Comptroller General
of the United States

Washington, D.C. 20548

150854

B-256507

February 22, 1994

The Honorable Paul Sarbanes
United States Senate

Dear Senator Sarbanes:

This letter is in response to your letter dated February 17, 1994, in which you asked some questions about the assumptions in our June 1992 report, Budget Policy: Prompt Action Necessary to Avert Long-Term Damage to the Economy (GAO/OCG-92-2, June 5, 1992). You also asked about the current long-term deficit outlook.

In our 1992 report, we looked at the trends driving the deficit over the long-term. We developed four scenarios to show the implications of various fiscal policies in dealing with the deficit. These scenarios, projected to the year 2020, were: (1) doing nothing and allowing the deficit and cumulative debt to grow unchecked, (2) holding the deficit to 3 percent of gross national product (GNP), (3) achieving a balanced budget early in the next century and maintaining balance thereafter, and (4) achieving a balanced budget and then moving into surplus.

You asked whether our analysis considered the costs or benefits of adopting a balanced budget amendment to the Constitution. It did not. GAO has long supported making the hard programmatic policy choices that would lead the country to a more balanced budget. We have not endorsed a balanced budget amendment to achieve this goal.

You also asked whether our economic model considered short- or medium-term effects of deficit reduction on the economy. As we stated in our report, our model assessed the impacts of deficit reduction scenarios on long-term economic growth and was not designed to forecast the short-term cyclical effects of macroeconomic policy. However, these scenarios were constructed to achieve deficit reduction of no more than 0.5 percent of GNP per year--a path that is gradual enough to permit monetary policy to largely offset the contractionary impact of deficit reduction without causing inflation.

With regard to your question about the current deficit outlook, it has indeed improved in the 2 years since our 1992 analysis. In the Omnibus Reconciliation Act of 1993, the Congress and the President have taken action that the Congressional Budget Office (CBO) estimates will reduce the deficit by $433 billion from 1994 through 1998. CBO now projects the deficit will be 3.1 percent of gross domestic product (GDP) in 2003, down from its projections of 6.8 percent a year ago.

These recent improvements in the deficit obviously would affect the starting point used in our 1992 report, which would in turn alter the outcomes of the four scenarios we outlined 2 years ago. At least through 2004, CBO's projections indicate that we have steered away from the path projected in the "no action" scenario. Indeed, CBO figures project that we will move somewhat below the 3 percent path over the next 8 years. In response to your question, we believe this CBO forecast is reasonable and reflects deficit reduction actions taken as well as other changes in the economy since 1992.

The deficit problem, of course, has not gone away. The forces identified in our 1992 report that were driving the long-term deficit remain at work--rising health care costs, the baby boom generation's eventual retirement, and rising interest costs. The near-term impact of these forces is reflected in CBO's projections forecasting the deficit resuming its growth after 1998, rising from 2.2 percent of GDP to 3.3 percent in 2004. As you suggest in your letter, health care reform legislation that succeeds in slowing the growth of these expenditures could significantly lower the long-term path of deficits over the next 30 years.

Finally, as you note, in the 2 years since we developed the model, new information has become available that shows somewhat higher productivity, lower federal interest costs, and higher labor force projections. We believe these changes could work to improve the long-term deficit outlook to some extent. However, we cannot determine the specific impact of these changes or assess the effects of changes in other factors until the model is updated.

Please contact Paul Posner, Director, Budget Issues, at (202) 512-9573 if you or your staff have any further questions.

Sincerely yours,

Charles A. Bowsher

Charles A. Bowsher
Comptroller General
of the United States