ECONOMIC ASSUMPTIONS

1. ECONOMIC ASSUMPTIONS

Introduction

The prudent fiscal and monetary policies pursued during this Administration have fostered the healthiest economy in over a generation. Judged by the yardsticks of growth, jobs, unemployment, inflation, interest rates and the stock market, 1997 was a banner year. Real Gross Domestic Product (GDP) expanded by nearly 4 percent, the Nation's payrolls increased by 3.2 million jobs, and the unemployment rate fell to the lowest level in 24 years. Despite robust growth, inflation edged down; the rise in the Consumer Price Index excluding the volatile food and energy components last year was the smallest since 1965. The combination of low inflation and low unemployment pulled the "Misery Index"—the sum of the inflation and unemployment rates—to its lowest level in three decades.

Households and businesses have prospered in this environment. Wages and salaries after adjustment for inflation have increased faster than at any time in the past two decades. And thanks to unusually strong productivity growth for this stage of an expansion, profits also have grown at a healthy pace. The share of profits in GDP climbed to over 10 percent last year, the highest it has been since 1968.

Financial markets have responded to these favorable developments by bidding up the prices of bonds and equities. Long-term interest rates, which move in the opposite direction from bond prices, fell one-half percentage point last year. At year's end, the yield on the 30-year Treasury bond was below 6 percent, the lowest level in four years. In early January, the rate fell another one-quarter percentage point to the lowest level since this maturity was first regularly issued in 1977.

The Dow Jones Industrial Average rose 23 percent during 1997, which followed a 68 percent gain during 1995–96. Since the end of 1994, the Dow average has doubled, making this the best three-year performance in the postwar period and the second best in the 101-year history of the Dow. The broader market indexes, the S&P 500 and the NASDAQ composite index, also doubled during these three years.

These outstanding financial and nonfinancial achievements—fostered by sound fiscal and monetary policies—have further boosted business and consumer confidence. Businesses last year spent heavily on capacity-expanding new plant and equipment; investment rose at a double-digit pace after adjustment for inflation. Consumer optimism soared. According to the University of Michigan Consumer Sentiment Index, optimism reached the highest level since the survey began in the early 1950s. Overseas investors also have expressed their confidence in the U.S. economy. With many financial markets around the world in turmoil, foreign investors increasingly turned to the safe haven provided by U.S. financial markets.

The fundamental forces affecting the economy and prospective fiscal and monetary policies point to continued healthy economic conditions in the coming years. The budget is projected to reach balance in 1999—the first time that has occurred in three decades—and to remain in balance during the remainder of the 10-year planning horizon. A stronger dollar is likely to keep inflation low. While some may have thought that real growth in the recent past was too fast, in the future these concerns may well be eased by developments in Asia. Against this background, monetary policy should be able to accommodate continued economic growth with low inflation.

The Administration projects real growth in the next few years to be around 2.0 percent per year, before rising to 2.4 percent in 2002–2007. The unemployment rate, which at current low levels may run the risk of igniting inflation, is projected to edge up slightly to a rate that the Administration conservatively estimates to be consistent with stable inflation. Nonetheless, millions of new jobs are expected to be created. Short-term interest rates are projected to decline and long-term rates are expected to remain relatively low as private and public credit demands ease and as expectations of continued low inflation are incorporated into bond yields. Beyond 1999, the Administration's economic projections represent expected trends rather than a definite cyclical pattern.

Private forecasters have a similarly favorable view of the economic outlook. The January *Blue Chip* consensus forecast, an average of 50 private forecasts, projected real growth, unemployment and inflation at rates nearly identical to those used in this budget. The projected interest rates were somewhat higher than in the budget assumptions. The similarity to the private sector forecasts is an indication that the Administration's assumptions are a reasonable, prudent basis for projecting the budget.

The expansion that began in April 1991 has just completed 82 consecutive months of growth, exceeding 17 of the 20 expansions of this century. By December of this year, the expansion will become the second longest U.S. expansion of all time and the longest peacetime expansion. If it continues through February 2000, this expansion will set a new longevity record, outlasting the current record of 106 months of uninterrupted growth in the 1960s. According to the *Blue Chip* survey, most private-sector forecasters now expect this to happen.

This chapter begins with a review of recent developments and then discusses two statistical issues: the

growing statistical discrepancy (the difference between the aggregate measures of output and income) and recent methodological improvements in the calculation of the Consumer Price Index. The chapter then presents the Administration's economic projections, followed by a comparison with the Congressional Budget Office's projections. The following sections present the impact of changes in economic assumptions since last year on the projected fiscal balance and the structural deficit. The chapter concludes with estimates of the sensitivity of the budget to changes in economic assumptions.

Fiscal and Monetary Policy

When this Administration took office, its first priority was to reverse the 12-year trend of large, uncontrolled fiscal deficits. The Administration proposed, and Congress passed, the landmark Omnibus Budget Reconciliation Act of 1993 (OBRA) which set the budget deficit on a downward path. After having reached a postwar record of $290 billion in 1992—a huge 4.7 percent of GDP—the deficit has declined each year, falling to just $22 billion in 1997—just 0.3 percent of GDP. The last time the deficit share of GDP was this low was in 1970.

The deficit reductions following OBRA have far exceeded predictions made at the time of its passage. OBRA was projected to reduce pre-Act deficits by $505 billion over the five years 1994–98. Over the five years 1993–97, the cumulative deficit reduction has been $811 billion. In other words, OBRA and subsequent developments have enabled the Treasury to issue $811 billion less debt than would have been required under previous law. By 1998, the cumulative deficit reduction from 1994 through 1998 is estimated to be $1.1 trillion, more than double the original estimate.

While OBRA fundamentally altered the course of fiscal policy towards lower deficits, it was not projected to eliminate the deficit. In the absence of further action, deficits were expected to begin to climb once again. To prevent this and bring the budget into surplus, last summer the Administration negotiated the Balanced Budget Agreement with the Congress. This budget proposes to achieve a surplus in 1999—three years earlier than originally projected. The last budget surplus was in 1969. OBRA and the Balanced Budget Agreement together are expected to reduce the deficit by a cumulative total of $3.3 trillion over 1993–2002 compared with the pre-OBRA baseline.

The economy has outperformed most forecasters' expectations in recent years and, at the same time, deficits have been much lower than projected. This is more than a coincidence. Lower deficits contribute to a healthy, sustainable expansion by reducing interest rates and boosting interest-sensitive spending in the economy. Rapid growth of business capital spending expands industrial capacity and boosts productivity growth. The extra capacity, in turn, prevents shortages and bottlenecks that might otherwise emerge.

Lower interest rates also raise equity prices, which reduces the cost of capital to business and increases household wealth and optimism. The added impetus to business and consumer spending creates new jobs and business opportunities. The result is more production, more income, more jobs, more Federal revenues, and a smaller deficit—a virtuous circle of prosperity. That has been the experience of the past five years, and it will be the likely consequence of policies that achieve budget surpluses, and reduce Government debt.

In this expansion, monetary policy shifted when necessary to prevent inflation from picking up, and shifted again to prevent the expansion from stalling when that seemed needed. In 1994 and early 1995, monetary policy tightened when rapid growth raised the possibility that inflationary pressures were about to build. During 1995 and early 1996, monetary policy eased because the expansion appeared to be slowing unduly and the risk of higher inflation had lessened. Since January 1996, monetary policy has remained steady. The sole adjustment was in March 1997 when the federal funds rate target was raised one-quarter percentage point to its current level of 5½ percent.

Stable monetary policy for the past two years has kept the 3-month Treasury bill rate in a narrow range around 5 percent. Long-term interest rates have fluctuated in response to the outlook for inflation and the deficit. When economic growth accelerated during the first four months of 1997, the yield on the 30-year Treasury bond edged up 50 basis points to 7.1 percent. During the remainder of the year, however, the rate fell over 100 basis points in response to low inflation, the agreement to balance the budget, the unexpectedly low 1997 budget deficit, and international developments. By early 1998, the yield had fallen to 5.7 percent.

Recent Developments

Real Growth: The economy expanded an estimated 3.7 percent over the four quarters of 1997, up from 2.8 percent the prior year. As in 1996, the fastest growing sector was business fixed investment. During the first three quarters of 1997, business spending for new plant and equipment rose at a 13 percent annual rate after adjustment for inflation, led by an 18 percent advance in equipment spending. The biggest gains continued to be for information processing and related equipment, but businesses invested heavily in other forms of equipment and in structures as well.

This exceptionally strong business capital spending has boosted productivity and expanded industrial capacity to meet current and future demands. Manufacturing capacity rose by more than 5 percent in each of the past three years. The last time capacity grew this rapidly was in the late 1960s. The extra capacity has helped keep inflation low by easing the bottlenecks that might otherwise have developed. In the fourth quarter of 1997, the manufacturing operating rate was near its long-term average, even though labor markets were much tighter than usual.

Growth last year was also supported by robust household spending. Low unemployment, rising real incomes,

and large capital gains have provided households with the resources and willingness to spend heavily, especially on discretionary purchases. Overall consumer spending after adjustment for inflation rose at a 4 percent annual rate during the first three quarters of the year; spending on durable goods soared at a 9 percent pace.

The same factors spurring consumption, along with relatively low mortgage rates, pushed new home sales during the first 11 months of 1997 to their highest level since 1978. Buoyant sales and low inventories of unsold homes have provided a strong incentive for builders to start new construction. Housing starts remained at high levels last year, and residential investment, after adjustment for inflation, increased at nearly a 5 percent annual rate during the first three quarters of the year.

Government purchases, on balance, made only a small contribution to GDP growth last year. Federal government spending in GDP after adjustment for inflation was about unchanged over the first three quarters. State and local spending rose at only a 2 percent rate during this period, despite the healthy fiscal surpluses that have resulted from sharply rising incomes and profits.

The foreign sector was the primary restraint on growth last year, trimming real GDP growth by nearly 1 percentage point during the first three quarters of the year. Although exports expanded rapidly, import growth was even stronger. The widening of the net export deficit reflected the relatively faster growth of domestic demand in the United States than in our trading partners, and also the rise in the dollar. Last year, the dollar gained 12 percent on a trade-weighted basis on top of a 4 percent rise during 1996.

Labor Markets: The performance of the labor market last year far exceeded most predictions. At the start of the year, most forecasters had expected the unemployment rate to rise slightly during 1997. Instead, the unemployment rate fell 0.6 percentage point to 4.7 percent by December 1997. November's rate was 4.6 percent. This is the lowest two consecutive months since March/April 1970. When this Administration took office, the unemployment rate was 7.3 percent. All demographic groups have benefited from the decline. Thirty-eight states had unemployment rates of 5.0 percent or less at the end of last year; only five had rates above 6.0 percent.

The Nation's payrolls expanded by 3.2 million jobs last year, the biggest gain since 1994. Since the Administration took office in January 1993, 14.3 million jobs have been created. Job growth was widespread across industries last year. The service sector accounted for most of the new jobs, but manufacturing industries increased their payrolls by over 200,000 jobs. State and local government payrolls also expanded, while Federal government employment continued to contract. The abundance of employment opportunities pushed the employment/population ratio up to 64.1 percent by year-end, the highest level on record.

Inflation: Despite rapid growth and the unusually low unemployment rate last year, inflation not only remained low, it actually declined. The broadest measure of inflation, the GDP chain-weighted price index, rose at just a 1.9 percent annual rate during the first three quarters of 1997, 0.4 percentage point less than during the four quarters of 1996. The last time aggregate inflation was this low was in 1964. The Consumer Price Index (CPI) and the CPI excluding food and energy also increased less in 1997 than in 1996. The core CPI excluding food and energy rose just 2.2 percent last year, the slowest rise since 1965. The total CPI rose even less, 1.7 percent, because of falling energy prices.

The favorable inflation performance was the result of several factors. The rise in the dollar has reduced the costs of imported materials and intensified price competition from imports. Non-oil import prices have fallen nearly every month in the past two years. Although the pace of wages and salaries picked up, overall compensation costs were restrained by continued low health-care inflation. Finally, robust investment in new plant and equipment has contributed to unusually strong productivity growth for this stage of an expansion, restraining inflation by offsetting gains in labor compensation. Unit labor costs have risen very slowly during the first three quarters of 1997.

The absence of inflation pressures has implications for the estimate of the level of unemployment that is consistent with stable inflation. This threshold has been called the NAIRU, or "nonaccelerating inflation rate of unemployment." Economists have been lowering their estimates of NAIRU in recent years in keeping with the accumulating experience that lower unemployment has not led to higher inflation, even after taking into account the influence of temporary factors. The economic projections for this Budget assume that NAIRU is 5.4 percent. That is 0.1 percentage point less than estimated in the 1998 Budget assumptions and 0.3 percentage point less than in the 1997 Budget.

By the end of 1997, the unemployment rate was about three-quarter percentage point below the current estimate of NAIRU. In the absence of special factors, if unemployment remains below NAIRU, inflation would eventually creep up. The Administration forecast for real growth over the next three years, however, is moderate enough to imply that unemployment will return to 5.4 percent.

Statistical Issues

The U.S. statistical agencies endeavor to produce accurate measures of the economy's performance. Nonetheless, in recent years serious concerns have been raised about possible mismeasurement, especially of real GDP growth and of inflation.

Real Growth: In a perfect statistical world, the value of *output* would equal the value of *income* generated in its production, that is, GDP would match Gross Domestic Income (GDI). However, because the series are based on different source data, each with its own gaps

and inconsistencies, the two measures are hardly ever identical. What is particularly unusual now is the wide and growing difference between product and income measures.

This "statistical discrepancy," defined as aggregate output minus aggregate income, was –$103 billion in the third quarter of 1997—a nearly record-setting 1.3 percent of nominal GDP. By comparison, in the first quarter of 1995, the statistical discrepancy was nearly zero, and two years earlier, in the first quarter of 1993, it was $71 billion. A swing of this magnitude means that during the past four and a half years, the annual average real growth rate measured from the familiar output side has been about 0.5 percentage point less than the growth rate measured from the income side. During the first three quarters of last year, real GDP rose at a 3.8 percent annual rate but real Gross Domestic Income at a 4.5 percent pace. In the third quarter of 1997, the divergence widened further. Real GDP growth was at a 3.1 percent annual rate, but real GDI surged at a 4.5 percent rate.

The absence of a single, clear picture of the economy's actual growth performance is a cause for concern. It is difficult to know if growth is accelerating or decelerating; if actual growth is above or below the economy's potential growth rate; or even what the economy's potential growth rate is.

Any estimate of potential growth depends on an estimate of trend productivity growth, which itself depends on recent data on actual growth. When there is a growing divergence between product and income measures, there is a comparable divergence in estimates of the productivity trend. For example, measured from the last cyclical peak to the third quarter of 1997, labor productivity growth has increased at a 1.1 percent annual rate according to the official productivity statistics which measure output growth from the product side. Labor productivity growth measured from the income side, however, has risen at a 1.5 percent annual rate.

It is unclear whether the product or the income side provides the more accurate measure of growth. The Bureau of Economic Analysis recognizes the shortcomings of both measures but believes that GDP is a more reliable measure of output than GDI (see *The Survey of Current Business,* August 1997, page 19). Other experts believe that GDI, or some figure between the two measures, may be more accurate.

There is circumstantial evidence to suggest that growth may be faster than shown by the traditional GDP measure. The recent combination of low inflation and a rising profits share suggests that productivity growth is stronger than reported from the output side. Moreover, the unexpected strength of Treasury receipts in the last two years suggests that the output measure, and even the income measure, may be too low. While some of the higher receipts are from capital gains generated by the booming stock market, which are excluded from the national income accounts, this source does not fully account for the surge.

The uncertainty surrounding actual growth and its trend makes it more difficult to determine appropriate monetary policy. From a budgetary perspective, estimates of receipts and expenditures have a larger degree of uncertainty because they are dependent on the forecast for growth. As shown in Table 1–6, "Sensitivity of the Budget to Economic Assumptions," errors in forecasting real GDP growth can have a significant effect on the budget balance.

Inflation: Accurate measurement of inflation has become increasingly important in recent years, even as inflation has been brought under control. Eliminating biases of even a few tenths of a percentage point a year can have important meaning relative to a goal of price stability when inflation is low, while it may have less significance when inflation is higher.

In recent years, serious questions have been raised about the magnitude of bias in the Consumer Price Index. In December 1996, the Advisory Commission to Study the Consumer Price Index, appointed by the Senate Finance Committee, reported that the index overstated the actual cost of living by 1.1 percentage points per year. The Bureau of Labor Statistics (BLS), however, believes that the empirically demonstrated bias is significantly less.

The BLS has instituted a number of methodological changes in recent years to improve the accuracy of the Consumer Price Index, and has announced several more changes that will be put in place this year and next. Taken together, these changes are estimated to result in a 0.7 percentage point slower annual rise in the CPI by 1999. The changes instituted from 1995–1997 are estimated to have slowed the growth of the CPI by 0.3 percentage point per year; the forthcoming changes are expected to trim another 0.4 percentage point per year. Because the CPI is used to deflate some nominal spending components of GDP, a slower rise in the CPI translates into a faster rise in real GDP. By 1999, measured real GDP growth and, therefore, productivity growth, is likely to be boosted by 0.2 percentage point per year as a consequence of the cumulative improvements to the CPI since 1995.

Two methodological improvements have been instituted beginning with the release of the CPI for January 1998: an updating of the expenditure weights, and a better technique for estimating quality improvements for computers. Together, the two changes are expected to slow CPI growth by 0.2 percentage point per year.

This year, the BLS updated the expenditure weights used in the CPI from a 1982–84 basis to 1993–95, using Consumer Expenditure Survey data. At the same time, BLS introduced a more accurate geographic sample based on the 1990 decennial census, and redefined the groupings of items. In the future, BLS expects to introduce updated expenditure weights more frequently than in the past, when there were approximately 10 years between updates.

For computers and peripheral equipment, the BLS has now begun to use a hedonic regression procedure to distinguish price from quality changes. The esti-

mated value of an improvement obtained from this regression procedure is deducted from the observed price change for the product. For example, if the CPI sample of computer prices shows no change in the retail price of a new computer, but it is 20 percent better than the prior model as measured by the hedonic procedure, the CPI will report a corresponding drop in price for this model. A similar procedure has been adopted for estimating computer prices in the Producer Price Index and in the National Income and Product Accounts. It is especially important to measure accurately, and on a timely basis, the extraordinary leaps in computer power that must be a part of a meaningful measure of computer prices.

For 1999, BLS has announced that it will select items to be sampled on a product rather than a geographical basis. This switch will allow more frequent sampling of categories with rapidly changing product lines, such as consumer electronics.

A very important change next year will be the replacement of the current fixed-weighted Laspeyres formula by a geometric mean formula for combining individual price quotations at the lower level of aggregation in the CPI. Under certain assumptions, a CPI calculated using geometric means more closely approximates a cost-of-living index. Unlike the current fixed-weighted aggregation, the geometric mean formula allows for shifts in consumer spending patterns in response to changes in relative prices within categories of goods and services.

Since last April, the BLS has been publishing an experimental CPI each month that uses geometric means for all lower level aggregation and has provided a historical series beginning with December 1990. If a geometric mean is used for all lower level aggregation, BLS estimates that the growth in the CPI would be slowed by about one-quarter percentage point per year. Partial adoption would result in a lesser impact. BLS is expected to announce shortly which categories will be shifted to geometric means next year and the likely impact on the growth of the CPI.

Economic Projections

The economy's strong performance last year and the continuation of the virtuous circle of prosperity made possible by sound fiscal and monetary policies raises the possibility that actual economic developments may even be better than the assumptions—as has been the case in recent years. Nonetheless, it is prudent to base budget estimates on a conservative set of economic assumptions close to the consensus of private sector forecasts.

Virtuous Circle of Prosperity: The economic assumptions summarized in Table 1–1 are predicated on the adoption of the policies proposed in this budget. The swing in the fiscal position from deficit to surplus is expected to support a continuation of the favorable economic performance of recent years. The shift from Federal Government dissaving to saving would pull interest rates down, stimulating private sector investment in new plant and equipment. The economy is likely to continue to grow, although at a more moderate pace than during 1997. While job opportunities are expected to remain plentiful, the unemployment rate is likely to rise gradually to a level consistent with stable inflation. New job creation would boost incomes and consumer spending and keep confidence at a high level. Continued low inflation would enable monetary policy to support economic growth. Growth, in turn, would further improve the budget balance.

Real GDP, Potential GDP and Unemployment: Over the next three years, real GDP is expected to rise 2.0 percent per year. This shift to more moderate growth recognizes that by conservative, mainstream assumptions, growth has exceeded the pace that can be maintained on a sustained basis, which could eventually result in upward pressures on inflation. A slowdown has been expected for this reason. Also, the financial dislocations in Asia could contribute to this slowing of U.S. growth. From 2001–2007, growth is expected to average a slightly faster 2.4 percent per year—the Administration's estimate of the economy's potential growth rate. Real GDP growth in 2008 is projected to slow to 2.3 percent to reflect the beginning of the years of slower growth of the workforce as the baby-boomers begin to retire.

The net export component of GDP is expected to restrain real growth by about 1 percentage point during 1998, as our export growth is curtailed by slower growth in Asia and the appreciation of the dollar. Thereafter, as the effects of the crisis abroad wane, export growth is likely to pick up slightly. Beginning with 1999, the foreign sector is not expected to make a large contribution, positive or negative, to overall growth.

As has been the case throughout this expansion, during the next six years business fixed investment is expected to be the fastest growing component of GDP. Although residential investment is also expected to benefit from low mortgage rates, the high level of housing starts in recent years and underlying demographic trends may tend to reduce growth. Consumer spending, especially on durable goods, is also likely to moderate from the rapid pace of 1997. The fundamental factors supporting consumer spending are likely to remain favorable, although not quite to the same extent as during 1997. The government component of GDP will hardly grow through 2003. A decline in Federal consumption and gross investment is projected to be offset by moderate growth in State and local spending.

Continued strong growth of business fixed investment and the output-increasing effects of methodological improvements to the CPI noted above are expected to raise the measured trend of productivity growth during the next six years to 1.3 percent per year. By comparison, during the seven years following the last business cycle peak in the third quarter of 1990, productivity growth averaged 1.1 percent per year, as measured from the GDP side of the accounts.

Table 1–1. ECONOMIC ASSUMPTIONS [1]

(Calendar years; dollar amounts in billions)

	Actual 1996	Projections						
		1997	1998	1999	2000	2001	2002	2003
Gross Domestic Product (GDP):								
Levels, dollar amounts in billions:								
Current dollars	7,636	8,080	8,430	8,772	9,142	9,547	9,993	10,454
Real, chained (1992) dollars	6,928	7,187	7,357	7,503	7,652	7,820	8,008	8,199
Chained price index (1992 = 100), annual average	110.2	112.5	114.6	116.9	119.5	122.1	124.8	127.5
Percent change, fourth quarter over fourth quarter:								
Current dollars	5.6	5.5	4.0	4.1	4.3	4.6	4.6	4.6
Real, chained (1992) dollars	3.2	3.6	2.0	2.0	2.0	2.3	2.4	2.4
Chained price index (1992 = 100)	2.3	1.9	2.0	2.1	2.2	2.2	2.2	2.2
Percent change, year over year:								
Current dollars	5.1	5.8	4.3	4.1	4.2	4.4	4.7	4.6
Real, chained (1992) dollars	2.8	3.7	2.4	2.0	2.0	2.2	2.4	2.4
Chained price index (1992 = 100)	2.3	2.0	1.9	2.0	2.2	2.2	2.2	2.2
Incomes, billions of current dollars:								
Corporate profits before tax	677	729	754	768	790	805	830	851
Wages and salaries	3,633	3,868	4,057	4,237	4,424	4,623	4,840	5,068
Other taxable income [2]	1,693	1,786	1,859	1,915	1,975	2,046	2,128	2,213
Consumer Price Index (all urban): [3]								
Level (1982–84 = 100), annual average	157.0	160.7	164.1	167.7	171.5	175.5	179.5	183.6
Percent change, fourth quarter over fourth quarter	3.2	2.0	2.2	2.2	2.3	2.3	2.3	2.3
Percent change, year over year	2.9	2.4	2.1	2.2	2.3	2.3	2.3	2.3
Unemployment rate, civilian, percent:								
Fourth quarter level	5.3	4.8	5.0	5.2	5.4	5.4	5.4	5.4
Annual average	5.4	5.0	4.9	5.1	5.3	5.4	5.4	5.4
Federal pay raises, January, percent:								
Military [4]	2.6	3.0	2.8	3.1	3.0	3.0	3.0	3.0
Civilian [5]	2.4	3.0	2.8	3.1	3.0	3.0	3.0	3.0
Interest rates, percent:								
91-day Treasury bills [6]	5.0	5.0	5.0	4.9	4.8	4.7	4.7	4.7
10-year Treasury notes	6.4	6.4	5.9	5.8	5.8	5.7	5.7	5.7

[1] Based on information available as of early December 1997.
[2] Rent, interest, dividend and proprietor's components of personal income.
[3] Seasonally adjusted CPI for all urban consumers. Two versions of the CPI are now published. The index shown here is that currently used, as required by law, in calculating automatic adjustments to individual income tax brackets. Projections reflect scheduled changes in methodology.
[4] Beginning with the 1999 increase, percentages apply to basic pay only; adjustments for housing and subsistence allowances will be determined by the Secretary of Defense.
[5] Overall average increase, including locality pay adjustments.
[6] Average rate (bank discount basis) on new issues within period.

Potential GDP growth of 2.4 percent during the projection horizon can be decomposed into the trend growth of productivity, 1.3 percent per year, plus the growth of the labor force, estimated at 1.1 percent annually. The Administration's labor force projection assumes that the population of working age will grow 1.0 percent per year and that the labor force participation rate will edge up 0.1 percent per year.

Both the labor force and participation rate assumptions are lower than recent experience. The participation rate has risen 0.4 percent per year since 1994, as falling unemployment and rapidly expanding job opportunities have strongly induced job-seeking. But with the labor force participation rate and employment/population ratio at post-World War II highs, it is prudent to project a slower rise in the coming years. In addition, the female participation rate, which had risen sharply during much of the postwar period, grew much slower during the 1990s, and this trend is assumed to continue.

The real GDP growth projection of 2.0 percent through 2000 is consistent with a gradual rise in the unemployment rate to 5.4 percent. Unemployment is then projected to remain on a plateau at that level from 2001 onward, when real GDP growth averages the Administration's estimate of the economy's potential growth rate.

Inflation: With unemployment expected to be slightly below NAIRU during the next three years, inflation is projected to creep up by about one-quarter percentage point by 2000. The CPI is projected to increase 2.3 percent in that year and the subsequent years of the forecast horizon; the GDP chain-weighted price index is projected to increase 2.2 percent in 2000 and beyond. The relatively small 0.1 percentage point difference between the two inflation measures is narrower than in the past because of recent and forthcoming methodological improvements to both indexes.

Despite the relatively tight labor market in the next few years, inflation is projected to remain low, partly because of two temporary factors. The rise in the dollar is expected to hold down import prices and intensify price competition from imported goods and services. In addition, wide profit margins provide a cushion that will enable firms to absorb cost increases without having to pass them on fully into higher prices.

Moreover, as discussed above, the methodological improvements to the CPI will offset some of the rise that might otherwise occur. By 1999, the improvements instituted this year and next will trim about 0.4 percentage point off of the annual rise in the CPI. These same improvements are likely to restrain the rise in the GDP chain weighted price index by about 0.1 percentage point per year.

Interest Rates: The assumptions, which were finalized in early December, project a gradual decline in short- and long-term interest rates consistent with the improved fiscal balance and low inflation. By 2001 the 91-day Treasury bill rate is expected to be 30 basis points lower than the fourth quarter 1997 average; the yield on the 10-year Treasury bond is projected to be 20 basis points lower.

The sharp drop in long-term rates in early 1998 has already driven long-term rates below the levels anticipated in the economic assumptions. Recent developments, including the improved budget outlook, may have caused market participants to lower their expectations for inflation and credit demands. The turmoil in Asian markets may have fostered further portfolio adjustments into the safe haven of U.S. bonds. In light of these developments, it is possible that long-term rates will be lower on average than those in the economic assumptions. Financial markets, however, can be quite volatile; the recent drop in long rates could prove to be temporary.

Incomes: The moderating of real growth during the projection horizon is expected to shift the distribution of national income slightly, augmenting the share going to labor while trimming the unusually high profits share in GDP. On balance, total taxable income is projected to decline gradually as a share of GDP.

Between 1997 and 2003, aggregate wages and salaries are projected to rise 31 percent in nominal terms and 15 percent after adjustment for inflation. Corresponding to the rise in the wage share, corporate profits before tax are projected to rise just 16 percent in nominal terms from 1997 to 2003, a markedly slower pace than in recent years. By 2003, taxable profits as a share of GDP are projected to be about 1 percentage point lower than the 30-year high reached during 1997. The favorable impact of lower interest rates on the debt service payments of the corporate sector helps to cushion the impact on profits of the expected shift of income back toward wages.

Lower interest rates will pull down the share of personal interest income in GDP because the household sector is a net lender in the economy. Little change is expected in the shares of other components of taxable income (dividends, rents and proprietors' income).

Comparison with CBO

The Congressional Budget Office (CBO) develops economic projections used by Congress in formulating its budget policy. In the executive branch, the analogous function is performed jointly by the Treasury, the Council of Economic Advisers (CEA), and the Office of Management and Budget (OMB). These two sets of economic projections can be compared with one another, but differences in their preparation should be borne in mind:

- The Administration's projections always assume that the President's policy proposals in the budget will be adopted in full. In contrast, CBO normally assumes that current law will continue unchanged; thus, it makes a "pre-policy" or baseline projection, while the Administration's projections are "post-policy."
- The two sets of projections are often prepared at different times. The Administration's projections must be prepared months ahead of the release of the budget. Differences in the Administration's and CBO's near-term forecasts, therefore, can be due to the availability of more recent data to CBO; a direct comparison with the CBO near-term projections is not always meaningful. Timing differences are much less likely to play an important role in any differences in outyear projections, however.

Table 1–2 presents a summary comparison of the current CBO and Administration projections.

- Real GDP: The projections of real GDP growth are quite similar. The Administration projects that real GDP will grow at an average annual rate of 2.2 percent from 1998 through 2003; CBO projects a 2.1 percent rate.
- Inflation: Both the Administration and CBO expect inflation to continue at a slow, steady rate over the next several years. For the chain-weighted GDP price index, CBO assumes that inflation will average 2.3 percent a year over the 1998–2003 period while the Administration projects a 2.1 percent average for that span; CBO expects the annual rate of change in the CPI to average 0.4 percentage point higher than the Administration forecast over the same period.
- Unemployment: CBO projects unemployment to rise from its fourth quarter average of 4.7 percent to 5.9 percent by 2003, slightly above its estimate of the NAIRU. The Administration believes unemployment will average its estimate of the NAIRU, 5.4 percent, during 2001 to 2003.
- Interest rates: Both the Administration and CBO expect a similar decline to a level of 4.7 percent by the year 2001 for the 91-day bill rate. The Administration, however, projects a slightly greater (0.2 percentage point) decline in long-term rates than does CBO.
- Income distribution: Both CBO and the Administration project a decline in the profits share of GDP, although both also expect a shift of income from personal interest income to corporate profits. In part because the Administration assumes a slightly larger decline in long-term interest rates than does CBO, it projects less of a decline in the profits share. CBO projects a slightly higher wage and salary share of GDP than does the Ad-

Table 1–2. COMPARISON OF ECONOMIC ASSUMPTIONS

(Calendar years; percent)

	Projections					
	1998	1999	2000	2001	2002	2003
Real GDP (chain-weighted): [1]						
CBO January	2.3	1.9	1.9	2.0	2.2	2.3
1999 Budget	2.0	2.0	2.0	2.3	2.4	2.4
Chain-weighted GDP Price Index: [1]						
CBO January	2.1	2.2	2.4	2.5	2.4	2.5
1999 Budget	2.0	2.1	2.2	2.2	2.2	2.2
Consumer Price Index (all-urban): [1]						
CBO January	2.4	2.5	2.7	2.8	2.8	2.8
1999 Budget	2.2	2.2	2.3	2.3	2.3	2.3
Unemployment rate: [2]						
CBO January	4.8	5.1	5.4	5.6	5.8	5.9
1999 Budget	4.9	5.1	5.3	5.4	5.4	5.4
Interest rates: [2]						
91-day Treasury bills:						
CBO January	5.3	5.2	4.8	4.7	4.7	4.7
1999 Budget	5.0	4.9	4.8	4.7	4.7	4.7
10-year Treasury notes:						
CBO January	6.0	6.1	6.0	5.9	5.9	5.9
1999 Budget	5.9	5.8	5.8	5.7	5.7	5.7
Taxable income [3] **(share of GDP):**						
CBO January	79.0	78.3	77.7	77.3	77.0	76.7
1999 Budget	79.1	78.9	78.6	78.3	78.0	77.8

[1] Percent change, fourth quarter over fourth quarter.
[2] Annual averages, percent.
[3] Taxable personal income plus corporate profits before tax.

ministration. Overall, CBO's taxable income share of GDP declines from 79.1 percent for 1997 to 76.7 percent for 2003; the Administration's assumptions also show a decline, but only to 77.8 percent for 2003. Both forecasts thus recognize that the 1997 share is historically high, in large measure reflecting the discrepancy in recent GDP and GDI growth rates discussed earlier in this Chapter.

CBO has a good economic forecasting record. During much of the 1980s, its forecasts were more accurate than those of the Administrations then in office. The record over the last five years, however, has been more mixed. Since it took office in 1993, this Administration has placed high priority on careful and prudent economic forecasts. Economic performance in the last four years has been better than assumed by the Administration, while exceeding CBO's assumptions by an even wider margin. The Administration's cautious approach to forecasting is one of the reasons that actual deficits have consistently come in below expectations since 1993.

The differences in economic assumptions between the Administration and CBO have been small—smaller than they were under previous Administrations, and well within the usual range of error in such projections. CBO's assumptions and those used in this Budget are unusually close, and both are similar to private sector forecasts such as the *Blue Chip* consensus. However, even small differences in economic assumptions can yield sizable differences in budget projections when extended over a long planning horizon. Given the positive economic outlook in the United States—steady growth, robust job creation, and low inflation and interest rates with none of the excesses that foreshadow an economic downturn—there are sound reasons for believing that the Administration's projection is likely to be close to the actual outcome.

Impact of Changes in the Economic Assumptions

The economic assumptions underlying this budget are similar to those of last year. Both budgets anticipated that achieving a balanced budget would result in a significant decline in interest rates that would serve to extend the economic expansion at a moderate pace, while helping to maintain low, steady rates of inflation and unemployment. A shift to a balanced budget and the ensuing lower interest rates were also expected to shift income from interest to profits. This would have favorable effects on budget receipts and the deficit, because profits are on average taxed more heavily than interest income.

The changes in the economic assumptions since last year's budget have been relatively modest, as Table 1–3 shows. The differences are primarily the result of more favorable economic experience in 1997 than was anticipated. Economic growth was stronger than expected in 1997, while inflation and unemployment were lower. Because of this favorable experience, the projected annual averages for the unemployment and inflation rates have been reduced slightly. At the same time, interest rates are again assumed to decline in this

Table 1–3. COMPARISON OF ECONOMIC ASSUMPTIONS IN THE 1998 AND 1999 BUDGETS

(Calendar years; dollar amounts in billions)

	1997	1998	1999	2000	2001	2002	2003
Nominal GDP:							
1998 Budget assumptions [1]	8,005	8,379	8,786	9,226	9,686	10,167	10,674
1999 Budget assumptions	8,080	8,430	8,772	9,142	9,547	9,993	10,454
Real GDP (percent change): [2]							
1998 Budget assumptions	2.0	2.0	2.3	2.3	2.3	2.3	2.3
1999 Budget assumptions	3.6	2.0	2.0	2.0	2.3	2.4	2.4
GDP price index (percent change): [2]							
1998 Budget assumptions	2.5	2.6	2.6	2.6	2.6	2.6	2.6
1999 Budget assumptions	1.9	2.0	2.1	2.2	2.2	2.2	2.2
Consumer Price Index (percent change): [2]							
1998 Budget assumptions	2.6	2.7	2.7	2.7	2.7	2.7	2.7
1999 Budget assumptions	2.4	2.1	2.2	2.3	2.3	2.3	2.3
Civilian unemployment rate (percent): [3]							
1998 Budget assumptions	5.3	5.5	5.5	5.5	5.5	5.5	5.5
1999 Budget assumptions	5.0	4.9	5.1	5.3	5.4	5.4	5.4
91-day Treasury bill rate (percent): [3]							
1998 Budget assumptions	5.0	4.7	4.4	4.2	4.0	4.0	4.0
1999 Budget assumptions	5.0	5.0	4.9	4.8	4.7	4.7	4.7
10-year Treasury note rate (percent): [3]							
1998 Budget assumptions	6.1	5.9	5.5	5.3	5.1	5.1	5.1
1999 Budget assumptions	6.4	5.9	5.8	5.8	5.7	5.7	5.7

[1] Adjusted for July 1997 NIPA revisions.
[2] Fourth quarter-to-fourth quarter.
[3] Calendar year average.

budget, but the decline is smaller in percentage points, in part because the deficit has already fallen much faster than expected.

The net effects on the budget of these modifications in the economic outlook are shown in Table 1–4. The largest effects come from higher receipts during 1998–2002 due to higher projected levels of taxable incomes. In all years through 2003, there are higher outlays for interest due to the smaller expected decline in interest rates, offset by lower outlays for cost-of-living adjustments to Federal programs due to lower rates of inflation. A more favorable economic outlook since last year improves the budget balance by $38 billion for 1998 and by $15 billion in 2003.

Table 1–4. EFFECTS ON THE BUDGET OF CHANGES IN ECONOMIC ASSUMPTIONS SINCE LAST YEAR

(In billions of dollars)

	1998	1999	2000	2001	2002	2003
Budget totals under 1998 Budget economic assumptions and 1999 Budget policies:						
Receipts	1,630.0	1,714.3	1,775.4	1,855.1	1,947.3	2,032.4
Outlays	1,677.9	1,745.0	1,796.8	1,846.8	1,874.5	1,964.5
Deficit (–) or surplus	–47.9	–30.7	–21.4	8.3	72.8	67.8
Changes due to economic assumptions:						
Receipts	27.9	28.4	18.2	7.5	2.0	–4.2
Outlays:						
Inflation	–4.4	–8.1	–12.4	–16.8	–20.8	–25.3
Unemployment	–5.4	–4.2	–2.4	–1.0	–1.0	–1.1
Interest rates	0.7	3.4	7.3	10.6	12.7	13.7
Interest on changes in borrowing	–1.0	–2.8	–4.2	–5.1	–5.8	–6.5
Total, outlay decreases (net)	–10.1	–11.8	–11.7	–12.4	–14.9	–19.2
Increase in surplus or reduction in deficit	38.0	40.2	29.9	19.9	17.0	15.0
Budget totals under 1999 Budget economic assumptions and policies:						
Receipts	1,657.9	1,742.7	1,793.6	1,862.6	1,949.3	2,028.2
Outlays	1,667.8	1,733.2	1,785.0	1,834.4	1,859.6	1,945.4
Deficit (–) or surplus	–10.0	9.5	8.5	28.2	89.7	82.8

Structural vs. Cyclical Balance

When the economy is operating above potential as it is currently estimated to be, receipts are higher than they would be if resources were less fully employed, and outlays for unemployment-sensitive programs (such as unemployment compensation and food stamps) are lower. As a result, the deficit is smaller or the surplus is larger than it would be if unemployment were at NAIRU. The portion of the surplus or deficit that can be traced to such factors is called the cyclical surplus or deficit. The remainder, the portion that would remain with unemployment at NAIRU (consistent with a 5.4 percent unemployment rate), is called the structural surplus or deficit.

Changes in the structural balance give a better picture of the impact of budget policy on the economy than does the unadjusted budget balance. The level of the structural balance also gives a clearer picture of the stance of fiscal policy, because this part of the surplus or deficit will persist even when the economy returns to normal operating levels.

In the early 1990's, large swings in net outlays for deposit insurance (the S&L bailouts) had substantial impacts on deficits, but had little concurrent impact on economic performance. It therefore became customary to remove deposit insurance outlays as well as the cyclical component of the surplus or deficit from the actual surplus or deficit to compute the adjusted structural balance. This is shown in Table 1–5.

Because unemployment is projected to be quite close to NAIRU over the forecast horizon, the cyclical component of the surplus is small. For the period 1997 through 2000, the unemployment rate is slightly below the estimated NAIRU of 5.4 percent, resulting in cyclical surpluses. Deposit insurance net outlays are relatively small and do not change greatly from year to year. The adjusted structural surplus or deficits in this budget display much the same pattern of year-to-year changes as the actual deficits. The most significant point illustrated by this table is the fact that of the $268 billion reduction in the actual budget deficit between 1992 and 1997 (from $290 billion to $22 billion), 35 percent ($94 billion) resulted from cyclical improvement in the economy. The rest of the reduction stemmed primarily from policy actions—mainly those in the Omnibus Budget Reconciliation Act of 1993, which reversed a projected continued steep rise in the deficit and set the stage for the remarkable cyclical improvement that has occurred.

Sensitivity of the Budget to Economic Assumptions

Both receipts and outlays are affected by changes in economic conditions. This sensitivity seriously complicates budget planning, because errors in economic assumptions lead to errors in the budget projections. It is therefore useful to examine the implications of alternative economic assumptions.

Many of the budgetary effects of changes in economic assumptions are fairly predictable, and a set of rules of thumb embodying these relationships can aid in estimating how changes in the economic assumptions would alter outlays, receipts, and the surplus or deficit.

Economic variables that affect the budget do not usually change independently of one another. Output and employment tend to move together in the short run: a higher rate of real GDP growth is generally associated with a declining rate of unemployment, while weak or negative growth is usually accompanied by rising unemployment. In the long run, however, changes in the average rate of growth of real GDP are mainly due to changes in the rates of growth of productivity and labor supply, and are not necessarily associated with changes in the average rate of unemployment. Inflation and interest rates are also closely interrelated: a higher expected rate of inflation increases interest rates, while lower expected inflation reduces rates.

Changes in real GDP growth or inflation have a much greater cumulative effect on the budget over time if they are sustained for several years than if they last for only one year.

Highlights of the budget effects of the above rules of thumb are shown in Table 1–6.

If real GDP growth is lower by one percentage point in calendar year 1998 only and the unemployment rate rises by one-half percentage point, the fiscal 1998 deficit would increase by $9.1 billion; receipts in 1998 would be lower by about $7.5 billion, and outlays would be higher by about $1.5 billion, primarily for unemployment-sensitive programs. In 1999, the receipts shortfall would grow further to about $16.2 billion, and outlays would increase by about $5.5 billion relative to the base, even though the growth rate in calendar 1999 equals the rate originally assumed. This is because the level of real (and nominal) GDP and taxable incomes would be permanently lower and unemployment higher.

Table 1–5. ADJUSTED STRUCTURAL BALANCE

(In billions of dollars)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Unadjusted deficit (–) or surplus	–290.4	–255.0	–203.1	–163.9	–107.4	–21.9	–10.0	9.5	8.5	28.2	89.7	82.8
Cyclical component	–72.5	–57.2	–27.8	–8.4	–4.2	21.4	30.1	19.6	9.0	.....	.....	.....
Structural deficit (–) or surplus	–217.9	–197.8	–175.3	–155.5	–103.2	–43.4	–40.1	–10.0	–0.4	28.2	89.8	82.8
Deposit insurance outlays	–2.3	–28.0	–7.6	–17.9	–8.4	–14.4	–4.5	–4.5	–1.9	–1.4	–1.2	–0.3
Adjusted structural deficit (–) or surplus	–220.3	–225.8	–182.9	–173.4	–111.6	–57.8	–44.6	–14.5	–2.3	26.7	88.6	82.5

The budget effects (including growing interest costs associated with higher deficits or smaller surpluses) would continue to grow slightly in later years.

The budget effects are much larger if the real growth rate is assumed to be one percentage point less in each year (1998–2003) and the unemployment rate to rise one-half percentage point in each year. With these assumptions, the levels of real and nominal GDP would be below the base case by a growing percentage. The budget balance would be worsened by $153.3 billion relative to the base case by 2003.

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, resulting in a $130.2 billion worsening of the budget balance by 2003.

The effects of an abrupt and sustained one percentage point increase in the level of the unemployment rate (due, say, to a sudden rise in labor force participation relative to the base case), with no change in the level or growth rate of real GDP, are shown in a fourth example. In this case, unemployment-sensitive outlays would increase by amounts rising from $6.5 billion in 1998 to $12.4 billion in 2003. The effects on the surplus would be smaller (a $7.9 billion reduction in 2003), however, because under current law, federal unemployment tax collections would gradually rise during a period of sustained higher unemployment rates.

Joint changes in interest rates and inflation have a smaller effect on the deficit than equal percentage point changes in real GDP growth, because their effects on receipts and outlays are substantially offsetting. An example is the effect of a one percentage point higher rate of inflation and one percentage point higher interest rates during calendar year 1998 only. In subsequent years, the price level and nominal GDP would be one percent higher than in the base case, but interest rates are assumed to return to their base levels. Outlays for 1998 rise by $5.8 billion and receipts by $8.7 billion, for a decrease of $2.8 billion in the 1998 deficit. In 1999, outlays would be above the base by $14.2 billion, due in part to lagged cost-of-living adjustments; receipts would rise $17.6 billion above the base, however, resulting in a $3.4 billion improvement in the budget balance. In subsequent years, the amounts added to receipts would continue to be larger than the additions to outlays.

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 GDP would 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 $62.6 billion to outlays and $106.5 billion to receipts in 2003, for a net increase in the surplus of $43.9 billion.

The table also shows the interest rate and the inflation effects separately, and rules of thumb for the added interest cost associated with changes in the budget surplus or deficit (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 have about the same magnitude as the effects shown in the table, but with the opposite sign.

These rules of thumb are computed while holding the income share composition of GDP 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. However, the relationships between changes in income shares and changes in growth, inflation, and interest rates are too complex to be reduced to simple rules.

Table 1–6. SENSITIVITY OF THE BUDGET TO ECONOMIC ASSUMPTIONS

(In billions of dollars)

Budget effect	1998	1999	2000	2001	2002	2003
Real Growth and Employment						
Budgetary effects of 1 percent lower real GDP growth:						
For calendar year 1998 only: [1]						
Receipts	–7.5	–16.2	–18.7	–19.0	–19.5	–20.1
Outlays	1.5	5.5	6.8	8.2	9.8	11.6
Decrease in surplus (–)	–9.1	–21.8	–25.5	–27.2	–29.3	–31.7
Sustained during 1998–2003: [1]						
Receipts	–7.5	–24.0	–43.4	–63.6	–85.2	–108.0
Outlays	1.5	7.1	14.0	22.3	32.6	45.3
Decrease in surplus (–)	–9.1	–31.1	–57.4	–86.0	–117.8	–153.3
Sustained during 1998–2003, with no change in unemployment:						
Receipts	–7.5	–24.3	–44.5	–66.1	–89.4	–114.4
Outlays	0.2	1.1	2.9	5.9	10.1	15.8
Decrease in surplus (–)	–7.7	–25.4	–47.4	–71.9	–99.5	–130.2
Budgetary effects of 1 percent higher unemployment rate:						
Sustained during 1998–2003, with no change in real GDP:						
Receipts	*	0.9	2.2	3.2	3.9	4.5
Outlays	6.5	9.4	10.1	10.7	11.4	12.4
Decrease in surplus (–)	–6.5	–8.5	–7.9	–7.5	–7.5	–7.9
Inflation and Interest Rates						
Budgetary effects of 1 percentage point higher rate of:						
Inflation and interest rates during calendar year 1998 only:						
Receipts	8.7	17.6	17.5	16.2	17.0	17.9
Outlays	5.8	14.2	11.9	11.5	11.1	10.5
Increase in surplus (+)	2.8	3.4	5.6	4.7	5.9	7.4
Inflation and interest rates, sustained during 1998–2003:						
Receipts	8.7	26.7	45.4	63.8	84.1	106.5
Outlays	5.9	20.7	32.8	44.0	53.6	62.6
Increase in surplus (+)	2.8	6.0	12.7	19.8	30.5	43.9
Interest rates only, sustained during 1998–2003:						
Receipts	1.2	2.9	3.7	4.0	4.3	4.6
Outlays	5.5	16.0	21.7	25.1	27.5	29.1
Decrease in surplus (–)	–4.3	–13.0	–17.9	–21.2	–23.2	–24.4
Inflation only, sustained during 1998–2003:						
Receipts	7.5	23.8	41.7	59.8	79.8	101.9
Outlays	0.4	4.7	11.1	18.9	26.1	33.5
Increase in surplus (+)	7.1	19.0	30.6	41.0	53.7	68.3
Interest Cost of Higher Federal Borrowing						
Outlay effect of $100 billion additional borrowing during 1998	2.9	5.5	5.6	5.8	6.0	6.3

*$50 million or less.

[1] The unemployment rate is assumed to be 0.5 percentage point higher per 1.0 percent shortfall in the level of real GDP.