Table 2-5.
CBO Projections for Outlays Under Current-Policy Economic Assumptions with Discretionary Inflation (By fiscal year)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
In Billions of Dollars												
Discretionary[a]												
Defense	274	265	272	278	286	297	299	311	320	330	344	351
Domestic and international	272	267	272	278	286	293	301	310	320	330	340	351
Violent Crime Reduction Trust Fund	b	1	2	3	4	3	3	4	4	4	4	4
Unspecified reductions	0	0	0	-12	-12	-14	-8	-11	-12	-13	-17	-15
Subtotal	546	533	546	546	563	579	596	614	632	651	671	691
Mandatory Spending	822	875	946	1,011	1,070	1,141	1,205	1,285	1,369	1,457	1,557	1,655
Offsetting Receipts	-80	-75	-84	-77	-76	-79	-81	-85	-88	-90	-93	-96
Net Interest	232	240	246	257	271	283	296	311	328	346	365	385
Total	1,519	1,572	1,654	1,737	1,828	1,925	2,016	2,125	2,242	2,365	2,500	2,636
On-budget	1,230	1,272	1,340	1,410	1,491	1,573	1,648	1,743	1,844	1,952	2,071	2,190
Off-budget[c]	289	300	314	327	337	352	368	382	398	413	429	446
As a Percentage of GDP												
Discretionary[a]												
Defense	3.8	3.5	3.5	3.4	3.3	3.3	3.2	3.1	3.1	3.0	3.0	2.9
Domestic and international	3.8	3.6	3.5	3.4	3.3	3.2	3.2	3.1	3.1	3.0	3.0	2.9
Violent Crime Reduction Trust Fund	d	d	d	d	d	d	d	d	d	d	d	d
Unspecified reductions	0	0	0	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.2	-0.1
Subtotal	7.6	7.1	7.0	6.6	6.5	6.4	6.3	6.2	6.1	5.9	5.8	5.7
Mandatory Spending	11.4	11.7	12.0	12.3	12.4	12.6	12.7	12.9	13.1	13.3	13.6	13.7
Offsetting Receipts	-1.1	-1.0	-1.1	-0.9	-0.9	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8
Net Interest	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.2	3.2	3.2
Total	21.2	21.0	21.1	21.1	21.2	21.3	21.3	21.4	21.5	21.6	21.8	21.9
On-budget	17.1	17.0	17.1	17.1	17.3	17.4	17.4	17.5	17.7	17.8	18.0	18.2
Off-budget[c]	4.0	4.0	4.0	4.0	3.9	3.9	3.9	3.8	3.8	3.8	3.7	3.7

SOURCE: Congressional Budget Office.

a. Projections assume that discretionary spending is adjusted for inflation up to the statutory caps that are in effect through 1998. All discretionary spending other than spending from the Violent Crime Reduction Trust Fund is assumed to equal the caps in 1998 and to grow from that level at the rate of inflation in later years. Unspecified reductions show the cuts that would be needed to satisfy the caps.

b. Less than $500 million.

c. Social Security and the Postal Service.

d. Less than 0.05 percent of gross domestic product.

All other spending is controlled by existing laws, and the baseline presents CBO's estimate of spending if those laws and policies remain unchanged. Under the baseline rules, CBO must assume that spending programs whose current-year outlays exceed $50 million will be extended. *Entitlements and other mandatory spending* consist overwhelmingly of benefit programs such as Social Security, Medicare, and Medicaid. Spending for those programs is generally controlled by setting rules for eligibility, benefit formulas, and so forth rather than by voting annually for dollar amounts. *Offsetting receipts*—fees and similar charges that are recorded as negative outlays—likewise are changed only when the Congress revisits the underlying laws. And growth in *net interest* spending is almost wholly driven by the government's deficits and by market interest rates.

Mandatory spending's share of GDP is expected to increase from its current 12 percent to almost 14 percent by 2006. Offsetting receipts and net interest spending will remain almost constant as a share of output at roughly 1 percent and slightly over 3 percent, respectively, throughout the projection period.

In total, federal spending now represents 21 percent of gross domestic product and will increase modestly to about 22 percent by 2006, assuming current-policy economic projections and that discretionary spending grows with inflation (see Table 2-5). That percentage does not vary dramatically under alternative assumptions. Assuming current-policy economic projections and a freeze on discretionary spending, total federal spending will fall slightly, to 20 percent of GDP in 2006. Under balanced budget policies, total federal spending will hold constant at 21 percent of GDP if discretionary spending grows at the rate of inflation, but will decline to 19 percent under a freeze.

Although federal spending has hovered around 21 percent of GDP for the past quarter-century, a pronounced shift has taken place in the composition of federal spending during that period. The government today spends more on entitlement programs and net interest, and less on discretionary activities, than in the past. According to CBO's projections, net interest spending will remain fairly constant, and mandatory spending will continue to rise faster than discretionary spending (see Figure 2-2).

Discretionary Spending

Each year, the Congress starts with a clean slate in the appropriation process. It votes on budget authority—the authority to commit money—for discretionary budget activities, and that authority translates into outlays when the money is actually paid out. In 1996, discretionary outlays are expected to total $533 billion. (Those figures do not reflect the Omnibus Consolidated Rescissions and Appropriations Act of 1996, which was signed into law on April 26.) Assuming growth at the inflation rate constrained by the caps, that figure increases 30 percent by 2006, to $691 billion (see Table 2-5). Those figures include unspecified reductions in discretionary spending that would be required to comply with the cap. CBO makes no assumptions in its projections about where the required reductions would be made.

Defense Discretionary Spending. The share of GDP that is devoted to defense has gradually shrunk in the past three decades, with only two major interruptions: the Vietnam War of the late 1960s and the Reagan-era defense buildup of the early 1980s. Even the costs of Operation Desert Storm appeared as barely a blip against this downward trend. Today, defense outlays are about 3.5 percent of GDP and are expected to fall to 2.9 percent of GDP assuming that they increase at the rate of inflation. Approximately 40 percent of the dollars devoted to defense provide compensation for members of the armed services and civilian employees of the Department of Defense.

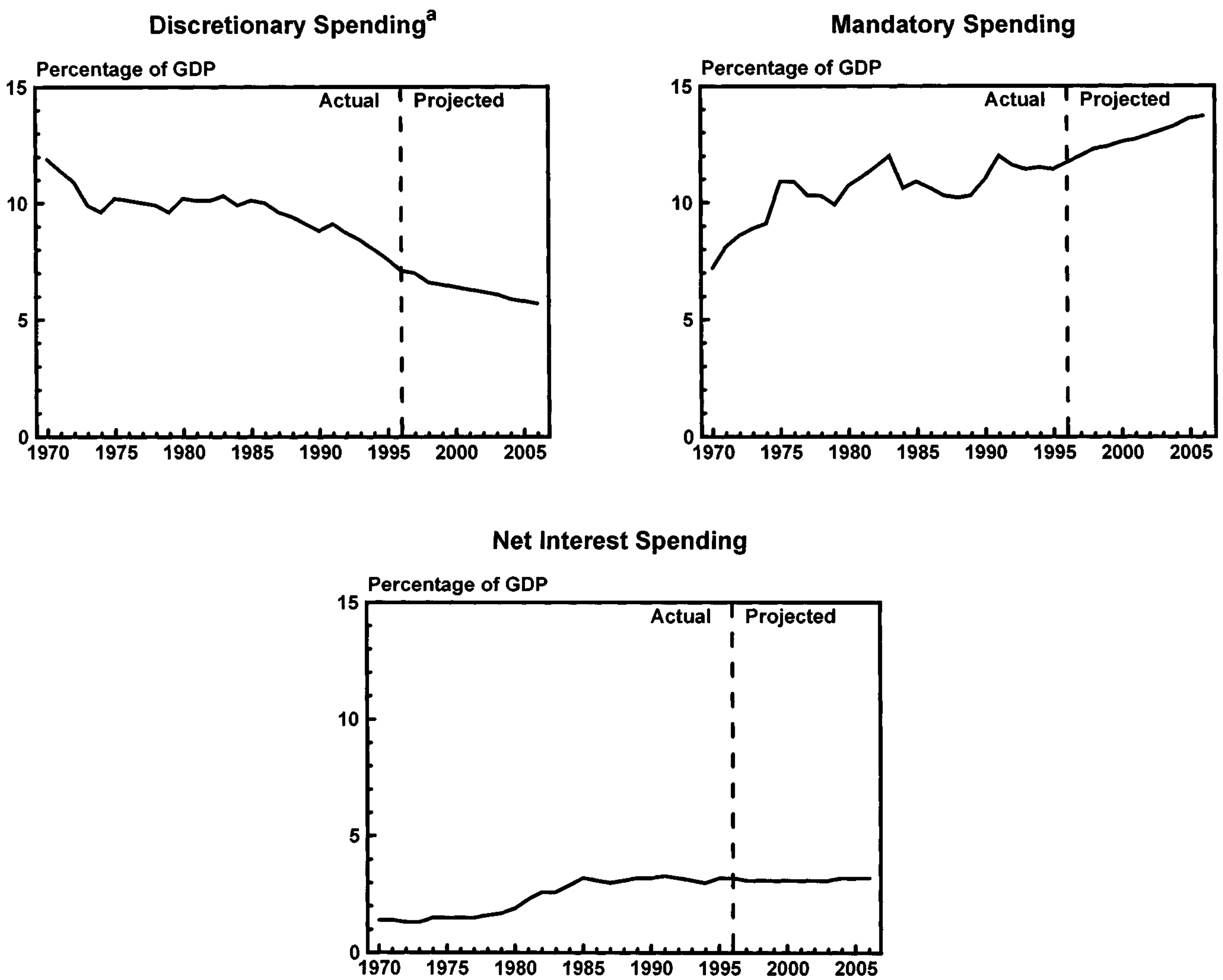
In dollar terms, defense outlays peaked at about $300 billion annually in 1989 through 1992 (not counting the estimated spending on Desert Storm in 1991). At $265 billion in 1996, defense outlays are down by about 12 percent from the 1989-1992 levels in 1996 dollars and by more than 30 percent when measured in 1989 dollars. Growth at the rate of inflation throughout the projection period would increase defense outlays to $351 billion in 2006.

Under the assumption that discretionary spending is frozen, the value of defense spending would be reduced by more than 25 percent when measured in 1996 dollars. If such a freeze occurred, real defense spending would be almost halved from its 1989 peak.

Nondefense Discretionary Spending. Even as defense spending generally drifted down as a share of GDP in the 1960s and 1970s, other discretionary spending climbed slowly, peaking at 5.2 percent of GDP in 1980 before its rise was reversed. Today, nondefense discretionary spending totals about 3.6 percent of GDP, not quite three-fourths of its peak level. Approximately 30 percent of that spending pays the compensation of federal employees at nondefense agencies.

Nondefense discretionary spending encompasses an array of federal activities. Leading claimants of the $267 billion in expected general-purpose outlays for 1996 are education, training, and social services ($38 billion); income security, chiefly housing subsi-

Figure 2-2.
Outlays by Category as a Share of GDP Under Current-Policy Economic Assumptions



SOURCE: Congressional Budget Office.

a. Projections assume that discretionary spending is adjusted for inflation up to the statutory caps that are in effect through 1998. All discretionary spending other than spending from the Violent Crime Reduction Trust Fund is assumed to equal the caps in 1998 and to grow from that level at the rate of inflation in later years.

dies and the administrative costs of running benefit programs ($38 billion); transportation ($36 billion); the administration of justice and such general government activities as running the Internal Revenue Service (together, $27 billion); health research and public health ($23 billion); natural resources and environment ($21 billion); international programs ($20 billion); veterans' benefits other than direct cash payments, chiefly medical care ($19 billion); and space and science ($16 billion). Spending from the Violent Crime Reduction Trust Fund is expected to total an additional $1 billion.

If nondefense discretionary spending grows with inflation, it will continue to shrink as a percentage of GDP, from 3.6 percent in the current year to 2.9 percent in 2006. If spending is subject to a freeze, the share of the economy devoted to providing those varied government services will be further reduced, to 2.1 percent of GDP in 2006.

Entitlements and Mandatory Programs

More than half of the $1.6 trillion of federal spending is for entitlements and mandatory programs (other than net interest). Such programs make payments to recipients—usually people, but sometimes businesses, not-for-profit institutions, or state and local governments—who are eligible and apply for funds. Payments are governed by formulas set in law and are not constrained by annual appropriation bills. In its baseline, CBO depicts the likely path of entitlement and mandatory spending if current laws remain unchanged. Such spending is expected to top $1 trillion in 1998—almost twice as much as discretionary spending in that year, the last one governed by the caps (see Table 2-5).

The Balanced Budget Act lumps mandatory programs (other than Social Security) together with receipts and subjects them to pay-as-you-go discipline; that is, liberalizations in those programs are supposed to be funded by cutbacks in other mandatory spending or by increases in taxes or fees. (Similarly, tax cuts must be offset by tax increases or by reductions in mandatory spending.) Violation of the pay-as-you-go rules will trigger a sequestration—an across-the-board reduction in spending authority—to ensure that the deficit is not increased. Social Security has its own set of procedural safeguards, which the Congress established to prevent policy actions that would worsen the long-run condition of the trust funds.

About one-fourth of entitlements and mandatory spending, or one-eighth of all federal spending, is means-tested—that is, paid to people who must document their need based on income or assets (and often other criteria, such as family status). The remainder, led by the government's big retirement-related programs, have no such requirements and are labeled non-means-tested.

Means-Tested Programs. Medicaid, the joint federal and state program providing medical care to many of the poor, makes up about half of means-tested entitlements. CBO projects that federal outlays for Medicaid will reach $243 billion in 2006, with growth averaging slightly under 10 percent a year in the 1996-2006 period (see Table 2-6).

The growth in Medicaid has subsided from the sky-high rates of the early 1990s. Spending for the Medicaid program jumped between 20 percent and 30 percent a year from 1990 through 1992, but its growth has decelerated to an average of 10 percent for the past three years. The program's surge was fueled by population pressures, inflation in the medical care sector, liberalizations in Medicaid eligibility contained in legislation (especially coverage of poor children), the recession of 1990-1991, court decisions that made the federal government raise its payments to institutions, and the fiscal pressures facing state and local governments that drove many of them to maximize funds from the federal government. CBO assumes that growth in spending for this program after 1996 will remain strong but that it will not return to the extraordinary levels experienced earlier in this decade.

With the exception of the family support program, which grows at about the inflation rate, all other means-tested programs are projected to rise more quickly than inflation during the next decade. The Supplemental Security Income program for the aged, blind, and disabled is expected to grow rapidly because of a continued steep rise in its caseload of disabled participants, especially children, and of el-

Table 2-6.
CBO Projections for Mandatory Spending Under Current-Policy Economic Assumptions (By fiscal year, in billions of dollars)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Means-Tested Programs												
Medicaid	89	96	105	115	126	138	152	166	183	201	221	243
Food Stamps[a]	26	26	28	30	31	32	34	35	37	38	40	41
Supplemental Security Income	25	24	28	30	33	38	35	40	43	46	54	53
Family Support	18	18	19	19	20	21	21	22	23	23	24	25
Veterans' Pensions	3	3	3	3	3	4	3	4	4	4	4	4
Child Nutrition	7	8	8	9	10	10	11	11	12	13	13	14
Earned Income Credit	15	18	20	21	22	23	23	24	25	26	27	28
Student Loans	4	2	2	2	3	3	3	3	3	3	4	4
Other	3	4	4	4	5	5	6	6	7	7	8	8
Total	191	199	217	234	252	274	287	312	336	362	394	420
Non-Means-Tested Programs												
Social Security	333	348	365	383	402	422	444	467	490	515	540	567
Medicare[b]	177	196	216	236	257	279	303	329	357	389	424	463
Subtotal	510	544	581	620	660	702	747	795	847	904	964	1,030
Other Retirement and Disability												
Federal civilian[c]	43	44	46	49	51	54	57	60	63	67	71	75
Military	28	29	30	31	32	33	34	35	36	38	39	40
Other	5	5	5	5	5	5	5	5	5	5	5	5
Subtotal	75	77	81	84	88	92	96	100	105	110	115	121
Unemployment Compensation	21	24	26	27	28	29	30	31	32	34	35	36
Deposit Insurance	-18	-10	-5	-2	-2	-2	-2	-1	-1	-1	-1	-1
Other Programs												
Veterans' benefits[d]	18	17	19	19	20	21	19	20	21	21	22	21
Farm price and income supports	6	7	7	7	7	7	6	5	5	5	5	5
Social services	6	5	6	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-2	-7	-7	-6	-6	-6	-6	-6	-6	-6	-7	-7
Other	15	19	20	21	18	20	22	21	23	23	23	23
Subtotal	42	41	45	48	45	47	47	47	49	49	50	49
Total	631	676	728	777	818	868	918	972	1,033	1,096	1,163	1,235
Total												
All Mandatory Spending	822	875	946	1,011	1,070	1,141	1,205	1,285	1,369	1,457	1,557	1,655
Memorandum:												
Medicare Spending Net of Premiums	157	176	195	214	233	254	277	301	328	359	393	431

SOURCE: Congressional Budget Office.

NOTE: Spending for benefit programs shown above generally excludes administrative costs, which are discretionary.

a. Includes nutrition assistance to Puerto Rico.

b. Spending for Medicare excludes premiums, which are considered offsetting receipts.

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

d. Includes veterans' compensation, readjustment benefits, life insurance, housing programs, and the Universal Service Fund created in the Telecommunications Act of 1996.

derly immigrants. Outlays for the Food Stamp program go up both because benefits are indexed and because an increasing share of the U.S. population is eligible for food stamps. Near-term growth in the refundable portion of the earned income credit (EIC) is influenced by the final phase-in of benefit increases stemming from 1993 legislation; over the longer term, the indexing of certain guidelines for program eligibility and the increase in the population of eligible workers accounts for growth that is slightly faster than inflation. Although the EIC is a provision of the tax code, direct payments to recipients who otherwise owe no taxes are treated as outlays since they are equivalent to benefit payments. Those direct payments account for more than 80 percent of the provision's total cost.

Non-Means-Tested Programs. Social Security, Medicare, and other retirement and disability programs dominate non-means-tested entitlements. In fact, Social Security surpassed defense in 1993 to become the biggest federal program. Most Social Security beneficiaries, who currently number nearly 44 million and are expected to number 50 million in 2006, also participate in Medicare.

Although Social Security is the larger program, Medicare has grown much faster despite repeated efforts to rein in its costs. Over the past decade, Medicare grew by an average of 10 percent a year compared with Social Security's 6 percent; for the next decade, Medicare is projected to grow by an average of 9 percent a year and Social Security by 5 percent. The share of the economy devoted to Social Security will remain fairly constant over that period, at 4.7 percent of GDP; Medicare's share will increase by almost 50 percent, from 2.6 percent to 3.8 percent of GDP.

Other retirement and disability programs, at $77 billion in 1996, are less than one-fourth the size of Social Security (see Table 2-6). They are dominated by benefits for the federal government's civilian and military retirees and Railroad Retirement and are expected to grow slightly faster than inflation.

Spending for both unemployment compensation and deposit insurance has declined from the top levels reached in the early 1990s. Outlays for unemployment compensation peaked at $37 billion in 1992 and are now less than two-thirds as large. They are expected to grow modestly in future years. Outlays for deposit insurance peaked at $66 billion in 1991 and are expected to return to more traditional levels as the Resolution Trust Corporation completes its work.

Other non-means-tested entitlements encompass a diverse set of programs, mainly veterans' benefits, farm price supports, certain social service grants to the states, and the Universal Service Fund created by telecommunications reform. This category totals $41 billion in 1996 and grows slightly slower than inflation throughout the projection period.

Why Does Mandatory Spending Increase? Spending for entitlements and mandatory programs has nearly doubled over the past decade, rising faster than both nominal growth in the economy and the rate of inflation. Why does such spending grow as fast as it does in the baseline? One convenient way of analyzing such growth is to break it down by its major cause. That analysis shows that rising caseloads, automatic increases in benefits, and greater use of medical services account for 90 percent of the growth in entitlements and other mandatory programs between 1996 and 2006.

Mounting caseloads account for about one-fifth of the growth in entitlement programs. Compared with this year's outlays, spending will increase as a result of higher caseloads by $14 billion in 1997 and $137 billion in 2006 (see Table 2-7). More than half of that growth is concentrated in the Social Security, Medicare, and Supplemental Security Income programs and is largely traceable to continued growth in the population of elderly and disabled people. Much of the rest is in Medicaid. Among the "big three" programs, growth in caseloads alone boosts outlays by 15 percent in Medicare and 16 percent in both Social Security and Medicaid over the 1997-2006 period.

Automatic increases in benefits account for about one-third of the growth in entitlement programs. All of the major retirement programs grant automatic cost-of-living adjustments (COLAs) to their beneficiaries. Those adjustments, which are pegged to the overall consumer price index, are expected to average about 3 percent a year through 2006. In 1996, outlays for programs with COLAs are already more than $460 billion, and COLAs are expected to add an extra $10 billion in 1997 and $160 billion in 2006.

Several other programs—chiefly the earned income credit, Food Stamps, and Medicare—are also automatically indexed to inflation. The income thresholds above which the EIC begins to be phased out are automatically adjusted for inflation using the consumer price index. The Food Stamp program makes annual adjustments to its benefit payments according to changes in the Department of Agriculture's Thrifty Food Plan index. Medicare's payments to providers are based in part on special price indexes for the medical sector. (The link between inflation and Medicare spending is complicated, however, because indexing provided for under current law would actually reduce fees for some providers. In those cases, CBO assumed that no reduction would take place.) The combined effect of indexing for these

Table 2-7.
Sources of Growth in Mandatory Spending (By fiscal year, in billions of dollars)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Estimated Spending for Base Year 1996	875	875	875	875	875	875	875	875	875	875
Sources of Growth										
Increases in caseload	14	25	38	50	63	76	90	105	120	137
Automatic increases in benefits										
Cost-of-living adjustments	10	25	40	56	71	88	105	122	142	160
Other[a]	10	18	26	32	37	41	45	49	56	66
Other increases in benefits										
Increases in Medicare and Medicaid[b]	16	35	57	80	108	140	177	217	259	304
Growth in Social Security[c]	5	9	11	15	22	28	34	41	47	56
Irregular number of benefit payments[d]	4	4	4	9	0	5	5	5	11	6
Change in outlays for deposit insurance	5	8	8	7	8	9	9	9	9	9
Other sources of growth	7	12	12	17	22	24	30	34	37	42
Total	71	136	196	267	330	410	494	583	682	780
Projected Spending	946	1,011	1,070	1,141	1,205	1,285	1,369	1,457	1,557	1,655

SOURCE: Congressional Budget Office.

a. Automatic increases in Food Stamp and child nutrition benefits, certain Medicare reimbursement rates, and the earned income credit under formulas specified by law.

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

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

d. Represents baseline differences attributable to assumptions about the number of benefit checks that will be issued in a fiscal year. Supplemental Security Income and veterans' compensation and pensions will pay 11 months of benefits in 1996 and 2001, 13 in 2000 and 2005, and 12 in other years.

programs contributes an extra $10 billion in outlays in 1997 and $66 billion in 2006 (see Table 2-7).

Medicaid is the only major entitlement program that is not automatically indexed for inflation at the federal level. Medicaid payments to providers are determined by the states, with the federal government matching those payments. If states increase payments, federal payments will rise. Higher payments to states are treated as other increases in Table 2-7.

Another third of the growth in entitlement spending stems from increases that cannot be attributed to growth in caseloads or automatic adjustments in reimbursements. Those sources of growth are expected to become more important over time. First, Medicaid grows with inflation even though it is not formally indexed (as discussed above). Second, the health programs have faced steadily rising costs per participant; that trend, which is known in Medicare jargon as "use" or "intensity," reflects a combination of more services per participant, more technological sophistication, and so forth. The residual growth in Medicare and Medicaid amounts to $16 billion in 1997 and $304 billion in 2006.

In most retirement programs, the average benefit grows faster than the COLA alone would explain. Social Security is a prime example. Because new retirees have more recent earnings that have benefited from real wage growth, their benefits generally exceed the monthly check of a long-time retiree whose last earnings may have been a decade or two ago and who has been receiving only cost-of-living adjustments since then. And because more women are working now, more new retirees receive benefits based on their own earnings rather than a smaller, spouse's benefit. In Social Security alone, such phenomena are estimated to add $5 billion in 1997 and $56 billion in 2006.

Depending on calendar flukes, three programs—Supplemental Security Income and veterans' compensation and pensions—may pay 11, 12, or 13 monthly checks in a fiscal year. Since only 11 checks will be mailed in the current fiscal year, spending in those programs is much higher relative to the 1996 base in all years except 2001, which is also an 11-check year (see Table 2-7).

Most of the remaining growth in benefit programs stems from rising benefits for new retirees in the Civil Service, Military, and Railroad Retirement programs (fundamentally the same phenomenon as in Social Security); larger average benefits in unemployment compensation, a program that lacks an explicit COLA provision but pays amounts that are automatically linked to the recent earnings of its beneficiaries; increases in family support costs, largely at the discretion of state governments; and other sources. All of those factors together, however, contribute just $42 billion of the total $780 billion rise in mandatory spending in 2006 (relative to 1996).

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 voluntary payments from the public in exchange for goods or services).

A decision to collect more (or less) in offsetting receipts usually requires a change in the underlying laws generating such collections. Thus, offsetting receipts are more like mandatory spending and revenues than like discretionary appropriations and are therefore also subject to the pay-as-you-go discipline.

Intrabudgetary transfers that represent agencies' contributions for their employees' retirement plan account for about 40 percent of offsetting receipts, a share that is expected to grow to 50 percent by 2006 (see Table 2-8). Those contributions are paid primarily to the trust funds for Social Security, Hospital Insurance, Military Retirement, and Civil Service Retirement. Some contribution rates are set by statute; others are determined by boards of actuaries. Agencies are required to pay for the retirement contributions of their employees because future retirement benefits are an important part of current compensation for the government's 4.4 million military, civilian, and postal employees. The budget treats those retirement contributions as part of agency budgets, and the deposits in retirement funds as offsetting receipts. Those transfers thus wash out in the budgetary totals, leaving only the funds' disbursements—for retirement benefits and administrative costs—reflected in total outlays.

The biggest proprietary receipt the government collects is premiums from the roughly 36 million people who enroll in Supplementary Medical Insurance (SMI, or Part B of Medicare), which primarily covers physician and outpatient charges. Premium collections from the elderly and disabled grow from an estimated $20 billion in 1996 to $32 billion in 2006, as the monthly charge climbs from $42.50 to an estimated $61.50 in 2006. Premiums are set to cover one-quarter of the costs of SMI through 1998. After 1998, premiums will increase at the same rate as the cost-of-living adjustment provided to Social Security beneficiaries, and the share of costs paid by beneficiaries will fall.

Other proprietary receipts come mostly from charges for energy, minerals, and timber and from various fees levied on users of government property or services. A relatively new entry—receipts from the Federal Communications Commission's auction of portions of the electromagnetic spectrum for use by telecommunications companies—is expected to bring in $5 billion in 1996 and $12 billion in 1997.

Table 2-8.
CBO Projections for Offsetting Receipts Under Current-Policy Economic Assumptions
(By fiscal year, in billions of dollars)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Employer Share of Employee Retirement												
Social Security	-6	-6	-7	-7	-8	-8	-9	-9	-10	-11	-12	-13
Military Retirement	-12	-11	-11	-11	-11	-11	-12	-12	-12	-12	-13	-13
Other[a]	-16	-16	-16	-17	-17	-18	-18	-19	-20	-21	-22	-23
Subtotal	-34	-33	-34	-35	-36	-37	-39	-40	-42	-44	-46	-48
Medicare Premiums	-20	-20	-21	-23	-24	-25	-26	-27	-29	-30	-31	-32
Energy-Related Receipts[b]	-4	-4	-5	-4	-4	-4	-4	-5	-4	-4	-4	-4
Natural Resource-Related Receipts[c]	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3	-3
Electromagnetic Spectrum Auctions	-8	-5	-12	-3	d	0	0	0	0	0	0	0
Other	-31	-30	-30	-32	-33	-34	-35	-37	-38	-38	-39	-40
Total	-80	-75	-84	-77	-76	-79	-81	-85	-88	-90	-93	-96

SOURCE: Congressional Budget Office.

a. Primarily Civil Service Retirement.

b. Includes proceeds from sales of power, various fees, and receipts from the naval petroleum reserves and Outer Continental Shelf.

c. Includes timber and mineral receipts and various user fees.

d. Less than $500 million.

Those receipts, which can be paid over time, are recorded on a net present-value basis pursuant to the Credit Reform Act of 1990.

Net Interest

For the four years between 1991 and 1994, net interest costs were remarkably flat at about $200 billion a year, even as the government added $1 trillion in debt. The government saved a lot of money during that period by issuing debt at interest rates that were the lowest in three decades. That stability is now past: interest costs shot up by $30 billion in 1995, increase modestly in 1996, and are expected to increase steadily through 2006 to $385 billion as debt held by the public increases from $3.6 trillion to $6.7 trillion (see Table 2-9). As a percentage of GDP, however, interest costs will hold steady at 3 percent.

Interest costs are not governed by any provisions of the Budget Enforcement Act because they are not directly controllable. Rather, interest depends on the outstanding amount of government debt and on interest rates. The Congress and the President influence the former by making decisions about taxes and spending and hence about borrowing. Beyond that, they exert no direct control over interest rates, which are determined by market forces and Federal Reserve policy.

Interest rates have a powerful effect on budget projections, as illustrated in Appendix C. If interest rates are 1 percentage point higher in 1996 through 2006 than CBO assumes, net interest costs will be greater by about $3 billion in 1996 and $85 billion in 2006. The extra costs stem from the huge volume of new financing and the rollover of existing debt by the Treasury.

Net or Gross? Net interest is the most useful measure of the government's current debt-service costs. Some budget-watchers stress gross interest (and its counterpart, the gross federal debt) instead of 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 received by the government.

The government has sold more than $3.6 trillion of securities to finance deficits over the years. But it has also issued $1.3 trillion of securities to its own trust funds (mainly Social Security and the other retirement funds). Those securities represent the past surpluses of the trust funds, and their total amount grows roughly in step with projected trust fund surpluses. The funds can redeem the securities to pay benefits; in the meantime, the government both pays and collects the interest on those securities. It also receives interest income from loans and cash balances. Broadly speaking, gross interest encompasses all interest paid by government (even to its own funds) and ignores all interest income. Net interest, in contrast, is the net flow to people and organizations outside government.

Net interest is only about two-thirds as big as gross interest. CBO estimates that the government will pay $344 billion in gross interest costs this year. Of that amount, however, $98 billion is simply credited to trust funds and does not leave the government or add to the total deficit. The government also collects $6 billion in other interest income. Net interest costs therefore total $240 billion.

Debt Subject to Limit. The Congress sets a limit on the Treasury's authority to issue debt. That ceiling applies to securities issued to federal trust funds as well as those sold to the public. Debt subject to limit is practically identical to the gross federal debt and is widely cited as the measure of the government's indebtedness. (The minor differences between gross debt and debt subject to limit are chiefly attributable to securities issued by agencies other than the Treasury, such as the Tennessee Valley Authority, that are exempt from the debt limit.) The net debt, which is debt held by the public, is about $1.3 trillion smaller than either gross federal debt or debt subject to limit.

The Congress recently raised the debt ceiling to $5.5 trillion, which will probably be adequate for about the next year and a half. For further details on the events leading to this year's increase in the debt limit, see Box 2-3.

Table 2-9.
CBO Projections for Interest Costs and Federal Debt Under Current-Policy Economic Assumptions (By fiscal year)

	Actual 1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
					Net Interest Outlays (Billions of dollars)							
Interest on Public Debt (Gross interest)[a]	332	344	353	368	386	402	421	441	462	485	507	532
Interest Received by Trust Funds												
Social Security	-33	-37	-41	-45	-50	-55	-61	-67	-73	-80	-88	-96
Other trust funds[b]	-60	-61	-61	-60	-59	-58	-56	-54	-51	-47	-43	-37
Subtotal	-93	-98	-101	-105	-109	-112	-117	-120	-124	-128	-131	-133
Other Interest[c]	-7	-6	-6	-6	-6	-7	-8	-9	-10	-11	-12	-13
Total	232	240	246	257	271	283	296	311	328	346	365	385
					Federal Debt, End of Year (Billions of dollars)							
Gross Federal Debt	4,921	5,191	5,483	5,789	6,120	6,478	6,845	7,233	7,640	8,071	8,529	9,008
Debt Held by Government Accounts												
Social Security	483	547	619	695	779	871	967	1,071	1,181	1,298	1,425	1,562
Other government accounts[b]	834	874	897	912	920	920	912	894	866	826	771	700
Total	1,318	1,421	1,516	1,607	1,699	1,791	1,879	1,965	2,047	2,124	2,196	2,262
Debt Held by the Public	3,603	3,770	3,967	4,181	4,422	4,687	4,966	5,268	5,593	5,947	6,333	6,746
Debt Subject to Limit[d]	4,885	5,154	5,446	5,751	6,083	6,440	6,808	7,195	7,603	8,034	8,491	8,971
					Federal Debt as a Percentage of GDP							
Debt Held by the Public	50.2	50.3	50.5	50.8	51.3	51.8	52.3	52.9	53.6	54.3	55.2	56.0

SOURCE: Congressional Budget Office.

NOTE: Projections of interest and debt assume that discretionary spending is adjusted for inflation up to the statutory caps that are in effect through 1998. All discretionary spending other than spending from the Violent Crime Reduction Trust Fund is assumed to equal the caps in 1998 and to grow from that level at the rate of inflation in later years.

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

b. Principally Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Highway and the Airport and Airway Trust Funds.

c. Primarily interest on loans to the public.

d. Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit.

Box 2-3.
Raising the Debt Limit

Since 1917, the Congress by statute has set an overall dollar ceiling on the amount of debt that the Treasury can issue. That ceiling is increased periodically, with each change typically giving the Treasury unfettered authority to issue debt for a couple of years before another increase is necessary. As fiscal year 1996 began, the Treasury's authority to issue debt, last raised in August 1993 to $4.9 trillion, was once again becoming inadequate.

Legislation increasing the debt limit has historically been viewed by the Congress as "must pass" legislation and has been used as a vehicle for enacting other measures important to the Congress. For example, the Balanced Budget and Emergency Deficit Control Act of 1985 was passed as part of legislation raising the debt ceiling. In 1995 and 1996, the Congress also attempted to use such legislation to achieve deficit reduction. The resulting deadlock over measures to reduce the deficit led to perhaps the longest impasse ever regarding the debt limit, stretching from November 1995 through March 1996.

Because the debt limit covers both debt sold to the public and government account series securities assigned to trust funds and other government accounts, the Treasury can disinvest (convert to uninvested balances) holdings of government account securities to create room under the debt limit to raise cash from the public. As negotiations on achieving a balanced budget continued past the start of the fiscal year, Treasury Secretary Robert E. Rubin authorized the use of that technique to ensure that the government would be able to make its November 15 quarterly interest payment to holders of public debt securities. The Secretary disinvested holdings of the Government Securities Investment Fund of the Thrift Savings Fund (a tax-deferred savings plan for federal employees) and the Civil Service Retirement and Disability Fund because statute permits it and provides that the funds be replenished in full with interest.

The continued inability of the President and the Congress to agree on legislation to balance the budget required the use of other techniques to allow the government to avoid the debt ceiling and continue borrowing. The Secretary withheld the semiannual interest payment to the Civil Service Retirement and Disability Fund, which is normally made in December, to prevent the debt ceiling from being reached (interest payments are invested in government account securities). Then, in order to make the February 15 quarterly interest payment to holders of public debt securities, the Secretary extended disinvestment of that fund, authorized withdrawals from the Exchange Stabilization Fund, and swapped agency securities of the Postal Service and the Tennessee Valley Authority held by the Federal Financing Bank with government account series securities held by the Civil Service Retirement and Disability Fund.

As the Treasury Secretary warned that the continued impasse over the debt limit threatened the timely payment of Social Security benefits for the month of March, the Congress passed legislation enabling the Treasury to borrow about $29 billion (the size of the March Social Security benefits) that would not be counted against the debt limit until March 15. That legislative technique was new; in prior impasses, the Congress had generally enacted temporary increases in the debt ceiling. As March 15 approached, the temporary exemption was extended through March 30 and amended to exclude inflows to government accounts from the debt ceiling.

Finally, on March 28, the Congress passed an increase in the debt limit to $5.5 billion. The bill also terminated Supplemental Security Income benefits for drug addicts and alcoholics and included an increase in the exempt earnings amount for Social Security beneficiaries who continue to work; it did not include significant deficit reduction. Under the Congressional Budget Office's baseline projections, the new ceiling will be sufficient through the beginning of fiscal year 1998.

Federal Funds and Trust Funds

Spending from federal funds excludes all spending that comes from federal trust funds. The government has more than 150 trust funds, though fewer than a dozen account for the vast share of trust fund holdings. The four largest are the Old-Age and Survivors Insurance, Civil Service Retirement, Hospital Insurance, and Military Retirement Trust Funds. Revenues for most trust funds exceed outgo.

The trust fund technique involves earmarking specific taxes or other revenues for financing certain

Table 2-10.
CBO Projections for Trust Fund Surpluses Under Current-Policy Economic Assumptions
(By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Social Security	64	72	76	84	92	97	104	110	117	127	137
Medicare											
Hospital Insurance	-7	-13	-22	-30	-38	-48	-57	-68	-82	-96	-112
Supplementary Medical Insurance	2	-1	2	2	2	2	2	3	3	3	4
Subtotal	-5	-14	-21	-28	-36	-46	-55	-66	-79	-93	-109
Military Retirement	3	2	2	1	1	1	a	a	a	-1	-1
Civilian Retirement[b]	28	28	28	28	29	30	31	31	31	31	31
Unemployment	6	5	4	3	3	4	4	5	5	6	7
Highway and Airport	-2	-4	-3	-3	-3	-3	-4	-4	-4	-5	-5
Other[c]	3	3	3	3	4	4	4	4	4	4	4
Total Trust Fund Surplus[d]	97	92	89	89	89	86	84	80	74	70	64
Federal Funds Deficit[d]	-241	-263	-283	-308	-334	-345	-369	-391	-417	-446	-468
Total Deficit	-144	-171	-194	-219	-244	-259	-285	-311	-342	-376	-403
Memorandum:											
Net Transfers from Federal Funds to Trust Funds	229	239	255	269	286	304	325	348	375	405	438

SOURCE: Congressional Budget Office.

NOTE: The numbers reflect the surplus or deficit (-) for the trust funds on a cash flow basis.

a. Less than $500 million.

b. Civil Service Retirement, Foreign Service Retirement, and several smaller funds.

c. Primarily Railroad Retirement, employees' health and life insurance, Hazardous Substance Superfund, and various veterans' insurance trust funds.

d. Assumes that discretionary spending reductions are made in non-trust-fund programs.

programs. That procedure helps to weigh the costs and benefits of the programs and gives beneficiaries some assurance that their benefits will be protected. For some programs, such as federal military and civilian retirement, the trust fund approach also allows agency spending to reflect accrued costs, even though the budget totals record spending on a cash basis. The two Social Security trust funds have been designated as off-budget by law.

Assuring the financial soundness of the trust funds requires that their receipts and expenditures be tracked separately from those of other programs. Thus, the principal significance of trust funds lies in an analysis of receipts and expenditures of the individual funds rather than in the totals for all trust funds combined, or the totals for federal funds excluding trust funds. The trust funds must be included in the budget totals with other programs when considering the effect of federal activities on national income and employment and on the Treasury's cash borrowing needs. The Congressional Budget Office, the Office of Management and Budget, and other fiscal analysts therefore focus on a comprehensive measure of the federal budget, including the trust funds.

Trust funds run surpluses because their earmarked annual income (chiefly from social insurance and excise taxes and from transfers within the budget, as explained below) exceeds annual spending for benefits, administration, and other costs. In CBO's projections, the total trust fund surplus is virtually flat through 2000 at about $90 billion a year. After 2000, that surplus declines steadily to $64 billion in 2006 as the deficit of the Hospital Insurance (HI) Trust Fund grows in the later years of the projection period (see Table 2-10). CBO also projects that the balance of the HI trust fund will be negative in 2001, concomitant with the fund's increased annual deficit. The Social Security and Medicare trust funds currently run a combined surplus of about $60 billion a year. All other trust funds run a combined surplus of about $40 billion a year, primarily in the trust funds for federal employee retirement and unemployment insurance.

Nearly all public attention focuses on the Social Security and Medicare trust funds. The Social Security trust funds enjoy a large and growing surplus; Medicare's HI trust fund, in contrast, is being depleted. The Social Security surplus currently accounts for approximately two-thirds of the total trust fund surplus. Both Social Security and the HI trust fund collect taxes from workers and pay benefits to or on behalf of elderly and disabled recipients. Medicare's SMI trust fund runs a small surplus or deficit in every year by design. SMI receives roughly one-fourth of its income from enrollee premiums and taps the general fund of the government for the rest of its $70 billion-plus outlays, generally permitting a small "surplus."

The total deficit of $144 billion in 1996 reflects the federal funds deficit of $241 billion offset by the trust fund surplus of $97 billion. The line between federal funds and trust funds is not so neat, however, because trust funds receive a large portion of their income from transfers within the budget. Such transfers shift money from the federal funds to trust funds, thereby boosting the federal funds deficit (the deficit excluding trust funds) and swelling the trust fund surplus. Those intragovernmental transfers total more than $229 billion a year (see Table 2-10).

Prominent among those intragovernmental transfers are interest paid to trust funds (about $98 billion in 1996), the government's contributions to retirement funds on behalf of its present and past employees ($65 billion), and contributions by the general fund to Medicare, principally SMI ($55 billion). Without those intragovernmental transfers, the trust funds would have an overall deficit in every year, ranging from $132 billion in 1996 to over $370 billion in 2006.