Chapter Four

The Spending Outlook

Federal spending totaled nearly $1.9 trillion in 2001—a 4.2 percent increase from 2000. In 2002, the Congressional Budget Office projects, spending will grow by 7.5 percent if current policies remain unchanged. Such an increase would be the largest since 1990, when there was a sizable jump in spending because of the savings and loan crisis. Excluding net interest (which has been declining in recent years), spending increased by 5.9 percent between 2000 and 2001 and is expected to climb by 10.6 percent from 2001 to 2002.

Recently enacted legislation, by increasing appropriations for both defense and nondefense activities, contributes to the substantial rise in the rate of growth in spending this year. On the basis of legislation enacted to date, CBO estimates that discretionary budget authority will increase by 7.4 percent from the 2001 level; discretionary outlays will grow by 12.8 percent. Driving that jump in outlays are the rapid increases in budget authority provided over the past couple of years and the spending of the emergency appropriations related to the September 11 attacks. Similarly, the Economic Growth and Tax Relief Reconciliation Act of 2001, which expanded the child tax credit, adds more than $4 billion in outlays in 2002 for the refundable portion of that credit.

Economic weakness will also contribute to higher spending in 2002. The recession and its aftermath are expected to push the unemployment rate to 6.2 percent by mid-2002. As a result, unemployment compensation is anticipated to soar by 67 percent from the level recorded in 2001. As more people become unemployed, participation in other support programs, such as Food Stamps, also increases. (Spending on Food Stamps is projected to rise by 19 percent this year.)

CBO projects that without enactment of further legislation, the rate of growth in spending will moderate to an average of 3.8 percent a year over the next 10 years. Total spending in CBOís baseline rises from $2.0 trillion in 2002 to $2.9 trillion in 2012. (See Tables 4-1 and 4-2.)

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

- *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 which activities. Certain fees and other charges that are triggered by appropriation action are classified as offsetting collections, which offset discretionary spending. CBOís baseline depicts the path of discretionary spending in accordance with the Balanced Budget and Emergency Deficit Control Act of 1985, which states that current spending (for this report, appropriations provided for fiscal year 2002) should be assumed to grow with inflation in the future.[1]

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 gross domestic product deflator (for other expenditures).

Table 4-1.
CBO's Baseline Projections of Outlays

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
							In Billions of Dollars							
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
							As a Percentage of GDP							
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
Memorandum:														
Gross Domestic Product (Billions of dollars)	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

SOURCE: Congressional Budget Office.

- *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 appropriating specific 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.

- *Offsetting receipts*—fees and other charges that are recorded as negative budget authority and outlays—are collected without annual appropriation action. 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).

- *Net interest*—which includes interest paid on Treasury securities and other interest that the government pays (for example, on late refunds issued by the Internal Revenue Service) minus 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 or deficits, and market interest rates.

The mix of federal spending has changed significantly over time. Today, the government spends less—as a proportion of GDP—on discretionary activities and more on entitlement programs than it did in the past. Discretionary spending fell from 12.7 percent of GDP in 1962 to 6.4 percent in 2001 (see Figure 4-1). Over that period, spending on entitlements

Table 4-2.
Average Annual Rate of Growth in Outlays (In percent)

	1991-1996	1996-2001	2000-2001	Estimated 2001-2002	Projected[a] 2002-2012
Discretionary	*	4.0	5.6	12.8	2.7
Defense	-3.6	2.8	3.8	14.8	2.3
Nondefense	4.5	5.2	7.3	11.0	3.0
Mandatory	5.7	5.1	6.1	9.1	5.4
Social Security	5.4	4.3	5.7	5.0	5.5
Medicare	10.9	4.5	10.1	4.9	7.2
Medicaid	11.9	7.2	11.1	9.5	8.5
Other[b]	-0.8	6.1	-0.2	22.1[c]	0.5
Net Interest	4.4	-3.1	-7.6	-17.4	-5.9
Total Outlays	3.3	3.6	4.2	7.5	3.8
Total Outlays Excluding Net Interest	3.2	4.7	5.9	10.6	4.4
Memorandum:					
Consumer Price Index	2.8	2.5	3.3	1.8	2.5
Nominal GDP	5.4	5.7	4.1	1.6	5.3
Discretionary Budget Authority	1.7	5.7	13.2	7.4	2.6
Defense	-4.4	4.5	10.0	5.1	2.6
Nondefense	2.0	7.0	16.7	9.7	2.6

SOURCE: Congressional Budget Office.

NOTE: * = between -0.05 percent and zero.

a. As specified by the Deficit Control Act, CBO's baseline incorporates as inflation rates the employment cost index for wages and salaries (for expenditures related to federal personnel) and the GDP deflator (for other expenditures).

b. Includes offsetting receipts.

c. Contributing to the increase from 2001 to 2002 is an estimated jump of 67 percent in unemployment compensation, an increase of 19 percent for Food Stamps, and a $4 billion increase for the child tax credit.

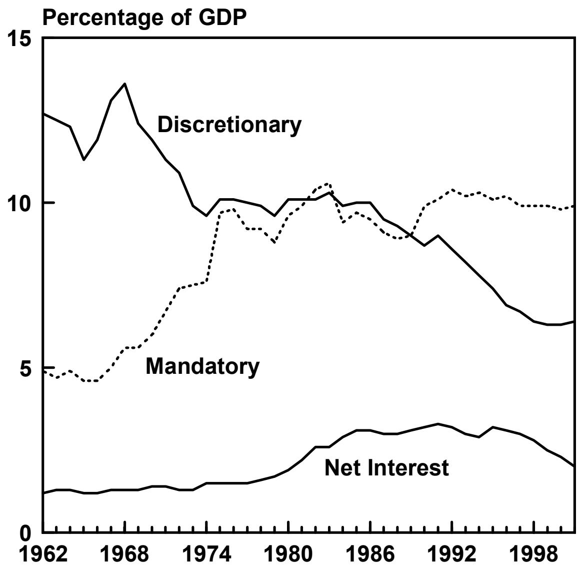
and other mandatory programs (net of offsetting receipts) increased from 4.9 percent to 9.9 percent of GDP. (For detailed annual data on spending since 1962, see Appendix F.)

According to CBO's baseline, discretionary outlays will grow about half as fast as the economy, at an average annual rate of 2.7 percent, from 2002 to 2012. Led by the two major health care programs, Medicare and Medicaid, mandatory spending (net of offsetting receipts) will grow slightly faster than the economy—at a rate of 5.4 percent—if current policies remain unchanged. At that rate, mandatory spending (net of offsetting receipts) will climb to 10.8 percent of GDP by 2012. Although interest payments currently consume a sizable portion of the federal budget, CBO projects that, with a shrinking amount of debt held by the public, such spending will decline from 2.0 percent of GDP in 2001 to 0.5 percent of GDP in 2012.

Discretionary Spending

Each year, the Congress starts the appropriation process anew. The annual appropriation acts that it

Figure 4-1.
Major Components of Spending, 1962-2001



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

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.

Recent Trends in Discretionary Spending

As a share of GDP, discretionary spending has dropped from 9.0 percent in 1991 to 6.4 percent in 2001 (see Table 4-3). The figures for total discretionary spending, however, mask large programmatic shifts that occurred between 1991 and 1996—defense spending declined from $320 billion to $266 billion, while nondefense spending increased from $214 billion to $267 billion. Between 1996 and 2001, defense outlays grew at an average rate of 2.8 percent a year, compared with a 5.2 percent rate for nondefense spending. In 2001, defense and nondefense outlays were $306 billion and $343 billion, respectively. Although spending for nondefense programs has outstripped that for defense, growth in the economy has been greater still. As a result, at the end of 2001, nondefense spending was below its 1991 level as a percentage of GDP. (For additional information on the growth in nondefense outlays, see Box 4-1.)

For 2002, CBO estimates that defense spending will rise to $351 billion and nondefense outlays will reach $381 billion. Total discretionary outlays, CBO expects, will increase by $84 billion (12.8 percent) from their level in 2001—a much faster rise than experienced in the 1990s. Emergency appropriations related to the September 11 attacks will generate about one-quarter of that growth. (For additional information on those appropriations, see Box 4-2.) Increased budget authority provided for 2002 and spending in the pipeline from appropriations before 2002 will account for the remainder.

Discretionary Spending for 2003 to 2012

CBO's projections should be viewed not as a prediction of future outcomes but rather as a reference point for assessing policy changes, in part because, as specified in the Deficit Control Act, CBO inflates discretionary budget authority from the level appropriated in the current year (in this case, 2002). In CBO's baseline, discretionary outlays reach $953 billion in 2012. The economy, however, is projected to continue growing faster than the baseline for such spending; as a result, discretionary outlays decline as a percentage of GDP from 7.1 percent in 2002 to 5.5 percent in 2012.

Because the size of projected deficits and surpluses is sensitive to assumptions about discretionary spending, CBO has prepared four alternative scenarios for such spending during the 2003-2012 period. One scenario assumes that budget authority grows at the same rate as nominal GDP after 2002 (5.3 percent a year, on average, compared with the 2.6 percent rate of growth assumed in the baseline). That assumption would cause discretionary outlays to be $1.2 trillion higher than the baseline figures over the 10-year period (see Table 4-4 on page 74). If budget authority increased even more rapidly—at the average annual rate of growth recorded between 1998 and

Table 4-3.
Defense and Nondefense Discretionary Outlays, 1991-2002

	Defense Outlays		Nondefense Outlays		Total Discretionary Outlays	
	In Billions of Dollars	As a Percentage of GDP	In Billions of Dollars	As a Percentage of GDP	In Billions of Dollars	As a Percentage of GDP
1991	320	5.4	214	3.6	533	9.0
1992	303	4.9	231	3.7	534	8.6
1993	292	4.5	247	3.8	539	8.2
1994	282	4.1	259	3.7	541	7.8
1995	274	3.7	271	3.7	545	7.4
1996	266	3.5	267	3.5	533	6.9
1997	272	3.3	276	3.4	547	6.7
1998	270	3.1	282	3.2	552	6.4
1999	275	3.0	297	3.2	572	6.3
2000	295	3.0	320	3.3	615	6.3
2001	306	3.0	343	3.4	649	6.4
2002[a]	351	3.4	381	3.7	733	7.1

SOURCES: Office of Management and Budget for 1991 through 2001 and Congressional Budget Office for 2002.

a. Estimated.

2002 (7.6 percent)—discretionary outlays would exceed the baseline figures by a cumulative $2.3 trillion. A third scenario does not inflate the $20 billion of emergency appropriations provided in Public Law 107-117 for 2002, but it assumes that all other budget authority grows at the baseline rates from 2003 to 2012.[2] Under that assumption, discretionary outlays over the 10-year period would be $0.2 trillion lower than the baseline figures. A fourth scenario assumes that budget authority is essentially frozen at the dollar level enacted for 2002. Under that assumption, discretionary outlays over the 2003-2012 period would total $1.0 trillion less than those in the baseline.

2. In September 2001, the 2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States (P.L. 107-38) provided $40 billion of budget authority—$20 billion in 2001 and a second $20 billion that could be obligated only though subsequent legislation. In December 2001, enactment of the Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002 (P.L. 107-117), made the second $20 billion available; as part of current-year appropriations, that amount is extended throughout the 10-year baseline period.

Entitlements and Other Mandatory Spending

Currently, more than half of the $2 trillion that the federal government spends each year supports entitlement programs and other types of mandatory spending (not including 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 generally are not constrained by annual appropriation acts.

As a share of total outlays, mandatory spending steadily increased from 32 percent in 1962 to 59 percent in 2001. If current policies remain unchanged, mandatory spending will continue to grow faster than other spending, reaching 70 percent of total outlays in 2012, CBO estimates. Among the largest mandatory programs are Social Security, Medicare, and Medicaid, which together accounted for over 72 percent of mandatory spending in 2001 and are projected

Box 4-1.
The Growth in Nondefense Discretionary Outlays

To focus on the increases in nondefense discretionary outlays since the emergence of a surplus in 1998, the Congressional Budget Office (CBO) examined such spending for the four-year periods before and after that year—for 1994 through 1998 and for 1998 through 2002 (which encompasses one year of CBO's estimates). Over the first period, nondefense discretionary outlays grew at an average annual rate of about 2 percent; for the second period, CBO estimates a growth rate of approximately 8 percent. All budget functions except one show increases in outlays over the second period. In 2002, the following four categories will account for about half of nondefense discretionary outlays (up from 45 percent in 1998).

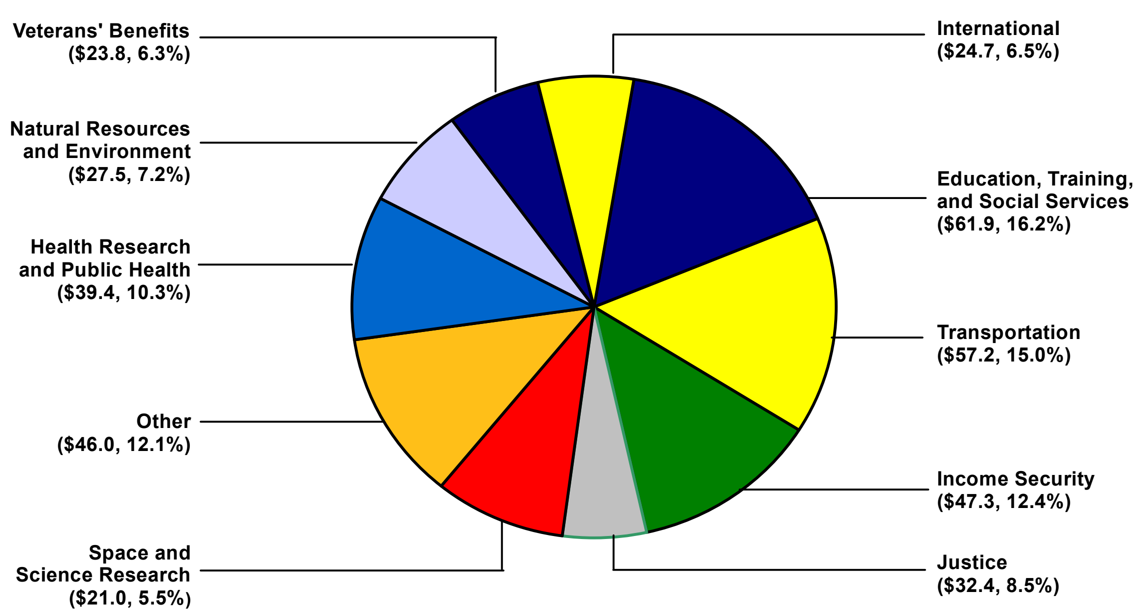
The education, training, and social services category will claim 16 percent of nondefense discretionary outlays in 2002, CBO expects (see the figure below). That budget function includes all federal programs related to education and employment as well as social services for children, families, the elderly, and disabled people. From 1994 through 1998, spending for the category grew at an average annual rate of about 3 percent. For the second period, CBO estimates that rate to be nearly 10 percent; much of that growth results from increased spending for education.

Transportation (ground, air, and water) will account for 15 percent of nondefense discretionary outlays in 2002, CBO estimates. For 1994 through 1998, transportation spending grew slowly, at an average annual rate of less than 2 percent; but for 1998 through 2002, CBO estimates a growth rate of almost 11 percent. Outlays for ground transportation have been the largest contributor to that growth, spurred by the Transportation Equity Act for the 21st Century (Public Law 105-178).

According to CBO's projections, health research and public health expenditures will make up more than 10 percent of nondefense discretionary outlays in 2002. For 1998 through 2002, CBO estimates an average annual rate of growth in spending for the category that is more than double the rate for the previous period. Fueling such growth are additional grants and contracts to research diseases and promote disease-prevention programs awarded by the Health Resources and Services Administration and the National Institutes of Health.

Since the mid-1990s, the federal government has stepped up its funding for the administration of justice at an average annual rate of more than 10 percent. Most of the increases have been devoted to correctional activities and law enforcement agencies, such as the Federal Bureau of Investigation, the Immigration and Naturalization Service, and the Customs Service. For 2002, CBO projects that the category will account for almost 9 percent of nondefense discretionary outlays.

Nondefense Discretionary Spending, by Budget Function, 2002
(In billions of dollars and percent)



Box 4-2.
$40 Billion of Emergency Discretionary Appropriations for 2001 and 2002

Responding to the events of September 11, the 2001 Emergency Supplemental Appropriations Act for Recovery from and Response to Terrorist Attacks on the United States (P.L. 107-38) provided $40 billion for disaster recovery and homeland security. That law stipulated, however, that half of the funds could not be obligated until subsequent legislation was enacted; the Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002 (P.L. 107-117), made the second $20 billion available.

From the first $20 billion, the Department of Defense (DoD) obtained more than any other agency, about $14 billion of budget authority; the Federal Emergency Management Agency's (FEMA's) disaster relief program received the next largest amount, $2 billion. Because P.L. 107-38 was enacted near the end of fiscal year 2001, CBO estimates that only $131 million of outlays from it occurred in 2001. The majority of the outlays will be recorded in 2002 (see the table below).

Of the second $20 billion, less than $4 billion was alloted to DoD; the remaining $16 billion was for combating terrorism, improving homeland security, providing aid, and promoting recovery. CBO estimates that the second $20 billion will result in outlays of $8 billion in 2002, about $5 billion in 2003, and the remainder in subsequent years.

Altogether, a little more than half of the $40 billion was provided to nondefense agencies. The largest amounts went to FEMA ($6.6 billion), the Department of Health and Human Services ($2.9 billion), the Department of Housing and Urban Development ($2.7 billion), and the Department of Justice ($2.2 billion).

In accordance with the Deficit Control Act, CBO's baseline projects budget authority by inflating the level appropriated for 2002. Because the first $20 billion was provided for 2001, its budget authority is not inflated, but the resulting outlays are included in the baseline. However, because the second $20 billion was provided for 2002, its budget authority is inflated through 2012 in the baseline.

Table 4-4 shows an alternative path of spending that excludes the second $20 billion from total discretionary budget authority from 2003 through 2012. Chapter 7 describes how much is being spent for homeland security, including a detailed breakout of the $40 billion of emergency appropriations (see Table 7-4 on page 117).

$40 Billion of Emergency Discretionary Appropriations, by Type of Spending (In billions of dollars)

	2001	2002	2003	2004 and Beyond	Total, 2001-2012
Defense					
Budget authority	14	4	0	0	18
Outlays	*	13	3	1	18
Nondefense					
Budget authority	6	16	0	0	22
Outlays	*	9	6	8	22
Total					
Budget authority	20	20	0	0	40
Outlays	*	21	9	9	40

SOURCE: Congressional Budget Office.

NOTE: * = less than $500 million.

Table 4-4.
CBO's Projections of Discretionary Spending Under Alternative Paths (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Baseline (Discretionary Spending Grows at the Rate of Inflation After 2002)[a]														
Budget Authority														
Defense	331	348	357	367	376	386	396	406	417	428	439	451	1,881	4,022
Nondefense	331	363	376	385	394	404	414	425	436	447	459	470	1,973	4,211
Total	662	711	733	751	770	790	810	831	853	875	898	921	3,854	8,233
Outlays														
Defense[b]	306	351	356	363	375	381	387	401	411	422	437	441	1,862	3,974
Nondefense	343	381	408	421	433	443	454	465	476	488	500	512	2,159	4,600
Total	649	733	764	784	808	824	841	866	888	910	937	953	4,021	8,575
Discretionary Spending Grows at the Rate of Nominal Gross Domestic Product After 2002														
Budget Authority														
Defense	331	348	367	389	410	431	454	477	502	528	555	584	2,050	4,697
Nondefense	331	363	385	408	429	451	474	498	524	551	579	609	2,146	4,907
Total	662	711	752	796	838	882	928	976	1,027	1,079	1,134	1,192	4,195	9,604
Outlays														
Defense[b]	306	351	362	380	403	421	439	465	490	515	545	565	2,005	4,586
Nondefense	343	381	413	436	458	481	504	528	553	580	607	636	2,292	5,196
Total	649	733	775	816	861	901	943	993	1,043	1,095	1,153	1,201	4,297	9,782
Discretionary Spending Increases at the Average Annual Rate of Growth from 1998 through 2002 (7.6 percent)														
Budget Authority														
Defense	331	348	374	403	433	466	502	540	581	626	673	725	2,178	5,323
Nondefense	331	363	392	420	452	485	522	561	604	649	698	751	2,271	5,535
Total	662	711	766	823	885	952	1,024	1,101	1,185	1,275	1,372	1,476	4,449	10,858
Outlays														
Defense[b]	306	351	367	391	423	451	481	521	561	604	654	695	2,113	5,147
Nondefense	343	381	416	445	475	507	542	580	620	664	711	761	2,385	5,721
Total	649	733	783	836	897	958	1,023	1,101	1,181	1,268	1,364	1,456	4,498	10,868
Discretionary Spending Excluding the Extension of Supplemental Appropriations for 2002 Grows at the Rate of Inflation After 2002[a,c]														
Budget Authority														
Defense	331	348	353	362	372	381	391	402	413	423	434	446	1,860	3,978
Nondefense	331	363	359	368	377	386	396	406	417	428	439	450	1,886	4,026
Total	662	711	712	730	749	768	788	808	829	851	873	896	3,747	8,004
Outlays														
Defense[b]	306	351	353	359	371	377	383	396	407	418	432	436	1,843	3,932
Nondefense	343	381	402	411	419	427	437	447	458	469	481	492	2,096	4,442
Total	649	733	755	770	790	804	820	843	865	887	913	928	3,939	8,374

(Continued)

Table 4-4.
Continued

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Discretionary Spending Is Frozen at the Level Enacted for 2002														
Budget Authority														
Defense	331	348	348	348	348	348	348	348	348	348	348	348	1,738	3,476
Nondefense	331	363	364	363	363	363	363	363	363	363	363	363	1,817	3,632
Total	662	711	712	711	711	711	711	711	711	711	711	711	3,555	7,108
Outlays														
Defense[b]	306	351	349	348	350	347	344	347	347	347	350	344	1,738	3,471
Nondefense	343	381	402	408	409	410	408	406	406	406	405	404	2,037	4,063
Total	649	733	751	755	760	757	751	753	753	752	754	748	3,774	7,534
Memorandum:														
Debt Service on Differences from Baseline														
Growth at rate of nominal GDP	0	0	*	1	4	8	13	20	29	40	53	68	26	235
Growth at annual average from 1998 through 2002	0	0	*	2	6	13	22	35	51	72	97	128	44	426
Growth excluding $20 billion	0	0	*	-1	-2	-3	-4	-6	-7	-9	-11	-13	-10	-55
Frozen at the 2002 level	0	0	*	-1	-4	-7	-12	-18	-26	-35	-46	-59	-24	-208

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 Airways 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 why 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 (the GDP deflator and the employment cost index for wages and salaries).

b. When October 1 falls on a weekend, certain federal payments due on that date are shifted into September; consequently, military personnel will be paid 13 times in 2005 and 2011 and 11 times in 2007 and 2012.

c. The Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002 (P.L. 107-117), provided $20 billion of supplemental budget authority for 2002. This scenario does not inflate that emergency appropriation from 2003 through 2012 but includes the outlays resulting from it.

to reach almost 79 percent of mandatory spending in 2012.

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 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. Between 1995 and 2000, means-tested outlays declined slightly as a share of GDP, measuring 2.4 percent in 2000. They increased to 2.5 percent in 2001, and CBO projects such outlays to climb to 2.7 percent in 2002. Changes in spending for means-tested programs are driven by several factors, including inflation, rising health care costs, fluctuating unemployment, growth of the eligible populations, and new legislation. CBO projects that spending for means-tested programs will grow more rapidly than the economy over the next 10 years—largely because of Medicaid's growth—climbing to 2.8 percent of GDP in 2012.

Medicaid. Outlays for Medicaid, the joint federal/state program that pays for the medical care of many of the nation's poor people, made up over half of all spending for means-tested entitlements in 2001 (see Table 4-5). Spending grew by 11.1 percent, marking the fifth consecutive year that spending growth in the program accelerated. The spending increase in 2001 resulted from a combination of higher prices and rising enrollment and utilization. Most notably, spending on outpatient prescription drugs jumped by 19 percent (after rising by 18 percent in 1999 and 22 percent in 2000). State and federal actions in recent years to expand eligibility and benefits, increase payment rates to providers, and conduct outreach have increased both enrollment and costs. States also expanded their use of financing mechanisms related to Medicare's upper payment limit (UPL) that generate additional federal payments.[3]

In 2002, spending for Medicaid will increase by 9.5 percent, CBO estimates—reflecting higher costs for prescription drugs, additional enrollment of children and adults resulting from rising unemployment, and states' continuing use of their UPL financing mechanisms. For 2003, CBO projects, spending growth will dip to 6.5 percent because a provision allowing "transitional eligibility" expires[4] and because restrictions that take effect will limit both UPL spending and payments to hospitals that serve a large number of Medicaid beneficiaries or other low-income people.

Over the next decade, Medicaid spending is projected to grow more rapidly than spending for other means-tested programs. Higher prices, greater consumption of services, and, to a lesser extent, higher enrollment will continue putting upward pressure on Medicaid costs—pushing outlays from $143 billion in 2002 to $323 billion in 2012—an average annual increase of 8.5 percent (see Figure 4-2). Spending for acute care services, which includes payments to managed care plans and payments for prescription drugs, accounts for more than half of all Medicaid outlays and is the most rapidly growing component of the program. Acute care spending is anticipated to grow from $76 billion in 2002 to $188 billion in 2012. Spending for long-term care, which accounts for about one-third of all Medicaid spending, is also expected to grow rapidly, climbing from $42 billion in 2002 to $98 billion in 2012, as states expand eligibility for home- and community-based services in response to legal challenges under the Americans with Disabilities Act.

3. The UPL is a regulatory ceiling in Medicaid's payment policy that prohibits states from paying certain groups of facilities more than they would under Medicare's rules. However, many states use particular financing mechanisms to pay certain public facilities at rates far above Medicaid's normal rates, but below Medicare's upper payment limit, and then receive federal matching funds for those payments. Those public facilities return the excess to the states, and the states then retain the additional funds from the federal match.

4. Medicaid allows enrollees who have returned to work and would otherwise be ineligible because they now have higher incomes to remain eligible for the program temporarily for the transitional period. Under current law, the provision is set to expire at the end of 2002.

Table 4-5.
CBO's Baseline Projections of Mandatory Spending (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Means-Tested Programs														
Medicaid	130	143	152	164	179	194	211	230	250	272	296	323	900	2,271
State Children's Health Insurance	3	4	4	5	5	5	5	5	5	5	5	5	23	50
Food Stamps	19	23	24	24	24	25	26	27	27	28	29	30	124	265
Supplemental Security Income	27	31	32	34	38	37	35	40	42	43	49	43	176	393
Family Support[a]	25	25	26	26	25	25	25	25	25	25	26	26	127	253
Veterans' Pensions	3	3	3	3	4	3	3	3	3	3	4	4	16	34
Child Nutrition	10	10	11	11	11	12	12	13	13	14	14	15	57	126
Earned Income and Child Tax Credits	27	33	34	34	34	37	38	38	39	40	43	31	176	367
Student Loans	-1	3	4	4	4	4	4	4	5	4	4	4	20	42
Foster Care	6	6	7	7	7	8	8	8	9	9	9	10	36	81
Total	249	281	297	311	331	349	367	393	417	445	480	491	1,656	3,883
Non-Means-Tested Programs														
Social Security	429	451	470	493	518	545	574	606	642	682	724	771	2,600	6,026
Medicare	238	249	263	279	302	318	346	374	404	435	471	498	1,508	3,690
Subtotal	667	700	733	771	820	863	920	980	1,046	1,117	1,195	1,269	4,108	9,716
Other Retirement and Disability														
Federal civilian[b]	53	56	59	62	65	68	71	75	78	82	86	90	325	737
Military	34	35	36	37	38	39	40	41	42	43	44	45	191	406
Other	5	5	5	5	5	6	6	6	6	6	7	7	27	58
Subtotal	93	97	100	104	108	113	117	122	126	132	137	142	543	1,201
Unemployment Compensation	28	47	50	41	37	38	39	41	43	44	46	48	205	427
Other Programs														
Veterans' benefits[c]	20	25	27	28	31	30	29	32	33	33	37	33	145	312
Department of Defense health care	0	0	6	7	7	8	8	9	10	10	11	12	36	88
Commodity Credit Corporation Fund	22	14	12	10	8	7	7	6	5	5	5	5	44	72
Social services	4	5	5	5	5	5	5	5	5	5	5	5	24	49
Universal Service Fund	5	5	5	5	5	5	6	6	6	6	6	6	27	56
Other	7	16	14	10	8	9	9	9	10	10	10	11	49	100
Subtotal	59	64	68	65	65	64	63	66	68	70	75	73	325	677
Total	847	907	951	981	1,030	1,078	1,140	1,209	1,283	1,364	1,453	1,531	5,181	12,022
Total														
All 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

SOURCE: Congressional Budget Office.

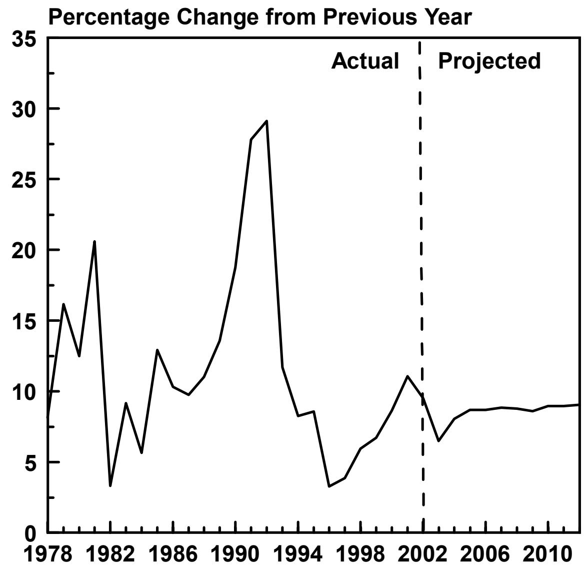
NOTE: The spending for the benefit programs shown above generally excludes administrative costs, which are discretionary. Spending for Medicare also excludes premiums paid by participants, which are considered offsetting receipts.

a. Includes Temporary Assistance for Needy Families and various programs that involve payments to states for child support enforcement and family support, child care entitlements, and research to benefit children.

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.

Figure 4-2.
Annual Growth of Federal Medicaid Outlays, 1978-2012



SOURCE: Congressional Budget Office.

Other Means-Tested Programs. Outlays for other means-tested programs are projected to grow at an average annual rate of 2.0 percent from 2002 through 2012, although two programs will experience significant growth this year. Because of current economic weakness, spending for the Food Stamp program is projected to jump 19 percent in 2002; however, growth will slow thereafter, yielding an average annual rate of 1.7 percent over the next decade. Outlays for refundable tax credits—the earned income tax credit and the refundable portion of the child tax credit—are projected to increase by 21 percent in 2002. Almost all of that jump results from the expansion of the child tax credit contained in the Economic Growth and Tax Relief Reconciliation Act of 2001. Beyond 2002, outlays for refundable tax credits are expected to rise to $43 billion in 2011 before falling to $31 billion in 2012, the first full year after the expanded child tax credit is scheduled to expire.

Although the student loan program is difficult to classify as either means-tested or non-means-tested, CBO includes that program in the former category because historically the majority of loans have had interest subsidies and have been limited to students from families with relatively low income and financial assets. However, in recent years, the fastest-growing category of loans involves no means-testing. For 2002, CBO estimates that about $37 billion in student loans will be guaranteed or provided directly by the federal government. Over the 2002-2012 period, total loan disbursements will top $475 billion. Of that total, the share of loans that are not means-tested will increase from 52 percent in 2002 to 57 percent in 2012.

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 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 $3 billion to $5 billion a year from 2002 through 2012.

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 $451 billion in 2002. It pays benefits to 46 million people—a number that is projected to increase to about 54 million by 2012. Most Social Security beneficiaries also participate in Medicare, which is expected to cost $249 billion in 2002. 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 $569 billion from 2002 to 2012 as the leading edge of the baby-boom generation reaches the age of eligibility. In total, Social Security and Medicare account for more than half of the projected increase in federal outlays over that period

Social Security. During the past decade, Social Security outlays grew by an average of about 4.9 percent a year. For the next 10 years, that figure will average about 5.5 percent a year, CBO projects. By 2012, spending for Social Security will total $771 billion. The share of the economy devoted to it will remain fairly constant at about 4.4 percent of GDP through 2012.

Social Security's Old-Age and Survivors Insurance (OASI) program pays benefits to retired workers, their eligible spouses and children, and to some survivors (chiefly young children and aged widows) of deceased workers. It will pay about $384 billion in benefits in 2002. Most beneficiaries are elderly, and most elderly people collect Social Security: three-fifths of people between the ages of 62 and 64 and more than 90 percent of people 65 and older collect Social Security. Consequently, CBO bases its estimates of the number of beneficiaries and of OASI outlays primarily on the size of the elderly population.

CBO projects that OASI benefits will cost $636 billion in 2012, an increase of 66 percent over the amount in 2002, reflecting an average growth rate of 5.2 percent a year. In contrast, benefits grew by 56 percent in the past decade, at an average rate of 4.5 percent a year. Overall, of that 4.5 percent average annual growth in OASI benefits during the past decade, roughly 2.7 percent can be assigned to cost-of-living adjustments (COLAs), 0.9 percent to increasing enrollment, and 0.9 percent to growth in the average real benefit (in excess of COLAs). For the next decade, CBO expects that the growth in COLAs will slow to 2.4 percent a year, enrollment will grow by 1.4 percent a year, and the average real benefit will increase by 1.2 percent a year.

The smaller Disability Insurance (DI) program pays benefits to insured workers who have suffered a serious medical impairment before they reach retirement age and to their eligible spouses and children. According to CBO's projections, DI benefits will grow even faster than OASI benefits, from $63 billion in 2002 to $130 billion in 2012, at an average rate of 7.6 percent a year. CBO ascribes 3.9 percent of that growth to increasing caseloads; 2.4 percent to COLAs; and 1.1 percent to other factors, chiefly the effect of wage growth on benefits. In the past decade, the average growth rate for the DI program was similar, measuring 8 percent. However, the source of that growth was somewhat different: CBO attributes roughly 5.3 percent to caseloads, 2.7 percent to COLAs, and barely anything to other factors.

Social Security outlays include about $4 billion in mandatory spending other than OASI and DI benefits. Almost all of that reflects an annual transfer to the Railroad Retirement program.

Medicare. Currently, Medicare spending is about 55 percent as large as Social Security spending, but it is expected to grow faster than Social Security spending over the next decade. By 2012, CBO projects, spending for the Medicare program will total more than $498 billion, and Medicare's share of the economy will have risen by about one-half of a percentage point, from 2.4 percent of GDP in 2002 to 2.9 percent.

Partly because of the effects of the Balanced Budget Act of 1997 on payment rates and a strong effort by the federal government to ensure compliance with the program's payment rules, the annual change in Medicare spending fell from almost a 9 percent increase in 1997 to a 1 percent decline in 1999. By the next year, the bulk of the savings had been realized, so in 2000 and 2001 Medicare spending grew by 3 percent and 10 percent, respectively. The acceleration in 2001 reflects large increases in payment rates for many categories of services. In addition, there was a shift into September 2001 of the October payments to Medicare+Choice plans. Without that payment shift, spending in 2001 would have increased by 8.6 percent. CBO projects that Medicare spending will grow by 4.9 percent in 2002—a figure that would have been 7.7 percent without the payment shift. Through 2012, Medicare spending will increase by an average of 7.2 percent per year, CBO estimates.

The projected growth in Medicare spending over the next decade 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 and other economic factors, including changes in GDP and productivity. CBO estimates that automatic updates to payment rates will average 3.1 percent per year (although updates for specific services will vary considerably) and will account for roughly 45 percent of the increase in Medicare spending from 2002 through 2012.

Second, increases in caseloads make up an additional 23 percent of the anticipated rise in Medicare spending over the 10-year period. CBO projects that the number of enrollees in Medicare's Hospital Insurance (Part A) program will expand by 17 percent, from 40 million to 47 million, between 2002 and 2012. The increases in spending associated with new enrollees will be greater in the second half of the decade than in the first half, as baby boomers begin to qualify for Medicare coverage. Growth in enrollment will accelerate from 1 percent in 2002 to 2.6 percent in 2012, CBO estimates.

The remainder of the increase results from other changes in covered benefits; from payment rates required by the Balanced Budget Act of 1997, the Balanced Budget Refinement Act, and the Benefits Improvement and Protection Act of 2000; and from such factors as changes in medical technology, billing behavior, and the age distribution of enrollees.

Other Non-Means-Tested Programs. Other federal retirement and disability programs, with outlays totaling $97 billion in 2002, 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 2002 through 2012.

The slowdown in economic growth has raised spending significantly for unemployment compensation, as the number of people who have lost jobs has swelled recently. The unemployment rate picked up rapidly at the end of fiscal year 2001, reaching 4.8 percent—almost a percentage point above its level of a year before. By the end of fiscal year 2002, that rate is projected to reach 6.2 percent. The change in 2001 caused outlays for unemployment benefits to grow by 35 percent, from $21 billion the year before to $28 billion. The jump in 2002 will cause spending for unemployment compensation to leap 67 percent, to $47 billion, CBO projects. Even with renewed economic growth later in this fiscal year, the unemployment rate is likely to remain high for some time. CBO therefore projects that spending for unemployment benefits will peak at $50 billion in 2003 before declining in subsequent years.

The balance of spending for non-means-tested programs funds a diverse set of activities—mainly veterans' benefits, health care benefits for military retirees, farm price and income supports, certain social service grants to the states, and the Universal Service Fund.[5] CBO projects that spending for other non-means-tested programs will total $64 billion in 2002 (up from $59 billion last year) and it will fluctuate between $63 billion and $75 billion each year over the next 10 years. By CBO's estimates, the introduction of additional health care benefits (medical coverage and prescription drug coverage) in 2003 for military retirees age 65 and over will increase mandatory spending by $6 billion in its first year, a figure that rises to $12 billion in 2012.

Spending for farm price and income supports was $22 billion in 2001, down from $30 billion in 2000. CBO projects that downward trend to continue as outlays fall to $14 billion in 2002 and to $5 billion in 2012. In recent years, the Congress has provided additional money—$14 billion in 2000 and $10 billion in 2001—through emergency or other one-time funding. The drop in mandatory agricultural spending over the 10-year period occurs in part because such funding is not part of the ongoing mandatory program and therefore is not projected in future years. In addition, with improved economic conditions and stronger demand for exports, CBO expects prices for major supported crops such as corn, cotton, and wheat to increase slowly throughout the decade.

What Explains the Projected Rate of Increase in Mandatory Spending?

As a whole, spending for entitlements and other mandatory programs has more than doubled since 1988—rising faster than both nominal growth in the economy and the rates of inflation. CBO's baseline projections show that trend continuing.

Why is mandatory spending projected to grow so much? One way to analyze that growth is to break it down by its major causes. Such a breakdown

5. That fund receives payments from all providers of telecommunications service and disburses them to those providers that serve high-cost areas, low-income households, libraries, and schools, as well as to rural health care providers.

Table 4-6.
Sources of Growth in Mandatory Spending (In billions of dollars)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Estimated Spending for Base Year 2002	1,188	1,188	1,188	1,188	1,188	1,188	1,188	1,188	1,188	1,188
Sources of Growth										
Increases in participants	11	14	25	39	55	73	93	115	138	166
Automatic increases in benefits										
Cost-of-living adjustments	9	24	39	55	71	87	104	121	139	156
Other[a]	10	20	31	44	58	74	90	106	124	142
Increases in Medicare and Medicaid[b]	9	26	46	69	92	118	146	178	209	243
Growth in Social Security[c]	8	14	22	30	41	53	67	83	101	122
Irregular number of benefit payments[d]	3	3	12	*	-2	3	3	3	14	-7
Other sources of growth	9	3	-2	2	4	5	9	14	20	12
Total	60	104	173	239	319	413	512	620	744	834
Projected Spending	1,248	1,292	1,362	1,428	1,508	1,602	1,701	1,809	1,933	2,023

SOURCE: Congressional Budget Office.

NOTE: * = between zero and $500 million.

a. Automatic increases in Food Stamps and child nutrition benefits, certain Medicare reimbursement rates, the earned income tax credit, and health care benefits for military retirees, as well as statutory increases for veterans' education.

b. All growth that is not attributed to increased caseloads and automatic increases in reimbursement rates.

c. All growth that is not attributed to increased caseloads and cost-of-living adjustments.

d. Represents differences attributable to the number of benefit checks that will be issued in a fiscal year. Normally, benefit payments are made once a month. However, Medicare will make 13 payments to Medicare+Choice plans in 2005 and 2011 and 11 in 2002, 2006, and 2012. Supplemental Security Income and veterans' benefits will be paid 13 times in 2005 and 2011 and 11 times in 2007 and 2012.

shows that 85 percent of the growth in entitlements and other mandatory programs between 2002 and 2012 results from more participants; automatic increases in benefits; and greater use of, and increasing prices for, medical services.

Rising numbers of participants produce about one-fifth of the total growth. Additional beneficiaries increase spending by $11 billion in 2003 and $166 billion in 2012 relative to outlays in 2002 (see Table 4-6). The majority of that spending is concentrated in Social Security and Medicare and can be traced to a growing number of elderly and disabled people; most of the rest is in Medicaid. CBO estimates that the growth in the number of participants alone will boost outlays for each of those three programs by between 10 percent and 25 percent during the 2003-2012 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 to their beneficiaries. The adjustment for 2002 is 2.6 percent, and CBO estimates that those adjustments, which are pegged to the consumer price index, will be 1.9 percent in 2003 and 2.5 percent thereafter. In 2002, outlays for programs with COLAs total almost $597 billion. COLAs are projected to add $9 billion to that amount in 2003 and $156 billion in 2012.

Several other programs—chiefly the earned income tax credit, the Food Stamp program, and Medicare—are also automatically indexed to changes in prices and other economic factors. The income thresholds above which the earned income tax credit begins to be phased out and the maximum amount of the tax credit are both automatically adjusted for in-

Table 4-7.
Costs for Programs That CBO's Baseline Assumes Will Continue Beyond Their Current Expiration Dates (In billions of dollars)

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Commodity Credit Corporation Fund[a]													
Budget authority	n.a.	11.8	9.7	8.3	7.4	6.9	5.9	5.4	5.4	5.4	5.3	44.1	71.5
Outlays	n.a.	11.8	9.7	8.3	7.4	6.9	5.9	5.4	5.4	5.4	5.3	44.1	71.5
Ground Transportation Programs Controlled by Annual Obligation Limitations[b]													
Budget authority	n.a.	n.a.	37.1	37.1	37.1	37.1	37.1	37.1	37.1	37.1	37.1	148.3	333.7
Outlays	n.a.	n.a.	0	0	0	0	0	0	0	0	0	0	0
Ground Transportation Programs Not Subject to Annual Obligation Limitations													
Budget authority	n.a.	n.a.	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	2.6	5.8
Outlays	n.a.	n.a.	0.1	0.3	0.5	0.6	0.6	0.6	0.6	0.6	0.6	1.5	4.7
Air Transportation Programs Controlled by Annual Obligation Limitations[b]													
Budget authority	n.a.	n.a.	3.4.	3.4	3.4	3.4	3.4	3.4	3.4	3.4	3.4	13.6	30.6
Outlays	n.a.	n.a.	0	0	0	0	0	0	0	0	0	0	0
Family Preservation and Support													
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	1.8
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.1	1.5
Rehabilitation Services and Disability Research													
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	2.8	2.9	3.0	3.0	3.1	3.2	2.8	18.0
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	2.0	2.8	2.9	3.0	3.1	3.2	2.0	17.0
State Children's Health Insurance Program													
Budget Authority	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5.0	5.0	5.0	5.0	5.0	0	25.2
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.1	4.0	5.0	5.2	5.3	0	21.6
Federal Unemployment Benefits and Allowances													
Budget authority	n.a.	0.3	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	2.1	4.6
Outlays	n.a.	0.2	0.4	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5	2.0	4.5

(Continued)

flation using the consumer price index.[6] The Food Stamp program makes annual adjustments to its benefit payments according to changes in the cost of the Department of Agriculture's Thrifty Food Plan. Medicare's payments to providers are based in part on special price indexes for the medical sector and other economic factors, including changes in GDP and productivity. The combined effect of indexing for all of those programs is an extra $10 billion in outlays in 2003 and $142 billion in 2012.

6. Credits are administered through the individual income tax, but credits in excess of tax liabilities are recorded as outlays in the budget.

The remaining boost in entitlement spending comes from increases that cannot be attributed to rising enrollment or automatic adjustments to benefits. Two of those sources of growth are expected to become even more important over time. First, CBO anticipates that prices for Medicaid will grow with inflation even though the program 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 in response to increased prices, federal payments will rise correspondingly. Second, the health programs have faced steadily escalating costs per partici-

Table 4-7.
Continued

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2003	Total, 2003-2012
Food Stamps													
Budget authority	n.a.	24.5	24.3	24.5	25.1	25.8	26.6	27.3	28.1	29.0	29.8	124.2	265.1
Outlays	n.a.	23.5	24.3	24.5	25.0	25.8	26.5	27.3	28.1	29.0	29.8	123.1	263.8
Child Nutrition[c]													
Budget authority	n.a.	n.a.	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6	1.9	4.7
Outlays	n.a.	n.a.	0.4	0.5	0.5	0.5	0.5	0.5	0.6	0.6	0.6	1.8	4.6
Child Care Entitlement to States													
Budget authority	n.a.	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	13.6	27.2
Outlays	n.a.	2.0	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7	12.9	26.5
Temporary Assistance for Needy Families													
Budget authority	n.a.	16.7	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	16.9	84.2	168.6
Outlays	n.a.	16.3	16.6	16.9	17.1	17.3	17.1	16.9	16.9	16.9	16.9	84.0	168.6
Veterans' Compensation COLAs													
Budget authority	0	0.3	0.9	1.5	2.1	2.5	3.2	3.9	4.5	5.6	5.4	7.2	29.8
Outlays	0	0.3	0.8	1.5	2.0	2.4	3.2	3.8	4.4	5.5	5.3	7.0	29.3
Total													
Budget authority	n.a.	56.3	96.5	95.9	96.2	100.0	105.6	106.7	108.2	110.2	110.9	444.9	986.5
Outlays	n.a.	54.1	54.9	55.0	55.6	58.6	62.1	65.1	67.6	69.8	70.6	278.4	613.5

SOURCE: Congressional Budget Office.

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

a. 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 that the FAIR provisions continue.

b. 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.

c. Includes the Summer Food Service program and state administrative expenses.

pant 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 growth in Medicare and Medicaid from both of those sources will be $9 billion in 2003 and $243 billion in 2012.

In most federal retirement programs, the average benefit grows faster than the COLA alone. Social Security is a prime example. Because awards to new retirees are buoyed by recent growth in wages, their benefits generally exceed the monthly check of a long-time 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 smaller benefits based on their status as a spouse of a retiree. In Social Security alone, CBO estimates, the resulting increase in benefits will add $8 billion to outlays in 2003 and $122 billion in 2012.

Mandatory spending will increase or decrease in a given fiscal year depending on whether the first day of the year, October 1, falls on a weekend. If it does, some benefit payments are made at the end of September, which increases spending in the year just ended and decreases spending in the new year. Thus, the Supplemental Security Income program, 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 2002, 2005 through 2007, 2011, and 2012.

Most of the remaining growth in spending for benefit programs derives from rising benefits for new retirees in the Civil Service and Military Retirement programs (fundamentally the same phenomenon as in Social Security); the new program to provide medical insurance for Department of Defense retirees, which will begin in 2003; and 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) and some education programs for veterans. Those factors together contribute just $12 billion of the total $834 billion increase in mandatory spending in 2012.

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 will be extended when their authorization expires.[7] The bulk of projected spending associated with such programs occurs after 2002 (see Table 4-7 on page 82). The Food Stamp, Temporary Assistance for Needy Families, and State Children's Health Insurance programs are examples of programs whose current authorizations expire but that in the baseline are assumed to continue. The Deficit Control Act also directs CBO to assume that cost-of-living adjustments for veterans' compensation are granted each year. In total, assuming that expiring programs are continued accounts for about $55 billion in outlays each year from 2003 to 2006 and larger amounts in subsequent years.

7. Section 257 of the Deficit Control Act stipulates that programs with current-year outlays of $50 million or more that were established prior to enactment of the Balanced Budget Act of 1997 should be assumed in the baseline to continue, but programs established after the 1997 law could be assumed in the baseline to expire. That decision is based on estimates by the Office of Management and Budget and CBO, in consultation with the House and Senate Budget Committees. For example, the authorization for the Initiative for Future Agriculture and Food Systems program, which was established in 1998 and for which outlays of $72 million are projected in 2002, is assumed to expire after 2003.

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

Collection of more (or less) money in the form of offsetting receipts generally requires a change in the laws that generate such collections. Thus, offsetting receipts are treated as offsets to mandatory spending. 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 employees' retirement plans account for roughly 45 percent of offsetting receipts—a share that is expected to range from 39 percent to 47 percent through 2012 (see Table 4-8). Agencies' contributions go 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. Those contributions are charged against the agencies' budgets in the same way as other elements of their employee compensation are. The budget treats them as outlays of the employing agency and records the deposits into retirement funds as offsetting receipts. The transfers thus wash out in the budget totals, leaving only the fund's disbursements—for retirement benefits and administrative costs—reflected in total outlays.

The program providing health care benefits for military retirees will work in the same way. The payment made by the Department of Defense will be off-

Table 4-8.
CBO's Baseline Projections of Offsetting Receipts (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Employer's Share of Employee Retirement														
Social Security	-8	-9	-10	-10	-11	-12	-12	-13	-14	-15	-16	-17	-55	-131
Military Retirement	-11	-12	-12	-12	-13	-13	-13	-14	-14	-15	-15	-15	-63	-136
Civil Service Retirement and other	-20	-20	-21	-22	-23	-24	-25	-26	-27	-28	-30	-30	-116	-258
Subtotal	-39	-42	-42	-45	-47	-49	-51	-53	-56	-58	-61	-63	-234	-525
Department of Defense Health Care	0	0	-8	-9	-9	-10	-10	-11	-12	-12	-13	-14	-46	-108
Medicare Premiums	-24	-26	-28	-31	-34	-37	-41	-45	-49	-53	-57	-62	-170	-435
Energy-Related Receipts[a]	-8	-5	-4	-4	-5	-5	-5	-6	-5	-5	-5	-5	-24	-51
Natural Resource-Related Receipts[b]	-4	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-4	-15	-32
Electromagnetic Spectrum Auctions	-1	-1	-3	-11	-11	-1	-1	*	*	*	*	*	-27	-27
Other[c]	-11	-12	-12	-10	-10	-10	-11	-11	-11	-11	-12	-12	-54	-110
Total	-87	-88	-101	-113	-119	-115	-122	-129	-136	-143	-152	-160	-570	-1,289

SOURCE: Congressional Budget Office.

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

a. Includes proceeds from the sale of power, various fees, and royalties on mineral production and oil and gas production from the Outer Continental Shelf.

b. Includes timber and mineral receipts and various fees.

c. Includes asset sales.

set by the receipt of that payment into the fund. The transfer will wash out, leaving only the fund's disbursements reflected as outlays. CBO projects that the program will collect $8 billion in receipts from the Department of Defense in 2003, an amount that increases to $14 billion in 2012.

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 beneficiaries is $54 in 2002; it is projected to climb to $114 in 2012.

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 400,000 enrollees who were not employed in jobs covered by Medicare payroll taxes long enough to qualify for free enrollment. CBO estimates that collections of premiums for both parts of Medicare will increase from $26 billion in 2002 to $62 billion in 2012; more than 95 percent of the increase in those collections is associated with enrollees' payments of the regular monthly Supplementary Medical Insurance 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. CBO projects that collections of premiums from nonfederal sources will increase from $22 billion in 2002 to $53 billion in 2012.

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 the auctions expires. CBO estimates that those auctions will bring in $500 million in 2002, $3 billion in 2003, $11 billion in both 2004 and 2005, and smaller amounts in subsequent years (for more details, see Box B-1 in Appendix B).

Net Interest

Interest costs are still a sizable portion of the federal budget, even though they have been shrinking in the past few years. (Net interest outlays peaked at $244 billion in 1997.) In 2001, such costs totaled $206 billion—more than 11 percent of government outlays. Although debt held by the public is projected to increase in 2002 to finance the deficit, net interest payments are anticipated to decline to $170 billion (see Table 4-9). That drop is mainly attributable to the recent decline in interest rates—particularly short-term rates—as well as a shift toward issuing securities with shorter maturity periods.

As interest rates rise in CBO's economic forecast, net interest also rises, growing to $188 billion in 2004 and remaining at that level in 2005. After 2005, as the decline in debt held by the public begins to gain speed, net interest begins to gradually fall. According to CBO's estimates, net interest as a share of total spending drops from 8 percent in 2002 to about 3 percent in 2012.

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 and the President affect the former through leg-

Table 4-9.
CBO's Baseline Projections of Federal Interest Outlays (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Interest on Public Debt (Gross interest)[a]	360	332	338	368	385	398	410	420	430	437	443	441	1,899	4,070
Interest Received by Trust Funds														
Social Security	-69	-77	-84	-93	-104	-117	-130	-144	-159	-175	-192	-210	-528	-1,409
Other trust funds[b]	-75	-74	-71	-76	-81	-86	-92	-97	-103	-109	-115	-122	-406	-953
Subtotal	-144	-152	-155	-169	-185	-203	-221	-241	-262	-284	-307	-332	-934	-2,361
Other Interest[c]	-9	-9	-8	-10	-11	-12	-12	-13	-14	-14	-15	-16	-53	-125
Other Investment Income[d]	0	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-4	-8
Total (Net Interest)	206	170	174	188	188	182	175	165	153	138	120	92	908	1,577

SOURCE: Congressional Budget Office.

a. Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).

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

c. Primarily interest on loans to the public.

d. Earnings on private investments by the National Railroad Retirement Investment Trust.

islation on taxes and spending and, thus, government borrowing. Interest rates are determined by market forces and the Federal Reserve's policies.

Net or Gross?

Net interest is the most economically relevant measure of the government's costs 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 $3.3 trillion in federal securities sold to the public to finance previous deficits is outstanding. The federal government also has issued about $2.5 trillion in securities to its own accounts (mainly Social Security and other retirement trust funds). Those securities represent the past surpluses of government accounts, and their total amount grows approximately in step with the projected trust fund surpluses (see Chapter 1). The funds redeem the securities as needed to pay benefits or finance programs; in the meantime, the government both pays and collects 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 entities outside the federal government.

In 2001, net interest was about two-thirds as large as gross interest. CBO estimates that the government will pay $332 billion in gross interest costs in 2002. Of that amount, however, $152 billion will be credited to trust funds and not paid out by the government. CBO also projects that the government will collect about $10 billion in other interest and investment income this year. Therefore, net interest costs will total $170 billion.

Other Interest

The $9 billion in other interest that CBO expects the government to receive in 2002 is the net of payments and collections. On balance, however, the government takes in more such interest 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. Among the collections is the interest received from the financing accounts of credit programs (such as direct student loans).

Other Investment Income

Beginning in 2002, a new category in the budget function for net interest will represent the earnings on the private holdings of the newly created National Railroad Retirement Investment Trust (see Box 4-3). As part of the Railroad Retirement and Survivors' Improvement Act of 2001, that trust is now allowed to invest the balances of the Railroad Retirement Trust Funds in non-Treasury securities, such as stocks and corporate bonds; previously, all balances could be invested only in nonmarketable Treasury securities. CBO makes no assumption about the gains or losses that the fund might incur when investing in riskier securities; its projections assume that such investments will earn a risk-adjusted rate of return equal to the average interest rate projected for Treasury bills and notes. Such earnings total less than $1 billion each year through 2012.

Box 4-3.
Budgetary Treatment of the National Railroad Retirement Investment Trust

When the President signed the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90) on December 21, 2001, the federal government received permission to acquire corporate stocks, bonds, and other assets to provide resources for an entitlement program (Railroad Retirement). Such action has no clear precedent and raises questions about how the federal government might behave as an investor in private enterprises. Proponents of the policy hope that the investments will produce higher returns than the program's traditional portfolio of government bonds. Opponents express concern that the government is taking on unnecessary risk and potentially involving itself in corporate governance or selective investing.

The law requires that the Secretary of the Treasury transfer any money in the Railroad Retirement Trust Funds that is not necessary to meet the funds' immediate cash needs to the newly established National Railroad Retirement Investment Trust, which would manage and invest that money. The trust is not an agency or instrumentality of the federal government; however, the Congressional Budget Office (CBO) and the Office of Management and Budget agree that it should be included in the federal budget because it will be acting as an agent of the federal government in managing the finances of a federal program.

P.L. 107-90 specifies that "[f]or all purposes of the Congressional Budget Act of 1974, the Balanced Budget and Emergency Deficit Control Act of 1985, and chapter 11 of title 31, United States Code, and notwithstanding section 20 of the Office of Management and Budget Circular No. A-11, the purchase or sale of non-Federal assets (other than gains and losses from such transactions) by the National Railroad Retirement Investment Trust shall be treated as a means of financing." That language suggests a budgetary treatment similar to the one for purchases and sales of private debt under the Credit Reform Act of 1990. Transactions of principal would be treated neither as outlays when securities were bought nor as offsetting receipts when they were sold. Income and losses on the trust's investments, including interest, dividends, and changes in asset values, would be recorded as they accrued. Thus, the acquisition or sale of assets by the trust would not be recorded as budgetary transactions, but its gains or losses would be reflected as decreases or increases in federal spending and thereby would affect the surplus or deficit.

How should returns on those investments be estimated for the purpose of baseline projections over a 10-year period? One method is to project returns on the basis of historical averages. Because the trust is expected to invest in private equities, and history indicates that stocks have outperformed government bonds over most historical periods, that approach would probably show the trust earning more by investing in private securities than by investing in government bonds. That so-called arbitrage profit would make it appear as if the government would come out ahead by borrowing money at the government interest rate and investing it in private markets. The more it borrowed, the more it would gain.

Such a presentation, however, would miss an important aspect of the investments in private securities. Private stocks and bonds carry greater risk than government bonds. Investors are willing to take on the additional risk of such investments only because the average return is higher than that from government bonds. An investor choosing between a risky stock portfolio and low-risk bonds would almost certainly choose the bonds if the expected return were the same on both. Thus, in the market, the price of bonds would be bid up relative to the price of stocks, until investors had no preference between bonds and stocks at their new prices—that is, until the additional expected yield on stocks exactly offset the costs of the investors' additional risk. Therefore, on a risk-adjusted basis, securities in private markets carry the same returns as government securities.

Such reasoning suggests that budget projections of the returns on the trust's investments should be calculated using the low-risk rate of return, the government's borrowing rate. CBO has projected earnings from the trust's investments on that basis, and as a result, the baseline projections of the surplus or deficit are unaffected by the fact that the government will issue more debt in order to invest Railroad Retirement funds in private securities.