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official Federal deficit introduces certain anomalies. In the official, 'unified' budget, sales of assets are netted against outlays. This offers encouragement to 'privatization' as a deficit-reducing policy. The deficit, as measured, could indeed be eliminated for many years by the expedient of selling off government properties on a lease-back arrangement. We might include Federal airports, highways, the military arsenal and the White House itself. Of course, eventually we would run out of properties to sell, and require a new expedient.

There is probably no one solution to deficit measurement problems. A crucial guide is the purpose of the measurement. If we are concerned with the impact on aggregate demand, how much the budget is adding to purchasing power, we would generally look at the disparity between total outlays and revenues. If we are concerned about the rate of national saving and provision for the future, we should look at a public capital budget for the contribution of public investment and a current account budget to ascertain the amount of private saving that is being used to finance public consumption or public provision of intermediate goods and services.

If we are concerned with sustainability we may wish to look at the 'primary' deficit, exclusive of interest payments. This would have to be in balance if interest rates on public debt are equal to the growth rate of the economy. Then the debt would grow at the same rate as GNP and the debt-GNP ratio would remain constant. So stated, though, the sustainability criterion relates to a permanent condition. The primary deficit can be in deficit for any finite number of years and the 'intertemporal budget constraint', that the present value of all future taxes must equal the present value of all future outlays, can still be met if the budget is in surplus for some, later finite number of years. One may also note, in addition, a recent paper (Bohn 1990) suggesting that the certainty of payment on public debt in a world where the growth process is stochastic may generally bring public interest rates below growth rates. This would permit even a permanent, primary budget deficit.

The question of sustainability also relates to the cyclical character of budget deficits. Revenues vary positively with GNP whether taxes are based largely on income – payroll taxes and personal and corporate income taxes, as in the United States – or also include major components related to sales or value added, as in much of Europe. Outlays, in turn, vary negatively with GNP as transfer payments, particularly for unemployment benefits, rise when the economy slows. Thus the deficit automatically rises in recessions and declines in booms.

It is often desirable to have a measure of the impact of the deficit on the economy independent of the effect of the economy on the deficit. For that the United States Bureau of Economic Analysis has provided cyclically-adjusted surpluses or deficits based on '6-percent unemployment rate trend GNP' and on 'middle-expansion trend GNP' and the OECD has offered cyclically-adjusted measures of primary balance and of net lending and cyclically- and inflation-adjusted measures of net lending. These are all estimates of what the deficit would be if the economy were at specified, constant rates of employment or on specified trend paths of output. Sustainability would then relate to whether the

debt-GNP ratio would remain constant at the average rate of employment or economic activity.

Evaluation of the relative size of deficits or intertemporal or international comparisons would appear generally more meaningful if they related to cyclically-adjusted and inflation-adjusted deficits. They should be the consolidated deficits of all government entities, national and state or local, trust funds, and 'off-budget' agencies and enterprises. They should include at least footnotes for changes in implicit and contingent liabilities such as unfunded pensions and retirement benefits and loan and deposit guarantees. And they should distinguish among current and capital accounts.

ROBERT EISNER

See also BALANCED BUDGET AMENDMENT; BURDEN OF THE DEBT; DEFICIT FINANCING; DEMAND MANAGEMENT; FULL EMPLOYMENT BUDGET SURPLUS; GRAMM-RUDMAN-HOLLINGS BALANCED BUDGET ACT; PUBLIC DEBT; PUBLIC SECTOR BORROWING; PUBLIC SECTOR BORROWING REQUIREMENT.

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budget projections. In their simplest form budget projections are little more than an estimate of the revenue collections and expenditures made by a governmental unit. As with any non-government operation, sound management practices require any level of government to have accurate financial information and forecasts of its financial structure.

At the most aggregate level, budget projections consist of three estimates: collection of revenues (receipts), expenditures (outlays), and their difference (the deficit).

The rules for making budget projections vary among the states and localities in the US, and between the states and the federal government. These estimates are not completely independent of each other since many states rely on the federal projections to assist in their own forecasting. The federal government has traditionally produced two sets of budget projections as required by the Congressional Budget Act of 1974: current services and proposed law. The current services forecast provides an estimate of future budget expenditures and receipts under the assumption that current government services are maintained at the same real level as in the previous year. Implicit in this projection are adjustments for inflation, and assumptions about the legal requirements of current law. This provides a framework for all other budget analysis by defining a baseline to which changes can be compared. Since there may be disagreements over the interpretation of current law, the current service baseline may be subject to debate. The proposed law forecast uses the current services forecast as a base, and

provides a forecast of receipts and outlays under the assumption that all of the programmes (both tax and expenditure) proposed by the President become law.

The Balanced Budget and Emergency Control Act of 1985 (see GRAMM-RUDMAN-HOLLINGS BALANCED BUDGET ACT) defined a third baseline – the sequestration baseline – to limit discretionary changes in the current services baseline. This Act, and subsequent changes in 1987 and 1990, have narrowed the scope of technical assumptions used to determine the baseline. While conceptually similar to the current services baseline, the sequestration baseline largely replaces one discretionary set of guidelines with another.

Two agencies are responsible for the production of US budget projections. The President's budget proposal is produced by the Office of Management and Budget. The Congressional Budget Office, created in 1974 as a non-partisan agency of the US Congress, re-estimates the baseline and the President's proposals. These two agencies' projections will differ since each uses a different set of economic assumptions, and may have different interpretations about the scope of current law. Because of these differences, these agencies will also differ in their estimates about the effects of proposed changes in policy.

Budget proposals are published in January of a given year for the five fiscal years beginning the following October. A Mid-Session Review of budget projections is performed at some time between June and August, with sequestration reports required in mid-August and mid-October.

The construction of a budget forecast begins with a set of economic and policy assumptions for the period the forecast is to encompass. The economic assumptions consist of a macroeconomic forecast which has been disaggregated to provide detailed information on variables which may affect any aspect of government spending or revenues. These variables include the gross national product, personal income, unemployment rates, interest rates, corporate profits and investment.

Both outlay and receipt estimates will be sensitive to the economic assumptions. For expenditure programmes, the economic forecasts are used to determine the amount of resources necessary to fulfil the legal mandates or policy objectives of government programmes. Expenditures on unemployment insurance, for example, will depend upon estimates of unemployment; inflation adjustments and debt service costs will depend upon inflation forecasts. These amounts are aggregated into a baseline estimate of total expenditures, and total expenditures under proposed policies. Tax collections by source (such as individual and corporate income taxes and excise taxes) each depend upon the state of the economy, and are based upon elements of the macroeconomic forecasts.

The deficit is calculated as the difference between tax collections and expenditures. While the deficit is a residual in concept, recent legislative changes enacted to reduce the US deficit have specified a maximum level of deficit spending for each year. This has led to the deficit being determined exogenously, with policy changes taking place to achieve the target.

While the forecast of the economy will determine the long-term trend in anticipated expenditures and tax

collections, current policies and economic conditions will also affect the budget. In estimating tax collections, for example, a given year's tax liability (how much tax must be paid) is dependent upon economic activity in that year, but payment of the liability may not occur until some months, or years, afterwards. This overlapping of financial activity is compounded whenever the government has a fiscal year that is different from that of most taxpayers. In the US, the fiscal year for the federal government begins on the first day of October, while most taxpayers follow a calendar year. The ratios used to allocate calendar year collections into the appropriate government accounting period are known as 'fiscal splits'.

Once the appropriate baseline is estimated, the effects of proposed policy changes can be added to determine the direction the budget would take if the policies are adopted. A proposed increase in expenditures for a particular programme would be reflected as an increase in outlays, and, *ceteris paribus*, an increase in the deficit. It is important to note, however, that while it is generally accepted that changes in fiscal policy (through changes in expenditures or taxation) will have at least a short-run effect on the economy, large feedback effects to the underlying macroeconomic forecast are explicitly ignored. Although the budget does recognize that fiscal changes can have sectoral effects, these sectoral changes are estimated within the constraint of a fixed level of gross national product.

It is particularly difficult to evaluate the accuracy or rationality of budget projections since rarely do the forecast and assumptions underlying the budget prove to be complete. Differences between projections and outcomes are classified into three categories: economic, policy or technical.

Economic differences arise because general or sectoral economic activity is different from forecast. These changes in economic conditions may cause the level of expenditures or receipts to differ from the baseline projections.

Policy differences are caused by a change in policy or law since the last projection. The enactment of new spending or tax programmes, as occur yearly, will result in spending or receipt changes that could not have been anticipated, or anticipated but not permitted to be included under the rules used to make budget forecasts. Policy changes, such as the tax law changes made in the US from 1981 to 1986, caused there to be substantial errors in the US budget forecasts in each of those years.

Finally, technical changes encompass errors in the forecasting process itself. Even with correct information about the future of the economy and budget policy, and with correctly specified economic models, random errors will exist. Additionally, systematic errors in budget projections due to underlying errors or mis-specification of the economic models used to construct the forecasts will also contribute to technical differences. With two agencies producing budget projections in the US, each relying on different methodologies to produce their respective forecasts, reconciliation of the projections will undoubtedly be partially due to technical differences.

As with any forecasting process there is a concern that the forecasts be as accurate as possible. Given the political nature of the budget, one might expect politically expedient

errors to exist. Since the President's budget is based upon the political goals and philosophy of the party in power, it must be viewed as a political document and therefore inherently suspect as an unbiased forecast of the future. Even if free of political influence, the Budget is subject to substantial legislative revision prior to its adoption, which will cause the original projections to be incorrect.

While the political nature of the budget process has raised questions about the ability of government agencies to produce an accurate, non-politically biased forecast, examination of recent US history suggests that no systematic bias exists in the estimates of macroeconomic variables and budget aggregates.

GEORGE PLESKO

See also BALANCED BUDGET AMENDMENT; BUDGETARY POLICY; BUDGET DEFICITS: PROBLEMS OF MEASUREMENT; BURDEN OF THE DEBT; CONGRESSIONAL BUDGET OFFICE; DEFICIT FINANCING; GRAMM-RUDMAN-HOLLINGS BALANCED BUDGET ACT; LAFFER CURVE.

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building societies. Building societies constitute a major part of the British financial system. At the end of 1990 their total assets amounted to close on £220 billion (as a point of comparison, the sterling assets of all UK retail banks amounted to £350 billion); they had 40 million personal investors, 6.7 million borrowers, and outstanding mortgage loans of £175 billion.

Building societies are essentially specialist, mutual deposit-taking financial institutions, which have a commanding position in the UK personal sector mortgage and savings markets. At the end of 1990 they accounted for over 60 percent of outstanding personal sector mortgage balances, and 45 percent of the sector's holdings of liquid assets. In both markets their major competitors are banks, which accounted for 30 percent of the mortgage market in 1990 (compared with 6 percent ten years earlier), and 45 percent

of the personal sector's holdings of liquid assets. Building society mortgage loans are almost exclusively based on a floating interest rate, with the building societies adjusting both their deposit and mortgage rates in line with movements in market rates. They are therefore not exposed to the interest rate mis-match risk that the US Savings and Loan Associations have experienced. The mortgage rate can be changed several times in a year, and although borrowers receive tax relief on interest payments on mortgages up to a value of £30,000, monthly payments can vary substantially even within a year. Between June 1988 and April 1990 the building societies' mortgage rate was raised in ten moves from 9.8 to 15.4 percent.

The first building societies were founded late in the 18th century and were originally societies of people who came together for the purpose of building their own houses. They often comprised only 20 or 30 members who paid weekly contributions to a fund which was used to buy land and then finance the building of houses. When all the members had been housed, the society terminated. By the beginning of the 19th century building societies had largely ceased to build houses, and by the 1850s they were becoming 'permanent' institutions (to distinguish them from the 'terminating' societies), which supplemented their funds by borrowing from those who did not necessarily want to buy homes, and which lent to people to buy existing houses as well as financing the construction of new dwellings. However, at this time societies were still small and operated only in local areas. The societies grew very rapidly during the 20th century and, while many remain local or regional in coverage, several have become major national financial institutions.

Although at the end of 1990 there was a total of 117 building societies, business is highly concentrated with 61 percent of the sector's assets accounted for by five societies and 80 percent by the largest ten. There has been a substantial consolidation in market structure with the number of societies declining steadily from 726 in 1960.

In many respects building societies operate essentially as mutual retail banks, although technically they are not defined as 'banks'. Unlike banks their allowable business is defined by law which forces a concentration on personal mortgages. The allowable range of business activities, and the extent to which they can diversify, are defined by Act of Parliament. They are supervised by the Building Societies Commission rather than the Bank of England which supervises banks. Until 1987 their only assets (other than their holdings of liquid assets) were mortgages which accounted for over 80 percent of the total. They have traditionally been single-product institutions on both sides of the balance sheet; mortgages were their exclusive lending asset, and they raised retail savings deposits entirely from the personal sector. Historically, they have been specialist mortgage and savings institutions. Regulation has not only restricted the range of lending business but their inability (until 1981) to pay interest gross of tax also effectively debarred them from funding in domestic and international wholesale deposit and capital markets. This type of regulation on both sides of the balance sheet distinguishes them from banks which are subject to no such restrictions.

The position was changed radically with the 1986