Appendix B

Changes in CBO's Baseline Since August 2001

Since January 2001, the cumulative budget surplus that the Congressional Budget Office (CBO) is projecting for the 2002-2011 period, under current policies, has dropped by $4 trillion. Nearly $1.8 trillion of that decline stems from changes made to CBO's baseline projections since the previous baseline was published in August 2001 (see Table B-1).[1] In the current baseline, the surpluses projected last summer have diminished or, for some years, disappeared. The reasons for those reductions are fairly evenly divided among legislative, economic, and technical factors.

Budget Totals in 2001

In August, CBO estimated that the surplus for fiscal year 2001 would total $153 billion; the actual surplus turned out to be $26 billion less. About two-thirds of that difference stemmed from lower-than-expected revenues, primarily in the category of individual income tax receipts.[2]

On the outlay side, two events produced notable differences from the August baseline. First, in September, the Treasury recorded outlays of $12 billion to reverse most of the downward credit reestimate it had recorded in July for loans made by the Federal Communications Commission (FCC) related to the auction of spectrum licenses. That reversal reflected a change in the Administration's assessment of the likely outcome of litigation involving borrowers that had filed for bankruptcy. Second, enactment of the Air Transportation Safety and System Stabilization Act in September increased outlays in 2001. That law provided $5 billion in grants to U.S. airlines in the aftermath of the September 11 terrorist attacks. About $2.3 billion of the grants were disbursed before the end of the fiscal year.

Changes in Projections for the 2002-2011 Period

CBO's baseline projections are intended to be a neutral benchmark against which policymakers can measure the effects of possible changes in tax and spending policies. Thus, rather than predicting future budgetary outcomes, the baseline projects what federal revenues and spending would look like over five or 10 years if current policies remained the same.

At least twice each year, CBO updates its baseline to reflect new legislation (which alters the definition of current policies), changes in the outlook for

1. Those projections appeared in Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2001).

2. Actual revenues in 2001 fell short of CBO's published estimate by more than $20 billion. However, CBO recorded $3.6 billion in advance refunds (included as part of last June's tax-cut law) as outlays in its baseline because those refunds were projected to exceed taxpayers' 2001 tax liabilities. The Treasury, by contrast, recorded all advance refunds as reductions in revenues, although that action was not consistent with normal budgetary practices; had CBO done the same, the revenue difference would have been $17 billion rather than $20 billion.

Table B-1.
Changes in CBO's Baseline Projections of the Surplus Since August 2001 (In billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2006	Total, 2002-2011
Total Surplus as Projected in August 2001	176	172	201	244	289	340	389	450	507	628	1,082	3,397
Changes to Revenue Projections												
Legislative	*	-2	-2	-3	-3	-2	-2	-2	-2	-2	-11	-19
Economic	-105	-80	-48	-44	-45	-48	-52	-58	-61	-67	-322	-609
Technical	-46	-43	-51	-50	-49	-45	-41	-36	-32	4	-238	-388
Total Revenue Changes	-151	-125	-101	-97	-96	-95	-95	-96	-95	-64	-571	-1,016
Changes to Outlay Projections												
Legislative												
Discretionary	34	42	44	46	48	49	50	50	51	52	214	467
Mandatory												
Debt service	1	3	6	9	12	16	20	23	28	32	30	149
Other	4	4	3	1	1	1	1	*	*	*	12	14
Subtotal, mandatory	5	7	9	10	13	17	20	24	28	32	42	163
Subtotal, legislative	39	48	53	56	61	66	70	74	79	85	257	630
Economic												
Discretionary	1	1	*	1	1	2	2	3	4	4	3	19
Mandatory												
Unemployment insurance	9	10	3	1	*	*	*	*	*	*	24	23
Medicare	-1	-2	-4	-5	-5	-4	-4	-4	-4	-4	-17	-36
Social Security	-2	-5	-6	-6	-7	-7	-7	-8	-10	-11	-25	-69
Net interest (Rate effects)	-15	-13	-5	-3	-2	-2	-1	-1	-1	-1	-38	-43
Debt service	1	6	10	12	15	17	20	24	28	32	44	165
Other	1	*	-2	-3	-3	-3	-3	-3	-3	-4	-7	-22
Subtotal, mandatory	-6	-5	-4	-3	-2	1	5	8	10	12	-19	18
Subtotal, economic	-5	-4	-3	-3	-1	3	7	12	14	16	-15	37

(Continued)

the economy, and various technical factors. The rest of this appendix outlines the revisions that CBO has made to the baseline since last August, when its previous projections were published.

Legislative Changes Since August

Laws enacted in the past six months are projected to reduce the cumulative surplus over the 2002-2011 period by $649 billion. Most of that change stems from higher discretionary spending and the costs of servicing the larger federal debt that will result from that spending.

Revenues. Legislation enacted since August is expected to decrease revenues only modestly over the next 10 years—by a total of about $19 billion (see Table B-2). The largest decline comes from the Investor and Capital Markets Fee Relief Act, which lowers fees charged by the Securities and Exchange Commission.

Discretionary Spending. In its August baseline, CBO extrapolated discretionary budget authority from the appropriations enacted for 2001 and calculated the outlays that would flow from such budget authority. In that baseline, budget authority for 2002 totaled $670 billion. However, the appropriation acts

Table B-1.
Continued

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2006	Total, 2002-2011
Changes to Outlay Projections (Continued)												
Technical												
Discretionary	8	4	2	2	2	1	2	2	2	2	18	27
Mandatory												
Medicare	-2	-3	-4	-5	-8	-10	-11	-13	-15	-25	-21	-96
Medicaid	-1	*	1	2	2	4	4	5	6	7	3	30
Social Security	-1	*	*	*	1	2	4	6	11	16	-1	38
Unemployment insurance	3	3	1	1	2	2	2	2	3	3	9	21
Universal Service Fund	-1	-1	-7	-8	-7	-7	-7	-7	-7	-7	-23	-60
Spectrum auctions	-5	5	-3	-10	*	0	0	0	0	0	-13	-13
Net interest	3	3	3	6	8	8	7	8	8	9	23	64
Debt service	1	3	7	9	12	15	19	22	25	27	32	139
Other	5	2	-2	-6	-6	-5	-6	-6	-7	-7	-7	-38
Subtotal, mandatory	3	11	-6	-11	4	9	12	17	23	22	2	86
Subtotal, technical	12	16	-3	-9	5	11	14	19	25	24	20	113
Total Outlay Changes	45	60	46	44	65	79	91	104	118	126	262	779
Total Impact on the Surplus	-197	-186	-148	-141	-161	-174	-186	-200	-213	-190	-832	-1,795
Total Surplus as Projected in January 2002	-21	-14	54	103	128	166	202	250	294	439	250	1,602
Memorandum:												
Total Legislative Changes	-39	-50	-55	-59	-64	-67	-72	-76	-81	-87	-267	-649
Total Economic Changes	-100	-77	-45	-42	-44	-51	-59	-70	-75	-83	-307	-645
Total Technical Changes	-58	-59	-47	-41	-54	-56	-55	-55	-57	-20	-258	-501

SOURCE: Congressional Budget Office.

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

for 2002 actually provided a total of $711 billion in budget authority (including $20 billion in emergency supplemental spending in response to the September 11 attacks). That additional $41 billion in budget authority for 2002 is extrapolated throughout the projection period in CBO's new baseline.

An earlier $20 billion in emergency supplemental funding, provided in September, also contributes to the increase in projected discretionary outlays for the next few years. That budget authority was enacted in fiscal year 2001, so it was not carried forward into the baseline projections for future years. But because it was provided so late in the fiscal year, most of the outlays from that budget authority will occur in 2002 and beyond—an estimated $14 billion in 2002, $4 billion in 2003, and $1 billion in both 2004 and 2005.

Overall, projected outlays for discretionary programs during the 2002-2011 period are $467 billion higher than they were in the August baseline because of new legislation. Defense spending accounts for $229 billion of that increase and nondefense programs for the other $238 billion.

Mandatory Spending. Legislative changes to projected mandatory spending since August (excluding

Table B-2.
Changes in CBO's Baseline Projections of Revenues Since August 2001 (In billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2006	Total 2002-2011
Revenues as Projected in August 2001	2,134	2,196	2,307	2,438	2,543	2,663	2,801	2,952	3,103	3,341	11,619	26,479
Legislative Changes												
Miscellaneous Fees	-1	-2	-2	-2	-2	-1	-1	-1	-1	-1	-10	-15
All Other Revenue Sources	1	*	*	*	*	*	*	-1	-1	-1	-1	-3
Total	*	-2	-2	-3	-3	-2	-2	-2	-2	-2	-11	-19
Economic Changes												
Individual Income Taxes	-46	-40	-29	-32	-35	-38	-41	-45	-47	-53	-183	-408
Corporate Income Taxes	-32	-18	-6	*	7	11	14	14	15	16	-48	22
Social Insurance Taxes	-21	-16	-9	-10	-15	-19	-22	-24	-26	-27	-72	-190
All Other Revenue Sources	-5	-6	-4	-3	-2	-2	-2	-3	-3	-3	-20	-33
Total	-105	-80	-48	-44	-45	-48	-52	-58	-61	-67	-322	-609
Technical Changes												
Individual Income Taxes	-45	-40	-35	-29	-26	-20	-14	-8	-3	10	-175	-211
Corporate Income Taxes	1	-3	-10	-13	-15	-16	-17	-18	-18	-19	-39	-127
Social Insurance Taxes	4	3	4	4	4	4	3	3	6	6	20	42
Estate and Gift Taxes	-5	*	-2	-4	-4	-5	-6	-6	-9	15	-14	-24
All Other Revenue Sources	-2	-3	-8	-8	-8	-8	-8	-8	-8	-7	-29	-68
Total	-46	-43	-51	-50	-49	-45	-41	-36	-32	4	-238	-388
Total Changes												
All Revenue Sources	-151	-125	-101	-97	-96	-95	-95	-96	-95	-64	-571	-1,016
Revenues as Projected in January 2002	1,983	2,070	2,206	2,342	2,447	2,568	2,706	2,856	3,008	3,277	11,048	25,464

SOURCE: Congressional Budget Office.

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

debt-service costs) stem primarily from the Air Transportation Safety and System Stabilization Act of 2001. That law aids U.S. passenger and cargo airlines through a combination of grants, federal credit assistance, and reimbursements for some increases in their insurance premiums. It also establishes compensation for families of the victims of the September 11 plane crashes and limits the liability of the air carriers involved in those crashes to the amount of insurance they had for such events. In addition, the law allows air carriers to buy insurance coverage from the federal government and, for a limited time, relieves them of liability for further terrorist acts. CBO estimates that the law will add about $10 billion to outlays over the 2002-2011 period.

Enactment of the Railroad Retirement and Survivors' Improvement Act has increased projected mandatory outlays by about $4 billion over 10 years. Moreover, that law—for the first time—allows some of the holdings of federal trust funds (the Railroad Retirement trust funds) to be invested in corporate stocks and bonds. (For details of how those investments would be treated in the federal budget, see Box 4-3 in Chapter 4.)

The additional $467 billion in discretionary outlays and $14 billion in mandatory outlays over 10 years that are caused by laws enacted since August decrease projected surpluses—and thus increase the amount of federal debt that will remain outstanding. As a result, those changes (plus the relatively small adjustments to revenues) are projected to raise the cost of servicing the debt by $149 billion between 2002 and 2011. All told, enacted laws increased mandatory spending by $163 billion relative to the August baseline.

Economic Changes Since August

CBO recently revised its economic outlook to reflect both the current recession and slightly smaller average rates of growth projected through 2012. Compared with its August forecast, CBO now expects the growth of gross domestic product (GDP) to drop more sharply this year and then rebound in 2003 and 2004. CBO is also projecting lower interest rates and significantly higher unemployment for the next two years than it did last summer.

Those changes in the economic forecast reduce the cumulative surplus projected for the 2002-2011 period by $645 billion. The bulk of that decline, $609 billion, comes from lower projections of revenues. The other $37 billion reflects higher projections of outlays (the net result of increases and decreases in those projections).

Revenues. CBO now estimates that nominal GDP will grow by only 1.6 percent in fiscal year 2002 before rebounding to 5.6 percent in 2003 and 6.1 percent in 2004. Slower growth of GDP (combined with a smaller share of GDP generated by corporate profits) leads to lower revenues. The short-term effects of the economic recession are reflected in drops in revenue projections since August—declines of $105 billion for 2002 and $80 billion for 2003. The anticipated recovery from recession translates into smaller projected revenue losses for 2004 and 2005. After that, however, the fact that CBO now expects real (inflation-adjusted) growth to be 0.1 percent slower per year, on average, than it did last August means that annual revenue projections continue to be $45 billion to $67 billion lower through 2011 than they were in August.

In all, revenue projections for the 2002-2011 period have dropped by roughly $610 billion because of changes in the economic outlook. More than $400 billion of that total is attributable to lower projections of individual income tax receipts. Nearly $200 billion reflects reduced projections of revenues from social insurance (payroll) taxes. Those reductions are both directly related to CBO's lower projections for wages and salaries, on which those taxes are imposed. Relatively small changes in other sources of revenue because of economic revisions roughly offset each other.

Outlays. Recent changes to CBO's economic outlook have a much smaller impact on projected outlays—a net increase of $37 billion over 10 years—than on revenues. But the result is the same: the changes reduce projected surpluses. Over the 2002-2011 period, the increased costs of debt service attributable to economic changes since August outstrip the short-term savings from lower inflation and interest rates.

CBO now expects the unemployment rate in 2002 and 2003 to be higher than it forecast in August (6.0 percent in both years, compared with the 5.1 percent and 5.2 percent forecast last summer). As a result, CBO has increased its projections of unemployment insurance payments—by $9 billion for 2002, $10 billion for 2003, and smaller amounts for 2004 and 2005—and made smaller adjustments to projected spending for other programs, such as Food Stamps and Medicaid.

Most of the other effects of the economic changes (excluding the increase in debt-service costs) reduce projected spending. Projections of Medicare outlays are lower by $4 billion to $5 billion a year beginning in 2004 because of lower expected inflation and real (inflation-adjusted) GDP in the next few years. (Medicare's payment rates for most services are automatically adjusted each year to reflect movement in the prices of inputs; payment rates for services paid under the physician fee schedule are also adjusted to reflect changes in real GDP.)

Ten-year projections of Social Security spending are also lower that they were in August, by a total of $69 billion. Because inflation was lower than expected in 2001, the cost-of-living adjustment effective in January 2002 turned out to be lower than CBO had anticipated. As a result, the base for benefits throughout the projection period has been reduced. (The projected January 2003 cost-of-living adjustment is significantly smaller as well.) In addition, since Social Security benefits are calculated from wages, CBO's projection of lower real wage growth means smaller initial benefits for new beneficiaries in the future.

The government's net interest costs are principally determined by two factors: the stock of outstanding debt and prevailing interest rates. CBO's forecast for interest rates has fallen since August, reducing the projected cost of issuing new debt. Net interest savings from that change are expected to be $15 billion in 2002, $13 billion in 2003, and smaller amounts thereafter, totaling $43 billion over the 2002-2011 period.

Because the recent economic revisions reduce projected surpluses (mainly because of the substantial drop in revenues described above), the stock of federal debt held by the public will no longer decline as quickly as CBO estimated in August. That slowdown adds an estimated $165 billion to debt-service costs through 2011, with most of the expense coming in the later years of that period.

Technical Changes Since August

Technical revisions are defined as any reestimates that are not ascribed to new legislation or to changes in the components of CBO's economic forecast. Overall, technical changes reduce the projected surplus for the 2002-2011 period by $501 billion.

Revenues. Since August, CBO has decreased its revenue projections for the 2002-2011 period by $388 billion because of various technical adjustments to the method for calculating how much revenue the projected level of economic activity will generate. More than $200 billion of that decrease reflects lower projections of individual income tax receipts. The technical factors involved are closely related to the revised economic outlook—most important, revisions to projections of capital gains realizations and adjustments for unexplained shortfalls in tax collections since July, as well as some minor changes to CBO's estimating methods.

Another $127 billion of the technical change affects projections of corporate income taxes. Again, that drop results from lower estimates of corporate capital gains realizations and from tax collections in 2001 that were smaller than CBO would have expected given the economic conditions.

By contrast, technical changes increased the projections for social insurance taxes by $42 billion from 2002 through 2011. That increase is based on information that current collections of Social Security and Medicare taxes are higher, given the level of economic activity, than models had projected. Such extra revenue is expected to persist. It does not raise total projected revenues, however, because it is linked to an offsetting decrease in individual income tax receipts.

Technical changes since August have lowered the 10-year projection for estate and gift tax receipts by $24 billion. That decline largely results from reductions in projected levels of wealth, which help determine how much money is subject to those taxes. However, the decline also reflects a new interpretation of how taxpayers will respond to the changes in tax law scheduled for 2010 and 2011. Under the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), calendar year 2010 will be a particularly good year to make taxable gifts, because the tax rates will rise substantially in 2011. The taxes on those gifts would be paid in fiscal year 2011. The additional receipts expected in that year partially offset the decline caused by lower projections of wealth.

Box B-1.
Uncertainty About Credit Reestimates for Spectrum Loans

Radio frequencies are a scarce and valuable resource for wireless and broadcast services. Consequently, federal auctions of licenses to use parts of the electromagnetic spectrum have generated billions of dollars for government coffers. In most cases, auction winners pay cash for their licenses, and those payments are recorded in the budget as offsetting receipts. In the mid-1990s, however, some auction winners borrowed money from the Federal Communications Commission (FCC) to pay for their spectrum licenses. Because those loans are subject to credit reform procedures, the budget records only the net subsidy associated with them, measured on a net-present-value basis over the life of the loans. Estimates of that subsidy have fluctuated dramatically over the past few years because of ongoing litigation and other market factors.

The most widely reported—and perhaps misunderstood—source of uncertainty about those subsidy estimates involves the licenses that were awarded in 1997 to NextWave. That company borrowed $4.9 billion from the FCC to acquire spectrum licenses but later filed for bankruptcy. The FCC reclaimed NextWave's licenses and reauctioned them in 2001 for a total of about $16 billion. NextWave has disputed the FCC's authority to reclaim the licenses, and the issue remains in litigation.

For estimating purposes, the Congressional Budget Office (CBO) has assumed that the amount the government will recover on its loans to NextWave will be midway between what it would collect if it lost its court case (which CBO estimates at about $6 billion because of accrued interest) and what it would collect if it won (the $16 billion bid at the reauction). Hence, the credit reestimates included in CBO's baseline reflect an expected value of $11 billion.

At the end of the most recent session of Congress, the Administration proposed a legislative settlement that would allow the federal government to keep the $16 billion from the reauction and require that $9.55 billion be appropriated for a payment to NextWave.[1] The government would retain the difference, or a total of $6.45 billion.[2] That amount would be $4.5 billion less than the $11 billion that CBO estimated under current law. Thus, CBO estimated that the settlement would add $4.5 billion to subsidy costs over the 2002-2004 period.

No legislative action was taken on the proposed settlement agreement in 2001. The Supreme Court is expected to decide this spring whether to review lower-court rulings related to NextWave's spectrum licenses. Until those issues are resolved by the courts or the Congress, estimates of the credit subsidies for FCC loans will remain uncertain.

1. Key provisions of the Administration's proposal were included in the Prompt Utilization of Wireless Spectrum Act of 2001 (H.R. 3484), introduced on December 13, 2001.

2. Some media reports suggested that the settlement would yield a total of about $10 billion to the government rather than the $6.45 billion estimated by CBO, because the bill would have required NextWave to pay $3 billion in taxes on its receipts from the settlement. However, taxes paid on government payments or benefits are not included in budgetary calculations for legislative proposals.

Among other revenue sources, projections of excise tax receipts have declined since August, partly for technical reasons. Those reasons include lower projections for aviation-related taxes in the wake of the September 11 terrorist attacks and some as-yet-unexplained reductions in other excise tax collections this year that are assumed to continue.

Together, technical adjustments have a fairly consistent effect on revenue projections for 2002 through 2010, reducing them by $32 billion to $51 billion per year. The picture reverses in 2011, however, when technical adjustments increase projected revenues by $4 billion because of the new interpretation of how the expiration of EGTRRA will affect estate and gift taxes.

Outlays. Technical changes since August have added $113 billion to CBO's 10-year projections of spending. Other than an increase of $139 billion in debt-service costs (largely the result of CBO's new revenue estimates), net technical changes lower projected outlays for the 10-year period by $26 billion. That amount represents a $27 billion increase in discretionary outlays outweighed by a $54 billion decline in mandatory spending.

Among mandatory programs, technical reestimates have lowered projected spending for some programs and raised it for others. Medicare saw the largest technical revision to projected outlays—a total reduction of $96 billion for the 2002-2011 period. About one-third of that change reflects the fact that spending in 2001 was higher than anticipated for relatively slow-growing categories of Medicare services (such as hospital inpatient services) and lower than expected for relatively fast-growing categories (such as services furnished by hospitals' outpatient departments and other facilities). The other two-thirds of the change results from an ongoing review of CBO's projections of Medicare enrollment. CBO reduced those projections to make them more consistent with its projections of the population eligible for Social Security and with the Medicare trustees' projections of total enrollment in the program.

Projected spending for Medicaid was also subject to technical revisions, which increased 10-year outlays by $30 billion. A shift of eligible Medicaid recipients to the State Children's Health Insurance Program is expected to lower Medicaid costs during the 2002-2011 period. But that reduction is projected to be more than offset by significant growth in the cost of prescription drugs.

Since August, CBO has also made technical reestimates of Social Security expenditures over the next 10 years, raising them by a total of $38 billion. Virtually all of that increase occurs in the second half of the projection period. It reflects changes in projected enrollment (in part because of new population projections) as well as changes in the calculation of average benefits that are unrelated to changes in the economic forecast.

Outlays for unemployment insurance are projected to be $21 billion higher during the 2002-2011 period than in CBO's August baseline because of reestimates of two factors: the number of unemployed people who will qualify and file for unemployment benefits and the length of time that they will receive benefits.

CBO has changed its projections for the Universal Service Fund account—which subsidizes telecommunications service in underserved or high-cost areas—to reflect new estimates for state universal service funds. In contrast to its previous assumptions, CBO now expects that the activities of state funds will not be reflected in the federal budget because those activities are not likely to be the result of existing federal law. That change lowers projected outlays over the 10-year period by $60 billion. However, because it also reduces projected revenues by roughly the same amount, the effect on the surplus is negligible.

Since the previous baseline, CBO has also lowered its projection of credit subsidies for FCC loans related to recent auctions of spectrum licenses. Although CBO's estimate of the amount of receipts that the FCC will collect from those auctions has not changed since August, the Administration recorded a change (credit reestimate) of about $12 billion in outlays in September to reflect its judgment about the possible outcome of legal proceedings (see Box B-1). To maintain its previous estimate of the total subsidy cost that will eventually be realized, CBO had to adjust its projection of future subsidy reestimates downward by about $13 billion. The year-to-year differences shown in Table B-1 also reflect changes in the expected timing of future auctions of spectrum licenses.

Technical adjustments to projections of net interest spending largely reflect new Treasury data on the stock of outstanding federal debt and revisions to CBO's assumptions about the future composition and growth of debt. Those adjustments increase projected net interest outlays over 10 years by $64 billion relative to the August baseline. In addition, interest payments on the debt resulting from CBO's various technical reestimates since August total $139 billion over the 2002-2011 period.