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SUPPLEMENT
CURRENT ECONOMIC AND FINANCIAL CONDITIONS

Prepared for the
Federal Open Market Committee

By the Staff
Board of Governors
of the Federal Reserve System

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SUPPLEMENTAL NOTES

Employment and Unemployment

The labor market softened in January as the number of persons unemployed rose 340,000. Total employment, as measured in the household survey, showed little change, and the jobless rate rose 0.3 percentage point to 6.2 percent--the highest rate since July 1978. Increases in joblessness were concentrated among adult men, while rates for adult women and teenagers were about unchanged.

In contrast to total employment, nonfarm payroll employment rose 305,000 in January, following a downward-revised advance of 130,000 in December. As has been the case over most of the past year, gains in January were concentrated in the service-producing industries. Manufacturing employment was about unchanged as the return of striking workers in the machinery industry roughly offset job cutbacks in auto-related industries. The factory workweek edged up 0.1 hour to 40.4 hours.

Wages

Wage rates for nonfarm production workers, as measured by the index of average hourly earnings, rose 0.2 percent to a level 7-3/4 percent above a year ago. The increase was concentrated in trade, probably reflecting the minimum wage adjustment that became effective January 1.

Manufacturers' Orders and Shipments

New orders for manufacturers' durable goods are indicated by preliminary, full-sample estimates to have increased 1.7 percent in December, instead of 0.6 percent as shown a week ago. The new data show a smaller

decline in orders received by primary metals producers than shown earlier. New orders for nondefense capital are now estimated to have increased 6.3 percent in December instead of 7.9 percent, and orders for defense capital goods to have declined 13.9 percent, instead of 14.5 percent. Unfilled orders for durable goods increased appreciably again in December, with the rise largely in the capital goods industries (excluding motor vehicles and parts.)

Manufacturers' shipments of durable goods are now indicated to have declined 0.7 percent in December, instead of 1.8 percent, with another quite large decline by producers of motor vehicles and parts and another moderately large decline by producers of household durable goods. Shipments of nondefense capital goods rose 2.9 percent in December--by more than the drop in the preceding month. Shipments of defense equipment rose 3.1 percent--instead of declining nearly 6 percent; in the fourth quarter shipments of these goods totaled 7.7 percent above those in the third quarter and nearly 14 percent above a year earlier.

Manufacturers' Inventories

The book value of manufacturers' inventories rose at an annual rate of \$23.0 billion in December--off from the \$32.5 billion November pace. For the fourth quarter as a whole, manufacturing firms increased stocks at a \$26.6 billion annual rate; the rates in the third quarter and first half were \$28.3 billion and \$32.6 billion, respectively. The increase in stocks in December was about evenly split between durable goods and nondurable goods; for the quarter, however, the rise in durable stocks was nearly four times as rapid as that in nondurables. By stage of processing, in December,

the largest increase was in stocks of finished goods (\$11.5 billion) followed by work-in-process (\$9.7 billion) and materials and supplies (\$1.8 billion). The ratio of inventories to shipments for all manufacturing was unchanged at 1.57 in December.

CHANGES IN EMPLOYMENT¹
(Thousands of employees; based on seasonally adjusted data)

	1978	1979				1980	
		Q1	Q2	Q3	Q4	Dec.	Jan.
- - - Average monthly changes - - -							
<u>Nonfarm payroll employment</u> ²	334	302	196	59	143	131	305
Strike adjusted	318	304	205	62	153	111	256
Manufacturing	69	64	-3	-38	-22	46	-15
Durable	57	56	3	-8	-42	23	-16
Nondurable	12	8	-6	-30	20	23	1
Construction	39	48	16	3	36	66	63
Trade, finance and services	169	150	113	77	45	-47	149
Private nonfarm production workers	256	230	111	11	98	77	174
Manufacturing production workers	50	44	-19	-46	-28	44	-29
<u>Total employment</u> ³	275	264	10	284	136	304	-108
Nonagricultural	268	282	35	244	138	330	-19

1. Changes are from final month of preceding period to final month of period indicated.

2. Survey of establishments. Not strike adjusted, except where noted.

3. Survey of households.

SELECTED UNEMPLOYMENT RATES
(Percent; based on seasonally adjusted data)

	1973	1979				1980	
		Q1	Q2	Q3	Q4	Dec.	Jan.
Total, 16 years and older	4.9	5.8	5.8	5.8	5.9	5.9	6.2
Teenagers	14.5	15.9	16.1	16.2	16.1	16.0	16.3
20-24 years old	7.8	8.7	8.8	9.2	9.4	9.8	10.1
Men, 25 years and older	2.5	3.2	3.2	3.3	3.4	3.2	3.7
Women, 25 years and older	4.0	4.9	4.9	4.7	4.8	4.7	4.9
White	4.3	5.0	5.0	5.1	5.1	5.1	5.4
Black and other	8.9	11.4	11.5	10.9	11.2	11.3	11.8
Fulltime workers	4.3	5.2	5.2	5.3	5.4	5.4	5.7
White collar	2.9	3.4	3.3	3.4	3.3	3.3	3.4
Blue collar	5.3	6.5	6.8	7.1	7.3	7.2	8.0

HOURLY EARNINGS INDEX¹
 (Percent change at compound annual rates;
 based on seasonally adjusted data)²

	Dec. 77	Dec. 78	1979				1980	
	to Dec. 78	to Dec. 79	Q1	Q2	Q3	Q4	Dec.	Jan.
Total private nonfarm	8.5	8.3	8.5	7.1	8.5	8.3	10.2	2.4
Manufacturing	8.6	8.9	8.5	9.7	8.1	8.8	10.3	2.4
Durable	8.8	8.8	8.6	10.0	7.9	7.9	11.2	1.3
Nondurable	8.2	9.2	8.4	9.1	8.6	10.5	8.7	4.3
Contract construction	7.7	6.8	7.7	7.6	6.6	4.7	8.1	-6.1
Transportation and public utilities	7.5	9.0	8.6	3.5	15.9	8.5	7.6	2.2
Total trade	9.6	7.5	10.3	5.8	7.2	7.0	7.0	12.1
Services	7.7	8.4	7.5	5.4	7.3	10.8	15.9	-1.4

1. Excludes the effect of interindustry shifts in employment and fluctuations in overtime pay in manufacturing.

2. Changes for other than monthly and yearly periods are compounded.

MANUFACTURERS' INVENTORIES: CHANGE IN BOOK VALUE
(Billions of dollars; seasonally adjusted, annual rate)

	1978		1979					
	H2	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.
Total	17.6	30.2	35.0	28.3	26.6	24.4	32.5	23.0
Durable	13.4	24.2	25.7	16.9	21.3	25.4	27.5	11.0
Nondurable	4.2	6.0	9.3	11.4	5.4	-1.0	5.0	12.0
Stage of Fabrication								
Materials & Supplies	4.5	12.8	8.0	9.9	11.4	18.7	13.7	1.8
Work-in-Process	8.7	9.9	16.6	11.7	12.2	13.9	13.1	9.7
Finished Goods	4.5	7.5	10.4	6.8	3.0	-8.2	5.7	11.5

Totals may not add due to rounding.

MANUFACTURERS' INVENTORY/SALES RATIOS

	1978		1979					
	H2	Q1	Q2	Q3	Q4	Oct.	Nov.	Dec.
Total	1.52	1.49	1.55	1.55	1.57	1.54	1.57	1.59
Durable	1.84	1.82	1.94	1.97	2.04	1.96	2.04	2.07
Nondurable	1.14	1.11	1.11	1.10	1.08	1.08	1.08	1.07

SELECTED FINANCIAL MARKETS QUOTATIONS
(percent)

	1974 High ¹	1979-1980 ²			Change from:	
		FOMC Oct. 5	FOMC Jan. 9	Jan. 31	FOMC Oct.	FOMC Jan.
<u>Short-term rates</u>						
Federal funds ³	13.55	11.91	13.94	13.54	1.63	-.40
Treasury bills						
3-month	9.63	10.70	11.76	12.00	1.30	.24
6-month	9.75	10.63	11.75	11.87	1.24	.12
1-year	9.54	10.28	10.76	11.17	.89	.41
Commercial paper						
1-month	12.25	11.73	13.07	13.01	1.28	-.06
3-month	12.25	11.86	13.04	13.04	1.18	0
6-month	12.00	11.84	12.50	12.76	.92	.26
Large negotiable CDs ⁴						
1-month	12.58	12.09	13.33	13.14	1.05	-.19
3-month	12.64	12.50	13.36	13.29	.79	-.07
6-month	12.30	12.80	13.33	13.52	.72	.19
Eurodollar deposit ³						
1-month	13.78	12.45	14.59	14.44	1.99	-.15
3-month	14.01	12.79	14.56	14.41	1.62	-.15
Bank prime rate	12.00	13.50	15.25	15.25	1.75	0
<u>Intermediate- and long-term rates</u>						
U.S. Treasury (constant maturity)						
3-year	8.84	10.01	10.68	11.19	1.18	.51
10-year	8.14	9.60	10.58	11.13	1.53	.55
30-year	n.a.	9.36	10.29	11.09	1.73	.80
Municipal (Bond Buyer) ⁵	7.15	6.64	7.32	7.52	.88	.20
Corporate Aaa New issue ⁶	10.61	10.22	--	--	--	--
Recently offered ⁷	10.52	10.25	11.42	12.29p	2.04	.87
Primary conventional mortgages ⁷	10.03	11.35	12.85	12.89	1.54	.04
	1974 Low ⁸	FOMC Oct. 5	FOMC Jan. 9	Jan. 31	FOMC Oct.	FOMC Jan.
<u>Stock prices</u>						
Dow-Jones Industrial	577.60	897.61	850.09	875.85	-21.76	25.76
NYSE Composite	32.89	63.39	62.72	65.61	2.22	2.89
AMEX Composite	58.26	235.15	251.75	275.42	40.27	23.67
NASDAQ (OTC)	54.87	152.29	151.60	161.75	9.46	10.15

1. Statement week averages except where noted.
2. One-day quotes except as noted.
3. Averages for statement week closest to date shown.
4. Secondary market.
5. One-day quotes for preceding Thursday.
6. Averages for preceding week.
7. One-day quotes for preceding Friday.
8. Calendar week averages.

MONETARY AGGREGATES
(Based on seasonally adjusted data)¹

	1979					1980	Jan. '79
	Q1	Q2	Q3	Q4 ^P	Dec. ^P	Jan. ^e	to Jan. '80 ^e
----- Percentage Change at Annual Rates -----							
<u>Major monetary aggregates</u>							
1. M-1	-1.3	8.1	9.7	5.0	5.4	1.6	6.2
2. Currency	9.1	7.3	11.1	8.5	5.7	11.3	9.0
3. Demand deposits	-5.3	8.3	9.3	3.7	5.2	-2.2	5.2
4. M-2	2.8	8.8	11.9	8.9	5.4	5.2	8.8
5. M-3	5.3	8.0	10.5	7.8	5.5	4.6	8.1
<u>Bank time and savings deposits</u>							
6. Total	9.5	1.1	8.9	14.5	3.4	8.5	8.1
7. Other than large negotiable CDs at weekly reporting banks	5.8	9.3	13.3	11.5	5.7	7.6	10.6
8. Savings deposits	-11.8	-3.5	5.8	-13.8	-9.8	-10.4	-6.1
9. Individuals ²	-10.4	-4.0	6.8	-12.6	-9.8	-10.5	-5.6
10. Other ³	-30.6	0.0	-5.5	-33.6	-18.5	-9.4	-12.4
11. Time deposits	19.3	18.4	18.5	28.1	14.4	18.2	22.8
12. Small time ⁴	20.3	35.9	25.7	30.0	27.3	27.2	33.5
13. Large time ⁴	17.6	-11.8	4.1	24.5	-12.3	-1.0	4.6
14. Time and savings deposits sub- ject to rate ceilings (8+12)	2.7	15.0	15.7	8.2	10.1	10.0	12.3
<u>Deposits at nonbank thrift institutions⁵</u>							
15. Total	8.8	6.8	8.4	6.3	5.6	3.8	7.0
16. Savings and loan associations	11.3	7.8	9.2	8.8	7.4	5.6	8.8
17. Mutual savings banks	4.6	3.1	2.2	0.3	-0.8	0.8	1.8
18. Credit unions	0.8	8.3	19.3	-0.7	4.3	-4.2	6.4
--- Average Monthly Change in Billions of Dollars ---							
<u>MEMORANDA:</u>							
19. Total U.S. govt. deposits ⁶	-2.0	-1.5	0.7	-0.8	2.5	1.5	0.0
20. Total large time deposits ⁷	1.4	-6.3	2.6	3.6	-1.9	0.6	0.0
21. Nondeposit funds	5.3	4.8	5.2	-4.3	-7.3	n.a.	n.a.
22. Other ⁸	2.0	1.3	2.2	-2.2	-1.0	n.a.	n.a.
23. Net due to related foreign institutions	3.3	3.6	2.9	-2.0	-6.3	n.a.	n.a.

1. Quarterly growth rates are computed on a quarterly average basis.
 2. Savings deposits held by individuals and nonprofit organizations.
 3. Savings deposits of business, government, and others, not seasonally adjusted.
 4. Small time deposits are in denominations of less than \$100,000. Large time deposits are in denominations of \$100,000 and above excluding negotiable CDs at weekly reporting banks.
 5. Growth rates are computed from monthly levels that are an average of current and preceding end-of-month data.
 6. Includes Treasury demand deposits at commercial banks and Federal Reserve Banks and Treasury note balances.
 7. All large time certificates, negotiable and nonnegotiable, at all CBs.
 8. Consists of nondeposit borrowings of commercial banks from nonbank sources, calculated at the sum of federal funds purchased, security RPs, other liabilities for borrowed money (including borrowings from the Federal Reserve), and loans sold less interbank borrowings.
- e--estimated. n.a.--not available. p--preliminary.

COMMERCIAL BANK CREDIT AND SHORT- AND INTERMEDIATE-TERM BUSINESS CREDIT
(Percentage changes at annual rates, based on seasonally adjusted data)¹

	1979						12 months ending Dec. ^e
	Q1P	Q2P	Q3P	Q4P	Nov.P	Dec. ^e	
----- Commercial Bank Credit -----							
1. Total loans and investments at banks ²	13.3	11.9	15.8	3.1	-0.5	3.3	11.4
2. Investments	7.6	5.4	8.5	3.5	3.0	2.1	6.4
3. Treasury securities	2.1	3.8	1.7	-6.3	-12.6	-7.6	0.3
4. Other securities	10.5	6.2	12.1	8.5	10.8	6.9	9.7
5. Total loans ²	15.2	14.2	18.2	2.9	-1.7	3.7	13.2
6. Business loans	20.5	16.6	22.7	5.0	-1.6	6.2	17.2
7. Security loans	33.0	38.1	8.7	-90.2	-128.2	-13.0	-6.2
8. Real estate loans	14.6	13.0	14.7	14.2	13.2	13.5	14.9
9. Consumer loans	16.3	12.4	7.5	6.0r	6.0	4.6r	10.9r
-- Short- and Intermediate-Term Business Credit --							
10. Total short- and intermediate-term business credit (sum of lines 13,14 and 15)	20.8	20.1	27.4	n.a.	0.6	n.a.	n.a.
11. Business loans net of bankers acceptances ¹	20.4	16.6	21.7	6.0	-0.4	4.7	17.2
12. Commercial paper issued by nonfinancial firms ³	33.5	65.7	69.7	15.5	-33.6	69.1	53.4
13. Sum of lines 11 & 12	21.4	20.3	25.7	6.9	-3.5	10.4	19.9
14. Finance company loans to business ⁴	16.6	17.7	9.4	n.a.	15.5	n.a.	n.a.
15. Total bankers acceptances outstanding ⁴	24.8	23.3	74.9	n.a.	5.5	n.a.	n.a.

1. Average of Wednesdays for domestic chartered banks and average of current and preceding ends of months for foreign-related institutions.

2. Loans include outstanding amounts of loans reported as sold outright to a bank's own foreign branches, unconsolidated nonbank affiliates of the bank, the bank's holding company (if not a bank), and unconsolidated nonbank subsidiaries of the holding company.

3. Average of Wednesdays.

4. Based on average of current and preceding ends of months.

e--estimated. p--preliminary. n.a.--not available.

APPENDIX A*

THE FEDERAL BUDGET FOR FISCAL YEAR 1981

Overview

On January 28, 1980, President Carter submitted his fiscal year 1981 budget to Congress. As the President promised, his new budget imposes considerable restraint on federal spending, holding its growth to a 9.3 percent annual rate. Revenues, on the other hand, are expected to rise at a 14.5 percent pace, mainly because of inflation, the proposed windfall profits tax, and the scheduled increase in social security taxes. As a result, the unified budget deficit is reduced from an estimated \$39.8 billion in fiscal year 1980 to \$15.8 billion in fiscal year 1981 (see table 1).

Even this large reduction in the fiscal year 1981 deficit understates considerably the degree of fiscal restraint proposed in the new budget. The high-employment budget, which measures discretionary changes in fiscal policy, is projected to shift toward surplus by more than \$50 billion between fiscal years 1980 and 1981. Scaled by potential GNP, this is among the largest increases in the post-war period.

The combined deficit--unified plus off-budget--is expected to drop from \$56.5 billion in the current fiscal year to \$33.9 billion in fiscal year 1981. The Treasury plans to finance this year's deficit by drawing down its cash balance and by issuing approximately \$44 billion in securities to the public. For fiscal year 1981 no further drawdown in the cash balance would occur, and borrowing from the public would drop to \$33 billion.

Economic Assumptions

The new budget estimates are based on the assumption that a mild recession will occur during the first half of calendar year 1980, followed by a recovery beginning in late 1980 and continuing through 1981. As shown in table 2, real GNP is projected to drop--fourth quarter over fourth quarter--by 1.0 percent during 1980, but to rise 2.8 percent during 1981. The unemployment rate is expected to climb steadily from 5.9 percent at present to 7.5 percent by the end of 1980, and to remain near that level during 1981. The administration now predicts that the average rate of inflation--as measured by the GNP implicit price deflator--will be 9.0 percent over the four quarters of 1980 and 8.6 percent during 1981. These economic assumptions are similar to those advanced by a number of private forecasters.

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Table 1
 SELECTED MEASURES OF THE FEDERAL BUDGET FOR RECENT FISCAL YEARS
 (Billions of dollars)

	1978	1979	1980 ^e	1981 ^e
<u>Unified Budget</u>				
Receipts	402.0	465.9	523.8	600.0
Outlays	450.8	493.7	563.6	615.8
Deficit(-)	-48.8	-27.7	-39.8	-15.8
<u>Off-Budget Outlays</u>				
	10.3	12.4	16.8	18.1
<u>Combined Federal Deficit(-)</u>				
	-59.2	-40.2	-56.5	-33.9
<u>NIA Budget¹</u>				
Receipts	414.7	483.7	530.6	607.7
Expenditures	450.1	493.6	564.2	626.3
Deficit(-)	-35.4	-9.9	-33.6	-18.6
<u>High-Employment Budget²</u>				
Receipts	417	479	561	660
Expenditures	446	491	557	603
Surplus(+)/Deficit(-)	-29	-12	4	57
Memo:				
Percent Increase in:				
Unified Budget Receipts	12.4	15.9	12.4	14.5
Unified Budget Outlays	11.9	9.5	14.2	9.3
NIA Budget Receipts	13.3	16.6	9.7	14.5
NIA Budget Outlays	9.4	9.7	14.3	11.0

1. Federal budget measured on the National Income and Product Accounts basis.

2. Unified receipts and outlays for the economy at a 5.1 percent unemployment rate.

e--estimated.

Table 2
 ECONOMIC ASSUMPTIONS IN THE BUDGET
 (Calendar years; billions of dollars)

	Forecast		
	1979	1980	1981
GNP:			
Current dollars:			
Amount	2,369	2,567	2,842
Percent change, year over year	11.4	8.3	10.7
Percent change, fourth over fourth	10.0	7.9	11.7
Constant (1972) dollars:			
Amount	1,431	1,423	1,448
Percent change, year over year	2.3	-0.6	1.7
Percent change, fourth over fourth	0.8	-1.0	2.8
Price level:			
GNP implicit price deflator			
Level (1972 = 100), annual average	165.5	180.4	196.3
Percent change, year over year	8.9	8.9	8.8
Percent change, fourth over fourth	9.1	9.0	8.6
Unemployment rate:			
Total, annual average	5.8*	7.0	7.4

*--actual.

Receipts

The President's budget contains no provisions for a tax cut. On the other hand, there are several initiatives on the receipts side that would add considerably to federal revenue. The windfall profits tax-- first proposed by the President in April 1979 as part of his comprehensive energy program--is intended to recoup from domestic oil companies a portion of their increased profits arising from the decontrol of domestic crude oil prices. The windfall profits tax is an excise levy on the difference between a base price and the price actually received by the oil producer. The tax rate varies for different classifications of oil; under the President's proposal the average rate would be close to 60 percent. The new tax (net of reduced corporate income tax liabilities) is expected to increase federal revenues by \$5.5 billion in fiscal year 1980 and \$13.9 billion in fiscal year 1981. The budget assumptions regarding this tax are close to current intentions of the conference committee.

The President has renewed the request made in last year's budget for a series of cash management initiatives that would result in more timely receipt by the Treasury of individuals' and corporations' estimated income tax payments and employer deposits of withheld income and payroll taxes. Although this proposal would not change tax liabilities, the accelerated collections would add \$4.5 billion to receipts in fiscal year 1981. Other receipts proposals affecting independent contractors, tax-exempt housing bonds, energy, railroad retirement pay, and pollution control are expected to raise \$0.9 billion in fiscal year 1980 and \$2.6 billion in fiscal year 1981.

Altogether, the President's tax initiatives would push receipts above the "current services" level¹ by a total of \$6.4 billion this fiscal year and \$21.0 billion next fiscal year (see table 3). These increases, combined with the effects of nominal income growth and the progressive nature of the income tax system, would raise federal receipts from \$523.8 billion in fiscal year 1980 to \$600.0 billion in fiscal year 1981. As shown in table 4, the 1981 total would equal 21.7 percent of projected GNP, the highest level since 1944.

Outlays

The rate of growth of federal spending is expected to be 9.3 percent in fiscal year 1981, down sharply from the current year's 14.2 percent pace, which has been exceeded only once since 1968 (see table 5). The growth in outlays for the current fiscal year

1. The current services estimate of receipts is based on the assumption that temporary provisions of tax law will be renewed and that previously legislated tax changes will take effect on schedule.

Table 3
EFFECTS OF ADMINISTRATION PROPOSALS ON RECEIPTS
(Fiscal years; billions of dollars)

	1980	1981
Current services receipts estimate	517.4	579.0
Windfall profits tax	5.5	13.9
Cash management initiatives	--	4.5
Other	<u>0.9</u>	<u>2.6</u>
Total proposed changes	6.4	21.0
Proposed receipts, President's budget	523.8	600.0

Table 4
COMPARATIVE CHANGES IN FEDERAL RECEIPTS
Fiscal Years 1973-1981

Fiscal Year	Unified Budget Receipts (\$ billions)	Change in Receipts from Previous Fiscal Year		Unified Budget Receipts as a Percent of GNP
		(\$ billions)	(percent)	
1973	232.2	23.6	11.3	18.8
1974	264.9	32.7	14.1	19.5
1975	281.0	16.1	6.1	19.3
1976	300.0	19.0	6.8	18.5
1977	357.8	57.8	15.4 ¹	19.4
1978	402.0	44.2	12.4	19.5
1979	465.9	63.9	15.9	20.1
1980 ^e	523.8	57.9	12.4	20.8
1981 ^e	600.0	76.2	14.5	21.7

1. Takes into account the transition quarter (July-September 1976).
e--estimated.

Table 5
COMPARATIVE CHANGES IN FEDERAL OUTLAYS
Fiscal Years 1973-1981

Fiscal Year	Unified Budget Outlays (\$ billions)	Change in Outlays from Previous Fiscal Year		Unified Budget Outlays as a Percent of GNP
		(\$ billions)	(Percent)	
1973	247.1	15.1	6.5	20.0
1974	269.6	22.5	9.1	19.8
1975	326.2	56.6	21.0	22.4
1976	366.4	40.2	12.3	22.6
1977	402.7	36.3	7.8 ¹	21.8
1978	450.8	48.1	11.9	21.9
1979	493.7	42.9	9.5	21.3
1980 ^e	563.6	69.9	14.2	22.4
1981 ^e	615.8	52.2	9.3	22.3

1. Takes into account the transition quarter (July-September 1976).
e--estimated.

(\$70 billion higher than fiscal year 1979) is nearly double the estimate made by the administration in last year's budget (\$38 billion higher). This sharp increase stems mainly from higher interest costs, new spending initiatives for low-income energy assistance and national defense, greater unemployment compensation, and higher inflation that pushed up costs for numerous income security programs. Table 6 provides a detailed reconciliation of the difference between the two estimates.

Federal spending as a percentage of GNP in both fiscal years is climbing back above 22 percent, a level reached only once since World War II--just after the 1974-1975 recession (see table 5). In real terms, the new budget proposes negligible growth (0.2 percent) in expenditures for fiscal year 1981, as compared with 2.2 percent in fiscal year 1980.

The restraint in outlay growth is being achieved mostly at the expense of nondefense purchases and grants to states and localities, which together are expected to drop in real terms by 0.3 percent in the current fiscal year and by 9.6 percent in fiscal year 1981. This huge drop leaves the President free to fulfill his longstanding promise to NATO and the Congress for real increases in defense spending, now projected at 2.0 percent this fiscal year and 3.5 percent next fiscal year. Finally, payments to individuals are expected to register real gains of 4.4 percent in fiscal year 1980 and 3.4 percent in fiscal year 1981.

The administration estimates "current services" outlays for fiscal year 1981 at \$612.0 billion, up \$51.4 billion, or 9.2 percent from fiscal year 1980. Current services expenditures are those that would occur if all federal programs were carried on as currently legislated and if there were no new policy initiatives. The administration's estimate of current services takes into account inflation adjustments that are mandatory under law; the estimate also allows for such uncontrollable items as expected changes in the number of beneficiaries in federal programs. This year, for the first time, the current services concept includes inflation adjustments for discretionary programs. Thus, the total spending estimate under current services represents the amount of federal outlays necessary to keep all programs on an even keel in real terms.

Proposed Expenditure Increases from Current Services Level

In order to achieve his goal of a 3.5 percent rise in real defense spending in fiscal year 1981, the President has asked for nominal outlay increases of \$5.4 billion above the current services level. Some \$4 billion of that increase would go toward operations and maintenance of strategic nuclear forces, NATO support, and the

Table 6
CHANGE IN FISCAL YEAR 1980 OUTLAY ESTIMATE
(Billions of dollars)

January 1979 Budget Estimate	531.6
Interest on the public debt	6.6
Energy security trust fund and other initiatives	2.1
National defense	4.6
Unemployment compensation	2.8
Medicare and medicaid	3.2
Social security and railroad retirement	2.4
Food stamps and child nutrition programs	2.1
All other	<u>8.2</u>
TOTAL--Outlay increases since the January 1979 Budget estimate	32.0
January 1980 Budget Estimate	563.6

naval fleet. Another \$1 billion of the increase from current services will be spent on research and development, while the remaining \$0.4 billion will be start-up costs for procurement of the MX missile, another Trident submarine, and cruise missiles. (Little change is planned in the number of military personnel.) These program increases are expected to push fiscal year 1981 defense outlays to \$142.7 billion, up 12 percent from a projected \$127.4 billion in fiscal year 1980.

Other budget requests for funding in excess of current services projections include: \$2.0 billion for energy security programs, particularly mass transit; \$1.0 billion for countercyclical fiscal aid to states and localities; \$0.8 billion for heating-bill assistance for low-income families; and \$1.5 billion for welfare reform and related contingencies. In all, the budget for fiscal year 1981 proposes \$13.5 billion in spending increases relative to current services, as shown in table 7.

Proposed Expenditure Reductions from Current Services Level

The largest spending cut from current services would result from a limit on October 1980 pay raises for all federal employees--6.2 percent for civilians, 7.4 percent for military personnel. This pay reform proposal would reduce spending \$2.7 billion from what current law requires. For the third consecutive year the President is asking for hospital cost containment legislation and other program changes that would cut \$1.4 billion from medicare and medicaid outlays. The administration's assumption for interest rates follows its projection of a modest decline in inflation; hence it anticipates \$1.2 billion in savings on net interest costs. Proposed reductions in college student assistance and federal impact aid to local school districts would cut \$1.1 billion from current services outlays for education. Other reductions are anticipated for school lunch and child nutrition programs (\$0.5 billion) and agricultural export credit sales (\$0.8 billion).

The proposed decreases total \$9.7 billion, partially offsetting the \$13.5 billion in proposed increases described earlier. The net change is an increase of \$3.8 billion above the current services outlay level. This yields the President's final spending proposal of \$615.8 billion in fiscal year 1981 (see table 7).

The estimates set forth in this budget depend heavily on the economic assumptions behind them. A higher-than-expected unemployment rate, for example, would automatically trigger greater outlays for unemployment insurance. Rapid increases in the price level would imply greater spending for those programs indexed for inflation, such as social security and food stamps. (On the other hand, higher nominal incomes would increase receipts, as inflation pushes wage earners into higher tax brackets.) The deficit is likely to be larger if defense spending proves even stronger than expected, although there are limits to the speed of a production buildup in this area. Still, military officials are already preparing a new supplemental request for some outlay overruns in the current fiscal year.

Table 7
DIFFERENCES BETWEEN ADMINISTRATION'S FISCAL YEAR 1981
BUDGET REQUEST AND CURRENT SERVICES LEVEL
(Billions of dollars)

	Fiscal Year 1981
Current services outlay estimate	<u>612.0</u>
Proposed increases (total)	<u>13.5</u>
National defense	5.4
(Operations and maintenance)	(4.0)
(Research and development)	(1.0)
(Procurement)	(0.4)
Energy security programs	2.0
Countercyclical fiscal assistance	1.0
Heating-bill assistance for low-income families	0.8
Welfare reform and contingencies	1.5
All other	2.8
Proposed decreases (total)	<u>-9.7</u>
Cap on federal pay raises (civilian and military)	-2.7
Medicare and medicaid	-1.4
Net interest	-1.2
Education	-1.1
School lunch and child nutrition programs	-0.5
Agricultural export credit sales	-0.8
All other	-2.0
President's request (total)	615.8