Statement of

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Mr. Chairman and Members of the Committee:

I welcome the opportunity of discussing with you today some of the issues raised by long range budget projections. As you are well aware, the Congressional Budget and Impoundment Act of 1974 gives the Congressional Budget Office considerable responsibility for projections. The Office is required by Section 308 (c) to issue a report detailing the long run implications of congressional budget actions as soon as is practicable after the start of the fiscal year. This report will contain five year projections of budget authority, outlays, revenues, and tax expenditures. The responsibility for assisting committees in the preparation of five-year budget outlay estimates for bills and resolutions that are reported (Section 308(a)) will also place the Congressional Budget Office squarely in the long-range projection business.

Moreover, projections are not just an ancillary duty of the CBO: They are central to its function and to the reason it was created. Over the years Congress has become increasingly aware of several weaknesses in its capacity to make informed budget decisions. One weakness was the lack of a legislative procedure for considering the budget as a whole -- deciding whether revenues were adequate to finance expenditures, whether larger or smaller deficits or surpluses were appropriate, and whether the priorities on both the expenditure and revenue sides reflected the desires of the Congress as a whole. The creation of two budget committees with responsibility for collecting the views of other committees, considering budget policy as a whole, and reporting two concurrent resolutions on the budget, gives the Congress for the first time a process for debating and voting on budget policy.

A second weakness has been that the Congress made budget decisions very late and without adequate attention to the future implications of current choices. Appropriations have generally not been passed until the year to which they applied was well underway, and decisions have often been made with little understanding of the commitments for future years that were involved. This lateness in decision-making robbed Congress of flexibility; it was already locked into decisions for the current year because major alterations in programs cannot be made quickly. It also meant that decisions often had unintended future consequences, locking future Congresses into difficult positions because apparently small programs turned out to have large future costs or apparently small tax changes entailed major future revenue losses. Some of these decisions might not have been made if the future consequences had been understood at the time of the decision.

The new budget procedures give some hope of improving the ability of Congress to make budget decisions in the light of fuller information about future consequences. Changing the fiscal year helps a little; it will increase the probability that appropriation actions will be completed by the time the fiscal year starts. The emphasis on projections in the new legislation holds much greater hope for real improvement in the process if Congress takes the projections seriously, as I believe it must. Indeed, projecting the consequences of alternative budget decisions has to become the first, not the last step, in Congress' decision process. Indeed, little will have been accomplished if the Congress retains its traditional focus on current year decisions (even with the new budget procedures), making current year decisions first and then asking "Let's see what these decisions mean for the future?" If, however, Congress starts with forward projections, asking itself "What do we want to see happen five years from now," debates these questions, and then translates its desires back into current budget decisions, the process will have been significantly altered for the better.

During the past five years the budget messages have focussed increasingly on the longer range. The FY 1971 and FY 1972 budget documents contained brief but informative five year projections of total federal outlays and receipts. The 1973 budget expanded on these five year outlooks by differentiating the changes that could be attributed to the initiatives contained in the budget from those that were related to existing programs. Both the 1974 and 1975 budgets went one step further, supplementing this information with a detailed breakdown of outlays and budget authority by functions and by agencies for the year following that of the budget. The budget just submitted by the President -- that for Fiscal Year 1976 -- represents the most complete effort to date in the area of long-range projection. Not only does it contain a detailed breakdown of outlays and budget authority by agency and function for the next five years, but it also provides an explicit presentation of many of the underlying assumptions concerning such economic factors as gross national product, income, inflation, unemployment, interest rates and federal pay. The Administration should be applauded for its openness and its willingness to provide this detail, for without such information it is difficult to gauge the value of any long-term projection.

The controversy that has swirled around the long-term budget projections presented in the President's budget and the long-term outlooks referred to in the statements of a number of Administration officials, however, indicates that more detailed long-range projections can at times act to generate more heat than light. Some of the problems stem from what I regard as a basic confusion between four quite distinct types of projections. Because this confusion is shared as often by those producing long-range budget outlooks as by those consuming these prognostications, I think it would be useful to spell out the four types of projections and the uses to which they might be put.

The most straightforward of these is the "Current Services" type of projection that attempts to show the budget outlook that would result if the nation's basic revenue structure remains unchanged and if existing expenditure programs are maintained at their current real service levels. This type of projection answers the question: What will happen if we don't do anything new? No matter how straightforward this may sound, the concept of "Current Services" is fraught with ambiguities and difficulties. While we may all agree that social security outlays must be increased to reflect the growing population of eligible recipients and the erosion of benefit payments by inflation if real service levels are to be maintained, it is by no means clear how one estimates constant real service levels in defense procurement or water pollution abatement programs. Furthermore, there is the basic problem of determining how one should handle programs whose activity levels are specified by existing laws to rise or fall in future years. Moreover, current services have to be projected on the basis of assumptions about what will happen to the price level and to the state of the economy over the projection period, and it is by no means obvious what assumptions are the most useful. These and related issues are currently being addressed by the Office of Management and Budget, this Committee, the Budget Committees, the GAO, and the Congressional Budget

Office, so that a Current Services Budget can be developed by November 10, 1975, and projected into the future on a useful basis.

A second type of long-range budget projection represents a desired course of policy, rather than a picture of the government sector that would result if no new initiatives were forthcoming. This type of projection is the answer to the question: What will the budget be like if we enact certain specified policies, if we increase defense capability, enact national health insurance, reform the tax system in specified ways, etc?

The "Most Desired" type of projection -- or rather a whole array of alternative projections of this type -- is actually the most useful for decisionmakers. To make sensible informed current decisions the Congress needs to begin thinking in terms of alternative budget futures and making decisions about which of the most desired projections it actually wants to see become a reality. This type of projection, however, is even harder to make honestly and accurately than the "Current Services" type. Proponents of particular policies tend to minimize their cost, while exaggerating the cost of policies they do not especially favor. Moreover, for this type of projection to be useful to the decisionmaker the different alternatives must reflect the same assumptions about price and unemployment and other economic variables in the future and it must be known what those assumptions are.

Still a third type of projection is that which is in essence a forecast of that which is most likely to occur. These "Most Likely" forecasts involve judgements about what the goals of various segments of society are, how the political process will interpret and modify these goals, and how actual economic developments will affect the results. The preceding two types of projections that I have referred to are not of this sort at all and it would be wrong to criticize them if history showed them to be far from that which actually occurred. "Most Likely" forecasts are best left to the private sector, since they have almost no usefulness for decisionmakers. Decisionmakers need to think about "What will happen if . . .?" and then do the best they can to choose a course that will lead to the desired outcome. They have no particular use for "Most Likely" forecasts and are unlikely to be very objective about them in any case.

The final type of projection that can be placed alongside of the "Current Services," the "Most Desired," and the "Most Likely" might be labeled the "Most Feared." Generally this type of projection involves some dire outcome such as the public sector absorbing all personal income at some future date or the public debt growing to unmanagable proportions. While such projections invariably are prefaced by a conditional statement relating to past experience, such as "if between now and 1990 the public debt grows at the rate experienced during the past decade," the sensationalism of the conclusion detracts attention from the qualifying phrase and the audience is generally not given any basis for evaluating the probability of the events contained in the conditional phrase. Despite these weaknesses cataclysmic projections do serve a useful purpose in that they highlight the long-run implications of certain short-term trends and this can bring home how unsustainable some of these trends are. However, considering the danger of misuse and misunderstanding, persons in positions of responsibility should engage in cataclysmic projecting only after careful warnings to their audience.

Having spelled out these four types of long-range budget projections let me now say a few words about those contained in the budget documents. Basically these fall somewhere between the "Current Services" and the "Most Desired" type of projection. The Administration has explicitly warned that these are not to be taken as forecasts of likely outcomes nor are they to be regarded as long-range policy recommendations. However, they are not "Current Services" projections either because the base from which the projections are made includes the policy initiatives of the President for the coming fiscal year. For example, the 1980 revenue and outlay figures supplied in this year's budget incorporate the effects of the President's tax changes, energy proposals, and social legislation (the cap on federal pay and retirement benefits and the changes in the food stamp program). These projections do represent the long-run implications of the Administration's short-term goals even if they do not reflect the longer run policy objective of the President. Furthermore, even over the longer haul there appears to be a degree of inconsistency in the way different program areas are handled. While entitlement programs are allowed to grow only at the pace implied by price rises and increases in recipient populations, defense procurement is projected to increase by 4 percent per year in real terms. Moreover, for no obvious reason, the defense projections have inflation assumptions built into them while many domestic programs other than entitlements do not. Functional categories such as "education, manpower, and social services" and "revenue sharing and general purpose fiscal assistance" are projected on the assumption that there will be no growth to cover price rises and hence a real decline in the value of the benefits provided. A separate general "allowance" is made to cover some types of cost increases in domestic programs as a whole.

Long-range budget projections like other numbers often take on an air of finality and of correctness once they are published. Users of such projections, therefore, should be armed with a healthy dose of skepticism. The process of making any type of long-range projection is judgmental not scientific. There are no "correct" or "right" sets of projections, for projections are the product of a multitide of assumptions. They can be tested only when all of the assumptions are realized.

Since -- with the exception of forecasts -- long-range budget projections do not have as their objective the spelling out of a "Most Likely" scenario, the test of history can rarely be applied. Even "Most Likely" forecasts seldom can be evaluated for actual events and may turn out to be the "Most Unlikely" -- the oil boycotts, the droughts, and the political upheavals -- rather than the expected. Considering that those offering projections operate in a world where they are rarely evaluated and where their audience often does not have the expertise needed to question their premises, it is incumbent on them to abide by several basic rules. In some respects these rules may be compared to the Surgeon General's warnings on cigarette packages.

First, those generating projections should specify clearly the basic type of projections that are being made -- is a "Current Services," "Most Likely," "Most Feared," or "Most Desired" scenario being produced? An explicit statement explaining the type of projection that is being made will reduce misunderstanding as well as set the ground rules for criticism.

Second, the assumptions concerning basic economic factors that underlie the projections should be spelled out in detail. Only with such explicit detail can the user of the projections have some feel for the credence that he should give the projections. Moreover, it should be possible for the user of the projection to plug in his own assumptions without too much difficulty or at least to find out easily how sensitive the projections are to changes in basic assumptions, such as a shift in the assumed inflation rate from 6 percent to 8 percent. It is not so important that the users of projections reach agreement on which assumptions are "best," but it is important that they know exactly what assumptions were used and how the results would be affected if the assumptions were changed.

Third, those who produce projections should be required to ensure a degree of consistency in their assumptions. At the simplest level this involves making sure that the unemployment, inflation, income, and tax figures fit together in a realistic fashion. Often "cataclysmic" projections do not meet such a test. At a more complex level consistency requires that similar methodologies are used to generate the forecasts. A "Current Services" budget outlook cannot be one that has social programs rising by price and population increases while the defense or highway sector increases in real per capita terms.

Finally, the consequences of certain assumptions should be spelled out when these assumptions are of a crucial nature and an effort should be made to evaluate their likelihood. Many of the assumptions that must be used in the process of constructing a long-range budget projection involve areas which we know little about. In other cases the assumptions, while sounding reasonable to the generalist, may be highly unlikely from the expert's viewpoint. For example, it may sound plausible that welfare rolls or social security beneficiaries should grow over the next decade at roughly the same rate as the have in the past ten years. An assumption to this effect, therefore, would raise few eyebrows. However, as someone who has studied the history of the past decade knows, much of the recent growth in welfare and social security rolls can be attributed to an increased fraction of those eligible to receive benefits actually receiving them. For example, Barbara Boland in her study of the AFDC program for this Committee estimated that participation among female-headed families who were eligible for AFDC benefits rose from 63 percent to 91 percent between 1967 and 1970. The future growth of recipients can clearly not be propelled much by increasing this fraction. If the welfare rolls were to grow as rapidly as they did in the past ten years it would indicate either a significantly increased rate of family disintigration in America or a major change in the eligibility requirements for the AFDC program. The latter would be inconsistent with a "Current Services" projection while the former might be considered unrealistic. Similarly, the fraction of the population over 64 years of age who are receiving social security payments rose from 69 percent in 1963 to 86 percent in 1973. A sustained expansion in recipients could only be accomplished if the age of retirement were lowered significantly. To take yet another example, grants in aid to state and local governments if they were to maintain the rate of growth experienced in the 1965-75 period during the next five years would amount to some $115 billion dollars and would absorb roughly one quarter of the federal budget. While a simple statement that grants in aid were assumed to grow at their past pace would not be treated as startling by any but the experts in the field, it would represent a very significant change in intergovernmental fiscal relations and in the level of state and local taxes.

In closing let me say a few words about the role that the Congressional Budget Office will play in the area of long-range budget projections. Naturally, I would hope that we would closely observe the rules which I have just outlined. I would also hope that, in time, we could develop the capacity to provide semi-annual or even quarterly revisions of long-run projections of revenues and major expenditures, in addition to the more detailed annual analysis provided for in the Budget Act. The experience of the past few months shows that long-range budget projections have a way of becoming dated very quickly as changing economic conditions shift views of what assumptions are relevant. Expectations of future inflation rates have dropped significantly in recent months, tax laws have been modified, new expenditure programs have been enacted. Such events make the estimates of three months ago totally outdated. For this reason the capacity to update these estimates at least in some crude fashion at something more than annual intervals is needed. Finally, I would hope to develop in the Congressional Budget Office the capacity to provide long-range projections under a variety of assumptions concerning basic economic conditions. Congressmen as well as experts differ with respect to desirable, tolerable, and likely levels of inflation and unemployment, factors which have a profound impact on the shape of long-range budget projections. The Congressional Budget Office, hopefully, will be in a position to provide some insight into how such projections vary when one changes the set of assumptions upon which they are based. Of course, in this area as well as in others we stand ready to accept the advice and the insights of members of this Committee as well as other members of Congress on how long-range budget projections can be made more useful and more understandable.