SUMMARY TABLE 4. RELATIVE COMPOSITION OF THE UNIFIED BUDGET (By fiscal year)

Budget Component	Actual 1981	Administration Estimates 1982	1983	1984	1985
		Outlays in Billions of Dollars			
National Defense	159.8	187.5	221.1	253.0	292.1
Payments for Individuals					
Direct	276.7	310.1	328.3	345.4	367.5
Through states and localities	39.9	41.5	37.6	40.0	42.3
Other Grants	54.8	49.6	43.7	41.8	41.1
Net Interest	68.7	83.0	96.4	98.7	100.8
Other Federal Programs	57.4	53.6	30.6	27.1	24.6
Total	657.2	725.3	757.6	805.9	868.5
		Percent Change			
National Defense	17.6	17.4	17.9	14.4	15.4
Payments for Individuals					
Direct	16.8	12.1	5.9	5.2	6.4
Through states and localities	16.9	3.9	-9.5	6.4	5.9
Other Grants	-4.3	-9.3	-11.9	-4.4	-1.7
Net Interest	31.0	20.8	16.1	2.4	2.1
Other Federal Programs	-4.5	-6.5	-43.0	-11.2	-9.2
Total	14.0	10.4	4.5	6.4	7.8

CBO ANALYSIS OF THE PRESIDENT'S BUDGET

The Congressional Budget Office's analysis of the President's February budget finds that revenues would be slightly lower than estimated by the Administration for 1983-1985 and budget outlays would be higher. This finding results from CBO's technical analysis of the Administration's budget estimates and a substitution of CBO's economic assumptions for the Administration's. The CBO budget reestimates are shown in Summary Table 5.

SUMMARY TABLE 5. CBO BUDGET REESTIMATES (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
CBO Technical Reestimates				
Revenues	4.3	-5.2	-13.0	-15.6
Outlays				
Unified budget	12.2	19.9	22.1	23.0
Off-budget entities	0.6	0.8	0.9	1.1
CBO Baseline Economic Assumptions				
Revenues	-3.4	-0.8	5.6	-4.9
Outlays	1.2	3.2	16.4	24.2
Total Reestimates				
Revenues	0.9	-6.0	-7.4	-20.5
Outlays				
Unified budget	13.5	23.1	38.5	47.2
Off-budget entities	0.6	0.8	0.9	1.1

These reestimates produce a dramatic increase in the budget deficit, as shown in Summary Table 6 and as portrayed graphically in Summary Figure 1. Under CBO's technical and economic reestimates, the unified budget deficit rises from $111 billion in 1982 to $140 billion by 1985, almost twice the level projected by the Administration. Over the three-year period, 1983 to 1985, CBO estimates that the President's budgetary proposals would result in budget deficits that exceed the Administration's estimates by more than $140 billion. Almost $100 billion, or about 70 percent, of these higher deficits results from technical estimating differences. Another $44 billion results from using CBO's baseline economic assumptions instead of the Administration's.

SUMMARY TABLE 6. UNIFIED BUDGET DEFICITS (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
President's February Budget	98.6	91.5	82.9	71.9
Deficit with CBO's Technical Reestimates	106.5	116.6	118.1	110.4
Deficit with CBO's Technical Reestimates and Baseline Economic Assumptions	111.1	120.6	128.9	139.6

CBO Technical Reestimates

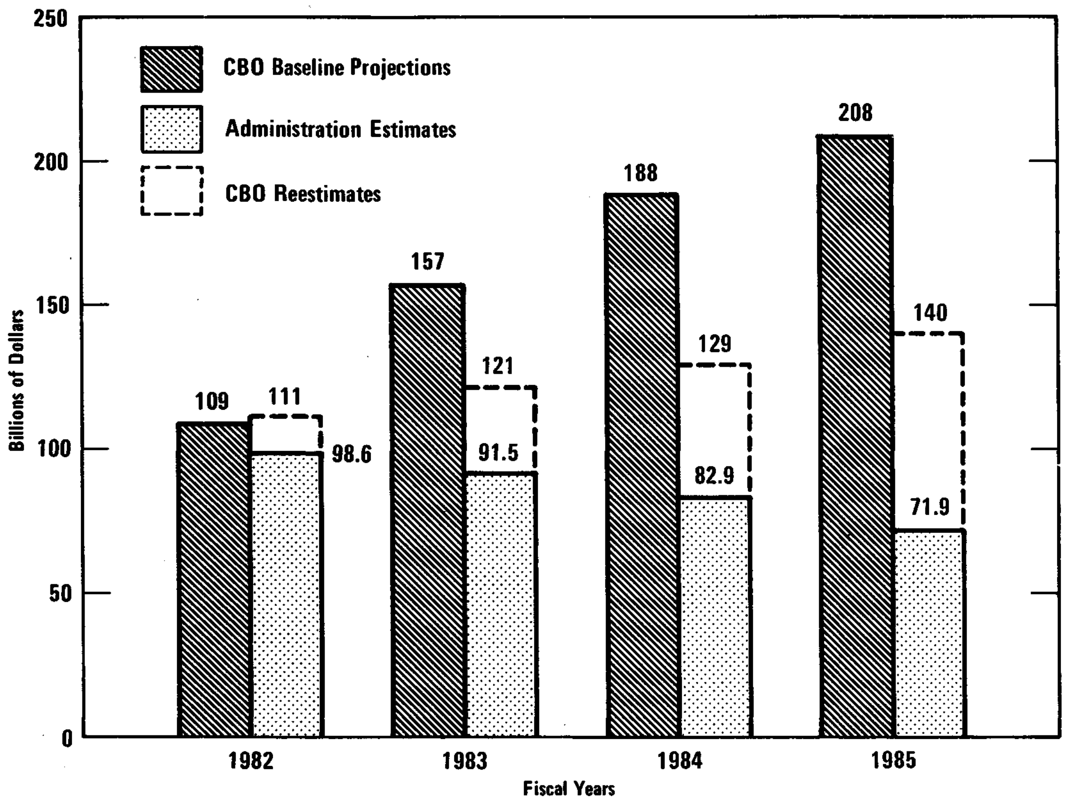
CBO's technical analysis of the Administration's budget estimates suggests that revenues may be overestimated in the February budget by about \$5 billion in 1983, \$13 billion in 1984, and \$16 billion in 1985. The technical reestimates for revenues result mainly from different estimates of the revenue effects of the Economic Recovery Tax Act. On the outlay side, CBO's technical reestimates suggest larger differences, averaging more than \$20 billion during 1983-1985. The major differences involve the cost of farm price supports, the rate of spending for defense procurement activities, likely receipts to be derived from the proposed accelerated leasing of OCS lands, and net interest costs. These four areas account for three-fourths of all the differences in CBO's technical reestimates for 1983-1985 outlays.

CBO Economic Reestimates

The economic forecasts of both the Administration and CBO are in close agreement for 1982. Real gross national product (GNP) is projected to rise by about 3 percent over the four quarters of the year, and the unemployment rate is expected to be in the neighborhood of 8½ percent at year's end. The forecasts of inflation and short-term interest rates are also similar in 1982.

In 1983, however, the Administration forecast for inflation and real growth is more optimistic than CBO's. While both forecasts imply virtually the same expansion of nominal GNP, the Administration looks for real GNP to grow by 5.2 percent over the four quarters of 1983, and for inflation (as measured by the GNP deflator) to fall to a rate of 5.5 percent. CBO expects real GNP to grow by about 1½ percentage points less than the Administration does in 1983, and the GNP deflator to rise by about 1½ percentage points more. The slower growth expected by CBO is largely the consequence of higher interest rates in its forecast, which would dampen the recovery in economic activity.

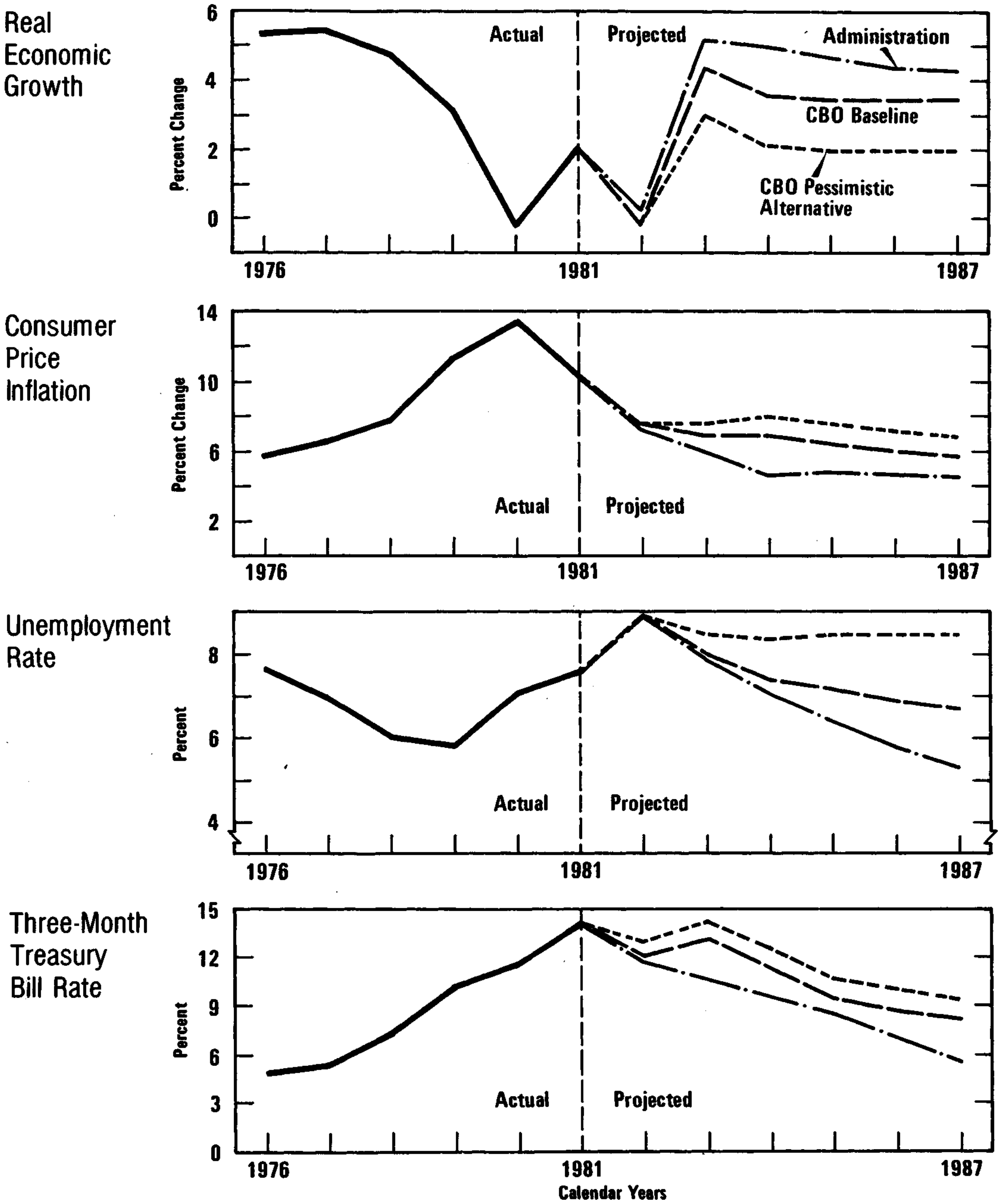
Summary Figure 1.
Budget Deficits



The Administration's economic assumptions for 1984 and beyond are also more optimistic than CBO's (see Summary Figure 2). Compared with CBO's baseline assumptions, the Administration projects higher real growth and sharper declines in inflation, unemployment, and interest rates.

Summary Figure 2.

Comparison of Major Economic Assumptions



SOURCES: For historical data, Department of Commerce, Bureau of Economic Analysis; Department of Labor, Bureau of Labor Statistics; and Federal Reserve System, Board of Governors. For projections, Congressional Budget Office and Office of Management and Budget.

The Administration's real growth assumptions for 1984-1987 are near the upper end of historical experience. In comparable four-year periods following previous postwar recoveries, real growth averaged 3.4 percent a year and ranged between 2.0 and 5.2 percent a year. The Administration assumes an average rate of growth of 4.6 percent a year between 1984 and 1987. CBO, in its baseline projections, assumes an average annual growth rate of 3.5 percent.

As shown in Summary Table 5, the effect of the somewhat less optimistic CBO baseline assumptions with respect to real growth, inflation, unemployment, and interest rates would be to raise unified budget outlays by $1 billion in 1982, $3 billion in 1983, over $16 billion in 1984, and $24 billion in 1985. Over the entire four-year period, budget outlays would be $45 billion higher than projected by the Administration. Revenues, on the other hand, would be very close to the Administration's estimates because of the similar assumptions about nominal GNP.

The Administration's Budget Reestimated

The CBO economic and technical reestimates assume that all of the President's legislative proposals for taxes and spending are approved by the Congress, and also that the Administration is successful in meeting most of its targets for revenue increases and outlay savings from various management initiatives. CBO has not been able to develop its own independent estimates for outlay savings from several of the management initiatives, particularly those that are clearly targets and not allocated to agency accounts. Based on past history, the unallocated targets for reduction of waste, fraud, and abuse; for improved debt collection; and for the sale of surplus or underused federal property appear to be very optimistic.

Summary Table 7 shows the effect on the Administration's budget of CBO's technical reestimates and of substituting CBO's baseline economic assumptions for the Administration's economic assumptions. Under CBO's pricing of the Administration's budgetary proposals, revenues would grow by less than 25 percent between 1982 and 1985, rising from an estimated $628 billion to $776 billion. Unified budget outlays would grow at approximately the same rate as revenues during this period, rising by 24 percent from $739 billion in 1982 to $916 billion in 1985.

The unified budget deficit rises from $111 billion in 1982 to $140 billion in 1985. When net outlays of off-budget federal entities are included, the total deficit rises from $131 billion in 1982 to more than

$1.0 trillion at the end of 1981 to more than $1.6 trillion at the end of 1985, or by more than 60 percent.

SUMMARY TABLE 7. THE ADMINISTRATION'S BUDGET REESTIMATED
(By fiscal year, in billions of dollars)

	Actual 1981	CBO Estimates 1982	1983	1984	1985
Revenues	599.3	627.7	660.1	715.6	776.1
Outlays					
Unified budget	657.2	738.8	780.7	844.5	915.7
Off-budget entities	21.0	20.2	16.5	15.2	12.0
Total Outlays	678.2	759.0	797.2	859.7	927.7
Deficit (-)					
Unified budget	-57.9	-111.1	-120.6	-128.9	-139.6
Off-budget entities	-21.0	-20.2	-16.5	-15.2	-12.0
Total Deficit	-78.9	-131.3	-137.1	-144.1	-151.6
Debt Subject to Limit	998.8	1,430.0	1,297.1	1,458.4	1,640.5

MAJOR RISKS

Several risks are inherent in the Administration's budget proposals. One is that the Administration may have underpriced its projected defense appropriation requests. CBO has identified two major elements of concern in this regard. First, inflation may not decline as rapidly as assumed in the Administration's budget estimates. This would require additional funds to complete the Administration's plans for defense purchases. Otherwise, higher than anticipated inflation could cause a scaling back of purchases to stay within available funds. CBO's reestimates of the President's budget did not adjust the Administration's proposed budget authority for defense programs for the higher inflation contained in CBO's baseline economic assumptions. If this were done, $61 billion in additional appropriations would be needed during the next five years to achieve the same real growth in defense spending as proposed by the Administration.

Second, the real cost of defense purchases has grown in recent years--averaging about 3½ percent per year since 1975. This has occurred for a variety of reasons, including program changes (such as new specifications for weapons or revised production schedules) and underestimates of real resources (such as manufacturing hours and materials costs). If the Administration is unable to curb this cost growth, further funds would be needed to meet its defense procurement objectives. If the 3½ percent average annual cost growth continues, for example, CBO estimates that an additional $48 billion in new budget authority will be required to fund major weapons procurement during 1983-1987.

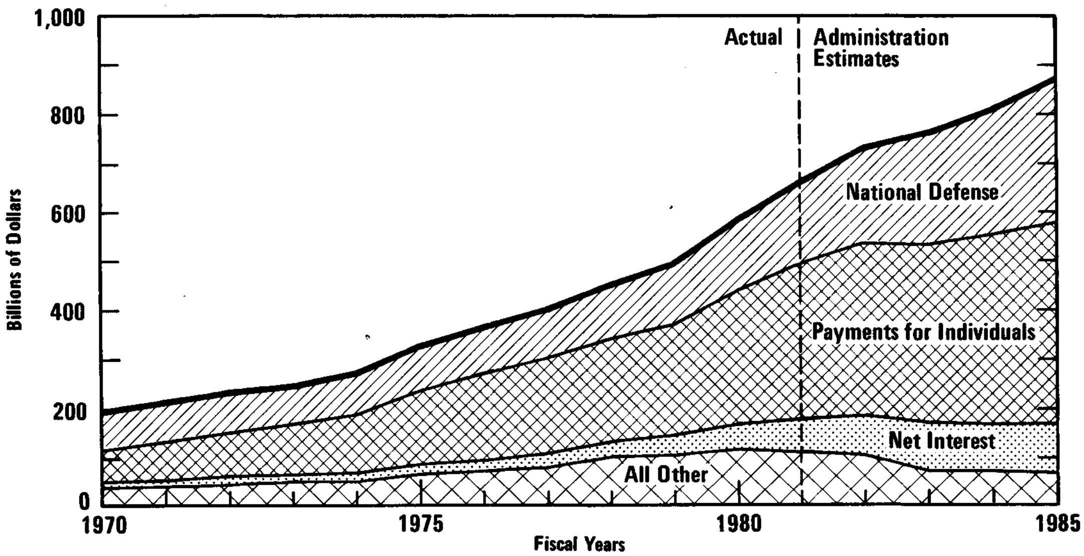
A second risk is that it will be very difficult to achieve lower deficits in the next few years if the major effort is focused primarily on the spending side of the budget. The sharp increases proposed for national defense programs, the rising outlays for Social Security and other benefit payments indexed for inflation, and the growing net interest costs place enormous pressure on the remaining portion of the budget. As shown in Summary Figure 3, these other federal outlays are projected to shrink steadily. The difficulty of finding still further significant reductions in this area of the budget is very great.

A more fundamental risk is the uncertainty in the economic outlook. The Administration's program implies a strong fiscal stimulus in 1982 and 1983. The large budget deficits projected in this report would result in a marked increase in Treasury borrowing that would put further upward pressure on interest rates. At the same time, the Federal Reserve's targets for monetary growth may act as a brake on economic growth during the next few years. Given the combination of monetary and fiscal policies and the projected economic recovery, high interest rates next year seem likely--although the level is hard to predict because this policy combination of a tight monetary policy and a stimulative fiscal policy is virtually without precedent. Nevertheless, there is a significant risk that the outcome could be even weaker growth than projected by either the Administration or CBO.

Since budget estimates are very sensitive to economic assumptions, policymakers must be prepared for the possibility of developments markedly different from those assumed by both the Administration and CBO. To illustrate the sensitivity of the budget to economic assumptions, CBO also has reestimated the President's February budget using a more pessimistic set of economic assumptions. In the CBO pessimistic alternative assumptions, portrayed in Summary Figure 2, real growth averages only 2.0 percent in 1984-1987, unemployment remains at about 8½ percent throughout the period, the rate of inflation remains above 7 percent until the end of the period, and short-term interest rates fall very slowly.

Summary Figure 3.

Federal Budget Outlays



SOURCE: *Budget of the United States Government, Fiscal Year 1983,* Table 22, p. 9-61.

Under this more pessimistic set of assumptions, growth in nominal incomes would be somewhat less and federal revenues would be lower by about $25 billion during 1982-1985 than projected by the Administration. The effect on outlays, however, would be much greater. By 1985, outlays would be over $50 billion higher than projected by the Administration, and over $100 billion higher for the entire four-year period. The effect of using the CBO pessimistic economic assumptions would be to raise the estimated level of the budget deficit under the Administration's proposals to $132 billion in 1983, $155 billion in 1984, and $184 billion in 1985 (see Summary Table 8).

SUMMARY TABLE 8. UNIFIED BUDGET DEFICITS UNDER CBO PESSIMISTIC ECONOMIC ASSUMPTIONS (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
President's February Budget	98.6	91.5	82.9	71.9
Deficit with CBO Technical Reestimates	106.5	116.6	118.1	110.4
Deficit with CBO Technical Reestimates and Pessimistic Economic Assumptions	112.7	132.1	154.9	183.6

AN ANALYSIS OF
THE PRESIDENT'S BUDGETARY PROPOSALS
FOR FISCAL YEAR 1983

CHAPTER I. THE ADMINISTRATION'S PROPOSALS

The federal government's budget, in the absence of major policy changes, faces large and growing deficits. This year, the deficit will probably exceed $100 billion for the first time. By 1985, it could top $200 billion.

The President's 1983 budget contains a lengthy list of spending reductions and a shorter list of tax increases designed to close the deficit gap. To allow substantial increases in spending for national defense, spending for nondefense programs (other than Social Security) would be cut sharply. The Administration also recommends large reductions in off-budget federal spending and in federal credit activities.

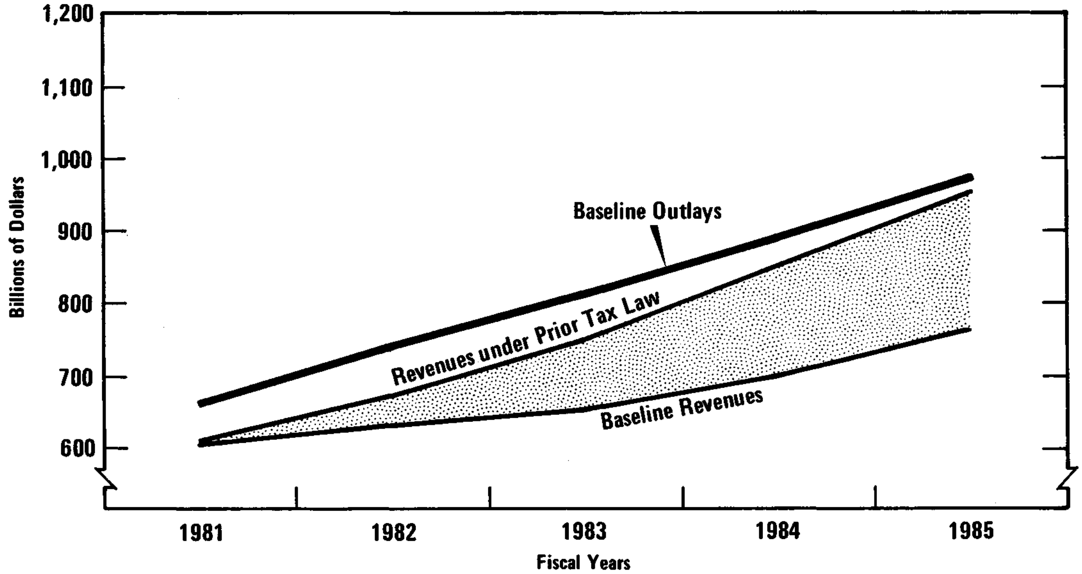
This chapter depicts the budget situation under current policies, using both Congressional Budget Office (CBO) and Administration projections, and explains how that situation came about. It then reviews the Administration's revenue and spending proposals, using the Administration's own figures. The chapter concludes with discussions of the Administration's proposals for federal off-budget spending, debt, and credit. The later chapters present CBO's estimates of revenues and spending under the Administration's policies, using CBO's own economic assumptions and estimating methods.

THE BUDGET OUTLOOK UNDER CURRENT POLICIES

While the budget deficit for 1981 was $58 billion, the 1982 deficit is now expected to exceed $100 billion under current policies. This sharp rise in the deficit can be attributed largely to the recession, which was not anticipated in last year's budget estimates. Although most economic forecasters expect that the economy will begin to recover later this year and move into a period of continued growth, budget projections show rising deficits under existing tax laws and current spending policies. This growing deficit gap is illustrated in Figure 1, which shows the CBO baseline budget projections through 1985.

Both the CBO baseline budget projections and the Administration's current services baseline (which includes the Administration's defense spending proposals) tell the same story. Under both sets of baseline projections, shown in Table 1, federal revenues would grow at an average annual rate several percentage points below the expected rate of growth of

Figure 1.
CBO Baseline Budget Projections



SOURCE: Congressional Budget Office.

the economy. Both CBO and the Administration assume that the gross national product (GNP) will grow by an average rate of between 10.5 and 11 percent during the next three years. The CBO baseline projections show revenues growing at an average annual rate of 6.5 percent between 1982 and 1985--somewhat less than the Administration's baseline projections of 7.5 percent.

Baseline outlays, as projected by both CBO and the Administration, would grow at a faster rate than revenues. The CBO projections show total outlays rising from an estimated $740 billion in 1982 to $971 billion in 1985. This represents an average growth rate of 9.5 percent a year, or 3 percentage points above the CBO projected growth in baseline revenues. The Administration projects a similar growth in baseline outlays--9.2 percent a year--that exceeds its baseline revenue projections by almost 2 percentage points.

The budget deficit under baseline assumptions is projected by CBO to almost double between 1982 and 1985--rising from $109 billion to $208 billion. The Administration's baseline projections also show a sharp rise in the budget deficit, although not quite as much as those of CBO,

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

	Actual 1981	Estimate 1982	Projections 1983	1984	1985
		CBO's Baseline			
Revenues	603	631	652	701	763
Outlays	660	740	809	889	971
Deficit	58	109	157	188	208
		Administration's Current Service Baseline a/			
Revenues b/	599	626	653	704	778
Outlays b/	657	728	799	869	946
Deficit	58	101	146	165	168

SOURCES: Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1983-1987 (February 1982), p. 9; Budget of the United States Government, Fiscal Year 1983 (February 1982), p. 3-8.

a/ Includes proposed defense spending growth.

b/ The Administration's 1983 budget has reclassified certain social insurance contributions as offsetting collections to spending, thereby reducing both revenues and outlays but leaving the deficit unchanged. The CBO figures reflect the previous classification.

largely because of different economic assumptions. In the absence of tax increases or spending reductions, CBO's baseline projections show the deficit rising to 5.0 percent of GNP in both 1984 and 1985. The Administration's baseline projections show the deficit rising to 4.3 percent of GNP in 1984 and 4.0 percent in 1985. The last time the budget deficit was this large was in 1976, as a result of the 1974-1975 recession.

These baseline projections are quite different from those of the past. In previous baseline projections, revenues grew faster than outlays, and the

90-395 O - 82 - 3

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 outlays, on the other hand, grew more slowly than GNP, because most spending was assumed merely to keep pace with inflation.

In the new baseline projections, revenues grow less rapidly than the economy. The projected lower revenue growth results primarily from the individual and corporation income tax cuts enacted in the Economic Recovery Tax Act of 1981 (ERTA). As shown in Table 2, federal revenues will be as much as $189 billion lower in 1985 than they would have been had the 1981 Tax Act not been enacted. The effect of the Tax Act will be to reverse the trend of a growing federal tax burden. Between 1976 and 1981, federal revenues rose from 18.2 percent to 21.0 percent of GNP. Under the current tax law, both the CBO and the Administration project a decline in revenues relative to GNP, to under 19 percent by 1985.

TABLE 2. ESTIMATED REVENUE LOSSES RESULTING FROM THE ECONOMIC RECOVERY TAX ACT OF 1981 (By fiscal year, in billions of dollars)

	1981	1982	1983	1984	1985
CBO Estimates	2	39	95	148	189
Administration Estimates	*	38	92	139	177

SOURCES: Congressional Budget Office, Baseline Budget Projections for Fiscal Years 1983-1987, p. 25; Budget of the United States Government, Fiscal Year 1983, p. 4-10.

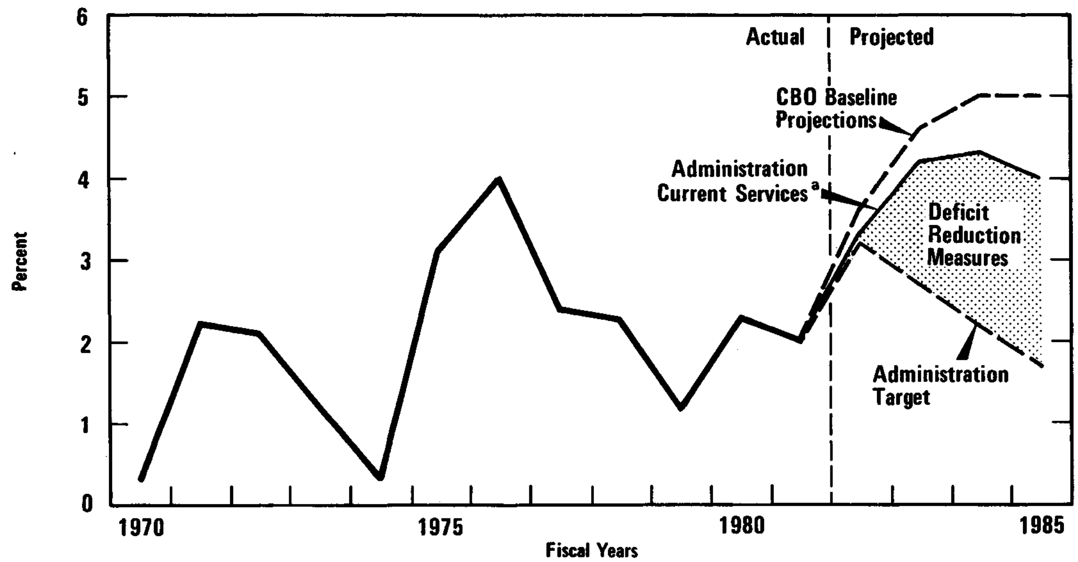
*Less than $500 million.

The price of this reduction in the tax burden is the widening gap between revenues and outlays. Figure 1 shows graphically that revenues under prior tax law would have been sufficient virtually to eliminate the projected deficits by 1985. Under current law, however, the deficits are projected to grow.

THE ADMINISTRATION'S BUDGET PROPOSALS

The Administration's 1983 budget includes a package of measures designed to reduce the federal deficit gradually over the next few years. If these proposals are adopted, the Administration projects that the deficit would decline from 3.2 percent of GNP in 1982 to 2.7 percent in 1983, 2.2 percent in 1984, and 1.7 percent in 1985. In the absence of such policy changes, the deficit by 1985 would widen to 4 or 5 percent of GNP, as shown in Figure 2.

Figure 2.
Federal Budget Deficit as a Percentage of GNP



[a] Includes Administration defense spending proposals.

SOURCES: *Budget of the United States Government, Fiscal Year 1983,* p. 3-8, and Table 21, p. 9-60; Congressional Budget Office, *Baseline Budget Projections for Fiscal Years 1983-1987* (February 1982).

The Administration's budget and the proposed deficit reduction measures represent a continuation of the policies that the Administration recommended, and that were in large part enacted, last year. Defense appropriations would grow rapidly. The major individual income tax reductions passed in 1981 would be left in place. Revenues would be modestly increased compared to the baseline, primarily through the elimination of tax provisions benefiting a few specific industries and through the improved collection of existing taxes. The proposed revenue increases and spending reductions total $242 billion over the 1982-1985 period (see Table 3). Of this amount, revenue increases comprise $50 billion, or about one-fifth, and spending reductions constitute the remaining four-fifths.

TABLE 3. THE ADMINISTRATION'S PROPOSED DEFICIT REDUCTION MEASURES (By fiscal year)

	1982	1983	1984	1985
	In Billions of Dollars			
Administration's Baseline Deficit with Proposed Defense Spending Growth	101	146	165	168
Less: Proposed Revenue Increases	*	-13	-19	-18
Proposed Spending Reductions	-3	-43	-65	-81
Total Deficit Reduction Measures	-3	-56	-84	-99
Plus: Proposed Spending Increases	*	2	2	3
Administration Deficit Target	99	92	83	74
	As a Percent of GNP			
Administration's Baseline Deficit with Proposed Defense Spending Growth	3.3	4.2	4.3	4.0
Administration's Deficit Target	3.2	2.7	2.2	1.7

SOURCE: Budget of the United States Government, Fiscal Year 1983, p. 3-8.

*Less than $500 million.

The spending reductions proposed by the Administration do not touch Social Security cash benefits, the single largest nondefense spending program, or interest costs on the national debt, which depend on the level of debt outstanding and on market interest rates and cannot be directly affected by policy changes. As a result, the proposed spending reductions would cut deeply into federal grants to state and local governments and into spending on the day-to-day domestic operations of the federal government.

Revenue Proposals

The Administration's revenue proposals, listed in Table 4, would increase revenues by about $13 billion in fiscal year 1983 and by roughly $18 billion in 1985, according to Administration estimates. Extension of the highway trust fund taxes beyond their current expiration date, already assumed in Administration and CBO baseline revenues, would yield an additional $4 billion in 1985. About $5 billion a year would come from legislative proposals to improve tax collection and enforcement by accelerating corporate tax payments, increasing staffing at the Internal Revenue Service, and instituting tax withholding on interest and dividends. Roughly $14 billion a year by 1985 would come from proposals characterized by the Administration as eliminating tax abuses and removing obsolete incentives. These include repeal of business energy tax credits, tighter rules for long-term contracts, cutbacks in the use of tax-exempt bonds for private purposes, modifications in the tax treatment of life insurance companies, increased taxes on commercial and industrial real estate construction, and a new minimum tax on corporations. The remaining revenue increases would be derived from reinstating and increasing several airport and airway trust fund taxes--including those on general aviation gasoline and jet fuel and on airline passenger tickets--and by requiring federal civilian employees to pay the hospital insurance portion of the Social Security payroll tax.

The Administration's tax proposals are heavily weighted toward increases in corporation income taxes, which account for about three-quarters of the net tax increases proposed for the 1983-1985 period. They amount to roughly $15 to $16 billion a year by 1985, and substantially offset the corporate tax reductions enacted in the Economic Recovery Tax Act. The proposed corporate tax increases amount to about 75 percent of the ERTA corporate tax reductions for 1984 and almost 60 percent of those for the 1983-1985 period, based on Administration estimates of ERTA revenue reductions. The proposed increases amount to 19 percent of the Administration estimates of total corporate taxes in 1984, and nearly 17 percent of their estimates of corporate taxes for the 1983-1985 period.

The distribution of the additional corporate tax burden, however, would be different from the distribution of the corporate tax savings from ERTA. The proposal to end completed contract accounting would affect primarily the defense, construction, and heavy machinery industries; the proposal to repeal business energy tax credits could have a significant impact on the paper industry; limits on tax-exempt revenue bonds would

TABLE 4. THE ADMINISTRATION'S REVENUE INCREASE PROPOSALS (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
Tax Revisions				
Completed contract accounting	---	3.3	5.0	3.2
Business energy tax credits	---	0.1	0.4	0.6
Tax-exempt revenue bonds	---	-0.2	0.3	1.1
Modified coinsurance	---	1.1	2.2	2.5
Construction period interest and taxes	---	0.5	1.1	1.0
Corporate minimum tax	---	2.3	4.6	5.1
Subtotal	---	7.2	13.5	13.5
Improved Tax Collection and Enforcement				
Withholding on interest and dividends	---	2.0	1.3	1.4
Acceleration of corporate tax payments	---	1.4	1.7	0.9
Internal Revenue Service staff increases	0.2	2.1	2.4	2.4
Subtotal	0.2	5.5	5.5	4.7
Enterprise Zones	---	---	-0.1	-0.5
Airport and Airway Trust Fund	0.1	1.2	1.4	1.5
Railroad Retirement	---	-1.7	-1.8	-1.9
Federal Employee Hospital Insurance Taxes	---	0.6	0.8	0.9
Other	*	0.1	0.1	0.1
Total	0.3	12.8	19.3	18.3

SOURCES: Budget of the United States Government, Fiscal Year 1983, p. 4-16, and the U.S. Department of the Treasury.

*Less than $50 million.