January 26, 1979

Budget: New Foundation

President Carter this week presented Congress with his budget for fiscal 1980, which begins October 1. The budget calls for expenditures of $531.6 billion, an increase of 7.7 percent ($38.2 billion) over the fiscal-1979 estimate. Since revenues are projected at $502.1 billion, the 1980 deficit will come out at $29.4 billion. This would be down $9.5 billion from the expected 1979 deficit, and would represent the smallest deficit of the past half-decade.

The realization of the President's budget depends upon what one observer describes as "the best of all possible worlds." The budget is aimed at slowing the rate of inflation by reducing stimulus from the public sector — but is also aimed at avoiding the restrictiveness which would shock the economy into a recession. The budget emphasizes the control and containment of expenditures rather than absolute across-the-board spending cuts. Altogether, it represents the financial support for the "New Foundation" which the President outlined in his State of the Union message.

Economic underpinnings

The 1980 budget will affect the economy by the degree of stimulus that it supplies to the income stream, but it in turn will be shaped by the state of the economy. The economic projections included with the budget help determine the estimates of Federal revenues, and thus are a significant factor in determining the projected deficit. In general, the Administration's forecast regarding economic growth and inflation is somewhat more optimistic than what most private forecasters are predicting.

The budget is predicated upon growth in real GNP — costant-dollar output — of 3.3 percent in 1979 and 2.5 percent in 1980. The pattern of growth should differ during the two years, however, so that on a year-end to year-end basis, real GNP should grow by 2.2 percent in 1979 and 3.3 percent in 1980. (The 1978 figure was 4.0 percent.) At the same time, the rate of inflation — as measured by the consumer price index — is expected to decelerate, year-end to year-end, from 1978's 9.2-percent figure to 7.4 percent in 1979 and 6.3 percent in 1980. (By a curious coincidence, the cost of the budget document for 1980 is 4.25 — which amounts to a 6.3-percent increase over the cost of the 1979 document.) The average unemployment rate is projected at 6.0 percent for 1979 and 6.2 percent for 1980, up from 5.8 percent for 1978.

Nonetheless, most private forecasters are distinctly more bearish than the Administration, with the consensus forecast indicating a brief and mild recession of about six months' duration during the second half of 1979. The consensus shows real GNP growing about 2.0 percent in 1979, compared with the 3.3-percent growth assumed in the budget. There is also disagreement over the price outlook, with most private forecasters expecting the inflation rate to be at least as bad in 1979 as in 1978. Ordinarily, slower growth would tend to lead to lower revenues, but if the inflation rate is higher, the upward pressure on incomes would actually boost revenues, given the progressive nature of the nation's tax system. Yet expenditures for unemployment compensation

(continued on page 2)
and other transfers could rise as employ-
ment falters, and the net effect could be a
larger deficit.

Taking a longer view, the Administration
expects real GNP growth to average
nearly 4½ percent in the 1981-83 period,
and to drop to 3 percent in 1984. With
this sustained growth, the unemploymnt
rate would drop to 4 percent by the end
of 1983, while the inflation rate would
drop to 2.7 percent by the end of 1984.
This longer-run forecast assumes that
policies would be implemented
to achieve the goals set down in the
Full Employment and Balanced Growth
Act of 1978 (the Humphrey-Hawkins
Act). Given such a pattern of growth,
the budget would show a very modest
deficit in 1981 ($1.2 billion), and would
show increasingly large surpluses there-
after — reaching $106.5 billion by 1984,
in the absence of major tax reductions.

The major, and possibly most controver-
sial, tax measure built into the budget
is the so-called “real-wage insurance”
program. This would provide a refund-
able tax credit to employees whose
compensation is kept within the 7-
percent anti-inflation guideline if the
inflation rate exceeds 7 percent. The
cost is estimated at $2.5 billion in 1980,
but it could run much higher if the infla-
tion rate exceeds the Administration’s
estimate for that year.

Who gets less — and more?
Despite the projected 7.7-percent
increase in 1980 spending, certain
programs are expected to be sharply
curtailed. One of the major cutbacks
will be in the public-service employ-
ment program (CETA). In view of the
sharp rise (3.3 million) in civilian
employment over the past year, the
countercyclical (Title 6) portion of the
program is due to be cut about $600
million, with the number of jobs being
reduced from 358,000 to 200,000 over
the course of the calendar year 1980.
The cutback is justified on the grounds
that this program was initiated when
unemployment was widespread, so that
it should be reduced as labor markets
become tighter. Also, the summer youth-
employment program would be reduced
by eliminating those under 15 years of
age and by carrying 1979 funding to
1980, with the cutbacks amounting to
about 250,000 jobs. Again, the number
of additional low-income families re-
ceiving rental housing assistance would
be cut by about 10 percent in 1980.

The Administration expects its largest
savings to come from the containment
of hospital costs, which if adopted
would result in total (public and pri-
vate) savings of $24 billion from 1980
to 1982 — and from other health-care
measures, which would generate
savings of around $3 billion in the
same period. The Administration also
proposes to “eliminate unnecessary
and windfall benefits” in the social
security system. In addition, it has
revived a perennial proposal to termi-
nate or reduce Federal aid to “impact-
ed” school districts — those
which have a heavy enrollment of child-
ren of servicemen or Federal employees
because of their location near Federal
installations.

In contrast, defense-related spending is
scheduled to increase by 3 percent in real
terms — about 10 percent in current-
dollars terms — to $125.8 billion in 1980. This represents the highest rate of real defense expenditure since 1972. The major increases will be directed toward beefing up strategic forces and re-equipping general-service forces. The development of a larger, more accurate intercontinental ballistic missile, and the procurement of an additional Trident submarine, are the major items in the strategic-forces budget. A strengthened NATO represents one of the chief aims in the general-forces budget, with the proposed addition of mechanized infantry and armored battalions in Europe. Additionally, the Navy will push forward a shipbuilding program.

Estimating the deficit

The actual Treasury deficit for fiscal 1980 will not be determined until the books are closed on September 30, 1980. Moreover, the track record of fiscal budget estimates does not exactly inspire confidence in the initial estimate. After all, the budget covers a period that is at least 18 months in the future, and the future has a habit of harboring unpleasant surprises that are not revealed until after the budgeting process is completed.

For confirmation, we need look no further back than the 1975 fiscal year. That year's budget was fashioned in late 1973 and early 1974, at a time when the economy was weakening but when no one foresaw the magnitude of the ensuing recession. Thus, the Administration estimated a $9.4-billion deficit for fiscal year 1975, only to be swamped by a massive $45.2 billion deficit as the recession unfolded.

The Administration’s budget for fiscal 1980 is fully compatible with its economic scenario of modest growth for the year ahead. We should remember, however, that the world has become a riskier place in recent years, and that the variance of economic forecasts has grown accordingly.

Herbert Runyon

![Graph of Federal Surplus/Deficit 1968-1978](image-url)
### BANKING DATA—TWELFTH FEDERAL RESERVE DISTRICT

#### Selected Assets and Liabilities

**Large Commercial Banks**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
<th>Change</th>
<th>Change from year ago</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans (gross, adjusted) — total</td>
<td>124,283</td>
<td>137</td>
<td>17,459</td>
</tr>
<tr>
<td>Security loans</td>
<td>1,776</td>
<td>-351</td>
<td>97</td>
</tr>
<tr>
<td>Commercial and industrial</td>
<td>29,080</td>
<td>-1</td>
<td>3,638</td>
</tr>
<tr>
<td>Real estate</td>
<td>35,265</td>
<td>40</td>
<td>7,910</td>
</tr>
<tr>
<td>Consumer installment</td>
<td>18,977</td>
<td>66</td>
<td>4,296</td>
</tr>
<tr>
<td>U.S. Treasury securities</td>
<td>8,475</td>
<td>67</td>
<td>955</td>
</tr>
<tr>
<td>Other securities</td>
<td>14,857</td>
<td>30</td>
<td>26</td>
</tr>
<tr>
<td>Deposits (less cash items) — total*</td>
<td>117,285</td>
<td>-403</td>
<td>11,842</td>
</tr>
<tr>
<td>Demand deposits (adjusted)</td>
<td>31,553</td>
<td>-293</td>
<td>2,123</td>
</tr>
<tr>
<td>U.S. Government deposits</td>
<td>309</td>
<td>-287</td>
<td>413</td>
</tr>
<tr>
<td>Time deposits — total*</td>
<td>83,517</td>
<td>390</td>
<td>10,416</td>
</tr>
<tr>
<td>States and political subdivisions</td>
<td>7,229</td>
<td>62</td>
<td>561</td>
</tr>
<tr>
<td>Savings deposits</td>
<td>31,366</td>
<td>152</td>
<td>-24</td>
</tr>
<tr>
<td>Other time deposits‡</td>
<td>42,472</td>
<td>220</td>
<td>10,459</td>
</tr>
<tr>
<td>Large negotiable CD's</td>
<td>20,628</td>
<td>146</td>
<td>5,732</td>
</tr>
</tbody>
</table>

#### Weekly Averages

**Weekly Figures**

<table>
<thead>
<tr>
<th>Description</th>
<th>Week ended 1/10/79</th>
<th>Week ended 1/03/79</th>
<th>Comparable year-ago period</th>
<th>Comparable year-ago period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Member Bank Reserve Position</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excess Reserves (+)/Deficiency (−)</td>
<td>- 43</td>
<td>+ 47</td>
<td>- 7</td>
<td></td>
</tr>
<tr>
<td>Borrowings</td>
<td>- 25</td>
<td>- 220</td>
<td>- 53</td>
<td></td>
</tr>
<tr>
<td>Net free (+)/Net borrowed (−)</td>
<td>- 68</td>
<td>- 173</td>
<td>- 60</td>
<td></td>
</tr>
<tr>
<td>Federal Funds—Seven Large Banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interbank Federal fund transactions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net purchases (+)/Net sales(−)</td>
<td>+ 1,180</td>
<td>+ 694</td>
<td>+ 1,244</td>
<td></td>
</tr>
<tr>
<td>Transactions with U.S. security dealers</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net loans (+)/Net borrowings (−)</td>
<td>+ 729</td>
<td>+ 369</td>
<td>+ 1,054</td>
<td></td>
</tr>
</tbody>
</table>

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

Editorial comments may be addressed to the editor (William Burke) or to the author. Free copies of this and other Federal Reserve publications can be obtained by calling or writing the Public Information Section, Federal Reserve Bank of San Francisco, P.O. Box 7702, San Francisco 94120. Phone (415) 544-2184.