



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

February 23, 2009

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

Honorable John M. Spratt Jr.
Chairman
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

Dear Madam Speaker and Mr. Chairman:

As you requested, CBO has estimated the budgetary impact of three alternative policy scenarios that would modify CBO's most recent baseline projections (released on January 7, 2009) using assumptions that you specified.¹ This letter details the results of those calculations.

CBO's Baseline Projections. CBO's baseline is constructed assuming that current laws and policies remain the same. Following that guideline, CBO's revenue projections incorporate the assumption that the major provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) will expire at the end of December 2010 and that other tax provisions slated to expire during the 10-year projection period will do so as scheduled. In addition, the baseline assumes that the alternative minimum tax (AMT) will not be modified for the years beyond 2008. CBO's projections of discretionary spending start with the funding provided to date for fiscal year 2009 (including \$68 billion provided for operations in Iraq and Afghanistan and for other activities related to the war

1. The Joint Committee on Taxation (JCT) provided estimates of the impact of proposals that modify the tax code.

on terrorism); that amount is projected to grow at specified rates of inflation. The baseline also incorporates the assumption that fees paid for physicians' services under Medicare will be reduced by more than 20 percent in 2010 and by additional amounts thereafter, as would result under current law. Under those and other assumptions underlying the baseline, CBO projects a deficit of \$1.2 trillion for fiscal year 2009 and a cumulative deficit of \$3.1 trillion between 2010 and 2019.

First Alternative Scenario. For the first scenario, you asked CBO to assume the following changes to the baseline projections:

- The budgetary effects of H.R. 1, the American Recovery and Reinvestment Act of 2009 (ARRA), as signed by the President on February 17, 2009, are incorporated (similar funding is not assumed to be provided in subsequent years);
- All provisions of EGTRRA and JGTRRA, as well as all other expiring tax provisions (except those newly enacted in H.R. 1), are extended;
- The exemption and bracket amounts for the AMT are indexed for inflation after 2009 (ARRA adjusted those amounts through this year);
- Nonemergency discretionary budget authority in 2009 will total \$1,012 billion—the amount specified in the 2009 budget resolution—and will remain at that level (adjusted for inflation) thereafter;
- The \$186 billion in total appropriations provided in 2008 for operations in Iraq and Afghanistan and for other activities related to the war on terrorism will also be provided in 2009 and in each year of the projection period, adjusted for inflation; and,
- The fees paid to physicians under Medicare would increase by 1 percent annually.

Under this first scenario, CBO estimates the deficit would be \$218 billion higher in 2009 and \$8.4 trillion larger over the 2010-2019 period than under baseline assumptions (see Table 1 attached).

Second Alternative Scenario. For the second scenario, you asked CBO to make the same assumptions as those for the first scenario, except:

- The number of troops deployed to Iraq, Afghanistan, and elsewhere in support of the war on terrorism declines gradually over a four-year period, from about 190,000 in 2009 to about 75,000 in 2013 and thereafter.

Under this second scenario, CBO estimates the deficit would be \$218 billion higher in 2009 and \$7.0 trillion larger over the 2010-2019 period than under baseline assumptions (see Table 2).

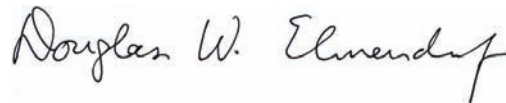
Third Alternative Scenario. For the third scenario, you asked CBO to make the same assumptions as those for the second scenario, except:

- Specified provisions of EGTRRA affecting upper-income taxpayers expire as scheduled (provisions affecting all other taxpayers are assumed to continue in effect) and the parameters for estate and gift taxes are maintained at their 2009 levels.

Under this third set of policy alternatives, projected deficits would still be higher than those under baseline assumptions, but smaller than those under the first two alternative scenarios. The deficit would be \$218 billion larger in 2009 and \$5.6 trillion larger over the 2010-2019 period than CBO's baseline estimates (see Table 3).

If you would like further details on these estimates, we would be pleased to provide them. The CBO staff contact is Barry Blom, who can be reached at 226-2880.

Sincerely,



Douglas W. Elmendorf
Director

Attachments

cc: Honorable John Boehner
Minority Leader

Honorable Paul Ryan
Ranking Member
Committee on the Budget

Table 1. First Policy Scenario Requested by Speaker Pelosi and Chairman Spratt

(By fiscal year, in billions of dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total, 2010- 2019
January 2009 Baseline Deficit	-1,186	-703	-498	-264	-257	-250	-234	-272	-234	-188	-235	-3,135
Effect on the Deficit of the American Recovery and Reinvestment Act of 2009	-185	-399	-134	-36	-28	-22	-5	7	8	6	1	-602
Adjustments to Projected Revenues ^a												
Extend EGTRRA and JGTRRA	0	-3	-124	-227	-261	-278	-293	-305	-317	-329	-342	-2,479
Extend other expiring tax provisions and index the AMT for inflation ^b	-1	-29	-124	-91	-102	-114	-127	-140	-156	-172	-191	-1,245
Interactive effect of extending EGTRRA and JGTRRA and indexing the AMT	<u>0</u>	<u>0</u>	<u>-15</u>	<u>-53</u>	<u>-60</u>	<u>-68</u>	<u>-76</u>	<u>-84</u>	<u>-92</u>	<u>-100</u>	<u>-109</u>	<u>-655</u>
Effect on the deficit (revenue changes)	-1	-32	-263	-370	-423	-459	-495	-529	-565	-602	-642	-4,380
Adjustments to Projected Outlays												
Assume the same amount of total appropriations for military operations in Iraq and Afghanistan and for other activities related to the war on terrorism as was provided in 2008	-26	-76	-107	-120	-126	-130	-134	-138	-142	-146	-150	-1,269
Increase Medicare payment rates for physicians by 1 percent annually	0	-10	-14	-19	-23	-29	-35	-41	-48	-56	-62	-335
Assume regular appropriations for 2009 are set at the level specified in the budget resolution ^c	<u>-5</u>	<u>-8</u>	<u>-9</u>	<u>-9</u>	<u>-10</u>	<u>-10</u>	<u>-10</u>	<u>-10</u>	<u>-11</u>	<u>-11</u>	<u>-11</u>	<u>-99</u>
Effect on the deficit (outlay changes)	-31	-93	-130	-148	-159	-169	-179	-190	-201	-212	-223	-1,704
Effect on Net Interest (debt service)	-1	-6	-19	-49	-92	-135	-179	-224	-274	-328	-386	-1,691
Total Effect on the Deficit	-218	-531	-546	-603	-702	-785	-858	-936	-1,032	-1,136	-1,250	-8,378
Projected Deficit Under the First Scenario	-1,404	-1,233	-1,044	-867	-959	-1,035	-1,092	-1,208	-1,266	-1,324	-1,485	-11,513

Sources: Congressional Budget Office; Joint Committee on Taxation.

Notes Negative amounts indicate an increase in the deficit. "Debt service" refers to changes in interest payments on federal debt resulting from changes in the government's borrowing needs.

EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003; AMT = alternative minimum tax;

- a. JCT estimates relative to CBO's January 2009 baseline were available for most of the effects stemming from tax code changes. For some of the minor provisions of EGTRRA and for all of the category of "other expiring provisions," CBO used JCT estimates from the summer of 2008, updated to reflect subsequent law changes in 2008 and to include an estimate for 2019. The estimates do not include extensions of provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), but estimates of extensions of previously-enacted provisions that interact with ARRA have been adjusted to reflect estimated interactions.
- b. This alternative incorporates the assumption that the exemption amount for the AMT is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2009. In addition, the treatment of personal credits against the AMT is assumed to be extended beyond 2009 (ARRA extended the higher exemption amount and adjustments to AMT tax brackets through this year). If the alternative was enacted jointly with the extension of expiring EGTRRA and JGTRRA provisions, an interactive effect would occur after 2010 that would make the combined revenue loss over the 2011-2019 period greater than the sum of the two separate estimates.
- c. The Concurrent Resolution on the Budget for Fiscal Year 2009 (S. Con. Res. 70) set the amount of nonemergency discretionary budget authority at \$1.012 trillion, \$9 billion above the level in CBO's January 2009 baseline.

Table 2. Second Policy Scenario Requested by Speaker Pelosi and Chairman Spratt

(By fiscal year, in billions of dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total, 2010- 2019
January 2009 Baseline Deficit	-1,186	-703	-498	-264	-257	-250	-234	-272	-234	-188	-235	-3,135
Effect on the Deficit of the American Recovery and Reinvestment Act of 2009	-185	-399	-134	-36	-28	-22	-5	7	8	6	1	-602
Adjustments to Projected Revenues ^a												
Extend EGTRRA and JGTRRA	0	-3	-124	-227	-261	-278	-293	-305	-317	-329	-342	-2,479
Extend other expiring tax provisions and index the AMT for inflation ^b	-1	-29	-124	-91	-102	-114	-127	-140	-156	-172	-191	-1,245
Interactive effect of extending EGTRRA and JGTRRA and indexing the AMT	<u>0</u>	<u>0</u>	<u>-15</u>	<u>-53</u>	<u>-60</u>	<u>-68</u>	<u>-76</u>	<u>-84</u>	<u>-92</u>	<u>-100</u>	<u>-109</u>	<u>-655</u>
Effect on the deficit (revenue changes)	-1	-32	-263	-370	-423	-459	-495	-529	-565	-602	-642	-4,380
Adjustments to Projected Outlays												
Reduce the number of troops deployed for military operations in Iraq and Afghanistan and other activities related to the war on terrorism to 75,000 by 2013 ^c	-26	-50	-63	-44	-21	-7	-1	3	6	6	6	-165
Increase Medicare payment rates for physicians by 1 percent annually	0	-10	-14	-19	-23	-29	-35	-41	-48	-56	-62	-335
Assume regular appropriations for 2009 are set at the level specified in the budget resolution ^d	<u>-5</u>	<u>-8</u>	<u>-9</u>	<u>-9</u>	<u>-10</u>	<u>-10</u>	<u>-10</u>	<u>-10</u>	<u>-11</u>	<u>-11</u>	<u>-11</u>	<u>-99</u>
Effect on the deficit (outlay changes)	-31	-68	-86	-72	-53	-45	-46	-48	-53	-61	-68	-600
Effect on Net Interest (debt service)	-1	-5	-18	-45	-84	-119	-156	-193	-234	-278	-326	-1,458
Total Effect on the Deficit	-218	-505	-501	-524	-587	-646	-702	-764	-844	-934	-1,034	-7,041
Projected Deficit Under the Second Scenario	-1,404	-1,207	-999	-787	-844	-896	-936	-1,035	-1,078	-1,122	-1,270	-10,176

Sources: Congressional Budget Office; Joint Committee on Taxation.

Notes: Negative amounts indicate an increase in the deficit. "Debt service" refers to changes in interest payments on federal debt resulting from changes in the government's borrowing needs.

EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003; AMT = alternative minimum tax;

- JCT estimates relative to CBO's January 2009 baseline were available for most of the effects stemming from tax code changes. For some of the minor provisions of EGTRRA and for all of the category of "other expiring provisions," CBO used JCT estimates from the summer of 2008, updated to reflect subsequent law changes in 2008 and to include an estimate for 2019. The estimates do not include extensions of provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), but estimates of extensions of previously-enacted provisions that interact with ARRA have been adjusted to reflect estimated interactions.
- This alternative incorporates the assumption that the exemption amount for the AMT is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2009. In addition, the treatment of personal credits against the AMT is assumed to be extended beyond 2009 (ARRA extended the higher exemption amount and adjustments to AMT tax brackets through this year). If the alternative was enacted jointly with the extension of expiring EGTRRA and JGTRRA provisions, an interactive effect would occur after 2010 that would make the combined revenue loss over the 2011-2019 period greater than the sum of the two separate estimates.
- This alternative does not extrapolate the funding for military operations and associated costs in Iraq and Afghanistan provided for 2008 or 2009. Rather, it incorporates the assumption that an additional \$87 billion in budget authority will be provided in 2009 to carry out operations in those countries, bringing the total for that year to \$155 billion. Funding for operations in Iraq, Afghanistan, or elsewhere would total \$149 billion in 2010, \$129 billion in 2011, \$95 billion in 2012, and about \$70 billion a year from 2013 on—for a total of \$867 billion over the 2010-2019 period.
- The Concurrent Resolution on the Budget for Fiscal Year 2009 (S. Con. Res. 70) set the amount of nonemergency discretionary budget authority at \$1.012 trillion, \$9 billion above the level in CBO's January 2009 baseline.

Table 3. Third Policy Scenario Requested by Speaker Pelosi and Chairman Spratt

(By fiscal year, in billions of dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Total, 2010- 2019
January 2009 Baseline Deficit	-1,186	-703	-498	-264	-257	-250	-234	-272	-234	-188	-235	-3,135
Effect on the Deficit of the American Recovery and Reinvestment Act of 2009	-185	-399	-134	-36	-28	-22	-5	7	8	6	1	-602
Adjustments to Projected Revenues ^a												
Extend certain provisions of EGTRRA ^b	0	*	-65	-136	-140	-144	-147	-150	-153	-156	-159	-1,249
Extend other expiring tax provisions and index the AMT for inflation ^c	-1	-29	-124	-91	-102	-114	-127	-140	-156	-172	-191	-1,245
Interactive effect of extending EGTRRA and indexing the AMT	0	0	-15	-53	-61	-68	-76	-85	-93	-101	-109	-661
Effect on the deficit (revenue changes)	-1	-29	-204	-280	-303	-326	-350	-375	-401	-429	-459	-3,156
Adjustments to Projected Outlays												
Reduce the number of troops deployed for military operations in Iraq and Afghanistan and other activities related to the war on terrorism to 75,000 by 2013 ^d	-26	-50	-63	-44	-21	-7	-1	3	6	6	6	-165
Increase Medicare payment rates for physicians by 1 percent annually	0	-10	-14	-19	-23	-29	-35	-41	-48	-56	-62	-335
Assume regular appropriations for 2009 are set at the level specified in the budget resolution ^e	-5	-8	-9	-9	-10	-10	-10	-10	-11	-11	-11	-99
Effect on the deficit (outlay changes)	-31	-68	-86	-72	-53	-45	-46	-48	-53	-61	-68	-600
Effect on Net Interest (debt service)	-1	-5	-17	-42	-74	-102	-131	-160	-190	-223	-260	-1,205
Total Effect on the Deficit	-218	-501	-441	-430	-458	-496	-532	-575	-637	-707	-786	-5,563
Projected Deficit Under the Third Scenario	-1,404	-1,204	-940	-694	-715	-745	-766	-847	-871	-895	-1,021	-8,698

Sources: Congressional Budget Office; Joint Committee on Taxation.

Notes: Negative amounts indicate an increase in the deficit. "Debt service" refers to changes in interest payments on federal debt resulting from changes in the government's borrowing needs.

EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; AMT = alternative minimum tax; * = between zero and \$500 million.

- JCT estimates relative to CBO's January 2009 baseline were available for most of the effects stemming from tax code changes. For some of the minor provisions of EGTRRA and for all of the category of "other expiring provisions," CBO used JCT estimates from the summer of 2008, updated to reflect subsequent law changes in 2008 and to include an estimate for 2019. The estimates do not include extensions of provisions of the American Recovery and Reinvestment Act of 2009 (ARRA), but estimates of extensions of previously-enacted provisions that interact with ARRA have been adjusted to reflect estimated interactions.
- The estimates do not include extension of the 33 percent and 35 percent individual income tax rates, the reduced income tax rates for capital gains and dividends, and the repeal of the limitation on itemized deductions and personal exemptions. The estimates also assume that the estate and gift tax is extended at its 2009 levels. All other provisions from EGTRRA are assumed to be extended.
- This alternative incorporates the assumption that the exemption amount for the AMT is extended at its higher level and, together with the AMT tax brackets, is indexed for inflation after 2009. In addition, the treatment of personal credits against the AMT is assumed to be extended beyond 2009 (ARRA extended the higher exemption amount and adjustments to AMT tax brackets through this year). If the alternative was enacted jointly with the extension of certain expiring EGTRRA provisions, an interactive effect would occur after 2010 that would make the combined revenue loss over the 2011-2019 period greater than the sum of the two separate estimates.
- This alternative does not extrapolate the funding for military operations and associated costs in Iraq and Afghanistan provided for 2008 or 2009. Rather, it incorporates the assumption that an additional \$87 billion in budget authority will be provided in 2009 to carry out operations in those countries, bringing the total for that year to \$155 billion. Funding for operations in Iraq, Afghanistan, or elsewhere would total \$149 billion in 2010, \$129 billion in 2011, \$95 billion in 2012, and about \$70 billion a year from 2013 on—for a total of \$867 billion over the 2010-2019 period.
- The Concurrent Resolution on the Budget for Fiscal Year 2009 (S. Con. Res. 70) set the amount of nonemergency discretionary budget authority at \$1.012 trillion, \$9 billion above the level in CBO's January 2009 baseline.