MIDYEAR AND LONG-TERM BUDGET PROJECTIONS

748

HEARING

BEFORE THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

OF THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

NINETY-FOURTH CONGRESS

FIRST SESSION

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SUBMISSIONS FOR THE RECORD

MONDAY, JUNE 2, 1975

MIDYEAR AND LONG-TERM BUDGET PROJECTIONS

MONDAY, JUNE 2, 1975

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES
AND ECONOMY IN GOVERNMENT
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:02 a.m., in room 1202, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senators Proxmire and Percy; and Representatives Hamilton, Brown of Michigan, and Brown of Ohio.

Also present: Richard F. Kaufman, general counsel; Lucy A. Falcone, Jerry J. Jasinowski, L. Douglas Lee, Loughlin F. McHugh, and Courtenay M. Slater, professional staff members; Michael J. Runde, administrative assistant; and George D. Krumbhaar, Jr., minority counsel.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. We are pleased to have with us this morning Mr. James Lynn, Director of the Office of Management and Budget, and Mr. Alan Greenspan, Chairman of the Council of Economic Advisers to discuss the mid-year budget revisions, and the long-range economic projections.

Following these gentlemen we will have Edward Gramlich, Barry Blechman, and Robert Hartman, coauthors of "Setting National Priorities: The 1976 Budget."

I would like to begin this hearing by making several comments on the budget revisions and indicating some areas we need to explore more fully. I will give you the opportunity to make any comments you wish before we begin the questioning.

First, this is the President's budget. The numbers in it reflect his legislative recommendations. They bear only passing resemblance to reality. Congress has effectively rejected some of the basic assumptions embodied in this document, and it is quite likely to reject several others.

As a forecast of what is likely to happen, this budget review is worse than useless because for the uninformed reader, it is misleading. Therefore, I think it is important that we examine the budget implications of changing some of these assumptions to arrive at a more realistic estimate.

Second, these budget revisions ignore the entire congressional budget process. Congress has just completed action on the first concurrent resolution on the budget and has set tax and spending levels different from those recommended by the President. The congressional program, for example, included more funds for public employment programs than the President has recommended, and he has vetoed that legislation. I want to know whether we can anticipate further vetoes of congressional initiatives incorporated in that resolution.

Third, these revisions incorporate a substantially revised economic outlook. You have raised the estimated unemployment rate for 1975 from 8.1 percent to 8.7 percent but continue to forecast 7.9 percent for 1976. I presume that this 1976 forecast results from your more optimistic projection of real economic growth—up from 4.8 percent to 6.3 percent. I would like to know what is your new source of optimism. What sectors of the economy do you see expanding rapidly enough to produce this 6.3 percent real growth rate, bearing in mind that the President has not recommended an extension of the 1975 tax cut, and bearing in mind neither the housing industry nor the automobile industry have been doing as well as many expected?

My fourth point relates to the long-range projections. I understand that the 1977–80 projections are for planning purposes only and do not represent a forecast or recommendation by the administration.

However, as a planning tool they can be quite useful. Your projections show that even with 5 consecutive years of 6.5 percent real economic growth per year, that growth is 100 percent above our long term trend but even so we cannot expect the unemployment rate to fall below 5 percent before 1980.

Furthermore, if instead of using your projection we take the best 5-year average growth rate we have enjoyed in the postwar period and project it out, the unemployment rate would not fall below 8 percent before 1978, and it would stand above 6½ percent in 1980. These projections clearly illustrate that we must do better than our best and better than you have projected if the unemployment rate is to approach a reasonable level in the foreseeable future. It is interesting to note that your projections show that under current law the actual budget would be approximately balanced in 1978 with a 6.5 percent unemployment rate and would show a $50 billion surplus in 1980 with a 5.1 percent unemployment rate.

Mr. Lynn, Mr. Greenspan, we would be happy to have your comments.

Senator Percy.

Senator PERCY. Just a brief comment because of the importance to underline in these hearings the very strong feelings we had when we put together the Budget Reform Act of 1974. It is important that we should have this kind of an updating. We have had presented to us now reestimates on fiscal 1975 that show a surprising and pleasing upward increase in income that we had not anticipated. We would like to know what the source of that is. I am glad it is on the up side rather than the downside. I think that in the fiscal year 1976 figures, as they are now refined, we have closer estimates and more realistic ones but still they do seem to incorporate the 5 percent cap on civil service pay increases, and the implementation of the President's energy program.

So we would appreciate your comments as to whether as a matter of policy you tilt toward indicating in the forecast what you hope will come about or what you realistically assume will come about and what those assumptions are.

But I certainly appreciate both of you being here this morning. In the questioning we will try to draw out some of these points. Your appearance here pursuant to the Budget Reform Act is a very important precedent for us to establish and I think again a great step forward in the closer working relationship between the Congress and the executive branch of the Government.

Chairman PROXMIRE. I would like to ask each of you gentlemen if you would like to comment on our opening remarks in any way. I think I have given you quite a bit to comment on, to agree or disagree with.

Mr. Lynn, would you like to start off?

STATEMENT OF HON. JAMES T. LYNN, DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET, ACCOMPANIED BY HON. ALAN GREENSPAN, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; AND DALE R. McOMBER, ASSISTANT DIRECTOR FOR BUDGET REVIEW, OMB

Mr. LYNN. Yes, Mr. Chairman. I do not have an opening statement but I would limit myself to a comment or two on your opening remarks and Senator Percy's remarks, if I might.

First, we welcome the opportunity to appear here, too, to answer your questions with respect to this update. I think being new to my present job I found the update most useful and I am sure the Congress will, too.

I was glad to hear you mention at the outset what the concept is of the President's budget because sometimes that concept is lost. By that I mean that the President's budget incorporates his proposals to the Congress of the United States. Of course, where action has already been taken that foreclosed his proposals, it reflects those changed circumstances. Thus, it adds $3 billion to the 1975 outlays and $3.8 billion in 1976 outlays by way of changes that are brought about through congressional action or inaction on some of the President's recommended cuts.

As to its being a forecast, of course it is not a forecast in the areas where there are differences of opinion on policy between the President and the Congress. I do not believe it is the function of the budget for the President to either automatically adopt the congressional position where he may have a difference with, shall we say, certain committee positions or individual members' positions, I think he should stick with his proposals and put them in the budget as his proposals.

Now, on the energy program, that is probably an excellent place to show how difficult updating the budget becomes. The President has had an energy program. There has been some activity in the Congress with respect to energy. There have been a number of proposals put forward. There has been one bill that has passed the Senate on a small piece of the matter. In the House of Representatives some very difficult work and important effort has been made by at least two committees trying to work toward an energy package, but it seems to me perfectly appropriate for the President to continue to support his proposal.

First, I happen to think it is the best around substantively, and secondly, we have yet to see a congressional position with respect to energy.

You did mention that we rejected additional public service jobs in the Jobs Assistance Act which the President vetoed. I would like to point out for the record that on the matter of the size of the public service jobs program, I believe there is little or no difference between the President's position and the congressional position. I think there is some $45 million of additional money for summer youth employment in the Job Assistance Act over what the President recommended. But our main difficulty with that act is that under the name Job Assistance Act it adds a little here, a little there, a little somewhere else to a whole plethora of programs in the Congress, running from dams and bridges and highways to buying automobiles and a number of other things, all under the name of job assistance. To the administration it is additional stimulus that we can ill afford at this time, given what it may do to choking off the recovery, and second, even if it did not do that, it would mean inflation followed by recession a year or year and one-half from now.

I would urge the Congress that as they look at this budget and as they look at further steps that they are taking, the time has come when we must look at 1977 outlay figures as well as 1976. A good number of things being considered by the Congress, as was the case with the Job Assistance Act that has been given to the President, involve heavy outlays in the years 1977 and 1978. I believe most economists feel there will then be additional activity, strong activity in the marketplace. The private sector will be on the upslope rather than the downslope.

So I think the time has come for us to look at 1976 very hard and continue to look at it but also start looking very hard at outlay effects in 1977, and so on, and out years beyond that.

Having said that, when you talk about things like upside on the economy, and so forth, I think I should defer to Mr. Greenspan. Alan, do you have any thing to add?

Mr. Greenspan. No. I think the best way to clarify our position would be to proceed question by question, Mr. Chairman.

Mr. Lynn. Mr. Chairman, I would like to place in the hearing record the "Mid-Session Review of the 1976 Budget," prepared by OMB.

Chairman Proxmire. Fine.

[The document follows:]

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MID-SESSION REVIEW OF THE 1976 BUDGET

May 30, 1975

NOTE: Detail may not add to totals due to rounding.

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This review of the 1976 budget transmits to the Congress the supplemental budget information required by section 221(b) of the Legislative Reorganization Act of 1970 (P.L. 91-510). It also provides additional information that will further aid the Congress and the public in assessing the budget outlook.

Part 1 contains revised budget summaries for fiscal years 1975 and 1976. It also includes data for the transition quarter, extending from July through September of 1976, that results from the change in the fiscal year under the Congressional Budget Act of 1974.

The estimates reflect changes that have occurred since the 1976 budget was sent to the Congress in February. In view of Congressional inaction thus far on the President's energy program, the starting date assumed has been changed to September 1. The budget as submitted in February included proposals to limit automatic cost-of-living increases in benefit programs to 5% through June 30 of next year. That limit was also proposed for civil service and military pay increases. The revised estimates assume that these "caps" will be enacted by the Congress except for increases effective on or before July 1. Thus, the full effect of the 8% social security benefit increase effective on June 1 is included in the estimates.

Part 2 presents 5-year projections of: Outlays and budget authority by agency and by function; receipts by major source; outlays for open-ended programs and fixed costs; and outlays from balances of budget authority for non-mandatory programs available at the end of fiscal year 1976.

Because Congressional action has not been completed on any of the 1976 appropriations bills and on much substantive legislation, the estimates shown in this review are necessarily tentative.

Part 1. The Budget Outlook for 1975, 1976, and the Transition Quarter

Budget Totals

The 1975 deficit is now expected to be $42.6 billion, $7.9 billion above the February estimate. Outlays are now estimated to be $323.6 billion, $10.2 billion more than in February, and receipts are estimated to be $281.0 billion, $2.2 billion above the February estimate.

The estimated deficit for 1976 has increased by $8.0 billion since February, to $59.9 billion. Outlays are up by $9.5 billion from the February estimate to $358.9 billion, and receipts have been revised upward by $1.5 billion, to $299.0 billion.

These figures reflect Congressional turndowns of $9.3 billion in deferrals and $2 billion in rescissions, adding outlays of $0.7 billion in 1975 and $1.3 billion in 1976. Unless early action is taken by the Congress on other budget reductions proposed by the President, this estimate of the deficit for 1976 will rise still further. Should the Congress fail to take action on any of these reduction proposals, over $8-1/2 billion will be added to outlays.

The following table compares the current estimates of budget totals with the estimates shown in the February budget.

Table 1

BUDGET TOTALS
(fiscal years; in billions of dollars)

Description	1974 Actual	1975 February estimate	1975 Current estimate	1976 February estimate	1976 Current estimate	Tr. Qtr. February estimate	Tr. Qtr. Current estimate
Budget receipts................	264.9	278.8	281.0	297.5	299.0	84.4	86.8
Budget outlays.................	268.4	313.4	323.6	349.4	358.9	94.3	95.8
Deficit (-)............	-3.5	-34.7	-42.6	-51.9	-59.9	-9.8	-9.0
Full-employment receipts.......	282.2	323.1	323.0	351.8	357.0	98.4	100.0
Full-employment outlays........	267.3	306.5	316.7	340.2	349.8	91.9	94.2
Full-employment surplus or deficit (-)........	14.9	16.6	6.3	11.6	7.2	6.5	5.8
Budget authority...............	313.9	395.1	408.9	385.8	383.8	88.2	88.8
Outstanding debt, end of year:							
Gross Federal debt..........	486.2	538.5	544.5	605.9	617.5	616.8	627.6
Debt held by the public.....	346.1	389.6	396.9	453.1	470.9	465.6	482.8
Debt subject to limit.......	476.0	528.9	534.0	596.4	607.1	607.3	617.2

Economic Assumptions

The economic assumptions through calendar year 1976 reflect a changed economic forecast, based on experience since the budget assumptions were developed. They are subject to considerable uncertainty, since economic forecasting is imprecise. In this context, it should be noted that the changes from the February budget in the growth of real GNP are minor relative to the uncertainties involved.

Table 2

ECONOMIC ASSUMPTIONS
(calendar years; dollar amounts in billions)

Item	Actual 1973	Actual 1974	Forecast 1975	Forecast 1976
Gross national product:				
Current dollars:				
Amount	$1,295	$1,397	$1,474	$1,680
Percent change	11.8	7.9	5.5	14.0
Constant (1958) dollars:				
Amount	$839	$821	$792	$842
Percent change	5.9	-2.1	-3.6	6.3
Incomes (current dollars):				
Personal income	$1,055	$1,150	$1,231	$1,351
Wages and salaries	$692	$751	$787	$871
Corporate profits	$123	$141	$106	$148
Prices (percent change)[1]:				
GNP deflator:				
Year over year	5.6	10.3	9.5	7.1
Fourth quarter over fourth quarter	7.4	12.0	7.8	6.5
CPI:				
Year over year	6.2	11.0	9.1	7.1
December over December	8.8	12.2	7.8	5.8
Unemployment rates (percent):				
Total	4.9	5.6	8.7	7.9
Insured[2]	2.8	3.8	7.7	6.4
Federal pay raise, October (percent)	4.77	5.52	5.00	12.25
Interest rate, 91-day Treasury bills (percent)[3]	7.0	7.9	5.1	5.1

[1] The 1975 and 1976 figures reflect the impact on prices of the President's energy program.

[2] Insured unemployment as a percentage of covered employment; includes unemployed workers receiving extended benefits.

[3] Average rate of new issues within period; the rate shown for 1975 and 1976 was the current market rate at the time the estimates were made.

Budget Receipts

Receipts in 1975 are now estimated to be $281.0 billion, $2.2 billion above the February estimate. The current estimate for 1976 is $299.0 billion, compared with $297.5 billion in February. These estimates are based on the economic assumptions presented in Table 2.

These receipt estimates -- including the 1975 estimates -- are tentative. There is still considerable uncertainty as to what tax collections will be in June, especially because large corporation income tax payments are made in that month.

Changes in budget receipts.--Receipts in 1975 are estimated to be $281.0 billion, $2.2 billion higher than the February estimate. The Tax Reduction Act of 1975 reduced 1975 receipts by $4.3 billion more than the tax reduction proposals in the February budget. This amount is more than offset by reestimates -- particularly of nonwithheld individual income taxes -- reflecting a significant underestimate of calendar year 1974 income tax liabilities in the budget. The data are not yet available to assess accurately the reasons for this underestimate.

Fiscal year 1976 receipts are currently estimated at $299.0 billion, $1.5 billion above the February estimate. The Tax Reduction Act reduced 1976 estimated receipts by $0.6 billion more than the President's February tax proposals, and the revised effective date of the President's energy program that is assumed in these estimates increases 1976 receipts by $1.8 billion from the amount proposed in the budget.[1] The remaining $0.2 billion change results from reestimates and changes in economic assumptions.

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[1] Exclusive of "plowback" and associated provisions, the effect of which will be neutral on the budget deficit.

The following table shows the changes in receipts by major source and indicates the reasons for these changes.

Table 3

CHANGES IN BUDGET RECEIPTS
(in billions of dollars)

	February estimate	Changes due to: Revised tax reduction	Changes due to: Delayed energy program[1]	Changes due to: Reestimates and revised economic assumptions	Current estimate
Fiscal year 1975					
Individual income taxes................	117.7	-4.5	+1.4	+7.1	121.6
Corporation income taxes................	38.5	+0.2	+1.8	+0.5	41.0
Social insurance taxes and contributions....	86.2	---	---	+0.3	86.5
Other.................	36.3	---	-3.7	-0.7	31.8
Total............	278.8	-4.3	-0.5	+7.1	281.0
Fiscal year 1976					
Individual income taxes................	106.3	-0.9	+12.4	+3.5	121.3
Corporation income taxes................	47.7	+0.3	-6.8	-3.4	37.8
Social insurance taxes and contributions....	91.6	---	---	-0.7	90.9
Other.................	52.0	---	-3.8	+0.8	49.0
Total............	297.5	-0.6	+1.8	+0.2	299.0

[1] Exclusive of "plowback" and associated provisions, the effect of which will be neutral on the budget deficit.

Receipts in the transition quarter are estimated at $86.8 billion, $2.4 billion above the February estimate.

Budget Outlays

Tables 8 and 9 compare the current outlay estimates by agency and by function with those made in February.

Fiscal year 1975.--Total outlays for 1975 are currently estimated to be $323.6 billion, $10.2 billion above the February estimate. The major changes now estimated are shown in the following table.

Table 4

1975 OUTLAYS:
MAJOR CHANGES FROM THE FEBRUARY BUDGET ESTIMATES
(in billions of dollars)

February budget estimate of 1975 outlays........................ $313.4

	Congressional action or inaction	Other changes	Total changes
Offshore oil receipts (an offset to outlays).....	---	2.7	2.7
DOD Military and MAP........	0.1	1.8	1.9
HEW........................	0.9	1.4	2.3
Treasury....................	1.7	-0.2	1.6
Veterans Administration.....	0.2	1.1	1.3
Food stamp outlays..........	0.2	1.1	1.3
Special unemployment assistance................	---	-1.5	-1.5
All other (net).............	-0.1	0.8	0.6
Total...................	3.0	7.2	10.2

Current estimate of 1975 outlays............................... $323.6

The $2.7 billion decrease in estimated offshore oil receipts (which are an offset to outlays) resulted primarily from a large shortfall in receipts from the February 1975 South Texas sale and indicates the difficulty of projecting what bidders will pay for leases of uncertain value.

Outlays for DOD Military and military assistance are $1.9 billion higher than in February as inflation and a drawdown in purchase backlogs have increased spending rates above what was originally anticipated. HEW spending is up by $2.3 billion, with $1.1 billion in health, $0.3 billion in education, and $0.8 billion in income security. About $0.6 billion of the HEW increase resulted from inaction on the President's reduction proposals.

The Tax Reduction Act of 1975 provided a $50 bonus to social security and certain other beneficiaries. This provision increases 1975 Treasury outlays by $1.7 billion. Veterans Administration outlays are $1.3 billion higher than in the budget because of inaction on the President's reduction proposals, deferred VA asset sales, and greater participation in the GI bill program than earlier anticipated. Food stamp outlays are $1.3 billion higher because of greater than anticipated participation and because of actions taken by the Congress to reject the President's food stamp reform proposals.

The major decrease in 1975 outlays results from a reestimate of outlays associated with unemployment assistance for those not covered by the regular unemployment insurance. The participation in this new program has been below the levels originally anticipated, reducing estimated outlays by $1.5 billion.

Fiscal year 1976.--The current estimate of total 1976 outlays is $358.9 billion, $9.5 billion above the February estimate. About $3.8 billion of this increase results from additions by the Congress, inaction on the President's reduction proposals, or from failure to support

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rescissions and deferrals proposed in the budget. The major changes are summarized in the table below.

Table 5

1976 OUTLAYS:
MAJOR CHANGES FROM THE FEBRUARY BUDGET ESTIMATES
(in billions of dollars)

February budget estimate of 1976 outlays........................ $349.4

	Congressional action or inaction	Other changes	Total changes
HEW........................	2.6	1.4	4.0
Department of Labor:			
Summer Youth and public sector employment.......	---	1.8	1.8
Extended unemployment benefits................	---	1.2	1.2
Reestimates..............	---	-3.0	-3.0
Highway trust fund..........	0.4	1.0	1.4
Food stamp program..........	0.6	2.3	2.9
Veterans Administration.....	---	1.5	1.5
Energy tax equalization payments...................	---	-1.2	-1.2
Petrodollar financing facility...................	---	-1.0	-1.0
All other (net)............	0.2	1.7	1.9
Total.................	3.8	5.7	9.5

Current estimate of 1976 outlays................................ $358.9

Compared with the February budget, estimated spending of HEW is up by $4.0 billion in 1976. About $2.2 billion of this results from inaction on the Administration's proposal to put a 5% ceiling on social security and supplemental security income benefit increases.

There are two major increases in employment-related outlays: First, the increased supplemental request for Summer Youth Employment and public service employment still pending before the Congress would add $1.8 billion in outlays; and second, the Administration's proposal to provide extended unemployment benefits through the end of calendar year 1976 adds another $1.2 billion. These increases are largely offset by major decreases in estimates based on experience with two new programs: unemployment assistance for those not covered by regular unemployment insurance ($-1.9 billion) and lower unemployment trust fund outlays, primarily for unemployment benefits extended beyond their regular duration ($-1.1 billion).

Highway trust fund outlays are $1.4 billion higher, resulting from releases of additional spending authority ($1.0 billion from Presidential release and $0.4 billion from Congressional releases). As in 1975, food stamp outlays are higher -- by $2.9 billion -- because of higher participation rates and the Congressional action rejecting the President's proposed reforms of the food stamp program. Veterans Administration outlays are higher due to expected participation in the GI bill program greater than anticipated in the budget, and increases in compensation and pensions.

These increases are partially offset by reduced energy tax equalization payments, which result from the delayed effective date of the Administration's energy program and by a shift in the petrodollar financing facility proposal from a direct loan program to a loan guarantee program.

Transition quarter.--Outlays in the transition quarter are estimated at $95.8 billion, $1.6 billion more than in February.

The Budget by Fund Group

Tables 10 and 11 contain figures on changes since February in 1975 and 1976 budget totals by fund group. Most of the changes in both 1975 and 1976 have occurred in the Federal funds.

Since February, estimates of Federal funds receipts for 1975 increased by about $2.5 billion, while outlays increased by $8.1 billion, resulting in a $5.7 billion increase in the anticipated 1975 Federal funds deficit. For 1976, the Federal funds receipts estimate has increased by $2.5 billion; estimated outlays have increased by about $5.5 billion; and the anticipated Federal funds deficit has increased by $3.0 billion.

Budget Authority

Tables 12 and 13 show the February estimates of 1975 and 1976 budget authority and changes since then, by agency and by major function.

Fiscal year 1975.--Total budget authority for 1975 is estimated at $408.9 billion, $13.8 billion above the February estimate. The major changes are shown in the following table.

Table 6

1975 BUDGET AUTHORITY:
MAJOR CHANGES FROM THE FEBRUARY ESTIMATE
(in billions of dollars)

February estimate of 1975 budget authority		$395.1
EPA - sewage plant construction grants	+4.3	
Offshore oil receipts (an offset to budget authority)	+2.7	
Treasury - $50 bonus to social security and certain other beneficiaries	+1.7	
HEW	+2.7	
Department of Labor - employment-related budget authority	+1.0	
Food stamps	+0.9	
All other (net)	+0.5	
Current estimate of 1975 budget authority		$408.9

The largest single increase in budget authority since February resulted from court action to release EPA funds not previously available for obligation. This action increased 1975 budget authority by $4.3 billion. The reduction in offshore oil receipts cited earlier increases budget authority by an additional $2.7 billion, and the $50 bonus payment to social security and certain other recipients increases budget authority by $1.7 billion. HEW spending authority is up by $2.7 billion, and Department of Labor authority is up by $1.0 billion due to the request for additional Summer Youth and public sector jobs. Budget authority for food stamps is up by $0.9 billion, providing funds for a larger number of participants and higher payments than anticipated in February.

Fiscal year 1976.--Total budget authority for 1976 is currently estimated at $383.8 billion, $2.0 billion below the February estimate. The major changes are shown in the table below.

Table 7

1976 BUDGET AUTHORITY:
MAJOR CHANGES FROM THE FEBRUARY ESTIMATE
(in billions of dollars)

February estimate of 1976 budget authority		$385.8
Petrodollar financing facility	-7.0	
Energy equalization payments	-1.2	
Veterans Administration	+1.7	
Food stamps	+3.4	
All other (net)	+1.1	
Current estimate of 1976 budget authority		$383.8

The change in the petrodollar financing facility from a loan basis to a loan guarantee basis reduces 1976 budget authority by $7.0 billion.

The revised effective date of the Administration's energy program reduces budget authority by $1.2 billion. A major increase in 1976 budget authority is $3.4 billion for food stamps, reflecting increased participation rates. Estimated budget authority required for veterans benefits is also up by $1.7 billion.

Transition quarter.--Budget authority in the transition quarter is estimated at $88.8 billion, $0.6 billion above the February estimate.

Table 8

CHANGES IN BUDGET OUTLAYS BY AGENCY
(fiscal years; in billions of dollars)

	1974 Actual	1975 February estimate	1975 Current estimate	1975 Change	1976 February estimate	1976 Current estimate	1976 Change
Defense and military assistance	78.4	84.8	86.7	1.9	92.8	92.8	---
Agriculture	9.8	8.8	10.3	1.6	9.7	13.0	3.4
(CCC and P.L. 480)	(1.7)	(2.1)	(2.3)	(0.2)	(1.6)	(1.8)	(0.2)
Commerce	1.5	1.6	1.6	*	1.8	1.8	0.1
Health, Education, and Welfare	93.7	109.9	112.2	2.3	118.4	122.4	4.0
(Social security trust funds)	(67.2)	(78.4)	(79.3)	(0.9)	(86.1)	(89.1)	(3.0)
Housing and Urban Development	4.8	5.5	5.7	0.2	7.1	7.6	0.5
Interior	1.8	2.2	2.2	*	2.5	2.5	*
Justice	1.8	2.1	2.1	---	2.2	2.2	---
Labor	9.0	19.0	17.4	-1.5	22.6	22.8	0.1
(Unemployment trust fund)	(6.1)	(13.0)	(13.0)	(---)	(15.9)	(15.7)	(-0.2)
State	0.7	0.9	1.0	0.1	1.0	1.2	0.2
Transportation	8.1	9.1	9.3	0.2	10.0	11.5	1.5
Treasury	36.0	39.7	41.2	1.6	43.5	43.5	0.1
(General revenue sharing)	(6.1)	(6.2)	(6.1)	(*)	(6.3)	(6.4)	(0.1)
(Interest on the public debt)	(29.3)	(32.9)	(32.8)	(-0.1)	(36.0)	(36.0)	(---)
Corps of Engineers	1.7	1.9	2.1	0.2	2.0	1.9	-0.1
Energy Research and Development Administration	2.3	3.1	3.1	*	3.8	3.8	---
Environmental Protection Agency	2.0	2.9	2.9	---	3.1	3.2	0.1
General Services Administration	-0.3	-1.0	-0.8	0.2	-0.5	-0.4	0.1
National Aeronautics and Space Administration	3.3	3.2	3.3	0.1	3.5	3.5	---
Veterans Administration	13.3	15.4	16.7	1.3	15.6	17.1	1.5
Foreign economic assistance	2.1	2.7	2.5	-0.2	3.0	3.0	*
Other agencies	15.1	17.7	17.9	0.2	19.6	18.8	-0.8
Allowances[1]	---	0.7	---	-0.7	8.0	6.8	-1.3
Undistributed offsetting receipts	-16.7	-16.8	-14.1	2.8	-20.2	-20.1	0.1
Total	268.4	313.4	323.6	10.2	349.4	358.9	9.5

[1] Includes allowances for civilian agency pay raises and contingencies.
* Less than $50 million.
NOTE: Detail may not add to totals due to rounding.

Table 9

CHANGES IN BUDGET OUTLAYS BY FUNCTION
(fiscal years; in billions of dollars)

	1974	1975			1976		
	Actual	February estimate	Current estimate	Change	February estimate	Current estimate	Change
National defense[1]	78.6	85.3	87.4	2.1	94.0	94.1	0.1
International affairs	3.6	4.0	5.0	0.1	6.3	5.5	-0.8
General science, space, and technology	4.2	4.2	4.3	0.1	4.6	4.6	---
Natural resources, environment, and energy	6.4	9.4	9.7	0.3	10.0	10.3	0.2
Agriculture	2.2	1.8	1.8	*	1.8	2.0	0.2
Commerce and transportation	13.1	11.8	12.6	0.8	13.7	15.7	1.9
Community and regional development	4.9	4.9	4.6	-0.3	5.9	6.1	0.2
Education, manpower, and social services	11.6	14.7	15.0	0.3	14.6	16.8	2.2
Health	22.1	26.5	27.6	1.1	28.0	29.0	1.0
Income security	84.4	106.7	109.1	2.4	118.7	122.8	4.1
Veterans benefits and services	13.4	15.5	16.7	1.3	15.6	17.1	1.5
Law enforcement and justice	2.5	3.0	3.0	*	3.3	3.3	---
General government	3.3	2.6	2.7	*	3.2	3.2	*
Revenue sharing and general purpose fiscal assistance	6.7	7.0	7.0	---	7.2	7.3	*
Interest	28.1	31.3	31.2	-0.1	34.4	34.4	---
Allowances[2]	---	0.7	---	-0.7	8.0	6.8	-1.3
Undistributed offsetting receipts:							
Employer share, employee retirement	-3.3	-4.1	-4.0	0.1	-3.9	-3.9	*
Interest received by trust funds	-6.6	-7.8	-7.8	*	-8.3	-8.1	0.2
Rents and royalties on the Outer Continental Shelf lands	-6.7	-5.0	-2.3	2.7	-8.0	-8.0	---
Total outlays	268.4	313.4	323.6	10.2	349.4	358.9	9.5

[1] Includes allowances for civilian and military pay raises for Department of Defense.

[2] Includes allowances for energy tax equalization payments, civilian agency pay raises, and contingencies.

* Change of less than $50 million.

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Table 10

CHANGES IN BUDGET RECEIPTS AND OUTLAYS BY FUND GROUP
(fiscal years; in billions of dollars)

	1974 Actual	1975 February estimate	1975 Current estimate	1975 Change	1976 February estimate	1976 Current estimate	1976 Change
Receipts							
Federal funds	181.2	186.0	188.4	2.5	199.3	201.8	2.5
Trust funds	104.8	118.7	117.3	-1.4	126.5	125.4	-1.1
Intragovernmental transactions	-21.1	-25.9	-24.7	1.2	-28.3	-28.2	*
Total	264.9	278.8	281.0	2.2	297.5	299.0	1.5
Outlays							
Federal funds	198.7	229.0	237.1	8.1	254.2	259.7	5.5
Trust funds	90.8	110.3	111.2	0.8	123.4	127.4	4.0
Intragovernmental transactions	-21.1	-25.9	-24.7	1.2	-28.3	-28.2	*
Total	268.4	313.4	323.6	10.2	349.4	358.9	9.5
Surplus or deficit (-)							
Federal funds	-17.5	-43.0	-48.7	-5.7	-54.9	-57.9	-3.0
Trust funds	14.0	8.3	6.1	-2.3	3.1	-2.0	-5.1
Total	-3.5	-34.7	-42.6	-7.9	-51.9	-59.9	-8.0

* Less than $50 million.

NOTE: Detail may not add to totals due to rounding.

Table 11

BUDGET SURPLUS OR DEFICIT (-) BY FUND GROUP AND TYPE OF TRANSACTION
(fiscal years; in billions of dollars)

	1974	1975			1976		
	Actual	February estimate	Current estimate	Change	February estimate	Current estimate	Change
Federal funds							
Transactions with the public...........	-2.8	-23.7	-30.5	-6.9	-33.3	-36.3	-3.0
Transactions with trust funds..........	-14.7	-19.4	-18.2	+1.2	-21.6	-21.6	*
Total.........................	-17.5	-43.0	-48.7	-5.7	-54.9	-57.9	-3.0
Trust funds							
Transactions with the public...........	-0.7	-11.0	-12.1	-1.0	-18.5	-23.6	-5.1
Transactions with Federal funds........	14.7	19.4	18.2	-1.2	21.6	21.6	*
Total.........................	14.0	8.3	6.1	-2.3	3.1	-2.0	-5.1
Budget total							
Federal funds.........................	-17.5	-43.0	-48.7	-5.7	-54.9	-57.9	-3.0
Trust funds...........................	14.0	8.3	6.1	-2.3	3.1	-2.0	-5.1
Total.........................	-3.5	-34.7	-42.6	-7.9	-51.9	-59.9	-8.0

* Less than $50 million.

NOTE: Detail may not add to totals due to rounding.

Table 12

CHANGES IN BUDGET AUTHORITY BY AGENCY
(fiscal years; in billions of dollars)

	1974 Actual	1975 February estimate	1975 Current estimate	1975 Change	1976 February estimate	1976 Current estimate	1976 Change
Defense and military assistance	88.9	90.8	90.2	-0.6	106.3	106.3	---
Agriculture	13.1	13.8	15.0	1.2	11.9	15.3	3.5
(CCC and P.L. 480)	(3.9)	(4.9)	(4.9)	(---)	(4.3)	(4.3)	(---)
Commerce	1.5	1.7	1.8	0.1	1.8	1.7	*
Health, Education, and Welfare	100.9	114.0	116.6	2.7	120.4	119.9	-0.4
(Social security trust funds)	(73.1)	(82.9)	(83.6)	(0.7)	(88.8)	(88.0)	(-0.8)
Housing and Urban Development	8.1	51.0	51.4	0.5	30.3	31.0	0.7
Interior	2.0	3.9	3.9	*	2.5	2.5	*
Justice	1.9	2.1	2.1	---	2.1	2.1	---
Labor	10.6	19.9	20.9	1.0	11.3	11.0	-0.3
(Unemployment trust fund)	(7.5)	(9.7)	(7.6)	(-2.1)	(9.8)	(9.3)	(-0.5)
State	0.8	0.9	1.2	0.3	1.0	1.0	*
Transportation	17.6	19.1	19.2	0.1	4.4	4.4	0.1
Treasury	36.0	39.7	41.4	1.7	43.6	43.6	---
(General revenue sharing)	(6.1)	(6.2)	(6.2)	(---)	(6.4)	(6.4)	(---)
(Interest on the public debt)	(29.3)	(32.9)	(32.8)	(---)	(36.0)	(36.0)	(---)
Corps of Engineers	1.8	1.7	1.7	---	1.9	1.9	---
Energy Research and Development Administration	2.5	3.6	3.6	---	4.2	4.2	---
Environmental Protection Agency	6.0	4.2	8.5	4.3	0.7	0.7	---
General Services Administration	-0.5	-0.9	-0.7	0.2	-0.3	-0.2	0.1
National Aeronautics and Space Administration	3.0	3.2	3.2	---	3.5	3.5	---
Veterans Administration	13.9	16.0	16.8	0.8	16.1	17.8	1.7
Foreign economic assistance	3.8	3.1	2.6	-0.5	3.0	3.7	0.7
Other agencies	18.5	23.5	23.4	-0.1	32.9	26.1	-6.8
Allowances[1]	---	0.8	---	-0.8	8.3	7.1	-1.2
Undistributed offsetting receipts	-16.7	-16.8	-14.1	2.8	-20.2	-20.1	0.1
Total	313.9	395.1	408.9	13.8	385.8	383.8	-2.0

1 Includes allowances for civilian agency pay raises and contingencies.
* Less than $50 million.
NOTE: Detail may not add to totals due to rounding.

Table 13

CHANGES IN BUDGET AUTHORITY BY FUNCTION
(fiscal years; in billions of dollars)

	1974	1975			1976		
	Actual	February estimate	Current estimate	Change	February estimate	Current estimate	Change
National defense[1]	89.3	91.3	90.9	-0.4	107.7	107.8	0.1
International affairs	5.3	4.9	4.7	-0.2	12.6	6.3	-6.3
General science, space, and technology	3.9	4.3	4.3	---	4.7	4.7	---
Natural resources, environment, and energy	10.7	11.5	16.0	4.5	12.2	12.3	0.1
Agriculture	4.5	5.9	5.9	*	4.3	4.3	---
Commerce and transportation	23.5	28.9	29.5	0.5	6.6	7.0	0.4
Community and regional development	4.0	5.1	5.2	0.1	5.2	5.4	0.3
Education, manpower, and social services	13.2	14.6	16.9	2.4	13.7	13.8	0.1
Health	26.4	28.4	29.6	1.2	31.0	31.0	*
Income security	95.2	156.1	158.9	2.8	135.3	138.1	2.7
Veterans benefits and services	14.0	16.0	16.8	0.8	16.2	17.8	1.7
Law enforcement and justice	2.6	3.1	3.1	*	3.2	3.2	---
General government	3.1	2.7	2.7	*	3.2	3.2	*
Revenue sharing and general purpose fiscal assistance	6.7	7.1	7.1	---	7.3	7.3	*
Interest	28.1	31.3	31.2	-0.1	34.4	34.4	---
Allowances[2]	---	0.8	---	-0.8	8.3	7.1	-1.2
Undistributed offsetting receipts:							
Employer share, employee retirement	-3.3	-4.1	-4.0	0.1	-3.9	-3.9	*
Interest received by trust funds	-6.6	-7.8	-7.8	*	-8.3	-8.1	0.2
Rents and royalties on the Outer Continental Shelf lands	-6.7	-5.0	-2.3	2.7	-8.0	-8.0	---
Total budget authority	313.9	395.1	408.9	13.8	385.8	383.8	-2.0

[1] Includes allowances for civilian and military pay raises for Department of Defense.

[2] Includes allowances for energy tax equalization payments, civilian agency pay raises, and contingencies.

* Change of less than $50 million.

Part 2. Longer-Range Projections

The February budget presented longer-range (through 1980[1]) projections in greater detail than was the case in earlier budgets. In addition, the budget provided detailed economic assumptions on which the projections were based. This section of the Mid-Session Review presents revisions of these longer-range data.

Economic Assumptions

The current state of the economic forecasting art is much too crude to attempt forecasts for the years beyond 1976. Indeed, as mentioned earlier, the 1976 forecasts also involve a large degree of uncertainty. Therefore, in Table 14, economic data for the years 1977 to 1980 are derived using a simple extrapolation based on the 1976 forecast. The projection assumes that real GNP grows at a rate of 6.5% a year -- the same rate that was used in the February budget. While the data derived from this assumption are provided in detail and as exact numbers, they are based on extrapolation and are not, therefore, forecasts.

There is no intent to imply that the economy will follow this exact path, nor that it is an ideal path. It may grow less rapidly in some periods and more rapidly in others, and it is hoped that -- in general -- it will average better than is assumed by these data. The purpose of

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[1] Due to the change in the fiscal year established by the Congressional Budget and Impoundment Control Act of 1974, fiscal year 1977 and subsequent fiscal years will begin on October 1 of one calendar year and end on September 30 of the following calendar year. Prior fiscal years, ending with fiscal year 1976, began on July 1 and extended through June 30 of the following calendar year.

presenting these assumptions is solely to provide a base for projecting the budget. The projections indicate what will result under present law and Presidential proposals if the economy follows a 6-1/2% growth path -- one that is not unreasonable judged by historical standards.

Budget Projections

The revisions in budget outlays, budget authority, and receipts through 1980 reflect:

- the out-year effects of the changed economic forecast for 1976;
- actions by the Congress and the President since February; and
- program experience since February.

Also presented in this section are two sets of projections required by section 221(b) of the Legislative Reorganization Act of 1970: Projections of outlays under open-ended programs and fixed costs; and projected outlays from balances of budget authority available at the end of fiscal year 1976 for non-mandatory programs.

The receipts projections in Table 16 reflect the economic assumptions presented in Table 14 and assume current tax law, except for the proposed modifications under the President's energy program. The outlay and budget authority estimates in Tables 17 through 19 indicate the degree to which resources would be committed by the continuation of existing and currently-proposed programs at the levels currently recommended for 1976. These projections are not intended as forecasts of future receipts, outlays, or budget authority because no attempt is made to predict future decisions or their effects. Nor are the projections intended as recommendations for future-year funding, since the continuation of Federal programs and taxes is a matter properly subject to continuous review in light of changing conditions.

Table 14

ECONOMIC ASSUMPTIONS FOR BUDGET PROJECTIONS[1]
(calendar years; dollar amounts in billions)

Item	Assumed for Purposes of Budget Projections			
	1977	1978	1979	1980
Gross national product:				
Current dollars:				
Amount	$1,891	$2,107	$2,335	$2,586
Percent change	12.6	11.4	10.8	10.8
Constant (1958) dollars:				
Amount	$897	$956	$1,018	$1,084
Percent change	6.5	6.5	6.5	6.5
Incomes (current dollars):				
Personal income	$1,515	$1,689	$1,874	$2,078
Wages and salaries	$978	$1,092	$1,211	$1,344
Corporate profits	$173	$193	$214	$237
Prices (percent change):				
GNP deflator:				
Year over year	5.7	4.6	4.1	4.0
Fourth quarter over fourth quarter	5.2	4.3	4.0	4.0
CPI:				
Year over year	5.3	4.4	4.0	4.0
December over December	4.8	4.2	4.0	4.0
Unemployment rates (percent):				
Total	7.2	6.5	5.8	5.1
Insured[2]	6.1	4.7	4.0	3.2
Federal pay raise, October (percent)	6.75	6.50	6.00	5.50
Interest rate, 91-day Treasury bills (percent)[3]	5.1	5.1	5.0	5.0

[1] Based on extrapolations using a 6.5% rate of real growth in GNP for 1977-1980.

[2] Insured unemployment as a percentage of covered employment; includes unemployed workers receiving extended benefits.

[3] Average rate of new issues within period.

In general, the outlay projections assume that program levels remain constant except where they would change under current law or where there is an explicit Administration recommendation to increase or decrease program levels over time. One example is the anticipated increase in energy research and development programs between 1976 and 1977. Similarly, while defense manpower requirements are assumed to remain constant, other defense purchases are assumed to rise by 4% a year in real terms. The projections allow for changes in beneficiary populations for programs such as social security. Allowances are also made for future cost-of-living adjustments to benefit levels, Federal pay raises, and other cost increases. These allowances are consistent with the economic assumptions outlined in Table 14 and with the effect of the proposed temporary 5% ceiling on automatic cost-of-living and comparability pay increases between 1975 and 1976.

Table 15

THE FISCAL OUTLOOK, 1977-1980
(in billions of dollars)

	1977	1978	1979	1980
Outlays under current programs.............	388.4	417.4	443.0	467.3
Outlays under proposed programs............	9.9	14.3	15.1	15.5
Total projected outlays...............	398.4	431.6	458.1	482.8
Receipts under current law................	364.0	416.4	466.4	517.2
Effects of energy tax proposals...........	+0.4	-4.2	-9.4	-12.4
Total projected receipts..............	364.4	412.2	457.0	504.8
Budget margin or deficit (-)...............	-34.0	-19.4	-1.1	+22.0

Table 15, above, compares projected total receipts and total outlays. The difference between these figures -- the budget margin -- is the potential budget surplus or deficit that would be expected to occur if there were to be no tax changes, no new programs created, and no discretionary program increases or decreases other than those currently recommended.

Table 16

RECEIPTS BY MAJOR SOURCE, 1977-1980
(in billions of dollars)

	1977	1978	1979	1980
Individual income taxes	151.3	174.2	197.5	222.9
Corporation income taxes	52.7	59.3	62.6	68.8
Social insurance taxes and contributions	106.3	121.8	136.9	150.0
Other	54.3	56.9	60.0	63.1
Total receipts	364.4	412.2	457.0	504.8

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Table 17

BUDGET AUTHORITY AND OUTLAYS BY FUNCTION
(in billions of dollars)

Description	1977	1978	1979	1980
Budget authority:				
National defense	119.0	128.8	138.8	147.6
International affairs	9.0	8.9	8.5	8.1
General science, space, and technology	4.8	4.6	4.2	3.7
Natural resources, environment, and energy	8.0	8.1	7.5	7.4
Agriculture	2.0	1.9	2.1	2.1
Commerce and transportation	14.5	14.9	27.9	15.1
Community and regional development	5.8	5.6	5.8	5.9
Education, manpower, and social services	13.2	13.2	13.2	13.3
Health	35.1	41.1	46.7	51.7
Income security	178.0	191.4	203.8	214.8
Veterans benefits and services	17.0	16.2	15.7	15.3
Law enforcement and justice	3.3	3.3	3.4	3.5
General government	3.6	3.6	3.7	3.9
Revenue sharing and general purpose fiscal assistance	7.4	7.5	7.7	7.8
Interest	38.9	40.4	41.4	42.4
Allowances	13.8	16.7	19.6	22.5
Undistributed offsetting receipts	-21.4	-22.2	-23.0	-23.8
Total budget authority	452.0	484.0	527.0	541.1
Outlays:				
National defense	105.5	120.5	131.6	141.5
International affairs	7.4	7.6	7.5	7.3
General science, space, and technology	4.7	4.6	4.3	3.9
Natural resources, environment, and energy	12.7	14.1	13.4	11.2
Agriculture	2.5	2.2	2.9	2.9
Commerce and transportation	16.1	16.5	15.8	15.5
Community and regional development	6.7	6.9	5.9	5.9
Education, manpower, and social services	13.6	13.3	13.3	13.2
Health	32.6	36.1	40.2	44.7
Income security	135.2	145.6	156.4	167.0
Veterans benefits and services	16.8	16.0	15.5	15.1
Law enforcement and justice	3.4	3.3	3.4	3.5
General government	3.5	3.5	3.6	3.7
Revenue sharing and general purpose fiscal assistance	7.5	7.5	7.6	7.7
Interest	38.9	40.4	41.4	42.4
Allowances	12.6	15.5	18.4	21.2
Undistributed offsetting receipts	-21.4	-22.2	-23.0	-23.8
Total outlays	398.4	431.6	458.1	482.8

Table 18

BUDGET AUTHORITY BY AGENCY
(in billions of dollars)

Department or other unit	1977	1978	1979	1980
Budget authority:				
Legislative and judicial branches............	1.4	1.3	1.3	1.3
Executive Office of the President............	.1	.1	.1	.1
Funds appropriated to the President..........	7.4	7.0	6.6	5.9
Agriculture:				
Food stamps and other nutrition programs..	9.0	9.2	9.7	10.0
Other Agriculture.........................	4.4	4.5	4.9	5.0
Commerce.....................................	1.9	1.9	1.9	2.1
Defense-Military:				
Military retired pay......................	7.7	8.3	9.5	10.3
Defense less retired pay..................	97.4	100.8	103.7	106.0
Pay and price increases...................	9.0	14.8	20.9	26.7
Defense-Civil................................	2.2	2.2	2.1	2.0
Health, Education, and Welfare:				
Social security...........................	77.7	86.2	95.4	105.1
Medicare..................................	21.5	26.5	30.8	34.5
Other Health, Education, and Welfare......	33.9	35.0	36.4	38.1
Housing and Urban Development................	54.3	54.1	54.0	54.0
Interior.....................................	2.2	2.5	2.5	2.6
Justice......................................	2.2	2.2	2.3	2.3
Labor:				
Unemployment trust fund...................	11.1	13.8	13.9	12.2
Other Labor...............................	4.0	3.7	3.8	3.8
State..	1.1	1.2	1.3	1.4
Transportation...............................	10.0	10.2	23.3	10.5
Treasury:				
Interest on the public debt...............	40.5	42.0	43.0	44.0
General revenue sharing...................	6.5	6.7	6.8	7.0
Other Treasury............................	1.3	1.4	1.5	1.6
Civil Service Commission.....................	14.4	16.4	18.5	20.7
National Aeronautics and Space Administration	3.6	3.4	3.1	2.7
Veterans Administration......................	17.0	16.2	15.7	15.3
Other agencies...............................	18.0	17.8	17.4	17.4
Allowances:				
Energy tax equalization payments..........	7.0	7.0	7.0	7.0
Other pay, price, and contingencies.......	6.8	9.7	12.6	15.5
Undistributed offsetting receipts............	-21.4	-22.2	-23.0	-23.8
Total budget authority.............	452.0	484.0	527.0	541.1
MEMORANDUM				
Federal funds................................	339.8	355.8	384.8	387.4
Trust funds..................................	145.9	160.8	177.8	193.9
Interfund transactions.......................	-33.7	-32.7	-35.6	-40.2
Total.............................	452.0	484.0	527.0	541.1

Table 19

BUDGET OUTLAYS BY AGENCY
(in billions of dollars)

Department or other unit	1977	1978	1979	1980
Outlays:				
Legislative and judicial branches	1.4	1.3	1.3	1.3
Executive Office of the President	.1	.1	.1	.1
Funds appropriated to the President	6.0	6.0	5.7	5.4
Agriculture:				
Food stamps and other nutrition programs	9.0	9.2	9.7	10.0
Other Agriculture	4.9	5.2	5.8	5.9
Commerce	2.1	1.9	1.9	2.1
Defense-Military:				
Military retired pay	7.7	8.3	9.5	10.3
Defense less retired pay	87.4	96.0	100.0	103.4
Pay and price increases	6.7	12.5	18.4	24.2
Defense-Civil	2.1	2.2	2.2	2.0
Health, Education, and Welfare:				
Social security	83.5	92.2	100.6	109.3
Medicare	18.3	21.0	24.0	27.2
Other Health, Education, and Welfare	34.9	35.7	36.9	38.3
Housing and Urban Development	8.2	9.3	9.6	10.7
Interior	2.0	2.2	2.2	2.3
Justice	2.3	2.2	2.3	2.3
Labor:				
Unemployment trust fund	14.6	13.7	12.7	11.4
Other Labor	4.1	3.7	3.8	3.8
State	1.1	1.2	1.3	1.4
Transportation	12.1	12.9	12.3	12.2
Treasury:				
Interest on the public debt	40.5	42.0	43.0	44.0
General revenue sharing	6.6	6.7	6.8	7.0
Other Treasury	1.3	1.5	1.5	1.7
Civil Service Commission	9.2	10.3	11.4	12.7
National Aeronautics and Space Administration	3.6	3.4	3.1	2.7
Veterans Administration	16.8	16.0	15.5	15.0
Other agencies	20.6	21.6	21.2	18.8
Allowances:				
Energy tax equalization payments	7.0	7.0	7.0	7.0
Other pay, price, and contingencies	5.6	8.5	11.4	14.2
Undistributed offsetting receipts	-21.4	-22.2	-23.0	-23.8
Total outlays	398.4	431.6	458.1	482.8
MEMORANDUM				
Federal funds	289.9	310.0	327.4	343.2
Trust funds	142.2	154.3	166.3	179.8
Interfund transactions	-33.7	-32.7	-35.6	-40.2
Total	398.4	431.6	458.1	482.8

Projections of Outlays for Open-Ended Programs and Fixed Costs

Section 221(b) of the Legislative Reorganization Act of 1970 requires that the President transmit to the Congress "summaries of the estimated expenditures for the first four fiscal years following fiscal year [1976], which will be required under continuing programs which have a legal commitment for future years or are considered mandatory under existing law." Table 20 contains these estimates.

Table 20 indicates that benefit payments to individuals under existing legislation are projected to grow by roughly $16 billion a year from 1977 to 1980. Although legislation to renew the program is pending, outlays for the existing general revenue sharing program are shown in this table as dropping from $6 billion in 1975 and 1976, to $3 billion in 1977, and to zero in 1978 because the current statutory authorization expires after December 1976 and only the existing program is currently "relatively uncontrollable." (In Tables 17, 18, and 19, however, the program is shown as continuing uninterrupted through 1980.) Outlays for other open-ended programs and fixed costs are projected to be relatively stable.

As the footnote on Table 20 states, the estimates represent simple projections of outlays under existing law. They are not intended to predict future economic conditions; nor do they reflect possible increases or decreases in the scope or quality of the program. Further, the resources that might appropriately be applied in later years will require a reexamination of the relative priorities of these and other Government programs in the light of economic and other circumstances then prevailing. Thus, the estimates do not represent a commitment as to amounts to be included in future budgets.

Table 20

PROJECTIONS OF OUTLAYS FOR OPEN-ENDED PROGRAMS AND FIXED COSTS UNDER EXISTING LAW[1]
(in billions of dollars)

Category	1976	Tr. qtr.	1977	1978	1979	1980
Relatively uncontrollable under present law:						
Open-ended programs and fixed costs:						
Payments for individuals:						
Social security and railroad retirement.........	76.3	20.9	87.9	96.8	105.3	114.1
Federal employees retirement and insurance......	16.0	4.3	18.6	20.8	22.8	24.9
Unemployment assistance........................	16.8	3.2	15.4	14.3	13.2	11.9
Veterans benefits..............................	13.4	3.0	12.6	11.8	11.2	10.7
Medicare and medicaid..........................	24.6	6.6	29.2	33.4	38.0	43.0
Housing payments...............................	2.6	0.7	3.1	4.0	5.6	6.9
Public assistance and related programs..........	18.4	4.9	19.3	19.9	20.4	21.0
Subtotal, payments for individuals..........	168.2	43.6	186.2	200.9	216.5	232.5
Net interest....................................	26.3	8.6	29.7	30.7	31.2	31.7
General revenue sharing (existing law only)........	6.4	1.6	3.4	---	---	---
Other open-ended programs and fixed costs..........	9.8	2.8	10.7	10.1	10.7	9.6
Total, open-ended programs and fixed costs, current law..................	210.6	56.7	229.9	241.8	258.3	274.8

[1] This table is supplied pursuant to the requirements of section 221(b) of the Legislative Reorganization Act of 1970 (P.L. 91-510). The estimates represent simple projections of outlays under existing law. They are not intended to predict future economic conditions; nor do they reflect possible increases or decreases in the scope or quality of the program. Further, the resources that might appropriately be applied in later years will require a reexamination of the relative priorities of these and other Government programs in the light of economic and other circumstances then prevailing. Thus, the estimates do not represent a commitment as to amounts to be included in future budgets.

NOTE: Detail may not add to totals due to rounding.

Outlays from Balances of Budget Authority Available at the End of Fiscal year 1976: Non-Mandatory Programs

Section 221(b) of the Legislative Reorganization Act of 1970 also requires that the President shall transmit to the Congress "summaries of estimated expenditures, in fiscal years following fiscal year [1976], of balances carried over from . . . fiscal year [1976]." Table 21 contains these estimates.

The current estimate of the balances at the end of fiscal year 1976 for programs -- the outlays for which are controllable -- is $187 billion, roughly $2 billion below the budget estimate. About $15 billion of this total is in guarantee and insurance program balances, very little of which is expected ever to be spent.

The spending pattern from the balances in other programs, which amount to $173 billion, is fairly consistent among the programs. Not surprisingly, the bulk of the spending takes place in the transition quarter and in 1977, and declines rapidly thereafter. On the average, more than 14% is expected to be spent in the transition quarter, 37% in 1977, and almost 16% in 1978.

Of the 1976 end-of-year balances in programs other than guarantee and insurance programs, about 14% ($26 billion) is expected to remain unexpended at the end of fiscal year 1980. Slightly more than $1 billion of the 1976 end-of-year balances are expected to expire (without being spent) during the transition quarter and fiscal years 1977 through 1980.

Table 21

ESTIMATED SPENDING FROM END OF FISCAL YEAR 1976 BALANCES OF BUDGET AUTHORITY:
NON-MANDATORY PROGRAMS
(in billions of dollars)

	Federal guarantee and insurance programs: Reserves for losses and standby and backup authority	Other unexpended balances, June 30, 1976	Total
Total balances, end of 1976 (current estimate)........	14.6	172.7	187.3
Spending from balances in:			
Transition quarter...............................	.1	26.8	26.9
1977..	.4	63.6	64.0
1978..	.2	29.1	29.4
1979..	.2	17.2	17.4
1980..	.2	9.0	9.2
Expiring balances, transition quarter through 1980....	*	1.2	1.3
Unexpended balances as of end of 1980.................	13.3	25.8	39.1

* Less than $0.5 billion.

Note: Detail may not add to totals due to rounding.

Chairman PROXMIRE. We will start the question period now, then.

Why, Mr. Greenspan, is your estimate less optimistic for 1975 for unemployment—you have increased your estimate of unemployment to 8.7 percent or something of that kind—and more optimistic for 1976? What is the basis for this kind of a change?

Mr. GREENSPAN. It basically is caused, Mr. Chairman, by the fact that the relationship that existed between the level of real GNP and the unemployment rate at the time when the original budget document was put together was apparently askew. And the forecast attempted to phase the discrepancy that then existed into the more formal relationship, and in this smoothing process we badly underestimated the early 1975 unemployment rate. Instead of returning to its normal relationship gradually, it did so very abruptly. In other words, it turned out that the deviation from the usual relationship during late 1974 was really quite short range and not something which could be projected.

So that what has occurred in effect is that the estimates for 1975 have been dramatically changed but, largely because of the fact that the relationship between unemployment and real GNP was phased back into the old forecast prior to the end of 1975, the estimates for 1976 were not affected.

Chairman PROXMIRE. But is it not true when unemployment goes up as high as you now expect it to go in 1975 in order to go down to the level that you had previously anticipated in 1976 you have to get a considerable improvement?

Mr. GREENSPAN. Certainly.

Chairman PROXMIRE. What is the basis for that substantial improvement in view of the fact that there seems to be a great deal of discouragement as I see it in the housing industry, for example, and some feeling that the automobile industry has not responded as they would like?

Mr. GREENSPAN. Well, we have at this stage virtually a half-year of evidence of what is going on in the economy so far as 1975 is concerned. So that even though the estimates are annual averages the central relationships we are looking at are not year-to-year averages but quarter-by-quarter or month-by-month patterns from which we then derive the actual annual figures.

First of all, it is certainly true that housing is well under its normal trend. Our view is that trends in household formations indicate a replacement demand in the market that is probably normalized in or upwards of the area of 1.9 million units of housing starts.

Housing starts, as you know, are running at an exceptionally low level. Even a housing recovery with starts rising to somewhere around 1½ million rate at the end of this year, which is about where our forecast occurs, will still involve a very substantial increase of approximately 50 percent from the present levels.

Chairman PROXMIRE. Now, let us stop right there because in housing there are two elements that in my view, and maybe you can disabuse me, are responsible for our difficulty. One element, of course, is the very high interest rates from a historical standpoint, the mortgage rates. They are still between 8½ and 9½ percent, a rate that is very discouraging, and many indications are it is likely to continue at that rate.

No. 2 is the fact that Government-assisted housing is expected to be for the next 18 months at a low level. We are told by the present Secretary of HUD, Carla Hills, that she anticipates that Government-assisted housing will not be the 600,000 that the goals provide but about 200,000.

Now, when you take those two combinations, the conventional being held down by high interest rates and the indications that high interest rates are likely to continue and the Government-assisted being held down because the programs will have difficulty getting started, it seems to me the outlook for the next year, year and a half, is not good in this very important area.

Mr. GREENSPAN. First, I certainly would agree that the key issue here is mortgage interest rates and I think that housing sales and completions have been suppressed by this. I think it is also important to recognize that the tide does not necessarily begin with the starts level but with the ability of our housing markets to absorb a number of these units.

I would suggest that even at existing mortgage rates we will soon find that the rate of starts would at least rise to the completion level or to 1.2 or 1.5 million unit annual rates. More importantly, we are beginning to see some very extensive amounts of mortgage credit moving into the market. Mortgage commitments are exceptionally high. The turnover of existing houses has improved markedly and I think that we will find that with the gradual moving of existing houses we can expect a rise in the normal basic market forces here even at these mortgage rates and we do hope that they will move lower.

Chairman PROXMIRE. You see, one of the great difficulties we have, I have, with your forecast is that our experience has been—the National Bureau of Economic Research indicated this in a study they made a few years ago—that forecasts for a short period, for 6 months or so, are likely to be quite accurate. For a longer period, whether they are Government forecasts or business forecasts or academic forecasts, they do not have that kind of a track record. Your short-term forecast is pessimistic, your long-term is optimistic, and it seems to me for that reason it is hard to put much confidence in this optimistic long-term forecast.

The second problem I have is that even if your optimistic forecast comes through and we have growth as I say at 100 percent higher than has been our normal pattern, 6 percent for a period of 3 or 4 years, we will still have a high level of unemployment right out to 1978.

Mr. GREENSPAN. Well, Senator, first of all, I would say that what I am forecasting at this moment are basically the next 6 months and I think that I would categorize 6-month forecasting as reasonably accurate. It is when you get beyond that that you run into problems.

Chairman PROXMIRE. Yes, and this is the period when it seems to be fairly pessimistic.

Mr. GREENSPAN. No. I would not describe our forecast at this point as pessimistic in any sense whatever. I would suggest that we are seeing, as you know, fairly clear evidence that the recessionary forces are spent. As you know there was a significant rise in building permits in April and a number of other indications in the housing industry which I think are quite favorable. Then we are, of course, seeing some fairly solid increases in consumer spending and I would not describe the outlook of the next 6 months in the context of what we have just been through as being pessimistic at all. I think, as I indicated the last time I was here, Mr. Chairman, that the growth rate will probably exceed a 7-percent annual rate in the fourth quarter.

Chairman PROXMIRE. Well, perhaps not pessimistic but you still have an 8.7-percent unemployment estimate for the year. You estimate that housing starts will attain a 1.5 level, annual rate, by the end of this year. What do you anticipate for 1976?

Mr. GREENSPAN. We think it is going to continue to move higher up toward the expected normal level by sometime in 1976.

Chairman PROXMIRE. What is that?

Mr. GREENSPAN. To about a 1.9 million annual rate.

Chairman PROXMIRE. Pardon?

Mr. GREENSPAN. About a 1.9 million rate of starts toward the end of 1976.

Chairman PROXMIRE. A million nine toward the end of 1976.

Let me ask you one more question. My time is almost up. Your midyear economic review—let me ask this of Director Lynn. Your midyear review I should say continues the practice of assuming spending for civilian programs, Mr. Lynn, remains constant in current dollars except where changes are mandated by current law. Defense purchases, however, you assume will grow 4 percent per year in real terms after you discount inflation. If we assume that defense and civilian programs are treated alike and held constant in real terms which may be or may not be the result of what Congress does, how would this affect your projected outlays by 1980?

Mr. LYNN. We do not have that at our fingertips, Mr. Chairman. We will be happy to provide it for the record.

I should go on and add that it is our feeling that we have seen for a period of time the funding of other programs in the Federal Government taken out of the defense portion. We in the administration, and the President, have been disturbed by this trend greatly and each one of us, and I know of your particular interest in this, is for as efficient utilization of dollars in defense as possible. We believe that the proper level of defense does require this kind of an increase on the procurement side.

As you know, that is a 4-percent increase per year for procurement, which means for total defense expenditures, a real increase more like 2 percent because half of the costs in defense are personnel requirements. But it is 4 percent on the purchases of the Defense Department.

Chairman PROXMIRE. Well, our estimates are—the staff estimates—that it would reduce the defense budget on constant real terms instead of 4-percent increase, about $10 billion. Could you say off the top of your head that that sounds about right?

Mr. LYNN. For what period, sir?

Chairman PROXMIRE. By 1980. Ten billion dollars annually by 1980?

Mr. LYNN. I would prefer to—Mr. McOmber, who is my Director of Budget Review, is having an instinctive reaction that no, it would not be that high. So I think that gives me my answer, that lest we give you a misstatement either way it would be best that we provide that for the record.

Chairman PROXMIRE. Very good.

[The information referred to follows:]

First, it should be noted that spending for civilian programs follows from the Administration's program, as well as current law. The projections in the mid-year review then hold civilian purchases constant in *real* terms. The only difference between the treatment of defense and of non-defense purchases, therefore, is the 4% real growth assumed for the procurement portion (but not the pay portion) of defense purchases.

The long-range projections for defense outlays include allowances for real growth of purchases of $1.2 billion in 1977, $3.2 billion in 1978, $5.3 billion in 1979, and $7.7 billion in 1980. Thus, holding the total budget constant in real terms implies outlays of $397.2 billion in 1977, $428.4 billion in 1978, $452.8 billion in 1979, and $475.1 billion in 1980.

Chairman PROXMIRE. Senator Percy.

Senator PERCY. Thank you, Mr. Chairman.

I would like to discuss something that is very much in the public mind and I am delighted to see it now in the minds of the administration, gasoline taxes. As you probably know, Mr. Lynn, I have long felt we ought to just bite the bullet, sock it right where it belongs, and I put in legislation months ago calling for a 20-cent gasoline tax this year and next year 30 cents. The President indicated that he would at least tilt the effect of the income tax toward gasoline. I have recommended that we push every conceivable way we can to keep it away from inflexible items such as petrochemicals, aviation fuel, heating fuel, and so forth, and put it right on the flexible line, on gasoline.

I know that Mr. Zarb yesterday said that he is looking toward 70-cent gasoline and that the effort is being made and intentionally to tilt the import tax toward gasoline rather than other items.

Is there now a real change in policy by the administration and a recognition that we ought to go strong not only for energy conservation, recognize the facts of life, but also to bring some revenue in and help reduce this deficit through a tax where we can take it on gasoline?

Mr. LYNN. I am not aware, Senator, of any change in policy by the administration in this respect. I think what——

Senator PERCY. It seems to be slipping out, though, gradually.

Mr. LYNN. No; I do not really think so. I listened to Mr. Zarb yesterday, too, and watched him, and I did not detect any change from what the President has said in the past. We believe that the tax should be on the whole barrel and let the economy operate, let the market operate as to where that may fall. There is some tilt, as we discussed before, toward gasoline in the short term, at least when we are talking about the $1 per barrel that was going on, and I believe that is still the policy. I have been in a number of meetings with respect to energy and one of the things that struck me as extremely difficult is to hit gasoline terribly hard and not work on the rest of the barrel. You get into differences of production that can warp refinery output tremendously if you take it too much out of the more volatile level side of the barrel. In other words, a refinery can only adjust to so much of the heavy ends and the light ends of the oil.

I have to say that my own particular biases are that I want the market to take care of the adjustment that is necessary as much as possible and the more that you direct, therefore, the burden toward one particular segment, whether it is gasoline or something else, the more difficult it becomes for that market to operate.

I must also say that the more we talk about allocation, the more we talk about hitting one part more than the other, it means more the involvement of the human beings in the Government trying to predict how much is enough in one place or another. As the chairman was saying, estimating future conditions accurately, for example, is very difficult to do, but it is essential to making proper allocations.

Alan, do you want to add anything to that.

Mr. GREENSPAN. No. I think that is fine.

Senator PERCY. I know how unpopular this is, but when you really get down to talk to people—and I have talked all over the State of Illinois for 7 solid days now—I do not know any one who does not recognize that this is a sensible program, to charge more for gasoline, to have a basic 500-gallon exemption for every driver for essential driving but try to restrict the excessive use of gasoline. And certainly to have an incentive and a penalty for those who buy large gas consuming cars or efficient automobiles is a sensible approach. These are the kinds of things that we are yearning to see the administration take a bold, imaginative, forward look on and I think the American people would be with them if they did.

Do we really think it is sensible any longer to deduct the State and local gasoline tax from our Federal return? That costs $800 million annually. Easy to pick up. And we know the "guesstimates" made are always on the generous side. Those are the kinds of things I feel we can do with some leadership from the administration. A lot of us down here will back you up if you wanted to really bring down the size of this deficit because we know what it costs us in the housing market alone to keep financing it.

I hope we even take another look at alcohol and tobacco taxes. They have not been increased in 23 years. They are the lowest in the world that I know of. We can easily pick up another $6 million by just reasonable increases in those taxes. I believe we do not have a lot of tobacco people in Illinois but we have got distilleries there and I think that would be sensible.

Those are just gratuitous suggestions. I think if we go after income we can start mixing it up.

I would like to ask about the deficit. I recall very vividly in December when Secretary Simon appeared before us and absolutely insisted the deficit in fiscal 1975 would be no more than $9 billion. I said my office has forecast a $17-billion, a conservative $17-billion, deficit. That was the minimum we could see. We have a comparatively small office, but with a pencil and paper they sat down and showed where it was. I gave the details to Secretary Simon. Yet a month and a half later, OMB or the Treasury came in with a figure of $34.7 billion and now we have got $42.6 billion. Those are really wide-ranging estimates. What I am saying is are we projecting what we hope is going to occur or what we realistically think is going to occur and why a little congressional office came up with better figures than all of OMB and the U.S. Treasury?

Mr. LYNN. Senator, this sounds a little bit like the kidding that I used to do with NOAA, the National Oceanographic and Atmospheric Agency, every year when I was Undersecretary of Commerce and I would say it appears to me from time to time, with all the millions you are spending, you are not doing a better job than the Farmer's Almanac does on the weather. I was kidding, of course, but there were times I felt that way.

I think what you are suggesting is that before I get any figures in the future I had better come see you and at least consult on what that private little shop of yours is doing. I did not have the pleasure of participating at that time when these earlier figures were being put together, but I can say to you on our estimates side both as to receipts and on those things that are not policy issues—by that I mean there are policy differences between certain quarters in the Congress and the President, and there we put forth the President's proposals—where we are estimating, we have done our best to make those reasonable estimates. You will notice that there has been quite an updating of those estimates.

Senator PERCY. There has been.

Mr. LYNN. In particular, we are showing some real increases in the so-called uncontrollable programs. That ties in very nicely, and I think your word of caution ties in with my own with regard to 1977. I think we are getting a real preoccupation with 1976. We must look at 1976 very, very hard; but the time has come when we must now ask a double barreled question or triple barreled, not just 1976. What is it going to mean when you take certain action with respect to 1977 and 1978 deficits?

Senator PERCY. Well, I cannot help but think of the difference accurate estimates make on the housing market, to all the finance institutions. The Treasury projected a $9 billion deficit and we end up with $43 billion. What a difference it makes in the whole money market of this country, the housing field, and so forth. I just think we have an obligation to be close.

I would like to just close with these thoughts. Is it possible for OMB to comment, when we come back, on these interim reporting sessions, on the estimates that are made by, say, the Senate Congressional Budget Committee, when it reduced OMB's February estimate of receipts from the Outer Continental Shelf lease by $4 billion? That is a terrific spread. I do not know of any comment here on the discrepancy, as to why the difference, whether we are wrong or whether you are wrong. If we are wrong we would like to revise our figures and update them but we ought to be getting closer together. Your midsession increase shows an increase in individual income tax receipts to $3.4 billion due despite the fact that the revised unemployment and inflation estimates are both lower than in February. It would be helpful I think if we comment on each others figures to see why we have such discrepancies.

Thank you very much indeed.

Chairman PROXMIRE. Congressman Hamilton?

Mr. LYNN. If I might just reply on the estimates, we have tried the best we can because the concurrent resolution from the Congress isn't precise in some areas, to see whether or not overall we have been more optimistic or the concurrent resolution has been more optimistic in the straight estimating business. The best we can calculate, and we are trying to work with the committees now, the staffs, to see whether we put it together right, they may have been a little bit inclined to be—to underestimate more than we did.

If you take the actual oil and take other estimates up and down, we are either at about the same—it nets out about the same in total or they are a little under us on total outlay effect, or total overall effect on the deficit.

Senator PERCY. Thank you.

Chairman PROXMIRE. Congressman Hamilton.

Representative HAMILTON. Thank you, Mr. Chairman.

Gentlemen, the general impression is that your projections for 1976 are brighter, somewhat less gloomy than they were earlier in the year when you made your first projections for 1976. What are the reasons that underlie the somewhat more optimistic projections?

Mr. GREENSPAN. First, I think it is important to recognize that the degree of accuracy in economic forecasting is less than what we would like it to be. And I would certainly subscribe to the chairman's remarks with respect to the accuracy, especially for more distant periods.

I would not myself put terribly much emphasis on the differences in these forecasts. In fact, I think I described them previously as qualitatively being approximately the same. When you consider the number of variables with which we have to deal, it is in the ranges of errors that invariably occur. I would say I am surprised that the differences between this forecast and the original one made approximately 5 months ago or thereabouts are as small as they are. Earlier in the year we suggested a very sharp econometric decline, early in 1975, followed by a bottoming out or a stabilization by midyear and a recovery during the second half of the year, accelerating moderately by the end of 1975 and into 1976.

There are differences in the numbers, and as you know, we published different numbers, but I would not want to make too much of the differences because it implies a degree of precision which we just do not have.

Representative HAMILTON. I understand that, Mr. Greenspan, but after you state all the qualifications and the uncertainties of economic forecasting, which we all readily acknowledge, you nonetheless come up with a somewhat better view.

Mr. GREENSPAN. Yes; I would think that——

Representative HAMILTON [continuing]. Now, why is that?

Mr. GREENSPAN. Well, first of all, the inventory liquidation occurred a bit more rapidly in this immediate, most recent period, than we expected, and the consumption of goods and services, so-called final demand, has also held up a bit better than was expected. Consumer expenditures basically have held up a bit better with the exclusion of automobiles, and in our original forecast of automobiles, we did not suggest anything resembling an auto boom and I would scarcely describe what we are having as that. So I would say that it is mainly in the area of consumer expenditures, ex-automobiles, and it requires really very little difference to do that.

Representative HAMILTON. Does the fact that you have a tax cut larger than you expected have anything to do with it?

Mr. GREENSPAN. In total it is difficult to judge where the changes are, but my judgment is that the answer to that is no—that this has been overwhelmed by other things that have occurred since the beginning of the year.

Representative HAMILTON. May I also ask about the budget deficit you project, which I think was $59.9 billion for 1976, and I wonder if you could indicate to me the assumptions which underlie that figure. With that figure, are you assuming that the President's program with regard to energy and the cap on social security benefits and all the rest of his program will be enacted as——

Mr. GREENSPAN. Yes, sir.

Representative HAMILTON. That is the assumption which underlies——

Mr. LYNN. Except the 5 percent on social security is not assumed any longer, and the $59.9 billion deficit assumed that the President's effort to put the cap on the social security will not come about.

Representative HAMILTON. What is——

Mr. LYNN. There are other caps, though, on civilian and military pay, and we still believe that Congress should enact those ceilings for this year.

Representative HAMILTON. What about the possibility of Congress extending the tax cut into 1976? Is that figured into this $59.9 billion?

Mr. LYNN. It is not, sir. We assume that the current law holds and the other side of that coin is that the extra tax cuts expire at the end of the year.

Representative HAMILTON. Now, I recall a few days ago reading about the increase in estimated receipts. My recollection was $7.5 billion. But I don't find that in the statistics here. I think that was estimated receipts for fiscal year 1975. Is my memory in error on that?

Mr. LYNN. If you have before you the update, Mr. Hamilton, on page 11, table 3, we show the differences in the estimating on the receipts for 1975 and 1976.

Representative HAMILTON. Thank you. That is helpful.

Now, why the underestimated individual income tax receipts? You were way off on that, over $7 billion. That is quite an error. What accounted for it?

Mr. LYNN. I will quote from our update on page 10, and I should say that this is essentially what Assistant Secretary Fiedler said at the press briefing we had last Friday: "The data are not yet available to assess accurately the reasons for this underestimate."

The simple answer is we don't know.

Mr. GREENSPAN. I should explain why we don't know.

Mr. LYNN. That is better.

Mr. GREENSPAN. The data are collected as they are received by the Treasury and all you have as a specific figure is a check on the income tax form. We don't know the extent to which the estimates are incorrect ahead of time because, for example, of variations in the capital gains tax, the need to base estimates upon a number of assumptions which relate to the specific items that appear within the tax forms, some of which may prove to be inaccurate, and it is only when either a full sample or a rather large sample or a full editing of all the tax forms is in within a year or two that we know why that estimate was wrong. We will then know exactly where the tax receipts came from with respect to the nature of the income itself.

Mr. LYNN. I can add one thing, Mr. Hamilton, that the things that resulted, the extra receipts that resulted in the estimate being so far off were bunched at the end. It has come in at the end of the fiscal year. I should also give one more warning. As we put on page 10, "There is still considerable uncertainty as to what tax collections will be in June, especially because large corporation income tax payments are made in that month." And just as we have had in the other areas of taxes this bulge at the end with extra receipts, we don't know which way that is going to fall with respect to the corporate receipts.

I can say as your friendly Budget Director that this is something I am going to be as curious on as you are, because those receipts estimates are extremely important to the work of the Congress as well as the work of the administration.

Representative HAMILTON. I notice you put your estimate up on individual income tax receipts for 1976. Was that done because the receipts are higher than you anticipated?

Mr. MCOMBER. Mr. Hamilton, it is a combination of our experience with 1975 receipts and our assessment of the economic assumptions that caused that $3.5 rise.

Representative HAMILTON. Thank you, Mr. Chairman.

Chairman PROXMIRE. Congressman Brown.

Representative BROWN of Michigan. Thank you, Mr. Chairman.

Let me thank you gentlemen for being here this morning. It is nice to see you again, Mr. Director, former Secretary.

You mentioned in your discussion of the energy bills about the comparison of the President's proposal with what Ways and Means has done, and you mentioned that you can accomplish a tilt for gasoline. I thought you were mentioning that in the context not of just market forces but in a different way. How do you accomplish this tilt?

Mr. LYNN. I must admit, Mr. Brown, that although I have a general working knowledge of this area, I am by no means an expert as to how FEA goes about doing this type of thing. Maybe Mr. Greenspan can add to this.

The main point I was trying to make, was that we really do believe that the economy can more easily adjust to the conservation measures that we believe are necessary if you spread the burden across the barrel rather than zeroing in on one particular place for it to be felt.

That doesn't mean some adjustment might not be advisable, but we are inclined to believe you ought to treat the whole barrel. When I say that I should add that it is interesting to note in the Ways and Means proposal they do try to treat part of the barrel beyond gasoline too. There are taxes on business for the use of oil. It is just that the committee tries to stay away from the concept of a tax on the barrel. You tax the gasoline, you tax the business usage of oil, and therefore, it isn't just a gasoline tax by the committee.

So they recognize, too, the need to treat the barrel across the board but they don't like talking about it in terms of the barrel.

Mr. Greenspan, would you like to add anything to that?

Mr. GREENSPAN. I think the FEA regulations on how the cost increases are passed through byproducts in a sense are regulations which adjust or can affect the prices of different products as they come out of the refinery.

Representative BROWN of Michigan. Senator Humphrey isn't here this morning but I will take up the cudgel for him and say with the present situation on the farm, how can you justify raising the cost of fertilizer through a tax on a barrel of oil?

Mr. LYNN. Well, first of all——

Representative BROWN of Michigan. As compared with nonnecessary driving?

Mr. LYNN. The minute you get to the question of nonnecessary driving, there are only two ways of addressing that. One is the——

Representative BROWN of Michigan. Let's presume all driving as compared with——

Mr. LYNN. OK. Because if you wanted to get finite on who is doing necessary driving and who isn't, you are talking about rationing and I want to stay as far away from that as I possibly can.

Now, with respect to the farmer, first of all, one of the things that is overlooked in the President's program constantly is the return of the money collected by the taxes to economy and we are still talking about that in the President's energy program. The energy program that is reflected in this budget is the President's original program updated to reflect changes that have already occurred. We couldn't put the program in April 1 any more by definition. So we had to, for budget presentations, make an assumption of a future date and we chose September 1 for that purpose.

We already have a difference in pricing to some extent in this situation and we had to take into account certain tax changes with the oil industry already. So there is a return to the economy that way.

Second, the President himself said I believe in a speech that he gave some months ago that he fully recognizes the problem on the farm side and that some relief would have to be given there, and I don't believe we have forgotten that statement.

Representative BROWN of Michigan. I am not sure that is too encouraging to farmers, though.

Mr. LYNN. No. Well, what we had hoped, Mr. Brown, was that as the President's proposal progressed in the Congress, that our people in the FEA, Frank Zarb, and others would sit down with the committee in the Congress and work out precisely how that should be done to help the farmer. And I know Mr. Zarb stood ready to do that, that is, working with the congressional committees. Unfortunately the discussion on what kind of an energy proposal we should have moved from the President's program to some Hill initiatives, which did not include any of the redistribution in the form of tax rebates that were in the President's program.

Representative BROWN of Michigan. Following the President's talk the other evening when he indicated that the extra $1 per barrel would be imposed, there were many critics of his talk and of his action who mentioned the inflationary impact and some of these same critics were supporting the Ways and Means bill. Can you reconcile criticism of the President's action with the proposed congressional action?

Mr. LYNN. I must admit that that criticism of his statement somewhat bewildered me, at least as to substantive grounds for the criticism. The committee proposal has a cumbersome and questionably effective rebate system, full of all sorts of exceptions.

Under the President's program, as you know, the $2 on oil, both foreign and domestic, the 37 cents on the natural gas, and so forth, were supposed to be returned through tax rebates to the American people. I have not seen anything in the committee proposals—perhaps

I am forgetting them—that would efficiently get those taxes returned to the people. We believe that the economic effect of our energy proposal, the President's energy proposal, would be pretty much neutral because of the refunds, the return of tax receipts to the economy. That doesn't mean that there would not be certain greater effects on some part of the economy than others. There always is in any action you take. But overall it would be neutral.

You will recall the debate of some months ago as to the ripple effect and that indeed the effect on the Consumer Price Index would be more than the 1½ to 2 percentage points that we predicted as a one-shot increase in the CPI, and that it is really much more than that.

Now, I have noticed again we are hearing a repeat of that same sort of thing out of another study that has been done very recently. We still don't believe that is the case. We do believe there will be the increase in the CPI, offset by the return of the money to the American people to cope with that increase. We reflect that quite honestly in our forecast, in our economic assumptions on page 9. The rate we show for the CPI, December over December and year over year, reflects the one-shot impact on the CPI of the President's energy program.

Representative BROWN of Michigan. Let me shift gears for a minute and ask you about housing. There has been a drawdown as I recall of somewhere around $6 million in the GNMA conventional plan and yet we still have reflected, as the chairman mentioned, mortgage rates of 8½, 9 percent, whereas the GNMA program provided for a secondary market at much lower rates. Why hasn't that lower rate been reflected in the cost of mortgage money today? Is it because——

Mr. LYNN. Which lower rates would be reflected?

Representative BROWN of Michigan. Under the GNMA conventional program which by and large results in below 8 percent now, doesn't it?

Mr. LYNN. I don't remember what it is now. I have kind of lost track in recent months. I believe it is around what, 7½, I think was the last rate that I was familiar with.

Representative BROWN of Michigan. But the first money went out a little above 8 under the Proxmire amendment.

Mr. LYNN. Yes, and what you are asking is why doesn't that affect the overall statistics as to where the interest rates are.

Representative BROWN of Michigan. Yes. Is it because this money has not been actually committed to units built since the program came into being? Is there that much lag time?

Mr. LYNN. I will have to ask Mr. Greenspan, because I don't know where those figures come from, whether they are on loan contracts or—the interest rates shown on mortgages, those are closing, aren't they? That could account for part of them. I am just guessing, because, as you know, the tandem program is one in which a commitment is made in advance and it is only after the home is built and the buyer for the home is found that you close the transaction, but that could be one of the reasons.

Representative BROWN of Michigan. Then can't we then expect that program to help reduce interest rates the latter part of this year as those commitments are actually, as those commitments become actually mortgage loans?

Mr. LYNN. If it did, Mr. Brown, I don't know that that would affect those rates that are being offered apart from tandem by the savings and loans because they still have to look at what they are paying to their depositors for money, whether long term or short term, and look at their own overhead and look at what they think is going to happen in markets in the future and decide their interest rate that way. Unless it is going to be some kind of a subsidized loan. It might bring the statistics down, but I don't think that it would alter a whole lot the savings and loan patterns unless the tandem program should become so huge that there isn't any business left for the savings and loans, and that would worry me substantially.

Representative BROWN of Michigan. My time has expired. Thank you very much.

Chairman PROXMIRE. Gentlemen, let me try to indicate what our problem is. I realize you have got a time problem. Let me say what our problem really is with what you have given us this morning, what you have given in these projections. You see, what we are talking about here is what should be our fiscal policy, our spending and tax policy, what should be our monetary policy, and that is the whole purpose, I take it, in having this kind of a discussion, so we can determine on the basis of a sensible kind of economic estimation of what the future is going to be like, what we ought to do.

Now, on the basis of this very, very rosy notion that we are going to have 6.5-percent growth between 1978 and 1980, as I say, that is twice as great as we have on the average in the past and the notion that we are going to have 6.3 over the next couple of years, we still would have unemployment on the basis of your estimate at 7.2 percent as late as 1977, 6.5 percent in 1978, and only then that would go down to 5.8 percent in 1979 and 5.1 percent in 1980.

Now, if we take the best years we have had in the last 30 years, the years of 1961, 1962, 1963, 1964, when the economy was growing rapidly, and assume that we are going to have that kind of growth, then we will have unemployment of 8.5 percent next year, 8.3 percent in 1977, 7.8 percent in 1978, 7.3 percent in 1979.

What I am getting at is it seems that the most logical and likely course of the economy is going to be such a heavy level of unemployment, so much unused capacity, that we should find ways of stimulating the economy as vigorously as we can. I would like to do it with monetary policy as much as possible. However, we do it, it seems to me even on your optimistic assumptions, if we are going to put our people to work and we are going to cut down on unemployment to a level that would be acceptable, it would seem to me that Congress and the American people—we have to have a more vigorously stimulative policy of some kind.

I would like to get your answer to that.

Mr. LYNN. I would like to start, Alan, if I might, just in general terms. Everyone wants to get those unemployment figures down. Certainly no one wants that more than the President of the United States. But I believe there is a growing awareness as we have seen recent figures that additional stimulus at this point could be totally counterproductive toward that goal of getting unemployment down. In fact, it could turn off the recovery so that we don't have the upturn, but the opposite. The one thing we don't want to be any party to is putting a huge dose of stimulus in there at this time and everybody seeing everything glorious for a period of 6 or 8 or 10 months.

Chairman PROXMIRE. That is very good rhetoric, but where is your logic? Where are your figures? What is too excessive a stimulation? Isn't it true, if we are going to get 6½ percent growth, twice the rate of growth that we have had in the past, we have to have some kind of economic leadership on the part of the Federal Government?

Mr. LYNN. We think we are giving that leadership, and we would hope that the Congress would join in that same leadership, Mr. Chairman. We don't think it is leadership to give us bills like the recent job assistance appropriation (the Emergency Employment Act), but would actually subsidize the Postal Service, buy more automobiles and add some more money to the general fund for buildings and construction in a way that does not really help employment.

Chairman PROXMIRE. Director Lynn, let me tell you I voted against that Job Assistance Act program. I would vote to sustain the veto. I thought it was wrong. It is a program that is going to come on the scene too late, won't become effective for 3 or 4 years.

My problem is the administration doesn't come up with anything, anything except the tax cut we had last year. They apparently oppose the emergency housing program we suggested, oppose any kind of vigorous monetary stimulation, nothing except this kind of a rosy optimistic notion that somehow, somewhere, we are going to get twice as great a growth in the economy as we have had in the past, and that is going to gradually reduce this very high level of unemployment.

I think that is a very poor prospect.

Mr. LYNN. Mr. Chairman, suppose we are right with respect to the 6.5 percent and you are wrong in this connection and, based upon your judgment, we have the Federal Government go out and borrow a lot more money than even those huge amounts we have to borrow now, and suppose that money is used for the kind of contracts that generally would be required by the kind of initiatives that the Congress is coming up with, and now the path of recovery is as we say it is.

Now, we have signed all those contracts in Commerce, Interior, in Health, wherever it may be. There is no way to turn them off. It is a little like you go beyond the cliff and jump off. There is no way of getting back up and defy gravity.

Chairman PROXMIRE. I am not recommending a bigger deficit.

Mr. LYNN. You are not?

Chairman PROXMIRE. I voted for the Dole amendment, to reduce the budget ceiling. I think there are ways in which we can stimulate the economy without a bigger deficit. The emergency housing program is one. It would reduce the deficit, bring in more revenues than it costs.

Mr. LYNN. Is that true?

Chairman PROXMIRE. We estimate it would bring in about—over $2 billion and cost about $1 billion, and I am sure you will recommend a veto to the President on that.

Mr. LYNN. I would like to see the bill before I make any recommendation. I believe action hasn't been taken by the Congress yet.

Chairman PROXMIRE. I am happy to hear that.

Mr. LYNN. But what I am saying is every proposal that is made by any group for Federal expenditures claim that we always are going to get back more than we will be putting out. When you are talking to one group or another, they stress the impact of their proposals on creating more jobs. I think we need more jobs and we need them as soon as we can get them, but I want to see those jobs come now from the private sector doing the right thing to bring them back.

Chairman PROXMIRE. Precisely, and that is why I think something like the emergency housing program is useful and also why I think monetary policy is useful, but when you have a situation with 7.5- or 8-percent unemployment, when you are operating that far below capacity, the likelihood of inflation coming from excess demand is really de minimis. There is really very little of it.

I would like to ask Mr. Greenspan to comment.

Mr. GREENSPAN. First of all, let's put the 6.5-percent growth rate in perspective. First of all, these were not done in the sense that we look at past rates of growth. I think two things have to be considered. One, we are starting at a much lower level than any of the previous periods during which you can make comparisons, and I think it is important to recognize that the rate of growth is a function of the basic level from which you start.

Second, the projections do not specify what the rate will be in 1977, 1978, and 1979. As we have indicated in the text, we are putting them in largely as projections that we may very well find that while on average we get that level, we may very well get up to a far sharper level of real growth in 1977, so that in a sense the recovery which we are looking at may very well occur much quicker than we have it in those particular numbers.

We want to emphasize that those numbers are not forecasts. What we basically are looking at is a projection. We were actually, in fact, discussing the meaningfulness of putting in the intervening years on a linear projection.

Chairman PROXMIRE. Indeed, they are not forecasts, but you see, if we assume this is the rate of growth and it is optimistic based on past experience, if we assume that is the rate of growth, then we get a diminution of unemployment at a fairly moderate level and we go way out to 1980 before we get it down to 5 percent. The point is, if we don't get that, then we are going to have an unacceptable level of unemployment and idleness, not only of human resources but also our factory resources.

Mr. GREENSPAN. Senator, I would not state at this particular point that I know we won't be getting a huge increase in 1977 so that a goodly part of that growth which we are projecting from 1976 to 1980 may very well occur in 1977.

And this is one of the reasons why I think it is important to recognize that when this economy gets moving, we don't know how much momentum there is.

I think you pointed out very correctly, Mr. Chairman, that our forecasting capability, especially that far out, is not very good, and when we are at these levels of activity I think it is quite possible that the average rate of unemployment is going to be a good deal lower than we show in that linear projection.

Chairman PROXMIRE. Gentlemen, I realize you have been very gracious with us in giving us this time. If either Congressman Hamilton or Congressman Brown have a question or two that they would like to ask, if you will permit it—I know you want to leave promptly, as promptly as you can.

Mr. LYNN. The one thing I don't want to do is get in a bad way with either body and the other body is waiting.

Chairman PROXMIRE. The other body is represented by the two other questioners, though.

Mr. LYNN. I know. So I will defer to your own judgment.

Representative HAMILTON. I have no further questions.

Representative BROWN of Michigan. I have nothing.

Chairman PROXMIRE. Thank you very much, gentlemen.

Mr. LYNN. Thank you. We will retreat to the "other body."

Chairman PROXMIRE. Our next witnesses are Robert W. Hartman, Brookings Institution, Edward M. Gramlich and Barry M. Blechman, also of Brookings Institution.

You are, I understand the authors of "Setting National Priorities: The 1976 Budget."

Mr. Gramlich, I understand you will lead off.

STATEMENT OF EDWARD M. GRAMLICH, ROBERT W. HARTMAN, AND BARRY M. BLECHMAN, THE BROOKINGS INSTITUTION

Mr. GRAMLICH. Senator, thank you for asking us up here to testify. We understand that we are talking about the midsession OMB review which you have just been discusssing and we just got this on Friday night—unfortunately we have not had time to prepare a formal statement. So we will just be talking from notes.

We also understand that we have sent up some drafts of various chapters in the book that we are currently preparing on the budget and most of the numbers in those drafts, and any tables that may be around, are based on the initial budget estimates which are in fact fairly close to these revisions. But just to avoid confusion in our remarks this morning, we are going to be talking totally in terms of the numbers of the midsession budget review.

What we would like to do in our talk this morning is essentially two things. The first is to talk about the numbers a little bit and say where we think that they are strong and weak and emphasize a few things about the numbers. Then we would like to go on from there and talk about what we understand to be the purpose of all this, that is, the implications of the longrun budget outlook proposed by OMB or revised now by OMB, and what it means about budget planning and policy options, and so forth.

We are not really economic forecasters, but having seen the economic assumptions in table 2[1] which you have been discussing at some length already, we feel that we would really like to say a couple of things about those forecasts.

First of all, in terms of where the economy comes out, that is, the growth in real GNP, unemployment, and so forth, the forecast in table 2 is really quite standard now for the forecasting fraternity. We have taken a look at several forecasts, and if we just focus on calendar year changes, 1976 or 1975, it is a fairly standard assumption to expect that real GNP will rise in the order of 6.5 percent. The unemployment rates of 8.7 and 7.9 are fairly standard. The rate of inflation in the forecast here is I think a little above the standard

[1] See table 2, p. 9.

estimate, but that is because the administration is still assuming that the energy package is put into effect, and many forecasters have revised assumptions on that.

But what I think is not standard about the forecast, and I think what ought to be pointed out about it, is that it is our impression, and it is certainly true in all the forecasts we have taken a look at, that most of them make the assumption that something like the budget of the congressional first concurrent resolution on the budget will be the appropriate fiscal policy in fiscal 1976. The forecast here, on the other hand, is still assuming essentially the budget as proposed by the President in January.

There are a few revisions mainly in connection with things that were supposed to have happened by now but in fact haven't happened. But apart from that, there are no important shifts, and if you look at the budget, defined at full employment, which is given in table 1,[1] there is really a rather slight $4.5 billion change between February and now. That is not trivial, but it is not terribly large. And just by way of comparison, our calculations of the implication of the first concurrent resolution on the budget of the Congress is that instead of shifting from a full employment surplus of 11.6 to 7.2 as is shown here in table 1, it is 11.6 to something like minus 6 billion. In other words, the Congress' really is a much more stimulative budget, and it is our impression that most other private forecasters who come out with similar GNP results as the administration does have also made this assumption of more stimulative fiscal policy. Thus, I think the first question to be raised about it, which indeed you have been raising more or less directly in the previous questioning period, is whether the budget policy implicit here which magically holds the line in deficit at $60 billion is enough to bring about the fairly optimistic economic projections that OMB is now making for fiscal 1976.

Second, I would raise a similar point about monetary policy. Just to give you a few more numbers, in the economic assumptions here the percentage change in current dollar GNP, 1976 over 1975, is 14 percent in this forecast. If you look at the bottom line of the table, the forecast assumes that interest rates are stable; that is, they don't rise—this is a very important point—they don't rise even in a period when real GNP is now turning around and starting to go up, and even in a period when there is still a sizable amount of inflation.

Now, one of the economic relationships that still does hold up pretty well is that there is a relationship between the rate of growth in money supply and the rate of growth in GNP. The implication of that relationship is that in order to achieve these two objectives—one, stable interest rates; and two, growth in current dollar GNP of 14 percent—you would need some sort of double-digit rate of monetary growth at least for a while. The precise number that comes out of that calculation is 12 percent. Arthur Burns has come down here and has said that he is aiming for from 5 to 7.5 percent, and I think the second question about the forecast is whether the stated intention of monetary policy is consistent with the economic assumption given here in table 2.[2]

[1] See table 1, p. 8.
[2] See table 2, p. 9.

So we are raising these questions both about fiscal policy and monetary policy, and it is our impression—we have done a little research on this over the weekend—that if you adjust for the tighter policy assumptions that the administration forecasts of table 2,[1] while maybe not totally out of the range of forecasting, because things are quite uncertain at the present time, it is at least on one side in terms of the assumption that it makes about the underlying animal spirits of the economy. They are assuming a lot of animal spirits and to give this forecast with the tighter policy assumptions.

That is what we would like to say about the short run. We also want to get into the long-run question because this session really should focus much more on that. In a minute Bob Hartman is going to talk in more specific policy terms, but I just want to pave the way for him by trying to put the long-run forecast that OMB has made in this document in historical perspective.

Let me do that by giving you two numbers. The first number is that if you adjust for cyclical movements both in GNP and in Government expenditures which again for these purposes we think is an appropriate thing to do, in 1960, a concept that we call permanent Government expenditures relative to full employment GNP was 17.3 percent. In 1970, after a decade of Great Society programs and then toward the end of the decade the large increase in military expenditures for Vietnam, that percentage has risen to 20 percent. In the President's program as initially proposed in January, it was back to 18.3 percent. In other words, even though there was an increase in the share of output devoted to Government in the sixties, that in the 1970's that had not only stopped, but had also reversed itself.

Now, the latest estimates changed that a little bit. If you take the President's program as revised, the share goes up to 19.4 percent. If you take the congressional budget in the first concurrent resolution, it goes up to 19.7 percent. But it is still true that even in the congressional first concurrent resolution, there has not been a growth in the share of output devoted to Government for the decade of the seventies. Thus, I think the first point to be made about this is that in terms of where we are today, the Government's share has remained stable, and is certainly not getting out of hand in any sense. Government seems to be growing at approximately the rate of full employment GNP.

Now, what does this mean when we look forward to 1980? Well, the administration has on table 15[2] given some very useful numbers. They show the budget outlook to 1980 both as they propose it in the budget and in the without any new programs. Let me just focus on the latter, that is, the implication of the budget as is implied by the present expenditure and tax programs of the Government. The 1980 number of $467.3 billion in expenditures in the actual budget translates to a share of Government devoted to government of just very slightly higher than the 1960 proportion, very slightly higher than 17.3 percent.

This means if, for example, the Congress and the administration were to call a 4-year moratorium on new expenditure programs that the share of output devoted to Government would gradually drift back to 1960 levels, not quite all the way, but very close.

[1] See table 2, p. 9.
[2] See table 15, p. 28.

If, on the other hand, you were to remain at the 1970 level, which is also approximately the level implicit in the first concurrent resolution, the expenditures could be $60 billion above the $467.3 given there. In other words, though this is very, very shorthand, back-of-the-envelope budget analysis, I think it is important to point out that it would be possible to spend something like $60 billion in new expenditures and still be consistent with maintaining a stable share of Government.

Obviously the—you could go anywhere in between that range. You could even go outside it if you decided that the share of Government ought to be at a different level that was true in the past. But again, it is important to make the point that on the one hand there is some room for some new programs sometime between now and 1980 and that that is consistent with a stable share of output devoted to Government.

Now, let me make two other points. One concerns the question that you are raising already about the $7 billion underestimate in personal tax revenues in 1975. We think we know part of the reason for that, and we think that it also has an implication in these forecasts.

Very briefly, we think that the OMB way of making projections underestimates the sensitivity of personal income taxes to changes in personal income and that that is one of their problems in 1975.

We have done some calculations and we think that the receipts under current law, if you adjust with that, are low by $25 billion.

Senator PROXMIRE. Mr. Gramlich, this is a very, very helpful opening statement. I would appreciate it if you could abbreviate your remarks so we save as much time as possible for questions. I want to leave some time for Mr. Hartman.

Mr. GRAMLICH. The other point is just the question about whether the payments to individuals are getting out of control, and this could be described in the same way. There has unquestionably been a rise in the share of Government expenditures devoted to payments to individuals in the early 1970's. That share grows from 6.5 percent in 1970 to 9.2 percent now, but again the rise appears to be slackening off, and indeed, in the 1980 projections, it is slated to fall back down toward 8.9 percent.

So again there is a picture of a rise at this time in the 1970's, but again the longrun projections given by OMB do not seem to indicate that that part of the budget is getting out of control either.

Now I would like to turn it over to Bob Hartman who will talk more specifically about some of the policy questions.

Chairman PROXMIRE. Mr. Hartman, we would appreciate that very much. As I say, it is 11:25 and we would like to question you if possible, so if you would limit your remarks to 10 minutes.

Mr. HARTMAN. Fine.

Chairman PROXMIRE. Mr. Blechman, do you have a statement?

Mr. BLECHMAN. No.

Mr. HARTMAN. What I want to do is talk a little bit about the uses of these long-range projections. I think we are at the stage where we want to know what to do with these.

The longer range projections of Federal expenditures and revenues presented in February and at the midsession review should become the focus for conscious budgetary planning. The projections have no real value unless they are used. Both the administration and the Congress should use these projections to set the framework for debate over current legislation; so that an integrated future plan guides present deliberations. I do not think that this second step has yet been taken, either by the administration or by the Congress, and I hope here to briefly indicate what is needed to make the projections a useful guide to policy.

First let me talk about outlays under current programs. These estimates show the spending implications of existing programs, with entitlement programs adjusted for beneficiary growth and inflation; with national defense and operating programs adjusted for pay and price increases; and with most other programs held to more or less constant nominal amounts. Particularly grants-in-aid are treated that way. It would certainly be a mistake to settle upon such a spending plan as a target for 1980, and even as a baseline budget, these outlays under current law leave something to be desired because of the imbalanced treatment of grants-in-aid which are not, generally, adjusted for inflation. We have attempted to estimate a current real services budget, which adjusts all programs for inflation to be used as a baseline. We estimate that this real services budget would be between $476 billion and $482 billion at full employment in 1980. That would be about 18 percent of full employment GNP.

I want to say right away that current services need not be continued to 1980 if they are wasteful, so one way to begin planning for what we want to do is to look at parts of the current year's services that the Nation can live without.

In our forthcoming study, we have looked at three principal ways of reducing spending under current law that merit attention. Let me just mention them and you can follow up if you want.

The first one is to eliminate the double counting of inflation for future social security retirees, which has the effect of raising the relationship between initial social security benefits and past wages. If we correct this mistake between now and 1980, we would be saving in that year about $5 billion.

Second, if we were to eliminate the 1 percent add-on bonus in the escalator in Government employee retirement programs, which overcompensates such people for inflation, we could save $1 billion to $2 billion by 1980.

In defense, a variety of efficiency measures and adjustments to new foreign policy facts in Southeast Asia that are discussed in our book could save anywhere up to $15 billion by 1980.

These potential savings may be contrasted to the administration's proposal for savings, which consist of caps on a number of entitlements programs and selected cuts in several health programs and in grants-in-aid for education and social services.

Looking in the other direction, namely upward, the menu of possible additions to spending is, of course, very long and it would be presumptuous of us to attempt to even suggest a well-rounded dinner. Current and past volumes of "Setting National Priorities" have, however, discussed and estimated the cost of national health insurance, welfare reform, and improvements in the defense program. Incidentally, real increases in defense as well as the energy tax offset payments constitute most of the administration's additions to outlays in their projected budget.

Now, the question of how much the Federal Government should be spending in 1980 could be discussed in philosophical terms, or it can be discussed by looking at the historical ratios, as Mr. Gramlich did. There are, however, some technical aspects to this that I would like to raise because I think it is important when we look at the outlays under current law that we understand what is implied by the projections.

The technical issue that is of some importance here is how we ought to treat inflation, and in particular growing Government salaries, in the context of budgetary planning. The OMB convention in defense projections, for example, is to fix the amount of manpower and plug in pay increases to 1980. The question should be raised whether this is what we expect to materialize or should Government agencies be expected to find productivity improvements to pay for part or all of their real pay boosts. Since grants-in-aid are ultimately used by State and local governments primarily for salaries, the same question arises there: does the Federal Government guarantee State and local governments inflation-escalated payments or does it insist that they too, find manpower savings?

Let me turn to my original theme, and try to wrap up the outlay part, by saying the administration would do the Nation a service and the Congress a service by going one step beyond the production of the numbers for the longer range projections. That next step should consist of a clear enunciation of its preferred public sector share for the future and a statement of its desired longrun policy toward compensating for inflation in grants-in-aid and operating programs. All that Congress has been told so far is the administration wants to cut entitlement programs to hold down longrun costs of government. But Congress can better decide if that is a good idea if an explicit overall goal for Federal spending is set forth.

I would note here, that OMB is very strong on pointing out that their projections are only projections and not forecasts. There is a third thing—that is what I am calling for here—which is neither a forecast nor a projection, but is a plan. In other words, I would like to know what the executive, at least, thinks the longrun growth of public spending ought to be, and I think Congress ought to debate that issue so that it will have a better idea of what lies out there as it makes current decisions on budgetary matters. That plan is missing from this projection or forecast or whatever we call it.

On the revenue side, our estimate of full employment revenues under current law in 1980 is $564 billion. That is about $25 billion above the administration's estimate for the reason Mr. Gramlich mentioned. There are two principal uses to which Federal revenues could be put. One is to allow revenues to exceed outlays at full employment, to run a full employment surplus, retire part of the debt, and rely upon monetary policy to stimulate the economy and bring it back to full employment.

This approach, which at high employment levels would imply that the Government is adding its saving to that generated in the private sector, can be called a high investment strategy. It means that the Nation chooses to devote a relatively larger share of GNP to investment and relatively less to private and public consumption. The degree to which it is felt that such a high investment strategy is needed determine show large a full employment surplus to plan for and how stimulative a monetary policy we will need to get back to full employment.

After setting aside part of full employment revenues for a high investment strategy, the remainder, except perhaps for a small planning allowance, can be used to finance public expenditures or to be returned to the private economy in the form of tax cuts.

Congress in its first concurrent resolution on the budget for 1976 has already indicated that it plans to extend the temporary provisions of the Tax Reduction Act of 1975 and we estimate that this would return about $14 billion to the economy in 1980. In addition, the first concurrent resolution specifies $1 billion in revenue from tax reform for 1976, although no future amount was indicated. The administration proposes a longrun net tax cut of approximately the same magnitude, as the result of a large income tax cut more than offsetting planned energy tax increases.

Let me talk now about reconciling outlays and taxes.

Neither the action taken on taxes by the Congress now the administration's proposed energy tax package amounts to a complete longrun program.

The administration's 1980 full-employment revenue projection, including its energy package, of about $525 billion exceeds its outlay projection of $483 billion, including its initiative proposals, by $42 billion. In other words, the administration is projecting to 1980 a $42 billion full-employment surplus.

The administration could justify this sum if it were to declare that its plan is either to propose further tax cuts between now and 1980 or to set aside *x* billion dollars to pursue a high investment strategy—in which case one would presume that the interest rates shown in the OMB projection would be lower—or that it anticipates proposing new spending programs after the current moratorium.

The missing element in the administration's plan is what they plan to do with that large full employment surplus in 1980.

Similarly, the first concurrent resolution implies a gap between full-employment revenues and spending in 1980 although Congress' higher proposed outlays in fiscal 1976 should make the gap a bit smaller than the administration's. No indication has yet been given on Congress' plans for tapping the over $130 billion tax expenditures in 1980, nor on what its view is of the desirability of pursuing a high investment strategy.

The next step, then, is for the executive branch and the Congress, presumably aided by the Congressional Budget Office, to put forward consistent longrun plans based on projections of present law but supplemented by numbers showing planned outlays, that is, present law plus cuts plus additions, and planned revenue, which is present law with cuts and additions, and the implied full-employment surplus for some "out year" for planning purposes. Such a plan ought not to be rigid, obviously, but its enunciation can be used to guide current decisions. Questions like, "will public works bills enacted now squeeze out preferred public programs later?" can only be answered if a long-term budget plan exists.

At a minimum, looking at the longrun numbers in this way will force a debate over the right budgetary issues; namely, the share of public spending, its allocation, and the division of private spending between consumption and investment.

Thank you.

Chairman PROXMIRE. Thank you, Mr. Hartman and Mr. Gramlich, and Mr. Blechman. We are delighted that you were able to come, Mr. Blechman, because I understand you are just back from Europe and just arrived, so we will have questions for all of you.

Mr. Gramlich, as I understood your statement, you indicated that the administration's forecast for 1976 was that you would—was fairly standard, a fairly standard result.

Now, what you also apparently implied, and perhaps expressed although I missed it, was that that was a standard expectation on the assumption which the administration did not make, that the tax cut would be extended, No. 1, that a cap on civil service pay would be—would not be insisted on, No. 2, so you would have a looser and more stimulative fiscal policy, and No. 3, monetary policy will be more expansive than Mr. Burns has indicated. And yet the administration with those less optimistic assumptions comes out with the same forecast. So there must be—what is the explanation?

Mr. GRAMLICH. Well, everything you said is correct. I am not sure what the explanation is. I think in fairness it should be pointed out that economic forecasting is a risky business and that nobody can be that precise in knowing the implications of various policies to be followed, but everything you said is quite true, and in that sense while the forecast looks standard, it really is not quite a consensus forecast.

Chairman PROXMIRE. Of these three elements, it seems to me the fiscal is likely from a realistic point of view to be extended. The tax cap is probably going to be knocked off. But the monetary policy is likely to be what Mr. Burns indicates the goal would be, in other words, around 6.5-percent money supply increase.

Can you give us any notion how that would affect the 1976 unemployment figures?

Mr. GRAMLICH. Well, I think it is pretty clear that if that happens, interest reates would begin rising again. I am not going to tell you how much they are going to rise, nor am I going to tell you how much it is going to cut into the real GNP growth. I could go back and work out some estimates, but I think the important policy question is in this expansion—which everybody agrees has to be a long and steady one to get back to anything close to full employment—is whether you want to have premature rises in interest rates, choking off the growth in real GNP. I think there is a worry that if monetary growth stays in the 5-to-7 range, that that will happen.

Having said that, let me say that nobody would propose that monetary growth should be forever above 5 or 7 percent. But at least for a while, may be a year or so, I think a reasonable target is to aim for stable interest rates and then let nature take its course if a strong expansion gets underway.

Chairman PROXMIRE. Mr. Blechman, we haven't heard from you. You were, as I say—I know you are back in the country very recently, but you were here during Mr. Lynn's and Mr. Greenspan's testimony this morning.

Mr. BLECHMAN. Yes.

Chairman PROXMIRE. What is your recommendation, or do you have any for reducing unemployment to, say, a 5-percent level over a period of years, and can it be done without reigniting inflation as the administration fears? Do you have any comments on that?

Mr. BLECHMAN. My particular area is defense. I will let one of the others answer.

Mr. HARTMAN. Under the circumstances it wouldn't be through expanded defense spending, I think is the answer to that.

Chairman PROXMIRE. What is that? I missed that.

Mr. HARTMAN. A side remark.

Chairman PROXMIRE. All right.

Mr. HARTMAN. I think that what is called for is probably a rate of expansion of GNP in the early stages of the recovery, hopefully somewhat higher than the administration projects. Having said that, let me say that I think that the implications of the first concurrent resolution's budget—if all the spending and revenue projections therein were carried out—would be to get a somewhat faster rate of growth.

I think a more important question is what kind of either expenditure or tax programs to undertake for the long run to insure that unemployment rates will come down, but also to insure that the Government is doing the right things, the things it ought to be doing, and here I would like to make a comment on the current controversy over public works bills. I don't think there is any more stimulating effect over a reasonable period of time from a bill that is labeled a job bill, or that looks obviously like a job bill, than from any other kind of Federal spending. In other words, the things that we have put aside this year, national health insurance, welfare reform, other things that I think from a longer range perspective the Nation really wants and needs and Congress is interested in—those kinds of public expenditures in the long run could have the same stimulating effect as bridges and harbors and rivers and roads, and I think it is a mistake to focus too much on the short run.

We have already built in through the tax cuts quite a bit of shortrun stimulus. The taking off of the caps on existing entitlement programs will provide even more. I think what we ought to be looking forward to is setting into place needed longrun programs and ultimately, in 3 or 4 years, they will be having approximately the same effect on employment as any shortrun programs that one can think of.

On the other hand, there is no harm, it is my feeling, in a 9-percent unemployment economy to having some shortrun programs that are guaranteed to be temporary. I don't know how you guarantee that they remain temporary, and that is a big problem. For instance, I have some sympathy with cyclical revenue sharing to be put into effect in the short run if it were guaranteed that it would phase out over the longer term because from the longer term point of view I think the Federal Government can find better things to do with its resources than to have——

Chairman PROXMIRE. The question that I tried to emphasize was can you do these things without the inflation which the administration and many others fear?

Mr. HARTMAN. Well, I think that most economists who specialize in the relation between unemployment and inflation—and they have not been terribly right in the past—would be agreed that from where we are now, 9-percent unemployment down to, say, the 6-percent unemployment range, is not really a danger zone—although you could move too fast within that range.

I don't see any real prospects of setting off inflation from fiscal-policy-induced causes over the next couple of years really, almost no matter what we do. When we get below 6 percent, the question becomes a little bit touchier. How can we go below 6 percent and down to a desirable target of 4 percent without inflation is something that I don't really have an answer to. I would not reject some of the old-fashioned remedies to improve the relationship between reducing unemployment and inflation, namely, things like manpower policies, better employment service policies and the like, although they haven't been notably effective in the past.

Beyond that, I don't think we should forget about the possibility of income policies, of wage-price guidelines. I don't think we should set that aside just because we don't need it now. We don't, but we may in a few years, and there is no reason not to begin putting into place the proper organizational structures to deal with wage-price policy.

Chairman PROXMIRE. Let me call on Mr. Blechman for one question before I yield to the other members.

Representative BROWN of Ohio. We have to leave at 10 minutes of.

Chairman PROXMIRE. I will yield now. Do you want to—either one of you gentlemen?

Representative BROWN of Michigan. Let me just ask Mr. Gramlich a question. You related budgets to GNP. In dealing with the 1960's, for instance, there was a sizable tax cut. How did you treat the tax cut, as an outlay, or what?

Mr. GRAMLICH. No. Not as an outlay. I just compared expenditures corrected for cyclical swings in unemployment compensation with GNP corrected the same way.

Representative BROWN of Michigan. But if instead of tax cuts those had been outlays, the percentage of outlays would have been—of income—would have been higher at that time.

Mr. GRAMLICH. That is right.

Mr. HARTMAN. But the effect of these repeated tax cuts in the past has really been to bring revenues back down into line with outlays at full employment. In other words, if we had left the revenue system alone in the last 15 years we would have much higher revenues than we have today. We would also have a much more severe recession, so those tax cuts—I don't think intentionally—brought the tax system back into equilibrium with the spending system at a full-employment level. In other words, the full-employment surplus has not been all that far from zero until recently. It has averaged about zero over the last 7 or 8 years.

Representative BROWN of Michigan. But the $23 million or $24 million tax reduction bill which we just had in effect could have been spent under the budget and become a budget outlay which increased the percentage of the budget outlay to GNP.

Mr. HARTMAN. That is right.

Representative BROWN of Michigan. Mr. Hartman, you said something that I don't think has been said very often by economists, and that is that the national health insurance, some welfare reform, some of these things would have just as great an impact as a stimulus as for instance, jobs programs, public works, and so forth.

Mr. HARTMAN. Right.

Representative BROWN of Michigan. Do many others share those views?

Mr. HARTMAN. If you took a poll among economists, it would be that any particular kind of public expenditure has about the same effect on GNP in the long run as any other particular public spending program. It occurs to me that is what Mr. Gramlich's thesis was about, so why don't you answer?

Mr. GRAMLICH. One thing I think is important. I agree with what Bob said, but I think——

Representative BROWN of Michigan. Ask the chairman if he agrees.

Mr. GRAMLICH. You would probably have more shortrun stimulation—more shortrun stimulation—of employment with the jobs than you would, say, with national health insurance and welfare reform, but I think an appropriate way to look at this is what you get over 3 or 4 years, and there are little differences, but basically they are not major.

Representative BROWN of Michigan. Of course, basically the argument as you heard earlier when Mr. Greenspan and Mr. Lynn were here, is that in effect in jobs programs—you get \$2 billion back for every \$1 billion you spend. Do you see a similar type return, budgetary impact, with respect to programs such as national health insurance?

Chairman PROXMIRE. If the Congressman would yield, I think it is my point that you get \$2 billion back in the housing bill because the Federal expenditure triggers a lot of projects. That is——

Representative BROWN of Michigan. Excuse me, I didn't mean to——

Mr. GRAMLICH. Do you want me to comment? National health insurance raises a lot of questions on the cost side and I am not quite sure how to make a very precise answer to you there. I guess, I think the important point to keep in mind, and I think the point Bob was trying to make, is that in the long run, for budgetary planning purposes, and that it is our understanding is what this session is all about, is important to do what you want to do in terms of social needs, economic needs, and so forth. It is probably not wise to worry too much about the temporary stimulation of employment, but to keep your eye on the ultimate objective. I think that is the point that Bob was trying to make, and that is the point I would also stress about these measures.

Representative BROWN of Ohio. I must say you have yet to make a better defense of the suggestion that having the Federal Government take over the management of the national health insurance—we have a national health insurance program now except it is in private hands and doesn't cover the same way the Federal program is designed to cover, but now shifting that from private hands into Federal hands is going to create jobs is something that I must have missed in the linkup. I just don't see that, see how that would occur, and I must say conversely it seems to me if you start—if the Fed starts a public works program or Federal spending—a program in the defense area, you do in fact put people to work in jobs. Can you explain to me either side of that coin, why national health insurance would be more stimulative of jobs than, say, public works projects?

Mr. HARTMAN. I don't think I said more stimulative, I think I said roughly equal.

Representative BROWN of Ohio. How can it be equal?

Mr. HARTMAN. If you think of a national health insurance program of a fairly comprehensive variety being fully in effect, Ned did indicate, and I agree with him, if we are looking 6 months ahead there is no question that jobs programs are more effective—we couldn't have national health insurance in 6 months—but if we look at it by the time it was fully into effect and fairly comprehensive a plan, the reason it would stimulate jobs to the same extent as any other equivalently expensive public program is the following. First of all, there would be some expansion in output in the medical sector. One of the effects of the national health insurance is that some people will use more medical facilities than they now use and in the longrun the supply of such facilities can be expanded. But more important——

Representative BROWN of Ohio. We have a lot of empty beds right now.

Mr. HARTMAN. We do have empty—my understanding is that it is hard to make the case that there are shortages of beds as a nationwide proposition right now.

Representative BROWN of Ohio. So I don't see how that translates into the expansion of facilities immediately. You may in the long run.

Mr. HARTMAN. By facilities, I am sorry, I didn't necessarily mean hospital places. I mean, just more medical services.

Representative BROWN of Ohio. You mean personal services?

Mr. HARTMAN. Drugs, personal services, the whole—whatever goes into health care. But this is not the main point. The main way that national health insurance would stimulate economic activity is really not in the health sector. It is that a lot of people are now spending their own money, part of their own earnings, on health care and if that were shifted into a public activity, there is no reason to believe that the money previously used for private health expenditures would be saved. People would be spending it on something else. I don't tell you what that something else is, but the fact is those other expenditures that people undertake will create jobs and income.

Representative BROWN of Ohio. Slow up a minute, because doesn't that mean that the money has to come from someplace and you even manufacture the dollars or you take it from them in taxes? One way or the other you have done that. I understand how if you just print dollars up and pay for health services with those dollars that you stimulate the economy some. That isn't what we were talking about. We are talking about whether or not that would be more stimulative than, say, public works jobs and I am hard pressed to see how those two things relate.

Mr. HARTMAN. Well, I agree that the answer to our question ought to ignore the means of finance because that would apply to jobs bills as well as to health insurance. The point is that the two kinds of public expenditures ultimately will have their major effect on employment and real output through the secondary and subsequent rounds of spending. The main reason you get jobs out of the national health insurance program, is not because of the direct moneys the Government is spending for health, but out of the respending of the initial public outlay on all kinds of other consumption and related items. That is the major effect of a public jobs program, too. Ultimately its biggest effect on employment is not the direct hiring of the person through the Government program, but it is on the income that is created in the first round, generating spending and jobs in later rounds. If you think about it that way, there isn't much difference between different kinds of public spending programs.

Chairman PROXMIRE. If the Congressman will yield—in other words, I think what you are saying is that if you spend $5.3 billion this year on health insurance programs or any other program, it would have roughly the same effect of spending $5.3 billion in a jobs program.

Mr. HARTMAN. We can't really do it in health insurance this year—but, if we could, the answer is yes.

Representative BROWN of Ohio. It is my point that the Federal Government taking over expenditures that are currently being made for this purpose, taking over the private insurance sector, taking over the decision with regard to which health expenditures have Government sanction and which ones might be made privately, is not going to stimulate jobs. It really is just an orientation of control, not an increase of services, unless you consider that you are going to determine the nature of those health expenditures and expand them vigorously.

Now, if you expand them vigorously, then I think that you could do just as well and perhaps better, and that is the defense I can't—I mean, that is the argument that I haven't quite heard made yet, why you would do so much better in expanding health services than you would in expanding public works services, for instance, or housing or any other production of physical assets that seem to have a balance effect further down the road than public health expenditures.

Representative BROWN of Michigan. May I extrapolate upon your basic premise that dollars spent by the Federal Government have the same impact as far as economic stimulation to say that really $50 given to 10 people in the way of tax reduction has the same implication as $500 given to one?

Mr. HARTMAN. There you have the question of what would be the effect on savings which I think is also the answer to Mr. Brown's question, too. If savings rates in the economy don't change, then what Congressman Brown said about health insurance really is not right. The only way that health insurance would have less of an effect than a job program is if there was some change in the consumer saving rates. If there isn't, that means they are going to spend it on something else. Now on the question you are raising here on tax cuts, I don't think most economists have a good answer as to whether the size of the tax cut for a particular person is going to affect the degree to which he spends it. If I had to give you a best guess, and I think most people would agree, it is that it wouldn't make any difference once again whether the $500 is given to the one person versus $50 to 10 people. The same fraction of that $500 will probably be spent maybe at a different rate, maybe taking 3 months instead of 1 month in one case than the other, but generally speaking, I would say economists have not been able to find a regular relationship between the size of a windfall tax cut and the degree to which it leads to spending.

Representative BROWN of Michigan. I just want to say you know we are agonizing over an awful lot of legislative proposals here in the Congress about trying to rifle in on things when really all we have got to do is just spend a budget deficit of $68.9 or whatever it is, and it doesn't make any difference where we spend it. It is going to have the same economic impact as far as recovery from the recession is concerned.

Mr. GRAMLICH. No; I think that is not the implication. I must say I don't quite agree with Bob that the differences in spending can be ignored, but I think they are distinctly minor relative to the differences in the effect of the program on the economy or society. I mean, if you cut taxes for high-income people or low-income people, obviously it has an effect on the income distribution. It may not be too much effect on unemployment and output, but it is obviously a very important question and we are trying to say that Congress ought to keep its eye on the important question and that temporary employment stimulus is a much less important question and probably not that different in various programs.

Chairman PROXMIRE. Congressman Hamilton.

Representative HAMILTON. Gentlemen, I want to say first of all that the series of books you and your colleagues have put out on setting the national priorities have been extraordinarily helpful to me, and I am looking forward to the new book when it is out. I commend you for these volumes.

As I understand it, you three have been working on the 1976 budget since the figures came out, so I have only this question.

As a result of your studies so far, what are your major criticisms of the 1976 budget? I know that calls for value judgments, taking you outside your role as economists. How would you summarize your major criticisms?

Mr. GRAMLICH. We each have our own bailiwick. I think that in terms of the economic stimulation, the problem is that the stimulation is modest.

Representative HAMILTON. Too modest?

Mr. GRAMLICH. Yes. Also there are a set of things about energy I don't really want to get into.

Representative HAMILTON. I want your general impression at this moment.

Chairman PROXMIRE. Mr. Blechman?

Mr. BLECHMAN. In the defense area, our finding is that the administration's projections of the future cost of its defense program are underestimated. We project the defense budget each year based on the administration's statements and we come up with real growth in baseline obligational authority of almost 5 percent per year. The administration claims that real growth will be closer to 2 percent per year, I believe. That is one area.

I also have specific reservations on various aspects of the defense program, but I don't think we should get into them.

Chairman PROXMIRE. Mr. Hartman.

Mr. HARTMAN. On the domestic side of the budget I think that the principal thing that was proposed by the administration—which is still a part of its midsession projections, with small modifications—was the cost-of-living modifications, the caps on the programs and assorted other cuts in medicare and other programs. Our feeling is that first of all this was undertaken from a shortrun, fiscal policy point of view. It really is uncalled for. The economy is very weak. There is no need to be so tightfisted. If it was undertaken from a long run point of view as a means of bringing about efficiency in domestic spending, we find a 5-percent cap is a very blunt instrument to use and there are many problems in the various entitlement programs that could better be solved by various kinds of structural reforms, some of which we deal with in our book. That would have been the preferable way to go in trying to reform domestic programs.

Representative HAMILTON. Thank you very much. Thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you. I would like to make one observation with respect to Congressman Brown's comments with respect to spending. I think that the kinds of spending we do is important in two respects. No. 1, the timing of that spending. It is possible for us to appropriate funds that won't be spent for 4 or 5 years. In public works that has happened again and again, and in defense and in many other areas, so if we are going to stimulate employment, timing is important.

The second point is whether that spending requires and successfully achieves a degree of stimulation of private spending that would otherwise not occur. That is why the housing bill may or may not be effective, but it is designed to be. If, for example, in order for a homebuyer to get a 3-percent subsidy, reduce the mortgage rate from 9 to 6 percent, he has to agree to buy a house with that enormous expenditure and borrow that much money and then agree to make payments over many years, obviously that has a very stimulative effect for each dollar of investment that you make, or at least it does to the extent it is effective.

I think those distinctions are important if you are thinking of stimulating the economy.

Representative BROWN of Ohio. If the chairman will yield, I concur heartily, and it seems to me medical expenditures which require some—not necessarily all doctors—but some sophisticated training as opposed to somebody who pounds nails with a hammer, really might be a somewhat slower feeding of funds into the public sector, the private sector if that is the way you want to do it. It is not my contention that it made no difference. It was the witness' contention.

Representative BROWN of Michigan. I might say I quite concur on the two points, although I don't necessarily say that the points apply to the examples submitted.

Chairman PROXMIRE. Mr. Blechman, I understand as you indicated in your analysis of the Defense budget through 1980, it shows a real increase of 4.9 percent annually on the baseline. Now, you have got 2 percent for manpower and 7.8 percent for procurement and other nonpay items. Can you explain your analysis and indicate—I think it is very important to show where the administration is wrong if they are wrong in their indication of defense. This morning I got a tacit apparent agreement out of the Secretary—rather, the Director of Management and Budget, Mr. Lynn, that the increase is 4 percent rather than 2 percent, 4-percent real increase. That differs from your estimate. At any rate, how do you—why do you differ? Where have they gone astray in your view?

Mr. BLECHMAN. In 1980 there is about a $6.5 billion difference between the two projections. Half of that comes from the manpower area. Defense considers all increases in military and civilian pay to be strictly a matter of inflation, whereas we consider that portion of Federal salaries that are increasing faster than the CPI to be a real increase in defense costs; that factor adds about $3.2 billion to the budget in 1980.

The other part comes from the projections of the procurement, R. & D., and military construction programs. What Defense did in its presentation was to assume that there would be a 4-percent real increase per year in those programs, based on rough estimates of the life cycles of major weapons and the real increase in the cost of new systems as they have been introduced into the inventory over the past 10 years.

What we do is to take each major weapon system and project the size of the buy and the cost each year. Defense does that also, of course, internally, but they have not made those figures available in their projection. What we come out with is that if you implement the administration's program, if we take the administration on its word as to how many tanks they will be buying, how many aircraft, and so forth, the increase in procurement is quite substantial in real terms.

Chairman PROXMIRE. It is indeed. Have you had any comment on this from the—you have released this publicly, of course. Have you had any comment on this from the Defense Department?

Mr. BLECHMAN. They know that they differ with our projection, but they will not identify which areas specifically. I might add that——

Chairman PROXMIRE. Has there been any attempt to elicit that from the Secretary of Defense?

Mr. BLECHMAN. Drafts of our chapters are circulated to various official, but we are dealing on an unclassified basis and they cannot——

Chairman PROXMIRE. Well, as chairman of this subcommittee I think we will write to Secretary Schlesinger and ask him to defend their estimates in view of what seems to be the very logical and strong position and analysis and criticism that you have.

Mr. Gramlich, in your long-range projections you estimate that tax receipts will be higher than the administration's projections largely due to the response of taxes to inflation. Now, if this is right, it would mean a much smaller deficit. Could you explain the difference in your estimates?

Do you have any thoughts on the colossal misestimate of 1975 receipts recently disclosed?

Mr. GRAMLICH. I have not gone through the back rooms of the Treasury where they make these estimates, so I do not know exactly how they did it and what they did. We can compute from the numbers OMB has helpfully made available to us in some background worksheets that the income tax elasticity—the response of personal income taxes to growth in personal income—in their projections is about 1.2. That is to say that if personal income rises 10 peccent, they would calculate personal income taxes rising by 12 percent.

There have been a lot of studies of this and many studies have been done at Brookings, and the upshot of those studies is that the number is more like 1.55, not 1.2.

I note that there is a sentence in the President's economic report which indicates that their estimate is even higher than ours. I would be pleased to read that if you want. I do not know why the longrun budget forecasts have assumed elasticity as low as 1.2, but it is a very low estimate given the work that has been done on this question, and it turns out to be a very important matter in longrun forecasting.

Chairman PROXMIRE. That is very helpful. We will follow up on that and try to elicit their response.

As you say, the fact that their council estimated this as 1.6, which is a little higher than those, means there is a conflict of judgment apparently, and we will try to reconcile that.

I would like to ask Mr. Hartman, would you agree that, from an economic standpoint, the defense budget is one of the least efficient ways to provide fiscal stimulus, or do you think that defense is as good or a better way to provide stimulus?

Let me indicate why I am asking that question after all the back and forth discussion we have had.

It seems to me it is a poor way to stimulate the economy and there are long lags between many types of defense appropriations and actual spending, and another reason is that the regional effect of defense spending may not be what is needed. Enormous effect in California; very little effect in Wisconsin where we have little defense activity. Big effect in Massachusetts; much less in a number of other States.

Mr. HARTMAN. Let me comment on the two aspects that you mentioned, the timing and the regional effect. On the timing part, what you say is certainly right for defense procurement, research, construction budgets. However, a large part of the defense budget is in manpower, and there the payout rate is as fast as in any other part of the budget; so I would have some reservations about what you say. It would really depend on the composition of the defense budget as to whether it is slow to generate outlays or fast to do so.

On the regional impact, I really do not have too much to say. My impression was, however, that if we look at all the secondary effects of defense spending it is not as highly concentrated as the initial effects of contract letting, but I do not really know as much about that. If it were really the case that it was highly concentrated geographically, then if all the Federal Government was doing was to engage in defense spending, you get a very imbalanced growth in the economy. But since defense is part of an overall package, I do not see why its stimulative effect ought to be less. The fact that more is spent in California does not say anything about the overall stimulus.

Chairman PROXMIRE. Is not there usually, under some certain circumstances, an inflationary bias to defense spending when your resources are fairly tight? The reason I say that is, if you spend money on manpower training, or spend it on housing, you are supplying an economic good, more skills, more houses. When you spend it on aircraft carriers and machine guns, you are not providing anything that people go into a supermarket and buy. So, you are increasing demand by increasing your expenditures in the economy, but not increasing the supply of any good.

Mr. HARTMAN. In terms of increasing the ability of the economy to produce goods and services, I am not sure I would cut things by defense and nondefense. I would cut things in another way. Transfer programs, for example, which are a very large part of the budget, do not directly increase the supply of anything. They just provide income to individuals. On the other hand, building roads or doing other things that facilitate commerce would certainly have an effect on increasing the overall productivity of the economy. I would be hard put to say whether the defense or nondefense budget is more heavily endowed with capacity-producing things. The Defense budget has some indirect effects on productivity through some of the research and development, which does end up in the civilian sector, although I think that has been overplayed in the past. A good part of the nondefense budget is not in supply-oriented things, so I do not have a judgment about the overall effects of either defense or nondefense budgets on productivity. I am pretty sure that that is not the basis on which we ought to decide whether we should have more or less national defense.

Chairman PROXMIRE. I certainly agree with that. It is just my feeling that defense spending by and large under some circumstances tends to be somewhat more inflationary.

Mr. BLECHMAN. I might add that there have been some studies showing that the secondary effects of defense spending on employment are less than spending in domestic areas; for two reasons. One very simple reason is that some part of the defense budget is spent overseas, so that there is no secondary effect here. That portion of the defense budget affects the Japanese or German economy rather than our own.

Second, there is some indication that some end items, like fighter aircraft, will have a lesser secondary effect on employment in this country than funds spent on other programs.

Chairman PROXMIRE. Now, Mr. Gramlich, you state in your analysis that Government prices are rising faster in real terms than are other prices. Can you explain the phenomenom, explain its significance?

Mr. GRAMLICH. Yes. That is a complicated matter. The whole reason—the entire reason for it is that the Government budget is largely made up of the wages of people that we have no way to evaluate the productivity of. The only way the Departments of Commerce and Labor statistics can compute a price index for Government purchases is to just use the gross increase in the Federal wage scale. If it is true that Federal workers are more productive over time, then, in fact, that is not a real increase in prices, but it does not appear that way because the wages keep rising year after year. And, so, it is awfully hard to know what to make of the fact that the price of Government purchases is rising more rapidly than other prices. It could be. But it could not be. And we just will never know until we can better evaluate the productivity of Government workers.

Chairman PROXMIRE. Mr. Blechman, I have the impression that many, if not most, of the cuts in defense mandated by Congress in recent years did not have much permanent effect on the defense program. That is, we have delayed or stretched out some programs, deferred others, but have not made any real changes in the force structure. Incidentally, we are beginning in a few minutes a debate on the defense procurement bill and our whole defense posture. It will be the first full dress debate of this kind that we have had, and I am looking forward to taking part in it. It will take most of this week and, perhaps, next week, too.

At any rate, will you comment on this situation where we seem to have had very little effect on the size of the budget? We may have stretched it out, but we have not reduced it. And indicate how, in the current budget request, Congress might make real changes in a responsible way.

Mr. BLECHMAN. Yes. Well, for example, last year Congress cut the defense request by nearly 7 percent, yet it did not change any of the policy departures which would cause a large increase in defense spending over the rest of the decade. As a result, when the request came back this year, there was the same, in fact, a little larger, increase in defense spending.

What the Congress typically does is to look for large first-year savings, thus it will do things like cut the number of a weapon system bought in that year, but not the overall program objective for that system.

Similarly, it will slow down R. & D. programs but not kill the program altogether. Or, it will cut the operating budget but not legislate a reduction in manpower.

Chairman PROXMIRE. The tactical way that operates in the Senate, and probably in the House, is that the Armed Services Committee will come to the floor with a budget and say, now, look, we have cut this 10 percent or 8 percent below the administration's request. It is already a barebones budget. But this is what they do. They cut the first-year stuff. They do not cut the program or they do not eliminate or reduce the program. So, as you say, they come back then with a bigger program this year to make up for it.

Mr. BLECHMAN. Right. If you want to have a lasting impact on the Defense budget, then you have to deal with the basic strategies and the purposes of the forces. What we do in the book this year is to show some alternative budgets which are geared to making changes over a 5-year period. For example, we reduce forces maintained for Asian contingencies. What this sort of an approach does is to lead to small savings in the first year. For example, if you look at our lower budgets, you would only save $1.9 billion in budget authority in 1976. However, those changes result in reductions in the fiscal 1980 budget of nearly $12 billion, which would be more than a 10-percent cut from the projection of the administration's program.

The main difference is whether your focus is on the near term—I am afraid most of the Congress' incentives are directed that way—or whether you can look further ahead. That is why we think it is extremely important, particularly in the defense area, but certainly not to exclude any others, to do planning on a longer term basis than it is done now.

Chairman PROXMIRE. Mr. Hartman, in your book you take issue with a statement Secretary Simon gave this committee recently to the effect that existing claims tend to exhaust national output in the future, even assuming rapid growth, and that if new commitments are made, existing claims must be eliminated or curtailed. Why do you disagree with Secretary Simon?

Mr. HARTMAN. I think Secretary Simon's statement is right only if you assume that the Government share should be held down in the long run, or if you assume there will ultimately be big tax cuts in the future.

Let me get very specific. If you look at the midsession review, reestimate, the administration is projecting in 1980 a budget of $482 billion or $483 billion. They project—even not corrected for full employment, and in putting in our allegation of underestimates—they project revenues of $504 billion; $504 billion is more than $20 billion higher than their projected outlay budget. That suggests to me that there is no overcommitment of the budget out in that future year. And I—the numbers I have just given you are all designed to prove Mr. Simon's point as best can be done. It seems to me that what lies behind that statement is a feeling that public expenditures should not rise above, say, its 1960 level in relation to GNP, and, indeed, if you want to hold public spending down to something like 17 percent of GNP, then current programs are excessive.

We will overshoot that target. But, once you allow for the growth of the economy, the fact that the tax system at present at least, is going to be generating a lot of revenues, I do not see why any new initiative has to be replaced by a cutback in existing programs.

I really think that the administration's own numbers do not prove the case unless they are supplemented by some extra additional assumption, namely, that the public sector is somehow too big now and must be cut back.

Chairman PROXMIRE. Well, if I could follow up on that particular observation with Mr. Gramlich, I understood you to indicate that—perhaps, it was Mr. Hartman—one of you indicated that 19.6 percent was the portion of gross national product spent by the public sector and, of course, this overlooks the very large and very rapidly rising amount spent by the State governments and local governments rising much more rapidly than the Federal spending and together making between 35 and 40 percent of the gross national product.

I think there are many people who feel if that continues to rise with national health insurance and other things that seem to be on the horizon, that we may be in inflationary difficulties in the future.

Would you acknowledge that you have between 35 and 40 percent public expenditure if you include local and State spending, and would you also acknowledge, or not acknowledge, that local and State spending is influenced very heavily by Federal policy?

Mr. GRAMLICH. I do not have a specific number for State and local spending, but make sure that you took out the portion due to Federal grants, because that is, in effect, double counting if you just add the totals together.

Chairman PROXMIRE. Yes, but you see what I am talking about are matching funds that often would not be spent by the State government if it were not for the Federal Government, for example.

Mr. GRAMLICH. It may be that you should worry about that but it is inappropriate to just add the two together. You have to add them and then subtract the Federal grants.

Chairman PROXMIRE. The figures I have got are corrected, I presume, for this.

Mr. GRAMLICH. OK. Fine. I think all we are trying to say is that we are just trying to put some of the rhetoric in perspective. It is true that the State and local share is rising. I think it has risen about 3 percent in the past 15 years. The Federal share, as we try to argue, is approximately stable under most calculations of what is going to be the budget this year. When you look up to 1980, I think the appropriate way to do it is to try to aim at the kind of Federal share that you want. On one hand, it is possible to get back toward the 1960 share if we declare a moratorium on new programs for a while. It is also possible to get back there with programs if you make some cuts.

We are just trying to put these longer numbers in perspective, and I think that the appropriate way to think about them is in the share of output devoted to government.

Mr. HARTMAN. I think also it is important, Senator, that you have said if the public sector share increases it will have inflationary impact. I think that is really a question of taxes. If we are willing to pay for a larger public sector share, there is no reason why there should be particularly inflationary consequences for the economy. In fact, the present tax system will grow so fast by itself because of its responsiveness to economic growth and to inflation that we might be able even to enjoy tax cuts in the long run and a larger public sector share, both.

Chairman PROXMIRE. But the difficulty, you see, is that there is such a complex amalgamation of taxes. If we just had—I think many of us think when we talk about taxes about the Federal income tax, which has been reduced rather consistently. On the other hand, the payroll tax has gone up consistently, and that is quite a burden. The property tax has gone up in many parts of the country, certainly in my State, and other areas, and while personal incomes have gone down in the Federal and State level, they have gone up in many areas.

When I talk to my constituents they are pretty unhappy about the level of taxes. You can see a situation, not only in New York but all over the country, where mayors and Governors are having to have draconian cuts in services because people simply will not accept any further increases in taxes. They just will not accept it.

There is a very powerful resistance to it. And it seems to me that under these circumstances it is very hard to justify a relaxed attitude toward Federal taxing and spending. We have to ease up here so they can do the job that seems to be required at the State and local level.

I have got one final question, Mr. Gramlich, for you. Do I understand you to feel that the monetary policy targets recently announced by Mr. Burns are consistent with the administration's forecast for 1976–76? I think you indicated earlier they might be.

Mr. GRAMLICH. They are inconsistent with the GNP forecast on the one hand, and the interest rate forecast on the other. Yes, sir. I think so.

Chairman PROXMIRE. Would you regard it as desirable for that 5 to 7½ percent to be abided by by the Federal Reserve?

Mr. GRAMLICH. No.

Chairman PROXMIRE. Or would it be better from your standpoint——

Mr. GRAMLICH. I think my prescription for monetary policy would be that for, let us say, a year or two the Fed ought to do what it takes to prevent interest rates from rising. After that time, as Mr. Greenspan said, you just cannot tell at this point. But I think in the early stage of the expansion, it would be unwise to stick to the Burns proposal because it would do two things that are undesirable right now. One is it would endanger the prospects for the recovery, and the second, it would aggravate the compositional problems that we are already having from the very tight policies in—monetary policies—in 1974, such as the sharp reduction in housiug and to a lesser degree in plant equipment investment.

I think both of those sectors need to be stimulated and if monetary policy is not expansionary, they will not be.

Chairman PROXMIRE. Do you other gentlemen agree?

Mr. HARTMAN. Yes.

Chairman PROXMIRE. Well, gentlemen, thank you very, very much for most helpful and useful testimony. Your work is most welcome and timely and useful to us in the Congress.

The subcommittee will stand adjourned, subject to the call of the Chair.

[Whereupon, at 12:30 p.m., the subcommittee adjourned, subject to the call of the Chair.]

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