last year of the projection. No other expiring tax provisions are automatically extended in CBO's baseline.

Total Effect of Expiring Provisions

If all of the tax provisions scheduled to expire were extended together, the revenue projection for 2006 would be about $16 billion lower. That revenue loss would grow to $45 billion in 2007 and $95 billion in 2010, before jumping to nearly $250 billion in 2011 and then reaching $422 billion in 2015. Over the entire 2006-2015 period, revenues would be reduced by about $2.1 trillion. That estimate includes interactions among the provisions. In particular, two AMT provisions—increasing the exemption amount for that tax and allowing certain personal credits to reduce AMT liability—interact with each other and with provisions that affect individual income tax rates.

Table 4-10.

Effect of Extending Tax Provisions That Will Expire Before 2015

(Billions of dollars)

Tax Provision	Expiration Date	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
							Provisions That Expire in 2005							
Abandoned Mine Reclamation Fees	06/30/05	**	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.9	1.9
Defer Losses of Certain Pension Plans	06/30/05	0	**	**	**	*	*	*	*	*	*	*	**	**
Reduced Pension Contributions of Certain Industries	12/27/05	n.a.	**	**	**	**	*	*	*	*	*	*	0.1	-0.1
Archer Medical Savings Accounts	12/31/05	n.a.	*	*	*	*	*	*	*	*	*	*	*	*
Authority for Undercover IRS Operations	12/31/05	n.a.	**	**	**	**	**	**	**	**	**	**	**	**
Brownfields Remediation Expensing	12/31/05	**	-0.2	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	-2.2
Combat Pay in Earned Income for Refundable Credits	12/31/05	n.a.	*	*	*	*	*	*	*	*	*	*	*	-0.1
Corporate Contributions of Computers to Schools	12/31/05	n.a.	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.7	-1.7
Credit for Electric Vehicles	12/31/05	n.a.	*	*	*	*	*	*	*	*	*	*	*	*
Credit for Electricity Production from Renewable Sources	12/31/05	n.a.	-0.3	-0.4	-0.4	-0.5	-0.6	-0.6	-0.6	-0.7	-0.8	-0.8	-2.1	-5.6
Credit for Research and Experimentation	12/31/05	n.a.	-2.2	-4.4	-5.7	-6.9	-7.8	-8.3	-8.8	-9.3	-9.7	-10.2	-27.0	-73.4
Deduction for Qualified Education Expenses	12/31/05	n.a.	-0.7	-2.3	-2.4	-2.5	-2.5	-2.6	-2.7	-2.8	-2.9	-3.0	-10.4	-24.5
Deduction for Teachers' Classroom Expenses	12/31/05	n.a.	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.9	-2.2
Deduction of State and Local Sales Taxes	12/31/05	n.a.	-0.5	-2.0	-2.0	-2.0	-2.0	-2.4	-3.7	-3.8	-3.9	-3.9	-8.6	-26.3
Deductions for Clean-Fuel Vehicles and Refueling Property	12/31/05	n.a.	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.8	-1.7
Depreciation for Business Property on Indian Reservations	12/31/05	n.a.	-0.2	-0.4	-0.6	-0.5	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3	-2.2	-3.8
Depreciation of Leasehold and Restaurant Improvements	12/31/05	n.a.	-0.1	-0.3	-0.5	-0.8	-1.1	-1.5	-1.8	-2.1	-2.5	-2.8	-2.9	-13.5
Increased AMT Exemption Amount	12/31/05	n.a.	-11.8	-31.7	-37.4	-43.7	-50.2	-41.0	-23.1	-27.2	-32.1	-37.2	-174.8	-335.4
Indian Employment Tax Credit	12/31/05	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.6
Interest Rate for Pension Calculations	12/31/05	n.a.	1.9	2.4	0.9	0.5	-0.2	-1.1	-1.5	-2.0	-2.4	-2.4	5.6	-3.8
Net Income Limitation for Marginal Oil and Gas Wells	12/31/05	n.a.	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.5
Parity in Mental Health Benefits	12/31/05	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.7
Qualified Zone Academy Bonds	12/31/05	n.a.	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Rum Excise Tax Revenue to Puerto Rico and the Virgin Islands	12/31/05	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.8
Special Rules for Pension Plans of Interstate Bus Companies	12/31/05	n.a.	**	**	*	*	*	*	*	*	*	*	*	*
Tax Incentives for Investment in the District of Columbia	12/31/05	n.a.	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.5	-1.7
Treatment of Personal Credits Under AMT	12/31/05	n.a.	-0.6	-2.9	-3.2	-3.5	-3.9	-4.7	-6.7	-7.4	-8.3	-9.0	-14.0	-50.0
Welfare-to-Work Tax Credit	12/31/05	n.a.	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.7
Work Opportunity Tax Credit	12/31/05	n.a.	-0.1	-0.2	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-1.3	-3.7

Continued

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
							Provisions That Expire Between 2006 and 2015							
Reduced Tax Rate on Repatriated Dividends	10/20/06	n.a.	*	-0.3	-2.6	-3.5	-4.6	-5.3	-6.1	-7.0	-8.1	-9.3	-11.0	-46.9
Andean Trade Preference Initiative	12/31/06	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1	-0.3
Biodiesel Fuel Tax Credit	12/31/06	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.4	-1.2
Credit for IRA and 401(k)-Type Plans	12/31/06	n.a.	n.a.	-0.5	-1.5	-1.4	-1.3	-1.3	-1.3	-1.2	-1.1	-1.0	-4.8	-10.6
Depreciation for Clean-Fuel Automobiles	12/31/06	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*	-0.1
Disposition of Electric Transmission Property	12/31/06	n.a.	0.4	-0.2	-0.7	-0.6	-0.4	-0.3	-0.2	-0.2	-0.1	-0.1	-1.6	-2.6
Generalized System of Preferences	12/31/06	n.a.	n.a.	-0.3	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9	-2.4	-6.5
Reduction in Policyholder Dividends for Insurance Companies	12/31/06	n.a.	n.a.	*	*	*	*	*	*	*	*	*	*	*
Subpart F for Active Financing Income	12/31/06	n.a.	n.a.	-0.8	-2.3	-2.6	-4.0	-4.6	-5.1	-5.6	-6.1	-6.8	-9.8	-38.0
Tax Incentives for Areas of New York City Damaged on 9/11	Various[a]	n.a.	n.a.	-0.2	-0.3	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-1.2	-2.4
Treatment of Income of Electric Cooperatives	12/31/06	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1	-0.3
African Growth Opportunity Act	09/30/07	n.a.	n.a.	n.a.	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.4
Depreciation Period for Motor Tracks	12/31/07	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	-0.1	-0.3
Dividends of Mutual Funds	12/31/07	n.a.	n.a.	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
FUTA Surtax of 0.2 Percentage Points	12/31/07	n.a.	n.a.	n.a.	1.0	1.4	1.5	1.5	1.5	1.5	1.5	1.5	3.9	11.5
New Markets Tax Credit	12/31/07	n.a.	n.a.	n.a.	-0.1	-0.3	-0.4	-0.6	-0.8	-1.0	-1.2	-1.3	-0.8	-5.9
Section 179 Expensing	12/31/07	n.a.	n.a.	n.a.	-2.6	-4.5	-3.2	-2.4	-2.0	-1.6	-1.4	-1.4	-10.3	-19.1
Tax Credit for Maintaining Railroad Tracks	12/31/07	n.a.	n.a.	n.a.	*	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0
Suspension of Alcohol Occupational Taxes	06/30/08	n.a.	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.6
Caribbean Basin Initiative	09/30/08	n.a.	n.a.	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.8
Expensing of Film and TV Productions	12/31/08	n.a.	n.a.	n.a.	n.a.	*	-0.1	-0.1	-0.1	*	*	*	-0.1	-0.4
Reduced Tax Rates on Dividends and Capital Gains	12/31/08	n.a.	n.a.	n.a.	-2.6	-13.0	-9.7	-24.5	-25.4	-27.1	-28.8	-30.5	-25.4	-161.6
Empowerment and Renewal Zones	12/31/09	n.a.	n.a.	n.a.	n.a.	n.a.	-0.8	-1.6	-1.8	-2.0	-2.1	-2.3	-0.8	-10.7
Exclusion of Gain on Brownfield Transactions	12/31/09	n.a.	n.a.	n.a.	n.a.	**	**	**	**	*	-0.1	-0.1	**	-0.1
Tax Incentives for Certain Diesel Fuel Production	12/31/09	n.a.	n.a.	n.a.	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
10 Percent Income Tax Bracket	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-35.1	-50.5	-50.5	-50.1	-49.9	n.a.	-236.1
Alcohol Fuel Tax Credit	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-1.3	-1.8	-1.8	-1.9	-1.9	n.a.	-8.7
Authority to Postpone Certain Tax Deadlines	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	*	*	*	*	*	n.a.	*
Child Tax Credit at $1,000	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-6.8	-34.1	-34.5	-35.0	-35.5	n.a.	-145.9
Earned Income Tax Credit Modification	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.2	-2.5	-2.5	-2.5	-2.5	n.a.	-9.7
EGTRRA Education Provisions	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-1.6	-2.4	-2.7	-3.1	-3.3	n.a.	-13.2
EGTRRA Pension Provisions	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-1.9	-3.6	-4.3	-5.0	-5.6	n.a.	-20.3
Estate and Gift Tax Changes	12/31/10	n.a.	-2.0	-1.5	-1.9	-1.7	-2.4	-29.0	-51.0	-55.3	-60.8	-65.0	-9.5	-270.6
Income Tax Rates of 25, 28, 33, and 35 Percent	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-42.8	-62.9	-65.4	-68.5	-71.9	n.a.	-311.6

Continued

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
Itemized Deduction and Personal Exemption Phaseout	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-6.0	-12.4	-13.4	-14.5	-15.7	n.a.	-62.0
Joint Filers' 15 Percent Bracket and Standard Deduction	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-5.5	-7.4	-6.8	-6.3	-5.9	n.a.	-31.9
Other Provisions of EGTRRA[b]	12/31/10	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.3	-0.9	-0.9	-0.9	-1.0	n.a.	-4.0
Small Ethanol-Producer Credit	12/31/10	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.2
Transfer of Excess Assets in Defined-Benefit Plans	12/31/13	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	**	**	n.a.	0.1
IRS User Fees	09/30/14	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.1	n.a.	0.1
All Expiring Provisions														
Interaction from Extending All Provisions Together		n.a.	0.9	2.4	2.6	2.7	2.9	-11.9	-34.0	-36.2	-37.9	-39.2	11.6	-147.5
Total		**	-15.5	-44.8	-64.8	-86.3	-94.7	-247.5	-357.6	-378.0	-400.8	-422.3	-306.1	-2,112.3

Sources: Congressional Budget Office; Joint Committee on Taxation.

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.

These estimates assume that the expiring provisions are extended immediately rather than when they are about to expire. The provisions are assumed to be extended at the rates or levels existing at the time of expiration. The estimates include some effects on outlays for refundable tax credits. They do not include debt-service costs.

a. 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. Includes provisions related to the adoption credit, dependent care credit, and the employer-provided child care credit.

APPENDIX

A

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, nonwage income, and corporate profits—which generally moves in step with overall economic activity. Spending for many mandatory 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 the amount of federal spending for interest on that debt is directly tied to such 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. They are not intended to substitute for a full analysis of an alternative economic forecast.

Four variables that figure in this illustration are real (inflation-adjusted) growth, interest rates, inflation, and wages and salaries as a percentage of the economy. For real growth, CBO's rule of thumb shows the effects of a rate that is 0.1 percentage point higher each year, beginning in January 2005, than the assumed rate of economic growth that underlies the agency's baseline budget 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 2005.

The rule of thumb for wages and salaries assumes that, beginning in January 2005, wages and salaries are 47 percent of gross domestic product (GDP) and that they continue to be 1 percentage point higher than the share assumed in the baseline for each year of the projection period. Corporate profits are therefore assumed to be 1 percentage point lower each year. This scenario assumes no change in projected levels of nominal or real GDP (which vary in two of the other rules of thumb).

Each rule of thumb is roughly symmetrical. Thus, the effects of lower growth, lower interest rates, lower inflation, or lower wages and salaries as a share of GDP 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.

Higher Real Growth

Stronger economic growth improves the federal budget's bottom line, and weaker economic growth worsens it. The first rule of thumb outlines the budgetary impact of economic growth that is slightly stronger than CBO's baseline assumes. Specifically, the rule illustrates the effects of growth rates for real GDP that are higher by 0.1 percentage point every year from January 2005 through the end of fiscal year 2015. 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 3.8 percent in calendar year 2005, 3.7 percent in 2006, and that it averages 2.9 percent from 2007 to

Table A-1.

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

(Billions of dollars)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total, 2006-2010	Total, 2006-2015
						Growth Rate of Real GDP Is 0.1 Percentage Point Higher per Year							
Change in Revenues	1	3	6	9	13	17	22	27	33	38	44	48	212
Change in Outlays													
Net interest (Debt service)	*	*	*	-1	-2	-3	-4	-6	-8	-11	-14	-6	-49
Mandatory spending	*	*	*	*	*	*	*	*	*	*	*	*	*
Total	*****	*****	**-1**	**-1**	**-2**	**-3**	**-4**	**-6**	**-8**	**-10**	**-14**	**-6**	**-48**
Change in Deficit or Surplus [a]	**1**	**3**	**7**	**10**	**15**	**20**	**26**	**33**	**40**	**49**	**58**	**55**	**261**
						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	10	23	32	37	42	46	48	49	49	50	49	180	425
Debt service	*	1	3	5	8	11	15	19	23	27	32	29	145
Total	**10**	**25**	**35**	**42**	**50**	**57**	**63**	**68**	**72**	**77**	**82**	**209**	**570**
Change in Deficit or Surplus [a]	**-10**	**-25**	**-35**	**-42**	**-50**	**-57**	**-63**	**-68**	**-72**	**-77**	**-82**	**-209**	**-570**
						Inflation Is 1 Percentage Point Higher per Year							
Change in Revenues	12	35	62	94	131	170	210	262	317	373	433	492	2,087
Change in Outlays													
Higher rates [b]	13	27	35	40	45	50	52	54	54	55	56	198	469
Debt service	*	*	1	1	2	1	1	*	-3	-6	-11	6	-14
Discretionary spending	0	5	13	22	32	43	55	66	79	92	106	116	515
Mandatory spending	1	11	23	36	52	69	89	110	136	164	196	191	886
Total	**14**	**44**	**72**	**100**	**131**	**164**	**196**	**230**	**266**	**305**	**347**	**511**	**1,856**
Change in Deficit or Surplus [a]	**-3**	**-9**	**-9**	**-6**	*****	**6**	**13**	**32**	**50**	**68**	**87**	**-19**	**231**
						Wages and Salaries' Share of GDP Is 1 Percentage Point Higher per Year							
Change in Revenues	11	12	14	16	17	18	20	21	23	24	25	76	190
Change in Outlays (Debt service)	*	-1	-1	-2	-3	-4	-6	-7	-8	-10	-12	-12	-55
Change in Deficit or Surplus [a]	**11**	**12**	**15**	**18**	**21**	**22**	**25**	**28**	**31**	**34**	**37**	**88**	**244**

Source: Congressional Budget Office.

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

a. Positive amounts indicate a decrease in the deficit or an increase in the surplus.

b. The change in outlays attributable to higher rates in this scenario is different than the estimate in the rule of thumb for interest rates because the principal on Treasury Inflation-Protected Securities grows with inflation.

2015 (see Chapter 2). Adding 0.1 percentage point to that rate each year means that the level of GDP would rise about 1 percent above the level assumed in CBO's baseline by 2015.

A higher rate of growth for GDP would have a number of budgetary implications. For example, it would suggest higher growth in taxable income, leading to increases in revenues that would mount from $1 billion in 2005 to $44 billion in 2015 (see Table A-1). Revenue gains would total 0.7 percent of the projected revenues over the 2006-2015 period.

Higher revenues would mean that the federal government borrowed less and incurred lower interest costs. The payments to service the debt would be minimally lower during the first few years of the projection period; but in later years those annual savings would gradually increase by amounts that reach $14 billion in 2015. The impact of debt-service savings would be blunted slightly by outlay increases, mostly for Medicare. All told, growth in real GDP that was 0.1 percentage point a year higher than the rate assumed in CBO's baseline would reduce deficits by amounts that climb to $58 billion a year by 2015.

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 a portion of its debt at market interest rates.

Under the assumption that, each year, interest rates are 1 percentage point higher than in the baseline for all maturities and that all other economic variables are unchanged, interest costs would be approximately $10 billion higher in 2005 (see Table A-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 25 percent of its marketable debt. Roughly $1 trillion in 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). Correspondingly, the budgetary effects mount; by 2010, the impact of interest rates that are 1 percentage point higher than is assumed in the baseline would be $46 billion, an impact that levels off for the remainder of the projection period.

Under this scenario, the Treasury would have to raise additional cash (above the levels assumed in the baseline) to finance the larger outlays related to higher interest rates. By 2015, such debt-service costs would climb to $32 billion. All told, if interest rates were a full percentage point higher than the rates assumed in CBO's baseline, interest payments (including additional debt-service costs) would surpass baseline levels by increasing amounts, reaching $82 billion by 2015.

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 translate directly into higher amounts of income taxes and payroll taxes withheld from people's paychecks. The impact of the higher personal incomes on revenues is reduced, with a lag, by indexation of tax brackets for inflation. In addition, higher corporate profits from faster growth in prices quickly boost receipts from firms' quarterly estimated tax payments. Those results reduce projected deficits or increase projected surpluses.

On the other hand, higher inflation pushes up spending for many benefit programs and drives growth in projections of discretionary spending. Many mandatory programs automatically adjust benefit levels each year to reflect price increases. Social Security, federal employees' retirement programs, Supplemental Security Income, veterans' disability compensation, 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. Other programs, such as Medicaid, are not formally indexed but nonethe-

less grow with inflation. 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. Finally, future spending for discretionary programs is projected on the basis of assumed rates of wage and price growth.

Inflation also has an impact on net interest because it is one component of nominal long-term interest rates (the other being a real rate of return). For example, if real rates of return remain constant, but inflation rises, interest rates will climb, and new federal borrowing will incur higher interest costs. In deriving this rule of thumb, CBO assumes that nominal interest rates rise in step with the increase in 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 about 7 percent from 2006 through 2015—and increase outlays by about 6 percent over that same period (see Table A-1). In the near term, the net effect would be higher deficits—as increases in outlays exceed the higher revenues. This is in large part because CBO assumes that interest rates rise when inflation increases, thus driving up interest payments. Mandatory spending responds to higher inflation in the short run as well. From 2005 through 2008, those increases in outlays exceed the boost in revenues projected under this scenario.

By 2009, however, the revenue acceleration associated with higher inflation overcomes the higher outlay levels. Revenues exceed outlays by $87 billion by the end of the projection period. Including debt-service costs, the net effect of this scenario is a reduction of $231 billion in the cumulative deficit over the 2006-2015 period.

Wages and Salaries as a Higher Percentage of GDP

Because different types of income are taxed at different rates, the variation in income shares over time has contributed to upward and downward movements in tax receipts relative to GDP. Considerable uncertainty exists in projections of the income shares.

Two of the most important types of income for projecting federal revenues are wages and salaries and corporate profits. Wages and salaries are the most highly taxed income in CBO's economic forecast. They are subject to taxation under the individual income tax as well as through payroll taxes for Social Security (up to a maximum amount) and Medicare. CBO estimates that an additional dollar of corporate profits produces less revenue than an additional dollar of wages and salaries. As a result, higher projections for wages and salaries, and correspondingly lower projections for profits, result in higher projected budget receipts.

CBO estimates that a shift of 1 percentage point of GDP out of profits and into wages and salaries would lead to gains in revenues of $11 billion in 2005, rising to $25 billion in 2015 (see Table A-1). Higher revenues would lead to an annual reduction in borrowing that would gradually reach $12 billion by 2015. Overall, under this scenario, the 2015 deficit would be $37 billion lower than that projected in the baseline, and the cumulative deficits over the 2006-2015 period would be reduced by 0.8 percent of projected revenues over the period.

APPENDIX

B

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 the main text of 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 goals of the budget are to provide information that can 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 set of 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. On average, the differences cause receipts and expenditures in the NIPAs, as projected by the Congressional Budget Office (CBO), to exceed the corresponding budget totals by roughly 3.5 percent and 3 percent, respectively, for the 2006-2015 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 inflow of revenues and the outflow of spending.[4] The main period of interest in the budget accounts is the federal fiscal year, which runs from October 1 through September 30. 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 gov-

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, "Federal Budget Estimates for Fiscal Year 2005," *Survey of Current Business* (March 2004); and *Budget of the United States Government, Fiscal Year 2005: Analytical Perspectives.*

2. Some accounts in the NIPAs, such as the domestic capital account (which shows saving and investment), focus on components of gross domestic product or 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 transactions.

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.

ernment makes direct loans or provides loan guarantees (as with student loans), tracking flows of cash would give a misleading view of costs; under what is known as credit reform, the budget records federal administrative expenses and the estimated subsidy costs at the time that the loans are made.

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]

5. As part of its comprehensive revisions to the NIPAs officially implemented in December 2003, 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 revised treatment changes the relative importance of different components of GDP as reported in Table 1.1.5 in the accounts ("Gross Domestic Product and Income"), it does not change the level of GDP or the transactions reported in the NIPAs' federal sector (Table 3.2 in the accounts).

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 federal 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 as a receipt in the NIPAs something that the federal budget reports as an offsetting (negative) budget outlay, 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 the NIPA measure of national saving. Two major departures from the budget are the treatment of federal investment spending (for such things as ships, computers, and office buildings) and the treatment of federal employees' retirement programs.

In the federal budget, outlays for investment purchases are treated like other cash outlays and thus are subtracted from budget revenues to determine the size of the federal deficit or surplus. In the NIPAs, by contrast, federal investment is not counted as federal spending for the purpose of measuring net federal saving (current receipts minus current expenditures).[7] That is because new purchases of federal capital (investments) do not measure the current inputs from the existing stock of capital used to provide government services. To approximate the cost of those capital inputs, the NIPAs include in current fed-

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

7. Federal investment is shown elsewhere in the NIPAs, along with private investment spending in the domestic capital account, which shows saving and investment (Table 5.1 in the accounts).

eral expenditures an estimate of the depreciation (consumption of fixed capital) of the stock of federal capital. The treatment is conceptually similar to that for the corporate business sector, which uses depreciation rather than investment purchases to compute net corporate saving (retained earnings). In the federal budget, depreciation is not tracked. In Table B-1, which provides a crosswalk between the budget and the NIPAs, that difference in coverage is shown under "Treatment of investment and depreciation."[8]

The transactions of federal employees' retirement programs are also handled very differently in the budget and the NIPAs. In the budget, federal employees' contributions for 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.[9] 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.[10] 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). That arrangement parallels the treatment for the private sector.

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, are treated as part of federal expenditures even though the corresponding receipts are recorded in the household sector. The government's payments for its workers' retirement are counted as federal expenditures (as part of employee compensation), as is the interest paid to federal retirement accounts. The different treatment of retirement contributions by federal employees shows up in Table B-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 do not count capital transfers or asset exchanges as part of federal receipts or expenditures, although the budget generally does include those transactions. The NIPAs define as capital transfers, and thus exclude, 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).[11] 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 B-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.

8. The estimates and presentation of the reconciliation between the budget and the NIPAs in Table B-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), and on BEA's reconciliation of the Administration's budget for fiscal year 2005, published in the March 2004 *Survey of Current Business*.

9. 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.

10. 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.

11. Another type of capital transfer recognized by BEA in the NIPAs is the annual lump-sum payment from the Treasury to the Uniformed Services Retiree Health Care Fund—a trust fund begun in fiscal year 2003 to pay for benefits received by Medicare-eligible retired members of the armed forces and their dependents. Those payments to the trust fund are for accrued but unfunded liabilities for benefits attributable to work performed before 2003. BEA now excludes those payments from federal expenditures because they are not related to current production. Thus, those payments have no impact on net federal saving. In the budget, those annual payments are recorded as outlays by the Treasury but as offsetting receipts (negative outlays) by the trust fund. Because those annual payments have no net impact on federal spending in either the NIPAs or the budget, there is no corresponding reconciliation item in Table B-1.

Table B-1.

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

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Receipts						
Revenues (Budget)[a]	1,880	2,057	2,212	2,357	2,508	2,662	2,806	3,062	3,303	3,474	3,657	3,847
Differences												
Coverage												
Contributions for government employees' retirement	-5	-4	-4	-4	-4	-4	-3	-3	-3	-3	-3	-2
Estate and gift taxes	-25	-24	-27	-25	-26	-27	-21	-19	-43	-46	-52	-58
Geographic adjustments	-4	-4	-4	-4	-4	-5	-5	-5	-5	-6	-6	-6
Universal Service Fund receipts	-7	-7	-7	-7	-7	-8	-8	-8	-8	-8	-8	-8
Subtotal, coverage	-40	-39	-42	-40	-42	-43	-37	-35	-59	-62	-68	-75
Timing shift of corporate estimated tax payments	1	5	0	0	0	0	0	0	0	0	0	0
Netting												
Medicare premiums	32	38	55	64	69	75	82	90	98	107	118	130
Deposit insurance premiums	*	*	1	1	1	1	2	2	2	2	2	2
Government contributions for OASDI and HI for employees	14	14	15	16	17	18	19	20	22	23	24	25
Income receipts on assets	16	16	17	16	18	18	18	18	19	19	19	20
Surpluses of government enterprises	5	6	6	5	5	5	6	6	6	6	6	6
Other	18	24	24	24	24	25	25	26	26	27	27	25
Subtotal, netting	85	99	117	127	135	143	151	161	172	183	197	209
Other adjustments	5	-13	-1	-5	4	-1	-2	-3	-6	1	1	*
Total Differences	**51**	**52**	**74**	**81**	**97**	**99**	**113**	**122**	**108**	**122**	**129**	**134**
Receipts in the NIPAs	1,930	2,109	2,286	2,438	2,605	2,761	2,919	3,184	3,411	3,596	3,787	3,981
						Expenditures						
Outlays (Budget)[a]	2,292	2,425	2,507	2,618	2,743	2,869	2,996	3,142	3,232	3,389	3,542	3,706
Differences												
Coverage												
Treatment of investment and depreciation	-15	-20	-22	-24	-26	-28	-31	-33	-36	-39	-42	-45
Contributions for government employees' retirement	35	37	35	34	35	36	37	38	39	41	42	43
Capital transfers	-45	-48	-51	-53	-54	-55	-56	-56	-57	-58	-59	-60
Lending and financial adjustments	17	13	14	21	21	11	12	11	12	13	13	14
Geographic adjustments	-13	-14	-14	-14	-15	-16	-16	-17	-18	-19	-20	-21
Universal Service Fund payments	-3	-6	-7	-7	-7	-7	-7	-7	-7	-7	-7	-8
Other	-41	-31	-22	-15	-16	-16	-13	-10	-10	-6	-5	-5
Subtotal, coverage	-64	-69	-66	-57	-62	-75	-74	-53	-77	-76	-78	-82
Timing adjustments	2	-13	6	9	0	0	0	-16	16	0	0	0

Continued

Table B-1.

Continued

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Differences (continued)												
Netting												
Medicare premiums	32	38	55	64	69	75	82	90	98	107	118	130
Deposit insurance premiums	*	*	1	1	1	1	2	2	2	2	2	2
Government contributions for OASDI and HI for employees	14	14	15	16	17	18	19	21	22	23	24	26
Income receipts on assets	16	16	17	16	18	18	18	18	19	19	19	20
Surpluses of government enterprises	5	6	6	5	5	5	6	6	6	6	6	6
Other	18	24	24	24	24	25	25	26	26	27	27	25
Subtotal, netting	85	99	117	127	135	143	151	161	173	184	197	209
Total Differences	**23**	**18**	**58**	**80**	**73**	**68**	**78**	**93**	**111**	**108**	**119**	**127**
Expenditures in the NIPAs	2,315	2,443	2,565	2,698	2,816	2,937	3,073	3,212	3,343	3,497	3,661	3,833
					Net Federal Government Saving							
Budget Deficit (-) or Surplus[a]	-412	-368	-295	-261	-235	-207	-189	-80	71	85	115	141
Differences												
Coverage												
Treatment of investment and depreciation	15	20	22	24	26	28	31	33	36	39	42	45
Contributions for government employees' retirement	-40	-41	-39	-38	-39	-39	-40	-41	-42	-44	-44	-45
Estate and gift taxes	-25	-24	-27	-25	-26	-27	-21	-19	-43	-46	-52	-58
Capital transfers	45	48	51	53	54	55	56	56	57	58	59	60
Lending and financial adjustments	-17	-13	-14	-21	-21	-11	-12	-11	-12	-13	-13	-14
Geographic adjustments	9	10	10	10	10	11	11	12	12	13	14	15
Universal Service Fund	-3	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1
Other	41	31	22	15	16	16	13	10	10	6	5	5
Subtotal, coverage	24	30	23	16	21	32	37	40	18	14	10	7
Timing adjustments	-1	17	-6	-9	0	0	0	16	-16	0	0	0
Other adjustments	5	-13	-1	-5	4	-1	-2	-3	-6	1	1	*
Total Differences	**28**	**34**	**16**	**1**	**25**	**31**	**35**	**53**	**-3**	**15**	**11**	**7**
Net Federal Government Saving	-384	-334	-278	-260	-211	-177	-154	-28	68	100	125	148

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.

Credit Programs

The budget is not affected by all of the transactions associated with federal loans and loan guarantees—just by federal 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 loan disbursements and repayments and 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 B-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.

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. Because federal transfers dominate those transactions, their exclusion tends to increase the NIPAs' depiction of net federal saving in comparison with the budget's measure of saving—the federal deficit or surplus. That difference in coverage is shown as geographic adjustments in Table B-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 payments 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 Service Administrative 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 B-1.

Interest Receipts

In the NIPAs, federal interest receipts are grouped with other types of federal receipts (in the category called "income receipts on assets") rather than netted against federal interest payments, as they are in the federal budget.[12] BEA's treatment is consistent with international accounting practices, under which interest receipts and payments are reported separately. That difference between the NIPAs and the federal budget in their treatment of interest receipts raises the NIPAs' measure of government receipts relative to federal budget revenues and increases the NIPAs' measure of federal spending relative to budget outlays. However, because the difference in treatment affects receipts and expenditures in the NIPAs by exactly the same amount, it has no impact on the NIPAs' measurement of net government saving.

Surpluses of Government Enterprises

In the NIPAs, the surpluses of government enterprises, such as the Postal Service, are shown on a separate line under federal government current receipts. That treatment is 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 offsetting receipts (negative outlays) in the federal budget.

Military Sales and Assistance in Kind

The NIPAs attempt to identify contributions to GDP by sector. Therefore, they do not classify as part of federal consumption military purchases of equipment and services that are intended for sale or as gifts to foreign governments. Instead, those transactions are part of net exports in the NIPAs' foreign transactions account (Table 4.1 in the accounts). In the case of gifts, the transactions are also recorded in the federal sector of the NIPAs as part of transfers to the rest of the world—a classification that parallels their treatment as outlays in the federal budget. By contrast with their treatment in the NIPAs, military

12. About half of interest receipts, mainly interest from penalties on late tax payments, are recorded as revenues in the federal budget.

sales to foreign governments are recorded in the federal budget as outlays, while the proceeds from those sales are recorded as offsetting receipts (negative outlays).

Timing Differences

The NIPAs attempt to measure income flows as much as possible when income is earned (on an accrual basis) rather than when income is received (on a cash basis).[13] 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 that respect: personal tax payments are counted as they are made and are not attributed back to the year in which 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 largely 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 are shown as the timing shift of corporate estimated tax payments in Table B-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, whereas 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 B-1.[14]

Personal Taxes. Although personal taxes are not recorded on an accrual basis in the NIPAs, BEA nevertheless 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 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. (As with accrual accounting, that treatment avoids spikes. Unlike accrual treatment, however, 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 shifts 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 B-1; they 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 providers—with income that is reported on an accrual basis in the NIPAs. Misalignments can occur because of delays in payments or quirks in the calendar.

For example, although SSI payments are usually made on the first day of each month, the checks are sometimes mailed a day or more in advance. That situation typically occurs when the first of the month falls on a weekend or holiday. If it 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 al-

13. See United Nations, *System of National Accounts* (1993), paragraph 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. See also Bureau of Economic Analysis, "The NIPAs and the System of National Accounts," *Survey of Current Business* (December 2004), pp. 17-32.

14. "Other adjustments" include timing differences not shown elsewhere in Table B-1, plus discrepancies between figures in the NIPAs and the budget that may diminish when BEA makes subsequent revisions.

ways 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 at the beginning and the middle of each month, the adjustment in the NIPAs always ensures 24 payments in a year. In the budget, by contrast, there can be 23 payments in some years and 25 in others. The timing adjustments for expenditures in Table B-1 reflect that regularizing for transfers and for military pay.

By contrast with the federal budget, the NIPAs record Medicare payments on an accrual rather than on a cash basis. That treatment better shows the link between the underlying economic activity (the medical services provided) and the associated federal transactions (payment for those services), which can be several months apart. That timing adjustment, however, has only a small effect on the NIPAs' measure of net federal saving.

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 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 B-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.

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 B-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 Social Security taxes, Medicare taxes and premiums, and unemployment insurance taxes. 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 individuals, governments, and the rest of the world); interest payments; and subsidies to businesses and 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 civilian federal employees.) Among the government's consumption expenditures, the consumption of fixed capital—depreciation—represents a partial measure of the services that the government receives from its stock of fixed assets, such as buildings or equipment.

Table B-2.

Projections of Baseline Receipts and Expenditures as Measured by the National Income and Product Accounts

(Billions of dollars)

	Actual 2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
						Receipts						
Current Tax Receipts												
Personal current taxes	779	879	965	1,059	1,150	1,238	1,331	1,525	1,676	1,783	1,890	2,003
Taxes on corporate income	209	225	247	245	266	276	280	287	296	307	319	331
Taxes on production and imports	89	97	102	106	110	113	117	122	126	129	134	135
Taxes from the rest of the world	8	9	10	11	12	13	14	16	18	19	20	21
Subtotal	1,086	1,209	1,324	1,421	1,538	1,640	1,742	1,950	2,115	2,238	2,363	2,490
Contributions for Government Social Insurance[a]	790	840	902	955	1,003	1,054	1,109	1,164	1,221	1,281	1,343	1,408
Current Transfer Receipts	26	28	30	30	31	33	35	36	38	40	42	44
Income Receipts on Assets	23	25	26	26	27	28	28	29	30	30	32	33
Current Surpluses of Government Enterprises	5	6	6	5	5	5	6	6	6	6	6	6
Current Receipts	**1,930**	**2,109**	**2,286**	**2,438**	**2,605**	**2,761**	**2,919**	**3,184**	**3,411**	**3,596**	**3,787**	**3,981**
						Expenditures						
Consumption Expenditures												
Defense												
Consumption	406	411	392	387	395	404	414	424	434	445	456	467
Consumption of fixed capital	63	64	64	65	66	66	67	68	69	69	70	71
Nondefense												
Consumption	201	219	228	236	241	247	253	259	265	272	280	287
Consumption of fixed capital	24	24	25	25	25	26	26	27	27	27	28	28
Subtotal	694	719	709	713	728	743	760	777	795	814	833	853
Current Transfer Payments												
Government social benefits												
To persons	986	1,041	1,129	1,206	1,266	1,333	1,410	1,492	1,568	1,671	1,779	1,896
To the rest of the world	3	3	3	3	3	4	4	4	4	4	5	5
Subtotal	989	1044	1,132	1,209	1,269	1,337	1,414	1,496	1,573	1,675	1,784	1,901
Other transfer payments												
Grants-in-aid to state and local governments	349	363	372	387	405	425	449	475	502	532	565	600
To the rest of the world	25	27	27	25	24	24	24	24	24	24	25	26
Subtotal	374	390	399	412	429	449	472	498	526	557	590	625
Interest Payments	217	236	274	315	343	364	382	396	403	405	408	407
Subsidies	40	54	50	49	46	45	45	45	45	45	46	46
Current Expenditures	**2,315**	**2,443**	**2,565**	**2,698**	**2,816**	**2,937**	**3,073**	**3,212**	**3,343**	**3,497**	**3,661**	**3,833**
						Net Federal Government Saving						
Net Federal Government Saving	**-384**	**-334**	**-278**	**-260**	**-211**	**-177**	**-154**	**-28**	**68**	**100**	**125**	**148**

Source: Congressional Budget Office.

a. Includes Social Security taxes, Medicare taxes and premiums, and unemployment insurance taxes.

Transfer payments (cash payments made directly to individuals and the rest of the world as well as grants to state and local governments or foreign nations) constitute another grouping. Most of the transfers to individuals are for social benefits.[15] 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 Medicaid 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 and agricultural assistance have dominated that category.

Net federal government saving in the NIPAs is the difference between the current receipts and the current expenditures of the federal sector. It is a component of net national saving (which also includes net saving by the state and local government sector, personal saving, and corporate retained earnings) and thus a partial measure of how much of the nation's income earned from current production is not consumed in the current period. Net federal saving (or dissaving) is not a good indicator of federal borrowing requirements because, unlike the budget deficit or surplus, it is not a measure of cash flows.[16]

15. In its July 2004 data revisions, BEA published a revised estimate of government social benefits to individuals for 2003 that was significantly below its previously reported estimate, including a downward revision to its estimate of Medicare benefits. See "Annual Revision of the National Income and Product Accounts: Annual Estimates, 2001-2003, and Quarterly Estimates, 2001: 2004-I," *Survey of Current Business* (August 2004). For 2004, CBO estimates the effect of the 2003 revisions to be about $17 billion, nearly half of it in Medicare benefits. Although CBO considers recent budget data more consistent with the higher estimates shown in the NIPAs before the July revisions, it nevertheless has adopted BEA's estimate for 2004 in Tables B-1 and B-2 presented here. Over the next few years, CBO's forecast gradually removes its estimate of the effects of BEA's revisions to the level of social benefits other than Medicare, phasing it out fully by 2007. However, on the basis of available information about BEA's methodology for its Medicare estimates, CBO is tentatively extending its estimate of the downward adjustment to Medicare benefits throughout the 2006-2015 projection period.

16. As an addendum in NIPA Table 3.2, BEA publishes a measure labeled "net lending or net borrowing," which is closer to a cash or financial measure in several ways. Like the budget, it includes investment purchases as expenditures because those purchases must be financed from current receipts or from federal borrowing. At the same time, it excludes consumption of fixed capital (depreciation) because those accounting charges are not a drain on current financial resources. In addition, it includes receipts from the sale of assets that are not produced, as well as capital transfer receipts (for example, estate and gift taxes) and capital transfer payments (for example, investment grants to state and local governments), which are not part of current receipts or expenditures in the NIPAs but do affect cash flows. Despite those adjustments, net federal lending or borrowing in the NIPAs differs from the budget deficit or surplus because of all of the other differences in timing and coverage that distinguish the NIPAs from the budget. BEA presents those differences in NIPA Table 3.18, which is similar to Table B-1 presented here.

APPENDIX

C

Budget Resolution Targets and Actual Outcomes

Budget resolution targets, adopted by both Houses of Congress in most years, specify proposed levels of revenues and spending for the upcoming fiscal year. The targets in the 2004 concurrent budget resolution, adopted in April 2003, yielded a proposed budget deficit of $385 billion. However, the deficit for fiscal year 2004 was $412 billion—$27 billion more than the deficit that the budget resolution anticipated.

In 2004, revenues were $1,880 billion, only about $3 billion lower than expected for the year. Total outlays, at $2,292 billion, ended up being $24 billion higher than anticipated, primarily because of outlays from supplemental appropriations that were not contemplated in the budget resolution.

Elements of the Analysis

The budget resolution—which consists of targets for revenues, spending, the deficit or surplus, and debt held by the public—is a concurrent resolution adopted by both Houses of Congress that sets forth the Congressional budget plan over five or more fiscal years. The resolution does not itself become law; instead, it is implemented through subsequent legislation. That legislation includes appropriation laws that are intended to adhere to limits set for discretionary spending, as well as changes in the laws that affect revenues and spending. Those changes are sometimes in response to reconciliation instructions in the resolution, as was the case in 2004.

For this analysis, the differences between the levels specified in the budget resolution and the actual outcomes are allocated among three categories: policy, economic, and technical. Although those categories help explain the discrepancies, the divisions are inexact and necessarily somewhat arbitrary.

Differences attributed to policy derive from enacted legislation not anticipated in the resolution or enacted legislation that was estimated to cost a different amount than the resolution originally assumed. Differences attributed to policy may also reflect lawmakers' decisions not to enact legislation that the budget resolution assumed would pass. To identify such differences arising from legislation, the Congressional Budget Office (CBO) normally uses the cost estimates that it prepared at the time the legislation was enacted. (To the extent that the actual budgetary impact is different from what CBO estimated, that difference is characterized as a technical change.)

A key element in preparing the budget resolution is forecasting how the economy will perform in the upcoming fiscal year. Since 1992, the Congress has adopted the most recent economic assumptions published by CBO.[1] CBO's economic forecast for the budget resolution is usually made more than nine months before the fiscal year begins. Forecasting the economy is an uncertain endeavor, and, almost invariably, the economy's actual performance differs from the forecast. Nevertheless, every resolution is based on assumptions about numerous economic variables—mainly, gross domestic product (GDP), taxable income, unemployment, inflation, and interest rates. Those assumptions are used to estimate revenues, spending for benefit programs, and net interest. In CBO's analysis, differences that can be linked directly to the agency's economic forecast are labeled economic.

Technical differences between the budget resolution targets and actual outcomes are those variations that do not arise directly from legislative or economic sources as categorized. In the case of revenues, technical differences

1. The Congress used the Administration's forecast in the resolutions for 1982, 1986, 1989, 1990, and 1992. The budget resolutions for 1983 and 1991 were based on assumptions developed by the budget committees' staff.

stem from a variety of factors, including changes in administrative tax rules, differences in the sources of taxable income that are not captured by the economic forecast, and changes in the amounts of income taxed at the various rates. In the case of many benefit programs, factors such as an unanticipated change in the number of beneficiaries, unforeseen utilization of health care services, changes in farm commodity prices, or new regulations can produce technical differences.

Comparing the Budget Resolution and Actual Outcomes for Fiscal Year 2004

The budget resolution for 2004 adopted the economic assumptions that CBO published in January 2003, which also underpinned CBO's March 2003 baseline prepared in conjunction with the agency's analysis of the President's 2004 Budget. Using those assumptions and incorporating planned policy changes, the resolution established the following targets for the year: total revenues of $1,883 billion, outlays of $2,268 billion, and a deficit of $385 billion (see Table C-1). Ultimately, revenues were lower by $3 billion and outlays were higher by $24 billion, resulting in a deficit that was $27 billion higher than the one anticipated in the resolution. Policy differences—primarily in the form of unanticipated discretionary outlays—raised the deficit by $44 billion relative to the target (see Table C-2). Conversely, a stronger-than-expected economy lowered the deficit by $27 billion compared to the target. Technical factors, mostly on the revenue side, accounted for the remainder of the difference (raising the deficit by $10 billion).

Differences Arising from Policy Changes

Of the many proposals incorporated in the budget resolution—some from the President's budget for 2004 and some originating in the Congress—a portion were eventually enacted (although sometimes in a different form than originally envisioned), and a portion were not. In addition, some legislation was enacted that was not envisioned in the resolution. In total, policy actions taken (or assumed but not taken) after the budget resolution targets were established increased the deficit by about $44 billion from the total assumed in the resolution. That net amount reflects $9 billion more in revenues and $53 billion more in outlays than the resolution assumed.

The resolution adopted most of the President's proposed tax cuts, including an economic growth package assumed to reduce revenues by $136 billion in 2004 and by $543 billion over the 2004-2013 period. When enacted, the Jobs and Growth Tax Relief Reconciliation Act of 2003, or JGTRRA, was estimated to lower 2004 revenues by roughly that amount. However, several other pieces of legislation expected to further reduce revenues were not enacted.

Table C-1.

Comparison of Budget Resolution Targets and Actual Budget Totals, 2004

(Billions of dollars)

	Budget Resolution Targets	Actual Budget Totals	Actual Minus Resolution
Revenues	1,883	1,880	-3
Outlays	2,268	2,292	24
Deficit (-)	-385	-412	-27

Source: Congressional Budget Office using data from H. Con. Res. 95, Concurrent Resolution on the Budget for Fiscal Year 2004 (adopted April 10, 2003).

Notes: The figures include amounts in the Social Security trust funds and the net cash flow of the Postal Service, which are off-budget.

These comparisons differ from those in the chapters of this volume, where differences are measured relative to CBO's baseline projections.

The resolution assumed that discretionary outlays in 2004 would total $861 billion—consistent with the level of budget authority in the President's request, adjusted for expected outlays from the April 2003 supplemental appropriations for operations in Iraq and Afghanistan. In fact, new supplementals drove discretionary budget authority $117 billion higher than anticipated in the resolution. Most of that amount stemmed from additional costs of the ongoing operations in Iraq and Afghanistan, which were funded in supplemental appropriation laws in November 2003 (Public Law 108-106) and August 2004 (P.L. 108-287). Supplemental spending thus accounted for much of the $47 billion overage in discretionary outlays attributable to legislation.

Differences arising from policy changes accounted for $8 billion of the mandatory outlays not anticipated in the resolution for 2004. Most important, mandatory spending was altered by legislation not contemplated in the budget resolution. The Unemployment Compensation

Table C-2.

Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, 2004

(Billions of dollars)

	Differences Arising from			
	Policy Changes	Economic Factors	Technical Factors	Total Differences
Revenues	9	8	-20	-3
Outlays				
Discretionary spending	47	*	-12	34
Mandatory spending[a]	8	-4	-4	-1
Net Interest	-1	-14	6	-9
Total	**53**	**-19**	**-10**	**24**
Effect on Deficit	-44	27	-10	-27

Sources: Congressional Budget Office using data from H. Con. Res. 95, Concurrent Resolution on the Budget for Fiscal Year 2004 (adopted April 10, 2003) and the Office of Management and Budget.

Notes: Differences are actual outcomes minus budget resolution targets. Positive differences denote a reduction in the deficit; negative differences denote an increase.

These comparisons differ from those in the chapters of this volume, where differences are measured relative to CBO's baseline projections.

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

a. Includes offsetting receipts.

Amendments of 2003 (P.L. 108-26), which further extended emergency unemployment benefits for recipients whose regular benefits would be exhausted before the end of December 2003, were enacted in May of 2003—at an estimated cost of $5 billion. In addition, JGTRRA included $10 billion in fiscal assistance to the states, with $5 billion of that amount for 2004 (and the first $5 billion in 2003).

The resolution's largest proposal for mandatory spending—albeit in years beyond 2004—was a prescription drug benefit for Medicare recipients. The budget resolution allowed for a program with costs totaling $400 billion over the decade, including $7 billion in 2004 to implement the proposal. Enacted in late 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 in fact boosted outlays in 2004 by an estimated $4 billion, or $3 billion less than anticipated by the budget resolution.

Other policy proposals assumed in the budget resolution were not enacted. For example, a proposal for health insurance tax credits that would have increased outlays by $50 billion from 2004 through 2013 was incorporated into the resolution but did not pass. (The effect in 2004 would have been small.)

Differences Arising from Economic Factors

Overall, the economic assumptions underlying the 2004 budget resolution proved to be reasonably accurate. Small deviations from the forecast led to revenues that turned out to be $8 billion (0.4 percent) higher than presumed and outlays that were $19 billion (about 1 percent) lower.

The resolution assumed that real GDP would grow by 2.4 percent in 2003 and by 3.4 percent in 2004, but, in actuality, GDP growth for those years was 2.5 percent and 4.6 percent, respectively. The stronger-than-anticipated recovery raised the level of nominal GDP compared to that anticipated by the resolution. Corporate profits were higher and personal incomes were lower than anticipated.

Mandatory spending is also sensitive to changes in the economic forecast. Although such spending flows from the provisions of permanent laws, the spending for many mandatory programs is keyed to the economy. As a result, mandatory outlays for programs such as unemployment

insurance and the refundable portion of the earned income tax credit decreased as the economy gained strength. Higher-than-expected inflation caused some offsetting increases in certain programs pegged to those indicators, but, overall, for economic reasons, mandatory outlays turned out to be $4 billion lower than the level assumed by the resolution.

Lower-than-anticipated interest rates drove projected outlays for net interest payments below the level assumed in the budget resolution. Most significantly, the resolution assumed that short-term (91-day Treasury) interest rates would average 2.9 percent in 2004; however, as a result of actions by the Federal Reserve, those rates averaged just 1.1 percent for the year. Consequently, outlays for net interest were $14 billion less than anticipated in the budget resolution.

Differences Arising from Technical Factors

Differences arising from technical factors—that is, differences between budget resolution targets and actual outcomes that cannot be traced to legislation or CBO's economic forecast—lowered revenues by $20 billion (about 1 percent) and outlays by $10 billion (0.4 percent) relative to the target levels. On balance, because of technical factors, the deficit was $10 billion higher than anticipated in the budget resolution.

Some of the decrease in anticipated revenues may have been related to economic factors (for example, decreased capital gains realizations) or may have resulted from economic factors that will be revealed in future revisions to economic variables; however, a full analysis of the 2004 results cannot be done now because information about sources of individual income typically lags behind the tax year by a couple of years.

The decrease in outlays attributable to technical differences resulted from slower-than-expected discretionary spending, as well as slightly slower spending in a host of mandatory programs. Debt-service costs were higher than expected, mostly because of the technical factors that reduced projected revenues.

Comparing Budget Resolutions and Actual Outcomes for Fiscal Years 1980 Through 2004

At the end of each fiscal year, actual revenues and outlays have always differed to varying degrees from budget resolution targets for that fiscal year. Over the 1980-1992 period, the deficit consistently exceeded the target in the resolution by amounts ranging from $4 billion in 1984 to $119 billion in 1990 (see Table C-3). That pattern changed in 1993, in part because spending for deposit insurance was substantially lower than expected. From 1994 through 2000, actual outcomes continued to be more favorable than the targets (with the exception of 1999, when there was no conference agreement on a budget resolution). However, in 2001, lower-than-expected revenues and higher-than-anticipated outlays combined to reduce the surplus to less than what was envisioned in the resolution. In 2002, those trends continued and caused very large differences from the resolution's envisioned surplus, resulting in a deficit of $158 billion that year. In 2003, there was no conference agreement for a budget resolution. In 2004, lower-than-expected revenues and higher-than-anticipated outlays caused the deficit to be larger than planned, but the difference was relatively small.

Differences Arising from Policy Changes

From 1980 through 2004, policy action or inaction (for example, the failure to achieve savings called for in a budget resolution) decreased the surplus or increased the deficit by an average of $19 billion a year compared with the target. In only four of those years did policymakers trim the deficit more, or add to it less, than the resolution provided. The largest differences attributable to policy changes occurred in three consecutive years, decreasing the surplus by $61 billion in 2000, $95 billion in 2001, and $56 billion in 2002 in comparison with the targets. In 2004, as described, policy changes increased the deficit by $44 billion. (By contrast, from 1980 through 1998, the differences ascribed to policy changes averaged less than $10 billion a year.)

Most of the impact stemming from legislation over the period was on the outlay side of the budget. On average, policy decisions added about $17 billion a year to the

Table C-3.

Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, 1980 to 2004

(Billions of dollars)

	Differences Arising from				
	Policy Changes	Economic Factors	Technical Factors	Total Differences	Total Differences as a Percentage of Actual Outcomes
			Revenues		
1980	6	8	-4	11	2.1
1981	-4	5	-13	-11	-1.8
1982	13	-52	-1	-40	-6.5
1983	-5	-58	-3	-65	-10.8
1984	-14	4	-4	-13	-2.0
1985	*	-20	3	-17	-2.3
1986	-1	-23	-2	-27	-3.5
1987	22	-27	7	2	0.2
1988	-11	4	-17	-24	-2.6
1989	1	34	-8	26	2.6
1990	-7	-36	9	-34	-3.3
1991[a]	-1	-31	-24	-56	-5.3
1992	3	-46	-34	-78	-7.1
1993	4	-28	3	-20	-1.7
1994	-1	12	4	15	1.2
1995	*	16	1	17	1.3
1996	-1	24	12	36	2.5
1997	20	44	46	110	7.0
1998	-1	62	59	120	7.0
1999	n.a.	n.a.	n.a.	n.a.	n.a.
2000	3	78	68	149	7.4
2001	-65	25	26	-14	-0.7
2002	-9	-125	-183	-317	-17.1
2003	n.a.	n.a.	n.a.	n.a.	n.a.
2004	9	8	-20	-3	-0.2
Average	-2	-5	-3	-10	-1.6
Absolute Average[b]	9	33	24	52	4.2
			Outlays		
1980	20	12	16	48	8.1
1981	25	6	16	47	6.9
1982	1	24	8	33	4.4
1983	18	*	8	26	3.2
1984	1	7	-18	-9	-1.1
1985	23	-5	-13	5	0.5
1986	14	-12	20	22	2.2
1987	7	-12	13	8	0.8
1988	-2	12	12	22	2.1
1989	17	14	12	43	3.8
1990	13	13	59	85	6.8
1991[a]	-19	1	-22	-40	-3.0
1992	15	-21	-60	-66	-4.8
1993	16	-19	-90	-92	-6.5
1994	10	-9	-36	-35	-2.4
1995	2	17	-14	6	0.4
1996	25	-24	-29	-28	-1.8
1997	15	7	-43	-21	-1.3

Continued

Table C-3.
Continued

(Billions of dollars)

	Differences Arising from				Total Differences as a Percentage of Actual Outcomes
	Policy Changes	Economic Factors	Technical Factors	Total Differences	
1998	5	-9	-37	-41	-2.5
1999	n.a.	n.a.	n.a.	n.a.	n.a.
2000	65	-1	-10	54	3.0
2001	30	-1	0	29	1.6
2002	46	-5	18	59	2.9
2003	n.a.	n.a.	n.a.	n.a.	n.a.
2004	53	-19	-10	24	1.0
Average	17	-1	-9	8	1.1
Absolute Average[b]	19	11	24	37	3.1
			Effect on Surplus or Deficit[c]		
1980	-13	-4	-19	-36	-6.1
1981	-28	-1	-29	-58	-8.6
1982	12	-76	-9	-73	-9.8
1983	-22	-59	-11	-92	-11.4
1984	-15	-3	14	-4	-0.5
1985	-23	-15	16	-22	-2.3
1986	-16	-11	-22	-49	-4.9
1987	15	-15	-6	-6	-0.6
1988	-9	-8	-29	-46	-4.3
1989	-17	20	-20	-17	-1.5
1990	-20	-49	-50	-119	-9.5
1991[a]	19	-32	-2	-15	-1.1
1992	-12	-25	26	-11	-0.8
1993	-12	-9	93	72	5.1
1994	-11	21	40	50	3.4
1995	-2	-2	15	11	0.7
1996	-25	48	40	63	4.0
1997	5	37	89	131	8.2
1998	-7	71	97	160	9.7
1999	n.a.	n.a.	n.a.	n.a.	n.a.
2000	-61	79	77	95	5.3
2001	-95	26	26	-43	-2.3
2002	-56	-119	-202	-376	-18.7
2003	n.a.	n.a.	n.a.	n.a.	n.a.
2004	-44	27	-10	-27	-1.2
Average	-19	-4	5	-18	-2.0
Absolute Average[b]	23	33	41	69	5.2

Source: Congressional Budget Office.

Notes: Differences are actual outcomes minus budget resolution targets. Positive differences denote an increase in the surplus or a reduction in the deficit; negative differences denote a decrease in the surplus or an increase in the deficit.

CBO allocates differences among the three categories soon after the fiscal year ends, so later changes in economic data are not reflected in those allocations.

* = less than $500 million; n.a. = not applicable (there was no budget resolution in 1999 and 2003).

a. Based on the budget summit agreement for fiscal year 1991 (as assessed by CBO in December 1990).

b. The absolute average disregards whether the differences are positive or negative.

c. In the case of the deficit or surplus, total differences are calculated as a percentage of actual outlays.

spending totals. In fact, 1988 and 1991 were the only years in which legislative action held outlays below the budget resolution targets. The biggest difference due to policy changes was in 2000, when the effects of legislation increased outlays by about $65 billion, mostly from higher-than-expected discretionary appropriations and unanticipated assistance to farmers and agricultural producers. The difference in 2004 was second largest: a $53 billion increase in outlays, primarily resulting from the unanticipated discretionary spending discussed above. On the revenue side of the budget, the largest difference arising from policy changes occurred in 2001, when the Economic Growth and Tax Relief Reconciliation Act reduced taxes by $65 billion more than was anticipated by the resolution. By contrast, in 2002 and 2004 that difference was, respectively, a $9 billion reduction and a $9 billion increase.

Differences Arising from Economic Factors

Inaccuracies in the economic forecast over the 1980-2004 period had a small net effect on the cumulative variation between resolution targets and actual outcomes. However, large differences occurred in many years—deviations that were mostly negative before 1994 and positive more recently (except for 2002). Until 1993, budget resolutions tended to use short-term economic assumptions that proved optimistic. The largest overestimates of deficits in the 1980s and early 1990s, not surprisingly, were in years marked by recession or the early stages of recovery—namely, in 1982 and 1983, and over the 1990-1992 period. In 2002, the economic assumptions were again too optimistic, resulting in a $119 billion difference between the budget resolution target and actual outcome—contributing to that year's deficit, despite the fact that the resolution had envisioned a surplus. In contrast, the improving economy during this past year meant that the economic assumptions underlying the 2004 resolution were not optimistic enough: as a result, economic factors pulled the deficit $27 billion lower than what was assumed in the budget resolution.

In absolute terms (disregarding whether the errors were positive or negative), the typical difference in the surplus or deficit attributable to incorrect economic assumptions was about $33 billion a year over the 1980-2004 period. Regardless of the direction of the errors in the forecasts, differences between the resolutions' assumptions and what happened in the economy primarily affected revenues.

Differences Arising from Technical Factors

Technical factors accounted for differences between budget resolution targets and actual surpluses or deficits that averaged $5 billion a year over the past 25 years. In absolute terms, however, such differences caused the targets to be off by $41 billion, on average. Overall, those deviations were about equally represented on the revenue and outlay sides of the budget.

The magnitude and causes of the differences ascribed to technical factors have varied over the years. On the revenue side, technical misestimates were generally not very large through 1990, but the budget resolutions significantly overestimated revenues in 1991 and 1992, when tax collections were weaker than economic data suggested. From 1997 through 2001, revenues were much higher than the budget resolution targets, but in 2002, the resolution again overestimated tax collections by $183 billion. Technical factors lowered revenues in 2004 by $20 billion compared to the amount anticipated in the resolution.

Misestimates arising from technical factors have also shown up on the outlay side of the budget. Through the mid-1980s, discrepancies in estimating receipts from offshore oil leases and spending on farm price supports, defense, and entitlement programs were the dominant technical differences. In addition, in the early 1990s, during the savings and loan crisis, outlays for deposit insurance were a major source of discrepancies attributable to technical factors. In recent years, technical differences between the resolutions' estimates of outlays and actual outlays have been spread among a variety of programs. In 2004, the difference was a relatively small $10 billion.

Differences as a Percentage of Actual Revenues or Outlays

Because the federal budget has grown considerably since 1980, differences between the revenue and spending levels in the budget resolutions and actual outcomes over the 1980-2004 period may be best compared as a percentage of total revenues or outlays. The total difference for revenues for 2004, at 0.2 percent below the budget resolution target, was much smaller than the absolute average of 4.2 percent over the 25-year period. Outlays in 2004 were 1.0 percent above the budget resolution target—also lower than the 3.1 percent absolute average difference for the years 1980-2004.

The size of the total difference between actual deficits or surpluses and the deficits or surpluses anticipated in budget resolutions depends in large part on whether the differences in revenues and outlays offset each other. For years in which the discrepancies in revenues and outlays affected the surplus or deficit in opposite ways, the total difference dropped to as little as 0.5 percent of actual outlays. But in other years, the discrepancies for both revenues and outlays affected the surplus or deficit in the same way. From 1980 to 2004, the differences between estimates of revenues and outlays in the budget resolutions and the actual amounts went in the same direction relative to the deficit or surplus in 14 of the 25 years. Although the 2004 outcomes exhibit the same pattern, the magnitude of the differences is much smaller.

APPENDIX

D

Forecasting Employers' Contributions to Defined-Benefit Pensions and Health Insurance

Most nonwage compensation that employees receive is exempt from income tax. During the next several years, two categories of such compensation—employers' contributions to private defined-benefit pension funds and premiums that employers pay for their employees' group health insurance—are likely to grow rapidly. That growth will reduce the taxable portion of employees' compensation, corporate profits, and the income base on which the corporate tax is levied.

Contributions to Defined-Benefit Pensions

In recent years, employers' contributions to defined-benefit pension plans have surged. According to the national income and product accounts (NIPAs), such contributions more than doubled from 2001 ($36.0 billion) to 2002 ($77.2 billion) and then jumped (to $102.8 billion) in 2003. The growth in contributions occurred because many plans had become underfunded, in some cases by substantial amounts. (Being "underfunded" means that the plans' assets are insufficient to meet their projected liabilities—the pensions owed to current workers and retirees and their survivors.) The plans' underfunding contrasted with the situation that prevailed during the late 1990s, as the boom in the stock market left many plans overfunded. In that instance, not only were firms not required to contribute to defined-benefit plans but they were discouraged from doing so by limits on the tax deductibility of contributions to overfunded plans. When stock prices declined between 2000 and 2002, the value of assets fell, and many plans abruptly became underfunded.

A pension plan's projected liabilities depend on the stream of payments that it expects to make, taking into account its rules and actuarial assumptions about mortality. A further, critical element is the interest rate used to compute the present value—the value in today's dollars—of future payments. The lower the interest rate, the lower the rate at which payments are discounted and, consequently, the higher the value of future payments in today's dollars. Under the Employment Retirement Income Security Act of 1974, which sets minimum standards for funding pension plans in private industry, the interest rate used for discounting must be no more than 105 percent of a weighted average of interest rates on 30-year Treasury securities over the previous four-year period.[1] The 2000-2002 decline in stock prices, however, coincided with a sharp fall in long-term interest rates—which exacerbated the emerging underfunding.

Defined-benefit pension plans received some temporary relief from falling interest rates under the Job Creation and Worker Assistance Act of 2002 (JCWAA) and the Pension Funding Equity Act of 2004. (JCWAA allowed plans to set a rate equal to 120 percent of the weighted-average 30-year Treasury rate in 2002 and 2003; the pension funding act stipulated that for 2004 and 2005, the maximum applicable rate would be a weighted average of rates on amounts "conservatively invested in long-term corporate bonds.") As a result, the maximum applicable rate for most plans was 6.65 percent in 2003 and 6.55 percent in 2004. (Without the legislation, it would have been about 5.8 percent in 2003 and about 5.5 percent in 2004.) The Congressional Budget Office (CBO) estimates that contributions in 2004 to private defined-benefit plans dropped to about $74 billion, or roughly $80 billion below what they would have been without the

1. The Department of the Treasury no longer issues 30-year securities. Consequently, the Internal Revenue Service has published a substitute applicable rate based on the 30-year Treasury bonds that mature in February 2031.

temporary relief provided by the Pension Funding Equity Act.

One consequence of that temporary relief is that the assets of defined-benefit pension plans are now further out of line with their liabilities than they would otherwise be, meaning that future contributions will probably have to be larger. CBO projects that for 2005, defined-benefit contributions will jump to $143 billion, reflecting the lower contribution level in 2004 as well as a decline—to 6.10 percent—in the maximum interest rate applicable to most plans.[2] Under current law, contributions in 2006 are projected to more than double, to about $300 billion, with the expiration of the temporary relief measures and the resultant fall—to about 5.5 percent, based on CBO's interest rate forecast—in the maximum applicable interest rate. But as that year's contributions diminish the funding gap and the interest rate moves upward toward its estimated long-run average of 6.4 percent, contributions in CBO's estimation will fall to about $250 billion for 2007, about $200 billion for 2008, and slightly over $100 billion annually by 2015.[3]

A number of factors—including the future path of stock prices, the risk of default on pension plans' obligations, and changes in interest rates—could make those catch-up contributions either larger or smaller than CBO is forecasting. Several years of rising stock prices could increase the value of assets by enough to eliminate the underfunding in many plans. Conversely, poor performance of the stock market could drive some of the most distressed plans into default, shifting the burden of payments from a plan's sponsors to the federal Pension Benefit Guaranty Corporation. (However, a weak stock market would probably also substantially increase the contributions required for defined-benefit plans that remained in existence.) Although CBO does not attempt to forecast stock prices, it does take their variability into account when projecting defined-benefit contributions (in part because greater variation in stock prices raises the probability that any given defined-benefit plan will go into default). Interest rates are also a factor in such projections. Thus, a large and sustained increase in rates—rendering them higher than the interest rate assumptions incorporated in CBO's baseline—would help lessen the catch-up contributions that firms were required to make.

Contributions to Medical Insurance Premiums

Over the past two decades, fluctuations in the share of compensation that employees receive in the form of benefits have been heavily influenced by employers' contributions to health insurance coverage. Health insurance benefits rose modestly as a share of compensation throughout the 1980s and then surged—between 1987 and 1993, their share of compensation rose from 4.6 percent to 6.2 percent, as employers' hourly cost of providing health insurance (total contributions divided by total hours worked) grew at a double-digit rate (see Figure D-1). But by 1997, the health insurance share of total compensation had fallen to 5.3 percent, as the pace of hourly cost increases slowed sharply.

Since 1998, the growth of those costs has accelerated again—by so much that in 2003, the share of compensation attributable to health insurance reached a record 6.8 percent. Data from the employment cost index indicate that increases in employers' hourly insurance costs for private-sector workers again reached double digits in 2002 and 2003, but by the third quarter of 2004, the year-over-year increase had slowed to 7.3 percent—still roughly double the 3.7 percent rise in total hourly compensation.

CBO expects that over the next several years, the rate of increase in employers' hourly costs for health insurance will continue to slow but still grow at a pace faster than that of overall compensation. A survey of employers by Mercer Human Resources Consulting indicated an average expected rate of increase in health insurance premiums (those paid by the employer and the employee) per active employee of 6.6 percent in 2005, down from 7.5 percent in 2004.[4] During the next several years, the growth of employers' health insurance costs may continue to slow, in part because excess "profits" received by nonprofit insurers will restrain the growth of premiums. However, any slowdown will be limited because the

2. That rate, which comes from the Internal Revenue Service's corporate bond rate table, represents the corporate bond weighted-average interest rate for plan years beginning in January 2005. (Most plans' years begin in January.)

3. That long-run average is based on an assumed spread of 0.6 percentage points between the rates on 10-year and 30-year Treasury securities.

4. Additional details are available at www.mercerhr.com/pressrelease/details.jhtml/dynamic/idContent/1162645.

aging of the workforce and the ongoing introduction of expensive new medical technologies are likely to push medical costs higher.

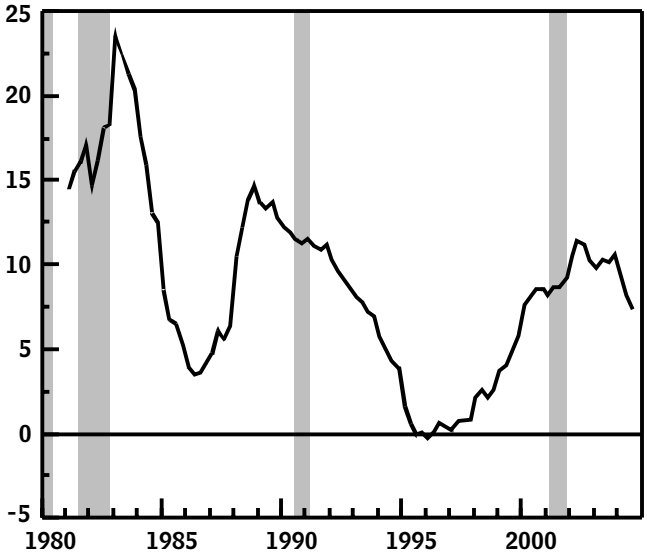
Implications for Projecting Income Shares and Revenues

Increases in employers' contributions to pensions and health insurance would, at first glance, boost labor's share of national income, resulting in lower profits and hence a smaller share of taxable income. However, the available evidence suggests that over a period of several years, most of the increased cost of those contributions will ultimately be borne by workers in the form of reduced wages or other benefits. Consequently, any effect that such increased costs might have on how income is distributed between labor and capital within the NIPAs would be short-lived; in fact, CBO's forecast incorporates the assumption that employers will be able to anticipate both regular pension contributions and increases in health insurance premiums and will take them into account in setting wages. Thus, changes in those factors will have no effect on labor's share of gross domestic product. However, required catch-up contributions to defined-benefit pension plans reflect the belated realization of previously incurred, or "sunk," costs rather than compensation for current workers (even though such contributions are treated as compensation in the NIPAs). Therefore, CBO assumes that catch-up contributions will not be offset by reductions in other forms of compensation and will continue to directly reduce firms' profits.

Figure D-1.

Employers' Hourly Health Insurance Costs

(Percentage change from previous year)



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

APPENDIX

E

CBO's Economic Projections for 2005 to 2015

Year-by-year economic projections for 2005 to 2015 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 2006. Instead, the projected values shown in the tables for 2007 through 2015 reflect CBO's assessment of average values for that period—which take into account the potential ups and downs of the business cycle.

Table E-1.

CBO's Year-by-Year Forecast and Projections for Calendar Years 2005 to 2015

	Estimated	Forecast		Projected								
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Nominal GDP (Billions of dollars)	11,730	12,396	13,059	13,766	14,486	15,210	15,940	16,680	17,437	18,221	19,031	19,861
Nominal GDP (Percentage change)	6.6	5.7	5.3	5.4	5.2	5.0	4.8	4.6	4.5	4.5	4.4	4.4
Real GDP (Percentage change)	4.4	3.8	3.7	3.7	3.4	3.1	2.9	2.8	2.7	2.7	2.6	2.5
GDP Price Index (Percentage change)	2.1	1.8	1.5	1.7	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Consumer Price Index[a] (Percentage change)	2.7	2.4	1.9	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Employment Cost Index[b] (Percentage change)	2.7	3.1	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Unemployment Rate (Percent)	5.5	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	1.4	2.8	4.0	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	4.3	4.8	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	984	1,331	1,222	1,233	1,275	1,320	1,349	1,390	1,438	1,499	1,566	1,635
Wages and salaries	5,346	5,665	5,979	6,309	6,646	6,982	7,317	7,655	8,000	8,355	8,721	9,096
Tax Bases (Percentage of GDP)												
Corporate book profits	8.4	10.7	9.4	9.0	8.8	8.7	8.5	8.3	8.2	8.2	8.2	8.2
Wages and salaries	45.6	45.7	45.8	45.8	45.9	45.9	45.9	45.9	45.9	45.9	45.8	45.8

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 2005 to 2015

	Estimated	Forecast		Projected								
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Nominal GDP (Billions of dollars)	11,553	12,233	12,888	13,586	14,307	15,029	15,757	16,494	17,245	18,023	18,826	19,652
Nominal GDP (Percentage change)	6.6	5.9	5.4	5.4	5.3	5.0	4.8	4.7	4.6	4.5	4.5	4.4
Real GDP (Percentage change)	4.6	3.8	3.7	3.8	3.5	3.2	3.0	2.8	2.7	2.7	2.6	2.6
GDP Price Index (Percentage change)	1.9	2.0	1.6	1.6	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.8
Consumer Price Index[a] (Percentage change)	2.3	2.8	1.9	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Employment Cost Index[b] (Percentage change)	2.7	3.1	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Unemployment Rate (Percent)	5.6	5.3	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	1.1	2.4	3.8	4.5	4.6	4.6	4.6	4.6	4.6	4.6	4.6	4.6
Ten-Year Treasury Note Rate (Percent)	4.3	4.6	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	970	1,257	1,247	1,223	1,264	1,311	1,342	1,378	1,426	1,483	1,549	1,614
Wages and salaries	5,279	5,584	5,900	6,225	6,562	6,898	7,233	7,570	7,912	8,265	8,629	9,002
Tax Bases (Percentage of GDP)												
Corporate book profits	8.4	10.3	9.7	9.0	8.8	8.7	8.5	8.4	8.3	8.2	8.2	8.2
Wages and salaries	45.7	45.7	45.8	45.8	45.9	45.9	45.9	45.9	45.9	45.9	45.8	45.8

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 to 2004. The data are shown in both nominal dollars and as a percentage of gross domestic product (GDP). Data for 2004 come from the Congressional Budget Office and the Office of Management and Budget. Some of the historical data have been revised since January 2004, when these tables were last published.

Federal revenues, outlays, the deficit or surplus, and debt held by the public are shown in Tables F-1 and F-2. Revenues, outlays, and the deficit or surplus 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. For the sake of consistency, the tables show the budgetary components of Social Security as off-budget prior to that year. The Postal Service was moved off-budget by the Omnibus Budget Reconciliation Act of 1989. This year, for the first time, the historical tables show the Postal Service as off-budget going back to 1972, the year it became an independent agency.

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 annual 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 largest programs—Social Security, Medicare, and Medicaid—and by various general categories. Income-security programs provide benefits to recipients with limited income and assets; those programs include unemployment compensation, Supplemental Security Income, and Food Stamps. Other 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 those military retirees 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 the Social Services Block Grant program.

The remaining tables, F-11 through F-13, show estimates of the standardized-budget deficit or surplus and its outlay and revenue components. The standardized-budget deficit or surplus (also called the structural deficit or surplus) excludes the effects that cyclical fluctuations in output and unemployment have on outlays and revenues; it also incorporates other adjustments. The change in that deficit or surplus 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.

Table F-1.

Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public, 1962 to 2004

(Billions of dollars)

			Deficit (-) or Surplus				Debt
	Revenues	Outlays	On-Budget	Social Security	Postal Service	Total	Held by the Public[a]
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	-26.1	3.1	-0.4	-23.4	322.4
1973	230.8	245.7	-15.2	0.5	-0.2	-14.9	340.9
1974	263.2	269.4	-7.2	1.8	-0.8	-6.1	343.7
1975	279.1	332.3	-54.1	2.0	-1.1	-53.2	394.7
1976	298.1	371.8	-69.4	-3.2	-1.1	-73.7	477.4
1977	355.6	409.2	-49.9	-3.9	0.2	-53.7	549.1
1978	399.6	458.7	-55.4	-4.3	0.5	-59.2	607.1
1979	463.3	504.0	-39.6	-2.0	0.9	-40.7	640.3
1980	517.1	590.9	-73.1	-1.1	0.4	-73.8	711.9
1981	599.3	678.2	-73.9	-5.0	-0.1	-79.0	789.4
1982	617.8	745.7	-120.6	-7.9	0.6	-128.0	924.6
1983	600.6	808.4	-207.7	0.2	-0.3	-207.8	1,137.3
1984	666.5	851.9	-185.3	0.3	-0.4	-185.4	1,307.0
1985	734.1	946.4	-221.5	9.4	-0.1	-212.3	1,507.3
1986	769.2	990.4	-237.9	16.7	*	-221.2	1,740.6
1987	854.4	1,004.1	-168.4	19.6	-0.9	-149.7	1,889.8
1988	909.3	1,064.5	-192.3	38.8	-1.7	-155.2	2,051.6
1989	991.2	1,143.8	-205.4	52.4	0.3	-152.6	2,190.7
1990	1,032.0	1,253.1	-277.7	58.2	-1.6	-221.1	2,411.6
1991	1,055.0	1,324.3	-321.5	53.5	-1.3	-269.3	2,689.0
1992	1,091.3	1,381.6	-340.4	50.7	-0.7	-290.3	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	-203.2	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	1,601.2	-103.3	81.3	*	-21.9	3,772.3
1998	1,721.8	1,652.6	-30.0	99.4	-0.2	69.2	3,721.1
1999	1,827.5	1,701.9	1.9	124.7	-1.0	125.5	3,632.4
2000	2,025.2	1,789.1	86.3	151.8	-2.0	236.2	3,409.8
2001	1,991.2	1,863.0	-32.5	163.0	-2.3	128.2	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	2,159.9	-538.4	155.6	5.2	-377.6	3,913.4
2004	1,880.1	2,292.2	-567.4	151.1	4.1	-412.1	4,295.5

Source: Congressional Budget Office.

Note: n.a. = not applicable; * = between -$50 million and $50 million.

a. End of year.

Table F-2.

Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public, 1962 to 2004

(Percentage of GDP)

			Deficit (-) or Surplus				Debt
	Revenues	Outlays	On-Budget	Social Security	Postal Service	Total	Held by the Public[a]
1962	17.6	18.8	-1.0	-0.2	n.a.	-1.3	43.7
1963	17.8	18.6	-0.7	-0.1	n.a.	-0.8	42.4
1964	17.6	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	34.9
1967	18.4	19.4	-1.6	0.5	n.a.	-1.1	32.9
1968	17.6	20.5	-3.2	0.3	n.a.	-2.9	33.3
1969	19.7	19.4	-0.1	0.4	n.a.	0.3	29.3
1970	19.0	19.3	-0.9	0.6	n.a.	-0.3	28.0
1971	17.3	19.5	-2.4	0.3	n.a.	-2.1	28.1
1972	17.6	19.6	-2.2	0.3	*	-2.0	27.4
1973	17.6	18.7	-1.2	*	*	-1.1	26.0
1974	18.3	18.7	-0.5	0.1	-0.1	-0.4	23.9
1975	17.9	21.3	-3.5	0.1	-0.1	-3.4	25.3
1976	17.1	21.4	-4.0	-0.2	-0.1	-4.2	27.5
1977	18.0	20.7	-2.5	-0.2	*	-2.7	27.8
1978	18.0	20.7	-2.5	-0.2	*	-2.7	27.4
1979	18.5	20.1	-1.6	-0.1	*	-1.6	25.6
1980	19.0	21.7	-2.7	*	*	-2.7	26.1
1981	19.6	22.2	-2.4	-0.2	*	-2.6	25.8
1982	19.2	23.1	-3.7	-0.2	*	-4.0	28.7
1983	17.4	23.5	-6.0	*	*	-6.0	33.0
1984	17.3	22.1	-4.8	*	*	-4.8	34.0
1985	17.7	22.8	-5.3	0.2	*	-5.1	36.3
1986	17.5	22.5	-5.4	0.4	*	-5.0	39.5
1987	18.4	21.6	-3.6	0.4	*	-3.2	40.6
1988	18.1	21.2	-3.8	0.8	*	-3.1	40.9
1989	18.3	21.2	-3.8	1.0	*	-2.8	40.6
1990	18.0	21.8	-4.8	1.0	*	-3.9	42.0
1991	17.8	22.3	-5.4	0.9	*	-4.5	45.3
1992	17.5	22.1	-5.5	0.8	*	-4.7	48.1
1993	17.5	21.4	-4.6	0.7	*	-3.9	49.4
1994	18.1	21.0	-3.7	0.8	*	-2.9	49.3
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	19.6	-1.3	1.0	*	-0.3	46.1
1998	20.0	19.2	-0.3	1.2	*	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	18.5	-0.3	1.6	*	1.3	33.0
2002	17.8	19.4	-3.1	1.5	*	-1.5	34.1
2003	16.4	19.9	-5.0	1.4	*	-3.5	36.1
2004	16.3	19.8	-4.9	1.3	*	-3.6	37.2

Source: Congressional Budget Office.

Note: n.a. = not applicable; * = between -0.05 percent and 0.05 percent.

a. End of year.

Table F-3.

Revenues by Major Source, 1962 to 2004

(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
2004	809.0	189.4	733.4	69.9	24.8	21.1	32.6	1,880.1

Source: Congressional Budget Office.

Table F-4.

Revenues by Major Source, 1962 to 2004

(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	17.6
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	17.6
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	18.4
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	1.6	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	17.1
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	5.6	0.7	0.2	0.3	0.4	18.5
1980	9.0	2.4	5.8	0.9	0.2	0.3	0.5	19.0
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	19.2
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	6.4	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	8.3	1.9	6.7	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	7.6	1.6	6.6	0.7	0.2	0.3	0.4	17.5
1993	7.7	1.8	6.5	0.7	0.2	0.3	0.3	17.5
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	6.7	0.6	0.3	0.2	0.3	17.8
2003	7.3	1.2	6.6	0.6	0.2	0.2	0.3	16.4
2004	7.0	1.6	6.3	0.6	0.2	0.2	0.3	16.3

Source: Congressional Budget Office.

Table F-5.

Outlays for Major Spending Categories, 1962 to 2004

(Billions of dollars)

	Discretionary Spending	Mandatory Spending: Program Spending[a]	Mandatory Spending: 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	505.1	-56.8	151.8	1,064.5
1989	488.8	549.8	-63.8	169.0	1,143.8
1990	500.6	626.8	-58.7	184.3	1,253.1
1991	533.3	702.3	-105.7	194.4	1,324.3
1992	533.8	716.8	-68.4	199.3	1,381.6
1993	539.4	738.0	-66.6	198.7	1,409.5
1994	541.4	786.0	-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	1,601.2
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	-78.6	222.9	1,789.1
2001	649.3	1,094.4	-86.8	206.2	1,863.0
2002	734.3	1,196.7	-91.0	170.9	2,011.0
2003	825.4	1,281.6	-100.2	153.1	2,159.9
2004	895.0	1,345.7	-108.7	160.2	2,292.2

Source: Congressional Budget Office.

a. Excludes offsetting receipts.

Table F-6.

Outlays for Major Spending Categories, 1962 to 2004

(Percentage of GDP)

		Mandatory Spending			
	Discretionary Spending	Program Spending[a]	Offsetting Receipts	Net Interest	Total Outlays
1962	12.7	6.1	-1.2	1.2	18.8
1963	12.6	6.0	-1.3	1.3	18.6
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	19.4
1970	11.9	7.2	-1.1	1.4	19.3
1971	11.3	8.0	-1.3	1.4	19.5
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	10.3	-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	21.7
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	22.8
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	22.1
1993	8.2	11.2	-1.0	3.0	21.4
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	19.6
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	2.0	18.5
2002	7.1	11.5	-0.9	1.6	19.4
2003	7.6	11.8	-0.9	1.4	19.9
2004	7.7	11.6	-0.9	1.4	19.8

Source: Congressional Budget Office.

a. Excludes offsetting receipts.

Table F-7.

Discretionary Outlays, 1962 to 2004

(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	734.3
2003	404.9	27.9	392.6	825.4
2004	454.1	33.8	407.1	895.0

Source: Congressional Budget Office.

Table F-8.

Discretionary Outlays, 1962 to 2004

(Percentage of GDP)

	Defense	International	Domestic	Total
1962	9.3	1.0	2.5	12.7
1963	9.0	0.9	2.7	12.6
1964	8.6	0.7	3.0	12.3
1965	7.4	0.7	3.2	11.3
1966	7.8	0.7	3.5	11.9
1967	8.9	0.7	3.6	13.1
1968	9.5	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	4.8	0.3	3.4	8.6
1993	4.4	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
2004	3.9	0.3	3.5	7.7

Source: Congressional Budget Office.

Table F-9.

Outlays for Mandatory Spending, 1962 to 2004

(Billions of dollars)

	Social Security	Medicare	Medicaid	Income Security[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	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	37.5	-29.2	262.1
1981	137.9	41.3	16.8	49.9	50.8	42.6	-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	45.5	-45.3	365.2
1984	176.1	61.1	20.1	51.7	59.8	36.8	-44.2	361.3
1985	186.4	69.7	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	93.2	34.6	60.8	74.6	56.2	-63.8	486.0
1990	246.5	107.0	41.1	68.4	76.1	87.7	-58.7	568.2
1991	266.8	114.2	52.5	86.6	82.2	100.0	-105.7	596.5
1992	285.2	129.4	67.8	110.0	84.8	39.6	-68.4	648.4
1993	302.0	143.2	75.8	116.1	87.2	13.7	-66.6	671.4
1994	316.9	159.6	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	38.8	-86.8	1,007.5
2002	452.1	253.7	147.5	179.9	124.9	38.6	-91.0	1,105.7
2003	470.5	274.2	160.7	196.4	129.4	50.5	-100.2	1,181.4
2004	491.5	297.4	176.2	190.7	135.0	54.8	-108.7	1,237.0

Source: Congressional Budget Office.

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 Mandatory Spending, 1962 to 2004

(Percentage of GDP)

	Social Security	Medicare	Medicaid	Income Security[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	1.2	1.3	-1.1	4.6
1966	2.7	0	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	5.7
1970	2.9	0.7	0.3	0.8	1.2	1.3	-1.1	6.0
1971	3.3	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	9.7
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	1.4	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	9.4
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	4.5	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	4.4	2.4	1.2	1.4	1.2	0.3	-0.9	10.0
1999	4.2	2.3	1.2	1.4	1.2	0.4	-0.8	9.9
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	10.0
2002	4.4	2.4	1.4	1.7	1.2	0.4	-0.9	10.6
2003	4.3	2.5	1.5	1.8	1.2	0.5	-0.9	10.9
2004	4.3	2.6	1.5	1.7	1.2	0.5	-0.9	10.7

Source: Congressional Budget Office.

Note: * = between zero 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.

Deficits, Surpluses, Debt, and Related Series, 1962 to 2004

	Billions of Dollars			Percentage of Potential GDP			GDP (Billions of dollars)	
	Deficit (-) or Surplus	Standardized-Budget Deficit (-) or Surplus[a]	Debt Held by the Public	Deficit (-) or Surplus	Standardized-Budget Deficit (-) or Surplus[a]	Debt Held by the Public	Actual[b]	Potential
1962	-7	-4	248	-1.2	-0.7	43.1	568	575
1963	-5	-4	254	-0.8	-0.6	42.0	599	604
1964	-6	-6	257	-0.9	-1.0	40.3	641	637
1965	-1	-5	261	-0.2	-0.7	38.6	687	675
1966	-4	-14	264	-0.5	-2.0	36.6	756	720
1967	-9	-22	267	-1.1	-2.8	34.3	810	777
1968	-25	-31	290	-3.0	-3.7	34.4	869	841
1969	3	-3	278	0.4	-0.3	30.3	948	917
1970	-3	2	283	-0.3	0.2	28.2	1,013	1,003
1971	-23	-10	303	-2.1	-0.9	27.8	1,080	1,091
1972	-23	-21	322	-2.0	-1.7	27.3	1,177	1,180
1973	-15	-20	341	-1.2	-1.6	26.8	1,311	1,274
1974	-6	2	344	-0.4	0.1	24.3	1,439	1,415
1975	-53	3	395	-3.3	0.2	24.4	1,561	1,616
1976	-74	-36	477	-4.1	-2.0	26.7	1,739	1,790
1977	-54	-21	549	-2.7	-1.1	27.4	1,974	2,003
1978	-59	-33	607	-2.7	-1.5	27.4	2,218	2,213
1979	-41	-18	640	-1.6	-0.7	25.9	2,502	2,472
1980	-74	-11	712	-2.7	-0.4	25.7	2,725	2,773
1981	-79	-12	789	-2.5	-0.4	25.2	3,059	3,131
1982	-128	-38	925	-3.7	-1.1	26.9	3,226	3,436
1983	-208	-109	1,137	-5.6	-3.0	30.9	3,443	3,686
1984	-185	-141	1,307	-4.7	-3.6	33.2	3,847	3,934
1985	-212	-180	1,507	-5.1	-4.3	36.0	4,149	4,188
1986	-221	-213	1,741	-5.0	-4.8	39.3	4,407	4,426
1987	-150	-159	1,890	-3.2	-3.4	40.3	4,654	4,688
1988	-155	-128	2,052	-3.1	-2.6	41.1	5,012	4,991
1989	-153	-120	2,191	-2.9	-2.2	41.0	5,402	5,341
1990	-221	-123	2,412	-3.9	-2.2	42.3	5,737	5,704
1991	-269	-153	2,689	-4.4	-2.5	44.2	5,934	6,081
1992	-290	-188	3,000	-4.5	-2.9	46.9	6,241	6,398
1993	-255	-192	3,248	-3.8	-2.9	48.4	6,578	6,711
1994	-203	-145	3,433	-2.9	-2.1	48.8	6,964	7,038
1995	-164	-145	3,604	-2.2	-2.0	48.8	7,325	7,390
1996	-107	-92	3,734	-1.4	-1.2	48.1	7,697	7,760
1997	-22	-78	3,772	-0.3	-1.0	46.3	8,187	8,152
1998	69	-34	3,721	0.8	-0.4	43.6	8,626	8,535
1999	126	8	3,632	1.4	0.1	40.5	9,127	8,965
2000	236	116	3,410	2.5	1.2	35.9	9,708	9,492
2001	128	115	3,320	1.3	1.1	32.9	10,060	10,077
2002	-158	-117	3,540	-1.5	-1.1	33.3	10,389	10,635
2003	-378	-303	3,913	-3.4	-2.7	35.0	10,841	11,182
2004	-412	-280	4,296	-3.5	-2.4	36.5	11,553	11,758

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 seasonally adjusted quarterly national income and product account data from the Bureau of Economic Analysis.

Table F-12.

Standardized-Budget Deficit or Surplus and Related Series, 1962 to 2004

(Billions of dollars)

	Budget Deficit (-) or Surplus	−	Cyclical Contribution	+	Other Adjustments[a]	=	Standardized-Budget Deficit (-) or Surplus	Revenues	Outlays
1962	-7		-2		1		-4	99	104
1963	-5		-2		*		-4	106	110
1964	-6		2		1		-6	109	115
1965	-1		5		1		-5	110	115
1966	-4		13		2		-14	115	130
1967	-9		12		-1		-22	131	153
1968	-25		11		5		-31	140	171
1969	3		14		8		-3	171	173
1970	-3		5		10		2	186	184
1971	-23		-4		9		-10	187	197
1972	-23		*		2		-21	199	220
1973	-15		14		8		-20	214	234
1974	-6		10		18		2	251	249
1975	-53		-22		35		3	300	297
1976	-74		-24		14		-36	309	345
1977	-54		-13		20		-21	357	379
1978	-59		3		29		-33	389	422
1979	-41		12		35		-18	442	460
1980	-74		-20		43		-11	521	532
1981	-79		-29		38		-12	611	623
1982	-128		-67		23		-38	661	699
1983	-208		-91		7		-109	657	766
1984	-185		-32		12		-141	675	816
1985	-212		-15		17		-180	723	902
1986	-221		-9		-1		-213	745	958
1987	-150		-11		-20		-159	813	972
1988	-155		9		37		-128	867	995
1989	-153		22		55		-120	936	1,055
1990	-221		12		109		-123	990	1,113
1991	-269		-46		70		-153	1,067	1,220
1992	-290		-61		41		-188	1,125	1,313
1993	-255		-51		11		-192	1,167	1,359
1994	-203		-29		30		-145	1,247	1,391
1995	-164		-19		*		-145	1,332	1,477
1996	-107		-21		-6		-92	1,419	1,511
1997	-22		12		-44		-78	1,498	1,576
1998	69		36		-67		-34	1,601	1,634
1999	126		60		-57		8	1,670	1,662
2000	236		83		-38		116	1,833	1,717
2001	128		6		-7		115	1,913	1,798
2002	-158		-79		-38		-117	1,839	1,956
2003	-378		-103		-29		-303	1,793	2,096
2004	-412		-60		72		-280	1,932	2,212

Source: Congressional Budget Office.

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

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 Deficit or Surplus and Related Series, 1962 to 2004

(Percentage of potential GDP)

	Budget Deficit (-) or Surplus	–	Cyclical Contribution	+	Other Adjustments[a]	=	Standardized-Budget Deficit (-) or Surplus	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	18.2
1964	-0.9		0.3		0.2		-1.0	17.1	18.0
1965	-0.2		0.7		0.2		-0.7	16.3	17.0
1966	-0.5		1.8		0.3		-2.0	16.0	18.0
1967	-1.1		1.6		-0.2		-2.8	16.9	19.7
1968	-3.0		1.3		0.6		-3.7	16.6	20.3
1969	0.4		1.5		0.9		-0.3	18.6	18.9
1970	-0.3		0.5		1.0		0.2	18.5	18.4
1971	-2.1		-0.3		0.9		-0.9	17.1	18.1
1972	-2.0		*		0.2		-1.7	16.9	18.6
1973	-1.2		1.1		0.6		-1.6	16.8	18.4
1974	-0.4		0.7		1.3		0.1	17.7	17.6
1975	-3.3		-1.3		2.1		0.2	18.6	18.4
1976	-4.1		-1.3		0.8		-2.0	17.2	19.3
1977	-2.7		-0.6		1.0		-1.1	17.8	18.9
1978	-2.7		0.1		1.3		-1.5	17.6	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	17.2	20.7
1985	-5.1		-0.4		0.4		-4.3	17.3	21.5
1986	-5.0		-0.2		*		-4.8	16.8	21.7
1987	-3.2		-0.2		-0.4		-3.4	17.3	20.7
1988	-3.1		0.2		0.7		-2.6	17.4	19.9
1989	-2.9		0.4		1.0		-2.2	17.5	19.8
1990	-3.9		0.2		1.9		-2.2	17.3	19.5
1991	-4.4		-0.8		1.1		-2.5	17.5	20.1
1992	-4.5		-1.0		0.6		-2.9	17.6	20.5
1993	-3.8		-0.8		0.2		-2.9	17.4	20.3
1994	-2.9		-0.4		0.4		-2.1	17.7	19.8
1995	-2.2		-0.3		*		-2.0	18.0	20.0
1996	-1.4		-0.3		-0.1		-1.2	18.3	19.5
1997	-0.3		0.1		-0.5		-1.0	18.4	19.3
1998	0.8		0.4		-0.8		-0.4	18.8	19.1
1999	1.4		0.7		-0.6		0.1	18.6	18.5
2000	2.5		0.9		-0.4		1.2	19.3	18.1
2001	1.3		0.1		-0.1		1.1	19.0	17.8
2002	-1.5		-0.7		-0.4		-1.1	17.3	18.4
2003	-3.4		-0.9		-0.3		-2.7	16.0	18.7
2004	-3.5		-0.5		0.6		-2.4	16.4	18.8

Source: Congressional Budget Office.

Note: * = between -0.05 percent and zero.

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

Annabelle Bartsch	Customs duties, miscellaneous receipts
Mark Booth	Individual income taxes
Paul Burnham	Retirement income
Barbara Edwards	Social insurance taxes, Federal Reserve System earnings
Pamela Greene	Corporate income taxes, estate and gift taxes
Laura Hanlon	Excise taxes
Ed Harris	Corporate income taxes
Rob McClelland	Estate and gift taxes
Larry Ozanne	Capital gains realizations
Monisha Primlani	Individual income taxes
Kurt Seibert	Earned income tax credit
David Weiner	Individual income taxes

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
Dan Frisk	Military activities in Iraq and Afghanistan and for the war on terrorism
J. Michael Gilmore	Military activities in Iraq and Afghanistan and for the war on terrorism
Raymond Hall	Defense (Navy weapons, missile defenses, stockpile sales, atomic energy defense)
Sarah Jennings	Military retirement, veterans' education
Fran Lussier	Military activities in Iraq and Afghanistan and for the war on terrorism

David Newman	Defense (infrastructure and procurement, military activities in Iraq and Afghanistan and for the war on terrorism)
Sam Papenfuss	Veterans' health care, military health care
Michelle Patterson	Defense (military personnel)
Adam Talaber	Military activities in Iraq and Afghanistan and for the war on terrorism
Jason Wheelock	Defense (military activities in Iraq and Afghanistan and for the war on terrorism, other programs), intelligence programs, radiation exposure compensation, Department of Energy employees' occupational illness compensation
Joseph Whitehill	International affairs (development, security, international financial institutions)
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Health

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Human Resources

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Kathleen FitzGerald	Food Stamps and nutrition programs, child and family services
Geoffrey Gerhardt	Federal civilian retirement, Pension Benefit Guaranty Corporation, Supplemental Security Income, Railroad Retirement
Justin Humphrey	Elementary and secondary education, Pell grants
Deborah Kalcevic	Education
Matthew Kapuscinski	Low Income Home Energy Assistance Program, refugee assistance
Chad Newcomb	Social Security
Kathy Ruffing	Social Security
Christina Hawley Sadoti	Unemployment insurance, training programs, Administration on Aging, foster care, Smithsonian, arts and humanities

Natural and Physical Resources

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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, 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
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Matthew Pickford	General government
Deborah Reis	Recreation, water transportation, community development, other natural resources, legislative branch
Lanette Walker	Justice, regional development
Greg Waring	Air transportation
Michael Waters	Science and space exploration, Bureau of Indian Affairs
Melissa Zimmerman	Commerce, Small Business Administration, Universal Service Fund

Other

Janet Airis	Unit Chief, Scorekeeping
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Joanna Capps	Appropriation bills (Agriculture, Interior)
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Ellen Hays	Federal pay, report coordinator
Catherine Little	Appropriation bills (VA-HUD, Transportation-Treasury)
Virginia Myers	Appropriation bills (Commerce-Justice-State, foreign operations)
Eric Schatten	Interest on the public debt, report coordinator
Robert Sempsey	Appropriation bills (Labor-HHS, Homeland Security, military construction)
Gerard Trimarco	Other interest, report coordinator
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Glossary

This glossary defines economic and budgetary terms as they apply to the Congressional Budget Office's annual *Budget and Economic Outlook* and also acts as a general reference for readers. Some entries sacrifice technical precision for the sake of brevity and clarity. Where appropriate, entries note the sources of data for economic variables 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 to 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, obligation delay,** and **unobligated balances.**

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, 2005." 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 authorization 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. That law 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 pay-as-you-go process and the discretionary spending limits separately. However, on September 30, 2002, the discretionary spending limits and the sequestration procedure to enforce those caps expired, and the Office of Management and Budget (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, discretionary spending limits, 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 deficit or surplus 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 approximately 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, entitlement 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: See **Balanced Budget and Emergency Deficit Control Act of 1985.**

budget function: One of 20 general subject 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 forth in law and in

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 monetary resources raised by governments, individuals, or businesses by issuing securities 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 to production in different ways.

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.**

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's 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 deficit or surplus: The portion of the federal budget deficit or surplus that results from cyclical factors rather than from underlying fiscal policy. This cyclical component reflects the way in which the deficit or surplus automatically increases or decreases during economic booms or recessions. (CBO) See **deficit, fiscal policy,** and **surplus;** compare with **standardized-budget deficit or surplus.**

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 deficit or surplus.

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 in 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: A 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. In this report, direct spending refers to the outlays that result from budget authority provided in laws other than appropriation acts. 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 of 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. In this report, discretionary spending refers to the outlays that result from budget authority provided in appropriation acts. 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. Although one provision has been made permanent, the remainder of the law's provisions are scheduled to expire on or before December 31, 2010. See **Jobs and Growth Tax Relief Reconciliation Act of 2003** and **Job Creation and Worker Assistance Act of 2002.**

economic profits: Profits of corporations, adjusted to remove 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 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: Work performed or services rendered in exchange for compensation. There are two commonly used estimates of employment: the establishment survey, based on a survey of employers (the Current Employment Statistics Survey); and the household survey, based on a survey of households (the Current Population Survey). In the establishment survey, employment is an estimate of the number of nonfarm wage and salary jobs (so a person with more than one job may be counted more than once). The establishment survey does not include the unincorporated self-employed, unpaid family workers, agriculture and related workers (except in the area of logging), private household workers, and workers who are temporarily absent from their jobs (for instance, those on leave without pay or on strike). In the household survey, employment is an estimate of the number of employed people (so a person with more than one job will be counted only once). The household survey is based on a smaller sample than the establishment survey and, therefore, yields a more volatile estimate of employment.

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 by changes in employment by industry. (BLS)

entitlement: A legal obligation of the federal government to make payments to a person, group of people, 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 (and offsetting collections) that are usually financed from an associated receipt account. See **federal funds** and **trust funds;** compare with **receipt account.**

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: In the federal accounting structure, federal funds are all accounts through which collections of money and expenditures are recorded, 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 stance 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,** 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 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 tax and spending programs, which influence 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 deficit or surplus, 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 effect on 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 deficit or surplus,** and **surplus.**

fiscal year: A yearly accounting period. The federal government's fiscal year begins October 1 and ends September 30. Fiscal years are designated by the calendar years in which they end—for example, fiscal year 2006 will begin on October 1, 2005, and end on September 30, 2006.

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, obligation delay,** and **unobligated balances.**

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 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 category of federal funds in the government's accounting structure. The general fund records all revenues and offsetting receipts not earmarked by law for a specific purpose and all spending financed by those revenues and receipts. See **federal funds, offsetting receipts,** and **revenues;** 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 workforce productivity. 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 allowing 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 law 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. See **Economic Growth and Tax Relief Reconciliation Act of 2001** and **Jobs and Growth Tax Relief Reconciliation Act of 2003.**

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 law 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 age 16 or older in the civilian, noninstitutional population who have jobs or who are available for work and are actively seeking jobs. The civilian, noninstitutional population excludes members of the armed forces on active duty and people in penal or mental institutions or in homes for the aged or infirm. The labor force participation rate is the labor force as a percentage of the civilian, 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,** and **short-term interest rate.**

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 such institutional factors as legal minimum wages, the presence of unions, social conventions, or employer wage-setting practices intended to increase workers' morale and effort. 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 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, forward funding,** and **unobligated balances.**

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 government agencies from other government accounts or from the public in businesslike or market-oriented transactions that are required by law to be credited directly to an expenditure account. Offsetting collections, treated as negative budget authority and outlays, are credits against the budget authority and outlays (either direct or discretionary spending) of the account to which the collections are credited. 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 government agencies from other government accounts or from the public in businesslike or market-oriented transactions that are credited to a receipt account. Offsetting receipts, treated as negative budget authority and outlays, offset gross budget authority and outlays in calculations of total direct spending. 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 on a cash accounting basis. However, outlays for interest on debt held by the public are recorded on an accrual accounting basis, and outlays for direct loans and loan guarantees (since credit reform) reflect estimated subsidy costs instead of cash transactions. See **accrual accounting, budget authority, cash accounting, 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 rev-

enues 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, OMB 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: The 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 dollar** and **nominal.**

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 that fund. The receipt account typically finances the obligations and outlays from an associated expenditure account. See **federal funds** and **trust funds;** compare with **expenditure account.**

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 revenues or direct spending laws under their jurisdictions 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 that arise from 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), or the volatility of interest rates or earnings (in the case of corporate equities).

S corporation: A domestically owned corporation with no more than 100 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 discre-

tionary 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 in 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 deficit or surplus: The level of the federal budget deficit or surplus that would occur under current law if the economy operated at potential GDP. The standardized-budget deficit or surplus 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 deficit or surplus.**

structural deficit or surplus: Same as **standardized-budget deficit or surplus.**

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: In the federal accounting structure, trust funds are accounts designated by law as trust funds (regardless of any other meaning of that term). Trust funds record the revenues, offsetting receipts, or offsetting collections earmarked for the purpose of the fund, and budget authority and outlays of that fund financed by those revenues or receipts. 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 col-**

lections, offsetting receipts, outlays, and **revenues;** compare with **federal funds.**

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: Official and private payments from the United States to sources abroad and from sources abroad to the United States, where the payments are not made in exchange for goods or services—for instance, a private gift sent abroad, a pension payment from a U.S. employer to a foreign resident, or taxes paid to the United States by people residing abroad.

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 expended or 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: Money charged by the federal government for federal services or for the sale or use of federal goods or resources that generally provide benefits to the recipients beyond those that may accrue to the general public. The amount of the fee is related to the cost of the service provided or the value of the good or resource used. In the federal budget, user fees can be classified as offsetting collections, offsetting receipts, or revenues. See **offsetting collections, offsetting receipts,** and **revenues.**

WFTRA: See **Working Families Tax Relief Act of 2004.**

Working Families Tax Relief Act of 2004 (Public Law 108-311): Referred to in CBO reports as WFTRA, it was signed into law on October 4, 2004. The law retains JGTRRA's acceleration of the tax reductions originally phased in under EGTRRA and extends numerous other provisions of the Internal Revenue Code that had expired, or were set to expire, including the research and experimentation tax credit, parity in the application of certain mental health benefits, and the increased share of rum excise tax revenues that is paid to Puerto Rico and the U.S. Virgin Islands. In addition, the law establishes a uniform definition of a "qualifying child" for determining taxpayers' filing status and eligibility for certain tax credits and exemptions. See **Economic Growth and Tax Relief Reconciliation Act of 2001** and **Jobs and Growth Tax Relief Reconciliation Act of 2003.**

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.**