Fact Sheet on CBO Surplus Projections for FY 2000-2010

January 31, 2000

On January 26, the Congressional Budget Office (CBO) released the *Budget and Economic Outlook for Fiscal Years 2001-2010*. This fact sheet presents some of the key economic and budget data contained in the report. For additional details, consult CBO's web site at www.CBO.gov.

The Size of the Surplus

For fiscal year 2000, CBO projects a unified surplus of $176 billion and a non-social security surplus of $23 billion. The on-budget surplus would be the largest ever in nominal dollars and the largest measured as a percentage of gross domestic product (GDP) since 1951.

The improvement in the on-budget deficit since last October stems mainly from higher revenues generated by stronger than anticipated economic growth. Higher revenues — not lower spending — erased the $17 billion deficit the Republicans left behind in October.

For fiscal years 2001-2010, CBO's report contains **three** sets of baseline projections which differ *only* with respect to the assumption made about the level of discretionary spending and the associated interest costs. On a unified basis, the new surplus estimates range from $3.2 trillion to $4.2 trillion over the period 2001-2010 – nearly $900 billion higher than the surpluses projected in July. The non-Social Security surplus ranges from $838 billion to $1.9 trillion for the ten-year period. Table 1 shows the surplus estimates for these three baseline scenarios.

Table 1: CBO Surplus Estimates: Three Scenarios

($ billions)	2001	2001-2005	2001-2010
Inflated baseline:			
On-budget	11	148	838
Unified	177	1,126	3,152
Freeze baseline:			
On-budget	22	379	1,858
Unified	188	1,358	4,179
Capped baseline:			
On-budget	69	594	1,918
Unified	235	1,571	4,232

Discretionary Baseline Variations

For the past nine fiscal years CBO's estimates of "current policy" for discretionary programs have assumed the statutory caps set most recently in the Balanced Budget Act of 1997. Current law was believed to be the best representation of current policy — and for many years, this was the case. However, in recent years, emergency designations and other scoring devices have been employed to allowing for additional spending outside the caps by significant amounts. Although not technically breached, the fiscal year 2000 spending limits assumed in CBO's July baseline projections were exceeded by nearly $40 billion for both budget authority and outlays.

In response to the level of uncertainty about how to best represent current congressional policy for annually appropriated programs, the CBO report includes three variations. These options result in different estimates of the surplus as shown in table 1 above. The three variations include:

- The ***"zero real growth"*** or ***"inflated"*** variation, which assumes that budget authority for discretionary programs grows at the rate of inflation each year after fiscal year 2000. OMB relies on this baseline to form the basis for the President's budget. It is also the baseline CBO used before discretionary spending limits were established in the Omnibus Budget Reconciliation Act of 1990. Note also that current budget law includes rules for constructing the inflated baseline.

- The ***freeze*** variation, which holds budget authority at the level enacted for the current budget year, including any appropriations already enacted as advance appropriations for fiscal year 2001.

- The ***capped*** variation, which assumes that discretionary spending equals CBO's estimates of the statutory caps through 2002 and grows at the rate of inflation thereafter.

Table 2: Alternative Discretionary Assumptions

(Outlays; $ billions)	Spending Level 2000	2001	2002	2010	Avg.1/ 2000-2010
Freeze	603	624	628	621	0.3%
Capped	603	578	571	696	1.4%
Inflated	603	635	650	786	2.7%
Historical (3.2 percent/yr): .	603	622	641	826	3.2%
Constant % of GDP (6.3%) . .	603	632	661	936	4.5%

1/ Average annual rate of growth between 2000-2010.

There are other variations that could serve as a reasonable proxy for current discretionary spending policy, as shown in Table 2 above. Spending could be held constant as a percent of GDP (6.3 percent in fiscal year 2000) or projections could be based on recent trends (between fiscal years 1997 and 2000, spending increased at an average annual rate of 3.2 percent; the 1999 increase was 3.7 percent and the 2000 increase was 4.8 percent.) Either of these alternatives would result in higher levels of discretionary spending and lower budget surpluses over the next ten years. The House and Senate Budget Committees will decide which of these baselines will serve as the benchmark for the 2001 congressional budget or, alternatively, they could devise a new variation.

The Only Realistic Discretionary Alternative

The CBO report notes that all three discretionary alternatives have their limitations. However, <u>of these three, only the inflated baseline is even close to realistic</u>.

Until recently, the statutory spending limits or "caps" were a fairly good proxy for congressional policy. Over the past two years, however, Congress has evaded the caps through questionable emergency designations, scoring adjustments, and other gimmicks. Meeting the caps in fiscal year 2001 would require spending cuts of nearly $46 billion from a freeze at last year's levels and $57 billion from an inflated baseline.

A freeze baseline is also an unrealistic proxy for current policy since it ignores the effects of pay raises and inflation -- costs that erode the amount of services or programs that the government can deliver over time. **A ten-year freeze would reduce purchasing power by more than 20 percent by 2010.** In addition to being a poor proxy for current policy, a freeze is completely unrealistic and overstates the size of the on-budget surplus. As shown in Table 3, between fiscal years 1999 and 2000, the GOP-controlled Congress increased discretionary spending by 4.8 percent. Over the period 1997-2000, discretionary spending increased at an average annual rate of 3.2 percent. The consumer price index, in contrast, increased by only 2 percent during the same time period.

Table 3: Historical Growth Rates in Discretionary Spending

(Outlays: $ billions)	1998	1999	2000	Avg.1/
Defense	-0.6%	1.9%	2.7%	1.4%
Nondefense	2.6%	5.3%	6.7%	4.9%
Total Discretionary	1.1%	3.7%	4.8%	3.2%
Consumer Price Index	*1.6%*	*1.9%*	*2.6%*	2.0%

1/ Average annual rate of increase between 1996 and 2000.

The "zero real growth" or "inflated" baseline best reflects what a baseline should be -- a representation of **current policy.** This baseline assumes constant purchasing power for appropriations. In other words, it tells us the cost of today's programs in tomorrow's dollars. **This was the baseline used most often by CBO and the Budget Committees before spending caps were enacted in budget law.**

This is *not* to say that Congress *should* maintain discretionary spending at inflation-adjusted levels. Nor is it to say that the inflated baseline is necessarily a good predictor of budget outcomes. As shown in Table 3 above, **congressional spending on appropriations has surpassed the rate of inflation for the past two years**.

Economic Uncertainty in the Forecast

CBO's baseline projections represent the midrange of possible outcomes for the economy and the budget, assuming current policies are not changed. Actual outcomes will vary if economic projections or other assumptions prove wrong. The nearly $1 trillion revision of the surplus from its level just six months ago highlights the uncertainties in any 10-year budget projection. Although revisions of late have been favorable, there is no guarantee that this will continue into the future.

To illustrate the possible effects of differences from the baseline assumptions, CBO has produced a set of budget projections under an optimistic and pessimistic scenario. Table 4 shows the on-budget baseline projections for each of the three discretionary assumptions under CBO's midrange, pessimistic, and optimistic scenarios. The optimistic scenario assumes that the robust economy will continue indefinitely and that Medicare and Medicaid will spend at a rate one percent slower than the baseline assumes. The pessimistic scenario assumes that the economy will revert back to stable, long-term trends, including faster growth in Medicare and Medicaid.

Under the optimistic scenario, on-budget surpluses range from $4.2 trillion to $5.2 trillion over 10 years. Under the pessimistic scenario, the on-budget surplus would disappear by the end of fiscal year 2000 and on-budget deficits would range from $1.9 to $2.9 trillion.

Given the uncertainty of any set of long-term projections, it makes sense to be cautious about making permanent structural changes in spending or revenue policies that commit large portions of a surplus that may not materialize.

Table 4: On-budget Surpluses Under Optimistic, Midrange and Pessimistic Scenarios			
($ billions)	2000	2001	2001-2010
Inflated:			
Optimistic	53	85	4,174
CBO baseline (midrange)	23	11	838
Pessimistic	-9	-76	-2,945
Freeze:			
Optimistic	53	96	5,195
CBO baseline (midrange)	23	22	1,858
Pessimistic	-9	-65	-1,925
Capped:			
Optimistic	53	143	5,255
CBO baseline (midrange)	23	69	1,918
Pessimistic	-9	-18	-1,865

Costs Omitted in Surplus Projections

Future surpluses will be reduced by other spending and tax changes that are entirely predictable, but not accounted for in any of CBO's baselines. For example, CBO's baselines assume that expiring provisions of the tax code will not be continued. Yet Congress has routinely extended several of these provisions in past years, and future extensions are virtually inevitable. Renewing these provisions would reduce the projected surplus by about $100 billion over the next ten years.

Similarly, CBO's baselines do not account for additional support payments for farmers. In fiscal years 1999 and 2000, Congress added about $6 billion a year for "emergency aid to farmers." Similar aid probably will continue in the future.

Many other costs can be anticipated in the future, but are not included in CBO's baselines. For example, former CBO Director Robert Reischauer has noted the likelihood that Congress will provide relief from the alternative minimum tax for middle class taxpayers, which could cost between $30 billion and $80 billion over ten years. He also projects that Congress will provide an additional $50 billion over the next decade to hospitals, nursing homes and other health care providers.

Surplus Projections and the Federal Debt

Under all three alternative baselines, the Treasury would have enough cash on hand to retire the *marketable* debt between 2007 and 2009. However, since some outstanding debt would not be available for repurchase, and other debt is tied up in savings bonds and bond issues to state and local governments, the Treasury would not be able to totally eliminate the debt. Therefore, debt held by the public declines to $941 billion under all three scenarios. The difference between the three is the amount of accumulated excess cash on hand. Under the freeze and capped baseline variations, there is sufficient cash to totally eliminate the debt numerically. Under the inflated baseline, there is $528 billion in cash, which is not sufficient to pay off the $941 billion in remaining debt. The CBO baseline assumes that the Treasury would invest all of its excess cash at an interest rate equal to the average rate for Treasury bills and notes, and would receive dividend or interest earnings from those investments.

Prepared by the Senate Budget Committee Democratic Staff