CBO budget projections took on added importance in 1981 because they served as the baseline for computing the spending reductions to be achieved in the budget reconciliation process. The reconciliation instructions contained in the First Concurrent Resolution on the Budget for Fiscal Year 1982 required Senate and House committees to reduce 1982 outlays by a total of about $36 billion below baseline levels, but each committee had discretion regarding how these savings were to be achieved.

CBO has made similar use of baseline budget projections in its bill cost estimates for calculating the costs or savings that would result from legislative proposals to change existing law. This is particularly important for calculating the budgetary effects of changes in various entitlement programs, such as Social Security benefits, Medicaid, veterans' pensions, and federal employee retirement.

PLAN OF THIS REPORT

Chapter II provides an overview of the baseline projections for revenues, budget authority, and outlays for 1983-1987. It begins with a discussion of the economic assumptions used for the projections and presents the baseline spending and revenue projections. The sensitivity of the budget projections to economic assumptions is demonstrated by showing how the projections would change under alternative economic assumptions. The chapter also examines how and why these projections differ from the targets set in the first and second budget resolutions for fiscal year 1982.

The third chapter presents further detail on the baseline revenue projections, showing the revenues by major source and discussing the impact of the Economic Recovery Tax Act of 1981. It also explains how the baseline revenue projections would be affected by assuming alternative economic paths and reviews the reasons that the revenue projections differ from the 1982 budget resolution targets.

The last chapter provides further detail on the baseline spending projections by major program category. It also discusses how specific spending programs are affected by the alternative economic paths and why the baseline outlay projections for 1982-1984 are different from the budget resolution targets.

The appendixes to this report contain a distribution of the baseline spending projections by budget function and committee jurisdiction, a translation of the projections into national income and product account terms, and a detailed description of the programmatic assumptions contained in the baseline projections.

CHAPTER II. OVERVIEW OF THE PROJECTIONS

The Congressional Budget Office estimates that in fiscal year 1982 federal government revenues will equal \$631 billion, outlays \$740 billion, and the unified budget deficit \$109 billion, or 3.6 percent of the gross national product (GNP). If current taxing and spending policies are continued unchanged, both revenues and outlays will grow in absolute dollars but will decline as a percent of GNP. Over the next five years, however, baseline revenues as a percent of GNP will fall more rapidly than baseline outlays, so that the deficit as a percent of GNP will grow. In the absence of tax increases or spending reductions, the unified budget deficit will equal \$157 billion (4.6 percent of projected GNP) in 1983, \$188 billion (5.0 percent of GNP) in 1984, and \$248 billion (5.0 percent of GNP) in 1987.

These baseline projections are clearly not a forecast of what will actually happen. The economy may not perform as assumed for the projections. Future budgets undoubtedly will change present taxing and spending policies to adjust to changes in the economy and in national priorities. The baseline projections show the effect on the budget of continuing current policies under the CBO economic forecast for 1982-1983 and longer-run assumptions for 1984-1987.

This chapter describes the economic assumptions on which the baseline projections rest and summarizes those projections. It indicates how those projections would change if alternative assumptions were made about defense spending and if the discretionary inflation adjustments assumed in those projections were not provided. Next, it presents two alternative sets of economic assumptions and describes the effect each would have on the baseline projections and on Social Security revenues, outlays, and trust fund balances. Finally, a comparison is drawn between the projections and the revenue and spending targets contained in the first and second budget resolutions for fiscal year 1982. Additional details on the revenue and outlay projections are presented in Chapters III and IV, respectively.

ECONOMIC ASSUMPTIONS

Since economic conditions have major effects on federal budget revenues and outlays, budget projections must be based on explicit assumptions about economic trends over the next several years. Tax receipts depend on taxable incomes, which reflect both real economic growth and inflation. About 30 percent of federal spending is directly indexed for inflation through automatic cost-of-living adjustments. The costs of certain benefit programs, such as unemployment insurance and food stamps, also depend on the level of unemployment in the economy. The costs of interest on the public debt depend on the level of interest rates. In the absence of major budget cuts or program increases, the remainder of the budget typically has kept pace with inflation through specific Congressional actions.

The major economic assumptions underlying the baseline budget projections are shown in Table 1 and displayed in Figure 1. These assumptions are explained in detail in a companion volume to this report; they are only summarized here. 1/

TABLE 1. BASELINE ECONOMIC ASSUMPTIONS (By calendar year, dollar amounts in billions)

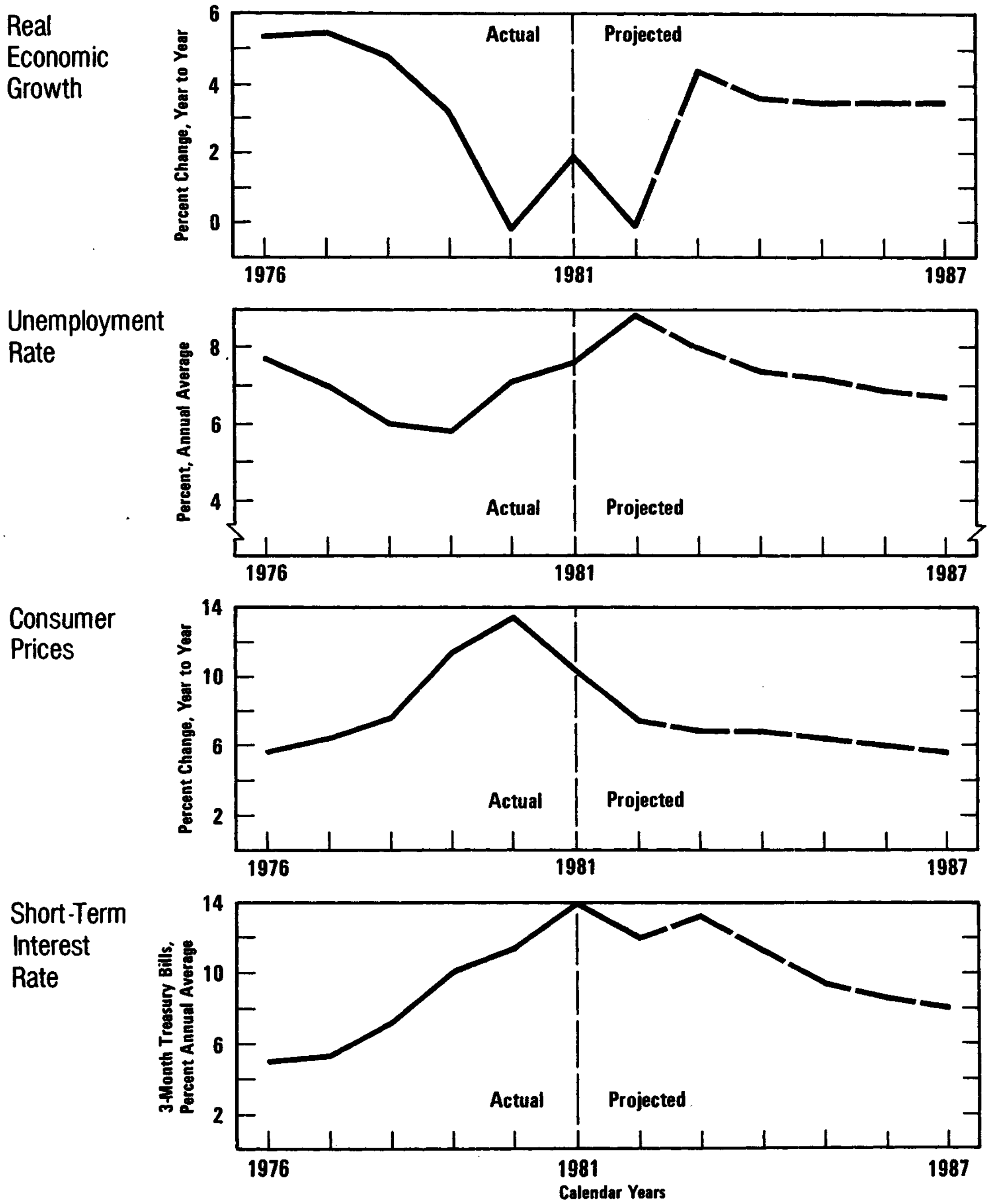
	1981 Actual	Forecast		Longer-Run Assumptions a/			
		1982	1983	1984	1985	1986	1987
Gross National Product (GNP)							
Current dollars							
Amount	2,922	3,140	3,515	3,882	4,259	4,659	5,083
Percent change, year to year	11.3	7.5	11.9	10.4	9.7	9.4	9.1
Constant (1972) dollars							
Amount	1,510	1,509	1,574	1,632	1,689	1,748	1,809
Percent change, year to year	1.9	-0.1	4.4	3.6	3.5	3.5	3.5
Prices							
GNP deflator (percent change, year to year)	9.1	7.5	7.3	6.6	6.0	5.7	5.4
Consumer Price Index (percent change, year to year)	10.3	7.5	6.9	6.9	6.4	6.0	5.7
Unemployment Rate (percent, annual average)	7.6	8.9	8.0	7.4	7.2	6.9	6.7
Interest Rate (91-day Treasury bills, percent, annual average)	14.0	12.0	13.2	11.3	9.4	8.7	8.1

a/ The CBO economic projections for the 1984-1987 period are not forecasts of probable economic conditions. Instead, they are assumptions that point to moderate noncyclical growth with sustained progress in reducing inflation and unemployment. It is uncertain whether the economic progress assumed in these projections can be attained with the prospective trend of money growth and without the enactment of further spending cuts or tax increases to reduce the deficit.

CBO projects that the current recession will continue through the first quarter of calendar year 1982, with an upswing beginning thereafter. The unemployment rate is projected to average 8.9 percent in calendar year

1/ See Congressional Budget Office, The Prospects for Economic Recovery (February 1982).

Figure 1.
Major Economic Assumptions



1982 and to decline to 8.0 percent in 1983. Inflation is expected to abate substantially because of food and fuel price increases below the overall rate of inflation and because of lower wage growth owing to the high unemployment. The rate of growth in the GNP deflator, which was 9.1 percent in 1981, is projected to decline to 7.5 percent in 1982 and 7.3 percent in 1983.

Because of the recession and lower inflation, interest rates are expected to decline during the first part of 1982. As the recovery progresses, however, a tight monetary policy is projected to push up real interest rates and restrain the rate of growth in real GNP below that generally expected during a recovery. The rate of interest on 91-day Treasury bills is projected to fall from 14.0 percent in 1981 to 12.0 percent in 1982, but to rise to 13.2 percent in 1983. Real GNP is assumed to decline by 0.1 percent in 1982 and to rise by 4.4 percent in 1983.

While all short-run economic forecasts are subject to considerable uncertainty, the range of uncertainty is even greater for economic assumptions more than two years into the future. The economic assumptions for 1984 and beyond are therefore not a forecast but an extrapolation of the forecast for 1982 and 1983. They are marked by continued moderate growth and steady reductions in inflation and unemployment. It is uncertain, however, whether the economic progress assumed in these baseline projections can be attained with the prospective trend of money growth and without the enactment of significant spending cuts or tax increases to reduce the deficit below projected baseline levels.

In the CBO long-run assumptions, growth in real GNP levels off at 3.5 percent a year. Unemployment gradually declines to 6.7 percent by 1987. The growth rate of the GNP deflator slows to 5.4 percent by 1987 as the result of prolonged high unemployment and below-average growth in food and fuel prices. The three-month Treasury bill rate is assumed to decline to 8.1 percent by 1987, reflecting the projected reduction in the rate of inflation and an easing in monetary policy.

BASELINE BUDGET PROJECTIONS

In previous CBO baseline projections, revenues grew faster than outlays and the budget began to show a surplus within two or three years. Projected revenues grew more rapidly than the economy, because inflation and economic growth pushed individuals into higher income tax brackets. Projected baseline outlays, on the other hand, grew more slowly than the gross national product, because most spending was assumed merely to keep pace with inflation.

The present baseline budget projections are quite different from those of the past. As a result of the tax cuts contained in the Economic Recovery Tax Act of 1981 (Public Law 97-34), baseline revenues grow less rapidly than the economy. Projected baseline outlays still grow less rapidly than the economy, but at a faster pace than revenues. The baseline budget projections are therefore characterized by large and growing deficits during the next five years, as shown in Table 2.

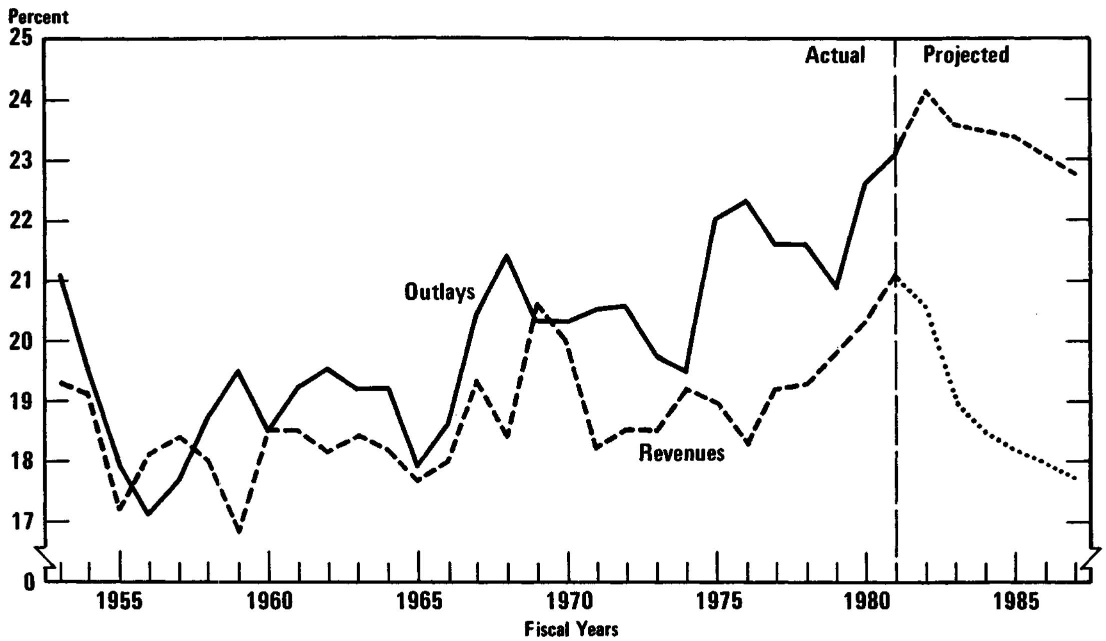
TABLE 2. BASELINE BUDGET PROJECTIONS (By fiscal year)

	1981 Actual a/	1982 Base	Projections				
			1983	1984	1985	1986	1987
			In Billions of Dollars				
Baseline Revenues	603	631	652	701	763	818	882
Baseline Outlays	660	740	809	889	971	1,052	1,130
Baseline Unified Budget Deficit	58	109	157	188	208	234	248
Outlays of Off-Budget Federal Entities	21	20	19	18	18	20	22
Total Deficit	79	129	176	206	226	254	270
Baseline Budget Authority	716	771	863	948	1,037	1,114	1,191
			As a Percent of GNP				
Baseline Revenues	21.1	20.6	19.0	18.5	18.3	18.0	17.7
Baseline Outlays	23.1	24.2	23.6	23.5	23.3	23.1	22.7
Baseline Unified Budget Deficit	2.0	3.6	4.6	5.0	5.0	5.1	5.0
Outlays of Off-Budget Federal Entities	0.7	0.7	0.6	0.5	0.4	0.4	0.4
Total Deficit	2.7	4.2	5.1	5.4	5.4	5.6	5.4

a/ As reported in Department of the Treasury, Final Monthly Treasury Statement of Receipts and Outlays of the United States Government for Period from October 1, 1980 through September 30, 1981.

Revenues. Baseline revenues are projected to rise from \$631 billion in 1982 to \$882 billion in 1987--an increase of 40 percent in five years. This represents an average growth of 6.9 percent a year, compared with an assumed average growth in nominal GNP of about 10 percent a year. Thus, as displayed in Figure 2, baseline revenues as a proportion of GNP are projected to decline from 21.1 percent in 1981 to 17.7 percent in 1987. The decline is relatively rapid during 1982, 1983, and 1984, when staged reductions in individual and corporate income taxes take place. The decline levels off thereafter, when personal income tax brackets are indexed to the Consumer Price Index in order to prevent effective tax rates from rising with inflation.

Figure 2.
Federal Revenues and Outlays as a Percentage of GNP



Outlays. Baseline outlays are projected to increase at a faster pace than revenues. Under baseline assumptions, outlays would rise from $660 billion in 1981 to $740 billion in 1982 and $1.1 trillion by 1987. This represents an average annual growth in outlays of 8.9 percent during the projection period (1982 to 1987), or about one percentage point less than the assumed growth in GNP and two percentage points higher than the projected growth in revenues. Under baseline assumptions, outlays would decline only slightly as a share of GNP--from 24.2 percent in 1982 to 22.7 percent in 1987. By 1987, the ratio of federal outlays to GNP would be about the same as it was in the 1975-1980 period, but would be higher than for the earlier postwar years.

Unified Budget Deficit. Under baseline assumptions, the unified budget deficit would rise significantly through 1984, both in dollar terms and as a percent of GNP. The deficit would equal $109 billion (3.6 percent of GNP) in 1982, $157 billion (4.6 percent of GNP) in 1983, and $188 billion (5.0 percent of GNP) in 1984.

From 1984 onward, baseline revenues and outlays would grow at similar rates. The deficit would grow in dollar terms, although it would remain roughly constant as a percent of GNP. By 1987, the deficit would equal $248 billion, or 5.0 percent of GNP.

Off-Budget Outlays. The spending of certain federal entities has, by law, been excluded from the unified budget totals. The outlays of these off-budget entities, however, must be added to the budget deficit to derive the total federal deficit that must be financed. Table 2 therefore shows the CBO baseline projection of the outlays of off-budget federal entities and of the total deficit.

Under baseline assumptions, the outlays of the off-budget federal entities are projected to decline from $20 billion in 1982 to $18 billion in 1984 and 1985, but to rise to $22 billion by 1987. As a fraction of GNP, off-budget outlays will decline from 0.7 percent in 1982 to 0.4 percent in 1985 and thereafter.

Taking into account off-budget outlays, the total federal deficit is projected to rise from 2.7 percent of GNP in 1981 to an average of 5.4 percent in the 1984-1987 period.

Effect of Alternative Defense Spending Assumptions

The baseline projections would not be the same, of course, if different assumptions were made about what constitutes existing federal spending policy. This section discusses how the projections would differ under two alternative defense spending assumptions.

The 1983-1987 baseline projections for the appropriated accounts, as explained in Chapter I, represent a continuation of the policies and program levels embodied in 1982 appropriation action. In the defense area, the baseline projections assume an explicit force structure and investment program that is described in Appendix D. Projected baseline defense appropriations adjusted for inflation rise by about 4.5 percent from 1982 to 1983, rise by another 2.2 percent in 1984, and decline slightly thereafter.

The first and second budget resolutions for 1982, however, assumed greater real increases in defense appropriations than are assumed in the baseline. CBO estimates that the 1982 budget resolutions provided for a 6.2 percent rate of growth in defense appropriations above and beyond the resolutions' assumed rate of inflation in 1983, and for a 7.0 percent real rate of growth in 1984. If these rates of real growth in defense appropriations were assumed, and if the 7.0 percent growth rate was continued through 1987, outlays and the deficit would be higher than the baseline by $1 billion in 1983, $7 billion in 1984, and $70 billion in 1987, as shown in Table 3. (These figures do not include any increases in interest costs on the federal debt resulting from higher outlays and deficits.) With 7.0 percent real growth in defense appropriations, total unified budget outlays would grow at about the same pace as GNP during the projection period, and would reach $1.2 trillion by 1987. The budget deficit would continue to grow relative to GNP throughout the projection period instead of leveling off after 1984. By 1987, as portrayed in Figure 3, the deficit would equal $318 billion, or 6.4 percent of projected GNP, compared with $248 billion and 5.0 percent under the baseline assumptions used for this report.

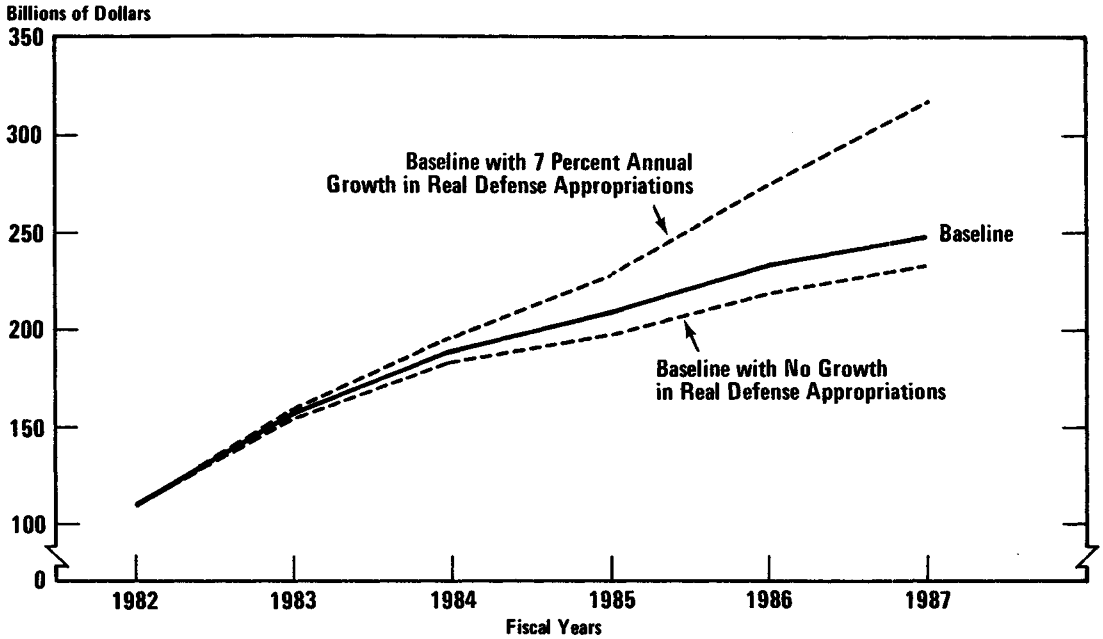
TABLE 3. EFFECT ON BASELINE OUTLAYS AND DEFICITS OF ALTERNATIVE DEFENSE APPROPRIATION ASSUMPTIONS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987
Effect of 7 Percent Annual Growth in Real Defense Appropriations	+1	+7	+20	+41	+70
Effect of No Growth in Real Defense Appropriations	-2	-5	-11	-15	-14

NOTE: The assumptions are explained in the text. The calculated outlays and deficits do not reflect changes in net interest outlays resulting from the changes in outlays and deficits.

In contrast, if no real growth in defense appropriations was assumed, outlays and the deficit would be lower than the baseline by $2 billion in 1983, $5 billion in 1984, and $14 billion by 1987. By 1987, the deficit would be $234 billion (4.7 percent of GNP).

Figure 3.
Federal Deficit Under Alternative Defense Appropriation Assumptions



Effect of No Discretionary Inflation Adjustments

As explained in Chapter I, the baseline projections assume that spending in annually appropriated accounts is increased each year to keep pace with inflation. In defense, the baseline reflects the projected increases in the costs of purchasing the underlying force structure and investment program. In the nondefense area, budget authority for the appropriated accounts is generally assumed to stay constant in real terms. These inflation adjustments are discretionary in nature, however, and need not be provided by the Congress.

If these discretionary inflation adjustments were not provided, outlays and the deficit would be lower than the baseline by $8 billion in 1983, $23 billion in 1984, and $82 billion in 1987, as shown in Table 4. By 1987, the deficit would be $166 billion instead of the $248 billion baseline projection.

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TABLE 4. EFFECT ON BASELINE OUTLAYS AND DEFICITS OF NO DISCRETIONARY INFLATION ADJUSTMENTS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987
Effect on Defense Programs	-4	-12	-23	-34	-46
Effect on Nondefense Programs	-4	-11	-19	-27	-36
Total	-8	-23	-41	-62	-82

NOTE: The calculated outlays and deficits do not reflect changes in net interest outlays resulting from the changes in outlays and deficits.

ALTERNATIVE ECONOMIC ASSUMPTIONS

As noted above, budget projections depend greatly on their underlying economic assumptions; changes in economic conditions can have major effects on revenues, outlays, and the deficit. Yet, forecasting economic conditions is subject to great uncertainty. Consequently, this section examines how the baseline budget figures would vary under alternative economic assumptions.

Although the economic assumptions underlying the baseline projections are those that CBO believes to be most likely, there is a good chance that the economy will perform differently than assumed. CBO has therefore prepared two alternative sets of economic assumptions, detailed in Table 5.

The first alternative is an optimistic one, predicated on lower inflation and a strong rebound in productivity growth. The assumption of low inflation permits larger gains in purchasing power and easier credit conditions than in the baseline; this, in turn, permits faster economic growth. Nominal GNP grows more rapidly than in the baseline. By the end of the projection period, the unemployment rate is stable at 5.6 percent, and the annual rate of increase in the Consumer Price Index is only 5.2 percent.

The second alternative is a pessimistic case, which illustrates the potential risks that the economy faces. In this alternative, inflation is higher and productivity growth is lower than in the baseline. In contrast to the first alternative, higher inflation is associated with an erosion of purchasing power and tighter credit conditions. Compared with the base-

TABLE 5. ALTERNATIVE ECONOMIC ASSUMPTIONS (By calendar year)

	1982	1983	1984	1985	1986	1987
Gross National Product (GNP)						
Current dollars (percent change, year to year)						
Optimistic alternative	7.7	13.0	11.5	10.7	9.6	9.1
CBO baseline projection	7.5	11.9	10.4	9.7	9.4	9.1
Pessimistic alternative	7.3	11.1	9.8	9.2	8.9	8.5
Constant (1972) dollars (percent change, year to year)						
Optimistic alternative	0.2	5.8	5.1	5.0	4.4	4.0
CBO baseline projection	-0.1	4.4	3.6	3.5	3.5	3.5
Pessimistic alternative	-0.3	3.0	2.1	2.0	2.0	2.0
Prices						
GNP deflator (percent change, year to year)						
Optimistic alternative	7.4	6.8	6.0	5.4	5.0	4.9
CBO baseline projection	7.5	7.3	6.6	6.0	5.7	5.4
Pessimistic alternative	7.6	7.9	7.5	7.1	6.7	6.4
Consumer Price Index (percent change, year to year)						
Optimistic alternative	7.5	6.4	6.2	5.7	5.3	5.2
CBO baseline projection	7.5	6.9	6.9	6.4	6.0	5.7
Pessimistic alternative	7.6	7.6	8.0	7.6	7.2	6.9
Unemployment Rate (percent, annual average)						
Optimistic alternative	8.9	7.6	6.6	6.0	5.6	5.6
CBO baseline projection	8.9	8.0	7.4	7.2	6.9	6.7
Pessimistic alternative	8.9	8.5	8.4	8.5	8.5	8.5
Interest Rate (91-day Treasury bills, percent, annual average)						
Optimistic alternative	11.5	10.7	9.4	8.3	7.6	7.4
CBO baseline projection	12.0	13.2	11.3	9.4	8.7	8.1
Pessimistic alternative	13.0	14.3	12.7	10.8	10.1	9.4

line, both real and nominal GNP grow more slowly. The unemployment rate remains at about 8.5 percent through 1987, and the rate of increase in the Consumer Price Index does not begin to come down until after 1985.

The revenues, outlays, and deficits resulting from these alternative economic assumptions are summarized in Table 6. Under the optimistic assumptions, the more rapid growth in GNP leads to higher revenues than in the baseline. Lower unemployment, inflation, and interest rates result in lower outlays. The deficits are therefore considerably smaller than in the baseline--leveling off in the vicinity of $150 billion in 1984 and thereafter. In the pessimistic alternative, exactly the reverse is true. Revenues rise more slowly than in the baseline, and outlays grow more rapidly. By 1987, the deficit would reach $367 billion. Further details on revenues and outlays under these alternatives are provided in Chapters III and IV.

TABLE 6. BASELINE BUDGET PROJECTIONS UNDER ALTERNATIVE ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

	1983	1984	1985	1986	1987
Baseline Revenues					
Optimistic alternative	658	713	786	849	921
CBO baseline projection	652	701	763	818	882
Pessimistic alternative	650	695	752	799	852
Baseline Outlays					
Optimistic alternative	800	863	932	1,001	1,067
CBO baseline projection	809	889	971	1,052	1,130
Pessimistic alternative	819	912	1,011	1,115	1,219
Baseline Unified Budget Deficit					
Optimistic alternative	142	150	146	152	146
CBO baseline projection	157	188	208	234	248
Pessimistic alternative	169	217	259	316	367

SOCIAL SECURITY PROJECTIONS

Social Security projections are particularly sensitive to economic assumptions. Social Security consists of four separately financed programs: old-age and survivors insurance (OASI), disability insurance (DI), hospital insurance (HI), and supplementary medical insurance (SMI). The first three of these programs are financed almost entirely by earmarked payroll tax contributions; the last is financed by a combination of general revenues and individual premium payments.

All OASI, DI, and HI payroll taxes are deposited in three separate trust funds--one for each program. The balances in these funds are invested in U.S. government securities, and all benefit and administrative payments are made from the funds. While the three payroll-tax-financed programs have separate trust funds, a program is allowed to borrow from one of the others if it is running short of money. This borrowing provision, however, is currently scheduled to expire on December 31, 1982.

Projections of Social Security trust fund outlays, incomes, and balances under the three sets of economic assumptions presented earlier are shown in Table 7. Figures are shown for the OASI, DI, and HI trust funds combined, on the assumption that the interfund borrowing provision will be extended beyond its current expiration date. The projections also assume that current law Social Security benefits would be paid, presumably out of general revenues, even if one of the trust funds was exhausted.

With current financing arrangements, the trust funds require a minimum level of reserves equal to 9 to 12 percent of annual expenditures at the beginning of a given month in order to be able to meet all benefit commitments during that month. They need this amount because cash benefits payments are made at one time early in each month, while tax payments are received continuously during the month.

Under baseline economic assumptions and absent new legislation, the combined OASI, DI, and HI trust funds would have positive balances at the start of each fiscal year, but during fiscal year 1984 the funds would drop below the 9 to 12 percent level necessary to avoid cash flow problems. Under the optimistic alternative, temporary cash flow problems would probably arise during early 1985 and early 1986, but the ratio of fund balances to outlays would begin to rise in 1986. Under the pessimistic alternative, balances would drop rapidly, and the combined trust funds would be exhausted by the end of fiscal year 1985.

TABLE 7. PROJECTIONS OF SOCIAL SECURITY TRUST FUND OUTLAYS, INCOMES, AND BALANCES UNDER ALTERNATIVE ECONOMIC ASSUMPTIONS (By fiscal year, dollar amounts in billions)

	1981 Actual	Projections					
		1982	1983	1984	1985	1986	1987
Outlays							
Optimistic alternative	169	192	214	234	255	277	300
CBO baseline projection	169	192	214	235	257	281	307
Pessimistic alternative	169	192	214	236	262	289	319
Income a/							
Optimistic alternative	167	189	205	227	259	292	320
CBO baseline projection	167	189	204	223	253	283	309
Pessimistic alternative	167	188	202	220	248	276	299
Year-End Balance							
Optimistic alternative	45	42	33	26	31	46	65
CBO baseline projection	45	42	31	20	15	16	18
Pessimistic alternative	45	41	30	13	-1	-14	-34
Start-of-Year Balance as a Percent of Outlays							
Optimistic alternative	27.7	23.6	19.5	14.2	10.3	11.2	15.3
CBO baseline projection	27.7	23.6	19.4	13.4	7.6	5.3	5.3
Pessimistic alternative	27.7	23.6	19.4	12.5	5.1	-0.2	-4.5

NOTE: The assumptions are detailed in the text. The figures shown are for the combined old-age and survivors insurance, disability insurance, and hospital insurance trust funds.

a/ Income to the trust funds is budget authority. It includes payroll tax receipts, interest on balances, and certain general revenue transfers.

BUDGET RESOLUTION TARGETS

The 1982 budget estimates and the 1983-1984 baseline projections differ significantly from the targets contained in the first and second budget resolutions for fiscal year 1982. As shown in Table 8, revenues in the baseline fall increasingly below the budget resolution targets, while baseline outlays increasingly overshoot the goals.

TABLE 8. COMPARISON OF BASELINE BUDGET PROJECTIONS AND FISCAL YEAR 1982 BUDGET RESOLUTION TARGETS (By fiscal year, in billions of dollars)

	1982	1983	1984
Revenues			
1982 budget resolution target	658	713	775
CBO baseline projection	631	652	701
Difference	-27	-61	-74
Outlays			
1982 budget resolution target	695	732	774
CBO baseline projection	740	809	889
Difference	45	77	115
Deficit (-) or Surplus			
1982 budget resolution target	-38	-19	1
CBO baseline projection	-109	-157	-188

For fiscal year 1982, estimated revenues are $27 billion less than the budget resolution target, while outlays are $45 billion higher. As a result, the projected deficit for fiscal year 1982 is $109 billion rather than the $38 billion anticipated in the 1982 budget resolutions. The differences between the resolutions and the baseline are larger still in 1983 and 1984. By 1984, baseline revenues are $74 billion below the budget resolutions, and outlays are above the resolutions by $115 billion. These differences turn a surplus of $1 billion in the budget resolutions into a deficit of $188 billion in the baseline.

The expected shortfall in revenues in each of the three years can be attributed almost entirely to changes in the economic outlook since the adoption of the first budget resolution. The economy is now expected to be performing at significantly lower levels during 1982-1984 than those assumed in the 1982 budget resolutions (see Table 9).

TABLE 9. COMPARISON OF ECONOMIC ASSUMPTIONS UNDERLYING BASELINE BUDGET PROJECTIONS AND FISCAL YEAR 1982 BUDGET RESOLUTIONS (By calendar year)

	1982	1983	1984
Gross National Product (GNP)			
Current dollars (percent change, year to year)			
1982 budget resolutions	13.0	12.4	10.8
CBO baseline projection	7.5	11.9	10.4
Constant (1972) dollars (percent change, year to year)			
1982 budget resolutions	4.1	5.0	4.5
CBO baseline projection	-0.1	4.4	3.6
Prices			
GNP deflator (percent change, year to year)			
1982 budget resolutions	8.6	7.0	6.0
CBO baseline projection	7.5	7.3	6.6
Consumer Price Index (percent change, year to year)			
1982 budget resolutions	8.3	6.2	5.5
CBO baseline projection	7.5	6.9	6.9
Unemployment Rate (percent, annual average)			
1982 budget resolutions	7.2	6.6	6.4
CBO baseline projection	8.9	8.0	7.4
Interest Rate (91-day Treasury bills, percent, annual average)			
1982 budget resolutions	10.5	9.4	8.2
CBO baseline projection	12.0	13.2	11.3

The bulk of the estimated increase in outlays for 1982 can be attributed to changes in economic assumptions and in other technical factors outside the control of the Congress. These include higher interest costs, unemployment and related benefits, farm price supports, and health care services costs. Most of the higher outlays projected for 1983 and 1984 can be attributed to higher interest costs and the exclusion from the baseline projections of unspecified outlay savings assumed in the 1982 budget resolutions for these years. These unspecified savings amount to $20 billion for 1983 and $28 billion for 1984.

Further details of the revenue and outlay comparisons are provided in Chapters III and IV, respectively.

CHAPTER III. BASELINE REVENUE PROJECTIONS

This chapter presents the baseline revenue projections, including the estimated revenue reductions attributable to the major provisions of the Economic Recovery Tax Act of 1981. It summarizes the effects of the act on tax burdens and its possible effects on economic efficiency. Finally, it describes the projections based on the alternative optimistic and pessimistic economic assumptions discussed in Chapter II.

The baseline revenues discussed equal those projected to accrue under current tax law with one exception: highway trust fund taxes are assumed to be extended at current rates throughout the projection period. Under current law, some of the highway trust fund taxes are scheduled to be reduced after fiscal year 1984. Both current law and baseline revenue projections are shown in Table 10.

Baseline revenues are estimated to equal $631 billion in fiscal year 1982 and to increase at an average annual rate of 6.9 percent over the projection period. This rate of growth is roughly two-thirds that of the rate of growth of the economy as a whole during the period. By fiscal year 1987, revenues are projected to equal $882 billion.

The signal characteristic of the baseline revenue path in the projection period is the slower rate of revenue growth as compared with the rates of growth experienced over the past decade. In contrast to the 6.9 percent average rate of growth projected between 1982 and 1987, revenues had increased at an average annual rate of 13.6 percent over the most recent six-year period, 1976-1981.

This moderation in revenue growth at a time when the economy is expected to be recovering strongly from the present recession means that the share of GNP claimed by the federal government through the tax system will be steadily dropping. The projected ratio of revenues to GNP falls steadily from 20.6 percent in 1982 to 17.7 percent in 1987--the smallest share claimed since 1965. (In fiscal year 1981, the revenue share reached 21.1 percent of GNP--the highest share since 1944. In the years between 1945 and 1980, it varied between 15 and 21 percent, impelled upward by the progressive income tax system and downward by periodic reductions in taxes.)

The shift in the course of revenue growth projected for the 1982-1987 period reflects the substantial structural changes in the tax

TABLE 10. BASELINE REVENUE PROJECTIONS BY SOURCE (By fiscal year, in billions of dollars)

	1981 Actual a/	1982 Base	Projections 1983	1984	1985	1986	1987
Individual Income Taxes	286	300	303	316	344	367	396
Corporate Income Taxes	61	50	51	62	63	64	73
Social Insurance Taxes	186	209	227	250	282	313	339
Excise Taxes	41	41	40	40	36	36	35
Windfall profit taxes	23	23	21	21	20	20	20
Other excise taxes	18	18	19	20	16	16	16
Estate and Gift Taxes	7	7	6	6	5	5	4
Customs Duties	8	9	9	9	10	10	10
Miscellaneous Revenues	14	15	16	18	19	19	19
Current Law Revenues	603	631	652	701	759	814	877
Extension of Highway Trust Fund Taxes	--	--	--	--	4	4	4
Baseline Revenues	603	631	652	701	763	818	882

a/ As reported in Department of the Treasury, Final Monthly Treasury Statement of Receipts and Outlays of the United States Government for Period from October 1, 1980 through September 30, 1981.

system brought about by the Economic Recovery Tax Act of 1981, signed into law on August 13, 1981.

THE ECONOMIC RECOVERY TAX ACT OF 1981

The Economic Recovery Tax Act departed from all other post-World War II tax legislation in its broad scope and in the magnitude of its revenue effects. The central objective of the act was to reduce the impediments thought to be placed by the tax system on productivity growth in a time of unusually high inflation. To this end, the act attempted to increase incentives to work, to save, and to invest. In the main, these incentives take three forms: reduced marginal tax rates on personal income, especially