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AN ECONOMIC EVALUATION OF THE CURRENT SERVICES BUDGET, FISCAL YEAR 1977

A STAFF REPORT

PREPARED FOR THE USE OF THE

JOINT ECONOMIC COMMITTEE CONGRESS OF THE UNITED STATES

DECEMBER 22, 1975

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LETTERS OF TRANSMITTAL

December 22, 1975

To the Chairmen and Members, Committees on the Budget, United States Senate and House of Representatives:

Sec. 605 of the Congressional Budget Act of 1974 requires the Office of Management and Budget to submit by November 10 of each year "the estimated outlays and proposed budget authority which would be included in the Budget . . . for the ensuing fiscal year if all programs and activities were carried on during such . . . year at the same level . . . and without policy changes." It further requires that the Joint Economic Committee "shall review the estimated outlays and proposed budget authority so submitted, and shall submit to the Committee on the Budget of both Houses an economic evaluation thereof on or before December 31 . . . ."

I am pleased to transmit herewith in accordance with Sec. 605 an economic evaluation prepared by the Joint Economic Committee staff at my instruction.

In addition to this staff evaluation the Joint Economic Committee has had the Congressional Budget Office review the Office of Management and Budget submission and has held hearings on the current services budget, receiving testimony from the Director of the Congressional Budget Office, the Deputy Director of the Office of Management and Budget, and public witnesses.

The Committee has been advised both by the Director of the Congressional Budget Office and by the Committee staff that the estimates submitted by the Office of Management and Budget have been carefully prepared and appear to comply fully with the letter and spirit of Sec. 605. I believe the Office of Management and Budget is to be commended for its effort to make this new document, required for the first time this year, a useful and important addition to the budget prodcess.

It was necessary for the Office of Management and Budget to prepare its current services budget estimates for fiscal 1977 before final action had been taken on all 1976 appropriations and before final action on the Second Concurrent Resolution of the 1976 budget. I have been advised both by the Director of the Congressional Budget Office and by the Committee staff that it would be very helpful to the Congress for an updated version of the current services budget to accompany the President's budget in January. If this is done, the Congress can more readily distinguish between budget revisions due to legislative and executive action and changes in economic conditions, on the one hand, and the policy recommendations of the President on the other. I have urged the Director of the Office of Management and Budget to provide such an updated current services budget along with the President's budget in January.

In order to make our evaluation of the current services budget as useful as possible to the Congress, I have asked the staff to analyze the probable impact of various possible changes in budget policy. The staff report transmitted herewith contains the first results of this analysis. As we all know, the budget is not a once-a-year event but a continuous process. The Joint Economic Committee will be conducting further analyses of possible changes in budget policy and will make the results available periodically.

Hubert H. Humphrey, Chairman
Joint Economic Committee

December 22, 1975

Hon. Hubert H. Humphrey
Chairman, Joint Economic Committee
Congress of the United States
Washington, D. C.

Dear Mr. Chairman:

In accordance with your request for the staff of the Joint Economic Committee to evaluate the Current Services Estimates for Fiscal Year 1977, prepared by the Office of Management and Budget, I am pleased to submit the attached report. This report was prepared by Richard Kaufman, Douglas Lee, Beverly Park, and Courtenay Slater of the Committee staff.

At your request, the Congressional Budget Office prepared five-year estimates of Federal receipts and outlays using economic assumptions supplied by the Committee staff. These estimates and an analysis of their implications are contained in the staff report transmitted herewith. The Congressional Budget Office was not able to provide the additional information you requested in time for the preparation of this report, but they have assured us of their desire to cooperate fully in supplying this information.

The current services estimates for 1977 presented as part of these five-year projections differ somewhat from the estimates submitted by the OMB. This is due in part to differences in economic assumptions, in part to technical differences in estimating techniques, and in part to the use of more up-to-date information by the Congressional Budget Office. These differences in budget totals in no way imply that one set of estimates is "right" and the other "wrong." As we have all learned, budget estimation is a complex endeavor and variations among different sets of estimates are inevitable.

The views expressed in this document do not necessarily represent the views of the Members of the Joint Economic Committee.

John R. Stark, Executive Director
Joint Economic Committee

Table of Contents

TABLES & CHARTS

TABLES

CHARTS

I. SUMMARY OF MAJOR FINDINGS

This economic evaluation of the current services budget reaches the following major conclusion with respect to the outlook for fiscal year 1977:

● In the absence of major economic policy changes, the recovery is likely to sputter out by 1977, leaving unemployment on a very high plateau, probably above 7-1/2 percent.

● A $395 billion spending ceiling could cause a severe setback to economic recovery. If Congress extends the current income tax withholding rates through 1977 and adopts a $395 billion spending ceiling, this study concludes that in calendar 1977:

-- the unemployment rate would rise to an average of 8.7 percent;

-- the rate of real economic growth would fall below 2 percent; and

-- the inflation rate would be somewhat higher than with a more expansive fiscal policy.

Regarding the five-year budget outlook, the following conclusions emerge:

● The Federal budget is <u>not</u> out of control. Without new policies, tax receipts will exceed outlays by 1981 in spite of extremely high unemployment rates. Spending for income support programs, which increased very rapidly throughout the 1950s and 1960s, is expected to slow significantly. Contrary to impressions created by the Administration, the share of gross national product devoted to these programs is expected to <u>decline</u> between 1975 and 1981.

● Estimates of the budget as it would be at a constant 4 percent rate of unemployment indicate that by fiscal 1981 a full employment surplus of $66 billion will be available for division among new programs, tax reductions, and contributions to the actual budget surplus.

63-391 O - 75 - 2

- Spending reductions and revenue-raising tax reforms are possible without severely reducing important government services. Changes discussed in this report, if adopted promptly, could produce by 1981 a budgetary impact of $30 to $35 billion.

- There is room in the budget for major new initiatives in the areas of welfare reform and national health insurance without eliminating the possibility of a budget surplus at full employment. However, a comprehensive health insurance plan financed largely through the Federal budget would require new sources of revenue.

II. INTRODUCTION

Submission of the 1977 Current Services Budget marks the first step in the official process of formulating the fiscal year 1977 budget. The Congressional Budget Act of 1974 calls for the preparation of current services estimates by the Office of Management and Budget and an economic evaluation of those estimates by the Joint Economic Committee. The following report presents an analysis of those estimates by the Committee staff. It also presents five-year budget projections intended to help Congress look ahead at the impact current policies will have on future Federal budget trends.

The report that has been prepared by the Office of Management and Budget (OMB) focuses primarily on the budget estimates themselves and the manner in which they were derived. The Congressional Budget Office (CBO) has reviewed these estimates at the Committee's request and has advised the Committee that the OMB estimates appear to be free of any serious inaccuracies and, with the exception of program caseload data, have been provided in the degree of detail required by the Budget Act. The Committee staff concurs that OMB has done a professional and competent job. This review, therefore, will focus less on the numbers themselves and more on ways these numbers can be used in policy analysis.

In December of 1973, the Joint Economic Committee (JEC) published a staff study which presented current services estimates for fiscal year 1975. In transmitting that report, it was described as a "baseline" projection of 1975 expenditures. Essentially this is an estimate of what expenditures would be if existing programs were allowed to grow at rates predetermined by legislation already enacted and by current and anticipated economic conditions. It is in no sense a recommendation of what the expenditure total should be or of the allocations that should be made within that total. A similar JEC staff study was prepared in December of 1974 projecting the 1976 current services or "baseline" budget. The document presented by OMB, while it contains a great deal more detailed information, is of the same nature and purpose.

A "baseline" or current services budget is especially helpful in evaluating alternative budget proposals made by the President and Congress. Since the "baseline" assumes no policy changes, the difference between an up-to-date baseline and the budget estimates presented in the Presidential recommendations submitted in January would be the policy proposals of the President. Likewise, a comparison of an up-to-date current services budget with the First Concurrent Resolution on the Budget that Congress will prepare in the spring will show the policy decisions made by Congress.

All budget estimates, of course, need to be continually updated for unanticipated changes in economic conditions as well as for executive and legislative actions. Therefore, the budget submitted by the President in January will differ from the November 10 current services budget in two ways. First it will be updated to reflect legislative and congressional action taken after September 11, 1975, and second it will incorporate the policy recommendations of the President. It would be extremely helpful to the Congress to be able to separate the updating from the policy recommendations. The Director of the CBO testified before the Committee that she believes updated current services estimates should accompany the President's budget. The Committee staff concurs in this recommendation.

To repeat a point made in earlier JEC reports, it must be recognized that decisions reached by Congress during consideration of a particular year's budget can have only a limited impact on spending in that year. Current spending levels and resource allocations were largely determined a year or more ago by decisions incorporated into earlier budgets. It stands to reason that Congress should spend considerable time on future planning as it is in a much better position to influence future budgets and future priorities than current ones. Accordingly, earlier staff reports were described as interim steps toward a goal of five year budget projections. With the assistance of the Congressional Budget Office, we are able this year to present five-year projections. They have been made based on existing law, assumptions about the renewal of existing programs which are not temporary, and an underlying projection of the economy supplied by the Joint Economic Committee staff.

Economic Assumptions

Any projection of budget outlays and receipts must be based on some underlying projection of the overall economy. Cyclical fluctuations in output and changes in the rate of inflation will affect both receipts and expenditures. For the purpose of making a five-year projection, this underlying economic path should be as neutral as possible. This is necessary to avoid biasing the projections in any way.

In the past, economists have often assumed a fully employed economy as a neutral path which avoids the impact of cyclical fluctuations on the budget. At times when the economy was operating reasonably close to full employment, and full employment appeared to be an attainable target, this assumption was probably the most useful that could be made. However, at times such as the present when the economy is so far from full employment that it cannot be regarded as an attainable target in the near term, an alternative path is more useful.

In choosing on alternative neutral path, we have used the following criteria: first, beyond the forecast horizon, the path should be free of cyclical fluctuations. Second, the path should lead back toward full employment. Third, the rate at which we approach full employment should be plausible. These criteria underlie the projections summarized in Table I. The estimates for 1976 and 1977 may be regarded as forecasts. The estimates for 1978 through 1980 are projections based on an assumed annual rate of growth of 5 percent. This growth rate is constant and therefore free of cyclical fluctuations. It slowly approaches a full employment goal. It is close to the most rapid growth rate this country has experienced over any five-year period since World War II and, therefore, is at the upper end of the range which past history would lead us to expect. It should be

Table 1.

Economic Assumptions

	Estimated	Forecast		Projections		
	1975	1976	1977	1978	1979	1980
Gross National Product (billions of dollars)	1473.9	1675.5	1844.8	2050	2270	2500
Growth Rate (percent)	5.5	13.6	10.1	11.2	10.7	10.2
GNP Deflator	185.3	197.7	209.8	222	235	246
Gross National Product (billions of 58$)	795.0	847.0	880.0	922	968	1015
Growth Rate (percent)	-3.2	6.6	3.8	4.9	4.9	4.9
Personal Income (billions of dollars)	1240.5	1390.0	1556.4	1700	1860	2045
Corporate Profits (billions of dollars)	121.4	162.9	187.7	205	226	250
Compensation of Employees (billions of dollars)	901.7	1022.5	1134.2	1250	1385	1525
Wages and Salaries (billions of dollars)	787.4	889.7	987.0	1088	1205	1325
Other Labor Income (billions of dollars)	57.9	68.5	75.2	84	93	104
Transfers to Persons (billions of dollars)	174.8	193.7	215.5	235	255	285
Rate of Change of GNP Deflator	8.9	6.6	6.1	6.0	5.5	5.0
Rate of Change of Consumer Index	9.2	7.1	6.9	6.0	5.5	5.0
Rate of Change of Wholesale Price Index	9.3	7.1	5.3	6.1	5.7	5.0
Unemployment Rate	8.5	7.9	7.9	7.7	7.3	7.0
Growth of Money Supply M_1 (percent)	4.7	7.7	7.0	7.5	7.5	7.5
Treasury Bill Rate	5.9	6.6	7.2	7.7	8.2	8.5
Corporate Aaa Bond Rate	8.9	9.3	9.6	9.9	10.1	10.3

stressed that these projections in no sense represent a desirable or target path.

Unlike the President's budget, which will present an economic forecast for 1976 and 1977, in their current services estimates OMB chose to present four alternative economic paths. Although this illustrates the sensitivity of budget projections to different assumptions, it is often confusing to users of the document because they simply do not know which set of numbers to believe. In order to simplify and make these estimates more useful, we have used a single set of assumptions. Just as the President's budget will forecast 1976 and 1977, we are presenting our best judgment about the most likely economic outlook for the next two years. The analysis and policy assumptions which underlie this forecast are discussed in Chapter IV.

Programmatic Assumptions

The assumption that current services are maintailed with no policy change seems simple enough until one tries to implement it. Where the current services concept does not provide unambiguous guidance, we have made specific assumptions. The following are embodied in the projections presented in Chapter III.

-- Entitlement programs have been adjusted to account for inflation, changes in the benefit base (usually earnings), and changes in the anticipated number of beneficiaries.

-- Grants to State and local governments are adjusted for inflation plus contractual commitments and legislated changes.

-- Interest on the public debt is estimated on the basis of the estimated deficit and the interest rate assumption shown in Table I.

-- General Revenue Sharing is assumed to be renewed.

-- New contract authority for the Environmental Protection Agency waste treatment plants is assumed to be zero.

-- The Tax Reduction Act of 1975 is assumed to be extended by keeping income tax withholding rates constant at their 1975 levels.

-- Temporary Employment Assistance, special unemployment assistance, and Federal supplemental unemployment benefits are assumed to be renewed.

-- The earned income credit is assumed to be extended, and is treated as a tax refund rather than as an outlay.

-- The $2 import fee on petroleum is assumed to be removed during 1976.

III. CURRENT SERVICES PROJECTIONS

Using the current services concept, Federal outlays are estimated to increase from $324.6 billion in fiscal year 1975 to $562.8 billion in fiscal year 1981. At the same time, budget receipts are estimated to rise from $281 billion in fiscal year 1975 to $567 billion in FY 81. Chart 1 illustrates how these budget totals change from 1970 to 1981. The general trends within these spending totals are illustrated by Chart 2.

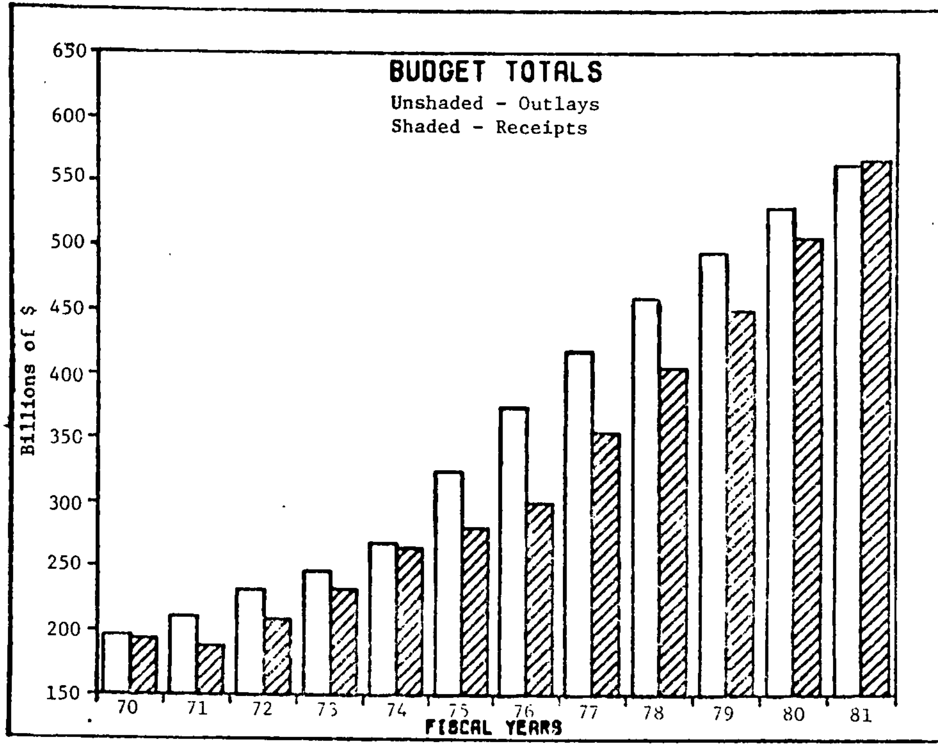
Outlays

Turning to the detailed projections, Table 2 shows budget outlays by functional categories. Some areas such as health, income security, defense, and interest payments show substantial increases. Other areas show far smaller changes.

A special note on the estimates of defense spending is in order. Outlays for national defense are estimated at $130.4 billion in fiscal year 1981. If the allowance for pay increases is included, the figure would be $134.5 billion. This estimate is somewhat lower than other estimates of future defense spending. The Administration estimated $141.4 billion for defense in 1980 in its fiscal year 1976 budget document and The Brookings Institution has published estimates of $148.7 billion in 1980. The differences mostly result from the estimating techniques. For example, CBO uses a strict current services budget concept and is constrained in its forward projections by the funding levels in current accounts. Brookings, on the other hand, assumes that present force levels will expand and its estimates are based in part on what it believes will be future force levels. Of course, cost figures also may vary depending upon assumptions such as future inflation. Using the Brookings approach we estimate outlays for national defense of about $160 billion in current dollars for FY 81. Most of the reductions we discuss in Chapter V could be achieved from the figures estimated by CBO. Some, however, would have to be considered in the framework of what future forces are likely to be.

63-391 O - 75 - 3

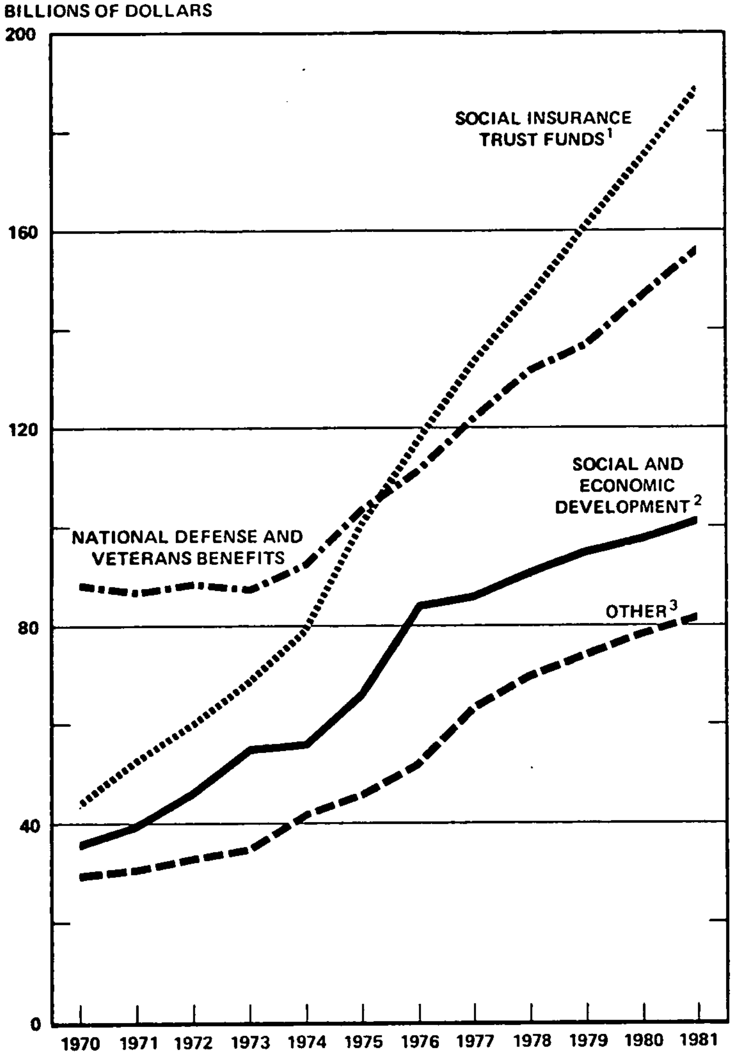
Chart 1.



SOURCE: Congressional Budget Office

Chart 2.

BUDGET TRENDS



1 Social Insurance Trust Funds include Civil Service Retirement, OASDI (Social Security), Medicare, and unemployment benefits.

2 Social and Economic Development includes education, manpower and social services; health (excluding Medicare); agriculture; natural resources, environment and energy; commerce and transportation; community and regional development; general revenue sharing; and allowances for civilian agency pay raises.

3 Other includes international affairs; general science, space, and technology; law enforcement and justice; interest; and general government.

Source: Budget of the U.S. Government, various years and Joint Economic Committee.

Table 2
Unified Budget Outlay Projections by Functional Category
(In billions of dollars)

Function	1975 Actual	1976 Estimate	Trans. Quarter Estimate	Projections 1977	1978	1979	1980	1981
National defense	86.7	91.9	24.8	98.0	108.3	112.5	122.3	130.4
International affairs	4.4	4.9	1.4	7.8	8.2	8.8	9.5	10.0
General science, space, and technology	4.2	4.6	1.3	4.7	5.1	5.4	5.6	5.7
Natural resources, environment, and energy	9.2	11.4	3.2	12.0	12.8	13.3	12.1	11.4
Agriculture	1.6	2.6	0.8	2.3	2.5	2.6	2.7	2.8
Commerce and transportation	16.0	18.3	5.4	16.0	16.6	16.8	16.9	17.1
Community and regional development	4.4	7.0	2.1	7.1	7.4	7.4	7.5	8.1
Education, manpower, and social services	15.2	20.9	5.4	21.3	22.3	23.6	24.9	25.9
Health	27.6	32.9	8.6	37.2	41.4	46.5	51.1	58.1
Income security	108.6	128.2	34.3	148.1	162.9	177.6	192.4	205.9
Veterans benefits and services	16.6	19.1	4.8	20.0	19.3	19.8	20.3	21.0
Law enforcement and justice	2.9	3.4	.9	3.4	3.4	3.7	3.9	4.1
General government	2.8	3.3	.9	3.4	3.6	3.8	4.0	4.4
Revenue sharing and general purpose fiscal assistance	7.0	7.3	2.1	7.3	7.6	7.8	8.0	8.2
Interest	31.2	35.4	10.0	44.8	52.5	58.8	64.4	68.0
Allowances								
Military Pay Adjustment 1/	---	.4	---	2.7	2.3	2.4	2.1	2.3
Civilian Pay Adjustment 1/	---	1.1	.1	4.2	3.6.	3.6	3.4	3.4
Undistributed offsetting receipts	-14.1	-17.1	-4.4	-20.0	-19.7	-22.2	-23.3	-24.0
TOTAL	324.6	374.9	101.7	420.3	460.1	492.2	527.7	562.8

1/ Consists of pay adjustment for each year, only.
Individual items may not add to totals due to rounding.
Source: Congressional Budget Office

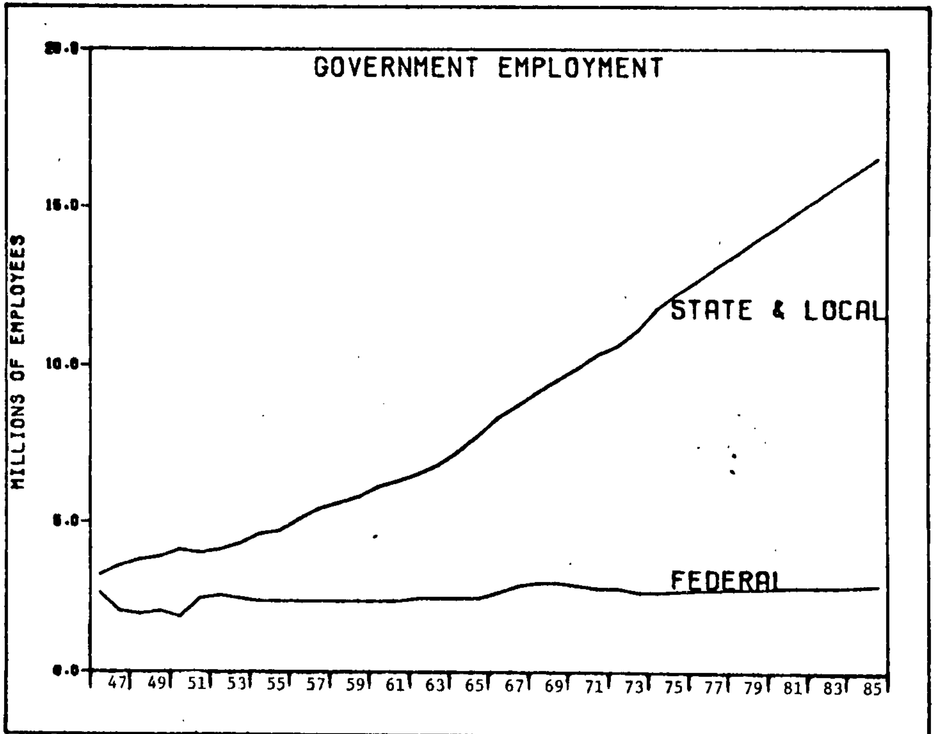
The outlay increase in the income security area stems largely from two sources: changes in the number of beneficiaries and inflation. The major income security programs -- social security, unemployment insurance, and Federal employee retirement benefits -- are primarily financed by trust funds. Other major items in this category include food stamps, public assistance, and supplemental security income. All of these programs are projected to increase because of inflation and, with the exception of unemployment benefits, because of increases in the number of benefiiaries.

When last year's budget was presented by the Administration, Congress was warned that increases in programs in this income security area threatened to consume an ever larger share of our national output. A closer examination of this "threat" showed that it could only materialize if major policy changes occurred -- changes neither proposed nor anticipated at the present time. These projections show that in the absence of policy change, income security programs would increase from about 35 percent of outlays in fiscal year 1977 to about 37 percent of outlays in fiscal year 1981, and the share of national output spent on these programs would actually decline by about one-half percent.

Much concern has also been expressed about the growth of government bureaucracy. Total government employment increased from about 6 million in 1946 to over 14 million in 1974. By 1985 government employees are projected to total over 19 million. It is interesting to note, however, that the vast majority of this increase in government has occurred at the State and local levels. Federal civilian employment has fluctuated between 2-1/2 and 3 million for many years and is expected to remain within this range for the foreseeable future. Chart 3 illustrates the trends in government employment.

Health outlays are projected to increase by about $31 billion from 1975 to 1981 or more than 100 percent. As discussed in Chapter V, inflation in medical care has been increasing substantially faster than the general price level. Hospital costs in 1975 increased

Chart 3.



SOURCE: Bureau of Labor Statistics, Forthcoming over twice as fast as other components of the Consumer Price Index. These projections assume that, in the absence of controls, health care costs will continue to increase more rapidly than the general price level. About one-half of the increase will be financed by trust funds.

The third largest increase is projected for interest payments on the national debt. This occurs because the debt is projected to increase through 1980 and because interest rates are expected to rise. It should be noted, however, that part of these debt service payments will be made to the trust funds that hold Federal debt. Interest paid to trust funds is estimated to rise from $7.7 billion in FY 75 to $11.3 billion in FY 81.

Receipts

Table 3 shows that tax receipts are projected to increase substantially over the next five years. These projections assume present withholding rates are extended but no other policy changes are included.

The largest increase occurs in individual income tax receipts. These receipts tend to rise more rapidly than the rate of inflation because as incomes rise to keep pace with inflation, people are moved into higher marginal tax brackets. The result is that when incomes rise by 10 percent, income taxes rise by about 15 percent.

Corporate and social insurance taxes also show substantial increases. Corporate taxes increase as profits recover from their recession levels and the wage base for social insurance taxes rises to keep pace with inflation.

Despite increases in all major sources of tax receipts, these projections show that the trend toward heavier reliance on the individual and social insurance taxes is continued. As shown in Chart 4, the share of total revenues from social insurance is projected to increase from 16 percent in 1960 to over 28 percent in 1980. At the same time, the share of receipts from corporate and other sources declines from 40 percent to about 23-1/2 percent.

Table 3

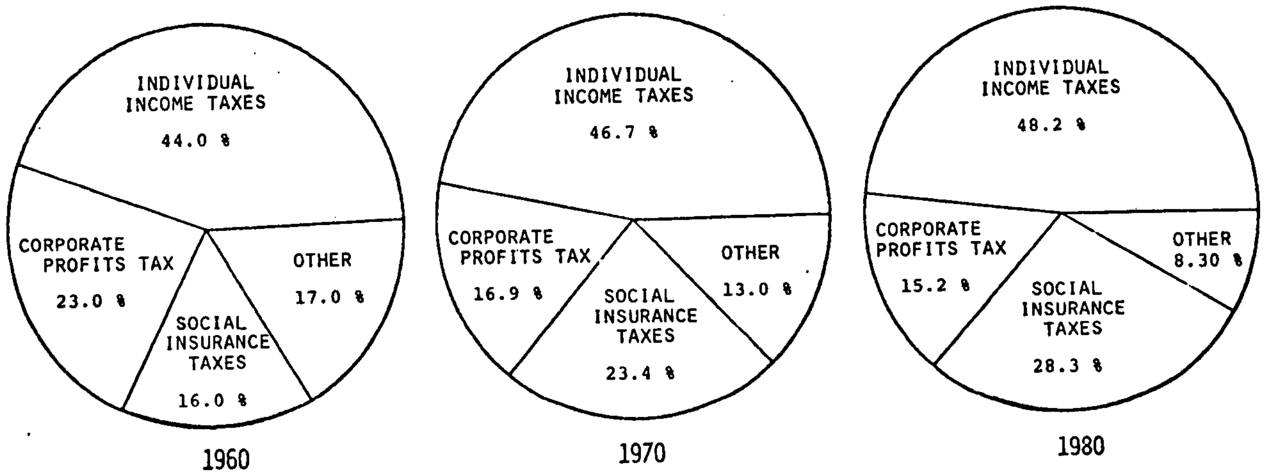
Current Services Receipts by Source
(fiscal years, billions of dollars)

Revenue Source	1975 Actual	1976 Estimate	Trans. Quarter Estimate	Projections 1977	1978	1979	1980	1981
Individual Income Taxes	122.3	135.0	41	161	187	213	244	278
Corporate Profits Tax	40.6	39.5	11	55	62	69	77	85
Social Insurance Taxes and Contributions	86.4	92.6	25	105	119	130	143	160
Other	31.5	33.7	9	34	37	38	42	44
TOTAL	280.9	300.8	86	355	405	450	506	567

Source: Congressional Budget Office

Chart 4.

DISTRIBUTION OF FEDERAL REVENUES, BY SOURCE



Source: Budget of the United States, Various Years; and the Congressional Budget Office

IV. FISCAL POLICY IMPLICATIONS OF THE CURRENT SERVICES BUDGET

While the budget is basically a plan for providing necessary public goods and services, it must at the same time serve as a principal policy tool for achieving and maintaining a healthy level of economic activity and employment. It is this latter, or fiscal policy, aspect of the budget which is discussed in this chapter.

Fiscal Policy Objectives for the 1977 Budget Year

Even though a recovery from the recent recession is now under way, both unemployment and inflation will still be at undesirably high levels when fiscal 1977 begins next October. Hence, the basic fiscal policy objectives to be served by the 1977 budget will be continuation of recovery and and moderation of inflation.

It is often supposed that these two objectives are in conflict, that the stronger the recovery, the greater the cost in terms of inflation. The history of past business cycles indicates, however, that the opposite is true. So long as utilization of labor resources and plant capacity is as far below normal as it is at present and will remain in the near future, rapid economic growth brings with it productivity gains which help restrain inflation. The evidence is persuasive that, in the 1977 budget year, the objective of reducing inflation will be best served by an economic policy which aims at an output growth rate adequate to achieve significant reductions in unemployment.

In recent years, the output growth necessary to keep pace with labor force growth and productivity gains, thereby holding the unemployment rate constant, has been about 4 percent per year. This is usually referred to as the potential growth rate. Approximately a 7 percent rate of output growth is required to reduce the unemployment rate by 1 percentage point per year. Over the next five years, the potential growth rate is expected to gradually diminish to about 3-1/2 percent per year, due primarily to slower growth of the working age population. For 1976 and 1977, however, the

4 percent rate of growth of potential remains a reasonable expectation, and should the rate of growth of real output fall significantly below 4 percent, unemployment must be expected to rise.

It is not possible to predict the precise economic situation which will exist when fiscal 1977 begins next October. The present expectation of many forecasters, however, is that the economy will continue on its present path of moderate recovery and gradual diminution of unemployment only through the first half of calendar 1976. After mid-year there is reason to expect that, in the absence of new policy steps, output growth will slow to a rate barely adequate to present a renewed rise in unemployment.

The main factors sustaining the present recovery are:

- a sharp swing in business inventories;

- the partial recovery of residential construction from the extraordinarily low levels of earlier this year;

- a strong export balance; and

- a pickup in consumer spending, attributable in part to last spring's tax rebate.

Of these factors, the inventory swing and the impact of the tax rebates are necessarily temporary; the export balance is probably at an unsustainably high level and will decline somewhat; and most forecasters expect that during the next year housing starts will rise only modestly from their November level of 1.4 million. Because of the severe financial constraints of many State and local governments, purchases by these units of Government are expected to be at best flat in real terms and could decline.

Hence, if there is to be growth in the economy after mid-1976 it must come either from personal consumption spending and business fixed investment or from an expansive Federal fiscal policy. Some observers expect a strong pickup in personal consumption and business investment in 1976. However, there is as yet no clear statistical evidence that such a strengthening is occuring. Surveys of consumer sentiment and business investment plans suggest weakness in both these sectors.

In preparing the budgetary projections used in this report, the Committee staff has used economic assumptions which reflect a judgment that the rate of output growth will diminish in late 1976 and remain sluggish in 1977. The unemployment rate is expected to fall a little below 8 percent by mid-1976 and remain in the 7.5 to 8 percent range through the end of calendar 1977. The inflation rate is expected to remain in the 6 to 7 percent range. Obviously, these assumptions do not represent a desirable path for the economy. Rather, they do reflect a judgment that this is the most likely pattern, given current policy trends.

Changes in fiscal policy could materially alter this economic outlook. A basic problem facing the Congress during consideration of the 1977 budget will be the changes from current services budget levels necessary to meet the objective of a continuing economic recovery.

The Budget and the Economy

Four alternative sets of current services budget estimates were presented by the Office of Management and Budget, based on four different sets of economic assumptions. Such a presentation is useful in that it illustrates the sensitivity of both receipts and outlays to changes in unemployment and inflation.

The economic path used by OMB for its detailed budget projections ("Path I") assumes an unemployment rate of 7.9 percent in calendar 1976 and 7.4 percent in 1977. The assumed inflation rate is 8.0 percent in 1976 and 7.0 percent in 1977. Table 4 presents the alternative assumptions used by OMB and their estimated impact on outlays and receipts.

The alternative economic assumptions are helpful, but they all lie within a rather narrow range. While each set of assumptions is plausible, it is quite

Table 4

Budgetary Impact of
Alternative Economic Assumptions

	Economic Assumptions Calendar years 1976	1977	Fiscal 1977 Budget Totals (Billions of Dollars) Receipts	Outlays	Deficit
OMB Assumptions					
Path I-Higher Inflation Higher Unemployment			$372.6	$414.5	$41.9
GNP Deflator 1/	8.0	7.0			
Real GNP Growth Rate 2/	6.0	5.0			
Unemployment rate	7.9	7.4			
Path II- Higher Inflation Lower Unemployment			380.9 3/	412.3	31.4
GNP Deflator 1/	8.0	7.0			
Real GNP Growth rate 2/	7.3	6.0			
Unemployment rate	7.4	6.8			
Path III-Lower Inflation, Higher Unemployment			361.5 3/	412.9	51.4
GNP Deflator 1/	6.0	5.0			
Real GNP Growth rate 2/	6.0	5.0			
Unemployment rate	7.9	7.4			
Path IV-Lower Inflation, Lower Unemployment			369.7 3/	410.7	41.0
GNP Deflator 1/	6.0	5.0			
Real GNP Growth rate 2/	7.3	6.0			
Unemployment rate	7.4	6.8			
JEC Assumptions					
GNP Deflator 1/	6.7	6.2	355.0	420.3	65.3
Real GNP Growth rate 2/	6.6	3.8			
Unemployment rate	7.9	7.9			

1/ Percent Change, fourth quarter over fourth quarter.

2/ Percent change, year over year

3/ The receipts estimates for Paths II, III, and IV were developed using less precise and less detailed estimating techniques than were used in developing Path I.

Sources: Office of Management and Budget, Congressional Budget Office, Joint Economic Committee.

possible that the actual path of the economy could lie outside the range of these assumptions. As also shown in Table 4, the economic assumptions developed by the Joint Economic Committee staff are similar to the OMB assumptions for 1976 but diverge in 1977, reflecting a judgment that the economy is likely to weaken.

It should be noted that the OMB estimates, unlike the estimates presented in this report, adjust outlays upward for inflation only where such adjustments are mandated by law. According to information provided by OMB, full inflation adjustment of all programs would add about $7.5 billion to the Path I outlay estimate. Other causes of the difference between the OMB and CBO estimates of budget totals are explained in Appendix B.

Both the OMB budget estimates and the estimates prepared for the Committee by the CBO are consistent with the respective underlying economic assumption on which they are based. However, the reverse is not the case. The assumed economic situation would not result from an actual budget held at the current services level. The economic scenarios are based, either implicitly or explicitly, on an assumption that the actual budget will differ from the current services estimates and a judgment as to the magnitude of that difference.

It is useful, however, to know the economic situation that would likely result from adoption of a budget held to the current services level, as well as the impact on the economy which departures from the current services level might produce. The results of three simulations prepared with the aid of an econometric model are presented in Table 5.

The first assumes budget totals at the current services level as estimated by the CBO. The second assumes that fiscal 1977 outlays are held to $395 billion. The third assumes 1977 outlays somewhat above the current services level and a 10 percent personal tax cut introduced at the start of fiscal 1977. These simulations should not be taken as precise forecasts of what will happen to the economy under different budget policies. Rather, they are presented as aids to understanding the likely general pattern of the economy and the magnitude of the impact of alternative policies.

Table 5.

Impact of Alternative Budget Policies

	I		II		III	
	Current Services Budget		Lower Outlays		Higher Outlays and Tax Cut	
	1976	1977	1976	1977	1976	1977
Percent Change in Real GNP	5.3%	3.4%	5.2%	1.9%	5.6%	4.6%
Unemployment Rate	8.1%	8.3%	8.1%	8.7%	8.0%	7.9%
Percent Change in GNP Deflator	6.2%	6.3%	6.2%	6.5%	6.3%	5.9%

Simulation I uses the current services budget estimates prepared by the CBO using economic assumptions supplied by the Committee. Outlays are estimated at $374.9 billion in fiscal 1976, $101.7 billion in the transition quarter, and $420 billion in 1977. Receipt estimates assume extension of 1975 tax withholding rates.

Holding the budget totals at these levels results in an estimated real GNP growth rate of only 3.4 percent in calendar 1977, and the unemployment rate rises from 8.1 percent in the first quarter of 1977 to 8.4 percent in the fourth.

The second simulation maintains the same assumption about tax policy but assumes that outlays are held to $373.7 billion in fiscal 1976, $99.5 billion in the transition quarter, and $395 billion in fiscal 1977. Thus, it is assumed that fiscal 1976 and transition quarter spending are held somewhat below the levels recently determined by Congress in the Second Concurrent Resolution of the 1976 Budget. Even so, in order to constrain fiscal 1977 spending to a total of $395 billion, it is necessary to assume an absolute reduction of about $5 billion in the annual rate of total spending between the third and fourth quarters of calendar 1976 and to permit an annual rate of spending growth in current dollars of less than 2 percent during the remaining quarters of fiscal 1977. With an expected inflation rate of 6 percent, this implies a reduction in real outlays of over 4 percent during the course of fiscal 1977.

The estimated economic impact of this more restrictive budget policy is unfavorable. The real GNP growth rate is less than 2 percent in calendar 1977 and the unemployment rate rises to 9 percent by the fourth quarter of that year. The inflation rate is slightly higher with the more restrictive budget policy.

The third simulation assumes fiscal 1977 outlays of $428 billion, or about $10 billion above the current services estimate. On the receipts side it assumes not only an extension of 1975 tax rates but also the introduction of an additional 10 percent personal income tax cut effective at the start of fiscal 1977 (i.e. October 1, 1976).

The effect on the economy of this more expansive fiscal policy is favorable. Of the three simulations, this is the only one in which output growth in 1977 is sufficient to prevent a renewed rise in unemployment. The inflation rate is slightly less with this more rapid output growth.

Even with this more expansive fiscal policy, however, the pace of recovery is sluggish. The growth of real GNP drops slightly below 4 percent in the second half of 1977 and the unemployment rate remains very close to 8 percent. Hence, even this fiscal policy falls short of meeting the objective of sustaining a recovery pace which achieves a continuing reduction in unemployment.

An analysis of the impact on the economy of alternative monetary policies goes beyond the scope of this study. However, it should be noted that each of the simulations described above assumes a rather expansive monetary policy, with growth of the money supply within the range of 8 to 10 percent per year.

Prediction of future economic conditions is difficult and the predictions grow increasingly imprecise as the time horizon is extended. The general shape of the forecasts presented here, while it reflects the best judgment of the Committee staff, is more pessimistic than some current forecasts.

The estimates presented above do not reveal the precise course which the economy will follow under alternative policies but they do illustrate the following:

- Fiscal policy changes can have significant impact on the behavior of the economy. By the end of 1977, the number of unemployed is more than one million greater under the most restrictive policy assumptions than under the most expansive.

- The challenge to policy in fiscal 1977 will be to prevent an excessive slowdown in the rate of recovery. Even the most expansive policy examined here does not produce in the simulations, strong recovery and rapid reduction in unemployment.. Congress may wish to consider both the adoption of a fiscal policy more expansive than any considered here and the supplementation of that policy with a direct job creation program.

The Full Employment Budget

Simulations produced with the aid of econometric models are one useful way of examining the probable impact of alternative policies. Another useful analytic device is to estimate budget totals as they would be at a constant level of unemployment. The Joint Economic Committee staff has prepared such estimates for each year through 1981 using the standard assumption of a 4 percent unemployment rate and the current services budget totals prepared for the Committee by CBO.

These estimates indicate that if spending were held at the current services level in fiscal 1977, the full employment budget would be in balance. Put another way the entire $63 billion current services deficit can be attributed to the lower tax receipts and higher uenmployment compensation costs associated with unemployment rates above 4 percent.

To understand the impact of the budget on the economy, it is necessary to look not just at the level of the surplus or deficit but at changes in that level. In the four quarters preceding fiscal 1977 the full employment budget is expected to be in deficit by an average of about $12 billion. Hence, if 1977 outlays are held at the current services level and the full employment budget is balanced, fiscal policy will be moving in a restrictive direction on a year-over-year basis. Viewed quarterly the pattern within 1977 is also restrictive with the budget shifting from a full employment deficit of about $13 billion in the first quarter of the fiscal year to a surplus of $10 billion in the final quarter -- a total swing of about $23 billion.

In part, this swing toward restriction results from the greater impact of inflation on receipts than on outlays. Outlays are fully adjusted for expected inflation in these estimates. Nonetheless, the impact of inflation on receipts is greater, primarily due to the fact that inflation pushes individuals into higher tax brackets. For every 10 percent inflation personal income tax receipts rise about 15 percent.

In addition to the restraint that is already built into these full employment estimates, there is a strong possibility that legislative action will worsen the problem. In 1975 several States have exhausted their balances in the Unemployment Trust Fund and have been forced to borrow from the Federal Government. If unemployment rates remain as high as estimated, this will happen to more States in 1976. To correct this problem, Congress is currently considering legislation to substantially increase the taxes paid to support the Unemployment Trust Fund. The legislation currently being considered would raise tax rates effective January 1, 1976, and increase the tax base effective January 1, 1977. If the tax increase occurs in FY 1977 as expected, the swing toward restriction will be greater than indicated by the full employment estimates.

The most expansive of the model simulations described above, which placed outlays $10 billion above current services levels and reduced personal taxes by 10 percent, replaces the budget swing toward restriction with a moderate movement in an expansive direction, and this is reflected in the stronger rate of economic growth.

By contrast, a $395 billion spending total in 1977 would produce an extremely sharp swing toward restriction. The full employment surplus would rise to about $40 billion by the final quarter of the fiscal year, a swing of nearly $50 billion from the $9 billion deficit which would exist in the first quarter of calendar 1976 under these spending assumptions. The most recent experience of a fiscal swing of similar magnitude is found in 1973-1974 when the full employment surplus rose by about $35 billion over a six-quarter period, helping to precipitate the most severe recession since 1937.

There are strong arguments in favor of moving toward a surplus in the full employment budget as an actual situation of full employment is approached. However, a time when unemployment is still extremely high and continuation of recovery is by no means assured does not seem to be an appropriate time for such a movement. A neutral or expansive budget policy would appear more appropriate for the short run. To achieve even a neutral fiscal policy in fiscal year 1977 will require either increases in outlays above the current services estimates and/or tax reductions (in addition to extension of the present, temporary tax cut), which together total about $12 billion.

The Five-Year Budgetary Outlook

The current services concept by definition excludes new or expanded programs, except where provision for such programs is already contained in current law. Hence, as the time horizon lengthens, the current services estimates increasingly diverge from the probable actual budget totals. The usefulness of the five-year projection of the current services budget is not to predict what the budget totals will actually be in future years but to examine the potential scope for and desirability of changes in budget policy.

Table 6 presents estimates of the full employment surplus in the current services budget in fiscal years 1977 through 1981. The full employment budget is in approximate balance in 1977 and the surplus rises steadily to about $66 billion in 1981. This rising surplus represents the margin which is available to be divided among new spending initiatives, tax reductions, and provision for an actual budget which would be in surplus at full employment.

The adoption in 1977 of program reforms and reductions such as those discussed in Chapter V and some tax reform could enlarge this margin by $30 to $35 billion or more by 1981. Possible use of this budget margin for new program initiatives in the areas of health care and income support are also discussed in Chapter V.

As discussed earlier, the outlook is for a real GNP growth rate of about 6.6 percent in calendar 1976 and 3.8 percent in 1977. For 1978 through 1980, we have assumed steady real growth of 4.9 percent per year. This brings the average growth rate for the entire 1975-1980 period to 5 percent per year, about the highest

Table 6.

Current Service Estimates on a Full Employment Basis*
(National Income Account basis, Fiscal years)
(billions of dollars)

	1976**	1977	1978	1979	1980	1981
Receipts	$374	$419	$468	$520	$575	$631
Outlays	386	419	457	492	529	565
Surplus	-12	0	11	28	46	66

* Assumes 4 percent unemployment rate, inflation rates (as measured by the GNP deflator) of 6.6 percent in calendar 1976, 6.1 percent in 1977, 6.0 in 1978, 5.5 in 1979, and 5.0 in 1980. Compnents may not add to total because of rounding.

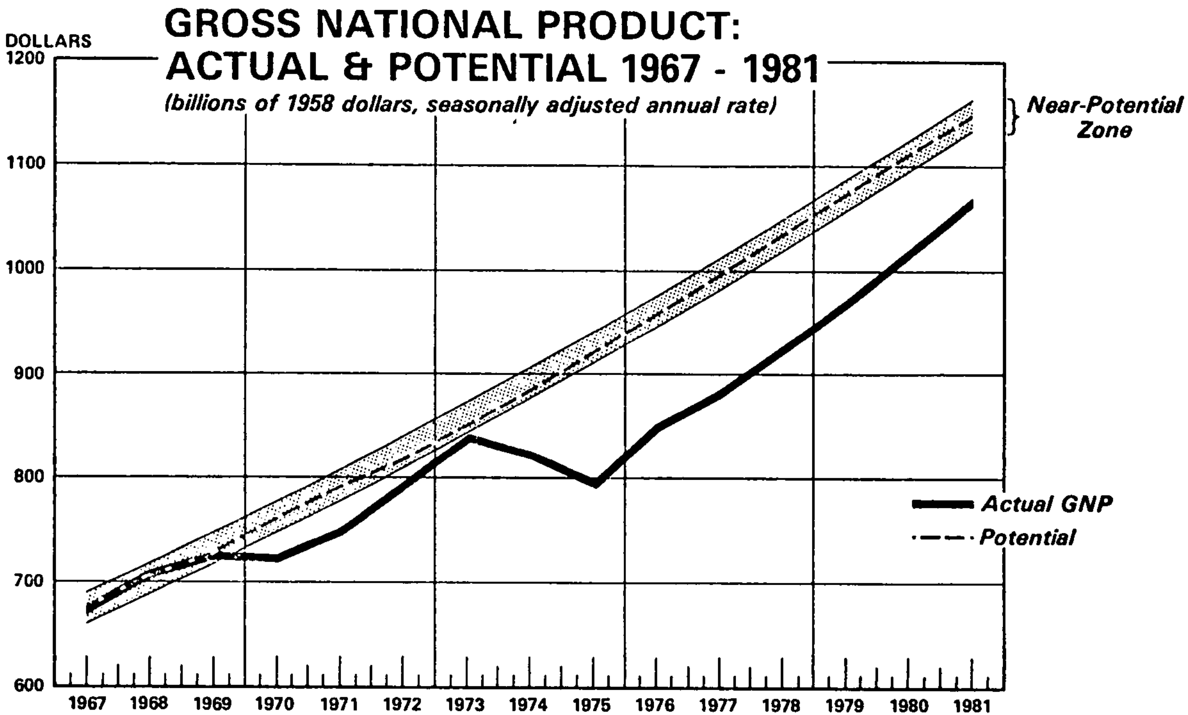
**For comparability with the new fiscal year dates this estimate covers the period October 1, 1975 to October 1, 1976.

Sources: Congressional Budget Office and Joint Economic Committee rate which past history suggests is probable. As illustrated in Chart 5, however, such a growth rate falls far short of adequacy for returning the economy to full employment. In 1980, real output is still about 9 percent below its potential, implying an unemployment rate of about 7 percent.

In its report to the Budget Committees last March, the Joint Economic Committee recommended the adoption of policies designed to bring real output into its potential zone and the unemployment rate below 5 percent no later than the end of 1979. The presentation of the weaker growth path used in this report is not meant to imply that these more ambitious targets are either unachievable or undesirable. The presentation does illustrate, however, that the economy is not presently on a track that would return it to the zone of full employment during the next five years.

To reach and sustain an economic pattern designed to restore relatively full employment during the next five years will require, among other things, a strongly supportive fiscal policy. The scope for such a policy is greatest in the immediate future while the volume of idle resources is still extremely large. Thus in the near-term the objective of a rapid return to full employment will be best served by utilizing the budget margin either for temporary outlay increases or for tax reductions rather than for additions to the full employment surplus. Indeed, for 1977 Congress may wish to consider a fiscal policy which places the full employment budget in deficit so as to avoid the potential swing toward a restrictive policy discussed earlier. If so, actions of a temporary nature, which will not jeopardize the achievement of a full employment budget balance in later years, might form a useful element in budget policy.

Chart 5.



Sources: Department of Commerce, Council of Economic Advisers, Joint Economic Committee.

V. CHANGING THE BUDGET PATH

After considering the budget path that is produced on the assumption of no policy changes between 1976 and 1980 and examining the total economic picture that emerges from that assumption, the next logical step is to examine ways to change that path. That is, what kind of policy changes might Congress wish to consider that would have significant impact on altering the path of the Federal budget over the next five years? Clearly such alterations could be achieved by increasing or reducing expenditures or increasing or reducing tax receipts. However, the possibility of an income tax increase is considered sufficiently remote that it is not discussed.

The following sections discuss some specific policy alternatives and present general estimates of their effect on future budgets. In formulating these alternative policies, the Chairman of the Joint Economic Committee requested advice from various private analysts knowledgeable in different fields of the budget.

Expenditure Reductions

When discussing ways to reduce Federal spending, everyone favors greater program efficiency and increased government productivity. With personnel costs running between $60 and $70 billion per year, it would be foolhardy to suggest that improvements in efficiency and productivity are not attainable. Some improvements can result from Executive action alone, but others will require congressional action.

To some extent, Congress has limited the ability of the Executive to eliminate waste and duplication by providing multiple objectives for each program. The entire welfare area is an example of overlapping programs and duplication of effort. Careful study and coordination of efforts by the Congress and the Executive Branch will be necessary to correct these problems.

The following paragraphs discuss certain specific areas that are frequently mentioned in discussions of improved economic efficiency and reduced Federal expenditures. We do not suggest that the following discussion is complete, and it is certainly not devoid of controversy. However, we do suggest that these program areas have been subject to sufficient controversy to merit a careful reevaluation.

National Defense

Reductions in defense outlays have been estimated on the basis of two types of actions: efforts to achieve greater efficiency and changes in the force structure. In 1974 and 1975 the Defense Department conceded that large savings from more efficient uses of resources were possible, a point that had been made by a number of congressional committees and individual Congressmen. Some steps toward greater efficiency have been taken, but the savings thus far have been reinvested in the defense program. For example, ground support forces and headquarters personnel were reduced in order to increase the size of combat forces in Europe. Large additional savings are possible, and if the decision is made to maintain the present defense structure rather than enlarging it, the savings can be used to reduce defense outlays.

Perhaps the largest sources of potential efficiency savings is in the area of manpower. Manpower costs take up slightly more than 50 percent of the defense budget. Cost savings have been estimated on the assumption that substantial reductions can be made in support and auxiliary functions, such as military schools, where the ratio of students to instructors is now 1-1/2 to 1. Far fewer instructors per student are carried in civilian schools. For example, in most colleges the ratio is about 15 to 1. Additional savings can be obtained by reducing the size and number of bases, lengthening tours of duty, reducing the number of people in Navy uniform to conform with the reduction that has already occurred in the number of ships, and reducing the size of civilian manpower to conform with the reduction of military manpower since 1968. Estimated savings assume a total manpower efficiency cut of 200,000 persons by the end of 1981, phased over the five-year period, beginning with a 40,000 reduction in

1977. In view of reports that the Administration is considering elimination of 85,000 persons from the Defense Department payroll in its fiscal year 1977 budget request, the assumption in this study should be considered conservative.

Greater efficiency can also be achieved in procurement. Numberous instances of waste and inefficiency in the procurement of weapons systems have been identified in recent years. A most recent example is the disclosure that the costs of repairing the wings of the C-5A aircraft are estimated as high as $1.3 billion and that total repairs of defects on this plane will cost about $1.5 billion. The inefficiency involved in paying such costs is underlined by the fact that the Air Force knew the wings were defective before most of the planes were delivered and that it was aware that the planes had many other major deficiencies prior to their acceptance. There is also substantial evidence of inefficiency in other aircraft, in Army weapons, and in the Navy's shipbuilding program. The 1975 report of the Senate Armed Services Committee cited as partial reasons for the latest cost increases in the shipbuilding program "low productivity, construction delays, and Navy changes." 1/ Estimated savings are based on more stringent policies requiring compliance with contract prices, specifications and delivery dates, and elimination of wasteful practices and activities.

While savings can result from greater efficiency without changes in the force structure, obviously large amounts can be saved by cutting back forces. We have selected two from the wide possibilities of force reductions. We believe that these can be defended on the grounds of changes in the international setting and the need to reduce unnecessary spending for strategic weapons.

The most notable international changes have occurred in Asia as a result of the end of the war in Vietnam and improved relations with China. There is now considerable evidence that substantial forces

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1/ Senate Armed Service Committee Report No. 94-196, p. 23.

deployed in Asia or based in the United States for possible use in a future Asian war can be reduced without endangering our interests in that part of the world. At present, forces for an Asian contingency cost about $23 billion annually. Reductions from this force of about 200,000 persons by the end of 1981 can be made without withdrawing any troops now deployed in Japan or South Korea. Somewhat more than one-fourth of the Asian force structure would be cut under this proposal.

Finally, reductions in the costs of strategic programs have been estimated on the assumption that some improvements can be safely terminated or deferred and some of the older systems phased out. Estimated savings from terminations or deferrals are based on terminating development of a new generation of land-based ICBMs, terminating improvements in the existing Minuteman force, suspending work on the submarine-launched cruise missile program, and slowing down the B-1 bomber and the new Air Force tanker program.

Calculations of savings from a slowdown of the B-1 are offset to some extent by the costs of developing an alternative standoff type bomber. Some of the older B-52s and the older Minuteman II force would be phased out. Further research in the ABM would be slowed down.

Table 7

Possible Savings From National Defense Program
(Fiscal Years 1977-1981)
(Outlays in billions of current dollars)

	1977	1978	1979	1980	1981
Manpower efficiency	$ .6	$1.2	$2.0	$2.8	$3.8
Procurement efficiency	.5	.8	1.0	2.0	2.0
Asian Forces reductions	.9	1.7	4.2	5.1	8.1
Strategic forces reductions	.6	1.9	3.5	4.5	4.8
TOTALS	$2.6	$5.6	$10.7	$14.4	$18.7

Regulatory Agencies

Suggestions are sometimes made that some regulatory agencies are inefficient and should be eliminated. The Interstate Commerce Commission (ICC) and the Civil Aeronautics Board (CAB) are often cited as examples. Phasing out regulatory agencies such as these would have a very small impact on the Federal budget. Since a regulatory agency by its nature changes pricing and other decisions within the private market, it is reasonable to expect that the largest impact would be felt within the private market and the regulated industries in particular.

As an illustration of the general magnitudes of potential budget savings from this source, Table 8 shows the spending reductions which occur if the ICC and CAB are phased out over the next three years.

Table 8

Spending Reductions from Regulatory Agency Change
(millions of dollars)

	FY 77	FY 78	FY 79	FY 80	FY 81
ICC Phaseout	$ 17	$ 35	$ 51	$ 64	$ 69
CAB Phaseout	32	57	81	100	107

Subsidy Payments

Studies previously published by the Joint Economic Committee have identified about $100 billion in various subsidy programs in 1975. Roughly one-third of these are reflected in budget expenditures. The remainder show up on the tax side of the budget or in the accounts of the off-budget agencies. Several of the outlay programs such as maritime subsidies, Export-Import Bank subsidies and aid for impacted school areas have been criticized as inefficient. Table 9 illustrates the general magnitude of budgetary saving that might be realized by an orderly phaseout of these programs. It assumes that no new contracts are entered for ship construction subsidies, no new loan commitments are made by the Export-Import Bank, and the hold harmless provisions of impacted area aid maintained.

Ship operating subsidies are normally paid through long-term contractual arrangements. Information was not available on the savings to be realized from allowing these contracts to expire, but we estimate that by fiscal year 1981 savings should be close to $130 million.

Table 9

Spending Reductions from Subsidy Change
(millions of dollars)

	FY 77	FY 78	FY 79	FY 80	FY 81
Ship Construction Subsidies	$ 14	$ 92	$ 178	$ 270	$ 300
Export-Import Bank Loans	1,100	2,100	2,800	3.400	3,800
Impacted Area School Aid	125	206	278	340	400

Federal Retirement Benefits

The current law provides that retired Federal employees, civilian and military, receive a 4 percent increase in benefits each time the Consumer Price Index increases 3 percent. Savings that might be realized by altering this provision to allow benefit increases equivalent to CPI increases are illustrated in Table 10. These estimates assume that the current timing of the inflation adjustment is maintained.

Table 10

Spending Reductions from
Eliminating Excess Inflation Adjustment
(millions of dollars)

	FY 77	FY 78	FY 79	FY 80	FY 81
Military Annuitants	$ 93	$ 215	$ 323	$ 496	$ 622
Civilian Annuitants	79	269	413	844	1,094

Social Security

Recent changes in social security legislation unintentionally introduced provisions which would allow some benefits to be adjusted twice for inflation. Benefits are calculated by multiplying a wage base by a formula that includes an inflation adjustment. In the case of retired persons the wage base is fixed so that their benefits are adjusted once (by the formula) for inflation. For workers not yet retired, however, the wage base will increase as wages go up. Thus they receive two inflation adjustments -- one from the higher wage base and one from the higher benefit formula.

Solving this problem by removing the double inflation adjustment is far more difficult than the simple explanation offered above would indicate. However, the problem is so serious that it must be faced squarely before it threatens the solvency of the entire social security system. The best information available indicates that the problem will become significant in the 1985-1990 period and increasingly serious thereafter.

Tax Reform

Over the past few years the Joint Economic Committee has recommended many tax changes which would increase Federal revenues. In its 1975 annual report the Committee recommended eliminating Domestic International Sales Corporation (DISC) provisions, limiting the foreign tax credit, and strengthening the minimum income tax provisions, among others. Past reports have also recommended reclassifying payments to foreign governments for mineral extraction rights as royalties rather than taxes, abolishing the deferral of income taxes on earnings of U.S. corporations generated abroad by foreign subsidiaries, and substantial revisions in capital gains, investment tax credit, and Asset Depreciation Range (ADR) provisions.

By enacting these and other tax reforms Congress could add substantially to the budget margin available for other uses. In 1976 the DISC tax provisions are estimated to cost $1.3 billion and by 1981 the revenue loss is estimated to exceed $2 billion. Legislation approved by the House of Representatives in November 1975 would increase tax receipts by over $4 billion by 1981, including over $1 billion for strengthening the minimum income tax provisions.

Estimates of the revenue loss from each specific tax expenditure item are not available at the present time. This is being studied by the Joint Committee on Internal Revenue Taxation and the Congressional Budget Office. Estimates should be available in early 1976. It seems reasonable to suppose that Congress, if it wishes, can increase Federal revenues by at least $5-$10 billion by 1981 through the types of reform discussed above.

Summary

This discussion has illustrated the general magnitude of expenditure reductions which might be made in some program areas. The single area with the largest potential is national defense. In most other areas, substantial reductions mean a level of important government services substantially below that now provided. In the civilian budget, we have detailed ways of saving about $6-1/2 billion by 1981; in the military about $18-1/2. When the additional revenues from tax reform are included, budget savings could total $30 to $35 billion by 1981.

Program Increases

As discussed in Chapter IV, the current services balance of receipts and expenditures is inadequate to support an acceptable economic recovery. Even the assumptions underlying the budget projections in this report -- a 5 percent annual rate of growth and a 7 percent unemployment rate in 1980 -- would not be produced by following the current services budget path. Below we discuss two spending alternatives that Congress has considered but not acted upon which could fulfill the dual role of needed program reform and economic support. A third alternative is presently being studied.

Employment Policy

The recession of 1975 has left behind it a legacy of extremely high unemployment rates. Even with a vigorous and sustained economic recovery, several years will be required to reabsorb this recession-induced unemployment through the normal workings of the labor market.

An immediate policy issue confronting the Congress during its consideration of the 1977 budget will be the question of how best to deal with this excess unemployment. As discussed in Chapter IV, a monetary and fiscal policy which supports steady and broadly based output growth is fundamental to any successful strategy for reducing unemployment. However, even a highly expansive fiscal and monetary policy cannot by itself be expected to bring unemployment down to what is generally considered a "normal" or "acceptable" level during the 1977 budget year. The assumed fiscal 1977 unemployment rate underlying the five-year budget projections presented in Chapter II is 7.9 percent. As discussed in Chapter IV, even this estimate assumes a fiscal policy significantly more stimulative than would be produced by the current services budget totals.

Most of the increase in unemployment during 1974 and 1975 was due to layoffs of experienced workers, the great majority of whom were entitled to unemployment insurance benefits. As the period of high unemployment is prolonged, a diminishing proportion of the unemployed will be receiving insurance benefits. Many will have exhausted all benefits to which they are entitled under current law. Many others will be new labor force entrants or reentrants who lack insurance coverage.

Essentially there are three policy options available to the Congress for dealing with the residual unemployment left by the recent recession. The first is to take no legislative action. The second is to adopt an income support strategy consisting either of an extension of unemployment benefits beyond the present five-week maximum, or of some alternative assistance program. The third is to increase temporary employment opportunities either through expansion of existing public service and public works programs or through adoption of a new emergency jobs program.

If no new legislative action is taken to assist the unemployed, a new burden will be placed on existing income support programs. The unemployed will turn increasingly to food stamps and, when they are eligible, to aid for families with dependent children, veterals benefits, and social security as the only available sources of income. Costs of each of these programs will rise significantly more than would otherwise be the case. Even so, many of the unemployed will be left without an adequate income. Viewed solely from the narrow perspective of budgetary impact, costs of public programs ranging from health care to crime control could be expected to rise.

Costs of extending unemployment benefits beyond the present 65-week maximum would depend on the scope and nature of the benefit extension. Under existing programs the average cost per beneficiary is about $62.50 per week. Extension of benefits at this average level to 1.5 million persons for one year would add about $5 billion to the $19 billion included in the current services budget as the estimated cost of existing unemployment insurance programs. Some part of this cost would be offset by savings on food stamps and other income support programs.

The cost of providing temporary work opportunities would also vary with the nature and magnitude of the program adopted. The Joint Economic Committee has recently recommended the adoption of a Federally funded program of locally initiated temporary work projects on a scale adequate to employ approximately 1.5 million persons at expected fiscal 1977 unemployment rates.[1/] At an average cost of $8,400 per job, including supplies and overhead, outlays on such a program would be $12.6 billion. However, about $3.7 billion of this would be recaptured in increased tax receipts. Savings in terms of reduced costs of unemployment compensation, food stamps, and other income supplement programs would be at least $4 billion. Thus, a program to create temporary job opportunities for 1.5 million of the unemployed would cost about $5 billion more than the alternative strategy of extending unemployment benefits, or about $3,220 for each full-year job provided.

The above estimate is both incomplete and inexact but it is based on conservative assumptions. The full impact of variations in the unemployment rate on the costs of Federal income support programs has not yet been successfully measured. If accurate estimates of this impact were available, it is quite probable they would indicate that the additional costs of an employment program, as compared to an income support alternative, are considerably less than the above estimates.

1/ "The 1975 Midyear Review of the Economy," Report of the Joint Economic Committee, October 1, 1975.

In addition to the direct budget impact of the three alternative approaches described above, it is obvious that they would have quite different general economic and social impacts. Failure to take any new legislative action to deal with unemployment would leave many of the unemployed without even minimum levels of income support. Some would be able to rely on family or friends for assistance, but others would be left destitute. Currently available information on the income situation of the unemployed is seriously inadequate. The Bureau of Labor Statistics plans a special survey in January which should yield additional information in this area.

Further extension of unemployment compensation and broadening of coverage would ease the income plight of the unemployed, but it would achieve little else. Provision of temporary public job opportunities would not only provide the unemployed with somewhat more adequate incomes, but would provide for the maintenance and enhancement of job skills and would result in the production of otherwise unavailable public goods and services.

Health Insurance

A major reform of the way health care is financed in this country has been high on the congressional agenda for several years. Numerous proposals have been put forward ranging from little change to comprehensive insurance coverage provided by the Federal Government. The measures necessary to finance these changes and the consequent impact on the Federal budget also cover a wide range.

To get some idea of the future budget impact of various proposals, we present cost estimates of three alternatives: the Administration's "CHIP" plan, the Health Security Act (S.3/H.R. 21), and the Long-Ribicoff Catastrophic Insurance proposal. Under any of these major changes, the length of time necessary for implementation would be about two years. Thus, the budget impact of action taken by Congress in 1976 will not be very large before 1978.

There is a fundamental difference between the method of financing the Health Security Act and other reforms. Both the Administration "CHIP" proposal and the Catastrophic Insurance Proposal rely heavily on the private insurance industry and out-of-pocket payments for financing. This represents little change from the way in which health care is presently financed. The Health Security Act, however, would place the vast majority of the financing burden on the Federal Government. Consequently, the impact on the Federal budget of the Health Security Act would be far greater -- approximately $100 billion by 1981.

Proponents of the Health Security Act argue that transferring the responsibility of financing health care to the Federal Government has an important advantage -- it allows greater control of health costs. In 1975 hospital charges have increased over 100 percent faster than other components of the Consumer Price Index and physician fees about 40 percent faster. Health costs are expected to continue to rise much more rapidly than general inflation. The Health Security Act contains cost control provisions which are designed to reduce the rate of inflation in medical costs by almost one-half. Thus, while the budgetary impact would be large, the Nation's total medical bill would be less than under either of the other reform proposals and, in fact, less than under a continuation of the existing system.

As shown in Table II below, either the Administration's "CHIP" proposal or the Catastrophic Insurance Proposal could be accommodated within the $66 billion margin we previously suggested would become available by 1981 with no tax changes. Implementing the Health Security Act, however, would necessitate additional budget revenues.

Table II

Expenditure Increases from Health Insurance Reform (billions of dollars)

	FY 78	FY 81
"CHIP" Proposal	$14.5	$20.2
Catastrophic Insurance Proposal	7.7	10.8
Health Security Act	98.6	114.5

Welfare Reform

A third use of part of the margin we have discussed earlier would be through welfare reform. The cost of such reform would vary widely depending upon minimum income levels, the extent to which the Federal Government assumes responsibilities now borne by States and localities, the number of existing programs incorporated in the reform, and various other factors. At the present time, estimates of the cost of various proposals before Congress are not available for future years or on a comparable basis. The Committee, however, has initiated a thorough evaluation of welfare reform proposals and hopes to have additional information available within the coming year.

Appendix Table A

Current Services Receipts and Expenditures, National Income Accounts Basis
(fiscal years, billions of dollars)

	1975 Actual	1976 Estimate	Trans. Quarter Estimate	Projections 1977	1978	1979	1980	1981
Unified Outlays	$324.6	$374.9	$101.7	$420.3	$460.1	$492.2	$527.7	$562.8
Difference	4.8	7.9	2.1	10.2	.6	11.7	12.4	12.7
NIA Outlays	329.4	382.8	103.8					
Unified Receipts	281.0	300.8	86.0	355.0	405.0	450.0	506.0	567.0
Difference	2.3	7.6	1.6	9.0	9.4	9.8	10.2	10.6
NIA Receipts	283.3	308.4	87.6	364.0	414.4	459.8	516.2	577.6
Surplus, NIA basis	-46.1	-74.4	-16.2	-66.5	-55.3	-44.1	-23.9	+ 2.1

Source: Congressional Budget Office

Appendix B

Differences in CBO and OMB Budget Estimates

As noted in various places throughout this report, the current services budget estimates for fiscal year 1977 are different from those prepared by OMB. The primary reasons are the following:

1. The underlying economic forecast is slightly different. This is discussed in Chapter IV.

2. The OMB estimates only include a partial inflation adjustment. This is because some programs have an explicit provision in the law for inflation adjustments, while others do not. This, however, is more the result of historical accident than a conscious policy decision on the part of Congress. The CBO estimates show virtually all programs fully adjusted for inflation.

3. The OMB estimates treat pay adjustments for the Department of Defense differently from all other agencies. Their estimates include pay adjustments for this agency in the defense functional category but all other pay adjustments are shown in a lump-sum allowance and are not distributed by agency or function. Estimates presented in this report have corrected this misleading treatment by dividing the allowances category into two lines -- one for military pay adjustments and one for civilian pay adjustments (see Table 2).

4. The OMB data was the most recent available as of September 1, 1975. This was before Congress finished consideration of the Second Concurrent Resolution on the Budget. The data in this report assumes the Second Concurrent Resolution as the 1976 base.

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