III. SUSTAINING OUR ECONOMIC PROSPERITY

III. SUSTAINING OUR ECONOMIC PROSPERITY

> *In 1993, Vice President Gore and I took office determined to change our course, to follow a new economic strategy founded on fiscal discipline, investment in our people, and expanded trade. Today the success of that strategy is very much in evidence . . . America has come a long way in the last seven years—from recession to recovery; from economic disorder to a fiscal house finally in order. We have even begun to pay down our debt. By putting first things first, by saving Social Security and strengthening Medicare, our Nation can actually become debt free for the first time since 1835, when Andrew Jackson was President.*
>
> President Clinton
> August 1999

When President Clinton took office in 1993, his greatest priority was to get the economy moving again and, in turn, restore prosperity and purpose to our Nation. To reach this goal, it was essential to reverse the unrestrained growth of the Federal budget deficit. In the previous 12 years, the budget deficit had exploded, sapping resources from productive investment and undermining confidence in the Government's ability to help shape our economic future for the better.

The President confronted a Federal budget deficit that had grown enormously since 1981—at $290 billion dollars in 1992, the deficit was the largest in the Nation's history. During the same period, the string of annual budget deficits added to the national debt held by the public.[1] The debt grew by $2.3 trillion in 12 years to reach a total of $3 trillion dollars in 1992. The publicly held debt was so large that it required, on an annual basis, almost 15 cents of every Federal dollar to provide for the interest costs to finance it. The Government's massive borrowing also imposed costs on the private sector; higher interest rates made it more expensive for Americans to finance home mortgages and other borrowing, and for American businesses to finance investments upon which the Nation's job creation and economic expansion depend.

Seven years later, the economy is strong, the budget is balanced, the publicly held debt is declining and can be eliminated in 2013. There are many measures of the economy's success: during this Administration, the economy has grown at an average inflation-adjusted rate of 3.8 percent; there are more than 20 million new jobs; and, the unemployment rate is at its lowest point in 30 years. The Administration's fiscal policy produced a profound reversal of course from the largest Federal budget deficit in history to the largest surplus in history, resulting in a total of $1.8 trillion in deficit reduction in the course of seven years. We have begun to reduce the publicly held debt, paying down $140 billion of debt and saving $8 billion in annual debt service costs. This turnaround in the national debt can continue. If we keep the course of a sound fiscal policy, we will eliminate publicly held debt by 2013, making the United States a debt-free Nation for the first time since 1835.

The Path to Prosperity

Immediately after taking office, the President moved to set the Nation's economic path right by introducing his three-part economic plan. This strategy was based upon: fiscal discipline, making Government more efficient, controlling the growth in spending,

[1] National debt held by the public (or publicly held debt) means funds that the Government has borrowed from—and owes to—the public.

and taking measures to cut significantly the Federal budget deficit; targeted investments, including education and research and development; and, engagement in the international economy, including expansion of global trade, and opening markets for American exports.

Several months later, after tireless efforts by the President, his Administration, and Democrats in Congress, Congress passed the Omnibus Budget Reconciliation Act (OBRA) of 1993 with its deficit reduction plan to cut the deficit in half as a percentage of the economy in five years. To finish the job of eliminating the deficit, the President and Congress joined in a bipartisan effort to pass the 1997 Balanced Budget Act (BBA), which reached its goal four years ahead of schedule, producing the first budget surplus in a generation in 1998. In six years, after inheriting the largest deficit in history, a $290 billion deficit, the President and his successful strategy produced the largest surplus in history, a $69 billion surplus, and proceeded to build on that accomplishment with another historic surplus, $124 billion, in the seventh year of the Administration.

The turnaround in the budget under President Clinton is the largest deficit reduction in dollar terms in our history; and relative to the economy, the improvement is the greatest since the years immediately following the massive deficits of World War II. Last year, 1999, marked the second year in a row that the budget was in surplus—the first back-to-back surpluses since the post-war economic boom of the mid-1950's.

The surplus has allowed the Government to turn the corner and to retire some of the publicly held debt, reducing the accumulated obligations from past deficits and bringing down the Government's ongoing interest costs. Because we have paid down the debt by $140 billion, while the economy has grown, debt service costs have declined almost to 12 cents on every Federal dollar, which produced a savings of $8 billion due to lower interest payments. By adhering to the path of fiscal discipline, the publicly held debt can be eliminated by 2013, which in turn will eliminate massive interest payments to finance the debt. In 1999, such interest payments amount to $230 billion.

These results are all the more remarkable when compared with the projected results if this Administration had not tackled the difficult problem of deficit reduction. If the Clinton Administration had not changed the inherited policy, with the same trajectory of growth, in 2001, the publicly held debt would exceed $6 trillion, or 67 percent of Gross Domestic Product (GDP), draining 17 cents from each Federal dollar to cover interest costs. Instead, the publicly held debt is now projected to be $3.3 trillion, or 33 percent of GDP, and declining. Under the President's long-term plan to meet the demographic changes of the Nation by strengthening Social Security and Medicare, to which debt reduction is central, debt held by the public can be reduced to zero by 2013.

The President's fiscal policy soon yielded changes in the economy that are so broad and enduring that February 2000 marks the achievement of the longest economic expansion in this Nation's history. At the very start of the President's deficit reduction strategy, financial markets responded to the prospect of meaningful deficit reduction by substantially reducing long-term real interest rates (that is, actual market rates minus expected inflation). These lower real interest rates reduced the cost of borrowing, prompting more business investment, which resulted in faster economic growth, increased job creation, rising productivity, and higher real wages.

The numbers confirm this story of economic success. Long-term real interest rates under President Clinton have been lower than those of the previous 12 years by an average of 1¼ percentage point. The rate of real economic growth in this Administration has averaged 3.9 percent per year—compared with an average growth rate of 2.8 percent per year in the previous 12 years. In the past seven years, more than 20 million new jobs were created. At 4.1 percent in December, 1999, the unemployment rate is at its lowest rate in three decades and has fallen by more than three percentage points since 1992. Productivity has risen by 2.7 percent annually in the last four years. As a result, after two decades of stagnant wages, real wages have grown during this Administration, for a total of 6.5 percent growth. The number of people in poverty has dropped by 4.8 million, and 7.2 million Americans have left the welfare rolls.

The economy continues to thrive, in part because price inflation has dropped. While the economy has continued its expansion, strong productivity growth, reflecting the payoffs of public and private investments in people and business, has helped keep inflationary pressures in check while supporting solid real wage gains. The underlying core rate of inflation was 1.9 percent in 1999, the lowest rate in more than 30 years. Slower inflation is not characteristic of previous economic booms and has contributed to the longevity of this expansion. The decline in the inflation rate and falling unemployment have produced the lowest "misery index" since the 1960s. (The index combines the unemployment and inflation rates.)

Budgetary Performance

Deficit Reduction has Far Exceeded Projections: In the 12 years of spiraling budget deficits before President Clinton took office, the national debt held by the public quadrupled, growing by $2.3 trillion.

In dollar terms, this was the largest buildup of Federal debt in the Nation's history. The President's program, enacted by Congress in 1993, OBRA, was a crucial step toward fiscal responsibility. The Administration expected OBRA to reduce the deficit significantly; but the actual improvement in the budget has been more than twice what was originally projected.

Economic Growth and Fiscal Discipline Benefit the American People

President Clinton's economic program has concentrated on changes that benefit the American people in their daily lives and their prospects for the future. The success of this strategy is clear:

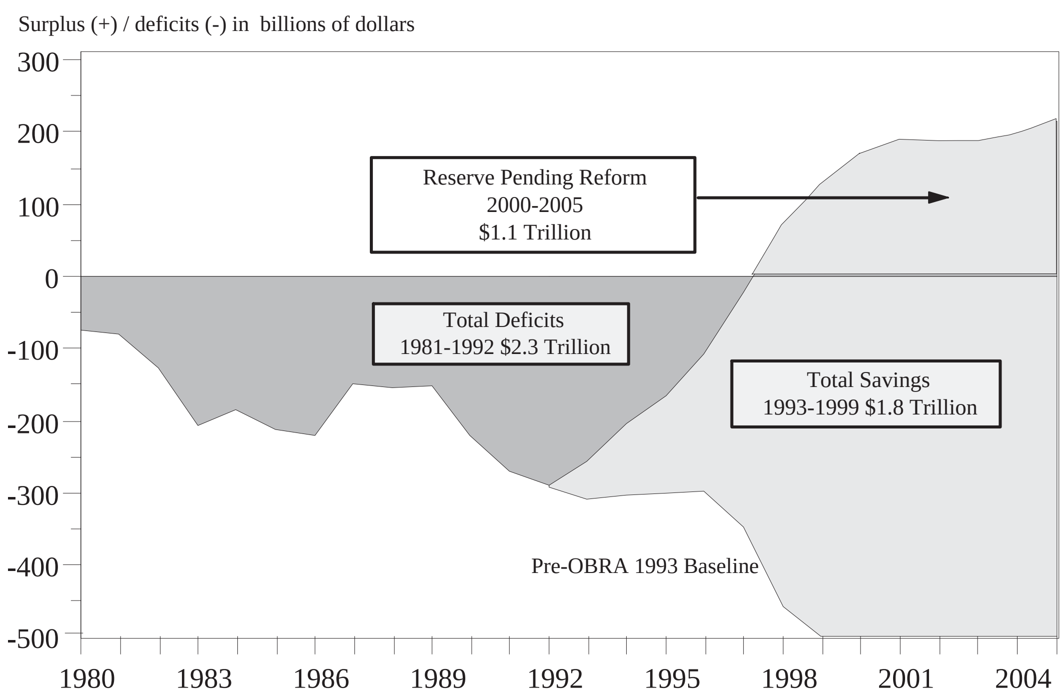
- The economy has created more than 20 million jobs since January 1993, nearly all of them in the private sector, most of them full-time, and in sectors that pay good wages.
- The unemployment rate is the lowest it has been in 30 years; for African Americans and Hispanics, unemployment is lower than at any time in the quarter-century for which separate statistics have been kept.
- Work has begun to pay more, reversing a two-decade trend of declining real wages—hourly wages have grown a cumulative 6.5 percent, boosting household incomes throughout the economy.
- Median family income, adjusted for inflation, has increased by $5,046 in 1998 dollars, rising from $41,691 in 1993 to $46,737 in 1998.
- After two decades of income decline and stagnation, Americans at the lower end of the income scale—those in the poorest 20 percent of households—have seen a rise in their real incomes. Since 1993, their incomes have risen by almost $900 per household (in 1998 dollars), a 10-percent increase.
- In the past seven years, 7.2 million people have left the welfare rolls, a 51-percent decline. Welfare recipients now account for the lowest percentage of the U.S. population since 1967. Meanwhile, 1.5 million people who were on welfare in 1997 are now working, and all States have met the work requirements imposed by the 1996 welfare reform law.
- From 1993 to 1998, the number of poor people in America declined by 4.8 million, and there are 2.1 million fewer poor children. The poverty rate has declined sharply from 15.1 percent to 12.7 percent, the lowest it has been since 1979.
- Crime rates are at the lowest level in over 25 years.
- A record number of Americans now own their own homes, which was made possible by lower real interest rates and larger real incomes. More than eight million additional households are homeowners since the President took office.

To finish the job of eliminating the budget deficit, the President worked with the Congress to enact the bipartisan BBA in mid-1997, which set a goal of reaching a balanced budget by 2002. Because of fiscal discipline and unexpectedly good economic performance, the budget went into surplus in 1998, four years sooner than projected. Upon OBRA's enactment, the Administration had projected that it would reduce the accumulated deficits from 1994 to 1998 by $505 billion. In fact, the back-to-back surpluses in 1998 and 1999, combined with reduced deficits from 1993 through 1997, were responsible for $1.8 trillion of deficit reduction (see Chart III–1). The total deficit reduction from 1993 to 2005 will be approximately $6.7 trillion.

The Clinton Economic Policy has Reversed the Debt Buildup of the 1980s: When the Government runs a deficit, it must borrow from the public to finance the excess outlays, in turn accumulating what is known as publicly held debt. For much of our Nation's history, the accumulation of debt was traditionally associated with the need to provide for wartime expenses. For example, compared with the size of the economy as measured by GDP, publicly held Federal debt accumulated to a sum even greater—peaking at 109 percent at the close of World War II in 1946. For many years after that, the economy grew faster than the debt, and the ratio of debt to GDP gradually fell to about 25 percent in the 1970s. The exploding deficits of the 1980s sent it back up; debt held by the public peaked at 50 percent of GDP in 1993. Since then, the Administration's policy of deficit reduction has steadily reduced this ratio. The back-to-back surpluses of 1998 and 1999 have even cut into the dollar amount of publicly held debt, driving down the size of the debt relative to the economy still faster. Publicly held debt is expected to fall to 21 percent of GDP by 2005, and to be eliminated by 2013.

Without a change in policy, both OMB and the Congressional Budget Office (CBO)

Chart III-1. Unified Budget Surpluses Follow Years Of Deficits



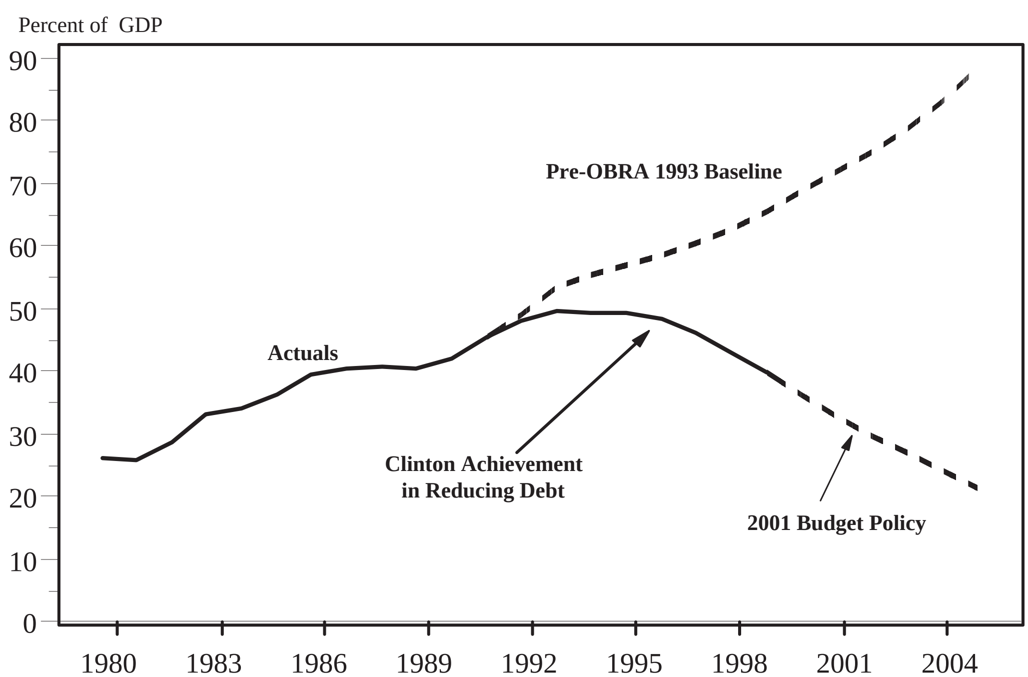
had projected publicly held debt would have approached $7 trillion, or 75 percent of GDP, by 2002, and would have reached even higher levels thereafter. Instead, because of the Clinton economic program, at the end of 1999, the ratio of publicly held debt to GDP had already fallen about 22 percentage points below projections made just before the Administration began pursuing its concerted policy of deficit reduction (see Chart III–2).

There is a Surplus by any Measure: Until recently, the unified budget has been the most commonly used framework for tallying the Federal Government's deficits and surpluses. The unified budget includes all Government receipts and spending, including Social Security contributions and benefits. This measure is the most appropriate to use in evaluating the effect of the Federal Government's operations on the economy; obviously, for that purpose, it is essential to leave nothing out.

Because contributions to Social Security have been greater than the benefits paid out, the Social Security trust funds have been accumulating surpluses. In the unified budget, these Social Security surpluses are counted toward the unified surplus. Without the Social Security surplus, the unified budget would not have been balanced in 1998.

Recently, attention has been focused on the budget surplus or deficit excluding Social Security trust fund surpluses—the so called "on-budget" surplus or deficit (which also excludes the relatively small surplus or deficit in the U.S. Postal Service fund). Within this budget framework there has also been a large reduction in the deficit over the past seven years (see Chart III–3). The on-budget deficit has fallen from $340 billion in 1992, to a $1 billion surplus in 1999. In 2000, it is expected that the surplus will be larger, at $19 billion. The improvement in the unified budget for the past seven

Chart III-2. Publicly Held Debt has been Brought Under Control



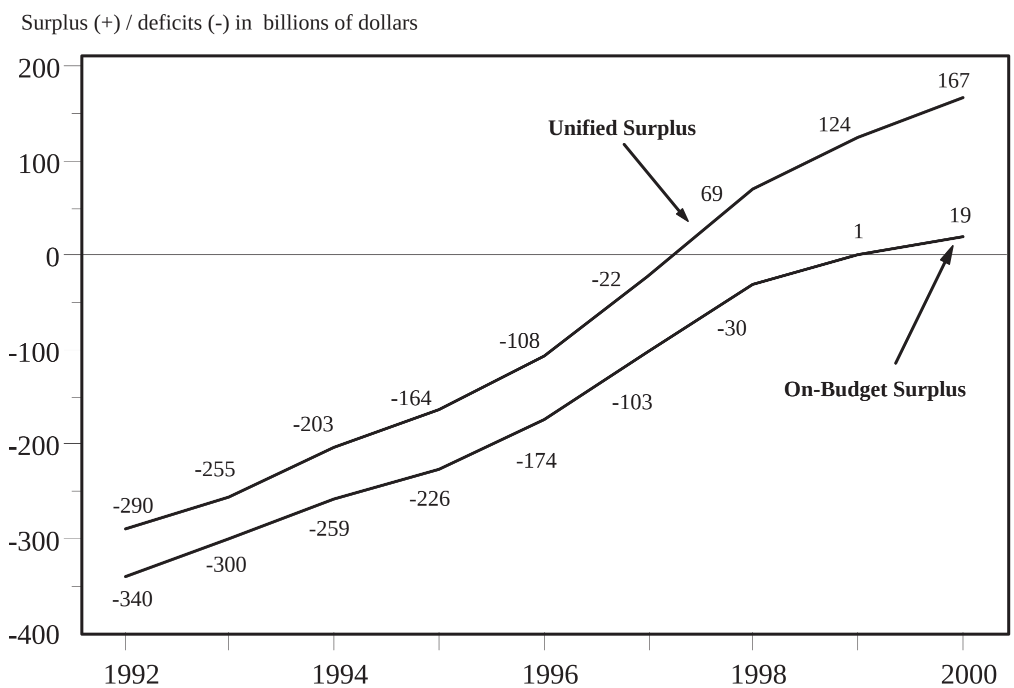
years is due primarily to the decline in the on-budget deficit.

Government Expenditure as a Share of the Economy has been Reduced: Federal spending reached a higher share of the economy during the previous two Administrations than at any other time since the end of World War II; it was still near its peak, at 22.2 percent of GDP, in 1992. The defense buildup in the early part of the 1980s, higher Federal interest payments because of increased debt plus high interest rates, and large increases in the cost of Federal health programs overwhelmed all efforts to reduce spending. This pattern has been reversed under President Clinton, while, at the same time, this Administration has made investments in education, the environment, and other priorities. During the last five years, the ratio of Federal spending to GDP has steadily declined, and in 1999 it was only 18.7 percent, a smaller percentage of the economy than at any time in a quarter century.

Economic Prosperity has Spurred Receipts: A healthy economy and a booming stock market have led to a surge of Federal tax receipts. In the past seven years, receipts have generally been higher and spending lower than projected in the budget, leading to more deficit reduction than expected. Most recently, the surprisingly strong growth in receipts has been especially important in bringing the budget into surplus well ahead of schedule, in turn starting the reduction of the national debt.

The United States is a World Leader in Budgetary Performance: In the 1980s, the United States was criticized by world leaders for its large budget deficits, which were seen as driving up worldwide interest rates and threatening global economic growth. The Clinton Administration's fiscal policies have put an end to this criticism. The United States can now point proudly to its fiscal policy as a model for other countries. The United States is a leader among the G–7 nations; only Can-

Chart III-3. On-Budget Deficits Have Been Turned Into Surpluses



ada runs a larger surplus as a percentage of its GDP, and four of the other five nations are in deficit (see Chart III–4). The reason for this outstanding U.S. performance is comparatively low public spending. The share of GDP devoted to taxes is lower in the United States than in any other leading country, even though the United States supports a much larger defense establishment than the other G–7 countries and maintains a balanced budget.

Economic Performance

The Administration's strategy of reducing the Federal budget deficit while investing in people and opening foreign markets has helped to unleash a powerful surge of private economic activity. Eliminating the deficit has freed savings to finance private investment in business and housing, and enabled the Federal Reserve to maintain generally lower interest rates for the past seven years; in turn, that has helped maintain and strengthen the economic expansion. Businesses have been able to borrow for capital improvements at favorable interest rates. New home buyers have been drawn into the housing market because of the lower interest rates, while current homeowners have been able to refinance their mortgages. The strong economy has fostered confidence among consumers and businesses, reinforcing the effects of the fiscal and monetary policy. The surge in business and residential investment since the early 1990s shows that the Administration's fiscal policy is working; and with the budget now balanced and producing a surplus, prospects for continued economic progress are excellent.

The Expansion Sets a New Record: This February, the economic expansion enters its 107th month, setting a new record as the longest expansion in U.S. history (statistics go back to the middle of the 19th Century). Earlier post-World War II expansions have generally been curtailed when rising inflation has forced the Federal Reserve to raise interest

Chart III-4. Among the Other G-7 Countries Only Canada had a Larger Budget Surplus in 1999

Source: Organization for Economic Cooperation and Development *Economic Outlook*, December 1999 rates to curb demand. Demand has grown very rapidly in the United States, but inflation has generally drifted downward, so monetary policy has been able to accommodate the growing economy. Such a moderate inflation performance this long into an expansion is unique in post-war economic history.

The Administration's Fiscal Policy has Helped Extend the Expansion: Federal budget deficits that were ultimately unsustainable helped stimulate the two other lengthy post-World War II economic expansions—the one in the 1960s and the other in the 1980s. In those earlier instances, an expanding Government dragged the private sector along—but those stimulative policies could not continue indefinitely, because they caused rising inflation and Federal debt. When the stimulus ended, the expansions lost their underpinnings.

In the expansion of the 1960s, the deficit was restrained at first, but it grew sharply after 1965 because of spending for the war in Vietnam, which helped bring on the inflation that marked the end of the decade, and with it the expansion. In the early 1980s, the "structural budget deficit" (the deficit that would remain even if the economy were at high employment) was pushed to almost five percent of GDP by large tax cuts and expanded military spending.[1] Though the actual deficit declined after the deep 1981–1982 recession was over, the "structural deficit" did not. The Government's failure to curb the structural deficit once the 1980s recovery was under way held up interest rates, contributing to the financial problems that marked the end of that decade and helped to bring on the recession of 1990–1991.

In contrast, during the current expansion, the Federal budget deficit has been eliminated; and that shift in fiscal policy has facilitated the rise in private investment that propelled the economy forward.

This Expansion has been Led by a Strong Private Sector: Since President Clinton took office in 1993, the economy has grown at an average rate of 3.9 percent per year after adjustment for inflation, compared with an average growth rate of 2.8 percent over the previous 12 years. Recent growth has been driven by increased demand for private goods and services. The Federal Government's direct claim on GDP (mainly defense and other discretionary spending, not counting transfer payments) has actually shrunk over the past 6¾ years at an average real rate of 0.6 percent per year, while the private sector of the economy has grown at a 4.2 percent annual rate. Meanwhile, 92 percent of the more than 20 million jobs created during this Administration have been in the private sector (and Federal Government employment has shrunk by 377,000, as described in Chapter 10, "Restoring Trust in Government").

Business Investment has Spurred Growth: The ratio of real business equipment investment to real GDP has reached record levels: 11.2 percent in the fourth quarter of 1999. Since the beginning of 1993, inflation-adjusted equipment investment has grown at an annual rate of 12.1 percent, more than 2½ times its annual rate of growth from 1980 through 1992 (see Chart III–5).

Investment growth is important for two reasons:

- Investment adds to the economy's productive capacity by providing more capital goods.
- New equipment added to the capital stock contains the latest technology; so the more we invest, the faster we adopt new production techniques.

Both additions to capacity and the adoption of new technology make workers more productive, and have helped to restore productivity growth to its fastest pace since the 1960s. Increases in productivity are the only way to raise real wages and average living standards over the long term, because employers cannot pay workers more unless they are producing more. Increased productivity also helps curtail inflation by allowing business to pay workers more without increasing prices because the workers' additional output pays for the higher wages.

[1] The structural deficit is the budget gap that would remain after removing the effects of the business cycle on spending and receipts (along with purely temporary factors, such as the annual budgetary effects that arose from the crisis in the Savings and Loan industry).

Chart III-5. Equipment Spending has led the Expansion

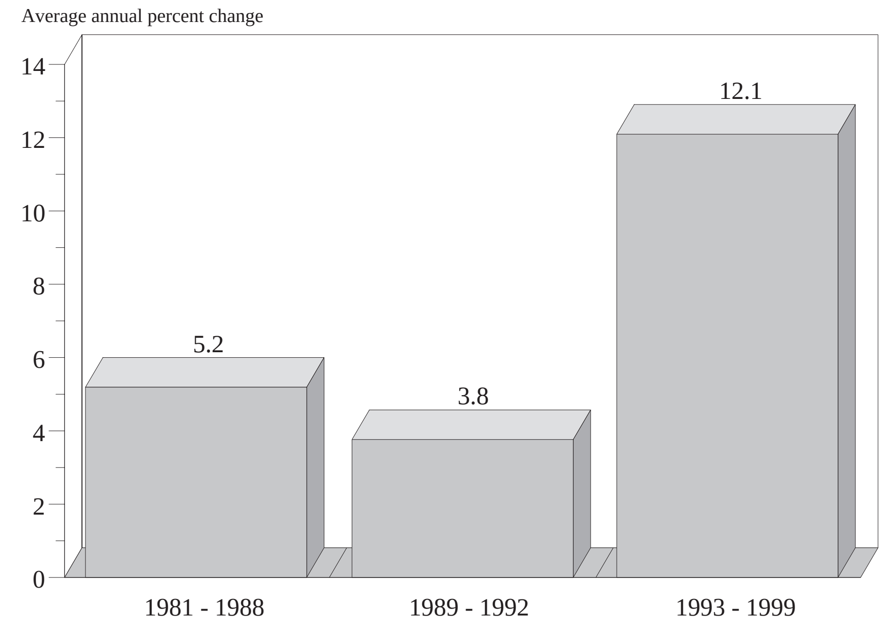
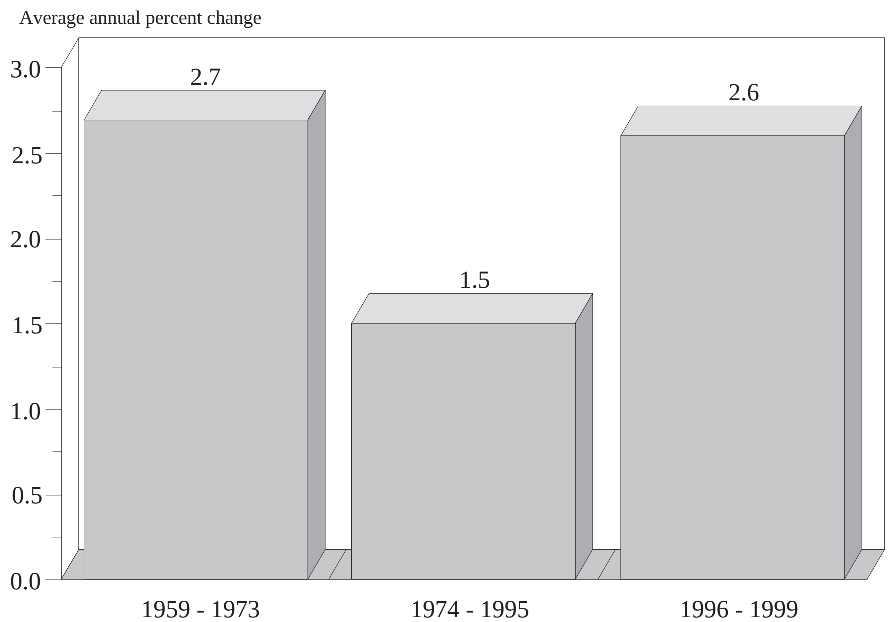


Chart III-6. Productivity Growth has Revived

Output per hour in the Nonfarm Business Sector



Productivity Growth has Revived: In the 1970s, productivity growth (the average annual growth rate in output per hour in the nonfarm business sector) fell sharply, from 2.7 percent per year to 1.5 percent. Lower productivity growth meant a slowdown in real wage growth and stagnating living standards. With productivity growing at nearly three percent per year, living standards double every generation. With productivity growing at only 1.5 percent per year, each generation sees only a 50 percent improvement in living standards, and many within each generation can find themselves falling behind the living standards of their parents (see Chart III–6).

For 20 years following the 1970s slowdown, productivity growth stayed at the new slower rate. Since then, however, productivity growth has staged a remarkable recovery. On average, in the four years since the third quarter of 1995, output per hour in nonfarm business has been rising by 2.7 percent per year. This is the same growth rate as before the slowdown.

It is still too soon to know for sure if the earlier trend has returned permanently. Some of the extra growth could be due to temporary factors that will be discernable only with the passage of time but the fact that the higher trend has endured for four years makes it more likely to persist. This is welcome news, not only for businesses seeking to hold down costs and maintain a competitive pricing structure, but also for American workers and their families, who once again see real improvements in their standard of living.

The Lowest Misery Index in 30 Years: Both unemployment and inflation have continued to fall even as the expansion finishes its ninth year. Last year, unemployment fell to 4.2 percent, the lowest annual average since 1969; inflation, at 1.9 percent (as measured by the core CPI, excluding volatile food and energy prices), was the lowest since 1965. The misery index—the combination of the inflation rate and the unemployment rate—is lower than at any time since the 1960s (see Chart III–7).

Unemployment Rates and Interest Rates are Both Low: The combination of interest rates and unemployment is at its lowest in decades. Generally, since President Clinton took office, interest rates have been below the average levels of the 1980s. It is noteworthy that real interest rates have remained low despite sustained economic growth and low unemployment, which increase the demand for credit and might normally send rates higher. Even with the recent increase in interest rates in the face of sustained strong economic growth, the combination of interest rates, growth, and unemployment remains the best in decades.

The Economic Outlook

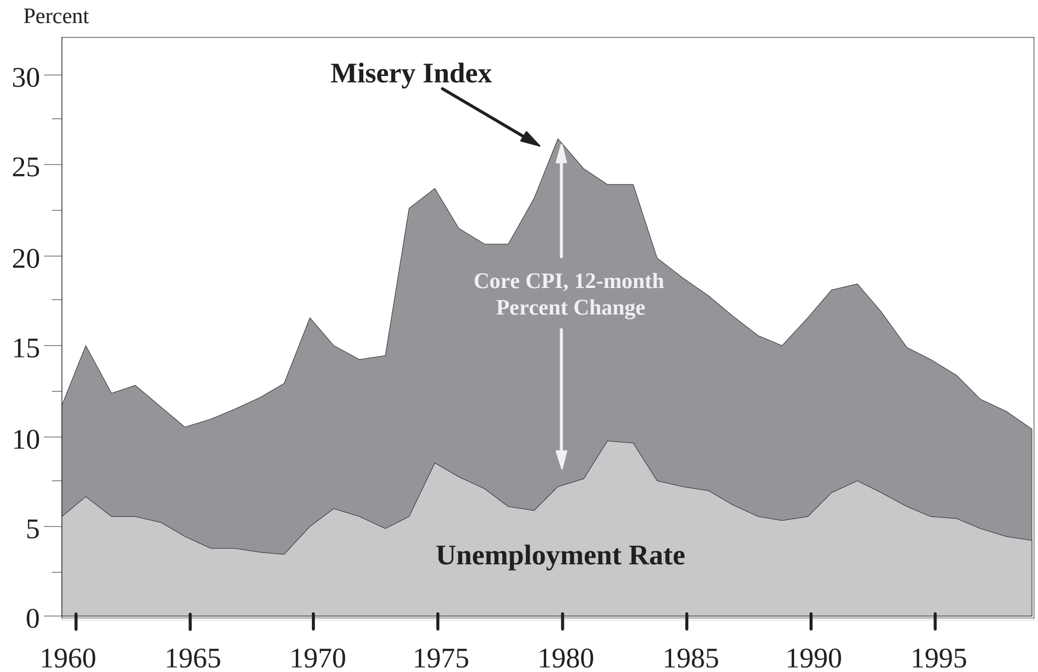
Conservative Forecasts Call for Continued Growth and Low Inflation: Continuing its prudent economic forecasts, the Administration projects that growth will moderate somewhat. Last year's unemployment rate was the lowest in three decades, and is projected to rise somewhat over the next few years; inflation is also projected to increase slightly. Special factors including the strong dollar, low oil prices, and the economic slowdown abroad have held inflation down over the last several years, but they are not expected to be permanent.

Still, if macroeconomic policies remain sound, the economy could well continue to outperform this conservative forecast, as it has for the past seven years. The Administration expects that the record-setting expansion will continue for the foreseeable future, and will sustain many of the economic gains of the last few years. Ultimately, the Administration believes the economy can return to its long-run potential growth rate of approximately three percent per year[3] on a sustainable basis by the middle of the new decade, accompanied by low levels of inflation and unemployment.

The longer-term economic and budget outlook also is favorable—even more so than only a few years ago. With prudent fiscal policy, the budget could remain in surplus for many decades. Still, there are foreseeable challenges that will threaten budgetary stability in the 21st Century. In less than

[3] In October, a major statistical revision adjusted real GDP upwards. The revision added about 0.4 percentage point to the recent growth rate of real GDP. That adjustment is reflected in this estimate. The revision is discussed in more detail in Chapter 1 of *Analytical Perspectives.*

Chart III-7. The Misery Index is at its Lowest Level in Thirty Years



10 years, the "baby-boomers"—the large generation born between 1946 and 1964—will become eligible for early retirement under Social Security. In the space of two decades, the elderly's share of the U.S. population will jump from around 13 percent to 21 percent. This demographic bulge will put intense pressure on the Federal budget through Social Security and the Federal health programs, Medicare and Medicaid. Reforms will be needed to preserve the affected programs; and budgetary restraint will be needed to preserve this Administration's fiscal achievements.

The Near-Term Economic Outlook: The Administration expects economic growth to moderate from its average pace of 4.3 percent per year during the past four years to 2.9 percent over the four quarters of 2000, and to an average of 2.5 percent in 2001–2003. Inflation should remain low. Recent growth has been much faster than mainstream forecasters have believed to be sustainable without higher inflation. The Administration projects that the more moderate pace of growth will keep inflation low.

After more than a year of worldwide financial turmoil, most of the affected countries in South East Asia and Latin America appear to have turned the corner toward recovery, or at least to have arrested their declines. Korea, one of the countries where the crisis began in 1997, has been recovering rapidly in 1999. Other East Asian economies are also beginning to emerge from recession. Europe, which suffered stagnant growth for much of the 1990s, has begun to grow more rapidly in the past year. Among the major industrial countries, Japan alone is still in the very early stages of recovery.

The worldwide economic crisis in 1997–1998 had very little effect on the overall U.S. economy. In 1999, growth continued at an average rate of 4.2 percent. Despite an adverse trade balance, strong consumer and investment demand kept the economy healthy. Looking ahead, mainstream forecasts, like the Administration's, expect some moderation in the growth of domestic demand in 2000. Consumer spending has been outpacing income growth, and cutting into personal saving; with the household saving rate at a record low, consumption may grow more slowly in the future. Business profits, which had been growing at double-digit rates from 1993 through 1997, have been rising more moderately since then. Profits are expected to continue to increase, but the unusually rapid growth is not projected to return. Furthermore, the rate of capital utilization is below its long-run average, which suggests that there could be some moderation in the rate of business investment as business finds less need to add to capacity (though businesses will continue to invest for modernization and to increase productivity). Though these developments could lead to more moderate economic growth, the longest economic expansion in history is expected to continue.

As the recent rapid increase of productivity growth moderates, the Administration estimates potential growth will moderate to 2.8 percent by 2007. Beginning in 2008, potential growth is expected to slow gradually as the retirement of the baby-boomers begins to cut into the growth of the labor supply.

Beginning later this year, as economic growth moderates, the unemployment rate is projected to rise gradually, stabilizing at 5.2 percent in 2003. Mainstream private-sector economic forecasters generally agree that inflation would be expected to accelerate when unemployment is under five percent. The modest anticipated increase in unemployment is expected to keep price inflation under control.

After rising by 1.6 percent in 1998, the Consumer Price Index (CPI) has picked up somewhat in 1999, rising at an annual rate of 2.7 percent. Just as falling energy prices held down the average inflation rate in 1998, rising energy prices drove it up in 1999. Economists often recompute the CPI excluding the volatile food and energy prices to get a clearer picture of the underlying (or core) rate of inflation. On this basis, inflation continued to decline in 1999; core CPI inflation, excluding food and energy, was only 1.9 percent. This was the lowest core rate of inflation since 1965, and it indicates that the faster inflation in energy prices was not passed through to other goods and services. The chain-weighted price index for GDP also increased somewhat faster in 1999 following an extremely low rate of increase in 1998. After rising 1.1 percent over the four quarters of 1998, it has increased at an average rate of 1.6 percent during 1999. It is projected to rise 1.9 percent in 2000 and 2.0 percent per year thereafter.

Interest rates on Treasury debt fell to extremely low levels—under five percent—during the world financial crisis of 1997–1998. Since then, they have increased somewhat. Short-term rates—following three interest rate hikes by the Federal Reserve during 1999—are back to pre-crisis levels, while 10-year rates are also approaching their pre-crisis average. The Administration projections are close to the levels at the end of last year, when the forecast was completed, with the 91-day Treasury bill rate at 5.2 percent and the yield on 10-year notes at 6.1 percent.

The medium-term projections shown in Table III–1 should be thought of as the average behavior expected for the economy, not a precise year-to-year forecast. In some years, growth could be faster than assumed; in other years, it could be slower. Similarly, inflation, unemployment, and interest rates could fluctuate around the projected values. But these assumptions, taken on average, provide a prudent basis for projecting the budget. In recent experience, the economy has outperformed the consensus forecast, and the Administration believes that it can continue to do so if fiscal policy remains sound.

Table III–1. Economic Assumptions [1]

(Calendar years; dollar amounts in billions)

	Actual 1998	Projections											
		1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Gross Domestic Product (GDP):													
Levels, dollar amounts in billions:													
Current dollars	8,760	9,232	9,685	10,156	10,621	11,105	11,644	12,236	12,847	13,477	14,118	14,777	15,471
Real, chained (1996) dollars	8,516	8,850	9,142	9,393	9,629	9,870	10,146	10,451	10,758	11,064	11,360	11,655	11,958
Chained price index (1996 = 100), annual average	102.9	104.3	105.9	108.1	110.3	112.5	114.8	117.1	119.4	121.8	124.3	126.8	129.4
Percent change, fourth quarter over fourth quarter:													
Current dollars	5.9	5.2	4.8	4.6	4.6	4.5	5.0	5.1	4.9	4.9	4.7	4.7	4.7
Real, chained (1996) dollars	4.6	3.8	2.9	2.6	2.5	2.5	3.0	3.0	2.9	2.8	2.6	2.6	2.6
Chained price index (1996 = 100)	1.1	1.4	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Percent change, year over year:													
Current dollars	5.5	5.4	4.9	4.9	4.6	4.6	4.9	5.1	5.0	4.9	4.8	4.7	4.7
Real, chained (1996) dollars	4.3	3.9	3.3	2.7	2.5	2.5	2.8	3.0	2.9	2.8	2.7	2.6	2.6
Chained price index (1996 = 100)	1.2	1.4	1.6	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Incomes, billions of current dollars:													
Corporate profits before tax	782	845	842	828	827	824	852	892	933	971	1,001	1,034	1,062
Wages and salaries	4,186	4,470	4,711	4,942	5,161	5,388	5,629	5,892	6,176	6,458	6,747	7,039	7,342
Other taxable income [2]	1,990	2,088	2,161	2,231	2,293	2,356	2,431	2,518	2,609	2,703	2,802	2,904	3,015
Consumer Price Index (all urban): [3]													
Level (1982–84 = 100), annual average	163.1	166.7	171.0	175.1	179.6	184.3	189.1	194.0	199.0	204.2	209.5	215.0	220.6
Percent change, fourth quarter over fourth quarter	1.5	2.7	2.3	2.5	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Percent change, year over year	1.6	2.2	2.6	2.4	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Unemployment rate, civilian, percent:													
Fourth quarter level	4.4	4.1	4.3	4.7	5.1	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Annual average	4.5	4.2	4.2	4.5	5.0	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Federal pay raises, January, percent:													
Military [4]	2.8	3.6	4.8	3.7	3.7	3.2	3.2	3.2	NA	NA	NA	NA	NA
Civilian [5]	2.8	3.6	4.8	3.7	3.7	3.2	3.2	3.2	NA	NA	NA	NA	NA
Interest rates, percent:													
91-day Treasury bills [6]	4.8	4.7	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2	5.2
10-year Treasury notes	5.3	5.6	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1	6.1

NA = Not Available.

[1] Based on information available as of late November 1999.

[2] Rent, interest, dividend and proprietor's components of personal income.

[3] Seasonally adjusted CPI for all urban consumers.

[4] Beginning with the 1999 increase, percentages apply to basic pay only; adjustments for housing and subsistence allowances will be determined by the Secretary of Defense.

[5] Overall average increase, including locality pay adjustments.

[6] Average rate (bank discount basis) on new issues within period.

The Budget Outlook

The Administration projects budget surpluses in 2000 and throughout the customary 10-year budget window. The unified surplus should reach $167 billion in 2000 and $184 billion in 2001, while the on-budget surplus remains in surplus.

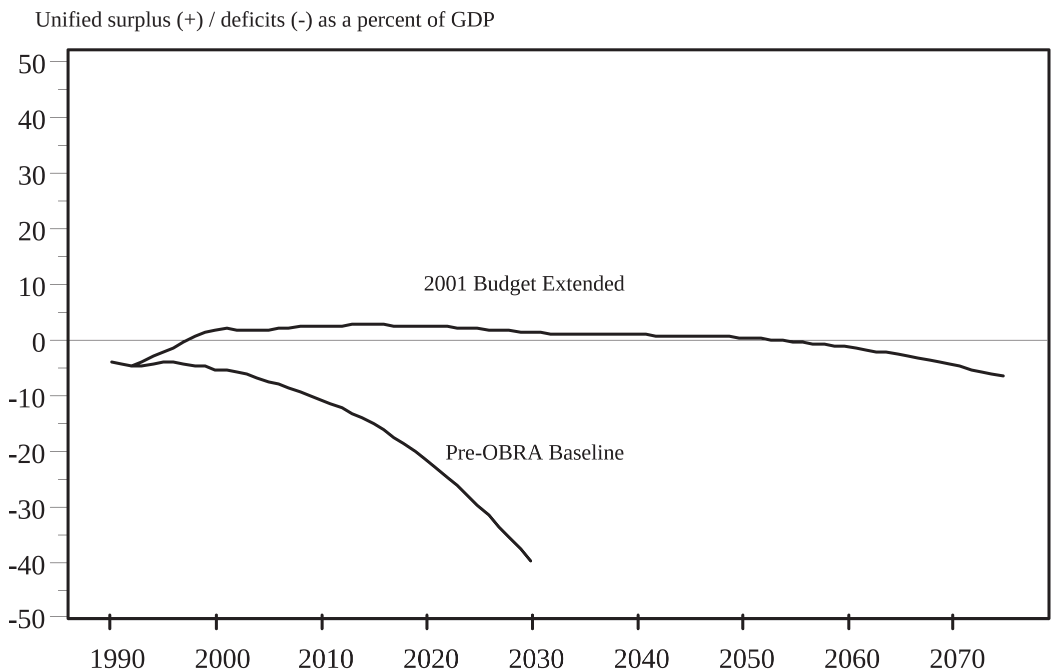
The Long-Term Budget Outlook: All budget projections contain elements of uncertainty, which are compounded as they extend further into the future. However, long-run budget projections are both valuable and necessary to identify future problems, thereby allowing policy makers to devise solutions on a timely basis. In the 1980s and before, budget projections were extended for no more than five years. In the 1990s, attention has increasingly focused on the outlook for 10 years and even longer, especially when it has been necessary to consider longer-term issues such as the aging of the population and possible reforms to Social Security.

The swift reduction of the budget deficit and the appearance of the surplus since the passage of OBRA in 1993 and the BBA in 1997 bodes well for the long run. Without the changes enacted in OBRA, the Federal deficit was projected to spiral out of control. Following the changes in OBRA, projections in the 1997 Budget showed a unified budget surplus beginning in 2002 and lasting for about 20 years; but the budget was projected to return to deficit in the long run. Since then, however, the economy and the budget have performed much better than projected, reducing the accumulated debt at the start of the long-run projections and thereby extending the projected surpluses for many decades. The current budget projection shows surpluses lasting until mid-century (see Chart III–8).

However, such projections are inherently uncertain, because, while prudent fiscal policy can safeguard our hard-earned prosperity, so too can reckless choices dissipate the benefits of the budget discipline that is responsible for our ongoing success. Strengthening Social Security and Medicare will lay a strong foundation to safeguard our hard-won fiscal stability and rid the United States of debt for the first time since 1835. Preserving fiscal discipline must include strategic investments and reform of these essential age-related entitlement programs. It must also include budget tools that have been essential to enforcing discipline, and the 2001 Budget proposes spending caps and PAYGO rules that work. The favorable long-term results shown in these projections will require prudent policy—choosing continuing reductions in outstanding debt over expensive tax cuts or spending increases—and avoiding adverse economic shocks that could knock the projections off track. However, ordinary business cycles should not affect the projections if economic assumptions prove on average accurate over time. (For more details on the long-run budget projections see *Analytical Perspectives,* Chapter 2, "Stewardship.")

The Clinton Administration's policy initiatives extend the solvency of Social Security and Medicare, protect current and future beneficiaries, and eliminate the publicly held debt. Restoring confidence in these vital programs is an Administration priority. The improvements in the long-term budget outlook illustrated here will offer the opportunity to get the job done.

Chart III-8. The Long-Run Budget Outlook is Much Improved



Investing in Federal Statistics

Our democracy and economy demand that public and private leaders have unbiased, relevant, accurate, and timely information on which to base decisions. Data on population, real GDP, the CPI, and the trade deficit, for example, are critical inputs to monetary, fiscal, trade, and regulatory policy. They also have a major impact on Government spending, budget projections, and the allocation of Federal funds. Taken together, statistics produced by the Federal Government on demographic, economic, and social conditions and trends are essential to inform decisions that are made by virtually every organization and household.

Rapid changes in our economy and society, including the unprecedented growth of e-commerce, have meant that the current funding levels of the Government's statistical agencies have not kept pace with the need for good statistics. The relevance and accuracy of some of our Nation's key statistics are in question. Without the improvements proposed in this budget, it will become more difficult for our statistical system to mirror our economy and society accurately, which, in turn, could undermine core Government activities, such as the accurate allocation of scarce Federal funds. Fortunately, the most serious shortcomings of our statistical infrastructure could be substantially mitigated by proposals set forth in the Administration's budget. These initiatives are documented in greater detail in Chapter 11 of *Analytical Perspectives*, "Strengthening Federal Statistics."

Saving Social Security

For more than 60 years, Social Security has formed the bedrock of income security for millions of Americans. For individuals who grow old after a lifetime of work, who become disabled, or who suffer the death of a family breadwinner, Social Security represents America's promise to stand by them.

The pending retirement of 76 million baby boomers will put significant pressure on the Social Security system, which is self-financed through payroll taxes and income taxes on Social Security benefits. These dedicated revenues go into the Old-Age and Survivors Insurance (OASI) and Disability Insurance (DI) trust funds. Currently, the revenues to these trust funds exceed the benefit payments going out. The surplus is invested in Treasury securities, which generate interest income for the trust funds. However, the system is not in balance over the 75-year period traditionally used by the Social Security Trustees to evaluate the financial status of the program. Under the Trustees' current projections, Social Security benefit payments will exceed dedicated tax revenues starting in 2014. By 2022, benefits paid out will exceed total tax revenues plus interest income—without any policy changes, the trust funds will have to draw on their reserves to meet benefit obligations. By 2034, those reserves are projected to be exhausted. At that time, payroll taxes are projected to cover only 71 percent of currently promised benefits. Two key demographic factors affect Social Security's financial status: the baby boomers and subsequent generations are living longer, and they are having fewer children. Consequently, they will spend more time in retirement, and there will be fewer younger workers paying into the system relative to the number of retirees.

The President's Plan

Restoring the Social Security trust funds to long-range solvency is one of the President's top priorities. He led the way in 1998 with a series of regional bipartisan forums to build public awareness of the problem, and to build public consensus for solutions. In 1999, the President proposed a framework built on the principle of maintaining long-term fiscal responsibility—ensuring that the benefits of fiscal discipline be used to extend the life of Social Security while also making prudent investments in activities that enhance the Nation's economic performance. Such a framework is crucial, because the Government's ability to pay future Social Security benefits is tightly linked to the long-term economic and budgetary outlook.

This year, the President urges the Congress to adopt his program to save Social Security through a commitment to sustained fiscal responsibility. Rather than dissipate all of the currently projected on-budget surpluses on new spending or tax cuts, the President proposes a balanced approach to prepare the Nation for the challenges ahead by paying down the entire debt held by the public by 2013 and encouraging economic growth.

- *Extend Social Security Solvency through Debt Reduction:* The President's sustained commitment to saving Social Security has led to an acceptance of the vital importance of protecting the Social Security surplus. However, the next step in saving Social Security is to truly protect Social Security by dedicating the resources needed to extend the solvency of the program. The President proposes to devote the entire Social Security surplus to paying down and eliminating the debt held by the public. Creating a debt-free United States will eliminate debt service costs and result in substantial interest savings. Devoting Social Security surpluses to debt reduction will reduce interest payments from $230 billion in 1999 to zero in 2013 and will dedicate interest savings to extend Social Security solvency to 2050. Paying down the publicly held debt will improve the Nation's ability to respond to Social Security's future needs.

Saving Social Security—Continued

- *Transfers to Extend Social Security Solvency:* The President proposes to devote the rewards of fiscal discipline to extending the life of Social Security. The substantially lower interest burden on the Federal budget will free up on-budget resources that can be transferred to the trust funds to extend their solvency. The President proposes to transfer part of the on-budget surplus to the trust funds from 2011 through 2050—fully justified by the annual interest savings attributable to dedicating the Social Security surpluses to debt reduction. The annual transfer would be $100 billion in 2011, growing through 2015, after which it would stay level at $211 billion. The framework includes an added safeguard to ensure that the transfers will not exceed the currently projected on-budget surpluses.

  The President also proposes to invest half of the transferred amounts in corporate equities. The share of trust funds invested in equities will be limited to 15 percent. The transfers of interest savings alone would extend the solvency of the trust funds from 2034 to 2050, investment in equities would extend solvency to 2054.

- *Promote Long-Term Fiscal Responsibility:* The President proposes to extend existing budget enforcement laws from their current scheduled expiration date in 2002 to 2010. These laws control discretionary spending levels and require new permanent spending increases or tax cuts to be offset fully by other spending cuts or revenue increases. The President also proposes to prohibit legislation that would cause or increase an on-budget deficit relative to the current baseline. These budget enforcement protections promote the fiscal discipline that is a critical feature of the President's program.

- *Reforms to the Social Security program:* The President encourages Congress to work with him in a bipartisan fashion to close the rest of the 75-year solvency gap through sensible reforms to the Social Security system. As part of a larger reform plan, the President is committed to improve income protections for elderly women who experience high poverty rates relative to the overall elderly population. In addition, the President believes that an overall Social Security solvency agreement should remove the barriers to work that result from the current Social Security earnings test. Social Security's rules discourage retired individuals from working, because their benefits are reduced when their earnings exceed a certain level.

The best way to ensure our ability as a Nation to meet future Social Security benefit obligations is to increase national income, thereby improving the Government's fiscal position. This can be accomplished by paying down and eliminating the Nation's publicly held debt, which frees up resources for private investment and reduces Federal interest payments, and by making targeted investments in areas such as education and research where there is a high payoff in increased productivity.

The President believes it is critical to address Social Security's financing shortfall now. The healthy American economy and the budget surplus provide a rare opportunity to tackle this problem from a position of strength. Addressing the issue now expands the number of options available for dealing with the problem and allows sufficient time to engage in careful deliberation and develop a well-thought-out plan that protects vulnerable populations. And making decisions now will allow individuals sufficient time to adjust their retirement planning, if necessary. The President believes that, working together, the Administration and Congress can fulfill America's long-standing promise to future generations.