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Mr. Chairman: In my presentation today, I would like to discuss some of the major challenges and opportunities facing the Congress as it plunges into the next budget cycle.

I will not limit my remarks to the Fiscal Year 1979 budget, however, because the goals that the Congress may wish to pursue through its budgetary policies cannot be achieved in a single year. Lowering the rates of inflation and unemployment, changing the size or composition of federal spending or the structure of federal taxes, or eliminating the federal deficit can be accomplished only gradually. Reaching such goals will require the adoption of a series of federal budgets that are consistent with certain objectives. Decisions on the Fiscal Year 1979 budget should, therefore, be regarded as part of a general budgetary strategy for the next several years.

WHERE WOULD CURRENT POLICY TAKE US

One can start by asking: What would happen to the federal budget if current policies were simply continued into the future? The answer, of course, depends on what happens to the economy. We have begun by assuming that the economy continues to recover at approximately the rates assumed in the conference report on the Second Concurrent Resolution on the Budget for Fiscal Year 1978--at least until the

unemployment rate reaches 4.5 percent--and that inflation declines slowly (see Table 1).

Under these assumptions, estimated receipts would increase from about \$463 billion in Fiscal Year 1979 to about \$777 billion in Fiscal Year 1983--or from 20 to 23 percent of the Gross National Product (GNP). 1/ (Table 2 depicts this rise.) Outlays would rise from about \$495 billion in Fiscal Year 1979 to about \$655 billion in Fiscal Year 1983, declining from 22 to 19 percent of GNP. The disproportionate rise in receipts as compared with outlays occurs because of the progressive nature of individual income taxes. 2/

OFFSETTING THE FISCAL DRAG

These projected current policy revenues and expenditures, however, are not consistent with the economic growth objectives set in the Second Concurrent Resolution for Fiscal Year 1978. If present policies were actually followed without change for the next five years, the federal budget would exert a restrictive influence on the economy. This is because, with incomes rising and inflation high, the government receipts grow much faster than do the outlays it puts back into the

1/ This projection includes the effects of the social security tax legislation passed after the Second Concurrent Resolution on the Budget for Fiscal Year 1978.

2/ More details are given here in Table 2 and in CBO Five-Year Budget Projections: Fiscal Years 1979-1983, Report, December 1977.

TABLE 1. AGGREGATE ECONOMIC ASSUMPTIONS: BY FISCAL YEARS

Selected Economic Variables	1977	1978	1979	1980	1981	1982	1983
Gross National Product (GNP)							
Current dol- lar GNP (billions of dollars)	1,841	3,057	2,274	2,519	2,783	3,079	3,386
Real GNP (billions of 1972 dollars)	1,319	1,387	1,451	1,520	1,593	1,670	1,736
Growth rate of real GNP (percent)	4.9	5.2	4.6	4.8	4.8	4.8	4.0
Unemployment Rate (percent)	7.3	6.7	6.3	5.8	5.3	4.8	4.5
Consumer Price Index (percent change)	6.1	6.0	6.0	5.8	5.5	5.6	5.8

TABLE 2. MAJOR COMPONENTS OF BUDGET OUTLAY AND REVENUE PROJECTIONS: BY FISCAL YEARS

Major Component	1977 Estimate	1978 Second Concurrent Resolution	Current Policy Projections				
			1979	1980	1981	1982	1983
<u>OUTLAYS</u>							
In Billions of Dollars							
National Defense	97	110	119	128	139	150	161
Contributory Benefit Payments for Individuals	136	148	161	176	194	213	238
Other Benefit Payments for Individuals	46	49	53	57	60	4	68
Grants to State and Local Governments	47	57	57	58	58	60	63
Net Interest	30	33	37	39	41	42	42
Other Federal Operations	47	62	68	72	73	77	82
TOTAL OUTLAYS	402	458	495	529	565	606	655

As a Percent of Total Outlays							
National Defense	24	24	24	24	25	25	25
Contributory Benefit Payments for Individuals	34	32	33	33	34	35	36
Other Benefit Payments for Individuals	11	11	11	11	11	11	10
Grants to State and Local Governments	12	12	12	11	10	10	10
Net Interest	7	7	7	7	7	7	6
Other Federal Operations	12	13	14	13	13	13	13
TOTAL OUTLAYS	100	100	100	100	100	100	100

As A Percent of GNP							
TOTAL OUTLAYS	21.8	22.3	21.8	21.0	20.3	19.7	19.3

<u>REVENUES</u>							
In Billions of Dollars							
TOTAL REVENUES	357	397 a/	463	528	608	692	777

As a Percent of GNP							
TOTAL REVENUES	19	19	20	21	22	22	23

NOTE : Detail may not add to totals because of rounding.

a/ The Second Concurrent Resolution on the Budget for Fiscal Year 1978 assumed energy legislation would add \$1.1 billion in receipts in fiscal year 1978.

economy in the form of wages, purchases, and benefit payments. Thus, if the level of unemployment is to be lowered significantly during the next five years, the government will have to counteract this restrictive effect (sometimes called "the fiscal drag") by cutting taxes or raising spending relative to the levels under current policy.

The extent to which the Congress elects to offset the fiscal drag, either by increasing spending or cutting taxes, depends on the relative importance it accords to two objectives: maintenance of rapid economic growth and avoidance of inflation. The larger the increase in spending or the cut in taxes, the better the chances that growth will be rapid and that unemployment will decline--but the greater the risk of accelerating inflation. (Let me point out that high growth is not necessarily associated with high federal spending. It could also be achieved by keeping federal spending to moderate levels, while making major cuts in taxes.)

The estimated size of the tax cuts or expenditure increases needed to keep the economy growing at the desired rate also depends partly on a force that is beyond the Congress' control: that is, the strength of the nonfederal sector of the economy. The vitality of private consumption, business investment, state and local government spending, and net exports cannot be predicted accurately. Some assumptions must be made--those made here are that the nonfederal sectors will

perform slightly above historical norms. But the Congress must stand ready to alter its budget policy if these assumptions prove too optimistic or too pessimistic, or if other, unpredicted events occur.

Despite all this uncertainty, however, it is safe to say the following: Unless nonfederal demand is unprecedentedly strong during the next five years, major new spending programs or tax reductions will be necessary to maintain economic growth at a rate high enough to provide jobs for a growing labor force. The combination of increased expenditures or lowered taxes chosen by the Congress will depend not only on how it weighs economic growth against the risk of inflation but also on how it balances desires for new government programs against desires to limit the role of government. Considerable pressures operate in both directions.

In the following sections, I will review some of the current major claims for additional spending and a few of the possible ways of reducing the budget over the next several years.

MAJOR CLAIMS

Welfare Reform

Reform of the nation's welfare system has long been a matter of urgent concern in the Congress. Recently, the Carter Administration submitted a proposal for comprehensive reform. The plan calls for replacement of several state and

federal assistance programs with a uniform cash assistance program, an expanded earned income tax credit, and an expanded public service employment program that would provide up to 1.4 million jobs in Fiscal Year 1981. If this proposal is adopted in 1978, it could increase federal welfare costs above those incurred under current policy by more than \$18 billion by Fiscal Year 1983. Debate is likely to center on whether such sweeping reform is preferable to more modest and less costly incremental changes in individual welfare programs. Cost estimates of both are shown in Table 3.

Defense Spending

Major programs to improve the capabilities of the U.S. strategic nuclear and general purpose forces are now underway. In the wake of the B-1 cancellation, proposals have been offered to accelerate the development and deployment of cruise missiles. In response to Soviet missile developments, programs are underway to develop a mobile ICBM--the M-X--and a more capable submarine-launched missile, the Trident II. Growing emphasis on forces for the defense of NATO Europe has given rise to proposals for more airlift, prepositioning of more army equipment in Europe, and some expansion of the tactical air forces. These pressures come on top of continuing modernization programs and the rising cost of the all-volunteer force.

TABLE 3. NET COST CHANGES RESULTING FROM WELFARE REFORM PROPOSALS:
BY FISCAL YEARS, IN BILLIONS OF DOLLARS

	1979	1980	1981	1982	1983
The Administration's Welfare Reform Proposal					
Federal	5.4	9.4	11.7	17.6	18.4
State and local	0	0	0	-3.2	-3.3
TOTAL	5.4	9.4	11.7	14.4	15.1
Incremental Option <u>a/</u>					
Federal	4.3	4.7	5.1	5.6	6.1
State and local	-3.0	-3.3	-3.5	-3.9	-4.2
TOTAL	1.3	1.4	1.6	1.7	1.9

a/ The combination of federalized AFDC and food stamp bonus value equal to 75 percent of poverty line. See Congressional Budget Office, Welfare Reform: Issues, Objectives, and Approaches, Background Paper (July 1977), pp. 59-65.

In May, the Administration--along with other NATO governments--agreed to raise defense spending by 3 percent per year in real terms. As can be seen in Table 4, 3 percent annual real growth in total defense spending could result in increases of \$22 billion over current policy levels by 1983. In the defense budget, "current policy" simply holds real spending constant, but it could fail to maintain real capability.

Health Care

Pressure to establish some sort of national health insurance system continues. A comprehensive system might cost as much as \$150 billion. It would probably have to be implemented in stages, both because the administrative machinery would take time to set up and because the health-care system would need time to adjust to changed patterns of demand. Since the Administration is not expected to present a national health insurance proposal until later this year, implementation of even the first stages of a comprehensive program could not be expected until Fiscal Year 1981.

Debate is likely to center on how a national system should be administered, to what extent it is to be financed by tax revenues, premiums, and on direct payments to patients. Other likely topics of debate include dental, mental, and long-term care, and the need for changes in the ways health care is delivered. Decisions on these issues will strongly

TABLE 4. COSTS OF ALTERNATIVE DEFENSE PROGRAMS: OUTLAYS IN BILLIONS OF DOLLARS

	1979	1980	1981	1982	1983
3 Percent Real Growth of DoD Military Spending	121	134	149	166	183
Fiscal Year 1978 Sub- mission, Five Year Projection	124	136	148	159	<u>a/</u>
Current Policy	119	128	139	150	161

a/ Not available.

influence the costs of a national program. If some form of catastrophic health insurance and a "federalization" of medicaid were to constitute the first stages of a health insurance plan, then federal health expenditures could rise by some \$30 billion by Fiscal Year 1983. (Table 5 illustrates this rise.)

Urban Programs

Numerous proposals to provide aid of various kinds to U.S. cities have been made in the Congress. Plans range from major attempts to rebuild decaying city centers to modest ones aimed at improving schools in areas with high concentrations of disadvantaged children. The Administration has indicated that it will introduce a proposal; details on this plan are not yet available. Because of the uncertainties and the range of possibilities, the projections for urban programs given later in this testimony simply assume a hypothetical program that starts at zero in 1979 and grows to \$12 billion in 1983. This can be taken to represent any of a number of possible, fairly extensive, programs.

Other Program Initiatives

Almost every Member of Congress can point to ongoing programs that he feels deserve more funding. In the context of a half-trillion dollar budget, most of these proposed increases are quite modest. But a series of small increases, when combined,

TABLE 5. COSTS OF ALTERNATIVE NATIONAL HEALTH INSURANCE PROPOSALS:
OUTLAYS IN BILLIONS OF DOLLARS

	1979	1980	1981	1982	1983
Catastrophic Health Insurance	0	0	11.3	16.6	21.8
Federalized Medicaid	<u>0</u>	<u>0</u>	<u>6.4</u>	<u>6.9</u>	<u>7.5</u>
TOTAL	0	0	17.7	23.5	29.3

can represent a significant rise in expenditures. For example, if the various contributory benefit payments to individuals rose at an average rate of 2 percent per year--keeping pace with the growth of wages rather than just rising with prices as is assumed in the current policy projections--outlays in Fiscal Year 1983 would rise by up to \$24 billion. A similar increase of 2 percent per year would raise grants to state and local governments by more than \$4 billion. If the Congress allowed small increases in many programs, it could lose the chance to achieve its economic goals while initiating major programs or tax cuts. Multiyear budgeting could help focus attention on this danger.

POSSIBLE TOTAL INCREASES

The foregoing list of new initiatives is clearly incomplete. I have said nothing about energy, for example, or about transportation, space exploration, or agriculture. But the few items I did touch on illustrate the point that proposals now under serious discussion could easily add \$100 billion to federal spending by Fiscal Year 1983, even without comprehensive national health insurance. 3/

3/ This sum breaks down as follows: welfare reform (\$18 billion), plus 3 percent real growth in defense spending (\$22 billion), plus catastrophic health insurance and federalized medicaid (\$30 billion), plus a new urban program (\$12 billion), plus a modest allowance for other increases (\$15 billion).

CUTS BELOW CURRENT POLICY

Cutting federal spending down from current policy levels is clearly more difficult than increasing it. Opportunities for cuts in some areas, however, may arise from the passage of new legislation in related areas. Thus, for example, some observers might feel that the enactment of an incremental welfare reform option that would federalize the state cost of Aid to Families with Dependent Children (AFDC) would allow the Congress to eliminate the state share of the general revenue sharing program. Similarly, an increase in federal funding for elementary and secondary education might permit a phasing out of all or part of the impact aid program. Such tradeoffs could be seen as part of an overall strategy to limit or reduce the federal role.

Refusals to grant discretionary increases for inflation might also hold expenditures below current policy levels. For example, \$7.7 billion could be saved in Fiscal Year 1983 by holding most state and local grant programs to current funding levels without allowances for inflation. A series of these cutbacks could have a significant effect on what share of the budget goes to different types of activities. The series of changes illustrated in Table 6 would have the effect of lowering the percentage of the budget that would aid state and local governments from 10 percent under current policy to roughly 8 percent in Fiscal Year 1983.

TABLE 6. POSSIBLE REDUCTIONS IN OUTLAYS FROM CURRENT POLICY FOR
SELECTED STATE AND LOCAL GRANT PROGRAMS: BY FISCAL YEARS,
IN BILLIONS OF DOLLARS

	1979	1980	1981	1982	1983
Eliminate State Share of General Revenue Sharing and Hold at Current Law Levels			2.6	3.1	3.7
Limit LEAA's ^{a/} Responsi- bility to Research	0.5	0.6	0.6	0.6	0.6
Eliminate "Impact" Aid (Education)	0.8	0.8	0.9	0.9	1.0
Hold Other Grant Programs at Current Levels (No Increases for Inflation)	0.6	1.9	3.5	5.3	7.7
TOTAL	1.9	3.3	7.6	9.9	13.0

^{a/} Law Enforcement Assistance Administration.

Additional reductions might be achieved by changes in Defense Department manpower policies. Programs designed to diminish the fraction of the armed forces engaged in training, to encourage reenlistment, to make military pay fully taxable, and to reform the department's civilian pay practices could save \$2.5 billion a year by 1983. Reform of the military retirement system could not bring about major savings during the next five years, but further in the future, the effects of reform could be quite significant, cutting outlays by as much as \$2 billion per year.

TAX REDUCTIONS AND REFORM

Support for major tax reductions grows largely out of two perceptions: that a general reduction in the size of the federal government is desirable, and that there is a need to offset the recently enacted social security tax increases and the effects of inflation on the income tax. By Fiscal Year 1983, the social security tax increase just passed will yield on the order of \$27 billion extra in federal revenues. These increased revenues are likely to have a depressing effect on the economy that will have to be offset by lowering other taxes. If the Congress votes major new tax increases as part of a comprehensive energy program, the need for tax cuts could be further intensified.

Thus, the situation the Congress faces, Mr. Chairman, is one of having to choose among competing goals. Faster economic

growth would entail a greater risk of inflation. Speedier reductions in unemployment require larger federal deficits. More program initiatives would mean smaller tax cuts. Tight restraints on the size of the federal sector of the economy would require difficult choices among new spending programs.

RESOURCES FOR PROGRAMS AND TAX CUTS

Economists used to warn the Congress that adding substantial new federal programs to the current policy base would require increases in tax rates. But with inflation running at 5 percent to 6 percent, increases in effective tax rates are automatic. Unless tax laws are changed or nonfederal demand is much stronger than it has been in recent years, the increases in expenditures required to achieve even quite modest rates of economic growth would probably be large enough to accommodate most of the major new spending programs proposed for the next few years (increased defense spending, welfare reform, the first phases of a national health insurance system, and new initiatives to aid cities). Indeed, if the Congress chooses to seek fairly rapid economic growth, but not to cut tax rates, even the adoption of all of these spending programs would fail to offset the fiscal drag; even larger increases in federal spending would be necessary.

But to hold tax laws constant and offset the fiscal drag entirely through increased federal spending would result in a federal sector that is much larger relative to GNP in the future

than it is today. If federal expenditures are to be held at or below their current 22 percent share of GNP, a large portion of the needed economic stimulus will have to be provided through tax reductions rather than spending increases.

THREE ALTERNATIVE BUDGETARY APPROACHES

To illustrate these points, we have prepared three hypothetical five-year budgets. The first and second cut the federal share of GNP but vary the extent to which the fiscal drag is offset and consequently the rates of economic growth, unemployment, and inflation. The third increases growth and employment rapidly by relatively unrestricted federal spending. Let me emphasize, however, that a large public share of GNP and rapid growth do not necessarily go together. Large tax cuts could make possible the combination of a much smaller federal share and rapid growth.

Budget I. Smaller Federal Sector

The budgetary policy depicted in Table 7 is designed to shrink the fraction of potential GNP accounted for by federal spending from its current level of 21 percent down to 19.5 percent by Fiscal Year 1983. At the same time, such a policy would promote a continuing, moderate rate of economic growth. (In this illustration and in all the illustrations I will present, we have assumed that the level of nonfederal demand is vigorous, but not unprecedentedly so.) Given the budget shown in Table 7,

TABLE 7. BUDGET I--LOWER GROWTH AND BALANCED BUDGET IN 1981 (EXPENDITURES FALL TO 19.5 PERCENT OF POTENTIAL GNP BY 1983): BY FISCAL YEARS, IN BILLIONS OF DOLLARS a/

	1979	1980	1981	1982	1983
Real GNP Growth Rate (percent)	4.3	4.0	4.0	4.0	4.0
Unemployment Rate (percent)	6.3	6.1	6.0	5.8	5.6
Inflation Rate (percent)	5.9	5.7	5.3	5.2	5.1

Current Policy Outlays	493	529	565	605	651
Changes from Current Policy					
3 percent real growth in defense spending	5	10	13	19	25
Incremental welfare reform <u>b/</u>	<u>4</u>	<u>5</u>	<u>5</u>	<u>6</u>	<u>6</u>
Subtotal	502	544	583	630	682
Spending Cuts Below Current Policy to Reach 19.5 Percent	<u>10</u>	<u>19</u>	<u>24</u>	<u>24</u>	<u>20</u>
TOTAL OUTLAYS	492	525	559	605	662

Current Policy Revenues	463	524	599	673	750
Tax Cuts Required Below Current Policy	<u>22</u>	<u>40</u>	<u>70</u>	<u>87</u>	<u>96</u>
TOTAL REVENUES	441	484	529	586	654

BUDGET SURPLUS	-51	-41	-30	-19	-8

NOTE: Assumes 4.0 percent real growth in GNP after fiscal year 1979.

a/ Detail may not add to totals because of rounding.

b/ Some increased federal spending is offset by decreased state and local spending.

inflation could be expected to decline from an estimated 6.0 percent in Fiscal Year 1978 to 5.1 percent in Fiscal Year 1983. This could be accomplished, however, only by slowing the rate of real economic growth to about 4 percent a year. This growth rate would be sufficient to alleviate unemployment only modestly--from 6.4 percent at present to about 5.6 percent in Fiscal Year 1983.

Reducing federal spending to 19.5 percent of potential GNP by 1983 restricts the growth of federal spending sharply. In fact, for the first three years shown in Table 7, federal outlays must be slightly below current policy outlays. Only in Fiscal Year 1983 do federal outlays rise above the current policy level, and then only by \$11 billion. This means that if any new federal spending is to be undertaken, offsetting cuts will have to be made in already existing programs. To illustrate this point, we have included in this budget sufficient increases in federal spending to allow 3 percent real growth of defense spending and a modest increase in federal spending associated with an incremental reform of the current welfare system. Please note that reductions of as much as \$20 billion must be made in other programs in order to make room for these increases in spending.

Because federal spending is so restricted in this budget, most of the fiscal drag offset required to produce even the relatively slow economic growth shown in the table is provided through tax cuts. These amount to \$22 billion in Fiscal Year 1979. Another \$74 billion cut below current policy is required between 1979 and 1983. Despite these large tax cuts, however, the federal deficit moves steadily toward surplus. A \$51 billion deficit in 1979 becomes an \$8 billion deficit in 1983.

Budget II. More Rapid Economic Growth and A Small Decrease
in the Federal Sector

The set of budgets illustrated in Table 8 would lower federal spending only to 20.5 percent of potential GNP by fiscal year 1983 and could produce a faster reduction in unemployment at the price of more inflation. In this example, larger spending increases and tax cuts result in real rates of economic growth of 4.8 percent a year through 1982 and a slower rate of 3.7 percent in 1983. The reason for this slowing in the rate of economic growth is that, by 1983, the unemployment rate would be down to 4.5 percent (a level sometimes termed "full employment") and if such rapid economic growth were to continue, strong inflationary pressures would be generated. As it is, the rate of inflation declines slightly in Fiscal Year 1981 but would begin to rise in 1982 and 1983.

TABLE 8. BUDGET II—CURRENT POLICY PLUS LIMITED INITIATIVES (EXPENDITURES GO TO 20.5 PERCENT OF POTENTIAL GNP BY 1983): BY FISCAL YEARS, IN BILLIONS OF DOLLARS a/

	1979	1980	1981	1982	1983
Real GNP Growth Rate (percent)	4.6	4.8	4.8	4.8	4.0
Unemployment Rate (percent)	6.3	5.8	5.3	4.8	4.5
Inflation Rate (percent)	6.0	5.8	5.5	5.6	5.8

Current Policy Outlays	495	529	565	606	655
Changes from Current Policy					
Five-year projection of defense spending	5	8	9	9	10 <u>b/</u>
Major welfare reform <u>c/</u>	5	9	12	18	18
Federalized medicaid <u>c/</u>	0	0	6	7	8
Other changes	<u>1</u>	<u>2</u>	<u>0</u>	<u>-1</u>	<u>4</u>
TOTAL OUTLAYS	506	548	592	639	695

Current Policy Revenues	463	528	608	692	777
Available for Tax Cuts Below Current Policy	<u>19</u>	<u>41</u>	<u>63</u>	<u>97</u>	<u>109</u>
TOTAL REVENUES	444	487	545	595	668

BUDGET SURPLUS	-62	-61	-47	-44	-27

NOTE: Assumes 4.8 percent real growth through fiscal year 1982, falling to 3.7 percent in fiscal year 1983.

a/ Detail may not add to totals because of rounding.

b/ Projected.

c/ Some increased federal spending is offset by decreased state and local spending.

By allowing federal expenditures to constitute a slightly larger share of GNP, more room is available in this example for new spending initiatives. By 1983, federal outlays can be \$40 billion higher than current policy levels. This amount is sufficient to allow defense spending to grow at the rates projected in the Five Year Defense Plan submitted with last year's budget request and to allow both the implementation of the Administration's welfare reform program and the "federalization" of the medicaid program. Even if these new programs were implemented, some room would be left over for small increases in other programs.

Federal outlays are higher in Budget II than in Budget I, but in later years, the tax cuts required to sustain the higher growth rates are larger also. By 1983, these cuts will have to be large enough so that federal revenues are \$109 billion below what they would be if current policy taxes were maintained. These large tax cuts, coupled with the spending growth, result in larger federal deficits than in the first hypothetical budget.

The tax cuts shown in Budget II can be characterized by their likely effect on individual income tax rates. If the \$107 billion cut were divided between business and personal taxes in roughly the same proportion as cuts have been divided in the past, one might expect that \$75 billion of the cut would be in personal income tax. Such a cut might be

accomplished in several ways, for example:

- o By subtracting 5 percent tax points from each rate so that the rates would range from 9 to 65 percent instead of the current 14 to 70 percent; or
- o By setting each rate at 80 percent of its previous level so that new rates would run from 11 percent to 56 percent.

Obviously, such changes are large enough to be perceptible to most taxpayers.

Budget III. Rapid Reduction in Unemployment, No Constraint on Federal Spending

A budget designed to lower the rate of unemployment to 4 percent by calendar year 1983 and then to maintain that level is illustrated in Table 9. To reach this goal, very rapid economic growth is needed and large amounts of federal stimulus are necessary to produce this rapid growth. The price paid for this rapid growth, however, is higher inflation. By 1983, inflation would remain at 6 percent per year. Because inflation usually lags behind economic growth, the worst of the inflation effects of this set of budgets would not appear until 1985 when the inflation rate would reach 7.5 percent.

Please note that it will be much easier to maintain a 4 percent level of unemployment after 1983 than it would be today. Declining birth rates in the past mean that, in the mid-1980s,

TABLE 9. BUDGET III--HIGHER EMPLOYMENT, GREATER INFLATION, MORE PROGRAM INITIATIVES: BY FISCAL YEARS, IN BILLIONS OF DOLLARS a/

	1979	1980	1981	1982	1983
Real GNP Growth Rate (percent)	4.6	4.8	4.9	5.0	5.0
Unemployment Rate (percent)	6.3	5.8	5.3	4.8	4.2
Inflation Rate (percent)	6.0	5.9	5.5	5.7	6.0

Current Policy Outlays	495	529	566	609	661
Changes from Current Policy					
Five-year projection of defense spending	5	8	9	9	10 <u>b/</u>
Catastrophic health insurance plus federalized medicaid <u>c/</u>	0	0	18	24	29
Major welfare reform <u>c/</u>	5	9	12	18	18
Urban policy initiative	0	6	8	10	12
Other changes	<u>3</u>	<u>7</u>	<u>13</u>	<u>29</u>	<u>53</u>
TOTAL OUTLAYS	508	559	626	699	783

Current Policy Revenues	463	529	610	695	788
Available for Tax Cuts Below Current Policy	<u>16</u>	<u>28</u>	<u>28</u>	<u>33</u>	<u>33</u>
TOTAL REVENUES	447	501	582	662	755

BUDGET SURPLUS	-61	-58	-44	-37	-28

NOTE: Assumes same path as Budget II but continued growth in fiscal years 1982 and 1983.

a/ Detail may not add to totals because of rounding.

b/ Projected.

c/ Some increased federal spending is offset by decreased state and local spending.

fewer young workers will be entering the labor force than are entering it today. This will slow the growth of the total labor force, and real economic growth of only about 2.8 percent per year will be needed to maintain unemployment at the 4 percent level; it takes about 3.8 percent real growth to accomplish this today.

In Budget III, no constraint is placed on the size of federal spending. For illustrative purposes, we have included all of the major new spending programs that have been suggested, as well as sizable increases in other, existing programs. These increases will result in a federal sector that would account for a slightly larger share of potential GNP in 1983 than it does today. Despite these large increases in federal spending, a large, permanent tax cut is still required initially to produce economic growth.

CONCLUSIONS

Mr. Chairman, the examples I have just outlined represent only a sampling of the budgetary options available to the Congress over the next five years. Moreover, of course, great uncertainty attaches to all these estimates. The examples do, however, illustrate the range of choices open to the Congress; they also show how choices of one goal or policy constrain the possibilities of pursuing other goals. Comparison of the three budgets

suggests the following general observations:

- o In order to get to an economic path with significant declines in unemployment, major tax cuts or increases in expenditures--or both--will be required.
- o Any economic path with significant economic growth will generate enough revenue to pay for most of the new program initiatives that are now under discussion, unless the Congress wishes to reduce the federal share of GNP.
- o If the Congress does wish to cut the share of GNP going to the federal government, then new initiatives will have to be limited or financed by cutbacks in current programs, and the offsets to fiscal drag will have to come mostly from tax cuts.

The hypothetical budgets also illustrate the importance of looking beyond Fiscal Year 1979. The performance of the economy varies only slightly from one example to another in Fiscal Years 1979 or 1980; but by 1983 these differences are quite marked. Major changes in the economy cannot be achieved in a year or two. Several years of concerted budgetary policies are needed. Similarly, program goals may take years to accomplish. Social programs must be phased in gradually to avoid disruption. Research and development must be completed before new weapon systems

can be deployed. The design of complex programs may require years of technical and political preparation. For all these reasons, it is necessary for the Congress to take actions today that are designed to bring about results in the future. Conversely, the Congress must also take into account now the fact that actions taken to achieve immediate ends may have budgetary or functional implications for the future. Decisions made to respond to needs in the short term can constrain the choices available to future Congresses.

Making changes in national policy and keeping current decisions consistent with future goals could be made considerably easier if the Congress had a method for systematic reconciliation of future goals and current decisions. Such a method could be provided by shifting to a multiyear framework for budgetary decisions, with the Congress adopting budgetary targets for five years in advance. Such targets would not be binding and could be reviewed each year. But the process of setting the targets would compel the Congress to consider the future consequences of present actions. This in turn would give the Congress the opportunity to influence the size and composition of federal spending and revenues by choice rather than by accident.

