Chapter One

The Budget Outlook

Over the past year, the outlook for the federal budget has changed substantially. Last January, the Congressional Budget Office (CBO) projected that if the tax and spending policies then in effect remained the same, the government would run surpluses totaling more than $5.6 trillion over the 10-year period from 2002 through 2011. CBO revised those projections in August, reducing the 10-year surplus to $3.4 trillion.[1] Now, CBO projects that the cumulative surplus for 2002 through 2011 under current policies would total $1.6 trillion—a drop of $4 trillion from last January's figure. Approximately 60 percent of that decline ($2.4 trillion) results from laws enacted in the past year. The other 40 percent reflects changes in the outlook for the economy and various technical adjustments to CBO's projections.

The message is much the same over a shorter, five-year horizon. Last January, CBO projected that under current policies, the government would show a surplus in each year and run a cumulative surplus of more than $2.0 trillion during the 2002-2006 period. Revisions to the baseline in August reduced that five-year figure to $1.1 trillion. Now, CBO projects that the total budget would be in deficit in 2002 and 2003 and would show a cumulative surplus of only $250 billion through 2006 under current policies. About half of the drop in that figure since last January ($870 billion) reflects new legislation. Changes in the economic outlook caused another $530 billion of the decline, and technical changes accounted for the remaining $356 billion.

1. The August 2001 revisions appeared in *The Budget and Economic Outlook: An Update*; the $2.2 trillion reduction in the projected 10-year surplus reflected a $1.4 trillion decline in revenues and a $0.8 trillion increase in outlays.

If current tax and spending policies remain in place, the total budget will show a deficit of $21 billion in 2002 and $14 billion in 2003, CBO projects (see Tables 1-1 and 1-2). Total budget surpluses reemerge in 2004 in CBO's baseline and accumulate to almost $2.3 trillion between 2003 and 2012 (the current 10-year projection period). But 80 percent of that cumulative surplus occurs in the last five years of the period, and almost half comes in the final two years—when the projections are, by their nature, the most uncertain. The surpluses projected for fiscal years 2011 and 2012 are particularly large because all of the remaining tax-cut provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) are scheduled to expire in December 2010. That expiration significantly boosts projected revenues.

Unlike total surpluses, on-budget surpluses—which exclude the transactions of Social Security and the Postal Service—do not reappear until 2010 in CBO's new baseline. Although those off-budget accounts are projected to show net surpluses every year through 2012, the rest of the budget is projected to post deficits of $181 billion in 2002, $193 billion in 2003, and declining amounts through 2009. The projected on-budget surplus jumps in 2011 and 2012 after most of the tax-cut provisions expire. If lawmakers extended those tax cuts, the total 10-year surplus would be about one-third less than the $2.3 trillion projected under the assumptions for the baseline (see Box 1-1 on page 4).

As dramatically as the budget outlook has worsened in the past year, it remains relatively bright by historical standards. Before 1998, the government had recorded deficits in 36 of the previous 37 years.

Table 1-1.
The Budget Outlook Under Current Policies (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
On-Budget Surplus or Deficit (-)	-33	-181	-193	-141	-108	-99	-76	-56	-23	4	131	319	-617	-242
Off-Budget Surplus[a]	161	160	178	195	212	227	242	258	274	290	307	322	1,054	2,505
Total Surplus or Deficit (-)	127	-21	-14	54	103	128	166	202	250	294	439	641	437	2,263
Memorandum:														
Social Security Surplus	163	163	179	195	211	227	242	258	274	290	307	322	1,054	2,505
Postal Service Outlays	2	3	1	*	-1	0	0	0	0	0	0	0	*	*
Total Surplus or Deficit (-) as a Percentage of GDP	1.3	-0.2	-0.1	0.5	0.8	1.0	1.2	1.4	1.7	1.9	2.7	3.7	0.7	1.6

SOURCE: Congressional Budget Office.

NOTE: * = between zero and $500 million.

a. Off-budget surpluses comprise surpluses in the Social Security trust funds as well as the net cash flow of the Postal Service.

The total deficits projected for the next two years are as small or smaller as a percentage of the nation's gross domestic product (GDP) than in any of those years (see Figure 1-1 on page 5). More important, public debt continues to decline in CBO's current baseline, albeit more slowly than in last year's projections. Under current policies, federal debt held by the public would equal 25 percent of GDP by 2006 (see Figure 1-2 on page 5). By 2010 (before the expiration of EGTRRA), projected debt would fall to roughly 15 percent of GDP—the lowest level since 1917.

Uncertainty and the Projection Horizon

Budget projections are always subject to considerable uncertainty (see Chapter 5 for more details). However, that uncertainty is particularly great this year as the nation continues to wage war on terrorism and recover from a recession. Actual budget totals will differ from the projections in this report, perhaps substantially. The major reason is that CBO's baseline, by law, must show future spending and revenues under current laws and policies—even though those will almost certainly change. For example, the first session of the 107th Congress left a number of policy issues unresolved, including an economic stimulus package, additional discretionary spending, prescription drug coverage for Medicare beneficiaries, and the extension of agricultural programs. Those policies could significantly affect spending and revenues for years to come.

Another source of uncertainty about the budget outlook is the accuracy of the economic and technical assumptions that underlie CBO's baseline. In recent years, economic growth has surpassed expectations, fueling projections of higher revenues and bigger surpluses. Now, the projections hinge on how rapidly and strongly the economy will rebound from the current recession and whether growth over the next 10 years will match the levels experienced in the late 1990s.

Uncertainty compounds as the projection horizon lengthens. Even small annual differences in the many key factors that influence the budget projections—factors such as inflation, increases in produc-

Table 1-2.
CBO's Baseline Budget Projections

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007[a]	Total, 2003-2012[a]
							In Billions of Dollars							
Revenues														
Individual income taxes	994	947	998	1,059	1,114	1,162	1,228	1,305	1,387	1,477	1,673	1,841	5,562	13,245
Corporate income taxes	151	179	175	199	235	246	260	275	289	303	319	335	1,115	2,635
Social insurance taxes	694	710	748	789	832	869	908	948	994	1,045	1,097	1,151	4,146	9,381
Other	152	146	149	159	161	170	172	179	186	183	188	223	811	1,769
Total	1,991	1,983	2,070	2,206	2,342	2,447	2,568	2,706	2,856	3,008	3,277	3,549	11,633	27,030
On-budget	1,484	1,464	1,525	1,632	1,739	1,816	1,907	2,014	2,130	2,243	2,474	2,706	8,620	20,187
Off-budget	508	518	545	574	602	631	661	693	727	764	803	842	3,014	6,842
Outlays														
Discretionary spending	649	733	764	784	808	824	841	866	888	910	937	953	4,021	8,575
Mandatory spending	1,095	1,188	1,248	1,292	1,362	1,428	1,508	1,602	1,701	1,809	1,933	2,023	6,837	15,904
Offsetting receipts	-87	-88	-101	-113	-119	-115	-122	-129	-136	-143	-152	-160	-570	-1,289
Net interest	206	170	174	188	188	182	175	165	153	138	120	92	908	1,577
Total	1,864	2,003	2,085	2,152	2,238	2,319	2,402	2,504	2,606	2,714	2,838	2,908	11,196	24,767
On-budget	1,517	1,645	1,718	1,774	1,848	1,915	1,983	2,069	2,153	2,240	2,343	2,387	9,237	20,429
Off-budget	347	358	367	379	391	405	419	434	453	474	495	521	1,960	4,337
Surplus or Deficit (-)	127	-21	-14	54	103	128	166	202	250	294	439	641	437	2,263
On-budget	-33	-181	-193	-141	-108	-99	-76	-56	-23	4	131	319	-617	-242
Off-budget	161	160	178	195	212	227	242	258	274	290	307	322	1,054	2,505
Memorandum:														
Gross Domestic Product	10,150	10,315	10,890	11,556	12,168	12,803	13,468	14,166	14,897	15,664	16,469	17,314	60,884	139,394
							As a Percentage of GDP							
Revenues														
Individual income taxes	9.8	9.2	9.2	9.2	9.2	9.1	9.1	9.2	9.3	9.4	10.2	10.6	9.1	9.5
Corporate income taxes	1.5	1.7	1.6	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8	1.9
Social insurance taxes	6.8	6.9	6.9	6.8	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.6	6.8	6.7
Other	1.5	1.4	1.4	1.4	1.3	1.3	1.3	1.3	1.2	1.2	1.1	1.3	1.3	1.3
Total	19.6	19.2	19.0	19.1	19.2	19.1	19.1	19.1	19.2	19.2	19.9	20.5	19.1	19.4
On-budget	14.6	14.2	14.0	14.1	14.3	14.2	14.2	14.2	14.3	14.3	15.0	15.6	14.2	14.5
Off-budget	5.0	5.0	5.0	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9
Outlays														
Discretionary spending	6.4	7.1	7.0	6.8	6.6	6.4	6.2	6.1	6.0	5.8	5.7	5.5	6.6	6.2
Mandatory spending	10.8	11.5	11.5	11.2	11.2	11.2	11.2	11.3	11.4	11.5	11.7	11.7	11.2	11.4
Offsetting receipts	-0.9	-0.9	-0.9	-1.0	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Net interest	2.0	1.7	1.6	1.6	1.5	1.4	1.3	1.2	1.0	0.9	0.7	0.5	1.5	1.1
Total	18.4	19.4	19.1	18.6	18.4	18.1	17.8	17.7	17.5	17.3	17.2	16.8	18.4	17.8
On-budget	14.9	16.0	15.8	15.3	15.2	15.0	14.7	14.6	14.5	14.3	14.2	13.8	15.2	14.7
Off-budget	3.4	3.5	3.4	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0	3.2	3.1
Surplus or Deficit (-)	1.3	-0.2	-0.1	0.5	0.8	1.0	1.2	1.4	1.7	1.9	2.7	3.7	0.7	1.6
On-budget	-0.3	-1.8	-1.8	-1.2	-0.9	-0.8	-0.6	-0.4	-0.2	*	0.8	1.8	-1.0	-0.2
Off-budget	1.6	1.6	1.6	1.7	1.7	1.8	1.8	1.8	1.8	1.9	1.9	1.9	1.7	1.8

SOURCE: Congressional Budget Office.

NOTE: * = between zero and 0.05 percent of GDP.

a. Numbers in the second half of the table are shown as a percentage of total GDP for this period.

Box 1-1.
The Expiration of Revenue Provisions

The scheduled expiration of various tax provisions has a significant impact on the outlook for the budget over the next decade.[1] Three provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) expire by the end of calendar year 2006, and the rest—representing the majority of the law's budgetary cost—expire on December 31, 2010. Many other provisions of the tax code, enacted before EGTRRA, either expired at the end of 2001 or are scheduled to expire in the next 10 years. They include the treatment of nonrefundable credits under the alternative minimum tax (AMT), which ended last year, and the research and experimentation credit, which expires in 2004.

By law, the Congressional Budget Office's (CBO's) budget projections must assume that almost all such provisions expire as planned. (The only exception is expiring excise taxes dedicated to trust funds, which by statute are assumed to be extended.) An alternative measure of the long-term budgetary effects of current tax policy could assume that the expirations do not occur as scheduled but rather that the Congress and the President immediately extend the provisions indefinitely (including those that expired in 2001). Under those assumptions, the Joint Committee on Taxation and CBO estimate, federal revenues would be $735 billion lower during the 2003-2012 period than in CBO's baseline (see the table below). In addition, the government's debt-service costs would increase. As a result, the total surplus for that 10-year period would be about one-third less than the $2.3 trillion projected under baseline assumptions.

More than three-quarters (or about $569 billion) of the revenue loss over 10 years from extending all provisions would result from extending EGTRRA. The majority of that amount would occur in 2011 and 2012 (the years after most of the law's provisions would have expired), but some effects of continuing EGTRRA would appear earlier. Extending the changes to estate and gift taxes could reduce revenues as early as 2003, because if taxpayers knew that the law's repeal of the estate tax would become permanent in 2011, some might postpone taxable gifts that they would otherwise have made during the decade.

The estimates for EGTRRA shown below also assume that the higher exemption levels for the AMT, which expire in 2004, are extended at their 2004 levels. Under that assumption, the exemption level would not rise with inflation, so a growing number of taxpayers would still become subject to the AMT over time—albeit fewer than if the higher exemption levels expire as now scheduled.

1. It can also be expected to affect the economy, but only some of those effects are reflected in the estimated revenue impact of the expiring provisions.

Effects on Revenues of Extending Expiring Tax Provisions (In billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Provisions in EGTRRA													
Provisions expiring in 2010	n.a.	-1	-1	-2	-2	-3	-3	-3	-4	-127	-229	-9	-374
Provisions expiring before 2010[a]	n.a.	n.a.	n.a.	-4	-13	-19	-24	-28	-31	-35	-39	-36	-194
Subtotal	n.a.	-1	-1	-6	-16	-22	-27	-31	-35	-162	-268	-46	-569
Other Expiring Tax Provisions[b]	-1	-3	-4	-9	-13	-17	-19	-21	-24	-27	-29	-46	-166
Total Effect on Revenues	-1	-4	-6	-15	-29	-38	-46	-52	-59	-189	-297	-92	-735

SOURCES: Congressional Budget Office and Joint Committee on Taxation.

NOTES: These estimates assume that the expiring provisions are extended immediately rather than when they are about to expire. They also assume extension of provisions that expired at the end of 2001. They do not include debt-service effects. In addition, the estimates include interactions between provisions, which are most significant in 2011 and 2012.

EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; n.a. = not applicable.

a. Includes the increased exemption amount for the alternative minimum tax (expires in 2004), the deduction for qualified education expenses (expires in 2005), and the credit for individual retirement accounts and 401(k)-type plans (expires in 2006).

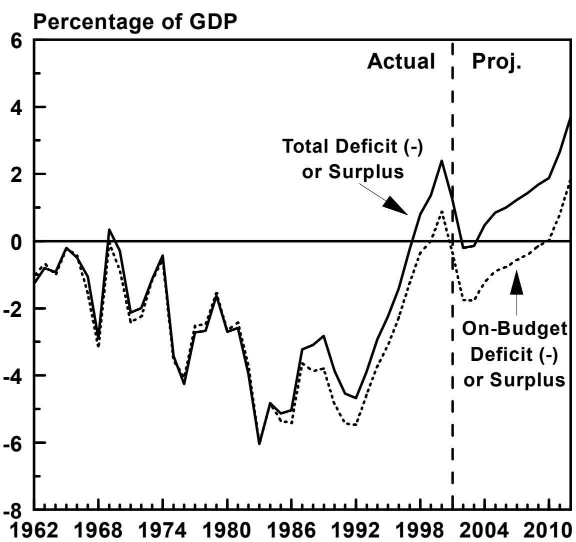
b. Includes numerous provisions, such as the tax credit for research and experimentation. For a complete list, see Table 3-12 in Chapter 3.

tivity, economic growth, the distribution of income, and growth rates for Medicare and Medicaid spending—can add up to substantial differences in the budget outcome 10 years from now. (For details of how changes in several key assumptions would affect the budget outlook, see Appendix A.)

Given such uncertainty, focusing on five-year projections may be more useful than relying on 10-year numbers. In addition, the current 10-year projections are significantly affected by the scheduled expiration, at the end of 2010, of last year's tax cuts. Many of the tables in this report show both five- and 10-year totals (2003-2007 and 2003-2012 for the new baseline; 2002-2006 and 2002-2011 when that baseline is being compared with last year's projections).

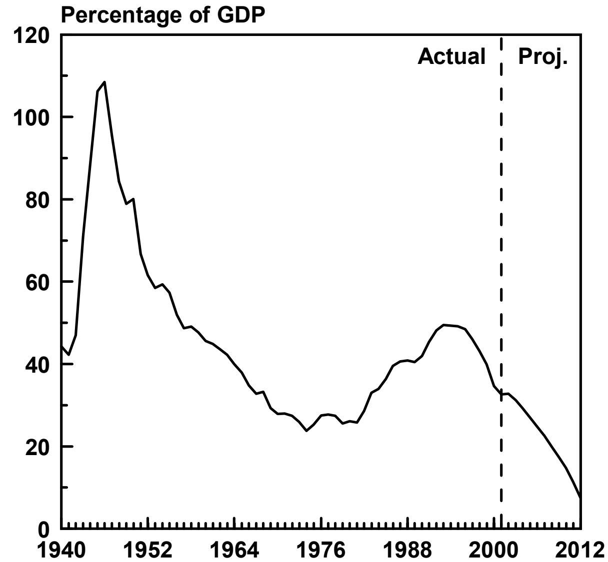
Looking at the longer term remains important, however, as the baby-boom generation approaches retirement age. The recent worsening of the budget outlook—along with its continuing uncertainty—makes the budgetary challenges that loom beyond the 10-year projection period even more difficult. By the end of that period, the baby-boom generation will begin qualifying in large numbers for Social Security and Medicare benefits, putting increased pressure on those programs. By 2030, the number of workers is expected to rise by only about 15 percent while the number of Social Security and Medicare beneficiaries will nearly double. That growth, combined with increases in life expectancy, will boost spending on long-term health care, about half of which is financed by Medicaid and Medicare.[2] Together, demographic changes and growth in medical costs are projected to push total federal spending on Medicare, Medicaid, and Social Security from just under 8 percent of GDP in 2001 to almost 15 percent of GDP in 2030. (For more information about the long-term budget outlook, see Chapter 6.)

Figure 1-1.
Total Deficits and Surpluses as a Share of GDP, 1962-2012



SOURCE: Congressional Budget Office.

Figure 1-2.
Debt Held by the Public as a Share of GDP, 1940-2012



SOURCE: Congressional Budget Office.

The Concept Behind CBO's Baseline

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

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

Box 1-2.
A Freeze in Discretionary Spending

The Balanced Budget and Emergency Deficit Control Act of 1985 sets the baseline for discretionary spending as the level appropriated for the current year adjusted for inflation and other specified factors. But some lawmakers view a freeze in discretionary spending at the current year's level as the most logical starting point for considering future appropriations. Indeed, total discretionary outlays remained roughly constant from 1991 through 1996, largely because of the decline in defense spending after the Cold War. Since 1998, however, discretionary spending has grown relatively rapidly, outpacing inflation.

If total discretionary spending were frozen at the level enacted for 2002, the budget would be very close to balance in 2003, and surpluses would grow larger in subsequent years than CBO's baseline projects. In that scenario, the total budget surplus would equal 5.2 percent of gross domestic product (GDP) by 2012 (see the table below). On-budget surpluses—which exclude the balances of the Social Security trust funds and the Postal Service—would equal 3.4 percent of GDP by 2012. At that point, in dollar terms, discretionary spending would be nearly 22 percent below the inflation-adjusted level assumed in the baseline.

The Budget Outlook Assuming That Discretionary Spending Is Frozen at the Level Enacted for 2002 (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
On-Budget Surplus or Deficit (-)	-33	-181	-180	-111	-57	-25	25	74	137	196	360	582	-348	1,000
Off-Budget Surplus	161	160	179	195	212	227	243	259	275	291	309	323	1,055	2,512
Total Surplus or Deficit (-)	127	-21	-1	84	155	202	268	333	411	487	668	905	707	3,512
Memorandum:														
Total Surplus or Deficit (-) as a Percentage of GDP	1.3	-0.2	*	0.7	1.3	1.6	2.0	2.3	2.8	3.1	4.1	5.2	n.a.	n.a.

SOURCE: Congressional Budget Office.

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

the Balanced Budget and Emergency Deficit Control Act of 1985 and the Congressional Budget Act of 1974. Those laws generally instruct CBO (and the Office of Management and Budget) to project federal spending and revenues under current policies.

For revenues and mandatory spending, section 257(b) of the Deficit Control Act requires that the baseline be projected on the assumption that current laws continue without change. In most cases, the laws that govern revenues and mandatory spending are permanent. The baseline projections reflect anticipated changes in the economy, demographics, and other relevant factors that affect the implementation of those laws.[3]

The rules are different for discretionary spending, which is governed by annual appropriation acts. Section 257(c) of the Deficit Control Act states that

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

projections of discretionary budget authority after the current year should be adjusted to reflect inflation—using specified indexes—as well as a few 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 the current level, adjusting for projected rates of inflation and other specified factors over the next 10 years.

This mechanical approach to developing baseline projections can be problematic. For example, all discretionary budget authority appropriated for the current year is inflated and extended through the entire projection period even if it was enacted for an emergency or other one-time event. Thus, CBO's current baseline projects into future years the $20 billion in supplemental budget authority for 2002 that was appropriated in response to the terrorist attacks of September 11.[4] Some people might argue that such an appropriation was intended as one-time spending and should not be extended past 2002. But the Deficit Control Act does not provide for such exceptions. And although that specific emergency appropriation may not be repeated, various types of emergencies that necessitate additional appropriations arise every year. (Chapter 4 presents an alternative path for discretionary spending that does not assume such appropriations in the future.)

CBO traditionally presents at least one other benchmark for discretionary spending. Lawmakers sometimes use a freeze in appropriations—the current year's amounts without adjustment for inflation—to gauge the impact of proposed levels of discretionary spending for the coming fiscal year. The budget outlook under such a freeze is shown in Box 1-2.

4. The 2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States provided $40 billion in budget authority—$20 billion in 2001 and a second $20 billion that could be obligated only when enacted in a later appropriation act. Because the first $20 billion was appropriated before the current fiscal year, that amount is not extended in the new baseline. However, the second $20 billion in emergency appropriations, which was attached to the 2002 defense appropriation act, is part of the current-year total for budget authority and is therefore inflated throughout the 10-year projection period.

CBO's baseline is intended to provide an objective foundation for assessing policy options. It is not intended to be a prediction 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 laws and policies.

Changes in the Baseline Since January 2001

Over the past year, CBO's projection of the cumulative surplus for the 2002-2011 period has fallen by $4 trillion (see Table 1-3). Roughly $2.4 trillion of that decline is attributable to laws passed since last January—primarily the EGTRRA tax cuts of June 2001 and increased discretionary spending. About $930 billion results from changes to CBO's economic forecast, and the remaining $660 billion reflects revisions to the projections that are technical in nature.[5]

Lower projected surpluses result in additional accumulated debt, which in turn requires higher spending for interest on the debt. Those increased debt-service costs, which amount to about $1 trillion through 2011, account for one-fourth of the reduction in the projected 10-year surplus. Last January, CBO estimated that the steady paying down of federal debt held by the public, which began with the onset of surpluses in 1998 and was projected to accelerate through the 2002-2011 period, would enable the Treasury to retire all of the debt available for redemption by 2006.[6] In the current baseline, that paydown has been interrupted—at least temporarily. The small deficits projected for 2002 and 2003 will necessitate additional net government borrowing. Not until 2004 will the emergence of a small surplus allow publicly held debt to begin declining again. As a result, CBO no longer projects that all available

5. For a similar analysis of how CBO's baseline has changed since August 2001, see Appendix B.

6. Part of the debt, including some long-term bonds and savings bonds, will remain outstanding regardless of the size of the surplus.

Table 1-3.
Changes in CBO's Baseline Projections of the Surplus Since January 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 January 2001	313	359	397	433	505	573	635	710	796	889	2,007	5,610
Changes to Revenue Projections												
Legislative	-32	-86	-103	-103	-128	-144	-152	-160	-178	-119	-452	-1,205
Economic	-148	-123	-80	-65	-56	-51	-47	-45	-45	-48	-473	-708
Technical	-73	-63	-64	-60	-57	-53	-50	-45	-41	-3	-317	-510
Total Revenue Changes	-253	-273	-247	-228	-242	-248	-249	-250	-264	-170	-1,243	-2,423
Changes to Outlay Projections												
Legislative												
Discretionary												
Defense	33	29	29	29	29	29	30	30	31	32	149	301
Nondefense	11	20	23	25	26	28	28	29	29	30	106	249
Subtotal, discretionary	44	49	52	54	56	57	58	59	60	61	255	550
Mandatory												
EGTRRA child tax credit	6	7	7	7	10	10	9	10	11	12	37	88
Debt service	5	12	22	32	44	57	72	88	106	124	114	562
Other	4	4	3	1	1	1	1	*	*	*	12	14
Subtotal, mandatory	15	22	31	40	54	67	82	98	118	137	163	665
Subtotal, legislative	60	72	83	94	110	124	140	157	177	198	418	1,215
Economic												
Discretionary	2	3	3	3	4	4	5	6	7	7	14	44
Mandatory												
Debt service	3	11	18	23	27	31	35	39	44	48	82	279
Other	-5	-6	-5	-10	-12	-12	-11	-12	-14	-15	-38	-102
Subtotal, mandatory	-2	5	13	13	15	19	24	28	30	33	43	177
Subtotal, economic	*	7	15	16	19	24	29	34	37	40	57	221

(Continued)

debt held by the public will be retired during the projection period.

By convention, CBO attributes changes in its baseline projections to three factors:

- Recently enacted legislation,
- Changes in the outlook for the variables that make up CBO's economic forecast, and
- Changes in anything else that affects the budget—a category labeled technical (see Figure 1-3 on page 10).

That categorization of revisions should be interpreted with caution, however. For example, distinguishing between economic and technical reestimates is imprecise. Changes in some factors that are related to the performance of the economy (such as capital gains realizations) are classified as technical reestimates because they are not driven directly by changes in the components of CBO's economic forecast.

Table 1-3.
Continued

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2006	Total, 2002-2011
Changes to Outlay Projections (Continued)												
Technical												
Discretionary	4	2	*	*	-1	-2	-2	-2	-1	2	6	2
Mandatory												
Debt service	3	7	12	15	18	22	27	31	34	38	55	207
Other	14	12	-15	-24	-10	-9	-11	-10	-9	2	-22	-60
Subtotal, mandatory	17	19	-3	-8	8	13	16	21	25	40	33	148
Subtotal, technical	21	22	-2	-8	7	11	14	19	24	42	39	150
Total Outlay Changes	80	101	96	101	136	159	184	210	239	280	514	1,585
Total Impact on the Surplus	-333	-373	-343	-330	-377	-406	-433	-460	-502	-450	-1,757	-4,008
Total Surplus as Projected in January 2002	-21	-14	54	103	128	166	202	250	294	439	250	1,602
Memorandum:												
Total Legislative Changes	-91	-158	-186	-197	-238	-268	-293	-317	-355	-317	-870	-2,420
Total Economic Changes	-148	-131	-95	-81	-75	-75	-76	-79	-82	-88	-530	-929
Total Technical Changes	-94	-84	-62	-51	-64	-64	-65	-64	-65	-45	-356	-660

SOURCE: Congressional Budget Office.

NOTE: EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; * = between -$500 million and $500 million.

Legislative Changes Since Last January

Altogether, laws passed since January 2001 have cut about $2.4 trillion from the projected surplus for the 2002-2011 period. Half of that amount comes from laws that reduce the amount of revenues that the government is likely to collect, and the other half stems from legislation that increases the amount of outlays for government programs or for paying interest on the government's debt.

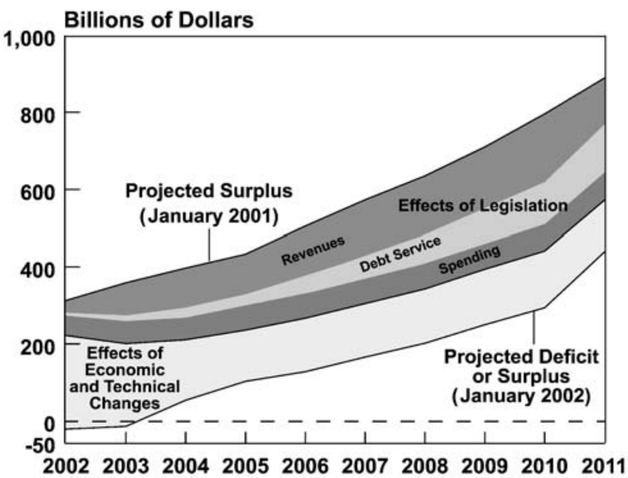
Revenues. In all, some 30 percent of the $4 trillion decline in the 10-year surplus is attributable to EGTRRA, which was enacted in June. CBO and the Joint Committee on Taxation estimated that the law will lower revenues by $1.2 trillion over the 2002-2011 period.[7] Other laws enacted since January have had little effect on revenues.

Outlays. The discretionary budget authority appropriated for 2002 exceeded the amount that CBO had projected a year ago on the basis of 2001 appropriations. That increase results in $550 billion in additional outlays over the 2002-2011 period compared with last January's projections. More than half of the rise in projected outlays, about $300 billion, represents increased defense spending. The rest reflects higher spending for all other discretionary programs.

Legislative changes to mandatory programs in the past year raised projected mandatory outlays (ex-

7. For more information about the budgetary effects of EGTRRA, see Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2001).

Figure 1-3.
Reasons for the Change in CBO's Projections Since January 2001



SOURCE: Congressional Budget Office.

cluding debt-service costs) by $103 billion through 2011. The largest contributor is EGTRRA's expansion of the child tax credit, which is estimated to increase outlays for refundable tax credits by $88 billion during the 2002-2011 period.

By far the biggest increase in mandatory spending, however, comes from higher debt-service costs as a result of laws enacted since January. By convention, CBO attributes increases or decreases in debt-service costs to the type of change (legislative, economic, or technical) that occasioned them. Of the aforementioned $1.0 trillion increase in projected debt-service costs over 10 years, CBO estimates that $562 billion is attributable to the effects of laws enacted in the past year.

Economic Changes Since Last January

Revisions to CBO's economic forecast over the past year have trimmed $929 billion from the total surplus projected for the 2002-2011 period. The recession plays a large role in explaining those revisions, perhaps accounting for as much as half of that 10-year budgetary impact. But other, longer-term changes in the outlook contribute as well. Virtually all of those other economic effects are traceable to a reduction in CBO's projection for investment throughout the 2002-2011 period. The current recession and projected future levels of investment are closely connected: the recession seems to have been precipitated mostly by a period of unsustainable investment in the late 1990s, and the recognition of that overinvestment has led CBO to reduce its estimate of the level of such spending over the next decade. (For details of the economic outlook, see Chapter 2.)

Revenues. Approximately three-quarters of the reduction in the 10-year surplus caused by economic changes represents lower projections for revenues: changes in the economic outlook since last January have lowered projected revenues by about $700 billion over 10 years. In the near term, the recession has slowed the growth of wages and salaries and thus of projected revenues from individual income taxes. The projected growth of investment continues to be slightly lower throughout the 10-year period, further contributing to the decline in receipts from individual income taxes. In addition, corporate profits have declined significantly, reducing projected corporate income tax receipts.

In CBO's outlook, as the economy recovers, tax receipts are anticipated to rise closer to the levels projected last January, although they remain below that level through 2012.

Outlays. As noted earlier, most of the change in projected discretionary spending results from recent increases in enacted appropriations. But changes in CBO's assumptions about two measures of inflation —the GDP deflator and the employment cost index for wages and salaries—over the past year cause an additional small net increase ($44 billion) in projected discretionary spending through 2011.

Projections of mandatory spending are also sensitive to changes in the economic forecast. Although such spending flows from the provisions of permanent laws, the growth of many mandatory programs is keyed to the economy. For example, since last January, lower inflation and wage growth have reduced projected spending for Social Security over the 2002-2011 period by $57 billion and projected spending for Medicare by roughly $33 billion. In addition, lower projections of future interest rates have decreased projected net interest costs during that decade by $53 billion.

Offsetting those declines are much larger changes that raise projected mandatory outlays—and thus reduce surpluses—relative to last January's baseline. The largest change to mandatory spending driven by economic revisions in the past year is the additional $279 billion in debt-service costs necessitated by the $929 billion drop in surpluses. In addition, CBO is forecasting higher unemployment for the next few years because of the weakened economy; that change has increased projected 10-year spending for unemployment compensation by $52 billion in the past year.

Technical Changes Since Last January

Reestimates that cannot be ascribed either to new laws or to changes in CBO's economic assumptions have reduced the projected 10-year surplus by $660 billion in the past year. As with the economic revisions, more than three-quarters of those technical changes involve revenues; the rest mostly reflect the resulting debt-service costs.

Revenues. About $500 billion of the decline in projected revenues since last January results from technical changes that are closely related to the revised economic outlook. Those changes reflect adjustments to the methods and assumptions that determine how much tax revenue any given tax base will generate. For example, the decline in the stock market has reduced projected capital gains realizations and the tax receipts they generate for both the individual and corporate income taxes—reductions that tend to dissipate over time. Slower growth in overall wealth has decreased projections of receipts from estate and gift taxes. In addition, current revenue collections are lower than CBO's economic forecast and revenue-estimating models projected, for reasons not entirely understood.

Outlays. Technical reestimates have had mixed effects on projected spending for both discretionary and mandatory programs since last January. For example, lower projections of Medicare enrollment have reduced expected outlays for that program over the 2002-2011 period by $96 billion. However, the largest change attributed to technical reestimates is the additional debt-service costs resulting from technical revisions—a $207 billion increase over the 2002-2011 period.

The Outlook for Federal Debt

Federal debt consists of two main components: 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. Debt held by government accounts is purely an intragovernmental IOU and involves no cash transactions. It is used as an accounting device to track cash flows relating to specific federal programs.

Debt held by the public and debt held by government accounts follow different paths in CBO's baseline. The holdings of government accounts have risen steadily for several decades and are expected to continue doing so. Debt held by the public, in contrast, fluctuates according to changes in the government's borrowing needs. After falling since 1998, publicly held debt is projected to increase in 2002 and 2003 and decline again thereafter (see Table 1-4). If current policies remain the same (and the tax cuts in EGTRRA expire as scheduled), debt will fall to 7.4 percent of GDP by 2012. Even before the expiration of EGTRRA, debt held by the public is projected to decline to 14.8 percent of GDP in 2010.

Debt Held by the Public

When revenues are insufficient to cover spending, the Department of the Treasury raises money by selling securities in the capital markets to investors. Debt held by the public represents the accumulation of those sales. For example, between 1969 and 1997, the Treasury sold debt to finance deficits, and debt held by the public climbed each year, peaking at $3.8 trillion in 1997. That trend reversed in 1998 with the onset of surpluses. By the end of 2001, debt held by the public had dropped by $453 billion, to $3.3 trillion. As a percentage of GDP, publicly held debt

Table 1-4.
CBO's Baseline Projections of Federal Debt (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Debt Held by the Public at the Beginning of the Year	3,410	3,320	3,380	3,410	3,373	3,288	3,177	3,027	2,840	2,605	2,325	1,900
Changes to Debt Held by the Public												
Surplus (-) or deficit	-127	21	14	-54	-103	-128	-166	-202	-250	-294	-439	-641
Other means of financing	37	39	16	16	18	17	16	16	15	15	14	14
Total	-90	60	31	-37	-86	-111	-150	-187	-235	-279	-425	-627
Debt Held by the Public at the End of the Year	3,320	3,380	3,410	3,373	3,288	3,177	3,027	2,840	2,605	2,325	1,900	1,273
Debt Held by Government Accounts												
Social Security	1,170	1,333	1,512	1,707	1,919	2,145	2,387	2,645	2,919	3,209	3,517	3,838
Other government accounts[a]	1,282	1,330	1,411	1,512	1,626	1,746	1,868	1,993	2,120	2,252	2,388	2,533
Total	2,452	2,664	2,923	3,219	3,544	3,891	4,256	4,638	5,039	5,461	5,905	6,372
Gross Federal Debt	5,772	6,043	6,334	6,592	6,832	7,068	7,282	7,478	7,644	7,786	7,805	7,645
Debt Subject to Limit[b]	5,733	6,004	6,299	6,563	6,808	7,044	7,259	7,455	7,622	7,764	7,783	7,624
Memorandum:												
Debt Held by the Public at the End of the Year as a Percentage of GDP	32.7	32.8	31.3	29.2	27.0	24.8	22.5	20.0	17.5	14.8	11.5	7.4

SOURCE: Congressional Budget Office.

a. Mainly the Civil Service Retirement, Military Retirement, Medicare, and Unemployment Insurance Trust Funds.

b. Differs from gross federal debt primarily because it excludes most debt issued by agencies other than the Treasury. The current debt limit is $5,950 billion.

(which had reached 50 percent as recently as 1993) had fallen to less than 33 percent by 2001.

Under current tax and spending policies, CBO's baseline projects that the recent steady decline in debt held by the public will be interrupted briefly as emerging deficits necessitate additional borrowing in 2002 and 2003. Publicly held debt is projected to begin falling again in 2004 under current policies, by amounts roughly equal to the size of future surpluses. It is projected to total less than $1.3 trillion (7.4 percent of GDP) by the end of 2012.

The Composition of Debt Held by the Public. About 85 percent of publicly held debt consists of marketable securities, such as Treasury bills, notes, and bonds and inflation-indexed notes and bonds. The remainder of that debt comprises nonmarketable securities (such as savings bonds and state and local government securities), which are nonnegotiable, nontransferable debt instruments issued to specific investors.

The Treasury sells marketable securities in regularly scheduled auctions, although the size of those auctions varies according to fluctuations in the government's cash flow. For some time, the Treasury has been shifting its borrowing toward shorter-term bills and notes. For example, it recently introduced a four-week bill and eliminated the 30-year bond. As a result, the Treasury securities sold to the public now range in maturity from one month to 10 years. Those changes may alter the composition of outstanding public debt in the future. However, the trend toward shorter-term securities may be offset to some extent if the Treasury curtails its recent program of buying back bonds before they reach maturity.

Why Changes in Debt Held by the Public Do Not Equal the Size of Surpluses and Deficits. In most years, the amount that the Treasury borrows or redeems approximates the total surplus or deficit. However, a number of factors broadly labeled "other means of financing" also affect the government's need to borrow money from the public. Through the projection period, public debt is expected to increase by more than the amount of deficits—and decrease by less than the amount of surpluses—as other means of financing activities increase the Treasury's borrowing needs.

In most years, the largest component of other means of financing is the capitalization of financing accounts used for federal credit programs. (In 2001, that component accounted for three-fifths of the total for other means of financing.) Direct student loans, rural housing programs, loans by the Small Business Administration, and other credit programs require the government to disburse money in anticipation of repayment at a later date. Those initial outlays are not counted in the budget, which reflects only the estimated subsidy costs of such programs. For the 10 years of CBO's current baseline, the amount of the loans being disbursed is typically larger than the repayments and interest. Thus, the government's annual borrowing needs are $11 billion to $17 billion greater than the annual budget surplus or deficit would indicate.

In 2001, other means of financing led to a net rise in borrowing of $37 billion, about $23 billion more than in 2000. That change largely resulted from higher-than-average increases in a host of financing activities, including premiums paid in the Treasury's bond buyback program, reestimates of subsidies for federal credit programs, payments to the International Monetary Fund, and cash balances held in commercial banks as compensation for financial services. CBO does not expect most of those higher-than-usual increases to recur in future years.

In 2002, other means of financing are projected to boost borrowing by $39 billion, about $20 billion more than in the other years of the projection period. Approximately $16 billion of that increase reflects the initial purchase of private securities by the National Railroad Retirement Investment Trust. (For more information about that new entity, see Box 4-3 in Chapter 4.) The rest of the increase is largely attributable to premiums paid in the bond buyback program, which CBO expects to be scaled back after 2002.

Debt Held by Government Accounts

In addition to the securities it sells to the public, the Treasury has issued about $2.5 trillion in securities to various federal government accounts. All of the major trust funds and many other government funds invest in special, nonmarketable Treasury securities known as the government account series. In practical terms, those securities represent credits to the various government accounts and are redeemed when funds are needed to pay benefits and other expenses. 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. Because those transactions and the interest accrued on them are intragovernmental, they have no direct effect on the economy. The largest balances of such debt are in the Social Security trust funds (nearly $1.2 trillion at the end of 2001) and the retirement funds for federal civilian employees ($543 billion). The balance of the Social Security trust funds is projected to rise to $3.8 trillion by 2012 and the balance of all federal trust funds to more than $5.9 trillion (see Table 1-5).

Gross Federal Debt and Debt Subject to Limit

Gross federal debt and its companion measure, debt subject to limit, include debt issued to government accounts as well as debt held by the public. The future path of gross federal debt will be determined by the interaction of those two components. In CBO's

Table 1-5.
CBO's Baseline Projections of Trust Fund Balances at the End of the Year (In billions of dollars)

Trust Funds	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Social Security	1,170	1,333	1,512	1,707	1,919	2,145	2,387	2,645	2,919	3,209	3,517	3,838
Medicare	239	273	307	346	383	425	467	510	551	592	633	677
Military Retirement	157	165	173	181	190	199	209	219	230	242	256	270
Civilian Retirement[a]	543	577	611	646	682	719	756	793	832	871	910	950
Unemployment Insurance	89	74	59	56	64	71	76	78	81	84	88	92
Highway and Airport	38	31	22	14	7	*	-6	-12	-17	-22	-26	-28
Railroad Retirement[b]	27	27	28	29	30	30	31	31	32	32	32	32
Other[c]	74	77	81	84	87	90	93	96	99	102	105	108
Total	2,335	2,558	2,794	3,064	3,362	3,679	4,013	4,362	4,728	5,111	5,514	5,938
Memorandum:												
Railroad Retirement (Non-Treasury holdings)[b]	n.a.	17	17	18	19	19	19	20	20	20	20	20

SOURCE: Congressional Budget Office.

NOTES: * = between zero and $500 million; n.a. = not applicable.

Some government accounts that are not trust funds invest in nonmarketable Treasury securities. Thus, the total trust fund balances shown here differ from the total debt held by government accounts shown in Table 1-4.

a. Includes the Civil Service Retirement, Foreign Service Retirement, and several smaller retirement trust funds.

b. The Railroad Retirement and Survivors' Improvement Act of 2001 established a new entity, the National Railroad Retirement Investment Trust, which will be allowed to invest in non-Treasury securities, such as corporate stocks and bonds. The total balance of the Railroad Retirement trust funds includes both the funds' Treasury and non-Treasury holdings.

c. Primarily trust funds for federal employees' health and life insurance, Superfund, and various veterans' insurance programs.

baseline projections, gross debt increases every year from 2002 to 2012 as the growth of debt held by government accounts outpaces the future redemption of debt held by the public.

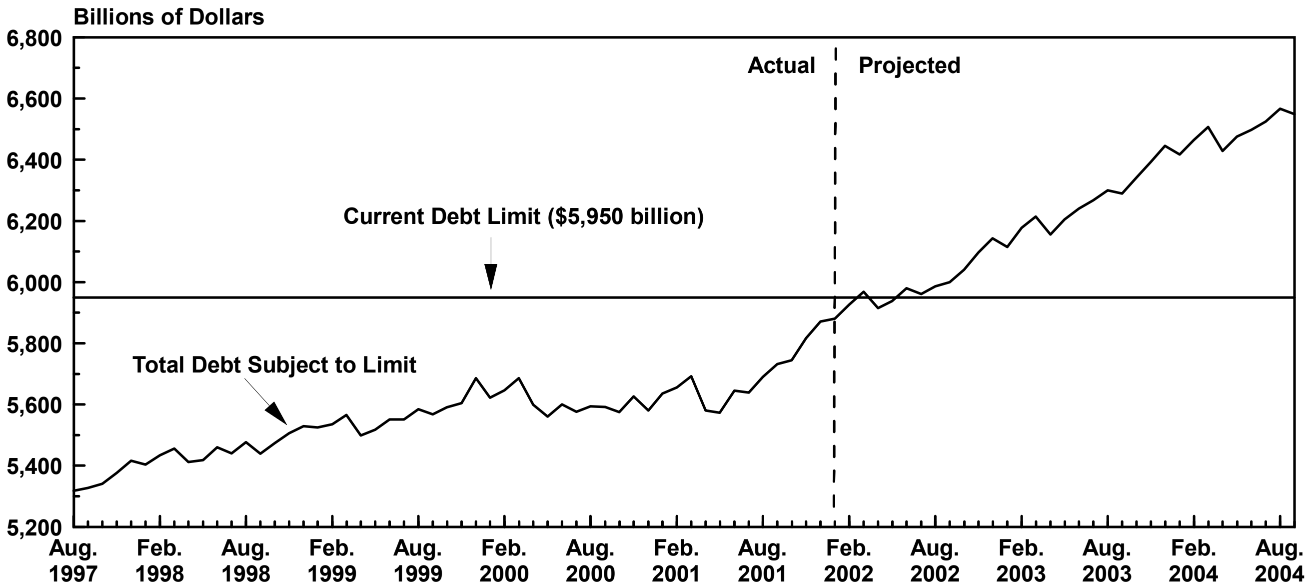
The Treasury's authority to issue debt is restricted by a statutory limit set by the Congress. (The debt subject to limit is nearly identical to gross federal debt, except that it excludes securities issued by agencies other than the Treasury, such as the Tennessee Valley Authority.) The current debt ceiling is $5.95 trillion, enacted in August 1997 (see Figure 1-4). CBO projects that, under current law, debt will exceed that limit sometime this year—possibly as early as March.

Federal Funds and Trust Funds

The budget comprises two groups of funds: trust funds and federal funds. Trust funds are those programs explicitly designated as trust funds in law; federal funds include all other transactions with the public. Over 60 percent of federal spending comes from federal funds.

The federal government has more than 200 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 Trust Fund and the Dis-

Figure 1-4.
Debt Subject to Limit Since August 1997



SOURCE: Congressional Budget Office.

ability Insurance Trust Fund) and those dedicated to Civil Service Retirement, Hospital Insurance (Part A of Medicare), 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 it would have to otherwise 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. In that case, 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 activities on the economy and capital markets. CBO, the Office of Management and Budget (OMB), and other fiscal analysts therefore focus on the total surplus or deficit.

Under current policies, the total deficit is projected to be $21 billion in 2002, which can be divided into a federal funds deficit of $243 billion and a trust fund surplus of $222 billion (see Table 1-6). That division is somewhat misleading, however, because trust funds receive much of their income in the form of transfers from federal funds. Such transfers increase the federal funds deficit and augment the trust fund surplus. Those intragovernmental transfers will total $340 billion in 2002. The largest of them involve interest paid to trust funds on their government securities ($152 billion); transfers of federal funds to Medicare for Hospital Insurance, or Part A ($12 billion), and Supplementary Medical Insurance, or Part B ($81 billion); and contributions by government agencies to retirement funds for their current and former employees ($40 billion). Without accounting for

Table 1-6.
CBO's Baseline Projections of Trust Fund Surpluses (In billions of dollars)

Trust Funds	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Social Security	163	163	179	195	211	227	242	258	274	290	307	322
Medicare												
Hospital Insurance (Part A)	29	33	36	38	38	42	41	40	39	38	37	41
Supplementary Medical Insurance (Part B)	-4	1	-1	*	*	*	2	2	2	3	4	4
Subtotal	25	34	35	38	38	42	42	42	42	41	40	45
Military Retirement	7	8	8	8	9	9	10	10	11	12	13	14
Civilian Retirement[a]	31	34	34	35	36	37	37	38	38	39	39	39
Unemployment Insurance	2	-15	-15	-2	8	7	5	3	3	3	4	4
Highway and Mass Transit	-3	-5	-6	-6	-5	-5	-4	-4	-4	-3	-3	-2
Airport and Airways	1	-2	-3	-2	-2	-2	-2	-2	-1	-1	-1	*
Other[b]	-1	4	23	24	25	27	29	31	33	35	38	40
Total Trust Fund Surplus	224	222	254	290	319	341	359	377	396	416	438	461
Federal Funds Surplus or Deficit (-)	-97	-243	-269	-237	-216	-213	-193	-174	-145	-122	1	180
Total Surplus or Deficit (-)	127	-21	-14	54	103	128	166	202	250	294	439	641
Memorandum:												
Net Transfers from Federal Funds to Trust Funds	350	340	357	382	413	441	477	515	555	597	645	688

SOURCE: Congressional Budget Office.

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

a. Includes the Civil Service Retirement, Foreign Service Retirement, and several smaller retirement trust funds.

b. Primarily trust funds for Railroad Retirement (both Treasury and non-Treasury holdings), federal employees' health and life insurance, Superfund, and various veterans' insurance programs. Beginning in 2003, the category also includes the Department of Defense's Medicare-Eligible Retiree Health Care Fund.

intragovernmental transfers, the trust funds as a whole would run a deficit every year, which would grow from $117 billion in 2002 to $227 billion in 2012.

Because intragovernmental transfers reallocate costs from one part of the budget to another, they 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.

The Expiration of Budget Enforcement Procedures

The rules that have formed the basic framework for budgetary decisionmaking over the past decade are set to expire on September 30, at the end of this fiscal year. Those budget enforcement procedures comprise annual limits on discretionary appropriations and a pay-as-you-go (PAYGO) requirement for new laws that affect mandatory spending or revenues.

They were established by the Budget Enforcement Act of 1990 (BEA) and later extensions.

Lawmakers are facing the issue of whether, or in what form, to continue that framework at a time when the large projected surpluses of recent years are gone. Although, under current policies, the return of deficits is projected to be short-lived, the current projections raise some of the same issues of budgetary constraint and discipline that led lawmakers to adopt the framework in the first place.

A History of Today's Budget Enforcement Procedures

The BEA built on an existing set of budget enforcement procedures. The Balanced Budget and Emergency Deficit Control Act of 1985 established a schedule of fixed, declining targets for the deficit that began in 1986 and led to a target of zero for 1991. That law also created a procedure—known as sequestration—in which spending for many federal programs would be automatically cut if the deficit for a fiscal year was estimated to exceed its target.

Although deficits shrank somewhat in the late 1980s, they failed to meet the statutory targets—in some years by wide margins. As a result of that failure, the BEA was enacted in the fall of 1990 as part of a plan to reduce deficits by an estimated $500 billion over the 1991-1995 period.[8] That law (which amended the Deficit Control Act) established new procedures for deficit control, including annual caps on the budget authority and outlays in appropriation acts and a PAYGO procedure to prevent new laws dealing with mandatory spending or revenues from increasing the deficit. Both of those controls were to be enforced by sequestration: a breach of the discretionary spending caps would lead to reductions in discretionary programs, and a breach of the PAYGO control would trigger cuts in certain mandatory programs. The BEA retained the Deficit Control Act's concept of deficit targets, but it specified that the targets could be adjusted for revisions in economic and technical estimates.

The BEA's procedures were originally set to expire at the end of fiscal year 1995. But the Congress has periodically extended them, most recently in the Balanced Budget Act of 1997. Currently, the major provisions of the BEA are set to end on September 30, 2002. Those provisions include the discretionary spending limits and related sequestration procedures (set out in section 251 of the Deficit Control Act) and the process for tracking the costs of legislation covered by the PAYGO requirement (under section 252 of the Deficit Control Act).[9]

Evaluating the Budget Enforcement Act

According to its proponents, the BEA helped provide budgetary discipline for most of the 1990s. From 1991 to 1997, total discretionary outlays grew much more slowly than the rate of inflation (principally because of significant cuts in defense spending after the Cold War). During the same period, new mandatory spending and revenue laws covered by the PAYGO requirement were estimated to reduce net deficits.[10] Since enactment of the BEA, only two small sequestrations of discretionary spending have been ordered, both in 1991.

Beginning in 1998, however, the fiscal environment changed. Large and growing surpluses began to emerge that year. In a time of surpluses, the discretionary spending caps and PAYGO requirement

8. The BEA was enacted as title XIII of the Omnibus Budget Reconciliation Act of 1990.

9. Section 252, which sets out the PAYGO procedure, does not expire at the end of 2002. After that time, however, OMB and CBO will no longer be required to track the budgetary effects of new mandatory spending and revenue laws for the purpose of enforcing the PAYGO requirement. That tracking—known as the PAYGO scorecard—generally records the five-year budgetary effects of all laws covered by the PAYGO requirement. The termination of that tracking will effectively shut down the PAYGO system for new laws. However, because section 252 itself does not expire, the possibility of a sequestration of mandatory spending would continue through fiscal year 2006 (the year that section 252 and other remaining provisions of part C of the Deficit Control Act will expire) for PAYGO legislation enacted before the end of fiscal year 2002. Thus, any sequestrations after 2002 would occur solely on the basis of the net costs from legislation enacted before the end of 2002.

10. PAYGO estimates and calculations for that period exclude the budgetary effects of the Omnibus Budget Reconciliation Act of 1993, the Balanced Budget Act of 1997, and the Taxpayer Relief Act of 1997. Those laws, which combined were estimated to reduce deficits, included provisions that prohibited their budgetary effects from being counted on the PAYGO scorecard.

(when enforced) generally bar legislative actions that would diminish projected surpluses.

As surpluses grew to record-setting levels, those procedures (as extended in 1997) were often circumvented. For example, in 1999 and 2000, lawmakers enacted record levels of emergency appropriations—which are effectively exempt from the budget enforcement procedures—and used advance appropriations, obligation delays, timing shifts, and other funding devices to increase discretionary spending well above the caps set in 1997. For 2001 and 2002, lawmakers set new, higher caps to accommodate substantial increases in total discretionary spending.[11] They also eliminated PAYGO balances for those years, removing the need to offset estimated costs of about $11 billion in 2001 and $130 billion in 2002 caused by new mandatory spending and tax laws enacted during the past two years.

Despite recent experience, however, the underlying philosophy of the Budget Enforcement Act—that appropriations should be enacted within enforceable limits and that the estimated costs of new mandatory spending and tax legislation should generally be offset—has proved to be effective in the past. Now, with deficits or small surpluses on the horizon for the next few years, lawmakers may decide that such discipline can again contribute to overall budgetary restraint.

11. The caps for the discretionary category were raised as part of the Congress's final action on regular appropriation acts for 2001 and 2002. The new outlay cap for 2001 was about $60 billion higher than the one for that year set in 1997 (as adjusted). The new outlay cap for 2002 was about $130 billion higher than the comparable 1997 cap (as adjusted).