Chapter Two

The Budget Outlook

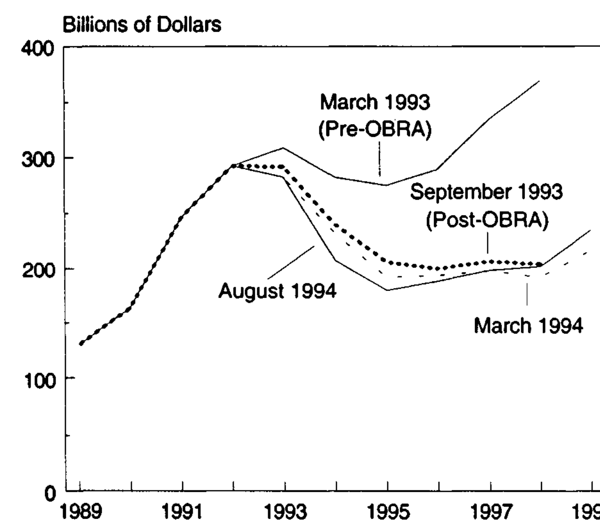
According to the latest projections of the Congressional Budget Office, the deficit in the fiscal year ending on September 30, 1994, will barely top $200 billion. That will be the smallest deficit chalked up in five years. Although the intervening years witnessed several events that temporarily ballooned the deficit--including a recession and massive spending to resolve failed savings and loan institutions--there is no denying the improvement. CBO expects that the deficit in 1995 will fall again in dollar terms (to $162 billion) and will slip below 2½ percent of gross domestic product--the smallest deficit, in relation to GDP, in 16 years. Much of the credit for the turnaround goes to the package of spending cuts and tax increases passed a year ago, the Omnibus Budget Reconciliation Act of 1993 (OBRA-93).

The year-to-year improvement in the deficit stalls after 1995. The deficit gets stuck at about 2½ percent of GDP for several years and then starts climbing at the end of the decade. In dollar terms, the deterioration starts sooner--indeed, immediately after 1995.

The near-term outlook is somewhat sunnier than in CBO's last report to the Congress. The deficit in 1994 will likely be about $26 billion smaller than CBO foresaw last winter; CBO has also trimmed $17 billion from its projected deficit for 1995. Although the revisions to revenues and spending are individually modest--amounting to less than 2 percent of total revenues and outlays--they nevertheless join to reduce the deficit noticeably. They are almost entirely attributable to new economic information and other developments; hardly any legislation affecting the budget totals has been adopted so far this year. These near-term revisions do not alter CBO's view of long-run budget trends. By the end of the decade, projected deficits are marginally bigger than those CBO published last winter.

The most striking aspect of CBO's semiannual budget review is the absence of any big news. Seasoned budget-watchers are accustomed to significant revisions in the budget outlook every six months or so, along with sharp disagreements between the projections of CBO and the Administration. Neither is present in this report. Indeed, in the 12 months since the Congress passed OBRA-93, CBO has issued several new sets of projections, but none has deviated very much from its predecessor (see Figure 2-1). All have conveyed the same underlying message: that OBRA-93 did not erase the deficit but did arrest its upward march for about five years. Nor are there significant differences between the budget stories as told by CBO and by the Administration in its midsession review, a comparison that is presented later in this chapter.

Figure 2-1.
Changes in CBO Deficit Projections, March 1993 to August 1994 (By fiscal year)



SOURCE: Congressional Budget Office.

The Deficit Outlook

At around $200 billion, the deficit in 1994 will be down by more than $50 billion from last year's level and will be the smallest since 1989. Two concerted efforts at deficit reduction took place in the meantime, in 1990 and in 1993. For a few years in the late 1980s, the deficit had seemed to settle at about $150 billion but then shot up. To make matters more awkward, statutory targets on the books at the time--contained in the law popularly known as Gramm-Rudman-Hollings--stipulated that the deficit was supposed to be falling precipitously, not rising. The bleak outlook spurred a months-long budget summit between the Congress and the Bush Administration, culminating in the Omnibus Budget Reconciliation Act of 1990. And when the budget numbers continued to worsen, despite the cuts adopted in 1990, a second big package (OBRA-93) followed less than three years later.

Both packages curbed spending, raised revenues, and downplayed fixed deficit targets, which had proved to be elusive in practice, in favor of reforms in the budget process to ensure that the hard-won savings would not be undone. Both also achieved significant savings on the deficit front--about $500 billion and $400 billion over their respective five-year horizons, according to past CBO estimates.[1] Yet as was widely acknowledged when OBRA-93 was enacted, the deficit is not about to fade away in the absence of further policy changes.

Part of the deficit's jump in the early 1990s stemmed from temporary causes that were well recognized at the time. In fact, although economists and financial market analysts use the deficit as a rough-and-ready measure of the government's drain on national saving and on credit markets, they routinely adjust it for ephemeral factors.

A prime example was the huge outlays for deposit insurance in the 1989-1991 period as the government moved to close or merge hundreds of ailing savings and loan institutions and, less prominently, commercial banks. Although such spending swells the government's outlays, economists treat it as involving little or no fiscal stimulus. After all, most of the losses symbolized by deposit insurance outlays were incurred in the past--when institutions made bad loans and investments--even though those losses were invisible in the budget totals at the time. The government's subsequent actions to protect insured depositors, who had regarded their funds as safe, injected no extra stimulus into the economy. And some deposit insurance spending results in the acquisition of assets by the government that are sold later, explaining why such spending swung below zero beginning in 1993.

A second factor that is regularly segregated when eyeing the deficit's trend is the effect of the business cycle. When the economy is performing far beneath its potential--as in a recession or the early stages of a recovery--revenues falter, outlays for programs such as unemployment insurance rise, and the deficit is bigger than it would be otherwise. These effects are captured in the cyclical deficit. The deficit that remains, after subtracting the cyclical deficit and spending for deposit insurance, cannot be ascribed to a weak economy or to ephemeral factors, and is labeled the standardized-employment, or structural, deficit. In 1991 and 1992, cyclical effects accounted for more than one-fourth of the record-high deficits. But in today's buoyant economy, as documented in Chapter 1, their contribution to the red ink is negligible.

A deficit of about $200 billion in 1994 marks a dramatic improvement over the 1991-1993 period taken at face value. The improvement is less pronounced but still impressive when the deficit is converted to a standardized-employment basis by adjusting it for the effects of deposit insurance spending and the business cycle (see Table 2-1 and Summary Figure 1). By either measure, the deficit bulged in the early 1990s and was reined in by OBRA-93.

Whatever measure is chosen, CBO's latest deficit projections tell the same story about the 1995-1999 period. The deficit falls from recent levels through mid-decade, flattens, then begins to climb

1. See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1992-1996* (January 1991), Chapter 3, and *The Economic and Budget Outlook: An Update* (September 1993), Chapter 2.

again, picking up steam in 1999. This pattern is not an accident; pressures created by the growth in health care spending and federal interest costs and by the expiration of the stringent caps on discretionary spending in 1999 drive up spending faster than revenues. Indeed, CBO's broadbrush projections for a 10-year period suggest that such fundamental long-run dynamics push the deficit up, not down (see Box 2-1).

Changes in the Budget Outlook Since Last Winter

CBO has revised its budget projections relatively little since the beginning of the year. On balance, CBO has trimmed its projections of the deficit in 1994 and 1995 but upped them in 1998 and 1999, with very small changes in the intervening years (see Table 2-2).

Table 2-1.
CBO Baseline Deficit Projections (By fiscal year)

	Actual 1993	1994	1995	1996	1997	1998	1999
	In Billions of Dollars						
Total Deficit Assuming Discretionary Caps	255	202	162	176	193	197	231
Deficit Excluding Deposit Insurance	283	207	180	188	198	202	235
Standardized-Employment Deficit[a]	221	184	183	195	200	196	223
On-Budget Deficit (Excluding Social Security and Postal Service)	300	258	233	254	276	285	325
Memorandum:							
Deposit Insurance	-28	-5	-17	-12	-5	-5	-4
Off-Budget Surplus							
Social Security	47	58	71	77	83	89	94
Postal Service	-1	-2	-1	1	b	-1	b
Total, Off-Budget Surplus	45	57	71	78	83	88	94
Hospital Insurance Surplus	4	4	7	6	b	-5	-14
	As a Percentage of GDP						
Total Deficit Assuming Discretionary Caps	4.0	3.0	2.3	2.4	2.5	2.4	2.7
Deficit Excluding Deposit Insurance	4.5	3.1	2.5	2.5	2.5	2.5	2.7
Standardized-Employment Deficit[a,c]	3.4	2.7	2.6	2.6	2.6	2.4	2.6

SOURCE: Congressional Budget Office.

a. Excludes the cyclical deficit and deposit insurance spending.

b. Less than $500 million.

c. Expressed as a percentage of potential GDP.

Box 2-1.
The Ten-Year Budget Outlook

The Congressional Budget Office's (CBO's) latest look at trends in revenues and spending over the next 10 years tells a familiar story--namely, that the federal deficit is expected to head back up in the late 1990s. The deficit is projected to double from around $200 billion in 1998 to nearly $400 billion by 2004 (see table at right). A more meaningful figure, the ratio of the deficit to gross domestic product (GDP), marches steadily upward from 2.4 percent to 3.6 percent over the same period. This trend clearly indicates that the savings achieved in 1990 and 1993 did not bring the deficit permanently under control.

In deriving its 10-year projections, CBO does not assiduously estimate every component of revenue and spending as it does for the full-fledged baseline. Rather, it attempts to capture broad trends in revenues and spending based on reasonable assumptions about the path of the economy and other factors. Such projections aid policymakers in looking beyond the usual five-year window that is mandated for budget estimates and Congressional scorekeeping.

The current extrapolation points to a deficit of $397 billion, or 3.6 percent of GDP, in 2004. This estimate barely differs from CBO's last such estimate of $385 billion, or 3.5 percent of GDP, presented last April in CBO's analysis of the President's budgetary proposals.

As before, the long-run projections single out discretionary spending and health care programs as the only broad areas likely to grow or shrink significantly--in relation to GDP--over the next 10 years. The dollar caps on discretionary outlays push such spending down from an estimated 8.2 percent of GDP in 1994 to 6.7 percent in 1998. Although CBO assumes that discretionary spending will increase with inflation beginning in 1999 (after the caps expire), such outlays would still drift down as a percentage of GDP, reaching 6.1 percent by 2004. This continued, albeit slower, decline results simply from the assumption that GDP will grow in real terms but discretionary spending will not.

CBO expects, however, that the two big health care programs, Medicare and Medicaid, will continue to grow faster than GDP, as they have since they were created in the mid-1960s. Outlays for these two programs combined are expected to climb from 3.6 percent of GDP in 1994 to 6.2 percent in 2004. Through 1998, the drop in discretionary spending (in relation to GDP) is enough to outweigh the steady rise in health care spending, but that is no longer true once the caps expire. Thus, all other things being equal, the deficit would start to climb as a percentage of GDP. And other things are roughly equal: other major categories of spending, as well as federal revenues, are expected to remain nearly constant as a share of GDP for the next decade. Social Security benefits, in particular, hover just under 5 percent of GDP through 2004--when the oldest members of the baby-boom generation are still at least three years from eligibility for retirement benefits. As a consequence of the deficit outlook, the debt-to-GDP ratio is basically flat (at about 51 percent) through 1998 but then inches up, reaching 56 percent by 2004.

Any long-range projection inherently contains a great deal of uncertainty. Over the 2000-2004 period, CBO assumes inflation (as measured by the consumer price index) of 3.4 percent and real economic growth of 2.3 percent annually. Interest rates are notoriously hard to forecast but are vitally important to the budget outlook, given the growing federal debt; CBO assumes a short-term interest rate of 4.9 percent on three-month Treasury bills and a long-term interest rate of 6.5 percent on 10-year Treasury notes. Of course, the economy will deviate from this path in ways that cannot be anticipated. Federal spending and revenues also may diverge from their assumed paths for unpredictable reasons. But from today's vantage point, a prudent observer should expect the deficit to grow unless the tax and spending policies now in place are changed.

The Budget Outlook Through 2004 (By fiscal year)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
In Billions of Dollars											
Revenues	1,265	1,363	1,433	1,492	1,562	1,632	1,713	1,799	1,891	1,988	2,091
Outlays											
Discretionary	545	546	550	547	547	566	585	605	626	647	669
Mandatory											
Social Security	317	333	350	368	388	408	430	452	476	501	528
Medicare	158	177	195	216	238	263	290	320	354	391	434
Medicaid	84	96	108	121	135	151	168	186	206	227	250
Civil Service and Military Retirement	63	65	68	71	74	79	83	87	91	95	100
Other	172	175	176	189	197	205	213	220	227	235	243
Subtotal	794	847	898	965	1,032	1,107	1,183	1,265	1,354	1,451	1,555
Deposit insurance	-5	-17	-12	-5	-5	-4	-2	-2	-2	-2	-2
Net interest	202	226	245	253	264	277	290	307	325	346	368
Offsetting receipts	-68	-77	-72	-75	-80	-83	-86	-90	-94	-98	-103
Total	1,467	1,525	1,609	1,684	1,758	1,863	1,970	2,086	2,209	2,343	2,488
Deficit	202	162	176	193	197	231	257	287	319	355	397
Deficit Excluding Deposit Insurance	207	180	188	198	202	235	260	288	321	357	399
Debt Held by the Public	3,440	3,611	3,801	4,011	4,226	4,476	4,753	5,059	5,397	5,771	6,188
As a Percentage of GDP											
Revenues	19.0	19.3	19.3	19.1	19.1	19.0	19.0	19.0	19.0	19.0	18.9
Outlays											
Discretionary	8.2	7.7	7.4	7.0	6.7	6.6	6.5	6.4	6.3	6.2	6.1
Mandatory											
Social Security	4.7	4.7	4.7	4.7	4.7	4.8	4.8	4.8	4.8	4.8	4.8
Medicare	2.4	2.5	2.6	2.8	2.9	3.1	3.2	3.4	3.5	3.7	3.9
Medicaid	1.3	1.4	1.5	1.6	1.7	1.8	1.9	2.0	2.1	2.2	2.3
Civil Service and Military Retirement	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other	2.6	2.5	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.2	2.2
Subtotal	11.9	12.0	12.1	12.4	12.6	12.9	13.1	13.4	13.6	13.8	14.1
Deposit insurance	-0.1	-0.2	-0.2	-0.1	-0.1	a	a	a	a	a	a
Net interest	3.0	3.2	3.3	3.2	3.2	3.2	3.2	3.2	3.3	3.3	3.3
Offsetting receipts	-1.0	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-0.9	-0.9	-0.9
Total	22.0	21.6	21.6	21.6	21.5	21.7	21.8	22.0	22.2	22.3	22.5
Deficit	3.0	2.3	2.4	2.5	2.4	2.7	2.9	3.0	3.2	3.4	3.6
Deficit Excluding Deposit Insurance	3.1	2.5	2.5	2.5	2.5	2.7	2.9	3.0	3.2	3.4	3.6
Debt Held by the Public	51.5	51.1	51.2	51.4	51.7	52.2	52.7	53.4	54.1	55.0	56.1

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent of GDP.

New legislation changes the outlook by less than $500 million in any year. Only two significant measures have been enacted. One made it easier for the Federal Housing Administration to sell property it had obtained through foreclosure, resulting in lower holding costs over many years. Under the reformed accounting rules adopted in 1990 for credit programs, the budget recorded the expected savings of about $400 million all at once when the legislation was enacted.

The other, the Federal Workforce Restructuring Act of 1994, mandated reductions in federal civilian employment of about 10 percent between now and 1999 and permitted agencies to offer buyouts of up to $25,000 through March 1995 to induce employees to leave. Because those changes would lead to additional retirement benefits in the near term, the act also directed agencies temporarily to contribute more to the retirement funds. Only these narrow retirement-related effects of the legislation show up

Table 2-2.
Changes in CBO Baseline Deficit Projections (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
Winter Baseline Deficit	228	180	180	192	187	213
Legislative Changes	a	a	a	a	a	a
Economic Changes						
Revenues	-9	-20	-20	-12	-6	-5
Outlays						
Net interest	3	15	17	13	13	14
Other outlays	-1	-3	-3	-2	-1	4
Subtotal, Outlays	2	12	14	11	12	17
Deficit	-8	-8	-5	-2	6	12
Technical Changes						
Revenues	-6	-4	-2	-1	1	3
Outlays						
Deposit insurance	-1	-5	2	1	a	a
Student loans	-2	a	1	a	a	a
Earned income tax credit	1	2	2	2	2	2
Medicaid and Medicare	-4	0	0	0	0	0
Offsetting receipts from agencies' contributions to retirement funds	a	1	1	1	2	2
Other	-6	-3	-3	-1	-1	-1
Subtotal, Outlays	-12	-5	4	4	3	3
Deficit	-18	-10	2	3	4	6
Total Changes	-26	-17	-4	1	10	18
Summer Baseline Deficit	202	162	176	193	197	231

SOURCE: Congressional Budget Office.

NOTE: Revenue increases are shown with a negative sign because they reduce the deficit.

a. Less than $500 million.

on the official pay-as-you-go scorecard that the Congress uses to monitor legislation, and they amount roughly to zero over the five-year period. The savings from the employment reductions will materialize in agencies' payroll accounts, which are a significant part (approximately one-fifth) of the discretionary spending cluster that is subject to the statutory caps; that is, savings on the personnel front were virtually inescapable under the belt-tightening already demanded by the caps.

A more important source of revision is changes in the economic outlook. Indeed, the underlying pattern of changes in the deficit outlook--first down, then up--is explained by this source. As noted in Chapter 1, the economy and, hence, revenues have perked up faster than anticipated. But over time, revenues return nearly to the path that CBO previously expected; after all, the economy cannot operate above its potential indefinitely. At the same time, less favorable trends take on added importance. Chief among them is the outlook for interest rates. Partly as a consequence of the buoyant economy, CBO now expects noticeably higher interest rates in the next two years than it did before, though by 1999 the increase tapers off to less than half a percentage point. The federal debt held by the public--now $3.4 trillion and expected to approach $4.5 trillion by 1999--is big enough that even such seemingly modest revisions in the assumptions about interest rates boost spending significantly. And a similar twist affects the projections for noninterest spending: reductions in outlays for unemployment insurance and similar programs occur early but give way to the extra spending that gradually results from higher inflation. In sum, revisions attributable to the economic forecast shrink the deficit by $8 billion in both 1994 and 1995 but boost it by $12 billion in 1999.

Revisions that do not result from economic developments or new legislation are dubbed technical and, as this definition implies, can stem from a variety of reasons. On the revenue front, technical revisions are favorable for a few years but then fade into insignificance. Upward revisions to taxes on corporate profits reflect the strong collections from this source (stronger even than suggested by data on profits) and dominate the numbers at first, but they are gradually overtaken by weaker trends in two much bigger revenue sources, individual income taxes and social insurance taxes.

On the spending side, deposit insurance--a volatile category of spending--is down by $5 billion in 1995, chiefly from lower estimates of spending by the Resolution Trust Corporation as it wraps up its phase of the savings and loan cleanup before passing the baton to the Savings Association Insurance Fund by July 1995. A downward revision in the outlays for the government's student loan program is mostly a one-shot affair: the Student Loan Marketing Administration (nicknamed Sallie Mae) repaid its entire $5 billion debt to the Treasury two years ahead of schedule. CBO had expected Sallie Mae to repay $2 billion of its debt in 1994 and the remaining $3 billion in 1996; Sallie Mae's decision to pay the full amount this year leads to equal and offsetting revisions in 1994 and 1996.

The earned income tax credit, a program aimed chiefly at supplementing the earnings of low-income families with children, is running $1 billion to $2 billion a year higher than expected. Spending for Medicare and Medicaid in 1994 is down about $4 billion from previous projections. Because the reasons for the slowdown are murky--and because $4 billion represents less than 2 percent of those programs' combined outlays--CBO has opted not to revise its 1995-1999 projections, which are serving as a base for estimating the budgetary effects of the competing health care proposals under consideration in the Congress. Estimated receipts of government retirement funds (such as Civil Service Retirement and Social Security) from federal agencies on behalf of their employees--an intrabudgetary collection--have been pruned by as much as $2 billion in 1999, partly because of the employment cuts that are now incorporated in CBO's projections and partly to reflect other new information about coverage and contribution rates.

Finally, other revisions are negligible in all years except 1994, when they lead CBO to trim its earlier projections by $6 billion. Lower-than-expected outlays in many departments this year--affecting programs as varied as international aid, space, justice, environmental spending, and credit programs--are largely responsible. Such trends, though, never send clear-cut messages. Outlays can emerge from the spending pipeline any time after agencies commit or obligate the budget authority that they are granted in appropriation acts; since agencies do commit most of their allowable money, sluggish disbursements in one year presumably will be offset in some future year. Furthermore, most of the programs that are spending less than anticipated this year are governed by the discretionary spending caps. The Congress decided in its budget resolution adopted in May to spend almost the full amount allowable under the outlay caps in 1995--mimicking CBO's baseline assumption and hence obviating the need for any revision in 1995 and beyond. That budget resolution is guiding the 13 regular appropriation bills now wending their way through the Congress for the fiscal year beginning October 1.

CBO Baseline Projections

In 1994, federal revenues are expected to equal $1,265 billion and outlays $1,467 billion. The major components of these totals, and their pro-

Table 2-3.
CBO Baseline Budget Projections, Assuming Compliance with Discretionary Spending Caps (By fiscal year)

	Actual 1993	1994	1995	1996	1997	1998	1999
			In Billions of Dollars				
Revenues							
Individual income	510	549	600	637	667	703	741
Corporate income	118	141	146	149	153	157	162
Social insurance	428	463	498	523	545	569	594
Other	98	112	119	124	127	131	135
Total	1,154	1,265	1,363	1,433	1,492	1,562	1,632
On-budget	842	929	1,003	1,055	1,096	1,148	1,200
Off-budget	312	336	360	378	395	414	433
Outlays							
Discretionary[a]							
Defense	292	280	273	277	283	291	298
International	22	20	21	21	22	22	23
Domestic	228	244	260	267	273	282	290
Unspecified reductions	0	0	-8	-15	-31	-48	-46
Subtotal	542	545	546	550	547	547	566
Mandatory	762	794	847	898	965	1,032	1,107
Deposit insurance	-28	-5	-17	-12	-5	-5	-4
Net interest	199	202	226	245	253	264	277
Offsetting receipts	-67	-68	-77	-72	-75	-80	-83
Total	1,408	1,467	1,525	1,609	1,684	1,758	1,863
On-budget	1,142	1,188	1,236	1,308	1,372	1,432	1,525
Off-budget	267	279	289	300	312	326	339
Deficit	255	202	162	176	193	197	231
On-budget deficit	300	258	233	254	276	285	325
Off-budget surplus	45	57	71	78	83	88	94
Debt Held by the Public	3,247	3,440	3,611	3,801	4,011	4,226	4,476

SOURCE: Congressional Budget Office.

a. Discretionary caps are set by law through fiscal year 1998. Discretionary outlays for 1999 are estimated as the 1998 amount adjusted for inflation. Estimates for particular subcategories--defense, international, and domestic--represent amounts that would be spent if 1994 jected growth over the next five years, are depicted in Table 2-3.

The Outlook for Revenues

Federal revenues are expected to equal 19.0 percent of GDP in 1994, rise to 19.3 percent in 1995 and 1996, then slip back to 19.0 percent by 1999. Individual income taxes are the only source of revenue that outpaces GDP, according to CBO's projections. From 8.2 percent of GDP this year, such taxes jump to 8.5 percent in 1995 and essentially stay there--a pattern largely traceable to the tax increases levied by OBRA-93. That law approaches its full revenue potential in fiscal year 1995. Its contributions in fiscal year 1994 are smaller, for two reasons: higher withholding from wages and salaries did not begin until January 1994; and on April 15, taxpayers were allowed to pay only one-third of the extra liabilities OBRA imposed on high-income people for calendar year 1993 (with the remaining two-thirds deferred to later years). The government's other major sources of revenue--corporate income taxes, social insurance

Table 2-3.
Continued

	Actual 1993	1994	1995	1996	1997	1998	1999
	As a Percentage of GDP						
Revenues							
Individual income	8.1	8.2	8.5	8.6	8.5	8.6	8.6
Corporate income	1.9	2.1	2.1	2.0	2.0	1.9	1.9
Social insurance	6.8	6.9	7.0	7.0	7.0	7.0	6.9
Other	1.6	1.7	1.7	1.7	1.6	1.6	1.6
Total	18.3	19.0	19.3	19.3	19.1	19.1	19.0
On-budget	13.4	13.9	14.2	14.2	14.1	14.0	14.0
Off-budget	5.0	5.0	5.1	5.1	5.1	5.1	5.0
Outlays							
Discretionary							
Defense	4.6	4.2	3.9	3.7	3.6	3.6	3.5
International	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Domestic	3.6	3.7	3.7	3.6	3.5	3.4	3.4
Unspecified reductions	0	0	-0.1	-0.2	-0.4	-0.6	-0.5
Subtotal	8.6	8.2	7.7	7.4	7.0	6.7	6.6
Mandatory	12.1	11.9	12.0	12.1	12.4	12.6	12.9
Deposit insurance	-0.4	-0.1	-0.2	-0.2	-0.1	-0.1	b
Net interest	3.2	3.0	3.2	3.3	3.2	3.2	3.2
Offsetting receipts	-1.1	-1.0	-1.1	-1.0	-1.0	-1.0	-1.0
Total	22.4	22.0	21.6	21.6	21.6	21.5	21.7
On-budget	18.1	17.8	17.5	17.6	17.6	17.5	17.8
Off-budget	4.2	4.2	4.1	4.0	4.0	4.0	3.9
Deficit	4.0	3.0	2.3	2.4	2.5	2.4	2.7
On-budget deficit	4.8	3.9	3.3	3.4	3.5	3.5	3.8
Off-budget surplus	0.7	0.8	1.0	1.0	1.1	1.1	1.1
Debt Held by the Public	51.6	51.5	51.1	51.2	51.4	51.7	52.2

appropriations were increased for inflation; unspecified reductions represent savings below those amounts required to satisfy the discretionary caps.

b. Less than 0.05 percent of GDP.

taxes, and other taxes such as excise taxes, estate and gift taxes, customs duties, and profits returned by the Federal Reserve System--remain constant or fall slightly in relation to GDP.

The Outlook for Spending

The Budget Enforcement Act of 1990 (BEA) formalized the use of several categories that CBO had long 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, and the operation of the Internal Revenue Service and the court system, to name a few.

Since fiscal year 1991, discretionary spending has been constrained by dollar caps. The BEA set caps for 1991 through 1995, and OBRA-93 extended their applicability through 1998. The caps will essentially freeze such spending at today's levels for four more years. Barring future emergencies, outlays will be held to the mid-$540 billion range, and budget authority (the authority to commit funds, the basic currency of the appropriation process) will be constrained accordingly. Within these limits, policymakers must make trade-offs among competing needs--defense, international, and domestic. Because the caps essentially hold discretionary spending flat even as the economy grows, such outlays shrink steadily in relation to the economy: from 8.2 percent of GDP today--already far below the levels of 10 percent to 12 percent that were typical of the 1960-1989 period--they drift down to 6.6 percent in 1999.

All other categories of spending are controlled indirectly by the Congress. Mandatory spending is the single biggest category of outlays, approaching $800 billion this year. It climbs steadily, outpacing the growth of GDP, in CBO's projections. By 1999, it amounts to 12.9 percent of GDP, up a percentage point from today's levels. The familiar benefit programs run by the government--led by Social Security, Medicare, and Medicaid, a joint federal/state program--dominate this huge category of spending (see Table 2-4). Lawmakers control such spending indirectly, not by voting annual dollar amounts but by setting standards for eligibility, benefit formulas, and so forth. The big health care entitlements essentially explain why mandatory spending, and eventually the deficit, are projected to grow in relation to GDP (see Box 2-1).

Deposit insurance outlays in CBO's newest projections are subdued in comparison with the wildly fluctuating levels of recent years. Deposit insurance spending spiked to $58 billion in 1990 and $66 billion in 1991, then registered negative outlays (that is, collections in excess of spending) of $28 billion in 1993. 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 lies outside policymakers' close control; they influence such costs indirectly by making decisions that affect the size of the debt, but they do not directly control the market interest rates that the Treasury must pay. Remarkably, net interest outlays in 1994 will be about $200 billion for the fourth year in a row, even as the debt has grown by $1 trillion over the same period. This welcome stability--the result of refinancing large amounts of maturing debt at lower rates--will soon end. Net interest is set to climb to $226 billion next year and to $277 billion in 1999, given CBO's outlook for interest rates and continued federal borrowing.

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

Table 2-4.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance
(By fiscal year, in billions of dollars)

	Actual 1993	1994	1995	1996	1997	1998	1999
	Means-Tested Programs						
Medicaid	76	84	96	108	121	135	151
Food Stamps[a]	25	26	26	27	28	29	31
Supplemental Security Income	21	25	24	24	29	32	35
Family Support	16	17	18	18	19	20	20
Veterans' Pensions	4	3	3	3	3	3	3
Child Nutrition	7	7	7	8	8	9	9
Earned Income Tax Credit	9	11	17	20	22	23	25
Student Loans	2	3	2	2	2	2	2
Other	3	3	3	4	4	4	5
Total, Means-Tested Programs	162	179	198	214	236	258	281
	Non-Means-Tested Programs						
Social Security	302	317	333	350	368	388	408
Medicare	143	158	177	195	216	238	263
Subtotal	445	475	510	545	584	625	671
Other Retirement and Disability							
Federal civilian[b]	39	40	43	44	46	49	51
Military	26	26	27	29	30	32	35
Other	4	5	5	5	5	5	5
Subtotal	69	72	75	78	82	86	91
Unemployment Compensation	35	27	22	24	25	27	28
Other Programs							
Veterans' benefits[c]	17	18	17	16	18	18	19
Farm price supports	16	11	9	8	9	9	9
Social services	5	6	6	6	6	6	5
Credit reform liquidating accounts	2	-5	-1	-3	-4	-5	-6
Other	11	12	11	10	10	10	8
Subtotal	51	41	41	37	38	37	36
Total, Non-Means-Tested Programs	600	615	649	684	728	775	826
	Total						
All Mandatory Spending, Excluding Deposit Insurance	762	794	847	898	965	1,032	1,107

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 nutritic ~ assistance to Puerto Rico.

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

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

Table 2-5.
Comparison of CBO Baseline with OMB Midsession Review (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
OMB Midsession Review Deficit[a]	220	167	179	190	192	207
Differences						
Outlays						
Discretionary spending	-7	1	5	2	-1	12
Deposit insurance	-2	1	-4	-2	-3	-1
Mandatory spending and offsetting receipts	-2	1	b	3	6	6
Net interest	-2	2	3	-2	-5	-5
Total	-13	4	4	1	-3	11
Revenues	-6	-9	-7	2	7	12
Deficit	-18	-5	-3	3	5	24
CBO Baseline Deficit	202	162	176	193	197	231

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

NOTE: Additional revenues are shown with a negative sign because they reduce the deficit.

a. Excluding the effects of the President's proposal for health care reform.

b. Less than $500 million.

A Comparison with the Administration's Projections

On July 14, the Administration's Office of Management and Budget (OMB) issued its midsession review of the budget. Disagreements between the OMB and CBO projections are muted (see Table 2-5). The only pronounced differences are in the first and last years of the projections, 1994 and 1999.

In 1994, the Administration arguably did not take full account of the sluggish spending that is discernible from the *Monthly Treasury Statement* and other data. CBO projects that the 1994 deficit will be $202 billion, versus the Administration's projection of $220 billion; two-thirds of the difference is attributable to CBO's lower projection of spending and just one-third to greater revenues.

The two agencies' projections for the 1995-1999 period are not strictly comparable. CBO's baseline estimates represent the implications of continuing current taxing and spending policies, whereas OMB's projections incorporate the effects of a few minor proposals that would alter current policies. The total effects of those proposals, however, are quite tiny, and most are concentrated in the discretionary spending area.[2] In its baseline projections, CBO assumes that discretionary spending is equal to the caps in 1995 through 1998; the Administration, in contrast, proposes spending that is slightly below the caps in 1996 and 1997. Furthermore, in 1999,

2. See Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1995* (April 1994), Table 1. One proposal that was identified as a departure from current policy in that report--the effects of cutting federal employment on retirement contributions--is now substantially incorporated in the CBO baseline because of the enactment of limits on federal civilian employment in the Federal Workforce Restructuring Act of 1994.

when the caps have expired, CBO returns to its traditional baseline practice of estimating discretionary spending at the previous year's level with an adjustment for inflation. OMB's projections, in contrast, incorporate hardly any rise in discretionary spending in 1999, generating a $12 billion difference in that final year.

Other differences between the two agencies' projections are similarly undramatic. By 1999, CBO expects $6 billion more in mandatory spending than does OMB, chiefly in Medicaid, unemployment insurance, and the earned income tax credit. As discussed in Chapter 1, CBO expects slightly higher rates on short-term Treasury bills than does the Administration, especially through 1995, but it also expects slightly lower rates on long-term Treasury notes and bonds for the entire five years ahead. Differences in the two agencies' projections of net interest spending roughly track these contrasting assumptions about interest rates. Finally, CBO assumes a larger nominal GDP than does OMB through 1995 but chooses a more conservative assumption about the economy's long-run potential for growth thereafter. Largely as a consequence, CBO's revenues are smaller than the Administration's in the last few years of the projection.

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 measuring the government's activities. The national income and product accounts (NIPAs) divide the government's spending and receipts into categories that are conventionally used to analyze domestic production and income, helping economists to trace 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--most of which are labeled offsetting receipts in the budget--from the spending to the receipts side of the NIPAs (see Table 2-6). Most are recorded in the budget as negative outlays because they are not deemed to result from the government's taxing power. Shifting them to the receipts side of the NIPAs satisfies the desire of the accounts' users for a fuller picture of government receipts regardless of source and clearly does not affect the total deficit. Such adjustments total $83 billion in 1994 and grow steadily thereafter.

Excluding lending and financial transactions, in contrast, does drive a wedge between the budget and NIPA deficits. Macroeconomic analysis typically disregards transactions that merely reflect the transfer of existing assets and liabilities and therefore do not contribute to current income or production. Prominent among such adjustments are those for deposit insurance outlays and direct loans made by (or repaid to) the government. Other, relatively minor factors that cause NIPA and budget totals to diverge are geographic adjustments (the exclusion of Puerto Rico, the Virgin Islands, and a few other areas from the 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--but does not routinely publish a full-fledged bridge to the budget totals. (Those 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 this 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 2-7). 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

Table 2-6.
Relationship of the Budget to the Federal Sector of the National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual 1993[a]	1994	1995	1996	1997	1998	1999
			Receipts				
Revenues (Budget basis)[b]	1,153	1,265	1,363	1,433	1,492	1,562	1,632
Differences							
Netting and grossing							
Government contributions							
for employee retirement	55	56	58	61	64	67	72
Medicare premiums	15	17	20	20	22	26	27
Deposit insurance premiums	6	7	7	5	3	3	3
Other	4	3	7	2	c	c	c
Geographic exclusions	-2	-3	-3	-3	-3	-3	-3
Other	12	5	-2	3	2	c	c
Total	89	86	86	87	89	92	98
Receipts (NIPA basis)	1,242	1,351	1,449	1,520	1,580	1,654	1,731
			Expenditures				
Outlays (Budget basis)[b]	1,408	1,467	1,525	1,609	1,684	1,758	1,863
Differences							
Netting and grossing							
Government contributions							
for employee retirement	55	56	58	61	64	67	72
Medicare premiums	15	17	20	20	22	26	27
Deposit insurance premiums	6	7	7	5	3	3	3
Other	4	3	7	2	c	c	c
Lending and financial transactions							
Deposit insurance	23	-1	11	7	2	1	c
Other	-6	1	-1	1	2	2	2
Defense timing adjustment	2	1	1	1	1	1	1
Geographic exclusions	-8	-9	-9	-10	-10	-11	-11
Other	-3	-16	-4	-2	-7	-7	-7
Total	88	59	89	83	76	83	86
Expenditures (NIPA basis)	1,497	1,526	1,614	1,692	1,761	1,841	1,949
			Deficit				
Deficit (Budget basis)[b]	255	202	162	176	193	197	231
Differences							
Lending and financial transactions	17	c	10	8	3	4	2
Defense timing adjustment	2	1	1	1	1	1	1
Geographic exclusions	-5	-6	-7	-7	-7	-8	-8
Other	-14	-22	-1	-6	-9	-7	-7
Total	-1	-27	3	-4	12	-10	-13
Deficit (NIPA basis)	254	174	165	172	181	187	218

SOURCE: Congressional Budget Office.

a. Estimate based on data from the Department of Commerce, Bureau of Economic Analysis, July 1994.

b. Includes Social Security and the Postal Service.

c. Less than $500 million.

Table 2-7.
Projections of Baseline Receipts and Expenditures Measured by the National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual 1993[a]	1994	1995	1996	1997	1998	1999
			Receipts				
Personal Tax and Nontax Receipts	514	558	611	650	680	717	755
Corporate Profits Tax Accruals	134	157	161	164	169	174	180
Indirect Business Tax and Nontax Accruals	83	91	97	97	93	96	98
Contributions for Social Insurance	511	545	580	610	638	667	698
Total	1,242	1,351	1,449	1,520	1,580	1,654	1,731
			Expenditures				
Purchases of Goods and Services							
Defense	307	292	292	297	304	313	324
Nondefense	140	145	155	161	167	173	179
Subtotal	447	437	447	458	471	486	502
Transfer Payments							
Domestic	634	661	703	749	797	849	908
Foreign	16	14	15	15	16	16	16
Subtotal	650	675	718	764	813	865	924
Grants-in-Aid to State and Local Governments	181	196	220	237	254	273	292
Net Interest	184	185	207	224	230	240	253
Subsidies Less Current Surplus of Government Enterprises	35	33	31	32	34	34	34
Required Reductions in Discretionary Spending	n.a.	n.a.	-11	-23	-41	-58	-57
Total	1,497	1,526	1,614	1,692	1,761	1,841	1,949
			Deficit				
Deficit	254	174	165	172	181	187	218

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Estimate based on data from the Department of Commerce, Bureau of Economic Analysis, July 1994.

the identity of the payer. The term "nontax" is a tip-off 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 2-7 as a consequence of the discretionary spending caps that are mandated by law. These caps will limit future spending for programs funded through the appropriation process. Though 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.