

Controlling Federal Outlays: Trends and Proposals

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IN his February 1985 budget message, President Reagan noted that

The past 4 years have also seen the beginning of a quiet but profound revolution in the conduct of our Federal Government. We have halted what seemed at the time an inexorable set of trends toward greater and greater Government intrusiveness, more and more regulation, higher and higher taxes, more and more spending, higher and higher inflation, and weaker and weaker defense.¹

Yet, federal outlays as a proportion of GNP were still half a percentage point above what they were when the administration took office in 1981.

The purpose of this article is to summarize recent trends in federal outlays and assess the administration's future plans by placing them in a historical context.² The focus of the discussion is on the behavior of federal outlays as a percent of GNP — a measure that was used initially by the administration to summarize the government's influence on the economy.

BUDGET OUTLAYS VS. CURRENT SERVICES

Interpreting budget trends requires some reference measure that can be used for comparison. The refer-

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¹Office of Management and Budget (1985a).

²Even though the administration's February 1985 proposals will not be realized, these proposals provide a base for debate by Congress whereby modifications will be made.

ence measure used in the February 1985 budget is the "current services budget." According to the budget document, "current services" estimates are defined as

... the estimated budget outlays and proposed budget authority that would be included in the budget for the following fiscal year if programs and activities of the United States Government were carried on during that year at the same level as the current year without a change in policy.³

Current services estimates "provide a base against which budgetary alternatives may be assessed."⁴

Table 1 summarizes both the administration's 1985 proposals and the current services estimates for 1985 through 1990.⁵ A comparison of the figures indicates that the administration plans to cut federal outlays by \$507 billion between 1986 and 1990, with the largest cuts coming in the last three years. When converted to percentages, the cuts range from 5 percent in 1986 to 10.7 percent in 1990.

The bottom half of table 1 shows the current services and proposed budget estimates as percentages of GNP. The proposed estimates represent sizable decreases in the proportion of federal government outlays to GNP compared with the current services estimates.

Whether such proposed reductions in the proportion of federal outlays relative to GNP will actually

³Office of Management and Budget (1985b), p. A-1.

⁴Ibid, p. A-2.

⁵For alternative estimates of both the administration's program and current services, see Congressional Budget Office (1985).

Table 1

Federal Outlays: Budget Estimates vs. Current Services, February 1985

	In Billions of Dollars					
	1985	1986	1987	1988	1989	1990
Current services	\$960.4	\$1024.5	\$1109.2	\$1200.0	\$1262.8	\$1332.8
Budget estimates	959.1	973.7	1026.6	1094.8	1137.4	1190.0
Difference	\$1.3	\$50.8	\$82.6	\$105.2	\$125.4	\$142.8
				\$506.8		
Percent difference	0.1%	5.0%	7.5%	8.8%	9.9%	10.7%
	As a Percent of GNP					
Current services	24.8%	24.4%	24.4%	24.4%	23.8%	23.4%
Budget estimates	24.8	23.2	22.6	22.2	21.4	20.9
Difference	0.0%	1.2%	1.8%	2.2%	2.4%	2.5%

NOTE: All figures include off-budget outlays.

occur depends crucially on both political considerations and future economic conditions — neither of which can be forecast with much reliability.⁶ One way to assess the significance of the proposed reductions, however, is to compare them with some longer-term trends in federal outlays. In this manner, it is at least possible to see what such reductions would mean in a historical context.

BUDGET OUTLAYS AS A PERCENT OF GNP: A HISTORICAL PERSPECTIVE

To examine properly federal outlays relative to GNP from a historical perspective requires adjusting outlays and GNP separately for the direct influence of the business cycle.⁷ Since federal outlays generally rise relative to GNP during recessions, the inclusion of such percentages without adjustment could distort the interpretation of underlying trends.

⁶See Carlson (1983).

⁷Federal outlays were adjusted for the cycle using correction factors implicit in the work by de Leeuw and Holloway (1983). This meant adjusting budget outlays in the same proportion as national income accounts federal expenditures are adjusted to derive cyclically adjusted expenditures. Following this procedure captures only the automatic response of federal outlays to the business cycle, meaning that countercyclical fiscal actions are still reflected in the figures. Trend GNP is middle-expansion trend GNP as defined by de Leeuw and Holloway. See also Holloway (1984).

Total Outlays

The historical record of cyclically adjusted federal outlays as a percent of adjusted GNP is summarized in chart 1. Even with cyclical adjustment, this measure of government activity is still quite volatile, especially on a year-to-year basis. Consequently, a trend line for the period 1956–81 has been plotted in the chart.

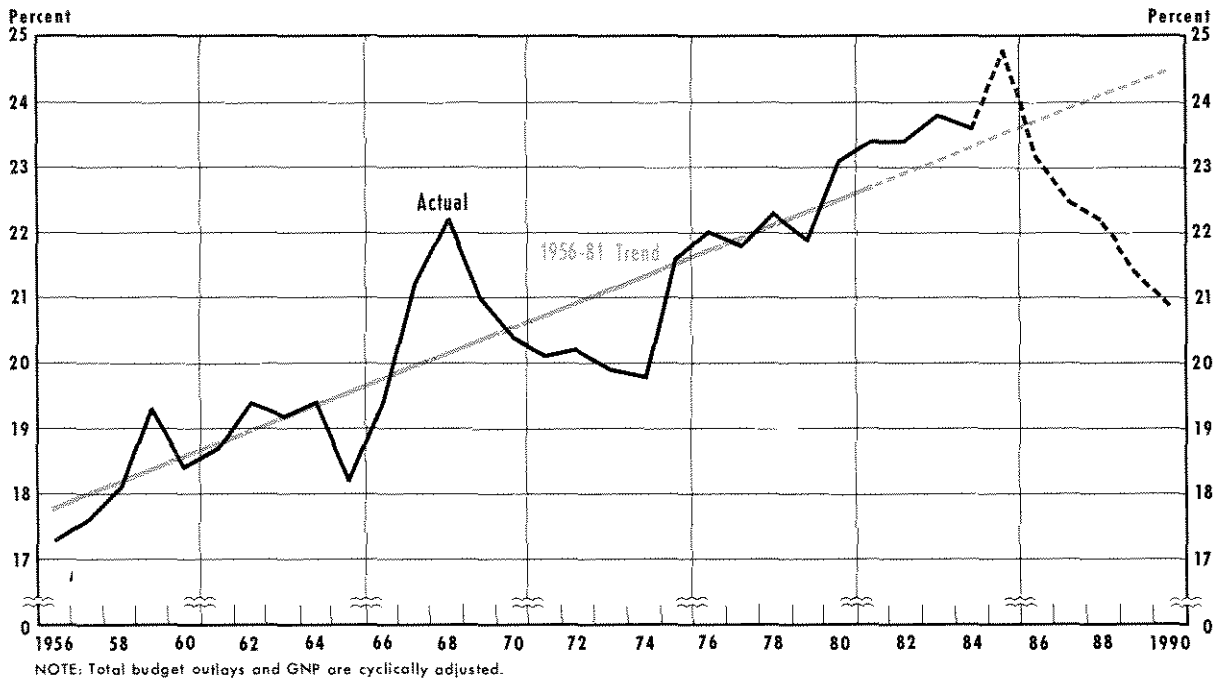
Extending the trend line from 1982 through 1990 indicates that the administration has not been successful in reducing total outlays as a percent of GNP in the 1981–84 period. Moreover, the proposed 1985 level of outlays is well above the historical trend.

Chart 1 does show that the administration is proposing a path of outlays after 1985 that differs dramatically from both the 1956–81 trend and its first four years in office. If the administration's proposals are enacted, the size of government would be reduced to that prevailing in the mid-1970s.

The Composition of Total Outlays

An examination of total budget outlays relative to GNP masks the contrasting differences taking place between defense and nondefense outlays. Chart 2 summarizes these outlays relative to GNP. Nondefense outlays and GNP are adjusted for the business cycle; defense outlays are not adjusted because they are not systematically related to the business cycle. The defense portion of the chart shows the downward trend

Chart 1
Total Budget Outlays as a Percent of GNP



of defense outlays relative to GNP from 1956 to 1981. Since 1981, the trend has been reversed, with defense spending rising to 6.3 percent of GNP in 1984. The administration plans for future defense spending to continue to rise relative to GNP; the proposed budget calls for defense outlays to reach 7.5 percent of GNP by 1990.⁸

The nondefense portion of the chart shows that the growth of cyclically adjusted nondefense outlays relative to trend GNP was extraordinarily rapid from 1956 to 1981. Such spending rose from 6.9 percent of GNP in 1956 to 18 percent in 1981. Since 1981, however, the ratio of nondefense outlays to GNP has been reduced relative to its 1956-81 trend.

The administration plans for the reduction in nondefense outlays relative to GNP to continue; these reductions are quite dramatic relative to the 1956-81 trend. The administration's proposals call for nonde-

fense outlays to be reduced to 13.4 percent of GNP by 1990. If realized, the relative size of the nondefense budget would be reduced to levels prevailing in the early 1970s.

The Composition of Nondefense Outlays

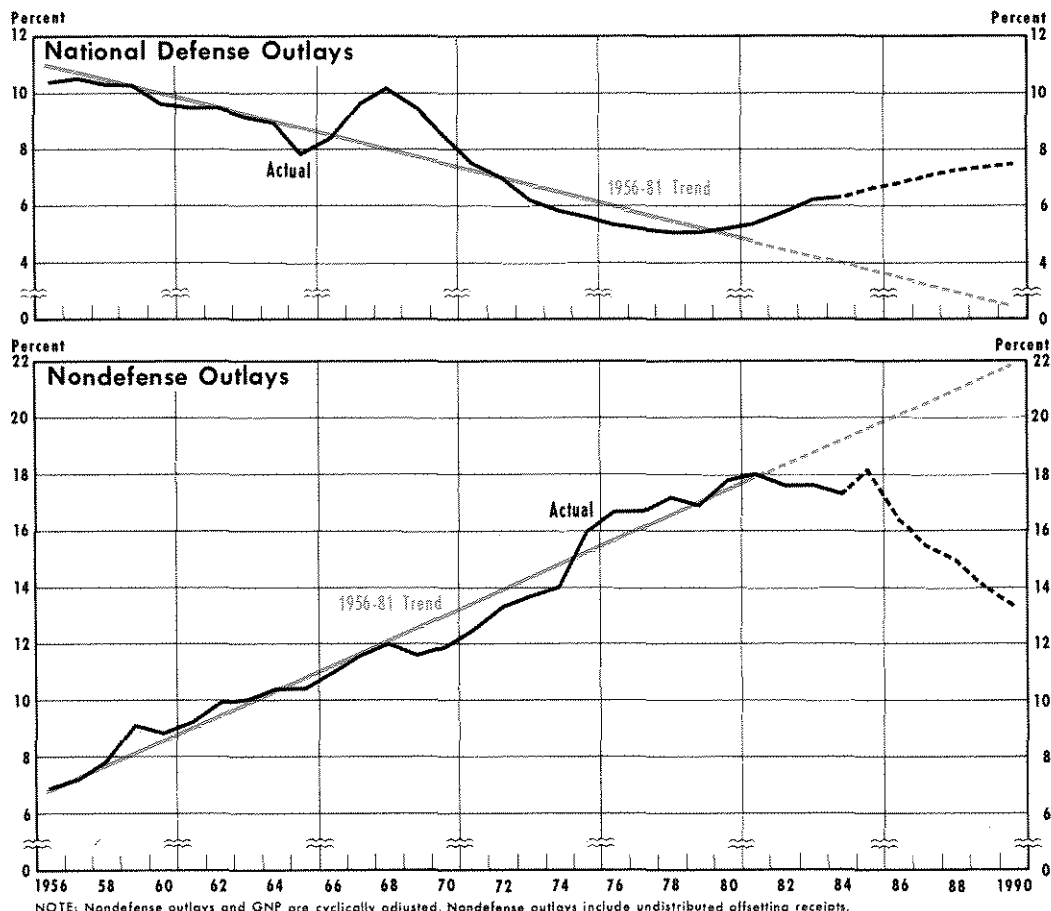
Chart 3 summarizes nondefense spending by major program category and emphasizes the method of carrying out government activities. The purpose of looking at these categories is to determine where the nondefense budget cuts will fall.⁹

The largest proportion of nondefense spending, given this set of categories, is payments for individuals. This category includes both direct (for example, Social Security benefits) and indirect (via grants to state and local governments, such as Medicaid and assistance payments) transfer payments by the federal government. According to the top tier of chart 3, this spending grew rapidly from 1956 to 1981; its trend has apparently been reversed since 1983. The administra-

⁸The administration indicates that its proposed defense outlays will be less than the current services estimates (see the appendix to this article for 1990 estimates). The Congressional Budget Office disputes this contention, claiming that the administration's defense proposals are greater than current services estimates. See Congressional Budget Office (1985), p. 22.

⁹For further detail relative to current services estimates, see the appendix.

Chart 2
Composition of Total Budget Outlays
 Percent of GNP



NOTE: Nondefense outlays and GNP are cyclically adjusted. Nondefense outlays include undistributed offsetting receipts.

tion plans to continue to reduce such payments relative to GNP to 9.8 percent by 1990, a dramatic departure from its growth over the 1956-81 period.

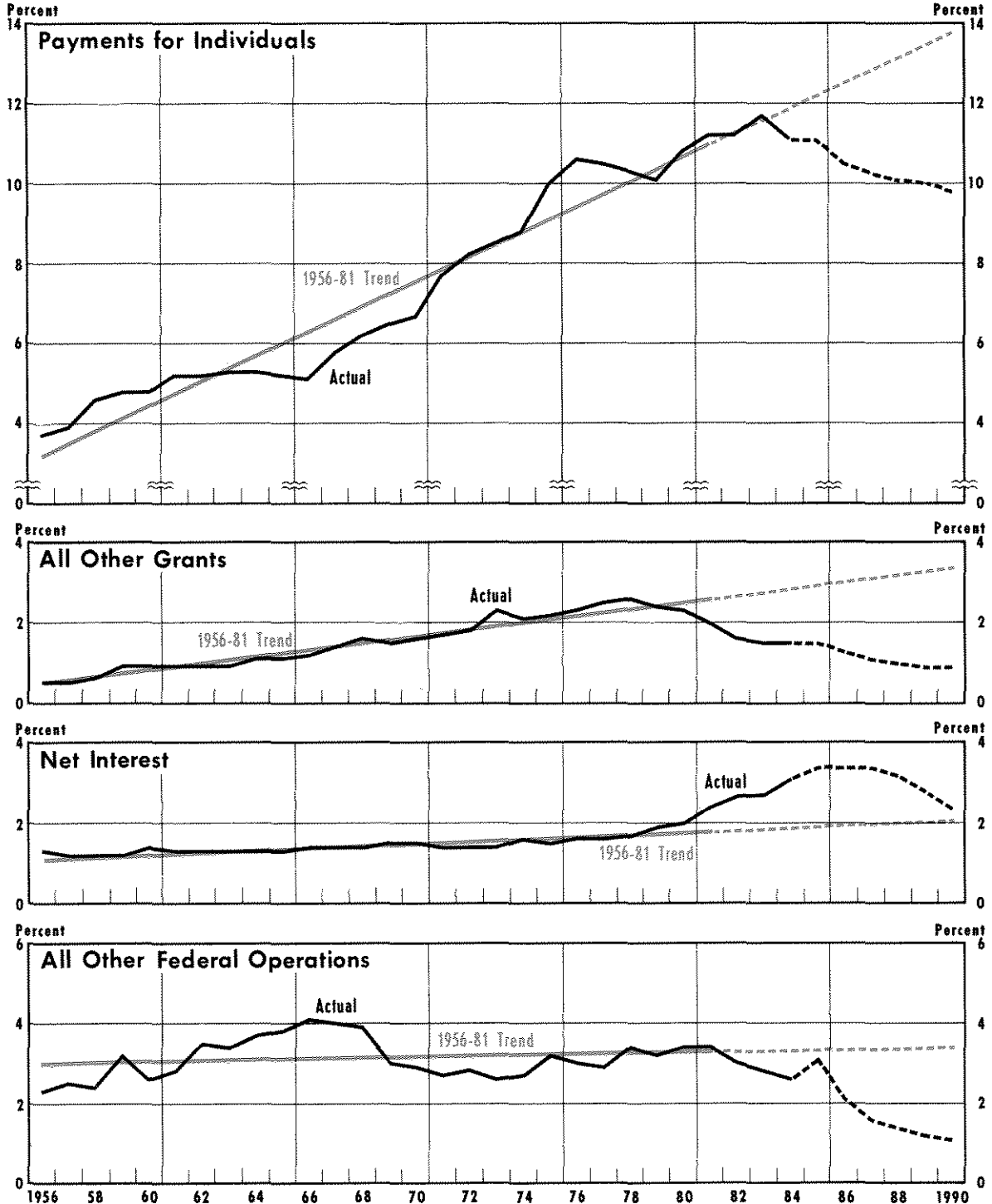
The category labeled "all other grants" includes all grants to state and local governments except transfer payments. Included in this category are grants for wastewater treatment plants, highway construction, community development, education, employment and training assistance, and general revenue sharing. The second tier of chart 3 indicates that this category of spending has been reduced well below the 1956-81 trend line in recent years. The extent of the cut is dramatic — from a peak of 2.6 percent of GNP in 1978 to 1.5 percent in 1984. Furthermore, this category is projected for further cuts in the future, to 0.9 percent of GNP in 1990.

The net interest category has attracted considerable attention in recent years. Once a relatively insignificant part of the budget, it has risen considerably to the point where policymakers now view it with major concern.¹⁰ The third tier of chart 3 shows that, after rising from 1.3 percent of GNP in 1956 to 1.6 percent in 1976, net interest rose steadily to 3.1 percent of GNP in 1984. Projections of net interest depend on a number of factors, the most important of which is the future course of deficits and the projected level of interest

¹⁰This is because of the cumulative effect of net interest. Higher net interest adds to the current deficit, which carries over to future years in the form of a larger debt that must be financed. See Carlin (1984).

Chart 3

Composition of Nondefense Outlays Percent of GNP



NOTE: GNP and payments for individuals are cyclically adjusted. All other federal operations does not include undistributed offsetting receipts.

rates. Given the administration's overall plan for reducing the size of the deficit and a projected decline in interest rates, net interest outlays as a percent of GNP is projected to continue rising through 1985, level off for two years, then drop sharply to 1990; however, it will still remain above the 1956-81 trend as extrapolated to 1990.

The "all other federal operations" category includes outlays for foreign aid, general science research and space technology, energy programs, farm price supports, housing credit activities and day-to-day operations of the government. Relative to GNP, as shown in the bottom tier of chart 3, this category of nondefense outlays displayed a slight upward trend during the 1956-81 period; it has declined in recent years. The jump in the estimate for fiscal year 1985 reflects primarily the surge in outlays related to the PIK farm program. The administration plans to continue to cut such outlays as a percent of GNP through 1990. Such proposed cuts are centered on farm price support programs, foreign aid and loan activities of the government.

SUMMARY

The federal government in its February 1985 budget announced cuts of about \$507 billion relative to current services estimates for the 1986-90 period. These proposed cuts were compared with recent trends in federal outlays relative to GNP since 1956; the results of these comparisons are summarized in table 2. The historical record indicates that, while attempts to cut the proportion of total federal outlays to GNP have been unsuccessful thus far, the administration's current proposals, if achieved, would reduce outlays relative to GNP. The historical comparisons show the present administration has altered the mix of total outlays between defense and nondefense quite dramatically, and a continuation of this reversal is proposed for the future.

Payments for individuals are scheduled to be cut moderately relative to GNP for each year after 1985. Net interest as a percent of GNP, which is currently climbing well above past trends, is projected to continue rising through 1985, level off, then move back toward

Table 2
Summary of Trends

Percent of GNP	Relation to 1956-81 trend ¹	
	1982-84	1985-90
Total budget outlays	Above	Below
National defense	Above	Above
Nondefense	Below	Below
Payments for individuals	Below	Below
All other grants	Below	Below
Net interest	Above	Above
All other federal operations	Below	Below

¹A straight line trend was fitted to the relevant measure of outlays as a percent of GNP.

trend after 1987. Budget cuts, as measured by outlay relative to GNP, are concentrated in "all other grants to state and local governments" and in "all other federal operations." The government's program is ambitious in order to reduce total budget outlays to 20.9 percent of GNP by 1990, while at the same time increasing defense outlays to 7.5 percent of GNP, nondefense outlays will have to be reduced to 13.4 percent of GNP from the current level of approximately 18 percent.

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APPENDIX: Composition of Federal Outlays

Federal outlays can be classified in terms of two analytical structures: budget function and major pro-

gram category. The functional classification presents outlays according to the purposes that federal pro-

Table A1
1990 Federal Outlays: Current Services vs. Administration Proposals
(amounts in billions of dollars)

Category	Current services	Administration proposal	Difference	Percent difference
National defense	\$441.7	\$428.6	\$-13.1	-3.0%
Benefit payments for individuals ¹	590.6	555.0	-35.6	-6.0
Health	48.9	40.8	-8.1	-16.6
Social Security and Medicare	369.2	355.4	-13.8	-3.7
Income security	140.8	130.6	-10.2	-7.2
Veteran payments	31.7	28.2	-3.5	-11.0
Other grants to state and local governments ¹	61.2	43.9	-17.3	-28.3
National resources and environment ²	3.5	2.7	-0.8	-22.9
Transportation ²	22.2	16.8	-5.4	-24.3
Community and regional development ²	5.7	3.8	-1.9	-33.3
Education, training, employment and social services ²	22.7	18.7	-4.0	-17.6
General purpose fiscal assistance	7.1	1.9	-5.2	-73.2
Net interest	164.2	137.7	-26.5	-16.1
Other federal operations ¹	117.3	69.9	-47.4	-40.4
International affairs	19.5	14.5	-5.0	-25.6
General service, space and technology	11.0	11.1	0.1	0.9
Energy	6.1	2.3	-3.8	-62.3
Natural resources and environment ²	9.3	7.3	-2.0	-21.5
Agriculture	20.1	3.8	-16.3	-81.1
Commerce and housing credit	3.8	-3.7	-7.5	-197.4
Transportation ²	10.0	7.6	-2.4	-24.0
Community and regional development ²	2.5	1.7	-0.8	-32.0
Education, training, employment and social services ²	11.6	9.5	-2.1	-18.1
Administration of justice	7.4	6.9	-0.5	-6.8
General government	6.1	4.9	-1.2	-19.7
Allowances	9.9	4.0	-5.9	-59.6
Undistributed offsetting receipts	-42.1	-45.0	-2.9	—

¹Amounts shown are the sums for the functions listed under them, and differ slightly from the "major program category" amounts shown in the budget.

²The budget gives current services estimates for the total. Estimates by major program category were estimated by the author.

grams are intended to serve. These functions are grouped into 18 broad areas, including, for example, national defense, international affairs, energy programs, agriculture, transportation, health and general government programs. Three additional categories — net interest, allowances and undistributed offsetting receipts — do not address specific functions, but are included to cover the entire budget.

Classification of federal outlays by major program category focuses on the method of carrying out an activity. The major program categories are national

defense, benefit payments to individuals, grants to state and local governments (other than for benefit payments), net interest, other federal operations and undistributed offsetting receipts. National defense, net interest, and undistributed offsetting receipts correspond to the functional categories of the same name, but, the remaining major program categories do not correspond to a simple summing of functional categories. Nonetheless, approximations can be made. The accompanying table groups 1990 outlays by function to show the approximate composition of some of the major program categories.