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THE CHAIRMAN OF THE  
COUNCIL OF ECONOMIC ADVISERS  
WASHINGTON

May 19, 1979

MEMORANDUM FOR THE PRESIDENT

From: James T. McIntyre, Jr.   
Charles L. Schultze *CLS*

Subject: Economic Assumptions for the  
Mid-Session Review

Background

We have to make a final decision, early next week, on the economic assumptions to be used in our Mid-Session Review of the budget, which has to be sent to the Congress this summer. That review must set forth economic projections and budget estimates through fiscal 1984.

The long-term economic projections in the Economic Report and the Budget issued in January were consistent with the economic goals established by the Humphrey-Hawkins Act -- a 4 percent overall unemployment rate and a 3 percent inflation rate by the end of calendar year 1983. They were therefore very optimistic. While neither the Economic Report nor the Budget implied that these goals could in fact be achieved simultaneously, the estimates and projections in the Budget were based on these assumptions.

In addition to being unrealistic, the use of overly optimistic economic assumptions causes serious problems for long-term budgetary control; it subverts the goals of our 3-year planning and tracking system. Because both inflation and unemployment are understated, the future year outlay totals are misleadingly low. In the case of receipts, the unrealistically low inflation assumptions are broadly offset by the unrealistically high projections of real income growth. Thus future year surpluses -- which are sometimes viewed as budgetary resources available for program initiatives or tax cuts -- are overstated.

The unrealistic assumptions also seriously impair the usefulness and destroy the credibility of long-term budget plans in the Defense Department and other agencies with fully-funded programs. Use of Humphrey-Hawkins inflation assumptions understates the defense request, and will inevitably lead to what appear to be "cost overruns" but are in fact a result of unrealistic inflation assumptions.

The Humphrey-Hawkins Act stipulates that the January budget be consistent with the medium-term economic goals, and requires the President to review progress toward those goals in the 1980 and subsequent Economic Reports. The Act permits the President to recommend modification of the timetable for achieving these medium-term economic goals in the 1980 and subsequent Economic Reports, if necessary. The Act does not explicitly refer to what we must do in the Mid-Session Review. In theory, the Mid-Session Review could ignore Humphrey-Hawkins. In practice, this would violate the spirit and intent of the law.

Our current internal economic forecasts have much higher inflation and somewhat weaker economic growth for 1979-1980 than the January assumptions. We will need to modify our 1979 and 1980 public forecast for the Mid-Session Review in this direction to maintain credibility. A new forecast will mean that achievement of the 1983 targets would require even more rapid (and less realistic) declines in inflation and unemployment, and increases in real growth, in 1981-83.

The Congress, in developing its budget resolutions, need not and does not meet the medium-term Humphrey-Hawkins goals. During the debate on the 1980 Resolution in the House, Representative Giaimo inserted into the record a fact sheet on the economic implications of achieving the Humphrey-Hawkins goals by 1983. The conclusions of the fact sheet were: (1) "A very optimistic economy must be assumed to reach Humphrey-Hawkins goals by 1983." (2) "There are inconsistencies between the unemployment, growth and inflation objectives that create severe problems accompanying any effort to reach the Humphrey-Hawkins objectives in 5 years."

Economic Assumptions for the Mid-Session Review

Even though the Humphrey-Hawkins Act does not technically apply to the Mid-Session Review, failure to acknowledge the Humphrey-Hawkins economic goals would clearly violate both the intent of the law and Administration support of its goals. On the other hand, the use of economic assumptions consistent with Humphrey-Hawkins would -- to put it mildly -- require great optimism and would seriously understate the level of outlays and overstate the potential surplus in future years.

In order to avoid this dilemma, we are planning to use alternative economic assumptions for the Mid-Session Review. The detailed multiyear planning base numbers would reflect economic assumptions that are more realistic than the Humphrey-Hawkins goals. The Mid-Session Review would contain a separate section discussing the Humphrey-Hawkins goals and present -- but only in very aggregate terms -- budget projections consistent with Humphrey-Hawkins.

The strongest proponents of Humphrey-Hawkins both inside and outside government will object to this change, arguing that the alternative economic projections we are recommending dilute the commitment to the Humphrey-Hawkins goals. We believe that the use of only the Humphrey-Hawkins assumptions would be extremely costly in terms of sound budget planning and public credibility. More realistic assumptions can be defended in the name of conservative and prudent budgeting, and the commitment to the Humphrey-Hawkins goals can be at least formally maintained in the discussion of the alternative Humphrey-Hawkins economic projections.

\_\_\_\_\_ Agree

\_\_\_\_\_ Disagree

cc: Vice President Mondale  
Secretary Blumenthal  
Mr. Eizenstat  
Mr. Watson