

A
CBO
REPORT

**AN ANALYSIS OF THE PRESIDENT'S BUDGETARY
PROPOSALS FOR FISCAL YEAR 2001**

The Congress of the United States
Congressional Budget Office

NOTES

Numbers in the text and tables of this report may not add to totals because of rounding.

Unless otherwise indicated, all years referred to in Chapter 4 are calendar years, and all years in other chapters and the appendixes are fiscal years.

Preface

This Congressional Budget Office (CBO) analysis of the President's budget request for fiscal year 2001 was prepared at the request of the Senate Committee on Appropriations. It was produced by the staffs of CBO's Budget Analysis, Macroeconomic Analysis, and Tax Analysis divisions under the supervision of Robert Sunshine, Robert Dennis, and Thomas Woodward. The baseline revenue estimates were prepared by CBO; the estimates of the President's revenue proposals were prepared by the Joint Committee on Taxation.

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Sherry Snyder, Leah Mazade, and Christian Spoor edited the report, and Kathryn Quattrone prepared it for publication. The authors owe thanks to Marion Curry, Linda Lewis Harris, Brianne Hutchinson, and Dorothy Kornegay, who assisted in producing sections of the report. Laurie Brown prepared the electronic versions for CBO's World Wide Web site.

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Contents

	SUMMARY	ix
ONE	AN OVERVIEW OF THE PRESIDENT'S POLICY PROPOSALS	1
	Spending Proposals 5	
	Revenue Proposals 10	
	Budgetary Conventions 15	
	Debt Reduction 16	
	Grants to State and Local Governments 17	
	Differences Between CBO's and the Administration's Estimates 19	
TWO	THE PRESIDENT'S HEALTH INSURANCE PROPOSALS	23
	Spending and Enrollment Trends in Medicaid and the State Children's Health Insurance Program 24	
	The President's Proposals for Medicaid and SCHIP 30	
	Spending and Enrollment Trends in Medicare 39	
	The President's Proposals for Medicare 43	
THREE	THE PRESIDENT'S TRUST FUND PROPOSALS	61
	The President's Social Security and Medicare Trust Fund Proposals 65	
	The President's Black Lung Disability Trust Fund Proposal 69	
FOUR	COMPARISON OF ECONOMIC FORECASTS	71
	Real Growth and Unemployment 71	
	Inflation and Interest Rates 74	
	Income 74	
	APPENDIXES	
A	CBO's Baseline Budget Projections 79	
B	Estimates of Outlays for National Defense 99	
C	Major Contributors to the Revenue and Spending Projections 105	

TABLES

S-1.	Comparison of CBO's and the Administration's Estimates of the President's Budget for 2001	x
S-2.	CBO's Estimate of the President's Budgetary Proposals Relative to CBO's Baseline Projections Assuming Inflated Appropriations	xi
S-3.	CBO's Estimate of the President's Budgetary Proposals Relative to CBO's Baseline Projections Assuming Frozen Appropriations	xii
1-1.	Estimates of Surpluses Under the President's Budgetary Proposals and CBO's Baseline Projections	2
1-2.	Impact of the President's Budgetary Proposals on Cumulative On-Budget Surpluses	3
1-3.	CBO's Estimate of the President's Budget	4
1-4.	Major Differences Between CBO's and the Administration's Estimates of Spending for Selected Mandatory Programs, Fiscal Years 2001-2010	5
1-5.	Estimates of Discretionary Spending Under the President's Budgetary Proposals and CBO's Baseline Projections	6
1-6.	Comparison of Discretionary Spending Enacted for 2000 with the President's Request for 2001	7
1-7.	Comparison of Discretionary Budget Authority Enacted for 2000 with the President's Request for 2001, by Budget Function	8
1-8.	CBO's Estimate of the Effect of the President's Budgetary Proposals on Mandatory Programs	9
1-9.	CBO's Estimate of the President's Revenue Proposals	11
1-10.	Comparison of Discretionary Spending Authority for Grant Programs Enacted for 2000 with the President's Request for 2001, by Budget Function	18
1-11.	Sources of Differences Between CBO's and the Administration's Estimates of the President's Budgetary Proposals	20
1-12.	Comparison of CBO's and the Administration's Baselines	21
2-1.	Ten-Year Estimates of the President's Health Insurance Proposals	24

2-2.	CBO's March 2000 Baseline for Medicaid and the State Children's Health Insurance Program	26
2-3.	CBO's Estimate of the President's Proposals for Medicaid and the State Children's Health Insurance Program	31
2-4.	CBO's Estimate of the President's FamilyCare Proposal	33
2-5.	Medicare Outlays Under CBO's Baseline Assumptions	40
2-6.	Outlays for Medicare Benefits, by Sector, Under CBO's Baseline Assumptions	41
2-7.	CBO's Estimate of Changes in Medicare Spending Under the President's Proposals	44
2-8.	CBO's Estimate of the President's Proposals to Modify Traditional Medicare	45
2-9.	CBO's Estimate of the President's Proposals to Expand Medicare Eligibility	49
2-10.	Government Subsidies for Drug Costs Under the President's Proposal for a Prescription Drug Benefit in Medicare	50
2-11.	CBO's Estimate of the President's Proposal for a Prescription Drug Benefit in Medicare	51
2-12.	Cost per Participant Under the President's Proposal for a Prescription Drug Benefit in Medicare	52
4-1.	Comparison of Economic Projections for Calendar Years 2000-2010	73
A-1.	Mandatory Programs with Expiring Authorizations That Are Assumed to Continue in CBO's Baseline	83
A-2.	CBO's Projections of Discretionary Spending Under Alternative Versions of the Baseline	84
A-3.	The Budget Outlook Under Current Policies	85
A-4.	Changes in CBO's Estimates of Surpluses Since January 2000 Under Alternative Versions of the Baseline	86
A-5.	Credit Subsidy Reestimates Since 1999	87
A-6.	CBO's Baseline Budget Projections, Assuming That Discretionary Spending Grows at the Rate of Inflation After 2000	88
A-7.	CBO's Baseline Budget Projections, Assuming That Discretionary Spending Is Frozen at the Level Enacted for 2000	90

A-8.	CBO's Baseline Budget Projections, Assuming That Discretionary Spending Equals CBO's Estimates of the Statutory Caps Through 2002 and Grows at the Rate of Inflation Thereafter	92
A-9.	CBO's Projections of Mandatory Spending	94
A-10.	CBO's Projections of Federal Interest Outlays Under Alternative Versions of the Baseline	95
A-11.	CBO's Projections of Federal Debt at the End of the Year Under Alternative Versions of the Baseline	96
B-1.	Differences Between CBO's and the Administration's Estimates of Outlays from the President's Budget Requests for Defense Discretionary Programs, 1994-2001	99
B-2.	Accuracy of CBO's and the Administration's Estimates of Defense Discretionary Outlays, 1994-1999	100
B-3.	Comparison of CBO's and the Administration's Estimates of Defense Discretionary Outlays for Fiscal Year 2001	102

FIGURES

2-1.	Annual Growth of Federal Medicaid Outlays, 1978-2010	25
2-2.	Budget Authority and Outlays Under the President's FamilyCare Proposal, 2001-2010	35
3-1.	Projected Expenditures and Receipts for Social Security and Medicare Combined	65
4-1.	Wages and Salaries Plus Corporate Before-Tax Profits	75

BOXES

3-1.	Overview of Federal Trust Funds	62
3-2.	Who Will Pay for the Baby Boomers' Future Benefits?	64
4-1.	The Potential Economic and Budgetary Effects of Higher Oil Prices	72

Summary

As requested by the Senate Committee on Appropriations, the Congressional Budget Office (CBO) has estimated the effects of the proposals in the President's budget request for fiscal year 2001 using CBO's economic and technical estimating assumptions.

Under the Administration's policies, CBO estimates a total budget surplus of \$190 billion for 2001—consisting of an on-budget surplus of \$24 billion and an off-budget surplus of \$166 billion. (On-budget totals exclude Social Security inflows and outflows as well as the net cash flow to the Postal Service.) Cumulative on-budget surpluses, by CBO's tally, would reach \$423 billion over the 2001-2010 period, and off-budget surpluses \$2.3 trillion, under the President's proposals (see Summary Table 1). CBO's estimates of budgetary totals are quite close to those of the Administration, which projects cumulative on-budget surpluses of \$350 billion over the 10-year period and off-budget surpluses of \$2.2 trillion.

The President's Budgetary Policies

To assess the impact of the President's budget as well as other budget plans, CBO uses its baseline as a benchmark for comparison. The baseline assumes that current laws governing federal revenues and mandatory spending programs remain in place. But discretionary spending is controlled by annual appropriation

acts, and no consensus exists about how to define current policy for such spending as it applies to future years. Consequently, CBO has prepared three variants of its baseline, each of which assumes a different path for discretionary spending:¹

- o The "inflated" variation assumes that budget authority for discretionary programs grows at the rate of inflation each year after 2000.
- o The "freeze" variation pegs discretionary budget authority to the level enacted for the current year plus amounts already enacted for 2001.
- o The "capped" variation assumes that discretionary spending equals CBO's estimates of the statutory caps on such spending through 2002 and grows at the rate of inflation thereafter.

Over the 2001-2010 period, the President's budgetary proposals lead to a cumulative total surplus that is smaller than such surpluses under CBO's baseline variants—\$472 billion less than under CBO's inflated variation (see Summary Table 2) and \$1,476 billion less than under the freeze variation (see Summary Table 3). A similar difference would result if the capped baseline was used for comparison. Nearly all of the differences between the budget's and CBO's estimates of the cumulative total surplus show up in on-budget accounts. Cumulative off-budget surpluses

1. CBO's *The Budget and Economic Outlook: Fiscal Years 2001-2010* (January 2000) describes its baseline in detail. The January estimates have been slightly revised; for updated projections, see Appendix A in this report.

would be essentially the same under all three versions of the baseline and the President's budget.

The President proposes several uses for the projected on-budget baseline surpluses. Some portion would be devoted to additional spending, and some would finance net tax cuts; the remainder would reduce federal debt. The budget also proposes spending policies that include increasing and extending the current statutory limits on discretionary spending as well as boosting outlays for some mandatory programs. The President's plan for revising the discretionary spending caps calls for a significant increase in 2001; after that, the proposed caps would result in a spend-

ing path similar to that suggested by the inflated variation of CBO's baseline. Relative to the freeze variation, the Administration's proposals would add more than \$860 billion to discretionary outlays over the 2001-2010 period (relative to the capped baseline, nearly \$840 billion would be added).

On the mandatory side of the budget, the proposals of major budgetary significance are concentrated on health initiatives—particularly for Medicare, Medicaid, and the State Children's Health Insurance Program (SCHIP). Additional spending for mandatory programs would total about \$218 billion over 10 years, CBO estimates.

Summary Table 1.
Comparison of CBO's and the Administration's Estimates of the President's Budget for 2001
(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
CBO's Estimate of the President's Budget													
Revenues	1,946	2,026	2,097	2,171	2,262	2,352	2,443	2,547	2,659	2,781	2,912	10,908	24,250
Outlays	<u>1,778</u>	<u>1,836</u>	<u>1,902</u>	<u>1,958</u>	<u>2,033</u>	<u>2,114</u>	<u>2,170</u>	<u>2,240</u>	<u>2,331</u>	<u>2,422</u>	<u>2,516</u>	<u>9,843</u>	<u>21,523</u>
Surplus	168	190	196	213	228	238	273	307	328	360	395	1,065	2,727
On-budget	15	24	14	18	20	14	34	54	62	80	103	90	423
Off-budget	153	166	182	195	208	224	238	253	266	280	292	975	2,304
Administration's Estimate of the Budget													
Revenues	1,956	2,019	2,081	2,147	2,236	2,341	2,440	2,559	2,676	2,785	2,917	10,825	24,202
Outlays	<u>1,790</u>	<u>1,835</u>	<u>1,895</u>	<u>1,963</u>	<u>2,041</u>	<u>2,125</u>	<u>2,185</u>	<u>2,267</u>	<u>2,362</u>	<u>2,456</u>	<u>2,553</u>	<u>9,860</u>	<u>21,683</u>
Surplus	167	184	186	185	195	215	256	292	314	329	363	965	2,519
On-budget	19	24	14	*	*	2	31	53	64	70	91	41	350
Off-budget	148	160	172	184	195	214	224	239	250	260	272	924	2,169
Differences (CBO minus Administration)													
Revenues	-11	7	16	24	26	12	3	-12	-17	-4	-5	84	48
Outlays	<u>-12</u>	<u>1</u>	<u>6</u>	<u>-5</u>	<u>-8</u>	<u>-11</u>	<u>-14</u>	<u>-27</u>	<u>-31</u>	<u>-34</u>	<u>-37</u>	<u>-17</u>	<u>-160</u>
Surplus	1	6	10	28	34	23	17	15	14	30	32	100	209
On-budget	-4	*	*	18	20	12	3	1	-2	10	12	49	73
Off-budget	5	6	10	11	14	11	14	14	16	20	20	51	135

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

The President's revenue proposals would shrink receipts by a total of \$146 billion over the 10-year period, according to CBO and the Joint Committee on Taxation. Most of that net reduction would occur in the later years of the period; over the first five years, the estimated effect totals \$5 billion. Revenue-damp-

ening proposals include tax cuts to alleviate the marriage penalty and a number of tax credits intended to promote various objectives. Those reductions are partially offset by revenue increases—for example, from raising the excise tax on tobacco.

Summary Table 2.
CBO's Estimate of the President's Budgetary Proposals Relative to CBO's Baseline Projections
Assuming Inflated Appropriations (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
CBO's Estimate of the Total Budget Surplus Under the Inflated Variation of the Baseline	179	181	212	231	250	273	330	374	404	449	495	1,147	3,199
Impact of the President's Proposals													
Revenues													
Reductions	*	-5	-14	-20	-25	-35	-44	-47	-50	-54	-57	-100	-351
Increases	<u>1</u>	<u>15</u>	<u>15</u>	<u>15</u>	<u>25</u>	<u>26</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>95</u>	<u>205</u>
Total Impact on Revenues	1	10	1	-6	-1	-9	-22	-25	-28	-32	-35	-5	-146
Outlays													
Discretionary spending													
Defense	5	-1	2	2	2	2	2	3	5	7	8	7	31
Nondefense	<u>3</u>	<u>1</u>	<u>4</u>	<u>1</u>	<u>*</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>*</u>	<u>-1</u>	<u>-2</u>	<u>5</u>	<u>1</u>
Subtotal	8	-1	6	3	3	1	1	2	5	6	6	12	32
Mandatory spending ^a													
Medicare outlays	0	-1	4	9	17	19	18	22	24	28	31	48	171
Medicare premiums	0	*	-2	-9	-11	-12	-11	-13	-13	-15	-17	-33	-102
Medicaid	0	*	*	1	2	4	-3	1	6	7	8	7	26
State Children's Health Insurance Program	0	*	1	2	3	5	18	13	7	8	7	11	64
Supplemental Security Income	2	-2	*	*	*	1	1	1	1	2	2	-1	6
Earned income tax credit	*	2	2	2	2	2	2	2	2	2	2	11	22
Child and dependent care tax credit	0	0	0	1	2	2	3	3	3	3	4	4	20
Other	<u>1</u>	<u>2</u>	<u>5</u>	<u>2</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>-1</u>	<u>11</u>	<u>10</u>
Subtotal	4	1	11	8	16	21	28	30	31	35	37	58	218
Net interest ^b	<u>*</u>	<u>*</u>	<u>*</u>	<u>1</u>	<u>2</u>	<u>4</u>	<u>6</u>	<u>9</u>	<u>13</u>	<u>18</u>	<u>23</u>	<u>8</u>	<u>76</u>
Total Impact on Outlays	12	1	17	13	21	26	35	41	49	58	65	77	326
Net Impact of the President's Proposals on the Total Budget Surplus	-11	9	-16	-18	-22	-35	-58	-67	-76	-90	-100	-82	-472
CBO's Estimate of the Total Budget Surplus Under the President's Budgetary Proposals	168	190	196	213	228	238	273	307	328	360	395	1,065	2,727

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: * = between -\$500 million and \$500 million.

a. Includes offsetting receipts.

b. Includes proceeds from investing excess cash.

Under the President's policies, annual spending by the federal government would rise over the projection period, but that spending as a share of gross domestic product (GDP) would fall. Overall, the Administration proposes to spend more than \$1.8 trillion—representing 18.3 percent of GDP—in 2001. Total annual spending is estimated to rise to \$2.5 trillion in

2010 but would account for only 16.9 percent of GDP, the lowest percentage since 1956. Most of that reduction is attributable to diminishing interest payments on government debt. Revenues would also decline as a share of GDP—from 20.2 percent in 2001 to 19.6 percent in 2010.

Summary Table 3.
CBO's Estimate of the President's Budgetary Proposals Relative to CBO's Baseline Projections Assuming Frozen Appropriations (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
CBO's Estimate of the Total Budget Surplus Under the Freeze Variation of the Baseline	179	192	237	273	315	358	436	502	558	629	704	1,374	4,204
Impact of the President's Proposals													
Revenues													
Reductions	*	-5	-14	-20	-25	-35	-44	-47	-50	-54	-57	-100	-351
Increases	<u>1</u>	<u>15</u>	<u>15</u>	<u>15</u>	<u>25</u>	<u>26</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>95</u>	<u>205</u>
Total Impact on Revenues	1	10	1	-6	-1	-9	-22	-25	-28	-32	-35	-5	-146
Outlays													
Discretionary spending													
Defense	5	5	15	21	30	37	44	52	63	73	83	108	424
Nondefense	<u>3</u>	<u>5</u>	<u>15</u>	<u>20</u>	<u>31</u>	<u>39</u>	<u>48</u>	<u>57</u>	<u>67</u>	<u>76</u>	<u>84</u>	<u>111</u>	<u>443</u>
Subtotal	8	10	29	42	61	76	92	109	130	149	167	219	866
Mandatory spending ^a													
Medicare outlays	0	-1	4	9	17	19	18	22	24	28	31	48	171
Medicare premiums	0	*	-2	-9	-11	-12	-11	-13	-13	-15	-17	-33	-102
Medicaid	0	*	*	1	2	4	-3	1	6	7	8	7	26
State Children's Health Insurance Program	0	*	1	2	3	5	18	13	7	8	7	11	64
Supplemental Security Income	2	-2	*	*	*	1	1	1	1	2	2	-1	6
Earned income tax credit	*	2	2	2	2	2	2	2	2	2	2	11	22
Child and dependent care tax credit	0	0	0	1	2	2	3	3	3	3	4	4	20
Other	<u>1</u>	<u>2</u>	<u>5</u>	<u>2</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>-1</u>	<u>11</u>	<u>10</u>
Subtotal	4	1	11	8	16	21	28	30	31	35	37	58	218
Net interest ^b	<u>*</u>	<u>*</u>	<u>2</u>	<u>4</u>	<u>8</u>	<u>13</u>	<u>21</u>	<u>30</u>	<u>42</u>	<u>55</u>	<u>70</u>	<u>28</u>	<u>246</u>
Total Impact on Outlays	12	12	42	54	86	111	141	170	202	238	274	304	1,330
Net Impact of the President's Proposals on the Total Budget Surplus	-11	-2	-41	-60	-86	-120	-163	-195	-230	-270	-309	-309	-1,476
CBO's Estimate of the Total Budget Surplus Under the President's Budgetary Proposals	168	190	196	213	228	238	273	307	328	360	395	1,065	2,727

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: * = between -\$500 million and \$500 million.

a. Includes offsetting receipts.

b. Includes proceeds from investing excess cash.

Although CBO estimates that on-budget surpluses under the Administration's budget would be smaller and would grow more slowly than under current policies (as reflected in CBO's baseline), they would nevertheless climb over the projection period, from \$24 billion to \$103 billion. (Off-budget surpluses would change only slightly from the levels projected under current policies.) CBO's estimates of surpluses under the President's proposals are higher than the Administration's estimates, largely because for the most part, CBO's projections of mandatory spending under current law are lower. Social Security accounts for much of the difference: CBO's baseline total for Social Security outlays over the 2001-2010 period is \$128 billion less than the Administration's.

The President's Health Insurance Proposals

After Social Security, Medicare and Medicaid are the largest federal entitlement programs. Those programs and the grants made to states under the State Children's Health Insurance Program provide federally funded or subsidized health insurance coverage to millions of low-income, disabled, or elderly people.

Initiatives in the President's budget would expand coverage of low-income people by Medicaid and SCHIP and increase Medicare coverage of disabled workers and certain people ages 55 and older who lose health coverage because of a job loss. The President also proposes to add a prescription drug benefit for all Medicare beneficiaries and to encourage health plans in Medicare to compete on the basis of price by enabling beneficiaries who choose low-cost plans to pay lower premiums. In addition, the budget includes a number of proposals to reduce the rate of growth of Medicaid and Medicare spending.

CBO estimates that, on balance, the President's health initiatives would increase federal spending during the 2001-2010 period—by \$26 billion for Medicaid, \$64 billion for SCHIP, and \$69 billion for Medicare. Additionally, the President's proposals to ex-

pand eligibility for Medicare would decrease tax revenues by \$8 billion and raise Social Security spending by \$1 billion.

The President's Trust Fund Proposals

Within the federal budget, receipts and expenditures for Social Security, Medicare, and a number of other programs are recorded as transactions of federal trust funds. That accounting structure often leads federal decisionmakers to focus on the financial status of the Social Security and Medicare trust funds and to view their solvency as an important policy objective.

In the public debate, "solvency" means keeping the trust funds from exhausting their balances. Federal trust funds, however, are merely accounting mechanisms established to link receipts that the government collects or assigns to specific uses with the expenditures of those resources; the balances of the funds are not assets of the government. And there is no relationship between the balances in a trust fund and its future obligations. In other words, the government will face claims whether or not the fund has sufficient balances, and it will need to acquire actual resources from the economy to meet those obligations when they come due.

The President's budget contains three proposals that the Administration says will postpone the insolvency of trust funds. The two largest proposals affect the Social Security and Medicare trust funds (the third applies to the Black Lung Disability Trust Fund). The President's budget would transfer amounts from the general fund of the Treasury to the two Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and to the Medicare Hospital Insurance (HI) Trust Fund. The transfers to Social Security would begin in 2011 and continue through 2050. In addition, portions of projected on-budget surpluses would be designated as transfers to the HI trust fund. Those transfers would take place in 2001 and 2002 and again in 2006 through 2010.

Those proposals would create transactions between government accounts, but such intragovernmental transfers would not by themselves increase the resources available to the government to meet its future obligations. Today's lawmakers can make a given set of future obligations more affordable for future generations by taking actions to enhance economic growth. In the short term, the most effective action would be to increase national saving and investment by maintaining projected budget surpluses and paying down debt held by the public. Such an approach would strengthen the nation's future ability to pay for all types of goods and services.

Comparison of Economic Forecasts

The Administration's economic assumptions for 2001 through 2010 are similar to those of CBO. Both project that growth over the next 10 years will slow from its recent rapid pace. The Administration expects real (inflation-adjusted) GDP to grow at an average annual rate of 2.7 percent, compared with CBO's forecast of 2.8 percent. Differences arise, however, in estimates of how sharp the slowdown will be and how long it will last. CBO expects a shallower but longer slowdown than the Administration does.

In both forecasts, slower growth brings the unemployment rate up to what is likely to be a more sustainable level. In January, that rate reached 4.0 per-

cent, producing the tightest labor market in 30 years. Both CBO and the Administration project that the unemployment rate will eventually rise to 5.2 percent. In the Administration's forecast, that level is reached by 2003; in CBO's, by 2008.

The Administration generally expects higher inflation rates over the next 10 years than CBO does, with the size of the differences varying according to the index used to measure inflation. Overall, the differences are greater for the GDP price index than for the consumer price index (CPI). The Administration's forecast of CPI inflation is just 0.1 percentage point higher than CBO's in every year except 2001, when the forecasts are the same. However, the Administration expects the GDP price index to grow 0.3 percentage points faster, on average, over the projection period than CBO does.

The Administration assumes that interest rates will remain steady through 2010, averaging 5.2 percent for three-month Treasury bills and 6.1 percent for 10-year Treasury notes. By contrast, CBO assumes that interest rates will follow the same moderate cycle as the growth of real GDP. That assumption reflects CBO's view that the Federal Reserve will raise interest rates further this year to dampen economic growth. As a result, CBO estimates that the rate for three-month bills will average 5.6 percent in 2001 and then fall, averaging 4.8 percent a year from 2004 on. Rates for 10-year Treasury notes are projected to average 6.4 percent in 2001, dropping to 5.7 percent a year in 2004 and beyond.

An Overview of the President's Policy Proposals

As requested by the Senate Committee on Appropriations, the Congressional Budget Office (CBO) has estimated the effects of the Administration's budgetary proposals using CBO's economic and technical estimating assumptions. Under the Administration's budget, CBO estimates, cumulative on-budget surpluses would total \$423 billion, and off-budget surpluses \$2.3 trillion, between 2001 and 2010 (see Table 1-1). (On-budget totals exclude Social Security inflows and outflows as well as the net cash flow to the Postal Service.)

To assess the impact of the President's budget as well as other budget plans, CBO uses its baseline projections as a benchmark for comparison. The baseline assumes that current laws governing federal revenues and mandatory spending programs remain in place. But discretionary spending is controlled by annual appropriation acts, and no consensus exists about how to define current policy for such spending as it applies in future years. Consequently, CBO has prepared three variants of its baseline, each of which assumes a different path for discretionary spending:¹

- o The "inflated" variation assumes that budget authority for discretionary programs grows at the rate of inflation each year after 2000.

- o The "freeze" variation pegs discretionary budget authority to the level enacted for the current year plus amounts already enacted for 2001.
- o The "capped" variation assumes that discretionary spending equals CBO's estimates of the statutory caps on such spending through 2002 and grows at the rate of inflation thereafter.

Over the 2001-2010 period, the President's budgetary proposals lead to cumulative on-budget surpluses that are smaller than such surpluses under each of CBO's baseline variants by amounts ranging from \$470 billion to \$1,525 billion (see Table 1-2). The budget proposes to devote some of those on-budget baseline surpluses to additional spending and some to net tax cuts—the remainder would be used to reduce federal debt. Cumulative off-budget surpluses would be essentially the same under all three versions of the baseline and the President's budget.

Overall, the President's revenue proposals would shrink receipts by \$146 billion over the 10-year period, according to CBO and the Joint Committee on Taxation (JCT). Revenue-dampening proposals include tax cuts to alleviate the marriage penalty and a number of tax credits intended to promote various objectives. Those reductions would be partially offset by revenue increases—for example, from raising the excise tax on tobacco.

Major spending proposals in the President's budget include increasing and extending the discretionary

1. See Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2001-2010* (January 2000), for a detailed description of CBO's baseline. The January estimates have been slightly revised; the updated projections are presented in Appendix A.

spending caps and boosting mandatory spending, primarily for health programs. After 2001, the President's proposal for a revised set of statutory caps charts a path for discretionary spending that is similar to that suggested by CBO's inflated baseline variant. Relative to the freeze and capped variations of the baseline, the Administration's proposals would add more than \$830 billion to discretionary outlays over the 2001-2010 period. On the mandatory side of the ledger, proposals of budgetary significance are concentrated on health initiatives—particularly involving Medicare, Medicaid, and the State Children's Health Insurance Program (SCHIP). The additional on-

budget spending for mandatory programs would total about \$216 billion over 10 years, by CBO's reckoning.

Annual spending by the federal government would rise over the projection period under the President's proposals, but that spending as a share of gross domestic product (GDP) would fall somewhat. Overall, the Administration proposes to spend more than \$1.8 trillion—representing 18.3 percent of GDP—in 2001 (see Table 1-3). Total annual spending is estimated to rise to \$2.5 trillion in 2010 but would account for only 16.9 percent of GDP, the lowest per-

Table 1-1.
Estimates of Surpluses Under the President's Budgetary Proposals and CBO's Baseline Projections
(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
CBO's Estimate of the President's Budgetary Proposals													
On-budget surplus	15	24	14	18	20	14	34	54	62	80	103	90	423
Off-budget surplus	<u>153</u>	<u>166</u>	<u>182</u>	<u>195</u>	<u>208</u>	<u>224</u>	<u>238</u>	<u>253</u>	<u>266</u>	<u>280</u>	<u>292</u>	<u>975</u>	<u>2,304</u>
Total	168	190	196	213	228	238	273	307	328	360	395	1,065	2,727
CBO Baseline^a													
Inflated variation													
On-budget surplus	26	15	29	36	42	48	92	121	138	169	202	171	893
Off-budget surplus	<u>153</u>	<u>166</u>	<u>182</u>	<u>195</u>	<u>209</u>	<u>225</u>	<u>238</u>	<u>253</u>	<u>266</u>	<u>280</u>	<u>293</u>	<u>976</u>	<u>2,307</u>
Total	179	181	212	231	250	273	330	374	404	449	495	1,147	3,199
Freeze variation													
On-budget surplus	26	27	54	77	106	132	197	248	290	349	410	396	1,891
Off-budget surplus	<u>153</u>	<u>166</u>	<u>182</u>	<u>196</u>	<u>209</u>	<u>225</u>	<u>239</u>	<u>254</u>	<u>267</u>	<u>281</u>	<u>294</u>	<u>978</u>	<u>2,313</u>
Total	179	192	237	273	315	358	436	502	558	629	704	1,374	4,204
Capped variation													
On-budget surplus	26	73	115	129	139	154	202	234	261	300	341	610	1,948
Off-budget surplus	<u>153</u>	<u>166</u>	<u>182</u>	<u>195</u>	<u>209</u>	<u>225</u>	<u>238</u>	<u>253</u>	<u>266</u>	<u>280</u>	<u>293</u>	<u>976</u>	<u>2,307</u>
Total	179	239	297	324	348	379	440	487	527	580	634	1,587	4,255

SOURCE: Congressional Budget Office.

a. Reflects changes since January 2000. See Appendix A for details.

centage since 1956. Revenues would also decline as a share of GDP—from 20.2 percent in 2001 to 19.6 percent in 2010.

CBO estimates that annual off-budget and on-budget surpluses would grow under the Administration's budget, the former climbing from \$166 billion

in 2001 to \$292 billion in 2010, the latter from \$24 billion to \$103 billion. CBO's estimates of surpluses under the President's policies are higher than the Administration's estimates, largely because CBO's projections of mandatory spending under current law are, for the most part, lower (see Table 1-4). Social Security accounts for much of the difference; CBO's

Table 1-2.
Impact of the President's Budgetary Proposals on Cumulative On-Budget Surpluses
(In billions of dollars)

	Inflated Appropriations		Frozen Appropriations		Capped Appropriations	
	2001-2005	2001-2010	2001-2005	2001-2010	2001-2005	2001-2010
Cumulative On-Budget Surpluses Under CBO's Baseline	171	893	396	1,891	610	1,948
Impact of the President's Proposals						
Revenues	-5	-146	-5	-146	-5	-146
Outlays						
Discretionary spending						
Defense	7	31	108	424	n.a.	n.a.
Nondefense	5	1	109	437	n.a.	n.a.
Subtotal	12	32	217	861	397	838
Mandatory spending						
Medicare	15	69	15	69	15	69
Medicaid and SCHIP	18	91	18	91	18	91
Other	24	57	24	57	24	57
Subtotal	57	216	57	216	57	216
Net interest ^a	7	75	28	245	62	324
Total Impact on Outlays	76	323	302	1,322	515	1,379
Total Impact of the President's Proposals on Cumulative On-Budget Surpluses	-81	-470	-307	-1,468	-520	-1,525
CBO's Estimate of Cumulative On-Budget Surpluses Under the President's Budgetary Proposals	90	423	90	423	90	423

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; SCHIP = State Children's Health Insurance Program.

a. Includes proceeds from investing excess cash.

Table 1-3.
CBO's Estimate of the President's Budget (By fiscal year)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
In Billions of Dollars												
Revenues	1,827	1,946	2,026	2,097	2,171	2,262	2,352	2,443	2,547	2,659	2,781	2,912
On-budget	1,383	1,466	1,524	1,572	1,624	1,692	1,755	1,820	1,898	1,982	2,075	2,174
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays												
Discretionary spending	575	611	635	656	670	684	701	714	729	752	770	788
Mandatory spending	978	1,021	1,071	1,131	1,204	1,288	1,376	1,441	1,523	1,618	1,721	1,829
Offsetting receipts	-80	-79	-88	-95	-110	-117	-126	-131	-141	-149	-160	-170
Net interest	230	225	218	209	194	179	162	146	129	111	91	72
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-2
Total	1,703	1,778	1,836	1,902	1,958	2,033	2,114	2,170	2,240	2,331	2,422	2,516
On-budget	1,382	1,451	1,500	1,559	1,606	1,672	1,742	1,786	1,843	1,921	1,995	2,071
Off-budget	321	327	336	343	352	362	373	385	397	410	427	446
Surplus	124	168	190	196	213	228	238	273	307	328	360	395
On-budget	1	15	24	14	18	20	14	34	54	62	80	103
Off-budget	124	153	166	182	195	208	224	238	253	266	280	292
Debt Held by the Public	3,633	3,464	3,287	3,100	2,903	2,690	2,465	2,204	1,907	1,587	1,236	941
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	93
As a Percentage of GDP												
Revenues	20.0	20.3	20.2	20.0	19.8	19.8	19.7	19.6	19.6	19.6	19.6	19.6
On-budget	15.2	15.3	15.2	15.0	14.8	14.8	14.7	14.6	14.6	14.6	14.6	14.6
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays												
Discretionary spending	6.3	6.4	6.3	6.3	6.1	6.0	5.9	5.7	5.6	5.5	5.4	5.3
Mandatory spending	10.7	10.7	10.7	10.8	11.0	11.3	11.5	11.6	11.7	11.9	12.1	12.3
Offsetting receipts	-0.9	-0.8	-0.9	-0.9	-1.0	-1.0	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Net interest	2.5	2.3	2.2	2.0	1.8	1.6	1.4	1.2	1.0	0.8	0.6	0.5
Proceeds from investing excess cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	*
Total	18.7	18.6	18.3	18.1	17.9	17.8	17.7	17.4	17.2	17.2	17.1	16.9
On-budget	15.2	15.1	14.9	14.8	14.7	14.6	14.6	14.3	14.2	14.1	14.0	13.9
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.1	3.0	3.0	3.0
Surplus	1.4	1.8	1.9	1.9	1.9	2.0	2.0	2.2	2.4	2.4	2.5	2.7
On-budget	*	0.2	0.2	0.1	0.2	0.2	0.1	0.3	0.4	0.5	0.6	0.7
Off-budget	1.4	1.6	1.6	1.7	1.8	1.8	1.9	1.9	1.9	2.0	2.0	2.0
Debt Held by the Public	39.9	36.1	32.7	29.5	26.5	23.5	20.7	17.7	14.7	11.7	8.7	6.3
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.6
Memorandum:												
Gross Domestic Product (Billions of dollars)	9,116	9,583	10,038	10,496	10,954	11,422	11,924	12,453	13,006	13,583	14,202	14,856

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = between -0.05 percent and 0.05 percent of GDP.

Table 1-4.
Major Differences Between CBO's and the Administration's Estimates of Spending for Selected Mandatory Programs, Fiscal Years 2001-2010 (In billions of dollars)

	CBO Baseline	Administration Current-Services Baseline	Difference
Social Security	5,265	5,393	-128
Medicare	2,858	2,868	-10
Medicaid and State Children's Health Insurance Program	1,894	1,844	50
Civil Service Retirement and Disability Fund	564	607	-43
Unemployment Compensation	319	351	-33
Veterans' Compensation	227	252	-25
Food Stamps	226	252	-26

SOURCE: Congressional Budget Office.

baseline total for Social Security outlays over the 2001-2010 period is \$128 billion less than the Administration's.

Spending Proposals

The President is requesting nearly \$625 billion in total discretionary budget authority for fiscal year 2001. Resulting outlays for that year, CBO estimates, would exceed the current statutory cap by \$56 billion, although they would equal the outlays projected in CBO's inflated baseline variation. In 2001, mandatory spending (including offsetting receipts but excluding interest costs) under the President's proposals would be only about \$1 billion more than in CBO's baseline. Over time, however, that budgetary impact would grow, boosting mandatory spending by an estimated \$37 billion in 2010. Total outlays would rise at an average annual rate of about 3.5 percent over the 2001-2010 period—discretionary spending at about a 2.4 percent rate and mandatory outlays (again, with offsetting receipts but without interest costs) at a rate of almost 6 percent.

Discretionary Spending

A key component of the Administration's budget is its proposal to revise the statutory limits on discretionary

spending that are currently in effect through 2002. (The Administration also proposes to extend pay-as-you-go requirements for mandatory spending and revenues.) Except for 2001, caps on budget authority and outlays would be set at or slightly below levels that would allow future discretionary spending to keep pace with inflation through 2010. For 2001, the Administration proposes a new cap on budget authority that would be \$7 billion above a level consistent with inflation and \$73 billion above the current cap. The Administration's proposed new caps on budget authority start at \$614 billion in 2001 and grow to \$758 billion in 2010 (see Table 1-5).² Its proposed caps on outlays rise from \$626 billion in 2001 to \$780 billion in 2010—an average annual rate of growth of about 2.5 percent.

In addition to extending the overall caps through 2010, the Administration would create a new cap for its Lands Legacy initiative. That program would acquire historic sites, open spaces, and threatened coastal areas; funding would average around \$1.5 billion annually over the 10-year period. Existing caps on highway and mass transit spending would be allowed to expire in 2003, as provided in current law.

2. Several of the tables in this chapter provide additional detail by breaking down discretionary spending into its two general categories of defense and nondefense spending. This overview, however, does not discuss defense spending separately. For a discussion of the differences between CBO's and the Administration's estimates of defense outlays, see Appendix B.

Table 1-5.
Estimates of Discretionary Spending Under the President's Budgetary Proposals
and CBO's Baseline Projections (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
CBO's Estimate of Total Discretionary Spending in the President's Budget											
Budget Authority											
Defense	292	306	310	316	324	332	341	350	359	368	378
Nondefense	<u>281</u>	<u>318</u>	<u>320</u>	<u>323</u>	<u>330</u>	<u>337</u>	<u>346</u>	<u>355</u>	<u>364</u>	<u>373</u>	<u>383</u>
Total	573	625	629	639	654	670	687	705	723	741	761
Outlays											
Defense	289	295	303	310	318	329	333	339	352	362	372
Nondefense	<u>322</u>	<u>340</u>	<u>353</u>	<u>360</u>	<u>366</u>	<u>373</u>	<u>381</u>	<u>390</u>	<u>399</u>	<u>408</u>	<u>416</u>
Total	611	635	656	670	684	701	714	729	752	770	788
CBO's Baseline Projections Assuming That Discretionary Spending Grows at the Rate of Inflation After 2000											
Budget Authority											
Defense	290	298	305	313	320	328	336	344	352	361	369
Nondefense	<u>280</u>	<u>309</u>	<u>317</u>	<u>325</u>	<u>333</u>	<u>341</u>	<u>350</u>	<u>358</u>	<u>367</u>	<u>376</u>	<u>385</u>
Total	570	607	622	638	654	669	685	702	719	737	754
Outlays											
Defense	284	296	301	308	316	326	331	336	347	356	364
Nondefense	<u>320</u>	<u>340</u>	<u>349</u>	<u>359</u>	<u>366</u>	<u>374</u>	<u>382</u>	<u>391</u>	<u>399</u>	<u>409</u>	<u>418</u>
Total	603	635	650	667	682	700	714	727	747	764	782
CBO's Baseline Projections Assuming That Discretionary Spending Is Frozen at the Level Enacted for 2000											
Budget Authority											
Defense	290	290	290	290	290	290	290	290	290	290	290
Nondefense	<u>280</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>	<u>296</u>
Total	570	586	586	586	586	586	586	586	586	586	586
Outlays											
Defense	284	290	288	289	289	291	289	287	289	289	289
Nondefense	<u>320</u>	<u>335</u>	<u>338</u>	<u>340</u>	<u>335</u>	<u>334</u>	<u>334</u>	<u>333</u>	<u>332</u>	<u>332</u>	<u>332</u>
Total	603	625	627	628	623	625	622	620	621	621	621
Caps on Discretionary Spending Proposed in the President's Budget^a											
Budget Authority	589	614	625	636	650	665	683	701	720	739	758
Outlays	608	626	649	663	679	699	709	723	743	762	780
CBO's Estimate of the Current Caps on Discretionary Spending^a											
Budget Authority	572	541	550	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Outlays	600	579	571	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Neither the President's proposed caps nor the current statutory limits divide discretionary spending into defense and nondefense costs.

Table 1-6.
Comparison of Discretionary Spending Enacted for 2000 with the President's Request for 2001
(By fiscal year, in billions of dollars)

	Defense Discretionary		Nondefense Discretionary		Total Discretionary	
	2000 Enacted	2001 Request	2000 Enacted	2001 Request	2000 Enacted	2001 Request
CBO's Estimate of Discretionary Spending						
Budget authority	290	306	280	318	570	625
Outlays	284	295	319	340	603	635
Adjustments						
Advance appropriations						
Budget authority	0	0	14	0	14	0
Outlays	0	0	0	0	0	0
Normalizing pay dates and removing obligation delays						
Budget authority	0	0	0	0	0	0
Outlays	2	-2	3	-3	6	-6
Incorporating obligation limitations for transportation programs ^a						
Obligation limitations	0	0	34	37	34	37
Outlays	0	0	0	0	0	0
Other ^b						
Budget authority	0	0	2	3	2	3
Outlays	0	4	-1	4	-1	8
CBO's Adjusted Estimate of Discretionary Spending						
Budget authority or obligation limitations ^a	290	306	331	358	621	664
Outlays	286	296	322	341	608	637
Memorandum:						
CBO Baseline						
Inflated variation						
Budget authority or obligation limitations ^a	290	298	314	344	604	642
Outlays	284	296	320	340	603	635
Freeze variation						
Budget authority or obligation limitations ^a	290	290	314	331	604	621
Outlays	284	290	320	335	603	625

SOURCE: Congressional Budget Office.

- a. A limitation on obligations is a ceiling on the amount of funds that can be obligated within a specified period, usually a fiscal year. It does not affect the amount of funds authorized, but it controls the rate at which those funds can be spent.
- b. Adjustments for proposed or enacted mandatory offsets, user fees, reclassifications, effects of supplemental appropriations for fiscal year 2000, rescissions of prior-year budget authority, and payment shifts between fiscal years.

Table 1-7.
Comparison of Discretionary Budget Authority Enacted for 2000 with the President's Request for 2001,
by Budget Function (By fiscal year, in billions of dollars)

Budget Function	2000 Enacted ^a	2001 Request ^a	Increase or Decrease (-)	
			Amount	Percentage
Defense Discretionary (National defense)	289.9	306.3	16.4	5.7
Nondefense Discretionary				
International affairs	22.3	22.8	0.5	2.3
General science, space, and technology	19.2	20.8	1.6	8.2
Energy	2.6	3.1	0.5	19.6
Natural resources and environment	24.0	25.1	1.1	4.5
Agriculture	4.5	4.8	0.3	7.1
Commerce and housing credit	6.9	3.7	-3.2	-46.7
Transportation	48.9	53.1	4.2	8.6
Community and regional development	11.4	12.5	1.1	9.8
Education, training, employment, and social services	54.6	61.5	6.9	12.7
Health	33.7	35.5	1.8	5.3
Medicare (Administrative costs)	3.1	3.3	0.3	8.5
Income security	36.4	41.3	4.9	13.5
Social Security (Administrative costs)	3.2	3.5	0.3	8.7
Veterans benefits and services	20.9	22.1	1.2	5.6
Administration of justice	26.6	30.0	3.4	12.7
General government	12.6	14.7	2.1	16.5
Subtotal	330.9	357.8	26.9	8.1
Total Discretionary	620.8	664.1	43.3	7.0

SOURCE: Congressional Budget Office.

- a. Includes appropriated obligation limitations (ceilings on the amount of funds that can be obligated within a specified period, usually a fiscal year) for transportation programs as well as adjustments to remove the effects of advance appropriations and other factors shown in Table 1-6 that distort year-to-year comparisons.

Because CBO's estimates of discretionary spending under the President's proposals are slightly higher than the Administration's, CBO expects that such spending would slightly exceed the proposed caps in every year. In 2001, CBO estimates, the proposed level of budget authority would exceed the Administration's cap by \$10 billion and the amount in the inflated variant of the baseline by \$17 billion; outlays subject to appropriation action would exceed the proposed cap by \$8 billion. Much of the difference in both budget authority and outlays is attributable to proposed spending cuts, revenue increases, or fees that the Administration employs to offset discretionary spending but that CBO believes cannot be used for that purpose

under the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.³

After adjusting for various shifts in the timing of payments and other budgetary anomalies, CBO estimates that the President's budget would increase spending authority for discretionary programs in 2001 by about 7 percent above the 2000 level (see Table

3. In 2001, those offsets include earnings transferred from the Federal Reserve (-\$3.8 billion); various proposals related to programs in the Department of Education (-\$2.3 billion); harbor services fees (-\$0.4 billion); user fees collected by the Federal Aviation Administration (-\$0.7 billion); a reduction to 1998 levels of supplemental grants in the Temporary Assistance for Needy Families program (-\$0.1 billion); and state bank examination fees (-\$0.2 billion).

1-6 on page 7). The largest upswings would occur in the budget functions for energy, general government, income security, education, and administration of justice (see Table 1-7). Only one function is slated for a cut under the President's proposals: budget authority for the commerce and housing credit function drops by nearly 47 percent from 2000 to 2001. That result is skewed, however, by the funding for conducting the census in 2000. Excluding the census, that function would also show an increase.

Mandatory Spending

In total, CBO estimates that the President's proposals would add \$218 billion in mandatory spending (both on- and off-budget) over the 2001-2010 period. Three health programs—Medicare, Medicaid, and SCHIP—account for nearly three-quarters of the proposed new outlays. (For a more detailed discussion of health care spending in the President's budget, see Chapter 2.)

Over the 10-year period, the President's Medicare policies would increase net outlays by \$69 billion, CBO estimates (see Table 1-8). The most costly pro-

posal would create a prescription drug benefit, beginning in 2003, for all Medicare beneficiaries. That plan would phase in benefits: in 2003, it would pay half of beneficiaries' drug costs up to \$2,000, increasing to a ceiling of \$5,000 by 2009, when the plan would be fully phased in. (There would be no deductible.) CBO projects that the proposal would cost Medicare \$260 billion between 2003 and 2010, but those costs would be offset by nearly \$130 billion in increased premiums. With the drug benefit in place, federal spending for the Medicaid program would also increase—by \$19 billion—because Medicaid subsidizes the premiums and shares the costs of low-income Medicare beneficiaries.

In addition to the drug benefit, the Administration proposes to allow certain people ages 55 to 64 to buy in to the Medicare program. The premiums paid by such enrollees would cover the cost of their insurance, by CBO's estimate. However, a tax credit to those enrollees for 25 percent of their premiums is projected to cost \$8 billion from 2002 through 2010.

Various other proposals for the Medicare program would reduce spending by approximately \$62 billion over the 2001-2010 period. The proposals in-

Table 1-8.
CBO's Estimate of the Effect of the President's Budgetary Proposals on Mandatory Programs
(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Medicare	0	-1	2	*	6	7	8	9	11	12	14	15	69
Medicaid	0	*	*	1	2	4	-3	1	6	7	8	7	26
State Children's Health Insurance Program	0	*	1	2	3	5	18	13	7	8	7	11	64
Supplemental Security Income	2	-2	*	*	*	1	1	1	1	2	2	-1	6
Earned Income Tax Credit	*	2	2	2	2	2	2	2	2	2	2	11	22
Child and Dependent Care Tax Credit	0	0	0	1	2	2	3	3	3	3	4	4	20
Other	<u>1</u>	<u>2</u>	<u>5</u>	<u>2</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>-1</u>	<u>11</u>	<u>10</u>
Total Effect	4	1	11	8	16	21	28	30	31	35	37	58	218

SOURCE: Congressional Budget Office.

NOTES: The estimates in the table, which cover both on- and off-budget spending proposals, include offsetting receipts.

* = between -\$500 million and \$500 million.

clude giving the fee-for-service sector of the program new purchasing tools to leverage volume discounts from health care providers, encouraging competition on the basis of price among Medicare+Choice plans, adding a new cost-sharing requirement for clinical laboratory services, and reducing the projected annual increases in payment rates for services furnished by hospitals and other providers.

A further proposal would broaden health coverage, allowing states to cover the uninsured parents of children eligible for Medicaid and SCHIP. Indeed, for certain parents, the proposal would require states to provide coverage. The new FamilyCare program, which would replace SCHIP, would boost federal matching payments to states that expanded their coverage of parents. CBO estimates that the FamilyCare initiative would increase spending by \$64 billion between 2001 and 2010; however, at the same time, federal Medicaid payments would decrease by \$7 billion as some recipients were shifted into the Family-Care program.

The President's budget contains several other proposals related to Medicaid. The most costly of them would restore full eligibility for certain legal immigrants. The Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (also known as welfare reform) restricted legal aliens' eligibility for welfare benefits. The President would restore it, at a total cost of \$10 billion between 2001 and 2010. The budget also proposes to extend and simplify the transitional Medicaid program, which provides up to one year of coverage for recipients who secure jobs; that change would raise spending by nearly \$5 billion over 10 years. (Without the extension, the program will end in October 2001.) The net effect of other proposed Medicaid provisions would be a drop in spending of less than \$1 billion from 2001 through 2010.

The income security function of the budget is another focus of major spending proposals by the Administration. Expanding the earned income tax credit would boost outlays by about \$2 billion per year from 2001 onward, and modifying the child and dependent care tax credit would raise annual spending by as much as \$4 billion. In total, those changes would add \$42 billion to outlays over 10 years. The Administration also proposes to restore Supplemental Security Income payments to legal immigrants who meet three

eligibility criteria: they entered the country after August 22, 1996; they have lived in the United States for more than five years; and they became disabled after entry. Restoring those benefits, which were eliminated by welfare reform, would cost \$6 billion from 2001 through 2010, CBO estimates.

Revenue Proposals

The President's budget proposes nearly 150 changes in tax laws that on balance would reduce revenues by almost \$150 billion from 2001 through 2010 (see Table 1-9). Over that period, proposals to cut taxes would subtract about \$350 billion from projected revenues. Five proposals account for nearly 60 percent of that amount: establishing Retirement Savings Accounts for individuals; providing relief from the marriage penalty and increasing the standard deduction; allowing people to claim certain exemptions and deductions under the alternative minimum tax; increasing the lifetime learning credit for taxpayers with post-secondary education expenses; and establishing a tax credit for taxpayers with expenses for long-term health care.

The budget also contains a number of proposals that would raise revenues by just over \$200 billion during the period. One proposal, calling for higher tobacco levies, makes up about 45 percent of that increase.

Overall, calculations by Congressional estimators of the impact of the President's revenue proposals are similar to those of the Administration. (For proposals that amend the Internal Revenue Code, CBO is required by law to use estimates provided by the Joint Committee on Taxation.)⁴ Thus, the Administration projects net losses in revenues from 2001 through 2010 that total only \$4 billion more than Congressional projections. But for certain proposals, the differences are greater. CBO and the JCT project more revenues than the Administration does from proposed in-

4. For a full set of such estimates, see Joint Committee on Taxation, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2001 Budget Proposal*, JCX-20-00 (March 6, 2000).

Table 1-9.
CBO's Estimate of the President's Revenue Proposals (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Provisions That Reduce Revenues													
Establish Retirement Savings Accounts	0	0	-1	-2	-2	-6	-10	-10	-10	-10	-10	-11	-61
Provide Marriage Penalty Relief and Increase the Standard Deduction	0	*	-1	-1	-2	-6	-7	-7	-7	-7	-7	-10	-47
Reduce Individuals' Alternative Minimum Tax	*	*	-1	-1	-1	-2	-2	-3	-5	-9	-13	-5	-38
Increase the Lifetime Learning Credit	0	*	-2	-3	-3	-3	-4	-4	-4	-4	-5	-11	-32
Establish a Credit for Long-Term Care ^a	0	*	-1	-2	-3	-3	-4	-4	-4	-4	-4	-10	-29
Expand Deductions for Charitable Contributions	0	*	-1	-1	-1	-1	-2	-3	-3	-3	-3	-6	-21
Establish a Credit for Certain Retirement Contributions of Small Businesses	0	0	*	-1	-2	-3	-3	-2	-2	-2	-2	-6	-17
Establish a Credit for Postemployment Health Insurance	0	0	*	-1	-1	-2	-2	-2	-2	-2	-2	-5	-13
Increase the Child and Dependent Care Credit ^a	0	*	*	*	-1	-1	-1	-1	-1	-1	-1	-3	-10
Other	*	-3	-6	-7	-8	-9	-10	-11	-10	-10	-9	-33	-84
Total	*	-5	-14	-20	-25	-35	-44	-47	-50	-54	-57	-100	-351
Provisions That Increase Revenues													
Increase the Excise Tax on Tobacco Products and Levy a Youth Smoking Assessment	0	4	4	4	13	13	11	11	11	11	11	37	92
Replace Sales-Source Rules	0	1	2	2	2	2	2	2	2	2	3	8	19
Reinstate Superfund Excise and Corporate Income Taxes	*	2	1	1	1	1	1	1	2	2	2	7	15
Modify Airport and Airway Trust Fund Taxes	0	1	1	2	2	2	1	1	*	0	0	7	9
Modify the Rules for Capitalizing Policy Acquisition Costs of Life Insurance Companies	0	*	1	1	1	1	1	1	1	1	1	5	9
Eliminate Nonbusiness Valuation Discounts	0	*	1	1	1	1	1	1	1	1	1	3	7
Other	*	7	5	5	5	7	4	5	5	6	6	28	54
Total	1	15	15	15	25	26	22	22	22	22	22	95	205
All Provisions													
Net Effect	1	10	1	-6	-1	-9	-22	-25	-28	-32	-35	-5	-146

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTE: * = between -\$500 million and \$500 million.

a. Does not include effects on outlays.

creases in taxes on tobacco, and the JCT anticipates more revenues from changes to the sales-source rules for multinational corporations. Other proposals, such as providing general remedies to curb tax shelters, will generate less revenue, according to the JCT. Indeed, its estimates show greater losses than those projected by the Administration for most of the largest revenue-trimming proposals.

Provisions That Reduce Revenues

The revenue-reducing proposals in the President's budget have multiple purposes. A number of them would establish or expand tax credits or make other changes to encourage individuals to undertake certain activities, such as saving for retirement, providing education and health care, investing in communities, and making charitable contributions. Other proposals have fair tax treatment as their goal. Those provisions would offer relief to taxpayers in particular circumstances, such as those who will incur marriage penalties or face the alternative minimum tax.

Retirement Savings Accounts. The budget proposes to allow certain individuals to contribute to a new savings vehicle called a Retirement Savings Account (RSA). Taxpayers between the ages of 25 and 60 with annual earnings of at least \$5,000 would establish the accounts with participating financial institutions, similarly to traditional individual retirement accounts (IRAs), or with their employers, through 401(k)-type plans. The proposal calls for the financial institution or employer to match the taxpayer's contributions by a proportion that would vary with the taxpayer's income and then to receive a general business tax credit that was nonrefundable and equal to the matching contribution.⁵ Participating financial institutions would also receive a credit of \$10 per account to cover expected administrative costs. The proposal would reduce revenues by about \$61 billion from 2001 through 2010.

The program would offer two types of matches: a basic one equaling up to 100 percent of the first

\$1,000 that the taxpayer contributed and a supplemental one of up to \$100 of the first \$100 contribution. (Thus, a taxpayer eligible for a full match who contributed \$500 would receive \$600 in matching contributions.) Matching rates of 100 percent would apply to married taxpayers filing jointly who had income below \$25,000 and single taxpayers with income below \$12,500. Taxpayers with higher incomes would qualify for lower rates, and the matches would be completely phased out for married taxpayers with income exceeding \$80,000 and single taxpayers with income of half that amount. Between 2002 and 2004, both the income thresholds and the maximum contribution eligible for a match would be lower.

As with deductible IRAs and 401(k) plans, people would not include contributions to RSAs in their taxable income, and any earnings within the account would not be taxed. Taxpayers would, however, have to pay tax on their withdrawals. Contributions to RSAs established with financial institutions, including any matching, would count toward the \$2,000 annual limit on IRA contributions.

Marriage Penalty Relief and the Standard Deduction. By 2005, the President's budget proposes to gradually raise the standard deduction for two-earner couples until it is twice that for single taxpayers. The increase would be limited to the earned income of the lower earner and would reduce so-called marriage penalties under current law. (The marriage penalty applies to certain married couples who together pay more income tax than they would if they were single.) Yet the proposal would also increase so-called marriage bonuses for other couples—those who pay less combined tax under current law than if both partners were single because one spouse generates much of the couple's earnings. CBO expects the standard deduction (which is indexed for inflation) to reach \$8,300 for married couples and \$5,000 for single taxpayers by 2005 under current law. The proposal would increase the deduction by \$1,700 for two-earner couples in that year.

In addition to those boosts, the Administration is proposing to increase the standard deduction for all taxpayers starting in 2005, including married couples who file jointly but have only one spouse with earnings. The uptick in the standard deduction would come to \$500 for married taxpayers filing jointly, \$250 for

5. A refundable credit generates a payment to the taxpayer from the government if the credit exceeds what the taxpayer owes—that is, the tax liability. A nonrefundable credit, in contrast, provides no such payment.

single taxpayers, and \$350 for head-of-household filers. Relief from the marriage penalty and other changes to the standard deduction would reduce revenues by an estimated \$47 billion through 2010.

Alternative Minimum Tax. The alternative minimum tax (AMT), enacted in 1978, has its own exemptions and deductions, rate schedule, and definitions of income. Today, the AMT generally affects higher-income taxpayers. Over time, however, its reach will expand sharply because key components, such as tax brackets, are not indexed for inflation (unlike those of the regular tax).

In contrast to current law, the President's budget would phase in exemptions for dependents for taxpayers subject to the AMT. In 2000, taxpayers would not be allowed to claim exemptions for their first two dependents, but they could claim them for any dependents beyond that number (for a third, a fourth, and so on). By 2010, they could claim exemptions for all dependents. In addition, the President proposes to allow taxpayers in 2000 and 2001 who claim the standard deduction for their regular taxes to claim it for the AMT as well. Those changes would mean a loss in revenues of \$38 billion over the 2001-2010 period. Near the end of the decade, that projected loss climbs sharply, because the proposal phases in the number of exemptions that can be claimed and because, under current law, an increasing share of taxpayers will become subject to the AMT over time.

Lifetime Learning Credit. The President proposes to increase the rate of the lifetime learning credit established by the Taxpayer Relief Act of 1997 to 28 percent of qualifying expenses. Under current law, taxpayers can claim a credit of 20 percent of qualified tuition and related expenses for postsecondary education up to \$5,000 (\$10,000 starting in 2003). The proposal would also expand eligibility for the credit by raising the income thresholds at which the credit phases out. In total, the provision would cause revenues to drop by about \$32 billion from 2001 through 2010.

Long-Term Care. A new tax credit would be established for taxpayers who either receive or provide long-term care. In 2001, the credit could be as much

as \$1,000; it would rise gradually to \$3,000 by 2005 and remain at that level. In recognition of the burden assumed by people who provide care themselves instead of paying for it, the credit would not be limited to out-of-pocket expenses, although it would phase out for married taxpayers with adjusted gross income (AGI) above \$110,000 and for single taxpayers with AGI above \$75,000. Over 10 years, the proposal would pare revenues by about \$29 billion. In addition, because the credit would be refundable under certain circumstances, outlays would increase by about \$3 billion through 2010.

Charitable Giving by Nonitemizing Taxpayers. The Administration proposes to allow taxpayers who do not itemize their deductions on their individual income tax return (and instead claim the standard deduction) to deduct 50 percent of their charitable contributions that exceed a specified threshold. The threshold for married taxpayers filing jointly would be \$2,000 a year through 2005 and \$1,000 thereafter; for single taxpayers, the threshold would be half those amounts. Revenues would fall by about \$21 billion through 2010 under the proposal.

Pension Contributions of Small Businesses. Under the Administration's budget, small employers (generally, those with 100 or fewer employees) could claim a credit against income tax equaling 50 percent of certain contributions they made to defined contribution or integrated defined benefit pension plans. The credit would be available from 2002 through 2011, and a firm could claim it for up to three years. However, the credit would not cover contributions for employees who were highly compensated. Under the provision, revenues would drop by about \$17 billion through 2010.

Health Insurance Coverage Following Employment. In certain cases, the Consolidated Omnibus Budget Reconciliation Act of 1985, or COBRA, allows continuation of employment-based health insurance for a defined period after employment ends. Under the President's budget, the tax code would offer a credit of 25 percent of the amount that an individual paid to maintain that coverage. The proposal would reduce revenues by \$13 billion through 2010, according to the JCT's estimate.

Child and Dependent Care. The Administration proposes a number of changes to the existing credit for workers who incur expenses for the care of their children age 13 or younger or their disabled dependents. Increasing the maximum rate of the credit from 30 percent to 50 percent and making it refundable are two of the proposals. In addition, the President wants to provide a new nonrefundable credit for taxpayers with children under the age of 1, whether or not they incur costs for those children's care. Taxpayers could receive a \$500 credit for each of up to two children. The changes would shrink revenues by about \$10 billion from 2001 through 2010 and increase outlays (through the refundable component) by about \$20 billion.

Other. The Administration's budget includes a number of other revenue-reducing provisions that would cut receipts by \$84 billion from 2001 through 2010. Those provisions, which make up roughly one-quarter of the total revenue cost of the President's proposals, include establishing a tax credit for premiums under the proposed Medicare buy-in program (\$8 billion); raising the limits on the low-income housing credit (\$6 billion); extending and modifying the credit for business activity in Puerto Rico (\$6 billion); establishing or extending various credits for purchases intended to improve the environment (\$6 billion); making numerous other changes to tax laws covering pensions and other retirement savings (\$6 billion); expanding empowerment zones (\$5 billion); and establishing a credit for certain investments in selected community development entities (\$4 billion). The budget also proposes—for a loss in revenues of \$4 billion over 10 years—to increase and simplify the earned income tax credit. However, the outlay side of the budget would record most of the cost of that proposal (\$22 billion) because the credit is refundable.

Proposals That Increase Revenues

A number of the tax changes that the President proposes would raise revenues. The proposals include excise taxes on tobacco, air travel, and petroleum; a new levy on tobacco companies; different accounting rules for domestic and multinational corporations; and increases in estate and gift taxes.

Tobacco. The President's budget would increase existing excise taxes on tobacco and, if youth smoking does not fall below specified levels, levy a new charge on tobacco companies. Starting in 2001, the excise tax would go up by 25 cents per pack, supplanting a 5-cent-per-pack increase scheduled for January 1, 2002. Moreover, if youth smoking has not been cut in half by 2004, the President proposes to begin levying an annual charge on tobacco companies of \$3,000 for every smoker under the age of 18.

The JCT and CBO project revenues of approximately \$92 billion through 2010 from those proposals, with about two-thirds of that amount generated by the youth smoking levy. The Administration projects that the proposals would raise about \$26 billion less, or \$66 billion. Most of the variance between the estimates stems from differing assumptions about when smoking levels might be low enough to turn off the levy. CBO projects that it will continue through 2010. The Administration expects youth smoking to have fallen sufficiently by 2008 to end the levy.

Export Sales Source. Under current law, U.S. multinational corporations enjoy a tax benefit that allows them to report some of their income from exports as foreign earnings, even if those exports are manufactured in the United States and the income from them is not subject to foreign taxes. That treatment allows certain multinational firms to increase their use of foreign tax credits and thus lower their federal tax payments. Repealing the provision, as the Administration proposes, would raise \$19 billion over 10 years, according to the JCT, which projects almost three times as much in revenues from the repeal as does the Administration. The variation stems mainly from different assumptions about foreign effective tax rates, the amount of excess foreign credits available to corporations, and corporations' sophisticated use of certain foreign tax arrangements, such as carryforward and carryback provisions.

Superfund. The President proposes to reinstate the taxes dedicated to the Hazardous Substance Superfund that expired in 1995. Through 2010, the excise tax on producers and importers of petroleum and certain chemicals would bring in \$8 billion to federal coffers, and the additional income tax that would be levied on all corporations would raise another \$7 billion.

Airport and Airway Trust Fund Taxes. The Administration proposes to convert the current excise taxes on air travel into an unspecified system of user fees related to the federal cost of providing air traffic services. Because the budget did not specify the amount of the fees, the JCT used the Administration's estimate of increased revenues—\$9 billion through 2010.

Life Insurance Costs. The President's budget would require life insurers to delay taking tax deductions for some of the costs (such as commissions and administrative expenses) that they incur in acquiring policies. Before 1990, life insurers could immediately deduct their expenses for policy acquisition, even though those activities generated income over multiple years. Legislation enacted in 1990, however, shrank the tax deferral by requiring life insurers to deduct a specified share of those costs, depending on the type of policy, over either five or 10 years. The new proposal would increase that share, boosting revenues by an estimated \$9 billion through 2010.

Nonbusiness Valuation Discounts and Estate and Gift Taxes. The valuation discount recognizes that a minority share of an active business is worth less than the proportionate share of its value to a sole owner. However, beneficiaries of estates in which control of a business is not an issue have been claiming the discount to reduce the value of other assets when they are divided at the time a gift is made or a death occurs. This proposal would limit the use of valuation discounts to active businesses and thus add \$7 billion to revenues over the 2001-2010 period. Other proposals in the budget would raise estate and gift taxes by nearly \$3 billion through 2010.

Other. Numerous other provisions that would increase taxes (by \$54 billion through 2010) are also part of the President's budget for 2001. They include providing general remedies, such as increased disclosure and penalties, to curb the growth of tax shelters (\$5 billion); disallowing some interest deductions by firms that invest in corporate-owned life insurance policies (\$5 billion); eliminating deductions by certain mutual funds for dividends paid to redeem stock from shareholders if the redemption does not represent a net contraction of the fund (\$4 billion); prohibiting the Federal Reserve from replenishing its surplus account

to offset the transfer to the Treasury for fiscal year 2000 that was legislated in November 1999 by Public Law 106-113, An act making consolidated appropriations for the fiscal year ending September 30, 2000, and for other purposes, referred to in this report as the Consolidated Appropriations Act (\$4 billion); and changing the period over which businesses amortize certain start-up and organizational expenditures (\$3 billion).

Budgetary Conventions

In addition to its policy proposals for fiscal year 2001, the Administration's budget contains a supplemental request for 2000. Among other things, the request calls for reversing a number of shifts in the timing of payments and delays in obligating funds that were enacted in previous legislation. The budget categorizes such reversals as "restoring budgetary conventions." Yet despite that characterization and all it seems to imply, the Administration has made other proposals that are inconsistent with budgetary tradition.

In a restoration of convention, the supplemental request proposes to reinstate certain federal pay dates that were to be shifted forward into the next fiscal year under the Consolidated Appropriations Act. In that legislation, the Congress and the President delayed a pay date to October 1 (the beginning of the government's fiscal year) that normally would have occurred on September 29 or September 30. Also during last year's appropriation process, part of the funding for several programs was withheld until late in the fiscal year. The effect of those timing shifts and obligation delays was to transfer nearly \$8 billion in spending from 2000 to 2001. Now, the Administration is proposing to shift \$7 billion of it back to 2000. (The Administration does not propose to reverse the delays in obligating funds for foreign operations programs, which account for the spending that does not shift back to 2000.)

A further proposal of that sort would restore the traditional payment dates for veterans' compensation and Supplemental Security Income at the end of 2000. Normally, benefits for those two programs are paid on the first day of each month, but when October 1 falls

on a weekend, payments shift back to the previous Friday. The Balanced Budget Act of 1997 undid the regularly scheduled shift in 2000; the Administration now proposes to pay those benefits (approximately \$4 billion) on September 29, 2000.

In an attempt to comply with the cap on budget authority in 2000, the Congress and the President enacted about \$14 billion in advance appropriations for 2001 that would ordinarily have been made available in 2000. Although the Administration includes legislative language in the budget to continue that practice in 2002, it has also indicated that it would consider legislation to restore the customary funding patterns. But the Administration's budget figures do not reflect such a shift, nor do CBO's.

Several proposals that are not consistent with normal budgetary conventions are also part of the President's budget. Those proposals include a shift in the timing of Medicare payments to health maintenance organizations; reclassification of certain discretionary programs as mandatory; a requirement that the Federal Reserve transfer additional earnings to the Treasury; and an administrative proposal concerning the payment of interest on net receipts from the Federal Housing Administration's mutual mortgage insurance program.

Debt Reduction

Surpluses (from off-budget or on-budget sources) that are not used to increase spending or reduce taxes are available to pay down debt. For example, setting aside the off-budget Social Security surpluses, as the President proposes, would enable the Department of the Treasury to significantly reduce debt held by the public. And under the President's budget, remaining on-budget surpluses would also be used to pare down that debt.

Other uses, however, are also proposed for portions of the on-budget surplus. The budget calls for transferring certain amounts, for example, to Medicare's Hospital Insurance Trust Fund. Yet those intragovernmental transactions would have no effect on the budget's bottom line. And although the trans-

fers would make the trust fund appear to be more financially sound, they would not actually provide any new resources to help the federal government meet its obligations to Medicare recipients over the long term. Similar transfers are proposed for Social Security beginning in 2011 and for the Black Lung Disability Trust Fund in 2001. Like the proposed Medicare transactions, those transfers would have no effect on the federal government's ability to meet the programs' obligations. (See Chapter 3 for a more detailed discussion of trust fund transactions.)

In one instance in the budget, a program is proposed but the money that would fund it is actually counted toward debt reduction. The budget mentions a "reserve for catastrophic prescription drug coverage." If the legislation was enacted, the reserve would consume \$35 billion of the surplus allocated to reducing debt between 2006 and 2010. But no specific information is provided about how the program would work, and because the budget applies the money needed to fund it to debt reduction, CBO's estimates do not include spending for the reserve.

If the surpluses that CBO projects under the President's budget—as well as under all three versions of its baseline—materialize, all debt held by the public that is available for redemption could be retired by 2010. "Available" is the key word: some portion of the outstanding debt will remain in public hands because many 30-year Treasury bonds are not slated to mature until after 2010. The Treasury conducted two trial buybacks of debt, each totaling \$1 billion, on March 9 and March 16; nevertheless, over time, the number of holders of 30-year bonds who would choose to sell their securities at prices that the government would be willing to pay is uncertain. Furthermore, unless the government discontinues the Treasury's programs for savings bonds and for state and local government securities, those forms of debt will continue to be issued and will remain outstanding at the end of the 2001-2010 period.

Under the President's proposals, after all accumulated surpluses had been used to retire available debt held by the public, \$93 billion in excess cash would remain in 2010. The Treasury would invest it, CBO assumes, at the average interest rate projected for Treasury bills and notes and would receive dividend or interest earnings from those investments.

Grants to State and Local Governments

In the current fiscal year, CBO estimates that the federal government will transfer about \$280 billion to state, local, and tribal governments through various grant programs. Although most budget functions include at least some spending for grants, the functions for health; income security; education, training, employment, and social services; and transportation have high concentrations of grant outlays. In the first three categories, federal grants primarily support payments to or services for individuals. Outlays for grants in those functions total about \$230 billion, or more than 80 percent of total grant spending for this year. The Medicaid program alone accounts for about 40 percent of grant spending—an estimated \$115 billion in 2000. Transportation grants, which make up 11 percent, or \$32 billion, of total grant expenditures, primarily fund the development of transportation infrastructure, particularly the construction of highways, mass transit systems, and airports.

In the four functions with the most spending for grants, CBO identified more than 350 different programs. The majority of them receive categorical grants, which provide aid for specific, narrowly defined purposes. A much smaller number of block grants provide funds for a broad range of activities. Those grants have only minimal restrictions on their use.

More than half of all grant programs focus on education, training, employment, and social services. In the current fiscal year, CBO estimates, a little over \$40 billion will be disbursed for those purposes to state, local, and tribal governments through more than 200 different programs. About 70 of them supply funds for elementary, secondary, and vocational education, and another 65 provide money for social services. The health category accounts for the next largest number of programs, and among them, Medicaid claims the biggest share of outlays (\$115 billion). Aside from Medicaid, CBO estimates that slightly less than \$8 billion in grants will be disbursed this year through approximately 70 other programs for health, most of which fund health care services.

The President's budget would boost spending for grants in 2001—by a significant amount for discretionary programs and by a more modest amount for mandatory programs. Outlays for grants would total \$303 billion in that year—or about one of every six dollars of federal spending, by CBO's estimate. Grant outlays in the 2001 budget include \$125 billion for discretionary programs and \$178 billion for mandatory programs.

Because annual changes in outlays reflect not only current decisions but past funding actions as well, changes in budget authority present a much clearer picture of the President's policy proposals for discretionary programs. After adjusting for various shifts in the timing of payments, CBO estimates that the President's budget would increase discretionary budget authority for grants by about \$11 billion, or 9 percent, compared with this year's level (see Table 1-10). The increase would fall largely within three functions: education, training, employment, and social services; income security; and transportation.

Almost half of the increase is centered on education, training, employment, and social services programs. The President's proposals would raise discretionary budget authority for those grants by almost \$5 billion above the 2000 level—an increase of about 14 percent. Funding for elementary and secondary education programs would climb the most. The President is requesting \$1.3 billion for a new program that consists primarily of loans to subsidize school renovations. Large increases for a number of existing education programs are also proposed, including programs for school improvement, education for the disadvantaged, education reform, and special education. Grants for training and employment services and social services for children and families would also see significant increases under the President's budget.

In the income security category, budget authority for grants would grow by about \$3 billion, which represents a 12 percent increase above this year's level of \$28 billion. That expansion includes substantial enlargement of a number of programs, including grants for homeless assistance and other housing programs and for child care and development.

Compared with the 2000 level, the President is requesting \$2.5 billion (or 7 percent) more in spending authority for transportation grants. Obligation limitations set in appropriation acts control annual spending for most of those grants. (A limitation on obligations is a ceiling on the amount of funds that can be obligated within a specified period, usually a fiscal year.) Under the President's proposals, the limitations that govern spending for highways and transit construction programs would rise by more than \$2 billion.

Although for most functions, budget authority for grants would grow under the President's budget, two functions would receive significantly less money

in 2001: administration of justice and natural resources and environment. The proposed drop in funding for justice grants results from a net decrease in grants to state and local governments for law enforcement activities and for programs to reduce violent crime. Those cuts would be partially offset by a proposed increase in budget authority for grants that support community-oriented policing. Similarly, a large cut in grants to states and tribal governments for environmental protection activities would more than offset smaller boosts in a few natural resources programs. The proposed cut in funding stems largely from the elimination of new budget authority for constructing water treatment facilities. Such grants were appropri-

Table 1-10.
Comparison of Discretionary Spending Authority for Grant Programs Enacted for 2000 with the President's Request for 2001, by Budget Function (By fiscal year, in billions of dollars)

Budget Function	2000 Enacted ^a	2001 Request ^a	Increase or Decrease (-)
Natural Resources and Environment	4.3	4.1	-0.2
Transportation ^b	35.5	38.0	2.5
Community and Regional Development	8.8	9.2	0.4
Education, Training, Employment, and Social Services			
School renovation program	0	1.3	1.3
Other elementary, secondary, and vocational education programs	22.1	24.0	1.9
Training and employment services	3.8	4.2	0.4
Children and family services	6.4	7.3	0.9
Other	<u>3.6</u>	<u>4.0</u>	<u>0.4</u>
Subtotal	35.8	40.7	4.9
Health	6.7	7.0	0.3
Income Security	27.7	31.1	3.4
Administration of Justice	3.9	3.3	-0.6
Other	<u>1.9</u>	<u>2.0</u>	<u>0.1</u>
Total	124.6	135.3	10.6

SOURCE: Congressional Budget Office.

a. Adjusted to account for timing shifts.

b. Includes appropriated obligation limitations (ceilings on the amount of funds that can be obligated within a specified period, usually a fiscal year).

ated for specific communities in the current fiscal year.

Outlays for grants under the President's proposals for entitlements and other mandatory programs would rise by less than \$0.5 billion in 2001, compared with current law. Most of the increase (about \$0.4 billion) would go toward new grants for early childhood education.

Differences Between CBO's and the Administration's Estimates

By CBO's reckoning, total surpluses under the President's policies would be \$209 billion higher from 2001 through 2010 than the Administration has estimated (see Table 1-11). The discrepancy occurs because in most years, CBO's economic and technical assumptions produce higher projected revenues and lower mandatory spending than the Administration anticipates under current law.

Differences in Estimates of the Baseline

No single defining pattern characterizes the differences between CBO's and the Administration's estimates over the 2001-2010 period. In projecting revenues, CBO's baseline posts higher totals from 2001 through 2006, exceeding the Administration's current-services estimate by a total of \$87 billion (see Table 1-12). But that relationship is reversed from 2007 through 2010, when CBO's estimate is a total of \$43 billion below that of the Administration. The pattern of revenue variations arises from different projections of taxable income; CBO's estimate is higher through 2004, but the Administration's is higher thereafter (for more details, see Chapter 4).

On the outlay side, CBO's baseline estimates for mandatory programs are lower than the Administration's in almost every year. From 2001 through 2010, CBO projects \$209 billion less in outlays, with much of that difference showing up in estimates of spending

for Social Security. The reasons for the difference vary depending on the year. In 2000 and 2001, CBO projects that caseloads will be slightly lower than the Administration expects. In the longer term, the Administration has overestimated the real (inflation-adjusted) growth in average benefits, CBO believes.

There are several potential sources for the discrepancies in growth rates of Social Security benefits. Because those benefits are computed on the basis of the earnings histories of beneficiaries, rising wages can be a significant factor in such growth over time. But the forecasts of annual wage increases in the Administration's and CBO's projections are comparable over the 2001-2010 period and therefore contribute little to explaining why projected benefits differ so much. Projections of caseloads and annual cost-of-living adjustments are similar as well. A significant portion of the difference lies in outlays for the Disability Insurance program. CBO projects average real growth in benefits for disabled workers of about 0.4 percent a year—the average for the past five years. The Administration, by contrast, estimates that real benefit growth will average 1.4 percent a year over the projection period.

Overall, the Administration anticipates that Social Security payments will grow at an average annual rate of 5.5 percent over the 10-year period, compared with CBO's projection of 5.2 percent growth. After adjustment for automatic increases, the Administration's estimates of average benefits are also noticeably higher than CBO's for Civil Service Retirement, unemployment compensation, veterans' compensation, and Food Stamps.

Differences in Estimates of the President's Proposals

Overall, CBO's estimates of the budgetary impact of the President's proposals are relatively close to those of the Administration, although for a particular program, there may be substantial variation between the two. For example, CBO's estimates of proposals for Medicaid and SCHIP together are lower than the Administration's in all years of the projection period (in 2010, the difference is nearly \$8 billion), mostly

Table 1-11.
Sources of Differences Between CBO's and the Administration's Estimates of the President's Budgetary Proposals (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Administration's Estimate													
Surplus Under the President's Budgetary Proposals	167	184	186	185	195	216	256	292	314	329	363	965	2,519
Sources of Differences													
Revenue Differences													
Baseline	-11	6	17	25	24	11	3	-11	-15	-8	-9	84	44
Policy	<u>*</u>	<u>*</u>	<u>-1</u>	<u>-2</u>	<u>2</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>-3</u>	<u>4</u>	<u>4</u>	<u>*</u>	<u>4</u>
Total	-11	7	16	24	26	12	3	-12	-17	-4	-5	84	48
Outlay Differences													
Discretionary	-6	1	5	5	3	*	4	5	7	8	7	14	45
Mandatory													
Baseline	-5	-4	*	-13	-10	-13	-22	-32	-36	-40	-40	-40	-209
Policy	<u>-1</u>	<u>4</u>	<u>1</u>	<u>4</u>	<u>-1</u>	<u>2</u>	<u>3</u>	<u>*</u>	<u>-2</u>	<u>-3</u>	<u>-4</u>	<u>9</u>	<u>3</u>
Subtotal	-5	*	1	-10	-11	-11	-18	-32	-38	-42	-44	-31	-206
Total	-12	1	6	-5	-8	-11	-14	-27	-31	-34	-37	-16	-160
All Differences	1	6	10	28	34	23	17	15	14	30	32	100	209
CBO's Estimate													
Surplus Under the President's Budgetary Proposals	168	190	196	213	228	238	273	307	328	360	395	1,065	2,727
Memorandum:													
Economic Differences													
Revenues	8	8	10	10	5	-5	-18	-27	-32	-30	-26	27	-106
Outlays	<u>1</u>	<u>2</u>	<u>*</u>	<u>-5</u>	<u>-10</u>	<u>-11</u>	<u>-11</u>	<u>-11</u>	<u>-10</u>	<u>-9</u>	<u>-8</u>	<u>-23</u>	<u>-73</u>
Total	7	6	9	15	15	6	-7	-16	-22	-21	-18	51	-32
Technical Differences													
Revenues	-18	-1	6	14	21	17	21	16	15	26	21	56	154
Outlays	<u>-12</u>	<u>-1</u>	<u>6</u>	<u>*</u>	<u>2</u>	<u>*</u>	<u>-3</u>	<u>-16</u>	<u>-21</u>	<u>-25</u>	<u>-29</u>	<u>7</u>	<u>-87</u>
Total	-6	*	*	14	19	17	24	31	35	51	49	49	241

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

Table 1-12.
Comparison of CBO's and the Administration's Baselines (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
CBO Baseline (Inflated variation)													
Revenues	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946	10,913	24,396
Outlays	1,766	1,835	1,885	1,945	2,012	2,089	2,135	2,198	2,282	2,364	2,451	9,766	21,197
Surplus	179	181	212	231	250	273	330	374	404	449	495	1,147	3,199
On-budget	26	15	29	36	42	48	92	121	138	169	202	171	893
Off-budget	153	166	182	195	209	225	238	253	266	280	293	976	2,307
Administration Current- Services Baseline													
Revenues	1,956	2,010	2,080	2,151	2,238	2,350	2,462	2,584	2,701	2,821	2,955	10,829	24,352
Outlays	1,776	1,839	1,883	1,958	2,025	2,103	2,158	2,236	2,324	2,410	2,499	9,807	21,434
Surplus	179	171	197	193	213	247	304	347	377	411	457	1,022	2,919
On-budget	32	11	25	8	18	33	80	108	127	151	184	95	746
Off-budget	148	160	173	185	195	214	225	239	250	260	272	926	2,173
Difference (CBO minus Administration)													
Revenues	-11	6	17	25	24	11	3	-11	-15	-8	-9	84	44
Outlays	-10	-4	2	-13	-13	-14	-23	-38	-41	-46	-47	-42	-237
Surplus	*	10	15	38	38	25	26	26	27	38	38	126	281
On-budget	-5	4	5	28	24	15	12	13	11	18	18	76	147
Off-budget	5	6	10	10	14	11	14	14	16	20	20	50	134

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and zero.

because of the proposed FamilyCare program. Starting in 2007, CBO estimates, the new authority in the President's budget combined with existing SCHIP spending would be insufficient to fund the program and meet states' obligations under it. CBO has therefore based its estimates of outlays for the proposal on the authority specified in the budget.

In contrast, CBO's estimate of the effects on outlays of the earned income and child and dependent

care tax credits is \$2 billion to \$3 billion a year higher than the Administration's. Most of that difference, though, arises because the Administration misclassified the outlay and revenue components of the policy.

Overall, after taking the various differences into account, CBO's projections of the President's policy proposals are within \$4 billion of the Administration's in every year between 2001 and 2010.

The President's Health Insurance Proposals

After Social Security, Medicare and Medicaid are the largest federal entitlement programs. Together with the State Children's Health Insurance Program, they provide federally funded or subsidized health insurance coverage to millions of low-income, disabled, or aged beneficiaries. This fiscal year, Medicaid will spend about \$115 billion on health care for 43 million low-income people and on subsidies to hospitals that serve low-income populations. SCHIP—which gives federal grants to states to provide health insurance for uninsured children who do not qualify for Medicaid—will spend \$2 billion. And Medicare will pay for the health care of some 39 million elderly and disabled people at a gross cost of about \$221 billion. (Premiums paid by participants cover some of those costs.) Together, those three programs will account for about 18 percent of federal outlays in 2000.

The President's budget for 2001 includes a variety of initiatives to expand health insurance coverage of low-income people through Medicaid and SCHIP and coverage of disabled workers and certain people ages 55 and older through Medicare. The President also proposes adding a prescription drug benefit to Medicare and encouraging health plans to compete on the basis of price by enabling Medicare beneficiaries who choose low-cost plans to pay lower Medicare premiums. In addition, the budget includes various proposals to reduce the growth rate of spending for Medicaid and Medicare.

The President also proposes transferring revenues from the general fund of the Treasury to Medicare's Hospital Insurance Trust Fund. Although that transfer would delay the date on which the trust fund is exhausted, it would not provide any new resources to address the budgetary pressures that will result from the projected rapid growth of Medicare spending over the coming decades.

Taken together, the health care initiatives in the President's budget would raise federal spending by \$159 billion over the 2001-2010 period, the Congressional Budget Office estimates (see Table 2-1). Of that total, \$26 billion would be spending for Medicaid, \$64 billion for SCHIP, and \$69 billion for Medicare. In addition, the President's proposals to expand eligibility for Medicare would reduce tax revenues by \$8.4 billion and increase Social Security spending (which is off-budget) by \$1.4 billion over the same period.

Because of the magnitude of federal health insurance programs and the scale of the President's proposals to alter them, an understanding of how those programs spend money is important in evaluating the proposals. Consequently, this chapter reviews trends in spending and enrollment for Medicaid and SCHIP before examining the changes to those programs proposed in the President's budget. It then does the same for Medicare. (The President's trust fund proposals are discussed in Chapter 3.)

Table 2-1.
Ten-Year Estimates of the President's Health Insurance Proposals (In billions of dollars)

	Administration	CBO
Medicaid and SCHIP (Federal payments)		
Medicaid		
FamilyCare	N.A.	-7.4
Effects of Medicare prescription drug benefit	33.7	18.7
Other proposals	<u>N.A.</u>	<u>15.1</u>
Subtotal	N.A.	26.4
SCHIP		
FamilyCare	N.A.	63.7
Other proposals	<u>N.A.</u>	<u>0.7</u>
Subtotal	N.A.	64.4
Both Programs		
FamilyCare	76.0	56.2
Effects of Medicare prescription drug benefit	33.7	18.7
Other proposals	<u>14.0</u>	<u>15.9</u>
Total	123.7	90.8
Medicare		
Changes to Traditional Medicare ^a	-54.1	-48.6
Expanded Eligibility	2.9	0.2
Prescription Drug Benefit	126.6	130.6
Competitive Defined Benefit	<u>-11.9</u>	<u>-13.7</u>
Total	63.5	68.6
Total Proposals		
Cost of the President's Health Insurance Proposals	187.2	159.4
Tax Credits for Expanded Eligibility in Medicare	<u>1.6</u>	<u>8.4</u>
Decrease in the Cumulative On-Budget Surplus	188.8	167.7
Social Security Outlays for Expanded Eligibility in Medicare (Off-budget)	<u>1.1</u>	<u>1.4</u>
Decrease in the Cumulative Total Budget Surplus	189.9	169.1

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

NOTE: SCHIP = State Children's Health Insurance Program; N.A. = not available.

a. Includes changes to fee-for-service Medicare, changes to Medicare+Choice, and the interactive effects of changes to fee-for-service Medicare that lead to changes in Medicare+Choice payments.

Spending and Enrollment Trends in Medicaid and the State Children's Health Insurance Program

CBO projects that spending for Medicaid and SCHIP will more than double over the next 10 years. Federal outlays for Medicaid (a joint federal/state program) will rise from \$115 billion in 2000 to \$264 billion in 2010—an average increase of 8.7 percent a year. That projected growth rate is higher than the rates experienced in recent years but well below the double-digit increases seen in the early 1990s. Federal outlays for SCHIP, which was created by the Balanced Budget Act of 1997, are projected to rise from \$2 billion in 2000 to nearly \$5 billion in 2010 (see Table 2-2 on pages 26 and 27).

Medicaid

Medicaid covers a range of acute and long-term care services for eligible beneficiaries. Under current law, spending on those benefits is projected to grow from \$100 billion this year to \$240 billion in 2010. The program also makes payments (known as DSH payments) to "disproportionate share" hospitals that serve large numbers of Medicaid recipients and other low-income people. CBO expects that statutory limits will keep those payments relatively flat over the next decade; they are estimated to rise only from \$9 billion in 2000 to \$10 billion in 2010. Administrative expenses are projected to grow from \$6 billion this year to more than \$14 billion at the end of the decade. Medicaid also provides funding of about \$0.5 billion a year to the Vaccines for Children program operated by the Centers for Disease Control and Prevention (CDC).

CBO estimates that total Medicaid enrollment will rise from 43 million in 2000 to almost 51 million by 2010. Enrollees can be divided into four general eligibility categories: aged, blind or disabled, children, and adults. Although the first two categories represent less than 30 percent of total enrollment, they account for more than 70 percent of total spending on benefits. Low-income children and adults make up the

majority of enrollees, but they account for a smaller portion of spending because they have much lower health care costs per capita.

Because states share the costs of the Medicaid program with the federal government, states' decisions about eligibility and the scope of benefits affect federal spending. The federal government pays for a percentage of each state's Medicaid outlays according to a formula based on the state's per capita income. That federal matching rate varies from state to state, ranging from 50 percent to 83 percent. On average, the federal government pays for 57 percent of total Medicaid spending; states are responsible for the other 43 percent. The state share of Medicaid spending is also projected to increase dramatically over the next decade—from \$88 billion to \$202 billion. Combining federal and state shares, total Medicaid spending will rise from \$203 billion to \$466 billion during that period.

Past and Future Growth of Federal Medicaid Outlays. After a period of rapid growth in the early 1990s, federal spending for Medicaid rose by only 3.3 percent in 1996 and 3.9 percent in 1997. CBO attributes the slowdown in growth to a number of factors: a decline in caseloads due to a combination of strong economic growth and welfare reform, one-time savings as states enrolled Medicaid beneficiaries in managed care, actions by states to limit reimbursements to health care providers, and statutory changes that limited the amount of DSH payments a hospital could receive to 100 percent of its uncompensated care.

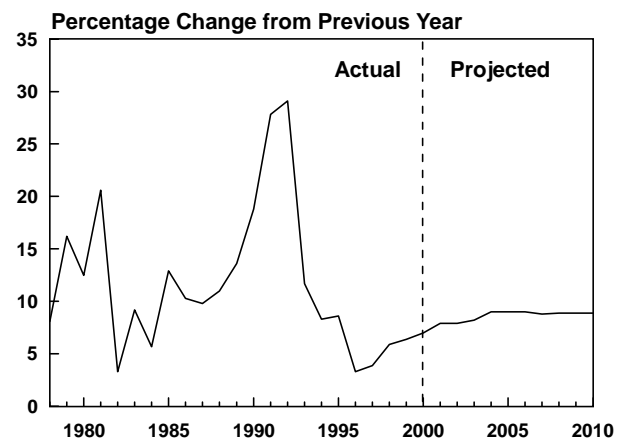
That slow growth has not lasted. Medicaid spending increased by 5.9 percent in 1998 and 6.4 percent in 1999. CBO expects higher growth rates in the future: 7 percent in 2000, rising to 9 percent a year after 2003. Although growth of 9 percent represents a sharp increase from the low rates of the mid-1990s, it remains well below growth rates of a decade ago (see Figure 2-1).

CBO anticipates that a number of factors will boost spending growth over the next several years. Some of those factors reflect states' decisions about the desired scope of their Medicaid programs; others are a function of the rising cost of providing health care benefits.

First, many of the forces that slowed growth in the mid-1990s have proved temporary. Medicaid caseloads are rising again as states reenroll children and adults who dropped out of the program after welfare reform legislation was enacted in 1996. (Higher enrollment of children has occurred as states identify children who are eligible for Medicaid while they seek out children to enroll in their SCHIP programs.) Health care providers are beginning to negotiate higher payment rates. And a modest slowdown in the growth of enrollment in Medicaid's managed care plans and pressure by those plans to raise payment rates are likely to reduce the savings from moving people into managed care.

Second, many states are expanding Medicaid eligibility under the program's existing authority and under waivers granted by the Health Care Financing Administration (HCFA). Those expansions will probably be modest in scope, focusing on pregnant women and other adults, or be waiver programs that specifically limit enrollment. However, states may choose to expand Medicaid eligibility further using revenues from their multibillion-dollar settlement with the tobacco industry and from the continuing strong economy. States may also expand enrollment of disabled

Figure 2-1.
Annual Growth of Federal Medicaid Outlays, 1978-2010 (By fiscal year)



SOURCES: Congressional Budget Office projections and historical data from the Office of Management and Budget.

NOTE: The growth rate for 1999 is estimated.

Table 2-2.
CBO's March 2000 Baseline for Medicaid and the State Children's Health Insurance Program
(By fiscal year)

	1999 ^a	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Medicaid												
<i>Federal Payments (Billions of dollars)</i>												
Benefits												
Acute care												
Fee-for-service	41.4	43.4	46.9	50.8	55.2	60.4	66.1	72.2	78.6	85.7	93.4	101.8
Managed care	13.3	15.3	17.3	19.4	21.5	23.7	26.1	28.7	31.5	34.6	38.0	41.7
Medicare premiums	2.4	2.5	2.7	2.9	3.1	3.5	3.9	4.3	4.7	5.1	5.6	6.1
Long-term care	35.8	38.6	41.6	45.1	48.6	52.9	57.7	63.0	68.9	75.3	82.4	90.0
Subtotal	92.9	99.8	108.5	118.2	128.3	140.5	153.8	168.1	183.7	200.7	219.3	239.5
Disproportionate Share Hospitals	8.7	8.6	8.4	8.1	8.3	8.5	8.7	9.0	9.2	9.4	9.6	9.8
Administrative Costs	5.5	6.3	6.8	7.3	7.9	8.6	9.4	10.2	11.1	12.1	13.2	14.4
Vaccines for Children	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Total	107.6	115.1	124.3	134.1	145.1	158.2	172.4	187.9	204.5	222.7	242.6	264.2
<i>Annual Growth Rate of Federal Payments (Percent)</i>												
Benefits												
Acute care												
Fee-for-service	6	5	8	8	9	10	9	9	9	9	9	9
Managed care	14	15	13	12	11	10	10	10	10	10	10	10
Medicare premiums	6	4	8	10	7	11	11	9	9	9	9	9
Long-term care	5	8	8	8	8	9	9	9	9	9	9	9
All Benefit Payments	6	7	9	9	9	9	9	9	9	9	9	9
Disproportionate Share Hospitals	2	-2	-2	-3	2	3	3	3	2	2	2	2
Administrative Costs	11	15	8	7	9	9	9	9	9	9	9	9
All Federal Payments	6	7	8	8	8	9	9	9	9	9	9	9
<i>Federal Benefit Payments by Eligibility Category (Billions of dollars)</i>												
Aged	27.7	29.7	31.8	34.2	36.5	39.5	42.8	46.3	50.4	54.8	59.6	64.9
Blind or Disabled	39.1	42.3	46.6	51.6	57.1	63.4	70.4	77.8	85.8	94.5	104.2	114.7
Children	15.8	16.7	18.1	19.3	20.7	22.3	24.1	26.1	28.2	30.4	32.9	35.4
Adults	10.4	11.1	12.1	13.0	14.1	15.3	16.6	17.9	19.4	20.9	22.6	24.5
Total	92.9	99.8	108.5	118.2	128.3	140.5	153.8	168.1	183.7	200.7	219.3	239.5

people who receive long-term care services at home or in the community because of concerns about complying with the Americans with Disabilities Act.

Third, administrative costs are expected to rise rapidly as states spend more on enrolling people who left the rolls under welfare reform and on other aspects of program management. States will also continue their long-standing efforts to receive additional federal matching payments by converting programs that they now fund themselves into Medicaid programs.

Fourth, Medicaid costs are expected to increase because of recipients' higher utilization of services

such as prescription drugs and long-term care provided in community settings.

Trends in Spending on Benefits. Health care benefits for enrollees account for the vast majority of Medicaid spending. More than 60 percent of spending on benefits goes for acute care services—a category that includes payments to fee-for-service providers, capitated (per capita) payments to managed care plans, and Medicare expenses for certain beneficiaries. The rest of benefit spending goes for institutional and noninstitutional long-term care services.

Table 2-2.
Continued

	1999 ^a	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Medicaid (Continued)												
<i>Enrollment by Eligibility Category (Millions of people)</i>												
Aged	4.3	4.4	4.5	4.5	4.6	4.6	4.7	4.8	4.9	5.0	5.1	5.2
Blind or Disabled	7.2	7.3	7.5	7.8	8.1	8.3	8.6	8.9	9.1	9.4	9.6	9.9
Children	21.6	22.3	23.0	23.1	23.3	23.6	23.9	24.3	24.5	24.8	25.1	25.4
Adults	<u>8.9</u>	<u>9.1</u>	<u>9.4</u>	<u>9.3</u>	<u>9.2</u>	<u>9.4</u>	<u>9.5</u>	<u>9.7</u>	<u>9.8</u>	<u>9.9</u>	<u>10.1</u>	<u>10.2</u>
Total	42.0	43.1	44.4	44.8	45.1	46.0	46.7	47.6	48.3	49.1	49.8	50.6
State Children's Health Insurance Program												
<i>Federal Payments (Billions of dollars)</i>												
Budget Authority	4.2	4.2	4.2	3.1	3.2	3.2	4.1	4.1	5.0	5.0	5.0	5.0
Outlays												
Separate state programs	0.6	1.3	1.8	2.1	2.4	2.7	2.8	2.7	2.8	2.9	3.0	3.4
Funds transferred to Medicaid ^b	<u>0.4</u>	<u>0.7</u>	<u>0.8</u>	<u>0.9</u>	<u>1.0</u>	<u>1.1</u>	<u>1.2</u>	<u>1.1</u>	<u>1.2</u>	<u>1.3</u>	<u>1.3</u>	<u>1.4</u>
Total	1.0	2.0	2.6	3.0	3.4	3.8	4.0	3.8	4.0	4.2	4.3	4.8
Memorandum:												
State Medicaid Payments	81.8	87.6	94.5	102.1	110.5	120.6	131.5	143.4	156.2	170.1	185.4	202.0
Total State and Federal Medicaid	189.5	202.8	218.8	236.2	255.6	278.8	304.0	331.2	360.6	392.8	427.9	466.2

SOURCE: Congressional Budget Office.

- a. Estimated (actual outlays are not known because state-reported Medicaid expenditures include spending on Medicaid expansions that are funded by SCHIP).
- b. Medicaid expansions that are funded by SCHIP; these are not included in baseline projections for Medicaid.

Acute Care Services. Payments made to health care providers on a fee-for-service basis are projected to increase from \$43 billion in 2000 to \$102 billion in 2010—an average of about 9 percent a year (see Table 2-2). That projection reflects the movement of beneficiaries out of fee-for-service arrangements and into managed care plans. The fastest growing component of fee-for-service acute care is spending for prescription drugs, which is projected to rise by about 12 percent annually because of both higher utilization and higher drug prices. Spending for some other acute care services—such as outpatient hospital, clinic, diagnostic, and screening services—is also expected to grow faster than the average, rising by about 10 percent a year.

Outlays for Medicaid's managed care plans, which receive a fixed payment per enrollee, are projected to rise from \$15 billion in 2000 to \$42 billion in 2010. Those figures include payments for fully and

partially capitated plans, primary care case-management fees, and other payments for uncompensated care that are included in some states' waiver programs. CBO projects that the annual growth of managed care payments will slow from 15 percent in 2000 to 10 percent in 2004. That slower growth is expected to occur for two reasons: some plans will leave the market because of insufficient capitation rates, and enrollment will increase more slowly as states face difficulties moving chronically ill aged and disabled beneficiaries into managed care.

Besides its regular benefits, Medicaid also pays the premiums and out-of-pocket expenses incurred by some low-income Medicare beneficiaries. For so-called qualified Medicare beneficiaries (QMBs), who have income below the federal poverty level, Medicaid pays all of Medicare's premiums and cost-sharing amounts. (About three-quarters of QMBs are dually eligible for full benefits under both programs.) For

specified low-income Medicare beneficiaries (SLMBs), who have income between 100 percent and 120 percent of the poverty level, Medicaid pays the premiums for Part B of Medicare (Supplementary Medical Insurance). In addition, certain qualified individuals who have income between 120 percent and 175 percent of the poverty level are eligible to have Medicaid pay some or all of their Part B premiums through 2002. (Although state Medicaid programs initially make the Part B premium payments for the latter group, Medicare reimburses states for 100 percent of the costs.) All together, CBO estimates that Medicaid spending on Medicare premiums for those three categories of low-income beneficiaries will more than double in the next decade, from \$2.5 billion to \$6.1 billion.

Long-Term Care Services. CBO projects that federal Medicaid spending on long-term care services will rise from \$39 billion this year to \$90 billion in 2010. In that projection, spending on long-term care provided in institutions such as nursing homes is expected to grow less rapidly (8 percent a year) than spending on non-institutional care (12 percent a year). Noninstitutional care includes a range of medical and support services, such as home health care, personal care, and other services offered under special waivers for home- and community-based care. Because of its faster growth rate, noninstitutional care will account for an increasing share of total spending on long-term care, rising from 28 percent in 2000 to 37 percent in 2010.

Trends in DSH Payments. The Balanced Budget Act set specific state allotments for disproportionate share hospital payments for each year of the 1998-2002 period. After that, state allotments will rise at the same rate as the consumer price index but will be capped at 12 percent of a state's total Medicaid spending. The act also limited state DSH payments to mental health facilities. CBO estimates that those limits, along with statutory restrictions on the amount that states may pay individual hospitals, will prevent some states from spending their entire DSH allotments. As a result, federal DSH payments are expected to decrease from \$8.6 billion this year to \$8.1 billion in 2002. After that, they are projected to grow by about 2.4 percent a year, reaching \$9.8 billion in 2010.

Trends in Administrative Costs. CBO estimates that Medicaid's spending on administration will grow at an average annual rate of 9 percent through 2010, rising from \$6 billion to \$14 billion. States are expected to drive that growth by increasing their efforts to enroll people who left the rolls under welfare reform and continuing to shift the administrative expenses of other welfare programs into Medicaid to maximize federal matching payments. Also contributing to growth is higher spending for improvements to computer systems, administration related to the provision of school-based health services, and mental health case management.

Trends in Enrollment. CBO estimates that over the 2000-2010 period, Medicaid enrollment will rise at an average annual rate of 1.6 percent. The number of blind or disabled enrollees will increase most quickly—by 3 percent a year, on average. That growth is tied largely to continued increases in the number of disabled recipients in the Supplemental Security Income (SSI) program, which usually confers eligibility for Medicaid as well. CBO also anticipates some growth in disabled enrollees because of states' efforts to comply with the Americans with Disabilities Act.

Enrollment of children is expected to increase by 3.1 percent next year before moderating in later years. As noted earlier, enrollment will jump in the near term as states work to enroll children in SCHIP and, in the process, identify children who are eligible for Medicaid. (Such children cannot participate in SCHIP.) In addition, children who dropped off the rolls after welfare reform have begun to return to the Medicaid program. Enrollment of adults is also likely to increase modestly in the near term as states expand coverage of parents, as permitted by the 1996 welfare reform law.

State Children's Health Insurance Program

The Balanced Budget Act established SCHIP as title XXI of the Social Security Act. The program gives states matching funds to provide health insurance to children who are uninsured but do not qualify for Medicaid. States can use their SCHIP funds to enroll children in their existing Medicaid program or estab-

lish a separate program. To date, about 70 percent of states have chosen to establish separate programs. To encourage states to participate in SCHIP, the federal government matches their SCHIP spending at a higher rate than Medicaid spending (70 percent versus 57 percent, on average).

Unlike Medicaid, which is an open-ended entitlement program, federal funding for SCHIP is limited. The federal government allocates money to the states each year for SCHIP on the basis of how many low-income and uninsured children they have. Total SCHIP allotments will be \$4.2 billion in 2000 and 2001, drop to \$3.1 billion in 2002, and then rise again, reaching \$5.0 billion by 2007. States have three years to spend their SCHIP allotments; after that, any unspent funds are reallocated to states that have exhausted their allotments and are made available for another year.

If a state runs out of SCHIP money, the consequences for children enrolled in the program depend on whether the state operates a separate program or one that enrolls children in Medicaid. Children in states that expanded their Medicaid programs with SCHIP funds are entitled to Medicaid benefits. If such a state uses up its SCHIP allotment, children can continue to receive services through Medicaid (although states will receive the lower Medicaid matching rate for those services). Children in states with separate programs, by contrast, are not entitled to Medicaid benefits; they may have to wait until the following year's funding becomes available to continue receiving services.

Trends in Spending. CBO projects that federal outlays for SCHIP will rise from \$2.0 billion this year to \$4.8 billion in 2010 (see Table 2-2). Outlay growth will be particularly strong in the next few years as states build up their programs. In 1998 and 1999 combined, federal spending was only about \$1 billion. That amount was much lower than the total available allotments for several reasons: the lengthy lead time necessary to develop large-scale health insurance programs, the constraints of states' legislative calendars, and program rules that limit administrative and outreach spending to 10 percent of total spending. States may also have been exercising caution as they planned the size of their programs out of concern about sharp drops in their allotments beginning in 2002.

Some states have already planned programs with large enrollment goals that will require as much or more funding than will be provided in their allotment amounts. Other states will need a few more years to develop larger programs. Still others may have programs that never use available allotment amounts because of the states' financial constraints or the preferences of state governments. In most years, states with large programs are expected to rely in part on the reallocation of unused funds from other states to support their programs. CBO estimates that in 2001, \$1.8 billion of the total 1998 SCHIP allotment will be reallocated, and \$0.5 billion of that amount will never be spent. In later years, a smaller proportion of the total allotment is likely to be reallocated as states develop greater capacity to spend their allocations within three years. Given states' preferences and constraints, SCHIP programs are expected to be fully developed by 2003.

Trends in Enrollment. Assessing enrollment levels in SCHIP is difficult for two reasons. First, to date, the program's experience suggests that children enroll in SCHIP for short spells, moving on and off the rolls as their family's income changes. Variation in earnings is common among families with children eligible for low-income health programs. SCHIP is designed to continue children's health coverage when their family's income rises above eligibility levels for Medicaid; conversely, those children can return to Medicaid from SCHIP when their family's income falls. In fact, many children who leave SCHIP reportedly reenroll in Medicaid.

Second, as states build up their SCHIP programs, reported levels of enrollment often account for only a few months of coverage during any given year. Consequently, data on the number of children enrolled in the program at a particular point in time, or at any time since the program's inception, overstate the number of children covered on a full-year-equivalent basis.

CBO estimates that enrollment in SCHIP could reach 2.1 million this year, with about 1.6 million children enrolled on a full-year-equivalent basis. After 2002, enrollment could reach a steady state of 2.5 million on an average annual basis, or closer to 2 million on a full-year-equivalent basis.

The President's Proposals for Medicaid and SCHIP

The President's budget includes numerous proposals that would affect the Medicaid and SCHIP programs. CBO estimates that those proposals would increase federal outlays for Medicaid by \$26 billion through 2010 (see Table 2-3). They would raise federal spending for SCHIP by \$64 billion over the same period.

The main Medicaid and SCHIP proposals focus on expanding eligibility. The most far-reaching of those initiatives, the FamilyCare proposal, would provide health insurance coverage to parents of children enrolled in Medicaid or SCHIP. The President's budget would also expand Medicaid and SCHIP eligibility to 19- and 20-year-olds, some aged or disabled people with income below 300 percent of the SSI benefit standard, and certain women with breast or cervical cancer. Other proposals would restore full Medicaid eligibility to immigrants who lost coverage under welfare reform, allow states to use SCHIP funds to cover immigrant children, and extend the Medicaid coverage of people who lose eligibility because of an increase in their earnings.

Other proposals in the budget would expand states' outreach efforts to children who are eligible for but not enrolled in Medicaid and SCHIP, reduce Medicaid spending for prescription drugs, and decrease federal reimbursement for some administrative costs related to enrolling welfare recipients in Medicaid. Proposals by the President that would affect prescription drug coverage, the Part B premium, and cost sharing in the Medicare program (discussed later in this chapter) would also increase spending for Medicaid. Finally, the President's budget includes proposals to combat fraud in Medicaid, improve the program's operations, and improve public health.

The FamilyCare Proposal

Under current law, Medicaid coverage in most states is far more expansive for children than for parents. Because of a combination of federal requirements and

optional eligibility expansions by states, Medicaid typically covers pregnant women and children at income levels at or above the federal poverty level. For most parents, by contrast, eligibility standards for Medicaid remain in line with standards for welfare programs, which are substantially below the poverty level. Although current law allows states to expand coverage of those parents, states have been cautious in their approach.¹ Also, states cannot use their SCHIP funds to cover the parents of children eligible for that program, although several states have expressed interest in doing so.

The President's proposal would add \$50 billion in budget authority between 2002 and 2010 to existing funds for SCHIP and rename that program FamilyCare. The FamilyCare proposal would expand eligibility for parents of Medicaid and SCHIP children—using an enhanced matching rate initially to motivate states to participate and a new federal requirement later to compel states to take part. The federal government would match FamilyCare spending at the same enhanced rate that applies in SCHIP (70 percent, on average). The proposal would also make eligibility standards for Medicaid more uniform among states. It would require that by 2006, all parents with income below the poverty level would be eligible for Medicaid and all children with family income below 200 percent of the poverty level would be eligible for either Medicaid or SCHIP. The program would provide enhanced matching funds to states that already cover parents above the poverty level and children with family income above federally mandated eligibility requirements.

The FamilyCare funding in the President's budget, however, would be insufficient to cover the full costs of the program after 2006, CBO estimates. Once annual FamilyCare funds were exhausted, additional costs for many of the program's beneficiaries would shift to Medicaid. Those additional Medicaid outlays would be matched at the lower Medicaid rate (57 percent, on average). Overall, CBO estimates, net federal spending on FamilyCare and Medicaid under

1. States can expand Medicaid coverage of parents either through authority granted under section 1115 of the Social Security Act or through permissive state income and resource requirements allowed under section 1931 of the act.

Table 2-3.
CBO's Estimate of the President's Proposals for Medicaid and the State Children's Health Insurance Program (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Federal Payments for Medicaid												
Eligibility Expansions												
FamilyCare proposal ^a	0.2	-0.1	*	*	0.2	-7.3	-3.6	0.7	1.0	1.5	0.3	-7.4
19- and 20-year-olds	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.7	1.7
300 percent of SSI standard	*	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.4	1.3
Women with breast or cervical cancer	*	*	*	*	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.6
Legal immigrants	*	0.1	0.3	0.5	0.8	1.0	1.3	1.7	2.0	2.4	1.7	10.2
Transitional Medicaid	<u>0</u>	<u>0.4</u>	<u>0.4</u>	<u>0.4</u>	<u>0.5</u>	<u>0.5</u>	<u>0.6</u>	<u>0.6</u>	<u>0.7</u>	<u>0.7</u>	<u>1.7</u>	<u>4.8</u>
Subtotal	0.4	0.6	0.9	1.2	1.8	-5.4	-1.3	3.5	4.2	5.2	5.0	11.1
Outreach Proposals	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.5	1.2
Medicaid Drug Proposals												
Sharing of price data with states	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.4	-1.3
Rebate requirement for generic drugs	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.8
Coverage of smoking-cessation drugs	*	*	*	*	*	*	*	*	*	*	<u>0.1</u>	<u>0.2</u>
Subtotal	<u>*</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.2</u>	<u>-0.2</u>	<u>-0.2</u>	<u>-0.2</u>	<u>-0.3</u>	<u>-0.3</u>	<u>-0.3</u>	<u>-0.6</u>	<u>-1.9</u>
Allocation of Administrative Costs	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-1.7	-3.6
Interactions with Medicare Proposals												
Cost sharing and Part B premiums	*	*	*	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.2	0.8
Medicare prescription drug proposal												
Low-income subsidy	0	0	*	0.6	1.4	1.7	1.9	2.1	2.2	2.5	2.0	12.4
Induced Medicaid enrollment	<u>0</u>	<u>0</u>	<u>0.2</u>	<u>0.5</u>	<u>0.8</u>	<u>0.8</u>	<u>0.9</u>	<u>1.0</u>	<u>1.1</u>	<u>1.1</u>	<u>1.4</u>	<u>6.3</u>
Subtotal	<u>*</u>	<u>*</u>	<u>0.3</u>	<u>1.1</u>	<u>2.2</u>	<u>2.6</u>	<u>2.9</u>	<u>3.1</u>	<u>3.4</u>	<u>3.8</u>	<u>3.7</u>	<u>19.5</u>
Other Proposals ^b	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>0.1</u>
Total	0.2	0.3	0.8	1.9	3.5	-3.2	1.1	6.1	7.1	8.5	6.9	26.4
Federal Payments for the State Children's Health Insurance Program												
Eligibility Expansions												
FamilyCare proposal ^a	-0.3	1.4	2.4	3.1	4.4	17.5	13.0	7.3	7.7	7.2	10.9	63.7
19- and 20-year-olds	*	*	*	*	*	*	*	*	*	*	0.2	0.4
Legal immigrants	*	*	*	*	*	*	*	*	*	*	<u>0.1</u>	<u>0.2</u>
Subtotal	<u>-0.3</u>	<u>1.4</u>	<u>2.4</u>	<u>3.1</u>	<u>4.5</u>	<u>17.5</u>	<u>13.1</u>	<u>7.4</u>	<u>7.8</u>	<u>7.3</u>	<u>11.2</u>	<u>64.3</u>
Outreach Proposals	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>*</u>	<u>0.1</u>
Total	-0.3	1.4	2.4	3.1	4.5	17.5	13.1	7.4	7.8	7.3	11.2	64.4
Federal Payments for Both Programs												
Total Cost of the President's Proposals	-0.1	1.8	3.3	5.1	8.1	14.3	14.1	13.6	14.9	15.8	18.1	90.8
Memorandum:												
Total FamilyCare Outlays ^a	-0.1	1.3	2.3	3.1	4.6	10.2	9.4	8.1	8.7	8.7	11.3	56.2

SOURCE: Congressional Budget Office.

NOTE: * = between -\$50 million and \$50 million; SSI = Supplemental Security Income.

a. Outlays as constrained by the budget authority provided in the President's budget.

b. Includes interactions with other programs and initiatives related to public health and program administration.

this proposal would total \$56 billion through 2010 (see Table 2-3). If spending were not constrained by the insufficient funds, the net costs of the proposal would increase by \$13 billion over the 2001-2010 period.

How the Program Would Operate. The FamilyCare proposal would be implemented in two distinct phases: an optional phase between 2001 and 2005 and a mandatory phase starting in 2006. The ways in which states could use their FamilyCare funds would differ tremendously between the two phases. During the mandatory phase, states would be required to pay for coverage of some FamilyCare beneficiaries through Medicaid (and some Medicaid beneficiaries through FamilyCare). States would receive an enhanced matching rate for some beneficiaries even though those people would be covered by Medicaid. The FamilyCare proposal is complex, and some key details are not specified in the President's budget.

Phase I: Voluntary Expansion, 2001-2005. To participate in the new program, states would first be required to expand SCHIP eligibility to children with family income up to 200 percent of the poverty level and eliminate waiting lists. The President's proposal would make FamilyCare funds available for five years (rather than the current three years under SCHIP) to give states more time to spend their money. CBO assumes that states could use their new FamilyCare funds to meet those initial requirements if their existing SCHIP allotments had run out.

After meeting those requirements, states could voluntarily extend coverage to parents of children in Medicaid or SCHIP. States would be required to enroll parents in the same program as their children and to enroll the parents of Medicaid children before the parents of SCHIP children. Starting in 2002, funding for those coverage expansions would come from the new FamilyCare allotments. (CBO assumes that any coverage expansions made in 2001 would be paid for out of current SCHIP allotments.) The federal government would match states' spending for FamilyCare at the same rate that now applies to SCHIP (although states would not be able to receive that rate for parents who have income below eligibility limits that were established before January 1, 2000).

Phase II: Mandatory Expansion, 2006 and After. Starting in 2006, all states would be required to expand eligibility to parents of Medicaid-eligible children up to the poverty level. That mandate has a complicated twist. States would have to cover all of those parents through Medicaid, including parents in that income category who were previously covered by FamilyCare. Therefore, some of the parents would shift from FamilyCare to Medicaid, but others would be newly enrolled in Medicaid. Expanded coverage for parents with income above the poverty level would still come from the FamilyCare allotments. Either way, states would receive the enhanced matching rate for all parents enrolled under the proposal. Only states that had expanded eligibility to parents under the poverty level before January 1, 2000, would fail to get an enhanced matching rate.

However, states that had covered parents with income above the poverty level before January 1, 2000, or that covered children above federally mandated eligibility requirements would be rewarded. In the first phase of the proposal, they would continue to receive the regular Medicaid match for those beneficiaries, even as other states that expanded their programs after the proposal's enactment received an enhanced match through FamilyCare. In phase II, however, the early-acting states would be able to transfer financing of those parents and children to FamilyCare (with its higher matching rate), even though those beneficiaries would remain entitled to Medicaid benefits.

CBO's Estimate. The President's budget would pay for the FamilyCare program with specified levels of budget authority that would fall short of full funding. To assess the extent of that shortfall, CBO estimated the implications of the proposal for the federal budget in two ways—without and with the constraints of the available budget authority (see Table 2-4). The first approach treats FamilyCare as an open-ended entitlement program and illustrates the full scope of the proposed expansion. For the second approach, CBO had to make assumptions about the amount of FamilyCare funding that would be available each year because the President's budget does not specify annual amounts. CBO then assessed whether that funding would be enough to cover the program's projected spending each year. The two approaches yield very different results.

Table 2-4.
CBO's Estimate of the President's FamilyCare Proposal (By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Proposal Without Annual Spending Constraints (Federal payments)												
FamilyCare Outlays												
Phase I: Voluntary expansion	-0.3	1.4	2.4	3.1	4.4	2.8	3.1	3.1	3.4	3.3	10.9	26.6
Phase II: Mandatory expansion	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>14.6</u>	<u>15.7</u>	<u>17.0</u>	<u>18.3</u>	<u>19.7</u>	<u>0</u>	<u>85.4</u>
Subtotal	-0.3	1.4	2.4	3.1	4.4	17.5	18.8	20.1	21.7	23.0	10.9	112.0
Medicaid Outlays												
Phase I: Voluntary expansion	0.2	-0.1	*	*	0.2	0.5	0.5	0.5	0.6	0.5	0.3	2.9
Phase II: Mandatory expansion	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>-7.8</u>	<u>-8.4</u>	<u>-9.1</u>	<u>-9.8</u>	<u>-10.6</u>	<u>0</u>	<u>-45.7</u>
Subtotal	0.2	-0.1	*	*	0.2	-7.3	-7.9	-8.6	-9.3	-10.1	0.3	-42.8
Total New Outlays	-0.1	1.3	2.3	3.1	4.6	10.2	10.9	11.5	12.4	12.9	11.3	69.1
SCHIP Outlays (Under current law)	2.6	3.0	3.4	3.8	4.0	3.8	4.0	4.2	4.3	4.8	16.9	38.0
Combined FamilyCare/SCHIP Outlays	2.3	4.4	5.8	6.9	8.4	21.3	22.8	24.3	26.0	27.8	27.8	149.9
Proposal With Annual Spending Constraints (Federal payments)												
FamilyCare Budget Authority												
SCHIP budget authority (Under current law)	13.9 ^a	3.1	3.2	3.2	4.1	4.1	5.0	5.0	5.0	5.0	27.4	51.6
Proposed FamilyCare budget authority	<u>0</u>	<u>3.2</u>	<u>4.5</u>	<u>4.5</u>	<u>4.5</u>	<u>6.3</u>	<u>6.5</u>	<u>6.5</u>	<u>7.0</u>	<u>7.0</u>	<u>16.7</u>	<u>50.0</u>
Total Budget Authority	13.9	6.3	7.7	7.7	8.6	10.4	11.5	11.5	12.0	12.0	44.1	101.6
Total Budget Authority, Start of Fiscal Year	13.9	17.9	21.2	23.0	24.7	26.7	17.0	11.5	12.0	12.0	n.a.	n.a.
Minus Combined FamilyCare/SCHIP Outlays	<u>-2.3</u>	<u>-4.4</u>	<u>-5.8</u>	<u>-6.9</u>	<u>-8.4</u>	<u>-21.3</u>	<u>-22.8</u>	<u>-24.3</u>	<u>-26.0</u>	<u>-27.8</u>	n.a.	n.a.
Total Budget Authority, End of Fiscal Year	11.6	13.5	15.4	16.1	16.3	5.4	0	0	0	0	n.a.	n.a.
FamilyCare Outlays Precluded by Available Budget Authority	0	0	0	0	0	0	-5.8	-12.7	-14.0	-15.8	n.a.	n.a.
Impact of Budget Authority on FamilyCare Outlays												
Unconstrained FamilyCare outlays	-0.3	1.4	2.4	3.1	4.4	17.5	18.8	20.1	21.7	23.0	10.9	112.0
FamilyCare outlays precluded by available budget authority	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>-5.8</u>	<u>-12.7</u>	<u>-14.0</u>	<u>-15.8</u>	<u>0</u>	<u>-48.3</u>
Revised FamilyCare Outlays	-0.3	1.4	2.4	3.1	4.4	17.5	13.0	7.3	7.7	7.2	10.9	63.7
Impact of Budget Authority on Medicaid Outlays												
Unconstrained Medicaid outlays	0.2	-0.1	*	*	0.2	-7.3	-7.9	-8.6	-9.3	-10.1	0.3	-42.8
Higher Medicaid outlays because of FamilyCare constraints	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>4.2</u>	<u>9.3</u>	<u>10.2</u>	<u>11.6</u>	<u>0</u>	<u>35.4</u>
Revised Medicaid Outlays	0.2	-0.1	*	*	0.2	-7.3	-3.6	0.7	1.0	1.5	0.3	-7.4
Total New Outlays	-0.1	1.3	2.3	3.1	4.6	10.2	9.4	8.1	8.7	8.7	11.3	56.2
Memorandum:												
Administration's Estimate of Total New Outlays	0.8	1.6	2.6	3.8	5.0	8.9	12.0	12.8	13.7	14.8	13.8	76.0

SOURCE: Congressional Budget Office.

NOTE: * = between -\$50 million and \$50 million; SCHIP = State Children's Health Insurance Program; n.a. = not applicable.

a. Includes \$9.6 billion in budget authority from prior fiscal years.

Phase I: Voluntary Expansion, 2001-2005. CBO assumed that all states would participate in the FamilyCare program to receive higher matching funds for expanding eligibility. Nonetheless, some states might choose not to take part during the voluntary phase. Poorer states already have higher-than-average matching rates in Medicaid and would receive only a modest enhancement under the proposal. In addition, states that now have more restrictive eligibility standards for adults and children and are not spending all of their SCHIP allotments might see little reason to participate voluntarily. States might also tailor the timing and magnitude of their participation in FamilyCare with an eye to the shortfall occurring in phase II.

CBO estimates that the first phase of FamilyCare would increase spending by \$26.6 billion through 2010. About 20 percent of that spending would be for states to meet the conditions of participating in FamilyCare. Approximately 20 states now have eligibility limits for SCHIP below 200 percent of the poverty level. Expanding those limits to qualify for FamilyCare would lead some of the states to exhaust their SCHIP allotments; CBO assumed that they would be able to use funds from their FamilyCare allotments to cover any shortfall. Eliminating waiting lists for SCHIP would have a similar effect on states whose SCHIP programs were near their allotment limits.

Making SCHIP funds available for five rather than three years, as the President proposes, would reduce SCHIP outlays by an estimated \$0.9 billion in 2001. Because SCHIP funds that remain unspent after three years are reallocated to states that have used up their allotments, giving states two more years to spend their allotments would essentially shift SCHIP funds to states that are less likely to spend them. States that had been planning to use reallocated SCHIP money in 2001 would have to compensate for the change by cutting their program, using state funds to make up the difference, or (if their SCHIP program was implemented as a Medicaid expansion) covering the affected beneficiaries under the state's regular Medicaid program. In later years, those states could also respond by using a portion of their FamilyCare allotments.

During the 2001-2005 period, CBO estimates, states would spend \$10.9 billion of their FamilyCare

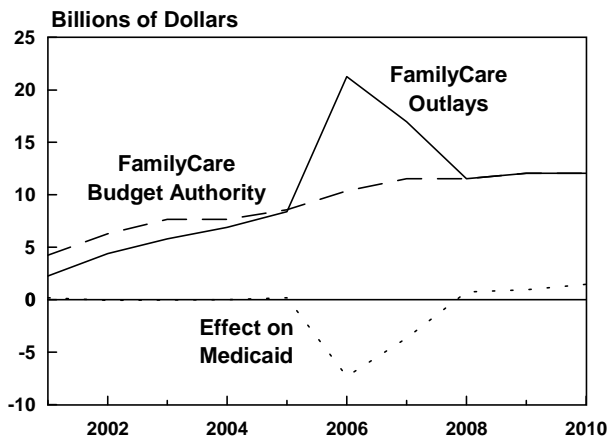
allotments. About 85 percent of that would cover parents of Medicaid children, with the rest covering parents of SCHIP children. Total SCHIP/FamilyCare allotment amounts over the period would be sufficient to pay for that spending, particularly because many states have significant unspent SCHIP funds. CBO assumes that states would expand their coverage of parents gradually, enrolling 50 percent of eligible parents with income below the poverty level, 25 percent of parents of Medicaid children with family income above the poverty level, and 12.5 percent of parents of SCHIP children by 2005.

The FamilyCare program would affect Medicaid in several ways during that period. First, Medicaid spending would increase as states that expanded their SCHIP programs identified children who were eligible for Medicaid. Second, Medicaid would pick up the costs for some of the children who lost SCHIP coverage because of the extension of funding availability from three to five years. Third, FamilyCare would induce some parents of children who were eligible for Medicaid but not enrolled to enroll their children. In the other direction, several states that would expand coverage to parents of Medicaid children anyway (after January 1, 2000) under current law would probably implement those expansions through FamilyCare, with its enhanced federal match, instead of through Medicaid. That switch would reduce Medicaid outlays, CBO estimates. On balance, the FamilyCare program would increase federal spending for Medicaid by \$0.3 billion over the 2001-2005 period (see Figure 2-2).

Phase II: Mandatory Expansion, 2006 and After. In 2006, as states were required to make all parents of Medicaid children with family income below the poverty level eligible for Medicaid (at an enhanced matching rate), FamilyCare spending on those parents would drop. At the same time, federal Medicaid spending would surge by more than \$4 billion a year to cover those parents and others made newly eligible under the requirement.

From a budgetary standpoint, a more significant change would occur in 2006: states that already covered parents of Medicaid children with family income above the poverty level as well as children beyond federally mandated levels would begin paying for those beneficiaries through FamilyCare instead of Medicaid

Figure 2-2.
Budget Authority and Outlays Under the
President's FamilyCare Proposal, 2001-2010
(By fiscal year)



SOURCE: Congressional Budget Office.

NOTE: The numbers for FamilyCare include budget authority and outlays projected under current law for the State Children's Health Insurance Program, which FamilyCare would replace. They assume the spending constraints in the President's budget.

(at an enhanced matching rate). Ignoring any constraints imposed by available funding, CBO estimates that the shift would cost FamilyCare \$14.6 billion in 2006 and a total of \$85.4 billion over the 2006-2010 period. Medicaid outlays would plummet by \$11.9 billion in 2006 and a total of \$69.5 billion through 2010 as a result of that shift. The net effect on federal outlays—a \$15.8 billion increase over the 2006-2010 period—reflects the higher cost of covering those beneficiaries under FamilyCare's enhanced matching rate. About 75 percent of the additional outlays would be for children.

Insufficient Funding. If the FamilyCare proposal was adequately funded, program spending would total \$112 billion over the 2001-2010 period. (Including outlays for SCHIP, that amount would be \$150 billion.) But in CBO's view, the amounts requested for FamilyCare in the President's budget would not be enough, even when combined with SCHIP allotments. Problems would begin in 2007, when states would have only \$17 billion available to cover an estimated \$23 billion in spending (see Table 2-4).

If states ran out of FamilyCare funds, about 90 percent of FamilyCare beneficiaries would retain Medicaid coverage. Those beneficiaries include parents of Medicaid children with family income above the poverty level and Medicaid children with family income above the federally mandated minimums. States would continue to cover those people under their Medicaid programs but would receive the lower Medicaid matching rate.

Prospects for SCHIP children and their parents would be murkier. In states that had enrolled them through an expanded Medicaid program, those enrollees would still be entitled to Medicaid after FamilyCare funds ran out. But enrollees would have no such guarantee in states that had created separate programs. Those states would face three choices when FamilyCare funds were exhausted: scale back their programs, fund any additional costs entirely from state coffers, or make their Medicaid eligibility standards less restrictive (which would allow them to receive additional federal matching funds, albeit at the lower Medicaid rate).

The constraints imposed by the President's budget request for FamilyCare would reduce the program's outlays substantially—to \$64 billion over the 2001-2010 period, CBO estimates, compared with \$112 billion. Likewise, Medicaid savings would be only \$7 billion over 10 years, compared with \$43 billion (see Table 2-4).

Comparison with the Administration's Estimate. CBO's estimate of net federal outlays under the FamilyCare proposal is substantially lower than the Administration's estimate. CBO projects that those outlays, including savings in Medicaid, would total \$56.2 billion through 2010 (with funding constraints). By contrast, the Administration estimates the net cost of the proposal at \$76.0 billion.

Other Proposals to Expand Eligibility

Expanded Coverage of 19- and 20-Year-Olds. Under current law, states are limited in their ability to cover 19- and 20-year-olds in Medicaid. People in that age group can qualify for Medicaid if they are pregnant, disabled, or have children of their own en-

rolled in the program and meet welfare-related standards. Some people who were formerly in foster care are also eligible. In all, about 1 million 19- and 20-year-olds, mostly with income below 200 percent of the poverty level, receive Medicaid through one of those categories. States are not allowed to cover 19- and 20-year-olds in their SCHIP programs.

The President's budget would give states the option of covering 19- and 20-year-olds in both programs. CBO anticipates that states that together contain 25 percent of the eligible people in that age group would take up the option for Medicaid and that states with 5 percent of the eligible population would do so for SCHIP. As a result, CBO estimates, the proposal would increase enrollment of 19- and 20-year-olds in Medicaid by about 10 percent, raising spending by \$1.7 billion over the next decade. Spending for SCHIP would increase by \$0.4 billion (see Table 2-3).

Expanded Eligibility for Long-Term Care Services.

The President's budget would also allow states to extend Medicaid eligibility for noninstitutional long-term care services to certain aged or disabled people with income up to 300 percent of the SSI standard (which is now \$512 per month). Qualified individuals would require the same high level of medical and social support needed by people in institutions and those receiving home- or community-based services.

Current law lets states expand eligibility for all aged or disabled people with income up to the poverty level. Many states set substantially higher income limits for people requiring institutional long-term care; that limit is commonly set at 300 percent of the SSI standard (which corresponds to about 225 percent of the poverty level). In addition, states can offer noninstitutional long-term care services to qualified people at similar income levels through special waivers for home- and community-based services.

Under the President's proposal, states could expand eligibility more broadly than under a waiver, which frequently limits enrollment to a specific, narrow set of people. However, CBO assumes that relatively few states—representing 5 percent of total Medicaid enrollment—would take advantage of the option, because of concerns about potentially large jumps in enrollment. (Many people in the expanded

income-eligibility range who do not receive long-term care services under current law could meet the qualifications for institutional or waiver care.) CBO estimates that this proposal would increase Medicaid spending by a total of \$1.3 billion over the 2001-2010 period.

Coverage for Certain Women with Breast or Cervical Cancer.

The President's budget would give states the option of providing Medicaid coverage to women who have been screened under the CDC's Breast and Cervical Cancer Early Detection Program and found to have breast or cervical cancer. Currently, screening services under that program are available only to women with income up to 250 percent of the poverty level (most states set their eligibility criteria at about 200 percent of the poverty level). States that exercised this option would receive the regular Medicaid matching rate from the federal government. CBO estimates that states that account for 15 percent of total Medicaid costs would expand eligibility in 2001 under this proposal. By 2005, that share would rise to around 30 percent. Under those assumptions, the proposal would increase federal Medicaid spending by \$0.6 billion over 10 years, CBO estimates.

Eligibility for Some Legal Immigrants.

The President's budget contains three proposals that would soften the restrictions on Medicaid eligibility for legal immigrants that were enacted as part of welfare reform. Under that reform, most legal immigrants who entered the country after August 22, 1996, are not eligible for nonemergency Medicaid services until they accumulate 10 years of Social Security-covered employment or become naturalized citizens. Eligibility was also tightened for other means-tested programs, such as SSI and Food Stamps.

Under the President's budget, immigrants who had been in the country for five years and who became disabled after entry would be allowed to receive SSI disability benefits. That proposal would also affect Medicaid because most SSI recipients are automatically eligible for Medicaid. In addition, the budget would give states the option of expanding their Medicaid programs to cover immigrant children and pregnant women. (The option for immigrant children would also make them eligible for SCHIP.)

CBO estimates that those proposals would increase federal outlays for Medicaid by \$10.2 billion and for SCHIP by \$0.2 billion through 2010. Most of the additional outlays—\$8.8 billion—would be for disabled immigrants receiving SSI. Those estimates are based on historical data about immigrants' participation in SSI and Medicaid; they also account for the fact that immigrants already receive limited Medicaid benefits if they require emergency medical treatment. On the basis of discussions with state officials, CBO assumed that states that together contain 90 percent of total Medicaid enrollees would ultimately choose to cover immigrant children and pregnant women.

Extension of Transitional Medicaid. Under current law, states must provide "transitional" Medicaid coverage to beneficiaries who would normally lose their Medicaid coverage when their earnings increase. States are required to cover those people for at least six months without regard to their earnings and for up to a year subject to certain income limits. Some states have extended that coverage to 18 or 24 months. The requirement will expire at the end of fiscal year 2001. The President's budget would permanently extend it and simplify income-reporting requirements for people enrolled in transitional Medicaid. CBO estimates that those changes would increase spending by \$4.8 billion through 2010.

Proposals to Increase Outreach

Some 4 million to 5 million children meet the eligibility standards for Medicaid but are not enrolled in the program. The President's budget includes three initiatives that aim to get more of those children enrolled by increasing outreach efforts. The first would let states expand the kinds of entities that can conduct presumptive eligibility determinations (which enroll poor, uninsured children in Medicaid on a temporary basis until a full determination of their eligibility can be made) to include schools, SCHIP workers, and homeless shelters. The second initiative would give states access to income information from the National School Lunch Program, which would give them another tool to identify eligible but unenrolled children. The third proposal would require states to make their enrollment requirements for Medicaid as simple as those for their SCHIP programs.

CBO estimates that those outreach proposals would bring less than 5 percent of the eligible but unenrolled children into Medicaid. As a result, the proposals would increase federal Medicaid spending by \$1.2 billion over the next decade. They would also increase SCHIP spending by \$0.1 billion through 2010.

Proposals Affecting Medicaid's Prescription Drug Benefit

Unlike Medicare, Medicaid covers prescription drugs for many beneficiaries. To lower Medicaid's spending on prescription drugs, HCFA negotiates rebates with drug manufacturers. The President's budget contains three proposals that would affect the program's prescription drug benefit. They would provide data about drug prices to state Medicaid programs, require an additional rebate from manufacturers of generic drugs, and extend coverage to certain drugs intended to help people stop smoking.

Providing Average Manufacturer Price Data to State Medicaid Programs. The President proposes allowing the Secretary of Health and Human Services (HHS) to give state Medicaid programs information about the average manufacturer price (AMP) of each drug that Medicaid covers. The AMP is the price that wholesalers pay, including discounts and price reductions, for drugs distributed to retail pharmacies. Drug manufacturers are required to provide that information on a confidential basis to HCFA in order to participate in Medicaid. HCFA uses the AMP information to calculate the amounts that manufacturers owe under Medicaid's rebate program (which is explained below). Most states set their drug reimbursement rates on the basis of estimates of pharmacies' acquisition costs plus a dispensing fee. States generally arrive at those estimates by applying a discount to the published list price. Certain drugs are also subject to specific upper payment limits.

Having AMP data would let states reevaluate their current payment rates. But the degree to which they would incorporate the new information is highly uncertain. CBO assumes that states would use the AMP data to reduce their reimbursement rates, lowering Medicaid outlays by \$1.3 billion through 2010.

Requiring an Additional Rebate from Manufacturers of Generic Drugs. Under current law, pharmaceutical manufacturers must sign a rebate agreement with the Secretary of HHS before Medicaid will cover their products. Rebates are based specifically on the AMP and on the number of units of the drug purchased by Medicaid. Manufacturers of both brand-name and generic drugs pay a basic rebate to Medicaid, but those rebates are calculated using different formulas. For makers of generic and other over-the-counter drugs, the basic rebate equals 11 percent of the AMP. For brand-name drugs, manufacturers must pay an additional rebate if they increase the prices of those drugs at a higher rate than general inflation. The additional rebate discourages manufacturers from circumventing the effect of the basic rebate by raising prices. The President's budget would extend that additional rebate to generic drugs.

Given the competitive nature of the market for generic drugs, extending the additional rebate to cover those drugs would bring in significantly less money than the additional rebates on brand-name drugs do. Nevertheless, recent evidence suggests that price increases for some generic products have exceeded general inflation. CBO estimates that this proposal would save \$0.8 billion over 10 years.

Mandating Coverage of Smoking-Cessation Drugs. Medicaid allows states to exclude coverage of certain types of drugs, including drugs for fertility, cosmetic purposes, and smoking cessation. However, an increasing number of states have recently expanded their coverage of smoking-cessation drugs, although the scope of that coverage varies from state to state. The President proposes requiring all states to cover prescription drugs, and at least one over-the-counter product, for smoking cessation. CBO estimates that this proposal would increase Medicaid outlays by \$0.2 billion over the 2001-2010 period.

Proposal to Reduce Medicaid's Administrative Costs

Before the 1996 welfare reform law, the three major public assistance programs—Aid to Families with Dependent Children (AFDC), Food Stamps, and Medic-

aid—all reimbursed states for 50 percent of most administrative costs. States usually charged the common administrative costs of those programs to AFDC. When the welfare reform law replaced AFDC with Temporary Assistance for Needy Families (TANF), an amount equal to historical administrative costs (including the common costs of administering Medicaid and Food Stamps) was included in the states' block grants. Under current law, states must charge part of the common costs of Medicaid and TANF to Medicaid, even if those costs are already included in their TANF block grants.

The President's budget proposes to reduce federal reimbursement for Medicaid administrative costs to reflect costs that are estimated to be covered by the TANF block grant. The reduction would amount to about one-third of the common costs of administering those programs. However, the proposal would allow states to use TANF funds to pay those costs. CBO estimates that the proposal would reduce federal Medicaid outlays by \$3.6 billion over 10 years. But outlays for TANF would rise by \$0.8 billion over that period as states offset some of the drop in Medicaid reimbursements.

Interactions with Medicare Proposals

Because Medicaid pays premiums and cost-sharing amounts for many Medicare beneficiaries with low income, policies that affect Medicare spending often have an impact on the Medicaid program. Several of the President's proposals for Medicare (which are described later in this chapter) would affect Medicaid spending for those beneficiaries. CBO estimates that the net effect of the proposals (excluding the proposal to add a prescription drug benefit to Medicare) would be to increase federal Medicaid outlays by \$0.8 billion through 2010.

The President's prescription drug proposal for Medicare would have a substantially greater effect on Medicaid spending for low-income Medicare beneficiaries. That effect is described in greater detail below, but its net cost to Medicaid would be \$12.4 billion over the next decade. Moreover, Medicaid would incur further costs because the new drug benefit would

induce more low-income Medicare beneficiaries to enroll in Medicaid. CBO estimates those additional costs at \$6.3 billion through 2010.

Other Proposals

The President's budget contains several other proposals that would have a small net effect—less than \$50 million a year—on Medicaid spending. They include initiatives that would save money by combating fraud and improving program operations, such as providing the Secretary of HHS with stronger enforcement tools, allowing civil penalties to be pursued against nursing home chains, and strengthening enforcement of orders for parents to pay medical child support. The budget also includes proposals that would increase Medicaid spending, such as launching an asthma-management initiative, exempting caregivers when Medicaid costs are recovered from estates, changing the car allowance rules in the Food Stamp program, and making certain housing funds contingent on the use of Medicaid waivers for home- and community-based services.

Spending and Enrollment Trends in Medicare

The growth rate of Medicare spending has slowed dramatically in recent years. After increasing by an average of 11 percent per year from 1990 through 1995, spending rose by 8 percent in 1996 and just 1.5 percent in 1998. In 1999, Medicare spending did not grow at all but instead declined by 0.7 percent.²

The decline in 1999 stems from several factors. First, it reflects a continuation of two trends that began in the mid-1990s: a slowing of growth in enrollment, and the effect of antifraud initiatives on compliance with Medicare's rules for payment. Second, the drop reflects changes in payment rates and other program rules required by the Balanced Budget Act (BBA).

2. Spending for Medicare benefits dropped by 0.9 percent in 1999, but that decrease was partially offset by an increase in spending for program administration.

The lull in the growth of Medicare spending is likely to prove short—in part because the Medicare, Medicaid, and SCHIP Balanced Budget Refinement Act of 1999 (BBRA) will increase Medicare's payments to health care providers beginning in 2000. CBO projects that spending growth will resume in the next few years and will average about 7 percent annually through both 2005 and 2010 (see Table 2-5). Total Medicare outlays (mandatory and discretionary) are projected to nearly double by the end of the decade, to \$438 billion. Much of that increase will reflect rising costs per beneficiary. Enrollment will expand only modestly, as the last of the relatively small cohorts born in the late 1930s and early 1940s reach age 65.

In the decades after 2010, Medicare spending will grow more rapidly, as the baby boomers begin to turn 65. Between 2010 and 2030, the elderly population will increase at a rate three times faster than between 2000 and 2010. Medicare costs are likely to keep growing considerably faster than program enrollment, however, because of advances in medical technology that are expected to raise health care costs and because of a continued increase in beneficiaries' use of services.

Medicare+Choice

The Balanced Budget Act established the Medicare+Choice program to expand the range of health plans available to beneficiaries and to lay the foundation for a more competitive Medicare system. Building on Medicare's previous risk-based sector, in which all of the plans were health maintenance organizations, Medicare+Choice allows a wider variety of health plans (including preferred provider organizations, private fee-for-service plans, and provider-sponsored organizations) to participate in Medicare. Whereas traditional Medicare pays health care providers on a fee-for-service basis, Medicare+Choice plans receive a fixed amount per enrollee for providing services.

CBO projects that payments for Medicare+Choice and other group plans will soar from \$41 billion this year to \$133 billion in 2010, as enrollment in those plans continues to expand (see Table 2-6). That spending increase also reflects projected growth in

Table 2-5.
Medicare Outlays Under CBO's Baseline Assumptions (By selected fiscal years)

	1990	1999	2000	2005	2010
In Billions of Dollars					
Gross Mandatory Outlays					
Benefits	107	208	217	308	433
Mandatory administration and grants ^a	—*	—1	—1	—1	—2
Total	107	209	218	310	434
Premiums	—12	—22	—22	—34	—51
Mandatory Outlays Net of Premiums	96	188	196	276	383
Discretionary Outlays for Administration	—2	—3	—3	—4	—4
All Medicare Outlays Net of Premiums	98	190	200	279	387
Average Annual Growth Rate from Previous Year Shown (Percent)					
Gross Mandatory Outlays	n.a.	7.7	4.3	7.3	7.0
Premiums	n.a.	6.7	1.3	9.4	8.3
Mandatory Outlays Net of Premiums	n.a.	7.7	4.7	7.0	6.8
Discretionary Outlays for Administration	n.a.	3.6	11.5	3.2	4.1
All Medicare Outlays Net of Premiums	n.a.	7.7	4.8	7.0	6.8

SOURCE: Congressional Budget Office.

NOTE: * = less than \$500 million; n.a. = not applicable.

a. Mandatory outlays for administration pay for peer-review organizations, certain activities against fraud and abuse, and grants to states for assistance with premiums.

costs per enrollee that (under current law) will roughly mirror growth in the fee-for-service sector. Within that sharply upward trend, however, annual changes in Medicare+Choice spending will vary considerably. Those fluctuations result from technical aspects of Medicare's reimbursement policy rather than sudden changes in underlying spending patterns.³

CBO projects that enrollment in Medicare's risk-based plans will grow by about 5 percent this year, to

6.4 million.⁴ That projection is lower than CBO had previously predicted. The reason is that Medicare beneficiaries have become less likely to switch from fee-for-service to Medicare+Choice plans since those plans announced higher premiums and reduced benefits for 2000 and withdrew from some localities. Over the longer run, however, CBO expects Medicare+Choice plans to continue offering more generous benefit packages than fee-for-service Medicare. Consequently, enrollment will continue to grow over the next decade—from 16 percent of Medicare enrollees this year to 31 percent in 2010. Because per-enrollee payments to Medicare+Choice plans are tied to fee-for-

3. Medicare generally pays Medicare+Choice plans on the first day of the month. When the first day falls on a weekend or holiday, payments are shifted to the last business day of the preceding month. In addition, the Balanced Budget Act alters some payment dates for group plans. For those reasons, the number of payments varies each fiscal year from 11 to 13. The growth of Medicare spending for group plans surges in years with 13 payments and slows in years with 11 payments.

4. Another 0.5 million beneficiaries are enrolled in group plans participating in a demonstration project or paid on a cost basis. CBO estimates that enrollment in those plans will decline to 0.1 million in 2010.

Table 2-6.
Outlays for Medicare Benefits, by Sector, Under CBO's Baseline Assumptions (By fiscal year)

Sector	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
In Billions of Dollars												
Group Plans ^a	37	41	48	44	53	60	75	73	90	103	117	133
Fee-for-Service Sector												
Skilled nursing facilities (Part A only)	12	11	12	13	14	15	16	18	19	20	21	23
Home health	10	10	11	12	14	17	19	21	23	26	28	31
Hospice	3	3	3	3	3	4	4	4	4	4	5	5
Hospital inpatient ^b	86	86	90	94	98	103	107	111	116	120	125	130
Physicians' services	33	36	38	40	41	42	43	44	45	45	46	48
Outpatient facilities	15	17	19	21	22	24	25	27	29	31	34	36
Other professional and outpatient ancillary services	13	14	14	15	16	18	19	20	22	23	25	27
Subtotal	171	176	187	198	210	222	234	246	258	270	284	299
Total	208	217	235	242	263	282	308	319	348	373	402	433
Annual Growth Rate (Percent)												
Group Plans ^a	15.1	9.2	16.3	-6.7	19.8	13.2	24.1	-2.1	23.4	14.2	14.0	13.5
Fee-for-Service Sector												
Skilled nursing facilities (Part A only)	-12.5	-2.9	9.2	9.5	5.9	7.0	7.3	7.3	7.0	6.9	6.8	6.9
Home health	-34.9	1.6	13.2	12.1	15.3	16.5	12.8	11.8	10.1	9.8	9.7	9.6
Hospice	18.6	11.0	7.9	6.2	6.5	6.0	5.4	5.2	5.0	4.9	4.9	4.8
Hospital inpatient ^b	-1.3	0.6	3.7	4.5	5.2	4.6	4.0	4.0	4.0	3.9	4.0	3.9
Physicians' services	5.1	7.6	6.0	4.1	3.5	2.9	3.1	2.1	1.4	1.2	2.0	2.8
Outpatient facilities	-8.2	12.3	15.2	8.3	7.2	7.0	6.8	7.1	7.1	7.5	7.6	7.5
Other professional and outpatient ancillary services	5.3	8.4	5.9	6.3	7.3	7.7	7.3	7.2	7.2	7.6	7.8	7.7
All Fee-for-Service	-3.8	3.1	6.4	5.7	5.9	5.8	5.3	5.1	4.9	4.9	5.2	5.3
All Medicare Benefits	-0.9	4.2	8.3	3.2	8.5	7.3	9.3	3.4	9.1	7.3	7.6	7.7
Memorandum:												
Part A Enrollment (Millions of people)												
Group plans ^a	6.6	6.9	7.2	7.5	7.9	8.6	9.4	10.3	11.2	12.2	13.3	14.2
Fee-for-service sector	32.2	32.3	32.5	32.7	32.7	32.7	32.4	32.2	32.0	31.9	31.9	31.8
Total	38.8	39.3	39.7	40.2	40.7	41.2	41.8	42.5	43.3	44.2	45.1	46.0
Group Plans as a Percentage of Part A Enrollment	17	18	18	19	20	21	22	24	26	28	29	31
Change in Part A Enrollment (Percent)												
Group plans ^a	14.5	4.4	3.3	4.1	6.5	7.8	9.6	9.5	9.3	9.0	8.2	7.2
Fee-for-service sector	-1.4	0.4	0.6	0.5	0.1	-0.2	-0.7	-0.7	-0.5	-0.3	-0.2	-0.1
Both Sectors	1.0	1.1	1.1	1.1	1.3	1.4	1.4	1.6	1.8	2.1	2.2	2.0
Part B Enrollment (Millions of people)	36.9	37.3	37.7	38.0	38.4	38.9	39.4	39.9	40.6	41.4	42.2	43.0
Number of Capitation Payments ^c	12	12	13	11	12	12	13	11	12	12	12	12

SOURCE: Congressional Budget Office.

- Includes Medicare+Choice, health maintenance organizations paid on a cost basis, and demonstration contracts paid under Medicare Part A. Does not include health care prepayment plans, which are paid on a cost basis for Part B services.
- Includes subsidies for medical education that are paid to hospitals that treat patients enrolled in Medicare+Choice plans.
- In general, capitation payments to group plans for the month of October are shifted to the preceding fiscal year when October 1 falls on a weekend. In addition, the Balanced Budget Act of 1997 shifts payments that would otherwise have been made on October 1, 2001, to the last business day of September 2001. The October payments in 2000 and 2006 will be made on October 2 instead of September 29.

service expenditures, higher enrollment in those plans does not necessarily slow the growth rate of Medicare spending.

Fee-for-Service Medicare

CBO projects that spending in Medicare's fee-for-service sector will increase from \$176 billion in 2000 to \$299 billion in 2010. That growth will occur despite shrinkage in fee-for-service enrollment—which will decline by 500,000 over the next decade—and cuts in the growth of payment rates for many services. Spending growth for different types of services will vary considerably over that period.

Postacute Care Services. Growth in payments for skilled nursing facility (SNF) and home health services—the fastest-growing areas of fee-for-service spending in the decade before the Balanced Budget Act—slowed significantly beginning in 1998. Spending for home health care fell by 14.9 percent in 1998 and by an even more dramatic 34.9 percent in 1999. SNF expenditures, by contrast, rose by 8.8 percent in 1998, but that was less than half the rate of the previous year. Spending for SNF services then dropped by 12.5 percent in 1999. Growth in payments for hospice services slowed to 1 percent in 1998, down from 5.7 percent the previous year. In 1999, however, growth in hospice payments soared to 18.6 percent.

The slowdown in spending for SNF and home health services mostly resulted from the new prospective payment systems enacted in the BBA. Increases in the time to process claims also played a role, particularly for SNF services. The delay between provision of services and payment by Medicare accounted for 1.5 percentage points of the drop in home health payments, on average, in 1998 and 1999. The payment lag accounted for 2.2 percentage points of the drop in SNF payments in 1998 and 5.5 percentage points in 1999. CBO expects claims for postacute care services to be processed more quickly in later years, eliminating the drag on spending.

The BBRA temporarily increased the payment rates for SNF services (from April 2000 through September 2002) and postponed by a year the 15 percent cut in payments for home health services that had been

scheduled for October 2000. The transition to prospective payment systems and the implementation of those BBRA provisions are expected to restore the growth of spending for postacute services. That spending is projected to increase through 2010 at an average annual rate of 7 percent for SNF services and 12 percent for home health services. Growth in payments for hospice services is expected to decrease to its long-term trend of around 5 percent per year by 2005.

Inpatient Hospital Services. Medicare payments for inpatient hospital services fell by 1.3 percent in 1999, to \$86 billion. The factors contributing to that drop included a decline in the volume of services provided as well as provisions in the BBA that froze payment rates for most operating costs, reduced capital-related payment rates by 17.8 percent, and cut subsidies for medical education. In addition, the case-mix index (a measure of the relative costliness of the cases treated in hospitals paid under the prospective payment system) fell by 0.5 percent in 1999 after falling by the same amount in 1998. The drop in that index may be attributable to the widespread adoption by hospitals of less aggressive billing practices following antifraud initiatives that focused on those practices.

For most hospitals, the Balanced Budget Act limits cumulative increases in payment rates for operating costs to about 6 percentage points below the total rate of inflation over the 1999-2002 period. Although the BBRA eased some of those limits for certain hospitals, continuing limits on rate increases will result in only a 0.6 percent rise in total payments for inpatient hospital services in 2000, CBO projects. After the BBA limits expire, however, annual growth rates are expected to accelerate again, averaging 4.2 percent from 2001 through 2010.

Physicians' Services. Medicare payments for physicians' services rose by 5.1 percent in 1999, to \$33 billion. Payments are projected to increase to \$36 billion this year and to grow at an average annual rate of 2.9 percent over the next decade, reaching \$48 billion in 2010. That growth rate results from payment formulas enacted in the BBA that tie the growth of enrollee spending for physicians' services to the growth of gross domestic product per capita.

Outpatient Services. Payments to outpatient facilities—such as hospitals' outpatient departments, therapy providers, dialysis facilities, and rural health clinics—fell by 8.2 percent in 1999, in part because the BBA's caps on therapy services were implemented. Those payments are projected to rebound this year and to grow by 15.2 percent in 2001 because of increases in prospective payment rates enacted in the BBRA. Annual growth rates are then expected to level off at 7 percent to 8 percent for the rest of the decade.

In 1999, Medicare spent almost \$13 billion on nonphysician professional services and other outpatient ancillary services—including Medicare-covered prescription drugs, durable medical equipment, ambulance services, and chiropractic care. Those outpatient costs are projected to grow, on average, by roughly 7 percent a year for the rest of the decade. That growth results in large part from rising payments for the limited category of drugs covered under Part B of Medicare.

The President's Proposals for Medicare

The President's budget request for 2001 includes provisions to expand Medicare eligibility to new populations, extend Medicare coverage to services such as prescription drugs, and reduce the growth of program spending for services covered under current law. Populations newly eligible for Medicare would include certain people between the ages of 55 and 64, who would be allowed to buy in to the program. The cost of those expansions would be offset by savings in Medicare's fee-for-service sector, which would have spillover effects on Medicare+Choice spending and also result in lower Part B premiums. The net effect of the President's Medicare proposals would be to increase Medicare spending by a total of \$69 billion through 2010 (see Table 2-7).

The budget also includes a \$750 million demonstration project to let Medicare beneficiaries participate in clinical trials. That program would be paid for

through the Treasury's general fund rather than the Medicare trust funds.

Proposals to Modify Traditional Medicare

The President proposes a variety of policy changes that would affect beneficiaries, providers, and health plans participating in Medicare, including:

- o Reductions in payments for certain services;
- o Modernization initiatives that would add innovations in health care financing used in the private sector to fee-for-service Medicare;
- o Adjustments to beneficiaries' cost-sharing requirements; and
- o New requirements to improve compliance with Medicare's payment rules.

Those proposals would reduce projected fee-for-service spending by \$40.4 billion between 2001 and 2010. Because the growth of spending in Medicare+Choice plans is linked to the growth of spending in the fee-for-service sector, those reductions would also lower payments to Medicare+Choice plans (by \$14.0 billion over 10 years). The President also proposes to accelerate implementation of methods of adjusting payments to Medicare+Choice plans to reflect health risks more accurately. That provision would reduce spending during the next decade by \$0.5 billion.

One-quarter of the gross savings in spending for Medicare Part B would be returned to beneficiaries in the form of lower premiums. Thus, beneficiaries would save \$6.3 billion through 2010 (see Table 2-7).

Reductions in Payments. Under the President's proposals, payments to certain providers and suppliers would fall significantly. In principle, those rates are updated each year to reflect changes in the costs of inputs (such as wages, medical equipment, drugs and other supplies, and so on). For many services, the Balanced Budget Act holds the increases in payment rates below the annual rate of inflation through 2002, with full adjustment for inflation resuming in 2003.

The President's proposals would continue holding those payment increases below inflation through 2005.

The largest savings would come from extending the BBA's reductions in annual payment updates for inpatient hospital services. The President proposes to reduce the annual updates for hospitals paid under the prospective payment system by 0.8 percentage points for urban hospitals and 0.4 percentage points for rural hospitals between 2003 and 2005. In addition, the BBA's provision to lower prospective capital payments to hospitals by 2.1 percent would be extended through 2005. Those provisions would save \$14.0 billion through 2010 (see Table 2-8). Additional savings would come from extending the BBA's update reductions through 2005 for hospitals paid on the reasonable-cost basis established by the Tax Equity

and Fiscal Responsibility Act of 1982; for suppliers of durable medical equipment, prosthetics and orthotics, and parenteral and enteral nutrition; for clinical laboratory services; and for ambulance services. Those provisions would lower spending by another \$5.0 billion through 2010.

The BBA reduced Medicare's payments for the bad debts that hospitals incur. The President's budget would further reduce those payments and would extend the reduction in payments for bad debts to other providers. Those providers include SNFs, providers of outpatient physical therapy, comprehensive outpatient rehabilitation facilities, community mental health clinics, federally qualified health centers, and rural health clinics. Total savings from reducing bad-debt payments would be \$5.3 billion through 2010.

Table 2-7.
CBO's Estimate of Changes in Medicare Spending Under the President's Proposals
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Changes to Traditional Medicare												
Reductions in payments	-0.8	-1.0	-1.9	-2.8	-3.6	-3.7	-3.9	-4.1	-4.3	-4.5	-10.0	-30.6
Fee-for-service modernization	0	-0.1	-0.2	-0.5	-0.7	-0.8	-0.9	-0.9	-0.9	-1.0	-1.6	-6.0
Adjustments to beneficiaries' cost sharing	0	0	0	*	-0.1	-0.2	-0.3	-0.4	-0.5	-0.6	-0.1	-2.2
Requirements to improve compliance	*	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.3	-0.3	-0.6	-1.9
Immunosuppressive drugs	*	*	*	*	*	*	*	*	*	*	*	0.2
Medicare+Choice	0	3.4	-4.6	-1.0	-1.5	-1.5	-1.8	-2.1	-2.5	-2.8	-3.7	-14.5
Part B premium receipts	<u>0.2</u>	<u>0.3</u>	<u>0.4</u>	<u>0.5</u>	<u>0.6</u>	<u>0.7</u>	<u>0.8</u>	<u>0.9</u>	<u>1.0</u>	<u>1.1</u>	<u>2.0</u>	<u>6.3</u>
Subtotal	-0.6	2.5	-6.5	-4.0	-5.4	-5.7	-6.3	-6.9	-7.5	-8.2	-14.1	-48.6
Expanded Eligibility												
Benefits	0	1.8	3.3	4.0	5.0	5.8	6.5	7.1	7.9	9.1	14.1	50.4
Premium receipts	<u>0</u>	<u>-2.0</u>	<u>-3.2</u>	<u>-4.0</u>	<u>-5.0</u>	<u>-5.8</u>	<u>-6.4</u>	<u>-7.0</u>	<u>-7.9</u>	<u>-9.0</u>	<u>-14.2</u>	<u>-50.2</u>
Subtotal	0	-0.2	*	*	*	0.1	0.1	0.1	0.1	*	-0.1	0.2
Prescription Drug Benefit												
Medicare and ESI outlays	0	0	14.7	21.6	26.8	29.9	35.1	38.7	44.4	49.0	63.1	260.4
Part D premium receipts	<u>0</u>	<u>0</u>	<u>-7.8</u>	<u>-10.8</u>	<u>-13.4</u>	<u>-14.8</u>	<u>-17.5</u>	<u>-19.1</u>	<u>-22.0</u>	<u>-24.2</u>	<u>-32.0</u>	<u>-129.7</u>
Subtotal	0	0	6.9	10.8	13.4	15.1	17.6	19.6	22.4	24.8	31.1	130.6
Competitive Defined Benefit												
Payments to plans	0	0	-1.9	-4.2	-7.2	-11.0	-12.5	-14.2	-16.1	-18.1	-13.3	-85.2
Premium receipts	<u>0</u>	<u>0</u>	<u>1.6</u>	<u>3.5</u>	<u>6.1</u>	<u>9.3</u>	<u>10.6</u>	<u>11.9</u>	<u>13.5</u>	<u>15.2</u>	<u>11.2</u>	<u>71.5</u>
Subtotal	0	0	-0.3	-0.7	-1.1	-1.8	-2.0	-2.3	-2.6	-2.9	-2.1	-13.7
Total Change in Outlays	-0.6	2.2	0.1	6.2	6.8	7.7	9.5	10.6	12.4	13.8	14.7	68.6

SOURCE: Congressional Budget Office based on the March 2000 baseline.

NOTE: * = between -\$50 million and \$50 million; ESI = employer-sponsored health insurance.

Table 2-8.
CBO's Estimate of the President's Proposals to Modify Traditional Medicare
(By fiscal year, in billions of dollars)

Proposal	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Gross Mandatory Medicare Outlays												
Reductions in Payments												
PPS hospital payments	0	0	-0.6	-1.3	-1.9	-1.9	-2.0	-2.0	-2.1	-2.2	-3.8	-14.0
TEFRA hospital payments	0	0	-0.1	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.7	-2.6
Laboratory, ambulance, DME, PEN, and P&O updates	0	0	-0.1	-0.2	-0.3	-0.3	-0.4	-0.4	-0.4	-0.5	-0.5	-2.5
Bad-debt payments	-0.4	-0.4	-0.5	-0.5	-0.5	-0.5	-0.6	-0.6	-0.6	-0.7	-2.3	-5.3
Other reductions	-0.4	-0.6	-0.6	-0.6	-0.6	-0.6	-0.6	-0.7	-0.8	-0.8	-2.7	-6.2
Fee-for-Service Modernization												
Centers of excellence	0	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.9
Preferred provider organizations	0	-0.1	-0.2	-0.3	-0.4	-0.5	-0.5	-0.5	-0.5	-0.6	-0.9	-3.5
Competitive acquisition	0	0	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.8
Contracting reform	0	0	0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.8
Disease and primary care case management	0	*	*	*	*	*	*	*	*	*	*	*
Adjustments to Beneficiaries'												
Cost Sharing												
Part B deductible indexed to CPI	0	0	*	-0.1	-0.2	-0.3	-0.3	-0.4	-0.5	-0.6	-0.3	-2.4
20 percent copayment for laboratory services	0	0	-0.5	-0.7	-0.7	-0.8	-0.8	-0.9	-1.0	-1.0	-1.9	-6.4
Elimination of cost sharing for preventive services	0	0	0.6	0.8	0.8	0.8	0.9	0.9	0.9	1.0	2.1	6.6
Requirements to Improve Compliance												
Secondary-payer reporting	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.5	-1.3
Partial hospitalization	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5
Other Proposals												
Immunosuppressive drugs	*	*	*	*	*	*	*	*	*	*	*	0.2
Medicare+Choice provisions	0	3.7	-4.1	-0.1	*	0	0	0	0	0	-0.5	-0.5
Interaction with Medicare+Choice												
Payment Rates ^a	0	-0.3	-0.6	-0.9	-1.5	-1.5	-1.8	-2.1	-2.5	-2.8	-3.2	-14.0
Subtotal	-0.8	2.1	-6.9	-4.5	-6.0	-6.4	-7.1	-7.7	-8.5	-9.2	-16.1	-54.9
Premiums												
Changes in Part B Premiums for Beneficiaries Enrolled Under Current Law ^b	0.2	0.3	0.4	0.5	0.6	0.7	0.8	0.9	1.0	1.1	2.0	6.3
Mandatory Medicare Outlays Net of Premiums												
Total	-0.6	2.5	-6.5	-4.0	-5.4	-5.7	-6.3	-6.9	-7.5	-8.2	-14.1	-48.6

SOURCE: Congressional Budget Office.

NOTE: * = between -\$50 million and \$50 million; PPS = prospective payment system; TEFRA = Tax Equity and Fiscal Responsibility Act of 1982 (facilities are paid on a reasonable-cost basis); DME = durable medical equipment; PEN = parenteral and enteral nutrition; P&O = prosthetics and orthotics; CPI = consumer price index.

- a. The effect on payments to Medicare+Choice plans of changes in the rate of growth of fee-for-service spending.
- b. The effect on Part B premiums of changes in Part B spending per capita.

Other services for which payments would be reduced include outpatient drugs, tests performed by clinical laboratories, and prosthetic and orthotic devices. The Administration also proposes to lower Medicare's payments for erythropoietin, a drug used by patients with end-stage renal disease who are receiving dialysis. In addition, the President's budget would eliminate Health Professional Shortage Area bonus payments for nonprimary care physicians practicing in urban areas. If enacted, those changes would save \$6.2 billion through 2010.

Fee-for-Service Modernization. The Balanced Budget Act took important steps toward improving the efficiency of Medicare's fee-for-service sector by establishing prospective payment systems for several services. The President's budget would seek further efficiencies by extending and making permanent a "centers of excellence" program that lets Medicare contract with certain hospitals to treat particular disorders. Those hospitals would be chosen on a competitive basis.

Under the proposal, the Secretary of HHS would be authorized to pay selected hospitals a single, bundled rate for all services associated with an acute hospital admission. The first contracts incorporating such payments would be established in 2002 for cardiac surgery and knee and hip replacements. Contracts for other procedures and medical conditions could be established in the future. CBO estimates that the proposal would save \$0.9 billion through 2010.

The President's budget would also authorize the Secretary of HHS to negotiate discounted payment rates for Medicare services with physicians and hospitals organized as preferred provider organizations. Those providers could make up for the loss in revenue from lower Medicare payments by attracting more patients, who would have lower cost sharing than under fee-for-service Medicare. CBO expects that the negotiated discounts would be small because the majority of Medicare enrollees (about 85 percent) have supplemental coverage that insulates them from cost-sharing requirements and because beneficiaries tend to stay with their current providers. Nevertheless, providers in competitive markets might feel that being designated a "preferred Medicare provider" would be necessary to maintain their patient base or attract new

Medicare patients. Those arrangements would save \$3.5 billion through 2010, CBO estimates.

The President also proposes to give the Secretary authority to contract selectively for some Part B services other than those furnished by physicians. That proposal would expand on a demonstration project in Polk County, Florida, in which Medicare is choosing suppliers through a competitive-bidding process for five types of products: oxygen equipment and supplies, hospital beds and accessories, enteral nutrition products and supplies, urological supplies, and surgical dressings. CBO estimates that allowing more competitive acquisition would save \$0.8 billion through 2010.

In addition, the President would allow both insurance companies and other entities that are experienced in processing claims to compete for Medicare business. The expanded competition would result in more accurate processing of claims, which CBO estimates would save \$0.8 billion over 10 years.

The President would also provide disease-management and primary care case-management services to certain Medicare beneficiaries in the fee-for-service sector. Based on the experience of the Medicare Case Management Demonstration projects conducted between 1993 and 1995—which found that case management failed to reduce overall use or cost of Medicare-covered services—CBO estimates that the proposal would have a negligible effect on spending for Medicare benefits over the 2001-2010 period.

Adjustments to Beneficiaries' Cost Sharing. Other provisions of the President's budget would require fee-for-service enrollees to pay more for Medicare services by indexing the Part B deductible to inflation and requiring coinsurance payments for clinical laboratory services. At the same time, coinsurance for certain preventive services would be eliminated. The net effect of those changes would be to reduce Medicare outlays by an estimated \$2.2 billion through 2010.

Under Part B, beneficiaries must pay for the first \$100 of covered services each year before Medicare begins paying. That deductible amount has remained the same since 1991. Under the President's proposal, it would increase by the percentage change in the con-

sumer price index beginning in 2003. In that year, CBO estimates, the deductible would be \$103, rising to \$122 in 2010.

Clinical laboratory services are an exception to the deductible rules; Medicare pays for 100 percent of those. The President's budget proposal would impose the standard Part B deductible and 20 percent coinsurance requirement on clinical laboratory services (other than preventive services) beginning in 2002. For certain preventive services, however, the proposal would eliminate both the deductible and the 20 percent coinsurance requirement. That change would substantially increase the use of those services and also increase demand for other services.

Requirements to Improve Compliance with Medicare's Payment Rules. The President's budget includes several initiatives to improve compliance with Medicare's payment rules and reduce fraud and abuse. In particular:

- o Group health plans would be required to notify Medicare of beneficiaries for whom they provide primary coverage. HCFA would then know immediately whether Medicare or a private insurer had primary responsibility to pay for a beneficiary's health services.
- o New rules would restrict the provision of partial hospitalization services—outpatient services furnished to patients who might otherwise be hospitalized for the treatment of mental health conditions. In addition, the Secretary of HHS would receive more authority to screen out unqualified providers of that benefit and could impose civil monetary penalties on physicians who falsely certified that patients needed those services.

Together, those provisions would save an estimated \$1.9 billion over 10 years.

Other Proposals. The budget also includes a proposal to lengthen coverage of immunosuppressive drugs for certain beneficiaries who receive organ transplants paid for by Medicare. Transplant recipients who have not exhausted their current drug coverage would qualify for a total of 48 months of continuous coverage for immunosuppressive drugs after their

transplant. All new transplant recipients would also be eligible for 48 months of drug coverage. That policy would amend temporary coverage extensions enacted in the BBRA. CBO estimated that the BBRA allowed for eight additional months of coverage beyond the former 36-month limitation for people eligible in 2000 and 11 additional months of coverage for people eligible in 2001 through 2004. Lengthening drug coverage would generate savings by averting costs associated with kidney rejection, such as rehospitalization, dialysis, and retransplantation. After accounting for those offsetting savings, CBO estimates that permanently extending the period of drug coverage to 48 months would cost \$0.2 billion over the 2001-2010 period.

The President's budget proposes making various changes to the Medicare+Choice program. The most sweeping proposal—to replace Medicare+Choice in 2003 with a new system for making payments to private health plans, called the competitive defined benefit system—is discussed in a separate section below. Before that system is put in place, the budget proposes to repeal the BBRA provision that slowed the implementation of improved methods of adjusting rates paid to Medicare+Choice plans to reflect differences in risk. The President would reestablish the original implementation schedule. Speeding the phase-in of improved risk adjustment would save \$0.5 billion between 2001 and 2010. In addition, the budget would shift the payments owed to Medicare+Choice plans in October 2002 to the end of September 2002. That shift would increase Medicare outlays for fiscal year 2002 and reduce outlays for 2003 but would have no cumulative effect.

Proposals to Expand Medicare Eligibility

The President's proposals to let people under age 65 buy in to the Medicare program are similar to proposals in last year's budget, with one exception. Under the current proposal, participants would be able to claim up to 25 percent of their buy-in premiums as an income tax credit. Two groups would be eligible to participate: people ages 62 to 64 who do not have private health insurance, Medicaid, or other public coverage; and certain workers ages 55 to 61 who lose

their health insurance because of a job loss. The terms of participation would differ for the two groups. Because of the tax credit, CBO's estimate of participation in the buy-in option is higher than the estimate for last year's version, and its estimate of adverse selection among participants is significantly less.

A third proposal to expand Medicare coverage, which would apply to disabled workers, is part of a broader initiative to allow the disabled to return to work and maintain their health insurance coverage.

Buy-In for People Ages 62 to 64. The Administration proposes allowing people ages 62 to 64 who do not have employment-based health insurance, Medicaid, or coverage through another government program to enroll voluntarily in Medicare, provided they do so as soon as they are eligible. Events that would make people eligible include turning 62 or losing employment-based health insurance between ages 62 and 64 under certain circumstances.

Medicare premiums under the buy-in would be paid in two parts, both of which would be adjusted for geographic variations in Medicare's costs and updated annually:

- o Before age 65, enrollees would pay premiums that reflected the average expected cost of benefits if everyone ages 62 to 64 participated in the buy-in. The national average monthly premium would be about \$326 in 2002, the first year of the program. Up to 25 percent of those premiums could be claimed as an income tax credit.
- o At age 65 and thereafter, buy-in participants would pay a premium surcharge (in addition to their regular Medicare premium) to recapture for the government the extra costs that Medicare would pay as a result of adverse selection in the buy-in program. The surcharge would reflect the difference between the premium paid before age 65 and the higher average costs of people who chose to participate in the program. CBO estimates that a person who enrolled in the buy-in program in 2002 at age 62 and stayed until age 65 would pay a surcharge of about \$4 a month in 2005. No part of those premiums could be claimed as an income tax credit.

The buy-in for people ages 62 to 64 would raise outlays for Medicare benefits by \$46.2 billion between 2002, when the program would begin, and 2010, CBO estimates (see Table 2-9).⁵ Premiums would total slightly more than that, resulting in net Medicare savings of \$0.1 billion. Tax revenues would be reduced by about \$7.7 billion because of the tax credit, which CBO assumed about three-quarters of participants would claim. About 650,000 people would participate in the program in 2002, rising to about 1.3 million by 2010. In addition, Social Security benefits would increase by about \$1.4 billion through 2010, under the assumption that approximately 1 percent of people ages 62 to 64 would retire if Medicare coverage was available to them.

Buy-In for Displaced Workers Ages 55 to 61. The Administration also proposes to allow certain workers ages 55 to 61 who lose health insurance because of a job loss to buy in to Medicare. (Their spouses would be eligible for coverage as well.) The program would be available only to people who met several eligibility requirements:

- o Having health insurance coverage for at least 12 months immediately before enrolling in the program;
- o Participating in their employer's plan immediately before losing their job;
- o Being eligible for unemployment insurance benefits; and
- o Being ineligible for any other employment-based or federal health insurance coverage. (That requirement means that workers would first have to exhaust the 18 months of continued coverage from their former employer available under the Consolidated Omnibus Budget Reconciliation Act of 1985, or COBRA.)

Monthly premiums for the buy-in would be about \$460 per person in 2002, but participants could claim a tax credit for up to 25 percent of their payments.

5. The basis for that estimate is similar to the approach that CBO used in estimating previous versions of the proposal. See Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1999* (March 1998), pp. 37-42.

Premiums would be updated annually and adjusted for geographic differences in costs. Those premiums would not quite cover the costs of the program, however, because the program would attract enrollees who expected to have high medical costs. As a result, CBO projects that the program would increase net Medicare outlays by about \$0.2 billion between 2002 (when it began) and 2010, reflecting outlays for benefits of \$4.1 billion and premiums of \$3.9 billion (see Table 2-9). The bulk of the program's costs would come from forgone tax revenue due to the tax credit, amounting to about \$0.7 billion through 2010. The proposal would also encourage a small number of additional workers to seek unemployment insurance, raising federal outlays for unemployment compensation by an estimated \$0.1 billion over 10 years.

Participation in the program would be limited because of the stringent eligibility requirements and the significant premiums that enrollees would pay, although the tax credits for both the buy-in premiums and COBRA premiums would result in substantially higher participation than otherwise. By 2010, CBO

estimates, about 90,000 people would be enrolled in the program at any one time.

Medicare Coverage for the Working Disabled. The Work Incentives Improvement Act of 1999 extended coverage under Medicare's Part A (Hospital Insurance) by four and a half years for certain disabled people who return to work. The President proposes to make that extension permanent. CBO estimates that the change would increase net Medicare outlays by \$0.1 billion over the 2001-2010 period.

Proposal to Add a Prescription Drug Benefit to Medicare

By far the President's costliest proposal for Medicare is to create a voluntary outpatient prescription drug benefit under a new Part D of the program. That benefit would begin in 2003 and be fully phased in by 2009. The benefit would pay half of the cost of prescription drugs, up to a specified cap. It would be

Table 2-9.
CBO's Estimate of the President's Proposals to Expand Medicare Eligibility
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Buy-In for Certain People Under Age 65												
Benefits												
Ages 62 to 64	0	1.8	3.1	3.8	4.6	5.3	5.9	6.4	7.1	8.2	13.2	46.2
Ages 55 to 61	0	0.1	0.2	0.3	0.4	0.5	0.6	0.7	0.7	0.8	0.8	4.1
Premiums												
Ages 62 to 64	0	-2.0	-3.1	-3.7	-4.6	-5.3	-5.8	-6.3	-7.2	-8.3	-13.4	-46.2
Ages 55 to 61	0	-0.1	-0.2	-0.3	-0.3	-0.5	-0.5	-0.6	-0.7	-0.8	-0.8	-3.9
Net Outlays	0	-0.2	*	*	*	0.1	0.1	0.1	*	*	-0.1	0.2
Coverage for the Working Disabled												
Benefits	0	0	0	0	0	0	*	*	0.1	0.1	0	0.2
Premiums	0	0	0	0	0	0	*	*	*	*	0	-0.1
Net Outlays	0	0	0	0	0	0	*	*	*	*	0	0.1

SOURCE: Congressional Budget Office.

NOTE: * = between -\$50 million and \$50 million.

financed half from premium payments by enrollees and half from general government revenues. Taking cost sharing and premiums into account, the average enrollee would pay about 75 percent of the cost of covered drugs, up to the cap. (The President's budget also provides \$35 billion from 2006 through 2010 for a possible catastrophic benefit, but no policy is specified. Consequently, that amount is not included in the estimates discussed below.)

How the Benefit Would Work. In 2003, all Medicare enrollees would have a one-time chance to purchase the new benefit. In later years, enrollees would be permitted to choose the Part D option only when they first became eligible for Medicare, with two exceptions: beneficiaries whose primary coverage was employer sponsored would be given one opportunity to enroll after their retirement (or after the retirement or death of the working spouse), and beneficiaries with employer-sponsored retiree health plans would have a one-time option to enroll if their former employer dropped prescription drug coverage for all retirees.

The new drug benefit would be administered by a pharmacy benefit management company (PBM) in each geographic area, selected through competitive bidding. All Part D enrollees would gain from the below-retail prices that PBMs can typically negotiate

with drug manufacturers and pharmacies. The benefit would have no deductible and would generally pay 50 percent of an enrollee's prescription drug costs, up to a limit of \$1,000 in 2003. That cap would gradually rise to \$2,500 in 2009. Thus, in 2009, a beneficiary who spent \$5,000 on prescription drugs would receive the maximum reimbursement of \$2,500. That beneficiary would also pay \$578.40 in Part D premiums that year. After 2009, the cap would be indexed to annual changes in the consumer price index (CPI). Assuming that the cost of prescription drugs continued to rise more rapidly than the CPI, the real value of the cap would shrink, thus eroding the benefit.

Certain low-income beneficiaries would receive help with drug-related costs through the Medicaid program. Medicaid would pay both the premiums and cost-sharing expenses under the drug benefit, at the usual federal/state matching rate, for participants who were also fully eligible for Medicaid (so-called dual-eligibles, who now receive full drug coverage through Medicaid) or who had income below the poverty line. The federal government would pay all of the premiums and cost-sharing expenses for other Part D enrollees with income below 135 percent of the poverty line, and part of the premiums for Part D enrollees with income between 135 percent and 150 percent of the poverty line (see Table 2-10). Eligibility for those

Table 2-10.
Government Subsidies for Drug Costs Under the President's Proposal for a Prescription Drug Benefit in Medicare (In percent)

Eligibility Status	Percentage of Costs Covered by Government Payments	
	Part D Costs	Costs Above the Part D Cap
Eligible for Full Medicaid Benefits	100	100
Eligible for Partial Medicaid Benefits or Not Eligible		
Income less than poverty level	100	0
Income between 100 percent and 135 percent of poverty level	100	0
Income between 135 percent and 150 percent of poverty level	25-50	0
Income more than 150 percent of poverty level	25	0

SOURCE: Congressional Budget Office.

NOTE: Includes Medicare and Medicaid payments for drug costs in effect under current law as well as proposed new government payments. Government payments are net of premiums and cost sharing paid by beneficiaries.

subsidies would be determined by state Medicaid agencies. Neither the federal nor state governments would be liable for covering any drug expenses above the Part D cap for low-income beneficiaries who were not fully eligible for Medicaid. For dual-eligibles, though, Medicaid would pay all drug costs not paid by Medicare, including expenses above the cap.

The President's proposal also includes an incentive that is intended to retain employer-sponsored drug coverage for retirees. Medicare would pay employers 67 percent of the premium-subsidy costs it would have incurred if the employers' retirees had enrolled in Part D instead. In addition, enrollees in Medicare's man-

aged care plans would receive their prescription drug coverage through those plans, which for the first time would be paid directly for providing such coverage (for enrollees who opted for the Part D benefit).

Medicare now pays for a limited list of drugs provided on an outpatient basis. Those drugs would continue to be covered under Part B of the program. Consequently, their costs would not be included in the cap on Part D benefits.

CBO's Estimate. The new Part D provisions would add a total of \$149 billion to federal costs through 2010, CBO estimates. (By comparison, the Adminis-

Table 2-11.
CBO's Estimate of the President's Proposal for a Prescription Drug Benefit in Medicare
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Medicare												
Benefits	0	0	14.3	21.1	26.2	29.2	34.3	37.8	43.4	47.9	61.6	254.2
Part D premium receipts	0	0	-7.8	-10.8	-13.4	-14.8	-17.5	-19.1	-22.0	-24.2	-32.0	-129.7
Subsidy to health plans for retirees	<u>0</u>	<u>0</u>	<u>0.4</u>	<u>0.5</u>	<u>0.6</u>	<u>0.7</u>	<u>0.8</u>	<u>0.9</u>	<u>1.0</u>	<u>1.1</u>	<u>1.5</u>	<u>6.1</u>
Net outlays	0	0	6.9	10.8	13.4	15.1	17.6	19.6	22.4	24.8	31.1	130.6
Medicaid (Federal)												
Part D benefits and premiums	0	0	*	0.6	1.4	1.7	1.9	2.1	2.2	2.5	2.0	12.4
Part A/B benefits and premiums	<u>0</u>	<u>0</u>	<u>0.2</u>	<u>0.5</u>	<u>0.8</u>	<u>0.8</u>	<u>0.9</u>	<u>1.0</u>	<u>1.1</u>	<u>1.1</u>	<u>1.4</u>	<u>6.3</u>
Net outlays	0	0	0.2	1.1	2.1	2.6	2.8	3.0	3.3	3.6	3.4	18.7
Net Effect on Federal Spending	0	0	7.1	11.9	15.5	17.6	20.4	22.6	25.7	28.5	34.5	149.3
Memorandum:												
Medicaid (Federal)												
Net outlays at usual federal/ state matching rate	0	0	*	0.3	0.7	0.8	0.8	0.9	0.9	1.1	0.9	5.4
Net outlays at 100 percent federal matching rate	0	0	0.3	0.8	1.5	1.8	2.0	2.1	2.4	2.6	2.6	13.4
Medicaid (State)												
Part D benefits and premiums	0	0	-0.2	-0.1	-0.1	*	-0.1	*	-0.1	-0.1	-0.4	-0.7
Part A/B benefits and premiums	<u>0</u>	<u>0</u>	<u>0.2</u>	<u>0.3</u>	<u>0.6</u>	<u>0.6</u>	<u>0.7</u>	<u>0.7</u>	<u>0.8</u>	<u>0.9</u>	<u>1.1</u>	<u>4.8</u>
Net outlays	0	0	*	0.2	0.5	0.6	0.6	0.7	0.7	0.8	0.7	4.0

SOURCE: Congressional Budget Office based on the March 2000 baseline.

NOTE: * = between -\$50 million and \$50 million.

Table 2-12.
Cost per Participant Under the President's Proposal for a Prescription Drug Benefit in Medicare
(By calendar year, in dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Monthly Part D Premium	n.a.	n.a.	24.10	24.90	32.30	33.50	40.10	41.70	48.20	50.90
Cap on Benefits	n.a.	n.a.	1,000	1,000	1,500	1,500	2,000	2,000	2,500	2,562
Percentage of Participants Over Cap	n.a.	n.a.	31	34	25	27	22	23	20	21
Average Benefit per Participant	n.a.	n.a.	568	589	770	803	969	1,011	1,173	1,240
Average Out-of-Pocket Expense per Participant ^a	n.a.	n.a.	1,410	1,572	1,604	1,785	1,853	2,046	2,147	2,358
Memorandum:										
Monthly Part B Premium										
Under current law	49.30	53.20	58.60	64.20	69.70	74.70	79.40	84.20	89.70	95.10
Under the proposal	48.90	52.60	57.80	63.20	68.40	73.30	77.90	82.50	87.80	93.00

SOURCE: Congressional Budget Office based on the March 2000 baseline.

NOTE: n.a. = not applicable.

a. Before reimbursement by a medigap plan, employer-sponsored insurance, or Medicaid.

tration's estimate is about \$160 billion.) Of CBO's total, almost \$131 billion would represent outlays for Medicare (net of premium receipts), and nearly \$19 billion would represent federal outlays for Medicaid (see Table 2-11). States would also face additional Medicaid costs—totaling some \$4 billion through 2010. CBO estimates that the premium for Part D would start at \$24.10 a month in 2003 and rise to \$50.90 in 2010 (see Table 2-12).

CBO's cost estimate assumes that most people who are enrolled in Part B of Medicare would also enroll in Part D. But some of those who have employer-sponsored drug coverage for retirees would keep that coverage rather than opt for the new benefit. In addition, CBO assumes that people who are eligible for benefits under Part B but do not actually enroll would also not enroll in Part D. Under those assumptions, nearly 36 million people would sign up for Part D in 2003, representing approximately 88 percent of total Medicare enrollment.

In 2003, about 31 percent of participants would have drug expenses exceeding the \$1,000 cap on Part D benefits. By 2010, when the cap would be \$2,562,

about 21 percent of participants would have expenditures exceeding it. The Part D benefits paid per participant would average \$568 in 2003, rising to \$1,240 in 2010.

CBO estimates higher Medicare costs for the prescription drug benefit than the Administration does but lower Medicaid costs. As a result, its estimate of net federal costs is about 7 percent lower than the Administration's. The two base their estimates of future drug spending on patterns reported in Medicare's Current Beneficiary Survey. However, CBO and the Administration differ in the adjustments they make to those data to account for underreporting in the survey and growth since the survey year. In particular, CBO uses a larger adjustment factor (1.33) to account for underreporting by noninstitutionalized respondents than the Administration does (1.15).⁶ Further, CBO assumes somewhat higher rates of growth in drug spending over the next few years than the Administration. Both CBO and the Administration assume that

6. Last year, the Administration used a 1.30 factor to adjust for underreporting.

the new drug subsidies for low-income people will induce more participation in Medicaid, but the Administration's estimate of that effect is larger.

Compared with its estimate of a similar proposal by the President last year, CBO made only two significant changes in the assumptions underlying its estimate of the Part D benefit (aside from reflecting the delayed start of the benefit from 2002 to 2003).⁷ One change affects Medicare costs and the other Medicaid costs. For Medicare, CBO's current assumption (based on the results of an employer survey conducted by Hewitt Associates) is that only 25 percent of employers would accept the premium subsidy and keep their current drug coverage for Medicare-eligible retirees.⁸ (In last year's estimate, CBO assumed that 75 percent of employers would accept the subsidy.) For Medicaid, CBO expects less of an increase in Medicaid participation because of low-income subsidies for the new drug benefit than it did last year (70 percent versus 80 percent). That change was made because of better information about the proportion of income-eligible people who would also meet the asset requirements for Medicaid eligibility.

Estimating the cost of a service not now covered by Medicare is inherently more difficult than estimating the cost of a change in the way a current service is paid for. With the proposed prescription drug benefit, uncertainties exist about the nature and value of the benefit, the effectiveness of PBMs in controlling drug costs, participation in Part D by Medicare beneficiaries who now have drug coverage, and the impact of the new benefit on Medicaid spending.

The Nature and Value of the Benefit. Per capita spending for prescription drugs has been growing at double-digit rates in recent years—faster than other components of health care spending. Whether that rapid growth will continue, accelerate, or moderate is unclear. A number of innovative drugs are likely to be approved for marketing in the near future, which would tend to increase both the use and the average

price of prescription drugs. However, a number of heavily used brand-name drugs are about to lose their patent protection (allowing entry of generic substitutes), which would tend to reduce prices. Thus, projections of the rate of growth in drug use and prices are highly uncertain even without changes in insurance coverage. For this estimate, CBO assumes that recent growth trends will continue for several years and then moderate.

Another area of uncertainty is the extent to which the coverage provided under the President's proposal would increase drug utilization by enrollees. Half of Medicare enrollees already have coverage for prescription drugs (typically through a retiree health plan or Medicaid) that is at least as generous as the coverage in the President's plan. For the other half, CBO estimates that the new Part D coverage would increase drug utilization by up to 25 percent.

Part D is designed to ensure that most enrollees would receive some benefit. However, because of the annual cap, it would not protect enrollees with chronic conditions who are dependent on prescription drugs from very large out-of-pocket expenses. Although the benefit cap would reduce Medicare's exposure to increases in prescription drug costs, it would also limit the value of the benefit to people who are especially vulnerable to those costs. Alternatively, a program that did not provide first-dollar coverage but limited an enrollee's out-of-pocket costs to some annual maximum (or stop-loss) would be less likely to cause a large increase in drug utilization and would better protect enrollees from catastrophic expenses. Under such a program, however, fewer enrollees would be likely to benefit. Further, a catastrophic benefit might result in higher prices for some drugs with no close substitutes because enrollees whose expenses exceeded the stop-loss amount would no longer be price-conscious.

The Effectiveness of PBMs. The President proposes to administer the drug benefit through private-sector pharmacy benefit management companies, which private health plans use to negotiate price discounts and control utilization. A single PBM, selected through competitive bidding, would administer the benefit in each region. CBO's cost estimate assumes that those PBMs would reduce costs by about 12.5 percent from the level that an uninsured retail purchaser would pay—smaller savings than PBMs now generate for large,

7. For last year's estimate, see the statement of Dan L. Crippen, Director, Congressional Budget Office, before the Senate Committee on Finance, July 22, 1999.

8. Hewitt Associates, *Retiree Health Coverage: Recent Trends and Employer Perspectives on Future Benefits* (Menlo Park, Calif.: Henry J. Kaiser Family Foundation, October 1999).

tightly managed health plans. That estimate could change, however, as details of the proposal's design emerge.

PBMs save money for private-sector health plans in four main ways. First, they negotiate discounts with pharmacies that agree to participate in their networks. Second, they obtain rebates from manufacturers of brand-name drugs in exchange for preferred status on the health plan's formulary. (A formulary is a list of drugs preferred by the plan's sponsor, in part because of their lower prices.) Third, PBMs use mail-order pharmacies, which are often better able than retail pharmacies to save money. Mail-order pharmacies are likely to have lower average operating costs, and they may be more likely to substitute generic or other lower-cost drugs for the ones prescribed. Finally, PBMs establish differential copayment requirements that encourage beneficiaries to select lower-priced options such as generic, preferred formulary, or mail-order drugs. Some PBMs also use management techniques such as on-line utilization review and prior approval to evaluate care and encourage the most cost-effective treatment practices.

Whether the PBMs chosen to administer the Part D benefit would have as much freedom to use those cost-saving techniques as they have in aggressive private insurance plans is unclear. For example, the President's proposal specifies that PBMs would have to set dispensing fees high enough to ensure participation by most retail pharmacies, which could reduce their ability to negotiate substantial discounts from pharmacies. The proposal also specifies that beneficiaries would be guaranteed access to off-formulary drugs when medically necessary, reducing PBMs' ability to negotiate rebates from manufacturers. Further, the proposal would limit their ability to encourage beneficiaries to choose lower-cost drugs through differential copayments. Although PBMs would not be prohibited from charging varying copayments, those copayments could not exceed 50 percent. Some private drug plans require enrollees to pay the full difference between the cost of a brand-name drug and its generic equivalent (if one exists) unless the prescribing physician specifically states that the brand-name drug is medically necessary. Such an approach would apparently not be permitted in the Part D program.

Indeed, how much incentive PBMs would have to generate savings under the program is very uncertain. The President's proposal envisions competitive bidding to select the PBM for each geographic area, but it is unclear what financial risks, if any, the winning PBM would bear beyond the costs of processing claims. The proposal indicates that contractual incentives (such as performance bonuses) might be used to encourage PBMs to focus more aggressively on generating savings, but those mechanisms have not yet been specified. Nor is it clear how savings would be measured. Actual savings could disappear, even though nominal discount and rebate rates were unchanged, if the prices from which discounts and rebates were calculated rose as a result of the new benefit.

Program Participation. CBO's estimate assumes that everyone who participates in Part B of Medicare would also participate in Part D, with one exception: a quarter of beneficiaries who have drug coverage through health plans for retirees would retain that coverage. Those assumptions are quite speculative, however, and participation rates might well be lower or higher.

As noted above, employers would receive federal payments equal to 67 percent of the Part D premium subsidy for eligible retirees if they kept (or instituted) prescription drug coverage at least as good as the Part D benefit. That subsidy payment—together with the tax exclusion of their health plan costs—would induce some employers to keep full drug coverage in their retiree health plans rather than eliminate it or wrap their plans' benefits around the new Part D package. (Employers with a wraparound plan would require Medicare to be the primary payer for prescription drugs, with the employer's plan serving as a supplement.) CBO assumes that about three-quarters of Medicare enrollees who now have drug coverage through a retiree health plan would enroll in Part D because their employers would either eliminate their drug coverage altogether or make it secondary to the Medicare benefit.

Because of the 50 percent coinsurance rate and the benefit cap, the benefits provided under Part D would be limited. Moreover, through their premiums, enrollees would pay for half of whatever benefits were

paid out. Consequently, the federal subsidy under Part D would amount to less than one-quarter of enrollees' drug costs, on average. Despite those limitations, Part D would offer a more generous drug benefit than standard medigap plans do, and at a lower premium. As a result, the three medigap plans that now offer drug coverage would no longer be competitive and might ultimately be replaced by a plan that supplemented the coverage offered under Part D.

Because of the one-time option to enroll and the 50 percent subsidy of premium costs, CBO expects that all Part B enrollees with medigap coverage or with no supplementary coverage would choose to enroll in Part D. CBO also expects states to enroll their dual-eligibles because that would shift some of the states' costs for drug coverage to Medicare. Other low-income people eligible for Medicaid assistance under the new drug benefit would also enroll in Part D to gain drug coverage.

Effects on Medicaid Costs. As Table 2-11 showed, the President's proposal would increase Medicaid's costs for drugs and other benefits—substantially in the case of federal costs and less sharply in the case of state costs. Although Medicaid would no longer have to pay all drug costs for Medicare beneficiaries who now receive full Medicaid benefits, those savings would be more than offset by additional Medicaid spending on behalf of other Medicare beneficiaries.

Part D would pay for a portion of the drug costs that Medicaid now pays for Medicare enrollees who are fully eligible for both programs. That expansion of Medicare's role would lower both federal and state Medicaid costs by shifting them to Medicare. But the savings would be partly offset by the Part D premiums that Medicaid would have to pay for those dual-eligibles.

Certain low-income Medicare beneficiaries who are not eligible for full Medicaid benefits would also become eligible for assistance to pay for their Part D premiums and cost sharing. As noted previously, the federal and state governments would share those costs for people with income below the poverty level. But the federal government alone would pay the premiums and cost sharing for beneficiaries with income between 100 percent and 135 percent of the poverty level, without any financial participation by the states. It would

also pay a part of the Part D premium costs for beneficiaries with income between 135 percent and 150 percent of the poverty level. To receive those benefits, however, eligible Medicare beneficiaries would have to enroll in the Medicaid program, and not all of them would choose to do so.

The President's proposal would also increase Medicaid spending for services not related to the new drug benefit. As noted above, many low-income Medicare beneficiaries who are ineligible for full Medicaid benefits are eligible to have their Medicare Part A and B premiums paid by Medicaid—and in some cases, their cost sharing as well. A sizable number of them do not enroll in Medicaid, however. CBO estimates that about 1.5 million Medicare beneficiaries with income below the poverty level are eligible for partial or full Medicaid assistance but do not participate in the program. A further 1.0 million beneficiaries with income between 100 percent and 120 percent of the poverty level who are eligible to have their Part B premiums paid by Medicaid do not participate. The availability of a free drug benefit, made possible by enrollment in Medicaid, would attract more Medicare beneficiaries into the Medicaid program, boosting spending for other benefits that Medicaid pays for as well as the prescription drug benefit. Participation in Medicaid by beneficiaries who are eligible for full Medicaid benefits might also increase, although their participation is already greater than that of other groups.

For this estimate, CBO assumed that the price of drugs under the proposed Medicare benefit for Medicaid beneficiaries would be similar to the price that Medicaid obtains under current law (including Medicaid rebates). If Medicare received deeper discounts and rebates, Medicaid's costs would be lower. Conversely, if Medicare paid more for drugs, Medicaid's costs would be higher.

Proposal to Create a Competitive Defined Benefit Program

The President is proposing to give Medicare's managed care plans various incentives to compete on the basis of price as well as quality through what the budget calls a competitive defined benefit program. CBO

estimates that the program would save Medicare \$13.7 billion through 2010, although that estimate is subject to great uncertainty (see Table 2-7 on page 44).

How the Program Would Operate. Beginning in 2003, the current system of paying for Medicare+Choice plans would be replaced with a bidding system. Under that approach, the premium that Medicare beneficiaries paid would depend on the plan they chose. Beneficiaries who stayed in the fee-for-service sector would pay the regular Part B premium, and those who chose the proposed prescription drug benefit would also pay the regular Part D premium. Competing plans would be free to charge a different premium than the fee-for-service program. However, beneficiaries who chose cheaper plans would generally pay lower premiums, and those who opted for more costly plans would pay the extra costs of that choice.⁹ Managed care plans would submit a bid price for the standard Medicare benefit package (including the drug benefit for those who chose it), enabling beneficiaries to make price comparisons among plans.

The actual amount that beneficiaries paid would depend on the difference between the bid price of their plan and a county-specific reference price, which would be the larger of two amounts: the payment rate established by the BBA for Medicare+Choice plans or 96 percent of average Medicare spending per enrollee in their county (that average is adjusted for the difference between the average health status of the county's Medicare enrollees and all Medicare enrollees).¹⁰ If beneficiaries enrolled in a plan with a bid price below the reference price, their Medicare premiums would be reduced by 75 percent of the difference (but not below zero). If they chose a plan with a bid price above the reference price, they would pay the full difference.

Managed care plans would receive their full bid price for the defined benefit package regardless of whether that price was above or below the reference price. But given the price structure that beneficiaries would face, plans would have a strong incentive to

keep their bid price below the reference price; otherwise, they would have trouble competing against the fee-for-service program. In markets with multiple plans, they would also have an incentive to compete against other managed care plans on the basis of price.¹¹

The government would adjust the payments to health plans to reflect differences in expected risk based on health status. Plans enrolling beneficiaries with greater-than-average health risks would receive higher federal payments than other plans. Risk adjustment has been considered a perennial problem for the Medicare program, however, and full implementation of Medicare's new risk-adjustment system is not expected until after 2003.

The amount the program would save (or lose) on people enrolling in plans would depend on the difference between the plan's bid price and the reference price, the health risk of the enrollee, and the difference between the reference price and spending per enrollee in the absence of the competitive defined benefit. (The following example makes the simplifying assumption that spending in the absence of the competitive defined benefit is equal to spending in the fee-for-service sector.)

Suppose, for example, that average costs in the fee-for-service sector were \$7,500, the annual premium for beneficiaries enrolled in that sector was \$1,200 (\$100 a month), and the reference price was \$7,200.¹² Beneficiaries choosing a less expensive plan with a bid price of, say, \$6,500 would have their annual premium reduced by 75 percent of the difference between the bid price and the reference price, or \$525 (75 percent of \$700). As a result, their annual premium would be \$675, or \$56.25 a month.

9. Because most beneficiaries' Medicare premiums are withheld from their Social Security checks, beneficiaries would see the effect of their plan choice as a change in the amount of their Social Security checks.

10. This factor is conceptually similar to the pre-BBA payment rate for risk-based plans, which was 95 percent of average Medicare spending per enrollee.

11. Plans could also offer additional benefits—beyond the basic Medicare benefit and drug benefit—for a separate premium, which would give them another way to compete against the fee-for-service sector and other managed care plans.

12. The reference price in this example is 96 percent of the average fee-for-service cost. The reference price would be higher than the average fee-for-service cost in areas where the BBA's payment rate for Medicare+Choice plans was higher than that cost. The reference price would be below 96 percent of the average fee-for-service cost in areas where the payment rate was below 96 percent of that average, because the reference price would be the greater of the BBA payment rate and the weighted average of per-enrollee spending in the fee-for-service and capitated sectors.

For a beneficiary in good health, costs in the fee-for-service sector might be expected to be only half the average, or \$3,750. Medicare would pay that person's plan half of the bid price, or \$3,250. The competitive defined benefit program would save \$500 compared with the fee-for-service sector but would give \$525 to the beneficiary through lower premiums. Thus, the program would lose \$25 on that person.

By contrast, the expected cost in the fee-for-service sector for a beneficiary in poor health might be twice the average, or \$15,000, and the payment to his or her plan would be twice the bid price, or \$13,000. The new program would save \$2,000 compared with the fee-for-service sector but would return \$525 to the beneficiary in lower premiums. Thus, Medicare's net savings for that person would total \$1,475. (In those examples, Medicare's net savings would be lower if the reference price was higher and greater if the reference price was lower.)

CBO's Estimate. Gross savings from the competitive defined benefit program would total \$85.2 billion through 2010, CBO estimates, of which \$71.5 billion would be returned to beneficiaries in the form of lower Medicare premiums (see Table 2-7). Thus, the program would reduce net Medicare outlays over 10 years by \$13.7 billion. (The Administration's estimate is \$11.9 billion.)

CBO analyzed data from Medicare's risk-based plans to estimate the bid prices such plans would offer under the proposal's bidding process. Those plans prepare adjusted community rate (ACR) proposals that indicate whether Medicare's payment is excessive and how much they would return to beneficiaries in the form of additional benefits or waived premiums. CBO's analysis relied on ACR data for 1997, the latest year for which per-enrollee spending in the fee-for-service sector is available at the county level.¹³ The analysis used the difference between the payment rate and the amount returned to beneficiaries in the form of additional benefits or waived premiums as the measure

of the bid price that plans would have submitted in 1997 if competition had been based on price.

CBO assumed that bid prices would increase at an average rate of about 5.5 percent per year, slightly lower than the growth rate of Medicare+Choice payments under current law. Plans would lose market share if they bid above the reference price. To maintain enrollment levels, such plans could subsequently reduce their bid prices, presumably by reducing their cost of providing services. CBO assumed that plans would not offer a Medicare+Choice product in counties where they could not operate profitably.

CBO projects that more counties would have managed care plans under the proposal than under current Medicare rules. The reference price would equal or exceed current-law payment rates in areas where the BBA rules will increase those rates—areas that often have few or no Medicare+Choice plans. Moreover, the reference price would be higher than current payment rates in areas where the BBA rules will reduce those rates (compared with pre-BBA rules). CBO's analysis assumed that the number of Medicare enrollees living in areas with access to a managed care plan would increase by 6 million from 2002 through 2010—equal to the projected growth in Medicare enrollment during that period.

Plans that offered beneficiaries substantial reductions in Medicare premiums would tend to gain market share at the expense of both the fee-for-service sector and plans that offered smaller reductions in Medicare premiums. However, plans that lowered their premiums might also reduce the benefits they offered. Beneficiaries would take into account both the savings from lower premiums and the benefits they would have to give up in deciding whether to move to a less expensive plan. The size of any gains in a plan's market share from one year to the next was assumed to be positively related to its market share in the preceding year. CBO also assumed that a substantial number of Medicare beneficiaries who would initially choose not to switch to a lower-cost plan would reconsider that choice and switch in later years. The initial change in market share in response to lower premiums would account for only one-third of the ultimate change.

Under current law, CBO projects, enrollment in Medicare+Choice plans will increase from 7.2 million

13. ACR proposals provide notoriously unreliable data on the cost to plans of providing basic Medicare benefits. The share of Medicare payments that plans report they are willing to give back to beneficiaries in the form of additional benefits and waived premiums may be a less reliable measure of the discount they would offer if price played a role in competition.

in 2002 to 14.1 million in 2010. Many beneficiaries enroll in Medicare+Choice plans to obtain prescription drug benefits that are not available in the fee-for-service sector. CBO assumes that the President's proposal to offer a drug benefit to enrollees in the fee-for-service sector would dramatically slow the growth of enrollment in Medicare+Choice. CBO estimates that with that benefit in place, enrollment in competitive defined benefit plans would be 11.6 million in 2010.

By that year, two-thirds of enrollees in those plans would not pay any Medicare premiums. They would live in areas where the reference price was substantially higher than the cost to an efficient plan of providing the defined package of Medicare benefits. Many beneficiaries, however, live in areas where the reference price would be more in line with the actual cost of providing services. They would not have access to plans that offered a substantial reduction in Medicare premiums.

CBO assumes that beneficiaries who chose to enroll in competitive defined benefit plans would tend to have better-than-average health and that risk adjustment would accurately reflect that. Based on the projected geographic distribution of enrollment and the health status of enrollees, CBO estimates that almost 85 percent of the savings achieved through the bidding process would be returned to beneficiaries in the form of lower premiums.

Other Issues. Promoting greater price competition in Medicare could broaden the options available to beneficiaries and slow the growth of spending. Those outcomes are by no means assured, however. Much would depend on the details of the proposal, many of which are unclear, and on the responses of beneficiaries and health plans to the new incentives, which are uncertain. Moreover, the potential for effective price competition among health plans varies from market to market across the country. Experience with Medicare's risk-based program to date suggests that competition is more likely to occur in large, high-cost urban markets, although the nature of the reference-price mechanism could modify that conclusion.

Under current law, there is effectively no price competition among Medicare+Choice plans. Medicare uses an administered pricing system to set its payments to plans, and plans are not allowed to offer cash

rebates or other financial incentives to encourage enrollment. Instead, they have incentives to increase optional benefits rather than to reduce costs. Consequently, even though beneficiaries gain if they enroll in managed care plans that are more efficient than the fee-for-service sector, Medicare does not. Moreover, beneficiaries who might prefer less generous benefits for a lower price do not have that option. The President's proposal would remove that bias and allow both beneficiaries and the Medicare program to benefit from less costly choices.

The proposal would go only partway, however, toward establishing a competitive model for Medicare. The fee-for-service sector—in which the large majority of Medicare beneficiaries are still enrolled—would not be required to compete fully on the basis of price with the private plans participating in Medicare. The special status of the fee-for-service sector could result in lower savings for the Medicare program than other competitive strategies might yield.

How plans would structure their offerings in this new type of competitive environment is very uncertain. It would depend on how responsive beneficiaries proved to be to changes in premiums. To date, beneficiaries have been attracted away from fee-for-service Medicare to managed care plans by the lower cost-sharing requirements and additional benefits (especially coverage of prescription drugs) that those plans offer. With prescription drug coverage available in the fee-for-service sector under the President's proposal, managed care plans would lose one of their major comparative advantages, slowing the growth of enrollment in managed care. How far lower premiums might offset that effect is unknown.

The mechanics for bidding and setting prices in the President's proposal are not clear, which adds to the difficulty of predicting the effects of the proposal on plans' behavior. For example, efficient plans in areas with a high reference price might be able to use high payment rates to subsidize packages of supplemental benefits as well as offer the basic Medicare package for a low or zero premium. (Although plans would be required to charge a separate premium for supplemental benefits, there is no indication that such a premium would have to be anything more than nominal.) Under those circumstances, plans would be able to compete against the fee-for-service sector and each

other on the basis of both price and benefits. Such competition would be less possible in markets with lower reference prices. Thus, although the proposal aims to reduce the current disparities in benefits among Medicare+Choice plans across the country, it might not end up doing so.

Even if beneficiaries proved highly responsive to reductions in Medicare premiums and plans chose to compete on that basis, the effects of the proposal on the growth of Medicare spending are speculative.

Would there be one-time savings—possibly stretched out over several years—as beneficiaries in fee-for-service shifted to managed care plans? Or would competitive forces be strong enough to foster efficiencies throughout the system, slowing the growth of costs in the future? Debate over those questions has been going on in the private sector since the mid-1990s, when many people with employer-sponsored health insurance plans began to shift from fee-for-service to more tightly managed plans. That debate has yet to be resolved.

The President's Trust Fund Proposals

As the population ages, the nation will devote more of its resources to the needs of older people. Within the federal budget, increases in the number of people ages 65 and older will cause spending for Social Security and Medicare to grow faster than the economy. Because policymakers are concerned about the future of those programs, many focus on the status of the Social Security and Medicare trust funds and identify the solvency of those funds as an important policy objective.

In the public debate, "solvency" means keeping the trust funds from exhausting their balances and ensuring the ability of the funds to finance promised benefits. Defined that way, however, trust fund solvency is not a meaningful measure of the government's ability to meet its future obligations, for two reasons:

- o Federal trust fund balances are not assets of the government. Under current law, trust funds are just accounting mechanisms established to link receipts that the government collects or assigns to specific uses with the spending of those receipts.¹ (See Box 3-1 for an overview of federal trust funds.) A trust fund balance indicates that over time, more has been credited to the fund than spent. Eventually, the government may

spend sums represented by those balances, but in order to do so, it will have to use other (non-trust-fund) receipts or run deficits and borrow from the public. Thus, the balances represent earmarks against future general funds. As there is no necessary relationship between the balances in a trust fund and its future obligations, the government may face claims whether or not the fund has sufficient balances. (For example, benefit levels in Social Security and Medicare are set independently of their trust funds' income and balances.)

- o Trust fund solvency can be altered through federal fiat. Those actions can change the amounts credited to a fund or the spending charged against it, add to or subtract from fund balances, and alter the purposes of a fund. Some of those measures may affect the economic resources available to the government or change its future obligations; others may involve only the government's internal bookkeeping. To determine which category an approach falls into, a proposal affecting the solvency of a trust fund must be reviewed in the larger context of its impact on total budget surpluses and the overall economy.

The President's budget for fiscal year 2001 contains three proposals that the Administration asserts will postpone the insolvency of certain trust funds. The two largest proposals affect Social Security and Medicare trust funds. Another, much smaller proposal would appropriate general funds to the Black Lung Disability Trust Fund.

1. The President's budget proposes to invest a portion of the Social Security trust funds in private equities beginning in 2011. That use of resources would depart from the current requirement that the trust funds invest only in Treasury securities. The budget proposal would alter the composition of trust fund holdings but would not necessarily improve the government's overall financial condition.

The President's budget would transfer amounts from general funds to the two Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and to Medicare's Hospital Insurance Trust Fund. The transfers to Social Security are intended to credit that program with a portion of the projected on-budget surpluses in 2011 and later years, as calculated by the Office of Management and Budget

(OMB) on the basis of the President's 2001 budget request. According to the Administration's estimates, the first of those transfers would be for \$100 billion in 2011, which is well beyond the time horizon that is being used during this year's budget deliberations. The transfers would grow to about \$211 billion in 2015 and would be capped at that level through 2050. The transfers to the Medicare HI trust fund would add

Box 3-1. Overview of Federal Trust Funds

The federal government accounts for its activities through two broad groups of funds: federal funds and trust funds. All such funds include both receipt and expenditure accounts. About 43 percent of federal spending and 51 percent of federal receipts now fall within the trust fund category. Over the past 50 years, those percentages generally have been growing (see the figure below). Social Security, Medicare, federal employees' retirement benefits, unemployment compensation, and many transportation activities are conducted through trust funds.

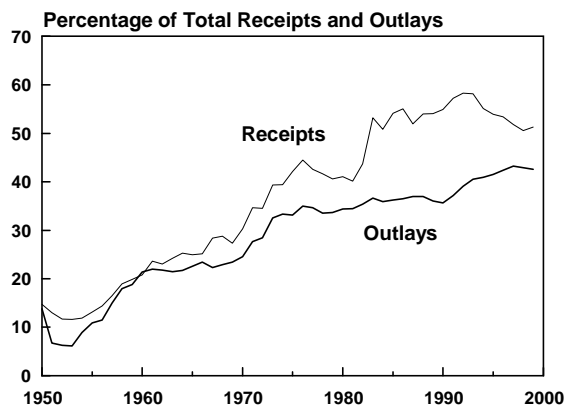
Trust funds are simply accounts labeled that way in law. The funds are established to record collections that are earmarked in legislation for the specific pur-

poses for which the funds were established. That characteristic is not unique to trust funds, however. Some categories of federal funds—special funds, revolving funds, and public enterprise funds, for example—also record receipts that are dedicated by law to specific activities. There are over 150 trust funds, but fewer than a dozen account for the vast share of trust fund dollars. Annual spending from such funds ranges from \$1 million or less for activities like the Eisenhower Exchange Fellowship and the Israeli Arab Scholarship Trust Funds to more than \$350 billion for Social Security's Old-Age and Survivors Insurance program.

Federal government trust funds differ from private trust funds in significant ways:

- o Claims by private trust funds against future output are limited by the value of the funds' assets. By contrast, federal trust funds function as accounting mechanisms that record tax receipts, user fees, and other credits and associated expenditures. When receipts exceed expenditures, the government's books show trust fund balances. According to the Office of Management and Budget, "These balances are available to finance future benefit payments and other trust fund expenditures but only in a bookkeeping sense. These funds are not set up to be pension funds, like the funds of private pension plans. They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures. The existence of large trust fund balances, therefore,

Trust Fund Receipts and Outlays



SOURCE: Congressional Budget Office using data from the *Budget of the United States Government, Fiscal Year 2001: Historical Tables*.

NOTE: Trust fund receipts and outlays are gross amounts and are not adjusted for interfund transfers.

\$299 billion to fund balances over 10 years—also by earmarking portions of projected on-budget surpluses. Transfers would take place in 2001 and 2002 and again in 2006 through 2010.

The Black Lung Disability Trust Fund records the collection of excise taxes on coal and expenditures for benefits paid to eligible coal miners and their sur-

vivors. The budget proposes to refinance the debt that the fund owes to the Treasury at a lower interest rate and to repeal a reduction in the excise tax rate scheduled for 2014. The trust fund would receive an appropriation that it would pay to the Treasury to compensate for lower annual interest payments. Because its operating expenses would be lower, the program's annual borrowing would be reduced. Eventually, the

Box 3-1. Continued

does not, by itself, have any impact on the Government's ability to pay benefits."¹

- o The beneficiary of a private trust fund usually owns the fund's income and often owns its assets. The trustee of a private trust fund has a fiduciary responsibility to manage the fund on behalf of its beneficiaries and cannot make unilateral changes to the provisions governing the trust. In contrast, federal trust funds are owned by the federal government.² They are created in legislation. Lawmakers can change the amount of receipts and payments flowing into and out of federal trust funds, add to or subtract from trust fund balances, alter the purposes of the funds, and even eliminate them altogether.
- o Private trust funds are more likely to represent saving—that is, forgoing current consumption for future uses—than are federal trust funds. In that manner, the assets of private trust funds add to net national savings and thus promote growth, producing a return for the beneficiary and for the economy.

Although a trust fund can use its income only for the purposes designated in law, the strength of the linkage between its earmarked receipts and its expen-

penditures varies. Some funds spend their income as soon as it is collected, and the relationship between receipts and spending can be readily viewed. In other funds, many years may elapse before their income is spent. In those cases, the linkage becomes less direct.

In addition to receipts from the public, trust funds record credits from federal funds. Those intragovernmental transfers take the form of interest earnings and other federal contributions. (For example, the general fund contributions to Medicare's Supplementary Medical Insurance, or SMI, Trust Fund cover about 75 percent of its costs.)³ Whereas spending from some trust funds may be limited to their income and available balances, other trust funds are authorized to borrow from the Treasury if they do not have sufficient income to finance their activities.

Trust fund balances indicate that the government may provide funding in the future for certain programs, but they do not have direct economic significance. The government can only "prefund" future obligations—that is, make it easier to meet them—by taking actions that enhance economic growth. Reducing debt held by the public is one of the most effective means of increasing saving and investment. Thus, the economy is the true "trust fund" because it forms the pool from which future consumption—public and private—will come.

1. *Budget of the United States Government, Fiscal Year 2000: Analytical Perspectives*, p. 337.

2. The federal government serves as a fiduciary trustee for some trust funds (such as the Thrift Savings Fund for federal employee) that are owned by their beneficiaries. The government accounts for those funds as deposit funds, which are nonbudgetary. Transactions between deposit funds and the government are treated as though they were transactions with the public.

3. Unlike the SMI trust fund, Medicare's Hospital Insurance (HI) Trust Fund does not have a backstopping contribution from general funds. One of the objectives of the Balanced Budget Act of 1997 (BBA) was to extend the solvency of the HI trust fund, which at that time was projected to become depleted in 2001. To help accomplish that goal, the BBA transferred certain spending for home health care services from the HI fund into the SMI fund. The transfer did not alter the federal government's costs, but it helped extend the life of the HI fund.

Box 3-2.
Who Will Pay for the Baby Boomers' Future Benefits?

Policy options for allocating budget surpluses—which the Congressional Budget Office estimates will total \$3.2 trillion to \$4.3 trillion over the 2001-2010 period, depending on the path assumed for discretionary spending—would affect different age groups differently. For that reason, it may be useful to consider the disposition of surpluses against the background of the Social Security and Medicare programs, whose benefits are largely provided to older people but whose financing comes mainly from younger, working people.¹

Maintaining the projected surpluses by paying down debt held by the public, rather than dissipating them through increased spending or tax cuts, would allocate some of the responsibility of paying for the baby boomers' benefits to current workers. That action would help to reduce the burdens Social Security and Medicare will impose on future taxpayers because paying down debt will increase national saving and investment, thus enhancing economic growth.

1. More than 82 percent of federal revenues derive from individual income and payroll taxes. Workers under the age of 65 pay virtually all of the payroll taxes; the income tax burden also rests largely on people in that age group. The Congressional Budget Office estimates that taxpayers ages 65 and older contribute 14 percent of the revenues from individual income taxes.

Those benefits, however, would be gained by increasing obligations on current workers. Running total budget surpluses forces current workers to finance part of their own future health and retirement costs. Because Social Security and Medicare are designed as pay-as-you-go systems—which means that payroll taxes go to finance current benefits—current workers "pay twice," once for the benefits of current retirees and once for a portion of their own future retirement costs.

The alternative to maintaining surpluses—dissipating them—is unlikely to increase the ability of today's workers to collect future benefits. Although some tax cuts and some spending increases could enhance the economy's rate of growth, the legislative process makes it difficult to limit the use of surpluses to changes that are considered economically productive. Most of the current proposals for using the surplus are more likely to boost consumption than to increase saving and investment.

In the absence of enhanced economic growth, future taxpayers may be unwilling to pay for the baby boomers' benefits at current rates, thereby prompting cuts in benefits. Whatever the shifts in burdens among generations, one certainty is that actions promoting economic growth help people of all ages.

program might be able to cover its full costs and begin to pay off its accumulated debt.

The three proposals share a common characteristic: none of the transfers would directly affect the government's ability to pay its obligations.² The only way that today's lawmakers can make a given set of future obligations more affordable for future generations is by taking actions to increase national saving and investment. (See Box 3-2 for a discussion of how that

2. This discussion is limited to the impact of the transfers and does not include the proposal to invest part of the transferred amounts in private equities. That action could have economic consequences and affect the calculation of total budget surpluses and publicly held debt, but it would not necessarily improve the government's overall fiscal condition.

decision would affect different generations.) In the short term, economists generally agree that the most effective action would be to maintain projected budget surpluses and pay down debt held by the public. That action would enhance economic growth and strengthen the nation's ability to pay for all types of goods and services—whether they are provided through the public or the private sector and benefit older citizens or other segments of the population.

The Administration's proposals would create transactions between government accounts, but such intragovernmental transfers do not by themselves increase the resources available to the government. The budget's trust fund proposals could, however, have an indirect impact on budget outcomes:

- o On the one hand, the proposed transfers of projected on-budget surpluses to the Social Security and Medicare trust funds might assist in packaging debt reduction into what may be a more popular form. The Administration asserts that the proposals could prevent transferred amounts from being used for additional spending or reductions in revenues (beyond the amounts it has already proposed in the budget for those purposes). The Social Security transfers might have that effect because they would reduce on-budget surpluses and correspondingly increase off-budget surpluses. As long as the Congress and the President remain committed to maintaining Social Security's off-budget surpluses, the transferred amounts might be less vulnerable to proposals to increase spending or reduce taxes. Because the Medicare transfers would not affect on-budget surpluses, they would be much less likely to help produce corresponding amounts of debt reduction.

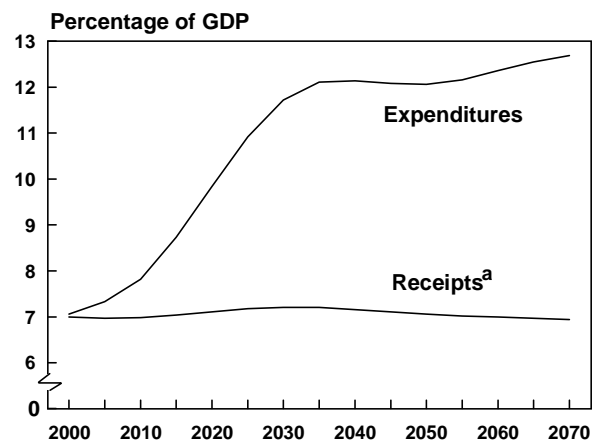
- o On the other hand, pumping up trust fund balances to extend a fund's solvency on paper could provide lawmakers and the public with a false sense of security and deter needed reform. The transfers would make Social Security and Medicare appear healthier, but because they would not directly enhance economic growth or reduce future obligations, they would not strengthen in any real sense the government's ability to pay future benefits. Whether tomorrow's taxpayers will agree to provide the resources to maintain current-law benefits will depend less on trust fund balances than on general economic conditions and spending priorities within the overall budget at that time. Larger trust fund balances, however, could provide a justification for delaying reform and make eventual solutions more difficult.

In short, if the transfers were made, more debt might eventually be paid off, but that gain could jeopardize needed reform. The consequences could—over the long run—prove to be detrimental, not beneficial, to Social Security, Medicare, and the government overall.

The President's Social Security and Medicare Trust Fund Proposals

The budget identifies solvency of the Social Security and Medicare trust funds as among the President's top priorities and suggests measures that it claims will help address the long-term challenges posed by an aging population. Between 2010 and 2030, according to the intermediate assumptions of the Social Security trustees, the number of older people in the United States will increase by 72 percent while the number between the ages of 20 and 65 will grow by only about 4 percent. As the proportion of workers to retirees declines, payroll tax revenues and other earmarked receipts will cover a shrinking share of the Social Security and Medicare benefits projected under current law (see Figure 3-1).

Figure 3-1.
Projected Expenditures and Receipts for Social Security and Medicare Combined



SOURCE: Congressional Budget Office using data from 1999 *Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds* (March 30, 1999) and *Annual Report of the Board of Trustees of the Federal Hospital Insurance Trust Fund* (March 30, 1999).

NOTE: Data are plotted at five-year intervals.

a. Includes payroll and income taxes, premiums paid by beneficiaries, and other noninterest receipts.

Any attempt to measure the solvency of the Social Security and Medicare trust funds outside the context of the rest of the budget provides an inadequate perspective on their financial status. The ability of the government to meet its obligations to Social Security and Medicare beneficiaries depends on the government's overall fiscal condition. Under current policies, as the population ages, funding for those programs will shift from payroll tax collections to general revenues and, eventually, proceeds from borrowing. That will be true whether or not there are trust fund balances. Thus, whatever the balances in the trust funds, future policymakers will have to decide how much to tax, spend, and borrow not only for Social Security and Medicare benefits but for the rest of government as well.

The budget does not address the long-term fiscal imbalance of the current situation. Instead, the Administration's plan would simply assign amounts to the Social Security and Medicare trust funds based on projected budget surpluses.

The President's Social Security Plan

Although Social Security currently brings in more in taxes than it pays out in benefits, that pattern will reverse as the baby-boom generation retires. The change will occur beyond the present 10-year horizon for budget projections and is barely apparent in the Congressional Budget Office's current baseline. CBO estimates a Social Security surplus under current policy of \$166 billion in 2001, growing to \$293 billion in 2010. Virtually all of that increase stems from growth in interest credited to the trust funds, not the excess of payroll and income tax receipts over benefits.

Shortly after 2010, surpluses will begin to decline as the ratio of workers to beneficiaries decreases. According to the March 1999 report of the Social Security trustees, under the intermediate set of assumptions, payroll taxes and other noninterest income (including income taxes on Social Security benefits) will exceed expenditures until 2014. Beginning in that year, financing from non-payroll-tax revenues or public borrowing will have to supplement payroll taxes to meet current-law benefit payments. The trustees estimate that the gap between benefits and payroll taxes

will be almost 0.5 percent of taxable payroll in 2015 (roughly \$19 billion in today's dollars) and will grow to nearly 5 percent of taxable payroll (in today's figures, \$190 billion, or 2 percent of gross domestic product). The Social Security trust funds will have balances to pay benefits until 2034 (the projected year of trust fund depletion). But after 2014, Social Security will stop making positive contributions to the government's bottom line and instead will impose net costs on the total budget.

The President's budget expressly recognizes that the government's ability to pay benefits "does not arise from the building up of large trust fund balances *in and of itself*" (emphasis in the original) and instead is "related to the health of its overall fiscal position and of the economy as a whole, rather than a simple function of trust fund balances."³ However, because the budget does not propose policies to address the imbalance between tax income and benefit costs, it would not actually change the programs. Instead, it would just postpone the date when the trust funds became insolvent on paper.

The President's plan for Social Security consists of the following measures:

- o An unspecified "lockbox" mechanism that would attempt to ensure that debt held by the public declines by at least the amount of the Social Security surpluses.
- o Transfers of a portion of projected on-budget surpluses to the Social Security trust funds that would increase balances in the funds. Under the proposal, the Social Security trust funds would be credited with amounts reflecting the increase in Social Security balances (calculated by OMB for the 2001-2015 period on the basis of the President's 2001 budget), multiplied by the assumed average market yields on outstanding Treasury obligations. The transfers would begin in 2011 and continue through 2050. Half of the transferred amounts would be invested in corporate equities. (The trust fund would be able to invest

3. *Budget of the United States Government, Fiscal Year 2001: Analytical Perspectives*, pp. 345-346.

up to 15 percent of its balances in private equities.)

- o Extension of existing budget enforcement laws that would promote budgetary discipline.⁴ In addition, the budget encourages the Congress to work with the President to make the trust funds solvent for 75 years. The plan mentions the Administration's commitment to repealing the Social Security earnings test (which defers payments to people under the age of 70 who continue to work after they have begun drawing benefits) and improving benefits for older women, but it does not include those proposals in the budget numbers.

"Saving" the Social Security Surpluses. Under its baseline assumptions, CBO estimates Social Security surpluses of \$2.3 trillion and total budget surpluses of between \$3.2 trillion and \$4.3 trillion (depending on which path is assumed for discretionary spending) for the 2001-2010 period.⁵ The President's budget would result in on-budget surpluses, CBO projects, that would be between \$470 billion and \$1,525 billion lower than the levels projected under CBO's baseline variations, and all available debt held by the public would be redeemed by 2010.

Although details are not provided in the budget, the proposed "lockbox" would seek to ensure that debt held by the public shrank by at least the amount of the Social Security surpluses. Such mechanisms are intended to create procedural hurdles that would make it more difficult to enact legislation that might lead to on-budget deficits. The perceived need for such constraints reflects the view that policymakers will be tempted to put projected surpluses to other uses. But unless the mechanism actually had a strong influence over decisionmakers' behavior, it would have no direct effect on taxes and spending or on the economy. Experience with the fixed deficit targets enacted in the Balanced Budget and Emergency Deficit Control Act

of 1985 shows that achieving bottom-line targets is a more difficult task than setting them.

"Interest Savings" Transfers to Social Security. As surpluses accrue to the budget, debt held by the public falls and the government's interest costs shrink. The Administration states that because total surpluses include large Social Security surpluses, the trust funds should be credited with "all of the interest savings that we get from saving the Social Security surplus."⁶ The Social Security trust funds already receive credits for interest on their accumulated balances under current law. CBO estimates that \$1.2 trillion, or 53 percent, of Social Security's projected surpluses for the 2001-2010 period will be in the form of interest. The proposed transfers would simply add extra interest credits on top of those that will be provided anyway. Carrying out such transfers would require legislation to override section 710 of the Social Security Act, which prohibits any payments from the general fund to the trust funds and payments from the trust funds to the general fund that were not authorized as of December 12, 1985 (the date the Deficit Control Act was enacted).

The transfers themselves would have no economic significance because they would flow out of one government fund and into another. Transferred amounts would be limited by the on-budget surpluses currently computed by OMB on the basis of the President's 2001 budget, but they would take place whether or not projected on-budget surpluses were actually achieved. OMB estimates that \$100 billion would be transferred in 2011. The transfers would grow each year through 2015 and remain frozen at that year's amount through 2050. Half of the transferred amounts would be invested in corporate equities until 15 percent of trust fund holdings were invested in private equities. (The Social Security actuaries estimate that the transfers and earnings from private securities would extend the trust funds' solvency through 2054.)

The additional transfers, like the interest credited under current law, would be charged against the general fund and credited to the trust funds. But such bookkeeping entries do not provide actual resources to

4. The proposals to raise and extend the caps on discretionary spending and extend the pay-as-you-go provisions are addressed in Chapter 1 of this volume.

5. Appendix A discusses the three paths for discretionary spending used in CBO's baseline.

6. Comments by Jack Lew, Director of the Office of Management and Budget (press briefing on the fiscal year 2001 budget, February 7, 2000).

the government. The proposed transfers would be nothing more than intragovernmental accounting transactions—although they would reduce on-budget surpluses and increase off-budget surpluses by the same amounts. Total budget surpluses would be unaffected, and the burden of paying future benefits would be unchanged.⁷

Other Proposals Included in the President's Social Security Plan. The budget proposes to raise and extend the current statutory caps on discretionary spending and to extend the pay-as-you-go requirement for changes to mandatory programs and tax law. Those provisions, which were designed to enforce budget targets and reduce deficits, will expire after 2002. As long as the Congress and the President remain committed to budgetary discipline, extending budget enforcement laws may make it more difficult to dissipate on-budget surpluses. But if policymakers' priorities change, procedural barriers will lose their effectiveness.

The President's plan also urges the Congress to work with the Administration on reforms to keep the Social Security trust funds from exhaustion for the next 75 years. (That is the period used by the actuaries to evaluate the program's financial health.) However, the budget does not propose any specific measures to reduce the gap between earmarked receipts and projected costs. Indeed, it demonstrates that the actuarial goal could be achieved, at least on paper, through additional transfers rather than substantive changes in program benefits or revenues. Those transfers would permit benefit levels to be maintained through greater infusions of general funds, but future taxpayers would still have to pay the bills.

The President's Medicare Transfers

Medicare benefits are financed through two trust funds. Payroll taxes and other receipts are credited to the HI trust fund to pay for inpatient hospital stays, certain home health and nursing home services immediately following a hospital stay, and hospice care. The Supplementary Medical Insurance (SMI) Trust

Fund pays for physicians' services, other ambulatory treatment, home health services that do not immediately follow a hospital stay, and other outpatient services. Beneficiaries' premiums pay for 25 percent of SMI costs. An annual infusion of general funds to the SMI trust fund covers the remaining 75 percent.

There is a structural imbalance between Medicare spending and the revenues that are specifically dedicated to the program. CBO estimates that under current law, the gap between noninterest Medicare receipts (including SMI premiums but excluding general fund transfers) and spending will grow from 0.8 percent of GDP in 2000 to 2.7 percent in 2030, a shortfall larger than that projected for Social Security.⁸ (That estimate also assumes that the annual growth in Medicare costs eventually moderates, as the Medicare trustees project.) The President's budget, however, proposes to increase spending for Medicare by \$69 billion between 2001 and 2010, CBO estimates. Those additional costs would grow in future decades and widen the long-term gap between receipts and spending.

Extending the Solvency of the Hospital Insurance Trust Fund. Instead of proposing specific policy measures to close the long-term gap between Medicare HI costs and noninterest receipts, the budget proposes to assign an extra \$15 billion in 2001 and \$13 billion in 2002 to the HI trust fund. Another \$271 billion would be credited to the fund between 2006 and 2010. The Administration projects that those transfers and the additional interest credits associated with them (which CBO estimates would total \$43 billion) would help keep balances in the HI trust fund until 2025—10 years longer than the estimates of when the fund would be depleted provided by Medicare's actuaries in March 1999. Since those amounts would not be needed immediately to pay benefits, the transfers would add to trust fund balances and make the HI program appear stronger financially. However, because such transfers would provide no new resources to the government as a whole, they would neither affect projected on-budget or total surpluses nor change the government's ability to meet future Medicare obligations.

7. This discussion excludes the potential effects of the budget's proposal to invest a portion of the transferred amounts in corporate equities.

8. See the statement by Dan L. Crippen, Director, Congressional Budget Office, before the Subcommittee on Health, House Committee on Ways and Means, September 22, 1999.

Reserve for Catastrophic Prescription Drug Coverage. The text of the President's budget identifies a "reserve" of \$35 billion to cover the costs of policies to provide for "protections against catastrophic drug costs for Medicare beneficiaries, or policies that otherwise strengthen the Medicare program."⁹ Between 2006 and 2010, the funding for those new benefits would come from projected on-budget surpluses. However, the surpluses displayed in the President's budget are not reduced to pay for the new program, and the budget does not show additional funding in the Medicare accounts. Instead, the budget uses the \$35 billion for debt reduction. If the Congress and the President agreed to use that amount for catastrophic drug coverage, surpluses would be \$35 billion lower (plus associated debt-service costs)—and debt held by the public would be that much higher—than the numbers shown in the budget. (Like the President's budget, CBO's analysis counts the \$35 billion as part of the surplus and the reduction in publicly held debt.)

The President's Black Lung Disability Trust Fund Proposal

The President's budget proposes to provide \$1.5 billion to the Black Lung Disability Trust Fund to refinance its outstanding debt to the Treasury. That proposal, although small in comparison with the Social Security and Medicare solvency proposals, helps to illustrate how trust fund accounting can generate complicated bookkeeping transactions that have no economic significance.

The Black Lung Disability Trust Fund records both income from the excise taxes imposed on mined coal and expenditures for benefits to eligible miners and their survivors and for the administrative costs of the program. Excise tax receipts have never been sufficient to cover the program's full cost, but the trust fund has the authority to borrow from the Treasury to make up the difference. Between 1978 and 2000, the trust fund borrowed \$6.7 billion. Excise tax collec-

tions in 2000 are expected to be sufficient to pay benefits and cover the program's administrative costs, but they fall well short of meeting the \$533 million bill for interest. As a result, the fund has to borrow to pay that bill and continues to be mired in spiraling debt and interest costs.

To improve the fund's financial status, the budget proposes to reduce its annual expenses by refinancing its Treasury debt at a lower interest rate and to repeal a reduction in the excise tax rate that is scheduled for 2014. The budget would provide the trust fund with an appropriation of \$1.5 billion to compensate the Treasury for any loss in annual interest payments. That appropriation would constitute a general fund subsidy to the trust fund, explicitly recognizing that the tax revenues earmarked for the fund are inadequate to finance payments from it. The program's benefit costs are declining, and if interest costs were lowered and tax revenues were maintained, the program might eventually be able to meet its obligations (including interest expenses) without new borrowing. The proposal's impact would be limited, however. Through 2005, CBO projects that the fund's borrowing and annual interest costs would still rise faster than benefit payments will decline. By CBO's reckoning, even if the budget proposal was adopted, the fund would have to continue to borrow each year through 2010. (Although CBO does not make budget projections beyond a 10-year period, the trends evident in the projection indicate that the trust fund would not begin to cover its operating costs, let alone be able to repay its debt, until far into the future.)

If the Black Lung Disability Trust Fund clearly linked excise tax receipts with program expenditures, the need to reduce benefits or increase taxes would be readily apparent. The convoluted flows between the trust fund and the general fund of the Treasury would be unnecessary if excise tax receipts covered costs for benefits, administration, and interest. Instead, the budget proposes to address the fund's insolvency without affecting coal mine operators or Black Lung beneficiaries. It would use bookkeeping changes to shift costs away from those who pay excise taxes—initially, the coal industry—and assign them instead to general taxpayers.

9. *Budget of the United States Government, Fiscal Year 2001*, p. 72.

Comparison of Economic Forecasts

The Administration's economic assumptions for the next 11 years are similar to those of the Congressional Budget Office. Overall, the Administration's assumptions produce just \$25 billion more in projected surpluses during the 2000-2010 period than CBO's do. That addition results from revenues that are \$98 billion higher (primarily because the Administration forecasts more rapid growth in the price index of gross domestic product, which boosts taxable income) and outlays that are \$73 billion higher (because the Administration assumes higher interest rates than CBO does over most of the projection period). The additional \$25 billion in projected surpluses is less than 0.1 percent of projected revenues over that period.

Although the assumptions of CBO and the Administration are similar over the entire projection period, CBO's are more positive for the surplus than the Administration's from 2000 to 2005 and more negative in later years. The most important difference between the forecasts over the next few years is CBO's assumption that a larger share of GDP goes to taxable forms of income. In later years, the more rapid growth of nominal GDP in the Administration's forecast outweighs the fact that a smaller share of that GDP is taxed, so the Administration's assumptions lead to higher projected revenues.

Although the two forecasts are similar, they show some important differences from that of the *Blue Chip* consensus, an average of the forecasts produced by approximately 40 to 50 private-sector economists. The most recent *Blue Chip* forecast, published in March, predicts stronger growth than either CBO or the Administration for 2000 and for 2003 and subse-

quent years. Because the *Blue Chip* forecasters also expect the GDP price index to grow more rapidly than CBO does, annual average growth of nominal GDP is 0.7 percentage points faster over the next 11 years than in CBO's projections. The *Blue Chip* forecasters also project higher interest rates than CBO does.

The *Blue Chip* consensus forecast for 2000 is more optimistic than that of either the Administration or CBO because it incorporates the stronger-than-expected economic data released after the other two forecasts were completed. Two factors may mute the impact that the *Blue Chip*'s more favorable forecast will have on the budget surplus, however. First, stronger growth in the *Blue Chip* forecast is accompanied by interest rates that are higher than CBO projects, which will boost outlays. Second, oil prices have risen more than any of the three forecasts anticipated, which could raise interest rates further through expectations of higher inflation. Higher oil prices could also trim GDP growth, offsetting some of the strength of recent data. Other than that, however, those prices would have little impact on the surplus (see Box 4-1).

Real Growth and Unemployment

Both the Administration and CBO project that growth over the next 11 years will slow from its recent rapid pace. The Administration expects real GDP to increase at an average annual rate of 2.7 percent, compared with CBO's 2.8 percent. The two differ, however, in their estimates of how sharp the slowdown

will be and how long it will last (see Table 4-1). CBO expects a shallower but more drawn out slowdown than the Administration does.

In both forecasts, slower growth brings the unemployment rate up to more sustainable levels. By January 2000, that rate had fallen to 4.0 percent, producing the tightest labor market in 30 years. Both CBO and the Administration project that the unemployment rate will eventually rise to 5.2 percent—by 2003 in the Administration's forecast and by 2008 in CBO's. That rate is reached sooner in the Administration's forecast because real GDP growth slows from 3.3 percent in 2000 to just 2.5 percent in 2002 and

2003. Growth then rebounds to a rate that is strong enough to keep unemployment from rising further.

By contrast, the slowdown in real GDP growth is more gradual in CBO's forecast, with growth averaging 2.8 percent between 2000 and 2003, compared with 2.6 percent in the Administration's forecast. Largely as a result, CBO's projected unemployment rate is 0.5 percentage points below the Administration's in 2003. From 2003 to 2008, however, real GDP grows at an average annual rate of 2.7 percent in CBO's forecast, compared with 2.9 percent in the Administration's. That growth rate brings CBO's projec-

Box 4-1.

The Potential Economic and Budgetary Effects of Higher Oil Prices

Oil prices have climbed much higher than the Congressional Budget Office (CBO) anticipated when it prepared its most recent economic forecast, in December. At that time, CBO predicted that West Texas intermediate crude oil would cost about \$23 per barrel during the second quarter of 2000. By mid-March, however, the price had risen to \$32 per barrel. Global demand for oil has exceeded supply by about 2 million barrels per day for more than a year, resulting in dwindling inventories and the spike in prices. Even if oil exporters boost production, prices are likely to remain higher than in CBO's forecast for several months, as the building of inventories puts pressure on limited refinery capacity.

Higher oil prices can hurt the economy through at least two channels. First, higher prices for imported crude oil act like a tax on U.S. energy users. After paying the "tax," consumers and businesses have less to spend on other goods and services, so real (inflation-adjusted) gross domestic product (GDP) falls. Second, the rise in oil prices may lead the Federal Reserve to raise interest rates further to fight inflation than it would otherwise. Of course, if the Federal Reserve believes that higher oil prices are only temporary and that any inflationary impact will eventually disappear as prices recede, there will be no need for it to boost interest rates.

The effects of higher oil prices on real GDP and interest rates are hard to predict. Thus, CBO has not

made any budgetary estimates of those effects. However, it is possible to estimate the budgetary consequences of the more direct impact of higher oil prices: the effects on the growth of the consumer price index (CPI) and incomes.

On the one hand, higher oil prices raise the CPI and thus boost the cost of federal programs that are indexed to it. On the other hand, the income of domestic oil producers rises, producing extra tax revenues and at least partially offsetting the impact from lower real GDP. Because changes in the CPI affect outlays only in the following year, the impact on revenues occurs before the impact on outlays. As a result, the net budgetary impact of a higher CPI and more income for oil producers would actually be positive in 2000 because the higher CPI would not affect spending until 2001.

The size of the effect in 2001 would depend on how long high oil prices persisted. Assuming that the price of crude oil remained roughly \$7 to \$8 per barrel greater than CBO expected through the end of 2001 and that those increased prices had no impact on real GDP or interest rates, outlays in 2001 would be \$3 billion to \$4 billion higher, and revenues would be \$4 billion to \$8 billion higher. If, by contrast, crude oil prices returned to projected levels at the beginning of 2001, outlays would still be \$3 billion to \$4 billion higher, but the impact on revenues would be smaller.

Table 4-1.
Comparison of Economic Projections for Calendar Years 2000-2010

	Forecast		Projected								
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Nominal GDP											
(Billions of dollars)											
CBO	9,692	10,154	10,610	11,069	11,544	12,054	12,589	13,148	13,734	14,362	15,024
Administration	9,685	10,156	10,621	11,105	11,644	12,236	12,847	13,477	14,118	14,777	15,471
<i>Blue Chip</i>	9,801	10,300	10,805	11,335	11,947	12,580	13,247	13,935	14,660	15,422	16,224
Nominal GDP											
(Percentage change)											
CBO	5.0	4.8	4.5	4.3	4.3	4.4	4.4	4.4	4.5	4.6	4.6
Administration	4.9	4.9	4.6	4.6	4.9	5.1	5.0	4.9	4.8	4.7	4.7
<i>Blue Chip</i>	5.9	5.1	4.9	4.9	5.4	5.3	5.3	5.2	5.2	5.2	5.2
Real GDP											
(Percentage change)											
CBO	3.3	3.1	2.8	2.6	2.6	2.7	2.7	2.7	2.7	2.9	2.9
Administration	3.3	2.7	2.5	2.5	2.8	3.0	2.9	2.8	2.7	2.6	2.6
<i>Blue Chip</i>	4.1	3.1	2.8	2.8	3.3	3.3	3.2	3.1	3.1	3.1	3.1
GDP Price Index^a											
(Percentage change)											
CBO	1.6	1.6	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Administration	1.6	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
<i>Blue Chip</i>	1.8	2.0	2.0	2.1	2.1	2.0	2.0	2.1	2.1	2.1	2.1
Consumer Price Index^b											
(Percentage change)											
CBO	2.5	2.4	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Administration	2.6	2.4	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
<i>Blue Chip</i>	2.6	2.6	2.6	2.6	2.5	2.4	2.4	2.5	2.5	2.5	2.5
Unemployment Rate											
(Percent)											
CBO	4.1	4.2	4.4	4.7	4.8	5.0	5.0	5.1	5.2	5.2	5.2
Administration	4.2	4.5	5.0	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
<i>Blue Chip</i>	4.0	4.2	4.5	4.7	4.7	4.7	4.6	4.7	4.7	4.7	4.7
Three-Month Treasury											
Bill Rate (Percent)											
CBO	5.4	5.6	5.3	4.9	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Administration	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
<i>Blue Chip</i>	5.8	5.9	5.5	5.4	5.4	5.2	5.2	5.2	5.2	5.2	5.2
Ten-Year Treasury											
Note Rate (Percent)											
CBO	6.3	6.4	6.1	5.8	5.7	5.7	5.7	5.7	5.7	5.7	5.7
Administration	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1
<i>Blue Chip</i>	6.5	6.4	6.2	6.1	6.1	5.9	6.0	5.9	5.9	5.9	5.9
Taxable Income^c											
(Billions of dollars)											
CBO	7,748	8,054	8,336	8,631	8,950	9,296	9,666	10,051	10,455	10,883	11,325
Administration	7,714	8,001	8,281	8,568	8,912	9,302	9,717	10,132	10,549	10,977	11,419

SOURCES: Congressional Budget Office; Office of Management and Budget; Aspen Publishers, *Blue Chip Economic Indicators* (March 10, 2000).

NOTE: Percentage changes are year over year.

a. The GDP price index is virtually the same as the implicit GDP deflator.

b. The consumer price index for all urban consumers.

c. Taxable personal income plus corporate profits before tax. The *Blue Chip* does not project taxable income.

tion of the unemployment rate in line with the Administration's in 2008. After that, real GDP grows slightly faster in CBO's projection, reflecting slightly stronger growth of potential GDP. (Potential GDP is an estimate of the level of output that is consistent with the long-term level of the civilian unemployment rate.)

Real GDP growth in the *Blue Chip* consensus forecast follows a pattern similar to the ones in CBO's and the Administration's forecasts but is generally stronger. In all three forecasts, that growth slows each year from 2000 to 2002 and remains below the growth of potential GDP in 2003. In response, unemployment rises through 2003 in all three forecasts. From 2004 on, however, average growth in the *Blue Chip* forecast is roughly 0.4 percentage points higher than in CBO's. The unemployment rate in that forecast stabilizes at around 4.7 percent, lower than CBO and the Administration project.

Inflation and Interest Rates

The Administration generally expects higher rates of inflation over the next 11 years than CBO does, but the differences are larger for the GDP price index than for the consumer price index (CPI). The Administration's forecast of CPI inflation is just 0.1 percentage point higher than CBO's in every year except 2001, when the forecasts are the same. However, the Administration expects the GDP price index to grow 0.3 percentage points faster, on average, over the projection period than CBO does.

On balance, the Administration's assumptions about inflation are more favorable for the budget outlook than CBO's are. Higher inflation boosts both revenues and outlays and thus has both positive and negative effects on the surplus. The positive effects come from a higher GDP price index, which increases both nominal GDP and taxable income (assuming that real GDP and the share of nominal GDP going to taxable income are unaffected). The negative effects come from a higher CPI, which affects the cost of several programs and the indexing of personal tax brackets and other tax parameters. Because the difference in projected growth rates is much greater for the GDP price index than for the CPI, the positive effects of the

Administration's higher GDP price index on revenues far outweigh the negative effects of its higher CPI.

The Administration assumes steady interest rates through 2010—5.2 percent for three-month Treasury bills and 6.1 percent for 10-year Treasury notes. By contrast, CBO assumes that interest rates will follow the same moderate cycle as real GDP growth. That assumption reflects CBO's view that the Federal Reserve will raise interest rates this year to slow economic growth to a more sustainable rate. CBO therefore projects that the short-term rate will be 5.4 percent in 2000, 5.6 percent in 2001, and then fall, averaging 4.8 percent a year from 2004 on. In both CBO's and the Administration's projections, rates for 10-year Treasury notes follow a pattern similar to that for three-month Treasury bills but are 0.8 to 0.9 percentage points higher. The impact that differences in interest rates have on outlays fades over time as the amount of debt held by the public gradually declines.

The interest rate forecasts for 2000 that CBO made in December now look optimistic. Early this year, rates for three-month Treasury bills had already risen above the levels forecast by CBO and the Administration. Both the *Blue Chip* forecast and the futures markets for the federal funds rate imply further increases in short-term interest rates.

Income

Projections of revenues depend not only on total output (GDP) and the income generated in producing that output but also on the distribution of income among its various categories. Several categories of income—such as depreciation (wear and tear and obsolescence of business equipment and structures), employer-paid health insurance, and employers' contributions to retirement accounts and Social Security—are not taxed. Income in other categories is taxed, but at different rates. Corporate profits and wages and salaries are the most important income categories for projecting revenues because they are taxed at the highest effective rates. The smaller the projected share of nominal GDP that goes to taxable income, especially to the highly taxed categories, the lower government revenues will be.

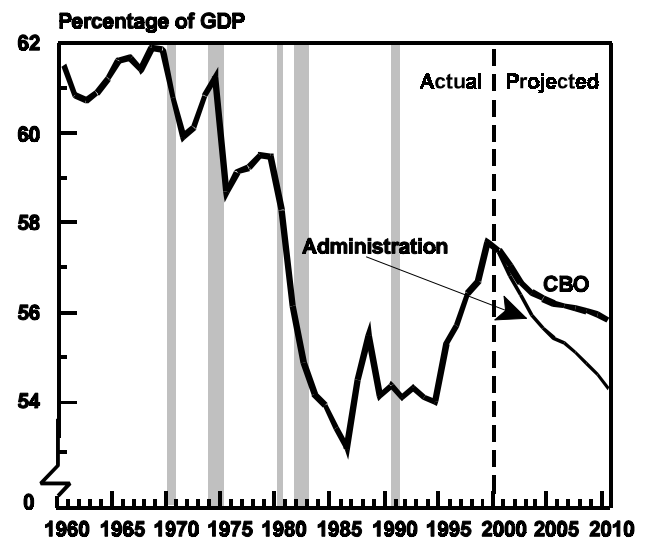
From 2000 to 2004, CBO's projection of taxable income is higher than the Administration's, boosting revenues by \$5 billion to \$10 billion a year. That projection is higher, even though CBO's projection of nominal GDP is lower, because CBO assumes a more gradual drop in the taxable share of nominal GDP, especially in the categories of corporate profits and wages and salaries, than the Administration does (see Figure 4-1). Nominal GDP is slightly lower in CBO's forecast, despite higher real GDP, because CBO anticipates slower growth for the GDP price index.

From 2005 to 2010, however, the Administration projects higher taxable income than CBO does, increasing revenues by \$23 billion a year. During that period, the Administration's more optimistic forecast for nominal GDP outweighs CBO's more optimistic forecast for taxable shares of GDP. By 2010, nominal GDP is 3.0 percent higher in the Administration's forecast than in CBO's. Taxable income is therefore higher in the Administration's projection, entirely because the Administration forecasts more rapid growth in the GDP price index. In total, the Administration's higher forecast for income boosts revenues by \$98 billion, or less than 0.4 percent of total revenues, during the 2000-2010 period.

The share of GDP going to the taxable income categories of corporate profits and wages and salaries drops in both forecasts for several reasons. First, nontaxable income accounts for a larger share of GDP as high projected levels of investment boost deprecia-

tion's share of output and as fringe benefits resume their historical upward trend as a share of GDP. In addition, businesses will have higher interest costs, reducing corporate profits' share of GDP.

Figure 4-1.
Wages and Salaries Plus Corporate Before-Tax Profits



SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Office of Management and Budget.

NOTE: The shaded vertical bars indicate periods of recession (measured from the peak to the trough of the recession).

Appendixes

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 what will actually occur, since policymakers will undoubtedly seek to alter current priorities. But CBO's 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 other initiatives.

The Baseline Concept

CBO's baseline projections follow some general rules. Revenues and mandatory spending (for entitlement programs such as Social Security and Medicare, among other things) are assumed to 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 the like. For those categories of the budget, the baseline represents CBO's forecast of what will happen in accordance with current laws. In the case of mandatory programs whose authorization will expire in the next 10 years, the Balanced Budget and Emergency Deficit Control Act directs CBO to assume that the programs will continue through the end of the projection period—provided that they were enacted before 1997 and have more than \$50 million in outlays in the current year. (See Table A-1 for the budget authority and outlays

associated with continuing programs that have expiring authorizations.)

Discretionary programs, unlike entitlement programs, are funded each year through the appropriation process. They encompass nearly all spending for defense and international affairs, as well as many domestic programs—such as space, energy, highway and airport grants, environmental protection, and health research—and the salaries and expenses of most government agencies.

No consensus exists about how best to project the continuation of current policy for discretionary programs. Therefore, in *The Budget and Economic Outlook: Fiscal Years 2001-2010*, published in January, CBO presented three variants of its baseline to reflect different assumptions about the path of discretionary spending (see Table A-2).

- o The "inflated" variation assumes that budget authority for discretionary programs grows at the rate of inflation each year after 2000.
- o The "freeze" variation limits discretionary budget authority to the level enacted for 2000 plus the amount already enacted for 2001.
- o The "capped" variation of the baseline assumes compliance with the statutory caps through 2002 and allows discretionary budget authority to grow at the rate of inflation thereafter.

The baseline includes three other categories of spending. Offsetting receipts encompass premium

payments by Medicare beneficiaries and a variety of other fees and collections. CBO's baseline for offsetting receipts is its estimate of the amount that the government will collect under current laws and policies.

The second category, net interest, basically reflects the government's interest payments on the national debt. Estimates of net interest are a function of market interest rates and the amount of federal debt held by the public. The amount of interest in CBO's baseline depends on the variation chosen for discretionary spending.

The third category is proceeds from investing excess cash. CBO's baseline assumes that the surpluses projected for the 2001-2010 period will be used to pay down the debt. But because some debt will not yet have matured or will be unavailable for repurchase, the projected surpluses may exceed the amount of debt that can absorb such cash. CBO's projections thus assume that excess cash will be invested at an interest rate equal to the average rate projected for Treasury bills and notes. However, CBO makes no explicit assumptions about the kind of investments that might be chosen (for example, whether they would be in debt or equity instruments, in the public or private sector, or in the United States or abroad).

Baseline Projections

In January, CBO published its baseline projections, which described key factors that influence the federal government's revenues, spending, and surplus. This report updates those projections to incorporate more recent information obtained from the President's budget submission and other sources. In each of CBO's baseline variations, and for every year, the total surplus is now slightly higher than CBO estimated in January—but by no more than \$6 billion in any one year. In 2000, the surplus will total \$179 billion, CBO now projects, in the absence of supplemental appropriations or other legislation that would affect revenues or spending. By CBO's reckoning, about \$153 billion of that surplus is derived from off-budget accounts—mainly the Social Security trust funds. That leaves a \$26 billion surplus in on-budget ac-

counts, the largest ever in nominal dollars (see Table A-3).

The Congressional Budget Office generally divides revisions to its estimates into three categories: legislative (those that result from new laws), economic (those that result directly from revised economic assumptions), and technical (those that do not fall into the first two categories). Because CBO has not updated its economic forecasts and no new legislation has affected projections since January, all of the changes to the baseline are technical. The technical revisions stem from new information that emerged through late February.

Projections of future surpluses depend in part on the path assumed for discretionary spending. Nonetheless, CBO forecasts growing surpluses in each of its baseline variations. Between 2001 and 2010, accumulated surpluses are projected to total \$3.2 trillion under the inflated variation, \$4.2 trillion under the freeze variation, and \$4.3 trillion under the capped variation. On-budget surpluses total nearly \$900 billion under the inflated version and \$1.9 trillion under the other two baseline alternatives.

CBO's revenue projections have not changed since January, and its outlay projections have changed only a little (see Table A-4). Technical revisions to the projected growth rates for discretionary budget authority reduce outlays by \$2 billion to \$4 billion per year from 2003 through 2010 in the inflated variation (such revisions do not affect the freeze or capped versions of the baseline). On the mandatory side of the budget, CBO's estimates of spending have increased slightly for programs such as unemployment insurance and Social Security; they have declined for Medicare. In addition, CBO has boosted its estimate of the volume of loans that will be guaranteed under the mutual mortgage insurance program of the Federal Housing Administration, which leads to an increase in net offsetting receipts to the government.

Projections of net interest have been reduced since January because of higher estimated surpluses. The debt-service savings under the capped and freeze variations of the baseline increase from less than \$500 million in 2001 to \$4 billion in 2010. Savings are slightly larger under the inflated baseline, reaching \$5 billion in 2010.

CBO's updated baseline also incorporates new information about credit reestimates calculated by various agencies. Credit programs provide both direct loans and loan guarantees to nonfederal government entities. Under credit reform, the budget records the net present value of the costs to the government of those loans. Such costs represent the net cash flows associated with interest rate subsidies, defaults, and other factors. Agencies are required to reestimate the subsidy costs of their credit programs annually to reflect actual experience and current economic conditions. At the end of fiscal year 1999, agencies determined that initial subsidy estimates, as a whole, were too low and that additional resources were required to reflect the costs of their credit activities. As a result, they revised their estimates of subsidy costs for 1999 upward by more than \$6 billion (see Table A-5).

Early this year, agencies estimated that credit costs would be lower than previously anticipated. Consequently, in its January report, CBO assumed a downward reestimate of approximately \$2 billion. CBO's current baseline incorporates new information for credit programs provided in the President's budget, which indicates that total program costs should be revised downward by almost \$3.5 billion.

The majority of those revisions involve credit reestimates associated with student loans and auctions of spectrum licenses. The reestimate to student loans is largely the result of revised interest rate projections used by the Department of Education. CBO's reestimates of the 2000 subsidy costs associated with certain spectrum auctions are unchanged from its January baseline. For 2001, however, CBO has included a further downward reestimate of \$1.6 billion because of the favorable outlook for recoveries on certain loans that the Federal Communications Commission made to entities acquiring licenses to use parts of the electromagnetic spectrum. (For a discussion of those loans and other spectrum issues, see Appendix B in *The Budget and Economic Outlook*.)

The remaining tables in this appendix (Tables A-6 through A-11) 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 should refer to that earlier publication.

The budget's total surplus is the difference between total revenues and total spending. However, the law specifies another way to measure the gap between revenues and spending—the on-budget surplus—which is shown in Table A-3 for each baseline variation. The on-budget surplus recognizes that the Social Security trust funds and the Postal Service have been given special off-budget status by law. Excluding those programs from the surplus alters the fiscal outlook, mainly because Social Security both receives and spends large amounts of money. The Social Security trust funds currently have large surpluses because trust fund income (payroll taxes plus the taxes paid on Social Security benefits and the income the trust funds receive from interest on their holdings of Treasury securities) exceeds benefits and administrative expenses. In 2000, Social Security income is expected to exceed benefits and administrative payments by \$153 billion under all three variations of the baseline. Under both the inflated and capped variations, on-budget surpluses are projected to reach \$293 billion in 2010; the surplus under the freeze variation is slightly higher because Social Security administrative expenses, which are classified as discretionary spending, are lower.

Tables A-6 to A-8 present federal revenues by source and outlays by broad category, both in dollars and in relation to gross domestic product (GDP). Revenue projections remain unchanged from those presented in CBO's January report and are unaffected by varying assumptions about the path of discretionary spending. Projected revenues as a percentage of GDP fall gradually from 20.3 percent in 2000 to 19.8 percent in 2004 and hold steady at that level through 2010. Total spending varies according to the assumption about discretionary spending and the resulting effect on net interest. Assuming that discretionary spending increases at the rate of inflation after 2000, total spending is expected to grow steadily from \$1.8 trillion this year to \$2.5 trillion in 2010. Alternatively, total spending is projected to grow to \$2.2 trillion in 2010 assuming that discretionary spending is frozen at the level enacted for 2000, and to \$2.3 trillion in 2010 assuming that discretionary spending equals CBO's estimates of the statutory caps through 2002 and increases at the rate of inflation thereafter.

Table A-9 presents spending projections for entitlements and other mandatory programs, by far the

largest spending category in the budget. That spending is expected to total more than \$1 trillion in 2000 and continue to grow rapidly through 2010. Expenditures for Social Security, Medicare, and Medicaid, which together account for slightly more than three-quarters of all mandatory outlays, are fueling that growth.

Interest costs are currently a sizable portion of the federal budget. But under CBO's baseline projections of rapidly rising annual surpluses through 2010, outstanding government debt declines sharply over that period. Therefore, despite a projected increase in interest rates in the near term, annual interest payments on the debt fall quickly over that period from their 1999 level of \$230 billion (see Table A-10).

The path of interest costs depends on the size and composition of federal debt. Unless the Treasury is able to repurchase outstanding debt, some of the securities that are now outstanding, such as long-term bonds, will not be available for redemption over the next 10 years.¹ Therefore, in any given year, a certain amount of debt will remain outstanding and incur interest costs, regardless of the size of the surplus. For

example, CBO estimates that for each variation of the baseline, the minimum level of outstanding debt will be \$941 billion in 2010 (see Table A-11). The three variations reach the minimum level of debt in a different year. However, once the minimum is reached, the baseline accounts for any excess cash from the surplus separately and does not consider proceeds generated by investing that cash as part of net interest. By 2010, all three variants will be at the minimum level of debt for the entire year and will therefore have identical net interest costs.

Although all three versions of the baseline have the same net interest costs in 2010, the path of those costs varies in previous years (see Table A-10). The inflated variation has the lowest surpluses and thus the highest federal debt and interest costs of the three variants. Yet even under that measure, the minimum level of debt is reached during 2009, and net interest drops from \$230 billion in 1999 to \$67 billion in 2010. The freeze and capped variants also project \$67 billion for net interest in 2010, but the drop is quicker and the minimum level of debt is reached earlier than in the inflated baseline. As a result, relative to that version, total net interest costs from 2001 to 2010 are \$80 billion less under the freeze and \$136 billion less under the capped variation. In all three, net interest as a share of total spending drops from 13 percent in 2000 to about 3 percent in 2010.

1. The Department of the Treasury has repurchased \$2 billion of outstanding marketable debt through March 16, 2000. CBO did not incorporate any assumptions about debt buybacks in its baseline projections.

Table A-1.
Mandatory Programs with Expiring Authorizations That Are Assumed to Continue in CBO's Baseline
(By fiscal year, in billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Commodity Credit Corporation Fund ^a										
Budget authority	n.a.	n.a.	9.1	8.4	7.0	6.0	5.1	4.8	4.8	4.8
Outlays	n.a.	n.a.	9.1	8.4	7.0	6.0	5.1	4.8	4.8	4.8
Ground Transportation Programs Controlled by Annual Obligation Limitations ^b										
Budget authority	n.a.	n.a.	n.a.	36.9	36.9	36.9	36.9	36.9	36.9	36.9
Outlays	n.a.	n.a.	n.a.	0	0	0	0	0	0	0
Ground Transportation Programs Not Subject to Annual Obligation Limitations										
Budget authority	n.a.	n.a.	n.a.	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Outlays	n.a.	n.a.	n.a.	0.1	0.3	0.5	0.5	0.6	0.6	0.6
Family Preservation and Support										
Budget authority	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Outlays	n.a.	0.1	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Rehabilitation Services and Disability Research										
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.8	2.8	2.9	3.0
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1.9	2.7	2.9	3.0
Federal Unemployment Benefits and Allowances										
Budget authority	n.a.	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Outlays	n.a.	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.4	0.4
Food Stamps										
Budget authority	n.a.	n.a.	20.8	21.6	22.3	23.0	23.7	24.5	25.3	26.1
Outlays	n.a.	n.a.	19.9	21.5	22.3	23.0	23.7	24.5	25.3	26.1
Child Nutrition ^c										
Budget authority	n.a.	n.a.	n.a.	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Outlays	n.a.	n.a.	n.a.	0.4	0.5	0.5	0.6	0.6	0.6	0.6
Child Care Entitlements to States										
Budget authority	n.a.	n.a.	2.7	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Outlays	n.a.	n.a.	2.2	2.7	2.7	2.7	2.7	2.7	2.7	2.7
Temporary Assistance for Needy Families										
Budget authority	n.a.	n.a.	16.7	16.9	16.9	16.9	16.9	16.9	16.9	16.9
Outlays	n.a.	n.a.	17.4	17.8	18.1	18.2	18.3	18.4	18.4	18.4
Veterans' Compensation COLAs										
Budget authority	0.4	0.9	1.4	2.0	2.7	3.1	3.4	4.3	4.8	5.5
Outlays	0.3	0.8	1.4	1.9	2.7	3.0	3.3	4.2	4.8	5.4
Total										
Budget authority	0.4	1.4	51.3	90.2	90.4	90.4	93.4	94.9	96.4	97.9
Outlays	0.3	1.1	50.4	53.4	54.1	54.5	56.8	59.1	60.8	62.3

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; COLAs = cost-of-living adjustments.

- Agricultural commodity price and income supports under the Federal Agriculture Improvement and Reform Act of 1996 (FAIR) generally expire after 2002. Although permanent price support authority under the Agricultural Adjustment Act of 1939 and the Agricultural Act of 1949 would then become effective, section 257(b)(2)(iii) of the Deficit Control Act provides that the baseline must assume continuation of the FAIR provisions.
- Authorizing legislation provides contract authority, which is counted as mandatory budget authority. However, because spending is subject to obligation limitations specified in annual appropriation acts, outlays are considered discretionary.
- The expiring child nutrition programs encompass the Summer Food Program and state administrative expenses.

Table A-2.
CBO's Projections of Discretionary Spending Under Alternative Versions of the Baseline
(By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Discretionary Spending Grows at the Rate of Inflation After 2000^a											
Budget Authority	570	607	622	638	654	669	685	702	719	737	754
Outlays	603	635	650	667	682	700	714	727	747	764	782
Discretionary Spending Is Frozen at the Level Enacted for 2000^a											
Budget Authority	570	586	586	586	586	586	586	586	586	586	586
Outlays	603	625	627	628	623	625	622	620	621	621	621
Discretionary Spending Equals CBO's Estimates of the Statutory Caps Through 2002 and Grows at the Rate of Inflation Thereafter											
Budget Authority	570	541	550	564	578	593	607	623	638	654	671
Outlays	603	579	571	585	600	615	630	646	662	679	696

SOURCE: Congressional Budget Office.

NOTE: In CBO's projections, discretionary outlays are always higher than budget authority because of spending from the Highway Trust Fund and the Airport and Airway Trust Fund, which is subject to obligation limitations in appropriation acts. The budget authority for such programs is provided in authorizing legislation and is not considered discretionary. Another reason outlays exceed budget authority is that they include spending from appropriations provided in previous years.

a. After adjustment for advance appropriations.

Table A-3.
The Budget Outlook Under Current Policies (By fiscal year, in billions of dollars)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Total, 2001- 2005	Total, 2001- 2010
Discretionary Spending Grows at the Rate of Inflation After 2000^a														
On-Budget Surplus	1	26	15	29	36	42	48	92	121	138	169	202	171	893
Off-Budget Surplus	<u>124</u>	<u>153</u>	<u>166</u>	<u>182</u>	<u>195</u>	<u>209</u>	<u>225</u>	<u>238</u>	<u>253</u>	<u>266</u>	<u>280</u>	<u>293</u>	<u>976</u>	<u>2,307</u>
Total Surplus	124	179	181	212	231	250	273	330	374	404	449	495	1,147	3,199
Discretionary Spending Is Frozen at the Level Enacted for 2000^a														
On-Budget Surplus	1	26	27	54	77	106	132	197	248	290	349	410	396	1,891
Off-Budget Surplus	<u>124</u>	<u>153</u>	<u>166</u>	<u>182</u>	<u>196</u>	<u>209</u>	<u>225</u>	<u>239</u>	<u>254</u>	<u>267</u>	<u>281</u>	<u>294</u>	<u>978</u>	<u>2,313</u>
Total Surplus	124	179	192	237	273	315	358	436	502	558	629	704	1,374	4,204
Discretionary Spending Equals CBO's Estimates of the Statutory Caps Through 2002 and Grows at the Rate of Inflation Thereafter														
On-Budget Surplus	1	26	73	115	129	139	154	202	234	261	300	341	610	1,948
Off-Budget Surplus	<u>124</u>	<u>153</u>	<u>166</u>	<u>182</u>	<u>195</u>	<u>209</u>	<u>225</u>	<u>238</u>	<u>253</u>	<u>266</u>	<u>280</u>	<u>293</u>	<u>976</u>	<u>2,307</u>
Total Surplus	124	179	239	297	324	348	379	440	487	527	580	634	1,587	4,255

SOURCE: Congressional Budget Office.

a. After adjustment for advance appropriations.

Table A-4.
Changes in CBO's Estimates of Surpluses Since January 2000 Under Alternative Versions
of the Baseline (By fiscal year, in billions of dollars)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Discretionary Spending Grows at the Rate of Inflation After 2000^a											
January 2000 Total Surplus	176	177	209	227	246	268	325	368	399	444	489
Technical Changes											
Revenues	0	0	0	0	0	0	0	0	0	0	0
Outlays											
Discretionary	*	*	*	-2	-2	-2	-2	-3	-3	-4	-4
Mandatory	-4	-5	-2	-2	-2	-1	-1	*	1	2	3
Net interest	*	*	-1	-1	-1	-1	-2	-2	-3	-4	-5
Subtotal	-3	-4	-3	-5	-5	-5	-5	-5	-5	-5	-6
Total Changes	3	4	3	5	5	5	5	5	5	5	6
March 2000 Total Surplus	179	181	212	231	250	273	330	374	404	449	495
Discretionary Spending Is Frozen at the Level Enacted for 2000^a											
January 2000 Total Surplus	176	188	232	271	312	355	434	500	556	628	703
Technical Changes											
Revenues	0	0	0	0	0	0	0	0	0	0	0
Outlays											
Discretionary	*	*	-1	1	*	*	*	*	*	*	*
Mandatory	-4	-5	-2	-2	-2	-1	-1	*	1	2	3
Net interest	*	*	-1	-1	-1	-1	-1	-2	-2	-3	-4
Subtotal	-3	-5	-4	-2	-3	-3	-2	-2	-2	-1	-1
Total Changes	3	5	4	2	3	3	2	2	2	1	1
March 2000 Total Surplus	179	192	237	273	315	358	436	502	558	629	704
Discretionary Spending Equals CBO's Estimates of the Statutory Caps Through 2002 and Grows at the Rate of Inflation Thereafter											
January 2000 Total Surplus	176	235	294	321	345	376	438	485	526	579	633
Technical Changes											
Revenues	0	0	0	0	0	0	0	0	0	0	0
Outlays											
Discretionary	*	1	*	*	*	*	*	*	*	*	*
Mandatory	-4	-5	-2	-2	-2	-1	-1	*	1	2	3
Net interest	*	*	-1	-1	-1	-1	-1	-2	-2	-3	-4
Subtotal	-3	-4	-3	-3	-3	-2	-2	-2	-1	-1	-1
Total Changes	3	4	3	3	3	2	2	2	1	1	1
March 2000 Total Surplus	179	239	297	324	348	379	440	487	527	580	634

SOURCE: Congressional Budget Office.

NOTE: * = between -\$500 million and \$500 million.

a. After adjustment for advance appropriations.

Table A-5.
Credit Subsidy Reestimates Since 1999 (By fiscal year, in billions of dollars)

	Actual 1999	2000 (Projected)		2001 (Projected)	
		January Baseline	March Baseline	January Baseline	March Baseline
Student Loans	0	0	-1.7	0	0
Federal Communications Commission's Spectrum Auctions	1.4	-1.8	-1.8	0	-1.6
Small Business Administration	-0.3	-0.5	-0.6	0	0
Federal Housing Administration	4.9	0	0	0	0
Veterans' Housing	0.4	0	0.2	0	0
Other	<u>-0.1</u>	<u>*</u>	<u>0.4</u>	<u>0</u>	<u>0</u>
Total	6.3	-2.2	-3.5	0	-1.6

SOURCE: Congressional Budget Office.

NOTE: * = less than \$50 million.

Table A-6.
CBO's Baseline Budget Projections, Assuming That Discretionary Spending Grows
at the Rate of Inflation After 2000 (By fiscal year)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
In Billions of Dollars												
Revenues												
Individual income	879	945	986	1,026	1,068	1,112	1,162	1,217	1,275	1,339	1,407	1,480
Corporate income	185	189	189	187	190	194	200	208	216	225	233	242
Social insurance	612	653	684	714	742	770	808	842	878	913	954	998
Other	<u>151</u>	<u>158</u>	<u>158</u>	<u>169</u>	<u>177</u>	<u>187</u>	<u>192</u>	<u>198</u>	<u>202</u>	<u>210</u>	<u>218</u>	<u>226</u>
Total	1,827	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946
On-budget	1,383	1,465	1,515	1,571	1,630	1,693	1,764	1,843	1,923	2,010	2,106	2,208
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays												
Discretionary spending	575	603	635	650	667	682	700	714	727	747	764	782
Mandatory spending	978	1,017	1,067	1,118	1,180	1,248	1,329	1,385	1,461	1,552	1,646	1,748
Offsetting receipts	-80	-79	-85	-92	-94	-94	-99	-104	-109	-114	-120	-126
Net interest	230	224	218	209	193	176	159	140	120	98	78	67
Proceeds from investing excess cash	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>-5</u>	<u>-20</u>
Total	1,703	1,766	1,835	1,885	1,945	2,012	2,089	2,135	2,198	2,282	2,364	2,451
On-budget	1,382	1,439	1,499	1,542	1,593	1,651	1,716	1,751	1,802	1,872	1,937	2,006
Off-budget	321	327	336	343	352	361	373	384	397	410	427	445
Surplus												
On-budget	124	179	181	212	231	250	273	330	374	404	449	495
Off-budget	1	26	15	29	36	42	48	92	121	138	169	202
Off-budget	124	153	166	182	195	209	225	238	253	266	280	293
Debt Held by the Public	3,633	3,452	3,284	3,078	2,858	2,618	2,355	2,034	1,667	1,270	1,016	941
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	189	603

Table A-6.
Continued

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
As a Percentage of GDP												
Revenues												
Individual income	9.6	9.9	9.8	9.8	9.7	9.7	9.7	9.8	9.8	9.9	9.9	10.0
Corporate income	2.0	2.0	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
Social insurance	6.7	6.8	6.8	6.8	6.8	6.7	6.8	6.8	6.8	6.7	6.7	6.7
Other	<u>1.7</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>
Total	20.0	20.3	20.1	20.0	19.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
On-budget	15.2	15.3	15.1	15.0	14.9	14.8	14.8	14.8	14.8	14.8	14.8	14.9
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays												
Discretionary spending	6.3	6.3	6.3	6.2	6.1	6.0	5.9	5.7	5.6	5.5	5.4	5.3
Mandatory spending	10.7	10.6	10.6	10.7	10.8	10.9	11.1	11.1	11.2	11.4	11.6	11.8
Offsetting receipts	-0.9	-0.8	-0.8	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.9
Net interest	2.5	2.3	2.2	2.0	1.8	1.5	1.3	1.1	0.9	0.7	0.5	0.5
Proceeds from investing excess cash	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>*</u>	<u>-0.1</u>
Total	18.7	18.4	18.3	18.0	17.8	17.6	17.5	17.1	16.9	16.8	16.6	16.5
On-budget	15.2	15.0	14.9	14.7	14.5	14.5	14.4	14.1	13.9	13.8	13.6	13.5
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0
Surplus												
On-budget	*	0.3	0.2	0.3	0.3	0.4	0.4	0.7	0.9	1.0	1.2	1.4
Off-budget	1.4	1.6	1.7	1.7	1.8	1.8	1.9	1.9	1.9	2.0	2.0	2.0
Debt Held by the Public	39.9	36.0	32.7	29.3	26.1	22.9	19.8	16.3	12.8	9.3	7.2	6.3
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1.3	4.1
Memorandum:												
Gross Domestic Product (Billions of dollars)	9,116	9,583	10,038	10,496	10,954	11,422	11,924	12,453	13,006	13,583	14,202	14,856

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = less than 0.05 percent of GDP.

Table A-7.
CBO's Baseline Budget Projections, Assuming That Discretionary Spending Is Frozen
at the Level Enacted for 2000 (By fiscal year)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
In Billions of Dollars												
Revenues												
Individual income	879	945	986	1,026	1,068	1,112	1,162	1,217	1,275	1,339	1,407	1,480
Corporate income	185	189	189	187	190	194	200	208	216	225	233	242
Social insurance	612	653	684	714	742	770	808	842	878	913	954	998
Other	<u>151</u>	<u>158</u>	<u>158</u>	<u>169</u>	<u>177</u>	<u>187</u>	<u>192</u>	<u>198</u>	<u>202</u>	<u>210</u>	<u>218</u>	<u>226</u>
Total	1,827	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946
On-budget	1,383	1,465	1,515	1,571	1,630	1,693	1,764	1,843	1,923	2,010	2,106	2,208
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays												
Discretionary spending	575	603	625	627	628	623	625	622	620	621	621	621
Mandatory spending	978	1,017	1,067	1,118	1,180	1,248	1,329	1,385	1,461	1,552	1,646	1,748
Offsetting receipts	-80	-79	-85	-92	-94	-94	-99	-104	-109	-114	-120	-126
Net interest	230	224	218	207	190	170	149	125	99	79	72	67
Proceeds from investing excess cash	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>-10</u>	<u>-36</u>	<u>-68</u>
Total	1,703	1,766	1,824	1,860	1,904	1,948	2,004	2,029	2,070	2,129	2,183	2,242
On-budget	1,382	1,439	1,488	1,517	1,552	1,587	1,632	1,645	1,674	1,720	1,758	1,798
Off-budget	321	327	336	343	352	361	372	384	396	409	426	444
Surplus												
On-budget	124	179	192	237	273	315	358	436	502	558	629	704
Off-budget	1	26	27	54	77	106	132	197	248	290	349	410
Off-budget	124	153	166	182	196	209	225	239	254	267	281	294
Debt Held by the Public	3,633	3,452	3,272	3,041	2,780	2,476	2,128	1,701	1,206	1,078	1,016	941
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	423	984	1,607

Table A-7.
Continued

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
As a Percentage of GDP												
Revenues												
Individual income	9.6	9.9	9.8	9.8	9.7	9.7	9.7	9.8	9.8	9.9	9.9	10.0
Corporate income	2.0	2.0	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
Social insurance	6.7	6.8	6.8	6.8	6.8	6.7	6.8	6.8	6.8	6.7	6.7	6.7
Other	<u>1.7</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>
Total	20.0	20.3	20.1	20.0	19.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
On-budget	15.2	15.3	15.1	15.0	14.9	14.8	14.8	14.8	14.8	14.8	14.8	14.9
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays												
Discretionary spending	6.3	6.3	6.2	6.0	5.7	5.5	5.2	5.0	4.8	4.6	4.4	4.2
Mandatory spending	10.7	10.6	10.6	10.7	10.8	10.9	11.1	11.1	11.2	11.4	11.6	11.8
Offsetting receipts	-0.9	-0.8	-0.8	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.9
Net interest	2.5	2.3	2.2	2.0	1.7	1.5	1.2	1.0	0.8	0.6	0.5	0.5
Proceeds from investing excess cash	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>-0.1</u>	<u>-0.3</u>	<u>-0.5</u>
Total	18.7	18.4	18.2	17.7	17.4	17.1	16.8	16.3	15.9	15.7	15.4	15.1
On-budget	15.2	15.0	14.8	14.5	14.2	13.9	13.7	13.2	12.9	12.7	12.4	12.1
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0
Surplus												
On-budget	1.4	1.9	1.9	2.3	2.5	2.8	3.0	3.5	3.9	4.1	4.4	4.7
On-budget	*	0.3	0.3	0.5	0.7	0.9	1.1	1.6	1.9	2.1	2.5	2.8
Off-budget	1.4	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.0	2.0	2.0
Debt Held by the Public	39.9	36.0	32.6	29.0	25.4	21.7	17.8	13.7	9.3	7.9	7.2	6.3
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3.1	6.9	10.8
Memorandum:												
Gross Domestic Product (Billions of dollars)	9,116	9,583	10,038	10,496	10,954	11,422	11,924	12,453	13,006	13,583	14,202	14,856

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable; * = less than 0.05 percent of GDP.

Table A-8.
CBO's Baseline Budget Projections, Assuming That Discretionary Spending Equals CBO's Estimates of the Statutory Caps Through 2002 and Grows at the Rate of Inflation Thereafter (By fiscal year)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
In Billions of Dollars												
Revenues												
Individual income	879	945	986	1,026	1,068	1,112	1,162	1,217	1,275	1,339	1,407	1,480
Corporate income	185	189	189	187	190	194	200	208	216	225	233	242
Social insurance	612	653	684	714	742	770	808	842	878	913	954	998
Other	<u>151</u>	<u>158</u>	<u>158</u>	<u>169</u>	<u>177</u>	<u>187</u>	<u>192</u>	<u>198</u>	<u>202</u>	<u>210</u>	<u>218</u>	<u>226</u>
Total	1,827	1,945	2,016	2,096	2,177	2,263	2,361	2,465	2,572	2,686	2,813	2,946
On-budget	1,383	1,465	1,515	1,571	1,630	1,693	1,764	1,843	1,923	2,010	2,106	2,208
Off-budget	444	480	502	525	547	570	597	623	649	676	707	738
Outlays												
Discretionary spending	575	603	579	571	585	600	615	630	646	662	679	696
Mandatory spending	978	1,017	1,067	1,118	1,180	1,248	1,329	1,385	1,461	1,552	1,646	1,748
Offsetting receipts	-80	-79	-85	-92	-94	-94	-99	-104	-109	-114	-120	-126
Net interest	230	224	217	203	182	161	138	114	91	77	72	67
Proceeds from investing excess cash	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>-3</u>	<u>-18</u>	<u>-44</u>	<u>-72</u>
Total	1,703	1,766	1,777	1,799	1,853	1,915	1,982	2,025	2,085	2,159	2,233	2,312
On-budget	1,382	1,439	1,442	1,457	1,501	1,553	1,610	1,641	1,688	1,749	1,806	1,867
Off-budget	321	327	336	343	352	361	373	384	397	410	427	445
Surplus												
On-budget	124	179	239	297	324	348	379	440	487	527	580	634
Off-budget	1	26	73	115	129	139	154	202	234	261	300	341
Off-budget	124	153	166	182	195	209	225	238	253	266	280	293
Debt Held by the Public	3,633	3,452	3,226	2,934	2,622	2,285	1,916	1,485	1,142	1,078	1,016	941
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	137	593	1,105	1,659

Table A-8.
Continued

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
As a Percentage of GDP												
Revenues												
Individual income	9.6	9.9	9.8	9.8	9.7	9.7	9.7	9.8	9.8	9.9	9.9	10.0
Corporate income	2.0	2.0	1.9	1.8	1.7	1.7	1.7	1.7	1.7	1.7	1.6	1.6
Social insurance	6.7	6.8	6.8	6.8	6.8	6.7	6.8	6.8	6.8	6.7	6.7	6.7
Other	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.5	1.5	1.5
Total	20.0	20.3	20.1	20.0	19.9	19.8	19.8	19.8	19.8	19.8	19.8	19.8
On-budget	15.2	15.3	15.1	15.0	14.9	14.8	14.8	14.8	14.8	14.8	14.8	14.9
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays												
Discretionary spending	6.3	6.3	5.8	5.4	5.3	5.3	5.2	5.1	5.0	4.9	4.8	4.7
Mandatory spending	10.7	10.6	10.6	10.7	10.8	10.9	11.1	11.1	11.2	11.4	11.6	11.8
Offsetting receipts	-0.9	-0.8	-0.8	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-0.9
Net interest	2.5	2.3	2.2	1.9	1.7	1.4	1.2	0.9	0.7	0.6	0.5	0.5
Proceeds from investing excess cash	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>n.a.</u>	<u>*</u>	<u>-0.1</u>	<u>-0.3</u>	<u>-0.5</u>
Total	18.7	18.4	17.7	17.1	16.9	16.8	16.6	16.3	16.0	15.9	15.7	15.6
On-budget	15.2	15.0	14.4	13.9	13.7	13.6	13.5	13.2	13.0	12.9	12.7	12.6
Off-budget	3.5	3.4	3.3	3.3	3.2	3.2	3.1	3.1	3.0	3.0	3.0	3.0
Surplus												
On-budget	1.4	1.9	2.4	2.8	3.0	3.0	3.2	3.5	3.7	3.9	4.1	4.3
Off-budget	*	0.3	0.7	1.1	1.2	1.2	1.3	1.6	1.8	1.9	2.1	2.3
Off-budget	1.4	1.6	1.7	1.7	1.8	1.8	1.9	1.9	1.9	2.0	2.0	2.0
Debt Held by the Public	39.9	36.0	32.1	28.0	23.9	20.0	16.1	11.9	8.8	7.9	7.2	6.3
Accumulated Excess Cash	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1.1	4.4	7.8	11.2
Memorandum:												
Gross Domestic Product (Billions of dollars)	9,116	9,583	10,038	10,496	10,954	11,422	11,924	12,453	13,006	13,583	14,202	14,856

SOURCE: Congressional Budget Office.

NOTES: n.a. = not applicable; * = less than 0.05 percent of GDP.

Table A-9.
CBO's Projections of Mandatory Spending (By fiscal year, in billions of dollars)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Means-Tested Programs												
Medicaid	108	115	124	134	145	158	172	188	204	223	243	264
State Children's Health Insurance Program	1	2	3	3	3	4	4	4	4	4	4	5
Food Stamps	19	19	19	20	21	22	22	23	24	25	25	26
Supplemental Security Income	28	29	30	32	34	36	41	40	38	44	46	49
Family Support ^a	20	22	23	24	24	24	25	25	26	26	26	27
Veterans' Pensions	3	3	3	3	4	4	4	4	3	4	4	4
Child Nutrition	9	9	9	10	10	11	11	12	12	13	13	14
Earned Income and Child Tax Credits	26	26	26	27	27	28	28	29	29	30	30	31
Student Loans	3	5	5	5	5	5	5	5	5	5	5	5
Foster Care	5	5	6	6	7	7	7	8	8	9	10	10
Total	221	235	249	264	280	297	320	337	355	382	407	435
Non-Means-Tested Programs												
Social Security	387	402	419	440	460	482	507	532	559	588	621	657
Medicare	209	218	236	244	264	284	310	320	349	375	403	434
Subtotal	596	620	656	683	725	766	816	852	908	963	1,024	1,091
Other Retirement and Disability												
Federal Civilian ^b	49	51	53	55	58	61	63	66	69	72	76	79
Military	32	33	34	35	35	36	38	39	40	41	42	43
Other	5	5	5	5	5	5	5	5	5	5	5	5
Subtotal	85	88	91	95	98	102	106	110	114	118	123	127
Unemployment Compensation	21	22	23	24	27	29	31	33	35	37	38	40
Other Programs												
Veterans' benefits ^c	22	22	23	24	25	26	29	27	26	29	29	30
Commodity Credit Corporation Fund	18	22	11	10	9	8	7	6	5	5	5	5
Social services	5	4	5	5	5	5	5	5	5	5	5	5
Credit liquidating accounts	-12	-12	-10	-9	-10	-11	-11	-11	-11	-11	-11	-10
Universal Service Fund	3	4	5	5	6	11	12	12	12	12	12	12
Other	19	11	14	16	16	14	15	15	13	13	14	14
Subtotal	60	54	48	51	50	54	55	53	51	54	55	56
Total	758	782	818	853	900	951	1,009	1,048	1,107	1,171	1,239	1,314
Total												
All Mandatory Spending	978	1,017	1,067	1,118	1,180	1,248	1,329	1,385	1,461	1,552	1,646	1,748

SOURCE: Congressional Budget Office.

NOTE: Spending for the benefit programs shown above generally excludes administrative costs, which are discretionary. Spending for Medicare also excludes premiums, which are considered offsetting receipts.

- a. Includes Temporary Assistance for Needy Families, Family Support, Child Care Entitlements to States, and Children's Research and Technical Assistance.
- b. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs and annuitants' health benefits.
- c. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

Table A-10.
CBO's Projections of Federal Interest Outlays Under Alternative Versions of the Baseline
(By fiscal year, in billions of dollars)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Discretionary Spending Grows at the Rate of Inflation After 2000^a												
Interest on Public Debt (Gross interest) ^b	354	363	371	374	372	369	366	363	359	355	354	362
Interest Received by Trust Funds												
Social Security	-52	-60	-70	-80	-91	-102	-113	-125	-138	-152	-167	-182
Other trust funds ^c	-67	-71	-75	-79	-82	-84	-87	-90	-93	-97	-100	-104
Subtotal	-119	-131	-144	-159	-173	-186	-200	-215	-231	-249	-267	-286
Other Interest ^d	-5	-8	-8	-7	-6	-7	-8	-8	-8	-8	-9	-9
Total (Net interest)	230	224	218	209	193	176	159	140	120	98	78	67
Discretionary Spending Is Frozen at the Level Enacted for 2000^a												
Interest on Public Debt (Gross interest) ^b	354	363	371	373	369	363	356	349	338	337	348	362
Interest Received by Trust Funds												
Social Security	-52	-60	-70	-80	-91	-102	-113	-125	-138	-152	-167	-182
Other trust funds ^c	-67	-71	-75	-79	-82	-84	-87	-90	-93	-97	-100	-104
Subtotal	-119	-131	-144	-159	-173	-186	-200	-215	-231	-249	-267	-286
Other Interest ^d	-5	-8	-8	-7	-6	-7	-8	-8	-8	-8	-9	-9
Total (Net interest)	230	224	218	207	190	170	149	125	99	79	72	67
Discretionary Spending Equals CBO's Estimates of the Caps Through 2002 and Grows at the Rate of Inflation Thereafter												
Interest on Public Debt (Gross interest) ^b	354	363	369	369	361	354	345	337	330	335	348	362
Interest Received by Trust Funds												
Social Security	-52	-60	-70	-80	-91	-102	-113	-125	-138	-152	-167	-182
Other trust funds ^c	-67	-71	-75	-79	-82	-84	-87	-90	-93	-97	-100	-104
Subtotal	-119	-131	-144	-159	-173	-186	-200	-215	-231	-249	-267	-286
Other Interest ^d	-5	-8	-8	-7	-6	-7	-8	-8	-8	-8	-9	-9
Total (Net interest)	230	224	217	203	182	161	138	114	91	77	72	67

SOURCE: Congressional Budget Office.

NOTE: Because proceeds from investing cash are not considered part of net interest, they are not shown in this table.

- a. After adjustment for advance appropriations.
- b. Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).
- c. Principally Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Airport and Airway Trust Fund.
- d. Primarily interest on loans to the public.

Table A-11.
CBO's Projections of Federal Debt at the End of the Year Under Alternative Versions of the Baseline
(By fiscal year, in billions of dollars)

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Discretionary Spending Grows at the Rate of Inflation After 2000^a												
Debt Held by the Public	3,633	3,452	3,284	3,078	2,858	2,618	2,355	2,034	1,667	1,270	1,016	941
Debt Held by Government Accounts												
Social Security	855	1,009	1,175	1,358	1,554	1,762	1,987	2,225	2,478	2,745	3,025	3,317
Other government accounts ^b	<u>1,118</u>	<u>1,200</u>	<u>1,274</u>	<u>1,361</u>	<u>1,446</u>	<u>1,528</u>	<u>1,609</u>	<u>1,698</u>	<u>1,786</u>	<u>1,882</u>	<u>1,967</u>	<u>2,051</u>
Subtotal	1,973	2,209	2,449	2,719	2,999	3,290	3,596	3,924	4,265	4,626	4,991	5,368
Gross Federal Debt	5,606	5,661	5,733	5,796	5,857	5,909	5,951	5,957	5,932	5,896	6,007	6,309
Debt Subject to Limit ^c	5,566	5,622	5,694	5,757	5,824	5,880	5,929	5,936	5,911	5,875	5,798	5,686
Accumulated Excess Cash Greater than Debt Available for Redemption	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	189	603
Net Indebtedness ^d	3,633	3,452	3,284	3,078	2,858	2,618	2,355	2,034	1,667	1,270	827	338
Memorandum:												
Debt Held by the Public as a Percentage of GDP	39.9	36.0	32.7	29.3	26.1	22.9	19.8	16.3	12.8	9.3	7.2	6.3
Discretionary Spending Is Frozen at the Level Enacted for 2000^a												
Debt Held by the Public	3,633	3,452	3,272	3,041	2,780	2,476	2,128	1,701	1,206	1,078	1,016	941
Debt Held by Government Accounts												
Social Security	855	1,009	1,175	1,358	1,554	1,762	1,987	2,225	2,478	2,745	3,025	3,317
Other government accounts ^b	<u>1,118</u>	<u>1,200</u>	<u>1,274</u>	<u>1,361</u>	<u>1,446</u>	<u>1,528</u>	<u>1,609</u>	<u>1,698</u>	<u>1,786</u>	<u>1,882</u>	<u>1,967</u>	<u>2,051</u>
Subtotal	1,973	2,209	2,449	2,719	2,999	3,290	3,596	3,924	4,265	4,626	4,991	5,368
Gross Federal Debt	5,606	5,661	5,722	5,760	5,779	5,766	5,724	5,624	5,471	5,704	6,007	6,309
Debt Subject to Limit ^c	5,566	5,622	5,683	5,721	5,746	5,738	5,702	5,603	5,450	5,260	5,002	4,682
Accumulated Excess Cash Greater than Debt Available for Redemption	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	423	984	1,607
Net Indebtedness ^d	3,633	3,452	3,272	3,041	2,780	2,476	2,128	1,701	1,206	655	32	-666
Memorandum:												
Debt Held by the Public as a Percentage of GDP	39.9	36.0	32.6	29.0	25.4	21.7	17.8	13.7	9.3	7.9	7.2	6.3

Table A-11.
Continued

	Actual 1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Discretionary Spending Equals CBO's Estimates of the Statutory Caps Through 2002 and Grows at the Rate of Inflation Thereafter												
Debt Held by the Public	3,633	3,452	3,226	2,934	2,622	2,285	1,916	1,485	1,142	1,078	1,016	941
Debt Held by Government Accounts												
Social Security	855	1,009	1,175	1,358	1,554	1,762	1,987	2,225	2,478	2,745	3,025	3,317
Other government accounts ^b	<u>1,118</u>	<u>1,200</u>	<u>1,274</u>	<u>1,361</u>	<u>1,446</u>	<u>1,528</u>	<u>1,609</u>	<u>1,698</u>	<u>1,786</u>	<u>1,882</u>	<u>1,967</u>	<u>2,051</u>
Subtotal	<u>1,973</u>	<u>2,209</u>	<u>2,449</u>	<u>2,719</u>	<u>2,999</u>	<u>3,290</u>	<u>3,596</u>	<u>3,924</u>	<u>4,265</u>	<u>4,626</u>	<u>4,991</u>	<u>5,368</u>
Gross Federal Debt	5,606	5,661	5,675	5,653	5,621	5,576	5,512	5,408	5,407	5,704	6,007	6,309
Debt Subject to Limit ^c	5,566	5,622	5,636	5,614	5,588	5,547	5,489	5,387	5,249	5,090	4,881	4,630
Accumulated Excess Cash Greater than Debt Available for Redemption	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	137	593	1,105	1,659
Net Indebtedness ^d	3,633	3,452	3,226	2,934	2,622	2,285	1,916	1,485	1,005	484	-90	-718
Memorandum:												
Debt Held by the Public as a Percentage of GDP	39.9	36.0	32.1	28.0	23.9	20.0	16.1	11.9	8.8	7.9	7.2	6.3

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

- a. After adjustment for advance appropriations.
- b. Mainly Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Airport and Airway Trust Fund.
- c. Differs from gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit. The current debt limit is \$5,950 billion.
- d. Debt held by the public minus excess cash.

Estimates of Outlays for National Defense

Under the President's budgetary proposals, discretionary outlays for national defense would total \$294.6 billion in 2001, the Congressional Budget Office (CBO) estimates. That figure is \$2.5 billion higher than the Administration's estimate. Estimating differences of that size have been common over the past several years; overall, however, CBO's estimates have been more accurate than the Administration's. Between 1994 and 1999, the Administration's estimates were always too low, averaging \$4.3 billion—or about 1.6 percent—less than actual spending. CBO's estimates during that time were also generally too low but were closer to actual spending, with an average error of \$3.7 billion. In addition, current projections suggest that CBO's estimates for 2000 were much closer to the mark than the Administration's.

Accuracy of Past Estimates

CBO and the Administration consistently produce different estimates of defense spending.¹ During the mid-1990s, differences in estimates of the outlays that would result from the President's budget requests were relatively small—about \$1 billion to \$2 billion annually, or less than 1 percent. But more recently, those differences have increased, peaking last year when

CBO's estimate for the President's 2000 budget request exceeded the Administration's estimate by \$9.6 billion (see Table B-1). Although the size of the dif-

Table B-1.
Differences Between CBO's and the Administration's Estimates of Outlays from the President's Budget Requests for Defense Discretionary Programs, 1994-2001
(By fiscal year, in billions of dollars)

	CBO	Adminis- tration	Difference (CBO minus Adminis- tration)
1994	279.3	277.7	1.6
1995	271.7	271.1	0.6
1996	263.7	262.2	1.5
1997	261.6	259.4	2.2
1998	265.8	260.1	5.7
1999	270.2	266.5	3.7
2000	284.5	274.8	9.6
2001	294.6	292.1	2.5

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

1. The Administration's defense estimates are produced jointly by the Office of Management and Budget and the Department of Defense.

Table B-2.
Accuracy of CBO's and the Administration's Estimates of Defense Discretionary Outlays, 1994-1999
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
Estimated Outlays (Based on enacted appropriations)						
CBO	276.0	270.2	264.2	265.1	268.4	277.8
OMB ^a	275.5	271.4	263.5	264.3	264.4	274.5
Actual Outlays	282.3	273.6	266.0	271.7	270.2	275.5
Difference (Actual minus estimate) ^b						
CBO	6.3	3.4	1.8	6.6	1.8	-2.3
OMB	6.8	2.2	2.4	7.4	5.8	1.0

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

- a. OMB did not publish its estimates of total defense appropriations for 1994 through 1996; as a result, CBO compiled estimates for those years using OMB's estimates of individual appropriation bills. Estimates for 1997 through 1999 come from OMB's sequestration reports.
- b. Positive numbers indicate an underestimate and negative numbers an overestimate.

ference has varied, the Administration's estimates have consistently been lower than CBO's.

The relative accuracy of CBO and the Administration can be measured by comparing their estimates of spending based on enacted appropriations (as opposed to estimates based on requested appropriations) with actual defense spending.² Analyzing the most recent estimates for 2000 also yields some insights into differences between the Administration and CBO.

Estimates for 1994 through 1999

During the mid-1990s, CBO and the Administration produced similar estimates of defense outlays. The Administration's average annual error between 1994 and 1996, \$3.8 billion, was virtually the same as CBO's average error, but CBO's estimates were closer to actual spending in two of those three years (see Table B-2). Both sets of estimates were relatively accurate when excluding the effect of an unexpected shift of one military payday from 1995 into 1994. That action caused 1994 outlays to jump by about \$2.4 billion but had no effect on the size of errors in later years. Excluding that portion of the 1994 error,

both sets of estimates averaged within \$3 billion, or about 1.1 percent, of actual spending over the 1994-1996 period. However, both sets consistently underestimated spending.

In 1997, CBO's estimate was more accurate than the Administration's but was \$6.6 billion too low. During the next two years, CBO's estimates missed actual spending by about \$2 billion annually. Although its estimate was too low again in 1998, CBO broke that pattern in 1999 when its estimate exceeded actual spending by just over \$2 billion, or about 0.8 percent. The Administration's estimates, by contrast, continued to be too low in every year: by an average of more than \$6.6 billion in 1997 and 1998 and by about \$1 billion in 1999. Over that three-year period, the Administration's error averaged \$4.7 billion a year, compared with \$3.6 billion for CBO. But because CBO's estimates varied from actual spending in both directions, its total error over the three-year period was less than half that of the Administration.

Estimates for 2000

At the start of the budget cycle for 2000, CBO's estimate of defense outlays based on the funds requested by the President exceeded the Administration's estimate by \$9.6 billion. That estimating difference narrowed slightly after the Congress modified the Presi-

2. The earliest year for which detailed data are available about Administration estimates based on enacted appropriations is 1994.

dent's request in its appropriation bills. Nevertheless, CBO's estimate of defense spending at that point—\$285.2 billion—was still more than \$7 billion above the Administration's estimate.

Recently, both the Administration and CBO updated their estimates to reflect the most current information, and both are now projecting outlays in the vicinity of \$284 billion to \$285 billion. Those estimates are slightly lower than CBO's original estimate but sharply higher than the Administration's. It now appears likely that the Administration's original estimate of about \$277.6 billion was \$6 billion to \$7 billion too low. If the most recent projections prove accurate, the Administration's original estimate of defense spending will have been too low by an average of at least \$5 billion annually over the 1997-2000 period, or almost 2 percent—much larger than CBO's errors over that time.

Estimating Differences for 2001

CBO's estimate of defense discretionary outlays for 2001, \$294.6 billion, is \$2.5 billion more than the Administration's figure (see Table B-3). Of that difference, \$2.1 billion is attributable to Department of Defense (DoD) programs and about \$0.4 billion is from the atomic weapons activities of the Department of Energy (DOE).

Spending by the Department of Defense

CBO's estimate of outlays for DoD—the major portion of defense spending—totals \$280.6 billion, which is \$2.1 billion more than the Administration's estimate. Most of that difference is in the operations, procurement, and research and development (R&D) accounts.

In the operations accounts, the main estimating difference stems from a supplemental appropriation request for 2000 (other differences in this category largely offset one another). The Administration requested \$2 billion to cover costs associated with operations in Kosovo and elsewhere. CBO's estimate of

outlays in 2000 from that request is \$0.5 billion, compared with the Administration's estimate of \$1.5 billion. CBO believes that most of those funds—\$1.1 billion—would be spent in 2001 because the funding would not be available to DoD until mid-to-late 2000. Moreover, those funds could be used to cover costs after 2000 because they would be available until expended.

The Administration, by contrast, estimates that most of the outlays would occur in 2000 at the same rate as if the funds had been provided at the start of the year. In CBO's view, that approach to estimating outlays from supplemental appropriations greatly overstates their impact on the current year (when spending caps may be of less concern) and minimizes their impact on the following year (when they might constrain the opportunities for new funding). In most cases, funding provided in the second half of a fiscal year is not obligated and spent at the same rate as funding provided at the beginning of the year.

In the areas of procurement and R&D, estimating differences are spread among a variety of accounts and result mainly from differing assumptions about spending from budget authority that was provided before 2000.

Spending on Atomic Energy Defense Activities

CBO estimates that spending on atomic energy defense activities, which are primarily DOE-related programs, would total nearly \$12.9 billion in 2001. That figure is about \$0.4 billion more than the Administration's estimate.

Most of that difference stems from the President's proposal to fund certain environmental cleanup activities. For 2001, the President has requested about \$0.5 billion in new budget authority to fund the design and construction by the private sector of large-scale facilities to clean up nuclear waste at DOE sites, including the Tank Waste Remediation System project at Hanford, Washington. The Office of Management and Budget (OMB), in consultation with the Congress, has established criteria for the budgetary treatment of capital investments like the Hanford project. (Those

criteria are identified in OMB Circular A-11, Appendix B.) Based on those criteria, it is clear to CBO that the Hanford project should be treated as a lease-purchase with substantial government risk, for three reasons. First, the construction would occur on government land. Second, the Hanford facility would be intended to meet the specialized needs of DOE; thus, there would be little or no private-sector market for it.

Third, DOE would be required to provide the necessary funds each year in amounts equal to the contractor's financial commitments, although there is no explicit government guarantee of third-party financing. In other words, the contractor would assume no risk because the government would pay all of the bills and would liquidate the private company's outstanding debt if the contract was terminated for any reason.

Table B-3.
Comparison of CBO's and the Administration's Estimates of Defense Discretionary Outlays for Fiscal Year 2001 (In billions of dollars)

	CBO	Administration			Difference (CBO minus adjusted Administration estimate)
		Estimate in President's Budget	Adjustment ^a	Adjusted Estimate	
Department of Defense					
Military personnel	72.5	75.1	-2.5	72.6	-0.1
Operations					
Operation and maintenance	107.1	108.6	-1.2	107.5	-0.4
Supplemental operation and maintenance	1.1	0.4	0	0.4	0.7
Working capital funds	1.6	1.7	-0.4	1.3	0.3
Subtotal	109.8	110.8	-1.5	109.2	0.6
Procurement	51.6	51.0	-0.4	50.6	1.0
Research, development, test, and evaluation	37.9	37.7	-0.3	37.4	0.5
Military construction and family housing	8.6	8.6	*	8.6	*
Other	0.2	4.5	4.7	0.2	*
Total	280.6	278.6	0	278.6	2.1
Other Departments and Agencies					
Atomic energy defense activities (Mostly Department of Energy)	12.9	12.5	0	12.5	0.4
Other defense-related activities (Miscellaneous agencies)	1.0	1.0	0	1.0	*
Total Defense Outlays	294.6	292.1	0	292.1	2.5

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

NOTE: * = less than \$50 million.

a. In the 2001 budget request, the Administration recorded its estimates of repealing various payment delays (affecting pay for DoD military and civilian personnel, as well as payments to DoD vendors) in an "other" category. CBO distributed its estimates of those repeal proposals to the appropriate categories of DoD spending. The adjustment in this table provides a similar distribution of the Administration's estimates, allowing for more meaningful comparisons.

When a project is classified as a lease-purchase with substantial government risk, outlays should be estimated as if the government were constructing the project itself. OMB, by contrast, estimated outlays assuming that the Hanford project would be an operating lease, thus recording much smaller spending in the first years. As a result, CBO's estimate of outlays in 2001 for the cleanup activities is about \$0.3 billion higher than the Administration's estimate.

For other programs in the atomic energy defense category, the remaining \$0.1 billion of estimating differences arises because CBO estimates that appropriations from prior years will be spent at a faster rate than the Administration assumes.

Major Contributors to the Revenue and Spending Projections

The following Congressional Budget Office analysts prepared the revenue and spending projections in this report:

Revenue Projections

Mark Booth	Individual income taxes
Pam Greene	Estate and gift taxes
Hester Grippando	Customs duties, miscellaneous receipts
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Robert Taylor	Excise taxes and social insurance taxes
David Weiner	Individual income taxes

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Kent Christensen	Defense (military construction, base closures, outlay estimates)
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Sunita D'Monte	International affairs (conduct of foreign affairs and information exchange activities), veterans' housing
Raymond Hall	Defense (Navy weapons, missile defenses, atomic energy defense)
Sarah Jennings	Military retirement, veterans' education
Matt Martin	Intelligence programs, defense acquisition reform
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JoAnn Vines	Defense (tactical air forces, bombers, Army)
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Health

Chuck Betley	Medicare, Federal Employees Health Benefits, Public Health Service
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Human Resources

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Mark Grabowicz	Justice, Postal Service
Kathleen Gramp	Energy, science and space, spectrum auction receipts
Mark Hadley	Commerce, credit unions, Small Business Administration, Universal Service Fund, deposit insurance
Victoria Heid	Conservation and land management, Outer Continental Shelf receipts, air transportation
Greg Hitz	Agriculture
David Hull	Agriculture
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Lanette Keith	Justice, community and regional development, Indian affairs
James Langley	Agriculture
Susanne Mehlman	Pollution control and abatement, Federal Housing Administration and other housing credit
James O'Keeffe	Highways, Amtrak, mass transit, air transportation
Deborah Reis	Recreation, water transportation, other natural resources
John Righter	General government, legislative branch
Susan Sieg	Conservation and land management

Other

Janet Airis	Appropriation bills (Legislative branch, District of Columbia)
Edward Blau	Authorization bills
Jodi Capps	Appropriation bills (Agriculture, Interior, Energy and water)
Betty Embrey	Appropriation bills (Commerce-Justice-State, foreign operations)
Kenneth Farris	Computer support
Mary Froehlich	Computer support
Terri Linger	Computer support
Catherine Little	Appropriation bills (Defense, VA-HUD, Treasury)
Taman Morris	National income and product accounts
Laurie Pounder	Net interest on the public debt
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Robert Sempsey	Appropriation bills (Labor-HHS, Transportation, military construction)
Susan Tanaka	Discretionary caps, overall budget outlook