CONGRESSIONAL BUDGET OFFICE
U.S. CONGRESS
WASHINGTON, DC 20515

Dan L. Crippen
Director

October 28, 1999

Honorable J. Dennis Hastert
Speaker
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Speaker:

As you requested in your letter of October 27, the Congressional Budget Office (CBO) has estimated the on-budget deficit for fiscal year 2000, incorporating appropriation action to date.

CBO's estimates are based on appropriation bills that have been signed by the President and, for those that have not yet been enacted into law, on the most recent conference agreements. The enclosed table provides CBO's estimate of how those bills would affect the on-budget surplus for fiscal year 2000. As you requested, the table displays the impact on that estimate of the adjustments made to CBO's figures for Congressional scorekeeping purposes—with the exception of the adjustment made for contingent emergencies.

In response to numerous questions about the on-budget deficit and related matters, CBO has prepared a memorandum entitled *Discretionary Spending Caps, Deficits, and the Social Security Surplus*, which provides some context for addressing the budgetary issues you have raised. A copy of that memorandum is enclosed.

If you wish further information, we will be pleased to provide it.

Sincerely,

Dan L. Crippen
Director

Enclosures

cc: Honorable Richard A. Gephardt
Minority Leader
U.S. House of Representatives

Honorable John R. Kasich
Chairman
House Committee on the Budget

Honorable John M. Spratt Jr.
Ranking Democratic Member

Honorable Pete V. Domenici
Chairman
Senate Committee on the Budget

Honorable Frank R. Lautenberg
Ranking Member

TABLE 1. ESTIMATED BUDGETARY IMPACT OF CURRENT APPROPRIATION ACTION FOR FISCAL YEAR 2000, AS OF OCTOBER 27, 1999 (In billions of dollars)

	Budget Authority	Outlays
Discretionary Appropriations (By bill)[a]		
Agriculture	22.7	22.7
Commerce, Justice, State, the judiciary	37.2	36.3
Defense	269.4	267.8
District of Columbia	0.4	0.4
Energy and water	21.3	21.0
Foreign operations	12.7	13.3
Interior	14.4	14.7
Labor, HHS, Education[b]	84.6	83.4
Legislative	2.5	2.5
Military construction	8.4	8.8
Transportation	13.6	44.7
Treasury and general government	13.7	14.7
Veterans, HUD, independent agencies	71.9	83.7
Subtotal[a]	572.9	614.1
Across-the-board reduction of 0.97 percent	-5.7	-3.5
Savings from additional collections of defaulted student loans	-0.1	-0.1
Total[a]	567.1	610.5
CBO's July 1999 Baseline Estimate of Discretionary Appropriations	539.3	579.8
Difference (Total appropriations minus baseline estimate)	27.8	30.7
Additional Interest Costs Resulting from Higher Appropriations	n.a.	0.8
Total Change from Baseline	n.a.	31.5
CBO's July 1999 Baseline Estimate of the On-Budget Surplus	n.a.	14.4
CBO's Estimate of the On-Budget Deficit (-) Reflecting Appropriation Action to Date[a]	n.a.	-17.1
Congressional Scorekeeping Adjustments[b]	3.4	18.1
Projected On-Budget Surplus Under Congressional Scoring	n.a.	1.0

SOURCE: Congressional Budget Office.

NOTE: HHS = Department of Health and Human Services; HUD = Department of Housing and Urban Development; n.a. = not applicable.

a. CBO estimates, excluding scorekeeping adjustments.

b. Reductions applied to CBO's estimates for Congressional scorekeeping purposes; not included in any of the figures above. Includes $0.4 billion in debt service savings, but does not include $1.6 billion in adjustments for contingent emergencies.

DISCRETIONARY SPENDING CAPS, DEFICITS, AND THE SOCIAL SECURITY TRUST FUNDS

October 28, 1999

The current budget debate centers around two distinct objectives. The first is adherence to the statutory caps on discretionary spending specified in the Balanced Budget Act of 1997 (BBA). The BBA extends an accounting framework for discretionary spending and requires across-the-board cuts (sequestration) if the caps are exceeded. The executive branch alone determines whether a sequestration is needed and, if so, executes it.

The second objective is avoiding an on-budget deficit—that is, avoiding the need to borrow from the Social Security trust funds to finance non-Social Security spending. Whether that objective is met depends on the total amount of revenues and spending in the rest of the budget. No enforcement mechanism, such as sequestration, exists to ensure the attainment of that goal.

Those two objectives are related but are not identical, and actions taken to achieve one of them would not necessarily increase the likelihood of achieving the other. In addition, confusion exists about the relationship between on-budget deficits and the Social Security surplus. In response to numerous questions, the Congressional Budget Office (CBO) has prepared this memorandum to provide some context for addressing those issues.

Limits of Budget Estimates

It is important to keep in mind that at this stage in the budget process, all of the numbers being presented are estimates of outcomes over the next 12 months. Even without future Congressional action, at this time next year, current estimates of total revenues and outlays will probably have proved to be too high or too low by significant amounts. Fourteen months ago, for example, CBO predicted an on-budget deficit of $37 billion for fiscal year 1999. (The spending and income of the Social Security trust funds and the Postal Service are defined by law as off-budget. All other spending and income of the government are on-budget.) In fact, the on-budget accounts were virtually in balance that year, recording a deficit of only $1 billion.

At present, the primary focus of the budget debate is the outlays that will occur in fiscal year 2000 as a result of discretionary appropriations of budget authority. On that score—estimating the outlays from discretionary budget authority—CBO has an admirable track record. Between 1993 and 1998, its projections of appropriated spending each year differed from actual outlays by an average of just

$2 billion, or 0.4 percent (disregarding whether the difference was above or below actual spending).

However, for the remainder of the budget (revenues and mandatory spending), CBO's projections—along with those of the Office of Management and Budget (OMB) and other forecasters—have not been as accurate. With total federal revenues and outlays in the vicinity of $1.8 trillion each year and a national economy of $9 trillion, even small variations from the forecasts for economic variables, tax revenues, or mandatory spending can lead to changes in the surplus or deficit of tens of billions of dollars. For fiscal year 2000, if revenues and outlays differ from CBO's estimates by as little as 1 percent, the on-budget surplus could be $36 billion higher or lower. Thus, the on-budget surplus for 2000 could differ substantially from CBO's baseline projection of $14 billion, even if the two objectives mentioned above are met.

Discretionary Spending Caps

The caps on discretionary spending are moving targets rather than permanently fixed values. The caps can be adjusted upward to account for funding designated as emergency requirements and for certain other, generally small, items. OMB, which is responsible for determining compliance with the caps, may also make adjustments to reflect changes in budgetary concepts and definitions. As a result of those various types of changes, the caps on discretionary outlays for 2000 have increased from a total of $564.3 billion (as initially set in the Balanced Budget Act) to $575.8 billion (as specified in OMB's *Sequestration Update Report*, issued on August 25, 1999).

Adherence to the caps is enforced through sequestration, which involves across-the-board cuts in funding for discretionary programs. After this session of Congress ends, OMB will determine whether a sequestration is required on the basis of its estimates of the discretionary caps as adjusted and of the spending that will result from appropriation actions. CBO produces estimates of both the caps and spending, but for the sequestration process, those estimates are purely advisory.

In CBO's view, the President's most recent budget request and House and Senate appropriation action to date all exceed the outlay caps for 2000 by similar amounts. CBO estimates that discretionary outlays from the policies of the President's *Mid-Session Review* would exceed CBO's July 1 estimate of the caps by $35 billion. The Administration, by contrast, asserts that those policies would adhere to the caps—in part because it estimates lower outlays from the policies and in part because it has proposed a number of offsets (such as tobacco taxes and Medicare savings) that CBO believes cannot be used to offset discretionary spending under the provisions of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended.

CBO estimates that Congressional appropriation action, as of October 27, also exceeds its July 1 estimate of the outlay caps—by a total of about $31 billion. But even though estimated outlays exceed the caps, a sequestration may not occur. A significant part of the overage—about $26 billion—results from spending that has been designated as emergency requirements. If the President concurs with the designation, that spending will result in corresponding upward adjustments to the caps.

In addition, OMB's estimates of outlays are lower than CBO's, especially for defense spending—and OMB's estimates are the ones that determine the need for a sequestration. Indeed, the budget committees' scoring of the appropriation bills includes scorekeeping adjustments intended to approximate the Administration's outlay estimates. Depending on the funding levels established in the appropriation bills that have not yet been enacted, the combination of emergency designations and lower outlay estimates may be enough for OMB to determine that a sequestration is not required.

On-Budget Surpluses or Deficits

The second budget issue that has received much attention lately is whether an on-budget surplus will result in fiscal year 2000. Whether discretionary spending adheres to the statutory caps, as determined by OMB, can affect whether the government ultimately achieves an on-budget surplus, but the first does not guarantee the second. It is possible to exceed the caps and still have an on-budget surplus; conversely, it is possible to adhere to the caps and still have an on-budget deficit. (The sequestration procedures are aimed at holding spending under the caps, not necessarily at avoiding on-budget deficits.)

Two major factors can account for those different outcomes: spending for which the caps are adjusted and estimating errors. Although the caps may be increased for spending designated as emergency requirements, such spending still counts toward determining the on-budget surplus or deficit. Thus, appropriating emergency funds is not a violation of the caps, but it will result in additional outlays that will lessen or eliminate an on-budget surplus.

Estimating errors can have a similar result. If the estimates of outlays used to determine compliance with the caps are too low, spending may appear to fall within the statutory limits when, in reality, it will exceed them. The use of OMB estimates—or scorekeeping adjustments that approximate them—creates such a possibility, particularly because the Administration has routinely underestimated defense spending in recent years.

CBO's current estimates indicate that there is some room to exceed the spending implied by the discretionary caps while still maintaining an on-budget surplus. In its summer update of the baseline, CBO projected an on-budget surplus of $14 billion for 2000, assuming that discretionary outlays would be about $580 billion (CBO's estimate of the discretionary caps at that time). If those projections are accurate, discretionary spending could exceed CBO's estimate of the caps by up to $14 billion without causing an on-budget deficit.

Both the President's budget proposals and Congressional action would result in discretionary spending that, by CBO's estimates, would exceed the caps by more than $14 billion and thus result in an on-budget deficit for 2000. CBO estimates that the President's budget, if enacted in full, would result in an on-budget deficit of $7 billion. That number is considerably lower than the amount by which his budget would exceed the spending caps because of his proposals to offset total outlays with revenue increases and Medicare reductions. However, the President's budget does not include provisions for some of the emergency appropriations that have been enacted. For example, the emergency agriculture package will add approximately $8 billion to outlays. Including that sum, the on-budget deficit for 2000 under the President's proposals would increase to $15 billion even if the offsets were enacted.

Outlays from Congressional action on appropriation legislation, including the latest action on all 13 regular appropriation bills, would also exceed the discretionary caps by more than CBO's baseline estimate of the on-budget surplus. After taking that surplus into account, CBO projects an on-budget deficit of about $17 billion (see Table 1).

The Social Security Surplus

The current off-budget surplus is much larger than any on-budget surplus projected for the near future. The Social Security trust funds account for virtually all of that off-budget surplus. (The net income or spending of the Postal Service is quite small in comparison.)

Income credited to the Social Security trust funds (from tax revenues and interest on the funds' holdings of Treasury securities) exceeded spending for Social Security benefits and administrative costs by about $125 billion in fiscal year 1999. CBO expects that, under current law, the Social Security surplus will grow to $147 billion in 2000. What happens to that money?

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Memorandum:		
Emergency Designations[b]	27.2	25.8
Congressional Scorekeeping Adjustments[c]	3.4	19.3

SOURCE: Congressional Budget Office.

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That surplus is invested in Treasury securities and earns interest for the trust funds. The cash that the Treasury receives in return for those securities can be used in two ways. If the revenues and expenses of the rest of the government (other than Social Security) are in balance, the cash generated by the Social Security surplus is used to reduce federal borrowing from the public—that is, to pay down the debt. Alternatively, if the budget of the rest of the government is in deficit, some of the cash generated by the Social Security surplus is used to pay other expenses of the government and to avoid the need to borrow from the public to support that spending. In either case, the balances credited to the Social Security trust funds and the government's legal obligation to pay Social Security benefits are unaffected.

Surpluses, both on-budget and off-budget, nevertheless have significant benefits because they allow the government to reduce debt held by the public. Such debt reduction cuts the government's interest costs, adding further to the surplus or providing more resources to be used for other purposes. In the long run, substantial reductions in federal debt held by the public can add significantly to national saving, thus enhancing economic growth and better equipping the nation to bear the economic and budgetary burdens imposed by the aging of the baby-boom generation.