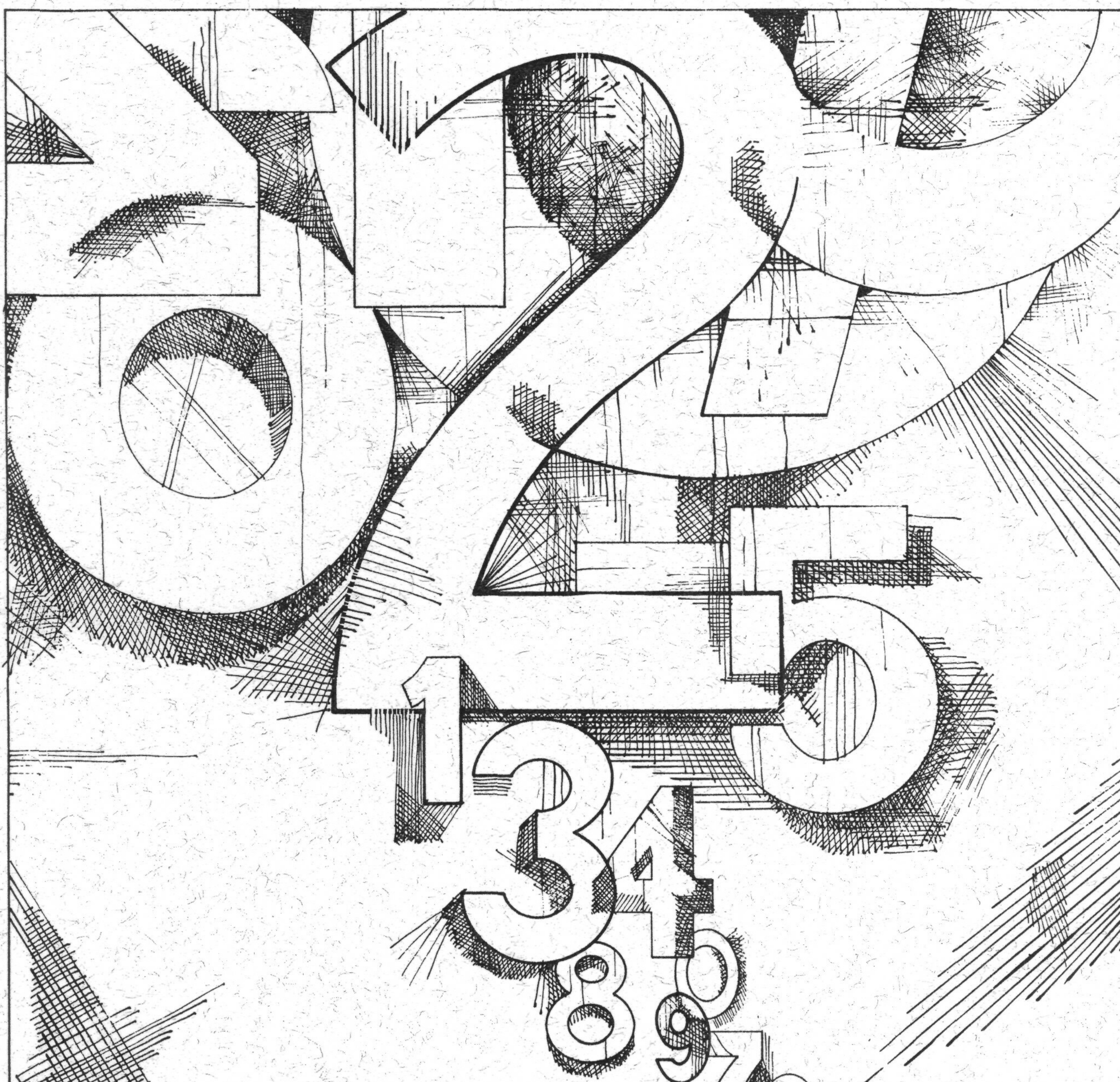
An Analysis of the President's Budgetary Proposals for Fiscal Year 1984

FEBRUARY 1983

Prepared at the Request of the Senate Committee on Appropriations



CONGRESS OF THE UNITED STATES

CONGRESSIONAL BUDGET OFFICE

AN ANALYSIS OF
THE PRESIDENT'S BUDGETARY PROPOSALS
FOR FISCAL YEAR 1984

The Congress of the United States
Congressional Budget Office

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, D.C. 20402

NOTES

Unless otherwise indicated, all years referred to in this report are fiscal years.

Details in the text and tables of this report may not add to totals because of rounding.

PREFACE

This analysis of the President's budget for fiscal year 1984 was prepared at the request of the Senate Committee on Appropriations. The report describes the problem of large and growing budget deficits faced by the federal government under existing tax laws and current spending policies. It discusses how the Administration's proposals would reduce these projected deficits over the next five years.

This report includes the Congressional Budget Office's preliminary reestimates of the budgetary impact of the Administration's proposals using CBO's economic assumptions and technical estimating methods. The report analyzes in some detail the major tax changes proposed by the Administration as well as the major spending increases proposed for defense programs and reductions in domestic programs. Finally, the report also discusses the economic outlook and the assumptions used for the President's budget.

This report was prepared by the staff of the Budget Analysis, Fiscal Analysis, and Tax Analysis Divisions under the supervision of James L. Blum, William J. Beeman, and James M. Verdier, respectively. Principal contributors are listed in an appendix.

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Director

February 1983

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CHAPTER I. SUMMARY AND INTRODUCTION

The Administration's budget proposal for fiscal year 1984 contains a number of tax increases and spending reductions designed to reverse the trend of growing federal deficits. At the same time, the Administration proposes to increase defense spending more rapidly than assumed in the First Concurrent Resolution on the Budget for Fiscal Year 1983. The Congressional Budget Office (CBO) estimates that the net effect of these changes would be to reduce projected deficits by $332 billion over the next five years. Nevertheless, the deficit in 1988 would still remain at a high level--$159 billion, or 3.3 percent of the gross national product (GNP). Of this amount, about $100 billion would persist even if the economy were to resume operating at a high-employment level.

THE BUDGET UNDER CURRENT POLICIES

CBO projects that, if current spending and taxing policies were to continue unchanged, the federal budget deficit would grow from $194 billion in fiscal year 1983 to $200 billion in 1984, $210 billion in 1985, and $268 billion in 1988. As a percentage of GNP, the deficit would decline only slightly--from 6.1 percent in 1983 to 5.6 percent by 1988.

These baseline budget projections, which are preliminary revisions of those published earlier this month, assume no change in current tax laws. 1/In instances of federal spending mandated by law, as is the case for Social Security benefits and other entitlement programs, the existing laws are assumed to remain unchanged, and future spending is assumed to respond to economic conditions and other influences in the same way as in the past. In instances of federal spending that is discretionary and subject to annual appropriations, the CBO baseline projections generally assume that the 1983 appropriation levels will be maintained, with future increases to keep pace with inflation. For national defense programs, the projections assume the spending levels specified in last year's Congressional budget resolution, as extrapolated by CBO.

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1. See Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1984-1988 (February 1983).

TABLE I-1. THE BUDGET OUTLOOK UNDER CURRENT POLICIES
(By fiscal year, in billions of dollars)

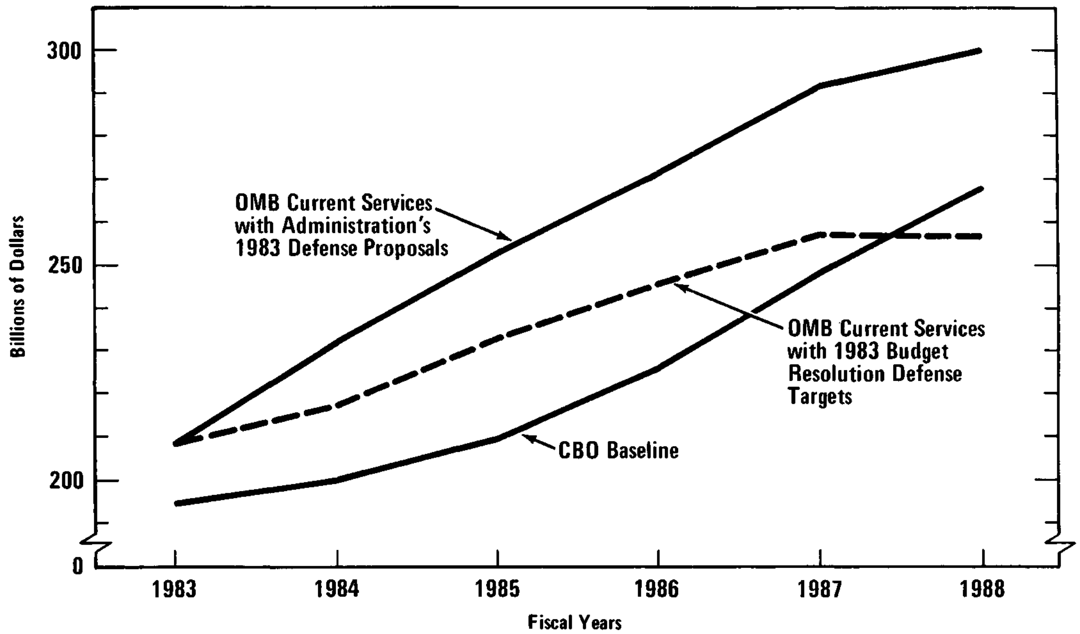
	1983 Base	Projections 1984	1985	1986	1987	1988
Revenues						
CBO baseline	606	654	718	774	827	882
OMB current services	598	649	713	781	849	927
Outlays						
CBO baseline	800	853	928	1,000	1,075	1,150
OMB current services a/	806	880	966	1,052	1,141	1,227
Deficit						
CBO baseline	194	200	210	226	248	268
OMB current services	208	232	253	271	292	300
Differences in Deficit Projections						
Policy Differences						
National defense	*	-12	-16	-22	-32	-39
Other	*	-3	-4	-3	-3	-5
Subtotal	*	-15	-20	-25	-35	-44
Economic and Technical Differences	-14	-17	-23	-20	-9	12
Total Difference	-14	-32	-43	-45	-44	-32

* Less than $500 million.

SOURCES: The CBO baseline figures are preliminary revisions of those appearing in Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1984-1988 (February 1983). The OMB current services figures are taken from Budget of the United States Government, Fiscal Year 1984 (January 1983).

a. Includes the Administration's February 1982 defense proposals.

Figure I-1.
Federal Budget Deficit Under Current Policies



SOURCES: *Budget of the United States Government, Fiscal Year 1984;* and Congressional Budget Office.

As shown in Table I-1, the current services budget projections of the Office of Management and Budget (OMB) present the same picture of large and growing deficits as do CBO's baseline projections. In the OMB projection, the deficit under current policies would rise from $208 billion in 1983 to $300 billion by 1988. Most of the difference between the CBO baseline and the OMB current services projections is attributable to different assumptions about current spending policy for defense.

The OMB current services projections for defense assume the levels of defense spending requested by the Administration in its 1983 budget, while the CBO baseline projections assume the defense spending levels provided in the 1983 Congressional budget resolution. This, together with other smaller policy differences, causes the two projections of outlays to diverge by $15 billion in 1984 and $44 billion by 1988. The remaining, and smaller, portion of the difference results from different economic and technical assumptions.

Figure I-1 depicts the CBO baseline and OMB current services deficit projections. It also shows the OMB projections adjusted to incorporate the budget resolution defense targets and otherwise to put them on the same conceptual basis as the CBO figures. With adjustments made to account for the differences in policy assumptions, CBO shows slightly lower deficits than OMB in the 1983-1987 period and a slightly higher deficit in 1988. This pattern reflects a more optimistic CBO forecast of economic growth in the early years and more pessimistic assumptions for the latter part of the period.

THE ADMINISTRATION'S BUDGET PROGRAM

The Administration's budget program is designed to reduce the deficits that would result from a continuation of current policies, as well as to provide further large increases in defense spending. The major elements of the program are depicted in Figure I-2 and listed in Table I-2. CBO estimates that the Administration's budget program would reduce projected deficits by $332 billion over the next five years.

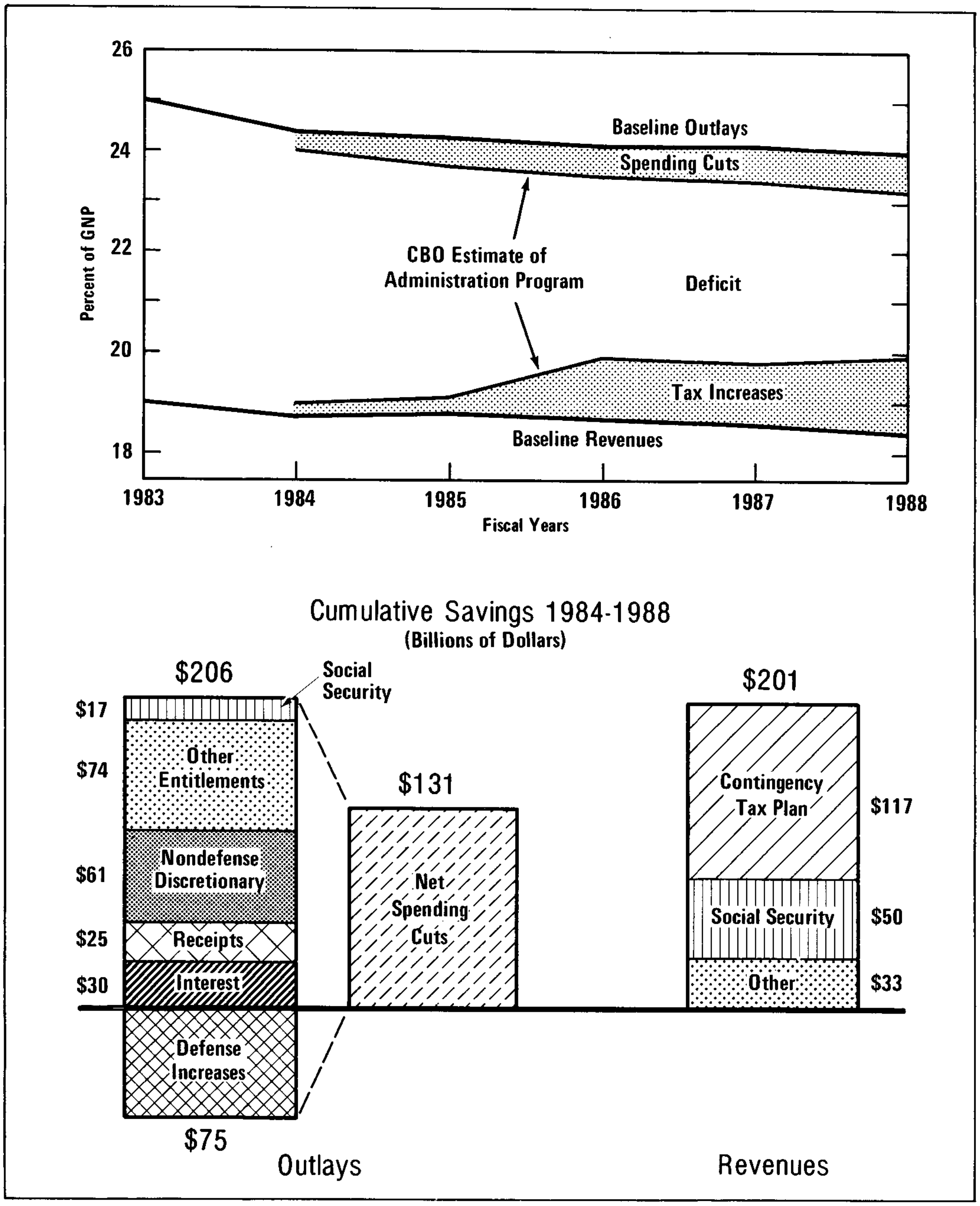
Tax increases proposed by the Administration total $201 billion over the 1984-1988 period. Of this increase, about 60 percent--$117 billion--would result from a contingency tax plan. The contingency taxes consist of an income tax surcharge and an excise tax on oil. These contingency taxes would go into effect in fiscal year 1986 if the projected budget deficit exceeds 2.5 percent of GNP, if the economy is growing, and if the Administration's other deficit reduction measures are enacted.

Another $50 billion in additional tax revenues would result from adoption of the recommendations of the National Commission on Social Security Reform. These include increases in the Social Security payroll and self-employed tax rates, taxation of half of Social Security benefits for upper-income taxpayers, and extension of coverage to include all employees of nonprofit institutions and new federal civilian employees. Finally, various other proposed tax increases and reductions would, on balance, produce $33 billion more in revenues from 1984 to 1988. (Revenue estimates and tax proposals are detailed in Chapter III.)

Proposed outlay reductions total $131 billion over the 1984-1988 period. This reduction is the net effect of $75 billion in increased spending for national defense and $206 billion in nondefense spending cuts. (The defense and nondefense portions of the budget are examined in Chapters IV and V.) The proposed reductions in nondefense spending consist of:

- **$17 billion in lower net spending resulting from the National Commission's Social Security financing plan.** This consists of $22 billion in reduced Social Security benefits stemming from a six-

Figure I-2.
Administration's Budget Program



SOURCE: Congressional Budget Office.

TABLE I-2. CBO ESTIMATE OF ADMINISTRATION'S BUDGET PROGRAM (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Total
CBO Baseline Deficit	200	210	226	248	268	1,152
Proposed Changes						
Revenues						
Contingency tax plan	--	--	-37	-39	-41	-117
Social security plan	-8	-5	-8	-9	-20	-50
Other, net	-3	-5	-7	-8	-11	-33
Subtotal	-11	-11	-52	-57	-71	-201
Outlays						
National defense	3	5	12	24	32	75
Social Security plan	-3	-3	-4	-4	-4	-17
Other entitlements	-6	-12	-16	-19	-21	-74
Nondefense discretionary spending	-5	-7	-11	-17	-21	-61
Offsetting receipts	-2	-4	-5	-6	-8	-25
Net interest	*	-1	-5	-10	-15	-30
Subtotal	-13	-23	-28	-31	-38	-131
Total Policy Changes	-24	-33	-79	-87	-109	-332
President's Budget as Estimated by CBO	176	177	147	160	159	820

month delay in cost-of-living adjustments, partly offset by liberalizations in Supplemental Security Income and by other benefit changes.

- **$74 billion in reductions in entitlement programs other than Social Security.** The largest reductions are in spending for Medicare, including increased copayment charges and changes in the hospital payment system. Cost-of-living adjustments in various pension programs would be delayed or reduced. Reductions are also proposed in farm price supports and various means-tested programs.

Under the Administration's proposals, outlays for non-Social Security entitlements would still rise from an estimated $221 billion in 1983 to about $270 billion by 1988, but their projected growth under CBO's baseline would be cut nearly in half.

- **$61 billion in lower nondefense discretionary spending.** This includes lower federal pay raises, a freeze on most human resources programs, broad reductions in transportation and natural resource programs, and cuts in aid to business and commerce. Only basic federal government operations and assistance to foreign governments remain largely unscathed. Relative to CBO's baseline projections, which allow spending to keep pace with inflation, the projected growth of nondefense discretionary outlays would be reduced by 50 percent over the next five years.

- **$25 billion in increased offsetting receipts.** This reflects higher premium charges for Supplementary Medical Insurance (Part B of Medicare), increased federal agency payments for employee retirement and health benefits, and a number of new user fees.

- **$30 billion in reduced interest costs.** This results largely from reductions in projected levels of debt caused by other deficit reduction measures. Even so, net interest outlays would rise from $87 billion in 1983 to $116 billion by 1988 on account of continued deficit financing.

In the aggregate, the foregoing revenue and outlay changes would reduce the deficit by $109 billion in fiscal year 1988, but a deficit of $159 billion would still remain.

The Administration's budgetary program would also significantly redirect the pattern of federal government spending, as shown in Table I-3. Total budget outlays would rise by $312 billion between 1983 and 1988. Of this amount, $176 billion--56 percent--would be devoted to national defense. As depicted in Figure I-3, defense spending would rise from 6.7 percent of GNP in 1983 to 8.1 percent of GNP in 1988--the level it reached in the Vietnam War year of 1970. In contrast, nondefense discretionary spending would decline to 3.4 percent of GNP, well below its 1970 level of 4.5 percent. Spending for entitlements and other mandatory programs would also decline significantly as a fraction of GNP.

CBO BUDGET ESTIMATES

CBO's estimates of the budget picture under Administration policies differ less from OMB's estimates than they have in recent years, although

TABLE I-3. CBO ESTIMATES OF ADMINISTRATION SPENDING PROGRAM BY MAJOR CATEGORIES (By fiscal year)

	1983	1984	1985	1986	1987	1988
	In Billions of Dollars					
National Defense	214	245	282	322	358	390
Entitlements and Other Mandatory Spending	385	386	403	430	458	492
Nondefense Discretionary Spending	145	147	152	156	160	163
Net Interest	87	96	105	110	114	116
Offsetting Receipts	-31	-33	-38	-44	-46	-48
Total Budget Outlays	801	840	905	973	1,044	1,113
	As a Percent of GNP					
National Defense	6.7	7.0	7.4	7.8	8.0	8.1
Entitlements and Other Mandatory Spending	12.0	11.0	10.6	10.4	10.3	10.3
Nondefense Discretionary Spending	4.5	4.2	4.0	3.8	3.6	3.4
Net Interest	2.7	2.7	2.7	2.7	2.6	2.4
Offsetting Receipts	-1.0	-1.0	-1.0	-1.1	-1.0	-1.0
Total Budget Outlays	25.1	24.0	23.7	23.5	23.4	23.2

there still are noticeable differences. In the aggregate, most of these differences derive from small variations in economic forecasts and assumptions. The remainder result from technical estimating factors. Overall, the CBO estimates suggest that the budget deficits in 1983-1985 would be somewhat lower than the Administration projects. For 1987-1988, on the other hand, CBO projects somewhat higher deficits under the Administration's plan.

Figure I-3.
Outlay Categories as Percentages of GNP

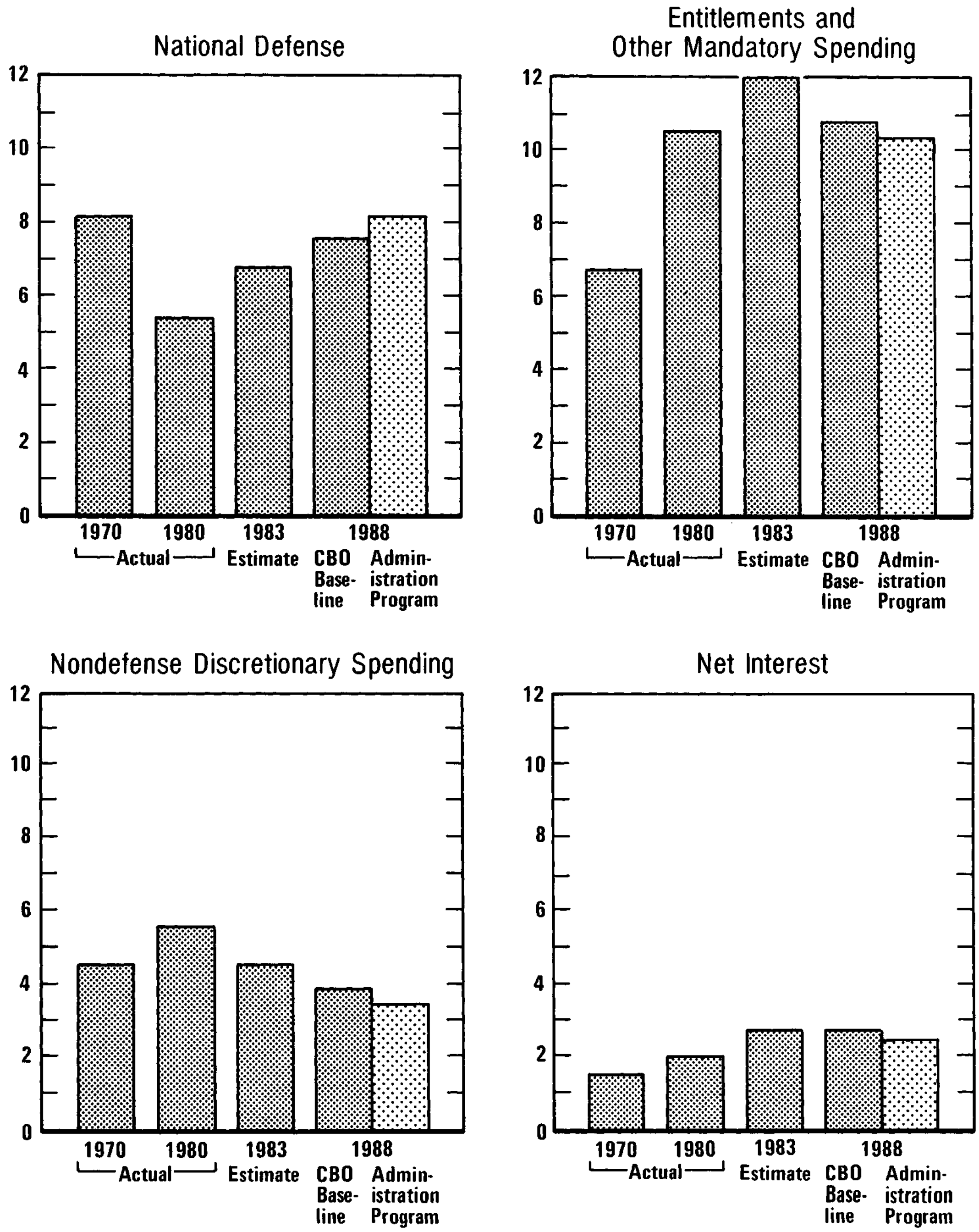


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TABLE I-4. THE BUDGET OUTLOOK UNDER ADMINISTRATION POLICIES (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Revenues						
Administration estimate	598	660	724	842	916	1,010
CBO estimate	606	665	728	826	884	954
Outlays						
Administration estimate	805	848	918	990	1,058	1,127
CBO estimate	801	841	905	973	1,044	1,113
Deficit						
Administration estimate	208	189	194	148	142	117
CBO estimate	195	176	177	147	160	159
Differences in Projections						
Revenues						
Economic	*	2	3	-7	-21	-40
Technical	9	3	1	-10	-12	-17
Total	9	5	4	-16	-33	-57
Outlays						
Economic	-2	-9	-9	-11	-12	-14
Technical	-2	1	-4	-6	-2	*
Total	-4	-8	-13	-17	-14	-14
Deficit						
Economic	-2	-11	-13	-5	9	26
Technical	-11	-2	-5	4	9	17
Total	-13	-13	-18	*	18	43

* Less than $500 million.

The current CBO economic forecast (detailed in Chapter II) is slightly more optimistic in the near term than is the Administration's. For 1983 to 1985, CBO projects stronger GNP in both current and constant dollars, lower unemployment, lower inflation, and lower interest rates. These factors result in higher revenues and lower outlays than the Administration projects. Using CBO's economic assumptions, the deficit would be lower by $2 billion in 1983, $11 billion in 1984, and $13 billion in 1985, as shown in Table I-4.

In later years, however, CBO assumes less rapid economic growth than does the Administration. Along with the assumption of continued lower inflation, this factor causes the CBO's revenue projections to fall below those of the Administration after 1985. CBO's outlay projections are lower, too, because lower inflation holds down spending for both cash and in-kind benefit programs. By 1987 and 1988, however, the reduction in outlays is not enough to offset the lower revenues. The difference between CBO and Administration economic assumptions adds $9 billion to the deficit projection in 1987 and $26 billion in 1988.

The largest technical estimating difference between the CBO and Administration budget estimates involves the oil excise tax, which is part of the contingency tax plan mentioned above. Although the President's budget calls for a $5 per barrel tax on oil consumption, the budget estimates are based on a $7 per barrel tax. CBO therefore estimates that the actual contingency tax plan would raise about $9 billion less per year than reported in the budget, or $27 billion less over the duration of the tax (1986-1988).

Other technical differences between CBO and Administration estimates are relatively small. These technical estimating differences are discussed in more detail in chapters of this volume on revenues, defense spending, and the domestic budget.

CHAPTER II. THE ADMINISTRATION'S ECONOMIC ASSUMPTIONS AND FISCAL POLICY

The economic projections of CBO and the Administration for the next five years are quite similar. In fact, the Administration's short-run forecast for 1983 is slightly less optimistic than that of CBO, in contrast to the case in previous years. Both the Administration and CBO expect economic recovery to begin in 1983 and to be of moderate strength by historical standards. Unemployment falls only gradually in both forecasts, and inflation remains near current levels throughout the five-year projection period. In later years, the Administration's projections of growth in real GNP and inflation are slightly higher than CBO's while unemployment is slightly lower.

Even with the projected recovery, however, the budget outlook is for high and steadily rising federal deficits, assuming no changes in tax or spending policies. The Administration's 1984 budget proposes several measures to reduce these projected deficits by amounts rising from $24 billion in 1984 to $109 billion in 1988, as discussed in Chapter I. If enacted, these measures would change the thrust of federal fiscal policy by significantly reducing projected "structural" deficits. While it is difficult to estimate the short-term economic impact of the proposals, over the longer run they should help to reduce interest rates and promote economic growth.

THE ECONOMIC OUTLOOK UNDER THE ADMINISTRATION'S PROGRAM

The Adminstration's forecast for 1983 shows real growth of 3.1 percent (on a fourth-quarter-to-fourth-quarter basis), while inflation stays near 5 percent, unemployment averages a postwar record annual level of 10.7 percent, and the three-month Treasury bill rate averages 8.0 percent (see Table II-1). By contrast, CBO's forecast shows 4.0 percent growth in real GNP on a fourth-quarter-to-fourth-quarter basis, while inflation, unemployment, and interest rates are all slightly lower than in the Administration forecast. 1/

The Administration estimates for 1984-1988 are not a forecast but rather represent a growth path based on assumptions that are "consistent

1. For a detailed discussion of CBO's forecast, see Congressional Budget Office, The Outlook for Economic Recovery (February 1983).

TABLE II-1. COMPARISON OF ADMINISTRATION AND CBO ECONOMIC PROJECTIONS
(By calendar year)

	1983	1984	1985	1986	1987	1988	1982:4 to 1983:4	1983:4 to 1984:4
				Percent Change (year-to-year)				
Gross National Product (GNP)								
Current dollars								
Administration	6.7	9.3	9.1	8.8	8.7	8.6	8.8	9.2
CBO	6.8	9.6	9.0	8.1	7.6	7.4	8.9	9.6
Constant (1972) dollars								
Administration	1.4	3.9	4.0	4.0	4.0	4.0	3.1	4.0
CBO	2.1	4.7	4.1	3.7	3.5	3.5	4.0	4.7
Prices								
GNP Deflator								
Administration	5.2	5.2	4.9	4.6	4.5	4.4	5.6	5.0
CBO	4.6	4.7	4.7	4.3	3.9	3.8	4.7	4.6
Consumer Price Index								
Administration	4.9	4.6	4.6	4.6	4.5	4.4	--	--
CBO	3.8	4.6	4.7	4.1	3.9	3.7	--	--
				Percent (annual rate)				
Unemployment Rate a/								
Administration	10.7	9.9	8.9	8.1	7.3	6.5	--	--
CBO	10.6	9.8	9.0	8.4	8.0	7.5	--	--
Interest Rate (91-day Treasury bill)								
Administration	8.0	7.9	7.4	6.8	6.5	6.1	--	--
CBO	6.8	7.4	7.2	6.6	6.1	5.9	--	--
"Real" Interest Rate b/								
Administration	2.8	2.7	2.5	2.2	2.0	1.7	--	--
CBO	2.2	2.7	2.5	2.3	2.2	2.1	--	--

a. The unemployment rate predicted by the Administration is for the entire labor force, while that predicted by CBO excludes military workers. Adjusting for this definitional difference involves increasing the Administration's figures by roughly 0.1 percentage point.

b. "Real" interest rates are defined here as the 91-day Treasury bill rate minus the rate of inflation as measured by the GNP deflator.

with the policy objectives of the administration" for reducing unemployment and inflation and sustaining real growth. 2/ These assumptions call for constant 4 percent growth in real GNP, with inflation slowing to the 4½ percent range. Unemployment is projected to decline steadily to about 6½ percent by 1988, close to the Administration's "high employment" benchmark of 6¼ percent. The longer-range CBO projection shows slightly slower growth in the outyears, though the figures are close to the Administration's. The overall similarity in the forecasts is emphasized by the fact that the expected levels of real GNP in 1988 are nearly the same.

ISSUES IN THE ECONOMIC OUTLOOK

Cutting the budget deficit in a period of economic weakness like the present poses dilemmas for policymakers. On the one hand, large deficits persisting after the economy is on the upswing may cause interest rates to rise and crowd out private investment borrowing. This could slow productivity growth and exacerbate inflation in later years. This outlook, together with uncertainty about the course of both monetary and fiscal policy, may be holding up long-term interest rates now, since these rates are sensitive to expected future financial conditions. If this is true, large expected deficits may be slowing the recovery in housing, investment, and other interest-sensitive sectors of the economy.

On the other hand, cutting deficits at a time when the economy is just emerging from recession might delay recovery by reducing current and expected incomes of households and businesses, thereby weakening aggregate demand and GNP.

While reducing the current deficit may not be desirable, enacting large reductions that would be effective in future fiscal years might greatly improve the economic outlook. Such changes would minimize short-term direct reductions in incomes, but might at the same time stimulate current investment and other interest-sensitive spending by reducing long-term interest rates. The Administration's proposals conform broadly to this guideline: no measures materially affect 1983, but later cuts are large enough to reduce the deficit substantially. No one can predict the program's economic impact with confidence--the Administration, for example, provides no indication of what the outlook would be without these measures--but it seems likely to improve the overall outlook, especially in the longer run.

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2. Budget of the United States Government, Fiscal Year 1984, p. 2-8.

The Role of Monetary Policy

The Administration's budget documents say nothing about the assumed behavior of monetary policy. At the time those documents were released, the Federal Reserve had not yet made its annual February announcement of strategies and targets for monetary policy in 1983, and there was unusual uncertainty about the central bank's plans. CBO and others believe, however, that during the next months the Federal Reserve will attempt to ensure, insofar as possible, that a moderate economic recovery occurs. 3/ This might serve to offset, at least in part, any short-term retarding effect of reduced deficits on economic recovery: the Federal Reserve might adjust its targets for short-term money growth so as to improve chances of sustaining the recovery. 4/ The same might be true if the recovery appeared stronger than expected--that is, the Federal Reserve might take steps to slow it down, fearing that an overly rapid expansion would be inflationary.

While it is difficult to estimate the economic impact of the budget proposals, they appear to increase the likelihood that CBO's projection of economic growth and improvements in inflation and unemployment will be realized. Quite apart from this, however, CBO expects that the Federal Reserve may try to steer the economy along roughly the course entailed in the CBO projections, offsetting any significant effects of budget policy. For those reasons, CBO's baseline forecast would not be significantly different if it incorporated the Administration's budget proposals.

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3. For a detailed discussion of the prospective strategy of the Federal Reserve, see Congressional Budget Office, The Outlook for Economic Recovery (February 1983), pp. 78-81.

4. If the central bank expected the impact of a fiscal change to be restrictive, it might not offset it if the bank's own overriding concern was to promote further reductions in inflation rather than steady economic recovery. Even if it is concerned with encouraging recovery, however, the Federal Reserve may fail to offset deficit reductions if it employs expectational economic analysis. In some forms, this analysis implies that budget cuts might have little restrictive impact because they would reduce the public's expectations of future inflation. Reduced inflationary expectations, according to this line of thought, might help maintain economic growth.

TABLE II-2. CBO PROJECTIONS OF STANDARD-EMPLOYMENT DEFICIT WITH AND WITHOUT PASSAGE OF THE ADMINISTRATION'S PROPOSED REDUCTIONS (Unified Budget basis)

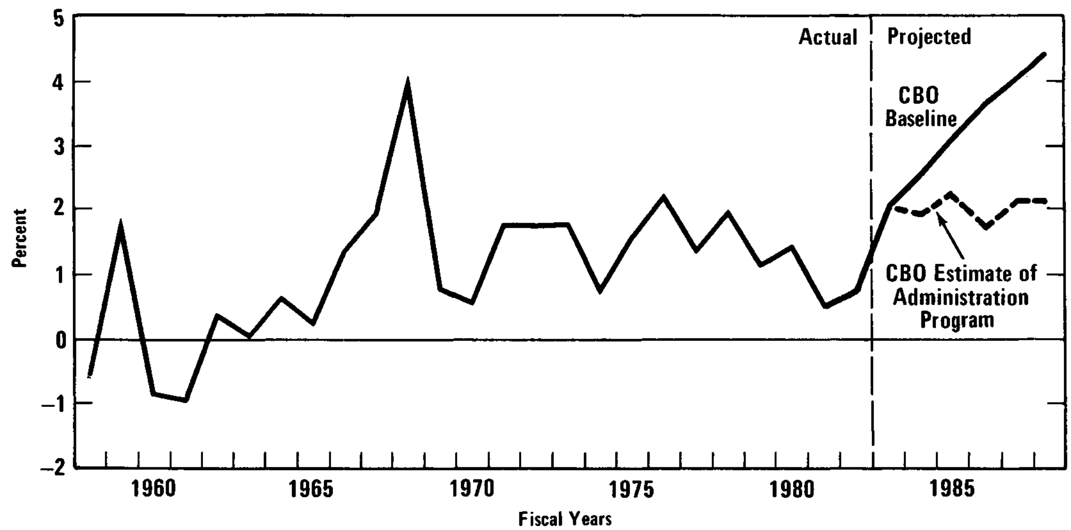
	1983	1984	1985	1986	1987	1988
			Billions of Dollars			
CBO Baseline	72	96	125	155	187	218
With Proposed Reductions	72	71	91	72	97	106
			As a Percent of Standardized GNP			
CBO Baseline	2.0	2.5	3.1	3.6	4.0	4.4
With Proposed Reductions	2.0	1.9	2.2	1.7	2.1	2.1

STRUCTURAL DEFICITS IN THE LONGER RUN

The Administration's proposed reductions in longer-term "structural" deficits should aid economic recovery by reducing interest rates and the tendency for government borrowing to crowd out business borrowing. Table II-2 shows CBO's estimates of one structural deficit measure--the "standard-employment" deficit--both before and after the Administration's proposed reductions. The standard-employment deficit is an estimate of how the deficit would look if the economy were strong enough to keep the unemployment rate at 6 percent. It provides a way of removing the effects of fluctuations in the economy on the budget. Before the Administration's program is taken into account, this deficit measure is projected to reach 4.4 percent of GNP in 1988, a postwar record. Assuming passage of all proposed cuts and implementation of the contingency tax proposals in 1986-1988, this deficit measure falls to 2.1 percent of GNP, which is close to the range of recent experience (see Figure II-1). 5/ Correspondingly, the federal debt

5. GNP has been standardized in these estimates to be consistent with the 6 percent assumed unemployment rate that underlies the "standard-employment" deficit figures.

Figure II-1.
Standard-Employment Deficit as a Percentage of Standardized GNP



SOURCE: Congressional Budget Office.
NOTE: Forecast reflects unified budget deficit standardized at 6 percent unemployment.

held by the public grows significantly more slowly as a percentage of GNP under the Administration's proposals than in CBO's baseline projection (see Figure II-2). Many analysts would argue that reductions of this magnitude would significantly lessen the crowding out of private investment. 6/ For this reason, financial markets may well react favorably and long-term interest rates may fall if the Administration's full program is enacted, and if its proposed contingency tax increases are expected to take effect.

CBO estimates that the contingency tax proposals of themselves would reduce the structural deficit by about one-fifth in 1986-1988. Because they

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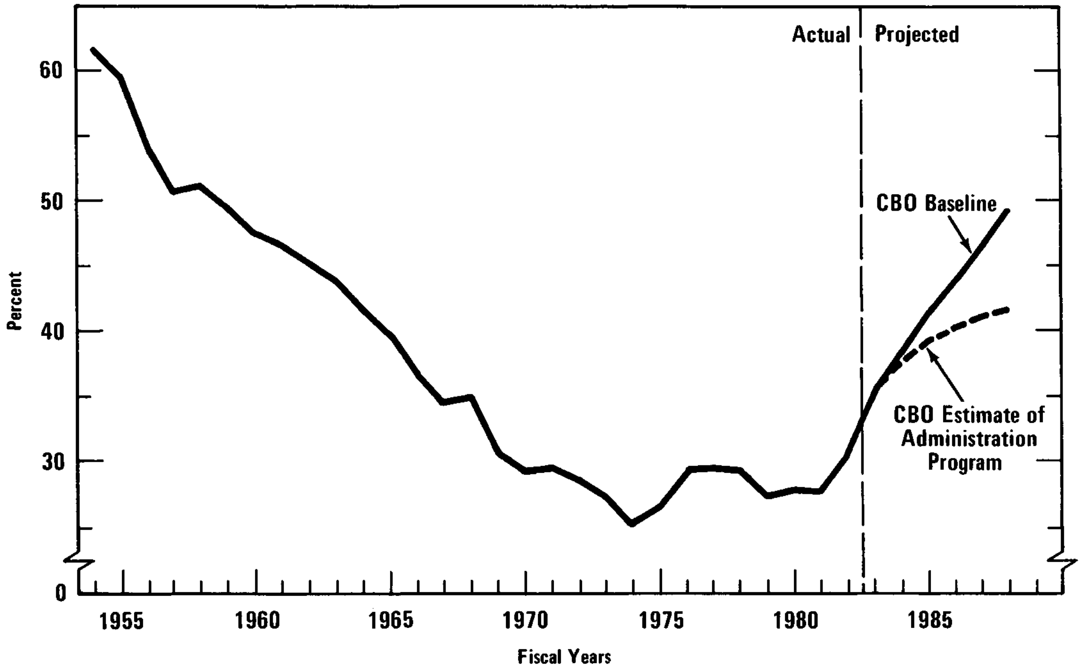
6. For detailed discussion of alternative quantitative criteria to guide reductions in structural deficits, see Congressional Budget Office, The Outlook for Economic Recovery, pp. 61-71.

Figure II-2.

Federal Debt Held by the Public as a Percentage of GNP



SOURCE: Congressional Budget Office.

are contingent on the enactment of other proposals, however, the financial markets may not be convinced that the tax increases will take effect as planned. No one knows what the political outlook will be in 1985, or what unforeseen economic contingencies may have arisen by then, when the taxes are provisionally scheduled to take effect. More concrete and definite measures to reduce expected deficits might be more effective in improving expectations in financial markets.

CHAPTER III. THE ADMINISTRATION'S REVENUE PROPOSALS AND ESTIMATES

The Administration's budget proposes revenues of $659.7 billion for 1984, rising to $1,010.3 billion by 1988 (see Table III-1). The budget includes net increases from proposed new tax legislation of about $11 billion in both 1984 and 1985--attributable mainly to the revenue portions of the proposals of the National Commission on Social Security Reform--followed by much larger increases in 1986-1988, mainly from proposed contingency tax increases. These contingency taxes--a 5 percent surcharge on individual and corporate income tax liabilities and a $5 per barrel tax on imported and domestic oil--would raise $46 billion in 1986 and $51 billion in 1988, according to Administration estimates. In combination with other smaller tax changes proposed by the Administration, these provisions would raise taxes as a percentage of GNP from 18.9 percent in 1984 to 20.6 percent in 1988, close to the post-World War II high of 20.9 percent reached in 1981. Without these proposed tax increases, revenues in 1988 would be 18.9 percent of GNP, according to Administration estimates.

CBO's reestimates of the revenue side of the budget are relatively minor, especially in the near term. CBO estimates that revenues under current law will be $4 billion to $5 billion higher than the Administration estimates in 1984 and 1985, but lower after that--by $7 billion in 1986 and $44 billion in 1988 (see Table III-2). Almost all of these differences arise from differences in economic assumptions: CBO assumes higher rates of real economic growth than the Administration in 1983-1985, and somewhat lower in 1986-1988. Technical estimating differences are small in each year, pushing CBO's estimate above or below the Administration's by $1-$3 billion in 1984-1987, and $8 billion below in 1988.

CBO has reestimated four of the Administration's tax proposals, reducing the estimated revenue gain by $9-$12 billion a year from 1986 to 1988 (see Table III-2). Most of the difference is in the proposed $5 per barrel contingency oil tax. The Administration estimates the revenue gain at $29-$30 billion a year from 1986 to 1988, but this is the amount that would be gained from a $7 per barrel tax. CBO estimates that about $9 billion less a year would be raised by a $5 per barrel tax. CBO also estimates that the proposed 5 percent individual income tax surcharge would raise about $2.2 billion less than the Administration's estimate over the 1986-1988 period. While the budget says that the surcharge is to cover corporate as well as individual taxes, the budget includes only the effects of

TABLE III-1. ADMINISTRATION AND CBO ESTIMATES OF ADMINISTRATION BUDGET REVENUES, BY SOURCE (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
			Administration Estimates			
Individual Income Taxes	285.2	295.6	317.9	358.6	395.7	446.1
Corporate Income Taxes	35.3	51.8	60.5	74.0	84.0	86.7
Social Insurance Taxes and Contributions	210.3	242.9	275.5	304.9	330.3	370.2
Excise Taxes						
Windfall profit taxes	13.8	12.2	11.3	10.5	9.8	9.2
Other a/	23.5	28.1	29.5	64.4	66.5	67.4
Other	29.4	29.1	29.6	29.6	30.0	30.6
Total	597.5	659.7	724.3	841.9	916.3	1,010.3
Percent of Administration GNP	18.7	18.9	19.0	20.3	20.3	20.6
			CBO Estimates			
Individual Income Taxes	285.8	294.8	317.0	358.8	386.3	416.5
Corporate Income Taxes	40.3	55.6	64.9	72.7	81.7	86.3
Social Insurance Taxes and Contributions	212.1	243.3	275.5	302.2	323.7	358.3
Excise Taxes						
Windfall profit taxes	14.4	13.5	12.2	10.3	9.6	9.0
Other a/	23.4	28.4	29.6	52.7	54.1	55.1
Other	30.2	28.9	29.2	28.9	28.4	28.4
Total	606.3	664.5	728.4	825.6	883.8	953.5
Percent of CBO GNP	19.0	19.0	19.1	19.9	19.8	19.9

a. The Administration's budget estimates include the revenue gain from a $7 per barrel fee on oil. The contingency tax actually proposed by the Administration is a $5 per barrel fee. Therefore, the CBO estimates include the estimated revenue gain from a $5 per barrel fee, which is expected to raise about $9 billion less per year than is shown in the Administration's budget.

TABLE III-2. CBO REESTIMATES OF ADMINISTRATION REVENUE PROJECTIONS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
President's 1984 Budget	597.5	659.7	724.3	841.9	916.3	1,010.3
CBO Reestimates of Existing Law						
Economic assumptions	a/	2.0	3.9	-5.7	-18.8	-36.0
Technical reestimates	8.8	2.7	0.5	-1.4	-3.1	-8.3
Subtotal, existing law	8.8	4.7	4.4	-7.0	-22.0	-44.3
CBO Reestimates of Administration Revenue Proposals						
Economic assumptions	---	a/	-0.6	-0.9	-2.1	-4.2
Technical reestimates	---	a/	0.2	-8.4	-8.5	-8.3
Subtotal, revenue proposals	---	0.1	-0.4	-9.3	-10.6	-12.4
Total Reestimates	8.8	4.8	4.1	-16.3	-32.6	-56.7
President's 1984 Budget as Estimated by CBO	606.3	664.5	728.4	825.6	883.8	953.5

a. Less than $50 million.

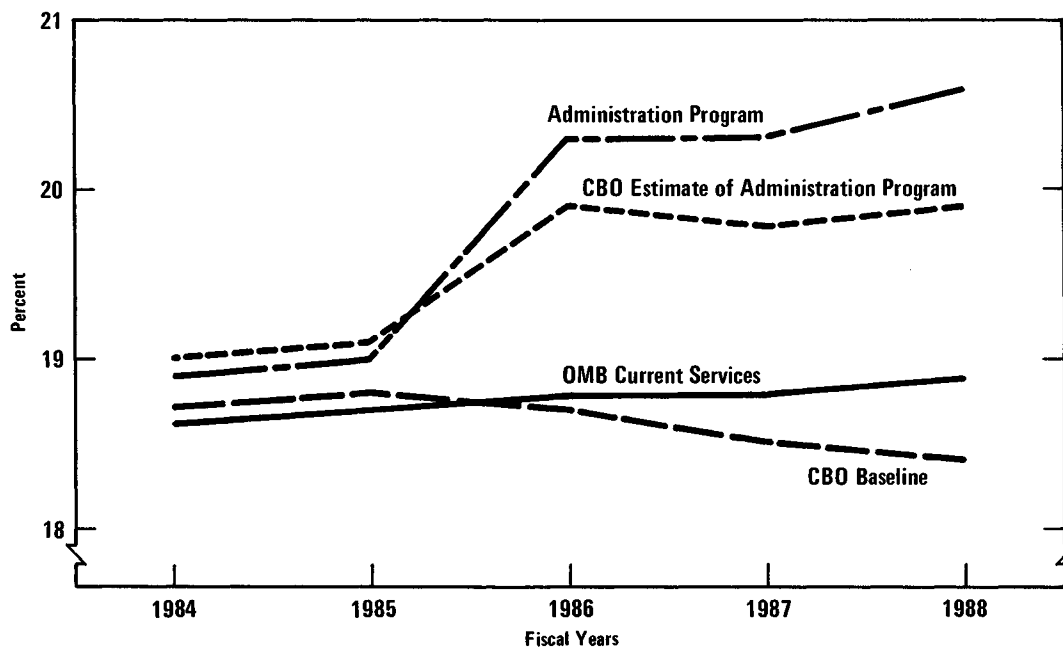
an individual surcharge. Finally, CBO's estimate of the revenue gain from the Social Security Commission proposals is somewhat below the Administration estimate, while CBO's estimate of the revenue gain from higher Civil Service Retirement contributions is somewhat above the Administration's.

In addition to the contingency, Social Security, and Civil Service Retirement tax increases, the Administration has proposed a number of smaller tax changes aimed primarily at achieving nontax goals. These include a cap on the amount of employer-paid health insurance that can be excluded from taxation; tuition tax credits and tax-exempt savings accounts for education expenses; a jobs tax credit for the long-term unemployed; a variety of special tax incentives for investment in enterprise zones; and proposals to help Caribbean Basin countries. Taken together, these proposals would raise a net total of $1.8 billion in 1984 and $8.4 billion in 1988.

The first part of this chapter analyzes the revenue proposals in the Administration's budget and some possible alternatives; the second compares the CBO estimates of receipts under existing tax law to those of the Administration. In broad terms, as shown in Figure III-1, the Administration

Figure III-1.

Federal Revenues as a Percentage of GNP Under the Administration Program and Current Policies



SOURCES: *Budget of the United States Government, Fiscal Year 1984;* and Congressional Budget Office.

NOTE: The revenues for the Administration program and for OMB current services are shown as a percentage of GNP as forecast by the Administration, whereas the revenues for the CBO estimate of the Administration program and for the CBO baseline are shown as a percentage of GNP as forecast by CBO.

and CBO estimates both of revenues under current law (current services or baseline revenues) and of the effects of the Administration's program as a whole, are very similar in 1984 and 1985. Beginning in 1986, however, CBO's estimate of baseline revenues drops below the Administration's current services estimate, reflecting mainly CBO's lower growth rate assumptions. CBO's estimate of the revenue gain from the new proposals in the Administration program is also lower in 1986-1988, reflecting mainly CBO's estimate of lower collections from the $5 per barrel oil tax.

THE PRESIDENT'S REVENUE PROPOSALS

The 1984 budget was written against a backdrop of very large federal deficits for the entire forecast and projections period. The revenue proposals thus seek for the most part to increase receipts. The revenue increases would come mainly from contingency taxes--$46.0 billion in 1986 and $51.4 billion in 1988 (see Table III-3). These taxes would go into effect in 1986 only if the deficit was large and the economy was growing at that time, and if the Congress had passed the Administration's deficit reduction measures. All the Administration's proposals combined would increase federal revenues to 18.9 percent of GNP in 1984, 19.0 percent in 1985, and 20.6 percent in 1988, according to Administration estimates (see Table III-1). Without the contingency taxes, 1988 revenues would be much less--19.6 percent of GNP. These ratios compare to a post-World War II high of 20.9 percent in 1981, and an average of 18.6 percent in the 1960s and 18.9 percent in the 1970s.

If revenue measures are chosen to close part of the budget gap, two factors must be considered. First, because the deficit is projected to be large throughout the budget planning period and beyond, and because tax revenues now grow significantly more slowly as the economy expands (as is demonstrated later in this chapter), the long-term yield of revenue proposals is especially important. Second, it is essential that revenue measures themselves not slow the economy, especially in the early stages of recovery, or blunt economic incentives to work, save, and invest.

The revenue proposals in the budget are analyzed in the following sections.

Contingency Taxes

The budget contains a contingency tax plan that would take effect in fiscal year 1986 only if the Administration forecasted on July 1, 1985, that the deficit for 1986 would exceed 2.5 percent of GNP; if the economy was growing; and if the Congress had passed the Administration's deficit reduction measures. The contingency tax plan consists of two parts: an individual and corporate income tax surtax and an excise tax on petroleum.

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TABLE III-3. ADMINISTRATION AND CBO ESTIMATES OF REVENUE CHANGES FROM ADMINISTRATION PROPOSALS (By fiscal year, in billions of dollars)

Proposal	1984	1985	1986	1987	1988
			Administration Estimates		
Bi-Partisan Social Security Plan	8.2	5.8	8.9	10.7	22.3
Contingency Tax Plan					
Income tax surtax	---	---	17.4	19.0	21.4
Petroleum excise tax	---	---	28.6	30.0	30.0
Taxation of Health Insurance Premiums	2.3	4.4	6.0	8.0	10.7
Higher Education Tax Incentive	a/	-0.1	-0.2	-0.3	-0.4
Tuition Tax Credit	-0.2	-0.5	-0.8	-0.8	-0.8
Jobs Tax Credit	-0.2	-0.2	-0.1	a/	a/
Enterprise Zone Tax Incentives	-0.1	-0.4	-0.8	-1.1	-1.1
Caribbean Basin Initiative	a/	a/	a/	a/	a/
Contributions to Civil Service Retirement	1.2	2.3	2.1	1.9	1.7
Other	a/	a/	a/	a/	a/
Subtotal	11.2	11.3	61.3	67.5	83.9

(Continued)

TABLE III-3. (Continued)

Proposal	1984	1985	1986	1987	1988
Administrative Action b/	-0.3	-0.3	-0.3	-0.3	-0.3
Total	10.9	11.0	61.0	67.3	83.6
Percent of Administration GNP	0.3	0.3	1.5	1.5	1.7
		Addendum: CBO Reestimates			
Bi-Partisan Social Security Plan	8.2	5.2	8.1	9.2	19.7
Contingency Tax Plan					
Income tax surtax	---	---	17.3	18.4	19.9
Petroleum excise tax c/	---	---	19.8	21.0	21.0
Contributions to Civil Service Retirement	1.2	2.5	2.5	2.5	2.4
Net Change from CBO Reestimates	0.1	-0.4	-9.3	-10.6	-12.4
Reestimated Total for All Administration Proposals	10.9	10.6	51.7	56.6	71.1
Percent of CBO GNP	0.3	0.3	1.2	1.3	1.5

SOURCES: Budget of the United States Government, Fiscal Year 1984, and Congressional Budget Office.

a. Less than $50 million.
b. The effect of the proposed October 1983 federal employee pay freeze on federal employee retirement contributions.
c. Joint Committee on Taxation and CBO estimate.

The combined yield of the taxes is intended to be approximately 1 percent of GNP; they would remain in effect for up to three years. (The budget does not say what, if anything, would cause the contingency taxes to last for less than three years.)

The proposal has the advantage of establishing the intent to raise taxes, but postponing the increases to a date when the economy would be stronger. On the other hand, the contingency tax plan depends on forecasts of both the deficit and GNP. Because such forecasts are often unreliable and always controversial, the triggering of the contingency taxes could be the subject of much uncertainty and dispute. But perhaps more important, the temporary contingency taxes might not be the best solution for what appears to be a continuing budget problem. Both the CBO and the Administration estimates indicate that the deficits will be substantial even after several years of economic growth. The Administration projects the 1988 budget deficit, if all of its spending reduction proposals are adopted but not counting the contingency tax revenues, at 3.4 percent of GNP (excluding off-budget spending). Thus in 1989, after the contingency taxes expired, the deficit would still be a serious problem. CBO's analysis later in this chapter shows that faster growth within a reasonable range will not narrow the deficit appreciably from the revenue side. It would seem inadvisable to enact temporary taxes for 1986-1988 when the evidence indicates that the need for additional revenue will not end in the foreseeable future, absent spending reductions substantially greater than those proposed by the Administration.

Any tax increase could be repealed in the future if economic growth closed the budget gap more rapidly than expected. The advantage of putting such a tax increase firmly and immediately on the books is that it would reassure the financial markets that future federal credit demands will not become burdensome. This would reduce, to some degree at least, upward pressure on interest rates.

The Surtax. The first part of the contingency tax plan is a 5 percent surtax on individual and corporate income tax liabilities. It would increase revenues by $17.4 billion in 1986, $19.0 billion in 1987, and $21.4 billion in 1988, according to Administration projections.

There is some uncertainty about the exact nature of the Administration's proposed surcharge. The budget describes it as "a surcharge on individuals and corporations approximately equivalent to 1% of taxable income," while the Treasury Department fact sheet describes it as "a surcharge of 5% on taxes paid by individuals and corporations." The revenue projections in the Administration budget, however, include a 5 percent surcharge on only individual income taxes. CBO estimates that the yield from this individual surcharge will be $0.1 billion less than the Administration estimates in 1986, $0.6 billion less in 1987, and $1.5 billion less in 1988, reflecting the lower projected CBO growth rates and incomes in those years. If a 5 percent surtax on corporate income tax liabilities was added to this, CBO estimates that about $3 billion more would be collected in 1986, and about $4 billion more in both 1987 and 1988. If the corporate surcharge was applied to taxes owed before deduction of investment and foreign tax credits (as was done with the Vietnam War surcharge), the revenue gain could be as much as twice as high.

An individual surtax can be calculated as a percentage of tax liability (as in the budget proposal) or as a percentage of income. The latter would place a relatively lighter burden on taxpayers with the highest incomes. Whatever its design, an individual surtax increases effective marginal tax rates, thus discouraging work, saving, and investment. The Administration's proposed surtax, for example, would increase the top marginal rate on individuals from 50 to 52.5 percent. A corporate surtax would likely have an even greater adverse impact on investment, because corporations usually invest large shares of their after-tax income. (Of course, corporations could adjust by reducing their dividend payments and increasing their borrowing, but this would reduce investment resources elsewhere in the economy.) Unless a corporate surtax accompanied the individual surtax, however, some would argue that the additional tax burden bore too heavily on households.

If the Congress decided to replace the contingency tax plan with unconditional and permanent tax increases, there could be several alternatives to the surtax. Some tax increase options and their estimated additions to revenues are shown in Table III-4. A simple tax rate increase might be more attractive than a permanent surtax, because the surtax would add a stage to the tax computation process while the rate increase would not. One option would be repeal of the 1983 10 percent rate cut. This would raise $30 billion in 1984 and $40 billion in 1988, compared to about $20 billion in 1988 for the proposed 5 percent surtax. Alternatively, the 1983 tax cut could be reduced to 5 percent, yielding half of the additional revenue of outright repeal. Another alternative would be to defer the tax cut in whole or in part until a later year.

Another option would be to cap the 1983 tax cut at $700 per joint return; this would have the effect of limiting the implicit tax increase to couples with incomes greater than about $50,000, and somewhat less for single persons. The cap option would raise far less revenue than repeal, however--$6 billion in 1984 and $9 billion in 1988. Repealing or reducing the 1983 tax cut would have the disadvantage of increasing tax revenues in the near term, when the economic recovery might still be fragile.

TABLE III-4. ESTIMATED REVENUE GAINS FROM MAJOR TAX INCREASE OPTIONS (By fiscal year, in billions of dollars)

Option	1984	1985	1986	1987	1988	Cumulative Five-Year Increase
Repeal July 1, 1983 Rate Reduction	30	33	35	38	40	177
Cap Third-Year Tax Rate Cut at $700	6	7	7	8	9	37
Repeal Indexing	--	6	17	28	40	90
Some Possible Base-Broadening Options						
Tax some employer-paid health insurance	3	5	6	7	9	30
Eliminate deductibility of state and local sales taxes	1	6	6	7	8	28
Limit nonbusiness, non-investment interest deductions to $10,000	1	2	2	2	2	9
Tax the accrued interest on life insurance reserves	2	6	7	8	9	31
Repeal net interest exclusion	---	1	3	3	4	11
Eliminate income averaging	3	4	4	5	5	21
Lengthen building depreciation period to 20 years	a/	2	4	6	8	19
Require full basis adjustment for the investment tax credit	a/	1	2	4	5	12

SOURCE: Congressional Budget Office, Reducing the Deficit: Spending and Revenue Options (February 1983), Chapter X and Appendix A. Assumes January 1, 1984, effective dates. Numbers may not add to totals because of rounding.

a. Less than $0.5 billion.

Yet another option would be to repeal the provision for indexing income taxes in 1985 and later years. Indexing would have the advantage of preventing unlegislated, automatic tax increases brought about by inflation, but it would widen the deficit correspondingly. The recent slowdown of inflation may make the need for indexing seem less urgent than was originally thought. The revenue gain from repealing indexing would be greatest if the economy grew rapidly, and least if the economy was sluggish; thus it would act as a brake on an overheated economy while not retarding a sluggish one. Repeal of indexing would not increase taxes until 1985, and thus would not impair the current recovery; it would raise $6 billion in 1985 and $40 billion in 1988. Alternatively, indexing could be postponed one or several years, rather than repealed outright.

Several income tax base-broadening steps might be substituted for a general surtax. These are also listed in Table III-4, and discussed in detail in CBO's Reducing the Deficit: Spending and Revenue Options (February 1983). Such base broadening would have the disadvantage of concentrating the tax increase on certain specific groups, but might also make the tax system more equitable and neutral with regard to different economic activities. One option, taxing part of employer-paid medical insurance premiums, is included in the Administration's budget proposal and is described later in this chapter. Other options, taken from the larger list in Reducing the Deficit, include limiting the deductibility of nonbusiness, noninvestment interest; taxing the accrued interest on life insurance reserves; repealing the net interest exclusion; eliminating income averaging; eliminating the deductibility of state and local sales taxes; lengthening the building depreciation period to 20 years; and requiring a full basis adjustment for the investment tax credit. Combining several of these base-broadening steps could raise as much revenue as the proposed surtax.

The Petroleum Excise Tax. The Administration's budget proposal includes a temporary contingency tax on consumption of imported and domestic oil. Although the budget specifies a $5 per barrel tax, the revenue estimates in the budget are based on a $7 tax, not a $5 tax. A $5 tax would raise approximately $9 billion less per year than estimated in the budget, or $27 billion less over the life of the tax (see Table III-3). (This revenue shortfall could, of course, be made up in some other way within the contingency tax program.) If the $5 tax took effect on October 1, 1985, it would raise an estimated $62 billion in revenue over the 1986-1988 period. 1/ To the extent that consumer prices were increased by the tax,

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1. Gross collections would be $83 billion before offsetting reductions in receipts from individual and corporate income and gasoline excise taxes. Possible offsets from higher outlays are not included.

part of the revenue would be offset by increased outlays in programs sensitive to changes in consumer prices, such as Social Security.

An oil tax would have certain effects that might be desirable from an energy policy standpoint. To the extent that it was shifted onto consumers, the tax would reduce the demand for oil, and therefore U.S. dependence on imported oil. In addition, it would increase incentives for the development of alternative energy sources (such as coal, natural gas, or solar energy), as well as raise the payback from conservation efforts by consumers. To the extent that it reduced petroleum imports, it would also limit the economic costs of any future supply disruption. In this context, a permanent tax would be more effective, because consumers would be more likely to change their behavior if they knew the tax was not temporary.

An oil tax would distort the relative prices of different fuels for consumers and could produce some economic inefficiencies. For example, it might lead New Englanders to switch from fuel oil to natural gas or coal for home heating, even though the economic costs of these fuels in that area are higher than for oil. This suggests that an ad valorem (percentage-of-price) tax on all energy consumption might be preferable to a tax solely on oil. For example, a 5 percent tax on all energy consumption would raise about the same amount (about $60 billion over 1986-1988) as a $5 per barrel oil tax, but it would not distort relative fuel prices. (The $5 per barrel tax is equivalent to a 17 percent ad valorem tax, assuming a $30 per barrel price.) In addition, a broad-based tax would tend to even out the regional variations in tax burdens that would result from a tax limited to oil.

The inefficiencies and distortions of a tax limited to oil may be a price worth paying for greater energy independence, however. In addition, a broad-based energy tax would not be without economic distortions. While it would be neutral among fuels, it would still distort the choice between energy-intensive goods and other goods. An ad valorem tax may also be more difficult to administer, since the "value" of a product grows at each stage of production and distribution, and may be difficult to determine precisely at some stages.

The current state of the oil market makes it attractive to impose an oil tax now rather than waiting until 1985 because declining oil prices would offset part (or all) of the tax. A $5 per barrel tax in the near term would thereby prevent the price of oil from falling as much as it would otherwise, preserving part of the energy conservation price incentives that currently exist. If part of the tax was absorbed by producers, the price of oil products would not rise by the full amount of the tax. So long as the market remained soft, the federal government would divert to itself part of the gain from high oil prices currently received by foreign as well as domestic producers. By waiting until 1985 to impose the tax, the government might lose the short-run opportunity of passing on a larger share of the tax to foreign suppliers, since the market could be tighter by then.

The advantages of imposing an energy tax now may be outweighed by its effect on economic recovery. However, an energy tax would probably do less to impair recovery than an income tax increase of the same size, since part of the energy tax would initially be absorbed by foreign oil producers. If an energy tax was intended to provide revenues on a long-term basis, it should probably be an ad valorem tax. A tax fixed in terms of dollars per barrel of oil would tend to fall as a percentage of GNP as prices rose over time.

Tax Treatment of Health Insurance Premiums

The Administration proposes that, effective January 1, 1984, employees be required to include in their taxable income employer-paid health insurance premiums in excess of $175 per month for family plans and $70 per month for single plans. Employer-paid premiums established in collective bargaining agreements would be exempted until expiration of the agreements, but no longer than the end of 1985. The maximum amount not subject to tax would be raised each year by the rate of increase of the Consumer Price Index for wage earners (CPI-W).

The CBO and the Administration both estimate that this proposal would bring in $1.7 billion in additional income tax revenue and $0.6 billion in additional payroll tax revenue in 1984, rising to $10.7 billion from both sources combined by 1988 (see Table III-3). The estimate includes the effects of temporarily exempting union contracts, which reduces income tax revenue by $0.4 billion and payroll tax revenue by $0.1 billion in 1984. These estimates assume adoption of the recommendations of the National Commission on Social Security Reform; payroll tax revenue would be about $30 million lower in the absence of this assumption.

Taxing employer-paid health insurance premiums as proposed would affect about 20 percent of all households in 1984, if there were no exemptions. The delayed coverage of union contracts would reduce the number of households affected in that year, but an increasing percentage of households would be affected in years after that, because premiums are expected to rise more rapidly than the ceiling. In 1984, affected households with incomes between $10,001 and $15,000 would pay an average of $193 in additional taxes, and affected households with incomes between $50,001 and $100,000 would pay $371.

The revenue gain could be increased by lowering the amount of employer-paid premium that is excluded from tax. For example, taxing employer payments for health insurance that exceed $150 per month for family coverage and $60 per month for single coverage would yield $0.7 billion more in income tax revenue and $0.3 billion more in payroll tax revenue in 1984 than the Administration proposal. The ceiling could be lowered even further if more revenue was desired, but continued exclusion of some minimum level of employer-paid health insurance premium might be advisable to encourage provision of a basic set of health benefits by employers.

Both tax-policy and health-policy arguments have been made for taxation of employer-paid health insurance premiums. Exclusion of employer-paid premiums benefits persons with higher incomes, both because they tend to have larger employer-paid health insurance premiums and because they are in higher marginal tax brackets. The average 1983 tax benefit for all households with incomes between $10,001 and $15,000 per year is estimated to be $83, while that for all households with incomes between $50,001 and $100,000 is estimated to be $622. 2/ Moreover, the exclusion leads to what many consider to be overly extensive health coverage, which has expanded use of health care services unnecessarily and driven up their prices.

Opponents of taxing any portion of employer-paid health insurance argue that present health insurance coverage is not excessive and that changing the current policy would result in less insurance coverage; this might, in turn, cause some people to forgo needed medical care. Also, they argue that a uniform ceiling would have uneven effects, since a given employer contribution purchases differing levels of coverage depending on several factors, such as the regional and demographic characteristics of the work force.

Jobs Tax Credit for the Long-Term Unemployed

The Administration proposes to extend the Federal Supplemental Compensation (FSC) program and to modify it by adding a tax credit for new employers of FSC recipients. The credit could be applied against either the employer's Unemployment Insurance (UI) payroll tax or his federal income tax, with the employer's wage and salary expense deduction reduced by the

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2. Congressional Budget Office, Controlling Medical Care Costs Through Market Forces (May 1982), p. 27.

amount of the credit. The tax credit would be available as a series of vouchers issued to eligible recipients, and would be equal to one-half of the person's weekly FSC benefit for each week of new employment, up to the amount of the recipient's FSC entitlement. The average FSC benefit currently is about $120 per week, and benefits are paid for up to 16 weeks; the average credit would thus be about $60 per week for up to 32 weeks. Although the Administration's proposal calls for FSC cash benefits to be provided only through September 30, 1983, the voucher program would continue until April 1, 1984. After September 30, individuals who would have qualified for cash benefits if that part of the program had continued would continue to be eligible for vouchers in equivalent amounts. As long as the individual was hired before April 1, 1984, the employer would still be eligible for the credit. The proposal is estimated to reduce revenues by $0.2 billion a year in 1984 and 1985, and by smaller amounts from 1986-1988 (see Table III-3).

Use of a voucher system based on FSC would allow targeting of this employment stimulus on certain long-term jobless persons with substantial work histories. Assistance to these UI recipients, however, could come at the expense of other jobless persons who would not be eligible to receive the wage subsidy. This could occur either because workers with vouchers would be hired instead of other jobless persons when employment expanded, or because workers with vouchers would be hired to replace other employees. In addition, because UI recipients often have considerable work experience, they might later return to their previous jobs or take better jobs when they became available, having used the voucher only to obtain interim employment. Even this interim employment might be better for both the worker and the government than continued unemployment, however.

An existing employment tax credit--the Targeted Jobs Tax Credit (TJTC)--also provides income tax reductions for some employers who hire certain jobless persons. The potential amount of the TJTC tax reduction--$3,000 in the first year and $1,500 in the second--is larger than that in the new tax credit proposed by the Administration, which would average out to less than $2,000 for one year ($60 per week for 32 weeks = $1,920). 3/ However, the target groups served by the TJTC include primarily unskilled workers whose value to an employer may be less than that of the more experienced FSC recipients, so that a smaller tax credit might be appropriate. Nonetheless, the TJTC has not been very effective in stimulating

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3. This does not take into account in either case the requirement that the employer's deduction for wage and salary expenses be reduced by the amount of the credit, which reduces the amount of the tax savings.

employment, and larger tax reductions might be necessary to generate program use by large numbers of employers. The Administration's tax credit proposal could potentially be used by more employers, however, because UI payroll tax payments are made by nearly all employers, while many do not have sufficient income to owe income taxes.

Because the voucher program would be new and unfamiliar, there is some question whether it could be fully implemented by its scheduled April 1, 1983, starting date, even if the enabling legislation were passed quickly. Further, employers and those who administer it may be reluctant to gear up fully to use a program that is scheduled to last for only one year. In the case of the TJTC, it took several months before the availability of the credit was known to many employers, and even longer before they started to use it.

A problem inherent in the use of employment tax credits is that the persons responsible for hiring in large firms are often not in close touch with those who prepare the tax returns. Thus, even if an employment tax credit could significantly reduce an employer's tax liability, it might not translate into increased hiring of eligible workers. Others have proposed that the employment stimulus be in the form of a direct cash grant that could be more closely associated with the hiring process. This could increase use of the stimulus while retaining the same cost per worker. As discussed at the end of this chapter in the section dealing with tax expenditures, certain adjustments have to be made to either the tax credit or the direct grant to make certain they are of equal value to the recipient and equal cost to the government.

Tax Incentives for Higher Education

To encourage saving for college education expenses, the Administration is proposing to exempt from taxation the earnings of special education accounts. Under the proposal, a separate account could be set up for each dependent child, and contributions would be permitted up to $1,000 per child per year for children under 18 years of age. The $1,000 contribution limit would decline for contributors with adjusted gross incomes above $40,000 and reach zero for those with incomes of $60,000 and above. The account must be used for payments directly to a university or college for tuition, room, or board; it must be for study toward an undergraduate degree; and it must be spent before the student reaches age 25. If the account meets these conditions, its interest earnings would never be taxed.

The main revenue loss from these education savings accounts (ESAs) lies in the future. The Administration estimates negligible revenue losses in

1984 and only $0.4 billion in 1988. However, the annual revenue losses can be expected to grow rapidly for the first 10 to 20 years as savings accumulate in these accounts. The delay of revenue losses is advantageous given the large deficits forecast for the near term, but the long-run losses need to be considered as well.

The ESA would offer a higher return than is now available to parents who save in their own accounts for their children's college education. For example, a typical family with a $30,000 income using an ESA could make an 18 percent smaller annual contribution to savings and still end up with the same amount after 18 years, assuming an 8 percent market interest rate.

Under existing law, parents can also use trusts or gifts to minors to set up savings accounts in their children's names. Earnings in these accounts are taxable to the child, and the child pays no tax until his or her interest earnings exceed the $1,000 personal exemption. With an 8 percent interest rate, the child could hold $12,500 before earning $1,000 in interest income. Trusts and gifts to minors are more flexible in their uses than ESAs, so many families may prefer to use them first. But with costs for many colleges well in excess of $12,500, families with the resources to save more than that per child could benefit from ESAs.

A number of bills have been proposed in the Congress that would provide tax-favored accounts for education. Compared to the Administration's proposal, most of them would allow greater flexibility in funding and spending, and also make the initial contribution tax deductible. This last feature means that a typical $30,000-a-year family contributing to one of these accounts would receive a tax saving in the year of the contribution equal to almost a quarter of the amount contributed; those in higher tax brackets would receive higher tax savings. The deduction for contributions would substantially increase the revenue loss compared to the Administration's proposal, particularly in the years immediately after enactment. The Congressional proposals eventually recoup a portion of the revenue loss by including the parents' contributions and the interest from the account in the taxable income of the offspring--for example, one-tenth of the amount yearly from ages 25 to 34. Even with this ten-year recapture, the revenue loss from the typical family's account is almost 80 percent larger than that under the Administration's proposal (or the equivalent tax reduction currently available through trusts or gifts).

Table III-5 compares alternative savings accounts for a typical family, assuming for purposes of the comparison a common goal of saving $1,000 by the time college starts. The family of four with $30,000 of income is assumed to open a college savings account at the birth of a child and to make equal contributions annually for 18 years. The table shows that at an 8 percent interest rate the annual contribution necessary to reach $1,000 in the parents' taxable account is $30.02. In the Administration's ESA, the required contribution is $24.72, or 18 percent less; in the prototype Congressional ESA, it is $19.03 (taking into account the tax savings from the deduction).

TABLE III-5. THE COST OF SAVING $1,000 FOR COLLEGE FOR A TYPICAL FAMILY UNDER ALTERNATIVE TAX TREATMENTS (In dollars) a/

	Parent Taxable Savings b/	Trusts and Administration ESA b/	Prototype Congressional ESA b/
Annual Family Deposit	30.02	24.72	24.72
Annual Tax Saving from Deductibility of Deposit	---	---	5.69
Net Annual Outlay	30.02	24.72	19.03
Life-Time Subsidy (present value of forgone tax)	None	53.60	95.29

a. See text for family characteristics and savings period. Calculations assume 8 percent market interest rate and discount rate. Parents are in 23 percent tax bracket; child until 18 pays no tax and from ages 25 to 34 is in the 15 percent tax bracket.

b. Parent Taxable Savings receive no special tax reductions from current law. Trusts and Administration ESA have tax-exempt earnings. The prototype Congressional ESA has deductible contributions, tax-exempt earnings, and $100 per year added to child's taxable income from ages 25 to 34.

The bottom line of the table gives the lifetime subsidy from the forgone taxes per $1,000 of accumulated savings. The $53.60 subsidy for the Administration ESA comes entirely from forgone taxes on earnings. The larger subsidy on the prototype Congressional ESA includes an additional $57.56 loss from permitting contributions to be deducted, offset by a $15.87 gain from including the account in the child's income. The subsidy rises in each case with the family's marginal tax rate.

In terms of the overall tax structure, tax-favored savings accounts erode the base of the income tax, thereby requiring higher tax rates on income from other capital and from labor. These accounts can be viewed as a step toward a consumption tax because they exempt one more form of savings from tax. While a number of families might shift savings into such accounts, the net increase in saving would probably be small because eligibility and contribution limits are restrictive.

National Commission on Social Security Reform Proposals

The President's budget includes the outlay reduction and tax increase proposals of the National Commission on Social Security Reform. CBO's estimate of the 1984-1988 revenue increase is $50.4 billion, $5.6 billion less than the Administration's estimate, mainly because the CBO economic forecast assumes a somewhat lower level of wages and salaries in the 1986-1988 period (see Tables III-3 and III-6). 4/

Other Proposals

The Administration proposed several other tax policy changes, as listed in Table III-3. An increase in federal employee contributions to the civil service retirement fund would raise $1.2 billion in 1984 and greater amounts in subsequent years. CBO's estimate of the revenue gain from this proposal is higher than the Administration's by about $0.2 billion in 1985 and $0.7 billion in 1988 (see Table III-3). About one-quarter of the difference is due to CBO's higher pay raise assumptions from 1985 through 1988, and about three-quarters to differences between CBO and Administration assumptions about how new employees will be affected by changes in Civil Service Retirement and Social Security. The enterprise zone and tuition tax

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4. The CBO estimate shown in Table III-6 is somewhat lower than that appearing in Reducing the Deficit: Spending and Revenue Options (February 1983). The reason is that CBO now assumes, as does the Administration, that income tax revenues will be reduced as a result of the proposed increases in payroll taxes. (The employer share of the payroll tax increase is assumed to be passed on to employees in the form of lower wages, thereby reducing employee taxable incomes.) Further, CBO has reestimated the revenue gain from including all new federal employees in the system. These factors reduce the previous CBO estimate of the unified budget impact of the commission proposals by $6.0 billion over the 1984-1988 period.

TABLE III-6. ESTIMATES OF THE REVENUE EFFECTS OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM PROPOSALS (By fiscal year, in billions of dollars)

Proposals	1984	1985	1986	1987	1988	Cumulative Five-Year Increase
Include All Non-Profit Institutions in the System a/	1.1	1.7	2.0	2.3	2.9	9.9
Income tax offset	-0.1	-0.2	-0.2	-0.3	-0.4	-1.2
Include All New Federal Employees in the System a/	0.1	0.2	0.3	0.5	0.6	1.7
Accelerate FICA/OASDI Tax Rate for Calendar Years 1984 and 1988	6.4	2.3	0.0	0.0	10.3	19.0
Income tax offset	-0.8	-0.1	0.0	0.0	-1.3	-2.2
Individual income tax credit for 1984 payroll tax increase	0.0	-4.3	0.0	0.0	0.0	-4.3
Raise the SECA/OASDI Tax Rate to the Combined Employer-Employee Rate a/	1.0	3.0	2.9	3.1	3.5	13.7
Income tax offset (deduction for half of tax)	-0.5	-1.5	-1.5	-1.6	-1.8	-6.8
Tax 50% of OASDI Benefits with Thresholds of $20,000 (single) & $25,000 (joint)	1.2	4.2	4.9	5.6	6.4	22.4
Total Increase in Social Security Trust Fund Revenues	9.7	11.5	10.1	11.5	23.7	66.6
Total Loss in Income Tax Revenues	-1.5	-6.1	-1.7	-1.9	-3.4	-14.6
Reduced Contributions to Civil Service Retirement b/	-0.1	-0.2	-0.3	-0.5	-0.6	-1.7
Total Increase in Unified Budget Revenues	8.2	5.2	8.1	9.2	19.7	50.4

a. Estimates include proposed increase in OASDI payroll tax rates.

b. Assumes contributions of new federal employees to Social Security will result in commensurate reductions in contributions to civil service retirement.

credit proposals closely follow versions considered in the previous Congress. The Caribbean Basin initiative is limited to two narrow provisions and would have very limited revenue consequences.

BASELINE REVENUE ESTIMATES

The preceding sections have dealt only with the Administration's proposals for changes in the tax law. This section compares CBO's "baseline" estimates of revenues that would be raised under current law to the Administration's "current services" estimates. The two estimates are conceptually the same; they both assume that present airport and airway taxes will be extended at current rates beyond the scheduled expiration date of December 31, 1987, but that existing law will remain otherwise unchanged throughout the 1983-1988 period. All scheduled increases and reductions in taxes are assumed to go into effect as scheduled.

As shown in Table III-7, CBO's current law estimate for 1983--$606 billion--is almost $9 billion higher than the Administration's. CBO's estimate remains about $4 to $5 billion higher in 1984 and 1985, and then moves below the Administration's estimate by increasingly large amounts in 1986-1988, falling $44 billion below the Administration's $927 billion estimate in 1988. As shown in the table, most of the differences between CBO and the Administration in the early years of the projection period are due to technical differences in estimating procedures and assumptions, while most of those in the later years are due to different assumptions about the economy. All of the differences are relatively small, however--less than 1 percent of total revenues in three of the six years, and less than 5 percent in 1988, the year with the largest difference.

Different Economic Assumptions

As discussed in Chapter II, CBO's economic projections are somewhat different from the Administration's, with CBO assuming higher real growth in 1983-1985, and lower real growth in 1986-1988. These different assumptions about economic growth are reflected in the levels of taxable personal income and corporate profits--the major determinants of projected revenues--in the CBO and Administration economic projections (see Table III-8). The relationships are not exact in 1983-1985: CBO has slightly lower levels of taxable personal income in 1983 and 1984, although the wage and salary component is higher than the Administration's in each of the years, and CBO's corporate profits are slightly lower in 1983 and 1985. CBO assumes lower income levels than does the Administration in 1986-1988, corresponding to the pattern of GNP growth.

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TABLE III-7. CBO AND ADMINISTRATION ESTIMATES OF REVENUES UNDER EXISTING TAX LAW (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Administration Current Services Estimates a/	597.5	648.8	713.3	780.9	849.1	926.7
Sources of Reestimates						
Different economic assumptions	b/	2.0	3.9	-5.7	-18.8	-36.0
Technical differences	8.8	2.7	0.5	-1.4	-3.1	-8.3
CBO Baseline (Revised) a/	606.3	653.6	717.7	773.9	827.1	882.4
			Addendum			
Administration Current Services Revenues as Percentage of Administration GNP	18.7	18.6	18.7	18.8	18.8	18.9
CBO Baseline Revenues as Percentage of CBO GNP	19.0	18.7	18.8	18.7	18.5	18.4

a. Assumes extension of airport and airway trust fund taxes in 1988; this adds $2.6 billion to 1988 revenues.

b. Less than $50 million.

The levels of taxable income and profits are not the only determinants of revenue estimates, of course. The assumed timing of tax collections has a significant effect, as do other technical aspects of the estimating procedures. These technical differences are discussed in general terms below. The most significant economic and technical differences in the major revenue sources are then discussed in more detail.

Technical Differences

CBO and the Administration use different procedures for estimating individual and corporate income taxes, windfall profit taxes, and several other taxes. For the most part, estimation procedures differ because CBO

TABLE III-8. ECONOMIC ASSUMPTIONS OF PARTICULAR IMPORTANCE FOR REVENUE ESTIMATES (Calendar year averages, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Taxable Personal Income						
CBO	2,268	2,456	2,658	2,857	3,061	3,278
Administration	2,278	2,466	2,653	2,863	3,114	3,378
Wages and salaries component						
CBO	1,649	1,783	1,925	2,074	2,229	2,395
Administration	1,640	1,780	1,921	2,090	2,281	2,483
Corporate Profits Before Tax						
CBO	168	221	244	283	305	318
Administration	177	206	246	296	316	329
Domestic Refiners' Acquisition Cost of Crude Oil (in dollars per barrel)						
CBO	30.85	32.15	32.60	33.42	34.72	36.00
Administration	31.00	31.96	33.73	35.64	37.61	39.68

and the Department of the Treasury have different data and analytical tools available to them. CBO has emphasized close coordination of its economic forecasting and revenue estimating efforts, with detailed translation of revenue collections data into the type of data that is used for economic forecasting. Historical data on the relationships between trends in the economy and revenue collections can then be used more readily to project future relationships, thereby maximizing consistency between projections of federal government revenues and conditions in other sectors of the economy.

The Treasury Department, by contrast, is required to make detailed estimates of the effects on current tax collections of a wide variety of specific tax law changes. This requires a great deal of information on and analysis of tax collections within single years, with somewhat less emphasis on projections of changes in collections over time in response to changing economic conditions. There is also less opportunity for close coordination of Treasury revenue estimating efforts with Administration economic forecasting, since a number of agencies outside the Treasury participate in formulating the Administration economic projections. These differences in approach will continue to lead to differences between CBO and Administration revenue estimates, especially in the later years of the projection period when small differences in economic forecasts may begin to cumulate into larger differences in revenue estimates.

In addition to utilizing formal estimation procedures, both CBO and the Administration assess daily and monthly tax collections data as they are made available. Since actual tax liabilities cannot be observed, current tax collections may be consistent with a range of potential tax liabilities. This is especially true for individual and corporate income taxes, where variations in payment patterns occur frequently, even in the absence of significant legislated changes such as those recently enacted. Differing interpretations of recent tax payment patterns are reflected in CBO and Administration estimates of current-year revenues. The combinations of formal and informal data-analyzing procedures developed by CBO and by the Treasury Department generate revenue estimates that are generally close when common economic assumptions are used, but minor differences persist.

Economic and Technical Differences by Source

Differences between the CBO and Administration current law estimates by tax source due to different economic assumptions, as mentioned above, generally result in higher CBO revenues in 1983-1985, and lower CBO revenues from 1986-1988 (see Table III-9). Differences between current law estimates due to technical estimating differences also generally result in higher CBO revenues in 1983-1985 and lower revenues in 1986-1988 (see Table III-10). As discussed below, however, the reasons for these technical differences are varied.

Individual Income and Social Insurance Taxes. Individual income taxes and social insurance taxes and contributions are based directly on personal income. Taken together, these taxes accounted for over 80 percent of total federal revenues collected in fiscal year 1982.

TABLE III-9. CBO REVENUE REESTIMATES ATTRIBUTABLE TO ECONOMIC ASSUMPTIONS, BY SOURCE (By fiscal year, in billions of dollars)

Source	1983	1984	1985	1986	1987	1988
Individual Income Taxes	-0.9	-2.4	+0.3	+0.1	-7.2	-21.3
Corporate Income Taxes	-0.2	+3.8	+4.7	-0.5	-1.7	+0.5
Social Insurance Taxes and Contributions	+1.9	+0.9	+0.3	-2.1	-5.8	-10.2
Windfall Profit Taxes	-0.1	+0.7	-0.2	-1.8	-2.3	-2.8
Other	-0.7	-1.0	-1.1	-1.4	-1.9	-2.3
Total	a/	+2.0	+3.9	-5.7	-18.8	-36.0

NOTE: CBO estimates less Administration estimates.

a. Less than $50 million.

Individual income taxes depend primarily on the level of taxable personal income, the largest component of which is wages and salaries. Social insurance taxes and contributions, which are payroll taxes, depend primarily on the level of wages and salaries. Since the CBO wage and salary assumptions, following the pattern of its GNP assumptions, are higher than the Administration assumptions in 1983-1985 and lower thereafter (see Table III-8), CBO's estimates of social insurance taxes and contributions also follow this pattern (see Table III-9).

CBO estimates of the other component of taxable personal income, nonwage income, are enough below the Administration assumptions in 1983 and 1984 to put CBO's total taxable personal income below the Administration assumptions in these years. 5/ These lower CBO estimates of nonwage income do not affect social insurance estimates at all, but nonwage income

5. Nonwage taxable income comprises proprietors' income, personal interest income, personal dividend income, and rental income.

TABLE III-10. CBO REVENUE REESTIMATES ATTRIBUTABLE TO TECHNICAL ASSUMPTIONS, BY SOURCE (By fiscal year, in billions of dollars)

Source	1983	1984	1985	1986	1987	1988
Individual Income Taxes	+1.5	+1.5	-0.9	-2.3	-4.2	-9.5
Corporate Income Taxes	+5.2	a/	-0.3	-1.2	-1.1	-1.4
Social Insurance Taxes and Contributions	-0.1	-0.5	-0.2	-0.2	+0.1	+0.3
Windfall Profit Taxes	+0.7	+0.6	+1.1	+1.6	+2.1	+2.5
Other	+1.4	+1.1	+0.9	+0.7	a/	-0.3
Total	8.8	2.7	0.5	-1.4	-3.1	-8.3

NOTE: CBO estimates less Administration estimates.

a. Less than $50 million.

makes up over one-fourth of the base used to calculate individual income taxes. These lower levels of nonwage income tend to reduce the CBO estimates of individual income taxes below the Administration estimates in these earlier years, even though CBO wage and salary levels are slightly higher. By 1986-1988, CBO wage and salary levels are lower as well. The largest difference in personal income-based revenue estimates occurs in 1988 when the CBO's lower income path brings the CBO estimate of the total individual income and social insurance taxes slightly more than $31 billion below the Administration estimate (see Table III-9).

For the most part, technical differences between CBO and Administration estimates of individual income and social insurance taxes are quite small, both in absolute terms and relative to the total amount of revenues raised (see Table III-10). However, for 1986-1988 CBO's estimation procedures lead to individual income tax estimates lower than the Administration's. The Administration projects a larger response of taxes to income growth in this period than it projects for 1984 and 1985, while CBO projects a stable pattern of response. Given the assumptions of moderate economic growth and moderate rates of inflation by both CBO and the Administration, relatively stable effective individual income tax rates seem more likely for 1986-1988 than rising ones.

Corporate Income Taxes. Corporate income taxes depend primarily on economic assumptions about corporate profits and the level of investment (which determines the amounts of depreciation deductions and investment tax credits available to reduce corporate taxes). CBO's corporate profit assumptions are higher than the Administration's in 1984 and lower by increasing amounts in 1985-1988. CBO expects business investment to grow more slowly than the Administration assumes, and to account for a smaller share of GNP in each year. CBO's lower levels of investment reinforce the effects of its higher profits in 1984, raising CBO's estimate of corporate tax collections above the Administration's in 1984 (and in 1985 because of the lags between corporate tax accruals and actual collections). In subsequent years the effects of the profit and investment assumptions are largely offsetting, with CBO's lower profits tending to pull tax collections down relative to the Administration, while its lower investment assumptions tend to push collections up.

The only large technical estimating difference between CBO and the Administration occurs in 1983. This difference, which puts the CBO estimate about $5 billion above the Administration's, results in part from the Administration's assumption that the high penalty interest rate imposed last year brought in an unusually large volume of "back taxes" that will reduce corporate income tax payments this year. CBO agrees that this is quite possible, but chooses not to include the assumption in its baseline estimates for 1983. Technical differences between the CBO and Administration corporate income tax estimates in other years are significant, but mostly offsetting.

Windfall Profit Taxes. In 1988, CBO projects an average domestic refiner acquisition cost of crude oil almost $4, or 9 percent, below the Administration's (see Table III-8). CBO's assumption of a lower oil price path beginning in 1985 reduces its estimates of windfall profit taxes below the Administration estimates by increasing amounts over the 1985-1988 period.

These differences in windfall profit tax estimates because of oil price assumptions are offset in part by a technical factor--CBO's assumption that some eligible tier-one oil will not be reclassified as lower-taxed incremental tertiary oil. This slower rate of reclassification is assumed to occur because, in certain circumstances, the cost to the producer of reclassifying is greater than the potential tax reduction.

Economic and technical differences between the CBO and Administration estimates of other tax sources are quite small, only about $1-2 billion per year, and mostly offsetting.

REDUCED SENSITIVITY OF REVENUES TO ECONOMIC GROWTH

The present tax structure has significantly reduced the sensitivity of revenues to different levels of economic growth. In July 1981, for example, before the Economic Recovery Tax Act of 1981 (ERTA) was enacted, CBO projected that current law revenues would increase from 21.4 percent of GNP in 1981 to 23.9 percent of GNP in 1986, using the optimistic economic assumptions of the first budget resolution for 1982. 6/ This year, by contrast, CBO's projection shows current law revenues dropping somewhat as a percentage of GNP over the 1983-1988 period under both the high- and low-growth alternatives to the baseline revenue projections. 7/

Thus, even though both CBO and the Administration are assuming moderate rates of economic growth that could conceivably be exceeded over the 1983-1988 period, the revenue share of GNP would not be sufficiently increased by any feasible overall economic performance to make a significant dent in projected budget deficits. There are two major reasons for this reduced sensitivity of revenues to changes in economic conditions:

- Starting in 1985, the individual income tax exemptions and rate brackets will be indexed to the rate of inflation. As a result, real tax revenues will no longer increase solely because of increases in the price level; rather, they will increase only at a rate very slightly higher than the rate of real income growth. Therefore, individual

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6. Congressional Budget Office, Baseline Budget Projections: Fiscal Years 1982-1986 (July 1981), p. 10.

7. Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1984-1988 (February 1983), p. 16.

income tax revenues will grow much more slowly relative to the size of the economy than they did in the late 1970s and early 1980s.

- o Corporate income tax revenues are now less sensitive to economic conditions because of the expansion of the investment tax credit and accelerated depreciation in ERTA. Economic upswings typically increase corporate profits more than in proportion to total income, but under the liberalized provisions of ERTA, capital cost recovery deductions and investment tax credits will increase at an even faster rate if investment shows its usual relationship to economic growth, and will provide greater tax reductions when inflation is moderate. As a result, corporate tax liabilities can be expected to grow more slowly than before as the economy recovers.

For these changes in the tax structure to be outweighed, yielding revenue growth comparable to recent experience as the economy expands, it would be necessary for major changes in the economy to occur that would increase taxable income as a share of GNP. Such changes are unlikely, however. There is little evidence to suggest that the nontaxable parts of GNP--primarily depreciation, employee fringe benefits, and indirect business taxes (mostly excise taxes)--will grow any more slowly than in recent years, and thus allow the taxable share of GNP to expand. Accordingly, the revenue outlook for the coming years under any given forecast of economic growth shows lower receipts than recent experience would suggest.

The effects of these two major structural changes in the tax system can be illustrated by calculating the revenue share of GNP that would result if economic growth over the 1983-1988 period were to produce:

- o Increases in taxable personal income each year higher than those experienced in all but one year during the entire post-World War II period (ranging from 13.3 to 13.5 percent per year);

- o Comparable increases in corporate profits (with the profits assumed to be paid out in dividends rather than used for investment, in order to maximize tax collections); and

- o No significant increase in inflation above the levels assumed by the Administration (to maximize the real growth share of personal income increases, and thus produce higher collections from an inflation-indexed income tax).

Even with these assumptions (which are unrealistic but are extremely favorable to revenue growth), revenues under existing law would rise to only

19.6 percent of GNP by 1988, only 1.2 percentage points above the 1988 CBO baseline share and only 0.7 percentage points above the Administration's 1988 current services share. In short, significant reduction in projected budget deficits from the tax side will require changes in current tax law.

TAX EXPENDITURES

As required by the 1974 Budget Act, the Administration's 1984 budget contains a list of current tax expenditures. Tax expenditures are revenue losses from provisions in the tax code that provide incentives for particular kinds of activities or that give selective tax relief to certain groups of taxpayers. Examples are the tax credit for the elderly, the partial exclusion of capital gains income, and the investment tax credit for certain types of equipment.

Although the process of defining which provisions in the tax code are normal and which are special--and therefore tax expenditures--is sometimes ambiguous, the annual lists of tax expenditures prepared by the Treasury and the lists prepared for the Congress by the Joint Committee on Taxation and the Congressional Budget Office have generally been in agreement. The tax expenditure budgets prepared by the Administration in 1982 and 1983, however, omit 13 provisions included in the most recent JCT/CBO listing (published March 8, 1982) and include one provision omitted from the JCT/CBO listing for definitional reasons. 8/ The Administration argues that the omitted provisions are not properly classified as tax expenditures. The largest omissions are those dealing with business depreciation.

In the Administration budgets submitted in 1982 and this year, the tax expenditure budget presented in Special Analysis G has included estimates of the "outlay equivalent" for each tax expenditure, as well as the usual revenue loss estimate. The outlay equivalent is the amount of direct outlay subsidy that would have to be provided to recipients in order for that subsidy to be equivalent in value to the subsidy provided through a given tax expenditure provision. The outlay equivalent is normally larger than the

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8. The provision included by the Administration but not by JCT/CBO was income of trusts to finance supplemental unemployment benefits under the "Exclusion of other employee benefits" heading. For a list of provisions not included by the Administration, see Congressional Budget Office, Tax Expenditures: Budget Control Options and Five-Year Budget Projections for Fiscal Years 1983-1987 (November 1982), p. 20.

revenue loss, since it is assumed that the recipient of an outlay subsidy would have to pay taxes on the amount of the direct subsidy. These taxes would reduce the value of the subsidy to the recipient. Most tax subsidies, by contrast, are not themselves subject to tax. The amount of the tax credit for home insulation, for example, is not treated as taxable income to the recipient, although a similar direct grant would be.

A tax subsidy can, in effect, be made subject to tax in a number of ways, thereby assuring that the tax subsidy and a taxable direct grant are equivalent. As is the case with the existing targeted jobs tax credit and the Administration's proposed jobs tax credit for the long-term unemployed, a tax credit could be made taxable by subtracting the amount of the credit from the amount the employer may deduct for wages paid. Similarly, the investment tax credit for machinery and equipment could be made equivalent to a taxable direct grant by reducing the amount of depreciation otherwise allowed by the amount of the credit (depreciation is now reduced by half the amount of the credit as a result of the Tax Equity and Fiscal Responsibility Act of 1982). Alternatively, a direct grant could be made equivalent to a nontaxable tax subsidy by increasing its size by the amount of tax that would be due on it, or explicitly exempting it from tax.

The outlay equivalent concept is most useful when the Congress is choosing between a tax subsidy and an alternative direct grant subsidy. When instead the choice is between keeping a tax subsidy or eliminating it, the usual revenue loss estimate is more relevant. Although the revenue loss estimates in the tax expenditure budget do not show the exact amount of revenue that would be gained if a provision was eliminated, since they do not take into account transitional effects, possible interactions with other parts of the tax code, and possible offsetting behavioral effects, they are a more reliable guide to the revenue cost of tax expenditures than are the outlay equivalent estimates.

CHAPTER IV. THE ADMINISTRATION'S DEFENSE BUDGET

The Administration's fiscal year 1984 budget proposes rapid real growth in defense spending over the next five years. New budget authority for national defense is projected to increase from $281 billion in 1984 to $433 billion in 1988, for a five-year total of about $1.8 trillion. This represents average annual real growth of 6.8 percent, using Administration assumptions about future rates of inflation. As a consequence, the defense share of the federal budget would climb steadily. Defense spending relative to the size of the economy would also grow, regaining the levels of the early 1970s.

The Administration's current defense budget plan is similar to the one proposed last year, although funding levels are somewhat lower. Budget authority is $11 billion less for 1984 and $55 billion less over the 1984-1988 period, mainly because pay raises, cost-of-living adjustments (COLA), and inflation estimates are lower. The Administration's plan also cuts previously planned purchases of ships, missiles, and aircraft. These reductions, however, are offset somewhat by funding increases for readiness activities.

The Administration's 1984 defense budget is higher than the targets set by the Congress in its First Concurrent Resolution on the Budget for Fiscal Year 1983. Compared to CBO's national defense baseline projections for 1984-1988, which are based on the 1983 Congressional budget resolution, the Administration's budget represents an increase of $81 billion in budget authority and $75 billion in outlays. In effect, the Administration budget substitutes reductions in pay raises, COLAs, and inflation assumptions for program reductions implicit in the resolution.

Despite recent revisions in defense procurement policies, defense purchases have experienced significant real cost growth again this year. CBO analysis shows that unit cost growth for 60 weapons systems has increased the 1984 budget by about $2.6 billion.

DEFENSE BUDGET GROWTH IN PERSPECTIVE

The Administration's defense budget for 1984-1988 is summarized in Table IV-1 and Figure IV-1. The Administration requests 1984 budget authority of $280.5 billion--a $35 billion, or 14 percent, increase over the

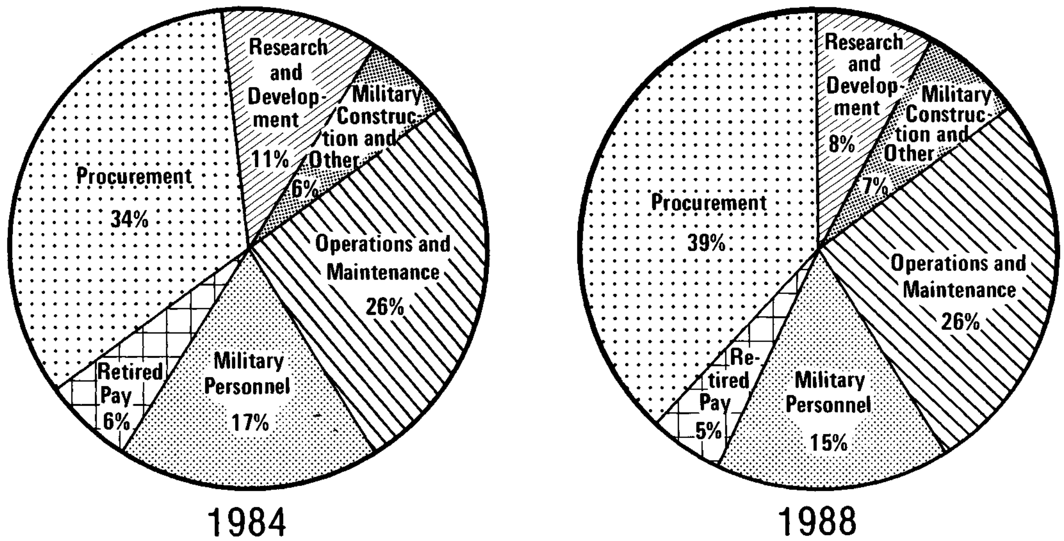
TABLE IV-1. THE ADMINISTRATION'S DEFENSE BUDGET (By fiscal year, In billions of dollars)

	Actual 1982	Administration Estimates 1983	1984	1985	1986	1987	1988
				Budget Authority			
Department of Defense-Military							
Operations	66.9	67.2	76.8	85.5	96.0	106.6	115.7
Procurement	64.5	80.3	94.1	119.6	136.4	150.4	170.3
Other	82.4	91.9	102.5	116.5	124.0	131.3	138.3
Subtotal, DoD	213.8	239.4	273.4	321.6	356.4	388.3	424.3
Other National Defense	5.0	6.0	7.1	8.4	8.4	8.7	8.4
Total	218.7	245.5	280.5	330.0	364.8	397.0	432.7
Real Growth (year to year in percents)	12.0	7.3	10.2	11.2	5.2	3.7	3.8
				Outlays			
Department of Defense-Military							
Operations	60.4	64.8	72.6	82.2	92.1	102.0	111.5
Procurement	43.3	55.2	68.2	85.9	103.7	117.5	131.4
Other	79.2	88.9	97.8	109.4	119.1	126.1	134.1
Subtotal, DoD	182.9	208.9	238.6	277.5	314.9	345.6	377.0
Other National Defense	4.5	5.9	6.7	7.8	8.1	8.7	8.0
Total	187.4	214.8	245.3	285.3	323.0	354.3	385.6
Real Growth (year to year in percents)	7.7	9.8	10.3	9.6	7.7	4.5	3.7

SOURCE: Office of Management and Budget.

Figure IV-1.

Defense Department Budget, Fiscal Years 1984 and 1988 (Budget Authority)

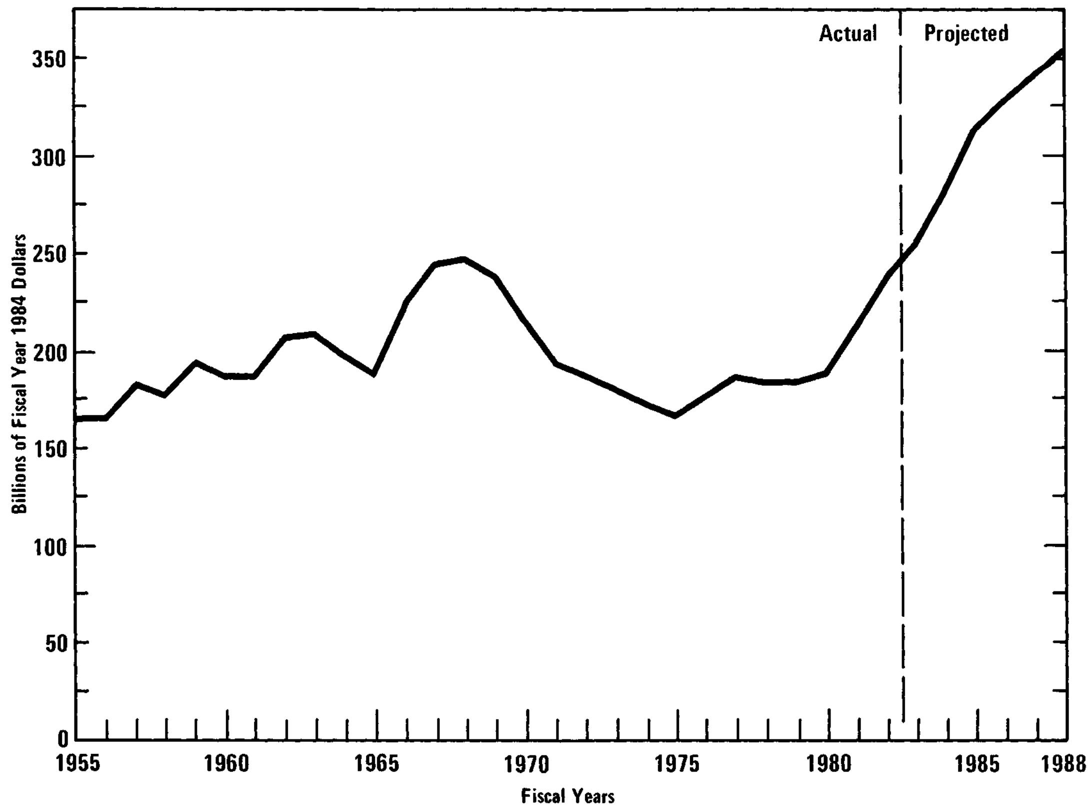


SOURCE: *Budget of the United States Government, Fiscal Year 1984.*

1983 estimated level. The January budget also proposes $1.6 billion for supplemental appropriations and $650 million in rescissions for defense programs in 1983.

Further large increases in defense appropriations are planned for 1985-1988. New budget authority would rise to $330 billion in 1985, $365 billion in 1986, $397 billion in 1987, and $433 billion in 1988. Together with the requested 1984 budget authority, this represents almost a $1.8 trillion defense program over the next five years. This is nearly $900 billion more for national defense than the Congress provided during the past five years (1979-1983)--or, in real terms, a 49 percent increase. Figure IV-2 portrays the proposed rapid real growth in the level of future Department of Defense (DoD) appropriations. Figure IV-3 shows the year-to-year real growth rates planned by the Administration.

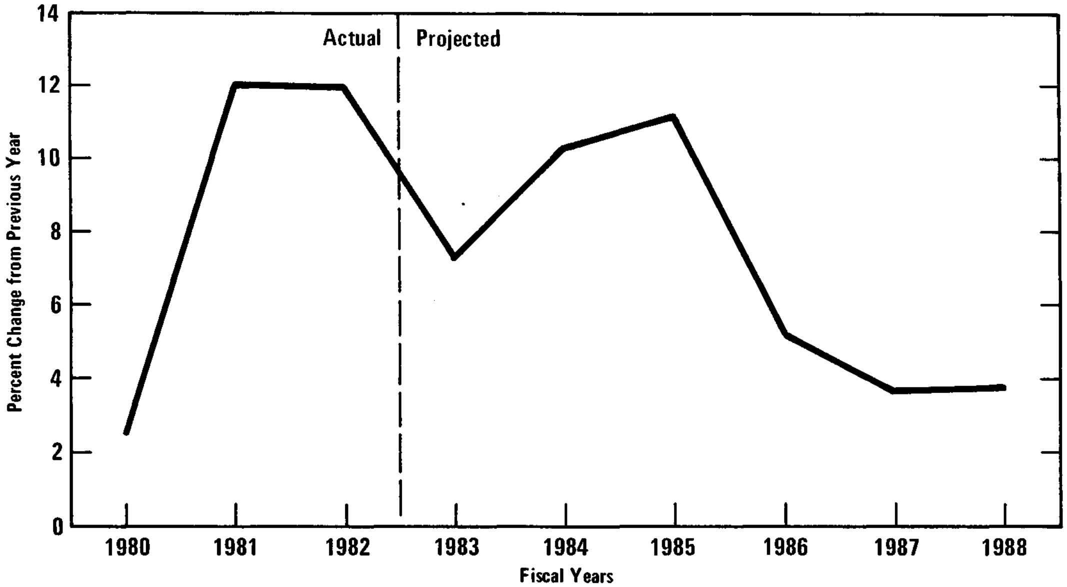
Figure IV-2.
Budget Authority for National Defense (In Constant 1984 Dollars)



SOURCE: CBO calculations based on data from the Department of Defense.

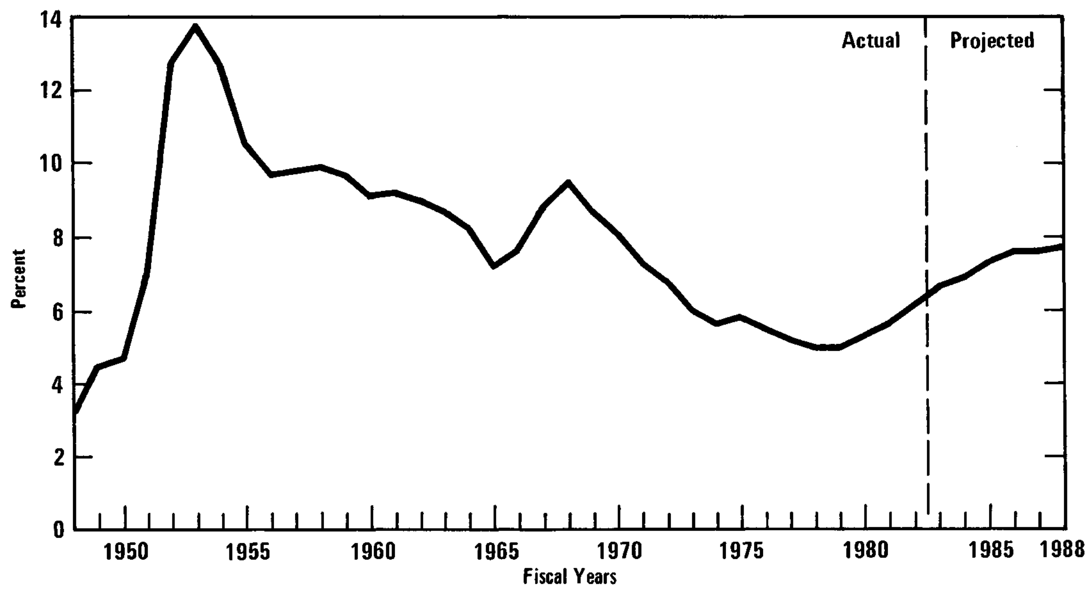
Relative to the total economy, the Administration estimates that defense spending would increase from 6.7 percent of GNP in 1983 to 7.9 percent in 1988. Figure IV-4 shows the post-World War II trend for defense outlays as a share of GNP. Over the 1984-1988 period, the Administration's proposed defense outlays would average 7.6 percent of GNP. This is higher than the average 5.8 percent of GNP for the preceding five years. It is lower, however, than the 10 percent average for several years following the Korean War.

Figure IV-3.
Real Growth in National Defense (Budget Authority)



SOURCE: CBO calculations based on data from the Office of Management and Budget.

Figure IV-4.
National Defense Outlays as a Percentage of GNP



SOURCES: For historical data, Department of Defense; for projections, *Budget of the United States Government, Fiscal Year 1984.*

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TABLE IV-2. SUMMARY OF MAJOR U.S. FORCES AND MANPOWER (By fiscal year)

	1983	1984
Active Forces (in units)		
Strategic bomber aircraft	297	297
Land-based intercontinental ballistic missiles	1,043	1,034
Sea-based intercontinental ballistic missiles	568	616
Army and Marine Corps divisions	19	19
Naval fleet	434	443
Tactical air squadrons	167	172
Manpower (personnel in thousands)		
Active duty end strength	2,127	2,165
Civilian end strength	1,056	1,072

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

Relative to total federal unified budget outlays, national defense outlays from 1979 to 1983 were about 25 percent--the lowest share since World War II. The Administration's 1984 budget proposes to increase this share to about 31 percent by 1988--a level last reached in 1972. In the post-World War II period, national defense as a percent of unified budget outlays exceeded 31 percent each peacetime year from 1954 to 1972.

The growth in the defense budget, according to the Administration, is necessary to meet the Soviet Union and Warsaw Pact threat. The Defense Department asserts that, even after including the efforts of our Allies, the Soviet Union and Warsaw Pact nations have both out-produced and out-spent the United States in military capability. 1/

Short term changes planned for U.S. strategic nuclear forces, tactical air forces, and general purpose naval forces are shown in Table IV-2. Major strategic force changes for 1984 are the retirement of nine Titan II intercontinental ballistic missile launchers, which will be offset by the

1/ Statement of the Secretary of Defense Caspar W. Weinberger before the Senate Armed Services Committee on February 1, 1983.

delivery of two Trident submarines. Tactical air forces will increase by five squadrons--three for the Navy and one each for the Marine Corps and Air Force. For naval forces, a net increase of nine ships is planned for the active fleet in 1984.

In the longer term, major planned increases in force structure are designed to meet the Administration's goal of expanding Navy resources from the current 434 active and 72 reserve ships to over 600 ships by the early 1990s. The Air Force is also projected to expand from its present level of approximately 41 tactical and air defense air wings to about 44 by 1988. The Administration's five-year plan for land forces includes continued force modernization through the acquisition of heavy and light armored vehicles as well as attack and assault-support helicopters.

The next section of this chapter discusses the Administration's 1984 appropriations request in terms of real growth in budget authority as well as the Administration's procurement plan for major weapons. The second section describes the revisions in the Administration's current defense plan compared to the five-year defense plan that the Administration submitted in February 1982. A third section compares the Administration's defense budget with the Administration's previous five-year plan and the national defense targets in the First Concurrent Resolution on the Budget for Fiscal Year 1983. To illustrate the point that initial outlay effects of defense budget authority reductions can be relatively small and that realizing the total outlay savings from such cuts typically requires several years, the last section briefly examines the structure of 1984 defense outlays.

REAL GROWTH IN DEFENSE SPENDING IN THE 1984 APPROPRIATION REQUEST

The 1984 defense appropriation request submitted by the President represents substantial real growth (measured in constant fiscal year 1984 dollars) of $25.2 billion--a 10.2 percent real increase above appropriations enacted for 1983. In dollar terms, the largest real increases in 1984 budget authority are for procurement ($7.7 billion), research, development, test, and evaluation ($5.8 billion), and operations and maintenance ($5.8 billion). Together, these categories account for over three-quarters of the real growth in the 1984 defense budget. A significant share of the growth in all these appropriation categories would fund strategic programs.

In percentage terms, the largest real growth rates are 196.6 percent for the revolving funds, which triple in terms of budget authority; 24.5 percent for research, development, test, and evaluation (RDT&E); and 22.3 percent for military construction. Defense real growth from 1983 to 1984 is summarized by appropriation categories in Table IV-3.

TABLE IV-3. REAL GROWTH IN DEFENSE BUDGET BY APPROPRIATION CATEGORIES
(Budget authority and outlays by fiscal year, in billions of dollars)

Category	1983 Enacted Appropriations	1984 President's Budget Request	1984 Real Growth in Budget Authority a/ Billions of Dollars	1984 Real Growth in Budget Authority a/ Percents b/
Department of Defense				
Military				
Military personnel				
Budget authority	45.5	47.9	2.1	4.7
Outlays	45.3	47.7		
Retired personnel				
Budget authority	16.2	16.8	0.6	3.8
Outlays	16.1	16.8		
Operations & Maintenance				
Budget authority	66.3	74.0	5.8	8.6
Outlays	64.6	71.7		
Procurement				
Budget authority	80.3	94.1	7.7	8.9
Outlays	55.2	68.2		
RDT&E				
Budget authority	22.8	29.6	5.8	24.5
Outlays	21.4	26.3		
Military construction				
Budget authority	4.5	5.8	1.1	22.3
Outlays	4.1	4.4		
Family housing				
Budget authority	2.5	2.8	0.2	6.6
Outlays	2.4	2.6		
Revolving funds				
Budget authority	0.9	2.8	1.9	196.6
Outlays	0.1	1.0		
Other DoD				
Budget authority	-0.5	-0.5	c/	-2.4
Outlays	-0.5	-0.1		
Subtotal				
Budget authority	238.4	273.4	25.2	10.2
Outlays	208.8	238.6		
Atomic Energy Defense Activities				
Budget authority	5.7	6.8	0.8	13.5
Outlays	5.5	6.4		
Defense Related Activities				
Budget authority	0.4	0.3	-0.1	-14.6
Outlays	0.4	0.3		
Total				
Budget authority	244.5	280.5	26.0	10.2
Outlays	214.7	245.3		

SOURCE: Compiled by CBO from data supplied by the Department of Defense, and CBO.

a. Real growth computed using CBO economic assumptions for purchases and retired pay with the President's pay raise assumptions.

b. Individual percentage calculations are not weighted and therefore are not additive.

c. Less than $50 million.

Procurement Plans

Under the Administration's defense budget, procurement appropriations would increase by about $7.7 billion in real terms from 1983 to 1984. Increases are proposed in the following areas: aircraft and missiles, including strategic systems such as the MX (Peacekeeper) missile, B-1 bomber and tactical air-to-surface and surface-to-surface missiles; light armored vehicles; readiness and sustainability items, such as spare and repair parts and ammunition; modifications of existing equipment; and investment in communications, electronics, vehicles, and other support equipment. The increases within proposed procurement programs are partially offset by several reductions, principally the proposed shipbuilding program. Real increases in procurement plans are discussed in this subsection; real cost growth is discussed later.

Aircraft. Table IV-4 shows planned aircraft purchases for the period 1983-1985. The budget proposes buying 44 more aircraft for 1984 than in 1983. Requested purchases of AH-64 attack helicopters would increase by 64 aircraft, although 12 fewer UH-60 assault-support helicopters and 11 fewer other aircraft would be purchased. Except for increases in AV-8B attack aircraft, requested purchases of Navy and Marine Corps aircraft in 1984 are relatively unchanged from the levels funded for 1983. The most significant changes in the Air Force are the projected increases for F-15, B-1B, and C-5 aircraft, with offsetting decreases for A-10 and E-3A aircraft.

The plan for 1985 proposes 200 more aircraft than the projected levels in 1984. Nearly 50 percent of the proposed increase would fund Navy and Marine Corps aircraft purchases, primarily AV-8B and other aircraft such as trainers and transports. In 1985 the Air Force plans to purchase more F-15, B-1B, C-5B, and E-3A aircraft than it proposes for 1984. Also, Army orders for AH-64 helicopters for 1985 would increase over the projected 1984 level.

Missiles. Projected purchases of all strategic and theater nuclear missiles for 1984 would decline by 109 missiles, below the quantities funded for 1983. As shown in Table IV-5, large net reductions in proposed Air Force strategic and theater nuclear missile procurement are offset partially by proposed increases in Army and Navy missile procurement. The initial production of the Army's Pershing II missiles would begin in 1984. The Pershing II program was scheduled to start production in 1983, but the Congress denied production funding because of test failures and other technical problems. The first successful test firing of Pershing II occurred on January 21, 1983. Navy proposed purchases of missiles would increase by 56 percent over the numbers funded for 1983. Significantly increased orders for Tomahawk would be offset somewhat by a reduction in the Trident I

TABLE IV-4. AIRCRAFT ACQUISITION PLANS, BY SERVICE (By fiscal year, in units procured)

Aircraft Type	1983	1984	1985
Army			
AH-64 helicopter	48	112	144
UH-60 helicopter	96	84	78
Other aircraft	23	12	18
Subtotal	167	208	240
Navy/Marine Corps			
F/A-18 aircraft	84	84	92
F-14 aircraft	24	24	24
AV-8B aircraft	21	32	48
A-6E aircraft	8	6	6
EA-6B aircraft	6	6	6
CH-53E helicopter	11	11	11
SH-60B helicopter	27	21	18
Other aircraft	91	97	169
Subtotal	272	281	374
Air Force			
F-16 aircraft	120	120	120
F-15 aircraft	39	48	72
A-10 aircraft	20	--	--
B-1B aircraft	7	10	34
KC-10 aircraft	8	8	8
E-3A aircraft	2	--	3
C-5B aircraft	1	4	10
TR-1 aircraft	5	5	5
Other aircraft	17	18	36
Subtotal	219	213	288
Total	658	702	902

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

program. Table IV-5 also shows that the proposed 1984 procurement program for Air Force strategic and theater nuclear missiles would decline by 267 missiles. Projected changes include the cancellation of previous plans to buy air-launched cruise missiles and increased purchases of ground-launched cruise missiles and MX missiles.

TABLE IV-5. STRATEGIC AND THEATER NUCLEAR MISSILE ACQUISITION PLANS, BY SERVICE (By fiscal year, in units procured)

Missile Type	1983	1984	1985
Army			
Pershing II	--	95	104
Navy			
Trident I	62	52	--
Tomahawk	51	124	353
Subtotal	113	176	353
Air Force			
MX	--	27	37
Air-launched cruise missile	330	--	--
Ground-launched cruise missile	84	120	120
Harpoon	--	--	50
Subtotal	414	147	207
Total	527	418	664

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

The procurement plan for 1985 includes 246 more missiles, or a 59 percent increase over proposed orders in 1984. Projected purchases include increases in Tomahawk and MX and the first order of 50 Harpoon missiles for the Air Force B-52 sea-control mission.

The Administration's proposed plan for tactical missiles includes the acquisition of four groups of missiles:

- o Air-to-air missiles, which include Air Force and Navy versions of Sparrow and Sidewinder, the Navy Phoenix, and the Air Force advanced medium range air-to-air missile (AMRAAM);

- o Air-to-surface missiles, which include Army and Navy purchases of Hellfire, and Air Force and Navy versions of Maverick and high-speed anti-radiation missiles (HARM), as well as purchases of a new missile-launched laser-guided bomb (LLGB) for the Navy;

- o Surface-to-air missiles, which include the Army Patriot, Navy Rolling Airframe missile (RAM), and Marine Hawk as well as purchases of Stinger for the Army, Marines, and Air Force; and

- o Surface-to-surface missiles, which include Army and Marine purchases of TOW anti-tank missiles (which can also be used as air-to-surface missiles) as well as Navy purchases of Harpoon and Standard missiles.

Table IV-6 shows that the number of tactical missile purchases in 1984 are projected to increase by roughly 9,700 missiles over the numbers funded for 1983. Proposed increases in purchases of air-to-surface missiles and surface-to-surface missiles would be partially offset by decreases in air-to-air missiles and surface-to-air missiles.

The plan proposed for 1985 includes a 21 percent increase, or about 8,100 more tactical missiles than the total plan for 1984. Increases for air-to-surface, surface-to-air, and surface-to-surface missiles would be partially offset by decreases for air-to-air missiles.

Armored Vehicles. Armored combat vehicles include tanks, fighting vehicles, Light Armored Personnel Carriers, and ancillary Armored Recovery Vehicles. The Administration's armored combat vehicle program emphasizes acquisition of two "families" of vehicles (see Table IV-7):

- o Heavy combat vehicles dedicated for use by Army forces in Europe commited to NATO; and

- o Light Armored Vehicles for both the Army and the Marine Corps to support the heavy combat vehicles committed to NATO and to strengthen the Rapid Deployment Force, primarily for deployment in the Middle East.

The major 1984 change for heavy combat vehicles is a reduction of 135 M-1 tanks from the purchases funded for 1983. Proposed quantities for the tank's companion fighting vehicles would remain at the 1983 funded level of

TABLE IV-6. TACTICAL MISSILE ACQUISITION PLANS, BY TYPE AND SERVICE (By fiscal year, in units procured)

Missile Type	1983	1984	1985
Air-to-Air Missiles			
Navy	1,228	1,335	2,549
Air Force	3,085	2,705	224
Subtotal	4,313	4,040	2,773
Air-to-Surface Missiles			
Army	3,971	5,351	6,026
Navy	172	614	2,438
Air Force	1,029	2,885	6,601
Subtotal	5,172	8,850	15,065
Surface-to-Air Missiles			
Army	2,543	2,033	3,425
Navy/Marine Corps	1,771	1,106	1,424
Air Force	---	108	108
Subtotal	4,314	3,247	4,957
Surface-to-Surface Missiles			
Army	12,000	18,000	18,000
Navy	1,372	1,520	2,140
Marine Corps	1,000	2,200	3,028
Subtotal	14,372	21,720	23,168
Total	28,171	37,857	45,963

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

600, however. The 1984 budget contains for the first time in a number of years an Army order for 652 Light Command Post Carriers. The budget also proposes increased quantities of Field Artillery Ammunition Support Vehicles and "off-the-shelf" Light Armored Vehicles, but reduced purchases of Armored Personnel Carriers.

The plan for 1985 includes about 600 fewer armored vehicles than the total requested for 1984. The proposed plan includes increases in Fighting

TABLE IV-7. ARMORED COMBAT VEHICLE ACQUISITION PLANS, BY TYPE AND SERVICE (By fiscal year, in units procured)

Vehicle Type	1983	1984	1985
Heavy Combat Vehicles			
Army			
M-1 Tanks	855	720	720
Fighting Vehicles	600	600	830
Subtotal	1,455	1,320	1,550
Light Armored Vehicles			
Army			
M-113 Armored Personnel Carriers	520	400	---
Light Command Post Carriers	---	652	---
Field Artillery Amunition Support Vehicles	54	217	274
M-88A1 Medium Recovery Vehicles	180	180	199
LAV-25 Light Armored Vehicles	36	176	257
Light Armored Recovery Vehicles	---	--	24
Subtotal	790	1,625	754
Marines			
Light Armored Vehicle	134	113	117
Total	2,379	3,058	2,421

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

Vehicles and Light Armored Vehicles, but no planned purchases of Light Command Post Carriers or Armored Personnel Carriers.

Readiness Procurement. Readiness procurement programs include the spare and repair parts, support equipment, facilities, and munitions necessary to keep military forces ready for combat in peacetime and to sustain their operation once combat begins. In past years, funding for readiness has often been traded off for procurement of aircraft, tanks, and ships. Both the current and previous Administrations are committed to raise funding levels for readiness.

As shown in Table IV-8, the proposed funding level for readiness items in 1984 would increase by about $4 billion over the level funded for 1983. Similarly, the planned level for 1985 expenditures is about $7 billion higher than the 1984 total. In each year, proposed funding for spare parts, support equipment, and facilities would receive the larger share of the increase.

TABLE IV-8. PROPOSED FUNDING FOR READINESS ITEMS (By fiscal year, in billions of dollars)

Readiness Category	1983	1984	1985
Spare Parts, Support Equipment, and Facilities	11.5	15.2	20.2
Munitions a/	3.3	4.0	5.9
Total	14.8	19.2	26.1

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

a. Navy ammunition was included in ordinance support equipment and aviation support equipment in the budget documentation.

Ships. The Administration has developed an ambitious shipbuilding and conversion program. As Table IV-9 shows, this plan calls for 145 ships to be constructed, converted, modified, or leased between 1984 and 1988.

The budget for shipbuilding and conversion declines from $16.2 billion in 1983 to $12.7 billion in 1984. The budget for 1984 contains a net increase of six ships from the revised 1983 budget request (see Table IV-9). The proposed funding difference is attributable to increases in less expensive auxiliaries, mine warfare, and amphibious ships, as well as one attack submarine which are offset by reductions of more costly ships in 1984--namely two nuclear carriers, one Service Life Extension Program carrier, and one battleship.

TABLE IV-9. ADMINISTRATION'S NAVY SHIPBUILDING PROGRAM FOR 1984-1988 (By fiscal year, in units procured)

Ship Type	Funded 1983	Planned 1984	1985	1986	1987	1988	Total 1984-1988
Trident Submarines	1	1	1	1	1	1	5
Nuclear Carrier Ships	2	--	--	--	--	1	1
Other Warships a/	7	6	10	8	12	13	49
Amphibious Ships b/	1	2	2	4	5	7	20
Mine Warfare and Patrol Ships	3	5	4	8	4	4	25
Auxiliaries b/	3	9	9	10	10	7	45
Total	17	23	26	31	32	33	145

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

a. Includes Service Life Extension Program for one conventional carrier in 1983, 1985 and 1987.

b. Includes planned reactivations and conversions.

Research and Development (R&D)

The Administration's 1984 appropriations request for R&D is spread across nearly all defense elements, but is concentrated in strategic programs. Major increases are for the Trident II missile, MX missile, Air Force Strategic Communications, and Army Ballistic Missile Defense .

Operations and Maintenance

The proposed real increase of $5.8 billion in 1984 for operations and maintenance (O&M) appropriations would support higher levels of activity. Among the military services, the Navy shows the largest gain in proposed funds (though the smallest percent change), with a combined Navy and Marine Corps real budget authority increase of $1.5 billion, or 6.6 percent. Much of this increase would be applied to depot maintenance and the support necessary to sustain a planned increase to annual ship operations of over 50 thousand hours at sea, or 5 percent more than proposed for 1983. The Air Force program shows real increases of almost $1.5 billion, mainly to fund space support programs, logistics programs, and operations support for about 80 thousand added flying hours--an increase of about 3 percent over the plan funded for 1983. The proposed $1.4 billion, or 8.6 percent, real increase in Army C&M appropriations primarily reflects the costs of continuing the Army modernization program and improvements in unit and individual training.

Military Personnel

A $2.5 billion increase to military personnel appropriations consists of four large adjustments and numerous smaller changes. A rise in troop strength and an increase in the length of service time of military personnel account for $1.1 billion. Adjustments to permanent-change-of-station costs amount to $400 million. Enacted legislation to pay unemployment compensation to ex-military personnel results in the need for an additional $200 million, while the Administration's request for enlistment/reenlistment bonuses is up by $188 million.

Other Accounts

The $1 billion proposed real increase in military construction from 1983 to 1984 results, in part, from the continuation of the facilities modernization program begun in 1981. The addition of new weapons systems, notably MX and Trident, explains part of the increase.

During 1982, the Congress directed the Department of Defense (DoD) to purchase from DoD's revolving funds the additional inventory associated with the authorized expansion of forces and activity levels of the four military services. This has resulted in a $1.9 billion real increase from 1983 to 1984. Of the $2.8 billion requested for the revolving and management fund accounts in 1984, $2.3 billion is to replenish and expand the peacetime inventory and $0.5 billion represents additions to the war reserve.

All categories of atomic energy defense accounts--namely, weapons research, development, test, and production, weapons materials production and waste management, naval reactor development, and other research programs--were increased in 1984 over the levels funded for 1983 by a total of $0.8 billion in real terms, or 13.5 percent.

CHANGES FROM THE 1983-1987 DEFENSE PLAN FOR FISCAL YEAR 1984

The Administration's fiscal year 1983 budget, submitted in February 1982, reflected its first complete analysis of defense requirements. These requirements were embodied in a five-year defense plan covering 1983-1987. The Congress set lower spending targets for national defense for 1983-1985 in its budget resolution for 1983 and provided lower 1983 appropriations for defense than proposed by the President. These reductions and other circumstances prompted the Administration to revise its five-year defense plan this year.

This section discusses the changes in this year's defense plan relative to the plan of a year ago. The discussion of the projected funding changes is limited primarily to fiscal year 1984. Whenever possible, the changes to last year's proposed forces, personnel levels, and purchases, beyond 1984 are also discussed.

As shown in Table IV-10, the 1984 budget reflects a reallocation of proposed funds for 1984 from procurement, pay, and military construction (about $18.5 billion) to other activities, primarily cost growth in weapons purchases, research and development (R&D) and spare parts purchases (about $8.0 billion).

This reallocation of funds represents a shifting of priorities. Proposed modernization, through investment in weapons production and facility construction, would be slowed in favor of increased readiness and future systems development and in response to the escalating unit cost of major weapons.

Program Decreases

The largest reductions are for purchases, which decline by roughly $10 billion in 1984, mainly because fewer weapons would be purchased under the Administration's new plan.

Aircraft. As shown in Table IV-11, this year's defense program proposes 93 fewer aircraft purchases for 1984, thereby saving about $3 bil-

TABLE IV-10. ADMINISTRATION CHANGES TO NATIONAL DEFENSE BUDGET FOR 1984 BETWEEN FEBRUARY 1982 AND JANUARY 1983 (Budget authority in billions of dollars)

Administration Proposal	
1984 Budget (January 1983)	280.5
1983 Budget (February 1982)	291.0
Total Net Change	-10.5
Decreases:	
Purchases	
Quantities of major weapons purchases	-7.0
Other purchases	-3.4
Pay raises and retired pay	-6.9 a/
Construction of facilities	-1.2
Subtotal, decreases	-18.5
Increases	
Costs of major weapons purchases	2.6
Research and development	2.1
Spare parts purchases by stock funds	2.0
Costs of military personnel	0.4
Nuclear materials costs	0.4
Other	0.5
Subtotal, increases	8.0
Total Net Change	-10.5

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

a. Pay raise data adjusted to reflect annualization of 1983 pay raise.

lion in budget authority for 1984. Proposed purchases of combat aircraft for the Navy and Air Force would be 44 and 17 fewer in 1984, respectively. Air Force procurement planning data indicate that 266 aircraft should be procured in 1984 to sustain the 41 tactical and air defense air wings now planned for 1984. Because these reductions limit proposed procurement to only 168 fighter and attack aircraft in 1984, the Defense Department does not propose procuring enough aircraft to sustain its existing Air Force tactical and air defense forces, and therefore would not be able to begin its proposed increase in the number of air wings. Navy and Air Force aircraft planned procurement would also be smaller in 1985. Army AH-64 helicopter procurement would increase in both 1984 and 1985.

TABLE IV-11. CHANGES IN ADMINISTRATION PLANS FOR AIRCRAFT PROCUREMENT BETWEEN FEBRUARY 1982 AND JANUARY 1983 (By fiscal year, in units procured)

Aircraft Type	1984	1985
Combat Aircraft		
Army		
AH-64	16	19
Navy		
F/A-18	-12	-16
F-14	-6	-6
Other	-26	-10
Air Force		
B-1	--	-2
F-15	-12	-24
F-5	-5	--
Other Aircraft	-48	1
Total	-93	-38

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

Missiles. Reduced procurement of missiles would save roughly $2 billion in budget authority for 1984. As shown in Table IV-12, the MX, the Trident I, Tomahawk, and air launched cruise missile--four of the six strategic missile systems being procured--would be reduced in both 1984 and 1985. This year's plan proposes buying nearly 8,000 fewer tactical missiles in 1984 compared to last year. Many systems would be reduced, but the largest planned decreases are for Sparrow, Maverick, and Stinger. The

Administration's new plan for the Air Force proposes nearly 4,000 fewer missile purchases for 1985, mainly Sparrows, Mavericks, and Stingers. These reductions would be offset by proposed increases in purchases of Navy tactical missiles, such as the Missile Launched Laser Guided Bomb and TOW.

TABLE IV-12. CHANGES IN ADMINISTRATION PLANS FOR MISSILE PROCUREMENT BETWEEN FEBRUARY 1982 AND JANUARY 1983 (By fiscal year, in units procured)

Missile Type	1984	1985
Strategic		
Navy		
Trident I	-20	-30
Tomahawk	-188	5
Air Force		
MX (Peacekeeper)	-26	-19
Air launched cruise missile (ALCM)	-440	-480
Subtotal, Strategic	-674	-524
Tactical		
Army	-2,791	-620
Navy/Marine Corps	-1,969	3,527
Air Force	-3,045	-3,828
Subtotal, Tactical	-7,805	-921
Total	-8,479	-1,445

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

Ships. The current shipbuilding plan for 1984 proposes four fewer ships for new construction than were proposed in last year's plan. This would save about $1 billion in budget authority in 1984. For 1984-1987, the latest shipbuilding plan cuts 21 from the number of ships to be built. Table IV-13 shows this reduction by category of ship.

Last year's shipbuilding plan was presented as the level of construction needed to meet the goal of a modern navy of 600-plus ships with 15 carrier

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TABLE IV-13. ADMINISTRATION CHANGES FOR NEW CONSTRUCTION IN NAVY SHIPBUILDING PLAN, 1984-1987, BETWEEN FEBRUARY 1982 AND JANUARY 1983 (In units procured)

Ship Type	1984	1984-1987
Cruisers	--	-3
Destroyers	--	-3
Frigates	-2	-10
Attack Submarines	--	1
Mine Warfare	--	1
Support	-2	-7
Total	-4	-21

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

battle groups by 1990. This goal may still be achievable with the revised shipbuilding plan. The pace of modernization will be much slower, however, particularly for major warships.

Tanks. Proposed purchases of M-1 tanks have been reduced by 360 tanks in both 1984 and 1985. This reduction would save about $900 million in 1984. Because a heavy division has approximately 360 tanks, the impact of this reduction could be to delay modernization of two heavy divisions.

Other Purchases. The Administration's current plan proposes reduced appropriations of about $1 billion from last year for planned equipment purchases including ammunition and tracked vehicles. Additional reductions in planned purchases, amounting to at least $2 billion, cannot be identified from available budget documents.

Pay Reductions. The Administration's previous national defense plan proposed pay increases for 1984 of about 5 percent for civilians and 7.6 percent for military personnel. The Administration now proposes no pay raises for 1984, which, in combination with the cap on 1983 pay raises, would save about $6 billion. In addition, the Administration's current budget reduces pay for military retirees to reflect enacted legislation that reduced 1983 cost-of-living adjustments (COLAs) for retirees under age 62 and the Administration's proposal to eliminate the potential COLA for 1984.

Construction. Future military construction programs have been reduced by about $1.2 billion from the $7.0 billion projected by the Administration in February 1982. This decrease represents a scaling down of plans for modernization of troop facilities.

Program Increases

Cost Growth in Weapons Purchases. A significant change in the 1984 budget is an increase in the price of major weapons systems. CBO's preliminary analysis of 60 major systems in the Administration's budget indicates that they have increased by a net \$2.6 billion in 1984. These increases reflect higher estimates of costs per unit in real terms, after adjustments for inflation.

Defense purchases have experienced significant real cost growth in recent years. This has occurred for a variety of reasons, including program changes (such as new specifications or revised production schedules) and the underestimation of real resources required, such as manufacturing hours, material, and labor costs. After recognizing the cost-growth problem in major weapons systems, the Administration instituted a number of acquisition initiatives to restrain it. Sufficient data is not available to evaluate fully the success of these initiatives. The data presented below, however, shows that real cost growth has continued for many major weapons systems during the second year of this Administration.

Table IV-14 provides cost-growth data on 60 major weapons systems by comparing 1984 unit costs as initially projected by the Administration in February 1982 against estimates contained in the current 1984 budget. The table shows a net cost growth of \$2.6 billion since last year, compared with an increase of \$2.7 billion for 48 systems in CBO's analysis of the 1983 budget.

One reason for this growth in unit costs is that the Administration's procurement strategy for 1984 involves decreases in planned order levels for many systems. The planned purchases for 22 of the 60 reviewed major systems are lower than planned a year ago. As shown in Table IV-15, all of these systems experienced unit price increases. Table IV-15 also shows four other systems, which would be purchased in increasing quantities and would experience the expected real declines in their procurement unit costs. Historically, reduced levels of annual purchases have been associated with increased costs because production levels become less economical and because the shift of production from earlier to later years raised costs as a result of inflation. The changes made to the 1984 budget since February 1982 appear inconsistent with the Administration's announced goal of cost saving through more economical production rates. Rather than cancel an entire weapons system, reductions in acquisition quantities have historically been used to reduce procurement cost in the current budget

TABLE IV-14. MAJOR WEAPONS SYSTEMS COST CHANGES IN THE 1984 PROGRAM BETWEEN FEBRUARY 1982 AND JANUARY 1983
(In millions of dollars and percents)

Weapon System	Procurement Unit Cost February 1982	Procurement Unit Cost January 1983	Percent a/ Change	Cost Impact on 1984 Budget a/
Laser Maverick Missile, Navy	0.14	0.27	95	22
MX Missile	57.38	102.59	79	1,221
SH-60B Helicopter	16.45	26.14	59	203
Tomahawk Missile	1.95	2.88	47	115
C-5 Aircraft	205.00	286.53	40	326
Sparrow Missile, Navy	0.16	0.22	40	44
TH-57 Helicopter	1.10	1.50	37	8
Harm Missile, Navy	0.62	0.84	35	50
IR Maverick Missile, Air Force	0.10	0.13	32	84
Patriot Missile	1.45	1.89	30	229
GLCM Missile	3.86	5.03	30	140
EA-6B Aircraft	51.50	66.60	29	91
Sparrow Missile, Air Force	0.14	0.18	26	38
Trident Submarine	1,533.80	1,848.00	20	314
Phoenix Missile	1.00	1.19	20	57
Stinger Missile, Army	0.08	0.09	16	20
Light Armored Vehicle, Marine Corps	0.60	0.69	16	11
Cost Effect of 18 Other Systems Showing Unit Price Increases				674
Cost Effect of 25 Other Systems Showing Unit Price Decreases				-1,098
Total Impact of 60 Systems				2,554

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

a. Percent change and cost impact were calculated prior to rounding procurement unit costs.

TABLE IV-15. CHANGE IN QUANTITY AND PROCUREMENT UNIT COST OF SELECTED WEAPONS IN THE ADMINISTRATION'S 1984 ACQUISITION PLANS BETWEEN FEBRUARY 1982 AND JANUARY 1983 (In percents)

Weapon System	Quantity Change	Procurement Unit Cost Change
Decreasing Quantity and Increasing Cost		
Patriot missile	-21	30
Stinger missile, Army	-54	16
Hellfire missile	-14	9
M-1 tank	-33	10
A-6E aircraft	-25	6
F-14 aircraft	-20	4
F/A-18	-13	1
SH-60B helicopter	-67	59
Trident I missile	-28	14
Tomahawk missile	-60	47
Sparrow missile	-43	40
Sidewinder missile	-22	14
Phoenix missile	-19	20
HARM missile, Navy	-8	35
Laser Maverick missile, Navy	-53	95
Light Armored Vehicle, Marine Corps	-20	16
Captor torpedo system	-50	15
F-15 aircraft	-20	6
MX missile	-49	79
Sparrow missile, Air Force	-52	26
Maverick missile, Air Force	-43	32
C-5 aircraft	-60	40
Increasing Quantity and Decreasing Cost		
AH-64 helicopter	17	-12
AV-8B aircraft	7	-6
Fighting vehicle	8	-4
T-34C aircraft	36	-6

SOURCE: Compiled by CBO from data supplied by the Department of Defense.

year. The data in Table IV-15 suggest that this technique may have been used for some of these weapons.

The most recent DoD study indicates that real cost growth between 1975 and 1980 in major weapons systems alone has averaged 3.5 percent per year. 2/ If the Administraton's attempts to curb this cost growth fail and this trend continues, the Administration's estimates for major weapons systems procurement from 1984 to 1988 would have to be increased by a total of about $69 billion, or more quantities would have to be cut in future years which would result in further increases in procurement unit costs.

Research and Development. The current R&D program for 1984 shows an increase of $2.1 billion over the program presented last year. Air Force strategic programs constitute $1.5 billion of this increase. Included is about $730 million more for an MX missile closely spaced basing (CSB) system, compared with the less expensive interim basing plan of February 1982. The balance of the increase is devoted to tactical programs of the Navy and the Air Force.

Spare Parts Purchases. Since last year's budget submission, the Administration plans to increase the peacetime inventory of spare parts. This requires a funding increase for defense stock funds of $2.0 billion compared to Administration estimates of a year ago. The Air Force stock funds would receive $1.6 billion of this amount, the largest share of the proposed increase, to support the weapons scheduled for delivery in 1984.

Military Personnel. Military personnel appropriations for 1984 would be $400 million larger in the latest budget request than projected a year earlier. Of this amount, $200 million would fund estimated payments of unemployment compensation to persons leaving military service. The remaining $200 million would fund higher estimates of costs for moving expenses and other items.

Nuclear Materials. All categories of the atomic energy defense account--namely weapons research; development, test, and production; weapons materials production and waste management; naval reactor development; and other research programs--were increased over the previously proposed 1984 levels. The total increase is $400 million.

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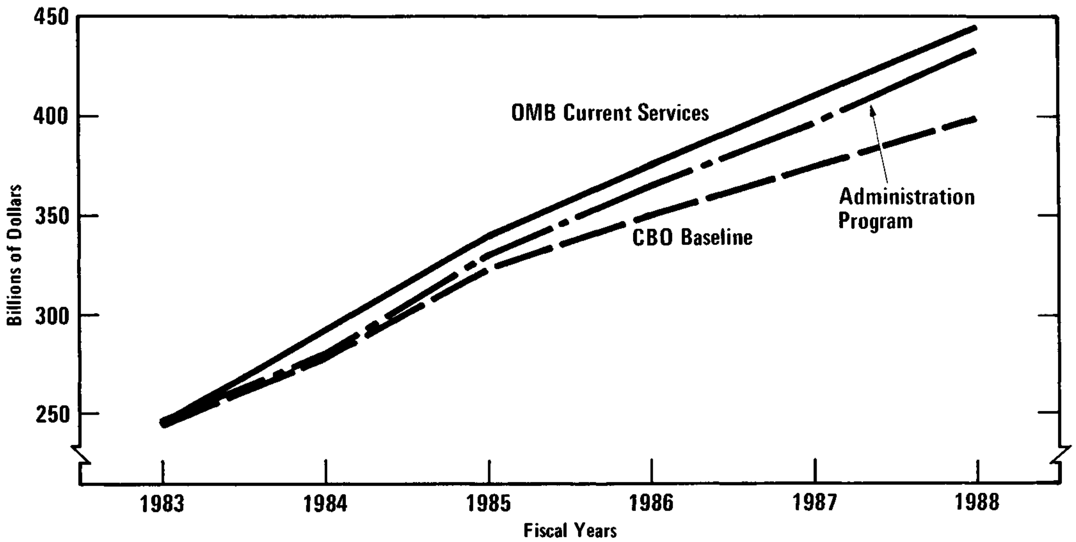
2. Milton A. Margolis, "Improving Cost Estimating in the Department of Defense," Concepts, vol. 4, no. 2 (Spring 1981), p. 8 (data are derived from DoD Selected Acquisition Reports); and Stephen Gross, "Program Cost Growth in the Department of Defense as of December 31, 1980," (paper prepared by the Air Force Data Services Center, undated).

CHANGES FROM CURRENT POLICIES

Figure IV-5 shows that the Administration's 1984 defense budget can be interpreted as a reduction or an increase, depending on what measure is used as current policy. The latest budget is a reduction from the Administration's 1982 projection for 1984, but an increase over the 1984 targets in the First Concurrent Resolution on the Budget for Fiscal Year 1983. 3/ This section focuses on changes when measured against previous Administration and Congressional plans.

Figure IV-5.

Comparison of Administration Defense Program and Current Policies (Budget Authority)



SOURCES: *Budget of the United States Government, Fiscal Year 1984;* and Congressional Budget Office.

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3. While the CBO baseline projections assume the defense spending levels provided in the 1983 Congressional budget resolution, the OMB current services projections assume the levels of defense spending requested by the Administration in February 1982.

The Administration has assessed its new budget plan against its current services estimates that include the funding request presented last year for the Department of Defense-Military. As shown in Table IV-16, the Administration's national defense budget would reduce 1984 budget authority by $11 billion and outlays by $8 billion; over five years the reductions would total $55 billion in budget authority and $47 billion in outlays.

TABLE IV-16. THE ADMINISTRATION'S NATIONAL DEFENSE BUDGET FOR 1984-1988 COMPARED WITH ITS CURRENT SERVICES ESTIMATES (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Total
Administration's Current Services Estimates						
Budget Authority	291.8	339.4	375.4	408.7	445.1	1,860.4
Outlays	253.7	293.4	332.2	364.7	396.6	1,640.6
Administration's Budget						
Budget Authority	280.5	330.0	364.8	397.0	432.7	1,805.0
Outlays	245.3	285.3	323.0	354.3	385.6	1,593.5
Savings						
Budget Authority	11.3	9.4	10.6	11.7	12.4	55.4
Outlays	8.4	8.1	9.2	10.4	11.0	47.1

SOURCE: Compiled by CBO from data supplied by the Office of Management and Budget.

In general, the Administration intends to achieve these savings without jeopardizing previous initiatives for new force modernization and improved readiness. Net savings are to be accomplished through such means as a pay freeze in 1984, lower inflation estimates (including lower fuel prices), and rescheduling of selected programs. For example, in 1984 the $11 billion in savings can be traced to three sources. First, the Administration's plan of a year ago anticipated that military pay would be increased by 8 percent in 1983 and 7.6 percent in 1984; the plan expected civilian pay raises of about 5 percent in each year. However, the actual 1983 pay raise was 4 percent for all federal employees and the Administration now proposes no pay raise for 1984, saving a combined $6 billion from last year's budget. Second, the reduction of the 1983 COLAs for retirees under 62 in the Omnibus Reconciliation Act of 1982, coupled with the Administration's proposal to eliminate cost-of-living adjustments for military retirees in 1984, would save about $1 billion from last year's budget. Finally, the Administration's economic forecast calls for less inflation than it expected a year ago, thereby saving about $4 billion in budget authority.

From the perspective of the Congress, however, the Administration's current services estimates may not be the appropriate base from which to assess the Administration's 1984 budget request. This different view could arise because the current services estimates include a restoration of the budgetary reductions implicit in the national defense targets set by the Congress in the first budget resolution for fiscal year 1983. In that budget resolution, the Congress reduced the Administration's defense budget authority request by $13 billion and $16 billion for 1984 and 1985, respectively--the final two years covered by the 1983 resolution.

CBO's baseline projections for national defense are consistent with the defense targets in the first budget resolution for 1983, which covered only the years 1983-1985. CBO estimated spending beyond 1985 by lowering Administration spending targets by about 2 percentage points. That reduction was the average real growth cut imposed by the budget resolution relative to Administration spending plans for the 1983-1985 period. When the Administration's budget for national defense, as reestimated by CBO is compared with CBO's baseline projections, the Administration's program represents an increase in budget authority of $2 billion in 1984 and a total of $81 billion for the 1984-1988 period, as shown in Table IV-17. (CBO's reestimates are discussed below.)

Thus, when compared to CBO's baseline for national defense, the Administration's budget request appears to have restored $2 billion of the $13 billion targeted for reduction by the Congress for 1984. The remaining $11 billion of funding reductions result from repricing the pay raise, lower COLAs, and lower inflation assumptions. In other words, despite the small difference in 1984, the Administration's plan includes almost none of the program reductions anticipated in the Congressional resolution and would exceed the resolution even more if it were adjusted for the resolution's pay and inflation assumptions. The program changes the Administration did make to its previous plan for 1984 take the form of significant reallocation of funds among programs, as discussed in the preceding section.

Finally, Table IV-18 shows the difference between the CBO and the Administration estimates of the outlays from the Administration's 1984 program. These estimates assume Congressional approval of the $1.6 billion

TABLE IV-17. THE ADMINISTRATION'S NATIONAL DEFENSE BUDGET AS REESTIMATED BY CBO FOR 1984-1988, COMPARED WITH CBO'S BASELINE PROJECTIONS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Total
CBO Baseline						
Budget Authority	278.3	322.4	350.0	373.0	398.0	1,721.7
Outlays	242.1	277.7	310.0	333.0	358.0	1,520.8
Administration's Budget as Reestimated by CBO						
Budget Authority	280.2	329.6	364.3	396.4	432.1	1,802.6
Outlays	244.7	282.3	321.6	357.5	389.8	1,595.9
Increases						
Budget Authority	1.9	7.2	14.3	23.4	34.1	80.9
Outlays	2.6	4.6	11.6	24.5	31.8	75.1

SOURCE: Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1984-1988 (February 1983), pp. 42-46; and data supplied by the Department of Defense.

supplemental for 1983 and the proposed rescission of $650 million of previously appropriated budget authority, both of which are to be submitted later.

On the basis of its analysis of historical spending patterns, CBO estimates that outlays would be somewhat lower through 1986, but about $2 billion higher over the six-year period than the Administration estimates. Budget authority would be the same, except for small differences in military retirement pay caused, in part, by differences in economic assumptions. The estimating differences are relatively small, no more than 1.1 percent in any one year, and represent a narrowing of differences from a year ago. The CBO and Administration estimates have tended to converge over time because the Administration appears to have raised its estimates and CBO has lowered its own.

TABLE IV-18. CBO REESTIMATES OF THE ADMINISTRATION'S DEFENSE BUDGET IN OUTLAYS (By fiscal year, in billions of dollars)

Category	1983	1984	1985	1986	1987	1988	Total 1983-1988
Administration's Budget	214.8	245.3	285.3	323.0	354.3	385.6	1,808.3
CBO Reestimates							
Economic	a/	a/	a/	-0.1	-0.2	-0.3	-0.6
Technical							
Procurement	-0.1	-1.7	-3.4	-1.8	1.9	3.5	-1.7
Operations	0.2	1.7	0.4	0.4	0.7	0.7	4.1
All Other, Net	-0.7	-0.6	0.1	0.1	0.9	0.3	0.1
Subtotal	-0.5	-0.6	-2.9	-1.4	3.5	4.5	2.5
Total Reestimates	-0.5	-0.6	-3.0	-1.5	3.3	4.2	1.8
CBO Reestimate of Administration's Budget	214.2	244.7	282.3	321.6	357.5	389.8	1,810.1

SOURCE: Budget of the United States Government, Fiscal Year 1984; and Congressional Budget Office.

a. Less than $50 million.

POTENTIAL REDUCTIONS

Much of the current debate about the Administration's defense budget request is motivated by efforts to reduce the 1984 deficit. It is important to understand that funds for some defense programs are appropriated in one year, but are spent over a number of years. Thus, a decision to cancel some investment programs in the 1984 budget would produce only a small fraction of outlay savings in 1984 compared with the total amount of funds requested. The following breakdown of the source of defense outlays in the 1984 budget helps to illustrate this problem.

- o 35 percent ($85 billion) of national defense outlays for 1984 result from budget authority provided in 1983 (including proposed supplementals) and earlier years.

- o 37 percent ($90 billion) of 1984 outlays relate to proposed 1984 budget authority to pay the active duty military and civilian defense personnel, plus pensions for retired personnel.

- o 14 percent ($35 billion) of 1984 outlays are for operating and support costs, including training, logistics, and various personnel support activities that sustain current force readiness.

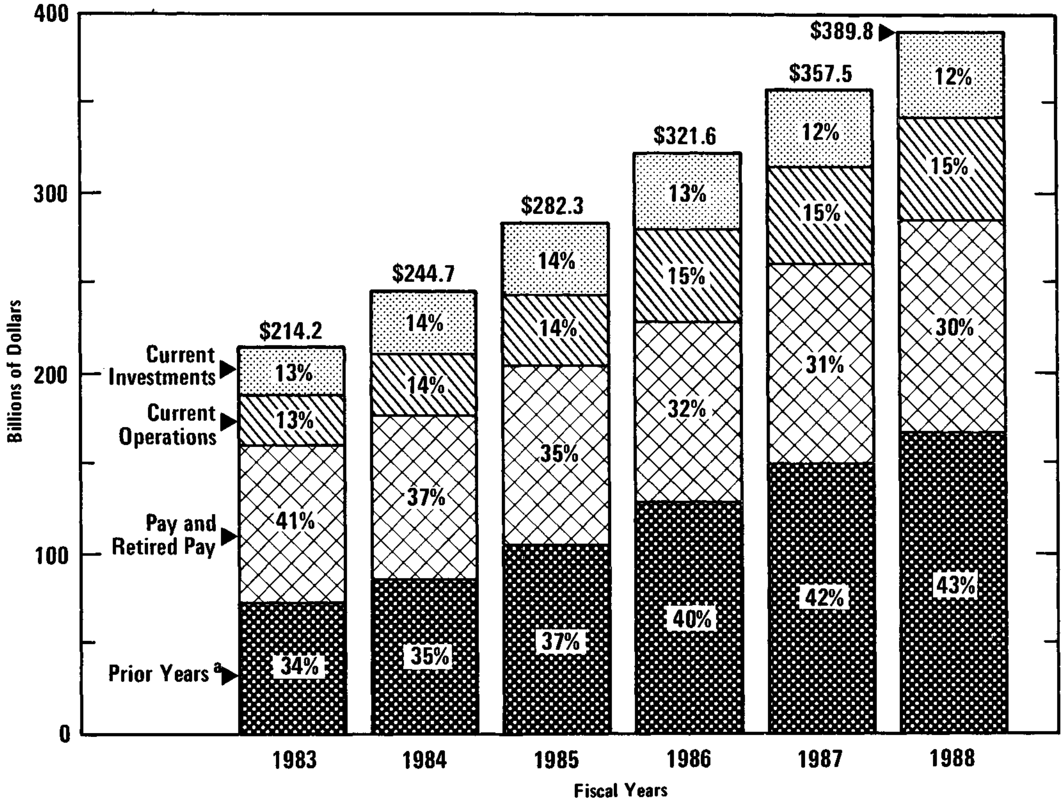
- o 14 percent ($35 billion) of 1984 outlays stem from 1984 budget authority for modernization through new weapons procurement, research and development, and military construction.

Reducing the $85 billion of 1984 outlays from prior-year budget authority would require cancellation, delay, or termination of programs already approved, often already under contract, and, in some cases, partially manufactured. Substantial financial penalties could result if the government canceled orders for partially built weapons or if the rate of production was substantially slowed. The preponderance of programs in this category represent fully funded orders for major weapons systems and construction that expend appropriations over several years. These characteristics mean that 1984 outlay savings would be only a small portion of the ultimate outlay reductions from cutting such programs.

Similar problems affect other categories. For example, if none of the $94.1 billion budget authority requested for weapons systems procurement was appropriated in 1984, outlays in that year would decline by less than $13 billion, because so much of the budget authority would be spent after 1984 when most production would occur. Thus, to achieve a high proportion of 1984 outlay savings from the Administration's 1984 request would require cuts other than those proposed for investments to improve future modernization. Immediate effects could be obtained by trimming purchases with relatively short order-to-delivery times, such as fuel, spare parts, and depot maintenance, all of which would affect current readiness, or by cutting personnel levels, which would reduce available forces.

Under the Administration's plan, the share of outlays from prior years' funding would rise steadily from 34 percent in 1983 to 43 percent in 1988 (see Figure IV-6). Thus, by currently approving programs with a larger

Figure IV-6.
Composition of National Defense Outlays



SOURCE: Congressional Budget Office.

[a] Outlays from prior years' budget authority.

modernization component, the Congress risks an out-year dilemma characterized by intensified competition for resources between modernization and readiness needs. If future defense budgets fall short of the real growth targets assumed here, the portion of total outlays required to finance previous years' programs would increase. This shift would further limit the Congress's flexibility to control defense outlays. It is not necessarily undesirable that larger shares of total outlays result from prior years' funding; what is important is that future outlay ceilings conform to Congressional program priorities and balance between readiness, modernization, and force growth.

In order to illustrate some of the choices that the Congress may have if it wishes to reduce the 1984 defense budget, Table IV-19 shows some options assuming fixed growth rates and specific program adjustments. While these options illustrate the outlay impact of various approaches to reducing the defense budget, they do not address a more difficult question that the Congress faces: which specific programs and systems are to sustain the reduced funding?

One set of options provides a fixed real growth rate for budget authority and usually assumes reductions would be made proportionally across defense purchases. These options establish a broad statement of defense funding priority relative to other government functions without providing much information concerning relative program emphasis within the defense budget. Table IV-19 shows the savings relative to the President's budget achieved by limiting real budget authority growth to 5 and 3 percent.

A second set of options could include a more deliberate approach to program trade-offs and might involve substituting lower levels of real growth for selected defense budget accounts. The Administration's budget provides substantial real growth in most accounts and, in this sense, emphasizes both readiness and modernization. CBO's baseline contains a projection showing that real increases through 1988 in these accounts follow from Congressional action on the 1983 budget, but to a lesser extent than in the Administration's request. For example, CBO projects the need for 4 percent real growth by 1988 in military personnel and operations and maintenance (O&M) to keep unit readiness at the levels funded in 1983. 4/ The President's budget shows about 27 percent real growth in these accounts by 1988, with the corresponding increase in readiness. If one judges readiness to be adequately funded in 1983, an option could contain a modernization emphasis simply by keeping the President's program in all areas except military personnel and O&M; such an option would save $107 billion in budget authority over the 1984-1988 period.

Similarly, CBO projects continued real growth (averaging about 4.5 percent annually for 1984-1988) in the procurement accounts consistent with appropriations for strategic and tactical force modernization in 1983 5/.

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4. See Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1984-1988 (February 1983), p. 105 for a list of the force levels supported by the military personnel and O&M projection.

5. See CBO, Baseline Budget Projections for Fiscal Years 1984-1988, p. 106 for a list of the investment programs funded by the CBO projections.

TABLE IV-19. COMPARISON OF THE ADMINISTRATION'S DEFENSE BUDGET WITH ALTERNATIVE BUDGET ASSUMPTIONS (By fiscal year, in billions of dollars)

Spending Level	1984	1985	1986	1987	1988	Cumulative Five-Year Savings
Administration's Request						
Budget Authority	281	330	365	397	433	
Outlays	245	285	323	354	386	
Savings Under Alternative Assumptions						
5 Percent Real Growth						
Budget Authority	14	31	33	28	23	129
Outlays	5	17	25	23	22	92
3 Percent Real Growth						
Budget Authority	19	42	52	55	60	228
Outlays	7	23	36	40	47	153
Slower Readiness Growth						
Budget Authority	8	16	23	29	32	107
Outlays	7	16	21	22	25	91
Slower Modernization Growth						
Budget Authority	2	16	22	27	28	94
Outlays	1	6	10	12	16	45

SOURCE: CBO and data supplied by the Department of Defense.

The Administration proposes substantially more funding for procurement--averaging 10 percent real growth per year for 1984-1988. This increased funding arises from changes in current programs and the out-year procurement of weapon systems now in the earliest stage of development. If one judges that continuation of current programs at current funding levels is adequate for the next five years, an option with the Administration's readiness initiatives and CBO's baseline procurement projection might provide the desired results in terms of savings and program balance. Readiness emphasis would save $94 billion in budget authority for 1984-1988.

All options discussed above entail rough approximations and much less precision than is ultimately required in making specific funding decisions. More detail and supporting analysis can be found in Chapter II of the CBO report, Reducing the Deficit: Spending and Revenue Options (February 1983).

CHAPTER V. THE ADMINISTRATION'S DOMESTIC BUDGET

With significant increases proposed in national defense outlays, the burden of spending restraint in the Administration's budget falls on domestic programs. As estimated by CBO, total nondefense spending in fiscal year 1984, on the unified budget, is projected to reach $596 billion. This represents an increase of just 1.5 percent above the 1983 estimate, compared with the 14 percent nominal growth in outlays projected for national defense. 1/ Excluding net interest, 1984 nondefense outlays would total $500 billion, the same as currently estimated for 1983. Because an increase of 4.7 percent would be required to keep pace with inflation, the Administration's 1984 budget implies a reduction in real nondefense spending (excluding net interest) of close to 5 percent below the 1983 level. This compares with 9-10 percent real growth in outlays for national defense for 1984 proposed by the Administration.

The 1984 budget continues the trends of the past few years. The rate of increase in domestic spending has been significantly slowed by decisions of the 97th Congress, through the reconciliation process, appropriations restraint, and other legislative actions. These actions have reduced nondefense outlays (excluding interest savings) by about $60 billion a year below the level that would have resulted from maintaining 1981 spending policies. Reductions of over $30 billion a year have been made in entitlement programs, including cuts in farm price supports, Medicare, Social Security, unemployment compensation, and the nutrition and income assistance programs. Discretionary spending has also been reduced, by about $26 billion a year, below the previous baseline levels. Consequently, nondefense spending (excluding net interest), which grew at an average rate of 13.8 percent per year from 1970 to 1981, will increase at a rate of only 5.1 percent per year from 1981 through 1988, under the Administration's budget plan. In contrast, defense outlays grew at an annual rate of only 6.7 percent from 1970 to 1981, but will grow by over 15 percent per year from 1981 to 1984, and by over 12 percent annually from 1984 to 1988, under the

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1. The Administration estimates that off-budget spending will decline from $17 billion in 1983 to $14 billion in 1984. Thus, aggregate domestic spending, both on and off budget, would grow by only $6 billion, or 1 percent, from 1983 to 1984. The Administration projects off-budget outlays to decline to $9 billion by 1988.

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President's plan. As a result, nondefense spending (excluding net interest), which accounted for over 67 percent of unified budget outlays in 1980, would drop to 59 percent in 1984, and to 54 percent in 1988.

The spending reductions proposed by the Administration span all the major categories of domestic spending--though some individual programs in each category are held even or increased in real terms. The largest cuts over the 1984-1988 period are in outlays for entitlements and other mandatory activities, which are reduced below the CBO baseline by $9 billion in 1984 and by $91 billion over the five-year period (see Table V-1). Reductions are also proposed for discretionary programs, totaling $5 billion in outlays in 1984 and $61 billion from 1984 through 1988. The budget also includes increases in offsetting receipts, which would reduce net spending by $2 billion in 1984 and by $25 billion over the five-year period. CBO estimates that savings in net interest costs resulting from the program changes and reduced deficits would total $30 billion from 1984 to 1988. In total, CBO estimates the Administration's domestic spending proposals would reduce the baseline deficit by $15 billion in 1984 and by $206 billion from 1984 to 1988.

The results of these reductions on the major components of the budget are shown in Table V-2. Under the Administration's plan, the fastest rising category of domestic expenditures would be outlays for Medicare and Medicaid, which would increase at a rate of almost 12 percent per year, growing from 2.4 percent of GNP in 1983 to 2.8 percent in 1988. These programs would account for 42 percent of the $136 billion increase in domestic spending from 1983 to 1988 under the President's budget proposals--despite the fact that the Administration proposals are estimated to reduce Medicare and Medicaid spending by $9 billion in 1988 and by more than $29 billion from 1984 through 1988. Social Security expenditures would rise at a much slower rate, about 6.4 percent per year--compared with projected increases under current law of 6.7 percent annually. Thus, the budget plan provides for a relatively small change in Social Security spending--about $5 billion in 1988 and $22 billion from 1984 through 1988, about a 2 percent reduction in outlays each year relative to the CBO baseline. Even with these savings, Social Security outlays would increase by $60 billion from 1983 to 1988, accounting for 44 percent of the growth in domestic spending. The outlay increases for Social Security, Medicare, and Medicaid combined, from 1983 to 1988, total $118 billion and represent 86 percent of the increase in domestic spending in that five-year period. Even with such large growth in dollar terms, outlays for these programs would remain unchanged as a percentage of GNP, at 7.5 percent.

The other major growth category is net interest, which would grow from $87 billion in 1983 to $116 billion in 1988, an increase of about 6

TABLE V-1. CBO ESTIMATE OF DOMESTIC SPENDING REDUCTIONS IN THE ADMINISTRATION'S 1984 BUDGET PLAN (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays - Domestic Programs	611	650	690	742	793	
Proposed Changes						
Entitlements and Other Mandatory Spending						
Social Security	-4	-4	-4	-5	-5	-22
Medicare and Medicaid	-2	-4	-6	-8	-9	-29
Other entitlements and mandatory spending	-3	-7	-9	-10	-11	-40
Nondefense discretionary spending	-5	-7	-11	-17	-21	-61
Net interest	*	-1	-5	-10	-15	-30
Offsetting receipts	-2	-4	-5	-6	-8	-25
Total Changes	-15	-27	-39	-55	-69	-206
President's Budget as Estimated by CBO	596	623	651	687	723	

* Less than $500 million.

percent per year. CBO estimates that, under the larger baseline deficits and without the policy changes implicit in the Administration's budget, net interest costs would grow an average of 8.5 percent annually, to $131 billion by 1988. Thus, the savings in other areas of the budget are projected to reduce net interest costs by $15 billion in 1988, and by a total of $30 billion from 1984 through 1988. As a result, net interest as a percentage of GNP would decline from 2.7 percent in 1983 to 2.4 percent in 1988.

TABLE V-2. THE ADMINISTRATION'S DOMESTIC BUDGET AS ESTIMATED BY CBO (By fiscal year)

	1983	1984	1985	1986	1987	1988
			Outlays in Billions of Dollars			
Entitlements and Other Mandatory Spending						
Social Security benefits	164	174	185	197	210	224
Medicare and Medicaid	76	84	94	105	118	133
Other entitlements and mandatory spending	145	128	124	128	130	135
Nondefense Discretionary Spending	145	147	152	156	160	163
Net Interest	87	96	105	110	114	116
Offsetting Receipts	-31	-33	-38	-44	-46	-48
Total	587	596	623	651	687	723
			Outlays as a Percent of GNP			
Entitlements and Other Mandatory Spending						
Social Security benefits	5.1	5.0	4.8	4.8	4.7	4.7
Medicare and Medicaid	2.4	2.4	2.5	2.5	2.7	2.8
Other entitlements and mandatory spending	4.5	3.7	3.2	3.1	2.9	2.8
Nondefense Discretionary Spending	4.5	4.2	4.0	3.8	3.6	3.4
Net Interest	2.7	2.7	2.7	2.7	2.6	2.4
Offsetting Receipts	-1.0	-1.0	-1.0	-1.1	-1.0	-1.0
Total	18.4	17.0	16.3	15.7	15.4	15.1

Three other components of the budget grow more slowly or decline under the President's proposals. Nondefense discretionary spending would rise from $145 billion in 1983 to $163 billion in 1988, an average of 2.4 percent per year. Almost $6 billion of this increase is attributable to highway spending resulting from the recently enacted Surface Transportation Assistance Act of 1982 (Public Law 97-424). All other discretionary spending is projected to increase by 8.5 percent, in total, from 1983 to 1988, an annual rate of 1.6 percent. Federal pay raises and increases in retirement contributions account for most of this remaining increase, and other spending remains virtually constant in the aggregate for the five-year period. About $61 billion, or almost 30 percent of the savings in the President's budget, relative to the baseline projections, fall in this category--and 1988 outlays would be about 11 percent below the baseline level. Consequently, nondefense discretionary spending would fall from 4.5 percent of GNP in 1983 to 3.4 percent in 1988.

Spending for entitlements and mandatory programs, other than Social Security, Medicare, and Medicaid, will decline, under the Administration's plan, from $145 billion in 1983 to $135 billion in 1988, dropping from 4.5 percent of GNP to 2.8 percent. A large part of this reduction is attributable to projected changes in the economic environment. Gradually declining unemployment is expected to result in a $7 billion drop in outlays for unemployment compensation, and diminishing crop surpluses are projected to make possible a $6.5 billion reduction in farm price support payments. In addition, the President is proposing legislation that would save about $10 billion in 1988, and a total of $40 billion over the five-year period. The largest legislative savings would be for farm price supports, federal employee retirement and disability programs, and food stamps.

Growth in offsetting receipts will also result in declining net outlays under the Administration plan. Normal growth, under current law, will produce a $9 billion increase in receipts by 1988. In addition, the budget plan includes a number of legislative initiatives that would add another $8 billion in receipts in 1988, and a total of $25 billion between 1984 and 1988. Of this total, about $10 billion reflects increased intragovernmental payments for the government's share of employee retirement contributions, which are offset in discretionary spending and do not represent net savings. In sum, offsetting receipts are projected to rise by over $17 billion from 1983 to 1988.

Each of these major spending categories will be discussed in more detail in the remainder of the chapter.

ENTITLEMENTS AND OTHER MANDATORY SPENDING

Entitlement programs provide benefits to persons, businesses, or units of government that meet eligibility requirements established in law. Social Security is the largest single entitlement program with outlays constituting about 20 percent of the entire federal budget. Other major entitlement programs include civil service retirement and disability, railroad retirement, and veterans' compensation; Medicare and Medicaid; farm price supports; Aid to Families with Dependent Children (AFDC), Supplemental Security Income (SSI), food stamps, and veterans' pensions; unemployment insurance; guaranteed student loans and veterans' readjustment benefits. Military retirement, also an entitlement, is not included in this section but is covered in Chapter IV on the defense budget.

Table V-3 shows outlays for entitlements and other mandatory spending programs proposed in the Administration's budget. Proposed spending in this category increases by $107.2 billion between 1983 and 1988. The fastest growing programs are Medicare, Medicaid, and Social Security. Medicaid and Medicare together grow by 76 percent and Social Security grows by 37 percent. The programs showing the greatest decline are unemployment insurance and farm price supports.

The President's budget proposes legislative initiatives in almost every major entitlement program. It proposes to reduce spending from current law levels in Social Security, Medicare, Medicaid, civil service retirement, AFDC, food stamps, guaranteed student loans, child nutrition, farm price supports, and other programs. As noted above, these legislative initiatives, if enacted, would reduce entitlement spending from CBO's baseline projections by almost $9 billion in 1984 and by $91 billion in the 1984-1988 period. These savings are shown in Table V-4. Only in unemployment insurance and in SSI are increases requested. The Administration proposes to extend the federal supplemental compensation program for the latter half of 1983 and to increase the income disregard in SSI to compensate partially for requested reductions in Social Security. These proposals would add to the legislative and administrative actions taken during the 97th Congress that have already reduced baseline spending for entitlement and other mandatory spending by $177 billion over the 1984 to 1988 period.

Proposals to reduce the growth in entitlement spending have been a consistent theme of all three of the Reagan Administration's budgets and represent a reversal of the policies and practices of the previous decade. During the 1970s, entitlement spending grew from $65 billion in 1970 to $267 billion in 1980, a fourfold increase.

TABLE V-3. PROPOSED OUTLAYS FOR ENTITLEMENTS AND OTHER MANDATORY SPENDING PROGRAMS AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Social Security Benefits	164.2	173.5	184.8	197.2	210.2	224.4
Other Retirement and Disability Programs	39.2	41.2	42.2	45.2	46.7	49.2
Medicare and Medicaid	75.9	83.8	94.2	105.1	118.5	133.4
Food Stamps, SSI, AFDC and Veterans' Pensions	33.2	30.7	31.4	32.3	33.2	34.8
Unemployment Benefits	32.8	25.9	24.6	24.2	24.0	23.8
Farm Price Supports	18.2	10.0	8.4	8.6	8.4	8.7
Other a/	21.6	20.6	17.7	17.1	17.4	17.9
Total	385.1	385.7	403.2	429.8	458.5	492.3

a/ A variety of programs providing educational assistance, nutrition assistance, aid to state and local governments, and aid to certain businesses.

Part of the growth in entitlement spending in the 1970s reflected increasing prices. Many of the benefits are indexed directly to changes in prices or respond more or less automatically to such changes. The growth in entitlement programs in the 1970s, however, far exceeded the increase in prices. Even after adjusting for price changes, entitlement spending grew at an average annual rate of 6.9 percent between 1970 and 1980, or from 6.7 percent of GNP in 1970 to 10.5 percent in 1980. As a percent of the federal budget, entitlement spending rose from 33 percent in 1970 to 47 percent in 1980.

This rapid real growth in the 1970s resulted in part from a natural growth in eligible recipients, but also from program liberalization and expansion. Some of the more important legislative changes during the 1970s

TABLE V-4. CBO ESTIMATE OF ADMINISTRATION'S PROPOSED REDUCTIONS IN ENTITLEMENTS AND OTHER MANDATORY SPENDING (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays - Entitlements and Other Mandatory Spending	394.6	418.4	448.7	481.2	517.6	
Proposed Changes						
Social Security	-3.8	-4.2	-4.3	-4.5	-4.9	-21.7
Medicare and Medicaid	-2.5	-3.9	-5.6	-8.1	-9.1	29.2
Other retirement and disability programs	-0.7	-1.4	-1.8	-2.2	-2.5	-8.5
Food stamps, SSI, AFDC and veterans' pensions	-1.0	-1.3	-1.4	-1.3	-1.2	-6.2
Farm price supports	-0.4	-1.6	-2.2	-2.8	-3.0	-10.0
Other	-0.4	-2.7	-3.7	-3.8	-4.5	-15.1
Total Changes	8.9	15.1	18.9	22.6	25.2	-90.8
President's Budget as Estimated by CBO	385.7	403.2	429.8	458.5	492.3	

included: 15, 10, and 20 percent increases in Social Security benefits in 1970, 1971, and 1972; the indexing of Social Security benefits to the CPI (1975); the start of the SSI program (1974); the expansion of Medicare eligibility to the disabled (1972); the mandating of the food stamp program to all counties (1974); and the elimination of the food stamp purchase requirement (1979).

The President's proposals would halve the real rate of growth in entitlement spending over the five-year period, from about 2 percent per year in constant dollars to about 1 percent. The President's legislative proposals and recent trends in the major entitlement programs are discussed in more detail below.

Social Security

The Old Age and Survivors Insurance (OASI) and Disability Insurance (DI) programs are expected to pay benefits totaling $177.3 billion to 37 million retired and disabled workers, their dependents, and survivors during fiscal year 1984. Outlays under existing law are estimated to increase 6.4 percent per year, with an average annual real growth rate of 1.8 percent.

The President's budget generally incorporates the recommendations of the National Commission on Social Security Reform. The commission was created in December 1981 to address the continuing deterioration of the financial position of the OASI trust fund. Members were appointed by the President, the Majority Leader of the Senate, and the Speaker of the House of Representatives. The bipartisan commission submitted its findings and recommendations on January 20, 1983, and the recommendations were quickly factored into the President's budget to meet the January 31st budget release date. The estimated outlay impact of the commission's proposals included in the President's budget for Social Security benefits are shown in Table V-5.

TABLE V-5. PROPOSED FUNDING CHANGES FOR SOCIAL SECURITY BENEFITS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	177.3	189.0	201.6	214.7	229.3	
Proposed Changes						
Six-month delay in cost-of-living adjustment	-3.8	-4.2	-4.5	-4.7	-5.2	-22.4
Miscellaneous Benefit Provisions	0.1	0.1	0.2	0.2	0.3	0.9
Total Changes	-3.8	-4.2	-4.3	-4.5	-4.9	-21.7
President's Budget as Estimated by CBO	173.5	184.8	197.2	210.2	224.4	

The only major proposal that would reduce outlay growth affects the cost-of-living adjustment (COLA). Currently, this adjustment is made to the June payment, payable in July of each year, and is equal to the change in the Consumer Price Index from the first quarter of the previous year to the first quarter of the current year. The President's budget, following the commission's recommendations, would delay this annual increase to the December benefit amount payable in January. Further, beginning in January 1985, the increase would be determined on the basis of the growth in the CPI from the third quarter of the previous year to the third quarter of the current year.

The six-month delay in the COLA, combined with adjustment in the indexing period, is estimated to save $1.7 billion in 1983, and $22.4 billion during the next five years (1984-1988). The change would affect the benefit payments of almost all the 37 million recipients. In 1984, these COLA adjustments would reduce the average yearly benefit from the baseline level by approximately $110 per person, or 2 percent.

A number of other minor proposals in the President's budget would mean, on balance, a small cost to the Social Security system. The largest of these miscellaneous changes would increase the benefit rate for disabled widows and widowers aged 50 to 59 to be the same as that for non-disabled widows and widowers first claiming benefits at age 60. This is estimated to cost $1 billion over the period. Other changes provide for increased benefits for certain groups of divorced or surviving beneficiaries, and for decreased benefits to persons with relatively short periods of work covered by Social Security. Together, these provisions would have a negligible impact on the budget.

Reducing benefits for all Social Security recipients, even by a small amount, would be a departure from recent practice. The reductions in the 1981 reconciliation act, for example, were targeted at particular groups of recipients: benefits for full-time college students between the ages of 18 and 22 and for parents of children aged 16 to 18 were phased out, the minimum benefit was eliminated for new recipients, and the lump sum death benefit was modified. Other efforts have focused on reducing the rate of growth of the DI program. Following a provision of the disability amendments of 1980, the Social Security Administration has been reviewing all continuing disability cases to assure that the recipients are still disabled. Partly as a result of these initiatives, the disability caseload has been falling for almost two years.

Most of the commission's proposals in the budget address the trust fund receipts. The proposals include taxing 50 percent of Social Security benefits for recipients with adjusted gross incomes of at least $20,000 if single and $25,000 for married couples filing jointly, increasing payroll taxes, and extending coverage to newly hired federal civilian workers and all employees of nonprofit organizations. Finally, the President's budget includes a commission proposal to transfer from the general fund $20 billion in 1983 for military wage credits and for benefit checks that were not cashed in past years. These revenue proposals are shown in greater detail in Chapter III.

The total impact on the OASDI trust funds from the reductions in trust fund outlays and the increase in income over the 1984-1988 period is a saving of $114 billion. The impact on the unified federal budget, however, is far less. There are several reasons for this. First, payments from the Treasury to the trust funds, such as interest payments on investments, are income to the trust funds but not to the federal government as a whole. Second, tax credits and tax deductions that offset some of the increases in Social Security taxes lower the net revenue gain to the government. Third, the budget shows new federal employees paying into Social Security. It is the intent of the Administration that revenues not change as a result of adding new federal employees to Social Security. The new employees are expected to pay into the civil service trust fund the difference between the civil service contribution for current employees and the Social Security tax. Finally related changes in SSI, railroad retirement, SMI premiums, Medicaid, and food stamps will affect the federal deficit without affecting the trust funds. Table V-6 shows CBO's estimate of the unified budget impact of the commission recommendations included in the President's budget. Over the five-year period, 1984-1988, these proposals would reduce the projected deficits by nearly $70 billion. Three quarters of the deficit would be produced by increased revenues.

Other Retirement and Disability Programs

The federal government provides benefits to the retired or disabled through several programs other than Social Security. Benefits are provided to former federal employees through civil service retirement and disability. Former railroad employees are compensated through the railroad retirement program. Veterans with service-connected disabilities may qualify for benefits from the veterans' compensation program. Taken together, these programs are expected to spend $39.2 billion in fiscal year 1983, and to increase gradually to $49.2 billion by 1988 (Table V-3).

The President's budget contains several proposals for reducing outlay growth in these programs from current law levels (see Table V-7).

TABLE V-6. ESTIMATED IMPACT OF THE NATIONAL COMMISSION ON SOCIAL SECURITY REFORM'S PROPOSALS ON THE UNIFIED BUDGET DEFICIT (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
Outlay Reductions						
Social Security						
COLA delay	3.8	4.2	4.5	4.7	5.2	22.4
Other proposals	-0.9	-1.1	-1.0	-1.0	-1.2	-5.2
Subtotal	2.9	3.1	3.5	3.7	4.0	17.2
Revenue Changes						
Social Security revenue increases	9.7	11.5	10.1	11.5	23.7	66.6
Loss in income tax revenues	-1.6	-6.3	-2.0	-2.4	-4.0	-16.3
Subtotal	8.2	5.2	8.1	9.2	19.7	50.4
Total Reduction in Budget Deficit	11.1	8.3	11.6	12.9	23.7	67.6

Civil Service Retirement. The President's budget includes proposals for civil service legislation to reduce benefits for early retirement, change the annuity calculation from the highest three years of earnings to the highest five years, freeze the 1984 cost-of-living increase, and continue the reduction in COLAs for optional retirees under age 62. These proposals would produce savings of $5 billion from projected current law levels during 1984-1988. Also, the President's budget proposes to increase contributions from employees' salaries and matching employer contributions from the current 7 percent to 9 percent in 1984 and to 11 percent in 1985.

While most of the outlay savings from the CBO baseline in 1984-1988 result from the COLA freeze, the most significant long-run change is the reduction in benefits for early retirement. Currently, a worker with 30

TABLE V-7. PROPOSED FUNDING CHANGES FOR OTHER RETIREMENT AND DISABILITY PROGRAMS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	41.9	43.6	47.0	48.9	51.7	
Proposed Changes						
Civil service retirement and disability						
Change annuity calculation and reduce benefits for early retirement	*	-0.1	-0.1	-0.3	-0.4	-0.9
COLA change	-0.3	-0.8	-0.9	-1.0	-1.1	-4.1
Railroad retirement	---	---	---	---	---	
Veterans' compensation						
COLA change	-0.2	-0.3	-0.3	-0.4	-0.5	-1.7
Retired commissioned health officers, Foreign Service retirement, Coast Guard retirement, black lung, and special benefits for disabled coal miners						
COLA change	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
Other changes	*	*	-0.3	-0.3	-0.3	-0.9
Total Changes	-0.7	-1.4	-1.8	-2.2	-2.5	-8.5
President's Budget as Estimated by CBO	41.2	42.2	45.2	46.7	49.2	

* Less than $50 million.

years of service may retire at age 55 with full benefits. The Administration proposes to phase in over ten years a 5 percent reduction in benefits for each year a worker chooses to retire before age 65. Those 55 or older at enactment would not be affected by this benefit reduction.

The President's budget continues the reductions in civil service retirement outlays that have occurred since 1981. Most of the changes have centered around the COLAs. Spending reductions during the 97th Congress included replacing twice-a-year COLAs with an annual COLA based on changes in the CPI, reducing the COLA for those under 62 in 1983-1985, and delaying the COLA one month each year in 1983-1985.

The spending reductions of the 97th Congress as well as the President's proposed cuts follow a period of rapid growth for federal retirement outlays. Between 1970 and 1980, civil service retirement outlays increased from $2.8 billion to $14.7 billion, reflecting increases in COLAs and also a growth in the number of recipients. Annuitants grew from about 1 million in 1970 to 1.7 million in 1980, while active employees remained at about 2.7 million. Deductions from employees' salaries accounted for 62 percent of outlays in 1970, but only about 24 percent in 1980. While employee contributions grew from $1.7 billion in 1970 to $3.6 billion in 1980, reflecting the approximate doubling of salaries that occurred over the decade, COLAs increased average retirement benefits by about 125 percent.

In response to these changes in the balance of contributions and outlays, the Administration proposes to increase employee and employer contributions as well as to reduce benefits. Raising employer and employee contributions to 11 percent of pay would bring contributions to about 27 percent of 1988 outlays, assuming all of the proposed savings legislation was enacted. During the 1984-1988 period, federal employment is projected to be relatively constant, with new workers being included in Social Security; and annuitants are assumed to increase from about 1.9 million to 2.2 million.

Railroad Retirement. The railroad retirement program pays benefits to retired and disabled railroad workers, their dependents and survivors. In general, these benefits contain both a Social Security component and a railroad pension component. The system is financed by a payroll tax on railroad workers and by general fund transfers.

The President's budget proposes no legislative initiatives for railroad retirement. Nevertheless, beneficiaries would receive a reduction in their benefits. Because employment in the railroad industry has fallen nearly 20 percent over the past two years, the system faces a funding problem. Trust fund revenues are insufficient to meet all the liabilities. Under provisions in the railroad amendments of 1981, benefits must be reduced in the railroad retirement pension portion of the program by an amount equal to the projected unfinanced liability. The law also requires that the Social Security portion of the benefit payment be paid in full. The estimated amount by which railroad benefits must be reduced is $532 million in 1984, $1,429 million in 1985, $777 million in 1986, $1,419 million in 1987, and $983 million in 1988. These estimated reductions are included in CBO's baseline projections.

Veterans' Compensation. Veterans' compensation payments are not automatically adjusted under current law, but have historically received cost-of-living increases on October 1 of each year equal to those given to Social Security recipients in July. The Administration proposes to delay these benefit increases from October 1, 1983, to April 1, 1984. In addition, it proposes to reduce the COLA to veterans who have disabilities rated at less than 100 percent. Those with 60 to 90 percent disability ratings would receive 85 percent of the COLA, those with 40 to 50 percent ratings would receive 60 percent of the COLA, and those with 10 to 30 percent ratings would receive only 45 percent of the COLA. These proposals would reduce projected spending for veterans' compensation by $1.7 billion during 1984-1988.

Other Cost-of-Living Adjustments. The President's budget proposes to reduce growth in outlays in several entitlement programs in which benefits are automatically adjusted by increases in cost-of-living indexes. It would freeze benefit increases for one year to persons receiving payments from the Retired Commissioned Health Officers Fund, the Foreign Service Retirement and Disability Fund, and the Coast Guard retirement programs. In addition, beneficiaries of the black lung and the coal miners' disability funds would not receive cost-of-living increases in 1984. These programs are indexed to the federal GS-2 wage levels and the Administration has proposed to freeze federal salaries. These proposals would save nearly $1 billion over the next five years.

Medicare and Medicaid

Medicare and Medicaid are the major entitlement programs that provide federal funding for health services. Medicare, which includes the Hospital Insurance (HI) and Supplementary Medical Insurance (SMI) programs, covers hospital, physician, and other medical costs for persons aged 65 and over, and for most disabled persons entitled to Social Security cash benefits. Medicaid, through joint federal and state financing, pays for health services for low-income persons. In total, Medicare and Medicaid provide benefits to about 48 million people, at an estimated cost of $76 billion in 1983 (see Table V-3).

The costs of Medicare and Medicaid have been increasing at a 17 percent annual rate over the last ten years. Most of that growth is attributable to rapidly rising medical care prices, which increased 9.5 percent annually during the period; some is explained by growth of program enrollments; and the rest is due to increasing use of medical services. The President's budget contains legislative proposals in the health area that would slow the increases in federal spending for health care (see Table V-8). The proposals in the budget would strengthen incentives for both individuals and providers to act in ways that would restrain the increases in prices and utilization. Under the President's proposals, Medicare and Medicaid recipients would pay for a larger proportion of their benefits through higher coinsurance, premiums, and deductibles. Beginning in 1986, payment rates for hospital care would be fixed in advance, or prospectively, with hospitals liable for their costs in excess of the rates. Reimbursable physicians' charges would be frozen in 1984.

The proposed legislation continues the efforts of the Administration and the Congress over the last two years to moderate the growth in health programs. But even if all of the President's proposals were to be enacted, health expenditures would still continue to grow rapidly (see Table V-8). From 1984 to 1988, Medicare and Medicaid spending is projected to grow 59 percent under the Administration's plan. In contrast, spending under current law is projected to grow 65 percent over the five years.

Medicare. The 1984 budget proposals are consistent with the Administration's intent to decelerate the rate of growth in federally-funded medical care programs. CBO estimates that the Administration's proposed legislation would save $26 billion from 1984 to 1988. The legislative package would increase the cost of health care to Medicare beneficiaries while also curbing the increase in reimbursement to providers. A major proposal affecting beneficiaries would increase cost sharing for short-term hospital stays. This would be offset somewhat by lower cost sharing for catastrophic illness. In addition, Medicare beneficiaries could also expect larger SMI premiums and slight delays in Medicare eligibility.

The major proposal affecting providers is the establishment of a prospective reimbursement system to expand and extend the current limits on hospital rates. In addition, physician fees would be frozen for one year. Some physicians would pass their unreimbursed costs on to the patient, thus increasing beneficiary costs, while others would not.

This legislative package follows $27 billion in cuts for the 1984-1988 period already enacted in both the reconciliation act of 1981 and TEFRA. These cuts included transfers of Medicare's costs to both beneficiaries and to providers. Deductibles for hospital care, other medical services, and

TABLE V-8. PROPOSED FUNDING CHANGES FOR MEDICARE AND MEDICAID (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	86.3	98.1	110.6	126.6	142.5	
Proposed Changes						
Medicare						
Provider payment reductions						
Pay hospitals prospectively	0	0	-1.5	-3.4	-3.8	-8.7
Freeze physicians' fees	-0.9	-1.0	-1.2	-1.4	-1.6	-6.1
Benefit reductions						
Alter hospital cost-sharing	-1.0	-1.5	-1.7	-1.9	-2.2	-8.3
Delay initial eligibility	-0.2	-0.3	-0.3	-0.4	-0.4	-1.6
Other	-0.1	-0.1	-0.2	-0.3	-0.3	-1.0
Other	-0.1	-0.1	*	-0.1	-0.1	-0.4
Medicaid						
Mandate copayments	-0.1	-0.2	-0.2	-0.2	-0.2	-0.9
Reductions on payments to states	0	-0.5	-0.4	-0.5	-0.6	-2.0
Other	-0.1	-0.1	-0.1	*	0.1	-0.4
Total Changes	-2.5	-3.9	-5.6	-8.1	-9.1	-29.2
President's Budget as Estimated by CBO	83.8	94.2	105.1	118.5	133.4	

* Less than $50 million.

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premiums paid by enrollees for the medical insurance part of Medicare were all increased. Payments to hospitals and for certain physicians' services were pared as well.

Despite the action of the last Congress, Medicare is still one of the fastest growing programs in the budget. Medicare spending climbed more than 15 percent in each of the last five years and is projected to rise 12.6 percent annually over the next five years, even with the enactment of the President's legislative package. The growth in these costs has caused the HI trust fund to fall to very low levels. Under CBO's baseline projections, the balances in the HI trust fund fall to zero in fiscal year 1987. Even with the Administration's budget proposals, the hospital insurance trust fund will become depleted by the end of the decade.

Whether these proposals will significantly reduce the explosive rise of medical care costs is unclear. The additional cost sharing proposed for short hospital stays should depress utilization somewhat and exert downward pressure on prices, but the proposed catastrophic coverage will have the opposite impact. Today, 30 percent of Medicare dollars are spent on delivering services to persons in their last year of life. This percentage could increase under the Administration's proposals. Another uncertainty is the reaction of hospitals to existing and proposed limits on Medicare payments. While both the Administration and CBO have estimated large savings from these limits, the actual savings will depend on many unknowns--the stringency of enforcement, for example, as well as the ability of hospitals to "game" the limits. Finally, the one-year freeze on physicians' fees clearly will have little long-run impact on their rates of increase, and may result in partially offsetting increases in use of physicians' services.

Medicaid. Increases in federal Medicaid expenditures have moderated considerably since the enactment of the 1981 reconciliation act. CBO estimates that the savings from that legislation total $3.4 billion over the 1984-1988 period. The Medicaid cuts enacted in TEFRA, as well as the proposed legislation in the President's 1984 budget, are modest in comparison to those affecting Medicare.

The two major legislative proposals in this year's budget are the expansion of the copayment legislation passed in TEFRA and the continuation of the reductions in payments to states passed in the 1981 reconciliation act. The copayment proposal was introduced in the President's 1983 budget. Last year, the Congress enacted a modified version that allowed states to impose certain copayments. The President is again proposing that these copayments be made mandatory. The other major proposal is to continue the reductions in payments to states, which would otherwise expire at the end of fiscal year 1984. CBO estimates that total savings in Medicaid from the President's legislation would be $3.1 billion from 1984 to 1988.

Major Means-Tested Transfer Programs

There are four major means-tested transfer programs outside of the health area: Aid to Families with Dependent Children, food stamps, Supplemental Security Income, and veterans' pensions. These programs provide the major governmental support to low-income families. They are means-tested in that persons qualify for benefits only if their incomes and resources fall below specified levels.

The AFDC program provides benefits to families with children who are deprived of parental support by the absence of a parent. In 22 states, two-parent families with an unemployed parent are also eligible for benefits. Financing of the program is partially by the federal government and partially by state and local governments. The SSI program provides benefits to the aged, blind, and disabled. It is fully federally financed, but most states provide supplements to at least some beneficiaries. The food stamp program provides food coupons to AFDC and SSI beneficiaries as well as to other households that meet the income and resource tests. The veterans' pension programs provide income support to needy war veterans who are either over age 64 or disabled from causes unrelated to military service. Low-income survivors of deceased war veterans are also eligible for benefits, which are fully financed from federal funds.

Legislation proposed by the President would reduce outlays in the four programs combined by $1.0 billion in fiscal year 1984 and $6.2 billion over the 1984-1988 period (see Table V-9). These cuts represent a 3 percent reduction in 1984 baseline outlays. They follow on large cuts from legislative actions in 1981 and 1982, estimated to total $3.4 billion in 1984. Nonetheless, program levels would remain considerably higher than in the 1970s.

Proposed legislative actions and past program trends differ significantly among these four means-tested programs, as is discussed below. Nonetheless, in all four programs, growth in the remainder of the 1980s should be considerably lower than in the 1970s.

Aid to Families with Dependent Children. Program cuts proposed in the President's budget are again sizable. Preliminary estimates by CBO show annual savings of $0.6 billion and savings for the 1984-1988 period of $2.6 billion. These savings include proposed changes in the Child Support

TABLE V-9. PROPOSED FUNDING CHANGES FOR MAJOR MEANS-TESTED TRANSFER PROGRAMS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	31.7	32.7	33.7	34.5	36.1	
Proposed Changes						
AFDC and child support enforcement	-0.3	-0.5	-0.6	-0.6	-0.6	-2.6
Food stamps	-1.1	-1.2	-1.2	-1.1	-1.0	-5.6
Supplemental security income	0.5	0.5	0.5	0.5	0.5	2.4
Veterans' pensions	*	-0.1	-0.1	-0.1	-0.1	-0.3
Total Changes	-1.0	-1.3	-1.4	-1.3	-1.2	-6.2
President's Budget as Estimated by CBO	30.7	31.4	32.3	33.2	34.8	

* Less than $50 million.

Enforcement (CSE) program in addition to those in AFDC. The CSE program enforces the support obligations owed by absent parents to their children; collections of support for AFDC children offset AFDC expenditures.

The President's major proposals, most of which were also proposed in last year's budget, are of three types: (1) a reduction in benefits to families with incomes or lower shelter expenses that are not currently accounted for; (2) mandating of job search and workfare for employable AFDC recipients; and (3) altering of CSE collection procedures and federal matching to improve the program's cost effectiveness.

The most controversial of these proposals would mandate job search and workfare for employable AFDC recipients whose children are six or older. Workfare requires recipients to "work off" their AFDC benefits; typically, the required number of hours of work is the AFDC benefit divided by the minimum wage. The CBO preliminary estimate of savings is considerably below the Administration's. Reasons for this estimating difference are unclear because details of the Administration's estimate, which shows savings of about $0.4 billion more than its estimate for similar legislation last year, have not been made available.

Any estimate of job search and workfare savings or costs is largely speculative. Savings to the federal government arise because some AFDC recipients lose benefits for refusing to participate in the job search and workfare programs, some find jobs they would not otherwise have found or find them more quickly, and some are deterred from even applying for AFDC. Offsetting these savings are the costs of administering such programs. There is no firm evidence yet available on whether savings exceed costs for workfare and for many types of job search. Programs initiated in the 1970s were often not cost-effective. A number of demonstrations are currently under way in AFDC, but final evaluations are not yet available and preliminary statistics are difficult to interpret. Even when they are available, it may be difficult to generalize these findings to all jurisdictions, with widely different approaches and sympathies to the proposals. Moreover, job search and workfare are now available to states at their option. It is possible that, if the states considered these proposals to be cost-effective, many would adopt them without being required, in which case little savings would arise from the proposed legislation.

If enacted, these proposed savings would add to the already sizable savings in AFDC and CSE from 1981 and 1982 legislation. The savings in 1984 of the recently enacted legislation are estimated to be $1.3 billion. If the new proposals are enacted, savings in 1984 would rise to $1.6 billion, or 16 percent of what outlays would have been in 1984 without the legislation.

Partly as a result of these legislative changes, but also because of the assumed reduction in unemployment and the difficult financial situation of the states, AFDC program trends are expected to be quite different in the 1980s as compared to the 1970s. The 1970s was a period of growth in AFDC. The numbers of beneficiary families rose from 1.8 million in 1970 to a peak of 3.8 million in 1981, partly from the trend of increasing participation among eligible families that began in the 1960s and partly from higher levels of unemployment. During the 1970s, average payments per family also rose by about 5.6 percent a year in nominal terms. With prices rising rapidly, however, average family payments declined sharply in real terms. For example, the maximum monthly payment level for a family of four fell from the 1970 level of $548 (in 1981 dollars) to the July 1981 level of $394.

For the remainder of the 1980s, numbers of families receiving AFDC are expected to remain steady at about 3.6 million, following declines from recent legislation. In these years, effects on numbers of AFDC families from falling unemployment rates are expected to be offset by sizable projected increases in numbers of female-headed households, about one-third of whom receive AFDC. Average payments per family are expected to rise by about 3.8 percent a year, more slowly than in the 1970s because of the financial pressures on states.

<u>Food Stamps</u>. The President's budget contains legislative proposals that would reduce food stamp program spending by modifying some aspects of eligibility rules and the method of benefit calculation, making states liable for a portion of benefit payments made in error, and delaying the cost-of-living adjustment. States would also be required to conduct workfare programs for food stamp program participants.

Most of the legislative savings would be achieved by reducing food stamp benefits to participating households. Enactment of this legislation would reduce the average household benefit by $7 to $8 monthly, or by about 7 percent. However, a substantial portion of the federal savings, nearly $0.5 billion during fiscal year 1984, would not result from reduced benefits but rather from reductions in the federal reimbursement for state administrative expenses or from direct billings to states under the proposal to make states liable for payments made in error in excess of 3 percent of all benefits. Costs incurred by states for the administration of the food stamp program would also be increased by about $0.1 billion because of the administrative expenses of operating the workfare programs.

The proposed changes would reduce food stamp outlays by about $1.1 billion in fiscal year 1984. Adding these savings to the estimated $2 billion of 1984 food stamp spending reductions enacted by the 97th Congress results in a 20 percent reduction in what spending for the program would have been in the absence of recent and proposed legislative changes.

Between 1975, when food stamps became a national program, and 1982, program outlays increased from $4.6 billion to $11.0 billion. Spending remained relatively constant between 1975 and 1978 because of declining participation, which resulted from improved economic conditions, and relatively small inflation adjustments in benefit levels. A major program change in 1979 in combination with high rates of food price inflation and increases in unemployment caused program spending to increase from $6.8 billion in 1979 to $11.3 billion in 1981. Despite continued increases in unemployment, outlays fell to $11.0 billion in 1982 because of program changes enacted during the 97th Congress.

Supplemental Security Income. In SSI, unlike the AFDC and food stamp programs, legislative proposals in the President's budget would add to program costs. The CBO preliminary estimates are that SSI outlays would rise on balance by $0.5 billion a year and $2.4 billion over the 1984-1988 period from the proposals.

The legislative proposals include an increase in the disregard on OASDI income from $20 to $50 a month; that is, an additional $30 of OASDI income of SSI beneficiaries would be disregarded in calculating countable income and SSI benefits. Hence, SSI benefits would rise for SSI beneficiaries with OASDI income. This proposal was one of the recommendations of the National Commission on Social Security Reform. Other changes proposed in the President's budget would result in SSI savings. The largest savings would arise from a six-month delay in the SSI cost-of-living adjustment.

As a result of these proposals, the current 1.6 million SSI beneficiaries with OASDI income would receive higher incomes; the increased disregard would more than offset the impact of the COLA delay. The remaining 1.8 million SSI beneficiaries, who typically have no other sources of income outside of SSI, would receive lower incomes; the impact of the COLA delay would not be offset by any increased benefits. In addition, the $50 disregard proposal would enable certain low-income OASDI beneficiaries to become newly eligible for SSI.

Because cuts in SSI as a result of 1981 and 1982 legislation were under $0.1 billion a year, the SSI program would expand as a result of legislative action taken in the last three years, if this year's proposed legislation is enacted. Nonetheless, growth in the program in the 1980s is expected to moderate considerably from that in the 1970s.

The SSI program was begun in 1974. Before then, aid to the aged, blind, and disabled was provided under a federal-state matching program as in AFDC today. After an initial buildup, numbers of beneficiaries declined somewhat during the remainder of the 1970s, primarily because more of the aged had other sources of income such as OASDI. Beginning in 1981, the rate of decline picked up considerably, partly as a result of demographic factors. Numbers of persons aged 50-59--those with the highest incidence of disability--began to decline in 1980 and will continue to decline during most of the decade. As a result, numbers of beneficiaries, which had averaged 3.9 million in 1975 and 3.7 million in 1980, are expected to decline to 3.1 million by 1988.

Growth in the program is expected to moderate not only because of beneficiary trends but also because average payments per beneficiary are estimated to grow less rapidly in the 1980s than in the 1970s. Payments in SSI have automatic COLAs and, with an anticipated slowdown in price increases, COLAs are expected to be considerably lower in the near future. In the five years 1978-1982, SSI COLAs summed to 49.3 percent; in the five years 1983-1987, COLAs are expected to sum to only 21.4 percent.

Veterans' Pensions. The President's proposal to delay for six months all automatic cost-of-living adjustments would affect the pension program established by the Veterans' and Survivors' Pension Improvement Act (Public Law 95-588) of 1978, the largest of the veterans' pension programs and the only one indexed for inflation. Preliminary CBO estimates indicate that this change would result in outlay savings of less than $0.1 billion a year. Total savings from 1984 to 1988 are estimated at $0.3 billion.

As part of the budget reconciliation process of 1982, savings provisions were enacted in veterans' pensions that are expected to reduce expenditures in 1984 by less than $0.1 billion. These savings, added to those anticipated from the President's proposal, would bring the total savings in 1984 to $0.1 billion, or 3 percent of the outlays that would have been expected without these amendments.

Even in the absence of further cost-reduction legislation, the trend in pension outlays in the 1980s is expected to be the opposite of that experienced in the 1970s, when outlays rose from $2.3 billion to $3.2 billion between 1970 and 1978. The changed outlook for pensions is attributable to the enactment of Public Law 95-588 in 1978--well before national attention focused on controlling the growth of federal expenditures. This legislation created a new pension program under which benefits are much more closely targeted to financial need. Virtually all exclusions from income for the purpose of calculating benefits and/or eligibility were eliminated, and benefits were indexed for inflation. Despite the indexation of benefits, which normally would be expected to increase costs over time, pension outlays are now projected to drop from their 1982 level of $3.9 billion to $3.5 billion in 1988, primarily as a result of the more restrictive eligibility standards of the new program.

Unemployment Insurance

Unemployment Insurance spending has risen rapidly over the last two years with the rise in the unemployment rate. Baseline spending is expected to fall from $31 billion in 1983 to $24 billion in 1988 as the unemployment situation improves.

The President's budget contains no legislative initiatives for 1984 through 1988. In 1983, however, the President is proposing a six-month extension and modification of the Federal Supplemental Compensation program.

Under the proposal, those in states with insured unemployment rates (IUR) of 6 percent and above could receive up to 16 weeks of jobless benefits; those in states with IURs between 4.5 percent and 6 percent could receive up to 12 weeks of added benefits; those in the remaining states could receive up to 8 weeks of added benefits.

Eligible persons could opt for a voucher, in place of the federal supplemental benefit, to use as a wage subsidy equal to one-half the weekly benefit amount for twice the number of weeks. Such a subsidy would take the form of a credit to the employer's federal unemployment tax or federal income tax. The Administration's preliminary estimate is that this proposal would add $1.85 billion to outlays in fiscal year 1983. A more complete discussion of this proposal is contained in Chapter III.

Farm Price Supports

Agricultural price supports provide price and income protection to farmers. Expenditures are made through a number of agricultural commodity programs designed to support and stabilize farm prices and incomes. The programs use several tools, including commodity loans and purchases, direct payments, and supply controls. The principal commodities covered by these programs are wheat, corn and other feed grains, rice, upland cotton, tobacco, peanuts, milk, and wool.

The President's primary legislative initiative is to freeze target prices at the 1983 crop year levels mandated in the 1981 Agriculture Act. It is the difference between target prices and market prices that determines the rate at which deficiency payments will be made on each eligible farmer's crop production. Freezing these levels is estimated to save $0.4 billion in fiscal year 1984, and $10.0 billion during the 1984-1988 period (see Table V-10). In addition, the President proposes to make the honey price support program discretionary, modify the price support mechanism and eliminate the allotment and quota system for extra-long-staple cotton, and expand the commodities in the Commodity Credit Corporation inventory eligible for donation.

This proposal comes at a time of rapidly rising farm support payments. Outlays for agricultural price support programs rose sharply in 1982 to a record $11.6 billion, nearly three times the 1981 level. This dramatic rise in

TABLE V-10. PROPOSED FUNDING CHANGES FOR FARM PRICE SUPPORT PROGRAMS (By fiscal year, in billions dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	10.4	9.9	10.8	11.2	11.7	
Proposed Changes						
Freeze target prices at 1983 crop year levels	-0.4	-1.6	-2.2	-2.8	-3.0	-10.0
President's Budget as Estimated by CBO	10.0	8.4	8.6	8.4	8.7	

spending reflected a sharp decline in farm prices resulting from large U.S. crops and weak export demand.

Further increases in outlays, to $18.2 billion, are estimated for fiscal year 1983 because of a continued growth in supplies relative to demand. Large crop inventories were carried into the 1982 crop year. Then, despite acreage reduction programs, feed grain production reached a record high and wheat production fell only slightly from 1981. These large supplies combined with declining exports are causing low crop prices. At the end of the 1982 crop year, grain stocks will be about one-half of total annual use, far in excess of adequate stock levels. Few of these stocks will be held free of government control--about two-thirds of them will be in the farmer-owned reserve and about one-fifth will be government-owned. Upland cotton stocks at the end of crop year 1982 will also be excessive: about 70 percent of annual use, despite a 23 percent drop in cotton production. Also included in 1983 outlays is $1.7 billion of interest paid to the Treasury deferred from fiscal year 1982.

While remaining above past levels, 1984 outlays are projected to decline by $8 billion. This decline will result from smaller harvests and fewer commodities under price support loans, and may be attributed to the reduced acreage programs required in the 1982 reconciliation act and the President's payment-in-kind (PIK) program. The PIK program gives farmers government-owned crops instead of cash to reduce planting more than required under the 1982 reconciliation act. Also contributing to the decline in 1984 outlays will be an $0.8 billion decrease in dairy program costs caused by declining milk production and increased revenues from assessments collected on milk marketings. The authorities to levy these assessments were also provided in the 1982 reconciliation act.

Other Entitlement and Mandatory Spending

This residual category includes a variety of programs providing educational assistance, nutrition assistance, aid to state and local governments, and aid to certain businesses. The President's budget contains a number of proposals to reduce spending from the baseline in this area (see Table V-11).

In three programs, the Administration's request holds funding at the fiscal year 1983 level. The CBO baseline projections include increases in funding to keep pace with inflation unless funding is constrained by authorization levels.

General Revenue Sharing. The President's budget proposes funding general revenue sharing at its 1983 level throughout the 1984-1988 period, whereas the CBO baseline is increased each year for inflation. Holding funding at the 1983 level would result in a 20 percent reduction in real spending by 1988.

Foster Care and Other Family Services. The President's budget is proposing to remove the entitlement status of foster care. Foster care and other family services programs would be funded at 1983 levels throughout the projection period.

Rehabilitation Services. The Administration is proposing to provide greater state flexibility in the use of the funds. The funding is held constant at 1983 levels throughout the five-year period.

In addition, the President's budget proposes legislation to reduce spending below baseline in a variety of other programs.

Child Nutrition. The Administration is proposing changes that would reduce spending by $0.3 billion in 1984. These savings would grow to $0.6 billion in 1988. Two-thirds of the savings result from creation of a General Nutrition Assistance Grant to states, similar to one proposed last year, that would replace the school breakfast, child care, and summer feeding programs. Other proposals include a six-month delay in the cost-of-living adjustment to reimbursement rates in the school lunch program, changing

TABLE V-11. PROPOSED FUNDING CHANGES FOR OTHER ENTITLEMENTS AND MANDATORY PROGRAMS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	21.0	20.4	20.8	21.2	22.4	
Proposed Changes						
Funding held at 1983 levels						
General revenue sharing	-0.2	-0.5	-0.7	-0.9	-1.2	-3.6
Rehabilitation services	*	-0.1	-0.2	-0.2	-0.3	-0.8
Foster care and family services	*	-0.1	-0.1	-0.2	-0.2	-0.6
Other reductions						
Child nutrition	-0.3	-0.4	-0.4	-0.5	-0.6	-2.2
Government contributions to employee health insurance	-0.1	-0.2	-0.5	-0.7	-0.9	-2.4
Guaranteed student loans	-0.1	-0.3	-0.3	-0.3	-0.3	-1.2
Pension benefits guaranty corporation	-0.1	-0.2	-0.2	-0.2	-0.3	-1.0
Other	0.4	-0.9	-1.3	-0.7	-0.7	-3.2
Total Changes	-0.4	-2.7	-3.7	-3.8	-4.5	-15.1
President's Budget as Estimated by CBO	20.6	17.7	17.1	17.4	17.9	

* Less than $50 million.

the indexing procedure for reimbursement rates for meals served to children from households with incomes between 130 percent and 185 percent of the poverty line, and requiring applications for free and reduced-price meals to be processed by local food stamp offices.

Government Contributions to Employee Health Insurance. The President's budget proposal would require some current federal employees and annuitants to pay an increasing share of the cost of their health insurance. The proposal would calculate future government contributions to employee health insurance by indexing the average contribution in 1983. Individuals selecting less expensive plans would receive a rebate, while individuals selecting more expensive plans would pay a larger share of their premiums.

Guaranteed Student Loans. The President proposes two programmatic changes in the guaranteed student loan (GSL) program effective July 1983. Again this year, the President proposes eliminating the $30,000 family income cap and limiting loan eligibility to assessed financial need. Second, the President proposes increasing the 5 percent origination fee to 10 percent for all graduate and professional students. In addition to these programmatic changes, the Administration proposes that certain loan advances to state agencies be returned to the federal government. The President's request for similar changes last year was not considered by the Congress.

Pension Benefit Guaranty Corporation. The severe recession of 1982 resulted in a large number of private pension plans terminating with assets insufficient to cover their liabilities. Such plans are taken over by the corporation, which assumes control of their assets, administers them through a trust fund held by a private bank, and takes responsibility for paying plan benefits. The large number of 1982 plan terminations caused the corporation's deficit to grow from $130.5 million at the end of fiscal year 1981 to $320 million at the end of 1982. Without an increase in the premiums paid by ongoing covered plans, it is expected that the deficit could reach $550 million by the end of 1984. The Administration is, therefore, requesting Congressional approval of an increase in the single-employer plan premium, as well as certain revisions in the single-employer plan insurance program. The changes have been estimated by the Administration to reduce 1984 outlays by $132 million. The specifics of the Administration's proposal are not yet available.

Other. The other savings are spread across several programs. The category also includes some savings that are offset in other spending categories. Finally, the changes in the Government National Mortgage Association's Management and Liquidation Functions Fund are discussed in the assistance to business and commerce section on discretionary spending.

NONDEFENSE DISCRETIONARY SPENDING

This category includes the programs in the unified budget for which no entitlement to benefits is established by law, thus enabling the Congress to set spending levels at its discretion. All such programs are subject to control through the appropriations process, either by the appropriation of budget authority, the establishment of loan limitations or obligation ceilings, or the provision of liquidating cash.

Unlike entitlement spending, outlays for discretionary programs increased only slightly as a proportion of total outlays during the 1970s, rising from about 22 percent in 1970 to about 24 percent in 1980. Since then, spending growth in this category has been sharply restrained, with outlays increasing a total of less than 4 percent over a three-year period. As a result, discretionary programs represent only 18 percent of 1983 outlays, and real spending for such programs has declined by 16 percent since 1980. The Administration's 1984 budget continues the policy of little growth in this category, with outlays estimated to increase from $145 billion in 1983 to $147 billion in 1984 and to $163 billion by 1988 (see Table V-12). These represent increases of only 1.5 percent in 1984, and about 2.5 percent annually from 1984 through 1988. If fully implemented, the budget would result in a savings of $5 billion in 1984, and a total deficit reduction of $61 billion between 1984 and 1988, relative to the CBO baseline projections for discretionary programs. As a consequence, spending for these programs would be 3.4 percent below the baseline in 1984, and more than 11 percent below by 1988. Outlays would fall to less than 15 percent of the budget by 1988.

This pattern of spending restraint has not been applied uniformly to all types of discretionary spending. The President's budget includes proposed increases in a number of areas, and decreases in others. As shown in Table V-13, nondefense discretionary spending can be divided into six general program subcategories. Of these, the Administration is proposing real 1984 increases for two--federal government operations, and aid to foreign governments and international organizations. The deepest cuts are targeted for assistance to business and commerce, and real reductions are also proposed for research and development, infrastructure, and benefits and services to individuals. Relative to CBO's baseline projections, which allow spending to keep pace with inflation, the Administration's 1984 budget plan would cut the projected growth of nondefense discretionary outlays by 50 percent over the next five years.

TABLE V-12. PROPOSED OUTLAYS FOR NONDEFENSE DISCRETIONARY SPENDING PROGRAMS AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Federal Government Operations	22.1	23.4	23.8	24.2	24.5	24.9
Aid to Foreign Governments and International Organizations	9.4	10.2	10.3	10.4	10.6	10.7
Transportation, Natural Resources, and Other Infrastructure	41.7	43.0	44.3	45.1	45.5	46.0
Research and Development	17.2	17.6	17.7	17.4	17.4	16.9
Benefits and Services to Individuals	47.5	46.5	46.7	47.5	48.0	48.8
Assistance to Business and Commerce	7.4	5.8	5.7	5.4	4.7	4.4
Civilian Agency Pay Raises and Increases in Retirement Contributions	---	0.9	4.0	6.3	8.7	11.1
Total	145.3	147.5	152.4	156.2	159.5	162.8

Federal Government Operations

These basic activities of the federal government, which account for about 15 percent of nondefense discretionary spending, encompass primarily the conduct of foreign affairs; the Coast Guard; the administration of Social Security and Medicare; law enforcement, judicial, and regulatory activities; the legislative branch; and the Internal Revenue Service. After an outlay

TABLE V-13. CBO ESTIMATE OF THE ADMINISTRATION'S PROPOSED REDUCTIONS IN NONDEFENSE DISCRETIONARY SPENDING (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays-Nondefense Discretionary Programs	152.7	159.6	167.0	176.2	183.7	
Proposed Changes						
Federal Government Operations	0.7	0.7	0.6	0.5	0.3	2.7
Aid to Foreign Governments and International Organizations	0.1	-0.1	-0.3	-0.5	-0.6	-1.5
Transportation, Natural Resources, and other Infrastructure	-1.8	-2.9	-3.5	-4.3	-5.1	-17.5
Research and Development	-0.1	-0.3	-1.2	-1.8	-3.1	-6.6
Benefits and Services to Individuals	-0.9	-3.4	-5.3	-7.5	-9.3	-26.5
Assistance to Business and Commerce	-2.6	-1.6	-2.2	-4.5	-5.1	-16.0
Federal Pay Raises and Retirement Contributions	-0.8	0.5	1.1	1.5	1.9	4.2
Total Changes	-5.3	-7.2	-10.8	-16.7	-21.0	-61.2
President's Budget as Estimated by CBO	147.5	152.4	156.2	159.5	162.8	

increase of 14 percent in 1983, the President is proposing to continue real growth in these programs. For 1984, the budget proposes a 7 percent increase in budget authority, resulting in an estimated outlay increase of $1.3 billion, or 5.8 percent. This represents an increase of over $0.7 billion above the baseline level, with the largest increases targeted for the Federal Bureau of Investigation, the Internal Revenue Service, the State Department, and the United States Information Agency (see Table V-14). Coast Guard programs are maintained at about the baseline level, while proposed funding for energy information, policy, and regulation activities is below the 1983 level.

TABLE V-14. PROPOSED FUNDING CHANGES FOR FEDERAL GOVERNMENT OPERATIONS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	22.7	23.1	23.6	24.1	24.6	
Proposed Changes						
Federal Bureau of Investigation	0.2	0.1	0.1	0.1	0.1	0.6
Internal Revenue Service	0.2	0.3	0.3	0.3	0.3	1.4
Department of State	0.1	0.1	0.2	0.2	0.2	0.8
United States Information Agency	0.1	0.2	0.3	0.3	0.3	1.2
Energy information, policy and regulation	-0.1	-0.1	-0.2	-0.2	-0.2	-0.8
Other	0.2	0.1	-0.1	-0.2	-0.4	-0.4
Total Changes	0.7	0.7	0.6	0.5	0.3	2.7
President's Budget as Estimated by CBO	23.4	23.8	24.2	24.5	24.9	

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Aid to Foreign Governments and International Organizations

This category includes programs for development and security assistance, contributions to international organizations, and international monetary programs. Outlays for these activities have increased from $7.6 billion in 1980 to a current estimate of $9.2 billion for 1983, with the largest growth occurring in the economic support fund and foreign military sales financing. Outlays for economic and financial assistance also increased during this period, reflecting increased funding for these programs in the late seventies.

The President's budget allows increased funding for foreign aid in 1984, with decreases in subsequent years, relative to the CBO baseline. The 1984 budget authority request for economic and financial assistance is slightly above the CBO baseline projection, primarily because of the substantial increase proposed for the International Development Association. This increase is offset by reductions in a number of other aid programs, so that 1984 outlays are $0.1 billion below the baseline projection. Additional savings of $1.4 billion are projected for 1985 through 1988, largely because the Administration's budget plan provides no increases in budget authority for those years (see Table V-15).

The largest 1984 increases are in funding for security assistance, for which the President is also seeking $0.4 billion in 1983 supplemental appropriations and $0.5 billion in additional 1983 off-budget direct loans for financing foreign military sales. The supplementals include $250 million for Lebanon, as well as funds previously requested but not provided in the Continuing Appropriations Resolution. Military assistance programs administered by the Department of Defense represent the bulk of the security assistance request. The largest single program is $4.4 billion requested in 1984 for foreign military sales guaranteed loans, provided off-budget by the Federal Financing Bank; this represents an increase of $0.8 billion above the $3.6 billion currently available for 1983 and $0.3 billion above the $4.1 billion level the President is now requesting for 1983. On-budget funding for military assistance is also increased, by $0.4 billion over the CBO baseline in 1984. For 1984 through 1988, total security assistance outlays are projected to match the baseline levels, with the increases in military assistance offset by cuts in forgiven direct loans to Israel. The percentage of military assistance provided as guaranteed loans is the same as in 1983, approximately 70 percent.

Current law for foreign military guarantees sales does not require the appropriation of reserves for new loans, and none is requested for 1984, even though a substantial proportion of the loans should be considered risky. The proposed 1983 supplemental and 1984 guaranteed loan programs include over

TABLE V-15. PROPOSED FUNDING CHANGES FOR AID TO FOREIGN GOVERNMENTS AND INTERNATIONAL ORGANIZATIONS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	10.1	10.4	10.7	11.1	11.4	
Proposed Changes						
Economic and financial assistance	-0.1	-0.2	-0.3	-0.5	-0.4	-1.5
Security assistance and other	0.2	0.1	*	-0.1	-0.2	*
Total Changes	0.1	-0.1	-0.3	-0.5	-0.6	-1.5
President's Budget as Estimated by CBO	10.2	10.3	10.4	10.6	10.7	

* Less than $50 million.

$1 billion in loans to 14 countries that are receiving balance-of-payments assistance from the International Monetary Fund (IMF). Payments to the Federal Financing Bank on rescheduled loans and defaults (late payments) are made by the Guarantee Reserve Fund. Net payments by the Guarantee Reserve Fund have been over $100 million per year since it was created in 1981, and are estimated to increase over the next five years. The Administration's projections show the fund's balance falling below $750 million in 1984 and being exhausted in 1987, requiring new appropriations to make payments on bad loans in 1988.

An agreement by the Interim Committee of the International Monetary Fund for an increase in the resources of the IMF was recently announced. The agreement calls for an increase in quota subscriptions of 47.4 percent and an increase in the General Arrangements to Borrow (GAB) to $19 billion. The U.S. share is estimated at $5.8 billion of the increased quota subscription and $2.6 billion for the GAB. The increase in both the quota and the GAB will require authorization and appropriation action. The last subscription increase required the United States to pay 25 percent of the quota subscription in Special Drawing Rights (SDRs), a monetary reserve asset, and 75 percent in the form of a letter of credit. Dollars are transferred to the IMF by drawing down the letter of credit or as loans through the GAB. As the letter of credit is drawn down or funds loaned through the GAB, the U.S. reserve position in the IMF, a liquid interest-earning asset, is increased. Dollar transfers to the IMF are not treated as net budget outlays, but they do affect the Treasury's cash position and borrowing requirements.

Transportation, Natural Resources, and Other Infrastructure

About 30 percent of discretionary spending is devoted to the construction, operation, management, or maintenance of the physical resources that make up the nation's infrastructure--including the major transportation systems, pollution control facilities, forests, parks, public lands, water, mineral and other natural resources, and community development projects. Spending for these programs has been reduced significantly since 1981, and 1983 outlays will be about 5 percent below the 1981 level, a real reduction of about 15 percent. The President is proposing to increase aggregate infrastructure spending by about 2 percent per year between 1983 and 1988, with the increase being focused almost entirely on two major areas--the federal-aid highways program, and Federal Aviation Administration (FAA) operations, facilities, and development activities (see Table V-16). Highway spending is governed largely by the recently enacted Surface Transportation Assistance Act of 1982 (Public Law 97-424), which sharply increased spending authority from the Highway Trust Fund, to be supported by increased gasoline taxes. Although the President is proposing slightly lower obligation ceilings than provided in the act, outlays for grants to states under the federal-aid highways program are estimated to increase from $8.4 billion in 1983 to $11.5 billion in 1984, and to $14.2 billion by 1988. 2/ FAA spending is also projected to rise rapidly under the Administration's proposal, from $3.6 billion in 1983 to $4.1 billion in 1984, and to $5.4 billion by 1988. FAA spending authority from the Airport and Airways Development Trust Fund was increased substantially by the 1982 tax bill (TEFRA), with

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2. Since the baseline incorporates the spending levels in the Surface Transportation Act of 1982, these do not appear as outlay increases in Table V-16. The savings shown in the table reflect the Administration's proposal to reduce the annual obligation ceilings established in the act.

TABLE V-16. PROPOSED FUNDING CHANGES FOR TRANSPORTATION, NATURAL RESOURCES, AND OTHER INFRASTRUCTURE (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	44.8	47.2	48.5	49.8	51.0	
Proposed Changes						
Federal Aviation Administration	0.1	0.3	0.5	0.7	0.8	2.4
Federal-aid highways	-0.3	-0.2	-0.2	-0.5	-1.0	-2.2
Mass transit programs	-0.5	-1.0	-1.1	-1.3	-1.2	-5.1
Corps of Engineers construction	-0.4	-0.6	-0.6	-0.7	-0.7	-3.0
Community & regional development	-0.2	-0.2	-0.6	-1.0	-1.3	-3.3
Energy programs	-0.1	-0.3	-0.3	-0.3	-0.3	-1.3
Forest Service	-0.3	-0.2	-0.2	-0.2	-0.3	-1.2
Other	-0.2	-0.7	-0.9	-1.0	-1.0	-3.8
Total Changes	-1.8	-2.9	-3.5	-4.3	-5.1	-17.5
President's Budget as Estimated by CBO	43.0	44.3	45.1	45.5	46.0	

large increases for grants-in-aid to airports and for development, procurement, and installation of improved air traffic control systems.

Under the President's budget plan, all other infrastructure spending would decline from $29.7 billion in 1983 to $27.4 billion in 1984 and to $26.4 billion by 1988. These spending levels represent a reduction in spending of 5 percent in 1984 and 15 percent by 1988, relative to the CBO baseline projection. The largest reduction relative to the baseline is for mass transit programs, with outlay savings of about $5 billion over the five-year period. This reflects primarily a 75 percent reduction in operating subsidies in 1984, and elimination of such subsidies thereafter. Corps of Engineers construction activities are also held below the baseline level, with budget authority reduced $0.6 billion in 1984 and $3.2 billion over the five-year period. In addition, spending reductions are proposed for community and regional development activities, with budget authority below the baseline by $0.9 billion in 1984 and by $5.9 billion between 1984 and 1988; resulting outlay savings on the unified budget are estimated to be $3.3 billion over the five-year period, with additional off-budget savings of $1.2 billion from the rural development insurance fund (RDIF). Appalachian regional development programs, the rehabilitation loan fund, the Economic Development Administration, and RDIF business loan guarantees would all be terminated, while rural water and waste disposal grants and loans would be sharply reduced. Funding for community development block grants and urban development action grants (UDAG) would be held at about the 1983 level through 1988.

The President proposes to reduce 1984 spending below the 1983 level for a wide array of other infrastructure programs including:

- Energy conservation grants;
- Forest Service activities;
- Land acquisition for parks, wilderness, and wildlife areas;
- Rail transportation;
- Environmental Protection Agency abatement control and compliance activities;
- National Oceanic and Atmospheric Administration programs.

These and other programs account for outlay savings totaling $0.7 billion in 1984 and $6.4 billion between 1984 and 1988, relative to the baseline projections.

Research and Development

The largest programs in this area include aeronautical and space activities of the National Aeronautics and Space Administration (NASA), totaling almost $7 billion in 1983; health research (over $4 billion in 1983, mostly at the National Institutes of Health); and energy research by the Department of Energy (over $3 billion in 1983). Programs of the National Science Foundation (NSF) and the Departments of Agriculture and Education also fall in this group. In aggregate, outlays for these programs have declined in real terms from 1981 to 1983, and the Administration is proposing to continue this trend over the next several years (see Table V-17). The President's budget includes $17.5 billion in budget authority for 1984, 2.6 percent above the 1983 level, but 1.2 percent below the baseline projection. Proposed funding for both NASA and NSF in 1984 is above the baseline level, by 3 percent and 12 percent respectively, while all other major research programs are reduced in real terms. The reduction in energy research is concentrated in fossil and solar energy, while nuclear-related research and development is increased in real terms. Funding for health research is frozen at about the 1984 level through 1988, with total outlays $2.4 billion, or 10 percent, below the baseline over the five-year period. Beginning in 1986, NASA outlays under the President's budget plan

TABLE V-17. PROPOSED FUNDING CHANGES FOR RESEARCH AND DEVELOPMENT (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	17.7	18.0	18.6	19.2	20.1	
Proposed Changes						
National Science Foundation	0.1	0.1	0.1	*	-0.1	0.2
NASA	0.1	0.1	-0.4	-0.7	-1.6	-2.5
Department of Energy	-0.2	-0.2	-0.2	-0.2	-0.2	-1.0
Health	-0.1	-0.2	-0.5	-0.7	-0.9	-2.4
Education, Agriculture, and other	*	-0.1	-0.2	-0.2	-0.3	-0.8
Total Changes	-0.1	-0.3	-1.2	-1.8	-3.1	-6.6
President's Budget as Estimated by CBO	17.6	17.7	17.4	17.4	16.9	

* Less than $50 million.

are below the baseline level, by a total of $2.7 billion through 1988, primarily reflecting proposed reductions in spending for space-shuttle operations.

Benefits and Services to Individuals

Over 30 percent of nondefense discretionary spending is currently devoted to providing benefits and services to individuals--including housing, education, employment and job training, health services, legal aid, veterans' hospitals, and assistance in paying energy costs. Spending for these programs has been reduced since 1981, with 1983 outlays estimated to be $0.5 billion, or 1.0 percent, below the 1981 level. The President is proposing to hold spending in this category about 2 percent below the baseline level in 1984, and about 10 percent below the baseline for 1984 through 1988 in total. This would produce a savings of $0.9 billion in 1984 and $26.5 billion over the five-year period, the largest amount (and the second largest percentage) of savings among the categories of discretionary spending used in this analysis (see Table V-18).

Education Programs. More than one-third of the five-year savings are projected in education programs. The President is proposing over $0.3 billion in rescissions for 1983, and 1984 budget authority $0.5 billion below the 1983 request, a combined reduction of over 7 percent below the current funding level. These savings would be obtained by sharply reducing funding for bilingual and vocational education, terminating the Indian education grant program, and eliminating certain grants to postsecondary institutions that provide education support services to low-income students. Increasing savings are projected in subsequent years, because funding for most programs is held at the 1984 level through 1988. As a result, the President's 1988 budget authority estimate is $4.0 billion, or 28 percent, below the baseline projection for that year, with outlays $3.3 billion below the baseline.

Employment and Training Programs are also targeted for significant reductions from the 1983 program levels, with outlays in 1984 estimated to be $0.8 billion, or 17 percent, below the baseline, and $0.4 billion below the 1983 level. The President is proposing to fund the Job Training Partnership Act at $3.6 billion in 1984, $0.2 billion below the 1983 appropriation. He would also eliminate the work incentive program. Funding for 1985 through 1988 is maintained at the 1984 level, resulting in 1988 outlays $1.6 billion, or 30 percent, below the CBO baseline.

Housing Programs are also a significant source of projected savings in the budget, reflecting the Administration's continuing efforts to restrain the

TABLE V-18. PROPOSED FUNDING CHANGES FOR BENEFITS AND SERVICES TO INDIVIDUALS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	47.4	50.1	52.8	55.5	58.1	
Proposed Changes						
Education programs	-0.3	-1.3	-2.0	-2.7	-3.3	-9.6
Employment and training programs	-0.7	-0.9	-1.2	-1.4	-1.6	-5.8
Housing programs	0.5	-0.3	-0.8	-1.8	-2.6	-5.1
Health programs	-0.1	-0.5	-0.6	-0.8	-1.0	-3.0
Social services	-0.4	-0.4	-0.6	-0.7	-0.8	-2.9
Legal Services Corporation	-0.2	-0.3	-0.3	-0.3	-0.3	-1.4
Food and nutrition programs	-0.1	-0.1	-0.2	-0.2	-0.3	-0.8
Veterans' hospitals and administration	0.2	0.4	0.6	0.8	1.1	3.1
Low-income energy assistance and other	0.2	0.1	-0.3	-0.4	-0.4	-0.8
Total Changes	-0.9	-3.4	-5.3	-7.5	-9.3	-26.5
President's Budget as Estimated by CBO	46.5	46.7	47.5	48.0	48.8	

growth of federal housing subsidies. In addition to reducing the number of additional units coming under payment, major structural changes are proposed for programs administered by both the Department of Housing and Urban Development (HUD) and the Farmers Home Administration (FmHA). Under these proposals, low-income rental assistance provided by HUD's Section 8 program would be in the form of five-year certificates (vouchers) rather than the 15-to-40-year contracts currently typical of the program. Other proposals would increase tenant contributions to rent by requiring that food stamps be counted as income and increasing the current 10 percent cap on annual tenant rent increases to 20 percent. As a result, outlay savings would total $5 billion by 1988, with additional savings in later years. The budget request would also virtually end FmHA's low- and moderate-income direct mortgage loan programs. State block grants are proposed in their place. Projected rural housing insurance fund (RHIF) loan activity in 1984, plus the proposed block grants, would result in obligations of $1.2 billion, compared with $3.4 billion in 1983. The President's rural housing proposals would produce net outlay savings of $12 billion from 1984 through 1988. Most of these would occur off budget, relative to the CBO baseline projections, because the Administration is proposing to change accounting procedures to eliminate the budgetary impact of RHIF asset transactions with the Federal Financing Bank.

Health Programs. The President is also seeking savings in health programs. The 1984 budget authority request is more than $0.2 billion below the 1983 level, and 11 percent below the CBO baseline. The largest reductions are sought in health education and training programs and in activities of the Indian Health Service. Most other programs are held at about the 1983 level for 1984 through 1988, resulting in outlay savings of $3 billion over the five-year period, relative to the CBO baseline. As a result, 1988 budget authority and outlays would be about $1 billion, or more than 25 percent, below the baseline projection.

Social Services Programs. The budget includes additional outlay reductions of $2.9 billion from 1984 through 1988 for social services programs, largely by eliminating community services block grants that were funded at $359 million in 1983. Most other social services programs are maintained at about the 1983 level through 1988.

Legal Services Corporation. No 1984 funds are requested for the Legal Services Corporation, which received $241 million in 1983, despite the Administration's attempt to eliminate its funding last year. Termination of the legal services program would save close to $300 million per year in outlays, and a total of $1.4 billion between 1984 and 1988, relative to the CBO baseline.

Food and Nutrition Programs. Another source of savings in this category is food and nutrition programs, primarily the special supplemental food program for women, infants, and children (WIC) and the commodity supplemental food program. The budget estimates for these programs for 1984 through 1988 are maintained at the 1983 level, resulting in outlay reductions of $50 million in 1984 and $0.8 billion in total through 1988, relative to the CBO baseline.

Low-Income Home Energy Assistance. The remaining source of savings is in low income home energy assistance. Almost $2.0 billion was appropriated for these grants to states in 1983. The President is proposing to reduce funding to $1.3 billion in 1984, and to target the assistance to states with the greatest need. With budget authority frozen at the 1984 level through 1988, real spending would be reduced by 47 percent in 1988.

Veterans' Programs. The one general area in this category budgeted for overall funding increases is the veterans' programs. The budget authority request for 1984 is $9.8 billion, compared with $9.1 billion in 1983. The largest increases are for medical care (up $0.4 billion) and for construction activities (up $0.3 billion), which are largely for increased geriatric research and care and for construction of additional Veterans Administration nursing homes, respectively. Construction spending between 1984 and 1988 is estimated to be $0.9 billion above the CBO baseline, while medical care outlays under the President's budget would be $2.1 billion above the baseline over the five-year period.

Assistance to Business and Commerce

The major federal activities in this area include the on-budget payment to the Postal Service and programs of the Departments of Agriculture and Commerce, the Government National Mortgage Association (GNMA), the Small Business Administration (SBA), and the Export-Import Bank. The Administration's proposed changes in these activities are the source of the largest 1984 outlay reductions in the nondefense discretionary category. However, the net savings from these program reductions are not as large as the figures that appear in Table V-19. In particular, the outlay decrease for the GNMA special assistance functions fund mortgage purchase program is estimated to be $1.4 billion in 1984 and $4.7 billion in total by 1988. These figures reflect not only the proposed termination of the program, and transfer of its assets and liabilities to HUD's management and liquidating functions fund, but also the proposed forgiveness of the large debt owed to the Treasury. 3/ The latter action would eliminate substantial intragovernmental interest payments from GNMA to the Treasury, which do not affect the unified budget totals. Actual savings from termination of this program are not significant until 1986, and are estimated to total about $0.3 billion by 1988.

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3. The management and liquidating functions fund is classified as nondiscretionary, and the impact on that fund of this change is included in the "other" proposed changes category in Table V-11.

TABLE V-19. PROPOSED FUNDING CHANGES FOR ASSISTANCE TO BUSINESS AND COMMERCE (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	8.4	7.3	7.6	9.3	9.5	
Proposed Changes						
GNMA mortgage purchase program	-1.4	*	-0.1	-1.5	-1.7	-4.7
Payment to the Postal Service	-0.4	-0.6	-0.5	-0.5	-0.5	-2.5
Small Business Administration	-0.5	-0.7	-0.8	-0.8	-0.9	-3.7
Export-Import Bank	-0.1	-0.3	-0.5	-0.6	-0.7	-2.2
Agriculture programs	-0.2	-0.3	-0.4	-0.6	-0.8	-2.3
Other	*	0.3	0.1	-0.5	-0.5	-0.6
Total Changes	-2.6	-1.6	-2.2	-4.5	-5.1	-16.0
President's Budget as Estimated by CBO	5.8	5.7	5.4	4.7	4.4	

* Less than $50 million.

The Administration is proposing to obtain further savings by reducing the payment to the Postal Service to $400 million per year, beginning in 1984--which would result in savings relative to the baseline of $0.4 billion in 1984 and $2.5 billion between 1984 and 1988. This would require elimination of the public service subsidy, and a reduction in revenue forgone subsidies for nonprofit mailers. Program cuts are also proposed for the Small Business Administration, including the elimination of most direct business loans and a reduction in the amount of loan guarantees. These are estimated to result in outlay savings of $0.2 billion in 1984 and $1.5 billion in total by 1988. In addition, the budget projections for SBA disaster loan net outlays are a total of $2.0 billion below the CBO baseline between 1984 and 1988, due in part to unrealistically low loan levels in view of historical experience. The savings also reflect the President's proposal to extend the existing provision excluding farmers from eligibility for SBA disaster loans.

The President is also proposing to constrain the lending activities of the Export-Import Bank, by reducing the direct loan limit from $4.4 billion in 1983 to $3.8 billion per year in 1984 through 1988. This would produce outlay savings relative to the baseline of $2.1 billion over the five-year period.

The largest reductions proposed by the President for discretionary agriculture programs are in direct loans made to farmers from the agricultural credit insurance fund (ACIF). Loan obligations in the budget for ACIF are frozen at about $4.0 billion per year from 1984 through 1988, which is below the Administration's estimated $4.4 billion for 1983 and below the baseline by a total of $5.4 billion from 1984 through 1988. Most of this reduction is attributable to the proposed ceiling of $1.5 billion on emergency disaster loans, and legislation will be proposed to allow the Secretary of Agriculture to restrict the availability of emergency disaster loans to areas where federal crop insurance is not available. The President also proposes to eliminate interest subsidies for low-income limited-resource farmers. Estimated ACIF savings relative to the baseline are about $1.4 billion on the unified budget, and about $4 billion off budget, from 1984 through 1988. The other major reductions in agriculture programs are in the Extension Service and the Animal and Plant Health Inspection Service, for which proposed 1984 budget authority is 17 percent and 19 percent, respectively, below the baseline, with total outlay savings of about $0.4 billion each from 1984 through 1988.

Allowances for Federal Pay Raises and Retirement Contributions

Although the spending for the pay and benefits of federal employees is recorded in the individual program accounts throughout the budget, an allowance for future-year changes for civilian agencies is shown in aggregate in an allowance category. It has not been included in the total for the categories of discretionary spending discussed previously. The Administration's budgeted allowances reflect two proposals affecting pay levels and retirement contributions. The President is proposing not to grant federal civilian and military employees a pay adjustment in fiscal year 1984, and to limit the increases in future years to the average annual change in private sector wages and salaries. CBO estimates that this action will reduce outlays by approximately $1.7 billion in 1984 and by a total of $5.8 billion through 1988 for all agencies other than the Department of Defense (see Table V-20).

TABLE V-20. PROPOSED CHANGES IN ALLOWANCES FOR FEDERAL PAY RAISES AND RETIREMENT CONTRIBUTIONS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	1.7	3.4	5.2	7.1	9.0	
Proposed Changes						
Limitation on pay raises	-1.7	-1.5	-1.1	-0.9	-0.6	-5.8
Increase in retirement contributions	0.9	2.0	2.2	2.4	2.5	10.1
Total Changes	-0.8	0.5	1.1	1.5	1.9	4.2
President's Budget as Estimated by CBO	0.9	3.9	6.3	8.6	10.9	

The President is also proposing to increase the amount federal workers and their employing agencies must pay into the civil service retirement (CSR) trust fund from the current 7 percent to 9 percent in 1984 and to 11 percent in 1985. If enacted, this proposal would increase the CSR contributions made by federal agencies by about $0.9 billion in 1984 and by $10.1 billion between 1984 and 1988. These increases in agencies' contributions would have no net outlay effect, however, since the higher agency payments would appear as an offsetting receipt elsewhere in the budget.

NET INTEREST

Net interest consists primarily of interest costs for that portion of the federal debt held by the public, including the Federal Reserve System. It also includes interest paid by the government on tax refunds, less interest received from federal agencies and the public.

The government's interest costs have been growing rapidly in recent years, reflecting increasing deficits and high interest rates. Outlays for net

TABLE V-21. PROPOSED NET INTEREST COSTS AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Interest on the Public Debt	126.9	138.5	150.9	159.9	165.1	170.3
Interest Received by Trust Funds	-16.9	-19.0	-20.3	-22.7	-25.4	-28.1
Other Interest	-22.7	-23.6	-25.7	-27.5	-25.6	-25.8
Total	87.3	95.9	104.9	109.8	114.1	116.3

interest have grown from $14 billion in 1970 to an estimated $87 billion in 1983. Under the Administration's budget plan, net interest would continue climbing to $96 billion in 1984 and to $116 billion in 1988, an average annual increase of 5.9 percent over the five-year period (see Table V-21). This represents a reduction from the CBO baseline projections of $30 billion between 1984 and 1988.

The President's budget would affect net interest in two major ways. The largest impact would be from lower deficits relative to the baseline, resulting in a lower public debt and smaller interest outlays. As shown in Table V-22, CBO estimates that the total federal debt held by the public would be about $365 billion lower at the end of 1988 under the President's budget than under the baseline, reflecting the cumulative reductions in both on- and off-budget deficits. Lower net interest outlays due to these deficit reductions amount to about $1 billion in fiscal year 1984 and about $46 billion over the 1984-1988 period (see Table V-23).

These savings are partially offset by lower interest payments from federal agencies, as a result of program reductions proposed by the Administration. Most of this reduction would occur in intragovernmental interest collections by the Treasury Department. A large number of budget accounts have authority to borrow from the Treasury and pay interest on these borrowings. The largest such intragovernmental interest payments are currently received from the Commodity Credit Corporation, the GNMA special assistance functions fund, and several Farmers Home Administration programs. The Administration's program calls for reduced outlays by many of these programs and, hence, a smaller volume of borrowing from the

TABLE V-22. PROJECTIONS OF DEBT HELD BY THE PUBLIC (By fiscal year)

	1983	1984	1985	1986	1987	1988
			In Billions of Dollars			
CBO Baseline	1,128	1,343	1,569	1,814	2,079	2,365
President's Budget as Estimated by CBO	1,131	1,321	1,507	1,663	1,832	2,000
			As a Percent of GNP			
CBO Baseline	35.3	38.4	41.1	43.8	46.6	49.4
President's Budget as Estimated by CBO	35.4	37.8	39.4	40.1	41.1	41.7

Treasury. Intragovernmental interest collections are also reduced by a proposal to forgive future interest payments for two GNMA accounts (the special assistance functions fund and emergency home purchase assistance). All of these reductions in intragovernmental interest collections are offset by outlay reductions elsewhere in the budget. The Administration's program would also result in lower interest payments to the Treasury by the off-budget Federal Financing Bank as a result of lower off-budget lending. The total reduction in interest receipts resulting from other program reductions is about $1 billion in fiscal year 1984, and about $16 billion over the entire 1984-1988 period.

OFFSETTING RECEIPTS

This category consists of various federal government receipts that are treated as deductions from outlays rather than as revenues. It includes proprietary receipts from the public, largely for lease, sale, or royalty payments for timber, power, or minerals. It also encompasses the receipts from federal agencies' payments (as an employer) for employee retirement and health benefits. Table V-24 shows CBO's estimates of the offsetting receipts that would result from the Administration's budget proposals for 1984-1988.

TABLE V-23. PROPOSED CHANGES IN NET INTEREST OUTLAYS AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	95.6	106.4	114.3	123.6	131.1	
Proposed Changes						
Debt service savings resulting from lower deficits	-0.8	-3.5	-8.0	-14.0	-19.8	-46.1
Changes in interest receipts due to other program changes	1.1	2.0	3.5	4.4	5.1	16.1
Total Changes	0.3	-1.5	-4.5	-9.5	-14.8	-30.0
President's Budget as Estimated by CBO	95.9	104.9	109.8	114.1	116.3	

Offsetting receipts are estimated to be about $31 billion in 1983, increasing to about $40 billion in 1988 under baseline assumptions. The Administration's budget includes a number of proposals that would increase receipts by $1.6 billion in 1984 and by a total of $25 billion between 1984 and 1988 (see Table V-25). About $12.5 billion of that amount, however, is an increase in intragovernmental payments for employee retirement benefits, reflecting the proposed increase in the percent of salary paid by both the government and the employee into the Civil Service Retirement fund. Only that portion paid by the Postal Service, and thus covered by postal rates, represents net additional receipts to the budget; that amount would be about $250 million in 1984 and a total of $2.4 billion between 1984 and 1988.

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TABLE V-24. PROPOSED OFFSETTING RECEIPTS AS ESTIMATED BY CBO (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Outer Continental Shelf Rents and Royalties	-10.1	-8.8	-9.2	-13.4	-11.5	-11.2
Other Mineral and Timber Sales and Leases	-3.8	-3.8	-4.1	-4.2	-4.4	-4.5
Medicare Premiums	-4.2	-4.7	-5.9	-7.4	-9.2	-11.4
Employer Share, Employee Retirement	-8.0	-9.6	-12.1	-12.9	-13.5	-14.2
Other	-4.8	-6.4	-6.5	-6.6	-7.0	-7.1
Total	-30.9	-33.3	-37.8	-44.5	-45.5	-48.4

The Administration is also proposing a number of new or increased user fees--the largest of which are for use of inland waterways ($0.2 billion per year), deep-draft ports (an average of $0.3 billion per year), and certain Coast Guard services (about $60 million annually). Several user fees were approved by the 97th Congress, including increased gasoline taxes to finance highway and transit programs, fees on electric utilities to finance nuclear waste disposal, and increased airport and airway taxes to finance part of the cost of the national aviation system. However, fees similar to the major new fees included in the 1984 budget were proposed last year and were not enacted.

The Administration's budget also includes additional receipts reflecting the proposal to increase premiums for the Supplementary Medical Insurance part of Medicare by 40 percent between January 1984 and January 1988. The added premiums are estimated to total $0.2 billion in 1985 and $8.8 billion between 1985 and 1988. If the change is enacted, the average aged enrollee's share of program costs would rise from 25 percent to 35 percent.

TABLE V-25. PROPOSED CHANGES IN OFFSETTING RECEIPTS (By fiscal year, in billions of dollars)

	1984	1985	1986	1987	1988	Cumulative Five-Year Changes
CBO Baseline Outlays	-31.7	-34.2	-39.7	-39.0	-39.9	
Proposed Changes						
Increased payments for employer share, employee retirement	-1.0	-2.4	-2.6	-2.8	-3.0	-11.8
Transportation user fees	-0.5	-0.5	-0.6	-0.6	-0.7	-2.9
SMI premiums	0.3	-0.2	-1.3	-2.8	-4.5	-8.5
Land sales and other	-0.3	-0.3	-0.3	-0.3	-0.3	-1.5
Total Changes	-1.6	-3.5	-4.8	-6.5	-8.4	-24.8
President's Budget as Estimated by CBO	-33.3	-37.8	-44.5	-45.5	-48.4	

The other major increase in offsetting receipts is attributable to the Administration's plan to sell public lands under the jurisdiction of the Departments of Agriculture and the Interior for the purpose of reducing the public debt. The proposed legislation would result in an estimated $0.2 billion in receipts in 1984 and a total of $1.4 billion by 1988, in addition to the sales already contemplated by the General Services Administration.

CBO OUTLAY REESTIMATES

As part of its analysis of the President's budget, CBO has reestimated the Administration's budget program to reflect CBO baseline economic assumptions and technical estimating methods. The effect of these reestimates on nondefense outlays is summarized in Table V-26 and explained in the remainder of this chapter. Most of the CBO reestimates result from the use of different economic assumptions--notably lower interest rates and lower prices. These different economic assumptions reduce estimated nondefense outlays by an amount growing from $2.0 billion in 1983 to $9.0 billion in 1984 and $14.1 billion by 1988. Technical estimating differences affect outlay estimates by smaller amounts, ranging from +$1.6 billion in 1984 to -$5.8 billion in 1987.

TABLE V-26. CBO REESTIMATES OF THE ADMINISTRATION'S NONDEFENSE SPENDING PROPOSALS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
President's Budget	590.4	603.2	633.3	666.5	704.2	741.4
Preliminary CBO Reestimates						
Different economic assumptions	-2.0	-9.0	-9.4	-11.0	-11.7	-14.1
Technical reestimates	-1.6	1.6	-1.0	-4.3	-5.8	-4.1
President's Budget as Estimated by CBO	586.9	595.8	622.8	651.3	686.6	723.2

Differences in Economic Assumptions

Economic conditions have major effects on federal budget outlays. About 30 percent of federal spending is directly indexed for inflation through automatic cost-of-living adjustments (COLAs). Social Security is the largest indexed program, accounting for 21 percent of total outlays in 1982. Other directly indexed programs include retirement benefits for federal civilian and military employees, veterans' pensions, railroad retirement benefits, and Supplemental Security Income benefits. Medicare and Medicaid costs, while not directly indexed for inflation, increase over time with the rising costs of medical care. The costs of certain other benefit programs, such as unemployment insurance and food stamps, vary with changes in the level of unemployment in the economy. Finally, the cost of servicing the federal debt depends on the level of interest rates.

CBO's baseline economic assumptions are discussed in Chapter II, and the differences between CBO and Administration assumptions are summarized in Table II-2. The effects of utilizing these CBO baseline economic assumptions on nondefense spending estimates are shown in Table V-27.

The largest economic reestimate results from different interest rate assumptions, with CBO's assumed interest rates being lower than those of OMB throughout the projections period. For calendar year 1983, CBO's assumed 91-day Treasury bill rate is 1.3 percentage points lower than OMB's, and CBO's assumed three- to five-year note rate is 0.7 percentage points lower. In later years, the assumed bill rates are closer together, but the differences in the longer maturities persist. CBO estimates that these lower interest rates will reduce debt service costs by $1 billion in 1983, $6 billion in 1984, and $12 billion in 1988. Other economic reestimates of outlays and revenues will also result in lower debt levels, which will further reduce interest outlays.

TABLE V-27. NONDEFENSE OUTLAY REESTIMATES BASED ON CBO'S BASELINE ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Interest Costs						
Lower interest rates	-1.1	-5.7	-6.6	-8.2	-10.5	-12.5
Different deficits	-0.1	-0.6	-1.6	-2.2	-2.0	-0.9
Social Security and Other Benefits Indexed to the CPI	-0.2	-1.8	-2.3	-2.6	-3.8	-5.7
Other Benefits Affected by Inflation	-0.2	-0.1	0.1	-0.3	-0.9	-1.9
Unemployment Compensation and Related Benefits	-0.7	-1.1	-0.4	0.4	1.9	3.0
Royalties from Offshore Oil and Gas Leases	0.3	0.4	1.4	1.8	3.6	3.8
Total	-2.0	-9.0	-9.4	-11.0	-11.7	-14.1

The inflation rates projected by CBO are slightly below the Administration's, particularly in 1983 and again in 1988. Hence, CBO's assumed automatic cost-of-living adjustments in federal programs are lower than the Administration's. For example, the 1983 Social Security COLA assumed by CBO is 4.1 percent, while the Administration's is 5.1 percent. The CBO and OMB assumptions for Social Security cost-of-living adjustments, which are based on the percentage increase in the Consumer Price Index for urban wage earners and clerical employees (CPI-W) from the first quarter of one year to the next, are shown in the following table.

Annual Social Security Cost-of-Living Adjustments (Percent)

	1983	1984	1985	1986	1987	1988
Administration	5.1	4.8	4.5	4.7	4.5	4.5
CBO	4.1	4.6	4.5	4.2	4.0	3.8

The lower COLAs projected by CBO for Social Security and other indexed benefits reduce outlays by $1.8 billion in 1984 and $5.7 billion in 1988. Other benefits affected by inflation also show reduced outlays under CBO economic assumptions. The reduction is small until 1986 and 1987, when it reaches $0.9 billion and $1.9 billion, respectively.

CBO assumes slightly lower unemployment rates than OMB early in the projections period but slightly higher unemployment later on. The lower rates in 1983 to 1985 contribute to reduced outlays compared with the Administration. In 1984, the resulting reduction is $1.1 billion, almost entirely in unemployment insurance benefits. In 1986 to 1988, however, CBO's higher unemployment rates add to outlays--$3.0 billion in 1988--partly offsetting the reductions because of interest rates and prices.

The final economic difference between CBO and OMB estimates is for royalties from offshore oil and gas leases. These royalties are a set percentage at the value of production and therefore vary with the level of energy prices. Because CBO assumes generally lower oil and gas prices than does the Administration, it also assumes lower royalty payments. The magnitude of the CBO reestimate is small in the early years but grows as more fields come into production. By 1988, CBO's estimate of royalty payments is almost $4 billion lower than OMB's.

Technical Estimating Differences

Technical estimating differences between CBO and OMB are small for nondefense spending in the aggregate, but there are a number of offsetting pluses and minuses. The major technical reestimates are displayed in Table V-28.

TABLE V-28. NONDEFENSE OUTLAY REESTIMATES BASED ON CBO'S TECHNICAL ESTIMATING METHODS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987	1988
Mineral Receipts	0.1	0.3	0.5	0.8	1.2	1.4
Farm Price Supports	*	0.8	0.8	2.0	1.6	1.4
Medicare	0.2	-0.7	-1.4	-0.8	*	1.0
Social Security	-1.0	-0.3	-1.7	-2.5	-3.5	-3.0
Unemployment Insurance	-3.4	-1.8	-0.9	-0.9	-1.4	-1.6
AFDC	-0.1	0.5	0.6	0.7	0.8	1.0
Veterans' Compensation and Pensions	0.2	-0.1	-0.4	-0.7	-1.1	-1.5
Interest Costs						
Estimating differences	-0.2	-0.1	0.1	-1.3	-3.2	-4.8
Different deficits	-0.4	-1.0	-1.3	-1.3	-0.7	0.2
OCS Receipts	1.4	2.7	1.6	-1.8	-0.7	0.1
Other, Net	1.6	1.3	1.1	1.5	1.2	1.4
Total	-1.6	1.6	-1.0	-4.3	-5.8	-4.1

* Less than $50 million.

CBO estimates that receipts from onshore mineral leases will be less than the Administration projects. This stems primarily from lower projections of royalties to be collected from recovery of oil, natural gas, and coal on federally owned lands. CBO assumes lower rates of production of oil and coal than does the Administration, as well as generally lower gas and oil prices.

Farm price support outlays are estimated to be above Administration estimates because of different assumptions about participation in various acreage reduction programs. Farmers participating in the payment-in-kind program are already eligible for payments and commodity loans under other acreage reduction programs; by participating in PIK, they receive noncash incentives to reduce planting further. In 1984 and 1985, CBO expects less acreage reduction than the Administration under PIK. The resulting larger harvest causes a higher commodity loan volume than estimated by the Administration. In 1986 through 1988, estimated supplies remain large, holding prices down. CBO's estimates of participation in assumed acreage reduction programs are greater than the Administration's, thereby increasing spending for deficiency payments.

In Medicare, the technical reestimate reflects differing CBO and Administration estimates of the effects of recently passed and newly proposed legislation. CBO expects greater savings from the revamped limits on reimbursable hospital costs, which were part of the Tax Equity and Fiscal Responsibility Act. CBO also makes different assumptions about the effect of proposed cost changes on beneficiaries' use of hospital services and about the response of physicians to the proposed freeze on reimbursable charges.

The reestimates in Social Security and veterans' compensation and pensions result from generally lower CBO projections of the beneficiary population. In Social Security, the difference represents 1 percent of program costs or less.

The CBO technical reestimate in unemployment compensation is based on continuation of the unusually low level of insured unemployment--the number of unemployed who claim unemployment compensation--relative to total employment. Last year, this divergence led to an overestimate of unemployment compensation outlays by both the Administration and CBO. The new CBO estimate reflects the recent relationship of insured to total unemployment. As a result, fewer states are expected to have insured unemployment rates high enough to trigger extended unemployment benefits, and fewer individuals are expected to collect both regular and extended benefits than in the Administration's estimates. In addition, the CBO estimate of extended benefits for 1983 is consistent with actual outlays during the first quarter of the fiscal year, while the Administration's outlays are well above the first quarter's rate.

The CBO technical reestimate for AFDC reflects different estimates of savings from the Administration's legislative proposals as well as different estimates of benefit increases under current law. CBO shows about $400 million lower savings per year for the job search/workfare proposals in 1984-1988 and lower savings for all proposals in 1984 because of assumed implementation delays. In addition, CBO projects increasingly higher benefit payments per family than does the Administration. CBO's projected payment increases are well below actual increases in recent years, however, because it is assumed that the financial problems of states will cause them to restrain AFDC program outlays.

CBO and Administration estimating differences in the net interest function are small, on balance, in the 1983-1985 period, although there are some offsetting changes. In the later years, CBO estimates are lower than the Administration's by increasing amounts, because CBO is more consistent in its treatment of interest payments on special debt issues held by federal government trust funds. These interest payments are recorded both as an outlay (interest on the public debt) and as offsetting receipts (interest received by certain trust funds) and, if estimated consistently, should have essentially no effect on net interest costs. Additional differences in interest costs result from the effect of other technical reestimates on debt levels.

The technical reestimates of receipts from Outer Continental Shelf (OCS) leases result from two factors. The reestimates for 1983 and 1984 derive from different projections of bonus receipts from new lease sales. The Administration expects record per-sale bonus receipts from Gulf of Mexico sales in 1983 and 1984. Based on recent past Gulf of Mexico sales and current economic conditions, CBO's estimates of bonuses for those sales are less than record levels. CBO also assumes a later release of sums currently in escrow accounts pending final judicial action. This reduces receipts in 1984 and 1985 but increases them in 1986 and 1987.

APPENDIX

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