

Why the 1984 Federal Budget Deficit was Lower Than Expected

The fiscal 1984 federal budget deficit came to just over \$175 billion, some \$25 billion lower than the Administration, the Congressional Budget Office (CBO), and many private analysts were projecting a year or so ago. To what extent is the lower-than-predicted deficit accounted for by the unexpected strength of the current economic recovery? Our analysis shows that only about one-fourth of the overestimate of the deficit can be explained by the course of the business cycle over the past year. The remainder was due to factors unrelated to the economy's performance (Table 1).

It is true that initial estimates of federal revenues and outlays were based on economic forecasts which underestimated real GNP growth over the past year to a considerable degree (Table 2). But the effect this had on the level of projected deficits was offset somewhat by predictions for interest rates which were too low. Forecasts for the rate of inflation—which proved to be too high—contributed to slight overestimates of both federal revenues and outlays, so they do not explain much of the lower deficit outcome.

If the unexpectedly low deficit had indeed been the result of the strong recovery, then most of the amount by which the deficit was overestimated should have been in those budget components which are especially sensitive to the economy's performance—in particular, tax receipts and expenditures for programs affected by the level of unemployment. But this was not the case in either the Administration's budget estimates or CBO's.

The underestimates of federal revenues due to cyclical factors was no more than \$4 billion (Table 1). This is because it takes about one year of sustained higher real growth before revenues are boosted appreciably.

While virtually all of the amount by which the deficit was overestimated occurred on the spending side of the budget, only a small portion was in cyclically sensitive categories (Table 1). Initial projections of outlays for programs affected by the level of unemployment were only about \$3 billion too high.* Any other unanticipated shortfalls in spending related to the stronger economy were largely offset by greater net interest outlays (about \$3 billion).

Most of the overestimates of federal spending were for defense, and were unrelated to real economic growth.

*This includes expenditures for unemployment compensation, Medicaid, Aid to Families With Dependent Children, and food stamps.

Table 1

Fiscal 1984 Federal Budget Deficit Overestimates

In billions of dollars

	Administration	CBO
Deficit forecast*	200	196
Actual deficit	175	175
Overestimate	25	21
Overestimate due to†		
Cyclical factors	6	5
Noncyclical factors	19	16
Revenues (forecast less actual)†	-1	-2
Cyclical factors	-2	-4
Noncyclical factors‡	1	2
Outlays (forecast less actual)†	24	19
Cyclical factors	4	1
Noncyclical factors	20	18

*Each forecast was based on federal policies in effect at the time

†Federal Reserve Bank of New York staff estimates

‡Includes legislation enacted during the year

Sources: Administration forecast from *Mid-Session Review of the 1984 Budget*, July 25, 1983; CBO forecast from *Economic and Budget Outlook: An Update*, August 1983

Table 2

Economic Assumptions Underlying Budget Estimates for Fiscal 1984: Ex Ante vs. Ex Post

In percent

Forecasts	Beginning of Fiscal 1984	Latest Estimate
Real GNP*		
Administration	4.5	6.5
CBO	4.3	6.6
Blue Chip Consensus	4.4	6.5
GNP Deflator*		
Administration	5.0	4.4
CBO	5.0	4.1
Blue Chip Consensus	5.3	4.0
Unemployment Rate†		
Administration	8.9	7.2
CBO	8.4	7.3
Blue Chip Consensus	8.6	7.4
3-Month T-Bill†		
Administration	8.5	9.5
CBO	8.6	10.0
Blue Chip Consensus	8.7	9.9

*Percent change, 1984-IV over 1983-IV

†Percent average, calendar year 1984

Sources: Administration ex ante and ex post forecasts are from the *Mid-Session Review of the 1984 Budget*, July 25, 1983 and *Mid-Session Review of the 1985 Budget*, August 15, 1984, respectively. The corresponding CBO forecasts are from the *Economic and Budget Outlook: An Update*, August 1983 and August 1984. The Blue Chip Consensus forecasts are from *Blue Chip Economic Indicators*, October 1983 and September 1984.

(Table 1). There are two principal reasons why initial estimates for defense outlays were too high—\$14 billion by CBO and \$18 billion by the Administration. First, the level of defense budget authority (BA) approved by Congress for fiscal 1984 was about \$10 billion less than CBO had initially assumed, and \$15 billion less than the Administration had requested. Second, an apparent slowdown in spendout rates from defense BA was not anticipated by most analysts.

Without the shortfall in outlays due to noncyclical factors, the deficit for fiscal 1984 would have been between \$190 and \$195 billion, the stronger-than-expected recovery notwithstanding. Furthermore, if the recent shortfall in defense expenditures is made up during the coming year, then current estimates of about \$175 billion for the fiscal 1985 deficit under existing policies may prove to be too low.

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