The Standardized Budget:
Details of the Projections

APRIL 2001

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NOTE

Numbers in the tables may not add up to totals because of rounding.

On January 31, 2001, the Congressional Budget Office (CBO) released *The Budget and Economic Outlook: Fiscal Years 2002-2011*. That document reports CBO's most recent projections of federal revenues, outlays, and surpluses over that period. Some policy analysts use an adjusted version of the budget balance known as the standardized budget surplus (or deficit), which is a measure of the budget balance that includes adjustments in order to better focus on how changes in the budget might affect the growth of the total demand for goods and services by changing government saving. That concept, known as fiscal stimulus or restraint, is usually defined as the annual change in the standardized budget measured as a percentage of potential gross domestic product (GDP). The standardized budget attempts to exclude the effect that cyclical movements in the economy may have on the budget, and CBO's current version of the standardized budget also contains other adjustments for factors such as capital gains taxes and federal interest payments to improve the measure's ability to reveal the budget's effect on total demand.

The standardized budget has its limitations, however, in measuring the federal budget's impact on the economy. The measure shows trends in federal government saving, but those trends are only one of the ways in which fiscal policy affects demand and the economy. Other important influences include fiscal policy's effects on incentives for private individuals to work and to save, but those incentives are not reflected at all in the standardized budget. Moreover, the standardized budget gives only a partial view even of the effect of the budget on total demand. Changes in private saving may partly offset changes in government saving if some people think their future tax liabilities are affected by how much the government saves. Moreover, the standardized budget reflects the budget balance as a whole and not the different components of the budget, although those different components probably affect demand in different ways: for example, a tax cut for wealthy individuals may largely be saved and thus not affect their consumption very much, while increases in spending on roads and bridges show up directly in the economy dollar for dollar.

Fiscal stimulus must be used with care. Fiscal stimulus means an increase in total demand achieved through a reduction in government saving. Such a stimulus may be appropriate when the economy is not using all of its productive capacity, though many economists are skeptical of using fiscal policy as an anticyclical measure because it is much less nimble than monetary policy and risks adding to demand when a cyclical upswing is already under way. Furthermore, even if fiscal stimulus may be appropriate for a time, a fiscal policy that remains stimulative for too long may reduce the growth potential of the economy by lowering national saving. Fiscal stimulus thus can have quite different implications for growth in the short run and in the long run.

Despite its limitations, the standardized budget can help in fiscal planning. By removing many temporary fluctuations in the budget surplus, it facilitates discerning budgetary trends. For that reason, some analysts, including those who advocate budgetary targets such as balancing the budget on average over the business cycle, find the standardized budget a useful way to monitor fiscal policy.

One of the by-products of the standardized budget is an estimate of the automatic responses of revenues and outlays to cyclical changes in income and unemployment. Those responses, known as the automatic stabilizers, tend to counteract economic fluctuations without any change in tax or spending policies. During economic downturns, for example, tax revenues automatically decline and outlays for unemployment insurance automatically rise, both of which help to sustain consumer spending. Those responses take effect immediately, without the sometimes long lags involved in the passage of budget legislation—and even before signs of the downturn become evident to forecasters and policymakers.[1]

This supplement to CBO's *The Budget and Economic Outlook: Fiscal Years 2002-2011* describes how the estimates of the standardized budget are produced and provides projections through fiscal year 2002.[2]

ADJUSTMENTS

CBO makes several types of adjustments to the total budget balance in calculating the standardized budget. It adjusts revenues and outlays to remove the effects of the business cycle. It also excludes factors that arguably may have no impact on total demand, such as asset sales[3] and "timing changes"—shifts of a day or two in the timing of receipts or outlays that move them from one fiscal year to another.

Beginning last year, CBO's calculations of the standardized budget incorporated new adjustments.[4] They remove several other sources of change in budget totals that confuse the effect of the budget on the growth of total demand. The most important new adjustments are the following:

- Capital gains tax collections have been removed from the calculations because large fluctuations in those taxes (cyclical or not) can distort measures of how the budget is affecting total demand. Suppose, for example, that capital gains tax rates are cut. That action is clearly a fiscal

1. For theoretical and empirical discussions of automatic stabilizers, see Darrel Cohen and Glenn Follette, "The Automatic Fiscal Stabilizers: Quietly Doing Their Own Thing," *Economic Policy Review*, Federal Reserve Bank of New York, vol. 6, no. 1 (2000), pp. 35-68.

2. Historical estimates are presented in Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002-2011* (January 2001), Appendix F, Tables F-2 and F-3, pp. 140-141.

3. Sales of federal assets have no direct effect on the economy. Nevertheless, such sales reduce the liquidity of private wealth, which conceivably could have some effect. Implicitly, by removing asset sales, CBO's estimates of the standardized budget assume that the liquidity of purchasers of federal assets is not constrained.

4. The adjustments adopted in 2000 are the subject of the CBO publication *The Standardized Budget: Revised Historical Estimates*, CBO Memorandum (June 2000).

stimulus, not a restraint. However, in the year or so following the tax cut, capital gains realizations could increase by more than enough to offset the revenue loss due to the tax cut, as investors take advantage of that cut. Large increases in realized capital gains are likely to strengthen consumer spending despite the taxes paid on them. Yet the increase in federal revenues from those realizations could increase government saving for a while, so if they were included in the standardized budget, they would incorrectly suggest fiscal restraint. (For 2000, capital gains tax collections have not yet been tabulated, so the adjustment for 2000 is estimated.)

- Estimates of the inflation component of federal interest payments are now excluded because that part of the payments probably is not stimulative. It is simply a return of principal to holders of public debt who otherwise would experience a capital loss; thus, the money is likely to be saved rather than spent. Without an adjustment to exclude that inflation component, changes in the standardized budget would tend to overstate fiscal stimulus (or understate fiscal restraint) when the inflation component rose as a share of potential GDP. That adjustment assumes, however, that bondholders do not use the inflation component of interest payments to finance consumption, even if other income is temporarily low. (If that is not the case, then making the adjustment would cause the standardized budget to overstate fiscal restraint, or understate fiscal stimulus, when the inflation component rose as a share of potential GDP).

- Estimates of large changes in withheld taxes that are not matched by changes in tax liabilities are now largely excluded because, for the majority of consumers, such changes are not likely to have much effect on their spending. In March 1992, for example, withholding rates were reduced significantly by executive order, which lowered revenues (and over-withholding) by more than $14 billion in fiscal year 1992 and by about $5 billion in 1993, even though there was no corresponding reduction in tax liabilities. The size of the effect on consumer spending depends on how many consumers face constraints in their financial liquidity because they are unable to finance additional consumption with credit or savings or do not do so for other reasons. Estimates of the effects of "liquidity constraints" vary considerably. CBO's fiscal measure assumes that consumers with such constraints and those with similar behavior account for 30 percent of all consumption. Because most consumers would not change their spending, CBO adjusted standardized-budget revenues upward by roughly $10 billion (about 70 percent of $14 billion) in fiscal year 1992 and $4 billion (about the same percentage of $5 billion) in 1993.

IMPLICATIONS

The budgetary changes measured by the standardized budget tended to dampen the short-term growth of total demand in 2000: from 1999 to 2000, the standardized-budget surplus rose from 0.2 percent to 1.1 percent of potential GDP (see Tables 1 and 2). Almost half of that restraint reflected a decline in real (inflation-adjusted) interest payments which fell from 1.9 percent to 1.5 percent of potential GDP (see Tables 3 and 4).

The rest of the restraint in fiscal year 2000 mainly reflected exceptionally strong growth in cyclically adjusted personal income tax payments that was not due to recent tax legislation or to the estimated effects of capital gains realizations. Those payments may have grown because a larger share of total income shifted to people in high tax brackets, or because capital gains realizations were greater than those CBO had in its adjustments, or because the growth in taxable income was stronger than that indicated by recent data from the national income and product accounts. But the various data needed to fully understand the strong growth in revenues will not be completely available until next year.

By contrast with last year, the standardized-budget surplus is expected to edge up by only 0.3 percent of potential GDP each year in 2001 and 2002, under the assumption that current policies remain in place. Such a small change in the surplus is not likely to have any clearly discernible impact on the growth of demand. Most of the total change over those two years is due to a continued decline in real interest payments. Standardized revenues, mandatory spending, and discretionary outlays are relatively unchanged as a percentage of potential GDP.

Table 1. The Standardized-Budget Surplus, Fiscal Years 1997-2002

	Actual				Projected	
	1997	1998	1999	2000	2001	2002
In Billions of Dollars						
Surplus	-56	-18	20	106	139	186
Revenues	1,508	1,613	1,688	1,821	1,937	2,057
Outlays	1,564	1,630	1,667	1,716	1,798	1,871
As a Percentage of Potential GDP						
Surplus	-0.7	-0.2	0.2	1.1	1.4	1.7
Revenues	18.4	18.8	18.7	19.1	19.2	19.2
Outlays	19.1	19.0	18.5	18.0	17.8	17.5

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

Table 2. Details of the Standardized-Budget Surplus, Fiscal Years 1997-2002 (In billions of dollars)

	Actual				Projected	
	1997	1998	1999	2000	2001	2002
Revenues						
Budget	1,579	1,722	1,827	2,025	2,135	2,236
Cyclical adjustments	*	-21	-37	-86	-68	-54
Other adjustments	-71	-88	-103	-118	-129	-125
Standardized	1,508	1,613	1,688	1,821	1,937	2,057
Mandatory Spending Less Offsetting Receipts						
Budget	808	857	898	949	1,002	1,061
Cyclical adjustments	3	7	8	11	6	5
Other adjustments	30	17	10	3	16	8
Standardized	841	881	916	962	1,023	1,075
Discretionary Spending						
Budget	549	555	575	617	646	682
Timing adjustment	0	0	0	-3	3	0
Standardized	549	555	575	614	649	682
Interest Payments						
Budget	244	241	230	223	205	179
Inflation adjustment	-70	-46	-54	-84	-79	-66
Standardized	174	195	176	139	126	114
Total Surplus						
Budget	-22	69	124	236	281	313
Cyclical adjustments	-3	-28	-45	-96	-74	-59
Other adjustments[a]	-32	-58	-59	-34	-68	-68
Standardized	-56	-18	20	106	139	186

SOURCES: Congressional Budget Office; Department of the Treasury; Office of Management and Budget.

NOTES: The cyclical adjustments to revenues are negative when actual GDP exceeds potential GDP. By contrast, the cyclical adjustments to mandatory spending are positive when the unemployment rate is less than the nonaccelerating inflation rate of unemployment. The cyclical adjustments to the budget surplus equal the cyclical adjustments to revenues minus the cyclical adjustments to mandatory spending.

* = less than $500 million and greater than -$500 million.

a. "Other adjustments" to the total surplus comprise "Other adjustments" to revenues minus the sum of "Other adjustments" to mandatory spending, the "Timing adjustment" to discretionary spending, and the "Inflation adjustment" to interest payments. Those adjustments are detailed in Table 4.

Table 3. Details of the Standardized-Budget Surplus, Fiscal Years 1997-2002 (As a percentage of potential GDP)

	Actual				Projected	
	1997	1998	1999	2000	2001	2002
Revenues						
Budget	19.3	20.0	20.2	21.2	21.1	20.9
Cyclical adjustments	*	-0.2	-0.4	-0.9	-0.7	-0.5
Other adjustments	-0.9	-1.0	-1.1	-1.2	-1.3	-1.2
Standardized	18.4	18.8	18.7	19.1	19.2	19.2
Mandatory Spending Less Offsetting Receipts						
Budget	9.9	10.0	10.0	10.0	9.9	9.9
Cyclical adjustments	*	0.1	0.1	0.1	0.1	*
Other adjustments	0.4	0.2	0.1	0	0.2	0.1
Standardized	10.3	10.3	10.2	10.1	10.1	10.0
Discretionary Spending						
Budget	6.7	6.5	6.4	6.5	6.4	6.4
Timing adjustment	0	0	0	*	*	0
Standardized	6.7	6.5	6.4	6.4	6.4	6.4
Interest Payments						
Budget	3.0	2.8	2.5	2.3	2.0	1.7
Inflation adjustment	-0.9	-0.5	-0.6	-0.9	-0.8	-0.6
Standardized	2.1	2.3	1.9	1.5	1.2	1.1
Total Surplus						
Budget	-0.3	0.8	1.4	2.5	2.8	2.9
Cyclical adjustments	*	-0.3	-0.5	-1.0	-0.7	-0.6
Other adjustments[a]	-0.4	-0.7	-0.7	-0.4	-0.7	-0.6
Standardized	-0.7	-0.2	0.2	1.1	1.4	1.7

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

NOTES: The cyclical adjustments to revenues are negative when actual GDP exceeds potential GDP. By contrast, the cyclical adjustments to mandatory spending are positive when the unemployment rate is less than the nonaccelerating inflation rate of unemployment. The cyclical adjustments to the budget surplus equal the cyclical adjustments to revenues minus the cyclical adjustments to mandatory spending.

* = less than 0.05 percent and greater than -0.05 percent.

a. "Other adjustments" to the total surplus comprise "Other adjustments" to revenues minus the sum of "Other adjustments" to mandatory spending, the "Timing adjustment" to discretionary spending, and the "Inflation adjustment" to interest payments. Those adjustments are detailed in Table 4.

Table 4. Other Adjustments to the Standardized-Budget Surplus, Fiscal Years 1997-2002

	Actual				Projected	
	1997	1998	1999	2000	2001	2002
In Billions of Dollars						
Revenues						
Capital gains	-72	-84	-98	-118	-129	-125
Timing	1	4	-5	0	0	0
Other	0	-8	0	0	0	0
Mandatory Outlays						
Deposit insurance	-14	-4	-5	-3	-1	-1
Asset sales	-5	-10	-3	-4	-4	-5
Spectrum auctions	-11	-3	-2	*	–9	*
Timing	0	0	0	4	-2	-3
Discretionary Outlays						
Timing adjustment	0	0	0	3	-3	0
Interest Payments						
Inflation adjustment	70	46	54	84	79	66
Total	-32	-58	-59	-34	-68	-68
As a Percentage of Potential GDP						
Revenues						
Capital gains	-0.9	-1.0	-1.1	-1.2	-1.3	-1.2
Timing	**	**	-0.1	0	0	0
Other	0	-0.1	0	0	0	0
Mandatory Outlays						
Deposit insurance	-0.2	-0.1	-0.1	0	0	0
Asset sales	-0.1	-0.1	0	0	0	0
Spectrum auctions	-0.1	0	**	**	-0.1	**
Timing	0	0	0	**	**	**
Discretionary Outlays						
Timing adjustment	0	0	0	**	**	0
Interest Payments						
Inflation adjustment	0.9	0.5	0.6	0.9	0.8	0.6
Total	-0.4	-0.7	-0.7	-0.4	-0.7	-0.6

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

NOTES: The signs of the adjustments to outlays in this table have the opposite sign of the corresponding adjustments in Tables 2 and 3 because the adjustments in this table sum to show the effect on the surplus.

* = less than $500 million and greater than -$500 million.

** = less than 0.05 percent and greater than -0.05 percent.