Statement of
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before the
Committee on the Budget
U.S. House of Representatives

January 31, 1990

NOTICE

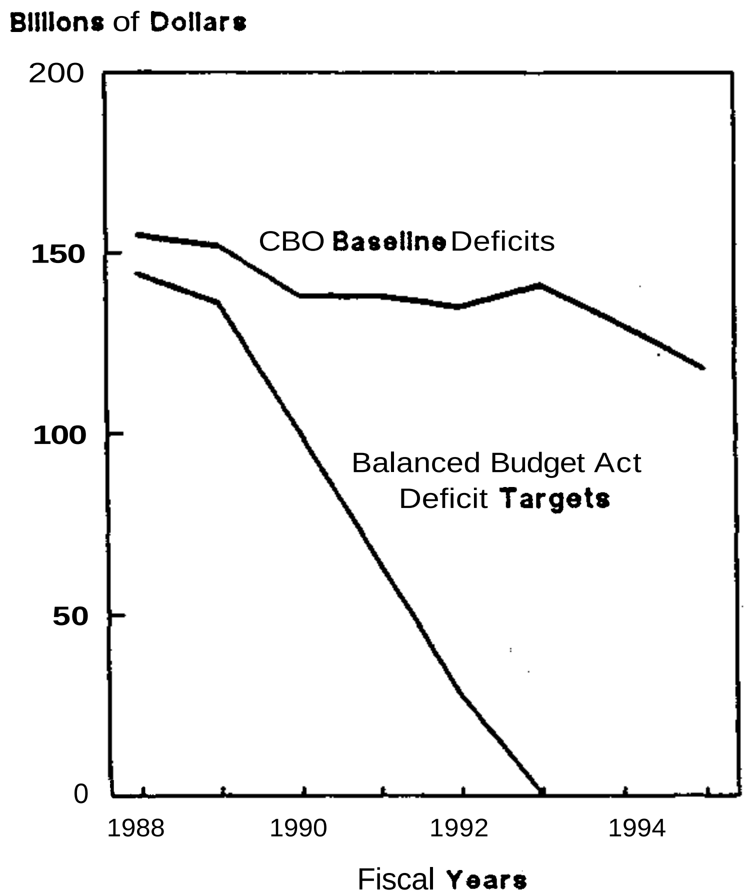
This statement is not available for public release until it is delivered at 1:00 p.m. (EST), Wednesday, January 31, 1990.

Mr. Chairman, I am pleased to appear before the Committee this afternoon to discuss the latest economic and budget projections of the Congressional Budget Office (CBO). These projections are described in detail in the CBO report titled *The Economic and Budget Outlook: Fiscal Years 1991-1995*, which is being released today.

CBO forecasts that the U.S. economy will grow by almost 2 percent in 1990 and slightly faster next year. The restrictive monetary policy that was in force from 1987 through mid-1989 is still tending to slow the economy, as will the tighter fiscal policy slated for 1990. The Federal Reserve began to loosen monetary policy in June 1989, and CBO expects that it will continue to encourage lower interest rates for most of this year. CBO forecasts that this policy will succeed in avoiding a recession in 1990 without boosting inflation.

CBO estimates that the federal budget deficit will fall from $152 billion in fiscal year 1989 to $138 billion in 1990. Over the next few years, no further progress in reducing the deficit can be expected under current budgetary policies. The Balanced Budget Act requires a deficit of $64 billion in 1991 and a balanced budget in 1993. But without spending cuts or tax increases, the deficit in 1993 is likely to be no lower than in 1990. Figure 1 compares CBO's baseline budget projections for 1990 through 1995 with the statutory targets.

Figure 1. Baseline Deficits and Targets



SOURCE: Congressional Budget Office.

CBO expects that the Federal Reserve will safely steer the economy between the shoals of a recession and higher inflation by further reducing interest rates this year. Most private-sector forecasters share this view, and the CBO forecast is close to the consensus for 1990 and 1991, as shown in Table 1. The Bush Administration, however, assumes even more rapid growth than does CBO and almost all private forecasters.

Forecast for 1990 and 1991

CBO forecasts that real gross national product (GNP) will grow 1.8 percent on a fourth-quarter-to-fourth-quarter basis in 1990. This is near the 1989 rate of 2.0 percent, when real GNP is adjusted to exclude the rebound of the farm sector from the previous year's drought. Lower interest rates in 1990 are expected to contribute to slightly faster growth of 2.5 percent in 1991. Short-term interest rates are projected to rise in 1991 as the Federal Reserve moves to head off inflationary pressures.

TABLE 1. COMPARISON OF CBO, *BLUE CHIP*, AND ADMINISTRATION SHORT-RUN ECONOMIC FORECASTS

	Actual 1988	Estimated 1989	Forecast 1990	Forecast 1991
Fourth Quarter to Fourth Quarter (Percentage change)				
Real Gross National Product				
CBO	3.4	2.5	1.8	2.5
Blue Chip	3.4	2.5	1.8	2.4
Administration	3.4	2.7	2.6	3.3
Implicit GNP Deflator				
CBO	4.0	3.9	4.1	4.0
Blue Chip	4.0	3.9	4.0	4.0
Administration	4.0	4.0	4.2	4.1
Consumer Price Index (CPI-U)[a]				
CBO	4.3	4.6	4.1	4.4
Blue Chip	4.3	4.6	4.2	4.2
Administration	4.3	4.4	4.1	4.0
Calendar-Year Averages (Percent)				
Civilian Unemployment Rate				
CBO	5.5	5.3	5.6	5.5
Blue Chip	5.5	5.3	5.6	5.6
Administration	5.5	5.2	5.4	5.3
Three-Month Treasury Bill Rate				
CBO	6.7	8.1	6.9	7.2
Blue Chip	6.7	8.1	7.1	7.2
Administration	6.7	8.1	6.7	5.4
Ten-Year Government Note Rate				
CBO	8.8	8.5	7.8	7.7
Blue Chip[b]	8.8	8.5	7.7	7.7
Administration	8.8	8.5	7.7	6.8

SOURCES: Congressional Budget Office; Eggert Economic Enterprises, Inc., *Blue Chip Economic Indicators* (January 10, 1989); Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; Office of Management and Budget.

NOTE: The CBO forecast does not reflect preliminary 1989 fourth-quarter data for GNP published in January 1990.

a. CPI-U is the consumer price index for all urban consumers.

b. *Blue Chip* does not project a 10-year note rate. The values shown here are based on the *Blue Chip* projection of the Aaa bond rate, adjusted by CBO to reflect the estimated spread between Aaa bonds and 10-year government notes.

The economic forecast assumes further movement toward the Balanced Budget Act (**Gramm-Rudman-Hollings**) target in 1991. Together with declines in long-term interest rates, this shift will reduce the fraction of the economy's real output devoted to personal and government consumption and increase the share going to business and residential investment. Continued depreciation of the dollar will increase real net exports. The increases in investment and net exports mirror a slightly higher national saving rate, which comprises saving by both the private sector and government. Nonetheless, the national saving rate next year will remain well below historical levels.

The CBO forecast envisions little change in inflation. Continued high rates of employment and factory utilization and rising import prices, which tend to increase inflation, will be balanced by slower growth in labor costs stemming from higher productivity growth. The consumer price index (**CPI**) is expected to rise 4.1 percent in 1990 and 4.4 percent in 1991, only slightly below the 1989 rate of 4.6 percent. The implicit GNP deflator is projected to rise 4.1 percent in 1990 and 4.0 percent in 1991, about the same as in the past two years.

The Bush Administration is considerably more optimistic than CBO on the outlook for **noninflationary** growth. The **Administation** forecasts **fourth-quarter-to-fourth-quarter** growth rates that exceed CBO's by 0.8 percentage points in both 1990 and 1991, but its inflation forecast is substantially the same. In addition, the Administration expects both short- and long-term interest rates to be considerably lower in 1991 than does CBO (see Table 1).

While the CBO forecast is close to the consensus of private forecasters, the Administration forecast is not. In the latest *Blue Chip* survey of forecasts for 1991, 36 of the 39 respondents expected real growth to be weaker than the Administration. Of those making interest rate forecasts, over 90 percent expected long-term interest rates to be higher, and all expected higher short-term rates.

Projections for 1992 Through 1995

For 1992 through 1995, CBO's economic assumptions are not a forecast of future economic conditions but are projections based on historical trends. Real GNP is projected to grow at an average annual rate of 2.4 percent, in line with labor force and productivity growth. Inflation and unemployment both hold steady. Interest rates are projected to decline throughout the 1992-1995 period until they reach the historical average of inflation-adjusted rates. CBO's five-year economic assumptions are shown in Table 2.

TABLE 2. COMPARISON OF CBO AND ADMINISTRATION ECONOMIC ASSUMPTIONS, 1989-1995 (By calendar year)

	Estimated 1989	Forecast 1990	Forecast 1991	Projected 1992	Projected 1993	Projected 1994	Projected 1995
Nominal GNP (Billions of dollars)							
CBO	5,235	5,334	5,893	6,279	6,688	7,121	7,579
Administration	5,236	5,583	6,002	6,439	6,881	7,324	7,771
Real GNP (Percentage change year over year)							
CBO	2.9	1.7	2.4	2.5	2.5	2.4	2.4
Administration	3.0	2.4	3.2	3.2	3.1	3.0	3.0
Consumer Price Index[a] (Percentage change year over year)							
CBO	4.8	4.0	4.3	4.3	4.3	4.3	4.3
Administration	4.8	3.9	4.0	3.9	3.6	3.3	3.0
Implicit GNP Deflator (Percentage change)							
CBO	4.2	4.0	4.0	4.0	4.0	4.0	4.0
Administration	4.2	4.1	4.2	3.9	3.6	3.3	3.0
Three-Month Treasury Bill Rate (Percent)							
CBO	8.1	6.9	7.2	6.9	6.5	6.1	5.8
Administration	8.1	6.7	5.4	5.3	5.0	4.7	4.4
Ten-Year Government Note Rate (Percent)							
CBO	8.5	7.8	7.7	7.6	7.5	7.4	7.3
Administration	8.5	7.7	6.8	6.3	6.0	5.7	5.4
Unemployment Rate							
CBO	5.3	5.6	5.5	5.5	5.5	5.5	5.5
Administration[b]	5.2	5.4	5.3	5.2	5.1	5.0	5.0
Tax Bases (Percentage of GNP)							
Wage and salary disbursements							
CBO	2,630	2,795	2,975	3,168	3,377	3,599	3,835
Administration	2,626	2,805	3,022	3,246	3,469	3,686	3,904
Other personal income[c]							
CBO	1,796	1,886	2,001	2,123	2,253	2,385	2,524
Administration	1,798	1,896	2,017	2,138	2,261	2,393	2,525
Corporate profits[d]							
CBO	294	320	356	371	386	414	438
Administration	303	360	421	472	515	548	579

SOURCES: Congressional Budget Office; Office of Management and Budget.

a. Consumer Price Index for all urban consumers.

b. The Administration's projection is for the total labor force, including armed forces residing in the United States, while the CBO projection is for the civilian labor force excluding armed forces. In recent years, the unemployment rate for the former has tended to be 0.1 to 0.2 percentage points below the rate for the civilian labor force alone.

c. Other personal income is personal income less wage and salary disbursements.

d. Corporate profits are book, not economic profits.

In comparison to CBO, the Administration's long-run assumptions are marked by stronger growth, lower inflation, and much lower interest rates. The Administration's projections rest on two major assumptions. First, the Administration assumes that labor productivity will grow at a rate near the post-World War II average. In the 1970s and 1980s, however, the growth of productivity has been substantially below the postwar average, and CBO assumes that productivity will continue to grow at the slower recent rates. Second, the Administration projects that inflation-adjusted long-term interest rates will fall below their historical average. This seems unlikely, however, as long as national saving--both private and government--remains depressed.

Achieving the Balanced Budget Act Targets

America's low saving rate is, of course, the primary reason for reducing the budget deficit. Low saving slows the growth in living standards by reducing the accumulation of productive capital by Americans. The low rate of saving is particularly disturbing because the retirement of the post-World War II baby-boom generation will also cause living standards to grow less rapidly starting in about 2010. A smaller portion of the population will be working then, and what those workers produce will have to be shared--through Social Security and other means--with the relatively large number of retired people. Increasing saving now will help increase the size of the economy over the next 20 years, helping to ease the transition to an older population.

The Administration and others have proposed additional tax incentives for private saving. Reducing the rate of tax on capital gains and expanding tax-advantaged savings accounts, they argue, would increase saving by raising its after-tax return. There is little evidence, however, that saving responds to the size of its return. During the first half of the 1980s, for instance, real interest rates rose sharply compared with the 1970s, marginal tax rates were cut, and several other policy measures were adopted to encourage saving. But the personal saving rate actually fell. Moreover, even if these new proposals did increase private saving somewhat, national saving would not rise unless the higher saving by individuals exceeded the government's loss in tax revenues, and that is not likely. Reducing the budget deficit therefore remains a uniquely promising way of increasing national saving.

In light of the poor performance of the economy in the October-December quarter, some observers have suggested that the Congress may wish to suspend the Balanced Budget Act process. If the rate of real economic growth is less than 1 percent for two consecutive quarters, the Balanced Budget Act provides that the Congress must consider, under expedited procedures, a joint resolution suspending the act. Since the Department of Commerce reported on January 25 that growth in the most recent quarter was at only a 0.5 percent rate, this provision of the act could conceivably apply this year.

The applicability of this provision, however, is far from a foregone conclusion. The fourth-quarter GNP estimate will be revised by the Commerce Department in February, March, and again in July. In recent quarters, revisions to the GNP growth rate have averaged about one-half of a percentage point and have sometimes exceeded a full percentage point. By the time the preliminary estimate of GNP for the January-March quarter is released in April, the estimate for the October-December quarter may no longer be below 1 percent.

Even if growth were to remain sluggish this quarter, the Congress should not rush to suspend **Gramm-Rudman-Hollings**. The appropriateness of calling off the deficit reduction process depends not on the economy's past but on its future. Recent economic weakness has resulted from restrictive monetary policy, which was in force through mid-1989 but has since been reversed. CBO and most private forecasters expect that the economy will soon rebound, and that growth during 1991 will exceed 2 percent. There is no reason why such an economy cannot accommodate deficit reduction reaching up to 1 percent of GNP per year. Moreover, any hint that this country is no longer serious about deficit reduction could have severe repercussions in world financial markets.

THE BUDGET OUTLOOK

The budget baseline shows what would happen if current budgetary policies were continued without change. It is not a forecast of future budget outcomes, since many policy changes will doubtless be made over the next five years. The baseline methodology hews to the rules contained in the Balanced Budget Act. For revenues and entitlement spending, the baseline generally assumes that laws now on the statute books will continue. For defense and nondefense discretionary spending, the projections for 1991 through 1995 are based on the 1990 appropriations, increased only to keep pace with inflation.

Baseline Projections Through 1995

Under CBO's baseline budget projections, the deficit is projected to remain near its 1990 level of $138 billion in 1991 through 1993. The baseline deficit then falls to $130 billion in 1994 and $118 billion in 1995, as shown in Table 3. As a share of GNP, the baseline deficit falls from 2.5 percent in 1990 to 2.4 percent in 1991 and 1.6 percent in 1995.

The Balanced Budget Act calls for a **deficit** of $64 billion in 1991, $28 billion in 1992, and zero in 1993. CBO's 1991 projection of $138 billion exceeds the target by $74 billion. Unless other spending cuts or tax increases were enacted, the act would require eliminating the excess deficit through automatic across-the-board cuts of 19 percent in defense and 28 percent in nondefense programs.

Under the terms of the Balanced Budget Act, however, the Office of Management and Budget (OMB), not CBO, determines whether automatic spending cuts are necessary and how large the cuts must be. Including the Food Stamp program, OMB's baseline deficit for 1991 is

TABLE 3. BASELINE BUDGET **PROJECTIONS**[a]

	1989	1990	1991	1992	1993	1994	1995
			In **Billions** of **Dollars**				
Revenues	991	1,067	1,137	1,204	1,277	1,355	1,438
Outlays	**1,143**	1,205	1,275	1,339	1,418	1,484	1,555
Deficit	152	138	138	135	141	130	118
Deficit **Targets**[b]	136	100	64	28	0	b	b
			As a Percentage of **Gross** National Product				
Revenues	19.2	19.6	19.6	19.5	19.4	19.3	19.3
Outlays	22.2	22.1	22.0	21.7	21.5	21.2	20.8
Deficit	2.9	2.5	2.4	2.2	2.1	1.8	1.6

SOURCE: **Congressional** Budget Office.

a. The budget figures include Social Security, which **is** off-budget but **is** counted for **purposes** of the Balanced Budget Act **targets**. For comparability with the **targets,** the projections exclude the Postal Service, which **is also** off-budget.

b. The Balanced Budget Act **established** targets for 1988 through 1993.

only $101 billion. According to OMB estimates, eliminating an excess deficit of $37 billion would require uniform reductions of 9 percent in defense and 13 percent in nondefense spending.

Economic Assumptions and Budget Projections

The differences between CBO's budget projections and those of the Administration stem largely from differences in economic assumptions. CBO's baseline deficit is flat for several years, then declines slowly, reaching $118 billion by 1995. The Administration, on the other hand, projects a small surplus by 1995, even with no change in policies.

Table 4 divides the differences between Administration current services and CBO baseline budget projections into those resulting from economic and other factors. Because of its projected higher growth rates, the Administration has higher taxable incomes than CBO--and therefore larger tax collections--in all years. In addition, the Administration's lower interest rate assumptions lead to lower federal borrowing costs. For 1991, economic assumptions account for about $26 billion of the $37 billion difference between the Administration and CBO projections. The remaining $11 billion results from higher CBO

TABLE 4. DIFFERENCES BETWEEN ADMINISTRATION CURRENT SERVICES AND CBO BASELINE PROJECTIONS (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
Administration Current Services **Deficit or Surplus**[a]	-122	-101	-74	-41	-15	12
Differences in Economic Assumptions						
Revenues	-1	-19	-36	-54	-64	-63
Interest	b	-7	-18	-29	-39	-50
Other outlays	b	b	b	-3	-8	-15
Subtotal	-1	-26	-55	-85	-111	-128
Technical and Other Differences						
Revenues	-5	b	4	8	17	20
Outlays	-11	-11	-10	-23	-20	-21
Subtotal	-16	-11	-6	-15	-3	-1
Total Differences	-16	-37	-61	-100	-115	-129
CBO Baseline Deficit	-138	-138	-135	-141	-130	-118

SOURCES: Congressional Budget Office and Office of Management and Budget.

NOTE: For comparability with the deficit targets, the projections include Social Security and exclude the Postal Service.

a. The OMB baseline has been adjusted to include Food Stamps and nutrition assistance for Puerto Rico and to exclude the aggregate spendout rate adjustment.

b. Less than $500 million.

outlay estimates for deposit insurance, Medicare and Medicaid, net interest, and other federal programs. By 1995, the difference between the CBO and Administration deficit projections grows to $129 billion, almost all of which is economic. While the Administration's assumptions are within the range of what is possible, CBO believes that its projections represent a more prudent basis for making budget plans for 1991 and future years.

Social Security Projections

The Balanced Budget Act currently includes Social Security in its calculations and makes Social Security subject to the same fiscal discipline as the rest of the budget. From an economic perspective, this approach makes sense. The purpose of reducing the deficit is to increase national saving, which can spur economic growth and capital formation. The federal budget deficit absorbs private saving, thereby impairing the growth of living standards. The annual balance in the Social Security programs affects national saving in exactly the same way as the balance in any other government account.

Thus, the most appropriate measure of the impact of the federal budget on the economy is the total deficit, not any part of it. The total government deficit, including the Social Security and other trust funds, determines the government's fiscal stance, its drain on credit markets, and the amount of saving that it diverts from uses that promote growth in living standards.

Nevertheless, the Balanced Budget Act requires that the Social Security trust funds be shown as off-budget to highlight their contribution to the totals. With income of the trust funds exceeding benefits and other costs, the Social Security surplus grows from $66 billion in 1990 to $128 billion in 1995, as shown in Table 5. An

TABLE 5. ON- AND OFF-BUDGET TOTALS (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994	1995
On-Budget (Excludes Social Security and Postal Service)						
Revenues	779	828	874	924	978	1,037
Outlays	984	1,041	1,095	1,163	1,220	1,283
Deficit	204	212	221	239	242	246
Off-Budget (Social **Security**)[a]						
Revenues	288	309	330	352	376	401
Outlays	222	234	244	254	264	273
Surplus	66	74	85	98	112	128
Total[a]						
Revenues	1,067	1,137	1,204	1,277	1,355	1,438
Outlays	1,205	1,275	1,339	1,418	1,484	1,555
Deficit	138	138	135	141	130	118

SOURCE: Congressional Budget Office.

a. For comparability with the Balanced Budget Act targets, the projections exclude the Postal Service, which ia also off-budget.

increasing amount of this surplus, however, reflects interest payments received from the Treasury. Because these interest payments are merely intragovernmental transfers, they do not reduce the government's need to borrow in the market. Excluding interest, Social Security's contribution to holding down the total deficit looks much smaller--about $50 billion in 1990 and $78 billion in 1995.

Sources of Growth in Spending

Baseline revenues and outlays are both projected to grow by $70 billion in 1991. Table 6 shows that $59 billion of the growth in outlays occurs automatically under current law. These built-in increases stem from such factors as cost-of-living increases and growth of caseloads for Social Security and other retirement and disability programs. Spending for Medicare and Medicaid, two of the fastest growing programs, is driven up by increases in the price of medical care and by the wider use of more expensive medical technologies. Net interest outlays--arguably the least controllable component of spending--are determined by the government's deficit and by interest rates.

Figure 2 illustrates how just three programs contribute half of the growth in spending. Social Security and Medicare account for $29

TABLE 6. COMPONENTS OF CBO BASELINE SPENDING PROJECTIONS (By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995
1990 Level	1,205	1,205	1,205	1,205	1,205
Current Law Increases					
COLAs for entitlement programs[a]	10	25	41	57	74
Increases in price of medical care[a]	4	9	16	24	32
Increases in entitlement program caseloads	7	14	22	30	40
Increases in use of medical care[b]	11	23	36	48	61
Rising benefits for new Social Security beneficiaries[b]	6	10	13	16	20
Expected changes in offsetting receipts	c	-3	-6	-9	-12
Increased interest costs	6	12	20	25	29
Other	14	15	22	16	13
Subtotal	59	105	164	209	257
Inflation Adjustments to Maintain Real Spending for Discretionary Programs					
Defense purchases	3	9	16	24	32
Defense pay	3	8	12	17	22
Nondefense purchases	3	8	15	22	29
Nondefense pay	1	3	5	7	9
Subtotal	11	28	48	70	93
Total Increases	70	134	212	279	350
CBO Baseline	1,275	1,339	1,418	1,484	1,555

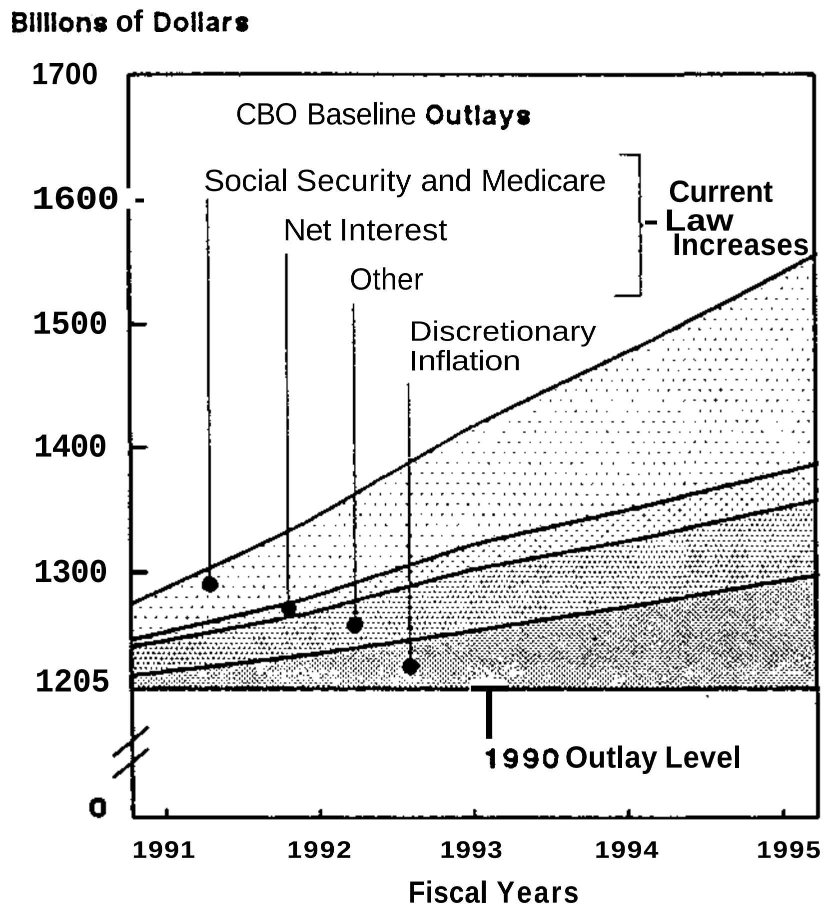
SOURCE: Congressional Budget Office.

a. Represents program growth that could be eliminated by freezing cost-of-living adjustments and certain medical reimbursement rates.

b. All growth not explained by increases in caseloads and prices.

c. Less than $500 million.

Figure 2. Sources of Growth in Outlays



SOURCE: Congressional Budget Office.

billion, or over 40 percent of the growth in 1991. Another $6 billion--almost 10 percent of the growth--is added by net interest. Other increases required under current law total $24 billion. Only $11 billion of the projected increase in spending in 1991 stems from discretionary increases in appropriations that are assumed in the CBO baseline.

The figures in Table 6 permit one to estimate the amount of deficit reduction required by Chairman Panetta's proposed Budget Process Reform Act. Under the Chairman's proposal, the 1991 deficit would have to be reduced by the amount of increases for inflation included in the baseline, plus an additional $10 billion. In the CBO baseline, inflation increases other than Social Security cost-of-living adjustments total about $18 billion. The required deficit reduction in 1991 would therefore total $28 billion, and the resulting deficit would be $110 billion.

Alternative Spending Paths

As noted earlier, the baseline projections for discretionary spending simply adjust the 1990 appropriations to allow for inflation. As a result, the baseline makes no explicit allowance for activities not covered in the 1990 appropriations, such as renewing long-term subsidized housing contracts that are about to expire. Conversely, the baseline for 1991 through 1995 includes money for items that were funded in 1990 but may not be needed in the future, such as the decennial census and hurricane and earthquake relief. Adjusting the baseline for these special situations, however, would have little effect on the totals.

Of greater consequence are the assumptions about defense spending. The CBO baseline assumes that defense appropriations are adjusted fully for inflation, the same treatment that applies to nondefense discretionary spending. Nevertheless, real defense appropriations have been falling since 1985. Many observers assume that future appropriations will similarly fail to match inflation. In their view, large federal deficits will join with reduced East-West tensions to restrain the defense budget.

Table 7 shows two hypothetical paths for defense spending relative to the CBO baseline. The first involves annual real declines in defense budget authority at roughly the rate of the last three years. A 2 percent annual real decline in defense budget authority would generate up to $4 billion in defense outlay savings next year, growing to about $30 billion in 1995, compared with the CBO baseline. Annual real declines of 4 percent double the savings and roughly correspond to a five-year freeze in nominal defense budget authority. This second path would reduce federal spending by $33 billion in 1993 and $68 billion in 1995, including reductions in interest costs. Even if all these savings were devoted to cutting the deficit, however, they would be only a quarter of what is needed to balance the budget in 1993.

Defense cuts of this magnitude would have little short-run economic impact. A 4 percent annual decline in real defense budget authority would cut federal spending by only 0.2 percent of GNP per

TABLE 7. HYPOTHETICAL SAVINGS FROM ALTERNATIVE DEFENSE BUDGET PATHS COMPARED WITH THE CBO BASELINE
(By fiscal year, in billions of dollars)

	1991	1992	1993	1994	1995
2 Percent Annual Real Decline in Budget Authority					
Change in Defense Spending	-4	-9	-15	-22	-30
Change in Interest Spending	a	-1	-2	-3	-5
Total Change in Deficit	-4	-10	-17	-25	-35
4 Percent Annual Real Decline in Budget Authority					
Change in Defense Spending	-8	-18	-30	-43	-57
Change in Interest Spending	a	-1	-3	-6	-10
Total Change in Deficit	-8	-19	-33	-50	-68

SOURCE: Congressional Budget Office.

a. Less than $500 million.

year. Even with larger, more rapid cuts, the Federal Reserve could probably offset the bulk of any temporary loss in real GNP.

The geographical and industrial concentration of defense spending means that the pain of any cutback would not be spread evenly. One key to offsetting the adverse effects is the rate of spending reduction. Gradual cutbacks of the sort portrayed here would provide more time for orderly planning and could avoid some of the adverse effects on specific industries and regions. Gradual cutbacks would also permit companies now heavily involved in defense production to attempt to diversify into nondefense ventures, a difficult task that in the past has met with mixed success.

Changes in the Projections Since August

CBO's new baseline projections reflect all legislation enacted during the first session of the 101st Congress and are based on up-to-date economic and technical estimating assumptions. The new projections differ little from those published in CBO's August 1989 report (see Table 8). Recently enacted legislation has reduced the projected deficits, but in most years these legislative changes are largely offset by economic and technical revisions.

TABLE 8. CHANGES IN CBO BASELINE DEFICIT PROJECTIONS SINCE AUGUST (By fiscal year, in billions of dollars)

	1990	1991	1992	1993	1994
August 1989 Baseline Deficit[a]	141	144	141	143	128
Changes					
Enacted legislation					
Appropriations	-1	4	6	6	6
Reconciliation					
Sequestration	-3	-4	-4	-4	-4
Other	-11	-5	-7	-7	-8
Repeal of catastrophic health insurance	5	1	-2	-2	-2
Other legislation	-1	-1	-1	-1	-1
Debt service	b	-1	-1	-2	-3
Subtotal	-12	-5	-8	-9	-12
Updated economic assumptions					
Revenues[c]	2	-1	b	6	13
Outlays	-3	-8	-10	-14	-19
Subtotal	-1	-9	-10	-8	-6
Technical reestimates					
Revenues[c]	1	b	1	4	4
Farm price supports	-2	b	1	1	1
Deposit insurance	8	2	2	-2	-3
Medicaid and Medicare	1	2	4	5	7
Social Security	1	1	2	2	2
Net interest	2	1	1	3	4
Other outlays	b	1	2	2	4
Subtotal	11	8	13	16	20
Total changes	-3	-6	-5	-2	2
January 1990 Baseline **Deficit**[d]	138	138	135	141	130

SOURCE: Congressional Budget Office.

a. Includes Social Security.

b. Less than $500 million.

c. Revenue decreases are shown with a positive sign because they increase the deficit.

d. Includes Social Security and excludes the Postal Service.

Before adjourning in November, the Congress cleared all 13 regular appropriation bills, adopted a reconciliation bill, and repealed catastrophic health insurance under Medicare. In total, this legislation cut the deficit by an estimated $12 billion in 1990 but by only $5 billion in 1991. The savings shrink in 1991 for two reasons. First, the reconciliation bill contained $7 billion in nonrecurring savings in 1990--$4 billion from accounting changes and timing shifts, such as taking the Postal Service off budget, and another $3 billion from speeding up payroll and certain excise tax collections. Second, the appropriation bills reduced outlays temporarily in 1990 because of $2 billion in receipts from foreign military sales prepayments, which will not be repeated in later years. The appropriation bills actually increased nondefense spending authority and raised outlays in 1991 and later years.

CBO's updated economic assumptions reduce the deficit by $1 billion in 1990, $9 billion in 1991, and similar amounts thereafter. Except for a slightly lower rate of inflation and stronger capital gains on financial assets, the current forecast differs little from last August's. By itself, lower projected inflation reduces baseline outlays and revenues in tandem and has little effect on the deficit. But the robust performance of financial markets increases receipts from taxes on capital gains, which reduce the overall loss in revenues.

All other revisions, termed technical reestimates, boost the deficit by $11 billion in 1990, $8 billion in 1991, and $20 billion in 1994. The 1990 increase is dominated by higher deposit insurance outlays, which result from additional spending for troubled banks, the outlay of money appropriated for savings and loans in 1989 but not spent, and a reduction in receipts from borrowing by the off-budget Financing Corporation. In later years, the technical reestimates arise from various sources. Notably, higher Medicaid outlays add to the deficit by increasing amounts, as spending continues to outstrip previous projections. Projected spending is also higher for Social Security and other benefits, revenues are slightly lower, and debt service costs therefore rise.

HOW WELL HAS THE BALANCED BUDGET ACT WORKED?

In closing, I would like to say a few words about the efficacy of the Balanced Budget Act process. By now, the defects of Gramm-Rudman-Hollings are well known. It has encouraged the use of overly optimistic economic and technical estimating assumptions. It has focused the budget process on a single year and sometimes lost sight of the long-term objective, which is a slow but steady reduction in the federal deficit. It has spawned accounting changes and other gimmicks that give the illusion of deficit reduction without the substance. And it has raised the level of conflict between the Congress and the Administration and within the Congress.

Such criticisms are correct, but they are also incomplete. The deficit reduction effort has been slow and halting, but without the Balanced Budget Act it might have been nonexistent. Five years ago, in February 1985, CBO's baseline deficit projection for fiscal year 1990 was $290 billion. This projection assumed a 5 percent annual increase in real defense spending, which appeared to represent Congressional policy at the time. Today, our estimate of the 1990 deficit is $138 billion. All of that $152 billion drop can be attributed to policy changes, notably lower defense spending, which has fallen in real terms every year since 1985. In fact, deficit reduction actions have exceeded $152 billion, but have been partly offset by changes in economic and technical estimating assumptions.

Without the discipline of deficit targets, would the Congress have been as successful in curbing new spending programs and tax breaks? I doubt it.

Would some other process be more successful in reducing the deficit? Perhaps. Some changes in the budget process might make a small contribution to reducing the deficit. But large budget deficits are not primarily the result of procedural defects. Rather, the process does not function well because profound differences exist over how to reduce the deficit. Real and long-lasting deficit reduction requires making painful political choices. No new budget process can avoid those choices or make them any easier.