INFORMED BUDGETEER

KOSOVO SUPPLEMENTAL & OTHER "EMERGENCIES"

- The table below compares the President's request for 1999 emergency spending for the Kosovo conflict with the results of the House Appropriations Committee mark-up of the same legislation.

House Appropriations Committee Emergency Supplemental
($ in millions)

	President's Request	HAC Action	Delta
DoD			
Military Personnel	16.5	16.5	---
Operations & Maintenance			
Overseas Contingency Ops	4,591.6	3,907.3	-684.3
Contingent Emergencies	850.0	1,311.8	+461.8
Procurement			
Weapons, Aircraft, Missiles	--	684.3	+684.3
Operational Rapid Response	--	400.0	+400.0
Total	--	1,084.3	+1,084.3
General Provisions			
Transfer Authority	(800.0)	(800.0)	--
Spare Parts	--	1,339.2	+1,339.2
Depot Maintenance	--	927.3	+927.3
Recruiting	--	156.4	+156.4
Readiness Training	--	307.3	+307.3
Base Operations	--	351.5	+351.5
Redux Pension Reform Repeal	--	796.0	+796.0
Pay Table Reform	--	196.0	+196.0
4.4 % Pay Raise	--	846.0	+846.0
Subtotal Raises & Retirement	--	1,838.4	+1,838.4
Subtotal	--	4,920.1	+4,920.1
Military Construction			
Europe & Southwest Asia	--	1071.0	+1,071.0
Total DoD	5,458.1	12,311.0	+6,852.9
State Department			
Diplomatic- Consular programs	17.1	17.1	--
Other	2.9	2.9	--
Embassy Security	5.0	5.0	--
(Contingent Emergency)	--	45.5	+45.5
Migration - Refugee Assistance	125.0	0	-125.0
(Contingent Emergency)	--	195.0	+195.0
Refugee & Migrations Asst	95.0	95.0	--
Subtotal	245.0	360.4	+115.5
Peace Corps & USIA			
Transfers	-1.0	-1.0	--
AID			
International Disaster Asst.	71.0	0	-71.0
(Contingent Emergency)	--	96.0	+96.5
Economic Support Fund	105.0	105.0	--
Assistance for Eastern Europe	170.0	75.0	-95.0
Subtotal	346.0	276.0	-70.0
Total State Department	591	636.5	+45.5
Grand Total	6,049.1	12,947.5	+6,898.4
Emergency	5,199.1	4,908.1	-291.0
Contingent Emergency	850.0	8,039.4	+7,189.4
Transfer Authority	801.0	801.0	--

- There are some important points to make about the decisions the House Appropriations Committee made.

- First, major additions are made for spare parts ($1.3 billion), depot maintenance for aging aircraft and weapons ($927 million), recruiting ($156 million), training ($307 million), base operations ($351 million), and a Rapid Response Contingency Account for quick weapon upgrades ($400 million) . Some will argue that this $3.4 billion added to the $5.4 billion requested by the President is a "larding on" of unnecessary and excessive defense spending.

- The *Bulletin* has heard reports of War Reserve stocks of spare parts and munitions being thoroughly depleted due to previous operations over Iraq and Bosnia, of aircraft "cannibalization" to find spare parts being at new highs, and of experienced pilots and maintenance personnel becoming rare commodities among the forces left in the US. Also a consideration is the 40-year old B-52s, 20 year old A-10s, and 15 year old F-16s that have been dodging Serb surface to air missiles for the past five weeks.

- The Committee added $1.1 billion for military construction. This money is actually for projects in Europe and Southwest Asia. Members of the Committee are reported to be distressed with the condition of facilities abroad. Additionally facilities, especially family housing and barracks, in the US also need repair and replacement. Some of these European projects were not high on the Defense Department's own priority lists.

- The Committee also added $1.8 billion for a 4.4% DoD-wide pay raise, repeal of the 1986 military pension reform (known as "REDUX"), and what DoD calls "Pay Table Reform" (higher pay for personnel getting faster promotions). These provisions are basically what the President requested in his FY 2000 budget.

- Three questions about these pay and pension provisions. First, why "emergency?" The bill specifies that the funds need not be made available until September 30, 2000. Moreover, when the Senate passed relevant legislation, S.4, there was no perceived need for the emergency designation. This pay and pension increase would have no conceivable immediate effect on the conflict in Yugoslavia.

- Second, as the *Bulletin* has pointed out in the past, these pay and pension increases have enormous budgetary implications. CBO has scored the President's pay and pension increases, as costing $24.1 billion over 10 years, and the costs grow dramatically after that. The $1.8 billion here is just the "camel's nose."

- Third, both CBO and GAO have seriously questioned the need for repealing the 1986 reform Congress enacted for military pensions. CBO has already reported to Congress that, contrary to the protests that REDUX is causing DoD retention problems, REDUX "is not having a discernable, widespread effect on the retention of midcareer personnel."

- Moreover, in a report not yet made available to Congress, GAO will report that there are more powerful issues effecting retention including the lack of needed and support equipment, such as spare parts, and munitions.

A LA CARTE MENU FOR STAYING WITHIN THE CAPS

- During debate on the President's budget and the budget resolution, both the Administration and the bipartisan leadership in the Congress pledged fealty to the discretionary caps set in the 1997 Bipartisan Budget Agreement, even while occasional dissident voices in both camps argued that the caps have to be increased.

- Certainly, the task for appropriators in 2000 is daunting. Putting the best face on it, even if they were to appropriate the exact same amount for every program in 2000 as provided for 1999 (excluding emergencies), appropriators would still exceed the caps by $10 billion and $13 billion for BA and outlays, respectively. And because both caps are binding, this likely means that BA would actually have to be reduced by at least $20 billion to guarantee the outlay cap is not exceeded.

- The budget resolution identified some savings that appropriators could consider to stay within the caps. On April 30, CBO released its nearly perennial publication with a much larger menu of savings options, now retitled as *Maintaining Budgetary Discipline: Spending and Revenue Options*. The *Bulletin* offers a few highlights to whet the appetite of budgeteers:

- Require all GSEs to Register with the SEC. Currently, five government-sponsored enterprises--Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, the Farm Credit System, and Sallie Mae--are exempt from the requirement of registering securities (and paying a related fee) with the SEC. The exemption was initially provided to allow the GSEs to become accepted names in the marketplace, which they certainly are by now. Repealing the exemption would save $259 million in 2000, and $2.1 billion over the next 10 years.

- Impose a Fee on GSE Investment Portfolios. Their charters provide GSEs with benefits that lower their cost of borrowing compared to competitors. Four GSEs--Fannie Mae, Freddie Mac, the Federal Home Loan Bank System, and Farmer Mac, have borrowed low cost funds and then reinvested the amounts in portfolios of debt securities, amounting to nearly $600 billion at the end of 1998. Imposing a fee 10 basis points on such portfolios on GSEs that earn arbitrage profits would save $550 million in 2000 and would reduce their competitive advantage.

- Charge a User Fee on Commodity Futures and Options Contract Transactions. CFTC regulation of commodity markets enhances their efficiency by ensuring their integrity and protecting against fraud. The SEC does the same for securities markets, although there currently is a fee on securities transactions, but not on commodity transactions. A per contract fee to cover the costs only of CFTC regulation would save about $60 million annually when fully implemented.

ANOTHER ITEM ON THE MENU FOR SAVINGS

- The President's budget request includes increases for defense discretionary programs paid for, in part, by savings attributable to lower inflation assumptions. Every year DOD prepares a five-year procurement plan which includes specific assumptions about future prices.

- Lower inflation assumptions change DOD's implied purchase power, allowing DOD to buy more of the same good because its price is expected to be lower or to buy more of a different good from the expected savings .

- Whether or not these savings are real is questionable. The savings from inflation are not realized as the difference between an assumption about inflation and an actual rate of inflation, but as the difference between the assumptions in two plans. If, however, these savings can be regarded as real, then a corresponding savings must exist in non-defense discretionary programs as well.

- By comparing effects of the CBO's inflation assumptions included in the Balanced Budget Agreement of 1997 to the actual rates of inflation and the OMB's current inflation assumptions from the President's Budget, a $17 billion savings between FY 1998-2002 in the non-defense discretionary programs can be calculated.

Non- Defense Inflation Savings
($ in Billions)

	1998	1999	2000	2001	2002
Baseline					
adjusted -BBA assumptions	130.7	134.2	137.8	141.6	145.4
adjusted-actual/current assmpt	128.8	131.4	134.4	137.5	140.6
Savings	1.9	2.9	3.5	4.1	4.8

- Assumptions: The baseline amount is the non-defense discretionary budget authority limitation set in the BBA for FY 1998 less the non-defense salaries and benefits estimated in OMB's object class analysis, deflated for the FY 1998 assumption for the CPI.

- Inflating the baseline amount each year by the CPI assumption in the BBA shows the expected cost of non-defense, non-salary expenses in 1997. Inflating the baseline amount by the actual CPI for FY 1998 and inflated by the OMB's current inflation assumptions from the President's Budget for FY 1999-2002 shows the actual cost of non-defense, non-salary expenses for FY 1998 and the current expectations of such expenses for FY 1999-2002.

- The difference between these two is a savings calculation conceptually consistent with the President's defense discretionary savings.

ECONOMICS

GLOBAL GROWTH OUTLOOK IMPROVES

- At last week's Spring Meetings, the IMF left its forecasts for global growth in 1999 and 2000 essentially unchanged from their December update. Yet, they did state that the downside risks had subsided considerably since last year. They also expect that 2000's growth will be roughly a percentage point faster than 1999's forecasted pace.

- Some private economists have been even more upbeat and have confidently declared that the global financial crisis is over. While this declaration may be somewhat premature, it is clear that the global financial markets share this optimism.

- Since January 1, Latin American stock markets have risen 25 percent in dollar terms while Asia/Pacific markets are up 19 percent. In contrast, the US stock market's 9 percent gains looks somewhat lackluster.

- In its latest update, the Institute of International Finance predicts that there will be a increase in private portfolio equity flows to emerging markets this year. However, they expect that overall private capital flows (including loans from banks and nonbank creditors) to these nations will stabilize at last year's levels. These aggregate numbers gloss over regional differences, however -- flows to Asia/Pacific are expected to pick-up, while flows to Latin America may ease further.

Private Financial Flows to Emerging Market Economies
($ Billions)

	1995	1996	1997	1998(e)	1999(f)
Overall private flows	**229**	**328**	**263**	**143**	**141**
Latin America	45	104	106	85	66
Europe	41	48	69	42	36
Africa/Middle East	8	6	16	8	10
Asia/Pacific	135	170	71	8	29

Source: Institute of International Finance, April 1999

- A stabilization in the global growth outlook is very good news — standards of living will begin to recover in many emerging nations and the threat of a sustained global financial market collapse will fade away. However, in a perverse sense, this global recovery may also carry risks for the US economy.

- As commodity prices rise (in reflection of higher global demand) and as investors start to shift their funds from safe havens assets back into emerging markets, there is likely to be upward pressure on US interest rates. Since low interest rates have been the major driver of recent growth, a future backup could be the catalyst for the elusive slowdown in US growth that nearly all economists have been forecasting unsuccessfully for the last few years.