BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

TO: Federal Open Market Committee DATE: January 31, 1992

FROM: Gary Gillum GTG

Attached for the Committee's information is a brief summary of the Administration's budget proposals for FY1993 prepared by the Board's Division of Research and Statistics.

Attachment

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

DIVISION OF RESEARCH AND STATISTICS

Date: January 31, 1992

To: Board of Governors

From: Division of Research and Statistics (Fiscal Analysis Section)

Subject: The President's Budget for FY1993

President Bush has submitted his FY1993 budget to the Congress. It contains large upward revisions to the Administration's July estimates for the federal budget deficit in FY1992 and over the next several years. In addition, it includes the proposals that were outlined in the President's State of the Union address.

Near-term Budget Developments

As shown below, the Administration now estimates the FY1992 deficit at $399 billion, compared with a figure of $348 billion in the July Mid-Session Review. The revision is

NEAR-TERM BUDGET PROJECTIONS
(Fiscal years, billions of dollars)

	Administration				CBO	
	July		January			
	1992	1993	1992	1993	1992	1993
Outlays	1494	1479	1475	1516	1454	1505
Receipts	1146	1233	1076	1165	1102	1179
Deficit	348	246	399	352	352	327
	---------Excluding deposit insurance and Desert Storm Contributions----------					
Outlays	1376	1430	1400	1441	1392	1437
Receipts	1146	1233	1076	1165	1102	1179
Deficit	230	197	324	276	290	258

more than accounted for by a sizable downward adjustment to receipts that reflects primarily the effects of weaker-than-anticipated economic activity, the change in withholding schedules announced by the President, and technical adjustments to effective tax rates. On the outlay side, spending on deposit insurance is lowered by nearly $40 billion--to $80 billion, but there is a partial offset from upward revisions to Medicaid and other programs. The Administration's new deficit estimate is considerably larger than the $352 billion figure released by the Congressional Budget Office last week: The CBO estimate, which was released on January 22, predates the change in withholding schedules, and it incorporates a lower projection for deposit insurance outlays this year. For FY1993, the Administration now projects the deficit at $352 billion--approximately $100 billion higher than expected last summer; changes to the baseline deficit essentially account for the upward revision, as the net effect on the deficit of the President's proposals is small.

The President's Proposals

The budget, of course, also incorporates the proposals outlined in the President's State of the Union address. Some are aimed at stimulating economic activity over the near-term, while others are geared to the achievement of longer-run budgetary objectives.

Many of the proposals are on the receipts side of the budget; overall, they are expected to lower receipts by $5 billion in FY1992, $4 billion in FY1993, and $25 billion for the 1992-97 period as a whole. They include the adoption of a temporary investment tax allowance (which is expected to cost $6 billion in FY1992), new provisions to stimulate home buying, an increase in the personal exemption of $500 per child, and an extension of the tax credit for research and experimentation. The change in withholding schedules, which is estimated to lower receipts by $14 billion in FY1992, is already reflected in the Administration's baseline and thus is not considered a "policy proposal" in the budget document. As in previous years, the President is requesting a reduction in capital gains tax rates and new incentives for personal saving.

With respect to discretionary spending, the President's program would hold outlays in each of the three major categories within the statutory caps, as currently estimated, in FY1993; for FY1994-95, when the cap applies to discretionary spending as a whole, the totals also would be within the statutory limits. The proposed savings in defense outlays add up to $5 billion in FY1993 and $27 billion over the entire 1992-97 period.

Specific proposals for mandatory spending programs do not appear to break much new ground--in part because any plans for "comprehensive health reform" are excluded from this document. Overall, the proposed savings total $68 billion for the 1992-97 period, with more than half coming from the assumed enactment of reforms to deposit insurance and to the Pension Benefit Guaranty Corporation (PBGC). Another $14 billion is slated to come from Medicare, where several of the proposals are similar to ones in last year's budget. The only noticeable increase in mandatory spending is from a further extension of unemployment insurance benefits.

Budget Accounting and Procedures

The Administration's program appears to comply with the requirements of the Budget Enforcement Act of 1990. However, it is worth noting that, in FY1992-93, compliance with the pay-as-you-go (PAYGO) requirements for mandatory spending and receipts is contingent on the enactment of the Administration's previously proposed reforms to deposit insurance and to the PBGC--and the scoring of the savings from those reforms on an accrual accounting basis.[1] In addition, the change in withholding schedules ordered by the President does not come under the discipline of the PAYGO constraints.

The budget also contains a few proposals that the President believes would make the budget process more effective. Notably, he endorses the concept of a cap on the growth of aggregate entitlement spending similar to one that had been proposed earlier by members of the House Budget Committee,[2] and he continues to favor the adoption of a line-item-veto. Also, he is willing to consider, under certain conditions, modifications to the budget act to allow the projected saving in defense outlays to offset the revenue loss from the proposed increase in the personal exemption.

The Administration's Economic Forecast

As shown below, the Administration anticipates that economic activity will strengthen over the near term and that

1. Under accrual accounting, changes in the present value of expected future insurance losses would be recorded in the budget as outlays. Thus, changes in programs that are expected to cut future cash outlays would be recorded in the budget sooner than under current rules.

2. Prior to the enactment of "comprehensive health reform", growth in entitlements other than deposit insurance would be held to the sum of projected population growth and the forecasted increase in the CPI, plus 2-1/2 percent--or about 6-1/2 percent per year. Spending above the cap would trigger the legislative reconciliation process to correct the excess; in addition, the PAYGO system would be modified so that any uncorrected breach of the cap would force a sequester on mandatory spending (other than Social Security). If enacted, the President's programmatic proposals would hold mandatory spending within the proposed cap.

real GDP growth will total 2-1/4 percent over the four quarters of 1992. Real growth is projected to pick up to 3 percent in

ADMINISTRATION ECONOMIC ASSUMPTIONS

	Calendar years					
	1992	1993	1994	1995	1996	1997
	--------Percent change, Q4 over Q4---------					
Real GDP	2.2	3.0	3.0	3.0	2.9	2.8
GDP deflator	3.2	3.4	3.3	3.3	3.2	3.2
Consumer Price Index	3.1	3.3	3.2	3.2	3.2	3.1
	----------Percent, annual average----------					
Civilian unemployment rate	6.9	6.5	6.1	5.8	5.4	5.3
Interest rates						
Treasury bills	4.1	4.9	5.3	5.3	5.2	5.1
Treasury notes	7.0	6.9	6.7	6.6	6.6	6.6

1993 and to remain at about that pace through 1997. With potential real GDP rising about 2-1/4 percent per year, the unemployment rate is projected to decline steadily--to 5-1/4 percent by 1997. Inflation, as measured by the consumer price index, is expected to be about 3 percent in 1992 and to edge up only a bit over the following few years.

The Longer-run Budget Outlook

The new estimates imply that the longer-run outlook for the budget also has deteriorated further, in part reflecting the lower level of economic activity throughout the period, as well as the higher interest costs associated with the larger deficits. The deficit excluding deposit insurance now is expected to flatten out in the mid-1990s at a bit more than $200 billion, and it is still equal in FY1997 to more than 2-1/2 percent of the GDP projected by OMB for that year. By contrast, at this time last year, the Administration was anticipating that the budget would be essentially balanced by the middle of the decade.

ADMINISTRATION POLICY BUDGET PROJECTIONS
(Billions of dollars)

	Fiscal years					
	1992	1993	1994	1995	1996	1997
Outlays	1475	1516	1475	1536	1608	1684
Receipts	1076	1165	1263	1344	1428	1502
Deficit	399	352	211	192	180	182
Deficit ex deposit insurance and Desert Storm contributions	324	276	236	219	202	214
Memo:						
Deposit insurance	80	76	-25	-27	-22	-32
Desert Storm contributions(-)	5	0	0	0	0	0
Deficit ex policy changes	394	356	228	212	--	--
Deficit ex policy changes, deposit insurance, and Desert Storm contributions	319	280	253	239	--	--

DEFICIT AS A PERCENT OF GROSS DOMESTIC PRODUCT

	Fiscal years					
	1992	1993	1994	1995	1996	1997
Deficit	6.8	5.7	3.2	2.7	2.4	2.3
Deficit ex deposit insurance and Desert Storm contributions	5.5	4.5	3.6	3.1	2.7	2.7