

Statement of
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before the
Subcommittee on Legislation and National Security
Committee on Government Operations
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NOTICE

This statement is not available for public release until it is delivered at 10:00 a.m. (EDT), Thursday, June 19, 1986.

Mr. Chairman, I am pleased to have the opportunity to discuss the sequestration procedures under the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177)--or more briefly, the Balanced Budget Act. My statement this morning will cover two areas:

- o The sequestration procedures for fiscal year 1987 that will begin in August; and

- o Some illustrative sequestration calculations for 1987.

SEQUESTRATION PROCEDURES

The Balanced Budget Act establishes steadily declining deficit targets after 1986, culminating in a balanced budget in fiscal year 1991. The deficit target for 1987 is \$144 billion. Unless the Congress acts to reduce the deficit to within \$10 billion of this level before the start of the fiscal year, the \$144 billion deficit target would be achieved by sequestering budgetary resources. The act provides a \$10 billion leeway for 1987 through 1990, but none for 1991. Except for trust and special funds, sequestration involves permanently canceling new budget authority and other spending authority to obligate and expend funds.

The deficit estimates used to implement the act are provided by the Congressional Budget Office (CBO), the Office of Management and Budget (OMB), and the General Accounting Office (GAO). Although the automatic spending reduction provision of the act has been ruled unconstitutional by a

federal district court and this ruling may be upheld by the Supreme Court, the sequestration of budgetary resources to achieve the deficit targets would remain an option to be used by the Congress under alternative procedures.

The first step in the sequestration process for 1987 will be a joint report by the Directors of CBO and OMB on August 20 that estimates budget base levels as of August 15, and calculates the amounts of budgetary resources to be sequestered if the deficit is greater than \$154 billion. The joint Directors' report, which must be printed in the Federal Register, will be made either to the Comptroller General or to a special joint committee of the Congress, depending upon the decision of the Supreme Court regarding the role of GAO in the sequestration process.

The next steps in the sequestration timetable are laid out graphically in Figure 1. If GAO remains in the process, the Balanced Budget Act sets forth a detailed schedule of events with specific dates. In the event that the GAO role is invalidated, the act sets forth an alternative procedure in which the Congress would vote on future sequestrations that would then be subject to Presidential approval. Under either set of procedures, the role of CBO and OMB remains the same. Our major tasks are to prepare two reports, one in August and the other in October. The October report is to reflect any Congressional action on the 1987 budget taken during September that would affect the August deficit estimates and sequestration calculations.

FIGURE 1. SEQUESTRATION TIMETABLE FOR FISCAL YEAR 1987

Balanced Budget Act Procedure	Alternative Fallback Procedure
Aug. 15 - Snapshot of deficit by CBO and OMB	Aug. 15 - Snapshot of deficit by CBO and OMB
Aug. 20 - CBO/OMB report sent to GAO	Aug. 20 - CBO/OMB report sent to the Congress
Aug. 25 - GAO report to the President	- Temporary Joint Committee on Deficit Reduction reports joint resolution within five days
Sept. 2 - Presidential order is issued	- House and Senate vote on joint resolution within five days
Oct. 1 - Presidential order takes effect	- President approves joint resolution and issues sequestration order
Oct. 6 - CBO/OMB issue revised report to GAO reflecting final Congressional action	Oct. 6 - CBO/OMB issue revised report to the Congress
Oct. 10 - GAO issues revised report to the President	- Congress votes on sequestration
Oct. 15 - Revised Presidential order is issued	- President approves and issues revised sequestration order
Nov. 15 - GAO compliance report is issued	

We have already begun to work with OMB to prepare for our August 20 report. This work involves the discussion of a few conceptual issues in defining the budget base for the August 15 "snapshot" in the event that the Congress does not complete action on the appropriation bills and other legislation affecting the 1987 budget. It also includes the review of the sequestration calculations as they affect specific budget accounts, and the coordination of our computer data systems so that we can exchange and compare budget estimates quickly. This joint work effort is going very smoothly, as it did last December and January when we produced the 1986 sequestration report.

ILLUSTRATIVE SEQUESTRATION FOR 1987

In our annual report to the Budget Committees last February, we gave a preview of the CBO budget estimates and sequestration calculations for 1987. This preview used our February economic forecast and technical estimating assumptions and was based on the laws in place at that time. Since then, the Congress has passed several measures that affect the budget outlook for 1987, the most important of which is the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA).

For today's testimony, we have updated our February estimates for enacted legislation but have left unchanged the economic and technical assumptions. These assumptions will be updated later for the August Directors' report, and there also may be additional budgetary legislation that is enacted before August 15. Thus, the numbers that are presented

today most certainly will change between now and August, and these changes could be significant. In addition, the August report will use the average of CBO and OMB estimates of key amounts, which will result in further changes to the sequestration calculations used here for illustrative purposes.

Budget Base Levels for 1987

The budget base levels of federal revenues and outlays determine the size of the excess deficit and, thus, the amount by which spending must be reduced through sequestration. The Balanced Budget Act contains a number of instructions for measuring the budget base. The revenue level in the budget base is to be estimated on the assumption that current tax laws continue unchanged, and that expiring provisions will terminate as scheduled except for excise taxes dedicated to a trust fund, which are to be extended at current rates.

The outlay level for entitlements or permanent appropriations is also to assume continuation of current law and termination of expiring provisions, except for Commodity Credit Corporation (CCC) price-support programs, which are to be extended at current rates. For annual discretionary appropriations, the outlay base estimates are to include enacted appropriation levels. If appropriations for the fiscal year have not been enacted by the "snapshot" date, the outlay base estimates are to assume appropriations equal to those in force for the previous year with no adjustments for inflation. Thus, for the upcoming August 20 report, we will use 1986 postsequestration appropriation levels for discretionary spending

programs unless any 1987 appropriations are enacted by August 15. If only a short-term continuing resolution is enacted by October 1, we will continue to use the 1986 appropriations, adjusted for the 1986 sequestration, for the budget base estimates for the October 6 report.

The latest CBO estimates of the 1987 budget base levels are shown in Table 1. These estimates assume that no appropriations for 1987 are enacted by August 15. Table 1 also shows our latest scorekeeping estimates for 1986 and updated baseline budget projections for 1987. I would like to make three comments about the budget estimates shown in Table 1. First, the outlay reduction for 1986 was limited by the Balanced Budget Act to a maximum of \$11.7 billion, regardless of the amount of the excess deficit. In 1987 and later years, the amount of possible outlay reductions is not limited.

TABLE 1. CBO BUDGET ESTIMATES FOR 1986 AND 1987 (By fiscal year, in billions of dollars)

	1986 Current Level <u>a/</u>	1987 CBO Baseline <u>b/</u>	1987 Sequester Base <u>b/</u>
Revenues	778.5	846.4	846.4
Outlays	980.3	1,018.6	1,007.0
Deficit	201.8	172.2	160.6
Balanced Budget Act Deficit Target	171.9	144.0	144.0

SOURCE: Congressional Budget Office.

- a. CBO scorekeeping estimates.
- b. CBO February projections updated only for Congressional legislative action.

Second, under our February economic and technical baseline assumptions, revenues will grow faster than outlays. As a result, the 1987 deficit will be smaller than is estimated for 1986. The updated CBO baseline projection for the 1987 deficit is \$172 billion, about \$30 billion lower than our latest scorekeeping estimate for the 1986 deficit.

Third, the sequestration base deficit estimate for 1987 of \$161 billion is lower than our baseline projection by over \$10 billion. This difference is because we must exclude from our sequestration calculations the various discretionary inflation and other adjustments that we make for our baseline projections to keep program levels constant in real terms. While we can take account of inflation and other factors in our CBO baseline budget projections, we cannot do so for our sequestration base estimates. As will be made clear later, this will have a major impact for a possible 1987 sequestration for the defense budget.

Sequestration Calculations

The major elements of the calculations for the illustrative 1987 sequestration are shown in Table 2. Although the sequestration actually applies to new budget authority and other spending authority, the calculations use outlay estimates to determine the amount of sequestration.

The first step is to divide the amount of estimated excess deficit--\$16.6 billion in our illustration--into two halves. One-half--\$8.3 billion--

is assigned to defense programs (budget accounts in function 050) and the other half to nondefense programs.

Second, the total amount of outlay savings from eliminating automatic spending increases is calculated. One-half of the resulting savings for indexed retirement and disability programs is applied to the required

TABLE 2. ILLUSTRATIVE SEQUESTRATION CALCULATIONS FOR 1987
(In billions of dollars)

Budget Base Estimates <u>a/</u>		
Revenues		846.4
Outlays		1,007.0
Deficit		160.6
Balanced Budget Act deficit target		144.0
Excess deficit		16.6
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Sequestration Calculations		
	<u>Defense</u>	<u>Nondefense</u>
Total required outlay reductions	8.3	8.3
Savings from eliminating automatic spending increases	0.6	0.6
Savings under special rules	---	1.5
Remaining reduction required	7.7	6.2
Sequestration outlay base	173.0	109.6
Uniform sequestration percentage <u>b/</u>	4.5	5.7

SOURCE: Congressional Budget Office.

- a. February CBO estimates updated only for Congressional legislative action.
- b. Remaining required reductions divided by the sequester outlay base.

reductions in defense programs and one-half to nondefense programs. Under our February economic assumptions, this amounts to an estimated \$1.2 billion for 1987, so that \$0.6 billion is subtracted from the \$8.3 billion required outlay reduction for both defense and nondefense programs.

Various additional calculations are made for nondefense programs, including the savings that can be obtained by eliminating automatic spending increases in three programs--the National Wool Act, the special milk program, and vocational rehabilitation grants. Also included are savings to be obtained by applying certain special rules for guaranteed student loans, foster care and adoption assistance, Medicare, and veterans health programs. These estimated savings amount to another \$1.5 billion, which is also subtracted from the required \$8.3 billion in nondefense outlays.

This leaves \$7.7 billion for defense programs and \$6.2 billion for nondefense programs to be obtained by across-the-board uniform percentage reductions in budgetary resources. The uniform percentages are calculated by dividing these dollar amounts by total estimated 1987 outlays associated with sequestrable budgetary resources. For defense programs, the sequestrable outlay base is estimated to be \$173.0 billion. For nondefense programs, the equivalent base is \$109.6 billion--lower than for defense programs because a large portion of nondefense spending is either exempt from sequestration or is limited by special rules. The resulting sequestration percentages are 4.5 percent for defense programs, and 5.7 percent for nondefense programs. These percentages are then applied to the new budget authority and other spending authority in the sequestration base.

Sensitivity of Sequestration Calculations

The sequestration base levels and sequestration calculations are very sensitive to changes in economic assumptions and other factors. It is not unusual these days for budget deficit estimates to change by tens of billions of dollars within a six-month period because of revised economic forecasts and other factors. For example, lower real growth and taxable income projections can result in significantly reduced revenues estimates. Similarly, lower farm commodity prices can result in sharply higher spending estimates for CCC outlays. Also, reestimates on the order of \$3 billion to \$4 billion are not uncommon for defense outlays because of changes in spending rates observed in monthly Treasury statements.

For each \$10 billion increase in the excess deficit, the uniform sequestration percentage for defense programs is increased by about 3 percentage points, and for nondefense programs by about 4.5 percentage points, as shown in Table 3. For example, if the August deficit estimate for 1987 is \$174 billion instead of \$161 billion because of such factors as lower revenues and higher farm price supports, which would not change the sequestration base by very much, the sequestration percentages would rise to 8.3 percent for defense programs and 11.8 percent for nondefense programs.

1987 Sequestration Impact

A 1987 sequestration of 4.5 percent for defense programs and 5.7 percent for nondefense programs would be much more severe than these percentages imply. First, in my illustration, these reductions would be on top of the

1986 sequestrations of 4.9 percent for defense programs and 4.3 percent for nondefense programs. Combining the two sequestrations, they imply reductions from 1986 appropriation levels of 9.2 percent for defense programs and 9.8 percent for nondefense programs. Second, the reduction in real terms would be even greater because of the loss of any adjustments for inflation in 1987.

The postsequestration budget levels for 1987 are shown in Table 4 in comparison to 1986 scorekeeping levels and 1987 CBO baseline projections

TABLE 3. SEQUESTRATION PERCENTAGE REDUCTIONS UNDER ALTERNATIVE BASE LEVEL DEFICIT ESTIMATES FOR 1987 (In billions of dollars)

Base Level Deficit	Excess Deficit	Sequestration Percentage <u>a/</u>	
		Defense Programs	Nondefense Programs
194	50	14.1	20.9
184	40	11.2	16.4
174	30	8.3	11.8
164	20	5.4	7.3
154	10	<u>b/</u>	<u>b/</u>

SOURCE: Congressional Budget Office.

- a. Assumes no changes in the sequestration outlay base for defense and nondefense programs from those shown in Table 1, and no changes in the savings from eliminating automatic spending increases and from applying special rules for Medicare and other programs.
- b. There would be no sequestration in 1987 if the base-level deficit does not exceed the deficit target by more than \$10 billion.

and sequestration base levels. Total outlays for 1987 would be limited to \$990 billion under our illustrative sequestration, only \$10 billion more than estimated for 1986. Defense outlays would be held to about the 1986 estimated level, while nondefense outlays would rise by only \$5 billion. To achieve these results, new budget authority for the national defense function would be reduced to \$276 billion through sequestration, more than

TABLE 4. EFFECTS OF THE ILLUSTRATIVE 1987 SEQUESTRATION (In billions of dollars)

	1986 Current Level	1987 CBO Baseline	1987 Sequester Base	1987 Post Sequester
National Defense <u>a/</u>				
Budget authority	286.8	300.9	289.2	276.2
Outlays	269.5	284.0	276.5	268.7
Nondefense Programs <u>b/</u>				
Budget authority	669.5	707.5	698.8	689.0
Outlays	610.0	626.8	623.2	614.8
Net Interest and Undistributed Offsetting Receipts <u>c/</u>				
Budget authority	100.8	107.8	107.4	106.7
Outlays	100.8	107.8	107.4	106.7
Total				
Budget authority	1,057.1	1,116.2	1,095.3	1,071.8
Outlays	980.3	1,018.6	1,007.0	990.2

SOURCE: Congressional Budget Office.

- a. Budget function 050.
- b. Budget functions 150 through 850 and 920.
- c. Budget functions 900 and 950.

\$10 billion below the amount available in 1986 and more than \$40 billion below the level requested by the President for 1987. Furthermore, the resulting program mix would be very different from that proposed by the President. Also, mandatory increases in Social Security outlays and other entitlement programs would have to be almost completely offset by decreases in other nondefense programs.

Additional details on the illustrative 1987 sequestration for defense programs are shown in Table 5. Although the impact would vary from program to program, it would not be much different from the impact of the 1986 sequestration except for the military personnel accounts, which would be especially hard hit.

The military personnel accounts were almost totally exempt from sequestration in 1986, but would not be exempt in 1987. They would be hit harder than other defense accounts in 1987 because the starting point for the reduction would be from an already depressed level. To fund certain pay raise and retirement costs, the 1986 appropriations for military personnel provided access to unobligated balances in the procurement accounts in lieu of new budget authority. Consequently, 1986 new budget authority in the military personnel accounts are about 7 percent (or \$5 billion) lower than actual costs. Reducing the 1986 budget authority level by another 4.5 percent under our illustrative sequestration would reduce available resources 11 percent below the level needed to support current manpower strengths. This could translate into a reduction of 350,000 or more active and reserve service personnel as a result of a 1987 sequestration.

CONCLUSION

Regardless of the outcome of the Supreme Court decision, the sequestration procedures for 1987 will begin in August when CBO and OMB release their initial budget estimates. The CBO estimates presented today are illustrative only and are subject to significant change over the next two months as

TABLE 5. ILLUSTRATIVE 1987 SEQUESTRATION FOR DEFENSE PROGRAMS (In billions of dollars)

	1986 Current Level	1987 CBO Baseline	1987 Sequester Base	1987 Post Sequester
Department of Defense—Military				
Military personnel				
Budget authority	67.7	74.9	70.3	67.1
Outlays	71.7	74.3	69.6	66.6
Operation and maintenance				
Budget authority	74.8	77.6	75.4	72.0
Outlays	74.1	76.1	74.2	71.6
Procurement				
Budget authority	93.3	96.8	93.3	89.1
Outlays	78.1	85.0	84.6	83.8
RDT&E				
Budget authority	33.6	34.4	33.6	32.1
Outlays	30.3	32.2	31.8	30.9
All other DoD				
Budget authority	9.7	9.3	8.9	8.5
Outlays	7.8	8.6	8.5	8.3
Other National Defense				
Budget authority	7.7	7.9	7.7	7.4
Outlays	7.4	7.8	7.8	7.5
Total				
Budget authority	286.8	300.9	289.2	276.2
Outlays	269.5	284.0	276.5	268.7

SOURCE: Congressional Budget Office.

the result of legislative actions, revisions to the underlying economic assumptions, and other factors. While our illustrative 1987 sequestration involves relatively low across-the-board percentage cuts in spending programs, the impact would be quite severe, especially for military personnel, since the cuts would be applied to 1986 postsequestration appropriation levels for most programs.