

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Date October 1, 1990

To Federal Open Market Committee

Subject: Budget Summit Agreement

From Michael Prell

Strictly Confidential (FR) Class II FOMC

The attached memo provides a very brief discussion of a few facets of the Budget Summit agreement and a reconciliation with the fiscal assumptions underlying the Greenbook GNP forecast.

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To Mr. Michael J. Prell

Subject: FY1991 Budget Agreement

From Glenn Follette

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On Sunday, September 30, a budget agreement was completed by the negotiators and a Continuing Resolution (CR) was passed. The budget agreement is summarized on table 1. The CR funds the government and delays the sequester until Friday. The debt ceiling also was extended until Friday. In the accord, it is expected that a 5-year extension of the debt ceiling will be enacted.

The budget agreement calls on Congress to pass a Budget Resolution by October 5 along with a new CR. Afterwards, the 13 appropriations bills and reconciliation legislation must be reported out of Committee by October 12 and passed by October 19. The reconciliation bill will contain the tax measures and the Medicare cuts and may be very contentious. The accord anticipates that the GRH sequester for FY1991 will be permanently canceled when the appropriations and reconciliation bills are passed.

The budget accord contains more tax increases than in the staff package, particularly excise taxes. Defense outlays are near the staff assumption. Table 2 compares the staff assumptions with the budget deal.

The GRH revisions cover several issues. First, there will be new deficit-reduction targets that call for a balanced budget by FY1995. (However, the GRH targets will be written in terms of the deficit excluding the social security trust fund and deposit insurance.) Second,

the sequester rules will be changed. There will be overall caps on defense, domestic, and foreign spending. Sequester will occur to the category that exceeds its limit. In addition, there will be sequesters on mandatory spending to the extent that new legislation is enacted that adds to mandatory spending which is not fully offset by outlay cuts or tax increases elsewhere.

The Administration also released new deficit numbers; the FY1991 baseline deficit is \$294 billion, compared to the staff forecast of \$234 billion. However the staff forecast includes \$35 billion in deficit reduction and \$20 billion less in deposit insurance. These two factors account for all but \$5 billion of the difference between the two forecasts. The Administration's economic assumptions for 1991, shown on table 3, are also close to the staff forecast.

The OMB also released figures for Operation Desert Shield. They now estimate \$11.5 billion in outlays in FY1991 (up from a previous estimate of \$11.3 billion), of which \$5.8 billion will be supplied by other countries. The amount provided by other countries appears to be less than our assumption of \$7.6 billion (\$4.6 billion of in-kind contributions and \$3 billion of cash contributions).

TABLE I DEFICIT REDUCTION
(in billions of dollars)

	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>91-95</u>
Discretionary:						
Domestic.....	--	--	-- }			
International.....	--	--	-- }	53.2	62.0	182.4
Defense.....	9.8	22.6	34.8 }			
Mandatory.....	12.1	20.9	23.9	28.8	33.3	119.0
Tax and receipt measures.....	16.2	26.7	27.0	32.1	31.8	133.8
Interest.....	<u>2.0</u>	<u>6.5</u>	<u>12.2</u>	<u>18.4</u>	<u>25.7</u>	<u>64.8</u>
Total deficit reduction.....	40.1	76.7	97.9	132.5	152.8	500.0

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Table 2

Deficit Reduction Packages
(billions of dollars)

	<u>Staff</u>		<u>Deal</u>		
	1991	1992	1991	1992	91-95
Outlays	22	47	24	50	366
Defense	10	25	10	23	182
Medicare	3	6	5		58
Agriculture	1	2	1		13
Interest	2	7	2	7	65
Other outlays	6	7	6		48
Revenues	13	27¹	16²	27²	134²
Individual ³	5	10	4	7	22
Corporate	1.5	4	-1	-4	-4
Social insurance ²	0	0	2	5	26
Excise	6.5	13	11	19	89
Total	35	74¹	40	77	500
Memo: Details of excise taxes					
Excise	6.5	12.7	10.9	18.5	89.3
Energy	0	5	6.8	12.5	56.8
Alcohol	3.5	4.7	1.5	2.1	10.0
Aviation	0	0	1.3	2.3	11.8
Tobacco	0	0	0.6	0.8	5.9
Telephone	3	3	0.0	0.0	0.0
Other	0	0	0.7	0.8	4.8

1. Includes revenue growth from 1991 actions.

2. Net of increased outlays from higher number of social security recipients.

3. Assumes all IRS enforcement enhancements are in personal income tax compliance.

TABLE 3 —ECONOMIC ASSUMPTIONS
(calendar years)

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>
Nominal GNP:							
Level (\$ billions).....	5201	5486	5807	6199	6670	7141	7607
Percent change, 4th/4th.....	5.4	6.0	6.0	7.3	7.5	6.8	6.4
Real GNP, percent change,							
4th/4th.....	1.6	0.7	1.3	3.8	4.1	3.7	3.5
GNP deflator, percent change,							
4th/4th.....	3.8	5.2	4.6	3.4	3.2	3.0	2.8
Unemployment rate.....	5.2	5.6	6.1	6.4	5.6	5.3	5.1
Interest rates:							
91-day Treasury bills.....	8.1	7.7	7.2	5.7	4.9	4.4	4.2
10-year Treasury notes.....	8.5	8.7	8.3	7.1	6.1	5.6	5.3
Domestic oil prices (\$/bbl).....	17.88	21.15	24.15	21.10	21.79	22.41	23.02