



United States  
General Accounting Office  
Washington, D.C. 20548

Accounting and Financial  
Management Division

B-248734

May 26, 1992

The Honorable Bob Graham  
United States Senate

Dear Senator Graham:

Thank you for your letter concerning the impact on the budget process of shared economic assumptions and for sending us the Center for Governmental Responsibility report on creating a consensus revenue estimating process at the federal level. We share your belief that credible economic assumptions accepted by all parties would help the quality of the budget debate. With agreed-upon assumptions, the debate might focus on priorities and/or on the impact of alternative proposals on the economy.

We have a strong interest in developments and innovations at the state and local level that have potential for federal application. However, as discussed in detail below, we do not think the Center's specific proposal offers a promising approach.

#### Extent of Forecast Differences at the Federal Level

It is possible to distinguish between estimates of economic activity in the short run, which the Congressional Budget Office (CBO) calls forecasts, and the longer run, which both the Office of Management and Budget (OMB) and CBO describe as projections. Forecasts generally extend for no more than 2 years, are based on a detailed examination of current economic data, and take into account cyclical factors. In this letter, we focus on the forecasts rather than the longer-term projections. We do so because the forecasts have the greatest relevance for current-year and one-year-out budget estimates and because these seem most relevant to the issues raised by the Center's study.

The enclosed tables provide some information for determining the extent of the differences between CBO, OMB, and private "blue chip" forecasts for economic growth,

short- and long-term interest rates, unemployment, and inflation for the periods 1988 through 1993. For years up to 1991, actuals are also shown.

On economic growth, OMB was substantially more optimistic than CBO for 1988 through 1991. In all 4 years, actual real gross national product (GNP) growth was closer to the original CBO forecast than to the original OMB estimate, although both significantly over-estimated growth in 1990 and 1991. The forecast profile changed with 1992. Original forecasts for 1992 and 1993 were quite close, and for 1993 OMB is more pessimistic than either CBO or the blue chip forecast. A like, although not identical, pattern can be seen in forecasts for short-term and long-term interest rates: OMB was more optimistic through 1991, and was less so for 1992. The three forecasts were nearly identical for 1993.

The tables show, for the years through 1991, four forecasts: the first one presented in the budget for that year [forecast for fiscal year 1990 would appear in January or February 1989]; the second appears about 6 months later; the third appears in January or February of the fiscal year, and the fourth that summer--less than 3 months before the end of the fiscal year. Not surprisingly, the tables show that forecasts made closer to the end of the period tend to converge and to grow closer to the actual result.

#### Center's Proposed Consensus Forecast Not a Model for the Federal Level

While these tables make clear that there are problems with forecasts at the federal level--both in the differences between CBO and OMB and in the ability of either to accurately predict the economy--the Center's briefing paper does not seem to offer a readily adaptable model for developing consensus forecasts at the federal level.

As the Center's report notes, achieving consensus on economic assumptions is easiest when either one party controls both the executive and the legislative branches or when there is bipartisan consensus on the basis for producing estimates. Neither of these conditions pertains today at the federal level.

In fact, one element of the Center's paper would represent quite a dramatic shift in power away from the legislative

branch to the executive. The conclusion of the Center's paper is less a call for agreed-upon estimates than a call for a balanced-budget requirement combined with a tremendous grant of power to the executive branch to reduce spending in any program to balance the budget in a single year. (See page 14 of the Center's report.) Under the Center's proposal, if the independent estimating agency revised its revenue estimates, OMB and the President would "determine and execute budget cuts to conform to the agency's revenue estimates." This would require that any increase in the deficit caused by a decline in economic activity be offset. Therefore, the Center's proposal would not only be a major shift of fiscal power, it would also eliminate any automatic countercyclical response by the budget.

As you note, the paper focuses entirely on revenue estimates. This seems highly relevant and appropriate for state budgets but less relevant for the federal budget.

Unlike many states, the federal government has a single unified budget and a public debt. The size of the debt and current deficits means that not only is revenue highly sensitive to economic growth, but expenditures are highly sensitive to interest rates. Since an administration's interest rate forecast might well influence actual interest rates, the administration is likely to publish interest rate forecasts that are more optimistic than others.

Also, most states must accept the state of the economy as given. Inflation, interest rates, and real GNP growth are influenced only indirectly if at all by state actions. States have limited ability to affect unemployment and growth even within the state in the short term. The federal government, however, need not always take the state of the economy as given; it may take action designed to change economic conditions. Any President who proposes such action will expect it to succeed; hence his estimates will assume the success of his economic program.

Consensus Forecasts Would Not Address Forecast or Estimating Inaccuracies

The Center's paper seems to focus as much on the inaccuracy of the deficit forecasts as on any disagreement between forecasters. Consensus forecasts, however, would not, by themselves, eliminate technical or procedural flaws giving

rise to estimating inaccuracies. For example, under the Gramm-Rudman-Hollings (GRH) law, there was an incentive for the administration to be overly optimistic in its forecasts, both for economic growth and for interest rates, to project compliance with deficit targets in any given fiscal year. Similarly, there was an incentive for the Congress to accept those overly optimistic forecasts; any less optimistic forecast would, under the structure of that law, have imposed more onerous choices on both the Congress and the administration. Under the Budget Enforcement Act of 1990, this incentive has been lessened significantly because the focus is on spending limits and pay-as-you-go requirements rather than on the more economic forecast-sensitive deficit goals. Indeed, after passage of the act, the overoptimism of the OMB economic growth forecasts moderated. This year CBO is somewhat more optimistic about economic growth in 1993 than is OMB.

Another structural flaw in GRH contributing to unrealistic and inaccurate forecasts was the fact that forecasts and estimates ceased to matter after the annual "snapshot." If automatic spending cuts were not triggered by that "snapshot" estimate, neither changes in economic conditions nor enactment of deficit-increasing legislation would force any action to reduce the deficit. The authors of the Budget Enforcement Act sought to remedy this defect by providing a mechanism for forcing spending reductions after-the-fact if discretionary spending exceeds the legislated caps or if new entitlement or tax legislation would add to the deficit.

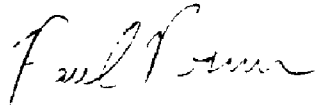
Our enclosed report, 1991 Budget Estimates: What Went Wrong examined budget forecasts for 1991. This study found that technical problems accounted for the largest portion of the forecasting "gap" between OMB's original estimate and the actual year-end results. These "technical" issues, however, include a significant over-estimate of capital gains tax receipts, some of which appears to be due to flaws in the way changes in real estate values are factored into revenue forecasts. The other major source of error was a mistake made by most forecasters, an expectation that the recession would end sooner than it did. As CBO noted in an earlier analysis of the differences between CBO and OMB forecasts, "forecast errors tend to grow larger when the economy is more unstable."

B-248734

Table number 6 of the enclosure compares CBO and OMB revenue estimates. These show quite a different pattern than the economic assumptions tables. Although CBO and OMB estimates are not identical, they generally are much closer to each other than to the actual receipts for a given year. This adds strength to the conclusion that the problem is less disagreement between forecasters than the difficulty in making accurate predictions, especially in times of economic uncertainty.

We would be glad to discuss this with you or to work with you on budget issues of mutual concern. Please feel free to call me at 275-9573.

Sincerely yours,



Paul Posner  
Director, Budget Issues

Enclosures

Table 1: Inflation

Enclosure I

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 Consumer Price Index Forecast Comparison  
 (% Change; 4th Quarter to 4th Quarter)

Forecast Period	Date of Forecast	CBO	OMB	Blue Chip	Actual
-----	-----	---	---	-----	-----
1993					
	Early 1992	3.6	3.3	3.7	
1992					
	Early 1991	3.5	3.9	4.1	
	Midyear 1991	3.9	3.9	4.0	
	Early 1992	3.4	3.1	3.3	
1991					
	Early 1990	4.3	4.0	4.2	
	Midyear 1990	4.4	4.2	4.3	
	Early 1991	4.0	4.3	3.8	
	Midyear 1991	3.2	3.4	3.5	3.1
1990					
	Early 1989	4.8	3.5	4.7	
	Midyear 1989	4.7	4.1	4.6	
	Early 1990	4.0	3.9	4.3	
	Midyear 1990	4.8	4.9	5.0	6.3
1989					
	Early 1988	4.8	3.9	4.7	
	Midyear 1988	5.0	3.9	5.0	
	Early 1989	5.0	3.6	4.8	
	Midyear 1989	5.3	4.9	5.3	4.6
1988					
	Early 1987	4.4	3.6	n/a	
	Midyear 1987	4.4			
	Early 1988	4.9	4.3	4.1	
	Midyear 1988	4.4	4.2	4.4	4.3

Note: Forecasts are presented in order. The first forecast in each year is about two years ahead of the end of the forecast period. The second is one and one-half years ahead, the third is one year ahead, and the fourth is one-half year before the end of the period. Midyear 1987 does not present OMB and blue chip forecasts. CBO and blue chip use CPI for all urban consumers (CPI-U). OMB uses CPI for urban wage earners and clerical workers (CPI-W). CPI-U was selected as the actual.

Sources: An Analysis of the President's Budgetary Proposals, various years; and The Economic and Budget Outlook: An Update, various years, both from the Congressional Budget Office. Also, Economic Report of the President, February 1992.

Table 2: Economic Growth

Enclosure I

Real Gross Domestic Product (1993), Real Gross National Product (1988-1992)

Forecast Comparison

% Change; 4th Quarter to 4th Quarter

Forecast Period	Date of Forecast	CBO	OMB	Blue Chip	Actual
1993	Early 1992	3.3	3.0	3.1	
1992	Early 1991	3.4	3.6	2.8	
	Midyear 1991	3.3	3.6	2.8	
	Early 1992	2.8	2.2	2.3	
1991	Early 1990	2.4	3.2	2.4	
	Midyear 1990	2.5	2.9	2.4	
	Early 1991	1.3	0.9	0.9	
	Midyear 1991	1.1	0.8	0.9	0.0
1990	Early 1989	2.2	3.4	1.9	
	Midyear 1989	2.0	2.6	1.7	
	Early 1990	1.7	2.4	1.6	
	Midyear 1990	2.3	2.2	2.0	0.5
1989	Early 1988	2.6	3.5	2.2	
	Midyear 1988	2.7	3.3	1.9	
	Early 1989	2.9	3.5	2.3	
	Midyear 1989	2.4	2.7	2.2	2.6
1988	Early 1987	2.9	3.7	n/a	
	Midyear 1987	2.7			
	Early 1988	1.8	2.4	1.8	
	Midyear 1988	2.6	3.0	3.0	2.8

Note: Forecasts are presented in order. The first forecast in each year is about two years ahead of the end of the forecast period. The second is one and one-half years ahead, the third is one year ahead, and the fourth is one-half year before the end of the period. Midyear 1987 does not present OMB and blue chip forecasts.

Sources: An Analysis of the President's Budgetary Proposals, various years; and The Economic and Budget Outlook: An Update, various years, both from the Congressional Budget Office. Also, Economic Report of the President, February 1992.

Table 3: Short-term Interest Rates

Enclosure I

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 Three-Month Treasury Bill Rate Forecast Comparison  
 Calendar-year Average (%)

Forecast Period	Date of Forecast	CBO	OMB	Blue Chip	Actual
-----	-----	---	---	-----	-----
1993	Early 1992	5.1	4.9	5.0	
1992	Early 1991	7.0	6.0	6.3	
	Midyear 1991	6.2	5.9	6.1	
	Early 1992	4.4	4.1	4.1	
1991	Early 1990	7.2	5.4	7.3	
	Midyear 1990	6.9	6.8	7.5	
	Early 1991	6.6	6.4	6.0	
	Midyear 1991	5.8	5.7	5.8	5.4
1990	Early 1989	7.1	5.5	7.3	
	Midyear 1989	7.2	6.7	7.4	
	Early 1990	6.9	6.7	7.3	
	Midyear 1990	7.6	7.7	7.7	7.5
1989	Early 1988	6.7	5.2	6.4	
	Midyear 1988	7.1	5.5	7.0	
	Early 1989	7.9	6.3	7.8	
	Midyear 1989	8.2	8.0	8.2	8.1
1988	Early 1987	5.7	5.6	n/a	
	Midyear 1987	5.7			
	Early 1988	6.2	5.3	5.9	
	Midyear 1988	6.3	6.0	6.5	6.7

Note: Forecasts are presented in order. The first forecast in each year is about two years ahead of the end of the forecast period. The second is one and one-half years ahead, the third is one year ahead, and the fourth is one-half year before the end of the period. Midyear 1987 does not present OMB and blue chip forecasts.

Sources: An Analysis of the President's Budgetary Proposals, various years; and The Economic and Budget Outlook: An Update, various years, both from the Congressional Budget Office. Also, Economic Report of the President, February 1992.



Table 4: Long-term Interest Rates

Enclosure I

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 Ten-Year Treasury Note Rate Forecast Comparison  
 Calendar-year Average (%)

Forecast Period	Date of Forecast	CBO	OMB	Blue Chip	Actual
-----	-----	---	---	-----	-----
1993	Early 1992	7.1	6.9	7.6	
1992	Early 1991	7.7	7.2	8.0	
	Midyear 1991	8.3	7.8	8.3	
	Early 1992	7.1	7.0	7.1	
1991	Early 1990	7.7	6.8	7.9	
	Midyear 1990	7.8	7.9	8.3	
	Early 1991	7.9	7.5	7.8	
	Midyear 1991	8.2	8.0	8.2	7.9
1990	Early 1989	9.0	7.2	8.4	
	Midyear 1989	8.2	7.7	8.1	
	Early 1990	7.8	7.7	7.9	
	Midyear 1990	8.5	8.5	8.5	8.6
1989	Early 1988	9.5	7.4	9.0	
	Midyear 1988	9.1	8.1	8.9	
	Early 1989	9.3	8.3	9.0	
	Midyear 1989	8.6	8.5	8.5	8.5
1988	Early 1987	7.2	6.6	n/a	
	Midyear 1987	6.8			
	Early 1988	9.3	8.0	8.8	
	Midyear 1988	8.9	8.5	8.9	8.8

Note: Forecasts are presented in order. The first forecast in each year is about two years ahead of the end of the forecast period. The second is one and one-half years ahead, the third is one year ahead, and the fourth is one-half year before the end of the period. Midyear 1987 does not present OMB and blue chip forecasts. Blue chip does not project 10-year note rates. Projection equals blue chip projection of Aaa bond rate adjusted by CBO to reflect spread between Aaa bonds and 10-year Government notes.

Sources: An Analysis of the President's Budgetary Proposals, various years; and The Economic and Budget Outlook: An Update, various years, both from the Congressional Budget Office. Also, Economic Report of the President, February 1992.

Table 5: Unemployment

Enclosure I

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 Civilian Unemployment Rate Forecast Comparison  
 Calendar-year Average (%)

Forecast Period	Date of Forecast	CBO	OMB	Blue Chip	Actual
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1993	Early 1992	6.4	6.5	6.4	
1992	Early 1991	6.4	6.6	6.3	
	Midyear 1991	6.2	6.4	6.5	
	Early 1992	6.9	6.9	6.9	
1991	Early 1990	5.5	5.3	5.6	
	Midyear 1990	5.4	5.6	5.5	
	Early 1991	6.8	6.7	6.5	
	Midyear 1991	6.7	6.6	6.7	6.8
1990	Early 1989	5.5	5.1	5.7	
	Midyear 1989	5.5	5.4	5.7	
	Early 1990	5.6	5.4	5.6	
	Midyear 1990	5.3	5.4	5.4	5.5
1989	Early 1988	6.1	5.6	6.1	
	Midyear 1988	5.5	5.2	5.5	
	Early 1989	5.5	5.2	5.4	
	Midyear 1989	5.3	5.2	5.3	5.3
1988	Early 1987	6.5	6.3	n/a	
	Midyear 1987	5.7			
	Early 1988	6.2	5.8	6.0	
	Midyear 1988	5.5	5.5	5.5	5.5

Note: Forecasts are presented in order. The first forecast in each year is about two years ahead of the end of the forecast period. The second is one and one-half years ahead, the third is one year ahead, and the fourth is one-half year before the end of the period. Midyear 1987 does not present OMB and blue chip forecasts. CBO and blue chip use civilian labor force; OMB uses total labor force. Actual shows civilian unemployment.

Sources: An Analysis of the President's Budgetary Proposals, various years; and The Economic and Budget Outlook: An Update, various years, both from the Congressional Budget Office. Also, Economic Report of the President, February 1992.

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 Comparison of CBO Baseline and OMB Current Services Revenue Estimates

	FY88	FY89	FY90	FY91	FY92	FY93
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<b>A: Estimates</b>						
<b>Next Fiscal Year</b>						
OMB Current Policy	910.4	964.0	1057.5	1156.3	1162.3	1164.3
CBO Baseline	900.5	954	1069	1137	1169	1173
OMB President's Proposal	916.6	964.7	1059	1170.2	1165.0	1165.4
CBO Re-estimate of Pres.	905.4	954.8	1070	1146.4	1172.2	1171.2
<b>Current Fiscal Year</b>						
OMB Current Policy	908.9	975.5	1072.8	1091.1	1076.6	
CBO Baseline	898	983	1067	1093	1088	
OMB President's Proposal	909.2	976	1073.5	1091.4	1075.7	
CBO Re-estimate of Pres.	898.8	983	1067.7	1093.6	1082.5	
<b>B: Actual</b>	909.0	990.7	1031.3	1054.3		
<b>C: Differences (using Next Fiscal Year data)</b>						
OMB Current Policy to CBO Baseline	10	10	-11	19	-7	-9
OMB Current Policy to Actual	1	-27	26	102		
CBO Baseline to Actual	-9	-37	38	83		

Note: Next Fiscal Year: forecasts for the FY shown were made approximately 18 months in advance of the start of the FY.

Current Fiscal Year: forecasts for the FY shown were made during the FY--approximately 3-6 months into the FY.

Sources: Budget of the United States Government (OMB), various years; An Analysis of the President's Budgetary Proposals (CBO), various years.