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UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

STATEMENT BY

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ON

THE GENERAL ACCOUNTING OFFICE'S

REVIEW OF THE

OMB/CBO INITIAL REPORT

UNDER THE DEFICIT CONTROL ACT

BEFORE THE

TEMPORARY JOINT COMMITTEE

ON THE REDUCTION OF THE DEFICIT

OF THE CONGRESS OF THE

UNITED STATES

SEPTEMBER 10, 1986



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I am pleased to appear today before the Temporary Joint Committee to discuss the results of our review of the Initial Sequestration Report for Fiscal Year 1987. That report was submitted to the Congress on August 20 by the directors of the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO).

Our review was performed at the request of Congressman Jack Brooks, Chairman of the Committee on Government Operations of the House of Representatives. This review is advisory only, in light

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of the Supreme Court's decision that the role originally assigned to us under the Act was unconstitutional. Our report, Budget Reductions for FY 1987: Review of Initial OMB/CBO Report Under the Deficit Control Act (GAO/OCG-86-4, September 4, 1986) has been provided to your committee.

DIFFERENCES FROM THE OMB/CBO REPORT

There are some areas in which our estimates differ from the OMB/CBO report. In summary, using the assumptions required by the Deficit Control Act, we estimate a deficit for FY 1987 of \$167.6 billion, about \$4 billion higher than the average reported by OMB and CBO. This difference is not great given the overall magnitude of the budget. But it suggests that, to reach the target, somewhat higher sequester percentages would be necessary than those reflected in the OMB/CBO report. Using our estimates, the required sequestrations for defense would be 6.7 percent instead of 5.6 percent and for nondefense it would be 9.4 percent instead of 7.6 percent.

Our principal differences from the OMB/CBO report are as follows:

1. Economic Assumptions

Our own forecast is that the economy will grow at a rate of 2.8 percent in 1987. This is somewhat slower than CBO's 3.2 percent, and substantially below OMB's 3.7 percent. We also assume somewhat lower interest rates. After reviewing the forecasts, however, we concluded that the differences between ours and CBO's was not great enough to justify producing a third set of

account-by-account estimates. Therefore, we used the CBO assumptions for calculations that are sensitive to economic conditions. The net effect of using these assumptions was to reduce our estimate of the deficit by about \$500 million, compared to the average of the OMB and CBO estimates.

2. Federal Pay Increase

OMB and CBO disagree over what financing should be assumed for the increase in federal pay rates anticipated for 1987. OMB believes the Act requires an assumption that all costs will be absorbed by the departments and agencies. CBO adopted the assumption in the OMB Midsession Review of the Budget that a substantial part will be financed by additional appropriations. After reviewing the contrasting arguments, we concluded that the CBO approach was appropriate. This accounted for about \$1.5 billion of the difference between our estimate and the OMB/CBO average.

3. Defense Outlays

OMB and CBO continue to disagree about outlays for defense programs in 1987. In the August 20 report, the difference is about \$5.0 billion, excluding the effect of the pay increase. Our analysis, based on our continuing audit work, leads us to conclude that the CBO estimate is more reasonable. This accounted for about \$2.5 billion of the difference between our estimate of the deficit and the OMB/CBO average.

4. Appropriated Entitlements

OMB and CBO were in disagreement over what the Act requires be assumed with respect to entitlement programs subject to the

annual appropriations process. Consistent with longstanding congressional budgeting procedures, CBO assumed funding for the full cost of the estimated benefits for 1987. OMB included these programs at their 1986 appropriations levels. After reviewing the legislation, we concluded that the CBO estimate was correct for several programs, including three of the largest--Medicaid, Supplemental Security Income, and AFDC. We believe the OMB approach is correct for the other appropriated entitlements. Our treatment of these accounts yielded an estimate \$340 million above the OMB/CBO average.

5. Other Differences

Other differences, including our re-estimate of net interest, added about \$350 million to our estimate of the deficit.

UNCERTAINTIES IN THE ESTIMATES

In concluding, I want to stress that all these estimates--OMB's and CBO's, as well as our own--are based on a complex set of tenuous assumptions. Many things can happen to cause revenues, outlays, and the deficit to depart substantially from these estimates.

For example, the estimates for most programs are required to be based on the assumption that appropriations for 1987 will be equal to those for 1986. It will be difficult for Congress and the President to constrain funding levels consistent with that assumption. Similarly, the estimates may understate significantly the costs of responding to urgent or unavoidable requirements.

Those requirements may involve defense, agriculture, or financial institutions, or some problem we don't yet know about.

The state of the economy also creates uncertainty. It is rather sluggish and its future course is very difficult to predict. This, in turn, means that estimates of revenues and outlays are subject to substantial change, depending on the performance of the economy.

A third source of uncertainty is the effect of the pending tax reform bill. It has been estimated that the bill would increase revenues for 1987, while reducing them for 1988 and 1989, but the amount of the change is very hard to estimate. Of course, because the bill has not yet been enacted, its effects are excluded from the current estimates of the deficit.

Considering all these factors together, we think there is a strong possibility that the deficit for 1987 will ultimately prove to be significantly higher than the current estimates under the Act. Thus, if the sequesters estimated in the OMB/CBO report are implemented, the budget deficit may still breach the \$144 billion target, unless further action is taken to reduce spending or increase revenues. The extent to which such further action may be warranted will become clearer over the coming months.

That completes my prepared statement. My colleagues and I would be pleased to respond to any questions.