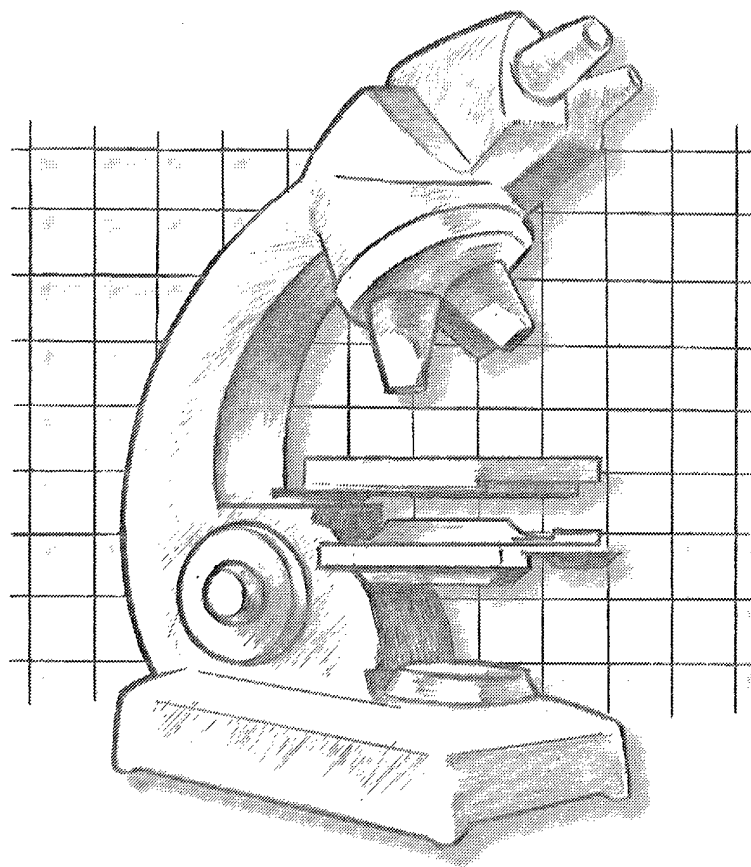


CONGRESS OF THE UNITED STATES
CONGRESSIONAL BUDGET OFFICE

An Analysis of the President's Budgetary Proposals for Fiscal Year 1999



PREPARED AT THE REQUEST OF THE
SENATE COMMITTEE ON APPROPRIATIONS



MARCH 1998

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**AN ANALYSIS OF THE PRESIDENT'S
BUDGETARY PROPOSALS
FOR FISCAL YEAR 1999**

The Congress of the United States
Congressional Budget Office

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NOTES

Unless otherwise indicated, all years referred to in Chapter 2 are calendar years, and all years in other chapters and the appendixes are fiscal years.

Some figures in this report indicate periods of recession by using shaded vertical bars. The bars extend from the peak to the trough of the recession.

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

The tables showing CBO's estimate of the effects of the President's budgetary proposals do not include the effects of his requests for 1998 supplemental appropriations that were made after the budget was submitted.

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

Preface

This analysis of the President's budget for fiscal year 1999 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 Frank Sammartino. Jeff Holland wrote the summary, Daniel Kowalski wrote Chapter 1 with assistance from Mark Booth and Marjorie Miller, and John Peterson wrote Chapter 2. Appendix A was written by Jennifer Winkler, and Appendix B was written by James Baumgardner, Sandra Christensen, and Jeffrey Lemieux. 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.

Sherry Snyder supervised the editing of the report, and Kathryn Quattrone supervised production. Major portions were edited by Leah Mazade and Christian Spoor. Melissa Burman 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 prepared the report for publication, with assistance from Martina Wojak-Piotrow. Laurie Brown prepared the electronic versions for CBO's World Wide Web site.

June E. O'Neill
Director

March 1998

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Summary

As requested by the Senate Committee on Appropriations, the Congressional Budget Office (CBO) has estimated the effects of the President's budget proposals for fiscal year 1999 using its own economic and technical assumptions. CBO estimates that the President's policies will reduce projected baseline surpluses for the total budget by \$43 billion between 1999 and 2003—and will temporarily dip the budget back into red ink by a small amount in 2000. Nonetheless, the overall picture is one of continuing surpluses through 2003.

Yet the good news embodied in the projections by both CBO and the Office of Management and Budget could easily be reversed. If revenue growth this year is just one-half of one percent lower than expected, the budget could remain in deficit. Alternatively, continued robust economic growth could push up estimated surpluses. In any case, deficits or surpluses over the next several years that differ from current projections by upward of \$100 billion are entirely possible.

The President's Budgetary Policies

CBO estimates that compared with its baseline projections, the policies outlined in the President's budget will decrease the surplus in each year from 1999 through 2003. CBO also expects that surpluses under those policies will turn out to be lower than projected by the Administration. Nevertheless, the President's budget is estimated to produce a \$42 billion surplus in 2003.

CBO's Estimates of the President's Policy Proposals

The President's plan would reduce the surpluses projected by CBO under current policies by \$43 billion over the 1999-2003 period (see Summary Table 1). In 1998, though, the President's proposals would increase the surplus by nearly \$1 billion.

The President's budget was designed to offset increases in spending for some programs with increases in revenues and decreases in spending for other programs. However, CBO estimates that net increases in spending will exceed additional revenues by between \$5 billion and \$16 billion a year over the five-year period.

Under the President's proposals, total revenues would exceed the CBO baseline by \$12 billion in 1999 and \$18 billion by 2003. The net boost in revenues stems mostly from assumed new revenues from tobacco companies totaling \$65 billion through 2003. The budget, however, does not specify the policies that might be implemented to raise that \$65 billion. Because there are a number of ways to achieve that end, the Joint Committee on Taxation, which estimates the effects of proposed changes to the tax code, simply accepted the Administration's totals. In addition, the budget proposes cumulative tax reductions of about \$24 billion through 2003 (such as an increase in the child and dependent care tax credit), which are offset by revenue increases of \$26 billion (for example, repealing the ability of certain multinational firms to expand their use of foreign tax credits and thereby decrease their federal tax payments) and other initiatives worth about \$12 billion.

CBO estimates that the increases in spending proposed in the President's budget will outstrip the revenues intended to cover the new programs. In particular, CBO estimates that discretionary spending proposed by the President will increase outlays above CBO's baseline by \$90 billion from 1999 through 2003, and proposals related to mandatory programs will boost out-

lays by \$28 billion over the same period. In total, the President's proposals would increase spending by \$118 billion over five years (not including additional debt-service costs).

Under the President's policies, discretionary outlays would rise from \$558 billion in 1998 to \$573 billion in

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

	1998	1999	2000	2001	2002	2003	Total, 1999- 2003
CBO Surplus Projections	8	9	1	13	67	53	n.a.
Effect on the Surplus of the President's Budgetary Policies							
Revenues							
Tobacco-related	0	10	12	13	15	16	65
Tax incentives	a	-3	-4	-5	-5	-6	-24
Revenue offsets	a	4	5	5	5	6	26
Other	<u>a</u>	<u>1</u>	<u>3</u>	<u>3</u>	<u>3</u>	<u>2</u>	<u>12</u>
Total	a	12	15	17	18	18	80
Outlays							
Discretionary	a	-12	-15	-15	-27	-22	-90
Mandatory							
Tobacco-related activities	0	-3	-4	-5	-5	-5	-22
Reduce class size in schools	0	a	-1	-1	-1	-2	-5
Repeal VA smoking decision	0	a	1	2	3	4	10
Other	<u>1</u>	<u>-2</u>	<u>-2</u>	<u>-3</u>	<u>-2</u>	<u>-2</u>	<u>-10</u>
Subtotal	1	-5	-6	-6	-6	-5	-28
Total	1	-17	-20	-21	-32	-27	-118
Total Effect of Policies	1	-5	-5	-4	-14	-9	-38
Debt Service	<u>a</u>	<u>a</u>	<u>a</u>	<u>-1</u>	<u>-1</u>	<u>-2</u>	<u>-4</u>
Total Effect on the Surplus	1	-5	-6	-5	-16	-11	-43
Surplus or Deficit (-) Under the President's Budgetary Policies as Estimated by CBO	8	4	-5	8	51	42	n.a.

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

NOTES: VA = Department of Veterans Affairs; n.a. = not applicable.

a. Less than \$500 million.

1999—an increase of less than 3 percent but \$12 billion above the statutory caps on such spending. Discretionary spending would continue to grow in the President's budget, reaching \$598 billion in 2003.

Among the Administration's initiatives for mandatory spending are proposals to allow certain groups of people who do not currently have access to employer- or government-sponsored health insurance to purchase Medicare coverage. Although CBO makes somewhat different assumptions about participation rates and costs per person than the Administration does, it generally concurs with the Administration's estimate that the provisions would have a small net budgetary impact. Net costs to the federal government would be held down by the high cost of the specified premiums and the stringency of the eligibility criteria, both of which severely limit the number of people who are likely to take advantage of the proposals.

Although the hike in net spending resulting from the President's proposals reduces projected baseline surpluses, CBO still estimates surpluses for each year (except for 2000) through 2003 under the President's policies. From an expected level of \$8 billion in 1998, the surplus is projected to rise to \$51 billion in 2002 before falling in 2003.

CBO's Estimates Compared with Those of the Administration

Although the pattern in the bottom line suggested by CBO's analysis of the President's budget is roughly similar to that estimated by the Administration, the surpluses that CBO projects are smaller. In addition, CBO estimates a small deficit in 2000. The Administration projected that by 2003 the surplus would reach \$83 billion, whereas CBO's estimate of the surplus in that year is about half that size (see Summary Table 2).

Variations between CBO and the Administration in estimating the deficit or surplus arise from baseline differences as well as differences in estimates of the effect of the President's policy proposals. In 1999 and 2000, variations in policy estimates are larger; however, from 2001 through 2003, baseline differences account for the major share of the discrepancy in the two projections.

Baseline Differences. The greatest differences between the two sets of current-policy projections are on the outlay side. The largest of those differences is in estimates of Medicare spending. The Administration expects that total outlays for Medicare over the next six years (including premiums paid to the government by Medicare beneficiaries) will be \$50 billion lower than CBO projects, largely because the Administration believes that policies enacted in last year's Balanced Budget Act will produce more savings than CBO had estimated. Indeed, Medicare alone accounts for around half of each year's difference in projected baseline outlays.

In addition, higher projections by CBO of inflation compared with those of the Administration push up estimates of spending for programs affected by cost-of-living increases (such as Social Security and Civil Service Retirement). Moreover, higher estimated unemployment and interest rates boost spending on unemployment insurance and net interest on the public debt, respectively. Overall, though, the Administration's assumptions about the performance of the economy over the next six years are not very different from CBO's.

In 1998, CBO's estimate of revenues is significantly higher than that of the Administration, mostly as a result of recent information about receipts for this year that was not available at the time of the Administration's (or CBO's January 1998) forecast. From 1999 through 2003, however, differences between CBO's and the Administration's revenue estimates under current policies are relatively small.

Differences in Policy Estimates. Almost all of the differences in policy estimates relate to the outlay side of the budget—and mostly to discretionary spending. CBO estimates that annual outlays for defense spending and subsidized housing, among other discretionary programs, will be higher under the President's proposed levels of funding than the Administration has estimated.

The major difference in mandatory outlays comes from the savings produced by repealing the recent ruling of the Department of Veterans Affairs that nicotine dependence can be considered a service-related disease for purposes of compensation. The Administration estimates that costs over the 1999-2003 period will be \$7 billion higher under current policies than CBO projects

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

	1998	1999	2000	2001	2002	2003
Deficit (-) or Surplus Under the President's Budgetary Policies as Estimated by the Administration	-10	10	9	28	90	83
Baseline Differences						
Revenues	22	9	5	1	-1	-2
Outlays						
Discretionary	5	a	-1	-1	-1	2
Mandatory	-1	6	9	16	23	31
Subtotal	4	6	9	15	23	34
Total ^b	18	3	-4	-15	-24	-36
Differences in Estimates of Proposed Policies						
Revenues	a	-1	a	a	-1	-1
Outlays						
Discretionary	a	7	7	4	11	a
Mandatory	-1	1	3	1	3	4
Subtotal	-1	8	10	6	14	4
Total ^b	1	-9	-9	-6	-15	-5
All Estimating Differences						
Total Differences ^b	18	-6	-13	-20	-39	-41
Deficit (-) or Surplus Under the President's Budgetary Policies as Estimated by CBO	8	4	-5	8	51	42

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

b. Reductions in the surplus are shown with a negative sign.

and therefore shows \$7 billion more in savings from repealing the decision.

CBO's Revised Baseline

In the course of preparing its annual analysis of the President's budget, CBO typically updates its baseline projections to take account of new information from the

President's budget and other sources. The revised March projections then usually become the baseline for the budget resolution.

CBO's new March projections are not materially different from those issued in its January 1998 report, *The Economic and Budget Outlook: Fiscal Years 1999-2008*. The only major change since January is an increase in revenues from 1998 through 2000 to reflect more rapid inflows into the Treasury than either CBO or the Administration had anticipated. That change,

however, is enough to shift CBO's projections from small annual deficits to small annual surpluses during those years. CBO expects that the budget surplus for this year will be nearly \$8 billion. Assuming that current policies do not change and that the economy stays on the anticipated course, surpluses are projected to rise eventually to \$138 billion in 2008.

Both federal spending and revenues are expected to total around \$1.7 trillion this year—or approximately 20 percent of gross domestic product. Under CBO's baseline assumptions, projected outlays as a percentage of GDP fall gradually to 18.3 percent by 2008. Revenues decline to 19.3 percent of GDP by 2003 and remain at that level through 2008.

The President's Budgetary Proposals

The spending policies proposed in the President's budget for fiscal year 1999 would boost outlays by a net \$123 billion (including debt service) over the 1999-2003 period, the Congressional Budget Office (CBO) estimates.¹ Over the same period, the President's policies would increase revenues by \$80 billion. About three-fourths of the increase in outlays, \$90 billion, would result from higher discretionary spending—the one-third of federal spending that is subject to annual appropriations by the Congress. The President's proposals for discretionary spending exceed the statutory limits on discretionary outlays by a total of \$64 billion through 2002.

The Office of Management and Budget (OMB) estimates that the President's budget would not change the budgetary outlook over the next five years because its proposed revenue increases would offset the net increase in spending. CBO, by contrast, estimates that the outlay proposals would cost a net \$42 billion more through 2003 than OMB predicts—which, combined with small differences in the estimates of revenue proposals, leaves \$43 billion in new spending to be financed from budget surpluses.

Spending Proposals

By CBO's estimate, federal spending would rise from \$1.7 trillion in 1998 to \$2.0 trillion in 2003 under the President's plan, an average increase of 3.5 percent a

1. That figure is relative to CBO's baseline, which assumes that current laws remain unchanged and that discretionary outlays are held to the levels of the existing spending caps for 1999 through 2002 and grow at the rate of inflation thereafter.

year. As a share of gross domestic product (GDP), outlays would remain at 20 percent in 1999—the same level projected for 1998—before beginning a descent to 19.1 percent by 2002 (see Table 1). Two factors would cause most of the decline in spending as a percentage of GDP: slow growth in discretionary spending and a reduction in net interest costs. (The government's net interest expenses will decline because the stock of outstanding federal debt will begin to decrease as the total budget's bottom line moves from deficit to surplus.) In the other direction, mandatory spending—primarily for Medicare and Medicaid—would continue to rise as a share of the nation's output.

Beyond the five-year budget horizon, that trend of increasing health care expenditures is expected to continue. In addition, Social Security outlays are expected to begin rising modestly as a share of GDP as the baby boomers approach retirement and experience higher disability rates. Nevertheless, the projected budget surplus would continue to rise—primarily because discretionary spending would be held in check under the Administration's assumptions and net interest expenses would decline further.

Discretionary Spending

Discretionary spending is subject to statutory caps through 2002 on both budget authority and outlays. For fiscal year 1999, the law establishes three categories for discretionary spending: defense, nondefense, and spending to reduce violent crime. For 2000, it combines defense and nondefense spending into a single discretionary category while retaining the violent crime reduction category. For 2001 and 2002, the law folds all three types of spending into one discretionary

Table 1.
CBO Estimate of the President's Budgetary Policies, 1998-2008 (By fiscal year)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
In Billions of Dollars											
Revenues	1,680	1,751	1,799	1,863	1,948	2,026	2,124	2,227	2,333	2,446	2,560
Outlays											
Discretionary											
Defense	269	270	273	272	280	290	298	308	312	317	328
Nondefense	<u>288</u>	<u>303</u>	<u>306</u>	<u>307</u>	<u>307</u>	<u>308</u>	<u>311</u>	<u>315</u>	<u>322</u>	<u>329</u>	<u>337</u>
Subtotal	558	573	580	579	587	598	608	623	634	646	664
Mandatory											
Social Security	376	392	409	428	449	471	496	522	551	582	614
Medicare	197	208	219	240	246	271	292	325	331	366	393
Medicaid	101	108	115	122	131	141	152	165	179	194	210
Other	<u>277</u>	<u>301</u>	<u>325</u>	<u>342</u>	<u>357</u>	<u>374</u>	<u>389</u>	<u>411</u>	<u>423</u>	<u>435</u>	<u>460</u>
Subtotal	951	1,009	1,067	1,132	1,183	1,257	1,329	1,423	1,483	1,577	1,678
Offsetting receipts	-82	-83	-87	-92	-105	-98	-104	-110	-116	-122	-128
Net interest	<u>245</u>	<u>247</u>	<u>243</u>	<u>237</u>	<u>231</u>	<u>227</u>	<u>222</u>	<u>216</u>	<u>210</u>	<u>202</u>	<u>193</u>
Total	1,671	1,747	1,803	1,855	1,897	1,983	2,056	2,152	2,211	2,303	2,407
Surplus or Deficit (-)	8	4	-5	8	51	42	68	75	121	142	153
Debt Held by the Public	3,774	3,785	3,803	3,810	3,774	3,747	3,694	3,634	3,528	3,399	3,260
As a Percentage of Gross Domestic Product											
Revenues	20.1	20.1	19.8	19.6	19.6	19.5	19.5	19.5	19.5	19.5	19.5
Outlays											
Discretionary											
Defense	3.2	3.1	3.0	2.9	2.8	2.8	2.7	2.7	2.6	2.5	2.5
Nondefense	<u>3.4</u>	<u>3.5</u>	<u>3.4</u>	<u>3.2</u>	<u>3.1</u>	<u>3.0</u>	<u>2.8</u>	<u>2.8</u>	<u>2.7</u>	<u>2.6</u>	<u>2.6</u>
Subtotal	6.7	6.6	6.4	6.1	5.9	5.7	5.6	5.4	5.3	5.2	5.1
Mandatory											
Social Security	4.5	4.5	4.5	4.5	4.5	4.5	4.5	4.6	4.6	4.6	4.7
Medicare	2.4	2.4	2.4	2.5	2.5	2.6	2.7	2.8	2.8	2.9	3.0
Medicaid	1.2	1.2	1.3	1.3	1.3	1.4	1.4	1.4	1.5	1.5	1.6
Other	<u>3.3</u>	<u>3.5</u>	<u>3.6</u>	<u>3.6</u>	<u>3.6</u>	<u>3.6</u>	<u>3.6</u>	<u>3.6</u>	<u>3.5</u>	<u>3.5</u>	<u>3.5</u>
Subtotal	11.4	11.6	11.7	11.9	11.9	12.1	12.2	12.4	12.4	12.6	12.8
Offsetting receipts	-1.0	-1.0	-1.0	-1.0	-1.1	-0.9	-1.0	-1.0	-1.0	-1.0	-1.0
Net interest	<u>2.9</u>	<u>2.8</u>	<u>2.7</u>	<u>2.5</u>	<u>2.3</u>	<u>2.2</u>	<u>2.0</u>	<u>1.9</u>	<u>1.8</u>	<u>1.6</u>	<u>1.5</u>
Total	20.0	20.0	19.8	19.5	19.1	19.1	18.8	18.8	18.5	18.4	18.3
Surplus or Deficit (-)	0.1	a	a	0.1	0.5	0.4	0.6	0.7	1.0	1.1	1.2
Debt Held by the Public	45.1	43.4	41.8	40.1	38.0	36.0	33.9	31.8	29.5	27.1	24.8
Memorandum:											
Gross Domestic Product (Billions of dollars)	8,369	8,729	9,097	9,499	9,933	10,405	10,909	11,431	11,973	12,539	13,129

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent.

Table 2.
CBO Estimate of the President's Discretionary Spending Proposals Compared with the Limits on Discretionary Spending, 1999-2002 (By fiscal year, in billions of dollars)

	1999		2000		2001		2002	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Statutory Limits from OMB's Sequestration Preview Report								
Defense	271.6	266.6	*	*	*	*	*	*
Nondefense ^a	255.5	289.3	*	*	*	*	*	*
Violent crime reduction	5.8	5.0	4.5	5.6	*	*	*	*
Overall discretionary ^b	*	*	<u>532.5</u>	<u>559.1</u>	<u>541.8</u>	<u>564.1</u>	<u>550.8</u>	<u>560.3</u>
Combined Limits	532.8	560.9	537.0	564.7	541.8	564.1	550.8	560.3
Adjustments to the Limits Under Current Law for the President's Proposals								
Defense	0	0	*	*	*	*	*	*
Nondefense	3.7 ^c	0.8 ^c	*	*	*	*	*	*
Violent crime reduction	0	0	0	0	*	*	*	*
Overall discretionary ^b	*	*	<u>0.6</u>	<u>1.2^c</u>	<u>0.6</u>	<u>1.3</u>	<u>0.6</u>	<u>1.2</u>
Combined Adjustments	3.7	0.8	0.6	1.2	0.6	1.3	0.6	1.2
Statutory Limits Under the President's Proposals as Estimated by CBO								
Defense	271.6	266.6	*	*	*	*	*	*
Nondefense	259.1	290.1	*	*	*	*	*	*
Violent crime reduction	5.8	5.0	4.5	5.6	*	*	*	*
Overall discretionary ^b	*	*	<u>533.1</u>	<u>560.4</u>	<u>542.4</u>	<u>565.4</u>	<u>551.4</u>	<u>561.6</u>
Combined Limits	536.5	561.6	537.6	565.9	542.4	565.4	551.4	561.6
Discretionary Spending Under the President's Proposals as Estimated by CBO								
Defense	272.0	270.2	*	*	*	*	*	*
Nondefense	267.6	298.2	*	*	*	*	*	*
Violent crime reduction	5.8	5.0	4.5	5.4	*	*	*	*
Overall discretionary ^b	*	*	<u>541.5</u>	<u>574.3</u>	<u>553.6</u>	<u>578.7</u>	<u>560.3</u>	<u>586.9</u>
Combined Spending	545.4	573.4	546.0	579.6	553.6	578.7	560.3	586.9
Amount Spending Is Over or Under (-) Limits								
Defense	0.4	3.6	*	*	*	*	*	*
Nondefense	8.5	8.2	*	*	*	*	*	*
Violent crime reduction	0	d	0	-0.2	*	*	*	*
Overall discretionary ^b	*	*	<u>8.4</u>	<u>13.9</u>	<u>11.3</u>	<u>13.3</u>	<u>8.9</u>	<u>25.3</u>
Combined Spending	8.9	11.8	8.4	13.7	11.3	13.3	8.9	25.3

SOURCE: Congressional Budget Office.

NOTE: OMB = Office of Management and Budget; * = not applicable.

a. Does not include conversion of Department of Transportation obligation limitations to discretionary budget authority.

b. This category comprises defense and nondefense spending in fiscal year 2000, plus violent crime reduction spending in 2001 and 2002.

c. The President proposes legislation to permit a cap adjustment for nondisability determinations of eligibility in the Supplemental Security Income program. If the proposal was adopted, the nondefense budget authority limit for 1999 would be increased by \$50 million, and the outlay limits would be increased by \$46 million for 1999 and \$4 million for 2000.

d. Less than \$50 million.

category, so the limits apply to total discretionary spending. By law, the discretionary spending limits are adjusted periodically to account for specific changes, such as the enactment of emergency appropriations.

To compare the President's budgetary proposals for discretionary spending with the caps, CBO first had to determine what the spending caps would be if those proposals were enacted. Current law requires adjusting the caps for the effect of proposed 1999 emergency appropriations, as well as for the full budgetary effect of appropriations for certain purposes specified in the law (including ensuring compliance with the earned income tax credit, conducting additional reviews to determine the eligibility of certain beneficiaries under the Social Security Act, and paying U.S. arrearages to international organizations). Those adjustments increase the cap on budget authority by \$3.7 billion for 1999 and by about \$600 million for each subsequent year through 2002 (see Table 2 on the previous page). The required increases in the outlay cap total \$800 million for 1999 and more than \$1.2 billion a year for 2000 through 2002.

After making those adjustments, CBO concluded that the Administration's proposed discretionary spending exceeds the caps in every year between 1999 and 2002. For 1999, the Administration's appropriation proposals exceed the budget authority cap by almost \$9 billion and the outlay limit by nearly \$12 billion. Over the four-year period, the President's proposed budget authority exceeds the caps by a total of more than \$37 billion, and outlays surpass the caps by \$64 billion.²

CBO's estimates do not include the effects of the President's requests for supplemental 1998 appropriations that were transmitted after the budget was submitted. The most significant requested item is almost \$18 billion in budget authority for the International Monetary Fund (IMF). However, enactment of that proposal would not affect CBO's estimates of discretionary outlays for 1999 through 2002 because no outlays flow

from IMF budget authority. (See Box 1 for a further discussion of the President's IMF request.)

The President's budget mentions two alternatives for raising discretionary spending to the recommended levels without breaching the spending limits, but it does not propose either one. The first alternative would include legislative language that increases revenues or reduces mandatory spending in appropriation bills. Under current law, OMB would count the effects of such language in the coming year against that year's spending and would raise the caps on discretionary spending to account for the effects in future years. Under the second alternative, the Administration would seek legislation specifically authorizing the use of tax increases or spending cuts to offset increased discretionary spending.

According to the budget, the Administration would finance its discretionary spending increases with revenues from the anticipated tobacco settlement and the reinstatement of the Superfund tax, as well as with reductions in mandatory spending. Using increased revenues to offset increased discretionary spending is contentious. CBO believes that the Balanced Budget and Emergency Deficit Control Act of 1985 does not permit that practice—even if the legislation that increases revenues is included in an appropriation bill. CBO's interpretation of the law is that increases in revenues can only be used to offset increases in mandatory spending. OMB, however, does not agree with that interpretation. And since OMB determines compliance with the discretionary spending caps, it could permit the appropriations committees to make such changes in order to offset increased spending and achieve compliance with the caps. Use of that technique could raise the permitted levels of discretionary spending well above the current limits.

The bulk of the Administration's proposed increase in 1999 spending occurs in what the budget calls three Funds for America. Those new funds are merely presentational devices that repackage current nondefense research, environmental, and transportation spending and add new spending. The existing mechanisms for enforcing the discretionary spending limits would not be changed to give special treatment to that spending; it would be treated as nondefense discretionary spending for the purposes of calculating whether a sequestration

2. The President's proposals exceed CBO's baseline for discretionary spending by a slightly greater amount, because the baseline assumes that spending is held to the level of the current caps, not the caps adjusted under current law for the various proposals discussed above.

(an across-the-board cancellation of budgetary resources) was required.

In all, the discretionary budget authority that the President proposes for 1999 is \$17 billion, or 3.3 percent, higher than the amount enacted for 1998. The largest increases in budget authority are \$3.4 billion for defense and \$3.3 billion to create a reserve for emergencies and other spending needs (see Table 3). The increase in defense, however, would represent only a 1.3 percent rise from 1998 funding, less than the ex-

pected rate of inflation. Other substantial increases are proposed for community and regional development (principally for disaster relief) and for education and training (largely for an increase from \$3,000 to \$3,100 in the maximum Pell grant for undergraduate students).

By CBO's estimate, outlays in 1999 would be \$16 billion, or 2.8 percent, higher than in the current year. The largest growth would occur in the budget functions for education and training, allowances for emergencies and other needs, the administration of justice, and in-

Box 1.

The President's Supplemental Appropriation Request for the International Monetary Fund

The International Monetary Fund (IMF) aims to promote trade and financial stability by lending reserve assets to countries whose domestic currencies are threatened by sharp declines in the foreign exchange markets. The amount of loan assistance that the IMF can provide is limited by the size of its resources—namely, the pool of currencies and other internationally accepted assets that member countries pay into the fund. Those subscription amounts are specified in the countries' assigned quotas. In view of the significant growth of international trade and finance, the governors of the IMF adopted a resolution last year proposing a 45 percent increase in member quotas.

The President has requested \$17.9 billion in supplemental 1998 budget authority for the IMF, consisting of \$14.5 billion for the United States' quota increase and \$3.4 billion for a backup line of credit for the fund. The expanded authority to lend would support an IMF initiative, the New Arrangements to Borrow, that would make more reserve assets available in case the resources provided by member quotas prove inadequate.

U.S. quota subscriptions involve an exchange of monetary assets between the Treasury and the IMF. The United States turns over one form of internationally acceptable money and, in return, receives rights to draw international reserves from the IMF pool. The IMF has asked that the United States pay its quota increase in the form of special drawing rights (a currency created by the IMF for the use of its members), which the United States would ultimately buy from other IMF members. Only one-quarter of that \$14.5 billion quota increase, or about \$3.6 billion, would be transferred to the IMF in the form of special drawing rights. The rest would be provided in a letter of credit, which the IMF could draw on as

needed. Similarly, the \$3.4 billion for the New Arrangements to Borrow, if approved by the Congress, would not involve cash payments to the IMF unless circumstances threatened international economic stability.

Exchanges of monetary assets—which change the composition but not the level of the government's holdings of cash—are not counted as budgetary outlays. Accordingly, increasing the United States' IMF quota would not directly affect the budget surplus or deficit. The \$17.9 billion increase in resources would, however, require an appropriation of budget authority by the Congress. Under the Balanced Budget and Emergency Deficit Control Act of 1985, the discretionary spending caps, committee allocations, and budget ceilings can be adjusted so that no offsetting reductions in other discretionary spending would be required to accommodate the requested IMF appropriation.

Although the U.S. quota increase will not affect the budget surplus or deficit, it can affect the economy and carries potential benefits and costs. The benefits stem from helping the IMF serve as a lender of last resort. Although individual governments might be able to perform a similar function, the IMF makes coordinated action easier. Analysts disagree about the likely effects of that action, however. Much of the argument stems from different views about how well international financial markets work and how likely governments or international organizations are to introduce distortions in those markets. To the extent that the IMF protects banks against losses in foreign countries, it may create incentives for careless lending, resulting in harmful economic consequences. Additional economic consequences, positive and negative, could stem from the variety of conditions that may be attached to IMF loans.

come security. Those increases reflect the effect on 1999 outlays of appropriations enacted in prior years (which explains why outlays rise in some of those functions by more than budget authority) as well as the spending levels recommended by the President for 1999.

Under the President's budget, nondefense discretionary outlays would increase by \$15 billion from 1998 to 1999. A portion of that increase (\$9 billion) is attributable to appropriations enacted in prior years and will occur even if 1999 budget authority is frozen at 1998 levels; the rest is attributable to the first-year effect of the \$14 billion in increased budget authority

proposed by the President. Total nondefense outlays in 1999 would be \$1 billion higher than the amount needed to preserve 1998 real resources (see Table 4).

Defense outlays, by contrast, would increase by only \$1 billion next year under the President's budget. That figure represents the \$1 billion decline in outlays that will occur even if budget authority for defense is frozen, offset by the \$2 billion increase in outlays that would result from the President's proposed \$3 billion increase in budget authority. At that rate, defense outlays would rise more slowly than inflation between 1998 and 1999.

Table 3.
CBO Estimate of the President's Discretionary Spending Proposals for Fiscal Year 1999, by Function
(In billions of dollars)

Budget Function	1998 (Enacted)		1999 (Proposed)		Change from 1998 to 1999	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
National Defense	268.6	269.2	272.0	270.2	3.4	1.0
International Affairs	19.1	18.7	20.2	18.9	1.1	0.3
General Science, Space, and Technology	17.9	17.6	18.5	18.1	0.5	0.4
Energy	2.8	3.9	3.6	3.7	0.7	-0.3
Natural Resources and Environment	23.2	22.2	22.8	22.7	-0.4	0.5
Agriculture	4.3	4.2	4.1	4.2	-0.2	-0.1
Commerce and Housing Credit	3.0	2.8	3.0	2.8	a	a
Transportation ^b	13.7	40.0	13.8	41.0	a	1.1
Community and Regional Development	8.6	11.4	11.5	11.2	2.9	-0.2
Education, Training, Employment, and Social Services	46.4	42.6	48.6	46.2	2.2	3.6
Health	26.4	25.3	27.5	26.3	1.2	1.1
Medicare	2.7	2.8	2.6	2.7	-0.1	-0.1
Income Security	32.2	40.6	33.2	42.3	1.0	1.7
Social Security	3.2	3.3	3.2	3.5	a	0.2
Veterans Benefits and Services	19.1	19.1	18.9	19.1	-0.2	0.1
Administration of Justice	24.2	21.5	25.8	24.7	1.6	3.2
General Government	12.5	12.4	13.0	12.6	0.4	0.2
Allowances for Emergencies and Other Needs	0	0	3.3	3.3	3.3	3.3
Undistributed Offsetting Receipts	0	0	a	a	a	a
Total	528.0	557.6	545.4	573.4	17.4	15.8

SOURCE: Congressional Budget Office.

a. Less than \$50 million.

b. Does not include conversion of Department of Transportation obligation limitations to discretionary budget authority.

Mandatory Spending

The President is proposing changes in mandatory spending that, according to CBO's estimate, would increase outlays by a total of \$28 billion during the 1999-2003 period compared with CBO's baseline projections (see Table 5). That net increase results from a few major proposals and a multitude of smaller proposals that

would boost spending, partially offset by reductions in spending and increases in fees.

Miscellaneous Tobacco-Related Activities. The largest proposed increase in mandatory spending (\$22 billion over five years and almost \$52 billion over 10 years) is for grants to state, local, and territorial governments that the Administration would include in any

Table 4.
CBO Estimate of Discretionary Outlays in the President's Budget Compared with Various Benchmarks
(By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003
Discretionary Outlays in the President's Budget						
Defense	269	270	273	272	280	290
Nondefense	<u>288</u>	<u>303</u>	<u>306</u>	<u>307</u>	<u>307</u>	<u>308</u>
Total	558	573	580	579	587	598
Amount of Discretionary Outlays Needed to Preserve 1998 Real Resources						
Defense	269	275	284	286	297	306
Nondefense	<u>288</u>	<u>302</u>	<u>311</u>	<u>320</u>	<u>329</u>	<u>338</u>
Total	558	577	595	607	626	644
Discretionary Outlays Assuming Budget Authority Is Frozen at 1998 Levels						
Defense	269	268	270	265	267	267
Nondefense	<u>288</u>	<u>297</u>	<u>299</u>	<u>297</u>	<u>294</u>	<u>294</u>
Total	558	565	569	562	561	561
Discretionary Outlays in the President's Budget Compared with the Amount Needed to Preserve 1998 Real Resources						
Defense	0	-4	-11	-15	-17	-17
Nondefense	<u>0</u>	<u>1</u>	<u>-5</u>	<u>-13</u>	<u>-22</u>	<u>-29</u>
Total	0	-3	-15	-28	-39	-46
Discretionary Outlays in the President's Budget Compared with the Amount Assuming Budget Authority Is Frozen at 1998 Levels						
Defense	0	2	3	7	13	23
Nondefense	<u>0</u>	<u>6</u>	<u>7</u>	<u>10</u>	<u>12</u>	<u>15</u>
Total	0	8	11	17	26	37

SOURCE: Congressional Budget Office.

tobacco-related legislative package. Since the proposed spending increase is largely unspecified, CBO has adopted OMB's estimate of the cost.

Medicare. The President's Medicare proposals would increase benefit payments by \$7.9 billion over the 1999-2003 period, by CBO's estimate. Higher premiums from beneficiaries would offset \$7.6 billion of that spending, leaving a \$300 million net increase in Medicare outlays.

Medicare Buy-In. A pair of new initiatives would allow people ages 62 to 64 without Medicaid or employment-based health insurance and displaced workers ages 55 to 61 who were previously covered by employment-based insurance to buy Medicare coverage. CBO estimates that the premiums paid by those people would not fully cover the \$9.3 billion they would cost the Medicare system during the 1999-2003

period, thus increasing net Medicare spending by \$1.4 billion over that period. In addition, CBO estimates that the Medicare buy-in proposals would lead to higher Social Security costs (as people ages 62 to 64 retired because of the availability of health insurance apart from employment) and to higher tax receipts (as firms cut back on health coverage for older employees). Those effects would add \$200 million to the cost of the proposals by 2003. For an in-depth discussion of CBO's estimate of those proposals, see Appendix B.

Fraud and Abuse Provisions. The President's budget contains several proposals to improve compliance with the Medicare program. They include assessing a fee on providers to cover the cost of auditing and settling their Medicare claims, as well as imposing new civil monetary penalties on physicians who falsely certify a beneficiary's need for mental health or hospice benefits and on providers who participate in kickback schemes.

Table 5.
CBO Estimate of the Effect on Outlays of the President's Mandatory Spending Proposals
(By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003	Total, 1999- 2003	Total, 1999- 2008
Tobacco-Related Activities ^a	0	3.4	3.9	4.6	5.0	5.4	22.3	51.5
Medicare								
Benefits	0	0.7	1.4	1.6	1.9	2.2	7.9	23.6
Premiums	<u>0</u>	<u>-0.9</u>	<u>-1.3</u>	<u>-1.6</u>	<u>-1.8</u>	<u>-2.1</u>	<u>-7.6</u>	<u>-22.8</u>
Subtotal	0	-0.1	0.1	0.1	0.1	0.1	0.3	0.7
Medicaid and State Children's Health Insurance	0	-0.1	-0.1	-0.2	-0.2	-0.2	-0.9	-2.1
Cancer Clinical Trials	0	0.2	0.3	0.3	0	0	0.8	0.8
Food Stamps	0	0.3	0.3	0.2	0.2	0.2	1.2	2.0
Education ^b	-0.6	0.1	0.6	1.2	1.7	2.0	5.6	21.5
Child Care Entitlement to States	0	0.5	0.6	0.6	0.6	0.8	3.2	13.5
Unemployment Insurance	0	0.1	0.1	1.0	0.7	0.5	2.4	5.3
Veterans' Benefits	0	-0.1	-0.6	-1.6	-2.6	-3.6	-8.5	-42.0
Other	<u>c</u>	<u>0.3</u>	<u>0.4</u>	<u>0.3</u>	<u>0.2</u>	<u>c</u>	<u>1.4</u>	<u>-2.9</u>
Total	-0.6	4.6	5.5	6.5	5.8	5.3	27.7	48.1

SOURCE: Congressional Budget Office.

- The estimate is taken from the President's budget.
- For one of the components of this group—the proposal to reduce class size in the primary grades—the estimate is taken from the President's budget.
- Less than \$50 million.

Medicare fines or overpayments would also be given priority in bankruptcy cases. CBO estimates that those provisions would improve the Health Care Financing Administration's (HCFA's) ability to enforce compliance and increase its collection of penalties but would not have a significant effect on spending.

Medicare as Secondary Payer. In cases in which Medicare is the secondary payer, HCFA is responsible for paying the claim amount minus the amount paid by the primary insurer. Sometimes, however, HCFA unknowingly pays the primary insurer's share and must track down the overpayment later. This proposal would require private insurers to provide information that would help HCFA determine before a claim is paid whether another insurer is responsible for the beneficiary's primary payment. CBO estimates that the proposal would reduce Medicare spending by \$400 million from 1999 through 2003 and by \$1.1 billion over 10 years.

Pharmaceuticals. The Administration proposes changing the method that Medicare uses to reimburse physicians and dialysis facilities for drugs they administer to Medicare beneficiaries. Under the current method, Medicare pays 95 percent of the average wholesale price (AWP) of the drug. Under this proposal, it would pay the national AWP, or the actual acquisition cost (AAC) of the drug, or the median AAC of all claims for that drug, whichever was lowest. Based on the experience of Medicaid's rebate program, CBO expects that manufacturers would raise prices in response to this policy. Nevertheless, the proposal would save an estimated \$600 million over five years.

The budget would also reduce payments for the drug Epogen, which is administered to patients with end-stage renal disease, from \$10 per 1,000 units to \$9 per 1,000 units. That provision would save \$100 million over the 1999-2003 period, CBO estimates.

Medicaid and State Children's Health Insurance. The budget would increase spending for children's health care by allowing states to conduct presumptive checks of Medicaid eligibility at a broader range of sites, permitting states to restore Medicaid benefits for legal immigrant children, and increasing aid to U.S. territories to purchase health insurance for children. Those proposals would increase federal spending by

\$800 million over five years. That cost would be more than offset, however, by a proposed reduction in the federal matching rate for Medicaid administrative expenses (from 50 percent to 47 percent), producing net savings of \$900 million through 2003 and \$2.1 billion over 10 years.

The budget would also add \$25 million to expand the use of a \$500 million fund to help states determine eligibility for people who lose welfare benefits but retain Medicaid eligibility. Because that proposal interacts with the proposed change in the federal matching rate for administration, CBO estimates that adding \$25 million to the fund would reduce federal administrative spending by \$14 million over five years while not increasing benefit costs.

Cancer Clinical Trials. The President would establish a demonstration program for Medicare beneficiaries that would pay the costs of patient care incurred as part of federally sponsored cancer clinical trials. The demonstration program would run in 1999, 2000, and 2001 and would cost a total of \$750 million.

Food Stamps. The budget proposes increases in eligibility for the Food Stamp program partly offset by changes in administrative funding. The eligibility provisions would permit certain legal immigrants to receive benefits at a cost of \$2 billion over five years. At the same time, as with Medicaid, the federal matching rate for administrative expenses would fall from 50 percent to 47 percent. That change would reduce federal costs by \$900 million, CBO estimates, for a net increase in federal Food Stamp spending of \$1.2 billion through 2003. CBO also estimates that state spending would increase by \$400 million over five years if the matching rate declined.

Education. The President's major mandatory spending proposals in the area of education are a new initiative to reduce class size in the primary grades and changes to the federal student loan programs for college students. The initiative to reduce class size would involve grants to the states. OMB estimates that the program would cost more than \$5 billion over five years and \$17 billion over 10 years. Because the Administration has not presented a concrete proposal for distributing those grants, however, CBO cannot reestimate the cost of the initiative and thus has adopted OMB's estimate.

The numerous changes that the Administration is proposing to the student loan programs include reducing the fees paid by borrowers, offering extended repayment options, eliminating the use of bankruptcy to discharge student loan obligations, and recalling capital advances from state guarantee agencies. CBO estimates that those provisions would increase mandatory spending by about \$500 million over the 1999-2003 period. (That figure does not include the effect of a proposal to change the interest rate formula for student loans that the Administration made after submitting its budget.)

Child Care. The Administration proposes a substantial increase in mandatory grants to the states for child care. CBO assumes that part of the increase will take the form of higher levels for existing grants—in which the federal government matches state funding for child care—and part will take the form of new, unmatched grants. Current law already provides escalating funding levels for the existing grants, which states have not fully drawn on. Consequently, CBO estimates that the increase in those grants will not be tapped until 2003. Before then, CBO estimates, states will take advantage of only the unmatched grants, resulting in additional federal outlays of \$3.2 billion over five years, rising to \$13.5 billion over 10 years.

Unemployment Insurance. Under the President's proposals, the long-term unemployed would receive extended unemployment compensation if a state had an unemployment rate of 7.5 percent (provided that rate was at least 110 percent of the state's total unemployment rate for the same quarter in either of the past two years). CBO estimates that costs would increase beginning in 2001 and would total \$1.6 billion through 2003. Other proposals for unemployment insurance include mandatory funding for states' administrative activities and the use of alternative base periods in determining benefits. Those proposals would raise spending by an additional \$800 million through 2003.

Veterans' Benefits. The President would reverse a 1997 ruling by the Department of Veterans Affairs (VA) that awarded compensation benefits to veterans who have illnesses related to nicotine dependence. CBO estimates that overturning that ruling legislatively would save \$10 billion over five years and \$45 billion over 10 years. The President's budget also proposes an increase in education assistance for current service

members and their survivors, at a total cost of \$1.5 billion over the 1999-2003 period, CBO estimates.

Other. Other proposals for mandatory spending—which include raising the Environmental Protection Agency's contributions to hazardous waste remediation, increasing the Federal Housing Administration's ability to participate in mortgage finance, and requiring banks to pay the expenses of their regulators—would increase outlays by a net \$1.4 billion over the five-year budget horizon.

Revenue Proposals

Following up on the substantial tax cuts that the Congress and President agreed to last year, the President has proposed another, much more modest, set of cuts. In the President's budget, the cost of those cuts would be completely offset over the next 10 years through a variety of proposals that would raise taxes (mostly on certain businesses). The Administration's budget also includes proposals that, on net, would significantly increase receipts, largely to finance specific spending programs. The bulk of those additional receipts would come from unspecified tobacco legislation.

Provisions That Reduce Revenues

The proposed tax cuts include new and expanded credits for child care, credits for the purchase of energy-efficient vehicles and other items, expanded credits for the construction of low-income housing, credits for investing in Puerto Rico, and new education benefits. CBO and the Joint Committee on Taxation (JCT), which produced most of the revenue estimates, project that those and other provisions would reduce federal revenues by almost \$24 billion over the next five years (see Table 6).³ The proposed tax cuts are only about one-sixth of the size of those enacted last year in the Taxpayer Relief Act.

3. 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 1999 Budget Proposal*, JCX-14-98 (February 24, 1998). For detailed descriptions of the revenue proposals, see Joint Committee on Taxation, *Description of the Revenue Provisions Contained in the President's Fiscal Year 1999 Budget Proposal*, JCS-4-98 (February 24, 1998).

Credits for Child Care Expenses. The largest proposed revenue reduction in the President's budget involves expanding the personal tax credit related to expenses for child and dependent care. The credit is calculated as a percentage of qualifying expenses. Under current law, qualifying expenses are capped at \$2,400 for one dependent and \$4,800 for two or more; in general, they cannot exceed a taxpayer's earnings (or the earnings of the lower-earning spouse, in the case of a married couple). The President's proposal would not change those caps but would increase the maximum credit rate from 30 percent to 50 percent. As a result,

the maximum credit would rise from \$720 to \$1,200 for families with one child and from \$1,440 to \$2,400 for families with two or more children. In addition, the maximum rate would apply to taxpayers with income up to \$30,000, compared with up to \$10,000 under current law. The minimum credit rate would remain at 20 percent, but that rate would apply to taxpayers earning \$59,000 or more rather than \$28,000, as under current law. The President's proposal would also index the dollar amounts for inflation after 2000. Together, those changes would reduce revenues by about \$5 billion through 2003 and \$12 billion through 2008.

Table 6.
CBO Estimate of the President's Revenue Proposals (By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003	Total, 1999-2003	Total, 1999-2008
Provisions That Reduce Revenues								
Child and dependent care	0	-0.3	-1.1	-1.2	-1.3	-1.4	-5.3	-13.2
Education benefits	a	-0.3	-0.7	-1.2	-1.2	-1.1	-4.6	-10.3
Energy-efficient purchases	a	-0.5	-0.6	-0.6	-0.9	-1.2	-3.7	-9.5
Targeted business incentives								
Low-income housing	0	a	-0.1	-0.2	-0.3	-0.5	-1.1	-5.1
Expiring provisions	-0.2	-1.6	-1.2	-0.9	-0.5	-0.3	-4.5	-5.3
Puerto Rico investment	0	a	-0.1	-0.1	-0.2	-0.5	-1.0	-9.6
Foreign dividends	-0.1	-0.2	-0.2	-0.3	-0.3	-0.2	-1.2	-1.4
Other	<u>a</u>	<u>-0.2</u>	<u>-0.4</u>	<u>-0.5</u>	<u>-0.4</u>	<u>-0.5</u>	<u>-2.0</u>	<u>-3.9</u>
Subtotal	-0.3	-3.2	-4.5	-5.0	-5.1	-5.8	-23.5	-58.4
Provisions That Increase Revenues								
Export sales source	a	0.8	1.8	1.9	2.0	2.2	8.6	22.3
Life insurance and annuities ^b	0	2.1	1.2	1.4	1.3	1.6	7.6	18.0
Estate and gift valuation	0	0	0.5	0.5	0.5	0.6	2.1	5.4
Other	<u>0.2</u>	<u>1.3</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>	<u>1.5</u>	<u>7.4</u>	<u>16.5</u>
Subtotal	0.2	4.1	5.0	5.3	5.4	5.8	25.6	62.2
Other Provisions That Affect Receipts								
Tobacco legislation ^c	0	9.8	11.8	13.3	14.5	16.1	65.5	153.2
Superfund	0.2	1.6	1.3	1.3	1.3	1.3	6.9	14.1
Airport and Airway Trust Fund ^c	0	0	1.7	1.7	1.7	0.9	6.0	6.9
Other	<u>0</u>	<u>-0.2</u>	<u>-0.2</u>	<u>a</u>	<u>a</u>	<u>-0.2</u>	<u>-0.5</u>	<u>-1.3</u>
Subtotal	0.2	11.3	14.6	16.3	17.6	18.0	77.8	172.9
Total	0.1	12.2	15.1	16.6	17.9	18.1	79.9	176.6

SOURCES: Congressional Budget Office; Joint Committee on Taxation.

a. Less than \$50 million.

b. For one of the components of this group—the proposal to modify the reserve rules for annuities—the estimate is taken from the President's budget.

c. The estimate is taken from the President's budget.

The budget also proposes a new credit for businesses that incur child care expenses for their employees. The credit would cover 25 percent of qualified expenses (including costs to acquire, construct, and operate property used as part of a child care facility) and would be capped at \$150,000. JCT estimates that the new credit would cost \$500 million through 2003 and \$1.5 billion through 2008.

Education Benefits. The Administration would allow state and local governments to issue more than \$20 billion in special bonds over the next few years to finance certain public school construction projects. The federal government would in effect pay the interest on those bonds by providing income tax credits to the bondholders. They, in turn, would include the credit amount in their taxable income just as if it were taxable interest. For the most part, anyone could purchase those bonds. By JCT's estimate, the proposal would reduce federal revenues by \$3 billion over five years.

Other education proposals—to extend by one year (through June 1, 2001) the exclusion of employer-provided educational assistance from the recipient's taxable income and to expand that exclusion to include graduate education—would reduce revenues by an additional \$1 billion over the next four years.

Credits for Energy-Efficient Purchases. The President proposes to provide tax credits for the purchase of energy-efficient items, including certain vehicles, homes, heating and air conditioning units, combined heat and power units, circuit breaker equipment, and equipment to recycle so-called greenhouse gases. All of the credits would be temporary, with expiration dates between the end of 2003 and 2010. The entire set of credits would reduce revenues by \$4 billion over five years and almost \$10 billion through 2008, with over half of that amount coming from the credit for fuel-efficient vehicles. That credit would total \$4,000 for vehicles with more than triple the base fuel efficiency of vehicles in their class and \$3,000 for vehicles with double the base fuel efficiency. It would be fully phased out by 2010.

Targeted Business Incentives. Under the President's budget, the quantity of low-income housing credits available for states to allocate would expand by 40 percent starting in 1999. That expansion would lower revenues by \$1 billion through 2003 and \$5 billion

through 2008. Because individuals and corporations claim the credit on their tax returns over a 10-year period, the revenue cost would mount through 2008 as state governments allocated new credits each year.

The budget also proposes extending a variety of credits and other tax benefits now scheduled to expire. Most notably, the research and experimentation credit (which expires on June 30, 1998) would be extended for one year, at a revenue cost of \$2 billion. In addition, the Generalized System of Preferences, which provides duty-free status to many imports from qualifying countries, would be extended by more than three years (to September 30, 2001), at a five-year revenue cost of \$1 billion. The work opportunity credit would be extended for almost two years (to workers hired by April 30, 2000), at a five-year cost of \$800 million. And the tax incentives for cleaning up polluted "brown-fields" would be made permanent, at a five-year cost of almost \$500 million. Finally, the welfare-to-work credit would be extended for one year, reducing revenues by \$150 million.

In addition, the President's budget proposes making permanent one of the two current Puerto Rico tax credits, both of which are scheduled to be phased out fully by 2006. The "economic activity credit" for investment in Puerto Rico was established in 1993 as an alternative to the "income credit," which had proved to be a costly way to create jobs in the territory. The income credit was allowed to continue after 1993 in reduced form, but both credits were phased out over a 10-year period in 1996 legislation. Reinstating the economic activity credit would lower revenues by \$1 billion over five years and almost \$10 billion through 2008. The revenue cost is concentrated in the later years of that period because of the phaseout of the credit under current law. In 2008, the cost would be nearly \$3 billion.

The budget also proposes to reduce tax liability and filing complexity for taxpayers who receive dividends from investments in certain foreign corporations. The proposal would allow recipients of dividends from corporations that are at least 10 percent, but not more than 50 percent, owned by U.S. shareholders—so-called 10/50 companies—to immediately use less restrictive rules for claiming foreign tax credits. (Those less restrictive rules are currently scheduled to become available only for dividends paid out of earnings produced after 2002.) The proposal would reduce the taxes of

those dividend recipients by more than \$1 billion through 2003.

Other Revenue-Reducing Provisions. Among other changes, the President proposes allowing terminated employees to exclude their first \$2,000 of severance pay from taxable income under certain circumstances and proposes creating a simplified pension plan for small businesses. Those provisions would reduce revenues by an estimated \$2 billion over five years.

Provisions That Increase Revenues

The budget also includes a substantial group of proposals that would increase revenues by approximately enough to offset the costs of the revenue-reducing provisions. The proposals that would raise the bulk of the revenues would cut back or eliminate certain tax preferences for businesses, such as tax benefits for multinational corporations and life insurance companies. (Additional proposals that raise receipts largely in order to finance spending programs, such as proposed tobacco receipts, are addressed in the next section.)

Export Sales Source. The budget would repeal a tax benefit under which U.S. multinational corporations can report some of their income from exports as foreign income, even if those exports were manufactured in the United States and the income was not subject to foreign taxes. That treatment allows certain multinationals to increase their use of foreign tax credits and decrease their federal tax payments. Repealing the provision would raise almost \$9 billion in revenues through 2003 and \$22 billion through 2008. (This proposal was included in last year's Presidential budget and was rejected by the Congress.)

Life Insurance and Annuities. The President proposes raising nearly \$8 billion over five years and \$18 billion over 10 years from different segments of the life insurance industry. One proposal would reduce the future reserve deductions that life insurance companies can take for their annuity contracts. According to the Administration, that proposal would increase revenues by almost \$5 billion over five years. JCT was unable to reestimate that figure, so it has adopted OMB's estimate. Other provisions would further restrict the tax benefit for business-owned life insurance policies, raising \$2 billion over five years, and limit the scope of

preferential asset exchanges, raising almost \$1 billion over the same period.

Estate and Gift Valuation. Another proposal in the President's budget would restrict the use of valuation discounts for gifts of minority interests in family limited partnerships or similar entities. That proposal would increase estate tax revenues by more than \$2 billion over five years and \$5 billion over 10 years.

Other Revenue-Raising Provisions. Among other changes, the budget proposes repealing the use of the "lower of cost or market" inventory accounting method, the ability of certain taxpayers to claim losses prematurely, and the use of foreign tax credits by oil and gas companies for payments to foreign governments that, arguably, more closely resemble royalties or rents. The three proposals each would raise between \$1 billion and \$2 billion over five years. In addition, the budget would raise a similar amount of revenue by reinstating through 2008 the excise tax of 5 cents per barrel on domestic crude oil and on imported oil and petroleum products. (That tax had been in effect until January 1, 1995.) As before, revenues from that tax would be dedicated to the trust fund that pays for cleaning up oil spills.

Other Provisions That Affect Receipts

The budget includes several other proposed sources of receipts, such as unspecified receipts from tobacco legislation, reinstated excise and corporate income taxes that finance the Superfund program, and restructured excise taxes that finance certain airport and airway spending. Those sources would bring in around \$78 billion in receipts over five years, with the majority coming from unspecified tobacco legislation.

Tobacco. The President's budget assumes a substantial amount of receipts from tobacco legislation—\$65 billion through 2003 and over \$150 billion through 2008—but offers no specific proposals to achieve them. Nevertheless, CBO has adopted the Administration's estimate of those receipts because policies could be put in place that would bring about such an increase.

Superfund. The President proposes to reinstate taxes dedicated to the Hazardous Substance Superfund trust fund that expired in 1995. They include the excise tax

on producers and importers of petroleum and certain chemicals and the small additional income tax levied on all corporations. Those taxes, which would expire at the end of 2008, would raise about \$7 billion over the five-year budget horizon.

Airport and Airway Trust Fund. The budget includes \$6 billion in receipts through 2003 from an unspecified policy that would entirely fund the Federal Aviation Administration through user fees. The fees would replace the existing taxes earmarked for the Airport and Airway Trust Fund. The Administration plans to propose specific legislation later; in the meantime, CBO has adopted the Administration's estimate of the proposal.

Other Receipt Provisions. Most notably, the President's budget proposes enacting the recommendations of the Advisory Commission on Consumer Protection and Quality in the Health Care Industry. Those recommendations include requiring health plans to improve their disclosure of information, enhancing access to certain types of health care providers, and adding appeal procedures for enrollees. Because those additional services would raise health care costs, employees would end up receiving a greater share of their income in the form of nontaxable benefits for health insurance, and tax receipts would fall. The current estimate assumes a revenue loss of \$1.5 billion over five years, but that figure could change when detailed legislative language becomes available. Other proposals that would increase receipts include encouraging states to raise unemployment insurance taxes and requiring the Federal Reserve to charge banks for the cost of examinations.

Estimating Differences Between CBO and the Administration

CBO's estimate of the total budgetary effect of the President's proposals differs somewhat from OMB's. CBO estimates that adoption of the budget as submitted would lead to smaller surpluses than the Administration expects and even a tiny deficit in 2000 (see Table 7). By 2003, the surplus would be about half of what the Administration is projecting. Those differ-

ences occur for two reasons: because CBO and OMB project different costs or savings for some of the President's proposals and, to a greater extent, because the two agencies are measuring the effects of those proposals against slightly different baselines. (For more information about CBO's baseline budget projections, see Appendix A.)

Differences in baselines—that is, in projections of what outlays and revenues would be in the absence of policy changes—account for about 60 percent of the cumulative difference in estimates. CBO's baseline projects higher outlays than the Administration's in each year from 1998 to 2003 and higher revenues in 1998 through 2001. Although differences in economic forecasts play some role, CBO's higher revenue projections result almost entirely from different assumptions about noneconomic, or technical, factors. Most of the technical differences occur in 1998, reflecting new information about government receipts in the months since the Administration prepared its forecast. By contrast, over three-fourths of CBO's higher outlay projections can be attributed to economic factors. CBO projects slightly higher inflation and interest rates than the Administration, which leads to greater estimates of spending for retirement programs and interest on the public debt. In fact, \$13 billion of the \$22 billion difference in outlays for 2003 that is attributable to economic factors results from higher Social Security cost-of-living adjustments and federal interest payments.

The largest technical difference in baseline outlays between CBO and OMB occurs in the Medicare program. CBO is not as sanguine as the Administration that policies enacted in last year's Balanced Budget Act will be effective in curbing Medicare spending. As a result, it projects \$50 billion more in spending for that program through 2003. Some of that difference is offset by CBO's lower outlay projections for Social Security (\$14 billion lower than OMB's over five years), for the Food Stamp program (\$6 billion lower), and for veterans' compensation (\$5 billion lower). CBO is projecting lower outlays than the Administration largely because of different assumptions about caseloads.

Differences in the estimated costs or savings of the policies in the President's budget also make a substantial difference in estimates of the budget's bottom line. Economic differences come into play only with CBO's estimate for the proposal to mandate payment of ex-

Table 7.
CBO Reestimate of the President's Budgetary Policies (By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003
Deficit (-) or Surplus Under the President's Budgetary Policies as Estimated by the Administration	-10	10	9	28	90	83
Baseline Differences						
Revenues						
Economic	7	8	1	-3	-8	-6
Technical	<u>15</u>	<u>1</u>	<u>4</u>	<u>4</u>	<u>7</u>	<u>4</u>
Total	22	9	5	1	-1	-2
Outlays						
Discretionary (Technical)	5	a	-1	-1	-1	2
Mandatory						
Economic	1	7	10	12	17	22
Technical	<u>-1</u>	<u>-1</u>	<u>a</u>	<u>4</u>	<u>7</u>	<u>10</u>
Subtotal	-1	6	9	16	23	31
Total	4	6	9	15	23	34
Total Baseline Differences ^b	18	3	-4	-15	-24	-36
Differences in Estimates of Proposed Policies						
Revenues (Technical)	a	-1	a	a	-1	-1
Outlays						
Discretionary (Technical)						
Defense	0	4	3	1	7	a
Nondefense	<u>a</u>	<u>4</u>	<u>3</u>	<u>4</u>	<u>4</u>	<u>a</u>
Subtotal	a	7	7	4	11	a
Mandatory						
Economic	a	a	a	1	a	a
Technical	<u>-1</u>	<u>1</u>	<u>3</u>	<u>a</u>	<u>3</u>	<u>4</u>
Subtotal	-1	1	3	1	3	4
Total	-1	8	10	6	14	4
Total Policy Differences ^b	1	-9	-9	-6	-15	-5
All Estimating Differences						
Total Differences ^b	18	-6	-13	-20	-39	-41
Deficit (-) or Surplus Under the President's Budgetary Policies as Estimated by CBO	8	4	-5	8	51	42

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

b. Reductions in the surplus are shown with a negative sign.

tended unemployment benefits if a state's total unemployment rate is 7.5 percent or higher (and other conditions are met). CBO expects a higher rate of unemployment than OMB and thus considers it more likely that extended benefits will be triggered.

Technical differences in policy estimates are most pronounced in the area of discretionary spending. They stem largely from differences in CBO's and OMB's assumptions about how fast programs spend money. The largest technical difference in mandatory programs involves the proposal to repeal the VA's ruling that nicotine dependence is a service-related disability. CBO projects \$7 billion less in savings through 2003 because it estimates that there will be fewer beneficiaries initially. CBO also expects \$1.7 billion less in savings from the Administration's proposed changes to the student loan programs. That difference stems largely from the provision that would eliminate bankruptcy as a way to discharge student loan obligations. OMB expects that eliminating the bankruptcy option would make borrowers more inclined to pay their debts; CBO believes that people who would file for bankruptcy to escape student loans would simply default on their obligations if the Administration's proposal was enacted. In the opposite direction, CBO expects \$6.1 billion lower spending over five years for the child care entitlement, largely because it does not believe that states will be eager to match federal funds.

Grants to State and Local Governments

CBO estimates that the federal government will transfer about \$250 billion to state, local, and tribal governments through various grant programs in the current fiscal year. Although most budget functions include at least some spending for grants, that spending is highly concentrated in four functions—health; income security; education, training, employment, and social services; and transportation. In the first three, federal grants primarily support payments to or services for individuals. Outlays for grants in those functions (about \$200 billion) account for over 80 percent of total grant spending this year. The Medicaid program alone accounts for about 40 percent of that total, with \$101 billion of estimated grant outlays in 1998. Another 11 percent (\$28

billion) will support transportation programs. Those grants primarily fund infrastructure projects, particularly the construction of highways, mass transit systems, and airports.

If the President's budget was enacted as submitted, outlays for grants would total \$269 billion in 1999, by CBO's estimate. That grant spending would include \$109 billion for discretionary programs and \$160 billion for mandatory programs such as Medicaid. The President's budget proposes little change in discretionary spending for grants but much more significant changes in mandatory grant programs.

In the discretionary budget categories, 1999 budget authority for grants would rise by only about \$2 billion, or less than 3 percent, from this year's level (see Table 8). (Changes in budget authority present a much clearer picture of the President's policy proposals for discretionary programs than changes in outlays do, because annual changes in outlays tend to reflect past funding actions as well as current decisions.) In only two functions—community and regional development, and education and training—would the proposed increases exceed \$1 billion. Those increases are partly offset by \$400 million decreases in grants for the administration of justice and general government. Just as the President's proposed changes are dispersed among the remaining budget functions, they are widely dispersed among the programs within those functions.

Most of the increase in community and regional development stems from the President's request for a \$2 billion increase in budget authority for the disaster relief account. That account receives additional budget authority sporadically, often with the stipulation that it cannot be obligated unless it is released by the President as an emergency requirement. Except for that request, total discretionary budget authority for grant programs would be virtually unchanged between 1998 and 1999.

The increased budget authority for grants in the education, training, employment, and social services function flows primarily to programs for children and families. The largest proposed increase in this function is for state education grants that support programs for disadvantaged students. The President proposes boosting the budget authority for those grants by \$600 million next year, to \$8.5 billion. Other programs in this

Table 8.
CBO Estimate of the President's Discretionary Spending Proposals for Grant Programs, by Function
(By fiscal year, in billions of dollars)

Budget Function	1998 Budget Authority (Enacted)	1999 Budget Authority (Proposed)	Change from 1998 to 1999
Energy	0.2	0.2	0.1
Natural Resources and Environment	3.9	3.7	-0.2
Transportation	0.6	0.3	-0.3
Community and Regional Development	6.7	8.9	2.2
Education, Training, Employment, and Social Services			
Education for disadvantaged students	7.9	8.5	0.6
Training and employment services	3.7	4.0	0.3
Children and families services	5.4	5.6	0.2
Other	<u>12.7</u>	<u>12.6</u>	<u>-0.1</u>
Subtotal	29.7	30.8	1.0
Health	4.8	4.8	0
Income Security	25.2	25.3	0.1
Administration of Justice	4.8	4.3	-0.4
General Government	1.0	0.6	-0.4
Other	<u>1.0</u>	<u>0.9</u>	<u>-0.1</u>
Total	77.8	79.8	2.0

SOURCE: Congressional Budget Office.

function that would get significant increases in funding include programs that provide training and employment services and services to children and families. The President would raise budget authority for those categories of programs by \$300 million and \$200 million, respectively.

The President's policy proposals for entitlements and other mandatory programs would increase spending for grants by a much larger amount—over \$4 billion in 1999 and about \$34 billion over the 1999-2003 period. That additional spending would primarily support a limited number of initiatives in health and education. The most significant ones were discussed in more detail in the section on the President's mandatory spending proposals (and are shown in Table 5 on page 8). As noted there, the single largest proposed increase in

mandatory spending is for unspecified grants to state, local, and territorial governments that the Administration would include in any tobacco-related legislation.

As with discretionary programs, the largest increases for specific mandatory grant programs would benefit state and local education and other programs for children. They include an initiative to reduce class size in the primary grades (costing \$5 billion over five years) and an increase in the child care entitlement to states (of \$3.2 billion over five years).⁴ The President also proposes increasing grants to states for unemployment insurance by \$2.4 billion through 2003.

4. In addition, the President's proposed tax credits for purchasers of certain school construction bonds, discussed on page 12, would provide significant benefits to state and local governments.

Not all of the proposed changes in mandatory grant programs would benefit states, however. States would lose a total of \$1 billion in payments under the Medic-

aid program as a result of the President's proposal to reduce the matching rate for administrative expenses from 50 percent to 47 percent.

Comparison of Economic Forecasts

The Administration's economic assumptions for the next six years differ little from those of the Congressional Budget Office, although the differences have noticeable effects on estimated surpluses in the later years of the projections. The variations in economic assumptions result in estimates by CBO of surpluses that differ by less than \$10 billion from those projected by the Administration for 1998 through 2000. In 2003, however, the Administration's economic assumptions lead to an estimated surplus that is almost \$30 billion greater than the one resulting from CBO's assumptions.

CBO is projecting more rapid growth than the Administration during 1998 and 1999, but the Administration's projections beyond the near term are slightly more optimistic than the CBO forecast. The Administration projects stronger real growth after 1999, and its projections of inflation, long-term interest rates, and the unemployment rate are lower than CBO's throughout the projection period. The Administration also assumes that incomes that are subject to federal taxation constitute a higher proportion of gross domestic product than does CBO.

Compared with the Administration's and CBO's projections, the most recent *Blue Chip* consensus forecast indicates somewhat stronger growth and higher interest rates, on average, over the next six years, as well as lower inflation in the near term. Real growth is 0.2 percentage points higher in the *Blue Chip* forecast than in CBO's, and *Blue Chip* interest rates in the projection period are 0.2 to 0.4 percentage points higher. In addition, because the consensus estimates took into account the recent sharp drop in petroleum prices,

which occurred after the government agencies had completed their forecasts, the consensus projects lower inflation for this year. The *Blue Chip* forecast does not indicate a lower underlying rate of inflation, however, because the inflation rates projected for subsequent years are higher than for 1998.

Real Growth and Unemployment

The Administration and CBO are projecting almost the same average rate of growth for real GDP, but in the CBO forecast, growth is slightly stronger in the near term and correspondingly weaker, on average, in the later years of the projection period. In addition, CBO assumes that such growth is consistent with a higher average level of unemployment than the level assumed by the Administration.

Both the Administration's and CBO's projections of real growth and unemployment are influenced by their estimates of potential GDP. Potential GDP is an estimate of the level of output that can be maintained without risking an increase in the underlying rate of inflation. Thus, the growth of potential GDP is an estimate of the sustainable growth rate of the economy.

The Administration and CBO both estimate that the level of potential GDP is currently below the actual level of GDP; that is, resources are now being used at a high rate, which carries the risk that inflation will increase. With the unemployment rate at 4.6 percent—the

lowest it has been in 24 years—labor markets are quite tight, and the capacity utilization rate for manufacturing is at a level that in the past has been associated with a pickup in inflation.

The two agencies differ in their assumptions about the inflationary implications of the current unemployment rate, however. The CBO forecast assumes that the risk of higher inflation will remain as long as the unemployment rate is below 5.8 percent; in other words, CBO assumes that the nonaccelerating inflation rate of unemployment (NAIRU) is 5.8 percent. In contrast, the Administration assumes that a steady rate of inflation is compatible with an unemployment rate of 5.4 percent. The experience of the past two and a half years, during which the rate of unemployment fell far below 5.8 percent without, as yet, any indication of an increase in the underlying rate of inflation, has led many economists to believe that the NAIRU is, indeed, lower than 5.8 percent. Most economists, as well as the Administration and CBO, partially discount recent experience, attributing the absence of higher inflation to temporary factors, such as falling prices for imports, that will not prevail in the long run.¹ The Administration, however, apparently puts slightly greater weight on recent experience than does CBO—and therefore assumes a lower NAIRU. Estimates of the NAIRU by private-sector economists vary widely, with most falling between 5.0 percent and 6.2 percent.

Both the Administration and CBO forecast an unemployment rate of about 5.0 percent for this year and next, up from February's rate of 4.6 percent. But their projections drift apart in subsequent years because of their differing assumptions about the NAIRU. The differences in the unemployment projections are consistent with the different rates of growth of real GDP between 1999 and 2003 (see Table 9).

Growth during 1997 was much greater than CBO's estimate of potential growth, and expectations are that the rate of growth during the first half of this year will continue to be faster than CBO's estimate of the growth of potential output. Continued strength in personal consumption is likely to keep demand strong. Growth in real disposable income averaged 3.7 percent during

1997, and real consumption grew by 3.8 percent. The surge in employment and wages that spurred the growth in personal income last year has continued into the initial months of this year at the same time that consumer inflation has eased, primarily because of a sharp drop in the price of petroleum. Real growth in consumption appears likely to be over 3 percent for the first half of 1998.

By the second half of this year, however, CBO anticipates that growth will slow. The effects of the Asian crisis are expected to dampen demand for U.S.-produced goods, and investment is likely to shrink in concert with that slowdown. Those developments would slow employment growth and ultimately reduce the growth of personal consumption as well.

The probability of a slowdown by the end of this year is strengthened by the Federal Reserve's concern about inflation. If the rate of growth of the economy does not moderate—if the effects of the Asian crisis on trade are smaller than anticipated or if they are offset by stronger-than-expected domestic demand—the Federal Reserve may feel it necessary to take monetary action to slow the economy and forestall an increase in inflation in 1999.

The Administration's forecast also indicates a slowing of growth this year, although the decline occurs somewhat sooner than the CBO forecast indicates. The Administration's forecast, like CBO's, cites the reduction in foreign demand for U.S. goods and a decline in the growth of investment as the causes of the slower growth. In its forecast, CBO puts more weight than does the Administration on the possibility of continued strong growth in demand this year.

Inflation and Interest Rates

The Administration's assumptions about the rate of inflation, whether measured by the consumer price index or the implicit GDP deflator, are lower than CBO's throughout the next six years. The difference in the two sets of inflation assumptions largely reflects the difference in assumptions for the NAIRU. CBO's analysis indicates tighter labor markets and stronger near-term growth than the Administration assumes, and CBO is

1. See *Economic Report of the President* (February 1998); and Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1999-2008* (January 1998).

Table 9.
Comparison of Economic Projections, Calendar Years 1998-2003

	Forecast		Projected			
	1998	1999	2000	2001	2002	2003
Nominal GDP (Billions of dollars)						
CBO	8,461	8,818	9,195	9,605	10,046	10,529
Administration	8,430	8,772	9,142	9,547	9,993	10,454
<i>Blue Chip</i>	8,449	8,833	9,248	9,692	10,177	10,696
Nominal GDP (Percentage change)						
CBO	4.7	4.2	4.3	4.5	4.6	4.8
Administration	4.3	4.1	4.2	4.4	4.7	4.6
<i>Blue Chip</i>	4.5	4.5	4.7	4.8	5.0	5.1
Real GDP (Percentage change)						
CBO	2.7	2.0	1.9	2.0	2.1	2.3
Administration	2.4	2.0	2.0	2.2	2.4	2.4
<i>Blue Chip</i>	2.7	2.2	2.2	2.2	2.4	2.5
Implicit GDP Deflator^a (Percentage change)						
CBO	2.0	2.2	2.3	2.4	2.4	2.5
Administration	1.9	2.0	2.2	2.2	2.2	2.2
<i>Blue Chip</i>	1.8	2.3	2.4	2.6	2.5	2.5
Consumer Price Index^b (Percentage change)						
CBO	2.2	2.5	2.7	2.8	2.8	2.8
Administration	2.1	2.2	2.3	2.3	2.3	2.3
<i>Blue Chip</i>	1.9	2.5	2.7	2.7	2.8	2.7
Unemployment Rate (Percent)						
CBO	4.8	5.1	5.4	5.6	5.8	5.9
Administration	4.9	5.1	5.3	5.4	5.4	5.4
<i>Blue Chip</i>	4.8	5.0	5.3	5.5	5.6	5.4
Three-Month Treasury Bill Rate (Percent)						
CBO	5.3	5.2	4.8	4.7	4.7	4.7
Administration	5.0	4.9	4.8	4.7	4.7	4.7
<i>Blue Chip</i>	5.1	5.2	5.1	5.2	5.1	5.1
Ten-Year Treasury Note Rate (Percent)						
CBO	6.0	6.1	6.0	5.9	5.9	5.9
Administration	5.9	5.8	5.8	5.7	5.7	5.7
<i>Blue Chip</i>	5.8	6.0	6.0	6.1	6.1	6.1
Taxable Income^c (Billions of dollars)						
CBO	6,688	6,906	7,147	7,426	7,732	8,080
Administration	6,670	6,920	7,188	7,474	7,798	8,132

SOURCES: Congressional Budget Office; Office of Management and Budget; Capitol Publications, Inc., *Blue Chip Economic Indicators* (March 10, 1998).

NOTE: Percentage change is year over year.

- a. The implicit GDP deflator is virtually the same as the GDP price index.
- b. The consumer price index for all urban consumers.
- c. Taxable personal income plus corporate profits before tax. *Blue Chip* does not forecast taxable income.

therefore more concerned about the possibility of higher inflation over the next few years. The differences between the agencies in their assumptions about inflation do not affect the budget projections in the first few years of the forecast, but they contribute to the differences in projected surpluses for 2002 and 2003.

CBO forecasts slightly higher interest rates over the next two years than does the Administration, but the interest rate projections are virtually identical for subsequent years. Again, because CBO considers an increase in inflation more likely than the Administration does, its near-term forecast reflects the possibility that the Federal Reserve might tighten monetary policy later this year. The CBO forecast of higher interest rates over the next two years is one of the reasons that CBO's projection of the surplus is slightly smaller than that of the Administration for 1999.

Income

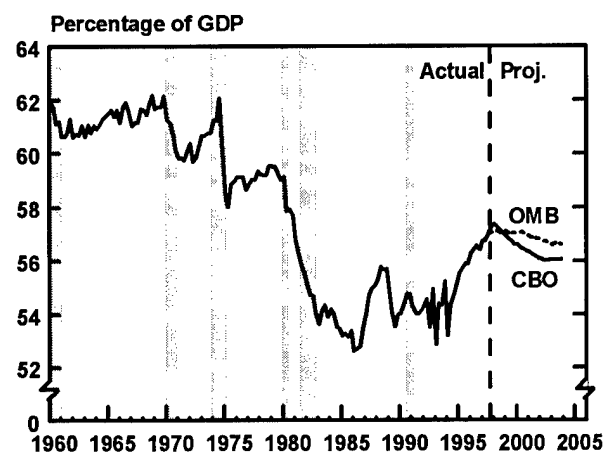
Budget forecasts are affected not only by the size of total output and the income generated in producing that output but also by the projected distribution of income among the various income categories. Corporate profits and wages and salaries are the most important income categories for revenue projections because they are effectively taxed at the highest rates. Other categories, such as dividends, interest income, proprietors' income, and rental income, are taxed at lower effective rates because most of those kinds of income are not subject to payroll taxes. Moreover, some of the income under those categories goes to tax-exempt entities (for example, pension funds) or is imputed income, which does not show up on tax returns. In addition, compliance problems reduce the effective tax rate on proprietors' incomes.

The combined share of GDP that corporate profits, wages, and salaries account for has grown rapidly since 1993 (see Figure 1). Both the Administration and CBO project that the combined share has peaked, but the Administration indicates only a slight decline over the next six years, whereas CBO projects a more significant re-trenchment. For 1998, the Administration's projection of the combined income share is virtually the same as CBO's; however, by 2003 the Administration's estimate is higher by 0.6 percentage points.

One reason that CBO projects a decline in the combined share of profits, wages, and salaries is that overall income is assumed to grow more slowly than overall output, or GDP. In principle, the output and income measures should be identical, but in practice they differ because they use different data sources. Income growth has far exceeded output growth for the past three years, leaving the measure of total income about \$100 billion greater than the measure of output at the end of 1997. CBO assumes that the difference will shrink as a percentage of GDP, implying that overall income will grow more slowly than GDP in the projection.

The share of profits, wages, and salaries also declines in the CBO forecast because CBO assumes that the share of GDP allocated to the consumption of fixed capital increases. (Consumption of fixed capital is also called depreciation—the wear and tear on business equipment and structures.) Rapid growth in investment over the past four years has increased the capital stock, resulting in higher levels of depreciation. Since depreciation is deducted against profits—not taxed—the projected increase in its share depresses the share of GDP accounted for by profits, wages, and salaries.

Figure 1.
Wages and Salaries Plus Corporate Profits



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

NOTE: Corporate profits are the profits of corporations, adjusted to remove the distortions in depreciation allowances caused by tax rules and to exclude capital gains on inventories.

CBO's income projections also reflect potential effects of the business cycle. Although CBO is not forecasting that a recession will occur in a particular year, the projections assume that the likelihood that a recession will occur some time in the next six years is greater than the likelihood that the current boom will

continue for the same period. The share of profits, wages, and salaries has generally been lower during a recession and the early years of a recovery than it has been in the last half of an expansion. As a result, the higher probability of recession that CBO assumes lowers the average income share in its projection.

Appendixes

CBO Baseline Budget Projections

Throughout this report, the Administration's proposals are contrasted with the Congressional Budget Office'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.

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 accordance with current law. In the case of programs with outlays of more than \$50 million in the current year, the Balanced Budget and Emergency Deficit Control Act of 1985 directs CBO to assume that the programs continue even when their authorization expires (see Table A-1 for the budget authority and outlays associated with the continuation of expiring programs).

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. Caps on total discretionary budget authority and outlays have been in place since 1991, and new limits on discretionary spending through 2002 were included in the Balanced Budget Act of 1997. The law specifies three separate sets of caps for that spending in 1998 and 1999: one for defense, one for violent crime reduction, and one for other nondefense, noncrime expenditures. In 2000, the number of sets narrows to two—a violent crime reduction spending cap and a cap for all other discretionary spending. In 2001 and 2002, a single cap covers all discretionary budget authority and outlays. CBO's baseline assumes compliance with the caps through 2002, which, as explained below, will force trade-offs among many competing programs. After the caps expire in 2002, the baseline assumes that discretionary spending grows at the rate of 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, rather than being directly controlled by policymakers, is driven by market interest rates and the outstanding stock of federal debt held by the public. As a result, CBO estimates such spending based on its projections of those two determinants.

Table A-1.
Program Continuations Assumed in the CBO Baseline (By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Commodity Credit Corporation Fund^a											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	4.5	4.5	4.5	4.5	4.5	4.5
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	4.5	4.5	4.5	4.5	4.5	4.5
Transportation Programs Controlled by Obligation Limitations^b											
Budget authority	n.a.	30.9	30.9	30.9	30.9	30.9	30.9	30.9	30.9	30.9	30.9
Outlays	n.a.	0	0	0	0	0	0	0	0	0	0
Transportation Programs Not Subject to Annual Obligation Limitations											
Budget authority	n.a.	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Outlays	n.a.	0.1	0.3	0.5	0.5	0.6	0.6	0.6	0.6	0.6	0.6
Family Preservation and Support											
Budget authority	n.a.	n.a.	n.a.	n.a.	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Outlays	n.a.	n.a.	n.a.	n.a.	0.1	0.3	0.3	0.3	0.3	0.3	0.3
Rehabilitation Services and Disability Research											
Budget authority	n.a.	0.3	2.7	2.7	2.8	2.9	3.0	3.0	3.1	3.2	3.3
Outlays	n.a.	0.2	2.0	2.6	2.8	2.9	2.9	3.0	3.1	3.2	3.3
Food Stamps											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	26.9	27.9	28.8	29.8	30.8	31.9
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	26.4	27.9	28.8	29.8	30.8	31.8
Child Nutrition											
Budget authority	n.a.	0.4	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Outlays	n.a.	0.3	0.4	0.4	0.5	0.5	0.5	0.6	0.6	0.6	0.6
Contingency Fund for State Welfare Programs^c											
Budget authority	n.a.	n.a.	n.a.	n.a.	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Outlays	n.a.	n.a.	n.a.	n.a.	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Child Care Entitlements to States											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	2.7	2.7	2.7	2.7	2.7	2.7
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	2.5	2.7	2.7	2.7	2.7	2.7
Temporary Assistance for Needy Families											
Budget authority	n.a.	n.a.	n.a.	n.a.	n.a.	16.7	16.8	16.8	16.8	16.8	16.8
Outlays	n.a.	n.a.	n.a.	n.a.	n.a.	17.3	17.6	17.7	17.8	17.8	17.8
Veterans' Compensation											
Budget authority	n.a.	0.3	0.8	1.4	2.0	2.7	3.5	4.7	5.2	5.7	7.1
Outlays	n.a.	0.3	0.8	1.3	2.0	2.7	3.5	4.7	5.2	5.7	7.1
Total											
Budget authority	n.a.	32.6	35.4	36.1	37.3	89.0	91.0	93.2	94.8	96.4	99.0
Outlays	n.a.	1.0	3.5	4.9	6.1	57.8	60.7	63.1	64.9	66.4	69.0

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

- Agriculture commodity price and income supports under the Federal Agriculture Improvement and Reform Act of 1996 (FAIR) generally expire after 2002. Although permanent price support authority under the Agricultural Adjustment Act of 1938 and the Agricultural Act of 1949 would then become effective, section 257(b)(2)(ii) of the Balanced Budget and Emergency Deficit Control Act of 1985 requires that the baseline assume continuation of the FAIR provisions.
- Authorizing legislation provides contract authority, which is counted as mandatory budget authority. However, because spending is subject to obligation limitations specified in annual appropriation acts, outlays are considered discretionary.
- Supplements the Temporary Assistance for Needy Families block grant by providing matching amounts to states that reach certain unemployment or Food Stamp thresholds and maintain 100 percent of historical state spending on block-grant programs.

Table A-2.
Changes in CBO Baseline Deficits or Surpluses Since January 1998 (By fiscal year, in billions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
January 1998 Baseline Deficit (-) or Surplus	-5	-2	-3	14	69	54	71	75	115	129	138
Changes											
Revenues	15	10	5	a	a	a	a	a	a	a	a
Outlays											
Discretionary	a	a	a	a	a	a	a	a	a	a	a
Mandatory	a	a	1	2	4	1	2	1	a	a	a
Net interest	<u>1</u>	<u>a</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>-1</u>	<u>a</u>	<u>a</u>	<u>a</u>	<u>a</u>
Subtotal	2	-1	a	1	3	1	1	1	a	a	a
Total	13	11	5	-1	-3	-1	-1	-1	a	a	a
March 1998 Baseline Surplus	8	9	1	13	67	53	70	75	115	130	138

SOURCE: Congressional Budget Office.

a. Less than \$500 million.

Baseline Projections

In January, CBO published its baseline projections in *The Economic and Budget Outlook: Fiscal Years 1999-2008*, which described the key factors that influence the federal government's revenues, spending, and deficit or surplus. Since that report was issued, CBO has revised its projection for 1998 from a \$5 billion deficit to an \$8 billion surplus. If that estimate proves correct, it will be the first time that the federal budget has been in balance since 1969. CBO has also revised its estimates for 1999 and 2000 from projections of small deficits to projections of small surpluses. The estimates for 2001 and beyond have changed very little (see Table A-2).

The Congressional Budget Office generally divides revisions to its estimates into three categories: economic, 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 projections since January, all changes to

the baseline are technical ones.¹ The technical revisions stem from new information that came to light through late February, much of it contained in the President's budget and supporting documents.

CBO has changed its January projections of deficits for 1998 through 2000 to surpluses largely because revenues this year have been coming in faster than expected. Additional revenues of \$15 billion in 1998, \$10 billion in 1999, and \$5 billion in 2000 are projected. In 1998, a \$2 billion increase in outlays partially offsets the additional revenues.

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.

Although the total deficit or surplus—simply the difference between total revenues and spending—is the most common measure of the deficit, there are several other ways analysts can measure how the government's

1. On February 25, the Congress overrode a Presidential line-item veto from the fall of 1997 and ordered the release of \$287 million for military construction projects in fiscal year 1998. That action is not reflected in the baseline because CBO had completed its estimates before that date.

spending compares with its revenues. Table A-3 displays several measures of the gap between spending and revenues.

One measure—the standardized-employment deficit or surplus—removes cyclical economic fluctuations and certain financial transactions when calculating a deficit

or a surplus. Cyclical economic factors are removed because they can obscure fundamental trends in the budget. Certain financial transactions, such as outlays for deposit insurance, merely represent an exchange of assets and have no macroeconomic effect. Current projections show a sizable difference between the total deficit and the standardized-employment deficit over the

Table A-3.
The Budget Outlook Under Current Policies (By fiscal year)

	Actual 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
In Billions of Dollars												
Baseline Total Deficit (-) or Surplus ^a	-22	8	9	1	13	67	53	70	75	115	130	138
Standardized-Employment Deficit (-) or Surplus ^b	-80	-47	-48	-32	1	52	58	76	96	113	130	146
On-Budget Deficit (Excluding Social Security and Postal Service)	-103	-92	-104	-121	-117	-72	-94	-88	-96	-64	-59	-59
Memorandum:												
Off-Budget Surplus												
Social Security	81	101	113	123	129	138	148	158	170	179	189	197
Postal Service	<u>c</u>	<u>-1</u>	<u>c</u>	<u>c</u>	<u>1</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>
Total	81	100	113	122	130	138	148	158	170	179	189	197
Deficit (-) or Surplus If Discretionary Spending Was Frozen at the 2002 Level from 2003 to 2008	-22	8	9	1	13	67	69	104	127	188	224	256
As a Percentage of GDP												
Baseline Total Deficit (-) or Surplus ^a	-0.3	0.1	0.1	d	0.1	0.7	0.5	0.6	0.7	1.0	1.0	1.1
On-Budget Deficit (Excluding Social Security and Postal Service)	-1.3	-1.1	-1.2	-1.3	-1.2	-0.7	-0.9	-0.8	-0.8	-0.5	-0.5	-0.5

SOURCE: Congressional Budget Office.

a. Assumes that discretionary spending grows with inflation after 2002.

b. These numbers exclude outlays for deposit insurance and offsetting receipts from spectrum auctions. They also reflect shifts in the timing of revenue collections as well as adjustments for fiscal years in which there are 11 or 13 monthly payments for various entitlement programs instead of the usual 12.

c. Less than \$500 million.

d. Less than 0.05 percent

next few years, a period in which CBO estimates that actual gross domestic product will exceed potential GDP. But that gap is expected to narrow as the difference between actual and potential GDP diminishes.

Another measure—the on-budget deficit or surplus—is rooted in legislation that granted special, off-budget status to the Social Security trust funds and to the Postal Service. The fiscal picture looks noticeably different if those off-budget programs are excluded from the deficit or surplus. In isolation, the Social Security trust funds run large surpluses because payroll taxes for the program currently exceed its benefits and administrative expenses. In addition, the trust funds receive income from interest on their investments in Treasury securities and from the taxes paid on Social Security benefits. (The interest payments take the form of intragovernmental transactions.) In 1998, Social Security income is expected to exceed benefits and administrative payments by \$101 billion; by 2008, the surplus in the trust funds is expected to climb to \$197 billion, mainly as a result of growing interest income. Consequently, even though CBO's new baseline shows total budget surpluses throughout the projection period, the on-budget measure indicates continuing deficits. Because Social Security spending and income are so substantial, any measure of the budget that excludes Social Security payroll taxes and benefits provides an incomplete picture of the government's role in the economy and its effect on credit markets.

Federal government revenues by source and outlays by broad category, both in dollar terms and in relation to GDP, are presented in Table A-4. Spending for entitlements and other mandatory programs, by far the largest spending category, is expected to be \$951 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-5).

In its baseline projections, CBO assumes that policymakers will continue to abide by the discretionary spending limits that are set by law through 2002. 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. The caps have no implications for particular programs; instead, accounts within each cap are forced to compete for resources. From 1999 through

2002, the caps on outlays are more stringent than those on budget authority, given the current mix of discretionary programs. Preserving resources next year at the 1998 level adjusted for inflation would cause budget authority to exceed the discretionary cap by \$17 billion and outlays to exceed it by \$16 billion (see Table A-6). Future decisions are likely to be more painful—even a freeze on total discretionary spending at the current level would result in outlays that were \$1 billion over the caps in 2002.

Interest costs are a significant portion of the federal budget—about 15 percent of all federal spending today. Under CBO's baseline scenario, which assumes stable interest rates throughout the projection period, interest payments will decline to 8 percent of federal outlays by 2008. In dollar terms, net interest will fall from \$245 billion in 1998 to \$194 billion in 2008. Measured as a percentage of GDP, interest costs are expected to decline from 2.9 percent this year to 1.5 percent by 2008 (see Table A-4).

Debt held by the public is the amount of money that the federal government has borrowed—by selling securities—to finance all of the deficits (less any surpluses) accumulated over time. Since 1969, the Treasury has sold ever-increasing amounts of securities to finance continuing deficits, thereby causing the debt held by the public to climb from year to year. As a result of the budget surpluses that CBO is projecting, the current baseline forecast reflects a changing scenario for that category of debt (see Table A-7). Debt held by the public is projected to decline from \$3.8 trillion in 1998 (45 percent of GDP) to \$3.3 trillion in 2008 (25 percent of GDP).

Gross federal debt counts debt issued to government accounts as well as debt held by the public. The government accounts consist mostly of trust funds, the largest of which are the Social Security and federal civilian employee retirement funds. Because the Treasury handles investments by trust funds and other government accounts, their purchases and sales of securities do not flow through the credit markets. Hence, interest on those securities is considered simply an intragovernmental transfer. CBO expects gross federal debt to be \$5.5 trillion in 1998. As trust fund balances accumulate in subsequent years, gross federal debt will continue to grow, reaching an estimated \$7.1 trillion by 2008.

Table A-4.
CBO Baseline Budget Projections, Assuming Compliance with Discretionary Spending Caps (By fiscal year)

	Actual 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
In Billions of Dollars												
Revenues												
Individual income	737	783	792	810	840	886	922	974	1,027	1,083	1,143	1,207
Corporate income	182	197	200	200	200	203	209	216	224	232	241	250
Social insurance	539	573	600	625	651	679	710	743	781	817	856	892
Other	<u>120</u>	<u>127</u>	<u>147</u>	<u>149</u>	<u>155</u>	<u>161</u>	<u>167</u>	<u>173</u>	<u>177</u>	<u>181</u>	<u>187</u>	<u>191</u>
Total	1,579	1,680	1,738	1,784	1,847	1,930	2,008	2,105	2,208	2,314	2,426	2,540
On-budget	1,187	1,262	1,300	1,326	1,369	1,432	1,487	1,559	1,634	1,712	1,796	1,882
Off-budget	392	417	438	458	477	498	521	546	574	601	630	658
Outlays												
Discretionary												
Defense	272	269	267	284	286	297	306	316	329	336	343	357
Nondefense	277	288	295	311	320	329	338	348	357	368	379	391
Unspecified reductions ^a	<u>0</u>	<u>0</u>	<u>0</u>	<u>-31</u>	<u>-43</u>	<u>-66</u>	<u>-68</u>	<u>-71</u>	<u>-77</u>	<u>-78</u>	<u>-79</u>	<u>-87</u>
Subtotal	548	558	561	565	564	560	576	592	609	626	643	661
Mandatory Spending	896	951	1,004	1,060	1,123	1,176	1,250	1,322	1,417	1,477	1,570	1,672
Offsetting Receipts	-87	-82	-82	-85	-91	-103	-97	-101	-107	-113	-119	-126
Net interest	<u>244</u>	<u>245</u>	<u>247</u>	<u>243</u>	<u>237</u>	<u>230</u>	<u>226</u>	<u>221</u>	<u>215</u>	<u>209</u>	<u>202</u>	<u>194</u>
Total	1,601	1,672	1,730	1,782	1,833	1,863	1,954	2,035	2,134	2,199	2,297	2,402
On-budget	1,291	1,355	1,405	1,447	1,486	1,504	1,581	1,647	1,729	1,777	1,856	1,942
Off-budget	311	317	325	335	347	359	373	388	404	422	441	461
Deficit (-) or Surplus	-22	8	9	1	13	67	53	70	75	115	130	138
On-budget	-103	-92	-104	-121	-117	-72	-94	-88	-96	-64	-59	-59
Off-budget	81	100	113	122	130	138	148	158	170	179	189	197
Debt Held by the Public	3,771	3,774	3,781	3,793	3,795	3,743	3,706	3,651	3,591	3,491	3,375	3,251
Memorandum:												
Gross Domestic Product	7,972	8,369	8,729	9,097	9,499	9,933	10,405	10,909	11,431	11,973	12,539	13,129

(Continued)

Table A-4.
Continued

	Actual 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
As a Percentage of Gross Domestic Product												
Revenues												
Individual income	9.3	9.4	9.1	8.9	8.8	8.9	8.9	8.9	9.0	9.0	9.1	9.2
Corporate income	2.3	2.4	2.3	2.2	2.1	2.0	2.0	2.0	2.0	1.9	1.9	1.9
Social insurance	6.8	6.8	6.9	6.9	6.9	6.8	6.8	6.8	6.8	6.8	6.8	6.8
Other	<u>1.5</u>	<u>1.5</u>	<u>1.7</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.6</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>	<u>1.5</u>
Total	19.8	20.1	19.9	19.6	19.4	19.4	19.3	19.3	19.3	19.3	19.3	19.3
On-budget	14.9	15.1	14.9	14.6	14.4	14.4	14.3	14.3	14.3	14.3	14.3	14.3
Off-budget	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Outlays												
Discretionary												
Defense	3.4	3.2	3.1	3.1	3.0	3.0	2.9	2.9	2.9	2.8	2.7	2.7
Nondefense	3.5	3.4	3.4	3.4	3.4	3.3	3.2	3.2	3.1	3.1	3.0	3.0
Unspecified reductions ^a	<u>0</u>	<u>0</u>	<u>0</u>	<u>-0.3</u>	<u>-0.4</u>	<u>-0.7</u>	<u>-0.7</u>	<u>-0.7</u>	<u>-0.7</u>	<u>-0.7</u>	<u>-0.6</u>	<u>-0.7</u>
Subtotal	6.9	6.7	6.4	6.2	5.9	5.6	5.5	5.4	5.3	5.2	5.1	5.0
Mandatory Spending	11.2	11.4	11.5	11.7	11.8	11.8	12.0	12.1	12.4	12.3	12.5	12.7
Offsetting Receipts	-1.1	-1.0	-0.9	-0.9	-1.0	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-1.0
Net Interest	<u>3.1</u>	<u>2.9</u>	<u>2.8</u>	<u>2.7</u>	<u>2.5</u>	<u>2.3</u>	<u>2.2</u>	<u>2.0</u>	<u>1.9</u>	<u>1.7</u>	<u>1.6</u>	<u>1.5</u>
Total	20.1	20.0	19.8	19.6	19.3	18.8	18.8	18.7	18.7	18.4	18.3	18.3
On-budget	16.2	16.2	16.1	15.9	15.6	15.1	15.2	15.1	15.1	14.8	14.8	14.8
Off-budget	3.9	3.8	3.7	3.7	3.7	3.6	3.6	3.6	3.5	3.5	3.5	3.5
Deficit (-) or Surplus	-0.3	0.1	0.1	b	0.1	0.7	0.5	0.6	0.7	1.0	1.0	1.1
On-budget	-1.3	-1.1	-1.2	-1.3	-1.2	-0.7	-0.9	-0.8	-0.8	-0.5	-0.5	-0.5
Off-budget	1.0	1.2	1.3	1.3	1.4	1.4	1.4	1.4	1.5	1.5	1.5	1.5
Debt Held by the Public	47.3	45.1	43.3	41.7	39.9	37.7	35.6	33.5	31.4	29.2	26.9	24.8

SOURCE: Congressional Budget Office.

a. These reductions represent the cuts that would be needed to comply with the statutory caps in 2000 through 2002 and the effects of those cuts projected into the future. In 1999, the law specifies separate cuts for defense and nondefense (including cuts for violent crime) outlays.

b. Less than 0.05 percent.

Table A-5.
CBO Baseline Projections for Mandatory Spending (By fiscal year, in billions of dollars)

	Actual 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Means-Tested Programs												
Medicaid	96	101	108	115	123	131	141	152	165	179	194	210
Child Health Insurance	a	1	3	4	4	4	4	4	4	4	4	5
Food Stamps	23	21	22	23	25	26	27	28	29	30	31	32
Supplemental Security Income	27	27	29	30	32	33	35	37	43	42	40	46
Family Support ^b	17	18	21	22	23	23	24	24	25	25	25	25
Veterans' Pensions	3	3	3	3	3	3	4	4	4	4	4	4
Child Nutrition	8	9	9	10	10	11	11	12	12	13	14	14
Earned Income Tax Credit ^c	22	22	25	26	27	28	28	29	29	30	30	31
Student Loans	4	4	4	4	5	5	5	5	5	5	5	6
Other	<u>4</u>	<u>4</u>	<u>5</u>	<u>5</u>	<u>6</u>	<u>6</u>	<u>6</u>	<u>7</u>	<u>7</u>	<u>8</u>	<u>8</u>	<u>9</u>
Total	203	210	229	243	256	270	285	302	323	339	356	382
Non-Means-Tested Programs												
Social Security	362	376	391	409	428	449	471	495	522	551	582	614
Medicare	<u>208</u>	<u>218</u>	<u>231</u>	<u>244</u>	<u>268</u>	<u>277</u>	<u>306</u>	<u>330</u>	<u>367</u>	<u>377</u>	<u>417</u>	<u>448</u>
Subtotal	570	594	622	652	695	726	777	826	889	928	999	1,063
Other Retirement and Disability												
Federal civilian ^d	46	48	50	52	55	58	61	64	68	72	76	80
Military	30	31	32	33	34	36	37	38	39	40	41	42
Other	<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>	<u>5</u>	<u>5</u>	<u>6</u>
Subtotal	81	84	87	91	95	98	103	107	112	117	122	128
Unemployment Compensation	21	20	22	24	26	28	29	31	32	33	35	36
Deposit Insurance	-14	-5	-4	-3	-2	-1	-1	-1	-1	-1	-1	-1
Other Programs												
Veterans' benefits ^e	19	21	21	23	24	25	27	28	32	31	31	34
Farm price and income supports	6	7	6	6	5	5	5	5	5	5	5	5
Social services	5	5	5	6	6	6	6	6	6	6	6	6
Credit reform liquidating accounts	-10	-6	f	-5	-6	-6	-6	-6	-6	-6	-6	-6
Other	<u>17</u>	<u>22</u>	<u>14</u>	<u>24</u>	<u>24</u>	<u>25</u>	<u>25</u>	<u>24</u>	<u>24</u>	<u>24</u>	<u>24</u>	<u>25</u>
Subtotal	37	48	47	52	53	55	57	57	61	60	60	64
Total	694	741	775	817	867	906	965	1,020	1,093	1,138	1,214	1,290
All Mandatory Spending												
Total	896	951	1,004	1,060	1,123	1,176	1,250	1,322	1,417	1,477	1,570	1,672

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.

- a. The State Children's Health Insurance Program was created as part of the Balanced Budget Act of 1997.
- b. Includes Temporary Assistance for Needy Families, Family Support, Aid to Families with Dependent Children, Job Opportunities and Basic Skills, Contingency Fund for State Welfare Programs, Child Care Entitlements to States, and Children's Research and Technical Assistance.
- c. Includes outlays from the child credit enacted in the Taxpayer Relief Act of 1997.
- d. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.
- e. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.
- f. Less than \$500 million.

Table A-6.
How Tight Are the Discretionary Caps? (By fiscal year, in billions of dollars)

	1999	2000	2001	2002
Budget Authority				
Caps ^a	533	537	542	551
Amount Needed to Preserve 1998				
Real Resources				
Defense	277	286	295	303
Domestic and international	266	276	285	294
Violent crime reduction	<u>6</u>	<u>6</u>	<u>6</u>	<u>6</u>
Total	549	568	585	604
Amount over or under (-) caps	17	31	44	53
Amount Needed to Freeze 1998 Dollar				
Resources				
Defense	269	269	269	269
Domestic and international	256	256	256	256
Violent crime reduction	<u>6</u>	<u>6</u>	<u>6</u>	<u>6</u>
Total	530	530	530	530
Amount over or under (-) caps	-3	-7	-12	-21
Outlays				
Caps ^a	561	565	564	560
Amount Needed to Preserve 1998				
Real Resources				
Defense	275	284	286	297
Domestic and international	297	306	314	323
Violent crime reduction	<u>5</u>	<u>5</u>	<u>6</u>	<u>6</u>
Total	577	595	607	626
Amount over or under (-) caps	16	30	43	66
Amount Needed to Freeze 1998 Dollar				
Resources				
Defense	268	270	265	267
Domestic and international	293	294	292	289
Violent crime reduction	<u>5</u>	<u>5</u>	<u>6</u>	<u>6</u>
Total	565	569	562	561
Amount over or under (-) caps	4	4	-2	1

SOURCE: Congressional Budget Office.

NOTE: Amounts needed to preserve 1998 real resources include adjustments for inflation of about 3 percent a year. Amounts needed to freeze 1998 dollar resources include no adjustment for inflation. There are no discretionary caps after 2002.

a. The caps reflect discretionary spending limits as specified by the Office of Management and Budget in the sequestration preview report included in the President's budget.

Table A-7.
CBO Projections of Interest Costs and Federal Debt (By fiscal year)

	Actual 1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Net Interest Outlays (Billions of dollars)												
Interest on Public Debt (Gross interest) ^a	356	365	372	377	380	383	388	394	400	406	411	416
Interest Received by Trust Funds												
Social Security	-41	-46	-53	-59	-65	-72	-79	-87	-96	-105	-115	-126
Other trust funds ^b	-64	-67	-66	-69	-71	-73	-75	-78	-80	-82	-84	-87
Subtotal	-105	-113	-119	-128	-136	-145	-155	-165	-176	-188	-200	-212
Other Interest ^c	-7	-7	-6	-6	-7	-7	-8	-8	-9	-9	-10	-10
Total	244	245	247	243	237	230	226	221	215	209	202	194
Federal Debt at the End of the Year (Billions of dollars)												
Gross Federal Debt	5,370	5,523	5,707	5,906	6,100	6,253	6,428	6,594	6,762	6,898	7,026	7,145
Debt Held by Government Accounts												
Social Security	631	732	845	967	1,097	1,235	1,383	1,541	1,711	1,890	2,079	2,277
Other accounts ^b	968	1,017	1,081	1,145	1,208	1,274	1,340	1,402	1,460	1,517	1,571	1,617
Subtotal	1,599	1,748	1,925	2,113	2,305	2,509	2,722	2,943	3,171	3,407	3,651	3,894
Debt Held by the Public	3,771	3,774	3,781	3,793	3,795	3,743	3,706	3,651	3,591	3,491	3,375	3,251
Debt Subject to Limit ^d	5,328	5,482	5,667	5,867	6,062	6,217	6,394	6,562	6,732	6,869	7,000	7,119
Federal Debt as a Percentage of GDP												
Debt Held by the Public	47.3	45.1	43.3	41.7	39.9	37.7	35.6	33.5	31.4	29.2	26.9	24.8

SOURCE: Congressional Budget Office.

NOTE: Projections of interest and debt assume that discretionary spending will equal the statutory caps that are in effect through 2002 and will grow at the rate of inflation in succeeding years.

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

The Administration's Medicare Buy-In Proposals

The President's budget contains two proposals intended to increase health insurance coverage by expanding the federal Medicare program. First, the Administration proposes to allow certain people ages 62 to 64 to purchase Medicare coverage. To the extent that premiums paid at those ages did not cover the cost of the additional benefits provided, participants would have to pay an additional premium from ages 65 to 84. Second, the Administration proposes to allow displaced workers ages 55 to 61 to purchase Medicare coverage. Under the Administration's proposal, the government would not attempt to recover the cost of adverse selection in that program.¹

In both programs, costs to the federal government would be held down by the high cost of the specified premiums and the stringency of the eligibility criteria. The Congressional Budget Office estimates that by 2003, only 6 percent of people ages 62 to 64 and 0.1 percent of people ages 55 to 61 would be eligible and choose to participate. If the premiums were reduced or the eligibility requirements were relaxed, participation in the programs could be greater and federal costs could be higher. Changes in assumptions about how people would respond to the new programs could also significantly affect the cost estimates.

1. The description and analysis of the Administration's proposals are based on information available to the Congressional Budget Office in late February.

Medicare Buy-In for People Ages 62 to 64

The Administration proposes to allow people ages 62 to 64 to enroll voluntarily in Medicare. Enrollment would be limited to people who do not have employment-based health insurance or Medicaid, and they would have to enroll as soon as they were eligible. Events that would qualify people for enrollment would include turning age 62 or losing employment-based health insurance under certain circumstances between ages 62 and 64.

Medicare premiums under the buy-in would be paid in two parts, both of which would be updated annually:

- o Premiums paid before age 65 would be set at a rate that would reflect the average expected cost of benefits if everyone ages 62 to 64 participated in the buy-in—about \$310 a month in 1999 (plus an additional \$6 a month for administrative costs). Premiums would be adjusted for geographic variation in Medicare costs.
- o Premiums paid at age 65 and thereafter would be set to recapture for the government the extra benefits Medicare would pay as a result of risk selection. Those premiums would be based on the estimated difference between the pre-65 premium and the higher average costs of people who would choose to participate. Enrollees would continue to pay post-65 premiums until they reached age 85.

To help reduce adverse risk selection, the President's plan would limit enrollment opportunities, prohibit reenrollment, and require buy-in participants who dropped Medicare before age 65 to pay the full post-65 premium for the year in which they dropped coverage.

Potential enrollees would decide whether to purchase coverage based on their comparison of the price of Medicare and the price of the private insurance available to them. The Medicare price is the pre-65 premium, which would be paid during the buy-in years, plus an amount that represents enrollees' perceptions of the present value of the post-65 premiums. If the price for the Medicare buy-in was perceived to be \$350 a month, for example, most people who could obtain other coverage for less than \$350 a month would decline to enroll. People who otherwise would have to pay more than \$350, however, would be more likely to sign up for Medicare. Assuming that Medicare's costs under the buy-in would be related to the prices people faced in the private market, covering the likely enrollees in this example would cost more than \$350 a month. If the price was raised, the composition of enrollment would change as well. Some people who could obtain private coverage for less—those who would be the least expensive to cover—would drop out, and the average cost of covering the remaining people would rise.

The Congressional Budget Office's estimate assumes that potential enrollees would heavily discount the extra premiums they would face after turning 65. As a result, they would base their decision to purchase Medicare on a price not much higher than the pre-65 premium alone. Under that assumption, and the assumption that Medicare's pre-65 premiums would be about 33 percent less than the private premiums that people of average risk would be charged for a comparable package of benefits, CBO estimates that 320,000 people would participate in 1999; 390,000 in 2003; and almost 500,000 in 2008. The estimate assumes that adverse selection would be a relatively limited problem and that the post-65 premiums would allow the program to cover its costs over the expected lifetime of each cohort of participants.

CBO estimates that Medicare costs for people who enrolled in 1999 would average about \$389 a month, about 25 percent more than the pre-65 premium of \$310. To recapture that difference, Medicare would add about \$10 a month to participants' Part B premi-

ums for each year they participated in the buy-in. Those purchasing Medicare for all three years of the buy-in period starting in 1999 would pay an additional \$31 a month from ages 65 to 84.

Budgetary Impact and Comparison with the Administration's Estimate

CBO estimates that the Medicare buy-in for people ages 62 to 64 would raise outlays for Medicare benefits by \$8.9 billion over the 1999-2003 period. Pre-65 premiums would total \$7.3 billion, and post-65 premiums would amount to \$0.2 billion (see Table B-1). The net increase in Medicare spending would be \$1.3 billion, roughly the same as the Administration's estimated net cost of \$1.4 billion over five years. Of the 320,000 people who would participate in 1999, two-thirds would otherwise have purchased private individual coverage, and about 30 percent would have been uninsured. The remainder would consist of people induced to retire because of the buy-in option.

CBO's estimates of the net cost of the buy-in are similar to the Administration's, although CBO's estimates of participation are higher. Overall, CBO concluded that participants would cost about 45 percent more than the average cost of the entire newly eligible group and about 25 percent more than the pre-65 premiums they would pay. The Administration estimated that participants would cost about 50 percent more than their pre-65 premiums. CBO's estimate of net costs per participant is lower for two reasons: it reflects the fact that some high-cost people in the eligible age group would already have Medicare because of a disability, and secondarily, it assumes higher estimated participation and slightly lower adverse selection. Reflecting the larger gap between the costs of coverage and pre-65 premiums, the Administration estimated that post-65 premiums would initially be about \$14 a month for each year of participation—higher than CBO's estimate of \$10 a month.

Like the Administration, CBO assumed that approximately 1 percent of people ages 62 to 64 would retire if they could obtain health insurance through the Medicare buy-in. As a result, Social Security benefits would increase by about \$0.2 billion a year. CBO further assumed that employers' coverage of retirees would fall by about 10 percent as a result of the buy-in, reduc-

ing employers' costs and thereby increasing federal tax revenues slightly. The estimate also includes additional costs to Medicaid for the post-65 premiums. In total, CBO estimates that the proposal would cost \$1.9 billion over the 1999-2003 period.

Basis of the Estimate

CBO's estimates of federal costs for the buy-in proposal for people ages 62 to 64 were based on several sources: population projections made by the Social

Table B-1.
Medicare Buy-In for People Ages 62 to 64 (By fiscal year, in billions of dollars)

	1999	2000	2001	2002	2003	Total, 1999-2003
Direct Spending						
Medicare Outlays						
Benefits	1.0	1.7	1.8	2.1	2.3	8.9
Premiums						
Pre-65	-0.9	-1.3	-1.5	-1.7	-1.9	-7.3
Post-65	<u>0</u>	<u>a</u>	<u>a</u>	<u>-0.1</u>	<u>-0.1</u>	<u>-0.2</u>
Subtotal	-0.9	-1.4	-1.5	-1.7	-2.0	-7.6
Outlays Net of Premiums	0.1	0.3	0.3	0.3	0.3	1.3
Social Security Benefit Payments	0	0.2	0.2	0.2	0.2	0.7
Medicaid Outlays	<u>0</u>	<u>b</u>	<u>b</u>	<u>b</u>	<u>b</u>	<u>b</u>
Total	0.1	0.5	0.5	0.5	0.5	2.0
Revenues						
Corporate Profits and Other Taxes	0	b	b	b	b	0.1
Total Cost of the Medicare Buy-In for People Ages 62 to 64						
Total	0.1	0.5	0.5	0.4	0.4	1.9
Memorandum (Calendar year):						
Participation	320,000	330,000	350,000	370,000	390,000	
Pre-65 Monthly Premium (Dollars) ^c	310	326	346	368	394	
Pre-65 Estimated Monthly Cost of Those Participating (Dollars)	389	407	431	456	486	
Post-65 Monthly Premium per Year of Participation (Dollars)	10	10	11	11	11	

SOURCE: Congressional Budget Office.

NOTE: The estimate assumes that the buy-in would become available on January 1, 1999. The Administration's estimate assumes that it would become available on July 1, 1999.

- a. Offsetting receipts of less than \$50 million.
- b. Outlays or revenues of less than \$50 million.
- c. Premiums shown are for benefit costs only, to be comparable with the premiums reported by the Administration. An allowance for administrative costs would increase those premium amounts by about 2 percent each year (making the 1999 pre-65 premium equal to \$316 a month).

Security Administration, the March 1997 Current Population Survey (CPS), and Medicare claims and administrative data.

Eligibility. Population projections by the Social Security Administration indicate that 6.3 million people will be ages 62 to 64 in 1999. Of that number, about 13 percent will already have Medicare because of a disability or renal disease, and another 10 percent will have Medicaid or other public coverage. Thus, only about 77 percent of all people ages 62 to 64—or 4.8 million people—would be potentially eligible for the buy-in. Of those people, 1.6 million would be immediately eligible because they are uninsured or have only private individual insurance. The other 3.2 million would not be immediately eligible because they have employment-sponsored insurance, but they would become eligible if they lost that coverage.

Participation. Using the Current Population Survey, CBO estimated participation in the buy-in for four distinct types of people.

- o *Those who lack insurance coverage* (about 1 million people in 1999). CBO assumed that among this group, people in poor health with high income (greater than three times the poverty level) and residing in states without community rating in the individual insurance market would all participate in the buy-in.² For the remainder, the probability of participation was assumed to depend on the percentage reduction in the price of insurance (the price of the buy-in relative to the price in the private individual market).³ Overall, about 9 percent of this group would participate in the buy-in.
- o *Those who purchase individual health insurance in the private market* (600,000 people). The more these people would save in insurance premiums by switching to Medicare, the more likely they would be to do so. Even if the Medicare premium was the same as the private premium, CBO assumed that 10 percent would switch to the buy-in because of

the greater assurance of its continued availability at affordable prices. CBO further assumed that the probability of participation would increase by 10 percentage points for each additional \$10 difference in premiums, up to a maximum of 80 percent participation. Finally, CBO assumed that 20 percent of those in the private insurance market would not switch regardless of the amount they could save. Under these assumptions, about 35 percent of this group would take advantage of the buy-in.

- o *Those who are working and covered by employment-based insurance* (1.8 million people). CBO assumed that 1 percent of this group would be induced to retire because of the buy-in option.⁴ All of those retirees would participate in the buy-in.
- o *Retirees whose employers currently offer retiree health insurance* (1.5 million people). This group is expected to diminish in number in the coming years, and the buy-in option would accelerate that decline. In the absence of the buy-in, people in this group who no longer had access to employment-based insurance would either purchase individual coverage in the private market or remain uninsured until they became eligible for Medicare. CBO used logistic regression to predict who would purchase individual coverage and who would remain uninsured. Using the methods described above, CBO then determined the probability that people would participate in the buy-in. By 2003, an estimated 3 percent of this group would take advantage of the buy-in.

Premiums. The price individuals face in the private insurance market would vary based on their health status, the insurance regulations in their state, the level of medical costs in their state, and the administrative costs of the private insurance. Medicare's buy-in premium in a given year would vary by only one factor—the level of medical costs in the state.

Under CBO's projections of Medicare costs, the pre-65 Medicare premium in 1999 would average \$310 a month for benefit costs, plus an estimated 2 percent—or \$6 a month—for administrative costs. However, the

2. Under pure community rating, everyone pays the same premium, regardless of age or health status. Under modified community rating, premiums may vary by age group but not by health status.

3. See Congressional Budget Office, *Behavioral Assumptions for Estimating the Effects of Health Care Proposals*, CBO Memorandum (November 1993).

4. See J. Gruber and B. Madrian, "Health Insurance Availability and the Retirement Decision," *American Economic Review*, vol. 85, no. 4 (September 1995), pp. 938-948.

actual premium that participants paid would vary by geographic area. CBO made adjustments for differences among states' Medicare costs based on the 1997 AAPCC. (The AAPCC is the adjusted average per capita cost of Medicare in a county; values for states were calculated as a weighted average of county values.) In addition to the pre-65 premium, CBO estimated an amount to reflect participants' perception of the additional costs they would incur for the post-65 premiums for which they would be liable in later years. That perceived amount was estimated as the present value (at the start of the buy-in year) of the post-65 premiums they would pay for that buy-in year, using a 30 percent discount rate and the expected remaining lifetime for a 65-year-old person. In estimating the post-65 premium, CBO assumed that people participating in the buy-in would have mortality rates similar to other people their age.

Medicare Costs. Based on Medicare claims data, CBO estimates that people who would be newly eligible for Medicare under the buy-in proposal would cost the program about 85 percent of the average cost of everyone ages 62 to 64 if they all enrolled. About 13 percent of all people in the eligible age group are already enrolled in Medicare because of a disability or renal disease, and that excluded group is a relatively costly one. Nevertheless, the average cost to Medicare for participants in the buy-in is expected to exceed the pre-65 premium by about 25 percent because of adverse selection among those eligible to participate.

Uncertainties in the Estimate. One of the most important areas of uncertainty is the extent to which eligible people would discount the post-65 premiums for which they would be liable if they participated in the buy-in. The two-part premium structure is designed to prevent the rising premiums and declining enrollment (termed a "death spiral") that would otherwise tend to develop. Medicare would be the insurer of last resort, because private insurers (except in the few states with community rating and guaranteed issue) could selectively enroll the healthier members of the group eligible for the buy-in. If the pre-65 premium was set to cover fully the costs of people expected to select the buy-in option, it would steadily increase relative to premiums in the private market, leading to declining participation and ever greater adverse selection for the buy-in plan. The two-part premium structure would avoid a death

spiral only if buy-in participants heavily discounted the post-65 premiums, so that the cost they perceived for the buy-in option was not much higher than the pre-65 premium.

CBO's estimates assume that individuals would discount future premiums much more heavily than the rate the government pays to borrow funds. If, however, they used the same discount rate as the government (6 percent), participation would be much lower and net costs would be higher—\$2 billion from 1999 through 2003 (see the table below). If individuals took no account of future premiums (that is, they had an infinite discount rate), participation would be higher and net costs would be slightly lower because there would be less adverse selection.

Alternative Assumptions	1999 Participation	Medicare Costs, 1999-2003 (Billions of dollars)
CBO Estimate	320,000	1.3
Individuals' Discount Rate		
6 percent	160,000	2.0
Infinite	360,000	1.1
Difference in Premium Between Medicare and Private Insurance for People of Average Risk		
20 percent	170,000	2.1
45 percent	420,000	0.7

Changes in other assumptions could also affect the estimates significantly. For example, if the premiums that people of average risk would be charged for comparable individual insurance in the private market exceeded Medicare premiums by 20 percent instead of the assumed 33 percent, participation in the buy-in would be much lower but net costs would be higher because of greater adverse selection. Conversely, if private premiums exceeded Medicare premiums by a greater amount, participation would be higher and costs would be lower.

Medicare Buy-In for Displaced Workers Ages 55 to 61

The Administration also proposes to allow a limited number of workers ages 55 to 61 (and their spouses) who lose health insurance because of a job loss to buy in to the Medicare program. Unlike the buy-in for people ages 62 to 64, this program would be available only to people who met several eligibility requirements related to losing their job. Those requirements include having received employment-based health insurance coverage for the 12 months before losing their job, being eligible for unemployment insurance benefits, and exhausting the 18 months of continued coverage that is available under the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).⁵

Premiums for the buy-in for displaced workers would be set at \$400 a month per person in 1999 and would be updated annually. CBO assumed that updates would reflect the growth of costs per capita in the Medicare program. Premiums would also be adjusted for geographic differences in costs. By design, premiums would not fully cover the costs of the program.

Budgetary Impact and Comparison with the Administration's Estimate

The combination of stringent eligibility requirements and relatively high premiums would result in limited participation—about 18,000 full-year-equivalents in 2003. Those most likely to enroll would be people with medical expenditures that were higher than average for their age. Over the 1999-2003 period, Medicare costs would increase by almost \$470 million, and premium collections would total about \$340 million. The net increase in Medicare outlays would be about \$130 mil-

lion over that period (see Table B-2). The proposal would also encourage a small number of additional workers to seek unemployment insurance, raising federal outlays for unemployment compensation by an estimated \$9 million over five years.

The Administration estimated that Medicare costs for workers ages 55 to 61 would amount to \$1.4 billion and that premium collections would total \$1.2 billion between 1999 and 2003. According to the Administration, the net increase in Medicare spending under the buy-in would be about \$160 million, based on estimated enrollment that would rise to 80,000 in 2003.

Basis of the Estimate

The Survey of Income and Program Participation (SIPP)—with its monthly information on respondents' work status, receipt of unemployment insurance, and health insurance coverage—was used to estimate the number of people who would participate in the program.

Eligibility. Using the SIPP data, CBO directly estimated the number of people who would meet the eligibility rules for unemployment insurance and a year of health insurance coverage before losing their job. Those data also provided information on the frequency of use of COBRA coverage by people who would meet other eligibility requirements for the program and the extent of other insurance coverage. CBO assumed that people with access to less expensive coverage, such as employment-based insurance with a contribution from an employer, would not purchase Medicare for \$400 a month. SIPP also provided evidence on the distribution of hospital use and physician visits by the eligible population; that information was used to estimate the costs of people likely to participate in the buy-in.

Participation. About 1 million people ages 55 to 61 are estimated to become eligible for unemployment insurance in a typical year. Only about half of them would meet the requirement of having employment-based insurance throughout their last 12 months of work. Furthermore, most of them would continue to have access to less expensive health insurance coverage after separating from their job. Thus, fewer than 190,000 workers annually would meet the requirement for unemployment insurance, have had enough insur-

5. CBO used those eligibility rules for its estimates, based on information received in February from the Office of Management and Budget. Proposed legislation recently released by the Administration, however, incorporates less restrictive requirements for prior coverage. In particular, any "creditable coverage" (as defined in the Health Insurance Portability and Accountability Act of 1996) would count toward the requirement for 12 months of prior coverage, provided the worker had been enrolled in the employer's plan at the time of separation. Thus, COBRA coverage would count toward the 12-month requirement rather than being a separate, additional requirement. Those looser requirements would increase CBO's estimates of coverage and costs.

ance on their previous job, and have gone through a period in which they had no access to less expensive coverage.

Of the eligible people who might be interested in enrolling in Medicare, about 80 percent would have worked at a firm of 20 or more employees. They would therefore be required to purchase COBRA coverage through their former employer for 18 months before being allowed to buy in to Medicare. The vast majority of workers in those circumstances either do not choose COBRA coverage at all or do not remain on COBRA for very long; therefore, they would not become eligible for the Medicare buy-in. Although workers from small firms do not have access to COBRA coverage, most of them would not purchase individual insurance at market rates.

People eligible to enroll in Medicare would also consider the options available to them in the private

market for individual insurance. The \$400 Medicare monthly premium would be about 50 percent higher than the expected Medicare cost of the average person ages 55 to 61. Therefore, people with average or relatively good health for their age would probably opt for private coverage rather than pay for the Medicare displaced workers program. In states with relatively strong community-rating laws, the Medicare buy-in would be even less desirable compared with private coverage.

Medicare Costs. Risk selection would result in net costs of about \$130 million over the 1999-2003 period. The displaced workers (and spouses) who would choose the buy-in would tend to be relatively high health risks who could not obtain a less expensive policy in the marketplace. That selection would result in a pool of participants whose average costs exceeded the \$400 buy-in premium, resulting in net costs to Medicare.

Table B-2.
Medicare Buy-In for Displaced Workers Ages 55 to 61 (By fiscal year, in millions of dollars)

	1999	2000	2001	2002	2003	Total, 1999-2003
Medicare Outlays						
Benefits	13	71	102	127	152	465
Premiums	<u>-9</u>	<u>-51</u>	<u>-74</u>	<u>-92</u>	<u>-110</u>	<u>-337</u>
Outlays Net of Premiums	4	20	28	35	42	128
Unemployment Compensation	<u>0</u>	<u>2</u>	<u>2</u>	<u>3</u>	<u>3</u>	<u>9</u>
Total Cost	4	21	30	37	45	137
Memorandum (Calendar year):						
Full-Year-Equivalent Participation	2,000	10,000	14,000	16,000	18,000	
Monthly Premium (Dollars)	400	420	447	475	508	
Estimated Monthly Cost of Those Participating (Dollars)	552	580	617	656	702	

SOURCE: Congressional Budget Office.

NOTE: CBO's estimates are based on information about the program's eligibility rules received in February from the Office of Management and Budget. Those rules would require displaced workers to have been enrolled in their employer's health plan for at least 12 months before losing their job and, in addition, to have exhausted their 18 months of COBRA coverage. Proposed legislation recently released by the Administration, however, incorporates less restrictive requirements for prior coverage. Although 12 months of previous health insurance coverage would still be required, COBRA coverage would count toward that requirement. Those looser requirements would increase CBO's estimates of coverage and costs.

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
Noah Meyerson	Social insurance taxes
Larry Ozanne	Capital gains realizations
John Sabelhaus	Estate and gift taxes
Sean Schofield	Excise taxes
Alyssa Trzeszkowski	Customs duties, miscellaneous receipts
David Weiner	Individual income taxes

Spending Projections

Defense, International Affairs, and Veterans' Affairs

Valerie Barton	Military retirement, veterans' education
Shawn Bishop	Veterans' health care, military health care
Kent Christensen	Defense (military construction, base closures)
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Raymond Hall	Defense (Navy weapons, missile defenses, atomic energy defense)
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Dawn Sauter	Intelligence programs and defense acquisition reform
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Health

Tom Bradley	Medicare Part A, managed care
Jeanne De Sa	Medicaid, State Children's Health Insurance Program
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Jennifer Jenson	Public Health Service, Medicare
Jeffrey Lemieux	Medicare Part B, federal employee health benefits, national health expenditures
Dorothy Rosenbaum	Medicaid, State Children's Health Insurance Program

Human Resources

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Dorothy Rosenbaum	Social services, food stamps, child nutrition
Kathy Ruffing	Social Security
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Natural and Physical Resources

Gary Brown	Water resources, other natural resources, regional development
Kim Cawley	Energy, pollution control and abatement
Clare Doherty	Transportation
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Mark Grabowicz	Justice, Postal Service
Kathleen Gramp	Energy, science and space
Victoria Heid	Conservation and land management, Outer Continental Shelf receipts
David Hull	Agriculture
Craig Jagger	Agriculture
James Langley	Agriculture
Kristen Layman	Transportation, Indian affairs, disaster assistance
Mary Maginniss	Deposit insurance, legislative branch
Susanne Mehlman	Justice, Federal Housing Administration and other housing credit
David Moore	Spectrum auction receipts
Deborah Reis	Recreation, water transportation, community development
John Righter	General government
Philip Webre	Universal Service Fund

Other

Janet Airis	Appropriation bills
Edward Blau	Authorization bills
Jodi Capps	Appropriation bills
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support
Mary Froehlich	Computer support

Vernon Hammett	Computer support
Jeffrey Holland	Net interest on the public debt
Daniel Kowalski	Credit programs, other interest
Catherine Mallison	Appropriation bills
Alex Roginsky	Computer support
Robert Sempsey	Appropriation bills
Stephanie Weiner	Budget projections, historical budget data
Jennifer Winkler	National income and product accounts, civilian agency pay