



FY2011 Budget Proposals and Projections

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Summary

This report provides an overview of major budget estimates and projections for the FY2011 federal budget cycle. The report presents and compares budget projections calculated by the Obama Administration's Office of Management and Budget (OMB) and the Congressional Budget Office (CBO). In addition, the report discusses major budgetary issues.

The congressional budget process, which includes the annual budget resolution and appropriations bills, usually begins once the Administration submits its budget to Congress. As Congress deliberates over the budget, the Administration often revises its proposals as it interacts with Members of Congress and as national and international economic conditions change.

The current economic climate poses major challenges to policymakers shaping the FY2011 federal budget. Although the economy has shown some signs of recovery from an economic recession that many economists consider the most severe since the Great Depression, unemployment remains at high levels. The U.S. economy grew at an annual rate of 5.9% in the last quarter of 2009 in inflation-adjusted terms, after having fallen at a 5.4% annual rate in the last quarter of 2008 and 6.4% in the first quarter of 2009. The national unemployment rate, which was 9.7% in February 2010, is projected to decline slowly. Weakness in residential and commercial real estate, high household debt levels, and fiscal challenges facing state and local governments may contribute to a long and slow economic recovery. The recession and the prospect of a slow recovery have strongly affected budget estimates and projections.

Federal spending tied to means-tested social programs has increased due to rising unemployment, while federal revenues are falling as individuals' incomes drop and corporate profits sink. Federal revenues fell 17% between FY2007 and FY2009. Although some costs of federal interventions in financial markets may be less than expected in late 2008 and early 2009, other interventions may present continuing fiscal challenges. Federal deficits, according to OMB and CBO projections, will likely remain high relative to historic norms over the next few years. Long-run fiscal challenges have received renewed attention as the ratio of federal debt held by the public to GDP, which compares the accumulation of federal debt (excluding intragovernmental debt) to the size of the economy as a whole, reached 53% at the end of FY2009 and, according to OMB and CBO estimates, will exceed 60% at the end of FY2010.

The Obama Administration released its FY2011 budget proposals on February 1, 2010. The Administration featured policy initiatives targeted at speeding up economic recovery, reducing the unemployment rate, implementing health insurance reform, overhauling financial regulation, and stabilizing housing markets and the automobile industry. The Administration also proposed a three-year freeze in non-security discretionary spending, which currently comprises about 15% of total federal outlays.

This report will be updated as warranted.

Contents

Overview of the FY2011 Budget Cycle	1
Budget Estimates, Proposals, and Projections	2
Projections of Federal Revenues.....	4
Federal Outlays.....	7
Outlays and Budget Authority	7
Federal Outlay Projections	7
Discretionary Outlays.....	9
Mandatory Outlays.....	9
Deficits	12
On-Budget Deficits and Off-Budget Surpluses	14
Federal Debt	17
Economic Projections and Economic Recovery	20
Issues Regarding Budget Projections	21
Accuracy and Statistical Bias in Budget Forecasts	22

Tables

Table 1. Budget Estimates and Proposals for FY2011	5
Table 2. Federal Revenues.....	6
Table 3. Federal Outlays.....	8
Table 4. Federal Discretionary Outlays.....	10
Table 5. Federal Mandatory Outlays.....	11
Table 6. Total Deficits	13
Table 7. On-Budget Deficits	15
Table 8. Off-Budget Surplus.....	16
Table 9. Debt Held by the Public at End of Fiscal Year	18
Table 10. Economic Projections: Gross Domestic Product (GDP).....	19

Contacts

Author Contact Information	23
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The federal budget not only outlines spending levels for government programs and how that spending will be funded, but also reflects the policy priorities of Congress and the President. This report provides an overview of major budget estimates and projections for the FY2011 federal budget cycle. The report presents and compares budget projections calculated by the Obama Administration's Office of Management and Budget (OMB) and the Congressional Budget Office (CBO). In addition, the report discusses selected major budgetary issues.

Overview of the FY2011 Budget Cycle

The congressional budget process, which includes the annual budget resolution and appropriations bills, usually begins once the Administration submits its budget to Congress.¹ As Congress deliberates over the budget, the Administration often revises its proposals as it interacts with Members of Congress and as national and international economic conditions change.²

The economy continues to post major challenges to policymakers shaping the FY2011 federal budget. The economic recession, which many economists consider the most severe American recession since the Great Depression, has strongly affected budget estimates and projections. The U.S. economy shrank at an annual inflation-adjusted rate of 5.4% in the last quarter of 2008, the biggest fall since 1982, followed by a 6.4% fall in annual-rate terms in the first quarter of 2009. Real GDP grew at an estimated annual rate of 5.9% in the fourth quarter of 2009, perhaps signaling the end of the recession.³ In addition, financial markets since mid-2009 appear to have stabilized significantly. While the economy is showing some signs of recovery, some project that unemployment rates could remain elevated for years. Some economists worry about the possibility of a "double-dip" recession, which would complicate existing budgetary challenges.

Federal spending tied to means-tested social programs has increased due to rising unemployment, while federal revenues are projected to fall as individuals' incomes drop and corporate profits sink. Total federal revenues fell 17% between FY2007 and FY2009, and corporate income tax receipts fell even more sharply. Federal deficits, according to OMB and CBO projections, will likely be high relative to historic norms over the next few years.

The federal government responded to the economic slowdown with an array of policy responses unprecedented in recent decades, including fiscal stimulus in the form of new spending and tax cuts. The federal government and the Federal Reserve also expanded or initiated major loan programs. As the economy recovers, the federal government and Federal Reserve plan to shrink or discontinue those programs as financial markets return to a more normal state. Some federal interventions, such as the Troubled Assets Relief Program, are now expected to cost far less than previous estimates, but the federal government may still face substantial credit risks associated with the takeovers of AIG, Fannie Mae, Freddie Mac, and large holdings in automobile

¹ The Budget and Accounting Act of 1921 requires the President to submit a budget to Congress each year. Current law (31 U.S.C. 1105(a)) requires the President to submit a budget no earlier than the first Monday in January, and no later than the first Monday in February.

² For an overview of federal budgetary issues, see CRS Report R41097, *The FY2011 Federal Budget*, by Mindy R. Levit.

³ U.S. Department of Commerce, Bureau of Economic Analysis, "Gross Domestic Product: Fourth Quarter 2009 (2nd Estimate)," press release BEA 10-05, February 26, 2010, available at http://bea.gov/newsreleases/national/gdp/2010/pdf/gdp4q09_2nd.pdf.

manufacturers. Furthermore, the federal government could face new fiscal challenges if economic recovery falters or if financial turmoil reemerges.

The Obama Administration released its FY2011 budget submission on February 1, 2010.⁴ The Administration featured policy initiatives targeted at speeding up economic recovery, reducing the unemployment rate, enacting health insurance reform, overhauling financial regulation, and stabilizing housing markets and the automobile industry.

On February 18, 2010, President Obama set up the National Commission on Fiscal Responsibility and Reform, which was charged with finding ways to “improve the fiscal situation in the medium term and to achieve fiscal sustainability over the long run.”⁵

Budget Estimates, Proposals, and Projections

Table 1 contains budget estimates for FY2011 from CBO and the Administration (the Office of Management and Budget, OMB). House and Senate Budget Committees are expected to issue their own budget totals in a budget resolution that reflects congressional funding priorities.

Budget estimates and projections vary due to differing underlying economic, technical, and budget-estimating assumptions and techniques, as well as differences in policy assumptions. Minor differences in underlying assumptions, which may generate small short-term discrepancies, can produce wide divergences in projected long-term budget paths. In addition, the extraordinary nature of federal responses to financial turmoil and economic recession have complicated some scoring issues. Budget estimates issued by the President, CBO, or by others, should be expected to change as new data arrive or as economic conditions change.

CBO current-law baseline projections are computed using assumptions set forth in budget enforcement legislation. The CBO baseline projections are not intended to serve as a prediction of what budget outcomes are most plausible or likely. Rather, the CBO baseline projections are designed to serve as a budgeting tool, which is used to determine how legislative changes would increase or decrease the federal deficit.⁶

CBO baseline projections typically yield estimates of higher growth in revenue and slower growth of discretionary spending relative to scenarios that independent forecasters consider likely. CBO baseline projections presume that

- discretionary spending remains constant in inflation-adjusted terms;
- the 2001 and 2003 tax cuts expire after FY2010 (as current law specifies);⁷

⁴ The Obama Administration’s FY2011 budget submission materials are available at <http://www.whitehouse.gov/omb/budget/>.

⁵ White House, “National Commission on Fiscal Responsibility and Reform,” Executive Order 13531, February 18, 2010, 75 Federal Register 7927, February 23, 2010, available at <http://edocket.access.gpo.gov/2010/pdf/2010-3725.pdf>.

⁶ CBO’s role is set forth in Title II of the Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344) and the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177). While the portions of that legislation affecting the CBO current-law baseline expired in September 2006, CBO has not changed how it constructs baseline projections.

⁷ See CRS Report R41111, *Expiration and Extension of the Individual Income Tax Cuts First Enacted in 2001 and* (continued...)

- the existing “patch” to the alternative minimum tax (AMT), which currently applies to tax year 2009, would lapse;⁸
- emergency unemployment benefits will not be extended;⁹ and
- cuts scheduled for Medicare physician services (Part B) as a result of “sustainable growth rate” calculations will not be delayed or cancelled.¹⁰

After FY2010, according to baseline projections, the expiration of most of the tax cuts from 2001 and 2003 would increase federal receipts. The assumption that these tax cuts expire and that growth in discretionary spending is zero in real terms explains much of the declining deficits that emerge over the 10-year CBO baseline forecast window and in the OMB BEA (Budget Enforcement Act) baseline. The Joint Committee on Taxation estimates that

- indexing the AMT to inflation for FY2010-FY2020 would cost \$584 billion and
- extending tax cuts enacted in 2001 and 2003 (mainly EGTRRA and JGTRRA) would cost \$2,465 billion over the FY2011-FY2020 period.¹¹

Beyond the end of the current 10-year forecast window, federal deficits are expected to grow rapidly, largely because of growing health care costs and the retirement of the baby boomers, unless major policy changes are made.¹²

CBO’s first budget report for the FY2011 budget cycle, released in January 2010, contained current-law budget baseline and economic projections for FY2011 through FY2020.¹³ This CBO report projected a FY2011 current-law baseline total deficit of \$980 billion, significantly smaller than the estimated FY2009 (\$1,414 billion) and FY2010 (\$1,349) deficits, but far larger than the FY2008 deficit (\$459 billion).

CBO’s January report also included estimated budgetary effects of selected policies on revenues and outlays. Those projections, which are based on assumptions that differ from current-law baseline conventions, can be used to assess costs of alternative policies.¹⁴ These alternative policy proposals interact in important ways, so that the costs of enacting two of these proposals may differ significantly from the sum of the costs of implementing each proposal separately. In

(...continued)

2003, by Maxim Shvedov.

⁸ The American Recovery and Reinvestment Act of 2009 (P.L. 111-5) included a one-year patch for the 2009 tax year. For details, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Steven Maguire.

⁹ For details, see CRS Report RS22915, *Temporary Extension of Unemployment Benefits: Emergency Unemployment Compensation (EUC08)*, by Julie M. Whittaker and Alison M. Shelton.

¹⁰ For details, see CRS Report R40907, *Medicare Physician Payment Updates and the Sustainable Growth Rate (SGR) System*, by Jim Hahn.

¹¹ U.S. Congress, Joint Committee on Taxation, “Estimated Revenue Effects Of The Revenue Provisions Contained In The President’s Fiscal Year 2011 Budget,” JCX-7-10, March 8, 2010.

¹² U.S. Congress, Congressional Budget Office, *The Long-term Budget Outlook*, June 2009, available at <http://www.cbo.gov/doc.cfm?index=10297&zzzz=39116>.

¹³ U.S. Congress, Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, available at <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>. CBO calls totals for the current fiscal year “estimates” and calls totals for future years “projections.”

¹⁴ Ibid., Table 1-5.

particular, the effects of indexing the AMT and the extension of the 2001 and 2003 tax cuts interact in significant ways.

On March 5, 2010, CBO published a preliminary analysis of the President's FY2011 proposals.¹⁵ CBO issued a more detailed analysis on March 24, which incorporated legislative changes made before mid-March 2010, although the projections of budget aggregates were only slightly changed.¹⁶ The March CBO budget projections do not reflect enactment of either the Hiring Incentives to Restore Employment Act (HIRE; P.L. 111-147) or the Patient Protection and Affordable Care Act (P.L. 111-148).

Administration proposals, according to CBO analysis, would lead to larger federal deficits over the 10-year FY2011-FY2020 budget window than those projected by the Obama Administration, in large part because CBO projects that the economy would grow more slowly than does OMB. CBO and OMB projections of gross domestic product (GDP) are presented in **Table 10**. A section following that table discusses some technical challenges of budget forecasting.

Projections of Federal Revenues

Administration and CBO projections of the future path of federal receipts are summarized in **Table 2**. Because economic conditions strongly affect federal revenue streams, forecasts of federal receipts beyond the short term are necessarily imprecise. Economic recession caused federal receipts to fall sharply in FY2008 and FY2009. Federal revenues fell 17% between FY2007 and FY2009. Receipts in FY2010 are expected to reflect renewed economic growth, and a modest rebound is expected in FY2011.

Corporate tax receipts and capital gains receipts can be especially sensitive to cyclical economic conditions. Asset values and corporate profits—and thus federal corporate income tax and capital gains revenues—typically recover more quickly after economic downturns than lagging indicators such as unemployment.

Several major legislative initiatives enacted in the past two years included tax provisions that had significant effects on federal revenues. The American Recovery and Reinvestment Act of 2009 introduced a temporary Making Work Pay tax credit, included a one-year AMT patch, and altered rules affecting business depreciation and the treatment of cancelled debts. The Children's Health Insurance Program Reauthorization Act of 2009 (P.L. 111-3) raised certain tobacco taxes to help fund the expansion of the State Children's Health Insurance Program (CHIP).¹⁷

¹⁵ U.S. Congress, Congressional Budget Office, *A Preliminary Analysis of the President's Budget Request for 2011*, letter to the Honorable Daniel K. Inouye dated March 5, 2010, available at <http://www.cbo.gov/ftpdocs/112xx/doc11231/index.cfm>. Also see Douglas Elmendorf, "Preliminary Analysis of the President's Budget," CBO Director's blog, available at <http://cboblog.cbo.gov/?p=482>.

¹⁶ U.S. Congress, Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 2011*, March 24, 2009, available at <http://www.cbo.gov/ftpdocs/112xx/doc11280/03-24-apb.pdf>.

¹⁷ CRS Report R40444, *State Children's Health Insurance Program (CHIP): A Brief Overview*, by Elicia J. Herz, Chris L. Peterson, and Evelyne P. Baumrucker.

Table 1. Budget Estimates and Proposals for FY2011

	Revenues	Outlays	Discretionary Outlays	Mandatory Outlays	Total	Deficits		Debt Held by the Public
						On-Budget	Off-Budget	
Billions of current dollars								
FY2010 CBO Baseline Estimate (3/10)	2,177	3,537	1,375	1,930	-1,360	-1,434	86	9,012
CBO Baseline, 1/2010	2,670	3,650	1,371	2,045	-980	-1,076	96	9,785
President's FY2011 Budget, 2/09	2,567	3,834	1,415	2,165	-1,267	-1,363	96	10,498
President's FY2011 Current Policy Baseline, 2/2010	2,583	3,728	1,376	2,100	-1,145	-1,241	96	
President's FY2011 BEA Baseline, 2/2010	2,782	3,694	1,396	2,050	-912	-1,008	96	
Prelim CBO Est. of Pres. Budget 3/2010	2,461	3,802	1,401	2,157	-1,341	-1,435	93	10,510
CBO Rev. Baseline 3/2010	2,673	3,668	1,369	2,032	-995			9,853
As % GDP								
FY2010 CBO Baseline Estimate	14.8%	14.9%	9.4%	13.2%	-9.3%	-9.8%	0.6%	61.7%
CBO Baseline, 1/2010	17.8%	24.3%	9.1%	13.6%	-6.5%	-7.2%	0.6%	65.3%
President's FY2011 Budget, 2/09	16.8%	25.1%	9.2%	14.2%	-8.3%	-8.9%	0.6%	68.6%
President's FY2011 Current Policy Baseline, 2/2010	16.9%	24.4%	9.0%	13.7%	-8.3%	-8.1%	0.6%	
President's FY2011 BEA Baseline, 2/2010	18.2%	24.1%	9.1%	13.4%	-8.3%	-6.6%	0.6%	
Prelim CBO Est. of Pres. Budget 3/2010	16.4%	25.4%	9.3%	14.4%	-8.9%	-9.6%	0.6%	68.7%
CBO Rev. Baseline 3/2010	17.8%	24.5%	9.1%	13.6%	-6.6%			65.7%

Sources: CBO and OMB

Notes: CBO estimates of FY2010 on- and off-budget deficits from January 2010 baseline. Debt held by public is amount projected for September 30, 2011, the end of FY2011. See text and source documents for additional caveats. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis.

Table 2. Federal Revenues

Estimates and Projections for the FY2011 Budget

Revenues	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
Historical	2,568	2,524	2,105											
CBO Baseline, 1/2010			2,105	2,175	2,670	2,964	3,218	3,465	3,625	3,814	3,996	4,170	4,352	4,563
President's FY2011 Budget, 2/09			2,105	2,165	2,567	2,926	3,188	3,455	3,634	3,887	4,094	4,299	4,507	4,710
President's FY2011 Current Policy Baseline, 2/2010			2,105	2,213	2,583	2,829	3,033	3,269	3,417	3,648	3,838	4,026	4,215	4,400
President's FY2011 BEA Baseline, 2/2010			2,105	2,231	2,782	3,069	3,308	3,581	3,760	4,018	4,235	4,452	4,671	4,885
Prelim CBO Est. of Pres. Budget 3/2010			2,105	2,118	2,461	2,807	3,095	3,341	3,504	3,693	3,869	4,031	4,212	4,417
CBO Rev. Baseline 3/2010			2,105	2,177	2,673	2,967	3,221	3,469	3,629	3,818	4,000	4,174	4,355	4,567
As % GDP														
Historical	18.5%	17.5%	14.8%											
CBO Baseline, 1/2010			14.8%	14.9%	17.8%	18.8%	19.3%	19.7%	19.7%	19.8%	19.9%	20.0%	20.1%	20.2%
President's FY2011 Budget, 2/09			14.8%	14.8%	16.8%	18.1%	18.6%	19.0%	18.9%	19.3%	19.4%	19.5%	19.5%	19.6%
President's FY2011 Current Policy Baseline, 2/2010			14.8%	15.1%	16.9%	17.5%	17.6%	18.0%	17.8%	18.1%	18.2%	18.2%	18.3%	18.3%
President's FY2011 BEA Baseline, 2/2010			14.8%	15.3%	18.2%	18.9%	19.3%	19.7%	19.6%	19.9%	20.0%	20.2%	20.2%	20.3%
Prelim CBO Est. of Pres. Budget 3/2010			14.8%	14.5%	16.4%	17.8%	18.6%	19.0%	19.0%	19.2%	19.3%	19.4%	19.4%	19.6%
CBO Rev. Baseline 3/2010			14.8%	14.9%	17.8%	18.9%	19.3%	19.7%	19.7%	19.9%	20.0%	20.0%	20.1%	20.3%

Sources: CBO and OMB

Notes: OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. See source documents and text for additional caveats. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis.

Both CBO and OMB estimate that federal revenues as a share of GDP in FY2010 (14.9%) will remain roughly the same as in FY2009 (14.8%). The CBO baseline forecast for FY2011 expects economic recovery to boost federal revenues to 17.8% of GDP. At the end of the 10-year budget window, federal revenues are projected to be just over one-fifth of GDP (20.2% in FY2020). All projections shown in **Table 2** project that FY2011 revenues will exceed FY2010 revenues due to the expectation that economic recovery will continue.

Federal Outlays

Outlays and Budget Authority

Many budget documents also report spending in terms of budget authority, which specifies what federal agencies can legally spend. Budget authority has been compared to funds deposited into a checking account, which then can be used for specified federal purposes. Congress often sets time limits on the availability of budget authority, although some accounts contain “no-year” funds that do not automatically expire. Federal agencies with available budget authority can obligate funds by signing contracts, hiring employees, or by entering into other binding agreements. Until the federal government disburses funds to make purchases, however, no outlays occur. Outlays will not increase until those funds are actually disbursed. Budget authority that is not obligated, aside from “no-year” funds, expires once the period of availability ends.¹⁸

Outlay data are more convenient for assessing the macroeconomic effects of the federal budgets, while analysts focusing on specific federal programs typically rely on budget authority figures. Appropriations legislation is generally framed in terms of budget authority, because Congress can control the amount of funds made available for specific purposes. The timing of federal outlays, on the other hand, often depends on administrative decisions of federal program officials, made within bounds set by Congress. This report focuses on outlays, rather than budget authority, in order to highlight broader effects of the federal budget on the economy.

Federal Outlay Projections

Table 3 summarizes Administration and CBO projections of future federal outlays (i.e., disbursed federal funds). Federal spending is projected to account for about a quarter of the U.S. economy in FY2011. In FY2008, federal spending accounted for just over one-fifth (20.9%) of the U.S. economy, nearly equal to its average share of gross domestic product (GDP) since FY1962.

The Administration’s budget submission calls for FY2011 outlays of \$3,834 billion (25.1% of GDP), \$166 billion above the March 2010 CBO baseline. Those baseline projections show outlays rising from \$3,537 billion in FY2010 to \$3,668 billion in FY2011. CBO estimates that outlays under the President’s budget plans would total \$3,802 billion in FY2011 and \$3,722 billion in FY2012.

¹⁸ Expired budget authority is kept on the federal government’s books for five years. After five years, balances are cancelled and expired accounts are closed. For a detailed description of federal appropriations procedures, see U.S. Government Accountability Office, *Principles of Federal Appropriations Law* (known as the “Red Book”), vol. 1, GAO-04-261SP, January 2004, available at <http://www.gao.gov/legal/redbook.html>.

Table 3. Federal Outlays
Estimates and Projections for the FY2011 Budget

Outlays	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
Historical	2,729	2,983	3,518											
CBO Baseline, 1/2010			3,518	3,524	3,650	3,613	3,756	3,940	4,105	4,335	4,521	4,712	5,000	5,250
President's FY2011 Budget, 2/09			3,518	3,721	3,834	3,755	3,915	4,161	4,386	4,665	4,872	5,084	5,415	5,713
President's FY2011 Current Policy Baseline, 2/2010			3,518	3,643	3,728	3,762	3,973	4,203	4,400	4,661	4,879	5,103	5,443	5,746
President's FY2011 BEA Baseline, 2/2010			3,518	3,635	3,694	3,682	3,869	4,077	4,252	4,487	4,680	4,874	5,178	5,443
Prelim CBO Est. of Pres. Budget 3/2010			3,518	3,618	3,802	3,722	3,842	4,065	4,297	4,587	4,808	5,032	5,364	5,670
CBO Rev. Baseline 3/2010			3,518	3,537	3,668	3,608	3,746	3,931	4,100	4,330	4,520	4,707	4,996	5,250
As % GDP														
Historical	19.6%	20.7%	24.7%											
CBO Baseline, 1/2010			24.7%	24.1%	24.3%	23.0%	22.5%	22.4%	22.3%	22.6%	22.6%	22.6%	23.1%	23.3%
President's FY2011 Budget, 2/09			24.7%	25.4%	25.1%	23.2%	22.8%	22.9%	22.9%	23.1%	23.1%	23.0%	23.5%	23.7%
President's FY2011 Current Policy Baseline, 2/2010			24.7%	24.9%	24.4%	23.2%	23.1%	23.1%	22.9%	23.1%	23.1%	23.1%	23.6%	23.9%
President's FY2011 BEA Baseline, 2/2010			24.7%	24.9%	24.1%	22.7%	22.5%	22.4%	22.2%	22.3%	22.1%	22.1%	22.4%	22.6%
Prelim CBO Est. of Pres. Budget 3/2010			24.7%	24.8%	25.4%	23.7%	23.0%	23.1%	23.3%	23.9%	24.0%	24.2%	24.8%	25.2%
CBO Rev. Baseline 3/2010			24.7%	24.2%	24.5%	22.9%	22.5%	22.3%	22.3%	22.5%	22.6%	22.6%	23.1%	23.3%

Sources: CBO and OMB

Notes: OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. See source documents and text for additional caveats. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis.

Discretionary Outlays

Discretionary spending is provided and controlled through appropriations acts, which fund many of the activities commonly associated with such federal government functions as running executive branch agencies, congressional offices and agencies, and international operations of the government.¹⁹ Essentially all spending on federal wages and salaries is discretionary.

Table 4 presents projections of discretionary outlays. While discretionary spending was the largest category of federal spending until the mid-1970s, mandatory spending in FY2010 (13.3% of GDP) accounted for about 4% more of GDP than discretionary spending (9.4% of GDP). Discretionary spending will decline to just 6.7% of GDP in FY2020, according to CBO baseline projections, which assume that discretionary spending is held constant in inflation-adjusted terms.

Discretionary spending over the next several fiscal years is projected to decrease in inflation-adjusted terms. The Obama Administration has called for a three-year freeze on non-security discretionary spending. The Obama Administration essentially defines “security” spending as funding for the Department of Defense, the Department of Energy’s National Nuclear Security Administration, the Department of Homeland Security, the Department of Veterans Affairs, the Department of State, and international food aid programs.²⁰ The Obama Administration has proposed moving funding for some Pell Grants, which are aimed at post-secondary education students that meet certain eligibility and financial need requirements, from discretionary spending to mandatory spending.²¹

Mandatory Outlays

Mandatory spending includes federal government spending on entitlement programs and the Supplemental Nutrition Assistance Program (SNAP; formerly Food Stamps) as well as other budget outlays controlled by laws other than appropriation acts.²² Entitlement programs such as Social Security and Medicare make up the bulk of mandatory spending. Other mandatory spending programs include Temporary Assistance for Needy Families (TANF), Supplemental Security Income (SSI), unemployment insurance, some veterans’ benefits, federal employee retirement and disability, and the earned income tax credit (EITC).

Table 5 summarizes projections of mandatory outlays. According to March 2010 CBO baseline estimates, mandatory outlays will total \$2,045 billion (13.6% of GDP) in FY2011 and \$1,996 billion (12.7% of GDP) in FY2012.

¹⁹ For details, see CRS Report RL34424, *Trends in Discretionary Spending*, by D. Andrew Austin and Mindy R. Levit.

²⁰ See notes for Office of Management and Budget, *Budget of the U.S. Government*, Table S-11, available at <http://www.whitehouse.gov/omb/budget/fy2011/assets/tables.pdf>. The George W. Bush Administration used a different definition for “security” funding.

²¹ For details, see CRS Report R41127, *The SAFRA Act: Amendments to Education Programs through Budget Reconciliation in the 111th Congress*, coordinated by Cassandra Dortch.

²² For details, see CRS Report RL33074, *Mandatory Spending Since 1962*, by D. Andrew Austin and Mindy R. Levit.

Table 4. Federal Discretionary Outlays

Estimates and Projections for the FY2011 Budget

Discretionary Outlays	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
Historical	1,041	1,135	1,219											
CBO Baseline, 1/2010			1,237	1,371	1,371	1,344	1,346	1,357	1,373	1,402	1,426	1,450	1,486	1,518
President's FY2011 Budget, 2/09			1,219	1,408	1,415	1,301	1,267	1,283	1,310	1,337	1,371	1,405	1,442	1,484
President's FY2011 Current Policy Baseline, 2/2010			1,219	1,397	1,376	1,340	1,343	1,367	1,396	1,425	1,460	1,496	1,534	1,573
President's FY2011 BEA Baseline, 2/2010			1,238	1,424	1,396	1,360	1,364	1,388	1,418	1,447	1,482	1,519	1,557	1,597
Prelim CBO Est. of Pres. Budget 3/2010			1,237	1,375	1,401	1,334	1,301	1,303	1,323	1,355	1,381	1,407	1,446	1,487
CBO Rev. Baseline 3/2010				1,375	1,369	1,344	1,347	1,358	1,374	1,403	1,427	1,451	1,488	1,519
As % GDP														
OMB/Historical/Actual FY2009	7.6%	7.9%	8.6%											
CBO Baseline, 1/2010			8.7%	9.4%	9.1%	8.5%	8.1%	7.7%	7.5%	7.3%	7.1%	7.0%	6.9%	6.7%
President's FY2011 Budget, 2/09			8.6%	9.6%	9.2%	8.0%	7.4%	7.1%	6.8%	6.6%	6.5%	6.4%	6.3%	6.2%
President's FY2011 Current Policy Baseline, 2/2010			8.6%	9.6%	9.0%	8.3%	7.8%	7.5%	7.3%	7.1%	6.9%	6.8%	6.6%	6.5%
President's FY2011 BEA Baseline, 2/2010			8.7%	9.7%	9.1%	8.4%	7.9%	7.6%	7.4%	7.2%	7.0%	6.9%	6.8%	6.6%
Prelim CBO Est. of Pres. Budget 3/2010			8.7%	9.4%	9.3%	8.5%	7.8%	7.4%	7.2%	7.0%	6.9%	6.8%	6.7%	6.6%
CBO Rev. Baseline 3/2010				9.4%	9.1%	8.5%	8.1%	7.7%	7.5%	7.3%	7.1%	7.0%	6.9%	6.7%

Sources: CBO and OMB**Notes:** OMB does not break out some future disaster spending estimates between mandatory and discretionary spending.

OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis.

See source documents and text for additional caveats.

Table 5. Federal Mandatory Outlays
Estimates and Projections for the FY2011 Budget

Mandatory Outlays	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
OMB/Historical/Actual FY2009	1,451	1,848	2,112											
CBO Baseline, 1/2010			2,094	1,946	2,045	1,989	2,077	2,188	2,272	2,414	2,524	2,638	2,838	3,008
President's FY2011 Budget, 2/09			2,112	2,123	2,165	2,107	2,208	2,364	2,500	2,696	2,815	2,942	3,182	3,384
President's FY2011 Current Policy Baseline, 2/2010			2,112	2,057	2,100	2,079	2,191	2,316	2,413	2,579	2,698	2,823	3,060	3,256
President's FY2011 BEA Baseline, 2/2010			2,093	2,023	2,050	1,993	2,101	2,224	2,319	2,483	2,600	2,721	2,951	3,142
Prelim CBO Est. of Pres. Budget 3/2010			2,094	2,034	2,157	2,091	2,176	2,322	2,454	2,636	2,752	2,871	3,084	3,267
CBO Rev. Baseline 3/2010				1,930	2,032	1,996	2,091	2,199	2,278	2,416	2,525	2,642	2,842	3,011
As % GDP														
OMB/Historical/Actual FY2009	10.4%	12.8%	14.8%											
CBO Baseline, 1/2010			14.7%	13.3%	13.6%	12.6%	12.5%	12.4%	12.3%	12.6%	12.6%	12.7%	13.1%	13.3%
President's FY2011 Budget, 2/09			14.8%	14.5%	14.2%	13.0%	12.9%	13.0%	13.0%	13.4%	13.3%	13.3%	13.8%	14.1%
President's FY2011 Current Policy Baseline, 2/2010			14.8%	14.1%	13.7%	12.8%	12.8%	12.7%	12.6%	12.8%	12.8%	12.8%	13.3%	13.5%
President's FY2011 BEA Baseline, 2/2010			14.7%	13.8%	13.4%	12.3%	12.2%	12.2%	12.1%	12.3%	12.3%	12.3%	12.8%	13.1%
Prelim CBO Est. of Pres. Budget 3/2010			14.7%	13.9%	14.4%	13.3%	13.0%	13.2%	13.3%	13.7%	13.7%	13.8%	14.2%	14.5%
CBO Rev. Baseline 3/2010				13.2%	13.6%	12.7%	12.5%	12.5%	12.4%	12.6%	12.6%	12.7%	13.1%	13.4%

Sources: CBO and OMB

Notes: OMB does not break out some future disaster spending estimates between mandatory and discretionary spending.

OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis.

See source documents and text for additional caveats.

Most of the costs of federal interventions that responded to financial turmoil in 2007 and 2008 were classified as mandatory, which pushed mandatory spending to \$2,112 billion (14.8% of GDP) in FY2009. Stabilization of financial markets is expected to lead to lower mandatory spending totals in the next few years. Rising entitlement program costs, however, are projected to lead to significant increases in mandatory spending in later years.

Deficits

Deficits occur when Congress and the President enact policies that cause federal spending to exceed federal receipts. Deficits increase government debt held by the public, generally increasing net interest payments. Surpluses occur when federal receipts exceed outlays, which reduces federal debt held by the public.²³ This can, in turn, reduce net interest payments.

Governments run deficits for several reasons. By running short-run deficits, governments can avoid raising taxes during economic downturns, helping households to smooth consumption over time. Running deficits can stimulate aggregate demand in the economy, giving policy makers a valuable fiscal policy tool that can help support macroeconomic stability. Long-run deficits allow transfers of economic resources from younger to older generations, enabling older generations to enjoy anticipated benefits of future economic growth, but also may be used to impose large burdens on future generations.²⁴

Deficits can seriously harm national economies. Governments can spend more than they collect in revenues by printing money, which can cause inflation, or by borrowing. In the short run, fiscal overstimulation leads to inflation. In the long term, deficits either reduce capital investment, which retards economic growth, or increase foreign borrowing, which swells the share of national income going abroad. In the long run, governments that fail to repay borrowers, at least to the extent of stabilizing the ratio of government debt to gross domestic product, risk default and bankruptcy.

Table 6 summarizes Administration and CBO projections of total federal deficits. Long-term CBO and OMB projections both show substantial increases in budget deficits in the years after FY2020.²⁵ These deficits result from a projected gap between rising federal outlays and revenues. The growth of health care spending, as well as demographic changes, plays an important part of those fiscal trends. The federal government last ran a surplus in FY2001, which amounted to \$128 billion or 1.3% of GDP.

²³ Very small surpluses might not reduce debt held by the public in some circumstances. In recent years, major financial interventions, such as the conservatorships of Fannie Mae and Freddie Mac, have led to increases in federal indebtedness that do not match federal deficits.

²⁴ See CRS Report RL33657, *Running Deficits: Positives and Pitfalls*, by D. Andrew Austin.

²⁵ U.S. Congress, Congressional Budget Office, *The Long-Term Budget Outlook*, June 2009, available at <http://www.cbo.gov/doc.cfm?index=10297>.

Table 6.Total Deficits

Estimates and Projections for the FY2011 Budget

Total Deficits	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
OMB/Historical/Actual FY2009	-161	-459	-1,413											
CBO Baseline, 1/2010				-1,349	-980	-650	-539	-475	-480	-521	-525	-542	-649	-687
President's FY2011 Budget, 2/09				-1,556	-1,267	-828	-727	-706	-752	-778	-778	-785	-908	-1,003
President's FY2011 Current Policy Baseline, 2/2010				-1,430	-1,145	-934	-940	-934	-983	-1,013	-1,042	-1,077	-1,227	-1,346
President's FY2011 BEA Baseline, 2/2010				-1,404	-912	-613	-561	-495	-492	-469	-445	-421	-507	-557
Prelim CBO Est. of Pres. Budget 3/2010				-1,500	-1,341	-915	-747	-724	-793	-894	-940	-1,001	-1,152	-1,253
CBO Rev. Baseline 3/2010				-1,360	-995	-641	-525	-462	-471	-512	-520	-533	-640	-683
As % GDP														
OMB/Historical/Actual FY2009	-1.2%	-3.2%	-9.9%											
CBO Baseline, 1/2010				-9.2%	-6.5%	-4.1%	-3.2%	-2.7%	-2.6%	-2.7%	-2.6%	-2.6%	-3.0%	-3.0%
President's FY2011 Budget, 2/09				-10.6%	-8.3%	-5.1%	-4.2%	-3.9%	-3.9%	-3.9%	-3.7%	-3.6%	-3.9%	-4.2%
President's FY2011 Current Policy Baseline, 2/2010				-10.6%	-8.3%	-5.1%	-4.2%	-3.9%	-3.9%	-3.9%	-3.7%	-3.6%	-3.9%	-4.2%
President's FY2011 BEA Baseline, 2/2010				-10.6%	-8.3%	-5.1%	-4.2%	-3.9%	-3.9%	-3.9%	-3.7%	-3.6%	-3.9%	-4.2%
Prelim CBO Est. of Pres. Budget 3/2010				-10.3%	-8.9%	-5.8%	-4.5%	-4.1%	-4.3%	-4.7%	-4.7%	-4.8%	-5.3%	-5.6%
CBO Rev. Baseline 3/2010				-9.3%	-6.6%	-4.1%	-3.1%	-2.6%	-2.6%	-2.7%	-2.6%	-2.6%	-3.0%	-3.0%

Sources: CBO and OMB**Notes:** OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis. See source documents and text for additional caveats.

On-Budget Deficits and Off-Budget Surpluses

The total federal deficit (or surplus) is the sum of the off-budget and on-budget deficits or surpluses. The U.S. Postal Service net profits or losses and Social Security revenues net of beneficiary payments are by law considered off-budget entities.

Table 7 summarizes projections of on-budget deficits. The on-budget deficit is estimated to decline to \$1,076 billion (7.2% of GDP) in FY2011 according to CBO March 2010 baseline projections. None of the projections show an on-budget surplus within the next 5 or 10 years.

Table 8 summarizes projections of off-budget surpluses, which mainly comprise Social Security surpluses. Since FY1985, Social Security surpluses have led to off-budget surpluses, which has reduced the size of the total deficit. High unemployment rates and other effects of economic recession have lowered inflows of payroll taxes, pushing off-budget surpluses below previously expected levels.

Table 7. On-Budget Deficits
Estimates and Projections for the FY2010 Budget

On-Budget Deficits	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
OMB/Historical/Actual FY2009	-342	-638	-1,550											
CBO Baseline, 1/2010				-1,434	-1,076	-757	-659	-608	-619	-659	-659	-669	-765	-793
President's FY2011 Budget, 2/09				-1,634	-1,363	-949	-863	-852	-910	-952	-952	-959	-1,075	-1,153
President's FY2011 Current Policy Baseline, 2/2010				-1,508	-1,241	-1,054	-1,074	-1,080	-1,139	-1,183	-1,209	-1,243	-1,385	-1,486
President's FY2011 BEA Baseline, 2/2010				-1,482	-1,008	-733	-695	-642	-648	-640	-613	-588	-665	-698
Prelim CBO Est. of Pres. Budget 3/2010				-1,585	-1,435	-1,020	-865	-854	-931	-1,033	-1,076	-1,131	-1,273	-1,365
As % GDP														
OMB/Historical/Actual FY2009	-2.5%	-4.4%	-10.9%											
CBO Baseline, 1/2010				-9.8%	-7.2%	-4.8%	-4.0%	-3.5%	-3.4%	-3.4%	-3.3%	-3.2%	-3.5%	-3.5%
President's FY2011 Budget, 2/09				-11.2%	-8.9%	-5.9%	-5.0%	-4.7%	-4.7%	-4.7%	-4.5%	-4.3%	-4.7%	-4.8%
President's FY2011 Current Policy Baseline, 2/2010				-10.3%	-8.1%	-6.5%	-6.3%	-5.9%	-5.9%	-5.9%	-5.7%	-5.6%	-6.0%	-6.2%
President's FY2011 BEA Baseline, 2/2010				-10.1%	-6.6%	-4.5%	-4.0%	-3.5%	-3.4%	-3.2%	-2.9%	-2.7%	-2.9%	-2.9%
Prelim CBO Est. of Pres. Budget 3/2010				-10.9%	-9.6%	-6.5%	-5.2%	-4.8%	-5.1%	-5.4%	-5.4%	-5.4%	-5.9%	-6.1%

Sources: CBO and OMB

Notes: OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis. See source documents and text for additional caveats.

Table 8. Off-Budget Surplus
Estimates and Projections for the FY2011 Budget

Off-Budget Deficit/Surplus	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
OMB/Historical/Actual FY2009	181	183	137											
CBO Baseline, 1/2010				86	96	108	120	133	139	138	134	127	116	107
President's FY2011 Budget, 2/09				78	96	120	136	146	158	175	174	174	167	151
President's FY2011 Current Policy Baseline, 2/2010				78	96	120	135	147	156	170	168	166	157	140
President's FY2011 BEA Baseline, 2/2010				78	96	121	135	147	156	170	168	166	158	140
Prelim CBO Est. of Pres. Budget 3/2010				85	93	105	118	130	138	139	136	130	121	112
As % GDP														
OMB/Historical/Actual FY2009	1.3%	1.3%	1.0%											
CBO Baseline, 1/2010				0.6%	0.6%	0.7%	0.7%	0.8%	0.8%	0.7%	0.7%	0.6%	0.5%	0.5%
President's FY2011 Budget, 2/09				0.5%	0.6%	0.7%	0.8%	0.8%	0.8%	0.9%	0.8%	0.8%	0.7%	0.6%
President's FY2011 Current Policy Baseline, 2/2010				0.5%	0.6%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.7%	0.6%
President's FY2011 BEA Baseline, 2/2010				0.5%	0.6%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.7%	0.6%
Prelim CBO Est. of Pres. Budget 3/2010				0.5%	0.6%	0.8%	0.8%	0.8%	0.8%	0.9%	0.8%	0.8%	0.7%	0.6%

Sources: CBO and OMB

Notes: OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis. See source documents and text for additional caveats.

Federal Debt

Gross federal debt is the sum of debt held by the public and intragovernmental (IG) debt.²⁶ IG debt is the amount owed by the federal government to other federal agencies, which the U.S. Treasury is obligated to pay at some future time. The Social Security and Medicare trust funds, which by law must be invested in federal securities, are the largest components of IG debt.²⁷ IG debt also includes dozens of other federal trust funds.²⁸

Debt held by the public is the total amount the federal government has borrowed from the public and remains outstanding. This measure is generally considered to be the most relevant in macroeconomic terms because it is the amount of debt sold in credit markets. **Table 9** shows various projections of debt held by the public.

Congress sets a ceiling on federal debt, which was raised twice in 2009 and once in early 2010. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (H.R. 1, P.L. 111-5) increased the debt limit to \$12,104 billion.²⁹

The FY2010 budget resolution (S.Con.Res. 13) recommended policies that would lead to a debt subject to limit of \$13,233 billion at the end of FY2010, a level that would require an increase in the statutory debt limit. The House's adoption of the conference report on the FY2010 budget resolution (S.Con.Res. 13) on April 29, 2009, triggered the automatic passage of H.J.Res. 45 to raise the debt limit to \$13.029 trillion. In August 2009, Treasury reportedly said that the debt limit would be reached in mid-October, although it later stated that the limit would not be reached until mid or late December 2009. H.R. 4314, passed by the House on December 16, 2009, and by the Senate on December 24, raised the debt limit to \$12.394 trillion when the President signed the measure (P.L. 111-123) on December 28. On January 28, the Senate passed an amended version of H.J.Res. 45, which the House passed on February 4 and the President signed on February 12 (P.L. 111-139), raising the federal debt limit to \$14.294 trillion.

Federal debt held by the public rose sharply from 40.8% of GDP at the end of FY2008 to 53.0% at the end of FY2010.³⁰ That ratio, according to the March 2010 CBO baseline, is projected to rise to 65.7% at the end of FY2011. CBO's analysis of the President's FY2011 budget proposals suggests that ratio would reach 84.3% of GDP at the end of FY2020.

²⁶ Gross federal debt is also referred to as total debt or total public debt outstanding. Intragovernmental debt is also referred to as intragovernmental holdings or debt held by federal government accounts.

²⁷ U.S. Executive Office of the President, Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2009, Analytical Perspectives*, February 2008, p. 408.

²⁸ Eric M. Patashnik, *Putting Trust in the U.S. Budget: Federal Trust Funds and the Politics of Commitment* (Cambridge, UK: Cambridge, 2000).

²⁹ See CRS Report RL31967, *The Debt Limit: History and Recent Increases*, by D. Andrew Austin and Mindy R. Levit.

³⁰ U.S. Congress, Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 2010, available at <http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf>.

Table 9. Debt Held by the Public at End of Fiscal Year

Estimates and Projections for the FY2011 Budget

Debt Held By the Public	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
Billions of current dollars														
OMB/Historical/Actual FY2009	5,035	5,803	7,545											
CBO Baseline, 1/2010				8,797	9,785	10,479	11,056	11,556	12,055	12,595	13,133	13,678	14,329	15,027
President's FY2011 Budget, 2/09				9,298	10,498	11,472	12,326	13,139	13,988	14,833	15,686	16,535	17,502	18,573
Prelim CBO Est. of Pres. Budget 3/2010				9,221	10,510	11,578	12,467	13,329	14,256	15,297	16,396	17,558	18,875	20,298
CBO Rev. Baseline 3/2010				9,012	9,853	10,541	11,102	11,595	12,092	12,641	13,209	13,790	14,479	15,211
As % GDP														
OMB/Historical/Actual FY2009	36.2%	40.2%	53.0%											
CBO Baseline, 1/2010				60.3%	65.3%	66.6%	66.3%	65.6%	65.4%	65.5%	65.5%	65.7%	66.1%	66.7%
President's FY2011 Budget, 2/09				63.6%	68.6%	70.8%	71.7%	72.2%	72.9%	73.6%	74.2%	74.9%	75.9%	77.2%
Prelim CBO Est. of Pres. Budget 3/2010				63.1%	68.7%	71.5%	72.6%	73.3%	74.3%	75.9%	77.6%	79.5%	81.8%	84.3%
CBO Rev. Baseline 3/2010				61.7%	65.7%	67.0%	66.6%	65.9%	65.6%	65.8%	65.9%	66.2%	66.8%	67.5%

Sources: CBO and OMB**Notes:** OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis. See source documents and text for additional caveats.

Table 10. Economic Projections: Gross Domestic Product (GDP)

Billions of Current Dollars

Gross Domestic Product	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018	FY2019	FY2020
OMB/Historical/Actual FY2009	13,896	14,439	14,237	14,624	15,299	16,203	17,182	18,193	19,190	20,163	21,136	22,087	23,065	24,067
CBO Baseline, 1/2010			14,236	14,595	14,992	15,730	16,676	17,606	18,421	19,223	20,036	20,823	21,667	22,544
CBO Rev. Baseline 3/2010			14,236	14,595	14,992	15,730	16,676	17,606	18,421	19,223	20,036	20,823	21,667	22,544

Sources: CBO and OMB

Notes: OMB data are divided by OMB GDP estimates; CBO data by CBO GDP estimates. "CBO Rev. Baseline 3/2010" data are taken from March 5, 2010, preliminary analysis. See source documents and text for additional caveats.

Economic Projections and Economic Recovery

Budget projections of the Administration and CBO are strongly influenced by expectations of the future health of the U.S. economy. The recent economic recession has also highlighted links between the federal budget and the economy. Budgetary projections for FY2011 and beyond depend in large part on how robust economic recovery is expected to be. The timing and strength of the economic recovery from the current recession will likely have major effects on the federal budget. In particular, changes in the expected path of the U.S. economy would affect future revisions of CBO baseline estimates of federal outlays and revenues. On the one hand, a faster-than-expected recovery would imply projections for higher federal revenues and lower outlays on certain “automatic stabilizer” programs whose spending increases when household incomes fall, which would lead to lower baseline projections of federal deficits. On the other hand, a slower or weaker-than-expected recovery would tend to increase projected federal deficits.

The current economic recession has been much deeper than many economic forecasters anticipated in 2007 and 2008. For instance, the U.S. economy contracted at an annual rate of 5.4% in the last quarter of 2008 and 6.4% in the first quarter of 2009, according to Commerce Department estimates, a sharper decline than many economists had expected. Estimates for the fourth quarter of 2009, which put annualized GDP growth at 5.9%, may signal an end of the economic recession.³¹

Some economic forecasters remain concerned about the medium-term strength of the economy for several reasons. State and local governments still face daunting fiscal problems, and many have exhausted rainy-day funds that cushioned them at the beginning of the recession. Interest-sensitive industries such as housing construction and automobile manufacturing that have helped spark past economic recoveries are considered unlikely to help economic recovery much in the near future. Many households are carrying high debt loads relative to historical levels and have suffered significant capital losses in housing and other investment, which may dampen private consumption for some time. Foreclosure rates are expected to continue at high levels, and concerns about the commercial real estate sector lead some to worry about the solvency of banks with substantial exposure to that sector. Finally, the financial services sector may face continuing challenges in coming years. For these reasons, many economists expect recovery from this recession to be more gradual than the economic rebound after shallower recessions in the past two decades.

Most economists expect unemployment rates to remain elevated for the medium term. Unemployment rates have risen dramatically, reportedly much more than Administration and private-sector economists expected in early 2009.³² Unemployment rates are typically a lagging indicator, meaning that unemployment rates during recessions have stayed high even as other indicators of economic activity have showed signs of recovery. CBO estimates that the

³¹ U.S. Department of Commerce, Bureau of Economic Analysis, “Gross Domestic Product: Fourth Quarter 2009 (2nd Estimate),” press release BEA 10-05, February 26, 2010, available at http://bea.gov/newsreleases/national/gdp/2010/pdf/gdp4q09_2nd.pdf.

³² David Leonhardt, “A Forecast With Hope Built In,” *New York Times*, July 1, 2009, p. B1.

unemployment rate will peak in early 2010 at just over 10% and will decline only to 9.5% in FY2011.³³

Forecasting turning points in economic trends, however, is difficult for technical and substantial reasons that are discussed in the next section. **Table 10** presents forecasts of gross domestic product (GDP), which measures the size of the economy.

Issues Regarding Budget Projections

Budget projections depend on models that reflect assumptions about the structure of the economy, expected tax and program changes, and how these interact, along with other factors that affect the budget. Changed economic conditions, such as faster or slower economic growth, higher or lower inflation, or new spending and tax policies, affect budget estimates and projections. In addition, technical components of the budget models may change as the structure of the economy evolves and as econometric techniques advance. In particular, major recessions can alter the structure of an economy in significant ways, making models based on historical data less reliable.

Budget forecasts, unlike most other types of economic forecasts, are constructed in order to estimate the incremental costs of policy changes (i.e., scoring) in a consistent manner. If policy changes do occur, actual budget outcomes will then differ from baseline estimates. Technical factors and changes in economic conditions also affect budget forecasts. In recent years, OMB and CBO have provided information about how past forecasts have varied from actual results.

CBO has analyzed the track record of its budget estimates extensively and now routinely includes information about its forecast record of baseline projections in its budget publications.³⁴ CBO also provides detailed explanations of why its projections differ from OMB projections.³⁵ CBO routinely provides a breakdown of economic, legislative, and technical factors responsible for divergences between past forecasts and actual outcomes.

Making accurate budget projections is inherently difficult. Reliable forecasting depends on the stability of trends. Some trends, such as population demographics, are highly predictable. For instance, many baby boomers will retire in the next decade, leading to higher spending for Medicare and Social Security. Estimating the growth in the beneficiary populations eligible for these programs is relatively straightforward. Budget estimates also depend on factors that are difficult to predict, such as future productivity growth and business cycles. Some factors that affect federal revenues, such as financial market trends, can be extremely volatile.

Making budget estimates and projections for the FY2011 budget cycle is especially challenging for several reasons. The economy is starting to recover from a painful recession that differs from recent downturns in important ways. The economy could emerge from the recession transformed in ways that may take time to understand fully. Continuing turmoil in financial markets makes forecasting interest rates, which affect the costs of many federal programs and debt servicing,

³³ U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020*, January 26, 2010.

³⁴ U.S. Congress, Congressional Budget Office, *"The Uncertainty of Budget Projections: A Discussion of Data and Methods,"* March 2006.

³⁵ U.S. Congress, Congressional Budget Office, *"Comparing Budget and Accounting Measures of the Federal Government's Fiscal Condition,"* December 2006.

difficult. Forecasting economic recoveries, even for milder downturns, is difficult. The Obama Administration has proposed major program initiatives in many policy areas. Estimating the budgetary effects of major changes is more difficult than estimating effects of incremental changes.

Even in less tumultuous times, small changes in projected economic growth trajectories can lead to large budgetary consequences, especially for longer time horizons. Small changes in economic conditions, such as GDP growth, can produce large changes in the budget estimates. According to CBO estimates, a persistent 0.1% decrease in the real GDP growth rate would increase a deficit, including interest costs, by \$61 billion cumulatively over a five-year period and by \$273 billion over 10 years. Faster GDP growth would decrease deficits.³⁶

Accuracy and Statistical Bias in Budget Forecasts

Budget projections are inherently uncertain. Two measures of the quality of economic forecasts are *statistical unbiasedness* and *accuracy*. Statistical unbiasedness means that average forecast errors over time are close to zero. An unbiased forecasting method may be of little use if forecast errors are large. Accuracy means that forecast errors are small, meaning that outcomes are close to predictions. Some forecasting methods may sacrifice unbiasedness in order to gain greater accuracy.³⁷ Most forecasters, as far as possible, strive to make projections that are both unbiased and accurate.

Presidential budget requests in recent years have included measures that can be used to assess the accuracy and statistical bias of previous forecasts.³⁸ Forecasts diverge from actual results because of legislative changes, unforeseen economic factors, and other factors. Current-law baseline projections will diverge from actual results when laws change, either expanding, constricting, or eliminating current programs, or by creating new programs. Projections that presume a president's policy proposals are enacted diverge from actual results if those policies are not enacted as proposed.

Since FY1982, OMB February deficit projections for the upcoming budget year underestimated the total deficit by \$55 billion. Changes in legislation accounted for most of that divergence. The standard deviation of Administration budget year deficit/surplus estimates was \$233 billion for the same period FY1982-FY2009.³⁹ A standard deviation measures the average size of forecast errors. The standard deviation for the corresponding four-years-ahead forecast was \$343 billion. The accuracy of forecasts generally declines as the forecast window extends to later years because more policy and economic changes can occur in the interim.

³⁶ Slower economic growth would also reduce a budget surplus.

³⁷ There may be a tradeoff between statistical unbiasedness and accuracy because some statistically biased methods may generate forecasts with greater accuracy. Also, other properties of forecasts may be important, such as predicting turning points in economic trends. For a nontechnical discussion of economic forecasting, see Peter Kennedy, *A Guide to Econometrics*, 3rd ed., Boston: MIT Press, 1992, ch. 17, pp. 268-277.

³⁸ Office of Management and Budget, *Budget of the U.S. Government: Analytical Perspectives, FY2011*, ch. 29, "Comparison of Actual to Estimated Totals," available at http://www.whitehouse.gov/omb/budget/fy2011/assets/technical_analyses.pdf.

³⁹ CRS calculation based on OMB data.

OMB used its standard deviation estimate to compute upper and lower bounds for deficit projections.⁴⁰ In the FY2011 budget submission, OMB estimated the FY2015 federal deficit would be 3.9% of GDP, with an upper bound of 10.4% of GDP and a lower bound of a 2.6% surplus.⁴¹ If the statistical assumptions underlying that calculation were valid, the actual FY2015 deficit should fall within the upper and lower bounds with a 90% probability. The spread between the upper and lower bounds indicates the estimated precision of the five-years-ahead deficit forecast.

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⁴⁰ The upper and lower bounds were computed assuming that forecast errors for different years are statistically independent and are normally distributed.

⁴¹ Office of Management and Budget, *Budget of the U.S. Government: Analytical Perspectives, FY2011*,” ch. 3, “Interactions between the Economy and the Budget,” p. 23, available at http://www.whitehouse.gov/omb/budget/fy2011/assets/econ_analyses.pdf.