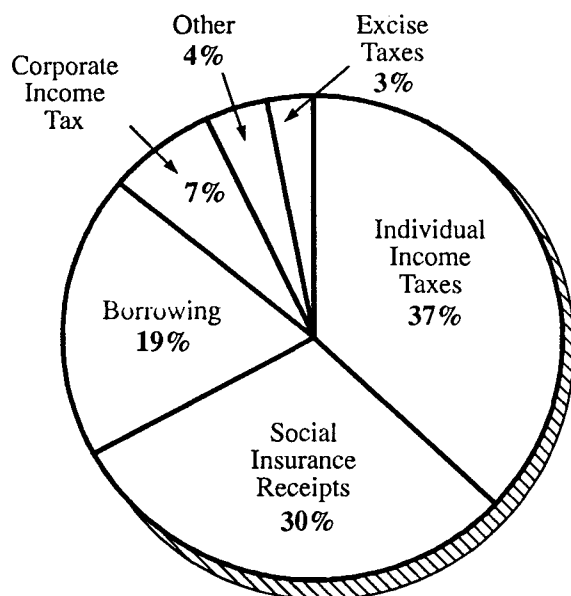

I. THE BUDGET MESSAGE OF THE PRESIDENT

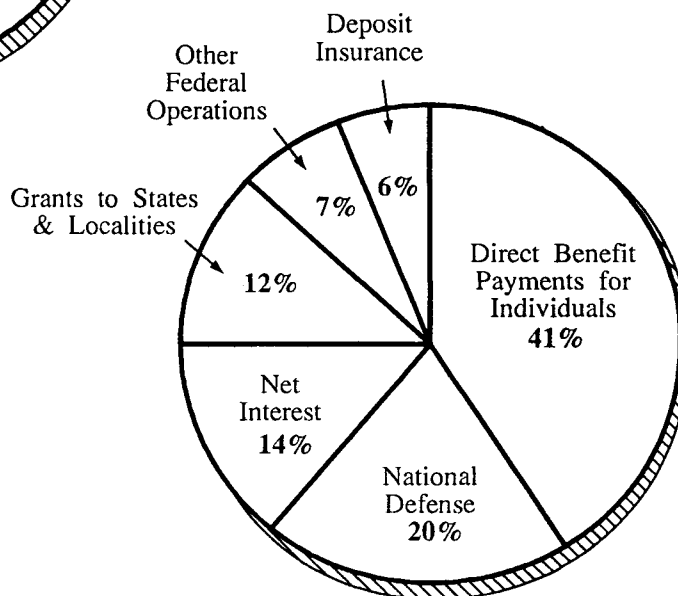
Part One-1

THE FEDERAL GOVERNMENT DOLLAR FISCAL YEAR 1992 ESTIMATE

Where It Comes From...



Where It Goes...



RECEIPTS, OUTLAYS, DEFICIT/SURPLUS UNDER THE PRESIDENT'S PROPOSED POLICY

(In billions of dollars)

	1990	1991	1992	1993	1994	1995	1996
Receipts	1,031.3	1,091.4	1,165.0	1,252.7	1,365.3	1,467.3	1,560.7
Outlays	1,251.7	1,409.6	1,445.9	1,454.2	1,427.1	1,470.3	1,540.8
Surplus or Deficit (+/-)	-220.4	-318.1	-280.9	-201.5	-61.8	-2.9	+19.9

I. THE BUDGET MESSAGE OF THE PRESIDENT

To the Congress of the United States:

I am pleased to present the *Budget of the United States Government for Fiscal Year 1992*.

The budget is consistent with the 5-year deficit reduction law enacted last fall. It recommends discretionary spending levels that fall within the statutory caps for defense, international, and domestic discretionary programs. It implements the entitlement savings and reforms enacted in the Budget Agreement. It conforms to the new pay-as-you-go requirements.

By holding the overall rate of growth of Federal Government spending to approximately 2.6 percent—below the inflation rate—the budget puts into effect the concept of a “flexible freeze,” which is an essential means of bringing the budget into long-term balance.

The longest period of peacetime economic expansion in history has been temporarily interrupted. We can, however, return to growth soon—and proceed on the path to a new era of expansion. With that goal in mind, the budget places special priority on policies that will enhance America’s potential for long-term economic growth, and that will give individuals the power to take advantage of the opportunity America uniquely offers.

To this end, I am again proposing tax incentives to increase savings and long-term investment.

On the spending side of the budget, the existence of a cap on domestic discretionary outlays rightly creates a competition for resources. Priorities must be set. This budget proposes that domestic investment be increased in the following key areas:

Education and Human Capital.—The budget proposes investments to prepare children better for school, to promote choice and excellence in our educational system, to improve math and science education, and to in-

crease the access of low-income Americans to higher education.

Prevention and the Next Generation.—The budget includes proposals to help reduce illness and death from preventable diseases, and to reverse the long-term trend of underinvestment in children.

Research and Development and the Human Frontier.—The budget recommends an increase of \$8.4 billion in the Federal investment in research and development, with special emphasis on basic research, high performance computing, and energy research and development. It proposes to extend permanently the tax credit for research and experimentation to encourage private sector R&D investment. In addition, the budget reflects the Administration’s continued commitment to expanding human frontiers in space and biotechnology.

Transportation Infrastructure.—The budget supports an expansion of the Federal Government’s investment in highways and bridges to over \$20 billion within 5 years, and proposes substantial increases to improve the condition of the Nation’s airports, to modernize the air traffic control system, and to continue to develop the transportation infrastructure for exploration and use of space.

America’s Heritage and Environmental Protection.—The budget includes increased funds for the expansion and improvement of America’s treasury of parks, forests, wildlife refuges, and other public lands; for the implementation of the Clean Air Act and other key environmental statutes; for the cleanup of pollution at various Federal facilities and at Superfund sites; and for protection and enhancement of coastal areas and wetlands.

Choice and Opportunity.—The budget provides: funds to help give parents greater choice in child care, health care, education, and housing; the resources to allow *all* Americans, especially those with low incomes, to seize the opportunities that such choice provides; and a

proposal to establish Enterprise Zones to bring hope to our inner cities and distressed rural areas.

Drugs and Crime.—The budget further increases the Administration's investment in drug prevention, treatment, and law enforcement. And the budget substantially increases the resources available to help the Federal Bureau of Investigation fight crime, the Federal prosecutors prosecute criminals, and the Federal prison system accommodate those convicted of crimes.

To make such investments possible, the budget includes recommendations to terminate or reduce Federal investment in certain low-return programs, and proposes reforms to slow the continuing growth of mandatory entitlement programs and to increase fairness in the distribution of the benefits these programs provide.

In addition, the budget contains a new proposal to fund various programs now carried out by the States through a comprehensive block grant. The States are continuing to develop new and innovative ways to deliver services more effectively. The budget not only highlights several of these innovations; it proposes to reinforce and build upon them.

The budget contains several proposals that reflect my commitment to managing govern-

ment better. These include measures to improve accountability, to reduce waste, to reform regulation, to employ risk management budgeting in addressing threats to health and safety, and to set clear objectives and measure performance in meeting them.

Finally, consistent with the statutory caps enacted last year, the budget provides the resources necessary to maintain national security, and to better advance American interests abroad. As the budget goes to press, the timing of the resolution of the multinational coalition's efforts to reverse the aggression in the Persian Gulf is uncertain. For this reason, the budget reflects only a placeholder for Operation Desert Shield. A supplemental request for the incremental costs of Desert Shield, which includes Desert Storm, will be forwarded to the Congress in the coming weeks.

The priority investments embodied in this budget will help America prepare for the requirements and opportunities presented by a rapidly changing world. I look forward to working with the Congress in developing a budget that lays the groundwork for a brighter future, protects our national interests, and helps create the conditions for long-term economic growth and prosperity.

GEORGE BUSH

FEBRUARY 4, 1991

II. DIRECTOR'S INTRODUCTION AND OVERVIEW TABLES

Part One-5

II. DIRECTOR'S INTRODUCTION AND OVERVIEW TABLES

A SOMBER MOMENT—BUT WITH HOPE FOR A NEW ORDER

Last year's budget was published in an historical context that bordered on the euphoric. Its introduction noted:

State-centered, command-and-control systems seem to be decomposing... Liberated celebrants have cheered the opening of the Berlin wall and the decline of communist dictators. So too have liberated Panamanians celebrated the fall of the dictator in near-by Panama...

This is not small stuff. It is another giant leap of the human spirit yearning to breathe free.

The introduction, then, went on to lament:

Yet this great historical shift has been almost trivialized in its translation into public debate about the budget. The issue has been framed as: "How big is the 'peace dividend'?"—and, in effect, "How can I get mine?"

This year's budget goes to press at a more somber moment, when the fragility of peace has again been made painfully evident. In August, a militaristic dictator brutally invaded a peaceful neighbor. He refused to conform to international norms established by the United Nations. He destabilized a region that is vital to the global economy—a region which, for too long, has been the victim of conflict.

As a result, suffering has increased within the region and throughout the world. Innocent people have been hurt. Economies have weakened. Allied military action has been undertaken as a last resort to enforce the resolutions of the United Nations. The early action has gone well. But precious lives have been lost. The poignant human costs of protecting freedom and the civilized rule of law have again been made clear.

Yet, although the moment is somber, there is cause for hope.

The liberation of Kuwait has begun. But of more far-reaching significance is this: With U.S. leadership, the global response to the

Iraqi invasion has the potential to set a favorable precedent for the post-Cold-War era—what the President has termed a New World Order.

At home, the Iraqi invasion of Kuwait has caused obvious economic difficulties. Oil prices were driven up for several months. Long-term interest rates reflected a risk premium. In the face of uncertainty, consumers and investors have understandably held back. The resulting economic slow-down has taken its toll. And the problem of the fiscal deficit has thus been compounded by the effects of the crisis in the Gulf.

Yet in this somber domestic picture, too, there is cause for hope. The move toward satisfactory resolution of the Gulf crisis is unequivocally positive for the domestic economy. And the residual fiscal crisis, though regrettable, has the potential to foster—even to accelerate—domestic reform. Within the framework of the 1990 Budget Agreement, constructive reforms can be framed. Though less grand than a New World Order, steps toward a new domestic order can continue to be advanced—at least at the margin of practicable change.

It is in this spirit that the new budget is presented.

This introduction:

- reviews the deficit outlook;
- outlines a reform agenda; and
- discusses the need for a new conception of "program life cycles"—within the framework of the 1990 Budget Act.

THE DEFICIT OUTLOOK—WORSE BEFORE BETTER

The new budget is for fiscal years 1992 and beyond. For each of these years, the consolidated deficit estimate promises to be better

than the year before. The projected deficit goes down by \$37 billion from 1991 to 1992. It reaches balance by 1996. (See Table II-1.) As a percent of GNP, it declines from 5.7 percent (near the recent high of 6.3 percent in 1983) to roughly 1 percent in the mid-1990s. The *longer-term* trend is favorable by several different measures of "the deficit." (See Chart II-1). But the inescapable reality of the *near term* is: the deficit outlook is not good.

The consolidated deficit for the current fiscal year, 1991, is estimated at \$318 billion. This

includes \$30 billion in budget authority and \$8 billion in outlays (net of foreign contributions) as a placeholder for the incremental costs of Operation Desert Shield. This does not fully cover the additional costs of actual combat, however. With substantial foreign contributions, the adverse financial effects on the United States should be mitigated. But neither full costs nor total contributions can be reliably estimated as the budget goes to press.

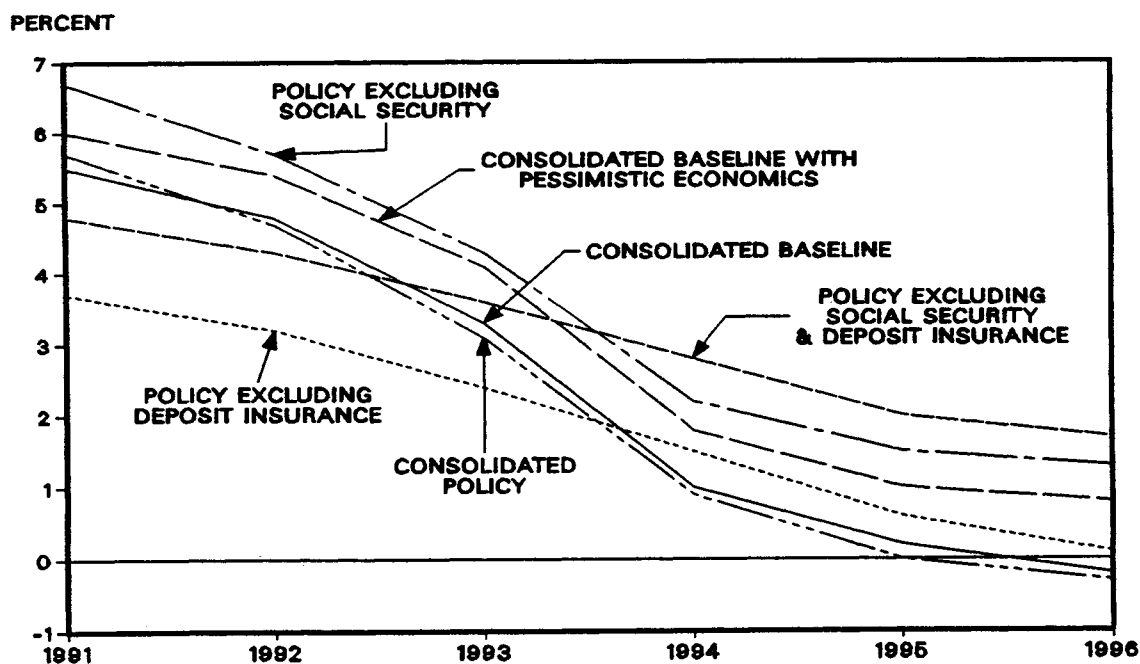
Even without the full net costs of Desert Shield (which includes Desert Storm), this

Table II-1. DEFICIT ESTIMATES, 1991-1996

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
Consolidated Baseline	-310.3	-284.9	-212.3	-67.5	-12.1	14.1
Consolidated Baseline with pessimistic economics	-336.1	-326.0	-262.1	-126.3	-75.3	-61.4
Consolidated Policy	-318.1	-280.9	-201.5	-61.8	-2.9	19.9
Policy excluding Social Security	-378.6	-343.3	-274.9	-151.1	-106.8	-101.9
Policy excluding Deposit Insurance	-206.6	-192.8	-157.3	-99.9	-45.3	-10.0
Policy excluding Social Security and Deposit Insurance	-267.1	-255.2	-230.7	-189.2	-149.1	-131.8

Chart II-1. DEFICITS AS A PERCENT OF GNP



1991 deficit estimate represents a substantial deterioration relative to the 1990 deficit of \$220 billion. It is worse than was estimated last summer, by both the Administration and the Congressional Budget Office, during the Budget Summit negotiations. And it is far worse than the baseline deficit estimated a year ago.

The two largest elements of this deterioration for 1991—each far greater than all others combined—are:

- an increase of \$105.5 billion in estimated outlays for thrift and bank insurance (part of which is due to a change in accounting treatment); and
- a decrease of \$87 billion in estimated receipts (principally due to a weaker economy).

The longest period of peacetime economic growth has been interrupted. Revised economic assumptions now reflect two consecutive quarters of negative real growth—the fourth quarter of calendar year 1990 and the first quarter of calendar year 1991. (See Table III-1)

This temporary economic downturn was not assumed last year by the Administration or by most outside economists. Indeed, it was not the result of ordinary causes. It did not start as a turn of the “business cycle.” Inventories were relatively low. And it was not a correction for “overheating.”

Among the principal causes of the weaker economy were a combination of the following:

- *monetary policy*, which for an extended period (roughly two years) remained on the tighter side of its target range—not seeking to halt real growth, but slowing growth out of concern for inflation and dollar weakness;
- the “*credit crunch*”—as the banking system (both banks and regulators) struggled to react to the S&L experience, new capital requirements, problems in the real estate market, and fears of a more general slowdown; and,
- perhaps most significantly, the multiple adverse economic and psychological effects of the *crisis in the Gulf* (as noted above).

The return to healthy economic growth—and the associated improvement in the deficit—assumes, and probably requires:

- improvement in all three areas—the Gulf, the financial system, and monetary policy;
- adoption of the growth-oriented policies noted in the President’s Message and discussed further below; and
- full implementation of the 1990 Budget Agreement—which reduces the previous baseline deficit by \$72.9 billion for 1992 and \$138.1 billion for 1995.

As always, there is a risk that these are excessively hopeful assumptions. But with the new Budget Agreement, the risk is arguably lower than in previous years.

Prior to enactment of the Agreement’s procedural reforms, there were incentives for the Administration to err in the direction of rosy projections. There were related incentives for the Congress first to criticize these projections (visibly) and then to adopt the same projections (invisibly). Now, these perverse incentives have been reduced.

For this and other reasons, the Administration’s projections are closer to mainstream thinking. The calendar year 1991 real growth forecast is almost identical to the current consensus forecast of the “Blue Chip” economic experts, and is actually below that of the Congressional Budget Office (CBO). The long-term growth forecast, although higher than that of CBO, is nonetheless below America’s post-World-War-II average. Thus, the deficit outlook presented here may be judged to be more credible than in the past.

Unfortunately, however, this does not necessarily mean that it is correct. Even in the best of times, macroeconomics is a highly fallible “science.” (Macroeconomists are often closer to each other than to reality.) And as this budget goes to press, there are crucial unknowns: the timing and character of events necessary to resolve the crisis in the Gulf. These are fundamentally relevant uncertainties. Much will turn on them.

So Chapter III, “Economic Assumptions and Sensitivities,” bears special attention. It discusses the extent to which the deficit outlook

should be modified if one wishes to use different economic assumptions.

REFORMIST STEPS—TOWARD A NEW DOMESTIC ORDER

Whatever one's economic assumptions, America nonetheless can—and must—continue its historic mission: protecting freedom, accelerating innovation, assuring fairness, increasing growth and opportunity, while limiting the expansion of intrusive and inefficient government. The President's 1992 budget limits the growth of Federal spending to 2.6 percent—less than the inflation rate. Within this limit, it nonetheless helps advance the process of American renewal. The budget proposes reform measures in each of the following domestic areas:

(1) Education Reform

The United States spends more per student on education than almost every other country on earth. Yet, the average performance of American elementary and secondary school students on internationally administered tests is disgracefully low. The performance is below that of America's major trading partners. It falls consistently near the bottom. The current system unnecessarily holds young people back, holds workers back, and holds the Nation back. Clearly, more of the same cannot be acceptable.

In coordination with the Nation's Governors, the President has initiated an ambitious national reform effort. Consistent with that reform effort, the budget gives special emphasis to increased investment in child care (including almost \$10 billion in tax credits and \$732 million for the new child care block grant), Head Start (\$2.1 billion), compensatory education (\$6.4 billion), mathematics and science education (\$1.9 billion), and the measurement of results.

To accelerate the more basic reforms that are necessary, the budget provides \$690 million for a new Educational Excellence Act. And, perhaps most importantly, it encourages increased parental choice through: demonstration grants, greater flexibility for States, an information clearinghouse, and a new incentive fund for States and localities that

adopt choice-oriented certificate programs. Greater choice would help foster a more market-like system and hold schools more accountable for performance. It is only with performance-based choice that more fundamental reform is likely to be achieved. (See Chapters IV.A. and V.A.)

(2) Research and Development

America's long-term position internationally and the potential for improvement in life at home depend fundamentally upon investment in a strong R&D base. Unfortunately, short-term claims and pressures often tend to drive out long-term investment. R&D is especially vulnerable in both the public and private sectors. Since the 1960s, investment in civilian R&D, particularly, has experienced a troublesome decline as a percent of GNP. To counter these tendencies, the President's budgets have sought to protect and increase R&D investment—without having the government cross the line into the problematic area of "industrial policy."

This budget proposes to make the R&D tax credit permanent in order to encourage more private R&D; while it also increases the direct Federal investment to \$76 billion for 1992—up \$8.4 billion to the highest level ever. Basic research would increase to \$13 billion, with pathbreaking efforts that range from high-energy physics to what promises to be one of the most important and far-reaching research projects in human history: the Human Genome Project. In applied civilian R&D, exciting investments range from materials processing, to biotechnology, to high-speed rail transport and electric battery technology, to high performance computing. This investment in R&D unquestionably has the potential—in time—to bring radical improvement in the quality of human life across-the-board. (See Table II-2 and Chapter IV.C.)

(3) Financial Sector Reform

The S&L crisis was a central focus of reform last year. This year, public attention has begun to shift to the risks associated with banks. While the analogy with S&Ls is not appropriate, there unquestionably are risks. From a budgetary perspective, they are reflected in the baseline projection for the Bank Insurance Fund. In the absence of remedial

Table II-2. ENHANCING RESEARCH AND DEVELOPMENT AND EXPANDING THE HUMAN FRONTIER—HIGHLIGHTS

(Dollar amounts in millions)

	Budget Authority			
	1991 Enacted	1992 Proposed	Dollar change	Percent change
Basic Research				
Doubling the NSF budget	2,316	2,722	+406	+18
Increasing Basic Biomedical Research at NIH	4,634	4,968	+334	+7
Human Genome Project	135	169	+35	+26
Agricultural Research Initiative	73	125	+52	+71
Superconducting Super Collider	243	534	+291	+120
Applied Research				
High Performance Computing and Communications	489	638	+149	+30
Energy R&D	676	903	+227	+34
Advanced Manufacturing and Materials	1,316	1,310	-6	—
HIV/AIDS	1,152	1,210	+58	+5
Moving Fusion Energy from Science to Engineering	275	337	+62	+23
Aeronautics R&D	482	543	+61	+13
Expanding R&D at the National Institute of Standards and Technology	215	248	+33	+15
Maintaining National Security: Defense R&D	37,783	43,247	+5,464	+14
Expanding the Geographic Frontier: Space Exploration				
Space Transportation Infrastructure	4,801	5,517	+716	+15
Space Science	1,774	2,141	+367	+21
Mission to Planet Earth (Global Change)	954	1,186	+232	+24
Mission From Planet Earth	2,199	2,470	+271	+12
Expanding the Human Frontier through Biotechnology	3,788	4,107	+319	+8

legislative action, the Fund balance would turn negative in 1992. (See Chapter VIII.A.)

But the issues involved are far broader than merely the accounting status of the Bank Insurance Fund. Financial markets have become global. So has competition in financial services. Technological advances have changed both the character of services and of service-providers. Yet, the legal and regulatory framework attempting to govern the American financial service sector has not adapted. It is outdated—as will be many American competitors if the framework is not modernized.

With this problem in clear view, the President is proposing a comprehensive reform of both deposit insurance and the legal-regulatory framework governing the financial services sector. (See associated Treasury study.)

(4) Incentives for Saving and Investment

In the past decade, significant tax bills have been enacted at the rate of almost one per year—including historic tax reform. On bal-

ance, the tax system has been radically improved. As a general matter, both the tax system and the taxpayer deserve a rest. Still, there is one area that continues to merit further reform: the need to strengthen incentives for saving and long-term investment.

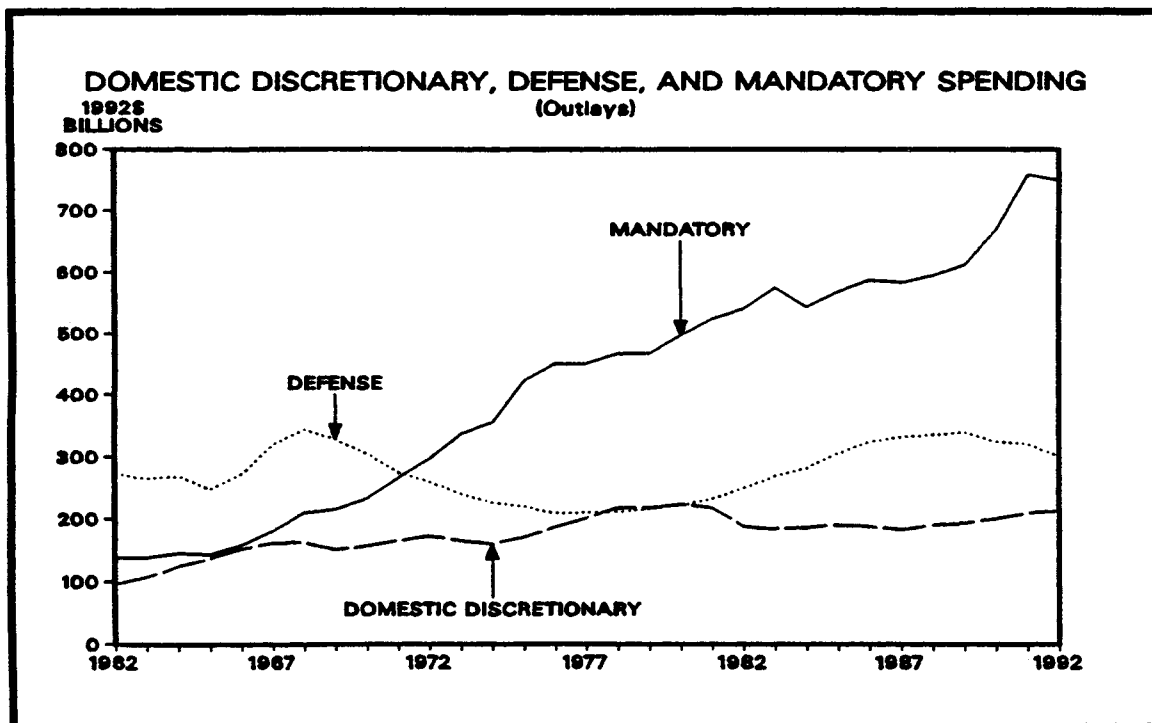
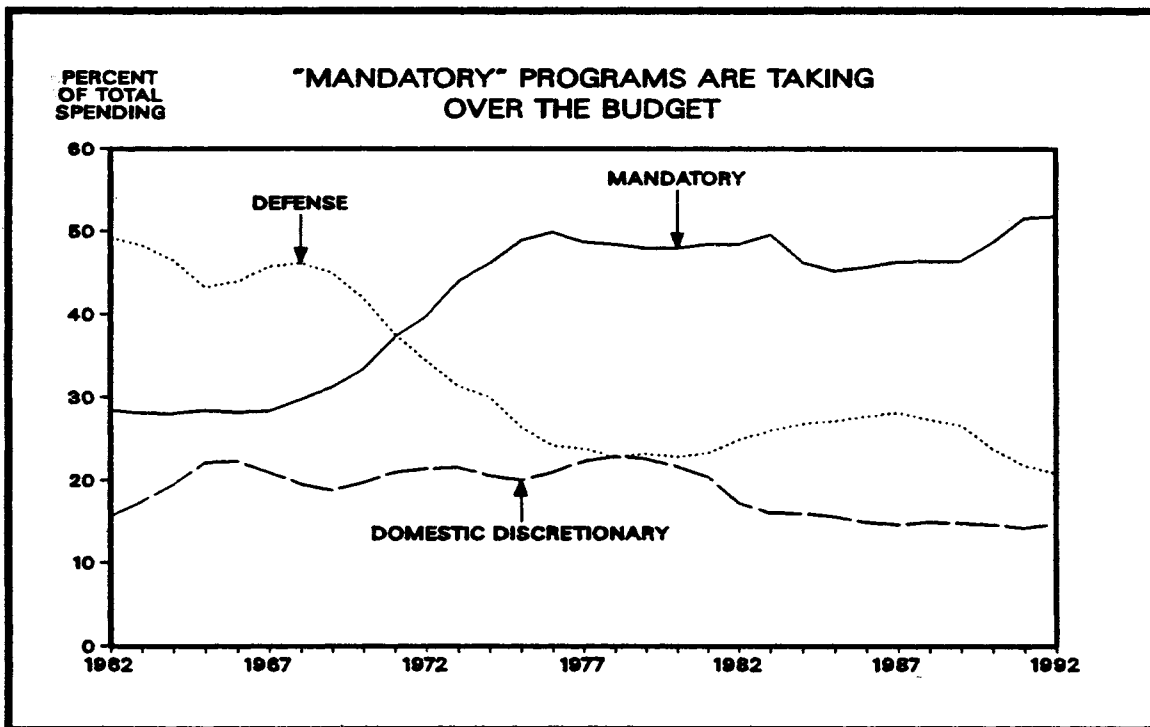
Accordingly, the President's budget proposes incentives to encourage: family savings, homeownership, longer-term investment, and investment in Enterprise Zones. (See Chapter X and the related discussion of pay-as-you-go requirements in Chapter XIV.)

(5) "Entitlement" Reform

In looking at the changing composition of the Federal budget since the 1960s, two trends stand out:

- First, the budget is being taken over by so-called "mandatory" or "entitlement" programs. These are largely transfer payments, which are not now subject to annual appropriation. They have grown from 28 percent of the budget in President Ken-

Chart II-2.



nedy's administration to nearly 52 percent today. (See Chart II-2).

- Second, within the "mandatory" total, funding for the non-poor has increased far more than for the poor. (See Chart II-3.)

No serious effort to address the deficit can ignore the 52 percent of the budget comprised by "mandatory" programs. That is why the 1990 Budget Act included measures to reduce the growth of "mandatories" by \$100 billion over five years. But that is still not enough.

Accordingly, this budget proposes to reduce "mandatories" by another \$47 billion over five years. (See Table II-9.) In addition, the budget reflects an important new emphasis for reform: increasing fairness in the distribution of benefits, reducing subsidies for those who do not need them.

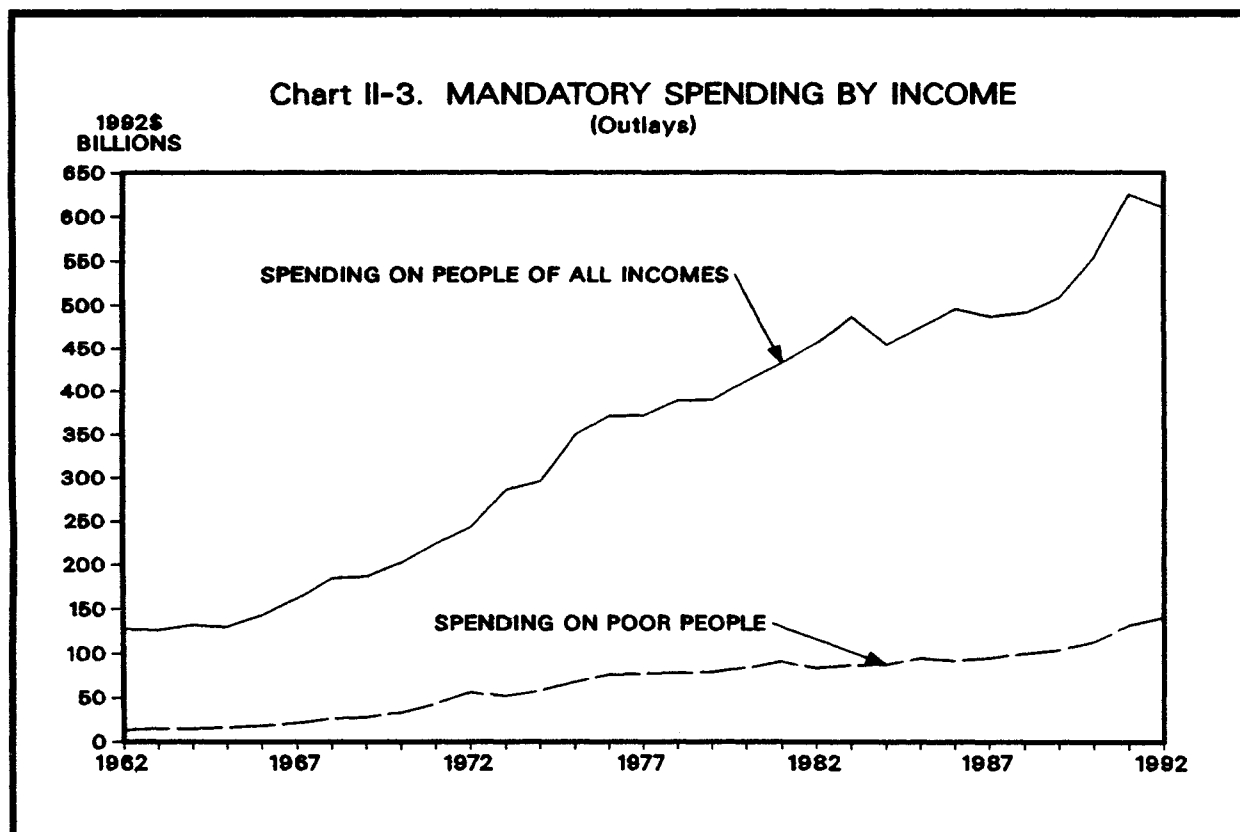
In particular the budget proposes to: reduce the subsidy of Medicare "Part B" premiums for individuals with annual incomes over \$125,000; restructure higher education assistance to serve the needy better; reallocate school lunch subsidies to increase benefits for

those with greater need; standardize benefits to increase payments to survivors of lower-ranking military personnel; and limit farm subsidies for individuals with non-farm income over \$125,000. (See Chapter V.C.)

(6) Health System Reform

Although the American health system leads the world in research and in many specialized areas, its general performance is not yet satisfactory. Its costs continue to grow faster than both inflation and the economy. Total national expenditures on health now claim 13.5 percent of GNP. Federal health spending is over 15 percent of the budget. This enormous and rising claim on resources comes at the expense of what might otherwise be the expansion of services for those who do not have fair or adequate access to the health system. And notwithstanding the huge expenditures, indicators such as infant mortality and preventable death and disease remain unnecessarily high.

The American health system is a hybrid—partly government-managed, partly private, partly in-between; partly a model of excellence,



and partly a disgrace. The challenge of reform is complex. Comprehensive reform plans abound. But none is a certain remedy, and some threaten to cause as many problems as they would cure. None is likely to be implemented quickly.

For the coming year, the Administration will continue to advance reform in manageable steps—implementing last year’s expansion of access to Medicaid and the reform of Medicare’s physician payment system, while also accelerating reform in two new areas:

- *Malpractice reform.* The budget proposes new Federal financial incentives for States to adopt model malpractice reform measures. This can help reduce both the direct costs of malpractice insurance and the indirect costs of “defensive medicine”—while expanding the availability of medical services and increasing attention to appropriate standards of care.
- *Investment in Prevention.* The budget proposes to fund a concerted effort—through both education and increased investment in preventive services—to stop avoidable health problems before they start. In doing so, it gives special emphasis to programs affecting children—and to prenatal care, infant nutrition, cancer screening, injury control, smoking cessation and other matters of personal responsibility. (See Tables II-3 and II-4, and see Chapter IV.B.)

(7) Drug Abuse Reduction

One of the most troubling breakdowns of personal responsibility is reflected in drug abuse. In the 1970s and 1980s, the problem grew to near-epidemic proportions. The President advanced the first National Drug Control Strategy in September 1989. Several recent studies have shown encouraging results. Cocaine use seems to have declined significantly from levels in the mid-1980s. But the drug abuse problem is far from solved.

Accordingly, the budget continues to increase the resources allocated to the National Drug Control Strategy. For 1992, the Federal share increases by \$1.1 billion to \$11.7 billion (80 percent higher than when the President took office). The increase in these resources is dis-

tributed to all elements of the Strategy. (See Chapter V.B.)

(8) Housing Reform

American public policy reflects a long-standing commitment to the importance of investment in housing. But the results have been mixed—and clearly unsatisfactory for many of the poorest Americans. Part of the problem has been conceptual: too great an emphasis on direct governmental ownership and management; too little emphasis on opportunities for poor people to benefit from choice and homeownership.

The budget reflects a reformist shift in concepts: It proposes to fund fully (\$2.1 billion in 1992) the new HOPE program—creating opportunities for tenant management and ownership. It requests a 38 percent increase in vouchers for low income people—to increase their power in the marketplace. And, on the tax side: it would permit the use of Individual Retirement Accounts by young families and first-time homebuyers; and it would offer special incentives for investment in Enterprise Zones—a refundable tax credit for wages, expensing of investor purchases of new corporate stock, and a zero capital gains rate for investment in tangible property within Enterprise Zones. (See Chapter V.A.)

(9) Transportation Infrastructure Investment

The Nation’s transportation systems are fundamental to both economic productivity and the quality of life. And the stresses upon these systems continue to mount. While attending to important limits on the Federal role and responsibility, the 1992 budget makes a major contribution to expansion and improvement of the transportation infrastructure:

- Annual obligations of the Highway Trust Fund would be increased to \$16 billion in 1992 and to more than \$20 billion by 1996. In seeking to reauthorize the Federal highway program, the Administration would simplify and strengthen the existing program—establishing a new National Highway System, giving States greater flexibility with a new block grant program, and allowing more innovative financing with private participation. In addition, the

Table II-3. SPENDING ON SELECTED PROGRAMS SERVING CHILDREN INCREASES 9.5 PERCENT IN 1992

(In millions of dollars)

	1990	1991	1992 Proposed
Nutrition:			
WIC	2,126	2,350	2,573
Child Nutrition	4,887	5,577	6,066
Other Nutrition	7,985	9,138	9,825
Health:			
Targeted Infant Mortality	—	¹ 34	139
Medicaid	8,200	10,300	12,000
Community/Migrant Health	227	238	238
Immunizations	187	218	258
Maternal/Child Health	554	¹ 554	554
Other Health	222	264	266
Education and Social Services:			
Head Start	1,552	1,952	2,052
Handicapped Education	2,055	2,467	2,730
Compensatory Education	5,368	6,225	6,424
Educational Excellence Act (proposed)	—	—	490
Precollege Math and Science Education	333	515	661
Child Care Block Grant	—	732	732
Foster Care	1,375	2,611	2,186
Social Security	8,375	9,048	9,716
Supplemental Security Income	1,261	3,531	2,497
Aid to Families with Dependent Children and Child Support	12,165	14,008	15,162
Other Education and Social Services	2,453	2,642	2,352
Refundable Tax Credits	6,287	6,941	9,973
Total Children's Funding	65,612	79,345	86,851

¹ Reflects HHS' plans to reprogram \$34 million from MCH Block Grant to Targeted Infant Mortality in 1991. Overall resources supporting this initiative will total \$57 million in 1991 and \$171 million in 1992, including funds from other public health grants.

Table II-4. THE BUDGET PROVIDES INCREASES FOR PROGRAMS FOCUSED ON PREVENTION AND THE NEXT GENERATION

(Obligations in millions of dollars)

	1991 Enacted	1992 Proposed	Percent Increase
Childhood immunization	218	258	+18.3
Infant Mortality Initiative	7,335	8,011	+9.2
(Targeted Infant Mortality Initiative—non-add)	57	171	+300.0
Breast and Cervical Cancer Prevention	269	410	+52.4
Smoking Cessation	90	97	+7.8
Physical Fitness and Diet	122	139	+13.9
Accident and Injury Prevention	1,683	1,907	+13.3
Access to Preventive Health Care	5,410	6,026	+11.4
Family Planning	399	420	+5.3
Lead Poisoning Prevention	8	41	+412.5
Substance Abuse Prevention	1,442	1,515	+5.1

**Table II-5. SELECTIONS FROM THE REFORM AGENDA—
WITHIN THE FLEXIBLE FREEZE FRAMEWORK ¹**

Area	Highlights
(1) Education Reform:	<ul style="list-style-type: none"> • Long-term national goals—with Governors • Special funding emphasis on early childhood (\$87 billion) • Parental choice—new incentive fund (\$200 million) • Educational Excellence Act (\$690 million) • Higher education funding reform • Math/Science improvement program (\$1.9 billion)
(2) Research and Development:	<ul style="list-style-type: none"> • Record level for R&D (\$76 billion) • Record level for basic research (\$13 billion) • Human Genome Project • Increased emphasis on applied civilian R&D (e.g., materials processing, biotechnology, high-performance computing)
(3) Financial Sector Reform:	<ul style="list-style-type: none"> • Deposit insurance reform • Recapitalization of Bank Insurance Fund • Comprehensive reform of legal and regulatory structure to modernize financial services sector
(4) Incentives for Saving and Investment:	<ul style="list-style-type: none"> • Enterprise Zones • Family Savings Account • IRA withdrawal for first-home buyers • Capital gains modification for longer-term investment
(5) Entitlement Reform:	<ul style="list-style-type: none"> • \$47 billion savings over 5 years • Increased fairness/reduced subsidies for wealthy
(6) Health System Reform:	<ul style="list-style-type: none"> • Physician payment reform • Malpractice reform • Increased investment in prevention (prenatal care, infant nutrition, cancer screening, education for personal responsibility, child care)
(7) Drug Abuse Reduction:	<ul style="list-style-type: none"> • National Drug Control Strategy • \$1.1 billion increase—to record \$11.7 billion (Federal share)
(8) Housing Reform:	<ul style="list-style-type: none"> • Full funding for HOPE (\$2.1 billion in 1992) • 38 percent increase in vouchers • IRA withdrawal for first-home buyers • Enterprise Zones (refundable wage credit, expensing for new stock, zero capital gains rate)
(9) Transportation Infrastructure Investment:	<ul style="list-style-type: none"> • New highway program (new National Highway System and new block grant) • Major increase in Highway Trust Fund obligations (over \$20 billion by 1996) • NASPLAN modernization • Space transportation systems (Shuttle, ASRM, ALS, NASP)
(10) Government Management Reform:	<ul style="list-style-type: none"> • Budget process reform • Regulatory reform • Accounting systems reform • High-Risk Area targeting • Terminations: 238 programs and 3,591 projects
(11) "States as Laboratories":	<ul style="list-style-type: none"> • Demonstrations and waivers • Evaluation of natural experiments • \$15 billion program turn-over to States (fully funded)

¹Proposed total governmental spending for 1992 is 2.6 percent greater than 1991 (i.e., growth is less than the inflation rate).

budget proposes funding for major technological advances in high-speed rail and "smart cars/smart highways," which could help relieve the stress on the current system. (See Chapter IV.D.)

- The budget would continue to modernize the national airspace system ("NAS-PLAN")—increasing funding for Federal Aviation Administration facilities, equipment, and systems by 29 percent, to \$2.7 billion.
- Within the budget for space exploration and development, there is funding for the space shuttle, a new advanced solid rocket motor (ASRM), a new advanced launch system (ALS), and a national aerospace plane (NASP). As the use of space becomes increasingly relevant, these essential elements of the space transportation system should be better understood—and funded—as a vital part of America's infrastructure investment. (See Chapter IV.C.)

(10) Governmental Management Reform

Any 1.4 trillion-dollar-per-year enterprise (e.g., the Federal Government) is bound to show signs of failure in one place or another. But the public is demanding; and respect for governmental performance remains understandably low. There is much room for management improvement.

Discontent with government is often visible (and deemed to be newsworthy). The less glamorous issues of management improvement typically are not. Nonetheless, management reform continues to be advanced:

- *Budget process reform.* The Administration is implementing the important and valuable reforms of the 1990 Budget Agreement—enforceable spending caps, "pay-as-you-go," and credit reform. Beyond these, the Administration continues to seek the line-item veto, joint (not concurrent) budget resolutions, biennial budgeting, and a balanced budget Constitutional amendment. (See Chapter IX.D.)
- *Regulatory reform.* The principles of regulatory reform continue to be advanced through the President's Competitiveness Council and the Office of Information and Regulatory Affairs—and through broader

application of Risk Management Budgeting. (See Chapter IX.C.)

- *Accounting reform and oversight.* The budget continues to expand its analysis and presentation of "Hidden Liabilities." (See Chapter VIII.) The Administration is implementing the new Chief Financial Officers legislation—improving accounting standards, financial reporting systems, and audits. The budget explicitly identifies High-Risk Areas of vulnerability to fraud, waste, and abuse. And, as appropriate, the Administration is engaging special teams in the effort to reduce these vulnerabilities. (See Chapter IX.A.)
- *Reducing waste and improving returns on investment.* This is not only a problem of accountancy and oversight, as suggested above. It is also a problem requiring greater program evaluation and a willingness to terminate outdated or ineffective programs and projects. (See Chapter IX.B.) The problem, however, goes beyond conventional matters of accounting and evaluation—as discussed further below.

PROGRAM LIFE-CYCLES—AND STATES AS LABORATORIES

Clearly, the government has a need and a responsibility to improve the return on investment of Federal dollars. And improved accounting, analysis, and evaluation have an important role to play in this effort. But beyond these rather technical issues, there are larger structural issues that also require attention.

Fortunately, the 1990 Budget Act creates a framework that can encourage a more basic reform perspective.

The discussion of Entitlement Reform (above) has highlighted the budgetary "take-over" by mandatory programs—and the tendency of such programs increasingly to benefit the non-poor. The pay-as-you-go reforms may serve not only to restrain the further expansion of "mandatories." They should also encourage greater anti-poverty efficiency in the design of such programs.

With respect to discretionary programs, the effect of budget process reforms may be an even more direct increase in attention to pro-

gram efficiency, effectiveness, and return on investment. This should be a natural outgrowth of the existence of fixed, enforceable caps on discretionary spending. With unequivocal limits on available resources, competition on the merits should increase.

As one begins to think about returns on investment, it is perhaps interesting to consider how much Federal spending might be considered "investment" at all. This question involves highly arguable definitional issues.

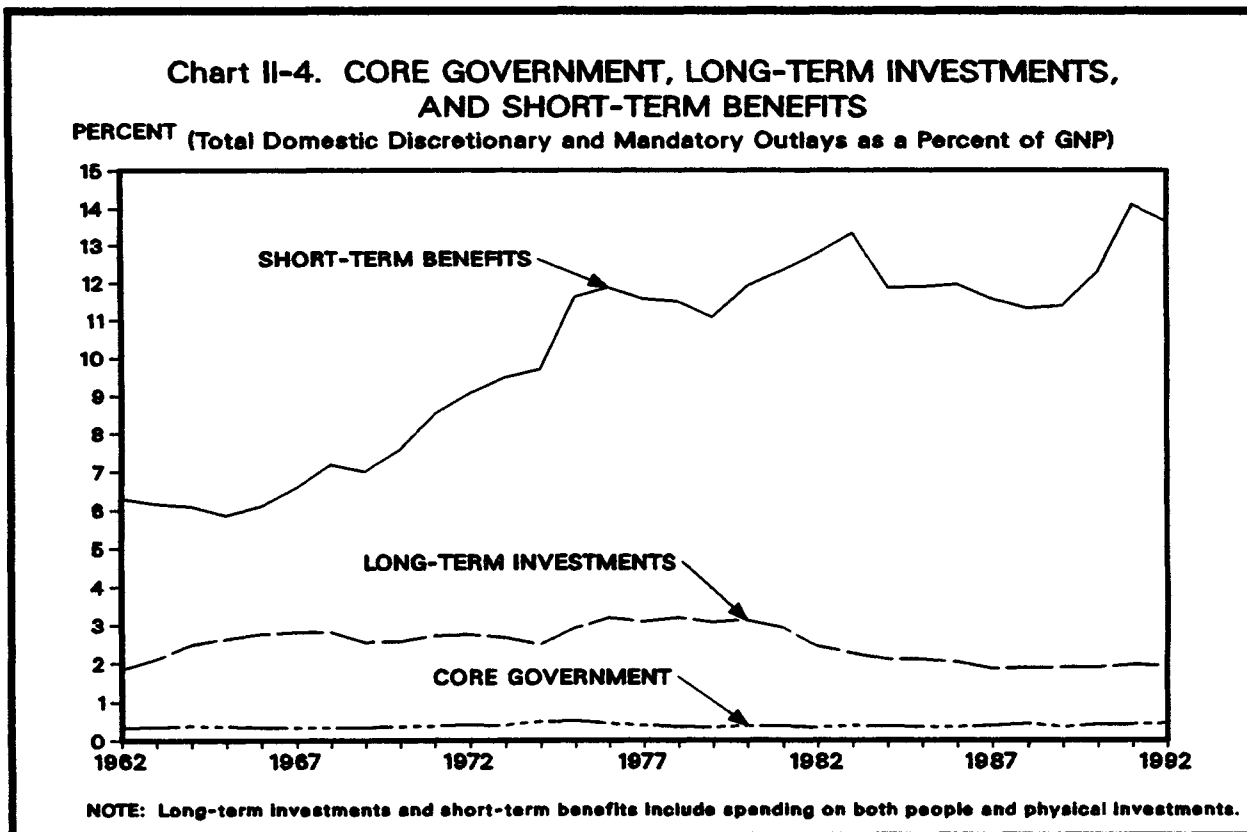
If one puts defense aside, and looks at how much nondefense spending is oriented toward longer-term investment (returns accruing over a period greater than five years), one finds that expenditures for short-term benefits clearly dominate. Long-term investments have been declining as a percent of GNP. (See Chart II-4.) This is, in part, a reflection of the budgetary "takeover" by transfer payments to individuals ("mandatories").

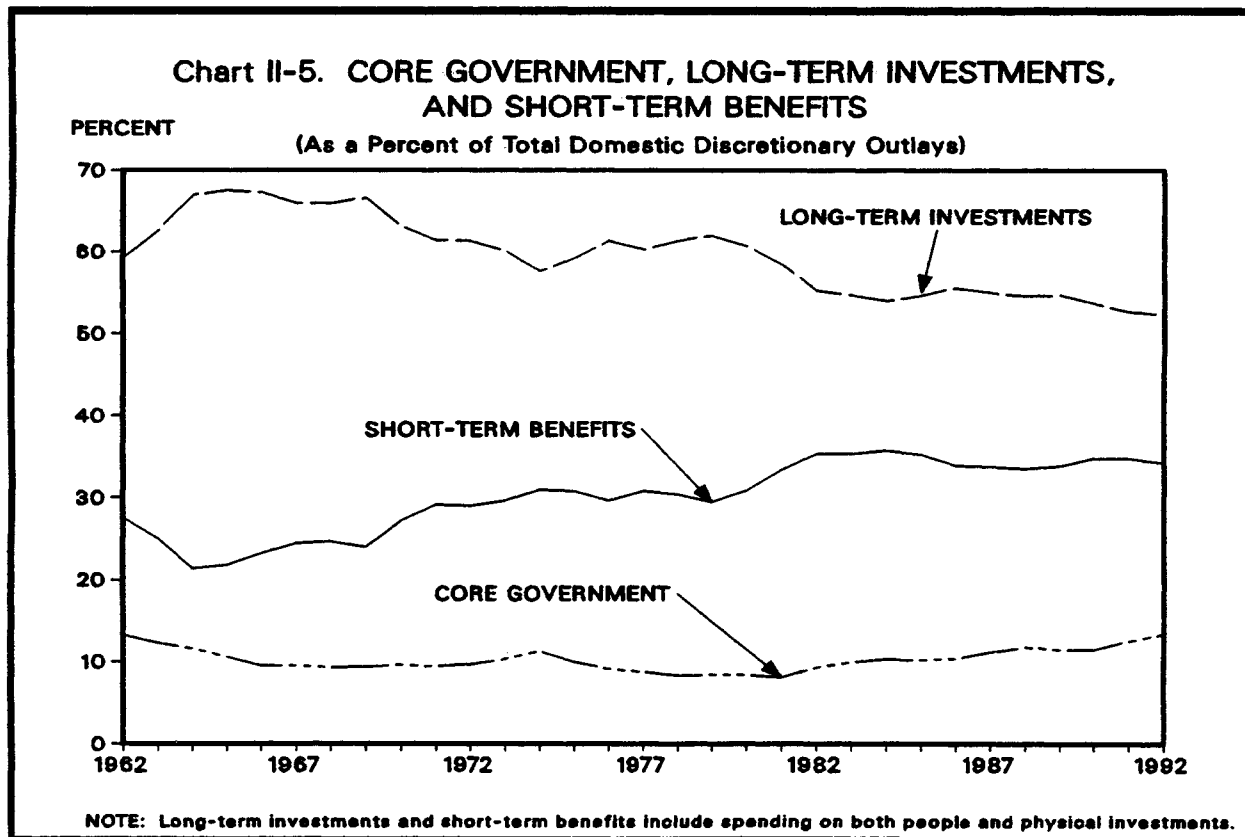
But even if one focuses only on domestic discretionary programs (*i.e.*, excluding mandatories), one finds that longer-term in-

vestments have been decreasing as a share of domestic discretionary spending. (See Chart II-5.) The President's budget seeks to correct this trend by increasing investment in R&D, prevention, early childhood, and transportation infrastructure—areas with higher return.

The expectation of a possible shift toward investment in programs with higher return may, of course, prove to be no more than a request and a hope. The existing domestic discretionary program structure has, to date, proven to be rather rigid. Reform will require a new flexibility and a new dynamic.

In the past, domestic discretionary programs often came into existence to address one alleged "urgent priority" or another. The urgency may have derived from a transitory emergency, a desire for "demonstration," or a perceived need for Federal leadership in areas where States and localities were slow to recognize or accept responsibility. As an abstract matter, this rationale may have been legitimate.





Once in existence, however, programs have tended to become fixtures in the budget. There is, in practice, little evidence of a program life-cycle—other than a move toward immortality.

In a world of fixed spending caps, there will be no room for emerging priorities if the programs-of-old remain immortal. To allow adaptation to shifting priorities, there will have to be a more dynamic concept of program life-cycles:

- Some programs and projects will have to die. This should be the case, for example, when a program (whether demonstration or not) has proven a failure, or when the urgency of a past priority has been overtaken by events. It should also be the case when a demonstration has proven a success and is, therefore, available for replication and funding through other sources. In applying these principles, this budget proposes the outright termination of 238 specific domestic discretionary programs and 3,591 specific projects. These terminations would save \$4.6 billion in

budget authority in 1992. (See Chapter IX.B.)

- Some programs should decline. This should be the case when their relative priority is judged to have decreased. This budget proposes declines of \$8.3 billion in budget authority from an additional 109 domestic discretionary programs. These programs were funded at a total of \$27.4 billion in 1991. Reasons for proposed reductions are presented in Chapter IX.B.
- Some programs should increase. The reductions and terminations noted above help finance program increases in areas judged to merit higher priority or improved return on investment. 250 domestic discretionary programs are specifically recommended for increases totaling \$17.8 billion. (See Table B-6 in Chapter IX.B and the associated detail in Chapter XIII.)
- Some programs should be consolidated and turned over to the States—funded in more flexible form. Programs appropriate for such turnover may be selected from two

broad categories: those whose purposes are judged by States to be of continuing value, but whose relative funding priority at the Federal level is declining; and those which seem, in any case, to be appropriate for flexible management by the States.

The President has established a target of \$15 billion in program turnovers for the States. A list of possible turnover candidates totaling over \$20 billion is at Table II-9. The actual selection of programs for turnover would have to be authorized by the Congress—in consultation with the Administration and the Governors. (After the actual selection is determined, the current distribution of such programs by State would be calculated. The Administration would then propose to replace these programs with a single consolidated block grant to the States. The formula for this new block grant would approximate the same distribution to the individual States as they would receive under the present program structure—seeking to assure that no State would be harmed by the move to a new, consolidated block grant.)

The value of this turn-over approach is as follows. It allows the Federal Government to reduce overhead. It allows States to manage a pool of financial resources more flexibly. It moves power and decisionmaking closer to the people. And it reenforces another reformist theme of this Administration: appreciation and encouragement of “States as Laboratories.”

This last point is especially important. The American Federal system has within it an enormous power for innovation: the natural variation and experimentation among the States. For too long, this potential has been under-appreciated at the Federal level. Nonetheless, the reality is that some of the most interesting examples of innovation are being set by the States—in areas ranging from educational choice, to enterprise zones, to health cost control,

welfare reform, and transportation finance. (See Chapter VI.)

The Administration seeks to reenforce this natural power of the States—and to help build upon it.

In sum, the opportunities for constructive reform are many. (See Table II-5.) Incentives for choice, innovation, and improved performance can be advanced in education. Investment in path-breaking R&D can be increased. The financial service sector can be modernized. Tax incentives for saving and long-term investment can be strengthened. The budgetary “takeover” by “mandatory” programs can be slowed; and the benefits of entitlements can be better targeted for the needy. The problems of the health system can be alleviated, to some degree, by physician payment reform, malpractice reform, and an emphasis on prevention. The National Drug Control Strategy can be carried forward aggressively to its next stage. The approach to housing can be improved by greater emphasis on choice, homeownership, and Enterprise Zones. Stresses on the transportation infrastructure can be relieved. And the government itself can be managed better—through budget process reform, accounting reform, program evaluation, regulatory reform, and reenforcement of the innovative power of “States as laboratories.”

These reforms can all be accommodated within the “flexible freeze” (with total spending growing at less than the inflation rate) and within the limits of the 1990 Budget Act.

If these reform measures are adopted—and assuming satisfactory resolution of the Gulf crisis in the not-too-distant future—the economy can not only return to economic growth. It can move on toward a new record for economic expansion as America advances to the 21st century.

RICHARD DARMAN
DIRECTOR,
OFFICE OF MANAGEMENT AND BUDGET

Table II-6. SPENDING, REVENUE, AND DEFICIT, 1991-1996
(Dollar amounts in billions)¹

	1991		1992		1993		1994		1995		1996	
	Dollars	Dollars	% Change	Dollars	% Change	Dollars	% Change	Dollars	% Change	Dollars	% Change	
Spending:												
Discretionary:												
Defense	307.8	300.4	-2.4	293.3	-2.4	287.6	-1.9	289.2	0.5	293.8	1.6	
International	18.7	19.6	4.7	20.4	4.2	21.5	5.1	21.8	1.3	22.0	0.9	
Domestic	199.8	212.0	6.1	223.2	5.3	228.9	2.6	231.7	1.2	238.5	2.9	
Subtotal, discretionary	526.3	532.1	1.1	536.9	0.9	538.0	0.2	542.7	0.9	554.2	2.1	
Mandatory	686.2	707.5	3.1	705.3	-0.3	673.5	-4.5	713.8	6.0	775.6	8.7	
Interest	197.0	206.3	4.7	212.0	2.8	215.5	1.6	213.8	-0.8	211.0	-1.3	
Total spending	1,409.6	1,445.9	2.6	1,454.2	0.6	1,427.1	-1.9	1,470.3	3.0	1,540.8	4.8	
Total revenues	1,091.4	1,165.0	6.7	1,252.7	7.5	1,365.3	9.0	1,467.3	7.5	1,560.7	6.4	
Consolidated deficit	318.1	280.9	—	201.5	—	61.8	—	2.9	—	-19.9	—	
Memorandum												
Deposit insurance (included above):												
Resolution Trust Corporation	84.6	76.1	—	34.3	—	-47.6	—	-45.7	—	-32.0	—	
Bank Insurance Fund	15.9	9.7	—	8.0	—	6.8	—	0.9	—	0.6	—	
FSLIC Resolution Fund	11.1	3.3	—	2.8	—	2.2	—	2.7	—	1.5	—	
Savings Association Insurance Fund and Other	—*	-1.0	—	-0.8	—	0.4	—	-0.3	—	*	—	
Subtotal, Deposit insurance	111.5	88.1	—	44.2	—	-38.1	—	-42.3	—	-29.9	—	
Desert Shield (placeholder, included above)	8.2	4.6	—	0.8	—	0.4	—	—	—	—	—	
Social Security (included above):												
Operating surplus	40.3	38.7	—	45.3	—	56.6	—	65.5	—	77.2	—	
Interest	20.2	23.7	—	28.0	—	32.8	—	38.3	—	44.6	—	
Total	60.4	62.4	—	73.3	—	89.3	—	103.9	—	121.8	—	

¹ Percent change measures change from previous year.

* \$50 million or less.

Table II-7. RECEIPTS MEASURES, 1991-1996
(In millions of dollars)

	1991	1992	1993	1994	1995	1996
Enhance long-term investment ¹	400	3,000	1,700	900	1,800	1,700
Extend HI coverage to State and local employees ²	—	1,125	1,537	1,545	1,548	1,544
Improve retail compliance with alcohol special occupational taxes ²	—	43	43	9	9	9
Increase IRS enforcement funding	—	35	133	176	180	184
Extend tax deadlines for Desert Shield (placeholder) participants	-38	21	6	—	—	—
Extend railroad UI reimburseable status ²	-10	2	10	8	-1	-1
Increase HUD land sales fee	—	*	*	*	*	*
Extend abandoned mine reclamation fees	—	—	—	—	—	260
Extend R&E credit	—	-500	-1,000	-1,300	-1,600	-1,800
Extend R&E allocation rules	—	-346	-264	—	—	—
Establish family savings accounts	—	-300	-800	-1,300	-1,800	-2,300
Extend health insurance deduction for self-employed	—	-120	-239	—	—	—
Extend low-income housing credit	—	-59	-215	-305	-337	-337
Extend targeted jobs credit	—	-56	-100	-64	-29	-20
Establish enterprise zones	—	-50	-160	-310	-520	-750
Waive excise tax for certain early withdrawals from IRAs ..	—	-50	-70	-100	-110	-110
Extend business energy credits	—	-30	-17	4	2	1
Double and restore adoption deduction	—	—	-3	-3	-3	-3
Extend highway trust fund taxes ²	—	—	—	—	—	-2,722
Total effect on receipts	352	2,715	561	-740	-861	-4,345
Total effect on receipts with enhance long-term investment at zero	-48	-285	-1,139	-1,640	-2,661	-6,045

* \$500,000 or less.

¹The proposal to enhance long-term investment is shown as estimated by the Treasury Department's Office of Tax Analysis (OTA). Because the methodological differences among OTA, Congressional estimators, and outside experts have not yet been resolved, totals are presented with the Administration's estimate and with a zero (neutral) entry for the proposal.

²Net of income tax offsets.

Table II-8. DEFICIT IMPACT OF ADMINISTRATION PAY-AS-YOU-GO PROPOSALS

(In billions of dollars)

	1991	1992	1993	1994	1995	1991-95
Deficit impact of Administration pay-as-you-go proposals:						
Direct spending (see Table II-8)	-0.1	-6.3	-9.3	-9.0	-11.0	-35.8
Receipts:						
Extenders (selected)	*	1.1	1.8	1.7	2.0	6.6
Long-term investment incentive ¹	-0.4	-3.0	-1.7	-0.9	-1.8	-7.8
All other	*	-0.8	-0.6	0.2	0.9	-0.3
Total, receipts	-0.4	-2.7	-0.4	0.9	1.0	-1.5
Total, receipts with long-term investment incentive at zero	*	0.3	1.3	1.8	2.8	6.3
Total, net deficit impact	-0.5	-9.0	-9.8	-8.1	-9.9	-37.3
Total, net deficit impact with long-term investment incentive at zero	-0.1	-6.0	-8.1	-7.2	-8.1	-29.5

* \$50 million or less.

¹The proposal to enhance long-term investment is shown as estimated by the Treasury Department's Office of Tax Analysis (OTA). Because the methodological differences among OTA, Congressional estimators, and outside experts have not yet been resolved, totals are presented with the Administration's estimates and with a zero (neutral) entry for this proposal.

Table II-9. PROPOSED POLICY CHANGES IN MANDATORY PROGRAMS
(Outlays; in millions of dollars)

	1992	1993	1994	1995	1996
Department of Agriculture					
Commodity Credit Corporation: reduce subsidies to those with off-farm income over \$125,000	-36	-90	-90	-90	-90
Crop Insurance: increase farmer responsibility for premium payments	-77	-167	-164	-152	-146
Food Safety and Inspection Service: seek reimbursement from industries for certain overtime activities	-50	-50	-50	-50	-50
Food Stamps: effect of increased child support enforcement	—	-10	-20	-30	-34
Miscellaneous User Fees: increase fees for recreation and grain inspection and establish fees for agricultural marketing	-29	-32	-32	-33	-34
Rural Electrification Administration: continue shift from direct to guaranteed loans	-13	-38	-59	-74	-67
Department of Education					
Guaranteed Student Loans: net impact of reducing the number of loans that default by: improving eligibility screening of schools; enhancing procedures for default collection; requiring risk sharing and increasing loan limitations	-102	-173	-229	-282	-289
Department of Energy					
Elk Hills Naval Petroleum Reserve: lease production rights	-1,191	139	120	113	95
Power Marketing Administrations: revise the level and schedule of the PMA's debt repayments to the Federal Government	-377	-382	-406	-417	-402
Strategic Petroleum Reserve: delay required purchase of petroleum until 1992 and 1993 ¹	36	86	—	—	—
Department of Health and Human Services					
Family Support: improve the child support enforcement system	-120	-129	-142	-163	-179
Foster Care: limit the Federal Government's payment of administrative costs to only those required to provide benefits to low-income children	-210	-290	-352	-405	-452
Medicaid: net impact of allowing States to expand medically-needy eligibility for pregnant women and children; strengthening medical child support enforcement; and the impact of Medicare proposals	25	75	75	90	95
Medicare:					
Clinical Labs:					
Apply 2% update for 1992 and 1993, only for those below payment caps	-20	-50	-70	-80	-90
Restore 20% co-insurance, identical to all other Part B services	-450	-800	-900	-1,020	-1,160
Subtotal, clinical labs	-470	-850	-970	-1,100	-1,250
Coordinated Care Initiative: Begin a Medicare coordinated care initiative whose costs would be largely offset by: applying home health limits by discipline and establishing a uniform disabled/ESRD secondary payor threshold	-130	25	40	70	195

¹The SPR proposal saves \$123 million in outlays for 1991.

**Table II-9. PROPOSED POLICY CHANGES IN MANDATORY PROGRAMS—
Continued**

(Outlays; in millions of dollars)

	1992	1993	1994	1995	1996
Durable Medical Equipment (DME):					
Adjust enteral/parenteral fee schedule	-10	-15	-15	-15	-15
Refine DME/oxygen payment methods, in part to reflect increased use of less-expensive oxygen delivery services	-35	-85	-105	-130	-135
Subtotal, medical equipment	-45	-100	-120	-145	-150
High-Income Beneficiaries: Reduce Federal Medicare subsidy for high-income beneficiaries (over \$125,000 AGI) ..	-41	-169	-245	-323	-426
Hospitals:					
Adjust indirect medical education add-on payment factor from 7.65% to 4.4% in 1992, phasing down to 3.2% in 1996	-1,045	-1,385	-1,705	-2,080	-2,500
Eliminate duplicate payments for hospital-based non-physician practitioners by adjusting hospital payment update factor	-10	-10	-10	-10	-10
Include payment for certain post-hospital services in Medicare hospital payment	-30	-40	-50	-50	-60
Limit graduate medical education per-resident payment, and encourage training of primary care physicians	-140	-160	-190	-230	-260
Place Medicare hospital update on a January 1 cycle	-670	-930	-1,320	-1,450	-1,540
Subtotal, hospitals	-1,895	-2,525	-3,275	-3,820	-4,370
Outpatient Departments (OPDs): Pay a uniform rate for outpatient services, whether performed in doctors' offices or OPDs	-50	-100	-125	-150	-175
Physicians:					
Eliminate double payment for physician collection of lab specimens	-10	-20	-20	-20	-25
Establish a single fee for anesthesia services	-80	-150	-170	-200	-230
Establish a single fee for assistants at surgery	-50	-80	-90	-100	-110
Revise 1991 Medicare volume performance standard to correct error	—	-90	-150	-190	-220
Revise Medicare economic index to reflect better data and new methodology	-30	—	—	—	—
Use efficient rate for radiology and diagnostic tests	—	-10	-15	-20	-20
Subtotal, physicians	-170	-350	-445	-530	-605
Other:					
Effect of Medicare proposals on HI premiums	17	20	26	30	33
Eliminate return-on-equity payments for proprietary skilled nursing facilities	-50	-70	-60	-60	-70
Establish a uniform payment policy for medicare covered drugs	-10	-30	-30	-40	-40
Recalculate payments for physical and respiratory therapy, based on newer data	-10	-10	-15	-15	-20
Subtotal, other	-53	-90	-79	-85	-97
Subtotal, Medicare	-2,854	-4,159	-5,219	-6,083	-6,878
Supplemental Security Income: collect SSI over-payments and charge States certain administrative fees	-96	-159	-250	-250	-240

**Table II-9. PROPOSED POLICY CHANGES IN MANDATORY PROGRAMS—
Continued**

(Outlays; in millions of dollars)

	1992	1993	1994	1995	1996
Department of Housing and Urban Development					
Federal Housing Administration: reduce FHA multifamily insurance claims through: improved underwriting, monitoring, and servicing; removal of legislative restraints on defaulted property sales; and the proposed Low-Income Resident Economic Empowerment program	-564	-1,062	-1,024	-860	-1,269
Government National Mortgage Association: exempt GNMA from VA's formula for acquiring foreclosed property producing savings for VA-guaranteed loans acquired by GNMA	-45	-38	-25	-20	-19
Department of the Interior					
Arctic National Wildlife Refuge: lease oil and gas exploration rights	—	-1,901	-1	-1,201	-1
Department of Labor					
Trade Adjustment Assistance: repeal TAA benefits for workers unemployed due to competition from imports	-114	-193	-204	-200	-194
Department of Treasury					
Coinage Profit Fund: finance numismatic and bullion coin operations for the United States Mint	-94	—	—	—	—
Department of Veterans Affairs					
Veterans Compensation and Pension: standardize Dependency and Indemnity Compensation payments; increase pension eligibility requirements and extend several expiring provisions of OBRA	-17	-433	-391	-354	-320
Veterans Home Loans: raise fee and require down payment for multiple use of loan guaranty benefit; improve formula used to acquire foreclosed property and extend expiring OBRA fee increase	-308	-242	-202	-178	-160
Veterans Readjustment Benefits: target eligibility for vocational rehabilitation to veterans with higher rated disabilities and eliminate step-children from eligibility for training and education benefits	-12	-32	-31	-31	-31
Veterans Third Party Medical Recoveries: extend several expiring provisions of OBRA	—	—	-225	-255	-274
Environmental Protection Agency					
Pesticide Reregistration Fee: remove existing cap on amount that may be collected from any one registrant	-3	-3	-3	-3	-3
Other Agencies					
Corps of Engineers: expand existing user fees for day use of developed recreational sites	-20	-20	-20	-20	-20
Postal Service: require the Postal Service to pay a larger share of the costs for health benefits and cost-of-living adjustments for post-1971 retired postal employees and their survivors	-198	-198	-198	-198	-198
Railroad Retirement Board: reflects net impact of conforming rail security benefits with social security benefits and requiring the rail pension to finance 25% of the windfall benefits	145	142	141	139	137
Other	8	15	17	20	24
Total, outlay savings	-6,316	-9,344	-8,984	-10,987	-10,999

Table II-10. POTENTIAL BLOCK GRANT PROGRAMS
(In millions of dollars)

Department/Programs	Enacted				Proposed							
	1991		1992		1993		1994		1995		1996	
	BA	O	BA	O	BA	O	BA	O	BA	O	BA	O
Education:												
Impact aid payments	781	815	620	695	620	651	620	624	620	620	620	620
Supplemental education opportunity grants	520	404	347	498	347	352	347	347	347	347	347	347
Chapter 2 block grant	449	533	449	465	449	445	449	449	449	449	449	449
Public library services programs	143	155	35	115	35	71	35	35	35	35	35	35
Environmental Protection Agency:												
Construction grants	2,083	2,345	1,900	2,195	1,200	2,082	600	1,883	—	1,482	—	1,025
Health and Human Services:												
State welfare administrative expenses for Medicaid, AFDC, and Food Stamps	5,178	5,167	5,878	5,867	6,453	6,440	7,062	7,048	7,701	7,686	8,366	8,349
Social services block grant	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800
Low-income home energy assistance program	1,610	1,669	1,025	991	875	796	625	552	475	393	375	287
Housing and Urban Development:												
Selected public and subsidized housing programs	5,512	3,185	4,789	3,805	4,837	4,484	4,897	4,685	4,961	5,036	5,026	4,968
Community development block grants	3,200	3,073	2,920	3,097	2,920	3,061	2,920	2,906	2,920	2,914	2,920	2,915
Justice:												
Byrne Memorial State and local law enforcement assistance program	490	342	490	421	490	475	490	481	490	484	490	491
Total	22,766	20,488	21,253	20,949	21,026	21,657	20,845	21,810	20,798	22,246	21,428	22,286

Table II-11. PROPOSED OUTLAYS, BY AGENCY
(In billions of dollars)

Agency	1991 ¹			1992		
	Discretionary	Mandatory	Total	Discretionary	Mandatory	Total
Cabinet Agencies:						
Agriculture	11.6	43.9	55.4	12.5	43.2	55.7
Commerce	2.9	-0.1	2.8	2.9	-0.1	2.8
Defense—Civil	3.4	23.0	26.4	3.5	24.7	28.2
Defense—Military	288.3	-0.8	287.5	283.8	-0.7	283.0
Education	18.8	6.1	24.8	20.5	7.0	27.5
Energy	16.0	-2.4	13.5	17.4	-2.5	14.9
Health and Human Services	27.8	458.4	486.3	28.7	496.6	525.3
Housing and Urban Development	21.8	1.7	23.5	23.4	0.9	24.3
Interior	6.6	-0.2	6.4	6.7	-0.2	6.5
Justice	7.7	1.0	8.7	9.0	1.0	10.0
Labor	8.8	25.7	34.5	9.2	25.5	34.8
State	4.0	0.3	4.3	4.2	0.3	4.5
Transportation	30.5	0.2	30.8	31.6	0.3	31.9
Treasury	8.8	268.3	277.1	9.6	289.0	298.6
Veterans Affairs	13.9	17.5	31.3	14.7	18.1	32.8
Major Agencies:						
Deposit Insurance Accounts	0.1	111.4	111.5	—	88.1	88.1
Environmental Protection Agency	5.9	-0.1	5.8	6.1	-0.2	5.9
General Services Administration	0.9	-0.1	0.8	0.9	-0.1	0.7
National Aeronautics and Space Administration	13.5	—	13.5	14.7	—	14.7
Office of Personnel Management	0.2	35.0	35.2	0.2	36.8	37.0
Small Business Administration	0.5	—	0.5	0.5	-0.2	0.3
Other Agencies:						
Executive Office of the President	0.3	—	0.3	0.3	—	0.3
Funds Appropriated to the President	11.8	-0.5	11.3	12.7	-0.7	12.0
Judicial Branch	1.9	0.2	2.1	2.2	0.1	2.3
Legislative Branch	2.2	0.3	2.5	2.6	0.4	3.0
Other Independent Agencies	10.3	4.0	14.2	9.4	4.6	14.0
Allowances	8.2	—	8.2	4.7	—	4.7
Undistributed offsetting receipts	—	-109.4	-109.4	—	-118.0	-118.0
Total Outlays	526.3	883.3	1,409.6	532.1	913.8	1,445.9

¹Includes impact of supplementals and rescissions.

**Table II-12. DISCRETIONARY PROPOSALS, BY APPROPRIATIONS
SUBCOMMITTEES**
(In millions of dollars)

Appropriations Subcommittee	1991 Enacted		1991 Proposed		1992 Proposed		1992 Proposed Less 1991 Enacted	
	BA	Outlays	BA	Outlays	BA	Outlays	BA	Outlays
Domestic Discretionary								
Commerce, Justice, State and Judiciary	13,941	14,311	13,981	14,339	15,686	15,927	1,745	1,616
District of Columbia	568	575	568	575	536	536	-32	-39
Energy and Water	9,062	8,607	9,062	8,607	9,830	9,132	768	525
Interior	12,758	11,816	12,758	11,816	12,068	12,214	-690	398
Labor, HHS, and Education	55,972	54,074	56,197	54,269	56,003	57,352	31	3,278
Legislative Branch	2,158	2,165	2,158	2,165	2,664	2,597	506	432
Rural Development, Agriculture, and Related Agencies	8,845	8,901	8,856	8,914	10,204	9,674	1,360	773
Transportation	12,498	29,842	12,498	29,842	14,560	31,067	2,062	1,225
Treasury, Postal Service and General Government ...	11,872	10,772	11,872	10,772	10,807	11,241	-1,065	469
Veterans Affairs, HUD, and Independent Agencies ...	60,265	58,549	60,198	58,516	64,914	62,195	4,649	3,646
Allowances	—	—	—	—	97	97	97	97
Total Domestic Discretionary	187,939	199,612	188,147	199,814	197,370	212,032	9,431	12,419
Defense Discretionary								
Defense	268,994	281,393	265,681	280,611	270,866	275,474	1,872	-5,919
Energy and Water, Function 050	10,955	10,355	11,578	10,513	11,780	11,443	825	1,089
Military Construction	8,410	7,939	8,290	7,928	8,143	8,366	-267	427
Commerce, Justice, State and Judiciary	225	166	225	166	225	178	—	12
Veterans Affairs, HUD and Independent Agencies	335	336	335	336	337	339	3	2
Total Defense Discretionary	288,919	300,189	286,109	299,554	291,351	295,800	2,432	-4,389
Allowance for Desert Shield (placeholder)	—	—	14,000	8,200	—	4,611	—	4,611
Total Defense Discretionary with Allowance for Desert Shield (placeholder)	288,919	300,189	300,109	307,754	291,351	300,411	2,432	222
International Discretionary								
Commerce, Justice, State, and Judiciary	4,279	4,632	4,379	4,715	5,402	4,906	1,123	274
Foreign Operations	14,869	12,855	14,730	12,897	27,311	13,578	12,441	723
Labor, HHS and Education	8	9	8	9	9	9	1	—
Rural Development, Agriculture, and Related Agencies	981	1,097	1,011	1,120	1,301	1,120	320	23
Total International Discretionary	20,137	18,593	20,129	18,740	34,022	19,613	13,885	1,021
Total Discretionary	496,995	518,394	508,385	526,308	522,744	532,056	25,749	13,662

III. ECONOMIC ASSUMPTIONS AND SENSITIVITIES

Part One-29

III. ECONOMIC ASSUMPTIONS AND SENSITIVITIES

INTRODUCTION

The economic expansion that began in November 1982—the longest peacetime period of continuous growth—has been interrupted. Iraq's invasion of Kuwait and the heightened uncertainties that ensued hurt consumer confidence and contributed to a curtailment of spending. That tipped the balance in the final months of the year from slow economic growth to contraction.

The current downturn is widely forecast to be shorter and shallower than the average postwar recession which lasted 11 months with a real GNP decrease of 2.6 percent. The more favorable outcome expected this time reflects the absence of cyclical imbalances and inflationary pressures. Energy conservation has made the economy much less vulnerable to oil shocks than it was in the 1970s. Barring a sustained surge in the price of oil, the economy should stabilize and turn toward recovery within the next few months.

RECENT DEVELOPMENTS

Real GNP, which grew at a 1.4 percent annual rate in the third quarter of 1990, declined in the fourth. The exact extent of the drop will not be known until this spring when final data for the quarter are available, but the decrease appears to have been substantial. Consumer spending, business fixed investment and housing construction fell, largely in response to the growing uneasiness about the future.

Businesses curtailed production and employment in order to avoid an unwanted buildup of inventories. Industrial production was reduced 2 percent from the third to the fourth quarter, with cutbacks widespread across industries. The Nation's payrolls were trimmed by 420,000 workers, about ½ percent. By December, the total unemployment rate reached 6.0 percent, 0.5 percentage point above the third quarter average, but was still low by historical standards.

An initial burst of inflation brought on by the surge in oil prices following the Iraqi invasion has given way to more moderate rises in recent months as oil prices have retreated. After increasing at a nearly 10 percent annual rate in August-September, the Consumer Price Index slowed to a 3.7 percent rate in November and December. Crude oil prices, which reached \$40 per barrel at their height in October, fell below \$30 early this year. Outside of the energy sector, inflation has been subdued recently.

Money growth decelerated sharply in 1990, with the M2 and M3 aggregates barely exceeding the lower limits of the Federal Reserve's target ranges. In the last 3 months of the year, both aggregates were virtually unchanged. M2 adjusted for inflation, often a leading indicator of economic activity, fell 3 percent from its peak in December 1989. To alleviate the decline in economic activity, the Federal Reserve lowered the Federal funds rate from 8¼ percent in July 1990 to around 6¾ percent at the beginning of this year. The discount rate was cut by ½ percentage point in December 1990.

The 3-month Treasury bill rate dropped about 1¼ percentage points from July to the beginning of 1991 to reach 6.5 percent. At the longer end of the maturity spectrum, the 10-year Treasury note rate declined only slightly over the period, primarily because of uncertainties related to tensions in the Persian Gulf. In early 1991, banks cut the prime rate ½ percentage point to 9.5 percent.

ECONOMIC ASSUMPTIONS

Short-Term Prospects.—The Administration's economic assumptions, developed jointly by the Council of Economic Advisers, the Treasury and the Office of Management and Budget, show a resumption of economic growth in the near future, with the pace accelerating into 1992. From the fourth quarter of 1990 to the fourth quarter of 1991, real GNP is

Table III-1. ECONOMIC ASSUMPTIONS
(Calendar years; dollar amounts in billions)

	Actual 1989	Assumptions						
		1990 ⁴	1991	1992	1993	1994	1995	1996
Major economic indicators:								
Gross national product, percent change, fourth quarter over fourth quarter:								
Current dollars	5.6	4.5	5.3	7.5	7.1	6.8	6.5	6.4
Constant (1982) dollars	1.8	0.0	0.9	3.6	3.4	3.2	3.0	3.0
GNP deflator (percent change, fourth quarter over fourth quarter)	3.7	4.5	4.3	3.8	3.6	3.5	3.4	3.3
Consumer Price Index (percent change, fourth quarter over fourth quarter) ¹	4.5	6.3	4.3	3.9	3.6	3.5	3.4	3.3
Unemployment rate, total (fourth quarter) ²	5.3	5.8	6.6	6.5	6.0	5.7	5.2	5.1
Annual economic assumptions:								
Gross national product:								
Current dollars:								
Amount	5,201	5,465	5,689	6,095	6,536	6,990	7,451	7,931
Percent change, year over year ..	6.7	5.1	4.1	7.1	7.2	7.0	6.6	6.4
Constant (1982) dollars:								
Amount	4,118	4,152	4,140	4,267	4,415	4,560	4,699	4,840
Percent change, year over year ..	2.5	0.8	-0.3	3.1	3.5	3.3	3.1	3.0
Incomes:								
Personal income	4,384	4,644	4,856	5,182	5,524	5,887	6,259	6,655
Wages and salaries	2,573	2,700	2,802	3,006	3,235	3,467	3,703	3,950
Corporate profits before tax	308	300	294	335	379	419	447	484
Price level:								
GNP deflator:								
Level (1982 = 100), annual average	126.3	131.6	137.4	142.8	148.0	153.3	158.6	163.8
Percent change, year over year ..	4.1	4.2	4.4	3.9	3.6	3.5	3.4	3.3
Consumer Price Index: ¹								
Level (1982-84 = 100), annual average	122.6	129.1	135.8	141.2	146.4	151.6	156.8	162.0
Percent change, year over year ..	4.8	5.3	5.2	4.0	3.7	3.5	3.4	3.3
Unemployment rate, total, annual average ²	5.2	5.4	6.7	6.6	6.2	5.8	5.4	5.1
Federal pay raises, January (percent)	4.1	3.6	4.1	4.2	4.7	4.3	4.1	4.0
Interest rates (percent):								
91-day Treasury bills ³	8.1	7.5	6.4	6.0	5.8	5.6	5.4	5.3
10-year Treasury notes	8.5	8.5	7.5	7.2	6.8	6.6	6.4	6.3

¹ CPI for urban wage earners and clerical workers. Two versions of the CPI are now published. The index shown here is that currently used, as required by law, in calculating automatic cost-of-living increases for indexed Federal programs.

² Percent of total labor force, including armed forces residing in the U.S.

³ Average rate on new issues within period, on a bank discount basis. These projections assume, by convention, that interest rates decline with the rate of inflation.

⁴ Based on data available as of mid-December 1990.

projected to rise only 0.9 percent, with most of the gain in the second half of the year. The slow growth is projected to push the total unemployment rate to the neighborhood of 6¾ percent for much of the year. Faster real growth of 3.6 percent during 1992 is expected

to put the unemployment rate back on a downward path (Table III-1).

The assessment that the downturn will be mild and soon turn toward recovery is based on several factors. *First, the economy entered*

this period of weakness in relatively healthy condition. Unlike previous cyclical peaks, it was not overheated last year: growth had already slowed to well below a sustainable pace, inflation and interest rates had not spiked, and business inventories remained in line with final sales. With few of the imbalances that typically arise at the end of an expansion, there is little need for a long period of decline while excesses are eliminated.

Second, the precipitous loss of consumer confidence since July was due to an external development, the Persian Gulf crisis, rather than internal weakness. Confidence can be restored quickly if it becomes evident that there will not be a replay of the previous oil shocks.

Third, a recovery in interest-sensitive sectors such as housing, consumer durables and business investment is likely as a consequence of the fall in interest rates in recent months. Moreover, economic activity will be supported by an improvement in the trade balance. The 12 percent depreciation of the dollar during 1990 has made domestically produced goods more competitive on world markets. In addition, faster growth abroad will further boost U.S. exports relative to imports.

Finally, the rate of inflation is likely to decline in 1991 and 1992, reflecting a return to pre-crisis oil prices, the weaker labor market, and greater excess capacity.

Table III-2 shows a range of estimates for economic variables related to saving, investment and foreign trade, as required by the Omnibus Trade and Competitiveness Act of 1988. The merchandise trade balance and current account are expected to improve consider-

ably in 1992 due to the continuing favorable impact on the Nation's competitive position of the dollar's decline during 1990 and relatively faster growth abroad. As a result, net foreign investment in the United States will be reduced. Net domestic saving and net private domestic investment in 1992 are projected to be around the levels of 1990 as declines during the period of sluggish activity in 1991 are offset by subsequent increases as rapid growth resumes.

It is difficult to gauge the effect of Federal Government borrowing from the public on interest rates and exchange rates as required by the Act. Both are influenced by many factors besides Government borrowing in a complicated process involving supply and demand of credit and public perceptions of fiscal and monetary policy here and abroad. The proposals in this budget are not expected to exert a substantial independent influence on exchange rates.

Long-Term Assumptions.—Real GNP growth is assumed to be about 3 percent annually by 1995-1996, accompanied by gradual declines in inflation and interest rates. The growth projection is based on a slowing in the growth of the labor force, offset by faster growth of labor productivity. The civilian labor force is assumed to rise about 1.3 percent per year toward the end of the projection period, slightly less than its average of the last four years. Labor productivity is assumed to increase at an annual rate of 1.9 percent per year at that time, up from the 1.3 percent of the last expansion.

Table III-2. SAVING, INVESTMENT, AND TRADE BALANCE

(In billions of dollars)

	1990 actual	1992 estimate
Merchandise trade balance	-102	-75 to -95
Current account balance	-96	-65 to -85
Net foreign investment	-88	-60 to -80
Net domestic saving (excluding Federal saving) ¹	256	240 to 260
Net private domestic investment	185	180 to 200

¹ Defined for purposes of Public Law 100-418 as the sum of private saving and the surpluses of State and local governments. All series are based on National Income and Product Accounts except for the current account.

The productivity gain is predicated on the adoption of sound fiscal and monetary policies that foster a higher rate of capital formation.

THE BUDGET OUTLOOK UNDER ALTERNATIVE ASSUMPTIONS

Because there is considerable uncertainty surrounding any economic projection, it is useful to consider how the budget deficit would be affected if economic performance differed from the assumptions underlying the budget. Two such alternatives are examined in this section.

The "higher growth" alternative allows for the possibility that the economy will pass through the next six years without a significant downturn in economic activity. Following a one-quarter decline in real GNP in the fourth quarter of 1990, real economic growth resumes in 1991 at a faster pace than in the budget assumptions. Real GNP rises 1.3 percent over the four quarters of 1991 and 3.8 percent during 1992 (Table III-3). This alternative might occur with a quick rebound in consumer confidence and spending or a strong performance of U.S. exports in early 1991.

GNP in this alternative is assumed to grow 3.2 percent per year in 1995-1996 compared with 3.0 percent in the budget. Inflation and interest rates are also assumed to be somewhat higher.

The 1992 deficit is \$6.9 billion lower with the high growth path than in the budget; by 1996 the deficit is \$30.3 billion less (Table III-4). The effect of faster economic growth and higher inflation on receipts outweighs the effect of higher inflation and interest rates on outlays.

In the "lower growth" alternative, the economy experiences a sharp and lengthy downturn in 1990-1991. The banking sector is assumed to be severely affected in this scenario, with a prolonged period of high losses and increasing insolvencies. This alternative might arise if confidence falls even further as the economy weakens. Economic growth following this recession is slower than in the budget, rising only 2.6 percent in 1996. Interest rates and inflation are somewhat lower in this alternative because of weaker demand.

The deficit is \$40.4 billion higher in 1992 on the lower growth path. This includes an

Table III-3. ALTERNATIVE ECONOMIC ASSUMPTIONS

(Calendar years)

	1991	1992	1993	1994	1995	1996
Percent increase, fourth quarter over fourth quarter:						
Real GNP:						
Budget assumptions	0.9	3.6	3.4	3.2	3.0	3.0
Higher growth	1.3	3.8	3.6	3.4	3.2	3.2
Lower growth	-1.3	3.5	3.3	2.9	2.7	2.6
GNP deflator:						
Budget assumptions	4.3	3.8	3.6	3.5	3.4	3.3
Higher growth	4.5	4.2	4.1	4.0	3.9	3.8
Lower growth	4.1	3.6	3.4	3.3	3.2	3.1
Total unemployment rate: ¹						
Budget assumptions	6.7	6.6	6.2	5.8	5.4	5.1
Higher growth	6.5	6.4	6.0	5.6	5.2	5.0
Lower growth	7.1	6.9	6.5	6.1	5.7	5.4
91-day Treasury bill rate: ¹						
Budget assumptions	6.4	6.0	5.8	5.6	5.4	5.3
Higher growth	6.7	6.5	6.4	6.2	6.0	5.9
Lower growth	6.2	5.7	5.5	5.3	5.2	5.1

¹ Annual average, percent.

Table III-4. **BUDGET EFFECTS OF ALTERNATIVE ASSUMPTIONS**

(Differences from budget; in billions of dollars)

	1991	1992	1993	1994	1995	1996
Higher growth:						
Receipts	3.3	10.7	20.3	30.6	42.4	54.9
Outlays	0.1	3.8	10.1	13.7	19.1	24.6
Deficit reduction (-)	-3.2	-6.9	-10.2	-16.9	-23.3	-30.3
Lower growth:						
Receipts	-13.4	-30.8	-40.2	-48.1	-57.8	-69.0
Outlays:						
BIF	10.6	8.6	8.3	8.5	1.5	-1.4
Other	1.5	1.0	0.5	0.6	2.2	3.8
Total outlays	12.1	9.6	8.8	9.1	3.7	2.4
Deficit increase (+)	25.5	40.4	49.0	57.2	61.5	71.4

\$8.6 billion increase in the FDIC Bank Insurance Fund (BIF) outlays. A tentative estimate would put additional BIF outlays at \$36 billion over the next 6 years. The deteriorating health of depository institutions is discussed in Chapter VIII.A., "Recognizing and Reducing Federal Underwriting Risks." By 1996, the deficit would be \$71.4 billion higher in this lower growth alternative.

STRUCTURAL vs. CYCLICAL DEFICIT

The OBRA reforms succeeded in putting the structural deficit on a declining path. This improvement, however, has been obscured by temporary factors.

The downturn in the economy has raised unemployment and caused GNP to fall below its high employment level. The decline in eco-

nomics activity has also caused the budget deficit to increase. Table III-5 divides the deficit into a cyclical component and a noncyclical structural component. On this calculation, cyclical factors account for \$45 billion of the 1992 deficit, up from \$5 billion in 1990.

Assuming that, by 1996, the total unemployment rate will have returned to 5.2 percent—its level in the second quarter of 1990—the cyclical portion of the deficit will be \$2 billion, while the structural portion will be a \$22 billion surplus. Although the cyclical deficit is virtually eliminated by 1996, the downturn has a lingering effect on the structural portion. Because of the additional debt incurred while the unemployment rate exceeds 5.2 percent, interest costs are permanently higher. These additional interest payments amount to \$13

Table III-5. **ADJUSTED STRUCTURAL DEFICIT**

(In billions of dollars)

	1990	1991	1992	1993	1994	1995	1996
Consolidated surplus or deficit (-) ...	-220	-318	-281	-202	-62	-3	20
Cyclical component	5	37	45	34	22	11	2
Structural surplus or deficit (-)	-215	-281	-236	-168	-40	8	22
Deposit insurance outlays	58	111	88	44	-38	-42	-30
Adjusted structural deficit	-157	-170	-148	-124	-78	-34	-8

billion in 1996. Without them, the structural surplus would be \$35 billion.

Outlays for deposit insurance of thrifts and banks, as well as the receipts from sales of assets of failed financial institutions, are "one-time only" transactions that will not be repeated once the problems of thrifts and banks are resolved. Moreover, the near-term outlays are partly balanced by future offsetting collections when the Government disposes of the assets it has acquired. The underlying deficit is not affected by such transactions. Removing deposit insurance from the deficit calculation reduces the 1992 deficit by \$88 billion, and adds \$30 billion to the 1996 deficit.

The consolidated deficit shows a large \$61 billion increase between 1990 and 1992 and a very rapid improvement over the succeeding four years. *Subtracting both the cyclical component and deposit insurance from the consolidated deficit yields an adjusted structural deficit that declines gradually between 1991 and 1996.*

IMPACT OF ECONOMIC CHANGES ON THE DEFICIT

Recent economic developments and changes in the economic assumptions from the 1991 budget for 1991-1995 have a large negative impact on the deficit (Tables III-6 and III-7). On balance, changes from the 1991 budget assumptions are estimated to have raised the deficit by about \$71 billion in 1991, and by \$109 billion in 1995. Receipts are \$49 billion lower in 1991 and \$43 billion lower in 1995. The much weaker economy in 1991 keeps the level of real GNP in subsequent years below that assumed in last year's budget. Outlays are higher in all years as a result of increased costs for unemployment-sensitive programs and higher interest costs associated with higher interest rates and a larger outstanding Federal debt. The enlargement of the deficit is ameliorated somewhat by slightly higher inflation, which adds more to receipts than to outlays. Changes in policies and technical reestimates, including the increased cost to resolve thrift and bank insolvencies, are not included in these figures.

Table III-6. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 1991 AND 1992 BUDGETS

(Calendar years; dollar amounts in billions)

	1990	1991	1992	1993	1994	1995
Nominal GNP:						
1991 budget assumptions ¹	5,544	5,958	6,391	6,830	7,270	7,713
1992 budget assumptions	5,465	5,689	6,095	6,536	6,990	7,451
Real GNP (percent change):²						
1991 budget assumption	2.6	3.3	3.2	3.1	3.0	3.0
1992 budget assumptions	—	0.9	3.6	3.4	3.2	3.0
GNP deflator (percent change):²						
1991 budget assumption	4.2	4.1	3.8	3.5	3.2	2.9
1992 budget assumptions	4.5	4.3	3.8	3.6	3.5	3.4
Interest rate on 91-day Treasury bills (percent):						
1991 budget assumptions	6.7	5.4	5.3	5.0	4.7	4.4
1992 budget assumptions	7.5	6.4	6.0	5.8	5.6	5.4
Total unemployment rate (percent):						
1991 budget assumptions	5.4	5.3	5.2	5.1	5.0	5.0
1992 budget assumptions	5.4	6.7	6.6	6.2	5.8	5.4

¹Adjusted for July 1990 revisions.

²Fourth quarter to fourth quarter.

Table III-7. EFFECTS ON THE BUDGET OF CHANGES IN ECONOMIC ASSUMPTIONS SINCE LAST YEAR

(In billions of dollars)

	1991	1992	1993	1994	1995
Budget totals under 1991 budget economic assumptions and 1992 budget policies:					
Receipts	1,140.8	1,228.2	1,323.0	1,422.3	1,510.1
Outlays	1,388.0	1,408.8	1,405.9	1,368.7	1,404.0
Surplus or Deficit (-)	-247.2	-180.6	-82.9	53.6	106.1
Changes due to economic assumptions:					
Receipts	-49.4	-63.2	-70.3	-57.0	-42.8
Outlays:					
Inflation	5.0	9.5	11.9	14.0	15.5
Unemployment	6.3	6.9	5.8	4.3	2.2
Interest rates	5.9	10.9	14.4	17.8	19.8
Interest on changes in borrowing	4.4	9.8	16.2	22.3	28.8
Total, outlays	21.6	37.1	48.3	58.4	66.3
Increase in deficit	71.0	100.3	118.6	115.4	109.1
Budget totals under 1992 budget economic assumptions and policies:					
Receipts	1,091.4	1,165.0	1,252.7	1,365.3	1,467.3
Outlays	1,409.6	1,445.9	1,454.2	1,427.1	1,470.3
Surplus or Deficit (-)	-318.1	-280.9	-201.5	-61.8	-2.9

SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS

Both receipts and outlays are powerfully affected by changes in economic conditions. This sensitivity seriously complicates budget planning because errors in economic forecasting lead to errors in the budget forecast. Many of the budgetary effects of changes in economic assumptions are fairly predictable, however, and rules of thumb embodying these relationships can be used to estimate how various changes in the economic assumptions would alter outlays, receipts, and the deficit. Table III-8 summarizes these rules of thumb.

These standard rules of thumb do not fully account for the budgetary impacts that are likely in an environment where many thrifts, banks, and other financial institutions are already under stress. In these circumstances, the impact on outlays of lower real GNP growth would be larger than shown in Table III-8. In the past, an average recession has been accompanied by a doubling in the rate of net charge-offs of nonperforming loans at banks,

leading to insolvencies. If the increase in charge-offs is greater than in past recessions, then the increase in Federal outlays to cover the liabilities of financial institutions would also be greater.

Table III-8 shows that if real GNP growth is lower by one percentage point in calendar 1991 only, and the unemployment rate rises by one-half percentage point, the 1991 deficit will be increased by \$5.9 billion. The budget effects are much larger if the real growth rate is assumed to be one percentage point less in each year 1991-1996 and the unemployment rate rises one-half point in each year. The levels of real and nominal GNP then are below the base case by a steadily growing percentage and the unemployment rate steadily rises compared with the base case. The deficit is \$117.8 billion higher than under the base case by 1996.

The effects of slower productivity growth are shown in a third example where real growth is one percentage point lower per year, while the unemployment rate is unchanged. In this

case, the estimated budget effects mount steadily over the years, but more slowly. The effect on the deficit reaches \$103 billion by 1996.

Joint changes in interest rates and inflation have a smaller effect on the deficit than equal percentage point changes in real GNP growth, because their effects on receipts and outlays are substantially offsetting. If the rate of inflation and the level of interest rates are higher by one percentage point in all years, the price level and nominal GNP rise by a cumulatively growing percentage above their base levels. In this case, the effects on receipts and outlays mount steadily in successive years, adding \$63.3 billion to outlays and \$78.5 billion to receipts in 1996, reducing the deficit by \$15.2 billion.

These estimates assume inflation adjustments with a 2-year lag to the ceilings for budget authority for discretionary programs in accordance with the procedures specified in the Budget Enforcement Act of 1990. They also assume that Congress would increase appropriations to the adjusted ceilings. The lag in-

involved in this adjustment to the ceiling for nominal budget authority results in a reduction in real outlays for discretionary programs when inflation is higher than was forecast in the Act, and an increase in real outlays when inflation is lower.

The table also shows the interest rate and the inflation effects separately, and rules of thumb for the added interest cost associated with higher or lower deficits (increased or reduced borrowing).

The effects of changes in economic assumptions in the opposite direction are approximately symmetric to those shown in the table. The impact of a one percentage point lower rate of inflation or higher real growth would be of about the same magnitude, but with the opposite sign.

These rules of thumb hold the income share composition of GNP constant. Because different income components are subject to different taxes and tax rates, estimates of total receipts can be affected significantly by changing income shares. These relationships are too complex, however, to reduce to simple rules.

Table III-8. SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS
(In billions of dollars)

Budget effect	1991	1992	1993	1994	1995	1996
Real Growth and Employment						
Effects of 1 percent lower real GNP growth in calendar year 1991 only, including higher unemployment: ¹						
Receipts	-5.2	-11.5	-13.9	-14.7	-15.4	-16.0
Outlays	0.7	3.9	4.5	5.8	7.5	8.7
Deficit increase (+)	5.9	15.4	18.4	20.5	22.9	24.7
Effects of a sustained 1 percent lower annual real GNP growth rate during 1991-1996, including higher unemployment: ¹						
Receipts	-5.2	-17.1	-32.0	-48.1	-66.0	-85.1
Outlays	0.7	4.6	9.9	15.2	24.4	32.7
Deficit increase (+)	5.9	21.7	41.9	63.3	90.4	117.8
Effects of a sustained 1 percent lower annual real GNP growth rate during 1991-1996, with no change in unemployment:						
Receipts	-5.1	-17.1	-32.2	-48.8	-67.5	-88.0
Outlays	0.1	1.0	2.8	5.7	10.5	15.2
Deficit increase (+)	5.2	18.1	35.0	54.5	78.0	103.2
Inflation and Interest Rates						
Effects of 1 percentage point higher rate of inflation and interest rates during calendar year 1991 only:						
Receipts	5.6	11.8	12.0	11.5	12.3	12.7
Outlays	4.6	11.0	10.1	11.0	11.4	11.5
Deficit increase (+)	-1.0	-0.8	-1.9	-0.5	-0.9	-1.2
Effects of a sustained 1 percentage point higher rate of inflation and interest rates during 1991-1996:						
Receipts	5.6	18.2	31.9	45.9	61.7	78.5
Outlays	4.6	16.2	27.7	39.2	51.2	63.3
Deficit increase (+)	-1.0	-2.0	-4.2	-6.7	-10.5	-15.2
Effects of a sustained 1 percentage point higher interest rate during 1991-1996 (no inflation change):						
Receipts	0.7	1.9	2.4	2.6	2.9	3.1
Outlays	4.3	13.6	20.0	24.1	27.8	30.0
Deficit increase (+)	3.6	11.7	17.6	21.5	24.9	26.9
Effects of a sustained 1 percentage point higher rate of inflation during 1991-1996 (no interest rate change):						
Receipts	4.9	16.3	29.5	43.3	58.8	75.4
Outlays	0.3	2.8	8.0	15.6	24.5	34.7
Deficit increase (+)	-4.6	-13.5	-21.5	-27.7	-34.3	-40.7
Interest Cost of Higher Federal Borrowing						
Effect of \$100 billion additional borrowing during 1991						
	2.7	7.6	7.9	8.3	8.8	9.0

¹The unemployment rate is assumed to be 0.5 percentage point higher per 1 percent shortfall in the level of real GNP.