CBO TESTIMONY

Statement of
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Director
Congressional Budget Office

on
The Economic and Budget Outlook:
Fiscal Years 2000-2009

before the
Committee on the Budget
United States Senate

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NOTICE

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Chairman Domenici and Members of the Committee, I am glad to be here this morning to discuss the current outlook for the economy and the budget. You have before you the Congressional Budget Office's (CBO's) new annual report, *The Economic and Budget Outlook: Fiscal Years 2000-2009*, which describes our 10-year projections in detail. In my statement today, I will summarize the analysis in that report.

Total federal revenues exceeded spending in fiscal year 1998 by $70 billion, producing the first surplus in almost 30 years. CBO estimates that under current law, the total budget surplus will reach $107 billion in 1999 and $131 billion in 2000 (see Table 1). When the off-budget spending and revenues of Social Security and the Postal Service are excluded, however, the remaining on-budget transactions show a deficit in those years—$19 billion in 1999 and $7 billion in 2000. But CBO projects that those on-budget deficits will give way to on-budget surpluses in 2001 and succeeding years as the total budget surplus climbs to $381 billion in 2009.

CBO's baseline projections are intended to provide the Congress with estimates of the spending and revenues that will occur if current laws affecting the budget remain unchanged. In the case of mandatory spending and revenues, which are generally governed by permanent law, the projections incorporate the effects of changes in benefit payments or tax rates that are provided in current law, as well as the effects of anticipated changes in the economy, demographics, or other factors that affect those parts of the budget. In the case of discretionary spending, which is controlled by annual appropriation acts, CBO's projections assume that enacted appropriations will be consistent with the statutory caps of the Balanced Budget and Emergency Deficit Control Act (the Deficit Control Act) that are in place through 2002. The projections of the surplus given above assume that discretionary spending will increase at the rate of inflation after the caps expire. If, instead, discretionary outlays are held to the dollar level of the 2002 caps through 2009, CBO projects that the total budget surplus will grow to $514 billion in that year.

The budget surplus is expected to increase in the next two years despite an anticipated slowing of the U.S. economy. CBO is forecasting real (inflation-adjusted) growth of about 2 percent annually in 1999 and 2000. That rate marks a significant drop from the 3.7 percent average annual growth of the past three years, but it still represents a healthy increase in the economy that will keep the budget in good shape. There is significant danger, however, that a worsening international financial situation or other developments could lead to a more precipitous slowdown in the United States, which in turn could threaten the anticipated budget surpluses in the near term. But it is also possible that the U.S. economy will continue to surprise most analysts and that taxable incomes will continue to grow rapidly for another year or more—in which case, surpluses are likely to be even larger than projected. In the longer term, CBO projects, real growth will average 2.3 percent a year from 2001 through 2009, taking into account the possibility of booms and recessions during that period.

CBO is now projecting budget surpluses that are much larger than those it projected last August, when CBO published its previous economic and budget outlook. Cumulative surpluses over the 1999-2008 period are $745 billion higher. Legislation enacted since August—primarily the Omnibus Consolidated and Emergency Supplemental Appropriations Act—lowers projected surpluses by $51 billion over that period. But that effect is more than offset by changes in economic and other factors that increase revenues and reduce spending.

Relatively small changes in CBO's economic projections boost surpluses by $348 billion in 1999 through 2008. In the short run, lower interest rates reduce projected net interest payments. But most of the improvement attributable to economic changes comes from a longer-term rise in revenues resulting from slightly higher gross domestic product (GDP) and a small increase in projected wage and salary disbursements as a percentage of GDP.

Changes in factors other than legislation and the economic outlook increase projected surpluses by $448 billion over the 1999-2008 period. A variety of those so-called technical factors raise projected revenues by almost $160 billion and reduce mandatory spending by nearly $185 billion (excluding debt-service savings) over that period. A substantial reduction in projected spending for Medicare and smaller reductions in several income security programs are only partially offset by increases in projected Medicaid costs.

Along with other forecasters, CBO expects that after three years of rapid growth, the economy will grow at a decidedly more moderate pace in the next two years. But moderate growth is not the only possibility. International financial instabilities or other forces could instead trigger a much sharper slowdown. Alternatively, there may be very little or no slowing of economic growth in the near future; there are no definitive signs yet that the anticipated slowdown has begun, and CBO and other analysts have been wrong in the recent past in assuming that a slowdown was imminent.

The Forecast for 1999 and 2000

In CBO's forecast, real economic growth, which was 3.7 percent in calendar year 1998, falls to 2.3 percent in 1999 and 1.7 percent in 2000 (see Table 2). With inflation, as measured by the GDP price index, expected to rise in 1999 and 2000, the growth rate of nominal GDP declines less rapidly—from 4.8 percent in 1998 to 4.1 percent in 1999 and 3.8 percent in 2000. The consumer price index is expected to grow a bit faster, the unemployment rate to rise a little, and interest rates to go up slightly from the levels of early January (which were below the average for 1998).

The rapid growth in recent years has been fueled by a boom in capital spending and strong personal consumption. The weakness in international economies, particularly in Asia, has restrained growth in the United States by reducing demand for U.S. exports, but it has also provided low-cost imports that have helped dampen inflation and alleviate the need for the Federal Reserve to tighten monetary policy. The international financial situation has also contributed to the continued expansion by increasing the supply of relatively low-cost foreign capital to U.S. businesses.

The spectacular six-year boom in business expenditures on plant and equipment and in consumer purchases appears to be moderating. Spending for real business fixed investment was weaker in the last half of 1998, and a slowdown in orders for capital goods, low capacity utilization in manufacturing, and a drop in corporate earnings suggest that investment is unlikely to rebound in the next two years. Growth in consumer spending is also expected to slow, from an unsustainable rate of over 5 percent in 1998 to less than 3 percent a year in 1999 and 2000. The persistent trade deficit and the slowdown in business fixed investment (which are likely to suppress growth in employment and personal income) and the anticipated drop in corporate profits (which may reduce gains in stock prices) are expected to restrain consumer spending.

CBO's forecast anticipates that the real U.S. trade deficit will remain at record highs in 1999 and 2000, although it will be less of a drag on GDP growth over the forecast period than in 1998. But the weakness in foreign economies will not be enough to hold inflation to 1998's rate. The underlying rate of inflation is expected to be subject to increasing upward pressure as labor markets remain tight and the recent fall in the value of the dollar keeps import prices from declining further. In addition, the drop in oil prices that helped mute inflation in 1998 is expected to be partially reversed in 1999.

The economic slowdown reflected in CBO's forecast is relatively moderate, in part because the Federal Reserve is not expected to tighten monetary policy. Moreover, corporations are much better prepared for a slowing in the growth of sales than they were in the years leading up to the 1990 recession, reducing the likelihood that investment will plummet. The slowdown in consumer spending is also likely to be gradual.

Nonetheless, certain events could lead to a more precipitous decline in economic growth late this year or next. Deterioration of the international financial situation or a significant drop in the stock market, for example, could undermine business and consumer confidence and seriously erode investment and consumption by the end of this year. If the special factors that have held down inflation in recent years fade more quickly than expected, inflation may accelerate and the Federal Reserve may have to tighten monetary policy, risking a recession in 2000. Although the economy could enter a recession sometime in the next two years, chances are equally good that the forces that have propelled the economy for the past three years will keep the boom alive even longer.

The Economic Projections for 2001 Through 2009

CBO does not attempt to forecast cyclical changes in the economy for more than two years. The economic projections for years beyond the forecast period—in this case, 2001 through 2009—are intended to represent the middle of a range of possible outcomes for the economy, taking into account the possibility of booms and recessions. CBO's estimates of the potential midrange outcomes are based on analyses of underlying trends in the basic factors that determine economic performance—capital investment, the labor force, and productivity.

In CBO's projections, real GDP growth averages 2.3 percent a year in 2001 through 2009, inflation as measured by the consumer price index increases at an average rate of 2.6 percent a year, and the unemployment rate averages 5.7 percent. Short-term interest rates on federal debt average 4.5 percent, and long-term interest rates average 5.4 percent.

Changes Since August

The current economic projections are not very different from those CBO published last August. Growth in real GDP is estimated to have been 0.3 percentage points higher in 1998 than was forecast. In 1999, however, it is likely to be similar to that previously forecast, and in 2000 it is expected to be a fraction lower. In the longer run, real GDP growth averages about 0.1 percentage point higher than was assumed in August, but that increase reflects a technical adjustment to account for changes in the measurement of the GDP price index and does not affect nominal GDP. In fact, projections of nominal GDP for any year have changed little since last summer.

Interest rates are now forecast to be significantly lower in 1999 and 2000 than CBO anticipated last August, but not very different in the longer run. The interest rate for three-month Treasury bills is expected to average 4.5 percent in 1999, down from the previous forecast of 5.2 percent. CBO assumes that the three-month bill rate will remain at 4.5 percent in 2000 and average that rate through 2009—a 0.3 percentage-point drop below the level projected for 2000 last summer, but a 0.1 percentage-point increase above the longer-run level projected at that time. The interest rate on 10-year Treasury notes is expected to be a full percentage point lower in 1999 and half a percentage point lower in 2000 than had been projected, but the average rate in the longer run is unchanged at 5.4 percent.

The forecast of wage and salary disbursements as a share of GDP in 1999 and 2000 is higher than it was in August, but that increase is partially offset by a reduction in the share of GDP represented by corporate profits. In the longer run, the projected share of corporate profits is the same as it was last summer, but the share of wage and salary disbursements is 0.4 percentage points higher by 2008.

CBO expects inflation, as measured by both the GDP price index and the consumer price index (CPI), to be slightly lower in 1999 and 2000 than it previously expected (the GDP index is down 0.3 percentage points in 1999 and 0.2 percentage points in 2000, and the CPI is down 0.1 percentage point in both years). In the longer run, the projected GDP price index is unchanged from August and the CPI is up by 0.1 percentage point a year. The projected difference between the two measures of inflation therefore rises to an average of 0.5 percentage points in 2000 through 2009, slightly lower than the average difference of 0.7 percentage points over the past four years.

THE BUDGET OUTLOOK

Under CBO's baseline assumptions, the first total budget surplus since 1969 will be followed by even larger surpluses in the next 11 years. The surplus grows from $70 billion (0.8 percent of GDP) in fiscal year 1998 to $107 billion (1.2 percent of GDP) in 1999 (see Table 3). Those projections assume that discretionary spending will equal the statutory caps of the Deficit Control Act and that policies affecting other spending and revenues will remain unchanged. If discretionary spending increases at the rate of inflation after the caps expire in 2002, the surplus will reach $381 billion (2.8 percent of GDP) in 2009, compared with $514 billion (3.8 percent of GDP) if discretionary spending is instead held to the dollar level of the 2002 caps after that year.

Although a total budget surplus is expected in 1999 and 2000, on-budget outlays will continue to exceed on-budget revenues during those years—by $19 billion in 1999 and $7 billion in 2000. (That calculation excludes the transactions of the Social Security trust funds and the Postal Service, which are designated by law as off-budget.) CBO projects that the on-budget accounts will show a small surplus in 2001, however, which will grow to $164 billion in 2009 (assuming that discretionary spending grows with inflation after 2002).

CBO's current budget projections are considerably more favorable over the next decade than the projections published last August. Slightly less than half of the improvement results from the more advantageous assumptions about the economy. The rest of the improvement results from other factors that have increased projected revenues and reduced projected outlays.

Current Revenue Projections for 1999 Through 2009

Revenues grew by 9 percent (almost twice as fast as the growth of nominal GDP) in fiscal year 1998, increasing to $1,721 billion, or 20.5 percent of GDP. Revenues have not accounted for that large a share of GDP since 1944, when they equaled 20.9 percent. In CBO's projections, growth in revenues tapers to 5.4 percent in 1999, but that rate is still faster than the projected growth in national income and nudges revenues to a 20.7 percent share of GDP. Revenues are then expected to grow more slowly than the economy for three years before leveling off at 20.2 percent of GDP in 2003 through 2009.

In the absence of changes in tax laws, total revenues tend to grow over a period of years at the same average rate as the economy. But 1998 marked the fifth consecutive year in which growth in revenues outstripped growth in national income. Tax increases enacted in 1993 helped boost revenues in 1994 and 1995, but rapid growth in taxes on capital gains realizations, increases in taxable incomes as a share of GDP, and other exceptional factors have driven the increases relative to GDP since then. Revenues from capital gains are expected to grow little in 1999, but CBO anticipates that those other factors will keep revenues increasing slightly faster than the economy in 1999. In 2000, an expected leveling off of the total amount of highly taxed incomes as a share of GDP, the effects of changes in tax law enacted in the Taxpayer Relief Act of 1997, and a drop in tax receipts from capital gains will push revenues down as a share of the economy. After 2002, revenues are projected to expand once again in tandem with the economy.

Current Outlay Projections for 1999 Through 2009

Total outlays grew by 3.1 percent in 1998, more slowly than nominal GDP. They rose to $1,651 billion but fell to 19.6 percent of GDP. Outlays have not been that low as a percentage of GDP since 1974, when they equaled 18.7 percent. If policies remain unchanged and discretionary spending complies with the statutory caps and then increases with inflation after 2002, outlays will rise at an average annual pace of 3.2 percent over the next 11 years. With the economy expanding at an average rate of 4.4 percent a year (including the effects of inflation) over the same period, outlays will drop to 17.3 percent of GDP.

Reductions in net interest payments—which are projected to decline by 65 percent over the next 11 years (from $243 billion in 1998 to only $85 billion in 2009)—are a major contributor to the relatively slow growth of outlays. Those reductions follow directly from the large surpluses projected for that period. If they are actually realized, those surpluses will reduce the federal debt held by the public from $3,720 billion (44.3 percent of GDP) at the end of 1998 to $1,206 billion

(9 percent of GDP) at the end of 2009. That would be less than half the lowest level of federal debt relative to GDP since World War II.

Discretionary spending also contributes to the relatively slow growth of total outlays. As a result of emergency appropriations provided in last year's Omnibus Consolidated and Emergency Supplemental Appropriations Act and other funding enacted in that and other appropriation bills, discretionary outlays are expected to climb by almost 4 percent in 1999 (after rising by less than 1 percent in 1998). To comply with the caps in the Deficit Control Act, discretionary outlays will have to decline in each of the next three years, shrinking from $575 billion in 1999 to $568 billion in 2002. Even if none of the funding that was designated as emergency spending (or that was provided for the International Monetary Fund) in 1999 is repeated next year and other appropriations are held to the same level in 2000 as was provided in 1999, discretionary spending will exceed the total allowed under the caps by an estimated $10 billion in budget authority and $13 billion in outlays. After the caps expire in 2002, discretionary spending continues to decline as a percentage of GDP in CBO's projections since it is assumed to grow only at the rate of inflation. CBO projects that discretionary outlays will fall from 6.6 percent of GDP in 1998 to 5.0 percent in 2009, half the level recorded as recently as 1986.

Entitlement programs, by contrast, are projected to grow at an average annual rate of 5.6 percent from 1998 to 2009, increasing as a share of GDP from 11.2

percent to 12.6 percent. The government's two big health care programs, Medicaid and Medicare, are the major contributors to that relatively rapid growth. Medicaid is the smaller of the two programs—$101 billion in 1998 outlays compared with $211 billion for Medicare—but its growth is expected to be faster (8.4 percent a year on average from 1998 to 2009 compared with 7 percent for Medicare). The growth rates for both programs are higher than those of the past few years but well below the rates of the early 1990s. Projections for each program assume that the number of eligible people and the per-person use of medical care services will increase and that medical care prices will rise faster than other prices. In addition, the projections for Medicaid reflect the likelihood that the states, which are important decisionmakers in this joint federal/state program, will expand the services and benefits they provide. Together, spending for Medicaid and Medicare is projected to rise from 3.7 percent of GDP in 1998 to 5.1 percent in 2009.

Spending for other mandatory programs is generally expected to increase more slowly. Social Security—the largest mandatory program (with outlays of $376 billion in 1998)—is projected to grow at an average annual rate of 4.8 percent over the next 11 years. Growth for all other mandatory spending combined ($250 billion in 1998) is expected to average 4.1 percent a year.

Changes Since August

Although legislative action since August 1998 has reduced projected surpluses somewhat, a slightly more favorable economic outlook and adjustments in revenues and the projected growth of some entitlement programs have increased the cumulative total budget surpluses that CBO projects by $745 billion from 1999 through 2008. CBO now expects the surplus for 1999 to be $27 billion higher than it anticipated in August; for 2008, the outlook for the surplus has improved by $105 billion (see Table 4).

Those changes are hardly insignificant, but they result from relatively small changes in projected revenues and spending. The total change of $57 billion in projected revenues for 2008 represents a 2.2 percent increase above the level projected in August. When the debt-service savings that result from the increases in the surplus are excluded, the total reduction in projected outlays for 2008 is $13 billion, which represents only a 0.5 percent change from the level projected in August.

Legislation enacted since August reduced projected surpluses by $51 billion over the 1999-2008 period. Most of the effect was from enacted appropriation bills, including the Omnibus Consolidated and Emergency Supplemental Appropriations Act. CBO estimates that appropriation actions increased spending above last August's baseline levels by $17 billion in 1999, $5 billion in 2000, and lower amounts in succeeding years. Other legislation changed revenues or outlays by no more than $2 billion in any year (and the revenue and outlay changes were largely offsetting), but debt service on the total legislative changes increased projected outlays by $1 billion to $2 billion a year. The total reduction in the projected surplus stemming from changes in laws is $3 billion in 2008.

Changes related to revisions in CBO's projections of major economic variables account for significantly more of the differences in the budget projections. The revisions in the economic outlook are not large, but revenues and some spending programs are quite sensitive to changes in economic variables. In the short run, the largest budgetary effect comes from projected interest rates that are lower than CBO anticipated in August, and those changes in rates reduce estimated net interest payments by $8 billion in 1999 and $11 billion in 2000. CBO currently projects that interest rates in years after 2000 will be close to (or in the case of short-term rates, slightly higher than) those projected in August, and the effect on net interest will therefore fade. Projected inflation that is slightly lower in the next few years also produces a small effect, lowering cost-of-living increases in Social Security and other indexed entitlement programs. By 2002, however, CBO's new economic projections include slightly higher inflation than was previously anticipated, and the cost-of-living savings turn into small costs.

In the longer run, the largest effect of changes in the economic outlook is on revenues. After 2000, GDP is slightly higher in CBO's current projections than in August's. In addition, CBO projects that wage and salary disbursements, which are taxed more heavily than other sources of income (such as interest and dividends), will be about 0.4 percentage points higher as a share of GDP. As a result of those and other economic factors, projected revenues are $39 billion higher in 2008 than was anticipated in August. In addition, CBO's projection of discretionary spending that assumes such spending increases at the rate of inflation after the caps expire is greater after 2002 (by as much as $4 billion in 2008) because of higher projected inflation. Debt-service savings, which stem from the other savings, total $16 billion in 2008.

A variety of factors other than newly enacted legislation and changes in the economic projections also affect revenues and spending. CBO lumps the changes resulting from such factors into a category it calls technical changes. Over the 1999-2008 period, a little less than half of the total technical differences in the surplus (excluding debt-service savings) result from changes in revenues. But in 2008, the increase in revenues ($19 billion) is slightly larger than the change in outlays ($17 billion, excluding debt-service savings).

In the near term, the increase in projected revenues is largely attributable to higher estimates of capital gains realizations. In the longer run, it primarily reflects the expectation that more retirement income will be distributed than had previously been projected. Since those reestimates are not directly related to changes in CBO's projections of major economic variables, the resulting changes in projected revenues are classified as technical.

On the spending side, the largest technical changes are in Medicare and Medicaid, and those changes go in opposite directions. CBO's projection of Medicare spending has been reduced by $10 billion in 1999 and by increasing amounts in succeeding years (up to $18 billion in 2008). Those reductions reflect slower-than-anticipated growth in Medicare spending in recent months that has reduced estimated 1999 spending and lowered the starting point for projections of spending in 2000 and beyond. In addition, CBO believes that the Health Care Financing Administration's recently announced plan to adjust payment rates for Medicare+Choice providers on the basis of risk is likely to slow the growth of Medicare spending. Previously, CBO had assumed that the risk adjustments, which are required by the Balanced Budget Act of 1997, would be carried out on a cost-neutral basis.

CBO's estimate of Medicaid spending for 1999 has barely changed since August, but projected spending for future years has been boosted by amounts that gradually rise from $2 billion in 2000 to $15 billion in 2008. Those increases in part reflect recent discussions with state officials, who indicated that a number of states are likely to expand Medicaid coverage and benefits in the coming years more than had been anticipated.

Several other entitlement programs had significant technical changes, although none of them are nearly as large as the changes for Medicare and Medicaid. Lower projected caseloads in the Temporary Assistance for Needy Families (TANF) program and the Food Stamp program led CBO to reduce estimated outlays for TANF by $3 billion in 1999, $4 billion in 2000, and declining amounts in succeeding years through 2006 (the projection changes very little in 2007 and increases by nearly $1 billion in 2008) and outlays for Food Stamps by amounts increasing from $1 billion in 1999 to $3 billion in 2008. Revised estimates of the number of retired federal employees, based on information from actuaries at the Office of Personnel Management, lowered projections of spending from the Civil Service Retirement Fund by amounts that increase from $1 billion in 1999 to $5 billion in 2008. CBO also lowered its projections of spending from the Universal Service Fund by as much as $4.5 billion a year. (The fund provides subsidies for telephone service in high-cost areas as well as to low-income customers and schools, libraries, and health care providers.) The changes in outlays from the Universal Service Fund have little effect on the projected surplus, however, because they are largely offset by corresponding reductions in revenues received by the fund.

Actual budget outcomes could be considerably different from CBO's baseline projections even if current policies do not change. Unexpected economic results alone could significantly affect the budget. Such unexpected results could take two forms. CBO's projections of medium-term economic trends might be accurate, but cyclical disturbances could change the performance of the economy in certain years. Or CBO's projections of medium-term trends might be too optimistic or too pessimistic.

Cyclical disturbances could have a significant effect on the budget at any time during the projection period. A recession would temporarily push down taxable incomes, thus depressing the growth of federal revenues. A recession would also boost spending for unemployment insurance and other benefit programs. CBO estimates that a relatively mild recession (similar to the one in the early 1990s) that began this year could reduce the projected surplus by $55 billion in 2000. A similarly mild recession starting in 2000 could reduce the surplus by an estimated $85 billion in 2002. Alternatively, a temporary continuation of the high growth and low inflation experienced for the past three years could boost revenues and reduce spending, increasing the surplus by close to $41 billion in 2000 and by $83 billion in 2002. In all of those scenarios, the surplus for 2009 would not be greatly different from the one in CBO's baseline projections.

Changes in longer-term economic trends would not have quite so great an influence in the short run, but they could have a significantly larger effect on surpluses in 2009. For instance, if combined wages, salaries, and corporate profits grew at a higher-than-expected rate over the next 10 years, so that taxable income in 2009 was roughly 8 percent higher than CBO's baseline assumes, the budget surplus in 2009 would be about $250 billion higher than the $381 billion CBO is projecting. Slower-than-anticipated growth that pushed incomes similarly below the level CBO projects for 2009 would reduce the surplus by about the same amount.

Of course, the performance of the economy is not the only potential source of deviations from the projected path of the budget. Over the past few years, for instance, only a part of the unexpected increases in revenues can be explained by higher-than-anticipated national income. Other factors such as unexpectedly high levels of capital gains realizations (which are related to the performance of the economy but are not included in standard measures of economic performance) have boosted revenues. Similarly, the slower-than-anticipated growth of spending for entitlement programs—particularly Medicare, Medicaid, and some other programs for low-income people—cannot be explained fully by the performance of the economy.

Developing alternative scenarios that adequately capture the potential effects of such noneconomic, or technical, factors on the future path of the budget is difficult, but the estimated effects of a few specific alternative assumptions can illustrate the magnitude of possible changes. For example, CBO's baseline projection assumes that changes in the effective tax rate for the individual income tax (the ratio of taxes paid to adjusted gross income) will reflect only real income growth and scheduled changes in tax law over the next 10 years. If, however, the effective tax rate increased 1 percent a year faster than those factors would dictate (the extra growth has been higher than that, on average, during the 1990s), revenues in 2009 would be about $150 billion higher than currently projected. On the outlay side, CBO assumes that combined spending for Medicare and Medicaid will grow at an average annual rate of about 7.5 percent over the next decade. If, instead, that growth averaged 9.5 percent annually—which is in line with historical growth rates for both Medicare and Medicaid—spending could be increased by as much as $150 billion in 2009. Of course, it is also possible that the effective individual income tax rate and spending for Medicare and Medicaid will grow more slowly than CBO anticipates.

Technical and economic errors in CBO's projections may be offsetting, or they may reinforce each other. That is one reason why it is difficult to estimate with any confidence the probability that actual outcomes will be within any particular range around the baseline projection of the surplus. History, however, provides some guidance. CBO has compared the actual surpluses for 1988 through 1998 with the first projection of the surplus it produced five years before the start of the fiscal year. (CBO has only recently begun to produce 10-year estimates, so there is no historical comparison with actual outcomes yet.) Excluding the estimated effects of legislation on the actual outcomes, the remaining errors averaged about 13 percent of actual outlays. A deviation of 13 percent of projected outlays in 2004 would produce an increase or decrease in the surplus of about $250 billion. In 2009, an error equal to 13 percent of projected outlays would produce a swing of about $300 billion. But since the errors in projections made 10 years in advance are probably larger than the errors in estimates made five years ahead, an average deviation in 2009 is likely to produce a swing that is larger than that.

CONCLUSION

The outlook for the budget under current policies over the next decade continues to be bright. Although there are reasons to fear that the long economic expansion could come to an end this year or next, CBO believes the economy is more likely to continue growing in the near term, albeit at a more moderate pace than in the past few years. Revenue growth is not expected to continue to outpace economic growth, but revenues are still projected to increase at a healthy rate. The growth in spending for a number of entitlement programs has slowed significantly in recent years. For many of those programs, growth rates are expected to accelerate over the next few years, but they are unlikely to return to the high levels of the early 1990s. CBO projects that if policies remain unchanged, rising surpluses in the total budget will shrink the amount of federal debt held by the public by two-thirds over the next decade.

Table 1.
The Budget Outlook Under Current Policies (By fiscal year, in billions of dollars)

	Actual 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total Budget Surplus	70	107	131	151	209	209	234	256	306	333	355	381
Off-Budget Surplus	99	127	138	145	153	161	171	183	193	204	212	217
On-Budget Deficit (-) or Surplus	-29	-19	-7	6	55	48	63	72	113	130	143	164
Memorandum:												
Total Budget Surplus Assuming a Freeze in Discretionary Spending After 2002	70	107	131	151	209	225	265	305	374	421	465	514

SOURCE: Congressional Budget Office.

NOTE: The projections assume that discretionary spending will equal the statutory caps on such spending in 2000 through 2002 and, with the exception of the memorandum item, will increase at the rate of inflation thereafter.

Table 2.
Comparison of CBO Economic Projections for Calendar Years 1999-2009

	Estimate	Forecast		Projected								
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Nominal GDP (Billions of dollars)												
January 1999	8,499	8,846	9,182	9,581	10,015	10,476	10,960	11,465	11,988	12,528	13,089	13,688
August 1998	8,487	8,839	9,204	9,572	10,008	10,475	10,955	11,446	11,950	12,473	13,015	n.a.
Nominal GDP (Percentage change)												
January 1999	4.8	4.1	3.8	4.3	4.5	4.6	4.6	4.6	4.5	4.5	4.5	4.4
August 1998	4.6	4.2	4.1	4.0	4.6	4.7	4.6	4.5	4.4	4.4	4.3	n.a.
Real GDP (Percentage change)												
January 1999	3.7	2.3	1.7	2.2	2.4	2.4	2.4	2.4	2.4	2.3	2.3	2.3
August 1998	3.4	2.2	1.9	1.8	2.4	2.5	2.4	2.3	2.3	2.2	2.2	n.a.
GDP Price Index[a] (Percentage change)												
January 1999	1.0	1.7	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1
August 1998	1.2	2.0	2.2	2.1	2.1	2.1	2.1	2.1	2.1	2.1	2.1	n.a.
Consumer Price Index[b] (Percentage change)												
January 1999	1.6	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
August 1998	1.7	2.6	2.7	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	n.a.
Unemployment Rate (Percent)												
January 1999	4.5	4.6	5.1	5.4	5.6	5.7	5.7	5.7	5.7	5.7	5.7	5.7
August 1998	4.6	4.7	5.1	5.5	5.7	5.7	5.7	5.7	5.7	5.7	5.7	n.a.
Three-Month Treasury Bill Rate (Percent)												
January 1999	4.8	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.5
August 1998	5.1	5.2	4.8	4.6	4.4	4.4	4.4	4.4	4.4	4.4	4.4	n.a.
Ten-Year Treasury Note Rate (Percent)												
January 1999	5.3	5.1	5.3	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4
August 1998	5.8	6.1	5.8	5.6	5.4	5.4	5.4	5.4	5.4	5.4	5.4	n.a.
Tax Bases (Percentage of GDP)												
Corporate profits												
January 1999	9.7	9.2	8.5	8.5	8.6	8.6	8.6	8.6	8.5	8.4	8.3	8.2
August 1998	9.6	9.4	9.2	8.8	8.6	8.5	8.5	8.4	8.3	8.3	8.3	n.a.
Wages and salaries												
January 1999	48.8	49.3	49.7	49.5	49.3	49.2	49.1	49.1	49.1	49.1	49.1	49.1
August 1998	48.7	48.8	48.7	48.8	48.7	48.7	48.7	48.7	48.7	48.7	48.7	n.a.

SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

NOTE: n.a. = not applicable.

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

b. The consumer price index for all urban consumers.

Table 3.
CBO Baseline Budget Projections, Assuming Compliance with the Discretionary Spending Caps
(By fiscal year)

	Actual 1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
					In Billions of Dollars							
Revenues												
Individual income	829	863	893	919	958	990	1,035	1,085	1,138	1,195	1,258	1,323
Corporate income	189	193	188	191	202	214	226	238	250	259	267	273
Social insurance	572	610	640	666	691	717	746	783	816	852	885	923
Other	132	148	148	154	164	170	177	182	188	194	200	208
Total	1,721	1,815	1,870	1,930	2,015	2,091	2,184	2,288	2,393	2,500	2,611	2,727
On-budget	1,306	1,368	1,402	1,443	1,508	1,563	1,634	1,711	1,791	1,871	1,956	2,046
Off-budget	416	446	468	488	506	527	550	577	602	628	654	681
Outlays												
Discretionary spending[a]	554	575	574	573	568	583	598	614	630	646	663	680
Mandatory spending	939	982	1,028	1,086	1,141	1,210	1,280	1,365	1,425	1,511	1,609	1,708
Offsetting receipts	-84	-80	-81	-87	-99	-95	-98	-103	-108	-114	-121	-127
Net interest	243	231	218	207	195	183	170	156	140	123	104	85
Total	1,651	1,707	1,739	1,779	1,806	1,881	1,951	2,032	2,086	2,166	2,255	2,346
On-budget	1,335	1,388	1,409	1,437	1,453	1,515	1,572	1,639	1,678	1,741	1,813	1,882
Off-budget	317	320	330	343	353	366	379	393	409	425	442	464
Deficit (-) or Surplus	70	107	131	151	209	209	234	256	306	333	355	381
On-budget deficit (-) or surplus	-29	-19	-7	6	55	48	63	72	113	130	143	164
Off-budget surplus	99	127	138	145	153	161	171	183	193	204	212	217
Debt Held by the Public	3,720	3,630	3,515	3,378	3,183	2,989	2,770	2,529	2,237	1,917	1,574	1,206
					As a Percentage of GDP							
Revenues												
Individual income	9.9	9.9	9.8	9.7	9.7	9.6	9.6	9.6	9.6	9.6	9.7	9.8
Corporate income	2.2	2.2	2.1	2.0	2.0	2.1	2.1	2.1	2.1	2.1	2.1	2.0
Social insurance	6.8	7.0	7.0	7.0	7.0	6.9	6.9	6.9	6.9	6.9	6.8	6.8
Other	1.6	1.7	1.6	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.5	1.5
Total	20.5	20.7	20.6	20.4	20.3	20.2	20.2	20.2	20.2	20.2	20.2	20.2
On-budget	15.5	15.6	15.4	15.2	15.2	15.1	15.1	15.1	15.1	15.1	15.1	15.1
Off-budget	4.9	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.0
Outlays												
Discretionary spending[a]	6.6	6.6	6.3	6.0	5.7	5.6	5.5	5.4	5.3	5.2	5.1	5.0
Mandatory spending	11.2	11.2	11.3	11.5	11.5	11.7	11.8	12.0	12.0	12.2	12.4	12.6
Offsetting receipts	-1.0	-0.9	-0.9	-0.9	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9
Net interest	2.9	2.6	2.4	2.2	2.0	1.8	1.6	1.4	1.2	1.0	0.8	0.6
Total	19.6	19.5	19.1	18.8	18.2	18.2	18.0	17.9	17.6	17.5	17.4	17.3
On-budget	15.9	15.8	15.5	15.2	14.7	14.6	14.5	14.5	14.2	14.1	14.0	13.9
Off-budget	3.8	3.6	3.6	3.6	3.6	3.5	3.5	3.5	3.4	3.4	3.4	3.4
Deficit (-) or Surplus	0.8	1.2	1.4	1.6	2.1	2.0	2.2	2.3	2.6	2.7	2.7	2.8
On-budget deficit (-) or surplus	-0.3	-0.2	-0.1	0.1	0.6	0.5	0.6	0.6	1.0	1.0	1.1	1.2
Off-budget surplus	1.2	1.4	1.5	1.5	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Debt Held by the Public	44.3	41.4	38.6	35.6	32.1	28.9	25.6	22.3	18.9	15.5	12.2	8.9

SOURCE: Congressional Budget Office.

a. The projection assumes that discretionary spending will equal the statutory caps on such spending in 2000 through 2002 and will increase at the rate of inflation thereafter.

Table 4.
Changes in CBO Budget Projections Since August 1998 (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
August 1998 Total Budget Surplus	80	79	86	139	136	154	170	217	236	251
Changes										
Legislative										
Revenues	a	2	b	-1	b	-1	-1	-1	a	a
Outlays[b]	-17	-8	-2	-3	-3	-3	-3	-3	-3	-3
Subtotal	-17	-6	-3	-4	-4	-3	-3	-4	-3	-3
Economic										
Revenues	3	5	12	19	22	25	31	35	37	39
Outlays[b]										
Other than debt service	9	14	12	10	7	4	2	a	-2	-3
Debt service	a	1	2	4	5	7	9	11	13	16
Subtotal	13	20	27	32	34	36	41	46	48	51
Technical										
Revenues	11	15	15	19	16	17	15	16	17	19
Outlays[b]										
Other than debt service	20	21	21	17	19	18	19	15	18	17
Debt service	1	3	5	7	9	11	14	16	19	21
Subtotal	32	38	41	42	43	47	48	47	53	57
Total Changes	27	52	65	70	74	79	85	90	98	105
January 1999 Total Budget Surplus	107	131	151	209	209	234	256	306	333	355
Memorandum:										
Total Change in Revenues	14	22	28	36	37	42	44	50	53	57
Total Change in Outlays	13	30	37	34	36	38	41	39	45	47

SOURCE: Congressional Budget Office.

a. Less than $500 million.

b. Increases in outlays are shown with a negative sign because they reduce surpluses.