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THE 1975 BUDGET: AN ADVANCE LOOK

A STAFF STUDY

PREPARED FOR THE USE OF THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

DECEMBER 27, 1973

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LETTERS OF TRANSMITTAL

DECEMBER 21, 1973.

To the Members of the Joint Economic Committee:

Transmitted herewith for the use of the Members of the Joint Economic Committee and other Members of Congress is a study entitled "The 1975 Budget: An Advance Look." The study has been prepared by members of the staff of the Joint Economic Committee and the Congressional Research Service of the Library of Congress, with the assistance of the staff of the Joint Committee on Internal Revenue Taxation.

The study is analytic in nature and while it identifies certain policy options with respect to the 1975 budget, it makes no policy recommendations. Nothing in the study should be interpreted as representing the views or recommendations of the Joint Economic Committee or any of its individual Members.

WRIGHT PATMAN,
Chairman, Joint Economic Committee.

DECEMBER 20, 1973.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee, Congress of the United States, Washington, D.C.

DEAR MR. CHAIRMAN:

Transmitted herewith is a study entitled "The 1975 Budget: An Advance Look." The study has been prepared by Richard Kaufman, Douglas Lee, and Courtenay Slater of the Joint Economic Committee staff and Nancy Teeters of the Congressional Research Service, Library of Congress, with the assistance of many other staff personnel. Revenue estimates were prepared at the Subcommittee's request by the staff of the Joint Committee on Internal Revenue Taxation, based on economic assumptions supplied by the staff of the Joint Economic Committee.

"The 1975 Budget: An Advance Look" was undertaken in order that the Members of the Joint Economic Committee and other Members of Congress might have readily available such information as it is possible to assemble from public sources regarding the possible shape of the 1975 budget. Only by making full use of all such information and by beginning analytic work on the budget considerably earlier than has been the case in the past can Congress hope to reassert its proper role in the budget-making process. This study is intended as a modest first step toward that objective.

It should be emphasized that the staff has prepared a "baseline" projection of 1975 expenditures. Essentially this is an estimate of what expenditures would be if existing programs were allowed to grow at rates predetermined by legislation already enacted and by current and anticipated economic conditions. It is in no sense a recommendation of what the expenditure total *should* be or of the allocations that should be made within that total. Later chapters of the study outline various feasible alternatives for modifying the baseline budget by program cuts, tax changes, and new program initiatives. Again, these are emphatically not recommendations, but rather a presentation of possibilities intended to assist the Members of Congress in arriving at their own judgments. Nothing in this study should be interpreted as representing the views or recommendations of the Joint Economic Committee or any of its Members.

I believe that this study will, in itself, be of substantial assistance to Members of Congress and, even more important, may serve as an impetus toward the far more extensive forward budget planning which Congress must equip itself to do. I would like to express my own appreciation to the Committee staff and to the Congressional Research Service personnel who have taken the initiative in preparing this study.

WILLIAM PROXMIRE,
Chairman, Subcommittee on Priorities and Economy in Government.

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I. BASELINE PROJECTIONS AS A BUDGETARY TOOL FOR CONGRESS

This study grows out of the work of the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee which has conducted hearings on the subject of national priorities during each of the past 5 years.[1] When Senator William Proxmire, Chairman of the Subcommittee, opened the hearings on "National Priorities and the Budgetary Process" on April 25, 1973, he pointed out how important it was for Congress to focus attention on *next year's* budget. Senator Proxmire said:

> If Congress is to have any real influence on what goes into next year's budget, it is essential that we start now.
>
> In the past, we have been presented with an accomplished fact. The President's budget is put together entirely in secret without any public review or public contribution. It becomes the priorities document and ends up with only minor changes at the end of the process.

Fortunately, during the current session Congress has given much thought and attention to the need to exert more control over spending priorities. Proposals to strengthen the budgetary role of Congress are now well along in the legislative process. It appears that enactment of significant changes can be anticipated in the near future.

The present study is intended as a contribution, however modest, to the goal of a larger, more informed congressional role in the budgetary process. A major purpose of the study is to demonstrate how spending levels in the current year influence spending levels in the following year. Many persons recognize that changes in government spending tend to be incremental from year to year rather than drastic. Although there are exceptions, such as defense outlays during a wartime buildup and other emergency programs, in general the great bulk of expenditures grow or shrink within predictable ranges determined by past legislation or in response to economic events such as inflation. What is not perhaps well understood is the degree to which Congress may or may not be locked into future spending by today's actions.

The figures we present must be used with some care. They do not represent a prediction of what the Federal Government will spend next year. They are in no sense proposals for what should be spent or a "counter-budget." They are baseline projections of what will be

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[1] "The Military Budget and National Economic Priorities," hearings, pts. 1, 2, and 3, June 1969; "Changing National Priorities," hearings, pts. 1 and 2, July 1970; "The Economics of National Priorities," hearings, pts. 1 and 2, June 1971; "National Priorities—The Next Five Years," hearings, May and June 1972; and "National Priorities and the Budgetary Process," hearings, April 1973.

spent for existing programs next year based on our estimates of what will be spent during the current fiscal year and assuming economic conditions typical of what many forecasters are presently predicting.

It is important to note the margin for error built into this approach. Fiscal year 1974 is only one-half over. Decisions could still be taken to alter present spending rates. A worsened energy crisis or a major natural disaster, to name only two possibilities, could accelerate spending programs. A sharp change in economic conditions could also result in an unanticipated speedup or slowdown of government outlays and receipts. Our estimates are based entirely on publicly available information regarding changes in the budget picture. We have no means of incorporating other possible changes in outlays which may be underway or contemplated by the Administration.

In addition, the baseline projections do not take into account future policy changes or new program initiatives. The baseline is the totality of existing government programs and activities. In making the projections we are simply showing what the programs now on the books, and none other, will cost next year. Undoubtedly there will be new initiatives and when these are made known or adopted the projections will have to be changed.

It is important to make the attempt to look ahead as realistically and as objectively as possible, for the reasons already cited. If unexpected events take place, if economic conditions change, and when new policy initiatives become known the baseline projections can be modified accordingly. The price of being totally absorbed in current problems is that the future comes as a total surprise.

It must be recognized that decisions reached by Congress during consideration of a particular year's budget can have only limited impact on spending in that year. Recent national priorities, insofar as they are influenced by the Federal Government, were largely determined a year or more ago by decisions incorporated into earlier budgets. It stands to reason that Congress should spend considerable time on future planning as it is in a much better position to influence future budgets and future priorities than current ones.

Concern over the long-term consequences of budgetary decisions is neither new nor recent. Public Law 84–801, enacted in 1956, requires that whenever a Federal agency recommends a new or expanded activity costing in excess of $1 million annually, the recommendation shall include a 5-year estimate of expenditures. This law has largely been ignored by both Congress and the Executive, although it is still on the books.

In 1963 a Subcommittee of the Joint Economic Committee held hearings on "The Federal Budget as an Economic Document." In its report the Subcommittee recommended that "The budget for each year should be presented in the context of a broader, longer run set of budgetary projections. These projections should probably cover at least a five-year period." [2] The Committee found that in almost all decisions that have a budgetary dimension, Congress must be concerned about the longrun implications, that it would seem virtually impossible for Congress to make the most rational decisions without forecasts.

[2] "The Federal Budget as an Economic Document," hearings before the Subcommittee on Economic Statistics, Apr. 23, 24, 25, and 30, 1963, and report, Aug. 14, 1963.

In 1965 the Planning-Programming-Budgeting (PPB) systems of the Department of Defense were adopted for the Government as a whole. The Bureau of the Budget's PPB revised guidelines required most agencies to prepare 5-year projections of program budgets. Beginning with the 1971 budget, 5-year projections of total outlays have been included in the President's budget. However, the executive branch has withheld from Congress the 5-year projections of existing program budgets on the grounds that they were only estimates which did not reflect official policy. The Subcommittee on Economy in Government in a 1970 report following an investigation of ways to improve budgetary procedures called attention to the withholding of these projections and the need for a more forward-looking budget document.

The Subcommittee was critical of the Budget Bureau's reluctance to open up to public scrutiny agency and program budgetary information other than what is directly related to either the annual budget proposal or past year's expenditures. "Budgetary information," the Committee concluded, "in the current budget document is backward looking." This form of presentation tended to emphasize the question of whether funds for a given agency or function were being increased or decreased from the prior year. While this question is important, unduly emphasizing it diverted attention from the problem of the future expenditure consequences of policy decisions made or about to be made. The report urged that 5-year projections be prepared for all major programs and submitted to Congress.[3]

Later that year Congress passed the Legislative Reorganization Act of 1970 (Public Law 91–510), requiring among other things that the budget transmitted annually to Congress include 5-year cost estimates for each proposal which would "create or expand any function, activity or authority." The same act also requires the President to transmit by June 1 of each year 5-year cost estimates for continuing programs which are mandatory under existing law or to which there is a legal commitment for future years.

As required by this law, the Office of Management and Budget has provided 5-year estimates for total revenues and expenditures and detailed 5-year projections for proposals which would require new or additional legislation. Thus, the 1974 budget, for example, provides 5-year cost projections for about 30 new and expanded programs. A summary estimate of the 5-year cost of social insurance trust funds and other "open-ended programs and fixed costs" is also provided each June 1, but this is not broken down by program. Thus, no program-by-program projection of future costs is available for the bulk of the budgetary requests, which are to fund existing programs and activities.

A footnote to the table in the budget showing 5-year projections for new and expanded programs states that for most programs the estimates represent simple projections of cost expressed in constant dollars, that they are not intended to predict future economic conditions and that they do not represent a commitment as to amounts to be included in future budgets. The effect of future price increases is included only when automatic adjustments for the increase in the cost of living has been legislated for a program. The limited usefulness of these projections is illustrated by the figures for the Department of

[3] "Economic Analysis and the Efficiency of Government," report of the Subcommittee on Economy in Government, Feb. 9, 1970.

Defense. Total DOD outlays are estimated in the budget at $79 billion for fiscal year 1974. Of the total DOD program, 5-year projections are made only for those activities requiring new legislation; that is, for a revised special pay structure for the uniformed services (as part of the All Volunteer Armed Force program) and improved retention incentives and other reforms to the military retirement system. Outlays for the two programs are estimated at $510 million for fiscal year 1974 and somewhat larger amounts for the next 4 years. A more complete projection would cover the entire DOD budget and show the cost consequences of current activities for each of the 5 years. A truly useful 5-year projection would do the same for total Federal spending broken down by agencies, major programs, and activities.

Estimates of future defense spending are particularly important because defense represents by far the largest share of expenditures which can be classified as relatively controllable; that is, those expenditures which it may be feasible to modify relatively quickly. Little more than one-quarter of the fiscal year 1974 budget was classified as "relatively controllable" at the time it was presented last January. The bulk of the remaining, "relatively uncontrollable," expenditures consists of "earned right" programs such as social security, civil service and railroad retirement, military retirement, veterans compensation and pensions, and unemployment benefits. Expenditures for these programs are authorized by existing law and they increase from year to year without new authorizations depending upon the increase in the number of people eligible. General revenue sharing, farm price supports, the postal deficit, and interest on the national debt are also considered uncontrollable as are outlays under contracts made in prior years. Of course, all programs are technically controllable because it is possible for new legislation to be passed changing the basis on which expenditures for these programs are calculated. But to legislate sudden, abrupt changes in these programs would have demoralizing and economically disruptive effects.

Most of the Federal budget is composed of uncontrollables. In the original fiscal 1974 budget submitted last January, $201.8 billion in outlays were identified by the Office of Management and Budget as relatively uncontrollable. Only $75.2 billion were considered relatively controllable and of this amount, $52.3 billion or 70 percent were accounted for by defense. (Athough the total defense budget is larger than $52.3 billion, the portion that goes for defense contracts, military retirement and pay raises is defined as uncontrollable.)

The need for future estimates of defense spending should be obvious. The amount of funds available for the entire range of controllable civilian programs and activities will depend upon how much is spent for defense. The choices for using funds expected to be available in the future are narrowed further by the requirements of ongoing controllable programs.

The fiscal 1974 budget, for the first time, included a 1-year advance projection of outlays broken down by function and agency. The projections are a step in the right direction. It is hoped that the next budget document will build on this beginning. Still lacking are similar projections for the longer term, the backup data, and an explanation in the budget document of the assumptions that underlie the projections. In some years, the underlying assumptions have been presented in the *Economic Report of the President*.

In order for Congress to be in a position to make reasoned judgments about the appropriate overall size and the composition of the budget, projections should include: Total revenues and outlays; underlying economic assumptions such as real gross national product, inflation and unemployment; pay and price adjustments; and assumptions of caseload and payment level growth for the "earned right" programs.

Our projections for fiscal 1975 include a discussion of underlying economic assumptions. We are fully aware of the limitations and shortcomings of our work. We are offering only 1-year projections. However, this study should be considered an intermediate effort toward the goal of 5-year projections as well as toward the goal of making continuously available to Congress an updated estimate of the current year's budget and that of the 5 years ahead. The Joint Economic Committee, in conjunction with the Congressional Research Service of the Library of Congress and with the assistance of other committees, presently has underway an effort to develop a capability to provide frequent updating of the current budget and its future implications. Future economic conditions can never be precisely known in advance and forecasts will always contain a degree of uncertainty. Nevertheless, we believe our estimates are reasonable and by making the assumptions explicit we are giving the reader the opportunity to evaluate the reasonableness of our conclusions.

The important thing is that Members of Congress begin thinking seriously about next year's major budgetary issues before it is too late. Even a few weeks advance notice of what the critical areas are likely to be next year will represent substantial improvement over past procedures. Members of Congress need to decide for themselves what next year's budgetary problems will be, rather than waiting for official transmittal of the budget document at the end of January. We hope this study will provide Congress with some assistance in their efforts to look ahead.

II. THE CURRENT SHAPE OF THE 1974 BUDGET

Comparing the most recent estimate of total outlays for fiscal year 1974 with last January's original estimates does not show a very dramatic change. Over the year, the estimated outlay total has risen about $3.5 billion. Within this total, however, there have been dramatic changes in the individual components of the budget. These are caused by a combination of legislative decisions made by Congress, administrative decisions made by the Executive, and economic events.

Many of the legislative actions taken by Congress increasing budget outlays have simply offset some of the effects of price increases rather than increased the real level of Federal services. For example, Congress voted to increase food stamp payments in line with increased food costs. This simply maintained the existing real value of the stamps. It did not increase the amount of food recipients could buy. Indeed after adjustment for the unanticipated inflation, the Federal Government on the whole is purchasing a significantly smaller volume of real goods and services and making smaller real transfer payments than was anticipated when the budget was presented last January. Put simply, the fiscal 1974 budget looks somewhat bigger in terms of total dollars being spent, but these dollars are buying considerably less than was expected last January.

Defense spending is a special case. It was originally estimated that the Department of Defense military spending would total $78.2 billion in fiscal 1974. However, this estimate was made prior to the Vietnam cease fire. The estimate included $4.1 billion in outlays for the Vietnam war, but it was widely assumed that substantially less would be spent for the war once the ceasefire went into effect, and that total Department of Defense military spending for fiscal 1974 would be reduced. We estimate potential savings due to the end of U.S. involvement in the Vietnam war at $1.2 billion. Additional potential savings from reductions ordered by Congress in military personnel, procurement, research and development, and operations and maintenance funds requested by the Administration bring the total potential savings to approximately $1.8 billion.

However, the potential savings will not be realized and military outlays for fiscal 1974 are likely to be slightly higher than the amount originally estimated. The explanation for the paradox of the same or higher military outlays in the year immediately following the end of the costly war in Vietnam than during the preceding year appears to lie in higher than expected inflation, especially in the price of fuel, the devaluation of the U.S. dollar, the costs of the aid to Israel program for the war in the Middle East and the costs of the supplemental aid requested for Cambodia.

Table 1 classifies the major changes in the 1974 budget into three groups: Those which primarily have the effect of offsetting or partially offsetting unanticipated inflation or other unexpected economic developments; those which represent changes in the real value of services; and those which are the effect of changes in proprietary and other receipts which are classified for budget accounting purposes as negative outlays. (Thus an *increase* in proprietary receipts is shown as a *decrease* in outlays.)

TABLE 1.—*Major changes in estimated 1974 budget outlays*

	Billions
Original 1974 outlay estimate (January 1973)	$268.7
Changes due primarily to unexpected economic events:	
Interest	2.2
Farm price supports	−1.2
Food stamps	.7
Federal civilian pay raise and retirement	.7
Armed Forces pay raise, retirement, veterans benefits	.8
Social Security [1]	.9
Major changes in real service levels:	
Medicaid benefits	.7
Medicare [2]	.6
Veterans	.8
School lunches	.2
Major changes in proprietary receipts and other negative outlays (increase —):	
Oil leases	−2.9
Stockpile sales	−.8
Bread tax (repeal by Congress)	.4
Financial asset sales	−.9
All other changes, net	1.4
Current 1974 outlay estimate (December 1973)	272.3

[1] Includes estimated cost of legislation passed by the Congress on Dec. 21, 1973.
[2] The Administration recommended a reduction in health services which was not accepted by Congress.

One of the largest single changes in the outlay estimates is an increase of about $2.2 billion in interest on the national debt, reflecting the cost to the Federal Government of higher than expected interest rates.

Unexpectedly high food prices lowered the cost of Federal subsidies to farmers. Because of these high prices, the Government did not need to support the market and even sold stockpiles. In view of the high food prices, the Administration decided to withhold much less land from production than in the past. The combination of these two events has reduced estimated Federal expenditures on farm price support programs by about $1.2 billion.

Certain government receipts such as those from sales of offshore oil leases and commodities from government stockpiles are recorded in the budget as negative outlays. Government receipts from the sale of offshore oil leases are especially difficult to predict accurately and often contain large fluctuations. Receipts from these sales are currently estimated to be $5 billion—almost $3 billion higher than was estimated in January.

This past year the General Services Administration has sold many Government assets held in stockpiles. The estimated receipts from these sales have increased about $800 million over the original estimate. Grants made by the Environmental Protection Agency have been about $400 million more than budgeted.

Several legislative changes had a significant impact on the budget. The farm bill contained amendments which provide for an automatic increase in food stamps when inflation increases the cost of living.

It also repealed the "bread tax"—a receipt which is, for accounting purposes, considered an offset against outlays. These changes together raised outlays $1.1 billion.

In the Department of Health, Education, and Welfare there have been several changes in addition to the social security legislation passed by Congress on December 21, 1973. Administrative changes which were intended to reduce State's support of medicaid did not have this effect, and consequently, the associated savings to the Federal Government did not materialize. Congress also increased certain medicaid benefits. The total impact is to add about $700 million to January's estimated outlays. The Administration's recommendation to shift part of medicare hospital costs to the patient was not accepted by Congress and thus $600 million in proposed savings will not be realized. The social service grant program has increased about $300 million.

Congress has substantially increased various veterans' benefits. Pensions and other benefits have been raised about $300 million. In addition, recommendations by the Administration to reduce burial benefits and pensions which would have saved over $500 million were not adopted by Congress.

Civil service retirement costs have increased because of legislated benefit increases and because of automatic increases which occur as the cost of living rises. The total increase in outlays is about $450 million. Federal civilian pay increases took effect earlier than planned, adding $350 million to fiscal 1974 costs.

The Administration's estimate of financial asset sales has been revised upward by $900 million. This represents additional planned sales of Federal mortgage loan assets. These are recorded in the budget as negative outlays.

Potential changes in social security benefits have been included in this table on the assumption that the legislation passed by Congress on December 21, 1973, will shortly be signed into law. We estimate that this will add an additional $0.8 billion to fiscal 1974 outlays. It must be emphasized that these estimates are preliminary.

Several bills which could add to 1974 outlays have passed one or both houses of Congress, but have not yet been enacted. These include mass transit operating subsidies, Federal employee health insurance, civil service minimum retirement, veterans' drug treatment, and trade adjustment assistance. If all of these were enacted they would add a maximum of $1 to $1.5 billion to 1974 outlays.

The revised estimate of 1974 outlays presented in this section is based on a compilation of information publicly available, primarily from the revised budget estimates presented by the Office of Management and Budget in June, October, and November and from the *Scorekeeping Reports* prepared by the staff of the Joint Committee on the Reduction of Federal Expenditures. In some cases we have used our own best judgment as to the outlay implications of various actions and events. However, we have no access to internal decisions which have been or may be made within the Administration. The Administration has sufficient discretion over the timing of many expenditures that outlays could vary several billion dollars on either side of our estimate purely as a result of administrative actions.

The Director of OMB has recently indicated that he expects 1974 outlays to be around $273 billion, not very different from our estimate. However, the available evidence on actual monthly spending through October suggests that so far outlays are running below this anticipated rate. The cost of the farm price support program appears to have dropped even more sharply than indicated in OMB's published revisions. Spending on the Atomic Energy Commission and on the Federal highway program appear to be running below projected levels. Spending on education is apparently being held strictly to the very small increase projected in the January budget. It thus appears possible that the Administration could hold outlays to the $270 billion estimate contained in the latest official revision.

III. AN EXPENDITURE BASELINE FOR 1975

The figures for 1975 in this study are baseline projections. They are not an attempt to predict the future or to anticipate the official 1975 Budget. Rather, they represent an effort to show how existing programs will change based on current law and projected changes in prices, wages and workloads.

Typically we observe expenditures on Federal programs growing over time. A large part of this is automatic growth which occurs even in the absence of policy changes. As population characteristics change more people may become eligible for Federal benefits. This accounts for much of the increase in social security costs, military and civil service retirement costs, and some public assistance programs. There are also wage increases which must be paid to keep Federal pay levels comparable to those in private industry. A third reason Federal programs tend to grow over time is inflation. Some programs such as civil service and military retirement, food stamps and social security benefits have provisions in the legislation which guarantee that expenditures will increase as prices increase. Programs such as medicare reflect the effects of inflation because they reimburse people for private expenditures. Other programs do not increase automatically, but if the level of goods and services provided is to remain constant, dollar spending must be raised. The decision to maintain the real level of services is not always made by the Federal Government alone. If State governments decide to increase programs where the Federal Government provides matching funds, then Federal expenditures will rise. All of these factors have been considered in our estimates of 1975 expenditures.

The two fundamental assumptions underlying the 1975 baseline projections are (1) maintenance of real levels of spending and (2) full employment. This first assumption is superseded in cases where legislative changes which have already been enacted will become effective during the fiscal year.

In most cases the two basic assumptions can be built into computer models and the projections made with relative ease. In other cases the projected spending is necessarily arbitrary and based on the authors' best judgment. Areas of particular uncertainty are outlined below.

(1) Recent information on the food stamp program indicates that although many people who are eligible for benefits are not being served, the number of new people applying for food stamp benefits is slowing down. Consequently, cost estimates may be too high. However, if unemployment rises as projected, the number of eligible persons will increase and thus the number of new applicants may continue to rise near their previous rates.

(2) Agricultural subsidies are projected to decline sharply based on an assumption of continued high food prices and an assumption

that the Administration will not withhold additional land from production.

(3) The increase in adult welfare benefits is difficult to estimate because the new federalized program does not begin until January 1, 1974. We have assumed that Federal outlays in this program category will rise about $500 million between fiscal 1974 and fiscal 1975.

(4) Receipts from sales of offshore oil leases are very volatile and practically impossible to predict accurately. To a lesser extent this also applies to receipts from stockpile sales. Both are counted in the budget as offsetting receipts; that is, negative outlays. We assume a substantial decline for both types of receipts from the unusually high fiscal 1974 levels.

(5) Although large amounts of grants from the Environmental Protection Agency are impounded at present, we assume that $2 billion will be released in fiscal 1975.

(6) The amount of interest paid on the national debt is sensitive both to economic conditions and to the Treasury's need to enter the financial markets. We assume that interest costs in 1975 will be approximately the same as in 1974, with declining interest rates offsetting any increase in the debt held by the public. Given present inflationary expectations and their inevitable impact on interest rates, our estimate of interest cost is probably near the bottom of the range of likely outcomes.

A look at the 1975 projections shows some very large increases over 1974. The largest single increase in outlays from 1974 to 1975 occurs in social security benefits. We tentatively estimate that the increased benefits contained in the bill passed by Congress on December 21, 1973, will add about $1.4 billion to 1975 outlays. To this we must add the increase that will occur even without the prospective legislation—about $5.6 billion. This yields a total increase in social security benefits from 1974 to 1975 of over $7 billion.

Other projected major increases in the Department of Health, Education, and Welfare include $1 billion in medicare, $800 million in medicaid, almost $1 billion in various welfare programs, and $350 million in aid to education.

Another very large change from 1974 to 1975 occurs in spending for the Department of Defense. We estimate the major changes will be $2.3 billion for military pay and retirement increases, $2.9 billion for price increases, $1.1 billion for aid to Israel and $100 million for aid to Cambodia. Again, it should be kept in mind that we are only projecting the cost consequences of decisions that have already been made. These estimates make no allowance either for new programs which may be proposed or for the savings which might result from program cuts or from increased efficiency in defense procurement.

In the Department of Agriculture, two large changes result from the assumption of continued high food prices: An increase in food stamp benefits of about $700 million, and a decline in price support payments by the Commodity Credit Corporation of about $1 billion.

The Department of Labor's outlays are projected to decrease about

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$750 million. This reflects the difference between an estimated 1974 unemployment compensation cost of $4.9 billion at the actual level of unemployment prevailing in fiscal 1974 and an estimate of unemployment compensation cost of $4.0 billion at a 4 percent unemployment rate in fiscal 1975. This 4 percent unemployment rate assumption is made in order to provide a full employment baseline projection. Increases in unemployment compensation cost caused by an unemployment rate greater than 4 percent are discussed in Section IV.

Two changes mentioned previously are those for the Environmental Protection Agency and the Department of the Interior's oil receipts. We have assumed a $2 billion decline in oil receipts. As mentioned earlier, the General Services Administration's receipts from stockpile sales are assumed to decline about $650 million.

Most of the Government's retirement programs increase automatically when there is significant inflation. We have projected net civil service retirement costs to rise $700 million in fiscal 1975 and veterans' pensions to rise almost $400 million.

These changes are summarized in table 2.

Estimated 1974 outlays and projected baseline 1975 outlays are shown in table 3.

TABLE 2.—*Major outlay changes from 1974 to 1975*

[Fiscal years, billions of dollars]

1974 Budget total	$272.3
Food stamps	.7
Commodity Credit Corporation	–1.0
Social Security [1]	7.0
Medicare	1.0
Medicaid	.8
Welfare	1.0
Education	.3
Oil receipts (decline) [2]	2.0
EPA grants	2.0
Stockpile sales (decline) [2]	.7
Retirement costs	1.1
National defense	6.4
Other	2.4
1975 Budget total	296.7

[1] Includes the 1975 effect of legislation passed by the Congress on December 21, 1973, which is estimated at $1.4 billion.

[2] For budget accounting purposes, declines in proprietary receipts from sales of offshore oil leases and stockpiled materials are treated as increases in outlays.

TABLE 3.—REVISED 1974 OUTLAYS AND PROJECTED BASELINE 1975 OUTLAYS

[Fiscal years, billions of dollars]

Department or other unit	Original, 1974 [1]	Revised, 1974 [1]	Estimated, 1975 [1]
Legislative branch	0.6	0.6	0.7
The Judiciary	.2	.2	.2
Executive Office of the President	.1	.1	.1
Funds appropriated to the President	3.9	3.9	3.9
Agriculture	9.6	10.0	10.1
Commerce	1.4	1.6	1.7
Defense, Military	78.2	79.6	86.0
Defense, Civil	1.6	1.6	1.7
Health, Education, and Welfare	93.8	96.7	107.2
Housing and Urban Development	4.8	4.8	5.1
Interior	2.7	2.9	3.0
Justice	1.7	1.8	1.8
Labor	8.1	8.0	7.3
State	.7	.7	.7
Transportation	8.1	8.3	8.6
Treasury [2]	26.6	29.0	28.9
Atomic Energy Commission	2.4	2.4	2.5
Environmental Protection Agency	2.1	2.5	4.5
General Services Administration	.9	1.0	1.0
National Aeronautical and Space Administration	3.1	3.2	3.3
Veterans	11.7	12.9	13.4
Other agencies [3]	7.6	[4] 7.2	7.9
Allowance for contingencies	1.8	.2	1.0
Total	271.7	279.2	300.7
Major offsetting receipts:			
Offshore oil leases	−2.7	−5.6	−3.5
Stockpile sales	−.4	−1.2	−.6
Total	268.7	272.3	296.7

[1] Individual items may not add to totals due to rounding error.
[2] Net of interest received by trust funds.
[3] Net of civil service retirement transfers.
[4] Changes include −$900 million in loan sales, +$100 million for receipts from Export-Import Bank, and +$150 million for transfer of post office retirement funds.

IV. BUDGET RECEIPTS AND THE ECONOMIC IMPACT OF THE 1975 BUDGET

The Full Employment Budget in 1975.—Although there is no realistic prospect that the U.S. economy will approach full employment during the next year, it is helpful for analytic purposes to look first at the budget as it would be at full employment. Comparing the changes in the budget surplus or deficit from year-to-year on the basis of the budget as it would look at some constant rate of economic growth is helpful in analyzing whether the impact of the budget on the economy is becoming more restrictive or more expansive. The assumption underlying our full employment analysis is the conventional one of an economy in which output grows at a constant rate sufficient to keep the unemployment rate steady at 4 percent.

In fiscal year 1975 full employment receipts on a unified budget basis are estimated at about $310 billion.[1] Thus if expenditures were held to the baseline of about $297 billion, there would be a full employment surplus of about $13 billion. This would be somewhat larger than the expected $8–$9 billion fiscal 1974 full employment surplus, which in turn represents a significantly more restrictive budget than in either 1972 or 1973, when the full employment budget was in slight deficit each year. At the time most decisions on the fiscal 1974 budget were being made, a move toward budget restraint seemed appropriate, as the economy was experiencing extremely rapid rates of real output growth late in calendar 1972 and early this year, and the rate of inflation was also high.

Although the rate of inflation has remained high in recent months, the major causes of this inflation—first the rapid increase in food prices and more recently the sharp increase in petroleum prices—have been and can be influenced little, if at all, by budgetary policy. During the course of calendar 1973 the rate of growth of real output has dropped sharply, and a further drop appears in prospect. The traditional prescription for such a situation would be a move toward a less restrictive fiscal policy. In the current situation in which part of the drop in output growth will be occasioned by supply shortages—primarily of fuels—this traditional prescription must be re-examined in the light of these special circumstances. However, an economic slowdown stemming from a slower growth of aggregate demand was widely anticipated and, indeed, was already under way before the Arab embargo made the fuel shortage suddenly such an important economic problem. To the extent that the anticipated slowdown stems from inadequate demand, a switch to a more expansive fiscal policy, together

[1] Estimates of full employment revenues are sensitive to the rate of inflation assumed in the projection. An inflation rate either greater or less than has been used in our projection could produce substantial variation in the revenue estimate.

with an appropriately accommodative monetary policy, is an entirely appropriate and valuable policy option. Certainly an *increasing* full employment surplus in fiscal 1975 would appear undesirable if economic conditions develop as anticipated.

Our estimate of an approximate $13 billion full employment surplus is derived from a projection of *baseline* expenditures. What this estimate shows is not that there will actually be a surplus of this amount, but that there is a $13 billion margin in the budget to raise expenditures above the baseline estimate without exceeding full employment receipts. As we discuss in Section V, this margin can be enlarged both by cuts in existing programs and by revenue-raising changes in the tax system.

Although the $13 billion margin between full employment receipts and baseline expenditures appears large, it is less than 5 percent of the total budget, and less than 1 percent of the gross national product. If it is used to finance major new programs whose costs grow rapidly over time, it will lead to baseline budgets in future years in which outlays exceed full employment receipts. A deficit in the full employment budget may be desirable under recessionary conditions, but an ongoing situation in which expenditures continually threatened to outrun receipts even under conditions of full employment would present serious fiscal problems.

This suggests that, in light of the anticipated rise in unemployment, expenditures on temporary programs with high job content would in many ways represent a desirable use of the budget margin. Because of the difficult problem created by a combination of supply shortages and slackening demand, the type of Federal expenditure as well as the total amount assumes particular importance. Any inflationary consequences of additional spending would be minimized by directing funds into programs which will create the maximum number of jobs relative to the demands placed on fuels or other commodities in short supply. Among the programs which might be considered are public service employment, improved unemployment compensation, counter-cyclical aid to State and local governments, and investments in the immediate improvement of the public transportation system. These are discussed in more detail in later sections of this study.[2] Several of these have been recommended by the Joint Economic Committee in the past as desirable anti-recession measures. If major permanent new programs are undertaken in fiscal 1975, their future costs should be carefully examined to determine the need to match expenditures with new sources of revenue or cuts in existing programs.

Actual Receipts in 1975.—At our request, the staff of the Joint Committee on Internal Revenue Taxation has prepared estimates of actual budget receipts in fiscal 1975 as they would be under an assumed set of economic conditions. The principal economic assumptions are shown below.[3]

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[2] For convenience, we have discussed these programs in Section VII in the context of possible uses of an increased gasoline excise tax. However, the merits of these spending programs as counter-cyclical measures are not dependent on the enactment of new taxes.

[3] These assumptions are taken from the Data Resources, Inc., forecast entitled "Pessimistic Alternative," Nov. 19, 1973.

TABLE 4.—*Economic assumptions underlying receipt estimates for fiscal 1975*

	Calendar Year 1975
Gross national product	$1374 billion
Personal income	$1121 billion
Corporate profits before tax	$112 billion
Unemployment rate	5.9 percent
Real gross national product growth rate	0.2 percent
Rate of change in gross national product deflator	6.6 percent

These assumptions are somewhat more pessimistic than those which apparently lie behind the unemployment estimates recently presented by the Chairman of the Council of Economic Advisers, and it is toward the pessimistic end of the range of forecasts presently being presented by private forecasters. Nonetheless, it is well within that range. For comparison purposes our discussion of revenue estimates also contains an estimate of what receipts would be under slightly more favorable economic conditions—conditions quite similar to those which we judge to be contained in the Council of Economic Advisers present forecast. All the revenue estimates are based on the existing tax system. The possible impact of any new energy-related taxes is discussed in a separate section.[4]

Given the economic assumptions described at the beginning of this section, unified budget receipts are estimated at $282 billion in fiscal 1975. Expenditures, too, will be effected by the deviation from full employment. Expenditures on unemployment compensation would rise by about $5 billion. Expenditures on Social Security would also rise as more people chose early retirement, and there would be increased outlays on such poverty-related transfer programs as welfare and food stamps. These expenditure changes are difficult to predict with any precision. But just the fall-off in receipts and the increase in unemployment compensation would shift the baseline budget from the $13 billion surplus that would have been realized at full employment to an actual deficit of about $20 billion, and because of the other expenditure effects which we do not attempt to estimate, this figure must be regarded as an under-estimate of the actual deficit resulting from an economic slowdown of the assumed magnitude.

Should the economic slowdown be less severe than our assumptions imply, the budget deficit would, of course, be smaller. Using an alternative assumption of a 1974 gross national product of $1390 billion and an unemployment rate of 5.5 percent, the staff of the Joint Committee on Internal Revenue Taxation estimates receipts of $287 billion. Expenditures on unemployment compensation would rise about $4 billion above the full employment estimate. The baseline deficit would be about $14 billion.

Similar reasoning would apply to situations in which unemployment rose even higher than the assumptions we have used. The Federal deficit is extremely sensitive to the rate of unemployment. Unemployment rates higher than those assumed here would produce rapidly increasing deficits.

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[4] The social security measures passed by Congress on Dec. 21, 1973, would add an estimated $800 million to the receipts estimates presented in this section.

Under any assumption which seems reasonable regarding the year ahead, an economy in or near recession is in prospect. As discussed above, the baseline budget, even though it will be in actual deficit by a significant amount, will have a growing full employment surplus and thus represents a highly restrictive fiscal policy at a time of recession. Increased expenditures of a counter-cyclical nature would seem appropriate.

V. TAX CHANGES AND PROGRAM CUTS AS SOURCES OF ADDITIONAL FUNDS

Tax Changes.—Past studies made for this Committee have indicated that many tax subsidies and privileges do not make a positive contribution to our economy.[1] Reforming the tax system could both raise revenues and improve overall equity. Table 5 lists some of the tax subsidies we consider to be prime candidates for reform. As shown in this table, a tax reform package if enacted promptly and made applicable to calendar 1974 liabilities could raise around $10 billion. The estimates in table 5 assume complete elimination of all the listed tax expenditures except the capital gains provision. Lesser but still substantial amounts of revenue could be obtained through less sweeping modification of these provisions.

The revenue potential of several changes has not been estimated for lack of information. Re-examination of the arrangements by which oil companies pay royalties to foreign governments in the form of tax payments and thereby receive U.S. tax credits would seem especially timely since this tax provision encourages foreign as opposed to domestic investment. Revenues would also be increased if the tax base for the minimum income tax were expanded, the $30,000 exemption reduced, and the deduction for taxes paid on regular income eliminated. Combining the estate and gift taxes and fully taxing capital gains transferred at death represent other revenue raising tax reforms.

TABLE 5.—SELECTED TAX SUBSIDIES

[In millions of dollars]

Calendar year	1972 (actual)	1974 (estimated) [1]
Exclusion of benefits and allowances to Armed Forces personnel	700	784
Deferral of income of domestic international sales corporations (DISC)	100	112
Depreciation on buildings (other than rental housing) in excess of straight line	500	560
Asset depreciation range	860	963
Dividend exclusion	300	336
Capital gains [2]	3,700	4,144
Bad debt reserves of financial institutions in excess of actual	400	448
Depreciation of rental housing in excess of straight line	600	672
Sick pay exclusions	225	252
Exclusion of unemployment benefits	700	784
Exclusion of workman's compensation benefits	375	420
Exclusion of veterans' benefits	480	538
Total	8,940	10,013

[1] Each of the subsidies is assumed to have grown by 6 percent a year.
[2] Only ½ of the revenue loss due to the capital gains provisions as assumed to be recaptured.

The selection of items for a tax reform proposal, like the selection of items for expenditure reduction, varies from one person to another.

[1] "The Economics of Federal Subsidy Programs: A Compendium of Papers Submitted to the Joint Economic Committee, Part 3—Tax Subsidies," Government Printing Office, Washington, D.C., July 15, 1972.

The basic list from which the items in table 5 were taken is contained in "Estimates of Federal Tax Expenditures." [2] The complete tax expenditure table from this document is reprinted as an Appendix to this study, as an aid to the user in developing alternative tax change "packages."

Defense Spending Cuts.—Each year defense requests are transmitted with the assurance that they represent the minimum amounts necessary to defend U.S. interests and commitments and to support the strategies required for meeting the major threats to our security. Such assurances are regularly given despite evidence of widespread waste and mismanagement of defense resources and indications that overall national security has been weakened by excessive defense spending.

A wide variety of alternative force structures based on varying assumptions concerning potential enemy threats, foreign commitments and military requirements to meet our commitments could be considered. For example, strategic nuclear offensive forces are now composed of long-range bombers, land-based intercontinental ballistic missiles and submarine launched ballistic missiles. Moving from a 3-pronged nuclear force to a 2-pronged nuclear force by phasing out the land-based missiles, as urged by some experts, would produce substantial savings.

It is also possible to achieve substantial savings while retaining the current assumptions about U.S. interests and present capabilities to defend those interests. Slowing down the pace of modernization of strategic forces and reducing military manpower by 100,000 and civilian manpower by a similar number could reduce outlays in fiscal 1975 by approximately $3 billion.

It is important to note that long-range planning requirements are particularly critical in the area of national defense. The cost consequences of defense policy decisions are almost always much greater in the long-term than during the year that decisions are made. A more deliberate modernization pace for strategic forces combined with modest manpower reductions could save as much as $10 billion annually by 1979.

Civilian Program Cuts.—There are areas in the civilian programs where outlays could be reduced. As with tax reform, there is little general agreement on which expenditure programs to reduce. If there were, they would no longer be in the budget.

One such area is the highway program. It would not be unreasonable to reduce Federal outlays for the interstate highways, especially now that reduced use of highways is likely to occur because of the shortages of gasoline.

Water pollution control expenditures could probably be slowed down, although many people feel they have been too slow in getting started already. However, somewhat slower and better planned development of water pollution control systems might be less costly in the long run and more efficient to operate. The 1972 Water Pollution

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[2] Committee on Ways and Means, prepared by the staffs of the Treasury Department and Joint Committee on Internal Revenue Taxation, June 1, 1973, JEC-20-73.

Control Act required comprehensive planning for water pollution control. The program could probably benefit from completion of at least the broad outlines of such plans.

Maritime subsidies aid the U.S. shipbuilding industry and help reduce operating costs on vessels under U.S. registry. Reduction in the construction subsidy would require more time than reduction in the operating subsidy because of continuing outlays on contracts made in prior years. However, new contracts for additional ships could be stopped and the operating subsidy eliminated.

Impacted school aid was established during World War II to aid school districts that unexpectedly acquired Federal installations, like a military base. It has now been 28 years since the end of World War II. The increased Federal employment has essentially stabilized and the military bases that were retained have been fully assimilated into the local economy, with a consequent increase in property values and local incomes. There is little reason to continue an emergency wartime measure at the present time.

Law enforcement grants to State and local governments have grown rapidly in the past 5 years from $28 million in fiscal 1969 to $624 million in fiscal 1973. An additional $173 million was proposed to start a revenue sharing program for law enforcement. Considering the rapid growth in the program, this level of funding may not be needed at this time. Slower expansion could result in more rational use of the funds in the long run.

Table 6 shows the savings which could be realized if these cuts were made in their entirety. We make no recommendations one way or the other as to the merits of these cuts. Our purpose is simply to identify some areas in which it would be technically feasible to achieve budget savings within the time frame we are discussing.

TABLE 6.—*Sources of funds in the Federal budget fiscal year 1975*

	Billions
Tax reform (one alternative)	$10.3
Defense reductions	3.0
Highway reduction	2.0
Water pollution slowdown	2.0
Maritime subsidies	.4
Impacted school aid	.6
Law enforcement revenue sharing	.2
Total	18.5

VI. NEW PROGRAM INITIATIVES

In this section we attempt to present a brief factual description of new programs which are likely to be seriously considered for inclusion in the 1975 budget. Our purpose is simply to highlight what appear to be the important choices which Congress will be asked to make next year among expenditure priorities. Our hope is that this listing will be of aid to Congress in making decisions on individual programs within a context of the overall budget picture.

National Health Insurance.—The Administration has promised for some time to propose a new health insurance program. Judging from the advance press reports, such a proposal will be contained in the 1975 budget. The proposal will apparently require employers to offer minimum health insurance to all employees and to pay a substantial portion of the costs. The Government would subsidize coverage for the unemployed or those too poor or too ill to qualify for private insurance. Such a program might cost $3–$4 billion more than present outlays.

In addition to the Administration's proposal, several alternative plans may be considered by Congress. These cover a wide range from comprehensive plans which could eliminate the need for private insurance to more modest proposals to insure against catastrophic illness. As the scope of these proposals changes, so too does their costs.

In conjunction with new health plans Congress might also consider the provisions in the tax law relating to medical costs. In 1970 the Federal income tax subsidy for medical care was estimated at $3.8 billion.[1] With the enactment of a new health insurance program, the need for many of those medical deductions may be removed and can thereby offset part of the cost of the new program.

Welfare Reform.—Congress may consider a thorough reform of our varied and overlapping welfare programs next year. Several plans are under consideration, but one feature they share is a replacement of the personal exemptions on personal income tax returns with a tax credit. This would make the tax structure more progressive and could be used to refund money to the poor who pay no income tax.

One plan being considered would provide a relatively large negative tax credit and would cost in the neighborhood of $15 billion. The basic aim would be to assure a family of four a minimum income of between $2,500 and $3,000. A credit of this magnitude would replace the major welfare programs such as most of AFDC, the Food Stamp Program and General Assistance.

An alternative approach would combine a smaller tax credit with wage subsidies and a public employment program. Wage subsidies

[1] Bridger M. Mitchell and Ronald J. Vogel, "Health and Taxes: An Assessment of the Medical Deduction" (1973, processed), pp. 21 and 31.

would be paid to those earning between $1.60 and $2.60 an hour and would equal approximately half the difference between the actual wage and a $2.60 ceiling. A public employment program would cover those unable to get jobs in the private sector. These jobs would probably pay less than the Emergency Employment Program of 1971, but would employ a significantly larger number of people.

One related proposal, though not strictly a reform of welfare programs, is the Work Bonus Plan approved by the Senate Finance Committee. This would add about $1 billion to the budget in its first year. It would provide a bonus of 10 percent to those earnings up to $4,000. Above $4,000 earnings would be taxed at a 25 percent rate so that the bonus would disappear at $5,600.

Federal Housing Assistance.—Past efforts of the Federal Government to assist people in obtaining adequate housing have been concentrated in two areas: (1) Tax benefits which have tended to reduce housing costs for middle and upper income groups; (2) direct subsidies to housing suppliers for construction and maintenance costs which have reduced the cost of housing to lower income groups. The latter subsidies—those for low income groups—are currently undergoing some significant changes.

Early this year, the Administration announced a moratorium on the approval of subsidized housing starts. Since that time there has been considerable debate about the proper form of housing subsidies. The Administration concluded that our current housing programs were a failure and should be radically changed. This ostensibly was the reason for the moratorium. Congress has not agreed with this judgment. A subcommittee of the Joint Economic Committee concluded, after carefully examining all available evidence, that the primary reason for program failures was the extremely poor management by the Department of Housing and Urban Development.[2]

As an alternative to the housing programs in effect prior to the moratorium, the Administration has discussed expanding a "housing allowance" program. This type of program is usually based on an estimate of the cost of adequate housing and a judgment about the proportion of income which should be spent on housing. As these two basic factors are changed, the cost of this type program changes. Estimates range from small savings to billions more than current costs. The number of people eligible for such a program would also affect costs. Another proposal which could be considered is combining housing assistance with welfare reform.

Hopefully the 1975 Budget will incorporate the Administration's proposals. Until changes in the current programs are agreed upon and made effective, there is a continuing need for the Federal Government to share the cost of providing decent housing for low and moderate income families, if these people are to be spared suffering in a period of transition.

Aid to Education.—When the Administration proposed special education revenue sharing in the 1974 Budget, they did not recom-

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[2] "Housing Subsidies and Housing Policy," a report of the Subcommittee on Priorities and Economy in Government of the Joint Economic Committee, Mar. 5, 1973.

mend a significant change in total spending. However, in the process of "folding in" six categorical grant programs, the Administration in effect proposed the elimination of many smaller programs such as School Library Resources. Rather than adopt the Administration's proposals, Congress chose to continue the six categorical grant programs. Many of the smaller programs the Administration proposed to eliminate were also continued. These programs will undoubtedly be considered again in the context of the 1975 Budget. In surveying potential changes, the Basic Opportunity Grant appears to be the most likely program for a significant increase.

In addition to programs which aid education directly, other programs may be closely related. For example, grants for basic medical research in fact help defray part of the salaries of medical school faculties. Thus a change in research grant aid will change the cost of educating medical personnel. These inter-relationships should be carefully considered before any changes are made.

VII. ENERGY-RELATED TAXES AND EXPENDITURES

Various tax measures designed to reduce consumption of fuels have recently been proposed. Among these are an increased excise tax on gasoline, an excise tax on crude petroleum, a comprehensive tax on all energy sources, and an excise tax on residential use of gas and electricity in excess of some predetermined base amount. While the purpose of such taxes would be to encourage conservation, the revenue effects of such taxes and the consequent fiscal management problems cannot be ignored. In the case of the gasoline tax, receipts could be quite large and could present a particularly difficult fiscal problem.

The possible revenue effects of each of these four types of tax are discussed below, together with possible uses of these receipts. Our revenue estimates are illustrative only. Actual receipts would vary widely according to the particular design of the tax and its effectiveness in reducing consumption. There is simply no way of estimating the latter factor accurately in advance. Any energy-related tax and expenditure package should contain provisions for flexibility in the event that actual receipts turn out to be at substantial variance with anticipated receipts.

Our purpose in presenting this discussion is not to either promote or discourage any particular tax or expenditure, but simply to point out some of the economic and budgetary consequences of various proposals presently being discussed.

The Effect of Increased Gasoline Taxes.—Our analysis of a possible gasoline tax is based on the assumption that direct allocation measures have been or will be taken which will reduce supplies of gasoline to retail outlets by some 25 to 30 percent below the demand which would have prevailed in 1974 in the absence of recent price rises and conservation measures. Allocation of the available gasoline supply can be achieved by price increases, taxes, rationing, or some combination of these three approaches. Unless one or more of these measures is employed to allocate supplies, a disorganized market characterized by long lines at the gas stations, spot shortages, and black markets must be expected.

A considerable increase in the price of gasoline has already taken place in the last three months, but a far larger increase may be necessary to achieve a market equilibrium. A tax of 30 cents per gallon, a widely discussed figure, would achieve most, though not necessarily all, of this further price increase. Such a tax is projected to produce about $17 billion per year in revenue.[1]

An alternative to a large increase in the tax on all gasoline would be to combine a basic rationing system—8 gallons per car per week, for example—with a stiff excise tax on any purchases in excess of the basic allocation. If the tax were set at 50 cents per gallon, this might produce annual revenues of $6 billion.[2]

Since there is no previous experience with an increase in gasoline taxes of this magnitude, a high degree of uncertainty attaches to any revenue estimate. Receipts might at first be higher than estimated and then drop gradually as people had time to adjust their gasoline consumption through purchases of smaller cars, car-pooling, and improvements in public transportation. The time when the economy is likely to be weakest—and hence most in need of fiscal stimulus—is the early part of next year, just the time when receipts from a newly imposed emergency excise tax might be highest. Hence, it is especially important that revenues collected from any such tax be returned promptly to the spending stream. Indeed, use of the revenues should be as nearly as possible simultaneous with their receipt.

Presumably such a large excise tax would be a temporary emergency measure. Hence, to finance permanent new programs from such a tax would be to invite increases in other forms of taxation at a later date. The most appropriate expenditures to be financed through a temporary gasoline tax would be either those directly associated with the fuel shortage and thus likely to be no longer necessary once the shortage abates, or else one-time outlays of a nonrecurring nature. Expenditures should also be of a type which can be started up promptly.

We outline a number of expenditure possibilities below and also a tax refund alternative. While these would be appropriate to finance through a gasoline tax, this is by no means the only financing possi-

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[1] If the short-term price elasticity of demand for gasoline is between 0.2 and 0.25 (a common assumption), a 125 percent price increase would reduce consumption between 25 and 30 percent. This implies that gasoline previously selling for, say, 35 cents per gallon would have to rise to 80 cents. Thus, a 30 cent tax accompanied by a 15 cent price rise would produce a market clearing situation. At least part of this price increase has already taken place.

The current 4 cents per gallon excise tax yields about $800 million annually per penny of tax collected from operators of private automobiles. With consumption reduced 25 to 30 percent, however, each penny of tax would yield only $560 to $600 million. A 30 cent tax would yield $16.8 to $18 billion, less the roughly $800 million in reduced yield from the existing 4 cent per gallon tax, or a net increase of $16 to $17 billion.

[2] Our assumption here is that 8 gallons per car per week represents about 57 percent of "pre-shortage" demand of approximately 14 gallons. Since we assume supply to retailers is to be cut 25 to 30 percent by direct allocation measures, this leaves about 15 percent of "pre-shortage" potential purchases available for taxed sale. For each penny of tax, annual revenue would be 15 percent of $800 million, that is, about $120 million, and a 50-cent tax would yield $6 billion. As there is no historical evidence on the price elasticity of demand for gasoline in excess of 8 gallons per week, it cannot be known in advance whether a 50-cent tax would produce a market-clearing price. Our assumption that consumption is reduced is based on the announced policy of directly reducing supplies to retailers rather than on any knowledge of the efficacy of any particular tax rate.

bility. In the absence of any new tax, many might feel that countercyclical expenditures such as these should have a very high priority claim on regular budget resources.

Unemployment Compensation.—Some part of the funds made available by a gasoline tax could be used to increase unemployment benefits. The present system of unemployment compensation provides a maximum of 26 weeks of benefits. An additional 13 weeks of benefits are provided for all States if the seasonally adjusted insured unemployment rate for the Nation is above 4.5 percent for three consecutive months. Individual States can receive the additional benefits if the insured unemployment rate is above 4 percent in that State for 13 consecutive weeks, and if the rate is at least 120 percent of the rate for the same 13-week period in the two preceding years.

Increased benefits could be provided by reinstituting the temporary compensation provision passed by Congress in 1972 which continued benefits up to 52 weeks. This program, which was in effect from February to December 1972, cost about $600 million. Using an assumption that the unemployment rate may average near 6 percent, the costs in fiscal 1975 might be approximately the same. Another possibility is for the Federal Government to temporarily increase the level of all benefits by 10 percent. The entire increase would be paid out of Federal funds, since States cannot increase the level of benefits without State-by-State legislative action. This temporary program could cost close to $1 billion in fiscal 1975.

Other proposals would have a long-term effect on unemployment insurance costs. An Administration-backed plan (H.R. 8600) would require States within two years to increase the maximum weekly benefit to 66⅔ percent of the average wage in the State and to pay each individual at least 50 percent of his weekly wage. During the two years when States are changing their laws, the Federal Government would pay the entire cost which would be approximately a 12 percent increase over the current program, or about $1 billion in fiscal 1975.

Another change which was considered during the Johnson administration but never adopted would shorten the required number of weeks worked to be eligible for benefits. Presently most States have a minimum ranging from 14 to 20 weeks worked. The Federal Government could require States to change their laws within two years to cover all those who have worked at least 14 weeks. During the 2-year grace period, the Federal Government would bear the entire cost of the change-over. This reform would aid a number of workers who now are ineligible for benefits because of insufficient work experience.

Public Service Employment.—Experience with the Emergency Public Service Employment program in 1971 and 1972 showed that such an effort can be activated quickly and can achieve reasonable success in providing work opportunities for many who would otherwise be unemployed. The experience already gained under this program should be of help in enabling an expanded program to be activated quickly and efficiently. The Chairman of the Council of Economic Advisers recently testified that the Administration has such a program under active consideration. He further indicated that such a program might be of particular value at the present time because of the spotty, localized pattern of unemployment which may be generated by the fuel shortage.

With 4 million persons out of work at the present time and with most forecasts showing the number of unemployed rising by over 1 million persons during the next year, a public service employment program designed to serve 500,000 to 1 million persons might be considered. Costs of such a program might range from $4 to $7 billion, depending on the number of persons served and the average wage paid.

Aid to State and Local Governments.—Like Federal revenues, State and local revenues are sensitive to the level of unemployment and the rate of economic growth. This sensitivity has increased as more States have adopted progressive income taxes. Unlike the Federal Government, State and local governments cannot rely on deficit financing to sustain expenditure levels in a recession. When receipts from existing taxes fall below their full-employment growth path, State and local governments must either impose new taxes or cut expenditures. Neither of these alternatives is desirable during a period of recession.

Many economists have long urged that the Federal Government undertake to stabilize State and local revenues through a system of countercyclical Federal grants. These grants would begin when unemployment rose above the full employment level, would increase in amount as unemployment rose, and would fade to zero as full employment was regained. The Joint Economic Committee first recommended such a program in mid-1971, and has subsequently reiterated this recommendation.

A reasonably complete offsetting of the State and local revenue loss occasioned by high unemployment would cost about $4 billion for each 1 percentage point by which unemployment rose above the full employment level. Thus if unemployment should average slightly under 6 percent next year, such a program might cost $6 to $8 billion.

Transportation Expenditures.—Substantial additional investment in public transportation may be required as part of any successful effort to reduce fuel use for transportation purposes. However, the need for quick start-up of spending and the presumably temporary nature of the proposed gasoline tax limit the number of transportation investments which it would seem appropriate to finance from this particular revenue source.

The quickest expansion of public transportation can be achieved through improved and expanded bus service. This suggests the possibility of a non-recurring fiscal 1975 grant to municipalities to cover increased costs of existing service, including rising fuel costs, and to expedite improved bus or other transit service. In determining the size of this grant the ability of the municipalities to spend the money quickly and the ability of private industry to respond to the increased demand for new buses and other capital equipment should be considered.

Such a grant might be distributed among municipalities on the basis of a flat amount per public transit passenger trip. This would provide some financial incentive to the municipality to increase public transportation usage. It would then be left up to the municipality to determine the specific use of the funds to develop and maintain a transportation system most appropriate to that particular city. Local public transit carried about 6½ billion passengers in 1972, 4½ billion of them by bus. Even if transit patronage could be doubled (which would mean restoring it to the levels of the early 1950s), a Federal grant equal to 10 cents per passenger trip would cost $1.3 billion. At higher levels of patronage local transit systems might find themselves in less need of subsidy in future years. If the need for Federal assistance should be found to continue, it might be possible to finance a continued transit program of this type out of other budget resources once the emergency gasoline tax were removed or reduced.

Another transportation expenditure which might be considered on an emergency basis would be an improvement program for the railroad track beds, especially in the Northeast Corridor, where expanded rail service is urgently needed both for passengers and to transport the coal now needed as a substitute for oil. A thorough rebuilding of the Nation's rail system might cost $15 to $20 billion and would require five to ten years to complete, suggesting that it should be financed from a more reliable source of revenue than a temporary emergency tax. However, an expenditure of $1 to $2 billion in fiscal 1975, which might be financed from a temporary tax, could achieve significant and fairly quick improvement in the rail service.

A Tax Refund Alternative.—An alternative use of some or all of the receipts from a gasoline tax would be a reduction in other taxes. A temporary income tax rebate to lower income taxpayers could be designed to remain in effect only so long as the gasoline tax remained in effect, and it would help offset the impact of the tax and of other recent price increases on this particularly hard-hit group. A tax credit of $100 per taxpayer ($200 on a joint return) for taxpayers with an adjusted gross income less than $5,000 and an equivalent cash payment to families and individuals with incomes too low to be able to fully utilize the credit would cost about $3.5 billion. If an adjusted gross income of $8,000 were used, the tax credit would cost about $5.5 billion.

An Excise Tax on Crude Petroleum.—An alternative to an excise tax on gasoline or other petroleum products would be an excise tax on the first sale of domestically produced crude petroleum. The Administration has recently indicated that it intends to ask Congress to consider a tax of this type.

Although the Administration's proposal was described as an "excess profits" tax, it is in fact a type of excise tax and as such its economic impact might be quite different from that of the type of "excess profits" tax which has been used at various times in the past.

Traditionally an excess profits tax has been a tax on corporate profits in excess of some base amounts, usually an average of several past years. This traditional type of excess profits tax presented numerous administrative difficulties, but its basic economic purpose was the reasonably straight-forward one of preventing total profits from grossly exceeding the amount necessary to cause goods or services to be produced. Support for this type of tax reflected the widespread political consensus in this country that profits grossly in excess of necessary amounts are an inequitable transfer of income from consumer to producer.

An excise tax on crude petroleum is related to the number of barrels produced and the price charged. It affects the profits of petroleum producers only indirectly. Neither in theory nor in practice is it designed to hold profits to any particular rate or amount.

The excise tax proposed by the Administration would be levied initially on that part of the per-barrel price of crude petroleum exceeding \$4.75 per barrel. The price segments on which the tax would be levied break down as follows:

	Tax (percent)	Cents
First, \$4.75	[1]	
Next, \$0.25	10	2.5
Next, \$0.35	20	7.0
Next, \$0.60	30	18.0
Next, \$0.80	50	40.0
Any remainder	85	

[1] No tax.

Thus if the price of crude oil rose to \$6.75, 67½ cents per barrel would be collected; 85 percent of any further increase in the price would be collected as tax. At the \$5.25 per barrel price recently approved by the Cost-of-Living Council only 7½ cents per barrel would be collected. This controlled price applies to roughly 75 to 80 percent of domestic production. If a 7½-cent tax were collected on 75–80 percent of the approximately 3.5 billion barrels of crude oil produced annually in the United States and, say, a 50-cent tax collected on the other 20–25 percent, which sells at a higher uncontrolled price, receipts from the tax would be \$500 to \$600 million. However, Secretary Shultz has estimated that the tax would produce \$3 to \$5 billion during the first full year it was in effect. This implies an average price of between \$7 and \$7.65 per barrel of crude oil.

Over a 3-year period, the tax schedules proposed by the Administration would be gradually adjusted upward to a point at which no tax would be collected except on that part of the price of crude oil in excess of \$7.00 per barrel.

A Comprehensive Energy Tax.—A comprehensive tax on all use of energy would both encourage conservation and raise substantial revenues. By taxing all sources and all uses equally it would avoid distorting choices among different fuel sources or among different end uses of energy. Total gross energy use in the United States exceeds 70 quadrillion Btu's annually. A tax of 4 cents per million Btu's, for example, would raise about \$3.0 billion annually.

In contrast to an emergency tax on gasoline, a comprehensive energy tax might be imposed for a number of years—perhaps a decade—and the receipts could, therefore, be made available to finance energy development and conservation projects which might take several years to complete.

A Tax on Excessive Residential and Commercial Use of Natural Gas and Electricity.—In contrast to petroleum products, direct rationing of residential use of natural gas and electricity does not appear practical, except through such extreme measures as complete interruption of service. A well designed tax scheme might, however, greatly strengthen appeals to conserve voluntarily. For example, for those households which heat with natural gas or electricity a penalty tax might be imposed on usage above the amount necessary for normal household uses, including the heating of a well-insulated home to 68°.

The tax rate would probably have to be quite high in order to have a significant deterrent effect. However, since payment of the tax could be largely avoided through the practice of appropriate conservation measures the tax would not impose onerous burdens nor, if successfully designed, would it raise large amounts of revenue.

In 1972 residential customers purchased about 52 billion therms of natural gas at an average price of about 12 cents per therm. Potential demand in 1974 is probably in the neighborhood of 56 billion therms. If the objective were to reduce residential natural gas usage slightly below 1972 levels, a penalty tax might be imposed on total use in excess of 49 billion therms. A tax of 60 cents per therm would raise the cost of excess use of natural gas by 500 percent. If highly successful in reducing consumption, such a tax might be collected on only about 1 billion therms and would result in revenues of $600 million. If largely unsuccessful, the tax might have to be collected on 7 billion therms, resulting in revenues of $4.2 billion. In this latter, unsuccessful case residential natural gas customers would be paying an average penalty of $75 per year for their failure to adopt conservation measures.

Depending on the urgency with which conservation was desired, higher or lower tax rates might be considered. Our numbers used above are purely illustrative. Any actual tax might well be designed with a tax rate that increases steadily with the amount of fuel used above the base amount. Similar tax schedules could be devised for residential use of electricity and for commercial use of both natural gas and electricity. Such a tax on only excess use differs from a flat tax rate on all natural gas or electricity use in that it provides a strong incentive for conservation and imposes little or no tax burden on those willing to adopt conservation measures.

APPENDIX TABLE

ESTIMATED FEDERAL INCOME TAX EXPENDITURES,[1] CALENDAR YEARS 1970-72[2]

[In millions of dollars]

Item	1970	1971	1972
NATIONAL DEFENSE			
Exclusion of benefits and allowances to Armed Forces personnel	500	650	[3] 700
INTERNATIONAL AFFAIRS			
Exemption for certain income earned abroad by U.S. citizens	40	50	50
Exclusion of income earned by individuals in U.S. possessions	10	10	10
Western Hemisphere trade corporations	50	75	50
Exclusion of gross-up on dividends of less-developed country corporations	55	55	60
Deferral of income of controlled foreign corporations	165	165	[3] 325
Exclusion of income earned by corporations in U.S. possessions	80	80	80
Deferral of income of domestic international sales corporations			100
AGRICULTURE			
Farming: Expensing and capital gain treatment	820	840	900
Timber: Capital gain treatment for certain income	130	175	175
NATURAL RESOURCES			
Expensing of exploration and development costs	325	325	[3,4] 650
Excess of percentage over cost depletion	980	985	[3] 1,700
Capital gain treatment of royalties on coal and iron ore	5	5	5
COMMERCE AND TRANSPORTATION			
Investment credit	910	1,800	3,800
Depreciation on buildings (other than rental housing) in excess of straight line	500	480	500
Asset depreciation range		700	[3] 860
Dividend exclusion	280	300	300
Capital gains: Corporation (other than farming and timber)[3]	425	380	400
Capital gains: Individuals (other than farming and timber)[5]	([6])	5,600	7,000
Bad debt reserves of financial institutions in excess of actual	380	400	[7] 400
Exemption of credit unions	40	40	[3] 90
Deductibility of interest on consumer credit	1,700	1,800	[3] 1,100
Expensing of research and development expenditures	540	545	570
$25,000 surtax exemption	2,000	2,300	2,500
Deferral of tax on shipping companies	10	10	30
Rail freight car amortization	105	45	[3,8] 80
HOUSING AND COMMUNITY DEVELOPMENT			
Deductibility of interest on mortgages on owner-occupied homes	2,800	2,400	3,500
Deductibility of property taxes on owner-occupied homes	2,900	2,700	3,250
Depreciation on rental housing in excess of straight-line	255	500	600
Housing rehabilitation		25	40

See footnotes at end of table, p. 32.

ESTIMATED FEDERAL INCOME TAX EXPENDITURES,[1] CALENDAR YEARS 1970-72 [2]—Continued

[In millions of dollars]

Item	1970	1971	1972
HEALTH, LABOR, AND WELFARE			
Disability insurance benefits	130	155	175
Provisions relating to aged, blind, and disabled:			
Combined cost for additional exemption, retirement income credit, and exclusion of OASDHI for aged	2,950	3,250	3,550
Additional exemption for blind	10	10	10
Sick pay exclusion	105	120	[3] 225
Exclusion of unemployment insurance benefits	400	800	700
Exclusion of workmen's compensation benefits	210	320	375
Exclusion of public assistance benefits	50	65	65
Net exclusion of pension contributions and earnings:			
Plans for employees	3,075	3,650	4,000
Plans for self-employed persons	175	250	200
Exclusion of other employee benefits:			
Premiums on group term life insurance	440	500	550
Deductibility of accident and accidental death premiums	25	30	35
Medical insurance premiums and medical care	1,450	2,000	2,500
Privately financed supplementary unemployment benefits	20	5	5
Meals and lodging	170	170	170
Exclusion of interest on life insurance savings	1,050	1,100	1,200
Deductibility of charitable contributions (other than education)	3,550	3,200	3,100
Deductibility of medical expenses	1,700	1,900	1,900
Deductibility of child and dependent care expenses	25	30	180
Deductibility of casualty losses	80	165	[3] 150
Excess of percentage standard deduction over minimum standard deduction	3,000	700	1,040
Pollution control amortization	15	15	25
Credit for employing public assistance recipients under WIN program			5
5-year amortization of child care facilities			5
EDUCATION			
Parental personal exemption for student age 19 or over	500	550	640
Deductibility of contributions to educational institutions	200	275	275
Exclusion of scholarships and fellowships	60	110	125
VETERANS' BENEFITS AND SERVICES			
Exclusion of certain veterans' benefits	650	700	[3] 480
GENERAL GOVERNMENT			
Political contributions			100
AID TO STATE AND LOCAL FINANCING			
Exemption of interest on State and local debt	2,300	2,600	[3] 2,900
Deductibility of nonbusiness State and local taxes (other than on owner-occupied homes)	5,600	5,600	5,300
Total	(9)	(9)	(9)

[1] Estimates are prepared on an individual basis for each item on the assumption that the item would be eliminated from the law without any other changes in the law with respect to the other items. If 2 or more changes in the law are made, the aggregate revenue effect will frequently not equal the sum of the revenue effects of the individual changes. Accordingly, the costs of the items are not additive.

[2] Roughly reflect fiscal years 1968 through 1973.

[3] Changes in the 1972 figures as compared to 1971 which are due wholly or in part to revised data and/or new sources of data and/or improved estimating methods.

[4] The estimate for 1972 considers this tax expenditure in isolation rather than in conjunction with percentage depletion as has been done for the years 1967–71.

[5] Assumes present restriction on capital losses is retained.

[6] Not available.

[7] This will decline over time as present law becomes fully effective.

[8] This item is being superseded by use of the investment credit.

[9] As explained more fully in the study and in footnote 1, these totals are of limited significance and utility. However, as a matter of convenience the mathematical sums of the respective columns are given here: about $44 billion in 1970; about $52 billion 1971; about $59 billion in 1972. Much of the increase in the total figures given for 1971 and 1972 over that for 1970 is due to the fact that the 1970 figure does not include any estimate for capital gains of individuals while the 1971 and 1972 totals include $5.6 billion and $7.0 billion, respectively.

Note: Changes in the figures from year to year not only reflect changes in the tax laws, in utilization of the items and in personal income and profit levels but also, in some instances, reflect revised and/or new sources of data and/or improved estimating methods.

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