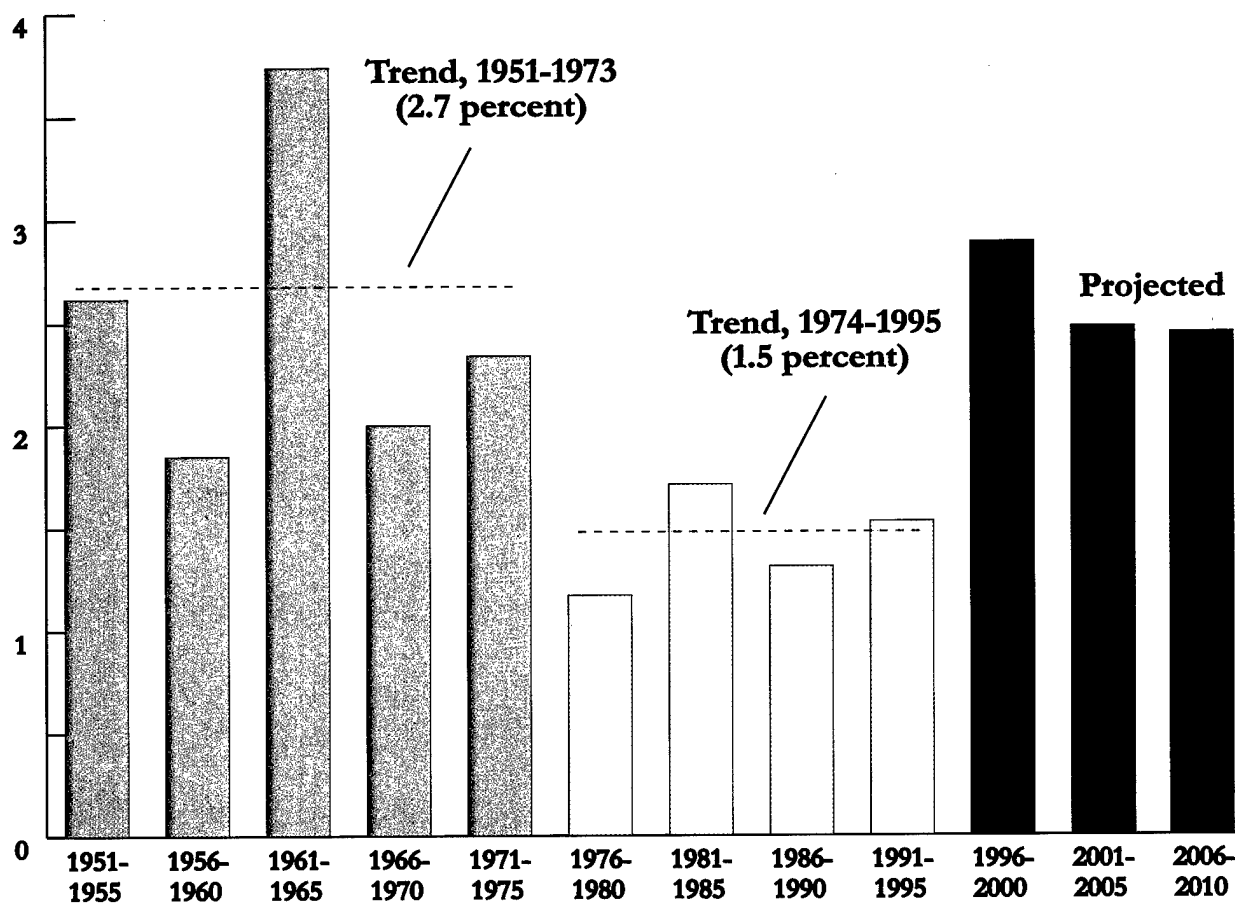


The Budget and Economic Outlook: Fiscal Years 2002-2011

Labor Productivity in the Nonfarm Business Sector (Average Annual Percentage Growth)



A REPORT TO THE SENATE AND
HOUSE COMMITTEES ON THE BUDGET



JANUARY 2001

**THE BUDGET AND ECONOMIC OUTLOOK:
FISCAL YEARS 2002-2011**

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NOTES

Numbers in the text and tables may not add up to totals because of rounding.

Unless otherwise indicated, all years referred to in Chapter 2 are calendar years, and all years in other chapters and appendixes are fiscal years.

Some of the figures in Chapter 2 indicate periods of recession by using shaded vertical bars. The bars extend from the peak to the trough of the recession.

Data for real gross domestic product are based on chained 1996 dollars.

The cover of this report illustrates one of the most remarkable changes in the U.S. economy in the past five years: the unexpected increase in the growth of the economy's ability to produce goods and services. That acceleration in the growth rate of labor productivity plays a major role in CBO's projections for the economy and the federal budget over the next decade.

Preface

This volume is one of a series of reports on the state of the economy and the budget 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 periodic reports to the Committees on the Budget with respect to fiscal policy and to provide five-year baseline projections of the federal budget. In accordance with CBO's mandate to provide objective and impartial analysis, the report contains no recommendations.

The economic outlook presented in Chapter 2 was prepared by the Macroeconomic Analysis Division under the direction of Robert Dennis. Ufuk Demiroglu, Kim J. Kowalewski, and John F. Peterson wrote the chapter and Appendix E. John F. Peterson, Robert Arnold, and Eric Warasta carried out the economic forecast and projections. Douglas Hamilton, Juann Hung, Mark Lasky, Angelo Mascaro, Preston Miller, Shinichi Nishiyama, Benjamin Page, Frank Russek, Matthew Salomon, Robert Shackleton, John Sturrock, and Christopher Williams contributed to the analysis. John McMurray and Eric Warasta provided research assistance.

The baseline spending projections were prepared by the staff of the Budget Analysis Division under the supervision of Robert Sunshine, Peter Fontaine, Janet Airis, Thomas Bradley, Kim Cawley, Paul Cullinan, and Jeffrey Holland. The revenue estimates were prepared by the staff of the Tax Analysis Division under the supervision of Thomas Woodward, Mark Booth, and David Weiner. The budget outlook described in Chapter 1 was written by Sandy Davis and Laurie Pounder. Mark Booth and Thomas Woodward wrote Chapter 3, and Barry Blom and Felix LoStraco wrote Chapter 4, with assistance from Kathleen Gramp, Jeanne De Sa, and Eric Rollins. Robert Dennis wrote Chapter 5 with assistance from many people in the Budget, Tax, and Macroeconomic Analysis Divisions. Frank Russek, Matthew Salomon, and John McMurray carried out the computations for Figure 5-1, and Mark Lasky prepared the recession scenario. Felix LoStracco wrote Appendix A; Takako Tsuji wrote Appendixes B, C, and F; and Barry Blom wrote Appendix D. Jennifer Smith coordinated the revision of the glossary. Jeffrey Holland wrote the summary of the report.

CBO's Panel of Economic Advisers commented on an early version of the economic forecast underlying this report. Members of the panel are Alan J. Auerbach, Michael Boskin, Barry P. Bosworth, John Cogan, Robert Dederick, William C. Dudley, Martin Feldstein, Robert J. Gordon, David Hale, Robert E. Hall, N. Gregory Mankiw, Allan Meltzer, William Niskanen, William D. Nordhaus, June E. O'Neill, Rudolph Penner, James Poterba, Robert Reischauer, Alice Rivlin, Joel Slemrod, John Taylor, and Martin B. Zimmerman. Although those outside advisers provided considerable assistance, they are not responsible for the contents of this report.

John Skeen, Leah Mazade, Christian Spoor, and Christine Bogusz edited the volume. Marion Curry, Linda Lewis Harris, Dorothy Kornegay, and Simone Thomas assisted in the preparation of the report. Kathryn Quattrone prepared the volume for final publication, and Annette Kalicki prepared the electronic versions for CBO's Web site. Barry Anderson designed the cover.

Dan L. Crippen
Director

January 2001

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are available at CBO's Web site:
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Contents

	SUMMARY	xiii
ONE	THE BUDGET OUTLOOK	1
	The Baseline Concept	5
	Recent Changes to the Budget Outlook	7
	The Outlook for Federal Debt	13
	Federal Funds and Trust Funds	18
	Comparing CBO's and the Clinton Administration's Baseline Projections	20
	The Expiration of Budget Enforcement Procedures	24
TWO	THE ECONOMIC OUTLOOK	27
	The Growth of the Economy's Potential to Produce	30
	CBO's Medium-Term Projections	32
	Recent Economic Developments	41
	CBO's Short-Term Forecast	47
THREE	THE REVENUE OUTLOOK	51
	Individual Income Taxes	54
	Corporate Income Taxes	61
	Social Insurance Taxes	63
	Excise Taxes and Other Sources of Revenue	64
	The Stock Market and CBO's Revenue Projections	66
	Expiring Tax Provisions	68
FOUR	THE SPENDING OUTLOOK	71
	Discretionary Spending	73
	Entitlements and Other Mandatory Spending	78
	Offsetting Receipts	86
	Net Interest	89
	Proceeds Earned on the Balance of Uncommitted Funds	92
FIVE	THE UNCERTAINTY OF BUDGET PROJECTIONS	93
	The Accuracy of CBO's Past Budget Projections	94
	Alternative Future Trends	97
	The Budgetary Effects of a Recession	102

APPENDIXES

- A Sequestration Preview Report for Fiscal Year 2002 107
- B How Changes in Assumptions Can Affect
Budget Projections 113
- C Budget Resolution Targets and Actual Outcomes:
Fiscal Years 1980 Through 2000 119
- D The Federal Sector of the National Income and
Product Accounts 127
- E CBO's Economic Projections for 2001 Through 2011 133
- F Historical Budget Data 137
- G Major Contributors to the Revenue and Spending
Projections 153

GLOSSARY

TABLES

S-1.	The Outlook for the Budget Under Current Policies	xiv
S-2.	Changes in CBO's Projections of the Surplus Since July 2000	xv
S-3.	CBO's Economic Projections for Calendar Years 2001-2011	xvii
1-1.	The Budget Outlook Under Current Policies	2
1-2.	CBO's Baseline Budget Projections	4
1-3.	Changes in CBO's Projections of the Surplus Since July 2000	8
1-4.	CBO's Projections of Debt Held by the Public and Net Indebtedness at the End of the Year	15
1-5.	CBO's Projections of Net Indebtedness at the End of the Year Under Alternative Scenarios for Debt Reduction	16
1-6.	CBO's Projections of Gross Federal Debt at the End of the Year	17
1-7.	Trust Fund Surpluses	19
1-8.	Comparison of CBO's Baseline with OMB's Current- Services Baseline	22
2-1.	CBO's Economic Projections for Calendar Years 2001-2011	28
2-2.	Change in Projections of Growth Over the Past Five Years	30
2-3.	Key Assumptions in CBO's Projection of Potential GDP	34
2-4.	Comparison of CBO's Current and Previous Economic Projections for Calendar Years 2001-2010	39
2-5.	Comparison of CBO's and the Clinton Administration's Economic Projections for Calendar Years 2001-2011	40
2-6.	CBO's Forecast for 2001 and 2002	48
2-7.	Comparison of CBO and <i>Blue Chip</i> Forecasts for Calendar Years 2001 and 2002	49
3-1.	Changes in CBO's Projections of Revenues Since July 2000	53
3-2.	CBO's Projections of Revenues	54
3-3.	Shares of Growth of Individual Income Tax Liabilities in Excess of Growth of GDP, by Source, Tax Years 1995-1998	56

3-4.	Actual Revenues in Fiscal Year 2000, by Source, Compared with CBO's January 2000 Projections	58
3-5.	CBO's Projections of Individual Tax Receipts and the Tax Base	59
3-6.	Actual and Projected Capital Gains	60
3-7.	CBO's Projections of Corporate Income Tax Receipts and the Tax Base	62
3-8.	CBO's Projections of Social Insurance Tax Receipts and Tax Base	63
3-9.	CBO's Projections of Social Insurance Tax Receipts, by Category	64
3-10.	CBO's Projections of Excise Tax Receipts, by Category	65
3-11.	CBO's Projections of Other Sources of Revenue	66
3-12.	Effect of Extending Tax Provisions That Will Expire Before 2011	69
4-1.	CBO's Baseline Budget Projections of Outlays	72
4-2.	Average Annual Rate of Growth in Outlays	74
4-3.	Defense and Nondefense Discretionary Outlays, Fiscal Years 1991-2001	75
4-4.	CBO's Projections of Discretionary Spending Under Alternative Paths	77
4-5.	CBO's Projections of Mandatory Spending	80
4-6.	Sources of Growth in Mandatory Spending	85
4-7.	Program Continuations Assumed in CBO's Baseline	87
4-8.	CBO's Projections of Offsetting Receipts	88
4-9.	CBO's Projections of Federal Interest Outlays and Proceeds from Uncommitted Funds	91
5-1.	Average Difference Between CBO's Budget Projections and Actual Outcomes Since 1981, Adjusted for Legislation	96
5-2.	Key Economic Variables Under Alternative Scenarios	98
5-3.	Budget Surpluses Under Alternative Scenarios	99
5-4.	Illustrative Recession Scenario	101

5-5.	Budget Surpluses in a Recession	102
A-1.	CBO's Estimates of Discretionary Spending Limits for Fiscal Years 2001 and 2002	108
A-2.	CBO's Estimates of Discretionary Spending Compared with the Statutory Caps for Fiscal Year 2002	110
A-3.	Budgetary Effects of Direct Spending or Receipt Legislation Enacted Since the Budget Enforcement Act of 1997	111
B-1.	Estimated Effects on CBO's Budget Projections of Selected Economic Changes	115
B-2.	Estimated Effects on CBO's Baseline of Increasing Discretionary Budget Authority by \$10 Billion in 2002	116
B-3.	Estimated Savings in Net Interest from Increasing the Surplus by \$10 Billion	117
C-1.	Comparison of Budget Resolution Targets and Actual Budget Totals, Fiscal Year 2000	121
C-2.	Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, Fiscal Year 2000	122
C-3.	Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, Fiscal Years 1980-2000	124
D-1.	Relationship of the Budget to the Federal Sector of the National Income and Product Accounts	128
D-2.	Projections of Baseline Receipts and Expenditures Measured by the National Income and Product Accounts	130
E-1.	CBO's Year-by-Year Economic Projections for Calendar Years 2001-2011	134
E-2.	CBO's Year-by-Year Economic Projections for Fiscal Years 2001-2011	135
F-1.	Deficits, Surpluses, Debt, and Related Series, Fiscal Years 1961-2000	139
F-2.	Standardized-Budget Deficit or Surplus and Related Series, Fiscal Years 1961-2000 (In billions of dollars)	140
F-3.	Standardized-Budget Deficit or Surplus and Related Series, Fiscal Years 1961-2000 (As a percentage of potential GDP)	141
F-4.	Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public, Fiscal Years 1962-2000 (In billions of dollars)	142
F-5.	Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public, Fiscal Years 1962-2000 (As a percentage of GDP)	143

F-6.	Revenues by Major Source, Fiscal Years 1962-2000 (In billions of dollars)	144
F-7.	Revenues by Major Source, Fiscal Years 1962-2000 (As a percentage of GDP)	145
F-8.	Outlays by Major Spending Category, Fiscal Years 1962-2000 (In billions of dollars)	146
F-9.	Outlays by Major Spending Category, Fiscal Years 1962-2000 (As a percentage of GDP)	147
F-10.	Discretionary Outlays, Fiscal Years 1962-2000 (In billions of dollars)	148
F-11.	Discretionary Outlays, Fiscal Years 1962-2000 (As a percentage of GDP)	149
F-12.	Outlays for Entitlements and Other Mandatory Spending, Fiscal Years 1962-2000 (In billions of dollars)	150
F-13.	Outlays for Entitlements and Other Mandatory Spending, Fiscal Years 1962-2000 (As a percentage of GDP)	151

FIGURES

S-1.	CBO's Projections of Federal Debt, Uncommitted Funds, and Net Indebtedness	xvi
S-2.	Uncertainty in CBO's Projections of the Total Budget Surplus Under Current Policies	xviii
1-1.	Debt Held by the Public as a Share of GDP, Fiscal Years 1940-2000	14
1-2.	Composition of Debt Held by the Public, Fiscal Years 2000, 2006, and 2011	14
2-1.	The Economic Forecast and Projections	29
2-2.	Labor Productivity in the Nonfarm Business Sector	31
2-3.	Prices for Computers Bought by Businesses	32
2-4.	Business Fixed Investment	32
2-5.	Prices for Imports, Excluding Petroleum and Computers	33
2-6.	Total Factor Productivity	35
2-7.	Gross Domestic Product	35
2-8.	Real Interest Rates	37

2-9.	Income Shares and Depreciation	37
2-10.	The S&P 500 Index of Stock Prices	43
2-11.	Home Sales and Affordability	43
2-12.	Nominal Trade Deficit	46
2-13.	Employment Cost Indexes for Wages and Benefits	47
3-1.	Annual Growth of Federal Revenues and GDP, Fiscal Years 1960-2011	51
3-2.	Total Revenues as a Share of GDP for Fiscal Years 1944-2011	52
3-3.	Revenues, by Source, as a Share of GDP for Fiscal Years 1960-2011	55
3-4.	Effective Tax Rate on Individual Income, Tax Years 1990-1998	58
4-1.	Major Components of Spending as a Percentage of GDP, Fiscal Years 1962-2000	73
4-2.	Nondefense Discretionary Spending, by Category, Fiscal Year 2001	76
4-3.	CBO's Baseline Projections of Federal Medicaid Spending, Fiscal Years 2001-2011	81
5-1.	Uncertainty in CBO's Projections of the Total Budget Surplus Under Current Policies	94
 BOXES		
1-1.	A Freeze in Discretionary Spending	6
1-2.	Budgetary Treatment of Government Purchases of Private Securities	21
2-1.	A Change in How CBO Calculates the Capital Input in Its Growth Model	36
2-2.	The Recent Slowdown in Manufacturing	42
2-3.	Recent Developments in Energy Markets	44
3-1.	Tax Bases and Tax Liability	57
4-1.	Auctions of Spectrum Licenses Are Likely to Yield Higher Proceeds	90

Summary

In the absence of significant legislative changes and assuming that the economy follows the path described in this report, the Congressional Budget Office (CBO) projects that the total surplus will reach \$281 billion in 2001. Such surpluses are projected to rise in the future, approaching \$889 billion in 2011 and accumulating to \$5.6 trillion over the 2002-2011 period. That total is about \$1 trillion higher than the cumulative surplus projected for 2001 through 2010 in CBO's July 2000 report. About \$600 billion of the \$1 trillion increase is due simply to shifting the 10-year horizon out one year, to 2011, and dropping 2001 from the total. The remaining \$441 billion results mostly from changes in the economic forecast, which are offset in part by the cost of legislation enacted since CBO's previous report.

Perhaps more important to some policymakers, the on-budget surplus (which excludes the spending and revenues of Social Security and the Postal Service) is anticipated to equal \$125 billion in 2001—a nearly \$40 billion increase from its level in 2000. The on-budget surplus will continue growing over the 10-year period, CBO projects, exceeding \$550 billion in 2011 and totaling over \$3.1 trillion between 2002 and 2011.

The growth of economic activity—as measured by real (inflation-adjusted) gross domestic product (GDP)—is likely to slow from its rapid pace of recent years to about 2.4 percent this calendar year. Spending by consumers and investment by businesses slowed late last year in response to the rise in interest rates during 1999 and early 2000 and to reduced expectations about future business conditions. Although the Federal Reserve Board in early January

responded to the slower growth by lowering the federal funds rate, spending by consumers and businesses is likely to remain weak in the near term. However, lower interest rates this year will set the stage for moderately faster growth of spending next year. Thus, CBO forecasts that economic growth will climb to about 3.4 percent in calendar year 2002.

How is it, then, that budget projections are getting better when the economy seems to be getting worse? There are two main answers to that question. First of all, the dip in the economy is expected to be short-lived. CBO forecasts that economic growth will pick up again by the middle of 2001. Over the 2002-2011 period, CBO anticipates that growth of real GDP will average a little over 3 percent per year—about 0.3 percentage points above its 10-year projection in July. That increase reflects a change in CBO's method of calculating the contribution of capital to growth, revised data showing greater investment for the past three years, and higher projected levels of investment. Changes due to higher projections of GDP and other economic factors boost projected revenues by \$802 billion from 2001 through 2010.

Second, recent economic conditions and actions by the Federal Reserve have led CBO to significantly reduce its forecast of interest rates in 2001 and 2002 (but that factor is not nearly as large as the first). Lower near-term interest rates and reduced levels of projected debt across the 10-year period (due to higher projected surpluses) combine to increase estimates of the surplus by about \$140 billion from 2001 through 2010.

Summary Table 1.
The Outlook for the Budget Under Current Policies (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	Total, 2002-2006	Total, 2007-2011	Total, 2002-2011
On-Budget Surplus	86	125	142	987	2,135	3,122
Off-Budget Surplus	<u>150</u>	<u>156</u>	<u>171</u>	<u>1,019</u>	<u>1,468</u>	<u>2,488</u>
Total Surplus	236	281	313	2,007	3,603	5,610

SOURCE: Congressional Budget Office.

The Budget Outlook

The outlook for the federal budget over the next decade continues to be bright. Assuming that current tax and spending policies are maintained, CBO projects that mounting federal revenues will continue to produce growing budget surpluses for the next 10 years. CBO's updated budget outlook continues a trend of steady and sometimes dramatic improvement in budget projections since 1997, reflecting the continuing impact of strong economic growth over the past few years. Although there are signs that economic growth is moderating from recent robust levels, substantial budget surpluses remain on the horizon for the next decade in the absence of large changes in policy. Over the longer term, however, budgetary pressures linked to the aging and retirement of the baby-boom generation threaten to produce record deficits and unsustainable levels of federal debt.

CBO projects that, in the absence of new legislation, total budget surpluses would grow from about 3 percent to more than 5 percent of GDP from 2002 through 2011.¹ Under current policies, total surpluses would accumulate to an estimated \$2 trillion over the next five years and \$5.6 trillion over the coming decade (see Summary Table 1). Such large surpluses would be sufficient by 2006 to pay off all

debt held by the public that will be available for redemption.

Within those totals, on-budget surpluses would accumulate to nearly \$1 trillion over the next five years and about \$3.1 trillion over the 2002-2011 period. On-budget surpluses would range between just over 1 percent to more than 3 percent of GDP. Off-budget surpluses also would total about \$1 trillion over the next five years and about \$2.5 trillion through 2011. Off-budget surpluses alone would be sufficient to eliminate the debt available for redemption by the end of the 10-year period.

The distinction between on- and off-budget surpluses is significant for the budget policy debate. Many lawmakers have declared their intent to preserve all off-budget surpluses, which consist principally of the surpluses generated by the Social Security trust funds, thereby reducing the outstanding public debt. As a result, on-budget surpluses are viewed by those lawmakers and others as establishing the budgetary boundaries for any new spending or revenue policies.

Changes Since July 2000

CBO's current budget outlook is more favorable than the one presented in July 2000. Since then, the Congress and the President have enacted legislation that, CBO estimates, increases projected spending over the 2001-2010 period by about \$561 billion and reduces projected revenues by \$37 billion, compared with the levels in CBO's July baseline (see Summary Table

1. These estimates assume that discretionary spending—which is provided and controlled in appropriation acts—grows over the 10-year period at the rates of inflation specified in the Balanced Budget and Emergency Deficit Control Act of 1985.

2). About two-thirds of that increase in projected spending results from extrapolating discretionary spending into the future on the basis of the level of appropriations for 2001. Expanded health care benefits for military retirees and increased payments for Medicare—along with additional debt-service costs resulting from legislative changes—account for most of the rest of the decrease in the cumulative surplus. The effects of legislation, however, have been more than offset by changes in CBO's estimates of future revenues that add to projected surpluses.

Most of the improvement in CBO's budget outlook since July results from changes in economic projections. Despite an expected short-term reduction in economic growth, CBO estimates that the economy will grow faster after 2001 than it estimated in July. That increase in growth boosts projected revenues by more than \$800 billion over the 2001-2010 period.

CBO projects that interest rates will be at least 1 percentage point lower in both 2001 and 2002 than previously forecast. As a result, projections of net

Summary Table 2.
Changes in CBO's Projections of the Surplus Since July 2000
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2010
July 2000 Projection of Total Surplus ^a	268	312	345	369	402	469	523	565	625	685	4,561
Changes											
Legislative											
Revenues	-2	-2	-3	-3	-3	-4	-4	-5	-6	-5	-37
Outlays ^b	-12	-40	-46	-51	-56	-60	-66	-71	-77	-83	-561
Subtotal	-14	-42	-49	-53	-59	-63	-70	-76	-83	-88	-598
Economic											
Revenues	-6	7	32	56	72	88	106	128	148	173	802
Outlays ^b	7	14	10	10	12	16	19	24	29	37	178
Subtotal	1	21	42	66	84	103	124	151	177	210	980
Technical											
Revenues	33	29	24	20	15	11	9	7	4	2	153
Outlays ^b	-6	-7	-3	-5	-10	-14	-13	-12	-12	-12	-95
Subtotal	27	22	21	15	6	-3	-4	-6	-8	-10	59
Total Changes	13	*	14	28	31	36	50	70	86	111	441
January 2001 Projection of Total Surplus	281	313	359	397	433	505	573	635	710	796	5,002
Memorandum:											
Total Change in Revenues	25	34	53	73	84	95	110	129	146	170	919
Total Change in Outlays ^b	-12	-33	-38	-45	-53	-59	-60	-59	-60	-58	-478

SOURCE: Congressional Budget Office.

NOTE: * = less than \$500 million.

a. The stated surplus assumes that discretionary spending grows at the rate of inflation after 2000 (one variation of the baseline described in CBO's July report).

b. Increases in outlays are shown with a negative sign because they reduce surpluses.

interest are lower by \$12 billion in 2001 and \$21 billion in 2002. At the same time, higher revenue projections and other factors reduce the projected costs of servicing the debt by a total of \$160 billion over the 10-year period.

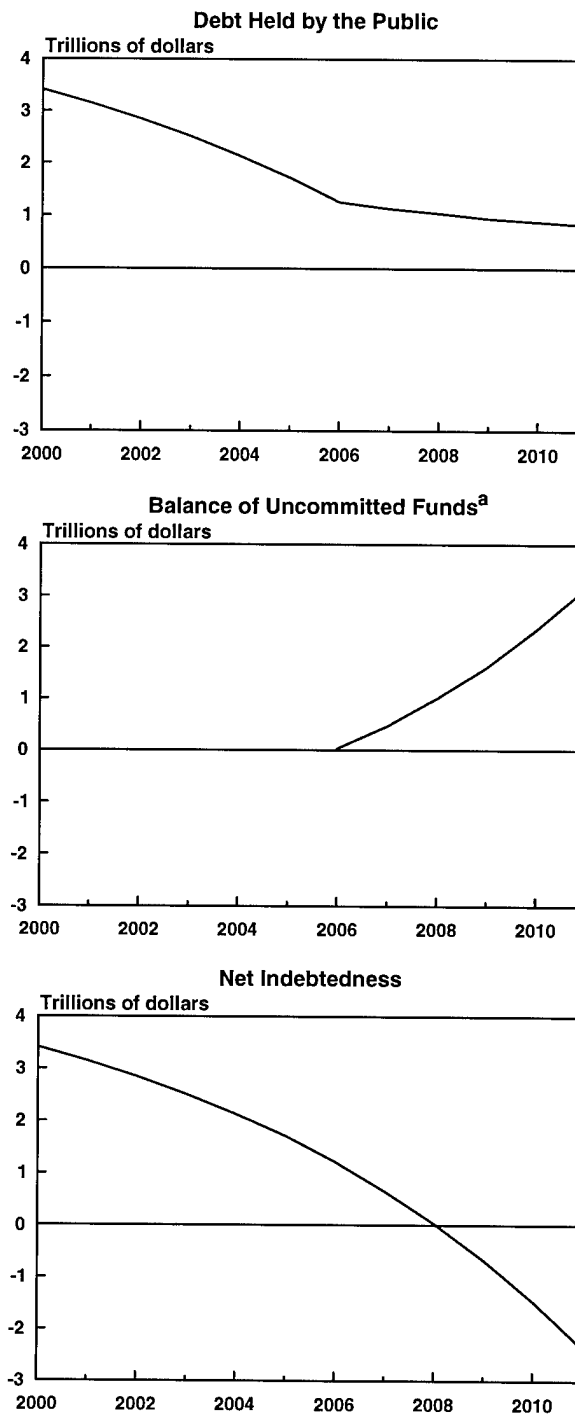
Changes in factors other than legislation and the economic outlook (so-called technical changes) increase projected surpluses by \$59 billion over 10 years. Technical changes to revenue projections increase surpluses by \$153 billion—mostly reflecting an increase in projected realizations of capital gains in the first half of the period and collections of revenues in fiscal year 2000 that were greater than anticipated in July. Technical changes to outlay projections offset \$95 billion of the increase in revenues between 2001 and 2010 through a mix of modifications in both directions. Among the largest are upward revisions for Medicaid and Social Security, which are only partially offset by downward reestimates for discretionary spending (mostly Section 8 housing assistance); estimates of greater receipts from auctions of licenses to use portions of the electromagnetic spectrum; and lower debt-service costs.

Projections of Federal Debt

Between 1969 and 1997, the Department of the Treasury sold ever-increasing amounts of securities to finance continuing deficits. As a result, debt held by the public climbed each year, peaking at \$3.8 trillion in 1997. But that trend has been reversed. Debt held by the public has dropped \$363 billion, to \$3.4 trillion at the end of fiscal year 2000.

CBO's baseline indicates that debt held by the public will continue to fall (see Summary Figure 1). If surpluses accrue as projected, much of the current debt will be paid down over the next several years; however, a part of it—including some long-term bonds and savings bonds—will not be available for redemption during CBO's 10-year projection period. Therefore, in any given year, some debt will remain outstanding and incur interest costs, regardless of the size of the surplus. Under CBO's assumptions for the baseline, surpluses exceed the amount of debt available for redemption beginning in 2006. After that point, surpluses not used to pay off debt accumu-

Summary Figure 1.
CBO's Projections of Federal Debt, Uncommitted Funds, and Net Indebtedness
(By fiscal year, in trillions of dollars)



SOURCE: Congressional Budget Office.

- a. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

late and are assumed to earn a rate of return equal to the average rate projected for Treasury securities.

CBO displays the full effect of surpluses on the government's financial position with a new measure—net indebtedness—which combines the outstanding debt held by the public and the balance of uncommitted funds. In 2006, by CBO's estimates, the surplus would be large enough to reduce debt held by the public to \$1,251 billion; however, another \$28 billion would be available to the Treasury but not applied to debt redemption because the remaining debt will have not yet reached maturity, will not be available for repurchase at a price that the Treasury would be willing to pay, or will be held in nonmarketable form (for example, savings bonds). The government's net representation in financial markets (net indebtedness) would therefore total \$1,223 billion—the difference between debt held by the public of \$1,251 billion and \$28 billion in uncommitted funds. Under CBO's baseline projections, net indebtedness turns negative after 2008, meaning that the balance of uncommitted funds at that point would exceed the remaining debt owed to the public.

The Economic Outlook

Real GDP is expected to grow half as fast in calendar year 2001 as it did in 2000, dropping from 5.1 percent to 2.4 percent. That rate of growth is expected to pick up in 2002 to 3.4 percent.

The rate of inflation, measured by the change in the consumer price index (CPI) for urban consumers, is expected to decline from 3.4 percent in calendar year 2000 to around 2.8 percent in 2001. That projected decline reflects CBO's view that oil prices will fall somewhat from last year's level, although the underlying inflationary pressure from the tight labor market will remain.

CBO anticipates that growth of real GDP will average about 3 percent in the 2002-2011 period. (CBO does not attempt to forecast year-to-year patterns in the business cycle more than two years

Summary Table 3.
CBO's Economic Projections for Calendar Years 2001-2011

	Estimated 2000	Forecast		Projected Annual Average	
		2001	2002	2003-2006	2007-2011
Nominal GDP (Percentage change)	7.3	4.7	5.6	5.1	5.0
Real GDP (Percentage change)	5.1	2.4	3.4	3.1	3.1
GDP Price Index (Percentage change)	2.1	2.3	2.1	1.9	1.9
Consumer Price Index ^a (Percentage change)	3.4	2.8	2.8	2.6	2.5
Unemployment Rate (Percent)	4.0	4.4	4.5	4.7	5.2
Three-Month Treasury Bill Rate (Percent)	5.8	4.8	4.9	4.9	4.9
Ten-Year Treasury Note Rate (Percent)	6.0	4.9	5.3	5.6	5.8

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.

a. The consumer price index for urban consumers.

ahead, but that average figure for economic growth takes into account a range of scenarios, including both a recession and the continuation of strong growth.) CBO also projects that CPI inflation will average 2.6 percent during that period, reflecting the agency's assumption about the level of inflation consistent with Federal Reserve policy. Given the projection of continued stable inflation, interest rates are expected to level off at rates similar to those seen in the second half of the 1990s. (See Summary Table 3.)

Uncertainty in the Projections

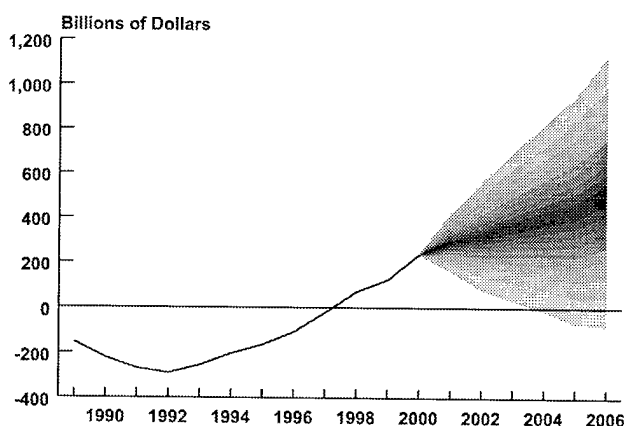
The baseline projections presented in this report represent the midrange of possible outcomes for the economy and the budget, based on past and current trends and the assumption that current policies are not changed. But considerable uncertainty surrounds those projections for two reasons. First, the U.S. economy and the federal budget are highly complex and are affected by many economic and technical factors that are difficult to predict. Second, future legislation is likely to alter the paths of federal spending and revenues. CBO does not predict future legislative changes in its baseline would undermine the usefulness of those numbers as the base against which to measure the effects of such changes. As a result, actual budgetary outcomes will almost certainly differ from CBO's baseline projections.

Experience shows that although CBO's projection of the surplus for the coming fiscal year is likely to err, on average, by about 1 percent of GDP (excluding the effects of new legislation), discrepancies can become more substantial over a five-year horizon. CBO has made 10-year projections only since 1992, so it is too soon to assess their accuracy; but 10-year projections are likely to be less accurate than five-year projections.

In view of those uncertainties, the outlook for the budget can best be described as a fan of probabili-

ties around the point estimates presented in this report. The fan is initially fairly narrow, but then widens as the period extends (see Summary Figure 2). The figure makes clear that nearby projections—other paths in the darkest part of the figure—have nearly the same probability as the baseline. Moreover, projections that are quite different from the baseline also have some significant probability of coming to pass. For example, the figure suggests some probability, albeit small, that the budget might fall into deficit in 2006, even without policy changes.

Summary Figure 2.
Uncertainty in CBO's Projections of
the Total Budget Surplus Under Current
Policies (By fiscal year)



SOURCE: Congressional Budget Office.

NOTES: The figure shows the estimated likelihood of alternative projections of the surplus under current policies. The calculations are based on CBO's past track record. The CBO projections described in Chapter 1 fall in the middle of the darkest area. Assuming that policies do not change, the probability is 10 percent that actual surpluses will fall in the darkest area and 90 percent that they will fall within the whole shaded area.

Actual surpluses will of course be affected by legislation enacted during the next 10 years, including decisions about discretionary spending. The effects of future legislation are not included in this figure.

An explanation of how this probability distribution was calculated will appear shortly on CBO's Web site at www.cbo.gov/otherdoc.html.

The Budget Outlook

The outlook for the federal budget over the next decade continues to be bright. Assuming that current tax and spending policies are maintained, the Congressional Budget Office (CBO) projects that mounting federal revenues will continue to outstrip spending and produce growing budget surpluses for the next 10 years. The update of CBO's budget outlook that this chapter describes continues a trend, since 1997, of steady and sometimes dramatic improvement, reflecting the continuing impact of strong economic growth over the past few years.

Although the economy has slowed in recent months—holding down the rate of growth in estimated surpluses in the short run—CBO expects economic growth to rebound later this year and, in the absence of substantial policy changes, to continue to produce large budget surpluses for the next decade. Nevertheless, over the longer term, budgetary pressures linked to the aging and retirement of the baby-boom generation threaten a return to high deficits and unsustainable levels of federal debt.¹

The favorable budget outlook for the next 10 years builds on a period of budget surpluses that is already historic. Fiscal year 2000 ended with a total surplus (that is, including the off-budget transactions of Social Security and the Postal Service) of \$236 billion.² CBO estimates that 2001 will conclude with

a total surplus of \$281 billion (see Table 1-1). That surplus, at 2.7 percent of gross domestic product (GDP), would be the largest relative to the size of the economy since 1948. If it is realized, 2001 will mark the first time in at least a century that rising surpluses have been recorded for four consecutive years. Over that four-year span, total surpluses could sum to more than \$700 billion, leading to a roughly equivalent reduction in federal debt held by the public. When combined with recent strong economic growth, that drop would also lead to a significant decrease in federal debt as a percentage of the economy. CBO estimates that federal debt will fall to around 30 percent of GDP in 2001, a substantial decline from the nearly 50 percent of GDP it reached in the mid-1990s.

Notably, the total surpluses for 2000 and 2001 also include growing on-budget surpluses (\$86 billion and \$125 billion, respectively)—the first large on-budget amounts since the recent string of surpluses began in 1998. Those on-budget amounts, and later projections of even greater sums, are significant for the budget policy debate. Many lawmakers have declared their intent to preserve all off-budget surpluses, which consist principally of those generated by the Social Security trust funds, to reduce outstanding debt held by the public. For those lawmakers,

budget federal entities are owned and controlled by the government, but their transactions are excluded from the budget totals by law; their receipts and outlays are excluded from the totals in the President's budget and from the Congressional budget resolution and are not counted for budget enforcement purposes. However, supporting budget documents and other analyses often combine off-budget and on-budget amounts into a consolidated, or unified, presentation to give a complete picture of total government revenues, spending, surpluses, and deficits.

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1. See Congressional Budget Office, *The Long-Term Budget Outlook* (October 2000).
 2. The Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and the Postal Service fund were placed off-budget by laws enacted in 1985 and 1989, respectively. Off-

Table 1-1.
The Budget Outlook Under Current Policies (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002- 2011
On-Budget Surplus	86	125	142	171	196	212	267	316	359	417	484	558	3,122
Off-Budget Surplus ^a	<u>150</u>	<u>156</u>	<u>171</u>	<u>188</u>	<u>201</u>	<u>221</u>	<u>238</u>	<u>257</u>	<u>276</u>	<u>294</u>	<u>312</u>	<u>331</u>	<u>2,488</u>
Total Surplus	236	281	313	359	397	433	505	573	635	710	796	889	5,610
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818	n.a.
Balance of Uncommitted Funds ^b	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28	466	1,003	1,608	2,338	3,164	n.a.
Net Indebtedness ^c	3,410	3,148	2,848	2,509	2,131	1,714	1,223	662	36	-669	-1,460	-2,346	n.a.
Memorandum:													
Social Security Surplus	152	157	172	188	202	221	238	257	276	294	312	331	2,490
Total Surplus as a Percentage of GDP	2.4	2.7	2.9	3.1	3.3	3.4	3.8	4.1	4.3	4.6	4.9	5.3	n.a.
Debt Held by the Public as a Percentage of GDP	34.7	30.5	26.2	21.9	17.7	13.5	9.4	8.1	7.1	6.1	5.5	4.8	n.a.

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.

b. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

c. Negative net indebtedness means that the balance of uncommitted funds exceeds the remaining debt held by the public.

only on-budget surpluses would be available for new spending or revenue policies, and those projected surpluses establish the limits for legislative action on the budget.

From 2002 through 2011, CBO projects rising surpluses under current policies. Total budget surpluses, by CBO's estimates, would grow from about 3 percent to more than 5 percent of GDP, and on-budget surpluses would climb from over 1 percent to more than 3 percent (see Table 1-2 on page 4).³ Under current policies, total surpluses would accumulate to an estimated \$2 trillion over the next five years and \$5.6 trillion over the coming decade, and would

be sufficient by 2006 to pay off all publicly held debt that is available for redemption. Within those totals, on-budget surpluses would climb to nearly \$1 trillion over the next five years and about \$3.1 trillion over the 2002-2011 period; five-year and 10-year totals for off-budget surpluses would be about \$1 trillion and about \$2.5 trillion, respectively. Off-budget surpluses alone would be sufficient to eliminate the available debt by the end of the 10-year period.

CBO's estimates of rising surpluses continue the recent trend of improving bottom lines in its baseline budget projections. The budget outlook in this report is more favorable than the one CBO issued in its July 2000 report, *The Budget and Economic Outlook: An Update*. Estimates of the total surplus and the on-budget surplus for 2001 have both improved:

3. Those estimates assume that discretionary spending grows at projected rates of inflation over the 10-year period.

the total surplus (\$281 billion) is about \$13 billion higher than CBO's estimate in July, and the on-budget surplus (\$125 billion) has increased by about \$23 billion. (CBO's current estimate of the off-budget surplus for 2001 is lower by about \$9 billion compared with July's.)

Last summer, CBO projected a cumulative total surplus of \$4.6 trillion for the 2001-2010 period. In this report, which discusses the outlook for 2002 through 2011, projected surpluses accumulate to \$5.6 trillion. Of that \$1 trillion increase, about \$600 billion is simply due to shifting the 10-year budget horizon forward one year and dropping 2001 from the total. The remaining \$441 billion is the net effect of CBO's higher baseline projections of total revenues and outlays since July.

As noted earlier, the projected strength in the economy over the next decade, which CBO estimates will boost revenues, is mainly responsible for the outlook's improvement since July. CBO's projections of revenues over the 2001-2010 period are now \$919 billion higher than they were in the summer. That hike can be attributed to the effects of a stronger economy over the period (\$802 billion) and adjustments for certain technical factors, such as higher capital gains realizations, over the next few years (\$153 billion). Tax cuts enacted near the end of the 106th Congress are projected to reduce revenues by about \$37 billion through 2010. CBO expects that the overall rate of growth in tax receipts will slow from its rapid pace of recent years; nevertheless, it will remain strong over the 10-year budget horizon. (Chapter 3 discusses CBO's outlook for revenues.)

About half of the projected boost in revenues is offset by higher anticipated spending over the period that curbs the overall rise in total surpluses. Under current policies, CBO expects a net increase in total spending of \$478 billion relative to the July projections. Legislation enacted since then pushes up outlays by \$561 billion, with about two-thirds of that legislated increase—\$368 billion—going toward discretionary spending (which is provided and controlled in annual appropriation acts) and the rest—\$193 billion—going toward mandatory spending (which is controlled by laws other than appropriation

acts).⁴ Of the estimated change in mandatory spending, about two-thirds (or \$127 billion) is for higher net interest costs associated with the increase in total spending caused by new legislation. Changes in CBO's economic and technical assumptions reduce projected net spending by \$83 billion below the July estimates.

The favorable outlook for the next several years, however, is subject to considerable uncertainty. Final annual outcomes for the federal budget will differ, perhaps significantly, from CBO's projections, which show spending and revenues under current policies. Those policies will almost certainly change, and the changes could have sizable budgetary effects. For instance, the Presidential and Congressional election campaigns in 2000 included major debates over how best to use burgeoning on-budget surpluses. Those debates may presage major changes in federal spending or tax policies in the coming years that are not reflected in CBO's budget outlook.

An additional source of uncertainty is the accuracy of the economic and technical assumptions that CBO uses in making its baseline budget projections. (Chapter 5 describes the uncertainties that underlie such assumptions.) In recent years, economic growth has surpassed expectations, fueling projections of higher revenues and bigger surpluses. A downturn in the economy, depending on its severity and duration, could greatly diminish or even eliminate surpluses over the next few years.

The uncertainty inherent in CBO's projections becomes more significant when considering the budgetary challenges that loom just beyond the current 10-year budget horizon. Toward the end of that period, the post-World War II baby-boom generation will begin leaving the workforce. The baby boomers' retirement and aging will lead to increasing pressure on spending for federal programs for the elderly. The projected surpluses, if realized, would help the country begin to address those longer-term budgetary stresses. Budget surpluses reduce the government's need to borrow, thereby increasing national saving.

4. Because appropriations for years after 2001 are not yet in place, CBO's projections of discretionary spending extrapolate from the levels appropriated for 2001.

Table 1-2.
CBO's Baseline Budget Projections (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
In Billions of Dollars												
Revenues												
Individual income	1,004	1,076	1,125	1,176	1,230	1,289	1,354	1,424	1,500	1,583	1,675	1,774
Corporate income	207	215	217	226	236	246	255	264	276	289	303	319
Social insurance	653	686	725	762	797	840	879	921	963	1,010	1,059	1,110
Other	161	158	169	179	190	194	200	207	216	225	233	244
Total	2,025	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447
On-budget	1,545	1,630	1,703	1,782	1,864	1,950	2,040	2,136	2,243	2,360	2,489	2,628
Off-budget	481	504	532	561	589	620	649	680	712	746	782	819
Outlays												
Discretionary spending	617	646	682	710	730	750	766	782	804	824	845	866
Mandatory spending	1,030	1,089	1,157	1,219	1,296	1,378	1,441	1,520	1,614	1,713	1,820	1,934
Offsetting receipts	-81	-87	-95	-108	-111	-107	-113	-119	-125	-131	-139	-147
Net interest	223	205	179	163	142	116	90	72	65	58	53	51
Proceeds earned on the balance of uncommitted funds ^a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-1	-12	-38	-68	-104	-146
Total	1,789	1,853	1,923	1,984	2,056	2,137	2,184	2,243	2,320	2,396	2,475	2,558
On-budget	1,458	1,506	1,561	1,611	1,669	1,738	1,773	1,820	1,884	1,943	2,005	2,070
Off-budget	331	348	361	373	388	399	411	423	437	453	470	489
Surplus	236	281	313	359	397	433	505	573	635	710	796	889
On-budget	86	125	142	171	196	212	267	316	359	417	484	558
Off-budget	150	156	171	188	201	221	238	257	276	294	312	331
Memorandum:												
Gross Domestic Product	9,828	10,319	10,880	11,477	12,059	12,656	13,279	13,932	14,619	15,338	16,109	16,922

(Continued)

Saving promotes economic growth, and a strong and growing economy will make future obligations, both public and private, easier to meet.

But even substantial surpluses over the next several years cannot eliminate the budgetary tensions that coming demographic changes and rising health care costs will bring. The nation will still have to find a way to deal with those long-term costs. Near-term surpluses do not change the underlying dynamic driving the long-term budget outlook. Over the next 40 years, the number of workers will increase by only about 18 percent while the number of Social Security and Medicare beneficiaries will almost double. With continuing boosts in life expectancy, those beneficiaries will also be older, causing a near-tripling in the population over age 85 by 2040. Further, those

trends will increase the cost of long-term care, over half of which is financed by Medicaid and Medicare.⁵ In its most recent report on the long-term budget outlook, CBO assumed that Medicare costs would continue to grow faster than the economy (by about 1 percent annually over the long term).⁶ That report projected that the combined effect of demographic developments and growth in medical costs would push spending on Medicare, Medicaid, and Social Security from 7.5 percent of GDP in 1999 to 16.7

5. See Congressional Budget Office, *Projections of Expenditures for Long-Term Care Services for the Elderly* (March 1999), pp. 1 and 5-6.

6. See Congressional Budget Office, *The Long-Term Budget Outlook*, pp. 3-4.

Table 1-2.
Continued

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
As a Percentage of GDP												
Revenues												
Individual income	10.2	10.4	10.3	10.2	10.2	10.2	10.2	10.2	10.3	10.3	10.4	10.5
Corporate income	2.1	2.1	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Social insurance	6.6	6.6	6.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Other	<u>1.6</u>	<u>1.5</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.4</u>	<u>1.4</u>
Total	20.6	20.7	20.5	20.4	20.3	20.3	20.2	20.2	20.2	20.3	20.3	20.4
On-budget	15.7	15.8	15.7	15.5	15.5	15.4	15.4	15.3	15.3	15.4	15.5	15.5
Off-budget	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.8
Outlays												
Discretionary spending	6.3	6.3	6.3	6.2	6.0	5.9	5.8	5.6	5.5	5.4	5.2	5.1
Mandatory spending	10.5	10.5	10.6	10.6	10.7	10.9	10.8	10.9	11.0	11.2	11.3	11.4
Offsetting receipts	-0.8	-0.8	-0.9	-0.9	-0.9	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9
Net interest	2.3	2.0	1.6	1.4	1.2	0.9	0.7	0.5	0.4	0.4	0.3	0.3
Proceeds earned on the balance of uncommitted funds ^a	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	*	-0.1	-0.3	-0.4	-0.6	-0.9
Total	18.2	18.0	17.7	17.3	17.1	16.9	16.4	16.1	15.9	15.6	15.4	15.1
On-budget	14.8	14.6	14.4	14.0	13.8	13.7	13.4	13.1	12.9	12.7	12.4	12.2
Off-budget	3.4	3.4	3.3	3.3	3.2	3.2	3.1	3.0	3.0	3.0	2.9	2.9
Surplus	2.4	2.7	2.9	3.1	3.3	3.4	3.8	4.1	4.3	4.6	4.9	5.3
On-budget	0.9	1.2	1.3	1.5	1.6	1.7	2.0	2.3	2.5	2.7	3.0	3.3
Off-budget	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8	1.9	1.9	1.9	2.0

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = between -0.5 percent and zero.

a. "Uncommitted funds" is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

percent in 2040. If federal policies did not change in response to those trends, high deficits would return and eventually drive federal debt to unsustainable levels.

mainly in the Balanced Budget and Emergency Deficit Control Act of 1985 (the Deficit Control Act) and the Congressional Budget Act of 1974. Those laws generally instruct CBO (and the Administration's Office of Management and Budget) to project federal spending and revenues by assuming that current policies remain the same.

The Baseline Concept

The baseline serves as a neutral benchmark that the Congress can use to measure the effects of proposed changes in spending and revenue policies. It is constructed following rules that are set forth in law,

For revenues and mandatory spending, section 257(b) of the Deficit Control Act requires baseline projections to assume that current laws continue without change. In most cases, the laws governing revenues and direct spending are permanent, and the projections incorporate the effects of anticipated

Box 1-1.
A Freeze in Discretionary Spending

The Balanced Budget and Emergency Deficit Control Act of 1985 sets the baseline for discretionary spending as the levels appropriated for the current year adjusted for inflation and certain other specified factors. But some lawmakers view a freeze in discretionary appropriations at the current year's levels as the most logical starting point for considering future appropriations. And from 1991 through 1996, largely because of the decline in defense spending following the end of the Cold War, total discretionary outlays were held at roughly a freeze level. Since 1998, however, discretionary spending has grown relatively rapidly—at a rate that has outpaced inflation over that time. Freezing appropriations for the next 10 years would reduce

discretionary spending in 2011 by about 25 percent from its level adjusted for inflation—a cut in resources that seems unrealistic in view of the recent rates of growth.

Nonetheless, if total discretionary spending was frozen at the level enacted for 2001, surpluses throughout the 2002-2011 period would grow even larger than CBO's baseline suggests. Under that scenario, total surpluses (including the off-budget balances of the Social Security trust funds and the Postal Service fund) would reach nearly 7 percent of gross domestic product (GDP), and on-budget surpluses almost 5 percent, by 2011.

**The Budget Outlook Assuming That Discretionary Spending Is Frozen
at the Level Enacted for 2001 (By fiscal year, in billions of dollars)**

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002- 2011
On-Budget Surplus	86	125	156	202	245	284	363	437	507	593	692	800	4,279
Off-Budget Surplus	<u>150</u>	<u>156</u>	<u>171</u>	<u>188</u>	<u>201</u>	<u>222</u>	<u>239</u>	<u>257</u>	<u>277</u>	<u>295</u>	<u>313</u>	<u>332</u>	<u>2,495</u>
Total Surplus	236	281	327	390	446	506	602	694	784	888	1,005	1,132	6,774
Total Surplus as a Percentage of GDP	2.4	2.7	3.0	3.4	3.7	4.0	4.5	5.0	5.4	5.8	6.2	6.7	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

changes in the economy, demographics, and other relevant factors to which those laws are linked.⁷

In the case of discretionary spending, which is provided and controlled by annual appropriation acts, section 257(c) of the Deficit Control Act states that projections of discretionary budget authority shall be adjusted after the current year to reflect inflation—

using specified indexes—and a limited number of other factors (such as the costs of renewing certain expiring housing contracts and of annualizing adjustments to federal pay). Accordingly, CBO's baseline extrapolates discretionary spending from its current levels, adjusting for projected rates of inflation and other specified factors over the next 10 years.

Last year, CBO presented two other benchmarks for discretionary spending—a freeze level and the statutory limits on discretionary spending. Lawmakers sometimes use a freeze in appropriations—or the current year's amounts without adjustment for inflation—to gauge the impact of proposed levels of discretionary spending for the upcoming fiscal year. However, recent trends in appropriations probably

7. Section 257(b) of the Deficit Control Act also specifies that expiring spending programs are assumed to continue if they have current year outlays greater than \$50 million and were established on or before the date of enactment of the Balanced Budget Act of 1997 (BBA). Programs established after enactment of the BBA are not automatically continued in the baseline. Expiring excise taxes dedicated to a trust fund are extended at current rates. However, the section does not provide for extending other expiring tax provisions, including those that have been routinely extended in the past.

make it unreasonable to assume a freeze in the baseline over the next 10 years (see Box 1-1). Throughout most of the 1990s, CBO's baseline for discretionary spending assumed adherence to the statutory limits that were originally enacted in 1990 (and extended in 1993 and 1997).⁸ However, the discretionary spending limits expire after 2002, and it is clear from appropriations enacted in recent years that they are no longer a useful measure of current policy or a viable guideline for projecting discretionary spending in the future. (For example, the adjusted limit on discretionary outlays for 2002—\$576 billion—is about \$71 billion below CBO's estimate of discretionary outlays for 2001.)

The baseline is intended to provide a neutral, nonjudgmental foundation for assessing policy options. It is not "realistic," because tax and spending policies will change over time. Neither is it intended to be a forecast of future budgetary outcomes. Rather, the projections presented in this report reflect CBO's best judgment about how the economy and other factors will affect federal revenues and spending under existing policies.

Recent Changes to the Budget Outlook

The prospects for the budget in CBO's current outlook are more favorable, as noted earlier, than those presented in July 2000. The total surplus for fiscal year 2000 was slightly above CBO's earlier projection, and the improvement for 2001 is expected to be even greater. Moreover, in the current outlook, the increases CBO projects in the surplus continue to rise over the next 10 years (see Table 1-3).

For 2000, the budget recorded a total surplus of \$236 billion—\$4 billion larger than CBO's estimate in July—and achieved an on-budget surplus of \$86 billion. Revenues for the year came in \$17 billion above expectations but were offset by \$13 billion more in spending—almost entirely from the Emergency Supplemental Appropriations Act (H.R. 4425).

That act shifted about \$8 billion in salary and benefit payments back into 2000 that had previously been pushed forward into 2001. Its repeal of other spending shifts and delays added \$3 billion more to the year's outlays. The bill also provided funds for national security activities, such as operations in Kosovo, and for domestic disaster assistance and counternarcotics efforts.

For 2001, CBO estimates that the total surplus will reach \$281 billion—a \$13 billion jump from the amount projected six months ago. By 2010, projections show the total surplus growing to \$796 billion rather than \$685 billion, as CBO estimated last July. The on-budget surplus is expected to reach \$484 billion, up \$107 billion compared with July's projection.

CBO conventionally attributes the changes in its projections to three factors: recently enacted legislation; changes in the overall economic outlook; and other, technical factors that affect the budget. Those categorizations should be viewed with caution. For example, changes ascribed to legislation represent CBO's best estimates of the future effects of laws measured around the time they are enacted. But if a new law has effects that differ from those reflected in CBO's initial estimate, the differences will appear as technical "reestimates" in later revisions to the baseline. Distinguishing between economic and technical reestimates is similarly imprecise. CBO classifies changes in some factors that are related to the performance of the economy (for example, capital gains realizations) as technical reestimates because those changes are not directly driven by components of CBO's economic forecast (for example, inflation and interest rates). Despite such imperfections, tracking and classifying reestimates of revenues and spending as either legislative, economic, or technical can be useful to budget analysts as they try to evaluate a changing budget outlook.

Over the 2001-2010 period, the total change in projected surpluses relative to the July outlook is an increase of \$441 billion. The overall improvement in the economic picture, despite a slowdown anticipated in 2001, adds \$980 billion to surpluses over the 10 years—largely from higher revenues. A myriad of technical changes also contribute \$59 billion to higher total surpluses. However, legislation enacted

8. Section 257(d) of the Deficit Control Act permits the use of "up-to-date concepts" in baseline budget projections.

Table 1-3.
Changes in CBO's Projections of the Surplus Since July 2000 (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2010
July 2000 Projection of Total Surplus ^a	268	312	345	369	402	469	523	565	625	685	4,561
Legislative Changes											
Revenues	-2	-2	-3	-3	-3	-4	-4	-5	-6	-5	-37
Outlays											
Discretionary	8	29	35	37	39	41	43	44	45	47	368
Mandatory											
Defense retiree health benefits	0	0	2	2	3	3	4	4	4	5	28
Medicaid	*	-1	-3	-5	-6	-8	-9	-10	-11	-12	-64
Medicare	4	8	7	7	8	8	9	10	11	12	84
Debt service	*	2	4	7	10	13	17	21	25	30	127
Other	*	2	2	2	2	2	2	2	3	2	18
Subtotal, mandatory	4	11	11	13	16	18	23	27	32	37	193
Subtotal, outlays	12	40	46	51	56	60	66	71	77	83	561
Total Impact on the Surplus	-14	-42	-49	-53	-59	-63	-70	-76	-83	-88	-598
Economic Changes											
Revenues	-6	7	32	56	72	88	106	128	148	173	802
Outlays											
Discretionary	*	*	*	-1	-1	-1	*	*	1	1	-1
Mandatory											
Medicaid	1	1	2	3	3	4	4	5	6	8	37
Social Security	1	2	1	2	2	3	4	5	6	7	35
Net interest (Rate effects) ^b	-12	-21	-13	-9	-8	-7	-5	-5	-5	-5	-89
Debt service	*	-1	-2	-5	-9	-14	-20	-27	-36	-46	-160
Other	3	4	2	*	*	-1	-2	-2	-2	-2	*
Subtotal, mandatory	-7	-14	-10	-9	-11	-15	-18	-24	-30	-38	-177
Subtotal, outlays	-7	-14	-10	-10	-12	-16	-19	-24	-29	-37	-178
Total Impact on the Surplus	1	21	42	66	84	103	124	151	177	210	980
Technical Changes											
Revenues	33	29	24	20	15	11	9	7	4	2	153
Outlays											
Discretionary	1	-3	*	*	-1	-3	-4	-5	-6	-7	-29
Mandatory											
Medicaid	5	7	9	10	10	10	10	11	10	11	92
Social Security	2	3	3	4	4	5	5	5	5	5	41
Debt service	-1	-2	-2	-3	-3	-3	-3	-2	-2	-1	-22
FCC spectrum receipts	3	2	-6	-9	0	0	*	0	*	*	-10
Other	-3	1	-1	3	*	6	4	3	4	5	23
Subtotal, mandatory	6	10	3	5	11	17	17	17	18	19	124
Subtotal, outlays	6	7	3	5	10	14	13	12	12	12	95
Total Impact on the Surplus	27	22	21	15	6	-3	-4	-6	-8	-10	59

(Continued)

Table 1-3.
Continued

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2010
All Changes											
Revenues	25	34	53	73	84	95	110	129	146	170	919
Outlays											
Excluding debt service	12	34	39	47	55	62	66	68	73	77	533
Debt service	*	*	-1	-1	-2	-4	-6	-9	-13	-18	-55
Subtotal, outlays	12	33	38	45	53	59	60	59	60	58	478
Total Impact on the Surplus	13	*	14	28	31	36	50	70	86	111	441
January 2001 Projection of Total Surplus	281	313	359	397	433	505	573	635	710	796	5,002

SOURCE: Congressional Budget Office.

NOTE: FCC = Federal Communications Commission; * = between -\$500 million and \$500 million.

- a. Calculated from the variation of CBO's July 2000 baseline that assumes discretionary spending grows at the rate of inflation after 2000.
- b. Includes the effect on proceeds earned on the balance of uncommitted funds, which is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

in the past several months is expected to decrease surpluses by \$598 billion during that time, mostly because of additional spending on discretionary activities and health care programs.

Recent Legislation

CBO anticipates that legislation enacted since July—mainly appropriation action—will draw down projected surpluses from 2001 through 2010. Appropriations for 2001 and outlays from supplemental appropriations for 2000 push up projected discretionary spending by \$368 billion over the period, the bulk coming in the later years. A large part of that change derives from extrapolating the higher appropriations for 2001 into the future.

Other legislative action, most of it incorporated in appropriation acts, boosts mandatory spending (by \$65 billion, not including debt service) and decreases revenues (by \$37 billion). Debt service attributable to legislative changes adds another \$127 billion to mandatory outlays from 2001 through 2010.

Discretionary Spending. The Congress and the President enacted the 13 regular appropriations for 2001 in 10 acts, including the Consolidated Appropriations Act, 2001 (Public Law 106-554). That consolidated law incorporates by reference three regular appropriation bills and five other acts. One of those others is a miscellaneous discretionary spending bill that provides for some additional spending and a small across-the-board spending cut.

The appropriations for 2001 directly affect CBO's estimates of discretionary spending throughout the 2001-2010 period. In its July baseline, CBO extrapolated discretionary budget authority for 2001—\$611 billion—from the appropriations for 2000. But the appropriation acts for 2001 actually provided a total of \$637 billion in budget authority. That higher level affects baseline estimates of future discretionary outlays in two ways:

- o First, only part of the additional budget authority approved for 2001 is expected to actually be spent in the current year. CBO thus projects only \$8 billion more in discretionary outlays for 2001 relative to last July. The remainder of the

higher budget authority appears as outlays in future years (since some programs spend their authority slowly).

- o Second, CBO's current baseline now uses discretionary budget authority for 2001, rather than the 2000 level, as a basis for extrapolating to 2002 and throughout the projection period. CBO thus assumes a higher level of discretionary budget authority for 2002 through 2010 than it assumed in July—which leads to greater projected outlays.

For both of those reasons, the increase in discretionary spending relative to the July baseline jumps to \$29 billion in 2002 and grows further, to \$47 billion by 2010.

The largest change in discretionary spending was for defense: outlays rose by \$3 billion in 2001 and by \$8 billion in 2002. Relative to the July baseline, projected spending on transportation and education programs also increased—by \$2 billion and \$1 billion, respectively, for 2001, and by \$5 billion and \$6 billion for 2002. Other discretionary categories receiving appropriations at markedly higher levels than CBO had assumed in the July baseline include natural resources, health programs, income security programs, and justice activities.

One notable decrease to discretionary spending also resulted from legislation. The appropriation for 2001 for the Census Bureau was \$4 billion lower than the amount projected in July. As described above, baseline rules require that future discretionary spending be extrapolated from the current year's budget authority. However, budget authority for the Census Bureau reached its 10-year peak in 2000 because of the decennial census, causing last year's baseline to overstate that spending for 2001 and beyond. Using the appropriated budget authority for 2001 as the base for projections brings spending for the census back down by several billion dollars. (However, those estimates similarly understate the amount necessary for the next decennial census, in 2010.) The change in spending on the census increases projected surpluses from 2001 through 2010 by \$49 billion.

Mandatory Spending. The legislated changes to mandatory spending come primarily from two sources, and both affect health care programs. The first source is provisions of the National Defense Authorization Act for Fiscal Year 2001 (P.L. 106-398) relating to health care benefits for military retirees. The second is the Medicare, Medicaid, and SCHIP Benefits Improvement and Beneficiary Protection Act of 2000 (H.R. 5661), which was incorporated in the Consolidated Appropriations Act, 2001.

The National Defense Authorization Act increases medical benefits, including prescription drug coverage, for retirees of the uniformed services who are age 65 and older. Currently, the Congress must appropriate funds for all health care benefits sponsored by the Department of Defense. But under the act, both the new and existing health benefits for those retirees become an entitlement beginning in 2003. Benefits will be paid for through a newly created trust fund that itself is financed by intragovernmental payments from the Department of Defense—although the general fund will have to cover any shortfalls.

CBO estimates that those benefits will add approximately \$60 billion to mandatory spending from 2001 through 2010, about two-thirds of which will pay for the new benefits. Spending will increase by \$6 billion beginning in 2003, with the added outlays growing to \$9 billion by 2010. Those figures do not include receipts in the form of payments from the Department of Defense that will be appropriated to finance the benefits. But such receipts are expected to total only \$29 billion over the period, leaving a net increase to mandatory spending of \$31 billion. About \$3 billion of that amount is recorded as higher Medicare spending, because CBO assumes that the improved benefits will cause retirees who are covered under both health plans to increase their use of medical services, including those that are paid for in part by Medicare. Thus, only \$28 billion of the 10-year figure is attributed to mandatory defense spending.

The Medicare, Medicaid, and SCHIP Benefits Improvement and Beneficiary Protection Act of 2000 increased projected costs for Medicare but lessened the spending that CBO expected for Medicaid. The act raised costs in the Medicare program in several

ways but primarily through larger payments to providers and to capitated health plans (such as health maintenance organizations, or HMOs, that accept a fixed reimbursement per beneficiary). Those increases came chiefly from bigger annual adjustments in payments to providers in the fee-for-service sector and a boost in the minimum payment to HMOs. All told, the act added an estimated \$94 billion to Medicare spending from 2001 through 2010, with annual upticks starting at \$4 billion in 2001 and rising to \$14 billion by 2010. Higher premium payments by Medicare beneficiaries will offset \$13 billion of those costs over the 10 years.

At the same time that it boosted Medicare costs, the act reduced Medicaid spending over the period by \$64 billion—mostly by restricting states' use of a financing mechanism that exploited a loophole in federal regulations. States have been paying inflated rates for services provided in health care facilities that are operated by local governments. By financing the inflated payments with transfers from those local governments, states have been able to collect federal matching funds for those payments without actually increasing their Medicaid spending. The term "Medicare upper payment limit," or UPL, is used to refer to that mechanism because the total amount that states can gain is limited by the difference between total payments to providers under Medicaid's rules and what those payments would be under Medicare's. The act restricts, but does not entirely eliminate, spending related to the UPL mechanism.

Revenues. Legislation enacted since July—primarily the Community Renewal Tax Relief Act of 2000 (H.R. 5662)—is expected to modestly decrease revenues, and therefore surpluses, over the next 10 years. H.R. 5662 removes \$26 billion from the projected receipts of individual income and corporate taxes by granting tax benefits (such as certain exemptions from capital gains taxes for individuals and wage credits for employers) to localities designated as renewal communities. Other legislation contributes varying amounts to the loss in revenues. For example, the FSC (Foreign Sales Corporation) Repeal and Extraterritorial Income Exclusion Act of 2000 (H.R. 4986) diminishes estimated revenues by about \$4 billion over 10 years. The act decreases corporate tax revenues in part by allowing U.S. firms to exclude certain foreign trade income from their taxable income.

Economic Changes

Since July 2000, CBO has revised its economic assumptions, which improved the budget outlook over the 10-year period by \$980 billion. The changes represent CBO's best judgment about the path of the economy over the next decade. (For a more extensive discussion of the economic outlook, see Chapter 2.) Compared with its previous forecast, CBO now anticipates a slowdown in 2001 but faster growth of real GDP in later years. Other changes for the near term include lower interest rates and slightly higher unemployment than CBO assumed in July. The economic changes primarily affect revenues, boosting them in relation to July's baseline by \$802 billion over the 10 years.

Revenues. Over the 2001-2010 period, CBO now estimates that, on a fiscal year basis, real GDP will grow at an average annual rate of about 3.0 percent, up from the 2.8 percent projected last July. Faster growth of GDP implies enhanced incomes and corporate profits, which in turn can generate substantially larger revenues over time. In 2001, however, CBO estimates that revenues will actually be \$6 billion lower than in the previous baseline, mainly because projected growth of real GDP dips by 0.7 percent in 2001 relative to the previous economic forecast. But beginning in 2002, projections of real GDP growth outstrip July's figures, bringing up CBO's estimates for revenues by increasing amounts over the remainder of the projection period.

Outlays. The impact of economic changes on projected outlays—a decrease of \$178 billion over 10 years—is significantly smaller than their impact on revenues, but the result is the same: they increase projected surpluses. The effects on outlays are dominated by revisions to net interest, which boost projected surpluses, but those changes are partially offset by revisions in spending programs, which decrease surpluses.

Net interest is principally determined by two factors: the stock of outstanding debt and the prevailing set of interest rates. All of the economic changes taken together swell projected surpluses—mainly because of the hefty revisions to revenues described earlier—and therefore allow the stock of debt to decline faster than CBO previously estimated.

That effect saves \$160 billion in debt service over 10 years, with most of the savings coming in the later years of the projection period. In addition, CBO's updated estimate of the interest rate on 10-year Treasury notes in fiscal year 2001 is down by 1.7 percentage points, dropping from 6.8 percent to 5.1 percent; for fiscal year 2002, the rate is lower by more than 1.3 percentage points, declining from 6.5 percent to 5.1 percent. Short-term Treasury rates are also lower (by 1 percentage point or more) in 2001 and 2002. Savings from such changes come to \$12 billion in interest payments in 2001; they peak at \$21 billion in 2002 and total \$89 billion from 2001 through 2010.

In contrast, economic changes affecting the Medicaid and Social Security programs decrease surpluses compared with July's projections. Medicaid's costs depend on states' decisions about reimbursement rates for providers, which in turn relate to the wages of medical workers and other medical price indexes. As a result of higher estimates of rates of growth in those factors, Medicaid spending is projected to be \$1 billion higher in 2001 than CBO estimated last summer. In 2010, those economic changes account for \$8 billion in increased spending; over the 2001-2010 period, a total of \$37 billion can be ascribed to their effects.

Similarly, Social Security costs are higher over the period. Inflation (which determines cost-of-living adjustments for beneficiaries) was higher than expected in 2000, creating a higher base for benefits over the 10-year projection span. In addition, since Social Security benefits are calculated from wages, CBO's projections of faster real wage growth relative to July mean bigger initial benefits for new beneficiaries in the future. The additional costs for Social Security occur largely in the later years of the decade and total \$35 billion from 2001 through 2010.

Technical Changes

Technical revisions are defined as any changes that are not ascribed to new legislation or to changes in the macroeconomic forecast. In total, CBO expects changes resulting from technical factors to enlarge surpluses by \$59 billion over the 2001-2010 period. However, that net amount comprises \$153 billion in upward reestimates of revenues and \$95 billion in

higher spending—which largely offsets the budgetary impact of the revenue changes. The adjustments to revenues are mostly in the first half of the projection period; the increases in outlays occur throughout the 10 years but are somewhat larger from 2006 through 2010. Technical changes as a whole, therefore, raise estimated surpluses by \$27 billion and \$22 billion, respectively, in 2001 and 2002. But in 2006, technical changes begin to have an opposite, diminishing effect, and by 2010, they shave \$10 billion from CBO's surplus projections.

Revenues. The technical adjustment to revenues is largest for 2001, with an expected hike of \$33 billion. But that effect steadily weakens; in 2010, revenues increase by just \$2 billion. Much of the upward technical reestimate reflects greater projected realizations of capital gains. CBO's revised projection is based on both higher-than-expected realizations in tax year 1999 and the high volume of stock transactions in tax year 2000 that should continue to unlock accrued gains even in the face of relatively stable or falling stock prices. The increase in revenues relative to July declines over the projection period as that capital gains effect fades. Also reflected in the upward revision is an effect stemming from collections of revenues for fiscal year 2000 that were greater than anticipated last July. Those collections create a higher initial starting point for projections and thus raise revenues throughout the period.

Outlays. Technical changes as a whole increase spending by \$95 billion, but they are a mix of modifications that operate in both directions. Among the largest are upward revisions to Medicaid and Social Security spending, which are only partially offset by downward reestimates for Section 8 housing assistance, Medicare, and debt-service costs. Further offsetting those upward revisions are higher estimates of receipts from spectrum auctions.

The technical revisions to Medicaid mainly reflect higher spending that arose from states' use of the Medicare UPL financing mechanism discussed earlier.⁹ CBO's previous projections did not fully

9. The Medicare, Medicaid, and SCHIP Benefits Improvement and Beneficiary Protection Act of 2000 restricted use of that mechanism, resulting in a legislative change that decreases baseline spending for Medicaid and for the most part offsets the technical change.

account for outlays related to that practice. In addition, the number of states engaging in it grew rapidly in 2000 as more states learned about the UPL loophole and hurried to exploit it and receive extra federal funds before the opportunity disappeared. The technical revisions CBO made in relation to UPL financing increase projected Medicaid outlays by \$3 billion in 2001; that amount swells to \$12 billion by 2010. Those changes and other small adjustments to Medicaid total \$92 billion in additional spending over 10 years.

CBO also increased its estimates of Social Security expenditures, raising them by about \$2 billion in 2001 and \$5 billion annually beginning in 2006. That change results from revisions to the models CBO uses to calculate the average benefit for Social Security recipients. The program's benefits are based on the wages a beneficiary earns during his or her working years. Previously, CBO's model used inflation plus a historical average for growth in real benefits to calculate expected benefit growth over time. The revised projections now explicitly use estimated real growth in wages when calculating future benefits. (As discussed earlier, the effect that CBO estimates from faster real growth in wages relative to the July baseline is considered an economic change.)

Section 8 housing assistance, with \$25 billion less in expenditures over the decade relative to July, is the source of most of the downward technical reestimate of discretionary spending. The change occurred because CBO modified its baseline to more accurately reflect the specifications in section 257 of the Deficit Control Act. For previous baselines, CBO implicitly assumed a gradually increasing stock of subsidized housing. Under the current approach, CBO assumes that the number of subsidized housing units remains the same as the number supported by funds provided through 2001.

Also offsetting the higher spending on Medicaid and Social Security are larger estimated receipts from Federal Communications Commission (FCC) spectrum auctions and lower debt-service costs. CBO revised upward its valuations of the spectrum licenses being auctioned by the FCC because of the significantly higher prices such licenses have brought in European countries over the past year and the robust bidding in similar ongoing auctions in the

United States (see the fuller discussion in Box 4-1 on page 90). In addition, the higher surpluses that result from all of the technical changes create debt-service savings that total \$22 billion over 10 years.

The Outlook for Federal Debt

Federal debt falls into two broad categories—debt held by the public and debt held by government accounts. Debt held by the public—the most meaningful measure of debt in terms of its relationship to the economy—is issued by the federal government to raise cash. The Treasury regularly sells securities to the public that currently range in maturity from three months to 30 years. Most of that debt is marketable—that is, freely traded in financial markets. Owners of debt held by the public include pension plans, mutual funds, individuals, state and local governments, foreign institutions, banks, and the Federal Reserve.

Debt held by government accounts, in contrast, is an intragovernmental IOU and involves no cash transactions. It is used as an accounting device to track cash flows relating to specific federal programs.

In addition to the differences in how the two kinds of debt relate to the economy, debt held by the public and debt held by government accounts follow different trends in CBO's baseline. Holdings by government accounts have risen steadily for several decades and are expected to continue doing so. However, debt held by the public, after growing for nearly 30 years, began to decline in 1998.

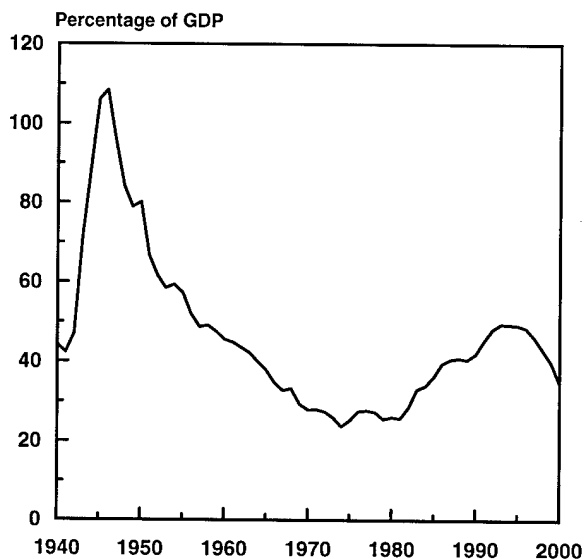
That decline is projected to continue under CBO's baseline assumptions for the 2001-2011 period. In fact, surpluses are projected to grow large enough to allow the federal government to retire all available debt held by the public and begin to hold large amounts of cash or other assets. In such a situation, another measure—net indebtedness—would be necessary to capture the full impact of surpluses on the government's financial position. As a measure of both debt and investments, net indebtedness would replace debt held by the public as the most complete gauge of the government's participation in the financial markets.

Reducing Debt Held by the Public

From 1969 through 1997, the Treasury sold ever-increasing amounts of debt to finance continuing deficits. As a result, debt held by the public climbed each year, peaking at \$3.8 trillion in 1997. That trend has now reversed. At the end of fiscal year 2000, debt held by the public had dropped by \$363 billion, to \$3.4 trillion. The decline as a percentage of GDP has been even more dramatic. After reaching a plateau of about 50 percent of GDP from 1993 to 1995, that share fell to 35 percent in 2000 (see Figure 1-1).

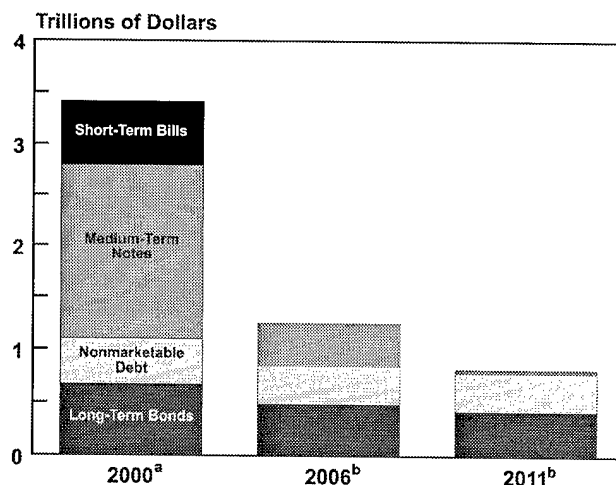
CBO's baseline indicates that if current policies remain in effect, debt held by the public will continue to fall. If surpluses accrue as projected, much of the nation's current debt will be paid down over the next several years. However, a part of it—including some long-term bonds and savings bonds—will not be available for redemption during CBO's 10-year projection period. Therefore, in any given year, some debt will remain outstanding and incur interest costs, regardless of the size of the surplus. In the baseline, debt falls each year from 2001 to 2005 by roughly the

Figure 1-1.
Debt Held by the Public as a Share of GDP,
Fiscal Years 1940-2000



SOURCE: Congressional Budget Office.

Figure 1-2.
Composition of Debt Held by the Public,
Fiscal Years 2000, 2006, and 2011



SOURCE: Congressional Budget Office.

a. Actual debt.

b. Debt not available for redemption under CBO's assumptions.

amount of the projected surplus.¹⁰ In 2006, CBO estimates, debt held by the public will reach a level at which the remaining debt is not available for redemption. That remaining, unavailable stock of debt also declines each year, eventually falling to \$818 billion in 2011 (see Table 1-4). From 2006 through 2011, the baseline accounts for residual surpluses (amounts not used to pay off debt) as uncommitted funds.¹¹

How Much Debt Is Not Available for Redemption? Most of the debt issued by the Treasury is not "callable" (cannot be redeemed on demand before maturity) and therefore will remain outstanding until it reaches its maturity date or is repurchased in the markets. Under CBO's assumptions, debt that is un-

10. Debt held by the public does not change exactly by the amount of the surplus because of a number of factors broadly labeled "other means of financing" that affect the government's borrowing needs. The largest of those factors is the capitalization (up-front disbursement of money) of student loans and loans from other such programs. Other factors include seigniorage, changes in the government's cash balances, and premiums paid by the Treasury in lieu of future interest payments when repurchasing bonds. In total, those factors add as much as \$20 billion to borrowing in every year between 2001 and 2011.

11. In previous baselines, CBO used the term "excess cash" to refer to those residual surpluses.

available for redemption totals \$1.25 trillion in 2006; its level drops thereafter (see Figure 1-2). However, the stock of such debt is measured at the end of the year, and those totals do not explicitly include any short-term securities that the Treasury might issue to fund monthly or seasonal swings in the government's financing needs.

The largest portion of unavailable debt is 30-year bonds, most of which are not slated to mature until after 2011. The Treasury instituted a program last year to repurchase those bonds in the private markets, and it bought back \$30 billion of long-term debt in calendar year 2000. It has also announced its intent to continue the buyback program. However, over \$600 billion in 30-year bonds is currently outstanding, and it is unlikely that all, or even a significant share, of the holders of those bonds will choose to sell them at prices that the government is willing to pay. CBO assumes that the Treasury will continue its buyback program at approximately the current level through next year but that after 2002, the amount of debt it repurchases will dwindle.

Debt that is held in nonmarketable form (for example, savings bonds or securities issued to state

and local governments) and serves other purposes besides financing government activities also adds to total debt unavailable for redemption. Unless the government chooses to discontinue such programs, nonmarketable debt will be issued according to trends unrelated to the government's financing requirements and remain outstanding through 2011.

CBO's calculations of unavailable debt also include some medium-term securities, such as five-year and 10-year notes. The Treasury has broad authority to make decisions regarding when and how much of each maturity to issue. About \$110 billion in five- and 10-year notes was issued in 2000. The size of such issues in future years determines how much medium-term debt will remain outstanding in 2011. CBO's baseline makes the simplifying assumption that no debt with a maturity of five or more years will be issued after 2002. As a result, CBO's estimate of unavailable debt does not include five-year notes after 2006 and has diminishing amounts of 10-year notes, the last of which would mature in 2012.

Uncommitted Funds. If the surpluses projected in CBO's baseline materialize, the Treasury's cash on hand would exceed its ability to retire debt held by

Table 1-4.
CBO's Projections of Debt Held by the Public and Net Indebtedness at the End of the Year
(By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818
Balance of Uncommitted Funds ^a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28	466	1,003	1,608	2,338	3,164
Net Indebtedness	3,410	3,148	2,848	2,509	2,131	1,714	1,223	662	36	-669	-1,460	-2,346
Memorandum:												
Debt Held by the Public as a Percentage of GDP	34.7	30.5	26.2	21.9	17.7	13.5	9.4	8.1	7.1	6.1	5.5	4.8

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

the public in each year from 2006 through 2011. Under such circumstances, the Congress and the President might decide to cut taxes or increase spending, or both, to dissipate some or all of the surpluses that were not needed to pay off publicly held debt. However, CBO's baseline uses only current tax and spending policies as its foundation. Thus, its projections simply assume that the Treasury will accumulate all funds exceeding the amounts needed to retire available debt.

In 2006, CBO's baseline shows a relatively small amount of uncommitted funds—\$28 billion—which is within the range of the Treasury's normal operating balances. But those funds grow rapidly after that year, and the balance of uncommitted funds is projected to reach an immense stock of \$3.2 trillion in 2011. The baseline assumes that such funds will be invested at a rate of return equal to the average rate projected for Treasury bills and notes. However,

CBO makes no explicit assumptions about how much of those funds the Treasury would invest through either its current arrangements with banks and the Federal Reserve or any other investments that might be chosen.

Net Indebtedness. Since the retiring of debt held by the public is limited by how much can be redeemed, CBO displays the full effect of surpluses on the government's financial position with a new measure—net indebtedness. Net indebtedness is a so-called stock measure that combines outstanding debt held by the public and the balance of uncommitted funds, thus showing the cumulative total of all annual deficits and surpluses. (In 2008, for example, \$1,039 billion of debt held by the public that is not available for redemption minus the \$1,003 billion of uncommitted funds gives a net indebtedness of \$36 billion; see Table 1-4.) Under CBO's baseline projections, net indebtedness turns negative in 2009, meaning that

Table 1-5.
CBO's Projections of Net Indebtedness at the End of the Year Under Alternative Scenarios
for Debt Reduction (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Dedicate Only Off-Budget Surpluses to Debt Reduction After 2001												
Debt Held by the Public	3,410	3,148	2,991	2,822	2,640	2,435	2,210	1,965	1,699	1,411	1,103	818
Balance of Uncommitted Funds ^a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	42
Net Indebtedness	3,410	3,148	2,991	2,822	2,640	2,435	2,210	1,965	1,699	1,411	1,103	776
Dedicate Both Off-Budget Surpluses and the Surpluses in the Medicare Hospital Insurance Trust Fund to Debt Reduction After 2001												
Debt Held by the Public	3,410	3,148	2,955	2,747	2,524	2,279	2,011	1,724	1,418	1,089	878	818
Balance of Uncommitted Funds ^a	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	133	434
Net Indebtedness	3,410	3,148	2,955	2,747	2,524	2,279	2,011	1,724	1,418	1,089	745	384

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption. Uncommitted funds accumulate from one year to the next.

Table 1-6.
CBO's Projections of Gross Federal Debt at the End of the Year
(By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Debt Held by the Public	3,410	3,148	2,848	2,509	2,131	1,714	1,251	1,128	1,039	939	878	818
Debt Held by Government Accounts												
Social Security	1,007	1,164	1,337	1,524	1,727	1,948	2,186	2,443	2,719	3,012	3,324	3,655
Other government accounts ^a	<u>1,212</u>	<u>1,290</u>	<u>1,379</u>	<u>1,470</u>	<u>1,561</u>	<u>1,653</u>	<u>1,753</u>	<u>1,853</u>	<u>1,952</u>	<u>2,054</u>	<u>2,159</u>	<u>2,265</u>
Total	2,219	2,454	2,716	2,995	3,288	3,601	3,940	4,295	4,671	5,067	5,483	5,919
Gross Federal Debt	5,629	5,603	5,564	5,503	5,418	5,315	5,191	5,423	5,710	6,006	6,361	6,737
Memorandum:												
Debt Subject to Limit ^b	5,591	5,566	5,528	5,472	5,393	5,295	5,172	5,405	5,692	5,988	6,344	6,721

SOURCE: Congressional Budget Office.

- a. Mainly Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Airport and Airway Trust Fund.
- b. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit. The current debt limit is \$5,950 billion.

the balance of uncommitted funds exceeds the remaining debt owed to the public.

Alternative Policy Scenarios for Debt Reduction. Policymakers have recently discussed proposals that would devote only certain portions of total surpluses to paying down debt and apply the remaining funds to decreases in taxes or increases in spending. Two such scenarios are dedicating just the off-budget—primarily Social Security—surpluses to reducing debt and dedicating both the off-budget and Medicare Hospital Insurance (HI) surpluses to debt reduction (see Table 1-5). Both of those alternatives have outcomes for debt that differ substantially from the baseline. If only off-budget surpluses were used to reduce debt, net indebtedness would fall to \$776 billion in 2011. However, the Treasury would be able to reduce the available debt only to \$818 billion; therefore, CBO estimates that the budget would record \$42 billion in uncommitted funds in 2011. If off-budget and HI surpluses were devoted to retiring debt, net indebtedness would be reduced further, to \$384 billion in 2011. Under that scenario, the budget would show uncommitted funds in two years, for a cumulative balance of \$434 billion by 2011.

Gross Measures of Federal Debt

Gross federal debt—and a similar measure, debt subject to limit—counts debt issued to government accounts as well as debt held by the public. In addition to selling securities to the public, the Treasury has issued about \$2.2 trillion in securities to various government accounts (mostly trust funds). The funds redeem securities when they need to pay benefits; in the meantime, the government both pays and collects interest on that debt.

Debt issued to government accounts is handled within the Treasury and does not flow through the credit markets. Those transactions are intragovernmental and have no direct effect on the economy. Similarly, interest on those securities is simply an intragovernmental transfer: it is paid by one part of the government to another part and does not affect the total deficit or surplus.

Gross Federal Debt. The future path of gross federal debt will be determined by the interaction of falling levels of debt held by the public and rising levels of debt held by government accounts. The total hold-

ings of government accounts grow approximately in step with projected trust fund surpluses. The largest balances of such debt are in the Social Security trust funds (\$1.0 trillion at the end of 2000) and the retirement funds for federal civilian employees (\$512 billion).

Debt held by government accounts has risen steadily over time and is expected to continue rising as the Social Security and other trust funds continue to record large surpluses. The balance of the Social Security trust fund is projected to mushroom to \$3.7 trillion by 2011 and the balance of all trust funds to more than \$5.9 trillion (see Table 1-6 on page 17). Therefore, even if debt held by the public were completely eliminated, gross debt would still measure almost \$6.0 trillion in 2011. Under CBO's baseline projections, gross debt falls in every year from 2001 to 2006 as the paying down of debt held by the public outpaces the rise in debt held by government accounts. After 2006, when the reduction of publicly held debt is limited to maturing securities, gross debt begins to grow again, reflecting the continued increase in trust fund balances.

Debt Subject to Limit. The Congress sets a limit on the Treasury's authority to issue debt. That ceiling—which currently stands at \$5.95 trillion—applies to securities issued to government accounts as well as those sold to the public. Debt subject to limit is practically identical to gross federal debt. The minor differences between the two arise chiefly because securities issued by agencies other than the Treasury, such as the Tennessee Valley Authority, are exempt from the debt limit.

Since trust funds and other government accounts as a whole will continue to swell even as surpluses are projected to continue in the total budget, debt subject to limit in the baseline follows a path similar to that for gross debt. In other words, it falls until 2006 and then begins rising, eventually reaching \$6.7 trillion by 2011. Under those projections, the debt ceiling would be reached in 2009—mostly as a result of the \$5.1 trillion in debt held by government accounts.

Federal Funds and Trust Funds

The budget comprises two groups of funds: trust funds and federal funds. Trust funds are those programs so labeled in legislation; federal funds include all other transactions with the public. Over 60 percent of federal spending is derived from federal funds.

The federal government has more than 150 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 and the Disability Insurance funds) and those dedicated to Civil Service Retirement, Medicare Hospital Insurance (Part A), and Military Retirement. Trust funds have no particular economic significance; they function primarily as accounting mechanisms to track receipts and spending for programs that have specific taxes or other revenues earmarked for their use.

Trust funds do not hold separate cash balances. When a trust fund receives payroll taxes or other income that is not currently needed to pay benefits, the excess is loaned to the Treasury. If the rest of the budget is in deficit, the Treasury borrows less from the public than would otherwise be required to finance current operations. If the rest of the budget is in balance or in surplus, the Treasury uses the cash from trust fund programs to retire outstanding debt held by the public.

The process is reversed when a trust fund's income falls short of its expenses. Then, the federal government must raise the necessary cash by boosting taxes, reducing other spending, borrowing more from the public, or (if the total budget is in surplus) retiring less debt.

Including the cash receipts and expenditures of trust funds in the budget totals with other federal programs is necessary to assess the effect of federal ac-

tivities on the Treasury's external borrowing needs. CBO, the Office of Management and Budget (OMB), and other fiscal analysts therefore focus on the total (or unified) surplus or deficit because it is an overall measure of the federal government's cash operations, which include trust fund programs, and provides the most relevant picture of the government's current impact on the economy.

In 2001, the total surplus is estimated to be \$281 billion, which can be divided into a federal funds sur-

plus of \$51 billion and a trust fund surplus of \$231 billion (see Table 1-7). That division is somewhat misleading, though, because trust funds receive much of their income in the form of transfers from federal funds. Such transfers shrink the federal funds surplus and augment trust fund surpluses. Those intragovernmental transfers will total \$319 billion in 2001. The largest of them include interest paid to trust funds (\$154 billion); contributions from the general fund to Medicare, principally Supplementary Medical Insurance (SMI), or Part B (\$79 billion); and govern-

Table 1-7.
Trust Fund Surpluses (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Social Security	152	157	172	188	202	221	238	257	276	294	312	331
Medicare												
Hospital Insurance (Part A)	30	29	36	39	41	40	44	41	41	39	37	34
Supplementary Medical Insurance (Part B)	*	-5	-1	-1	-1	*	3	2	2	3	3	3
Subtotal	30	24	35	39	40	40	47	43	43	42	40	38
Military Retirement	6	7	7	8	9	9	10	11	11	12	13	14
Civilian Retirement ^a	31	32	31	31	31	31	31	31	32	32	32	33
Unemployment	9	6	6	5	2	2	1	1	-1	*	1	2
Highway and Mass Transit	3	*	-1	-2	-2	-2	-2	-1	*	*	*	1
Airport and Airways	2	2	2	2	3	3	4	4	5	6	7	8
Other ^b	6	3	4	4	4	4	4	4	4	4	4	4
Total Trust Fund Surplus	238	231	257	274	288	308	333	349	369	389	409	430
Federal Funds Deficit (-) or Surplus	-2	51	56	86	109	125	172	223	266	321	387	459
Total Surplus	236	281	313	359	397	433	505	573	635	710	796	889
Memorandum:												
Net Transfers from Federal Funds to Trust Funds	333	319	333	358	385	416	447	480	516	554	596	640

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

a. Includes Civil Service Retirement, Foreign Service Retirement, and several small retirement funds.

b. Primarily Railroad Retirement, federal employees' health and life insurance, Superfund, and various veterans' insurance trust funds.

ment agency contributions to retirement funds on behalf of present and past employees (\$76 billion). Without intragovernmental transfers, the trust funds would have an overall deficit each year that would grow from \$88 billion in 2001 to \$211 billion in 2011.

Intragovernmental transfers reallocate costs from one part of the budget to another. For example, transfers representing government contributions to retirement funds attribute a portion of anticipated future retirement costs to current personnel budgets and require agencies to bear a greater share of the full cost of their hiring decisions. Such transfers, however, do not change the total surplus or the government's borrowing needs. As a result, they have no effect on the economy or on the government's future ability to sustain spending at the levels indicated by current policies.

All major trust funds except the Medicare SMI fund are now generating surpluses, and CBO projects that they will continue doing so through 2011. (The flows into and out of the SMI fund, unlike those of other major trust funds, are designed to be approximately in balance each year, although the fund maintains a small contingency reserve. CBO expects that the fund will run small deficits between 2001 and 2005 to reduce accumulated holdings.) The Social Security trust funds are currently running a combined annual surplus of \$157 billion. By 2011, that surplus is expected to increase to \$331 billion. But it will begin to shrink shortly afterward when large numbers of baby boomers begin to retire. (Some proposals have suggested shoring up the Social Security trust funds by enabling them to purchase private securities. See Box 1-2 for a discussion of the budgetary treatment of government purchases of private securities.)

Comparing CBO's and the Clinton Administration's Baseline Projections

On January 16, 2001, the Clinton Administration issued its baseline budget projections—which are known as current-services projections—for 2002

through 2011.¹² Like CBO, the Administration's Office of Management and Budget concludes that the surplus will climb steadily through 2011. That projection—again, like CBO's—assumes that revenues and mandatory spending continue to be governed by current laws and that discretionary appropriations keep pace with inflation.

Although CBO and OMB both project large surpluses, those projections differ in certain respects. The 10-year total surplus that CBO projects for 2002 through 2011 is \$613 billion larger than the cumulative surplus OMB anticipates (see Table 1-8). Although that discrepancy of \$613 billion may seem large, it results from differences of only 1.1 percent in total revenues projected for the period and 1.4 percent in total projected outlays. CBO's projections of on-budget surpluses are \$676 billion larger over the 10-year period than OMB's; in contrast, CBO's cumulative off-budget surpluses are \$63 billion lower than the corresponding OMB projections.

Nearly half of the difference (or \$299 billion) between CBO's and the Clinton Administration's projections of the 10-year surplus derives from variations in the two sets of revenue projections. CBO's projections are higher in each year of the budget period—as much as \$52 billion higher in 2004. Those differences taper off in later years and drop to \$13 billion in 2011 (\$39 billion in higher projected on-budget revenues offset by \$26 billion in lower off-budget tax receipts).

CBO projects higher revenues than does OMB even though its projection of growth in nominal GDP over the baseline period is lower than that of the Administration. CBO's economic projection of somewhat slower growth in aggregate income reduces its projection of revenues relative to the Administration's by about \$300 billion over 10 years. But that downward effect is more than offset by CBO's projection of faster growth in tax receipts for a given level of income in the economic forecast, which increases its projection of revenues by about \$600 billion relative to the Administration's.

12. See Office of Management and Budget, *FY 2002 Economic Outlook, Highlights from FY 1994 to FY 2001, FY 2002 Baseline Projections* (January 2001).

Box 1-2.**Budgetary Treatment of Government Purchases of Private Securities**

Government purchases of private securities, including corporate bonds and equities, pose an interesting and unprecedented dilemma for federal budgeteers. Long considered an esoteric topic, such purchases were discussed during the 106th Congress (for example, in considering President Clinton's Social Security plan and bills changing the investment practices of the Railroad Retirement Board), thus hastening the need to reassess their budgetary treatment.

The Office of Management and Budget's Circular A-11 contains some direction for how federal purchases of private securities should be treated. It specifies that the purchases should be considered outlays at the time they are made and offsets to outlays (offsetting receipts) when the securities are sold. Interest and dividend payments are also to be classified as offsetting receipts. Under that treatment, the budget would not distinguish between using \$10 million to purchase private securities and spending the same amount to procure office supplies or an office building. Indeed, Circular A-11 directs that all federal purchases of assets, whether financial or physical, be accorded that same treatment and be shown as budgetary outlays. Its approach is consistent with the practice of recording most government transactions on a cash basis.

But some experts question whether the purchase of private securities should be treated as the circular directs. They argue that the securities would be purchased as a means of financing future government obligations and would not constitute a use of budgetary resources. Those purchases would in some senses be the mirror image of government borrowing—which is not recorded in the budget. According to that interpretation, it would be more appropriate to account for such purchases not as government outlays but rather as part of the process by which the government finances its activities. Treating purchases in that way would be comparable to the treatment accorded to transactions of the financing accounts for credit programs, the profits from the government's sale of its

gold reserves, or the seigniorage on the coins it issues.¹

In recent years, numerous proposals to strengthen the nation's system of retirement income have called for new, individually based savings accounts, or personal retirement accounts (PRAs).² Some proposals have made PRAs compulsory, whereas others have made them voluntary. In some proposals, investment of funds from the accounts would be administered by the federal government, while in others, investment would be privately administered.

If all of the benefits and risks of the PRAs and their accumulations accrue to the individual investor (as they do for current individual retirement accounts and the federal employees' Thrift Savings Plan), then there would be no reason to incorporate these accounts into the federal budget. Under some proposed PRA designs, however, the federal government (and therefore taxpayers) would retain a substantial interest in the assets that accumulated in the accounts. For example, a proposal might specify that 2 percentage points of the current Social Security payroll tax be directed to PRAs and that an account holder's Social Security benefits be reduced dollar for dollar for payments from the account. Many, if not most, account holders would receive no net gain from such PRAs. In that case, those account holders have become investing agents for the federal government, a situation that many people would consider much like direct government investing. A strong case could be made that the cash flow associated with that particular form of PRA should be included in the federal budget, and at that point, the issue of the appropriate budgetary treatment for federal purchases of private securities would arise.

1. Those items are not recorded in the budget (in other words, they do not contribute to deficits or surpluses). However, they are regarded as "means of financing" because they increase or decrease the amount that the government needs to borrow to finance all of its activities.

2. See Congressional Budget Office, *The Budgetary Treatment of Personal Retirement Accounts* (March 2000).

Table 1-8.**Comparison of CBO's Baseline with OMB's Current-Services Baseline (By fiscal year, in billions of dollars)**

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002- 2011
CBO's January 2001 Baseline												
Revenues	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447	27,886
On-budget	1,630	1,703	1,782	1,864	1,950	2,040	2,136	2,243	2,360	2,489	2,628	21,195
Off-budget	504	532	561	589	620	649	680	712	746	782	819	6,691
Outlays												
Discretionary	646	682	710	730	750	766	782	804	824	845	866	7,759
Mandatory	1,002	1,061	1,112	1,185	1,270	1,328	1,401	1,489	1,582	1,681	1,787	13,896
Net interest and proceeds earned on the balance of uncommitted funds ^a	<u>205</u>	<u>179</u>	<u>163</u>	<u>142</u>	<u>116</u>	<u>90</u>	<u>60</u>	<u>27</u>	<u>-10</u>	<u>-51</u>	<u>-95</u>	<u>622</u>
Total	1,853	1,923	1,984	2,056	2,137	2,184	2,243	2,320	2,396	2,475	2,558	22,277
On-budget	1,506	1,561	1,611	1,669	1,738	1,773	1,820	1,884	1,943	2,005	2,070	18,073
Off-budget	348	361	373	388	399	411	423	437	453	470	489	4,204
Surplus	281	313	359	397	433	505	573	635	710	796	889	5,610
On-budget	125	142	171	196	212	267	316	359	417	484	558	3,122
Off-budget	156	171	188	201	221	238	257	276	294	312	331	2,488
OMB's January 2001 Current-Services Baseline												
Revenues	2,125	2,210	2,301	2,401	2,525	2,649	2,788	2,934	3,088	3,257	3,434	27,587
On-budget	1,620	1,678	1,741	1,811	1,898	1,994	2,098	2,210	2,328	2,455	2,589	20,802
Off-budget	504	532	560	589	626	656	690	725	760	803	845	6,786
Outlays												
Discretionary	654	682	710	728	749	769	790	811	832	855	876	7,801
Mandatory	1,004	1,059	1,111	1,174	1,263	1,327	1,408	1,503	1,600	1,704	1,822	13,971
Net interest and proceeds earned on the balance of uncommitted funds ^a	<u>210</u>	<u>192</u>	<u>174</u>	<u>155</u>	<u>133</u>	<u>108</u>	<u>81</u>	<u>51</u>	<u>18</u>	<u>-19</u>	<u>-75</u>	<u>818</u>
Total	1,868	1,933	1,994	2,058	2,145	2,204	2,279	2,365	2,450	2,540	2,623	22,591
On-budget	1,522	1,575	1,628	1,679	1,752	1,796	1,854	1,923	1,987	2,052	2,110	18,356
Off-budget	346	358	366	379	393	408	425	442	463	488	514	4,235
Surplus	256	277	307	343	380	446	509	570	638	717	810	4,996
On-budget	98	103	113	133	146	198	244	287	341	402	479	2,446
Off-budget	158	174	194	210	234	248	266	282	297	315	331	2,551

(Continued)

On the spending side, CBO's estimates of total outlays are \$314 billion lower than those of the Administration for the 2002-2011 period. However, nearly two-thirds of that difference—or about \$200 billion—comes from CBO's estimates of lower net interest payments fueled by the lower interest rates and debt levels that it projects over the 10 years.

Total discretionary spending under CBO's baseline is similar to the totals estimated by the Administration for the period. However, components of the two baselines differ for 2001 and 2002. In 2001,

CBO expects agencies to spend budget authority (including prior balances) more slowly than does OMB; as a result, CBO's estimate of outlays for discretionary programs is \$8 billion lower than OMB's estimate. For 2002, the upcoming budget year, CBO's and OMB's projections of total discretionary outlays are similar, but that similarity masks differences in the defense and nondefense categories.

For the defense discretionary category, CBO's outlay estimate for 2002 exceeds the Administration's by about \$7 billion—continuing a pattern of

Table 1-8.
Continued

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002- 2011
Difference (CBO minus OMB)												
Revenues	10	26	42	52	45	40	27	21	19	14	13	299
On-budget	10	25	41	53	52	46	38	33	32	35	39	394
Off-budget	*	1	1	-1	-6	-7	-11	-12	-14	-21	-26	-94
Outlays												
Discretionary	-8	1	*	1	2	-3	-8	-7	-8	-10	-10	-43
Mandatory	-2	2	1	11	7	1	-7	-14	-18	-23	-35	-75
Net interest and proceeds earned on the balance of uncommitted funds	<u>-5</u>	<u>-13</u>	<u>-11</u>	<u>-13</u>	<u>-17</u>	<u>-18</u>	<u>-21</u>	<u>-24</u>	<u>-28</u>	<u>-31</u>	<u>-20</u>	<u>-196</u>
Total	-15	-10	-11	-1	-8	-20	-36	-45	-54	-65	-65	-314
On-budget	-16	-14	-17	-10	-14	-23	-35	-39	-44	-47	-40	-283
Off-budget	2	4	7	9	6	4	-2	-6	-11	-18	-25	-32
Surplus	25	36	52	54	53	59	63	66	73	79	78	613
On-budget	27	39	58	63	65	69	72	72	76	82	79	676
Off-budget	-2	-3	-6	-9	-12	-10	-9	-6	-3	-3	-1	-63

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: * = between -\$500 million and \$500 million.

a. "Uncommitted funds" is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

recent years in which CBO's estimates of defense spending for the budget year have exceeded those of the Administration.¹³ For the nondefense discretionary category, CBO's outlay estimate for 2002 is \$7 billion lower than OMB's and, like its estimate for 2001, generally reflects CBO's expectation that certain agencies will spend new budget authority and prior balances more slowly than OMB expects.

Over time, differences in spending between the two sets of estimates are much smaller and can be explained mostly by variations in the projected inflation rates used to adjust budget authority in the future (the GDP deflator and the employment cost index for wages and salaries). Those rates are slightly lower in CBO's view than in the Administration's and therefore generate marginally lower annual outlays.

For mandatory spending, CBO and OMB project similar totals over the 2002-2011 period. Within those totals, however, there are some variances. In particular, CBO's estimate of Social Security outlays is \$127 billion lower than OMB's for the 10-year period. That difference is offset by CBO's estimate of Medicare outlays, which is \$130 billion higher over that time. In the case of Social Security, OMB projects higher spending than CBO does because, overall for the 10-year period, it assumes slightly larger increases for cost-of-living adjustments in benefit payments, additional costs for more disability awards related to a redesign of the award process, slightly bigger caseloads, and faster growth in average benefits. In the case of Medicare, OMB projects lower spending than does CBO because it assumes a smaller number of disabled enrollees and because it makes different assumptions about the budgetary effects of adjusting Medicare+Choice payments for differences in health status.

13. For a discussion of defense spending and differences between CBO's and the Administration's estimates, see Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2001* (April 2000), Appendix B.

Discrepancies between CBO's and OMB's projections of net interest (including the proceeds earned on uncommitted funds) result mostly from different projections of future interest rates and different assumed levels of debt. CBO's projections of short-term interest rates are about 1 percentage point lower than OMB's in the near term and 0.4 percentage points lower in later years. CBO's projections of long-term rates are also lower than OMB's through 2005; thereafter, they are the same. CBO projects higher surpluses through 2011 than does OMB, which results in lower projections of debt in the future. The combination of lower rates and less debt leads to projected net interest costs over the 2002-2011 period that are \$196 billion lower under CBO's baseline than in OMB's estimates.

The Expiration of Budget Enforcement Procedures

Lawmakers are approaching a crossroads in the federal budget process. The major enforcement procedures under the Deficit Control Act, as modified by the Budget Enforcement Act of 1990 and subsequent extensions, expire at the end of fiscal year 2002. Those procedures—the annual limits on discretionary appropriations and the pay-as-you-go (PAYGO) requirement for new mandatory spending and revenue laws—have formed the basic framework for budgetary decisionmaking for the past decade.

Barring a dramatic reversal of current trends, the expiration of the discretionary caps and PAYGO requirement will occur in a vastly different budget and fiscal environment than that existing when those procedures were first put in place (1990) and later extended (1993 and 1997). The discretionary caps and PAYGO requirement were instituted during a time of large deficits. They were intended to help reduce and control those deficits by ensuring that new legislation did not make projected deficits bigger. With the emergence of surpluses, the objective has changed.

In a time of surpluses, the discretionary caps and PAYGO requirement, when enforced, generally bar legislative actions that would make projected sur-

pluses smaller. Although preserving surpluses may serve important objectives—chief among them that of reducing federal debt—it may be a goal that is increasingly difficult to sustain if total surpluses materialize at the record-setting levels now projected. Although the goal of lawmakers to preserve the off-budget (Social Security) portion of those surpluses for reducing public debt has imposed a new informal constraint on budget legislation, the emergence last year of the first large on-budget surplus—and projections of such amounts in the future—may have made that constraint less restrictive than it was when total budget surpluses first appeared in 1998.

For most of the 1990s, the consensus to reduce and eliminate the deficit made it easier for lawmakers to maintain the budgetary disciplines they had put in place to carry out that accord. However, no overall agreement has developed for the use of on-budget surpluses to replace the one that had been forged to eliminate the deficit. Without such an agreement, and for other reasons, the discretionary caps and PAYGO requirement have come under increasing stress. In 1999 and 2000, for example, lawmakers enacted record levels of emergency appropriations—which are effectively exempt from budget enforcement procedures—and used other funding devices to increase discretionary spending in excess of the caps set in 1997. For 2001, lawmakers set new, higher caps to accommodate increases in discretionary spending—the new outlay cap is about \$60 billion higher than the one set in 1997—and eliminated the PAYGO balance for the year. That action obviated the need to offset an estimated \$10.5 billion drop in the surplus caused by new mandatory spending and tax laws enacted during the last session of the 106th Congress.

The current period of unprecedented budgetary prosperity raises fundamental questions about how lawmakers should budget in a time of surpluses. Budgeting is a process for setting priorities and allocating scarce resources. Sustained surpluses of the magnitude now projected would retire all available debt held by the public in the next few years. What should be lawmakers' overriding budgetary objective? Is it possible in the current environment to structure a budget process with constraints? Should limits of the current type remain in effect? If so, what should those limits be, and how should they be structured? One current proposal, known as the

“lockbox,” would establish procedures to preserve minimum amounts of surpluses for certain purposes—Social Security, Medicare, debt reduction, and other uses. That approach might impose budget discipline, but it could also make the process of budgeting more difficult and inflexible if future surpluses did not materialize at the levels now projected.

With this budgetary environment as a backdrop, lawmakers will consider whether or in what form the discretionary caps and PAYGO requirement should be extended. Because the context for such a debate is now so different from that in earlier years, it may prompt a wider examination of the budget process and related issues. For example, the absence of overall agreement on what to do with surpluses may have led to delays in enacting budget legislation—especially appropriation bills. To help ease such tie-ups,

some lawmakers advocate converting the annual budget cycle into a two-year timetable and changing the Congressional budget resolution into a joint resolution signed by the President. In addition, a number of lawmakers are concerned that the existing budget enforcement framework has made the budget process too complex and confusing; they seek changes that would make the process simpler, easier to understand, and more efficient. Concerns about long-term budgetary pressures may prompt proposals to restructure federal programs in ways that raise significant questions about the budget process, such as how the proposed changes should be treated and displayed in the federal budget. Those and other issues are important components of the more fundamental debate over surpluses that confronts lawmakers in the 107th Congress.

The Economic Outlook

The growth of economic activity—as measured by real (inflation-adjusted) gross domestic product—is likely to slow from its rapid pace of recent years to about 2½ percent this calendar year and 3½ percent next year (see Table 2-1 and Figure 2-1). Spending by consumers and investment by businesses slowed late last year in response to higher interest rates in 1999 and early 2000 and lower expectations about future business conditions (reflected in last year's drop in stock prices and tightening of standards and terms for borrowing by businesses). Although in early January the Federal Reserve Board responded to the slowdown in growth by lowering the federal funds interest rate, spending by consumers and businesses is likely to remain weak this year. However, lower interest rates will set the stage for spending to grow more quickly next year.

The rate of inflation, as measured by the growth of the consumer price index (CPI), is expected to decline from 3.4 percent in 2000 to around 2.8 percent in 2001. That projected decrease reflects the Congressional Budget Office's view that oil prices will fall somewhat from last year's level, although underlying inflationary pressures from the tight labor market will remain.

Significant uncertainty surrounds that short-term forecast. For various reasons, economic conditions in the next two years could be much worse or better than CBO anticipates:

- o The primary negative risk is that the current slowdown might turn into a recession. Although forecasters widely anticipated that eco-

nomic activity would slow, the deceleration has been surprisingly rapid. Reports of rising loan losses at commercial banks and defaults on high-risk bonds, combined with the drop in stock prices, have heightened fears that financial markets might severely reduce the supply of credit and capital and choke off the economic expansion. In addition, consumers have become less optimistic about the future, in part because of the decline in the stock market. The possibility of further slowing is heightened by the weakness evident in recent economic data, such as those showing slower growth of retail sales and employment. Although those developments must be watched carefully, they do not as yet constitute a strong reason to expect a recession.

- o In the other direction, the economy might continue to grow rapidly without an increase in inflation, rather than slowing as CBO forecasts. In recent years, the unexpected endurance of the expansion has continually surprised analysts and has proved to be the most significant source of error in their economic forecasts.
- o Another source of risk to CBO's short-term forecast is that inflation might rise. Productivity growth—which has been rapid and kept production costs low—could slow more than generally anticipated, and businesses could pass the resulting cost increases on to customers in the form of higher prices. In that case, rising inflation would be coupled with slowing growth. Alternatively, inflation might start to rise because of continued rapid growth of GDP and

increasing wage pressures from the labor market, which has been unusually tight. Or the dollar could fall from its current high level, leading the prices of imported goods to rise and temporarily boosting inflation. Whatever the cause, any further rise in inflation increases the possibility that the Federal Reserve will raise short-term interest rates, with the attendant risk of a recession next year.

Those risks are less important for the economic outlook over the next 10 years as a whole. CBO anticipates that growth of real GDP will average about

3 percent over the 2001-2011 period. CPI inflation is projected to average 2.6 percent during that period, reflecting CBO's assumption about what level of inflation would be consistent with Federal Reserve policy. Given the projection of continued stable inflation, interest rates are expected to remain at levels similar to those seen in the second half of the 1990s (see Figure 2-1).

The major uncertainty in those medium-term economic projections is the growth rate of potential GDP (defined as the highest level of output that could persist without spurring higher inflation). CBO

Table 2-1.
CBO's Economic Projections for Calendar Years 2001-2011

	Estimated 2000	Forecast		Projected Annual Average	
		2001	2002	2003-2006	2007-2011
Nominal GDP (Billions of dollars)	9,974	10,446	11,029	13,439 ^a	17,132 ^b
Nominal GDP (Percentage change)	7.3	4.7	5.6	5.1	5.0
Real GDP (Percentage change)	5.1	2.4	3.4	3.1	3.1
GDP Price Index (Percentage change)	2.1	2.3	2.1	1.9	1.9
Consumer Price Index ^c (Percentage change)	3.4	2.8	2.8	2.6	2.5
Unemployment Rate (Percent)	4.0	4.4	4.5	4.7	5.2
Three-Month Treasury Bill Rate (Percent)	5.8	4.8	4.9	4.9	4.9
Ten-Year Treasury Note Rate (Percent)	6.0	4.9	5.3	5.6	5.8
Tax Bases (Percentage of GDP)					
Corporate profits ^d	9.4	8.9	8.5	8.2	8.0
Wages and salaries	47.8	48.2	48.2	48.2	48.0

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.

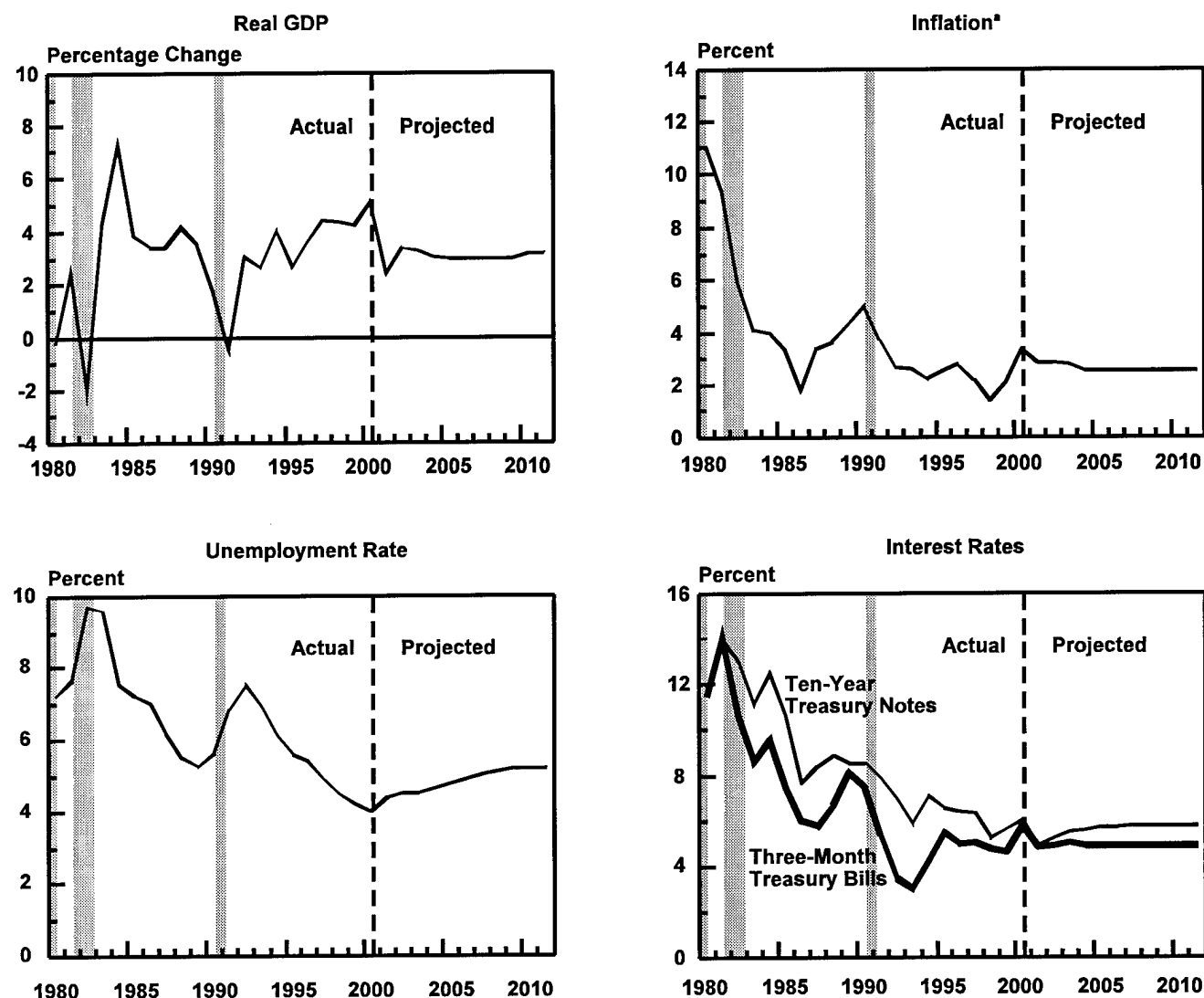
Annual economic projections for calendar years 2001 through 2011 appear in Appendix E.

- a. Level of GDP in 2006.
- b. Level of GDP in 2011.
- c. The consumer price index for all urban consumers.
- d. Corporate profits are book profits.

has raised its projections of both potential and actual GDP over the past few years in response to the investment boom of the late 1990s, evidence of the economy's faster growth of productivity, and changes in the data used to calculate GDP. That rise parallels changes made by private-sector forecasters and the Clinton Administration (see Table 2-2). Their and CBO's upward revisions were mostly driven by the

increasing belief that acceleration in the growth of information technology—which was a major force behind the investment boom of the late 1990s—will continue to stimulate investment over the next decade. However, economists are uncertain about the degree to which information technology will continue to support economic growth over the next 10 years.

Figure 2-1.
The Economic Forecast and Projections



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

NOTE: All data are annual values; percentage changes are year over year.

a. The consumer price index for all urban consumers, with current methodology applied to historical price data (CPI-U-RS).

Table 2-2.
Change in Projections of Growth Over the Past Five Years (By calendar year)

Date Projection Was Published ^a	Period Covered by Projection	Average Annual Growth Rate of Real GDP (Percent)		
		CBO	Blue Chip	Clinton Administration
2001	2001-2010	3.0	3.3	3.1
2000 ^b	2000-2009	2.8	2.7	2.8
1999 ^b	1999-2008	2.3	2.4	2.3
1998	1998-2007	2.2	2.3	2.3
1997	1997-2006	2.1	2.3	2.3

SOURCES: Congressional Budget Office; Aspen Publishers, Inc., *Blue Chip Economic Indicators*; Office of Management and Budget.

- a. CBO and Clinton Administration projections were published in January and completed in November or December of the previous year. *Blue Chip* publishes long-term projections twice a year, in March and October; the projections shown here are those published in October of the previous year.
- b. About 0.3 percentage points of the change between these projections stemmed from a benchmark revision to gross domestic product during 1999 that, for the first time, included software in GDP.

The Growth of the Economy's Potential to Produce

The performance of the U.S. economy in the past five years has been extraordinary. Real growth, which averaged 2.8 percent a year during the 1974-1995 period, rose to an average of 4.4 percent from mid-1995 to mid-2000. The unemployment rate fell to 30-year lows. And in a departure from historical patterns, inflation eased despite the low unemployment.

That confluence of events stemmed primarily from an unexpected increase in the growth of the economy's underlying ability to produce goods and services. The growth of labor productivity accelerated from a trend rate of 1.5 percent a year during the 1974-1995 period to 2.9 percent (see Figure 2-2). An important factor behind that recent surge was the acceleration of investment in information technology (IT), which appears likely to continue to contribute to the underlying growth rate of the economy in the years ahead.

Other important developments also played a role in the economy's outstanding performance over the past five years. Changes in corporate behavior, particularly increased efforts to reduce costs (which

were facilitated by the IT revolution), appear to have helped raise the sustainable growth rate of productivity. Weakness in many foreign economies, coinciding with a period when inflationary pressures in the U.S. economy were building, kept the prices of imports low, dampening inflation. The weakness abroad also encouraged foreigners to invest in the United States. And massive improvement in the federal budget reduced the government's demand for credit and thus made more funds available for investment.

The Information Technology Boom

Recent progress in information technology has contributed to the increase in productivity growth in various ways. The most visible and clearly quantified way involves the manufacturing of IT equipment itself. The rate of technical change in that sector is reflected in the quality-adjusted price index for computers and related equipment. That index has been declining for many years because of ongoing improvements in productivity, but it fell more rapidly between 1995 and 1999 (see Figure 2-3). Although some of that faster decline stemmed from temporary market developments, CBO anticipates continued rapid productivity gains in the production of IT equipment.

Besides those gains, information technology has helped businesses lower their costs of production. Significant cost savings from IT investments are hard to quantify precisely, but numerous anecdotes suggest that savings are greatest in business operations that involve intensive handling, disseminating, or archiving of information or that require constant monitoring of data—operations such as purchasing, delivery, and inventory management.

The unusually large declines in IT prices, combined with the clear benefits of IT investment, resulted in a surge in such investment by businesses. Indeed, the investment boom of the late 1990s was led by higher spending on new software and computing and communications equipment (see Figure 2-4).

Changes in Corporate Management and Culture

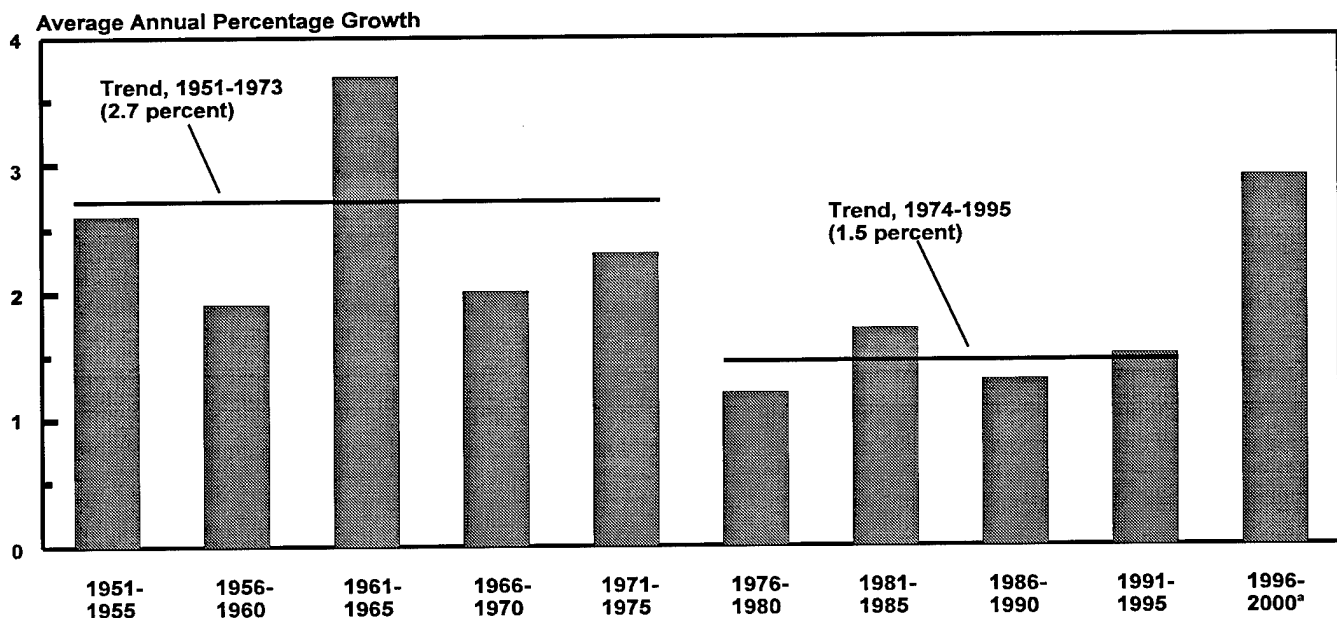
Advances in information technology, coupled with increased globalization, have created a more competi-

tive environment for businesses, causing them to significantly change the way they behave. In particular, increased competition has forced firms to sharpen their focus on controlling production costs. Rather than try to pass on higher costs to consumers or improve their profits by raising prices, companies appear more ready and willing to reduce costs by embracing new technology quickly, undertaking large investments, and making changes in their organizational structures that increase efficiency. Although businesses have always tried to lower costs, the IT revolution appears to have given them both the additional means and the need to focus more attention on cost-cutting innovations.

Weakness in the Rest of the World

Weakness in other countries in the second half of the 1990s helped the U.S. economy, on balance, by providing financial capital and a low-cost source of imports. Many foreign economies—notably Asian ones—were plagued by economic problems during that

Figure 2-2.
Labor Productivity in the Nonfarm Business Sector



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

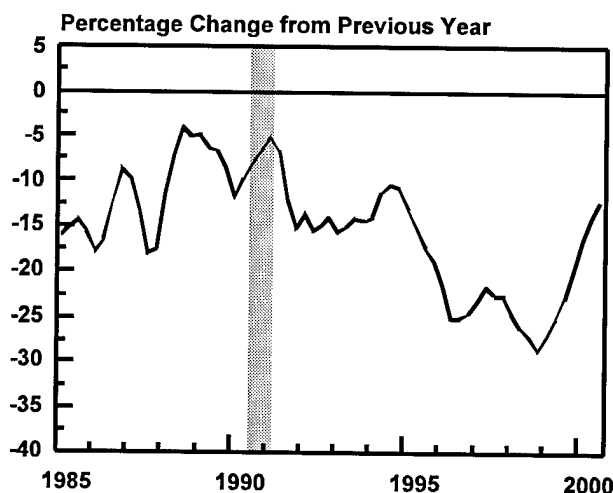
a. Includes CBO's estimate for the fourth quarter of 2000.

period. Capital flowed to the United States seeking higher risk-adjusted rates of return, and as a result, the dollar strengthened. That effect was compounded by the flight of capital to U.S. markets in search of a safe haven during the Asian crisis. Those inflows of capital stimulated investment by making more funds available.

In addition, the combination of a strong dollar and excess capacity abroad held down prices of imports and overall inflation through 1999. Prices of imported goods (excluding petroleum and computers) fell by an average of 2.3 percent per year between 1996 and 1999 after increasing by an average of 3.0 percent per year in the previous 10 years (see Figure 2-5). Lower import prices reduce overall inflation in two ways: directly through the share of imported goods and services in the price indexes used to measure inflation, and indirectly through increased foreign competition that limits the ability of U.S. producers to raise prices.

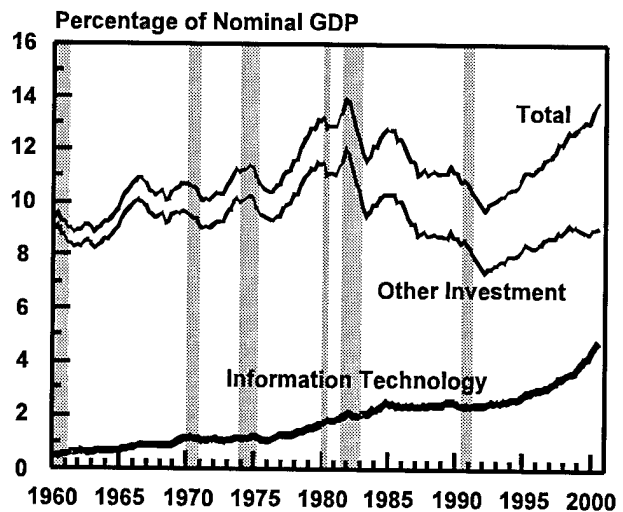
The weakness in world economic activity also reduced prices for commodities (such as grains, metals, and crude oil). Petroleum prices eased for most of the second half of the 1990s before starting their run-up in 1999.

Figure 2-3.
Prices for Computers Bought by Businesses



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

Figure 2-4.
Business Fixed Investment



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

Improvement in the Federal Budget

Another factor that contributed to the favorable economic performance of the past five years was the improvement in the federal budget, which added to national saving, making more funds available for private investment. The budget moved from a \$164 billion deficit in 1995 to a \$236 billion surplus in 2000. Part of that improvement stemmed from policy changes that increased revenues in the 1990s and restrained spending when surpluses emerged. But the bulk of the improvement occurred because economic developments spurred phenomenal growth in revenues.

CBO's Medium-Term Projections

CBO projects that real GDP will grow at an average rate of 3.0 percent in the medium term (defined as the 2001-2011 period). That rate is significantly higher than the 2.7 percent that CBO projected last July.¹ The faster growth rate results from a change in

1. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (July 2000).

CBO's method of calculating the contribution of capital to growth, an upward revision in the official data on investment for the past three years, and higher projected levels of investment. Inflation in the CPI is projected to average 2.6 percent, and the unemployment rate is expected to average 4.8 percent.

Growth of Potential GDP

Potential GDP—the highest level of output that the U.S. economy can produce given its labor force, capital stock, and technology without generating inflationary pressures—is the basis for CBO's medium-term projections of real GDP. Potential GDP is projected to grow at an average rate of 3.3 percent a year through 2011 (see Table 2-3).

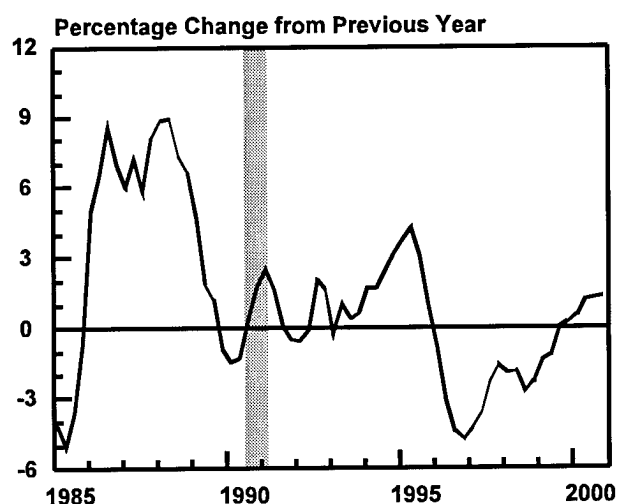
By CBO's estimate, the annual growth rate of potential GDP increased from 2.9 percent between 1982 and 1995, on average, to about 3.4 percent between 1996 and 2000. Much of that acceleration can be attributed to an increase in the growth of the capital input (a measure of the flow of services provided by the stock of capital). The contribution of the capi-

tal input to the overall growth of potential output in the nonfarm business sector rose to 1.5 percent in the 1996-2000 period from 0.9 percent in the 1982-1995 period.

Potential GDP accelerated more in the past five years, however, than can be explained simply by additional capital. The remaining increase is assumed to be an increase in total factor productivity (TFP).² CBO estimates that the underlying trend for TFP (known as potential TFP) in the nonfarm business sector grew at an average rate of 1.5 percent for the past five years, up from its average of 1.1 percent growth for the 1982-1995 period. The growth of actual TFP escalated further in the past year and a half, but that surge is projected to be reversed as the economy reverts to its potential level, and thus the surge has virtually no effect on potential TFP (see Figure 2-6).

Although much of the increase in the growth of potential GDP in the second half of the 1990s is carried forward in CBO's projections, the growth of potential GDP is slower between 2006 and 2011 than in the past five years. That slowing is primarily caused by slower growth in total hours worked, reflecting a corresponding reduction in the growth of the working-age population, and the stabilization of the overall rate of labor force participation.³

Figure 2-5.
Prices for Imports, Excluding Petroleum
and Computers



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

The Increase in the Capital Input. The recent investment boom raised the growth of the capital input to about a 5.0 percent pace in the past five years from 3.1 percent in the previous 15 years, adding significantly to the growth of potential GDP. That increase resulted not only from greater capital investment but also from an increase in the share of investment devoted to information technology. A dollar's worth of IT investment contributes more to output per year than other types of investment; IT equipment has a shorter service life than other types of capital, on average, so to be profitable, its contribution to production per year of service life must be higher (see Box 2-1 on page 36). The shift in the composition of in-

2. The measure of TFP discussed in this report is an estimate from CBO's growth model. See Congressional Budget Office, *CBO's Method for Estimating Potential Output*, CBO Memorandum (October 1995).

3. See Congressional Budget Office, *The Budget and Economic Outlook: An Update* (July 2000), Appendix A.

vestment toward IT capital raises the growth rate of the capital input. It also implies, of course, that the capital stock depreciates faster and that a greater share of earnings in the future will be devoted to replacing depreciated equipment.

The Rise in the Growth of Potential TFP. Two quantifiable and long-lasting factors appear to explain most of the 0.4 percentage-point increase in the growth rate of potential total factor productivity during the 1996-2000 period.

Table 2-3.
Key Assumptions in CBO's Projection of Potential GDP (By calendar year, in percent)

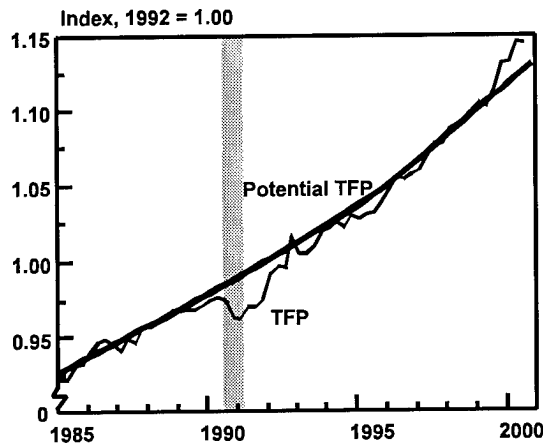
	Average Annual Growth Since 1951					Projected Average Annual Growth Through 2011		
	1951-1973	1974-1981	1982-1995	1996-2000	Total, 1951-2000	2001-2005	2006-2011	Total, 2001-2011
Overall Economy								
Potential Output (GDP)	3.9	3.2	2.9	3.4	3.4	3.5	3.2	3.3
Potential Labor Force	1.6	2.5	1.4	1.2	1.7	1.1	1.0	1.0
Potential Labor Force Productivity ^a	2.2	0.7	1.4	2.2	1.8	2.4	2.2	2.3
Nonfarm Business Sector								
Potential Output	4.0	3.6	3.1	4.0	3.7	4.1	3.6	3.8
Potential Hours Worked	1.3	2.2	1.6	1.4	1.5	1.2	1.0	1.1
Capital Input	3.7	4.3	3.1	5.0	3.8	5.8	4.8	5.2
Potential Total Factor Productivity	2.0	0.8	1.1	1.5	1.5	1.5	1.5	1.5
Potential TFP Excluding Adjustments	2.0	0.8	1.1	1.1	1.4	1.1	1.1	1.1
TFP Adjustments	0	0	0	0.4	0	0.4	0.4	0.4
Computer quality	0	0	0	0.2	0	0.2	0.2	0.2
Price measurement	0	0	0	0.1	0	0.2	0.2	0.2
Temporary adjustment ^b	0	0	0	0.1	0	0	0	0
Contributions to Growth of Potential Output (Percentage points)								
Potential hours worked	0.9	1.5	1.1	1.0	1.1	0.9	0.7	0.8
Capital input	1.1	1.3	0.9	1.5	1.1	1.7	1.4	1.6
Potential TFP	<u>2.0</u>	<u>0.8</u>	<u>1.1</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>
Total Contributions	4.0	3.6	3.1	4.0	3.7	4.1	3.6	3.8
Memorandum:								
Potential Labor Productivity ^c	2.7	1.4	1.5	2.6	2.2	2.8	2.6	2.7

SOURCE: Congressional Budget Office.

NOTE: CBO assumes that the growth rate of potential total factor productivity changed after the business-cycle peaks of 1973 and 1981 and again after 1995.

- Potential GDP divided by the potential labor force.
- The temporary adjustment raises the growth of potential TFP during the 1996-2000 period to help make the estimate of potential GDP more compatible with the observed weakness of inflation. That adjustment is considered transitory, in the sense that although it has a permanent effect on the estimated level of potential TFP, its effect on the growth rate of TFP is temporary.
- Estimated trend in the ratio of output to hours worked in the nonfarm business sector.

Figure 2-6.
Total Factor Productivity



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

- o About 0.2 percentage points of the increase can be traced to productivity gains in the production of IT equipment (the line labeled “computer quality” in Table 2-3). CBO assumes that their contribution to the trend growth of TFP will continue for the next 10 years.
- o Another 0.1 percentage point of the increase stems from a definitional change in the way prices were measured for some of the categories of GDP in the 1990s. The Bureau of Economic Analysis (BEA) adopted price indexes for hospital services and for physicians’ services from the Bureau of Labor Statistics’ producer price index to use in its GDP data starting in 1993 and 1994, respectively. The changes created a discontinuity in the growth rates for those series, as the new price indexes showed much slower rates of increase than the old indexes. Those and other, smaller changes to price indexes that the BEA was not able to carry back in benchmark revisions of the GDP data resulted in a slight discontinuity in the measures of real GDP and productivity between the 1996-2000 period and earlier years. The effect of the new measurement method on real growth is carried forward in CBO’s calculations of potential GDP.

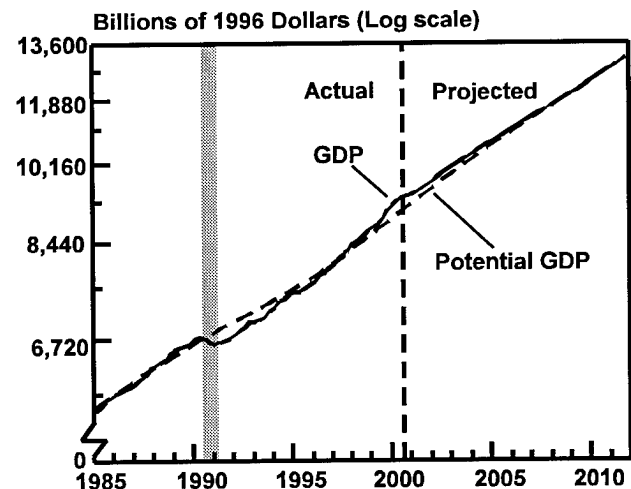
In CBO’s medium-term projections, the growth rate of potential total factor productivity through 2011 matches that of the 1996-2000 period (see Table 2-3).

Growth of Real GDP

CBO’s projection of actual GDP growth is slightly lower than its projection of potential GDP growth because CBO assumes that the economy is still operating at an unsustainably high rate of resource use, despite the slowdown at the end of 2000. As a result, GDP is projected to grow at a 3.0 percent rate, on average, even as potential GDP grows at a 3.3 percent rate. The slower growth of GDP brings its projected level down to that of potential GDP during the medium term (see Figure 2-7).

By its construction, that projection allows for the likelihood that a recession will occur sometime in the next 10 years. It also incorporates the probability of above-trend growth. As long as the economy is not buffeted by external shocks to prices (such as occurred in 1974 and 1979), gross domestic product is expected to be above its estimated potential during booms and below its estimated potential during recessions. On average over the business cycle, GDP should be equal to potential GDP.

Figure 2-7.
Gross Domestic Product



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

Inflation and Unemployment

Inflation averages 2.6 percent in the medium term as measured by the change in the consumer price index and 2.0 percent as measured by the change in the GDP price index (a summary of the prices of all goods and services that make up GDP). CBO's projections for inflation reflect an assumption about the rate of inflation consistent with Federal Reserve policy.

CBO assumes that the current unemployment rate, although it has been accompanied by only a slight increase in the inflation rate, is too low to be sustained for a long period without causing inflation to rise. The recent surge in productivity growth appears to have temporarily lowered the rate of unemployment that is compatible with stable inflation, pri-

marily because it may take several years for the process of setting wages to adjust to a sudden change in productivity growth. Consequently, it is likely that the growth rate of labor costs will eventually catch up to the increase in productivity growth, putting downward pressure on profits and upward pressure on inflation. That inflationary pressure is likely to occur even if the growth of labor productivity remains fairly high. CBO's projections assume that an unemployment rate averaging close to 5 percent is compatible with the projection for CPI inflation.

Interest Rates

CBO projects interest rates by adding the projection for CPI inflation to a projection for inflation-adjusted interest rates. The real rate on three-month Treasury

Box 2-1.

A Change in How CBO Calculates the Capital Input in Its Growth Model

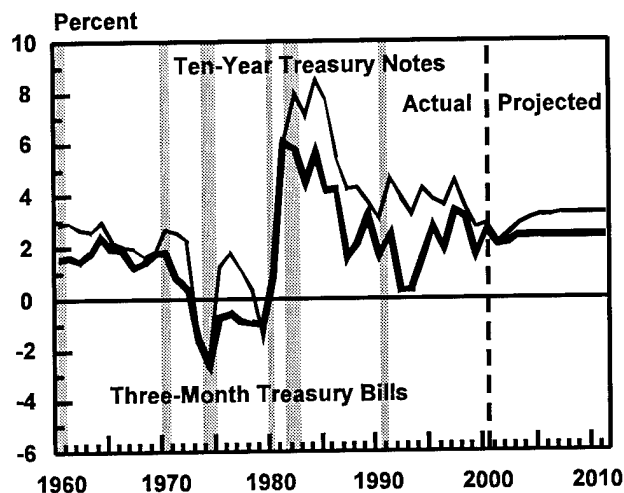
The Congressional Budget Office uses a neoclassical growth model to project the level of real gross domestic product 10 years ahead. The model tries to explain the historical trends in the growth of real GDP by estimating the contributions of two factors of production, labor and capital, and a residual called total factor productivity (TFP). CBO estimates the underlying trend in real GDP (called potential GDP) by estimating trend lines through the historical pattern of ups and downs in labor hours and TFP. CBO bases its estimate of the capital input on the actual capital stock. That modeling approach is useful for estimating the contribution each factor makes to the growth of potential GDP, but measuring the inputs is often difficult.

The measurement of the capital input has been a particular problem in recent years. The difficulty stems from the heterogeneity of capital goods—different types of capital have different levels of productivity. For example, an electric utility turbine has a long service life. Therefore, its rate of depreciation is low, and the part of its value that it contributes to output each year—the capital input—is also low. In contrast, a computer depreciates quickly, having a very short service life. Computers must be productive enough to pay for that high rate of depreciation and thus must provide a large capital input relative to their cost. If

they did not, buying computers would ultimately undermine businesses' profitability.

In fact, the primary uncertainty now about the contribution of capital to the growth of potential GDP concerns computers. Estimates of computers' contribution to output vary over time and differ among analysts. Indeed, the latest estimates of capital input from the Bureau of Labor Statistics (BLS) and some private forecasters show faster growth during the late 1990s than CBO's estimate from July 2000 did, largely because those analysts place a heavier weight on computers when they construct their measures of capital input. Because recent data and revisions to older data lend further support to the weighting schemes used by those other forecasters, CBO has raised its estimate of the contribution of the computer capital stock to output. The change aligns CBO's estimate with those of BLS and private forecasters. The revisions to older data plus the greater weight on computers raised the growth of the capital input by about 1.2 percentage points over 10 years. That revision caused an offsetting change in CBO's estimate of TFP over history. It did not significantly alter the trend in TFP, however, so potential TFP was almost unaffected. The net result is an upward revision of 0.3 percentage points to the projection for growth of potential GDP.

Figure 2-8.
Real Interest Rates



SOURCES: Congressional Budget Office; Federal Reserve Board; Department of Labor, Bureau of Labor Statistics.

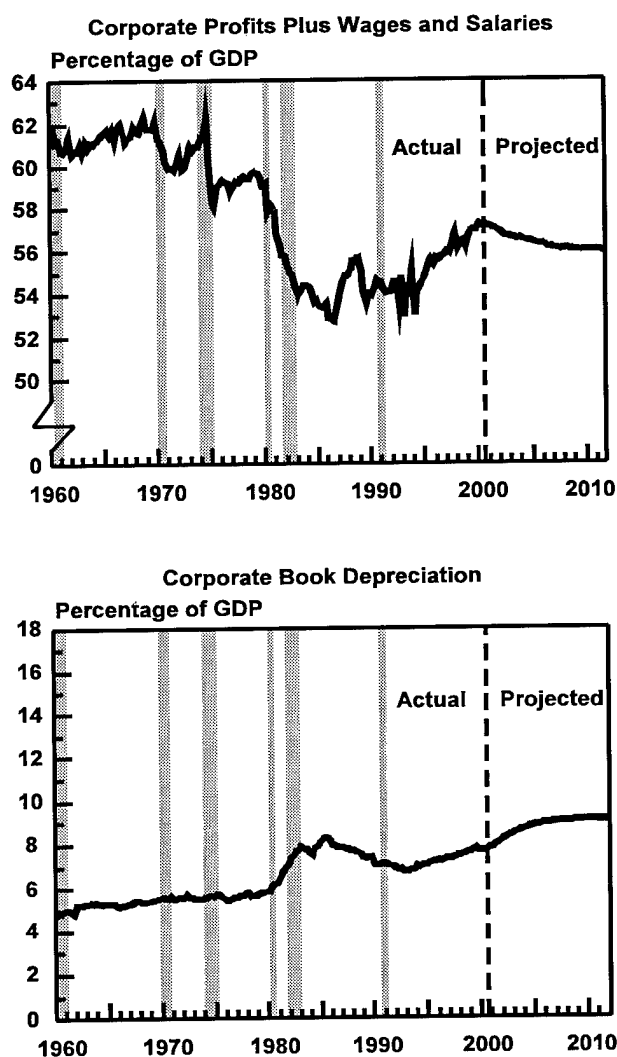
bills averages 2.4 percent during the last years of CBO's projection period, and the real rate on 10-year Treasury notes averages 3.3 percent (see Figure 2-8). The real 10-year rate is about the same as its average of the past four decades; the real three-month rate is slightly higher. Both are also close to their ranges during the stable inflation years of the 1960s but lower than their averages of the early 1980s. Real rates should be lower, on average, for two reasons: because of mounting federal surpluses and because the inflation stability that has occurred since the mid-1980s is likely to have lowered the additional return that investors require for uncertainty in inflation. Combined with projected rates of CPI inflation, those real rates imply nominal interest rates of 4.9 percent for three-month Treasury bills and 5.8 percent for 10-year Treasury notes.

Taxable Income

CBO's projections for the federal budget are closely connected to its projections of economic activity and components of national income. Because different components are taxed at different rates, and some are not taxed at all, the distribution of income among its components is an important part of CBO's economic

projections. Wage and salary disbursements and corporate profits are particularly important because they produce the most tax revenues. As a share of GDP, those two categories combined have risen sharply, from 54.0 percent in 1994 to 57.2 percent in 2000. In CBO's projections, however, their share declines to 56 percent (see Figure 2-9).

Figure 2-9.
Income Shares and Depreciation



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

NOTE: Corporate profits are book profits.

CBO expects the sum of those high-tax categories of income to grow more slowly than GDP during the next 10 years because depreciation will be higher, reflecting the high investment rates of the recent past. The boom in business investment during the past five years has led to a rapid increase in the size of the nation's capital stock. Consequently, firms will be able to deduct growing amounts for depreciation from their taxable earnings. CBO projects that such deductions for depreciation will rise from 7.8 percent of GDP in 2000 to 9.1 percent in 2008 and will remain at that percentage through 2011 (see Figure 2-9).

Comparison with CBO's July 2000 Projections

The current medium-term economic projections have more favorable implications for the budget outlook than did CBO's previous projections, published last July. The current projections indicate higher federal revenues because the growth of real GDP is significantly higher, the growth of the GDP price index is slightly higher, and the high-tax categories of income together make up a greater share of GDP (see Table 2-4). Other changes, such as a higher projected unemployment rate and lower projected interest rates in the short term, have relatively small effects on the outlook for the budget.

Growth of Real GDP. CBO has raised its projections for the growth of both GDP and potential GDP since last July. In the current projections, potential output grows at an average rate of 3.3 percent through 2011, compared with last July's projection of 3.1 percent. As noted earlier, that increase reflects a change in the method that CBO uses to calculate the economy's stock of productive capital, an upward revision to the official data on investment for the past three years, and higher projected levels of investment. Those changes raised the estimated growth of the capital input during the recent past as well as in CBO's projections—where growth of the capital input now averages 5.2 percent through 2011, up from 3.9 percent in last July's projections.

Since July, CBO has not changed its estimate of the gap between actual and potential GDP in 2000. Consequently, the growth of real GDP between 2000 and 2011, like that of potential GDP, is also higher

than in the July projections, averaging 3.0 percent now compared with 2.7 percent then.

Other Significant Changes. Two other changes to CBO's economic outlook since last July that have particular importance for the budget projections are increases in the projected growth of the GDP price index and in the high-tax income categories as a share of GDP.

The new projection for the GDP price index raises projected surpluses slightly. The GDP price index is now expected to grow at an average rate of 2.0 percent through 2010, compared with 1.9 percent last July. That change raises revenue projections because it tends to raise the projected level of taxable income. Outlay projections, however, depend primarily on the growth of the CPI, which has changed little from the July projection.

The fact that more highly taxed categories of income make up a greater share of GDP in the current economic outlook than last July also leads to a more favorable budget projection. The combined share of wage and salary disbursements and corporate profits is 56 percent of GDP in 2010 in the current projection compared with 55.1 percent in 2010 last July. Their share is higher in the current projection largely because CBO has lowered its projections of the growth of fringe benefits and businesses' interest payments as a percentage of GDP. (Fringe benefits are expected to grow faster than in the past but slower than projected last July.) Since fringe benefits are not taxed and businesses can deduct their interest payments from earnings when determining corporate tax liability, the reduction in the projections of those categories results in higher taxable income relative to GDP.

Comparison with the Clinton Administration's Projections

The final economic projections of the Clinton Administration expect stronger growth this year than CBO's current projections do but virtually the same growth for the medium term (see Table 2-5). The Bush Administration is preparing its own economic forecast.

Table 2-4.
Comparison of CBO's Current and Previous Economic Projections for Calendar Years 2001-2010

	Estimated 2000	Forecast		Projected Annual Average	
		2001	2002	2003-2006	2007-2010
Nominal GDP (Billions of dollars)					
January 2001	9,974	10,446	11,029	13,439 ^a	16,308 ^b
July 2000	9,907	10,433	10,940	13,077 ^a	15,675 ^b
Nominal GDP (Percentage change)					
January 2001	7.3	4.7	5.6	5.1	5.0
July 2000	7.0	5.3	4.9	4.6	4.6
Real GDP (Percentage change)					
January 2001	5.1	2.4	3.4	3.1	3.0
July 2000	4.9	3.1	2.7	2.6	2.8
GDP Price Index (Percentage change)					
January 2001	2.1	2.3	2.1	1.9	1.9
July 2000	2.1	2.1	2.1	1.9	1.8
Consumer Price Index ^c (Percentage change)					
January 2001	3.4	2.8	2.8	2.6	2.5
July 2000	3.1	2.7	2.9	2.6	2.5
Unemployment Rate (Percent)					
January 2001	4.0	4.4	4.5	4.7	5.1
July 2000	3.8	3.7	4.1	4.7	5.2
Three-Month Treasury Bill Rate (Percent)					
January 2001	5.8	4.8	4.9	4.9	4.9
July 2000	5.9	6.7	5.5	4.8	4.8
Ten-Year Treasury Note Rate (Percent)					
January 2001	6.0	4.9	5.3	5.6	5.8
July 2000	6.5	6.8	6.3	5.7	5.7
Tax Bases (Percentage of GDP)					
Corporate profits ^d					
January 2001	9.4	8.9	8.5	8.2	8.0
July 2000	9.2	8.4	7.7	7.3	7.0
Wages and salaries					
January 2001	47.8	48.2	48.2	48.2	48.0
July 2000	48.1	48.5	48.8	48.6	48.3

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 of GDP in 2006.
- b. Level of GDP in 2010.
- c. The consumer price index for all urban consumers.
- d. Corporate profits are book profits.

Table 2-5.
Comparison of CBO's and the Clinton Administration's Economic Projections
for Calendar Years 2001-2011

	Estimated 2000	Forecast		Projected Annual Average	
		2001	2002	2003-2006	2007-2011
Nominal GDP (Billions of dollars)					
CBO	9,974	10,446	11,029	13,439 ^a	17,132 ^b
Administration	9,991	10,536	11,099	13,676 ^a	17,536 ^b
Nominal GDP (Percentage change)					
CBO	7.3	4.7	5.6	5.1	5.0
Administration	7.4	5.5	5.3	5.4	5.1
Real GDP (Percentage change)					
CBO	5.1	2.4	3.4	3.1	3.1
Administration	5.2	3.3	3.2	3.2	2.9
GDP Price Index (Percentage change)					
CBO	2.1	2.3	2.1	1.9	1.9
Administration	2.2	2.0	2.1	2.1	2.1
Consumer Price Index ^c (Percentage change)					
CBO	3.4	2.8	2.8	2.6	2.5
Administration	3.4	2.7	2.6	2.7	2.7
Unemployment Rate (Percent)					
CBO	4.0	4.4	4.5	4.7	5.2
Administration	4.0	4.1	4.4	4.8	5.1
Three-Month Treasury Bill Rate (Percent)					
CBO	5.8	4.8	4.9	4.9	4.9
Administration	5.9	6.0	5.7	5.3	5.3
Ten-Year Treasury Note Rate (Percent)					
CBO	6.0	4.9	5.3	5.6	5.8
Administration	6.1	5.8	5.8	5.8	5.8
Tax Bases (Percentage of GDP)					
Corporate profits ^d					
CBO	9.4	8.9	8.5	8.2	8.0
Administration	9.4	8.8	8.4	8.0	7.5
Wages and salaries					
CBO	47.8	48.2	48.2	48.2	48.0
Administration	47.7	47.7	47.8	48.0	48.1

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

NOTE: Percentage changes are year over year.

a. Level of GDP in 2006.

b. Level of GDP in 2011.

c. The consumer price index for all urban consumers.

d. Corporate profits are book profits.

The Clinton Administration anticipated a more favorable economic outlook than CBO for 2001 primarily because it completed its forecast in November, before the recent spate of data indicated a sudden weakening in growth. Real GDP growth and interest rates for this year are significantly higher in the Administration's forecast than in CBO's, and the unemployment rate is much lower.

For the entire 2001-2011 period, the Administration's projection of real GDP growth averages only slightly more than CBO's projection. The difference stems from higher assumed growth of the labor force, not of labor productivity. Short-term interest rates are higher as well in the Administration's medium-term projections, but all other aspects of the economic outlook are similar to CBO's projections.

Recent Economic Developments

In the last five years of the 1990s, the economy grew much more rapidly than CBO's estimate of its potential growth. But during the second half of 2000, economic activity appears to have shifted from above-trend growth to below-trend growth. (That shift was especially pronounced in the manufacturing sector; see Box 2-2 for details.) After an extraordinarily rapid increase—6.1 percent—during the previous four quarters, real GDP slowed to 2.2 percent annual growth in the third quarter of 2000 and appears to have remained at a subdued pace in the final quarter.

Slower growth in spending by consumers and businesses accounts for much of the slowdown in overall growth. That sudden deceleration has raised the chances that the economy could slip into a recession this year—although in CBO's view, that possibility is not as likely as the mild slowdown that CBO has forecast for the short term. In any event, such a slowdown has few lasting effects and thus has little impact on the medium-term projections.

The recent slowing in economic activity followed restrictive monetary actions by the Federal Reserve and probably a shift in consumers' and businesses' confidence about future economic activity.

The Federal Reserve responded to the earlier rapid growth in aggregate demand by tightening conditions in credit markets, raising its target for the federal funds rate from 4.75 percent in early June 1999 to 6.5 percent by May 2000. In the second half of 2000, credit markets grew more cautious as losses on business loans and bonds mounted, and they raised lending standards and interest rates, particularly for high-risk borrowers. Stock prices fell with investors' diminished expectations about the future growth of profits, which in turn lowered consumers' wealth and raised businesses' cost of capital.

The Federal Reserve made no further changes to its target for the federal funds rate in the second half of 2000 as growth began decelerating and the rate of inflation eased from its pace in the first half of the year. However, at the end of 2000, the Federal Reserve indicated that the balance of risks in the economy had shifted from rising inflation to economic weakness. In a surprise move, it lowered its target for the federal funds rate by 0.5 percentage points in the first week of January.

Consumer Spending and Residential Investment

The Federal Reserve's move reflected in part a sharp slowdown in consumer spending toward the end of last year. After growing at an average annual rate of 5.4 percent from the second quarter of 1999 through the second quarter of 2000, real consumer spending slowed to a still-strong annual growth rate of 4.5 percent in the third quarter of 2000. However, available data on spending confirmed news reports of disappointing holiday sales and indicate that consumer spending on goods slowed further in the fourth quarter.

Some of that slowdown was probably inevitable because spending had grown very rapidly at the end of 1999 and beginning of 2000. Sales of cars and light trucks, for example, rose from an average rate of about 15 million units a year during the 1994-1998 period to an annual rate of 17 million in the second half of 1999 and 18.2 million in the first quarter of 2000—the strongest quarter on record. Sales of those vehicles fell back to an annual rate of 15.3 million by December 2000. Domestic manufacturers have

Box 2-2. The Recent Slowdown in Manufacturing

Output from the manufacturing sector has grown much more slowly in recent months, and some monthly indicators point toward further slowing and a significant risk of a recession in that sector. The Congressional Budget Office does not consider the recent weakness to be a strong signal of an overall recession, however. The slowdown may be temporary, and even if the weakness in manufacturing persists, the overall economy may continue to grow.

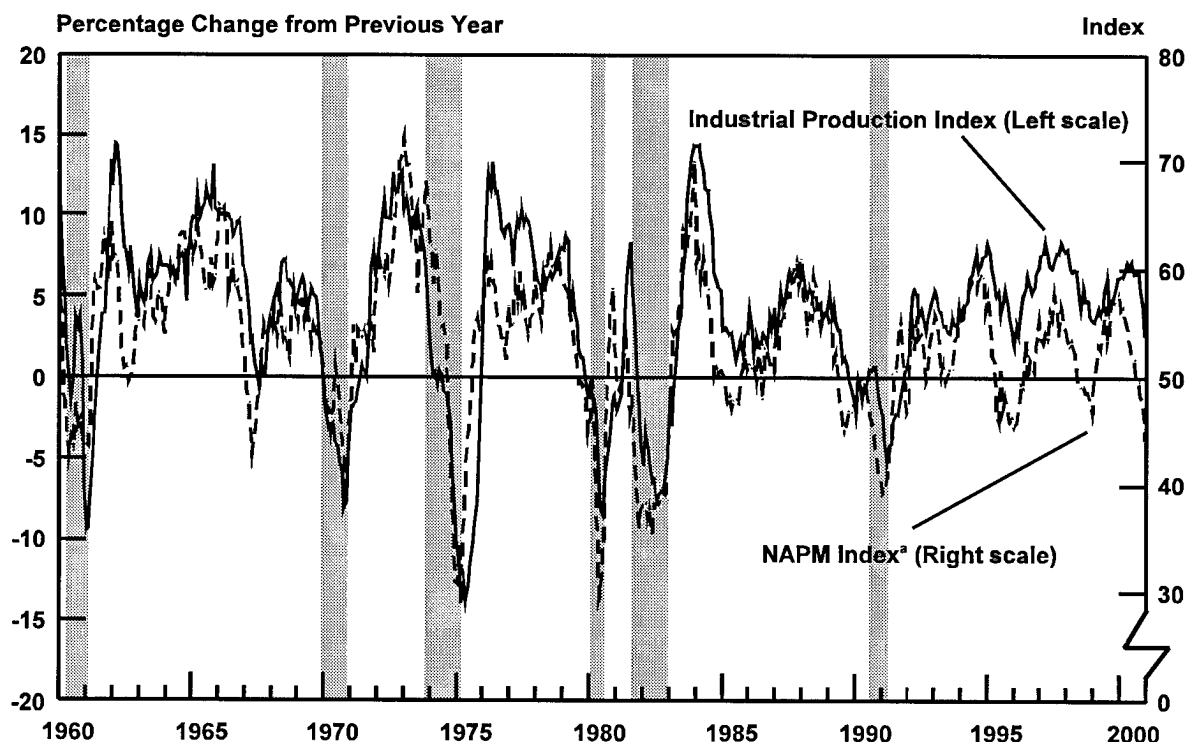
One measure that indicates further slowing in manufacturing is the National Association of Purchasing Managers' (NAPM) index, which dropped sharply in 2000 (see the figure below). Until recent years, the growth of the Federal Reserve's industrial production (IP) index for manufacturing—a measure of manufacturing output adjusted for inflation—would turn negative or be very weak soon after the NAPM index fell below a value of 50. That relationship changed during the second half of the 1990s. IP growth remained above 3 percent even when the NAPM index fell well below 50. The change resulted from the growth in the manufacturing sector's output of information technology, particularly semiconductors. In spite of that change in the

relationship between the two indicators, the recent drop in the NAPM index is a strong signal of further slowing in the growth of manufacturing output.

A moderate recession in manufacturing would not necessarily imply a recession for the economy as a whole, however. The IP index was flat or fell over a number of four- or five-month periods during the 1980s and 1990s (in 1986, 1993, 1995, and 1998) when the economy was not in recession. Moreover, the output of the manufacturing sector accounts for only about 16 percent of gross domestic product, so continued strength in the output of services can offset weakness in manufacturing.

Furthermore, any recession in manufacturing could be brief. Since firms have developed better inventory information and control systems over the years, manufacturers may be able to realign output with demand quickly. In addition, manufacturing output could pick up soon because the recent easing of interest rates by the Federal Reserve may spur demand for and production of manufactured goods.

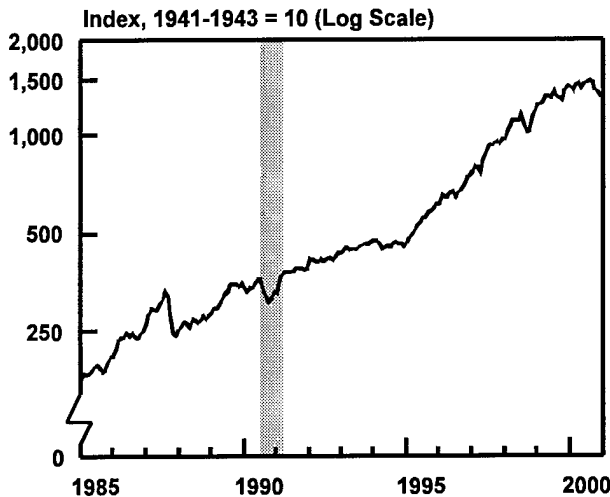
Indicators of Change in Total Manufacturing



SOURCES: Congressional Budget Office; Federal Reserve Board; National Association of Purchasing Managers.

- a. The National Association of Purchasing Managers' (NAPM) index is a composite measure of the seasonally adjusted diffusion indexes for five indicators that reflect current activity. Diffusion indexes indicate what percentage of people surveyed said that current business conditions were favorable, unfavorable, or unchanged. A reading above 50 indicates that the manufacturing sector is generally expanding; below 50, that it is generally contracting.

Figure 2-10.
The S&P 500 Index of Stock Prices



SOURCES: Congressional Budget Office; Standard & Poor's.

scaled back their production plans to reduce inventories of unsold vehicles.

The slowdown in consumer spending also reflected a weakening in some fundamental factors that determine such spending, including consumers' expectations about future business conditions. Before 2000, a significant share of the strength in consumer spending reflected a rise in consumers' wealth, much of which resulted from sharp increases in stock prices (see Figure 2-10). Correspondingly, the decline in stock prices in 2000 reduced consumers' wealth. In addition, the growth of employment slowed in 2000, which may have moderated consumers' expectations about their income growth. Higher interest rates on consumer loans may also have dampened spending slightly. Rising energy prices may have been another factor, as well as the early arrival of winter in several parts of the country (see Box 2-3). Those two factors ran up consumers' heating bills and kept some shoppers from stores during the crucial holiday season.

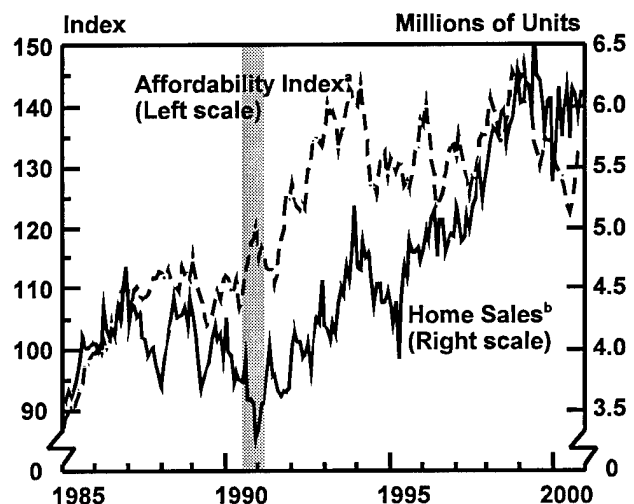
Investment in housing also slowed in the second half of last year. After growing at an average annual rate of 2.2 percent in the first half of 2000, real residential investment fell by 10.6 percent in the third quarter of 2000 and appears to have remained weak through the end of the year. That drop probably reflected many of the same factors that slowed consumer spending; it also resulted from a decline in the

affordability of housing in the first half of 2000 that occurred because of rapidly rising housing prices and higher mortgage rates (see Figure 2-11).

Business Fixed Investment

Like consumer spending, spending by businesses on structures, equipment, and software—known as business fixed investment (BFI)—weakened in the second half of 2000 after a strong showing in the first half. The growth of real BFI slowed to an annual rate of 7.7 percent in the third quarter of 2000 after averaging 17.7 percent in the first half of the year. Spending on equipment and software accounted for all of that slowdown in the third quarter, and data on shipments suggest that equipment spending remained subdued in the fourth quarter. Spending on nonresidential construction, however, was strong last year, buoyed in part by a sharp rise in exploration for petroleum and natural gas in response to higher energy prices.

Figure 2-11.
Home Sales and Affordability



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of the Census; National Association of Realtors.

- A value of 100 for the affordability index indicates that a family with the median income can afford to buy the median-priced home, given prevailing mortgage rates.
- Sales of new and existing single-family homes.

Some of the slowdown in BFI in the second half of last year may have been a rebound from the unusually fast growth of equipment spending in the first half of 2000. But part of the slowdown may prove more lasting if it reflects weaker business confidence and a higher cost of capital. The growth of corporate

profits slowed in the second half of last year, and credit and equity markets tempered their willingness to assume risk. An important source of uncertainty in CBO's short-term forecast is the degree to which financial markets will reduce their lending and further weaken investment by businesses.

Box 2-3.

Recent Developments in Energy Markets

Prices for crude oil, petroleum products, and natural gas shot up in 2000. The markets for different energy products—especially crude oil and petroleum products—influence one another, but each market is affected by special and independent circumstances. The recent price increases probably will not continue beyond this winter. Developments in oil markets, in fact, point strongly to the prospect of lower prices this year.

Crude Oil

Ironically, the broad swings in oil prices seen in recent years stem largely from efforts by the Organization of Petroleum Exporting Countries (OPEC) to keep prices within a narrow range. The Asian financial crisis of 1997 and 1998 caused a severe drop in demand for oil in that region and a collapse of oil prices—to less than \$15 per barrel in mid-1998. The drop in demand prompted OPEC producers to curtail their output, and the prospect of falling prices led oil companies to pare down their petroleum inventories. In 1999, however, rebounding Asian demand, solid economic growth in the United States and Europe, and some extreme summer weather combined to push demand for oil beyond OPEC's expectations. With low stocks of oil and growing demand, prices rebounded in 1999 and 2000. They reached 10-year highs in the second half of 2000 before OPEC made its first efforts to increase production.

As of January, oil production once again appears to exceed demand, and the easing of oil prices that occurred in the last quarter of 2000 looks likely to continue. However, events such as production cutbacks by OPEC, a cold winter, or adverse political developments in the Middle East could keep prices from falling much farther in the near term.

Petroleum Products

Although prices for refined petroleum products in the United States have largely followed the cycle of world oil prices, special circumstances pushed up heating oil prices last fall by even more than the increase in crude oil prices. Heating oil is produced in conjunction with gasoline, so the low levels of gasoline production last year—coupled with a late-winter surge in demand for heating oil in early 2000—made it difficult to rebuild heating oil stocks for the current winter. Demand for heating oil to rebuild U.S. stocks and meet needs in Europe (which experienced early cold weather) contributed to the jump in prices for heating oil that occurred in September 2000.

Below-average levels of petroleum stocks in the United States and worldwide—and very low stocks of U.S. heating oil—point to the possibility of further large increases in prices should demand this winter prove extreme. Through early January, this winter had been colder in the United States than the past three winters. If such cold weather continues, prices may remain high for a few more months. A further concern is that uncertainty about the use of the government's new Northeast Petroleum Reserve could complicate oil companies' decisions about inventories and exacerbate pressures on heating oil prices.

Natural Gas

Because it is difficult in the short run to substitute between natural gas and petroleum products, the market for natural gas is largely independent of the world market for crude oil. Nevertheless, natural gas prices also rose sharply in 2000. The producer price index for residential natural gas has soared by 30 percent since the spring of 2000 (see the figure at right). The forces that caused that increase had been building for many

Financial Markets and Monetary Policy

Financial markets retrenched in the second half of 2000, as expectations about the future growth of corporate earnings declined and concerns about the qual-

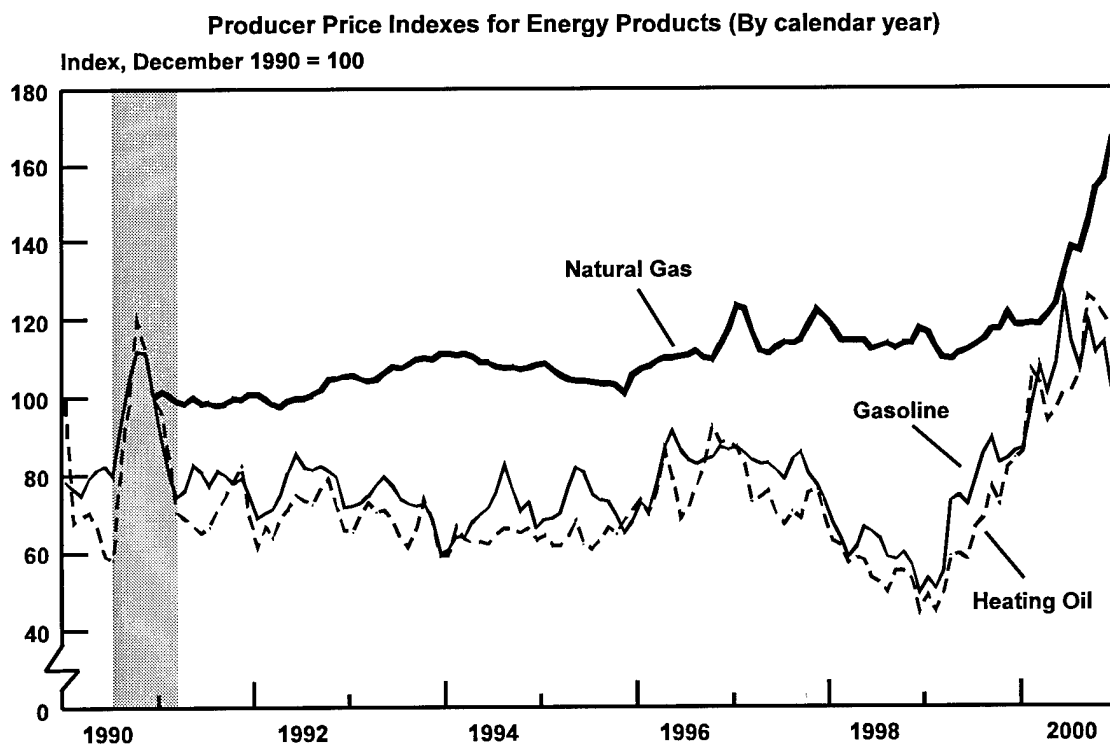
ity of credit rose. The Standard and Poor's (S&P) 500 stock price index, which summarizes the stock market values of major U.S. corporations, fell at an annual rate of 17 percent between June and December of last year, after growing at an annual rate of almost 15 percent in 1999 and the first half of 2000.

years, including low levels of exploration for natural gas and growing demand for gas by electric utilities and homes—both a response to 15 years of low prices. During the summer of 2000, record high temperatures and demand for cooling across the central southern states and problems with electricity restructuring in California added to the demand for natural gas and impeded efforts to build underground gas reserves. (Electricity producers burn gas in turbines to generate power to meet peak-period demand.)

In response to the high prices, however, natural gas exploration and development have risen sharply. Thus, some additional supplies should be reaching the market soon. That extra supply should help limit further price increases in the near future and perhaps—as futures markets for natural gas expect—cause prices to decline.

Implications for the Economy

So far, developments in energy markets appear unlikely to dampen U.S. economic growth significantly, though they will have some effect. In general, consumers and businesses have been able to shift to lower-cost sources of energy or conserve enough that basic economic activity has not been curtailed, except in isolated cases. However, because half of the petroleum consumed in the United States is imported, the increase in oil prices will depress economic activity slightly. The value of net petroleum imports last year was nearly twice as high as in 1999. That increase was similar to a \$60 billion excise tax and will dampen real consumption.



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

Moreover, the share prices of many high-technology firms collapsed. On average, the businesses listed by the Nasdaq stock market, which include many well-known high-technology companies, lost about half of their market value between March 2000 and the end of the year. High-technology start-ups lost much of their attractiveness to investors and faced greater difficulty raising funds in capital markets.

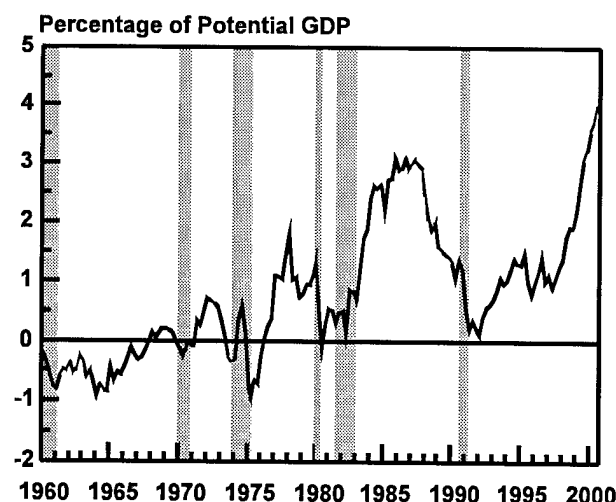
Credit markets have also become more cautious in their lending. Commercial banks tightened their standards and terms of lending to businesses last year in the face of rising delinquencies and losses on business loans. As a consequence, the growth of business loans slowed, although to a pace still consistent with continued economic expansion. The spread between the interest rates on top-quality corporate bonds and lower-quality bonds increased last year, indicating that lenders' perception of the risk of default increased. The corporate bond market also pulled back from new issues of risky debt such as high-yield (or junk) bonds in the face of greater defaults; the amount of funds raised in the high-yield market was sharply lower in 2000 than in 1999. Although some of the pullback by banks and the bond market may reflect a better assessment of risk that will enhance the productivity of business investment in the long run, there is always a danger that lenders will overreact and sharply curtail funding to low-risk firms.

Against that backdrop of tighter supply in credit and capital markets and a slowdown in economic activity, the Federal Reserve eased monetary policy early this year. On January 3, it cut the target for the federal funds rate from 6.5 percent to 6 percent. The size and timing of that move surprised financial markets. In contrast to its usual practice, the Federal Reserve had not signaled its intentions to the markets ahead of time. Before the cut, the futures market for federal funds had expected the Federal Reserve to drop its target gradually to 6 percent by the end of March and to 5.5 percent by midyear. After the January cut, the futures market lowered its expectation for the federal funds rate to 5 percent by midyear.

Net Exports

The trade deficit continued to grow in the third quarter of 2000, widening to a record \$389.5 billion, or 3.9 percent of GDP (see Figure 2-12). Preliminary

Figure 2-12.
Nominal Trade Deficit



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

data indicate that it remained large in the fourth quarter.

The uninterrupted rise in the trade deficit since 1997 has resulted mainly from the gap between economic growth rates in the United States and abroad as well as from the persistent strength of the U.S. dollar. The deceleration in U.S. growth in the second half of last year did not help reduce that deficit because trade adjusts relatively slowly to changes in growth and because foreign economic growth also slowed. For example, economic recovery in Japan and other Asian countries, which showed some promise in the first half of 2000, faltered again in the second half under the weight of higher oil prices and slower U.S. demand for Asian goods. The growth of European economies also slowed in the second half of last year for similar reasons as well as because of higher interest rates.

The fragility of foreign recoveries and a relatively more favorable investment environment in the United States kept the dollar strong last year, despite the persistence of the trade deficit and a consequent rise in U.S. external indebtedness. The strength of the dollar has continued to keep the prices of U.S. exports high relative to those of imports, constraining U.S. exports and stimulating imports.

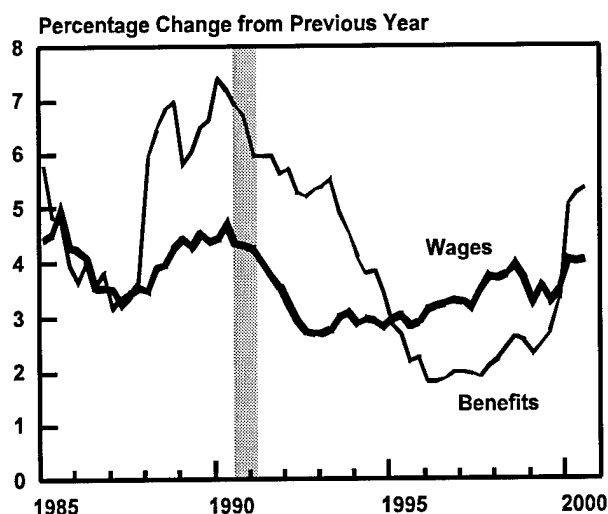
Government Spending

Direct government spending for goods and services—by both the federal government and state and local governments—has supported strong growth over the past year. Real federal government spending for goods and services surged back during the past two years after a prolonged contraction between 1990 and 1998, and state and local spending, although easing somewhat in recent quarters, has been strong for more than four years.

Labor Markets and Wage and Price Inflation

Labor markets continued to be extremely tight in the second half of 2000 despite the slowdown in growth of GDP; the unemployment rate remained at a remarkably low 4.0 percent. In line with tight labor markets, labor compensation—including benefits as well as wages and salaries—grew faster in 2000 than the year before (see Figure 2-13). An important reason for the spurt in benefit costs has been an acceleration in the cost of medical benefits, which analysts expect to continue this year.

Figure 2-13.
Employment Cost Indexes for Wages and Benefits



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

The growth of the broad price indexes used to measure inflation generally showed little change in the second half of 2000. The core rate of inflation (the growth rate of the consumer price index excluding food and energy) inched up slightly, but the growth rate of the overall CPI did not. The difference in behavior between the two rates reflects a deceleration in the average growth of the energy component of the CPI. Although economic activity has slowed, the economy's continued high level of resource use may put more pressure on prices in the near future.

CBO's Short-Term Forecast

Those various recent economic developments suggest that the slowdown that many forecasters expected has arrived. CBO anticipates that in 2001 and 2002, real GDP will grow well below the 4.6 percent rate of the past two years and below the estimated potential growth rate of GDP discussed earlier. CPI inflation is expected to fall from 3.4 percent in 2000 to 2.7 percent in 2001, reflecting CBO's belief that energy prices will remain lower than last autumn's levels (see Table 2-6). In addition, slower growth of economic activity than in recent years will probably contribute to lower interest rates. A major risk to CBO's short-term forecast is that consumers and businesses will curtail their spending much more than CBO assumes, leading to a recession this year. Alternatively, the growth of consumption and investment could pick up again from its modest rates of late last year, producing faster economic activity than CBO anticipates.

The current CBO forecast for growth and inflation in the next two years is about the same as that of the *Blue Chip* consensus, an average of approximately 50 private-sector forecasts (see Table 2-7). Compared with the *Blue Chip* consensus, CBO's forecast for growth of real GDP is slightly lower for 2001 and about the same for 2002, and its forecasts for inflation are slightly higher for both years. CBO's forecasts for interest rates are noticeably lower than those of the *Blue Chip* consensus, but that is probably because the latter did not fully reflect the Federal Reserve's surprise interest rate cut of early January.

CBO's current forecast for 2001 is weaker than its previous forecast, published last July (see Table 2-4 on page 39). The growth rate of real GDP is substantially lower, the unemployment rate is significantly higher, and interest rates are much lower. The forecast for CPI inflation is virtually unchanged, whereas the forecast for inflation in the GDP price index is slightly higher.

Growth of Real GDP

CBO's forecast for the growth of real GDP over the next two years reflects the view that the factors stimulating overall demand during the second half of 1999 and the first half of 2000 have waned. Investors' expectations of the growth of corporate profits, which boosted stock prices and encouraged greater lending for business investment, provided much of that stimulus. Higher stock prices in turn spurred consumer spending. Favorable rates of return in U.S. capital markets also encouraged foreigners to invest

in the United States, which further lowered the cost of investment for U.S. businesses.

Investors' expectations were deflated in the second half of last year, when slower profit growth and rising defaults on business loans and high-yield bonds began to appear. A less bullish stock market will continue to limit the growth of consumers' wealth and thus their spending. A higher cost of equity capital, plus stricter lending standards by banks and bond investors, will dampen investment by keeping the cost of funds higher and their availability less than in recent years. Moreover, because the economic outlook abroad has sagged, the trade deficit is unlikely to improve noticeably over the next two years despite moderate growth in the United States.

A major risk to that forecast is that the growth of spending may slow more than CBO assumes. Consumers may retrench drastically in response to the drop in their stock market wealth and to lower expectations about their future income. Businesses

Table 2-6.
CBO's Forecast for 2001 and 2002

	Estimated 2000	Forecast	
		2001	2002
Fourth Quarter to Fourth Quarter (Percentage change)			
Nominal GDP	6.1	5.0	5.6
Real GDP	3.7	2.6	3.4
GDP Price Index	2.4	2.3	2.1
Consumer Price Index ^a			
Overall	3.4	2.7	2.8
Excluding food and energy	2.6	2.8	2.8
Calendar Year Average			
Real GDP (Percentage change)	5.1	2.4	3.4
Unemployment Rate (Percent)	4.0	4.4	4.5
Three-Month Treasury Bill Rate (Percent)	5.8	4.8	4.9
Ten-Year Treasury Note Rate (Percent)	6.0	4.9	5.3

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

a. The consumer price index for all urban consumers.

Table 2-7.
Comparison of CBO and *Blue Chip* Forecasts for Calendar Years 2001 and 2002

	Estimated 2000 ^a	Forecast	
		2001	2002
Nominal GDP (Percentage change)			
<i>Blue Chip</i> high 10		5.5	6.1
<i>Blue Chip</i> consensus		4.8	5.4
CBO	7.3	4.7	5.6
<i>Blue Chip</i> low 10		3.9	4.8
Real GDP (Percentage change)			
<i>Blue Chip</i> high 10		3.1	4.0
<i>Blue Chip</i> consensus		2.6	3.4
CBO	5.1	2.4	3.4
<i>Blue Chip</i> low 10		2.0	2.8
GDP Price Index (Percentage change)			
<i>Blue Chip</i> high 10		2.5	2.4
<i>Blue Chip</i> consensus		2.1	2.0
CBO	2.1	2.3	2.1
<i>Blue Chip</i> low 10		1.7	1.4
Consumer Price Index ^b (Percentage change)			
<i>Blue Chip</i> high 10		3.1	3.0
<i>Blue Chip</i> consensus		2.6	2.5
CBO	3.4	2.8	2.8
<i>Blue Chip</i> low 10		2.2	1.9
Unemployment Rate (Percent)			
<i>Blue Chip</i> high 10		4.6	4.9
<i>Blue Chip</i> consensus		4.4	4.5
CBO	4.0	4.4	4.5
<i>Blue Chip</i> low 10		4.2	4.2
Three-Month Treasury Bill Rate (Percent)			
<i>Blue Chip</i> high 10		5.8	5.9
<i>Blue Chip</i> consensus		5.4	5.4
CBO	5.8	4.8	4.9
<i>Blue Chip</i> low 10		4.9	4.9
Ten-Year Treasury Note Rate (Percent)			
<i>Blue Chip</i> high 10		5.9	6.2
<i>Blue Chip</i> consensus		5.3	5.6
CBO	6.0	4.9	5.3
<i>Blue Chip</i> low 10		4.9	5.1

SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board; Aspen Publishers, Inc., *Blue Chip Economic Indicators* (January 10, 2001).

NOTE: The *Blue Chip* high 10 is the average of the 10 highest *Blue Chip* forecasts; the *Blue Chip* consensus is the average of all 50 *Blue Chip* forecasts; and the *Blue Chip* low 10 is the average of the 10 lowest *Blue Chip* forecasts.

a. CBO's estimate for 2000.

b. The consumer price index for all urban consumers.

may slash their investment plans if they grow more wary or may be forced to cancel those plans if a shortage of capital and credit occurs. Foreign investors may become disenchanted with the U.S. economy, perhaps because of its growing trade deficit, and move their capital to other countries, thus raising interest rates and further curtailing spending in the United States. A greater slowdown in the U.S. economy would also be felt in the rest of the world as the United States imported fewer goods.

Alternatively, since unemployment is low and real wage growth has remained strong, consumption may rebound. If so, manufacturers could quickly sell off excess inventories, employment and investment growth could bounce back, and overall economic growth would be faster than CBO anticipates.

Inflation and Unemployment

CBO expects that a drop in energy prices will slow the rate of consumer price inflation this year to 2.7 percent from 3.4 percent last year (see Table 2-6). However, core CPI inflation will edge upward to 2.8 percent from 2.6 percent last year because the high level of resource use will continue to put upward pressure on the core rate of inflation. The unemployment rate is projected to rise over the next two years, reflecting CBO's view that the growth of GDP will be less than CBO's estimate of the growth of potential GDP.

If the growth of labor productivity slows dramatically from its rapid pace of recent years, inflation may increase by more than CBO anticipates. That

recent rapid growth has held down inflation and costs per unit of labor in the face of strong demand for labor and output. A sudden drop in the growth of productivity could increase businesses' costs and the prices of their products. In those circumstances, the Federal Reserve would probably feel compelled to raise interest rates to preempt an increase in inflation, thus slowing the economy even more.

A sudden drop in the exchange value of the U.S. dollar would also lead to higher inflation than CBO expects. The large U.S. current-account deficit and international indebtedness indicate that the dollar eventually needs to fall to help lower that deficit. Although the dollar declined at the end of 2000, it is still strong relative to its average of the 1990s. The fragility of economic recoveries in many countries, however, suggests that the dollar may remain strong for a while longer despite weaker economic activity in the United States.

Interest Rates

CBO believes that interest rates in 2001 and 2002 will, on average, be lower than last year's levels. Slower growth of aggregate demand is likely to continue to contribute to lower interest rates this year. Indeed, financial markets have reduced their expectations of the federal funds rate for the first part of 2001, indicating that they believe that the Federal Reserve will relax monetary policy further this year. However, if inflation picks up more than the markets expect, interest rates will be higher than they anticipate.

The Revenue Outlook

The Congressional Budget Office estimates that total federal revenues will exceed \$2.1 trillion in fiscal year 2001 if current policies remain unchanged, marking the ninth consecutive year in which the growth of revenues has outstripped the growth of the nation's gross domestic product (see Figure 3-1). Revenues are expected to grow more slowly than GDP (nominal) through 2007 and then faster than GDP through 2011. In that year, revenues are projected to be \$3.4 trillion, or about 20.4 percent of GDP.

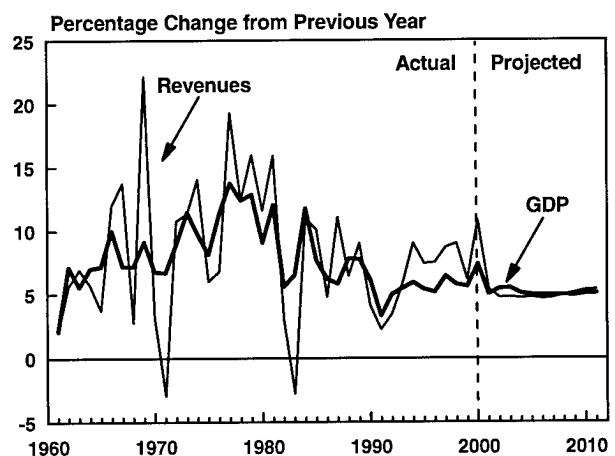
CBO expects that the growth of receipts will be slower than the rapid pace of the past few years. From 1994 to 2000, revenues rose at an average annual rate of 8.3 percent, much faster than GDP. In 2000, at 10.8 percent, the growth of receipts was faster than in any year since 1987 (when growth was subject to a one-time boost from the Tax Reform Act of 1986). Consequently, as a share of GDP, revenues rose from 18.1 percent in 1994 to a post-World War II high of 20.6 percent in 2000—a level exceeded only once, in 1944 (see Figure 3-2).

Although slowing in 2001, the growth of receipts, projected at 5.4 percent over the previous year, still outpaces the projected growth of GDP, pushing the ratio of receipts to GDP to 20.7 percent in 2001, which is expected to become the new post-war peak. In 2002, the growth of receipts is projected to slow further, to 4.7 percent—less than the growth of GDP—so as a percentage of GDP, receipts will slip to 20.5 percent. The growth of receipts remains at about that rate through 2007 but as a percentage of GDP continues to fall, to 20.2 percent.

After 2007, the growth of receipts is expected to rise, to 5.4 percent in 2011, and to increase relative to GDP, reaching 20.4 percent by the end of the projection period.

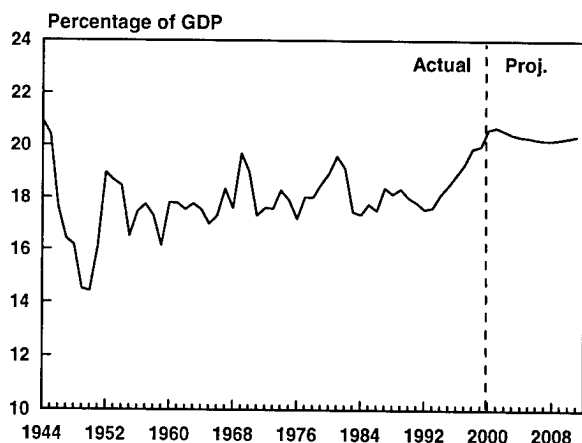
The current revenue outlook is \$919 billion higher through 2010 than CBO projected last July (see Table 3-1). About seven-eighths of that increase—or about \$800 billion—stems from changes in CBO's economic forecast, which causes a boost in receipts from individual and corporate income and social insurance taxes. The net effect of recently enacted legislation—primarily the Community Renewal

Figure 3-1.
Annual Growth of Federal Revenues and GDP,
Fiscal Years 1960-2011



SOURCE: Congressional Budget Office.

Figure 3-2.
Total Revenues as a Share of GDP,
Fiscal Years 1944-2011



SOURCE: Congressional Budget Office.

Tax Relief Act of 2000 (H.R. 5662) and the FSC (Foreign Sales Corporation) Repeal and Extraterritorial Income Exclusion Act of 2000 (H.R. 4986)—reduces projected revenues by about \$37 billion over the 10 years from 2001 to 2010. The remainder of the increase since July results from a number of adjustments in the methodology and assumptions that determine how much tax is generated by the tax base. Those technical revisions total \$153 billion over the 10 years.

Federal revenues consist of individual income taxes, corporate income taxes, social insurance taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. Individual income taxes produce about half of total revenues, an amount equal to roughly 10 percent of GDP (see Table 3-2 and Figure 3-3). Corporate income taxes contribute about a tenth of revenues, equaling approximately 2 percent of GDP. Social insurance taxes (including Social Security taxes, which are off-budget) are the second largest source of revenues, equaling about a third of total receipts and less than 7 percent of GDP. Other taxes and miscellaneous receipts, including profits from the Federal Reserve System, make up the balance.

- o *Individual income tax receipts*, bolstered primarily by higher realizations of capital gains and increases in the effective tax rate, have

fueled the rapid growth of revenues relative to GDP over the past few years. Because those trends are not expected to continue, the growth of revenues will slow over the next few years. The higher realizations of capital gains stemmed largely from the sharp rise in stock prices. Increases in the effective tax rate were the result of growth in real incomes generally, which increased the amount of income taxed at higher marginal tax rates (the tax rates that apply to an additional dollar of income), and of a rapid rise in income among high-income taxpayers, who are taxed at higher marginal rates.

Although the growth of individual income tax receipts is projected to slow as capital gains in particular play a smaller role in boosting receipts, higher nominal income raises the average effective tax rate as the number of taxpayers affected by the alternative minimum tax (AMT) increases and growth in real income subjects more income to higher marginal tax rates. For the first half of the projection period of fiscal years 2001 to 2011, the depressing effect of slackening capital gains overwhelms the effect of a rising effective tax rate, lowering individual income tax receipts as a share of GDP. Thereafter, the increase in the effective tax rate is the more important effect, so the share of GDP rises. That pattern tends to drive the ratio of total receipts to GDP, largely dominating the effects of corporate income taxes and excise taxes, which tend to fall relative to GDP over the 11 years.

- o *Corporate income taxes* contributed somewhat to the increase in revenues in the 1990s, as profits improved over their performance of the 1970s and 1980s. But from 2001 to 2011, profits are projected to recede from the unusually high levels of the late 1990s. As a result, projected corporate income tax receipts as a percentage of GDP are expected to fall somewhat from 2.1 percent to 1.9 percent.
- o *Social insurance taxes*, consisting largely of taxes for the Medicare program and Social Security, have changed little as a share of GDP in the past decade. From 2001 to 2011, they are

also expected to remain essentially stable at about 6.6 percent of GDP.

- o *Excise taxes*, although a relatively small revenue source, are expected to reduce receipts as a share of GDP during the projection period, dropping from 0.7 percent to 0.6 percent of GDP from 2001 to 2011. That share falls because many excise taxes are levied per unit or transaction rather than as a percentage of value.

Receipts, therefore, tend to rise mainly with increases in real, rather than nominal, GDP.

- o All other revenue sources—estate and gift taxes; customs duties; and miscellaneous receipts, including receipts from the Federal Reserve System—are expected to remain just under 1 percent of GDP throughout the projection period.

Table 3-1.
Changes in CBO's Projections of Revenues Since July 2000 (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2010
July 2000 Projection of Revenues	2,109	2,202	2,290	2,380	2,486	2,594	2,706	2,826	2,960	3,102	n.a.
Legislative Changes											
Individual Income	-1	-1	-2	-2	-2	-2	-3	-3	-3	-3	-22
Corporate Income	0	-1	-1	-1	-1	-1	-2	-2	-2	-2	-14
Other	<u>-1</u>	<u>-1</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>-1</u>
Subtotal	-2	-2	-3	-3	-3	-4	-4	-5	-6	-5	-37
Economic Changes											
Individual Income	-4	-1	10	22	31	41	51	61	72	84	366
Corporate Income	4	15	24	29	31	33	36	42	49	58	319
Social Insurance	-3	-2	2	8	12	16	20	26	30	33	143
Other	<u>-4</u>	<u>-5</u>	<u>-4</u>	<u>-3</u>	<u>-2</u>	<u>-2</u>	<u>-1</u>	<u>-1</u>	<u>-2</u>	<u>-2</u>	<u>-26</u>
Subtotal	-6	7	32	56	72	88	106	128	148	173	802
Technical Changes											
Individual Income	25	20	12	8	5	2	0	-2	-4	-6	60
Corporate Income	11	11	10	10	10	9	8	8	7	6	90
Other	<u>-3</u>	<u>-1</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>0</u>	<u>1</u>	<u>2</u>	<u>1</u>	<u>2</u>	<u>4</u>
Subtotal	33	29	24	20	15	11	9	7	4	2	153
Total Changes											
All Sources	25	34	53	73	84	95	110	129	146	170	919
January 2001 Projection of Revenues	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

Table 3-2.
CBO's Projections of Revenues (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
In Billions of Dollars												
Individual Income	1,004	1,076	1,125	1,176	1,230	1,289	1,354	1,424	1,500	1,583	1,675	1,774
Corporate Income	207	215	217	226	236	246	255	264	276	289	303	319
Social Insurance	653	686	725	762	797	840	879	921	963	1,010	1,059	1,110
Excise	69	71	74	76	78	81	83	86	88	91	94	97
Estate and Gift	29	30	32	34	35	36	37	39	43	46	48	52
Customs Duties	20	21	23	24	25	26	27	27	28	29	30	31
Miscellaneous	43	36	41	44	51	52	54	55	57	59	61	63
Total	2,025	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447
On-budget	1,545	1,630	1,703	1,782	1,864	1,950	2,040	2,136	2,243	2,360	2,489	2,628
Off-budget ^a	481	504	532	561	589	620	649	680	712	746	782	819
As a Percentage of GDP												
Individual Income	10.2	10.4	10.3	10.2	10.2	10.2	10.2	10.2	10.3	10.3	10.4	10.5
Corporate Income	2.1	2.1	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Social Insurance	6.6	6.6	6.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Excise	0.7	0.7	0.7	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Estate and Gift	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
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
Miscellaneous	0.4	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total	20.6	20.7	20.5	20.4	20.3	20.3	20.2	20.2	20.2	20.3	20.3	20.4
On-budget	15.7	15.8	15.7	15.5	15.5	15.4	15.4	15.3	15.3	15.4	15.5	15.5
Off-budget ^a	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.8

SOURCE: Congressional Budget Office.

a. Social Security.

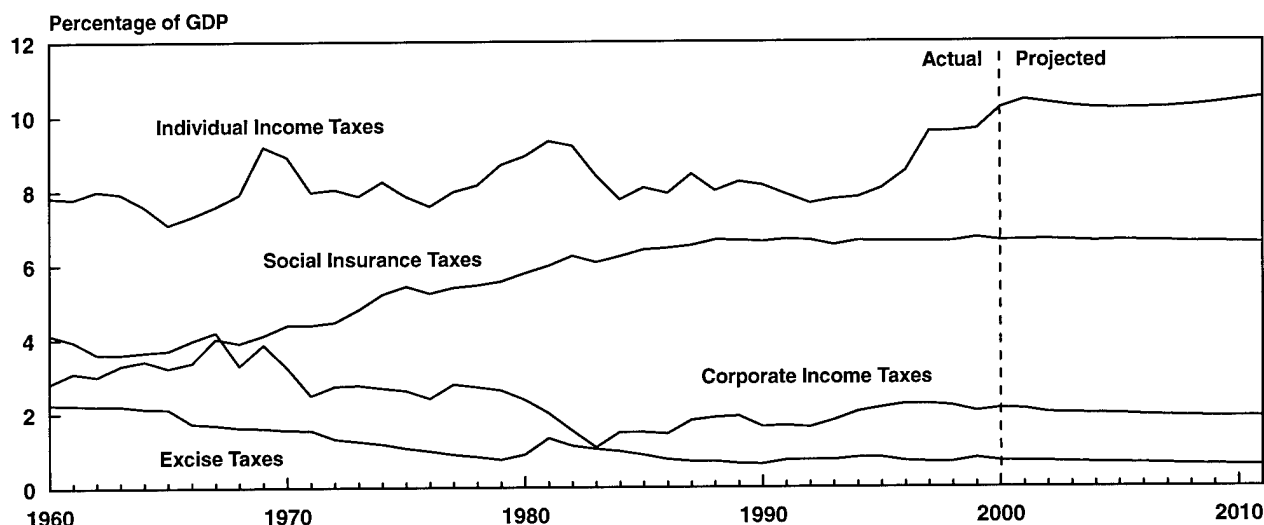
Individual Income Taxes

Individual income taxes account for most of the recent rise in revenues as a percentage of GDP. From 1993 to 1998, those receipts averaged growth of more than 10 percent a year. In fiscal year 1999, partly because of the tax cuts enacted in the Taxpayer Relief Act of 1997, they slowed to their lowest rate of increase since 1992. But in fiscal year 2000, they jumped more than 14 percent, reaching their highest share of GDP ever. Their share is expected to peak in 2001 and then to slowly recede as some of the fac-

tors that caused the rise moderate. But in 2006, the factors tending to boost the share of individual tax receipts begin to dominate, so by 2011, those receipts as a percentage of GDP reach a new historical peak.

Individual income tax projections over the 2001-2010 period are about \$400 billion higher than in July. More than \$350 billion of that change is due to the revised economic forecast. About \$60 billion of the increase is from technical changes, most importantly revisions in the capital gains projection, adjustments for unexplained higher-than-expected tax collections since July, and some minor changes in

Figure 3-3.
Revenues, by Source, as a Share of GDP for Fiscal Years 1960-2011



SOURCE: Congressional Budget Office.

CBO's methodology. Legislation reduced the projections by about \$20 billion.

Sources of Recent Growth in Individual Income Taxes

Historically, individual income taxes have tended to grow only slightly faster than GDP, with few exceptions. In 1969, for example, a surtax caused income tax receipts to increase significantly faster than GDP; and before the tax code was indexed, inflation pushed the growth of income tax receipts well above that of the economy by effectively decreasing the levels of real income at which higher tax rates applied. But those phenomena were largely temporary and were followed by years in which the growth of income tax receipts fell below that of GDP. From 1994 to 2000, however, the annual growth of those receipts surpassed that of the economy for reasons unrelated to new tax legislation. In fact, in 1998 and 1999, receipts increased as a percentage of GDP despite new tax breaks concerning children and education.

CBO examined a sample of detailed tax-return data to identify the sources of the recent growth in individual income tax liabilities as a percentage of GDP. Liabilities (what taxpayers determine they owe to the government) roughly translate into receipts

(what the government receives). An analysis of tax years (the years in which the tax liabilities are incurred) 1994 through 1998 attributes the surge to four sources. (As described below, Table 3-3 traces the share of the growth attributable to each of the four sources.)¹

The first significant source of the increase in individual income tax liabilities as a percentage of GDP was the rapid growth of components of GDP that are taxable to individuals. (For more information on the relationship between tax liability, taxable income, and GDP, see Box 3-1.) Taxable personal income—the sum of wages, interest, dividends, proprietors' income, and rental income, as measured in the national income and product accounts (NIPAs)—grew faster than GDP from 1994 to 1998. The resulting rise in the proportion of taxable personal income in GDP raised the tax base for individual income taxes and accounted for roughly 20 percent of the growth of tax liabilities in excess of the growth of GDP over that period.

1. For consistency, the percentage contribution of each of the four sources is calculated using the amount of tax liability that would have accrued if the child and education tax credits that became effective in tax year 1998 had not been enacted.

The next two sources are components of adjusted gross income (AGI)—the actual income base of the individual income tax—which rose more rapidly than taxable personal income. Capital gains realizations, which are not included in either GDP or taxable personal income, account for a large part of the growth in AGI. Between 1994 and 1998, realizations of capital gains nearly tripled, with most of that increase occurring before the cut in tax rates for them in 1997. Taxes on capital gains accounted for roughly 30 percent of the growth of those liabilities relative to the growth of GDP from 1994 to 1998.

Other components of AGI that are not part of taxable personal income or GDP also rose more rapidly than both of those measures—especially retirement income from distributions from 401(k) plans and individual retirement accounts and from taxable Social Security benefits. The growth of the retirement and nonretirement components together accounted for about 6 percent of the increase in liabilities relative to the growth of GDP from 1994 to 1998.

The most significant source of the growth of income taxes relative to GDP was the increase in the effective tax rate. In tax years 1995 to 1998, increases in the effective rate (on income other than capital gains) accounted for more than 40 percent of the growth of liabilities in excess of the growth of GDP. Increases in real income for taxpayers generally placed more income into higher tax brackets. That phenomenon alone accounted for more than half of the increase in income tax liabilities relative to GDP that resulted from the rise in the effective tax rate. The remainder was due to income growth concentrated at the top of the income distribution, which raised the effective tax rate by increasing the proportion of income taxed at the highest rates. Even though no income group was subjected to higher statutory tax rates, a larger share of income accrued to taxpayers with the highest tax rates. (See Figure 3-4.)

Although the proximate causes of the surge in individual income tax receipts can be identified by examining tax filings, the underlying causes are more

Table 3-3.
Shares of Growth of Individual Income Tax Liabilities in Excess of Growth of GDP,
by Source, Tax Years 1995-1998 (In percent)

Source of Growth of Tax Liabilities	1995	1996	1997	1998 ^a	Total, 1995- 1998 ^a
Taxable Personal Income (TPI) Grew Faster Than GDP	21	12	14	33	20
Adjusted Gross Income (AGI) Grew Faster than TPI					
Capital gains taxes grew faster than TPI	21	52	30	15	30
Other AGI grew faster than TPI	14	4	9	2	6
Changes in the Effective Rate on AGI					
Effect of real growth on rate	21	17	27	29	24
Growth in incomes of high-income taxpayers	<u>23</u>	<u>15</u>	<u>20</u>	<u>21</u>	<u>20</u>
Total	100	100	100	100	100
Memorandum:					
Growth of Individual Income Tax Liabilities in Excess of Growth of GDP (Billions of dollars)	27	39	35	40	141

SOURCE: Congressional Budget Office using data from the Internal Revenue Service's *Statistics of Income, 1994-1998*.

a. The estimates of 1998 tax liabilities do not include the child and education credits enacted in the Taxpayer Relief Act of 1997.

Box 3-1. Tax Bases and Tax Liability

The ratio of tax receipts to gross domestic product (GDP) varies for reasons other than changes in tax law. In particular, the bases on which taxes are imposed differ from GDP, and their growth is sometimes faster or slower than that of GDP. Although the bases for taxes on individual and corporate income and social insurance are similar to gross domestic product, they differ from GDP in a number of important respects.

Individual Income Tax Base

Taxable personal income is the first approximation of the individual income tax base. It comprises dividends, interest, wages and salaries, rent, and proprietors' income. It does not include depreciation, indirect business taxes, fringe benefits, or retained corporate profits.

Not all of that income is taxed, however. Some 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 from retirement accounts. 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 from owner-occupied housing—which is not taxable. Consequently, a large amount of interest, dividend, and rental income is excluded from the taxable base of the income tax.

Taxpayers make further adjustments, both additions and subtractions, to taxable personal income to derive *adjusted gross income* (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 to tax-deductible individual retirement accounts and 401(k) programs are excluded, but distributions to retirees from those programs are included. Taxpayers also make a variety of other, smaller adjustments.

Exemptions and deductions are subtracted from AGI to yield taxable income, which is then subject to progressive tax rates (that is, rates that rise as income rises). The resulting tax may then be subject to further adjustments in the form of *credits*, such as the child tax credit for taxpayers with children under 17, which reduce the taxpayers' *tax liability*. 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. Taxpay-

ers then pay the higher of the AMT or the ordinary tax. The ratio of tax liability to AGI is called the *effective tax rate on AGI*.

Corporate Income Tax Base

Corporate income in GDP is calculated on the basis of *economic depreciation*—the dollar value of productive capital assets that have been used up. For tax purposes, however, corporations calculate *book profits*. Those profits are calculated on the basis of *book*, or *tax*, *depreciation*, which is typically more generous than economic depreciation; that is, the capital is assumed to be used up faster than it actually is, allowing firms a greater reduction in their reported (and therefore taxable) profits.

The measure of book profits must then be adjusted to remove profits of the Federal Reserve System, which are counted with corporate profits in the national accounts but as federal revenues, as miscellaneous receipts, in the budget. They are also adjusted to allow for the taxation of U.S. income earned by foreign corporations and the deferral of most foreign income earned by U.S. corporations. Those and other, smaller adjustments yield *taxable income* for corporations. If taxable income is negative (that is, the firm loses money), the loss (within limits) may be carried back or forward to be netted against previous or future taxable income to lower taxes in those other years. A tax rate is applied to determine tax liability, which credits may reduce further. The ratio of corporate taxes to taxable income is the *average tax rate*.

Social Insurance Tax Base

Social insurance taxes, the other big source of receipts, use payroll as their base. Those taxes largely fund Social Security and Hospital Insurance (Part A of Medicare). Social Security taxes are imposed as a percentage of pay up to a *taxable maximum* that is indexed for wage growth in the economy. Medicare's Hospital Insurance taxes are not subject to a taxable maximum.

Despite the many adjustments that must be made to calculate the true tax bases, a ready approximation is the sum of wages and salaries and corporate book profits (see Chapter 2). Those items pick up much of the bases of the individual income, corporate income, and social insurance taxes and therefore constitute the bulk of taxed income.

difficult to discern. In particular, it is difficult to isolate the role of the extraordinary rise in the stock market. The potential role of the stock market in boosting individual income taxes, and in generating receipts from other tax sources, is discussed in more detail below.

Revenues in 2000

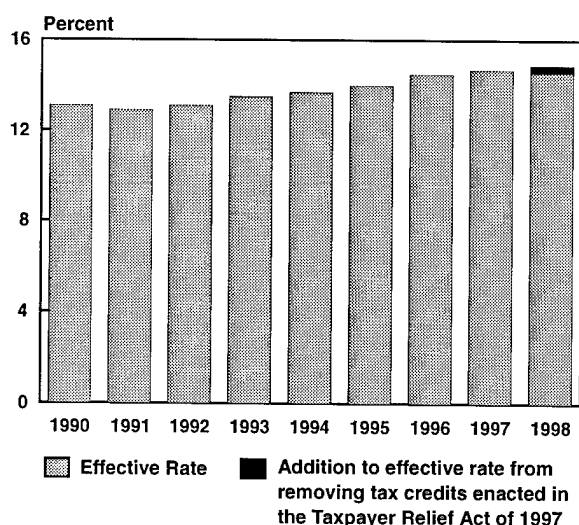
After three years in which revenues exceeded one-year-ahead projections by substantial amounts, CBO's January 1999 revenue projection was largely on target. But in fiscal year 2000, revenues again exceeded CBO's projection by a substantial amount. In January 2000, CBO estimated that 2000 revenues would total \$1,945 billion. However, the end-of-year figure was \$2,025 billion, or \$80 billion more. Individual income taxes accounted for three-quarters of the difference (see Table 3-4). About half of the \$60 billion underestimate of individual income taxes stemmed from higher-than-expected withholding. The other half was from nonwithheld receipts, largely due to the return of the "April surprise" of unexpected final payments in the spring of 2000.

Table 3-4.
Actual Revenues in Fiscal Year 2000, by Source, Compared with CBO's January 2000 Projections (In billions of dollars)

Source	Actual 2000 Reve- nues	CBO's January 2000 Projec- tions	Differ- ence
Individual Income Taxes			
Withheld	780	749	31
Nonwithheld	358	331	27
Refunds	-134	-135	1
Subtotal	1,004	945	60
Corporate Income Taxes	207	189	18
Social Insurance Taxes	653	653	0
Excise Taxes	69	68	1
Other Revenue Sources	92	90	2
Total	2,025	1,945	80

SOURCE: Congressional Budget Office.

Figure 3-4.
Effective Tax Rate on Individual Income, Tax Years 1990-1998



SOURCE: Congressional Budget Office.

Fiscal year 2000 individual income tax receipts jumped 14 percent over their level in fiscal year 1999—not only a substantial increase over the 6.1 percent of the previous year, but more than in any year in the 1990s. As a result, individual income tax receipts exceeded \$1 trillion for the first time and reached a new peak as a percentage of GDP, exceeding 10 percent for the first time (see Table 3-5).

Capital gains realizations are notoriously difficult to predict. They constitute a relatively small percentage of tax receipts, however, which mutes their role in generating large errors in revenue projections (see Table 3-6). The January 2000 estimate of realizations in tax year 1999, which are important for fiscal year 2000 receipts because much of the resulting tax is paid with the subsequent filing of tax returns, was \$500 billion, compared with actual realizations of about \$555 billion.

Expected Pattern of Future Receipts

The growth of individual income tax receipts is expected to slow substantially in 2001, to 7.1 percent. That increase still exceeds the growth of GDP, so in 2001 individual income tax receipts as a percentage of GDP are projected to reach a new peak, 10.4 percent (see Table 3-5). Growth is then expected to slow further to 4.6 percent for three years and then increase each year through the end of the projection period, approaching 6 percent in 2011. So in that year, receipts as a share of GDP are projected to surpass previous highs, reaching 10.5 percent.

A cooling of the economy is partly responsible for the slower growth at the beginning of the projection period: according to CBO's economic forecast, the growth of GDP is expected to slow from 7.3 percent in 2000 to an average of 5.2 percent over the next four years. But other, tax-specific factors also affect the path of individual tax receipts, namely, the four factors described above that explain the rapid growth of receipts during the 1995-1998 period: taxable personal income relative to GDP, capital gains

realizations, taxable retirement income and other components of AGI that are not taxable personal income, and the effective tax rate.

In CBO's 2001-2011 economic projections, taxable personal income decreases as a share of GDP, which tends to slow the growth of receipts and further reduce their share of GDP over time. Much of that decrease in income, however, is in the more lightly taxed interest and dividend components of income rather than in wages and salaries. Consequently, the decline of taxable personal income as a share of GDP only slightly lowers the ratio of total receipts to GDP over the period of 2001 to 2011.

The components of AGI fare differently in the projections. Capital gains realizations gradually resume their historical relation to GDP (with due allowance given to the effect of lower capital gains tax rates on taxpayers' willingness to realize gains), slowing the growth of receipts and reducing their share of GDP. As a result, receipts are about \$120 billion lower in 2011 than they would have been if they maintained the same share of GDP as in 2000.

Table 3-5.
CBO's Projections of Individual Tax Receipts and the Tax Base (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Receipts												
In billions of dollars	1,004	1,076	1,125	1,176	1,230	1,289	1,354	1,424	1,500	1,583	1,675	1,774
As a percentage of GDP	10.2	10.4	10.3	10.2	10.2	10.2	10.2	10.2	10.3	10.3	10.4	10.5
Annual growth rate	14.2	7.1	4.6	4.6	4.6	4.8	5.0	5.2	5.3	5.5	5.8	5.9
Taxable Personal Income												
In billions of dollars	6,952	7,314	7,684	8,066	8,428	8,800	9,193	9,610	10,036	10,478	10,948	11,440
As a percentage of GDP	70.7	70.9	70.6	70.3	69.9	69.5	69.2	69.0	68.7	68.3	68.0	67.6
Annual growth rate	6.7	5.2	5.1	5.0	4.5	4.4	4.5	4.5	4.4	4.4	4.5	4.5
Individual Receipts as a Percentage of Taxable Personal Income												
	14.4	14.7	14.6	14.6	14.6	14.7	14.7	14.8	14.9	15.1	15.3	15.5

SOURCE: Congressional Budget Office.

NOTE: The tax base in this table reflects income as measured by the national income and product accounts rather than as reported on tax returns.

Other components of AGI, especially retirement income, become more important, raising the growth of individual income tax receipts slightly and slowly increasing their share of GDP over time. The growth of retirement income adds roughly \$30 billion to receipts in 2011 relative to what they would have been with a constant receipts-to-GDP ratio.

The effective tax rate rises as a consequence of higher incomes. Because the alternative minimum

tax is not indexed for inflation, higher nominal incomes subject more taxpayers to it. In addition, even though the regular income tax is indexed for inflation, real growth in incomes causes more people to be taxed at higher marginal rates because of the progressive rate structure. Those two factors tend to boost the growth of receipts and cause the receipts-to-GDP ratio to rise over time. The effects of the AMT raise receipts in 2011 by about \$30 billion relative to what they would have been if the receipts-to-GDP ratio

Table 3-6.
Actual and Projected Capital Gains (In billions of dollars)

	Realizations		Liabilities		Receipts ^a		Receipts as a Percentage of Total Individual Income Tax Receipts
	Level (CY)	Percentage Change	Level (CY)	Percentage Change	Level (FY)	Percentage Change	
1990	124	-20	28	-21	32	-14	7
1991	112	-10	25	-11	27	-17	6
1992	127	14	29	16	27	1	6
1993	152	20	36	25	32	20	6
1994	153	0	36	0	36	12	7
1995	180	18	44	22	40	10	7
1996	261	45	66	50	54	36	8
1997	365	40	79	19	72	33	10
1998	455	25	89	12	84	16	10
1999	555	22	109	22	98	17	11
2000	652	18	129	19	118	20	12
2001	652	0	129	0	129	9	12
2002	619	-5	121	-6	125	-3	11
2003	593	-4	116	-5	119	-5	10
2004	574	-3	111	-4	114	-4	9
2005	561	-2	108	-3	110	-3	9
2006	553	-1	106	-2	107	-2	8
2007	551	0	106	-1	106	-1	7
2008	554	0	106	0	106	0	7
2009	560	1	107	1	106	1	7
2010	571	2	109	2	108	1	6
2011	586	2	111	2	110	2	6

SOURCES: Congressional Budget Office; Department of the Treasury.

NOTE: CY denotes data on a calendar year basis, and FY denotes data on a fiscal year basis. Realizations represent net positive long-term gains. Data on realizations and liabilities after 1998 and data on receipts for all years are projected by CBO.

a. Receipts approximate the timing of the payments of liabilities during fiscal years.

remained constant. (Those receipts include the additional receipts from disallowing child and education tax credits against the AMT after 2001.) The effects of real growth on the regular income tax raise 2011 receipts by approximately \$75 billion relative to what they would have been if the receipts-to-GDP ratio remained constant. Although the rapid income growth among high-income taxpayers is not expected to further increase the effective tax rate beyond 2001, those taxpayers are expected to maintain the shares of income they gained during the recent economic boom. As a result of that distributional change, CBO expects that the growth of receipts will slow and the receipts-to-GDP ratio will level off.

Together, the four tax-specific factors will cause the growth of individual receipts to slow and the receipts-to-GDP ratio to decline at first and then rise again. Initially, the pattern of lower capital gains realizations relative to GDP and slower growth of taxable personal income dominates and causes the receipts-to-GDP ratio to fall. Slowly, however, the other effects—the growth of taxable retirement income and the higher effective tax rate resulting from real income growth—cause the ratio to rise after 2005 so that it achieves a new postwar peak by the final year of the projection.

Clearly, the future course of most of these factors is very uncertain. The implications of different courses for the effective tax rate and economic growth for the budget surplus are discussed in Chapter 5.

Corporate Income Taxes

In recent years, corporate income tax receipts have grown more rapidly than the overall economy. From 1995 to 1998, corporate income tax receipts as a percentage of GDP grew to levels not achieved since 1980. That performance was largely driven by very strong growth in corporate profits. In 1999, corporate income tax receipts as a percentage of GDP slipped as profit growth slowed. But in 2000, receipts as a share of GDP rebounded as profits grew strongly again.

CBO projects that from 2001 to 2011, corporate income tax receipts will no longer grow more rapidly

than the economy, and over the next couple of years, they will grow little, if at all (see Table 3-7). Receipts rise very modestly in 2001, mainly because of the lagged effects of the strong profit growth recorded in 2000, and remain about the same in 2002. Corporate receipts begin to grow again in 2003 and continue to grow through 2011. As a percentage of GDP, they fall from 2.1 percent in 2000 and 2001 to 2.0 percent in 2002 through 2004 and 1.9 percent in 2005 and remain at that level thereafter.

The projection of corporate income tax receipts is nearly \$400 billion more over the period of 2001 to 2010 than CBO's July projection. More than \$300 billion of that increase is due to the change in the economic forecast. About \$90 billion of it is due to technical revisions stemming from higher-than-expected corporate tax collections since July.

Projections of corporate income tax receipts are always subject to a great deal of uncertainty, although their relatively small size dampens the effect of that uncertainty on projections of total revenues. Much of the uncertainty stems from the fluctuation of corporate profits. Profits are essentially the residual income in an economy—what remains for the owners of firms after all of the other productive inputs have been compensated. As a result, profits tend to vary much more over time than do other sources of taxable income, making them difficult to project.

Uncertainty also arises from unexpected movements in the average tax rate (total corporate receipts as a percentage of total taxable profits). Those unexpected movements have been greatest following major changes in corporate tax law, such as occurred in 1986.² Over much of the period since then, the average tax rate has been relatively stable, so CBO's projection error has typically resulted from profits that grew at rates different from those anticipated.

The slow growth of corporate income tax receipts in CBO's projection is the result of projected slow growth in taxable profits. A factor responsible for part of the slow growth of profits over the next several years is the projected behavior of book depre-

2. See Congressional Budget Office, *The Shortfall in Corporate Tax Receipts Since the Tax Reform Act of 1986*, CBO Paper (May 1992).

ciation (the allowance for depreciation that firms are permitted for tax purposes). Investment in assets with short depreciable lives for tax purposes has risen sharply in recent years and is expected to rise strongly in 2001 and 2002 and then to slow. Thus, in 2001 and 2002, depreciation for tax purposes is expected to grow rapidly, followed by a gradual moderation in its growth. (The behavior of tax depreciation is the biggest reason that CBO's projections of book profits, which are close to the income measure on which taxes are collected, differ from the commonly used corporate economic profits that appear in the NIPAs as part of GDP.)

CBO makes several adjustments to book profits to produce an even better approximation of the corporate tax base, called "taxable corporate profits." First, CBO's measure excludes corporate profits from foreign subsidiaries of U.S. firms. Taxes on those profits are largely deferred under the corporate income tax until the profits are repatriated to the U.S. parent corporation, and even then they typically are

not taxed because of a credit for foreign taxes paid on that income. Second, CBO's measure excludes profits of S corporations, which are usually smaller firms that qualify for taxation as partnerships. As such, their profits are considered to flow through automatically to the shareholders and are taxed as individual rather than corporate income. Other adjustments include subtracting corporate income taxes paid to state and local governments and the profits of the Federal Reserve System, and adding capital gains realized by corporations.

Book and taxable profits follow a very similar pattern over the projection period, growing at average annual rates of 3.7 percent and 3.8 percent, respectively. Differences occur in some years, but they are minor. CBO projects that through 2002, profits will remain relatively stable in dollar magnitude and therefore decline as a share of GDP. In 2003, profits are projected to start growing noticeably, although more slowly than GDP through 2007. Beyond 2007, profits will remain a relatively stable share of GDP.

Table 3-7.
CBO's Projections of Corporate Income Tax Receipts and the Tax Base (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Corporate Income Tax Receipts												
In billions of dollars	207	215	217	226	236	246	255	264	276	289	303	319
As a percentage of GDP	2.1	2.1	2.0	2.0	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Annual growth rate	12.2	3.8	0.7	4.3	4.5	4.2	3.6	3.6	4.4	4.6	5.1	5.1
Corporate Book Profits												
In billions of dollars	920	929	940	965	1,007	1,043	1,081	1,119	1,174	1,231	1,296	1,369
As a percentage of GDP	9.4	9.0	8.6	8.4	8.4	8.2	8.1	8.0	8.0	8.0	8.0	8.1
Annual growth rate	16.3	1.0	1.2	2.7	4.4	3.6	3.7	3.5	4.9	4.9	5.3	5.6
Taxable Corporate Profits												
In billions of dollars	741	753	769	791	826	855	886	915	959	1,004	1,056	1,115
As a percentage of GDP	7.5	7.3	7.1	6.9	6.9	6.8	6.7	6.6	6.6	6.5	6.6	6.6
Annual growth rate	13.8	1.6	2.1	2.9	4.4	3.5	3.6	3.4	4.8	4.7	5.2	5.5
Corporate Receipts as a Percentage of Taxable Profits												
	28.0	28.6	28.2	28.6	28.6	28.8	28.8	28.9	28.8	28.7	28.7	28.6

SOURCE: Congressional Budget Office.

NOTE: The tax base in this table reflects income as measured by the national income and product accounts rather than as reported on tax returns.

Receipts follow that pattern, so the average tax rate, defined as corporate receipts as a percentage of taxable profits, varies within a relatively narrow band of 28 percent to 29 percent over the projection period.

Social Insurance Taxes

Social insurance taxes follow roughly the same path as wages and salaries (see Table 3-8). The largest components are Social Security (Old-Age, Survivors, and Disability Insurance, or OASDI) taxes and Medicare (Hospital Insurance, or HI) taxes (see Table 3-9). They are calculated as a percentage of covered wages, the former up to a taxable maximum that is indexed to wage growth over time. Consequently, OASDI and HI taxes tend to remain 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 stable. That relative stability is reflected in CBO's projection of social insurance tax receipts, which are expected to remain nearly flat at 6.6 percent of GDP between 2001 and 2011. As a share of wages and salaries, CBO projects that those receipts will drop by 0.1 percent-

age point to 13.8 percent in 2001 and then will decline only very slowly thereafter, to 13.7 percent through 2011. Since the July report, CBO's projection of social insurance receipts has increased by about \$130 billion over 2001 to 2010. That increase is due almost entirely to CBO's revised economic forecast.

Projected social insurance taxes drop as a fraction of wages in 2001 largely because the Treasury Department adjusted its 2000 tabulation of Social Security receipts to reflect previous misestimates, and CBO expects no similar adjustment in 2001. When OASDI and HI taxes are withheld from paychecks and remitted to the Treasury, they are indistinguishable from the individual income tax withholding that is remitted at the same time. The social insurance portions of the payments are estimated and assigned to the respective trust funds on the basis of Treasury's projections. As an accounting of the payments becomes available in the following years, the trust funds are adjusted to make up for any shortfall or excess in the estimates. As a result, lump-sum adjustments of social insurance tax receipts (with offsetting adjustments in individual income tax receipts) may occur in years other than those in which the payments were received and the liabilities in-

Table 3-8.
CBO's Projections of Social Insurance Tax Receipts and Tax Base (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Social Insurance Tax Receipts												
In billions of dollars	653	686	725	762	797	840	879	921	963	1,010	1,059	1,110
As a percentage of GDP	6.6	6.6	6.7	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6	6.6
Annual growth rate	6.7	5.1	5.7	5.1	4.6	5.4	4.7	4.7	4.6	4.9	4.8	4.8
Wages and Salaries												
In billions of dollars	4,696	4,965	5,246	5,535	5,813	6,097	6,392	6,702	7,027	7,368	7,733	8,118
As a percentage of GDP	47.8	48.1	48.2	48.2	48.2	48.2	48.1	48.1	48.1	48.0	48.0	48.0
Annual growth rate	6.7	5.7	5.7	5.5	5.0	4.9	4.8	4.8	4.9	4.8	5.0	5.0
Social Insurance Receipts as a Percentage of Wages and Salaries	13.9	13.8	13.8	13.8	13.7	13.8	13.8	13.7	13.7	13.7	13.7	13.7

SOURCE: Congressional Budget Office.

NOTE: The tax base in this table reflects income as measured by the national income and product accounts rather than as reported on tax returns.

curred. In 2000, such an adjustment increased social insurance receipts by about \$3 billion (an increase in OASDI taxes of \$4 billion and a reduction in HI taxes of \$1 billion). By their nature, these adjustments are unpredictable. Consequently, CBO makes no comparable or offsetting adjustments for 2001 or any other year in the projection period. Hence, social insurance taxes fall slightly as a percentage of wages in 2001 and are unaffected thereafter.

The very slow decline in social insurance receipts as a fraction of wages and salaries after 2001 is driven largely by revenues associated with Social Security and federal retirement programs. Revenues from Social Security retirement programs as a share of wages will fall slightly over the projection period as the portion of wages subject to Social Security taxes continues to decline gradually. Revenues from federal retirement programs—most of the “other retirement” category—will also decline slightly as federal workers under the old Civil Service Retirement System (CSRS), which has higher contribution rates, retire.

The projected level of receipts from the unemployment insurance program (including both the state and federal components of the unemployment tax system) fluctuates somewhat between 2001 and 2011.

The recent extended period of high employment has caused benefit outlays to decline generally in recent years and thereby has permitted states to lower their contributions. For this reason, receipts in 2001 are projected to decline slightly. In 2003, according to CBO’s projection, the Federal Unemployment Tax Act trust fund will reach its statutory cap, causing the federal government to transfer additional revenues to the states, permitting the states to further lower their unemployment tax rates and causing unemployment insurance receipts to decline the next year. Beyond 2004, however, unemployment insurance receipts will gradually increase, at a rate slightly faster than the increase in wages. CBO projects the unemployment rate to gradually increase through 2009, which causes benefit outlays, and the receipts that finance those outlays, to increase faster than wages.

Excise Taxes and Other Sources of Revenue

Excise taxes are expected to continue their long-term decline as a percentage of GDP, falling from their share of 0.7 percent in fiscal year 2000 to 0.6 percent toward the end of the projection period. Most excise

Table 3-9.
CBO’s Projections of Social Insurance Tax Receipts, by Category (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Social Security	481	504	532	561	589	620	649	680	712	746	782	819
Medicare	136	146	155	163	171	180	189	198	208	218	229	240
Unemployment Insurance	28	27	29	30	29	31	32	34	34	37	40	43
Railroad Retirement	4	4	5	5	5	5	5	5	5	5	5	5
Other Retirement	5	4	4	4	4	4	4	4	4	4	3	3
Total	653	686	725	762	797	840	879	921	963	1,010	1,059	1,110

SOURCE: Congressional Budget Office.

taxes—those representing about 80 percent of total excise tax receipts—are levied per unit of good or per transaction, rather than as a percentage of value. Thus, although excise receipts grow with real output, they do not rise with inflation and therefore do not grow as fast as nominal GDP. CBO's current projection of excise taxes is changed little from that of July.

Nearly all excise taxes fall into five major categories: highway, airport, telephone, alcohol, and tobacco taxes. Almost half of all excise tax receipts are for the Highway Trust Fund, primarily from gasoline and diesel taxes (see Table 3-10). Most airport and telephone taxes are levied on a percentage basis, so they grow faster than other excise taxes. A small hike in tobacco taxes enacted in 1997 will increase the level of receipts in 2002. However, the projection of tobacco tax receipts also reflects the drop in tobacco consumption that is expected to result from the higher tobacco prices caused by the industry's settlements with the states. The net effect, CBO believes, is that tobacco receipts will be stable after 2003.

Smaller amounts of revenue come from estate and gift taxes, customs duties, and numerous miscellaneous sources (see Table 3-11). Estate and gift tax receipts have tended to grow more rapidly than in-

come because the unified credit for the estate and gift tax, which effectively exempts some assets from the tax, is not indexed for inflation. (The annual exclusion for gifts is indexed for inflation, but the \$10,000 maximum annual exclusion will not change until the cumulative inflation since 1997 is at least 10 percent.) By 2006, however, a higher unified credit enacted in the Taxpayer Relief Act of 1997 will be phased in, more than offsetting the absence of indexing and tending to reduce receipts relative to GDP. At the same time, however, the aging of the population will tend to increase estate tax receipts. These effects combine to cause estate and gift taxes as a share of GDP to decline slightly until 2006 and then slowly rise again through the end of the projection period.

Customs duties grow over time in tandem with imports. Their growth will be restrained in the next few years, however, as tariff reductions enacted in 1994 are phased in.

The largest component of miscellaneous receipts is the profits of the Federal Reserve System, which are counted as revenues when turned over to the Treasury. Those profits depend on interest rates and the system's gains and losses on its foreign cur-

Table 3-10.
CBO's Projections of Excise Tax Receipts, by Category (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Highway	35	36	37	38	39	40	41	43	44	45	46	47
Airport	10	10	11	12	13	13	14	15	16	16	17	18
Telephone	6	6	6	7	7	8	8	8	9	9	10	11
Alcohol	8	8	8	8	9	9	9	9	9	9	9	10
Tobacco	7	7	8	8	8	8	8	8	8	8	8	8
All Other	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>3</u>
Total	69	71	74	76	78	81	83	86	88	91	94	97

SOURCE: Congressional Budget Office.

Table 3-11.
CBO's Projections of Other Sources of Revenue (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Estate and Gift	29	30	32	34	35	36	37	39	43	46	48	52
Customs Duties	20	21	23	24	25	26	27	27	28	29	30	31
Miscellaneous												
Federal Reserve	32	24	29	30	32	33	34	36	38	40	42	44
Universal Service Fund	5	5	6	8	13	13	13	13	13	13	13	14
Other	6	6	6	6	6	6	6	5	5	5	5	5
Subtotal	43	36	41	44	51	52	54	55	57	59	61	63
Total	92	87	96	102	111	114	117	121	128	133	139	147

SOURCE: Congressional Budget Office.

rency holdings. An act making consolidated appropriations for fiscal year 2000 (Public Law 106-113), however, required the Federal Reserve to turn over to the Treasury about \$3.8 billion of its "surplus," or capital (the cumulation of earnings that the Federal Reserve previously retained), which raised the contribution of Federal Reserve receipts to the Treasury for that year. But the Federal Reserve is rebuilding its capital in 2001 by reducing the amount of receipts that it would otherwise turn over. Consequently, those receipts are expected to be lower in 2001 and then to resume their normal level.

Another significant component of miscellaneous receipts is the Universal Service Fund. Collected from telecommunications companies, money from the fund is intended to finance Internet service for libraries and schools in low-income areas and subsidize basic telephone service for high-cost areas and low-income households. That source of revenue hovers close to \$5 billion until 2003, then more than doubles as more elements of the program get under way.

The Stock Market and CBO's Revenue Projections

CBO's estimates of revenues remain above 20 percent of GDP throughout the projection period. At the

end of the period, in 2011, the share is projected to be 20.4 percent, not very much less than the share in 2000, and much higher than the postwar norm. The surge in revenues in the late 1990s was fueled by phenomena that are only imperfectly understood. The extraordinary rise in the stock market has been repeatedly cited as a potential explanation. So the question arises of whether CBO's revenue projections depend on a continuation of the stock market boom of the late 1990s.

There are many possible means by which the stock market can affect receipts. Two have received special attention from analysts: capital gains realizations and income from stock options. The rising prices of financial assets increase the accrual of capital gains, which ultimately lead to taxable realizations. Income from stock options exercised in any given year typically represents the appreciation of the stock price from the time the option was issued to the time it is exercised, so that income from options too—and the tax receipts thereby generated—is swelled by a rising market.

CBO does not build a forecast of stock prices into its projections. Its projections of capital gains are based largely on the historical relationship between realizations and the size of the overall economy. As a result, the current projections assume that receipts from capital gains will decline from their current high levels to levels more consistent with

their historical relationship to the size of the economy. CBO does not include stock options separately in its models but rather as part of the projection of wage and salary income. The offsetting effect of option income on individual and corporate receipts, however, indicates that whatever their size, their impact on overall receipts is likely to be small. The main reasons that the receipts-to-GDP ratio remains high over the projection period are the progressive structure of the income tax and the AMT.

Capital Gains Realizations

Capital gains can generate receipts in a variety of ways. They affect the taxable bases of both the individual income tax and the corporate income tax. Moreover, they affect individual income receipts through different routes. Most significantly, they appear as income on 1040 forms. But they also affect the income of trusts and estates, which is taxed under the individual income tax. They also affect receipts in other less significant ways not discussed here.

Table 3-6 shows actual and projected capital gains receipts from individuals. As shown in Table 3-3, capital gains realizations have been a major reason for the increase in individual income tax liabilities relative to GDP. As a proportion of individual income tax receipts, they have grown from about 6 percent or 7 percent at the beginning of the 1990s to nearly 12 percent. The contribution of corporate capital gains to receipts is considerably smaller. Although data are not available to separately identify the income tax receipts from estates and trusts that are due to capital gains realizations, much of the recent growth of those receipts is probably due to increased realizations of gains. Under an extreme assumption that would count all of the receipts from estates and trusts as from gains realizations, total receipts from those three sources of capital gains taxation were possibly as high as 5 percent of all revenues in fiscal year 1995 and 9 percent in fiscal year 2000.

The methods used for projecting receipts from capital gains realizations over the long term are consistent with a number of different scenarios for the stock market. A significant amount of realizations comes from assets other than stocks, especially real

estate. Moreover, movements in realizations are not contemporaneous with movements in asset prices. Accrued gains are not taxed until taxpayers realize the gains when they sell the assets. At any given time, a great many accrued gains are available for realization and taxation, depending on taxpayers' decisions about when to sell their assets. Consequently, realizations (and the taxable income they generate) may lag well behind a market increase. And high stock market volume, even in the face of falling stock prices, may generate substantial taxable gains as earlier appreciation of assets is finally realized.

CBO's projections of receipts from individual income taxes and corporate income taxes do not depend on a continuation of the stock market surge, or even growth at the historical average rate—which is most clearly evident in the projections of liabilities from capital gains realizations under the individual income tax. Those gains reported on 1040 forms are an important reason why the ratio of receipts to GDP is projected to fall over the next few years. Specifically, gains for tax year 2000 are expected to rise on the basis of the behavior of the market and the economy in that year; and those receipts will partly show up in fiscal year 2001 revenues. But receipts from gains are then projected to fall as a percentage of taxes and of GDP after fiscal year 2001, throughout the projection period, so by the final three years, gains will account for roughly the same percentage of individual income tax receipts that they did in the early 1990s.

Stock Options

Employee stock options usually generate income tax receipts when they are exercised. Tax rules require that income earned on most stock options be reported as wage and salary income. Neither the tax data nor the NIPAs break out option income from other wage and salary income. Estimates derived from corporate financial reports suggest that option income was on the order of 1 percent to 2 percent of wage and salary income in calendar year 1999, or about \$50 billion to \$100 billion. With much of it probably concentrated among taxpayers paying the higher marginal rates, the result would have been roughly \$15 billion to \$30 billion of individual income tax receipts.

Nonetheless, a significant amount of option income would still be generated in a less robust market. Even in a generally falling market, some prices still rise. In addition, if the market failed to supply option income for employees, firms would likely replace at least some with other forms of compensation. Consequently, the drop in individual income tax receipts that would come from the effect of a sluggish stock market on option income would presumably be less than the total amount of receipts from such income.

Most important, because income from realized options is deductible for purposes of the corporate income tax, the impact on total receipts is less than that implied by a reduction in the option income of individuals. Every dollar of option income realized by individuals generates a dollar reduction in corporate profits. The positive net revenue impact of option income in the year of realization, therefore, is largely limited to options realized by employees of unprofitable firms, which pay no income tax anyway and for which the additional deduction has no effect on their tax liability.³ Consequently, given the largely offsetting effects on corporate receipts, even a substantial fall in option income would probably generate only a small decline in total taxable income, so the bottom-line impact on total receipts would likely be minor.

In short, CBO's revenue projections are not based on implicitly optimistic or pessimistic assumptions about the stock market's performance. The factors known to have driven the recent surge in revenues are not assumed to continue as they have over the past few years. But they are not assumed to go away completely either and are projected to continue contributing to revenues over the projection period. The projection has both upside and downside risks. The receipts-to-GDP ratio remains high over the period primarily because of the progressive structure of the income tax and the AMT. It is not an assumption of a continuing strong stock market that drives the revenue projections, but the effect of growing incomes on the effective tax rate.

Expiring Tax Provisions

CBO's revenue projections assume that current tax law remains unchanged and that scheduled changes and expirations occur on time. The sole exception to that approach is CBO's treatment of the expiration of excise taxes dedicated to trust funds. Under the rules governing the construction of CBO's projections, those taxes are included in the revenue projections even if they are scheduled to expire.

The largest trust fund excise taxes that are slated to expire during the next decade finance the Highway Trust Fund. Some of the taxes for that fund are permanent, but most of them expire on September 30, 2005. Extending those taxes at today's rates contributes about \$39 billion to CBO's revenue projection in 2011, about 40 percent of total excise tax receipts.

The assumed extension of other expiring trust fund taxes accounts for smaller amounts in 2011. Taxes dedicated to the Airport and Airway Trust Fund, scheduled to expire at the end of fiscal year 2007, contribute about \$17 billion in revenues in 2011. Taxes for the Leaking Underground Storage Tank Trust Fund, set to expire on March 31, 2005, contribute about \$250 million in 2011. No other expiring tax provisions are automatically extended in CBO's projections.

Twelve provisions are slated to expire by the end of 2001 (see Table 3-12). Because they provide tax benefits, they would all reduce revenues if extended. Extending all of them through at least 2011 would lower revenues by a total of about \$81 billion over the projection period and by \$16 billion in 2011. Over the period, about \$42 billion of that cost, or about half, would come from the provision that allows individuals to claim certain personal credits against the AMT. Without that provision, as assumed in CBO's projections beyond 2001, some taxpayers would be unable to claim the child and education tax credits that were enacted in the Taxpayer Relief Act of 1997. The provision allowing an exemption from taxable income for certain financing income earned abroad would reduce revenues by an estimated \$21 billion if extended at least through 2011. Extending the Generalized System of Prefer-

3. There may still be an offsetting deduction in a future year should the corporation become profitable for tax purposes.

Table 3-12.
Effect of Extending Tax Provisions That Will Expire Before 2011 (By fiscal year, in billions of dollars)

Tax Provision	Expiration Date	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2001-2011
Provisions Expiring in 2001													
Generalized System of Preferences	9/30/01	n.a.	-0.5	-0.5	-0.5	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-0.8	-6.3
Andean Trade Preference Initiative	12/4/01	n.a.	*	*	*	*	*	*	*	*	*	*	-0.3
Credits for Electricity Production from Wind and Biomass	12/31/01	n.a.	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.7
Deductions for Clean-Fuel Vehicles and Refueling Property	12/31/01	n.a.	*	*	*	*	*	*	*	*	*	*	-0.3
Exclusion for Employer-Provided Education Assistance	12/31/01	n.a.	-0.4	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-0.5	-0.6	-0.6	-4.6
Net Income Limitation for Marginal Properties	12/31/01	n.a.	*	*	*	*	*	*	*	*	*	*	-0.4
Qualified Zone Academy Bonds	12/31/01	n.a.	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.4
Subpart F for Active Financing Income	12/31/01	n.a.	-0.3	-1.3	-1.4	-1.7	-1.9	-2.2	-2.5	-2.9	-3.3	-3.8	-21.2
Credit for Electric Vehicles	12/31/01	n.a.	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.4
Treatment of Nonrefundable Personal Credits Under the AMT	12/31/01	n.a.	-0.3	-1.4	-1.7	-2.4	-3.2	-4.1	-5.3	-6.4	-7.9	-9.7	-42.2
Welfare-to-Work Credit	12/31/01	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-1.2
Work Opportunity Credit	12/31/01	n.a.	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-3.6

(Continued)

ences, which provides nonreciprocal tariff preferences to many developing countries, would reduce revenues by about \$6 billion. If extended, the provisions that allow an exclusion for certain employer-provided educational assistance and provide a work opportunity tax credit would reduce revenues by \$4.6 billion and \$3.6 billion, respectively.

Twelve provisions expire between 2002 and 2011, seven of which would reduce revenues if extended. The one with the largest revenue effect by far is the research and experimentation tax credit, which was first enacted in 1981 and affects businesses. In 1999, the Congress extended that tax benefit for the ninth time since 1985. That extension

(through June 2004) is its longest. Extending that provision through 2011 would reduce revenues by about \$29 billion through 2011. The other five revenue-losing provisions expiring after 2001 were all recently extended in the Community Renewal Tax Relief Act of 2000. Combined, they would reduce revenues by about \$6 billion through 2011 if extended.

Four provisions that expire between 2002 and 2011 would raise revenues if extended. Extending the luxury tax on passenger vehicles and the abandoned mine reclamation fees would each raise revenues by about \$2 billion. Extending the Internal Revenue Service's user fees and the provision that allows

Table 3-12.
Continued

Tax Provision	Expiration Date	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2001-2011
Provisions Expiring Between 2002 and 2011													
Medical Savings Accounts	12/31/02	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1
Luxury Tax on Passenger Vehicles	12/31/02	n.a.	n.a.	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	2.2
IRS User Fees	9/30/03	n.a.	n.a.	n.a.	**	**	**	**	**	**	**	**	0.3
Corporate Contributions of Computers to Schools	12/31/03	n.a.	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-1.2
Brownfields Environmental Remediation	12/31/03	n.a.	n.a.	n.a.	*	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.5
District of Columbia First-Time Homebuyer Credit	12/31/03	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	-0.2
Tax Incentive for Investment in the District of Columbia	12/31/03	n.a.	n.a.	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-1.0
Credit for Research and Experimentation	6/30/04	n.a.	n.a.	n.a.	-0.4	-2.5	-3.2	-3.8	-4.3	-4.7	-4.9	-5.0	-28.8
Abandoned Mine Reclamation Fees	9/30/04	n.a.	n.a.	n.a.	n.a.	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.7
Transfer of Excess Assets in Defined Benefit Plans	12/31/05	n.a.	n.a.	n.a.	n.a.	n.a.	**	**	**	**	**	**	0.2
FUTA Surtax of 0.2 Percentage Points	12/31/07	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0	0	0	0	0
Empowerment Zones	12/31/09	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.6	-1.2	-1.7
All Expiring Provisions													
Total		n.a.	-1.6	-3.8	-5.0	-8.1	-10.0	-12.0	-14.1	-16.1	-19.0	-22.0	-111.6

SOURCES: Joint Committee on Taxation, Congressional Budget Office.

NOTES: n.a. = not applicable; AMT = alternative minimum tax; IRS = Internal Revenue Service; FUTA = Federal Unemployment Tax Act.

* = loss of less than \$50 million.

** = gain of less than \$50 million.

employers to transfer excess assets in defined benefit plans to a special account of health benefits for retirees would each raise less than \$50 million a year.

One provision has no effect on revenues. Although the Federal Unemployment Tax Act surcharge brings in about \$2 billion a year, the additional income would be passed to the states. CBO assumes that the states would then use those rebates to lower

their unemployment insurance tax rates. Since the state taxes are also part of federal unemployment tax receipts, extending the surcharge would have no net effect on revenues.

If all expiring provisions were extended, CBO's projections of revenues would be lower by \$22 billion in 2011 and by \$112 billion over the projection period.

The Spending Outlook

The Congressional Budget Office projects that federal spending will total \$1.9 trillion in 2001—a 3.6 percent increase from 2000. Assuming that current policies remain unchanged, CBO expects spending to rise to \$2.6 trillion in 2011 (see Table 4-1). The rate of growth in spending will average 3.8 percent from 2001 through 2011 under baseline assumptions.

Federal spending averaged about 19 percent of the country's gross domestic product in the 1960s, rising to about 22 percent in the 1980s. Under CBO's baseline, projected real growth in the economy outstrips the growth in federal spending, which falls from 18 percent of GDP in 2001 to approximately 15 percent of GDP by 2011.

Federal spending can be divided into categories based on its treatment in the budget process:

- o *Discretionary spending*—which pays for such things as defense, transportation, national parks, and foreign aid—accounts for about one-third of the budget. Discretionary programs are controlled by annual appropriation acts; policymakers decide each year how many dollars to devote to continuing current activities and funding new ones. CBO's baseline depicts the path of discretionary spending in accordance with the Deficit Control Act, which states that current spending should be assumed to grow with inflation in the future.¹
- o *Entitlements and other mandatory spending*—which constitute more than half of the federal budget—consist overwhelmingly of benefit programs such as Social Security, Medicare, and Medicaid. The Congress generally controls spending for those programs by setting rules for eligibility, benefit formulas, and other parameters rather than by voting for dollar amounts each year. CBO's baseline projections of mandatory spending assume that existing laws and policies remain unchanged and that most expiring programs will be extended.
- o *Offsetting receipts*—fees and other charges that are recorded as negative budget authority and outlays—are collected without annual appropriation action. (Fees and other charges that are triggered by appropriation action are classified as offsetting collections, which are credited to discretionary spending.) 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 businesslike transactions (such as rents and royalties from leases for oil and gas drilling on the Outer Continental Shelf).
- o *Net interest*—which includes interest paid on Treasury securities, other interest that the government pays (for example, on late refunds issued by the Internal Revenue Service), and interest that the government collects from various sources (such as from commercial banks for deposits in tax and loan accounts)—is driven by the size of the government's debt, annual budget 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 (for expenditures related to federal personnel) and the GDP deflator (for other expenditures).

Table 4-1.
CBO's Baseline Budget Projections of Outlays (By fiscal year)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
In Billions of Dollars												
Discretionary Spending	617	646	682	710	730	750	766	782	804	824	845	866
Mandatory Spending	1,030	1,089	1,157	1,219	1,296	1,378	1,441	1,520	1,614	1,713	1,820	1,934
Offsetting Receipts	-81	-87	-95	-108	-111	-107	-113	-119	-125	-131	-139	-147
Net Interest	223	205	179	163	142	116	90	72	65	58	53	51
Proceeds Earned on the Balance of Uncommitted Funds ^a	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>-1</u>	<u>-12</u>	<u>-38</u>	<u>-68</u>	<u>-104</u>	<u>-146</u>
Total	1,789	1,853	1,923	1,984	2,056	2,137	2,184	2,243	2,320	2,396	2,475	2,558
On-budget	1,458	1,506	1,561	1,611	1,669	1,738	1,773	1,820	1,884	1,943	2,005	2,070
Off-budget	331	348	361	373	388	399	411	423	437	453	470	489
As a Percentage of GDP												
Discretionary Spending	6.3	6.3	6.3	6.2	6.0	5.9	5.8	5.6	5.5	5.4	5.2	5.1
Mandatory Spending	10.5	10.5	10.6	10.6	10.7	10.9	10.8	10.9	11.0	11.2	11.3	11.4
Offsetting Receipts	-0.8	-0.8	-0.9	-0.9	-0.9	-0.8	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9
Net Interest	2.3	2.0	1.6	1.4	1.2	0.9	0.7	0.5	0.4	0.4	0.3	0.3
Proceeds Earned on the Balance of Uncommitted Funds ^a	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>*</u>	<u>-0.1</u>	<u>-0.3</u>	<u>-0.4</u>	<u>-0.6</u>	<u>-0.9</u>
Total	18.2	18.0	17.7	17.3	17.1	16.9	16.4	16.1	15.9	15.6	15.4	15.1
On-budget	14.8	14.6	14.4	14.0	13.8	13.7	13.4	13.1	12.9	12.7	12.4	12.2
Off-budget	3.4	3.4	3.3	3.3	3.2	3.2	3.1	3.0	3.0	3.0	2.9	2.9

Memorandum:

Gross Domestic Product
(Billions of dollars)

9,828 10,319 10,880 11,477 12,059 12,656 13,279 13,932 14,619 15,338 16,109 16,922

SOURCE: Congressional Budget Office.

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

a. "Uncommitted funds" is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

o *Proceeds earned on the balance of uncommitted funds*—another category that offsets outlays—is the return that CBO assumes will be earned on surplus funds that are not used to redeem debt held by the public. CBO's baseline assumes that the surpluses projected for the 2002-2011 period will initially be used to pay down debt. But because some debt will not yet have matured or will be unavailable for repurchase, the projected surpluses may exceed the amount of

debt that can be paid off in a particular year.² CBO's projections thus assume that those uncommitted funds will be invested at a rate of return equal to the average rate projected for Treasury bills and notes. However, CBO makes no explicit assumptions about how much of the

2. Outstanding long-term bonds and ongoing programs that issue non-marketable debt restrict the Treasury's ability to use surpluses to reduce debt held by the public. Although the Treasury can repurchase some long-term debt, it is unlikely that all bondholders would be willing to sell at prices that the government would be willing to pay.

funds the Treasury would invest through its current arrangements with banks and the Federal Reserve or through any other investments that might be chosen (for example, debt or equity instruments, in the public or private sector, or in the United States or abroad).

The mix of federal spending has changed significantly over time. Today, the government spends more—as a proportion of GDP—on entitlement programs and less on discretionary activities than it did in the past. Spending on entitlements and other mandatory programs (net of offsetting receipts) increased from 4.9 percent of GDP in 1962 to 9.7 percent in 2000. Over the same period, discretionary spending fell from 12.7 percent to 6.3 percent of GDP (see Figure 4-1). (For detailed annual data on each of the broad categories of spending since 1962, see Appendix F.)

Under CBO's baseline projections, mandatory spending (net of offsetting receipts) will climb to 10.5 percent of GDP by 2011 as discretionary spending falls to 5.1 percent of GDP. CBO estimates that mandatory spending (net of offsetting receipts) will continue to grow faster than the economy—at a rate of 6.0 percent a year—led by the spending for the two major health care programs, Medicare and

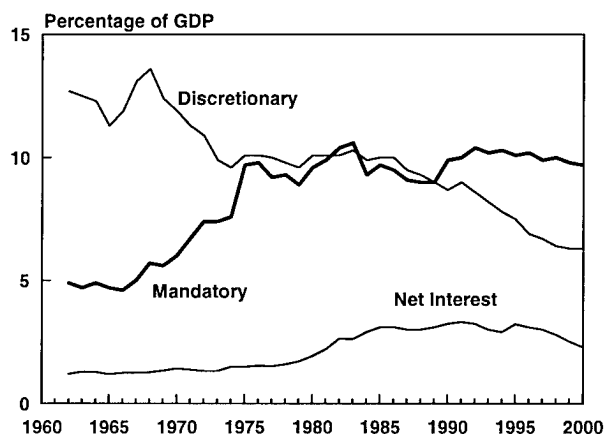
Medicaid, which are projected to grow at an average annual rate of 7.2 percent and 8.6 percent, respectively (see Table 4-2).

Although total discretionary outlays were virtually unchanged from 1991 through 1996, defense spending declined 3.6 percent, while nondefense spending rose 4.7 percent. From 1996 through 2000, total discretionary outlays increased 3.7 percent, although defense spending grew more slowly than nondefense spending. From 2000 to 2001, CBO estimates, discretionary budget authority will increase by 8.5 percent, while discretionary outlays will grow by 4.8 percent. Under CBO's baseline projections, total discretionary outlays will rise at an average annual rate of 3.0 percent from 2001 to 2011.

Discretionary Spending

Each year, the Congress starts the appropriation process anew. The annual appropriation acts it passes provide new budget authority (the authority to enter into financial obligations) for discretionary programs and activities. That authority translates into outlays when the money is actually spent. Although some funds are spent quickly, others are disbursed over several years. In any given year, discretionary outlays include spending from both new budget authority and from amounts appropriated previously.

Figure 4-1.
Major Components of Spending as a
Percentage of GDP, Fiscal Years 1962-2000



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

Trends in Discretionary Spending

As a percentage of GDP, discretionary spending has dropped from 9.0 percent in 1991 to 6.3 percent in 2000. In nominal (or dollar) terms, total discretionary outlays were only \$1 billion higher in 1996 than in 1991. After 1996, discretionary spending began to rise; outlays were \$83 billion higher in 2000 than in 1996.

Focusing only on total discretionary spending, however, masks significantly different and sometimes offsetting trends in defense and nondefense outlays. Defense outlays fell from \$320 billion in 1991 to \$266 billion in 1996, while nondefense spending jumped from \$214 billion in 1991 to \$269 billion in

Table 4-2.
Average Annual Rate of Growth in Outlays (By fiscal year, in percent)

	1991-1996	1996-2000	Projected 2000-2001	Projected ^a 2001-2011
Discretionary	*	3.7	4.8	3.0
Defense	-3.6	2.6	2.2	2.8
Nondefense	4.7	4.6	7.2	3.1
Mandatory ^b	5.6	4.9	5.6	6.0
Social Security	5.4	4.0	5.8	5.3
Medicare	10.9	3.2	10.5	7.2
Medicaid	11.9	6.3	10.6	8.6
Other	-0.1	7.3	-1.4	4.1
Net Interest ^c	4.4	-1.9	-8.2	-13.0
Total Outlays ^c	3.3	3.5	3.6	3.8
Total Outlays Excluding Net Interest	3.2	4.4	5.3	4.9
Memorandum:				
Consumer Price Index	2.8	2.4	2.9	2.6
Nominal GDP	5.4	6.3	5.0	5.1

SOURCE: Congressional Budget Office.

NOTE: * = between zero and 0.05 percent.

- a. Using the inflators specified in the Deficit Control Act (gross domestic product deflator and employment cost index) for discretionary spending after 2001.
- b. Includes offsetting receipts.
- c. Includes proceeds earned on the balance of uncommitted funds.

1996 (see Table 4-3).³ Since 1996, both defense and nondefense outlays have grown, although the rise in nondefense spending has continued to outstrip that for defense. From 1996 through 2000, nondefense outlays grew at an average annual rate of 4.6 percent, compared with a 2.6 percent average annual rise in defense spending (see Table 4-2). Despite the apparently rapid surge in spending for nondefense programs (relative to defense programs), economic growth has exceeded the growth in nondefense outlays, which at the end of 2000 were below their 1991 level as a percentage of GDP.

The Caps on Discretionary Spending

The Budget Enforcement Act of 1990 placed limits on budget authority and outlays. For 2001, the caps apply to three categories of discretionary spending: overall discretionary (which comprises the spending categories previously separated as defense, nondefense, and violent crime reduction), highways, and mass transit. The limits are enforced through sequestration, which provides for an across-the-board cut in funding for discretionary programs to eliminate excess spending.

As an enforcement mechanism, the caps have become less effective than when they were first implemented. Over the past few years, the Congress and the President have used a number of tactics—

3. The Department of Defense estimates that its outlays in 1991 included approximately \$20 billion in discretionary spending attributable to Operation Desert Storm.

Table 4-3.
Defense and Nondefense Discretionary Outlays, Fiscal Years 1991-2001

	Defense Outlays		Nondefense Outlays		Total Discretionary Outlays (In billions of dollars)
	In Billions of Dollars	As a Percentage of Total Discretionary Outlays	In Billions of Dollars	As a Percentage of Total Discretionary Outlays	
1991	320	60	214	40	533
1992	303	57	232	43	535
1993	292	54	249	46	541
1994	282	52	262	48	544
1995	274	50	272	50	546
1996	266	50	269	50	534
1997	272	49	277	51	549
1998	270	49	284	51	555
1999	275	48	300	52	575
2000	295	48	322	52	617
2001 ^a	301	47	345	53	646

SOURCES: Office of Management and Budget for 1991 through 2000 and Congressional Budget Office for 2001.

a. Estimated.

including advance appropriations, obligation and payment delays, emergency designations, and specific legislative direction—to boost discretionary spending while statutorily complying with the limits. To accommodate additional discretionary spending in 2001, the Congress and the President simply increased the caps on budget authority and outlays by \$99 billion and \$59 billion, respectively.

For 2002, CBO estimates the total limits on discretionary spending to be \$552 billion for budget authority and \$576 billion for outlays.⁴ In comparison, those caps are below the adjusted 2001 limits by \$89 billion and \$69 billion, respectively. Total discretionary budget authority and outlays under CBO's baseline for 2002 exceed their respective caps by \$113 billion and \$106 billion. (For additional information on the discretionary spending caps, see Appendix A.)

Composition of Discretionary Spending in 2001

CBO's estimate of \$646 billion in discretionary spending for 2001 is nearly \$30 billion higher than the level in 2000. Additional nondefense outlays account for 78 percent of that increase. The faster growth in nondefense outlays slightly increases their share of total discretionary outlays to 53 percent in 2001.

Nondefense spending is distributed among several categories, with the three largest accounting for between 12 percent and 16 percent of such spending in 2001 (see Figure 4-2). The education, training, and social services category, with expected outlays of \$54 billion, includes all federal programs related to education and employment as well as social services for children, families, the elderly, and disabled people. Transportation (ground, air, water, and mass transit) is expected to record \$50 billion in outlays in 2001. Under the income security category, two-thirds of the anticipated \$44 billion in spending pays for housing assistance; most of the remainder funds nutrition programs and the administrative costs of mandatory benefit programs.

4. Those amounts include the new land conservation, preservation, and infrastructure caps, which take effect in 2002.

Spending for other categories that account for more than 5 percent of nondefense discretionary outlays in 2001 includes \$34 billion for health research and public health (including the Indian Health Service); \$29 billion for the administration of justice; \$26 billion for natural resources and the environment; \$23 billion for international programs (mainly the conduct of foreign affairs, security assistance, and development and humanitarian aid); \$22 billion for veterans' benefits (medical care and other noncash benefits); and \$20 billion for space and science research.

Discretionary Spending for 2002 to 2011

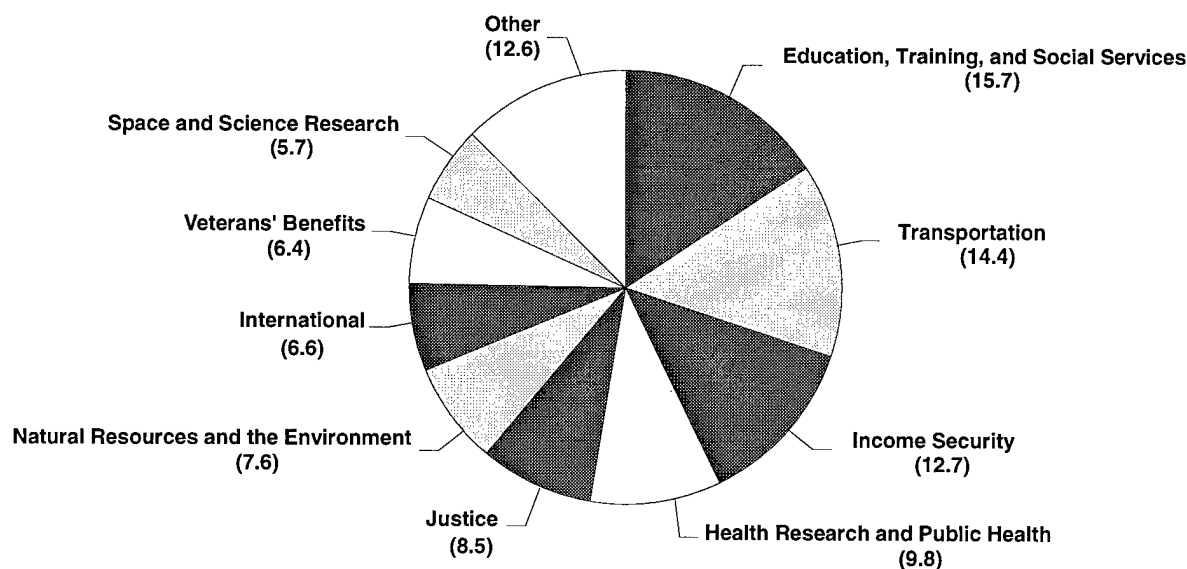
To construct the baseline for discretionary spending, CBO inflated budget authority from the level appropriated in 2001 using the employment cost index (for expenditures related to federal personnel) and the GDP deflator (for other expenditures). In 2002, however, outlays rise by more than just those rates of inflation because of spending from budget authority

appropriated in prior years and other technical factors. Since the Deficit Control Act requires CBO to use those inflation factors and to assume that current policies remain in place, the baseline projection is not a prediction of future outcomes but rather a reference point for assessing policy changes.

Under CBO's baseline, discretionary outlays increase from \$646 billion in 2001 to \$866 billion in 2011. Because the economy is projected to grow faster than the baseline for such spending, discretionary outlays drop as a percentage of GDP from 6.3 percent in 2001 to 5.1 percent in 2011.

Since the size of the projected surpluses is very sensitive to assumptions about discretionary spending, CBO has calculated four alternative scenarios for such spending during the 2002-2011 period. One scenario assumes that budget authority grows at the same rate as nominal GDP after 2001 (an annual average of 5.1 percent), causing discretionary outlays to be \$905 billion higher than the baseline over the 10-year period (see Table 4-4). Another alternative assumes that budget authority grows by 1 percentage

Figure 4-2.
Nondefense Discretionary Spending, by Category, Fiscal Year 2001 (In percent)



SOURCE: Congressional Budget Office.

NOTE: Projected nondefense discretionary spending for 2001 totals \$345 billion.

Table 4-4.
CBO's Projections of Discretionary Spending Under Alternative Paths (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Baseline (Discretionary Spending Grows at the Rate of Inflation After 2001)^a												
Budget Authority												
Defense	301	311	322	330	339	347	356	365	375	385	394	405
Nondefense	<u>285</u>	<u>326</u>	<u>343</u>	<u>353</u>	<u>362</u>	<u>371</u>	<u>380</u>	<u>389</u>	<u>399</u>	<u>409</u>	<u>419</u>	<u>430</u>
Total	587	637	665	683	701	718	736	755	774	793	814	835
Outlays												
Defense	295	301	314	323	332	344	350	356	369	379	388	399
Nondefense	<u>322</u>	<u>345</u>	<u>368</u>	<u>387</u>	<u>398</u>	<u>407</u>	<u>416</u>	<u>426</u>	<u>435</u>	<u>446</u>	<u>456</u>	<u>468</u>
Total	617	646	682	710	730	750	766	782	804	824	845	866
Discretionary Spending Grows at the Rate of Nominal Gross Domestic Product After 2001												
Budget Authority												
Defense	301	311	328	346	364	382	400	420	441	462	486	510
Nondefense	<u>285</u>	<u>326</u>	<u>346</u>	<u>365</u>	<u>383</u>	<u>402</u>	<u>422</u>	<u>443</u>	<u>464</u>	<u>487</u>	<u>512</u>	<u>537</u>
Total	587	637	674	711	747	784	823	863	905	950	997	1,047
Outlays												
Defense	295	301	318	334	351	372	388	405	428	449	472	495
Nondefense	<u>322</u>	<u>345</u>	<u>370</u>	<u>395</u>	<u>414</u>	<u>433</u>	<u>452</u>	<u>473</u>	<u>494</u>	<u>516</u>	<u>540</u>	<u>566</u>
Total	617	646	688	729	765	805	840	877	922	966	1,012	1,061
Discretionary Spending Grows at the Rate of Inflation Plus One Percentage Point After 2001^a												
Budget Authority												
Defense	301	311	325	337	350	362	375	388	402	417	432	447
Nondefense	<u>285</u>	<u>326</u>	<u>343</u>	<u>356</u>	<u>369</u>	<u>382</u>	<u>396</u>	<u>410</u>	<u>424</u>	<u>440</u>	<u>455</u>	<u>472</u>
Total	587	637	668	693	719	744	770	798	827	856	887	919
Outlays												
Defense	295	301	316	328	340	356	366	377	394	408	423	438
Nondefense	<u>322</u>	<u>345</u>	<u>368</u>	<u>389</u>	<u>403</u>	<u>416</u>	<u>429</u>	<u>443</u>	<u>458</u>	<u>473</u>	<u>489</u>	<u>505</u>
Total	617	646	684	717	743	772	795	820	851	881	912	943
Discretionary Spending Is Frozen at the Level Enacted for 2001												
Budget Authority												
Defense	301	311	311	311	311	311	311	311	311	311	311	311
Nondefense	<u>285</u>	<u>326</u>	<u>330</u>	<u>329</u>	<u>329</u>	<u>329</u>	<u>329</u>	<u>329</u>	<u>329</u>	<u>329</u>	<u>329</u>	<u>329</u>
Total	587	637	641	641	641	641	641	641	641	641	641	641
Outlays												
Defense	295	301	307	307	308	311	309	307	310	310	310	310
Nondefense	<u>322</u>	<u>345</u>	<u>362</u>	<u>373</u>	<u>376</u>	<u>373</u>	<u>371</u>	<u>370</u>	<u>369</u>	<u>369</u>	<u>369</u>	<u>368</u>
Total	617	646	669	681	684	684	680	677	679	679	679	679

(Continued)

Table 4-4.
Continued

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Discretionary Spending Equals CBO's Estimates of the Statutory Caps in 2002 and Grows at the Rate of Inflation Thereafter^b												
Budget Authority	587	637	552	567	582	597	611	627	642	658	675	692
Outlays	617	646	576	592	607	623	638	654	671	687	704	722
Memorandum:												
Debt Service on Differences from Baseline												
Growth at rate of nominal GDP	0	0	*	1	2	5	8	14	20	28	38	50
Growth at inflation plus one percentage point	0	0	*	*	1	2	3	5	8	11	15	20
Frozen at the 2001 level	0	0	*	-1	-3	-7	-11	-17	-24	-33	-43	-55
Equal to the Caps in 2002	0	0	-3	-8	-15	-23	-31	-40	-50	-60	-71	-83

SOURCE: Congressional Budget Office.

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

In CBO's projections, discretionary outlays are always higher than budget authority because of spending from the Highway Trust Fund and the Airport and Airway Trust Fund, which is subject to obligation limitations in appropriation acts. The budget authority for such programs is provided in authorizing legislation and is not considered discretionary. Another reason outlays exceed budget authority is that they include spending from appropriations provided in previous years.

- a. Using the inflators specified in the Deficit Control Act (GDP deflator and employment cost index).
- b. Using the consumer price index for urban consumers.

point more than inflation (the inflation rates used here are the same ones used in CBO's baseline, as specified in the Deficit Control Act). Under that assumption, discretionary outlays from 2002 through 2011 are a cumulative \$359 billion higher than the baseline. A third scenario assumes that budget authority is essentially frozen at the nominal level enacted for 2001. Under the freeze assumption, discretionary outlays over the 2002-2011 period total \$968 billion less than the baseline. The fourth alternative assumes that budget authority and outlays equal CBO's estimate of the 2002 caps and grow with the consumer price index for urban consumers thereafter; under that assumption, discretionary outlays from 2002 through 2011 would total \$1,284 billion less than the baseline.

Entitlements and Other Mandatory Spending

Currently, more than half of the \$1.9 trillion that the federal government spends each year supports entitlement programs and other types of mandatory spending (other than net interest). Most mandatory programs make payments to recipients—a wide variety of people, as well as businesses, nonprofit institutions, and state and local governments—that are eligible and apply for funds. Payments are governed by formulas set in law and are not constrained by annual appropriation bills.

As a share of total outlays, mandatory spending jumped from 32 percent in 1962 to 58 percent in 2000. If current policies remain unchanged, CBO

estimates that mandatory spending will continue to grow faster than other spending, reaching 64 percent of total outlays, or nearly twice the size of discretionary outlays, by 2005.

The Deficit Control Act makes legislation that affects mandatory programs (other than Social Security) and receipts subject to pay-as-you-go discipline through 2002. The pay-as-you-go budgetary restriction means that any increase in spending or reduction in receipts should be offset by cuts in other mandatory spending or by increases in revenues, as measured on an annual basis. Violation of the pay-as-you-go rules triggers a sequestration—an across-the-board cut in certain mandatory spending programs—to offset any net reduction in the surplus.⁵ Social Security has its own set of procedural safeguards, which the Congress established to prevent policy actions that would significantly worsen either the short-term or the long-term condition of the program's trust funds.

Less than one-fourth of entitlements and mandatory spending, or about one-seventh of all federal spending, is means-tested—that is, paid to individuals who must document their need on the basis of income or assets that are below certain specified thresholds. In some cases, other criteria, such as family status, are also used. The remainder of mandatory spending has no such restrictions and is labeled non-means-tested.

Means-Tested Programs

Since the 1960s, spending on means-tested benefits has more than tripled as a share of the economy—from 0.8 percent of GDP in 1962 to a high of 2.6 percent in 1995. Since 1995, means-tested outlays have declined slightly as a share of GDP, slipping to 2.4 percent in 2000; however, that trend is not expected to continue. Changes in spending for these programs are driven by several factors, including inflation, rising health care costs, fluctuating unemployment, growth of the eligible populations, and new legisla-

tion. Largely because of Medicaid growth, CBO projects that spending for means-tested programs will grow more rapidly than the economy, climbing to 2.8 percent of GDP by 2011.

Medicaid. Outlays for Medicaid, the joint federal/state program that provides medical care to many of the nation's poor people, made up nearly half of all spending for means-tested entitlements in 2000 (see Table 4-5). Over the next decade, Medicaid is projected to grow more rapidly than other means-tested programs, with its federal outlays mounting from \$130 billion in 2001 to \$295 billion in 2011, an average annual growth rate of 8.6 percent. Spending for acute care services, which includes pharmaceuticals and payments to managed care plans, accounts for more than half of Medicaid outlays (see Figure 4-3). CBO projects that acute care spending will grow from \$67 billion in 2001 to \$166 billion in 2011. Spending for long-term care, which accounts for about one-third of Medicaid outlays, is expected to climb from \$40 billion in 2001 to \$96 billion in 2011. Growth in payments to hospitals that serve a disproportionate share of Medicaid beneficiaries or other low-income people—so-called disproportionate share hospital (DSH) payments—is limited by statute. As a result, that spending is projected to remain almost flat over the next decade, growing from \$9 billion in 2001 to \$10 billion in 2011. Administrative expenses are expected to remain at 5 percent of total Medicaid spending, rising from \$7 billion in 2001 to \$16 billion by 2011. Other payments to providers, mainly spending related to the Medicare upper payment limit, are projected to remain at about \$7 billion over the next decade as restrictions on those payments take effect.⁶

Medicaid spending in 2000 exceeded CBO's expectation of 7 percent growth, climbing to 9 percent—the highest level in seven years. Between 1996 and 1997, growth in spending ranged from 3 percent to 4 percent a year, before rising to 6.7 percent in 1999. The recent jump in growth has several components. The most notable factor has been states' increasing use of a financing mechanism related to the Medicare upper payment limit. Under

5. However, the Congress may choose to legislatively eliminate pay-as-you-go balances to avoid a sequestration. For example, the pay-as-you-go balance for 2001, which the Office of Management and Budget estimated at \$10.5 billion, was reset to zero as directed by the Consolidated Appropriations Act, 2001.

6. The term "Medicare upper payment limit" refers to a regulatory ceiling in Medicaid payment policy. States may not pay certain groups of facilities more than they would using Medicare payment principles.

Table 4-5.
CBO's Projections of Mandatory Spending (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Means-Tested Programs												
Medicaid	117	130	141	153	166	180	194	211	229	248	271	295
State Children's Health Insurance	2	3	3	3	4	4	4	4	4	5	5	5
Food Stamps	18	19	20	21	22	23	24	24	25	26	27	27
Supplemental Security Income	31	28	32	34	36	41	40	39	45	47	50	52
Family Support ^a	21	23	24	24	25	25	25	26	26	26	27	27
Veterans' Pensions	3	3	3	3	3	4	3	3	3	4	4	4
Child Nutrition	9	10	10	10	11	11	12	12	13	13	14	14
Earned Income and Child Tax Credits	27	27	27	27	28	28	28	28	29	29	29	29
Student Loans	1	5	5	5	4	4	5	5	5	5	5	5
Foster Care	5	6	6	7	7	8	8	9	9	10	11	11
Total	236	252	272	288	305	328	343	361	388	413	441	471
Non-Means-Tested Programs												
Social Security	406	430	452	474	498	523	550	578	608	642	679	719
Medicare	216	238	252	270	290	317	333	363	391	421	456	492
Subtotal	622	668	704	744	788	840	882	940	998	1,063	1,135	1,211
Other Retirement and Disability												
Federal civilian ^b	50	53	56	59	62	65	68	71	75	78	82	85
Military	33	34	35	36	37	38	39	40	41	42	43	44
Other	5	5	5	5	5	5	5	5	5	5	6	6
Subtotal	88	92	96	100	104	108	113	117	121	126	131	135
Unemployment Compensation	21	23	26	27	29	31	33	35	37	40	41	43
Other Programs												
Veterans' benefits ^c	24	22	25	27	28	31	30	29	32	33	33	34
Commodity Credit Corporation Fund	30	17	10	9	9	9	8	6	5	5	5	5
Social services	4	5	5	5	5	5	5	5	5	5	5	5
Credit liquidating accounts	-13	-9	-8	-9	-10	-10	-10	-10	-10	-10	-9	-9
Universal Service Fund	4	5	6	6	12	13	13	13	13	13	13	13
Department of Defense health care	0	0	0	5	6	6	7	7	8	8	9	10
Other	14	13	21	17	19	17	16	16	16	16	16	16
Subtotal	63	53	58	60	69	71	69	66	69	71	72	74
Total	794	836	884	932	990	1,050	1,097	1,159	1,226	1,300	1,379	1,463
Total												
All Mandatory Spending	1,030	1,089	1,157	1,219	1,296	1,378	1,441	1,520	1,614	1,713	1,820	1,934

SOURCE: Congressional Budget Office.

NOTE: Spending for the benefit programs shown above generally excludes administrative costs, which are discretionary. Spending for Medicare also excludes premiums, which are considered offsetting receipts.

a. Includes Temporary Assistance for Needy Families, Payments to States for Child Support Enforcement and Family Support, Child Care Entitlement to States, and Children's Research and Technical Assistance.

b. Includes Civil Service, Foreign Service, Coast Guard, and other small retirement programs and annuitants' health benefits.

c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

that mechanism, states pay certain public facilities at rates far in excess of normal Medicaid rates and generate additional federal Medicaid spending. In 2000, a number of states expanded their use of that mechanism.

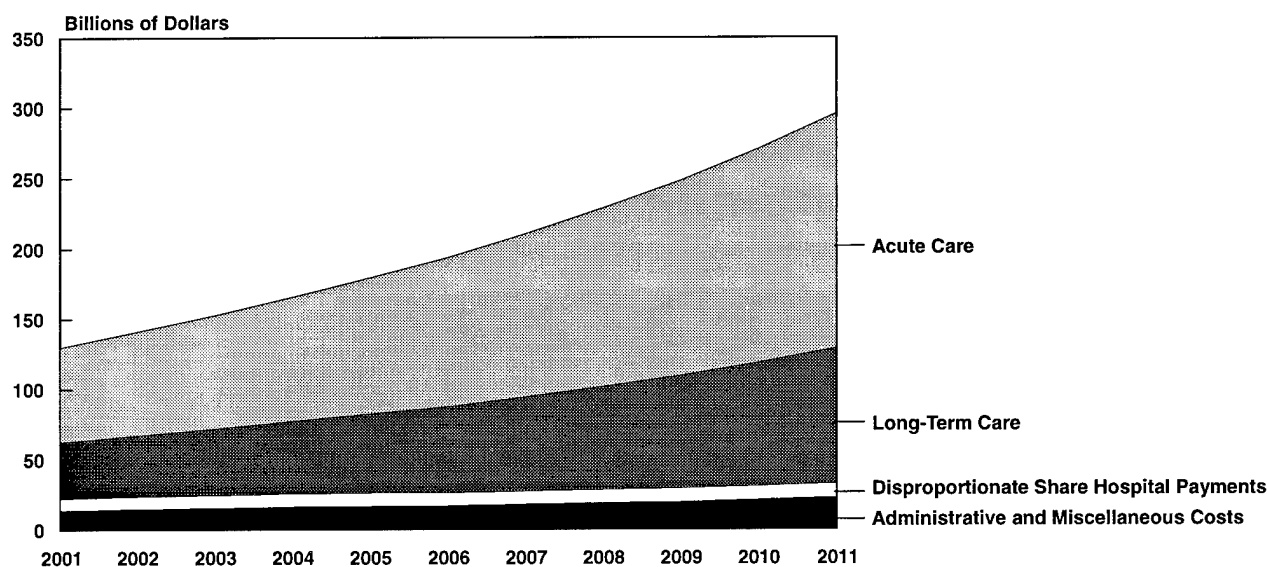
At the same time, the cost and use of medical care services, particularly prescription drugs, increased across the board. States' decisions to expand Medicaid eligibility, increase payment rates to providers, and initiate outreach efforts have increased both enrollment and costs. Enrollment of adults and children grew in 2000 as state outreach efforts and advocacy campaigns reached former Medicaid enrollees who had left the rolls following welfare reform. Enrollment also grew as a result of state expansions of eligibility for parents and outreach related to the State Children's Health Insurance Program (SCHIP).

CBO anticipates that the growth in Medicaid spending will continue to escalate in 2001, increasing by 10.6 percent over 2000. After that, the program is expected to grow at 8 percent to 9 percent annually. In the short term, several factors appear likely

to contribute to accelerated spending growth. States will continue to generate additional federal spending from their use of the UPL mechanism, although regulations required by the Benefits Improvement and Protection Act (BIPA, Public Law 106-554) will begin to curb it in later years. Growth in medical costs and wages also is likely to place upward pressure on spending. In addition, spending on pharmaceutical benefits is expected to continue to rise as demand for and the prices of current and new high-cost products increases.

Furthermore, recent legal challenges under the Americans with Disabilities Act are causing states to increase the number of disabled people receiving long-term care services at home or in the community. New enrollment of children will also likely continue to grow through 2002, and it will be amplified because New York is expected to enroll more than 100,000 children in Medicaid who were incorrectly covered by SCHIP. Administrative costs for computer systems and for Medicaid services provided in schools will also exert pressure on spending in the near term.

Figure 4-3.
CBO's Baseline Projections of Federal Medicaid Spending, Fiscal Years 2001-2011



SOURCE: Congressional Budget Office.

In the longer term, CBO expects that medical and wage inflation will continue as will expansion of eligibility for and use of noninstitutional long-term care services and pharmaceutical benefits. In addition, states will likely have to pay higher rates to managed care organizations to maintain their participation in the program. Continued efforts by states to convert programs to Medicaid that they now fund alone will also drive new spending. Lastly, enrollment will continue to outstrip population growth in most years as participation by the eligible but previously unenrolled rises and states expand coverage to include new populations.

Other Means-Tested Programs. Outlays for other means-tested programs are generally projected to grow more slowly than those for Medicaid. Spending for the State Children's Health Insurance Program is estimated to increase from about \$3 billion in 2001 to \$5 billion in 2011. Food Stamp outlays are expected to grow moderately from \$19 billion in 2001 to \$27 billion in 2011 (see Table 4-5). Supplemental Security Income (SSI) benefits are estimated to grow from \$28 billion in 2001 to \$52 billion in 2011. Roughly half of that growth results from cost-of-living adjustments in benefits; most of the rest stems from the growth in and shifting mix of SSI caseloads.

CBO expects spending for family support programs, including Temporary Assistance for Needy Families (TANF), to gradually increase from its 2001 level of \$23 billion to reach \$27 billion in 2011. That increase in spending is the result of several factors. From 2001 through 2011, cash benefit levels will increase and investments by states in work, training, and child care programs will become fully phased-in. Furthermore, states will exercise their flexibility under TANF to spend money in nontraditional ways, such as for transportation, child welfare activities, or substance abuse counseling. Outlays for refundable tax credits—the earned income tax credit and the child tax credit—are expected to grow from \$27 billion in 2001 to \$29 billion in 2011.

The student loan program is difficult to classify as either means-tested or non-means-tested. CBO includes that program in the means-tested category because historically the majority of loans have had interest subsidies and have been limited to students from families with relatively low income and finan-

cial assets. However, in recent years, the fastest-growing category of loans is the set to which no means-testing is applied. In 2001, about \$33 billion in student loans will be guaranteed or provided directly by the federal government. Over the 2001-2011 period, total expected loan disbursements top \$410 billion. Of that total, the percentage of loans that are not means-tested is projected to increase from 49 percent in 2001 to 54 percent in 2011.

The costs included in the federal budget for student loans reflect only a small portion of the disbursements. 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 in-school interest subsidies, default costs, and other expected costs over the life of the loans. CBO estimates that the subsidy and administrative costs of the student loan program will range from \$4 billion to \$5 billion a year through 2011.

Non-Means-Tested Programs

Social Security, Medicare, and other retirement and disability programs dominate non-means-tested entitlements. Social Security is by far the largest federal program, with expected outlays of \$430 billion in 2001. It pays benefits to 45 million people—a number that is projected to increase to more than 55 million by 2011. Most Social Security beneficiaries also participate in Medicare, which is expected to cost \$238 billion in 2001. Together, those two programs account for more than one out of every three dollars that the federal government spends (up from about one in four dollars in 1980). CBO projects that the two programs combined will grow by more than \$540 billion from 2001 to 2011—even before the surge in beneficiaries that is expected to begin shortly thereafter as increasing numbers of baby boomers retire.

Social Security. During the past decade, Social Security outlays grew by an average of about 5.1 percent a year. Over the next decade, that growth rate is projected to average about 5.3 percent a year. Similarly, the share of the economy devoted to Social Security will remain fairly constant at about 4 percent of GDP through 2011. CBO estimates that by 2011, spending for Social Security will total \$719 billion.

The Social Security program for Old-Age and Survivors Insurance (OASI) will pay about \$372 billion in benefits in 2001. Benefit costs for that program are easier to project, in the near term, than those for other non-means-tested programs because the forces that drive its costs are quite predictable. More than 90 percent of people over age 65, and more than half of those ages 62 to 64, collect Social Security benefits on the basis of their past earnings (or the earnings of their spouse). Therefore, CBO bases its projections of OASI benefits chiefly on estimates of the size of the elderly population and on the assumption that the average benefit will continue to grow at a rate higher than that for inflation.

The other component of Social Security, the Disability Insurance (DI) program, will pay about \$58 billion in benefits in 2001 to disabled workers between the ages of 18 and 65 and their dependents. Projections of DI costs tend to be more uncertain than the costs of the OASI program because DI's growth will depend on the number of people who suffer from serious medical impairments that lead them to seek disability benefits. Thus, in the short run, inaccuracies in projections of Social Security spending are most likely to stem from misestimates of the number of disabled beneficiaries or of the cost-of-living adjustments made to all Social Security benefits each year, which depend on inflation.

Medicare. Currently, Medicare spending is about half as large as Social Security spending, but it is expected to grow faster than Social Security over the next decade. By 2011, CBO projects that spending for the Medicare program will total more than \$492 billion, and Medicare's share of the economy will have risen by more than one-half of a percentage point, from 2.3 percent of GDP in 2001 to 2.9 percent.

Historically, Medicare's growth rate has varied widely, and such fluctuations are likely to continue. The program's outlays increased by an average of almost 11 percent a year during the first half of the 1990s. Between 1997 and 1999, however, the rate of growth in spending slowed each year, falling from a high of almost 9 percent in 1997 to a 1 percent decline in spending in 1999. In 2000, by contrast, Medicare spending increased by 3 percent, and CBO projects it will grow by more than 10 percent in 2001

(those numbers exclude premiums). Annual spending increases for the period from 2001 through 2011 will average 7.5 percent, according to CBO estimates.

Why did Medicare spending drop so precipitously from 1997 through 1999, and why is it expected to pick up again in 2001 (and beyond)? Most of the decline can be explained by a strong effort to ensure compliance with payment rules. The savings from this effort more than offset the additional spending caused by increases in payment rates and higher enrollment in the late 1990s. However, the bulk of the savings from that effort has been realized, and as a result the increases in spending are now greater than the reduction caused by stricter compliance with payment rules.

Growth from 2000 to 2011 stems from various factors. First, payment rates for most services in the fee-for-service sector (including hospital care and services furnished by physicians, home health agencies, and skilled nursing facilities) are subject to automatic updates based on changes in input prices in those settings. CBO estimates that annual updates will increase by an average of 3.1 percent from 2001 through 2011. That increase is the net effect of legislation increasing certain rates and the expiration of legislation restricting certain other automatic updates. Roughly 43 percent of the increase in Medicare spending over the 10-year period comes from automatic updates to payment rates.

Second, increases in caseloads make up an additional 26 percent of the increase in Medicare spending from 2001 through 2011. CBO projects that the number of enrollees in Medicare's Hospital Insurance (Part A) program will swell by 20 percent, from 40 million to 48 million, between 2001 and 2011. However, the increases in spending that will accompany those enrollees will be greater in the second half of the decade than in the first half as growth in enrollment accelerates from 1.1 percent in 2001 to 3.1 percent in 2011.

The remainder of the increase results from other changes in covered benefits and payment rates required by the Balanced Budget Act of 1997, the Balanced Budget Refinement Act (BBRA), BIPA, and by such factors as changes in medical technology,

practice patterns, billing behavior, and the age distribution of enrollees.

Other Non-Means-Tested Programs. Other federal retirement and disability programs, totaling \$92 billion in 2001, are less than one-fourth the size of Social Security. They are dominated by benefits for the federal government's civilian and military retirees and the Railroad Retirement program. Those programs are expected to average 3.9 percent annual growth from 2001 through 2011.

The strong economy has reduced spending for unemployment compensation from its peak of \$37 billion in 1992 to \$21 billion in 2000. As the projected rate of growth in the economy slows and the unemployment rate rises, CBO estimates that spending for unemployment compensation will creep up.

The balance of spending for non-means-tested programs funds a diverse set of activities—mainly veterans' benefits, farm price and income supports, certain social service grants to the states, the Universal Service Fund, and health care benefits for military retirees. Credit liquidating accounts add offsetting collections to the category's total (total net credit re-estimates, which are included in the "other" category in Table 4-5, also reduce mandatory spending—by more than \$6 billion—in 2001). CBO projects that spending for other non-means-tested programs will total \$53 billion in 2001 (down from \$63 billion in 2000) and that it will fluctuate between \$58 billion and \$72 billion over the baseline period before ending the decade at \$74 billion. The estimated drop over the next decade in spending for farm price and income supports is more than offset by a continuing increase in net outlays for veterans' benefits and for the Universal Service Fund. In addition, costs will rise from the expansion of health care benefits (medical coverage and prescription drug coverage) for military retirees age 65 and over. CBO estimates that the program, which takes effect in 2003, will increase mandatory spending by \$5 billion in its first year, rising to \$10 billion by 2011.

Because of weak global demand and plentiful crop supply in recent years, prices for major supported crops such as corn, cotton, and wheat have been low. As a result, both automatic and legislated increases in agricultural spending soared in 2000

from already-high 1999 levels. Spending for farm price and income supports surged from \$18 billion in 1999 to \$30 billion in 2000, and automatic price supports provided farmers with about \$4 billion more in income assistance in 2000 than in 1999. In addition to the normal farm program benefits, the Congress provided \$5 billion in emergency appropriations in 1999, \$13 billion in 2000, and \$4 billion in 2001.

In spite of the recent upsurge, CBO estimates that spending for farm price and income supports will drop to \$17 billion in 2001 and continue falling to roughly \$5 billion a year toward the end of the decade. The drop in spending over the 10-year period occurs because emergency appropriations are not part of the ongoing mandatory program and therefore are not projected in future years. Also, demand for U.S. agricultural products is expected to gradually improve, bringing commodity prices back to more normal levels by the latter half of the decade.

Why Does Mandatory Spending Increase?

As a whole, spending for entitlements and other mandatory programs has more than doubled since 1985—rising faster than both nominal growth in the economy and the rates of inflation. CBO's baseline projections expect that trend to continue.

Why does mandatory spending grow so fast? One convenient way to analyze that growth is to break it down by its major causes. Such a breakdown shows that rising caseloads, automatic increases in benefits, and greater use of medical services will account for about 85 percent of the growth in entitlements and other mandatory programs between 2002 and 2011.

Mounting caseloads produce more than one-fifth of the total growth. Relative to 2001 outlays, higher caseloads increase spending by \$13 billion in 2002 and \$194 billion in 2011 (see Table 4-6). The majority of that spending is concentrated in Social Security and Medicare and can be traced to continued expansion of the elderly and disabled populations. Most of the rest is in Medicaid. The growth of caseloads alone will boost outlays in each of those three

programs by between 13 percent and 27 percent during the 2001-2011 period.

Automatic increases in benefits account for more than one-third of the growth in entitlement programs. All of the major retirement programs grant automatic cost-of-living adjustments (COLAs) to their beneficiaries. CBO expects those adjustments, which are pegged to the consumer price index, to be 2.9 percent in 2001, and to range between 2.6 and 2.8 percent from 2002 through 2004 before leveling off at 2.5 percent thereafter. In 2001, outlays for programs with COLAs total almost \$567 billion. COLAs are projected to add an extra \$12 billion to that amount in 2002 and \$161 billion in 2011.

Several other programs—chiefly the earned income tax credit (EITC), Food Stamps, and Medicare—are also automatically indexed to changes in prices. The income thresholds above which the EITC begins to be phased out as well as the maximum amount of the tax credit are both automatically adjusted for inflation using the consumer price index (the credit is administered through the individual income tax, but credits in excess of tax liabilities are recorded as outlays in the budget). The Food Stamp program makes annual adjustments to its benefit payments according to changes in the Department of Agriculture's Thrifty Food Plan index. Medicare's payments to providers are based in part on special price indexes for the medical sector. The combined effect

Table 4-6.
Sources of Growth in Mandatory Spending (By fiscal year, in billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Estimated Spending for Base Year 2001	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089	1,089
Sources of Growth										
Increases in caseloads	13	26	41	58	75	94	115	139	164	194
Automatic increases in benefits										
Cost-of-living adjustments	12	29	46	62	77	93	110	126	143	161
Other ^a	10	20	31	43	55	67	81	97	115	133
Other increases in benefits										
Increases in Medicare and Medicaid ^b	19	33	52	72	94	117	141	166	196	225
Growth in Social Security ^c	8	13	18	25	33	42	51	63	76	92
Irregular number of benefit payments ^d	-1	2	2	11	-2	-5	2	2	2	2
Change in outlays for deposit insurance	*	*	1	1	*	*	*	*	*	*
Other sources of growth	<u>6</u>	<u>8</u>	<u>17</u>	<u>18</u>	<u>21</u>	<u>23</u>	<u>25</u>	<u>30</u>	<u>35</u>	<u>39</u>
Total	68	131	207	289	352	431	525	624	731	845
Projected Spending	1,157	1,219	1,296	1,378	1,441	1,520	1,614	1,713	1,820	1,934

SOURCE: Congressional Budget Office.

NOTE: * = between zero and \$500 million.

- Automatic increases in Food Stamp and child nutrition benefits, certain Medicare reimbursement rates, the earned income tax credit, and several smaller adjustments under formulas specified by law.
- All growth not attributed to increased caseloads and automatic increases in reimbursement rates.
- All growth not attributed to increased caseloads and cost-of-living adjustments.
- 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 2001 and 2005 and 11 in 2002 and 2006. Supplemental Security Income and veterans' benefits will be paid 11 times in 2001, 13 times in 2005, 12 times in 2006, and 11 times in 2007.

of indexing for all of those programs is an extra \$10 billion in outlays in 2002 and \$133 billion in 2011.

The remaining boost in entitlement spending comes from increases that cannot be attributed to rising caseloads or automatic adjustments to benefits. Two of those sources of growth are expected to become even more important over time. First, CBO anticipates that Medicaid spending will grow with inflation even though it is not formally indexed at the federal level. Medicaid payments to providers are determined by the states, and the federal government matches those payments, according to a formula set by law. If states increase their benefits to account for inflation, federal payments will rise correspondingly. Second, the health programs have faced steadily escalating costs per participant beyond the effects of inflation; that trend, which is often termed an increase in "intensity," reflects the consumption of more health services per participant and the growing use of more costly procedures. CBO estimates that the residual growth in Medicare and Medicaid from both of those sources will be \$19 billion in 2002 and \$225 billion in 2011.

In most retirement programs, the average benefit grows faster than the COLA alone. Social Security is a prime example. Because new retirees have recent earnings that were bolstered by real wage growth, their benefits generally exceed the monthly check of a longtime retiree who last earned a salary a decade or two ago and has been receiving only cost-of-living adjustments since then. And because more women are working today, more new retirees receive benefits based on their own earnings rather than a smaller spouse's benefit. In Social Security alone, CBO estimates that those trends will add \$8 billion in outlays in 2001 and \$92 billion in 2011.

Mandatory spending will increase or decrease in a given year depending on whether October 1 falls on a weekend. If it does, a benefit payment is made at the end of September, which increases spending in the year just ended and decreases spending in the new fiscal year. Thus, Supplemental Security Income, veterans' compensation and pension programs, and Medicare (for payments to health maintenance organizations) may send out 11, 12, or 13 monthly checks in a fiscal year (see Table 4-6). Irregular

numbers of benefit payments will affect mandatory spending in 2001, 2002, and 2005 through 2007.

Most of the remaining growth in spending for benefit programs derives from (1) rising benefits for new retirees in the Civil Service and Military Retirement programs (fundamentally the same phenomenon as in Social Security) and (2) larger average benefits for unemployment compensation (a program that lacks an explicit COLA but pays amounts that are generally linked to the recent earnings of its beneficiaries). Those factors together contribute just \$39 billion of the total \$845 billion increase in mandatory spending by 2011.

Legislation Assumed in the Baseline

The general baseline concept for mandatory spending is to project budget authority and outlays in accordance with current law. However, in the case of certain programs with outlays of more than \$50 million in the current year, the Deficit Control Act directs CBO to assume that the programs continue when their authorization expires.⁷ The bulk of projected spending associated with such programs occurs after 2002, when the current authorizations for the Food Stamp and TANF programs expire (see Table 4-7). In addition, the act directs CBO to assume that cost-of-living adjustments for veterans' compensation are granted each year.

Offsetting Receipts

Offsetting receipts are income that the government records as negative spending. Those receipts are either intragovernmental (reflecting payments from one part of the federal government to another) or propri-

7. Section 257 of the Deficit Control Act stipulates that programs with current year outlays of \$50 million or more established prior to enactment of the Balanced Budget Act of 1997 should be assumed to continue in the baseline, but programs established after the 1997 act could be assumed to expire in the baseline. That decision is based on scoring by OMB and CBO, in consultation with the budget committees. For example, the authorization for the Initiative for Future Agriculture and Food Systems program, with outlays of \$60 million in 2001, is assumed to expire after 2003.

Table 4-7.
Program Continuations Assumed in CBO's Baseline (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Commodity Credit Corporation Fund ^a											
Budget authority	n.a.	n.a.	9.2	9.2	8.8	8.0	6.4	5.3	5.3	5.2	5.1
Outlays	n.a.	n.a.	9.2	9.2	8.8	8.0	6.4	5.3	5.3	5.2	5.1
Ground Transportation Programs Controlled by Obligation Limitations ^b											
Budget authority	n.a.	n.a.	n.a.	37.1	37.1	37.1	37.1	37.1	37.1	37.1	37.1
Outlays	n.a.	n.a.	n.a.	0	0	0	0	0	0	0	0
Ground Transportation Programs Not Subject to Annual Obligation Limitations											
Budget authority	n.a.	n.a.	n.a.	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Outlays	n.a.	n.a.	n.a.	0.1	0.3	0.5	0.6	0.6	0.6	0.6	0.6
Air Transportation Programs Controlled by Obligation Limitations											
Budget authority	n.a.	n.a.	n.a.	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4
Outlays	n.a.	n.a.	n.a.	0	0	0	0	0	0	0	0
Family Preservation and Support											
Budget authority	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Outlays	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Rehabilitation Services and Disability Research											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.8	2.9	3.0	3.0	3.1
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.0	2.8	2.9	3.0	3.1
State Children's Health Insurance Fund											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.0	5.0	5.0	5.0
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.9	0.8	3.7	5.0
Federal Unemployment Benefits and Allowances											
Budget authority	n.a.	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Outlays	n.a.	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.5
Food Stamps											
Budget authority	n.a.	n.a.	21.3	22.2	23.0	23.7	24.5	25.2	26.0	26.8	27.5
Outlays	n.a.	n.a.	19.9	22.1	22.9	23.7	24.4	25.2	26.0	26.7	27.4
Child Nutrition ^c											
Budget authority	n.a.	n.a.	n.a.	0.5	0.5	0.5	0.5	0.5	0.5	0.6	0.6
Outlays	n.a.	n.a.	n.a.	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.6
Child Care Entitlement to States											
Budget authority	n.a.	n.a.	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Outlays	n.a.	n.a.	2.1	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Temporary Assistance for Needy Families											
Budget authority	n.a.	n.a.	16.7	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9
Outlays	n.a.	n.a.	17.6	17.8	18.0	18.1	18.2	18.2	18.2	18.2	18.2
Veterans' Compensation COLAs											
Budget authority	0	0.4	1.0	1.6	2.4	2.9	3.2	4.0	4.6	5.3	6.0
Outlays	0	0.4	1.0	1.6	2.4	2.8	3.1	4.0	4.6	5.2	5.9
Total											
Budget authority	0	1.0	51.6	94.8	96.1	96.5	98.9	104.5	105.9	107.3	108.7
Outlays	0	0.7	50.4	54.5	56.2	57.0	58.6	60.9	62.5	66.8	69.4

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; COLAs = cost-of-living adjustments.

- Agricultural commodity price and income supports under the Federal Agriculture Improvement and Reform Act of 1996 (FAIR) generally expire after 2002. 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 continuation of the FAIR provisions.
- 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.
- The expiring child nutrition programs are the Summer Food Service program and state administrative expenses.

etary (reflecting payments from the public in exchange for goods or services).

A decision to collect more (or less) money in the form of offsetting receipts usually requires a change in the laws that generate such collections. Thus, offsetting receipts are treated as offsets to mandatory spending for pay-as-you-go purposes. Fees and other charges that are triggered by appropriation action are classified as offsetting collections. In those cases, the collections offset discretionary spending.

Intragovernmental transfers representing the contributions that federal agencies make to their employee retirement plans account for roughly 45 percent of offsetting receipts—a share that is expected to remain relatively constant through 2011 (see Table 4-8). Agency contributions are paid primarily to the trust funds for Social Security, Military Retirement, and Civil Service Retirement. Some contribution rates are set by statute; others are determined on an actuarial basis. The contributions that agencies must make for their employees are charged against their budgets in the same way as other elements of their

Table 4-8.
CBO's Projections of Offsetting Receipts (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Employer's Share of Employee Retirement												
Social Security	-8	-8	-9	-9	-10	-11	-11	-12	-13	-14	-15	-16
Military Retirement	-11	-11	-12	-13	-13	-14	-14	-15	-15	-16	-16	-17
Civil Service Retirement and other	<u>-19</u>	<u>-19</u>	<u>-20</u>	<u>-21</u>	<u>-22</u>	<u>-23</u>	<u>-23</u>	<u>-24</u>	<u>-26</u>	<u>-27</u>	<u>-28</u>	<u>-29</u>
Subtotal	-38	-39	-41	-42	-45	-47	-49	-51	-54	-56	-59	-62
Medicare Premiums	-22	-24	-27	-30	-33	-37	-40	-43	-47	-51	-56	-61
Energy-Related Receipts ^a	-6	-8	-7	-6	-6	-6	-5	-5	-5	-5	-5	-5
Natural Resource-Related Receipts ^b	-3	-4	-4	-3	-3	-3	-3	-3	-4	-4	-4	-4
Electromagnetic Spectrum Auctions	*	-1	-4	-10	-10	-1	-1	-1	*	*	*	*
Department of Defense Health Care	0	0	0	-3	-3	-4	-4	-4	-4	-4	-4	-4
Other ^c	<u>-12</u>	<u>-12</u>	<u>-13</u>	<u>-12</u>	<u>-10</u>	<u>-10</u>	<u>-11</u>	<u>-11</u>	<u>-11</u>	<u>-11</u>	<u>-12</u>	<u>-12</u>
Total	-81	-87	-95	-108	-111	-107	-113	-119	-125	-131	-139	-147

SOURCE: Congressional Budget Office.

NOTE: * = between zero and -\$500 million.

a. Includes proceeds from the sale of power, various fees, and naval petroleum reserve and Outer Continental Shelf receipts.

b. Includes timber and mineral receipts and various fees.

c. Includes asset sales.

employee compensation. Future retirement benefits are an important part of the compensation package for the government's roughly 4.2 million civilian, military, and postal workers. The budget treats those contributions as outlays and handles the deposits made in retirement funds as offsetting receipts. The transfers thus wash out in the budgetary totals, leaving only the funds' disbursements—for retirement benefits and administrative costs—reflected in total outlays.

The largest proprietary receipt that the government collects comprises premiums from the 38 million people enrolled in Supplementary Medical Insurance (Part B of Medicare), which primarily covers physicians' and outpatient hospital services. Premiums in the program are set to cover one-quarter of its costs. The monthly charge for SMI beneficiaries is \$50 in 2001; it is projected to climb to \$110 in 2011.

Almost all enrollees in Part B of Medicare pay the monthly premium. In the case of Part A, the Hospital Insurance program, most beneficiaries are considered to be entitled to those benefits and are not charged a premium. However, Medicare collects Part A premiums for about 360,000 enrollees who did not participate in employment covered by Medicare payroll taxes for a sufficient amount of time to be entitled to free enrollment. CBO estimates that collections of premiums for both parts of Medicare will increase from \$24 billion in 2001 to \$61 billion in 2011; more than 95 percent of the increase in those collections is associated with enrollees' payments of the regular monthly SMI premium. The federal government, however, also pays a substantial share of those premiums because Medicaid pays the Part B premium (and, if necessary, the Part A premium) for Medicare enrollees who are eligible for Medicaid. Thus, CBO projects that collections of premiums from nonfederal sources will increase from \$19 billion in 2001 to \$45 billion in 2011.

The program providing health care benefits for military retirees will collect \$3 billion in receipts in 2003 and increase slowly to \$4 billion in 2011. Other proprietary receipts come mostly from royalties and charges for oil and natural gas, electricity, minerals, and timber and from various fees levied on users of government property and services. Auctions by the Federal Communications Commission of

rights to use parts of the electromagnetic spectrum are expected to continue through 2007, when the authority to conduct them expires. CBO estimates those auctions will bring in \$1 billion in 2001, between \$4 billion and \$10 billion each year from 2002 to 2004, and smaller amounts in subsequent years (see Box 4-1).

Net Interest

Interest costs are a sizable but shrinking portion of the federal budget, representing more than 12 percent of government outlays in 2000—which is down from 15 percent in 1998. Under CBO's baseline projections of rapidly rising surpluses for 2001 through 2011, outstanding government debt continues to decline sharply over the period. Therefore, annual interest payments on the debt over the period quickly plummet from their 2000 level of \$223 billion.

The path of interest costs depends in part on the size and composition of federal debt. Some of the securities that are currently outstanding, such as long-term bonds, will not be available for redemption over the next 10 years (see the discussion in Chapter 1). Therefore, in any given year, some will remain outstanding and incur interest costs, regardless of the size of the surplus. Starting in the first year when all available debt is retired, 2006 under CBO's baseline assumptions, any uncommitted funds from residual surpluses are accounted for separately, and proceeds earned by investing those funds are not considered part of net interest.

Net interest drops from \$205 billion in 2001 to \$90 billion in 2006 (see Table 4-9). After 2006, as the remaining long-term debt slowly matures, net interest declines more gradually, reaching \$51 billion in 2011. Under baseline assumptions, net interest as a share of total spending drops from 11 percent in 2001 to about 2 percent in 2011.

In general, interest costs are not covered by the enforcement provisions of the Deficit Control Act because they are not directly controllable. Rather, interest payments depend on the amount of outstanding government debt and on interest rates. The Congress

Box 4-1.**Auctions of Spectrum Licenses Are Likely to Yield Higher Proceeds**

CBO's baseline projection of offsetting receipts from Federal Communications Commission (FCC) auctions of portions of the electromagnetic spectrum totals nearly \$28 billion over the 2001 through 2011 period, an increase of more than \$10 billion relative to CBO's July 2000 estimate.¹ The prices being paid for spectrum licenses have skyrocketed over the last year, leading CBO to revise its valuations upward as well.

Many telecommunications and broadcast services require the use of the radio spectrum. By law, the FCC must use competitive bidding, or auctioning, to assign commercial licenses to use the radio spectrum when more than one commercial party seeks such licenses. In developing baseline projections for spectrum auctions, CBO attempts to measure the net effect of several factors that will determine future auction receipts. Those factors include the amount of spectrum that will be auctioned, the likely prices for that spectrum, and the statutory guidelines that shape FCC auctions.²

Like other nations, the United States will be making large blocks of spectrum available for new uses over the next few years, including spectrum for "third generation" (also known as "3G") mobile telecommunications services, which would simultaneously provide voice and high-speed data communications. The commission is in the process of allocating spectrum for 3G services, with auctions planned for sometime in the fall of 2002. CBO expects the FCC to auction licenses for other purposes as well, in accord with its broad statutory authority to allocate frequencies for commercial use as new technologies and market developments permit.

While CBO's assumptions about the amount of spectrum to be auctioned have not changed substantially since last year, recent actions by the commission suggest that the timing of auctions may change if the statutory deadlines conflict with other legislative directives regarding spectrum management. As a result, CBO now expects auction receipts to peak in fiscal years 2003 and 2004 rather than in 2002, the year targeted in the Balanced Budget Act of 1997.

CBO's new price assumptions reflect the dramatic increase in amounts paid for spectrum licenses in Europe and the United States in the past year. European auctions held over the spring and summer of 2000 yielded unit prices that were, on average, about four times higher than the amounts previously paid for similar licenses in the United States. Bidding in the FCC's reauction of certain "C-block" licenses was robust as well. Those higher prices have been driven largely by market enthusiasm for 3G services.

While it appears that auction proceeds over the next five years will exceed CBO's earlier expectations, those projections—and all other spectrum estimates—are subject to considerable uncertainty. The process of making new frequencies available for auction has moved more slowly than anticipated. Both public and private users of the radio spectrum have strongly resisted efforts to make their spectrum available for new uses. Spectrum values have also proven to be volatile, changing in response to trends in technology, the extent of competition for telecommunications markets, and the availability of capital at the time of the auction. Future auctions also are likely to involve frequencies that are encumbered by other uses or technical limitations, suggesting that prices may be lower than those being paid for the unencumbered spectrum auctioned in 2000.

1. CBO's current estimate does not include receipts from the FCC's reauction of certain "C-block" licenses, which ended on January 26, 2001. Proceeds from the reauction of C-block licenses are subject to credit reform procedures and are not included in the \$28 billion estimate of offsetting receipts projected for 2001-2011. Instead, any proceeds retained from the reauction will be treated as a recovery on the loans made by the FCC to the original C-block licensees. The money recovered from such loans determines the amount of the credit subsidy, which is measured on a present-value basis over the life of the loan. Credit subsidies, which are classified as mandatory, are estimated annually and are adjusted to reflect the most recent information regarding the cash flows being generated by the licenses. Although the final disposition of the reaucted licenses remains subject to certain legal proceedings, CBO expects that the Office of Management and Budget will make a downward adjustment in the estimated subsidy for the C-block portfolio, which would appear as a negative outlay in fiscal year 2001. On the basis of the results of the auction at the time CBO prepared this baseline, it estimated that the subsidy re-estimate could total about \$9 billion. Total winning bids were close to \$17 billion—a few billion dollars higher than CBO estimated when completing its baseline projections earlier in the month. Future revisions to the baseline, which are generally completed before the Congress adopts a budget resolution, will reflect more up-to-date information on the reauction of C-block licenses.

2. For a more detailed description of these factors, see *The CBO Baseline for Spectrum Auction Receipts*, which is included as Appendix B to CBO's *Budget and Economic Outlook: Fiscal Years 2001-2010* (January 2000).

and the President influence the former by making decisions about taxes and spending and thus about government borrowing. Beyond that, they exert no direct control over interest rates, which are determined by market forces and Federal Reserve policy.

Net or Gross?

Net interest is the most economically relevant measure of what it costs the government to service its debt. However, some budget watchers stress gross interest (and its counterpart, gross federal debt) rather

than net interest (and its counterpart, debt held by the public). But that choice exaggerates the government's debt-service burden because it overlooks billions of dollars in interest income that the government now receives.

Currently, about \$3.4 trillion worth of federal securities sold to the public to finance previous deficits are outstanding. The federal government also has issued more than \$2.1 trillion worth of securities to its own trust funds (mainly Social Security and other retirement trust funds). Those securities represent the past surpluses of the trust funds, and their total amount grows approximately in step with the

Table 4-9.
CBO's Projections of Federal Interest Outlays and Proceeds from Uncommitted Funds
(By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Interest on the Public Debt (Gross interest) ^a	362	369	337	331	325	315	307	307	319	334	350	371
Interest Received by Trust Funds												
Social Security	-60	-68	-75	-83	-93	-104	-117	-131	-146	-162	-180	-198
Other trust funds ^b	-69	-85	-73	-78	-81	-85	-89	-93	-98	-102	-106	-111
Subtotal	-129	-154	-149	-161	-174	-189	-206	-224	-244	-264	-286	-309
Other Interest ^c	-10	-11	-9	-8	-9	-10	-10	-11	-11	-11	-11	-11
Total (Net Interest)	223	205	179	163	142	116	90	72	65	58	53	51
Proceeds Earned on the Balance of Uncommitted Funds ^d	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-1	-12	-38	-68	-104	-146
Total (Net interest plus proceeds earned on the balance of uncommitted funds)	223	205	179	163	142	116	90	60	27	-10	-51	-95

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

- Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).
- Principally Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Airport and Airway Trust Fund.
- Primarily interest on loans to the public.
- "Uncommitted funds" is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

projected trust fund surpluses (see Chapter 1). The funds redeem the securities as needed to pay benefits; in the meantime, the government both pays and collects the interest on those securities. It also receives interest income from loans and short-term cash balances. Broadly speaking, gross interest encompasses all interest paid by the government (even to its own funds) and ignores all interest received. Net interest, by contrast, is the net flow to people and organizations outside the federal government (excluding any proceeds earned on uncommitted funds).

In 2000, net interest was about two-thirds as large as gross interest. CBO estimates that the government will pay \$369 billion in gross interest costs in 2001 (see Table 4-9). Of that amount, however, \$154 billion is credited to trust funds and is not paid out by the government. CBO also projects that the government will collect nearly \$11 billion in other interest income this year. Therefore, net interest costs will total \$205 billion in 2001.

Other Interest

The \$11 billion in other interest that CBO expects the government to receive in 2001 comprises some interest payments and some interest collections. On balance, however, the government takes in more in that category than it pays out. Among the expenditures are Treasury payments for interest on tax refunds that are delayed for more than 45 days after the filing date (those payments total approximately \$3 billion a year). An example of other collections is the interest

received from the financing accounts of credit programs, mostly for direct loans. As those programs (student loans, for instance) make more loans, they borrow money from and pay interest to the Treasury. Interest payments from such programs are expected to rise slightly from \$10 billion in 2000 to \$11 billion in 2011.

Proceeds Earned on the Balance of Uncommitted Funds

By 2006, the baseline begins to record uncommitted funds from the residual of the surplus after all available debt is paid down. CBO makes no explicit assumption about what the Treasury might do with balances of uncommitted funds; its projections simply assume that all funds over the amounts needed to retire available debt will earn proceeds at a rate equal to the average rate projected for Treasury bills and notes.

The initial proceeds are quite small, only \$1 billion in 2006. But they grow quickly as large amounts of uncommitted funds are accumulated in the later years of the projection period. Under baseline assumptions, CBO assumes that the balance of uncommitted funds will reach almost \$3.2 trillion by 2011 and the proceeds from investing it will reach \$146 billion in that year.

The Uncertainty of Budget Projections

The baseline projections in Chapters 1 and 2 represent the midrange of possible outcomes for the economy and the budget, based on past and current trends and the assumption that current policies do not change. But considerable uncertainty surrounds those projections for two reasons. First, future legislation is likely to alter the paths of federal spending and revenues. The Congressional Budget Office does not predict future legislation—indeed, any attempt to incorporate future legislative changes into its baseline would undermine the usefulness of those numbers as the base against which to measure the effects of legislative action. Second, the U.S. economy and the federal budget are highly complex and are affected by many economic and technical factors that are difficult to predict. As a result, actual budgetary outcomes will almost certainly differ from CBO's baseline projections.

This chapter explores how errors in the assumptions about economic and technical factors that CBO incorporates into its baseline can affect the accuracy of budget projections. If the future record is like the past, there is about a 50 percent chance that such errors will cause CBO's projection of the total budget surplus for the coming fiscal year to miss the actual outcome by more than 0.9 percent of GDP (or \$97 billion) and its projection of the annual surplus five years ahead to miss by more than 1.8 percent of GDP (or \$245 billion). CBO has been making 10-year projections for less than a decade, so it is not yet possible to assess their accuracy. But 10-year projections are likely to be less accurate than five-year projections.

In view of those uncertainties, the outlook for the budget can best be described not as the single row of numbers presented in CBO tables but as a fan of probabilities around those numbers. That fan widens as the projection extends (see Figure 5-1). The budget projections in Chapter 1 fall in the middle of the highest probabilities—the darkest part of the figure. But as the figure shows, nearby projections—other paths in the darkest part of the figure—have nearly the same probability as the baseline projections in Chapter 1. Moreover, projections that are quite different from the baseline also have a significant probability of coming to pass.

Figure 5-1 is intentionally somewhat fuzzy because the uncertainties are themselves estimates. The figure is derived from CBO's past five-year projections (which is why it extends for only five years). However, the record on which the probabilities are based is short, and it may not be representative of future uncertainties. The historical record contains only one full recession (that of 1990-1991) and the recovery from another (that of 1981). Moreover, the record includes no years in which inflation exceeded 7 percent, although inflation was higher than that in six of the eight fiscal years from 1974 through 1981.

In theory, current projections would be expected to be more accurate than those of the past because forecasters, including CBO, learn from their past inaccuracies. But forecasters must also deal with a changing economy. As this report was being pre-

pared, the economy appeared to be weakening more than previously expected, leading the Federal Reserve to take unusually emphatic action to restrain any further weakening. Economists are usually unable to forecast the turning points of business cycles—and indeed do not have a good record in recognizing them in the first months after they have occurred. Thus, the short-term outlook for the economy, and hence for the budget, is particularly uncertain when the business cycle may be approaching a turning point.

The longer-term outlook is also unusually hard to discern at present. Many commentators believe that major structural changes have created a “new economy,” and that belief influences the economic

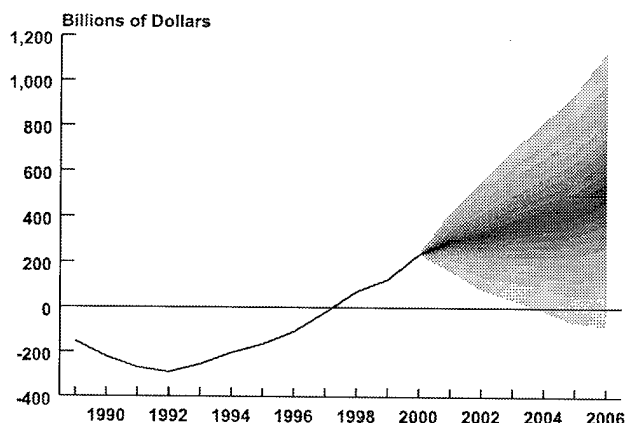
projections described in Chapter 2. However, CBO’s projections, like those of other forecasters, are based on very limited information about just a few years’ increased growth of productivity and strong investment in information technology. Projections of those recent changes as far as five or 10 years into the future are bound to be highly uncertain.

Another way to show the uncertainty of projections is to calculate the effects of specific sets of alternative assumptions on the budget outlook. CBO has chosen two alternative trend scenarios that make different but reasonable assumptions about the future course of the economy and the cost of federal health care programs. One scenario assumes that the good economic news of the past few years will continue for the next decade; the other assumes that the economy has simply experienced a temporary divergence from stable, long-term trends and will shortly return to the trend it followed from about 1973 through 1995. The projections that result from those two scenarios also suggest a very wide range of possible outcomes for the budget.

Policymakers will have to decide what that degree of uncertainty means for a budget process that currently relies on 10-year projections. Looking forward five or 10 years allows the Congress to consider the longer-term budgetary implications of policy changes. But it also increases the likelihood that budgetary decisions will be made on the basis of projections that later turn out to have been far wrong.

In contrast to the optimistic and pessimistic trend scenarios, a recession of average size would probably not alter the 10-year outlook significantly. The reason is that CBO’s baseline 10-year assumptions allow for the likelihood that a recession of average severity will occur over the next decade, as well as for the possibility of periods of above-trend growth.

Figure 5-1.
Uncertainty in CBO’s Projections of the Total Budget Surplus Under Current Policies
(By fiscal year)



SOURCE: Congressional Budget Office.

NOTES: The figure shows the estimated likelihood of alternative projections of the surplus under current policies. The calculations are based on CBO’s past track record. The CBO projections described in Chapter 1 fall in the middle of the darkest area. Assuming that policies do not change, the probability is 10 percent that actual surpluses will fall in the darkest area and 90 percent that they will fall within the whole shaded area.

Actual surpluses will of course be affected by legislation enacted during the next 10 years, including decisions about discretionary spending. The effects of future legislation are not included in this figure.

An explanation of how this probability distribution was calculated will appear shortly on CBO’s Web site at www.cbo.gov/otherdoc.html.

The Accuracy of CBO’s Past Budget Projections

Because baseline budget projections are destined to deviate from reality in some respects, assessing their historical accuracy is not a simple matter. Baseline

projections are meant to serve as a neutral reference point for evaluating policy changes, so they make no assumptions about future legislation that might alter current budget policies. Of course, legislation is likely to be enacted, but the purpose of baseline estimates is not to forecast legislation. Consequently, this chapter concentrates on inaccuracies in forecasting that flow from economic and technical factors, not from the effects of new legislation.

To assess the accuracy of its past annual projections, CBO compared those projections with actual budgetary outcomes and attempted to determine the sources of any differences (after adjusting for the estimated effects of policy changes). The comparisons included 19 sets of projections for the current fiscal year (the one in which the projections were made), 18 sets for the following fiscal year (referred to as the budget year), and 14 sets of projections that extend five years into the future.¹

Innovations in This Analysis

For the purpose of this assessment, discretionary spending is handled somewhat differently from CBO's usual practice.² CBO normally allocates part of any discrepancies between the assumptions for discretionary spending in the baseline and what is finally enacted to the category of economic or technical differences. But discretionary spending, which is appropriated annually, is not controlled by the sort of

permanent laws and automatic rules that determine entitlement spending and taxes in the absence of new legislation. Indeed, when the Congress makes its actual decisions about discretionary spending, it does so through new legislation. For that reason, discretionary spending is treated as determined entirely by legislation and excluded from the uncertainties discussed in this chapter.

This analysis also differs from CBO's other evaluations of its track record by omitting any distinction between economic and technical differences (see Chapter 1 and Appendix C). That distinction can be arbitrary and subject to change as the underlying economic data are revised. In any case, the distinction is unnecessary for this analysis.³

CBO's Track Record

On average, the absolute difference (without regard to whether the difference was positive or negative) between CBO's estimate of the federal deficit or surplus and the actual result was 0.5 percent of gross domestic product for the current fiscal year, 1.1 percent for the budget year, and 3.1 percent for the fifth year beyond the current year (see Table 5-1). If those averages were applied to CBO's current baseline, the estimated surplus could be off in one direction or the other, on average, by about \$52 billion in 2001, \$120 billion in 2002, and \$412 billion in 2006.

Misestimates of the projected deficit or surplus are the net result of the separate estimates for revenues and outlays. In many past years, revenue and outlay differences did not offset each other but tended to work in the same direction with regard to the deficit or surplus—short-term projections on average had outlays too high but revenues too low, and medium-term projections on average had outlays close to actual levels but revenues too high.

1. The projections are those made in July 1981 and CBO's winter projections (usually published in January) from 1983 through 1999. Insufficient data were available to use either projections made before 1981 or the projection made in early 1982. To calculate the role of policy changes in the projection errors, CBO used estimates of the budgetary effects of legislative changes that were made soon after the legislation was enacted. CBO does not recalculate those estimates with more recently available macroeconomic or other data.

2. In previous analyses of its track record, CBO split discrepancies in discretionary spending into three components: the lion's share was attributed to legislation, but small portions were attributed to economic and technical assumptions. Attributing all discrepancies in discretionary spending to legislation, as is done in this chapter, permits the use of a larger historical record. Since 1986, the Balanced Budget and Emergency Deficit Control Act has mandated that the baseline for discretionary spending reflect assumptions about inflation. As a result, baselines for discretionary spending made before 1986 are not comparable with those made after that date. Counting all discrepancies in discretionary spending as legislative avoids that problem.

3. Appendix C also looks at budgetary outcomes but compares them with the targets for the coming fiscal year set forth by the Congress in its concurrent resolution on the budget. Those targets often use as a starting point CBO's baseline projections for the coming year. However, the targets represent the Congress's budgetary goals, to be implemented through subsequent legislation, including appropriation acts and changes in laws that affect revenues and direct spending. Appendix C attributes differences between the targets and actual budgetary outcomes to policy, economic, and technical differences.

Misestimates of revenues have generally been larger than misestimates of outlays, reflecting the greater sensitivity of revenues to economic developments. In absolute terms, revenue projections have differed from actual outcomes by an average of about 1.7 percent of revenues for the current year, 4.0 percent for the budget year, and 11.5 percent for the fifth year. Inaccuracies in outlay projections were similar to those in revenue projections for the current year

but nearly 50 percent smaller than revenue inaccuracies for the budget year. Outlays projected five years ahead missed actual outlays by 5.6 percent, on average.

The misestimates of the budget's bottom line went in both directions: sometimes the projections were too high and at other times too low. On average, CBO's forecast of the deficit or surplus has

Table 5-1.
Average Difference Between CBO's Budget Projections and Actual Outcomes Since 1981,
Adjusted for Legislation (In percent)

	Year for Which the Projection Was Made					
	Current Year	Budget Year	Budget Year + 1	Budget Year + 2	Budget Year + 3	Budget Year + 4
Difference as a Percentage of GDP						
Surplus or Deficit						
Average difference ^a	0.3	0.2	*	-0.3	-0.7	-1.1
Average absolute difference	0.5	1.1	1.7	2.1	2.6	3.1
Revenues						
Average difference	0.1	0.1	-0.2	-0.3	-0.6	-0.9
Average absolute difference	0.3	0.8	1.2	1.6	1.8	2.1
Outlays						
Average difference	-0.2	-0.2	-0.1	-0.1	0.1	0.2
Average absolute difference	0.4	0.5	0.7	0.8	1.0	1.2
Difference as a Percentage of Actual Outcome						
Revenues						
Average difference	0.5	0.2	-1.2	-2.2	-3.5	-5.6
Average absolute difference	1.7	4.0	6.6	8.4	9.8	11.5
Outlays						
Average difference	-0.8	-0.8	-0.8	-0.5	0.2	0.6
Average absolute difference	1.7	2.4	3.2	3.7	4.7	5.6

SOURCE: Congressional Budget Office.

NOTES: This comparison covers the baseline budget projections that CBO published in July 1981 in *Baseline Budget Projections: Fiscal Years 1982-1986* and the ones it published each winter between 1983 and 1999 in *The Economic and Budget Outlook*.

The current year is the fiscal year in which the projections are made; the budget year is the following fiscal year.

Differences are actual values minus projected values. Unlike the average difference, the average absolute difference ignores arithmetic signs and thus indicates the average distance between actual and projected values without regard to whether individual projections are overestimates or underestimates.

* = less than 0.05 percent.

a. A positive average difference for the surplus or deficit means that, on average, CBO underestimated the surplus or overestimated the deficit.

tended to be slightly pessimistic—that is, CBO overestimated deficits—for the current year and the budget year and slightly optimistic for the third through the fifth years of the projection. (That pattern may reflect the fact that deficit projections made before 1991 were too optimistic and those made in more recent years were too pessimistic; data on the later years are incomplete for projections made after 1995.) However, the average underestimates and overestimates at different horizons were not statistically significant and thus were not incorporated into Figure 5-1.

Sources of Past Inaccuracies in Projecting Revenues

Misestimates of revenues can rarely be traced to a single cause, but a few major factors can be identified. Both recessions and booms can be a problem for revenue projections—as noted earlier, predicting turning points is one of the most difficult challenges facing economic forecasters. Thus, revenues tend to be overestimated in recessions and underestimated during booms. In the past few years, the major source of inaccuracies in revenue projections was the failure to predict both the apparent change in the trend growth of the economy (described in Chapter 2) and the economic changes associated with it, especially the boom in the stock market and the increasing concentration of income growth among taxpayers in the highest tax brackets. The stock market boom led to huge capital gains on paper, which boosted tax revenues as investors began to realize those gains. That factor will probably continue to keep revenues high for several more years.

Only during unusual periods has CBO's revenue forecast for the budget year been off by more than 5 percent of revenues in either direction. The forecasts produced during the boom years of 1996 through 1999 (for fiscal years 1997 through 2000) are the only ones that underestimated revenues (excluding subsequent policy changes) by more than 5 percent. The three forecasts that overestimated revenues to that degree were produced in the recession years of 1981, 1990, and 1991.

Sources of Past Inaccuracies in Projecting Nondiscretionary Outlays

Economic performance affects federal spending, both directly and indirectly. CBO often overestimated inflation in the early 1980s, and more recently it anticipated an upturn in inflation during the late 1990s that did not occur. Overestimating inflation results in overestimating cost-of-living adjustments for beneficiaries of many cash benefit programs and reimbursements for health care providers. CBO also overestimated unemployment rates in the 1990s, which meant a corresponding overstatement of caseloads for means-tested benefit programs (such as Food Stamps and Medicaid) and of the number of applicants for unemployment and disability benefits.

Misestimates of those broad economic trends, however, account for only part of the inaccuracies in past outlay projections. The remainder come from errors in assumptions about such factors as what proportion of eligible individuals and families will participate in benefit programs, how sound financial institutions will be, and how health care providers will behave. Those factors can be extremely difficult to predict. For example, the deposit insurance crisis of the 1980s and the federal costs for its cleanup came as a surprise, though once the resolution was under way, CBO's estimates proved quite accurate. CBO also did not anticipate the expanded use of creative financing mechanisms to obtain federal Medicaid funds, which occurred in the late 1980s and early 1990s, or the more recent (and apparently temporary) slowing of the growth of Medicare costs.

Alternative Future Trends

The differences between CBO's past projections and actual budgetary outcomes could suggest how accurate future projections will be—if future errors are likely to mirror those of the past. But whether that will happen is an open question. Chapter 2 describes the important changes of the past few years (the transition to a “new economy”) that have led CBO to raise its estimates of the long-term rate of economic growth, and Chapter 3 identifies trends in income that have boosted revenues recently. However, not

enough time has elapsed for analysts to be sure that those changes really represent a new trend in the economy rather than a temporary deviation. Thus, the range of uncertainty around CBO's projections must include the possibility that the "new economy" is no more than a temporary increase in productivity growth, as well as the possibility that it is even more robust than CBO's baseline economic projections assume.

To examine the range of uncertainty in a different way, CBO has constructed two alternative scenarios about future trends. Referred to as the optimistic and pessimistic trend scenarios, they are intended to reflect assumptions that—although systematically different from the ones in the baseline projections—still seem reasonable to CBO analysts. They alter not only economic assumptions but also some assumptions that are usually labeled technical, such as assumptions about the level of capital gains realizations and the growth of spending for the major federal health care programs. (The scenarios illustrate possible alternative paths and are not intended to be symmetrical.)

The two trend scenarios illustrate a wide range of possible outcomes for the budget. Under them, the total budget surplus in 2011 differs from the one in CBO's baseline projections by \$600 billion to \$800 billion in either direction; the on-budget surplus or deficit in 2011 differs by \$600 billion to \$700 billion. The 10-year totals generally differ by \$3 trillion to \$4 trillion.

CBO's Baseline Assumptions

The baseline economic assumptions reflect recent favorable developments for the budget, including the extraordinary growth in productivity, the rise in income and capital gains realizations relative to GDP, and the concentration of income growth among people with higher tax rates (see Chapters 2 and 3). Labor productivity had been increasing at a trend rate of about 1.5 percent a year since 1974, but beginning in 1996 it accelerated, averaging about 2.9 percent growth from 1996 through 2000 and peaking at 5.0 percent from mid-1999 through mid-2000. CBO's

Table 5-2.
Key Economic Variables Under Alternative Scenarios (By fiscal year, in percent)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Growth of Real GDP											
Optimistic Scenario	2.9	3.6	3.8	3.5	3.4	3.4	3.4	3.4	3.4	3.5	3.5
CBO Baseline	2.7	3.2	3.4	3.1	3.0	3.0	3.0	3.0	3.0	3.1	3.1
Pessimistic Scenario	2.4	2.3	2.4	2.0	2.1	2.3	2.3	2.4	2.3	2.3	2.3
Personal Income Taxes as a Share of NIPA Taxable Personal Income											
Optimistic Scenario	15.0	15.3	15.6	16.0	16.3	16.5	16.6	16.8	17.0	17.2	17.5
CBO Baseline	14.7	14.6	14.6	14.6	14.7	14.7	14.8	14.9	15.1	15.3	15.5
Pessimistic Scenario	14.5	14.1	13.6	13.2	12.9	12.9	12.9	13.0	13.1	13.2	13.3
Growth of Medicare and Medicaid Spending											
Optimistic Scenario	9.5	6.1	6.6	7.0	8.0	5.4	8.0	7.2	7.2	7.6	7.6
CBO Baseline	10.5	7.1	7.6	8.0	9.0	6.4	9.0	8.2	8.2	8.6	8.6
Pessimistic Scenario	11.5	8.1	8.6	9.0	10.0	7.4	10.0	9.2	9.2	9.6	9.6

SOURCE: Congressional Budget Office.

NOTES: See the text for a description of the scenarios.

NIPA = national income and product accounts.

baseline economic projections assume that most, but not all, of that acceleration is permanent: in those projections, trend labor productivity grows at a rate of about 2.7 percent a year.

In addition, personal income tax liabilities grew at an average annual rate of about 11 percent from 1994 to 2000, while taxable personal income in the national income and product accounts grew by 6.6 percent a year. As a result, personal income taxes as a share of taxable personal income rose by 3 percentage points, from 11.5 percent to 14.5 percent. (CBO estimates that the latter figure would have been 0.3 percentage points higher if the Congress had not passed legislation in 1997 cutting individual income taxes.) A number of factors caused that rapid rise, including growth in capital gains realizations, real income, and the proportion of income taxed at higher rates (see Chapter 3).

CBO expects personal income tax liabilities to continue growing faster than income because real income growth places more income in higher tax brackets and makes more people subject to the alternative minimum tax. In its baseline, CBO projects that personal income tax liabilities will rise from 14.7 percent of taxable personal income in 2001 to 15.5 percent in 2011 (see Table 5-2).

The Optimistic Trend Scenario

Although those baseline assumptions appear reasonable given the available data, other assumptions are clearly possible and also reasonable. Thus, one of CBO's alternative trend scenarios assumes that the recent good news for the budget continues more or less unabated. In that alternative (the optimistic trend scenario), trend growth of labor productivity is 3.2 percent rather than 2.7 percent. In addition, the alter-

Table 5-3.
Budget Surpluses Under Alternative Scenarios (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002- 2011
Total Budget Surplus												
Optimistic Scenario	310	386	485	583	676	797	913	1,031	1,168	1,323	1,494	8,856
CBO Baseline	281	313	359	397	433	505	573	635	710	796	889	5,610
Pessimistic Scenario	257	238	215	175	140	152	156	148	144	136	122	1,627
On-Budget Surplus or Deficit (-)												
Optimistic Scenario	153	212	291	373	444	543	638	733	848	981	1,129	6,193
CBO Baseline	125	142	171	196	212	267	316	359	417	484	558	3,122
Pessimistic Scenario	103	73	39	-8	-57	-56	-64	-87	-102	-120	-143	-525
Net Indebtedness												
Optimistic Scenario	3,119	2,746	2,281	1,717	1,057	274	-628	-1,649	-2,812	-4,130	-5,621	n.a.
CBO Baseline	3,148	2,848	2,509	2,131	1,714	1,223	662	36	-669	-1,460	-2,346	n.a.
Pessimistic Scenario	3,172	2,948	2,752	2,595	2,472	2,333	2,188	2,050	1,911	1,780	1,661	n.a.

SOURCE: Congressional Budget Office.

NOTES: See the text for a description of the scenarios.

n.a. = not applicable.

native assumes that the recent increase in personal tax liabilities as a share of taxable personal income that was unrelated to real growth (caused largely by capital gains and the concentration of income growth among higher-income taxpayers) continues for another five years. Those tax liabilities therefore rise to 17.5 percent of taxable personal income by 2011—2 percentage points higher than in the baseline—with a small amount of that increase resulting from the higher real growth and productivity in that scenario (see Table 5-2). On the outlay side of the budget, the optimistic scenario assumes that spending for Medicare and Medicaid will grow at an annual rate that is 1 percentage point lower than in the baseline. The scenario makes a variety of other assumptions whose effects are smaller but all of which tend to increase the projected surplus.

The budget outlook would improve dramatically under the assumptions of the optimistic trend scenario (see Table 5-3 on page 99). By 2011, if there was no other action to cut taxes or increase spending, the annual on-budget surplus would exceed \$1.1 trillion, and the total budget surplus would near \$1.5 trillion. Projected surpluses of that magnitude would imply massive federal holdings of nonfederal assets (more than \$6 trillion) by 2011.⁴

The Pessimistic Trend Scenario

The pessimistic trend scenario reverses most of the assumptions of the optimistic scenario and assumes that the economy reverts in many respects to its situation before 1996. In this scenario, trends in the economy are generally unfavorable to the budget. The pessimistic alternative does not explicitly incorporate a recession, because the likelihood of one is already built into the economic baseline described in Chapter 2. Instead, the pessimistic trend scenario assumes that the recent burst of productivity will prove temporary, so future productivity growth averages its historical rate of 1.5 percent. In addition, the scenario assumes that the 1994-2000 increases in personal tax liabilities as a share of taxable personal income that were unrelated to real income growth largely phase

out over the next five years. Medicare and Medicaid spending is assumed to grow 1 percentage point faster than in the baseline.

Under that scenario, the on-budget surpluses expected under baseline assumptions would disappear after 2003. Instead, on-budget deficits would rise to more than \$140 billion a year by 2011 (see Table 5-3). Including off-budget accounts, the total budget would show a surplus in 2011 of a little over \$120 billion, and the federal government would remain in debt.

Other Possibilities

The optimistic and pessimistic trend scenarios are not meant to encompass the full range of possible outcomes for the budget, but rather to illustrate how those outcomes could differ from the one described in Chapter 1. Even higher or lower budget surpluses are not difficult to envisage.

CBO's alternative trend scenarios do not explore all of the possible changes in assumptions. For example, they take labor force projections as a given. Over a 10-year period, the principal uncertainties in labor force projections come from assumptions about labor force participation and legal and illegal immigration. The Social Security Administration assumes much lower labor force participation than CBO does in its projections; if those assumptions proved accurate, they would worsen the 10-year budget outlook by reducing the sustainable growth of the economy. Likewise, CBO's projections follow the Census Bureau's in assuming that net immigration will average nearly 900,000 people per year between 2000 and 2011. Immigration is partly a matter of policy and can be affected both by altering quotas for legal immigrants and by changing the degree of effort made to keep out illegal immigrants. Policy changes that increased the number of immigrants (particularly those with high skills) could increase growth. They might also improve the outlook for the federal budget, because immigrant workers usually pay taxes but are not generally eligible for most federal benefits in their first years in the United States.

An even wider range of assumptions about productivity growth than that lying between the optimis-

4. That figure is slightly larger than the \$5.6 trillion of net indebtedness shown in Table 5-3 because the government would probably not be able to retire all of its existing debt (see Chapter 1).

tic and pessimistic trend alternatives might also be reasonable. CBO's pessimistic scenario, in particular, assumes that the future growth rate of productivity will return to its trend of 1974 to 1995. If productivity growth over the next 10 years is instead slower than its previous trend, thus reversing the gains since 1996, the budget outlook will be substantially worse than even in the pessimistic scenario.

Assumptions about federal health care costs could also span a much broader range of possible

growth rates than the alternative scenarios incorporate. Those scenarios reflect growth rates that are 1 percentage point above or below CBO's baseline assumptions. But historical spending patterns in the Medicare and Medicaid programs suggest that a much broader range of outcomes around CBO's baseline is plausible. For example, from 1981 through 1990, the growth of Medicare spending over and above that attributable to enrollment and general inflation averaged 5.2 percent, compared with 3.1 percent in CBO's baseline.

Table 5-4.
Illustrative Recession Scenario (By calendar year)

	Forecast		Projected Annual Average	
	2001	2002	2003-2006	2007-2011
Nominal GDP (Billions of dollars)				
Recession scenario	10,196	10,741	13,180 ^a	16,869 ^b
CBO baseline	10,446	11,029	13,439 ^a	17,132 ^b
Nominal GDP (Percentage change)				
Recession scenario	2.2	5.3	5.2	5.1
CBO baseline	4.7	5.6	5.1	5.0
Real GDP (Percentage change)				
Recession scenario	0.1	3.6	3.8	3.1
CBO baseline	2.4	3.4	3.1	3.1
Consumer Price Index ^c (Percentage change)				
Recession scenario	2.7	2.4	2.1	2.5
CBO baseline	2.8	2.8	2.6	2.5
Unemployment Rate (Percent)				
Recession scenario	5.2	5.6	4.7	4.8
CBO baseline	4.4	4.5	4.7	5.2
Three-Month Treasury Bill Rate (Percent)				
Recession scenario	4.0	3.2	4.0	5.0
CBO baseline	4.8	4.9	4.9	4.9
Ten-Year Treasury Note Rate (Percent)				
Recession scenario	4.2	4.3	5.1	5.8
CBO baseline	4.9	5.3	5.6	5.8

SOURCE: Congressional Budget Office.

NOTE: Percentage changes are year over year.

a. Level of GDP in 2006.

b. Level of GDP in 2011.

c. The consumer price index for all urban consumers.

How likely is it that the actual outcome for the budget will lie between the optimistic and pessimistic scenarios? Unfortunately, no exact probability calculations can be made. The scenarios were constructed by choosing optimistic and pessimistic assumptions in several areas, and it is clearly less likely that all of those assumptions will prove true at once than that any one of them will prove true. If that were the only consideration, the scenarios might encompass most of the likely outcomes, and more extreme assumptions would be relatively unlikely. But an even wider range of assumptions might be reasonable. If CBO's track record is any guide, both the optimistic and pessimistic scenarios lie well within the range of uncertainty of the budget projections (see Figure 5-1 on page 94).

The Budgetary Effects of a Recession

One obvious concern about budget projections is how vulnerable they are to a recession. Although the current U.S. economic expansion is the longest ever, history strongly suggests that some form of downturn should be expected to occur in any 10-year period. In the experience of CBO and other forecasters, however, predicting the turning points of business cycles is extremely difficult. For that reason, CBO does not attempt to forecast cyclical developments in the economy beyond the next year. Instead, its economic projections for 2003 through 2011 are based on a relatively smooth path that eventually (by 2008) brings

the economy to its estimated long-term trend, or potential (see Chapter 2 for more details).

By its construction, that baseline projection allows for the likelihood that a recession of average severity will occur sometime in the next 10 years. It also weights in the probability of above-trend growth. As long as the economy is not buffeted by external shocks to prices (such as occurred in 1974 and 1979), gross domestic product is expected to be above its estimated potential during booms and below its estimated potential during recessions. On average over the business cycle, actual GDP should be equal to potential GDP.

Currently, disappointing retail sales at the end of 2000, growing inventories of automobiles, and reports of a sharp slowdown in manufacturing have joined with the steep drop in stock market indexes to suggest to many analysts that a significant slowdown may be under way. The Federal Reserve has taken that possibility seriously enough to cut its target for the federal funds rate by 0.5 percentage points between meetings of the Federal Open Market Committee—a strong indication of concern. Although few analysts now believe the slowdown will develop into a recession, it is worth considering what might happen to the budget if a recession were to develop in the near future.

To illustrate the possible budgetary implications of a recession, CBO has constructed an alternative scenario that resembles a mild recession, of about the same depth as that in 1990 and 1991 (see Table 5-4 on page 101). It assumes that a further deterioration in business and consumer confidence leads to de-

Table 5-5.
Budget Surpluses in a Recession (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002- 2011
Recession Scenario	234	250	341	396	429	501	568	628	702	785	876	5,477
CBO Baseline	281	313	359	397	433	505	573	635	710	796	889	5,610

SOURCE: Congressional Budget Office.

clines in consumption and investment this year. Real GDP growth of just 0.1 percent in 2001 pushes the unemployment rate up to 5.9 percent at the beginning of 2002 and modestly lowers inflation. However, the Federal Reserve cuts interest rates aggressively, helping to restore confidence and bringing the recession to an end late in 2001. The subsequent recovery is strong, bringing real GDP above its baseline level by 2005. Real interest rates are also close to baseline levels by that year.

Other scenarios for the business cycle are possible. Most postwar recessions have been preceded by larger increases in inflation, and thus larger rises in interest rates, than those of the past two years. Such a recession would have different budgetary effects from the one examined here. In addition, a recession could have different effects on the income of taxpayers facing different marginal tax rates. Little is known, however, about the effects of recessions on

income distribution, so this cyclical scenario omits such effects.

Budget projections based on this scenario suggest that the surpluses projected in Chapter 1 for the next 10 years would not vanish in a recession unless it was much larger than normal. In this scenario, the total budget surplus would dip below CBO's baseline projection by about \$45 billion in 2001 and \$65 billion in 2002, before recovering in the following two years (see Table 5-5). Although real GDP is assumed to be above baseline levels from 2005 on, surpluses remain slightly below those in the baseline—partly because lower surpluses during the recession boost interest payments in later years and partly because lower inflation in this scenario reduces revenues more than outlays. In the recession scenario, the cumulative surplus from 2002 to 2011 is just \$133 billion smaller than in the baseline.

Appendixes

Sequestration Preview Report for Fiscal Year 2002

The Balanced Budget and Emergency Deficit Control Act of 1985 (the Deficit Control Act) requires the Congressional Budget Office (CBO) to issue a sequestration preview report before the President submits his annual budget to the Congress. This report provides CBO's estimates of the discretionary spending caps and the pay-as-you-go (PAYGO) balances at the beginning of the 107th Congress.

Compared with CBO's baseline estimate of discretionary spending for fiscal year 2002, budget authority would have to be reduced by \$113 billion and outlays by \$106 billion to comply with the 2002 caps. Although the Consolidated Appropriations Act, 2001 (Public Law 106-554) instructed the Office of Management and Budget (OMB) to change the \$11 billion PAYGO balance for 2001 to zero, a \$16 billion balance (resulting from previous legislation that will increase direct spending or reduce revenues) remains for 2002.

Discretionary Sequestration Report

The Deficit Control Act limits discretionary spending in 2002 and provides for sequestration (a cancellation of budgetary resources) if annual appropriations exceed those limits. For 2002, the last year for which section 251 of the Deficit Control Act is in effect, the caps apply to four categories of spending: overall

discretionary (which comprises the spending categories previously separated as defense, nondefense, and violent crime reduction), overall conservation (which has six subcategories for programs related to conservation, preservation, and infrastructure), highway, and mass transit. The caps on highway and mass transit spending apply only to outlays; caps for the overall discretionary and the overall conservation categories cover both budget authority and outlays (see Table A-1).¹

Adjustments to the Spending Limits

The discretionary spending limits in this report reflect four types of adjustments made since CBO's final sequestration report (published on December 29, 2000): adjustments for differences between CBO's and OMB's estimates, for releases of emergency funds, for changes in the classification of certain spending as mandatory or discretionary, and for updated assumptions about transportation spending.

Differences Between the Limits in CBO's and OMB's Final Reports. OMB is responsible for determining whether a sequestration is required to eliminate a breach of the discretionary spending caps; CBO's estimates are merely advisory. Therefore,

1. The highway category does not have caps on budget authority because obligation limitations (which do not count as budget authority) set in appropriation bills control all of its spending. A combination of appropriations and obligation limitations control spending for mass transit, so it also has no statutory limit on budget authority.

Table A-1.**CBO's Estimates of Discretionary Spending Limits for Fiscal Years 2001 and 2002****(In millions of dollars)**

	2001		2002	
	Budget Authority	Outlays	Budget Authority	Outlays
Total Discretionary Spending Limits in CBO's December Final Report	640,800	644,785	552,324	576,009
Overall Discretionary Category ^a				
Spending limits in CBO's December final report	640,800	613,226	550,564	541,433
Adjustments				
Technical differences from OMB's January final report	3	21	-231	-1,920
Contingent emergency appropriations designated since OMB's January final report	0	636	0	722
Changes in mandatory spending contained in 2001 appropriation acts	n.a.	n.a.	-1,103	-486
Changes in appropriated spending contained in 2001 authorization acts	<u>n.a.</u>	<u>n.a.</u>	<u>805</u>	<u>604</u>
Spending limits as of January 25, 2001	640,803	613,883	550,035	540,353
Highway Category ^b				
Spending limits in CBO's December final report	n.a.	26,920	n.a.	27,925
Adjustments				
Technical differences from OMB's January final report	n.a.	0	n.a.	0
Revised trust fund revenue assumptions	n.a.	n.a.	n.a.	1,315
Revised technical assumptions	n.a.	<u>n.a.</u>	n.a.	<u>-351</u>
Spending limits as of January 25, 2001	n.a.	26,920	n.a.	28,889
Mass Transit Category ^b				
Spending limits in CBO's December final report	n.a.	4,639	n.a.	5,419
Adjustments				
Technical differences from OMB's January final report	n.a.	0	n.a.	0
Revised technical assumptions	n.a.	<u>n.a.</u>	n.a.	<u>71</u>
Spending limits as of January 25, 2001	n.a.	4,639	n.a.	5,490
Overall Conservation Category				
Spending limits in CBO's December final report	n.a.	n.a.	1,760	1,232
Adjustment (Technical differences from OMB's January final report)	n.a.	n.a.	<u>0</u>	<u>0</u>
Spending limits as of January 25, 2001	n.a.	n.a.	1,760	1,232
Total Discretionary Spending Limits as of January 25, 2001	640,803	645,442	551,795	575,964

SOURCE: Congressional Budget Office.

NOTE: OMB = Office of Management and Budget; n.a. = not applicable.

- a. This category comprises defense, nondefense, and violent crime reduction spending.
- b. The highway and mass transit categories do not have budget authority limits. Obligation limitations, which are not counted as budget authority, control all of the spending in the highway category and most of the spending in the mass transit category.

before making other changes, CBO first adjusts the estimates of the caps that appeared in its most recent sequestration report to match the figures in the equivalent OMB report.

The Deficit Control Act prescribes that CBO and OMB adjust their estimates of the caps for appropriations that the Congress and the President have designated as emergencies. However, section 701(b)(1) of the Foreign Operations, Export Financing, and Related Appropriations Act, 2001 (P.L. 106-429) states that “with respect to fiscal year 2001,” no adjustment to the caps for emergency funding is permitted in the final sequestration report. As a result, CBO in its December report made no adjustment in the caps for 2001 related to such funding, but it adjusted the limits in 2002. In contrast, OMB did not make any such adjustments for emergency funding for either 2001 or 2002. That difference causes the 2002 caps for the overall discretionary category in OMB’s report to be lower than CBO’s estimates of the limits by \$231 million in budget authority and \$1,920 million in outlays.

Recently Released Emergency Appropriations.

CBO has also adjusted its outlay caps in this report for contingent emergency appropriations that the President released after the publication of OMB’s final report.² For that reason, the outlay caps for the overall discretionary category have been increased by \$636 million in 2001 and \$722 million in 2002.³ Three-quarters of the 2001 amount and more than one-third of the 2002 amount were for fighting wildfires, subsequent rehabilitation efforts, and other related activities.

Classification of Spending. Under scorekeeping rules, when changes in mandatory spending are made in an appropriation act, those changes are initially counted as discretionary spending for assessing the

impact of appropriation action. Such spending remains subject to the caps in the current year—2001 in this report. But for subsequent years, the costs of such changes are moved back to the mandatory side of the budget (where they would normally be classified), and the discretionary caps are adjusted accordingly. As a result, the spending limits for the overall discretionary category have been reduced by \$1,103 million in budget authority and \$486 million in outlays for 2002, mostly reflecting additional funds for farmers and the Food Stamp program enacted in the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act for 2001 (P.L. 106-387).

Similarly, changes in discretionary programs are sometimes made in authorization acts. The first-year costs of those changes are counted as mandatory spending and governed by PAYGO procedures. In this report, such spending in subsequent years reverts to the discretionary side of the budget, and the caps are adjusted so that changes in appropriated spending made by the authorizing committees do not affect the appropriations committees. For that reason, the spending caps for 2002 for the overall discretionary category have been increased by \$805 million in budget authority and \$604 million in outlays. Additional funds for the Training and Employment Administration and the Ricky Ray Hemophilia Relief Fund triggered most of that increase.

Updated Assumptions About Transportation Spending. The Deficit Control Act requires that the outlay caps for the highway and mass transit categories be adjusted in this report to reflect changes in assumptions since those caps were established in 1998 by the Transportation Equity Act for the 21st Century (P.L. 105-178).

CBO made two adjustments to the 2002 outlay cap for the highway category. One change, an increase of \$1,315 million, is from new revenue estimates for the Highway Trust Fund. The other adjustment, a reduction of \$351 million, arises from changes in spendout rates and reestimates of outlays from prior year obligations. This second type of adjustment accounts for the \$71 million increase in the 2002 outlay limit for the mass transit category.

2. CBO believes that the prohibition on adjustments for emergencies in section 701 of the Foreign Operations Appropriations Act applied only to the final sequestration report for 2001.

3. In accordance with section 251(b)(2)(A) of the Deficit Control Act, those amounts exclude \$2,210 million in 2001 and \$87 million in 2002, which was provided to cover agricultural crop disaster assistance.

Table A-2.**CBO's Estimates of Discretionary Spending Compared with the Statutory Caps for Fiscal Year 2002
(In billions of dollars)**

	Budget Authority	Outlays
CBO's Estimate of the Total Discretionary Spending Limits as of January 25, 2001	552	576
CBO's Estimate of Discretionary Spending		
Baseline ^a	665	682
Freeze scenario ^b	641	669
Amounts by Which Discretionary Spending Exceeds the Limits		
Baseline ^a	113	106
Freeze scenario ^b	89	93

SOURCE: Congressional Budget Office.

- a. Assumes that discretionary spending grows according to the inflators specified in the Deficit Control Act (the gross domestic product deflator and the employment cost index).
- b. Assumes that discretionary budget authority is frozen at the level enacted for 2001.

Compliance with the Discretionary Spending Limits

For 2001, appropriations enacted thus far are below or equal to the limits. For the overall discretionary category, budget authority and outlays are \$6,545 million and \$2,464 million below their respective limits, according to OMB's estimates.⁴ Outlays in the highway category are \$23 million below their limit, whereas outlays in the mass transit category are at their limit.

Even assuming that discretionary budget authority is frozen at the level enacted for 2001, however, discretionary spending in 2002 would be far above the adjusted caps. Under CBO's freeze scenario, discretionary budget authority equals \$641 billion and outlays total \$669 billion in 2002. Those amounts are above their respective 2002 caps by \$89 billion and \$93 billion (see Table A-2).

Pay-As-You-Go Sequestration Report

In addition to limiting discretionary spending, the Deficit Control Act contains a mechanism to ensure that any legislation affecting direct spending or receipts enacted through fiscal year 2002 does not result in a net cost. If legislative changes enacted through the end of a session of Congress produce a net cost, a PAYGO sequestration is required at the end of the session. Under that type of sequestration, budgetary resources available for nonexempt mandatory programs are cut sufficiently to eliminate the net cost. The PAYGO discipline governs legislation enacted through 2002, but the sequestration procedure applies through 2006 to eliminate any projected decrease in the surplus caused by such legislation.

Both CBO and OMB estimate the net cost in each year that results from direct spending or revenue legislation. But, as with the discretionary spending caps, OMB's estimates determine whether a sequestration is necessary. For this report, therefore, CBO has adopted as its starting point the estimated PAYGO effects of legislation from OMB's final sequestration report.

4. Office of Management and Budget, *OMB Final Sequestration Report to the President and Congress for Fiscal Year 2001* (January 2001), Table 4.

Table A-3.
Budgetary Effects of Direct Spending or Receipt Legislation
Enacted Since the Budget Enforcement Act of 1997 (By fiscal year, in millions of dollars)

	2001	2002	2003	2004	2005	2006
Total PAYGO Balance in OMB's Final Sequestration Report	0	16,053	18,465	19,336	20,673	0

SOURCE: Congressional Budget Office.

NOTES: OMB = Office of Management and Budget.

Section 254 of the Deficit Control Act requires a list of all bills that are included in the PAYGO calculation. Since the data in this table begin with OMB's estimate of the total change in the surplus resulting from bills enacted through the date of its report, readers are referred to Tables 6 and 7 of *OMB Final Sequestration Report to the President and Congress for Fiscal Year 2001*, issued on January 16, 2001.

The Consolidated Appropriations Act, 2001 (P.L. 106-554) instructed OMB to change the PAYGO balance for 2001 to zero; OMB's estimate of that balance before the change was \$10,542 million.

Pursuant to the Deficit Control Act, the net costs for 2000 and 2001 were combined to determine the magnitude of a PAYGO sequestration for 2001. Although OMB estimated that legislative actions would reduce the surplus by approximately \$10.5 billion, the Consolidated Appropriations Act instructed OMB to change the PAYGO balance for 2001 to zero, thereby avoiding a PAYGO sequestration.⁵ For 2002, however, OMB estimates that a \$16

billion balance remains outstanding, meaning that a PAYGO sequestration would be required in 2002 unless legislation is enacted to eliminate that balance (see Table A-3). Similarly, 2003 through 2005 also have positive PAYGO balances. Under the Deficit Control Act, estimates of the net cost of direct spending or revenue legislation must be provided for the year in which the legislation was enacted and the following four years (2001 through 2005 in this report); therefore, the PAYGO balance for 2006 is currently zero.

5. The \$10,542 million balance, as estimated by OMB, is composed of net reductions in the surpluses for 2000 and 2001 of \$42 million and \$10,500 million, respectively.

How Changes in Assumptions Can Affect Budget Projections

The federal budget is highly sensitive to economic conditions. Revenues depend on taxable income—including wages and salaries, interest and other nonwage income, and corporate profits—which generally moves in step with overall economic activity. The benefits of many entitlement programs are pegged to inflation either directly (like Social Security) or indirectly (like Medicaid). And the Treasury regularly refinances portions of the government's debt at market interest rates.

To illustrate how assumptions about key economic factors can affect federal budget projections, the Congressional Budget Office (CBO) uses what it terms rules of thumb. Those rules are rough orders of magnitude for gauging how changes in individual economic variables, taken in isolation, will affect the budget's totals.

The variables that figure in this illustration are real (inflation-adjusted) growth, inflation, and interest rates. For real growth, CBO's rule shows the effects of a rate that is 0.1 percentage point lower each year, beginning in January 2001, than the rate of growth used in CBO's baseline (outlined in Chapter 2). The rules for inflation and interest rates assume an increase of 1 percentage point over the rates in the baseline, also starting in January 2001. Each rule is roughly symmetrical. Thus, the effects of higher growth, lower inflation, or lower interest rates would have about the same magnitude as the effects shown in this appendix but with the opposite sign.

The calculations that appear here are merely illustrative of the impact that changes in assumptions

can have. CBO uses variations of 0.1 percentage point or 1 percentage point for the sake of simplicity; those variations should not be viewed as typical forecasting errors. (For details about the accuracy of CBO's past budget projections, see Chapter 5.) Moreover, readers should be careful about extrapolating from small, incremental rule-of-thumb calculations to much larger changes, because the magnitude of the effect of a larger change is not necessarily a multiple of a smaller change. Furthermore, budget projections are subject to other kinds of errors that are not directly related to economic forecasting.

This year, in addition to the rules of thumb related to economic projections, CBO presents two new rules that affect the levels of projected surpluses. The first illustrates the impact on projections of discretionary spending of budget authority that is \$10 billion greater in 2002 than in CBO's estimate. The second shows the effect on net interest payments of surpluses that deviate from those projected in the baseline.

Lower Real Growth

Strong economic growth improves the federal budget's bottom line, and weak economic growth worsens it. The first economic rule of thumb outlines the budgetary impact of economic growth that is slightly weaker than CBO's baseline assumes. Specifically, the rule illustrates the effects of growth rates for real gross domestic product (GDP) that are lower by 0.1

percentage point every year from January 2001 through 2011.

Those effects differ from the effects of a cyclical change, such as a recession, because of a difference in duration. This rule constitutes a decline in growth that is permanent rather than temporary, such as a drop associated with cyclical changes. (For the effects of a recession on 10-year budget projections, see Chapter 5.) Moreover, CBO's rule for GDP uses 0.1 percentage point—rather than the full percentage point used in the inflation and interest rate rules—because projected real growth is unlikely to differ from actual growth by such a large amount over the next 10 years. A difference as large as 1 percentage point might occur for a few years, however, as a result of a cyclical change.

The baseline projects that real GDP grows by an average of 3.0 percent a year through 2011 (see Chapter 2). Subtracting 0.1 percentage point each year from that rate means that the level of GDP would lie roughly 1 percent below CBO's baseline by 2011.

A lower rate of growth for GDP would have a number of budgetary implications. For example, it would suggest lower growth of taxable income, leading to losses in revenues that would mount from \$1 billion in 2001 to \$40 billion in 2011 (see Table B-1). Cumulatively, revenue losses would total \$197 billion over the 2002-2011 period. Lower growth would also mean that the government borrowed more and incurred greater interest costs. Debt service would be minimally affected during the first few years of the period, but in later years, those costs would gradually rise, reaching \$14 billion in 2011. (The rule of thumb makes no assumptions about effects on unemployment.) Altogether, these changes (along with small effects on the earned income tax credit and Medicare) would reduce the projected surplus for 2011 by \$54 billion. The cumulative surplus would decline by \$245 billion over the 10-year period.

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. If interest rates were higher than CBO's baseline assumes over the 2001-2011 period, outlays would be greater in the near term because of higher costs for interest on debt held by the public. Toward the end of that period, however, the balance of uncommitted funds assumed in CBO's baseline would earn higher returns and more than offset the increased interest paid on the remaining debt. (Uncommitted funds, as discussed in Chapter 1, are residual surpluses above the amounts used to pay off debt.)

When the budget is in surplus, the Treasury uses a portion of those funds to reduce debt held by the public, but it also refinances some debt at market interest rates. Currently, the bulk of marketable federal debt (debt that is freely traded in financial markets) consists of medium- and long-term securities that were issued with initial maturities of two to 30 years. If interest rates for all maturities were 1 percentage point higher than in the baseline in each year of the 2001-2011 period (and all other economic variables were unchanged), the government's interest costs would increase by \$6 billion in 2001. That initial boost would be fueled by the extra costs of refinancing the government's short-term Treasury bills, which make up about one-fifth of all marketable debt. Those costs rise to about \$10 billion in each of the following three years.

However, the effects of higher interest rates would begin to wane after 2003, for two reasons. First, baseline surpluses are projected to continue rising through 2011, allowing securities to be redeemed and causing debt held by the public to decline. That reduced stock of debt would be less sensitive to changes in interest rates. Second, CBO assumes that the federal government will invest its un-

Table B-1.
Estimated Effects on CBO's Budget Projections of Selected Economic Changes
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Growth Rate of Real GDP Is 0.1 Percentage Point Lower per Year											
Change in Revenues	-1	-3	-6	-9	-13	-16	-20	-25	-29	-35	-40
Change in Outlays											
Net interest (Debt service)	*	*	*	1	2	3	4	6	8	11	14
Mandatory spending	*	*	*	—	—	—	—	—	—	—	—
Total	*	*	*	1	2	3	4	6	8	11	14
Change in the Surplus	-1	-4	-7	-10	-14	-19	-24	-30	-37	-45	-54
Interest Rates Are 1 Percentage Point Higher per Year											
Change in Revenues	0	0	0	0	0	0	0	0	0	0	0
Change in Outlays (Net interest and proceeds from uncommitted funds) ^a											
Higher rates	6	10	11	10	8	5	*	-5	-10	-17	-25
Debt service	—	—	—	—	—	—	—	—	—	—	—
Total	6	11	13	12	11	8	5	*	-6	-14	-23
Change in the Surplus	-6	-11	-13	-12	-11	-8	-5	*	6	14	23
Inflation Is 1 Percentage Point Higher per Year											
Change in Revenues	12	36	61	89	120	154	192	234	281	333	391
Change in Outlays											
Net interest and proceeds from uncommitted funds ^a											
Higher rates	7	12	13	12	10	7	3	-2	-8	-15	-23
Debt service	*	*	-1	-2	-4	-7	-11	-17	-25	-35	-47
Discretionary spending	*	4	10	16	23	31	40	48	58	68	78
Mandatory spending	—	—	—	—	—	—	—	—	—	—	—
Total	12	29	46	63	80	96	111	127	142	156	168
Change in the Surplus	*	7	15	26	40	58	80	107	139	177	222

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

a. "Uncommitted funds" is CBO's term for the surpluses remaining in each year after paying down publicly held debt available for redemption.

committed funds, which begin to appear in 2006. Under this rule, proceeds from those investments would be greater in CBO's baseline if interest rates were 1 percentage point higher. By 2011, the effect of higher interest rates on those proceeds would outstrip their effect on the remaining publicly held debt, thereby increasing the total surplus by \$23 billion in that year.

Higher Inflation

The third rule of thumb shows the budgetary impact of inflation that is 1 percentage point higher than the baseline projects. The effects of inflation on federal revenues and outlays partly offset each other. On the one hand, if no other economic variables are affected, higher inflation will lead to a boost in taxable income and, hence, greater revenues. On the other hand, it will also increase spending for many benefit programs (although with a lag).

Specifically, an increase of 1 percentage point per year in projected inflation from 2001 through 2011 would increase revenues by \$391 billion and outlays by \$168 billion in 2011. The combined effect of those changes would increase the projected surplus in that year by \$222 billion.

Higher Discretionary Budget Authority

Baseline projections of discretionary spending are not directly related to economic conditions. Such projections are constructed following the rules set forth in the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, which essentially dictates that CBO (and the Office of Management and Budget) assume that appropriations for the current year—in this case, 2001—grow at the specified rates of inflation in the years that follow.

Nevertheless, it may be useful to estimate the sensitivity of discretionary outlays (and thus the surplus) to changes in discretionary budget authority that are unrelated to changes in economic assumptions. Under baseline rules, providing \$10 billion more in budget authority in 2002 would lead to an increase in budget authority of \$13 billion in 2011 (see Table B-2).

Budget authority is the legal authority to incur financial obligations that will result in immediate or future outlays of federal government funds. The Congress grants budget authority for discretionary programs annually; outlays from that authority may occur in the year that the authority is granted, or they may occur in future years. Fast-spending activities (such as meeting payrolls or directly providing services) generally expend most of their budget au-

Table B-2.
Estimated Effects on CBO's Baseline of Increasing Discretionary Budget Authority by \$10 Billion in 2002
(By fiscal year, in billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Budget Authority	10	10	11	11	11	11	12	12	12	13
Outlays	6	9	10	10	11	11	11	12	12	12

SOURCE: Congressional Budget Office.

NOTE: CBO assumes that budget authority grows at the rates of inflation specified in the Deficit Control Act (using the GDP deflator and employment cost index for wages and salaries).

Table B-3.
Estimated Savings in Net Interest from Increasing the Surplus by \$10 Billion
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Savings from Adding \$10 Billion to the Surplus in 2001 Only	-0.2	-0.5	-0.6	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8	-0.9	-0.9
Savings from Adding \$10 Billion to the Surplus Each Year	-0.2	-0.8	-1.3	-2.0	-2.6	-3.3	-4.1	-4.9	-5.7	-6.6	-7.5

SOURCE: Congressional Budget Office.

thority in the year that it is granted; slow-spending activities (such as procuring weapons or building roads and other infrastructure) spend their authority over a longer period.

As a result, changes in budget authority do not immediately translate into equal changes in outlays. CBO estimates that, on average, approximately 60 percent of budget authority for discretionary spending is spent in the year in which it is granted. Therefore, an additional \$10 billion in budget authority in 2002 would lead to \$6 billion more in outlays that year. The remaining \$4 billion would be spent over the following few years. Overall, applying this rule of thumb to the 2002-2011 period would lead to \$105 billion in additional baseline outlays.

Increase in the Surplus

CBO's projections of net interest are consistent with its projections of future interest rates and debt held by the public. Changes from year to year in debt held by the public in turn depend mostly on the size of the

surplus. If surpluses turned out to be different from those projected in the baseline—for whatever reason—interest costs would also change. (The converse of that relationship also applies to the balance of uncommitted funds from 2006 through 2011. Additional surpluses in those years would increase projections of those funds rather than decrease debt.)

An increase of \$10 billion in the surplus would affect CBO's projections of net interest from 2001 through 2011 in two ways (see Table B-3). A one-time increase of \$10 billion in 2001 would enable the Treasury to redeem an additional \$10 billion in debt in that year, compared with the assumption in CBO's baseline. Removing that debt from the outstanding stock would save \$0.2 billion in net interest costs in 2001 and nearly \$1 billion a year by 2011. (Savings in later years stem from the compounding effect of debt reduction in 2001.)

Interest savings would be even greater if the \$10 billion increase in the surplus was sustained in every year through 2011. In that case, savings from additional debt reduction (or increases in uncommitted funds) and the compounding effect of such savings would increase the surplus in 2011 by \$7.5 billion.

Budget Resolution Targets and Actual Outcomes: Fiscal Years 1980 Through 2000

In most years, the Congress passes a concurrent resolution that sets out its recommended budget targets for the coming fiscal year. The resolution for 2000, adopted in April 1999, anticipated a total budget surplus of \$141 billion.¹ But actual spending, revenues, and the surplus for 2000 turned out to be substantially different from the levels in the budget resolution.

This appendix analyzes the differences between the resolution's targets and actual outcomes for that year.² In 2000, revenues were \$149 billion higher than expected, owing both to economic conditions that were more favorable than originally projected and to other factors. Total outlays also ended up higher—by \$54 billion—primarily because of legislative actions that differed from those assumed in the resolution. The actual surplus was \$236 billion, or \$95 billion more than the budget resolution anticipated.

In addition to those assessments, this appendix provides another perspective by comparing the differences between the Congress's targets and actual outcomes in 2000 with such discrepancies in the years since 1980. Fiscal year 2000 was the seventh consec-

utive year (excluding 1999, when the two Houses did not adopt a conference report on a budget resolution) in which actual outcomes were more favorable than targets. Deviations that occurred before 1993 were of a different character: for 13 years in a row, the actual deficit was greater than the resolution's estimate. Over that period, the difference between targets and actual deficits ranged from less than 1 percent to more than 11 percent of actual outlays. For 2000, the difference between the assumed and actual surplus represented 5.3 percent of total outlays.

Elements of the Analysis

The budget resolution is a concurrent resolution adopted by both Houses of Congress that sets out a Congressional budget plan over five or more fiscal years. The plan consists of targets for spending, revenues, the deficit or surplus, and public debt. It is not presented to the President and does not become law. Instead, it is implemented through subsequent legislation, including appropriation acts and changes in laws that affect revenues and direct spending. (Sometimes, those revenue and direct spending changes may be made in response to reconciliation instructions that are included in the resolution.) In general, the targets established in the budget resolution are enforced through procedural mechanisms set out in the Congressional Budget and Impoundment Control Act of 1974.

For this analysis, the differences between the levels specified in the budget resolution and actual outcomes are allocated among three categories: pol-

-
1. By law, the revenues and outlays of the Social Security trust funds are off-budget and are not included in the revenue, outlay, and deficit or surplus totals in the budget resolution. For the purposes of this analysis, however, the Congressional Budget Office's (CBO's) totals include both on- and off-budget amounts.
 2. In contrast to the analysis in Chapter 5, in which actual results are compared with CBO's projections, this assessment compares actual outcomes with the Congress's blueprint for the budget. Consequently, total discrepancies and the discrepancies attributed to policy, economic, and technical factors may be measured differently here than in the analysis in that chapter.

icy, economic, and technical. Although those categories help to explain the discrepancies, the divisions are both inexact and necessarily arbitrary.

Differences between targets and outcomes that are ascribed to policy changes derive from legislation. They reflect the passage of laws that were not explicitly anticipated in the resolution or that cost (or saved) more money than the resolution assumed. (An example of legislation that by definition is hard to anticipate is aid to victims of natural disasters.) Policy differences can also reflect lawmakers' failure to enact legislation that the resolution expected would be passed. In identifying differences arising from policy changes, the Congressional Budget Office (CBO) typically uses the cost estimates it made at the time the legislation was enacted. (To the extent that the budgetary effects of the policy change turn out differently than CBO estimated, those effects are implicitly characterized as technical.)

A key element in preparing the budget resolution is forecasting how the economy will perform in the upcoming year. Typically, the Congress draws the economic assumptions for its resolution from the most recent forecast published by CBO. In 1982 and most years between 1988 and 1992, however, it chose to use a different forecast (generally, the Administration's, published by the Office of Management and Budget).

The forecast for the budget resolution is usually made more than nine months before the fiscal year begins. Forecasting the economy is always an uncertain business, and almost invariably, the economy's actual performance differs from the forecast. Nevertheless, every resolution is based on the forecast's assumptions about numerous economic variables—mainly, gross domestic product (GDP), taxable income, unemployment, inflation, and interest rates—in the national income and product accounts (NIPAs).³ Those assumptions are used to estimate revenues, spending for benefit programs, and net interest. In CBO's analysis, only differences that can be directly linked to NIPA variables are labeled economic. Other differences that might be tied to eco-

nomic performance, such as changes to estimates of capital gains realizations or labor force participation, are categorized as technical.

In analyzing the deviation between budget resolution targets and outcomes, CBO cumulates differences that arise from changes in the economic forecast since the time that the resolution was completed. That calculation is not subsequently adjusted, even though revisions to data about GDP and taxable income continue to trickle in over a number of years.

Technical differences between the budget resolution and outcomes are those variations that do not arise directly from legislative or economic sources as initially categorized. The largest dollar impacts of technical differences are concentrated in two areas: on the revenue side of the budget and among open-ended commitments of the government, such as entitlement programs. In the case of revenues, technical differences stem from a variety of factors, including changes in administrative tax rules, differences in sources of taxable income that are not captured by the NIPAs, and changes in the relative amounts of income taxed at the various income tax rates. In the case of entitlement programs, factors such as a change in the number of beneficiaries, changes in farm prices, or new regulations can produce technical differences.

Comparing the Budget Resolution and Actual Outcomes for Fiscal Year 2000

The budget resolution adopted the economic assumptions that CBO published in January 1999 but modified them to reflect the near-term strength of the economy that became evident after CBO had completed its forecast. In particular, the resolution boosted the expected growth of real (inflation-adjusted) GDP for 2000 from 1.7 percent to 2.0 percent.⁴

3. The NIPAs are the official U.S. accounts, maintained by the Commerce Department's Bureau of Economic Analysis, that track the level and composition of GDP and how the costs of production are distributed as income.

4. That assumption used a calendar year basis rather than a fiscal year basis. In addition, the adjustment raised the resolution's estimate of revenues slightly above CBO's projection.

Table C-1.**Comparison of Budget Resolution Targets and Actual Budget Totals, Fiscal Year 2000**
(In billions of dollars)

	Budget Resolution	Actual Budget Totals	Actual Minus Resolution
Revenues	1,876	2,025	149
Outlays	1,735	1,789	54
Surplus	141	236	95

SOURCE: Congressional Budget Office using data from H. Con. Res. 68, Concurrent Resolution on the Budget for Fiscal Year 2000, adopted on April 15, 1999, and the Office of Management and Budget.

NOTES: The figures in the table include Social Security and the Postal Service, which are off-budget.

These comparisons differ from those in earlier chapters in which differences are measured relative to CBO's baseline projections.

For 2000, the resolution specified few legislative changes other than a reduction in discretionary spending.⁵ It called for \$571 billion in discretionary outlays—slightly below the statutory cap on such spending that was in effect at the time but \$34 billion below the estimated amount needed to keep pace with inflation.

The resolution established the following targets for the year: total revenues of \$1,876 billion, outlays of \$1,735 billion, and a surplus of \$141 billion (see Table C-1). That surplus corresponds to the resolution's assumption about the surplus in the Social Security trust funds. Ultimately, both revenues and outlays were greater than envisioned. Revenues were higher by \$149 billion and outlays by \$54 billion, resulting in a surplus that was \$95 billion larger than expected.

Differences Arising from Policy Changes

The Congress enacted policies that the budget resolution did not take into account, and by the end of fiscal

year 2000, those changes increased discretionary spending by \$42 billion and mandatory spending by \$22 billion (see Table C-2). Including a small increase in revenues and changes to net interest, CBO estimates that policy changes reduced the resolution's estimated surplus for the year by \$61 billion.

Actual budget authority and outlays for discretionary programs were both higher than the budget resolution had assumed. A total of \$536 billion in budget authority was proposed in the resolution (\$290 billion for defense and \$246 billion for non-defense discretionary programs), but appropriation actions provided an additional \$51 billion. That boosted the actual total to about \$587 billion (\$301 billion for defense and \$285 billion for nondefense programs). Discretionary outlays for 2000 turned out to be \$617 billion (\$295 billion for defense and \$322 billion for nondefense), approximately \$46 billion more than the resolution's target. About \$42 billion of that amount can be attributed to the increase in budget authority.⁶ Nearly \$4 billion is attributable to technical factors.

Mandatory spending also outpaced the resolution's estimate for 2000, rising by \$22 billion for policy reasons. Approximately \$13 billion of that in-

5. The budget resolution envisioned total budget surpluses of \$2.0 trillion over the 2000-2009 period. Of that sum, \$1.9 trillion represented off-budget surpluses, generated almost entirely by the Social Security trust funds. The resolution also expected the government's on-budget accounts to be in balance from 2000 through 2003 and to record surpluses totaling \$92 billion over the following six years. Incorporated in its targets were tax cuts slated to total \$778 billion through 2009. It recommended beginning those cuts in 2001.

6. Roughly one-quarter of the \$42 billion policy difference came from the budget resolution's unusually low outlay target for national defense. Specifically, the resolution's target of \$278 billion was \$7 billion below CBO's estimate of the President's budgetary request for defense outlays, although the resolution assumed the appropriation of more budget authority—not less—than the request.

crease came from legislative actions that provided additional assistance to farmers and agricultural producers. Another \$4 billion resulted from eliminating the Social Security earnings test.

Differences Arising from Economic Factors

Even with the upward adjustment to real GDP growth, the economic assumptions underlying the 2000 budget resolution proved too pessimistic: differences between those assumptions and the economy's actual performance culminated in an underestimate of \$79 billion in the surplus. In particular, the growth of nominal GDP for the fiscal year turned out to be about 3.5 percentage points higher than originally forecast, generating \$78 billion more in revenues than anticipated.

Economic factors had little effect on outlays, however. The actual unemployment rate was lower

than projected by about 1 percentage point, reducing the costs of unemployment insurance and contributing to about one-third of the \$7 billion decrease in mandatory spending that resulted from the economy's strong performance. Cost-of-living adjustments for various benefit programs and indexes of prices for medical care were also lower than expected. In contrast, interest rates were higher than anticipated, leading to bigger net interest payments. Although some of those estimated payments were offset by lower debt service (stemming from the larger-than-anticipated surplus), net interest spending was still higher than the resolution's target by \$6 billion. When both effects are combined, economic factors account for only \$1 billion of the difference in outlays.

Differences Arising from Technical Factors

About \$77 billion of the unexpected improvement in the surplus for 2000 came from higher revenues and

Table C-2.
Sources of Differences Between Budget Resolution Targets and Actual Budget Totals, Fiscal Year 2000
(In billions of dollars)

	Policy Differences	Economic Differences	Technical Differences	Total Differences
Revenues	3	78	68	149
Outlays				
Discretionary spending	42	*	4	46
Mandatory spending ^a	22	-7	-13	2
Net interest	*	6	-1	6
Total	65	-1	-10	54
Surplus	-61	79	77	95

SOURCE: Congressional Budget Office using data from H. Con. Res. 68, Concurrent Resolution on the Budget for Fiscal Year 2000, adopted on April 15, 1999, and Office of Management and Budget.

NOTES: Differences are actual outcomes minus budget resolution assumptions.

These comparisons differ from those in earlier chapters in which differences are measured relative to CBO's baseline projections.

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

a. Includes offsetting receipts.

lower outlays that cannot be directly traced to legislative actions or economic assumptions. CBO attributes such differences to so-called technical factors. About \$10 billion of the improvement resulted from lower-than-expected outlays—mostly in the Medicare program. Revenues that were higher than anticipated accounted for \$68 billion in technical differences. Most of those additional revenues are attributable to unexpectedly high individual income tax receipts, stemming from growth in realizations of capital gains, unforeseen increases in the effective tax rate, and incomes that were higher than initially reported. Also, the difference between actual revenues and CBO's final projection for 2000 was characterized as technical.

Comparing Budget Resolutions and Actual Outcomes for Fiscal Years 1980 Through 2000

Budget resolution targets and actual outcomes have deviated to varying degrees in virtually every year of the past two decades. Over the 1980-1992 period, the actual 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).

Differences Arising from Policy Changes

From 1980 through 2000, policy action or inaction (the failure to achieve savings called for in the budget resolution) increased the deficit or decreased the surplus by an average of \$12 billion a year compared with the targets. In only four of those years did policymakers trim the deficit by more, or add to it by less, than the resolution provided. Most of the im-

pact stemming from legislation over the period was felt on the outlay side of the budget. On average, policy decisions added about \$14 billion a year to the spending totals. In fact, 1988 and 1991 were the only years in which legislative action reduced outlays below the resolution's targets. By far the biggest difference was in 2000, with added outlays of \$65 billion.

Differences Arising from Economic Factors

Over the 1980-2000 period, errors in the economic forecast, on average, had very little net effect on the variations between targets and actual outcomes for deficits or surpluses. But that average masks large differences in many years—deviations that were mostly negative before 1993 and positive more recently. Until 1993, budget resolutions tended to use short-term economic assumptions that proved overly optimistic. The largest overestimates 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 again in the 1990-1992 period. Since 1993, that pattern has largely been reversed. Short-term economic assumptions in 1993 through 2000 for the most part were overly pessimistic.

In absolute terms (disregarding whether the errors were positive or negative), the typical difference in the surplus or deficit attributable to faulty economic assumptions was about \$29 billion a year over the 1980-2000 period. Regardless of the direction of the error in the forecast, differences between the resolution's assumptions and what actually happened in the economy primarily affected revenues and net interest.

Differences Arising from Technical Factors

Technical factors were responsible for differences between budget resolution targets and actual deficits or surpluses that averaged \$16 billion during the past two decades. In absolute terms, however, such differences caused the resolutions' estimates to be off by \$35 billion, on average. Overall, about two-thirds

Table C-3.
Sources of Differences Between Budget Resolution Targets and Actual Budget Totals,
Fiscal Years 1980-2000 (In billions of dollars)

	Policy Differences	Economic Differences	Technical Differences	Total Differences	Total Differences as a Percentage of Actual
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
Average	1	-1	5	5	-0.9
Absolute Average ^b	6	31	16	44	3.9
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
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
Average	14	*	-10	3	0.9
Absolute Average ^b	16	11	27	37	3.3

(Continued)

Table C-3.
Continued

	Policy Differences	Economic Differences	Technical Differences	Total Differences	Total Differences as a Percentage of Actual ^c
Deficit or Surplus					
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
Average	-12	-2	16	2	-1.2
Absolute Average ^b	17	29	35	57	4.9

SOURCE: Congressional Budget Office.

NOTES: Differences are actual outcomes minus budget resolution assumptions.

Differences are allocated among the three categories soon after the fiscal year ends. Later changes in economic data are not reflected in those allocations.

These comparisons differ from those in earlier chapters in which differences are measured relative to CBO's baseline projections.

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

- 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.

of those misestimates have been on the outlay side of the budget.

The magnitude and causes of the differences ascribed to technical factors have varied over the years. On the revenue side, misestimates were generally not very great through 1990, but revenues were significantly overestimated in 1991 and 1992, when tax collections were weaker than economic data seemed to justify. Over the past few years, revenues have been much higher than the resolutions' estimates. The individual income tax has been the locus of most of the technical error, primarily because of higher realizations of capital gains, unexpected increases in the effective tax rate, and higher-than-reported incomes. Greater realizations of capital gains most likely stemmed from upturns in the prices of stocks and in the volume of stock transactions. The unexpected rise in the effective tax rate was largely due to a disproportionately rapid increase in income among taxpayers taxed at the highest marginal rates. Also contributing to the error in estimating individual income tax receipts were underestimates of reported incomes in the NIPAs that were revised too late to be incorporated in CBO's forecasts.

Misestimates arising from technical factors show up to an even greater extent on the outlay side of the budget. Errors in estimating receipts from offshore oil leases and spending on farm price supports, defense, and entitlement programs dominated technical differences through the mid-1980s. In addition, outlays for deposit insurance developed into a major source of technical estimating errors in the early 1990s during the savings and loan crisis. By the mid-1990s, however, they became a much less significant factor. In recent years, technical differences have been spread among various programs.

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 1980-2000 period are best compared as a percentage of total revenues or outlays. Total absolute differences for both revenues and outlays averaged between 3 percent and 4 percent of actual levels (see Table C-3). The total difference in revenues for 2000—which came to 7.4 percent of actual revenues for the year, or \$149 billion—was above that average. Estimates of revenues were off by about 7 percent in 1997 and 1998 as well.

The total difference in outlays from the budget resolution target for 2000 was 3.0 percent of actual outlays—below the 3.3 percent absolute average difference for the 1980-2000 period. Differences between outlay targets and actual outcomes ranged from a high of 8.1 percent in 1980 to a low of 0.4 percent in 1995.

The size of the total difference between actual deficits or surpluses and the deficits or surpluses specified in budget resolutions depends in large part on whether the revenue and outlay differences offset each other. For years in which the errors in revenues and outlays went in opposite directions relative to the deficit or surplus, the difference dropped to as little as 0.5 percent of actual outlays. But in other years, in which the errors in both revenues and outlays raised or lowered the budget balance, the difference was as much as 11.4 percent of outlays. Indeed, from 1980 to 2000, the errors in revenues and outlays went in the same direction relative to the deficit or surplus in 11 years. In 2000, misestimates of revenues and outlays partially offset each other and thereby produced a total difference that represented 5.3 percent of actual outlays—slightly higher than the average absolute difference of 4.9 percent over the 20-year period.

The Federal Sector of the National Income and Product Accounts

The federal budget is not the only mechanism for gauging the effect of federal government revenues and spending on the economy. That effect is also measured in the official national income and product accounts (NIPAs) produced by the Commerce Department's Bureau of Economic Analysis. The NIPAs provide a picture of government activity in terms of production, distribution, and use of output. They recast the government's transactions into categories that affect gross domestic product, income, and other macroeconomic totals, thereby helping to trace the relationship between the federal sector and other areas of the economy.

Relationship Between the Budget and the NIPAs

A number of major differences distinguish the treatment of federal receipts and expenditures in the NIPAs from their treatment in the unified budget. For example, the NIPAs shift certain items from the spending to the receipt side of the ledger to reflect intrabudgetary or voluntary payments that the budget records as negative outlays. Such shifts are referred to as *netting and grossing* adjustments and do not affect the surplus or deficit (see Table D-1).

By contrast, other differences between the NIPAs and the federal budget do affect the surplus or deficit. The NIPA totals exclude government transactions that involve the transfer of existing assets and

liabilities and that therefore do not contribute to current income and production. Prominent among such *lending and financial* adjustments are those for deposit insurance outlays, cash flows for direct loans made by the government before credit reform, and sales of government assets. Other factors that separate NIPA accounting from budget accounting include *geographic adjustments* (the exclusion of Puerto Rico, the Virgin Islands, and a few other areas from national economic statistics) and *timing adjustments* (such as correcting for irregular numbers of benefit checks or paychecks in the budget because certain pay dates fall on a weekend or holiday).

In the NIPAs, the government's *contributions for employee retirement* are considered the personal income of federal workers covered by the retirement plans. In the budget, those contributions are classified as government receipts. Therefore, on a NIPA basis, outlays from the retirement funds are treated as transactions outside the government sector of the economy.

Capital transfers—which include grants to state and local governments for highways, transit, air transportation, and water treatment plants as well as payments of estate and gift taxes—are transactions in which one party provides something (usually cash) to another without receiving anything in return. Those transactions are linked to, or are conditional on, the acquisition or disposition of an asset. Because such transactions transfer existing assets from one party to another, they do not affect disposable income or production in the current period and are therefore not counted in the NIPAs.

Table D-1.
Relationship of the Budget to the Federal Sector of the
National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual											
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Receipts												
Revenues (Budget) ^a	2,025	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447
Differences												
Netting and grossing												
Medicare premiums	22	24	27	30	33	37	40	43	47	51	56	61
Deposit insurance premiums	*	*	*	*	*	1	1	1	2	2	2	2
Other	5	6	3	*	-3	-4	-5	-6	-7	-9	-10	-11
Geographic adjustments	-3	-4	-4	-4	-4	-4	-4	-5	-5	-5	-5	-6
Contributions for employee retirement	-5	-4	-4	-4	-4	-4	-4	-4	-4	-4	-3	-3
Estate and gift taxes	-29	-30	-32	-34	-35	-36	-37	-39	-43	-46	-48	-52
Universal Service Fund receipts	-5	-5	-6	-8	-13	-13	-13	-13	-13	-13	-13	-14
Other	14	11	3	*	*	-1	*	*	1	2	2	2
Total Difference	-1	-2	-13	-20	-26	-24	-23	-22	-22	-22	-21	-21
Receipts (NIPAs)	2,024	2,132	2,223	2,323	2,427	2,545	2,666	2,793	2,933	3,085	3,251	3,426
Expenditures												
Outlays (Budget) ^a	1,789	1,853	1,923	1,984	2,056	2,137	2,184	2,243	2,320	2,396	2,475	2,558
Differences												
Netting and grossing												
Medicare premiums	22	24	27	30	33	37	40	43	47	51	56	61
Deposit insurance premiums	*	*	*	*	*	1	1	1	2	2	2	2
Other	5	6	3	*	-3	-4	-5	-6	-7	-9	-10	-11
Lending and financial transactions	14	17	12	19	19	11	11	12	11	11	11	12
Geographic adjustments	-10	-11	-12	-12	-13	-13	-14	-14	-15	-16	-17	-17
Timing adjustments	-8	7	3	0	0	-13	3	9	0	0	0	0
Contributions for employee retirement	44	45	47	48	50	52	54	56	58	60	63	66
Capital transfers	-35	-38	-42	-45	-46	-47	-48	-49	-49	-50	-51	-52
Treatment of investment and depreciation	-12	-12	-11	-14	-17	-20	-23	-27	-30	-33	-36	-40
Universal Service Fund payments	-4	-5	-6	-6	-12	-13	-13	-13	-13	-13	-13	-13
Other	1	-2	-3	-3	-2	-3	-3	-3	-3	-3	-3	-3
Total Difference	17	31	18	18	9	-13	3	10	1	1	2	4
Expenditures (NIPAs)	1,806	1,885	1,941	2,002	2,065	2,124	2,186	2,253	2,321	2,397	2,477	2,563

(Continued)

Table D-1.
Continued

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Surplus												
Surplus (Budget) ^a	236	281	313	359	397	433	505	573	635	710	796	889
Differences												
Lending and financial transactions	-14	-17	-12	-19	-19	-11	-11	-12	-11	-11	-11	-12
Geographic adjustments	7	7	8	8	9	9	9	10	10	11	11	12
Timing adjustments	8	-7	-3	0	0	13	-3	-9	0	0	0	0
Contributions for employee retirement	-48	-50	-51	-53	-54	-56	-58	-60	-62	-64	-66	-70
Capital transfers	35	38	42	45	46	47	48	49	49	50	51	52
Estate and gift taxes	-29	-30	-32	-34	-35	-36	-37	-39	-43	-46	-48	-52
Treatment of investment and depreciation	12	12	11	14	17	20	23	27	30	33	36	40
Universal Service Fund payments	-1	*	*	-2	-1	*	*	*	*	*	*	*
Other	<u>12</u>	<u>13</u>	<u>6</u>	<u>3</u>	<u>2</u>	<u>2</u>	<u>3</u>	<u>3</u>	<u>4</u>	<u>4</u>	<u>5</u>	<u>5</u>
Total Difference	-18	-34	-31	-38	-35	-12	-25	-32	-23	-22	-22	-25
Surplus (NIPAs)	218	247	282	321	362	421	480	541	612	688	774	863

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

a. Includes Social Security and the Postal Service.

The NIPAs and the unified budget also differ in their *treatment of investment and depreciation*. The total budget reflects all expenditures of the federal government, including investment purchases of such items as buildings and aircraft carriers. The NIPAs show the current, or operating, account of the federal government; consequently, they exclude government investment and include the government's consumption of fixed capital, or depreciation. Although government investment is included in the calculation of gross domestic product and budget outlays, it is not part of the NIPA measure of federal expenditures.

The *Universal Service Fund*, which is administered by a nonprofit entity, receives funds from all telecommunications service providers and disburses them to providers that serve high-cost areas, low-income households, libraries, schools, and rural health care providers. As a result, its receipts and payments are classified as intracorporate transfers and do not show up in the NIPAs.

NIPA Receipts and Expenditures

The federal sector of the NIPAs generally classifies government receipts according to their source. The leading source in the 2001-2011 period is taxes and fees paid by individuals, followed by contributions (including premiums) for social insurance programs, such as Social Security, Medicare, unemployment insurance, and federal employees' retirement (see Table D-2). The remaining categories are accruals of taxes on corporate profits, including the earnings of the Federal Reserve System, and accruals of indirect business taxes (chiefly excise taxes) and nontax accruals (chiefly fees).

Government expenditures are classified according to their purpose and destination. Defense and

Table D-2.
Projections of Baseline Receipts and Expenditures Measured by the
National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual 2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Receipts												
Personal Tax and Nontax Receipts	988	1,062	1,114	1,169	1,222	1,281	1,345	1,414	1,490	1,572	1,663	1,762
Contributions for Social Insurance	685	717	752	790	828	874	916	961	1,008	1,059	1,112	1,168
Corporate Profits Tax Accruals	245	242	243	248	260	270	281	291	306	320	337	354
Indirect Business Tax and Nontax Accruals	<u>107</u>	<u>111</u>	<u>114</u>	<u>116</u>	<u>117</u>	<u>120</u>	<u>124</u>	<u>126</u>	<u>130</u>	<u>134</u>	<u>138</u>	<u>142</u>
Total	2,024	2,132	2,223	2,323	2,427	2,545	2,666	2,793	2,933	3,085	3,251	3,426
Expenditures												
Purchases of Goods and Services												
Defense												
Consumption	256	269	276	286	294	303	312	320	329	339	348	358
Consumption of fixed capital	65	66	67	68	68	68	69	69	70	71	71	72
Nondefense												
Consumption	141	148	156	159	162	165	167	169	171	175	178	182
Consumption of fixed capital	<u>27</u>	<u>30</u>	<u>32</u>	<u>34</u>	<u>36</u>	<u>38</u>	<u>41</u>	<u>43</u>	<u>45</u>	<u>47</u>	<u>49</u>	<u>51</u>
Subtotal	489	513	531	547	561	575	587	601	615	631	646	663
Transfer Payments												
Domestic	759	808	858	901	951	1,004	1,060	1,121	1,184	1,255	1,332	1,413
Foreign	<u>12</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>	<u>9</u>
Subtotal	771	817	867	910	960	1,013	1,070	1,130	1,193	1,264	1,341	1,422
Grants-in-Aid to State and Local Governments	242	265	286	304	322	339	356	376	398	422	448	477
Net Interest ^a	261	245	220	204	184	160	135	107	75	40	1	-42
Subsidies Less Current Surplus of Government Enterprises	<u>43</u>	<u>45</u>	<u>37</u>	<u>36</u>	<u>38</u>	<u>38</u>	<u>38</u>	<u>38</u>	<u>39</u>	<u>40</u>	<u>41</u>	<u>42</u>
Total	1,806	1,885	1,941	2,002	2,065	2,124	2,186	2,253	2,321	2,397	2,477	2,563
Surplus												
Surplus	218	247	282	321	362	421	480	541	612	688	774	863

SOURCE: Congressional Budget Office.

a. Includes proceeds from uncommitted funds.

nondefense consumption of goods and services represents purchases made by the government for immediate use. Compensation for federal employees makes up the largest part of that consumption. Consumption of fixed capital is the use the government gets from its fixed assets.

Transfer payments are cash payments made directly to people or foreign nations. Grants-in-aid are payments that the federal government makes to state or local governments, which then use them for transfers (such as paying Medicaid benefits), consumption (such as hiring additional police officers), or investment (such as building highways).

Although both the unified budget and the NIPAs contain a category labeled "net interest," the NIPA figure is bigger. Various differences cause the two measures to diverge. The largest difference involves the treatment of interest received by the Civil Service and Military Retirement trust funds. In the unified budget, such receipts offset the payments made by the Treasury. In the NIPAs, however, those receipts have been reclassified as contributions to personal income and do not appear on the government ledger.

The NIPA category labeled "subsidies less current surplus of government enterprises" contains two components, as its name suggests. The first—subsidies—is defined as monetary grants paid by the government to businesses, including state and local government enterprises. Subsidies are dominated by housing assistance.

The second part of the category is the current surplus of government enterprises, which are certain business-type operations of the government, such as the Postal Service. The operating costs of government enterprises are mostly covered by the sale of goods and services to the public rather than by tax receipts. The difference between sales and current operating expenses is the enterprise's surplus or deficit. *Government enterprises* should not be confused with *government-sponsored enterprises* (GSEs), which are private entities established and chartered by the federal government to perform specific financial functions, usually under the supervision of a government agency. Examples of GSEs include Fannie Mae and the Farm Credit System. As privately owned organizations, GSEs are not included in the budget or in the federal sector of the NIPAs.

CBO's Economic Projections for 2001 Through 2011

Year-by-year economic projections for 2001 through 2011 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 recessions and recoveries into its projections for

years after 2002. Instead, the projected values shown here for 2003 through 2011 reflect CBO's assessment of average values for that period—which take into account potential ups and downs in the business cycle.

Table E-1.
CBO's Year-by-Year Economic Projections for Calendar Years 2001-2011

	Estimated 2000	Forecast		Projected								
		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Nominal GDP (Billions of dollars)	9,974	10,446	11,029	11,623	12,206	12,809	13,439	14,100	14,796	15,525	16,308	17,132
Nominal GDP (Percentage change)	7.3	4.7	5.6	5.4	5.0	4.9	4.9	4.9	4.9	4.9	5.0	5.0
Real GDP (Percentage change)	5.1	2.4	3.4	3.3	3.0	3.0	3.0	3.0	3.0	3.0	3.1	3.1
GDP Price Index (Percentage change)	2.1	2.3	2.1	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Consumer Price Index ^a (Percentage change)	3.4	2.8	2.8	2.7	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Unemployment Rate (Percent)	4.0	4.4	4.5	4.5	4.7	4.8	4.9	5.0	5.1	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	5.8	4.8	4.9	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Ten-Year Treasury Note Rate (Percent)	6.0	4.9	5.3	5.5	5.6	5.7	5.8	5.8	5.8	5.8	5.8	5.8
Tax Bases (Billions of dollars)												
Corporate profits ^b	934	929	940	972	1,013	1,048	1,085	1,127	1,184	1,240	1,308	1,374
Wages and salaries	4,770	5,031	5,319	5,605	5,883	6,169	6,468	6,782	7,111	7,456	7,827	8,217
Tax Bases (Percentage of GDP)												
Corporate profits ^b	9.4	8.9	8.5	8.4	8.3	8.2	8.1	8.0	8.0	8.0	8.0	8.0
Wages and salaries	47.8	48.2	48.2	48.2	48.2	48.2	48.1	48.1	48.1	48.0	48.0	48.0

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. The consumer price index for all urban consumers.

b. Corporate profits are book profits.

Table E-2.
CBO's Year-by-Year Economic Projections for Fiscal Years 2001-2011

	Actual 2000	Forecast		Projected								
		2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Nominal GDP (Billions of dollars)	9,828	10,319	10,880	11,477	12,059	12,656	13,279	13,932	14,619	15,338	16,109	16,922
Nominal GDP (Percentage change)	7.4	5.0	5.4	5.5	5.1	5.0	4.9	4.9	4.9	4.9	5.0	5.0
Real GDP (Percentage change)	5.4	2.7	3.2	3.4	3.1	3.0	3.0	3.0	3.0	3.0	3.1	3.1
GDP Price Index (Percentage change)	1.9	2.3	2.2	2.1	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9
Consumer Price Index ^a (Percentage change)	3.2	2.9	2.8	2.8	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Unemployment Rate (Percent)	4.0	4.3	4.5	4.5	4.6	4.8	4.9	5.0	5.1	5.2	5.2	5.2
Three-Month Treasury Bill Rate (Percent)	5.6	5.2	4.8	5.1	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Ten-Year Treasury Note Rate (Percent)	6.2	5.1	5.1	5.5	5.6	5.7	5.7	5.8	5.8	5.8	5.8	5.8
Tax Bases (Billions of dollars)												
Corporate profits ^b	920	927	935	962	1,004	1,039	1,076	1,115	1,170	1,225	1,290	1,358
Wages and salaries	4,696	4,965	5,246	5,535	5,813	6,097	6,392	6,702	7,027	7,368	7,733	8,118
Tax Bases (Percentage of GDP)												
Corporate profits ^b	9.4	9.0	8.6	8.4	8.3	8.2	8.1	8.0	8.0	8.0	8.0	8.0
Wages and salaries	47.8	48.1	48.2	48.2	48.2	48.2	48.1	48.1	48.1	48.0	48.0	48.0

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. The consumer price index for all urban consumers.

b. Corporate profits are book profits.

Historical Budget Data

This appendix provides historical data for revenues, outlays, and the deficit or surplus. Estimates of the standardized-budget deficit or surplus and its revenue and outlay components for fiscal years 1961 through 2000 are reported in Tables F-1 through F-3, along with estimates of potential gross domestic product (GDP), actual GDP, and the nonaccelerating inflation rate of unemployment (NAIRU). The standardized-budget measure and its components also are shown as a percentage of potential GDP.

The change in the standardized-budget deficit or surplus is a commonly used measure of the short-term impact of fiscal policy on aggregate demand.¹ The standardized-budget deficit, which is often called the structural deficit, excludes the effects on revenues and outlays of cyclical fluctuations in output and unemployment and makes other adjustments. Historical estimates for standardized-budget revenues, outlays, and the deficit or surplus have been revised.

Budget data consistent with the projections in Chapters 1, 3, and 4 are available for fiscal years 1962 through 2000 and are reported in Tables F-4 through F-13. The data are shown both in nominal dollars and as a percentage of GDP. Data for 2000 come from the Department of the Treasury, *Final Monthly Treasury Statement* (October 2000), and the Office of Management and Budget.

Federal revenues, outlays, the deficit or surplus, and debt held by the public are shown in Tables F-4 and F-5. Revenues, outlays, and the deficit or surplus have both on-budget and off-budget components. Social Security receipts and outlays were placed off-budget by the Balanced Budget and Emergency Deficit Control Act of 1985; the Postal Service was moved off-budget four years later by the Omnibus Budget Reconciliation Act of 1989.

The major sources of federal revenues (including off-budget revenues) are presented in Tables F-6 and F-7. Social insurance taxes include payments by 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. Miscellaneous receipts consist of deposits of earnings by the Federal Reserve System and numerous fees and charges.

Total outlays for major spending categories are shown in Tables F-8 and F-9. (Those totals include both on- and off-budget outlays.) To compare historical outlays with the projections in Chapters 1, 3, and 4, the historical data have been divided into the same categories of spending as the projections. Spending controlled by the appropriation process is classified as discretionary. Tables F-10 and F-11 divide discretionary spending into its defense, international, and domestic components. Entitlements and other mandatory spending include programs whose spending is

1. In previous reports, this measure was referred to as the standardized-employment deficit or surplus.

governed by laws that set requirements for eligibility. Additional detail on entitlement programs is shown in Tables F-12 and F-13. Net interest is identical to the budget function of the same name (function 900). Offsetting receipts include the federal government's

contribution to retirement programs for its employees, fees and charges such as Medicare premiums, and receipts from the use of federally controlled land and offshore territory.

Table F-1.
Deficits, Surpluses, Debt, and Related Series, Fiscal Years 1961-2000

	In Billions of Dollars			As a Percentage of GDP			GDP (Billions of dollars)		NAIRU ^d (Percent)
	Deficit (-) or Surplus	Standardized- Budget Deficit (-) or Surplus ^a	Debt Held by the Public	Deficit (-) or Surplus	Standardized- Budget Deficit (-) or Surplus ^{a,b}	Debt Held by the Public	Actual ^c	Potential	
1961	-3	3	238	-0.6	0.6	44.9	531	546	5.5
1962	-7	-4	248	-1.3	-0.7	43.6	569	575	5.5
1963	-5	-4	254	-0.8	-0.6	42.3	600	606	5.5
1964	-6	-6	257	-0.9	-0.9	40.0	642	638	5.6
1965	-1	-4	261	-0.2	-0.6	37.9	688	676	5.6
1966	-4	-13	264	-0.5	-1.8	34.8	757	720	5.7
1967	-9	-20	267	-1.1	-2.6	32.8	812	776	5.8
1968	-25	-30	290	-2.9	-3.5	33.3	870	840	5.8
1969	3	-10	278	0.3	-1.1	29.3	949	915	5.8
1970	-3	-8	283	-0.3	-0.8	27.9	1,014	1,002	5.9
1971	-23	-12	303	-2.1	-1.1	28.0	1,082	1,090	5.9
1972	-23	-19	322	-2.0	-1.6	27.4	1,178	1,179	6.0
1973	-15	-20	341	-1.1	-1.6	26.0	1,314	1,274	6.1
1974	-6	1	344	-0.4	0.1	23.8	1,442	1,416	6.2
1975	-53	-2	395	-3.4	-0.2	25.3	1,559	1,616	6.2
1976	-74	-36	477	-4.2	-2.0	27.5	1,736	1,787	6.2
1977	-54	-20	549	-2.7	-1.0	27.8	1,975	2,001	6.2
1978	-59	-31	607	-2.7	-1.4	27.4	2,219	2,213	6.3
1979	-41	-15	640	-1.6	-0.6	25.6	2,505	2,472	6.3
1980	-74	-15	712	-2.7	-0.5	26.1	2,732	2,772	6.2
1981	-79	-17	789	-2.6	-0.5	25.8	3,060	3,121	6.2
1982	-128	-52	925	-4.0	-1.5	28.6	3,231	3,425	6.1
1983	-208	-120	1,137	-6.0	-3.3	33.0	3,442	3,673	6.1
1984	-185	-144	1,307	-4.8	-3.7	34.0	3,847	3,922	6.1
1985	-212	-177	1,507	-5.1	-4.2	36.4	4,142	4,179	6.0
1986	-221	-212	1,741	-5.0	-4.8	39.6	4,398	4,421	6.0
1987	-150	-155	1,890	-3.2	-3.3	40.6	4,654	4,691	6.0
1988	-155	-127	2,052	-3.1	-2.5	40.9	5,017	4,999	5.9
1989	-152	-115	2,191	-2.8	-2.1	40.5	5,407	5,351	5.9
1990	-221	-119	2,412	-3.9	-2.1	42.0	5,738	5,715	5.9
1991	-269	-151	2,689	-4.5	-2.5	45.4	5,928	6,098	5.8
1992	-290	-184	3,000	-4.7	-2.9	48.2	6,222	6,416	5.7
1993	-255	-181	3,249	-3.9	-2.7	49.5	6,561	6,731	5.6
1994	-203	-138	3,433	-2.9	-2.0	49.4	6,949	7,055	5.4
1995	-164	-136	3,605	-2.2	-1.8	49.2	7,323	7,404	5.3
1996	-108	-89	3,735	-1.4	-1.1	48.5	7,700	7,777	5.2
1997	-22	-56	3,773	-0.3	-0.7	46.0	8,194	8,186	5.2
1998	69	-18	3,722	0.8	-0.2	42.9	8,666	8,589	5.2
1999	124	20	3,633	1.4	0.2	39.7	9,153	9,026	5.2
2000	236	106	3,410	2.4	1.1	34.7	9,828	9,532	5.2

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

a. Excludes deposit insurance, receipts from auctions of the electromagnetic spectrum, timing adjustments, asset sales, the inflation component of interest payments, capital gains tax revenues, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

b. The standardized-budget deficit or surplus is shown as a percentage of potential GDP.

c. Actual GDP numbers by fiscal year are calculated from quarterly national income and product account numbers from the Bureau of Economic Analysis.

d. The NAIRU is the nonaccelerating inflation rate of unemployment. It is the benchmark for computing potential GDP.

Table F-2.
Standardized-Budget Deficit or Surplus and Related Series,
Fiscal Years 1961-2000 (In billions of dollars)

	Budget Deficit (-) or Surplus	Cyclical Adjustment ^a	Other Adjustments ^b	Standardized		
				Deficit (-) or Surplus	Revenues	Outlays
1961	-3	6	1	3	98	94
1962	-7	2	1	-4	100	104
1963	-5	2	-1	-4	106	110
1964	-6	-1	2	-6	109	115
1965	-1	-4	2	-4	111	115
1966	-4	-13	3	-13	116	130
1967	-9	-12	1	-20	133	153
1968	-25	-11	7	-30	141	171
1969	3	-14	1	-10	164	173
1970	-3	-6	1	-8	176	184
1971	-23	3	8	-12	185	197
1972	-23	*	5	-19	201	220
1973	-15	-14	9	-20	214	234
1974	-6	-10	17	1	250	249
1975	-53	20	31	-2	295	298
1976	-74	24	14	-36	308	344
1977	-54	12	22	-20	358	378
1978	-59	-3	31	-31	390	421
1979	-41	-13	38	-15	444	460
1980	-74	13	46	-15	517	532
1981	-79	22	40	-17	605	622
1982	-128	53	23	-52	646	699
1983	-208	79	8	-120	644	765
1984	-185	29	12	-144	671	815
1985	-212	15	20	-177	722	899
1986	-221	9	*	-212	748	960
1987	-150	10	-15	-155	811	966
1988	-155	-7	36	-127	870	997
1989	-152	-18	55	-115	939	1,054
1990	-221	-8	111	-119	993	1,112
1991	-269	46	73	-151	1,065	1,216
1992	-290	68	39	-184	1,124	1,308
1993	-255	60	14	-181	1,172	1,352
1994	-203	38	28	-138	1,254	1,391
1995	-164	22	6	-136	1,334	1,471
1996	-108	23	-5	-89	1,421	1,510
1997	-22	-3	-32	-56	1,508	1,564
1998	69	-28	-58	-18	1,613	1,630
1999	124	-45	-59	20	1,688	1,667
2000	236	-96	-34	106	1,821	1,716

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

- a. The cyclical adjustment is positive when cyclical conditions are temporarily depressing revenues and raising outlays.
- b. Consists of deposit insurance, receipts from auctions of the electromagnetic spectrum, timing adjustments, asset sales, adjustments for certain changes in the amount of taxes overwithheld, adjustments for temporary tax changes, the inflation component of federal interest payments, tax receipts from capital gains, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

Table F-3.
Standardized-Budget Deficit or Surplus and Related Series,
Fiscal Years 1961-2000 (As a percentage of potential GDP)

	Budget Deficit (-) or Surplus ^a	Cyclical Adjustment ^b	Other Adjustments ^c	Standardized		
				Deficit (-) or Surplus	Revenues	Outlays
1961	-0.6	1.0	0.1	0.6	17.9	17.3
1962	-1.3	0.4	0.2	-0.7	17.3	18.0
1963	-0.8	0.3	-0.1	-0.6	17.5	18.1
1964	-0.9	-0.2	0.2	-0.9	17.1	18.0
1965	-0.2	-0.7	0.3	-0.6	16.4	17.0
1966	-0.5	-1.8	0.4	-1.8	16.2	18.0
1967	-1.1	-1.6	0.1	-2.6	17.1	19.7
1968	-2.9	-1.3	0.8	-3.5	16.8	20.3
1969	0.3	-1.5	0.1	-1.1	17.9	19.0
1970	-0.3	-0.6	0.1	-0.8	17.6	18.4
1971	-2.1	0.2	0.8	-1.1	17.0	18.1
1972	-2.0	*	0.4	-1.6	17.0	18.6
1973	-1.1	-1.1	0.7	-1.6	16.8	18.4
1974	-0.4	-0.7	1.2	0.1	17.7	17.6
1975	-3.4	1.2	1.9	-0.2	18.3	18.4
1976	-4.2	1.3	0.8	-2.0	17.3	19.3
1977	-2.7	0.6	1.1	-1.0	17.9	18.9
1978	-2.7	-0.1	1.4	-1.4	17.6	19.0
1979	-1.6	-0.5	1.5	-0.6	18.0	18.6
1980	-2.7	0.5	1.6	-0.5	18.6	19.2
1981	-2.6	0.7	1.3	-0.5	19.4	19.9
1982	-4.0	1.6	0.7	-1.5	18.9	20.4
1983	-6.0	2.2	0.2	-3.3	17.5	20.8
1984	-4.8	0.7	0.3	-3.7	17.1	20.8
1985	-5.1	0.4	0.5	-4.2	17.3	21.5
1986	-5.0	0.2	*	-4.8	16.9	21.7
1987	-3.2	0.2	-0.3	-3.3	17.3	20.6
1988	-3.1	-0.1	0.7	-2.5	17.4	19.9
1989	-2.8	-0.3	1.0	-2.1	17.5	19.7
1990	-3.9	-0.1	1.9	-2.1	17.4	19.5
1991	-4.5	0.7	1.2	-2.5	17.5	19.9
1992	-4.7	1.1	0.6	-2.9	17.5	20.4
1993	-3.9	0.9	0.2	-2.7	17.4	20.1
1994	-2.9	0.5	0.4	-2.0	17.8	19.7
1995	-2.2	0.3	0.1	-1.8	18.0	19.9
1996	-1.4	0.3	-0.1	-1.1	18.3	19.4
1997	-0.3	*	-0.4	-0.7	18.4	19.1
1998	0.8	-0.3	-0.7	-0.2	18.8	19.0
1999	1.4	-0.5	-0.7	0.2	18.7	18.5
2000	2.4	-1.0	-0.4	1.1	19.1	18.0

SOURCE: Congressional Budget Office.

NOTE: * = between -0.05 percent and 0.05 percent.

- a. The budget deficit or surplus is shown as a percentage of actual GDP.
- b. The cyclical adjustment is positive when cyclical conditions are temporarily depressing revenues and raising outlays.
- c. Consists of deposit insurance, receipts from auctions of the electromagnetic spectrum, timing adjustments, asset sales, adjustments for certain changes in the amount of taxes overwithheld, adjustments for temporary tax changes, the inflation component of federal interest payments, tax receipts from capital gains, and contributions from allied nations for Operation Desert Storm (which were received in 1991 and 1992).

Table F-4.
Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public,
Fiscal Years 1962-2000 (In billions of dollars)

	Revenues	Outlays	Deficit (-) or Surplus			Total	Debt Held by the Public ^b
			On-Budget ^a	Social Security	Postal Service ^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	-26.4	3.0	n.a.	-23.4	322.4
1973	230.8	245.7	-15.4	0.5	n.a.	-14.9	340.9
1974	263.2	269.4	-8.0	1.8	n.a.	-6.1	343.7
1975	279.1	332.3	-55.3	2.0	n.a.	-53.2	394.7
1976	298.1	371.8	-70.5	-3.2	n.a.	-73.7	477.4
1977	355.6	409.2	-49.8	-3.9	n.a.	-53.7	549.1
1978	399.6	458.7	-54.9	-4.3	n.a.	-59.2	607.1
1979	463.3	504.0	-38.7	-2.0	n.a.	-40.7	640.3
1980	517.1	590.9	-72.7	-1.1	n.a.	-73.8	711.9
1981	599.3	678.2	-74.0	-5.0	n.a.	-79.0	789.4
1982	617.8	745.8	-120.1	-7.9	n.a.	-128.0	924.6
1983	600.6	808.4	-208.0	0.2	n.a.	-207.8	1,137.3
1984	666.5	851.9	-185.7	0.3	n.a.	-185.4	1,307.0
1985	734.1	946.4	-221.7	9.4	n.a.	-212.3	1,507.4
1986	769.2	990.5	-238.0	16.7	n.a.	-221.2	1,740.8
1987	854.4	1,004.1	-169.3	19.6	n.a.	-149.8	1,889.9
1988	909.3	1,064.5	-194.0	38.8	n.a.	-155.2	2,051.8
1989	991.2	1,143.7	-205.2	52.4	0.3	-152.5	2,191.0
1990	1,032.0	1,253.2	-277.8	58.2	-1.6	-221.2	2,411.8
1991	1,055.0	1,324.4	-321.6	53.5	-1.3	-269.4	2,689.3
1992	1,091.3	1,381.7	-340.5	50.7	-0.7	-290.4	3,000.1
1993	1,154.4	1,409.5	-300.5	46.8	-1.4	-255.1	3,248.8
1994	1,258.6	1,461.9	-258.9	56.8	-1.1	-203.3	3,433.4
1995	1,351.8	1,515.8	-226.4	60.4	2.0	-164.0	3,604.8
1996	1,453.1	1,560.6	-174.1	66.4	0.2	-107.5	3,734.5
1997	1,579.3	1,601.3	-103.4	81.3	*	-22.0	3,772.8
1998	1,721.8	1,652.6	-30.0	99.0	0.2	69.2	3,721.6
1999	1,827.5	1,703.0	0.7	124.7	-1.0	124.4	3,632.9
2000	2,025.2	1,789.0	86.4	151.8	-2.0	236.2	3,410.1

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = less than \$500 million.

a. In fiscal years 1962 through 1988, the Postal Service was on-budget and included in the on-budget total.

b. End of year.

Table F-5.
Revenues, Outlays, Deficits, Surpluses, and Debt Held by the Public,
Fiscal Years 1962-2000 (As a percentage of GDP)

	Revenues	Outlays	Deficit (-) or Surplus			Total	Debt Held by the Public ^b
			On-Budget ^a	Social Security	Postal Service ^a		
1962	17.5	18.8	-1.0	-0.2	n.a.	-1.3	43.6
1963	17.8	18.5	-0.7	-0.1	n.a.	-0.8	42.3
1964	17.5	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	34.8
1967	18.3	19.4	-1.6	0.5	n.a.	-1.1	32.8
1968	17.6	20.5	-3.2	0.3	n.a.	-2.9	33.3
1969	19.7	19.3	-0.1	0.4	n.a.	0.3	29.3
1970	19.0	19.3	-0.9	0.6	n.a.	-0.3	27.9
1971	17.3	19.4	-2.4	0.3	n.a.	-2.1	28.0
1972	17.6	19.6	-2.2	0.3	n.a.	-2.0	27.4
1973	17.6	18.7	-1.2	*	n.a.	-1.1	26.0
1974	18.3	18.7	-0.6	0.1	n.a.	-0.4	23.8
1975	17.9	21.3	-3.5	0.1	n.a.	-3.4	25.3
1976	17.2	21.4	-4.1	-0.2	n.a.	-4.2	27.5
1977	18.0	20.7	-2.5	-0.2	n.a.	-2.7	27.8
1978	18.0	20.7	-2.5	-0.2	n.a.	-2.7	27.4
1979	18.5	20.1	-1.5	-0.1	n.a.	-1.6	25.6
1980	18.9	21.6	-2.7	*	n.a.	-2.7	26.1
1981	19.6	22.2	-2.4	-0.2	n.a.	-2.6	25.8
1982	19.1	23.1	-3.7	-0.2	n.a.	-4.0	28.6
1983	17.4	23.5	-6.0	*	n.a.	-6.0	33.0
1984	17.3	22.1	-4.8	*	n.a.	-4.8	34.0
1985	17.7	22.9	-5.4	0.2	n.a.	-5.1	36.4
1986	17.5	22.5	-5.4	0.4	n.a.	-5.0	39.6
1987	18.4	21.6	-3.6	0.4	n.a.	-3.2	40.6
1988	18.1	21.2	-3.9	0.8	n.a.	-3.1	40.9
1989	18.3	21.2	-3.8	1.0	*	-2.8	40.5
1990	18.0	21.8	-4.8	1.0	*	-3.9	42.0
1991	17.8	22.3	-5.4	0.9	*	-4.5	45.4
1992	17.5	22.2	-5.5	0.8	*	-4.7	48.2
1993	17.6	21.5	-4.6	0.7	*	-3.9	49.5
1994	18.1	21.0	-3.7	0.8	*	-2.9	49.4
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	19.5	-1.3	1.0	*	-0.3	46.0
1998	19.9	19.1	-0.3	1.1	*	0.8	42.9
1999	20.0	18.6	*	1.4	*	1.4	39.7
2000	20.6	18.2	0.9	1.5	*	2.4	34.7

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = less than 0.05 percent.

a. In fiscal years 1962 through 1988, the Postal Service was on-budget and included in the on-budget total.

b. End of year.

Table F-6.
Revenues by Major Source, Fiscal Years 1962-2000 (In billions of dollars)

	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Excise Taxes	Estate and Gift Taxes	Customs Duties	Miscel- laneous 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

SOURCE: Congressional Budget Office.

Table F-7.
Revenues by Major Source, Fiscal Years 1962-2000 (As a percentage of GDP)

	Individual Income Taxes	Corporate Income Taxes	Social Insurance Taxes	Excise Taxes	Estate and Gift Taxes	Customs Duties	Miscel- laneous Receipts	Total Revenues
1962	8.0	3.6	3.0	2.2	0.4	0.2	0.1	17.5
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	17.5
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	18.3
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	1.5	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	17.2
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	5.5	0.7	0.2	0.3	0.4	18.5
1980	8.9	2.4	5.8	0.9	0.2	0.3	0.5	18.9
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	19.1
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	6.5	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	8.2	1.9	6.6	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	7.7	1.6	6.6	0.7	0.2	0.3	0.4	17.5
1993	7.8	1.8	6.5	0.7	0.2	0.3	0.3	17.6
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	19.9
1999	9.6	2.0	6.7	0.8	0.3	0.2	0.4	20.0
2000	10.2	2.1	6.6	0.7	0.3	0.2	0.4	20.6

SOURCE: Congressional Budget Office.

Table F-8.
Outlays by Major Spending Category, Fiscal Years 1962-2000 (In billions of dollars)

	Discretionary Spending	Entitlements and Other Mandatory Spending	Net Interest	Offsetting Receipts	Total Outlays
1962	72.1	34.7	6.9	-6.8	106.8
1963	75.3	36.2	7.7	-7.9	111.3
1964	79.1	38.9	8.2	-7.7	118.5
1965	77.8	39.7	8.6	-7.9	118.2
1966	90.1	43.4	9.4	-8.4	134.5
1967	106.5	50.9	10.3	-10.2	157.5
1968	118.0	59.7	11.1	-10.6	178.1
1969	117.3	64.6	12.7	-11.0	183.6
1970	120.3	72.5	14.4	-11.5	195.6
1971	122.5	86.9	14.8	-14.1	210.2
1972	128.5	100.8	15.5	-14.1	230.7
1973	130.4	116.0	17.3	-18.0	245.7
1974	138.2	130.9	21.4	-21.2	269.4
1975	157.9	169.5	23.2	-18.3	332.3
1976	175.5	189.2	26.7	-19.6	371.8
1977	197.0	203.8	29.9	-21.5	409.2
1978	218.6	227.5	35.5	-22.8	458.7
1979	239.9	247.1	42.6	-25.6	504.0
1980	276.2	291.3	52.5	-29.2	590.9
1981	307.9	339.5	68.8	-37.9	678.2
1982	325.9	370.8	85.0	-36.0	745.8
1983	353.3	410.6	89.8	-45.3	808.4
1984	379.4	405.6	111.1	-44.2	851.9
1985	415.7	448.3	129.5	-47.1	946.4
1986	438.5	461.8	136.0	-45.9	990.5
1987	444.2	474.2	138.7	-52.9	1,004.1
1988	464.4	505.1	151.8	-56.8	1,064.5
1989	488.8	549.7	169.0	-63.8	1,143.7
1990	500.5	626.9	184.4	-58.7	1,253.2
1991	533.3	702.4	194.5	-105.7	1,324.4
1992	534.6	716.1	199.4	-68.4	1,381.7
1993	541.0	736.4	198.7	-66.6	1,409.5
1994	543.9	783.6	203.0	-68.5	1,461.9
1995	545.7	817.7	232.2	-79.7	1,515.8
1996	534.5	856.9	241.1	-71.9	1,560.6
1997	548.9	896.3	244.0	-88.0	1,601.3
1998	554.7	938.6	241.2	-81.9	1,652.6
1999	575.0	976.8	229.7	-78.4	1,703.0
2000	617.0	1,029.8	223.2	-81.1	1,789.0

SOURCE: Congressional Budget Office.

Table F-9.
Outlays by Major Spending Category, Fiscal Years 1962-2000 (As a percentage of GDP)

	Discretionary Spending	Entitlements and Other Mandatory Spending	Net Interest	Offsetting Receipts	Total Outlays
1962	12.7	6.1	1.2	-1.2	18.8
1963	12.5	6.0	1.3	-1.3	18.5
1964	12.3	6.1	1.3	-1.2	18.5
1965	11.3	5.8	1.2	-1.1	17.2
1966	11.9	5.7	1.2	-1.1	17.8
1967	13.1	6.3	1.3	-1.3	19.4
1968	13.6	6.9	1.3	-1.2	20.5
1969	12.4	6.8	1.3	-1.2	19.3
1970	11.9	7.2	1.4	-1.1	19.3
1971	11.3	8.0	1.4	-1.3	19.4
1972	10.9	8.6	1.3	-1.2	19.6
1973	9.9	8.8	1.3	-1.4	18.7
1974	9.6	9.1	1.5	-1.5	18.7
1975	10.1	10.9	1.5	-1.2	21.3
1976	10.1	10.9	1.5	-1.1	21.4
1977	10.0	10.3	1.5	-1.1	20.7
1978	9.9	10.2	1.6	-1.0	20.7
1979	9.6	9.9	1.7	-1.0	20.1
1980	10.1	10.7	1.9	-1.1	21.6
1981	10.1	11.1	2.2	-1.2	22.2
1982	10.1	11.5	2.6	-1.1	23.1
1983	10.3	11.9	2.6	-1.3	23.5
1984	9.9	10.5	2.9	-1.2	22.1
1985	10.0	10.8	3.1	-1.1	22.9
1986	10.0	10.5	3.1	-1.0	22.5
1987	9.5	10.2	3.0	-1.1	21.6
1988	9.3	10.1	3.0	-1.1	21.2
1989	9.0	10.2	3.1	-1.2	21.2
1990	8.7	10.9	3.2	-1.0	21.8
1991	9.0	11.8	3.3	-1.8	22.3
1992	8.6	11.5	3.2	-1.1	22.2
1993	8.2	11.2	3.0	-1.0	21.5
1994	7.8	11.3	2.9	-1.0	21.0
1995	7.5	11.2	3.2	-1.1	20.7
1996	6.9	11.1	3.1	-0.9	20.3
1997	6.7	10.9	3.0	-1.1	19.5
1998	6.4	10.8	2.8	-0.9	19.1
1999	6.3	10.7	2.5	-0.9	18.6
2000	6.3	10.5	2.3	-0.8	18.2

SOURCE: Congressional Budget Office.

Table F-10.
Discretionary Outlays, Fiscal Years 1962-2000 (In 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	39.7	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	62.1	157.9
1976	89.9	7.5	78.2	175.5
1977	97.5	8.0	91.5	197.0
1978	104.6	8.5	105.4	218.6
1979	116.8	9.1	114.0	239.9
1980	134.6	12.8	128.8	276.2
1981	158.0	13.6	136.3	307.9
1982	185.9	12.9	127.1	325.9
1983	209.9	13.6	129.8	353.3
1984	228.0	16.3	135.1	379.4
1985	253.1	17.4	145.2	415.7
1986	273.8	17.7	146.9	438.5
1987	282.5	15.2	146.4	444.2
1988	290.9	15.7	157.7	464.4
1989	304.0	16.6	168.2	488.8
1990	300.1	19.1	181.3	500.5
1991	319.7	19.7	193.9	533.3
1992	302.6	19.2	212.8	534.6
1993	292.4	21.6	227.0	541.0
1994	282.3	20.8	240.8	543.9
1995	273.6	20.1	252.0	545.7
1996	266.0	18.3	250.2	534.5
1997	271.7	19.0	258.3	548.9
1998	270.2	18.1	266.4	554.7
1999	275.5	19.5	280.0	575.0
2000	295.0	21.3	300.7	617.0

SOURCE: Congressional Budget Office.

Table F-11.
Discretionary Outlays, Fiscal Years 1962-2000 (As a percentage of GDP)

	Defense	International	Domestic	Total
1962	9.2	1.0	2.5	12.7
1963	8.9	0.9	2.7	12.5
1964	8.6	0.7	3.0	12.3
1965	7.4	0.7	3.2	11.3
1966	7.8	0.7	3.4	11.9
1967	8.9	0.7	3.6	13.1
1968	9.4	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	4.9	0.3	3.4	8.6
1993	4.5	0.3	3.5	8.2
1994	4.1	0.3	3.5	7.8
1995	3.7	0.3	3.4	7.5
1996	3.5	0.2	3.2	6.9
1997	3.3	0.2	3.2	6.7
1998	3.1	0.2	3.1	6.4
1999	3.0	0.2	3.1	6.3
2000	3.0	0.2	3.1	6.3

SOURCE: Congressional Budget Office.

Table F-12.
Outlays for Entitlements and Other Mandatory Spending,
Fiscal Years 1962-2000 (In billions of dollars)

	Means-Tested Programs			Non-Means-Tested Programs								Total Entitlements and Other Mandatory Spending
	Medicaid	Other	Total Means-Tested	Social Security	Medicare	Other Retirement and Disability	Unemployment Compensation	Farm Price Supports	Deposit Insurance	Other	Total Non-Means-Tested	
1962	0.1	4.2	4.3	14.0	0	2.7	3.5	2.4	-0.4	8.2	30.4	34.7
1963	0.2	4.5	4.7	15.5	0	2.9	3.6	3.4	-0.4	6.6	31.5	36.2
1964	0.2	4.8	5.0	16.2	0	3.3	3.4	3.4	-0.4	8.0	33.9	38.9
1965	0.3	4.9	5.2	17.1	0	3.6	2.7	2.8	-0.4	8.7	34.5	39.7
1966	0.8	5.0	5.8	20.3	*	4.1	2.2	1.4	-0.5	10.1	37.6	43.4
1967	1.2	5.0	6.2	21.3	3.2	4.8	2.3	2.0	-0.4	11.6	44.7	50.9
1968	1.8	5.7	7.5	23.3	5.1	5.7	2.2	3.3	-0.5	13.1	52.2	59.7
1969	2.3	6.3	8.6	26.7	6.3	5.2	2.3	4.2	-0.6	11.9	56.0	64.6
1970	2.7	7.4	10.1	29.6	6.8	6.6	3.1	3.8	-0.5	12.9	62.4	72.5
1971	3.4	10.0	13.4	35.1	7.5	8.3	5.8	2.9	-0.4	14.3	73.5	86.9
1972	4.6	11.7	16.3	39.4	8.4	9.6	6.7	4.1	-0.6	17.0	84.5	100.8
1973	4.6	11.4	16.0	48.2	9.0	11.7	4.9	3.6	-0.8	23.4	100.0	116.0
1974	5.8	13.7	19.5	55.0	10.7	13.8	5.6	1.0	-0.6	25.9	111.4	130.9
1975	6.8	18.6	25.4	63.6	14.1	18.3	12.8	0.6	0.5	34.2	144.1	169.5
1976	8.6	21.7	30.3	72.7	16.9	18.9	18.6	1.1	-0.6	31.3	158.9	189.2
1977	9.9	23.4	33.3	83.7	20.8	21.6	14.3	3.8	-2.8	29.1	170.5	203.8
1978	10.7	24.8	35.5	92.4	24.3	23.7	10.8	5.7	-1.0	36.1	192.0	227.5
1979	12.4	26.5	38.9	102.6	28.2	27.9	9.8	3.6	-1.7	37.9	208.2	247.1
1980	14.0	31.9	45.9	117.1	34.0	32.1	16.9	2.8	-0.4	43.0	245.4	291.3
1981	16.8	37.1	53.9	137.9	41.3	37.4	18.3	4.0	-1.4	48.1	285.6	339.5
1982	17.4	37.4	54.8	153.9	49.2	40.7	22.2	11.7	-2.1	40.4	316.0	370.8
1983	19.0	40.3	59.3	168.5	55.5	43.2	29.7	18.9	-1.2	36.7	351.3	410.6
1984	20.1	41.2	61.3	176.1	61.0	44.7	17.0	7.3	-0.8	39.1	344.3	405.6
1985	22.7	43.3	66.0	186.4	69.6	45.5	15.8	17.7	-2.2	49.3	382.3	448.3
1986	25.0	44.9	69.9	196.5	74.2	47.5	16.1	25.8	1.5	30.2	391.9	461.8
1987	27.4	45.5	72.9	205.1	79.9	50.8	15.5	22.4	3.1	24.6	401.3	474.2
1988	30.5	50.0	80.5	216.8	85.7	54.2	13.6	12.2	10.0	32.1	424.6	505.1
1989	34.6	54.2	88.8	230.4	94.3	57.2	13.9	10.6	22.0	32.4	460.9	549.7
1990	41.1	58.8	99.9	246.5	107.4	59.9	17.5	6.5	57.9	31.3	527.0	626.9
1991	52.5	69.7	122.2	266.8	114.2	64.4	25.1	10.1	66.2	33.4	580.2	702.4
1992	67.8	78.7	146.5	285.2	129.4	66.6	36.9	9.3	2.6	39.7	569.6	716.1
1993	75.8	86.5	162.3	302.0	143.1	68.7	35.4	15.6	-28.0	37.4	574.1	736.4
1994	82.0	95.0	177.0	316.9	159.5	72.1	26.4	9.9	-7.6	29.4	606.6	783.6
1995	89.1	101.5	190.6	333.3	177.1	75.2	21.3	5.8	-17.9	32.3	627.1	817.7
1996	92.0	104.2	196.2	347.1	191.3	77.3	22.4	5.0	-8.4	26.0	660.7	856.9
1997	95.6	107.2	202.8	362.3	207.9	80.6	20.6	5.8	-14.4	30.8	693.5	896.3
1998	101.2	107.8	209.0	376.1	211.0	82.9	19.7	8.5	-4.4	35.7	729.6	938.6
1999	108.0	112.7	220.7	387.0	209.3	85.3	21.1	18.0	-5.3	40.7	756.1	976.8
2000	117.4	118.6	235.9	406.0	216.0	87.8	20.7	30.5	-3.1	35.8	793.9	1,029.8

SOURCE: Congressional Budget Office.

NOTE: * = less than \$50 million.

Table F-13.
Outlays for Entitlements and Other Mandatory Spending,
Fiscal Years 1962-2000 (As a percentage of GDP)

	Means-Tested Programs			Non-Means-Tested Programs							Total Entitle-ments and Other Mandatory Spending	
	Medicaid	Other	Total Means-Tested	Social Security	Medicare	Other Retirement and Disability	Unemploy-ment Compens-ation	Farm Price Supports	Deposit Insur-ance	Other		Total Non-Means-Tested
1962	*	0.7	0.8	2.5	0	0.5	0.6	0.4	-0.1	1.4	5.3	6.1
1963	*	0.8	0.8	2.6	0	0.5	0.6	0.6	-0.1	1.1	5.2	6.0
1964	*	0.7	0.8	2.5	0	0.5	0.5	0.5	-0.1	1.2	5.3	6.1
1965	*	0.7	0.8	2.5	0	0.5	0.4	0.4	-0.1	1.3	5.0	5.8
1966	0.1	0.7	0.8	2.7	*	0.5	0.3	0.2	-0.1	1.3	5.0	5.7
1967	0.1	0.6	0.8	2.6	0.4	0.6	0.3	0.2	*	1.4	5.5	6.3
1968	0.2	0.7	0.9	2.7	0.6	0.7	0.2	0.4	-0.1	1.5	6.0	6.9
1969	0.2	0.7	0.9	2.8	0.7	0.6	0.2	0.4	-0.1	1.3	5.9	6.8
1970	0.3	0.7	1.0	2.9	0.7	0.7	0.3	0.4	*	1.3	6.2	7.2
1971	0.3	0.9	1.2	3.2	0.7	0.8	0.5	0.3	*	1.3	6.8	8.0
1972	0.4	1.0	1.4	3.3	0.7	0.8	0.6	0.3	-0.1	1.4	7.2	8.6
1973	0.4	0.9	1.2	3.7	0.7	0.9	0.4	0.3	-0.1	1.8	7.6	8.8
1974	0.4	0.9	1.4	3.8	0.7	1.0	0.4	0.1	*	1.8	7.7	9.1
1975	0.4	1.2	1.6	4.1	0.9	1.2	0.8	*	*	2.2	9.2	10.9
1976	0.5	1.3	1.7	4.2	1.0	1.1	1.1	0.1	*	1.8	9.2	10.9
1977	0.5	1.2	1.7	4.2	1.1	1.1	0.7	0.2	-0.1	1.5	8.6	10.3
1978	0.5	1.1	1.6	4.2	1.1	1.1	0.5	0.3	*	1.6	8.7	10.2
1979	0.5	1.1	1.6	4.1	1.1	1.1	0.4	0.1	-0.1	1.5	8.3	9.9
1980	0.5	1.2	1.7	4.3	1.2	1.2	0.6	0.1	*	1.6	9.0	10.7
1981	0.6	1.2	1.8	4.5	1.3	1.2	0.6	0.1	*	1.6	9.3	11.1
1982	0.5	1.2	1.7	4.8	1.5	1.3	0.7	0.4	-0.1	1.3	9.8	11.5
1983	0.6	1.2	1.7	4.9	1.6	1.3	0.9	0.5	*	1.1	10.2	11.9
1984	0.5	1.1	1.6	4.6	1.6	1.2	0.4	0.2	*	1.0	9.0	10.5
1985	0.5	1.0	1.6	4.5	1.7	1.1	0.4	0.4	-0.1	1.2	9.2	10.8
1986	0.6	1.0	1.6	4.5	1.7	1.1	0.4	0.6	*	0.7	8.9	10.5
1987	0.6	1.0	1.6	4.4	1.7	1.1	0.3	0.5	0.1	0.5	8.6	10.2
1988	0.6	1.0	1.6	4.3	1.7	1.1	0.3	0.2	0.2	0.6	8.5	10.1
1989	0.6	1.0	1.6	4.3	1.7	1.1	0.3	0.2	0.4	0.6	8.5	10.2
1990	0.7	1.0	1.7	4.3	1.9	1.0	0.3	0.1	1.0	0.5	9.2	10.9
1991	0.9	1.2	2.1	4.5	1.9	1.1	0.4	0.2	1.1	0.6	9.8	11.8
1992	1.1	1.3	2.4	4.6	2.1	1.1	0.6	0.1	*	0.6	9.2	11.5
1993	1.2	1.3	2.5	4.6	2.2	1.0	0.5	0.2	-0.4	0.6	8.8	11.2
1994	1.2	1.4	2.5	4.6	2.3	1.0	0.4	0.1	-0.1	0.4	8.7	11.3
1995	1.2	1.4	2.6	4.6	2.4	1.0	0.3	0.1	-0.2	0.4	8.6	11.2
1996	1.2	1.4	2.5	4.5	2.5	1.0	0.3	0.1	-0.1	0.3	8.6	11.1
1997	1.2	1.3	2.5	4.4	2.5	1.0	0.3	0.1	-0.2	0.4	8.5	10.9
1998	1.2	1.2	2.4	4.3	2.4	1.0	0.2	0.1	-0.1	0.4	8.4	10.8
1999	1.2	1.2	2.4	4.2	2.3	0.9	0.2	0.2	-0.1	0.4	8.3	10.7
2000	1.2	1.2	2.4	4.1	2.2	0.9	0.2	0.3	*	0.4	8.1	10.5

SOURCE: Congressional Budget Office.

NOTE: * = less than 0.05 percent.

Major Contributors to the Revenue and Spending Projections

The following Congressional Budget Office analysts prepared the revenue and spending projections in this report:

Revenue Projections

Barbara Edwards	Individual income taxes
Pam Greene	Estate and gift taxes
Ed Harris	Social insurance taxes
Carolyn Lynch	Corporate income taxes, Federal Reserve System earnings
Larry Ozanne	Capital gains realizations
Robert Taylor	Excise taxes
Will Terry	Earned income tax credits
Erin Whitaker	Customs duties, miscellaneous receipts

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Kent Christensen	Defense (military construction, base closures)
Sunita D'Monte	International affairs (conduct of foreign affairs and information exchange activities), veterans' housing
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Health

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Charles Betley	Medicare, Federal Employees Health Benefits program
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Human Resources

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Susan Sieg Tompkins	Housing assistance
Donna Wong	Elementary and secondary education, Pell grants

Natural and Physical Resources

Coleman Bazelon	Spectrum auction receipts
Megan Carroll	Conservation and land management
Lisa Cash Driskill	Energy, Outer Continental Shelf receipts
Mark Grabowicz	Justice, Postal Service
Kathleen Gramp	Energy, science and space, spectrum auction receipts
Mark Hadley	Deposit insurance, credit unions
Greg Hitz	Agriculture
David Hull	Agriculture
Ken Johnson	Commerce, Small Business Administration, Universal Service Fund
James Langley	Agriculture
Susanne Mehlman	Pollution control and abatement, Federal Housing Administration and other housing credit programs
Rachel Milberg	Water resources, Federal Emergency Management Agency
James O'Keeffe	Highways, Amtrak, mass transit, air transportation
Deborah Reis	Recreation, water transportation, community development, other natural resources
John Righter	General government, legislative branch
Lanette Keith Walker	Justice, regional development, Bureau of Indian Affairs

Other

Janet Airis	Appropriation bills (legislative branch, District of Columbia)
Edward Blau	Authorization bills
Barry Blom	National income and product accounts, monthly Treasury data
Joanna Capps	Appropriation bills (Agriculture, Interior)
Sandy Davis	Budget process
Kenneth Farris	Computer support
Mary Froehlich	Computer support
Ellen Hays	Unauthorized appropriations, expiring authorizations, federal pay
Catherine Little	Appropriation bills (VA-HUD, Treasury)
Felix LoStracco	Other interest, discretionary spending
Virginia Myers	Appropriation bills (Commerce-Justice-State, foreign operations)
Laurie Pounder	Net interest on the public debt
Robert Sempsey	Appropriation bills (Labor-HHS, Transportation, military construction)
Takako Tsuji	Budget resolution, historical data, rules of thumb
Amy Wendholt	Appropriation bills (Defense, energy and water)

Glossary

This glossary defines economic and budgetary terms as they relate to this report and for the general information of our readers. Definitions of some budgetary terms are based on the definitions in General Accounting Office, *A Glossary of Terms Used in the Federal Budget Process, Exposure Draft*, GAO/AFMD-2.1.1 (January 1993). Most entries have been revised by the Congressional Budget Office, sacrificing precision for the sake of brevity and clarity to the lay reader. Where appropriate, sources of data for economic variables are indicated as follows:

- o BEA denotes the Bureau of Economic Analysis in the Department of Commerce;
- o BLS denotes the Bureau of Labor Statistics in the Department of Labor;
- o CBO denotes the Congressional Budget Office;
- o FRB denotes the Federal Reserve Board; and
- o NBER denotes the National Bureau of Economic Research (a private entity that engages in economic research and, by convention, identifies peaks and troughs of business cycles).

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 certain contributions for individual retirement accounts and alimony payments. 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 one for which the appropriation act is enacted. The amount of budget authority is included in the budget totals for the fiscal year in which it will become available. See **appropriation act**, **budget authority**, and **fiscal year**; compare with **forward funding** and **obligation delay**.

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 prevent higher-income taxpayers from excessively reducing their tax liability through the use of preferences in the tax code. Under the AMT, taxpayers 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.

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, 2001.” Generally, 13 regular appropriation acts are considered annually to fund the operations of the federal government; the Congress may also consider supplemental or continuing appropriations 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 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 must then be 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 this report as the Deficit Control Act, it was originally known as Gramm-Rudman-Hollings. 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 and most recently by the Balanced Budget Act of 1997. See **discretionary spending limits**, **pay-as-you-go**, and **sequestration**.

baseline: A benchmark for measuring the budgetary effects of proposed changes in federal revenues or spending. Generally, the baseline is an estimate of spending, revenues, surplus or deficit, and public debt projected during a fiscal year under current laws and policy. For purposes of the Deficit Control Act, the baseline is the projection of current-year levels of new budget authority, outlays, revenues, and the surplus or deficit into the budget year and outyears based on laws enacted through the applicable date, calculated in conformance with the rules set forth in section 257 of that act. See **fiscal year**, **direct spending**, **discretionary spending**, and **revenues**.

basis point: One-hundredth of a percentage point. (For example, the difference between interest rates of 10.5 percent and 10.0 percent is 50 basis points.)

Blue Chip consensus forecast: The average of about 50 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 authority to obligate offsetting collections or receipts. Offsetting collections and receipts are classified as negative budget authority. See **appropriation act**, **authorization act**, **offsetting collections**, **offsetting receipts**, and **outlays**.

budget function: One of 20 broad categories into which budgetary resources are grouped so that all budget authority, outlays, and tax expenditures can be presented according to the interests being addressed. There are 17 broad 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 **net interest** and **offsetting receipts**.

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 outyears. 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 out in law and 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 permitting 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 its 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)

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 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 funds raised by governments, individuals, or businesses by incurring liabilities 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 it accounts for the fact that different types of capital goods (such as equipment, structures, inventories, and land) have different levels of productivity.

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**.

civilian unemployment rate: Unemployment as a percentage of the civilian labor force—that is, the labor force excluding armed forces personnel. (BLS) See **unemployment**.

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 consumers' attitudes and buying plans. One such index is constructed by the University of Michigan Survey Research Center on the basis of surveys of consumers' views about the state of the economy and their personal finances, both current and future.

consumer price index (CPI): A measure of the change in 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**.

consumption: Total purchases of goods and services during a given period. It may measure such purchases by both households and governments or only by households. In this report, consumption is the total purchases by households only. (BEA) See **personal consumption**.

contract authority: A form of budget authority that specifically permits contracts or other obligations to be entered into in advance of available funding for that purpose. Therefore, the contractual or other obligation must be funded later, usually by 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 funding. See **appropriation act** and **budget authority**.

CPI: See **consumer price index**.

credit crunch: A sudden reduction in the availability of loans and other types of credit from banks and capital markets at given interest rates. The reduced availability of credit can result from many factors, including an increased perception of risk on the part of lenders, an imposition of credit controls, or a sharp restriction of the money supply. See **money supply**.

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**.

currency value: See **exchange rate**.

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 surplus: The part of the budget surplus that results from cyclical factors rather than from underlying fiscal policy. Economists divide the budget surplus into a cyclical component (which reflects the way the surplus automatically increases or decreases in booms or recessions) and the standardized-budget surplus (which is a measure of the surplus that would occur if the economy was operating at potential GDP). (CBO) See **fiscal policy**, **NAIRU**, **potential GDP**, and **surplus**; compare with **standardized-budget surplus**.

debt: Total debt 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 this report, debt service refers to a change in interest payments resulting from a change in estimates of the surplus or deficit.

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**.

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: 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 or wear. *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 assets. 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 fall in the value of a currency that occurs when a government declares that its domestic currency will buy fewer units of a foreign currency. Such a policy involves government intervention to peg its currency (that is, fix its exchange rate). Many governments peg their domestic currencies to a stable currency, such as the U.S. dollar or the German mark. See **depreciation** and **exchange rate**.

direct spending: Synonymous with *mandatory spending*. Direct spending is budget authority provided in laws other than appropriation acts. For the purposes of the Deficit Control Act, it is also defined as including entitlement authority and the Food Stamp program. See **appropriation act**, **budget authority**, and **entitlement**; compare with **discretionary spending**.

discount rate: The interest rate the Federal Reserve System charges on a loan that 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**.

discretionary spending: Budget authority provided in appropriation acts, except that provided to fund direct spending programs. See **appropriation act**; compare with **direct spending**.

discretionary spending limits (or caps): Ceilings imposed in each fiscal year through 2002 on budget authority provided in annual appropriation acts and the outlays that flow from that budget authority. The limits are set forth in section 251 of the Deficit Control Act. Separate caps have often been imposed on specific categories—or subsets—of discretionary spending, such as defense, highways, and violent crime reduction. Each discretionary spending limit is enforced through sequestration. See **budget authority**, **discretionary spending**, **outlays**, and **sequestration**.

disposable personal income: The income that individuals receive, including transfer payments, minus the personal taxes and fees that they pay to government. (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 profits: Profits of corporations, adjusted to remove the distortions in depreciation allowances caused by tax rules and to exclude capital gains on inventories. Economic profits are a better measure of profits from current production than are the book profits reported by corporations. (BEA) See **book profits** and **depreciation**.

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. 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**.

employment cost index (ECI): An index of the cost of an hour of labor—comprising the cost to the employer for wage or salary payments, employee benefits, and contributions for social insurance programs. The ECI is structured so that changes in the mix of occupations and employment by industry do not affect it. (BLS)

entitlement: A legal obligation on the federal government to make payments to a person, business, or unit of government that meets the criteria set in law. The Congress generally controls entitlement programs by setting eligibility criteria and benefit or payment rules—not by providing budget authority in an appropriation act. 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**.

European 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 a European Central Bank and adopted a common currency, the euro.

excess cash: The term used in previous CBO publications to describe the portion of the surplus that is greater than that necessary to redeem debt. The term has been superceded by *uncommitted funds*. See **debt** and **uncommitted funds**.

exchange rate: The number of units of a foreign currency that can be bought with one unit of the domestic currency. (FRB)

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 that extends from a trough to the next peak. (NBER) See **business cycle** and **recovery**; compare with **recession**.

expenditure account: An account established within federal funds and trust funds to record appropriations, obligations, and outlays usually financed from the associated receipt account. See **federal funds**, **receipt account**, and **trust funds**.

federal funds: Part of the budgeting and accounting structure of the federal government. Federal funds are all funds that make up the federal budget 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 for overnight loans from 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**.

Federal Open Market Committee: The group within the Federal Reserve System that determines the direction 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 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 Reserve System**, **monetary policy**, **money supply**, and **short-term interest rates**.

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** and **monetary policy**.

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 choice of tax and spending programs, which influences the amount and maturity of government debt as well as the level, composition, and distribution of national output and income. An "easy" fiscal policy stimulates the short-term growth of output and income, whereas a "tight" fiscal policy restrains their growth. Movements in the standardized-budget surplus constitute one overall indicator of the tightness or ease of

federal fiscal policy; an increase relative to potential gross domestic product suggests fiscal ease, whereas a decrease suggests fiscal restriction. The President and the Congress jointly determine federal fiscal policy. See **debt**, **national income**, **potential GDP**, and **standardized-budget 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 2002 will begin October 1, 2001, and end September 30, 2002. 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. The *current year* is the fiscal year immediately preceding the budget year. An *outyear* is a fiscal year following the budget year.

forward funding: The provision of budget authority that becomes available for obligation sometime after the first day of a fiscal year and remains available for obligation into the following fiscal year. For example, budget authority may be made available from July 1 of one fiscal year to September 30 of the next fiscal year. Such provision is often made to finance ongoing grant programs. See **budget authority**, **fiscal year**, and **obligation delay**; compare with **advance appropriation**.

GDI: See **gross domestic income**.

GDP: See **gross domestic product**.

GDP gap: The difference between potential and actual real GDP, expressed as a percentage of potential real GDP. See **potential GDP** and **real**.

GDP price index: A summary measure of the prices of all of the 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: A classification of federal funds whose receipt account is credited with federal revenues and offsetting receipts not earmarked by law for a specific purpose, and whose expenditure accounts record amounts provided in appropriation acts or other laws for the general support of the federal government. See **expenditure account**, **federal funds**, and **receipt account**; compare with **trust funds**.

GNP: See **gross national product**.

government-sponsored enterprises (GSEs): Financial institutions established and chartered by the federal government, as privately owned and operated entities, to facilitate the flow of funds to selected lending markets, such as those for residential mortgages and agricultural credit. Although they are classified as private entities for purposes of the federal budget (and thus their transactions are not included in the budget totals), GSEs retain a relationship with the federal government that confers certain advantages on them that would not be available to similar private entities that were not federally sponsored. Major examples of GSEs are the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Banks.

Government Performance Results Act of 1993 (Public Law 103-62): The law that requires federal agencies to create a framework and develop the information that will lead to more effective planning, budgeting, program evaluation, and fiscal accountability for federal programs. The law's intent is to hold agencies accountable for achieving program results and to improve budget formulation and Congressional decisionmaking. In furtherance of those objectives, agencies must submit performance plans that clearly state performance goals and indicators for each program as well as reports that evaluate actual program performance. (For more information, see the Office of Management and Budget's Web site at www.whitehouse.gov/omb/mgmt-gpra/index.html.)

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: Total debt issued by the federal government. 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. (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, gross investment, government purchases of goods and services, 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 in 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 measure of the general level of prices, usually expressed as an annual rate of change. See **consumer price index** and **GDP price index**.

infrastructure: Government-owned 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 either 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. *Investment in human capital* is spending on education, training, health services, and other activities that increase the productivity of the workforce. 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**.

labor force: The number of people who have jobs or who are available for work and are actively seeking jobs. The *labor force participation rate* is the labor force as a percentage of the 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.

lockbox: Any of several legislative mechanisms that attempt to isolate or “lock away” funds of the federal government for purposes such as reducing federal spending, preserving the surplus, or protecting the solvency of trust funds. See **surplus** and **trust funds**.

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 other 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**.

means-tested programs: Programs that provide cash or services to people who meet a test of need based on income and assets. Most means-tested programs are entitlements (such as Medicaid, Food Stamps, Supplemental Security Income, family support, and veterans’ pensions), but in the case of a few such programs (such as subsidized housing and various social services), budget authority for the program is provided in appropriation acts. See **appropriation act** and **entitlement**.

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 money growth and initially lower short-term interest rates in an attempt to increase aggregate demand, but it may lead to a higher rate of inflation. A “tight” monetary policy suggests slower money growth and higher interest rates in the near term in an attempt to reduce inflationary pressure by reducing aggregate demand. The Federal Reserve System conducts monetary policy in the United States. See **aggregate demand**, **Federal Reserve System**, **inflation**, and **money supply**.

money supply: Private assets that can readily be used to make transactions or are easily convertible into assets that can. It includes currency and demand deposits and may also include broader measures, such as other types of deposits and securities.

NAIRU (nonaccelerating inflation rate of unemployment): The unemployment rate 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**.

national income: Income from all sources earned by U.S. residents, including compensation of employees (wages, salaries, and benefits), 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 and how 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 or deficit). National saving represents all income not consumed, publicly or privately, during a given period. (BEA) See **net national saving** and **personal saving**.

net exports: Exports of goods and services produced in a country minus its imports of goods and services produced elsewhere (sometimes referred to as the trade deficit or surplus).

net indebtedness: The amount of debt held by the public minus any balance of uncommitted funds. See **debt** and **uncommitted funds**.

net interest: In the federal budget, net interest includes federal interest payments to the public as recorded in budget function 900. It also includes, as an offset, interest income received by the government on loans and cash balances.

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. For income or spending, the nominal level is measured in current dollars. For an interest rate, the nominal rate on debt selling at par is the current-dollar interest paid in any year as a ratio to the current-dollar value of the debt when it was issued. For debt initially issued or now selling at a discount, the nominal rate includes as a payment the estimated yearly equivalent of the difference between the redemption price and the discounted price. For an exchange rate, the nominal rate is the rate at which one nominal unit of currency trades for another. See **current dollar**; compare with **real**.

obligation delay: Legislation that precludes the obligation of an amount of budget authority provided in an appropriation act or 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 2001 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, 2000, the first day of fiscal year 2001. See **appropriation act**, **fiscal year**, and **forward funding**; compare with **advance appropriation**.

obligation limitation: Legislation that reduces existing authority to incur obligations. Compare with **obligation delay**.

off-budget: Spending or revenues excluded from the budget totals by law. The revenues and outlays of the two Social Security trust funds (the Federal 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, those transactions 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: Amounts received by the federal government that are considered negative budget authority and outlays (rather than revenues) and, by law, are credited directly to expenditure accounts. Most offsetting

collections are credited to discretionary spending accounts and thus offset budget authority provided in appropriation acts. Usually, they are authorized to be spent for the purposes of that account without further Congressional action. The authority to spend offsetting collections is a form of budget authority. Business-like or market-oriented activities with the public and other government accounts are the source of most offsetting collections. See **appropriation act, budget authority, direct spending, discretionary spending, expenditure account, and outlays**; compare with **offsetting receipts**.

offsetting receipts: Amounts received by the federal government that are considered negative budget authority and outlays (rather than revenues) and are not authorized to be credited to expenditure accounts; instead, they are credited to receipt accounts. The legislation that authorized the offsetting receipts may earmark them for a specific purpose and may either authorize them to be spent directly or require them to be appropriated in annual appropriation acts before they may be spent. Offsetting receipts are a form of direct spending, reducing the total amount of budget authority and outlays that are classified as direct spending. Like offsetting collections, most offsetting receipts result from business-like or market-oriented activities with the public and other government accounts. See **appropriation act, budget authority, direct spending, outlays, and receipt account**; compare with **offsetting collections**.

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 when payments are made or when cash is disbursed from the Treasury. However, outlays for interest on the public debt are recorded when the interest is earned, and outlays for direct loans and loan guarantees (since credit reform) reflect estimated subsidy costs instead of cash transactions. See **budget authority, credit subsidy, debt, and fiscal year**.

outyear: See **fiscal year**.

pay-as-you-go (PAYGO): A procedure set forth in the Deficit Control Act that ensures that all legislation affecting direct spending or receipts is budget neutral in each fiscal year. The Office of Management and Budget and CBO estimate the five-year budgetary effects of all such legislation enacted before September 31, 2002. If the estimated budgetary effects in the budget year would increase the deficit or reduce the surplus for that year, a PAYGO sequestration—or cancellation of budgetary resources available for direct spending programs—is triggered. See **direct spending, fiscal year, and sequestration**.

peak: See **business cycle**.

personal consumption: Total purchases of goods and services during a given period by households for their own use. (BEA) See **consumption**.

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**.

potential GDP: The highest level of real gross domestic product that could persist for a substantial period without raising the rate of inflation. CBO calculates potential real GDP by relating it to the rate of unemployment that is consistent with a constant inflation rate. (CBO) See **gross domestic product, inflation, NAIRU, real, and unemployment**.

potential labor force: The labor force adjusted for movements in the business cycle. See **business cycle** and **labor force**.

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, given an interest rate of 5 percent, 95 cents today will grow to \$1 next year. Hence, the present value of \$1 payable a year from today is only 95 cents.

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**.

probability scoring: A method of calculating the expected costs of a legislative proposal that uses the baseline as just one of the plausible projection paths with which to compare the proposal. Probability scoring is employed only when a point estimate (measurement against only the baseline) will not adequately capture the potential budgetary effects of a legislative proposal. Such proposals are ones that would change a federal program in a way that would not affect estimated costs when measured against the baseline but could affect costs in just one direction (increasing or reducing them, but not both) if future events differ from the assumptions underlying the baseline. (For more information about this estimating method, see *Estimating the Cost of One-Sided Bets: How CBO Analyzes Proposals with Asymmetric Uncertainties*, CBO Memorandum, October 1999.) See **baseline**.

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 and, usually, the administrative expenses of that program. 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 **nominal** and **current dollar**.

receipt account: An account established within federal funds and trust funds to record offsetting receipts or revenues credited to the fund. See **federal funds**, **offsetting receipts**, **revenues**, and **trust funds**.

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 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 legislative procedure by which the Congress implements 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 existing revenue or direct spending programs under their jurisdiction to achieve a specified budgetary result. The legislation to implement the instructions is usually combined into one comprehensive *reconciliation bill*. 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 arising from the sovereign power of the government. Federal revenues consist of receipts from income taxes (individual and corporate), 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 Federal Reserve earnings, 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 an asset whose perceived return is riskier than that of a hypothetically safe asset. 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 earnings (in the case of corporate equities).

S corporation: A domestically owned corporation with no more than 75 owners who have elected to pay taxes under Subchapter S of the Internal Revenue Code. S corporations are taxed like partnerships. That is, they are exempt from the corporate income tax, but the 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 Department of the Treasury at a discount in denominations from \$50 to \$10,000. The interest earned on savings bonds is exempt from state and local taxation and 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 discretionary spending limits and pay-as-you-go procedures in that year. Pursuant to procedures set forth in the Deficit Control Act, a sequestration is triggered if the Office of Management and Budget determines that budget authority or outlays provided in appropriation acts exceed the discretionary spending limits or that enacted legislation affecting direct spending and receipts increases the deficit or reduces the surplus. Discretionary spending in excess of any of the limits would cause the cancellation of budgetary resources within the applicable discretionary spending programs. Changes in direct spending and receipts that increase the deficit or reduce the surplus would result in reductions in direct spending not otherwise exempt by law. 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 surplus: The level of the federal budget surplus that would occur under current law if the economy operated at potential GDP. The standardized-budget surplus provides a measure of underlying fiscal policy by removing the influence of cyclical factors from the budget surplus. (CBO) See **fiscal policy**, **potential GDP**, and **surplus**; compare with **cyclical surplus**.

structural surplus: Same as **standardized-budget 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. 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.

thrift institutions: Savings and loan institutions and mutual savings banks.

total factor productivity: See **productivity**.

trade deficit: See **net exports**.

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 welfare, Social Security, and unemployment benefits. (BEA)

trough: See **business cycle**.

trust funds: Government funds that are designated by law as trust funds (regardless of any other meaning of that term). Trust funds account for the revenues, offsetting receipts or offsetting collections, and outlays that result from the implementation of the law that designated the fund as a trust fund. The federal government has at least 130 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 collections**, **offsetting receipts**, **outlays**, and **revenues**; compare with **federal funds**.

unavailable debt: See **debt**.

uncommitted funds: The amount of the surplus in a fiscal year that is greater than the amount necessary to redeem federal debt available for redemption. See **debt** and **surplus**.

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, energy, and used cars. See **consumer price index** and **inflation**.

unemployment: Joblessness. The measure of unemployment is the number of jobless people who are available for work and are actively seeking jobs. The *unemployment rate* is unemployment as a percentage of the labor force. (BLS) See **discouraged workers** and **labor force**.

unemployment gap: The difference between the nonaccelerating inflation rate of unemployment (NAIRU) and the unemployment rate. See **NAIRU**.

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 for 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 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: A fee charged to recipients of goods or services provided by the federal government. User fees generally apply to activities that provide special benefits to identifiable recipients, and the amount of the fee is usually related to the cost of the good or service provided. In the federal budget, most user fees are classified as offsetting collections or offsetting receipts; however, some user fees result from the government's sovereign powers and are classified as revenues. See **offsetting collections**, **offsetting receipts**, and **revenues**.

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 of 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**.