

Statement of
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Mr. Chairman, I am pleased to appear here today to discuss the relationship of the preliminary Grace Commission recommendations to the ongoing work of the Committee and of the Congressional Budget Office (CBO) in dealing with the structural deficit problem. In my statement, I will cover three topics:

- o The scope and nature of the Grace Commission's proposals;
- o How the CBO is making use of the Grace Commission's work in our analysis of budget options; and
- o General considerations in the use of budget-reduction lists.

BACKGROUND

President Reagan established the President's Private Sector Survey on Cost Control (PPSSCC) in June 1982 under the chairmanship of J. Peter Grace. Thirty-seven task forces have produced 2,236 recommendations. According to commission documents, total "savings" and "revenue enhancements" of \$341 billion (over three years) have been identified. Of this total, the commission claims that \$145 billion can be attained through administrative actions within the agencies; the rest would need legislation. The final reports of the commission's task forces are now being published, and a summary final report is scheduled to be released in December.

Giving an overview of the commission's work is difficult because of its monumental nature. The dollar value of the various commission recommendations run from a saving of several billions of dollars for retirement system reforms to a \$1 million saving from monitoring telephone usage in the Department of Labor to reduce unauthorized phone calls. Some of the commission's suggestions would produce long-term budget reductions, but other savings might be quite short-lived. In short, the 1,300 members of the commission's task forces left very few stones unturned.

RELATION OF THE GRACE COMMISSION TO CBO'S WORK

CBO is now in the process of preparing its fifth annual report on "Reducing the Deficit." Like the Grace Commission reports, this volume features lists of deficit-cutting options with their multiyear budget effects displayed. (Unlike the Grace Commission reports, the CBO volume presents only options, not recommendations.) In preparing our report, CBO adheres to a fairly strict methodology. First, budgetary savings are measured against a uniform and fully documented budgetary baseline. Second, the outlay savings or revenue gains are based on specific detailed proposals, very often those found in bills previously submitted to the Congress. Third, the budget proposals specify a particular assumption about dates of enactment, and the associated budget changes are consistent with those assumptions. Finally, insofar as possible, budgetary interactions are taken into account so that the budget savings are reported on a net basis and duplication is either eliminated or noted. For example, several alternatives for increasing Medicare coinsurance will be discussed and, in each case, the

offsetting increases in Medicaid spending that would result will be subtracted from the estimated savings in Medicare.

In the past, the sources for our deficit-reduction options have been bills introduced in recent Congresses, suggestions from the Budget Committees and other Members, and CBO's program analyses. This year, I am adding to this list the reports of the Grace Commission. Our analysts are examining the commission's final reports as they appear and are incorporating a number of their suggestions into the options we will present in our report. Naturally, the commission's proposals are being converted into budget numbers through the method outlined above. The results of this long, laborious process will be available in early February.

In addition, a number of the Grace Commission proposals require more detailed analysis so that the Congress can choose from several definitive options. The following are three examples of studies we have under way that address proposals made by the commission:

- o The Grace Commission proposed substantial changes in the military retirement system that would reduce benefits for those who retire early and so bring the system more in line with private-sector plans. At the request of the House Budget Committee, we are looking at alternative retirement options, including the commission's proposals, in light of their effects on costs and on the ability of the services to retain needed career personnel.

- o The commission proposed paying physicians in Medicare according to a negotiated fee schedule rather than on the basis of "reasonable" charges. CBO is studying a broad range of options for physician reimbursement under Medicare.

- o The Grace Task Force on Personnel Management found that prevalent overgrading of civilian jobs has led to excessive administrative and payroll costs. Their recommendations do not, however, explicitly recognize current statutory provisions that protect workers' salaries in the event their positions are lowered in grade. CBO is undertaking a study of the budgetary impacts of current misgrading of federal white-collar jobs and of alternative remedies that include modification of these statutory provisions.

Finally, in February, we will analyze the President's 1985 budget proposals, including those inspired by the Grace Commission.

As this demonstrates, the commission's proposals have already affected CBO's ongoing activities and will continue to do so as we approach the budget proposal stage.

Having said that, I must caution the Members of this Committee that it would be impossible for CBO to review all 2,236 recommendations and still do justice to the many other demands for our services. Aside from the workload problem, I should note that the Grace Commission estimates that about 40 percent of the savings from its recommendations would come from

the management area. These recommendations—many of which get down to the subagency level—are not the kinds of program changes that CBO staff is best suited to analyze.

GENERAL CONSIDERATIONS IN USING BUDGET-REDUCTION LISTS

The Committee should keep in mind three general considerations when using any list of budget-reduction ideas—ours or that of the Grace Commission. First, although deficit reduction must receive high priority, all changes achieving substantial savings also impose costs. Second, estimating the precise year-by-year savings that would result from any policy change is difficult. Third, some types of savings have historically proven difficult to obtain.

Assessing Costs and Benefits

Even at this early stage of our review of the Grace Commission budget-cutting proposals, it is obvious that almost all involve difficult tradeoffs that cannot be resolved without making value judgments. As is usual, progress in reducing the deficit is not painless; specific individuals, institutions, and regions are going to be hurt. Some recommendations explicitly cut out or reduce a program's benefits, as does the commission's proposal to reduce food stamp benefits. But even those that are directed mainly toward efficiency would impose costs on someone. Let me give two examples:

Port User Tonnage Fee. The commission recommends levying a port user tonnage fee to cover the \$500 million annual operating cost of deep-draft harbor dredging by the Corps of Engineers. If the fee was uniform, users of low-cost ports would subsidize users of high-cost ports. But if the charge at each port reflected its actual dredging costs, high-cost ports would lose traffic to low-cost ports. In either case, port users would pay more than under the present system, and there would probably be a shift of economic activity among regions.

Revise Selection Criteria for IRS Audits: This commission proposal would almost surely raise federal revenues and improve taxpayer compliance. But it would be almost equally sure to impose added audit costs not only on cheaters but also on those in full compliance. These costs, though outside the budget, should not be ignored.

Indeed, many of the commission recommendations have appeared before in the President's budget or in CBO annual deficit-reduction volumes. (For examples, see the appendix to my testimony.) Because of their distributional or other effects, the Congress has not seen fit to implement them.

Let me stress that just because subtractions from the budget deficit may hurt someone does not mean they are not worth doing. Benefits must always be assessed against costs. Similarly, the fact that proposals have been considered in the past and rejected, implicitly or explicitly, does not mean they should not be considered again. The Congress faces an

extraordinarily difficult deficit problem; if there were painless solutions, the problem would have been solved long ago. The Grace Commission does not claim to have found easy solutions and it has not.

Savings Estimates

Although the Grace Commission is now using an estimate of \$341 billion for the savings that would be enjoyed over three years, one must not jump to the conclusion that more than \$100 billion could be saved on average in each of the three years 1985, 1986, and 1987. As the commission report clearly points out, the \$341 billion estimate includes much duplication, is based on an assumed inflation rate far higher than used in CBO projections, and involves some recommendations that could not be fully implemented in the 1985-1987 time frame.

The following warning appears in each volume of the commission report:

It is important to note that cost savings, revenue, and cash acceleration opportunities in this report may duplicate similar dollar opportunities reported in other task force reports. Thus, there may be instances of double counting of dollar opportunities between task force reports. These duplications will be netted-out in the Final Summary Report to the President. Additionally, dollar estimates in this report are based on reasonable and defensible assumptions, including standard three-year projections based on when first, second, and third year partial or full implementation will occur and not specific fiscal years. Accordingly, estimated savings or revenue opportunities are understandably of a "planning" quality and not of a "budget" quality. Therefore, the reader should guard against drawing conclusions or making dollar projections based on the disclosures contained only in this report. . . .

The standard three-year projections of cost savings and revenues include 10% inflation in Years 2 and 3. On revenue accelerations and cash accelerations, savings are claimed on the interest avoided which is estimated at 10%. These rates reflect generally prevailing rates at the time the Task Force reports were prepared and may be adjusted, as necessary, in the Final Summary Report to the President.

Let me illustrate what some of these caveats mean for those who wish to translate the Grace Commission proposals into budget recommendations.

The 10 percent inflation and interest rate assumption is well above the rates that CBO currently projects—for example, we project the inflation rate to be under 5 percent for the next three years. Savings from procurement reductions, program eliminations, or reductions in eligibility for transfer payments will be overstated if based on a higher rate of inflation.

The fact that the three-year period referred to in the Grace Commission reports is not always the same three years means that one cannot simply add up the savings from various proposals and apply them to the next few years. For example, the commission recommendation to relax Davis-Bacon requirements would not significantly affect outlays until spending from past commitments was replaced by post-reform contracts. Similarly, military retirement changes recommended would not begin to reduce government outlays substantially for eight years because benefits for senior personnel now on active duty would not be changed.

The preface of the Grace Commission report cautions that the various task force reports may contain several duplications, so that potential savings may be significantly overstated. Several other sources of overstatement also bear mention. One lies in the interaction of different programs. For example, the savings from streamlining the Disability Insurance appeals process, as recommended by the commission, would be partially offset by increased food stamp benefits for which many applicants denied Disability Insurance would become eligible. Another factor that needs scrutiny is the representativeness of the time period over which savings are measured. For example, certain kinds of "cash management" savings (in which the government slows down the rate at which it pays or speeds up the rate at which it collects) may save large amounts in the first few years as payments are slowed, but much less in future years as the delayed payments are finally made. Slowing progress payments on military contracts, which the Grace Commission estimates would save \$9.4 billion over the first three years but only a little more than a billion dollars a year thereafter, is a good example of how short-run savings may not be an accurate indicator of long-run savings.

Speed of Implementation

One additional lesson from budget history is worth noting here. History shows that government programs rarely go up as fast as their proponents wish, and the same inertia often holds back the pace of reductions as well. Specifically, many programs are locked in by contracts already drawn or by commitments already made. In other cases, the

Congress will see fit to phase in changes or to grandfather or hold harmless certain recipients. Thus, estimates of the long-run savings based on the full implementation of many proposals will overstate what is possible in the short run.

Overview of General Considerations

The upshot of all these considerations is that one cannot expect to realize every dollar of the savings estimates in the Grace Commission reports. Indeed, based on the few cases we have had a chance to investigate, the savings potential of a number of the Grace Commission recommendations may be only a small fraction of the amount stated. I am concerned that the broad publicity given to what may be considerably inflated estimates will create false hopes now and disappointments later when the numbers are refined.

Nevertheless, the reports make an extremely important contribution. They contain a number of good ideas, and the commission is to be congratulated for its effort.

CONCLUSION

In conclusion, as the Congress considers options for dealing with today's troublesome budget deficits, suggestions from all sources covering a range of possible actions should be considered. The Grace Commission is certainly one important new source of deficit-reduction ideas. Nonetheless,

in using the commission's work—as in using any budget-reduction list—the Congress should be aware that most proposals that would achieve appreciable budget savings would adversely affect some current beneficiaries of present federal policies; that the year-by-year savings from some actions may be difficult to estimate; and that some types of savings may be especially difficult to achieve.

Finally, if we are to do justice to the Grace Commission proposals in the context of the Congressional budget process, those put forward for adoption must be specified in great detail. Detailed specification is necessary if CBO is to produce independent estimates of budget savings. Even then some savings—such as those from the management initiatives in the Grace Commission reports—will be difficult to assess accurately. Also, past experience indicates that vaguely described "management savings" have not come to fruition, and relying on these has only reduced the credibility of the budget process.

Let me close by again commending the Grace Commission. An enormous amount of personal effort—much of it provided on a volunteer basis—went into its task. The job was indeed formidable, and I look forward to the final report.

APPENDIX: ILLUSTRATIVE GRACE COMMISSION ITEMS

Included in Past CBO Deficit-Reduction Reports 1/

- Limit use of tax-exempt bonds to finance hospital capital projects.
- Change the definition of "prevailing wage" under the Davis-Bacon Act and limit coverage of the act.
- Limit physician reimbursement under Medicare.
- Eliminate dual pay for reservists who are federal employees.
- Reform military retirement.
- Increase collections from Power Marketing Administration.

Included in Past Administration Budgets 1/

- Eliminate the \$10 minimum benefit in the Food Stamp program.
- Consolidate selected postsecondary student grant programs.
- Consolidate the administrative expenses of AFDC, Food Stamps, and Medicaid into a block grant to states.
- Implement a system for providing operating subsidies for public housing projects based on market rents in privately owned units.
- Foster defense management initiatives.
- Increase sanctions on states for payment errors in the Aid to Families with Dependent Children program.

Not Included Either in Past CBO Reports Or in the Administration's 1984 Budget

- Consolidate the National Direct Student Loan and Guaranteed Student Loan programs.
- Lower the benefit base used in the Food Stamp program.
- Collect interest on erroneous overpayments to Social Security recipients.
- Base federal civil service pay scales on local area wage rates.
- Deposit seized cash awaiting disposition in an interest-bearing account.
- End federal operation of low-volume air traffic control towers.

1. Items do not necessarily appear in the same form in both places.