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A BUDGET RESOLUTION: WHAT IS IT?

A budget resolution is a fiscal blueprint, a guide, a road map, that the Congress develops to direct the course of federal tax and spending legislation. It is a set of aggregate spending and revenue numbers covering the twenty broad functional areas of the government, over a long-term fiscal horizon. It is less than substantive law, but is much more than a sense of the Congress resolution. It is a tool for Congress. A budget resolution does not require the President's signature and does not become law.

Nevertheless, a budget resolution can require congressional action leading to changes in substantive law that require Presidential approval. Conversely, substantive law can effect the construction of a budget resolution. For example, substantive law changes enacted last year specifiy parameters that must be followed in the 1999 Budget Resolution. The resolution is enforceable on Congress and it penalizes committees that violate its guidelines. A budget resolution is not a line-item detail document, but conversely line-item assumptions are often required to construct the resolutions' aggregate numbers.

The Concurrent Resolution on the Budget for 1999

Title III of the Congressional Budget Act of 1974 requires the Congress to complete action on a concurrent resolution on or before April 15 of each calendar year for the fiscal year that begins on October 1. Unlike recent past budget resolutions, the 1999 Budget Resolution should represent a continuum in carrying out the Bipartisan Budget Agreement (BBA) announced by the President Clinton and the Congressional leadership eleven months ago on May 7, 1997.

That continuum includes the Senate Budget Committee's reporting on May 19, 1997, by a vote of 17-4, a 1998 Budget Resolution implementing the BBA, ultimately leading to the enactment of the Balanced Budget Act of 1997 and the Taxpayer Relief Act of 1997 on August 5, 1997, and thirteen individual appropriation bills.

The enacted Balanced Budget Act of 1997 extended discretionary spending limits and pay-as-you-go through 2002. These procedures were first enacted in the 1990 Budget Enforcement Act. As the Congress goes on to consider and adopt the 1999 Budget Resolution and subsequent spending bills -- unlike previous years -- fiscal guideposts for discretionary spending have already been established for the Administration and Congress. Revisions to those guideposts would require in most instances changes to substantive law, and therefore, agreed on changes to the historic agreement reached last year.

The President's 1999 budget submitted to Congress in February, as reestimated by the

Congressional Budget Office, was found to have violated the BBA by proposing to spend nearly $12 billion over the agreed on spending caps in 1999, and nearly $68 billion more than was agreed to over the period through 2002. Law binds the Senate Budget Committee, however, not to report a budget resolution that exceeds the spending limits established in last year's agreement.

Markup Book Outline

The purpose of this markup book is to describe what is required to construct a budget resolution. Procedures, baselines, and economic assumptions represent three key components in the construction of any budget resolution. Assumed changes in policies to the defined baseline, create a new fiscal road map in the adopted budget resolution.

This first section provides a brief, but broad historical perspective of the federal budget -- deficits/surpluses, spending, entitlements, and revenues by major components. Deficits and surpluses are presented within the framework of a **unified federal budget**.[1]

A critical component required to construct any budget resolution are the underlying economic assumptions used over the fiscal horizon of the resolution. Included in this section is a description of the current economic assumptions used to construct and develop the baseline spending and revenue paths. A brief summary follows this of the baseline that will be used to develop the 1999 Budget Resolution.

The second section reviews **procedures** the Committee and Congress must follow in constructing a budget resolution. This section reviews content and format of a resolution and floor procedures for considering a resolution, and procedures for enforcing a resolution once adopted.

The third section of the markup book is devoted to a discussion of each of the twenty spending and revenue functions in the budget. These functional discussions include a description of the President's request, the CBO baseline, and the BBA assumptions.

[1]When the Committee reports a budget resolution for the upcoming fiscal year. the Committee's resolution, like past reported budget resolutions. will comply with the Budget Enforcement Act, Subtitle C, Social Security, Section 13301, which requires the exclusion of receipts and disbursements of the Federal Old-Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund from the reported resolution. As is the custom in the budgets submitted by the President and analyzed by the Congressional Budget Office and others, summary tables are included in this Markup Book that present a complete accounting of all federal activities.

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This second section also contrasts the President's 1999 budget request with the BBA. The Committee Majority staff has developed estimates of the BBA to reflect the discretionary spending levels included in the 1998 Budget Resolution, including the priority spending function levels established in the BBA, updated for enacted legislation and technical and economic changes since the agreement.

The markup book appendix concludes with brief summaries of the Senate Committees' "views and estimates" transmitted to the Budget Committee as required under Section 301 of the Congressional Budget Act.

A Brief on the Federal Budget

The federal budget is: (1) a plan for how the federal government disburses and allocates taxpayers dollars among various competing public functions, (2) a plan for how the federal government collects revenues, (3) a plan for how the federal government will finance any deficit spending by borrowing from the public, and (4) a tool for formulating macro fiscal policy.

Chart 1 that follows presents the history and the current CBO baseline projection of the federal deficit through early in the next century. After reaching a peak of $290 billion in 1992 (4.7 percent of GDP), the unified budget deficit has declined to where the CBO now projects a slight surplus in the current fiscal year of nearly $8 billion. Current laws and policies left unchanged, and real economic growth averaging 2.2 percent annually, the unified budget surplus is projected to grow to $67 billion by 2002 (0.7 percent of GDP) and nearly $138 billion by 2008 (1.1 percent of GDP).

The on-budget deficit excludes spending and revenues of the two Social Security trust funds and the transactions of the Postal Service. Measured this way the on-budget deficit remains relatively unchanged throughout the period -- $92 billion in 1998 (1.1 percent of GDP) increasing to $117 billion in 2001 (1.2 percent of GDP), and then declining to a $60 billion deficit in 2008 (0.5 percent of GDP).

(Chart 1. Total Budget Deficit/Surpluses and Deficit Excluding Social Security)

The federal budget consists of more than 1,060 spending accounts that fund an estimated 113,000 programs, projects, and activities. The federal budget and a Congressional budget resolution collapse these accounts into twenty budget functions. The bulk of this markup book describes each of these, with further clarification between those programs in each function that are subject to annual appropriations or are defined as mandatory spending -- not controlled by annual appropriations.

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A further simplification of federal spending is depicted in Chart 2. This chart categorizes all federal spending (outlays) into four major components: (1) entitlements and mandatories, (2) defense discretionary, (3) nondefense discretionary, and (4) net interest on our public debt. Offsetting receipts are excluded from this chart. Offsetting receipts are represented in the federal accounts as negative budget authority and outlays and are credited to separate receipt accounts. In 1997 offsetting receipts totaled nearly $87 billion and consisted primarily of intergovernmental receipts from agencies contributions for federal workers' retirement, and Medicare premium payments.

Clearly federal spending has increased dramatically over the last twenty years and left unchanged will continue to grow into the future. Entitlement and mandatory programs which represented 35 percent of all federal spending in 1970 will exceed 56 percent in 1998. Including net interest payments on federal borrowing over the years, the percentage of the federal budget today that is either an entitlement or a mandatory payment reaches nearly 72 percent.

(Chart 2. Major Components of the Budget)

Discretionary appropriated accounts that represented 25 percent of total spending in 1970 have grown to about 33 percent in 1998. Between 1981 and 1998, all discretionary spending, both defense and nondefense, in constant dollars (adjusted for inflation) has increased less than 0.2 percent annually. Over this period, where there has been growth in nondefense spending after accounting for inflation, that growth has been targeted in a few specific areas: programs related to federal crime fighting activities have increased 112 percent; more than 50 percent increase for space and science programs; and 122 percent for housing programs. Other nondefense spending has seen significant reductions: energy programs down 67 percent; international affairs down 22 percent; commerce programs down 57 percent; and transportation funding flat.

Annual discretionary defense spending -- in constant dollars -- has declined a total of 17 percent since 1983. Annual discretionary nondefense spending, however, in constant dollars has increased 4 percent since 1983.

Total entitlement and mandatory spending growth is shown in Chart 3. In 1995, 72 percent of all mandatory spending fell into three programs: (1) social security, (2) Medicare, and (3) Medicaid. Spending for mandatory programs as a whole has more than doubled during the past decade, rising faster than both nominal growth in the economy and the rate of inflation. These programs are expected to continue to grow in the future, but growth in caseload will account for only about one-fifth of the growth. Automatic increases in benefits will account for more than one-third of growth and nearly 40 percent of the growth comes from increased utilization of medical services.

(Chart 3. Major Components of the Entitlements and Other Mandatory Programs)

Finally, total federal revenues in 1998 will reach nearly $1.7 trillion. Social insurance taxes contributed 35 percent of total revenues, up from 25 percent less than a quarter of a century ago. The share of revenues collected from the individual income tax has remained steady at close to 45 percent over the years, while the proportion of revenues from corporate and excise taxes have declined from 25 percent in 1970 to 15 percent today.

(Chart 4. Major Components of Federal Revenues)

ECONOMIC ASSUMPTIONS

The Chairman's Mark baseline is built upon CBO's latest multi-year economic assumptions. CBO compiles economic forecasts for 1998 and 1999, which reflect the current state of the economy and relative position in the business cycle. CBO's out-year projections are based upon longer-term trends in the economy.

Overview

The economy was exceptionally strong in 1997 -- real GDP grew by 3.8 percent while the unemployment rate dropped to 4.7 percent by year-end. Despite above-trend growth, inflation fell slightly from its 1996 pace. This performance is even more noteworthy, since it occurred seven years into the present expansion. The more favorable economic backdrop accounts for roughly one third of the drop in the FY 1999-2003 cumulative deficit from CBO's September baseline to their March 1998 estimate.

Yet, looking ahead, there are an unusual number of uncertainties on the horizon, most notably the fall out from the Asian financial crisis. When coupled with the maturity of the current expansion, the present economic backdrop argues for caution in the FY 1999 budget.

Comparison of Administration Economics Versus CBO's

OMB's and CBO's economic forecasts are extremely similar overall and are within the range of error on these forecasts. OMB is slightly more optimistic on inflation and income shares. CBO is slightly more optimistic on the level of nominal GDP.

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Growth. OMB and CBO look for the economy to slow from 1997's torrid pace. Both expect below-trend real growth over much of the 1999-2003 budget window, induced in part by the spillover effects of the Asian crisis on US net exports. Yet, OMB believes more of the slowdown will occur in 1998 and the early part of the budget window, while CBO expects the slowdown to be more weighted toward the latter part. OMB expects average annualized real GDP growth of 2.2 percent during the budget window, while CBO expects 2.1 percent growth. However, CBO assumes slightly faster nominal GDP growth.

Inflation. OMB has lower CPI and GDP deflator forecasts than does CBO. While inflation was very subdued in 1997, CBO believes that this is the result of a series of temporary factors -- namely, lower import prices due to the strong dollar, sharp declines in computer prices and slower growth of medical costs. As these factors fade, CBO expects CPI growth to pick up. In contrast, OMB looks for inflation to stay low due to continued dollar strength and the likelihood that firms will absorb some price increases given their wide profit margins.

These CPI differences arise solely from variations in the underlying economic assumptions. Both OMB and CBO assume that ongoing technical changes by the BLS will shave roughly 0.4 percentage points from CPI growth during the budget window. Largely, these adjustments were already reflected in the BBA baseline.

The spread between CPI and the GDP deflator also matters for budget projections. Since indexed outlays are linked mainly to CPI while revenue projections are based off of the GDP deflator, budget forecasts look better the lower CPI is in relation to the GDP deflator. OMB expects a lower spread than CBO.

Income Shares. Income shares depict the breakdown of national income between wages and salaries, benefits, corporate profits, proprietors' income, rental income and net interest. They are expressed as a share of GDP. Wages and salaries and corporate profits are taxed at a higher effective rate -- the higher they are compared with the other income categories, the higher the projected revenue stream.

Unlike last year, differences in wages and salaries and profit shares have relatively little budgetary effect -- while the sum of OMB's wage and salary and corporate profit shares are higher, this is largely offset by CBO's higher nominal GDP forecasts.

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Revenue Strength

In the last four years, revenue growth has outstripped GDP growth by more than 2 percent, boosting the ratio of federal revenues to GDP to a post-1945 record of 19.8 percent.

In 1997 revenue growth was particularly strong, with actual revenues coming in roughly $70 billion above both CBO's and OMB's January 1997 projections. According to CBO's analysis, 85 percent of the surprise was accounted for by higher than expected individual income tax receipts. The strength in 1997 individual income tax receipts likely derived from three sources: 1) stronger than expected growth in personal income due to the robust economy, 2) unusually high capital gains realizations, and 3) a rise in the effective tax rate. The latter two factors caused individual receipts to rise at twice the rate as personal income growth.

Based on continued economic strength and the likely persistence of some technical factors, both CBO and OMB largely extrapolated FY 1997's revenue surprise into FY 1998 and FY 1999. Beyond FY 1999, both made at least partial extrapolation of the FY 1997 surprise. CBO's and OMB's current services revenue projections are now essentially identical.

Sensitivity to Economic Changes

Last year' s experience showed the sensitivity of the deficit to economic and technical changes. While 1997's outcome was favorable, it could just as easily have been a negative surprise. CBO notes that seeing a 2 percent swing in any one year from projections of both revenue and outlays is not uncommon. Should revenues fall short by 2 percent and outlays run ahead by the same amount, this could produce a $60 billion increase in the deficit.

The onset of recession would have an even larger effect. CBO notes that a "typical" recession could increase the deficit by more than $100 billion. While no one expects a near-term US recession, a further worsening of the Asian crisis could bring such fears into view.

Remembering the maturity of the current economic expansion is also important. Now into its eighth year, it will be the longest peacetime expansion if it lasts until the end of 1998. If it lasts until the end of the budget window, it will be the longest expansion on record. CBO attempts to account for recession risks by having the economy operate at slightly below its level of potential GDP in the out years. Yet, should a recession hit within the five-year budget window, budget outcomes would be much worse than current estimates. This argues for cautious FY 1999 budgeting.

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Long-Term Outlook

CBO's long-term fiscal analysis shows that the Bipartisan Budget Agreement has improved the long-term outlook. Yet, it does not prevent an eventual explosion in our debt/GNP ratio once the baby-boomers' retirement costs mount early in the next century. To solve the US' long-term fiscal problems, CBO finds that the government would need to cut either spending or raise taxes by 1.6 percent of GDP permanently.

(Chart 5, Projections of Debt-to-GNP Ratios and Chart 6, Real GNP per Capita)

CBO's projections may well err on the optimistic side. CBO uses population projections formulated by the Social Security Administration. The Advisory Council on Social Security and many private demographers believe that median life expectancies have increased more than SSA assumes, which would worsen CBO's long-term fiscal projections. Thus, we should not rush to spend any prospective surplus. Instead, the near-term reprieve in fiscal outlook is an opportunity to undertake meaningful reform of entitlement programs like Medicare and Social Security. Only through such action, will there be a truly favorable fiscal outlook overall.

ECONOMIC PROJECTIONS COMPARISON
(Calendar Years)

	1997	1998	1999	2000	2001	2002	2003
% Change (Year to Year):							
Nominal GDP Growth							
Administration*	5.9	4.3	4.1	4.2	4.4	4.7	4.6
CBO*	5.9	4.7	4.2	4.3	4.5	4.6	4.8
Blue Chip*	5.9	4.5	4.5	4.6	4.8	4.9	4.9
Real GDP Growth							
Administration	3.8	2.4	2.0	2.0	2.2	2.4	2.4
CBO	3.8	2.7	2.0	1.9	2.0	2.1	2.3
Blue Chip	3.8	2.6	2.2	2.0	2.2	2.4	2.4
Consumer Price Index							
Administration	2.3	2.1	2.2	2.3	2.3	2.3	2.3
CBO	2.3	2.2	2.5	2.7	2.8	2.8	2.8
Blue Chip	2.3	2.0	2.5	2.9	2.9	2.8	2.8
GDP Price Deflator							
Administration	2.0	1.9	2.0	2.2	2.2	2.2	2.2
CBO	2.0	2.0	2.2	2.3	2.4	2.4	2.5
Blue Chip	2.0	1.9	2.3	2.6	2.6	2.5	2.4
Annual Rate:							
Unemployment							
Administration	5.0	4.9	5.1	5.3	5.4	5.4	5.4
CBO	5.0	4.8	5.1	5.4	5.6	5.8	5.9
Blue Chip	5.0	4.8	5.0	5.5	5.6	5.6	5.4
Three-Month T-Bill							
Administration	5.1	5.0	4.9	4.8	4.7	4.7	4.7
CBO	5.1	5.3	5.2	4.8	4.7	4.7	4.7
Blue Chip	5.1	5.1	5.1	5.0	5.0	5.0	5.1
Ten-Year T-Note							
Administration	6.4	5.9	5.8	5.8	5.7	5.7	5.7
CBO	6.4	6.0	6.1	6.0	5.9	5.9	5.9
Blue Chip	6.4	5.8	5.9	6.2	6.1	6.1	6.1
Share of GDP:							
Corporate Profits (Book Profits) + Wages and Salaries							
Administration	57.0	57.0	57.1	57.0	56.8	56.7	56.6
CBO	57.0	57.2	56.7	56.5	56.2	56.1	56.0

*Administration is from President's FY 1999 Budget. CBO is from CBO's "Economic and Budget Outlook: Fiscal Years 1999 - 2008." Blue Chip Economic Indicators: 1998 and 1999 forecasts are from February 1998, 2000-2003 forecasts from October 1997.

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BASELINE ASSUMPTIONS

The "baseline" -- the starting point required to construct any budget resolution -- is another important element in the development of any budget resolution. Alternative baselines can be constructed. The baseline described in this markup book has been developed by the Committee Majority Staff with the assistance of the Congressional Budget Office (CBO) and is called the "Freeze baseline".

The Freeze baseline is calculated in the general manner proscribed by the BEA, except that discretionary appropriated accounts are "frozen" at the 1998 enacted level and include no increase for inflation. This is the same as CBO's updated February WODI (without discretionary inflation) baseline, with several adjustments to discretionary spending.

- The baseline incorporates the effects of the Military Construction veto override that passed the Senate on February 25, 1998. The measure passed too late to be included in CBO's revised baseline. No assumptions have been made regarding the 1998 supplemental.

- The baseline is adjusted downward to reflect discretionary funding that is outside the caps, pursuant to Section 251 of the Balanced Budget and Emergency Deficit Control Act (Gramm-Rudman) and Section 314 of the Congressional Budget Act. These adjustments include: arrearages for international organizations, peacekeeping, and multilateral development banks; continuing disability reviews (CDRs); and an IRS initiative to improve EITC compliance.

- The baseline for highway and mass transit programs reflect the assumptions in last year's BBA, adjusted for congressional action, to maintain the baseline for the ISTEA Reauthorization.

Estimates for direct spending, which is all spending authority provided by law other than appropriations acts, assume full funding of current law, including cost-of-living adjustments. Direct spending includes entitlements and other mandatory programs such as social security, medicare, and federal retirement, where spending levels are controlled by eligibility rules, benefit calculations. participation levels, and other non-discretionary cost factors. The baseline assumes that all programs greater than $50 million a year will continue, even if their authorization expires. Net interest spending, which is another subset of direct spending, is driven by the size of the annual and cumulative cash deficits and interest rates and is rarely affected directly by Congressional action.

Likewise, baseline revenue estimates assume no change in current tax law. Excise taxes dedicated to a trust fund are assumed to continue if their expiration occurs during the baseline period. However, other expiring provisions of tax law, whether increasing or decreasing revenues, are not extended in the baseline.