

Statement of
Rudolph G. Penner
Director
Congressional Budget Office

before the
Temporary Joint Committee on Deficit Reduction
United States Congress

September 11, 1986

NOTICE

This statement is not available for public release until it is delivered at 11:30 a.m. (EDT), Thursday, September 11, 1986.

I am pleased to have the opportunity to discuss the initial sequestration report for fiscal year 1987. My statement this morning will cover the highlights.

BUDGET BASE LEVELS

The budget estimates contained in the report follow the specifications of the Balanced Budget and Emergency Deficit Control Act of 1985 or, more briefly, The Balanced Budget Act. They are based on laws and regulations in effect on August 15--the so-called "snapshot" date--and on appropriations for fiscal year 1986 since no appropriations for 1987 have been enacted. The Congressional Budget Office's (CBO's) estimate of the deficit is \$170.6 billion and the Office of Management and Budget's (OMB's) estimate is \$156.2 billion, as shown in Table 1.

The major reasons for the difference are summarized in Table 2. The largest difference is technical in nature. CBO estimates a higher spendout rate for defense and a higher cost of agricultural programs than does OMB.

TABLE 1. BUDGET BASE LEVELS FOR FISCAL YEAR 1987 (In billions of dollars)

Budget Aggregates	OMB Estimates	CBO Estimates	Average
Revenues	826.4	827.8	827.1
Outlays	<u>982.6</u>	<u>998.5</u>	<u>990.5</u>
Deficit	156.2	170.6	163.4

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

These and other less important technical differences account for \$8.8 billion or 60 percent of the total difference between our estimates.

Conceptual differences in how to apply the Balanced Budget Act's specifications amount to another \$4.7 billion. These differences involve the treatment of appropriated entitlements and allowances for federal pay raises, and are discussed in some detail in our report.

TABLE 2. DIFFERENCES BETWEEN OMB AND CBO BASELINE DEFICITS
(In billions of dollars)

OMB Deficit	156.2
Differences:	
Conceptual:	
Appropriated entitlements	1.7
Pay raises:	
Defense	2.8
Nondefense	<u>0.1</u>
Subtotal, conceptual	4.7
Technical:	
Defense function	5.2
Farm price supports	5.1
Other outlays	0.7
Receipts	<u>-2.2</u>
Subtotal, technical	8.8
Economic:	
Receipts	0.7
Outlays	<u>0.2</u>
Subtotal, economic	<u>0.9</u>
Total differences	<u>14.5</u>
CBO Deficit	170.6

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

Differences in economic assumptions account for only about \$1 billion of the difference between CBO's and OMB's deficit estimates. The economic assumptions of the two organizations are compared in Tables 3 and 4.

The law instructs CBO and OMB to average their deficit estimates, which results in a deficit estimate of \$163.4 billion. This amount is \$19.4 billion above the 1987 target of \$144 billion. Because the law allows a \$10 billion margin of error, only \$9.4 billion of this excess must be removed by legislation in order to avoid the specter of sequestration. If sequestration occurs, however, it would involve spending reductions of the full amount of the excess deficit, or \$19.4 billion.

TABLE 3. ECONOMIC ASSUMPTIONS (Fiscal Year 1987)

Economic Variable	OMB	CBO
Gross National Product:		
Current dollars (in billions of dollars)	4,449	4,423
Percent change, year over year	6.8	6.2
Constant (1982) dollars (in billions of dollars)	3,797	3,777
Percent change, year over year	3.7	3.2
GNP Implicit Price Deflator (percent change, year over year)	3.0	2.9
CPI-W (percent change, year over year)	2.1	2.6
Civilian Unemployment Rate (percent, fiscal year average)	6.7	6.8
Interest Rates (fiscal year averages):		
91-day Treasury bills	6.2	6.3
10-year Treasury notes	7.5	7.7

SEQUESTRATION CALCULATIONS

While everyone hopes that a sequestration can be avoided, CBO and OMB were required to show the amounts and percentages by which various budgetary resources must be sequestered in order to eliminate the full excess deficit. The calculations are complex and are described in full detail in our report. (They are summarized in Table 5 of this testimony.) I would emphasize only a few points:

- o The across-the-board sequestration percentage for defense programs is 5.6 percent and for nondefense programs is 7.6 percent. The defense percentage is lower than the nondefense because the military personnel accounts are not exempt from sequestration in 1987, which has the effect of increasing the defense outlay base for the across-the-board cuts.

TABLE 4. REAL ECONOMIC GROWTH RATES BY QUARTER (In percents, annual rates)

	Fiscal Year 1986			Fiscal Year 1987 Estimates			
	Actual		Estimate	Oct-Dec 1986	Jan-Mar 1987	Apr-Jun 1987	Jul-Sep 1987
	Jan-Mar 1986 a/	Apr-Jun 1986 a/	Jul-Sep 1986				
OMB	3.8	1.1	4.0	4.0	4.2	4.2	4.2
CBO	3.8	1.1	3.0	3.6	3.9	3.7	3.3

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

a. As reported by the Department of Commerce (July 22, 1986).

TABLE 5. SEQUESTRATION CALCULATIONS FOR 1987 (Outlays in millions of dollars)

Category	OMB	CBO	Average
Defense Programs:			
Total required reductions	6,086	13,323	9,704
Estimated savings from automatic spending increases:			
Indexed retirement programs <u>a/</u>	139	221	180
Amount remaining to be obtained from uniform percentage reductions of budget resources	5,947	13,102	9,525
Estimated outlays associated with across-the-board sequestrable budget resources	164,330	173,635	168,983
Uniform reduction percentage	3.6	7.5	5.6
Nondefense Programs:			
Total required reductions	6,086	13,323	9,704
Estimated savings from automatic spending increases:			
Indexed retirement programs	139	221	180
Other indexed programs	7	7	7
Estimated savings from the application of special rules:			
Guaranteed student loans	29	31	30
Foster care and adoption assistance	2	2	2
Medicare	1,115	1,240	1,178
Other health programs	164	161	163
Amount remaining to be obtained from uniform percentage reductions of budget resources	4,631	11,661	8,146
Estimated outlays associated with across-the-board sequestrable budget resources <u>b/</u>	108,350	106,998	107,674
Uniform reduction percentage	4.3	10.9	7.6

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

- a. These retirement programs are not included in the national defense function of the budget; most are included in the income security function.
- b. Includes estimates 1988 outlays for the Commodity Credit Corporation (CCC) that can be affected by a 1987 sequestration (see discussion of special rule for the CCC). The OMB estimate is \$14,137 million, the CBO estimate is \$9,215 million, and the average if \$11,676 million.

- o A large part of the budget is either exempt from sequestration or is unaffected by it. As a consequence, the reductions are concentrated in about 40 percent of total outlays. To get \$19.4 billion in outlay reductions, an even larger amount of new budget authority and other spending authority has to be sequestered. For example, defense spending authority has to be reduced by \$19.1 billion to get outlay savings of \$9.5 billion in 1987. This calculation indicates that a sequestration would reduce spending for a number of years following fiscal year 1987.

- o A 1987 sequestration of 5.6 percent for defense programs and 7.6 percent for nondefense programs would be much more severe than these percentages imply. First, these reductions would be on top of the 1986 sequestrations. Second, the reduction in real terms would be even greater because of the loss of any adjustments for inflation in 1987. The combined effect suggests reductions from the original 1986 appropriation levels of close to 13 percent for defense programs and 14 percent for nondefense programs.

CONCEPTUAL ISSUES

In addition to our conceptual differences in defining the budget base, CBO and OMB differed on whether the sequestration applied to Washington Metropolitan Area Transit Authority and other interest accounts and to Veterans Administration policy loans. There is now no third party to

resolve these differences and, therefore, the sequestered amounts are averaged. Both CBO and OMB agree that averaging makes no sense whatsoever. Unfortunately, under the fallback procedure, the Joint Committee cannot change our report. The problem can be solved only by amending the Balanced Budget Act. The Senate-passed amendments to the Balanced Budget Act would resolve most of our conceptual differences. The effect, however, would be to raise the averaged CBO/OMB estimate of the 1987 deficit by about \$4 billion.

CONCLUSION

I would like to end this statement by noting that our working relationship with OMB remained excellent, and by again praising the OMB/CBO staffs for their arduous work on the complex task of producing this report under the direction of James L. Blum and Carey P. Modlin. The staffs have been working on the report since May, with all of the detailed work being done in the last few weeks at the same time as we faced a flurry of legislative activity and our summer budget update reports.

As in January, the task was accomplished with the utmost professionalism and good humor, and for that the staffs of both offices deserve a great deal of credit.