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GAO

Report to the Chairman, Committee on Government Operations
House of Representatives

September 1986

BUDGET REDUCTIONS FOR FY 1987

Review of Initial OMB/CBO Report Under the Deficit Control Act

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GAO

United States
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Washington, D.C. 20548

Comptroller General
of the United States

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September 4, 1986

The Honorable Jack Brooks
Chairman, Committee on Government Operations
House of Representatives

Dear Mr. Chairman:

This report is in response to your July 24, 1986, request that we review the Initial Sequestration Report for Fiscal Year 1987, submitted to the Congress jointly on August 20 by the directors of the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) under the Balanced Budget and Emergency Deficit Control Act of 1985 (Gramm-Rudman-Hollings).

Our review suggests a deficit estimate for fiscal year 1987 of $167.6 billion, which is higher than the OMB/CBO average of $163.4 billion. This difference is not great given the overall magnitude of the budget. However, it suggests somewhat higher sequester percentages of 6.7 percent for defense and 9.4 percent for nondefense, compared with 5.6 percent and 7.6 percent, respectively, in the OMB/CBO report. Our estimates are based on the assumptions the Act requires be used in the OMB/CBO report. A number of circumstances—such as enactment of the pending tax bill, a further slowdown in the economy, or the need to provide additional program funds—could cause the deficit to exceed substantially any estimates under the Act. Our review of the OMB/CBO deficit estimate and sequester percentage determinations is discussed in appendix I.

Economic Forecasts and Analyses

For the purpose of this review, we made an independent forecast of the economy. Our forecast assumes real economic growth for fiscal year 1987 of 2.8 percent, slower than CBO's 3.2 percent and substantially slower than OMB's 3.7 percent. We also assume somewhat lower interest rates. For example, we assume that the 3-month Treasury bill rate will average 5.8 percent in fiscal year 1987, while OMB and CBO assume 6.2 and 6.3 percent, respectively.

At our request, CBO estimated the effect of our assumptions on projections of the deficit. Given the uncertainties involved in such projections, the differences between our economic assumptions and the deficit they produce and CBO's economic assumptions and deficit do not justify our producing a third set of account-by-account estimates. For calculations in this report that are sensitive to economic assumptions, we use the CBO relevant information, leads us to conclude that the CBO estimate of total defense outlays, $274.8 billion, is more reasonable, and we use it in our report. We also use CBO's estimate for this report because it is based on historical patterns. We find little evidence to support DOD's assertion that fiscal year 1987 outlays will depart from past trends.

Suggestions have been made that defense outlays can be constrained through special actions to delay selected outlays to the next fiscal year. These include slowing the payment of bills and shifting military payrolls by 1 day to a new fiscal year. Short-term solutions of this type do not contribute to a permanent reduction in the deficit.

On a second issue, OMB and CBO both estimate that $53.3 billion of unobligated balances in DOD will be available for obligation in fiscal year 1987. However, our audit work, including an examination of obligation rates from fiscal year 1980 through the first 8 months of fiscal year 1986, leads us to conclude that these estimates are about $3.5 billion too low.

Federal Pay Increase

OMB and CBO disagree on the proper treatment of the anticipated 1987 federal pay increase. OMB, on the basis of its interpretation of the Act, assumes that the entire increase will be absorbed by the departments and agencies, while CBO assumes that a substantial portion, about $3 billion, will be funded through additional appropriations. CBO's estimate uses the financing assumptions incorporated in OMB's midsession review of the fiscal year 1987 budget, which appears to be the most authoritative statement of the President's current plans for financing the pay increase. Therefore, we use the CBO estimate. The primary effect is an increase in defense program outlays, with a small increase in nondefense outlays as well.

Nondefense Programs

For a number of nondefense programs, our estimates differ from the OMB/CBO average. In the Postal Service, OMB and CBO agree on the amount to be sequestered, but CBO assumes that the sequestration will have no outlay effect. We disagree and use the OMB estimate. In the Maritime Administration's Federal Ship Financing Fund, our audit work leads us to conclude that OMB has significantly underestimated the rapidly rising costs of defaults on ship construction mortgages. We therefore use the CBO estimate, which is about $398 million higher.

Other differences with respect to nondefense programs are relatively small. Some have a modest effect on total outlays. Others affect only the

The OMB/CBO report—and this report—may also significantly underestimate the costs of responding to urgent or unavoidable program requirements, like the unanticipated requirements for additional spending in fiscal year 1986 for defense, agriculture, and financial institutions. For example, OMB assumes that the Commodity Credit Corporation will make no advance deficiency payments in fiscal year 1987 under the farm price-support programs; CBO assumes about \$4.3 billion in such payments. Under current law, this decision is at the discretion of the administration, and we have no basis for choosing one assumption over the other. It is clear, however, that the decision might cause actual outlays, and the deficit, to depart from the estimates in the report by several billion dollars.

Considering these factors, a strong possibility exists that fiscal year 1987 will see significant increases in the deficit beyond the current estimates under the Act. Therefore, further budget reductions or revenue increases will likely be required to achieve the Act's target deficit level of \$144 billion in fiscal year 1987, even if the sequesters estimated in the OMB/CBO report are implemented.

While GAO no longer plays a statutory role in the Gramm-Rudman-Hollings process as a result of the recent Supreme Court decision, we are pleased to provide this analysis in response to your request. (See appendix VI.) We trust that our report will be helpful to the Committee and the Congress.

Sincerely yours,

Charles A. Bowsher
Comptroller General
of the United States

Tables

assumptions. Our economic forecast, the forecasts by OMB and CBO, and our decision to adopt CBO's assumptions are discussed in appendix II.

Lastly, we analyzed a number of individual accounts for which substantial differences exist between OMB and CBO, or for which other evidence available to us called into question the treatment of the account in the initial report. These analyses are discussed in appendix III (defense programs), appendix IV (nondefense programs), and appendix V (entitlements and special rules). The principal conclusions of these analyses are described below. Table 1 summarizes the results of our review as they relate to the OMB/CBO report.

Table 1: Summary of Differences Between the OMB/CBO Report and GAO's Analysis

Dollars in billions

	OMB/CBO report			
	OMB	CBO	Average	GAO
Revenues	$826 4	$827 8	$827 1	$827 8
Outlays	982 6	998 5	990 5	995.3
Deficit[a]	156 2	170.6	163 4	167.6
Maximum deficit under P L 99-177	144 0	144 0	144 0	144 0
Excess deficit	$12.2	$26 6	$19 4	$23 6
Sequestration percentages				
Defense	3 6	7 5	5 6	6.7
Nondefense	4.3	10.9	7 6	9 4

[a]Individual items do not subtract to deficit due to rounding

Defense Outlays and Unobligated Balances

There is a continuing disagreement between OMB and CBO over outlays for defense programs in fiscal year 1987. OMB estimates these outlays at $269.6 billion, while CBO estimates them at $274.8 billion, excluding the cost of the 1987 pay increase.

We continue to be concerned about the inadequacies of the data available as a basis for estimating various elements of the defense budget and for overseeing its execution. These inadequacies, arising from problems in the Department of Defense's (DOD) accounting and budgeting systems, make it difficult to develop reliable estimates for implementing the Act.

We have performed substantial additional audit work during the past few months to develop a more reliable basis for these estimates and plan further work in this area. Our work, together with our review of other extent to which resources are sequestrable and do not change total outlays.

Uncertainties in the Estimates

These estimates—OMB's and CBO's, as well as our own—are based on a complex set of tenuous assumptions. In this regard, it is instructive to recall the history of fiscal year 1986 budget projections. In August 1985 the estimate of the deficit for fiscal year 1986 used by congressional policymakers was about $175 billion. A few months later, that estimate rose to $190 billion, then to $220 billion. It now appears that the deficit for fiscal year 1986 will be in the range of $225 billion to $230 billion, despite the imposition of Gramm-Rudman-Hollings budget reductions to reduce outlays by almost $12 billion.

For fiscal year 1987, the economic forecasts range from modest to robust growth rates. However, the economy is sluggish at present, making its future course very difficult to anticipate. This difficulty, in turn, creates substantial uncertainty about the reliability of revenue and spending estimates that are sensitive to economic conditions.

The pending tax reform bill is another possible source of change in the estimates. Because it has not yet been enacted, the bill's potential effect on fiscal year 1987 revenues is excluded from consideration in the OMB/CBO report. It has been estimated that the tax reform bill, when enacted, may yield an increase in fiscal year 1987 revenues, but these estimates are highly uncertain.

Gramm-Rudman-Hollings requires the assumption that funding levels for most programs for fiscal year 1987 will be the same as appropriations for fiscal year 1986. It will be difficult for the Congress and the President to constrain funding levels consistent with that assumption. For example, in fiscal year 1986 about $4 billion of military personnel costs were covered by the transfer of prior-year unobligated balances from other accounts. This means that the actual appropriation for fiscal year 1986 (and thus the funding level assumed in the reports for fiscal year 1987) is insufficient to cover the true military personnel costs. To avoid a very large reduction in personnel levels in fiscal year 1987, the difference will have to be made up by higher appropriations (relative to those assumed in the reports) or by again transferring balances from other accounts.

Contents

Abbreviations

CBO	Congressional Budget Office
CPI	Consumer Price Index
CPI-W	Consumer Price Index for Urban Wage Earners and Clerical Workers
DOD	Department of Defense
DRI	Data Resources, Inc.
GAO	General Accounting Office
GNP	gross national product
OMB	Office of Management and Budget
RDT&E	Research, Development, Test, and Evaluation
SSI	Supplemental Security Income
VA	Veterans Administration
WMATA	Washington Metropolitan Area Transit Authority

Budget Estimates and Required Reductions

Economic Forecast and Budget Totals

To carry out the Balanced Budget and Emergency Deficit Control Act of 1985, OMB and CBO must make a series of estimates about the economy, the budget totals, the required reductions in outlays, and the sequester percentages needed to achieve those reductions. This appendix summarizes the results of our review of those estimates. Some of the issues that arose during our review are discussed in more detail in other appendixes.

To provide a basis for assessing the OMB/CBO report, we first developed an independent GAO economic forecast and compared it with the forecasts of the other two agencies. Our forecast assumes real economic growth of 2.8 percent, slower than CBO's estimate of 3.2 percent, and substantially below OMB's growth estimate of 3.7 percent. We also assume somewhat lower interest rates. For example, we assume that the 3-month Treasury bill rate will average 5.8 percent in fiscal year 1987, while OMB and CBO assume 6.2 and 6.3 percent, respectively. Overall, however, the differences between our forecast and CBO's are relatively small. Therefore, for the purpose of this review, we use the economic assumptions proposed by CBO. The forecasts are discussed in greater detail in appendix II.

Revenues

Our estimates of revenues, outlays, and the deficit are shown in table I.1, which also shows the comparable figures from the OMB/CBO report. Our estimate of total revenues, $827.8 billion, is the same as CBO's, reflecting our use of the CBO economic assumptions. As required by the Act, the revenue estimates are based on current law; thus, they do not include any changes that may occur if the pending tax legislation were to be enacted.

Outlays

Our estimate of total outlays is $995.3 billion. This figure reflects several differences from the OMB/CBO report. In summary, these are as follows:

- We believe the CBO estimate of total defense outlays is more accurate than OMB's and more likely to approximate actual outlays in fiscal year 1987 than the OMB/CBO average.
- We believe that a portion of the cost of the 1987 pay raise, as estimated by CBO, should be included in the estimates.
- Our review of the Act's requirements and our adoption of the CBO economic assumptions suggest different estimates for some entitlement programs.

- Each of these changes alters the estimate of the outstanding debt and thus of the net interest estimate.

These differences are discussed further in a later section of this appendix.

Deficit

Using our estimates of revenues and outlays, the estimated total budget deficit for fiscal year 1987 is $167.6 billion. We stress that this estimate is based on the assumptions that the Act requires be used in the OMB/CBO report. A number of circumstances, such as enactment of the pending tax bill, a further slowdown in the economy, or the need to provide program funds beyond those that have been assumed, could cause the deficit to be substantially different from the amount estimated in this report.

Table I.1: Fiscal Year 1987 Revenues, Outlays, Deficit, and Required Reductions

Dollars in billions

	OMB/CBO report			
	OMB	**CBO**	**Average**	**GAO**
Total budget revenues	$826 4	$827 8	$827 1	$827.8
Total budget outlays	982 6	998 5	990.5	995 3
Budget deficit[a]	156.2	170 6	163 4	167 6
Maximum deficit under P L 99-177	144 0	144 0	144 0	144 0
Excess deficit	**12.2**	**26.6**	**19.4**	**23.6**
Required outlay reductions				
Defense	6 1	13 3	9 7	11 8
Nondefense	6 1	13 3	9 7	11 8

[a]Individual items do not subtract to deficit due to rounding

Required Reductions in Outlays

The Act requires that the full amount of the excess deficit be eliminated in fiscal year 1987 if the estimated deficit exceeds the Act's $144 billion target by more than $10 billion. Using our estimates, the amount of the required outlay reductions would be $23.6 billion. These computations are illustrated in table I.1.

Half the needed reductions are required to be made in defense programs and half in nondefense programs. Accordingly, the required reductions in defense and nondefense programs would each be $11.8 billion.

Required reductions must be taken from a limited portion of the budget. Table I.2 shows the distribution of the budget between those elements subject to reduction and those that are exempt.

Table I.2: Base-Level Outlay Estimates for Fiscal Year 1987

Dollars in billions

	OMB/CBO report				GAO	
Category	**OMB**	**CBO**	**Average**	**Percent of total**	**Estimate**	**Percent of total**
Defense programs[a]						
Subject to across-the-board reduction	$164 3	$173 6	$169 0	17 1%	$173 7	17 5%
Exempt from sequestration[b]	105 3	104 0	104 6	10 6	103 8	10 4
Subtotal, Defense programs	269 6	277 6	273 6	27 6	277 5	27 9
Nondefense programs						
Subject to sequestration						
Programs with automatic spending increases[c]	49 1	48 4	48 8	4 9	48 8	4 9
Certain special rule programs[d]	86 3	86 5	86 4	8 7	85 6	8 6
Subject to across-the-board reduction[e]	94 2	97 8	96 0	9 7	96 6	9 7
Subtotal, subject to sequestration	229 6	232 7	231 1	23 3	231 0	23 2
Exempt from sequestration						
Social Security	204 3	204 3	204 3	20 6	204 3	20 5
Net interest	139 1	138 3	138 7	14 0	138 9	14 0
Earned income tax credit	1 2	1 3	1 3	0 1	1 3	0 1
Low-income programs[f]	61 8	63 6	62 7	6 3	63 4	6 4
Veterans' compensation and pensions	14 2	14 1	14 2	1 4	14 2	1 4
State unemployment benefits	14 8	14 5	14 7	1 5	14 5	1 5
Offsetting receipts[g]	−51 5	−51 4	−51 5	−5 2	−51 5	−5 2
Other[h]	99 4	103 4	101 4	10 2	101 6	10 2
Subtotal, exempt from sequestration	483 4	488 2	485 8	49 0	486 7	48 9
Subtotal, nondefense programs	713 0	720.9	716 9	72 4	717.8	72 1
Total	**$982.6**	**$998.5**	**$990.5**	**100.0%**	**$995.3**	**100.0%**

[a]Budget function 050 excluding Federal Emergency Management Agency programs

[b]Largely outlays from obligated balances

[c]Primarily federal employee retirement and disability programs

[d]Guaranteed student loans, foster care and adoption assistance, Medicare, veterans' medical care, and other health programs

[e]Excludes 1988 outlays in the Commodity Credit Corporation, $11 7 billion in the GAO estimate

[f]Aid to Families with Dependent Children, child nutrition, Medicaid, food stamps, Supplemental Security Income, Special Supplemental Food Program for Women, Infants, and Children

[g]Offsetting receipts and collections are not subject to reduction under the Act, although outlays from collections from nonfederal sources credited to accounts are subject to reduction

[h]Outlays from prior-year appropriations, certain prior legal obligations, and small exempt programs

Automatic Spending Increases

We agree with OMB and CBO that increases in outlays due to changes in indexes for programs listed in section 257(1) of the Act—such as military and civilian retirement programs—are required to be reduced to zero. For programs listed in section 257(1)(A), we estimate that this requirement will reduce outlays by $439.1 million. Half this amount ($219.6 million) would be credited to the required reduction in defense programs and half to nondefense programs.

Of the programs listed in section 257(1)(B) of the Act, it appears that only spending under the National Wool Act will automatically increase. The elimination of this increase, which is estimated to be $6.8 million, would be credited to the required reduction in nondefense programs.

Appendix V discusses the outlay savings from reducing automatic spending increases and reasons for differences from the OMB/CBO report.

Remaining Reduction—Defense Programs

After crediting the savings from eliminating automatic spending increases, our estimate of the remaining required reduction for defense programs would be $11.6 billion. The outlays from new budget authority and unobligated balances in defense programs are estimated at $173.7 billion. To achieve our estimate of the required reduction in outlays in defense programs, it would be necessary to reduce new budget authority and unobligated balances by 6.7 percent in each account. Table I.3 shows these computations and compares them with the OMB/CBO report. Our results differ from the OMB/CBO report's figures primarily because of our higher estimate of the excess deficit. In addition, our figures reflect differing estimates of the sequester base for certain accounts, as discussed in appendix III.

Table I.3: Computation of Defense Percentage Reduction

Dollars in billions

	OMB/CBO report			
	OMB	CBO	Average	GAO
Total reduction required	$6 1	$13 3	$9 7	$11 8
Reductions from automatic spending increases	0 1	0 2	0 2	0 2
Remaining reduction required[a]	5 9	13 1	9 5	11 6
Outlays from sequestrable budget resources	$164 3	$173 6	$169 0	$173 7
Percentage reduction	**3.6**	**7.5**	**5.6**	**6.7**

[a]Numbers do not subtract due to rounding

Remaining Reduction—Nondefense Programs

After crediting our estimate of the appropriate savings from eliminating automatic spending increases, the remaining required reduction for nondefense programs would be $11.6 billion.

The Act provides special rules that limit outlay reductions in certain programs, the largest of which is Medicare. The application of these rules is estimated to reduce fiscal year 1987 outlays by a total of $1.4 billion, as discussed in appendix V.

After applying the special rules, we estimate that the outlay reduction required in the remaining nondefense programs would be $10.2 billion. Outlays from sequestrable resources are estimated at $108.3 billion. To achieve the needed reduction in these outlays, sequestrable budgetary resources would need to be reduced by 9.4 percent. This reduction differs from that of the OMB/CBO report primarily because of our higher estimate of the excess deficit. In addition, it reflects differences in the sequester base for certain accounts, as discussed in appendix IV. Table I.4 shows how the nondefense reductions were computed and compares them with those of the OMB/CBO report.

Table I.4: Computation of Nondefense Percentage Reduction

Dollars in billions

	OMB/CBO report			
	OMB	**CBO**	**Average**	**GAO**
Total reduction required	$6 1	$13 3	$9 7	$11 8
Reduction from automatic spending increases	0 1	0 2	0 2	0 2
Reduction under special rules	1 3	1 4	1 4	1 4
Remaining reduction[a]	4.6	11 7	8 1	10 2
Outlays from sequestrable budget resources	$108 4	$107 0	$107 7	$108.3
Percentage reduction	**4.3**	**10.9**	**7.6**	**9.4**

[a]Numbers do not subtract due to rounding

Required Reductions by Department and Agency

Our estimates of the sequestrations of various types of budgetary resources by cabinet departments and major agencies, and of the resulting outlay savings, are summarized in table I.5.

Table I.5: GAO's Estimates of Required Sequestrations by Department and Agency

Dollars in billions

Department or other unit	Spending[a] authority	Direct loan obligations	Loan guarantees	Estimated outlays
Legislative branch	$0 2	$ •	$ •	$0 1
Judiciary	0.1	•	•	0 1
Executive Office of the President	(b)	•	•	(b)
Funds appropriated to the President	1 3	0 5	(b)	0 6
Agriculture	2 6	2.2	1 0	2 7[c]
Commerce	0 2	•	(b)	0 1
Defense—military	22.6	•	•	11 3
Defense—civil	0 5	•	•	0 4
Education	1 3	(b)	•	0 3
Energy	1 1	•	•	0 5
Health and Human Services	3 3	(b)	•	2 8
Housing and Urban Development	1.4	0 1	29 8	0 2
Interior	0 6	(b)	(b)	0 5
Justice	0 4	•	•	0 3
Labor	0.7	•	•	0 3
State	0 3	(b)	•	0 2
Transportation	2 9	(b)	(b)	0 6
Treasury	0 6	•	•	0 5
Environmental Protection Agency	0 4	(b)	•	0 1
General Services Administration	0 1	•	•	(b)
National Aeronautics and Space Administration	0 7	•	•	0 5
Office of Personnel Management	0 4	•	•	0 4
Small Business Administration	(b)	0.1	0 4	(b)
Veterans Administration	0.5	(b)	3 6	0 4
Other independent agencies	0 9	0.2	1 1	0 7
Total	**$43.1**	**$3.1**	**$35.9**	**$23.6**

[a]Includes new budget authority For defense programs, includes unobligated balances For nondefense programs, includes obligation limitations and certain other forms of spending authority

[b]Less than $50 million

[c]Includes $1 1 billion in estimated 1988 outlay savings for the Commodity Credit Corporation

Differences Affecting Total Outlays

Our estimates of total outlays, and thus of the deficit, reflect several differences from the OMB/CBO report. These are summarized in table I.6 and discussed below.

Table I.6: Summary of Differences Affecting Total Outlays

Dollars in billions

	Total Outlays
OMB/CBO report (average)	**$990.5**
GAO differences:	
Federal pay increase	1.5
Other defense outlays	2 5
Appropriated entitlements	0 3
Other nondefense outlays	0 2
Effect of economic assumptions	0 2
Total GAO differences[a]	**4.8**
GAO estimate of total outlays	**$995.3**

[a]Numbers do not add due to rounding

Department of Defense

There is a continuing disagreement between OMB and CBO over outlays for defense programs in fiscal year 1987. OMB estimates these outlays at $269.6 billion, while CBO estimates them at $274.8 billion, excluding the cost of a pay increase, which is discussed separately in the next section.

We continue to be concerned about the inadequacies of the data available as a basis for estimating various elements of the defense budget and for overseeing its execution. These inadequacies, arising from problems in DOD's accounting and budget systems, make it difficult to develop reliable estimates for implementing the Act.

We have performed substantial additional audit work during the past few months to develop a more reliable basis for these estimates and plan further work in this area. This work, together with our review of other relevant information, leads us to conclude that the CBO estimate of total defense outlays, $274.8 billion, is reasonable. We also use CBO's estimate for this report because it is based on historical patterns. We find little evidence to support DOD's assertion that fiscal year 1987 outlays will depart from past trends. Our analysis of defense outlays is discussed further in appendix III.

Federal Pay

OMB and CBO disagree over the estimated outlays that will flow from the increase in federal pay rates anticipated for 1987. While both agree on the percentages by which pay rates will increase (4 percent for military and 2 percent for civilian), OMB assumes that all costs will be absorbed by the departments and agencies, and CBO assumes only partial absorption. On this basis, CBO estimates outlays from new budget authority of $3 billion.

The difference between the estimates of CBO and OMB with respect to pay raises is due to different interpretations of the language of Public Law 99-177. The Act requires OMB and CBO to assume that federal pay adjustments for statutory pay systems "will be as recommended by the President." OMB does not consider that language to authorize inclusion of any new resources for pay raises unless those pay raises have actually been enacted into law. CBO considers the language to apply both to the determination of any increase in federal pay and to the calculation of resources necessary to meet those increases. CBO's estimate is based on OMB's midsession review of the budget, issued on August 6, 1986, 14 days before the OMB/CBO report. We agree with CBO that the midsession review is an appropriate basis for the estimates under the Act, and we have adopted the CBO estimate.

Federal Ship Financing Fund

OMB and CBO disagree over total estimated outlays for this fund. We agree with CBO's estimate of loan default rates. Consequently, we estimate that total outlays will be $523.6 million. This issue is further discussed in appendix IV.

Entitlement and Special Rule Programs

Our estimates of outlays for several of these programs are materially higher than the average of the OMB and CBO estimates because of the way we treated appropriated entitlements and because we adopted CBO's economic assumptions. These differences are discussed in appendix V.

Net Interest

Our estimate of net interest outlays, $138.9 billion, differs from the average of the OMB and CBO estimates because it reflects the effect on the deficit (and thus on the outstanding debt and the cost of carrying that debt) of the revenue estimates we have adopted and of the changes in estimated program outlays discussed earlier.

Differences Affecting Sequestrable Resources

Most of the differences affecting total outlays also affect the outlays from sequestrable resources. The only exceptions are those involving exempt accounts, such as net interest and outlays resulting from prior legal obligations, and those involving programs subject to special rules. In addition, however, we identified several differences that affect outlays from sequestrable resources. These are summarized below and discussed in more detail in the respective appendixes.

- Department of Defense. In estimating unobligated balances from prior-year appropriations, OMB and CBO adopted the estimates that supported the President's budget for fiscal year 1987, less the reductions imposed by the fiscal year 1986 sequester order. On the basis of our analysis of DOD's estimates, we believe the OMB/CBO estimate is too low. Our review of obligation rates from fiscal year 1980 through the first 8 months of fiscal year 1986 leads us to an estimate of unobligated balances that is higher by about $3.5 billion. Appendix III discusses the reasons for these differences and identifies the affected accounts.
- Postal Service. OMB and CBO disagree on whether reductions of budgetary resources of the Postal Service Fund will result in outlay savings. We agree with OMB that outlay savings should result from a sequester applied to $1.2 billion in Postal Service Fund budgetary resources. (See appendix IV.)
- WMATA and similar programs. OMB and CBO disagree on whether the federal interest payments to the Washington Metropolitan Area Transit Authority (WMATA) and two other federal interest subsidy programs are subject to reduction. We agree with CBO that these programs are not the types of expenditures that the drafters of the Act appear to have intended to subject to sequester. However, we conclude, as does OMB, that none of the existing exemptions in the Act cover these programs and that they are subject to sequester. (See appendix IV.)
- VA policy loans. OMB and CBO disagree on whether loans to Veterans Administration (VA) insurance policyholders are exempt. We agree with CBO that they are exempt as prior legal obligations of the government. (See appendix V.)

Economic Assumptions

Projections of the federal deficit are based on forecasts of those economic variables that influence federal revenues and outlays. Thus, a necessary part of any review of the deficit projections of OMB and CBO is a review of the economic assumptions upon which they are based. This appendix outlines the process we followed in reviewing the OMB and CBO assumptions; the conclusions we reached; and the implications for revenue, outlay, and deficit projections.

We performed our review by developing our own set of economic assumptions for fiscal year 1987 and comparing our assumptions with those adopted by OMB and CBO. In certain important respects, our assumptions are less optimistic than either OMB's or CBO's. For instance, we assume that real economic growth in fiscal year 1987 will be 2.8 percent, whereas CBO assumes 3.2 percent and OMB assumes 3.7 percent. On the other hand, we are more optimistic than the other two agencies about interest rates. We assume that the 3-month Treasury bill rate will average 5.8 percent in fiscal year 1987, whereas OMB and CBO assume it will average 6.2 percent and 6.3 percent, respectively. Taken as a whole, our view of the economy appears to correspond more closely to that of CBO than to that of OMB.

We asked both OMB and CBO to estimate the budgetary effect of using our economic assumptions. We were unable to obtain such an estimate from OMB. CBO estimates that our assumptions would reduce fiscal year 1987 revenues by $5.5 billion from the level it projects using its economic assumptions. Primarily as a result of the lower interest rates, CBO estimates that our assumptions would reduce fiscal year 1987 outlays by $2.2 billion. Thus, using all of the other assumptions that CBO employed in preparing its estimates for the joint OMB/CBO report, but substituting our economic assumptions for CBO's, would increase CBO's fiscal year 1987 deficit projection by $3.3 billion.

Given the uncertainties involved in projecting both the economy and the deficit, we do not view the differences between our economic assumptions and the deficit they produce and CBO's economic assumptions and deficit to be significant enough to justify our producing a third set of account-by-account estimates. The difference between our view of the economy and the view adopted by OMB is greater, and we do not know what OMB's deficit estimate would be using our assumptions. Thus, for those calculations in this report that are sensitive to economic assumptions, we have decided to use the CBO assumptions.

How We Developed Our Forecast

In order to review OMB's and CBO's economic assumptions, it was necessary for us to develop an independent judgment of the most likely future course of the economy. We decided not to select any one particular individual's or organization's forecast as the standard against which to evaluate the OMB and CBO forecasts. History suggests that it is unreasonable to expect absolute accuracy in the economic projections of any individual or organization and that any forecast will prove inaccurate, at least to some degree. Experience also suggests that it is unreasonable to assume that a forecaster, or forecasting technique, that produces the most accurate forecast for one particular year will necessarily produce the most accurate forecast for a subsequent year.

Mindful of these inherent forecasting limitations, we decided that the most effective method for developing an independent view of future economic events would be to develop on our own a forecast that reflects a consensus of the views of experienced private-sector forecasters. Accordingly, we organized a panel of outside experts and worked closely with them to develop a GAO economic forecast.

We began by assembling, both for our own use and for the panel's use, information on current economic conditions. In addition, we asked three leading economic consulting firms—Data Resources, Inc. (DRI); Chase Econometrics, Inc.; and Wharton Econometric Forecasting Associates, Inc.—to supply us with their best estimates of economic conditions in 1987,[1] assuming that the targets specified in the Balanced Budget Act were achieved. We also asked each of the panel members to supply us with his own individual forecast.

On the basis of this work, we developed a tentative economic forecast that we distributed to the panel members along with summaries of the other information we had gathered. The panel convened in late July in Washington, reviewed the information we had given it, and gave us its suggestions for modifying our tentative forecast. The GAO forecast incorporates the suggestions we received and the latest economic data available to us early in August.

The GAO Forecast

Our forecast assumes that real economic growth will continue at a moderate pace through the end of fiscal year 1987. Specifically, we assume that the growth rate for real GNP in both fiscal year 1986 and fiscal year

[1] Throughout this appendix, years are calendar years unless otherwise indicated

1987 will be 2.8 percent. Our forecast is based on several important general assumptions, including

- that the total deficit targets contained in the Balanced Budget Act are achieved;
- that Federal Reserve monetary policy is accommodative, permitting monetary aggregates and interest rates to be consistent with moderate economic growth and no substantial acceleration of inflation;
- that despite short-run volatility, the average level of oil prices over the next 5 calendar quarters will be close to their level in late July; and
- that tax reform following the basic outlines being discussed in late July will be enacted this fall.

Components of Final Demand

Our forecast of GNP growth embodies the following assumptions about the major components of aggregate demand.

Consumption

Our forecast assumes that consumption spending will grow more slowly in fiscal year 1987 than it did in the Commerce Department's most recent estimates for the 4 quarters ending in June 1986 but that consumption will continue to grow more rapidly than GNP. Our assumption about continued strength in consumption is consistent with several positive developments:

- Current estimates are that real disposable personal income grew at an annual rate of 6.9 percent in the first half of 1986 and that real total net worth grew at an annual rate in excess of 10 percent in the 2 quarters ending in March 1986 (the most recent data now available), providing the basis for continued strength in consumption spending.
- Revised estimates released in July suggest that the personal saving rate was not as low in 1985 and early 1986 as had been thought previously, quieting fears that consumers would reduce spending.
- Both the University of Michigan and the Conference Board indexes of consumer sentiment are quite high. The July figure in the Michigan survey is down somewhat from June, but the June figure is 2.9 percent above a year ago, while the July level is 4.1 percent above a year ago. The June survey also shows record high sentiment in favor of purchases of automobiles, large household durables, and houses.

Business Fixed Investment

Our forecast assumes that real business fixed investment will recover a little following its decline in the first half of 1986, but not by enough to lift the constant dollar level in fiscal year 1987 above the fiscal year 1986 level. The declines in the first half of 1986 appear to be largely the result of developments in the mining and petroleum industries and in the computer equipment market. While we are assuming that these declines are behind us, we do not assume very much growth. This rather pessimistic assessment is based on factors such as the following

- the current low rate of capacity utilization, which was estimated at 78.9 percent for the second quarter of 1986.
- the results found in recent surveys of business capital spending plans. The April/May Commerce Department survey of investment anticipations projected a 1.3 percent real decline for 1986. The McGraw-Hill spring survey revealed plans by business to cut its real spending by 4.2 percent in 1986 (and a further decline in 1987, although the survey is less reliable the longer the horizon).
- the expectation that tax reform will increase effective tax rates on most real estate investment and the persistence of high office vacancy rates in many parts of the country.

The investment outlook does contain some positive factors. In particular, the decline in interest rates should make capital spending more attractive. Nonetheless, we assume that these positive factors will be too weak to offset fully the drop in business investment that occurred in the first half of 1986.

Housing

Our forecast assumes that housing investment will continue to grow through the end of 1986 but will level off in real terms thereafter. According to the Commerce Department's August estimates, residential investment grew by 9.8 percent between the second quarter of 1985 and the second quarter of 1986. In large measure, this growth is in response to a drop of 170 basis points in the new-home mortgage rate during this same period of time. So far in 1986, prices of new and existing homes have been rising faster than the consumer price index (CPI). However, the decline in mortgage rates has more than offset any housing price increases so that conventional measures show new housing to be more affordable today than it was a year ago.

Our forecast assumes continued strength in single-family housing. We also assume, however, that investment in multifamily housing will be somewhat weaker. New multifamily housing starts declined in the second quarter of 1986. Considering the rising vacancy rates in many parts of the country and the prospects that tax reform will reduce the incentive to invest in such housing, we are assuming that the weakness in the multifamily sector will continue.

Inventories

Historically, inventory investment has been quite volatile and difficult to predict, and current estimates of inventory-to-sales ratios give no indication of impending sharp increases or declines in inventory investment. Our forecast therefore assumes that inventory investment will continue at roughly the same level as it has in the recent past.

Government Purchases

In accordance with our fiscal policy assumption, our forecast assumes that real federal government expenditures for goods and services will decline in fiscal year 1987. Current Commerce Department estimates show real state and local government purchases of goods and services increasing 4.0 percent between the second quarter of 1985 and the second quarter of 1986. Our forecast assumes continued growth in real state and local purchases but, partially in response to declines in federal grants-in-aid, we assume a slight decline in the rate of growth.

Net Exports

Forecasting net exports is particularly difficult at this time. Since February 1985, the dollar has fallen by about 35 percent against the major European currencies and the Japanese yen. Most forecasters expect that, sooner or later, the decline in the value of the dollar will lead to improvements in net U.S. exports. However, the current data show real net exports continuing to decline, although at a decreasing rate.

The recent continued deterioration in net exports may be due to any of several factors. For one thing, although the dollar has fallen against the currencies of many of our important trading partners, it has either not changed or risen in value against the currencies of other trading partners, including Canada and Mexico (our largest and third largest trading partners, respectively) and many of the Pacific rim countries now becoming industrialized. In addition, it may take a little longer than some had thought before relative prices change and domestic and foreign buying decisions adjust to the change. Finally, it appears that the most recent data may overstate our trade deterioration; a significant part of the deterioration in the second quarter of 1986 can be attributed to a bulge in petroleum imports that most observers expect to be temporary.

Taking into account all these factors, we decided to assume a moderate improvement in the net export component of GNP. Our assumption lies between the net export trends expected by the optimists and those expected by the pessimists.

Interest Rates

Our forecast assumes that the Federal Reserve will be able to supply sufficient liquidity to accommodate moderate growth without jeopardizing its inflation and exchange rate constraints. Therefore, we assume that 3-month Treasury bill rates during fiscal year 1987 will average roughly the same level as prevailed in early August 1986. Our forecast also assumes that the bond markets will lower their expectations about future short-term interest rates and, as a result, that the yield curve will be somewhat flatter in fiscal year 1987 than it was in 1985 and early 1986. Thus, given our assumption that short-term interest rates remain largely unchanged, we assume that long-term bond rates will be lower.

Income Shares

Our assumption about aggregate wage and salary disbursements is built from assumptions about compensation trends and from assumptions about employment trends that were derived from our forecast of GNP. In our forecast, wage and salary disbursements rise slightly as a percent of GNP. Our forecast assumes they will average 49.4 percent of GNP in fiscal year 1987, whereas current estimates show them averaging 49.2 percent of GNP in the 4 quarters ending in June 1986.

Our forecast assumes that corporate profits (with the inventory valuation adjustment and the capital consumption adjustment) will average 7.4 percent of GNP, 0.4 percentage points higher than the ratio prevailing in the second quarter of 1986, according to the Commerce Department's August estimate. We are assuming that the decline in the value of the dollar will take some of the pressure off profit margins and, together with the decline in interest rates, will allow the profit share to increase somewhat.

Comparison of Forecasts

The economic assumptions we developed are shown in table II.1 along with those adopted by OMB and CBO. Under GAO's assumptions, real GNP grows by 2.8 percent in fiscal year 1987. By comparison, CBO assumes real GNP growth will be 3.2 percent, and OMB assumes it will be 3.7 percent. During fiscal year 1987, quarterly real growth rates are in the neighborhood of 3.0 percent in GAO's assumptions, 3.5 percent in CBO's assumptions, and about 4.2 percent in OMB's assumptions. The assumptions about unemployment rates during fiscal year 1987 reflect the differences in the assumptions about real GNP growth.

Table II.1: Summary of Economic Assumptions, Fiscal Year 1987

Economic variable	OMB	CBO	GAO
Nominal GNP (billions of current dollars)	$4,449	$4,423	$4,403
Nominal GNP growth (percent change, year over year)	6.8	6.2	5.7
Real GNP (billions of 1982 dollars)	$3,797	$3,777	$3,760
Real GNP growth (percent change, year over year)	3.7	3.2	2.8
Quarterly real GNP growth (percent change, annual rate)			
April-June 1986[a]	1.1	1.1	1.1
July-September 1986	4.0	3.0	3.1
October-December 1986	4.0	3.6	2.7
January-March 1987	4.2	3.9	2.9
April-June 1987	4.2	3.7	3.1
July-September 1987	4.2	3.3	3.0
GNP implicit price deflator (percent change, year over year)	3.0	2.9	2.9
CPI-W (percent change, year over year)	2.1	2.6	2.5
Civilian unemployment rate (percent, fiscal year average)	6.7	6.8	6.9
Three-month Treasury bill rate (percent, fiscal year average)	6.2	6.3	5.8
Ten-year Treasury note rate (percent, fiscal year average)	7.5	7.7	7.1

[a]Estimate reported by the Department of Commerce on July 22, 1986, subsequently revised

According to the Commerce Department estimates released in August, real GNP was 2.8 percent higher in the 4 quarters ending in June 1986 than in the previous 4 quarters and was 3.9 percent higher in the 4 quarters ending in June 1985 than in the previous 4 quarters. Thus, we assume real growth during fiscal year 1987 at the same rate experienced in the 4 quarters ending in June 1986; CBO assumes real growth at a rate somewhat higher than the rate experienced in that time period; and OMB assumes real growth during fiscal year 1987 at a rate almost as high as the rate experienced in the 4 quarters ending in June 1985.

OMB, CBO, and GAO have nearly identical assumptions about changes in the implicit GNP price deflator, the broadest measure of inflation. GAO also has nearly the same assumption as CBO about changes in the CPI. OMB's assumption about CPI growth is, however, somewhat lower than either CBO's or GAO's.

GAO's interest rate projections are lower than either CBO's or OMB's, and, in this case, the OMB assumptions are closer to ours than are the CBO assumptions. In OMB's assumptions, both the short-term and the long-term Treasury rates are 40 basis points above the level GAO assumes. CBO assumes that the short-term rate will be 50 basis points higher and that the long-term rate will be 60 basis points higher than we assume. In the week ending July 26, 1986, 3-month Treasury bills yielded 5.72 percent (on a bank discount basis), which is 8 basis points below the average level we assume for fiscal year 1987. In effect, both OMB and CBO assume that these rates will rise over the next 15 months, whereas GAO assumes that they will not. Similarly, in the week ending July 26, the gap between 10-year Treasury note yields and 3-month Treasury bill yields was 154 basis points. Both GAO and OMB assume the gap will narrow to 130 basis points in fiscal year 1987, whereas CBO assumes it will narrow to 140 basis points.

Table II.2 compares GAO's assumptions (and those of OMB and CBO) with the July forecasts of three of the major private-sector economic consulting firms. In many respects, GAO's assumptions are quite similar to the simple average of the forecasts of the three firms, indicating that we have achieved our objective of developing a set of economic assumptions that is consistent with the private-sector consensus (at least as it existed in July 1986). For example, the commercial firms' fiscal year 1987 real growth forecasts are 2.6 percent, 2.5 percent, and 3.6 percent, respectively. The average is 2.9 percent as compared with GAO's assumption of 2.8 percent. GAO's assumption about the profit share in GNP is the same as the three-firm average, while its assumption about the wage and salary share is slightly above the three-firm average. GAO's interest rate assumptions are somewhat below the corresponding three-firm averages.

Table II.2: Comparison of Agencies' Economic Assumptions With Selected July 1986 Commercial Forecasts for Fiscal Year 1987

	Government agencies			Commercial firms			
	OMB	CBO	GAO	Average	Chase	DRI	Wharton
Growth rates (percent, fiscal year/ fiscal year)							
GNP	6.8	6.2	5.7	5.7	5.5	4.9	6.6
Real GNP	3.7	3.2	2.8	2.9	2.6	2.5	3.6
GNP deflator	3.0	2.9	2.9	2.7	2.8	2.4	2.9
Income shares (percent of GNP)							
Wages and salaries	(a)	49.3	49.4	49.1	48.9	49.1	49.2
Economic profits	(a)	7.4	7.4	7.4	7.7	7.0	7.5
Interest rates (percent)							
Three-month Treasury bills	6.2	6.3	5.8	6.0	5.8	6.0	6.3
Ten year Treasury notes	7.5	7.7	7.1	7.5	7.6	7.6	7.4
Labor market							
Employment (millions)	(a)	(a)	111.0	111.1	110.7	111.6	111.1
Unemployment (percent)	6.7	6.8	6.9	7.0	7.2	6.9	6.8

[a]Not published

Effect of GAO's Assumptions on the Estimated Deficit

We asked both OMB and CBO for their estimates of aggregate revenues, aggregate outlays, and the total deficit using the same technical assumptions that they would be using in their joint report but employing our economic assumptions. CBO gave us its estimate, but OMB informed us that it would be unable to do so.

Compared with its estimate using its own economic assumptions, CBO estimates that GAO's economic assumptions would reduce fiscal year 1987 revenues by $5.5 billion. CBO estimates that our assumptions would reduce fiscal year 1987 outlays by $2.2 billion, largely because we assume lower interest rates. The net effect is an increase of $3.3 billion in the total deficit estimate for fiscal year 1987.

Conclusions

Our judgment as to the most likely future course of the economy is more compatible with the economic assumptions adopted by CBO than with those adopted by OMB. CBO's real growth rate and nominal incomes are higher than ours, but the effect of these differences on CBO's estimate of the deficit is partially offset by the fact that we assume lower interest rates than does CBO.

CBO finds that when the only change made is the use of GAO's economic assumptions, its estimate of the fiscal year 1987 deficit rises by $3.3 billion. Given the uncertainties inherent in forecasting the economy and the deficit, we do not consider the difference introduced by the use of our economic assumptions to be significant. Thus, we conclude that our use of the CBO economic assumptions will produce estimates that we consider to be reasonable. In contrast, we do not know how an OMB estimate of the deficit using our economic assumptions would differ from OMB's estimate using its own economic assumptions, and, therefore, we do not know whether the use of OMB's assumptions would produce estimates that we would consider acceptable. Thus, on the basis of the information available to us, we have decided to use the CBO economic assumptions for our report.

For budget items sensitive to economic assumptions, the average of the OMB and CBO figures represents an averaging of differences traceable to economic assumptions as well as to other causes. Having adopted CBO's economic assumptions for the purpose of this report, we must remove that part of any difference between the OMB and CBO estimates that is traceable to the economic assumptions. Thus, for these items, the estimates we use for this report differ from the average presented in the OMB/CBO report. We have adopted the CBO estimate of total revenues instead of the average of the OMB and CBO revenue estimates. In estimating outlays, where it was possible to do so, we adjusted the OMB estimate to reflect the effect of different economic assumptions and, absent any other source of disagreement with either the OMB or CBO estimate, we adopted the average of the CBO estimate and the adjusted OMB estimate. When we could not adjust the OMB estimate to reflect our economic assumptions and when we had no other reason to disagree with the estimates, we used CBO's estimate instead of the average.

August GNP Revision

On August 19, 1986, the Department of Commerce released its "first revision" of its estimate of GNP during the second quarter of 1986. In the August estimate, real growth in the second quarter was 0.6 percent, as compared with 1.1 percent in the July "preliminary" estimate. Since our assumptions were completed during the first week of August, they do not reflect these revisions; the OMB and CBO assumptions also do not reflect these revisions

The major factors contributing to Commerce's lowered estimate of second quarter real growth were a reduction of $8 billion (40 percent) in inventory investment and a reduction of $4.2 billion (2.9 percent) in net exports. The effect of these reductions was offset partially by increases of $4.4 billion (1.4 percent) in real federal government purchases and $3.4 billion (0.1 percent) in consumption. Had these estimates been available to us when we developed our assumptions, we would have adjusted slightly our assumptions about the individual GNP components, but we probably would not have changed materially our forecast of fiscal year 1987 aggregate real growth.

The August 19 estimate also revised the earlier estimate of second quarter corporate profits from current production (i.e., profits including the inventory valuation adjustment and the capital consumption adjustment). In the preliminary estimate, these profits were 7.4 percent of current dollar GNP. In the revised estimate, they fell to 7.0 percent of GNP, reflecting a $19.3 billion downward revision. Had this information been available to us in early August, we might well have assumed somewhat lower profits in our forecast.

Review of Defense Program Accounts

We have identified three areas in which our estimates differ from the OMB/CBO average in the initial sequestration report. First, we would add $1.4 billion in budget authority with equivalent associated outlays for the defense program portion of the anticipated 1987 federal pay raise. Second, we would increase the unobligated balances for defense programs by $3.5 billion. Third, we would increase total defense program outlays by an additional $2.5 billion.

In conducting our review, we used the data provided by OMB and CBO in their report, DOD budget and accounting reports, Monthly Treasury Statements, and the results of our ongoing audit work on defense programs and the DOD budget. We examined the OMB/CBO report to determine if there were any major errors or omissions in the identification or estimation of budget resources or outlays. In particular, we carefully reviewed major accounts for which the OMB and CBO estimates differed significantly. When we identified questionable entries or significant differences, we contacted OMB, CBO, or DOD officials to discuss the issues and our concerns.

Federal Pay

As discussed in appendix I, OMB and CBO disagree over the estimated outlays that will flow from the increase in federal pay rates anticipated for 1987. On the basis of its interpretation of the Act, OMB assumes that pay increases will be absorbed by the departments and agencies. CBO, on the basis of OMB's midsession review of the budget, estimates outlays from new budget authority of about $2.8 billion in defense accounts, which includes $2.6 billion for military pay raises and $243 million for civilian pay raises. We agree with CBO's estimate.

Estimates of Unobligated Balances

OMB and CBO agree that estimated unobligated balances in the sequestrable base for DOD programs will total $53.3 billion These estimates were adopted from the President's fiscal year 1987 budget submission, adjusted for the fiscal year 1986 sequester order.

Using actual obligations from fiscal year 1980 through the first 8 months of fiscal year 1986, we estimate that fiscal year 1987 sequestrable unobligated balances will be $56.8 billion, $3.5 billion more than reported by OMB and CBO. As we discussed in our March 1986 report, Budget Issues: Potential for Excess Funds in DOD (GAO/NSIAD-86-76), DOD has consistently underestimated unobligated balances in its budget submissions. We believe that using the most recent available information in estimates of unobligated balances yields a more accurate estimate.

The main impact of our estimate is an increase in the unobligated balances in the procurement accounts (see table III.1), which contain over 85 percent of the total unobligated balances. This increase in the procurement accounts is offset in part by a decrease in the unobligated balances for research, development, test, and evaluation (RDT&E) accounts.

Table III.1: Unobligated Balances in Defense Programs: Comparison of OMB/CBO and GAO Estimates

Dollars in billions

	OMB/CBO average	GAO estimate	Difference
Procurement	$45 6	$49.6	+$4 0
RDT&E	3 9	3 4	−0 5
Military construction	3 2	3 2	(a)
Other accounts	0 6	0 6	(b)
Total - Department of Defense[c]	**$53.3**	**$56.8**	**+$3.5**

[a]Less than $50 million

[b]We did not calculate new estimates for these accounts

[c]Excludes defense programs outside DOD

Whether the $3.5 billion is treated as an unobligated balance or an obligated balance has no effect on estimated total defense program outlays because the OMB/CBO report uses the same rates in computing outlays from unobligated and obligated balances. In general, balances that are obligated at the beginning of a fiscal year would be expected to spend out faster during the year than balances that are unobligated at the beginning of the year. However, for the procurement funds involved here, this difference is not material.

Defense Outlay Estimates

The CBO outlay estimate for defense programs is $277.6 billion, $8 billion more than the OMB estimate of $269.6 billion. Of this $8 billion difference, $2.8 billion is associated with the federal pay issue discussed earlier. The remaining $5.1 billion is the result of differences between CBO and OMB in estimating methodologies and assumptions. On the basis of our analysis of OMB's and CBO's estimates in comparison with actual outlays since fiscal year 1978, we believe that CBO's estimates are more accurate than OMB's and more likely to approximate actual outlays in fiscal year 1987 than the OMB/CBO average.

CBO bases its estimate on the historical trend in actual defense outlays (averaging rates of the 5 most recent fiscal years). OMB's estimates are based on a variety of sources and, for fiscal year 1987, assume outlays lower than CBO's. On the basis of actual outlays from fiscal year 1980 through the first 9 months of fiscal year 1986, we estimate that outlays for fiscal year 1986 will be $8 billion over OMB's estimate in the President's fiscal year 1986 budget. The CBO estimates for fiscal year 1987 are more consistent with our estimates. Therefore, we used the CBO estimate. This increases total estimated outlays for defense programs, relative to the OMB/CBO average, by $2.5 billion.

DOD has stated that it could take special actions to reduce outlays in fiscal year 1987. These actions include slowing the payment of bills, shifting military payrolls and retirement contributions from the end of one fiscal year to the beginning of the next, and delaying and reducing progress payments to contractors. Actions such as shifting military payrolls by 1 day to a new fiscal year only postpone outlays from one accounting period to the next. In addition, most of the actions proposed would not affect outlays from the operations and maintenance accounts, where most of the estimating differences occur. We believe that short-term solutions of this sort do not contribute to a permanent reduction in the deficit.

Transfers

In addition to the items noted above, we are concerned about the impact of certain fiscal year 1986 budget authority transfers on the fiscal year 1987 funding levels assumed in the OMB/CBO report. Fiscal year 1986 appropriation acts authorized DOD to transfer over $9 billion in prior-year budget authority to fund fiscal year 1986 requirements. Most of this transfer authority was provided in lieu of new budget authority to meet those current requirements. OMB and CBO do not include these transferred funds in DOD's fiscal year 1987 sequestrable base, in accordance with the procedures required by the Act. We agree with the exclusion of these transferred funds from the sequestrable base under the Act, but we believe that the exclusion significantly understates the cost of carrying out DOD's fiscal year 1986 program. This is particularly true in the transfers from procurement accounts (multiyear funds) to military pay, which is spent in a single year. Since this reduced fiscal year 1986 budget base is used for the fiscal year 1987 estimate under the Act, the deficit estimate may be artificially reduced by several billion dollars.

Review of Nondefense Program Accounts

We identified several nondefense program accounts for which our estimates differ from those of OMB and CBO because of conceptual differences in applying the Act and differences regarding estimated outlay rates. We also identified a number of accounts where the OMB/CBO average may not accurately reflect the correct amount of budgetary resources or outlays because of ambiguities in the definitions of administrative expenses, prior legal obligations, and voluntary contributions.

We conducted our review using the data provided by OMB and CBO in their initial fiscal year 1987 sequestration report. We examined the account data from several perspectives to determine if any major errors or omissions occurred. We reviewed each exempt account to ensure that it had been handled properly, and we reviewed all accounts for which OMB's and CBO's estimates of sequestrable outlays differ widely. We reviewed accounts identified for changes in our January 21, 1986, sequestration report to the President and the Congress[1] to determine if those accounts have been treated properly in the 1987 report. Finally, we compared the current OMB/CBO report with the fiscal year 1987 budget appendix to determine which accounts had been completely omitted from the OMB/CBO sequestration report and the reason for their omission.

When we identified differences, we contacted the OMB and CBO analysts responsible for the accounts and discussed the issues and our concerns. In some cases, we contacted agency officials for further clarification. The major areas about which we continue to have concerns and for which our estimates differ from the OMB/CBO average are listed below.

Postal Service Fund

In their report OMB and CBO agree that $1.2 billion of the Postal Service Fund's budgetary resources for administrative expenses are sequestrable. However, OMB and CBO disagree on the outlay savings that could be expected to result from the sequestration. OMB assumes that outlay savings would equal the sequester. CBO assumes that there would be no savings. CBO sees no evidence that the Postal Service has taken steps to reduce its fiscal year 1986 spending in response to the last sequestration order and states that the administration appears to have no mechanism for enforcing the order.

[1]Budget Reductions for FY 1986: Balanced Budget and Emergency Deficit Control Act of 1985, (GAO/OCG-86-1)

We consider it inappropriate to assume that the Postal Service will not follow the requirements of Public Law 99-177. In addition, to assume so would increase inequitably the required sequester amounts for all other accounts. Consequently, we agree with OMB's treatment of this account. As a result, outlay savings should result from a sequester applied to $1.2 billion in Postal Service Fund budgetary resources.

Federal Pay

As discussed in appendix I, OMB and CBO disagree over the estimated outlays that will flow from the increase in federal pay rates anticipated for 1987. On the basis of its interpretation of the Act, OMB assumes that pay increases will be absorbed by the departments and agencies. CBO, on the basis of OMB's midsession review of the budget, estimates outlays from new budget authority of $129 million in nondefense accounts. We agree with CBO's estimate.

Washington Metropolitan Area Transit Authority and Related Cases

OMB and CBO also disagree on whether the federal interest payment to WMATA is subject to reduction. CBO concludes that the federal payment is exempt as an obligated balance because appropriations for WMATA are provided to fulfill past commitments of the federal government under contracts authorized by law and because the bonds for which the payment is made are guaranteed by the federal government. OMB concludes that, under the terms of the contract, the government is not obligated to make any payment to WMATA in excess of the amount of available appropriations, including any reduction required by Public Law 99-177.

We agree with CBO's view that the federal payment of interest on WMATA bonds, made in furtherance of an underlying contractual commitment on the part of the government, is not the type of expenditure that the drafters of Public Law 99-177 intended to subject to automatic sequestration. We agree, as apparently does OMB, that the federal payment to WMATA was inadvertently left off the list of exempt programs included in the Act.

In January 1986 we concluded that the federal payment to WMATA constituted an obligated balance because the relevant contingency in the subsidy agreement—the availability of appropriations—had been met. However, this is not now the case. Because the WMATA subsidy agreement is contingent on the availability of funds and because fiscal year 1987 appropriations have not yet been enacted for WMATA, we consider OMB's application of the statute technically correct and conclude that a sequester should be applied to WMATA budgetary resources of $51.7 million.

The joint OMB/CBO report cites two other cases similar to WMATA's in which OMB and CBO disagree on whether to reduce appropriations provided to fulfill prior contractual agreements: the Medical Facilities Guarantee and Loan Fund in the Department of Health and Human Services and the Higher Education Facilities Loans and Insurance account in the Department of Education. In both of these cases, according to the report, the agreements involved are expressly subject to the availability of annual appropriations. Our views regarding these programs are consistent with our views on the federal payment of interest to WMATA. We believe therefore that a sequester should be applied to $18.0 million in budgetary resources of the Higher Education Facilities Loan and Insurance account and $25.0 million in the Medical Facilities Guarantee and Loan Fund account.

Federal Ship Financing Fund

The prior legal obligations of the Federal Ship Financing Fund are specifically exempt from sequestration under the Act. While estimates of outlays from exempt budgetary resources do not affect the sequester amount for a given account, they do affect the total outlay estimate and, thus, the estimated deficit. For this account, CBO's estimates of exempt budgetary resources and outlays from those resources are higher than OMB's estimates. On the basis of our audit work concerning the Fund's outlays to cover loan defaults, we conclude that the CBO estimates are more realistic. Therefore, we agree with CBO's estimate of total outlays, which is about $398 million higher than OMB's.

Federal Building Fund

The Federal Building Fund is an intragovernmental fund that is exempt from sequestration, except for any direct appropriations or administrative expenses funded by collections from nonfederal sources. Both OMB and CBO would sequester amounts from direct appropriations, but CBO would also sequester administrative expenses funded by offsetting collections. We agree that there should be a sequester of administrative expenses, but we believe that the CBO amount is too high. We would not include within that amount any portion financed from offsetting collections from federal sources, since those portions were already sequestered in the source account. We conclude that the appropriate amount to include is $201,000.

Definitional Ambiguities

The Act lists a number of accounts and kinds of accounts that are exempt or partially exempt from sequestration. In reviewing the way OMB and CBO treat exempt accounts, we encountered ambiguities in how OMB and CBO interpret and apply certain terms in the Act. Specifically, we question how OMB and CBO define the terms "administrative expenses," "prior legal obligations," and "voluntary contributions." Failure by the two agencies to establish clear and consistent definitions makes it difficult to determine whether the exemptions have been properly applied. In several cases the lack of clear definitions appears to have led to inconsistent treatment of similar accounts.

Administrative Expenses

The Act stipulates that—notwithstanding any exemption, exception, limitation, or special rule—"administrative expenses" of all agencies are subject to reduction. In reviewing the amounts that OMB and CBO identify as sequestrable administrative expenses, we noted inconsistencies in the determinations made by the two agencies as to what types of expenses fall within the meaning of that term. In some cases it appears that insufficient amounts are identified, especially if a broad definition of the term is used.

In these cases, the lack of a clear and consistent definition of the term "administrative expenses" made it difficult for us to assess OMB's and CBO's decisions. An independent assessment through use of budget reporting information is not possible because that information frequently does not identify the administrative components of accounts. We think that a full and consistent sequestration of administrative expenses can be ensured only if clear definitions and revised reporting conventions on administrative expenses are established.

Prior Legal Obligations

The Act lists several accounts for which the "prior legal obligations" of the government are exempt from sequestration. In such accounts, budgetary resources are to be sequestered if they are for current program and administrative expenses rather than for prior legal obligations. In examining the OMB/CBO treatment of these accounts, we have found that some current program funds may not have been included in the sequestrable base. However, it is difficult to reach a definite conclusion on this matter because of uncertainty about what distinguishes current program funds from prior legal obligation amounts. As with administrative expenses, an independent assessment through use of budget reporting information is not possible because that information does not clearly or consistently distinguish between such amounts. Progress in developing clear and consistent definitions of prior legal obligations, and improving budget reporting on such amounts, would facilitate the proper application of this exemption.

Voluntary Contributions

The Act includes an exemption for "activities resulting from private donations, bequests, or voluntary contributions to the Government." In several cases it is difficult for us to determine whether amounts have been properly exempted under this provision. It is not always possible to determine from reported budget information whether funds credited to an account are the result of a voluntary contribution or are given as payment for a service provided by the government. Consequently, in many cases we could not determine whether OMB and CBO properly applied this exemption.