Chapter Two

The Baseline Budget Outlook

The Congressional Budget Office estimates that the deficit in the fiscal year ending September 30, 1995, will total $161 billion--the smallest posted deficit since 1989 and almost $100 billion lower than the deficit recorded just two years ago. Under current taxing and spending policies, though, the deficit is expected to resume an upward trend in 1996. CBO projects a deficit of $189 billion next year, rising to $462 billion in 2005 if there is no change in the laws and policies underlying the budget. As a percentage of gross domestic product, the deficit rises from 2.3 percent in 1995 to 4.0 percent in 2005. Concerned over the prospect of persistent large deficits, the Congress is attempting to bring the budget into balance by 2002. Chapter 3 describes the deficit path proposed in the budget resolution.

In terms of baseline projections, little has changed since CBO's last report to the Congress. The near-term outlook is somewhat brighter: compared with the estimates CBO published in its April report, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1996,* the deficit is likely to be about $13 billion lower in 1995 and $21 billion lower in 1996. Those changes are almost entirely attributable to new economic information and other developments; legislation adopted so far this year has scarcely affected the budget totals. The near-term revisions, however, do not alter CBO's view of long-run budget trends. By 2005, projected deficits are basically the same as those CBO published in April.

The Deficit Outlook

Much of the concern about the budget stems from the sheer size of the federal deficit; Table 6 displays several measures of that gap. The most commonly used measure of the deficit is simply the difference between total revenues and total spending. Since the statutory caps on discretionary spending are currently set to expire in 1998, CBO produces two projections of that difference--one assuming that discretionary spending grows at the rate of inflation after 1998 and the other assuming that it is frozen at the 1998 dollar level.

Participants in the budget debate often cite other measures of the deficit, such as the standardized-employment, or structural, deficit. That figure shows what is left after removing the cyclical deficit (the reduction in revenues and the extra spending on benefits that result when the economy operates below its full potential). With output around its full employment level, the distinction between the structural deficit and the conventionally measured deficit is far less relevant now than during a period of recession, such as was experienced in the early 1990s.

Spending and receipts for Social Security and the Postal Service, which are designated as off-budget by statute, are often displayed separately. The surpluses or deficits of those programs are depicted in Table 6. Despite their special status, those off-budget transac-

Table 6.
CBO Deficit Projections (By fiscal year)

	Actual 1994	1995	1996	1997	1998	1999	2000
	In Billions of Dollars						
Baseline Total Deficit							
With discretionary inflation after 1998	203	161	189	218	229	261	288
Without discretionary inflation after 1998	203	161	189	218	229	243	250
Standardized-Employment Deficit[a]							
With discretionary inflation after 1998	194	189	188	211	221	251	277
Without discretionary inflation after 1998	194	189	188	211	221	233	239
On-Budget Deficit (Excluding Social Security and Postal Service)							
With discretionary inflation after 1998	259	224	253	286	301	338	373
Without discretionary inflation after 1998	259	224	253	286	301	319	335
Memorandum:							
Deposit Insurance	-8	-16	-8	-4	-5	-3	-2
Cyclical Deficit	16	-11	9	12	13	13	14
Off-Budget Surplus							
Social Security	57	62	63	67	70	76	84
Postal Service	-1	1	b	1	1	b	1
Total, Off-Budget Surplus	56	63	63	68	71	77	85
	As a Percentage of GDP						
Baseline Total Deficit							
With discretionary inflation after 1998	3.1	2.3	2.6	2.8	2.8	3.1	3.2
Without discretionary inflation after 1998	3.1	2.3	2.6	2.8	2.8	2.9	2.8
Standardized-Employment Deficit[a,c]							
With discretionary inflation after 1998	2.9	2.7	2.6	2.7	2.7	2.9	3.1
Without discretionary inflation after 1998	2.9	2.7	2.6	2.7	2.7	2.7	2.7

SOURCE: Congressional Budget Office.

NOTE: Caps on discretionary spending are set by law through 1998. Measures of the deficit "with discretionary inflation" assume that discretionary spending grows at the rate of inflation after 1998. Measures of the deficit "without discretionary inflation" assume that discretionary spending remains frozen in dollar terms at the level of the 1998 caps.

a. Excludes the cyclical deficit and deposit insurance.

b. Less than $500 million.

c. Expressed as a percentage of potential gross domestic product.

tions loom so large in the revenue and spending totals that any measure of the budget that omits them yields a distorted picture of the government's drain on credit markets and its role in the economy.

Changes in the Budget Outlook Since April

Although the outlook for this year's and next year's deficit has noticeably improved, the longer-term picture remains close to what CBO had projected at the beginning of the year. Deficits are down in each year, chiefly because of lower projected interest rates. New information on revenues and mandatory programs also contributes to lower deficit estimates; however, revenue losses due to economic changes partially offset those improvements in the deficit outlook (see Table 7).

Only three bills enacted so far this year have contributed significantly to changes in the baseline. Supplemental emergency spending--primarily for defense readiness and disaster assistance--increases

Table 7.
Changes in CBO Baseline Deficit Projections Since April 1995 (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000
April Baseline Deficit with Discretionary Inflation After 1998[a]	175	210	230	232	266	299
Legislative Changes	b	-2	-1	b	b	b
Economic Changes						
Revenues	2	9	12	12	11	9
Outlays						
Net interest	-2	-17	-15	-8	-5	-5
Other outlays	b	1	1	1	b	-3
Subtotal	-2	-16	-13	-7	-6	-7
Deficit	b	-6	-1	6	6	2
Technical Changes						
Revenues	-4	-5	-5	-3	-5	-6
Outlays						
Discretionary	-2	b	b	0	0	0
Mandatory	-7	-7	-3	-2	-3	-2
Deposit insurance	-1	0	0	0	0	0
Net interest	b	-1	-2	-2	-3	-4
Subtotal	-9	-8	-5	-5	-5	-6
Deficit	-13	-13	-10	-8	-11	-13
Total Changes	-13	-21	-12	-3	-5	-11
August Baseline Deficit with Discretionary Inflation After 1998[a]	161	189	218	229	261	288

SOURCE: Congressional Budget Office.

NOTE: Revenue increases are shown as negative because they reduce the deficit.

a. Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998 and grows at the rate of inflation after that.

b. Less than $500 million.

the deficit by $2 billion to $3 billion a year from 1996 onward. That supplemental spending, however, is authorized in two rescission bills that also provide for cuts in outlays by similar amounts each year. In addition, to fund the extension of the deduction for health insurance costs incurred by self-employed individuals, the Congress imposed an interest and dividend test on recipients of the earned income tax credit (EITC) and repealed the preferential tax treatment of income from sales of broadcast facilities to buyers certified as minority businesses. In total, legislative action so far this year has reduced the deficit by $2 billion in 1996 and $1 billion in 1997, with negligible effects in other years.

A more important source of revision is changes in the economic outlook. As noted in Chapter 1, projected interest rates over the next year are expected to

Table 8.
CBO Baseline Budget Projections with Discretionary Inflation After 1998 (By fiscal year)

	Actual 1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
					In Billions of Dollars							
Revenues												
Individual income	543	595	625	652	687	725	767	812	859	908	960	1,016
Corporate income	140	156	159	164	171	177	183	189	196	204	212	221
Social insurance	461	484	507	527	551	579	609	638	670	703	737	775
Other	113	122	122	124	128	131	135	140	146	151	157	163
Total	1,258	1,357	1,413	1,468	1,537	1,612	1,694	1,779	1,870	1,966	2,066	2,175
On-budget	923	1,007	1,046	1,085	1,136	1,190	1,249	1,313	1,381	1,452	1,528	1,608
Off-budget	335	350	367	383	401	422	445	466	489	513	538	566
Outlays												
Discretionary[a]												
Defense	282	269	270	278	285	295	304	314	324	334	345	356
International	21	21	22	22	22	23	24	24	25	26	27	28
Domestic	243	256	264	274	285	296	307	317	327	338	349	360
Unspecified reductions	0	0	-6	-21	-36	-39	-42	-44	-45	-47	-48	-50
Subtotal	546	546	550	553	556	574	593	612	631	651	672	694
Mandatory	791	835	893	958	1,023	1,095	1,172	1,246	1,333	1,425	1,523	1,635
Deposit insurance	-8	-16	-8	-4	-5	-3	-2	-2	-2	-2	-1	-1
Net interest	203	233	242	255	271	288	305	321	342	364	388	415
Offsetting receipts	-71	-79	-75	-75	-79	-81	-85	-89	- 93	-97	-102	-106
Total	1,461	1,518	1,602	1,686	1,766	1,873	1,982	2,087	2,211	2,341	2,480	2,637
On-budget	1,182	1,231	1,299	1,371	1,437	1,527	1,622	1,710	1,817	1,930	2,052	2,190
Off-budget	279	287	304	315	329	346	360	377	393	410	428	447
Deficit	203	161	189	218	229	261	288	308	340	375	414	462
On-budget deficit	259	224	253	286	301	338	373	397	436	478	523	582
Off-budget surplus	56	63	63	68	71	77	85	89	96	103	110	119
Debt Held by the Public	3,432	3,605	3,809	4,044	4,289	4,568	4,873	5,199	5,557	5,949	6,380	6,860
Memorandum:												
Gross Domestic Product	6,634	6,992	7,295	7,667	8,062	8,479	8,918	9,379	9,862	10,370	10,904	11,465

(Continued)

be about a full percentage point lower than CBO had previously forecast. With federal debt held by the public standing near $3.6 trillion, those lower rates translate into significant interest savings--$17 billion in 1996 and $15 billion in 1997. Smaller savings accrue through the end of the decade as interest rates adjust to projected long-term levels.

Decreased revenues stemming from downward revisions in CBO's income projections, though, will more than offset interest rate savings by 1998. In that year, revenues are projected to be $12 billion less, leading to an overall increase of $6 billion in CBO's baseline deficit due to economic changes.

Table 8.
Continued

	Actual 1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
					As a Percentage of GDP							
Revenues												
Individual income	8.2	8.5	8.6	8.5	8.5	8.5	8.6	8.7	8.7	8.8	8.8	8.9
Corporate income	2.1	2.2	2.2	2.1	2.1	2.1	2.0	2.0	2.0	2.0	1.9	1.9
Social insurance	7.0	6.9	7.0	6.9	6.8	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Other	1.7	1.7	1.7	1.6	1.6	1.5	1.5	1.5	1.5	1.5	1.4	1.4
Total	19.0	19.4	19.4	19.1	19.1	19.0	19.0	19.0	19.0	19.0	19.0	19.0
On-budget	13.9	14.4	14.3	14.1	14.1	14.0	14.0	14.0	14.0	14.0	14.0	14.0
Off-budget	5.1	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	4.9	4.9
Outlays												
Discretionary[a]												
Defense	4.3	3.8	3.7	3.6	3.5	3.5	3.4	3.3	3.3	3.2	3.2	3.1
International	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2	0.2	0.2
Domestic	3.7	3.7	3.6	3.6	3.5	3.5	3.4	3.4	3.3	3.3	3.2	3.1
Unspecified reductions	0	0	-0.1	-0.3	-0.4	-0.5	-0.5	-0.5	-0.5	-0.4	-0.4	-0.4
Subtotal	8.2	7.8	7.5	7.2	6.9	6.8	6.6	6.5	6.4	6.3	6.2	6.0
Mandatory	11.9	11.9	12.2	12.5	12.7	12.9	13.1	13.3	13.5	13.7	14.0	14.3
Deposit insurance	-0.1	-0.2	-0.1	-0.1	-0.1	b	b	b	b	b	b	b
Net interest	3.1	3.3	3.3	3.3	3.4	3.4	3.4	3.4	3.5	3.5	3.6	3.6
Offsetting receipts	-1.1	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9	-0.9
Total	22.0	21.7	22.0	22.0	21.9	22.1	22.2	22.3	22.4	22.6	22.7	23.0
On-budget	17.8	17.6	17.8	17.9	17.8	18.0	18.2	18.2	18.4	18.6	18.8	19.1
Off-budget	4.2	4.1	4.2	4.1	4.1	4.1	4.0	4.0	4.0	4.0	3.9	3.9
Deficit	3.1	2.3	2.6	2.8	2.8	3.1	3.2	3.3	3.5	3.6	3.8	4.0
On-budget deficit	3.9	3.2	3.5	3.7	3.7	4.0	4.2	4.2	4.4	4.6	4.8	5.1
Off-budget surplus	0.8	0.9	0.9	0.9	0.9	0.9	1.0	0.9	1.0	1.0	1.0	1.0
Debt Held by the Public	51.7	51.6	52.2	52.7	53.2	53.9	54.6	55.4	56.3	57.4	58.5	59.8

SOURCE: Congressional Budget Office.

a. Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998 and grows at the rate of inflation after that. Discretionary outlays would be $18 billion lower in 1999 and $39 billion lower in 2000 if no adjustment for inflation was assumed.

b. Less than 0.05 percent.

Revisions that do not result from economic developments or new legislation are classified as technical and can occur for a variety of reasons. Income tax projections, for example, have been revised upward because of higher-than-expected receipts this year and other factors.

Other, relatively small revisions to CBO's outlook have occurred since April. In addition to the reduction in outlays for the earned income tax credit achieved through legislation, CBO has reduced its estimates of EITC outlays by $2 billion to $3 billion a year throughout the projection period. EITC spending has been lower than expected this year, possibly as a result of a recent crackdown by the Internal Revenue Service on fraudulent claims. Current spending patterns also indicate that the Commodity Credit Corporation, the Postal Service, and various other mandatory programs will spend less this year than originally thought.

CBO Baseline Projections

In 1995, federal revenues are expected to equal $1,357 billion and outlays $1,518 billion. The major components of those totals and their projected growth over the next five years are depicted in Table 8 (see pages 22 and 23).

Although persistent deficits have spurred a number of recent proposals to balance the budget over the next several years, none of the proposals have yet been enacted (see Chapter 3). CBO's baseline projections therefore do not reflect the savings those proposals might achieve. Instead, the projections indicate the path that federal spending will take if government programs continue on the course implied by current law. Although spending and revenues are understandably more difficult to estimate beyond the usual five-year budget window, long-term projections often figure heavily in policymakers' decisions. Thus, CBO makes reasonable assumptions about future budget levels based on its analysis of broad trends in federal programs.

The Outlook for Revenues

Federal revenues are expected to equal 19.4 percent of GDP in 1995, up from 19.0 percent in 1994. Individual income taxes are the main source of that growth; they increase from 8.2 percent of GDP in 1994 to 8.5 percent in 1995, reflecting in part the tax increases legislated in the Omnibus Budget Reconciliation Act of 1993. The government's other major sources of revenue--corporate income taxes, social insurance taxes, excise taxes, estate and gift taxes, customs duties, and profits returned by the Federal Reserve System--remain more or less constant over the next decade as a percentage of GDP.

The Outlook for Spending

The Budget Enforcement Act of 1990 formalized the use of several categories that had long been used to describe federal spending. Discretionary spending is funded anew each year through the appropriation process. Such spending encompasses nearly the entire budgets for defense and international affairs and a wide variety of domestic programs--space and science, environmental protection, transportation, many education and social service programs, veterans' medical care, law enforcement activities, and the operation of the Internal Revenue Service, to name a few.

In its baseline projections, CBO assumes that policymakers will continue to abide by the discretionary spending limits set in law through 1998. Separate caps apply to budget authority (the authority to commit funds, the basic currency of the appropriation process) and outlays (actual spending); the stricter constraint governs. Within those limits, policymakers must make trade-offs among competing needs--defense, international, and domestic. Because the caps hold discretionary spending relatively flat even as output grows, such outlays shrink steadily in relation to the economy. From 7.8 percent of GDP today--already far below the levels of 10 percent to 12 percent that were typical of the 1960-1989 period --total discretionary spending drifts down to 6.0 percent in 2005 if it grows with inflation after 1998.

The drop in discretionary spending as a percentage of GDP is even more precipitous if appropriations are frozen at the 1998 level. As shown in Table 9, discretionary outlays would fall to 4.9 percent of GDP in 2005--less than one-fourth of total federal spending--if frozen at their 1998 level.

Outlays for entitlements and other mandatory programs, by far the largest spending category, will amount to $835 billion this year and are growing fast. Fueling that growth are expenditures for Social Security, Medicare, and Medicaid, which together account for about three-quarters of all mandatory outlays. Lawmakers control mandatory spending indirectly--not by voting annual dollar amounts but by setting standards for eligibility, benefit formulas, and so forth. Table 10 displays more information about this huge cluster of programs.

The big health entitlements essentially explain why mandatory spending, and eventually the deficit, are projected to grow in relation to GDP. Health-

Table 9.
The Budget Outlook Through 2005 Without Discretionary Inflation After 1998 (By fiscal year)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
					In Billions of Dollars						
Revenues	1,357	1,413	1,468	1,537	1,612	1,694	1,779	1,870	1,966	2,066	2,175
Outlays											
Discretionary	546	550	553	556	556	556	556	556	556	556	556
Net interest	233	242	255	271	287	302	316	332	348	365	382
All other[a]	739	810	879	939	1,011	1,085	1,155	1,238	1,326	1,420	1,528
Total	1,518	1,602	1,686	1,766	1,854	1,944	2,027	2,126	2,230	2,341	2,467
Deficit	161	189	218	229	243	250	247	256	264	275	292
Debt Held by the Public	3,605	3,809	4,044	4,289	4,549	4,816	5,081	5,355	5,636	5,929	6,239
					As a Percentage of GDP						
Revenues	19.4	19.4	19.1	19.1	19.0	19.0	19.0	19.0	19.0	19.0	19.0
Outlays											
Discretionary	7.8	7.5	7.2	6.9	6.6	6.2	5.9	5.6	5.4	5.1	4.9
Net interest	3.3	3.3	3.3	3.4	3.4	3.4	3.4	3.4	3.4	3.3	3.3
All other[a]	10.6	11.1	11.5	11.7	11.9	12.2	12.3	12.6	12.8	13.0	13.3
Total	21.7	22.0	22.0	21.9	21.9	21.8	21.6	21.6	21.5	21.5	21.5
Deficit	2.3	2.6	2.8	2.8	2.9	2.8	2.6	2.6	2.5	2.5	2.5
Debt Held by the Public	51.6	52.2	52.7	53.2	53.7	54.0	54.2	54.3	54.4	54.4	54.4

SOURCE: Congressional Budget Office.

NOTE: Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998. Discretionary spending is held constant at the 1998 level from 1999 through 2005.

a. Spending for all other categories--mandatory outlays, deposit insurance, and offsetting receipts--would be the same as in Table 8.

Table 10.
CBO Baseline Projections for Mandatory Spending (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Means-Tested Programs											
Medicaid	89	99	110	122	135	148	163	178	195	212	232
Food Stamps[a]	26	27	29	30	32	33	35	37	39	40	42
Supplemental Security Income	24	24	30	33	36	43	39	47	50	54	63
Family Support	18	19	19	20	20	21	21	22	23	24	24
Veterans' Pensions	3	3	3	3	3	3	3	3	3	3	3
Child Nutrition	8	8	9	9	10	11	11	12	13	13	14
Earned Income Tax Credit	15	18	20	21	22	23	24	25	26	27	28
Student Loans[b]	4	3	3	3	3	3	3	3	4	4	4
Other	3	4	4	5	5	6	6	7	7	8	8
Total, Means-Tested Programs	191	205	226	245	266	291	306	333	359	386	420
Non-Means-Tested Programs											
Social Security	333	352	371	391	412	434	456	480	505	532	560
Medicare	178	199	219	240	263	288	315	345	379	416	458
Subtotal	511	551	590	631	675	722	771	825	884	948	1,018
Other Retirement and Disability											
Federal civilian[c]	43	44	46	49	51	54	57	59	62	65	69
Military	28	28	30	31	33	34	36	38	39	41	43
Other	5	4	4	5	5	5	5	5	5	5	5
Subtotal	75	76	80	84	89	93	97	102	106	111	116
Unemployment Compensation	21	24	25	26	27	28	30	31	33	34	35
Other Programs											
Veterans' benefits[d]	17	17	19	19	20	22	23	23	24	25	27
Social services	6	6	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-1	-4	-6	-7	-7	-7	-7	-7	-7	-7	-7
Other	15	18	18	19	19	17	19	19	19	19	19
Subtotal	37	37	37	37	38	39	41	42	43	44	46
Total, Non-Means-Tested Programs	644	687	732	778	829	882	940	1,000	1,066	1,137	1,215
Total											
Total Mandatory Spending	835	893	958	1,023	1,095	1,172	1,246	1,333	1,425	1,523	1,635

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as domestic discretionary spending; Medicare premium collections are classified as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Formerly known as guaranteed student loans.

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

d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

related mandatory spending is growing considerably faster than the rest of the economy. Rising at a rate of about 10 percent a year, total Medicaid and Medicare outlays are projected to more than double by 2005. That rapid growth helps explain why the Hospital Insurance Trust Fund is expected to begin running a deficit in the current fiscal year and will be out of money in 2001. Combined, Medicaid and Medicare will expand dramatically in relation to GDP, from 3.8 percent in 1995 to 6.0 percent in 2005. CBO projects that those two programs alone will nearly equal total discretionary spending at the end of 10 years or easily surpass it if discretionary spending is not allowed to grow with inflation after 1998. (See Appendix D for a discussion of national expenditures on health care.)

Deposit insurance spending spurted from 1988 to 1991 but then subsided, turning negative in 1993 and 1994 (see Table 8). CBO expects that net outlays will continue to be negative but in shrinking amounts after 1995, as proceeds from liquidations begin to dry up and as the government cuts the assessment that institutions must pay to the Bank Insurance Fund on insured deposits.

Net interest payments for the past few years have been remarkably flat (around $200 billion a year), largely because of low interest rates. However, the combination of higher interest rates early in 1995 and a persistently large deficit will boost net interest to $233 billion in 1995 and over $400 billion in 2005. Correspondingly, federal debt will continue to increase, with debt held by the public rising to almost 60 percent of GDP in 2005. Another measure of debt that will be receiving a lot of attention as the Treasury nears the ceiling on federal borrowing authority this fall is the debt subject to limit. Chapter 4 discusses that measure and projects its future growth.

The last category of outlays, offsetting receipts, is composed of various receipts and collections that are recorded as negative outlays rather than as revenues. Those receipts come either from the public (such as voluntary Medicare premiums or payments for licenses to use portions of the electromagnetic spectrum) or from within the government (such as agencies' contributions to retirement funds). Offsetting receipts amount to a steady 1 percent of GDP in CBO's projections.

Ten-year projections inherently carry with them a great deal of uncertainty. Unexpected changes in economic growth or interest rates can have profound effects on revenues and outlays. Also, unanticipated occurrences will certainly affect federal finances 10 years down the road. Nevertheless, despite the uncertainties surrounding the economic and budget projections, attempts to eliminate the deficit within the next 10 years will clearly require significant changes in current fiscal policy.

A Comparison with the Administration's Projections

At the end of July, the Administration's Office of Management and Budget (OMB) issued its midsession review of the budget. In that publication, the Administration outlined a budgetary plan for fiscal years 1996 through 2005 that included reductions in corporate subsidies and outlay savings designed to make large reductions in the federal deficit. The President's plan, though, starts from a baseline that differs from CBO's baseline by growing amounts through 2005 (see Table 11).

CBO and OMB agree about the current year's deficit; by 2005, however, CBO's estimate of the deficit under current policies is $214 billion above OMB's projection. Small differences in economic assumptions along with other, technical estimating differences add up to large discrepancies by the end of the projection period.

On average, the Administration foresees slightly faster economic growth and lower inflation (as measured by the consumer price index) than does CBO. Because the CPI affects indexed benefit programs and tax brackets, and the GDP deflator affects estimates of taxable income, CBO's assumption of a larger gap between the two growth rates adds to its projection of the deficit. Projections of economic growth and inflation diverge by just 0.1 percentage point a year; but combined with offsetting technical differences, that translates into a $76 billion gap in revenues in 2005.

Estimating differences unrelated to economic assumptions also contribute to the difference between CBO's estimate of the baseline deficit and the Administration's. In 2005, about $52 billion of the difference in projected spending stems from differences in Medicare and Medicaid. Although CBO believes that the growth of those programs will slow from the extremely high rates of recent years, it is not quite as optimistic as the Administration about the extent to which such a slowdown would occur without a change in policy.

The Federal Sector of the National Income and Product Accounts

The projections summarized so far in this chapter draw on the usual labels--revenues by source, outlays by category--that are familiar to policymakers. Economists, though, often use another approach for

Table 11.
Comparison of CBO Baseline with OMB Midsession Review Baseline (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
OMB Midsession Review Baseline Deficit	160	185	197	194	202	208	206	216	222	235	248
Differences											
Outlays											
Discretionary	-5	-1	-1	1	1	2	2	3	4	5	5
Mandatory											
Social Security	-1	2	3	4	4	5	6	7	8	9	9
Medicare	3	2	3	4	8	10	12	15	20	25	32
Medicaid	1	3	5	8	10	12	14	15	17	18	20
Other	1	-1	a	-1	6	8	14	16	20	22	26
Subtotal	5	5	11	14	28	35	46	54	65	75	88
Net interest	1	-5	-6	-5	-3	a	2	11	21	32	44
Total	a	-1	4	10	27	37	50	68	91	112	138
Revenues	1	5	17	24	32	43	51	57	62	66	76
Deficit	1	4	22	35	59	80	101	125	153	178	214
CBO Baseline Deficit	161	189	218	229	261	288	308	340	375	414	462

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTES: Both baselines assume that discretionary spending is equal to the spending limits that are in effect through 1998 and grows at the rate of inflation after that.

Reductions in revenues are shown as positive because they increase the deficit.

a. Less than $500 million.

Table 12.
Relationship of the Budget to the Federal Sector of the National Income and Product Accounts
(By fiscal year, in billions of dollars)

	Actual 1994[a]	1995	1996	1997	1998	1999	2000
			Receipts				
Revenue (Budget basis)[b]	1,258	1,357	1,413	1,468	1,537	1,612	1,694
Differences							
Netting and grossing							
Government contributions							
for employee retirement	57	58	60	63	67	70	74
Medicare premiums	18	20	20	22	24	26	27
Deposit insurance premiums	7	7	2	2	2	2	2
Other	3	9	3	c	c	-2	-2
Geographic exclusions	-2	-3	-3	-3	-3	-3	-3
Other	10	-3	c	3	2	2	c
Total	92	89	83	88	92	96	98
Receipts (NIPA basis)	1,349	1,445	1,496	1,555	1,629	1,708	1,792
			Expenditures				
Outlays (Budget basis)[b]	1,461	1,518	1,602	1,686	1,766	1,873	1,982
Differences							
Netting and grossing							
Government contributions							
for employee retirement	57	58	60	63	67	70	74
Medicare premiums	18	20	20	22	24	26	27
Deposit insurance premiums	7	7	2	2	2	2	2
Other	3	9	3	c	c	-2	-2
Lending and financial transactions							
Deposit insurance	1	11	5	1	1	c	-1
Other	-1	-3	-1	1	2	1	c
Defense timing adjustment	1	1	5	1	1	1	1
Geographic exclusions	-9	-9	-10	-10	-11	-11	-12
Other	-8	-4	-4	-8	-8	-8	-14
Total	68	90	82	73	78	79	75
Expenditures (NIPA basis)	1,529	1,608	1,684	1,759	1,845	1,951	2,057
			Deficit				
Deficit (Budget basis)[b]	203	161	189	218	229	261	288
Differences							
Lending and financial transactions	c	8	5	2	3	c	-2
Defense timing adjustment	1	1	5	1	1	1	1
Geographic exclusions	-6	-7	-7	-7	-8	-8	-9
Other	-18	-1	-3	-11	-10	-10	-14
Total	-24	2	-1	-15	-14	-17	-24
Deficit (NIPA basis)	180	163	189	203	215	244	265

SOURCE: Congressional Budget Office.

NOTE: Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998 and grows at the rate of inflation after that.

a. Differences estimated by CBO. Actual NIPA receipts, expenditures, and deficit for 1994 are subject to revision by the Department of Commerce, Bureau of Economic Analysis.

b. Includes Social Security and the Postal Service.

c. Less than $500 million.

Table 13.
Projections of Baseline Receipts and Expenditures Measured by the National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual 1994[a]	1995	1996	1997	1998	1999	2000
Receipts							
Personal Tax and Nontax Receipts	552	599	636	664	700	738	780
Corporate Profits Tax Accruals	161	177	173	180	186	194	201
Indirect Business Tax and Nontax Accruals	93	97	94	92	94	95	97
Contributions for Social Insurance	543	572	592	619	649	681	714
Total	1,349	1,445	1,496	1,555	1,629	1,708	1,792
Expenditures							
Purchases of Goods and Services							
Defense	296	288	293	299	307	319	330
Nondefense	144	148	154	161	168	174	181
Subtotal	439	436	446	460	475	493	511
Transfer Payments							
Domestic	660	700	752	801	852	907	964
Foreign	16	15	15	15	16	16	16
Subtotal	676	715	766	816	868	923	980
Grants-in-Aid to State and Local Governments	195	213	225	239	256	274	292
Net Interest	186	213	221	231	246	263	278
Subsidies Less Current Surplus of Government Enterprises	32	31	31	34	35	38	38
Required Reductions in Discretionary Spending	*	*	-6	-22	-36	-39	-43
Total	1,529	1,608	1,684	1,759	1,845	1,951	2,057
Deficit							
Deficit	180	163	189	203	215	244	265

SOURCE: Congressional Budget Office.

NOTES: Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998 and grows at the rate of inflation after that.

* = not applicable.

a. Differences estimated by CBO. Actual NIPA receipts, expenditures, and deficit for 1994 are subject to revision by the Department of Commerce, Bureau of Economic Analysis.

measuring the government's activities. The federal sector of the national income and product accounts (NIPAs) divides the government's spending and receipts into categories that are conventionally used to analyze domestic production and income. That categorization allows economists to track the relationship between the government and other sectors of the economy.

Just a few major differences distinguish the NIPA versions of federal receipts and expenditures from their budget analogues. Netting and grossing adjustments move some collections, mainly those labeled offsetting receipts in the budget, from the spending to the receipts side of the NIPAs (see Table 12 on page 29). Most are recorded in the budget as negative outlays because they do not result from the government's taxing power. Shifting them to the receipts side of the NIPA ledger gives the users a fuller picture of government receipts regardless of source and does not affect the total deficit.

Macroeconomic analysis typically disregards transactions that merely reflect the transfer of existing assets and liabilities and do not contribute to current production. The NIPAs therefore exclude lending and financial transactions that appear in the budget. Prominent among such adjustments are those for deposit insurance outlays and for direct loans and guarantees made before 1992 (when credit reform was enacted). Other, relatively minor factors that cause the NIPA and budget totals to diverge are geographic adjustments (the exclusion of Puerto Rico, the Virgin Islands, and a few other areas from domestic economic statistics) and timing adjustments (such as the recording of corporate taxes when accrued rather than paid, adjustments for irregular numbers of benefit checks or paychecks because of calendar quirks, and so forth).

Tracing the relationship between the NIPA and the budget data is complicated by the fact that the Bureau of Economic Analysis regularly revises the NIPA data--sometimes by large amounts. Budget totals, in contrast, seldom receive more than negligible revisions. Nevertheless, when the dust finally settles, the NIPA deficit generally resembles the budget deficit excluding deposit insurance--echoing CBO's frequent emphasis on that measure in its regular budget reports.

The NIPA federal sector generally portrays receipts according to their sources and expenditures according to their purpose and destination (see Table 13). Receipts are split into four large categories--personal tax and nontax receipts, corporate profits tax accruals, indirect business tax and nontax accruals, and social insurance contributions--whose labels summarize the nature of the collection and the identity of the payer. The term "nontax" indicates that NIPA receipts include some charges, such as fees and premiums, that are not generally treated as revenues in the budget.

Federal spending can take the form of defense and nondefense purchases (which enter directly into GDP), transfers (most of which find their way into personal income and from there into consumption or saving), grants to state and local governments (which may end up as state and local purchases or transfers), net interest, and the subsidies less the current surplus of government enterprises such as the Postal Service and public housing authorities. A final category--required reductions in discretionary spending--appears in Table 13 as a consequence of the discretionary spending caps that are mandated by law. Those caps will limit future spending for programs funded through the appropriation process. Although no one can predict how particular programs will fare, the deepest effects of the required reductions will almost certainly be felt in the NIPA categories of defense and nondefense purchases and grants.