INFORMED BUDGETEER

WHAT EXACTLY DOES "ELIMINATE THE DEBT" MEAN?

• President Clinton says he will "eliminate the debt." Congressional leaders have a plan to "eliminate the debt." What do they mean?

• They are talking about eliminating the portion of gross federal debt know as "debt held by the public." At the close of December 1999, debt held by the public stood at $3.7 trillion.

• Let's start at the top. The broadest concept of federal debt is gross federal debt. Gross federal debt is the sum of two parts - debt held by government accounts and debt held by the public. Federal government borrowing is currently subject to a statutory limit($5.95 trillion); debt subject to the statutory limit is nearly identical to gross federal debt. Gross federal debt stood at $5.7 trillion as of December 31, 1999.

• Debt held by government accounts represents the holdings of debt by federal trust funds and other special funds. This is debt that the federal government owes itself. When trust funds are in surplus, as social security is now, the surplus funds are invested, by law, in government securities. The annual change in the level of debt held by government accounts is equal to the amount of trust fund surpluses for that year. Debt held by government accounts equaled $2.0 trillion at the end of December.

• Debt held by the public represents the holdings of debt by individuals, institutions and other buyers outside the federal government and by the Federal Reserve System. The annual change in debt held by the public represents the amount of borrowing that the federal government must do to finance the excess of total federal outlays over total federal revenues. The change in debt held by the public in one year, therefore, closely tracks the unified budget deficit or surplus for that year.

• Note that President Clinton's budget last year (including his Social Security framework) did not reduce the debt. Both debt held by the public and gross federal debt were higher if one assumed the President's Social Security framework than if one did not. By 2009, debt held by the public was over $1 trillion higher assuming the Social Security framework; gross federal debt was over $2.8 trillion higher assuming the framework.

• Congressional Republicans last year pledged not to touch the Social Security surplus and President Clinton echoed that pledge. **Simply adhering to this pledge will make it possible to pay off the debt by 2013 (according to the new CBO projections and SBC calculations), which would leave all of the on-budget surplus available to be spent (as proposed by the President) or to be used to pay off the debt earlier.**

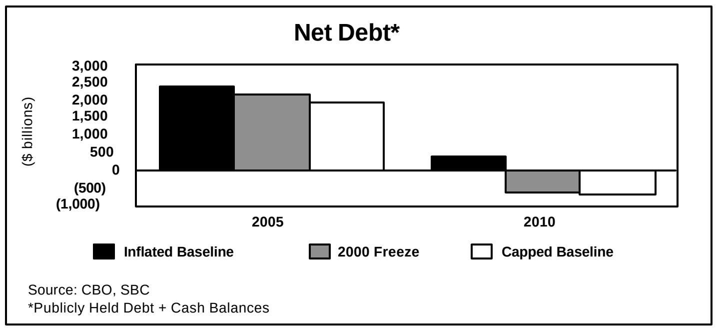
CBO'S DEBT NUMBERS

• Even budgeteers could be forgiven for being confused with the debt numbers CBO presented in its annual report. Even though the three baselines project different cumulative surplus estimates, debt held by the public is projected to be at the same level in 2010 – $941 billion.

• How is this possible? In order to run the debt down to zero, the government would have to buy back a significant amount of outstanding Treasuries. At the time that CBO did their baseline, however, Treasury had not announced whether it would buy back debt. Thus, CBO felt that it could not assume buy backs. This meant that at least $941 billion in Treasuries would still be outstanding in 2010.

• However, that left CBO with a problem – what to do with the rising surpluses if they couldn't go toward further debt reduction. As an alternative, CBO assumed that the US would build up large cash balances. Under two of their baselines, these balances grow to roughly $1.6 trillion by 2010.

• While CBO's accounting is understandable, it is somewhat confusing at first glance. To make things clearer, we have netted the publicly held debt with the cash balances. This gives *the debt stream that would result if we could buy back all of our debt.* Under this accounting, the debt is paid off in 2009-2010 under the capped and freeze baselines and falls to roughly $400 billion under the inflated baseline.



CBO'S ECONOMIC AND BUDGET OUTLOOK, FY2001-2010

• The Congressional Budget Office released its updated economic assumptions and budget projections on January 26. CBO confirmed that legislative action last year did not cause a dip into the Social Security surplus in 2000; the on-budget surplus is projected to be $23 billion in 2000, following a $0.7 billion on-budget surplus in 1999.

• CBO presented three baselines (and the surpluses associated with those baselines) in its report (see 1/18/00 Bulletin for a lengthy discussion of the different baselines). The following table summarizes CBO's on-budget surplus projections.

CBO On-Budget Surplus Projections
Baseline Scenarios, $ in Billions

Discretionary Spending	2000	2001	2001-05	2001-10
Capped[A]	23	69	594	1918
Nominal Freeze[B]	23	22	379	1858
Inflated[C]	23	11	148	838

SOURCE: CBO; [A]Caps hold in 2001 and 2002. [B]Spending is frozen in nominal terms at 2000 level. [C]Spending grows with inflation from 2000 level.

• CBO's projections for revenues and most mandatory spending are the same in all baseline scenarios. The various surplus projections differ because of assumptions about discretionary spending. The following table summarizes the discretionary budget authority and outlay levels for the three baseline scenarios.

Discretionary Spending Projections
$ in Billions

Baseline Scenarios		2000	2001	$ Change
CBO Capped[A]	BA	570	540	-30
	OT	603	578	-25
CBO Nominal freeze[B]	BA	570	586	+16
	OT	603	624	+21
Nominal freeze less one time	BA	570	577	+8
spending[C]	OT	603	620	+18
	BA	570	606	+36
CBO Inflated[D]	OT	603	635	+32

SOURCE: CBO; [A]Caps hold in 2001 and 2002. [B]Spending is frozen in nominal terms at 2000 level. [C]SBC staff estimate when one-time 2000 spending is removed (e.g. Census, disaster assistance, Wye River, UN arrears) and then frozen at 2000 level. [D]Spending grows with inflation from 2000 Level.

- CBO's report includes a table detailing the changes in the surplus projections since July 1999 (under the capped baseline). The projected 10-year surplus is now $879 billion higher than CBO projected in July.

- Legislation enacted since July reduced surplus projections by a total of $127 billion; 14 percent ($18 billion) due to legislation that reduced revenues and 86 percent ($109 billion) due to legislation that increased spending. The effects of legislation were more than offset by economic and technical updates.

Changes in Surplus Projections, Capped Baseline
$ in billions

	2000	2001	2000-2009
July Baseline Total Surplus	161	193	2,895
Changes:			
Legislative			
Revenues	3	-6	-18
Outlays	-33	-11	-109
Economic	25	40	640
Technical	20	19	366
Total Changes	15	42	879
January Baseline Total Surplus	176	235	3,774

TAX CHANGES FOR THE NEW MILLENNIUM

- Even though President Clinton vetoed the Republican taxcut plan last year, Congress' past efforts to cut taxes resulted in many tax changes effective January 1, 2000. The Ways and Means Committee released its fourth annual Top Ten Tax Changes for the Year 2000 earlier this month:

1. Alternative Minimum Tax (AMT) Protection for 1 Million Filers. More than 1 million Americans will avoid a tax increase in 2000 because Congress passed a bill allowing filers to offset fully regular tax liability by the personal nonrefundable credits.

2. Letting Seniors Make $1,500 More Without Losing Social Security Benefits. Seniors between the ages of 65-69 will be able to earn up to $17,000 without losing any of their Social Security benefits, up from $15,500 in 1999.

3. Increasing 401(k) Plan Contribution Limits by $500 to $10,500 because of cost-of-living adjustments Congress built into the tax code.

4. Traditional IRA Expansion. Effective January 1st, the phase-out range will increase to $62,000 for joint filers and $42,000 single filers. Taxpayers earning less than these limits are permitted a deductible contribution of up to $2,000.

5. Student Loan Interest Deduction Up by $500 to $2,000.

6. Continued Deduction for Employer-Provided Education Assistance.

7. Relief from Death Taxes. The current $650,000 exemption from death taxes is increased to $675,000 in 2000.

8. Small Businesses Expensing Increased by $1,000 to $20,000.

9. Tax Brackets for 2000. Brackets are fully indexed to protect against increases in the cost of living.

10. Standard Deduction for 2000 will go up $100 for single individuals (to $4,400) and up $150 for married couples filing jointly (to $7,350).

- There is also one tax increase enacted by a past Congress – beginning January 1st, the current 12.4 percent payroll tax which is dedicated to Social Security will now be levied on the first $76,200 of earnings, up from $72,600 in 1999.

ECONOMICS

A STRONG ECONOMY BUOYS BUDGET NUMBERS

- Over the last six months, private forecasters have revised up their forecasts for US economic growth substantially, in deference to the economy's excellent near-term performance and apparent improvement in underlying productivity growth.

- CBO has made similar upward revisions. CBO now assumes that real GDP growth over the next 10 years will average 2.8%, a pick-up of 0.4% from its July 1999 estimates. Roughly half of this improvement stems from upward revisions to underlying productivity growth. The remaining 0.2% improvement is split between assumptions of faster labor force growth and technical revisions to the GDP series. (Note: these latter technical changes boosted GDP but had very little effect on revenue projections).

- In contrast, CBO's inflation projections were little changed from last July, while interest rate forecasts were slightly higher.

- On net, the improved economic forecasts were responsible for roughly 75% of the upward revision in 10-year budget totals. While some might wonder if these surpluses are built on overly rosy economics, it is important to note that CBO's economic forecasts are still conservative in relation to the private forecasters.

Average Real GDP Growth Rates: by %

	1999-2005	1999-2008	1999-2010
CBO	2.9	2.8	2.8
DRI	3.3	3.4	3.2
Macro Advisors	2.9	3.0	- -
WEFA	3.2	- -	- -

BUDGET QUIZ

Question: For FY1999, was there an on-budget deficit or surplus?

Answer: If you picked – an on-budget **deficit** of $1 billion (based on the final Monthly Treasury Statement for FY 1999, released October 27, 1999) – *you lost*! Last week, the Treasury Department released revised figures for 1999 that show an on-budget surplus instead, amounting to $675 million–a change of $1.7 billion. This first on-budget surplus since 1960 was, compared to the initial "actual" reported for 1999, mostly brought about by a downward revision in actual outlays after additional reporting by the Department of Education.

Senate Budget Committee 2000 Hearing Schedule

All hearings will be held in Dirksen 608 at 10:00 am unless otherwise noted. Additional hearings and witnesses may be scheduled.

February 1: Federal Spending Priorities: Exercising Oversight. Witness: GAO Comptroller General, David Walker.
February 2: Federalism in the Information Age: Internet Tax Issues. Witnesses: Massachusetts Governor Paul Cellucci; Michigan Governor John Engler; Charles E. McLure, Jr., Senior Fellow, Hoover Institution, Stanford University; Mr. Aaron Lukas, Trade Policy Analyst, Cato

Institute; and Ms. Iris Lav, Deputy Director,Center on Budget and Policy Priorities

February 3: Joint hearing with Senate Transportation Appropriations Subcommittee- Modernizing the Federal Aviation Administration: Challenges and Solutions. Witnesses: FAA Administrator, Jane Garvey; Assistant Secretary for Budget and Programs, Office of the Secretary of Transportation, Ken Mead; and Chief Financial Officer, NAV Canada, John Crichton.

February 8: President's FY 2001 Budget. Witnesses: Education Secretary, Richard Riley; and Treasury Undersecretary, Stu Eisenstat.

February 9: President's FY 2001 Budget. Witness: OMB Director, Jack Lew.

February 10: Spectrum Auctions, Technology and the Federal Budget. Witness: FCC Chairman, William Kennard.

February 11: President's FY 2001 Budget. Witness: Secretary of State, Madeline Albright.