CONGRESS OF THE UNITED STATES
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An Analysis of the President's Budgetary Proposals for Fiscal Year 1993

Prepared at the Request of the Senate Committee on Appropriations

AN ANALYSIS OF THE PRESIDENT'S BUDGETARY PROPOSALS FOR FISCAL YEAR 1993

The Congress of the United States
Congressional Budget Office

NOTES

Unless otherwise indicated, all years referred to in Chapter 2 are calendar years, and all years in other chapters and Appendix A are fiscal years.

Unemployment rates throughout the report are calculated on the basis of the civilian labor force.

Details in the text and tables of this report may not add to totals because of rounding.

The source of data concerning President Bush's budget is the Office of Management and Budget. The source of other data, unless otherwise noted, is the Congressional Budget Office.

The Balanced Budget and Emergency Deficit Control Act of 1985 is referred to in this volume as Gramm-Rudman-Hollings. This act was amended by the Omnibus Budget Reconciliation Act of 1990, referred to in this volume as OBRA-90.

A glossary of economic and budget terms used in this report appears in Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1993-1997* (January 1992).

Preface

This analysis of the President's budget for fiscal year 1993 was prepared at the request of the Senate Committee on Appropriations. The report discusses the President's policies in terms of changes from the Congressional Budget Office's (CBO's) baseline budget projections for 1993 through 1997. It provides estimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods.

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Paul L. Houts supervised the editing and production of the report, with the assistance of Sherry Snyder. Major portions were edited by Paul L. Houts, Sherry Snyder, Sherwood D. Kohn, and Roger Williams. Christian Spoor provided editorial assistance during production. The authors owe special thanks to Marion Curry, Janice Johnson, Dorothy Kornegay, Wendy Stralow, Denise Thomas, Simone Thomas, and Emma Tuerk, who typed the many drafts. Kathryn Quattrone and Martina Wojak prepared the report for publication.

Robert D. Reischauer
Director

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Introduction and Summary

The Bush Administration's 1993 budget holds to the fiscal policy course set by the 1990 budget agreement. The budget aims to meet the legal limits on discretionary spending for 1993 through 1995, as well as the pay-as-you-go requirement for revenues and mandatory spending. The Congressional Budget Office (CBO), however, estimates that the Administration's proposals will add small amounts to the deficit in some years, reduce it in others, and slow the accumulation of federal debt by only $3 billion over the 1992-1997 period.

CBO projects that, under the Administration's policies, the federal deficit will reach $372 billion in 1992, setting a new record for the second year in a row (see Table 1-1). In relation to the size of the economy, the 1992 deficit will amount to 6.4 percent of gross domestic product (GDP), slightly exceeding the previous postwar high reached in 1983. By the mid-1990s, the deficit will drop to about $200 billion, or about 3 percent of GDP.

Yet, the total deficit is not the most relevant measure for policy discussions. Its ups and downs are affected by temporary factors that obscure an underlying stability in federal fiscal policy. To appreciate the fundamental pattern, these temporary factors must be removed from the figures.

First, federal spending in recent years has been swelled by the cost of bailing out or closing hundreds of insolvent thrift institutions and commercial banks whose deposits are insured by the federal government. The costs of deposit insurance are expected to remain enormous through 1993, drop sharply in 1994, and turn negative in 1995, when proceeds from selling the assets of previously failed institutions will exceed the spending required to resolve new failures.

Contributions from U.S. allies to help finance Operation Desert Storm represent a second transitory item. Those contributions lower the deficit by $43 billion in 1991 and $5 billion in 1992. The large year-to-year swings in deposit insurance spending and the U.S. allies' contributions have little current effect on the economy or interest rates.

Excluding deposit insurance and Desert Storm contributions, and assuming enactment of the Administration's proposals, the deficit peaks at 5.3 percent of GDP in fiscal year 1992 and then declines gradually to about 3 percent in 1995 through 1997. But even these deficit estimates are not the most relevant because they contain a cyclical element that should be less troubling than a structural imbalance. The standardized-employment deficit, which removes the cyclical component, reaches a low of 2.6 percent of potential GDP in 1996 and then starts to rise again.

The Economic Outlook

CBO and the Administration show an unusual amount of agreement on the economic outlook. Both see a recovery getting under way this spring, and both expect this recovery to be about half as strong as the average postwar rebound. The recovery will be relatively weak because the economy is still wringing out the structural imbalances that developed over the last 15 years. Those include the excess commercial real estate that dots many large cities, the fragility of some financial institutions, the overextended position of state and local governments, and the heavy debt burdens accumulated by both households and businesses during the 1980s.

CBO forecasts slightly more robust growth in 1992 and 1993 than the Administration, but the Administration assumes somewhat faster growth in the 1994-1997 period. CBO and the Administration, however, assume almost identical rates of increase in the implicit GDP deflator. Thus, CBO shows a slightly higher level of nominal GDP in the short term but a marginally lower level of GDP and personal incomes in the long run.

The Administration is more optimistic than CBO about the outlook for inflation and nominal interest rates. The Administration's

Table 1-1.
CBO Estimates of the Deficit Under the Administration's Policies (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
	In Billions of Dollars					
Total Deficit	372	332	277	214	184	216
Deficit Excluding Deposit Insurance and Desert Storm Contributions	312	263	244	230	228	245
Standardized-Employment Deficit[a]	213	194	196	190	197	225
On-Budget Deficit (Excluding Social Security and Postal Service)	425	396	353	301	282	326
	As a Percentage of GDP					
Total Deficit	6.4	5.3	4.2	3.0	2.5	2.8
Deficit Excluding Deposit Insurance and Desert Storm Contributions	5.3	4.2	3.7	3.3	3.1	3.1
Standardized-Employment Deficit[a,b]	3.5	3.0	2.9	2.7	2.6	2.8
On-Budget Deficit (Excluding Social Security and Postal Service)	7.3	6.3	5.3	4.3	3.8	4.2
Memorandum: Gross Domestic Product	5,846	6,237	6,621	7,004	7,414	7,849

SOURCE: Congressional Budget Office.

NOTE: Estimates are on a cash basis and exclude estimated accrual savings for deposit and pension insurance.

a. Excluding deposit insurance and Desert Storm contributions.

b. Shown as a percentage of potential GDP.

forecast of inflation, as measured by the increase in the consumer price index, is 0.3 percentage points lower than CBO's in 1992 and 0.5 percentage points lower by 1997. The Administration's assumptions for interest rates fall below CBO's figures by similar amounts.

The similarity between the two forecasts may seem surprising, since CBO's forecast assumes a continuation of current budgetary policies, whereas the Administration asserts that its forecast depends importantly on enactment of its budget and economic program. In CBO's view, the Administration's program would add some stimulus to the economy in the short term, but on balance it would provide no appreciable boost over the long run. Some of the Administration's policies--notably, the reduction in income tax withholding, the investment tax allowance, and the credit for first-time homebuyers--could increase the growth rate by half a percent or so in 1992 by moving spending forward from later years. They would decrease the growth rate, however, by a comparable amount in 1993 and beyond. In the longer term, the Administration's budget proposals would have at best only small effects on the federal deficit, saving and investment, and the growth of the economy.

Because CBO's and the Administration's economic forecasts do not differ greatly in 1992 and 1993, they lead to only small differences in budget estimates in those years. In 1994 and beyond, however, CBO assumes slightly less rapid growth and somewhat higher inflation and interest rates. As a result, CBO projects lower revenues, greater outlays for benefit programs (chiefly those with automatic cost-of-living adjustments), and higher interest costs than does the Administration. Chapter 2 discusses the economic outlook and the economic impact of the Administration's proposals in more detail.

Table 1-2.
CBO Estimates of the Administration's Policy Proposals (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Deficit[a]	368	336	267	203	189	236
Policy Changes						
Discretionary	b	-2	6	4	-11	-27
Pay-as-you-go						
Spending	b	-3	-5	-5	-8	-9
Revenues[c]	6	2	8	11	12	13
Subtotal	5	-1	3	6	4	4
Other						
Spending	b	-2	b	-1	-1	-1
Revenues[c]	b	b	1	2	3	4
Subtotal	-1	-2	1	1	2	3
Total	5	-4	10	11	-5	-20
President's Budget as Estimated by CBO	372	332	277	214	184	216

SOURCE: Congressional Budget Office.

a. Assuming compliance with the discretionary spending limits.

b. Less than $500 million.

c. Reductions in revenues are shown with a positive sign because they increase the deficit.

The Administration's Proposals

The budget baseline has traditionally served as the benchmark against which the Administration's budget program is measured. For tax revenues and mandatory spending, the baseline generally assumes that laws now on the statute books will continue. Through 1995, discretionary spending is constrained by limits established in the Budget Enforcement Act of 1990 (BEA). After 1995, the baseline assumes that discretionary spending will just keep pace with inflation. Under these assumptions, CBO projects that the baseline deficit would be $336 billion in 1993, $267 billion in 1994, and around $200 billion in the 1995-1997 period. (Appendix A summarizes the current baseline budget projections, which incorporate minor revisions to those CBO released this past January.)

The policies proposed in the fiscal year 1993 budget would have little effect on the outlook for the federal deficit. Table 1-2 shows the Administration's budget proposals in the three major categories established by the Budget Enforcement Act--spending sub-

Table 1-3.
CBO Estimates of the President's Budget (By fiscal year)

Category	1992	1993	1994	1995	1996	1997
	In Billions of Dollars					
Revenues						
Individual income	477	512	542	582	619	658
Corporate income	91	108	122	125	129	131
Social insurance	416	451	483	512	543	572
Other	98	101	105	109	109	112
Total	1,082	1,171	1,252	1,327	1,399	1,474
On-budget	778	843	902	955	1,003	1,054
Off-budget	305	328	350	372	395	420
Outlays						
Defense discretionary	312	293	285	284	287	291
International discretionary	21	21	21	21	21	21
Domestic discretionary	216	226	237	237	237	237
Subtotal	548	541	543	542	545	549
Mandatory spending, excluding deposit insurance	709	748	794	846	898	970
Deposit insurance	65	69	33	-16	-44	-29
Net interest	201	214	232	246	262	279
Offsetting receipts	-69	-67	-72	-75	-77	-79
Asset sales	0	-2	a	-2	-1	a
Total	1,455	1,503	1,529	1,541	1,582	1,690
On-budget	1,202	1,239	1,255	1,256	1,286	1,380
Off-budget	252	264	274	285	297	310
Deficit	372	332	277	214	184	216
On-budget deficit	425	396	353	301	282	326
Off-budget surplus	52	64	76	87	99	110
Debt Held by the Public	3,054	3,386	3,666	3,886	4,077	4,301

(Continued)

SOURCE: Congressional Budget Office.

ject to the discretionary caps, mandatory spending and revenues subject to the pay-as-you-go requirement, and other mandatory spending and revenues. CBO estimates that the Administation's proposed discretionary spending would, in total, fall slightly below the legal limits in 1993 but, excluding unspecified savings, would breach the limits in 1994 and 1995.

The Budget Enforcement Act requires that, taken together, changes in receipts and in mandatory spending programs may not increase the deficit in any year. In CBO's estimation, however, the Administration's pay-as-you-go proposals would add to the deficit in all years but 1993 and would lead to a pay-as-you-go sequestration even in 1993. That result would occur because of the Budget Enforcement Act's look-back provisions, which require that actions taken since the end of the last session of Congress that affect fiscal year 1992 be added to the 1993 figure on the pay-as-you-go scorecard. In CBO's estimation, this increase in the deficit for 1992 would amount to $5 billion. Other changes in mandatory spending and revenues, primarily asset sales and administrative actions that are not counted for purposes of pay-as-you-go, would also affect the deficit by small amounts.

Table 1-3.
Continued

Category	1992	1993	1994	1995	1996	1997
	As a Percentage of GDP					
Revenues						
Individual income	8.2	8.2	8.2	8.3	8.3	8.4
Corporate income	1.6	1.7	1.8	1.8	1.7	1.7
Social insurance	7.1	7.2	7.3	7.3	7.3	7.3
Other	1.7	1.6	1.6	1.5	1.5	1.4
Total	18.5	18.8	18.9	18.9	18.9	18.8
On-budget	13.3	13.5	13.6	13.6	13.5	13.4
Off-budget	5.2	5.3	5.3	5.3	5.3	5.3
Outlays						
Defense discretionary	5.3	4.7	4.3	4.1	3.9	3.7
International discretionary	0.4	0.3	0.3	0.3	0.3	0.3
Domestic discretionary	3.7	3.6	3.6	3.4	3.2	3.0
Subtotal	9.4	8.7	8.2	7.7	7.4	7.0
Mandatory spending, excluding deposit insurance	12.1	12.0	12.0	12.1	12.1	12.4
Deposit insurance	1.1	1.1	0.5	-0.2	-0.6	-0.4
Net interest	3.4	3.4	3.5	3.5	3.5	3.6
Offsetting receipts	-1.2	-1.1	-1.1	-1.1	-1.0	-1.0
Asset sales	0	b	b	b	b	b
Total	24.9	24.1	23.1	22.0	21.3	21.5
On-budget	20.6	19.9	19.0	17.9	17.3	17.6
Off-budget	4.3	4.2	4.1	4.1	4.0	3.9
Deficit	6.4	5.3	4.2	3.0	2.5	2.8
On-budget deficit	7.3	6.3	5.3	4.3	3.8	4.2
Off-budget surplus	0.9	1.0	1.2	1.2	1.3	1.4
Debt Held by the Public	52.2	54.3	55.4	55.5	55.0	54.8

a. Less than $500 million.

b. Less than 0.05 percent of GDP.

Table 1-3 shows CBO's estimates of the Administration's budget program by major tax source and spending category, as well as projections of federal debt. Under the Administration's program, debt held by the public will swell from $2.7 trillion at the end of 1991 to $4.3 billion by 1997--an increase of 60 percent.

Discretionary Spending

The Budget Enforcement Act established separate dollar limits on defense, international, and domestic discretionary spending for fiscal year 1993. A single overall limit applies to total discretionary spending in 1994 and 1995.

The Administration proposes to hold discretionary spending authority $9.4 billion below the legal limits in 1993. Three-quarters of this reduction would arise in the defense category. CBO estimates that the Administration's proposals for international and domestic discretionary spending would exceed the outlay limits in 1993, though in both cases the excess is within the margin of error allowed by the Budget Enforcement Act.

In 1994 and later years, the Administration would keep discretionary budget authority for each category roughly constant at the 1993 level in nominal dollars. With inflation running at about 3½ percent a year, each type of discretionary spending would thus suffer the same real annual reduction. In addition, the budget includes unspecified reductions in domestic discretionary outlays of $7.6 billion in 1994 and $4.6 billion in 1995. Based on recent experience, however, CBO believes that such savings are unlikely to occur without specific policy proposals. Excluding the unspecified savings, CBO estimates that the Administration's proposals would exceed the discretionary outlay limits by $6 billion in 1994 and $4 billion in 1995. The budget thus underscores a point that CBO has been making for some time--namely, that it will be extremely hard to satisfy the discretionary spending caps in 1994 and 1995 if the full amount of available discretionary budget authority is appropriated in 1993.

Defense Discretionary Spending. The 1993 defense budget is the first defense budget prepared since the Soviet Union disintegrated. Compared with the previous budget (adjusted for inflation), the 1993 budget requests $50 billion less in budget authority for defense over the 1992-1997 period. The big question facing the Congress and the country is, could the peace dividend be larger?

If the goal were to maintain real nondefense discretionary spending at 1992 levels and stay within the total discretionary spending limits, additional reductions in defense would be required. Compared with the President's proposal, defense budget authority would have to be cut an extra $14 billion in 1994, $19 billion in 1995, and a total of $71 billion in the 1994-1997 period. If the goal were to increase real nondefense discretionary spending, defense would have to be cut even more.

International Discretionary Spending. The international affairs budget also reflects the end of the Cold War. The Administration is asking for an additional $550 million in 1992 funding to assist the states of Eastern Europe and the former Soviet Union in their transition to democracy. In 1993, $900 million of the proposed international affairs budget would be directed toward former adversaries. In addition, the domestic discretionary budget will provide an estimated $500 million to purchase grain and other commodities in 1992 and 1993, and the 1992 defense budget contains $500 million for weapons destruction and humanitarian aid.

The Administration seeks appropriations of $350 million above the current real level each year for United Nations-sponsored peacekeeping activities, primarily in Yugoslavia, El Salvador, and Cambodia. It has also renewed last year's request for the Enterprise for the Americas Initiative--a program designed to increase trade and investment within the Western Hemisphere--and for a $12 billion increase in the U.S. quota with the International Monetary Fund.

Domestic Discretionary Spending. The limits on domestic discretionary spending for 1993 require reductions of $6.4 billion in budget authority and $6.8 billion in outlays compared with the real 1992 levels (see Table 1-4). In attempting to meet the outlay limit, the Administration finds it has to hold budget authority $1.9 billion below its limit. Even so, in the estimation of the Congressional Budget Office, domestic discretionary outlays would exceed the 1993 cap by $1.0 billion.

Within the domestic discretionary category, a few areas would receive real increases, whereas others would face particularly large reductions. The Administration proposes higher spending for science and space, the administration of justice, Head Start, and a few general government programs. Some of the largest cuts would be made in grants to state and local governments. The Administration would eliminate community services block grants, economic development assistance, and impact aid "b" grants. It would reduce funding for mass transit, community development block grants, low-income home energy assis-

Table 1-4.
The Administration's Proposals for Domestic Discretionary Spending in Fiscal Year 1993
(In billions of dollars)

Function	CBO Baseline Without Discretionary Caps[a]		President's Budget as Estimated by CBO		Difference	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
General Science, Space, and Technology	17.9	16.9	18.4	17.1	0.5	0.3
Energy	6.4	5.8	5.8	5.6	-0.6	-0.2
Natural Resources and Environment	22.1	21.4	21.2	20.9	-0.9	-0.5
Agriculture	4.6	4.5	4.2	4.3	-0.4	-0.2
Commerce and Housing Credit	3.7	3.5	3.1	3.0	-0.6	-0.5
Transportation	15.5	35.8	13.6	35.0	-1.9	-0.8
Community and Regional Development	6.8	6.8	5.5	6.5	-1.3	-0.3
Education, Training, Employment, and Social Services	36.7	35.6	36.6	34.8	-0.1	-0.7
Health	20.3	20.0	19.9	19.5	-0.4	-0.5
Medicare	2.9	2.9	2.8	2.8	-0.1	-0.1
Income Security	32.4	32.8	30.1	31.0	-2.2	-1.8
Social Security	0	2.7	0	2.6	0	-0.1
Veterans Benefits	16.5	16.3	16.5	16.1	-0.1	-0.3
Administration of Justice	14.8	14.8	15.2	15.4	0.4	0.6
General Government	12.2	12.4	12.2	12.6	b	0.2
Allowances	0	0	-0.5	-0.4	-0.5	-0.4
Undistributed Offsetting Receipts	0	0	-0.3	-0.3	-0.3	-0.3
Total	212.7	232.2	204.4	226.5	-8.4	-5.7
Domestic Discretionary Caps[c]	206.3	225.4	206.3	225.4	n.a.	n.a.
Difference	6.4	6.8	-1.9	1.0	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Excluding projection of emergencies.

b. Less than $50 million.

c. End-of-session limits as estimated by CBO.

tance, and housing assistance. Most of these proposals are similar to those in previous budgets.

The budget counts as reductions in discretionary spending close to $2 billion in changes in mandatory spending or fees. Under the scorekeeping rules of the Budget Enforcement Act, changes in direct spending and receipts are counted on the discretionary rather than the pay-as-you-go scorecard if they are included in appropriation bills. Almost $1.4 billion would come from new or increased user fees, including fees for operating nuclear power plants, Medicaid and Medicare certification, Food and Drug Administration reviews, veterans' medical care copayments, and veterans' housing loan guarantees. In addition, $0.6 billion in spending for grants to states to assist in legalizing undocumented aliens would be shifted from 1993 to 1994. The President also proposes to delay the 1993 pay raise for federal civilian employees by three months, thereby reducing required domestic discretionary appropriations by $0.5 billion.

The Administration claims $1.2 billion in discretionary savings in 1993 and additional amounts in later years for its proposal to lease the naval petroleum reserve (NPR) at Elk Hills, California. These receipts would be partially offset by the loss of the income that the government would have received from selling oil and gas from the NPR. In CBO's view, however, leasing the NPR is an asset sale, the proceeds from which cannot be counted as savings for purposes of the Budget Enforcement Act.

Pay-As-You-Go Proposals

The Administration proposes to pay for its tax proposals through a variety of reductions in mandatory spending programs, including the accrued savings from changes in deposit and pension insurance. As explained below, however, CBO believes that no pay-as-you-go savings should be recorded for the proposed changes in the insurance programs (see Table 1-5 for CBO's version of the pay-as-you-go scorecard).

Spending Proposals. The Administration's pay-as-you-go spending proposals would reduce outlays by $2.7 billion in 1993, $5.5 billion in 1994, and $8.9 billion in 1997. About 40 percent of these savings would be achieved in Medicare through a three-month delay in the annual update of hospital payments, a reduction in payments for laboratory services, and an increase in the physician insurance (Part B) premium for certain high-income beneficiaries. Other major proposals include permanently eliminating the option for a lump-sum payment in Civil Service Retirement, auctioning a portion of the electromagnetic spectrum, and extending various cost-saving provisions affecting veterans' benefits. The budget also assumes that customs user fees will be continued beyond their scheduled expiration in 1995.

CBO does not give the Administration pay-as-you-go credit for its proposal to lease the rights to explore and drill for oil and gas in the Alaska National Wildlife Refuge because CBO believes that leasing the refuge (like leasing the NPR) is an asset sale. But CBO estimates greater receipts than does the Administration from the proposal to auction licenses and permits to use the electromagnetic spectrum.

Revenue Proposals. The budget contains a package of tax changes aimed at stimulating saving and investment. The major elements of this package are reducing the tax rate on capital gains, establishing Flexible Individual Retirement Accounts, instituting a temporary tax credit for first-time homebuyers, providing a temporary investment tax allowance, and extending certain expiring tax preferences, including the research and experimentation tax credit and allocation rules. The Administration also proposes to increase by $500 the personal income tax exemption for dependent children under age 18. The two largest revenue-raising proposals in the budget are the extension of Medicare taxes and coverage to all employees of state and local governments and an increase in the contributions of federal workers covered by the Civil Service Retirement System. A number of smaller revenue-raisers are also included. Finally, the budget incorporates a reduction in income tax withholding; that change has already been carried out by executive action.

CBO and the Joint Committee on Taxation (JCT) estimate that the Administration's pay-as-you-go revenue proposals would reduce governmental receipts by $5.5 billion in 1992, $1.9 billion in 1993, and $12.6 billion in 1997. Even larger reductions in revenues are likely in later years as a result of the proposal to exclude the earnings on Flexible Individual Retirement Accounts from taxation. Including the effects of the increased exemption for children, the revenue loss over the the 1992-1997 period is estimated to total $51 billion.

For only one item--the proposal to reduce the tax rate on capital gains--does the CBO/JCT estimate differ significantly from that of the Administration. CBO/JCT and the Administration concur that the proposal would

Table 1-5.
The Administration's Pay-As-You-Go Proposals (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
Spending						
Medicare	a	-1.2	-2.0	-2.6	-3.0	-3.5
Civil Service Retirement	0	0	0	0	-2.1	-2.8
Customs user fees	0	0	0	0	-0.7	-0.8
Veterans' benefits	0	-0.6	-0.5	-0.6	-0.6	-0.7
Spectrum auctions	0	0	-2.0	-1.6	-0.7	0
Other	-0.3	-0.9	-0.9	a	-0.5	-1.2
Subtotal	-0.4	-2.7	-5.5	-4.8	-7.7	-8.9
Revenues						
Provide investment tax allowance	-6.1	-1.6	3.6	1.0	0.8	0.6
Establish Flexible Individual Retirement Accounts	0	2.0	0.8	0.5	-0.8	-1.9
Provide credit to first-time homebuyers	-0.3	-2.7	-2.5	-0.5	-0.1	a
Exclude portion of capital gains	0.8	3.7	-3.4	-5.7	-5.6	-5.2
Extend expiring provisions	-0.5	-1.9	-2.5	-2.2	-2.3	-2.7
Extend Medicare taxes and coverage to state and local employees	0.4	1.7	1.7	1.7	1.6	1.6
Increase employee contributions to Civil Service Retirement	0	0.4	1.0	1.1	1.0	1.0
Increase exemption for children	0	-3.4	-5.0	-5.0	-5.1	-5.3
Other	0.2	-0.1	-1.9	-1.8	-1.4	-0.7
Subtotal	-5.5	-1.9	-8.3	-10.9	-11.8	-12.6
Deficit	5.2	-0.7	2.8	6.1	4.2	3.7
Administration's Estimate[b]	4.8	0.3	-3.4	-1.5	-5.1	-2.6
Differences						
CBO reestimates	a	-1.5	3.6	7.6	7.8	6.2
Classification differences	0.4	0.4	2.6	a	1.5	0.1
Total	0.3	-1.1	6.2	7.6	9.3	6.3

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

a. Less than $50 million.

b. Excludes estimated accrual savings for deposit and pension insurance.

boost revenues in 1992 and 1993, when taxpayers respond with a burst of asset sales. The Administration believes that the proposal would generate extra revenues in 1994, 1995, and 1996 as well. In contrast, CBO and the JCT believe that the proposal would reduce revenues beginning in 1994.

As an alternative to some of its pay-as-you-go proposals, the Administration indicates that it would be willing to consider modifying the BEA to allow the projected reduction in defense outlays (below the level in the Administration's fiscal year 1992 budget) to offset the proposed increase in the personal exemption. The Administration would make this step conditional on a commensurate reduction in the discretionary spending caps and on an extension of the enforcement provisions of the BEA until the budget is balanced. Obviously, to the extent that defense reductions are used to finance tax cuts, they are not available to protect domestic discretionary spending or to reduce the deficit.

CBO and Administration Budget Estimates

This year, unlike many others, CBO and the Administration hold similar views of the budget outlook (see Table 1-6). CBO projects lower deficits in 1992 and 1993, but somewhat bigger deficits thereafter. In the long run, these differences primarily reflect CBO's expectations of less robust economic performance. Technical estimating disagreements center on the effects of the President's proposals (notably the reduction of the tax rate on capital gains), spending for deposit insurance, and the growth of Medicaid.

Other Budgetary Issues

CBO's estimates of the budget do not reflect the Administration's proposals to adopt a form of accrual accounting for deposit and pension insurance and to place a limit on the annual growth of entitlement programs. As explained below, CBO believes that the proposed accrual accounting measures are not yet ready to be included in the budget. Moreover, the Administration itself does not incorporate the entitlement cap in its own budget estimates.

Deposit and Pension Insurance

The Administration proposes to convert the budgetary accounting for deposit insurance and the Pension Benefit Guaranty Corporation (PBGC) from a cash to an accrual basis. In addition, the Administration recommends a number of program changes to reduce the government's long-run liability for deposit and pension insurance. The Administration would allow banks to branch across state lines, offer additional financial services, and become part of financial-services holding companies. The pension proposals include raising required contributions for sponsors of underfunded single-employer pension plans, freezing the level of the federal guarantee for chronically underfunded plans, and improving the status of PBGC claims in bankruptcy proceedings. The Administration's insurance proposals would produce small changes in cash flows in the next few years, but they could create large immediate savings under the Administration's accrual accounting plan.

Clearly, cash-based accounting for insurance programs provides incomplete information about the cost of these activities. Cash flows for deposit insurance include the distorting effects of outlays for acquiring assets and receipts from disposing of those assets. Similarly, cash flows give the false impression that the government is earning profits from pension insurance.

Nevertheless, CBO concludes that the accrual accounting measures the Administration proposes are not suitable to use in the budget at this time. First, without sufficient justification, the Administration proposes to create different accrual concepts for deposit insurance and the PBGC. Second, the Administration's methods for estimating accrued costs are very complicated, would be difficult to replicate and carry out, and are not necessarily the best way to estimate costs.

CBO believes that no pay-as-you-go savings should be recorded for the Administration's deposit and pension insurance proposals, regardless of whether the proposed accounting changes are enacted. Using highly uncertain future savings to offset real current costs is dubious budgetary policy. Moreover, since both bank and pension insurance are intended to be self-financing, any savings are likely to benefit the premium-payer more than the taxpayer.

The Administration's proposals for deposit and pension insurance also contain a subtle, but major, change in the primary source of funding for financial shortfalls. In the past, the first step in covering deficiencies in these

Table 1-6.
Differences Between CBO and Administration Estimates of the Administration's Proposed Budget (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
Administration's Estimate of the Deficit	400	350	212	194	181	188
CBO Reestimates of Pay-As-You-Go Proposals[a]						
Capital gains proposal[b]	c	c	6	6	6	5
Other revenue proposals[b]	c	-2	1	1	1	c
Outlay proposals	c	1	-3	1	1	1
Subtotal	c	-2	4	8	8	6
Economic Differences						
Revenues[b]	-2	-2	5	13	19	21
Benefit programs	c	1	2	5	6	8
Net interest	-2	-2	-1	4	10	18
Subtotal	-4	-3	7	21	35	47
Technical Differences						
Revenues[b]	-5	-2	-1	-4	2	-3
Deposit insurance	-15	-7	58	11	-23	4
Medicaid	-4	-5	-9	-13	-18	-24
Proposed asset sales[d]	0	0	3	-2	1	c
Unspecified discretionary savings	0	0	8	5	0	0
Other outlays	c	c	-4	-5	-2	c
Subtotal	-24	-14	54	-9	-41	-24
Total	-28	-18	65	20	2	29
Administration's Proposed Deficit as Estimated by CBO	372	332	277	214	184	216
Memoranda:						
Total Economic Reestimates	-4	-3	7	21	35	46
Total Technical Reestimates	-24	-15	58	-1	-33	-18

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

a. The reestimates are almost wholly technical.

b. Reductions in revenues are shown with a positive sign because they increase the deficit.

c. Less than $500 million.

d. Asset sales are ineligible for pay-as-you-go scoring.

programs has been to raise the level of premiums. The Administration would replace this process with an annual mandatory appropriation from the general fund to cover shortfalls. Such a fundamental policy change should be debated on its own merits and should not be hidden in a reform of budgetary accounting.

In CBO's view, the Budget Enforcement Act effectively removed the cash flows associated with deposit insurance from the pay-as-you-go calculations. Unless explicitly changed, this exclusion would continue to apply under an accrual accounting system.

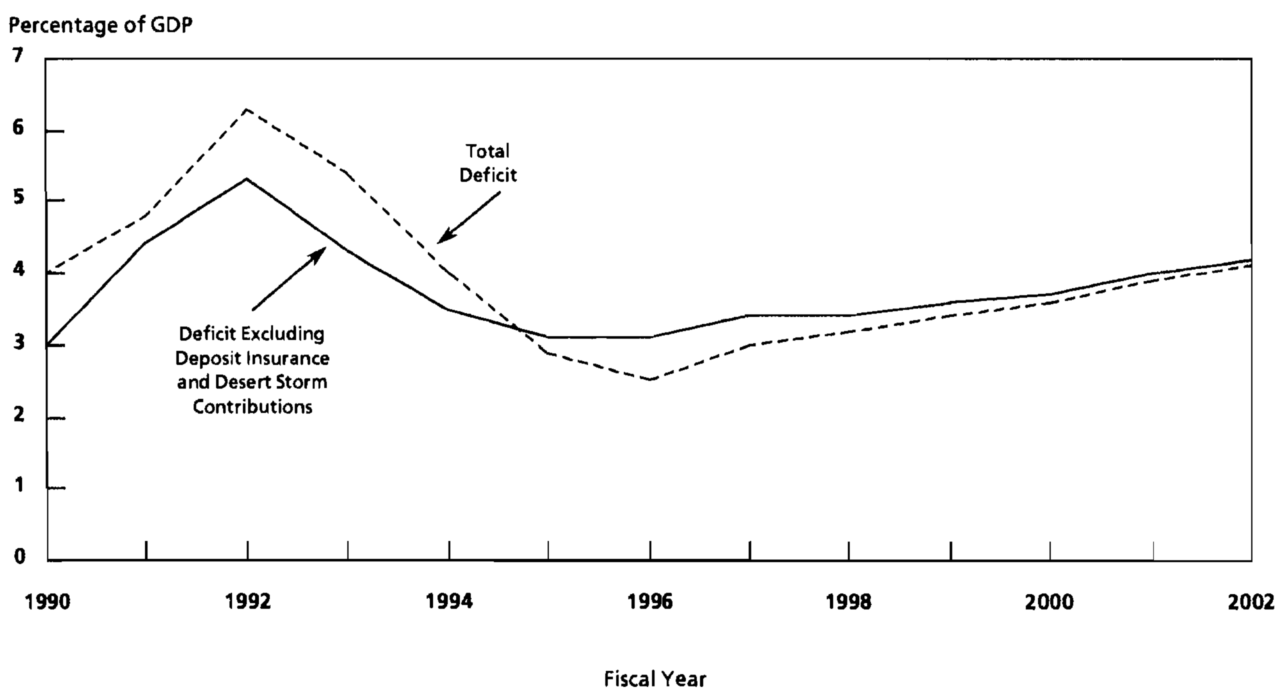
Ideally, the BEA should be amended to exclude pension insurance, like deposit insurance, from pay-as-you-go. The proposed changes in the PBGC are designed to pay for existing, but previously unrecognized, commitments of the federal government. Any savings in pension insurance should be applied to these as yet unrecognized insurance costs and not used to pay for other budgetary initiatives. Without such an exclusion, however, CBO will continue to use cash-based accounting for proposed changes in pension insurance.

Controlling Growth in Entitlement Spending

CBO's five-year budget projections indicate that, under current policies, the federal deficit is likely to start rising again as a percentage of GDP after 1996. Longer-run extrapolations show this trend continuing. Excluding deposit insurance, the deficit is projected to climb from 3.1 percent of GDP in 1996 to 4.2 percent in 2002 (see Figure 1-1).

That growth in the deficit is propelled by the growth in mandatory spending, especially for health care services. Excluding Social Se-

Figure 1-1.
Federal Budget Deficit



SOURCE: Congressional Budget Office.

curity, deposit insurance, and net interest, mandatory spending could balloon from 7.3 percent of GDP in 1992 to 8.9 percent in 2002. All of this growth is concentrated in Medicare and Medicaid, which are projected to soar from 3.4 percent of GDP in 1992 to 4.4 percent in 1997 and 5.9 percent in 2002.

To check the growth in entitlements, the Administration proposes to place a limit, or cap, on the overall growth of mandatory programs. If the Congressional reconciliation process fails to eliminate any mandatory spending above the limit, an automatic sequestration of mandatory programs would be triggered. Most mandatory programs that are now exempt, except Social Security, would become subject to this new sequestration, although it is not entirely clear how such a sequestration would work.

The proposal for a cap on growth in mandatory spending deserves two comments. First, experience with the fixed deficit targets of the Gramm-Rudman-Hollings legislation suggests that mechanical budget formulas can present serious problems. In particular, the required reductions can become so large that the threat of a sequestration to achieve them is no longer credible. As an alternative to the entitlement cap, the BEA could be amended to require a specified amount of deficit reduction--say, $35 billion to $50 billion a year--for a number of years, or until a target deficit is reached.

Second, as the figures cited earlier show, the problem of the growth in entitlement spending is really a manifestation of the rapid rise in the cost and use of medical care. Thus, the abstract concept of an entitlement cap cannot be turned into reality without squarely addressing the problems of health care costs. Also, to the extent that access to health care is improved, the cost problem will become even more acute. The experience of the past two decades suggests that greater control over health spending probably cannot be achieved without significant changes in the health care system--changes that may limit desirable features such as freedom to choose insurance plans and providers, rapid access to new technologies and treatments, and sustained levels of research and development. The priority the nation places on these other goals will determine how effectively cost containment is pursued.

Conclusion

Although the recession has made further deficit reduction inadvisable this year, the deficit should soon return to the top of the political agenda. Excluding deposit insurance, the deficit is likely to exceed $200 billion for the foreseeable future and move higher toward the end of the 1990s. Deficits of those magnitudes cripple economic growth by reducing national saving and capital formation. They also create a vicious cycle of more federal borrowing and higher debt service costs, which in turn make it even more difficult to reduce the deficit. The Administration's fiscal year 1993 budget does little to address this fundamental fiscal problem and leaves its resolution to yet another year.

Chapter Two

Comparison of Economic Forecasts

The Administration's forecast for the nation's economy is quite similar to that of the Congressional Budget Office (CBO). The Administration is slightly less optimistic about real gross domestic product (GDP) in the short term (1992 through 1993) and slightly more optimistic over the medium term (1994 through 1997). By 1997, the Administration's projection of real GDP exceeds CBO's by 0.7 percent, a difference in the average rate of growth over six years of about 0.1 percentage point a year. The Administration's forecast of the inflation rate is close to CBO's when measured by the GDP deflator, but falls below CBO's when the consumer price index is used as a measure. The Administration generally foresees lower interest rates than does CBO in both the short and medium terms.

Although the forecasts of the Administration and CBO are quite similar, they are based on very different premises. The Administration maintains that its forecast depends critically on the enactment of its policy proposals. The Administration predicts that if current policy continues instead, the growth rate of real GDP would be lower than it has forecast by 0.6 percentage points a year in 1992 and 1993, and by an average of 0.4 percentage points a year from 1994 through 1997. By contrast, CBO's forecast assumes that current policy continues. Moreover, although CBO concludes that adopting the Administration's policy could add modestly to growth in 1992, it would do so by borrowing from growth in 1993, while adding little to growth in later years. Therefore it would not appreciably affect the average rate of growth through 1997.

Short-Term Outlooks

Both the Administration and CBO anticipate that an economic recovery will be under way by the middle of 1992. Both expect the recovery to be moderate by historical standards (proceeding at about half the normal pace), providing a basis for sustainable growth with moderate and stable inflation in later years. In detail, the Administration's short-term forecast is similar to that of CBO, although slightly less optimistic. In any case, however, the differences between the forecasts are small in light of the normal uncertainty of forecasting. Both forecasts, moreover, are generally similar to the consensus of private economic forecasters.

The Administration's outlook for growth of real GDP is similar to CBO's, but slightly weaker (see Box 2-1 for a brief explanation of GDP). The Administration's forecast is lower than CBO's by 0.6 percentage points for 1992, and by 0.3 percentage points for 1993, on a fourth-quarter-to-fourth-quarter basis (see Table 2-1).[1] Through 1993, the real rate of

1. The Administration's economic projections discussed in this chapter are those dated January 10, 1992. They differ slightly from preliminary economic projections made in early December, on which the Administration's budget estimates are based.

growth in the Administration's forecast averages 0.4 percentage points a year lower than that of CBO and more nearly matches the *Blue Chip* consensus forecast than does CBO's. (The *Blue Chip* consensus forecast is the average of about 50 forecasts surveyed by Eggert Economic Enterprises, Inc.)

Until recently, the Administration typically forecast somewhat stronger economic growth than did CBO, but it has not done so for the last year. After the Balanced Budget Act (Gramm-Rudman-Hollings) was passed in 1985, each of the six budgets released by the Office of Management and Budget between 1985 and 1990 assumed stronger economic growth than did the corresponding CBO forecasts. Given the fixed deficit targets of Gramm-Rudman-Hollings, more optimistic forecasts promised easier attainment of the targets. But the Budget Enforcement Act of 1990 allowed the deficit targets to vary with changes in the economic outlook, thereby eliminating the advantage of optimistic forecasts. Last year was the first since Gramm-Rudman-Hollings was passed that the Administration forecast lower economic growth than did CBO, a decline in real gross national product (GNP) on a calendar-year basis of 0.3 percent in 1991, as opposed to zero growth forecast by CBO. (The actual decline for 1991 was 0.7 percent.)

The Administration and CBO agree more closely on the short-term outlook for the rates of inflation and interest than for the growth of real output. Both expect inflation and interest rates to rise slightly during the recovery before stabilizing. CBO predicts slightly higher rates of inflation when measured by the consumer price index than does the Administration. But the two outlooks for inflation differ by no more than 0.3 percentage points in either 1992 or 1993, and closely match the *Blue Chip* consensus as well. The Administration's and CBO's forecasts of interest rates--both long-term and short-term--also closely parallel each other, and they both foresee lower long-term interest rates in 1993 than does the *Blue Chip* forecast.

Although differences between the forecasts of the Administration and CBO are not always trivial, they are small when compared with the degree of uncertainty that normally accompanies economic forecasts. For example, the disparity between the forecasts of the average growth of real GDP through 1993 is

Box 2-1.
The Switch from GNP to GDP and Revisions to the National Income and Product Accounts

Gross domestic product (GDP) replaced gross national product (GNP) in December 1991 as the basic measure of total economic output in the United States. GDP represents the value of goods and services produced by factors of production--land, labor, and capital--located in the United States, whether the factors are provided by U.S. residents or nonresidents. By contrast, GNP represents the value of goods and services produced by factors provided by U.S. residents, whether the factors are located here or abroad. Numerically, the two measures differ primarily because GNP includes income of residents from property they own abroad and excludes income of nonresidents from property they own here. In the United States, GDP is about 99.8 percent as large as GNP and grows at nearly the same rate (on average, about 0.1 percentage point a year faster over the last decade).

The Commerce Department switched to GDP as its basic measure of output at the same time that it revised the national income and product accounts by redefining some concepts and by using 1987 instead of 1982 as the base year for calculating real (constant dollar) values. For brief discussions of the switch from GNP to GDP and of the revisions, see Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1993-1997* (January 1992), pp. 5 and 19.

Table 2-1.
Comparison of CBO, Administration, and *Blue Chip* Short-Run Economic Forecasts, Calendar Years 1990-1993

	Actual	Estimated	Forecast	
	1990	1991	1992	1993
Fourth Quarter to Fourth Quarter (Percentage change)				
Real GDP				
CBO	-0.1	0.4	2.8	3.3
Administration	-0.1	0.4	2.2	3.0
Blue Chip	-0.1	0.4	2.3	3.1
Implicit GDP Deflator				
CBO	4.2	3.0	3.1	3.2
Administration	4.2	3.0	3.2	3.4
Blue Chip	4.2	3.0	2.9	3.3
Consumer Price Index[a]				
CBO	6.3	3.0	3.4	3.6
Administration	6.3	3.0	3.1	3.3
Blue Chip	6.3	3.0	3.3	3.7
Calendar-Year Average (Percent)				
Civilian Unemployment Rate				
CBO	5.5	6.7	6.9	6.4
Administration	5.5	6.7	6.9	6.5
Blue Chip	5.5	6.7	6.9	6.4
Three-Month Treasury Bill Rate				
CBO	7.5	5.4	4.4	5.1
Administration	7.5	5.4	4.1	4.9
Blue Chip	7.5	5.4	4.1	5.0
Ten-Year Treasury Note Rate				
CBO	8.6	7.9	7.1	7.1
Administration	8.6	7.9	7.0	6.9
Blue Chip[b]	8.6	7.9	7.1	7.6
Spread Between Ten-Year Treasury Note Rate and Three-Month Treasury Bill Rate				
CBO	1.0	2.5	2.7	2.0
Administration	1.0	2.5	2.9	2.0
Blue Chip	1.0	2.5	3.0	2.6

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (February 10, 1992).

NOTE: The CBO forecast is based on data available through December 1991 and does not reflect the fourth-quarter data for gross domestic product or the consumer price index published in January 1992. The *Blue Chip* forecast is an average of 50 private forecasters.

a. Represents the consumer price index for all urban consumers (CPI-U).

b. The *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year Treasury notes.

0.4 percentage points. By comparison, CBO has estimated that about 2 percentage points is the normal range of uncertainty for a forecast of the average rate of growth of real output over the succeeding two years. This means that such forecasts will fall within 2 percentage points of the average rate of real growth that actually transpires over the succeeding two years about 67 percent of the time.[2] Similarly, the differences between the Administration's and CBO's forecasts of the rates of inflation and interest are small when compared with the normal range of uncertainty that attends their forecasts.

The similarity of forecasts by the Administration and CBO reflects their substantial agreement on the current state of the economy and its prospects. Both cite virtually the same factors: those now providing a foundation for recovery, those acting to moderate it, and those posing risks to it.

Three factors provide a foundation for recovery. First, interest rates have fallen substantially since the Federal Reserve took strong action in the fourth quarter of 1991 to ease monetary conditions. The interest rate on three-month Treasury bills fell by 1.4 percentage points from September to January. Rates on long-term securities also fell by appreciable, though smaller, amounts. Lower interest rates reduce the carrying cost of debt for households and businesses, making investments in housing and capital goods more attractive, although they also reduce household income.

Second, the relatively low exchange value of the dollar will provide a mild stimulus to net exports by making U.S. goods relatively cheap to foreigners and foreign goods relatively expensive to residents of the United States. Finally, both the Administration and CBO note that the financial and real estate sectors are being restructured, and the debt positions of households and businesses are being retrenched--developments that are expected to set the stage for more balanced growth in the future.

But other factors cited by the Administration and CBO suggest that the recovery will probably be weaker than is typical. High vacancy rates in commercial real estate and multifamily housing, and a slowing of the rate of household formation, will make construction less influential than usual during the recovery. Cutbacks in defense spending and fiscal restraint by state and local governments will constitute a fiscal drag, a contrast to the typical pattern of earlier recoveries that have reflected more fiscal stimulus. Slow economic growth among U.S. trading partners will weaken demand for U.S. exports. Finally, interest rates will remain higher than usual during the recovery because of the demands for investment arising principally from the integration of Western Europe and the breakup of the former Soviet bloc. All of the aforementioned factors are expected to slow the recovery, but not to stop it.

In addition, the Administration and CBO cite several atypical features of the current state of the economy that pose risks to the recovery. Conditions in credit markets remain uncertain, with banks reported to be less willing than usual to lend to creditworthy borrowers. Determining whether the collapse of lending reflects weak credit demand or follows in part from financial restructuring complicates the task the Federal Reserve faces in determining the appropriate monetary policy.

At the same time, the conduct of monetary policy is also complicated by the possibility that the economy's response to monetary actions may no longer follow its historical pattern. Innovations in financial markets have left the domestic demand for new housing less sensitive than before to movements in interest rates, whereas net exports are more sensitive. The response of net exports to changes in interest rates, however, takes longer and is less easily discernible than the response of housing construction.

2. These estimates are based on historical relationships that provide a technical measure of the precision of a forecast--the "standard error" of a forecast. The estimates also assume that such forecasts are accurate on average, which historically has been true of both the Administration's and CBO's forecasts.

Finally, consumer confidence remains low, much lower than appears consistent with other economic indicators, such as personal income or unemployment. Consumption accounts for two-thirds of output, so consumers could stall the recovery if they cut back their spending.

Medium-Term Projections

Neither the Administration nor CBO attempts to forecast cyclical fluctuations beyond 1993. Instead, projections are based on extrapolation of trends in fundamental economic variables. The Administration and CBO project the paths of variables such as real output, inflation, and interest rates based on the projected gap between their values at the end of 1993 and their potential or long-run values implied by projections of fundamental conditions of supply--the levels of capital, labor, and technology.

In general, the Administration's economic projections for the medium term (1994 through 1997) would reduce the deficit slightly more than those of CBO for the following reasons (see Table 2-2 and Figure 2-1):

- o Growth of real GDP averages about 0.3 percentage points higher in the Administration's projections than in those of CBO (about 2.9 percent for the Administration compared with about 2.6 percent for CBO).
- o The rate of inflation (measured by the consumer price index) projected by the Administration averages about 0.4 percentage points lower than CBO's.
- o Interest rates, especially long-term rates, fall farther in the Administration's projections than in CBO's.
- o Nominal income contains more profits and other components that are taxed at relatively higher rates in the Administration's projections than in CBO's.

The Outlook for Growth of Real GDP

Both the Administration and CBO base their projections on the assumption that the level of output by 1997 will be governed, not by cyclical factors, but by fundamental factors that determine the economy's capacity to produce. The projections assume that output will grow fast enough in the medium term to purge the economy of the remaining cyclical weakness that characterizes the forecasts for 1993. The Administration's more optimistic projections of the growth of output are accounted for by more optimistic assumptions about the growth of output per worker.

CBO's Method of Projecting Real GDP in the Medium Term. CBO's projection of the growth of output in the medium term depends on an estimate of potential output, which represents a supply constraint for the economy. Trying persistently to produce above potential would lead to higher inflation rather than to sustainable increases in real output. Usually the economy operates somewhat below its potential; historically, the gap between actual GDP and its potential has averaged about 0.6 percentage points. CBO's projections assume that real GDP will grow fast enough from the end of 1993 to reach a level that is 0.6 percent below its potential in 1997.

CBO's projection of potential real GDP depends on projections of the growth rates of the capital stock, the labor force, and total factor productivity--a measure of the growth of real output that cannot be accounted for by growth of capital and labor alone. Total factor productivity differs from the more familiar measure of labor productivity--output per hour worked--because total factor productivity takes account of growth of the capital stock as well as growth of hours worked. Total factor productivity is, therefore, the more fundamental measure. Growth of total factor productivity is commonly attributed to technical progress, although it may result from intangible factors other than technology, such as organizational methods used in business or improvements in the skills of the work force.

Table 2-2.
Comparison of CBO, Administration, and *Blue Chip* Economic Projections, Calendar Years 1991-1997

	Estimated	Forecast		Projected			
	1991	1992	1993	1994	1995	1996	1997
Nominal GDP (Billions of dollars)							
CBO	5,674	5,931	6,337	6,714	7,104	7,520	7,961
Administration	5,674	5,926	6,307	6,712	7,141	7,589	8,054
Real GDP (Percentage change, year over year)							
CBO	-0.7	1.6	3.6	2.7	2.5	2.6	2.6
Administration	-0.7	1.5	3.0	3.0	3.0	2.9	2.8
Blue Chip[a]	-0.7	1.6	3.2	2.9	2.3	2.3	2.5
GDP Deflator (Percentage change, year over year)							
CBO	3.6	2.9	3.2	3.2	3.2	3.2	3.2
Administration	3.6	2.9	3.3	3.3	3.3	3.2	3.2
Blue Chip[b]	3.6	2.7	3.2	3.9	3.8	3.6	3.6
Consumer Price Index[c] (Percentage change, year over year)							
CBO	4.2	3.3	3.6	3.6	3.6	3.6	3.6
Administration	4.2	3.0	3.3	3.2	3.2	3.2	3.1
Blue Chip	4.2	3.2	3.7	4.1	4.0	3.9	3.8
Civilian Unemployment Rate (Percent)							
CBO	6.7	6.9	6.4	6.2	6.0	5.9	5.7
Administration	6.7	6.9	6.5	6.1	5.8	5.4	5.3
Blue Chip	6.7	6.9	6.4	5.8	5.8	5.7	5.7
Three-Month Treasury Bill Rate (Percent)							
CBO	5.4	4.4	5.1	5.2	5.4	5.5	5.6
Administration	5.4	4.1	4.9	5.3	5.3	5.2	5.1
Blue Chip	5.4	4.1	5.0	6.3	6.2	6.2	6.2

(Continued)

CBO derives its projection of the capital stock using a standard growth model. National saving and borrowing from abroad determine investment--that is, the increase in the capital stock. The model then allocates capital and labor among nonfarm business, government, and smaller sectors, given assumptions about government policy and the shares of the smaller sectors in output. A stable rate of private saving is assumed, so that any variation in the national saving rate--and, therefore, in the growth of the capital stock--depends on government deficits.

The underlying (cyclically adjusted) rates of growth of the labor force and of total factor productivity in the nonfarm business sector are projected independently of the growth model. Following midrange projections of the Bureau of Labor Statistics, the underlying rate of growth of the labor force is assumed to average 1.3 percent a year over the medium term. The underlying rate of growth of total factor productivity in the nonfarm business sector is expected to continue at the rate it achieved in the 1980s--0.7 percent a year, a rate that is slightly below its average since the early 1960s.

Following the method described above, CBO's projection of the growth rate of potential real GDP averages about 2.1 percent a

Table 2-2.
Continued

	Estimated 1991	Forecast 1992	Forecast 1993	Projected 1994	Projected 1995	Projected 1996	Projected 1997
Ten-Year Treasury Note Rate (Percent)							
CBO	7.9	7.1	7.1	7.1	7.1	7.1	7.1
Administration	7.9	7.0	6.9	6.7	6.6	6.6	6.6
Blue Chip[d]	7.9	7.1	7.6	7.7	7.7	7.8	7.8
Nominal Income (Percentage of GDP)							
Wage and salary disbursements							
CBO	49.5	49.4	49.4	49.5	49.6	49.8	49.9
Administration	49.5	49.7	49.7	49.7	49.7	49.7	49.7
Other personal income[e]							
CBO	35.7	36.0	35.7	35.9	36.2	36.3	36.5
Administration	35.7	35.3	35.6	35.4	35.5	35.4	35.4
Corporate profits[f]							
CBO	5.5	6.0	6.6	6.5	6.3	6.2	6.2
Administration	5.5	5.8	6.7	6.8	6.9	6.9	6.9

SOURCES: Congressional Budget Office; Office of Management and Budget; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators*.

NOTE: The CBO forecast is based on data available through December 1991 and does not reflect fourth-quarter data for gross domestic product or the consumer price index published in January 1992. The *Blue Chip* forecasts through 1993 are based on a survey of 50 private forecasters published on February 10, 1992. The *Blue Chip* projections from 1994 through 1997 are based on a survey of 41 forecasters published on October 10, 1991.

a. The *Blue Chip* projections for 1994 through 1997 were made on the basis of gross national product (GNP) in constant 1982 dollars.

b. The *Blue Chip* projections for 1994 through 1997 were made on the basis of the implicit deflator for GNP given 1982 as the base year.

c. Consumer price index for all urban consumers (CPI-U).

d. The *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year Treasury notes.

e. Personal income less wage and salary disbursements.

f. Corporate profits reported are book, not economic, profits.

year from 1994 through 1997.[3] The projection of accumulated capital reflects reductions in the deficit as a share of GDP, caused both by the recovery and budget discipline of the Budget Enforcement Act. The underlying growth rates of capital, labor, and total factor productivity in the nonfarm business sector imply an underlying annual rate of growth of potential real GDP per worker of 0.9 percent and of labor productivity in the nonfarm business sector of about 1.1 percent. Potential labor productivity in the nonfarm business sector is projected to grow faster than potential output per worker, largely because the average workweek is expected to shorten.

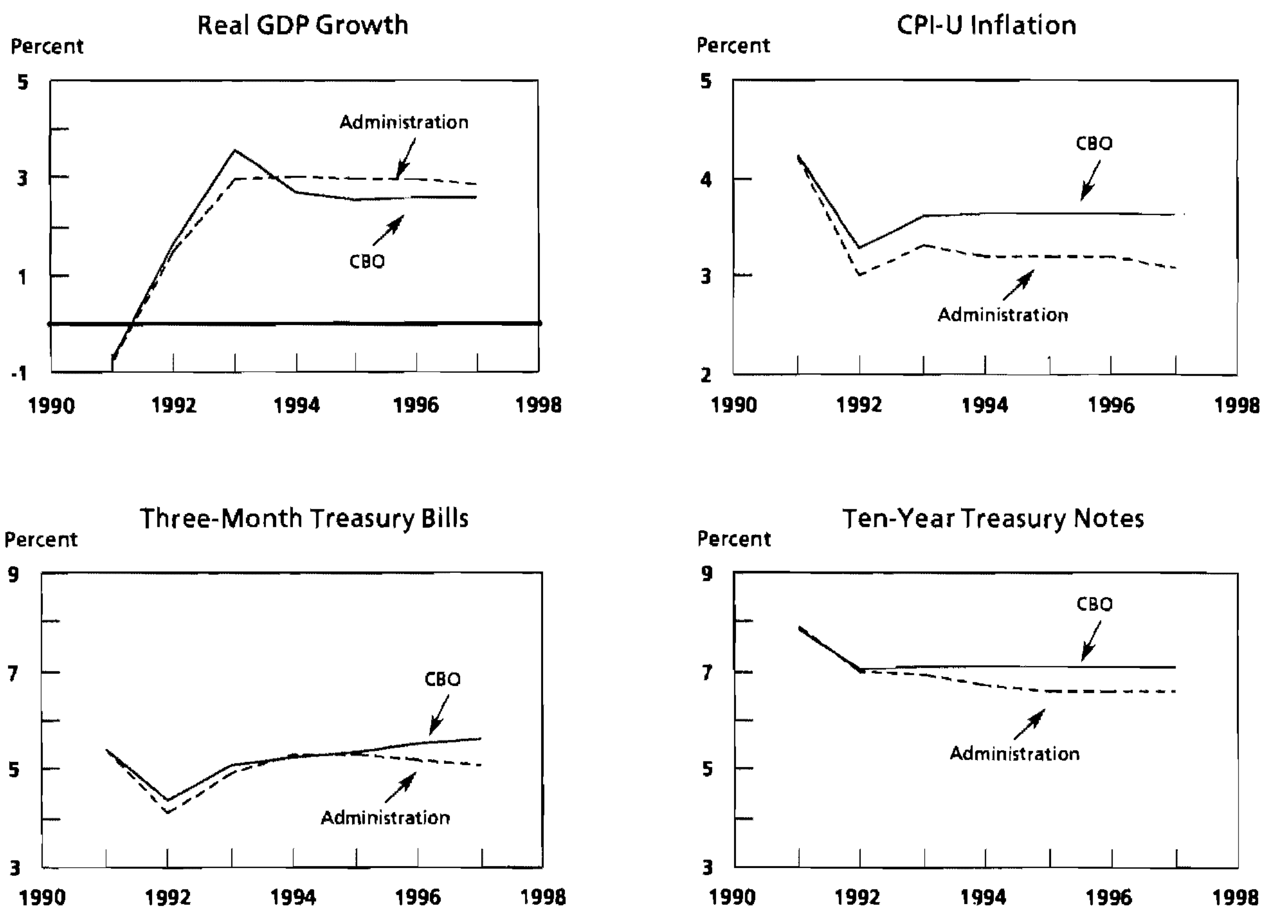
CBO then projects real GDP to reach a level 0.6 percent below its potential in 1997--the average historical gap. Because the gap between real GDP and its potential is forecast to be 2.3 percent at the end of 1993, real GDP must grow in the medium term about 0.5 percentage points a year faster than its potential to reach the average gap in 1997. Therefore, CBO projects that real GDP will grow at an average rate of 2.6 percent a year in the medium term. Correspondingly, the

3. This projection depends on provisional assumptions that CBO had to make because the Department of Commerce has not yet published all of the revised series that CBO uses in constructing potential real GDP. See Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1993-1997* (January 1992), pp. 22-23.

rates of growth of real GDP per worker and labor productivity (output per hour of work) in the nonfarm business sector are also projected to rise above their underlying rates--to 1.0 percent and 1.4 percent, respectively.

Comparison of Real GDP Projected by CBO and the Administration. Growth of productivity accounts for the entire difference between the Administration's and CBO's projections of the growth of real GDP over the medium term. The Administration projects that real GDP will grow at an annual pace of 2.9 percent, employment at 1.6 percent (the same rate that CBO projects), and real GDP per worker at 1.3 percent--0.3 percentage points faster than CBO's projection. The Administration projects a closely related measure--labor productivity in the nonfarm business sector--to grow at 1.6 percent a year. This rate is slightly lower than the average rate of 1.8 percent over the postwar period, but significantly higher than the 1.0 percent rate experienced since the end of the 1960s.

Figure 2-1.
Comparison of CBO's and the Administration's Economic Assumptions



SOURCES: Congressional Budget Office; Office of Management and Budget.
NOTE: CPI-U = consumer price index for all urban consumers.

The Administration's projections of the growth of labor productivity implicitly assume noticeably higher rates of capital accumulation or growth of total factor productivity than CBO foresees. (The Administration maintains that adoption of its budgetary program will increase the rate of growth, a judgment that is addressed below.) Given the historical experience of these factors, there appears to be little reason to expect a significantly higher rate of growth of labor productivity than CBO projects. Nevertheless, the differences between the Administration's and CBO's projections of productivity growth and real output lie well within the range of normal uncertainty for forecasts.

The Outlook for Inflation

The Administration is more optimistic than CBO about the prospects for inflation. Both anticipate that the rate of inflation will rise from its current level, which has been reduced by the recession. Still, both foresee a recovery that will be moderate enough to keep inflation from rising sharply. In CBO's view, the outlook for stable inflation is enhanced by the fact that actual output is far below potential output.

Projections of the rate of growth of the GDP deflator by the Administration and CBO are nearly identical, averaging 3.3 percent and 3.2 percent, respectively, over the medium term (see Table 2-2). But the Administration expects the consumer price index to grow slightly more slowly than the GDP deflator. By contrast, CBO and the *Blue Chip* project that the consumer price index will grow by an average of 0.4 percentage points, or 0.2 percentage points a year faster than the GDP deflator, over the medium term.[4] Unlike the GDP deflator, the consumer price index is not affected by changes in the composition of output. Therefore, it constitutes a better measure of pure price inflation.

CBO believes that the consumer price index will continue to grow more rapidly than the GDP deflator, largely because the two measures treat computers differently. The share of GDP devoted to computers (now about 1.3 percent in real terms) is expected to continue rising, and the quality-adjusted price of computers is expected to continue falling. But the weight given to computers in the consumer price index is both small and fixed, so the fall in computer prices has little scope to retard the growth of the index.

The Outlook for Interest Rates

The Administration is more optimistic than CBO about interest rates. It projects that the interest rate on three-month Treasury bills will fall slightly over the medium term, whereas CBO expects the rate to rise steadily. Therefore, although the Administration's projection is 0.1 percentage point higher than CBO's in 1994, it is 0.5 percentage points lower than CBO's by 1997. Over the medium term, the Administration's projection of the bill rate averages about 0.2 percentage points lower than CBO's (see Table 2-2).

This difference in projections of short-term interest rates may reflect, in part, the Administration's lower projection of the rate of growth of the consumer price index. Both the Administration and CBO project that the real (inflation-adjusted) rate of interest on three-month Treasury bills in 1997 will be about 2 percent. (CBO computes the real interest rate by subtracting the rate of inflation of the

4. The *Blue Chip's* medium-term projections of respective rates of inflation were made in October 1991. Since that time, the *Blue Chip's* forecasts of inflation in 1992 and 1993 have dropped by about 0.5 percentage points. If the *Blue Chip's* projections of inflation rates in the medium term also drop by the same amount, their respective average rates over the medium term would closely match those of CBO. There is no reason to suppose that the *Blue Chip* forecasters would not continue to project faster growth in the consumer price index than in the GDP deflator. (The *Blue Chip* projections were made on the basis of the GNP deflator, whose growth rate has been virtually identical to that of the GDP deflator and is expected to remain so.)

consumer price index from the nominal interest rate.) The real bill rate holds steady in the Administration's projections at about 2 percent, and it rises steadily in CBO's projections from 1.6 percent in 1994 to 2 percent in 1997. The higher rate of inflation projected for the consumer price index by CBO, however, leads to CBO's higher projection for the nominal bill rate.

CBO's projection of real interest rates is based on an assessment of supply and demand for funds. The domestic supply of funds, by itself, should act to lower the real interest rate. CBO expects the net national saving rate to rise above its average for the 1986-1989 period by 0.6 percentage points. This increase should occur partly because a growing portion of the population will be at an age when their personal saving rates are high, but mostly because the growing economy and the requirements of the Budget Enforcement Act should cause federal deficits to fall as a fraction of GDP. But increases in the demand for funds are expected to outweigh growth in the domestic supply. Some of this growth will arise from a demand for investment created by a growing economy, but most will be driven by an increased world demand for investment funds. These demands stem from developments in Europe--German unification and the economic integration of Western Europe--and to a lesser extent from construction needs in the former Communist bloc and reconstruction needs in the Middle East in the aftermath of the Persian Gulf War.

Both the Administration and CBO anticipate that the yield spread between the 10-year Treasury note and the three-month Treasury bill will revert from its current value of nearly 3 percentage points to a more normal value of 1.5 percentage points by 1997. The spread should narrow as participants in credit markets come to expect fairly stable short-term rates of interest to prevail in the future. Therefore, given their projections of bill rates, both the Administration and CBO project stable 10-year rates over the medium term--the Administration at 6.6 percent, CBO at 7.1 percent.

The Outlook for Nominal Income and Its Components

Projections of the size and distribution of nominal income affect deficit projections for two reasons: higher income implies higher tax receipts, and different components of income--profits, wages and salaries, dividends, interest, and so forth--are taxed at different effective marginal rates. (The effective marginal tax rate on a given component of income represents the amount of additional tax collected from each additional dollar of such income.) Corporate profits and wages and salaries are taxed at the highest effective marginal rates (about 30 percent); dividends and the income of proprietors are taxed at about half that rate. Interest and rental income are taxed at even lower marginal rates (effectively zero in the case of rental income).

Effective marginal tax rates on various components of personal income differ for two principal reasons. First, wages and salaries are subject to both personal taxes and payroll taxes. Second, other components are often defined differently for tax purposes than for purposes of the national income and product accounts (NIPAs). For example, some monetary income from dividends and interest accrues to pension funds and other tax-exempt organizations. In addition, some interest and rental income reported by the NIPAs (most notably the rental value of owner-occupied homes) represents untaxed income in kind rather than monetary income. Finally, the taxable income of the self-employed is often reduced by allowable deductions that are not considered to be economic costs of business in the NIPAs.

The Administration's projection of income and its components in the medium term favors deficit reduction slightly more than CBO's. In 1994, the Administration's and CBO's projections of nominal GDP are virtually identical. By 1997, however, the Administration's projection rises to $93 billion above CBO's (about 1.2 percent higher). In addition to projecting a higher level of income, the Administration expects a greater share of income to be taxed at the highest effective marginal rates. During the medium term, the Administration's projection of wages as a share of GDP holds steady at 49.7 percent, and CBO's rises from 49.5 percent to 49.9 percent. At the same time, the Administration's projection of corporate profits as a share of GDP averages about 0.6 percentage points higher than CBO's, which--following a historical trend--falls from 6.5 percent in 1994 to 6.2 percent in 1997 (see Table 2-2). As a result, the Administration projects the sum of wages and corporate profits as a share of GDP to be about 0.6 percentage points higher than CBO's corresponding projection. This amount slightly more than offsets CBO's projection of a higher share of nonwage personal income.

The rising share of profits in the Administration's projection could be caused by a combination of several factors. First, higher growth tends to be associated with a higher share of profits, partly at the expense of other component shares of taxable income. Second, lower interest rates reduce corporate interest expenses, leaving a higher share of capital income accruing as profits and a lower share accruing as interest income. Finally, increasing the share of equity (and lowering the share of debt) in corporate capital structures would also lead to lower interest expenses for corporations.

Implications of the Administration's Economic Program for Growth

The Administration states that unless its budgetary program is adopted, growth would fall significantly short of its forecast. The program is intended to stimulate aggregate demand in the short term and to enhance productivity in the long term. Under current policy, the Administration predicts that the annual rate of growth of real GDP would fall below its forecast by 0.6 percentage points a year in 1992 and 1993 and by an average of 0.4 percentage points a year from 1994 through 1997 (see Table 2-3). Such growth through 1993 would be lower than that forecast by CBO and the *Blue Chip* consensus by an average of 1 percentage point and 0.7 percentage points a year, respectively.

Despite the strictures of the Budget Enforcement Act, the Administration's program would make federal fiscal policy behave much as it usually has in response to a recession. In the past, at or about the trough of a recession, spending was usually raised or taxes were cut to boost the economy. On average, fiscal authorities have raised the standardized-employment deficit (a measure of the deficit that removes the effects of the business cycle) by 0.8 percent of potential GDP between the year preceding and the first year of a recovery. According to CBO's preliminary estimate, the standardized-employment deficit as a proportion of potential GDP would rise during a corresponding period by 0.3 percentage points under current policy and by 0.6 percentage points under the Administration's policy. (The difference includes reduced withholding from paychecks that the Administration has imposed by executive action.)

Description of the Administration's Program

The Administration's program of tax and spending initiatives aims both to stimulate demand in the short term by providing incentives to accelerate private spending, and to enhance productivity in the longer term by encouraging private saving and investment as well as undertaking public investment.

The Administration proposes three tax initiatives that would temporarily accelerate private spending:

- *Reduced personal income tax withholding rates* will act like a temporary tax cut for 1992. (Unlike the other tax proposals--which would require passage by the Congress--reduced withholding has already been initiated by executive action and therefore is considered apart from the rest of the Administration's program in other chapters.)

- *A temporary investment tax allowance* would increase the rate at which businesses could depreciate equipment they buy in 1992.

- *A temporary tax credit for a first-time home purchase* would give new homebuyers in 1992 a credit of 10 percent of the cost of a home, up to a maximum of $5,000.

Proposals for permanent changes to the tax code that could enhance future productivity by affecting private saving and investment include:

- *Excluding 45 percent of capital gains from income* (but exposing the excluded gains to the alternative minimum tax);

- *Establishing Flexible Individual Retirement Accounts (FIRAs)*, the contributions to which would not be deductible, but the earnings of which could be withdrawn free of tax or penalty after seven years;

Table 2-3.
Comparison of Alternative Economic Projections by the Administration: Current Policy versus Administration Policy

	1992	1993	1994	1995	1996	1997
	Fourth Quarter to Fourth Quarter (Percentage change)					
Real GDP						
Current policy	1.6	2.4	2.5	2.6	2.5	2.4
Administration policy	2.2	3.0	3.0	3.0	2.9	2.8
GDP Deflator						
Current policy	3.3	3.4	3.3	3.3	3.2	3.2
Administration policy	3.2	3.4	3.3	3.3	3.2	3.2
	Calendar-Year Average (Percent)					
Civilian Unemployment Rate						
Current policy	7.1	6.9	6.7	6.3	5.8	5.6
Administration policy	6.9	6.5	6.1	5.8	5.4	5.3
Three-Month Treasury Bill Rate						
Current policy	4.2	5.1	5.5	5.5	5.4	5.3
Administration policy	4.1	4.9	5.3	5.3	5.2	5.1
Ten-Year Treasury Note Rate						
Current policy	7.2	7.3	7.1	7.0	7.0	6.9
Administration policy	7.0	6.9	6.7	6.6	6.6	6.6

SOURCE: Office of Management and Budget, *Budget of the United States Government: Fiscal Year 1993*, Table 3-2.

- *Allowing penalty-free withdrawals from IRAs* for educational and medical expenses or for a first-time home purchase; and

- *Extending the 20 percent tax credit for qualified research and experimentation (R&E) spending* (above a company-specific base).

Other proposals to change taxes would have little effect on saving or investment. Three that have drawn prominent attention include modifying the alternative minimum tax for corporations, the passive loss rule for real estate developers, and the sale-leaseback rule for pension funds and educational institutions making real estate investments. But the combined reduction in taxes from these proposals would amount to less than 0.2 percent of total income from business property, which would roughly translate into increased total demand for investment of less than 0.01 percent of GDP. (Modifying the sale-leaseback rule would not add to total investment demand; it would merely redirect funds from other investment projects to real estate.)

The individual effects on the overall economy of other tax proposals are unlikely to be significant during the next six years. The proposal with the largest effect on the deficit over the next six years would increase the exemption for dependent children by $500 per child, starting October 1, 1992 (amounting to a total of $24 billion through fiscal year 1997). But, as a whole, the program would have little permanent effect on the deficit through 1997. (Chapter 3 provides a more complete discussion of the Administration's tax proposals.)

The Administration also maintains that some of its spending proposals would contribute to future productivity because they represent increased public investment. These include:

- *Public infrastructure*,

- *Research and development (R&D)*, and

- *Human resource programs*, such as education and training, preventive health care, and anticrime and drug-abuse programs.

Increased spending for such programs, if sustained, could enhance productivity in the longer term by contributing to the stock of capital, the level of technology, and the health and skills of the population. (Chapters 4 and 5 provide a more complete discussion of the Administration's spending proposals.)

CBO's analysis of the Administration's program is limited to the likely effects that the tax and spending proposals would have on real GDP during the next six years. Therefore, proposals to reform the financial sector, legal system, or regulatory structure, or to negotiate market-expanding trade agreements, are not considered here. Furthermore, some of the proposals either might generate little effect on GDP until after 1997 or might serve purposes other than (or in addition to) increasing GDP. For example, some human resource programs--such as Head Start or Healthy Start--would have little effect on GDP through 1997, but could enhance both prospects for the disadvantaged and productivity in the long term.

Effects of the Administration's Program in the Short Term

The Administration's program would impart more stimulus in 1992 than would current policy, although the exact amount is uncertain. But the stimulus would begin to reverse itself during 1993. By 1993, or 1994 at the latest, real GDP would probably return to the level it would have attained without the program's stimulus.

Temporary factors would provide the principal additional stimulus under the Administration's program. Reduced withholding for

Table 2-4.
CBO Estimates of the Effects of the Administration's Budgetary Program (Change from baseline in billions of dollars, by fiscal year)

	1992	1993	1994	1995	1996	1997	Total
			Excluding Reduced Withholding				
Revenues	-5	-2	-9	-13	-15	-16	-60
Outlays	-1	-7	a	-2	-20	-36	-65
Deficit	5	-4	10	11	-5	-20	-5
			Reduced Withholding				
Revenues	-14	-5	-1	-1	-1	-1	-24
			Total				
Deficit	19	1	11	11	-4	-19	19

SOURCE: Congressional Budget Office.

a. Less than $500 million.

personal income taxes would act like a temporary tax cut to provide households with an additional $21 billion in cash in calendar year 1992 (unless people readjust their withholding rates). In addition, two temporary measures--an investment tax allowance and a tax credit for a first-time home purchase--would provide more stimulus in 1992 than they would if they were permanent. The tax provisions would stimulate the economy, not so much because they would encourage businesses or households to buy more or bigger machines or houses, but because the allowances and credits would encourage them to buy now, instead of later, in order to take advantage of the temporary tax benefits.

By contrast, the other features of the program would give only a nudge to demand. Excluding the revenue effects of reduced withholding, the program would change the deficit too little to stimulate demand directly in any significant way, either by raising federal spending directly or by raising net private income through increased transfers or lowered taxes (see Table 2-4). The partial exclusion of capital gains would initially encourage consumption by increasing the value of existing wealth, and would encourage investment by lowering the cost of funds for some investments. But CBO and others have estimated that this stimulus would not appreciably raise the rate of growth.[5]

The temporary nature of the principal elements of the Administration's program makes it difficult to determine their effective stimulus. First, conventional analysis indicates that, unlike investment in machines or housing, consumption responds less to temporary tax cuts than to permanent ones. Estimates vary widely, but suggest that the response of consumers to a temporary cut may be about half of that to a permanent one.[6] Second, the rest of the program would have to be passed

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5. See Congressional Budget Office, "Effects of Lower Capital Gains Taxes on Economic Growth," CBO Paper (August 1990); and Brian W. Cashell and Jane G. Gravelle, "Potential Macroeconomic Effects of a Capital Gains Tax Cut," *CRS Report for Congress* (January 2, 1992).

6. See Alan S. Blinder and Angus Deaton, "The Time Series Consumption Function Revisited," *Brookings Papers on Economic Activity* (1985:2), pp. 465-521. A more recent competing analysis suggests that a temporary tax cut would provide more stimulus than a permanent one, but that a permanent cut would be less stimulating than conventional analysis indicates. Simulations of the McKibbin-Sachs Global model of the world economy contain this feature.

quickly to have the desired effect. Businesses and households would not accelerate their investments in machines or housing without being sure that they would receive the tax benefits. Third, some mechanism would have to be devised that would enable new homebuyers to use the tax credit to help make a downpayment. (Half the credit would apply in 1993 against taxes for 1992 and the other half in 1994 against taxes for 1993.) Without such a mechanism, the tax credit may not help many new homebuyers who would not have bought anyway in 1992. (New homebuyers, however, could reduce the amount withheld from their paychecks to accumulate up to $2,500 in cash in 1992 against the credit.)

Although the magnitude of the response in 1992 is uncertain, its eventual reversal is more predictable. After 1992, the effects of the program would begin to wear off. Reduced withholding would no longer provide a significant stimulus. Even though withholding schedules would remain below current rates (unless people readjusted their withholding rates), higher take-home pay in 1993 would be nearly offset by reduced refunds (or increased tax payments) for the tax liabilities of 1992. Therefore, most of the stimulus provided by higher take-home pay would not persist beyond 1992.

Moreover, the aftereffects of the investment tax allowance and the tax credit for first-time homebuyers would begin to act adversely. Most of the stimulus from the provisions would occur because businesses and first-time homebuyers would accelerate their planned purchases, moving them into 1992 from 1993 or later.[7] But, in total, such purchases would fall from the level they would otherwise have attained in 1993 and later by roughly the same amount that they rose in 1992. In this case, the positive stimulus would not only cease after 1992, but would turn negative. In this way, the Administration's program would essentially borrow growth in 1992 from growth in 1993 or later.

In conclusion, the proposals do not lend themselves easily to conventional economic analysis. Their assessment therefore depends more heavily than is usual on the judgments of market observers, which vary widely. CBO finds it plausible that the Administration's program could add about one-half of a percentage point to growth in 1992, but concludes that any addition to growth in 1992 would be largely reversed in 1993.

Effects of the Administration's Program in the Medium Term

In principle, several of the Administration's proposals could raise productivity, but they would probably not have much effect in the next six years. The principal tax proposals would partially exclude capital gains from income taxation, establish FIRAs, allow penalty-free early withdrawals from IRAs, and permanently extend a tax credit for research and experimentation. The Administration also maintains that its program would raise productivity in the longer term by raising spending for public infrastructure and research and development.

To be effective, such programs would need to increase the rate of technological innovation or raise saving to provide more capital per worker. Guided by standard theory, CBO calculates that it would require an increase in the national saving rate of one-half of a percentage point--a total of about $200 billion over the next six years--to raise the rate of growth of real GDP by an average of 0.1 percentage point a year (assuming that output is unaffected by the drop in aggregate demand).[8]

7. The investment tax allowance and tax credit for first-time homebuyers could continue to have some positive effects in early 1993. The proposals would apply to machines or homes bought in 1992 and put into service or moved into before July 1, 1993.

8. Raising the same amount of capital by borrowing or absorbing investment from abroad, rather than by saving, would also raise domestic output, but much of the additional income generated would accrue to the foreign lenders or investors. As noted, in any case the Administration's proposals would provide very little permanent impetus to investment in capital.

If increases in capital accelerate innovation and thereby contribute twice as much to increases in output as standard theory implies, a total of $100 billion of additional national saving over the next six years would be needed to raise the average rate of growth by 0.1 percentage point a year.[9] But the Administration's program seems unlikely to raise national saving by more than that, and may raise it by far less.

How Much Would the Administration's Program Add to National Saving? The most direct way that the program could affect national saving is through its effect on the deficit. Because the deficit subtracts from funds available to finance investment in private capital, it represents dissaving when it finances government consumption. Other things being equal, raising the deficit reduces national saving, whereas reducing the deficit raises national saving. In considering the program's effect on the deficit through 1997, it is appropriate to exclude the direct revenue effects of reduced withholding because, although it affects the timing of tax payments, it does not affect tax liabilities. (Reduced withholding will slightly raise interest costs, however, by requiring more borrowing to finance spending during the period before the tax liability is settled.) But as Table 2-4 showed, when the effects of reduced withholding are excluded, the Administration's program would, on balance, leave the deficit virtually unaffected through 1997. Therefore, any material effect the program would have on national saving would depend on how it would affect private saving and public investment.

Aside from any effect they would have on the deficit, the proposals could raise national saving. Both the partial exclusion of capital gains and new provisions for IRAs could increase private saving by making some forms of holding assets more attractive. The tax credit for research and experimentation would not increase saving in itself, but could channel more funds to R&E, which generates more benefits to society than it costs.[10] This stream of extra returns to additional R&E would be equivalent to an addition to saving. Productive public investment for infrastructure and R&D also constitutes a type of saving because it represents public funds that are committed to future use rather than being immediately consumed.

CBO has considered the possible contributions of the Administration's program to growth by estimating the total amount of additional saving that it would be likely to generate through 1997. The exercise does not consider effects after 1997 or other merits that may recommend the proposals.

The *partial exclusion of capital gains* would raise the after-tax rate of return on some forms of saving; therefore, the effect of the exclusion depends on how much saving would respond to a change in its after-tax rate of return. Using the results of a study that estimates a response in the upper range of published estimates, together with CBO's economic projections, CBO calculates that the partial exclusion of capital gains could increase private saving by about $25 billion through 1997.[11] (This calculation overstates the likely change in saving, given the results of the study, because it does not consider the negative effect on saving that the exclusion would have by raising the value of existing wealth, thereby inducing more consumption.)

New provisions for Individual Retirement Accounts--*FIRAs and penalty-free early with-*

9. See George Hatsopolous, Paul R. Krugman, and Lawrence H. Summers, "U.S. Competitiveness: Beyond the Trade Deficit," *Science* (July 15, 1988). The implications of national saving for future living standards are discussed in Congressional Budget Office, *The Economic and Budget Outlook: Fiscal Years 1990-1994* (January 1989), pp. 79-99.

10. For instance, see Edwin Mansfield and others, "Social and Private Rates of Return from Industrial Innovations," *Quarterly Journal of Economics*, vol. 91 (May 1977), pp. 221-240.

11. The study concludes that private saving rises by 0.4 percent for each 1 percent that the after-tax rate of return to saving rises. See Michael J. Boskin, "Taxation, Saving, and the Rate of Interest," *Journal of Political Economy*, vol. 86, no. 2, pt. 2 (1978), pp. S3-S27.

drawals from IRAs for qualified purposes--would probably not have a major effect on saving. Although total contributions to such accounts might be large, a relatively small portion seems likely to represent additional saving. Judging from experience, the addition to contributions could total $150 billion through 1997--perhaps $130 billion for FIRAs and $20 billion for IRAs. (These figures are rough guesses made for this exercise. Gross contributions are considered because qualified early withdrawals would arguably finance investment rather than consumption.) But most of the additional contributions would probably represent transfers of existing saving into such accounts rather than additional saving.

Estimates of the additional saving that IRAs have induced in the past vary widely, but in this case those at the lower end of the range appear to be more reliable. One study found that about two-thirds of contributions to IRAs, as they existed from 1982 through 1986, represented additional saving.[12] The authors concluded that IRAs boosted saving so much because, under the law at the time, they were dedicated to saving for retirement, penalties were applied to early withdrawals, and contributions were deductible from taxable income. But none of these conditions would apply to FIRAs, and the first two would no longer apply to IRAs under the Administration's proposals. Furthermore, other authors have found that IRAs, as they existed from 1982 through 1986, had much smaller effects on saving. One study implied that about 30 percent of contributions to IRAs represented additional saving; another found that, at most, 4 percent did.[13] Therefore, although the highest estimate suggests that the proposals could add $100 billion to saving through 1997, the lower estimates that others have reported and the questionable applicability of the studies to the current proposals suggest that the result would be much smaller.

The *tax credit for R&E* would probably have no appreciable effect on growth over the next six years. Even if each dollar of the credit corresponded to a dollar of additional R&E, only an additional $8 billion of R&E would result.[14] Furthermore, R&E usually does not lead to marketable applications for several years. So, even if a dollar of R&E eventually adds as much to output as two or three dollars of capital, the effects of the credit would be negligible through 1997.

When compared with current policy, the Administration's proposals for *spending for public infrastructure* would not add appreciably to growth. The amounts involved are negligible, even if a dollar spent for productive public capital added twice as much to output as a dollar spent for private capital.[15] The Administration proposes to spend $7 billion less for nondefense infrastructure through 1997 than under current policy.[16] Even though spending would shift to areas that have

12. Steven F. Venti and David A. Wise, "The Saving Effect of Tax-Deferred Retirement Accounts: Evidence from the SIPP Data," in B. Douglas Bernheim and John Shoven, eds., *National Saving and Economic Performance* (Berkeley: University of California Press, 1991).

13. See Douglas H. Joines and James G. Manegold, "IRAs and Saving: Evidence from a Panel of Taxpayers," Working Paper, University of Southern California (September 1991); and William G. Gale and John Karl Scholz, "IRAs and Household Saving," Working Paper, University of California at Los Angeles (April 1990).

14. Estimates of the revenue effects of the tax credit are well-founded because it has been in operation for two years on a temporary basis. Preliminary evidence suggests that R&E spending has not responded markedly differently to the provisions of the current credit than to the provisions of an earlier credit, although the current version provides more incentive to undertake additional R&E than did the earlier version. For a discussion of the estimated response of R&E spending to the earlier version, see Joseph J. Cordes, "Tax Incentives and R&D Spending: A Review of the Evidence," *Research Policy*, vol. 18 (June 1989), pp. 119-133.

15. For an exposition of this view, see David A. Aschauer, "Is Public Capital Productive?" *Journal of Monetary Economics*, vol. 23 (1989), pp. 177-200. Most analysts, however, estimate smaller effects than those Aschauer finds. For a critical discussion and review of the literature on Aschauer's hypothesis, see Congressional Budget Office, *How Federal Spending for Infrastructure and Other Public Investments Affects the Economy* (July 1991), pp. 23-31.

16. See Office of Management and Budget, *Budget of the United States Government: Fiscal Year 1993*, Table 29-9.

been identified in the past as productive, the shift would add little to measured growth. For example, spending for roads and airports--the areas that have yielded the highest estimated returns in the past--would be only $3 billion higher through 1997 under the Administration's program than under current policy. Furthermore, the return on roads and airports is estimated by the value of time saved by commuters and travelers, which does not appear in GDP.

Proposed changes in *spending for R&D* would also add little, if at all, to growth through 1997. Given the spending caps of the Budget Enforcement Act, budget authority for civilian R&D would provisionally be frozen in the medium term at its proposed 1993 level. Compared with allowing the authority to grow from its 1992 level to keep pace with inflation, the Administration's program would increase the authority by $1 billion in 1993, but decrease it by a total of $5 billion in the medium term. (The same calculation for defense research and development would yield a shortfall of $19 billion through 1997.)

At the same time, however, some R&D spending might be shifted away from large projects that are not directly aimed at increasing output and toward areas that have been productive in the past.[17] For example, compared with the 1992 budget request, spending for the space station, Earth Observation System, and Superconducting Super Collider would be slightly cut or slowed, but spending for health research would be increased. This shift in spending could yield more direct benefits from federal R&D than if the shift did not occur. But the amounts involved are too small, and the lag from research and development to the market too long, for the shift in spending to yield appreciable results in the medium term.

Conclusion. The principal elements of the Administration's program would be unlikely to raise national saving by more than a total of $100 billion over the next six years (and may easily raise it far less). If those elements could not raise saving by more than that, they could not raise the rate of growth through enhanced productivity by more than 0.1 percentage point a year in the medium term--even under favorable conditions. That result, together with CBO's assessment of the short-term effects of the Administration's program, suggests that the program would fall far short of raising growth by an average of one-half of a percentage point a year through 1997, as the Administration claims.

17. For a discussion of estimates of the economic return to federal spending for R&D, see CBO, *How Federal Spending for Infrastructure and Other Public Investments Affects the Economy*, pp. 73-101.

Chapter Three

The Administration's Revenue Proposals

The President's budget contains a large number of revenue proposals. Some are directed at stimulating the economy in the short run, others at increasing economic growth in the long run. The President has made many of the proposals before, but the Congress has not adopted them. Included in this group are the initiatives to liberalize Individual Retirement Accounts (IRAs) and reduce the tax on capital gains. The short-run stimulative initiatives include temporary incentives to boost investment in plant and equipment and to spur the purchase of homes by first-time buyers. No new major revenue-raising measure is offered.

Revenue Estimates

The Congressional Budget Office (CBO) estimates that total revenues under the Administration's budget proposals would increase from $1,082 billion in 1992 to $1,171 billion in 1993 and $1,474 billion in 1997. The CBO projections of revenues assuming enactment of the President's proposals are slightly higher than the Administration's projections for 1992 and 1993 but are lower beginning in 1994 (see Table 3-1). Most of the difference in estimates is for projected receipts under present law and results from different economic forecasts. The other major difference in estimating is for the President's capital gains proposal.

Taken together, the President's proposals reduce receipts in every year (see Table 3-2). The President's proposed Flexible Individual Retirement Accounts (FIRAs) guarantee that the trend of growing proposed reductions from present-law receipts, apparent in the CBO estimates for the 1993-1997 period, will continue in the years beyond 1997.

Present Policy and the President's Withholding Reduction

Both the CBO and Administration baselines include the revenue effect of the speedup in corporate income tax payments enacted in February in the bill extending supplemental unemployment compensation benefits. Both baselines also include the reduction in personal income tax receipts resulting from the reduction in withholding rates put in place by the President, effective March 1, 1992. Withholding by top-bracket taxpayers remains unchanged. The change in withholding is estimated to lower receipts by $14 billion this year, $5 billion in 1993, and about $1 billion per year thereafter.

CBO baseline revenues take account of the effect of the Federal Reserve System's lowered reserve ratio requirement for banks and other depository institutions. The President's budget was released before the change was announced and therefore does not take it into account. The lower level of reserves will reduce Federal Reserve payments to the Treasury and will raise corporate income and tax liability.

Finally, CBO baseline revenues do not include the effect of the Administration's position on tariff reduction in the Uruguay Round of the General Agreement on Tariffs and Trade. Therefore, the effect of the proposed reduction in tariffs that can be accomplished by executive action is removed from the Administration's baseline revenues (as published), and the reduction is shown as a proposal.

CBO's Reestimate of the Administration's Budget Revenues

CBO's reestimate of the Administration's budget revenues reflects differences in the economic activity, incomes, and prices assumed for 1992 through 1997. CBO's economic forecast produces higher revenues in the near term, through 1993, but lower reve-

Table 3-1.
Administration and CBO Estimates of the Administration's Budget Revenues, by Major Source (By fiscal year, in billions of dollars)

Revenue Source	1992	1993	1994	1995	1996	1997
		Administration Estimates				
Individual Income Taxes	478.7	515.2	562.5	602.8	643.8	677.5
Corporate Income Taxes	89.0	103.8	118.2	125.3	136.9	141.4
Social Insurance Taxes and Contributions						
On-budget	109.9	120.9	131.1	138.8	146.3	151.6
Off-budget[a]	300.9	325.8	348.8	369.9	394.3	418.3
Excise Taxes	46.1	48.1	49.7	51.1	48.9	49.9
Other	51.0	51.6	52.8	54.5	56.6	57.9
Total	1,075.7	1,165.4	1,263.1	1,342.4	1,426.8	1,496.6
As a Percentage of GDP	18.3	18.7	19.0	19.0	19.0	18.8
		CBO Estimates				
Individual Income Taxes	476.8	511.6	542.2	581.7	618.5	658.2
Corporate Income Taxes	91.4	107.5	122.1	125.0	128.8	130.8
Social Insurance Taxes and Contributions						
On-budget	111.3	122.7	132.4	140.1	147.5	152.9
Off-budget[a]	304.5	328.1	350.3	371.8	395.3	419.5
Excise Taxes	46.5	48.8	50.3	51.4	49.0	49.9
Other	52.0	52.6	55.0	57.1	59.6	62.2
Total	1,082.5	1,171.2	1,252.2	1,327.2	1,398.6	1,473.6
As a Percentage of GDP	18.5	18.8	18.9	18.9	18.9	18.8

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget, *Budget of the United States Government: Fiscal Year 1993.*

a. Off-budget revenues consist of Old-Age, Survivors, and Disability Insurance tax revenues.

nues thereafter. The estimate by CBO and the Joint Committee on Taxation (JCT) of the larger reduction in revenues from the proposed capital gains exclusion depresses the CBO reestimate further after 1993. Other reestimates of baseline receipts and budget proposals are relatively small.

Differences in income forecasts dominate the reestimates. CBO projects lower growth in nominal and real personal income, which produces lower individual income and payroll tax receipts. For corporations, CBO projects a quicker and more substantial recovery in profits this year followed by slower growth in profits thereafter. This path produces higher corporate income tax revenues through 1994, but lower revenues in later years. The economic forecasts have little effect on budget proposals. The overall effect of different forecasts on the reestimate is to put CBO's revenue estimates above the Administration's by about $2 billion in 1992 and 1993 and then below the Administration's by amounts increasing from $5 billion in 1994 to $21 billion in 1997 (see Table 3-3).

Table 3-2.
CBO Estimates of Revenue Proposals in the Administration's 1993 Budget (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Before Withholding Reduction	1,102.2	1,178.7	1,262.4	1,340.6	1,414.6	1,491.1
President's Withholding Reduction (Now in effect)	-14.4	-5.2	-0.8	-0.7	-1.4	-1.2
Proposals						
Pay-As-You-Go Proposals						
Provide investment tax allowance	-6.1	-1.6	3.6	1.0	0.8	0.6
Provide Flexible IRAs	0	2.0	0.8	0.5	-0.8	-1.9
Provide credit to first-time homebuyers	-0.3	-2.7	-2.5	-0.5	-0.1	a
Exclude portion of capital gains	0.8	3.7	-3.4	-5.7	-5.6	-5.2
Extend expiring provisions	-0.5	-1.9	-2.5	-2.2	-2.3	-2.7
Expand Medicare coverage	0.4	1.7	1.7	1.7	1.6	1.6
Increase employee contributions to Civil Service Retirement	b	0.4	1.0	1.1	1.0	1.0
Other	0.2	-0.1	-1.9	-1.8	-1.4	-0.7
Subtotal	-5.5	1.5	-3.3	-5.9	-6.7	-7.3
Increase exemption for children	b	-3.4	-5.0	-5.0	-5.1	-5.3
Total	-5.5	-1.9	-8.3	-10.9	-11.8	-12.6
Other Proposals						
Prohibit double-dipping by thrifts	0.2	0.2	0.1	0.1	0.1	-0.1
Implement Uruguay Round[c]	b	-0.4	-1.2	-1.9	-2.7	-3.6
Total	0.2	-0.3	-1.0	-1.8	-2.7	-3.7
Total, Proposals	-5.3	-2.2	-9.4	-12.8	-14.5	-16.3
President's Budget Revenues as Estimated by CBO	1,082.5	1,171.2	1,252.2	1,327.2	1,398.6	1,473.6

SOURCES: Joint Committee on Taxation; Congressional Budget Office.

a. Loss of less than $50 million.

b. Not yet in effect.

c. Administrative proposal.

The remaining influences on the baseline projections are classified as technical. Reestimates of baseline revenues stemming from technical assumptions are much smaller this year than in the past. There is no one major reestimate of this type. Taken together, technical factors raise CBO's baseline revenues above the Administration's in every year except 1996 (see Table 3-3).

CBO reestimates of the President's tax proposals attributable to technical factors are dominated by the reestimate of the proposed exclusion for capital gains. CBO and the JCT estimate that the President's capital gains proposal would reduce receipts by $15 billion over the 1992-1997 period, whereas the Administration estimates that it would increase receipts by $7 billion. This reestimate alone matches the scale of technical reestimates of the proposals overall for 1992 through 1997. The assumption primarily responsible for the difference in estimates of the capital gains exclusion is the assumption by CBO and the

Table 3-3.
CBO Reestimates of the Administration's Budget Revenues (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
Revenues as Estimated by the Administration	1,075.7	1,165.4	1,263.1	1,342.4	1,426.8	1,496.6
CBO Reestimates						
Baseline[a]						
Economic	2.1	1.8	-5.0	-12.6	-18.9	-20.9
Technical	4.7	2.2	0.5	3.9	-2.2	3.5
Total	6.8	4.0	-4.6	-8.7	-21.1	-17.4
Pay-As-You-Go Proposals						
Capital gains exclusion						
Economic	b	b	b	b	b	b
Technical	0.2	-0.1	-5.5	-6.0	-5.9	-5.0
Subtotal	0.2	-0.1	-5.5	-6.0	-5.9	-5.0
Other						
Economic	0.1	0.1	0.1	0.1	0.1	0.1
Technical	-0.2	2.1	-1.0	-0.7	-1.4	-0.4
Subtotal	-0.1	2.2	-0.9	-0.6	-1.3	-0.4
Total	0.1	2.1	-6.4	-6.6	-7.2	-5.4
Other Proposals						
Economic	0	0	0	0	0	0
Technical	-0.2	-0.3	0.1	0.1	0.1	-0.2
Total	-0.2	-0.3	0.1	0.1	0.1	-0.2
Total, Reestimates	6.8	5.9	-10.9	-15.3	-28.2	-23.0
Economic	2.2	1.9	-4.9	-12.5	-18.8	-20.9
Technical	4.6	3.9	-6.0	-2.7	-9.3	-2.1
Revenues as Estimated by CBO	1,082.5	1,171.2	1,252.2	1,327.2	1,398.6	1,473.6

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget, *Budget of the United States Government: Fiscal Year 1993* (January 1992).

NOTES: Revenues include payroll tax receipts of the Old-Age, Survivors, and Disability Insurance trust funds, which are off-budget.

a. The reduction in income tax withholding put in place by President Bush is assumed in both the CBO and Administration baselines.

b. Less than $50 million.

JCT of an increase in realizations of capital gains in reaction to the new exclusion that, while substantial, is not as large as that assumed by the Administration. The proposal is described below. CBO reestimates of other budget proposals are small.

Longer-Term Effects of the Administration's Proposals

Some of the Administration's proposals will produce annual revenue losses in the long run that are much larger than the annual losses for 1992 through 1997. For example, CBO and JCT estimate that the proposal to allow taxpayers to establish new Flexible Individual Retirement Accounts and to transfer money to such accounts from existing IRAs in 1992 would increase revenue by $0.6 billion over the 1992-1997 period. When taxpayers have reached their desired level of assets in the Flexible Individual Retirement Accounts, however, the proposal could reduce revenues by between $7 billion and $17 billion annually, measured at 1992 levels of income. The increase in revenue in the early years occurs because taxpayers who transfer funds from existing IRAs to FIRAs will be required to report these transfers as taxable income and pay tax on the funds over a four-year period. These tax payments represent a prepayment of future tax liability in exchange for exemption of more income in later years; in that sense, they are equivalent to a loan from the taxpayer to the government at a very high interest rate. In addition, the revenue loss from extending the low-income housing credit for 18 months will continue beyond 1997 because taxpayers receive credits for 10 years.

An Overview of the President's Tax Proposals

The Administration's proposals claim a number of objectives. The one direct tax cut for households--the increase in the exemption for dependents--provides tax relief for families with children. Other proposals that reduce revenue include new and expanded incentives for investment and saving, targeted tax benefits for rental real estate and owner-occupied housing, and new and extended targeted tax benefits for other economic sectors and groups. The targeted tax benefits include incentives for research, employment of people from disadvantaged groups, investment and employment in economically distressed areas, investment in renewable energy, and benefits for farmers, students, the self-employed, and employees who use public transit.

In many circumstances, narrowly targeted benefits have been judged to be unfair: they allow some taxpayers to pay lower taxes than others with the same income, and they reduce economic efficiency by encouraging people to select investments with relatively lower social productivity than others that do not receive tax benefits. But some of the proposals for targeted tax relief in the budget arguably have merit on tax policy or economic grounds.

For example, an argument for extending and making the credit for research and experimentation expenditures permanent is that such expenditures have "spillover" effects that create productivity gains beyond those that add to the profitability of firms conducting the research. Some other proposals may warrant consideration on the grounds that, for some activities, current law imposes extremely stringent (if not punitive) limits on the deductibility of ordinary business costs. The proposals to provide relief from the limits on deductibility of passive losses for those actively involved in developing and managing real estate and to make depreciation rules under the corporate alternative minimum tax less stringent attempt to remedy the problem. All of these proposals, however, are narrow in scope, and even taken together, their effect on economic growth would at most be marginal.

Short-Term Economic Stimulus

Some of the President's proposals are aimed at providing immediate economic stimulus, thereby accelerating recovery from the current recession. These include the investment tax allowance and the tax credit for first-time homebuyers, which are available only for transactions between February 1, 1992, and the end of the year. Because these tax incentives are available only for 1992, their main effect will be to cause some businesses to accelerate purchases of equipment and some households to accelerate home purchases that they had intended to make in 1993 or later. The Administration's changes in withholding tables for individuals, which did not require legislation, are also intended to shift demand from later years to 1992 by temporarily increasing cash flow for households. The potential effects of these proposals on the economic recovery are assessed in Chapter 2.

Private Saving, Investment, and Economic Growth

A major goal of the revenue proposals in the budget is to promote economic growth by reducing the tax burden on saving and investment. The budget emphasizes the economic benefits of reducing the capital gains tax and promoting saving by expanding the use of Individual Retirement Accounts and introducing a new tax-advantaged savings vehicle, the Flexible Individual Retirement Account.

The proposal to reduce the capital gains tax would directly benefit mainly high-income taxpayers. CBO estimates that families in the top quintile would receive 94 percent of the benefit from the proposal, and families in the top 1 percent would receive 50 percent of the benefit.

This tax cut could increase economic growth if it induces high-income families to save more or if changes in relative yields among assets cause more savings to flow to investment with high rates of return. Many analysts are skeptical, however, about whether saving would increase enough to raise the growth rate noticeably. For example, a CBO review of eight empirical studies of the effects of a cut in the capital gains tax found no consensus among economists that a lower capital gains tax would raise saving and investment enough to increase the gross national product significantly.[1]

Another means by which a lower capital gains tax could increase growth is by channeling more funds to venture capital. Investors in new ventures typically receive a larger fraction of their return in the form of capital gains, compared with interest and dividends, than investors in bonds or equity in mature companies. Proponents of reducing the capital gains tax note that investment in enterprises financed by private venture capital firms increased dramatically after the cut in the capital gains tax in 1978. Some analysts, however, are skeptical that the capital gains cut caused the increase in venture capital, pointing to data that show that most of the increase in financing for venture capital firms came from investors (such as pension funds, corporations, and foreign investors) who were not affected directly by the cut in the capital gains tax for individuals.[2]

The proposals to allow expanded use of IRAs and to create FIRAs would substantially increase the amount of saving done in the form of tax-advantaged accounts. Whether they would increase total personal saving significantly is, however, unclear. The proposals might not increase saving much, in part because of limits on contributions to tax-advantaged accounts. People who have already accumulated more wealth than the limits on annual contributions can receive the full tax benefit, at least for a time, by trans-

1. Congressional Budget Office, "Effects of Lower Capital Gains Taxes on Economic Growth," CBO Paper (August 1990).

2. See Department of the Treasury, *Report to Congress on the Capital Gains Tax Reductions of 1978* (September 1985); and James Poterba, "Capital Gains Tax Policy Toward Entrepreneurship," *National Tax Journal* (September 1989).

ferring these accumulations to IRAs and FIRAs. Similarly, people who are currently saving more than the contribution limits can receive the full tax benefit by depositing these savings in IRAs and FIRAs.

Evidence of the effect of IRAs on saving between 1982 and 1986 is mixed. Some studies have concluded that the IRAs were largely funded from transfers of existing assets, whereas others have concluded that a large portion of IRA contributions represented new saving.

Analysts who believe IRAs increase total saving, however, attribute much of the increase in saving to features of IRAs that would apply less to the ones proposed by the President than to current IRAs. Two of these features are the restriction of IRAs to saving for retirement and the penalty on early withdrawals. Because these limits make IRAs less like other forms of saving, people may have financed these accounts by reducing consumption instead of other saving. The proposals in the budget broaden the purposes for which the accounts can be used and permit earlier penalty-free withdrawals. Those make the accounts more like other forms of saving and increase the likelihood that more of the contributions to IRAs and FIRAs will represent transfers from other saving instead of reduced consumption.

FIRAs and expanded IRAs are more likely to increase private saving over an extended time period than during the next few years. Most people do not have sufficient accumulations of wealth or sufficient rates of ongoing saving to allow them to contribute the maximum amount to IRAs and FIRAs for more than a few years. Eventually, the expanded IRAs and FIRAs will increase the after-tax return many people receive on their last dollar of net increase in saving. If saving responds positively to higher after-tax returns, people will accumulate more wealth over their lifetime and leave more to future generations. Most empirical studies have found little or no response of saving to rates of return, but some analysts question the validity of these studies, especially in the context of permanent incentives to save.

The combined effect of the capital gains tax cut and the expansion in the availability of IRAs on national saving depends on how the revenue losses they produce are financed. CBO and the JCT estimate that the capital gains tax cut will reduce revenues after the first two years. In addition, as noted above, the long-run revenue loss from the IRA and FIRA proposals will be much larger than the loss reported for the 1992-1997 period. If these future revenue losses are not offset by spending cuts or higher taxes, the resulting increase in the federal deficit will dampen any increase in national saving that a higher private saving rate produces. If the private saving response is small, the net effect may be to reduce national saving in the long run.

Assistance to Families

Another stated goal of the budget is to ease the financial burden on families. The primary proposal in the budget to promote this goal is the $500 increase in the dependent exemption for children. The Administration has also argued that the expansion of IRAs and the introduction of FIRAs will help families prepare for the future.

The exemption for dependents reduces the tax burden on families with children by a small amount. CBO estimates that the average annual tax reduction for all families with children from the larger exemption is $114 or about 1.0 percent of total tax liability and 0.3 percent of after-tax income. Families with children in the lowest income quintile receive a much smaller average reduction--about $10 per family--because many of them do not pay income tax now and therefore do not benefit from an increased exemption. Families with children in the second, third, and fourth quintiles of the income distribution receive the largest proportionate increase in after-tax income from the tax cut ($117 per family, $133 per family, and $165 per family, respectively--or 0.5 percent, 0.4 percent, and 0.3 percent of after-tax income).

Expanding the availability of IRAs and introducing FIRAs reduce the tax liability of families who save through such accounts and benefit those families even if the incentives do not induce them to increase total saving. Experience with universal IRAs between 1982 and 1986 indicates, however, that most families did not contribute to IRAs, and those that did had higher-than-average incomes. In 1985, the peak year of IRA use, only 18 percent of taxpayers with earnings contributed to IRAs. The participation rate was much greater for the 8 percent of taxpayers with earnings who reported an adjusted gross income (AGI) of $50,000 or more. Among tax returns reporting earnings, 63 percent with AGI of more than $50,000 contributed to IRAs, compared with only 14 percent with AGI of less than $50,000.

An Examination of the Tax Proposals

Most of the President's proposals for revenues fall under the pay-as-you-go limits of the Budget Enforcement Act of 1990. Under these limits, the net effect of changes in tax revenues and entitlement spending must not increase the budget deficit. Two proposals not subject to pay-as-you-go limits are discussed at the end of the chapter.

To ease discussion here, the nearly 40 proposals are grouped into six categories: incentives for saving and investment, targeted tax incentives, personal income tax cuts, excise taxes, revenue-raising proposals, and other proposals.

Incentives for Saving and Investment

The Administration is proposing a number of incentives to encourage saving and investment. These incentives include the introduction of a temporary investment tax allowance for machinery and equipment, a proposal to liberalize slightly and to simplify depreciation rules under the corporate alternative minimum tax, and a proposal to exclude from income 45 percent of capital gains realizations on qualified assets for individual taxpayers.

For individual savers, the Administration is also proposing to introduce a new general purpose saving incentive, the Flexible Individual Retirement Account, and to broaden the purposes for which existing IRAs can be used. Major components of both proposals were included in the Administration's previous two budgets. The Administration is also proposing a variety of modifications in the tax law to simplify the taxation of employer-funded pensions.

Adopt Temporary Investment Tax Allowance. The Administration proposes to allow an up-front deduction of 15 percent of the purchase price of equipment acquired between February 1, 1992, and January 1, 1993, if the equipment is placed in service before July 1, 1993. The investment tax allowance (ITA) would be taken in the year the equipment is placed in service. Taxpayers would be allowed to claim depreciation deductions on the remaining 85 percent of the purchase price as under present law. The ITA would not be a preference under the alternative minimum tax.

The allowance, which is like a loan from the government, would affect the cost of capital in much the same way as a small (about 1 percent) investment tax credit. Because the ITA is temporary, taxpayers with sufficient taxable income would have an incentive to accelerate planned investments to take advantage of the allowance. Thus, the ITA would provide a small temporary stimulus to the economy in 1992, but at the expense of investment in later years. In addition, because the ITA is temporary, it would favor assets that can be purchased quickly, such as cars and computers, over major investments that require a longer lead time.

The JCT estimates that revenue loss from the ITA will total $7.7 billion in the first two years; this initial loss will be partially offset by revenue gains in 1994 through 1997 (see Table 3-4). The offset occurs because the extra deductions that firms claim in 1992 would come at the expense of reduced deductions in later years. Over the budget period, the revenue loss is estimated at $1.7 billion.

Simplify Alternative Minimum Tax Depreciation. The Administration proposes to remove the special depreciation adjustment used to compute adjusted current earnings (ACE) under the corporate alternative minimum tax. Under present law, corporations subject to the alternative minimum tax must compute depreciation in three different ways for certain depreciable assets. The proposal would allow corporations to use the same method to compute ACE as they use to compute alternative minimum taxable income. It would reduce the cost of capital for certain corporations slightly and would simplify their tax calculation. The JCT estimates that the proposal would lose $1.4 billion over the budget period (see Table 3-4).

Exclude 45 Percent of Long-Term Capital Gains. For the fourth time, the Administration has proposed tax relief for capital gains. The proposal would allow individuals to exclude from their income a portion of the capital gain realized on qualified assets. The percentage excluded would increase with the holding period: 15 percent for assets held one to two years, 30 percent for assets held two to three years, and 45 percent for assets held three years or more. The included portion of the capital gain would be taxed as under current law. Because tax rates on capital gains are capped at 28 percent under current law, the exclusion would imply tax rates for maximum capital gains on assets held more than three years of 15.4 percent for taxpayers in the 28 percent and 31 percent tax brackets, and 8.3 percent for taxpayers in the 15 percent bracket.

The exclusion would apply to all capital assets except collectibles, such as art, antiques, and precious metals. Depreciation deductions would be recaptured as ordinary income, which means that only the increase in sales price over the original cost of an asset would be treated as a capital gain.

Under the Administration's proposal, the excluded portion of capital gains would be considered a tax preference under the alternative minimum tax (AMT). Because the maximum capital gains tax rate would be substantially below the AMT tax rate of 24 percent, the addition of this large preference item would more than double the number of individuals subject to the minimum tax. Thus, the effective marginal tax rate on capital gains for many taxpayers would be 24 percent. Taxpayers who would be subject to the AMT at current-law levels of realizations account for about 60 percent of realized gains. In addition, some taxpayers who increase their realizations would also be affected by the AMT. The result is that the AMT would substantially diminish the effects on incentives of the capital gains tax reduction and would require a more complicated tax calculation for many taxpayers.

The capital gains exclusion would apply to capital gains realized after February 1, 1992. The requirements for two- and three-year holding periods would be phased in over three years. During the balance of 1992, all qualifying assets held for at least one year would be eligible for the 45 percent exclusion. In 1993, assets held for at least two years would be eligible for the 45 percent exclusion; assets held for at least one year would receive a 30 percent exclusion. The full sliding scale described above would take effect in 1994. The phase-in of the requirement for an extended holding period, by allowing the full 45 percent exclusion for assets held less than three years in 1992 and 1993, would avoid discouraging sales of such assets during the

Table 3-4.
CBO/JCT and Administration Estimates of Incentives for Saving and Investment
(By fiscal year, in billions of dollars)

Proposal	1992	1993	1994	1995	1996	1997
Business Investment and Capital Gains						
Adopt Temporary Investment Tax Allowance						
CBO/JCT	-6.1	-1.6	3.6	1.0	0.8	0.6
Administration	-6.1	-1.6	3.5	0.9	0.8	0.6
Simplify Alternative Minimum Tax Depreciation						
CBO/JCT	-0.2	-0.3	-0.3	-0.3	-0.2	-0.1
Administration	-0.2	-0.4	-0.4	-0.3	-0.2	-0.1
Exclude 45 Percent of Long-Term Capital Gains						
CBO/JCT	0.8	3.7	-3.4	-5.7	-5.6	-5.2
Administration	0.6	3.8	2.1	0.3	0.3	-0.2
Subtotal						
CBO/JCT	-5.5	1.8	-0.1	-5.0	-5.0	-4.7
Administration	-5.7	1.8	5.3	1.0	0.9	0.3
Individual Retirement Accounts (IRAs) and Pensions						
Establish Flexible IRAs						
CBO/JCT	0	2.0	0.8	0.5	-0.8	-1.9
Administration	0.1	0.5	0.1	-0.4	-1.0	-2.1
Broaden Uses of Existing IRAs						
CBO/JCT	-0.2	-0.3	-0.3	-0.2	-0.2	-0.2
Administration	a	-0.2	-0.2	-0.2	-0.3	-0.2
Promote Retirement Saving and Simplify Taxation of Pension Distributions						
CBO/JCT	0.5	0.5	-0.9	-0.5	-0.2	0.2
Administration	0.1	a	a	0.3	0.4	0.4
Reform Underfunding of Pensions						
CBO/JCT	b	b	b	b	b	b
Administration	c	c	-0.3	-0.4	-0.6	-0.8
Subtotal						
CBO/JCT	0.3	2.2	-0.7	-0.6	-1.8	-2.7
Administration	0.2	0.3	-0.5	-0.8	-1.5	-2.7
Total						
Incentives for Saving and Investment						
CBO/JCT	-5.2	4.0	-0.8	-5.6	-6.8	-7.4
Administration	-5.5	2.2	4.8	0.2	-0.5	-2.4

SOURCES: Joint Committee on Taxation; Office of Management and Budget.

a. Less than $50 million.

b. CBO has included the Administration's estimate.

c. Not yet in effect.

first two years of the budget period and thus would boost short-run receipts.

The JCT estimates that the proposal would raise $4.5 billion in revenues in 1992 and 1993, because taxpayers would respond with a burst of asset sales in 1992, but thereafter would reduce revenues by $3 billion to $6 billion a year (see Table 3-4). The Administration estimates that the proposal would raise $4.4 billion in 1992 and 1993 and thereafter increase revenues by decreasing amounts ending in a small loss in 1997. The results primarily differ because JCT assumes that taxpayers are less responsive after the first year to the changed capital gains tax rate than the Administration assumes.

Establish FIRAs. The President proposes establishing FIRAs to provide a general purpose savings incentive. FIRAs are identical to the Family Savings Accounts the President proposed in the 1991 and 1992 budgets. In addition, this year's proposal would allow people to transfer funds without penalty from existing IRAs to FIRAs until the end of 1992.

Under the proposal, taxpayers would be allowed to make nondeductible contributions of up to $2,500 annually to FIRAs. The investment income in FIRAs would accumulate tax-free. Withdrawals of investment income attributable to contributions left on deposit for at least seven years would also be tax-free. Withdrawals of investment income attributable to contributions left on deposit between three and seven years would be included in income for tax purposes, but would not be subject to a penalty. Withdrawals of investment income attributable to contributions left on deposit for less than three years would be taxable and also subject to a 10 percent penalty. For all FIRAs, withdrawals of contributions would be tax-free because they were not deductible at the time deposited. The proposal would be effective starting in 1992.

Eligibility to contribute to FIRAs would be limited to people with adjusted gross income below certain levels--$60,000 for single taxpayers, $100,000 for heads of households, and $120,000 for couples filing joint returns. As with an IRA, contributions to a FIRA could not exceed a person's earnings or the $2,500 contribution limit. Each member of a couple filing jointly, however, could contribute up to $2,500, provided the total contribution did not exceed the couple's combined earnings. For example, a couple in which one spouse worked outside the home earning $30,000 could contribute up to $2,500 to accounts for each spouse for a total of up to $5,000. Dependents would be ineligible.

New in this year's proposal is the provision for penalty-free transfers of funds from IRAs to FIRAs. From February 1 through December 31, 1992, individuals could withdraw funds from IRAs without paying the normal 10 percent penalty tax as long as the amounts were redeposited in FIRAs. The withdrawals would be fully subject to income taxes, as are other IRA withdrawals, but the income tax owed on amounts transferred would be spread over four years. IRA balances attributable to rollovers from qualified retirement plans would be ineligible for transfer to a FIRA.

The six-year revenue estimate for FIRAs includes two offsetting effects--one temporary and one permanent--and greatly understates the long-run cost of the proposal. Transfers from existing IRAs to FIRAs raise revenue through 1995 because the amounts transferred are included in income for tax purposes. The revenue gain from transfers from IRAs is a constant amount for four years and falls to zero afterward. The buildup of assets from contributions to FIRAs reduces revenue because investment earnings in FIRAs are untaxed. The revenue loss from the buildup of assets is small initially, but increases rapidly because the stock of assets yielding tax-free income grows much faster than contributions. Combining both effects, the net revenue effect is positive in the first year, but declines rapidly and eventually turns negative.

The Administration shows revenues turning negative in 1995 and estimates a cumulative revenue loss of $2.8 billion over the 1992-1997 period (see Table 3-4). The JCT shows revenues turning negative in 1996 and a cumulative revenue gain of $0.6 billion over the five-year period because it assumes a larger volume of transfers from IRAs than does the Administration. The higher revenues the JCT estimates thus result entirely from a larger shift of tax payments from the future to the 1992-1997 period.

In 1997, when the revenue gains from the transfers are exhausted, both the JCT and the Administration show the revenue losses from FIRAs increasing rapidly. These losses would continue to increase until people are able to reach their desired level of FIRA balances. How much of the assets paying taxable interest and dividends would ultimately be shifted is uncertain. If people ultimately shift 10 percent of their taxable financial assets to FIRAs, the annual revenue loss in 1992 dollars would stabilize at about $7 billion. If people ultimately shift 25 percent, the annual loss would stabilize at about $17 billion.

Broaden Uses of Existing IRAs. The President proposes to permit penalty-free withdrawals from IRAs for medical and educational expenses and for a down payment on a first home purchase. Withdrawals for these purposes could be made from IRAs as of February 1, 1992.

Penalty-free distributions would be allowed for medical expenses in excess of 7.5 percent of AGI. Penalty-free distributions for educational expenses would be allowed up to the amount of expenditures for higher education and postsecondary vocational expenses. Finally, penalty-free withdrawals of up to $10,000 would be allowed for the purchase of a home by taxpayers who have not owned a home in the last three years.

The JCT estimates that permitting penalty-free withdrawals for education and medical expenses and first-time home purchases would reduce revenues by $1.3 billion between 1992 and 1997 (see Table 3-4).

In the 1991 and 1992 budgets, the President proposed to permit penalty-free withdrawals for the purchase of a first home. Unlike the current proposal, which is available for any first home, the previous proposals would have waived the penalty only for homes that cost less than 110 percent of the median home price in an area.

Promote Retirement Saving and Simplify Taxation of Pension Distributions. The President proposes seven modifications to the current tax treatment of pension plans. The proposals largely reduce the administrative burden of providing pensions, particularly for small employers, with the objective of encouraging more employers to offer pensions to their employees. The proposals have not appeared in previous budgets, but they are similar to provisions for pension simplification advanced by the Administration and Members of Congress in 1991.

The JCT estimates that these proposals will be essentially revenue neutral as a package (see Table 3-4). By easing the requirements for employers to offer pension plans, the proposals should modestly increase their use, particularly among small employers. Only a small increase in personal saving should be expected given the uncertainty about how many firms will initiate pensions and the uncertain effect of pension coverage on personal saving. An additional benefit will be the reduced burden of pension administration.

Reduce Underfunding of Pensions. The Administration proposes to increase the rate at which employers must reduce underfunding of their pension plans. The purpose of the proposal is to reduce the risk that underfunded plans will ultimately be terminated and become the liability of the Pension Benefit Guaranty Corporation (PBGC). The PBGC insures payment to the beneficiaries of most benefits under defined benefit plans, and the proposal for increasing funding is included with other proposals to limit future liabilities of the PBGC (see Chapter 1).

Under the funding proposal, employers with underfunded pension plans will be required to increase contributions to their plans starting in 1994. (The proposal does not apply to multiemployer plans.) The Administration assumes that businesses will pay these higher contributions by reducing taxable wages for employees, which in turn will reduce income and payroll tax revenues. The budget supplement shows these revenue losses starting at $0.3 billion in 1994 and reaching $0.8 billion in 1997 (see Table 3-4). CBO has adopted the Administration's estimate for this analysis.

Although more rapid funding of pension plans would reduce revenues in the immediate future, the reduction is merely a speedup of revenue losses that are likely to result from the eventual funding of already promised pension benefits. Furthermore, the faster funding should reduce future outlays by the PBGC by reducing the amount of unfunded benefits assumed by the PBGC in future pension plan terminations.

Targeted Tax Incentives

The Administration is also proposing a wide array of tax provisions that affect more narrowly defined economic sectors, groups of taxpayers, and activities. These include extensions of tax incentives that are scheduled to expire in 1992 and new tax incentives, some of which have appeared in previous budgets and others that the Administration is proposing for the first time this year. This section describes the proposed extensions first and then discusses the new provisions.

Extend Low-Income Housing Credit. The Administration proposes to extend the credit for certain expenditures made by owners of low-income housing projects. The credit was introduced in 1986 and has been extended three times. The credit applies to the depreciable costs incurred to provide low-income housing units, subject to limits on rent levels and the income of tenants. Designated state housing agencies allocate credit authority subject to per capita limits. The credit is paid out over 10 years and may have a present value of up to 70 percent of construction and renovation costs of qualified housing that does not receive other federal subsidies. A reduced credit (30 percent of present value) is available for subsidized housing and for the purchase cost of existing housing that is rehabilitated.

The proposal would extend the credit, which is currently set to expire on June 30, 1992, for 18 months through December 31, 1993. The revenue loss from this extension, however, extends beyond the budget period because the credit is claimed over 10 years. The JCT estimates the revenue loss at $0.1 billion in 1993, growing to $0.4 billion per year by 1997 (see Table 3-5).

The revenue loss from an 18-month extension understates the long-term revenue cost of a permanent low-income housing credit. If the credit were fully used and in place for long enough that 10 years' worth of credits were being paid each year, the cost could exceed $3 billion per year.

Extend Mortgage Revenue Bonds. The Administration proposes to extend tax-exempt mortgage revenue bonds (MRBs) for 18 months through December 31, 1993. MRBs have been in use since the mid-1970s. The Mortgage Revenue Bond Act of 1980 was the first piece of legislation to set any limits on their use and to subject them to an expiration date. Since then, the bonds have been extended six times, with modifications. This year is the first time that the Bush Administration has proposed extending them.

State and local governments use the proceeds of MRBs to provide below-market financing for single-family homes. The loans are targeted to first-time homebuyers with family income of less than 115 percent of the median family income for the area in which the residence is located. The purchase price of the home may not exceed 90 percent of the average purchase price of residences in that area. MRBs are subject to limits on the vol-

Table 3-5.
CBO/JCT and Administration Estimates of Targeted Tax Incentives
(By fiscal year, in billions of dollars)

Proposal	1992	1993	1994	1995	1996	1997
			Extensions			
Extend the Low-Income Housing Credit						
CBO/JCT	a	-0.1	-0.2	-0.3	-0.3	-0.4
Administration	a	-0.2	-0.3	-0.4	-0.4	-0.4
Extend Mortgage Revenue Bonds						
CBO/JCT	a	-0.1	-0.1	-0.1	-0.1	-0.1
Administration	a	a	-0.1	-0.1	-0.1	-0.1
Extend Permanently the Research and Experimentation Credit						
CBO/JCT	-0.2	-0.8	-1.4	-1.6	-1.8	-2.1
Administration	-0.2	-0.8	-1.4	-1.6	-1.8	-2.1
Extend the Research and Experimentation Allocation Rules						
CBO/JCT	-0.1	-0.6	-0.2	0	0	0
Administration	-0.2	-0.5	-0.3	0	0	0
Extend Permanently the Orphan Drug Credit						
CBO/JCT	a	a	a	a	a	a
Administration	a	a	a	a	a	a
Extend the Targeted Jobs Credit						
CBO/JCT	a	-0.1	-0.2	-0.1	a	a
Administration	-0.1	-0.2	-0.2	-0.1	a	a
Extend Business Energy Credits						
CBO/JCT	a	a	a	a	a	a
Administration	a	a	a	a	a	a
Extend Farmer Bonds						
CBO/JCT	a	a	a	a	a	a
Administration	a	a	a	a	a	a
Extend the Health Insurance Deduction for the Self-Employed						
CBO/JCT	-0.1	-0.2	-0.3	0	0	0
Administration	-0.1	-0.2	-0.3	0	0	0
Subtotal						
CBO/JCT	-0.5	-1.9	-2.4	-2.1	-2.2	-2.6
Administration	-0.5	-1.9	-2.5	-2.2	-2.4	-2.6

(Continued)

SOURCES: Joint Committee on Taxation; Office of Management and Budget.

a. Less than $50 million.

Table 3-5.
Continued

Proposal	1992	1993	1994	1995	1996	1997
	New Provisions					
Provide Passive Loss Relief for Real Estate						
CBO/JCT	-0.1	-0.4	-0.4	-0.4	-0.5	-0.5
Administration	-0.1	-0.4	-0.4	-0.4	-0.5	-0.6
Facilitate Real Estate Investments by Tax-Exempt Pension Funds and Educational Institutions						
CBO/JCT	a	a	a	a	a	a
Administration	a	a	a	a	a	a
Enact Tax Credit for First-Time Homebuyers						
CBO/JCT	-0.3	-2.7	-2.5	-0.5	-0.1	a
Administration	-0.2	-2.1	-2.5	-0.6	0.2	0.1
Allow Deduction for Loss on the Sale of a Principal Residence						
CBO/JCT	a	-0.4	-0.4	-0.4	-0.4	-0.4
Administration	a	-0.4	-0.4	-0.4	-0.4	-0.3
Establish Enterprise Zones						
CBO/JCT	0	-0.1	-0.4	-0.8	-1.0	-1.0
Administration	0	-0.1	-0.2	-0.3	-0.5	-0.8
Permit Deduction of Interest on Student Loans						
CBO/JCT	-0.1	-0.3	-0.4	-0.4	-0.4	-0.4
Administration	-0.1	-0.4	-0.7	-0.7	-0.8	-0.9
Restore and Double the Adoption Deduction						
CBO/JCT	a	a	a	a	a	a
Administration	a	a	a	a	a	a
Expand the Public Transit Exclusion to $60 per Month						
CBO/JCT	a	a	a	-0.1	-0.1	-0.1
Administration	a	a	a	a	a	a
Revise Rules for Charitable Contributions						
CBO/JCT	a	a	-0.2	-0.2	-0.2	-0.2
Administration	a	0.1	0.1	0.1	0.1	0.2
Subtotal						
CBO/JCT	-0.5	-3.9	-4.3	-2.8	-2.7	-2.6
Administration	-0.5	-3.3	-4.0	-2.4	-1.9	-2.3
	Total					
Targeted Incentives						
CBO/JCT	-1.0	-5.9	-6.7	-4.9	-5.0	-5.2
Administration	-1.0	-5.2	-6.5	-4.5	-4.3	-4.9

ume of tax-exempt bonds issued for private purposes. (Instead of issuing MRBs, state and local governments may issue mortgage credit certificates to qualifying homebuyers. These certificates provide the purchaser with a tax credit equal to a portion of the home mortgage interest payments.)

The JCT estimates that the revenue loss from extending MRBs will amount to $0.5 billion in 1992 through 1997 (see Table 3-5).

Extend Permanently the Research and Experimentation Credit. The Administration proposes to make the income tax credit for research and experimentation (R&E) expenses permanent; the credit is currently scheduled to expire for expenses paid after June 30, 1992. The credit allows a business to reduce its tax liability by 20 percent of the amount by which its current R&E expenses exceed a base amount derived from its recent level of sales and the historical relationship between its R&E expenses and level of sales. Qualifying R&E expenses include the wages of employees engaged in research and the costs of supplies used in research, as well as a portion of contract research costs and certain computer costs. The R&E credit first appeared as a temporary four-year credit in the Economic Recovery Tax Act of 1981, but it has been extended and modified five times since then. The JCT estimates that making the R&E credit permanent would reduce revenues by $0.8 billion in 1993 and by $7.8 billion in 1992 through 1997 (see Table 3-5).

Extend the Research and Experimentation Allocation Rules. The Administration proposes to extend until December 31, 1993, the statutory rules that U.S. multinational corporations use to allocate R&E expenses between domestic and foreign operations. The current statutory rules were enacted as part of the Technical and Miscellaneous Revenue Act of 1988 and have been extended three times since then. The statutory rules superseded the Treasury regulations issued in 1977. Compared with the regulations, the statutory rules generally allow U.S. multinational corporations to allocate more R&E expenses to domestic operations and fewer to foreign operations, making domestic-source income lower and foreign-source income higher. As a result, U.S. multinational corporations with excess foreign tax credits can use their excess credits to reduce the U.S. income tax they pay on their worldwide income. The JCT estimates that extending the statutory rules for allocating R&E expenses would reduce revenues by $0.6 billion in 1993 and by $0.9 billion in 1992 through 1997 (see Table 3-5).

Extend Permanently the Orphan Drug Credit. The Administration proposes to make the orphan drug credit, which is scheduled to expire on June 30, 1992, permanent. The provision was originally enacted in 1983 and has since been extended three times.

Drugs for treating rare diseases or conditions are commonly known as "orphan drugs" because the narrow demand for them discourages the costly investment in clinical testing that is necessary before the Food and Drug Administration can approve their manufacture and distribution. To encourage development of the drugs, current law allows taxpayers to claim a nonrefundable tax credit of 50 percent of the costs of clinical testing. The credit covers the testing of drugs for such rare conditions as Huntington's disease, myoclanus, Lou Gehrig's disease, Tourette's syndrome, and Duchenne's dystrophy. The amount the taxpayer claims as a credit is not a deductible business expense.

The Administration proposes to make the credit permanent on the grounds that clinical testing is long term and taxpayers should be able to plan their activities knowing that the credit will be available. The Administration has not previously proposed making the credit permanent. The JCT estimates that the proposal will cost less than $50 million through 1997 (see Table 3-5).

Extend Targeted Jobs Credit. The President proposes to extend the targeted jobs tax credit--scheduled to expire on June 30, 1992--to December 31, 1993. The Administration is proposing to extend the credit for the second consecutive year. It was first enacted in the Revenue Act of 1978 and has since been extended eight times, with modifications.

The credit is available to employers for hiring economically disadvantaged individuals from nine groups. Economically disadvantaged youth are the largest group; others include recipients of Supplemental Security Income, summer youth employees, Vietnam veterans, and former convicts.

The credit is equal to 40 percent of the first $6,000 of qualified first-year wages (the maximum credit is $2,400 per individual). The qualifying wages are limited to the first $3,000 for economically disadvantaged summer youth workers, yielding a maximum credit of $1,200. The credit is not available for wages paid beyond the first year of employment.

In order for employers to claim the credit, the economically disadvantaged individual must be employed for at least 90 days (14 days in the case of summer youth employees) or complete at least 120 hours of work (20 in the case of summer youth employees). The employer's deduction for wages must be reduced by the amount of the credit claimed.

The JCT estimates that extending the credit for 18 months would reduce revenues by $0.5 billion in 1992 through 1997 (see Table 3-5).

Extend Business Energy Credits. The Administration proposes to extend business energy tax credits for solar and geothermal properties for 18 months, from June 30, 1992, to December 31, 1993. The Energy Tax Act of 1978 created the credits, and they have since been extended six times. This year's budget marks the second time the Administration has proposed extending them. The 10 percent credits are available for investments in equipment that uses solar or geothermal energy for heating, cooling, or electricity generation.

The JCT estimates that extending the credits for 18 months would reduce revenues by less than $100 million during the 1992-1997 period (see Table 3-5).

Extend Farmer Bonds. The Administration proposes to extend to December 31, 1993, the use of tax-exempt, small-issue industrial development bonds to make loans to first-time farmers. The Administration did not propose extending small issue bonds for any purpose in previous years.

At present, small-issue bonds may be used to provide loans at below-market interest rates to construct manufacturing facilities or to permit first-time farmers to acquire land and equipment. (First-time farmers account for a relatively small share of these bonds.) The bonds are subject to the overall state-by-state limits on the volume of tax-exempt bonds for all private activities. The proceeds of bonds for manufacturing facilities are limited to individuals or entities with relatively small capital investments. The proceeds of bonds loaned to first-time farmers may not exceed $250,000 per farmer. Under current law, small-issue bonds for all purposes are scheduled to expire on June 30, 1992. The Administration would extend the use of the bonds for first-time farmers, but would permit the use of the bonds for manufacturing facilities to expire as scheduled.

The JCT estimates that extending the use of tax-exempt bonds for first-time farmers will reduce revenues by less than $50 million in 1992 through 1997 (see Table 3-5).

Extend Partial Deduction for Health Insurance Premiums for the Self-Employed. The Administration proposes to extend through December 31, 1993, the provision that allows self-employed people a deduction equal to 25 percent of the cost of providing health insurance for themselves and their families. The Congress first enacted the provision as part of the Tax Reform Act of 1986. It has been extended three times--most recently by the Tax Extension Act of 1991--and is now scheduled to expire after June 30, 1992. The Administration proposed making the deduction permanent in its budget for fiscal year 1991, but proposed only a one-year extension in last year's budget. (The Administration's comprehensive health reform proposal would increase the deductible amount to 100 percent of premiums and make it permanent.)

The provision reduces the disparity between the treatment of the self-employed and employees whose employers provide group health insurance. Employers can deduct the cost of providing health insurance to their employees, but the employees do not owe taxes on the value of the insurance. Self-employed people, however, cannot deduct the cost of their own insurance as a business expense. The JCT estimates that the extension would reduce revenues by a total of about $0.6 billion in 1992 through 1997 (see Table 3-5).

Provide Passive Loss Relief for Real Estate. The Administration proposes to allow taxpayers who actively participate in the rental of property they develop to deduct losses on such rentals against other income as well as against income from other development activities. That provision would be an exception to the passive loss rules enacted in 1986 that generally disallow the deduction of rental losses against other income. The proposal would lower the cost of capital slightly for real estate developers, but would have a negligible effect on real estate prices because it would not affect most new investors in real estate. There is a risk that passive loss exceptions could lead to new tax shelters, as had proliferated before the 1986 Tax Reform Act was passed, especially if tax rates on capital gains are reduced as proposed. However, because the proposal applies only to active developers (not to limited partners in real estate developments), the scope for increased tax shelter activity is limited. The JCT estimates the annual revenue loss at $0.4 billion in 1993, increasing slightly over time (see Table 3-5).

Facilitate Real Estate Investments by Tax-Exempt Pension Funds and Educational Institutions. The President proposes to expand slightly the types of debt-financed real estate investments in which pension funds and educational institutions can invest without being subject to the unrelated business income tax. The proposal is intended to remove limits on the real estate investments of these major sources of investment capital at a time when much real estate is in need of buyers.

Investors in pension and education funds expect that these proposals will have only a minor impact on the amount they invest in real estate. The JCT estimates that the revenue losses will be less than $50 million per year (see Table 3-5).

Enact Tax Credit for First-Time Homebuyers. The Administration has proposed a temporary tax credit for first-time homebuyers. The credit would equal 10 percent of the purchase price of the house, up to a maximum of $5,000. To qualify, the home would have to be purchased between February 1 and December 31, 1992. Only half of the credit could be claimed against 1992 taxes; the other half could be claimed against 1993 taxes. The credit would not be refundable, but amounts in excess of current liability could be used to reduce income taxes during the next five years.

The proposal defines first-time homebuyers as people who have not owned a home for three years. All buyers of a home would have to be first-time buyers, and only one credit could be claimed per home purchased.

The JCT estimates that the credit would reduce revenues by $6.1 billion in the 1992-1997 period (see Table 3-5). The estimate implies that slightly more than 1 million taxpayers would claim the credit.

The intent of the credit is to stimulate the economy by accelerating home purchases into 1992. Increased demand for both existing and new homes would exert some upward pressure on housing prices, thereby stimulating some new construction. Another objective is to assist people in buying their first home. The fraction of young people owning their own home declined in the 1980s. Factors that may have contributed to this decline were lower real earnings of young workers, high real mortgage interest rates, and a decline in the value of tax benefits of ownership compared with renting.

Both the amount of purchases of new homes and the effect of the credit in stimulating additional purchases in 1992 are uncertain. The revenue estimates are consistent with an assumption that home purchases by first-time buyers in 1992 will be of roughly the same magnitude as in 1988 and 1989. That level of home purchases may be achieved, however, without the credit because of low mortgage rates. If the credit causes home purchases by first-time buyers to increase significantly above the projected amount, it will stimulate the economy in 1992, but the revenue loss could be greater than expected. Even if the credit increases home purchases, most if not all of that increase is likely to be offset by reduced purchases in 1993 and later years.

The one historical precedent for the credit is the new home credit in the Tax Reduction Act of 1975. As part of an antirecessionary package, the Congress enacted a temporary credit of 5 percent of the purchase price, up to a maximum of $2,000, for new homes purchased between March 12, 1975, and January 1, 1976, and for which construction began before March 26, 1975. Its purpose was to reduce the existing inventory of unsold new homes. The credit reduced tax liability by $716 million for the 535,000 taxpayers who used the credit. A CBO analysis of the credit found little or no effect on the inventory of unsold new houses, new home sales, housing starts, or employment in the construction industry the first six months it was available.[3]

Allow Deduction for Loss on the Sale of a Principal Residence. The Administration proposes to allow people who sell their homes at a loss to claim an itemized deduction as a casualty loss. Under current law, casualty losses are deductible to the extent each loss exceeds $100 and the sum of all losses exceeds 10 percent of AGI. For example, a taxpayer with an AGI of $50,000 who sells his or her home for a loss of $10,000 would have a deductible loss of $4,900 under the proposal. The deduction would be larger if other losses were claimed in the same year.

The proposal would also allow the portion of the loss not deducted to be added to the basis of the next home purchased, if one were purchased within the next two years. In the above example, the taxpayer could add $5,100 to the basis of a home purchased within two years.

The proposal would apply to principal residences sold on or after February 1, 1992. For principal residences sold at a loss on or after January 1, 1991, the proposal would allow taxpayers to apply the entire loss to the basis of homes purchased within two years of the date of sale.

In support of the proposal, the Administration notes that, under current law, capital gains on sales of a principal residence are added to income for tax purposes, but losses are not deductible. Taxing gains while disallowing deduction of losses would, by itself, create a bias against housing. In practice, however, most capital gains on home sales are not taxed. Gains on the sale of a home can be deferred if another home of equal or greater value is purchased within two years. In addition, there is a one-time exclusion of $125,000 of gains for people over age 55, and all gains held until death permanently escape the income tax. Current law also favors investment in housing over business assets by allowing the deduction of mortgage interest and property taxes, even though the home does not generate taxable income.

The proposal would provide some relief for people forced to sell homes for a loss. Because of inflation and real increases in home prices for many years, however, few taxpayers who sell homes would report a loss. As a result, both the revenue loss of the proposal and any potential distortion of the allocation of investment is limited. The JCT estimates a

3. Congressional Budget Office, "An Analysis of the Impact of the $2,000 Home Purchase Tax Credit" (November 20, 1975).

revenue loss of $0.4 billion in 1993 and $2.1 billion in 1992 through 1997 (see Table 3-5).

Establish Enterprise Zones. In order to encourage investment in economically distressed urban and rural areas, the Administration proposes to designate up to 50 enterprise zones over a four-year period and to provide the following tax incentives: elimination of the capital gains tax for tangible property located within enterprise zones and used in enterprise zone businesses for at least two years; expensing of equity investments in enterprise zone corporations with assets of less than $5 million; and a refundable 5 percent wage credit on the first $10,500 earned by low-income employees of businesses in enterprise zones (up to $525 per worker, with the credit phasing out when the worker earns between $20,000 and $25,000 of total annual wages). Proposals for enterprise zones have appeared in each of the President's previous budgets.

Some states have established enterprise zones and have reported consequent gains in investment and employment. It is unclear, however, how much employment in the zones is new instead of relocated employment. Enterprise zones are much more likely to affect the location of investment than to contribute to net new investment or employment.

The JCT estimates that the revenue loss from tax incentives in enterprise zones will amount to $3.3 billion from 1992 through 1997 (see Table 3-5). The Administration's estimate for the same period is a revenue loss of $1.8 billion.

Permit Deduction of Interest on Student Loans. The Administration proposes to allow taxpayers who itemize to deduct from taxable income the interest incurred on loans for education above the high school level after July 1, 1992. Current law allows homeowners to deduct qualified mortgage interest, including interest on home equity loans, although taxpayers cannot deduct interest for that portion of home equity loans exceeding the lesser of $100,000 or their equity in their residences. Homeowners can use the proceeds of home equity loans, on which interest payments are deductible, to finance education expenses. The Administration's proposal would make deductible the financing of loans for education available to taxpayers who do not own their own home. For homeowners, the student loan would be included in a combined ceiling of $100,000 for student loans and home equity loans.

The JCT estimates that this provision would reduce income tax revenues by $0.3 billion in 1993 and about $2 billion over the 1992-1997 period (see Table 3-5). The Administration estimates a revenue loss that is almost twice as great, with larger differences in later years. The differences occur because the JCT assumes that interest costs fall mainly on students, who generally do not itemize deductions, whereas the Administration assumes that parents pay and could, therefore, deduct the interest.

Restore and Double the Adoption Deduction. The Administration proposes to restore the deduction for the costs incurred in adopting a child with special needs--for example, a physical or mental handicap--effective February 1, 1992. This proposal has been in the Administration's budget for the past three years. The Tax Reform Act of 1986 repealed the deduction, and it was replaced with a program that reimburses families for these costs (up to a limit). The proposal would permit the deduction from income of unreimbursed adoption costs up to a maximum of $3,000 per child, double the maximum under pre-1986 law. Deducted costs that were subsequently reimbursed would be counted as income in the year received. The JCT estimates that the proposal would reduce income tax revenues by less than $50 million over the 1992-1997 period (see Table 3-5).

Expand the Public Transit Exclusion to $60 per Month. The Administration proposes to increase the public transit exclusion from $21 per month to $60 per month. Under current law, employer reimbursements of up to $21 per month for employee expenses for commuting by public transportation are treated as a "de minimis" fringe benefit and, therefore, are excluded from taxable income. If the reimbursement exceeds $21 per month, the entire reimbursement is included in taxable income. This exclusion, created in 1984, was set at $15 per month and was raised by regulation to $21 per month effective July 1, 1991, to account for inflation since 1984. The proposal would exclude from taxable income reimbursements of up to $60 per month even if the total reimbursement exceeds the limit of $60 per month. The JCT estimates that expanding this exclusion would reduce revenues by $0.2 billion from 1992 through 1997 (see Table 3-5).

Revise Rules for Charitable Contributions. The Administration proposes three changes in rules regarding charitable contributions. First, it would make permanent and extend to all types of property the exclusion from alternative minimum taxable income (AMTI) of the fair market value of charitable contributions of appreciated property. The Tax Reform Act of 1986 eliminated the deductibility of the capital gain component of the value of property donated to charities in calculating AMTI. Subsequent legislation removed that limitation with respect to contributions of tangible personal property for tax year 1991 and for tax year 1992 if contributions are made before July 1, 1992. The proposed change would make that rule permanent and broaden it to include intangible personal property and real property. That change would be effective for contributions made in 1992 or later years.

Second, the Administration proposes that all charitable deductions made after December 31, 1991, be allocated to U.S.-source income. Currently, such deductions are allocated in proportion to U.S.- and foreign-source income.

Third, the Administration would require charitable organizations with annual gross receipts of $25,000 or more to report to the Internal Revenue Service, as well as to donors, annual contributions in excess of $500 from any individual. Organizations must now report only contributions that exceed $5,000 for individual donors. The change would apply to contributions made on or after July 1, 1992.

The JCT estimates that the first two changes would reduce revenues by about $1.2 billion over the 1992-1997 period, and the last change would raise revenues by about $0.4 billion over the same period, yielding a net revenue reduction of about $0.8 billion (see Table 3-5). In contrast, the Administration estimates that the three provisions would increase revenues by about $0.6 billion over the six-year period. The estimates differ because the Administration assumes the change in reporting requirements will yield a much greater increase in compliance than does the JCT.

Personal Income Tax Cuts

The only general cut in personal income taxes in the Administration's proposals is an increase in the personal exemption for dependent children.

Increase the Exemption for Dependent Children. The personal exemption for dependents age 18 and under would be increased by $500 under the Administration's proposal. The proposal is effective October 1, 1992, with the amount for the 1992 tax year prorated to $125. The full $500 amount applies for tax years 1993 and beyond and is indexed to changes in the consumer price index.

Under current law, personal exemptions are phased out for high-income taxpayers. Therefore, for these taxpayers, the benefit of the increase in the dependent exemption would be limited until 1996 when this phaseout provision expires.

The JCT estimates that the proposal would lose $3.4 billion in 1993 and would cost $23.8 billion over five years (see Table 3-6). The budget document suggests that 18-year-olds would not be eligible for the credit, but subsequent supporting materials indicate that they would be eligible. The JCT estimate assumes 18-year-olds would not be eligible.

Excise Taxes

The Administration is proposing to repeal the luxury tax on boats and airplanes and to pay for this by repealing the tax exemption for diesel fuel in recreational boating. The Administration is also proposing minor increases in certain excise taxes and fees, which are discussed in the following section on revenue-raising proposals.

Repeal the Luxury Tax on Boats and Airplanes and Finance It by Repealing the Diesel Fuel Exemption. The Administration proposes repealing the current luxury tax equal to 10 percent of the retail price over $100,000 for boats and $250,000 for airplanes, beginning February 1, 1992. (Exclusions apply to boats and airplanes that are used for business.) The JCT estimates that this proposal would reduce revenues by about $0.2 billion over the 1992-1997 period. To offset this revenue loss, the Administration proposes repealing the current tax exemption for diesel fuel used in boats for pleasure use, beginning July 1, 1992. The JCT estimates that repealing the diesel exemption would increase revenues by about $0.2 billion over the estimation period. Thus, the two proposals would be about revenue neutral (see Table 3-7).

Revenue-Raising Proposals

The Administration's budget includes some revenue-raising proposals. Those proposals would increase employee taxes and contributions to federal retirement; widen the scope of and extend certain excise taxes and fees; and broaden the income tax base for individuals and corporations. Altogether, the proposals discussed in this section increase revenue by $3.3 billion in 1993 and by $23.2 billion over the 1992-1997 period.

Extend Hospital Insurance to All State and Local Government Workers. Under current law, all workers of state and local governments hired after March 31, 1986, are required to pay Medicare's Hospital Insurance (HI) taxes. The Administration's proposal would extend HI coverage to all state and local government workers. The Administration has made the same proposal in its previous budgets.

The main rationale for the proposal is that the vast majority of currently exempt workers already qualify for Medicare benefits because either they have contributed to the system at other jobs or their spouses are covered through their own employment. Although more than 90 percent of state and local government workers receive Medicare benefits in retirement, one-fourth of those who receive benefits have not paid Medicare taxes while working in government jobs. Therefore, they

Table 3-6.
CBO/JCT and Administration Estimates of Increase in Personal Exemption for Children (By fiscal year, in billions of dollars)

Proposal	1992	1993	1994	1995	1996	1997
Increase the Personal Exemption for Dependent Children						
CBO/JCT	a	-3.4	-5.0	-5.0	-5.1	-5.3
Administration	a	-4.4	-4.6	-4.7	-5.0	-5.2

SOURCES: Joint Committee on Taxation; Office of Management and Budget.

a. Not yet in effect.

receive Medicare benefits in return for a smaller amount of lifetime payroll taxes than are paid by employees who work continuously in covered employment. CBO estimates that mandatory HI contributions from all state and local government workers, beginning July 1, 1992, would raise $1.7 billion in 1993 and $8.7 billion in 1992 through 1997 (see Table 3-8). Outlays for benefit payments would increase somewhat, but only $0.1 billion of the increased costs would occur by 1997.

Increase Employees' Contributions to the Civil Service Retirement System. Currently, about one-third of the Civil Service Retirement System's (CSRS's) liabilities are unfunded. Most employees enrolled in CSRS and their employing agency pay 7 percent of their base pay into the retirement system. The Administration proposes for the first time to increase the employees' tax rate in two stages. CSRS employees' tax rate would increase by 1 percentage point on January 1, 1993, and again on January 1, 1994. That increase would slightly improve the financial soundness of the fund.

Some may consider this proposal unfair because it penalizes those employees who chose to remain in CSRS when the Federal Employees' Retirement System (an alternative retirement program) was introduced. If employees were given another opportunity to switch, however, then the revenue gain from one rate increase would be reduced.

CBO estimates that the proposed increases in the CSRS employees' tax rate would raise $0.4 billion in 1993 and about $1.0 billion each subsequent year (see Table 3-8). Overall, revenues would increase by $4.5 billion in 1992 through 1997.

Conform the Compensation Base for Railroad Retirement with Social Security. Under current law, differences exist between compensation included in the tax base for Railroad Retirement and Social Security, specifically in sickness and accident disability payments made to an employee or dependent, remuneration for service as a delegate of a lodge, and noncash remuneration. The only difference that is expected to have an appreciable effect on revenues is including sickness and disability payments in the Railroad Retirement base. CBO estimates that bringing the Railroad Retirement base into conformity with the Social Security base, beginning January 1, 1993, would increase revenues by about $70 million during the budget period (see Table 3-8).

Expand the Communications Excise Tax. Under current law, local and toll telephone and teletypewriter communications services are subject to a 3 percent tax. The Administration proposes to expand the tax base to include communications via digital transmission and coin-operated telephones. Specifically, the 3 percent tax would apply to digital transmission of data over long-distance com-

Table 3-7.
CBO/JCT and Administration Estimates of the Excise Tax Proposal (By fiscal year, in billions of dollars)

Proposal	1992	1993	1994	1995	1996	1997
Repeal Luxury Tax on Boats and Airplanes and Repeal Diesel Fuel Exemption						
CBO/JCT	a	a	a	a	a	a
Administration	a	a	a	a	a	a

SOURCES: Joint Committee on Taxation; Office of Management and Budget.

a. Less than $50 million.

Table 3-8.
CBO/JCT and Administration Estimates of Revenue-Raising Proposals
(By fiscal year, in billions of dollars)

Proposal	1992	1993	1994	1995	1996	1997
Employee Taxes and Contributions						
Extend Hospital Insurance to All State and Local Government Workers						
CBO/JCT	0.4	1.7	1.7	1.7	1.6	1.6
Administration	0.3	1.6	1.5	1.5	1.5	1.5
Increase Employees' Contributions to Civil Service Retirement System						
CBO/JCT	a	0.4	1.0	1.1	1.0	1.0
Administration	a	0.4	1.1	1.2	1.2	1.2
Conform the Compensation Base for Railroad Retirement with Social Security						
CBO/JCT	a	b	b	b	b	b
Administration	a	b	b	b	b	b
Subtotal						
CBO/JCT	0.4	2.2	2.7	2.7	2.7	2.6
Administration	0.3	2.0	2.6	2.8	2.8	2.8
Excise Taxes and Fees						
Expand Communications Excise Tax						
CBO/JCT	b	b	b	b	0.1	0.1
Administration	b	0.1	0.1	0.1	0.1	0.1
Establish New Federal Communications Commission Fees						
CBO/JCT	a	0.1	0.1	0.1	0.1	0.1
Administration	a	0.1	0.1	0.1	0.1	0.1
Extend Abandoned Mine Reclamation Fees						
CBO/JCT	a	a	a	a	0.2	0.2
Administration	a	a	a	a	0.2	0.3
Subtotal						
CBO/JCT	b	0.1	0.1	0.1	0.3	0.3
Administration	b	0.2	0.2	0.2	0.4	0.4

(Continued)

Table 3-8.
Continued

Proposal	1992	1993	1994	1995	1996	1997
Broadening the Income Tax Base for Individuals						
Modify Taxation of Annuities Without Life Contingencies						
CBO/JCT	b	0.1	0.2	0.3	0.5	0.8
Administration	b	0.2	0.2	0.3	0.4	0.5
Change Effective Date on Taxation of Annuities						
CBO/JCT	b	b	b	b	b	b
Administration	b	b	b	b	b	b
Subtotal						
CBO/JCT	b	0.1	0.2	0.3	0.5	0.8
Administration	b	0.1	0.2	0.3	0.4	0.5
Broadening the Income Tax Base for Corporations						
Conform Book and Tax Accounting for Securities Dealers' Inventories						
CBO/JCT	0.1	0.4	0.5	0.5	0.5	0.5
Administration	0.2	0.6	0.8	0.8	0.8	0.8
Repeal Tax Exemption for Large Credit Unions						
CBO/JCT	0.1	0.3	0.4	0.4	0.4	0.4
Administration	0.1	0.2	0.2	0.2	0.2	0.2
Disallow Interest Deductions for Corporate-Owned Life Insurance Loans						
CBO/JCT	0.1	0.3	0.4	0.6	0.7	0.8
Administration	0.1	0.3	0.4	0.5	0.6	0.7
Subtotal						
CBO/JCT	0.3	1.0	1.3	1.5	1.6	1.7
Administration	0.5	1.0	1.3	1.5	1.6	1.7
Total						
Revenue-Raising Proposals						
CBO/JCT	0.7	3.3	4.2	4.6	5.0	5.4
Administration	0.8	3.4	4.3	4.7	5.1	5.4

SOURCES: Congressional Budget Office; Joint Committee on Taxation; Office of Management and Budget.

a. Not yet in effect.

b. Less than $50 million.

munication lines leased by private parties. In addition, the current exemption for local calls from coin-operated telephones would be repealed. These provisions would be effective July 1, 1992. The JCT estimates revenues would increase by $0.2 billion in 1992 through 1997 (see Table 3-8).

Establish New FCC Fees. The Administration proposes establishing fees to cover certain operations of the Federal Communications Commission. Beginning in October 1992, the FCC would have the authority to charge fees to cover costs of policymaking, rulemaking, and enforcement. At present, fees cover only the processing of applications. CBO estimates that, net of income and payroll tax offsets, establishing the fees would increase revenues by about $50 million each year (see Table 3-8).

Extend Abandoned Mine Reclamation Fees. Abandoned mine reclamation fees were extended for three years in the Omnibus Budget Reconciliation Act of 1990. They will expire on September 30, 1995. The Administration proposes extending the fees through fiscal year 1997. The existing fee schedule would be retained: 35 cents per ton on coal from surface mines, 15 cents per ton on coal from underground mines, and 10 cents per ton of lignite coal. These fees fund grants to states for the cleanup of abandoned mines. CBO estimates that, net of income and payroll offsets, extending the fees would increase revenues by $0.2 billion per year in 1996 and 1997 (see Table 3-8).

Modify Taxation of Annuities Without Life Contingencies. The President proposes to tax annually the accruing earnings of certain annuities. Annuities that have a substantial life contingency--that, is those whose total payout is linked to the recipient's life span--would not be affected by the proposal. Exceptions would also be allowed for pension annuities and for annuities of structured settlements.

Annuities are investment vehicles sold by insurance companies. Investors make an initial cash payment in return for a fixed repayment in the future. Frequently, repayment takes the form of monthly or other periodic payments. In life annuities, the periodic payments are guaranteed through the life of the beneficiary, which makes the actual return from the annuity uncertain. If the investor has a shorter-than-expected life span, a substantial portion of the principal can be lost; if the investor lives longer than expected, the total return can be substantial. Life annuities are particularly valuable because they insure that beneficiaries will not spend their savings before they die.

Under current law, annuity repayments are divided into two components--a return of principal and investment income--with the division determined by the ratio of the annuity cost to the sum of the expected annuity payments. The investment income is included in taxable income. This treatment defers the taxation of earnings on an investment in an annuity until the annuity payment begins, and it allows a relatively slow schedule of interest payout.

Annuities without life contingencies are close substitutes for certificates of deposit and bonds. The deferral of taxation on annuities, however, reduces the effective tax rate on these annuities relative to that on certificates of deposit or bonds, which are taxed on annual earnings. The President's proposal would remove the tax difference between these similar investment vehicles by taxing the annual earnings on annuities without substantial life contingencies, but would introduce a difference in treatment between annuities with and without substantial life contingencies.

The JCT estimates that the proposal will raise $1.9 billion in 1992 through 1997 (see Table 3-8).

Conform Book and Tax Accounting for Securities Dealers' Inventories. The Administration proposes to require securities dealers to include in taxable income both unrealized gains and losses on year-end securities inventories, ending the tax law's preferential treatment whereby losses may be included in taxable income, but gains need not be. Under the tax-preferred inventory accounting method called "lower of cost or market" (LCM), currently available to all businesses, dealers' inventory gains are considered taxable income typically in the following year when the securities are sold.

The Administration's proposed treatment would deem that a sale is not necessary to trigger tax recognition of a securities dealer's gains or losses on inventory. Under the proposal, all other industries would still be able to use the LCM method of inventory accounting because inventories of manufacturing and retail firms are more difficult to value at market prices. Indeed, securities firms alone are required to use market valuation for regulatory purposes. The JCT estimates that the proposal would raise $2.5 billion over the 1992-1997 period (see Table 3-8).

Repeal Tax Exemption for Large Credit Unions. Credit unions are not subject to federal income taxes and hence are treated more favorably than competing thrift institutions, such as savings and loan institutions and mutual savings banks. The Administration proposes to repeal the tax exemption for large credit unions--those with more than $50 million in assets--and tax them like other thrift institutions. In 1985, the Reagan Administration proposed repealing the tax-exempt status for credit unions with more than $5 million in assets, and the Carter Administration proposed total repeal in the 1979 budget. The JCT estimates that the proposal would raise $2 billion in revenues in the 1992-1997 period (see Table 3-8).

Disallow Interest Deductions for Corporate-Owned Life Insurance Loans. The Administration proposes to disallow the deduction for interest that corporations pay on loans secured by the cash value of life insurance policies. Corporations purchase whole life insurance policies to protect against the death of their more important--and increasingly wider group of--employees. These purchases provide a tax benefit when corporations take out a loan with the cash value of the policy as collateral. As with all whole life insurance policies, the buildup of investment income within a corporate-owned policy is exempt from tax, but a corporation can deduct the associated loan's interest expense from its taxable income. In 1986, the Congress limited the size of a loan that qualifies for the interest deduction to $50,000 per insured employee, but corporations have responded by spreading smaller policies over more employees. The JCT estimates that this proposal would raise $2.8 billion over the 1992-1997 period (see Table 3-8).

Other Proposals

The President's budget includes a proposal for reducing tariffs, most of which can be accomplished by executive action, but some of which requires legislative action. Tariff reduction accomplished by executive action is not counted for pay-as-you-go purposes. In addition, the Budget Enforcement Act of 1990 excludes from pay-as-you-go direct spending and receipts resulting from "full funding of, and continuation of, the deposit insurance commitment in effect on the date of enactment of the section." Consequently, CBO concludes that the proposal to prohibit double-dipping by thrifts should be excluded. The provision would affect deposit insurance costs, but it would not alter the deposit insurance commitment.

Implement the Uruguay Round. The President's budget takes into account carrying out the Administration's position on reducing tariffs in the Uruguay Round of the General Agreement on Tariffs and Trade. Implementation would reduce customs duty receipts. The Uruguay Round of negotiations began in 1986 and may conclude in 1992. Once a trade agreement is reached, the agreed-upon tariff reductions can be put in place through a combination of executive and legislative action. The Omnibus Trade and Tariff Act of 1988 granted the President the authority to lower certain tariffs by specified amounts. Further tariff reduction requires legislative action and is subject to pay-as-you-go requirements. The Administration's position on reducing tariffs in the Uruguay Round included in the budget would require legislative action for a small portion of the reduction; the bulk of the reduction could be accomplished by executive action. The Administration estimates that the proposed reduction of tariffs involving executive action would reduce customs duty receipts by $9.8 billion over the 1993-1997 period and that requiring legislative action would reduce receipts by an additional $0.1 billion. (see Table 3-9).

Prohibit Double-Dipping by Certain Thrifts. The Administration proposes legislation to deny certain tax benefits for pre-1989 acquisitions of insolvent thrift institutions. In the past, the Federal Savings and Loan Insurance Corporation (FSLIC) often guaranteed to reimburse the acquirer of an insolvent thrift for any subsequent capital losses on certain covered assets. Under a legal view widely held by some at the time, the acquirer did not have to include the FSLIC reimbursement in taxable income. However, the loss on the covered assets was deductible against other taxable income in the year of the sale--a combined treatment called "double-dipping" that allowed the acquirer to deduct taxable income from a loss that was never incurred. The FSLIC recognized the value of these tax benefits and negotiated to share them with the acquirer.

The tax benefits were repealed in 1989, but assets covered under earlier acquisitions have continued to receive the benefits. Many of these assets have yet to be sold and the tax benefits yet to be taken. The Internal Revenue Service now holds that the benefits are not allowed under current law, but it is unclear whether the IRS would prevail in court. The Administration proposes for the first time to clarify tax treatment by writing into law that the losses reimbursed by the FSLIC are not deductible, effective March 4, 1991. The JCT estimates that the proposal would raise $0.5 billion in revenues through 1997 (see Table 3-9). A part of the increase in revenues would be offset by a reduction in offsetting receipts of $0.2 billion (scored as increased outlays) because the federal government would receive fewer payments in the form of tax sharing from acquirers.

Table 3-9.
CBO/JCT and Administration Estimates of Other Proposals
(By fiscal year, in billions of dollars)

Proposal	1992	1993	1994	1995	1996	1997
Implement Uruguay Round of the Multilateral Trade Negotiations						
CBO/JCT	a	a	a	a	a	a
Administration	b	-0.4	-1.1	-1.9	-2.8	-3.7
Prohibit Double-Dipping by Thrifts Receiving Federal Financing Assistance						
CBO/JCT	0.2	0.2	0.1	0.1	0.1	-0.1
Administration	0.4	0.4	0.1	c	c	0.1
Total						
CBO/JCT	0.2	-0.3	-1.0	-1.8	-2.7	-3.7
Administration	0.4	c	-1.1	-1.9	-2.8	-3.5

SOURCES: Joint Committee on Taxation; Office of Management and Budget.

a. CBO has included the Administration's estimate.

b. Not yet in effect.

c. Less than $50 million.

Chapter Four

The Administration's Proposals for Defense and International Affairs

The Administration's budgets for defense and international affairs reflect the end of the Cold War. For 1993, the defense plan would take funding below the levels agreed on in the 1990 budget summit; by 1997, defense would reach a level 18 percent lower than an average budget for the last one and a half decades of the Cold War. The change in the international affairs budget is evident from the economic, humanitarian, and technical assistance programmed for Eastern Europe and the republics of the former Soviet Union.

The Budget Enforcement Act (BEA) set ceilings for discretionary programs, including specific 1993 caps for defense and international affairs programs. The Administration's budget would fund both of those functions at levels roughly 2.5 percent below the BEA caps. In dollar terms, the reduction in budget authority in defense is much larger--$6.8 billion compared with $600 million for international affairs (see Table 4-1). Although the Congressional Budget Office estimates that defense outlays will fall below the BEA caps, it also estimates that outlays for international affairs will exceed the caps.

The Peace Dividend in the Administration's Defense Budget

With the end of the Cold War, many people look to the defense budget for a peace dividend--that is, for funds that can be redirected to other purposes including domestic programs, tax cuts, and deficit reduction.

In a sense, a substantial peace dividend has already been achieved: the limits on defense spending established in the 1990 budget agreement for the 1991-1993 period, and those proposed by the President in last year's budget, represent a substantial reduction from the level provided in 1990, the last year of the Cold War. For 1997, the President's 1992 budget anticipated budget authority roughly 23 percent below the inflation-adjusted levels of 1990; over the 1991-1997 period, spending would be some $410 billion below the 1990 baseline level.

The key question now is, how much *more* can defense spending be reduced? In other words, what additional dividend might be reaped after the failed coup, the disintegration of the Soviet Union, and the emergence of 15 independent republics?

By means of proposals to rescind a net $6.6 billion from 1992 funding and to scale down requests for the next five years by about $43 billion, the current defense request would increase the dividend by $50 billion. Of the savings to be realized between 1993 and 1997, about $29 billion would come from ending only two programs--the B-2 bomber and the Seawolf submarine (see Box 4-1 and Table 4-2). The remaining $14 billion would be obtained primarily by cutting more than that amount in other purchases of weapons and adding funds for operation and maintenance.

The Budget Enforcement Act dealt specifically with defense through 1993 only. For 1994-1995, the BEA provided a total amount for discretionary spending; the allocation between defense and nondefense would be made in those years. If nondefense discretionary budget authority were held at 1992 levels (in real terms) through 1995, reductions in defense over this period would have to reach $57 billion to stay within the BEA limits. That represents $33 billion in additional reductions compared with the $24 billion proposed by the Administration over this period. Obviously, if nondefense discretionary programs were to grow in real terms within the BEA totals, the defense budget would have to absorb an even greater reduction.

Comparisons with Cold War Defense Budgets

With the dissolution of the Warsaw Pact and the unraveling of the Soviet Union, the Administration's proposals would reduce the defense budget to levels lower than the average Cold War budget that prevailed over the 1975-1990 period. That period begins at the spending trough following the Vietnam War, encompasses the peacetime buildup that ended in 1985, and continues through the 1986-1990 retrenchment. The all-volunteer force was in effect, with its attendant costs, throughout the period. In addition, the 1975-1990 weapons are comparable with the weapons of the 1990s, and so are their acquisition and operating costs. With full adjustment for inflation, the average budget for this period would total about $307 billion in 1993 and $356 billion in 1997.

The transition to the post-Cold War budget will come gradually. By 1997, the Administration would reduce military personnel levels to about 1.6 million people--23 percent below the 1975-1990 average. But overall funding would be only 18 percent lower (see Table 4-3 on page 65). What explains that disparity? The answer can be found in operation and maintenance (O&M), a set of accounts devoted to meeting everyday expenses, and in research, development, test, and evaluation (RDT&E), accounts representing investment in new weapons.

Table 4-1.
Comparison of the Administration's Request for Defense and International Affairs with the BEA Caps for 1993 (In millions of dollars)

	Defense	International Affairs
Discretionary Budget Authority		
Caps as Determined by OMB	289,035	22,758
Administration's Request as Estimated by CBO	282,186	22,161
Difference	-6,849	-597
Discretionary Outlays		
Caps as Determined by OMB	296,824	20,591
Administration's Request as Estimated by CBO	293,462	21,086
Difference	-3,362	495

SOURCE: Congressional Budget Office.

NOTE: BEA = Budget Enforcement Act; OMB = Office of Management and Budget.

Force Operations

In 1997, funding to operate forces would be 17 percent lower in real terms than it is this year and about 18 percent lower than the 1975-1990 average. Lower personnel levels obviously require less money. Although funding for O&M would fall at about the same rate as military strength compared with today, it would fall less than one-half as much as military strength compared with the 1975-1990 average. For a comparison of 1990 and 1997 forces, see Table 4-4 on page 66.

Military Personnel. The Administration proposes to cut funding for the military personnel accounts somewhat more than it proposes to reduce personnel strength. Normally, one would expect costs to be proportional because these accounts fund little other than military pay. Some of the extra dollar savings can be traced to the Department of Defense's (DoD's) payments to cover the future costs of retirement benefits as they are earned each year. An independent board of actuaries estimates the appropriate charge for each payment to the military retirement trust fund. Beginning in 1994, the budget assumes that the actuaries will not charge DoD as much as it now does for the retirement contribution. The annual price is assumed to fall by almost $3 billion per year based on assumptions about pay raises and interest rates over the long term. The actuaries may not agree with this estimating proposal.

At first glance, this proposition would appear to reduce the deficit, but that will not be the case even if the actuaries prepare the estimates as expected. The estimates would be deficit neutral at best because forgone receipts in the trust fund would cancel outlay savings in defense. But under the fixed caps of the BEA, that change could produce a greater deficit--through the increased discretionary spending that results from the way effects on outlays are categorized. The DoD savings on

Box 4-1.
The Administration's Rescission and Supplemental Proposals for 1992

In addition to the request for 1993, the Administration is asking the Congress to rescind or cancel about $7.7 billion provided for 1992 and prior years. The details of the rescission proposal have not been announced, but the Department of Defense has categorized them as follows (budget authority in billions of dollars):

Funding for programs that have been terminated	4.1
Funding for programs in excess of requirements	2.2
Funding for programs that do not contribute to defense	0.4
Funding for programs that cannot be sustained	0.7
Funding that cannot be effectively used in 1992	0.4
Total	7.7

The Administration is also proposing additional funding for 1992 for environmental programs on DoD installations. The $1.1 billion in supplemental funds would aim at complying with federal, state, and local environmental laws and regulations. Thus, the net effect of the proposals for 1992 would be to reduce defense funding below the Budget Enforcement Act ceiling by $6.6 billion.

Until the Administration forwards more details, it will be hard to interpret how DoD has grouped the rescission proposals. Presumably, the $3 billion provided in 1992 and previous years for Seawolf submarines will be rescinded. Other programs that DoD considers marginally useful will include items added by the Congress without a request from the Administration. The $1.9 billion appropriated to buy equipment for Reserve and National Guard components, as well as funding for university research initiatives, could be among those items.

outlays are categorized as discretionary spending, and the forgone trust fund receipts are considered mandatory. At this point, the proposed estimate would appear to be deficit neutral. However, because the BEA sets a cap for discretionary spending, the proposal would really make room for more discretionary spending--for which there would be no offsetting change in the budget for mandatory accounts. To avoid an increase in the deficit, the discretionary spending caps would have to be adjusted downward.

As part of its regional defense strategy, the Administration seeks a balance between active and reserve forces. Just what that balance should be, however, has raised some controversy. The budget would cut reserve forces less than was proposed a year ago, at least in part because the Congress resisted last year's

Table 4-2.
Proposed Major Spending Changes in the President's Budget for Function 050, National Defense (By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	Cumulative Five-Year Savings
			Budget Authority			
President's 1992 Budget	288.4	289.4	292.8	295.2	300.6	
Proposed Changes						
Military personnel	-0.3	-1.0	-1.4	-0.9	-1.2	-4.9
Operation and maintenance	3.1	1.3	1.8	2.4	3.1	11.7
Procurement	-11.3	-9.2	-10.4	-12.3	-12.9	-56.1
RDT&E	-1.6	0.1	0.9	1.4	1.8	2.6
Atomic energy defense	0	-0	-0	-0	-0.1	-0.1
Other defense	2.7	1.1	0.7	0	-0.6	3.8
Total	-7.4	-7.8	-8.5	-9.5	-10.0	-43.1
President's 1993 Budget	281.0	281.6	284.3	285.7	290.6	
			Outlays			
President's 1992 Budget	294.1	288.7	289.0	292.1	297.2	
Proposed Changes						
Military personnel	-0.3	-1.0	-1.4	-0.9	-1.2	-4.9
Operation and maintenance	2.6	1.5	1.7	2.3	2.9	11.0
Procurement	-3.3	-6.0	-8.2	-9.6	-11.1	-38.2
RDT&E	-1.3	-0.6	0.4	1.0	1.5	1.0
Atomic energy defense	-0.1	-0.1	-0.1	0	-0.1	-0.4
Other defense	0.5	0.9	1.5	1.3	0.2	4.3
Total	-1.9	-5.3	-6.1	-6.0	-7.8	-27.1
President's 1993 Budget	292.2	283.4	282.9	286.1	289.4	

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

NOTES: This table shows the 1992 and 1993 budget requests as estimated by CBO. The estimate of the 1992 request includes an adjustment for inflation lower than previously assumed.

RDT&E = research, development, test, and evaluation.

proposals. Compared with 1992 levels, reserve strengths would be scaled back by about 18 percent, and active forces would be roughly 13 percent below today's levels. Nevertheless, under the Administration's proposals, active troop strength would fall by 23 percent and reserve strength by 7 percent, compared with the 1975-1990 average. In other words, the reserves would constitute a larger share of the force in 1997 than they did over the 1975-1990 period and a slightly smaller share than they do today. As shown in Table 4-4, reserve combat forces would comprise a relatively greater portion of Army divisions, carrier air wings, and other tactical air wings.

Operation and Maintenance. O&M accounts pay to fuel, repair, and maintain weapons; provide military personnel with medical care, food, housing, and other support services; and maintain and operate bases worldwide. The accounts pay most of the civilians DoD employs; in fact, 40 percent of all O&M funding goes for civilian salaries. O&M budgets pose

Table 4-3.
Comparison of the President's Budget for 1997 with an Average Cold War Budget, 1975-1990, and the CBO Baseline

Category	Average Cold War Budget (1975-1990)	CBO Baseline[a]	President's Budget	Budget Less the Following (Percentage change): Cold War Average	Budget Less the Following (Percentage change): CBO Baseline[a]
	Budget Authority (Billions of 1997 dollars)				
Department of Defense--Military					
Operations					
Military personnel	103.9	94.6	75.6	-27	-20
Operation and maintenance	99.0	105.8	90.2	-9	-15
Family housing	3.7	4.3	3.7	-2	-15
Subtotal	206.7	204.7	169.5	-18	-17
Investment					
Procurement	95.9	75.7	63.1	-34	-17
RDT&E	36.6	45.0	36.0	-2	-20
Military construction	6.4	5.8	5.5	-14	-6
Subtotal	138.9	126.5	104.6	-25	-17
Other	1.9	3.0	0.5	-73	-83
Total	347.5	334.3	274.6	-21	-18
Other Defense	8.4	15.3	16.0	90	4
Total, National Defense	355.9	349.6	290.6	-18	-17
	Manpower (Thousands)				
Military					
Active	2,105	1,865	1,626	-23	-13
Reserve	987	1,120	920	-7	-18
Civilians	1,064	1,001	904	-15	-10

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

NOTE: RDT&E = research, development, test, and evaluation.

a. The CBO baseline is either constrained to (kept within) the BEA caps or unconstrained. The unconstrained baseline adjusts the regular appropriations for 1992 for inflation each year through 1997. This table refers to the unconstrained baseline less the projection of appropriation for operation Desert Storm.

special problems because they fund such a wide variety of functions. It is not always clear, particularly in the out-years, what would and would not be funded in a budget request. Even though force levels in 1997 will be much lower than during the Cold War, or even now, at that point the Administration's O&M funding would be only 9 percent lower than an average Cold War budget between 1975 and 1990.

Why should the cut in O&M be less than that in other accounts? One explanation might be found in the costs of an all-volunteer force. Military pay rose dramatically as the nation abandoned conscription in favor of a volunteer force, but pay is only part of a soldier's compensation. DoD also compensates its troops with such in-kind support as medical care, billeting, child care services, and base transportation. Raising the troops' standard of living in those ways uses O&M funds. After certain thresholds have been passed, O&M cuts may end up being roughly proportional to strength cuts. (See discussion of base closures below.) Two other cost factors involve modern weapons and medical care: today's complex weapons may be more expensive to use in terms of fuel consumption and spare parts; similarly, per capita medical care for

Table 4-4.
Summary of Forces and Manpower, 1990 and 1997

	1990	1997[a]	Changes: Number	Changes: Percent
		Forces		
Army Divisions				
Active	18	12	6	33
Reserve	10	8[b]	2	20
Aircraft Carriers	15	12	3	20
Carrier Air Wings				
Active	13	11	2	15
Reserve	2	2	0	0
Battle Force Ships	546	451	95	17
Tactical Fighter Wings				
Active	24	15	9	38
Reserve	12	11	1	8
Strategic Bombers	268	180	88	33
		Manpower (Thousands)		
Military				
Active	2,070	1,626	444	21
Reserve	1,128[c]	920	208	18
Civilian	1,073	904	169	16

SOURCES: Congressional Budget Office based on data from the Department of Defense.

a. Planned forces for 1997 are assumed to be the same as those for 1995.

b. Includes two cadre divisions.

c. Does not include about 26,000 members of the Selected Reserve who were activated for Operation Desert Storm. They are included in the 1990 active manpower total.

active and retired personnel, and their dependents, is more expensive nowadays.

Although one might expect the projected changes in DoD's O&M and civilian expenditures to be roughly proportional, they are not. Compared with a Cold War budget between 1975 and 1990, civilian employment would decline much more than O&M funding, but still less than active troop strength. The larger reduction in the number of civilians suggests that support functions, particularly base operations and central logistics, would suffer more than force and training programs. Another possibility is that the Administration is moving toward substituting contract services for those the government supplies.

Indeed, some of those changes may already be in place. A comparison with the unconstrained CBO baseline projection for 1997 reveals that O&M funding would be cut more than civilian employment (15 percent versus 10 percent).[1] In fact, O&M funding decreases at the same rate as active troop strength, but civilian employment decreases only 70 percent as fast.

Why is the O&M cut so much more in 1997 relative to the present? Although the answer is far from clear, it can probably be traced to the buildup of the 1980s. During that period, DoD might have established a base level of funding consistent with new weapons, a raised standard of living, and renewed emphasis on training and readiness. With that higher base, there was simply more to cut. But the Administration's proposals for O&M would remove relatively few civilians from the baseline. Perhaps to sustain force levels, the resources devoted to force operations and training might be reduced by a relatively large amount, and resources devoted to supporting those forces--both weapons support and the soldier's standard of living--would remain relatively plentiful. Moreover, any closing of bases after 1997 may ultimately lower civilian employment.

Base Closures. Most of the savings from closing military bases come from lower personnel costs. So far there have been two rounds of decisionmaking in this area. About 120 installations have been slated for closing, but to date few major bases have been closed completely. The delay reflects in part the time needed to transfer activities to other places, and it may also explain why the civilian cuts lag behind those in military personnel. Moreover, current law calls for two more rounds of discussions to decide which bases to close in 1993 and 1995.

The net, one-time costs of closing bases generally appear in the budget for military construction, but O&M accounts will eventually realize most of the recurring savings. The Congress has provided about $2.3 billion through 1992 to meet those one-time costs, and the Administration is seeking another installment of $2.2 billion for 1993. Once the process of closing bases is complete, DoD expects annual savings to total more than $2 billion for rounds one and two. About 35,000 civilian positions would be eliminated. Of course, the next two rounds of closing bases will increase the annual dollar savings and reduce civilian employment even more.

Family Housing. The family housing account covers the costs of providing quarters "in kind" to active-duty military personnel. When service members do not receive housing in kind, they receive instead pay supplements (in the military personnel accounts) that enable them to secure housing in the community. Compared with this year, funding for family housing would be cut by the same proportion as active-duty personnel. But compared with the 1975-1990 average, funding would drop only 2 percent, despite a 23 percent drop in the population served. One reason for this might be that the Administration plans to provide people with government quarters instead of a housing allowance in their pay for private-sector housing.

1. The CBO baseline is either kept within the BEA caps or unconstrained. The latter represents 1992 funding levels adjusted for inflation. All references in this chapter to the CBO baseline are to the unconstrained version, but they exclude projections of Desert Storm appropriations.

Investment in Weapons

DoD could face a daunting modernization program after 1997, when scheduling calls for several expensive weapons to be bought for the first time. In fact, CBO has projected that, under last year's plan, a period of annual real growth will soon replace the current period of annual real decline in defense funding.[2] The Administration has now announced a new acquisition strategy that will contribute to holding down the projected growth.

DoD has chosen to concentrate on developing weapons technology at the expense of producing weapons immediately. The new approach would continue to fund RDT&E, including research into manufacturing and operational risks. It would, however, postpone the actual production of some new weapons until various technical risks are minimized and military threats demand their deployment. The Administration's budget proposals show evidence of the differential emphasis on RDT&E versus procurement.

Procurement. The 1993 procurement budget is marked by the cancellation of, or sharp reductions in, some high-profile weapons. Procurement of the B-2 would be capped at 20 aircraft instead of the 75 DoD has recently sought or the 132 in the original plan. Outright cancellations and deferrals would similarly lower the anticipated wave of modernization. For example, the Seawolf submarine contract would be canceled, the Army would defer purchasing the new Comanche attack helicopter and forgo a new air defense system, and the Air Force would not buy the small intercontinental ballistic missile known as Midgetman.

Overall, procurement would be 34 percent lower in 1997 than the 1975-1990 Cold War average--a cut exceeding that in military forces. Compared with this year, purchases of weapons would fall by about 17 percent, a bit more than the reduction in forces. In the last two years, DoD has stopped buying many systems, including such weapons used in the Persian Gulf War as the Abrams tank, Apache helicopter, and F-15 aircraft. DoD has also stopped purchasing the Peacekeeper (MX) missile and Trident submarine strategic systems, and it has canceled plans to buy next-generation stealth weapons--the Navy's Advanced Tactical Fighter and the A-12 attack aircraft. Most other weapons would be purchased in smaller numbers because there would be fewer forces to use them.

Notwithstanding those major changes in weapons programs, DoD still faces decisions about major weapons that could lead to growth in procurement funding. During the next decade, DoD must decide whether to buy weapons--and, if so, what kind--to modernize the Navy's attack submarines and tactical aircraft, the Army's fleet of armored vehicles, and the Air Force's fleet of tactical aircraft. If the new acquisition strategy precludes procuring many of those weapons, thereby creating older or smaller military forces, increases in procurement funding will not be needed. If most of the new weapons are purchased, procurement funds will have to rise above planned 1997 levels.

RDT&E. The Administration's defense budget would provide nearly $40 billion a year between 1993 and 1997 for RDT&E of weapons, although funding levels gradually decrease during this period. In 1997, the $36 billion projected for those activities would be about 20 percent below the amount projected in the CBO baseline--in other words, about 20 percent lower than today's funding in real terms. In 1997, however, RDT&E programs would remain only 2 percent lower than the 1975-1990 average. The relatively elevated level of RDT&E funding can be traced primarily to the Strategic Defense Initiative (SDI). At about $6 billion per year, SDI funding would be much greater than average funding for strategic defenses between 1975 and 1990.

2. Congressional Budget Office, "Fiscal Implications of the Administration's Proposed Base Force," CBO Staff Memorandum (December 1991).

Other National Defense Programs

The atomic energy defense activities of the Department of Energy dominate funding for the remaining national defense programs. During the Cold War, the nuclear weapons complex conducted research on materials and weapons, produced weapons, and engaged in related activities. Most production was halted in the late 1980s, when safety and environmental issues came to light, and the funding was used for environmental restoration and safety measures.

It is hard to make precise estimates of the costs necessary to clean up the environment; the size of the problem has not yet been fully determined, and cures remain controversial and elusive. The funding request for 1993 is more than $500 million higher than last year's projection for 1993 and $900 million higher than the amount provided for 1992.

There are many uncertainties in estimating cleanup costs. For example, the Energy Department plans to complete its cleanup by the year 2019; yet, the technology to treat many of the department's unique waste streams does not now exist, and plans for waste storage at the Waste Isolation Pilot Plant have been delayed by lawsuits. Moreover, responsibilities under laws and agreements with other federal agencies, state and local governments, and Native Americans are not firm. On the brighter side, some new methods of treatment are bringing costs below what had been anticipated.

The Administration's budget proposals would continue to provide a high level of funding for restoring the environment. After an increase of 25 percent in 1993, the projected budget grows by 10 percent each year through 1997.

The Budget Request for International Affairs

The Congress has been asked to consider at least two requests for international affairs. One concerns regular appropriations for the year in progress. Unable to forge a bill for some international activities in 1992, the Congress passed a six-month continuing resolution to maintain foreign assistance programs and the Export-Import Bank (Eximbank) pending a funding agreement. The Administration is also asking for $550 million in additional 1992 funds to aid states of the former Soviet Union, support international peacekeeping activities, and undertake other initiatives.

The second concerns the request for 1993, which includes estimates foı fiscal years 1994 through 1997. In 1993, budget authority for international affairs would total $19.4 billion, or only 1 percent of all spending in the President's budget (see Table 4-5). Programs funded annually--discretionary programs--would receive $22.2 billion, and funding for the so-called mandatory accounts would total a negative $2.8 billion, reflecting offsetting collections.

The estimates for fiscal years 1994 through 1997 may be incomplete and therefore misleading. The international affairs budgets of the last decade have typically included supplementals for the year in progress, increases for the upcoming year, and real cuts thereafter. The five-year profile in the 1993 budget probably does not represent a lasting plan for international affairs. Indeed, for many programs the projections for fiscal years 1994 through 1997 are frozen at the level requested for 1993--a pattern reminiscent of previous budget requests; the same approach has been applied to domestic programs overall.

Table 4-5.
Proposed Major Spending Changes in the President's Budget for Function 150, International Affairs (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
			Budget Authority			
CBO Baseline[a]	19.1	19.0	19.9	20.9	21.4	22.3
Policy Changes						
Assistance to former Soviet Union	0.2	0.4	0	0	0	0
Enterprise for the Americas						
Loan modifications and Investment Fund	0.4	0.4	0.4	0.1	0.1	0
Loan liquidating accounts	-0.5	-0.3	-0.3	0.2	0.2	0.2
Peacekeeping	0.4	0.3	0.3	0.3	0.3	0.3
International Monetary Fund quota increase	12.3	0	0	0	0	0
Capital projects	0	0.1	0.1	0.1	0.1	0.1
Food for Peace (P.L. 480)	0	-0.2	-0.3	-0.3	-0.4	-0.4
Security assistance	0.5	-0.4	-0.6	-0.9	-1.1	-1.4
Other	0	0.1	-0.3	-1.0	-1.6	-2.2
Total	13.2	0.4	-0.7	-1.4	-2.4	-3.4
President's 1993 Budget as Estimated by CBO	32.3	19.4	19.3	19.5	19.1	18.8
			Outlays			
CBO Baseline[a]	17.3	17.1	17.9	18.6	19.3	20.2
Policy Changes						
Assistance to former Soviet Union	0.1	0.2	0.1	0.1	0.1	0
Enterprise for the Americas						
Loan modifications and Investment Fund	0.3	0.3	0.4	0.1	0.1	0.1
Loan liquidating accounts	-0.5	-0.3	-0.3	0.2	0.2	0.2
Peacekeeping	0.4	0.3	0.3	0.3	0.3	0.3
Capital projects	0	0	0	0.1	0.1	0.1
Food for Peace (P.L. 480)	0	-0.2	-0.2	-0.3	-0.3	-0.4
Security assistance	0.1	0	-0.2	-0.6	-0.9	-1.1
Other	0	0.1	0	-0.4	-0.9	-1.5
Total	0.2	0.4	0.1	-0.5	-1.4	-2.3
President's 1993 Budget as Estimated by CBO	17.5	17.5	17.9	18.1	18.0	17.9

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

a. The CBO baseline is either constrained to (kept within) the BEA caps or unconstrained. The unconstrained baseline adjusts either regular appropriations or the continuing resolution for 1992 for inflation each year through 1997. This table refers to the unconstrained baseline.

Although bilateral foreign aid is the best-known program in the international affairs budget, it has competitors for funding. The State Department needs money to conduct foreign affairs. The United States also contributes to international organizations and peacekeeping activities. Such federal operations as the U.S. Information Agency promote information and exchange activities, and Eximbank advances U.S. economic interests. The 1993 request for discretionary funding in international affairs is distributed as follows:

Budget Authority
(Billions of dollars)

Foreign Aid	15.8
State Department and Other Agencies	2.9
International Organizations	1.4
Information and Exchange	1.4
Financial Programs	0.7
Total	22.2

Foreign Aid

Foreign aid represents 71 percent of the international affairs function, or $15.8 billion. Of that, $8.4 billion is for development and humanitarian assistance programs, which are designed to promote economic development and eliminate human suffering. In recent years, the United States has spent a relatively small share of its gross national product (GNP) on development assistance compared with certain other leading industrialized countries. According to the Organization for Economic Cooperation and Development, in 1990, the latest year for which figures are available, the United States spent more in dollar terms on development assistance than did Japan or Germany, but those countries spent more in relation to the size of their economies: 0.2 percent of GNP for the United States, 0.3 percent for Japan, and 0.4 percent for Germany.

As the world has changed during the last three years, so have the stated goals of the U.S. foreign aid program. Instead of strengthening security relationships, they now emphasize strengthening democracy and promoting market economies. In meeting these new goals, however, the Administration relies on existing programs. Funding levels in the proposed budget for most programs differ only marginally from current levels. The request remains oriented toward the Middle East and southern Europe. Nearly $5.3 billion in budget authority, almost 25 percent of the whole international affairs request, would continue to go to two countries--Israel and Egypt. Another $800 million would cover the costs to subsidize $1.1 billion in loans and grants to Greece, Turkey, and Portugal.

Aid to Eastern Europe and the States of the Former Soviet Union. After the end of the Cold War, the United States began to provide aid to Eastern Europe and the former Soviet Union. In 1992, aid money has come from both the international affairs and the defense budgets, as well as through agricultural programs on the domestic side of the budget. In 1993, the Administration proposes aid from international affairs and agriculture programs only. The table below provides details.

Budget Authority
(Millions of dollars)

	1992	1993
International Affairs (Function 150)		
Food for Peace (P.L. 480)	10	10
Economic Support Fund	0	100
Humanitarian and technical assistance	150[a]	350
Support for Eastern European democracies	400[a]	450
Subtotal	560	910
Defense (Function 050)		
Weapons destruction	400	0
Humanitarian aid	100	0
Agriculture (Function 350)		
Subsidy cost of guarantees	490[b]	490[b]
Total	1,550	1,400

a. Proposed 1992 funding.

b. No specific request has been made. The estimate consists of $12 million for Eastern Europe and $478 million for the former Soviet Union.

Most nonagricultural aid would be in the form of technical and humanitarian assistance. Funding enacted from 1992 defense appropriations will assist with the destruction and nonproliferation of nuclear weapons, as well as with humanitarian assistance. Proposed 1992 and 1993 funding from international programs aims to relieve hardship and assist the transition to democracy.

Agriculture-related assistance appears as loan guarantees that enable countries to purchase grain and other agricultural products. The levels in the table above represent the estimated subsidy cost associated with the guarantees. The United States has pledged to provide Eastern European countries with $1 billion in loan guarantees for agricultural commodities over five years. Annual estimates for this assistance are uncertain, in part because it is not known what level of assistance the countries will use. The levels in the table assume that $200 million will be provided annually, resulting in subsidy budget authority of $12 million each year.

The level of agricultural aid to the former Soviet Union also remains uncertain. The United States is providing new guarantees to the former Soviet states only if they remain current on their interest and principal payments for previous loans. The estimates in the table assume that guarantees totaling $2.5 billion will be issued in 1992, requiring subsidy budget authority of $478 million at a subsidy rate of 19 percent. Because specific plans for 1993 have not been announced, any estimate for that year is highly uncertain. CBO assumes that aid will continue at estimated 1992 levels.

Enterprise for the Americas. The Administration has renewed its request for the Enterprise for the Americas Initiative (EAI)--a program designed to increase trade and investment within the Western Hemisphere. It is requesting budget authority of $900 million for fiscal years 1992 through 1995 to restructure bilateral debt, and $500 million for fiscal years 1992 through 1996 to contribute to an investment fund that will be administered by the Inter-American Development Bank. Interest on the new debt may support environmental activities in debtor countries. In addition, the proposal includes a complicated triangular sale of loan assets held by the Commodity Credit Corporation and Eximbank; purchasers of the loans would exchange them for equity or environmental considerations.

The debt to be restructured consists primarily of loans for development assistance bearing interest rates between 0.75 percent and 3 percent a year, with up to 37 years to repay. The appropriation request represents the difference between the Administration's estimate of the present value of the old loans and the present value of the new debt instrument that will replace them. That request comes on the heels of other debt restructuring in the so-called Paris Club, from which the Administration derives a two-price system for making loans. The EAI and the two-price system together raise important issues. Was an appropriation required for the Paris Club rescheduling? How creditworthy are the affected countries? (See Box 4-2.)

In addition, the Administration's estimates make the loan modifications in the EAI appear less expensive than they really are. The Administration first assumes that payment streams are drawn out beyond their due date. The Administration then discounts the modified streams using risk factors that anticipate not being paid on time. That underestimates the cost of loan modifications by more than 50 percent through lowering the present value twice for the same reason. Further, the modifications will lower budget outlays in the year the loan is modified and raise them thereafter as a result of the loss of receipts.

Peacekeeping Programs. The Administration has requested about $350 million annually in additional funding for U.S. contributions to international peacekeeping activities sponsored by the United Nations. The funds would pay the estimated U.S. assessments for peacekeeping, mainly in Yugoslavia, El Salvador, and Cambodia. But the size of the relevant forces has not been determined.

Thus, the amount of the U.S. contribution, which equals about 30 percent of the total funding, is unknown. The press has quoted State Department officials as saying that even the amount requested may be insufficient for current or planned peacekeeping.

Other International Programs

The Administration's budget includes $12 billion to meet the U.S. share of an increase in the deposits of the International Monetary Fund (IMF) in 1992. For the 1993-1997 period, the budget calls for a new $500 million program for capital projects and also for the reduction of other programs, including Food for Peace (Public Law 480) and security assistance. The 1993 requests for most other programs approximate the levels in the CBO baseline.

International Monetary Fund. The IMF lends funds to countries having balance-of-payments problems, provided the borrower enacts economic reforms. IMF funding comes from member countries, which exchange their deposits for an equivalent amount of other monetary assets.

A review of IMF resources and objectives, in which the Treasury Department participated, concluded that member nations need to increase their deposits--called quotas. The request for 1992 contains $12.3 billion in budget authority for the U.S. share of the IMF quota increase. (The exact amount depends on exchange rates once the funds have been provided to the IMF.) Transactions with the IMF are considered exchanges of monetary assets, not part of expenditures or receipts; thus, no outlays are estimated for such transactions.

Box 4-2.
Credit Reform Issues in International Affairs

Unlike the defense budget, the budget for international affairs includes many credit programs through which the federal government either makes or guarantees loans to private entities or other governments. The federal budget was recently changed to display the upfront subsidy costs of credit programs instead of their cash flows. The reform requires that the Congress fund the subsidy explicitly and thus requires programs to compete for funding based on their long-run cost to the taxpayer.

The Administration's budget, however, adopts a two-price system for loans to foreign countries that skews some estimates and implicitly favors certain programs. The Administration is using a method of estimating that produces substantially different values for practically identical loans. Debtor nations facing imminent default meet with creditor nations in what is called the Paris Club to reschedule certain existing loans. Loans made before a certain date are eligible for rescheduling. According to the Administration, rescheduled loans are effectively subordinated to loans that have not been rescheduled; that is, if a country experiences balance-of-payments problems, its unrescheduled loans would be repaid first. Consequently, a loan that is not rescheduled would have one price and a rescheduled loan a lower price.

The two-price system implies that the rescheduled loans enjoy a higher subsidy than the others. If the Paris Club's actions increase the subsidy, under the Credit Reform Act a Congressional appropriation is required to cover the higher cost. But the Administration has not requested such an appropriation. It claims instead that the rescheduling is an administrative action to maximize the value of government assets under the threat of imminent default; therefore, the argument goes, there is no loss in value. Without such a loss, there is no justification for a two-price system.

If loans are rescheduled because they are about to default, extending even more credit to the countries involved seems questionable.

Capital Projects. The budget requests $500 million in budget authority over five years for as-yet-unspecified capital projects using U.S. labor and businesses to promote overseas development. Given its worldwide scope, the proposed size of the fund is small. As one benchmark, planned funding over the next five years scarcely exceeds the total the United States has spent and will need to spend to complete the new U.S. embassy complex in Moscow.

Public Law 480. The Food for Peace program, popularly known as P.L. 480, is designed to provide concessional loans to foreign governments for the primary purposes of promoting U.S. commodities, providing food grants in response to emergencies and for other humanitarian relief, and aiding the poorest countries needing food. The Administration's request for the program is $200 million lower than the CBO baseline in 1993. The Administration justifies the reduction by citing lower estimated commodity prices for the same level of shipments as in 1992. CBO, which has higher price estimates for commodities shipped through the program, would interpret the Administration's funding request as a reduction in shipments.

Security Assistance Programs. Funding for security assistance--programs providing military and economic aid to U.S. allies--accounts for nearly 50 percent of the foreign aid budget. The $8 billion requested for 1992 exceeds the amount provided in the continuing resolution by $500 million. For 1993, the Administration is requesting $7.4 billion--$350 million less than a projection of the continuing resolution for 1992. Less aid has been requested in 1993 for both Pakistan and the Philippines, the latter cut reflecting the closing of Clark Air Force Base and a lower payment for the use of military facilities on the islands. (The naval facility at Subic Bay is expected to close in December 1992.) Compared with the CBO baseline, the increase requested for 1992 and the reduction for 1993 together have little effect on 1993 outlays.

CBO Reestimates of the Budget for Defense and International Affairs

This section describes the differences between CBO and Office of Management and Budget (OMB) estimates of outlays for defense and international affairs programs. For discretionary programs, both sets of estimates assume that budget authority equals the amounts requested; the only differences result from categorizing among functions or between mandatory and discretionary. CBO and OMB can have different estimates of budget authority and outlays for mandatory programs. Nevertheless, the objective is to measure the impact of the President's policies on the deficit (outlays).

National Defense

For most accounts in the defense budget, CBO and OMB have identical estimates of outlays. Table 4-6 summarizes the few estimating differences that exist, and the following paragraphs discuss them.

CBO's estimates of defense outlays are lower than the Administration's by about $1 billion in 1992. But CBO's 1993 estimate runs about $900 million higher. The two biggest differences occur in revolving and management funds. First, CBO projects outlays from the Defense Business Operations Fund to be $800 million lower in 1992 and $700 million higher in 1993 than does DoD or OMB. Second, CBO's estimates of outlays in 1993 from the National Defense Stockpile Transaction Fund are $400 million lower than OMB's.

The Administration proposes to sell materials from the National Defense Stockpile and use the proceeds for environmental restoration at military facilities. Because asset sales are involved, CBO sets the proceeds from the proposal apart from the request for appropriations; OMB did not do that. The effect is that CBO has a higher estimate of outlays subject to the 1993-1995 BEA caps by about $600 million per year.

International Affairs

CBO reestimates the Administration's international affairs requests in several programs, including Food for Peace, other foreign aid, the Eximbank, loan liquidating accounts, and the Exchange Stabilization Fund. All reestimates are technical in nature; that is, they do not involve different economic or legislative assumptions (see Table 4-7).

Discretionary Programs. Compared with the Administration's estimates, CBO's estimates for discretionary outlays are $500 million higher in 1993. However, CBO's reestimates of discretionary spending are $200 million to $300 million lower in 1995 through 1997.

Foreign Aid. For fiscal years 1992 and 1993, the Administration has lowered its outlay estimates for a number of foreign aid accounts from a year ago--in particular, the Foreign Military Financing program, the Economic Support Fund, the Special Defense Acquisition Fund, and bilateral assistance programs. Through the first quarter of fiscal year 1992, CBO has discerned no trend justifying such a slowdown in outlays, and CBO's 1992-1994 estimates therefore are higher than those of the Administration.

Public Law 480. Based partly on the spending slowdown experienced in fiscal year 1991, the Administration has estimated lower outlays from new budget authority. CBO considers the 1991 slowdown to be not a new pattern but the result of the reorganization required

Table 4-6.
CBO Reestimates of Proposed Spending in the President's Budget for Function 050, National Defense (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	307.3	291.4	283.4	283.2	286.3	289.3
CBO Reestimates						
Department of Defense						
Defense Business Operations Fund	-0.8	0.7	0.1	0	0	0
Stockpile asset sales	0	0	-0.6	-0.6	-0.6	-0.6
Other revolving funds outlays	0	-0.4	0.6	0.6	0.6	0.6
Procurement	-0.2	0.5	-0.1	-0.2	-0.1	0.1
Operation and maintenance	0.1	0.1	a	b	a	a
Other	a	a	a	a	a	a
Subtotal	-1.0	0.9	b	-0.2	-0.1	0.1
Other Defense	b	b	a	b	b	b
Total	-1.0	0.9	b	-0.2	-0.1	0.1
President's 1993 Budget as Estimated by CBO	306.3	292.2	283.4	282.9	286.1	289.4

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

a. Less than $50 million.

b. Negative outlay of less than $50 million.

by statutory changes in the Food, Agriculture, Conservation, and Trade Act of 1990. A slowdown is inconsistent with the Administration's plan, announced last December, to accelerate obligations to stimulate the economy. Lower outlays in fiscal year 1993 are an estimate of recoveries of lapsing funds.

Eximbank Negative Subsidy Receipts. The Administration is requesting authority to spend receipts collected in an Eximbank Negative Subsidy Special Fund--a budget account that accumulates funds when the present value of cash inflows exceeds that of cash outflows. The budget's estimate of those receipts is inconsistent with OMB's guidelines (in Circular A-34) for the treatment of receipts from negative subsidy loans under credit reform. The inconsistency occurs because the budget estimate assumes more receipts than the amount prescribed. CBO estimates that following the OMB guidelines would lower the amount of budget authority in the program account by $76 million, or 10 percent. With lower budget authority, the bank would lack the funds for 7.5 percent of its anticipated loan volume.

Mandatory Programs. CBO's estimates of outlays for mandatory programs are $900 million lower than the Administration's in 1993 and $500 million to $700 million lower in 1994 through 1997.

Loan Liquidating Accounts. The Administration has lowered its estimate of receipts and collections in the loan liquidating accounts, using a method tied to risk factors developed for estimating the cost of new loans under credit reform. The lower estimates appear for the P.L. 480 program, Eximbank, and bilateral loans made by the Agency for International Development before 1992.

In CBO's view, recent history suggests that the Administration should have raised the estimates instead. The Administration may have resisted that course because it wants to

Table 4-7.
CBO Reestimates of Proposed Spending in the President's Budget for Function 150, International Affairs (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	17.8	18.0	18.6	18.9	18.8	18.7
CBO Reestimates						
Discretionary						
Foreign aid	0.4	0.4	0.1	0	0	0
Food for Peace (P.L. 480)	0.2	-0.1	0	0	0	0
Export-Import Bank	0	-0.1	-0.1	-0.1	0	0
Other	-0.1	0.2	0	-0.1	-0.3	-0.2
Subtotal	0.5	0.5	0	-0.2	-0.3	-0.3
Mandatory						
Loan liquidating accounts	-0.7	-0.6	-0.4	-0.3	-0.1	0
Exchange Stabilization Fund	-0.1	-0.3	-0.4	-0.4	-0.4	-0.5
Subtotal	-0.8	-0.9	-0.7	-0.7	-0.5	-0.5
Total	-0.3	-0.4	-0.7	-0.9	-0.9	-0.8
President's 1993 Budget as Estimated by CBO	17.5	17.5	17.9	18.1	18.0	17.9

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

modify certain loans. Underestimating outlays makes the modifications look less costly than they really are.

Exchange Stabilization Fund. CBO estimates interest income for the Exchange Stabilization Fund using interest rate assumptions from its economic forecast for the various foreign currency investments the fund holds. CBO's estimates of these receipts exceed the Administration's estimates by $100 million in 1992, $300 million in 1993, and about $400 million a year thereafter.

Chapter Five

The Administration's Domestic Proposals

The President identifies selected savings in the domestic arena that, in isolation, will help to trim the deficit modestly. The Budget Enforcement Act of 1990 (BEA) erected a fence between two broad types of domestic spending: *discretionary spending* (which is controlled by annual appropriations) and *mandatory spending* (controlled more indirectly, generally by changing underlying laws governing eligibility and benefits). The former is controlled by dollar caps. The latter is lumped together with federal revenues in a pay-as-you-go regime, which bars actions affecting these categories from adding to the deficit.

Mandatory programs make up about two-thirds of all federal spending and about four-fifths of domestic spending. The President's proposals barely nick the growth in that category: mandatory programs other than net interest and deposit insurance are expected to grow an average of about 6.9 percent a year through 1997 under current policies versus about 6.7 percent a year under the Administration's proposals. In the near term, roughly half of the President's savings in mandatory spending come from Medicare and the rest from a sprinkling of other programs--chiefly federal employees' health benefits, veterans' programs, auctioning licenses to use portions of the electromagnetic spectrum, and others. Later savings (in 1996 and 1997) come from extending some expiring provisions that affect Civil Service Retirement and Customs Service user fees. Modest savings are spelled out for several other entitlement programs (including student loans, farm price supports, family support, and food stamps), and two of the biggest entitlement programs (Social Security and Medicaid) emerge from the President's budgetary review virtually untouched.

As in previous budgets, the President again proposes to sell or lease various government assets: one of the naval petroleum reserves, the Arctic National Wildlife Refuge, and the Alaska Power Marketing Administration. CBO has argued consistently that the proceeds from these proposals do not belong on the act's deficit reduction scorecard, which specifically bars credit for asset sales.

Domestic discretionary spending makes up only about one-sixth of the budget. Although the President cites an overriding goal of controlling domestic discretionary spending, the proposals do not fully comply with the discipline required by 1990's Budget Enforcement Act. Decisions about funding for discretionary programs are made one year at a time. In 1993, caps set in the act will continue to govern domestic discretionary spending. CBO judges that the President's requested funding for domestic programs satisfies the budget authority cap but exceeds the outlay cap by about $1 billion (within the margin of error permitted by the BEA). The President accomplishes that by freezing total appropriations at this year's levels, with just a few favored areas (notably space, science, and the justice programs) slated for increases and several others (chiefly postal subsidies, transportation, community and regional development, and fuel and housing assistance) marked for outright cuts.

In 1994 and 1995, however, the Administration has yet to come to grips with the act's tough requirements. After 1993, domestic discretionary spending vies with international and defense spending under a single overall cap. Although the President proposes roughly to freeze most domestic appropriations at 1992's levels through 1997, that is not enough. To adhere to the caps in 1994 and 1995, the Administration must find more cuts--either in defense or in domestic programs.

Chapter 1 sketched the President's major proposals using the broad categories--discretionary, pay-as-you-go, and other spending--that are central to the budget enforcement process. This chapter details the Administration's proposals for 18 budget functions covering the domestic side of the budget. Each function covers spending that addresses a particular national need, such as energy, agriculture, or health. (A few functions--such as net interest--do not address national needs as conventionally defined but are included for completeness.) A typical domestic function contains both discretionary and mandatory spending.

The key comparison made for each function is between the Administration's proposal and CBO's baseline, a comparison that highlights how the President wants to change today's allocation of resources. The baseline--as more fully explained in Appendix A--depicts the path of spending if current laws and policies remain unchanged. For mandatory programs (such as Social Security and Medicare), the baseline simply shows CBO's best estimate of payments that would occur under current laws. For discretionary programs, the baseline for each individual function shows the spending that would result if appropriations in real terms were kept constant at 1992's level (that is, permitted to keep pace with inflation). CBO's baseline projection for total outlays assumes that discretionary outlays will be constrained within the BEA's caps. There are literally thousands of ways the caps could be met, however, and a comparison with today's real spending levels is one useful way of highlighting the possible trade-offs and the implications for particular programs. The discussions also note major estimating differences between CBO and the Administration--disagreements that can stem from contrasting economic forecasts or from other, technical factors.

Many domestic functions contain some credit activity--that is, programs in which the government lends money directly or guarantees loans extended by private lenders, often with maturities of a decade or more. The Budget Enforcement Act changed the budgetary treatment of credit programs, addressing long-standing criticism that the focus on near-term cash flows merely encouraged myopic decisions. Now, costs of credit programs are expressed in terms of subsidies. A subsidy is the value, in today's dollars, of all the future cash flows that a loan or guarantee is expected to entail--or, in plain English, the amount the government expects to lose on the transaction. Throughout this chapter, subsidy is the yardstick used whenever credit programs are discussed.

Function 250: General Science, Space, and Technology

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	16.4	16.7	17.6	18.4	19.0	20.0
Proposed Changes						
Pay-As-You-Go						
Superconducting Super Collider Trust Fund	0	0.1	0.3	0.4	0.5	0.4
Discretionary						
Department of Energy	0	0.1	0.1	0.1	a	-0.1
National Science Foundation	0	0.2	0.3	0.3	0.2	0.1
National Aeronautics and Space Administration	0	a	-0.2	-0.7	-1.2	-1.8
Department of Defense	0	a	-0.1	-0.1	-0.1	-0.1
Subtotal	0	0.3	0.1	-0.5	-1.1	-1.8
Total	0	0.4	0.4	-0.1	-0.6	-1.4
President's 1993 Budget as Estimated by CBO	16.4	17.0	18.0	18.3	18.4	18.6
President's 1993 Budget	16.4	17.0	18.1	18.4	18.4	18.7
CBO Reestimates	a	a	-0.1	-0.1	-0.1	-0.1

a. Less than $50 million.

Proposed Changes

The 1993 budget seeks modest increases for function 250. The proposed budget authority for 1993 would be $0.7 billion (4 percent) above the CBO baseline, with a resulting increase in outlays of $0.4 billion (2 percent). Proposed budget authority for 1994 through 1997 is frozen at the 1993 level, about $18.4 billion; outlays would increase slowly to about $18.6 billion by 1997. Both proposed budget authority and outlays would be below the baseline in 1995 through 1997.

All of the programs in the function would receive a spending increase in 1993. Budget authority for the Department of Energy's general science programs would be above the baseline by $365 million (24 percent) in 1993; the National Science Foundation, by $378 million (14 percent); and the National Aeronautics and Space Administration, by $41 million (0.3 percent).

Pay-As-You-Go Policy Changes

The Administration proposes to establish a trust fund for the Superconducting Super Collider (SSC) from which donations from nonfederal sources would be spent. This trust fund would provide $233 million in budget authority and $93 million in outlays in 1993. In the following years, the trust fund would provide higher budget authority and outlays, reaching $570 million in budget authority and $500 million in outlays in 1996.

Discretionary Policy Changes

The Department of Energy's Superconducting Super Collider would receive the largest increase in appropriations. The $650 million requested in 1993 would exceed the baseline by about $150 million, and the outlays would be about $60 million above the baseline. Combined with the trust fund spending, total outlays for the SSC would be about $600 million in 1993.

Spending for the National Science Foundation (NSF) would again be raised. For 1993, the NSF appropriation would exceed the baseline by $378 million, although $78 million of this increase results from shifting a portion of the Antarctic research program out of the Department of Defense. Most of the funding increase would go to National Science Foundation research and related activities, for which the 1993 budget authority would be $278 million above the baseline.

The National Aeronautics and Space Administration (NASA) would receive a small increase in budget authority--$41 million--relative to the baseline in 1993. Although some programs within NASA, such as the space station Freedom, would receive substantial increases, these increases would be offset by reductions or cancellations of other programs, such as the Advanced Solid Rocket Motor program.

CBO Reestimates

CBO's outlay estimates are close to the Administration's figures for all years.

Function 270: Energy

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	3.8	5.5	5.8	5.6	5.4	5.0
Proposed Changes						
Pay-As-You-Go						
Power marketing reforms	0	0	-0.4	-0.4	-0.5	-0.5
Discretionary						
Uranium enrichment	0	-0.2	-0.3	-0.3	-0.4	-0.2
Strategic Petroleum Reserve	0	-0.1	-0.2	-0.2	-0.4	-0.5
Fossil and energy supply R&D	0	a	-0.1	-0.2	-0.3	-0.4
Naval petroleum reserve	0	a	-0.1	-0.2	-0.2	-0.2
Nuclear waste disposal	0	0.1	0.1	0.1	0.1	0.1
Other	0	a	a	-0.1	-0.1	-0.2
Subtotal	0	-0.2	-0.5	-0.9	-1.4	-1.4
Other Changes						
Loss of naval petroleum reserve and Alaska PMA receipts[b]	0	0	0.5	0.6	0.5	0.5
Rural electrification	0	-0.3	a	a	a	a
Subtotal	0	-0.3	0.5	0.6	0.5	0.5
Total	0	-0.5	-0.4	-0.7	-1.3	-1.3
President's 1993 Budget as Estimated by CBO	3.8	5.0	5.4	4.8	4.1	3.7
President's 1993 Budget	4.0	4.6	5.5	4.8	4.0	3.7
CBO Reestimates	-0.2	0.4	-0.1	a	a	a

a. Less than $50 million.

b. Receipts from the proposed lease of the naval petroleum reserve at Elk Hills, California, and from the proposed sale of the Alaska Power Marketing Administration (PMA) are shown in function 950. Outlays in function 270 would increase relative to the baseline because the assets would no longer generate direct receipts to the government. (For Elk Hills, the government would receive royalty payments after 1993; those receipts are also shown in function 950.) The loss of receipts in function 270 is included here under "other changes" because CBO considers these proposals to be asset sales.

Proposed Changes

Under the President's budget, net spending on energy programs would total about $5 billion in 1993, which is $0.5 billion below the projected baseline level. Most of this reduction would result from two proposals: (1) a new fee on nuclear utilities to offset some environmental cleanup costs associated with the government's uranium enrichment program, and (2) modifications of rural electrification loans, which higher outlays would offset in future years. Despite these savings, net energy spending is expected to increase by more than $1 billion from 1992 to 1993, primarily because of large planned increases in capital investment by the Tennessee Valley Authority.

Other energy proposals would have significant budgetary effects after 1993--most notably, power marketing repayment reforms and no new funding to acquire oil for the Strategic Petroleum Reserve (SPR). Outlay savings relative to the baseline would total $4.2 billion over the 1993-1997 period.

The above savings are net of losses in receipts that would result from the proposed sale of the Alaska Power Marketing Administration (PMA) and the proposed lease of the naval petroleum reserve at Elk Hills, California (NPR-1). Those savings also include intragovernmental receipts for the proposed modification of rural electrification loans. Excluding these transactions, outlay savings would total $6.1 billion from 1993 through 1997.

Pay-As-You-Go Policy Changes

PMA Repayment Reforms. The President is again seeking to establish a fixed schedule for the interest and principal repayments that PMAs make to the Treasury. Interest rates would be changed to the Treasury's cost of borrowing at the time each PMA investment went into service. These reforms would increase the price of federally generated hydropower and would increase offsetting receipts by $1.7 billion for fiscal years 1994 through 1997. CBO expects that the policy cannot be fully carried out until 1994.

Discretionary Policy Changes

Uranium Enrichment. The President proposes to levy a new fee on operators of commercial nuclear reactors and to use the proceeds to offset appropriations for environmental cleanup activities in the uranium enrichment program. The proposed fee of 0.33 mill per kilowatt-hour of gross electricity generated by each reactor would raise approximately $0.2 billion per year. In addition, spending would be held below baseline levels in all years.

Strategic Petroleum Reserve. The President's proposal for the SPR would reduce expenditures for the SPR by 48 percent over the next five years relative to the baseline. Most of the reduction would occur because the President does not request any additional funding to purchase oil for the reserve. The budget assumes purchases at an average rate of 25,000 barrels per day in 1993 and 1994, using existing funds in the SPR oil account. At this rate, existing funds would be spent before the end of 1995, and the SPR would hold about 600 million barrels of oil by 1997. By contrast, the baseline would support purchases averaging about 40,000 barrels per day throughout the 1993-1997 period, which would place 650 million barrels of oil in the SPR by the end of 1997.

Fossil Energy and Energy Supply Research and Development. The budget requests 1993 funding for fossil energy that would be 33 percent, or $157 million, below the baseline. The 1993 request for energy supply research and development (R&D) is 4 percent above the baseline, an increase of $129 million. After 1993, however, appropriations for R&D for both fossil energy and energy supply research would be frozen at the 1993 request levels, resulting in estimated outlay savings of just under $1 billion, relative to the baseline, over the 1993-1997 period.

Nuclear Waste Disposal. The President's 1993 request for this program is 38 percent, or $108 million, above the baseline level. This and subsequent-year increases would result in program outlays that are 26 percent above the baseline over the 1993-1997 period. Most of the increases are for expanded surface-based testing at Yucca Mountain, the candidate site for a waste repository. The budget assumes a volunteer site will be found for the monitored retrievable storage facility that the government plans to complete before it takes title to commercial nuclear waste in 1998.

Other. The President proposes to reduce lending by the Rural Electrification Administration (REA) to electric and telephone cooperatives. The proposal would eliminate the 5 percent loans for telephone borrowers; it also would cut the 5 percent loans to electric borrowers, reducing the loan level to 20 percent below the baseline. Outlay savings in 1993 would amount to less than $10 million in reduced subsidy costs, but would total about $230 million over the 1993-1997 period.

The President also requests $48 million of subsidy authority in 1993 for modifications of REA loans. This authority would be used to ease repayment terms on existing loans, resulting in an intragovernmental payment of $266 million from the nonbudgetary financing account to the REA liquidating account in 1993. This receipt, however, would be offset by forgone receipts in future years. The changes in the liquidating account would not be scored in either the pay-as-you-go or the discretionary category.

Other Changes

Naval Petroleum Reserve. The President proposes to lease NPR-1 at the end of fiscal year 1993. CBO considers this an asset sale and thus does not include changes in NPR receipts in pay-as-you-go scoring. Receipts from the asset sale, including both bonus bid receipts and federal royalties, appear in budget function 950 and total an estimated $1.9 billion over the 1993-1997 period. These savings would be partially offset, however, by an increase in outlays in function 270 because the government would no longer be collecting receipts from selling oil and gas produced at Elk Hills. In 1994, the proposed asset sale would result in a loss of receipts of $0.5 billion, with similar losses in subsequent years.

After leasing Elk Hills, appropriations for operating the reserve would no longer be necessary, but the President proposes to use some of these savings to establish a defense petroleum inventory of 10 million barrels. Savings from discontinued federal operations of NPR-1, less amounts proposed for the inventory, are shown in the discretionary category and would total $0.7 billion over the 1993-1997 period.

CBO Reestimates

CBO's estimates of net outlays for function 270 under the President's budget proposals are above the Administration's estimates by $0.4 billion in 1993. Net reestimates in other years are relatively small.

The largest estimating difference involves the pay-as-you-go proposal for PMA repayment reform. The budget assumes that PMA rates could be increased in time to collect an additional $0.4 billion in power receipts for 1993. CBO estimates that such a large electric rate increase would require more time to implement and that additional receipts could not be collected until 1994.

Function 300: Natural Resources and Environment

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	20.5	21.5	22.6	23.4	24.1	24.8
Proposed Changes						
Pay-As-You-Go						
Corps of Engineers recreation fees	a	a	a	a	a	a
Discretionary						
Water resources	0	-0.3	-0.5	-0.7	-0.9	-1.1
Conservation and land management	0	-0.2	-0.4	-0.6	-0.8	-1.0
Recreational resources	0	a	-0.1	-0.3	-0.4	-0.5
Pollution control and abatement	0	0.1	a	-0.3	-0.9	-1.6
Other natural resources	0	-0.1	-0.2	-0.3	-0.4	-0.6
Subtotal	0	-0.5	-1.2	-2.2	-3.4	-4.9
Other Changes						
Leasing the Arctic National Wildlife Refuge (Alaska's share of proceeds)[b]	0	0	0	-0.8	-0.5	a
Total	a	-0.5	-1.2	-3.0	-3.9	-4.9
President's 1993 Budget as Estimated by CBO	20.5	21.0	21.4	20.4	20.2	19.9
President's 1993 Budget	20.2	20.5	20.0	21.1	19.9	20.1
CBO Reestimates	0.3	0.4	1.4	-0.7	0.3	-0.2

a. Less than $50 million.

b. Projected receipts from leasing the Arctic National Wildlife Refuge would be split between the federal government and the state of Alaska. The federal share of leasing receipts appears in function 950, Alaska's share appears in function 300, and the proposed payout to Alaska of its share of receipts is shown in function 800.

Proposed Changes

The President's proposals for natural resource and environmental programs would reduce outlays below the CBO baseline by $0.5 billion in 1993 and by $13.6 billion over the 1993-1997 period. Most of the savings would be obtained by holding discretionary appropriations at or below the 1992 level throughout the five-year period.

Pay-As-You-Go Policy Changes

The President's budget includes proposed new recreation fees to be collected from people using facilities of the U.S. Army Corps of Engineers. CBO estimates that this proposal would yield additional offsetting receipts of about $5 million in 1992 and $20 million a year thereafter.

Discretionary Policy Changes

The President is requesting 1993 appropriations of $21.2 billion for discretionary natural resource and environmental programs, $0.9 billion (4 percent) below the CBO baseline level of $22.1 billion. Outlays in 1993 would be about $0.5 billion (2 percent) below the baseline.

Water Resources. The President's 1993 appropriation request for water resource programs totals $4.5 billion. This funding level is 8 percent ($408 million) below the CBO baseline in 1993 and would result in outlay savings of $276 million. These savings reflect decreases from baseline budget authority of 6 percent for the Army Corps of Engineers, 13 percent for the Bureau of Reclamation, and 29 percent for the Soil Conservation Service. Over the 1993-1997 period, budget authority would be $4 billion, or 15 percent, below baseline levels; outlay savings would total $3.6 billion.

Conservation and Land Management. The President is requesting 1993 appropriations for conservation and land management activities totaling $4.8 billion, which is $275 million (5 percent) below the baseline. Resulting outlays would be about $200 million below baseline levels. Funding for all major land management agencies would be below baseline levels, including reductions of 13 percent for land conservation activities carried out by the Department of Agriculture, 1 percent for the Forest Service, and 1 percent for the Bureau of Land Management. Over the 1993-1997 period, budget authority for all land management agencies would be $3.4 billion, or 12 percent, below the baseline, and outlay savings would total $3.1 billion. The Administration is also proposing to collect holding fees for hard-rock mining claims, which CBO estimates would increase receipts by $41 million in 1993 and by about $36 million annually thereafter.

Recreational Resources. The President's 1993 request for discretionary funding of recreational programs is $2.2 billion, about $64 million less than the 1992 funding level and $194 million, or 8 percent, below the CBO baseline. Outlay savings would total about $10 million for the budget year. Most of the decrease proposed for these programs would be borne by multiyear construction projects of the National Park Service and the Fish and Wildlife Service, which would be cut by $212 million in the budget year. Additional outlay savings would be achieved by instituting new recreational user fees under the President's America the Beautiful initiative. CBO estimates that the proposed fees would increase federal receipts by about $34 million in 1993 and by $261 million over the 1993-1997 period. In 1993, outlay savings from proposed recreation fees and construction cuts would be offset partially by increases in spending for resource management and protection and for other recreational programs.

Pollution Control and Abatement. The President's 1993 budget for environmental programs results in outlays that are $53 million, or about 1 percent, above the baseline. The budget includes 1993 funding increases above baseline levels for a number of activities of the Environmental Protection Agency--including cleanup of hazardous wastes (Superfund), research and development, and salaries and expenses. Over the 1993-1997 period, however, outlays would fall about $2.8 billion, or 8 percent, below the baseline. The proposed phaseout of the grant program for construction of wastewater treatment facilities would produce most of these savings--$1.9 billion over five years. Appropriations for these grants would increase from $2.4 billion in 1992 to $2.5 billion in 1993 and then fall to zero in 1997. Authorizations for this program in the Clean Water Act currently end in 1994. The remaining savings after 1993 reflect an assumed freeze on appropriations at 1993 levels.

Other Natural Resources. The President proposes 1993 funding above the baseline for the National Oceanic and Atmospheric Administration's (NOAA's) construction and operations, research, and facilities activities, financed partly with funds transferred from the Marine Navigation Trust Fund. Also, proposed reductions in spending for the Department of the Interior's Geological Service and Bureau of Mines would result in savings of $95 million in 1993 and $0.9 billion over the 1993-1997 period. In total, spending authority for other natural resource programs would be 5 percent below the baseline in 1993, and outlay savings would be about $60 million.

Other Changes

The President proposes to share half the proceeds from selling oil and gas exploration and development rights for the Arctic National Wildlife Refuge (ANWR) with the state of Alaska. CBO considers these transactions to be asset sales because the sale of such rights would result in the depletion of mineral resources currently owned by the federal government. Alaska's share of ANWR leasing receipts--which CBO estimates would total about $800 million in 1995 and about $450 million in 1996--is shown in function 300, and the proposed payout of those receipts to the state is shown in function 800. The federal share of such receipts is shown in function 950. The overall effect of these transactions on the federal budget, net of payments to Alaska, would be receipts totaling $1.3 billion in 1995 and 1996.

CBO Reestimates

CBO's estimates of outlays are above the Administration's estimates by $0.4 billion in 1993 and by $1.3 billion over the 1993-1997 period, primarily reflecting different spending rates for many accounts in the conservation and land management and pollution control programs. CBO also assumes that any action by the Congress to open the ANWR to oil and gas exploration and development is likely to occur later than the Administration assumes. Consequently, CBO assumes that the first lease sale would occur in 1995 rather than 1994. CBO also projects that Alaska's share of bonus bids from competitive bidding would be about $0.8 billion lower than estimated by the Administration over the 1993-1997 period.

Function 350: Agriculture

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	15.6	16.3	15.0	13.0	13.2	13.5
Proposed Changes						
Pay-As-You-Go	0	-0.2	-0.1	a	-0.1	a
Discretionary						
Agricultural Credit Insurance Fund	0	-0.1	-0.1	-0.1	-0.2	-0.2
Other	0	-0.1	-0.3	-0.5	-0.7	-0.9
Subtotal	0	-0.2	-0.4	-0.6	-0.8	-1.1
Other Changes	0	a	a	a	a	a
Total	0	-0.5	-0.5	-0.7	-0.9	-1.1
President's 1993 Budget as Estimated by CBO	15.6	15.8	14.5	12.4	12.3	12.4
President's 1993 Budget	17.4	16.1	14.9	12.6	12.4	12.0
CBO Reestimates	-1.8	-0.3	-0.4	-0.2	a	0.4

a. Less than $50 million.

Proposed Changes

CBO estimates that changes proposed by the Administration would save $0.5 billion in 1993 and $3.6 billion over the 1993-1997 period relative to the CBO baseline. Agriculture spending is projected to decline over this period, even under current law, because crop prices are expected to improve, resulting in smaller direct payments to farmers.

Pay-As-You-Go Policy Changes

Commodity Credit Corporation (CCC). About 60 percent of the spending in this function is for price support activities of the CCC, which are estimated to cost $8 billion to $10 billion a year between 1993 and 1997. The Administration is proposing only one change in these programs--eliminating payments for any producers who earn more than $100,000 per year in income from off-farm sources. Although the budget shows savings in 1992, CBO assumes that this change would take effect with the 1993 crops and that savings would begin in 1993. This proposal would affect a relatively small number of producers, and the amount of savings is uncertain because farmers may restructure their finances to stay below the income threshold. CBO estimates that this proposal would reduce deficiency payments by about $45 million per year once the program is fully in effect and would save about $200 million over the 1993-1997 period.

Farm Credit System. The President proposes to require the Farm Credit System to make annual payments to the Financial Assistance Corporation (FAC) to cover FAC's debt service obligations. Such debt was issued to assist system institutions experiencing financial difficulties. Under current law, FAC would pay off its debt and repay Treasury interest costs after 2006. The President's proposal would result in savings of about $0.2 billion on a present-value basis. The budget would record these estimated savings in 1993.

Other. The budget also includes a proposal to eliminate the mandatory payments of $3 million per year that the Cooperative State Research Service makes to states.

Discretionary Policy Changes

Agricultural Credit Insurance Fund. The Farmers Home Administration makes direct loans and loan guarantees to farmers to purchase and operate farms. The President's budget would reduce the subsidy appropriations necessary to make these loans by $0.1 billion in 1993 relative to the baseline. About 90 percent of this cut would result from a proposed 64 percent reduction in subsidies for direct operating loans. Reductions in other direct loan programs would be partly offset by increases in funding for loan guarantees.

Other Agriculture Programs. The President is proposing to reduce funding for many activities of the Department of Agriculture below 1992 levels and to freeze appropriations at the 1993 levels in subsequent years. The President's proposals would result in net outlay savings of about $0.1 billion in 1993 and $2.5 billion over the 1993-1997 period compared with the CBO baseline. Decreases relative to the baseline are slated for the Agricultural Stabilization and Conservation Service, the Animal and Plant Health Inspection Service, the Cooperative State Research Service, the Agricultural Research Service, the Extension Service, and the Foreign Agricultural Service. In contrast, increased funding is provided for research on new uses of agricultural commodities and the development of biofuels. The President has also asked for authority to levy user fees for grain inspection and agricultural marketing services.

Other Changes

The Enterprise for the Americas Initiative. As part of an initiative to reduce the debt of Latin American countries, the Administration proposes to sell some of the debt that these countries owe to the Commodity Credit Corporation. The sale would require additional subsidy appropriations and outlays in function 150, and would result in net receipts to the CCC liquidating account in function 350, which makes and receives payments related to previously guaranteed export loans. The sale receipts would be offset by smaller repayments in 1993 and subsequent years and would not be counted for deficit reduction purposes. CBO estimates that this proposal would produce net receipts in function 350 of $28 million in 1993 and $1 million in 1994, followed by outlays of $32 million over the 1995-1997 period.

CBO Reestimates

CBO's outlay estimates for agriculture programs are significantly lower than the Administration's in 1992 and somewhat lower in other years. The bulk of the difference is in CCC outlays.

CBO estimates CCC outlays to be lower than those forecast by the Administration by about $1.9 billion in 1992, $1.6 billion in 1993, and $2.1 billion over the 1994-1997 period. These differences result in part from CBO's projections of higher prices for wheat and feed grains. Recent data on current commodity demand and on 1992 crop plantings for the major grains imply lower stocks and higher prices than those estimated by the Administration. Therefore, deficiency payments made in 1992 are likely to be lower and crop loan repayments higher than the Administration projects. In addition, unlike CBO, the Administration projects that unexpected expenses for working capital will total $1 billion a year.

CBO estimates higher outlays both for existing export credit guarantees and for new credits. This difference amounts to $2 billion over the 1993-1997 period and occurs because CBO projects a higher subsidy cost for loan guarantees extended to the republics of the former Soviet Union.

Finally, CBO expects lower savings than does the Administration from the proposal to eliminate program payments for producers whose off-farm income exceeds $100,000. CBO assumes a greater degree of farm reorganization to avoid the payment threshold, resulting in estimated savings that are about $0.1 billion a year lower between 1994 and 1997.

Function 370: Commerce and Housing Credit

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	72.6	75.6	36.5	-13.8	-41.7	-25.1
Proposed Changes						
Pay-As-You-Go	0	0	0	0	0	0
Discretionary						
Rural Housing Insurance Fund	0	-0.1	-0.2	-0.2	-0.3	-0.3
Postal Service	0	-0.4	-0.4	-0.4	-0.4	-0.4
Small Business Administration	a	-0.2	-0.3	-0.3	-0.3	-0.4
Other	a	0.1	0.1	a	-0.2	-0.3
Subtotal	0.1	-0.5	-0.7	-0.9	-1.2	-1.4
Other Changes						
Postal Service	0	0.3	0.1	0	-0.3	-0.1
Banking reform	0	0	0	0	0	0
Total	0.1	-0.2	-0.6	-0.9	-1.5	-1.5
President's 1993 Budget as Estimated by CBO	72.7	75.4	36.0	-14.7	-43.2	-26.6

a. Less than $50 million.

Proposed Changes

Under the Administration's budget, spending for commerce and housing credit programs would be below the baseline in each year during the 1993-1997 period, largely because of proposed cuts in discretionary spending programs totaling $0.5 billion in 1993 and $4.7 billion over the five-year period.

Under baseline assumptions, total spending in this function is projected to plummet from $76 billion in 1993 to $37 billion in 1994. By 1997, the function would show negative outlays, or net receipts, of $25 billion. Spending under the Administration's policy would follow the same pattern. This dramatic decline in outlays will occur primarily because spending for resolving failed savings and loan institutions is expected to peak in 1993 at about $53 billion, and the government will then begin to collect increasing amounts of receipts from selling the assets of the failed thrifts. CBO also estimates that net outlays of the Bank Insurance Fund (BIF) will decline substantially from 1993's level of $17 billion.

Discretionary Policy Changes

Rural Housing Insurance Fund (RHIF). The program changes proposed in the President's budget are similar to those included in last year's budget. Currently, the bulk of rural housing assistance is in the form of deeply subsidized direct loans to low-income households and developers of low-income rental housing. The President would replace some of these direct loans with guarantees of private loans. Low-income borrowers with guaranteed loans would receive federal subsidies that could reduce the effective interest rate an estimated average of 3 percentage points. Other borrowers would receive no assistance beyond the guarantee.

The budget includes a 1993 appropriation request of $0.5 billion for rural housing subsidies, which is estimated to support about $1.7 billion in single-family and multifamily lending, down from $2.2 billion in 1992. The direct loan activity proposed by the President for 1993 is estimated to provide single-family assistance to about 7,400 households and to fund 8,200 rental units. The Administration's loan guarantee program would assist an additional 13,100 borrowers. The budget proposals would reduce outlays for subsidies and administrative costs by less than $0.1 billion in 1993 and by about $1.0 billion over the 1993-1997 period relative to the baseline.

These savings would be offset partially by additional spending for a proposed rental voucher program for rural areas. This program would be similar to that operated by the Department of Housing and Urban Development. The budget includes (in function 600) annual funding of $140 million for vouchers, which could support an additional 5,000 to 6,000 units each year.

Payment to the Postal Service. The President is proposing to terminate or restrict certain preferred postage rates, to increase the rates for most preferred mailers, and to eliminate the portion of the appropriated subsidy that covers these preferred postage rates. Relative to the CBO baseline, these changes would save $0.4 billion annually over the 1993-1997 period.

Small Business Administration (SBA). About $0.2 billion of the 1993 savings relative to the CBO baseline would be achieved through reduced appropriations for SBA loan subsidies and administrative costs. The Administration proposes to convert all SBA direct lending to guaranteed lending, except for certain direct loans to minority-owned firms, and to increase the fees that are charged for several types of loan guarantees. This proposal is similar to those included in previous budgets. Total 1993 subsidy appropriations would be $88 million, well below the CBO baseline level of $279 million. Total loans made or guaranteed would decline from $4.9 billion in 1992 to $4.8 billion in 1993.

Other. The Administration would achieve savings of $55 million in 1993 and $318 million over five years by establishing a new transaction fee to be collected by the Commodity Futures Trading Commission. Requested 1993 appropriations of $371 million for the Federal Housing Administration's General and Special Risk Insurance Fund programs--$115 million above the baseline--would raise outlays for these programs by $73 million in that year. The significant increase in funding would be required because, based on new data, the Administration has substantially raised its estimate of the subsidy cost for these guarantees.

Other Changes

Postal Service (Off-Budget). The President is proposing to increase Postal Service payments to the Civil Service Retirement Fund (see function 950) and to the Federal Employees Health Benefits Fund (see function 550) during fiscal years 1993 through 1995. These increases, totaling $0.3 billion annually and $0.9 billion over the next three years, are intragovernmental transactions and would be reflected as receipts on the discretionary scorecard in functions 950 and 550, respectively. The net effect in function 550 would be to reduce the required general fund appropriation to the Federal Employees Health Benefits Fund. Including the cuts in postal subsidies discussed above, the proposals in the budget affecting the Postal Service would result in reduced appropriations of $2.3 billion (in functions 370 and 550) and increased receipts of $0.6 billion (in function 950), or a net spending reduction of about $2.9 billion (on-budget) relative to the baseline over the five-year period.

To recover these costs, the Postal Service is likely to increase postal rates, resulting in net savings to the federal government. Rates for preferred mailers affected by the proposal would probably be raised in 1993. A rate increase to cover the additional costs for payments to the Civil Service Retirement and Federal Employees Health Benefits funds would be in addition to the 13 percent general rate hike that CBO assumes would occur in February 1994. Before that increase, net outlays of the Postal Service would rise by $0.4 billion over the 1993-1994 period as a result of this proposal. Although the Administration is proposing to enact these changes in appropriation bills, this amount would not be scored as discretionary spending because the Postal Service is off-budget. The Postal Service surplus or deficit would be unaffected once these additional costs are covered by higher rates.

Banking Reform Proposals. The President again proposes to allow interstate banking and branching, to permit commercial ownership of banks, and to authorize banks to affiliate with a broad range of financial firms through the formation of financial-services holding companies. These proposals were originally made last year as part of a comprehensive banking and deposit insurance reform package, but were not included in the Federal Deposit Insurance Corporation Improvement Act of 1991, which was enacted last fall. Although the Administration has included estimated savings from these proposals in its pay-as-you-go tabulations, CBO believes that the Budget Enforcement Act of 1990 effectively removed the effects of such proposals from the pay-as-you-go calculations. Furthermore, as discussed below, CBO estimates that the Administration's proposals would have no significant effect on the government's cash flows over the next five years.

CBO Reestimates

CBO estimates that outlays for this function will be lower than the Administration projects by $14.8 billion in 1992 and $8.7 billion in 1993, but higher by $47 billion over the following four years. Most of these variations are attributable to differing estimates for spending on deposit insurance activities by the Bank Insurance Fund and the Resolution Trust Corporation (RTC).

Pay-As-You-Go Reestimates

Bank Insurance Fund. The Administration has estimated that its banking reform proposals would reduce BIF's cash outlays by $7.8 billion in 1994, $11.7 billion in 1995, and $6.6 billion in 1996, and would increase outlays by $7.8 billion in 1997. The Administration believes that the proposals would reduce the number and cost of bank failures by raising the earnings of banks, increasing their cost efficiency, diversifying their risk, and improving their ability to raise capital.

CBO estimates that these proposals would not have a significant impact on BIF spending over the next five years. Over the long term, they should lead to a more diversified, more efficient, and more competitive banking industry. But improved efficiencies are more likely to result in lower costs to consumers of banking services than in higher profits to banks. Furthermore, the bank losses that BIF will have to cover during the next few years have already been incurred or would not be avoided by enacting the Administration's proposals. In fact, there could be additional losses in the short term because most geographic expansion is expensive and increased competition may threaten the viability of some local banks. Consequently, CBO sees no significant benefit to the Bank Insurance Fund over the 1992-1997 period.

Other Reestimates

Bank Insurance Fund. CBO differs significantly from the Administration not only in its assessment of the legislative proposals but also in its projections of BIF spending under current law. The budget projects unprecedented costs for case resolution over the next several years, particularly between 1992 and 1995.

The Administration estimates that bank losses covered by BIF during that period would total about $72 billion on failed assets of about $360 billion. CBO believes that the prospects for the banking industry are less severe and projects bank losses of $43 billion on failed assets of $250 billion over the same period. Largely as a result of these differences, CBO's estimate of the fund's outlays is lower than the Administration's by $18.5 billion in 1992, by $20.7 billion in 1993, and by another $3.5 billion over the following four years.

Resolution Trust Corporation. CBO expects that about 500 more savings and loan institutions will become insolvent through 1995 than does the Administration. Under CBO's baseline projections, the RTC's cumulative losses will be about $150 billion, compared with the Administration's estimate of about $130 billion. Both the Administration and CBO treat the funds necessary to meet the government's commitment to insure deposits as mandatory, and both assume that sufficient funds will be provided to allow the RTC to resolve the inventory of failed thrifts. CBO expects that the RTC will need to continue closing or merging sick thrifts through 1995, whereas the Administration expects it to complete its caseload by 1993. As a result, the most significant difference in outlays over the 1993-1997 period occurs in 1994, when CBO expects that net outlays will exceed the Administration's estimate by $55 billion.

CBO's estimates for net outlays in 1993 and 1995 are higher than those estimated in the President's budget by $17 billion and $8 billion, respectively, largely because CBO projects the closing of more insolvent thrifts and the acquisition of more assets in the resolution process. The additional spending for working capital is expected to generate future offsetting collections for the agency when the assets are sold. Thus, CBO's estimate of net outlays in 1996 is lower than the Administration's by $26 billion.

FSLIC Resolution Fund. This fund is charged with paying off the obligations incurred by the Federal Savings and Loan Insurance Corporation. The fund makes payments to acquirers of failed thrifts, mostly to cover interest and principal payments on notes and to maintain yields or cover capital losses on assets purchased from failed thrifts. The Congress appropriated $15.9 billion in 1992 for the fund to renegotiate the assistance agreements that were made final before 1989 in an effort to reduce the government's long-term costs. The President's budget assumes that $5.6 billion of this authority will not be used in 1992 and that appropriations in 1993 will be needed to replenish this lapsed authority. Because CBO expects that the agency will spend most of its 1992 funding this year, its estimate of outlays is higher by $4.0 billion for 1992, but lower by $3.4 billion for 1993. Over the 1994-1997 period, CBO's estimate of outlays is $0.8 billion less than the Administration's, largely because of higher projected collections from asset sales.

GNMA Mortgage-Backed Securities. At the beginning of 1993, the Administration would transfer the Government National Mortgage Association's guarantee portfolios in good standing from the on-budget liquidating account to the nonbudgetary financing account, regardless of when the guarantees were originated. The liquidating account would include only those portfolios that defaulted before October 1, 1992. This change would increase on-budget outlays by $2.2 billion in 1993 and by small amounts in future years, reflecting the shift to the financing account of Treasury securities that support the guarantee liabilities that would be transferred. Credit reform procedures adopted in 1990, however, specify that the consequences of guarantees in effect before October 1, 1991, should appear in the liquidating account. Therefore, CBO believes that this transaction does not properly reflect credit reform procedures and has excluded it from its budget estimates.

Postal Service. CBO's estimates of Postal Service outlays are different from the Administration's primarily because the budget does not reflect the large year-to-year swings in net operating income that result from periodic rate increases. CBO's estimate of Postal Service outlays is $1.8 billion lower than the Administration's over the 1993-1997 period and reflects a projected rate increase in fiscal year 1994.

Other. CBO estimates that outlays in the credit liquidating account of the Federal Housing Administration's Mutual Mortgage Insurance Fund will be greater than the Administration estimates in 1992 and each of the next four years. These differences result primarily from varying estimates of claims from insurance commitments issued before 1992. Over the 1992-1997 period, CBO's estimate of outlays in this account is $1.5 billion higher than the Administration's.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 370 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	87.5	84.1	-20.1	-23.2	-20.3	-31.8
CBO Reestimates						
Pay-As-You-Go Proposals						
Bank Insurance Fund	0	0	7.8	11.7	6.6	-7.8
Other						
Bank Insurance Fund	-18.5	-20.7	-4.8	-5.8	-2.5	9.6
Resolution Trust Corporation	-0.4	17.5	55.1	8.0	-26.4	a
FSLIC Resolution Fund	4.0	-3.3	a	a	-0.4	-0.3
GNMA	-0.3	-2.5	-0.5	-0.5	-0.5	-0.5
Postal Service	a	a	-1.7	-2.0	a	1.9
Other	0.3	0.4	0.2	-2.8	0.2	2.3
Subtotal	-14.8	-8.7	48.3	-3.2	-29.5	12.9
Total	-14.8	-8.7	56.1	8.6	-22.9	5.2
President's 1993 Budget as Estimated by CBO	72.7	75.4	36.0	-14.7	-43.2	-26.6

a. Less than $50 million.

Function 400: Transportation

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	33.6	36.0	39.0	40.7	42.3	43.8
Proposed Changes						
Pay-As-You-Go	0	0	0	0	0	0
Discretionary						
Mass transit	0	-0.4	-0.6	-0.8	-0.9	-1.1
Federal-aid highways	0	-0.1	-0.7	-1.2	-1.7	-2.3
Miscellaneous highway construction projects	0	-0.1	-0.3	-0.5	-0.6	-0.6
Grants to Amtrak	0	-0.3	-0.3	-0.4	-0.4	-0.4
Northeast Corridor Improvement Program	0	a	-0.1	-0.2	-0.2	-0.2
Federal Aviation Administration	0	a	-0.1	-0.4	-0.7	-1.1
Other	a	0.1	-0.1	-0.3	-0.5	-0.7
Total	a	-0.8	-2.2	-3.7	-5.0	-6.4
President's 1993 Budget as Estimated by CBO	33.6	35.2	36.7	37.0	37.3	37.4
President's 1993 Budget	34.0	35.1	36.7	37.0	37.2	37.3
CBO Reestimates	-0.4	0.1	a	0.1	0.1	0.1

a. Less than $50 million.

Proposed Changes

Outlays for transportation programs under the Administration's policies would be $0.8 billion lower than the CBO baseline in 1993. These savings result from proposals that would limit 1993 discretionary budget authority to a level $1.9 billion (12 percent) below the baseline and that would hold down obligations for highway and transit programs controlled by obligation ceilings. There are no pay-as-you-go proposals in this function.

Ground Transportation. Reductions in spending for ground transportation would account for almost all of the savings in this function. The budget request for mass transit programs would result in outlays of $3.4 billion--$0.4 billion below the CBO baseline. Annual obligations for these programs are controlled by both annual appropriations and annual obligation ceilings. Given the requested appropriations and obligation ceilings, CBO estimates that total obligations for transit programs in 1993 would be $3.0 billion, compared with $3.9 billion under the baseline. Programs targeted for cuts include operating subsidies for larger urban areas and capital subsidies provided through discretionary grants.

Highway programs are also targeted for cuts. The Administration's proposal would limit total obligations for federal-aid highways in 1993 to $19.2 billion--$2.2 billion above the estimated 1992 level, but $0.8 billion below the CBO baseline--resulting in outlay savings of $0.1 billion in 1993. The requested 1993 obligation ceiling would be higher than the baseline level, but the budget also incorporates a proposal to include under the ceiling several programs that are now exempt. Including previously exempt programs and freezing the obligation ceiling at the 1993 level for subsequent years would save $6 billion over the five-year period. (Despite these cuts in obligations, CBO estimates that spending for federal-aid highways under the Administration's proposals would increase by 17 percent over the 1992-1995 period, reflecting the delayed impact of increases in obligations between 1990 and 1992.) The proposal to eliminate new funding for miscellaneous appropriated highway demonstration projects would reduce 1993 budget authority by $0.6 billion, saving $0.1 billion in outlays in that year. The savings on such projects over the five-year period would total $3.3 billion.

Additional savings would be achieved by reductions in funding for Amtrak subsidies, including subsidies for improvements to the Northeast Corridor, and by a proposal to delay the availability of 1993 capital assistance for Amtrak until July of that year. The proposals would reduce appropriations for Amtrak subsidies by $0.3 billion below the baseline and would eliminate all appropriations for the Northeast Corridor ($0.2 billion in 1992). As a result, 1993 outlays would be reduced by $0.4 billion compared with the CBO baseline.

Air Transportation. Funding for aviation programs would be increased in 1993 and would then be held constant over the 1994-1997 period. The President's proposed spending authority for the Federal Aviation Administration (FAA) in 1993 is $0.6 billion, or 6 percent, above the 1992 level and $0.2 billion (2 percent) above the CBO baseline. Most of this increase would be used to continue modernizing and improving the air traffic control system. Spending authority for FAA facilities and equipment would be increased from $2.4 billion in 1992 to $2.7 billion in 1993, an increase of almost 13 percent and more than $0.2 billion above the CBO baseline. The Administration proposes to derive 85 percent of the funds for the FAA from the Airport and Airway Trust Fund over the 1993-1997 period, up from 75 percent in 1992.

Water Transportation. The President proposes 1993 appropriations for discretionary water transportation programs of $3.0 billion, 6 percent above the 1992 level. The proposed funding level is $38 million (about 1 percent) above the CBO baseline for such programs and would result in additional outlays of $37 million. The increase is largely for operating expenses of the U.S. Coast Guard, offset by small cuts in other discretionary accounts.

CBO Reestimates

CBO's estimates of spending under the President's policies are $0.4 billion lower than the Administration's estimate in 1992 and $0.1 billion higher in 1993. Most of the difference in 1992 is attributable to differing assumptions about spending from budget authority from previous years for Coast Guard operating expenses. Other reestimates are relatively small.

Function 450: Community and Regional Development

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps[a]	7.0	7.3	7.2	7.2	7.2	7.5
Proposed Changes						
Pay-As-You-Go	0	0	0	0	0	0
Discretionary						
Community development	b	b	-0.3	-0.6	-0.8	-1.0
Area and regional development	b	-0.2	-0.4	-0.6	-0.8	-0.9
Disaster relief and insurance	0	-0.1	-0.1	-0.1	-0.1	-0.1
Total	b	-0.3	-0.8	-1.3	-1.7	-2.0
President's 1993 Budget as Estimated by CBO	7.0	7.0	6.4	5.9	5.4	5.5
President's 1993 Budget	6.9	7.0	6.5	5.8	5.4	5.2
CBO Reestimates	b	b	-0.1	0.1	0.1	0.3

a. Excludes projection of 1992 emergency appropriation of $800 million for disaster relief.

b. Less than $50 million.

Proposed Changes

Under the President's proposals for community and regional development programs, both budget authority and outlays would fall below the baseline. Budget authority would be about $6.2 billion for 1993, $1.4 billion below the CBO baseline. Outlays would fall below the baseline by about $0.3 billion in 1993 and would be about 17 percent below baseline levels over the 1993-1997 period. There are no pay-as-you-go proposals in this function.

Community Development. The community development programs focus primarily on housing and economic development in urban areas. As in previous years, the President proposes to reduce funding for the Community Development Block Grant program in 1993 and beyond. Appropriations would drop from the 1992 level of $3.4 billion to $2.9 billion per year thereafter. Because the program spends at a relatively slow rate, the reduction would not have a significant effect on outlays in 1993, but would reduce outlays by $2.5 billion over the next five years. The President's budget also proposes eliminating the community development loan guarantee program after 1992.

Additional savings in community development would result from eliminating supplemental assistance to the homeless and emergency grants for community water assistance. The savings are offset somewhat by slight increases in salaries and expenses and research and development activities of the Department of Housing and Urban Development, and in funding for a number of independent housing agencies.

Area and Regional Development. Area and regional development programs primarily fund rural economic development. The President has again proposed eliminating some of these programs and reducing funding for others. The proposed levels of budget authority would result in outlay savings relative to the baseline of $0.2 billion in 1993 and nearly $3.0 billion over the 1993-1997 period.

The President proposes to end the Economic Development Administration's economic development assistance and loan guarantee programs, which would save $39 million relative to the baseline in 1993 and $0.9 billion over five years. In addition, the President seeks to reduce appropriations for the Appalachian Regional Commission development programs and the Tennessee Valley Authority. These reductions would result in outlay savings of $15 million in 1993 and $0.5 billion over the 1993-1997 period.

The budget includes no funding for the Rural Electrification Administration's distance learning and medical link grants and for the Farmers Home Administration's (FmHA's) rural community fire protection grants. It provides reduced funding for FmHA water and waste disposal grants. These proposals would result in outlay savings of $3 million in 1993 and $0.2 billion from 1993 through 1997. These reductions are partially offset by slight increases in funding for FmHA rural development grants, the rural development loan program, and the Rural Telephone Bank (RTB).

Once again, the President proposes to discontinue the Rural Development Insurance Fund's loan guarantees for water and waste disposal systems, but recommends increasing the authorization for the fund's guarantees of community development loans. The Administration also proposes increases in the authorized loan level and subsidy appropriation for RTB direct loans. Under the Administration's plan, all telephone loans made by the Department of Agriculture would be arranged through the RTB. The President requests a direct loan authorization of $475 million, which includes an authorization level of $60 million for low-interest loans for telephone borrowers who would not qualify for RTB loans under existing criteria.

Proposed reductions in spending for Bureau of Indian Affairs (BIA) programs would result in outlay savings of $0.1 billion for 1993 relative to the CBO baseline. Funding for the operation of Indian programs and BIA construction would be reduced by 13 percent in 1993, relative to the baseline, resulting in outlay savings of $48 million for 1993 and $0.8 billion for the 1993-1997 period. The President also proposes to discontinue the BIA direct loan program and to increase the authorized amount for BIA loan guarantees. The President's budget would reduce the amount appropriated for settlements of Indian claims, reflecting an estimate of fewer settlements in the next fiscal year.

Disaster Relief and Insurance. As in last year's budget, the President proposes to limit Small Business Administration disaster loans to borrowers unable to obtain loans from private lenders. In addition, the interest rate on such disaster loans would be increased to the Treasury cost of borrowing. These proposals would reduce outlays by $0.1 billion in 1993 and by $0.6 billion over five years relative to the baseline.

CBO Reestimates

CBO's estimates of outlays for function 450 are very close to the Administration's.

Function 500: Education, Training, Employment, and Social Services

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	45.9	50.2	50.3	50.9	47.7	53.4
Proposed Changes						
Pay-As-You-Go						
Guaranteed student loan programs	-0.3	a	-0.1	-0.1	-0.1	-0.1
Foster care	0	a	0.1	0.1	0.1	0.1
Trade Adjustment Assistance	0	a	-0.1	-0.1	-0.1	-0.1
Subtotal	-0.3	a	-0.1	a	a	-0.1
Discretionary						
Elementary and secondary education	0	-0.1	0.1	-0.2	-0.7	-1.3
Student financial assistance	0	0.1	0.2	a	-0.3	-0.5
Training and employment	0	-0.1	-0.1	-0.5	-0.7	-1.1
Social services	0	-0.6	0.5	-0.3	-0.4	-0.6
Other	a	a	a	-0.1	-0.2	-0.4
Subtotal	a	-0.7	0.7	-1.1	-2.4	-3.9
Total	-0.3	-0.7	0.6	-1.2	-2.5	-3.9
President's 1993 Budget as Estimated by CBO	45.6	49.4	50.9	49.8	45.3	49.5
President's 1993 Budget	45.0	49.6	51.5	50.3	45.9	50.1
CBO Reestimates	0.6	-0.1	-0.6	-0.5	-0.6	-0.6

a. Less than $50 million.

Proposed Changes

The President's proposals for education, job training, employment, and social services would reduce spending $0.7 billion, about 1 percent, below CBO baseline projections in 1993. By 1997, spending would fall $3.9 billion below the CBO baseline, or about 7 percent. In 1993, virtually all spending reductions result from spending cuts for discretionary programs. With a few exceptions--the Head Start program, some elementary and secondary education programs, and Pell Grants--virtually all of the discretionary programs are held at or below baseline levels in 1993 and are frozen at the President's 1993 request level from 1994 through 1997.

Pay-As-You-Go Policy Changes

Guaranteed Student Loan Programs. The President's 1993 budget calls for a number of changes to the guaranteed student loan programs; these changes would reduce spending by an estimated $0.3 billion in 1992 but have small effects on spending in 1993 and succeeding years. Annual borrowing limits in the Stafford Loan program would increase between $875 and $1,000 for most borrowers, depending on the student's year in school.

Annual borrowing limits in the Supplemental Loans for Students program would be increased by $2,000 for most undergraduate students and $6,000 for graduate students. CBO estimates that approximately 1.2 million borrowers will increase their borrowing an average of $900 in 1993, raising loan volume by 9 percent. Less-than-half-time students would become eligible to participate in the guaranteed student loan programs under the Administration's plan, raising participation and loan volume marginally.

The President also proposes to continue recent legislative efforts aimed at reducing federal default costs. For 1992 and following years, the budget includes several provisions that could prevent defaults, increase default collections, or lower federal default costs by sharing costs with state governments and lenders. After 1993, costs of the increased loan volume would be more than offset by reductions in the loan subsidy as a result of these measures. Under credit reform accounting, and assuming enactment in 1992, the present value of the savings on loans outstanding in 1992 would be shown as an outlay reduction in 1992.

Foster Care. The Administration proposes to restructure Foster Care and Adoption Assistance fundamentally, without significantly changing total funding. A new capped entitlement for Child Welfare Services (CWS) of $1.3 billion in 1993 would replace the administrative and training portions of the existing Foster Care and Adoption Assistance programs. Such a reform would reduce the paperwork and disputes clouding the current process for funding the administrative costs of foster care. Troubled children and families could also benefit from the broader array of services allowed under the proposed CWS grants. A key question is whether the proposed funding levels for the CWS grants over the next five years are higher or lower than what states would otherwise have claimed under the existing programs. CBO estimates that the five-year total of $8.3 billion in Child Welfare Services grants is 5 percent greater than administrative and training expenditures under current law and would increase federal outlays by a five-year total of $0.4 billion. Under the Administration's estimates, this restructuring would be budget neutral.

Trade Adjustment Assistance. As in recent years, the President proposes to eliminate the Trade Adjustment Assistance training programs (as well as cash payments in function 600). This proposal would affect approximately 20,000 people and save $0.1 billion a year after 1993. Savings in 1993 would be smaller than in later years because people training during the week of September 30, 1992, would continue to receive services.

Discretionary Policy Changes

Elementary and Secondary Education. The President requests an increase in budget authority that is $0.3 billion, or about 2 percent, above the CBO baseline projections in 1993. This increase accommodates two new initiatives that would raise 1993 funding by a total of $664 million. The first initiative funds parental choice programs that would expand educational options for children from middle- and low-income families. The second funds a variety of programs designed to help communities achieve the national educational goals by the year 2000. However, Impact Aid grants to school districts for children whose parents either work or live on federal property would be eliminated, and other grant programs would be pared. Outlays would be $0.1 billion below the baseline in 1993 because cuts in Impact Aid payments would occur sooner than increased spending on new initiatives.

Student Financial Assistance. The President's budget includes $7.7 billion in federal funding for student financial assistance, $0.6 billion or 8 percent above the baseline. More than half of this increase--$332 million--covers funding shortfalls in past years in the Pell Grant program. Within the remaining funding increases, the President proposes to reallocate funds among student aid programs. In the Pell Grant program, the maximum grant would be increased by $1,300, to a total of $3,700. Also proposed is a new $170 million Presidential Achievement Scholarship program for Pell Grant recipients who excel in their studies. Another $50 million in new funding would help states improve the licensing of schools participating in the federal student aid programs. These program increases are partially offset by provisions that channel Pell Grant funds to the neediest students, thus eliminating approximately 400,000 current recipients from the program. Student aid costs are further reduced by substantial cuts in supplemental grants, work-study, and Perkins loans and by elimination of state student incentive grants. Funding is frozen at the 1993 level for 1994 through 1997.

Training and Employment. Policy changes in 1993 are minor in training and employment programs, although after 1993 most programs are frozen at the 1993 or 1994 level. In addition, the Administration proposes to target Job Training Partnership Act funds toward people who are most in need of training by replacing the existing block grant and summer youth programs with separate year-round programs for low-income adults and youth. Also, a new grant program--Youth Opportunities Unlimited--is proposed for fiscal years 1993 through 1995 to provide comprehensive services to youth living in high-poverty areas.

Social Services. The President's budget proposes to increase Head Start funding by $530 million (23 percent above the baseline) in 1993, to shift $823 million of State Legalization Impact Assistance Grant (SLIAG) funds from 1993 to 1994, and to end the Community Services Block Grant program. Other changes are modest.

The President's budget highlights the Head Start program, which provides comprehensive services to low-income children of preschool age. The program would be funded at $2.8 billion in 1993. Adjusting average costs per child for inflation, Head Start services would reach 788,000 youngsters, a 166,000 increase over the expected participation in 1992. The President proposes to freeze Head Start funding at 1993 levels for 1994 through 1997.

SLIAG grants go to states to pay for certain costs of the legalization of undocumented aliens required by the Immigration Reform and Control Act of 1986. The President proposes to rescind $823 million of SLIAG's already appropriated 1993 funds and restore those funds in 1994. This shift lowers 1993 outlays by $0.6 billion and increases 1994 outlays by an equal amount. California, the recipient of approximately 60 percent of SLIAG funds to date, is likely to be the most affected by the delayed funding.

Once again, the President proposes eliminating the Community Services Block Grant program, reducing spending by $0.3 billion in 1993.

CBO Reestimates

The CBO reestimates in this function are small and are made up of both economic and technical changes. CBO's slightly higher projection of interest rates accounts for small upward reestimates in guaranteed student loan programs. However, CBO projects lower growth in student loan volumes than the Administration does, which leads to downward reestimates in the out-years. Reestimates are also made for the Foster Care and Adoption Assistance program and for discretionary education programs.

Function 550: Health

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	90.7	104.4	115.4	127.4	141.7	157.1
Proposed Changes						
Pay-As-You-Go						
Federal Employees Health Benefits	0	-0.1	a	-0.1	-0.1	-0.1
Other	0	a	a	-0.1	-0.1	-0.1
Subtotal	0	-0.1	a	-0.1	-0.2	-0.2
Discretionary						
Public Health Service	a	a	-0.5	-0.8	-1.5	-2.3
Federal Employees Health Benefits	0	-0.1	-0.1	-0.1	0	0
Other	a	-0.4	-0.4	-0.5	-0.6	-0.7
Subtotal	a	-0.5	-1.1	-1.4	-2.1	-3.0
Other						
Federal Employees Health Benefits	0	-0.1	-0.3	-0.5	-0.5	-0.6
Total	a	-0.7	-1.5	-2.0	-2.9	-3.8
President's 1993 Budget as Estimated by CBO	90.7	103.7	113.9	125.4	138.8	153.3

a. Less than $50 million.

Proposed Changes

The President's 1993 budget proposes modest spending cuts compared with the CBO baseline, reducing health spending by $0.7 billion in 1993 and $3.8 billion in 1997. These changes would reduce baseline spending by about 2.5 percent in 1997. The Federal Employees Health Benefits program and the Public Health Service are targeted for the largest reductions, but Medicaid is left almost untouched.

Pay-As-You-Go Policy Changes

Federal Employees Health Benefits. The President's budget for the Federal Employees Health Benefits (FEHB) program includes a pay-as-you-go proposal that would reduce program spending by $85 million in 1993 and by $375 million over the 1993-1997 period. The plan would limit the amount providers can bill for certain health services for retired enrollees who are over age 65 but are not covered by Medicare. According to the proposal, allowed charges for physician services would be limited to Medicare's maximum allowable actual charge, reducing FEHB outlays as well as the out-of-pocket payments of annuitants. The proposal is estimated to save the government $85 million in 1993 and $95 million in 1997.

Other. The President's 1993 budget includes a Medicaid proposal that would slightly reduce Medicaid spending; proposed changes to two other programs would indirectly increase Medicaid spending by small amounts. The Medicaid proposal would enhance state authority to collect medical child support payments through the Child Support Enforcement Agency and would also allow a custodial parent to file directly with the noncustodial parent's insurer for reimbursement for a child's medical payments. CBO estimates that this proposal would result in savings of $5 million in 1993, rising to $19 million in 1997.

Other proposed changes that would affect Medicaid spending include changes to the pension program of the Department of Veterans Affairs (function 700) and to the Aid to Families with Dependent Children program (function 600). Together these changes would result in increased Medicaid spending of $77 million in 1993, reaching $104 million in 1997.

Discretionary Policy Changes

Public Health Service. The Administration's funding level for the discretionary programs of the Public Health Service would approximate CBO baseline levels in 1993 and maintain the 1993 funding level from 1994 through 1997. By 1997, spending would be reduced below the CBO baseline by $2.3 billion, or 11 percent.

Within the Public Health Service, the Administration would fund most of the programs of the Health Resources and Services Administration (HRSA) at baseline levels in 1993 and maintain the 1993 funding level from 1994 through 1997. As in previous budgets, the Administration also proposes to eliminate most of the HRSA's health professions' grant programs. Savings, compared with the CBO baseline, would rise from $19 million in 1993 to $358 million in 1997.

As in the last 10 budgets, the Administration plans to cut funding for the construction of Indian health facilities. The 1993 funding request is 6 percent below the CBO baseline for 1993. Under the President's request, spending for Indian health facilities would fall $6 million below the CBO estimate in 1993 and $181 million below in 1997. The Administration also plans to decrease 1993 funding for the Indian Health Service by 7 percent, compared with the CBO baseline, and maintain the 1993 funding level through 1997. The President's request would put Indian Health Service spending $0.1 billion below the CBO baseline in 1993 and $0.3 billion below in 1997.

The Administration's planned funding for both the Centers for Disease Control (CDC) and the Alcohol, Drug Abuse, and Mental Health Administration (ADAMHA) is slightly above the CBO baseline for 1993 and continues the 1993 level through 1997. By 1997, spending relative to the CBO baseline would be $0.2 billion lower for CDC and $0.3 billion lower for ADAMHA.

The Administration's request for research programs of the National Institutes of Health is 2 percent above the CBO baseline for fiscal year 1993. The 1993 funding level would be maintained from 1994 through 1997. In addition, the President's request would delay obligations of $0.6 billion of each year's funding in 1993 through 1997. These delays would slow spending on a portion of each year's funding. The two changes result in savings of $0.3 billion in 1994, compared with the CBO baseline, growing to $1 billion in 1997.

Although the Administration intends to reduce funding for the Food and Drug Administration (FDA), it would institute user fees for submitting applications to market new products and assume the availability of other existing fees; as a result, total FDA funding would approximately equal the CBO baseline. Under the proposal for user fees, which was also in the previous two budgets, federal funding would be 26 percent lower than CBO's baseline in 1993, resulting in savings that would increase from $0.2 billion in 1993 to $0.4 billion in 1997.

Federal Employees Health Benefits. The budget has proposed appropriation language to reduce federal spending for annuitants' health benefits. Reductions would be achieved by requiring the Postal Service to reimburse the government for a certain portion of past payments for federal health benefits for Postal Service annuitants. In a series of changes since 1986, the Congress has sought to reduce the government's liability for paying the government portion of FEHB premiums for these annuitants. The President's budget proposal would require the Postal Service to make three lump-sum payments of $105 million in 1993 through 1995.

Other. The President's budget for Medicaid would reduce federal spending for surveying and certifying providers by funding these activities through user fees collected from service providers and depositing the fees in a revolving fund. CBO estimates that this proposal, which was included in the President's 1992 budget, would save $0.1 billion in each of the years from 1993 through 1997.

The Administration's proposed funding level for Consumer and Occupational Health and Safety programs is $0.2 billion below the CBO baseline in 1993, with the 1993 funding level maintained through 1997. Spending would be $0.3 billion below the CBO baseline in 1993 and $0.6 below in 1997.

Other Changes

The President's budget for FEHB includes several policy changes to be achieved by administrative action. The plan would increase cost sharing for federal annuitants who are also Medicare beneficiaries by requiring copayments for prescription drugs and limiting payments for physician services to the Medicare-allowed charge. Savings are estimated at $75 million in 1993, rising to $155 million in 1997.

In addition, the budget plan includes a change in the current policy of calculating the government's premium contribution based on the average premium of the "big six" FEHB plans, including a proxy premium for the high-option Aetna plan that is no longer offered. A temporary provision of the Omnibus Budget Reconciliation Act of 1990 specified that a proxy premium be used in place of the (high-option) Aetna premium for calculating the government's contribution. The new formula would instead be based on the remaining five plans, resulting in a drop in the federal government's contribution of $231 million in 1994 and $473 million in 1997.

CBO Reestimates

Medicaid. CBO's baseline for federal expenditures for Medicaid is $4.2 billion lower than the President's in 1992 and $24.3 billion lower in 1997. The difference stems largely from differing assessments of state forecasts of Medicaid spending. Although both the Administration and CBO use state forecasts of Medicaid expenditures in developing their Medicaid projections, each uses them differently. The CBO Medicaid baseline is developed using the states' current-year estimates to calibrate current-year spending for the CBO Medicaid projection model; CBO then applies inflators representing the growth of prices, populations, and service intensity to the current-year estimate to forecast spending throughout the projection period.

In contrast, the Administration uses state estimates of Medicaid spending as the starting point for its projections of Medicaid outlays, but it believes the state forecasts are systematically biased downward. In its estimates for fiscal years 1992 and 1993, the Administration has adjusted the state forecasts upward by $4.4 billion and $10.7 billion, respectively, to compensate for the perceived underestimates of Medicaid outlays by state offices. The Administration then projects out-year spending based on the adjusted state estimates for 1992 and 1993. Because the Administration's estimates for 1992 and 1993 are significantly higher than CBO's, the resulting out-year projections are higher. Moreover, in 1994 through 1997, the Administration assumes that Medicaid will grow by about 15 percent a year, but CBO projects an average increase in outlays of 12 percent a year.

Other. CBO's reestimates of the President's budget for all other programs in function 550 are small.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 550 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	94.6	108.2	122.9	138.5	156.8	177.8
CBO Reestimates						
Pay-As-You-Go Proposals						
Technical	0	0.1	0.1	0.1	0.1	0.1
Other						
Technical						
Medicaid	-4.2	-4.9	-9.2	-13.5	-18.5	-24.4
Other	0.3	0.4	0.1	0.3	0.4	-0.3
Subtotal	-3.9	-4.5	-9.1	-13.2	-18.1	-24.6
Total	-3.9	-4.4	-9.0	-13.1	-18.0	-24.6
President's 1993 Budget as Estimated by CBO	90.7	103.7	113.9	125.4	138.8	153.3

Function 570: Medicare

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	118.0	130.5	144.7	161.0	180.6	201.7
Proposed Changes						
Pay-As-You-Go						
Delay hospital update	0	-0.6	-1.0	-1.2	-1.1	-1.1
Reduce payment for laboratory services	0	-0.3	-0.5	-0.7	-0.9	-1.2
Reduce federal subsidy for high-income beneficiaries	a	-0.1	-0.3	-0.5	-0.7	-0.9
Other	a	-0.1	-0.2	-0.3	-0.3	-0.3
Subtotal	a	-1.2	-2.0	-2.6	-3.0	-3.5
Discretionary						
Medicare contractors and HCFA administration	0	-0.1	-0.3	-0.4	-0.6	-0.7
Total	a	-1.3	-2.3	-3.0	-3.6	-4.2
President's 1993 Budget as Estimated by CBO	118.0	129.2	142.4	158.0	177.0	197.5
President's 1993 Budget	118.6	129.3	142.8	158.7	178.9	200.4
CBO Reestimates	-0.7	-0.1	-0.4	-0.6	-1.9	-2.9

a. Less than $50 million.

Proposed Changes

The President's budget proposes to reduce Medicare spending by $1.3 billion in 1993 and by $4.2 billion in 1997, compared with baseline levels. Medicare baseline spending is projected to grow at an average annual rate of 11.3 percent from 1992 through 1997. The Administration's proposals would reduce this growth by 0.4 percentage points annually. Reductions are proposed in both the Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) portions of Medicare. In addition, some Medicare enrollees would be required to pay higher premiums.

Pay-As-You-Go Policy Changes

Delay the Hospital Update. The President's plan would delay the annual hospital payment update from October 1 to January 1 each year. The Administration states that this proposal would put the hospital update on the same payment cycle used for most other health providers. Under CBO's assumed rates of inflation, the proposals would reduce reimbursements to hospitals by about 1.5 percent a year. CBO estimates that this one-time delay would save $0.6 billion in 1993 and $1.1 billion in 1997.

Reduce the Payment for Laboratory Services. The President's budget includes two proposals to revise the payment structure and slow the growth of spending for clinical laboratory services. (From 1987 through 1991, spending for independent clinical laboratory services increased at an average annual rate of 19 percent.) The first proposal would lower the existing cap on fees from 88 percent to 76 percent of the median amount charged by all carriers. The second proposal would give the Secretary of Health and Human Services (HHS) discretion when applying the update factor for laboratory services. These updates could be positive or negative for each service. The Administration's assumption of a freeze in the laboratory update for 1993 through 1997 was used to estimate this proposal. The savings from the two proposals would be $0.3 billion in 1993, increasing to $1.2 billion by 1997.

Reduce the Federal Medicare Subsidy for High-Income Beneficiaries. The President's budget proposes raising the SMI premium for certain high-income beneficiaries. The current monthly premium, set by the Omnibus Budget Reconciliation Act of 1990, equals approximately 25 percent of program costs. The remaining 75 percent of SMI program costs are financed from general revenues. The President proposes to increase the SMI premium to 75 percent of program costs for beneficiaries with annual income greater than $100,000 for single beneficiaries and $125,000 for couples. This budget assumes an effective date of April 1, 1992. The monthly premium paid by these higher-income enrollees would be $104.10 in 1993, compared with $36.60 under current law. Around 875,000 beneficiaries could be required to pay the higher premium by 1997 if they chose to continue their enrollment in SMI. Versions of this proposal were considered and rejected both during the 1990 budget summit negotiations and in Congressional deliberations on last year's Presidential budget.

Estimated savings from this proposal are $45 million in 1992, increasing to $0.9 billion by 1997. These estimates are subject to considerable uncertainty because the enforcement mechanisms have not yet been specified. Also, the costs associated with administering this proposal are estimated to be $25 million in 1992 and $50 million in each succeeding year. These added administrative costs do not appear to have been included in the Administration's request for Medicare administration.

Other Proposals. The budget includes three other Medicare proposals. Reimbursement for anesthesia services would be paid at a single fee regardless of whether the service is provided by an anesthesiologist working alone or one supervising a certified registered nurse anesthetist (CRNA). This change would reduce the total payment when an anesthesiologist is supervising a CRNA. In addition, the proposal would lower payments to CRNAs. Estimated annual savings from both changes are $0.1 billion in 1993 and $0.2 billion in 1997.

Unlike previous budgets, this budget includes only one proposal that would reduce payments to suppliers of durable medical equipment. The President's budget proposal would give the Secretary of HHS discretion when applying the update factor for items of durable medical equipment. These updates could be positive or negative for each item of equipment provided. Savings were estimated based on the Administration's assumption that the fee schedule update would be frozen in 1993 and 1994. CBO estimates annual savings of $35 million in 1993 and $170 million by 1997.

The President also proposes to include under Medicare all state and local government employees hired before April 1, 1986. Most state and local employees already have HI coverage, either through previous employment or through their spouses. This proposal would affect both revenues (see Chapter 3) and outlays. Only the effect of the increased HI outlays is shown in function 570. Outlay increases from this proposal are estimated at $3 million in 1993, rising to $50 million in 1997. The Administration did not include the effect on HI outlays in its budget.

Discretionary Policy Changes

Medicare Administration. The President's request for administrative funds for the Health Care Financing Administration is $0.1 billion below the CBO baseline in 1993 and $0.7 billion below in 1997. The request contains two components: a four-year freeze, and a change in the funding source for survey and certification activities from a general fund appropriation to user fees. The 1994-1997 request is frozen at the 1993 level. User fee collections are expected to raise $0.2 billion annually.

CBO Reestimates

CBO's estimate of the Medicare program is lower than, though very close to, the Administration's in 1992 through 1997. The differences stem from different economic and technical estimating assumptions. The hospital market basket update and the Medicare Economic Index are the two major indices used to project Medicare spending. Wages are a large part of both indices, and CBO's projections of wage growth are lower than those of the Administration. CBO technical factors also result in downward reestimates in the out-years, partially resulting from lower estimated growth in the use of physician and laboratory services.

Function 600: Income Security

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	196.4	197.0	206.5	217.2	227.1	239.5
Proposed Changes						
Pay-As-You-Go						
Civil Service Retirement	0	0	0	0	-2.1	-2.8
AFDC, Food Stamps, and Child Support Enforcement	0	-0.2	-0.1	-0.1	-0.1	-0.2
Trade Adjustment Assistance and other	a	-0.1	-0.2	-0.2	-0.2	-0.3
Subtotal	a	-0.3	-0.3	-0.3	-2.4	-3.2
Discretionary						
Low-income energy assistance	0	-1.2	-0.5	-0.6	-0.6	-0.7
Program administration	0	a	-0.1	-0.4	-0.6	-0.8
Housing assistance	a	-0.1	0.2	a	-0.2	0.5
Child nutrition	0	-0.2	-0.2	-0.2	-0.3	-0.3
Other	0	-0.4	-0.5	-0.7	-0.7	-0.8
Subtotal	a	-1.8	-1.2	-1.9	-2.4	-3.2
Total	a	-2.1	-1.5	-2.2	-4.8	-6.4
Public Health Service Retired Officers Fund (Transfer from function 500)	0	0.1	0.1	0.1	0.1	0.1
President's 1993 Budget as Estimated by CBO	196.4	195.0	205.1	215.1	222.4	233.2

a. Less than $50 million.

Proposed Changes

The President's proposals would reduce outlays for income security programs by $2.1 billion relative to CBO baseline levels in 1993 (about 1 percent) and by $6.4 billion in 1997 (about 3 percent). Savings would total $17 billion over five years. Two-fifths of the savings would result from pay-as-you-go policy changes, most notably from eliminating the optional lump-sum payment in Civil Service Retirement. Outlays for low-income energy assistance and several other discretionary programs would be lowered through a combination of reduced funding levels and restrictions that delay obligations. Reimbursements would be reduced for meals served in family day care homes. Funding reallocations, including some funding increases, are proposed for housing and nutrition programs.

Pay-As-You-Go Policy Changes

Civil Service Retirement. The President's budget would eliminate the option of a lump-sum payment in Civil Service Retirement. Current law will give federal employees retiring after October 1, 1995, the option of withdrawing their contributions on retirement in exchange for reduced annuity payments. Certain small groups of federal retirees are already allowed to elect a lump-sum benefit. The President's proposal would permanently extend the current law's prohibitions on lump-sum payments and would also eliminate the option for those groups currently allowed it, effective October 1, 1995. CBO estimates that eliminating the lump-sum option for all federal employees would save $2.1 billion in 1996 and $2.8 billion in 1997. These savings, however, would be offset in later years by higher annuity payments.

AFDC, Food Stamps, and Child Support Enforcement. The President's proposed changes to these programs are modest, resulting in savings of $0.1 billion to $0.2 billion a year and $0.7 billion over five years. Of the seven policies discussed below, four were included in last year's budget.

Two new policy proposals would increase spending under the Aid to Families with Dependent Children (AFDC) and Food Stamp programs at the states' discretion. CBO assumes that half the states would elect the two policy changes. The first proposal would allow families already on AFDC to accumulate resources up to $10,000 without losing AFDC or food stamp eligibility. Current resource limits are $1,000 in AFDC and $2,000 in the Food Stamp program. Given the limited asset-generating ability of low-income families, CBO estimates that this change would increase the AFDC caseload by only 5,000 families, increasing AFDC costs by less than $0.1 billion over the 1993-1997 period.

The second proposal involves the Administration's new Plan for Achieving Self-Support (PASS), which encourages entrepreneurial activities among AFDC recipients. Under this plan, states would disregard all income and resources associated with a family's approved self-employment plan when calculating eligibility and benefits for AFDC and food stamps. Administrative data and self-employment demonstration projects suggest that fewer than 1 percent of AFDC recipients would participate in PASS. With low participation expected, CBO estimates that the proposal would increase AFDC and food stamp costs by $0.1 billion over the five-year estimation period.

A third AFDC legislative proposal would limit assistance provided in the AFDC Emergency Assistance program to 30 consecutive days in a 12-month period. This limitation would reduce federal funding to a number of states that use Emergency Assistance funds to cover emergencies for up to 12 consecutive months and would save an estimated $0.2 billion over the 1993-1997 period.

Three proposals would modify the Child Support Enforcement (CSE) program. First, the Administration has expanded last year's proposal requiring food stamp recipients to cooperate with CSE personnel to also include recipients of housing assistance. The second change, identical to a proposal in last year's budget, would mandate higher fees for CSE services provided to families that are not receiving AFDC. Third, a new performance-based incentive formula would reward states for establishing paternities and child support obligations. Net savings from these three proposals are estimated to total $0.8 billion over five years.

Finally, the Administration proposes a minor reduction in food stamp outlays in 1996 and 1997 by extending a 1990 farm bill provision due to expire in 1995. The provision would reduce the share of overpayment collections retained by the states and increase the federal share of such collections by less than $20 million annually.

Trade Adjustment Assistance and Other Proposals. As it has in recent years, the President's budget proposes to eliminate the Trade Adjustment Assistance program for workers who lose their jobs because of competition from foreign imports. The proposal would save an estimated $0.1 billion annually and would eliminate benefits for approximately 24,000 workers in 1993.

The remaining pay-as-you-go policy changes affect nutrition programs, the Pension Benefit Guaranty Corporation, and the Supplemental Security Income program. The Administration proposes a series of largely offsetting policy changes in child nutrition programs in order to shift more benefits to lower-income children. Subsidies for meals served to children from families with income between 130 percent and 185 percent of the poverty line would be increased by 25 cents for lunches and 20 cents for breakfasts. This increase would be offset by a proposed 6 cent reduction in subsidies for meals served to children from families with income above 185 percent of the poverty line. Past budgets have included similar proposals for child nutrition programs.

Proposals that would affect the Pension Benefit Guaranty Corporation (PBGC) include revising the funding requirements for single-employer plans, placing certain limits on guaranteed benefits, enforcing the minimum funding requirements, and changing the treatment of PBGC claims in bankruptcy cases. On a cash basis, the Administration estimates that these changes would have no effect on federal outlays over the projection period, although they would produce savings in later years. CBO estimates that these changes would have small near-term savings, no more than $20 million a year. The changes would also cause significant revenue losses, as discussed in Chapter 3. The Administration proposes to convert PBGC from cash to accrual accounting and would give pay-as-you-go credit for its legislative proposals ($8.7 billion in 1992). CBO has not included the effects of this accounting change in its spending estimates and does not believe that any pay-as-you-go credit should be given, as discussed in Chapter 1.

Finally, the Administration has one legislative pay-as-you-go proposal affecting the Supplemental Security Income (SSI) program. The proposal would allow the Social Security Administration to collect SSI overpayments by reducing Social Security payments. This action would reduce SSI outlays by an estimated $34 million in 1993 and by $23 million in 1997. The amount that would be collected in 1993 is more than would be collected in 1997 because of an existing backlog of uncollected overpayments.

Discretionary Policy Changes

Low-Income Home Energy Assistance. The Administration requests $1.1 billion for the Low-Income Home Energy Assistance Program (LIHEAP) in 1993, of which $0.8 billion, or 75 percent, would not be available for obligation until September 30, 1993. The CBO baseline for 1993 includes a higher funding level of $1.5 billion and no obligation delay. The combination of lower funding and delayed obligations reduces 1993 outlays under the President's budget by $1.2 billion relative to the CBO baseline. The Administration proposes to hold LIHEAP funding constant at $1.1 billion from 1993 through 1997, resulting in a funding level that by 1997 falls to 60 percent of CBO's inflation-adjusted baseline.

The Administration's proposed delay of obligations extends a policy contained in LIHEAP's 1992 appropriation language, which states that over one-fourth of the 1992 appropriation cannot be obligated until after September 30, 1992. The President's proposal to delay the majority of the 1993 appropriation is in part an adjustment for the 1992 delay, although the proportion of 1993 funds proposed to be delayed is considerably higher than was delayed in 1992.

Program Administration. Outlays under the President's proposed funding levels for administrative expenses for unemployment compensation, Supplemental Security Income, food programs, and other income security programs are within $50 million of CBO baseline levels in 1993, but fall to $0.8 billion below CBO baseline levels in 1997. The growing stream of outlay savings relative to CBO's baseline is the result of the President's proposal to freeze most administrative programs at the 1993 level; in contrast, the CBO baseline adjusts levels for inflation through 1997. The largest reduction in administrative expenses is for unemployment compensation.

The President's request for administrative expenses for SSI is higher than the CBO baseline in both 1993 and 1994, with the requested amounts dropping below the baseline from 1995 through 1997 as the result of a proposed 1994-1997 freeze. The requested increases are in response to a higher rate of disability applications, which has increased the average time for processing disability claims. The President's request for 1993 would be even higher except for a proposal to fund part of the SSI program's administrative expenses through a fee imposed on states that choose to have the Social Security Administration administer their state supplemental payments. The fee, which the Administration is proposing in appropriation language for the Limitation on Administrative Expenses (LAE) account, would equal 1.67 percent of a state's supplementary payments and would be credited directly to the LAE account. The amount collected from the states in 1993 would be approximately $60 million.

Housing Assistance. For 1993, the President has requested $20.3 billion for the housing assistance programs of the Department of Housing and Urban Development (HUD) and the Farmers Home Administration. This funding level is $1.5 billion below the baseline level for 1993. Estimated outlays would fall only $0.1 billion below the baseline in the first year, however, because of the multiyear nature of many housing programs. Over the 1993-1997 period, the President's budget proposals would reduce housing assistance outlays by $0.6 billion, a reduction of one-half of 1 percent below baseline levels.

The President's request would shift funds among the various housing programs and would make vouchers the principal means of providing rental assistance. The HUD proposal would fund 98,000 vouchers, compared with the 22,000 vouchers assumed in the CBO baseline. Emphasizing vouchers raises outlays in the beginning of the five-year projection period because appropriations for vouchers are spent more rapidly than for other housing programs. These increases in housing outlays would be offset by proposals to eliminate funding for public housing construction, to reduce the public housing modernization program, and to reduce or eliminate several smaller housing programs.

The President also proposes to significantly reallocate funding among three programs authorized in the National Affordable Housing Act of 1990. The Administration proposes to increase funding for HOPE (Homeownership and Opportunity for People Everywhere) grants, which enable some residents of public housing and other low-income families to purchase their residences. Funding would also be increased for a program allowing HUD to offer various inducements to owners of low-income housing to maintain low-income tenancy. Increases in these two programs would be largely offset by a reduction of more than 50 percent in funding for the Home Investment Partnership Program, which provides funds to participating state and local jurisdictions to increase the availability of low-income housing.

Child Nutrition. The Administration's budget request for child nutrition programs includes a proposal to reduce subsidies for meals served to children in family day care homes unless the family day care home determines that the children are from families with income at or below 185 percent of the poverty line. The estimated savings of between $0.2 billion and $0.3 billion a year would be scored as a discretionary change, even though child nutrition programs are entitlement programs, because the change is proposed through appropriation language.

Other. Under the President's proposals, outlays for the remaining income security programs fall $0.4 billion below CBO's baseline in 1993 and $3.1 billion below CBO's baseline over the five-year projection period. The largest reduction is in the Refugee and Entrant Assistance program, which would be cut by almost 50 percent. The President also proposes a 1993-1997 freeze and an obligation delay for the Child Care and Development Block Grant program.

For 1993, the President proposes a modest increase in the Special Supplemental Food Program for Women, Infants, and Children (WIC), but this increase is partially offset by reduced funding for the Commodity Supplemental Food, Emergency Food and Shelter, Elderly Nutrition, Food Distribution on Indian Reservations, and Soup Kitchen programs. Because the budget holds requests for 1994 through 1997 at 1993 levels, outlays for these six nutrition programs fall $0.6 billion below CBO baseline levels over five years.

Other Changes

The final change in function 600 would be a transfer of about $0.1 billion annually from function 550 for payment of retirement benefits for Public Health Service commissioned corps officers. Financing of the retirement fund would be changed from a pay-as-you-go system to an accrual-basis system, but there would be no change in benefit levels and no net change in outlays.

CBO Reestimates

Pay-As-You-Go Reestimates. CBO's reestimates of the pay-as-you-go proposals are small for 1993 through 1995. The positive reestimates of $0.1 billion in both 1996 and 1997 are largely the result of CBO's smaller estimates of savings from the proposed elimination of the lump-sum benefit in Civil Service Retirement. This difference reflects CBO's smaller estimate of the number of people electing the lump-sum benefit under current law.

Other Reestimates. CBO's economic reestimates increase spending in most programs because CBO projects higher inflation, resulting in more rapid growth in indexed entitlements. Also, CBO's projections for unemployment rates are higher than the Administration's projections in every year but 1993, resulting in further upward reestimates. The reestimates are downward for a few programs because of lower projections for the consumer price index for "food away from home" and certain federal pay assumptions.

CBO's technical reestimate of the Supplemental Security Income program lowers outlays by $1.4 billion in 1993 and by $2.9 billion in 1997. Most of the SSI reestimate results from differing assumptions about the number of SSI recipients. In 1993, CBO assumes a slightly smaller number of blind or disabled beneficiaries than the President's budget assumes. CBO is also lower than the Administration in estimating the number of claimants who, as a result of the Supreme Court's decision in *Sullivan* v. *Zebley*, will seek benefits that were denied in the past. In 1997, the difference in projected outlays results from the Administration's higher estimate of recipients in the base year and slightly higher estimated rates of growth in the recipient population throughout the projection period.

Estimates of the number of people receiving unemployment compensation, food stamps, and Aid to Families with Dependent Children--three programs particularly sensitive to changes in unemployment rates--are again uncertain this year. Caseload increases in these programs in the past year were larger than expected given current unemployment rates. For the Food Stamp program, CBO reestimates outlays downward by between $1.1 billion and $1.5 billion annually because CBO projects an earlier peak in the growth of the caseload than the Administration does. For both unemployment compensation and AFDC, CBO projects more recipients than does the Administration, resulting in upward outlay reestimates.

CBO's reestimates for the child nutrition programs result from lower assumptions about participation in the Child Care and Adult Food program. Other reestimates are dominated by negative reestimates in the earned income tax credit program.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 600 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	198.1	196.7	206.5	216.2	221.7	231.7
CBO Reestimates						
Pay-As-You-Go Proposals						
Technical	a	a	a	a	0.1	0.1
Other						
Economic	0.3	0.3	0.7	1.8	2.7	3.4
Technical						
Supplemental Security Income	-1.3	-1.4	-1.4	-2.0	-2.4	-2.9
Food stamps	-0.5	-1.2	-1.5	-1.4	-1.1	-1.1
Unemployment compensation	0.4	0.7	0.7	0.9	1.2	1.2
AFDC and child support	a	0.3	0.6	0.8	1.0	1.4
Child nutrition	-0.1	-0.2	-0.3	-0.4	-0.4	-0.5
Other	-0.4	-0.4	-0.2	-0.7	-0.3	-0.1
Subtotal	-2.0	-2.1	-2.1	-2.8	-2.1	-1.9
Total	-1.7	-1.8	-1.4	-1.0	0.7	1.6
President's 1993 Budget as Estimated by CBO	196.4	195.0	205.1	215.1	222.4	233.2

a. Less than $50 million.

Function 650: Social Security

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	287.0	303.2	320.5	338.4	357.4	377.4
Proposed Changes						
Discretionary						
Administrative costs	0	-0.1	-0.1	-0.2	-0.3	-0.5
Other Changes[b]						
Earnings test	0	0.1	0.1	a	a	a
Other	0	a	a	a	a	a
Subtotal	0	0.1	0.1	a	a	a
Total	0	a	0.1	-0.1	-0.3	-0.5
President's 1993 Budget as Estimated by CBO	287.0	303.2	320.5	338.2	357.0	377.0

a. Less than $50 million.

b. Changes in Social Security benefits and revenues are not included under the general pay-as-you-go restrictions, but instead are subject to separate rules in the Senate and the House.

Proposed Changes

The President's 1993 budget proposes only minor changes in Social Security. The overall policy changes would modify program spending by less than 0.1 percent over the next five years.

Administrative Costs. Funds for administering the Old-Age and Survivors Insurance (OASI) program and the Disability Insurance (DI) program would increase under the President's request at approximately baseline rates between 1992 and 1993. CBO shows a small reduction below baseline levels for these programs' administrative expenses in 1993. This reduction is the result of an anomaly involving the distribution of the limitation on administrative expenses for the Social Security Administration between the Social Security programs and the Supplemental Security Income program. During the 1994-1997 period, the President's plan would freeze administrative expenses at 1993 levels, resulting in growing savings in discretionary spending. By 1997, spending would fall $460 million below the CBO baseline.

Because CBO is forecasting increases in the number of DI applications over the projection period, the administrative funding in the President's budget could result in significant increases in processing time for disability claims. The Social Security Administration's budget justification cites this as a possible problem even in 1993.

Earnings Test. The Administration proposes modest adjustments in the limits on exempt earnings for people ages 65-69 in 1993 and 1994, with the limits returning to the current law's levels in 1995. The exact increases have not been specified except that they would total $1,000 in 1993 and 1994. However, the estimated additional benefit payments in the President's budget are consistent with a $500 increase for both 1993 and 1994 on top of projected exempt amounts of $10,680 in 1993 and $11,160 in 1994. CBO estimates that the additional outlays from these increases would total $235 million over the next five years.

CBO Reestimates

CBO has reestimated the President's budget request upward by about $0.3 billion in 1992 and about $9.5 billion in 1997. CBO's projections of higher inflation and the resulting higher cost-of-living adjustments increase outlays by $6.2 billion in 1997.

Social Security Cost-of-Living Adjustments
Assumed by CBO and the Administration
(In percent, by fiscal year)

	1993	1994	1995	1996	1997
CBO	3.2	3.7	3.6	3.7	3.6
Administration	3.0	3.2	3.2	3.2	3.2

CBO's technical estimating assumptions increase outlays by $0.3 billion in 1992 and about $3.4 billion in 1997. Average monthly benefits, after accounting for differences in cost-of-living adjustments, are the largest element of the reestimate and amount to about $2.6 billion in 1997. That figure represents a reestimate of about 0.7 percent, less than $5 per month for the average beneficiary. CBO predicts a slightly larger number of Social Security beneficiaries than does the Administration--the net effect of a lower number of OASI recipients and a higher number of DI recipients. Overall, this causes CBO to project about $1.0 billion more in benefit payments than the Administration does over the projection period. The remaining significant source of reestimate is retroactive benefits, which CBO projects at $0.1 billion to $0.4 billion a year higher than the President's budget.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 650 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	286.7	302.3	317.7	333.5	350.0	367.4
CBO Reestimates						
Economic						
Cost-of-living adjustments	0	0.4	1.6	2.9	4.4	6.2
Technical						
Average benefits adjusted for inflation	0.2	0.4	0.8	1.4	2.0	2.6
Number of beneficiaries	a	-0.1	a	0.2	0.3	0.6
Retroactive benefits	0.1	0.2	0.3	0.4	0.3	0.1
Other	0	a	a	a	a	a
Subtotal	0.3	0.6	1.2	1.9	2.6	3.4
Total	0.3	1.0	2.8	4.8	7.0	9.5
President's 1993 Budget as Estimated by CBO	287.0	303.2	320.5	338.2	357.0	377.0

a. Less than $50 million.

Function 700: Veterans Benefits and Services

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	34.2	35.3	38.1	37.9	37.6	40.4
Proposed Changes						
Pay-As-You-Go						
Pensions	0	-0.2	-0.2	-0.2	-0.2	-0.3
Housing programs	0	-0.4	-0.1	-0.1	-0.1	-0.1
Reimbursements, medical care	0	0	-0.2	-0.2	-0.2	-0.3
Education programs	0	a	a	-0.1	-0.1	-0.1
Subtotal	0	-0.6	-0.5	-0.6	-0.6	-0.7
Discretionary						
Housing programs	0	-0.2	-0.2	-0.2	-0.1	-0.2
Reimbursements, medical care	0	-0.1	-0.1	-0.1	-0.1	-0.1
Medical care	0	a	a	-0.9	-1.6	-2.3
General operating expenses	0	a	a	-0.1	-0.1	-0.2
Other	0	a	a	-0.1	-0.2	-0.2
Subtotal	0	-0.3	-0.3	-1.3	-2.1	-3.0
Total	0	-0.9	-0.8	-1.9	-2.8	-3.7
President's 1993 Budget as Estimated by CBO	34.2	34.4	37.3	36.0	34.8	36.7

a. Less than $50 million.

Proposed Changes

The President's 1993 budget includes more than 20 legislative proposals for veterans benefits and services. The combined effect of these proposals would be to reduce spending for function 700 over the 1993-1997 period by $10.1 billion (5.3 percent) relative to the CBO baseline. Almost all proposals would reduce spending below baseline levels. Many would extend sunset dates on savings provisions enacted in the Omnibus Budget Reconciliation Act of 1990 (OBRA-90) or would restate proposals offered in last year's budget.

Pay-As-You-Go Policy Changes

Pensions. The President proposes eliminating the sunset clauses in two pension-related provisions of OBRA-90. The first provision authorizes the Department of Veterans Affairs (VA) to have access to Internal Revenue Service data for the purpose of verifying the income reported by VA pensioners. Under current law, this authority would expire on September 30, 1992. Extending this authority would save an estimated $344 million from 1993 through 1997.

A second proposal would eliminate the September 30, 1992, sunset date on a provision that limits to $90 a month the pension for any unmarried or childless veteran who is receiving Medicaid coverage in a Medicaid-approved nursing home. This change would affect about 14,000 veterans a year and would save $739 million in pensions through 1997. Medicaid requires that any income above a personal-needs allowance (generally $30 a month) be used to defray nursing home costs before Medicaid will pay the remaining costs. Therefore, Medicaid costs would rise as pension benefits are lowered. The net five-year savings to the federal government from this proposal would be $325 million.

Housing Programs. The President proposes several changes in the VA programs that guarantee home loans to veterans. In the Guaranty and Indemnity program, greater restrictions would be placed on the multiple use of the loan guaranty benefit. Currently, a veteran who has paid off a guaranteed loan can receive a second loan on the same basis as the first. The President's proposal would require a 10 percent down payment and a 2.5 percent origination fee for any subsequent use of the entitlement. (Under current law, the fee ranges from 0.5 percent to 1.25 percent depending on the loan-to-value ratio.)

Approximately 15 percent of VA mortgage guarantees are used by individuals who have had their entitlement restored after paying off an earlier guaranteed loan. Thus, around 31,000 potential homebuyers would be affected by this proposal. About 4,600 (15 percent) of them would be expected to obtain financing from non-VA sources if the proposal were enacted. The requirement of a 10 percent down payment on second-use guarantees is also estimated to reduce the foreclosure rate on the affected loans by approximately 15 percent.

Another proposal would affect both the Guaranty and Indemnity program and the Loan Guaranty program. The President again proposes to alter the agency's procedure on foreclosures. The effect of this proposal would be to decrease VA payments on certain defaults, and it is estimated to save $400 million in 1993--when the effects on existing loans are scored--and approximately $90 million a year thereafter.

Reimbursements for Medical Care. The President's budget proposes to repeal the sunset date on another provision of OBRA-90 related to billing for services provided in VA medical facilities. The VA's authority to bill health insurers for the care of non-service-connected conditions provided to insured service-disabled veterans expires under current law on September 30, 1993. Extending this authority through 1997 would bring in an estimated $200 million in additional insurance reimbursements each year.

Education Programs. The Administration proposes to limit vocational rehabilitation benefits to veterans with service-connected disabilities rated at 30 percent or higher. Approximately 1,200 veterans with disabilities rated at 20 percent would become ineligible in 1994, increasing to around 5,000 ineligible veterans in 1997. The option is estimated to save more than $75 million in the first five years.

A second proposal would require active-duty service personnel who elect to participate in the Montgomery GI Bill program to contribute $1,400 to the program over a 12-month period, rather than the current required contribution of $1,200. This would restore the benefits-to-contributions ratio to 9 to 1; the ratio was reduced last year when benefits were increased without a corresponding change in the contribution level. Contributions would be expected to increase by $155 million over the 1993-1997 period under this proposal.

Compensation. The President's budget proposes a 3 percent cost-of-living adjustment (COLA) in the compensation program rates, effective December 1, 1992. Because compensation COLAs are assumed in both the CBO and Administration baselines, this proposal has no cost relative to those baselines.

Discretionary Policy Changes

The President is proposing several changes in mandatory spending accounts that would be made through amendments in appropriation language. Normally, changes to mandatory accounts are subject to pay-as-you-go procedures. However, because these changes would be effected through appropriation bills, they are shown as discretionary proposals.

Housing Programs. The President is proposing to increase all fees for VA home loan guarantees by 0.75 percentage points. This change would reduce the subsidy cost of such loans by around $155 million a year, for a total savings over five years of $790 million.

Reimbursements for Medical Care. The President would extend two provisions of OBRA-90 that grant the VA the authority to collect copayments from certain veterans receiving VA medical care. Under present law, these provisions would expire after 1992. One provision would continue an increase in the level of copayments levied against an estimated 10,000 admissions and 50,000 outpatient visits each year. The second provision would continue the copayment on medication provided by the VA on an outpatient basis. Extending these two authorities is expected to bring in nearly $300 million in copayment collections over the next five years.

The President is also proposing a change in appropriation language to require copayments of service-disabled veterans with disabilities rated below 50 percent who are seeking care for non-service-connected conditions. Under this provision, copayments would be newly levied on an estimated 50,000 admissions to VA hospitals and 275,000 outpatient visits. This provision would increase collections by more than $35 million in 1993 and $140 million over five years.

Medical Care. The 1993 budget reflects several policy changes in the medical care account that would result in a small net savings in 1993, a small net cost in 1994, and a large and growing net savings from 1995 through 1997. The President is requesting 1993 appropriation language that would delay the availability of $429 million in funds for equipment, land, and structures until August 1, 1993. A similar obligation delay has been included in every appropriation since 1990. This proposal would shift $260 million in outlays from 1993 to 1994. Under a second proposal, only veterans living more than 50 miles from a VA facility would be reimbursed for travel expenses to and from VA hospitals. This requirement would generate savings of around $40 million annually.

Finally, the President's budget authority request for medical care differs substantially from the CBO baseline. The President's request for 1993 is more than $300 million above the baseline level, but the requests for 1994 through 1997 are held virtually flat at the 1993 level. Under this pattern of budget authority, outlays would exceed the baseline by $280 million in 1993, then fall short by amounts increasing from $190 million in 1994 to $2.3 billion in 1997. A reduction in outlays of the magnitude the President has proposed for 1997 would represent 13.5 percent of total baseline outlays for VA medical care in that year.

General Operating Expenses. The President's requested spending levels for administering veterans' benefits fall below the inflation-adjusted levels in the CBO baseline by increasing amounts between 1993 and 1997. By 1997, a shortfall of $180 million, more than 18 percent of the baseline total, is expected.

CBO Reestimates

Pay-As-You-Go Reestimates. CBO's reestimates of the Administration's pay-as-you-go proposals are relatively small. The largest difference is in CBO's estimate of the savings from the Administration's proposals for VA housing programs. CBO's estimate of the savings in 1993 is more than $200 million below the Administration's estimate as a result of differences in estimated default costs for loans originated before 1992. Because the CBO baseline reflects lower default costs for these loans than are projected by the Office of Management and Budget, CBO's estimate of the proposal's impact on those costs is lower.

Other Reestimates. Differences in economic assumptions cause CBO's estimates of compensation and pension outlays to be $24 million above the President's estimates in 1993, with the difference growing to $355 million by 1997. The difference results from higher COLAs underlying CBO's estimates. (See function 650 for CBO's and the Administration's COLA assumptions.)

In both the Guaranty and Indemnity program and the Loan Guaranty program, CBO's estimate of average default costs on future and existing guaranteed loans is significantly lower than the Administration's estimate. As a result, subsidy and outlay estimates are lower. Between 1993 and 1997, CBO estimates Guaranty and Indemnity subsidies at $2.8 billion less than the Administration does and Loan Guaranty subsidies at $630 million less.

The differences between the CBO and OMB estimates of total benefits for the compensation and pension programs are relatively small; the differences in the outlay estimates, however, are considerably larger. The first day of fiscal years 1994 and 1995 will fall on a weekend. Based on previous practice, CBO assumes that the VA will issue benefit checks to arrive on Friday, thereby moving one month's outlays into the preceding fiscal year. Under this assumption, 13 months of benefits will be outlaid in 1994, 12 months in 1995, and 11 months in 1996. It appears that the Administration's outlay estimates reflect a different timing.

In 1992, CBO's compensation baseline includes $115 million for the payment of eight months of benefits to certain incompetent veterans resulting from a recent court decision. This decision enjoined the VA from withholding compensation benefits from these veterans in compliance with a provision of OBRA-90. The effect of the injunction is not reflected in the President's budget.

The remaining reestimates are small and are in the areas of medical care, medical reimbursements, and readjustment benefits.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 700 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	33.8	34.4	36.3	35.9	35.0	36.8
CBO Reestimates						
Pay-As-You-Go Proposals	0	0.2	-0.1	a	a	a
Other						
Economic						
Cost-of-living adjustments	0	a	0.1	0.2	0.2	0.4
Technical						
Housing programs	-0.3	-0.5	-0.6	-0.7	-0.7	-0.7
Compensation and pensions	0.3	0.4	0.8	0.1	0.1	0.2
Other	0.5	a	0.6	0.3	0.2	a
Subtotal	0.4	-0.1	0.9	-0.2	-0.4	-0.5
Total	0.4	0.1	0.9	a	-0.2	-0.2
President's 1993 Budget as Estimated by CBO	34.2	34.4	37.3	36.0	34.8	36.7

a. Less than $50 million.

Function 750: Administration of Justice

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	14.3	15.3	16.0	16.6	18.0	18.7
Proposed Changes						
Pay-As-You-Go						
Customs user fees	0	0	0	0	-0.7	-0.8
Discretionary						
Law enforcement programs	0	a	-0.1	-0.4	-0.8	-1.2
The Judiciary						
Original request	a	0.3	0.6	0.9	1.3	1.8
President's adjustment	0	0	-0.4	-0.8	-1.3	-1.9
Federal prison system	0	0.1	a	-0.1	-0.2	-0.3
Justice assistance	0	a	-0.1	-0.2	-0.2	-0.2
Other	0	0.1	a	-0.1	-0.2	-0.3
Subtotal	a	0.6	0.1	-0.6	-1.3	-2.0
Total	a	0.6	0.1	-0.6	-2.0	-2.8
President's 1993 Budget as Estimated by CBO	14.3	15.9	16.1	16.0	16.0	15.9
President's 1993 Budget	14.1	15.4	16.0	15.7	15.7	15.7
CBO Reestimates	0.2	0.5	0.2	0.3	0.2	0.2

a. Less than $50 million.

Proposed Changes

The President's budget for administration of justice increases spending above the baseline in 1993 and holds spending for many programs constant thereafter. The President's budget proposes $15.8 billion in spending authority for 1993--an increase of $1.2 billion, or 8 percent, over 1992 spending authority. The President's proposals would result in net outlays that are $0.6 billion (4 percent) above the CBO baseline for 1993, but $4.7 billion, or 6 percent, below the baseline for the 1993-1997 period. As a result of steady increases in funding for programs and activities in this function, outlays in 1993 would be almost 60 percent above the 1990 level.

Pay-As-You-Go Policy Changes

Customs User Fees. The President's budget includes receipts from customs user fees beyond their scheduled expiration date in 1995. Extending these fees would yield a total of $1.5 billion in 1996 and 1997.

Discretionary Policy Changes

Law Enforcement Programs. Law enforcement spending would be slightly above the baseline in 1993 under the proposals contained in the President's budget. Total budget authority for law enforcement would be about $80 million, or 1 percent, above the CBO baseline, with the largest increases targeted for the Federal Bureau of Investigation, the Drug Enforcement Administration, and the Immigration and Naturalization Service. Outlays for law enforcement would be about $40 million above the baseline in 1993 and about $2.5 billion below the baseline over the following four years, excluding the extended customs user fees.

The Judiciary. The budget submitted by the Judiciary includes a significant increase in spending in 1993. Budget authority would total $2.8 billion compared with $2.4 billion in 1992, a 19 percent increase. Outlays would be $300 million, or 13 percent, above the CBO baseline for 1993 and about $5 billion above the baseline over the 1993-1997 period. Normally, the President's budget includes the Judiciary's request without change. This year, however, the Administration has adjusted the 1994-1997 estimates downward, bringing them close to baseline levels.

Federal Prison System. The Administration is requesting increased funding for the federal prison system that would result in outlays $121 million above the baseline in 1993. The budget assumes that funding is frozen at the 1993 level over the following four years. Outlays would fall below the baseline by close to $600 million over that period. Spending authority for the system's operating expenses would be $1.9 billion in 1993, an increase of almost $300 million (19 percent) from 1992. The increase is intended to cover the costs of a growing inmate population and the opening of five new prisons. In contrast, the funding request for buildings and facilities is 25 percent below the 1992 level. Also, the Administration is requesting authority to collect fees from prisoners equivalent to the first year's cost of incarceration. These fees are estimated to bring in $48 million a year.

Justice Assistance. Under the President's proposals, spending for justice assistance would be below the baseline each year. The 1993 appropriation request for the Office of Justice Programs would be $137 million (15 percent) below the baseline. The decrease would come primarily from juvenile justice grants and grants to areas with a high incidence of drug trafficking.

Other. Most other programs would be targeted for increases in 1993 and held constant thereafter. The President would hold budget authority for the Legal Services Corporation constant at the 1992 level, resulting in a reduction in spending of almost $200 million relative to the CBO baseline from 1993 through 1997.

CBO Reestimates

CBO estimates that spending under the Administration's policies would be slightly higher in each year than estimated in the budget.

Function 800: General Government

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	13.0	13.8	14.2	14.4	14.5	15.0
Proposed Changes						
Pay-As-You-Go						
Payment to Alaska from leasing Arctic National Wildlife Refuge	0	0	0	0.8	0.5	a
Impact assistance to coastal communities	0	0	a	a	0.1	0.1
Subtotal	0	0	a	0.8	0.5	0.1
Discretionary						
Legislative branch						
Original request	0	0.2	0.1	a	-0.1	-0.2
President's adjustment	0	-0.2	-0.2	-0.2	-0.2	-0.2
Internal Revenue Service	0	0.1	-0.1	-0.4	-0.7	-1.1
Federal Buildings Fund	0	0.1	-0.1	-0.1	-0.3	-0.4
Other	0	-0.1	-0.2	-0.3	-0.4	-0.5
Subtotal	0	0.2	-0.5	-1.0	-1.7	-2.4
Total	0	0.2	-0.5	-0.2	-1.2	-2.4
President's 1993 Budget as Estimated by CBO	13.0	14.1	13.7	14.3	13.3	12.7
President's 1993 Budget	12.8	14.0	15.1	13.3	13.4	12.6
CBO Reestimates	0.2	0.1	-1.3	1.0	-0.1	0.1

a. Less than $50 million.

Proposed Changes

Under the President's budget for 1993, spending for discretionary general government activities would increase by $0.2 billion above baseline levels. Funding for most of these programs would be frozen at the 1993 level over the 1994-1997 period, resulting in savings for discretionary programs of almost $6 billion during that period. These savings would be partially offset by increases from pay-as-you-go proposals.

Pay-As-You-Go Policy Changes

The budget includes two proposals that would affect mineral leasing payments to states beginning in 1994. Alaska would be paid 50 percent of receipts earned from leasing the Arctic National Wildlife Refuge (ANWR). CBO estimates that the payments to Alaska would total $0.8 billion in 1995 and $0.5 billion in 1996. In addition, the President's plan to share 12.5 percent of new royalties from oil and gas production on the Outer Continental

Function 900: Net Interest

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline[a]	201.0	214.0	231.8	246.1	261.5	279.7
Proposed Changes						
Pay-As-You-Go						
Interest on IRS refunds	-0.1	-0.4	-0.4	-0.4	-0.5	-0.5
Other Changes						
Debt service	0.1	0.2	0.4	1.0	1.2	0.4
Other	b	b	-0.2	-0.3	-0.3	-0.3
Subtotal	0.1	0.1	0.2	0.8	0.9	0.1
Total	0.1	-0.3	-0.2	0.4	0.4	-0.4
President's 1993 Budget as Estimated by CBO	201.1	213.7	231.6	246.4	261.9	279.3

a. Assumes compliance with discretionary spending caps.

b. Less than $50 million.

Proposed Changes

The President's budget contains only one pay-as-you-go proposal affecting net interest. Under certain circumstances, the government pays interest on tax payments that must be refunded. Specifically, in the case of income tax refunds, the government pays interest beginning 45 days after the original due date. Thus, taxpayers who file amended returns (for which the original filing date has passed) typically collect one or more years' worth of interest. Under the President's proposal, the government would owe little or no interest to such filers so long as it processed their amended returns promptly. The Administration also proposes extending the 45-day interest-free processing period to certain refunds not currently covered, such as those for excise, estate, and gift taxes. The proposal would be effective in July 1992. In CBO's estimation, it would reduce interest paid to taxpayers by $50 million in the last quarter of 1992 and by about $400 million to $500 million per year thereafter.

The largest component of net interest--payments on the public debt--is a function of the federal deficit and market interest rates and therefore cannot be controlled directly. As explained in Chapter 1, CBO estimates that the Administration's policies would add to the deficit in most years. As a result, debt service costs would exceed those in the baseline by amounts ranging from $0.1 billion in 1992 to $1.2 billion in 1996.

Federal Debt

Debt held by the public grows each year by roughly the amount of the federal deficit. Thus, the growth in federal debt slows gradually through 1996 and picks up again in 1997. As the table shows, debt held by the public is expected to leap from just over $3 trillion at the end of 1992 to $4.3 trillion at the end of 1997. The President's proposals hardly make a dent in the rapid buildup of debt. As a percentage of gross domestic product, debt held by the public is projected to rise from 52 percent in 1992 to around 55 percent in 1994 through 1997.

CBO Reestimates

Reestimates of the Administration's net interest spending add $2.3 billion to outlays in 1992, less than $50 million in 1993, and $15.8 billion in 1997. These differences stem mostly from technical estimating differences in the near term and from higher interest rate assumptions in 1995 through 1997.

As discussed in Chapter 2, CBO assumes generally lower interest rates from 1992 through 1994 than does the Office of Management and Budget, but higher rates in 1995 through 1997. By 1997, CBO's assumed interest rates on all maturities are approximately 0.5 percentage points higher than the Administration's estimates. These higher rates are reflected in economic reestimates of $12.4 billion in 1997.

Technical reestimates to interest on the public debt add an average of more than $4 billion per year to outlays. CBO disagrees with OMB's assumption that relatively high-rate state and local government issues will be redeemed rapidly and replaced with lower-yielding instruments. Furthermore, CBO assumes that relatively more borrowing will occur in the early part of each year, thereby accruing interest costs more quickly.

This function includes, as receipts, interest that the Federal Financing Bank (FFB) earns on its loans to the Resolution Trust Corporation and the Bank Insurance Fund. CBO anticipates that the two deposit insurance agencies will together borrow more than OMB assumes and thus create larger receipts of interest earnings for the FFB. Between 1992 and 1997, this difference (which is offset in the budget in function 370) totals an additional $11.3 billion. Smaller technical estimating differences are attributed to other intragovernmental interest accounts, interest to and from credit financing accounts, and interest on tax refunds.

As discussed in Chapter 1, CBO believes that the Administration's deficit estimates are too high in 1992 and 1993 and too low in 1994 through 1997. Thus, CBO estimates lower debt service costs through 1994 and higher debt service costs thereafter. By 1997, CBO's reestimate boosts debt service by $3.7 billion.

CBO PROJECTIONS OF FEDERAL DEBT HELD BY THE PUBLIC (By fiscal year)

	1992	1993	1994	1995	1996	1997
			In Billions of Dollars			
CBO Baseline[a]	3,049	3,385	3,656	3,865	4,061	4,304
President's Proposed Budget as Reestimated by CBO	3,054	3,386	3,666	3,886	4,077	4,301
Difference	5	1	10	21	16	-3
			As a Percentage of GDP			
CBO Baseline[a]	52.2	54.3	55.2	55.2	54.8	54.8
President's Proposed Budget as Reestimated by CBO	52.2	54.3	55.4	55.5	55.0	54.8

SOURCE: Congressional Budget Office.

a. Assumes compliance with discretionary spending caps.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 900 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	198.8	213.7	230.9	242.2	253.0	263.5
CBO Reestimates						
Economic						
Net interest on public debt	-2.1	-1.6	-0.5	3.1	7.6	12.5
Other interest	a	a	a	a	-0.1	-0.1
Subtotal	-2.1	-1.6	-0.5	3.1	7.6	12.4
Technical						
Net interest on public debt	5.2	4.5	4.5	4.4	4.0	4.2
Receipts from deposit insurance agencies	-0.8	-0.7	-1.8	-3.6	-2.9	-1.5
Other	0.6	a	-1.0	-1.6	-2.4	-2.9
Subtotal	5.0	3.8	1.7	-0.8	-1.3	-0.3
Debt Service	-0.6	-2.2	-0.6	1.9	2.6	3.7
Total	2.3	a	0.6	4.3	8.9	15.8
President's 1993 Budget as Estimated by CBO	201.1	213.7	231.6	246.4	261.9	279.3

a. Less than $50 million.

Function 920: Allowances

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	0	0	0	0	0	0
Proposed Changes						
Discretionary						
Davis-Bacon reform	0	-0.1	-0.1	-0.1	-0.1	-0.1
Pay raise delay	0	-0.5	0	0	0	0
Government contribution for proposed Public Health Service commissioned corps	0	0.1	0.1	0.1	0.1	0.1
Total	0	-0.4	0	0	0	0
President's 1993 Budget as Estimated by CBO	0	-0.4	0	0	0	0
President's 1993 Budget	0	-0.4	-7.6	-4.6	0	0
CBO Reestimates	0	0	7.6	4.6	0	0

Proposed Changes

Function 920 has traditionally been used to record proposed costs or savings that, for various reasons, cannot easily be allocated by function or agency elsewhere in the budget. Ultimately, however, these items would have to be reflected in appropriations for specific budget accounts.

As in last year's budget, the President proposes to modify the Davis-Bacon Act, a law that requires the payment of prevailing wages on construction projects financed with federal funds. The proposed changes would increase the minimum contract covered by Davis-Bacon from the current level of $2,000 to $250,000. This change is assumed to reduce the required budget authority and outlays in domestic discretionary accounts by about $0.1 billion annually. Proposed savings in national defense are incorporated in function 050.

The President's appropriation requests in other functions of the budget assume that the Department of Labor will issue regulations on the use of helper workers. The department promulgated regulations on helpers in February 1991, but the 1991 supplemental appropriation contained language specifically prohibiting the Secretary of Labor from using any funds to carry out those regulations. The regulations would save $0.6 billion per year by 1997.

The President proposes to delay the 1993 pay adjustment for federal civilian employees by three months. The Federal Employees Pay Comparability Act of 1990 linked General Schedule and other white-collar salary adjustments to the annual increase in the Employment Cost Index. Salaries are adjusted each January. The President's proposal would delay the 1993 white-collar salary increase to April 1993. Salary adjustments for each of the wage areas of the Federal Wage System (FWS) are staggered throughout the year; the President's proposal would delay the 1993 FWS salary adjustments by three months. The proposal would save $460 million in 1993.

As discussed in function 550, the President proposes new, accrual-based rules for funding Public Health Service retirement. The proposal would require additional contributions by several agencies on behalf of their workers, amounting to about $100 million a year. The extra contributions are placed in this function; the offsetting receipts are in function 950 of the budget.

CBO Reestimates

The Administration's budget includes unspecified savings in discretionary spending in 1994 and 1995. Based on recent experience, however, CBO believes that such savings are unlikely to appear in the absence of specific policy proposals. CBO has deleted the unspecified savings from its estimate of the President's budget, increasing outlays by $7.6 billion in 1994 and $4.6 billion in 1995.

Function 950: Undistributed Offsetting Receipts

PROPOSED SPENDING CHANGES (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
CBO Baseline Without Discretionary Caps	-39.1	-39.9	-39.5	-40.5	-41.3	-43.0
Proposed Changes						
Pay-As-You-Go						
Spectrum auctions	0	0	-2.0	-1.6	-0.7	0
Discretionary						
Employer's share of employee retirement	0	-0.3	-0.3	-0.3	-0.1	-0.1
Spectrum auctions	0	0	0	-0.3	-0.2	0.1
Subtotal	0	-0.3	-0.3	-0.6	-0.3	a
Other Changes						
Lease of naval petroleum reserve at Elk Hills[c]	0	-1.2	-0.2	-0.2	-0.2	-0.2
Lease of Arctic National Wildlife Refuge (Federal share)[b]	0	0	0	-0.8	-0.5	a
Sale of Alaska PMA[c]	0	-0.1	0	0	0	0
Subtotal	0	-1.3	-0.2	-1.0	-0.6	-0.2
Total	0	-1.6	-2.5	-3.2	-1.6	-0.2
President's 1993 Budget as Estimated by CBO	-39.1	-41.5	-42.0	-43.7	-42.9	-43.2

a. Less than $50 million.

b. Projected receipts from leasing the Arctic National Wildlife Refuge would be split between the federal government and the state of Alaska, with the Alaskan share of leasing receipts shown in function 300 and the proposed payout of those receipts to the state shown in function 800.

c. The receipts from the proposed lease of the naval petroleum reserve at Elk Hills, California, and from the proposed sale of the Alaska Power Marketing Administration (PMA) are shown in function 950. Outlays in function 270 would increase relative to the baseline if these transactions are carried out, because the assets would no longer generate direct receipts to the government.

Proposed Changes

The budget includes measures that would increase undistributed offsetting receipts by $1.6 billion in 1993. The President proposes to sell the rights to oil and gas production at the naval petroleum reserve at Elk Hills, California (NPR-1), the rights to oil and gas exploration and development at the Arctic National Wildlife Refuge (ANWR), and the Alaska Power Marketing Administration (PMA). The budget also includes a proposal to auction the rights to use communications frequencies. Additional proposals would affect the amounts agencies contribute to employee retirement, which appear as receipts in this function. Most of these proposals are similar to ones that appeared in previous years' budgets.

Pay-As-You-Go Policy Changes

Spectrum Auctions. The President proposes to use competitive bidding to award all initial licenses and new construction permits involving use of the electromagnetic spectrum.

In addition, the legislation proposed by the Administration would require the Federal Communications Commission (FCC) to free up 45 megahertz (MHz) of the electromagnetic spectrum currently used by government agencies and open it for competitive bidding and assignment during the 1995-1997 period. The FCC would move current commercial and federal government users from their existing frequencies and auction the freed-up frequencies for new commercial uses. CBO estimates that this initiative would result in gross receipts of $5 billion over the 1994-1996 period from auctioning about 220 MHz currently planned for reassignment plus the 45 MHz mandated by the Administration's legislative proposal.

The Administration's proposal would require appropriation action for auctioning 20 MHz of the 45 MHz mandated by the bill. CBO therefore includes receipts of $4.3 billion in the pay-as-you-go category and the remaining $0.7 billion under discretionary savings. CBO estimates that relocating government users would cost $500 million over the 1995-1999 period, $300 million of which would occur between 1995 and 1997. These expenditures would be discretionary and would partially offset the projected receipts in that spending category.

Discretionary Policy Changes

Employer's Share of Employee Retirement. The President's budget proposes to make the Postal Service pay for any remaining unfunded liability resulting from pre-1991 cost-of-living adjustments. These payments would increase receipts by $210 million annually from 1993 through 1995.

Another proposal would establish an accrual-based retirement system for commissioned corps officers of the Public Health Service. Under this proposal, increased employer contributions to the retirement system would raise receipts shown in function 950 by $98 million in 1993 and by $536 million over the 1993-1997 period. These additional receipts would offset higher spending in other budget functions, thus resulting in no net budgetary impact.

Other Changes

CBO considers the proposed sale of production rights at NPR-1 and the ANWR to be asset sales because the sale of such rights would deplete mineral resources currently owned by the federal government. Under the Balanced Budget and Emergency Deficit Control Act of 1985, the proceeds of nonroutine asset sales are not credited for deficit reduction purposes.

Naval Petroleum Reserve. The President proposes to transfer the rights to produce oil and gas at the government's Elk Hills, California, oil field to a private operator through a long-term lease. The buyer(s) of these rights would pay the government $1.2 billion in 1993 and additional amounts over the 1994-1997 period. Over a seven-year period, the state of California would receive 7 percent of these bonus payments. Starting in 1994, the federal government and California would share equally in royalties on future production, which would be paid at a rate of 12.5 percent.

CBO estimates that the federal share of NPR-1 royalties and bonus payments would total $1.9 billion over the 1993-1997 period. These receipts would be partially offset (in function 270) by a loss of about $1.3 billion in net income that the government would otherwise receive over the five-year period from selling NPR-1 products. The government would forgo additional net income in years after 1997 as well. The President also proposes to use some of the royalty and bonus payment receipts to establish a defense petroleum inventory of 10 million barrels. Expenditures for the proposed inventory are included in function 270. They would total about $100 million over the 1993-1997 period and an additional $200 million after 1997.

Arctic National Wildlife Refuge. The President proposes opening the ANWR to exploration and drilling for oil and gas, and splitting the proceeds of ANWR lease sales evenly between the federal government and the state of Alaska. CBO expects that lease sales would occur in 1995 and 1996, with net federal receipts totaling $0.8 billion and $0.5 billion, respectively. (Collection of the Alaskan share of ANWR receipts is shown in function 300, and the payment of those funds to the state is shown in function 800.)

Sale of Alaska Power Marketing Administration. The President proposes to sell the Alaska PMA at the end of 1993, yielding $85 million. This income would be partially offset by the loss of income that the government would receive if it kept the PMA. This loss would appear in function 270 and would amount to $44 million over the 1993-1997 period and more in subsequent years.

CBO Reestimates

CBO's estimates of the budgetary impacts of each of the proposals affecting this function differ significantly from the Administration's, but the aggregate difference over the 1992-1997 period is less than $0.3 billion.

Pay-As-You-Go Reestimates

Spectrum Auctions. The Administration estimates that the sale of licenses and permits would generate gross receipts of about $6.8 billion over the 1995-1997 period, and that the auction would entail discretionary costs of $3.0 billion over the same period for relocating government users. Thus, the budget includes net receipts of $3.8 billion. By comparison, CBO estimates that net receipts would total $4.7 billion over the 1994-1997 period, of which $4.3 billion would count for pay-as-you-go purposes.

The legislation proposed by the Administration would require the FCC to auction new licenses and construction permits, with some exceptions. CBO believes that this legislation would require the FCC to auction not only the 45 MHz specified in the President's request, but also additional frequencies that the FCC will make available through current proceedings. (The Administration's estimate appears to encompass only the 45 MHz.) CBO therefore estimates that the proposed legislation would lead to earlier auctions than assumed in the budget, and that the auctions would yield $2 billion in receipts in 1994. The President's budget does not project any auction receipts until 1995.

Other Reestimates

Employer's Share of Employee Retirement. CBO's estimates of offsetting receipts for agency contributions to retirement programs for the government's civilian employees are lower than the Administration's estimates by $0.2 billion in 1992; this difference increases to $2.3 billion by 1997. CBO's estimates of employer contributions for military employees exceed the Administration's estimates by $1.3 billion in 1994, with the difference falling to $0.9 billion by 1997.

CBO's estimates of agency retirement contributions for civilian employees are lower than the Administration's estimates mainly because CBO's estimates reflect the budget's proposed reductions in the number of civilians working for the Department of Defense (DoD) and the Administration's estimates do not.

CBO's estimates of agency retirement contributions for military employees are higher because the Administration's request for fiscal years 1994 through 1997 assumes a change in the long-term economic assumptions used to calculate the government's contribution rate for military retirement. This change would effectively lower DoD's contributions to the retirement fund by about $2.8 billion each year. Whether this change occurs will depend on the decisions of an independent board of actuaries charged with evaluating the soundness of the military retirement fund. CBO's estimates assume that the actuaries will revise the long-term assumptions, but only by about half as much as the Administration assumes.

Arctic National Wildlife Refuge. The President proposes to open the ANWR to oil and gas exploration and development, and assumes that legislation would be enacted by June 1992, with the first lease sale occurring in 1994. CBO assumes that any Congressional action is likely to occur later--by early in fiscal year 1993--and that the first lease sale could not occur until 1995. CBO also projects that the federal share of bonus bids from competitive bidding would be about $0.8 billion less than the Administration projects over the 1993-1997 period.

Outer Continental Shelf. CBO's estimates of receipts from Outer Continental Shelf leasing are higher than the President's by $0.4 billion in 1993 and by an average of $0.6 billion annually from 1994 through 1997, primarily because CBO assumes higher oil and gas prices than the Administration does.

CBO REESTIMATES OF PROPOSED SPENDING IN FUNCTION 950 OF THE PRESIDENT'S BUDGET (By fiscal year, outlays in billions of dollars)

	1992	1993	1994	1995	1996	1997
President's 1993 Budget	-38.8	-41.6	-40.3	-42.0	-44.4	-45.0
CBO Reestimates						
Pay-As-You-Go Proposals						
Spectrum auctions	0	0	-2.0	-0.3	1.0	0.8
Other						
Employer's share of employee retirement	0.2	0.5	-0.6	0.3	1.0	1.4
Lease of Arctic National Wildlife Refuge	0	0	1.3	-0.8	0.3	a
Outer Continental Shelf	-0.6	-0.4	-0.5	-0.6	-0.6	-0.6
Other	0	0	0.2	-0.3	-0.2	0.1
Total	-0.4	0.2	-1.6	-1.7	1.5	1.8
President's 1993 Budget as Estimated by CBO	-39.1	-41.5	-42.0	-43.7	-42.9	-43.2

a. Less than $50 million.

Appendixes

Appendix A

Baseline Budget Projections

Throughout this volume, the Administration's proposals are contrasted with the Congressional Budget Office's (CBO's) baseline estimates of the budget. The baseline shows the path of revenues and spending if current laws and policies remain unchanged. It is not a forecast of budget outcomes, since policymakers will certainly seek many changes in priorities. But the baseline is a handy yardstick for gauging the potential impacts of proposed changes--those advocated in the President's budget as well as in competing packages.

Baseline projections follow long-established rules. *Revenues* and *entitlement programs* (like Social Security and Medicare) continue on their course until the Congress changes the laws that underpin them--laws setting tax rates and taxable income, benefit formulas and eligibility, and so forth. For these categories, therefore, the baseline represents CBO's best estimate of what will happen under current laws. Any expiring provisions of law are assumed to expire as scheduled, with two important exceptions. The baseline assumes that excise taxes dedicated to trust funds (such as the Airport and Airway Trust Fund), and any large entitlement programs, will continue past their current expirations--two assumptions that are explicitly stated in law.

Unlike entitlement programs, *discretionary programs* are funded anew each year through the appropriation process. Discretionary programs encompass nearly all the defense and international affairs budgets and many domestic programs: space, energy, transportation, environmental protection, health research, and salaries and expenses of civilian agencies, to name just a few. The Budget Enforcement Act of 1990 (BEA) set multiyear caps on appropriations, both on budget authority (the ability to obligate money) and on outlays (actual spending). Through 1993, separate caps apply to three broad types of discretionary spending: defense, international, and domestic. In 1994 and 1995, a single lid covers all discretionary spending. CBO's baseline assumes compliance with these caps, which will inexorably force trade-offs among many competing programs (see discussion below).

No discretionary spending caps are specified after the Budget Enforcement Act expires in 1995. The baseline projections simply preserve 1995's real spending levels in 1996 and 1997, boosting them for inflation of about 3.4 percent per year.

A few categories of spending remain. The government has pledged to protect depositors in banks and savings and loan institutions, and the baseline for *deposit insurance* shows the cost of meeting those promises. *Offsetting receipts*, such as fees and collections, represent CBO's best estimate of sums collected under current laws and policies. And *net interest* is not directly controlled by policymakers but is driven by market interest rates and future deficits.

Changes in the CBO Baseline

CBO's report, *The Economic and Budget Outlook: Fiscal Years 1993-1997* (January 1992), described the baseline projections in detail. Since then, CBO has made modest revisions to its baseline projections (see Table A-1).

Only one piece of legislation has affected the budget totals since January. A bill further extending unemployment benefits in the wake of the recession (P.L.102-244) boosts spending in 1992 and, by a smaller amount, in 1993. The same act modifies the rules that corporations use to calculate estimated income tax payments; this provision, though it affects the timing of receipts, is nevertheless revenue neutral over the 1992-1996 period.

Recent administrative actions have led CBO to drop its estimate of revenues by $15 billion in 1992, $6 billion in 1993, and small amounts in later years. The revision is almost wholly the result of the Administration's move to reduce income taxes withheld from workers' paychecks, a step that did not require legislation. Long-run effects are virtually nil because lower collections in one year are offset by shrunken tax refunds in the next. Another, smaller revision (amounting to less than $500

Table A-1.
Changes in CBO Deficit Projections Since January (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
January 1992 Estimate	352	327	260	194	178	226
Legislative Changes (Extension of Unemployment Insurance)						
Revenues	0	1	a	-1	a	0
Outlays	3	1	0	0	0	0
Deficit	3	a	a	1	a	0
Other Policy Changes[b]						
Revenues	-15	-6	-1	-1	-2	-2
Outlays	0	0	0	0	0	0
Deficit	15	6	1	1	2	2
Technical Revisions						
Revenues	a	a	a	a	a	a
Outlays						
Discretionary programs	1	4	5	6	6	6
Mandatory programs	-3	-1	1	1	2	2
Subtotal	-2	4	6	7	9	9
Deficit	-2	4	6	7	9	9
Total	16	10	7	9	11	10
Current Estimate	368	336	267	203	189	236

SOURCE: Congressional Budget Office.

NOTE: Projections include Social Security and the Postal Service, which are off-budget. Projections assume compliance with discretionary spending caps in the Budget Enforcement Act.

a. Less than $500 million.

b. Change in individual income tax withholding tables and in required reserve ratios for commercial banks.

million a year) marks a recent reduction in the reserves that banks and other depositing institutions must set aside with the Federal Reserve System, which affects corporate income taxes and Federal Reserve earnings.

Technical revisions in outlays boost the projected deficit. Extra spending in discretionary programs reflects new, higher spending caps that were published in conjunction with the Administration's budget. The Budget Enforcement Act designated the Administration's Office of Management and Budget (OMB) as the official scorekeeper for compliance purposes. In announcing new caps for fiscal year 1993 and previewing those for later years, OMB consistently adopted more generous solutions than did CBO (in its own advisory report) on several contentious issues: the size of a downward adjustment that was required by unexpectedly low inflation, the amount of cuts required to comply with last year's highway bill, and the amount of elbow room afforded for spending related to Operation Desert Storm. Altogether, OMB's more generous interpretations allow $4 billion to $6 billion a year more in discretionary spending than CBO assumed earlier. Because OMB's

Table A-2.
The Deficit Outlook Under Current Policies (By fiscal year)

	Actual 1991	1992	1993	1994	1995	1996	1997
			In Billions of Dollars				
Total Deficit Assuming Discretionary Caps	269	368	336	267	203	189	236
Deficit Excluding Deposit Insurance and Desert Storm Contributions	246	307	267	235	219	233	265
On-Budget Deficit (Excluding Social Security and Postal Service)	321	420	400	344	290	287	346
Standardized-Employment Deficit[a]	172	209	198	186	180	202	245
Memoranda:							
Deposit Insurance	66	65	69	33	-17	-45	-29
Desert Storm Contributions	-43	-5	0	0	0	0	0
Off-Budget Surplus							
Social Security	54	53	65	76	86	98	110
Postal Service	-1	-1	-1	b	1	b	-1
Total, Off-Budget Surplus	52	52	64	76	87	98	109
			As a Percentage of GDP				
Total Deficit Assuming Discretionary Caps	4.8	6.3	5.4	4.0	2.9	2.5	3.0
Deficit Excluding Deposit Insurance and Desert Storm Contributions	4.4	5.3	4.3	3.5	3.1	3.1	3.4
Standardized-Employment Deficit[a, c]	2.9	3.4	3.1	2.7	2.5	2.7	3.1

SOURCE: Congressional Budget Office.

a. Excludes deposit insurance and Desert Storm contributions.

b. Less than $500 million.

c. Shown as a percentage of potential GDP.

estimates will control the appropriation process, CBO now uses OMB's official caps. Revisions to mandatory programs are relatively small, changing outlays by $1 billion to $3 billion a year.

In sum, the revisions to CBO's baseline swell the deficit by $16 billion in 1992 and by an average of $9 billion a year thereafter (see Table A-1). The resulting deficit falls through mid-decade but then turns up again. As CBO's January report explained more fully, today's record-breaking deficits stem partly from temporary factors--namely, from the recession, which depresses revenues and boosts spending, and from the hemorrhage of spending on deposit insurance. Stripping such factors out of the totals helps to highlight the government's underlying deficit (see Table A-2). These temporary factors fade in importance. At the same time, the Budget Enforcement Act's caps on discretionary spending call for further belt-tightening in 1993 through 1995. Thus, the deficit dwindles before getting stuck at about 3 percent of gross domestic product (GDP) in mid-decade.

Totals for the major revenue sources and spending categories are presented in Table A-3. Because entitlement spending alone--largely fueled by the government's health care and retirement programs--accounts for ap-

Table A-3.
Baseline Budget Projections, Assuming Compliance with Discretionary Spending Caps (By fiscal year)

Category	Actual 1991	1992	1993	1994	1995	1996	1997
			In Billions of Dollars				
Revenues							
Individual income	468	476	513	556	596	633	673
Corporate income	98	98	110	120	125	129	131
Social insurance	396	415	449	480	509	540	570
Other	92	98	102	106	110	111	115
Total	1,054	1,088	1,173	1,262	1,340	1,413	1,490
On-budget	760	783	845	911	968	1,018	1,070
Off-budget	294	305	328	350	372	395	420
Outlays							
Defense discretionary	317	313	297	a	a	a	a
International discretionary	19	20	21	a	a	a	a
Domestic discretionary	196	215	225	a	a	a	a
Subtotal	532	548	543	537	538	556	575
Mandatory spending, excluding deposit insurance	636	710	751	797	848	903	977
Deposit insurance	66	65	69	33	-17	-45	-29
Net interest	196	201	214	232	246	262	280
Offsetting receipts[b]	-108	-69	-67	-69	-73	-74	-77
Total	1,323	1,455	1,510	1,529	1,543	1,602	1,726
On-budget	1,081	1,203	1,246	1,255	1,258	1,305	1,416
Off-budget	242	252	264	274	285	297	310
Deficit	269	368	336	267	203	189	236
On-budget deficit	321	420	400	344	290	287	346
Off-budget surplus	52	52	64	76	87	98	109

(Continued)

SOURCE: Congressional Budget Office.

proximately half of all federal spending, more detail about this huge category is depicted in Table A-4.

How Tight Are the Caps?

By setting broad caps on discretionary spending, the BEA's drafters forced trade-offs among programs. There are literally thousands of possible ways to comply with the caps. CBO's baseline projections assume that policymakers will achieve compliance. CBO cannot project how individual programs will fare in the ensuing competition, but it can sketch the implications of the discretionary caps for budget totals.

One way to illustrate the policymakers' task is to compare the caps with a path that keeps real spending at today's levels. Table A-5 shows how high discretionary spending levels--both budget authority and outlays--would climb if they preserved the amount and mix of discretionary spending in 1992. Because of inflation, these amounts would grow every year. But the law does not allow policymakers to appropriate this much money. In 1993, the legislators must freeze domestic appropriations at roughly the 1992 levels, while chopping the defense budget from this year's figure. Moreover, further rounds of cuts

Table A-3.
Continued

Category	Actual 1991	1992	1993	1994	1995	1996	1997
	As a Percentage of GDP						
Revenues							
Individual income	8.3	8.1	8.2	8.4	8.5	8.5	8.6
Corporate income	1.7	1.7	1.8	1.8	1.8	1.7	1.7
Social insurance	7.0	7.1	7.2	7.2	7.3	7.3	7.3
Other	1.6	1.7	1.6	1.6	1.6	1.5	1.5
Total	18.7	18.6	18.8	19.1	19.1	19.1	19.0
On-budget	13.5	13.4	13.6	13.8	13.8	13.7	13.6
Off-budget	5.2	5.2	5.3	5.3	5.3	5.3	5.3
Outlays							
Defense discretionary	5.6	5.4	4.8	a	a	a	a
International discretionary	0.3	0.3	0.3	a	a	a	a
Domestic discretionary	3.5	3.7	3.6	a	a	a	a
Subtotal	9.5	9.4	8.7	8.1	7.7	7.5	7.3
Mandatory spending, excluding deposit insurance	11.3	12.1	12.0	12.0	12.1	12.2	12.4
Deposit insurance	1.2	1.1	1.1	0.5	-0.2	-0.6	-0.4
Net interest	3.5	3.4	3.4	3.5	3.5	3.5	3.6
Offsetting receipts[b]	-1.9	-1.2	-1.1	-1.0	-1.0	-1.0	-1.0
Total	23.5	24.9	24.2	23.1	22.0	21.6	22.0
On-budget	19.2	20.6	20.0	19.0	18.0	17.6	18.0
Off-budget	4.3	4.3	4.2	4.1	4.1	4.0	4.0
Deficit	4.8	6.3	5.4	4.0	2.9	2.5	3.0
On-budget deficit	5.7	7.2	6.4	5.2	4.1	3.9	4.4
Off-budget surplus	0.9	0.9	1.0	1.2	1.2	1.3	1.4

a. Discretionary spending caps are specified by category through 1993 and in the aggregate for 1994 and 1995. Projections for 1996 and 1997 assume that spending grows at the rate of inflation after 1995.

b. Includes contributions from allied nations for Operation Desert Storm.

Table A-4.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance (By fiscal year, in billions of dollars)

	Actual 1991	1992	1993	1994	1995	1996	1997
		Means-Tested Programs					
Medicaid	53	68	80	89	100	113	126
Food Stamps[a]	20	23	23	23	23	24	25
Supplemental Security Income	15	17	18	21	22	21	25
Family Support	14	16	17	17	18	19	19
Veterans' Pensions	4	4	4	4	4	4	4
Child Nutrition	6	6	6	7	7	8	8
Earned Income Tax Credit	5	7	8	9	12	12	13
Stafford Loans[b]	5	2	3	3	3	3	3
Other	2	3	3	3	4	4	4
Total	122	146	162	177	193	207	228
		Non-Means-Tested Programs					
Social Security	267	285	301	318	335	354	374
Medicare	114	128	143	159	177	198	220
Subtotal	381	413	443	477	513	553	594
Other Retirement and Disability							
Federal civilian[c]	37	38	39	42	44	50	54
Military	23	24	26	27	28	30	32
Other	4	5	5	5	5	5	5
Subtotal	64	67	70	74	78	85	91
Unemployment Compensation	25	35	26	25	26	26	27
Other Programs							
Veterans' benefits[d]	14	16	16	18	17	16	18
Farm price supports	10	9	11	10	9	9	9
Social services	6	5	6	5	5	5	5
Credit reform liquidating accounts	0	9	5	2	-1	-8	-5
Other	13	10	12	10	9	9	10
Subtotal	43	49	50	44	39	32	37
Total	514	564	589	620	655	696	748
		Total					
All Mandatory Spending, Excluding Deposit Insurance	636	710	751	797	848	903	977

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as nondefense discretionary spending, and Medicare premium collections as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Formerly known as guaranteed student loans.

c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.

d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

Table A-5.
Comparison of Discretionary Spending Levels (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
Amounts Required to Preserve Real Resources[a]						
Budget Authority						
Defense	301	302	313	325	337	350
International[b]	21	21	22	23	24	25
Domestic	204	213	220	228	242	256
Total	526	536	556	576	603	630
Outlays						
Defense	313	307	311	319	329	341
International[b]	20	20	21	22	23	23
Domestic	215	232	245	255	265	275
Total	548	560	578	596	617	639
Savings from Complying with Caps						
Budget Authority						
Defense	0	-13	c	c	c	c
International[b]	0	1	c	c	c	c
Domestic	0	-6	c	c	c	c
Total	0	-18	-44	-59	-68	-78
Outlays						
Defense	0	-10	c	c	c	c
International[b]	0	d	c	c	c	c
Domestic	0	-7	c	c	c	c
Total	0	-17	-41	-58	-60	-64
Baseline Assuming Compliance with Caps						
Budget Authority						
Defense	301	289	c	c	c	c
International[b]	21	23	c	c	c	c
Domestic	204	206	c	c	c	c
Total	526	518	511	517	535	553
Outlays						
Defense	313	297	c	c	c	c
International[b]	20	21	c	c	c	c
Domestic	215	225	c	c	c	c
Total	548	543	537	538	556	575

SOURCE: Congressional Budget Office.

a. Preserves 1992 real resources, except emergency appropriations.

b. The international caps would permit a slight increase in real resources in 1993.

c. Discretionary spending caps are specified by category through 1993 and in the aggregate for 1994 and 1995. Projections for 1996 and 1997 assume that spending grows at the rate of inflation after 1995.

d. Less than $500 million.

will be required in 1994 and 1995. The cuts will be painful even if they are not savage. By 1995, total discretionary spending--in real dollars--would be about 10 percent below 1992 levels. As a percentage of GDP, it will have slipped below 8 percent, the lowest share in decades.

Trust Funds in the Projections

Legislation passed in 1983 formally placed the two Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) off-budget. Both CBO and the Administration comply with this law by displaying on- and off-budget totals separately. (Besides Social Security, the much smaller Postal Service fund is also legally off-budget.) These off-budget totals are shown in Table A-2. Economists and credit market participants focus on the government's total finances, ignoring the on- and off-budget distinction. Social Security alone accounts for about one-fourth of government revenues and one-fifth of spending. No useful budget measures can overlook such large flows.

The Social Security funds are merely the largest of many federal trust funds. The major funds and their surpluses are depicted in Table A-6. In the budget, trust funds serve a purely bookkeeping role, tracking earmarked collections and spending. The apparent size of Social Security and other trust fund surpluses has distorted budget debate. Specifically, some budget watchers maintain that trust funds mask the true deficit--their term

Table A-6.
CBO Projections of Trust Fund Surpluses (By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997
Social Security	53	65	76	86	98	110
Medicare	14	11	9	9	7	4
Military Retirement	13	12	10	10	9	8
Civilian Retirement[a]	24	26	29	31	30	31
Unemployment	-15	-2	2	3	5	4
Highway and Airport	2	2	b	-1	-1	-1
Other[c]	3	2	2	2	2	2
Total Trust Fund Surplus	95	117	128	139	149	158
Federal Funds Deficit[d]	-463	-454	-395	-342	-338	-395
Total Deficit	-368	-336	-267	-203	-189	-236
Memorandum:						
Net Transfers from Federal Funds to Trust Funds	192	201	214	234	257	281

SOURCE: Congressional Budget Office.

a. Civil Service Retirement, Foreign Service Retirement, and several smaller funds.

b. Less than $500 million.

c. Primarily Railroad Retirement, employees' health insurance and life insurance, Hazardous Substance Superfund, and various veterans' insurance trust funds.

d. Assumes that discretionary spending reductions are made in non-trust-fund programs.

for the federal funds deficit, which excludes trust funds. That is a misconception, for two compelling reasons.

First, all trust funds rely, to a greater or lesser degree, on transfers from elsewhere in the budget to generate their surpluses. (In a classic example, the Medicare Part B program finances just one-fourth of its costs from premiums, simply counting on a general fund transfer for all the rest, thereby posting a small "surplus.") Such transfers swell the federal funds deficit and the trust fund surplus by equal amounts but obviously do not change the total deficit or the government's borrowing needs by one penny. As Table A-6 shows, such transfers total roughly $200 billion a year; without them, the trust funds would not show surpluses.

Second, and more important, decisions about programs financed by trust funds are part and parcel of overall decisions about the use of economic resources. No major federal government program is self-supporting in any meaningful way. Every dollar of spending requires taxing (or borrowing from) someone and granting benefits to others. Trust fund status alone ought not to protect certain programs in the competition for scarce resources when other needs lack such a protective label.

The Ten-Year Budget Outlook

CBO generally does its baseline projections for a five-year horizon. But budget forecasters are often queried about the longer-run outlook. Does the deficit eventually go away of its own accord? The answer appears to be no. Under current policies, after the mid-1990s the deficit is expected to start climbing in dollar terms and--more worrisome--as a percentage of GDP. A broad-brush view of the budget outlook through 2002 is presented in Table A-7.

CBO expects that, under current policies, revenues will barely outpace the growth in GDP, climbing from 19.0 percent of GDP in 1997 to 19.1 percent in 2002. Personal income taxes account for this slight rise.

But spending grows faster than revenues. Outlays grow by more than 1 percent of GDP in the 1997-2002 period. Within the spending totals, some categories grow faster than GDP while others lag behind. The government's big health care programs--Medicare and Medicaid--continue to soar, and together they represent 5.9 percent of GDP in 2002 (versus 4.4 percent in 1997). Net interest outlays inch up from 3.6 percent of GDP in 1997 to 3.8 percent in 2002. Social Security benefits stay just below 5 percent of GDP. In 2002, the final year of this projection, the big demands that the baby-boom generation will place on Social Security and Medicare will still lie more than five years away. Most other spending programs roughly preserve their 1997 shares. A sole exception is discretionary spending--defense, international, and domestic. These program areas are assumed, in the baseline projections, merely to keep up with inflation once the Budget Enforcement Act's caps expire in 1995. They therefore dwindle gradually as a share of GDP, from 7.3 percent in 1997 to 6.7 percent in 2002.

As large deficits persist, the debt held by the public soars to more than 59 percent of GDP under current policies, up from 52 percent today. Not since the mid-1950s (when nearly all the debt was left over from World War II) will the debt-to-GDP ratio have been so high.

Economic assumptions are critical to these projections. For 1998 through 2002, CBO posits that real economic growth continues at about 2 percent a year. The unemployment rate is about $5\frac{1}{2}$ percent, down slightly from the 1997 level. Short-term interest rates (as measured by three-month Treasury bills) and longer-term rates (such as 10-year Treasury

Table A-7.
The Budget Outlook Through 2002 (By fiscal year)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
					In Billions of Dollars						
Revenues	1,088	1,173	1,262	1,340	1,413	1,490	1,578	1,665	1,755	1,851	1,953
Outlays											
Discretionary	548	543	537	538	556	575	596	618	640	663	687
Mandatory											
Social Security	285	301	318	335	354	374	395	418	441	466	492
Medicare	128	143	159	177	198	220	244	271	301	335	372
Medicaid	68	80	89	100	113	126	142	160	180	202	227
Other	229	228	231	235	238	256	265	276	288	299	312
Subtotal	710	751	797	848	903	977	1,046	1,124	1,209	1,302	1,404
Deposit insurance	65	69	33	-17	-45	-29	-19	-14	-12	-10	-9
Net interest	201	214	232	246	262	280	299	319	340	365	393
Offsetting receipts[a]	-69	-67	-69	-73	-74	-77	-81	-85	-89	-94	-99
Total	1,455	1,510	1,529	1,543	1,602	1,726	1,843	1,962	2,089	2,226	2,376
Deficit	368	336	267	203	189	236	265	296	333	375	423
Deficit Excluding Deposit Insurance and Desert Storm Contributions	307	267	235	219	233	265	283	311	345	385	432
Debt Held by the Public	3,049	3,385	3,656	3,865	4,061	4,304	4,576	4,879	5,220	5,602	6,032
					As a Percentage of GDP						
Revenues	18.6	18.8	19.1	19.1	19.1	19.0	19.0	19.1	19.1	19.1	19.1
Outlays											
Discretionary	9.4	8.7	8.1	7.7	7.5	7.3	7.2	7.1	7.0	6.8	6.7
Mandatory											
Social Security	4.9	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8	4.8
Medicare	2.2	2.3	2.4	2.5	2.7	2.8	2.9	3.1	3.3	3.5	3.6
Medicaid	1.2	1.3	1.3	1.4	1.5	1.6	1.7	1.8	2.0	2.1	2.2
Other	3.9	3.7	3.5	3.4	3.2	3.3	3.2	3.2	3.1	3.1	3.1
Subtotal	12.1	12.0	12.0	12.1	12.2	12.4	12.6	12.9	13.1	13.4	13.7
Deposit insurance	1.1	1.1	0.5	-0.2	-0.6	-0.4	-0.2	-0.2	-0.1	-0.1	-0.1
Net interest	3.4	3.4	3.5	3.5	3.5	3.6	3.6	3.6	3.7	3.8	3.8
Offsetting receipts[a]	-1.2	-1.1	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0	-1.0
Total	24.9	24.2	23.1	22.0	21.6	22.0	22.2	22.5	22.7	23.0	23.3
Deficit	6.3	5.4	4.0	2.9	2.5	3.0	3.2	3.4	3.6	3.9	4.1
Deficit Excluding Deposit Insurance and Desert Storm Contributions	5.3	4.3	3.5	3.1	3.1	3.4	3.4	3.6	3.7	4.0	4.2
Debt Held by the Public	52.2	54.3	55.2	55.2	54.8	54.8	55.2	55.9	56.7	57.8	59.1

SOURCE: Congressional Budget Office.

a. Includes contributions from allied nations for Operation Desert Storm.

notes) are also assumed to remain constant at 5.6 percent and 7.1 percent, respectively. Inflation chugs along at about 3.6 percent.

Five-year budget projections are highly uncertain, and 10-year projections are even more so. Major uncertainties include assumptions about economic performance (chiefly real economic growth and interest rates); others are more narrowly budget-related--the outlook for a continued surge in use of medical care, the size and timing of outlays for deposit insurance, and so forth. CBO's projections, uncertain though they are, nevertheless challenge the comfortable notion that the deficit will eventually go away of its own accord.

Appendix B

Major Contributors to the Revenue and Spending Projections

The following analysts prepared the revenue and spending projections in this report:

Revenue Projections

Mark Booth	Corporate income taxes, Federal Reserve System earnings
Leonard Burman	Individual income taxes
Maureen Griffin	Social insurance contributions, excise taxes, estate and gift taxes
Jon Hakken	Corporate income taxes
Katherine Johnson	Excise taxes, NIPA receipts
Larry Ozanne	Individual income taxes
Linda Radey	Excise taxes
Pearl Richardson	Individual and corporate income taxes
John Stell	Customs duties, miscellaneous receipts
David Weiner	Individual income taxes
Roberton Williams	Individual income taxes

Spending Projections

Defense and International Affairs

Eugene Bryton	Defense
Kent Christensen	International affairs
Raymond Hall	Defense
Barbara Hollinshead	Defense
William Myers	Defense
Mary Helen Petrus	Defense
Amy Plapp	Defense
Lisa Siegel	Defense
Joseph Whitehill	International affairs

Human Resources

Sandra Clark	Child nutrition, veterans' compensation and pensions
Paul Cullinan	Social Security
Cathy Ellman	Civil Service Retirement, Railroad Retirement

Alan Fairbank	Hospital Insurance
Scott Harrison	Medicare
Jean Hearne	Medicaid
Lori Housman	Medicare
Julia Isaacs	Food stamps, foster care, child care
Deborah Kalcevic	Education
Josh Leichter	Social service programs, Head Start
Jeff Lemieux	Health
Cory Oltman	Unemployment insurance, training programs, veterans' education
Pat Purcell	Supplemental Security Income, Medicaid
Kathleen Shepherd	Veterans' benefits
Connie Takata	Public Health Service
John Tapogna	Aid to Families with Dependent Children, child support enforcement

Natural and Physical Resources

Philip Bartholomew	Deposit insurance
Kim Cawley	Energy, pollution control and abatement
Patricia Conroy	Community and regional development, general government
Peter Fontaine	Energy
Mark Grabowicz	Science and space, justice
Theresa Gullo	Water resources, conservation, and land management
James Hearn	General government, Agricultural Credit Insurance Fund, Outer Continental Shelf receipts
David Hull	Agriculture
Thomas Lutton	Deposit insurance
Mary Maginniss	Deposit insurance
Eileen Manfredi	Agriculture
Marjorie Miller	Transportation, Federal Housing Administration
Andrew Morton	Agriculture
Deborah Reis	Recreation, water transportation
Mitchell Rosenfeld	Air transportation, justice, Postal Service
Brent Shipp	Housing and mortgage credit
John Webb	Commerce, disaster relief

Other

Janet Airis	Appropriation bills
Edward Blau	Appropriation bills
Betty Embrey	Appropriation bills
Kenneth Farris	Computer support
Glen Goodnow	Authorization bills
Alice Grant	Appropriation bills
Leslie Griffin	Net interest on the public debt
Vernon Hammett	Computer support
Ellen Hays	Other interest, credit
Sandra Hoffman	Computer support
Jeffrey Holland	Net interest on the public debt
Richard Krop	Civilian agency pay, historical data

Terri Linger	Computer support
Fritz Maier	Computer support
Kathy Ruffing	Treasury borrowing, interest, and debt
Robert Sempsey	Appropriation bills
Jeff Swersey	Computer support

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