

Statement of
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before the
Committee on the Budget
United **States** Senate

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Mr. Chairman, I am pleased to appear here today with the Comptroller General, Charles Bowsher, to report on the results of our joint review of the Grace **Commission's** major proposals for cost control. We undertook this analysis at the request of both Budget Committees. Copies of our joint report have been distributed to Members, and our statements this afternoon will **summarize** our findings.

FOCUS OF THE CBO-GAO ANALYSIS

Both the Congressional Budget Office (CBO) and the General Accounting Office (GAO) devoted considerable effort to this task. We reviewed nearly **400** of the **2,478** recommendations made by the Grace Commission, officially known as the **President's** Private Sector Survey on Cost Control (PPSSCC). While this amounts to only 16 percent of the **total** number of recommendations contained in **47** separate Survey reports, the recommendations reviewed account for nearly 90 percent of the net **three-**year cost savings and revenue increases estimated by the commission in its final report to the President.

We focused our review on those recommendations that the Grace Commission estimated would produce savings of \$1 billion or more over a **three-year** period for two reasons:

- o First, we had only a short time to devote to this task. The commission's final report to the President was not completed until **mid-January**, as were several of the separate task force reports.

- Second, given the magnitude of the budget deficits facing us in the coming years under current policies, we believed it essential to direct our analysis toward those commission recommendations that potentially could produce the largest budgetary savings.

This was the first time that the **CBO** and **GAO** undertook a joint study effort. The collaboration worked splendidly and I hope that the Committee will find the results **useful**. Our division of labor was as follows: The **CBO** undertook to **estimate--to** the extent **possible--the** potential impact of the Grace Commission proposals on our baseline projections for fiscal years 1985-1989, and to analyze their likely program impact. The **GAO** analyzed whether the proposals could be implemented administratively or would require legislation and provided invaluable assistance to us in estimating possible budget savings and program impact.

In accordance with our mandate, **CBO** takes no position on the relative merits of the Grace Commission recommendations. However, **GAO's** views on the merits of the recommendations are included in the report in a number of instances based on previous or continuing reviews and evaluations.

I will focus the remainder of my remarks on the results of **CBO's** budget analysis of those Grace Commission recommendations that we reviewed. Comptroller General Bowsher will give you the results of **GAO's** analysis.

POTENTIAL BUDGETARY IMPACT

For purposes of analysis and discussion, our report groups the 396 Grace Commission recommendations selected for review into 90 separate sets of proposals. It was possible to develop estimates of potential budgetary impact for 67 of these 90 sets. For the other 23 sets of proposals reviewed, budget estimates could not be prepared because either the proposals were too vague or the available information too scant.

Our savings estimates for those Grace Commission proposals that we could measure against our baseline projections for fiscal years 1985-1989 are summarized in Table 1. Assuming that these proposals are implemented by October 1, 1984, we estimate that they could result in unified budget deficit reductions of about \$15 billion in 1985 and nearly \$70 billion by 1989. The cumulative five-year reductions from CBO's baseline projections amount to \$194 billion, including lower net interest costs of \$34 billion as a result of lower deficits. Reductions in off-budget spending would add another \$7-\$8 billion annually during the next five years. The total deficit reduction effect for 1985-1989 is projected to be \$233 billion.

Focusing on just the next three years--1985 to 1987--which will be the period covered by the next Congressional budget resolution, the CBO estimate for total deficit reductions comes to \$98 billion for those commission proposals for which we could measure possible budget impact. This is considerably below the figure of \$298 billion that the Grace Commission has used as its estimate of potential savings over a three-year period for the corresponding proposals. I will discuss later in my statement the reasons for the difference to these estimates.

TABLE 1. CBO SAVINGS ESTIMATES FOR MAJOR GRACE COMMISSION PROPOSALS (By **fiscal** year, in billions of dollars)

	Annual Savings or Revenue					Cumulative Five-Year Impact
	1985	1986	1987	1988	1989	
Savings from CBO Outlay Baseline						
National defense	1.7	5.3	2.1	1.9	2.6	13.7
Entitlements and other mandatory spending programs	2.8	3.9	8.3	14.5	21.1	50.6
Nondefense discre- tionary spending and offsetting receipts	3.5	3.7	4.7	5.2	6.2	23.3
Federal civilian employ- ment and compen- sation	<u>3.2</u>	<u>4.1</u>	<u>5.7</u>	<u>7.8</u>	<u>9.3</u>	<u>30.2</u>
Subtotal						
Addition to CBO Revenue Baseline	2.5	5.0	8.7	11.4	14.3	42.1
Reduction in Interest Costs	<u>0.8</u>	<u>2.7</u>	<u>5.6</u>	<u>9.7</u>	<u>15.3</u>	<u>34.2</u>
Unified Budget Deficit Reduction	14.5	24.7	35.2	50.4	68.9	194.0
Off-Budget Outlay and Deficit Reduction	<u>6.7</u>	<u>8.3</u>	<u>8.4</u>	<u>8.2</u>	<u>7.7</u>	<u>39.3</u>
Total Deficit Reduction	21.3	33.0	43.6	58.6	76.6	233.3

Although the majority of the Grace Commission recommendations can be characterized as management proposals to achieve greater **efficiencies** or to operate on a more **business-like** basis, the bulk of the cost savings estimated by both the CBO-GAO study and by the commission are associated with often very dramatic proposals to change policies or to

restructure programs. Many of these policy-change proposals go far beyond any recently contemplated by the Congress, and all of them would require Congressional action.

National Defense Programs

The budgetary savings that we could identify for national defense programs are ~~small--only \$14 billion over five years--because~~ the budget impact for most of the 112 recommendations could not be estimated. The Grace Commission gave considerable attention to reviewing defense programs. Four task forces were assigned to conduct separate reviews of the Department of Defense, and eight other commission reports also made recommendations for achieving cost savings. But the bulk of the recommendations were not sufficiently specific to develop a good budget impact estimate.

This does not mean that the commission's recommendations for defense program savings lack merit or are ill conceived. Indeed, the task force recommendations generally are based on widely accepted principles of good management and efficiency. Many of these recommendations have been previously proposed by the General Accounting Office and also cover many of the same areas that were included in the ~~so-called~~ Carlucci initiatives announced by the Defense Department in 1981. These initiatives include use of multiyear procurement, ~~dual-sourcing~~ of procurement contracts, and more efficient production rates, as well as other means to improve management of the procurement process, all of which were major Grace Commission proposals.

The Survey task force estimates of potential savings for most defense recommendations, at best, are illustrative and are not founded on historical data, detailed analyses, specific budget proposals of programmatic changes. Many of their estimates are based on judgmental assumptions based on industry experience that we could not validate. While their cost estimates may be adequate for illustrative purposes, more programmatic information is needed for purposes of making budget estimates.

The Grace Commission proposals for national defense programs for which we could measure budgetary impact include reforms in military retirement pay, revisions in military commissary operations, two medical cost proposals, removal of restrictions on silver stockpile sales, and revision of progress payment rates for DoD contracts. The commission proposal that would have the largest measurable budget impact in the next five years is reform of military retirement pay to make benefits more comparable to those in the private sector. Similar proposals are made by the commission for federal civilian employee retirement benefits as well. They include such changes as raising the retirement age, **figuring** pensions on lower **final** salary averages, reducing **cost-of-living** adjustments, and integrating federal pensions with Social Security. The budget outlay impact of these proposals during the next five years would be relatively modest, but would be significant on budget authority for military retirement benefits, which will be shown in the budget on an accrual basis beginning in 1985.

Entitlements and Other Mandatory Spending Programs

The Grace Commission advanced an array of proposals for cutting spending on entitlement programs, based on a judgment that many program benefits may be too generous or available to too many people. Accordingly, the commission recommends policy changes that would reduce either the size or the availability of benefits, or both. While other proposals in this area seek to improve program administration, by far the greatest savings potential lies in revising policies and restructuring programs.

We analyzed **43** different Grace Commission recommendations for entitlement and other mandatory spending programs. The estimated budget savings for the next three years is relatively modest, but over five years could exceed \$50 billion. The largest saving would be in the area of federal health care programs, where the commission recommends limiting the growth of health care expenditures to the annual change in the gross national product (GNP). In conjunction with this expenditure cap, it also proposes a dramatic restructuring of federal health care programs. Though the specifics of the **commission's** plan are not fully developed, it apparently would apportion federal health funds among geographic regions on a per capita basis that also reflected regional variations in health care costs. Monies would go to private, state, and local bidders competing for service contracts. What services would be provided are not clearly outlined. The CBO budget estimate for this proposal assumes that such a major program restructuring would take at least two years to put into place. By 1989, CBO

projects that limiting health care expenditures to GNP growth would reduce **Medicare-Medicaid** outlays by 10 percent from baseline projections of current law, and produce total savings of \$29 billion during 1987-1989.

Other Grace Commission proposals that CBO and GAO reviewed in this area included reductions in food stamp benefits, guaranteed student loans, railroad retirement **benefits**, and Social Security disability insurance benefits. In addition, the commission suggests increasing the premiums that private firms pay to the Pension Benefit Guarantee Corporation. Together, these other proposals are estimated to reduce budget outlays by another \$22 billion over the next five years.

Nondefense Discretionary Spending and Offsetting Receipts

The Grace Commission made numerous recommendations affecting nondefense discretionary **spending--a** category that encompasses areas as widely varying as federal highway assistance, health care for veterans, agricultural loans, research and development spending, and the day-to-day operations of most arms of the federal government. Other proposals would affect offsetting **receipts--for** example, income from the sale of **government-owned natural resources--that** are subtracted from spending in calculating net federal outlays. The commission proposal in this area that would have the largest budget impact would reduce off-budget spending, which is not recorded as part of the unified budget but which **affects** total federal borrowing needs.

We reviewed 133 different Grace Commission recommendations that are classified in this area of the budget and estimate that possible budget **savings--where** these could be **estimated--would amount** to \$10 billion in 1985 and \$12 to **\$14** billion annually over the next four years. The cumulative five-year total would amount to over \$60 billion, assuming implementation starting October 1, **1984**. Almost all of the potential savings would require Congressional action. The recommendations fall into four general categories: modifying loan programs and altering federal debt-**collection** practices; modifying spending programs; increasing receipts from the sale of natural resources or federally provided services; and making more efficient use of government funds and general management improvements.

By far the largest **five-year** savings in this entire spending area would result from the proposal to replace certain direct loan programs with loan guarantees. The commission proposes to convert the direct loan programs of the Farmers Home Administration and the major business loan programs of the Small Business Administration into guaranteed loan programs, with the government guaranteeing no more than 75 percent of the principal amount. This would transfer more responsibilities and risk to the private sector and encourage more careful selection of loan recipients. On the other hand, such a shift would increase **borrowers'** costs in those programs that currently have subsidized interest rates, thus reducing the **programs'** ability to serve households and businesses with limited financial resources.

CBO estimates that this change alone would reduce total government **outlays--both** on and off **budget--by** more than **\$40** billion over the 1985-1989 period, **largely** because loan disbursements averaging about \$9 billion per year would be forgone. Long-term savings would be appreciably less, however, because the federal government would also forgo the repayments, which currently stretch out as long as 50 years.

Federal Civilian Compensation and Work Force Management

The Grace Commission proposes several ways to reduce the federal **costs--now** some \$75 billion a **year--of** compensating the government's 2.1 million civilian employees (excluding postal workers) and its 2 million civilian retirees and survivors. The proposals to reduce costs fall into two categories: changes in **federal** compensation policy covering levels of pay and employment benefits to achieve what the commission believes would be a closer alignment with the private sector, and management initiatives that would result in a smaller civilian work **force.**

According to CBO estimates, the **commission's** recommendation's offer potential budgetary savings approaching \$30 billion over the next five years. By far the greatest savings would **come** from restructuring the contributions to and benefits from the Civil Service Retirement system, along the lines I mentioned earlier in describing the commission's proposals for defense programs.

In addition, the Grace Commission recommends policy changes for disability benefits and health care coverage, and altering both the methods

of calculating annual wage and salary adjustments and the grade levels held by many workers under the General Schedule system. It also proposes a number of management initiatives which could be implemented **administratively** and produce budget savings of \$5 billion or more over the next five years. These concentrate largely on contracting out to the private sector for support services and improving work force productivity.

Revenues

The Grace Commission reports offer several revenue-raising proposals that could help to narrow the long-term federal deficit. The revenue proposals include four tax policy **recommendations--one** of which has already been **enacted--and** several initiatives that could mean more efficient management of the federal **government's** cash flow. Of the tax policy recommendations, the most far-reaching is the proposal calling for the taxation of federal subsidy payments. The management initiatives include shortening tax deferral periods allowed some taxpayers and accelerating the **government's** deposit of tax and other receipts. CBO estimates that the overall increase in revenues from these **proposals--not** counting one proposal that CBO could not **estimate--could** amount to more than **\$40** billion during the next **five** years.

The scope of the Grace Commission proposal to tax federal subsidies is very broad, ranging from cash benefits under Social Security or Aid to Families with Dependent Children (AFDC) to in-kind goods and services such as food stamps and **Medicaid**. In particular, the commission sees poor

targeting and duplication of benefits to individuals qualifying for several **means-tested** programs as giving rise to substantial waste of federal dollars. Besides the potential increase in tax receipts, the commission sees improved targeting of **means-tested** benefits as an important effect from taxing federal subsidies. Although the Survey report on Federally Subsidized Programs discusses the **inclusion** of all federal subsidies in taxable income, the estimated savings in the report result solely **from** the taxation of means-tested benefits. **CBO** estimates that taxation of means-tested benefits could raise as much as **\$15** billion over the 1985-1989 period.

A second major revenue raiser recommended by the Grace Commission would be derived by augmenting the Internal Revenue **Service's** staffing for collection of delinquent taxes and examination of tax returns, and from the accelerated disposition of tax cases brought before the U.S. Tax Court. **CBO** estimates revenue increases amounting to \$13 billion over the next five years. The **commission's** proposal to limit the use of tax-exempt bonds for private purposes would add another \$9.5 billion during 1985-1989.

COMPARISON WITH GRACE COMMISSION ESTIMATES

In its final report to the President, delivered only a little more than a month ago, the Grace Commission estimated that implementation of its nearly 2,500 recommendations would produce savings of **\$424** billion over three years. This is considerably higher than the savings of \$233 billion **CBO**

estimated **for** the next five years that could result from the 396 commission recommendations that we reviewed. What accounts for this difference?

First, the Grace Commission estimates and the CBO estimates are not fully comparable. The CBO estimates were calculated in federal budget accounting terms, for fiscal years 1985-1989, whereas the commission's estimates are characterized as planning figures and do not refer to **specific** years. In some instances, the commission reports acknowledge that their recommendations could not be implemented in the next three years, and that some would not produce savings until the 1990s or even later. In other instances, the commission calculated its savings in terms not generally used for the federal budget, and as a result are not true indicators of possible deficit reductions in the next three-to-five years. For example, the **commission's** savings estimates for its proposed changes in federal civilian and military retirement benefits are based on projected payroll costs in the years 2001 to 2003 and have been discounted to their 1983 estimated value. While this accrual accounting approach is similar to the new treatment for military retirement costs in the 1985 defense budget, it greatly overstates the near-term budget impact for reducing projected federal deficits.

Second, the commission carefully stated in its reports that its figures were of a "planning" nature and not of "budget" quality. Furthermore, the commission noted that its recommendations were not all based on the same level of research and analysis and, as a result, the planning **figures** were not all of the same quality.

The CBO estimates, on the other hand, adhered to a strict methodology. Potential budgetary savings were measured against a uniform and fully documented set of budget projections for the next five fiscal years. Potential outlays savings or revenue gains were estimated only for those recommendations reviewed that were sufficiently specific to provide a basis for cost analysis and for which data were available to develop a budget estimate. The estimates also assume that any needed Congressional action would be taken this year, and that the proposals would be implemented at a reasonable pace in line with past administrative performance.

While I believe our budget estimates are reasonably good, I should note that in a number of instances they are based on estimating assumptions that may not accurately reflect what the commission had in mind in making its proposals. We could not always find the basis for the **commission's** estimates in its published reports or background materials.

A great amount of uncertainty should also be attached to many of the Survey and CBO savings estimates, particularly for proposals that call for substantial change in current laws, policies, and administrative practices. The past is not always a good guide for predicting how substantial changes would affect future government spending and revenues, so our estimating assumptions may not prove to be correct.

Finally, many of the proposals by the Grace Commission are duplicative and would have interaction effects. Both the commission and

CBO tried to eliminate these effects in arriving at an overall total, but I suspect we did not catch all of them and, therefore, our estimates for potential savings, if anything, are too high.

A comparison of the Grace Commission three-year savings estimates with the CBO budget estimates for fiscal years 1985-1987 is shown in Table 2 for those commission recommendations included in our review. In a number of cases, we found that the commission's proposals would have no impact on the CBO baseline projections because they are already being implemented and are included in the baseline, or their impact **would** come after 1989. In a few instances, we found that the **commission's** proposals would entail added costs when measured against the CBO baseline, such as the proposals to reform pay for federal **blue-collar** workers. Because annual pay raises have been limited for a number of years, the catch-up in pay levels to achieve comparability would exceed the savings under the **commission's** plan. Thus, it would not produce savings but would raise costs.

In other instances, the CBO budget estimates for 1985-1987 are **larger** than the net **three-year** savings projected by the Grace Commission. The largest difference is for the effect of the **commission's** proposal to replace direct loan programs with loan guarantees. The CBO savings estimate includes the effect of this proposal for off-budget financing of these loans by the Federal Financing Bank, which is not included in the **commission's** estimates.

TABLE 2. A COMPARISON OF **THREE-YEAR** SAVINGS ESTIMATES
(Savings in billions of dollars)

	No. of CBO-GAO Analyses	No. of PPSSCC Rec's.	PPSSCC 3-Year Planning Ests.	CBO Budget Estimates for 1985-1987
Budget Impact Estimates Could Be Made				
No budget impact	8	21	13.2	0
Added costs rather than savings	4	29	8.5	-1.8
Greater savings than estimated by PPSSCC	9	22	5.9	33.0
Lower savings than estimated by PPSSCC	46	202	270.8	66.7
Subtotal	<u>67</u>	<u>274</u>	<u>298.4</u>	<u>97.9</u>
Budget Impact Estimates Could Not Be Made				
	<u>23</u>	<u>122</u>	<u>80.7</u>	<u>N.A.</u>
Total	90	396	379.0	N.A.

In most cases, however, where CBO could develop specific budget estimates for the recommendations reviewed, we project smaller savings during the next three fiscal years than implied by the **commission's** planning figures. As shown in Table 2, the total savings estimated by CBO for 1985-1987, including **lower** interest costs and **off-budget** savings, for the proposals for which budget estimates could be made is 33 percent of the \$298 billion net three-year savings figure estimated by the commission.

The potential deficit reductions for 1985-1987 resulting from the adoption of all of the Grace Commission recommendations could be larger than CBO has estimated, since the CBO estimates apply to only 70 percent

of the savings projected by the commission. Also, the CBO estimates do not include possible dynamic budget effects resulting from induced changes in the economy, especially lower interest rates brought about by lower budget deficits. On balance, however, it is **CBO's** judgment that the Grace Commission estimates of possible savings that could be derived from its recommendations during the next three years are overstated. This judgment apparently is shared by the Grace Commission.

In recent testimony before the Senate Finance Committee, Mr. Grace emphasized that the **commission's three-year** savings estimate of **\$424** billion did not refer to particular fiscal years and certainly not the next three. He identified a number of proposals, however, that he thought could produce savings of \$59 billion over the next three years. While not agreeing necessarily with the specific savings estimates attached to those commission proposals singled out by Mr. Grace for quick action, CBO does agree that savings of this magnitude are a more reasonable estimate of what could be achieved during the next three years by implementing the **commission's** many recommendations.

CONCLUDING REMARKS

Most of the Grace Commission recommendations involve various management improvements that could be implemented administratively. The bulk of the potential savings, however, relate to recommendations that would require **significant** changes in current laws and policies. The federal spending generated by the policies and programs studied by the Grace Commission has been subject to close scrutiny before and should continue to

be reviewed for possible savings. The magnitude of the savings projected by the Grace Commission for its proposals in these areas, however, is much too large to be attributed simply to eliminating waste and inefficiency. Rather, the **commission's** proposals should be characterized for the most part as possible changes in public policy that could help reduce mounting federal deficits.

These proposals all represent tough decisions with **difficult** trade-offs. The **CBO-GAO** analysis reveals that the Grace Commission has not found an easy solution to the federal deficit problem, although it has helped to focus attention within the Administration and the Congress on some ways to control the rising cost of government.