TESTIMONY OF
ALICE M. RIVLIN
DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
BEFORE THE
COMMITTEE ON THE BUDGET
UNITED STATES SENATE

March 20, 1996

Mr. Chairman, Members of the Committee, I am pleased to be with you today to discuss the President's budget for fiscal 1997.

This budget:

- reaches balance in 2002, while

- reforming entitlement programs and

- continuing to invest in the future.

The budget reaches balance the right way, by making government more efficient and cutting lower priority spending. It is designed to make further progress on the central goal of this Administration -- to promote a strong economy and, with it, higher average living standards now and in the future.

This budget reaches balance in seven years, using either the Administration's economic and technical assumptions or the latest assumptions from the Congressional Budget Office.

If I have a single point to make today, it is this: The President is committed to putting the budget firmly on a track to balance this year -- not after the political season, not after the November elections, but now.

We should not let this opportunity pass us by. Over the last several months, the President worked closely with the bipartisan congressional leadership to reach an agreement on balancing the budget over seven years. He spent over 50 hours with the leaders in serious, productive negotiations. They came much closer together.

In fact, the two sides have close to $700 billion in savings in common -- savings in entitlements and discretionary programs, savings in Medicare and Medicaid, and savings in welfare and other programs. Those savings would not only balance the budget, but also pay for a modest tax cut for average Americans and small businesses. The budget embodies those common savings.

The congressional leadership wants bigger tax cuts, offset by deeper cuts in Medicare and Medicaid, other mandatory programs that help farmers and the poor, and discretionary spending. But the President believes those cuts are too deep and would threaten the Government's vital role in guaranteeing health care to vulnerable Americans and investing in the future. He has proposed that the two sides quickly enact the savings they have in common and give the American people a balanced budget.

Three Years of Progress

Upon assuming office over three years ago, this Administration faced two problems.

- First, we had an economy stuck in low gear. Although it had emerged from recession almost two years earlier, growth was slow. In fact, the unemployment rate at the beginning of 1993 was a quarter-point higher than when the recession ended. Investment was slow, limiting growth in future productivity and living standards.

- Second, we inherited a huge budget deficit. It had risen from a then-record $74 billion in 1980 to $290 billion in 1992. As a share of the Nation's Gross Domestic Product (GDP), the deficit was at levels that it had previously reached only in recessions. The 1980-92 deficits, in turn, quadrupled the national debt in just 12 years. And perhaps most ominously, the debt grew much faster than the economy. From 1981 to 1993, the ratio of national debt to GDP almost doubled.

The size of the budget deficit and the weakness of the economy were not unrelated. As long as the Federal Government would claim so much of the Nation's supply of credit, interest rates would remain high, and investment would remain correspondingly low. Without greater investment, growth would remain sluggish in the short run, and productivity and incomes would be limited in the long run.

Facing such serious challenges, the President stepped up to the plate. Despite concerns about the near-term economic and political implications, the President put the long-run interests of the nation first and proposed a serious deficit reduction plan.

Skeptics reacted strongly. Many predicted that the economy would plunge into recession, that employment would shrink, and that the deficit actually would rise, rather than fall. They were wrong:

- The economy has performed better than even we had projected. Strong economic growth means higher incomes and greater prosperity.

-- Real median family income rose in 1994 (the last year for which data are available) compared to 1992, the year before the President took office. The rise was the first since 1989. The poverty rate also fell for the first time in five years.

-- Since January 1993, real average hourly earnings are up by 0.6 percent -- reversing a trend of falling wages through the 1980s.

• During the 1992 campaign, then-Governor Clinton promised eight million new jobs in four years. Last month, with the President in office just over three years, job growth hit 8.4 million. Moreover, this increase in employment has been solid.

-- Almost 93 percent of the new jobs are in the private sector.

-- More than half of the jobs are in the high-paying managerial and professional occupational categories.

-- After falling for the preceding 12 years, manufacturing employment is up in this Administration.

-- The new jobs are full-time jobs. While total employment is up by 8.4 million under this Administration, part-time employment among those who say they would prefer to work full time but cannot find full-time jobs has fallen by 1.45 million.

• Even though the economy continues to grow, interest rates are down -- partly because the President addressed the deficit problem. On the day the President took office, the 30-year Treasury bond yield stood at 7.32 percent. It has fallen below 6 percent at times in the last three years and now stands below 7 percent.

• Investment has boomed under this President. Inflation-adjusted investment in producers' durable equipment has grown at double-digit rates -- two-and-a-half times faster than from 1981 to 1988. That increase, which reflects the private sector's confidence in America's economic future, is the best proof that the President's policies are good for business, investment, and capital formation.

-- Stock market investors believe in prospects for this economy as well; stock prices are up over 60 percent in three years.

• Even in a growing, high-employment economy, inflation remains low. Under most measures, inflation has remained below 3 percent a year -- even with unemployment under 6 percent since mid-1994.

• Finally, and partly because of these other economic achievements, we have cut the budget deficit. In dollar terms, it has already fallen almost in half, from $290 billion in 1992 to $164 billion in 1995. As a share of the economy, it has fallen by more than half -- from 4.7 percent to 2.3 percent.

-- We have cut the deficit for three straight years for the first time since Harry Truman was President. We are on track for a fourth straight year of deficit reduction in 1996, and we are proposing additional reduction for 1997 -- producing five straight years of deficit reduction for the first time since before the Civil War.

-- In every year of this Presidency, the deficit has come in lower than the Administration projected at the beginning of the year. Put simply, our deficit reduction program has performed better than even we projected.

-- The Nation's debt is no longer growing faster than its income. After almost doubling from 26.5 percent to 51.9 percent from 1981 to 1993, the ratio of national debt to the GDP has reversed course, falling to 51.4 percent in 1995.

And yet, while the economy and budget are moving in the right direction, we still have work to do. Wages and family incomes have begun to rise, but families still find it hard to make ends meet. Even with millions more new jobs, many hard-working Americans still feel insecure in the jobs they have. We need to complete the job that the President began three years ago: We need to balance the budget and invest in the education and skills of the American people.

The President's budget has five main goals:

1. Reaching Balance in Seven Years

Under OMB's assumptions and estimates, the budget reaches balance in 2001. CBO's scoring is more cautious. We estimate that using CBO's last available assumptions and estimates, the President's budget reaches balance in 2002. With so much focus on CBO scoring, we have taken extraordinary steps to ensure that the budget reaches balance in 2002 according to CBO (even though, half-way through fiscal 1996, this is now more a six-year plan to reach balance than a seven-year plan).

• First, if the deficit in 2000 is not well below CBO's projections, the tax cuts end. At that point, those who want to maintain the tax cuts would have to comply with the "pay-as-you-go" rules and find a way to pay for them.

To date, the President's budget policies have cut the deficit much more than the Administration or CBO has projected. We believe that this budget also will exceed CBO's estimates for deficit reduction, thus leaving the tax cuts in place.

On the other hand, if deficit reduction is proceeding well ahead of CBO's estimate, a "trigger" provides for (1) continuing the tax cuts, (2) adding to discretionary spending after the year 2000, and (3) splitting any additional savings among more tax cuts, more discretionary spending, and more deficit reduction.

• Second, the budget includes a mechanism to ensure balance in the face of changing CBO economic and technical assumptions. CBO plans to update its assumptions in March or April, and these assumptions could change the President's path to balance; in 2002, they could produce a bigger surplus or a deficit. In the event that CBO estimates a deficit in 2002, the budget calls for an automatic reduction in the discretionary spending limits, or "caps," to reach balance.

As you can see, the President has gone the extra mile to keep his commitment to reaching balance in seven years, as scored by CBO. We hope this satisfies those in Congress who have said that their most important goal was a seven-year, CBO-scored balanced budget.

2. Controlling Spending

The President's economic program of 1993 was designed to generate $505 billion of deficit reduction over five years, with more than half ($255 billion) coming through lower spending. In fact, we now estimate that the five-year plan, plus the economic improvements that the plan helped to bring about, will generate $796 billion in deficit reduction.

It is spending constraint, more than increased revenues, that put deficit reduction ahead of schedule. In fiscal 1994 and 1995, over 60 percent of the deficit reduction above what we had originally expected has come because spending was lower than projected; less than 40 percent has come from greater-than-expected revenues.

In 1995, Federal outlays equaled 21.7 percent of GDP -- the lowest ratio since 1979. In both 1994 and 1995, spending was a smaller share of GDP than in any year under the previous two Administrations.

Furthermore, since 1992, Federal spending has grown at an annual rate of 3.2 percent per year -- less than half the rate of growth in 1988-92 (6.7 percent) or 1980-88 (7.6 percent). In "real" (inflation-adjusted) terms, the disparity is even more striking. Real spending since 1992 has grown only 0.8 percent a year -- less than a third the rate of 1988-92 (2.5 percent) or 1980-88 (2.7 percent).

The President's 1997 budget continues to control spending. The President proposes about $630 billion of spending cuts (measured with CBO scoring) over the seven-year period, 1996-2002.

Discretionary spending. About $297 billion of the savings will come in this category. Discretionary spending is already at its lowest share of GDP since at least 1962. In inflation-adjusted dollars, discretionary spending in 2002 would reach its lowest level since 1979.

Through its proposals for discretionary spending, the budget funds a Government that is leaner, but not meaner, one that works efficiently, manages resources wisely, focuses on results rather than merely spending money, and provides better service to the American people. Through the National Performance Review, led by Vice President Gore, we are making real progress in creating a Government that "works better and costs less."

We have cut the size of the Federal workforce by over 200,000 people, creating the smallest Federal workforce in 30 years and the smallest as a share of the total workforce since before the New Deal. We are ahead of schedule to cut the workforce by 272,900 positions, as required by the 1994 Federal Workforce Restructuring Act that the President signed into law.

Just as important, the Government is working better. Such agencies as the Social Security Administration, the Customs Service, and the Veterans Affairs Department are providing much better service to their customers. Across the Government, agencies are using information technology to deliver services more efficiently to more people.

We are continuing to reduce the burden of Federal regulation, ensuring that our rules serve a purpose and do not unduly burden businesses or taxpayers. We are eliminating 16,000 pages of regulations across Government, and agencies are improving their rule-making processes.

In addition, we continue to overhaul Federal procurement so that the Government can buy better products at cheaper prices from the private sector. No longer does the Government pay outrageous prices for hammers, ashtrays, and other small items that it can now buy more cheaply at local stores.

As we look ahead, we plan to work more closely with States and localities, with businesses and individuals, and with Federal workers to focus our efforts on improving services for the American people. Under the Vice President's leadership, agencies are setting higher and higher standards for delivering faster and better service.

Entitlements. Another $277 billion of spending cuts comes in this category, building on this Administration's impressive record of restraint. Since 1992, entitlement spending has grown less than half as fast as in 1988-92 (2.4 percent a year, compared to 5 percent) -- despite today's larger and faster-growing elderly and retired population.

The budget brings much-needed reforms to the major entitlements -- including Medicare, Medicaid, and welfare -- while protecting the elderly, working families, children, and other vulnerable Americans.

<u>Medicare</u>: The budget strengthens and improves Medicare, extending the solvency of the Part A Hospital Insurance trust fund through the next decade. It gives older Americans and people with disabilities more choices among private health plans, makes Medicare more efficient and responsive to beneficiary needs, attacks fraud and abuse through programs praised by law enforcement officials, slows the growth rate of provider payments, and holds the Part B Supplementary Medical Insurance premium at 25 percent of program costs; it imposes no new cost increases on beneficiaries.

The budget reforms payment methods for hospitals, doctors, managed care facilities, and other providers; enhances access to, and the quality of, health care in rural areas; expands and improves Medicare managed care; and expands coverage of preventive benefits.

<u>Medicaid</u>: The budget reforms Medicaid to give States unprecedented flexibility to manage their programs while preserving the guarantee of health coverage for the most vulnerable Americans. Millions of children, pregnant women, people with disabilities, and the elderly would retain the guarantee of basic health and long-term care services.

The budget imposes a per-person limit on spending, and cuts Disproportionate Share Hospital (DSH) payments and retargets them to hospitals that serve large numbers of Medicaid and uninsured patients. It provides special payments to States for their transition into the new system, and for meeting their most pressing needs. It gives States significant new flexibility to administer their programs more efficiently. And it retains current nursing home quality standards and enforcement, and continues to protect the spouses of nursing home residents from impoverishment.

In addition, the budget proposes premium subsidies to help those who lose their jobs pay for private coverage for up to six months.

<u>Welfare</u>: Welfare reform is mainly about work. The President's plan would repeal Aid to Families with Dependent Children (AFDC) and create a new, time-limited, conditional entitlement for cash assistance. As soon as they join the rolls, beneficiaries would have to develop and sign a personal responsibility contract with their welfare office. Within two years, able-bodied parents would have to work or lose their benefits. And after five years, they would no longer get cash benefits.

The budgets builds upon the steps that the President has already taken to fix specific parts of the welfare system. In 1994, the Federal Government collected a record $10 billion in child support. A year later, the President signed an Executive Order to make the Federal Government a model employer for collecting child support. In July 1995, the President ordered that Federal regulations be strengthened to prevent welfare recipients who refuse to work from getting higher Food Stamp benefits when their welfare checks are cut. And, over the last three years, the Administration has given 37 States the freedom to test ways to move people from welfare to work and protect children.

3. Investing in the Future

Like the President's previous budgets, this budget proposes steps to help Americans build a brighter future for themselves and their families. It maintains the President's investments in education and training, science and technology, environmental protection, and other priorities. And it maintains a strong defense and provides the resources to conduct an effective foreign policy.

Education and Training: Today's most successful workers are those with technical skills and a firm educational footing who continue to learn throughout their careers in order to compete successfully in this fast-changing economy.

The budget maintains and expands the President's investments in Head Start, Goals 2000, Charter Schools, Title I - Education for the Disadvantaged, Safe and Drug-Free Schools and Communities, and Pell Grants. It proposes an income tax deduction of up to $10,000 to help middle-income families pay for postsecondary education and training expenses. And it proposes a series of new initiatives.

Because technology can expand learning opportunities for all students and help raise student achievement, the President is proposing a "Technology Literacy Challenge Fund," with four goals: helping States put enough computers in every classroom; connecting these computers to the Information Superhighway; giving teachers the training they need to integrate technology into teaching; and fostering the development of high quality, widely available educational software.

The President also proposes to create an achievement-based scholarship program, rewarding the best and the brightest of high school students. This program would grant $1,000 honors awards to the top five percent of graduating students in every secondary school in the Nation, making clear the Government's commitment to excellence for all children.

The Environment: Americans want a government that helps protect the environment and our natural resources without burdening business, choking innovation, or wasting taxpayer dollars. To meet these objectives, the Administration has been reinventing the regulatory process to cut excessive regulation, and targeting investments in programs that will have the biggest impact on improving the environment, protecting public health, providing more opportunities for outdoor recreation, and enhancing natural resources. While continuing to maintain environmental enforcement and protect national parks and other sensitive resources, the President proposes new initiatives to address specific environmental challenges.

The President proposes to offer a targeted tax incentive to clean up "brownfields" -- older, contaminated industrial sites in distressed urban and rural communities. This incentive would spur the private sector to create jobs, return land to productive use, and clean up the environment in our communities.

The President also proposes an "Everglades Restoration Fund" to provide a steady source of funding mainly for land acquisition to maintain the South Florida Ecosystem -- a unique national treasure that includes the Everglades, Florida Bay, and other internationally-renowned natural resources. The budget proposes $100 million a year for four years to establish the Fund. It also proposes a 1-cent-per-pound marketing assessment on Florida sugar production, which would add about $35 million a year to the Fund.

Science and Technology (S&T): Technological innovation has accounted for at least half of the nation's productivity growth in the last 50 years. Technology has become a major engine of economic growth, a significant contributor to our national security, a generator of new knowledge, and a critical tool in protecting our health and environment.

The budget maintains vital investments in S&T by adding funds for basic research in health sciences at the National Institutes of Health, for basic research and education at the National Science Foundation, for research at other agencies that depend on S&T for their missions, and for cooperative projects with industry and universities.

The budget maintains the President's commitment to biomedical and behavioral research, which promotes the health and well-being of all Americans. For the National Institutes of Health, the budget includes increases for HIV/AIDS-related research, research into breast cancer and other health concerns of women, minority health initiatives, high performance computing, prevention research, gene therapy, and developmental and reproductive biology.

Also with regard to AIDS, the budget proposes increased funding for the Ryan White CARE Act for grants to cities disproportionately affected by the HIV epidemic; to States to provide medical and support services; to community-based organizations to provide HIV early intervention services; and to support pediatric AIDS demonstration activities. The President also has sought more funds for State AIDS drug assistance programs funded under Title II of the Ryan White program -- to finance newly-discovered life-prolonging AIDS therapies, some of which are beginning to receive FDA approval.

American Leadership: The budget provides the resources to support U.S. diplomatic leadership in defending our interests and promoting democracy, free markets, and peace throughout the world. It also proposes to continue sustaining and modernizing the world's strongest, best-trained, best-equipped, and most ready military force.

On the diplomatic side, the budget proposes to increase funding for international security assistance to support the peace process in the Middle East (including partial financing of a squadron of F-16 aircraft for Jordan), to further the move toward free markets and democracy in Central Europe and the New Independent States through programs such as the President's Partnership for Peace initiative, and to continue to support the peace process in the Balkans.

To promote an open trading system, the budget puts a high priority on programs that help U.S. exporters meet foreign competition and seize the opportunities that trade agreements offer. It proposes to address the new transnational threats to U.S. and global security and prosperity; to better meet our commitments to international organizations; to increase voluntary contributions to a variety of international organizations principally involved in development, population, and environmental programs; and to continue providing humanitarian and disaster relief.

For defense, the budget continues the Administration's policy of the last three years -- sustaining and modernizing the world's strongest and most ready military force, capable of prevailing with our regional allies in two nearly simultaneous regional conflicts. This budget maintains our commitment to high levels of training and readiness for that force and equipping it with technology second to none.

The President continues to strongly back programs that support military readiness, directly or indirectly. Our armed forces have been extremely successful in attracting and retaining motivated, high-quality personnel, in part due to the President's continuing strong commitment to adequately fund service members' quality of life programs. For example, the budget provides military personnel a 3 percent military pay raise, effective January 1997, and increased funding to upgrade and improve military barracks and family housing.

4. Cutting Taxes for Average Americans and Small Business

The President believes we can balance the budget and, at the same time, provide modest tax relief for middle-income Americans and small businesses. Because resources are scarce, we must put them where we need them most. Thus, the President has proposed tax-cut initiatives that focus on the highest family and national priorities, and that will help families and small businesses to help themselves.

Child tax credit. To help moderate-income working families with children, the budget phases in a $500 tax credit for dependent children. The full credit is available for families with incomes under $60,000, and the credit is phased out at incomes of $75,000. The credit will apply before the earned income tax credit, thus giving these moderate-income families even more help.

Tuition deduction. The budget phases in a $10,000 tax deduction for education and training expenses, including college tuition. It will be available whether or not the taxpayer itemizes deductions, and is phased out between $100,000 and $125,000 of income. It will provide relief from the heavy burdens of college and mid-career training costs, and should encourage especially those families who may be most deterred by the up-front cost of trying to send their first family members to college.

Individual Retirement Accounts. The budget expands the availability of Individual Retirement Accounts (IRAs) by doubling, over time, the income limits. It allows families to make penalty-free withdrawals for educational, housing, and medical needs. It establishes new back-loaded IRAs for those eligible for regular deductible IRAs. These provisions will encourage families to save for their own retirements and for other contingencies, so that they can contribute to their own economic security.

Small business incentives. The budget increases, from $17,500 to $25,000, the amount of investment eligible for expensing, thus reaching the level that the President originally proposed in 1993. It also provides targeted relief from estate taxation for small businesses and family-owned farms.

Pension simplification. Building on bipartisan efforts in the Congress, the President proposes to simplify rules (and expand coverage) for pension plans sponsored by businesses of all sizes, nonprofit organizations, and State and local governments, as well as for multiemployer plans. The budget includes a new, simple retirement savings plan (the National Employee Savings Trust, or NEST) for small businesses that combines the most attractive features of the IRA and the 401(k) plan, minimizes administrative and compliance costs, and eliminates the need for employer involvement with the Government.

Urban and environmental initiatives. The President proposes to expand the number of enterprise zones (EZs) and enterprise communities (ECs), and to liberalize the tax treatment of expenses for environmental remediation of contaminated sites ("brownfields") in low-income areas.

To finance these initiatives and help reach balance, the budget saves $59 billion over seven years by cutting corporate tax subsidies, closing loopholes, and improving tax compliance. For example, the budget prevents corporations from achieving tax arbitrage by deducting interest on borrowings against life insurance policies on their employees, or where the corporation owns tax-exempt obligations; addresses recent developments in tax-motivated financial products; curtails manipulation of the tax accounting rules; and tightens rules that are designed to prevent tax avoidance through expatriation and the use of foreign trusts.

The budget improves compliance with, and refines eligibility for, the earned income tax credit (EITC). But it protects the 1993 expansion of the EITC that cut taxes for 15 million working Americans. We must not raise taxes on low- and moderate-income working families with children to pay for tax cuts for the most well-off.

5. Completing the Task

I will conclude my testimony where I began: The President is committed to reaching an agreement with Congress to balance the budget -- and doing it this year.

We stand at an important moment in the Nation's history. For the first time in memory, we have a President and Congress who agree on the need to balance the budget. We must not waste this opportunity.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

August 4, 1995

BUDGET PROCEDURES MEMORANDUM NO. 808

TO: PROGRAM ASSOCIATE DIRECTORS
DEPUTY DIRECTOR FOR MANAGEMENT
PROGRAM DEPUTY ASSOCIATE DIRECTORS
DEPUTY CONTROLLER, OFFICE OF FINANCIAL MANAGEMENT
ASSISTANT DIRECTOR FOR LEGISLATIVE REFERENCE

FROM: Barry Anderson BA
Assistant Director for Budget

SUBJECT: Agency Budget Submissions for the FY 1997 Budget

1. Purpose. This memorandum asks Resource Management Offices (RMOs) to remind agencies that their initial budget submissions are due to OMB by September 8th and to inform them that outyear estimates through FY 2006 should be included in the submissions.

2. Background. OMB Circular No. A-11, dated June 6, 1995, requires that Cabinet and other Executive branch agencies submit their initial budget requests to OMB by Friday, September 8th. The due date for these submissions remains unchanged, even though there is more than the usual uncertainty over the outcome of congressional deliberations on the FY 1996 Budget and the actions necessary to stay on a path to a balanced budget.

In addition, OMB Circular No. A-11 specifies that FY 1997 agency budget submissions cover both budget and outyear estimates through FY 2002. However, since the Circular was issued, the President has made a commitment to balance the budget in ten years. As a result, agencies are now required to submit outyear estimates through FY 2006.

3. Action required. **RMOs are asked to forward the attachment to this BPM to agencies for which they are responsible as soon as possible.**

4. Inquiries. Questions concerning these instructions should be directed to Bev Thierwechter, ext. 53593.

Attachment

Attachment
BPM No. 808

Guidance on Initial Agency Budget Submissions for the FY 1997 Budget

1. Purpose. This guidance confirms the September 8th due date for initial agency budget submissions, as prescribed by OMB Circular No. A-11, and revises that Circular's requirement for submission of outyear estimates.

2. Initial Agency Budget Submissions.

(a) Due Date. Section 10.3 of OMB Circular No. A-11, dated June 6, 1995, requires that Cabinet and other Executive branch agencies provide their initial budget submissions to OMB by Friday, September 8th. The due date for these submissions remains unchanged, even though there is more than the usual uncertainty over the outcome of congressional deliberations on the FY 1996 Budget and the actions necessary to stay on a path to a balanced budget.

(b) Planning guidance. Agency budget submissions should be consistent with the FY 1997 budget planning guidance provided to agencies recently by OMB, and agency requests should not exceed planning guidance levels.

(c) Outyear estimates. Sections 15.1-15.2 of OMB Circular No. A-11 specify that FY 1997 agency budget requests cover both budget year and outyear estimates through FY 2002 (BY+5). However, since the Circular was issued, the President has made a commitment to balance the budget in ten years. As a result, this requirement has been revised. For their initial FY 1997 budget submissions, agencies are now required to submit outyear estimates through FY 2006 (BY+9). This applies to requirements for the summary and highlight statement and initial budget justifications, wherever outyear estimates are required (e.g., sections 15.1 and 15.2(a)(5)).