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Division of  
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CONFIDENTIAL (FR)  
CLASS II - FOMC

TO: Federal Open Market Committee

FROM: Joseph S. Zeisel

SUBJECT: Impact of the Automatic Stabilizers on the Fiscal  
Year 1980 Budget

This memorandum is in response to a question raised at the August 14 meeting of the Committee.

The extent to which the budget automatically moves into deficit as a result of a slowdown in economic activity can be estimated by focusing on changes in both the high employment and national income accounts (NIA) budgets. Specifically, the high employment budget estimates what the federal government's budget position would be in the absence of cyclical changes, assuming the economy grows along a path of relatively full capacity output. Since cyclical fluctuations are excluded from this measure, changes in the high employment budget reflect discretionary attempts by the fiscal authorities to influence economic activity.

The NIA budget, in contrast, includes not only the discretionary response of policymakers to changes in economic activity but also the automatic tendency of the budget to go into deficit as a result of declines in employment and income. Changes in the NIA budget, therefore, include both an automatic and discretionary component. Given these relationships,

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the automatic response of the budget to the projected slowdown in economic activity between fiscal year 1979 and 1980 can be estimated by taking the difference between the high employment budget and the NIA budget.

The increase in the unemployment rate from 5.8 percent in fiscal year 1979 to 7.3 percent in fiscal year 1980, and the resulting slowdown in economic activity is estimated to have increased the projected fiscal year 1980 budget deficit by \$28 billion.<sup>1/</sup> (See Attached Table)

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<sup>1/</sup> The \$18 billion increase in the high employment budget surplus reflects the impact of inflation on incomes and on high employment budget receipts. While this rise is automatic in nature, the high employment budget treats the gain as discretionary. The implicit assumption, in this instance, is that the fiscal authorities consciously choose not to offset the inflation-induced increase in federal revenues with a tax cut.

The Automatic Response of the Fiscal Year 1980 Budget  
to Changes in Economic Conditions  
(Billions of Dollars)

Item	FY '79 to FY '80
Change in NIA Budget (discretionary plus automatic fiscal actions)	-\$10*
Less	
Change in High Employment Budget (discretionary fiscal actions)	\$18
Equals	
Automatic Change in Budget Due to Slowdown in Economic Activity	-\$28

\* A negative refers to an increase in the deficit or a decrease in the surplus.