

Statement by
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before the
Joint Economic Committee
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Mr. Chairman and Members of the Committee, I appreciate having this opportunity to discuss with you the current services budget estimates for fiscal 1977 that were submitted to the Congress recently by the President. I believe it would be most useful this morning if I spent some time on the purpose and uses of current services budget estimates, the problems involved in making these estimates, and our assessment of the fiscal 1977 estimates that were prepared by the Office of Management and Budget.

The purpose and uses of current services budget estimates

The primary purpose of current services estimates is to provide a baseline or basic reference point for consideration of discretionary changes in the budget. The baseline that most often has been used is last year's budget level. Thus, a common question in any budget hearing, whether conducted in the Executive Branch or in the Congress, is "What did you get last year?" While this is an important consideration, it is not always the most relevant question for a number of reasons.

First, economic conditions change significantly from year to year. The level of unemployment may be expected to increase or decrease. Similarly, the rate of inflation may be expected to accelerate or decline.

Changes in price levels and the level of unemployment affect budget spending very significantly without any discretionary changes in budget policy, because many Federal programs are tied directly or indirectly to the cost of living or to the level of unemployment. For example, social security benefits are adjusted automatically under current law each June for increases in the Consumer Price Index whenever the CPI increases by more than 3 percent during the previous year. In fiscal 1974, according to OMB estimates, more than 25 percent of Federal budget outlays were for programs with such automatic adjustments for inflation under current law.

Other Federal program outlays are indirectly indexed for inflation. Good examples are health expenditures under the medicare and medicaid programs and Federal employee compensation. The costs of medical care have been rising rapidly for several years and these increasing prices automatically result in higher outlays under medicare and medicaid as the bills are presented for payment. Federal employee compensation is directly related to private sector wages and salaries under the Federal Pay Comparability Act of 1970. Thus, as wages and salaries rise in the private sector partly in response to increases in the cost of living, Federal pay will also rise, although with some delay.

Outlays for unemployment compensation are obviously related directly to the level of unemployment. To a somewhat lesser extent, spending under other Federal programs, such as food stamps and public assistance, is also directly related to unemployment levels.

A second reason why last year's spending level may not be relevant for budget planning purposes is that important program variables change

from year to year. For example, the number of social security beneficiaries will increase as more people live longer and retire earlier. The number of beneficiaries of various veterans benefits depends in part on the age of veterans of past wars.

The costs of various Federal programs can be affected by other factors as well. For example, the value of social security benefits will be greater to recent retirees than to the average social security beneficiaries because the level of average wages has been increasing over time. Also, the cost of the average public assistance (AFDC) benefit depends to a large extent on average family size for the eligible population which has been falling recently.

A third reason why last year's spending level may not be relevant for some programs is that they operated for less than 12 months during the previous year. Thus, more funds will be required in the following year to provide for a full 12 months of operation or for "annualization."

Thus, more relevant questions to ask for budget planning purposes include: "How are the major built-in forces likely to affect next year's budget? "What would it cost to provide the same level of operation or service as last year with no policy changes, assuming the following set of economic assumptions?" "What changes would be introduced by making different assumptions about prices, unemployment, interest rates and other variables affecting outlays and revenues?" The purpose of current services budget estimates is to provide answers to such questions. There need be no presumption that current services levels are immutable, but it is certainly important for budget decision makers to know what these levels are.

Current services budget estimates can be used for both macro and micro analysis of the budget. For example, current services budget estimates are essential for examining the fiscal policy implications of a "no-policy change" budget stance. Would such a budget policy provide the right amount of stimulus or restraint to the economy to achieve or maintain full employment, price stability or other economic goals? If not, the comparison of current services estimates with budget aggregates more consistent with full employment and price stability would show how much discretionary change would be needed in the budget to achieve these economic goals.

On the micro side, a detailed current services budget would allow the various Congressional committees to see explicitly what discretionary actions the President is proposing for each program when he submits his annual budget. Many of the changes from year to year do not represent changes in policy, but these built-in changes are frequently hard to identify in the President's annual budget.

A detailed current services budget would also allow the Appropriations Committees and other committees with jurisdiction over the budget to judge the implications for real program levels of any given dollar appropriation. In some cases, however, it is not clear that information about current services levels would be viewed as desirable data by those concerned with controlling increases in government spending. For example, such information could make it more difficult to reduce real program levels by holding to last year's dollar amounts and portraying the action as "no change from last year's budget."

The submission by the President of a current services budget for the next fiscal year on or before November 10 will allow the Congress to get an early start in considering the annual budget. This is particularly important because of the tight time schedule set forth in the Congressional Budget Act for Congressional action on the budget each year. The current services estimates will be essential for focusing early attention on the budget.

Thus, Mr. Chairman, I believe that the current services budget estimates required by the new budget process are very important and will provide a useful analytical tool to the Congress in its consideration of the annual budget. They will provide a base from which various budget alternatives can be judged.

It should be clear that a current services budget does not necessarily represent the policy recommendations of either the President or the Congress. It simply provides a better baseline from which such policy recommendations can be constructed than is provided by last year's budget.

The problems with making current services estimates

At first blush, it may appear a relatively easy matter to develop current services budget estimates. This may be true for some programs, but for most there are many problems involved.

One problem area involves the appropriate set or sets of economic assumptions to be used. Economic forecasting models are better at indicating trends than giving precise point estimates for various economic variables during the next year or two. Obviously, the farther out in time you go, the less precise the accuracy of the models. Therefore, it is advisable to have more than one set of economic assumptions.

There is also a problem with how the economic assumptions should be constructed. Should they represent a forecast of the most likely outcome with appropriate confidence levels or should they represent the most desirable outcome or goals or targets? In the past, a set of assumptions representing full employment were considered to be the most neutral for developing current services estimates. This makes sense when the economy is operating close to full employment. However, when the economy is far from full employment, a full employment set of assumptions would not be considered plausible.

Another problem is that the current services budget estimates will not necessarily be consistent in a macro or fiscal policy sense with the economic assumptions used to develop individual program estimates. For example, the economic assumptions may contain a rate of real economic growth that would not occur if the Federal budget actually adhered to a current services level, unless there was very strong growth in private investment, consumption, net exports, and/or State and local government spending. In this case, it would be useful to calculate the difference between Federal revenues and outlays on a current services basis with those under one or more fiscal policies that would be consistent with the assumed or target rates of growth. This difference would represent changes needed in discretionary spending and/or taxes to achieve these growth rates.

Another difficulty relates to defining "no new policy changes." One approach might be to adopt a current law definition, but this turns out not to be very useful. Some Federal programs are permanent under current law and others have to be renewed periodically. The difference appears

largely to be an accident of legislative history in many cases. Therefore, the most useful approach is to assume renewal of all programs except those which are genuinely temporary in nature.

A third problem area involves adjustments for inflation. A large portion of the Federal budget is not directly or indirectly indexed for inflation. Should a current services concept include inflation adjustments for all programs? The argument for including such inflation adjustments is that this would provide a consistent treatment for all programs and not change the relative spending priorities that are embodied in the base year. On the other hand, the Congress has the discretion each year to decide whether to maintain real program levels in many areas or to allow inflation to result in a decrease in real program activity. Thus, the argument against including inflationary adjustments for non-indexed programs is to avoid committing the Congress in advance.

There are also other conceptual problems in defining current services. For example, it has been argued that certain defense purchases should be increased 4 percent a year in real terms in order to provide a constant defense capability. Presumably, the same argument could be made for other program areas. Another problem involves large procurement and construction programs that generate outlays over a several year period. Should a "no-new-starts" assumption be made, or a constant number of new starts or some other assumption?

I dwell on these problems so as to emphasize that applying a current services concept is not easy to do in practice and that there will be many

differences of opinion as to the most useful way to define current services. I believe with time, however, many of these problems will be resolved and that current services budget estimates will prove to be enormously useful to the Congress.

Assessment of OMB estimates

My staff has examined the 1977 current services estimates submitted by the President on November 10. Our overall assessment is that a very professional job was done. The OMB staff are to be congratulated for handling the various problem areas well. We have not found any serious inaccuracies in the OMB estimates based on the economic assumptions and current services definitions used.

I believe the calculation of current services estimates under four alternative sets of economic assumptions is useful. This is prudent given the uncertainty over the economic outlook for the next few years and it also demonstrates the sensitivity of Federal revenues and outlays to changes in economic assumptions.

OMB also has provided information on the effect of non-renewal of certain programs that expire under current law, including general revenue sharing so that alternative definitions of current services can be used. Similarly, while OMB did not adjust all Federal spending for expected inflation in 1977, information is provided separately which shows the impact of including inflation adjustments for non-indexed programs under current law, such as veterans benefits.

Finally, OMB has provided a large amount of program detail in its estimates which should aid Congressional staff in understanding the forces underlying the Federal budget.

There are some problems with the OMB estimates, but OMB should not be held responsible for most of these. One problem is the fiscal 1976 estimates for budget authority and outlays are too low as viewed by the Congress. This is largely because the OMB estimates are based on actions taken as of September 1, 1975. As of that date, only three regular fiscal 1976 appropriation bills had been enacted. Three more were enacted in October and the large Defense and Labor-HEW appropriations bills are still under action in the Congress.

The Congress is presently acting upon the second concurrent resolution for the 1976 budget. As passed by both the House and the Senate, the totals for budget authority and outlays are above the OMB 1976 current services base estimates by several billion dollars. On the other hand, the OMB current services base estimates for total budget receipts for 1976 is slightly higher than provided by either the House or the Senate in their action on the second budget resolution. As a result, the OMB current services base deficit is significantly lower than is likely to be contained in the second budget resolution.

Table 1. Comparison of Fiscal 1976 Budget Estimates
(in billions of dollars)

| | Total Budget Authority | Total a/ Outlays | Total a/ Revenues | Deficit |
|-----------------------------|------------------------------|---------------------|----------------------|---------|
| OMB current services base.. | 396.6 | 368.5 | 303.6 | 64.9 |
| Second budget resolution: | | | | |
| House action Nov. 12 | 408.0 | 373.9 | 301.8 | 72.1 |
| Senate action Nov. 20 ... | 406.2 | 375.6 | 300.8 | 74.8 |

a/ OMB estimates include \$1.2 billion in outlays for earned income credit. The second budget resolutions deduct this amount from revenues.

The differences between the OMB 1976 current services base estimates and the House and Senate second budget resolution figures can be explained

largely in terms of (1) appropriation increases over the continuing resolution levels, (2) allowance in the second resolution for certain new spending initiatives such as additional foreign aid to the Middle East and new energy measures, and (3) different estimates for spending for certain non-discretionary or entitlement programs. In addition, OMB has included \$1.2 billion in outlays for the earned income tax credit provided to low-income taxpayers under the Tax Reduction Act of 1975. The House and Senate budget resolutions treat this item as an offset to receipts.

Table 2. Comparison of Fiscal 1976 Outlay Estimates for Major Functions (In billions of dollars)

| Function | OMB current services base | Second Budget Resolution | |
|--|---------------------------|--------------------------|--------|
| | | House | Senate |
| National defense | 91.5 | 91.6 | 92.1 |
| International affairs | 4.6 | 5.0 | 4.8 |
| General science, space and technology | 4.3 | 4.6 | 4.6 |
| Natural resources, environment and energy | 11.2 | 11.2 | 11.5 |
| Agriculture | 2.4 | 2.5 | 2.6 |
| Commerce and transportation... | 17.2 | 18.6 | 18.3 |
| Community and regional development | 6.0 | 7.0 | 7.1 |
| Education, manpower & social services | 18.7 | 21.3 | 20.9 |
| Health | 32.5 | 32.9 | 33.0 |
| Income security a/ | 129.9 | 128.5 | 128.1 |
| Veterans benefits & services.. | 18.6 | 19.1 | 19.1 |
| Law enforcement & justice | 3.3 | 3.4 | 3.4 |
| General government | 3.4 | 3.3 | 3.3 |
| Revenue sharing and general purpose fiscal assistance... | 7.2 | 7.3 | 7.3 |
| Interest | 35.1 | 35.4 | 35.2 |
| Allowances | 1.1 | .9 | .9 |
| Undistributed offsetting receipts | -18.5 | -18.6 | -16.6 |
| Total a/ | 368.5 | 373.9 | 375.6 |

a/ OMB outlay estimates include \$1.2 billion for earned income credit. The second budget resolutions deduct this amount from revenues.

It is therefore likely that the OMB 1977 current services estimates for budget authority and outlays are somewhat below the levels that would be obtained if the second budget resolution is used as the 1976 base. Thus, the 1977 OMB estimates for outlays might be raised from \$414.5 billion to something over \$420 billion. Furthermore, if inflation adjustments were made for all Federal programs, another \$7.5 billion would have to be added. So it would not be unreasonable to have a 1977 current services outlay estimate as high as \$427 - \$430 billion under plausible economic assumptions. This would be as much as a \$55 billion increase over fiscal 1976. This compares to an increase in total outlays from 1975 to 1976 of approximately \$50 billion. In percentage terms, the 1976 to 1977 increase would actually be smaller than the 1975 to 1976 increase, especially when converted to an annual rate by correcting for the intervening transition quarter.

A second problem with the OMB current services estimates is that they are made only for one year in advance, which is all that is required of the President under section 605 of the Congressional Budget and Impoundment Control Act of 1974. However, I believe it would be more useful to make current services estimates several years in advance in order to provide the proper perspective for explicit decisions about budget priorities. In any one year, a little change can be made in the Federal budget without changing current law. But, over the longer run, dramatic changes can be made in the allocation of Federal resources. Therefore, decisions about budget priorities - about how much of the nation's resources should be allocated to public purposes and the distribution of these resources among alternative uses - should be made in a longer run perspective than the

annual budget. Current services estimates over a five-year period would give the appropriate baseline to consider such major decisions.

Fortunately, the Congressional Budget Act in section 308(c) also directs the CBO to make a five-year projection of the Federal budget as soon as practicable after the beginning of each fiscal year. We are currently working on the projections for 1977 to 1981. We will use a current services concept to make these projections and they will be based on the second concurrent resolution on the 1976 budget. We will also use two separate sets of economic assumptions for the projections. This report should be ready the first part of January.

We will also supply the Joint Economic Committee with a 5-year budget projection based on the economic assumptions supplied to us by the Committee, as you have requested, Mr. Chairman.

A third problem with the OMB current services estimates is that they will not be updated by OMB and included in the President's 1977 budget. The preparation of the November 10 estimates was conducted as a separate undertaking by OMB and Federal agency staff and not as an integral part of the 1977 budget formulation process. I believe the estimates would be more useful if they were an integral part of the budget planning process in the Executive Branch. The President's annual budget would also be more meaningful and useful if the budget year column were divided into two parts: a current services estimate and the President's recommended changes in current services spending levels.

In closing, Mr. Chairman, I want to emphasize again the potential usefulness of current services estimates as an important analytical device for considering various budget alternatives. I believe that the use of such estimates will become wide spread, both in the Congress and in the Executive Branch.