STRICTLY CONFIDENTIAL (FR)
CLASS II - FOMC

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date November 9, 1990

To Federal Open Market Committee

Subject:

From Michael J. Prell MJP

The attached note, prepared by the Fiscal Analysis Section of the Division of Research and Statistics, analyzes the recent budget agreement.

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Subject: Fiscal Year 1991 Budget Agreement

From Division of Research and Statistics
(Fiscal Analysis Section)

On November 5, the President signed into law the Omnibus Budget Reconciliation Act of 1990. For the most part, the law implemented the deficit reductions and changes in budgetary process that were agreed to earlier by the Administration and members of the Congress. Under the economic and technical assumptions developed by OMB, the changes are large enough to shift the total budget toward a position of surplus by the mid-1990s. Even under less favorable assumptions, the fiscal changes contribute to a substantial improvement in the budget outlook.

The Budget Agreement, the Summit, and the Staff Projection

According to preliminary estimates provided by OMB, the budget agreement contains deficit reductions relative to the adjusted OMB baseline of $40 billion for FY1991 and $484 billion over the FY1991-95 period.[1] The total savings are a bit smaller than in the Summit agreement, with slightly larger tax increases and a small reduction in the outlay savings. More than two-thirds of the savings come from outlays. There are, however, larger differences in the composition of the outlay cuts and tax increases. On the outlay side, the major modification is a reduction in the size of the Medicare cuts. The discretionary spending

1. In September, the Administration raised substantially its estimates for the baseline deficit in the near term--to about $300 billion in both FY1991 and FY1992. Much of the change reflected higher outlays for deposit insurance, but there also were significant changes to other technical assumptions (mainly with respect to domestic discretionary programs) and to the economic forecast. The savings in the budget agreement are calculated relative to the new, higher baseline.

COMPARISON OF THE FY1991 RECONCILIATION ACT
AND THE SEPTEMBER BUDGET SUMMIT AGREEMENT
(FY1991 through FY1995, change from baseline in billions of dollars)

	Summit Agreement	Reconciliation Act[1]
Outlays	**366**	**345**
Discretionary	182	182
Defense (FY1991-93 total)	67	67
International (FY1991-FY1993)	0	0
Domestic (FY1991-FY1993)	0	0
Mandatory and fees	119	98
Medicare	60	42
Other	59	56
Interest	65	64
Revenues	**134**	**139**
Excise taxes	89	69
Energy	57	25
Other	32	44
Social insurance taxes	26	41
Personal income taxes	14	22
Corporate income taxes	5	4
Other		2
Total deficit reduction	**500**	**484**

1. Does not include $9 billion of revenues from IRS management initiatives claimed in congressional estimates of the Budget Agreement. These savings are not enforced in the Reconciliation Bill and are being discounted by Board staff.

cuts are the same as in the Summit. Compositional changes are larger on the revenue side. The Reconciliation Bill raises less revenue from excise taxes (primarily because a smaller gasoline tax increase was specified), but raises more from social insurance taxes (primarily from a larger increase in the Medicare wage cap) and the individual income tax (primarily from higher marginal tax rates and the phase-out of personal exemptions for upper income taxpayers).

DEFICIT REDUCTION
(Change from baseline in billions of dollars, fiscal years)

	1991	1992	1993	1994	1995	1991-1995
Outlay reductions	22	46	68	96	115	345
Revenue increases	18	30	28	32	31	139
Total	40	76	96	128	146	484

Using the economic and technical assumptions developed by OMB in September, enactment of the agreement would shift the budget into considerable surplus by FY1995; the preliminary estimates imply a surplus

THE OUTLOOK FOR THE BUDGET
(Billions of dollars, fiscal years)

	1991	1992	1993	1994	1995
Baseline deficit	294	306	227	116	85
- Proposed savings	*40*	*76*	*96*	*128*	*146*
= Agreement deficit	255	233	132	-12	-62
Ex. deposit insurance	158	153	113	42	-17

of $62 billion in the consolidated budget for that year--$17 billion if net receipts from deposit insurance programs, which are scored as offsets to outlays in the unified budget, are excluded. Substantial receipts from the sale of RTC assets are projected for 1995.

The total amount of savings in FY1991 and FY1992 is only slightly larger than the changes in outlays and revenues assumed in the September Greenbook; we had assumed $35 billion in each year. However, the composition is somewhat different; the agreement relies more heavily on taxes (especially excise and social insurance taxes) and less on outlay cuts. The additional excise taxes--most of which will go into effect on January 1, 1991--will tend to heighten the excise tax-induced price bulge that is expected to occur in early 1991. In addition, the new luxury tax is expected to pull some consumer spending from 1991 into the fourth quarter of this year. In the November Greenbook, excise tax changes cushion about 1-1/4 percentage points (annual rate) of the drop in real consumer spending in the fourth quarter. However, these purchases are expected to come largely out of inventories and are expected to have little net effect on real GNP.

Proposed Changes in Outlays

For FY1991, the agreement contains $22 billion of spending cuts, with the largest reductions slated for defense spending ($10 billion, excluding any additional costs for Operation Desert Shield) and Medicare ($3 billion). The agreement also calls for increased user fees and scattered reductions in mandatory spending programs. Nondefense discretionary spending is capped at the OMB adjusted baseline level through FY1993.

Outlay savings are projected to grow after FY1991 and to total $345 billion over the five years. Defense is expected to account for much of the savings. It is capped at levels that will reduce outlays at least $23 billion in FY1992 and $35 billion in FY1993. The agreement does not specify a defense path beyond 1993. Rather, it provides a total of net cuts--$53 billion in FY1994 and $62 billion in FY1995--from defense and discretionary nondefense programs. If the entire reduction were applied to defense, the defense cuts would total $182 billion over the five years and would result in a path of outlays that declined roughly 4 percent per year in real terms between FY1990 and FY1995.

PROPOSED REDUCTIONS IN OUTLAYS
(Change from baseline in billions of dollars, fiscal years)

	1991	1992	1993	1991-1995
Discretionary	10	23	35	182
Domestic	0	0	0	
International	0	0	0	
Defense	10	23	35	
Mandatory and fees	10	17	20	98
Medicare	3	6	9	42
Interest	2	7	12	64
Total	22	46	68	345

Outlays for Medicare are expected to be reduced $42 billion over the five years--noticeably less than in the Summit agreement. The savings are expected to come mainly through reductions in payments to Medicare providers; nevertheless, there will be a gradual rise in premiums that enrollees must pay for Medicare Part B coverage, which provides reimbursement for doctors' bills, and the annual deductible paid by Part B beneficiaries will increase from the current $75 to $100 in 1991. Other notable savings are anticipated to come from agriculture programs, the elimination of the Civil Service lump-sum retirement option, and other Civil Service and Postal Service health insurance and retirement reforms. In addition, there are increases in bank deposit insurance assessments and in other user fees. Finally, given the smaller deficits projected, debt service is estimated to be lower by $64 billion over the five years.

Changes in Revenues

The agreement calls for $18 billion of new revenues in FY1991.[2] The agreement's provisions are expected to raise between $28 billion and $31 billion per year during the FY1992-1995 period, bringing the five-year total to $139 billion--$153 billion if user fees and Medicare premiums are included (they are scored as outlay offsetting receipts in the unified budget but are partially classified as taxes in the NIPA accounts). The increase in FY1991 is relatively small, mainly because implementation for most of the provisions is delayed until January of next year. Also, the implementation delay creates incentives to move forward into 1990 income tax deductions and purchases of certain commodities in order to minimize tax burdens over time. Such a taxpayer response occurred in late 1986 after passage of the Tax Reform Act, but the effect in the current situation is likely to be smaller because the tax changes themselves are not as large.

2. The $18 billion figure is the net result of $20 billion of tax increases and $2 billion of provisions that lose revenue in FY1991. Over the full five years, revenue raising provisions are expected to be worth $167 billion, and revenue losers $27 billion. In the table, figures shown in the "other" categories are net results of numerous small increases and decreases.

CHANGES IN REVENUES
(Change from baseline in billions of dollars; fiscal years)

	1991	1992	1993	1991-1995
Excise	**10**	**13**	**15**	**69**
Energy	5	5	5	25
Telephone	2	3	3	13
Airport	1	2	3	12
Alcohol	1	2	2	9
Tobacco	1	1	2	6
Luxury goods	0	0	0	2
Other	0	1	1	2
Social Insurance	**3**	**9**	**9**	**41**
Medicare wage cap	2	6	6	27
Extend coverage to state and local government employees	0	2	2	9
Other	1	1	1	5
Individual Income	**3**	**7**	**2**	**22**
Limit itemized deductions	1	4	4	18
Rates	1	2	2	11
Exemption phase-out	1	2	2	11
Earned income tax credit	0	-2	-2	-12
Accelerate withheld tax collections	1	2	-3	0
Other	-1	-1	-1	-6
Corporate Income	**2**	**0**	**1**	**4**
Insurance companies	1	2	2	8
Other	1	-2	-1	-4
Other			**1**	**2**
Total	**18**	**30**	**28**	**139**

Roughly half of the total five-year revenue gain is attributable to higher excise taxes. The largest single revenue-increasing measure is a 5 cents per gallon tax on motor fuels effective December 1, 1990, that is worth about $25 billion over five years. The other excise tax provisions include: an extension of the 3 percent excise tax on telephone services; an extension of aviation excise taxes and an increase in the airplane ticket tax from 8 percent to 10 percent; higher taxes on distilled spirits and wine (by about 20 cents per bottle) and beer (by about 16 cents per six pack); and an increase in the tax on cigarettes in two stages by a total of 8 cents. In addition, a new tax would be imposed on certain luxury items (such as expensive autos, jewelry, and yachts). The tax would be equal to 10 percent of the purchase price in excess of a specified threshold; the thresholds are not indexed for inflation.

New provisions affecting social insurance revenues account for about 30 percent of the total revenue raised. The largest revenue-raising provision lifts the cap on wages considered in calculating the Medicare tax from $51,300 to $125,000; this is estimated to bring in about $27 billion over five years and would mean roughly a $1,000 increase in taxes in 1991 for a worker earning the new ceiling amount or more. Another provision would extend Social Security (OASDI) to those state and local employees not currently participating in a public employee retirement program; it is estimated to bring in $9 billion over 5 years.

Provisions affecting individual income taxes, on balance, would raise about $22 billion over five years. An increase in the top statutory individual income tax rate, a phase-out of the personal exemption, and a reduction in itemized deductions each would increase revenues. First, a new 31 percent statutory tax rate is to be added to the current rate structure and would apply to taxable incomes in 1991 of about $82,000 for a joint return and $49,000 for a single return. In addition, the alternative minimum tax rate is increased from 21 to 24 percent and the maximum capital gains rate is capped at 28 percent. Second, the current phase-out of the tax benefit of the personal exemption is to be replaced with a new one that reduces the amount of each personal exemption by 2 percent for each $2,500 by which adjustable gross income exceeds (indexed) thresholds of $150,000 for joint returns and $100,000 for single returns. As a result, the phase-out is complete when adjustable gross income exceeds these thresholds by $125,000. However, over this range of incomes, the tax rate on marginal income effectively rises about 0.5 percentage points per exemption above the new statutory 31 percent level for essentially the same reason that the current phase-out of the benefit of the personal exemption helps create a "bubble." Thus, this provision maintains a "bubble" in marginal effective tax rates, albeit at higher income levels. Third, allowable itemized deductions are to be reduced by 3 percent of the excess of adjusted gross income (AGI) over $100,000; however, no taxpayer would lose more than 20 percent of total deductions. For example, for a taxpayer whose AGI is $150,000, allowable itemized deductions are reduced by 3 percent of $50,000 or by $1500. For most taxpayers, a virtually equivalent way of raising revenue would be to increase the marginal tax rate on income in excess of $100,000 (assuming that this excess income is taxable and that the taxpayer is an itemizer). The revenue gain from these three provisions is partially offset by some revenue-losing provisions, the largest of which is an expanded earned income tax credit for low-income taxpayers.

The tax provisions affecting corporate income have virtually no effect, on balance, on total revenues. Insurance companies would pay higher taxes, but the plan also contains incentives for oil and gas exploration as well as certain other revenue-losing provisions.

Budget Outlook Under Alternative Economic Assumptions

One source of skepticism about the Budget Agreement has been the comparatively optimistic economic assumptions that OMB specified for the 1992 to 1995 period in its September baseline estimates. However, the total amount of deficit reduction relative to baseline should be affected only minimally by the specific economic assumptions made by OMB, even though the projected level of the deficit is quite sensitive to these assumptions.

To assess the effects of OMB's economic assumptions on the budget outlook, an alternative set of deficit projections based on less optimistic economic assumptions was computed. The alternative assumptions shown below are identical to the November Greenbook projection through 1992. Beginning in 1993, it is assumed that real GNP will continue to grow 2.5 percent per year--our estimate of the growth rate of potential GNP--thereby stabilizing the unemployment rate at 6.8 percent. With the maintenance of substantial slack in the economy through 1995, inflation is projected to slow to 2.2 percent by 1995. Nominal interest rates are expected to decline, reflecting lower price inflation and a drop in real rates toward the averages that were realized during the 1950s and 1960s.

ALTERNATIVE ECONOMIC ASSUMPTIONS

	1990	1991	1992	1993	1994	1995
	----------Percent change, Q4 to Q4----------					
Real GNP						
OMB	.7	1.3	3.8	4.1	3.7	3.5
ALTERNATIVE	.4	1.2	2.5	2.5	2.5	2.5
Implicit GNP deflator						
OMB	5.2	4.6	3.4	3.2	3.0	2.8
ALTERNATIVE	4.1	4.5	3.7	3.2	2.7	2.2
	-------Percent, calendar year average-------					
Unemployment rate						
OMB	5.6	6.1	6.4	5.6	5.3	5.1
ALTERNATIVE	5.5	6.7	6.8	6.8	6.8	6.8
Three-month Treasury bills						
OMB	7.7	7.2	5.7	4.9	4.4	4.2
Ten-year Treasury notes						
OMB	8.7	8.3	7.1	6.1	5.6	5.3

Deficit estimates based on the alternative economic assumptions and staff technical assumptions are shown in the next table. November Greenbook projections are used for 1991 and 1992. The net effect of moving to less optimistic economic assumptions is to shift the 1995 budget position from a $62 billion surplus to a $29 billion deficit--or to a $74 billion deficit if deposit insurance-related outlays are excluded. More than two-thirds of the difference in these estimates reflects lower revenues resulting from the lower nominal and real GNP paths in the alternative scenario. Much of the remainder of the difference is attributable to the higher interest costs that occur as a consequence of the alternative path's higher near-term interest rates. Other factors that boost the deficit include interest payments on higher debt levels and higher unemployment benefit payments.

THE OUTLOOK FOR THE BUDGET
(Billions of dollars, fiscal years)

	1990a	1991	1992	1993	1994	1995
OMB policy budget:						
Outlays	1252	1372	1418	1402	1359	1399
Revenues	1031	1116	1185	1270	1371	1461
OMB deficit estimate	**220**	**255**	**233**	**132**	**-12**	**-62**
Adjustments for alternative assumptions	**0**	**-3**	**1**	**36**	**70**	**91**
Alternative deficit estimate	**220**	**253**	**234**	**168**	**58**	**29**
Memo: Deficit excluding deposit insurance						
OMB	162	158	153	113	42	-17
Alternative	162	158	149	149	112	74

a-actual

The cumulative effect of these adjustments is to add $195 billion to federal debt over the five years. This does not diminish the size of the package because both the baseline and the policy deficits are boosted about equally. Indeed, raising the interest rate forecast increases the value of the package by raising the interest savings from any given amount of noninterest deficit reduction. Even under these less optimistic assumptions, the deficit (excluding deposit insurance outlays) falls to about 1 percent of GNP by 1995, the lowest level since 1974.

The Budget Agreement and Fiscal Policy

The direct effect on aggregate demand of the spending cuts and tax increases proposed in the budget agreement can be summarized by the staff's fiscal impetus measure, FI.[3] As seen near the bottom of the next table, FI implies that the overall package is restrictive--especially in fiscal years 1991 and 1992 when the deficit-reducing provisions amount to over 0.5 percent of GNP. The smaller impact in later years occurs because most of the tax provisions and cuts in the mandatory spending programs become fully effective by the beginning of 1992 and thus impart little additional restraint thereafter. Nevertheless, there is still some restraint in the later years because of further cuts in discretionary spending programs slated to occur then.

Other entries in the table help to place the restraint implied by the budget agreement in an historical perspective. They show estimates of the magnitude of fiscal restraint for earlier periods of sustained substantial tightness; in the cases where the fiscal contraction lasted for more than four quarters, the value shown in the table is expressed at an annual rate. As can be seen, in each of the first two years, the budget package generates restraint similar to that which occurred in the late 1950s and the early 1980s, but much less than was associated with the defense cutbacks after the Korean and Vietnam wars. However, the restraint in the historical episodes lasted at most for two years, whereas the restraint implied by the budget agreement lasts much longer (albeit at a reduced level in the later years).

3. FI in any of the fiscal years is the weighted sum of the spending cuts and net tax increases scheduled to occur in that year. However, FI in any year does not capture the potential effect on aggregate demand in that year of changes in spending programs or tax schedules anticipated to occur in subsequent years. This implies that FI does not capture the present effects of the reduction in long-term interest rates (and the associated rise in aggregate demand) that models of forward-looking consumers and financial market participants would predict to result from the out-year deficit reductions included in the agreement.

FISCAL IMPETUS (FI) DURING MAJOR HISTORICAL EPISODES OF FISCAL RESTRAINT
(NIPA basis; negative sign implies fiscal restraint)

Period of restraint	FI as a percent of real GNP (standardized to an annual rate)
1. FY1954 - FY1955 (defense cuts)	-2.0
2. 1972Q4 - 1973Q4 (cuts in defense and grants)	-1.6
3. 1968Q2 - 1970Q1 (defense cuts, social security tax hike, income tax surcharge)	-.9
4. 1959Q1 - 1960Q1 (defense cut and social security tax hike)	-.7
5. 1980Q2 - 1981Q2 (social security and windfall profits tax increase)	-.6
Budget Agreement of 1990	
FY1990 - FY1991	-.6
FY1991 - FY1992	-.5
FY1992 - FY1993	-.3
FY1993 - FY1994	-.3
FY1994 - FY1995	-.1
Memo:	
Early Gramm-Rudman period	
1985Q3 - 1989Q4	-.1

Note: Estimate for the period, FY1954-FY1955, is based on staff interpretation of information found in Pechman, Federal Tax Policy, The Brookings Institution, 1977; quarterly estimates are not available. All other estimates are computed by FRB staff.

Similar results concerning the relative size of the fiscal restraint implied by the budget agreement are implied by the traditional high-employment budget deficit (as a share of nominal potential GNP), as seen in the next table. Using this alternative fiscal measure, the restraint over the next two years again is roughly equivalent to that of the least restrictive of the major historical episodes of restraint. Reliable estimates beyond 1992 are not available because we do not have staff forecasts of the requisite underlying detailed economic assumptions. However, given the broad contour of the deficit path relative to baseline associated with the budget agreement, the high-employment budget deficit in rough terms should move toward surplus on average by 0.2 to 0.3 of a percent of potential GNP per year between 1993 and 1995; this is similar to the restraint implied by the estimates of FI.

Enforcement and Budget Process Reform

The Reconciliation Bill includes several provisions that are directed primarily at enforcing the amount of deficit reduction (from the baseline tax and spending policies stipulated in prior laws) that is mandated in the Bill. Revenues and mandatory spending (which includes entitlements and other longer-term commitments such as CCC and interest outlays) are limited by a "pay-as-you-go" mechanism that makes policy changes that increase the deficit subject to a sequester. Discretionary spending in the FY1991 through FY1993 budgets is limited by separate caps on domestic, international, and defense spending; caps on total discretionary spending are applied in FY1994 and FY1995. The caps are expected to restrict only new deficit-increasing legislation because they must be adjusted when technical and economic assumptions change.

CHANGES IN THE HIGH-EMPLOYMENT BUDGET DEFICIT DURING MAJOR HISTORICAL EPISODES OF FISCAL RESTRAINT
(NIPA basis; negative sign implies fiscal restraint)

Period of restraint	Change in high-employment deficit as a percent of nominal potential GNP (standardized to an annual rate):
1. 1958 Q4--1960 Q1 (cut in purchases and social security tax hike)	-2.4
2. FY1954--FY1955 (defense cuts)	-2.0
3. 1967 Q3--1969 Q2 (defense cuts, social security tax hike, income tax surcharge)	-1.7
4. 1972 Q4--1974 Q3 (cuts in defense and grants, fiscal drag from inflation)	-1.4
5. 1977 Q3--1979 Q2 (fiscal drag from inflation, overwithholding)	-1.0
6. 1980 Q2--1981 Q2 (social security and windfall profits tax increases)	-.8
Budget Agreement of 1990 1990 Q4--1992 Q4	-.7
Memo: Gramm-Rudman period	
1985 Q4--1989 Q4	-.2
1989 Q4--1990 Q4	-.9

Note: Estimates for the post-1970 period are based on the staff's revised real potential GNP series. This revised series is based on the NIPA benchmark revisions and on an "Okun's Law" model developed by the staff; it is consistent with a six percent high-employment unemployment rate. Estimates for the pre-1970 period are based on a BEA potential GNP series (found in the Survey of Current Business, November 1980) in which the high-employment unemployment rate rises slowly from 4.5 percent in 1966 to around 5 percent in 1970. Estimates for the other episodes, including the initial Gramm-Rudman period, were computed by the FRB staff.

These enforcement provisions, which target a fixed amount of deficit reduction, contrast with the targets of the prior Gramm-Rudman-Hollings law that fixed a deficit level. A vestige of the prior law is retained in the form of a new, higher set of deficit targets. But, these new deficit targets must be adjusted for new economic and technical estimating assumptions in the FY1992 and FY1993 budgets, and the Administration has the option of making further adjustments in the FY1994 and FY1995 budgets. Thus, the deficit targets are superfluous for the FY1991 through FY1993 budgets because any change that might trigger a deficit sequester also would violate the pay-as-you-go mechanism for revenues and mandatory spending or the discretionary spending caps. A sequester could occur in FY1994 and FY1995 if changed economic or technical assumptions increase the deficit enough (there is a $15 billion error allowance) and the Administration does not exercise its option to adjust the targets.

Enforcement of discretionary spending limits. The initial discretionary spending caps and projected savings are shown in the table. These caps will be adjusted for changes in economic and technical assumptions in the Administration's annual budget submission. In addition, the caps will be adjusted for a number of special factors, including IMF funding, IRS compliance funding changes, the costs of Operation Desert Shield, foreign debt forgiveness, and reestimates related to credit budget reform provisions (described below). Furthermore, funding for emergencies (as determined by the President and agreed to by Congress) is not counted against the caps.

DISCRETIONARY SPENDING CAPS
(Fiscal years, billions of dollars)

	1991	1992	1993	1994	1995
Defense					
Outlay cap	297.7	295.7	292.7	---	---
Change from baseline[1]	-10	-23	-35	---	---
International					
Outlay cap	18.6	19.1	19.6	---	---
Change from baseline[1]	0	0	0	---	---
Domestic					
Outlay cap	198.1	210.1	221.7	---	---
Change from baseline[1]	0	0	0	---	---
Total discretionary					
Outlay cap	---	---	---	534.8	540.8
Change from baseline[1]	---	---	---	-53	-62

1. September 1990 OMB baseline.

The caps are enforced by a sequester mechanism--if spending is estimated to exceed the cap for a particular category, an automatic, across-the-board cut of spending within that category may be triggered. A Presidential sequester for the coming (or just started) fiscal year would be issued within 15 days of the end of a congressional session. During the following congressional session, legislation (e.g. supplemental appropriations) that breaches the limits that is enacted before July 1 would trigger a sequester within 15 days. If the legislation is enacted after July 1, the excess would be deducted from the following year's caps.

Enforcement of pay-as-you-go. The pay-as-you-go constraint specifies that new revenue and entitlements legislation may not increase the deficit. As with discretionary spending, legislation that the

President and Congress determine to be for emergency purposes would not be subject to pay-as-you-go requirements. Legislation that provides funding for the deposit insurance guarantee commitments in effect on the date of enactment also is exempt from the pay-as-you-go requirements.

Enforcement is through a sequester on mandatory spending accounts that were not exempt under prior Gramm-Rudman-Hollings sequester rules. The timetable for implementing pay-as-you-go triggered sequesters is the same as for discretionary sequesters. If required, an initial sequester order would be issued within 15 days of the end of the congressional session. During the following congressional session, legislation enacted before July 1 that violates the constraint would trigger a sequester within 15 days of enactment. Violations that occur after July 1 would be scored against the following fiscal year's pay-as-you-go constraint.

Enforcement of deficit targets. The new deficit targets are shown in the following table. They generally follow the deficit path that is implied by OMB's September baseline estimate and the savings enacted in the Reconciliation Bill, with the exception of the 1995 target, which is $23 billion higher than the OMB based projection. A $15 billion error allowance also is provided for in FY1994 and FY1995, so a sequester would not be triggered unless the 1995 deficit is estimated to exceed $98 billion (compared to the $62 billion September OMB projection). Thus, unless there are substantial technical estimating or economic assumption adjustments after 1993, no further deficit reduction efforts are implied by these targets. The present deficit targets are much higher than the targets adopted in 1987, in part because of a definition difference--the Social Security surplus is now excluded from deficit calculations--and, in part due to the high near-term costs of the thrift bailout (at the time the targets were revised in 1987, a small surplus was being projected in deposit insurance accounts). However, as shown in the memo items, the new targets are substantially higher even after adjustment for these factors. In essence, the goal of balancing this portion of the budget has been deferred from 1993 to 1995.

GRAMM-RUDMAN-HOLLINGS DEFICIT TARGETS
(Fiscal years, billions of dollars)

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
Original law (1985)	172	144	108	72	36	0				
Amendments (1987)			144	136	100	64	28	0		
Present law (1990)						327	317	236	102	83
memo:										
less Net deposit insurance outlays						96	78	19	-54	-45
plus Social Security surplus (-)						-74	-83	-99	-114	-126
equals Present law targets adjusted for the removal of Social Security from the 1990 targets and changes in deposit insurance cost estimates						157	156	118	42	2

Furthermore, the Administration is required to adjust the deficit targets for new economic and technical estimating assumptions in its FY1992 and FY1993 budget submissions to Congress. Thus, only new legislation could force a breach of the deficit targets in 1992 and 1993. But new legislation is limited by the discretionary caps and pay-as-you-go mechanism. Consequently, it is not expected that the deficit limits would be binding on the FY1991 through FY1993 budgets. The President also has the option of making economic and technical adjustments to the 1994 and 1995 targets, making these potentially superfluous. The targets would be adjusted for reestimates of deposit insurance outlays, even if the President does not choose to make other adjustments.

Enforcement of the deficit targets would be through the existing Gramm-Rudman-Hollings procedures. A deficit excess would be eliminated by an across-the-board sequester that is split equally between nonexempt defense and nondefense accounts. The sequester would go into effect 15 days after the end of the congressional session.

Suspension in the event of low growth or war. As under prior Gramm-Rudman-Hollings law, a projected or actual period of low real GNP growth, or a declaration of war can trigger a suspension of the enforcement provisions of the law. If two consecutive quarters of below one percent real GNP growth are reported by the Department of Commerce, or if the CBO or OMB project two consecutive quarters of decline in real GNP, then Congress must consider, on an expedited basis, a joint resolution (which is subject to the same presidential veto provisions as a new law) suspending the enforcement provisions of the Reconciliation Act. A declaration of war also would trigger a suspension of the enforcement provisions. A suspension for low growth or war would apply to any subsequent sequester reports and sequestrations, but would not repeal previous sequestration orders.

A suspension triggered by low growth would be lifted for the first fiscal year beginning at least 12 months after the enactment of the joint resolution suspending the Act. A suspension triggered by a declaration of war would be lifted for the first fiscal year after the war is concluded.

Budget timetable. The next table sets out the major deadlines of the reformed congressional budget process.

Credit reform. The Reconciliation Bill eliminates the federal credit budget, which established limits on the volume of new direct loans and federal loan guarantees. In its place, it requires that estimates of the subsidy implicit in federally assisted credit be included in agencies' budget authority and outlay allocations. Estimates of these subsidy costs also are included in the discretionary spending caps that are enforced by this Bill.

Social Security. The off-budget status of Social Security is reaffirmed. Furthermore, the Act removes Social Security from all deficit estimates and calculations made in the sequester process. Thus, for example, savings from Social Security could not be used to offset other spending increases in order to satisfy the pay-as-you-go requirement. The Act also establishes points-of-order against legislation that would change the actuarial balance of the Social Security trust funds, creating a so-called "firewall" against changes in in the financing of this program.

KEY DATES IN THE CONGRESSIONAL BUDGET TIMETABLE

Date	Action
First Monday after January 3 (may be delayed to first Monday in February in rare exigencies)	President submits budget request. Economic and technical assumptions are locked-in for the coming fiscal year. A sequester preview report updates deficit targets and discretionary spending caps. It also reports status of enacted legislation relative to the spending caps and the pay-as-you-go and maximum deficit requirements. (CBO issues sequester preview report 5 days before OMB).
April 15	Congress completes action on budget resolution.
May 15	Appropriation bills may be considered in the House (even if budget resolution is not completed).
June 30	Congress completes action on appropriation bills.
July 1	Supplemental appropriations for the current fiscal year that are enacted before this date and breach a discretionary spending cap trigger a sequester within 15 days. Bills enacted after this date would reduce the following year's cap.
August 15	CBO updates sequester preview report.
August 20	OMB updates sequester preview report.
October 1	Fiscal year starts.
10 days after Congress adjourns.	CBO final sequester report (is only advisory).
15 days after Congress adjourns.	OMB final sequester report. President issues sequester order if required.
30 days after final OMB report.	GAO issues sequester compliance report.