CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC  20515

*Douglas Holtz-Eakin, Director*

March 14, 2005

Honorable Nancy Pelosi
Democratic Leader
U.S. House of Representatives
Washington, DC 20515

Dear Leader Pelosi:

In response to your request for long-term budget simulations, the Congressional Budget Office has prepared the attached set of three figures that summarize the fiscal impacts of two different tax policies. The spending side of the budget reflects the assumptions underlying scenarios 2 and 5 in our December 2003 study, *The Long-Term Budget Outlook*. The revenue projections are based on the technical and economic assumptions from our August 2003 economic update. Current law reflects the law in effect at the time. Changes in the budget outlook over the past 15 months would not lead us to substantially modify our long-range assumptions about spending or revenues. These projections are based on national income and product account classifications that differ somewhat from formal budget concepts, but those differences do not significantly affect the future paths of spending and revenues.

Figure 1 illustrates projected spending and revenues under the assumption that revenues would follow current law—that is, the tax provisions enacted in 2001 and 2003 would expire as scheduled, mostly at the end of 2010—except that the alternative minimum tax (AMT) would have all of its parameters indexed to inflation and that the exemption currently in place would be extended. Under that scenario, total federal revenues would slowly climb from about 20 percent in 2015, to 21 percent in 2030, and almost 22 percent in 2050. Total spending would reach 20 percent of the gross domestic product in 2020, nearly 23 percent in 2032, and roughly 27 percent in 2050. The accelerating spending growth under this scenario is driven by health care programs, debt service, and Social Security.

Figure 2 presents the results under the same assumptions except that the 2001 and 2003 tax provisions are assumed to be permanently extended. Revenues under that scenario grow more slowly as a share of the economy after 2010 rising to 20 percent of GDP by 2050. The larger gap between revenues and non-interest spending causes a much more rapid growth in debt service costs and boosts total spending to nearly 25 percent of GDP in 2030 and 32 percent in 2050. A comparison of the federal debt held by the public under the two scenarios appears in Figure 3.

The first two figures also display the spending and revenues for the Social Security program and the rest of the government. As you requested, spending for Social Security includes benefits as well as administrative costs, and revenues include dedicated payroll and income taxes as well as interest income. (Note that under budgetary conventions, these interest payments are receipts of the Social Security trust funds, but they are not classified as revenues.) Therefore, interest paid to Social Security from the general fund of the Treasury shows up as an outlay in the rest of the government category. The alternative tax scenarios you specified have only a very small impact on Social Security through the differing revenues from the taxation of Social Security benefits. In contrast, the rest of government has much lower revenues and much higher outlays (debt service costs) under the assumptions that the tax cuts would be extended.

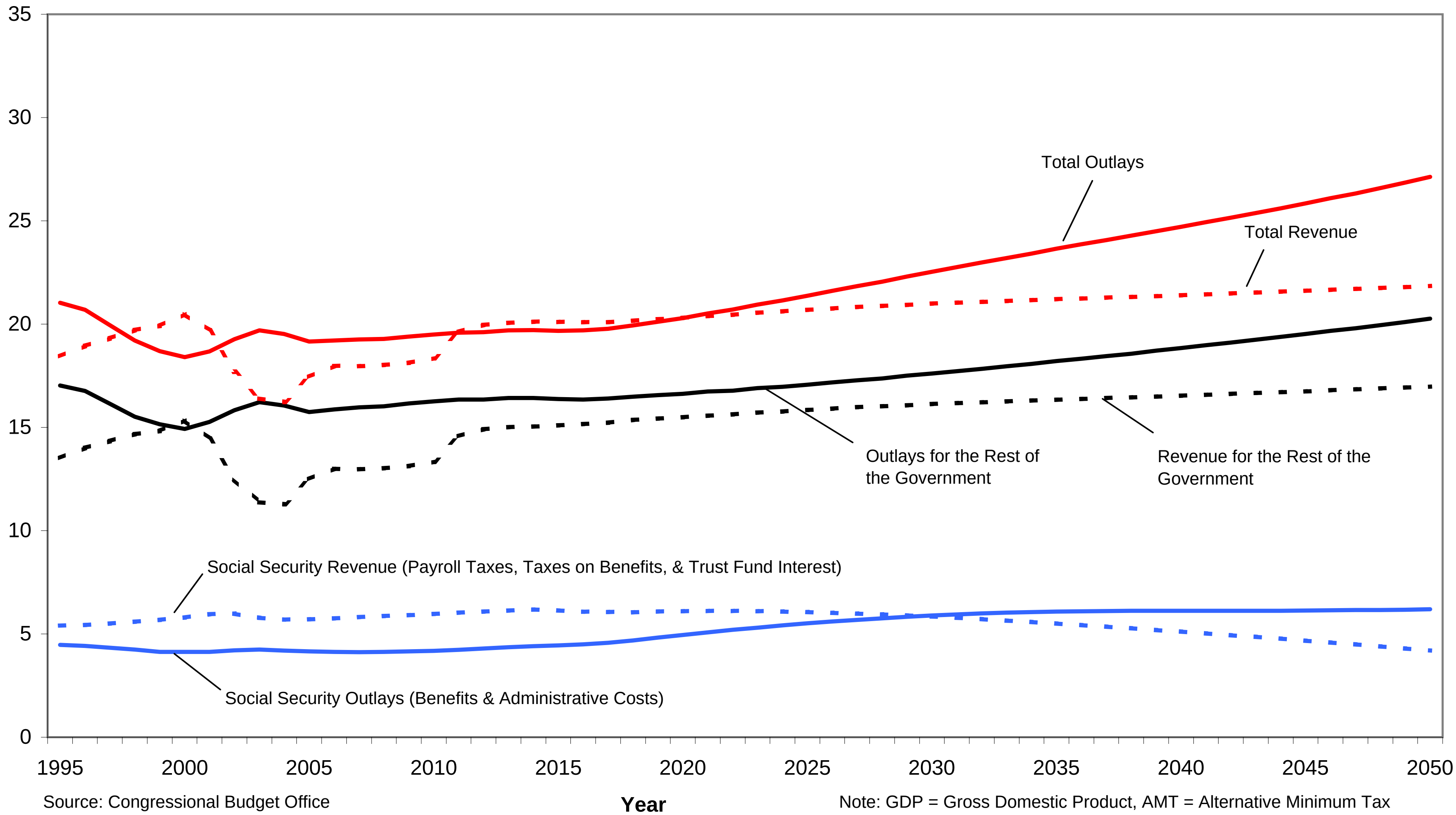
In addition to the materials provided here, we are forwarding the underlying data to your staff. If you have any additional questions concerning this analysis, the CBO staff contact is Paul Cullinan.

Sincerely,

Douglas Holtz-Eakin
Director

Attachment

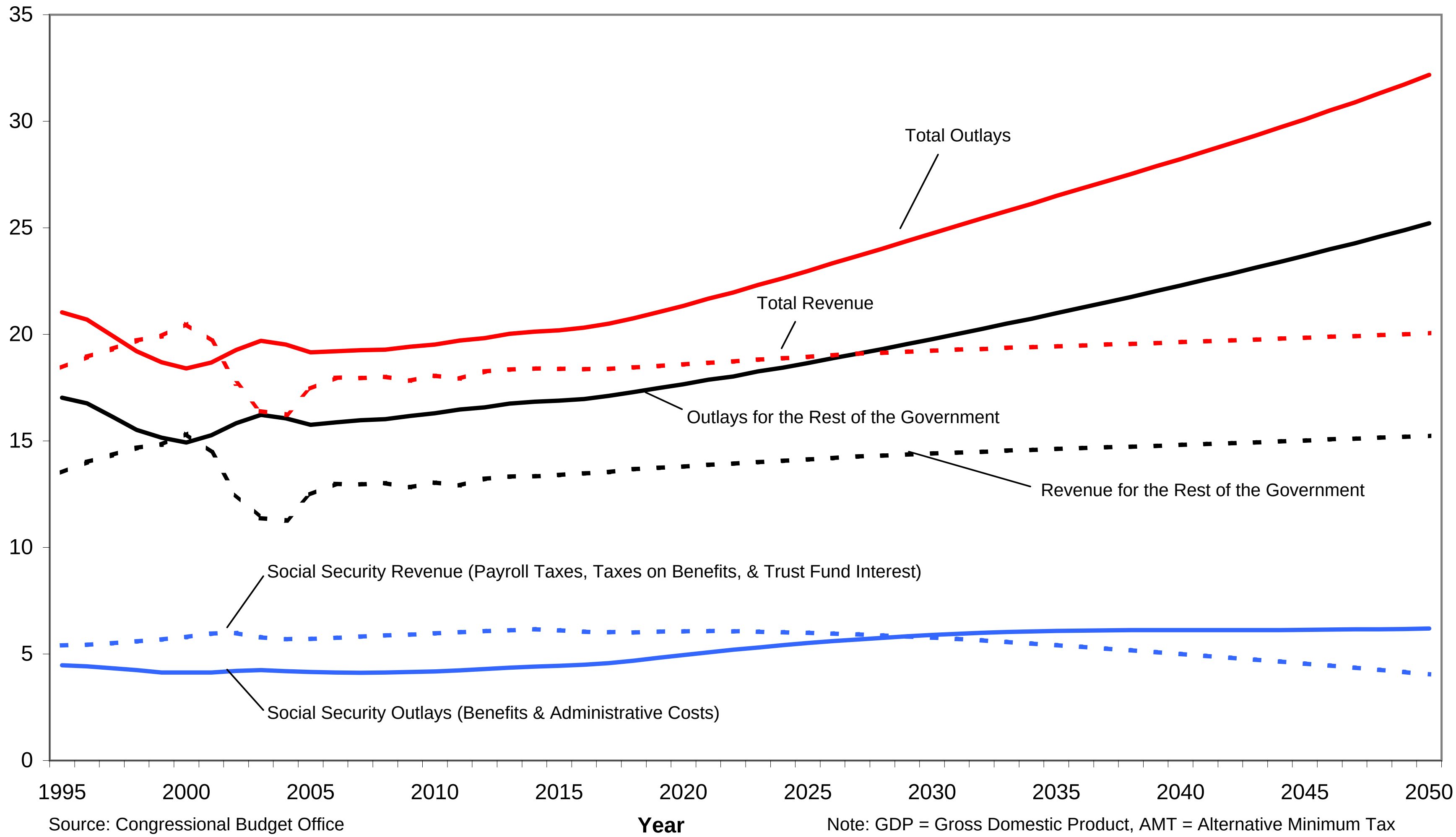
**Figure 1.**
**Outlays & Revenue for Social Security and the Rest of the Government**
**Current Law Taxes with AMT Fix**
**(Percentage of GDP)**




Source: Congressional Budget Office

Note: GDP = Gross Domestic Product, AMT = Alternative Minimum Tax

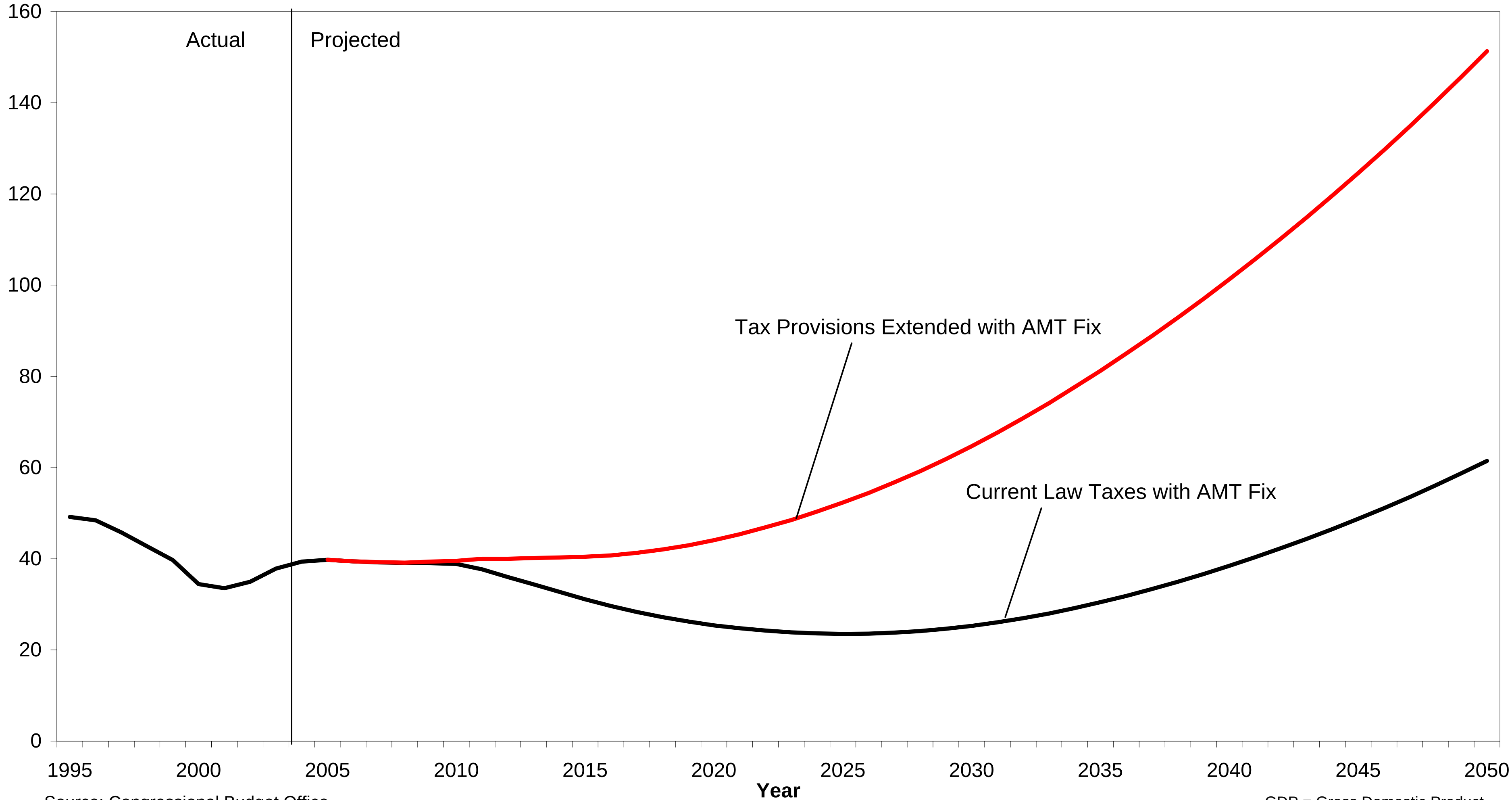
**Figure 2.**
**Outlays & Revenue for Social Security and the Rest of the Government**
**Tax Provisions Extended with AMT Fix**
**(Percentage of GDP)**




Source: Congressional Budget Office

Note: GDP = Gross Domestic Product, AMT = Alternative Minimum Tax

**Figure 3.**
**Federal Debt Held By Public Under Certain Long-Term Budget Scenarios**
**(Percentage of GDP)**




Source: Congressional Budget Office

Note: Assumptions about federal spending are those specified for Scenarios 2 and 5 in CBO's The Long-Term Budget Outlook, December 2003.

GDP = Gross Domestic Product
AMT = Alternative Minimum Tax