The Budget and Economic Outlook: Fiscal Years 2003-2012

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, the years referred to in this report are federal fiscal years, which run from October 1 to September 30.

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

Some of the figures in this report indicate periods of recession by using shaded vertical bars. The bars extend from the peak to the trough of each recession. The recession that began in March 2001 is assumed to end in the first quarter of calendar year 2002.

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

For purposes of comparison, the figure on the cover shows projections for 2002 through 2011 because that was the period covered by CBO's January 2001 baseline. The current projection period extends from 2003 through 2012.

A glossary of budgetary and economic terms used in this report is available on CBO's Web site (www.cbo.gov). Other supplemental material that will appear on the site shortly includes *CBO's Economic Forecasting Record* and *Uncertainties in Projecting Budget Surpluses: A Discussion of Data and Methods*.

Preface

This volume is one of a series of reports on the state of the budget and the economy that the Congressional Budget Office (CBO) issues each year. It satisfies the requirement of section 202(e) of the Congressional Budget Act of 1974 for CBO to submit to the Committees on the Budget periodic reports about fiscal policy and to provide five-year baseline projections of the federal budget. In accordance with CBO's mandate to provide impartial analysis, the report contains no recommendations.

The baseline spending projections were prepared by the staff of CBO's Budget Analysis Division under the supervision of Robert Sunshine, Peter Fontaine, Janet Airis, Thomas Bradley, Kim Cawley, Paul Cullinan, Jeffrey Holland, and Jo Ann Vines. The economic outlook was prepared by John Peterson and Eric Warasta of the Macroeconomic Analysis Division, with assistance from the staff of the division, under the direction of Robert Dennis. The revenue estimates were prepared by the staff of the Tax Analysis Division under the supervision of Thomas Woodward, Mark Booth, and David Weiner, with assistance from the Joint Committee on Taxation.

Jeffrey Holland wrote the summary of the report. Ellen Hays wrote Chapter 1 and Appendix B, with assistance from Mark Booth, Sandy Davis, Adaeze Enekwechi, Kathleen Gramp, and Jina Yoon. Mark Lasky wrote Chapter 2, with assistance from many members of the Macroeconomic Analysis Division. Mark Booth and Thomas Woodward wrote Chapter 3. Barry Blom and Felix LoStracco wrote Chapter 4, with contributions from Paul Cullinan, Jeanne De Sa, Eric Rollins, and Jina Yoon. Robert Dennis wrote Chapter 5, with assistance from many people in the Budget, Tax, and Macroeconomic Analysis Divisions. Ufuk Demiroglu, Frank Russek, and John McMurray carried out the computations for Figure 5-1. Benjamin Page wrote Chapter 6. Matthew Schmit wrote Chapter 7, with help from Jen Bullard Bowman, J. Michael Gilmore, Theresa Gullo, Leo Lex, David Moore, and Jo Ann Vines. Adaeze Enekwechi wrote Appendixes A, C, and F, and Barry Blom wrote Appendix D.

CBO's Panel of Economic Advisers commented on an early version of the economic forecast underlying this report. Members of the panel are Andrew B. Abel, Alan J. Auerbach, Michael J. Boskin, Barry P. Bosworth, Robert Dederick, William C. Dudley, Martin Feldstein, Robert J. Gordon, Robert E. Hall, N. Gregory Mankiw, Allan Meltzer, William Niskanen, William D. Nordhaus, June E. O'Neill, Rudolph G. Penner, James Poterba, Michael Prell, Robert Reischauer, Alice Rivlin, Joel Slemrod, and Martin B. Zimmerman. Sara Johnson of DRI/WEFA, Chris Varvares of Macroeconomic Advisers, and David Wyss of Standard & Poor's participated as guests at the panel's meeting. Although CBO's advisers provided considerable assistance, they are not responsible for the contents of this report.

Christine Bogusz, Leah Mazade, John Skeen, and Christian Spoor edited the volume. Marion Curry, Linda Lewis Harris, Denise Jordan, and Dorothy Kornegay assisted in its production. Kathryn Winstead prepared the report for publication, with assistance from Sharon Corbin-Jallow. Annette Kalicki, with help from Simone Thomas and Martina Wojak-Piotrow, prepared the electronic versions for CBO's Web site. Barry Anderson designed the cover, and Kathryn Winstead produced it.

Dan L. Crippen
Director

January 2002

This study and other CBO publications
are available at CBO's Web site:
www.cbo.gov

Contents

	SUMMARY	xiii
ONE	THE BUDGET OUTLOOK	1
	Uncertainty and the Projection Horizon *2* The Concept Behind CBO's Baseline *5* Changes in the Baseline Since January 2001 *7* The Outlook for Federal Debt *11* Federal Funds and Trust Funds *14* The Expiration of Budget Enforcement Procedures *16*	
TWO	THE ECONOMIC OUTLOOK	19
	Recent Economic Developments *21* CBO's Economic Forecast for 2002 and 2003 *30* The Outlook Beyond 2003 *36*	
THREE	THE REVENUE OUTLOOK	43
	Changes in CBO's Revenue Projections Since January 2001 *44* Revenues by Source *46* Expiring Tax Provisions *62*	
FOUR	THE SPENDING OUTLOOK	67
	Discretionary Spending *69* Entitlements and Other Mandatory Spending *71* Offsetting Receipts *84* Net Interest *86*	
FIVE	THE UNCERTAINTY OF BUDGET PROJECTIONS	89
	The Accuracy of CBO's Past Budget Projections *90* Alternative Economic and Budget Scenarios *94*	
SIX	THE LONG-TERM BUDGET OUTLOOK	101
	Pressures on Spending for Health and Retirement Programs *105* Conclusion *107*	
SEVEN	HOMELAND SECURITY	109
	What Is Homeland Security? *109* How Much Is Being Spent on Homeland Security? *111* Conclusion *121*	

APPENDIXES

A How Changes in Assumptions Can Affect Budget Projections *125*

B Changes in CBO's Baseline Since August 2001 *131*

C Budget Resolution Targets and Actual Outcomes *139*

D The Federal Sector of the National Income and Product Accounts *147*

E CBO's Economic Projections for 2002 Through 2012 *153*

F Historical Budget Data *157*

G Major Contributors to the Revenue and Spending Projections *173*

TABLES

S-1.	Changes in CBO's Baseline Projections of the Surplus Since January 2001	xiv
S-2.	The Budget Outlook Under Current Policies	xv
S-3.	CBO's Economic Forecast for 2002 and 2003	xvii
1-1.	The Budget Outlook Under Current Policies	2
1-2.	CBO's Baseline Budget Projections	3
1-3.	Changes in CBO's Baseline Projections of the Surplus Since January 2001	8
1-4.	CBO's Baseline Projections of Federal Debt	12
1-5.	CBO's Baseline Projections of Trust Fund Balances at the End of the Year	14
1-6.	CBO's Baseline Projections of Trust Fund Surpluses	16
2-1.	CBO's Economic Forecast for 2002 and 2003	20
2-2.	CBO's Current and Previous Economic Projections for Calendar Years 2001 Through 2011	22
2-3.	Changes in Forecasters' Estimates for Calendar Year 2002	32
2-4.	Comparison of *Blue Chip*'s and CBO's Forecasts for Calendar Years 2002 and 2003	34
2-5.	Key Assumptions in CBO's Projection of Potential GDP	37
3-1.	Changes in CBO's Baseline Projections of Revenues Since January 2001	45
3-2.	Estimated Effects on Revenues of the Economic Growth and Tax Relief Reconciliation Act of 2001, 2001-2011	47
3-3.	CBO's Baseline Projections of Revenues	48
3-4.	CBO's Baseline Projections of Individual Income Tax Receipts and the Individual Income Tax Base	50
3-5.	Sources of Growth of Individual Income Tax Liabilities in Excess of Growth of GDP, Tax Years 1995-1999	51
3-6.	Actual and Projected Capital Gains	54
3-7.	CBO's Baseline Projections of Corporate Income Tax Receipts and Tax Bases	57

3-8.	CBO's Baseline Projections of Social Insurance Tax Receipts and the Social Insurance Tax Base	59
3-9.	CBO's Baseline Projections of Social Insurance Tax Receipts, by Category	60
3-10.	CBO's Baseline Projections of Excise Tax Receipts, by Category	61
3-11.	CBO's Baseline Projections of Other Sources of Revenues	62
3-12.	Effect of Extending Tax Provisions That Will Expire Before 2012	64
4-1.	CBO's Baseline Projections of Outlays	68
4-2.	Average Annual Rate of Growth in Outlays	69
4-3.	Defense and Nondefense Discretionary Outlays, 1991-2002	71
4-4.	CBO's Projections of Discretionary Spending Under Alternative Paths	74
4-5.	CBO's Baseline Projections of Mandatory Spending	77
4-6.	Sources of Growth in Mandatory Spending	81
4-7.	Costs for Programs That CBO's Baseline Assumes Will Continue Beyond Their Current Expiration Dates	82
4-8.	CBO's Baseline Projections of Offsetting Receipts	85
4-9.	CBO's Baseline Projections of Federal Interest Outlays	86
5-1.	Average Difference Between CBO's Budget Projections and Actual Outcomes Since 1981, Adjusted for Subsequent Legislation	92
5-2.	Key Economic Variables and Budget Consequences Under Alternative Cyclical Scenarios	98
5-3.	Key Economic and Budget Assumptions in Alternative Trend Scenarios	99
5-4.	Budget Surpluses Under Alternative Trend Scenarios	100
6-1.	Alternative Assumptions About Health Costs, Population, and Productivity in Calendar Year 2030	106
6-2.	Spending for Social Security, Medicare, and Medicaid in Calendar Year 2030 Under Alternative Assumptions About Health Costs, Population, and Productivity	107

7-1.	Appropriations for Combating Terrorism and Protecting Critical Infrastructure Since 1998 and the Funding Requested for 2002 Before September 11, 2001	113
7-2.	Comparison of Funding for Combating Terrorism and Protecting Critical Infrastructure Before and After September 11, 2001	114
7-3.	Estimated 2002 Funding for Combating Terrorism and Protecting Critical Infrastructure, by OMB's Classification of Purpose	115
7-4.	Emergency Supplemental Appropriations Conveyed in Public Laws 107-38 and 107-117, by Activity	117
7-5.	Additional Resources for Homeland Security Provided in Other Legislation for 2001 and 2002	119
A-1.	Estimated Effects of Selected Economic Changes on CBO's Budget Projections	127
A-2.	Estimated Effects on CBO's Baseline of Increasing Discretionary Budget Authority by $10 Billion in 2002	128
A-3.	Estimated Savings in Net Interest from Borrowing $10 Billion Less	129
B-1.	Changes in CBO's Baseline Projections of the Surplus Since August 2001	132
B-2.	Changes in CBO's Baseline Projections of Revenues Since August 2001	134
C-1.	Comparison of Budget Resolution Targets and Actual Budget Totals, Fiscal Year 2001	140
C-2.	Differences Between Budget Resolution Targets and Actual Budget Totals, Fiscal Year 2001	141
C-3.	Differences Between Budget Resolution Targets and Actual Budget Totals, Fiscal Years 1980-2001	144
D-1.	Relationship of the Budget to the Federal Sector of the National Income and Product Accounts	148
D-2.	Projections of Baseline Receipts and Expenditures as Measured by the National Income and Product Accounts	151
E-1.	CBO's Year-by-Year Forecast and Projections for Calendar Years 2002 Through 2012	154
E-2.	CBO's Year-by-Year Forecast and Projections for Fiscal Years 2002 Through 2012	155

F-1. Revenues, Outlays, Surpluses, Deficits, and Debt Held by the Public, 1962-2001 (In billions of dollars) 158

F-2. Revenues, Outlays, Surpluses, Deficits, and Debt Held by the Public, 1962-2001 (As a percentage of GDP) 159

F-3. Revenues by Major Source, 1962-2001 (In billions of dollars) 160

F-4. Revenues by Major Source, 1962-2001 (As a percentage of GDP) 161

F-5. Outlays by Major Spending Category, 1962-2001 (In billions of dollars) 162

F-6. Outlays by Major Spending Category, 1962-2001 (As a percentage of GDP) 163

F-7. Discretionary Outlays, 1962-2001 (In billions of dollars) 164

F-8. Discretionary Outlays, 1962-2001 (As a percentage of GDP) 165

F-9. Outlays for Entitlements and Other Mandatory Spending, 1962-2001 (In billions of dollars) 166

F-10. Outlays for Entitlements and Other Mandatory Spending, 1962-2001 (As a percentage of GDP) 167

F-11. Surpluses, Deficits, Debt, and Related Series, 1960-2001 168

F-12. Standardized-Budget Surplus or Deficit and Related Series, 1960-2001 (In billions of dollars) 169

F-13. Standardized-Budget Surplus or Deficit and Related Series, 1960-2001 (As a percentage of potential GDP) 170

FIGURES

S-1. Uncertainty in CBO's Projections of the Total Budget Surplus Under Current Policies xviii

1-1. Total Deficits and Surpluses as a Share of GDP, 1962-2012 5

1-2. Debt Held by the Public as a Share of GDP, 1940-2012 5

1-3. Reasons for the Change in CBO's Projections Since January 2001 10

1-4. Debt Subject to Limit Since August 1997 15

2-1. The Economic Forecast and Projections 23

2-2. Growth in Real GDP 24

2-3.	Interest Rate Spreads	25
2-4.	Real Consumer Spending	26
2-5.	The Federal Funds Rate	27
2-6.	Real Exports	28
2-7.	Nonfarm Payroll Employment	30
2-8.	The Corporate Financing Gap	32
2-9.	Business Inventory Investment	35
2-10.	Ratio of Inventories to Sales	36
2-11.	Gross Domestic Product	36
2-12.	CBO's and *Blue Chip*'s Projections of Real Business Fixed Investment	38
2-13.	Corporate Profits Plus Wages and Salaries	40
3-1.	Annual Growth of Federal Revenues and GDP, 1956-2012	43
3-2.	Total Revenues as a Share of GDP, 1944-2012	44
3-3.	CBO's Baseline Projections of Total Revenues, 2001-2011	46
3-4.	Revenues, by Source, as a Share of GDP, 1960-2012	49
3-5.	Effective Tax Rate on Individual Income, Tax Years 1990-1999	55
3-6.	CBO's Projections of the Effects of the Individual Alternative Minimum Tax	56
4-1.	Major Components of Spending, 1962-2001	70
4-2.	Annual Growth of Federal Medicaid Outlays, 1978-2012	78
5-1.	Uncertainty in CBO's Projections of the Total Budget Surplus Under Current Policies	89
6-1.	Spending for Social Security, Medicare, and Medicaid Under CBO's Midrange Assumptions	101
6-2.	Factors Affecting Long-Term Pressure on Spending for Social Security, Medicare, and Medicaid	104
6-3.	Estimated Cost Growth in Excess of Wage Growth per Enrollee in Medicare	105
F-1.	Federal Debt Held by the Public as a Percentage of Gross National Product, 1790-2000	171

BOXES

1-1.	The Expiration of Revenue Provisions	4
1-2.	A Freeze in Discretionary Spending	6
2-1.	How the Global Downturn Could Affect Economic Recovery in the United States	29
2-2.	How Does This Recession Compare with Others?	31
2-3.	Effects on Productivity Growth of Increasing Spending for Security	39
3-1.	Tax Bases and Tax Liability	52
4-1.	The Growth in Nondefense Discretionary Outlays	72
4-2.	$40 Billion of Emergency Discretionary Appropriations for 2001 and 2002	73
4-3.	Budgetary Treatment of the National Railroad Retirement Investment Trust	88
5-1.	Innovations in This Analysis	91
5-2.	Risks from Terrorism	94
5-3.	Could Monetary Policy Lose Its Clout?	97
6-1.	How CBO Makes Its Long-Term Projections	102
7-1.	Homeland Security Spending and the Economy	112
7-2.	Federal Spending to Aid New York City After the September 11 Attacks	118
B-1.	Uncertainty About Credit Reestimates for Spectrum Loans	137