

Statement of Alice M. Rivlin  
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Before the Subcommittee on Employment Opportunities  
Committee on Education and Labor  
U.S. House of Representatives  
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There should be  
no release of this  
statement before  
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Mr. Chairman, in 1978, unemployment declined substantially, but inflation accelerated to near record levels for the postwar period. As a result, the Administration and the Federal Reserve have undertaken an anti-inflation program of tightened credit and wage-price guidelines, and the President has proposed spending cuts in the fiscal year 1980 budget.

In my statement today, I will cover four topics that affect consideration of the fiscal year 1980 budget:

- o The main outlines of the Administration's proposed budget and its effect on the economy;
- o The economic outlook for 1979 and 1980, with particular reference to the forecasts by the Congressional Budget Office and the Administration;
- o Fiscal policy options for 1980; and
- o Longer-run economic goals and policy strategies.

#### THE ADMINISTRATION'S BUDGET PROPOSAL

The Administration proposes to reduce spending growth significantly in fiscal year 1980 in order to complement the anti-inflationary effects of the wage-price program and tight monetary policy. The Administration's budget recommends outlays of \$531.6 billion, receipts of \$502.6 billion, and a budget deficit of \$29.0 billion (see Table 1). Under the Administration's proposed budget, total outlays for 1980 would be 7.7 percent above the estimated 1979 level. This contrasts with the 9.5 percent growth in federal spending expected in 1979 and the 11.9 percent growth that occurred in 1978.



TABLE 1. THE FEDERAL BUDGET OUTLOOK UNDER THE CBO CURRENT POLICY ESTIMATES AND THE ADMINISTRATION PROPOSAL: BY FISCAL YEAR, IN BILLIONS OF DOLLARS

	1978 (actual)	CBO Current Policy Estimates		Administration Budget Proposal	
		1979	1980	1979	1980
Receipts	402.0	453.3	502.3	456.0	502.6
Outlays	450.8	493.8	551.5	493.4	531.6
Deficits	48.8	40.5	49.2	37.4	29.0

SOURCES: The Budget of the U.S. Government, Fiscal Year 1980,  
and the Congressional Budget Office.

The Administration's recommended 1980 outlays are substantially below those that would result from continuing the current spending policies as established by the second budget resolution for 1979. CBO estimates that current policy outlays in 1980 would total \$551 billion, nearly \$20 billion above the President's budget proposal. Approximately \$8.5 billion of the difference between the Administration's request and CBO's current policy estimates is related to differences in economic assumptions and estimating methodologies. The remaining difference--\$11.5 billion--results from cutbacks in programs.



### Program changes recommended by the President

Some of the larger program reductions are in the areas of the budget dealing with employment and training, health care financing, and income security (see Table 2).

- o For Comprehensive Employment and Training Act (CETA) programs, the President has proposed a net decrease of \$3.1 billion in outlays from current policy levels. This would substantially reduce the number of public service employment jobs and the number of slots in several youth programs (see Table 3). As a result of the recent reauthorization of CETA, the remaining public service jobs would be more targeted on disadvantaged workers.
- o For health care programs, the President has recommended a reduction in funding of \$2.6 billion below current policies. This reduction includes a \$2.3 billion decline in medicare and medicaid spending, resulting from proposed legislation to contain hospital costs and from other program changes. Reduced funding for health care personnel training has also been recommended.
- o For income security programs, the President has proposed cutting certain social security benefits, including eliminating the \$255 lump-sum death benefit, phasing out college aid for dependents, terminating the parent's benefit once the youngest child reaches age 16 (rather than age 18), and eliminating the minimum benefit for new recipients. These proposals would reduce social security outlays by \$0.6 billion.

Although the President's proposed budget cuts are disproportionately in the domestic areas of the budget, the intent of the Administration is that these reductions will not reduce benefits or services to the poor.

On the other hand, the President's budget proposals for national defense spending are not significantly different from current policy. Both the CBO estimate of current policy outlays for national defense and the President's proposal include a 3 percent real growth in outlays, resulting from past appropriations for procurement of weapons.





TABLE 2. CURRENT POLICY OUTLAYS AND THE ADMINISTRATION'S PROPOSED CHANGES: FISCAL YEAR 1980, IN BILLIONS OF DOLLARS

	CBO Estimate of Current Policy	CBO Estimate of Administra- tion's Request	Difference
<b>National Defense</b>			
Military and civilian pay raises	3.1	2.2	-0.9
DoD operations and maintenance	38.0	38.9	0.9
Other national defense	84.2	84.3	0.1
Subtotal	<u>125.3</u>	<u>125.4</u>	<u>0.1</u>
<b>Human Resources</b>			
CETA employment and training programs	12.7	9.6	-3.1
Education programs	14.5	13.9	-0.6
Other function 500	7.6	7.3	-0.3
Medicare and medicaid	48.4	46.1	-2.3
Other health programs	9.3	8.9	-0.3
Social security	117.3	116.7	-0.6
Food stamps	6.1	7.5	1.4
Real wage insurance	—	0.3	0.3
Other income security	60.8	60.8	a/
Veterans' readjustment benefits	2.6	2.3	-0.3
Veterans' hospital and medical care	6.4	5.8	-0.5
Other veterans' benefits and services	12.6	12.5	-0.1
Subtotal	<u>298.2</u>	<u>291.6</u>	<u>-6.6</u>
Net Interest	46.0	45.2	-0.8
<b>All Other</b>			
Natural resource and environment programs	12.8	11.9	-0.9
Farm price supports	3.4	2.6	-0.8
Commerce and housing credit	4.1	3.4	-0.7
SBA disaster loans	0.8	a/	-0.8
Antirecession fiscal assistance	0.5	—	-0.5
Civilian agency pay raises	1.4	0.9	-0.5
All other, net	59.0	59.0	a/
Subtotal	<u>82.0</u>	<u>77.8</u>	<u>-4.2</u>
Total	551.5	540.0	-11.5

a/ Less than \$50 million.



TABLE 3. ADMINISTRATION'S FISCAL YEAR 1980 BUDGET REQUEST FOR SELECTED COMPREHENSIVE EMPLOYMENT AND TRAINING ACT (CETA) PROGRAMS

Program	Outlays (In millions of dollars)		Average Slot Levels		
	President's budget	CBO estimate of current policy	President's budget	President's budget under CBO cost estimates	CBO estimate of current policy
Public Service Employment					
Title II-D	2,359	3,145	267,000	249,000	293,000
Title VI	<u>2,571</u>	<u>4,344</u>	<u>279,000</u>	<u>273,000</u>	<u>458,000</u>
Total	<u>4,930</u>	<u>7,489</u>	<u>546,000</u>	<u>522,000</u>	<u>751,000</u>
Youth Programs					
Young Adult Conservation Corps	153	332	14,600	14,600	31,600
Youth Community Conservation Improvement Projects	140	150	16,600	16,600	17,900
Youth Incentive Entitlement Pilot Projects	43	160	7,700	7,700	28,500
Youth Employment and Training Program	850	641	164,800	164,800	123,000
Job Corps	400	407	42,000	42,000	n.a.
Summer Youth Program	545	933	<u>128,000 a/</u>	<u>128,000 a/</u>	<u>219,000 b/</u>
Total	<u>2,131</u>	<u>2,623</u>	<u>373,700 c/</u>	<u>373,000</u>	<u>n.a.</u>

n.a. = not available

a/ Annual average based on 750,000 persons served during the summer months.

b/ Annual average based on 1,000,000 persons served during the summer months.

c/ Annual average includes service years provided under the Summer Youth Program. Thus, the number of slots varies from 245,700 during non-summer months to 995,700 during the summer.



### Effects of the President's Budget Proposals

If the Congress holds taxes and spending at current policy levels, the budget would likely exert a mildly restrictive effect on the economy in 1980. The spending cuts proposed by the Administration would make the budget somewhat more restrictive than current policy. CBO estimates that the spending cuts would raise the unemployment rate by about 0.2 percentage point by the fourth quarter of 1980 (see Table 4). The effects of the spending cuts on inflation would be quite small initially, but their impact would continue to build for some time, if the restrictive policies were maintained. Spending cuts lower inflation because they reduce demand pressures generally and because some cuts, such as the proposed cap on hospital cost reimbursement, may have a direct effect on inflation (the direct anti-inflation impact of this proposal is not incorporated in CBO's estimates).

TABLE 4. CBO ESTIMATES OF THE ECONOMIC EFFECTS OF THE ADMINISTRATION'S PROPOSED SPENDING CUTS RELATIVE TO THE EFFECTS OF A CONTINUATION OF CURRENT POLICY: BY CALENDAR YEAR a/

	1980:4	1981:4
GNP (billions of current dollars)	-15	-20
GNP (billions of 1972 dollars)	-5	-4
Unemployment Rate (percentage points)	+0.2	+0.2
Employment (thousands)	-350	-350
Inflation Rate (percentage point change in GNP implicit price deflator, fourth quarter to fourth quarter)	-0.1	-0.2

a/ Does not include the real wage insurance proposal.



On balance, the effects of the President's budget recommendations on structural unemployment are uncertain. If, as a result of the Administration's proposals, unemployment increases substantially, a greater proportion of structurally disadvantaged individuals than of the general population will become unemployed. On the other hand, several of the Administration's budget proposals could beneficially affect structural unemployment, not significantly in 1979 and 1980, but over a longer horizon; two examples are the jobs component of the welfare reform proposal and the proposed National Development Bank. The President has also stated his intention to request a supplemental appropriation for additional public service jobs if unemployment increases. In addition to these proposals, the targeted jobs tax credit, which was enacted last year, is being phased in. But there is a time gap between the proposed phasing down of the countercyclical jobs program and the implementation of these longer-run initiatives; there is also the uncertainty over whether the new proposals will be adopted and, if they are adopted, whether they will be effective.

#### THE ECONOMIC OUTLOOK

The President's proposals, need to be viewed within the current economic environment in order to assess their desirability. The Administration's budget cuts are being proposed in the context of stubbornly high inflation and an uneven labor market that is relatively tight for some population groups. On the one hand, unemployment rates for some groups of workers are





nearing a "caution zone" in which inflationary pressures could become significant. One measure of labor market slack--the jobless rate for married men--has dropped below its 1972 level and is nearing its rate during the "boom" year of 1973 (see Table 5). On the other hand, unemployment rates for some groups--particularly nonwhites--remain considerably above 1972-1973 levels.

TABLE 5. MEASURES OF LABOR MARKET SLACK

Unemployment Rates for Selected Groups (as Percent of Civilian Labor Force)	1972	1973	1978	Fourth Quarter 1978
All Workers	5.6	4.9	6.0	5.8
Married Men, Wife Present	2.8	2.3	2.8	2.5
Professional and Technical Workers	2.4	2.2	2.6	2.7
Craft and Kindred Workers	4.3	3.7	4.6	4.5
White 20 Years and Over				
Males	3.6	2.9	3.7	3.5
Females	4.9	4.3	5.2	5.0
Nonwhite 20 Years and Over				
Males	6.8	5.7	8.6	8.3
Females	8.8	8.2	10.6	10.2
Teenagers				
White	14.2	12.6	13.9	14.0
Nonwhite	33.5	30.2	36.3	35.3

SOURCE: U.S. Department of Labor, Bureau of Labor Statistics.



## The CBO Economic Forecast

While labor markets may be relatively tight today, most forecasters expect that the unemployment rate will rise later this year, even without the President's proposed budget cuts. Although economic growth has been strong recently, the high rate of inflation has planted the seeds of a slowdown in the economy:

- o In response to the increase in prices and the associated depreciation of the dollar, the Federal Reserve has tightened monetary policy. The resulting credit restraint is expected to affect housing and business investment adversely later this year.
- o Rapid inflation apparently has also led to buy-in-advance behavior by consumers. This response is reflected in the record high ratios of consumer debt to income and may be borrowing sales from later in the year.
- o Finally, consumer and business confidence dropped sharply toward the end of last year, in part because periods of high inflation are typically followed by recession.

While most forecasters agree that there will be a slowdown in the pace of economic activity this year, they differ concerning the timing and the severity of the slowdown.

According to the CBO forecast, which is based upon a continuation of current fiscal policy and of a tight monetary policy, economic growth is expected to slow significantly during 1979, and the unemployment rate is projected to rise to a 6.2 to 7.2 percent range by the end of the year (see Table 6). The economic downturn predicted by CBO during the second half of 1979 is the outcome of continued high rates of inflation and tight credit conditions. (CBO assumes that monetary policy will not ease during the first half of 1979 as long as inflation rates remain high.)



A mild recovery in economic growth is foreseen in 1980, but the unemployment rate is projected to persist in the 6.2 to 7.2 percent range during the year (see Table 6). Meanwhile, inflation is expected to remain stubbornly high.

TABLE 6. SUMMARY OF CBO ECONOMIC PROJECTIONS UNDER CURRENT POLICY, CALENDAR YEARS 1979 AND 1980

Economic Variable	1976:4 to 1977:4 (actual)	1977:4 to 1978:4 (actual)	1978:4 to 1979:4	1979:4 to 1980:4
GNP (current dollars, percent change)	11.9	12.9	7.0 to 11.1	9.7 to 13.9
GNP (1972 dollars, percent change)	5.5	4.3	0.0 to 2.0	3.0 to 5.0
Consumer Price Index (percent change)	6.6	8.9	7.0 to 9.0	6.5 to 8.5
Unemployment Rate, End of Period (percent)	6.6	5.8	6.2 to 7.2	6.2 to 7.2

The Administration's Forecast

The Administration's forecast is more optimistic than CBO's (see Table 7). The Administration forecast shows a greater moderation in inflation in 1979, somewhat higher real economic growth, and a smaller increase in the unemployment rate.



TABLE 7. THE ADMINISTRATION'S FORECAST, CALENDAR YEARS 1979 AND 1980

Economic Variable	1978:4 to 1979:4	1979:4 to 1980:4
GNP (current dollars, percent change)	9.8	9.8
GNP (1972 dollars, percent change)	2.2	3.2
Consumer Price Index (percent change)	7.5	6.4
Unemployment Rate, End of Period (percent)	6.2	6.2

SOURCES: The Budget of the United States Government, Fiscal Year 1980 and Economic Report of the President (January 1979).

BUDGET OPTIONS FOR FISCAL YEAR 1980

If the Congress feels that the President's spending cuts do not satisfy its priorities, it can consider other budget options that could have roughly the same effect on inflation and a less severe impact on employment. Two possible options are:

- o Reducing payroll taxes by \$10 billion; or
- o An across-the-board reduction in spending rather than one that has a disproportionate effect on domestic programs.





Payroll Tax Cuts. In contrast to most tax cuts, which stimulate employment but increase prices, payroll tax cuts would be expected to have a beneficial effect on inflation, at least in the short run. For example, CBO's analysis suggests that a reduction of \$10 billion in the social security tax would reduce the Consumer Price Index by approximately 0.2 percentage point after four quarters and 0.3 percentage point after eight quarters. This anti-inflation effect is greater than CBO's estimate of the short-run impact of the Administration's proposed cuts in spending. A reduction in social security taxes, however, would be contrary to the goal of making that program self-financing, unless program benefits were also reduced.

Cutting Expenditures Across-the-Board. The precise composition of any cut in federal expenditures has important implications for the effect of the budget on the economy. For example, a reduction in income transfers to persons generally would have less effect on spending and real Gross National Product (GNP) than a reduction of similar size in direct federal purchases of goods and services. In addition, reductions in spending for public service employment are generally believed to have disproportionately large effects on employment and on the unemployment rate.

Thus, an across-the-board cut in federal expenditures--with equal proportionate reductions in transfers, purchases, and grants--could have about the same impact on inflation as the



package of cuts proposed by the Administration, but a somewhat lesser effect on employment. These differences, however, would not be large in terms of impacts on the overall economy. (The magnitude of the cuts that we are talking about are not large in a \$2.5 trillion economy.) A disadvantage of this approach is that an across-the-board cut would probably have to sacrifice such Congressional priorities as full funding of entitlement programs.

#### LONGER-TERM ECONOMIC GOALS

During the fiscal year 1980 budget deliberations, the Congress will be considering both short- and longer-term economic goals. The Humphrey-Hawkins Act establishes targets of 4 percent unemployment and 3 percent inflation for 1983, with priority given to the unemployment goal.

The Congress will, in all probability, encounter difficulties in reaching its longer-term economic goals. As recognized in the Humphrey-Hawkins Act, it is unlikely that both the unemployment and inflation targets can be reached by 1983 using monetary and fiscal policies alone. These policies reduce inflation by creating slack in the economy, and this medicine works slowly. To illustrate, a slow-growth option simulated by CBO suggests that five years of unemployment at about 7 percent would be needed to bring inflation down to the neighborhood of 4 percent. These results are based on the assumption that no price shocks occur--from the weather, OPEC, government, or other sources.



In contrast, expansionary monetary and fiscal policy could reduce unemployment to about 4 percent by 1983, but at the cost of sharply accelerating inflation. It is true that this jobless rate has occurred in the past with less upward pressure on prices than would occur now; however, low levels of unemployment are more difficult to achieve today because of the different demographic structure of the labor force and institutional changes such as increased coverage of unemployment insurance and the minimum wage.

Since the Humphrey-Hawkins goals will be difficult to achieve through the use of monetary and fiscal policies alone, the Congress may want to supplement the traditional tools with structural programs and reforms that may help to achieve the simultaneous reduction of inflation and unemployment. In looking at economic policy over the next five years, the Congress might consider supplementary tools such as the following:

- o Reducing government regulation of prices, wages, market entry, and methods of production;
- o Reducing government protection against inflation for various groups in the economy--for example, limiting agriculture price supports, holding down increases in the minimum wage, or reducing the effective indexing of transfer payments;
- o Reducing trade barriers;
- o Implementing incomes policies such as the President's wage-price program, that attempt to limit the catch-up to past inflation in wages, salaries, and profits; and
- o Expanding skill training and public-service jobs programs.



We cannot estimate with precision how effective these structural programs and reforms would be in slowing inflation and reducing unemployment. Some such programs appear to be necessary, however, if we are to achieve the goals of the Humphrey-Hawkins Act.

