The On-Budget Deficit and Its Variants

A deficit sometimes cited by policymakers, the press, and the public is the on-budget deficit. Unlike the measures just discussed, this measure has no particular usefulness for macroeconomic analysis; rather, it is rooted in legislation that granted special, off-budget status to particular programs run by the government.

On- and Off-Budget Programs. The two Social Security trust funds--Old-Age and Survivors Insurance and Disability Insurance--were granted off-budget status in the Balanced Budget Act, known informally as Gramm-Rudman-Hollings. This shift nevertheless did not affect the choice of fiscal policy targets. The 1985 act and its 1987 successor still focused on the total deficit, including Social Security, in setting out a daunting timetable to balance the budget by the early 1990s.

Both 1990's Budget Enforcement Act and 1993's Omnibus Budget Reconciliation Act, which amended the Balanced Budget Act, downplayed fixed deficit targets. Dollar targets exist on paper through 1995, but they move up and down, either automatically or at the President's option, with the economic and technical factors that buffet the budgetary outlook. The existing targets apply to the on-budget deficit--that is, they exclude Social Security and the much smaller net outlays of the Postal Service, which is also legally off-budget.

The budget picture looks quite different if off-budget programs are excluded (see Table 2-1). In isolation, Social Security runs a surplus; its income from payroll taxes, interest, and other sources exceeds its outlays for benefits and other, minor categories of spending. Thus, removing Social Security from the on-budget totals makes the remaining deficit bigger. The Social Security surplus is entirely in the Old-Age and Survivors Insurance fund. The Disability Insurance fund is hemorrhaging fast and, in the absence of legislative action to raise or reallocate taxes or to stabilize benefits, is expected to exhaust its balances sometime early in fiscal year 1996, just two years from now. About one-half of Social Security's total surplus stems not from its excess of taxes over benefits, but from interest on its holdings of Treasury securities.

Social Security benefits alone account for over one-fifth of federal spending and its payroll taxes for over one-fourth of government revenues. When analyzing the budget to gauge the government's role in the economy and its drain on the credit markets, excluding such a big program wholesale is clearly unhelpful.

Many economists and policymakers worry about the future demands that will be placed on the budget by demographic pressures, especially as the baby-boom generation born after World War II joins the Social Security and Medicare rolls. CBO and others have pointed out that the best way to prepare for such pressures is to save and invest more now, thereby enlarging the future economic pie and diminishing the relative sacrifices that will be demanded of future workers. The most obvious way to save and invest more is to reduce the federal deficit, which siphons private saving. But CBO has also pointed out that what really matters is that this saving gets done somehow, not whether it is recorded in the Social Security or non-Social Security part of the budget.[2]

Federal Trust Funds. The two Social Security funds share the trust fund label with many other federal programs. In total, there are more than 150 federal trust funds, though fewer than a dozen account for the vast share of trust fund dollars.

Viewed by themselves, trust funds run surpluses because their earmarked income (chiefly from social insurance taxes and from transfers within the budget, as explained below) exceeds spending for benefits, administration, and other costs. The total trust fund surplus is expected to climb from about $113 billion in 1994 to $145 billion in 1999 (see Table 2-2). Although a fund's annual surplus is of interest to policy analysts who monitor that program, its usefulness is necessarily limited. It cannot possibly reveal, for example, who is paying the taxes, who is receiv-

2. Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1990-1994* (January 1989), Chapter 3.

ing the benefits, and whether the program is in good enough shape to meet its long-run commitments.

The federal funds deficit is the deficit excluding all trust funds. In 1994, for example, the total deficit of $223 billion could be characterized as a federal funds deficit of $336 billion offset by a trust fund surplus of $113 billion. The line between federal funds and trust funds is frequently crossed, however, because trust funds receive a large portion of their income from transfers within the budget. Such transfers shift money from the general fund (thereby boosting the federal funds deficit) to trust funds (swelling the trust fund surplus). These intragovernmental transfers total more than $200 billion a year (see Table 2-2). Prominent among them are interest paid to trust funds (about $88 billion in 1994), government contributions to retirement funds on behalf of its employees ($68 billion), and the general fund contribution to Supplementary Medical Insur-

Table 2-2.
CBO Projections of Trust Fund Surpluses (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
Social Security[a]	62	70	76	84	92	100
Medicare						
Hospital Insurance	5	7	5	1	-5	-13
Supplementary Medical Insurance	3	-6	-4	b	2	2
Subtotal, Medicare	8	1	1	1	-3	-11
Military Retirement	9	9	10	10	10	10
Civilian Retirement[c]	29	30	32	33	35	36
Unemployment	3	6	7	7	7	6
Highway and Airport	-1	-2	1	1	1	1
Other[d]	3	3	3	3	3	3
Total Trust Fund Surplus[e]	113	118	130	139	146	145
Federal Funds Deficit[e]	-336	-289	-296	-321	-326	-349
Total Deficit	-223	-171	-166	-182	-180	-204
Memorandum:						
Net Transfers from Federal Funds to Trust Funds	212	214	233	254	275	297

SOURCE: Congressional Budget Office.

a. Old-Age and Survivors Insurance and Disability Insurance.

b. Less than $500 million.

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

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

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

ance ($46 billion), which covers about three-quarters of that program's costs and typically allows its trust fund to post a small "surplus." Clearly, most of these transfers were instituted for a purpose--for example, to require agencies to consider the cost of funding future retirement benefits as part of their current budgets. But it is equally clear that transferring money from one part of the government to another does not change the total deficit or borrowing needs by one penny.

How Has the Budget Outlook Changed Since September?

The budget outlook has improved marginally since CBO published its projections in September. Projected deficits are down in every year, by $30 billion in 1994 and smaller amounts thereafter (see Table 2-3). But when all the sources of revision--legislative, economic, and technical--are taken together, CBO has trimmed its projections of deficits in the 1994-1998 period by just a bit over 10 percent since last fall, hardly a dramatic change.

Recent Legislation

Little budgetary legislation has passed since last September. The legislation to implement the North American Free Trade Agreement was the only new law with significant effects on revenues; it diminished customs duties but largely recouped this loss by accelerating the timetables for depositing certain taxes electronically with the government (a speedup that has an unusually big effect in 1998).

On the spending side of the budget, the biggest change reflects the sixth extension of unemployment insurance to recipients in danger of exhausting their benefits, boosting outlays by slightly more than $1 billion in 1994. The first such extension came in the fall of 1991, and this latest expires in February 1994. The enactment of emergency appropriations and the use of the special outlay allowance increased the discretionary spending limits, accounting for another $1 billion in outlays in 1994.

Economic Changes

Revisions that stem from changes in the economic outlook are modestly favorable; revenues are up, and outlays are down. On the revenue front, extra collections are expected to total $4 billion in 1994 and $6 billion to $10 billion a year thereafter. Upward revisions to the forecast of wages and other sources of personal income bolster the expected take from individual income taxes and social insurance taxes; however, changes in the outlook for corporate profits dampen receipts in every year except 1994.

On the outlay front, the costs of benefit programs are now expected to be lower by $2 billion to $3 billion in most years, largely because the cost-of-living adjustment for Social Security recipients and other retirees in early 1994 will be smaller than CBO had assumed. And with a slightly more favorable outlook for interest rates and federal deficits, CBO has shaved its projected outlays for net interest by $2 billion to $3 billion a year (see Table 2-3).

Technical Reestimates

Technical revisions are any changes that are not ascribed to legislation or a new economic forecast. In 1994, this category is dominated by CBO's revision to its estimates of spending on deposit insurance. With passage of its long-delayed funding bill, the Resolution Trust Corporation can finally wrap up its phase of the cleanup of the savings and loan industry before turning over responsibilities to its successor, the Savings Association Insurance Fund. This last big push will probably be cheaper than CBO thought, and the resulting downward revision is $16 billion in 1994--split roughly equally between smaller losses and lower requirements for working capital. The Bank Insurance Fund also shares in the sunnier outlook. A special section later in this chapter describes the outlook for deposit insurance spending.

Technical reestimates apart from those to deposit insurance are scattered, but nevertheless join to trim projected deficits by as much as $12 billion a year. Revisions to revenues are small. Along with private spending for health care, the government's big health care programs--Medicaid and Medicare--are experi-

Table 2-3.
Changes in CBO Deficit Projections Since September (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998
September 1993 Estimate	253	196	190	198	200
Legislative Changes					
Revenues	a	a	a	a	-1
Outlays	2	a	a	a	a
Deficit	2	a	a	a	-1
Economic Changes					
Revenues	-4	-6	-8	-8	-10
Outlays					
Benefit programs	-2	-3	-3	-2	-1
Net interest	-2	-2	-2	-3	-3
Discretionary spending	0	a	a	a	1
Deficit	-9	-12	-13	-13	-13
Technical Changes					
Revenues	-3	a	a	a	2
Outlays					
Savings-and-loan-related[b,c]	-16	a	-3	-2	1
Bank Insurance Fund	-2	-2	-1	3	-1
Medicaid and Medicare	-2	-5	-5	-6	-8
Income security and Social Security	-3	-2	a	a	a
Federal Communications Commission auction receipts	1	-3	1	1	1
Net interest[c]	a	-2	-1	-1	-1
Other	1	-1	-1	1	1
Deficit	-24	-14	-11	-3	-5
Total Changes	-30	-25	-24	-16	-20
Current Estimate	223	171	166	182	180

SOURCE: Congressional Budget Office.

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

a. Less than $500 million.

b. Includes the Resolution Trust Corporation, the Savings Association Insurance Fund, and the FSLIC Resolution Fund.

c. Net of interest payments by deposit insurance agencies to the Federal Financing Bank; those payments are intrabudgetary and do not affect the total deficit.

encing a slowdown in their growth, and the expected result is lower outlays (of about $2 billion in 1994 and $8 billion in 1998). A few other benefit programs--notably unemployment insurance, the earned income tax credit, and Civil Service Retirement--are expected to spend somewhat less than previously projected. And fuller information about the Federal Communications Commission's plans for auctioning the unassigned portion of the electromagnetic spectrum, as mandated by OBRA-93, has led CBO to expect significantly bigger receipts in 1995 but somewhat smaller collections in other years.

The Spending Outlook

CBO expects that federal spending will approach $1.5 trillion in 1994 and top that figure in 1995 (see Table 2-4). For more than a decade, policymakers and budget analysts have broken down the huge federal budget into several distinct clusters. These categories were formalized in 1990's Budget Enforcement Act.

Discretionary spending encompasses programs controlled by annual appropriation bills. For these programs--whether defense, international, or domestic--policymakers decide afresh each year how many dollars will be devoted to continuing existing activities and funding new ones. The baseline projections depict discretionary spending's path assuming compliance with the caps dictated by the Balanced Budget Act through 1998. There are no caps in 1999, and the estimates for that year simply equal the previous year's amounts adjusted for inflation.

All other spending is controlled by existing laws, and the baseline presents CBO's best guess of spending if laws and policies remain unchanged. Any spending that is not discretionary is labeled direct spending, but this broad category is usually further divided into four clusters. *Entitlements and other mandatory spending* consist overwhelmingly of benefit programs, such as Social Security, Medicare, and Medicaid. Spending for these 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. *Deposit insurance spending* reflects commitments that the government made to protect depositors in insolvent institutions, promises that now must be honored. And growth in *net interest spending* is wholly driven by the government's deficits and by market interest rates.

Federal spending now represents about 22 percent of gross domestic product and is expected to drift down to about 21 percent over the next five years. In the 1960s, federal spending averaged 19.1 percent of GDP; for the 1970s and 1980s, the figures were 20.6 percent and 23.1 percent, respectively. But although federal spending now represents a bigger share of the economy than in the 1960s and 1970s and only a slightly smaller share than in the 1980s, a pronounced change has taken place in its composition. In a nutshell, the government today spends more on entitlement (chiefly benefit) programs and on net interest, and less on other activities, than in the past (see Figure 2-2). Fuller historical data are contained in Appendix E, which lists annual spending for each of these broad categories of spending and for federal revenues.

Discretionary Spending: Defense, International, and Domestic

Each year, the Congress revisits discretionary programs in the appropriation process. Discretionary programs cover virtually the entire defense and international affairs budgets, but only about one-fifth of domestic spending. In 1994, discretionary spending is expected to total $543 billion, roughly half of it for defense (see Table 2-4).

Relative to the economy, discretionary spending is well down from typical levels of the 1960s and 1970s. The fortunes of defense and domestic programs have waxed and waned several times over the past few decades. Comparisons with GDP merely express how much a society devotes to public spending in relation to its resources; they tell nothing about the adequacy of such spending, especially as the needs and threats faced shift markedly.

Defense Discretionary Spending. The share of GDP that is devoted to defense has gradually shrunk

Table 2-4.
CBO Projections of Outlays by Category, Assuming Compliance with Discretionary Spending Caps (By fiscal year)

Spending Category	Actual 1993	1994	1995	1996	1997	1998	1999
			In Billions of Dollars				
Discretionary[a]							
Defense	292	278	274	279	285	293	301
International	22	21	21	21	21	22	22
Domestic	230	244	257	266	275	284	292
Unspecified reductions	0	0	-11	-19	-35	-51	-50
Subtotal	543	543	541	547	547	547	564
Mandatory Spending, Excluding Deposit Insurance	761	803	844	890	960	1,026	1,099
Deposit Insurance	-28	-5	-11	-14	-6	-4	-4
Offsetting Receipts	-67	-69	-77	-74	-78	-83	-86
Net Interest	199	201	212	228	239	249	261
Total	1,408	1,474	1,509	1,577	1,661	1,736	1,834
On-budget	1,142	1,194	1,219	1,276	1,347	1,408	1,494
Off-budget[b]	266	280	290	301	314	328	340
			As a Percentage of GDP				
Discretionary[a]							
Defense	4.6	4.2	3.9	3.8	3.7	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	3.5	3.4
Unspecified reductions	0	0	-0.2	-0.3	-0.4	-0.6	-0.6
Subtotal	8.6	8.2	7.7	7.4	7.0	6.7	6.6
Mandatory Spending, Excluding Deposit Insurance	12.1	12.1	12.0	12.1	12.3	12.5	12.8
Deposit Insurance	-0.4	-0.1	-0.2	-0.2	-0.1	c	c
Offsetting Receipts	-1.1	-1.0	-1.1	-1.0	-1.0	-1.0	-1.0
Net Interest	3.2	3.0	3.0	3.1	3.1	3.0	3.0
Total	22.4	22.2	21.5	21.3	21.4	21.2	21.3
On-budget	18.1	18.0	17.4	17.3	17.3	17.2	17.4
Off-budget[b]	4.2	4.2	4.1	4.1	4.0	4.0	4.0

SOURCE: Congressional Budget Office.

a. Discretionary spending caps are set in the aggregate for 1994 through 1998. Projections for individual categories (defense, international, and domestic) show amounts that would be spent if 1994 funding levels were increased by the rate of inflation. Unspecified reductions show the cuts that would then be needed to satisfy the caps. Projections for 1999 represent 1998 spending adjusted for inflation.

b. Social Security and the Postal Service.

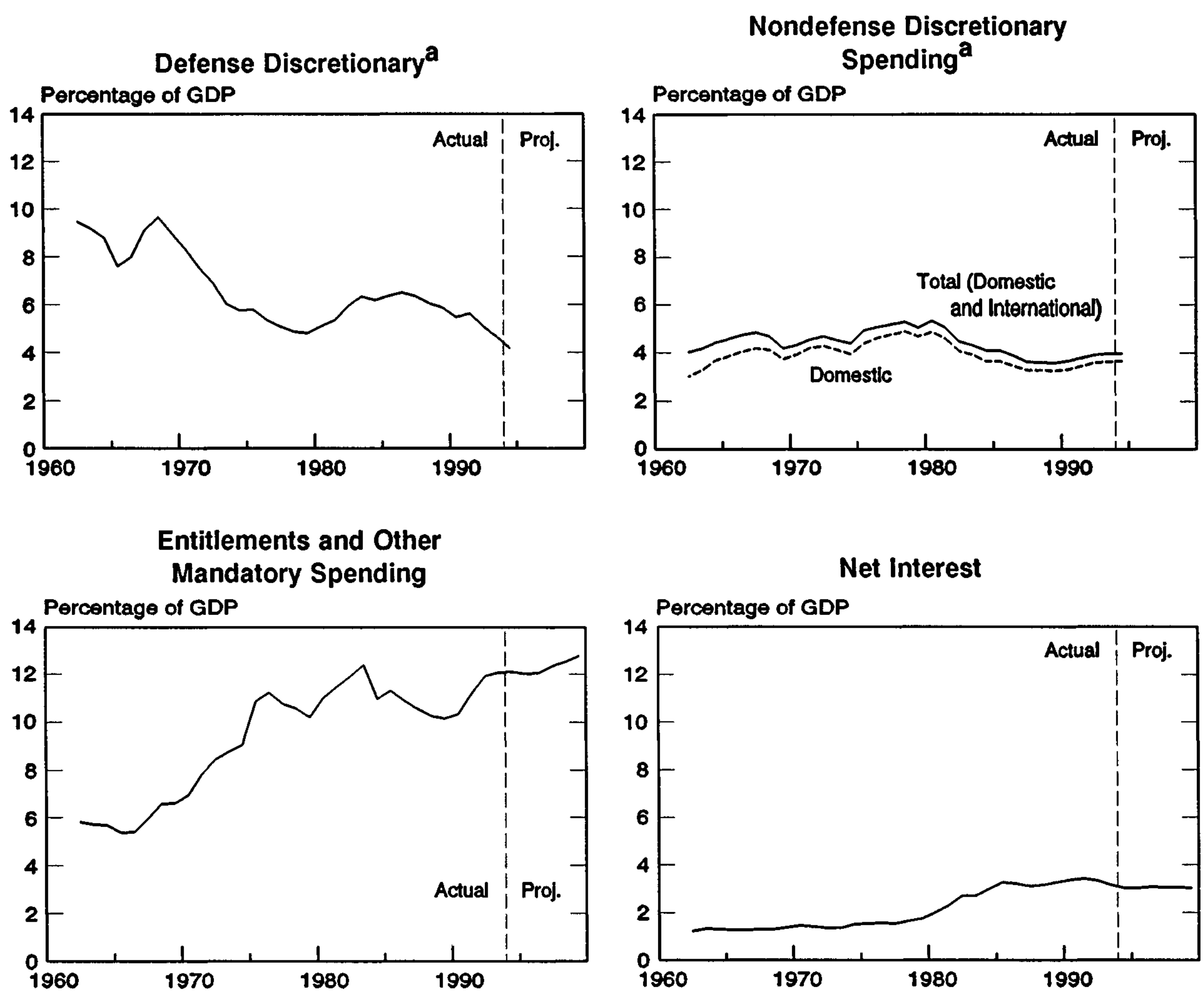
c. Less than 0.05 percent of GDP.

in the past three decades, with just 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 just over 4 percent of GDP.

Domestic Discretionary Spending. Even as defense spending generally drifted down (in relation to GDP) in the 1960s and 1970s, discretionary spending for domestic programs climbed slowly. It peaked at 4.9 percent of GDP in 1980 before its rise was abruptly reversed. Today, it totals less than 4 percent of GDP, about three-fourths of its peak level in the mid-1970s.

This category encompasses a wide variety of federal government activities. Of the $244 billion in expected outlays for 1994, leading claimants are education, training, and social services ($38 billion);

Figure 2-2.
Outlays by Category as a Share of GDP



SOURCE: Congressional Budget Office.

a. Assumes compliance with discretionary spending caps in the Balanced Budget Act.

transportation ($37 billion); income security, primarily housing subsidies and the administrative costs of running benefit programs ($35 billion); the administration of justice and general government activities such as running the Internal Revenue Service (together, $27 billion); natural resources and the environment ($22 billion); health research and public health ($21 billion); veterans' benefits, chiefly medical care, other than direct cash payments ($18 billion); and space and science ($18 billion). In its 1994 appropriations, the Congress chose not just to maintain but to slightly increase real funding for domestic discretionary programs. Overall, the budget authority for these programs grew by about 2 percent more than the rate of inflation, with extra money plowed into training and social services, the Public Health Service, and income security.

International Discretionary Spending. The smallest of the three major categories of discretionary outlays is international discretionary spending, at about $21 billion, or 0.3 percent of GDP, in 1994. This category chiefly includes aid to other countries for humanitarian or security purposes, contributions to international organizations such as the United Nations, and the conduct of foreign affairs. Its share of GDP has slipped steadily for the past three decades (see Figure 2-2).

Discretionary Spending and the Caps. Since 1991, stringent dollar caps set in the Balanced Budget Act (as amended by the Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993) have crimped spending for discretionary programs. In 1991 through 1993, three separate caps applied to defense, international, and domestic appropriations. In 1994 through 1998, a single lid applies to all three categories, sharpening the competition for resources.

As explained below, the caps will barely allow programs to grow in dollar terms over the 1995-1998 period. Because inflation, though subdued, continues at about 3 percent a year, discretionary programs will shrink by almost 10 percent in real terms from today's levels.

Separate caps apply to budget authority and outlays. *Budget authority* is the basic currency of the appropriation process; it represents the permission to commit funds. This commitment always precedes actual *outlays* or disbursements--with a short lag for fast-spending activities such as meeting payrolls or providing services directly, and a longer lag for slow-spending activities such as the procurement of weapons or other complicated items. The caps limit both budget authority and outlays in every year through 1998, and the more stringent cap prevails. During the 1995 appropriation cycle, which is just getting under way, the outlay cap is by far the tougher.

No one can predict how particular clusters of spending will fare in the upcoming appropriation debate. Literally thousands of outcomes are possible because so many programs are funded out of this single pot. But it is useful to compare the caps with two hypothetical paths for discretionary spending.

Both paths take as their point of departure the actual levels of funding in 1994, which came to slightly more than $500 billion in total discretionary budget authority. The first path, a traditional *inflation-adjusted baseline*, preserves real resources at 1994's levels by assuming that future appropriations for each program grow in step with inflation (about 3 percent a year). The second path, an *across-the-board freeze*, restricts each program to the same dollars it received in 1994--implicitly forcing it to trim its activities by about 3 percent a year in real terms. In both paths, projected levels of budget authority for domestic programs appear slightly erratic from year to year because of fluctuations in the volume of contracts for subsidized housing units that come up for renewal. The Balanced Budget Act directs CBO to incorporate such renewals into its baseline projections; other domestic programs, in these illustrations, are simply adjusted by inflation (in the first path) or by nothing at all (in the second).

Overall, complying with the outlay caps is roughly equivalent to freezing appropriations in 1995 at 1994's levels. Doing so for all programs across the board would bring total discretionary budget authority to about $504 billion and outlays to $541 billion--within a half-billion dollars of the outlay cap (see Table 2-5). Ironically, this approach would seemingly leave the appropriators with $13 billion in budget authority to spare; but little, if any, of this

Table 2-5.
How Tight Are the Discretionary Caps? (By fiscal year, in billions of dollars)

	1995	1996	1997	1998
	Budget Authority			
Discretionary Caps[a]	518	517	527	531
Amount Needed to Preserve 1994 Real Resources				
Defense	271	280	289	298
International	20	21	22	22
Domestic	230	245	253	267
Total	521	546	563	587
Amount over or under (-) caps	4	29	36	56
Amount Needed to Freeze 1994 Dollar Resources				
Defense	262	262	262	262
International	20	20	20	20
Domestic	222	230	231	238
Total	504	512	513	520
Amount over or under (-) caps	-13	-5	-14	-11
	Outlays			
Discretionary Caps[a]	541	547	547	547
Amount Needed to Preserve 1994 Real Resources				
Defense	274	279	285	293
International	21	21	21	22
Domestic	257	266	275	284
Total	552	566	581	598
Amount over or under (-) caps	11	19	35	51
Amount Needed to Freeze 1994 Dollar Resources				
Defense	268	265	263	262
International	21	20	20	20
Domestic	252	254	256	257
Total	541	540	539	539
Amount over or under (-) caps	b	-7	-7	-8

SOURCE: Congressional Budget Office.

NOTE: Amounts needed to preserve 1994 real resources include adjustments for inflation of about 3 percent a year. Amounts needed to freeze 1994 dollar resources include no adjustment for inflation. Both paths include the budget authority necessary to renew expiring contracts for subsidized housing.

a. The estimated caps are based on those published in Office of Management and Budget, *OMB Final Sequestration Report to the President and Congress for Fiscal Year 1994* (December 10, 1993), as modified by CBO (see Appendix A).

b. Less than $500 million.

authority could be used without breaching the outlay caps. In fact, 1995 is shaping up as a reprise of 1994's appropriation experience, in which lawmakers used nearly every penny of allowable outlays but left more than $12 billion in budget authority unused.

What about 1996 and beyond? It is fair to say that the freeze on appropriations would essentially continue in 1996 through 1998. Policymakers could afford to devote only about $7 billion to $8 billion a year in outlays (and commensurate amounts of budget authority) beyond the levels implied by a strict freeze, as suggested in the bottom panel of Table 2-5. Even this slight thaw would leave discretionary spending in 1998 at $51 billion below what is needed to preserve today's funding in real terms.

Because defense, international, and domestic programs must jostle for funding, their individual fates are uncertain. Appropriators faced a single cap for the first time in 1994; they met it by maintaining and even slightly increasing real appropriations for domestic programs while cutting defense, with the President's approval. Will this same strategy be possible in 1995?

The Clinton Administration will not submit its proposed budget for 1995, including its requested funding for defense, until February. But without this information, some clues can be gleaned from documents submitted by the Administration last year. A year ago, the President planned to request $263 billion in defense budget authority in 1995, and CBO estimated the accompanying outlays at $273 billion (clearly, many of them stemming from obligations incurred in earlier years when appropriations were higher). And for 1996, the President planned to request $254 billion in defense budget authority and (according to CBO) $265 billion in outlays.[3] A little arithmetic shows that following this blueprint for defense would expose domestic programs to real reductions--again, chiefly because of the outlay, not the budget authority, caps. Specifically, domestic and international outlays together would have to be held to roughly $268 billion in 1995 (the $541 in total outlays allowable, minus about $273 billion for defense) and to about $281 billion in 1996--about $10 billion and $6 billion, respectively, below the amounts needed to preserve today's real resources in those years.

Last year's defense request preceded the Congress's decision to grant locality-based pay raises to federal civilian employees and across-the-board raises to members of the armed services in 1994 (neither of which was requested by the Clinton Administration); it also preceded new worries about developments in the former Soviet Union, North Korea, and other spots. Furthermore, there were already widespread concerns about whether the Administration's request was sufficient to maintain and equip its envisioned force of 1.4 million and its planned weapons acquisitions. In short, it will not be easy to tap the defense budget for the dollars to preserve domestic activities even though they now compete in a single arena.

Nearly all federal employees are paid from the discretionary portion of the budget. Awareness of the discretionary caps' tightness--and a general interest in doing more with less--have recently sparked interest in paring federal employment levels (see Box 2-2).

Entitlements and Mandatory Programs

More than half of federal spending goes for entitlements and mandatory programs. Such programs make payments to recipients--usually people, but occasionally businesses 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.

The Balanced Budget Act lumps these programs together with receipts and subjects them to pay-as-you-go discipline; that is, liberalizations in mandatory 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 other tax increases or by savings in mandatory spending.) The CBO baseline depicts the likely path of entitlement and mandatory spending under current law.

3. Congressional Budget Office, "An Analysis of the President's February Budgetary Proposals," CBO Paper (March 1993).

Box 2-2. Federal Civilian Employment

Last September, the federal government counted about 2.16 million civilian employees in the executive branch (excluding the Postal Service), about 70,000 fewer than a year earlier. Another 66,000 civilians work in the judicial and legislative branches.

When it comes to measuring executive branch employment, however, the Office of Management and Budget (OMB) favors a measure known as "full-time equivalent" (FTE) rather than a simple head count. A head count merely reveals the number of people employed on a snapshot date. The FTE instead reveals employment over a span of time--a pay period, a month, or a full fiscal year. The FTE adjusts for the presence of part-time employees (for example, by counting two half-time workers as one FTE) and, when measured over a full year, automatically adjusts for seasonal fluctuations in employment as well. OMB estimates that FTEs in the nonpostal executive branch in 1993 numbered about 2.130 million--about two-fifths of them in the Department of Defense and the rest in civilian agencies. OMB also estimates that agencies will use about 2.104 million FTEs in 1994.

The vast majority of civilian employees are paid from discretionary salary and expense (or, in the case of the Defense Department, operation and maintenance) accounts. Agency costs for pay and the associated contributions to retirement funds in 1994 will equal about $105 billion, or nearly one-fifth of all discretionary spending. Benefits unrelated to retirement (mostly contributions for health insurance) add several billion dollars more.

CBO is often asked what level of employment it assumes in its projections, but there is no satisfactory answer. Appropriation bills simply set the total dollars for salaries and expenses. Within reason, agencies can alter the mix of personnel and other expenses (such as travel or contractual services) and still comply with their appropriation. They could also replace a $60,000 employee (one FTE) with two $30,000 employees (two FTEs). All such actions are perfectly compatible with a given dollar total. The Budget Enforcement Act, in fact, simply directs CBO to project the baseline for discretionary accounts by adjusting the current appropriation by a blended average of overall changes in prices (as measured by the GDP inflator) and expected increases in the employment cost index (ECI), not by trying to anticipate agencies' plans.

Under current law, most federal employees are to receive two distinct types of pay raises. Across-the-board raises are linked to growth in the ECI, which tracks growth in private-sector wages, with a timing lag of slightly more than a year and with one-half of one percentage point subtracted. And most civil servants will also receive locality raises, which are meant to narrow over a nine-year period the measured gap between federal and nonfederal salaries in different geographic areas; that gap was estimated on the basis of Bureau of Labor Statistics surveys to average about 26 percent. The Congress suspended the first raise for 1994 but preserved the second.

In 1995 through 1998, CBO projects that cumulative pay raises for General Schedule employees--the bulk of the federal civilian work force--will total 23 percent under current law, or an average of more than 5 percent each year. The average annual across-the-board raise is 2.9 percent, and the average annual locality raise is 2.3 percent. If such raises went into effect, and if civilian employment stayed at the 2.1 million level that OMB estimates for 1994, total pay and retirement contributions would mount from $100 billion in 1994 to $129 billion in 1998. In a regime in which total discretionary spending must be held almost flat, such growth would clearly squeeze agency budgets.

Of course, compensating savings can and will be found. The Defense Department is already taking steps to cut the active-duty military from 1.7 million to 1.4 million, although some of the resulting savings will be eaten up by pay raises for those remaining in the service, and is trimming its civilian work force as well. Last winter, the Clinton Administration directed executive branch agencies to cut civilian employment by about 100,000 FTEs over the 1993-1995 period; the National Performance Review (often dubbed the "Reinventing Government" or Gore report) advocated cutting federal civilian employment by a total of 12 percent, or about 250,000 FTEs, through 1999. These themes were quickly picked up, with variations, by several legislators, though no employment ceilings have actually been enacted into law. Clearly, however, civilian payroll costs are likely to grow unless there is a fairly significant combination of personnel reductions and cuts in scheduled pay raises.