Statement of
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before the
Committee on Appropriations
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NOTICE

This statement is not available for public release until it is delivered at 9:30 a.m. (EST), on Thursday, February 19, 1987.

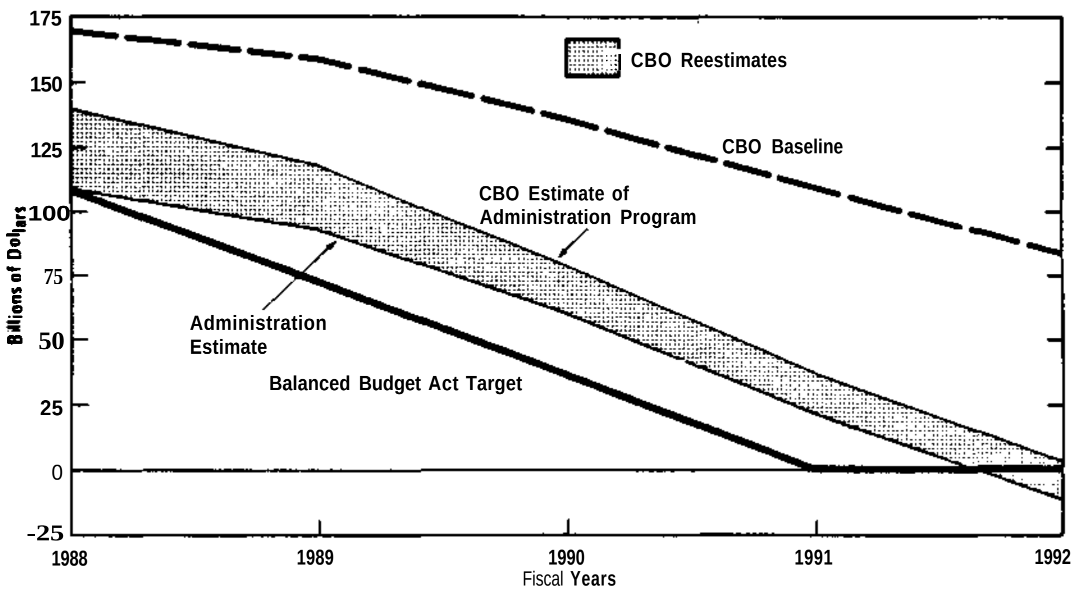
Mr. Chairman, at the request of this Committee, the Congressional Budget Office (CBO) has prepared an analysis of the President's budgetary proposals for 1988. Copies of our report have been distributed to Members, and I am pleased to have the opportunity this morning to summarize its findings.

CBO analyzes the Administration's budget in terms of changes from its baseline, which projects the course of the budget on the assumption that current taxing and spending policies continue unchanged. CBO reestimates, or reprices, the Administration's budget using CBO's economic and technical estimating assumptions and methods. The differences between the baseline projections and the CBO estimate of the budget measure the effects of the Administration's proposed policy changes. Appendix A of our report further describes the baseline projections, which update those published last month in CBO's annual report, *The Economic and Budget Outlook: Fiscal Years 1988-1992.*

CBO estimates that the federal deficit under Administration policies would be $134.4 billion in 1988, $117.1 billion in 1989, and $1.2 billion in 1992. These figures are noticeably higher than the Administration's own deficit estimates--$107.8 billion in 1988, $92.8 billion in 1989, and a surplus of $12.3 billion in 1992. CBO's estimate for 1988 represents a reduction of $36.1 billion below its baseline but is still $26.4 billion above the $108 billion target established in the Balanced Budget Act (see Figure 1 and Table 1).

CBO's reestimate for 1988 is slightly below the low end of the range of our preliminary analysis of the President's budget that we made a month ago. At that time, we estimated that the President's budgetary policies would produce a deficit within the range of $135 billion to $140 billion. Our new estimate of $134.4 billion can be attributed almost entirely to the Administration's plan not to provide advance deficiency payments on 1988 crops during fiscal year 1988.

Figure 1.
Federal Deficit Projections and Targets



SOURCE: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.

CBO's estimates of the deficit exceed the Administration's estimates by $3.0 billion in 1987, $26.6 billion in 1988, and declining amounts in later years. Table 2 divides the CBO reestimates of the Administration's budget into those resulting from different economic assumptions and those resulting from technical factors. Most of the reestimates are economic.

TABLE 1. THE BUDGET OUTLOOK UNDER THE ADMINISTRATION'S POLICIES (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues						
Administration Estimate	842.4	916.6	976.2	1,048.3	1,123.2	1,191.2
CBO Estimate	834.2	905.4	969.1	1,058.8	1,146.9	1,230.6
Outlays						
Administration Estimate	1,015.6	1,024.3	1,069.0	1,107.7	1,144.4	1,178.9
CBO Estimate	1,010.4	1,039.8	1,086.2	1,136.7	1,182.6	1,231.9
Deficit (-) or Surplus						
Administration Estimate	-173.2	-107.8	-92.8	-59.5	-21.3	12.3
CBO Estimate	-176.2	-134.4	-117.1	-77.9	-35.7	-1.2
Balanced Budget Act Targets	-144.0	-108.0	-72.0	-36.0	0	0

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

NOTE: Totals include Social Security, which is off-budget.

Effects of Economic Assumptions

Although the differences between CBO and Administration economic assumptions are relatively small, they affect the budget estimates substantially. CBO's economic assumptions increase the estimated deficit by $4.2 billion in 1987, $15.0 billion in 1988, and $20.0 billion in 1992.

TABLE 2. CBO REESTIMATES OF THE ADMINISTRATION'S BUDGET (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Deficit, President's Budget	173.2	107.8	92.8	59.5	21.3	-12.3 a/
CBO Reestimates						
Economic						
Revenues	-3.9	-9.7	-9.8	-3.0	8.1	22.6
Outlays	0.3	5.3	11.2	19.0	30.1	42.7
Deficit	4.2	15.0	21.0	22.0	22.0	20.0
Technical						
Revenues	-4.3	-1.4	2.7	13.5	15.7	16.8
Outlays	-5.5	10.2	6.1	9.9	8.0	10.2
Deficit	-1.2	11.6	3.3	-3.6	-7.6	-6.5
Total Reestimates	3.0	26.6	24.4	18.4	14.4	13.5
Deficit, President's Budget as Estimated by CBO	176.2	134.4	117.1	77.9	35.7	1.2

SOURCES: Congressional Budget Office; Office of Management and Budget.
NOTE: Totals include Social Security, which is off-budget.
a. Surplus.

As shown in Table 3 and discussed in Chapter II, CBO assumes consistently lower real economic growth, higher interest rates, and faster inflation than does the Administration. The first two factors tend to increase the estimated deficits, while the third tends to lower them (see Table 4). Lower real economic growth holds down tax receipts, while increasing outlays for unemployment insurance and related programs. CBO's real growth assumption adds to the deficit in the President's budget by amounts growing from $7 billion in 1987 to $86 billion in 1992. Higher interest rates increase debt service costs by a negligible amount in 1987, $3 billion in 1988, and $18 billion in 1992.

Faster inflation increases most revenue sources (by increasing taxable incomes and consumption) but only raises some outlay categories (primarily indexed benefit programs). It therefore reduces the estimated deficits--by $3 billion in 1987, $8 billion in 1988, and $84 billion in 1992. CBO bases its estimates of defense and nondefense discretionary appropriations on the dollar value of the Administration's request; it does not increase the request to take account of CBO's higher assumed inflation rates. If CBO's inflation assumptions prove correct, these appropriations will buy fewer real goods and services than the Administration anticipates.

TABLE 3. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC ASSUMPTIONS, 1987-1992 (By calendar year)

Economic Variable	Actual 1986	1987	1988	1989	1990	1991	1992
Nominal GNP (billions of dollars)							
Administration	4,208	4,493	4,816	5,165	5,524	5,879	6,214
CBO	4,208	4,469	4,779	5,124	5,503	5,888	6,288
Real GNP (percent change)							
Administration	2.5	3.1	3.5	3.6	3.6	3.5	3.4
CBO	2.5	2.8	3.0	3.0	3.1	2.7	2.5
Consumer Price Index a/ (percent change)							
Administration	1.6	3.0	3.6	3.6	3.2	2.8	2.2
CBO	1.6	3.5	4.3	4.3	4.3	4.3	4.3
GNP Deflator (percent change)							
Administration	2.7	3.3	3.5	3.5	3.2	2.8	2.3
CBO	2.7	3.2	3.8	4.1	4.2	4.2	4.2
Three-Month Treasury Bill Rate (percent)							
Administration	6.0	5.4	5.0	5.3	4.7	4.2	3.6
CBO	6.0	5.6	5.7	5.6	5.5	5.3	5.2
Ten-Year Government Bond Rate (percent)							
Adminstration	7.7	6.7	6.6	6.1	5.5	5.0	4.5
CBO	7.7	7.2	7.2	6.6	6.2	5.9	5.6
Civilian Unemployment Rate (percent)							
Administration b/	6.9	6.7	6.3	6.0	5.8	5.6	5.5
CBO	7.0	6.6	6.5	6.3	6.1	6.0	6.0

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

NOTE: Percent change is for calendar-year averages.

a. Urban wage and clerical workers.

b. The Administration's projection is for the total labor force including armed forces residing in the United States, while CBO's is for the civilian labor force excluding armed forces. In recent years, the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

Effects of Technical Assumptions

Technical reestimates increase the estimated 1988 deficit by $11.6 billion--primarily by raising outlays. CBO's estimated spending for Medicare, which assumes a continuation of recent growth rates, exceeds the Administration figure by $5.0 billion (see Table 5). CBO's estimates for Medicaid and income security programs are $3.3 billion higher than the Administration's. CBO also believes that the Administration's proposals for restructuring foreign military sales debt, recapitalizing the Federal Savings and Loan Insurance Corporation, and selling Amtrak assets--for which the budget includes a total of more than $3 billion in savings--would do little to reduce 1988 outlays. Technical reestimates of revenues add another $1.4 billion to the estimated 1988 deficit.

TABLE 4. EFFECTS OF CBO ECONOMIC ASSUMPTIONS ON ESTIMATES OF THE ADMINISTRATION'S DEFICIT (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Lower Real Economic Growth	7	20	33	41	60	86
Higher Inflation	-3	-8	-16	-28	-51	-84
Higher Interest Rates	a/	3	5	8	13	18
Total Economic Reestimates	4	15	21	22	22	20

SOURCE: Congressional Budget Office.
NOTE: The figures include the changes in debt service costs caused by different borrowing.
a. Less than $0.5 billion.

In the 1989-1992 period, the differences in the assumed growth of Medicare, Medicaid, and income security programs continue to raise the outlay figures, but technical reestimates also add to revenues by growing amounts. Principal among these differences are different assumptions about how taxpayers will respond to the Tax Reform Act of 1986. CBO assumes that taxpayers will be less successful than does the Administration in finding alternative ways to reduce their taxable incomes. In 1992, technical estimating differences add $16.8 billion to revenues, increase outlays by $10.2

TABLE 5. CBO REESTIMATES RESULTING FROM DIFFERENT TECHNICAL ASSUMPTIONS (By fiscal year, in billions of dollars)

	1987	1988	1989	1990	1991	1992
Revenues	-4.3	-1.4	2.7	13.5	15.7	16.8
Outlays						
Medicare	1.8	5.0	4.5	5.6	6.5	7.7
Medicaid	0.5	1.6	1.5	1.3	1.0	0.5
Income security	-0.8	1.7	2.9	2.8	4.3	5.8
FMS debt restructuring a/	0.2	1.1	-0.9	-0.9	-0.9	-0.8
Deposit insurance	-1.8	1.0	1.9	1.3	0.2	0.9
Sale of Amtrak assets	0	1.0	0	0	0	0
Net interest a/	-2.1	-1.4	-3.0	-3.1	-4.8	-2.3
Other a/	3.3	-0.1	0.9	-2.9	-1.7	1.5
Subtotal, Outlays	-5.5	10.2	6.1	9.9	8.0	10.2
Total Technical Reestimates	-1.2	11.6	3.3	-3.6	-7.6	-6.5

SOURCE: Congressional Budget Office.

a. Intragovernmental transactions that are offset elsewhere in the budget have been removed.

billion, and reduce the estimated deficit by $6.5 billion. Chapters III, IV, and V of our report describe CBO's reestimates of the Administration's budget in more detail.

THE ADMINISTRATION'S BUDGET PROGRAM

CBO's baseline projections provide a benchmark against which the Administration's budget program can be measured. Because the baseline and the CBO estimate of the budget employ the same economic and technical assumptions, differences between the two are solely the result of proposed policy changes. CBO estimates that the Administration's budget proposals would reduce the 1988 deficit to $134.4 billion--$36.1 billion below the baseline level of $170.6 billion. By 1992, the budget would be roughly in balance. Over the 1988-1992 period, the Administration's proposals would reduce the deficit by nearly $300 billion (see Table 6).

The Administration is requesting an increase in real defense appropriations of about 3 percent in 1988 and 2 percent a year thereafter (on the basis of CBO's assumed rates of inflation). Proposed appropriations for procurement are lower than the 1987 amounts, while those for operation and maintenance and for research and development are higher. The higher appropriations sought by the Administration would increase defense outlays by $7.8 billion in 1988 and $71.6 billion over the 1988-1992 period compared with the CBO baseline, which assumes no real growth in defense spending.

TABLE 6. THE ADMINISTRATION'S BUDGET PROGRAM AS ESTIMATED BY CBO (By fiscal year, in billion of dollars

Item	1988	1989	1990	1991	1992	Cumulative Five-Year Changes
CBO Baseline Deficit	170.6	164.4	136.8	109.5	84.0	
Defense Increases	7.8	9.2	14.0	17.5	23.1	71.6
Deficit Reductions						
Revenue increases	-5.0	-7.1	-7.7	-8.0	-8.2	-36.0
Outlay reductions						
Financial transactions	-6.6	-2.7	0.3	2.6	5.6	-0.7
Sale of physical assets	-2.8	-1.8	-1.7	-4.2	-2.1	-12.6
Spending delays	-6.5	-0.1	a/	a/	a/	-6.6
User fees and offsetting receipts	-2.7	-4.5	-5.3	-6.3	-7.4	-26.2
Nondefense discretionary programs	-10.7	-20.5	-28.9	-36.4	-43.9	-140.3
Entitlement programs	-8.5	-15.9	-22.3	-27.8	-34.3	-108.8
Debt service savings	-1.2	-4.0	-7.3	-11.3	-15.6	-39.4
Subtotal, reductions	-43.9	-56.5	-72.9	-91.4	-105.9	-370.5
Total Policy Changes	-36.1	-47.3	-58.9	-73.8	-82.8	-298.9
Deficit, President's Budget as Estimated by CBO	134.4	117.1	77.9	35.7	1.2	

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

NOTE: Totals include Social Security, which is off-budget.

a. Less than $50 million.

To allow for this growth in defense while reducing the deficit, the Administration proposes cuts in nondefense spending and increases in revenues totaling $43.9 billion in 1988 and $370.5 billion over five years. Revenue increases account for $36.0 billion, or only 10 percent, of the five-year deficit reduction. Of this amount, $14.4 billion would result from adding over 10,000 positions to the Internal Revenue Service (IRS) examination and enforcement staff. (The revenue baseline already includes $17 billion in additional revenues from 1987 to 1992 resulting from the 5,500 new IRS positions added in the 1987 appropriation.) Extending Medicare coverage to all state and local employees would raise an additional $9.3 billion. Other revenue proposals include increasing railroad pension and unemployment insurance contributions, increasing the coal tax that finances the Black Lung program, and eliminating the exemption of state and local governments and most bus companies from highway excise taxes.

The Administration is proposing a number of financial transactions that would reduce recorded outlays in the short run, especially in 1988, though generally at the cost of increased spending later on. These financial transactions account for $6.6 billion, or 15 percent, of the $43.9 billion in deficit reduction in 1988, but add $5.6 billion to the 1992 deficit (not counting debt service savings). Sales of existing loan assets of the Export-Import Bank, Farmers Home Administration, and other agencies produce $5.3 billion in outlay reductions in 1988. In addition, as part of its credit reform proposals (discussed in Chapter VI), the Administration is proposing to sell a number of new loans soon after they are made.

The proposed sale of physical assets--primarily the Naval Petroleum Reserves and the power marketing administrations--reduces outlays by $2.8 billion in 1988 and $12.6 billion over five years. The loss of receipts from the sale of oil and electricity, however, would add to the deficit after 1992.

Although these asset sales provide a temporary reduction in the deficit under current accounting conventions, they squeeze credit markets in almost the same fashion as borrowing by the government. The amount paid for the asset is no more available for private investment than is a like amount loaned to the Treasury.

Proposed delays in spending for Medicare and farm price supports cause a one-time reduction in outlays of $6.5 billion in 1988 but make no lasting contribution to deficit reduction. Delaying the reimbursement of hospitals and doctors for Medicare services reduces 1988 outlays by $2.0 billion. Not making advance deficiency payments to farmers, though done in 1987 and three out of the past four years, lowers 1988 outlays by $4.5 billion compared with the CBO baseline.

The Administration is proposing to increase a number of charges and fees that are recorded in the budget as offsets to outlays rather than as tax revenues. Increased premiums for Supplementary Medical Insurance (Part B of Medicare) account for $16.8 billion of the $26.2 billion to be raised through such user fees over the next five years. The Administration is also proposing to charge more for Federal Housing Administration and Veterans Administration home mortgage insurance, for pension benefit guarantees, and for use of the national parks and forests, and to impose fees for Coast Guard services and meat and poultry inspection.

The foregoing proposals to raise revenues, sell physical and financial assets, delay payments, and increase charges for services constitute a little over 20 percent of the Administration's five-year deficit reduction total. Debt service savings contribute another 10 percent of the savings. The bulk of the deficit reduction, however, is achieved through cutbacks in nondefense discretionary and entitlement programs.

Proposed cuts in nondefense discretionary spending total $140.3 billion over the 1988-1992 period. Among the largest proposed reductions are Farmers Home Administration direct loans, excluding asset sales ($16.3 billion), transportation programs ($15.4 billion), assistance for college students ($13.9 billion), civilian agency pay raises ($14.0 billion), energy supply and conservation ($13.9 billion), natural resources and environment ($12.1 billion), elementary and secondary education ($11.1 billion), Public Health Service programs ($10.7 billion), and housing assistance ($8.5 billion). Similar reductions were proposed in last year's budget, but not enacted. Increases are proposed for international affairs, science and space, and the Internal Revenue Service.

Proposed reductions in Medicare and Medicaid would reduce outlays by $56.7 billion-half of the five-year savings in entitlement programs. Reductions in Commodity Credit Corporation (CCC) direct loans and income support payments to farmers would save another $20.7 billion. Federal employee retirement and health benefits would be cut by $10.5 billion, child nutrition and food stamps by $7.1 billion, and guaranteed student loans by $6.6 billion. With the exception of CCC, most of these proposals were also advanced but rejected last year.