

National and District Overview

HOW RELIABLE ARE FEDERAL BUDGET PROJECTIONS?

Current projections by the Congressional Budget Office (CBO) and the Office of Management and Budget (OMB) show relatively large budget surpluses over the next decade. According to one scenario constructed by the CBO, the federal budget surplus is expected to total just under \$3.2 trillion between 2001 and 2010. The OMB projects a 10-year cumulative surplus of \$2.5 trillion.

Just a few short years ago, projections of rather large and rising budget deficits were the norm, making this turnaround in the U.S. government's finances nothing short of stunning.

Some Budget Basics

The surpluses cited above refer to the "unified" surplus. This surplus, though, is just one of three that the government reports. The other two, which combine to form the unified budget, are the off-budget and the on-budget. There is no particular economic or budget rationale for this arrangement—the budget's accounting conventions tend to be driven by political expediency. The Social Security program makes up nearly all of the off-budget account. In fiscal year (FY) 1999, the off-budget surplus was about \$124 billion. The on-budget account includes everything else, such as defense and highway spending; the on-budget surplus was less than \$1 billion in FY 1999. Of the projected \$3.2 trillion in cumulative unified budget surpluses noted above, nearly 75 percent come from the projected excess of Social Security revenues (taxes)—the off-budget side.

Mandatory Spending

In FY 1999, the federal government spent \$1.703 trillion dollars. Of that amount, two-thirds, or a little more than \$1.1 trillion, was spent on mandatory government

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programs and net interest on government debt (\$230 billion). The largest chunk of mandatory expenditures, not surprisingly, is government transfers to the elderly, the poor and the disabled, as reflected in outlays for Social Security (\$387 billion) and Medicare and Medicaid (\$296 billion). The level of mandatory spending is determined by law. In other words, unless Congress and the president agree to change the law, a huge portion of government expenditures does not change very much from year to year—although significant changes in economic conditions can result in substantially different outcomes from those initially projected a few years earlier.

Discretionary Spending

The remaining one-third of federal spending in the government's annual budget is called discretionary spending. Unlike mandatory spending, discretionary spending is determined annually by Congress and the president. Each year, after Congress receives the president's budget, it holds hearings and, ultimately, passes 13 appropriations bills that determine how much the government spends on such things as defense spending, farm programs and the judicial system.

This process has been amended in recent years, as Congress has operated under discretionary spending "caps" and "pay-as-you-go" legislation. Essentially, these laws, which can only be superseded by emergency legislation, such as monies to help victims of natural disasters, force Congress to operate within preset spending levels.

The Importance of Economic Assumptions

An important aspect of the budget process is the economic assumptions used by budget analysts. Putting together the economic forecast is crucial because the economy's rate of growth ultimately determines the amount of revenues collected and a substantial portion of the expenditures doled out. For example, if the economy turns out stronger than expected, then, all else equal, the outlays for unemployment benefits and other government assistance to the poor will turn out smaller than originally projected. Likewise, since faster growth boosts individual and corporate incomes, the amount of individual and corporate tax revenues that flow to the government will be greater than expected.

Indeed, this situation goes a long way in explaining the multi-trillion dollar budget surpluses projected by CBO and OMB. Are these budget surplus projections too optimistic? If the past is any guide, one should view them cautiously. For example, as recently as 1996, the CBO was projecting a \$400 billion *deficit* by 2006; today, under the most conservative scenario, it is projecting a \$325 billion *surplus* in 2006. As even both the CBO and the OMB acknowledge, the considerable difficulty of projecting economic outcomes, government programs and tax rates years in advance ensures that future large surpluses are anything but guaranteed. And even if they do materialize, policy-makers will still have to eventually deal with the larger unfunded liabilities (Social Security and Medicare) that stem from the retirement of the baby boom generation.

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