

Statement of
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Before the
Committee on the Budget
House of Representatives

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Mr. Chairman and Members of the Committee:

As you are aware, federal budget outlays for both fiscal year 1976 and the transition quarter fell substantially below the levels estimated by both OMB and CBO. This shortfall means that the federal budget for fiscal year 1976 and the transition quarter had a substantially less stimulative effect on the economy than the Congress intended when it adopted its budget resolutions for these periods. Indeed, the shortfall in spending has clearly contributed to the poorer than expected performance of the economy in recent months.

Moreover, the shortfall in fiscal year 1976 and transition quarter outlays calls into question the validity of the outlay ceilings for fiscal year 1977 voted by Congress in the Second Concurrent Resolution. If substantial portions of the past shortfall represent spending that was merely delayed and will show up in fiscal year 1977, then federal spending in the current fiscal year will turn out to be more stimulative than the Congress intended; outlay ceilings might be breached and necessitate a third budget resolution even without additional Congressional action on spending programs or revenue measures.

More fundamentally, Mr. Chairman, the outlay shortfall in fiscal year 1976 and the transition quarter brings forcefully to the attention of the Congress the fact that the United States Government does not have an accurate way of monitoring its own current spending. This fact has worried economists concerned with fiscal policy for many years. It did not have a

major impact on the Congress before now because prior to the enactment of the Congressional Budget Act of 1974 Congress acted upon a series of separate spending and taxing measures without too much concern about how they related to the total budget and its impact on the economy. Under the new Congressional budget procedures, however, the Congress actually votes for budget totals deemed appropriate to the needs of the economy in the next fiscal year. Hence, errors in estimating outlays have serious consequences, not just for the economy, but for pending Congressional spending actions. Indeed, the credibility of the whole budget process depends to an important degree on the availability of accurate outlay estimates for the coming year. Congress will not long continue the rigorous discipline of the budget process, which often involves rejecting needed new expenditures on the grounds that they violate outlay ceilings, if the outlay estimates prove unreliable by billions of dollars. The Congress and the Administration must work together to develop procedures that yield far more accurate outlay estimates as well as monitoring systems which will provide timely warning when actual outlays deviate from estimates.

My testimony today will focus on five questions and will attempt to provide at least preliminary answers.

1. What was the magnitude of the spending shortfalls and when did they occur?
2. Why did the spending shortfalls occur?

3. What impact are these shortfalls having on the economy?
4. What is the implication of the spending shortfalls and a changing economic outlook for estimates of outlays and receipts in fiscal year 1977?
5. What can or should be done to make more accurate spending estimates in the future?

The Magnitude of the Shortfall

There is no single "right" answer to the question: how big was the spending shortfall for the fifteen-month period which included fiscal year 1976 and the transition quarter? This is because several sets of outlay estimates were made at various times during the period. Moreover, adding estimates made at different times for fiscal year 1976 and the transition quarter can involve some double counting.

Shortfall from the Second Concurrent Resolution. As may be seen in Table 1, actual spending as reported by the Treasury was \$10.1 billion less than the outlays voted by Congress in the Second Concurrent Resolution on the fiscal year 1976 Budget; outlays for the transition quarter were \$7.8 billion lower than specified in the comparable resolution.

Table 1. Congressional Budget Resolution and Actual Results,
Fiscal Year 1976 and the Transition Quarter
(In billions of dollars)

| | Budget Authority | Outlays | Receipts | Deficit |
|--|---------------------|---------|----------|---------|
| <hr/> | | | | |
| <u>Fiscal Year 1976</u> | | | | |
| First budget resolution (adopted May 14, 1975) | 386.7 | 367.0 | 298.2 | 68.8 |
| Second budget resolution (adopted December 12, 1975). | 408.0 | 374.9 | 300.8 | 74.1 |
| Actual results <u>a/</u> | 413.4 | 364.8 | 299.2 | 65.6 |
| Transition Quarter (July - September 1976) | | | | |
| First budget resolution (adopted December 12, 1975). | 91.1 | 101.7 | 86.0 | 15.7 |
| Second budget resolution (adopted May 13, 1976)..... | 96.3 | 102.2 | 86.0 | 16.2 |
| Actual results <u>a/</u> | n.a. | 94.4 | 81.7 | 12.7 |

a/ The earned income credit is deducted from receipts (rather than added to outlays) to achieve comparability with the budget resolutions.

These figures overstate the shortfall, however, because the budget authority and outlays figures specified in the Second Concurrent Resolution serve as a ceiling or upper limit on new Congressional spending actions. Actual spending can turn out to be less because Congress chooses not to take action on specific spending measures or because Congressional action is delayed or

because of changes in the estimates for programs on which Congress does not take annual action (e.g., Social Security and interest on the public debt). Therefore a more useful benchmark for measuring the shortfall is an estimate of the spending that would result from specific Congressional spending actions, such as the passage of the annual appropriations bills.

Shortfall from CBO Scorekeeping Reports. Under the Congressional Budget Act, the CBO is required to issue periodic scorekeeping reports on the status of Congressional budget action. As may be seen in Table 2, the final CBO estimate for fiscal year 1976 outlays was \$372.5 billion, or \$7.7 billion above the actual level reported by the Treasury. For the transition quarter, the difference between estimated and actual outlays was \$6.7 billion.

The spending estimates provided in CBO scorekeeping reports are derived largely from federal agency estimates and past spending patterns. The CBO makes its own independent estimates in some instances, especially for entitlement programs that are influenced by economic conditions but, for the bulk of the estimates, we review data provided by the Office of Management and Budget and other agencies. Where we judge these estimates to be appropriate, they are adopted in our scorekeeping data base. Under the ground rules adopted by the

two Budget Committees, CBO makes only four comprehensive re-estimates of spending during the year which are scheduled to follow the submission of revised estimates by the Administration: in January when the President submits his annual budget, on or before April 10 and July 15 when the President is required to submit a statement of estimated outlays and receipts, and on or before November 10 when the President is required to submit current services estimates for the next fiscal year.

Table 2. Congressional Scorekeeping Estimates and Actual Results, Fiscal Year 1976 and the Transition Quarter
(In billions of dollars)

| | Budget Authority | Outlays | Receipts | Deficit |
|---|------------------|---------|----------|---------|
| <u>Fiscal Year 1976 (Parliamentarian Status Report)</u> | | | | |
| January 30, 1976 | 396.7 | 371.0 | 301.1 | 69.9 |
| April 26, 1976 | 402.2 | 371.7 | 301.1 | 70.6 |
| June 30, 1976 | 406.2 | 372.5 | 301.1 | 71.4 |
| Actual results <u>a/</u> | 413.4 | 364.8 | 299.2 | 65.6 |
| <u>Transition Quarter (Senate Budget Scorekeeping Report)</u> | | | | |
| July 19, 1976 | 93.4 | 100.4 | 86.0 | 14.4 |
| September 27, 1976 | 95.8 | 101.1 | 86.0 | 15.1 |
| Actual results <u>a/</u> | n.a. | 94.4 | 81.7 | 12.7 |

a/ The earned income credit is deducted from receipts (rather than added to outlays) to achieve comparability with the congressional budget resolutions and scorekeeping reports.

Shortfall from Administration Estimates. It is also appropriate to measure actual spending against the estimates made by the Administration. Table 3 provides a summary of the spending estimates submitted to the Congress since January for fiscal year 1976 and the transition quarter. The differences between the July estimates and actual outlays were \$3.5 billion for 1976 and \$7.6 billion for the transition quarter. These differences are reversed if the January budget is used as the estimate -- \$7.9 billion for 1976 and \$3.5 billion for the transition quarter.

Table 3. Administration Budget Estimates and Actual Results, Fiscal Year 1976 and the Transition Quarter *
(In billions of dollars)

| | Budget Authority | Outlays | Receipts | Deficit |
|---------------------------|------------------|---------|----------|---------|
| <u>Fiscal Year 1976</u> | | | | |
| January estimate | 408.4 | 373.5 | 297.5 | 76.0 |
| March estimate | 409.8 | 374.4 | 297.5 | 76.9 |
| July estimate | 409.9 | 369.1 | 299.4 | 69.6 |
| Actual results | 414.2 | 365.6 | 300.0 | 65.6 |
| <u>Transition Quarter</u> | | | | |
| January estimate | 88.1 | 98.0 | 81.9 | 16.1 |
| March estimate | 88.8 | 98.5 | 81.9 | 16.6 |
| July estimate | 93.9 | 102.1 | 82.1 | 20.0 |
| Actual results | n.a. | 94.5 | 81.8 | 12.7 |

* The earned income credit is treated as a budget outlay rather than an offset to receipts.

Timing of the Shortfalls

It is clear from examining the monthly Treasury statements for fiscal 1976 and the transition quarter that the spending shortfalls occurred during the last nine months of the fifteen-month period. By the end of December, or half-way through fiscal 1976, actual spending totalled \$184.5 billion, or almost 50 percent of total spending estimated by the Administration in the President's January budget and by CBO in its last scorekeeping report for 1976. However, spending in the January-March quarter was down nearly \$3 billion from the average of the first two quarters. While spending picked up slightly in the April-June quarter, it was over \$7 billion below the level needed to reach the January OMB and June CBO estimates for total spending for the year.

Recognizing this phenomenon, OMB in July revised its fiscal year 1976 outlay estimate downward by \$5.3 billion from its March estimate. OMB also revised its outlay estimate for the July-September transition quarter up sharply in July on the assumption that part of the shortfall in spending in the previous six months would be made up during the next quarter. CBO's spending estimate for the transition quarter was essentially the same as the OMB July estimate. At the time, it was believed that the change in the fiscal year from July-June to October-September and the availability of fiscal year 1976 appropriations through the transition quarter upset the

historical spending patterns on which agencies base their outlay estimates. The effect of the change to the new fiscal year was to relieve agencies of the need to obligate funds in May and June to prevent their lapsing. Thus, it was generally expected that spending would pick up in the transition quarter. For a variety of reasons, however, this anticipated spillover of spending from the last quarter of fiscal 1976 into the transition quarter did not occur. Thus, while total spending for the transition quarter was up \$3 billion over the level of the previous three months, it was about \$7 billion below the OMB and CBO estimates.

This also explains why double counting would be involved in adding together the differences between the CBO estimates and actual outlays for fiscal year 1976 and the transition quarter. About \$3 billion of outlays that previously were estimated to occur in fiscal year 1976 were added to the transition quarter estimates once it became clear that the fiscal year 1976 estimates were too high.

Reasons for the Shortfall

Mr. Chairman, since OMB officials testified yesterday before this Committee on the differences between the Administration spending estimates and the actual results as reported by Treasury, I will confine my remarks today to a discussion of the shortfalls from the CBO spending estimates.

There are essentially four main areas of differences between actual outlays and the CBO estimates for FY 1976 and the transition quarter.

First, spending estimates for a number of open-ended spending programs which are affected by economic conditions and other uncontrollable factors proved to be too high.

Second, State and local governments did not spend federal grant funds in certain programs as fast as was anticipated by the outlay estimates.

Third, federal agencies did not obligate appropriated funds at the speed assumed for the outlay estimates. This was particularly true for the Department of Defense.

Fourth, there were a number of unexpected financial transactions, especially in the transition quarter, that had the effect of lowering actual outlays as reported by the Treasury, but have no economic impact.

Table 4 summarizes the magnitude of these four main areas of difference which account for about 90 percent of the total. Table 5 provides a summary of the differences between CBO spending estimates and actual outlays by major function.

Table 4. Major Areas of Differences Between the CBO Outlay Estimates and Actual Outlays for Fiscal Year 1976 and the Transition Quarter (In billions of dollars)

| | Fiscal 1976 | Transition Quarter |
|---|----------------|-----------------------|
| 1. Misestimates of open-ended entitlement and related programs | 2.0 | 1.3 |
| 2. Slower than expected spending by State and local governments for selected programs | 1.0 | 0.4 |
| 3. Slower than expected spending by Federal agencies due to lags in obligations and related actions | 3.7 | 3.3 |
| 4. Misestimates of various financial transactions | 0.2 | 1.1 |
| 5. All other, net | 0.8 | 0.6 |
| Total difference | 7.7 | 6.7 |

Table 5. Comparison of FY 1976 and Transition Quarter Outlays to CBO Estimates
(In billions of dollars)

| Function | FY 1976 | | | Transition Quarter | | |
|--|--------------|-------------------------|-------------|--------------------|------------------------------|-------------|
| | Actual | CBO Estimate June 30 | Difference | Actual | CBO Estimate September 27 | Difference |
| 050 National Defense | 90.0 | 92.0 | -2.0 | 22.5 | 26.0 | -3.5 |
| 150 International Affairs | 4.1 | 5.0 | -.9 | 2.0 | 2.0 | - |
| 250 General Science, Space, and Technology | 4.4 | 4.6 | -.2 | 1.2 | 1.2 | - |
| 300 Natural Resources, Environment, and Energy | 11.3 | 11.5 | -.2 | 3.3 | 3.9 | -0.6 |
| 350 Agriculture | 2.5 | 3.0 | -.5 | 0.3 | 0.9 | -0.6 |
| 400 Commerce and Transportation | 17.2 | 17.8 | -.5 | 4.7 | 5.3 | -0.6 |
| 450 Community and Regional Development | 5.3 | 6.0 | -.7 | 1.6 | 1.7 | -0.1 |
| 500 Education, Training, Employment, and Social Services | 18.1 | 19.7 | -1.6 | 4.9 | 4.9 | - |
| 550 Health | 33.5 | 32.8 | .6 | 9.0 | 8.8 | 0.2 |
| 600 Income Security * | 126.6 | 128.0 | -1.4 | 32.6 | 33.2 | -0.6 |
| 700 Veterans Benefits and Services | 18.4 | 18.8 | -.4 | 4.0 | 4.4 | -0.4 |
| 750 Law Enforcement and Justice | 3.3 | 3.4 | -.1 | 0.9 | 0.9 | - |
| 800 General Government | 2.9 | 3.4 | -.5 | 0.8 | 0.9 | -0.1 |
| 850 Revenue Sharing and General Purpose Fiscal Assistance | 7.1 | 7.2 | -.1 | 2.0 | 2.0 | - |
| 900 Interest | 34.7 | 34.2 | .5 | 7.3 | 9.5 | -2.2 |
| 950 Undistributed Offsetting Receipts | -14.7 | -15.0 | .3 | -2.6 | -4.4 | 1.8 |
| Total ** | 364.8 | 372.5 | -7.7 | 94.4 | 101.1 | -6.7 |

* Excludes earned income credit.

** Details may not add due to rounding.

Mr. Chairman, we are preparing a detailed analysis of the spending shortfalls for use by the Committee. I will give you a few highlights of this analysis for each of the four main areas of differences.

Open-ended entitlement and related programs. About one quarter of the total differences between estimated and actual outlays occurred in programs that are sensitive to changes in economic conditions and other factors essentially beyond the control of federal agencies in the short run. Spending estimates for these programs are based largely on past relationships between economic variables and demographic factors and actual outlays. Two things can go wrong with these estimates: the assumed economic variables and other factors can change or the past relationships between these factors and program spending can change. For the most part, the differences between estimated and actual outlays for these programs in FY 1976 and the T.Q. can be attributed to the use of wrong assumptions about the underlying economic, demographic and other factors.

For example, assumptions about the level of inflation and unemployment during the first half of calendar 1976 were somewhat higher than occurred. As a result, the CBO estimate of the costs of unemployment compensation was too high for fiscal 1976 by about \$650 million. During the past few months, however, the rate of unemployment increased, so that the CBO estimate of unemployment compensation during the transition quarter was too low by nearly \$100 million.

Actual outlays for supplemental security income and aid to dependent families were also lower by over \$200 million for both fiscal 1976 and the transition quarter partly because unemployment and inflation were lower than anticipated during the first half of the year. On the other hand, outlays for medicaid and medicare were over \$200 million higher than estimated for 1976, and the transition quarter estimate for medicaid was also too low by over \$200 million. These are probably due to underestimates of medical price increases and of increases in the quality and quantity of services provided for eligible persons.

The assumed rate of participation in the GI Bill program proved to be too high. As a result, the costs of these education and training benefits were \$300 million less than was estimated for FY 1976 and \$400 million less than estimated for the transition quarter. Participation in these programs increased markedly during the first half of fiscal 1976, and a supplemental appropriation was requested and given to support the higher rate of participation through the next nine months. However, participation rates then began to fall off and the costs of these benefits were less than estimated.

Another significant difference between estimated and actual outlays was for farm price supports. The estimates for these programs are particularly difficult to make because they depend upon assumptions about weather conditions, farm exports, and other factors that affect the prices farmers receive for their crops.

After a number of upward adjustments in the estimated costs of these programs for FY 1976, actual costs were about \$500 million less than the final CBO estimate. Another large overestimate for these programs was made for the transition quarter.

Other similar misestimates were made for 1976 outlays for child nutrition programs, the Civil Service retirement and disability fund, and railroad retirement benefits. Altogether, misestimates of this type account for over \$2 billion of the spending shortfall in 1976 from CBO estimates, and \$1.5 billion for the transition quarter. In most cases, these shortfalls will have no effect on our current 1977 estimates. For some, however, such as veterans' readjustment benefits, it is now clear that our current 1977 estimate is too high and needs to be revised downwards by several hundred million dollars. On the other hand, our current 1977 estimates for medicaid and medicare are probably too low.

State and local programs. For a number of programs, State and local governments did not spend federal grants at the rate assumed for FY 1976 and T.Q. outlay estimates. For example, outlays for temporary public service employment assistance under title VI of the Comprehensive Employment and Training Act were over \$400 million lower than estimated for fiscal 1976 because of slower hiring by state and local governments than was anticipated. This was probably caused by the relatively late funding of the program, uncertainties about future funding and some confusion over the administrative regulations for the program. The rate of spending

for the program picked up in the transition quarter but was still over \$80 million below the CBO outlay estimate.

Outlays under the Department of Transportation grant programs were also overestimated for 1976 and the transition quarter. In the federal aid to highways program, FY 1976 obligations were only \$4.6 billion in contrast to the obligation limitation of \$7.2 billion in the 1976 transportation appropriations bill. Apparently, the lack of state matching funds is a problem. Our current FY 1977 estimates may have to be revised downward.

Outlays for various expiring community grant programs such as urban renewal also failed to occur at the level anticipated as fewer communities than expected made application to close out their grants made in previous fiscal years.

The shortfall in grant programs of this type accounts for nearly \$1 billion of the 1976 overestimate and about \$400 million of the transition quarter overestimates.

Lags in Federal agency spending. About half of the difference between estimated and actual outlays was due to lags in the federal agency spending. There are probably many reasons for this, including later than anticipated enactment of some FY 1976 appropriation bills (e.g., the 1976 foreign assistance appropriations bill was not signed until June 30, the last day of the fiscal year and the 1976 defense appropriations did not become available until February, the opportunity to obligate 1976 appropriated funds over a 15-month period, delays in construction projects and the awarding of contracts, etc.

The most significant shortfall in actual outlays from CBO estimates was for the Department of Defense. Outlays for major hardware procurement were over \$1.5 billion lower than expected for the 15-month period, apparently because of the late availability of 1976 appropriations and the increase in the level of funds for this purpose. Since these are multi-year funds, this shortfall presumably will be made up eventually. The effect of this lag on our 1977 outlay estimate for Defense procurement is unclear at this time.

The Defense Department also spent over \$1 billion less than expected for military personnel and operation and maintenance during the two fiscal periods. One reason for the slower than expected obligation rates for these annual appropriation funds may be that the extension of the expiration date for obligations from 12 to 15 months as part of the transition to a new fiscal year upset traditional expenditure patterns.

The Energy Research and Development Administration also spent less than estimated because of a slower than expected rate of obligations. This slower pace reflects program delays in fossil, solar and geothermal energy research and development. This resulted in an outlay shortfall of over \$300 million for the two fiscal periods.

The Department of Agriculture foreign assistance and special export programs (P.L. 480) also had an outlay shortfall of about \$400 million in fiscal 1976 as the result of the negotiations of

sales agreements. Community Services Administration outlays also were lower than expected in both 1976 and the transition quarter by almost \$100 million for each period because the agency changed its accounting and grant supervision procedures which delayed the rate of obligations. Tennessee Valley Authority outlays were over \$250 million below the CBO estimates for 1976 and the transition quarter primarily because of delays in construction projects, especially nuclear, brought about by legal actions pending in the courts.

It appears that spending delays of this type accounted for about \$3.7 billion of the spending shortfall against CBO estimates for 1976 and \$3.1 billion for the transition quarter.

Financial transactions. The budget contains a number of spending accounts that reflect the net result of financial transactions of various types, and also certain receipts from the public such as rents and royalties on the Outer Continental Shelf. These transactions and receipts do not have any direct impact on the economy, but they do affect the budget totals. The CBO net outlay estimates for the transition quarter were too high because several unanticipated events occurred. The Department of Housing and Urban Development made a significantly larger sale of mortgages during this period than was expected because of improved market conditions. This had the effect of lowering net outlays during the transition quarter receipts for foreign military sales which caused net outlays to be lower by more than \$600 million during the T.Q.

Impact on the Economy

For judging the impact of these spending shortfalls on the economy, it is useful to examine what is happening to federal sector expenditures in the national income accounts. This is a better source of data for measuring economic impact because such items as HUD sales of mortgages and other financial transactions which do not affect the production of goods and services are excluded in the national income accounts (although they appear in unified budget outlays).

To measure the extent of the shortfall, a comparison can be made between a translation of the budget resolutions into NIA terms and actual federal sector expenditures as reported quarterly by the Department of Commerce. The graph provides such a comparison and clearly shows that the spending shortfall in NIA terms occurred primarily in the first six months of calendar 1976, with the greatest shortfall occurring in the second quarter (April-June). However, in contrast to the picture that has emerged from looking at the unified budget, the shortfall was sharply reduced in the third or transition quarter in the NIA accounts. Federal sector spending in the third quarter, adjusted to annual rates, appears to be back on track and ready to move forward on the path contemplated by the second budget resolution for fiscal 1977.

While we have not yet completed our analysis of the shortfall's effect on the economy, we can make some assessments of their timing.

THE SHORTFALL IN FEDERAL OUTLAYS
(NIPA basis)

———— actual through 1976:3
----- Congressional budget resolutions

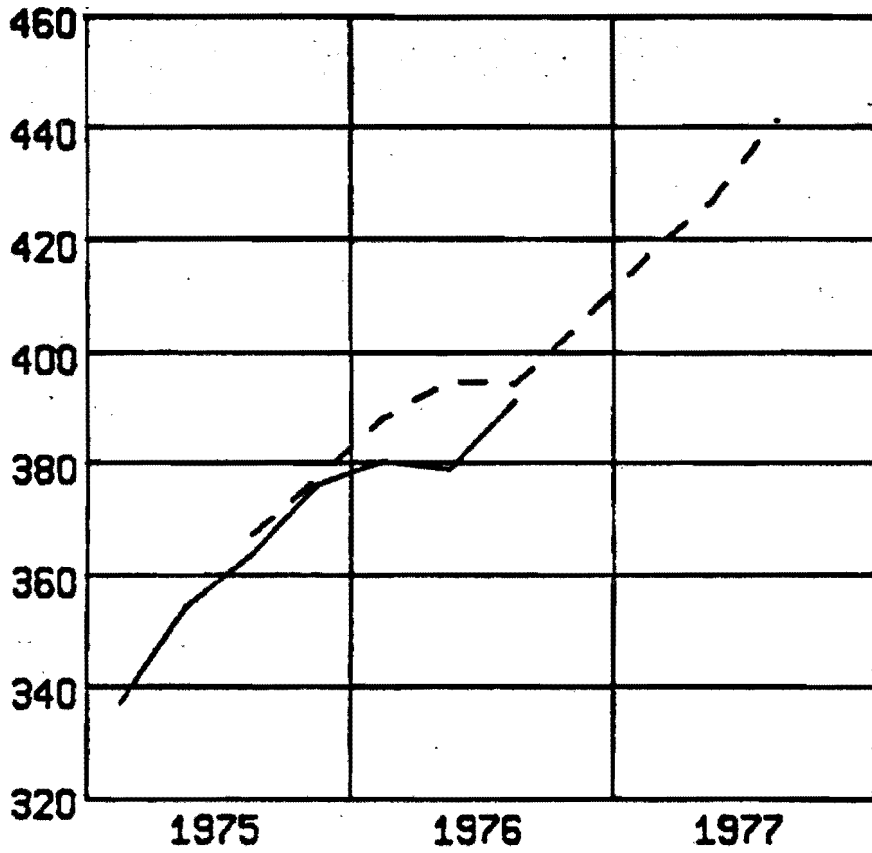


Table 6 provides an analysis of NIA spending shortfall by type of expenditure. The shortfall in nondefense purchases should have the most immediate effect on GNP. This impact should be concentrated in the 1976 calendar year. The shortfall in transfers and in grants-in-aid to state and local governments is the largest in dollars terms but has a less immediate impact on GNP than the shortfall in purchases. Transfers and grants have their initial impacts on the income of persons and the receipts of state and local governments, and only after a lag do they affect spending and production.

While the actual dollar effects on the economy of the shortfalls in government expenditures have not yet been fully evaluated, it seems likely that the shortfalls were a major cause of the current economic lull, lowering the growth of real GNP by roughly 1.0 percentage points (annual rate) during the second and third quarters of 1976. If the shortfall was a unique event, however, the worst of its effects will soon be over and will be less seriously felt as government expenditures resume the growth at the previously expected pace.

Even if federal spending climbs back close to the ceilings set by Congress, however, it is becoming more and more clear that the economic assumptions underlying the second budget resolution and the CBO economic forecast of August 3 are too optimistic. The pause in the economic recovery has lasted longer than anticipated, so that the level of GNP in 1977 will be lower, and the unemployment rate higher, than we (and other forecasters) expected, a few months ago.

Table 6. Shortfalls in Federal Sector Expenditures in
the National Income Accounts
(In billions of dollars)

| | Fiscal Year 1976 | | | | T.Q. |
|------------------------------------|------------------|-------|-------|-------|-------|
| | 75:3 | 75:4 | 76:1 | 76:2 | 76:3 |
| Total Federal Sector Expenditures: | | | | | |
| Estimated ^{1/} | 367.0 | 377.5 | 388.0 | 394.8 | 394.4 |
| Actual ^{2/} | 363.7 | 376.0 | 380.3 | 378.7 | 391.1 |
| Shortfall | 3.3 | 1.5 | 7.7 | 16.1 | 3.3 |

Shortfalls by Major Components ^{3/}

| | | | | | |
|---|-----|------|------|------|------|
| Purchases | | | | | |
| Defense | -.7 | -.7 | 0.1 | -0.6 | -- |
| Nondefense | .3 | .2 | 2.3 | 4.2 | -0.7 |
| Transfers | 1.0 | .3 | 3.6 | 5.5 | 1.0 |
| Grants-in-aid | 3.2 | 2.4 | 2.7 | 6.2 | 2.7 |
| Net Interest | -.1 | .2 | 0.4 | 1.0 | 0.4 |
| Subsidies less current surplus | -.7 | -1.0 | -1.2 | -0.1 | -- |
| Shortfall | 3.3 | 1.5 | 7.7 | 16.1 | 3.3 |

^{2/} Seasonally adjusted at annual rates.
Subject to revision.

^{1/} Estimated from congressional budget resolutions

^{3/} Negative sign indicates an underestimate.

We are currently working on a new economic forecast to be ready when the Congress returns on January 4. It is too early to say exactly what will be in our forecast, which will also cover 1978. Most forecasters are now projecting an unemployment rate for 1977 at least half a percent higher than assumed for the second budget resolution. The current consensus on the rate of real GNP growth for 1977 is at least half a percentage point below the assumption underlying the second budget resolution.

1977 Budget Estimates

We are also reviewing our current estimates of fiscal year 1977 receipts and outlays to develop a revised set of budget estimates by early January. These estimates will be based on the new economic forecast and will incorporate to the extent possible the results of our analysis of 1976 and transition quarter spending shortfalls.

These reestimates will be incorporated in the scorekeeping reports the CBO provides to the Budget Committees for the purpose of advising them on the current level of revenues and spending. Under the Congressional Budget Act, a point of order may be made in either House against spending or taxing measures that, if enacted, would cause budget authority or outlays to exceed, or revenues to be less than, the appropriate levels set forth in the second budget resolution. Table 7 provides a tabulation of the estimated current levels of new budget authority, outlays and revenues as of October 1, 1976, the close of the 2nd Session of the 94th Congress.

Table 7. CBO Budget Estimates for FY 1977 as of October 1, 1976
(In billions of dollars)

| | <u>Budget Authority</u> | <u>Outlays</u> | <u>Revenues</u> |
|---|-----------------------------|----------------|-----------------|
| 1. Enacted | 426.7 | 402.1 | 362.5 |
| 2. Entitlement authority and other mandatory items requiring further appropriation action | 6.5 | 6.3 | -- |
| 3. Continuing resolution authority | <u>4.9</u> | <u>2.3</u> | <u>--</u> |
| CURRENT LEVEL | <u>438.2</u> | <u>410.7</u> | <u>362.5</u> |
| Second Concurrent Resolution | 451.55 | 413.1 | 362.5 |
| Amount remaining | 13.4 | 2.4 | -- |

On the receipts side, I would expect to see a downward revision on the order of \$5 to \$10 billion below the \$362.5 billion estimated for the second budget resolution. The revenue reduction probably will be concentrated in the individual and corporation income taxes and will reflect the change in the underlying economic forecast during the next 12 months. Revenues, even more than outlays, are highly responsive to changes in the economy.

On the spending side, I do not expect to see much, if any, change from our current estimates. In our most recent scorekeeping report, which tabulated the effects of congressional budget actions during the past year, we estimated that outlays for fiscal 1977 would be \$410.7 billion, or \$2.4 billion below the level specified in the second budget resolution. This is because Congress did not complete action on a number of items assumed for the second resolution.

In its November report on current services estimates for fiscal 1978, the Administration estimated 1977 outlays on a current services basis at \$412.9, or more than \$2 billion above the current CBO estimate. We are now reviewing the OMB November estimates with the staffs of the Budget and Appropriations Committees. While we expect to revise our estimates for a number of different programs, it now looks as though increases for such items as unemployment compensation and farm price supports will be offset by decreases for other programs such as veterans' readjustment benefits, interest on the public debt and federal aid to highways.

Thus, we do not now expect to see a large net spillover of unexpected spending in fiscal 1977 as a result of the spending shortfalls during the past nine months. There will be some increases for a number of programs but these are likely to be offset by decreases in our spending estimates for other programs. Similarly, I do not expect to see a sharp reduction in our current estimates.

We will have an opportunity to review our spending estimates again next January and February when President Ford submits his 1978 budget proposals and actual spending for the first quarter of fiscal 1977 is released by the Treasury. We believe that by this time the agencies, particularly the Defense Department, will have better information on the effects of the spending shortfalls in 1976 and the transition quarter for 1977 outlays. Also, the

agencies can be expected to do a more careful job on estimating 1977 outlays for the January budget than was done for the Administration's November current services estimates report.

Budget Estimates: The Past Record

In considering how to avoid budget estimating errors in the future, it is important to recognize that the experience of fiscal year 1976 and the transition quarter is not unique. An examination of the record of past budget estimates reveals a systematic pattern of discrepancies between estimated and actual outlays. Table 8 compares the Administration's original budget and midyear outlay estimates with actual outlays for the last 17 years. The differences between estimated and actual outlays show the following pattern: the original budget outlay estimates, made six months before the start of the fiscal year, are generally too low by an average of almost 3 percent. Twelve months later, or mid-way through the fiscal year, the Administration outlays estimates are generally too high by an average of six-tenths of one percent.

This pattern appears to reflect a general tendency on the part of the Administration to underestimate spending when putting together the budget for the next year, particularly for open-ended entitlement and other uncontrollable programs -- perhaps to show a budget surplus or smaller deficit than would otherwise occur. Later, after Congress has completed action on Administration proposals and the Administration is focusing on formulating its next fiscal year budget,

the midyear outlay estimates is based on agency expectations which appear to have an upward bias. Agencies are generally not penalized for overestimating, but the penalties for underestimates can be considerable. Thus, to be conservative, the agencies may tend to shade their estimates of outlays whenever there is a reasonable range of possible estimates. This tends to bolster their case for more money next year, as well as protecting them against the charge of "over-spending" in the current year.

Whatever the reasons, in only one year since 1969 has the midyear estimate of outlays proved too low. That year was fiscal 1975 when a combination of factors, including an unanticipated deterioration in the economy and Congress' refusal to accept Administration proposed cutbacks in various programs, resulted in a higher level of outlays than was estimated in January.

Doing a Better Estimating Job

Both the Administration and Congress needs accurate estimates of revenue and outlays. Neither can make informed decisions about fiscal policy unless they can forecast these outlays and receipts reliably and obtain early warning when their estimates go off the track. The new congressional budget process merely dramatizes a long standing need for accurate estimates. Hence, a major cooperative effort must be undertaken by the Congress and the Administration to improve the accuracy of receipt and outlay estimates and to monitor actual performance.

Table 8. Comparison of Estimated and Actual Outlays,
Fiscal Year 1960 - Transition Quarter, 1976

(in billion of dollars)

| Fiscal Year | Original Budget Estimate | Mid-Year Estimate | Actual | Difference from | |
|----------------|--------------------------------|----------------------|--------|----------------------|----------------------|
| | | | | Original Estimate | Mid-Year Estimate |
| 1960 | 92.9 | 95.3 | 94.3 | +1.4 | -1.0 |
| 1961 | 96.3 | 97.9 | 99.5 | +3.2 | +1.6 |
| 1962 | 101.8 | 111.1 | 107.7 | +5.9 | -3.4 |
| 1963 | 114.8 | 116.8 | 113.8 | -1.0 | -3.0 |
| 1964 | 122.5 | 122.7 | 120.3 | -2.2 | -2.4 |
| 1965 | 122.7 | 121.4 | 122.4 | -0.3 | +1.0 |
| 1966 | 127.4 | 135.0 | 137.8 | +10.4 | +2.8 |
| 1967 | 145.0 | 160.9 | 158.4 | +13.4 | -2.5 |
| 1968 | 172.4 | 175.6 | 178.9 | +6.5 | +3.3 |
| 1969 | 186.1 | 183.7 | 184.6 | -1.5 | +0.9 |
| 1970 | 195.3 | 197.9 | 196.6 | +1.3 | -1.3 |
| 1971 | 200.8 | 212.8 | 211.4 | +10.6 | -1.4 |
| 1972 | 229.2 | 236.6 | 231.9 | +2.7 | -4.7 |
| 1973 | 246.3 | 249.8 | 246.5 | +0.2 | -3.3 |
| 1974 | 268.7 | 274.7 | 268.3 | -0.4 | -6.4 |
| 1975 | 304.4 | 313.4 | 324.6 | +20.2 | +11.2 |
| 1976 | 349.4 | 373.5 | 365.6 | +16.2 | -7.9 |
| T.Q. | 94.3 | 98.0 | 94.5 | +0.2 | -3.5 |

Outlay estimates will always be subject to some error. For those spending programs, such as entitlement programs, that are closely related to economic conditions, it is necessary to pay close attention to economic changes that could require revisions in the estimates. If the unemployment rate rises dramatically, outlays for unemployment insurance must be expected to rise. The same holds for revenue estimates, which are extremely sensitive to changes in economic activity.

For other programs, such as Department of Defense procurement programs, there is more discretion on the part of federal officials. For these programs great care must be taken to ensure that there is no incentive for agencies to overestimate future outlays or to give an inaccurate picture of what they expect to happen. Once the fiscal year starts, there must be much closer monitoring of actual outlays against detailed spending plans in order to decrease the time it takes to recognize a spending shortfall or overage.

The Executive Branch must be the primary source for spending estimates. The federal agencies are in a better position than the CBO or other legislative staffs to estimate the effects of various factors on spending. In the future, the federal agencies should develop and make available to the Congress monthly spending plans that CBO and other staffs could match against actual outlays. Significant differences from plan could then be followed up quickly to determine if a revised spending estimate is needed. Perhaps

the President should be required to transmit formal spending reestimates on the same basis as he now submits budget amendments and budget impoundment actions.

In closing, Mr. Chairman, I believe a better job can be done in estimating outlays and in managing the budget. There will always be some errors in forecasting, but with more careful initial estimates and more assiduous and timely monitoring of actual experience, we should be able to avoid such large discrepancies between spending estimates and actual outlays in the future.