Appendixes

Appendix A

Sequestration Preview Report for Fiscal Year 1995

The Balanced Budget and Emergency Deficit Control Act of 1985 (the Balanced Budget Act), as amended, requires the Congressional Budget Office (CBO) to issue various sequestration reports each year: a preview report five days before the President's budget submission in January or February, an update report on August 15, and a final report 10 days after the end of a session of the Congress. The sequestration preview report must contain estimates of the following items:

- the limits on discretionary spending and any adjustments to them;
- the amount by which direct spending or receipt legislation enacted since the Budget Enforcement Act of 1990 has increased or decreased the deficit; and
- the maximum deficit amount.

This report to the Congress and the Office of Management and Budget (OMB) provides the required information (summarized in Table A-1).

CBO ordinarily issues its annual *Economic and Budget Outlook* on the date specified for submission of its sequestration preview report--five days before the President's budget is submitted--and includes the sequestration report in that volume, where it will be readily available to interested readers. Although this year's *Economic and Budget Outlook* is scheduled for release 11 days before the submission date for the President's budget, the sequestration report is included. In the event that anything affecting the sequestration report occurs during the additional six days before the President's budget is submitted, CBO will notify the Congress and OMB of the appropriate modification to the sequestration report.

Discretionary Sequestration Report

The Omnibus Budget Reconciliation Act of 1993 (OBRA-93) amended the Balanced Budget Act and established new limits on total discretionary budget authority and outlays for fiscal years 1996 through 1998. But it left in place the existing discretionary spending limits for fiscal years 1993 through 1995 and the discretionary sequestration procedures --including the requirements to adjust the discretionary limits--established by the Budget Enforcement Act (BEA). CBO's estimates of the limits on discretionary spending for fiscal years 1994 through 1998 are shown in Table A-2.

The estimated spending limits in this report differ from those in CBO's December 1993 final sequestration report for two reasons. First, the estimates have been revised to reflect differences between the spending limits in CBO's final report and those specified in OMB's December 1993 final sequestration report. Second, the limits have been changed by adjustments that the Balanced Budget Act specifies must be made in a preview report. The limits do not include any prospective adjustments--changes that cannot legally be made until future sequestration reports. (The CBO baseline for discretionary spending detailed in Chapter 2 is based on spending limits that do include CBO's estimate of such prospective adjustments--namely, for the special budget authority allowance in the final sequestration report for fiscal year 1995 and for differences between anticipated and actual inflation in future preview reports. As a result, the estimated caps described in Chapter 2 are slightly higher than the caps depicted here. The baseline caps do not include adjustments in this preview report that were recognized after the baseline had been completed.)

Technical Differences from OMB's December 1993 Final Report

The Balanced Budget Act requires both CBO and OMB to calculate the changes in the discretionary spending limits specified in the act. OMB's estimates of the limits are controlling in determining whether enacted appropriations fall within the limits or whether a sequestration is required to eliminate a breach of the limits. CBO's estimates are advisory. Acknowledging OMB's statutory role, CBO adjusts its previous estimates to conform to the spending limits in the most recent OMB sequestration report before making the additional adjustments required for the current report.

The 1994 limit on domestic discretionary budget authority in CBO's December 1993 final report exceeded that in the subsequent OMB final report by $755 million. This discrepancy results from a conceptual difference in estimating contingent emergency appropriations. The Balanced Budget Act requires that OMB and CBO adjust the spending limits to reflect enactment of appropriations that are designated as emergency expenditures both by the legislation providing the appropriations and by the President. Contingent emergency appropriations are appropriations that have been designated as emergency funding in the appropriation act but are available for obligation only if the President also designates them as emergency funding. Because no further Congressional action is necessary to make these funds available for obligation, CBO includes the full amount of these contingent appropriations in its estimates and adjusts the spending limits accordingly. OMB includes in its estimates and cap adjustments only the contingent appropriations that the President has designated as emergency funding and made available for obligation. The adjustment that

Table A-1.
CBO Estimates of Discretionary Spending Limits, Changes in the Deficit, and the Maximum Deficit Amount for Fiscal Years 1994 Through 1998 (In millions of dollars)

	1994	1995	1996	1997	1998
Discretionary Spending Limits					
Budget authority	513,268	515,010	516,734	525,608	528,102
Outlays	542,672	539,539	546,127	545,544	545,653
Changes in the Deficit Since the Budget Enforcement Act	-34	-972	-470	-409	-1,013
Maximum Deficit Amount	n.a.	244,000	n.a.	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

Table A-2.
CBO Estimates of Discretionary Spending Limits for Fiscal Years 1994 Through 1998 (In million of dollars)

	1994		1995		1996		1997		1998	
	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays	Budget Authority	Outlays
Limits in CBO's December 1993 Final Report	513,932	542,798	517,398	540,653	519,142	547,771	528,079	547,513	530,639	547,875
Adjustments										
Technical differences from OMB's December 1993 final report	-755	-192	0	-155	0	-38	0	-11	0	0
Contingent emergency appropriations designated since OMB's December 1993 final report	91	66	0	16	0	5	0	2	0	2
Concepts and definitions										
OPIC budget authority	0	0	-157	0	-158	0	-158	0	-160	0
Category changes										
Bankruptcy judges' salaries	0	0	-48	-48	-50	-50	-52	-51	-54	-53
Wetland reserve	0	0	0	53	0	0	0	0	0	0
Funds for strengthening markets	0	0	-30	-27	0	-3	0	0	0	0
Cooperative work trust fund	0	0	0	-21	0	0	0	0	0	0
Rehabilitation services	0	0	0	0	0	-2	0	0	0	0
Emergency preparedness grants	0	0	-13	-1	0	-6	0	0	0	0
General Services Administration	0	0	-12	-12	-12	-12	-12	-12	-12	-12
Black Lung benefits	0	0	22	22	20	20	19	19	18	18
National service initiative reappropriation	0	0	0	8	0	0	0	0	0	0
Subtotal	0	0	-238	-26	-200	-53	-203	-44	-208	-47
Change in 1993 inflation	0	0	-2,033	-834	-2,088	-1,466	-2,144	-1,810	-2,202	-2,063
Credit subsidy reestimates	0	0	-117	-115	-120	-92	-124	-106	-127	-114
Total	-664	-126	-2,388	-1,114	-2,408	-1,644	-2,471	-1,969	-2,537	-2,222
Limits as of January 27, 1994[a]	513,268	542,672	515,010	539,539	516,734	546,127	525,608	545,544	528,102	545,653

SOURCE: Congressional Budget Office.

NOTE: OMB = Office of Management and Budget; OPIC = Overseas Private Investment Corporation.

a. The limits assumed in CBO's January 1994 baseline discussed elsewhere in this volume are lower than those shown here, primarily because the baseline caps include estimated adjustments that will be made in later sequestration reports.

CBO's final report made to the limit on domestic budget authority included $755 million for contingent emergency appropriations that had not been designated by the President at the time of OMB's report.

Similarly, the limit on domestic discretionary outlays in CBO's December report exceeded that in OMB's final report by $192 million in 1994, $155 million in 1995, $38 million in 1996, and $11 million in 1997, largely because of the scoring of the contingent emergencies the President did not designate. The difference was partially offset in 1994 because OMB made a larger adjustment for the special outlay allowance in its final report than did CBO. That allowance is available if the estimated budget authority that is enacted equals or falls below the spending limit but outlays exceed their limit. OMB estimated that 1994 domestic outlays overshot their limit by $822 million before the special outlay allowance was applied, and made a corresponding adjustment to the limit. CBO estimated that outlays exceeded the limit by $462 million and adjusted the limit by that smaller amount.

Contingent Emergency Appropriations Designated Since OMB's December 1993 Final Report

No emergency appropriations have been enacted since OMB's December 1993 final sequestration report. However, several contingent emergency appropriations that had not been designated before OMB's report was issued--and were therefore not included in the adjustments in its report--have subsequently been designated. The adjustments to the limit on 1994 budget authority and to the limits on outlays in 1994 through 1998 reflect the effects of the budget authority newly available as a result of these emergency designations.

Concepts and Definitions

The Balanced Budget and Emergency Deficit Control Act provides for adjustments that reflect changes in budgetary concepts and definitions. One such adjustment made in this report reflects a revised method of counting budget authority for the Overseas Private Investment Corporation's noncredit programs account. The account is funded by offsetting collections, and CBO and OMB have assumed that the negative budget authority representing the collections was completely offset by the authority to spend those collections. However, not all of the collections are available for obligation in the year they are received. Under the definition of budget authority adopted as part of the BEA, only the amount available for obligation should be counted as positive budget authority. The account should therefore reflect negative budget authority equal to the amount of collections not available for obligation. CBO will begin scoring appropriation bills accordingly, and the limits on budget authority have been reduced to account for this change.

Adjustments for changes in budgetary categories are also made under the concepts and definitions authority. One such adjustment involves a true change in classification of spending from discretionary to mandatory. The lists of mandatory and discretionary appropriation accounts that accompanied the BEA specified that the account providing funding for "Courts of Appeals, District Courts, etc." was split--annual appropriations for salaries of judges would be counted as mandatory, and all other funding in the account would be counted as discretionary. Both CBO and OMB have counted only the salaries of judges specifically authorized under Article III of the Constitution as mandatory. CBO and OMB (after consultation with the budget committees) have agreed, however, that the salaries of bankruptcy judges are mandatory by statute--though not required by the Constitution--and both agencies will begin counting appropriations for salaries of bankruptcy judges as mandatory. The discretionary spending limits are reduced here to account for this change.

The other category changes made in this report result from the practice of assigning certain legislated changes in mandatory spending to the discretionary spending side of the Balanced Budget Act ledger and certain legislated changes in discretionary programs to the pay-as-you-go (PAYGO) side, which is generally supposed to deal with mandatory spending and tax legislation. OMB and the budget committees have determined that any costs or savings that result from provisions in an appropriation act should be reflected in enforcement of the discretionary spending limits, even if the costs or savings are in a mandatory spending program. Similarly, any appropriation for a discretionary program provided in authorizing legislation is included in the PAYGO scorecard.

Changes in current year or budget year mandatory spending made in appropriation acts are included in the estimate of discretionary spending for that year, but appropriations for that year provided in authorizing legislation are not. Because estimates of discretionary spending attributed to future appropriation acts will include all such spending provided in previous years--whether in appropriation or authorization acts--and exclude mandatory spending provided in previous appropriation acts, the discretionary spending limits for future years are adjusted to ensure that the appropriations committees are held responsible for the future effects of changes in mandatory programs included in their legislation, but are not affected by appropriations for discretionary programs provided by other committees. Without compromising Balanced Budget Act enforcement, adjustments of this sort provide a simple alternative to permanently tracking all of the effects of appropriation actions on mandatory spending and all discretionary spending provided by authorizing legislation.

For example, the fiscal year 1994 appropriation act for the Department of the Interior and related agencies (Public Law 103-138) contained a provision that reduced mandatory spending from the Forest Service Cooperative Work Trust Fund by $21 million in 1994, but increased spending by $21 million in 1995. The 1994 savings were included in the estimate of the 1994 appropriation act, but rather than attribute the 1995 cost to next year's appropriation act, the 1995 discretionary outlay limit has been reduced by $21 million. Similarly, a reappropriation included in the National Service Trust Act (Public Law 103-82), an authorizing act, increased outlays from a discretionary account by $12 million in 1994 and $8 million in 1995 and was reflected in the PAYGO scorecard. Because the $8 million outlay will be attributed to an appropriation act as a prior-year discretionary outlay in 1995, the discretionary outlay limit for 1995 has been increased by $8 million. This ensures that the appropriations committees are not adversely affected by an action of the authorizing committee that has already been counted for purposes of the Balanced Budget Act.

Change in 1993 Inflation

The Balanced Budget Act requires that the discretionary spending limits for 1995 through 1998 be adjusted for the difference between the actual inflation rate in 1993 and the rate for that year anticipated when the BEA was enacted in 1990. Because actual inflation (measured by the implicit gross domestic product deflator) was lower in 1993 than had been expected in 1990, the adjustment reduces the spending limits--for budget authority, by around $2 billion each year, and for outlays, by about $800 million in 1995 to $2 billion in 1998.

CBO estimated the inflation adjustment using the method that OMB adopted in its 1993 sequestration preview report. This method entails adjusting only nonpersonnel costs instead of adjusting all discretionary spending. Although CBO believes there is no justification for OMB's interpretation of the inflation adjustment provision in the Balanced Budget Act, OMB's cap adjustments are controlling, and CBO follows its lead in order to avoid confusion.

Credit Subsidy Reestimate

The Balanced Budget Act required that the discretionary spending limits be adjusted in the fiscal year 1993 and 1994 sequestration preview reports to reflect changes in the estimated subsidy rate for credit programs. This provision was intended to hold the appropriations committees harmless for increases in the estimated subsidy cost of direct loans and loan guarantees and to prevent a windfall if the subsidy estimates were reduced. Policymakers feared that the subsidy estimates, first required in 1992 when the Credit Reform Act of 1990 was implemented, could be quite volatile because the information required to make the estimates was incomplete at best at that time. The Balanced Budget Act also provides that a credit reestimate adjustment be made in the 1995 preview report if the President chooses to adjust the maximum deficit amounts to account for revised economic and technical assumptions, as he has indicated will occur in OMB's forthcoming preview report. The reductions shown in Table A-2 reflect CBO subsidy rates that are lower than the rates OMB used for fiscal year 1994. The largest adjustments result from different estimates of the subsidies involved in mortgage-backed guarantees of the Government National Mortgage Association; general- and special-risk guarantees of the Federal Housing Administration; and direct loans of the Rural Housing Insurance Fund.

Pay-As-You-Go Sequestration Report

If changes in direct (mandatory) spending programs or governmental receipts enacted since the BEA increase the combined current year and budget year deficits, a pay-as-you-go sequestration is triggered at the end of the Congressional session, and nonexempt mandatory programs are cut enough to eliminate the overage. The pay-as-you-go provisions of the Balanced Budget Act had applied through fiscal year 1995, but OBRA-93 extended them through 1998.

As is the case with the discretionary spending limits, the Budget Enforcement Act requires both CBO and OMB to estimate the net increase in the deficit resulting from direct spending or receipt legislation. OMB's estimates are controlling, however, in determining whether a sequestration is required. CBO therefore adopts the estimate of the change in the deficit specified in OMB's most recent sequestration report as the starting point for its estimate. Table A-3 shows CBO's estimate of the

Table A-3.
Budgetary Effects of Direct Spending and Receipt Legislation Enacted Since the Budget Enforcement Act (By fiscal year, in millions of dollars)

	1994	1995	1996	1997	1998
Total from OMB's December 1993 Final Report[a]	-26	-971	-473	-410	-521
Legislation Enacted Since OMB's Final Report					
North American Free Trade Agreement Implementation Act (P.L. 103-182)	-1	0	-1	0	-493
Jefferson Commemorative Coin Act of 1993 (P.L. 103-186)	-7	-6	1	1	1
Government Securities Act Amendments of 1993 (P.L. 103-202)[b]	1	1	1	1	1
Coast Guard Authorization Act of 1993 (P.L. 103-206)	-1	-1	-1	-1	-1
Higher Education Technical Amendments of 1993 (P.L. 103-208)	c	5	3	c	c
Total	-8	-1	3	1	-492
Total Change in the Deficit Since the Budget Enforcement Act	-34	-972	-470	-409	-1,013

SOURCE: Congressional Budget Office.

NOTES: The following bills affected direct spending or receipts but did not increase or decrease the deficit by as much as $500,000 in any year through 1998: Fresh Cut Flowers and Greens Promotion and Information Act (P.L. 103-190); Copyright Royalty Tribunal Reform Act (P.L. 103-198); Friendship Act (P.L. 103-199); Domestic Chemical Diversion Control Act of 1993 (P.L. 103-200); Resolution Trust Corporation Completion Act (P.L. 103-204); an act to Suspend Implementation of Certain Requirements of the Food Stamp Program until March 15, 1994 (P.L. 103-205); and an act to Provide Additional Authority for the Secretary of Veterans Affairs to Provide Health Care for Veterans of the Persian Gulf War (P.L. 103-210).

OMB = Office of Management and Budget; P.L. = Public Law.

a. Section 254 of the Balanced Budget and Emergency Deficit Control Act of 1985, as amended, calls for a list of all bills enacted since the Budget Enforcement Act that are included in the pay-as-you-go calculation. Because the data in this table assume OMB's estimate of the overall changes in the deficit resulting from bills enacted through December 3, 1993, readers are referred to the lists of those bills included in Table 7 of the *OMB Final Sequestration Report to the President and Congress for Fiscal Year 1994* (December 10, 1993) and in previous sequestration reports issued by OMB.

b. Reductions in receipts are shown with a positive sign because they increase the deficit.

c. Less than $500,000.

changes in the deficits for 1994 through 1998 that result from direct spending and receipt legislation enacted since the BEA (assuming OMB's estimates of changes in the deficit resulting from legislation enacted through December 3, 1993). Before the pay-as-you-go provisions were extended through 1998, PAYGO estimates did not include the effects of enacted legislation on deficits for 1996 through 1998. Therefore, the effects on deficits that are shown in Table A-3 for those years reflect only the effects of legislation enacted since OBRA-93.

CBO's estimate of changes in direct spending and revenues provided by legislation signed by the President since December 3, 1993--added to the total 1994 and 1995 deficit reduction of $997 million that OMB estimated in its December 1993 final report--yields a net decrease in the combined 1994 and 1995 deficits of $1,006 million. According to these calculations, no pay-as-you-go sequestration would be required for fiscal year 1995.

Deficit Sequestration Report

The BEA established procedures to enforce annual deficit targets through 1995. Those procedures were crafted in such a way that they have imposed no additional budgetary discipline beyond the constraints of the discretionary spending limits and the PAYGO requirement. OBRA-93 did not extend the provisions for enforcing deficit targets beyond their scheduled expiration at the end of 1995.

The 1995 maximum deficit target has no effect for two reasons. First, when the President submits the budget for fiscal year 1995, he will exercise the option provided by the Balanced Budget Act to adjust the deficit targets for revised economic and technical assumptions, in addition to making the required adjustments to account for changes in the discretionary caps and pay-as-you-go balances. Second, the assumptions used in preparing the President's budget must be used by OMB for all subsequent Balanced Budget Act calculations that year. Therefore, even if the budgetary outlook deteriorates after the President's budget is submitted, as long as the discretionary spending limits and pay-as-you-go requirements are met, the deficit targets will be said to have been satisfied.

The BEA provides that the estimated maximum deficit amounts shall equal the projected on-budget baseline deficit (which excludes net spending by the Postal Service and Social Security receipts and benefit payments)--assuming that discretionary spending is held to the adjusted limits--minus any net deficit increases or decreases that appear on the PAYGO scorecard. CBO's current estimate of the maximum deficit amount for 1995, based on the economic and technical estimating assumptions described elsewhere in this volume, is shown in Table A-4. This figure excludes changes in the deficit resulting from enacted pay-as-you-go legislation, as well as assumed prospective adjustments to the 1995 discretionary spending limits for the special budget authority allowances. The figure includes Social Security administrative costs that are legally off-budget but that are covered by the discretionary spending limits as a result of OMB's interpretation of the Balanced Budget Act. As a result, it differs slightly from the on-budget deficit for fiscal year 1995 shown in the rest of this volume.

Since the December 1993 final sequestration report, CBO's estimate of the 1995 maximum deficit amount has decreased by $20 billion. This decrease results primarily from changes in economic and technical assumptions.

Table A-4.
CBO Estimate of the Maximum Deficit Amount for Fiscal Year 1995 (In billions of dollars)

	1995
Estimate in CBO's December 1993 Final Report	264
Adjustments	
Economic and technical reestimates	-19
Changes in discretionary spending limits	-1
Total	-20
Estimate as of January 27, 1994	244

SOURCE: Congressional Budget Office.

Appendix B

An Analysis of Congressional Budget Estimates

In May 1992, the Congress adopted a budget resolution for fiscal year 1993 that anticipated a deficit of $327 billion. When fiscal year 1993 ended 17 months later, the Treasury Department tallied the deficit at $255 billion--$72 billion smaller than anticipated. This was the first time in 14 years that the actual deficit was less than in the budget resolution. That good news, however, is tempered; a single unpredictable category of spending, deposit insurance, more than accounts for the huge difference. Other factors, on balance, were a bit worse than envisioned.

Sources of Differences

The Congressional Budget Office divides the differences between budget resolutions and actual outcomes into three categories: policy, economic, and technical.

Policy differences reflect the passage of legislation that was not explicitly anticipated in the budget resolution or legislation that cost (or saved) more money than was assumed. Examples are the Tax Reform Act of 1996, which was not explicitly included in the 1987 budget resolution but brought in a first-year surge of extra revenues, and emergency appropriations, such as those for Operation Desert Storm, which are by definition difficult to anticipate. Policy differences can also reflect the failure to enact legislation that was assumed in the resolution.

Economic differences can be blamed on the failure to anticipate the actual performance of the economy. Every budget resolution contains assumptions about several key economic variables--chiefly gross domestic product (GDP), unemployment, inflation, and interest rates--that are needed to develop estimates of revenues and spending for benefit programs and net interest. Typically (as for the 1993 budget resolution) the economic assumptions are drawn from a CBO forecast, although in nearly one-half of the cases the drafters have chosen a non-CBO forecast, generally one from the Administration.

Soon after the end of the fiscal year in question, CBO judges how much of the difference between the budget resolution and the actual revenue and outlay totals should be ascribed to economic factors, using data available at that time; this allocation is not subsequently changed even though revisions to data about GDP and taxable incomes con-tinue to trickle in thereafter. Only the differences that can be linked rigorously to these major variables are labeled economic. Other differences that could be tied to economic performance (for example, higher support payments to farmers in response to weak agricultural exports) are not included in this category because their relationship to the published forecast is more tenuous.

Technical differences are all other types of discrepancies. The portions of the budget that have contributed the biggest technical differences in the past 14 years are noted at the end of this appendix. Large technical differences often prompt both the Congressional Budget Office and the Administration to review their methods of projection, but some such differences are inevitable given the size and complexity of the budget.

By convention, nearly all the differences in deposit insurance outlays--a major source of the deficit's volatility in recent years--are classified as technical, a convention that merits explanation. In August 1989, the Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act to reform deposit insurance, beef up regulation, and fund savings and loan resolutions. It soon became clear that the cleanup was woefully underfunded, and the Resolution Trust Corporation (RTC) had to make three return trips to the Congress for more money. Because deposit insurance is a legal obligation of the government, CBO and the Administration began to show estimates of future outlays on the assumption that necessary funds would be provided. Sanctioning this practice, the Budget Enforcement Act of 1990 (BEA) stated that funding that merely honors the government's existing commitment would not be recorded as an entry on the official pay-as-you-go scorecard, signifying that it does not require offsetting tax increases or spending cuts. Even so, there were three interruptions in the RTC's funding, including one that lasted from April 1992 until December 1993.

In theory, it might be possible to separate the huge differences in deposit insurance outlays into those stemming from legislative inaction (presumably a policy difference) and those from CBO's estimating errors (a technical difference). In practice, this is not only tricky but misleading; showing big "savings" from underfunding the savings and loan cleanup would imply that policymakers deserve praise for cutting the deficit. In fact, as CBO consistently emphasized, delays in funding did nothing to shrink the cleanup's total cost but probably increased it. Thus, by convention, the differences in deposit insurance estimates, whether positive or negative, are simply listed on the technical side of the tally sheet.

The Budget Resolution for Fiscal Year 1993

The budget process for fiscal year 1993 began in early 1992. For the second year in a row, policymakers essentially followed a blueprint set out by the Budget Enforcement Act. The act held them to strict limits on appropriations and required that entitlement and revenue legislation, on balance, could not add to the deficit--the "pay-as-you-go" rule. (Of course, deficit reductions were always permissible.) Emergencies constituted the only allowable exceptions to these rules.

Fiscal year 1993 was the last year for which the BEA set separate limits on the three types of discretionary spending--defense, international, and domestic. By contrast, in fiscal years 1994 through 1998, a single lid applies to all three. The House Committee on the Budget, in its recommendations on the budget resolution, urged that the Congress consider reallocating the limits--that is, permit some of the allowable defense dollars to be used for domestic purposes--in light of the crumbling of the Warsaw Pact and the general lessening of international tensions. This effort came to naught, however, and the three caps stood intact.

Table B-1.
Comparison of 1993 Budget Resolution with Actual Outcomes (In billions of dollars)

	Budget Resolution[a]	Actual	Difference
Revenues	1,173	1,153	-20
Outlays	1,500	1,408	-92
Deficit	327	255	-72

SOURCE: Congressional Budget Office using data from the Concurrent Resolution on the Budget--Fiscal Year 1993 (May 1992); and Department of the Treasury, *Final Monthly Treasury Statement for Fiscal Year 1993* (October 1993).

a. Consolidated totals.

The conference resolution on the budget contained few policy departures. Specifically, it called for domestic and international appropations to be at or near their respective caps, but for defense appropriations to fall well below their BEA limits. It also called for $2 billion in unspecified savings in mandatory spending, though without directing any committee to achieve this savings through reconciliation.

The resolution called for revenues of $1,173 billion, outlays of $1,500 billion, and a deficit of $327 billion (see Table B-1). Revenues, outlays, and the deficit all ended up lower than projected, for reasons that are discussed below.

Changes in Policies

Policy actions boosted the deficit by about $12 billion above the figure in the resolution, but these additions were mostly for emergencies (see Table B-2). The last installment of Desert Storm funds for defense, aid to victims of several natural disasters, and an extension of unemployment benefits in March 1993--the only such extension that was labeled an emergency--added $10 billion. The remaining $2 billion was mainly attributable to slightly higher defense spending than envisioned in the resolution and to the failure to achieve the unspecified mandatory savings. Several other legislative initiatives, chiefly two earlier extensions of unemployment insurance, were accompanied by revenue increases and cuts in other programs and thus complied with the pay-as-you-go rules.

Economic Factors

The divergence between the economy as it appeared at the end of fiscal year 1993 and what was assumed

Table B-2.
Sources of Differences Between Actual Budget Totals and Budget Resolution Totals for Fiscal Year 1993 (In billions of dollars)

	Policy				
	Emergencies	Other	Economic	Technical	Total
Outlays					
Defense discretionary	3	1	0	-1	3
International discretionary	0	a	0	1	1
Domestic discretionary	4	0	0	a	4
Entitlements and other mandatory spending	3	5	a	4	12
Deposit insurance[b]	0	0	0	-92	-92
Offsetting receipts	0	a	0	a	a
Net interest[b]	0	a	-19	-1	-20
Total	10	6	-19	-90	-92
Revenues	0	4	-28	3	-20
Deficit	10	2	9	-93	-72

SOURCE: Congressional Budget Office.

NOTE: Differences are actual outcomes less budget resolution assumptions.

a. Less than $500 million.

b. Adjusted for differences in interest paid by deposit insurance agencies to the Federal Financing Bank. These payments are intrabudgetary and do not affect the deficit.

Table B-3.
Sources of Differences Between Actual Budget Totals and First Budget Resolution Estimates for Fiscal Years 1980-1993 (In billions of dollars)

	Policy	Economic	Technical	Total
		Revenues		
1980	6	8	-4	11
1981	-4	5	-13	-11
1982	13	-52	-1	-40
1983	-5	-58	-3	-65
1984	-14	4	-4	-13
1985	a	-20	3	-17
1986	-1	-23	-2	-27
1987	22	-27	7	2
1988	-11	4	-17	-24
1989	1	34	-8	26
1990	-7	-36	9	-34
1991[b]	-1	-31	-24	-56
1992	3	-46	-34	-78
1993	4	-28	3	-20
Average	a	-19	-6	-25
Absolute Average	7	27	9	30
		Outlays		
1980	20	12	16	48
1981	25	6	16	47
1982	1	24	8	33
1983	18	a	8	26
1984	1	7	-18	-9
1985	23	-5	-13	5
1986	14	-12	20	22
1987	7	-12	13	8
1988	-2	12	12	22
1989	17	14	12	43
1990	13	13	59	85
1991[b]	-19	1	-22	-40
1992	15	-21	-60	-66
1993	16	-19	-90	-92
Average	11	1	-3	9
Absolute Average	14	11	26	39
		Deficit		
1980	13	4	19	37
1981	28	1	29	58
1982	-12	76	9	73
1983	22	59	11	91
1984	15	3	-14	4
1985	23	15	-16	22
1986	16	11	22	49
1987	-15	15	6	6
1988	9	8	29	46
1989	17	-20	20	17
1990	20	49	50	119
1991[b]	-19	32	2	15
1992	12	25	-26	11
1993	12	9	-93	-72
Average	10	21	3	34
Absolute Average	17	23	25	44

SOURCE: Congressional Budget Office.

NOTE: Differences are actual outcomes less budget resolution asumptions.
The allocation of revenue differences between economic and technical factors is done soon after the fiscal year in question and is not subsequently changed to incorporate revisions in economic data.

a. Less than $500 million.

in the resolution accounts for $9 billion of higher deficit. Lower-than-expected taxable incomes dampened revenues by an estimated $28 billion, but that was largely offset by savings of $19 billion in interest costs as interest rates plummeted to their lowest levels in three decades.

Technical Factors

Deposit insurance spending came in $92 billion below expectations, dwarfing all other technical differences. About three-fourths of the deposit insurance shortfall was attributable to spending on the cleanup of the savings and loan industry (chiefly by the Resolution Trust Corporation and stemmed from the Congress's failure to provide any funding for the RTC for a 20-month period. The rest was attributable to smaller-than-expected outlays by the Bank Insurance Fund, as dire projections for the banking industry proved to be overly pessimistic. Other technical errors were small and scattered among many programs, driving the total technical error to $93 billion.

Budget Resolutions in 1980 Through 1993

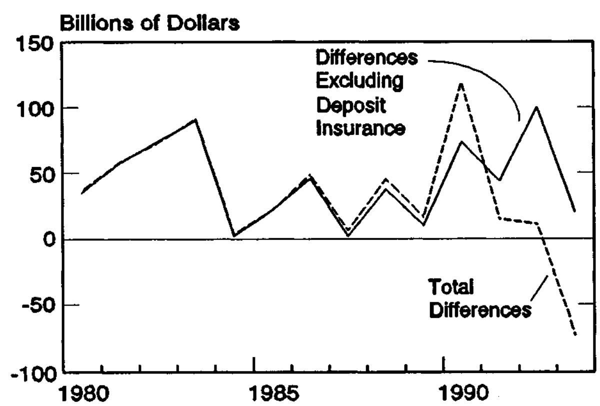
The 1993 budget resolution broke a pattern: for the first time in 14 years, the deficit was smaller than assumed in the first budget resolution. The overruns in 1980 through 1992, by contrast, ranged from as little as $4 billion to as much as $119 billion (see Table B-3).

Policy action or inaction (the failure to achieve savings called for in budget resolutions) has generally added to deficits, by an average of $10 billion a year. There were only three major exceptions: in fiscal year 1982, the first Reagan-era budget, when tax cuts fell shy of the resolution's assumption; in 1987, as the new Tax Reform Act temporarily swelled collections; and in 1991, when contributions from foreign nations for Operation Desert Storm poured into government coffers. Since 1991, the Congress has hewed quite faithfully to the strictures of the Budget Enforcement Act, and nearly all additions to the deficit have been for emergencies.

Because the budget process for a fiscal year begins about nine months before the year starts, economic performance is a major source of uncertainty. Revisions to economic data, which continue long after the fiscal year in question, often make it hard to disentangle economic and technical errors; nevertheless, with just one exception (in 1989), budget resolutions over this 14-year span used short-term economic assumptions that proved overly optimistic. The worst errors, not surprisingly, were in years marked by recession or early stages of recovery--namely in 1982 and 1983 and again in the 1990-1992 period. The economic differences occur chiefly in revenues and, on the spending side of the budget, in net interest. On average, they contributed $21 billion in extra deficits.

The causes of large technical errors have varied over the years. On the revenue side, such errors were generally not very great through 1990 but ballooned in 1991 and 1992, when tax collections proved to be even weaker than economic data would seem to justify. On the outlay side, farm price supports, receipts from oil sales, defense, and benefit programs dominated the errors through the mid-1980s. Such errors briefly became less significant at decade's end. Underestimates of benefit outlays,

Figure B-1.
Differences Between Actual Deficit and Deficit in First Budget Resolution (By fiscal year)



SOURCE: Congressional Budget Office.

especially for health care, loomed large once again in 1991 and 1992. All of these errors, however, pale next to deposit insurance, the volatility of which has played havoc with budget estimates from the late 1980s to the present.

Although the lower-than-expected deficit in 1993 was overwhelmingly attributable to deposit insurance, that year's other errors were fairly small by recent historical standards (see Figure B-1). Excluding deposit insurance, the deficit in 1993 was $20 billion higher than projected. That overestimate was markedly smaller than errors in 1990 though 1992 and compares favorably even with earlier budget resolutions.

Appendix C

How the Economy Affects the Budget

The federal budget is highly responsive to changes in economic conditions. Most revenues rise or fall with gross domestic product (GDP), or more precisely, with taxable incomes. Many benefit programs are tied to the rate of inflation, either directly (like Social Security) or indirectly (like Medicare). Programs like unemployment compensation are sensitive to changes in the unemployment rate, and outlays for interest on the federal debt are largely at the mercy of market interest rates.

Faulty economic assumptions have been a chronic source of error in past budget estimates. As Congressional budget resolutions over the 1980-1993 period indicate, policymakers have usually chosen economic assumptions that proved to be too optimistic. On average, erroneous economic assumptions over the past 14 years have caused each succeeding year's deficit to be underestimated by more than $20 billion (see Appendix B).

The Congressional Budget Office has developed rules of thumb to illustrate the relationship between budget projections and four key economic variables: real growth, unemployment, inflation, and interest rates (see Table C-1). Each rule depicts the effect on budget totals of a 1-percentage-point change in CBO's baseline assumptions for these variables, starting in January 1994. As noted below, the rules of thumb are highly simplified and should be used with caution.

Real Growth

Strong economic growth narrows the deficit; weak economic growth widens it. CBO's baseline assumes that real growth in GDP will be fairly steady over the forecast period, averaging about 2.7 percent. The first rule of thumb was developed to show the budgetary effect of a sharp reduction in economic growth. Subtracting 1 percentage point from real growth implies anemic growth of less than 2 percent a year throughout the forecast period. By 1999--the fifth year--total GDP lies more than 5 percent below CBO's baseline assumption.

This scenario assumes that weak demand is the principal cause of slow economic growth, as opposed to, say, dramatically lower gains in labor productivity. Thus, sluggish growth affects labor markets as well, because businesses employ fewer workers; the unemployment rate inches up to 7.8 percent in 1999, more than 2 percentage points above the baseline.

The economic slowdown impedes the growth in taxable incomes, leading to revenue losses estimated at $8 billion in 1994 and $118 billion by 1999 (see Table C-1). In 1999, the revenue loss is about 7 percent of baseline revenues, even greater than the loss in GDP. Outlays for benefit programs--chiefly unemployment insurance--grow by a modest $800 million in 1994, but by larger amounts thereafter, generating $11 billion in additional spending by

Table C-1.
Effects on CBO Budget Projections of Selected Changes in Economic Assumptions (By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	1999
			Real Growth: Effect of 1-Percentage-Point Lower Annual Rate Beginning January 1994			
Change in Revenues	-8	-25	-46	-69	-93	-118
Change in Outlays						
Net interest (Debt service)	a	1	4	7	13	20
Other	1	2	4	6	9	11
Total	1	4	8	14	22	31
Change in Deficit	9	29	54	82	115	149
			Unemployment: Effect of 1-Percentage-Point Higher Annual Rate Beginning January 1994			
Change in Revenues	-33	-49	-50	-52	-54	-57
Change in Outlays						
Net interest (Debt service)	1	3	7	10	14	18
Other	3	5	5	5	5	6
Total	4	8	12	15	20	24
Change in Deficit	37	57	62	67	74	81
			Inflation: Effect of 1-Percentage-Point Higher Annual Rate Beginning January 1994			
Change in Revenues	7	20	35	51	68	87
Change in Outlays						
Net interest						
Higher rates	5	15	20	24	29	33
Debt service	a	a	a	a	a	a
Other	1	5	14	25	38	55
Total	5	20	34	49	66	88
Change in Deficit	-1	-1	-2	-2	-1	1
			Interest Rates: Effect of 1-Percentage-Point Higher Annual Rates Beginning January 1994			
Change in Revenues	0	0	0	0	0	0
Change in Outlays						
Net interest						
Higher rates	5	15	20	24	29	33
Debt service	a	1	2	4	6	8
Other	a	1	1	1	1	a
Total	5	16	23	29	35	42
Change in Deficit	5	16	23	29	35	42

SOURCE: Congressional Budget Office.

a. Less than $500 million.

1999. Over time, however, net interest is the bigger culprit behind the extra federal spending. As revenues fall off, the government borrows more and incurs greater debt-service costs. In total, the deficit in 1999 would be an estimated $149 billion greater--almost three-quarters more than in CBO's baseline projections--if real growth were 1 percentage point lower each year than projected.

Unemployment

Calculations using the second rule of thumb measure the impact on the budget of a 1-percentage-point increase in the unemployment rate. In the short run, economic growth and unemployment are clearly related. Okun's law, named after economist Arthur Okun, quantifies this relationship, positing that an extra percentage point of unemployment is accompanied by a 2½ percent loss in GDP.

CBO assumes that the unemployment rate will be 6.4 percent in 1994, falling off to 5.7 percent by 1999. Using this second rule of thumb, unemployment would instead jump to 7.4 percent in 1994 and average 6.7 percent in 1999. The path of interest rates and inflation is unchanged. Heeding Okun's law, GDP is 2½ percent lower than baseline levels in all six years of the forecast period. Not surprisingly, revenues drop, outlays for benefits rise, and interest costs grow in relation to the baseline. Combined, these forces drive up the deficit by $37 billion in 1994 and by $81 billion in 1999.

It is illuminating to compare this example with the projections derived using the first rule of thumb, which depicted the effects of an extended period of lethargic growth. Under Okun's law, it takes about two and one-half years of dampened growth, as described under the first rule, to generate an extra percentage point of unemployment. Thus, GDP and taxable incomes in the first scenario lie above their counterparts in calculations using the second rule of thumb through mid-1996 but fall farther and farther below them thereafter. The budgetary effects closely follow this pattern.

Inflation

Inflation affects the federal budget in mixed ways. On the one hand, higher inflation swells taxable incomes and hence revenues, assuming that all other economic variables, mainly economic growth, are unaffected. On the other hand, higher inflation boosts spending, particularly for benefit programs. Discretionary spending, too, would feel the higher inflation, although with a lag, unless policymakers were content to see real resources evaporate. And interest rates would almost surely rise with inflation, fueling higher costs for borrowing.

These effects nearly offset one another, and according to CBO, higher inflation leaves the deficit basically unchanged. In other words, higher inflation pushes up revenues and spending by essentially the same amounts, so the effect on the deficit is trivial.

The effect of inflation on the budget is subtle, however, and different conclusions are possible if one or two key assumptions are changed. The assumption that higher inflation is accompanied by higher interest rates is critical; $5 billion of the extra spending in 1994 and $33 billion in 1999 hinge on it (see Table C-1). The treatment of discretionary programs is also pivotal. CBO explicitly assumes that policymakers would attempt to preserve real resources for discretionary programs at the current level of funding by appropriating more dollars in response to a jump in inflation. The Balanced Budget Act discretionary spending caps limit appropriations through 1998, but the caps are partially adjusted to reflect increases (or decreases) in inflation. The rule of thumb assumes that discretionary spending will change by the amount of the cap adjustment through 1998 and by a full inflation adjustment in 1999, when the caps have expired. In 1996 and 1999, incorporating this assumption in the rule of thumb entails extra discretionary spending of $600 million and $11 billion, respectively. Easing this assumption would imply that higher inflation subdues the deficit, but with a hidden cost--an even greater erosion in the real resources of discretionary programs than the caps already impose.

Interest Rates

The last rule of thumb was designed to illustrate the sensitivity of the budget to changes in interest rates. The Treasury finances the government's substantial debt at market interest rates. Assuming that interest rates are 1 percentage point higher than assumed in the baseline for all maturities in each year would push interest spending up by $5 billion in 1994. The initial boost in interest costs is in large part fueled by the increased costs of refinancing the government's short-term Treasury bills, which make up roughly one-fourth of its marketable debt. More than $650 billion worth of Treasury bills are now outstanding, and none of them have a maturity of more than a year.

The bulk of the government's marketable debt is not held in short-term bills but in medium- to long-term securities, mainly those with initial maturities of 2 to 10 years. Many of them will come due for refinancing over the next few years. And to finance the deficit, the Treasury continues to incur new debt. Thus, the budgetary effects mount as more and more debt is hit with higher interest rates. By 1999, almost all of the debt is affected. Of the marketable debt outstanding in that year, CBO estimates that 27 percent would have been originally borrowed during the 1994-1999 period and would therefore be affected by the higher rates; about 55 percent was already outstanding in early 1994 but was refinanced during the 1994-1999 period; and only 18 percent was unaffected. The 1999 deficit climbs by $42 billion as a result of the interest rate hike. This rule of thumb includes small changes in other spending programs that are sensitive to interest rates, mainly student loans. It does not, however, incorporate any changes in revenues or in deposit insurance, since the impact of higher interest rates on these areas is less clear.

Conclusions

The rules of thumb highlight the sensitivity of the budget to economic assumptions. The rules are roughly symmetrical; that is, higher real growth, lower interest rates, and so on, would change budget projections by roughly the same amount as depicted in Table C-1, but in the opposite direction.

CBO presents rules of thumb each year in its annual report. They always change somewhat from year to year because of the intervening growth in the economy (principally affecting revenues), changes in interest rates, adjustments to the discretionary caps, and new projections of growth in benefit programs, among other reasons. When this year's rules of thumb are compared with those that appeared in CBO's January 1993 report, several differences stand out. The revenue effects of the rules dealing with real growth, unemployment, and inflation are larger, chiefly as a result of higher tax rates set in the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) and interim growth in the economy. This year's calculations also indicate a small reduction in the budget's sensitivity to changes in interest rates. This reduction can also be explained largely by OBRA-93, which slowed the rate at which the government is accumulating debt.

Although rules of thumb offer a simple way to express the relationship between economic assumptions and budget outcomes, they have their limitations. Sustained errors of 1 percentage point are used for simplicity; they do not represent typical forecasting errors. Neither the size nor the timing of faulty assumptions is likely to match these examples. Some variables, notably interest rates, are significantly more difficult to predict than others; a sustained error of 1 percentage point in interest rates is more likely than a similar error in the forecast of real growth. In addition, economic variables are related to each other, so that changes do not occur in isolation. Finally, budget projections are constantly revised, not only because of changes in economic assumptions, but for technical reasons as well. There is no similarly easy way of capsulizing the variety of budget outcomes that could result from technical uncertainty.