enrolled on at least a half-time basis. The deduction would not be allowed for expenses associated with meals, lodging, student activities, health care, transportation, books, and other living expenses. The amount of qualified expenses would be reduced by any nontaxable education assistance, such as certain scholarships and fellowships.

The Joint Committee on Taxation estimates that the deduction would cost $26 billion over five years and $7 billion in 2000 (see Table 12).

At current levels of enrollment, about 60 percent of the students eligible to claim the deduction would come from families with income of $50,000 or less. Because students from higher-income families tend to have higher tuition expenses on average, the 40 percent of students from families with income of $50,000 or more would claim about 50 percent of the total deductions.

As with all deductible expenditures, the education deduction would provide greater tax relief for families in higher tax brackets than for those in lower tax brackets. A $10,000 deduction would save $2,800 in taxes for a family in the 28 percent bracket, but $1,500 for a family in the 15 percent bracket. The deduction would not benefit families with income too low to owe taxes, although most such families already qualify for existing federal education assistance.

Some of the benefits from the deduction would go to schools if they took advantage of the deduction to raise tuition without increasing the after-tax cost to students. Research on previous increases in federal educational assistance has shown only a weak link between increased aid and higher tuition levels. Because the proposed deduction would be available to most students, however, schools could raise tuition without making many students worse off. A significant number of schools might choose to adopt that course.

Because the deduction would have to be taken in the year in which educational expenses are paid, students who finance their own education with loans would receive no tax benefits. The deduction would do them little good while they are in school and have little income and hence little or no tax liability, and would not be available later when they are working and paying back a loan. Allowing students to deduct repayment of principal and interest later on student loans would provide them with equal treatment but would also add to the cost of the proposal.

Because the $10,000 deduction would be phased out over a relatively narrow range of income, the proposal would significantly increase marginal tax rates for eligible families who have income in that range; for example, by 14 percentage points for a family in the 28 percent bracket. Only families that choose to take the deduction and have income in the phaseout range would be affected.

Expanded Individual Retirement Accounts

The Administration proposes to expand eligibility for deductible individual retirement accounts, establish new "special IRAs," and allow penalty-free withdrawals from regular IRAs for certain qualified purposes.

Extend Eligibility for Deductible IRAs. Under current law, a taxpayer may make a tax-deductible contribution to an IRA of up to a $2,000 a year. The amount contributed cannot exceed the taxpayer's earnings. If the taxpayer or the taxpayer's spouse is an active participant in an employer-sponsored retirement plan, the $2,000 limit is reduced by $1 for every $5 of income in excess of $40,000 for a couple and $25,000 for a single taxpayer. Thus, couples with an income of $50,000 or more and singles with an income of $35,000 or more cannot make deductible contributions. If taxpayers cannot make fully deductible contributions because their income exceeds those limits, they can nevertheless contribute to a nondeductible IRA.

Investment income in an IRA is tax-exempt while it accrues. A taxpayer must include in taxable income the full amount of withdrawals from an account (withdrawals from a nondeductible IRA are only included in taxable income insofar as they exceed the original contributions). An additional 10 percent penalty generally applies to withdrawals made before age 59½.

The Administration proposes to double the income limits for deductible contributions to $80,000 for a couple and $50,000 for a single taxpayer. The proposal would also double the phaseout range from $10,000 to $20,000. The income limits, the phaseout range, and the current annual contribution limit of $2,000 would be indexed for inflation.

Establish Special IRAs. The Administration also proposes to establish new special IRAs. Taxpayers who are eligible for regular deductible IRAs could choose to contribute an amount up to the contribution limit to either a deductible or a special IRA. Contributions to a special IRA would not be tax-deductible, but taxpayers could withdraw contributions and earnings that remained in the account for a least five years tax-free and with no penalties. Earnings taken out before they had been in the account for five years would be subject to income taxes. An additional 10 percent penalty would apply to those early withdrawals of earnings unless the money withdrawn was used for certain purposes. Taxpayers eligible for special IRAs could transfer balances in deductible IRAs to special IRAs penalty-free, but those transfers would be subject to tax. Transfers made before January 1, 1997, could be included in taxable income spread evenly over four years.

Allow Penalty-Free Withdrawals for Certain Expenditures. The Administration proposes to allow penalty-free withdrawals of funds from a regular IRA as well as funds held in a special IRA less than five years if the money is used for postsecondary education, to buy a first home, to cover living costs if unemployed, or to pay for catastrophic medical expenses (including some nursing home costs).

The Joint Committee on Taxation estimates that the proposal to expand IRAs would cost $6.3 billion over five years. The proposal would raise revenues in the first year as holders of regular IRAs transfer funds to special IRAs (and pay taxes on those transfers), and those additional revenues would offset some of the costs through 1999. The proposal would cost $3.4 billion by 2000 and increase in cost thereafter. Although the Administration projects that the proposal to expand IRAs would cost somewhat less--about $4 billion over five years--the differences in the estimates are quite small in view of the range of uncertainty. The projections depend on estimates of the amount of contributions by newly eligible taxpayers, whether taxpayers will choose to contribute to regular or special IRAs, the amount of funds that will be transferred from existing IRAs to special IRAs, and when people will withdraw funds from special IRAs.

The Administration's proposal differs from the proposal to expand IRAs in title VI of the Tax Fairness and Deficit Reduction Act. That bill would not change existing IRAs but would create new American Dream Savings Accounts (ADSAs). As with special IRAs, contributions (up to $2,000 per taxpayer) to an ADSA would not be tax-deductible, but withdrawals would not be included in taxable income. If withdrawals were made before age 59½, the portion attributable to investment earnings would be subject to income tax and a 10 percent penalty unless the ADSA had been in existence for at least five years and the withdrawals were used for higher education expenses, a first-time home purchase, or medical expenses. There would be no income limits for eligibility to contribute to an ADSA. A taxpayer could contribute up to $2,000 to both an ADSA and an IRA, a total of $4,000. Taxpayers could transfer funds from an existing deductible IRA to an ADSA. Transfers would be penalty-free but taxable.

The new special IRAs proposed by the Administration and the American Dream Savings Accounts are examples of back-loaded tax-favored savings accounts. They are back-loaded because contributions are not tax-deductible when they are made but, together with accumulated earnings, are not taxable when withdrawn from the account. By contrast, regular IRAs are front-loaded because contributions are initially tax-deductible but, together with accumulated earnings, are taxable when withdrawn.

As long as taxpayers are in the same marginal tax bracket when they make contributions to an IRA and when they withdraw funds at retirement, the economic benefits of a front-loaded and a back-loaded account are the same. For example, 40-year-old workers in the 15 percent tax bracket who make a $1,000 contribution to a deductible (front-loaded) IRA will have $3,870 in their accounts at age 60 if they earn a 7 percent annual return on their investment. After paying taxes--assuming they are still in the 15 percent bracket--they will have $3,289 to spend. If those workers chose instead to open a nondeductible (back-loaded) IRA with their $1,000, they would have $850 to deposit in the account after paying taxes. When the workers reached the age of 60, that investment would have grown to $3,289 and, owing no additional taxes, they would have that amount to spend.

Back-loaded IRAs can be more advantageous than front-loaded IRAs when both have the same annual contribution limit. For back-loaded and front-loaded IRAs with the same contribution limit, investors can place the equivalent of more before-tax income in the back-loaded IRA. Thus, back-loaded IRAs have higher effective limits, as taxpayers can accumulate more retirement savings tax-free with the back-loaded IRA.

Estimates of the cost of special IRAs and ADSAs anticipate a pickup in revenue initially as taxpayers transfer funds from regular IRAs, pay tax on those transfers, and deposit the after-tax proceeds in the new accounts. Some taxpayers would be willing to make the transfer, trading a front-loaded account for a back-loaded account, because both special IRAs and ADSAs offer the advantage of penalty-free withdrawals much sooner then regular IRAs. The revenue increase represents an acceleration of taxes that would have been paid in the future and thus a corresponding revenue loss outside the five-year projection period in the budget.

In addition to the effect from accelerating future revenues into the five-year budget period, the long-term revenue loss from special IRAs will grow over time. Special IRAs differ from ordinary taxable accounts because earnings on contributions are not taxed. Since it would take some time for funds to build up in special IRAs, the revenue loss would be small initially but would grow as funds accumulated in those accounts. By contrast, the government loses more revenue initially from deductible IRAs, when taxpayers make tax-deductible contributions.

The government loses revenues from special IRAs or regular deductible IRAs because it would have collected taxes on annual investment earnings if those funds were saved in ordinary taxable accounts. If the funds contributed to IRAs come from money that would have been spent and not saved in ordinary taxable accounts, there is no revenue loss from IRAs.

The Administration's proposal would increase the amount saved in IRAs, but how much of that would be an increase in total personal saving and not a shift of funds from taxable saving is unclear. People may respond initially by transferring assets from other savings to IRAs and receive the full tax benefit. Eventually, many people will exhaust existing savings to transfer, and contributions to IRAs will come from new saving. Whether this new saving would be greater than the amount that people would have saved without the additional tax incentives is also unclear. People who had planned to save at least as much as the contribution limit to IRAs would not receive a tax advantage for additional saving and thus should not be expected to increase saving. Higher-income families, the group made eligible for IRAs under the Administration's proposals as well as for ADSAs, are more likely to have planned to save at least as much as the contribution limit.

For people with little other savings to transfer to IRAs and who would have saved less than the amount of the contribution limit, the tax advantages of IRAs would raise the after-tax rate of return from saving, which would encourage them to save more than they would have otherwise, because each dollar of saving could buy more in the future. Since the after-tax rate of return would be higher, however, people would have to save less in order to reach some savings goal. The net effect could be an increase in saving, but it could also be no change or even a decrease. The evidence on how people respond to changes in after-tax rates of return is mixed, but most studies suggest a small increase in saving in response to an increase in the after-tax rate of return.

IRAs are thought to promote saving in other ways, aside from the way in which people respond to a change in the after-tax return from saving. The penalty for early withdrawals encourages the use of IRAs to save for retirement, making those accounts less like other forms of saving and making it less likely that people will use them as substitutes for nonretirement saving. Tax deductible contributions (front-loading) of regular deductible IRAs are thought to encourage contributions at the expense of current consumption because it is easier for people to perceive the immediate benefit of the deduction--for example, when faced with the choice between making a tax payment on April 15th or depositing their money in an IRA and reducing their tax bill.

Special IRAs (and ADSAs) do not have those possible added inducements for saving. They broaden the purposes for which taxpayers can make withdrawals free of penalties, making the accounts more like other forms of saving and increasing the likelihood that more contributions to the new accounts will come from transfers from other saving instead of reduced consumption. Special IRAs (and ADSAs) do not allow tax-deductible contributions, but if certain conditions are met, all withdrawals will be tax-free. Although back-loaded benefits such as those offered by special IRAs and ADSAs are economically equivalent to those offered by regular deductible IRAs, they do not provide the psychological inducement of an immediate reduction in taxes.

Although research and experience have produced mixed messages about the effect of IRAs on saving, the conclusion that IRAs increase private savings by only a small amount cannot be ruled out. The Administration's proposals (and ADSAs) contain features that make them less likely to increase private savings than existing IRAs. Because the revenue loss from the proposal grows over time, if the private savings response is small the net effect may be to reduce national savings (the sum of public and private savings) in the long run.

Table 13.
Comparison of Revenue Estimates of the President's 1996 Budgetary Proposals to Modify Eligibility Rules for the Earned Income Tax Credit (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	1995-2000
Earned Income Tax Credit Compliance Proposals[a]							
CBO/JCT	0	b	b	b	b	b	0.1
Administration	0	b	0.1	0.1	0.1	0.1	0.4
Interest and Dividend Test for Earned Income Tax Credit[c]							
CBO/JCT	0	b	0.1	0.1	0.1	0.1	0.3
Administration	0	b	0.1	0.1	0.1	0.1	0.3

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

NOTE: JCT = Joint Committee on Taxation.

a. Changes in outlays are included in Chapter 3. Earned income tax credit outlays would decrease by $10 million in 1996 and by $0.2 billion per year in 1997 through 2000.

b. Less than $50 million.

c. Changes in outlays are included in Chapter 3. Earned income tax credit outlays would decrease by $13 million in 1996 and by $0.3 billion per year in 1997 through 2000.

Modifying the Earned Income Tax Credit Eligibility Rules

The Administration proposes two changes in the eligibility rules for the EITC. The first is intended to focus the credit more sharply on families with low earnings and little other economic resources by denying it to families with income from interest and dividends of $2,500 or more. The second proposal would prevent individuals who are not authorized to work in the United States from receiving the credit. The proposals would have a small effect on revenues (see Table 13). The main effect would be to reduce outlays by reducing earned income tax credit refunds.

Interest and Dividend Test for the Earned Income Tax Credit

The EITC is payable to taxpayers who have modest amounts of income from wages or self-employment. The amount of the credit depends on the level of earnings and whether the taxpayer has one, two or more, or no qualifying children. Earnings (or if greater, adjusted gross income) above certain thresholds reduce the amount of the credit. The EITC is a refundable credit, payable to taxpayers even if it exceeds the amount of their tax liability.

Under current law, taxpayers can receive the earned income tax credit even though they have significant amounts of income from interest and dividends. A family with one qualifying child, for example, could receive the maximum credit even though it had more than $5,000 in income from interest and dividends.

The Administration proposes to deny the EITC to taxpayers who receive more than $2,500 in annual interest and dividend income beginning in 1996. The $2,500 threshold would be indexed for inflation in subsequent years.

The Administration's proposal does not allow for a phaseout of the credit if interest and dividend income exceed the $2,500 threshold by a small amount. Because families with interest and dividend income just over the threshold would lose the entire credit, they would have a strong incentive to rearrange their assets so as to reduce their interest and dividend income below $2,500.

The Congress has already passed H.R. 831, the Self-Employed Health Insurance Act of 1995. That act includes a provision similar to the Administration's proposal, but would deny the EITC to taxpayers who receive interest and dividend income in excess of $2,350. The $2,350 threshold would not be indexed for inflation.

Earned Income Tax Credit Compliance Proposal

Under current rules, a taxpayer must live in the United States for more than six months to be eligible for the EITC. Beginning in 1995, nonresident aliens are not entitled to the credit. The Administration proposes to tighten compliance procedures so that illegal aliens or those who do not have the proper documentation for employment purposes would be denied the earned income tax credit.

Other Revenue Proposals

The Administration's budget includes other revenue proposals (see Table 14). Two proposals, aimed at increasing the number of empowerment zones and reducing the vaccine excise tax, would reduce revenues by a small amount. The remaining proposals would raise revenues by tightening the rules for taxing income from foreign trusts, limiting opportunities for tax avoidance by U.S. citizens who renounce their citizenship, increasing bank examination fees and fees charged under the securities laws, and reauthorizing the corporate environmental income tax used to finance the cleanup of hazardous waste sites. CBO estimates that those proposals together would increase revenues by about $6 billion over the next five years, or about $1 billion less than the amount projected by the Administration.

Table 14.
Comparison of Revenue Estimates of Other Tax Provisions in the President's 1996 Budget
(By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	1995-2000
			Increase Number of Empowerment Zones				
CBO/JCT	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.7
Administration	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.7
			Reduce Excise Tax on Certain Vaccines				
CBO/JCT	0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4
Administration	0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3
			Tax Unrealized Capital Gains of Americans Who Renounce Citizenship				
CBO/JCT	0.1	0.2	0.2	0.3	0.4	0.5	1.7
Administration	0	0.1	0.2	0.3	0.4	0.5	1.5
			Revise Taxation of Foreign Trusts				
CBO/JCT	0.1	0.2	0.2	0.2	0.2	0.2	1.1
Administration	0	0.3	0.4	0.4	0.5	0.5	2.0
			Extend Corporate Environmental Income Tax				
CBO/JCT	0	0.3	0.5	0.5	0.6	0.6	2.5
Administration	0	0.3	0.5	0.5	0.5	0.5	2.4
			Increase or Expand Fees Collected Under Securities Laws				
CBO/JCT	0.1	0.2	0.2	0.3	0.3	0.3	1.3
Administration	0.1	0.3	0.3	0.3	0.4	0.4	1.8
			Impose Fees on State Chartered Banks				
CBO/JCT	0	0.1	0.1	0.1	0.1	0.1	0.3
Administration	0	0.1	0.1	0.1	0.1	0.1	0.4
			Limit Pay Raises for Federal Employees				
CBO/JCT[a]	0	0	0	0	0	0	0
Administration	0	-0.1	-0.2	-0.3	-0.4	-0.5	-1.3
Memorandum:							
			Tax Unrealized Capital Gains of Americans Who Renounce Citizenship				
	0.1	0.2	0.3	0.4	0.5	0.7	2.2
			Revise Taxation of Foreign Trusts				
	0.1	0.3	0.5	0.5	0.5	0.6	2.4

Memorandum note: After the budget was published, the Treasury Department issued corrected estimates of the following two provisions. The earlier estimates were based on a later effective date than the final proposal. The revised estimates are shown above under "Memorandum".

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

NOTE: JCT= Joint Committee on Taxation.

a. As a result of proposals to limit future increases in federal pay, the Administration assumes a decrease in federal employee contributions to the Civil Service Retirement System and the Federal Employees' Retirement System. Under Congressional scorekeeping rules, revenue estimates are not adjusted for changes in discretionary appropriations.

Increase the Number of Empowerment Zones

The Administration would authorize the designation of two additional urban empowerment zones. The Omnibus Budget Reconciliation Act of 1993 provided tax incentives for nine empowerment zones and 95 enterprise communities. Businesses located in an empowerment zone receive such tax advantages as tax credits, more liberal write-off of investment expenses, and access to subsidized borrowing.

Reduce Vaccine Excise Taxes

The Administration proposes a reduction in manufacturers' excise taxes on certain vaccines. Net revenues from vaccine excise taxes are deposited in the Vaccine Injury Compensation Trust Fund and used to compensate individuals who are injured by those vaccines. The trust fund has accumulated a large balance, and at current rates, transfers to the fund will continue to exceed outlays. A decrease in taxes will still allow the fund to provide compensation.

Tax Unrealized Capital Gains of Americans Who Renounce Citizenship

By relinquishing U.S. citizenship, a U.S. taxpayer can avoid tax on unrealized capital gains that were earned while he or she was a citizen. The Administration proposes that when a U.S. citizen renounces citizenship, that individual's assets will be treated as if a transaction occurred in which all gains and losses were realized and subject to tax. The provision would exempt the first $600,000 in gains.

Revise Taxation of Income from Foreign Trusts

The Administration proposes to tighten the rules for taxing foreign trust income of U.S. taxpayers. The proposals would strengthen reporting requirements for U.S. taxpayers who transfer property to foreign trusts and limit opportunities to defer or completely avoid tax on income from such trusts. The proposals would reduce the tax incentives to establish and maintain foreign trusts by treating domestic and foreign trusts in a more even-handed way.

Extend Corporate Environmental Income Tax

The Administration proposes to extend the environmental tax on corporate taxable income that is scheduled to expire on December 31, 1995. Under current law, a tax of 0.12 percent of alternative minimum taxable income in excess of $2 million is levied on all corporations and deposited in the Hazardous Substance Superfund. Monies from the fund are used to clean up hazardous waste sites.

Increase or Expand Fees Collected Under Securities Laws

The Administration proposes a multitiered structure of increases in fees collected under the securities laws to fund the continuing operations of the Securities and Exchange Commission and reduce the deficit. Some of the increases would be classified as governmental revenues and some would be offsetting collections.

Impose Fees for Examination of State-Chartered Banks

Depository institutions such as thrifts, credit unions, and nationally chartered banks all pay a bank examination fee to the federal agency that supervises them. The Administration proposes to require state-chartered banks that are not members of the Federal Reserve System to pay examination fees to the Federal Deposit Insurance Corporation. Under the proposal, state-chartered member banks of the Federal Reserve System would pay examination fees to it.

Because the Federal Reserve would no longer be required to fund the cost of bank examinations from earnings, earnings of the Federal Reserve, which are classified as government revenues, would increase. Fees collected by the Federal Deposit Insurance Corporation are classified as offsetting receipts and are not counted as part of revenues.

Appendixes

Appendix A

CBO's Baseline Budget Projections

Throughout this report, the Administration's proposals are contrasted with the Congressional Budget Office's (CBO's) baseline estimates of the budget. Those estimates show the path of revenues and spending if current laws and policies remain unchanged. They are not forecasts of budget outcomes, since policymakers will certainly seek to alter current priorities. But these current-policy estimates serve as handy yardsticks for gauging the potential impact of proposed changes--those advocated in the President's budget as well as in competing packages.

The Baseline Concept

Baseline projections follow some general rules. Revenues and entitlement programs (like Social Security and Medicare) continue on their course until the Congress changes the laws that underpin them--laws that define taxable income and set tax rates, benefit formulas, eligibility, and so forth. For those categories, therefore, the baseline represents CBO's best estimate of what will happen in the absence of any changes to current laws.

Discretionary programs, unlike entitlement programs, are funded anew each year through the appropriation process. Discretionary programs encompass nearly all spending for defense and international affairs plus many domestic programs--for space, energy, highway and airport grants, environmental protection, and health research, to name just a few--as well as the salaries and expenses of civilian agencies. The Budget Enforcement Act of 1990 set caps on total discretionary spending for the 1991-1995 period, and the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) extended them through 1998. CBO's baseline assumes compliance with the caps, which, as explained below, will force trade-offs among many competing programs. No law specifies caps after 1998. Thus, for 1999 and 2000, CBO produces two alternative projections of discretionary spending. One set of baseline projections preserves discretionary spending at the same real level as in 1998, increasing it by around 3 percent a year to account for inflation. The other set of projections assumes that discretionary spending is frozen at the 1998 dollar level.

Three categories of spending remain. The federal government has pledged to protect depositors in banks and savings and loan institutions, and the baseline for deposit insurance shows the net cost of meeting those promises. The category labeled offsetting receipts, which encompasses Medicare insurance premiums and similar fees and collections, represents CBO's best estimate of the amounts that the government will collect under current laws and policies. The last category is net interest, which is driven by market interest rates and future deficits rather than being directly controlled by policymakers; CBO estimates such spending consistent with its projections of those two fundamental determinants.

Baseline Projections

In January, CBO published its baseline projections in *The Economic and Budget Outlook: Fiscal Years 1996-2000* and described the key factors that drive the federal government's revenues, spending, and deficit. Since then, CBO has revised its baseline projections modestly in the face of new information. Those revisions raise projected deficits in every year after 1995 (see Table A-1).

Because CBO has not updated its economic forecast and no new legislation has affected outlay projections since January, all changes to the baseline fall into the technical category. Technical revisions stem from new information that has come to light through late February, much of it contained in the President's budget and supporting documents.

The largest technical revision reflects adjustments made by the Office of Management and Budget (OMB) to the discretionary spending caps specified in OBRA-93. CBO conforms its baseline for total discretionary spending to the most recent official limits published by OMB. Ordinarily, there are only small differences between CBO's previous estimate of the limits and OMB's official limits. In this instance, however, different interpretations of a provision in OBRA-93 led to OMB limits that are significantly higher than CBO's estimates. Instead of continuing to adjust the caps for the difference between

Table A-1.
Changes in CBO's Baseline Deficit Projections (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000
January Baseline Deficit with Discretionary Inflation After 1998[a]	176	207	224	222	253	284
Technical Revisions						
Discretionary spending[b]	4	3	6	9	9	10
Mandatory spending						
Medicaid	-1	-1	-1	-1	-1	-1
Medicare	2	3	3	3	2	2
FHA mutual mortgage insurance	-3	-4	-3	-3	-1	c
FCC spectrum auctions	-3	0	c	c	0	-1
Other	-1	c	c	c	1	3
Subtotal	-6	-2	-1	-1	1	2
Deposit insurance	c	2	1	c	c	c
Interest	1	c	1	1	2	3
Total Revisions	-1	3	6	10	13	15
March Baseline Deficit with Discretionary Inflation After 1998[a]	175	210	230	232	266	299

SOURCE: Congressional Budget Office.

NOTE: FHA = Federal Housing Administration; FCC = Federal Communications Commission.

a. Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998 and equal to the 1998 limit adjusted for inflation after that.

b. The changes in 1996 through 2000 are the result of differences between CBO's January estimate of the discretionary spending limits for 1996 through 1998 and the official limits presented in the President's budget.

c. Less than $500 million.

Table A-2.
CBO's 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	175	210	230	232	266	299
Without discretionary inflation after 1998	203	175	210	230	232	247	258
Standardized-Employment Deficit[a]							
With discretionary inflation after 1998	187	199	218	229	230	260	289
Without discretionary inflation after 1998	187	199	218	229	230	241	248
On-Budget Deficit (Excluding Social Security and Postal Service)							
With discretionary inflation after 1998	259	243	283	309	317	355	395
Without discretionary inflation after 1998	259	243	283	309	317	336	354
Memorandum:							
Deposit Insurance	-8	-16	-8	-4	-5	-3	-2
Cyclical Deficit	23	-8	b	5	6	10	13
Off-Budget Surplus							
Social Security	57	69	73	78	84	89	95
Postal Service	-1	b	b	1	1	b	1
Total	56	69	73	79	85	89	96
			As a Percentage of GDP				
Baseline Total Deficit							
With discretionary inflation after 1998	3.1	2.5	2.9	3.0	2.8	3.1	3.3
Without discretionary inflation after 1998	3.1	2.5	2.9	3.0	2.8	2.9	2.9
Standardized-Employment Deficit[a,c]							
With discretionary inflation after 1998	2.8	2.8	2.9	2.9	2.8	3.0	3.2
Without discretionary inflation after 1998	2.8	2.8	2.9	2.9	2.8	2.8	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.

Table A-3.
CBO's Baseline Budget Projections with Discretionary Inflation After 1998 (By fiscal year)

	Actual 1994	1995	1996	1997	1998	1999	2000
	In Billions of Dollars						
Revenues							
Individual income	543	594	628	656	693	731	772
Corporate income	140	149	151	155	161	167	173
Social insurance	461	494	517	539	565	590	618
Other	113	119	122	125	127	130	134
Total	1,258	1,355	1,418	1,475	1,546	1,618	1,697
On-budget	923	998	1,043	1,084	1,135	1,187	1,245
Off-budget	335	357	375	392	411	431	452
Outlays							
Discretionary[a]							
Defense	282	270	270	278	285	295	304
International	21	21	22	22	22	23	24
Domestic	243	256	264	274	285	296	307
Unspecified reductions	0	0	-4	-21	-35	-38	-40
Subtotal	546	548	552	553	557	575	595
Mandatory	791	843	897	961	1,025	1,098	1,176
Deposit insurance	-8	-16	-8	-4	-5	-3	-2
Net interest	203	235	260	271	281	296	313
Offsetting receipts	-71	-80	-73	-75	-79	-82	-86
Total	1,461	1,530	1,628	1,706	1,778	1,885	1,997
On-budget	1,182	1,241	1,326	1,393	1,452	1,543	1,641
Off-budget	279	289	302	313	326	342	356
Deficit	203	175	210	230	232	266	299
On-budget deficit	259	243	283	309	317	355	395
Off-budget surplus	56	69	73	79	85	89	96
Debt Held by the Public	3,432	3,618	3,843	4,090	4,338	4,621	4,938
Memorandum:							
Gross Domestic Product	6,632	7,036	7,370	7,747	8,152	8,572	9,013

(Continued)

SOURCE: Congressional Budget Office.

Table A-3.
Continued

	Actual 1994	1995	1996	1997	1998	1999	2000
	As a Percentage of GDP						
Revenues							
Individual income	8.2	8.4	8.5	8.5	8.5	8.5	8.6
Corporate income	2.1	2.1	2.1	2.0	2.0	2.0	1.9
Social insurance	7.0	7.0	7.0	7.0	6.9	6.9	6.9
Other	1.7	1.7	1.7	1.6	1.6	1.5	1.5
Total	19.0	19.3	19.2	19.0	19.0	18.9	18.8
On-budget	13.9	14.2	14.2	14.0	13.9	13.9	13.8
Off-budget	5.1	5.1	5.1	5.1	5.0	5.0	5.0
Outlays							
Discretionary[a]							
Defense	4.3	3.8	3.7	3.6	3.5	3.4	3.4
International	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Domestic	3.7	3.6	3.6	3.5	3.5	3.4	3.4
Unspecified reductions	0	0	-0.1	-0.3	-0.4	-0.4	-0.4
Subtotal	8.2	7.8	7.5	7.1	6.8	6.7	6.6
Mandatory	11.9	12.0	12.2	12.4	12.6	12.8	13.1
Deposit insurance	-0.1	-0.2	-0.1	-0.1	-0.1	b	b
Net interest	3.1	3.3	3.5	3.5	3.4	3.5	3.5
Offsetting receipts	-1.1	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0
Total	22.0	21.7	22.1	22.0	21.8	22.0	22.2
On-budget	17.8	17.6	18.0	18.0	17.8	18.0	18.2
Off-budget	4.2	4.1	4.1	4.0	4.0	4.0	4.0
Deficit	3.1	2.5	2.9	3.0	2.8	3.1	3.3
On-budget deficit	3.9	3.5	3.8	4.0	3.9	4.1	4.4
Off-budget surplus	0.8	1.0	1.0	1.0	1.0	1.0	1.1
Debt Held by the Public	51.7	51.4	52.1	52.8	53.2	53.9	54.8

a. Projections assume that discretionary spending is equal to the spending limits that are in effect through 1998 and equal to the 1998 limit adjusted for inflation after that. Discretionary outlays would be $19 billion lower in 1999 and $38 billion lower in 2000 if no adjustment for inflation was assumed.

b. Less than 0.05 percent.

actual inflation experienced in the most recently completed year (1994 in this instance) and the inflation anticipated for that year when the limits were set, OMB adjusted for the differences between its current forecast of inflation in 1996, 1997, and 1998 and the inflation forecast for those years when the limits were set. The resulting limits are as much as $9 billion higher by 1998 than CBO estimated in January. Although CBO believes that OMB's interpretation of the law is incorrect, CBO will continue to use OMB's limits in its baseline budget projections.

Other, relatively small revisions to CBO's outlook have occurred since January. Projected Medicaid outlays are expected to grow slightly more slowly than previously assumed, whereas expenditures for Medicare should grow slightly faster. In particular, new data about payments on behalf of Medicare beneficiaries who enroll in health maintenance organizations show those payments rising more rapidly than had been thought earlier. Also, fewer claims are expected in the Federal Housing Administration's mutual mortgage insurance program from properties insured before 1992, thereby generating fewer default payments.

When CBO released its January baseline, the Federal Communications Commission (FCC) had just begun its most recent auction of rights to use portions of the electromagnetic spectrum. Since then, the FCC has received $7 billion in bids in the ongoing auction (in addition to $1 billion from the previous auction). With another $1 billion in receipts expected before the end of the year, CBO has raised its estimate of 1995 auction receipts by $3 billion. CBO has also increased its projection of net spending by deposit insurance agencies by $2 billion in 1996 and $1 billion in 1997 to reflect a further reduction in premiums that banks pay to the Bank Insurance Fund to maintain a balance of $1.25 per $100 of insured deposits.

The remaining tables in this appendix update some of the most widely used information in CBO's January report. Because the revisions are relatively minor, readers seeking a fuller explanation of underlying trends in the budget can rely on that earlier publication.

Much of the concern about the budget stems from the sheer size of the federal deficit; Table A-2 displays several measures of that gap. The most commonly used measure of the deficit is simply the difference between total revenues and spending. As explained above, 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 as well--most usefully, the standardized-employment or structural deficit. That figure shows what is left after removing the cyclical deficit--in other words, the weakened revenues and extra benefit spending that result when the economy operates below its potential. With the current economic recovery on a solid footing, the distinction between the structural deficit and the conventionally measured deficit is less relevant now than during periods of slower growth.

Spending and receipts for a number of large programs are generally tracked separately; chief among them are Social Security and the Postal Service (both of which are off-budget under different statutory provisions). The surpluses or deficits of those programs are depicted in Table A-2. Despite their special status, those programs 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.

Federal government revenues by source and outlays by broad category, both in dollar terms and in relation to the country's gross domestic product (GDP), are presented in Table A-3. Spending for entitlements and other mandatory programs, by far the largest spending category, will reach almost $850 billion this year and is growing fast. Fueling that growth are expenditures for Social Security, Medicare, and Medicaid, which together account for around three-quarters of all mandatory outlays. Table A-4 displays more information about this huge cluster of programs. In response to increased interest in the projected growth of individual mandatory programs, CBO has for the first time extended that table through 2005.

Table A-4.
CBO's 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	38	40	42
Supplemental Security Income	24	24	30	33	36	43	39	47	51	55	64
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	17	20	23	24	25	26	27	28	29	30	31
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	193	207	229	248	268	293	309	336	362	389	423
Non-Means-Tested Programs											
Social Security	334	352	371	391	412	435	458	483	509	537	566
Medicare	178	199	219	240	263	288	315	345	379	416	458
Subtotal	512	551	590	631	675	723	773	828	888	953	1,024
Other Retirement and Disability											
Federal civilian[c]	42	44	46	49	51	54	57	60	63	66	69
Military	28	28	30	31	33	35	36	38	39	41	43
Other	5	4	4	4	4	5	5	5	5	5	5
Subtotal	74	76	80	84	89	93	98	102	107	112	117
Unemployment Compensation	21	23	24	26	27	28	30	31	33	34	35
Other Programs											
Veterans' benefits[d]	17	17	19	19	20	22	23	24	24	25	26
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	20	20	19	19	19	18	18	18	18	18	18
Subtotal	42	39	38	36	38	39	40	41	41	42	43
Total, Non-Means-Tested Programs	649	689	732	777	829	883	941	1,002	1,069	1,142	1,220
Total											
Total Mandatory Spending	843	897	961	1,025	1,098	1,176	1,250	1,339	1,431	1,531	1,643

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.

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 both budget authority (the authority to commit funds, the basic currency of the appropriation process) and outlays (actual spending); the stricter constraint governs. The caps have no unique implications for particular programs but rather force a bruising competition for resources. In a reversal from previous years, in 1996 the limit on budget authority may be more constraining than the limit on outlays. Table A-5 shows that preserving resources next year at the 1995 level adjusted for inflation would cause budget authority to exceed the discretionary cap by $13 billion and outlays to exceed the cap by $4 billion. Future cuts are likely to be painful --even a freeze of total discretionary spending at the current level would result in outlays just $12 billion below the caps in 1998.

Net interest payments for the past few years have been remarkably flat (around $200 billion a year), thanks to low interest rates. However, as Table A-6 shows, the combination of higher interest rates and a persistently large deficit will boost net interest to $235 billion in 1995 and over $300 billion in 2000. Correspondingly, federal debt will continue to increase, with debt held by the public rising to almost 55 percent of GDP in 2000.

Long-range budget projections are highly uncertain because no one can foresee the path of the economy or such important trends as growth in health care spending. CBO's long-run extrapolations thus contain less detail than its five-year projections, which are required under the Congressional budget process. Nevertheless, CBO's broad-brush overview suggests that after 1998--in the absence of concerted action by policymakers--the deficit is likely to continue climbing both in dollar terms and, more worrisomely, as a percentage of GDP (see Table A-7). Sustained growth in the two big health care programs, Medicare and Medicaid, is the major reason, as they mount steadily from 3.8 percent of GDP today to 5.9 percent of GDP in 2005.

Most other spending programs, along with federal revenues, are expected to be roughly flat as a percentage of GDP over the next 10 years. Discretionary spending, the exception, will drop sharply (relative to GDP) through 1998. After the caps expire in 1999, the programs governed by them may resume growing, but even if discretionary spending increases at the rate of inflation, it will continue to decline as a proportion of GDP. If discretionary spending is held to the 1998 dollar level, it will decline even more rapidly--to 4.8 percent of GDP by 2005--and the deficit will stabilize at approximately 2.5 percent of GDP (see Table A-8).