tax break

by William G. Gale and Peter R. Orszag

Perspectives on the Budget Outlook

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I. Introduction

The release of the Congressional Budget Office's new baseline budget projections on January 29 offers the opportunity to reassess the fiscal status of the federal government as Congress and the administration consider a new set of budget proposals. This article examines the current budget outlook, the magnitude and sources of changes in the outlook since January 2001, and adjustments to the official data that more accurately reflect the continuation of current policy and the government's underlying financial status. Based on this analysis, we also provide a very preliminary and brief assessment of the administration's new budget proposals. We reach the following conclusions:

- CBO now projects a 10-year baseline unified surplus of $1.3 trillion for fiscal years 2004 to 2013. But the budget outside of Social Security faces a baseline deficit of $1.2 trillion, and outside of the Medicare and Social Security Trust Funds, the baseline deficit is $1.6 trillion. (None of the figures in this article include recent tax proposals, a Medicare prescription drug benefit, or the cost of a war with Iraq. Incorporating these items would make the budget outlook look less promising.)
- These figures represent staggering declines from the baseline forecasts made two years ago. The projected unified budget outcome for 2002 to 2011 deteriorated from a projected surplus of $5.6 trillion (4 percent of GDP) in January 2001 to essentially zero ($20 billion) in January 2003. The budget outcome for 2002 alone declined by $471 billion (4.6 percent of GDP).
- The short-term changes are due primarily to worsening economic conditions, which account for about two-thirds of the decline in 2002 and about half of the projected change for 2003. The longer-term changes are due as much to the 2001 tax cut — which accounts for 40 percent of the deterioration in the budget outlook for 2010 — as to economic and technical changes, which account for 37 percent.
- The official projections significantly misrepresent the government's underlying fiscal position because of unrealistic assumptions regarding the continuation of current policy and because retirement programs are merged with other programs in the budget.
- Making realistic assumptions about how current policies will be maintained — in particular, that expiring tax provisions are extended, a moderate AMT fix is provided, and real per capita discretionary spending is held constant — we estimate that the adjusted unified budget is in deficit for each of the next 10 years and will cumulate deficits of $1.1 trillion over the decade. These deficits emerge just from efforts to maintain the policy status quo. The differences between the official and our adjusted projections for the unified budget grow over time. In 2013 alone, the difference exceeds $600 billion (3.6 percent of GDP).
- The unified budget figures above include large cash-flow surpluses accruing in trust funds for Social Security, Medicare, and government pensions over the next 10 years. But in the longer term, Social Security and Medicare face significant deficits. The adjusted budget outside of these trust funds faces a deficit of $4.5 trillion over the next decade, including an adjusted deficit of 4 percent of GDP in 2003 and an average deficit of just over 3 percent of GDP during the rest of the decade.
- Policymakers face three sets of budget challenges: near-term deficits (over the next two years), medium-term deficits (over the next three to 10 years), and long-term deficits (beyond the 10-year horizon). The near-term deficits are not a major problem in and of themselves — the economy could use a boost right now and unusual events like a war should be at least partially funded via deficits.
- The implied medium- and long-term deficits, however, are troubling. First, our adjusted unified budget shows a deficit in each of the next 10 years, even though the economy is predicted to have reached full employment

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within the next few years. This indicates a persistent and fundamental imbalance between projected tax and spending policies even before the bulk of the baby boomers will have retired. Second, the medium-term deficits will be followed by a period in which projected deficits rise substantially. The time profile of projected deficits implies that if fiscal responsibility is not established in the remainder of this decade, it will prove much more difficult to do so after the baby boomers start retiring.

- Ignoring the medium- and long-term fiscal gaps would represent a significant policy mistake. Making the fiscal gap worse would be an even bigger mistake. Policymakers should be particularly wary of proposals that would raise medium- and long-term deficits; that reduce medium-term deficits by shifting revenues from the future to within the 10-year budget window; or that detract attention from these issues.
- The administration's new budget is replete with such problematic proposals. These include making the 2001 tax cut permanent, massively expanding Roth IRA treatment of saving, encouraging rollovers of existing IRAs to back-loaded saving plans, and focusing on a five-year budget horizon. The administration's policies would produce unified "deficits as far as the eye can see" even though the economy is projected to return to full employment in a few years. The deficits would be much larger if the retirement trust funds were not included. The administration's proposals would exacerbate the nation's fiscal problems in the medium and long term.

The administration's new budget is replete with problematic proposals.

Section II summarizes CBO's recent budget projections and discusses the level and sources of changes in the projections over time. Section III explores adjustments to the official budget baseline. Section IV offers a set of concluding remarks.

II. The Changing Budget Outlook

Table 1 reports selected baseline projections made by the Congressional Budget Office (CBO) since January 2001. Appendix Table 1 contains the projections for each year, and Figures 1a-1c plot the data on an annual basis.

Before turning to the specific figures, it is helpful to note the two dominant general trends. First, projected budget outcomes have deteriorated dramatically since January 2001. The unified budget shows a cumulative decline of $5.6 trillion over the 2002 to 2011 horizon. This change is substantial; it represents more than 4 percent of projected GDP and more than 20 percent of projected federal revenue or projected federal spending over this period. Moreover, the change is not a temporary shock. The time path of projected revenue has fallen substantially over the entire decade since the January 2001 forecast.

Second, all of the official projections show significantly worse outcomes in the next few years than toward the end of the decade. The time pattern of the deficits may at first glance be heartening, since the official baseline appears to imply that the budget will right itself over time. However, as we show in section III, realistic adjustments for current policy will imply continual deficits rather than the re-emergence of surpluses over time.

The specific figures show that the unified budget deficit was $158 billion in 2002. The baseline projects a unified deficit of $199 billion in 2003, with the deficit then falling and eventually turning to a surplus by 2007. The official projected surplus then rises to more than $500 billion by 2013. (As shown below, the entire baseline surplus in 2013 reflects assumptions that expiring tax provisions — like the 2001 tax cut — are allowed to expire, and that no fix for the AMT is provided.) As a result, the budget for 2004 through 2009 runs a cumulative deficit, and more than 90 percent of the cumulative $1.3 trillion 10-year surplus for 2004 to 2013 is accounted for by surpluses projected for 2011 to 2013.

Outside of Social Security, the 10-year budget now faces a deficit of $1.2 trillion, with deficits in every year through 2010. In contrast, in January 2001, the non-Social Security budget was projected to run surpluses of $3.1 trillion through 2011, with annual surpluses rising steadily over time from $141 billion to $558 billion.

Outside of the Social Security and Medicare Trust Funds, the budget is projected to stay in deficit until 2012, and has a cumulative deficit of $1.6 trillion over the next 10 years. Again, these projections represent stark changes from January 2001. At that point, the budget outside of the Medicare and Social Security Trust Funds had a projected surplus of $2.7 trillion through 2011.

Table 2 examines the sources of the decline since January 2001 in projected unified budget outcomes over the 2002-2011 time period (with the annual figures presented in Appendix Table 2 and plotted in Figure 2). Of the $5.6 trillion decline in the cumulative 2002-11 projected surplus, about $1.6 trillion is due to the 2001 tax cut, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), including the additional interest on induced increases in federal debt.[1] About $2.6 trillion arises from the combination of economic and technical changes, while $1.4 trillion is attributable to increased spending — primarily defense ($736 billion) and homeland security outlays in the aftermath of the terrorist attacks — and other revenue changes, namely the 2002 tax cut stimulus package.

(Text continued on p. 1010.)

[1]This figure includes only the revenue losses, outlay increases, and debt services costs that occur within the 2002 to 2011 time period. It omits the direct revenue losses due to the tax cuts that occurred in 2001, but includes the interest costs on those tax cuts in subsequent years.

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Table 1: Changing Budget Projections (Surplus or Deficit in Billions of Current Dollars)

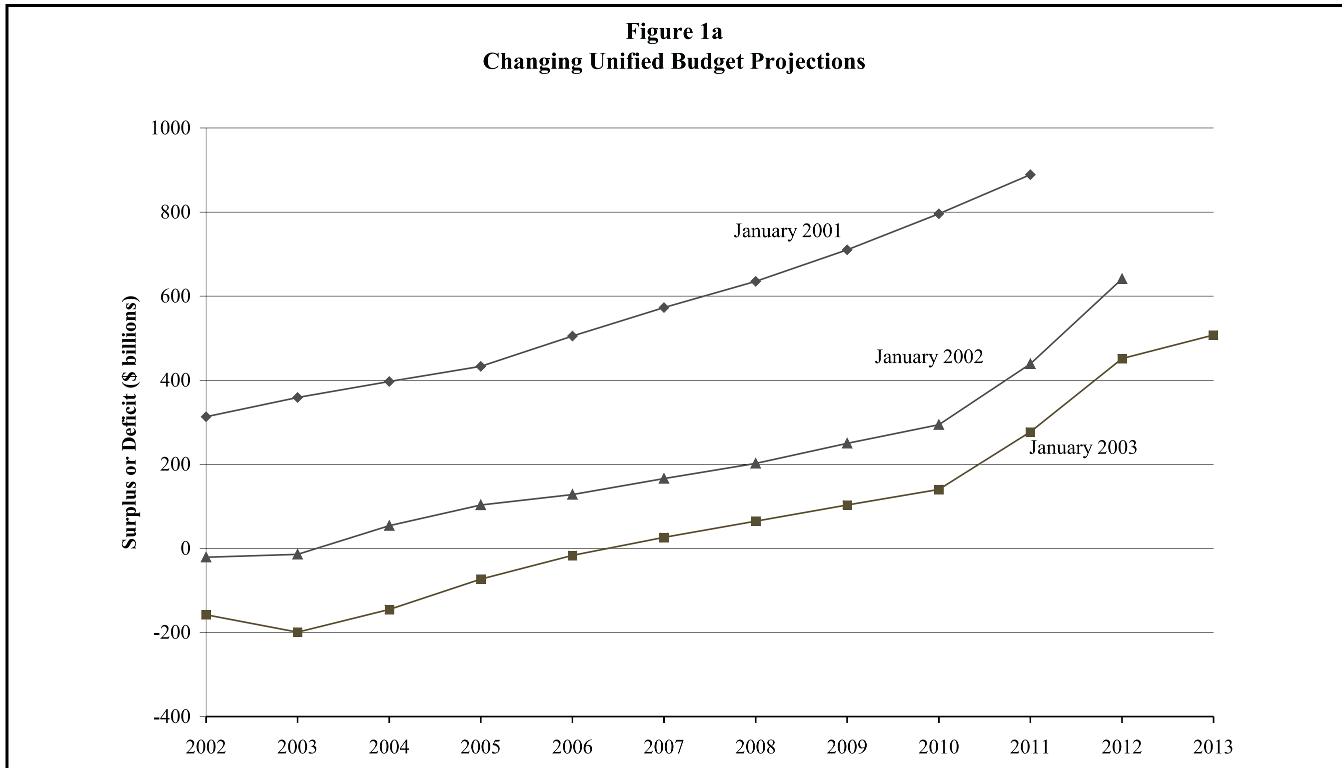
Projection Date	Projection Horizon	Unified Budget	Non-Social Security Budget	Non-Social Security, Non-Medicare Budget
10-Year Baseline				
January 2001[1]	2002-11	5,610	3,119	2727
January 2002[2]	2002-11	1,601	-745	-1127
January 2003[3]	2002-11	20	-2,219	-2551
January 2002[2]	2003-12	2,263	-242	-632
January 2003[3]	2003-12	629	-1,768	-2107
January 2003[3]	2004-13	1,336	-1,231	-1580
5-Year Baseline				
January 2001[1]	2002-06	2,007	986	786
January 2002[2]	2002-06	250	-725	-912
January 2003[3]	2002-06	-592	-1,492	-1,641

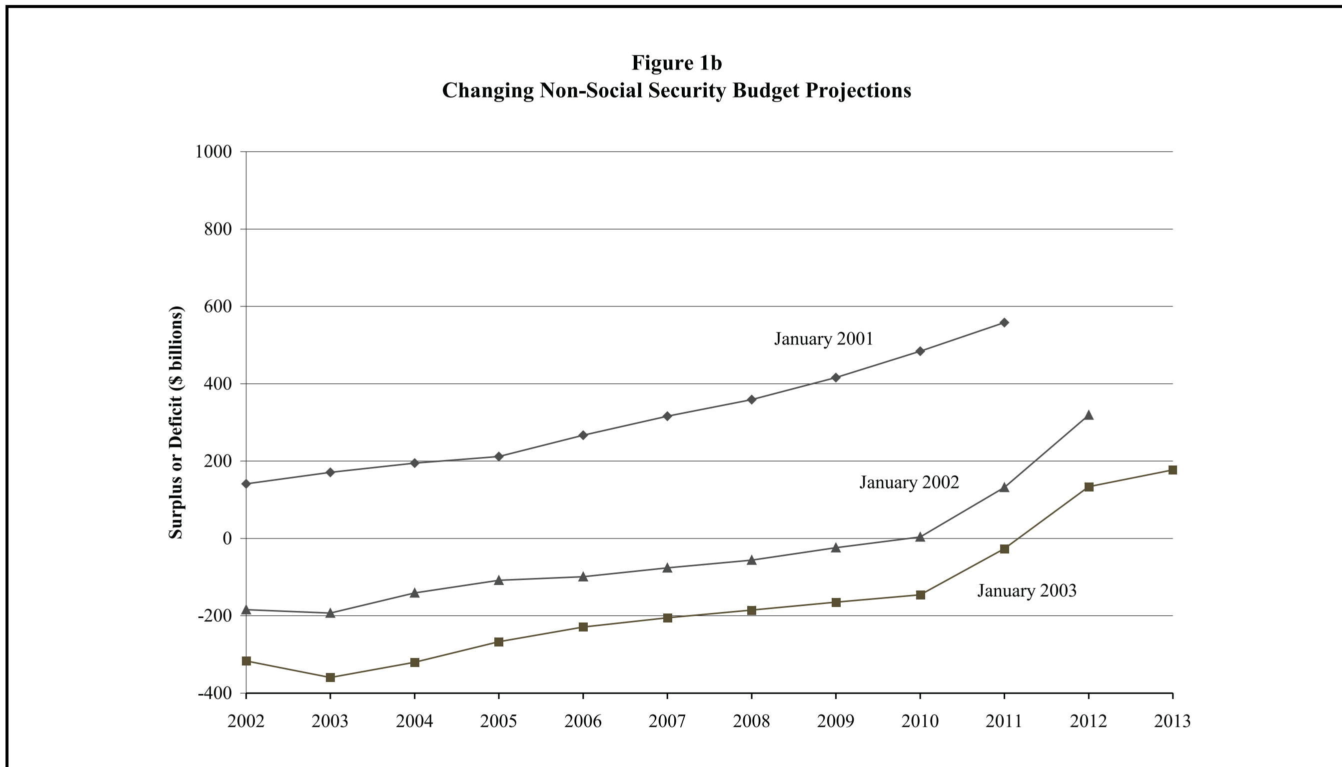
[1]Congressional Budget Office. "The Budget and Economic Outlook: Fiscal Years 2002-2011" January 2001. Tables 1-1 and 1- 7.
[2]Congressional Budget Office. "The Budget and Economic Outlook: Fiscal Years 2003-2012." January 2002. Summary Table 1, Tables 1-1 and 1-6.
[3]Congressional Budget Office. "The Budget and Economic Outlook: Fiscal Years 2004-2013." January 2003. Tables 1-2 and 1-5.

Table 2: Sources of Change in the Unified Budget Baseline, 2002-2011
January 2001-January 2003

	January 2001-January 2003[1,2]	
	($ billions)	(percent of change)
Legislative Changes		
EGTRRA		
Revenue Provisions	1,186	21.2
Outlays	88	1.6
Debt Service	372	6.7
Subtotal	1,647	29.5
Other Revenue Changes		
Revenue	55	1.0
Debt Service	54	1.0
Subtotal	110	2.0
Other Outlays		
Outlays	960	17.2
Debt Service	296	5.3
Subtotal	1,256	22.5
Economic and Technical Changes		
Revenue	2,101	37.6
Outlay	476	8.5
Subtotal	2,577	46.1
Total Change in Surplus	5,590	100.0

[1]Columns may not sum to total due to rounding.
[2]Source and notes: see Appendix Table 2.





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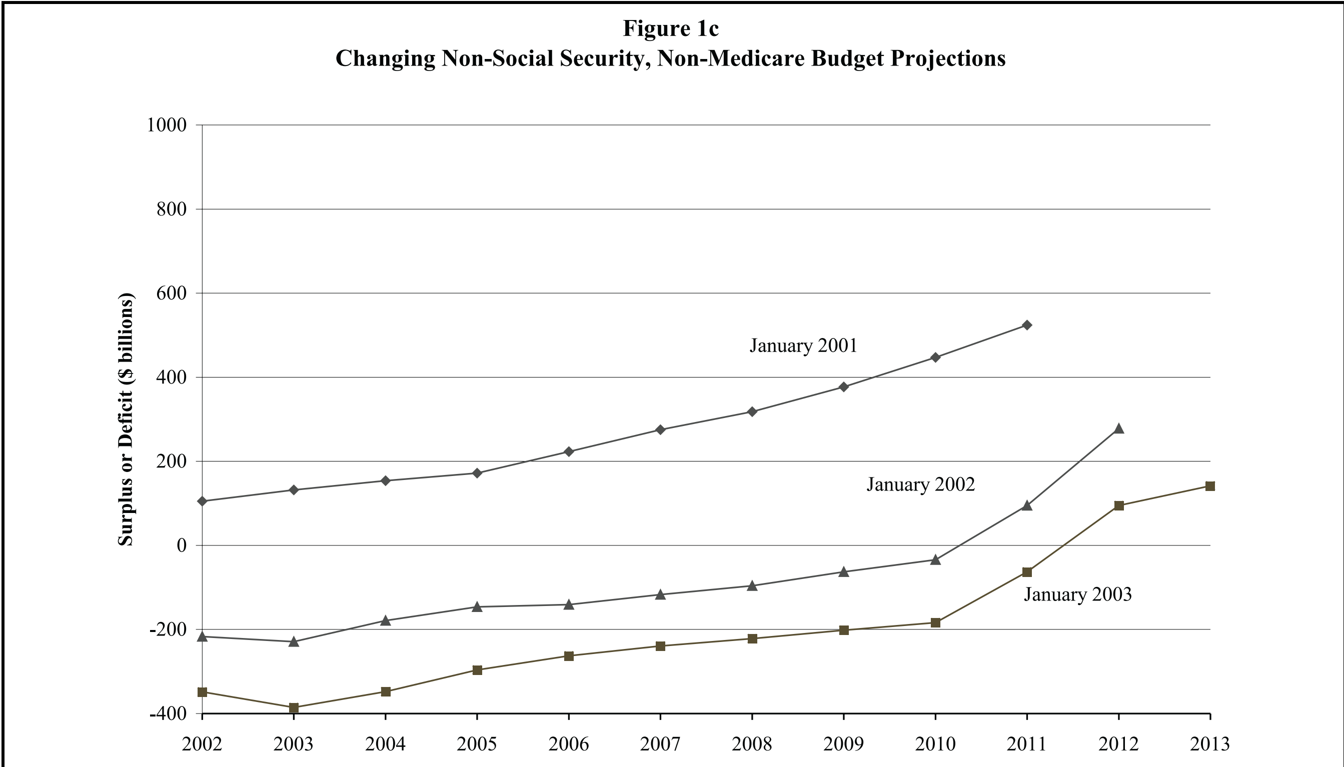

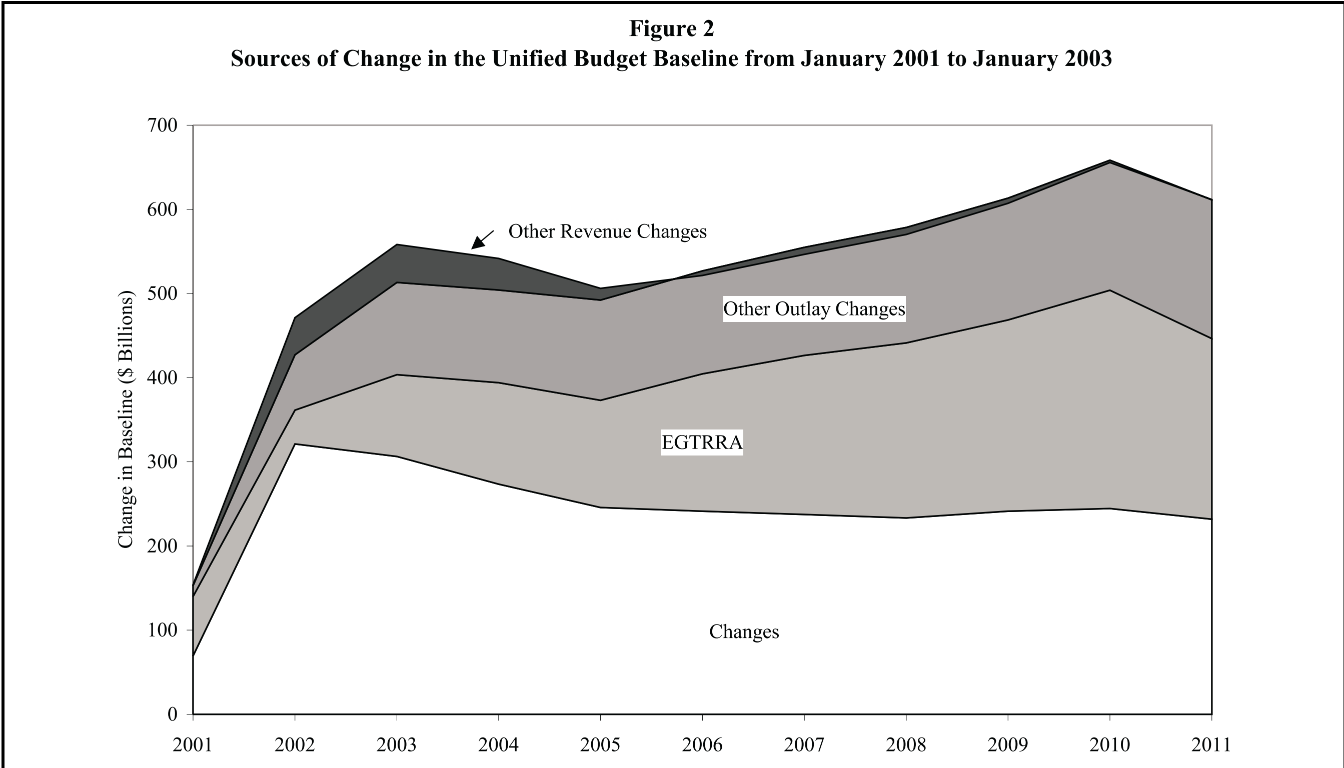

The decline in the budget surplus over the next few years is due predominantly to economic and technical changes, which in turn are due largely to the economic slowdown. In later years, however, these changes decline in importance as EGTRRA phases in more completely. In 2010, just before it sunsets, the tax cut accounts for 40 percent of the decline in the projected surplus since January 2001, slightly more than the economic and technical changes.

III. Adjusting the 10-Year Budget Outlook

The CBO publishes baselines at least twice a year. CBO (2002) describes the budget baseline as a mechanical forecast of current policy and that is intended to serve only as a "neutral benchmark . . . according to rules [that are] set forth in law and long-standing practices . . . ." The budget baseline is useful — indeed, it is necessary — because Congress needs a benchmark against which to measure the costs of proposals that change the tax law, spending rules, or spending amounts.

> ***The budget baseline is useful — indeed, it is necessary — because Congress needs a benchmark against which to measure the costs of proposals that change the tax law, spending rules, or spending amounts.***

The CBO baseline budget projections dominate public discussions of the fiscal status of the government, but as CBO itself emphasizes, the baseline is not intended to serve as a prediction of likely budget outcomes, for at least three reasons. First, the baseline by design does not reflect major new initiatives that may be enacted. Prominent examples currently include a Medicare prescription drug benefit and new tax cuts or spending increases to stimulate the economy. Second, even in the absence of major new initiatives, the set of default assumptions about current spending and tax policies used to develop the baseline are often unrealistic. Third, the economy — and with it revenue and spending totals — may evolve differently than the baseline projections assume.

A. Current Policy

To obtain a better understanding of whether the government is living within its means under current policies, we adjust the baseline budget figures. To do this, we maintain the assumption that no major new initiatives are enacted and that the economy evolves according to CBO's projections. But we make what we believe are more realistic assumptions than the baseline does about what constitutes current policy for spending and taxes. This clearly involves a set of judgment calls, so we explain the adjustments and their justifications below.

The first area where CBO's baseline assumptions do not appear to be a good reflection of current policy involves discretionary spending, which represents slightly more than a third of total outlays. Discretionary spending typically requires new appropriations by Congress every year. That is, current laws generally do not determine what discretionary spending will be in future years, raising the issue of what levels should be assumed in the budget projections for such spending. CBO routinely assumes that real discretionary spending (that is, spending adjusted for inflation) will remain constant at the level prevailing in the first year of the 10-year budget period. Because population and income grow over time, this assumption implies that by 2012 discretionary spending will fall by more than 20 percent relative to gross domestic product (GDP) and by about 8 percent in real per capita terms.

Although judgments may reasonably differ about future spending choices, CBO's assumption is unrealistic — either as a measure that holds current policy constant or as a prediction of likely spending outcomes.[2] To maintain current policy, we believe that a baseline computed on the assumption that real discretionary spending grows at the same rate as the population would be appropriate.[3] This is the same criterion endorsed by George W. Bush as a presidential candidate.[4]

The second area where the baseline makes unrealistic assumptions involves expiring tax provisions. CBO assumes that Congress will extend expiring spending programs, but that all temporary tax provisions (other than excise taxes dedicated to trust funds) expire as scheduled, even if Congress has repeatedly renewed them. The assumption regarding spending is reasonable, since spending programs with expiration dates are normally renewed. But the assumption regarding taxes is not reasonable in most cases. The Internal Revenue Code currently contains several sorts of expiring tax provisions. The first includes provisions

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[2]As a measure of likely budget outcomes, we believe that holding discretionary spending constant as a share of GDP would be appropriate. As CBO (2003) notes, nondefense discretionary spending has been roughly constant as a share of GDP since the early 1980s. Defense and homeland security spending will likely rise as a share of GDP over the next decade. For convenience, we also report budget measures below with discretionary spending held constant as a share of GDP.

[3]In recent years, CBO has presented sensitivity analysis with a variety of alternative discretionary spending paths. Theoretically, one would prefer the measure that best reflects the cost of maintaining a given level of government services. The problem arises because some types of discretionary spending (like FBI staffing) likely require real increases that at least keep pace with population growth to maintain a given level of services, whereas others (like administrative expenses for government departments) may be largely fixed in real terms and therefore not need to keep pace with population growth. Still other types of spending (like the costs of inspecting imports, which may be proportionate to the volume of imports) may require a constant or rising share of output to maintain a constant level of services. In any case, both casual inspection of the fixed cost component of various categories of spending and historical analysis of spending trends suggest that real discretionary spending is unlikely to decline sharply on a per capita basis.

[4]Bush argued that an "honest comparison" of spending growth should take inflation and population growth into account (Slater 1999, Calmes 1999).

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Table 3: Baseline and Adjusted Budget Outcomes for 2004-2013 (Surplus or Deficit in $ Billions)[1]

Projection Date	January 2003[2]		
Projection Horizon	2004-08	2009-13	2004-13
CBO Unified Adjusted Budget Baseline	-144	1,480	1,336
-Adjustment for expiring tax provisions			
Repeal sunset provisions	5	605	610
Extend AMT provisions	57	134	191
Extend JCWA	145	117	262
Extend other expiring provisions	30	129	159
Interest	24	179	203
Subtotal	261	1,164	1,425
=Unified Budget adjusted for expiring tax provisions	-404	316	-88
-Adjustment for AMT			
Index AMT	40	320	360
Allow Dependent Exemption	27	59	87
Interest	6	65	71
Subtotal	73	445	517
=Unified Budget adjusted for expiring tax provisions and AMT	-477	-128	-605
-Adjustment for holding real DS/person constant			
Hold real DS/person constant	109	327	437
Interest	11	78	89
Subtotal	120	405	525
=Unified Budget adjusted for expiring tax provisions and AMT with real DS/person constant	-597	-533	-1,131
-Adjustment for Retirement Funds			
Social Security	1,062	1,505	2,567
Medicare	162	187	349
Government Pensions	226	258	484
Subtotal	1,451	1,950	3,400
=Non-retirement fund budget adjusted for expiring tax provisions and AMT with real DS/person constant	-2,048	-2,483	-4,531
-Further adjustment if discretionary spending/GDP constant			
Outlays	175	624	799
Interest	16	136	152
Subtotal	190	760	951
=Non-retirement fund budget adjusted for expiring tax provisions and AMT with DS/GDP constant	-2,238	-3,243	-5,481

[1]Due to rounding, columns may not sum to total.
[2]Source and notes: see Appendix Table 3.

of the 2001 tax cut, EGTRRA. All of these provisions "sunset," or end automatically in 2010, and some end sooner than that. The second category includes the elements of the 2002 economic stimulus package. The third involves the alternative minimum tax, which we discuss further below. The fourth includes a variety of other tax provisions that have statutory expiration dates but that are routinely extended for a few years at a time as their expiration date approaches. We believe that the most accurate assumption of current policy, on balance, would be that all of these various provisions will be extended. This is not a statement of desired or optimal policy, simply a statement of what we see as the current stance of policy.

The third issue involves the alternative minimum tax (AMT), which offers a dramatic example of how the baseline projections generate unlikely outcomes. The AMT was designed in the late 1960s, and then strengthened in 1986, to curb excessive use of tax shelters and other tax avoidance (see Burman, *et al.*, 2002). The AMT runs parallel to the regular income tax system. It uses a somewhat different measure of income, permits fewer deductions, and applies flatter rates than does the regular income tax. In theory, each taxpayer must compute tax liability under both the conventional income tax and the AMT and pay the larger liability. In practice, the AMT currently generates larger liability for so few taxpayers — about 3 million — that few

filers, other than the tiny minority who might be affected, bother with it.

Because the AMT is not adjusted for inflation, while the ordinary income tax is, the AMT applies to ever more taxpayers as prices rise. In addition, EGTRRA, which cut the ordinary income tax but not the AMT, will greatly increase the number of people subject to the AMT. All told, by 2010 an estimated 36 million filers will become subject to the AMT under current law. This result is troubling in large part because the AMT is significantly more complex than the regular tax. Policymakers will therefore be under powerful pressure to modify the AMT.

Our budget estimates reflect current policy toward the AMT in two ways. First, we assume that provisions of the AMT that are slated to expire before the end of the budget window are granted a continuance. Under current law, the AMT exemption is increased for 2001 to 2004, but after 2004 it reverts to its 2000 level. We assume that the temporary increase in the exemption is made permanent. Also, under current law, the use of nonrefundable personal credits against the AMT is allowed through 2003. We assume that this provision is made permanent as well. Our second adjustment is to index the AMT exemption, brackets, and phaseouts for inflation starting in 2004 and to allow dependent exemptions in the AMT.[5]

Table 3 splits these costs into two components. The cost of extending the exemption and use of nonrefundable credits is shown as an "adjustment for expiring tax provisions" and based on CBO estimates. The additional costs of indexing and adding a dependent exemption are shown separately and are based on estimates using the Tax Policy Center microsimulation model. Taken together, the adjustments would reduce revenues by $638 billion and add $114 billion to debt service costs, for a total budgetary cost of $752 billion. Even so, it would leave 8.5 million taxpayers on the AMT in 2013 assuming that EGTRRA is extended — well above current numbers but well below the 43.5 million slated to face the AMT without these changes.

B. Retirement Funds

Another reason the unified budget projections over the next 10 years do not provide an accurate indicator of the underlying stance of government policy — including its sustainability and its effects on the economy — is that some currently legislated policies have budgetary implications in years more than a decade into the future. Those implications are not captured in medium-term budget projections. In particular, projecting the unified budget over a decade or less provides a misleading picture of the long-term budget position of the federal government when current or past policies result in a spending-revenue imbalance after the end of the budget projection period. Under current laws, the primary source of such imbalances is long-term commitments to pay pension and health care benefits to the elderly through Social Security, Medicare, Medicaid, and the Federal Employees Retirement program. Currently, taxes earmarked to pay for Social Security and Medicare Hospital Insurance exceed outlays on those programs. But in the long run, the programs face significant deficits.

There are several potential ways to address this problem, each with different strengths and weaknesses. The approach we take here is to separate some of these programs from the official budget. In various pieces of legislation between 1983 and 1990, Congress took a step in this direction by classifying Social Security as "off-budget."[6] The Congressional Budget Office and the Office of Management and Budget now report revenues and expenditures not only for the unified budget, but also for "off-budget" programs and "on-budget programs." The exclusion from the "on-budget" accounts of current cash flow surpluses in Social Security partially offsets the omission of sizeable deficits in that program that are expected to occur in years beyond the 10-year budget window.[7] We extend this approach by also considering the budget picture, excluding the trust funds for Social Security, Medicare, and government pensions.

C. Implications of the Adjustments

Table 3 shows the sizable effects of adjusting the surplus for current policy assumptions and retirement trust funds over the 10-year period. (Appendix Table 3 provides the figures on an annual basis, and Figure 3 plots different measures of the adjusted baseline on an annual basis.)

As noted above, the CBO unified budget baseline projects a 10-year surplus of $1.3 trillion, with surpluses rising sharply over time. Adjusting the CBO baseline for our assumptions regarding current policy implies that the unified budget will be in *deficit* to the tune of $1.1 billion over the next decade if real discretionary spending per capita is held constant. Notably, the adjusted unified baseline shows a deficit in every year through 2013.[8]

The unified budget, however, includes retirement trust fund surpluses that exceed $3 trillion. Adjusting

[5]This is "plan 2" in Burman, *et al.* (2002) and is designed to reduce the chances that households with income below $100,000 end up on the AMT.

[6]At the same time, Congress also designated the U.S. Postal Service as an off-budget entity. The Postal Service's budgetary impact, though, is a tiny fraction of Social Security's.

[7]This economic logic may help explain the significant, bipartisan political support a few years ago for the notion that retirement trust funds ought to be kept separate from the rest of the budget. Both Houses of Congress voted overwhelmingly in 2000 to support measures that protected the Medicare Hospital Insurance Trust Fund from being used to finance other programs or tax cuts (Mohr 2001). A recent legislative proposal would provide similar protection to military pensions (U.S. House of Representatives 2001). Almost all states already separate pension reserves from their operating budgets.

[8]If discretionary spending grows with GDP — instead of growing with inflation and population — the adjusted unified deficit would be $2.1 trillion.

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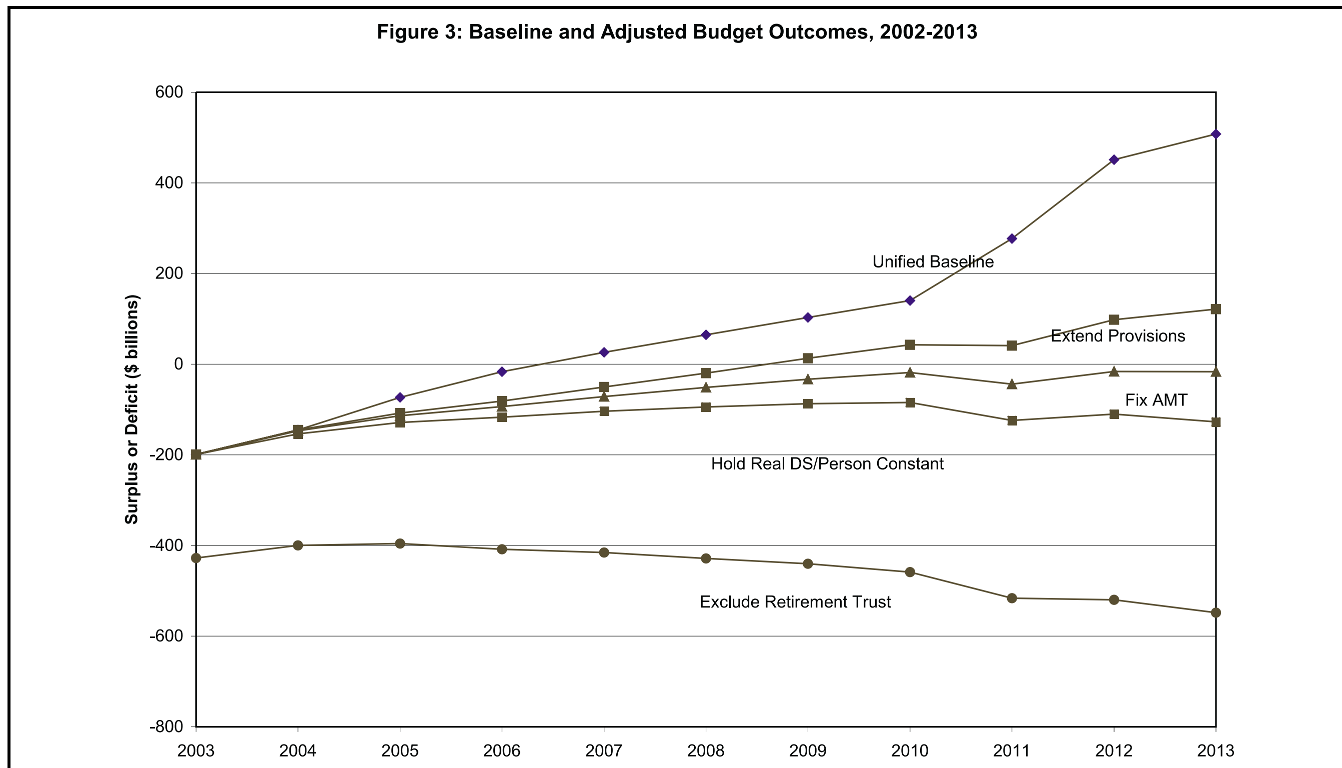

further by taking the retirement funds off-budget generates a 10-year deficit, other than retirement funds, of $4.5 trillion.

Although the precise figures should not be taken literally due to uncertainty and other factors, the basic trends in the data are clear. First, the CBO baseline suggests that the budgetary future features rising surpluses within the 10-year window, while our adjusted unified budget baseline implies continual deficits through 2013. Second, the differences grow over time. By 2013, the annual difference between the official projected unified budget and our alternative unified deficit is more than $600 billion. Third, acknowledging that the retirement trust funds are running current surpluses but will run deficits in the future makes the budget outlook far worse. The adjusted budget outside of the retirement trust funds is projected to run deficits of $4.5 trillion over the next decade, and the difference between the official unified projection and our adjusted non-retirement-trust-fund budget exceeds $1 trillion in 2013 alone.

D. Longer-Term Estimates

The adjusted budget figures above give a more accurate assessment of the government's fiscal status than the unified budget does, but both the adjusted and official figures focus only on the next 10 years. The adjusted budget thus represents a somewhat awkward half-step to examining long-term budget issues directly. An alternative solution — one that we do not follow here, but that is worth mentioning — is to extend the budget horizon beyond 10 years. The Social Security and Medicare actuaries, for example, annually publish 75-year projections of the financial balance under these programs. Extending this approach to the entire budget suggests significant long-term budget challenges. Auerbach, et al. (2003), using estimates from the August 2002 CBO baseline, estimate that federal revenues are likely to fall short of federal spending by 4 to 8 percent of GDP in the long run. That is, it would require an increase in federal revenues of about 20 percent-38 percent, a comparable decline in spending, or some combination of the two, to bring the long-term budget into balance.

Substantial uncertainty surrounds both the short-term and long-term projections. Much of the problem stems from the fact that the surplus or deficit is the difference between two large quantities, taxes and spending. Small percentage changes in either direction can result in large percentage changes in the difference between them. CBO (2003) publishes a very useful "fan" graph that shows that the range of possible baseline budget outcomes is large. The source of this variation, though, is that the economy (and associated technical factors affecting the budget) may evolve differently than anticipated by CBO. This source of uncertainty does not significantly affect our adjustments: The difference between the official projection and our adjusted outcome would remain largely intact even in very different underlying economic conditions. In addition, although there is significant uncertainty in the longer-term forecasts beyond 10 years, most studies have concluded that even adjusting for the contingencies, the likelihood of a significant fiscal gap is high (see Auerbach, et al., 2003).

IV. Discussion

The budget outlook presents policymakers with a complex and difficult set of problems. A short-term

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deficit is certain over the next year or two; a medium-term deficit is highly likely over the next 5 to 10 years; and a significantly larger long-term fiscal gap appears probable.

In the near term, as long as economic growth is sluggish and capacity is underused, current budget deficits can help stimulate aggregate demand and return the nation to its full-employment growth path. In addition, financing a significant part of any war with deficits is appropriate.

Nevertheless, policymakers should not consider themselves free to run up short-term or medium-term deficits without constraint. Specifically, the danger is that policies that raise short-term deficits end up putting the economy on a path where large structural deficits persist, even after the economy returns to full employment and war efforts have subsided. Indeed, our estimates suggest the economy is already on such a path, especially when the retirement trust funds are excluded from the totals.

In light of these concerns, policymakers should be especially wary of three kinds of policies: those that raise long-term deficits; those that artificially reduce deficits in the short or medium term by shifting revenue streams from the future; and those that shift attention away from medium- and long-term fiscal challenges.

Unfortunately, a first glance suggests the administration's new budget proposals are replete with such problematic policies. Making the 2001 tax cut permanent would raise the long-term fiscal gap by between 1.5 and 1.9 percent of GDP, depending on the AMT fix involved (Auerbach, et al., 2003). The expansion of Roth IRA treatment for saving would also dramatically reduce long-term revenues. The encouragement of rollovers from existing tax-deferred saving into backloaded saving plans would generate a shift of revenues from outside the budget window to inside the window. Choosing to focus on a five-year budget horizon is an effort to downplay problems over the remainder of the decade and the longer term, and is especially hypocritical for an administration that is proposing tax cuts that *begin* to take effect well after the five-year window expires. The president claims that these policies will allow the economy to grow its way out of the budget problem, but the administration's own estimates belie that claim. The administration's forecast shows the economy returning to full employment in the next few years, but it also shows — in the words of budget director Mitch Daniels — deficits for "the foreseeable future" (Rosenbaum, 2003). These deficits would be much larger if the retirement trust funds were not included.

In short, the administration's new budget proposals would increase fiscal problems in the medium and long term. Whatever their other effects, these proposals will create a fiscal drag that reduces future income growth and imposes new burdens on future generations (Gale and Orszag, 2002, 2003). Indeed, the implied increase in the public debt and in burdens placed on future generations due to the president's policies to date and the new proposals runs in the trillions of dollars. In contrast, policies that increase the deficit now but reduce it in future years would help in the short term by fueling aggregate demand and returning the economy to full employment, and help in the long term by providing the fiscal discipline that would raise national saving and capital formation.

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Appendix Table 1: Changing Annual Budget Projections (Surplus or Deficit in Billions of Current Dollars)[1]												
	2002	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
Unified Budget												
January 2001[2]	313	359	397	433	505	573	635	710	796	889		
January 2002[3]	-21	-14	54	103	128	166	202	250	294	439	641	
January 2003[4]	-158	-199	-145	-73	-16	26	65	103	140	277	451	508
Non-Social Security Budget												
January 2001[2]	141	171	195	212	267	316	359	416	484	558		
January 2002[3]	-184	-193	-141	-108	-99	-76	-56	-24	4	132	319	
January 2003[4]	-317	-360	-320	-267	-229	-205	-185	-165	-145	-26	134	177
Non-Social Security, Non-Medicare Budget												
January 2001[2]	105	132	154	172	223	275	318	377	447	524		
January 2002[3]	-217	-229	-179	-146	-141	-117	-96	-63	-34	95	278	
January 2003[4]	-349	-386	-348	-296	-263	-239	-222	-202	-183	-63	95	142

[1]Due to rounding, annual data from Appendix Table 1 may not sum to the CBO totals listed in Table 1.
[2]Congressional Budget Office. "The Budget and Economic Outlook: Fiscal Years 2002-2011." Tables 1-1 and 1-7.
[3]Congressional Budget Office. "The Budget and Economic Outlook: Fiscal Years 2003-2012." Tables 1-1 and 1-6.
[4]Congressional Budget Office. "The Budget and Economic Outlook: Fiscal Years 2004-2013." Tables 1-2 and 1-5.

Appendix Table 2: Sources of Change in the Unified Budget Baseline, Year-by-Year January 2001 to January 2003												
	2001	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**Total**
Legislative Changes												
EGTRRA												
Revenue Provisions	70	31	84	101	100	126	142	151	158	176	117	1,186
Outlays	0	6	7	7	7	10	10	9	10	11	12	88
Debt Service[1]	0	3	7	13	20	28	37	48	60	72	85	372
Subtotal	71	40	97	121	127	163	189	208	227	259	215	1,647
Other Revenue Changes												
Revenue	1	43	42	32	7	-13	-15	-15	-12	-9	-6	55
Debt Service	0	1	3	5	7	7	7	6	6	6	6	54
Subtotal	1	44	45	38	14	-5	-8	-8	-6	-3	0	110
Other Outlays												
Outlays	13	64	104	98	101	98	97	98	98	100	102	960
Debt Service	0	2	5	12	18	25	32	39	46	54	63	296
Subtotal	13	66	110	110	119	122	128	137	145	154	165	1,256
Economic and Technical Changes												
Revenue	72	308	295	266	237	206	184	171	163	155	115	2,101
Outlay	-3	13	11	8	8	36	53	62	78	90	116	476
Subtotal	69	321	306	274	246	241	238	233	241	245	232	2,577
Total Change in Surplus	154	471	558	542	506	521	547	570	607	656	612	5,590

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Appendix Table 2 *(continued)*												
As Percent of Change in Surplus[2]												
EGTRRA	46	9	17	22	25	31	35	36	37	40	35	29
Other Revenue Changes	1	9	8	7	3	-1	-2	-1	-1	0	0	2
Other Outlays	8	14	20	20	24	23	23	24	24	24	27	22
Economic/ Technical Changes	45	68	55	50	49	46	43	41	40	37	38	46
Total	100	100	100	100	100	100	100	100	100	100	100	100

[1]Debt Service is apportioned to each of the categories based on CBPP imputations of the interest rate.
[2]Percents may not sum to 100 due to rounding.

Appendix Table 3: Baseline and Adjusted Budget Outcomes for 2003-2013 January 2003 Projections (Surplus or Deficit in $ billions)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
CBO Unified Adjusted Budget Baseline[1]	-199	-145	-73	-16	26	65	103	140	277	451	508
-Adjustment for expiring tax provisions											
Repeal sunset provisions[2]	0	1	1	1	1	2	2	2	131	230	240
Extend AMT provisions[2]	0	0	4	13	18	22	27	31	28	23	26
Extend JCWA[3]	0	0	28	42	40	35	30	26	22	20	19
Extend other expiring provisions[4]	0	-1	1	6	10	14	15	17	26	35	36
Interest[5]	0	0	1	4	7	12	16	21	30	46	65
Subtotal	0	0	35	65	77	85	90	97	236	353	386
=Unified Budget adjusted for expiring tax provisions	-199	-145	-108	-81	-50	-20	13	43	41	98	121
Adjustment for AMT[6]											
Index AMT	0	0	2	6	12	20	31	42	61	84	101
Allow Dependent Exemptions	0	1	4	6	7	9	10	11	12	13	14
Interest	0	0	0	1	2	3	5	8	12	17	24
Subtotal	0	2	6	12	21	32	46	61	85	114	138
=Unified Budget adjusted for expiring tax provisions and AMT	-199	-147	-114	-94	-71	-51	-33	-18	-44	-16	-17
Adjustment for holding real DS/person constant[7]											
Hold real DS/person constant	0	7	14	22	29	38	46	55	65	75	86
Interest	0	0	1	2	3	5	8	11	15	19	25
Subtotal	0	7	15	23	32	43	54	66	80	94	111
=Unified Budget adjusted for expiring tax provisions and AMT with real DS/person constant	-199	-154	-129	-117	-104	-94	-87	-85	-124	-110	-127
Adjustment for Retirement Funds[8]											
Social Security	160	175	194	212	231	250	268	286	303	317	330
Medicare	26	28	29	34	34	36	37	38	37	39	36
Government Pensions	42	43	44	45	46	48	48	50	52	53	55
Subtotal	228	246	267	291	312	335	353	374	392	409	421
=Non-retirement fund budget adjusted for expiring tax provisions and AMT with real DS/person constant	-428	-400	-396	-408	-415	-429	-440	-458	-516	-520	-548
Nominal GDP[9]	10,756	11,309	11,934	12,582	13,263	13,972	14,712	15,480	16,250	17,013	17,851
=Adjusted budget, given as percent of nominal GDP	-4.0	-3.5	-3.3	-3.2	-3.1	-3.1	-3.0	-3.0	-3.2	-3.1	-3.1
Further Adjustment for holding DS/GDP constant[10]											

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Appendix Table 3 *(Continued)*											
Outlays	0	6	18	33	50	68	86	105	124	144	165
Interest	0	0	1	2	5	8	13	19	26	34	45
Subtotal	0	6	19	35	54	76	99	124	149	179	210
=Non-retirement fund budget adjusted for expiring tax provisions and AMT with DS/GDP constant	-428	-406	-415	-443	-469	-504	-539	-582	-666	-698	-758
=Adjusted budget, given as percent of nominal GDP	-4.0	-3.6	-3.5	-3.5	-3.5	-3.6	-3.7	-3.8	-4.1	-4.1	-4.2

[1]The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Table 1-2.
[2]The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Table 3-11.
[3]The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Box 1-2.
[4]Author's calculations. Numbers are calculated so that the subtotal sums to Table 3-11, excluding interest costs.
[5]CBO debt service matrix, January 2003.
[6]Author's calculations using microsimulation of Tax Policy Center.
[7]The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Table 4-1. U.S. Bureau of the Census. Annual Projections of the Total Resident Population as of July 1: Middle, Lowest, Highest, and Zero International Migration Series, 1999 to 2100. February 14, 2000.
[8]The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Table 1-5.
[9]The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Table E-2.
[10]Author's calculations using The Budget and Economic Outlook: Fiscal Years 2004-2013. January 2003. Table 4-4.

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