

**A**  
**CBO**  
**REPORT**

**AN ANALYSIS OF THE PRESIDENT'S  
BUDGETARY PROPOSALS  
FOR FISCAL YEAR 1998**

**MARCH 1997**

The Congress of the United States  
Congressional Budget Office

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## **NOTES**

Unless otherwise indicated, all years referred to in Chapter 2 and Appendix B are calendar years, and all years in other chapters and Appendix A are fiscal years.

Unemployment rates throughout the report are calculated on the basis of the civilian labor force.

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

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# Preface

**T**his analysis of the President's budget for fiscal year 1998 was prepared at the request of the Senate Committee on Appropriations. It was produced by the staffs of the Budget Analysis, Macroeconomic Analysis, and Tax Analysis divisions under the supervision of Paul Van de Water, Robert Dennis, and Rosemary D. Marcuss. James Horney wrote Chapter 1, Juann Hung wrote Chapter 2, Daniel Kowalski wrote Chapter 3, and Richard Kasten wrote Chapter 4. Appendix A was written by Jeffrey Holland, and Appendix B was written by John Peterson and James Horney, with assistance from Laurie Brown. The baseline revenue estimates were prepared under the direction of Richard Kasten. The estimates of the President's revenue proposals were prepared by the Joint Committee on Taxation. The principal contributors to the revenue and spending estimates and analyses are listed in Appendix C.

Paul L. Houts supervised the editing and production of the report. Major portions were edited by Paul L. Houts, Sherwood Kohn, and Christian Spoor. Marlies Dunson provided editorial assistance. The authors owe thanks to Marion Curry, Linda Harris, Denise Jordan, Dorothy Kornegay, and Simone Thomas, who assisted in producing sections of the report. Kathryn Quattrone and Jill Sands prepared the entire report for publication.

June E. O'Neill  
Director

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# Summary and Introduction

**O**n February 6, 1997, the President submitted to the Congress a budget for fiscal year 1998. The Administration estimates that, if the economy performs as it expects, the basic policies proposed in the budget will produce a surplus of \$17 billion in 2002. The President has also proposed an alternative set of budgetary policies to eliminate the deficit in 2002 under the more cautious Congressional Budget Office (CBO) assumptions. Under those alternative policies, some proposed tax cuts would "sunset," or expire, at the end of calendar year 2000, and spending would be held significantly below the levels of the President's basic policies in fiscal years 2001 and 2002.

As requested by the Senate Committee on Appropriations, CBO has estimated the effects of the President's budgetary proposals using its own economic and technical assumptions. CBO estimates that a deficit of \$69 billion would remain in 2002 under the President's basic policy proposals. The alternative policies proposed by the President were designed to eliminate exactly any size deficit that CBO might project under the basic policies. Under those policies, the proposed alternative level of discretionary spending hinges on estimates that CBO makes during the current budget cycle. After CBO estimates the deficit, taking into account the other alternative policies, the Administration will adjust the proposed level of discretionary spending for 2001 and 2002 so that it is just low enough to ensure that any remaining deficit estimated for 2002 would be eliminated under CBO's assumptions.

In addition to estimating the President's budget, CBO has made some small revisions in the baseline budget projections published in its January report, *The*

*Economic and Budget Outlook: Fiscal Years 1998-2007*. CBO has revised its estimate of the deficit for 1997 downward from \$124 billion to \$115 billion because of lower projected spending. But beyond 1997, it has made only small revisions in projected deficits. As discussed in Chapter 3 of the January report, such projections are highly uncertain. Unanticipated swings in the economy—or an unexpected event such as the savings and loan crisis of the late 1980s and early 1990s—could lead to deficits that are much higher or lower than CBO projects even if policies are unchanged.

CBO estimates that balancing the budget in 2002 would produce changes in the economy—lower interest rates, slightly higher real growth, and an increase in the share of national income represented by corporate profits. Those changes would produce a fiscal dividend of \$34 billion in 2002. Under CBO's projections that include the fiscal dividend, \$153 billion in policy savings (including associated debt-service reductions) would be needed in 2002 to produce a balanced budget in that year. Those projections provide the starting point for CBO's analysis of the budget, since the President's budget is intended to eliminate the deficit in 2002.

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## The President's Basic Budgetary Policies

CBO estimates that the basic policies specified in the President's budget would save \$84 billion in 2002—compared with its projections of the deficit under cur-

rent policies that include the fiscal dividend—and would reduce the deficit in that year to \$69 billion (see Table 1).

increase the deficit. In 1998, in fact, the net effect of the President's policies is to push the deficit of \$24 billion above the baseline level.

## CBO's Estimate of the President's Policy Proposals

Although collectively the President's policies reduce the deficit in most years, a number of his proposals would

Under the President's proposals, revenues would be \$10 billion lower in 1998 than is anticipated under current policies. In addition, CBO estimates that discretionary spending proposed by the President would exceed CBO's baseline level by \$9 billion. Proposed new initiatives in Medicaid would increase spending in 1998

**Table 1.**  
**CBO Estimate of the Effect on the Deficit of the President's Basic Budgetary Policies**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1998-2002
CBO Deficit Projections, Including Fiscal Dividend <sup>a</sup>	115	121	145	159	142	153	n.a.
Effect on the Deficit of the President's Budgetary Policies							
Revenues <sup>b</sup>							
Reductions	1	21	21	22	27	28	120
Increases	<u>-1</u>	<u>-11</u>	<u>-16</u>	<u>-17</u>	<u>-18</u>	<u>-19</u>	<u>-81</u>
Subtotal	c	10	5	5	10	9	39
Outlays							
Discretionary	c	9	-3	-13	-29	-42	-79
Mandatory	<u>c</u>	<u>5</u>	<u>-6</u>	<u>-17</u>	<u>-26</u>	<u>-46</u>	<u>-90</u>
Subtotal	1	13	-8	-29	-55	-89	-168
Total, policies	1	23	-3	-24	-46	-79	-129
Debt service	<u>c</u>	<u>1</u>	<u>1</u>	<u>c</u>	<u>-2</u>	<u>-5</u>	<u>-4</u>
Total Effect on the Deficit	1	24	-2	-24	-47	-84	-133
Deficit Under the President's Budgetary Policies as Estimated by CBO	116	145	142	135	95	69	n.a.

SOURCE: Congressional Budget Office.

NOTES: The estimates in this table exclude alternative policies to eliminate the deficit under CBO assumptions.

n.a. = not applicable.

- The projections assume both balanced budget economic assumptions and discretionary spending that increases with inflation, subject to the statutory cap for 1998.
- Reductions in revenues are shown with a positive sign because they increase the deficit. The revenue estimates differ somewhat from those published by the Joint Committee on Taxation (JCT). CBO has used Administration estimates for two proposals that the JCT was unable to estimate because the proposals had not been specified by the time CBO finished its estimate of the budget—a new aviation fee system and a tax-incentive program for the District of Columbia. CBO's estimates also include additional fee proposals and exclude a proposal that would affect only outlays. In addition, the estimates assume that tax cuts specified in statutory language to sunset in 2000 are extended permanently.
- Less than \$500 million.

by \$2 billion. Expanded health care coverage for children and a new program to provide health insurance for unemployed workers would cost \$3 billion in 1998. Relaxing provisions in last year's welfare reform legislation that affect Supplemental Security Income and Food Stamps would increase spending for those two programs by \$2 billion and \$1 billion, respectively. Additional spending for education and training, including more than \$1 billion for a new program to help fund school construction, would raise the deficit by about \$2 billion. Those deficit-increasing proposals would be partially offset by \$3 billion in Medicare savings and \$2 billion in savings in other mandatory programs.

As estimated by CBO (and for most of the revenue proposals, by the Joint Committee on Taxation), the \$84 billion in deficit reduction in 2002 is composed of:

- o Savings of \$42 billion from reducing discretionary spending below the level of the 1998 caps adjusted for inflation.
- o Net savings of \$46 billion in mandatory spending, of which \$29 billion comes from Medicare and \$12 billion from auctioning additional parts of the electromagnetic spectrum.
- o A \$9 billion increase in the deficit on the revenue side of the budget, the result of \$28 billion in tax cuts partially offset by \$19 billion in tax increases, including \$7 billion from user fees that would replace aviation excise taxes that expired last December. That estimate assumes that the tax cuts specified in the statutory language to sunset at the end of 2000 would not expire, but instead would be extended permanently.
- o Debt-service savings of \$5 billion in 2002.

Under the President's basic policies, discretionary outlays would rise to \$553 billion in 1998 and \$572 billion in 2002. Projected outlays for 1998, which represent an increase above the \$534 billion spent in 1996 and the estimated \$549 billion in 1997 spending, are more than \$25 billion higher than the discretionary spending assumed for 1998 in last year's budget resolution. Projected outlays in 2002 under the President's proposals would be almost \$50 billion (8 percent) below the level needed to keep pace with inflation but al-

most \$60 billion above the amount assumed in the budget resolution.

## **CBO's Reestimate of the Administration's Baseline Projections**

CBO's estimated deficit of \$69 billion in 2002 under the President's policies stands in sharp contrast to the surplus of \$17 billion that the Administration estimates. About 70 percent, or \$60 billion, of that \$86 billion discrepancy stems from differences between CBO's and the Administration's estimates of the deficit under current policies (see Table 2). Compared with recent years, estimates of spending for Medicare and Medicaid do not contribute much to the baseline differences between the Administration and CBO—only about \$2 billion separates the two agencies' projections of combined Medicare and Medicaid spending in 2002 under current law.

Although the Administration's economic projections are similar to CBO's projections that incorporate the effects of balancing the budget, slight differences in economic outlook account for more than the \$60 billion difference in the baseline projections of the deficit in 2002. The Administration projects nominal gross domestic product (GDP) that is some \$80 billion higher in 2002 than CBO's projection—a very small difference in a \$10 trillion economy. CBO assumes higher unemployment rates, but that largely reflects differences in projected GDP and has relatively little independent effect on overall budget outlays. The two agencies differ a bit on inflation and interest rates, and each of those differences has some budgetary effect. But from a budgetary standpoint, the most significant difference in economic assumptions involves shares of national income: the Administration assumes a slightly higher percentage of GDP in categories that tend to produce revenues, such as wage and salary disbursements and corporate profits.

## **CBO's Reestimate of Policy Proposals**

Reestimates of the effect of the President's proposed policy changes account for the remaining \$27 billion difference in deficit projections in 2002. Differences in estimates of the savings from the President's proposals

for discretionary spending are relatively small (CBO estimates \$1 billion less in savings). Most of the \$21 billion reestimate of proposals affecting mandatory spending (including offsetting receipts) stems from two

estimates: the estimate of the President's Medicare proposals (CBO estimates that they will save \$6 billion less in 2002 than the Administration assumes) and the estimate of the proposed auction by the Federal Com-

**Table 2.**  
**CBO Reestimate of the President's Basic Budgetary Policies (By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002
Deficit Under the President's Basic Budgetary Policies as Estimated by the Administration	126	121	117	87	36	-17
<b>Baseline Reestimates</b>						
Economic Differences						
Revenues <sup>a</sup>	8	17	25	35	40	46
Outlays <sup>b</sup>	<u>c</u>	<u>4</u>	<u>11</u>	<u>15</u>	<u>17</u>	<u>23</u>
Subtotal <sup>b</sup>	8	22	36	50	57	68
Technical Differences						
Revenues	-11	-11	-15	-13	-14	-15
Outlays <sup>b</sup>	<u>-10</u>	<u>4</u>	<u>-6</u>	<u>6</u>	<u>-5</u>	<u>6</u>
Subtotal <sup>b</sup>	-21	-7	-22	-7	-19	-9
Total Baseline Differences	-13	15	15	43	38	60
<b>Policy Reestimates</b>						
Revenues <sup>a</sup>	1	3	4	1	4	5
Outlays						
Discretionary	1	1	5	-1	7	1
Mandatory	<u>c</u>	<u>5</u>	<u>2</u>	<u>5</u>	<u>10</u>	<u>21</u>
Subtotal	1	7	7	4	17	22
Total Policy Differences	3	10	10	5	21	27
<b>All Reestimates</b>						
Total Differences	-10	25	25	48	59	86
Deficit Under the President's Basic Budgetary Policies as Estimated by CBO	116	145	142	135	95	69

SOURCE: Congressional Budget Office.

NOTE: The estimates in this table exclude alternative policies to eliminate the deficit under CBO assumptions.

- a. Reductions in revenues are shown with a positive sign because they increase the deficit.
- b. These amounts reflect a revised allocation of estimated debt-service effects between economic differences and technical differences since CBO's *Preliminary Analysis of the President's Budgetary Proposals for Fiscal Year 1998* was published on March 3, 1997. Total differences between the baselines are unchanged.
- c. Less than \$500 million.

munications Commission of additional portions of the electromagnetic spectrum (CBO estimates that the auctions will bring in \$11 billion less in 2002 than the Administration does).

Accounting for the remaining \$5 billion reestimate of proposed mandatory savings are estimates of a number of proposals (including some that increase spending and others that reduce spending), as well as the debt-service costs linked to all the reestimates. According to CBO and the Joint Committee on Taxation, the President's tax proposals will reduce revenues by \$5 billion more in 2002 than the Administration estimates (both estimates assume that certain proposed tax cuts do not expire at the end of calendar year 2000).

## The President's Alternative Budgetary Policies

The President's budget briefly mentions an alternative set of policies that are designed to eliminate the deficit in 2002 under CBO's slightly less optimistic economic and technical assumptions. (If actual budgetary outcomes are less favorable than CBO estimates, the President's proposal does not call for savings to be increased even more to ensure that the deficit would still be eliminated.) That alternative set of policies includes all of the policies detailed in the President's budget submission plus additional policies that would be in effect only if CBO's assumptions are used in the budget process. Those additional policies were outlined in supplemental information provided by the Administration after the budget was submitted.

If CBO's assumptions are used for budget planning, the President would allow most of his tax cuts to sunset at the end of calendar year 2000. The Joint Committee on Taxation estimates that ending those tax cuts would increase revenues in 2002 by \$24 billion above the level that would result if the tax cuts are kept in place (see Table 3).

In addition, the President's alternative policies include a 2.25 percent across-the-board cut in mandatory spending programs that would reduce Medicare spending in 2002 by \$6 billion, Medicaid spending by \$3 billion, and other nonexempt mandatory spending by

\$1 billion. The alternative policies also include a proposal to limit cost-of-living increases for federal benefit programs (excluding Social Security) to 0.46 percent in 2002 (CBO projects an increase of 3 percent under current law). CBO estimates that the proposal would save \$3 billion in 2002. The Administration also proposes a contingent fee on television broadcasters that would be assessed in 2002 if proceeds from the proposed auction of the analog broadcast spectrum are less than the amount included in the budget. CBO estimates that proceeds from the sale will fall \$9 billion short of the Administration's estimated \$15 billion, requiring that \$9 billion in fees be levied on holders of broadcast licenses in 2002.

Finally, the Administration would reduce discretionary spending in 2001 and 2002. The size of the cut would be determined by the amount of additional savings needed to eliminate the deficit in 2002 under CBO's assumptions. To produce the savings needed to

**Table 3.**  
**Estimate of the President's Alternative Policies to Eliminate the Deficit Under CBO Assumptions (By fiscal year, in billions of dollars)**

	2001	2002
Revenues <sup>a</sup>	-3	-24
Outlays		
Discretionary	-14	-20
Mandatory		
Medicare	0	-6
Medicaid	0	-3
Fee on broadcasters	0	-9
Cost-of-living adjustments <sup>b</sup>	0	-3
Other	<u>0</u>	<u>-1</u>
Subtotal	0	-23
Total, policies	-17	-67
Debt Service	<u>c</u>	<u>-2</u>
Total Effect on the Deficit	-17	-69

SOURCE: Congressional Budget Office.

a. Increases in revenues are shown with a negative sign because they reduce the deficit.

b. Exempts the cost-of-living adjustment for Social Security beneficiaries.

c. Less than \$500 million.

eliminate the deficit under its assumptions, CBO estimates that discretionary outlays in 2002 would have to be \$20 billion below the President's basic proposals. That amount would require a cut in budget authority in 2001 and 2002 of about 4 percent from the level in the

President's basic policies, roughly twice as large as the 2.25 percent reduction estimated by the Administration. Debt-service savings of \$2 billion in 2002 would provide the remaining deficit reduction required to eliminate the deficit under CBO's assumptions.

**Table 4.**  
**CBO Estimate of the Effect on the Deficit of the President's Alternative Budgetary Policies**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1998-2002
CBO Deficit Projections, Including Fiscal Dividend <sup>a</sup>	115	121	145	159	142	153	n.a.
Effect on the Deficit of the President's Alternative Budgetary Policies							
Revenues <sup>b</sup>							
Reductions	1	21	21	24	24	5	95
Increases	<u>-1</u>	<u>-11</u>	<u>-16</u>	<u>-17</u>	<u>-18</u>	<u>-19</u>	<u>-81</u>
Subtotal	c	10	5	7	6	-14	14
Outlays							
Discretionary	c	9	-3	-13	-43	-62	-112
Mandatory	<u>c</u>	<u>5</u>	<u>-6</u>	<u>-17</u>	<u>-26</u>	<u>-70</u>	<u>-113</u>
Subtotal	1	13	-8	-29	-69	-132	-224
Total, policies	1	23	-4	-23	-62	-146	-211
Debt service	<u>c</u>	<u>1</u>	<u>1</u>	<u>c</u>	<u>-2</u>	<u>-7</u>	<u>-7</u>
Total Effect on the Deficit	1	24	-2	-22	-64	-153	-218
Deficit Under the President's Alternative Budgetary Policies as Estimated by CBO	116	145	142	137	78	0	n.a.

SOURCE: Congressional Budget Office.

NOTES: The estimates in this table include alternative policies to eliminate the deficit under CBO assumptions.

n.a. = not applicable.

- The projections assume both balanced budget economic assumptions and discretionary spending that increases with inflation, subject to the statutory cap for 1998.
- Reductions in revenues are shown with a positive sign because they increase the deficit. The revenue estimates differ somewhat from those published by the Joint Committee on Taxation (JCT). CBO has used Administration estimates for two proposals that the JCT was unable to estimate because the proposals had not been specified by the time CBO finished its estimate of the budget—a new aviation fee system and a tax-incentive program for the District of Columbia. CBO's estimates also include additional fee proposals and exclude a proposal that would affect only outlays.
- Less than \$500 million.

The total savings in various categories produced under the President's alternative set of policies are substantially higher than under his basic policies. For instance, under the President's alternative policies, projected revenues would be \$14 billion higher in 2002 than they would be under current law, and mandatory spending would be pared by \$70 billion below the baseline levels (see Table 4). Discretionary spending in 2002 under the alternative policies would total \$553 billion.

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## **CBO's Revised Baseline**

In conjunction with its analysis of the President's budget, CBO has revised its baseline projections to take in-

to account new information gleaned from the President's budget and other sources. Other than a \$9 billion reduction in the estimated deficit for 1997, the changes in the projections are quite small. The economic assumptions on which the projections are based have not changed. The only legislation enacted since CBO's January baseline that affects the budget is a bill signed into law on February 28 that reinstated aviation excise taxes. However, because CBO had completed its baseline before that date, the additional \$2.7 billion in revenues is not reflected in the revised baseline. In addition, no change has been made in projected mandatory spending for health programs. CBO's revised baseline projects a deficit of \$115 billion in 1997, although the aviation tax legislation enacted after the baseline was completed would lower that amount to \$112 billion.





# Economic Assumptions

The Administration's economic projections for the 1997-2002 period, which incorporate the effects of its budget proposals, are similar to the alternative projections of the Congressional Budget Office, which assume a balanced budget by 2002. (CBO's baseline economic projections are not comparable because they assume that current budgetary policies do not change.) Both agencies project that real gross domestic product will grow at a moderate pace of just over 2 percent, inflation will remain subdued on average, and interest rates will decline and stay below their 1996 levels. The Administration's projection of nominal GDP is only about \$80 billion higher than CBO's in 2002—a small difference in a \$10 trillion economy (see Table 5).

On the whole, the differences in economic assumptions between the two official forecasts are well within the normal range of error in medium-term forecasts. From a budgetary perspective, however, it is significant that CBO projects slightly higher inflation as measured by the consumer price index (CPI), a more modest decline in long-term interest rates, and a somewhat lower share of wages, salaries, and corporate profits in GDP than does the Administration. The differences in those three indicators account for a major part of the difference between the Administration's and CBO's projections of the deficit in 2002. CBO also assumes a higher unemployment rate, although the unemployment rate alone does not have a large impact on budget projections.

If one looks back over previous official economic forecasts, CBO's record of accuracy has been slightly better than that of previous administrations. The record

of comparisons between CBO's economic forecasts and those of the current Administration is less conclusive. The forecasts were made so recently that only a few comparisons with actual data are possible. However, the ultimate test of an official economic forecast is in the deficit projections derived from it: on that basis, CBO's projections have been closer to the mark than the Administration's in seven out of the 10 possible comparisons (see Appendix B).

For the next five years, the differences between the forecasts of the two agencies and those of private forecasts (reflected by the *Blue Chip* consensus) tend to be small and without systematic pattern. On the whole, CBO's projections are closer to the *Blue Chip* consensus for CPI inflation and interest rates, whereas the Administration's forecasts are closer to the consensus for nominal GDP growth. (The *Blue Chip* does not project wage and salary incomes.) The *Blue Chip* is an average of private forecasts, comprising about 50 forecasts for 1997 and a smaller number for subsequent years. Comparisons between official forecasts and the *Blue Chip* consensus must be made cautiously because the consensus is not necessarily a coherent forecast—just the average of forecasts that make disparate assumptions. More important, the fiscal policy assumptions of the *Blue Chip* forecasters vary, and it is unlikely that many of them assume balanced budget policies. The relatively pessimistic fiscal policy assumptions of the private forecasters probably help to account for the consensus interest rates being considerably above those of both CBO and the Administration. The *Blue Chip* consensus was prepared about three months after the CBO and Administration forecasts, and thus embodies more recent information than either of the official fore-

casts (see Table 5). For example, the recent announcement of high GDP growth in the last quarter of 1996 caused the *Blue Chip* participants to revise upward their expected growth rates for 1997.

ences between the two forecasts of real GDP growth are small: CBO projects slightly faster real growth in 1997 and 1998, but marginally slower growth farther down the road.

## Real GDP Growth

In building its projection of real growth, the Administration assumes a 2.3 percent growth rate of potential output, whereas CBO assumes that the growth of potential output will be about 2.3 percent only through 1998 and then slow to 2.1 percent by 2002. The differ-

The two agencies' projections of the components of overall real growth are also very similar. Growth in nonfarm business output can be broken down into two parts: the growth in total hours worked and the growth in labor productivity. On the basis of demographic trends, both agencies assume that the labor force will grow at an average annual rate of 1.1 percent through 2002, down from the 1.6 percent average over the 1981-1990 period. The two projections agree that

**Table 5.**  
**Comparison of Economic Projections, Calendar Years 1996-2002**

	Estimated <sup>a</sup>	Forecast		Projected			
	1996	1997	1998	1999	2000	2001	2002
<b>Nominal GDP (Billions of dollars)</b>							
CBO	7,570	7,918	8,282	8,688	9,110	9,550	10,008
Administration	7,577	7,943	8,313	8,717	9,153	9,610	10,087
<i>Blue Chip</i>	7,580	7,958	8,328	8,724	9,175	9,649	10,137
<b>Real GDP (Percentage change)</b>							
CBO	2.3	2.3	2.1	2.2	2.2	2.2	2.1
Administration	2.3	2.2	2.0	2.2	2.3	2.3	2.3
<i>Blue Chip</i>	2.4	2.6	2.1	2.1	2.5	2.4	2.3
<b>GDP Price Index (Percentage change)</b>							
CBO	2.1	2.3	2.5	2.6	2.6	2.6	2.6
Administration	2.2	2.5	2.6	2.6	2.6	2.6	2.6
<i>Blue Chip</i>	2.1	2.2	2.5	2.6	2.6	2.7	2.7
<b>Consumer Price Index (Percentage change)<sup>b</sup></b>							
CBO	2.9	2.9	2.9	3.0	3.0	3.0	3.0
Administration	2.9	2.7	2.7	2.7	2.7	2.7	2.7
<i>Blue Chip</i>	3.0	2.9	3.0	3.0	3.0	3.2	3.1
<b>Civilian Unemployment Rate (Percent)</b>							
CBO	5.4	5.3	5.6	5.8	5.9	6.0	6.0
Administration	5.4	5.3	5.5	5.5	5.5	5.5	5.5
<i>Blue Chip</i>	5.4	5.4	5.5	5.9	5.9	5.7	5.5

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (March 10, 1997); Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Federal Reserve Board.

NOTES: Percentage change throughout is year over year.

GDP = gross domestic product.

hours worked will grow at an average of 1.2 percent a year through 2002. In view of the investment boom in recent years, both agencies also expect labor productivity to rise to its trend growth rate of 1.2 percent a year over the 1996-2002 period.

## Unemployment

Both the Administration and CBO forecast that unemployment will edge down from last year's 5.4 percent to 5.3 percent in 1997, but their projections begin to diverge in 1998. The Administration assumes that unem-

ployment will stabilize at about 5.5 percent after 1997, whereas CBO projects that it will rise gradually to 6 percent in 2002. The difference between the unemployment projections reflects in part the different assumptions made by the two agencies about the level of the nonaccelerating inflation rate of unemployment (NAIRU). The Administration assumes the NAIRU to be 5.5 percent, whereas CBO assumes it to be 5.8 percent. In addition, CBO assumes that the average gap between the civilian unemployment rate and the NAIRU during the projection period will be the same as the historical average of about 0.2 percentage points. That assumption takes into account the possibility of recessions during the forecast period. The Administra-

**Table 5.**  
**Continued**

	Estimated <sup>a</sup>	Forecast		Projected			
	1996	1997	1998	1999	2000	2001	2002
<b>Three-Month Treasury Bill Rate (Percent)</b>							
CBO	5.0	5.0	5.0	4.6	4.2	3.9	3.9
Administration	5.0	5.0	4.7	4.4	4.2	4.0	4.0
<i>Blue Chip</i>	5.1	5.2	5.2	5.0	5.0	5.2	5.2
<b>Ten-Year Treasury Note Rate (Percent)</b>							
CBO	6.4	6.2	6.1	5.8	5.5	5.5	5.5
Administration	6.5	6.1	5.9	5.5	5.3	5.1	5.1
<i>Blue Chip</i>	6.4	6.5	6.5	6.4	6.4	6.5	6.5
<b>Nominal Income (Billions of dollars)</b>							
<b>Wage and salary disbursements</b>							
CBO	3,628	3,799	3,953	4,131	4,321	4,521	4,730
Administration	3,628	3,808	3,982	4,168	4,374	4,590	4,810
<b>Corporate profits<sup>c</sup></b>							
CBO	634	650	669	684	712	750	781
Administration	652	676	714	757	796	816	849
<b>Nominal Income (Percentage of GDP)</b>							
<b>Wage and salary disbursements</b>							
CBO	47.9	48.0	47.7	47.6	47.4	47.3	47.3
Administration	47.9	47.9	47.9	47.8	47.8	47.8	47.7
<b>Corporate profits<sup>c</sup></b>							
CBO	8.4	8.2	8.1	7.9	7.8	7.9	7.8
Administration	8.6	8.5	8.6	8.7	8.7	8.5	8.4

a. The *Blue Chip* forecast was prepared several months later than the other forecasts. Thus, the *Blue Chip* data for 1996 are actual.

b. Consumer price index for all urban consumers (CPI-U).

c. Corporate profits reported are book, not economic, profits.

tion assumes that, on average, the actual unemployment rate will not deviate from the NAIRU. The higher unemployment rate projected by CBO, however, largely reflects differences in projected GDP and has relatively little independent effect on overall budget outlays.

On the basis of the recent behavior of inflation and unemployment, some economists have argued that most estimates of the NAIRU (roughly between 5.5 percent to 6 percent) are too high and that the NAIRU has declined in recent years. CBO believes the evidence is against a decline in the NAIRU. For one thing, a structural change in the NAIRU would probably take place gradually. But the relationship between unemployment and inflation deteriorated abruptly, beginning in mid-1995. CBO examined that issue in its most recent economic and budget volume.<sup>1</sup>

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## Inflation

Both the Administration and CBO expect that overall inflation will remain mild through 2002, although the Administration's assumption for CPI inflation is slightly more optimistic than CBO's. In terms of the GDP price index, CBO takes a slightly more benign view of inflation (2.4 percent) for 1997 and 1998 than does the Administration (2.6 percent), but agrees with the Administration that inflation will average about 2.6 percent a year from 1999 through 2002. CBO's forecast of CPI inflation, however, is persistently higher than that of the Administration. CBO projects CPI inflation at 2.9 percent in 1997 and 1998, rising slightly to 3 percent through 2002. The Administration projects that CPI inflation will edge down to 2.7 percent in 1997 and average that rate thereafter.

One would expect a small difference in assumptions about inflation to have little effect on projections of the general deficit, since the difference should have largely offsetting effects on outlays and revenues. In practice, however, for a given rate of increase in the GDP price index, a higher CPI inflation rate will give rise to a larger deficit. That is because taxable income is closely related to growth in nominal GDP, which is in turn linked to growth in the GDP price index, whereas

personal income tax brackets and indexed budget programs (such as Social Security, Supplemental Security Income, and Military and Civil Service Retirement) are tied to CPI inflation. A rise in the growth of the CPI in relation to the GDP price index would hold down revenues by keeping a larger percentage of households in lower marginal tax brackets but increase outlays of indexed federal programs, thereby deepening the deficit. The difference between CPI inflation and inflation in the GDP price index—often referred to as the "wedge"—thus affects deficit projections. In general, the larger the projected wedge between the two inflation measures, the worse will be the projected deficit.

The wedge between the two inflation measures has averaged about 0.5 percentage points since 1989. During 1996, that wedge widened even further to 0.8 percentage points. The wedge has persisted because of differences in the coverage, weighting, source data, and aggregation of the two inflation measures. The GDP price index includes many goods and services—most notably investment goods—that are not included in the CPI, and the prices of the items not included in the CPI have tended to grow less rapidly than the prices included in the CPI over the last 20 years. The weighting of individual items also differs. For example, medical care and computers carry greater weight in the GDP price index, whereas petroleum prices have a greater weight in the CPI. The source data also differ for a few categories that are included in both indexes. In particular, the GDP price index for hospital and physician prices uses producer price index source data, not the data for those series compiled for the CPI. Finally, the CPI is a fixed-weighted index and the GDP price measure, a chain-type index, has varying weights.

The drop in petroleum prices in late 1985 and early 1986 affected the CPI more than the GDP price index, causing the wedge to be negative in 1986 (see Figure 1). Similarly, the temporary increase in petroleum prices in late 1990 caused the wedge to increase. The 1996 increase in the wedge stems primarily from an acceleration in the drop in computer prices, an increase in petroleum prices, and the combined effect of a general slowing of the growth of medical care prices and milder growth of medical prices in the producer price index data than in that of the CPI.

Both CBO and the Administration project that CPI inflation will exceed growth in the GDP price index.

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1. Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1998-2007* (January 1997), p. 4.

**Box 1.****Projections of the Difference Between the Growth of the CPI and the Growth of the GDP Price Index**

The difference between the Congressional Budget Office's (CBO's) and the Administration's projection of the "wedge" between the consumer price index (CPI) inflation and growth in the gross domestic product (GDP) price index can be attributed to three major factors.

About one-third of the 0.3 percentage-point difference is caused by different estimates of the underlying historical trend in the wedge. CBO based its estimate on the pattern between 1989 and the third quarter of 1996, when it averaged 0.5 percentage points. The Administration appears to have relied more on the pattern between 1991 and the third quarter of 1996, when it averaged just under 0.4 percentage points (see Figure 1). CBO believes it is inappropriate to use 1991 data without also including those for 1990 because the negative values of the wedge in 1991 were caused in large measure by the decline in petroleum prices from their 1990 spike. Another reason for assuming a slightly higher base trend in the wedge is CBO's expectation that the high rates of inflation in medical care that prevailed during the late 1980s and early 1990s will not fully return. For most of the late 1980s and early 1990s, inflation in medical care was much higher than the average inflation of other prices. That difference tended to dampen the wedge because medical care prices weighed heavier in the GDP price index. However, inflation in medical care sank toward the average CPI inflation rate in 1995 and 1996 and permitted the wedge to widen, although its effect on the wedge in 1995 was offset by other factors such as the drop in petroleum prices. CBO anticipates that inflation in medical care will rise slightly over the forecast period, but not to the high rates of the late 1980s and early 1990s. Therefore, the contribution of medical prices to the size of the wedge should be slightly higher in the projections than it was during the last 10 years.

An additional one-third of the difference between CBO and the Administration stems from assumptions about substitution bias. When the prices of some goods rise more quickly than others prices, consumers often substitute cheaper goods for those that have become more expensive. As consumers make those substitutions, their consumption basket changes and the share of goods that have faster-growing prices will shrink. The CPI inflation rate will therefore tend to overstate the true increase in the average cost of living because it measures inflation based on the weights of the market basket that prevailed in the base period. That overestimation of the growth in the cost of living is referred to as substitution bias. Inflation in the GDP price index is less prone to substitution bias because it is based on weights that vary as the market basket changes. CBO assumes a slight upward drift in the growth of the CPI in relation to the GDP price index because of substitution bias, and the Administration does

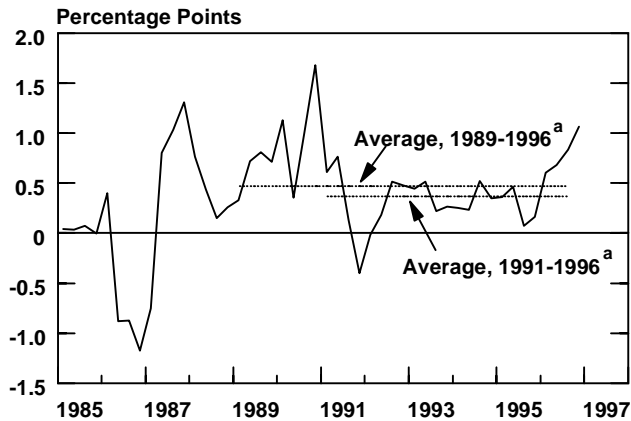
not factor in any increase. CBO's estimate of the increase in the bias is 0.1 percentage points of the 0.3 percentage-point difference in the wedge for the 1997-2002 period.

Part of the remaining third is caused by different assumptions about the effect of the technical change in the CPI that occurred in mid-1996. At that time, the Bureau of Labor Statistics (BLS) changed the way new items were brought into the sample. The Administration assumed that change would depress CPI growth in relation to the GDP price index in 1997 and subsequent years by 0.04 percentage points, whereas CBO assumed that the change would make no significant difference for the projection of the wedge.

For those reasons, differences in projected wedges occur even though the two agencies do have similar views about the following aspects of inflation projections:

- CBO and Administration forecasts agree on the net effect of two technical alterations in the CPI already announced by the BLS. The two are (1) a modification of the procedure for measuring price changes for hospital care that took place in January 1997, and (2) the rebenchmarking of the CPI—recalculating the CPI using the average weights of the 1993-1995 period to replace the average weights of the 1982-1984 period—that will take place beginning in January 1998. Both agencies assume that the combined effect of those two technical changes in the CPI will dampen CPI inflation by the end of 1998 by about 0.2 percentage points. Compared with CBO, the Administration attributes more of that change to the modification of procedures for measuring hospital prices and less to the rebenchmarking. But the sum of the Administration's assumed effect of the changes is the same as CBO's.
- Neither agency's forecast incorporates Boskin Commission recommendations that are not already in the plans of the BLS. The Boskin Commission, a group appointed by the Senate Finance Committee to study the appropriateness of using the CPI as a cost-of-living index, reported that the CPI consistently overstates the increase in the cost of living. The commission felt that the overstatement was most likely between 0.8 percentage points and 1.6 percentage points per year. The commission made a number of recommendations to the BLS, such as changing the way price quotes should be combined, which it felt would make the CPI better reflect changes in the cost of living. But neither agency included any estimates of possible future changes to the CPI that have not already been announced by the BLS.

**Figure 1.**  
**Difference Between the Growth of the CPI-U**  
**and the GDP Price Index**



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

NOTES: The CPI-U is the consumer price index for all urban consumers.

GDP = gross domestic product.

a. Averages are based on data through the third quarter of 1996.

Nevertheless, CBO's projection of the inflation wedge is noticeably greater than the Administration's throughout the 1997-2002 period (see Box 1). CBO projects that the inflation wedge will return to about 0.4 percentage points after 1997. That projection is very close to the *Blue Chip* average. By contrast, the Administration predicts that the wedge will narrow sharply to 0.1 percentage points in 1998 and stay at that rate through 2002.

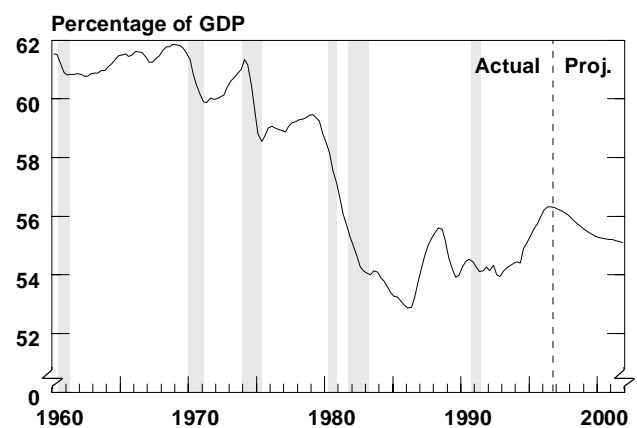
## Interest Rates

Both the Administration and CBO assume that moves to balance the budget will reduce nominal as well as real (inflation-adjusted) interest rates. Over the long term, the two agencies' projections of interest rates are broadly similar. From a budgetary perspective, however, it is significant that CBO's projections of nominal short-term rates are higher than the Administration's over the short term and that its projections of long-term nominal rates are higher over the long term.

CBO's projections of the short-term rates exceed the Administration's by about 0.3 percentage points in 1998 and 1999, although they fall slightly below the Administration's after 2000. CBO's projections of the long-term rates are higher than the Administration's by an average of about 0.2 percentage points over the 1997-2000 period; they become higher by 0.4 percentage points over the 2001-2002 period.

Although those differences in nominal interest rates are modest, they play a significant role in explaining the difference in the deficit projections of the two agencies. On the outlay side, higher nominal interest rates will increase government interest payments. On the revenue side, because the corporate sector owes more debt than it owns financial assets, higher nominal interest rates will increase corporate interest payments, thereby tending to lower corporate profits. Because corporate profits are subject to higher effective marginal tax rates than private interest income, the decrease in revenues from lower corporate profits will be only partially offset by an increase in revenues from higher interest income. (The effective marginal tax rate on a given component of income represents the amount of additional tax collected from each additional dollar of

**Figure 2.**  
**Incomes (Sum of wages and salaries and**  
**corporate book profits)**

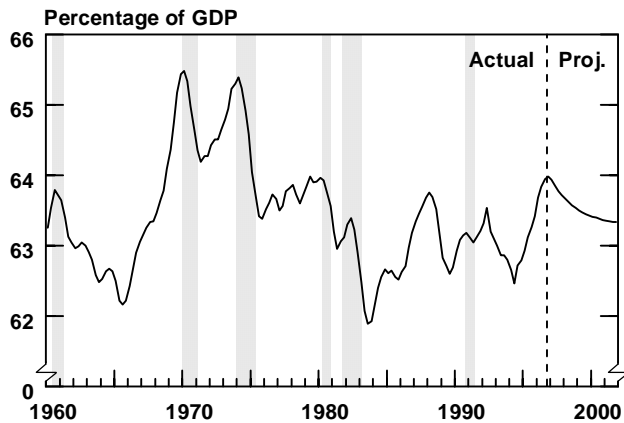


SOURCES: Congressional Budget Office; Department of Commerce, Bureau of Economic Analysis.

NOTES: The figure shows a four-quarter centered moving average of incomes as a percentage of GDP.

GDP = gross domestic product.

**Figure 3.**  
**Labor Income**



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

NOTES: Labor income is the sum of wages and salaries, other labor income (employers' contributions to health insurance premiums, pensions, life insurance, workers' compensation, and unemployment insurance), employers' contributions to social insurance, and three-fourths of proprietors' income. The figure shows a four-quarter centered moving average of labor income as a percentage of GDP.

GDP = gross domestic product.

income. Interest income is subject to relatively low effective marginal tax rates because some of it accrues to tax-exempt entities such as pension funds.) Because only a modest portion of long-term debts is rolled over each year, the budgetary effects of the differences in projected short-term rates show up much more quickly than those of projected long-term rates.

## Incomes

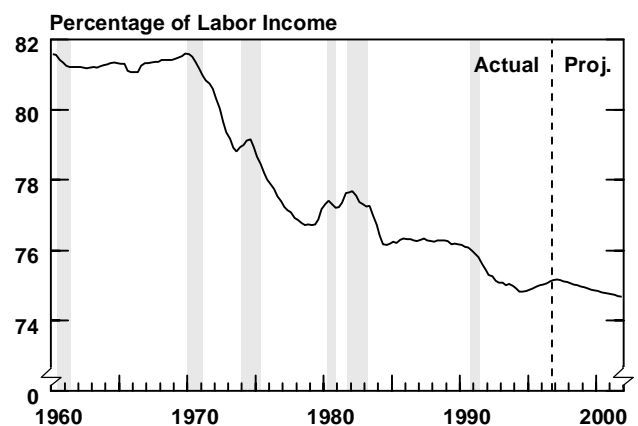
The size of national output can be measured by GDP, which is the sum of all the output produced, or by gross domestic income (GDI), which is the sum of all incomes generated in producing that output. Estimates of future deficits are affected not only by the size of total output and income but by the projected distribution of income among various categories. Corporate profits and wages and salaries are the most important income categories for revenue projections because they are effectively taxed at the highest marginal rates. Divi-

dends, like interest income, are taxed at a lower effective rate because they are not subject to payroll taxes and some of them accrue to tax-exempt entities such as pension funds. The effective tax rate on proprietors' income is also lower than that on profits, in part because of compliance problems.

The combined share of corporate profits, wages, and salaries in GDP has risen noticeably since 1991 (see Figure 2). Both CBO and the Administration project that this recent trend will be reversed during the 1997-2002 period. But CBO projects a more noticeable decline in the combined income share than does the Administration. For 1997, the Administration's projection of the total income share is 0.3 percentage points higher than CBO's. By 2002, the Administration's projection becomes 1 percentage point higher than that of CBO.

CBO's projections of declining income shares are based on two main assumptions. First, they take into account the possibility of both recessions and economic booms, weighting them appropriately. That assumption lowers the projected shares of GDP represented by

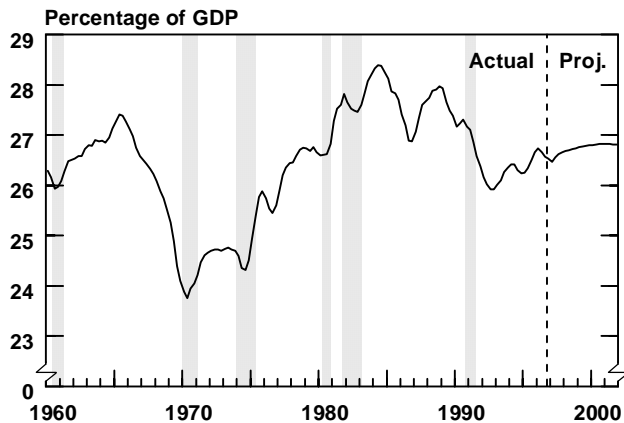
**Figure 4.**  
**Wages and Salaries as a Share of Labor Income**



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

NOTE: Labor income is the sum of wages and salaries, other labor income (employers' contributions to health insurance premiums, pensions, life insurance, workers' compensation, and unemployment insurance), employers' contributions to social insurance, and three-fourths of proprietors' income. The figure shows a four-quarter centered moving average of the wage and salary share of labor income.

**Figure 5.**  
**Capital Income**



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

NOTES: Capital income is the sum of corporate profits, interest payments by business, depreciation, rental income, and one-fourth of proprietors' income. The figure shows a four-quarter centered moving average of capital income as a percentage of GDP.

GDP = gross domestic product.

profits and wages and salaries because recessions tend to depress both shares. In addition, CBO assumes that GDP shares of wages and salaries as well as of corporate profits will resume their historical trends over time.

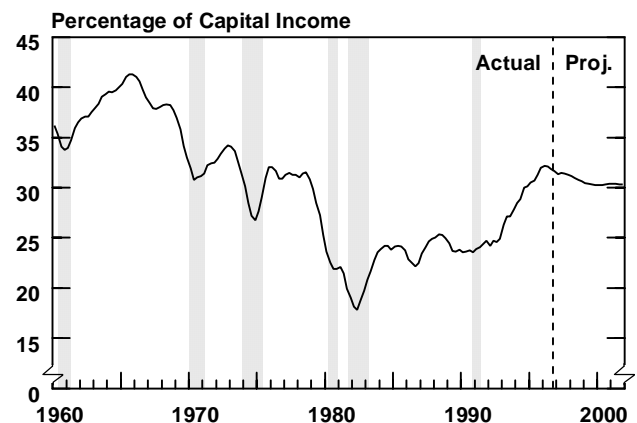
CBO makes two assumptions about the trend of the GDP share of wages and salaries. The first is that an unusually fast growth of GDI in relation to GDP during the past two years will be partially reversed. In theory those two measurements should be equal, but in practice they tend to differ because they are based on different data. The rise of labor income as a share of GDP over the last two years reflects in part the unusually fast growth of GDI, which rose about 1 percentage point faster than GDP over the last two years. If GDI now returns to a more normal relationship to GDP, labor income as a share of GDP is also likely to return to a lower level (see Figure 3). Second, CBO assumes that the share of total labor compensation that takes the form of nontaxable benefits will rise consistent with its long-term trend; that is, the share of labor income from wages and salaries will decline throughout the projection period (see Figure 4). That assumption is based on the view that the recent decline in the share of nonwage

compensation reflects a one-time shift of the private sector to managed health care and is unlikely to continue at the same pace in the future.

The Congressional Budget Office's forecast that the shares of corporate profits will decline is based on several assumptions. First, the GDP share of total capital income—the sum of corporate profits, interest income, depreciation, rental income, and proprietor's income—will stay roughly unchanged after 1998 (see Figure 5). Second, proprietors' income as a share of capital income will rise continuing its 15-year upward trend. Third, corporate interest payments will rise, despite the projected drop in interest rates, as growth in corporate debt (which has been unusually slow over the last six years) returns to its historical pattern. Fourth, depreciation will increase because of the investment boom in recent years. Taken together, those assumptions imply that corporate profits—gross profits minus depreciation and interest payments—will decline somewhat as a share of capital income and GDP over the next two years (see Figure 6).

Although the differences in projected income shares are modest, they translate into a growing divergence in terms of dollar level over time. The Administration's

**Figure 6.**  
**Corporate Profits as a Share of Capital Income**



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

NOTE: Capital income is the sum of corporate profits, interest payments by business, depreciation, rental income, and one-fourth of proprietors' income. The figure shows a four-quarter centered moving average of the profit share of capital income.



projection of income in the two most important categories exceeds CBO's by about \$35 billion in 1997; the difference grows to about \$150 billion in 2002. Such a difference is important for budget projections, but it remains small in relation to likely projection errors. From 1996 through 2002, the Administration expects the combined incomes to grow 32 percent, and CBO expects a growth of 29 percent, an insignificant difference.

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## Conclusion

The Administration's economic assumptions do not differ widely from those of CBO. In most respects, the difference lies well within the usual margin of error. Nevertheless, the Administration's economic assumptions produce a somewhat more optimistic outlook for the budget than CBO's. Such an outcome is certainly possible, but so is an outcome of economic assumptions that are more pessimistic than CBO's. CBO's projections are thus the more prudent ones to use for budget plans.



# The President's Spending Proposals

**P**resident Clinton's 1998 budget offers two sets of revenue and spending proposals. Under the economic and technical assumptions of the Administration, the basic set of policies yields a modest budget surplus in 2002. The alternative set of budgetary proposals is designed to reach balance in 2002 under the slightly less optimistic economic and technical assumptions of the Congressional Budget Office.

CBO estimates that the President's basic set of spending policies would reduce spending by a net \$168 billion over the 1998-2002 period (relative to projections that assume that discretionary outlays for 1998 are held to the levels of the existing spending cap and grow with inflation thereafter). The largest spending reductions are found in the Medicare program, the nation's health care program for the elderly and disabled, followed closely by discretionary spending, the one-third of federal spending that is subject to annual appropriations by the Congress. Medicare savings amount to \$82 billion, and discretionary savings are set at \$79 billion, for a total of \$160 billion of the \$168 billion in net outlay reductions that the President proposes. Other savings of \$45 billion are largely offset by new spending initiatives such as providing health insurance for children and the unemployed and rolling back benefit restrictions in the Food Stamp and Supplemental Security Income programs that were enacted as part of last year's welfare reform package.

The President's alternative spending proposals reduce spending by an additional \$57 billion in 2001 and 2002 combined, yielding a total net decrease in outlays of \$224 billion over the 1998-2002 period. Under the set of alternative policies, the largest spending cuts

come from discretionary spending (a total of \$112 billion over five years), followed by reductions in the Medicare program (\$88 billion over five years). In addition, a new fee would be imposed on television broadcasters to eliminate any difference between actual receipts from auctioning certain portions of the electromagnetic spectrum and the amount budgeted by the Administration (estimated by CBO at \$9 billion for 2002).

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## The President's Basic Spending Proposals

Federal spending will increase from \$1.6 trillion in 1997 to \$1.9 trillion in 2002 under the President's plan. As a percentage of gross domestic product, outlays will increase to 20.8 percent in 1998 (up from 20.7 percent in 1997) before beginning their descent to 19.5 percent in 2002 (see Table 6). The bulk of that decline in spending as a percentage of GDP is attributable to very slow growth in discretionary spending. Mandatory spending (other than net interest) rises as a share of the nation's output despite policies to achieve budgetary balance.

### Discretionary Spending for 1998

Under current law, discretionary spending is subject to caps on both budget authority and outlays. (Budget authority confers the ability to commit the government to pay money, and outlays are the money paid to meet

**Table 6.**  
**CBO Estimate of the President's Basic Spending Proposals (By fiscal year)**

	1997	1998	1999	2000	2001	2002
<b>In Billions of Dollars</b>						
Discretionary						
Defense	268	266	264	269	270	278
Nondefense	<u>281</u>	<u>288</u>	<u>295</u>	<u>298</u>	<u>298</u>	<u>294</u>
Subtotal	549	553	559	567	567	572
Mandatory						
Social Security	363	381	399	420	441	464
Medicare	209	224	239	257	266	289
Medicaid	99	107	115	121	129	138
Other	<u>239</u>	<u>270</u>	<u>283</u>	<u>303</u>	<u>308</u>	<u>321</u>
Subtotal	909	981	1,036	1,100	1,144	1,211
Offsetting Receipts <sup>a</sup>	-83	-85	-82	-85	-90	-103
Net Interest	<u>248</u>	<u>253</u>	<u>259</u>	<u>257</u>	<u>253</u>	<u>251</u>
Total	1,623	1,703	1,772	1,839	1,874	1,931
<b>As a Percentage of Gross Domestic Product</b>						
Discretionary						
Defense	3.4	3.2	3.1	3.0	2.9	2.8
Nondefense	<u>3.6</u>	<u>3.5</u>	<u>3.4</u>	<u>3.3</u>	<u>3.2</u>	<u>3.0</u>
Subtotal	7.0	6.8	6.5	6.3	6.0	5.8
Mandatory						
Social Security	4.6	4.7	4.7	4.7	4.7	4.7
Medicare	2.7	2.7	2.8	2.9	2.8	2.9
Medicaid	1.3	1.3	1.3	1.3	1.4	1.4
Other	<u>3.1</u>	<u>3.3</u>	<u>3.3</u>	<u>3.4</u>	<u>3.3</u>	<u>3.2</u>
Subtotal	11.6	12.0	12.1	12.2	12.1	12.2
Offsetting Receipts <sup>a</sup>	-1.1	-1.0	-1.0	-0.9	-1.0	-1.0
Net Interest	<u>3.2</u>	<u>3.1</u>	<u>3.0</u>	<u>2.9</u>	<u>2.7</u>	<u>2.5</u>
Total	20.7	20.8	20.6	20.4	19.9	19.5
<b>Memorandum:</b>						
Gross Domestic Product (In billions of dollars)	7,830	8,186	8,584	9,003	9,439	9,892

SOURCE: Congressional Budget Office.

a. Includes asset sales.

those commitments.) Separate caps apply to spending from the Violent Crime Reduction Trust Fund (VCRTF) and other general-purpose spending. Those caps expire at the end of fiscal year 1998.

CBO calculates that outlays flowing from the budget authority proposed by the President would exceed the estimated 1998 outlay limit on general-purpose discretionary spending by \$6.1 billion. The VCRTF outlays, by contrast, fall \$1.3 billion below their cap. Bud-

get authority as proposed by the Administration is comfortably within the limit on general-purpose spending, and is equal to the budget authority cap for VCRTF spending (see Table 7). The Administration estimates that its discretionary spending proposals will not exceed either the budget authority limit or the outlay cap.

CBO has adjusted the current statutory levels of the cap to reflect changes that the Administration proposes in calculating the discretionary spending limits. The

**Table 7.**  
**Comparison of CBO's Estimate of the President's Discretionary Spending Proposals with the Limits for 1998 (In millions of dollars)**

	Budget Authority	Outlays
Statutory Limits from OMB's Sequestration Preview Report		
General-purpose limits	528,280	541,501
Violent Crime Reduction Trust Fund limits	<u>5,500</u>	<u>4,904</u>
Combined Limits	533,780	546,405
Adjustments to the General-Purpose Limits		
Current-law adjustments	6,390	1,338
Proposed adjustments	<u>1,036</u>	<u>930</u>
Total Adjustments	7,426	2,268
Statutory Limits as Estimated by CBO Under Presidential Policy		
General-purpose limits	535,706	543,769
Violent Crime Reduction Trust Fund limits	<u>5,500</u>	<u>4,904</u>
Combined Limits	541,206	548,673
Discretionary Spending as Estimated by CBO		
General-purpose spending	531,609	549,847
Violent Crime Reduction Trust Fund spending	<u>5,500</u>	<u>3,592</u>
Combined Spending	537,109	553,439
Amount Over or Under (-) Limits		
General-purpose spending	-4,097	6,078
Violent Crime Reduction Trust Fund spending	<u>0</u>	<u>-1,312</u>
Combined Spending	-4,097	4,766

SOURCE: Congressional Budget Office.

NOTE: OMB = Office of Management and Budget.

largest adjustment to the budget authority limits under the President's proposals is the result of his request for a \$5.8 billion reserve of contingent emergency appropriations for Presidential response to disasters. The Office of Management and Budget would count as new budget authority only the amounts actually released by the President and would adjust the cap accordingly.

CBO counts the entire amount of contingent emergency appropriations when they are appropriated by the Congress and adjusts the cap by that amount. Outlays, however, are not expected to flow from those appropriations until 1999. Other adjustments required under current law include the 1998 effect on outlays of proposed 1997 emergency supplemental appropriations

**Table 8.**  
**Discretionary Spending for 1998 Under the President's Proposals (In billions of dollars)**

	Enacted Discretionary Spending for 1997		Proposed Discretionary Spending for 1998		Proposed 1998 Less Enacted 1997 Discretionary Spending	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Defense	265.8	267.5	266.4	265.8	0.5	-1.7
International	18.1	19.2	23.0	19.3	4.9 <sup>a</sup>	0.1
Domestic						
General science, space, and technology	16.6	17.0	16.4	17.0	-0.2	0
Energy	4.3	4.9	4.7	5.1	0.4	0.2
Natural resources and environment	21.5	21.5	22.4	21.1	0.9	-0.5
Agriculture	4.2	4.2	4.1	4.2	0	0
Commerce and housing credit	2.8	2.8	3.2	3.1	0.4	0.3
Transportation	13.8	36.9	13.5	37.5	-0.3	0.5
Community and regional development	9.3	11.7	16.7	11.1	7.4 <sup>b</sup>	-0.7
Education, training, employment, and social services	42.4	40.3	46.5	43.2	4.0	2.8
Health	25.0	23.8	25.3	24.8	0.3	1.0
Medicare	2.6	2.7	2.8	2.7	0.2	0
Income security	26.6	40.9	32.9	41.8	6.3 <sup>c</sup>	1.0
Social Security	3.5	3.4	3.3	3.4	-0.2	0.1
Veterans' benefits	18.9	19.3	18.8	19.4	-0.2	0.1
Administration of justice	22.9	20.4	24.4	22.2	1.5	1.8 <sup>d</sup>
General government	<u>11.8</u>	<u>11.9</u>	<u>12.8</u>	<u>12.0</u>	<u>1.0</u>	<u>0.1</u>
Subtotal	226.2	261.8	247.8	268.3	21.6	6.5
Total	510.1	548.5	537.1	553.4	27.0	4.9

SOURCE: Congressional Budget Office.

- a. Principally loans to the International Monetary Fund.
- b. Primarily funds for disaster relief.
- c. Largely subsidized housing renewals.
- d. Reflects outlays from Violent Crime Reduction Trust Fund appropriations enacted in previous years.

and funding for additional reviews to determine the eligibility of beneficiaries required under legislation enacted last year.

In addition to those increases in the caps required under current law, the President proposes that certain existing and new fees counted as revenues be used to increase discretionary spending through an adjustment to the caps. Examples of those fees include existing State Department passport and visa fees and proposed Food and Drug Administration user fees. CBO esti-

mates that those proposals would add more than \$900 million in 1998 budget authority and more than \$800 million in outlays. Other proposed adjustments include additional spending on reviews of eligibility for Unemployment Insurance and housekeeping items such as reclassifying the expenses of the Federal Reserve Board as discretionary spending instead of as an offset to revenues generated by Federal Reserve earnings.

In total, the President's proposed 1998 discretionary budget authority is \$27 billion higher than was en-

### Box 2.

#### Budgetary Effects of the President's Proposals for the District of Columbia

The financial and administrative problems of the District of Columbia have attracted considerable national attention in recent years. In response to those problems, the Administration's budget proposes that the federal government assume additional responsibility for several functions currently provided by the District in exchange for ending the annual federal payment to the District.

**Discretionary Spending.** The federal government currently makes an annual payment to the District of Columbia. For fiscal year 1997, the federal payment is \$719 million, which includes \$660 million in general assistance, \$52 million in contributions to the District's retirement system, and \$7 million in other assistance. The Administration's plan would eliminate the annual federal payment beginning in 1998 and replace it with funding for several D.C. services, including its courts, prisons, and individual income and payroll tax collections. Putting the President's proposal in place would result in discretionary outlays that are approximately \$900 million lower over the 1998-2002 period than continuing to provide the District with an annual payment of \$712 million.

**The Tax Incentive Program.** The budget includes \$300 million in tax incentives for the District over the 1998-2002 period. One-sixth of that total would go to a new District of Columbia Economic Development Corporation that would allocate a total of \$95 million in tax breaks for District business investments. The corporation would also have authority to issue tax-exempt private activity bonds to finance businesses in certain areas of the District. Eligible businesses in the District would also receive jobs tax credits and liberalized deduction provisions for certain equipment costs.

**Medicaid.** The Administration proposes to increase the federal government's share of Medicaid spending for the District by having the federal government pay the minimum allowable state match in addition to the federal match that it currently pays. Under this proposal, the District will be responsible for paying the maximum 30 percent share that localities can be required to pay in states that receive a 50 percent federal match. The total share of Medicaid borne by the federal government would increase to 70 percent from its current level of 50 percent. The proposal would increase federal outlays by \$900 million over the 1998-2002 period.

**Pensions.** Under the President's budget, the federal government would assume responsibility for the District's existing pension plans for law enforcement officers, firefighters, teachers, and judges. The District would close out those plans and transfer their assets and liabilities to the federal government at the beginning of fiscal year 1998. As of October 1, 1996, the plans had \$7.6 billion in liabilities but held only \$3.7 billion in assets.

Although the pension proposal would add \$3.9 billion to the federal government's unfunded liabilities, it would initially have no effect on the deficit, which generally reflects the federal government's cash flows. Until the assets of the plans run out, payments to beneficiaries would be made from those assets, including the cash received from investing and selling the assets. When those assets are exhausted—probably shortly after fiscal year 2007—the federal government would begin to pay the remaining pension benefits out of general revenues. Annual outlays at that time would be between \$700 million and \$800 million.

acted for fiscal year 1997. Outlays flowing from that increase in budget authority are \$4.9 billion higher than anticipated for the current year (see Table 8 on page 22). The biggest bump in outlays is found in the education, training, employment, and social services function, and reflects the President's education initiatives—the largest being his proposed increase from \$2,700 to \$3,000 in the maximum Pell grant for undergraduate students. That total also reflects the Administration's plan to restructure the federal government's budgetary relationship with the District of Columbia, which is discussed in more detail in Box 2 on page 23.

## Discretionary Spending After 1998

The priorities reflected in the President's budget cannot be compared with CBO's baseline projections because the baseline includes unspecified spending reductions to ensure compliance with the discretionary spending caps. Accordingly, CBO's analysis in this section uses its calculations of discretionary spending that are not constrained by those caps.

The President's discretionary proposals yield total outlays that are somewhat higher than those that result from a spending freeze at 1997 levels of discretionary budget authority, and yet they are below those that are necessary to adjust 1997 budget authority fully for the effects of inflation. For 1998 and 1999, the Administration spends somewhat more than the midpoint between a freeze and full compensation for the effects of inflation, and spends at about the midpoint for 2000 and 2001. For 2002, outlays proposed by the President are \$34 billion higher than the level suggested by a freeze, but are \$49 billion lower than the level that is necessary to adjust spending authority for inflation (see Table 9).

The increases in discretionary spending largely accrue on the nondefense side of the ledger sheet, at least until 2002. Nominal defense outlays decline slightly in the near term, then remain level for 2000 and 2001. Even though outlays increase in 2002, the increase in 2002 in contrast to 1997 levels is less for defense than for nondefense programs. Defense overall receives \$77 billion less than is necessary to offset the effects of inflation. That decline in purchasing power is greater than the decline in purchasing power received by nondefense spending.

The President's request for defense spending is similar to the levels contained in last year's Congressional budget resolution. For the 1998-2001 period, the President's proposal seeks defense outlays that are only \$3 billion lower than called for in the budget resolution. The Administration's plan slightly boosts those outlays compared with the Congress's plan for 2002. For defense and nondefense combined, however, the 1998 budget proposal spends a cumulative total of \$211 billion more on discretionary programs than would be allowed under the 1997 budget resolution in 1998 through 2002. Of that amount, \$206 billion benefits nondefense programs.

## Mandatory Spending

CBO estimates that the President's basic spending proposals for mandatory spending will decrease the deficit by a net \$90 billion over the 1998-2002 period. Reductions in the growth of Medicare and Medicaid—the government's health care programs for the elderly and poor—account for \$89 billion of that decline. Cuts in other programs and receipts from the sales of government assets largely offset mandatory spending initiatives proposed by the President—principally, expanded health insurance coverage for unemployed workers and their families and the rollback of welfare reform (see Table 10).

**Medicare.** Under current policies, CBO projects that gross mandatory spending for Medicare will increase from \$209 billion in 1997 to \$314 billion in 2002, an average annual increase of 8.5 percent (see Table 11 on page 27). Net mandatory spending, which takes into account premiums paid by Medicare beneficiaries, will increase at an average annual rate of 8.8 percent. CBO's baseline projections of Medicare spending are virtually the same as those of the Administration.

The budget contains many proposals intended to reduce the growth of spending in Medicare. Those proposals for savings reduce Medicare outlays by \$99 billion over the 1998-2002 period. At the same time, the Administration is proposing to expand some benefits, increasing costs by \$17 billion during that period. On balance, CBO estimates that the President's basic proposals would lower Medicare spending by \$82 billion over five years and slow the growth of net Medicare spending to 6.6 percent a year. The depletion of the



**Table 9.**  
**Discretionary Outlay Levels as Estimated by CBO (By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1998-2002
<b>CBO Reestimate of the President's Budget</b>							
Defense	268	266	264	269	270	278	1,346
Nondefense	<u>281</u>	<u>288</u>	<u>295</u>	<u>298</u>	<u>298</u>	<u>294</u>	<u>1,473</u>
Total	549	553	559	567	567	572	2,819
<b>CBO Projections Assuming No Discretionary Spending Caps in 1998 and Adjusting for Inflation</b>							
Defense	268	270	276	287	289	301	1,423
Nondefense	<u>281</u>	<u>288</u>	<u>296</u>	<u>304</u>	<u>312</u>	<u>321</u>	<u>1,520</u>
Total	549	558	572	591	601	621	2,943
<b>CBO Projections Assuming Discretionary Budget Authority Is Frozen at 1997 Levels</b>							
Defense	268	265	265	267	261	264	1,322
Nondefense	<u>281</u>	<u>282</u>	<u>279</u>	<u>277</u>	<u>275</u>	<u>274</u>	<u>1,387</u>
Total	549	547	544	544	536	538	2,709
<b>Congressional Budget Resolution for Fiscal Year 1997</b>							
Defense	265	264	267	271	270	270	1,341
Nondefense	<u>274</u>	<u>263</u>	<u>258</u>	<u>255</u>	<u>246</u>	<u>245</u>	<u>1,267</u>
Total	539	527	525	525	516	514	2,608
<b>CBO Reestimate Compared with CBO Projections Assuming No Discretionary Spending Caps in 1998 and Adjusting for Inflation</b>							
Defense	0	-4	-13	-18	-19	-23	-77
Nondefense	<u>0</u>	<u>0</u>	<u>-1</u>	<u>-6</u>	<u>-14</u>	<u>-26</u>	<u>-48</u>
Total	0	-4	-13	-24	-33	-49	-124
<b>CBO Reestimate Compared with CBO Projections Assuming Discretionary Budget Authority Is Frozen at 1997 Levels</b>							
Defense	0	1	-1	2	9	14	24
Nondefense	<u>0</u>	<u>6</u>	<u>16</u>	<u>20</u>	<u>22</u>	<u>21</u>	<u>86</u>
Total	0	7	16	22	31	34	110
<b>CBO Reestimate Compared with Congressional Budget Resolution for Fiscal Year 1997</b>							
Defense	3	2	-3	-2	0	8	5
Nondefense	<u>7</u>	<u>25</u>	<u>37</u>	<u>43</u>	<u>51</u>	<u>50</u>	<u>206</u>
Total	10	26	34	41	51	58	211

SOURCE: Congressional Budget Office.

Medicare Hospital Insurance Trust Fund would also be prevented throughout CBO's 10-year projection horizon (see Box 3 on page 28).

CBO's estimate of the savings that result from the budget's basic Medicare proposals is \$19 billion lower than the Administration's. CBO estimates that the President's proposed expansions of benefits would cost \$4 billion more and that the proposed reductions would save \$15 billion less than the Administration assumes. CBO's estimate of reductions in payments to fee-for-service providers is \$11 billion smaller than the Administration's, and its estimate of savings in payments to managed care plans is \$4 billion less.

Over half of the savings in the President's proposals would stem from curtailing payments to providers of health care services in Medicare's fee-for-service sector. The President proposes limiting growth in aggregate payments to physicians to the rate of growth in national income, adjusted for changes in the number of beneficiaries. That limit would slightly reduce the rate of growth compared with current law. Increases in payments to hospitals for both inpatient care and outpatient care would be limited through changes in the formulas used to adjust reimbursement rates. Caps on the num-

ber of residents per hospital would limit growth in spending for graduate medical education. Prospective payment mechanisms for skilled nursing facilities and providers of home health care would be established to slow the growth of spending in those sectors. New competitive payment mechanisms for laboratory services and suppliers of durable medical equipment are proposed; the budget would ensure that those mechanisms reduced payment rates by at least 20 percent. Overall, payments to fee-for-service providers would be pared by an estimated \$53 billion over the 1998-2002 period.

Another \$30 billion in savings would arise from reduced payments to risk-based health maintenance organizations (HMOs). Because payments to HMOs are linked to spending in the fee-for-service sector, much of that reduction would result from slowing the growth in payments to fee-for-service providers. In addition, the budget proposes to reduce the HMO payment rate from 95 percent to 90 percent of Medicare's adjusted average per capita cost (AAPCC) beginning in 2000.

The Administration further proposes to remove payments for disproportionate share hospitals (DSH)

**Table 10.**  
**CBO Estimate of the President's Basic Mandatory Spending Proposals**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1998-2002
Medicare	0	-3	-10	-18	-22	-29	-82
Medicaid	a	2	2	-1	-4	-6	-7
Health Insurance	0	3	3	3	4	1	14
Supplemental Security Income	a	2	2	2	2	2	9
Food Stamps	a	1	1	1	1	1	5
Education and Training	0	2	2	3	2	c	9
Spectrum Auctions	0	0	-3	-4	-6	-12	-24
Other	<u>a</u>	<u>-2</u>	<u>-2</u>	<u>-2</u>	<u>-2</u>	<u>-5</u>	<u>-13</u>
Total	a	5	-6	-17	-26	-46	-90

SOURCE: Congressional Budget Office.

NOTE: The estimates in this table exclude alternative policies to eliminate the deficit under CBO assumptions.

a. Less than \$500 million.

and graduate medical education from the AAPCC. That change would reduce average payment rates by an additional 5 percent. Removing those special payments

from the AAPCCs would have little net budgetary impact, however, because the funds would be returned directly to DSH and teaching hospitals based on the

**Table 11.**  
**CBO Estimate of the President's Medicare Proposals (By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1998-2002	Average Annual Rate of Growth, 1997-2002 (Percent)
<b>CBO Baseline</b>								
Benefit Payments <sup>a</sup>	208.8	227.0	248.2	273.0	285.6	313.7	1,347.5	8.5
Premiums	<u>-20.2</u>	<u>-21.4</u>	<u>-22.4</u>	<u>-23.4</u>	<u>-24.5</u>	<u>-25.6</u>	<u>-117.4</u>	<u>4.8</u>
Total <sup>b</sup>	188.6	205.5	225.7	249.5	261.1	288.1	1,230.0	8.8
<b>Proposed Changes</b>								
Benefit Payments								
Payments to fee-for-service providers	0	-3.0	-7.6	-11.4	-14.2	-16.7	-52.9	n.a.
Payments to HMOs	0	-0.9	-2.9	-6.7	-8.2	-11.1	-29.9	n.a.
Additional benefits	0	1.2	3.0	3.8	4.5	5.0	17.5	n.a.
Other changes <sup>c</sup>	<u>0</u>	<u>-0.2</u>	<u>-1.9</u>	<u>-2.0</u>	<u>-2.1</u>	<u>-2.3</u>	<u>-8.5</u>	n.a.
Subtotal	0	-2.9	-9.4	-16.3	-20.1	-25.1	-73.8	n.a.
Premiums	<u>0</u>	<u>0.2</u>	<u>-0.6</u>	<u>-1.4</u>	<u>-2.2</u>	<u>-3.8</u>	<u>-7.8</u>	n.a.
Total	0	-2.8	-10.0	-17.7	-22.3	-28.8	-81.6	n.a.
<b>CBO Estimate of the President's Proposals</b>								
Benefit Payments <sup>a</sup>	208.8	224.0	238.8	256.7	265.5	288.7	1,273.7	6.7
Premiums	<u>-20.2</u>	<u>-21.2</u>	<u>-23.0</u>	<u>-24.8</u>	<u>-26.7</u>	<u>-29.4</u>	<u>-125.2</u>	<u>7.7</u>
Total <sup>b</sup>	188.6	202.8	215.7	231.8	238.8	259.3	1,148.5	6.6
<b>Memorandum:</b>								
SMI Premium (In dollars)								
Under current law	43.80	45.80	47.10	48.50	50.00	51.50	n.a.	n.a.
Under proposals	43.80	45.80	49.50	52.50	55.90	61.20	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTES: The estimates in this table exclude alternative policies to eliminate the deficit under CBO assumptions.

n.a. = not applicable; HMOs = health maintenance organizations; SMI = Supplementary Medical Insurance.

a. Includes mandatory administrative expenses.

b. Excludes discretionary administrative expenses.

c. Primarily the extension of secondary-payer provisions enacted in the Omnibus Budget Reconciliation Act of 1993.

number of HMO enrollees served. (Those direct payments are included under payments to fee-for-service providers in Table 11.)

The Administration's proposal would also narrow the gap between counties with high and low payment rates by phasing in a blend of local and price-adjusted national rates by 2002, and by setting a minimum payment rate of \$350 per month. It would guarantee that no county's payment rate in 1998 and 1999 was cut from its level in the previous year. However, counties with high payment rates would face reductions from current-law levels to finance increases to counties with low payment rates. The budget includes a computation to ensure that the hold-harmless provision and the \$350

floor on payment rates do not increase overall federal payments to HMOs. The new payment rates would be updated annually by the growth in national Medicare spending per capita, with a minimum update of 2 percent a year, beginning in 2000.

The Administration's proposal also contains several features intended to make HMOs more attractive to beneficiaries. It would allow Medicare to contract with additional types of plans (including preferred provider organizations and provider-sponsored networks), establish an annual open-enrollment period, provide beneficiaries with standardized comparative materials about plans, and guarantee that medigap coverage would be available at community rates for beneficiaries choosing to disenroll from a Medicare HMO.

CBO estimates that the Administration's proposal would not significantly increase or decrease enrollment in managed care plans. Some elements of the proposal—such as using a coordinated enrollment period and contracting with new types of plans—would tend to expand the managed care program. But enhancing the benefits package in fee-for-service Medicare and reducing HMO payments relative to those in the fee-for-service sector would discourage enrollment.

The largest expansion of benefits proposed by the President would reduce the out-of-pocket cost of Supplementary Medical Insurance (SMI) beneficiaries for services provided in hospital outpatient departments. Under current law, the effective coinsurance rate paid by beneficiaries for those services is much higher than the 20 percent rate applied to other SMI benefits. The reason for the difference is that the coinsurance rate is based on hospital charges rather than on Medicare's allowed payments, which generally are lower. As part of its proposal to restructure payments for hospital outpatient services, the Administration proposes to phase in a reduction in the coinsurance rate for services provided in hospital outpatient departments from the nearly 50 percent projected under current law in 1998 to 20 percent by 2007. That provision would cost \$7 billion over the 1998-2002 period—and more than \$10 billion a year by 2007 when fully phased in.

In addition, the President proposes increased coverage of preventive services. The budget would provide Medicare coverage for annual screening mammography and would waive cost sharing for both screening and

### Box 3.

#### Status of the Hospital Insurance Trust Fund Under the President's Medicare Proposals

Under current law, the Congressional Budget Office (CBO) estimates that the Hospital Insurance (HI) Trust Fund will be depleted by the end of 2001. CBO estimates that enacting the Administration's policies would maintain a positive balance in the HI trust fund through at least the end of 2007. The Administration's policies have two components: a reduction in the growth of spending and a transfer of spending for certain home health visits from the HI program to the Supplementary Medical Insurance (SMI) program. The transfer would have no impact on total Medicare spending, but it would help avoid depletion of the HI trust fund.

Under the Administration's proposal, the HI program would retain responsibility for the first 100 visits in an episode of home health care following a hospital stay of at least three days. SMI would pay for all other home health visits—about 65 percent of the total. Home health visits would not be subject to coinsurance or the SMI deductible and would not be included in calculating the SMI premium. After taking account of the Administration's proposal to reduce payments to home health providers, CBO estimates that \$86 billion in spending will be shifted from HI to SMI over the 1998-2002 period. Without the proposed shift of home health spending, the Hospital Insurance Trust Fund would be depleted in 2003 under the President's remaining proposals.

diagnostic tests. Screening tests for detecting colorectal cancer would be covered, as would training and supplies for managing diabetes. Reimbursement rates would be increased for administering Medicare-covered preventive injections. Respite care of up to 32 hours a year would be provided for the families of Medicare beneficiaries with Alzheimer's disease or other severe mental impairments. Those new benefits would increase Medicare spending—net of any savings attributable to avoided illness—by about \$7.5 billion over the 1998-2002 period.

The Administration also proposes to reduce the penalty for late enrollment. Under current law, people who do not enroll in the SMI program on turning 65 pay a premium that is 10 percent higher for each year that they delay enrollment and are not covered by a group health insurance plan. Reducing that penalty would encourage people to enroll in the program who would not have done so otherwise. Medicare costs would increase by \$3 billion over the 1998-2002 period, principally because the additional premiums paid by those people cover would only 25 percent of the additional benefits.

Under the President's proposals, premiums paid by beneficiaries would increase relative to current law. Such premiums now cover 25 percent of spending for Supplementary Medical Insurance. Under current law, however, SMI premiums may increase by no more than the Social Security cost-of-living adjustment after 1998, and the share of costs covered by premiums will then begin to shrink by about 1 percentage point a year. The Administration would maintain the share of SMI spending covered by premiums at 25 percent after 1998. In conjunction with other proposals in the budget, that change would boost receipts by \$8 billion over the 1998-2002 period. Premium receipts would grow by 8 percent a year, up from 5 percent a year under current law. In 2002, the projected SMI monthly premium would be \$61.20 under the Administration's proposal compared with \$51.50 projected under current law.

**Medicaid.** CBO projects that federal outlays for Medicaid will grow from \$99 billion in 1997 to \$144 billion in 2002 under current law—an average annual increase of just under 8 percent (see Table 12). Medical assistance payments, the largest component of spending, are projected to rise from about \$84 billion in 1997 to \$123 billion by 2002.

The President's basic budget includes proposals that would produce savings in Medicaid, as well as several measures that would increase Medicaid spending. The net effect of those policies is to reduce Medicaid spending by \$7.5 billion over the 1998-2002 period compared with current law. In addition, the budget makes a number of proposals that increase the flexibility of states in administering the Medicaid program. Although CBO's baseline projections for Medicaid are slightly higher than those of the Administration, CBO and the Administration have similar estimates of the President's proposals.

The President's budget would achieve savings in Medicaid by placing caps on federal payments to states for each beneficiary and by limiting the growth in those caps to slightly more than the rate of economic growth per person. Separate caps would be established for the four main groups of people eligible for Medicaid—the aged, disabled, children, and other low-income adults—but states whose average spending for one group was below the cap could apply the savings to other groups. CBO estimates that the per capita caps would save \$9 billion over the 1998-2002 period—with most of the savings occurring in the last two years.

The President also proposes to limit Medicaid's payments to disproportionate share hospitals to \$10 billion in 1998, \$9 billion in 1999, and \$8 billion in 2000 and thereafter. That change would save \$17 billion over the 1998-2002 period compared with current law. The savings are partly offset by almost \$3 billion in supplemental payments for federally qualified health centers, rural health clinics, and other purposes.

The President's budget would expand Medicaid spending in several ways. First, the budget proposal would add more children to the program by allowing states to guarantee at least 12 months of continuous eligibility after a child becomes eligible for Medicaid. It would also increase Medicaid enrollment among children who are already eligible for benefits as a by-product of giving states grants to expand children's health insurance coverage. CBO estimates that those changes would cost \$6 billion over the 1998-2002 period. Second, the budget proposes to repeal provisions in last year's welfare reform law that removed certain legal aliens and disabled children from the Medicaid rolls.

Reinstating those beneficiaries would cost \$7 billion over five years. Finally, other changes in Medicaid—including the effects on Medicaid of the Administration's proposals for Medicare—would increase costs by \$3 billion over the 1998-2002 period.

**Other Health Insurance Proposals.** The President's budget would create three new federal grants to states for the purpose of expanding health insurance coverage. First, the budget would provide nearly \$10 billion over the 1998-2001 period for programs providing health

**Table 12.**  
**CBO Estimate of the President's Medicaid Proposals (By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1998-2002	Average Annual Rate of Growth, 1997-2002 (Percent)
<b>CBO Baseline</b>								
Federal Outlays	98.6	105.3	113.6	122.9	132.8	143.8	618.4	7.8
<b>Proposed Changes</b>								
Savings Proposals								
Per capita cap <sup>a</sup>	0	0	-0.2	-1.5	-2.9	-4.7	-9.3	n.a.
Reductions in DSH payments <sup>b</sup>	0	-0.3	-2.1	-3.8	-4.7	-5.6	-16.6	n.a.
Supplemental payments <sup>c</sup>	<u>0</u>	<u>0</u>	<u>1.0</u>	<u>0.8</u>	<u>0.6</u>	<u>0.4</u>	<u>2.8</u>	n.a.
Subtotal	0	-0.3	-1.3	-4.6	-7.0	-9.9	-23.1	n.a.
New Initiatives								
Children's health	0	1.0	1.1	1.1	1.2	1.3	5.7	n.a.
Retain benefits for disabled children	d	0.1	0.2	0.2	0.2	0.2	1.0	n.a.
Retain benefits for certain aliens	0.1	0.9	1.0	1.1	1.3	1.6	5.8	n.a.
Payments to the District of Columbia	0	0.1	0.2	0.2	0.2	0.2	0.9	n.a.
Other proposals	<u>0</u>	<u>d</u>	<u>0.4</u>	<u>0.5</u>	<u>0.6</u>	<u>0.8</u>	<u>2.2</u>	n.a.
Subtotal	0.1	2.1	2.8	3.1	3.5	4.1	15.6	n.a.
Total	0.1	1.8	1.5	-1.5	-3.5	-5.8	-7.5	n.a.
<b>CBO Estimate of the President's Proposals</b>								
Federal Outlays	98.8	107.1	115.2	121.4	129.3	138.0	610.9	7.0

SOURCE: Congressional Budget Office.

NOTES: The estimates in this table exclude alternative policies to eliminate the deficit under CBO assumptions.

n.a. = not applicable; DSH = disproportionate share hospital.

- a. Assumes a per capita growth rate equal to the growth of gross domestic product per capita plus 2 percentage points in 1997 and 1998, 1.5 percentage points in 1999, and 0.5 percentage points in 2000 and thereafter.
- b. Assumes DSH payments would be limited to \$10 billion in 1998, \$9 billion in 1999, and \$8 billion in 2000 and thereafter.
- c. Assumes that supplemental payments for federally qualified health centers, rural health clinics, and other purposes would total \$2.8 billion.
- d. Less than \$50 million.

insurance to certain unemployed workers and their families. The budget includes no funding for those grants in 2002. (CBO also estimates that those grants would increase Unemployment Insurance costs by \$1 billion during the duration of the grant program since the availability of health insurance will increase the average length of unemployment. That amount is not included in the \$10 billion figure given above.) Second, grants of \$750 million a year would be made available to expand health insurance coverage among children. As noted above, CBO estimates that the resulting outreach efforts would also generate additional costs for the Medicaid program. Finally, \$25 million a year would be devoted to helping to establish health insurance purchasing cooperatives. In total, those three grants would cost \$14 billion over the next five years.

**Supplemental Security Income.** The President's proposed changes to the Supplemental Security Income (SSI) program would exempt aliens who became disabled after entering the United States from the new restrictions on SSI and Medicaid benefits contained in last year's welfare reform legislation. In addition, the President proposes to extend from five to seven years the period that refugees and asylees may receive SSI benefits after being admitted to the United States. Because of the difficulty in establishing the onset of disability for immigrants and because determining disability for the aged is problematic, CBO estimates that nearly all aliens who would otherwise be barred from SSI disability benefits and two-thirds of the aged would be able to secure eligibility for SSI benefits under this proposal. The two proposals would increase SSI spending by \$9 billion over the 1997-2002 period.

**Education and Training.** The President's major mandatory spending proposals in the education and training areas are a new initiative to provide interest subsidies to certain school districts so that they can increase their level of improvements to infrastructure and a temporary, five-year initiative to use the Americorps and college work-study programs to provide tutoring services to children in grades K-3. In addition, the budget requests mandatory appropriations of \$0.8 billion in 1998, \$1.0 billion in 1999, and \$1.2 billion in 2000 for state and local governments to help long-term welfare recipients obtain jobs.

**Electromagnetic Spectrum Auctions.** The authority of the Federal Communications Commission (FCC) to

conduct auctions of the electromagnetic spectrum expires in 1998. The President proposes extending and expanding the authority of the FCC to conduct spectrum auctions during the 1998-2002 period. OMB estimates that additional auctions would raise \$36 billion over that period; CBO, however, estimates that those auctions would raise only \$24 billion.

CBO expects that prices for additional spectrum will not hold firm in future auctions. Although CBO's estimated prices for the spectrum reflect adjustments for inflation, CBO expects that the price of FCC licenses will fall as more spectrum is brought to the market. Three factors support that conclusion. First, an increase in the supply of licenses will depress prices. Second, a regulatory trend permitting current licensees to put their spectrum to the most profitable use will reduce demand for new licenses. Third, new technologies that increase the information-carrying capacity of the spectrum will further depress demand. The differences in price largely account for the difference in savings estimates for the President's proposals.

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## The President's Alternative Spending Proposals

The President's budget briefly mentions an alternative set of proposals that are designed to result in a balanced budget estimate in 2002 under CBO's current economic and technical assumptions. The spending components of that plan would reduce outlays by an additional \$14 billion in 2001 and \$43 billion in 2002 relative to CBO's estimate of the budget's basic proposals (see Table 13).

The President's alternative spending proposals add four components to his basic spending proposals. First, it directs an across-the-board cut of 2.25 percent that would reduce Medicare spending in 2002 by \$6 billion, Medicaid spending by \$3 billion, and other nonexempt mandatory spending by \$1 billion. Second, cost-of-living increases for federal benefit programs (excluding Social Security) would be limited to 0.46 percent in 2002 instead of the 3 percent projected under current law. CBO estimates that the proposal would save \$3 billion in 2002. Third, a fee on television broadcasters would be assessed in 2002 in the amount of the short-

**Table 13.**  
**Estimate of the President's Alternative**  
**Spending Proposals to Eliminate the Deficit**  
**Under CBO Assumptions**  
**(By fiscal year, in billions of dollars)**

Outlays	2001	2002
Discretionary	-14	-20
Mandatory		
Medicare	0	-6
Medicaid	0	-3
Fee on broadcasters	0	-9
Cost-of-living adjustments <sup>a</sup>	0	-3
Other	<u>0</u>	<u>-1</u>
Subtotal	0	-23
<b>Total</b>	<b>-14</b>	<b>-43</b>

SOURCE: Congressional Budget Office.

a. Exempts the cost-of-living adjustment for Social Security beneficiaries.

fall between the amount anticipated by the budget for certain spectrum auctions in that year and actual receipts; CBO expects that the fee must generate \$9 billion. Last, the Administration proposes that discretionary spending levels be reduced in both 2001 and 2002 to wipe out the remaining deficit.

The Administration proposes that the magnitude of the supplemental discretionary spending cut equal the additional savings needed to eliminate the deficit in 2002 under CBO's current economic and technical assumptions. CBO estimates that discretionary outlays would need to be \$20 billion below the levels of the President's basic proposals for 2002 to achieve the savings necessary to eliminate the deficit. Achieving that level of outlay reductions would require cuts in budget authority of \$22 billion in 2001 and \$23 billion in 2002. Those amounts represent a cut in budget authority of about 4 percent from the level of the President's basic policies, significantly larger than the 2.25 percent the Administration has suggested might suffice.

Total spending would still increase in 2001 and 2002 under the President's alternative proposals (see Table 14). Nondefense discretionary spending, by contrast, will decrease in nominal terms in each of those years.



**Table 14.**  
**CBO Estimate of the President's Alternative Spending Proposals (By fiscal year)**

	1997	1998	1999	2000	2001	2002
<b>In Billions of Dollars</b>						
Discretionary						
Defense	268	266	264	269	263	268
Nondefense	<u>281</u>	<u>288</u>	<u>295</u>	<u>298</u>	<u>290</u>	<u>284</u>
Subtotal	549	553	559	567	554	553
Mandatory						
Social Security	363	381	399	420	441	464
Medicare	209	224	239	257	266	282
Medicaid	99	107	115	121	129	135
Other	<u>239</u>	<u>270</u>	<u>283</u>	<u>303</u>	<u>308</u>	<u>316</u>
Subtotal	909	981	1,036	1,100	1,144	1,197
Offsetting Receipts <sup>a</sup>	-83	-85	-82	-85	-90	-113
Net Interest	<u>248</u>	<u>253</u>	<u>259</u>	<u>257</u>	<u>253</u>	<u>248</u>
Total	1,623	1,703	1,772	1,839	1,860	1,885
<b>As a Percentage of Gross Domestic Product</b>						
Discretionary						
Defense	3.4	3.2	3.1	3.0	2.8	2.7
Nondefense	<u>3.6</u>	<u>3.5</u>	<u>3.4</u>	<u>3.3</u>	<u>3.1</u>	<u>2.9</u>
Subtotal	7.0	6.8	6.5	6.3	5.9	5.6
Mandatory						
Social Security	4.6	4.7	4.7	4.7	4.7	4.7
Medicare	2.7	2.7	2.8	2.9	2.8	2.9
Medicaid	1.3	1.3	1.3	1.3	1.4	1.4
Other	<u>3.1</u>	<u>3.3</u>	<u>3.3</u>	<u>3.4</u>	<u>3.3</u>	<u>3.2</u>
Subtotal	11.6	12.0	12.1	12.2	12.1	12.1
Offsetting Receipts <sup>a</sup>	-1.1	-1.0	-1.0	-0.9	-1.0	-1.1
Net Interest	<u>3.2</u>	<u>3.1</u>	<u>3.0</u>	<u>2.9</u>	<u>2.7</u>	<u>2.5</u>
Total	20.7	20.8	20.6	20.4	19.7	19.1
<b>Memorandum:</b>						
Gross Domestic Product (In billions of dollars)	7,830	8,186	8,584	9,003	9,439	9,892

SOURCE: Congressional Budget Office.

a. Includes asset sales.



# The President's Revenue Proposals

For the third year, the Administration has proposed a number of tax cuts and a long list of tax increases that would offset some of the tax reduction. Reimposing trust fund taxes that have expired would yield about half of the increased revenues. The Administration has proposed that the largest tax cuts expire ("sunset") at the end of 2000 if Congressional Budget Office assumptions are used for budget planning by the Congress. In that case, the Administration proposes fast-track procedures to reinstate the tax cuts for one year at a time if actual deficits for 2000 and 2001 turn out to be lower than CBO currently estimates. This chapter provides estimates of the President's forecast revenue proposals with and without sunset provisions.

If the President's proposals are enacted and the tax cuts are permanent, CBO estimates that revenues would grow from \$1.507 trillion this year (excluding \$2.7 billion in revenues from the February 28 temporary extension of aviation taxes) to \$1.862 trillion in 2002—\$9 billion lower than projections under current law in that year. As a percentage of gross domestic product, revenues are projected to fall from 19.3 percent in 1997 to 18.8 percent in 2002—with most of the reduction caused by shifts in the forecast for income shares rather than by the proposals (see Tables 15 and 16).

The net revenue losses from the proposals would grow after 2002, mostly because of the expanded individual retirement accounts (IRAs). In the years from 1998 through 2002, the net revenue loss would be \$39 billion. In the following five years, the revenue loss would be nearly \$90 billion. In the early years, the revenues generated when taxpayers switch from existing

IRAs to the new IRAs proposed by the Administration would offset some of the revenue loss. That revenue results from speeding up taxes that would have been paid in later years on withdrawals from existing IRAs. Moving those payments forward contributes to the growing revenue loss in later years.

Under the Administration's alternative budget proposal that includes expirations of the major tax cuts, revenues would be \$1.885 trillion in 2002—\$14 billion higher than under current law—or 19.1 percent of GDP.

The Joint Committee on Taxation (JCT) estimated the Administration's revenue proposals except for those involving fees, customs duties, and unemployment taxes, which CBO calculated.<sup>1</sup> JCT and CBO estimated that the revenue loss from the President's proposals would be greater than the Administration estimates—\$5 billion greater in 2002. The largest difference is in the IRA proposal.

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## Tax Relief for Middle-Income Families

As in 1995 and 1996, the major initiative in the President's budget is to reduce taxes for middle-income fam-

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1. For a full set of revenue estimates, see Joint Committee on Taxation, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 1998 Budget Proposal*, JCX-8-97 (February 27, 1997). For detailed descriptions of the revenue proposals, see Joint Committee on Taxation, *Description of the Revenue Provisions Contained in the President's Fiscal Year 1998 Budget Proposal*, JCX-6-97 (February 10, 1997).

ilies. The Administration proposes to provide tax relief through a nonrefundable tax credit for each child under 13, a set of tax incentives for education and training, and expanded benefits for saving through IRAs. None of the proposals would help low-income families that have no income tax liabilities, and all would limit the benefits to families below certain income levels. The JCT estimates that those proposals together would cost \$106 billion through 2002, or \$82 billion if all three proposals sunset at the end of 2000 (see Table 17).

### Tax Credit for Families with Children Under Age 13

The Administration proposes a nonrefundable tax credit for each dependent child under the age of 13. Taxpayers with adjusted gross income (AGI) under \$60,000 would be eligible for the full credit. The credit is phased out for taxpayers with AGIs of between \$60,000 and \$75,000. Taxpayers with AGIs of over \$75,000 would not be eligible for the credit. For those who are eligible, the credit amount would be \$300 for

tax years 1997 through 1999. Beginning in tax year 2000, the credit amount would be raised to \$500. Beginning in 2001, the credit and beginning of the phase-out range would be indexed for inflation. A permanent credit would cost \$11.3 billion in 2002.

The President's proposal is similar to a tax credit for dependent children proposed in the American Family Tax Relief Act (sponsored by Senators William V. Roth and Trent Lott). The \$500 credit in the American Family Tax Relief Act differs, however, in several ways from the President's plan. First, the value of the credit would begin immediately in 1997 at \$500. Second, it would be available for dependent children under the age of 18. Third, the credit would be phased out beginning at AGIs of \$110,000 for joint returns and \$75,000 for single returns over a \$20,000 range. Thus, joint returns with AGIs of over \$130,000 and single returns with AGIs of over \$95,000 would not be eligible for the credit. Fourth, the credit amount and the phaseout ranges would not be indexed for inflation. Finally, the legislation would create a permanent credit—at a cost of \$20.2 billion in 2002.

**Table 15.**  
**CBO Estimate of Revenues Under the President's Proposals (By fiscal year)**

	1997 <sup>a</sup>	1998	1999	2000	2001	2002
<b>In Billions of Dollars</b>						
Total Revenues						
With sunset	1,507	1,557	1,630	1,702	1,782	1,885
Without sunset	1,507	1,557	1,630	1,704	1,779	1,862
<b>Memorandum:</b>						
Gross Domestic Product	7,830	8,186	8,584	9,003	9,438	9,892
<b>As a Percentage of Gross Domestic Product</b>						
Total Revenues						
With sunset	19.3	19.0	19.0	18.9	18.9	19.1
Without sunset	19.3	19.0	19.0	18.9	18.8	18.8

SOURCE: Congressional Budget Office.

a. Does not include \$2.7 billion in revenues from temporary reinstatement of the Airport and Airway Trust Fund taxes enacted on February 28, 1997.

## Tax Incentives for Education and Job Training

The Administration's education proposals include five tax benefits to subsidize the cost of higher education. The largest of those benefits are the Hope Scholarship tuition tax credit, which is proposed for the first time, and the education and job training tax deduction, first proposed in 1995. The budget shows those proposals as permanent. Yet the Administration has indicated that they will sunset at the end of 2000 if CBO assumptions are used for budget planning.

According to the JCT estimates, if the Administration's proposals to encourage postsecondary education are permanent, they would lower revenues by \$43 billion through 2002. If the credit and deduction expire at the end of 2000, the revenue loss would fall to \$36 billion. The Administration estimates revenue losses without a sunset to be \$5 billion lower through 2002, although the JCT estimates a smaller revenue loss by 2002.

**Hope Scholarship Tuition Tax Credit.** The Administration proposes creating a nonrefundable tax credit for educational expenses incurred during the first two years of postsecondary education. Taxpayers could claim the credit for the year in which expenses were paid; expenses financed by loans would qualify for the credit in

the year incurred, not the period over which the loan is repaid. Qualifying students must attend a program leading to a recognized educational credential on at least a half-time basis, not have been convicted of a federal or state felony involving illegal drugs, not be a nonresident alien, and achieve at least a B- average during the first year to qualify for a second year's tax credit.

The credit would apply only to out-of-pocket tuition and fees and would be subject to an annual maximum of \$1,500 per student, indexed for inflation after 1998. Expenses for meals, lodging, student activities, health care, transportation, books, and other living expenses would not qualify for this credit. Moreover, the maximum value of the credit would be reduced for students by any federal educational aid, such as a Pell grant, that they might receive. Thus, students receiving the average Pell grant of just over \$1,500 would not qualify for the credit. Deducting educational expenses under other provisions of the tax code would also disqualify the student for the credit.

The credit would phase out for taxpayers with a modified adjusted gross income of between \$50,000 and \$70,000 (\$80,000 and \$100,000 for joint tax returns). In addition to the usual components of AGI, modified AGI includes taxable Social Security benefits and otherwise excludable income earned outside the United States and would be calculated before the pro-

**Table 16.**  
**Comparison of Revenue Estimates of the President's Proposals**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1997-2002
CBO/JCT							
With sunset	0.2	-10.1	-5.0	-6.7	-6.5	14.3	-13.7
Without sunset	0.2	-10.1	-5.0	-5.0	-9.6	-9.4	-38.9
Administration	1.6	-7.0	-1.4	-3.7	-5.5	-4.9	-20.8
Difference Without Sunset	-1.4	-3.1	-3.6	-1.3	-4.1	-4.6	-18.1

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

NOTE: JCT = Joint Committee on Taxation.

**Table 17.**  
**Comparison of Revenue Estimates of the President's Provisions That Would Reduce Revenues**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1997-2002
<b>Provide Tax Credit for Dependent Children</b>							
CBO/JCT							
With sunset	a	-8.9	-7.7	-8.1	-9.8	0	-34.5
Without sunset	a	-8.9	-7.7	-8.0	-11.4	-11.3	-47.4
Administration	-0.7	-9.9	-6.8	-8.6	-10.4	-10.4	-46.7
<b>Provide Tax Incentives for Education and Training</b>							
CBO/JCT							
With sunset	-0.2	-7.5	-8.9	-10.6	-8.4	a	-35.7
Without sunset	-0.2	-7.5	-8.9	-9.1	-8.9	-8.5	-43.2
Administration	-0.2	-4.7	-6.9	-8.6	-8.9	-9.4	-38.6
<b>Expand Individual Retirement Accounts</b>							
CBO/JCT							
With sunset	a	-2.3	-1.5	-2.4	-3.2	-2.2	-11.5
Without sunset	a	-2.3	-1.5	-2.4	-4.0	-5.7	-15.9
Administration	0	-1.5	-0.5	-0.8	-1.2	-1.7	-5.5
<b>Subtotal: Tax Relief for Middle-Income Families</b>							
CBO/JCT							
With sunset	-0.3	-18.6	-18.1	-21.1	-21.4	-2.2	-81.7
Without sunset	-0.3	-18.6	-18.1	-19.5	-24.3	-25.6	-106.4
Administration	0	-16.0	-14.2	-17.9	-20.4	-21.4	-90.8
<b>Total of Other Provisions That Would Reduce Revenues</b>							
CBO/JCT							
With sunset	-0.5	-2.5	-2.6	-2.8	-2.7	-2.5	-13.5
Without sunset	-0.5	-2.5	-2.6	-2.8	-2.9	-2.9	-14.1
Administration	-0.6	-2.8	-2.8	-2.6	-2.4	-2.3	-13.5
<b>Total of All Provisions That Would Reduce Revenues</b>							
CBO/JCT							
With sunset	-0.7	-21.1	-20.7	-23.9	-24.1	-4.7	-95.3
Without sunset	-0.7	-21.1	-20.7	-22.3	-27.2	-28.5	-120.5
Administration	-1.4	-18.8	-16.9	-20.5	-22.9	-23.7	-104.3

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

NOTE: JCT = Joint Committee on Taxation.

a. Less than \$50 million.

posed deduction for educational expenses. Phaseout ranges would be indexed for inflation after 2001.

### **Tax Deduction for Education and Job Training.**

The Administration also proposes a deduction for qualified expenses for postsecondary education. Taxpayers would be allowed to deduct the expenses of education and training for themselves, their spouses, or their dependents. The maximum deduction would be \$5,000 in 1997 and 1998, and \$10,000 in 1999 and thereafter. The deduction would be phased out over the same income ranges as the credit proposal. Taxpayers need not itemize to claim that deduction.

Students in their first two years of school will have to choose between the credit and the deduction. Because the inflation-indexed credit would exceed 15 percent of the maximum deduction, taxpayers in the 15 percent bracket would gain more from the credit, even after the deduction limit is raised to \$10,000. Taxpayers in the 28 percent bracket would elect the credit if their eligible expenses were not more than \$5,357 (in 1998 dollars). With higher expenses, the deduction would reduce the liability of taxpayers more than the credit.

Families with multiple students would face a more complicated decision. Because such a family could take the credit for one student and the deduction for another, the optimal choice would depend on total qualifying expenses, the division of those expenses among family members, and the family's marginal tax rate. The difficulties inherent in determining whether to take the credit or deduction would complicate an already complex tax return. The B-average requirement for the credit in the second year would make administering the credit difficult.

At current levels of enrollment, about 60 percent of the students eligible to claim the deduction would come from families with incomes under \$50,000. Because students from higher-income families tend to have higher tuition expenses on average, the 40 percent of students from families with incomes of \$50,000 or more would claim about 50 percent of the total deductions. However, most students in their first two years of postsecondary study would benefit more from the credit. In 1996, the average tuition payment (net of financial aid) was estimated to be about \$3,000, and only about one in seven students spent more than

\$5,000. For students from higher-income families with higher tax rates, and hence greater tax savings, the deduction would be more valuable.

Some of the benefits from both the credit and the deduction would go to schools if they took advantage of the tax savings to raise tuition without increasing the after-tax cost to students. Research on previous increases in federal educational assistance has shown only a weak link between increased aid and higher tuition levels. Because the proposed credit and deduction would be available to most students, however, schools could raise tuition without making many students worse off.

Because both the credit and the deduction would have to be taken in the year in which educational expenses are paid, students who finance their own education with loans and have low incomes while they are in school would receive few or no tax benefits. Neither option would do them much good while they are in school and have little or no tax liability, and neither option would be available to them later when they are working and paying back loans. Allowing students credits or deductions for repaying principal and interest later on student loans would treat them equally but would also add to the cost of the proposal.

Because both the credit and the deduction would be phased out for taxpayers over a relatively narrow range of income, the proposal would significantly increase marginal tax rates for eligible families who have income in that range. The phaseout of the deduction, for example, would increase the marginal rate for a family in the 28 percent bracket by 14 percentage points if their expenses were larger than the maximum deduction that their income allows. The phaseout of the credit would add 7.5 percentage points per student to the marginal tax rates of affected families.

**Other Educational Proposals.** The Administration also proposes three smaller tax incentives to promote postsecondary education. Those incentives would expand the exclusion from income of student loans forgiven for students who work in certain occupations, extend through 2000 the exclusion from income of employer-provided educational assistance and reinstate the exclusion for graduate education, and provide a new tax credit for training expenses of small businesses.

## Expanded Individual Retirement Accounts

The Administration proposes to expand eligibility for deductible individual retirement accounts, establish new "Special IRAs," and allow penalty-free withdrawals from regular IRAs for certain qualified purposes. All of the IRA provisions would expire in 2000 under the alternative budget proposal.

**Extend Eligibility for Deductible Individual Retirement Accounts.** Under current law, a taxpayer may make a tax-deductible contribution to an IRA of up to \$2,000 a year, but not more than his or her total earnings. A couple filing a joint return can contribute up to \$2,000 for each spouse, but the contribution cannot exceed the couple's combined earnings. If the taxpayer or the taxpayer's spouse is an active participant in an employer-sponsored retirement plan, the \$2,000 limit is reduced by \$1 for every \$5 of income in excess of \$40,000 for a couple and \$25,000 for a single taxpayer. Thus, couples with an income of \$50,000 or more, and singles with an income of \$35,000 or more, cannot make deductible contributions. If taxpayers cannot make fully deductible contributions because their income exceeds those limits, they can nevertheless contribute to a nondeductible IRA, retaining the same overall limit on contributions.

Investment income in an IRA is tax-exempt while it accrues. But a taxpayer must include in taxable income the full amount of withdrawals from an account (withdrawals from a nondeductible IRA are included in taxable income only insofar as they exceed the original contributions). An additional 10 percent penalty generally applies to withdrawals made before age 59½. Exceptions to the 10 percent penalty apply to withdrawals for medical expenses in excess of 7.5 percent of income and medical insurance premiums of the unemployed.

The Administration proposes to double the income limits and phaseout ranges for deductible contributions in two steps. For 1997, 1998 and 1999, the income phaseout range for joint returns would be \$70,000 to \$90,000 and \$45,000 to \$65,000 for single returns. Starting in 2000, the phaseout range for joint returns would be \$80,000 to \$100,000, and for single returns it would be \$50,000 to \$70,000.

The \$2,000 IRA contribution limit would be indexed for inflation occurring after 1997. Current law imposes a limit of \$9,500 for salary deferrals to 401(k) plans or similar arrangements. Under the proposal, the sum of the taxpayer's contributions to IRAs and the salary deferrals could not exceed the limit.

**Establish Special IRAs.** The Administration also proposes to establish new Special IRAs. Taxpayers who are eligible for regular deductible IRAs could choose to contribute an amount up to the limit to either a deductible or a Special IRA. Contributions to a Special IRA would not be tax-deductible, but taxpayers could withdraw contributions and earnings that remained in the account for a least five years without any tax or penalty. Earnings taken out before they had been in the account for five years would be subject to income taxes. An additional 10 percent penalty would also apply unless the money withdrawn was used for the purposes described below. Taxpayers eligible for Special IRAs could transfer balances in deductible IRAs to Special IRAs without penalty, but those transfers would be subject to tax. Transfers made before January 1, 1999, could be included in taxable income, spread evenly over four years.

The current form of nondeductible IRAs would be repealed. Thus, taxpayers who could not contribute to deductible or Special IRAs (because their incomes were too high and they participated in a pension) would no longer be able to contribute to IRAs.

**Allow Penalty-Free Withdrawals for Certain Expenditures.** The Administration proposes to allow penalty-free withdrawals of funds from a regular IRA as well as funds held in a Special IRA less than five years if the money is used to pay for postsecondary education, buy a first home, cover living costs if unemployed, or pay for catastrophic medical expenses. All of those expenses for the taxpayer, spouse, and dependents are eligible. For some types of withdrawals, expenses for nondependent children, grandchildren, parents, or grandparents will also be eligible. Penalty-free withdrawals are already allowed for catastrophic medical expenses of the taxpayer and the taxpayer's dependents.

**Other Proposals.** The main features of the Administration's proposal are similar to those of other proposals introduced in recent years, but important differences



remain. For example, the American Family Tax Relief Act (S. 2) would also expand eligibility, introduce Special IRAs, and expand allowable withdrawals. Unlike the Administration's proposal, however, S. 2 would entirely phase out income limits on contributors and exempt its qualifying withdrawals from both income and penalty taxes, but would not allow withdrawals for general uses before age 59½.

**Effect on Revenues and Saving.** The revenue loss from expanding IRA eligibility and introducing Special IRAs would grow rapidly over the decade after enactment. Moreover, it becomes substantially higher when the IRA provisions continue after 2000. Even if the provisions expire, the revenue loss continues to grow because of the steady accrual of earnings on expanded contributions made during 1997 through 2000. Allowing taxpayers to shift existing IRA balances to Special IRAs adds to the rapid growth of the revenue loss in later years. The Joint Committee on Taxation estimates that if the proposal does not expire, it will reduce revenues by \$16 billion through 2002 and by \$67 billion through 2007. If it does expire, the loss through 2002 would be \$12 billion and \$35 billion through 2007.

The Administration estimates a substantially smaller revenue loss. Assuming the proposal does not expire, the Administration estimates that the proposal would reduce revenues by \$6 billion through 2002 and by \$21 billion through 2007. Those estimates show a similarly rapid growth rate through 2007, but are about one-third the size of the corresponding estimates by the Joint Committee on Taxation. The difference in size stems largely from different assumptions about how much taxpayers would contribute and what portion of the contributions would be shifted from saving that otherwise would have been deposited in taxable accounts. The uncertainty about the level of contributions arises both from the novel provisions in the proposal and from questions about how far the recent expansion of opportunities for saving in 401(k) plans and related arrangements would reduce IRA contribution rates below those between 1982 and 1986, the last time IRAs were widely available.

Estimates of the revenue effects from Special IRAs include some revenue gains in the early years as taxpayers transfer funds from regular IRAs, pay taxes on those transfers, and deposit the after-tax proceeds in the new accounts. Because Special IRAs offer the advan-

tage of penalty-free withdrawals much sooner than regular IRAs, some taxpayers would be willing to make the transfer, trading a front-loaded account for a back-loaded account. The revenue increase represents an acceleration of taxes that would have been paid in the future and thus a corresponding revenue loss outside the projection period in the budget.

In addition to the effect from accelerating future revenues into the budget period, the long-term revenue losses from Special IRAs will grow over time. Special IRAs differ from ordinary taxable accounts because earnings on contributions are never taxed. Since it would take some time for funds to build up in Special IRAs, the revenue loss would be small initially but would grow as funds accumulated. By contrast, the initial revenue loss is greater from deductible IRAs because taxpayers are making tax-deductible contributions, but that loss grows more slowly because some of that initial loss is recouped later when taxpayers withdraw from those accounts.

Revenue losses result from IRAs because taxes would have been paid on annual investment earnings if those funds had been saved in taxable accounts. If the funds contributed to IRAs would have been spent instead, there are no revenue losses.

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## Other Tax Reductions

The Administration has proposed a number of other proposals that would reduce revenues. Together they would lower revenues by about \$14 billion through 2002.

Three of the proposals would extend existing tax provisions that are scheduled to expire this year. The Generalized System of Preferences, which expires May 31, 1997, affords nonreciprocal tariff preferences to approximately 145 developing countries. The Administration proposes to extend the program through September 30, 2007. The extension, along with other tariff reductions, would reduce revenues by about \$3 billion through 2002. The Administration also proposes to extend the tax credit for research expenses for an additional year, through May 31, 1998, reducing revenues by about \$2 billion. The work opportunity tax credit would be extended for a year, to September 30, 1998,

and expanded to include some Food Stamp recipients. Employers who hire those recipients would be able to receive the credit through September 30, 2000. The credit would be supplemented with a new welfare-to-work tax credit. Together, the proposals related to wage credits for hiring low-income workers would cause a drop in revenues of about \$1 billion.

Other proposals would expand current tax preferences. A new proposal to exclude up to \$500,000 of capital gains from each sale of an owner-occupied home would reduce revenues by nearly \$3 billion through 2002. Additional proposals would expand tax incentives in distressed areas, increase the size of closely held businesses eligible for special estate tax treatment, make the new economic activity credit for Puerto Rico more generous, and add computer software to the list of exports eligible for special tax treatment.

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## Provisions Reinstating Expired Taxes

The Administration has proposed a long list of tax increases to offset the proposed revenue-reducing provisions. Taken together, revenue-increasing provisions would boost revenues by about \$80 billion through 2002 (see Table 18). About half of the additional revenues would come from reinstating taxes that have expired in the last few years. The Administration recommended reimposing the same taxes in 1996. The taxes would be restored through 2007.

Reinstating aviation taxes accounts for \$33 billion of the additional revenues. The Administration proposes to reinstate the Airport and Airway Trust Fund taxes, which consist of a 10 percent ticket tax and taxes on international departures, cargo, and fuel. Those taxes expired December 31, 1996. (A bill extending the taxes through the end of fiscal year 1997 was enacted on February 28, 1997—too late to be reflected in the numbers in this report.) The second step of the proposal is to replace the ticket tax with a system of fees, beginning in fiscal year 1999. The estimate presented here for 1998 reflects extending current law plus \$300 million from a new, still-unspecified fee. The Administration has not specified the replacement fee system,

and so CBO has used Administration estimates for 1999 and later years.

The Administration also proposes to reinstate the Superfund environmental tax on corporate taxable income and the three Superfund excise taxes. Those taxes expired at the end of 1995. The receipts would be deposited in the Hazardous Substance Superfund and used to clean up hazardous waste sites. Reinstating those taxes would add \$6.4 billion to revenues through 2002. Furthermore, the Administration proposal reinstates the Oil Spill Liability excise tax, which expired at the end of 1994, and the Leaking Underground Storage Tank excise taxes, which expired at the end of 1995.

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## Other Provisions That Would Increase Revenues

Most of the remaining revenue increases proposed by the President result from modifying the tax treatment of corporations and investors. Those same proposals were offered in 1996. Several new proposals replace provisions proposed last year and subsequently enacted. Those enacted provisions include disallowing interest deductions for corporate-owned life insurance, reducing the possessions tax credit, equalizing the treatment of the bad debt of thrift institutions and commercial banks, and tightening provisions affecting expatriates and foreign trusts.

The President's proposals affecting the treatment of the foreign income of businesses would increase revenues by \$12 billion through 2002. The largest increase, about \$8 billion, would come from a new proposal. That proposal would limit the amount of income that exporters can classify as foreign-source income, thus reducing the amount of usable foreign tax credits. Other proposals, repeated from last year, would limit the use of foreign tax credits to reduce previous years' taxes and change the treatment of income from foreign oil and gas extraction.

The President's proposals for financial products, which are also repeated from last year, would raise \$6.6 billion through 2002. The largest increase would come

from changing the rules for taxpayers who sell part of their holdings of an asset. Under the proposal, taxpayers would be required to calculate capital gains using the average cost of their holdings. Under current law,

taxpayers can reduce their gains by selling the assets purchased at the highest cost. Other proposals would reduce the dividends-received deduction for some corporations and limit interest deductions.

**Table 18.**  
**Comparison of Revenue Estimates of the President's Provisions That Would Increase Revenues**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1997-2002
<b>Total of Provisions That Would Reinstate Expired Taxes</b>							
CBO/JCT <sup>a</sup>	0.7	6.9	8.2	8.2	8.4	8.6	40.9
Administration	2.4	7.1	8.4	8.5	8.7	8.9	44.0
<b>Total of Foreign Provisions</b>							
CBO/JCT	b	1.2	2.5	2.6	2.8	2.9	12.0
Administration	0	1.0	1.8	2.0	2.2	2.3	9.4
<b>Total of Provisions Relating to Financial Products</b>							
CBO/JCT	b	1.2	1.1	1.4	1.4	1.4	6.6
Administration	0.1	1.1	1.4	1.6	1.7	1.7	7.6
<b>Total of Accounting Provisions</b>							
CBO/JCT	b	0.3	0.5	0.5	0.5	0.5	2.2
Administration	0.1	0.5	0.6	0.7	0.7	0.5	3.1
<b>Total of Other Corporate Tax Reforms</b>							
CBO/JCT	0.2	0.8	1.2	1.4	1.1	0.9	5.5
Administration	0.5	1.1	1.1	1.3	1.2	1.2	6.4
<b>Total of Other Provisions That Would Increase Revenues</b>							
CBO/JCT	b	0.8	2.2	3.1	3.4	4.7	14.2
Administration	b	1.0	2.1	2.7	2.9	4.3	13.0
<b>Total of All Provisions That Would Increase Revenues</b>							
CBO/JCT	0.9	11.1	15.7	17.2	17.6	19.0	81.5
Administration	3.0	11.8	15.6	16.8	17.4	18.9	83.5

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

NOTE: JCT = Joint Committee on Taxation.

a. The Administration proposes that aviation excise taxes be repealed effective October 1, 1998, and replaced with cost-based user fees. Because the user fee proposal has yet to be specified, CBO has accepted OMB's estimate beginning in fiscal year 1999. The estimate does not reflect the temporary extension of the aviation taxes enacted on February 28, 1997.

b. Less than \$50 million.

In addition, a proposed limitation in the use of current-year losses to reduce prior-year taxes would add \$3.5 billion to revenues through 2002. Modifications to inventory rules would raise about \$2 billion. Other modifications to the corporate income tax would raise an additional \$2 billion in revenues.

The remaining proposed tax and fee increases add a further \$14 billion to revenues. About half of those revenues would be in the form of Federal Unemployment Tax Act (FUTA) taxes. A FUTA surtax that was first enacted in 1976 is scheduled to expire at the end of 1998. The Administration proposes to extend that sur-

tax through 2007 and retain those receipts by allowing the federal trust fund to accumulate larger balances. The Administration also proposes a speed up in the deposit of state and federal unemployment taxes, starting in 2002. That proposal would move \$1.3 billion into 2002, with almost no effect on revenues in subsequent years and no effect at all on tax liabilities. Other proposals would raise the retirement contributions of federal employees and provide for continuous levies by the Internal Revenue Service on the federal benefit payments of delinquent taxpayers until those debts have been fully paid.

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# Appendixes



# CBO Baseline Budget Projections

**T**hroughout 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 in competing packages.

CBO compared the President's budget to its baseline and made additional adjustments for the economic effects of balancing the budget. Credible legislative changes intended to balance the budget would produce lower interest rates and slightly higher growth than under the baseline economic scenario, thereby producing a fiscal dividend. The projections including the fiscal dividend, which show how much tax and spending policies must be changed to eliminate the deficit, are presented at the end of this appendix.

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## The Baseline Concept

CBO's baseline projections follow some general rules. Revenues and entitlement programs (such as Social Security and Medicare) 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 so forth. For those categories of the budget, therefore, the baseline represents

CBO's best estimate of what will happen in the absence of any changes to current laws.

Discretionary programs, unlike entitlement programs, are funded anew each year through the appropriation process. Discretionary programs encompass nearly all spending for defense and international affairs, as well as many domestic programs—for space, energy, highway and airport grants, environmental protection, and health research, to name just a few—and the salaries and expenses of government agencies. The Budget Enforcement Act of 1990 set caps on total discretionary spending for 1991 through 1995, and the Omnibus Budget Reconciliation Act of 1993 extended them through 1998. CBO's baseline assumes compliance with the caps in 1998—which, as explained below, will force trade-offs among many competing programs. No law specifies caps after 1998, so CBO produced two alternative projections of discretionary spending for the years beyond that. One set of baseline projections preserves discretionary spending at the same real level as in 1998, increasing it by around 3 percent a year to account for inflation. The other set assumes that discretionary spending is frozen at the 1998 dollar level with no increases for inflation.

The budget includes two other categories of spending: offsetting receipts, which encompass Medicare insurance premiums and similar fees and collections, and net interest, which basically reflects the government's interest payments on the national debt. CBO's baseline for offsetting receipts represents the agency's best estimate of the amount that the government will collect under current laws and policies. Net interest is driven by market interest rates and future deficits rather

**Table A-1.**  
**Changes in CBO Deficit Projections Since January (By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
January 1997 Baseline Deficit	124.2	119.7	147.2	171.3	167.2	188.4	201.6	219.3	253.7	265.6	278.0
Technical Changes											
Revenues <sup>a</sup>	0.4 <sup>b</sup>	0.4	0.4	0.4	0.3	0.1	c	c	c	-0.1	-0.1
Outlays											
Discretionary	1.7	1.5	1.5	1.6	1.6	1.7	1.7	1.8	1.8	1.9	1.9
Mandatory											
Social Security	-1.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Student loans	-2.0	0.6	0.3	0.1	-0.1	-0.2	-0.1	-0.2	-0.3	-0.3	-0.4
Food Stamps	-1.0	-0.8	-0.6	-0.3	b	b	-0.1	-0.1	-0.1	-0.1	-0.1
FCC spectrum auctions	-3.0	1.7	1.9	0.3	0	0	0	0	0	0	0
Net interest	-0.6	-0.6	-1.0	-1.2	-1.1	-1.1	-0.9	-0.7	-0.3	0.3	0.9
All other	<u>-3.8</u>	<u>-0.3</u>	<u>-0.9</u>	<u>0.4</u>	<u>-1.2</u>	<u>-1.2</u>	<u>-0.2</u>	<u>0.1</u>	<u>0.7</u>	<u>1.0</u>	<u>-2.4</u>
Subtotal, mandatory	-11.3	0.5	-0.4	-0.9	-2.5	-2.6	-1.5	-1.0	-0.1	0.8	-2.1
Total, outlays	-9.6	2.0	1.1	0.7	-0.8	-1.0	0.2	0.8	1.7	2.7	-0.2
Total Technical Changes	-9.1 <sup>b</sup>	2.4	1.5	1.1	-0.6	-0.9	0.2	0.8	1.7	2.6	-0.3
March 1997 Baseline Deficit	115.1 <sup>b</sup>	122.1	148.7	172.4	166.6	187.5	201.8	220.1	255.4	268.1	277.7

SOURCE: Congressional Budget Office.

NOTE: FCC = Federal Communications Commission.

- a. Reductions in revenues are shown with a positive sign because they increase the deficit.  
 b. Does not include \$2.7 billion in revenues from temporary reinstatement of the Airport and Airway Trust Fund taxes enacted on February 28, 1997.  
 b. Less than \$50 million.

than being directly controlled by policymakers, so CBO estimates net interest spending based on its projections of those two determinants.

## Baseline Projections

In January, CBO published its baseline projections in *The Economic and Budget Outlook: Fiscal Years 1998-2007*, which described the key factors that drive the federal government's revenues, spending, and deficit. Since that report, CBO has revised its deficit projection for 1997 downward by \$9 billion; however, without much additional information about future years, the projections for 1998 and beyond have changed very little (see Table A-1).

The Congressional Budget Office generally divides revisions to its estimates into three categories: eco-

nomie, legislative, and technical (whatever does not fall into the first two categories). Because CBO has not updated its economic forecast, and no new legislation has affected deficit projections since January, all changes to the baseline are technical ones.<sup>1</sup> The technical revisions stem from new information that came to light through late February, much of which was contained in the President's budget and supporting documents.

The only significant changes in the baseline are for estimates of fiscal year 1997 outlays. CBO lowered its estimate of the 1997 deficit for three main reasons:

1. On February 28, the President signed into law a bill reinstating aviation excise taxes through the end of fiscal year 1997. That action, which will raise \$2.7 billion in revenues, is not reflected in the baseline because CBO completed its estimates before that date.



**Table A-2.**  
**CBO Deficit Projections (By fiscal year)**

	Actual 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>In Billions of Dollars</b>												
Baseline Total Deficit												
Discretionary spending grows with inflation after 1998	107	115	122	149	172	167	188	202	220	255	268	278
Discretionary spending is frozen at the 1998 level	107	115	122	128	133	99	99	89	81	90	69	42
Standardized-Employment Deficit <sup>a</sup>												
Discretionary spending grows with inflation after 1998	125	145	131	145	156	166	178	192	210	230	255	282
Discretionary spending is frozen at the 1998 level	125	145	131	124	117	98	90	79	70	65	56	47
On-Budget Deficit (Excluding Social Security and Postal Service)												
Discretionary spending grows with inflation after 1998	174	193	201	238	268	265	291	311	334	376	395	410
Discretionary spending is frozen at the 1998 level	174	193	201	216	229	198	203	198	194	210	196	175
<b>Memorandum:</b>												
Deposit Insurance	-8	-12	-4	-3	-1	b	b	-1	-1	-1	-1	-1
FCC Spectrum Auctions	b	-10	-7	-2	-1	b	0	0	0	0	0	0
Timing of Payments	-5	0	0	0	8	-8	0	0	0	14	1	-16
Cyclical Deficit	-4	-8	3	8	9	10	10	11	11	12	12	13
Off-Budget Surplus												
Social Security	66	79	81	88	94	98	104	109	114	120	127	133
Postal Service	<u>1</u>	<u>-1</u>	<u>-3</u>	<u>1</u>	<u>1</u>	<u>1</u>	<u>b</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	67	78	79	89	96	99	104	109	114	120	127	133
<b>As a Percentage of Gross Domestic Product</b>												
Baseline Total Deficit												
Discretionary spending grows with inflation after 1998	1.4	1.5	1.5	1.7	1.9	1.8	1.9	2.0	2.0	2.3	2.3	2.2
Discretionary spending is frozen at the 1998 level	1.4	1.5	1.5	1.5	1.5	1.1	1.0	0.9	0.7	0.8	0.6	0.3
Standardized-Employment Deficit <sup>a,c</sup>												
Discretionary spending grows with inflation after 1998	1.7	1.9	1.6	1.7	1.7	1.8	1.8	1.9	1.9	2.0	2.2	2.3
Discretionary spending is frozen at the 1998 level	1.7	1.9	1.6	1.4	1.3	1.0	0.9	0.8	0.6	0.6	0.5	0.4

SOURCE: Congressional Budget Office.

NOTES: Caps on discretionary spending are set by law through 1998. The first projection assumes that discretionary spending increases at the rate of inflation after 1998. The second projection assumes that discretionary spending remains frozen in dollar terms at the level of the 1998 cap.

FCC = Federal Communications Commission.

- a. Excludes the cyclical deficit, deposit insurance, FCC spectrum auctions, and timing adjustments. Also incorporates technical revisions since January 1997.
- b. Less than \$500 million.
- c. Expressed as a percentage of potential gross domestic product.

- o The Federal Communications Commission resolved problems that threatened to delay until next year the issuing of licenses and recording of payments for past spectrum auctions. That change increased CBO's projections of offsetting receipts in 1997 by \$3 billion.
- o Spending patterns through the first four months of the fiscal year have led CBO to expect that Social Security and the Food Stamp program will each spend \$1 billion less in 1997 than previously anticipated.

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

	Actual 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>In Billions of Dollars</b>												
<b>Revenues</b>												
Individual income	656	676	708	740	777	817	857	900	947	994	1,042	1,096
Corporate income	172	179	184	187	189	193	198	205	213	223	234	245
Social insurance	509	534	553	578	604	630	659	687	717	749	784	820
Other	<u>115</u>	<u>117<sup>a</sup></u>	<u>122</u>	<u>128</u>	<u>134</u>	<u>141</u>	<u>146</u>	<u>151</u>	<u>156</u>	<u>161</u>	<u>167</u>	<u>172</u>
<b>Total</b>	<b>1,453</b>	<b>1,507</b>	<b>1,566</b>	<b>1,633</b>	<b>1,705</b>	<b>1,781</b>	<b>1,860</b>	<b>1,943</b>	<b>2,033</b>	<b>2,127</b>	<b>2,227</b>	<b>2,333</b>
On-budget	1,086	1,119	1,164	1,211	1,263	1,320	1,378	1,440	1,509	1,579	1,652	1,731
Off-budget	367	388	403	422	442	461	482	503	524	549	575	602
<b>Outlays</b>												
<b>Discretionary</b>												
Defense	266	268	270	276	287	289	301	310	319	332	339	345
Domestic and international	267	279	285	292	299	307	316	325	334	345	355	366
Violent Crime Reduction												
Trust Fund	1	2	3	4	5	5	5	5	5	6	6	6
Unspecified reductions <sup>b</sup>	<u>0</u>	<u>0</u>	<u>-13</u>	<u>-10</u>	<u>-11</u>	<u>-4</u>	<u>-7</u>	<u>-7</u>	<u>-7</u>	<u>-10</u>	<u>-6</u>	<u>-3</u>
Subtotal	534	549	545	562	579	597	615	633	652	672	693	715
Mandatory spending	858	909	976	1,036	1,111	1,161	1,239	1,311	1,390	1,491	1,572	1,655
Offsetting receipts	-73	-83	-84	-77	-78	-81	-84	-87	-89	-92	-95	-99
Net interest	<u>241</u>	<u>248</u>	<u>252</u>	<u>260</u>	<u>266</u>	<u>271</u>	<u>278</u>	<u>288</u>	<u>300</u>	<u>311</u>	<u>325</u>	<u>341</u>
<b>Total</b>	<b>1,560</b>	<b>1,622</b>	<b>1,689</b>	<b>1,782</b>	<b>1,877</b>	<b>1,947</b>	<b>2,048</b>	<b>2,145</b>	<b>2,253</b>	<b>2,383</b>	<b>2,495</b>	<b>2,611</b>
On-budget	1,260	1,312	1,365	1,449	1,531	1,585	1,670	1,751	1,843	1,954	2,047	2,141
Off-budget	300	310	324	333	346	362	378	394	410	428	448	469
<b>Deficit</b>	<b>107</b>	<b>115</b>	<b>122</b>	<b>149</b>	<b>172</b>	<b>167</b>	<b>188</b>	<b>202</b>	<b>220</b>	<b>255</b>	<b>268</b>	<b>278</b>
On-budget deficit	174	193	201	238	268	265	291	311	334	375	395	410
Off-budget surplus	67	78	79	89	96	99	104	109	114	120	127	133
<b>Debt Held by the Public</b>	<b>3,733</b>	<b>3,864</b>	<b>4,004</b>	<b>4,167</b>	<b>4,353</b>	<b>4,534</b>	<b>4,735</b>	<b>4,949</b>	<b>5,179</b>	<b>5,445</b>	<b>5,722</b>	<b>6,011</b>
<b>Memorandum:</b>												
Gross Domestic Product	7,485	7,829	8,182	8,576	8,991	9,421	9,870	10,334	10,815	11,315	11,835	12,379

SOURCE: Congressional Budget Office.

- o The Department of Education has announced plans to record a \$3 billion reduction in the estimated subsidy costs of outstanding student loans (that reduction is partially offset by other changes that increase projected loan costs).

In addition, CBO's estimates of discretionary spending have increased by nearly \$2 billion in each year through 2007 because of adjustments in the discretionary spending caps based on the official levels reported by the Office of Management and Budget.

**Table A-3.**  
**Continued**

	Actual 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>As a Percentage of Gross Domestic Product</b>												
<b>Revenues</b>												
Individual income	8.8	8.6	8.6	8.6	8.6	8.7	8.7	8.7	8.8	8.8	8.8	8.9
Corporate income	2.3	2.3	2.2	2.2	2.1	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Social insurance	6.8	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.6	6.6	6.6	6.6
Other	<u>1.5</u>	<u>1.5<sup>a</sup></u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.4</u>	<u>1.4</u>	<u>1.4</u>	<u>1.4</u>
<b>Total</b>	<b>19.4</b>	<b>19.2</b>	<b>19.1</b>	<b>19.0</b>	<b>19.0</b>	<b>18.9</b>	<b>18.8</b>	<b>18.8</b>	<b>18.8</b>	<b>18.8</b>	<b>18.8</b>	<b>18.8</b>
On-budget	14.5	14.3	14.2	14.1	14.0	14.0	14.0	13.9	14.0	14.0	14.0	14.0
Off-budget	4.9	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.8	4.8	4.9	4.9
<b>Outlays</b>												
<b>Discretionary</b>												
Defense	3.6	3.4	3.3	3.2	3.2	3.1	3.0	3.0	3.0	2.9	2.9	2.8
Domestic and international Violent Crime Reduction Trust Fund	c	c	c	0.1	0.1	0.1	0.1	0.1	0.1	c	c	c
Unspecified reductions <sup>b</sup>	<u>0</u>	<u>0</u>	<u>-0.2</u>	<u>-0.1</u>	<u>-0.1</u>	<u>c</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.1</u>	<u>c</u>
Subtotal	7.1	7.0	6.7	6.6	6.4	6.3	6.2	6.1	6.0	5.9	5.9	5.8
Mandatory spending	11.5	11.6	11.9	12.1	12.4	12.3	12.6	12.7	12.9	13.2	13.3	13.4
Offsetting receipts	-1.0	-1.1	-1.0	-0.9	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8
Net interest	<u>3.2</u>	<u>3.2</u>	<u>3.1</u>	<u>3.0</u>	<u>3.0</u>	<u>2.9</u>	<u>2.8</u>	<u>2.8</u>	<u>2.8</u>	<u>2.8</u>	<u>2.7</u>	<u>2.8</u>
<b>Total</b>	<b>20.8</b>	<b>20.7</b>	<b>20.6</b>	<b>20.8</b>	<b>20.9</b>	<b>20.7</b>	<b>20.7</b>	<b>20.8</b>	<b>20.8</b>	<b>21.1</b>	<b>21.1</b>	<b>21.1</b>
On-budget	16.8	16.8	16.7	16.9	17.0	16.8	16.9	16.9	17.0	17.3	17.3	17.3
Off-budget	4.0	4.0	4.0	3.9	3.9	3.8	3.8	3.8	3.8	3.8	3.8	3.8
<b>Deficit</b>												
On-budget deficit	2.3	2.5	2.5	2.8	3.0	2.8	3.0	3.0	3.1	3.3	3.3	3.3
Off-budget surplus	0.9	1.0	1.0	1.0	1.1	1.0	1.1	1.1	1.1	1.1	1.1	1.1
<b>Debt Held by the Public</b>	<b>49.9</b>	<b>49.4</b>	<b>48.9</b>	<b>48.6</b>	<b>48.4</b>	<b>48.1</b>	<b>48.0</b>	<b>47.9</b>	<b>47.9</b>	<b>48.1</b>	<b>48.4</b>	<b>48.6</b>

a. Does not include \$2.7 billion in revenues from temporary reinstatement of the Airport and Airway Trust Fund taxes enacted on February 28, 1997.

b. The amount that spending would need to be reduced to meet the cap on discretionary outlays in 1998 and the effects of that reduction on CBO's discretionary totals in later years.

c. Less than 0.05 percent.

The remaining tables in this appendix 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 can rely on that earlier publication.

Much of the concern about the budget stems from the size of the federal deficit; Table A-2 on page 49 displays several measures of that gap. The most commonly used measure is simply the difference between total revenues and spending. As explained above, CBO produces two projections of that difference—one assuming that discretionary spending grows at the rate of inflation after 1998 and the other assuming that such spending is frozen at the 1998 level.

Participants in the budget debate often use other measures of the deficit as well—in particular, the standardized-employment, or structural, deficit. That measure shows the underlying deficit by removing cyclical effects (the weakened revenues and extra benefit spending that result when the economy operates below its potential) and other temporary factors. With the economy continuing on a solid footing, the distinction between the structural deficit and the conventionally measured deficit is less important now than during periods of economic slowdown.

Spending and receipts for a few large programs are generally tracked separately; chief among them are Social Security and the Postal Service (both of which are off-budget under different statutory provisions). Despite their special status, those programs loom large enough in the revenue and spending totals that any measure of the budget that omits them yields a distorted picture of the government's drain on credit markets and its role in the economy.

Federal government revenues by source and outlays by broad category, both in dollar terms and in relation to the country's gross domestic product (GDP), are presented in Table A-3 on pages 50 and 51. Spending for entitlements and other mandatory programs, by far the largest spending category, will reach \$900 billion this year and is growing fast. Fueling that growth are expenditures for Social Security, Medicare, and Medicaid, which together account for around three-quarters of all mandatory outlays (see Table A-4).

In its baseline projections, CBO assumes that policymakers will continue to abide by the discretionary spending limits set in law through 1998. Separate caps apply to budget authority (the authority to commit funds, the basic currency of the appropriation process) and outlays (actual spending); the stricter constraint governs. For general-purpose discretionary accounts, the caps have no implications for particular programs but rather force a competition for resources. The cap on budget authority for 1998 is large enough that the Congress could theoretically preserve budget authority at this year's level adjusted for inflation—but doing so would leave outlays \$13 billion above their cap. Even if the Congress froze discretionary spending at this year's level, the cap would require an additional \$2 billion cut in outlays. The Violent Crime Reduction Trust Fund is also subject to a cap on outlays, but it does not constrain projected spending.

Interest costs are a significant portion of the federal budget—about 15 percent of all federal spending today. Under CBO's assumption of stable interest rates throughout the projection period, if discretionary spending increases with inflation, interest payments will decline to 13 percent of federal outlays by 2007. In dollar terms, net interest will rise steadily from \$241 billion in 1996 to \$341 billion in 2007 (see Table A-5). Debt held by the public is projected to swell during that period from \$3.7 trillion to \$6 trillion. Measured as a percentage of GDP, however, interest costs are expected to decline from 3.2 percent this year to 2.8 percent in 2007, and debt held by the public will stabilize at about 48 percent of GDP.

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## The Fiscal Dividend

Policy changes that would significantly reduce the size of the budget deficit can be expected to have an impact on the larger economy, lowering interest rates and stimulating economic growth. Those economic changes would in turn boost revenues, reduce outlays, and ultimately reduce the size of the deficit by more than the amount of the policy changes. The extra measure of deficit reduction induced by those economic feedbacks is called the fiscal dividend. To help legislators and the public more realistically assess the magnitude of the

**Table A-4.**  
**CBO Baseline Projections of Mandatory Spending, Including Deposit Insurance**  
**(By fiscal year, in billions of dollars)**

	Actual 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>Means-Tested Programs</b>												
Medicaid	92	99	105	114	123	133	144	156	169	183	199	216
Food Stamps <sup>a</sup>	25	24	24	26	27	29	29	30	31	32	33	34
Supplemental Security Income	24	27	26	28	33	30	35	37	40	46	45	44
Family Support	18	20	22	22	23	23	23	23	24	24	24	25
Veterans' Pensions	3	3	3	3	4	3	4	4	4	4	4	4
Child Nutrition	8	8	8	9	9	10	10	11	11	12	12	13
Earned Income Tax Credit	19	21	22	22	23	24	25	26	27	28	29	30
Student Loans <sup>b</sup>	4	c	3	4	4	4	4	4	4	4	4	4
Other	<u>4</u>	<u>4</u>	<u>4</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>6</u>	<u>6</u>	<u>7</u>	<u>7</u>	<u>8</u>	<u>8</u>
Total	196	206	218	233	251	260	279	297	316	340	358	378
<b>Non-Means-Tested Programs</b>												
Social Security	347	363	381	399	420	441	464	487	512	539	568	598
Medicare	<u>191</u>	<u>209</u>	<u>227</u>	<u>248</u>	<u>273</u>	<u>286</u>	<u>314</u>	<u>339</u>	<u>368</u>	<u>410</u>	<u>438</u>	<u>464</u>
Subtotal	538	572	608	648	692	726	777	827	881	949	1,005	1,062
Other Retirement and Disability												
Federal civilian <sup>d</sup>	44	46	48	51	54	56	59	63	66	70	75	79
Military	29	30	31	32	33	34	35	37	38	39	40	42
Other	<u>5</u>	<u>4</u>	<u>4</u>	<u>4</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>	<u>5</u>
Subtotal	77	81	84	87	92	96	100	104	109	114	120	126
Unemployment Compensation	23	23	24	26	28	29	30	32	33	34	36	37
Deposit Insurance	-8	-12	-4	-3	-1	c	c	-1	-1	-1	-1	-1
Other Programs												
Veterans' benefits <sup>e</sup>	17	18	20	21	23	20	22	23	23	25	24	23
Farm price supports	5	6	7	7	7	5	5	5	5	5	5	5
Social services	5	5	5	5	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-9	-8	-6	-6	-6	-6	-5	-6	-6	-6	-6	-6
Other	<u>14</u>	<u>19</u>	<u>19</u>	<u>18</u>	<u>20</u>	<u>24</u>	<u>25</u>	<u>23</u>	<u>24</u>	<u>24</u>	<u>24</u>	<u>25</u>
Subtotal	32	40	46	45	49	49	52	52	53	55	54	53
Total	662	703	758	804	860	900	960	1,014	1,074	1,151	1,213	1,277
<b>Total</b>												
All Mandatory Spending	858	909	976	1,036	1,111	1,161	1,239	1,311	1,390	1,491	1,572	1,655

SOURCE: Congressional Budget Office.

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

- Includes nutrition assistance to Puerto Rico.
- Formerly known as guaranteed student loans.
- Less than \$500 million.
- Includes Civil Service, Foreign Service, Coast Guard, other retirement programs, and annuitants' health benefits.
- Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

policy changes needed to attain a particular amount of deficit reduction, CBO has prepared economic and budgetary projections that incorporate those dynamic feedback effects.

Incorporating the fiscal dividend into CBO's baseline projections would reduce the amount of deficit reduction needed to balance the budget in 2002 from \$188 billion to \$153 billion (see Table A-6). About

**Table A-5.**  
**CBO Baseline Projections of Federal Debt and Interest Costs (By fiscal year)**

	Actual 1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>Net Interest Outlays (Billions of dollars)</b>												
Interest on Public Debt (Gross Interest) <sup>a</sup>	344	359	368	380	390	400	412	426	442	457	475	492
Interest Received by Trust Funds												
Social Security	-37	-43	-48	-53	-58	-64	-69	-76	-82	-89	-97	-104
Other trust funds <sup>b</sup>	<u>-61</u>	<u>-63</u>	<u>-61</u>	<u>-60</u>	<u>-59</u>	<u>-58</u>	<u>-56</u>	<u>-54</u>	<u>-51</u>	<u>-47</u>	<u>-43</u>	<u>-37</u>
Subtotal	-97	-106	-109	-113	-117	-121	-125	-130	-133	-137	-139	-141
Other Interest <sup>c</sup>	<u>-5</u>	<u>-6</u>	<u>-7</u>	<u>-7</u>	<u>-7</u>	<u>-8</u>	<u>-8</u>	<u>-8</u>	<u>-9</u>	<u>-10</u>	<u>-10</u>	<u>-10</u>
Total	241	248	252	260	266	271	278	288	300	311	325	341
<b>Federal Debt, End of Year (Billions of dollars)</b>												
Gross Federal Debt	5,182	5,433	5,683	5,954	6,243	6,522	6,818	7,119	7,429	7,758	8,090	8,424
Debt Held by Government Accounts												
Social Security	550	629	710	798	892	990	1,094	1,204	1,318	1,438	1,565	1,697
Other government accounts <sup>b</sup>	<u>899</u>	<u>940</u>	<u>969</u>	<u>989</u>	<u>997</u>	<u>998</u>	<u>989</u>	<u>967</u>	<u>932</u>	<u>875</u>	<u>803</u>	<u>716</u>
Total	1,449	1,569	1,679	1,787	1,889	1,989	2,083	2,171	2,249	2,313	2,367	2,413
Debt Held by the Public	3,733	3,864	4,004	4,167	4,353	4,534	4,735	4,949	5,179	5,445	5,722	6,011
Debt Subject to Limit <sup>d</sup>	5,137	5,390	5,643	5,914	6,203	6,482	6,778	7,079	7,389	7,718	8,050	8,384
<b>Federal Debt as a Percentage of Gross Domestic Product</b>												
Debt Held by the Public	49.9	49.4	48.9	48.6	48.4	48.1	48.0	47.9	47.9	48.1	48.4	48.6

SOURCE: Congressional Budget Office.

NOTE: Projections of interest and debt assume that discretionary spending is adjusted for inflation up to the statutory caps that are in effect through 1998. All discretionary spending other than spending from the Violent Crime Reduction Trust Fund is assumed to equal the caps in 1998 and to grow from that level at the rate of inflation in later years.

- Excludes interest costs of debt issued by agencies other than the Treasury (primarily the Tennessee Valley Authority).
- Principally Civil Service Retirement, Military Retirement, Medicare, unemployment insurance, and the Highway and the Airport and Airway Trust Funds.
- Primarily interest on loans to the public.
- Differs from the gross federal debt primarily because most debt issued by agencies other than the Treasury is excluded from the debt limit.

\$27 billion of that reduction can be attributed to interest rates that would be 70 basis points (0.7 percentage points) lower than projected in the baseline, and \$5 billion would result from higher revenues associated

with slightly greater growth in GDP. For a more detailed discussion of the economic and budgetary implications of balancing the budget, see Chapter 4 of CBO's January report.

**Table A-6.**  
**Changes in the Deficit Resulting from the Economic Effects of Balancing the Budget by 2002**  
**(By fiscal year, in billions of dollars)**

	1997	1998	1999	2000	2001	2002	Total, 1997-2002
CBO Baseline Deficit	115	122	149	172	167	188	n.a.
Change Resulting from Lower Interest Rates							
Outlays							
Net interest	0	a	-2	-8	-15	-20	-45
Other	a	a	a	a	a	a	a
Revenues <sup>b</sup>							
Federal Reserve earnings	0	a	a	1	2	3	6
Shift in income shares	<u>a</u>	<u>a</u>	<u>-1</u>	<u>-3</u>	<u>-6</u>	<u>-9</u>	<u>-19</u>
Subtotal	a	a	-2	-10	-19	-27	-58
Change Resulting from Higher Gross Domestic Product	a	-1	-2	-3	-4	-5	-14
Change in Debt Service	<u>a</u>	<u>a</u>	<u>a</u>	<u>-1</u>	<u>-2</u>	<u>-3</u>	<u>-5</u>
Total Effect on the Deficit	a	-1	-4	-13	-24	-34	-77
Deficit Including Fiscal Dividend	115	121	145	159	142	153	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Less than \$500 million.

b. Revenue reductions are shown as positive because they increase the deficit.





# Comparing the Accuracy of Forecasts by CBO and the Clinton Administration

Since taking office, the Clinton Administration has produced four multiyear economic forecasts and current-services budget projections that can be compared with projections by the Congressional Budget Office (CBO). The four sets of projections provide a total of 10 forecasts to measure against actual results (the projection made in early 1993 can be evaluated for four years, 1993 through 1996; the projection from early 1994 can be evaluated for three years, 1994 through 1996; and so on).

In those 10 forecasts, CBO generally proved more accurate than the Administration in projecting the size of the deficit: it more accurately forecast seven of the 10 yearly deficits (see Table B-1). By contrast, the record for the two institutions' forecasts of individual macroeconomic variables was more mixed (see Table B-2). In general, CBO had more success forecasting the growth rate of nominal gross domestic product (GDP), inflation in the GDP price index and the consumer price index (CPI), and long-term interest rates. For its part, the Administration was more accurate in predicting real (inflation-adjusted) GDP growth and the total amount of incomes (corporate profits plus workers' wages and salaries).

Because only a small number of forecasts are available for comparison and the differences between the two institutions' numbers are not large, such a comparison is of limited use in evaluating their relative accuracy even for the one- to four-year horizons examined here. Still less can be gleaned from this comparison

about which institution's current forecasts for 2002 are likely to prove more accurate.

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## Comparing the Accuracy of Deficit Projections

Typically, the Administration produces two sets of budget projections: one assuming that current policies continue without change, and another incorporating the effects of the policies proposed in the President's budget submission to the Congress. A comparison of the Administration and CBO must use the Administration's current-policy projections because they are produced using the same principle as CBO's baseline budget projections (that no changes are made in policies).

The alternative—comparing the Administration's estimate of the deficit that includes the effects of the President's proposals (the deficit highlighted in the President's budget) with CBO's current-policy baseline deficit—would be misleading. For example, assume that CBO projected a deficit of \$200 billion under current laws and policies, whereas the Administration projected a deficit of \$150 billion if the President's policies were enacted or \$250 billion if no policy changes occurred. If the President's policies were not enacted but the deficit turned out to be \$170 billion, it would not be appropriate to conclude that the Administration's estimate of \$150 billion was closer to the actual deficit

than CBO's \$200 billion estimate. For that reason, the comparisons made here use the current-policy budget projections of both institutions.

Since President Clinton took office, the Administration and CBO have produced 10 forecasts of the yearly deficit for fiscal years 1993 through 1996. As noted above, CBO was closer to the mark in seven of them. However, all of the differences between its errors and the Administration's were small, amounting to \$13 billion or less in each case (see Table B-1). All 10 forecasts, both by CBO and the Administration, projected higher deficits than actually came to pass.

One reason both institutions erred on the high side is that policy changes enacted after the forecasts were issued had the net effect of reducing the deficit. For instance, in the spring of 1993 CBO projected that the deficit would be \$279 billion in fiscal year 1996, and the Administration projected that it would be \$290 billion. The actual deficit in 1996 was \$107 billion, meaning that CBO's projection was too high by \$172 billion and the Administration's by \$183 billion. However, CBO estimates that \$83 billion of the reduction in the 1996 deficit resulted from policy changes contained in the Omnibus Budget Reconciliation Act of 1993, which was enacted several months after those projections were made. Changes in policies also affected the accuracy of subsequent projections, although by lesser amounts.

Because changes in policies contribute equally to both CBO's and the Administration's errors, they do not affect the comparisons between the two institution's projections made in this analysis.

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## Comparing the Accuracy of Economic Projections

Comparing economic forecasts is hampered to some extent by differences in assumptions about fiscal policy. The Administration's forecasts assume that the President's proposed policies will be adopted. CBO's forecasts, as mentioned above, assume the continuation of current policy. However, for the forecast horizons used here (one to four years ahead), the small differ-

ences in policy assumptions are unlikely to affect the results of the comparison.

CBO and the Administration publish projections for a number of important macroeconomic indicators: growth of nominal GDP, growth of real GDP and the GDP price index, growth of the CPI, the total amount of corporate profits and wage and salary disbursements, the unemployment rate, and interest rates on three-month Treasury bills and 10-year Treasury notes. Not all of those indicators are independent—for example, the projections for nominal GDP are based on the projections for real GDP and the GDP price index. Also, CBO produces separate projections for corporate profits and for wage and salary disbursements, but because they have similar implications for budget projections, it combines the two into a single measure of incomes.

In early 1996, the federal government changed the way it officially measures real GDP and the GDP price index; as a result, some of the forecasts for those indicators cannot be directly compared with the actual measure. In addition, the comparison of income forecasts is limited because the Administration did not publish such a forecast in its April 1993 projections.

Overall, between 1993 and 1996, CBO's forecasting record was more accurate than the Administration's for nominal GDP growth, for inflation as measured by both the GDP price index and the CPI, and for long-term interest rates (see Table B-2). The Administration was more accurate in forecasting real GDP growth and the sum of corporate profits and wages and salaries. Both institutions made similar errors in forecasting the unemployment rate and short-term interest rates. (See Tables B-3 through B-10 for comparisons for those eight macroeconomic indicators.)

At first glance, CBO's smaller error in forecasting nominal GDP growth but larger error in forecasting wage and salary disbursements and corporate profits appears contradictory. How could the Congressional Budget Office have a more accurate estimate of nominal GDP but a less accurate estimate of important income categories that form part of GDP? The answer stems from an extraordinarily large difference between the growth of overall incomes and the growth of output in 1995 and 1996. Income growth exceeded output growth by 1 percentage point in both of those years.

Conceptually, the two measures of economic activity—income and output—are the same, but differences occur because the Commerce Department uses different sources of data to calculate them. The difference between the two measures is referred to as the statistical discrepancy, and it cannot be forecast. CBO's errors in forecasting incomes closely match the statistical dis-

crepancy.<sup>1</sup> Because CBO based its forecast for the growth of incomes on its forecast for the growth of output, it underestimated the former in 1995 and 1996 even though it quite accurately forecast the latter.

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1. See Congressional Budget Office, *The Economic and Budget Outlook: An Update* (August 1996), Appendix A.

**Table B-1.**  
**Administration and CBO Current-Policy Deficit Projections (By fiscal year, in billions of dollars)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	310	297	283	279
CBO, March 1993	302	287	284	290
Administration, February 1994	*	235	177	178
CBO, January 1994	*	223	171	166
Administration, February 1995	*	*	189	201
CBO, January 1995	*	*	176	207
Administration, March 1996	*	*	*	154
CBO, April 1996	*	*	*	144
<b>Actuals</b>				
Deficit	255	203	164	107
<b>Errors<sup>a</sup></b>				
Administration, April 1993	55	94	119	172
CBO, March 1993	47	84	121	183
Administration, February 1994	*	31	13	71
CBO, January 1994	*	20	7	59
Administration, February 1995	*	*	25	94
CBO, January 1995	*	*	12	100
Administration, March 1996	*	*	*	46
CBO, April 1996	*	*	*	37

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

NOTE: \* = not applicable.

a. Projected deficits minus actual deficits. Errors include the effects of legislation enacted after the projections.

**Table B-2.**  
**Accuracy of Administration and CBO Economic Assumptions Since 1993, by Economic Indicator**

	CBO Forecast Closer to Actual	Administration Forecast Closer to Actual	Tie or Near-Tie (Difference of 0.1 percentage point or less)	Number of Forecasts Compared
Nominal GDP Growth	7	0	3	10
Real GDP Growth	1	4	2	7 <sup>a</sup>
GDP Price Index Growth	4	0	3	7 <sup>a</sup>
CPI-U Inflation	5	1	4	10
Incomes <sup>b</sup>	1	3	2 <sup>c</sup>	6 <sup>d</sup>
Unemployment Rate	2	2	6	10
Three-Month Treasury Bill Rate	4	4	2	10
Ten-Year Treasury Note Rate	5	0	5	10

SOURCE: Congressional Budget Office.

NOTE: GDP = gross domestic product; CPI-U = consumer price index for all urban consumers.

- a. Official measures of real GDP and the GDP price index changed in early 1996, which reduced the number of forecasts available for comparison by three.
- b. Wages and salaries plus corporations' book profits.
- c. Difference in errors of \$10 billion or less.
- d. The Administration's projections published in 1993 did not include incomes, which reduced the number of forecasts available for comparison by four.

**Table B-3.**  
**Administration and CBO Projections of Nominal GDP Growth (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	5.7	6.2	6.0	5.7
CBO, January 1993	5.2	5.4	5.3	5.0
Administration, February 1994	*	5.7	5.7	5.7
CBO, January 1994	*	5.6	5.5	5.4
Administration, February 1995	*	*	5.7	5.5
CBO, January 1995	*	*	5.8	4.6
Administration, March 1996	*	*	*	5.1
CBO, May 1996	*	*	*	4.6
<b>Actuals</b>				
Nominal GDP Growth	4.9	5.8	4.6	4.4
<b>Errors<sup>a</sup></b>				
Administration, April 1993	0.8	0.4	1.4	1.3
CBO, January 1993	0.3	-0.4	0.7	0.6
Administration, February 1994	*	-0.1	1.1	1.3
CBO, January 1994	*	-0.2	0.9	1.0
Administration, February 1995	*	*	1.1	1.1
CBO, January 1995	*	*	1.2	0.2
Administration, March 1996	*	*	*	0.7
CBO, May 1996	*	*	*	0.2

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

NOTE: GDP = gross domestic product; \* = not applicable.

a. Forecasts minus actuals.

**Table B-4.**  
**Administration and CBO Projections of Real GDP Growth (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	3.1	3.3	2.9	a
CBO, January 1993	2.8	3.0	2.9	a
Administration, February 1994	*	3.1	2.8	a
CBO, January 1994	*	2.9	2.7	a
Administration, February 1995	*	*	2.8	a
CBO, January 1995	*	*	3.1	a
Administration, March 1996	*	*	*	2.2
CBO, May 1996	*	*	*	2.0
<b>Actuals</b>				
Real GDP Growth				
In 1987 dollars	3.1	4.1	3.2 <sup>b</sup>	a
In chained 1992 dollars	*	*	*	2.4
<b>Errors<sup>c</sup></b>				
Administration, April 1993	0	-0.8	-0.3	a
CBO, January 1993	-0.3	-1.1	-0.3	a
Administration, February 1994	*	-1.0	-0.4	a
CBO, January 1994	*	-1.2	-0.5	a
Administration, February 1995	*	*	-0.4	a
CBO, January 1995	*	*	-0.1	
Administration, March 1996	*	*	*	-0.2
CBO, May 1996	*	*	*	-0.4

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

NOTE: GDP = gross domestic product; \* = not applicable.

- a. The Bureau of Economic Analysis discontinued the 1987-dollar GDP series in 1995. Thus, in 1996 there was no actual value to compare with the projection.
- b. Because the Bureau of Economic Analysis did not publish 1987-dollar GDP data for the fourth quarter of 1995, this figure incorporates a CBO estimate for that quarter.
- c. Forecasts minus actuals.

**Table B-5.**  
**Administration and CBO Projections of Growth in the GDP Price Index (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	2.5	2.9	3.0	a
CBO, January 1993	2.4	2.4	2.3	a
Administration, February 1994	*	2.6	2.8	a
CBO, January 1994	*	2.7	2.7	a
Administration, February 1995	*	*	2.8	a
CBO, January 1995	*	*	2.6	a
Administration, March 1996	*	*	*	2.8
CBO, May 1996	*	*	*	2.6
<b>Actuals</b>				
GDP Price Index				
In 1987 dollars	2.2	2.1	1.7 <sup>b</sup>	a
In chained 1992 dollars	*	*	*	2.1
<b>Errors<sup>c</sup></b>				
Administration, April 1993	0.3	0.8	1.3	a
CBO, January 1993	0.2	0.3	0.6	a
Administration, February 1994	*	0.5	1.1	a
CBO, January 1994	*	0.6	1.0	a
Administration, February 1995	*	*	1.1	a
CBO, January 1995	*	*	0.9	a
Administration, March 1996	*	*	*	0.7
CBO, May 1996	*	*	*	0.5

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Labor, Bureau of Labor Statistics.

NOTE: GDP = gross domestic product; \* = not applicable.

- a. The Bureau of Economic Analysis discontinued the 1987-dollar GDP series in 1995. Thus, in 1996 there was no actual value to compare with the projection.
- b. Because the Bureau of Economic Analysis did not publish 1987-based price data for the fourth quarter of 1995, this figure incorporates a CBO estimate for that quarter.
- c. Forecasts minus actuals.



**Table B-6.**  
**Administration and CBO Projections of CPI-U Inflation (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	3.1	3.1	3.3	3.3
CBO, January 1993	3.0	2.7	2.7	2.7
Administration, February 1994	*	2.8	3.2	3.3
CBO, January 1994	*	2.7	3.0	3.1
Administration, February 1995	*	*	3.1	3.2
CBO, January 1995	*	*	3.1	3.4
Administration, March 1996	*	*	*	2.8
CBO, May 1996	*	*	*	2.8
<b>Actuals</b>				
CPI-U Inflation	3.0	2.6	2.8	2.9
<b>Errors<sup>a</sup></b>				
Administration, April 1993	0.1	0.5	0.5	0.4
CBO, January 1993	0	0.1	-0.1	-0.2
Administration, February 1994	*	0.2	0.4	0.4
CBO, January 1994	*	0.1	0.2	0.2
Administration, February 1995	*	*	0.3	0.3
CBO, January 1995	*	*	0.3	0.5
Administration, March 1996	*	*	*	-0.1
CBO, May 1996	*	*	*	-0.1

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Labor, Bureau of Labor Statistics.

NOTE: CPI-U = consumer price index for all urban consumers; \* = not applicable.

a. Forecasts minus actuals.

**Table B-7.**  
**Administration and CBO Projections of Incomes (By calendar year, in billions of dollars)**

	1994	1995	1996
<b>Published Projections</b>			
Administration, February 1994	3,769	3,973	4,191
CBO, January 1994	3,759	3,949	4,149
Administration, February 1995	*	3,973	4,182
CBO, January 1995	*	4,013	4,180
Administration, March 1996	*	*	4,257
CBO, May 1996	*	*	4,189
<b>Actuals</b>			
Incomes	3,773	4,029	4,271
<b>Errors<sup>a</sup></b>			
Administration, February 1994	-4	-56	-80
CBO, January 1994	-14	-80	-122
Administration, February 1995	*	-56	-89
CBO, January 1995	*	-16	-91
Administration, March 1996	*	*	-14
CBO, May 1996	*	*	-82

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

NOTES: Incomes represent corporations' book profits plus wage and salary disbursements. No comparisons are possible for forecasts made in 1993 because the Administration did not include forecasts of incomes in its April 1993 projections.

\* = not applicable.

a. Forecasts minus actuals.

**Table B-8.**  
**Administration and CBO Projections of the Unemployment Rate (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	6.9	6.4	6.1	5.9
CBO, January 1993	7.1	6.6	6.2	6.0
Administration, February 1994	*	6.5	6.1	5.9
CBO, January 1994	*	6.4	6.1	5.9
Administration, February 1995	*	*	5.8	5.9
CBO, January 1995	*	*	5.5	5.7
Administration, March 1996	*	*	*	5.7
CBO, May 1996	*	*	*	5.8
<b>Actuals</b>				
Unemployment Rate	6.9	6.1	5.6	5.4
<b>Errors<sup>a</sup></b>				
Administration, April 1993	0	0.3	0.5	0.5
CBO, January 1993	0.2	0.5	0.6	0.6
Administration, February 1994	*	0.4	0.5	0.5
CBO, January 1994	*	0.3	0.5	0.5
Administration, February 1995	*	*	0.2	0.5
CBO, January 1995	*	*	-0.1	0.3
Administration, March 1996	*	*	*	0.3
CBO, May 1996	*	*	*	0.4

SOURCES: Congressional Budget Office; Office of Management and Budget; Department of Labor, Bureau of Labor Statistics.

NOTE: \* = not applicable.

a. Forecasts minus actuals.

**Table B-9.**  
**Administration and CBO Projections of the Three-Month Treasury Bill Rate (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	3.7	4.3	4.7	4.8
CBO, January 1993	3.1	3.7	4.4	4.7
Administration, February 1994	*	3.4	3.8	4.1
CBO, January 1994	*	3.5	4.3	4.6
Administration, February 1995	*	*	5.9	5.5
CBO, January 1995	*	*	6.2	5.7
Administration, March 1996	*	*	*	4.9
CBO, May 1996	*	*	*	4.9
<b>Actuals</b>				
Three-Month Treasury Bill Rate <sup>a</sup>				
New issue	3.0	4.3	5.5	5.0
Secondary market	3.0	4.2	5.5	5.0
<b>Errors<sup>b</sup></b>				
Administration, April 1993	0.7	0	-0.8	-0.2
CBO, January 1993	0.1	-0.5	-1.1	-0.3
Administration, February 1994	*	-0.9	-1.7	-0.9
CBO, January 1994	*	-0.7	-1.2	-0.4
Administration, February 1995	*	*	0.4	0.5
CBO, January 1995	*	*	0.7	0.7
Administration, March 1996	*	*	*	-0.1
CBO, May 1996	*	*	*	-0.1

SOURCES: Congressional Budget Office; Office of Management and Budget; Federal Reserve Board.

NOTE: \* = not applicable.

a. The Administration projects the new-issue rate, whereas CBO projects the secondary-market rate.

b. Forecasts minus actuals.

**Table B-10.**  
**Administration and CBO Projections of the Ten-Year Treasury Note Rate (By calendar year, in percent)**

	1993	1994	1995	1996
<b>Published Projections</b>				
Administration, April 1993	6.7	6.6	6.5	6.5
CBO, January 1993	6.7	6.6	6.6	6.5
Administration, February 1994	*	5.8	5.8	5.8
CBO, January 1994	*	5.8	6.0	6.1
Administration, February 1995	*	*	7.9	7.2
CBO, January 1995	*	*	7.7	7.0
Administration, March 1996	*	*	*	5.6
CBO, May 1996	*	*	*	6.1
<b>Actuals</b>				
Ten-Year Treasury Note Rate	5.9	7.1	6.6	6.4
<b>Errors<sup>a</sup></b>				
Administration, April 1993	0.8	-0.5	-0.1	0.1
CBO, January 1993	0.8	-0.5	0	0.1
Administration, February 1994	*	-1.3	-0.8	-0.6
CBO, January 1994	*	-1.3	-0.6	-0.3
Administration, February 1995	*	*	1.3	0.8
CBO, January 1995	*	*	1.1	0.6
Administration, March 1996	*	*	*	-0.8
CBO, May 1996	*	*	*	-0.3

SOURCES: Congressional Budget Office; Office of Management and Budget; Federal Reserve Board.

NOTE: \* = not applicable.

a. Forecasts minus actuals.



# 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	Corporate income taxes, Federal Reserve System earnings, excise taxes
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## Spending Projections

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Edward Blau	Authorization bills
Jodi Capps	Appropriation bills
Betty Embrey	Appropriation bills
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Mary Froehlich	Computer support



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