In the present projections, which assume no real growth in defense budget authority over the 1986 program level, the defense share of GNP hits a maximum of 6.4 percent in 1985 and 1986 and then drops. By 1991, under these assumptions, the ratio of defense to GNP would be 5.7 percent--less than in fiscal year 1982--as Figure II-4 illustrates.

Entitlements and Other Mandatory Spending

An entitlement program is one that provides benefits to any person, business, or unit of government that meets the established eligibility requirements. Authorization for entitlements constitutes a binding obligation of the federal government, and eligible recipients have legal recourse if the obligation is not met. In addition, as described in Appendix A, other permanent appropriations and certain annually appropriated accounts are treated as mandatory even though the House and Senate Budget Committees do not both consider them entitlements.

Table II-8 divides entitlement and mandatory spending into two broad categories--means-tested and nonmeans-tested programs. The means-tested category comprises programs that provide cash benefits or services to low-income people. These programs represent about 15 percent of entitlement outlays--$69.5 billion in 1986 and $85.9 billion in 1991. The largest and most rapidly growing program in the category is Medicaid, with outlays of $24.4 billion in 1986 and $33.5 billion in 1991. Other means-tested programs include Food Stamps, assistance payments, and Supplemental Security Income.

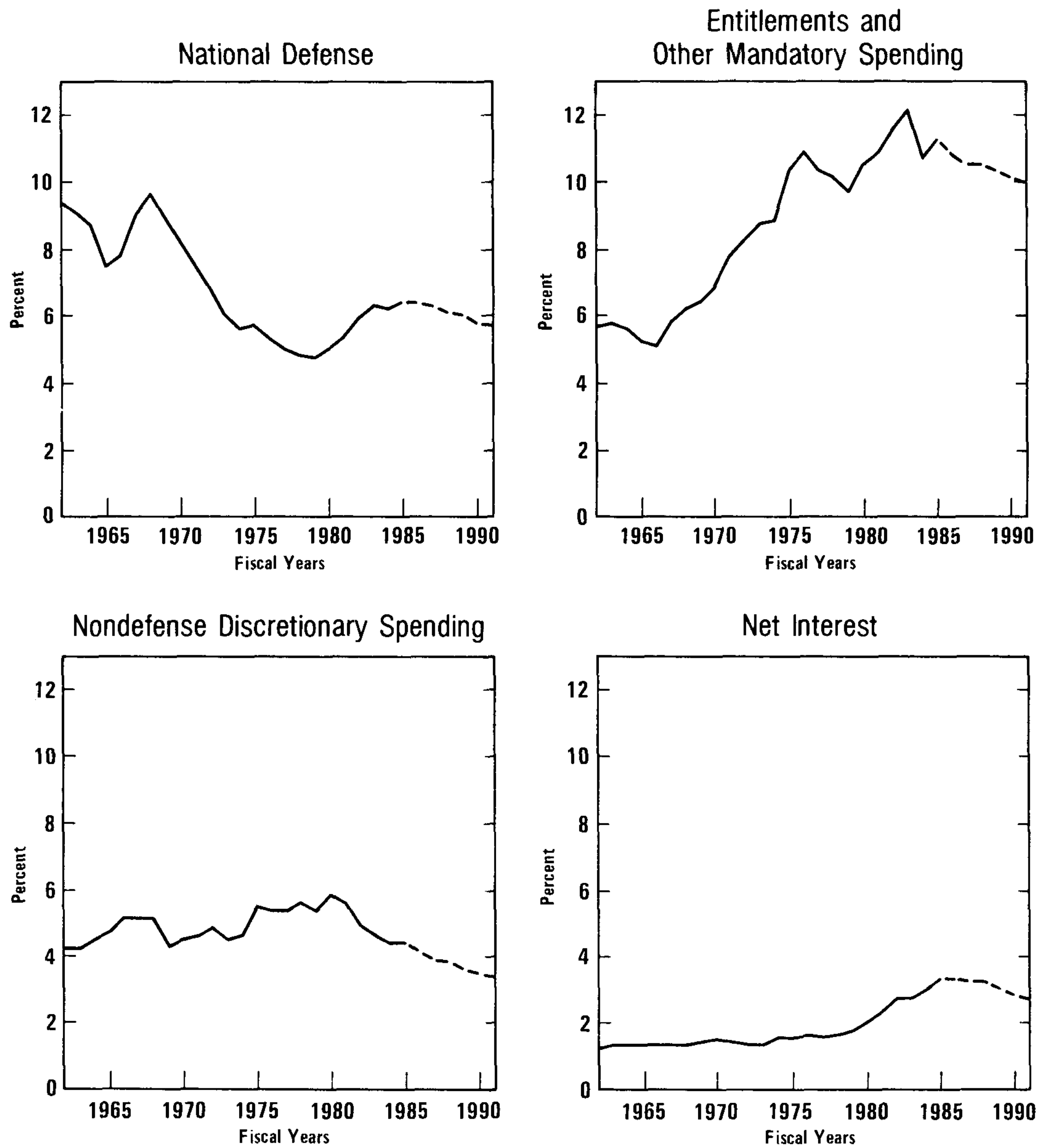
Nonmeans-tested programs can be subdivided into Social Security and Medicare, other retirement and disability programs, unemployment compensation, and other entitlement programs. Social Security and Medicare alone account for $269.8 billion, or almost 60 percent of entitlement spending in 1986; by 1991 they grow to $399.1 billion, or two-thirds of the entitlement total. Other retirement and disability programs, primarily federal civilian and military retirement, constitute 10 percent of entitlements. Unemployment compensation and other entitlements shrink from 15 percent to 9 percent of the total over the next five years.

Nondefense Discretionary Spending

Nondefense discretionary spending covers all remaining discretionary programs subject to annual appropriations or to loan or obligation limits imposed in appropriation acts. It includes portions of all budget functions

Figure II-4.

Outlays by Category as Percents of GNP



SOURCE: Congressional Budget Office.

TABLE II-8. CBO BASELINE OUTLAY PROJECTIONS FOR ENTITLEMENTS AND OTHER MANDATORY SPENDING (By fiscal year, in billions of dollars)

	1985 Actual	1986 Base	Projections 1987	1988	1989	1990	1991
Means-Tested Programs							
Medicaid	22.7	24.4	26.0	27.8	29.6	31.4	33.5
Food stamps	11.7	11.8	12.2	12.7	13.2	13.7	14.3
Supplemental Security Income	9.6	10.2	10.5	11.7	11.4	11.0	12.5
Assistance payments	8.6	9.2	9.5	9.8	10.0	10.3	10.8
Veterans' pensions	3.8	3.8	3.8	3.7	3.7	3.7	3.6
Child nutrition	3.7	3.9	4.2	4.5	4.8	5.1	5.4
Guaranteed student loans	3.5	3.4	3.4	3.4	3.3	3.1	3.0
Other	2.7	2.7	2.8	2.8	2.8	2.8	2.9
Total, Means-Tested Programs	66.3	69.5	72.3	76.4	78.8	81.5	85.9
Nonmeans-Tested Programs							
Social Security	186.5	197.3	209.3	223.9	239.3	255.7	273.4
Medicare	69.8	72.5	80.2	90.1	100.7	112.5	125.7
Subtotal	256.3	269.8	289.5	314.0	339.9	368.2	399.1
Other Retirement and Disability							
Federal civilian a/	23.1	24.1	25.4	27.2	29.0	31.0	33.1
Military	15.8	17.6	18.3	19.4	20.6	21.8	23.0
Other	5.2	5.1	5.3	5.5	5.6	5.8	6.0
Subtotal	44.0	46.8	49.0	52.0	55.3	58.6	62.1
Unemployment Compensation	17.5	16.4	16.7	16.9	17.0	17.0	17.5
Other Programs							
Veterans' benefits b/	12.9	13.1	13.3	13.6	13.5	13.5	13.8
Farm price supports	17.8	24.7	18.3	20.7	17.5	13.0	10.6
General revenue sharing	4.6	4.4	4.2	4.6	4.6	4.6	4.6
Social services	3.5	4.0	4.3	4.3	4.4	4.5	4.6
Other	17.3	4.9	6.0	6.4	5.5	5.9	5.9
Subtotal	56.0	51.1	46.0	49.6	45.4	41.4	39.5
Total, Non-Means-Tested Programs	373.9	384.2	401.2	432.5	457.6	485.3	518.1
Total Outlays	440.2	453.7	473.6	509.0	536.4	566.5	604.1

SOURCE: Congressional Budget Office.

a. Includes Coast Guard retirement.

b. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

except national defense, net interest, and undistributed offsetting receipts. A large part of this category represents the salary and expense accounts that finance the ongoing operations of the civilian agencies of the federal government; this includes the legislative, judicial, and tax-collecting functions, the conduct of foreign affairs, and the costs of administering Social Security and Medicare. This category also covers most grants to state and local governments, including those for subsidized housing, highways and mass transit, elementary and secondary education, employment and training assistance, and low-income energy assistance. Nondefense discretionary spending, which already has declined to about the same share of GNP as it represented in 1962, falls further throughout the projections period to 3.4 percent of GNP in 1991.

Net Interest

The net interest category principally represents interest costs on federal debt held by the public, including that held by the Federal Reserve System. Interest paid to government trust funds has no effect on net interest outlays, since it is counted both as an expenditure and a receipt. Net interest costs are very sensitive to the assumptions made about future deficits and interest rates. A sustained one percentage-point rise in all interest rates would cause net interest outlays to exceed the baseline by $3 billion in 1986, $10 billion in 1987, and $26 billion in 1991. An increase in the deficit of $10 billion in each fiscal year during the 1986-1991 period would cause net interest to rise by $300 million in 1986, $1.4 billion in 1987, and $5.0 billion in 1991.

Because of declining deficits and interest rates (which are predicated on reaching the deficit targets in the Balanced Budget Act), the baseline projections reflect a slowing in the rate of growth of net interest. As a share of GNP, net interest declines from its 1985-1986 peak of 3.3 percent to 2.7 percent in 1991. Debt held by the public also grows more slowly (see Box II-2 on federal government borrowing and debt) and begins to decline as a percent of GNP after 1988 (as shown in Table II-1). Debt subject to statutory limit will reach its current ceiling of $2,078.7 billion in September 1986.

Offsetting Receipts

Offsetting receipts comprise federal government proprietary receipts from the public that are substracted from outlays rather than included in reve-

BOX II-2

FEDERAL GOVERNMENT BORROWING AND DEBT

The federal government borrows to finance its total deficit--the on-budget deficit less the off-budget surplus. Debt held by the public is the federal government's cumulative borrowing over the years from individuals, banks, and other private investors (including the Federal Reserve System). Each year debt held by the public grows by the amount of the total deficit, with small adjustments for changes in cash balances and other means of financing.

Debt held by government accounts represents holdings of debt by federal government trust funds and other special funds. These holdings grow as the trust funds run surpluses, which are invested in special interest-bearing Treasury securities. The surpluses of the off-budget Social Security trust funds (as well as those of the on-budget trust funds) thus reduce the need to borrow from the public but increase the debt held by government accounts by an equal amount and do not affect gross government debt. The trust funds' debt holdings represent their future claim on the government's cash when the funds' earmarked receipts may--for short or long periods--fall below their spending.

Debt subject to statutory limit is the figure voted by the Congress when raising the federal government's debt issuance authority. It differs from the gross federal debt in excluding a small amount of agency and other debt.

(In billions of dollars)

	1985	1986	1987	1988	1989	1990	1991
Total Deficit	212	208	181	165	144	120	104
Other Means of Financing	15	-2	1	1	1	1	1
Borrowing from the Public	197	210	180	164	143	119	103
Gross Federal Debt							
Held by the public	1,510	1,720	1,900	2,064	2,207	2,326	2,429
Held by government accounts	318	394	461	543	635	744	864
Total	1,827	2,114	2,362	2,607	2,842	3,070	3,293
Debt Subject to Statutory Limit	1,824	2,110	2,358	2,604	2,838	3,067	3,290

nues, as well as certain intragovernmental transactions. Of the $48.8 billion estimated in this category for 1986, $29.1 billion is the federal employer share of employee retirement. Another $5.8 billion consists of premiums paid by enrollees in Supplementary Medical Insurance (Medicare Part B) and by those who do not have sufficient quarters of coverage for Hospital Insurance (Medicare Part A). The next largest item, $5.1 billion, is rents and royalties for leases on Outer Continental Shelf tracts. Other receipts are for the sale or lease of minerals, electric power, and timber. Offsetting receipts are projected to represent 1.1 percent to 1.2 percent of GNP in all years.

REVENUE PROJECTIONS BY MAJOR SOURCE

Baseline revenues (including off-budget revenues) are projected to keep pace with GNP in 1986, increasing by $43.8 billion to $777.8 billion, while remaining at 18.6 percent of GNP. Revenue growth is projected to outpace the economy in 1987 and 1988. Revenues will reach $844.0 billion in 1987, or 18.7 percent of GNP, and $921.0 billion in 1988, or 19.0 percent of GNP. From 1988 through 1991, revenues are projected to grow somewhat more slowly than the economy, totaling $1,143.6 billion, or 18.9 percent of GNP in 1991 (see Table II-9). With only minor changes in economic assumptions and no major new legislation, revised baseline revenues will claim almost the same share of GNP at the end of the projection period as did CBO's projected baseline revenues in August 1985.

The pickup in baseline revenue growth in 1987 reflects the delayed effect of strong corporate profit increases in 1986. Individual income taxes grow slightly faster than the economy throughout the 1987-1991 period, because increases in real earnings push taxpayers into higher tax rate brackets. The 0.72 percentage-point increase in combined employer-employee Social Security tax rates effective in January 1988 underlies the strong revenue growth in 1988. Only personal income and Social Security taxes keep pace with GNP after 1988. By 1991 revenues as a whole grow a bit more slowly than GNP. Personal taxes account for an unprecedented 84 percent of total revenues in 1991, with the share of other taxes continuing to fall below previous levels (see Figure II-5).

BASELINE CREDIT PROJECTIONS

The credit baseline shows the level of new direct loan obligations and primary loan guarantee commitments that, like the baselines for federal spending and revenues, would occur with the continuation of current policies. These credit activities are not accurately measured by the outlay totals discussed previously, which include only loan disbursements net of any repayments and guarantees in the event of default. Consequently, they must be separately measured and analyzed.

TABLE II-9. BASELINE REVENUE PROJECTIONS BY SOURCE (By fiscal year)

Major Source	1985 Actual	1986 Base	Projections 1987	1988	1989	1990	1991
			In Billions of Dollars				
Individual Income	334.5	354.4	384.7	421.8	460.7	500.7	543.0
Corporate Income	61.3	72.2	89.2	100.2	108.0	112.2	113.9
Social Insurance	265.2	280.8	300.9	331.7	355.0	385.2	415.3
Windfall Profit	6.3	4.2	2.0	1.6	1.6	1.5	1.4
Other Excises	29.7	29.1	28.6	27.6	27.2	27.8	28.7
Estate & Gift	6.4	6.1	5.6	5.4	5.1	5.4	5.8
Customs Duties	12.1	12.3	13.6	14.9	15.9	16.9	18.1
Miscellaneous	18.5	18.7	19.4	17.8	17.8	17.7	17.5
Total Revenues	734.1	777.8	844.0	921.0	991.3	1,067.5	1,143.6
On-Budget Revenues	547.9	579.5	630.6	680.3	730.2	780.8	831.7
Off-Budget Revenues	186.2	198.3	213.4	240.7	261.2	286.7	312.0
			As Percents of GNP				
Individual Income	8.5	8.5	8.5	8.7	8.8	8.9	9.0
Corporate Income	1.6	1.7	2.0	2.1	2.1	2.0	1.9
Social Insurance	6.7	6.7	6.7	6.9	6.8	6.9	6.9
Windfall Profit	0.2	0.1	a/	a/	a/	a/	a/
Other Excises	0.8	0.7	0.6	0.6	0.5	0.5	0.5
Estate & Gift	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Customs Duties	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Miscellaneous	0.5	0.4	0.4	0.4	0.3	0.3	0.3
Total Revenues	18.6	18.6	18.7	19.0	19.0	19.0	18.9
On-Budget Revenues	13.9	13.8	14.0	14.1	14.0	13.9	13.8
Off-Budget Revenues	4.7	4.7	4.7	5.0	5.0	5.1	5.2

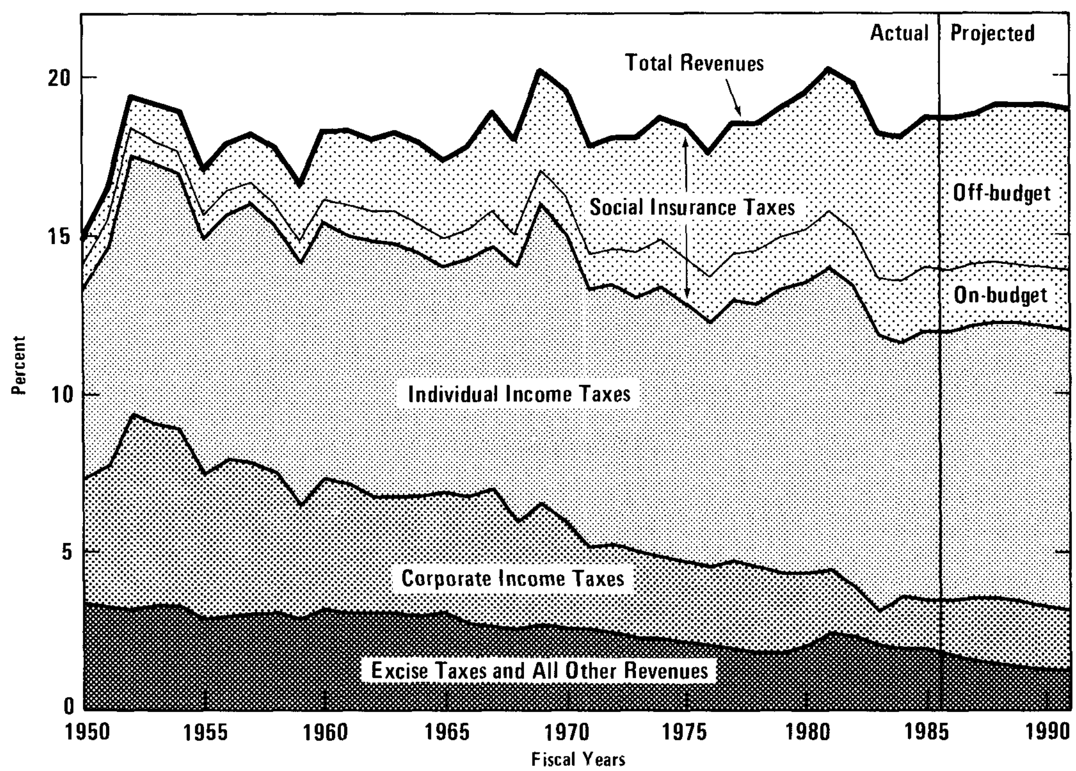
SOURCE: Congressional Budget Office.

a. Less than 0.05 percent.

Credit activity is projected from the limits set in fiscal year 1986, as reduced by the Balanced Budget Act. From this base, loan obligations or commitments for the 1987-1991 period are generally projected to grow at the rate of inflation. For credit programs without appropriation limits, the projections represent CBO's best estimate of loan activity.

Under these baseline assumptions, CBO projects that annual total federal credit activity will decrease from a 1986 base of $138 billion in new direct loan obligations and new primary loan guarantee commitments to

Figure II-5.
Revenues by Source as Percents of GNP



SOURCE: Congressional Budget Office.

$126 billion in 1987, and then grow slowly to $132 billion in 1991 (see Table II-10). The major factor in the decrease between 1986 and 1987 is a drop of $12 billion in primary guarantee commitments by the Federal Housing Administration (FHA). From 1986 through 1991, new direct loan obligations are expected to fall from $43 billion to $34 billion, or about 20 percent. The major areas of reduction are the CCC commodity price support loans and Farmer's Home Administration loan programs. Primary loan guarantee commitments will grow from $94 billion in 1986 to $98 billion in 1991, an increase of 4 percent. Secondary guarantees of the Government National Mortgage Association and the Trade Credit Insurance Fund grow from $55 billion in 1986 to $67 billion in 1991, an increase of 22 percent.

For both direct and guaranteed loans, five budget functions predominate in the totals (see Appendix Table B-3). Direct loans are made mainly for agriculture, commerce and housing, international affairs, veterans' affairs, and education. Housing loan guarantees made by the VA and FHA themselves comprise over 60 percent of total guarantees in any year.

The Balanced Budget Act integrated credit activity into the budget process and made credit activity subject to the act's sequestration orders. While the credit totals shown in Table II-10 better reflect the new lending

TABLE II-10. CBO BASELINE CREDIT PROJECTIONS (By fiscal year, in billions of dollars)

Credit Activity	1985 Actual	1986 Base	Projections 1987	1988	1989	1990	1991
Net Direct Loan Obligations	52.8	42.8	37.5	36.1	35.1	34.1	33.9
Primary Loan Guarantees	84.7	94.4	88.1	91.6	94.7	97.9	97.6
Total	137.5	137.2	125.6	127.7	129.8	132.0	131.5
Secondary Guarantees	54.6	55.3	57.5	59.9	62.3	64.6	67.3

SOURCE: Congressional Budget Office.

activity than do budget outlays, neither the credit budget nor the spending budget adequately measures the economic significance of credit transactions. A better indicator would be the effective loan subsidies provided in any year. For direct loans, the subsidy is the difference between rates charged borrowers on private and government loans that are comparable in other respects. For guarantees, the subsidy is the difference between the cost of the government's guarantee and the fee that would be charged by a private insurer.

CHAPTER III

AUTOMATIC SPENDING REDUCTIONS UNDER THE BALANCED BUDGET ACT

The Balanced Budget and Emergency Deficit Control Act of 1985 (Public Law 99-177) establishes steadily declining deficit targets after 1986, culminating in a balanced budget in fiscal year 1991. The deficit target for fiscal year 1987 is $144 billion. Unless the Congress acts to reduce the deficit to this level before the start of the fiscal year, any excess deficit would be removed by sequestering budgetary resources. The deficit estimates used to implement the act are provided by the Congressional Budget Office (CBO), the Office of Management and Budget (OMB), and the General Accounting Office (GAO). Although the automatic spending reduction provision of the act has been ruled unconstitutional by a federal district court and this ruling may be upheld by the Supreme Court, the sequestration of budgetary resources to achieve deficit targets would remain an option to be used by the Congress under alternative procedures.

Given CBO's February assumptions, total outlays under a 1987 sequestration would have to be reduced to approximately $989 billion, or $37 billion below CBO's baseline estimate. There would be almost no growth in nominal outlay levels beyond CBO's postsequestration 1986 baseline level of $986 billion. For defense programs, new budget authority for 1987 would be limited to $271 billion, which is $30 billion below CBO's baseline projection and $49 billion below the Administration's budget request.

The sequestration procedures for 1987 will begin in August when the CBO and OMB will make their initial budget estimates, either to the Comptroller General or to a special joint committee of the Congress. The CBO estimates presented in this chapter are made for illustrative purposes and are subject to significant revision over the next six months as the result of legislative actions, changes in the economic outlook, and other factors. These estimates show that relying on the sequestration procedures to reach the $144 billion deficit amount specified for 1987 would mean reductions of $18 billion in outlays for defense programs and $17 billion for nondefense programs from CBO projected baseline levels. To achieve these outlay results, defense appropriations for 1987 would have to be reduced by 6.2 percent below 1986 postsequestration levels, and nondefense discretionary appropriations would have to be cut by 8.4 percent. The reductions in real terms would be even greater because of the loss of any adjustments for inflation in 1987.

PROVISIONS OF THE BALANCED BUDGET ACT

The Balanced Budget Act stipulates that budget deficits must be decreased annually and specifies measures that must be taken to achieve this result. The maximum deficit amounts set by the act for fiscal years 1986 to 1991 are (in billions of dollars):

Fiscal Year	Maximum Deficit
1986	171.9
1987	144.0
1988	108.0
1989	72.0
1990	36.0
1991	zero

If the deficit is estimated to exceed the maximum level by any amount in 1986 and 1991, or by more than $10 billion in 1987 through 1990, an automatic spending reduction procedure is triggered to eliminate the excess deficit through the sequestration of budgetary resources. Except for trust and special funds, this involves the permanent cancellation of new budget authority and other authority to obligate and expend funds. For 1986, the outlay reduction is limited by the act to a maximum of $11.7 billion, regardless of the amount of the excess deficit. In later years, the amount of possible outlay reductions is not limited.

The first step in the sequestration process is a joint report by the Director of the Office of Management and Budget and the Director of the Congressional Budget Office to the Comptroller General that:

- Estimates budget base levels, including the amount by which the projected deficit exceeds the maximum deficit amount for the fiscal year covered by the report;

- Provides OMB and CBO economic assumptions, including the estimated rate of real economic growth; and

- Calculates the amounts and percentages by which various budgetary resources must be sequestered in order to eliminate any deficit excess.

If either CBO or OMB projects real economic growth to be less than zero for any two consecutive quarters, or if the Department of Commerce reports actual real growth to be less than 1 percent for two consecutive quarters, many of the provisions of the Balanced Budget Act can be suspended by the Congress, including a sequestration order if it has not already gone into effect.

For fiscal year 1986, the joint OMB/CBO report to the Comptroller General was made on January 15, 1986, and was published in the *Federal Register* on that date. For subsequent years, the Directors will make an initial report on August 20 and a revised report on October 5 to reflect final Congressional action on the budget during the month of September.

The Comptroller General reviews the Directors' reports and issues his own reports to the President and the Congress that confirm or modify the information reported by OMB and CBO. The Comptroller General's reports are the basis for reductions in budgetary resources to be ordered by the President. For fiscal year 1986, the Comptroller General's report to the President was made on January 21, 1986, and was published in the *Federal Register.* For subsequent years, his initial report will be made on August 25 and the revised report on October 10.

The Presidential order to sequester funds specified by the Comptroller General was issued on February 1 for 1986 and will be issued on September 1 for subsequent years. Unless the Congress acts--and the President agrees--to modify the sequestration results by adopting an alternative plan to reduce the deficit, the 1986 reductions will take effect March 1, 1986, and the 1987-1991 reductions on October 1 in those years. Any Congressional action taken during September to reduce excess deficits for 1987 through 1991 will be reflected in a final Presidential order to be issued on October 15.

The constitutionality of the Balanced Budget Act procedures is now under review by the Supreme Court. The District Court for the District of Columbia ruled on February 7 that the role played by the Comptroller General in the sequestration procedures was unconstitutional because the act vests executive power in an officer who can be removed by the Congress. If the Supreme Court upholds the view of the district court, an alternative set of procedures would go into effect. The joint report by the Directors of CBO and OMB would be transmitted to a joint committee of the Congress made up of the entire membership of the House and Senate Budget Committees. This joint committee will report the contents of the CBO/OMB sequestration report in the form of a joint resolution to be passed by both Houses and approved by the President. Upon enactment of the joint resolution, the sequestration of budgetary resources would proceed.

This chapter gives a preview of the August 1986 CBO/OMB report to the Comptroller General or to the joint Budget Committee for fiscal year 1987. The calculations of amounts to be sequestered presented in this chapter use the CBO baseline and alternative economic assumptions discussed in Chapter I, and the baseline budget projections discussed in Chapter II. The August sequestration report will differ to the extent that there are legislative actions during the next six months that affect revenues or outlays, or that there are changes in the economic outlook or in other factors affecting budget estimates. In addition, the August report will use the average of CBO and OMB estimates of key amounts instead of relying solely on the CBO estimates used here for illustrative purposes.

BUDGET BASE LEVELS FOR 1987

The budget base levels of federal revenues and outlays determine the size of the excess deficit and, thus, the amount by which spending must be reduced under the emergency deficit reduction procedures mandated by the Balanced Budget Act. The budget base level estimates are, therefore, a key ingredient in the sequestration calculations.

The act provides that the base be calculated on a somewhat different basis than is used for the CBO baseline projections. The revenue level in the budget base is to be estimated on the assumption that current tax laws continue unchanged, and that expiring provisions will terminate as scheduled except for excise taxes dedicated to a trust fund, which are to be extended at current rates. The outlay level for entitlements or permanent appropriations is also to assume continuation of current law and termination of expiring provisions, except for Commodity Credit Corporation (CCC) price-support programs, which are to be extended at current rates. For annual discretionary appropriations, the outlay base estimates are to include enacted appropriation levels. If appropriations for the fiscal year have not been enacted five days or more before the CBO/OMB reporting dates, the outlay base estimates are to assume appropriations equal to those in force for the previous year with no adjustments for inflation.

CBO estimates of 1987 budget base levels are shown in Table III-1. The base level deficit for a possible 1987 sequestration is estimated at $166.6 billion, using CBO's February economic forecast. Under high-growth alternative economic assumptions, the base level deficit falls to $138.7 billion, which is about $5 billion below the maximum deficit amount specified for 1987. Under these assumptions, the emergency deficit reduction procedures would not be invoked. On the other hand, the base level deficit would climb to $208.1 billion under CBO's low-growth assumptions. These assumptions, however, include a recession in 1987, so that the Congress would have the option of suspending the sequestration procedures.

Changes from Baseline Budget Projections

The 1987 budget base levels shown in Table III-1 include a number of changes from the CBO baseline budget projections discussed in Chapter II. First, they assume termination of expiring provisions of law that were assumed to be extended for the CBO baseline projections. The major item is general revenue sharing, which will terminate at the end of fiscal year 1986 unless the current law is extended. Also, the temporary reduction in federal employees' retirement fund contributions will expire on April 30, 1986. This reduction was assumed to be extended for the CBO baseline projections.

Second, the budget base level estimates for outlays exclude discretionary inflation and other adjustments made to 1986 postsequestration appropriation levels for the CBO baseline projections. These adjustments were made in the CBO baseline to keep program levels constant in real terms, but they would not be included for sequestration calculations. The outlay estimates include proposed pay increases for military and federal civilian employees contained in the President's budget for 1987, which differ somewhat from the CBO baseline assumptions. Finally, net interest costs are adjusted to reflect the changed deficit levels in the budget base. These changes in CBO baseline budget projections are summarized in Table III-2.

TABLE III-1. BUDGET BASE LEVELS FOR THE 1987 SEQUESTRATION UNDER ALTERNATIVE ECONOMIC ASSUMPTIONS (In billions of dollars)

Budget Aggregates	CBO February Forecast	High-Growth Alternative	Low-Growth Alternative
Revenues	844.6	866.4	818.2
Outlays	1,011.2	1,005.1	1,026.3
Deficit	166.6	138.7	208.1

SOURCE: Congressional Budget Office.

Base Level Outlay Estimates

Further detail on the CBO base level outlay estimates for 1987 are provided in Table III-3, which shows that a relatively small portion of 1987 outlays will be affected by the sequestration of budgetary resources. About $172 billion of estimated 1987 outlays for defense programs, or 62 percent of total defense outlays, is associated with budgetary resources subject to an across-the-board percentage reduction. This amount includes $67 billion for military personnel accounts. The special exemption for military personnel accounts made by the President for 1986 will not be permitted in 1987 under the Balanced Budget Act. Outlays for military retirement benefits are included in the nondefense spending category.

TABLE III-2. CHANGES IN CBO BASELINE BUDGET PROJECTIONS TO CALCULATE BUDGET BASE LEVELS FOR SEQUESTRATION (In billions of dollars)

Item	Revenues	Outlays	Deficit
CBO Baseline Projections a/	844.0	1,025.3	181.3
Changes:			
Assume termination of expiring provisions of law:			
General revenue sharing	---	-3.4	-3.4
Federal employee retirement adjustment	0.6	---	-0.6
Exclude discretionary inflation and other adjustments to 1986 appropriation (postsequestration) levels:			
Defense programs	---	-7.5	-7.5
Nondefense programs	---	-2.6	-2.6
Adjust net interest costs	---	-0.6	-0.6
Total changes	0.6	-14.1	-14.7
Budget Base Levels a/	844.6	1,011.2	166.6

SOURCE: Congressional Budget Office.

a. Calculated using the CBO February economic forecast discussed in Chapter I.

TABLE III-3. BASE LEVEL OUTLAY ESTIMATES FOR THE 1987 SEQUESTRATION

Category	Billions of Dollars	Percent
Defense Programs a/		
Subject to across-the-board reduction	171.9	17.0
Other b/	104.6	10.3
Subtotal, defense programs	276.5	27.3
Nondefense Programs		
Programs with automatic spending increases c/	50.3	5.0
Certain special rule programs d/	96.2	9.5
Subject to across-the-board reduction	100.3	9.9
Major exempt programs		
Social Security and Railroad Retirement Tier 1	210.2	20.8
Net interest	144.4	14.3
Earned Income Tax Credit	1.2	0.1
Low-income programs e/	64.9	6.4
Veterans' compensation and pensions	14.4	1.4
State unemployment benefits	15.0	1.5
Offsetting receipts	-52.1	-5.2
Other f/	90.0	8.9
Subtotal, nondefense programs	734.7	72.7
Total	1,011.2	100.0

SOURCE: Congressional Budget Office.

a. Budget function 050, national defense.

b. Outlays from obligated balances.

c. Primarily federal employee retirement and disability programs, including military retirement.

d. Guaranteed student loans, foster care and adoption assistance, Medicare, veterans' medical care, community health, migrant health, and Indian health.

e. Aid to Families with Dependent Children, child nutrition, Medicaid, Food Stamps, Supplemental Security Income, and the Supplemental Feeding Program for Women, Infants, and Children.

f. Outlays from prior-year appropriations, certain prior legal obligations, and small exempt programs.

About $247 billion, or one-third of estimated outlays for nondefense programs, are associated with sequestrable budgetary resources. Of this total, $50 billion is for programs with automatic spending increases, primarily military and federal civilian employee retirement and disability programs. For these programs, the amount of spending reduction required by the act is limited to the cost-of-living adjustments, which are projected generally to be 3.4 percent for 1987. Another $96 billion in nondefense outlays is associated with certain special rule programs, of which the largest is Medicare. The act also limits the extent of spending reductions for these programs to not more than 2 percent in 1987 and future years.

Only $100 billion in 1987 nondefense outlays--about 14 percent--is associated with budgetary resources subject to an across-the-board percentage reduction. About $400 billion, or more than one-half of total estimated outlays for nondefense programs, is exempted from sequestration by the act. As shown in Table III-3, these exempt outlays are mostly for Social Security benefits and net interest costs.

CALCULATIONS FOR THE ILLUSTRATIVE 1987 SEQUESTRATION

The major elements of calculations for the illustrative 1987 sequestration, using CBO's February economic assumptions, are shown in Table III-4. Although the sequestration actually applies to new budget authority and other spending authority, the calculations use outlay estimates to determine the amount of sequestration.

The first step is to divide the amount of excess deficit--$22.6 billion for 1987--into two halves. One-half--$11.3 billion--is assigned to defense programs (budget accounts in function 050) and the other half to nondefense programs.

Second, the total amount of outlay savings from eliminating automatic spending increases is calculated. One-half of the resulting savings for indexed retirement and disability programs is applied to the required reduction in defense programs and one-half to nondefense programs. This amounts to an estimated $1.2 billion for 1987, so that $0.6 billion is subtracted from the $11.3 billion required reduction for both defense and nondefense programs.

Various additional calculations are made for nondefense programs, including the savings that can be obtained by eliminating automatic spending increases in three other specific programs--the National Wool Act, the special milk program, and vocational rehabilitation grants. Also included are savings to be obtained by applying certain special rules for guaranteed student loans, foster care and adoption assistance, Medicare, and certain health programs. These estimated savings amount to another $1.5 billion, which is also subtracted from the required reduction of $11.3 billion in non-defense outlays.

This leaves $10.7 billion for defense programs and $9.2 billion for non-defense programs to be obtained by across-the-board uniform percentage reductions in budgetary resources. The uniform percentages are calculated by dividing these dollar amounts by total estimated 1987 outlays associated

TABLE III-4. CALCULATING THE ILLUSTRATIVE SEQUESTRATION FOR 1987 (Outlays in billions of dollars)

Sequestration Items	Defense Programs	Nondefense Programs
Total Required Reductions	11.3	11.3
Savings from Eliminating Automatic Spending Increases		
Indexed retirement and disability programs	0.6	0.6
Other indexed programs	---	a/
Savings Under Special Rules	---	1.5
Remaining Reduction Required	10.7	9.2
Sequestration Outlay Base	171.9	109.5b/
Uniform Reduction Percentage c/	6.2	8.4

SOURCE: Congressional Budget Office.

a. Less than $50 million.

b. Includes $9.2 billion in estimated 1988 outlays for the Commodity Credit Corporation that can be affected by a 1987 sequestration.

c. Remaining required reductions divided by the sequestration outlay base.

with sequestrable budgetary resources. For defense programs, the sequestrable outlay base is $171.9 billion. For nondefense programs, the base is $109.5 billion, which includes $15.2 billion of 1988 outlays for farm price-support programs that can be affected by the 1987 sequestration. The resulting percentages are 6.2 percent for defense programs, and 8.4 percent for nondefense programs. These percentages are then applied to the new budget authority and other spending authority in the sequestration base.

As noted earlier, the budget base levels and calculations of the sequestration are very sensitive to changes in economic assumptions and other factors. For example, the base level deficit for a possible 1987 sequestration ranges from $139 billion to $208 billion under alternative economic assumptions, as shown in Table III-1. The likely deviation from the $167 billion base level deficit under CBO's February forecast caused by changes in the economic outlook between now and August should be smaller than indicated by this range, but could still be large.

Factors other than changes in the economic outlook can also affect significantly the estimates of outlays and the deficit. For example, the CBO estimates for 1986 outlays were increased by $16 billion between November 1985 and January 1986 because of Congressional actions and technical reestimates of spending. The largest change in 1986 outlay estimates was for agriculture programs, primarily CCC farm price-support programs. The farm bill passed in December added between $2 billion and $3 billion to estimated 1986 outlays, and lower farm commodity prices than assumed earlier led to a sharp upward revision in CBO spending estimates by $7 billion to $8 billion. Similar changes could be made in 1987 CCC outlay estimates in either direction between now and August, if unexpected changes occur in the size of harvests this summer or in farm exports. Another area where major technical reestimates of spending could be made is for defense programs. Reestimates on the order of $3 billion to $4 billion are not uncommon because of changes in spending rates observed in monthly Treasury statements.

For each $10 billion increase in the excess deficit, the uniform reduction percentage for defense programs is increased by about 3.0 percentage points, and for nondefense programs by about 4.5 percentage points, as shown in Table III-5. For example, if the August estimate of the base level deficit were $20 billion higher than the CBO February estimate of $166.6 billion because of such factors as lower revenues and higher interest rates, which do not change the sequestration base, the sequestration percentages would be 12.1 percent for defense programs and 17.5 percent for nondefense programs.