CBO TESTIMONY

Statement of
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Director
Congressional Budget Office

on
the Administration's Budgetary Proposals

before the
Joint Economic Committee
United States Congress

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NOTICE

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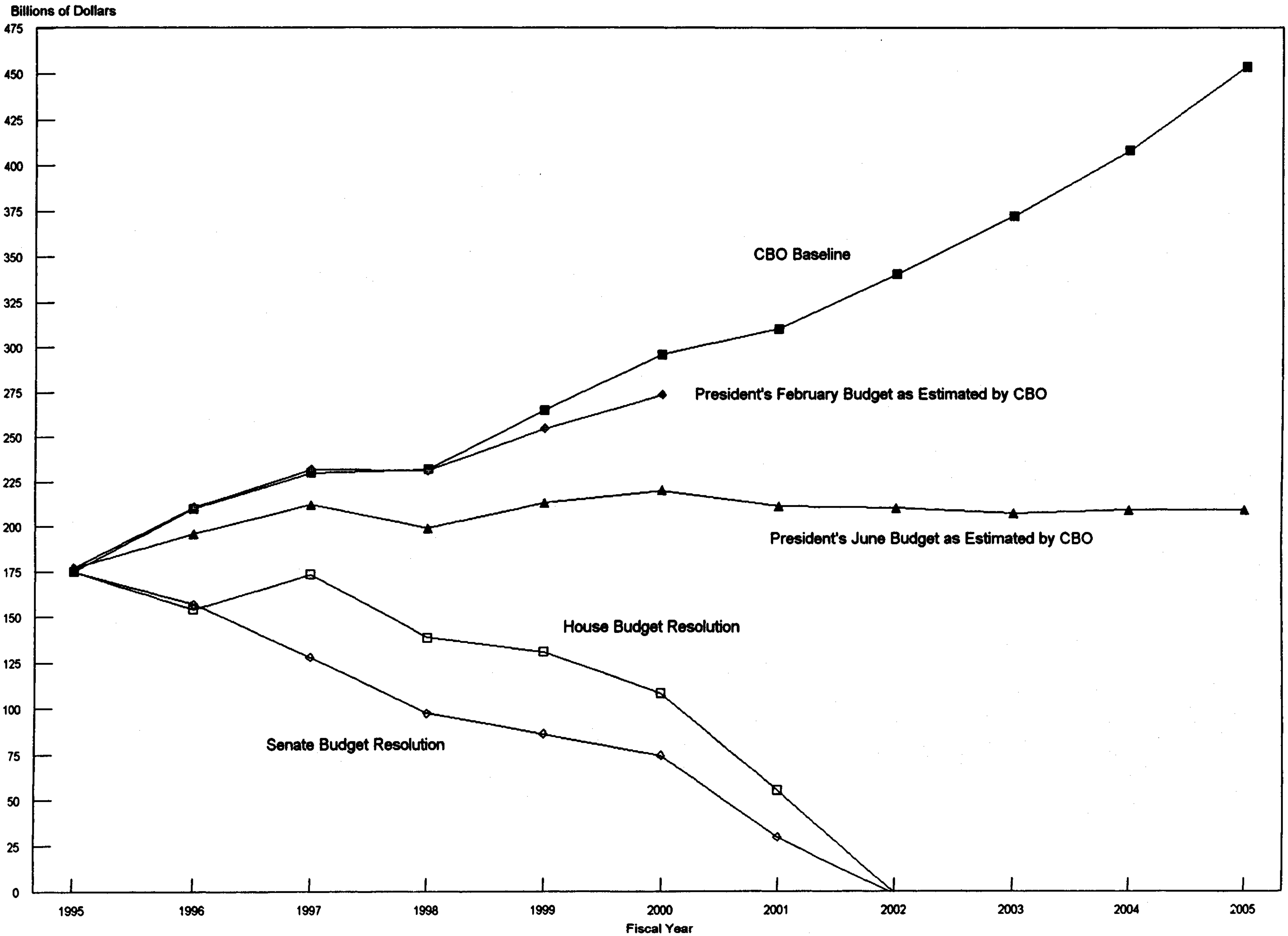
Chairman Mack, Congressman Saxton, and Members of the Committee, I am pleased to be with you this morning to review the budgetary plan that the Clinton Administration released on June 13. The budget that the Administration submitted in February for fiscal years 1996 through 2000 would not have substantially changed the projected budget deficits. By contrast, the Administration's revised budgetary plan for fiscal years 1996 through 2005 includes additional reductions in spending and increases in taxes designed to make large reductions in the federal deficit (see Figure 1). In my statement today, I will describe the Congressional Budget Office's (CBO's) preliminary assessment of the Administration's new plan and explain the differences between CBO's estimates and those of the Administration.

THE ADMINISTRATION'S BUDGETARY PLAN

The budget submitted by the Administration in February recommended changes in policies that would have reduced the cumulative deficit by about $30 billion between 1995 and 2000. The President proposed tax changes that would shrink revenues by $60 billion over the six-year period. The major tax initiative would provide for tax relief in the form of a nonrefundable tax credit for families with young children, a deduction for postsecondary education and training expenses, and expansion of individual retirement accounts. Proposed savings in Medicare (stemming primarily from extending provisions of the Omnibus Budget Reconciliation Act of 1993 that expire at the end of 1998) and other mandatory programs offset only about $17 billion

FIGURE 1. COMPARISON OF PROJECTED DEFICITS



SOURCE: Congressional Budget Office.

of the revenue loss. The President also proposed to sell assets that CBO estimated would produce almost $8 billion in receipts. Finally, compared with CBO's baseline, which allows for inflation in discretionary programs after 1998, the President's budget would have reduced discretionary spending by a cumulative total of $67 billion, with most of the reductions occurring in 1999 and 2000.

The President's June budgetary plan retains most of the elements of the February budget. In addition, it extends the fiscal horizon through 2005 and assumes additional savings intended to achieve budget balance in 10 years. The major new areas targeted for reduction are:

- Discretionary spending--$112 billion in cuts in 2005 and $505 billion in cumulative reductions over the 1996-2005 period compared with CBO's baseline with discretionary inflation after 1998;

- Medicare--$67 billion in 2005 and $295 billion over the 1996-2005 period;

- Medicaid--$19 billion in 2005 and $105 billion in total;

- Welfare programs--$9 billion in 2005 and $63 billion in total; and

- Corporate subsidies--$6 billion in 2005 and $43 billion in total.

The Administration's June package also contains several health initiatives. In addition to providing for spending reductions in Medicare and Medicaid, the Administration proposes a number of new benefits, including subsidies of health insurance for people unemployed up to six months, grants to states for home- and community-based long-term care, an Alzheimer's respite care benefit within Medicare, and elimination of the copayment for mammograms. The Administration would also increase the fraction of health insurance costs that the self-employed can deduct for income tax purposes from 30 percent to 50 percent.

As explained by the staff of the Office of Management and Budget (OMB), the additional budgetary savings included in the Administration's new plan are "indicative proposals" that as of yet do not represent specific policies. Therefore, a detailed program-by-program evaluation of the President's June budget is not possible now. Relying on the Administration's estimates of the proposed savings, however, CBO has prepared a preliminary assessment of the budgetary effect of the President's new plan.

CBO estimates that the President's June budget plan would hold the total deficit to about $200 billion a year if the plan's assumptions were translated into specific policies (see Tables 1 and 2). For comparability with the budget resolution, CBO has adjusted its baseline deficit to reflect the projected effects on mandatory spending and revenues of rebenchmarking the consumer price index (CPI). In 1998,

TABLE 1. PRELIMINARY ASSESSMENT OF THE PRESIDENT'S BUDGETARY PROPOSALS (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	1996-2002	1996-2005
CBO Baseline Deficit with Discretionary Inflation After 1998[a]	210	230	232	266	299	316	349	384	422	472	n.a.	n.a.
Adjustment for Rebenchmarking of the Consumer Price Index	0	0	0	-1	-3	-6	-10	-12	-14	-18	n.a.	n.a.
Adjusted Baseline Deficit	210	230	232	265	296	310	340	372	408	454	n.a.	n.a.
President's Budgetary Proposals[b]												
Discretionary spending	-5	-8	-16	-30	-45	-53	-62	-79	-94	-112	-219	-505
Mandatory spending												
Medicare	-4	-6	-10	-16	-23	-30	-39	-45	-55	-67	-128	-295
Medicaid	-4	-4	-6	-7	-9	-11	-13	-15	-17	-19	-54	-105
Poverty programs	-2	-4	-5	-6	-6	-7	-8	-8	-8	-9	-38	-63
Other	-2	-2	-1	3	3	3	-2	-2	-2	-1	2	-3
Subtotal	-11	-16	-22	-26	-35	-46	-62	-70	-82	-95	-218	-465
Revenues[c,d]	3	10	11	14	18	20	21	21	25	23	97	166
Corporate subsidies[d]	-1	-2	-3	-4	-5	-5	-5	-6	-6	-6	-25	-43
Debt service[e]	-1	-2	-3	-6	-10	-15	-22	-31	-42	-55	-57	-185
Total Changes	-14	-18	-33	-52	-77	-99	-130	-165	-199	-246	-422	-1,031
Deficit Under the President's Budgetary Proposals	196	212	199	213	220	211	210	207	209	209	n.a.	n.a.

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTES: Numbers may not add to totals because of rounding. n.a. = not applicable.

a. Assumes compliance with discretionary spending limits through 1998. Discretionary spending is assumed to increase at the rate of inflation after that.

b. Discretionary savings equal the difference between CBO's baseline discretionary spending and the levels of discretionary spending specified in "The President's Economic Plan," released June 13, 1995. Mandatory spending savings and revenue changes are at the levels specified in the President's plan. CBO has not reestimated the savings because there is not sufficient detail available at this time to allow a reestimate.

c. Excludes estimated loss of revenues from the Federal Reserve as a result of the Administration's anticipated reduction in interest rates.

d. Revenue losses are shown as positive because they increase the deficit.

e. Debt service represents CBO's estimate of the reduction in interest payments that would result directly from the noninterest savings shown in this table. It does not include any possible effect from lower interest rates that might result from lower deficits.

TABLE 2. PRELIMINARY ASSESSMENT OF BUDGETARY ESTIMATES UNDER THE PRESIDENT'S POLICIES (By fiscal year, in billions of dollars)

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Outlays										
Discretionary										
Defense	262	258	255	260	268	276	281	282	283	283
Nondefense	285	287	286	284	281	286	293	297	303	308
Subtotal	547	545	541	545	550	562	574	579	586	591
Mandatory[a]										
Medicare[b]	175	191	206	221	238	257	276	303	329	357
Medicaid	95	106	116	128	139	152	165	179	195	213
Other	534	567	597	637	675	702	735	773	813	860
Subtotal	805	865	919	986	1,051	1,109	1,176	1,255	1,337	1,431
Net interest[c]	260	270	278	290	304	314	327	340	353	365
Total	1,612	1,680	1,738	1,822	1,905	1,985	2,077	2,174	2,276	2,388
Revenues[d]	1,416	1,467	1,538	1,608	1,685	1,774	1,868	1,967	2,066	2,179
Deficit Under the President's Budgetary Proposals	196	212	199	213	220	211	210	207	209	209
Deficit as a Percentage of GDP	2.7	2.7	2.4	2.5	2.4	2.2	2.1	2.0	1.9	1.8
Memorandum:										
Gross Domestic Product	7,370	7,747	8,152	8,572	9,013	9,483	9,978	10,499	11,047	11,623

SOURCES: Congressional Budget Office; Office of Management and Budget, "The President's Economic Plan," released June 13, 1995.

NOTES: Numbers may not add to totals because of rounding.

a. Projected mandatory spending is based on the Administration's estimates of savings from a current-policy baseline. CBO has not reestimated the savings because there is not sufficient detail available at this time to allow a reestimate.

b. Includes receipts from Medicare beneficiary premiums as offsets to Medicare spending.

c. Net interest projections are based on CBO's estimate of the reduction in interest payments that would result directly from the noninterest savings shown in this table. They do not include any possible effect from lower interest rates that might result from lower deficits.

d. Projected revenues are based on the Administration's estimates of changes from a current-policy baseline. CBO has not reestimated the changes because there is not sufficient detail available at this time to allow a reestimate. The projections exclude the estimated loss of revenues from the Federal Reserve associated with the Administration's anticipated reduction in interest rates.

the weights of the various categories of consumption in the CPI will change from the current 1982-1984 basis to a 1993-1995 basis. The budget resolutions passed by the House and Senate assume that this change will reduce the growth of the overall CPI by about 0.2 percentage points a year compared with CBO's winter economic assumptions.

Because of the different budgetary rules governing discretionary and mandatory programs, CBO has used different methods for estimating the savings in the two budgetary categories. For defense and nondefense discretionary spending, CBO's estimate assumes the level of outlays specified in the President's plan. The estimated discretionary savings equal the difference between the level of discretionary spending in CBO's baseline and that in the President's plan. Because CBO's baseline for those programs is higher than the Administration's baseline, CBO's estimates of the amounts of discretionary savings are larger than the Administration's savings figures. For mandatory spending programs and revenues, CBO's preliminary assessment assumes that the net changes from the baseline equal those specified by the Administration. The revenue changes differ from those shown by the Administration because they exclude a reduction in Federal Reserve earnings resulting from the Administration's assumed drop in interest rates. CBO has estimated the resulting amount of savings in debt service using the interest rates that underlie its April baseline.

Under those assumptions, the budget deficit under the President's policies would represent about 2 percent of gross domestic product (GDP) in 2005. By contrast, CBO's baseline deficit averages more than 3 percent of GDP over the 1995-2005 period. The reduction in the deficit under the President's policies would allow a modest drop in interest rates compared with those in CBO's baseline. Because of the uncertainties surrounding the President's plan and the estimates of its effects on the budget, CBO has not incorporated a drop in interest rates attributable to deficit reduction. But even if some allowance was made for that effect, the deficits under the President's June budget would probably remain near $200 billion through 2005.

DIFFERENCES BETWEEN CBO AND OMB ESTIMATES

In contrast to the deficit of $209 billion in 2005 estimated by CBO, the Administration projects that its policies would produce a budget surplus of $18 billion. What accounts for that difference of almost $230 billion between the two estimates?

First, in 2005 the Administration assumes more than $60 billion in additional savings from lower interest rates--the so-called fiscal dividend. As previously indicated, we believe that the Administration's plan would produce a much smaller fiscal dividend than OMB anticipated because we estimate that the amount of deficit reduction falls short of that needed to achieve budgetary balance by 2005.

Second, CBO's projected baseline deficit is much higher than OMB's. As shown in Table 3, CBO projects that the budget deficit under current policies will reach $454 billion in 2005, assuming that discretionary spending keeps pace with inflation after the discretionary spending limits expire in 1998. By contrast, OMB projects a baseline deficit of only $266 billion for 2005. Excluding differences in discretionary spending, CBO's projected baseline deficit exceeds OMB's by almost $170 billion.

Although the economic assumptions of CBO and the Administration appear quite similar, the differences are in fact sufficient to produce marked differences in budget projections that only grow with time. On average, the Administration foresees slightly faster economic growth than does CBO. Over the next five years, the Administration's average rate of growth of real GDP is 0.2 percentage points a year faster than CBO's. Also, CBO and the Administration differ in their projections of the growth of the CPI relative to that of the GDP deflator. CBO assumes that the CPI will grow significantly faster than the deflator, whereas the Administration assumes only slightly faster growth (see Table 4). Because the CPI affects indexed benefit programs and tax brackets, whereas the GDP deflator affects estimates of taxable income, CBO's assumption of a larger gap between the two growth rates adds to its projection of the deficit. Largely as a result of differences in economic assumptions, CBO's projection of revenues in 2005 is $62 billion below the Administration's.

TABLE 3. COMPARISON OF BASELINE PROJECTIONS (By fiscal year, in billions of dollars)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
OMB Baseline											
Receipts	1,346	1,418	1,482	1,560	1,638	1,729	1,823	1,924	2,028	2,141	2,257
Outlays											
Discretionary[a]	554	555	556	557	573	590	607	625	644	663	683
Mandatory											
Medicare	154	175	192	209	228	249	273	298	326	357	392
Medicaid	88	96	105	115	125	136	149	163	178	194	212
Other	508	537	576	604	634	668	700	733	769	807	847
Subtotal	751	808	873	928	987	1,053	1,122	1,195	1,274	1,359	1,451
Net interest	234	257	271	284	300	315	329	344	359	374	390
Total	1,539	1,620	1,700	1,769	1,860	1,958	2,058	2,164	2,276	2,396	2,524
Deficit	193	201	218	209	221	229	235	240	248	255	266
Deficit as a Percentage of GDP (As reported by OMB)	2.7	2.7	2.8	2.5	2.5	2.5	2.4	2.3	2.3	2.2	2.2
CBO Baseline											
Receipts	1,355	1,418	1,475	1,546	1,618	1,698	1,789	1,884	1,982	2,085	2,196
Outlays											
Discretionary[a]	548	552	553	557	575	595	615	636	658	680	703
Mandatory											
Medicare	158	179	197	216	237	261	287	315	348	384	424
Medicaid	89	99	110	122	135	148	163	178	194	212	232
Other	499	538	573	603	640	678	706	745	783	823	870
Subtotal	747	816	881	941	1,012	1,086	1,155	1,238	1,325	1,419	1,526
Net interest	235	260	271	281	296	313	329	349	371	394	421
Total	1,530	1,628	1,706	1,778	1,884	1,995	2,099	2,223	2,354	2,494	2,650
Deficit	175	210	230	232	265	296	310	340	372	408	454
Deficit as a Percentage of GDP	2.5	2.9	3.0	2.8	3.1	3.3	3.3	3.4	3.5	3.7	3.9

(Continued)

TABLE 3. Continued

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Difference (CBO baseline minus OMB baseline)											
Receipts	9	-1	-7	-13	-20	-31	-34	-40	-46	-56	-62
Outlays											
Discretionary	-6	-3	-3	-1	2	5	8	11	14	17	20
Mandatory											
Medicare	4	4	6	7	9	11	14	17	21	26	32
Medicaid	1	3	5	8	10	12	13	15	16	18	20
Other	-9	1	-3	-1	6	10	6	12	14	16	23
Subtotal	-4	8	8	13	25	33	33	43	52	60	76
Net interest	1	3	b	-3	-4	-1	b	5	12	20	30
Total	-9	8	6	9	24	37	41	60	77	97	126
Deficit	-18	9	12	23	44	68	74	100	124	153	188
Deficit as a Percentage of GDP	-0.3	0.1	0.2	0.3	0.5	0.7	0.8	1.0	1.2	1.4	1.6

SOURCES: Congressional Budget Office; Office of Management and Budget.

NOTE: GDP = gross domestic product.

a. Assumes compliance with discretionary spending limits through 1998. Discretionary spending is assumed to increase at the rate of inflation after that.

b. Less than $500 million.

TABLE 4. COMPARISON OF ECONOMIC ASSUMPTIONS, CALENDAR YEARS 1995-2005

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Nominal GDP (Billions of dollars)											
CBO	7,127	7,456	7,847	8,256	8,680	9,128	9,604	10,106	10,633	11,188	11,772
Administration	7,116	7,504	7,921	8,361	8,823	9,310	9,822	10,359	10,926	11,524	12,156
Real GDP (Percentage change, fourth quarter over fourth quarter)[a]											
CBO	2.5	1.9	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3	2.3
Administration	2.4	2.5	2.5	2.5	2.5	2.5	2.4	2.4	2.4	2.4	2.4
GDP Deflator (Percentage change, fourth quarter over fourth quarter)											
CBO	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
Administration	2.9	2.9	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
Consumer Price Index (Percentage change, fourth quarter over fourth quarter)[b]											
CBO	3.2	3.4	3.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Administration	3.3	3.2	3.2	3.2	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Civilian Unemployment Rate (Percent)											
CBO	5.5	5.7	5.8	5.9	6.0	6.0	6.0	6.0	6.1	6.1	6.1
Administration	5.8	5.9	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Three-Month Treasury Bill Rate (Percent)											
CBO	6.2	5.7	5.3	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Administration, without fiscal dividend	5.9	5.5	5.5	5.5	5.5	5.5	5.4	5.3	5.2	5.1	5.0
Administration, with fiscal dividend[c]	5.9	5.4	5.2	5.0	4.8	4.6	4.5	4.3	4.1	4.0	3.9
Ten-Year Treasury Note Rate (Percent)											
CBO	7.7	7.0	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7
Administration, without fiscal dividend	7.9	7.2	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0	7.0
Administration, with fiscal dividend[c]	7.9	7.2	6.6	6.4	6.2	6.0	5.8	5.6	5.4	5.3	5.3

SOURCES: Congressional Budget Office, Office of Management and Budget.

a. Based on 1987 dollars.

b. Consumer price index for all urban consumers (CPI-U). CBO has adjusted its January projection to reflect a 0.2 percent decrease in CPI growth resulting from rebenchmarking beginning in 1998.

c. Includes the reduction in interest rates assumed by the Administration to result from the deficit reduction proposed in "The President's Economic Plan," released June 13, 1995.

Estimating differences unrelated to economic differences also contribute to CBO's estimate of the baseline deficit compared with the Administration's estimates. In 2005, $52 billion of the difference in projected spending can be traced to differences in projected spending in the Medicare and Medicaid programs alone. Although CBO believes that the growth of those programs has slowed from the extremely high rates of recent years, it is not quite as optimistic as the Administration about the extent to which such a slowdown would occur without a change in policy.

Differences in estimates of other mandatory programs contribute $23 billion to the difference between CBO's and OMB's estimates of the baseline deficit. Finally, a $30 billion difference in projected net interest costs primarily reflects the debt service on the increase in the projected deficits that stems from CBO's other reestimates.

CONCLUSION

The Congressional Budget Office has long stressed the importance of bringing the federal deficit under control. Large federal deficits crowd out capital investment, raise interest rates, and restrict economic growth. If noninterest spending exceeds tax

revenues, growing federal deficits will eventually lead to rapidly rising federal interest costs, unsustainable increases in the federal debt, and a reversal in the long-term trend of rising living standards.

The Administration's new budget proposal represents a significant step toward limiting the rise in federal deficits and debt. CBO estimates that if the plan's targets were met, the budget deficit would remain roughly constant in nominal terms and would decline in relation to the size of the economy. Although the plan would not produce a balanced budget, if carried out it would start to move federal fiscal policy off its present, unsustainable course.

The uncertainties involved in budget projections are legion, and small differences in estimating assumptions can lead to large differences in the projected deficit five or ten years in the future. Although the Administration's budget projections are somewhat more optimistic than those of CBO, they fall within the range of plausible outcomes. The 20-year history of Congressional budget projections, however, suggests that the budget deficit is much more likely to exceed projections than to come in lower. It is CBO's view that erring on the side of caution increases the likelihood that a balanced budget will actually be achieved in the time desired.