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Business & Financial Letter

Shortfall

Pentagon purchasing agents did their best, pushing out $1.7 billion in new contracts on the very last day, yet the Federal government fell far short of its spending target in the fiscal year which ended September 30. Last January, budget analysts envisioned total spending of more than $411 billion, but the actual figure probably fell below $402 billion. This embarrassing situation followed on the heels of a similar shortfall last year, which was widely blamed for the late-1976 "pause" in economic activity.

Many people are surprised (although perhaps not concerned) that the bureaucracy has failed to do what it usually does very well—that is, spend money. The average critic believes that the Federal government already takes too much of our income—roughly 20 to 25 percent of total U.S. output over the past two decades. Thus, with outlays reduced, the Federal deficit (and Treasury borrowing needs) could be smaller, thereby lowering interest payments and taxes. Under these circumstances, more of the nation's resources could be devoted to meeting private needs rather than the public sector's demands. Just as importantly, a smaller Federal deficit could lower inflationary expectations and reduce price pressures on the general economy.

Why worry?
The concern with a shortfall rather focusses upon the short-run impact which Federal underspending could have on budget planning and the strength of the overall economy. Continued shortfalls could undermine the still-fragile budget-reform process, and tempt Congress to adopt broad new spending programs because of a belief that all the money would not be spent. Moreover, as we saw during the 1976 "pause," a spending shortfall could adversely affect many individuals who were counting on the jobs created by Federally-supported construction work in their communities.

The $7-billion shortfall in fiscal 1976 outlays, coupled with the underspending in the ensuing (July-September) transition quarter, could partially explain the economic slowdown during that period. (According to the Congressional Budget Office, the shortfall reduced GNP in summer-fall 1976 at about a one-percent annual rate.) Some observers foresee a certain parallelism this fall, with the 1977 shortfall being accompanied by another slowdown in economic activity. The fears have been reinforced by the expected dependence of the economy on government spending in the year ahead.

The second stage of the Administration's stimulus program has just begun with large transfers to state and local governments, most of whom are in relatively good financial shape and anxious to spend

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funds rather than reduce debt. In total, the Federal government in fiscal 1978 is expected to boost outlays by some $60 billion to about $463 billion (unified budget basis). In the Administration's view, Federal spending of that magnitude should help generate more than 4-percent real growth in the economy, and thereby help bring the unemployment rate below the 7-percent plateau around which it has hovered since last spring. (In the past, a 4-percent growth rate has been just sufficient to maintain, but not reduce, the current jobless rate.) Another shortfall in budgeted expenditures could, of course, upset those hopes.

Why the shortfall?
Actually, expenditures have fallen short of budgeted outlays in 12 of the past 18 years, but the shortfalls have been especially significant last year and this. And most of the spending which does not occur within the budgeted time appears lost, not to be made up in future budget periods. Part of the explanation may be the budget process itself, which builds into the system a bias toward overestimating the government's ability to spend money. Agencies may seek more than they can spend, in an effort to insure even more funds in future years for as-yet-unexpected programs.

Again, budget estimates are based upon some sizable unknowns at the time when estimates are initially made. Estimates for open-ended spending programs which are affected by changing business conditions sometimes end up too high in an expanding economy. (Budget outlays decrease about $15 billion for each one-percent drop in the unemployment rate.) Again, snags develop in certain programs, especially those affecting states and localities, because of massive paperwork which involves several government agencies in each case. Another unpredictable factor is the Congressional calendar, which frequently delays appropriations for various purposes. Even the weather, such as last winter's severe cold, can delay spending for construction and other programs.

Despite all the different theories, budget experts are still not certain what is throwing off their spending projections. Consequently, the past record becomes an important element in predicting future spending patterns. And some analysts, looking at our recent experience with the estimates produced by the Office of Management and Budget (OMB), argue that actual expenditures in fiscal 1978 will fall short of the projected $463 billion.

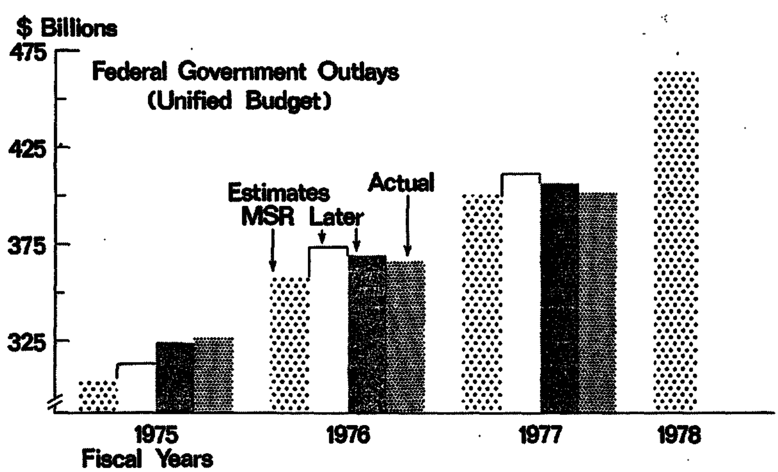
When the error?
But a closer look into OMB's forecasting record can produce a surprisingly different conclusion. The likelihood of a spending shortfall depends on which of several different spending estimates are compared with the expenditure figure which finally materializes. The first estimate—which we don't consider in these comparisons—is published in the January prior to

the beginning of the fiscal year, and this is followed by the midsession review (MSR) published each summer near the beginning of each fiscal year. (This MSR estimate is the one emphasized in this article.) Later budget revisions are published within each fiscal year. For example, a midsession review of the fiscal 1975 budget figure was published in May 1974, and later projections were published in February and May 1975.

In recent years, MSR estimates have actually underestimated the final outlay figures. The upward bias that budget experts talk about—the shortfall—occurred in fiscal 1976 and 1977 only in the interyear revisions. For example, actual final outlays in fiscal 1976 amounted to \$366½ billion, representing a \$7-billion shortfall from the estimate made the previous January, while the probable figure for fiscal 1977—\$400 to \$402 billion—represents roughly a \$10-billion shortfall from last January's estimate. In contrast, the MSR estimate for fiscal 1977, which was made in July 1976, was very close to (perhaps a little below) the figure which will finally be reported. It should be noted, however, that that estimate would have been considerably higher (\$414 billion) but for Ford Administration "hold-downs" on certain programs that were ignored in later budget revisions.

What of fiscal 1978? In July of this year, OMB estimated budget outlays of \$463 billion for that period—more than 15 percent higher than the actual figure now expected for fiscal 1977. However, given the intense scrutiny which OMB is now giving its own estimates, there is less likelihood than before of a shortfall in any of the estimates developed for the new fiscal year. In view of the sharp spending increase that has already been projected, this suggests that the government sector will indeed provide a significant stimulus to the economy in the year ahead.

Rose McElhattan



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BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT
(Dollar amounts in millions)

Selected Assets and Liabilities Large Commercial Banks	Amount Outstanding 9/28/77	Change from 9/21/77	Change from year ago Dollar	Change from year ago Percent
Loans (gross, adjusted) and investments*	100,863	– 89	+ 10,715	+ 11.89
Loans (gross, adjusted)—total	78,298	+ 68	+ 10,001	+ 14.64
Security loans	1,670	– 92	+ 220	+ 15.17
Commercial and industrial	24,062	+ 32	+ 1,842	+ 8.29
Real estate	25,919	+ 87	+ 5,077	+ 24.36
Consumer instalment	13,583	+ 87	+ 1,828	+ 15.55
U.S. Treasury securities	8,296	– 177	– 870	– 9.49
Other securities	14,269	+ 20	+ 1,584	+ 12.49
Deposits (less cash items)—total*	99,414	+ 1,087	+ 9,671	+ 10.78
Demand deposits (adjusted)	27,726	– 223	+ 2,645	+ 10.55
U.S. Government deposits	959	+ 431	+ 406	+ 73.42
Time deposits—total*	69,146	+ 842	+ 6,582	+ 10.52
States and political subdivisions	5,280	+ 1	– 40	– 0.75
Savings deposits	31,885	+ 219	+ 4,269	+ 15.46
Other time deposits‡	29,598	+ 492	+ 2,433	+ 8.96
Large negotiable CD's	11,930	+ 459	+ 655	+ 5.81

Weekly Averages of Daily Figures	Week ended 9/28/77	Week ended 9/21/77	Comparable year-ago period
Member Bank Reserve Position			
Excess Reserves (+)/Deficiency (–)	+ 49	+ 30	+ 17
Borrowings	28	41	0
Net free(+)/Net borrowed (–)	+ 21	– 11	+ 17
Federal Funds—Seven Large Banks			
Interbank Federal fund transactions			
Net purchases (+)/Net sales (–)	– 883	+ 694	– 1,570
Transactions with U.S. security dealers			
Net loans (+)/Net borrowings (–)	+ 274	+ 411	+ 127

*Includes items not shown separately. ‡Individuals, partnerships and corporations.

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