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## THE CURRENT COURSE: DEFICITS "AS FAR AS THE EYE CAN SEE"

Last month, the Congressional Budget Office (CBO) issued new budget projections that show the federal government running a large cumulative deficit over the next ten years. As CBO acknowledges, however, its baseline projection is unrealistically optimistic, since it does not include the cost of continuing current policies, such as the recent tax cuts. As explained below, we adjust the CBO baseline to take into account those costs that are likely or inevitable if policymakers fail to take budget discipline seriously and the country continues on its current course.

- We find that, over the next ten years, the federal government is likely to run a cumulative deficit of \$4.6 trillion, for 2005-2014. The deficit will not fall below \$300 billion in any year. By 2014, federal deficits will climb to \$640 billion and the interest payments on the debt will reach \$460 billion.<sup>1</sup> (See Table 1)

To arrive at these projections, we make the following adjustments to the CBO baseline<sup>2</sup>:

1. **Extend the 2001 and 2003 tax cuts, as proposed by the Administration:** CBO's projections assume that all expirations occur on schedule.

In Table 1, we combine the costs of extending the 2001 and 2003 tax cuts as proposed by the Administration and the routine extension of a number of expiring tax breaks that are slated to expire every few years and always are extended with strong bipartisan support. These result in a total of \$1.5 trillion in costs, including interest payments that are not reflected in the CBO baseline.

<sup>1</sup> In September 2003, the Center on Budget and Policy Priorities, the Committee for Economic Development, and the Concord Coalition jointly released a report projecting cumulative deficits of cumulative deficits of \$5 trillion over the ten year period from 2004-2013. We currently project lower deficits, but the improvement is entirely explained by the fact that, unlike in last fall's report, we now assume that the bonus depreciation tax cut — that was enacted in 2002 and enlarged in 2003 and is scheduled to expire after 2004 — will not be extended. The Administration did not propose extension of this provision in its FY 2005 Budget. Nonetheless, some policymakers continue to advocate extension, and the fate of bonus depreciation remains unclear. If this provision were extended, we would currently project deficits of \$5.0 trillion over the 2004-2013 period and deficits of \$5.2 trillion for the ten year period from 2005-2014.

<sup>2</sup> For more details on methodology, see CBPP, CED, and Concord Coalition, "Mid-Term and Long-Term Deficit Projections," September 29, 2003.

2. **Continue relief from the Alternative Minimum Tax:** The provisions of current law that prevent the Alternative Minimum Tax from affecting large numbers of middle-class taxpayers are scheduled to expire at the end of 2004. There is little question such relief will be extended. Without it, the number of taxpayers subject to the AMT will explode from about 3 million today to 46 million by 2014, assuming the 2001 tax cut is extended past its 2010 expiration date. CBO estimates that the cost of continuing the type of AMT relief in effect through the end of 2004 by indexing the AMT exemption and tax brackets to inflation and maintaining the current AMT treatment of certain tax credits equals \$708 billion over the next ten years, including interest.
3. **Defense, Homeland Security, and International Affairs:** CBO's baseline projections assume discretionary (or non-entitlement) programs will continue to be funded at 2004 levels, adjusted only to cover inflation. The baseline projections overstate defense costs in some respects and understate them in others.

We produce a more plausible projection of costs in this area by making several adjustments. We adjust the baseline downward by removing from CBO's March baseline the mechanical annual repetition of last fall's \$87.5 billion supplemental appropriation for defense and international affairs; we add to the resulting baseline the amount needed to fully fund the Pentagon's "Future-Year Defense Plan" and continued operations for the global "war on terrorism," as estimated by CBO; and we assume that homeland security spending is increased to the levels proposed in the President's FY 05 Budget. Altogether, over ten years, this adds \$351 billion to the deficits.

4. **Domestic Discretionary Programs Outside Homeland Security:** CBO projects that discretionary funding will keep pace with inflation. For 2005, this is likely to overstate domestic discretionary spending outside homeland security. In its FY 2005 Budget, the Administration holds domestic discretionary appropriations outside homeland security to less than one percent nominal growth for 2005, and we assume that funding for 2005 is set at the Administration's proposed level. But this low level of growth is likely unsustainable in light of historical trends. After 2005, we assume that funding for domestic discretionary programs outside homeland security holds steady with inflation and population. These adjustments add \$37 billion to the deficit over ten years.

<b>Adjustments to CBO Deficit Projections</b>											
(in billions of dollars)											
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
<b>CBO March 2004 projections</b>	<b>-363</b>	<b>-273</b>	<b>-274</b>	<b>-286</b>	<b>-281</b>	<b>-272</b>	<b>-176</b>	<b>-38</b>	<b>-34</b>	<b>-15</b>	<b>-2,012</b>
Tax cut extension	-18	-38	-44	-48	-59	-59	-203	-316	-345	-379	-1,510
AMT relief	-10	-27	-36	-46	-59	-73	-88	-103	-122	-145	-708
Defense, international, and homeland security	3	-9	-10	-16	-19	-39	-52	-57	-74	-79	-351
Domestic discretionary (excl. homeland sec.)	6	8	7	4	1	-3	-7	-12	-17	-23	-37
<b>Resulting deficit projections</b>	<b>-381</b>	<b>-340</b>	<b>-358</b>	<b>-392</b>	<b>-417</b>	<b>-446</b>	<b>-526</b>	<b>-526</b>	<b>-592</b>	<b>-641</b>	<b>-4,618</b>
Resulting deficit projections as a percent of GDP	3.2%	2.7%	2.7%	2.8%	2.9%	2.9%	3.3%	3.2%	3.4%	3.5%	3.1%

*Notes: Negative values indicate deficits or costs that increase deficits. Positive values reflect surpluses or policies that reduce deficits. All figures include both the policy's direct costs and the additional interest costs it generates.*