THE CREDIT BUDGET

The credit budget, instituted in 1980, attempts to bring together and focus attention on the new lending activities of the federal government. It records estimates by program of new direct loan obligations and new loan guarantee commitments. The credit budget totals are based on gross levels of activity, without offsets for repayments. Guaranteed loan totals are based on the full amount of the loan, even if the amount covered by the guarantee is less than the total.

During its first session, the 97th Congress took a number of actions to control the federal credit budget. Limitations were included in appropriation bills for 40 percent of direct loans and 70 percent of loan guarantees. Language in the Continuing Appropriations Resolution (Public Law 97-92) specified that these limitations should also be taken as target levels that should be met unless there were insufficient qualified borrowers. This stipulation was included to prevent administrative reductions in the credit budget. In response, the Administration has submitted proposals to reduce a number of 1982 limitations as part of its proposed 1983 budget.

The Administration believes that the rapid growth of federal credit activity has adversely affected the nation's productivity by channeling funds to less productive borrowers and has increased pressures on interest rates in the private market. It is, therefore, proposing that the credit budget for 1983 be limited to an increase of 3 percent above the revised 1982 level. Its proposed credit budget for 1983 totals $147.3 billion--$49.0 billion in new direct loan obligations and $98.4 billion in new loan guarantee commitments. The 1983 request for direct loans is 13 percent below the revised 1982 request, while the request for primary loan guarantees is 13 percent above the revised 1982 request. Table 15 provides a comparison of the 1981 actual credit budget and the Administrations' proposals for 1982 and 1983.

Table 16 shows the Administration's major changes in the 1983 credit budget. The only major growth in direct loans is for international security assistance, primarily foreign military sales credit, which will increase by $1.0 billion as part of the Administration's program to increase military assistance to strategically important nations. The Administration proposes a $2.6 billion reduction in direct loans through the Farmers Home Administration, including major decreases in direct loans for rural housing. Commodity Credit Corporation (CCC) loans are projected to decrease by $2.0 billion, on the assumption of improved market conditions for farmers. The reduction of $4 million for direct loans of the Small Business Administration would eliminate this program entirely.

TABLE 15. TOTAL CREDIT BUDGET (By fiscal year, in billions of dollars)

	Actual 1981	Administration Estimates 1982	Administration Estimates 1983
Direct Loan Obligations			
On Budget	40.9	39.9	31.8
Off Budget	31.5	29.6	25.5
Total	72.4	69.5	57.3
Less: FFB Sales of Loan Assets	-15.2	-13.2	-8.3
New Direct Loan Obligations	57.2	56.4	49.0
New Loan Guarantees	152.7	166.1	161.4
Less: Secondary Loan Guarantees	-44.1	-48.7	-38.4
Guaranteed Loans Held as Direct Loans			
Federal Financing Bank	-30.3	-28.5	-24.7
Government National Mortgage Association	-1.8	-1.9	---
Primary Guarantees	76.5	87.1	98.4
Credit Budget Total	133.7	143.4	147.3

The projected increases in loan guarantees are largely the result of the expected improvement in the housing market. Growth is anticipated in the guaranteed loan programs of the Federal Housing Administration (FHA) and the Veterans Administration. An increase of $1.5 billion in guaranteed loans for public housing is also projected, as a result of prior-year commitments. Decreases in guaranteed loans are proposed for the Farmers Home Administration, the Rural Electrification Administration, and the Small Business Administration.

TABLE 16. CHANGES IN THE 1983 CREDIT BUDGET TOTALS (In billions of dollars)

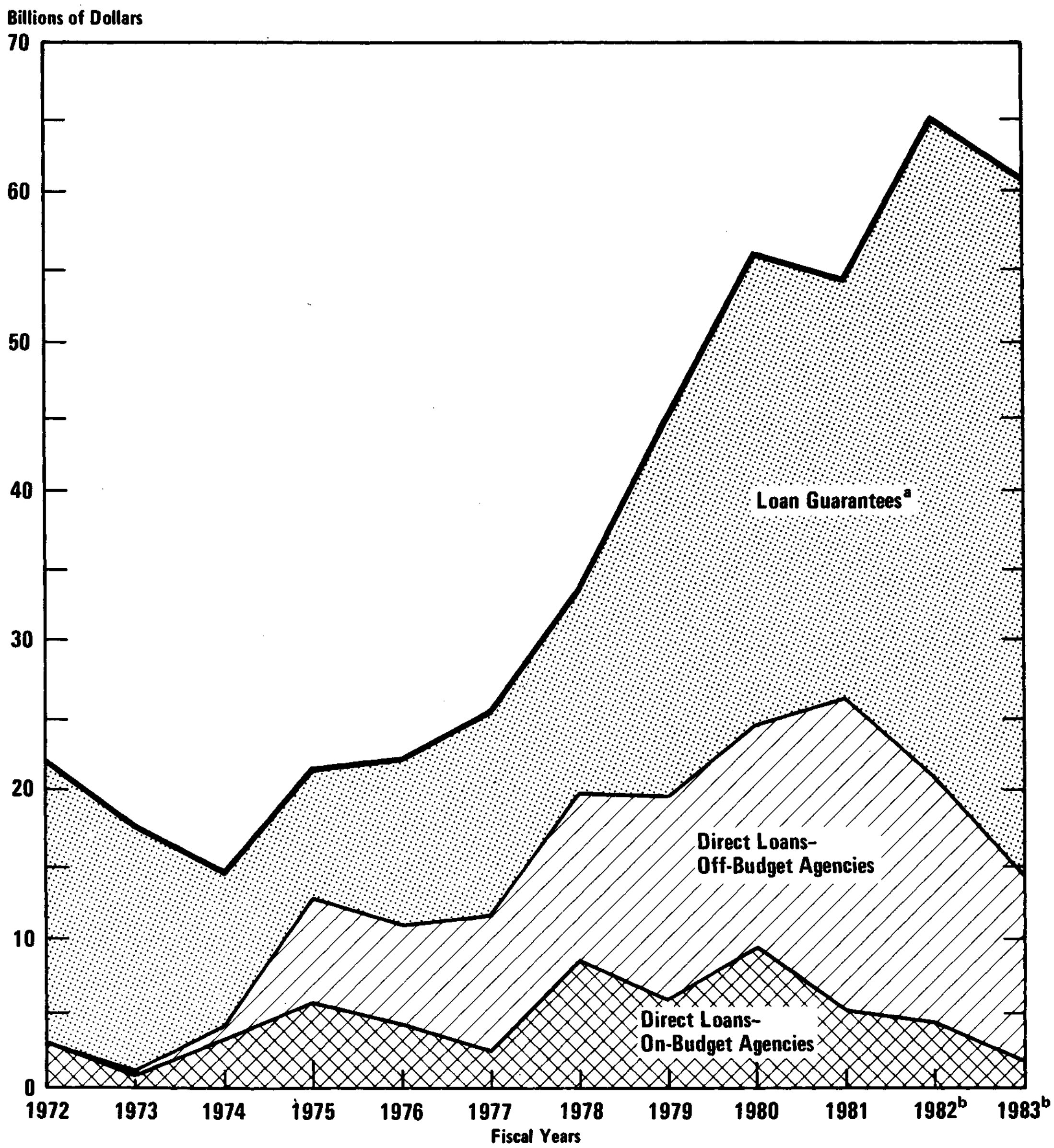
	Direct Loan Obligations	Guaranteed Loan Commitments
Credit Budget Totals for 1982	56.4	87.1
Major Program Changes		
Export-Import Bank	-0.6	---
Farmers Home Administration	-2.6	-0.6
Rural Electrification Administration	-0.4	-0.5
Small Business Administration	-0.4	-0.3
Low-income public housing	-0.5	1.5
International security assistance	1.0	0.8
CCC price supports	-2.0	---
FHA fund	-0.1	6.4
Veterans' housing	*	2.9
Other	-1.8	1.0
Total Program Changes	-7.4	11.3
Credit Budget Totals for 1983	49.0	98.4

SOURCE: Budget of the United States Government, Fiscal Year 1983, p. 3-25.

*Less than $50 million.

As the result of both the reductions in the credit budget proposed by the Administration and increased repayments, net credit extended is estimated to decrease by 6 percent between 1982 and 1983. Figure 7 provides an historical perspective on the components of net federal lending. The 1983 decrease will be only the second reduction since 1974, when federal credit activities began to expand at an accelerated rate.

Figure 7.
Components of Net Federal Credit, Fiscal Years 1972-1983



[a] Primary guarantees: excluding secondary guarantees and guaranteed loans acquired by on- and off-budget agencies.
[b] Estimates

SOURCE: *Budget of the United States Government, Fiscal,Year 1983,* Special Analysis F, Federal Credit Programs.

CHAPTER II. THE ADMINISTRATION'S ECONOMIC ASSUMPTIONS

Both the Congressional Budget Office and the Administration anticipate an end to the current recession early in 1982, with a resumption of moderate growth and a continued slowing of inflation. While the recovery projected by the Administration is not particularly strong compared with earlier cyclical recoveries, its projections through 1987 are more optimistic than those of most economic forecasters, including CBO. 1/ In CBO's view, tight credit conditions are likely to limit economic growth. In fact, there is a risk that the clash between restrictive money growth and fiscal stimulus will lead to higher interest rates and weaker growth than forecast by either CBO or the Administration.

ECONOMIC DEVELOPMENTS IN 1981

The performance of the economy in 1981 was mixed. Economic growth was weak; measured from fourth quarter to fourth quarter, real GNP increased a scant 0.7 percent during 1981 while the unemployment rate rose to 8 1/2 percent by year's end. On the other hand, inflation slowed significantly in 1981; measured from fourth quarter to fourth quarter, the growth in the Consumer Price Index (CPI) slowed from a rate of 12.5 percent in 1980 to a rate of 9.5 percent in 1981.

The sluggish growth in 1981 resulted largely from very tight credit conditions. 2/ Inflation slowed mainly because of bountiful farm output, which resulted in relatively modest food price increases, because of the glut in world oil markets, which stabilized energy prices, and because of the appreciation of the dollar in foreign exchange markets, which reduced prices of imported goods. The developments in food and fuel were largely unexpected by forecasters a year ago. Accordingly, most forecasters, including the Administration and CBO, have modified their projections for 1982 and 1983 to show lower real growth and/or lower inflation than previously expected.

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

2/ The Federal Reserve's policies in 1981 are analyzed in The Prospects for Economic Recovery, pp. 39-49.

COMPARISON OF ADMINISTRATION AND CBO FORECASTS FOR 1982 AND 1983

The Administration and CBO forecasts are in close agreement for calendar year 1982 (see Table 17). They see output in constant dollars rising by about 3 percent over the four quarters of the year, and unemployment in the neighborhood of 8 1/2 percent at year's end. The forecasts are also in close agreement for inflation and short-term interest rates.

TABLE 17. COMPARISON OF ADMINISTRATION AND CBO FORECASTS (By calendar year)

	1982	1983
Gross National Product (GNP)		
Current dollars (percent change, fourth quarter over fourth quarter)		
President's February budget	10.4	11.0
CBO baseline	10.3	11.1
Constant (1972) dollars (percent change, fourth quarter over fourth quarter)		
President's February budget	3.0	5.2
CBO baseline	2.8	3.9
Prices		
GNP deflator (percent change, fourth quarter over fourth quarter)		
President's February budget	7.2	5.5
CBO baseline	7.2	6.9
Consumer Price Index (percent change, fourth quarter over fourth quarter)		
President's February budget	6.6	5.1
CBO baseline	6.4	7.2
Unemployment Rate (percent, fourth quarter)		
President's February budget	8.4	7.6
CBO baseline	8.7	7.6
Interest Rate (91-day Treasury bills, percent, annual average)		
President's February budget	11.7	10.5
CBO baseline	12.0	13.2

In 1983, however, the Administration's forecast for inflation and growth is more optimistic than CBO's. The Administration looks for real GNP to expand by 5.2 percent, and for inflation (as measured by the GNP deflator) to fall to a rate of 5.5 percent. The unemployment rate in the Administration's forecast falls to 7.6 percent by the fourth quarter of next year and, for the year as a whole, the three-month Treasury bill rate is expected to average 10.5 percent.

By contrast, CBO expects real GNP to grow by about 1 1/2 percentage points less than the Administration in 1983, and the GNP deflator to rise about 1 1/2 percentage points more. 3/ Short-term interest rates average 2 3/4 percentage points higher over the year, while the unemployment rate falls to the same level as in the Administration's forecast. This latter result, despite different rates of economic expansion in the two forecasts, may be caused by assumed patterns of productivity growth during the recovery.

The slow growth expected by CBO for 1983 is largely the consequence of higher real rates of interest in its forecast that serve to dampen the recovery in economic activity. The key factors behind the CBO forecast of a modest further deceleration of inflation are:

- Wage demands will soften in the face of slack labor markets, but the reduction in labor costs will probably be limited once the recovery is well underway.

3/ As measured by the CPI, the two forecasts of inflation are similar in 1982 but diverge in 1983. The Administration expects a CPI increase of 6.6 percent in 1982, slowing further in 1983 to 5.1 percent, measured from fourth quarter to fourth quarter. CBO, on the other hand, expects 6.4 percent in 1982 and 7.2 percent in 1983. A detailed comparison of these CPI inflation forecasts is not possible given the absence of comparative detail on individual prices used to construct the CPI. The 1983 increase reflected in the CBO forecast does not, however, represent an assumed intensification of underlying inflationary pressures. Rather, it reflects assumed patterns of change in oil prices and in mortgage rates between 1982 and 1983. CBO assumes that energy cost and mortgage interest cost movements will hold down the increase in the CPI below the underlying rate of inflation in 1982 but not in 1983. Thus, by 1983, CBO's forecast of the CPI reflects more modest expectations of the reduction in the inflation rate.

90-395 O - 82 - 5

- The cyclical increase in labor productivity growth is more likely to affect profits than prices.

- The supply-inducing effects of the 1981 tax act will probably build slowly, in part because of high real interest rates.

Short-Run Forecast Risk. At present, the key element of uncertainty in the CBO forecast is the prospective course of monetary policy. The CBO forecast for 1982 and 1983 assumes growth in the monetary aggregates at the upper ends of the current target ranges. Given the historical relationship between money and nominal GNP, and the CBO view that inflation will decelerate slowly, the assumed Federal Reserve policy implies that real growth during the cyclical recovery period will be less than normal as the result of continued high levels of interest rates. There is considerable chance, moreover, that economic growth will be much weaker than projected by CBO, especially if the Federal Reserve limits money growth more severely than assumed.

In addition, high federal deficits will result in a marked increase in Treasury borrowing in the CBO forecast, putting further upward pressure on interest rates. As the recovery gets under way, the conflict between the stimulative fiscal policy and a tight monetary policy could push interest rates to high levels. The outcome is very difficult to predict because this policy combination has no historical precedent. However, there is a distinct possibility of even weaker growth than that projected by either the Administration or CBO.

The general rise in interest rates since late November 1981 is most unusual during a recession and represents a significant risk to the forecast in the months ahead. If interest rates do not moderate soon, the projected upturn in economic activity could be delayed. The rise in long-term interest rates since the passage of the tax act, for example, has probably offset much of the reduction in capital costs brought about by the Accelerated Cost Recovery System. Continued high interest rates would bear heavily on residential construction, autos, and other durable goods industries. Tight credit conditions are hitting the economy hardest in those very sectors where fiscal policy is seeking to promote increases in the supply of productive resources and capacity. If this situation persists, little supply response can be expected from the Administration's program, even over the medium term. Indeed, a prolonged period of slack characterized by low rates of capacity utilization and diminished employment opportunities could actually discourage capital formation and inhibit labor supply growth, thereby severely limiting the economy's productive potential. Finally, if tight credit conditions persist, more and more businesses will find themselves in financial distress.

THE PROSPECTS FOR GROWTH THROUGH 1987

The Administration's economic assumptions for the 1984-1987 period are also more optimistic than CBO's (see Table 18 and Figure 8). The projections beyond 1983 are not forecasts of probable economic outcomes but, rather, are assumptions. The Administration's long-range assumptions are, in its words, "projections consistent with the economic policy objectives of the Administration." CBO's baseline assumptions, on the other hand, are projections of what appears to be an attainable improvement in economic conditions. 4/

Real Growth. The Administration assumes an average rate of growth of 4.6 percent a year between 1984 and 1987. CBO, on the other hand, assumes an average growth rate of 3.5 percent. In comparable four-year periods following previous postwar recoveries, real growth has averaged 3.4 percent a year, and ranged between 2.0 and 5.2 percent. 5/ Real growth in the 1984-1987 period could be higher than the average of historical experience for three reasons.

- The fiscal stimulus over this period will be sizable;
- The gap between current and potential production is very large, according to most estimates, meaning that there is little chance that the economy will reach its capacity limits quickly even if real growth is rapid; and
- Some of the 1981 tax act's features could provide a substantial boost to supply over a period of several years, increasing the economy's capacity limits.

4/ The Administration's description is from Budget of the United States Government, Fiscal Year 1982 (January 1981), p. 2-4. CBO's long-range assumptions are described in The Prospects for Economic Recovery, p. 58.

5/ If the business cycle trough is assumed to occur sometime during the first half of this year, as most forecasters now predict, the 1984-1987 period represents a four-year period beginning roughly two years after a business cycle trough as designated by the National Bureau of Economic Research.

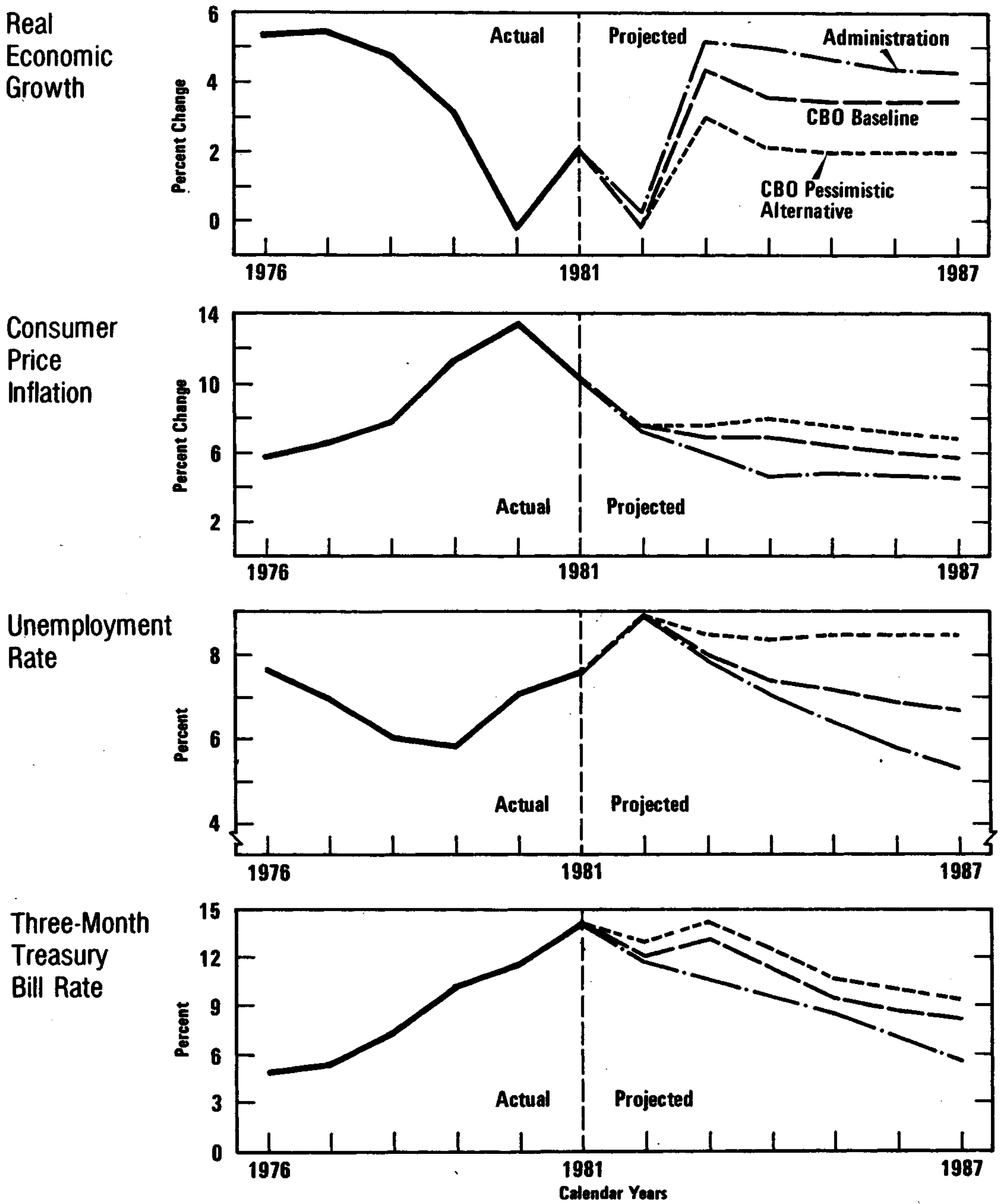
TABLE 18. COMPARISON OF ADMINISTRATION AND CBO LONG-RUN ECONOMIC ASSUMPTIONS (By calendar year)

	1982	1983	1984	1985	1986	1987
Gross National Product (GNP)						
Current dollars (percent change, year to year)						
President's February budget	8.1	11.5	10.2	9.7	9.2	9.0
CBO baseline	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)						
President's February budget	0.2	5.2	5.0	4.7	4.4	4.3
CBO baseline	-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)						
President's February budget	7.9	6.0	5.0	4.7	4.6	4.5
CBO baseline	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)						
President's February budget	7.3	6.0	4.6	4.8	4.6	4.5
CBO baseline	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)						
President's February budget	8.9	7.9	7.1	6.4	5.8	5.3
CBO baseline	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)						
President's February budget	11.7	10.5	9.5	8.5	7.0	5.5
CBO baseline	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
"Real" Interest Rate a/						
President's February budget	3.8	4.5	4.5	3.8	2.4	1.0
CBO baseline	4.5	5.9	4.7	3.4	3.0	2.7
Pessimistic alternative	5.4	6.4	5.2	3.7	3.4	3.0

NOTE: The Administration's assumptions include the presumed effects of its new budget initiatives. The CBO economic assumptions are based on estimates of current policy taxes and spending.

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

Figure 8.
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.

There are, however, a number of reasons why one might expect growth to be lower than the average of the postwar experience.

- o Inflation may remain stubbornly persistent as the result of "sticky" wage behavior;
- o Interest rates are likely to remain high, in real terms, relative to the postwar average;
- o Trend growth in productivity may remain low relative to postwar experience; and
- o Supply shocks of the sort that wracked the economy in the 1970s could recur.

There is no sure way of predicting the net outcome of all these factors during the decade, particularly since typical cyclical comparisons may not be applicable to the current recovery period. In the interests of prudent budgeting, the Congress may want to consider what the effects would be on the budget if economic growth were weaker than projected by CBO. For this reason, CBO has constructed a pessimistic alternative projection in which inflation is higher and productivity growth is lower than in the CBO baseline (see Table 18 and Figure 8).

Monetary Policy, Interest Rates, and the Deficit. Tight credit conditions may be the most serious impediment to economic growth during the next several years. On October 6, 1979, the Federal Reserve adopted new operating procedures aimed at achieving greater control over the long-run growth of the monetary aggregates. The objective was a gradual reduction in the growth of money and credit in order to reduce inflation. In the light of this policy objective, the question arises whether the realized rates of money growth in future years will permit sustained rapid increases in real economic activity. Ultimately, the answer to this question will be determined by three factors:

- o The rate of money growth;
- o The effective limit on nominal GNP growth resulting from money growth and the rate of money velocity growth; 6/

6/ Velocity may be defined as the number of times an average dollar in the money supply is used to finance transactions over a given period of time. Its rate of growth is thus simply the difference between growth rates in nominal GNP and growth in the monetary aggregate.

- o The actual rate of inflation which, given the ceiling on nominal GNP, will determine how much room is left for real GNP growth.

The Administration assumes a further gradual but steady reduction in the growth of M1 to a rate of about 3 1/2 percent in 1986. 7/ Given the Administration's assumed rates of nominal GNP growth, the implied rates of M1 velocity growth are displayed in Figure 9. The rates of M1 velocity growth through 1986 implied by the Administration's economic assumptions are very high by historical standards. 8/

Past experience suggests that such high rates of M1 velocity growth are associated with high interest rates. Furthermore, the CBO reestimates of the President's budget through 1985 suggest that federal borrowing will be significant in each year even if the Administration's proposals are adopted. This will place still more upward pressure on interest rates. Of course, if the Federal Reserve permitted somewhat more rapid but still declining rates of money growth, the potential velocity (and interest rate) constraint on real growth would be eased, leaving more room for a greater expansion in economic activity. Nevertheless, the assumption of high velocity growth raises the possibility that the strong economic growth assumed by the Administration will not materialize.

CONCLUSION

There is a serious risk that the Administration's economic assumptions will prove to be too optimistic. If so, the budget deficits will be larger than projected by the Administration, even if all of its budget proposals are enacted. Moreover, CBO's technical reestimates of the revenue and spending levels associated with the Administration's programs, presented in

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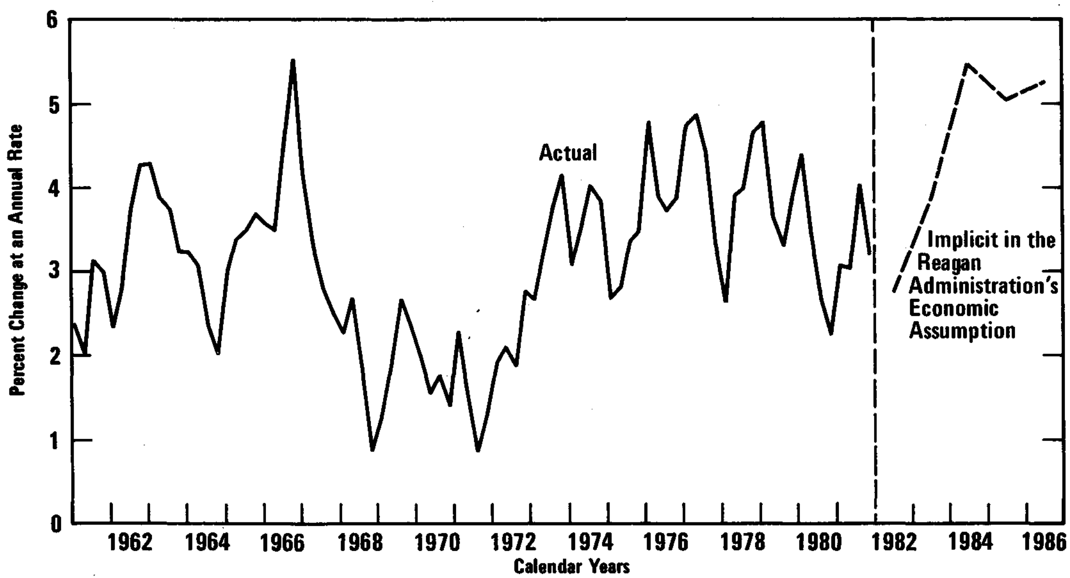
7/ In the Economic Report of the President (February 1982, p. 206), the Council of Economic Advisers states: "From the fourth quarter of 1979 to the fourth quarter of 1980, M1 (currency plus checkable deposits) grew at a 7.3 percent annual rate. The Administration assumes a gradual but steady reduction in the growth of money to one-half that rate by 1986."

8/ It is possible, of course, that high rates of M1 velocity growth could be sustained as long as financial practices aimed at economizing on money balances continue to grow over time. To what extent this will happen, particularly if real interest rates fall (which would reduce incentives to adopt more sophisticated money management techniques) is very much an open question.

subsequent chapters, also raise the prospect of much higher budget deficits. The projections of high deficits for the foreseeable future is a matter of serious concern, particularly because they are only partially the result of the recession. Such deficits would not only increase the risk of a serious clash between monetary and fiscal policy during the next few years; they would also crowd out private investment and this, in time, would adversely affect long-run economic growth.

Figure 9.
Percent Change in the Velocity of M1B from Two Years Earlier



SOURCES: Federal Reserve System, Board of Governors; U.S. Department of Commerce, Bureau of Economic Analysis; Executive Office of the President, Office of Management and Budget.

CHAPTER III. CBO REVENUE REESTIMATES

According to the Congressional Budget Office's analysis of the President's February budget revenue estimates, unified budget receipts could be slightly higher than projected by the Administration in 1982, but lower in subsequent years, ranging from \$6.0 billion less in 1983 to \$20.5 billion less in 1985.

CBO's reestimates of revenues for the 1982-1985 period are lower than those of the Administration for two reasons:

- o CBO's less optimistic economic assumptions, and
- o Differences in technical estimating.

Economic conditions could be less favorable than those assumed by the Administration. The revenue reestimates attributable to the differences between the Administration's economic assumptions and the CBO baseline economic forecast and longer-run assumptions are small, amounting to a net reduction in revenues of about \$3.5 billion over the 1982-1985 period. Reestimation using the CBO baseline economic assumptions causes a reduction in revenues of about \$3 billion in 1982 and \$1 billion in 1983, an increase of about \$6 billion in 1984, and a reduction of about \$5 billion in 1985. If more pessimistic economic assumptions were used instead of the baseline assumptions, revenues would be reduced by about \$4 billion in 1982, \$3 billion in 1983, \$1 billion in 1984, and \$16 billion in 1985.

CBO's preliminary technical analysis of the Administration's budget estimates suggests that revenues could be about \$4 billion higher than projected by the Administration in 1982, but lower in subsequent years, by amounts ranging from about \$5 billion in 1983 to \$16 billion in 1985.

A potential third reason for reduced revenues over the 1982-1985 period would be the failure of the Administration's new tax proposals to provide the estimated net increases. Two factors could contribute to this shortfall: the Congress might not approve the legislative changes required to implement these proposals; or, if approved, the new proposals might not produce as much revenue as the Administration now predicts.

Since the Administration has provided only limited information on its new tax proposals, CBO could not develop independent estimates of their revenue effects. (See Chapter I for a brief discussion of these proposals.) This chapter presents CBO's reestimates of the President's budget revenues generated by substituting CBO's baseline economic assumptions for those of the Administration and using CBO's technical estimating methods. The CBO reestimates, which are summarized in Table 19, assume that all of the President's new tax proposals are approved by Congress and that these initiatives provide the revenue increases specified by the Administration. Table 20 presents the Administration's revenue estimates and the CBO reestimates by source.

TABLE 19. CBO REESTIMATES OF ADMINISTRATION BUDGET REVENUES (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
President's February Budget	626.8	666.1	723.0	796.6
Preliminary CBO Reestimates				
Different economic assumptions	-3.4	-0.8	5.6	-4.9
Technical differences	4.3	-5.2	-13.0	-15.6
Total Reestimates	0.9	-6.0	-7.4	-20.5
President's Budget Reestimated	627.7	660.1	715.6	776.1

DIFFERENCES IN ECONOMIC ASSUMPTIONS

Revenue estimates are highly sensitive to economic assumptions. In particular, revenue estimates depend upon assumptions about wages and salaries and other income from dividends, interest, rental property, and unincorporated businesses; corporate profits; inflation; and interest rates.

Since the individual income tax system is progressive, revenue estimates depend upon assumptions about the relative effects of productivity increases and inflation on incomes, as well as upon assumptions about the aggregate level of income. Because individual income taxes are such an important source of revenue, accounting for almost 48 percent of total revenues in 1981, slight changes in assumptions about personal income can have significant effects on revenue projections.

TABLE 20. ADMINISTRATION BUDGET REVENUES AND CBO REESTIMATES, BY SOURCE (By fiscal year, in billions of dollars)

	1982	1983	1984	1985
	Administration Budget			
Individual Income Taxes	298.6	304.5	322.9	362.0
Corporate Income Taxes	46.8	65.3	83.7	88.2
Social Insurance Taxes a/	206.5	222.5	242.5	273.1
Excise Taxes				
Windfall profit taxes	24.1	21.2	20.0	19.0
Other excise taxes	18.9	20.4	21.5	21.7
Other	32.0	32.1	32.4	32.5
Total	626.8	666.1	723.0	796.6
	CBO Reestimates			
Individual Income Taxes	300.0	306.2	318.6	346.9
Corporate Income Taxes	50.5	59.8	77.9	77.8
Social Insurance Taxes a/	205.0	222.0	244.3	275.7
Excise Taxes				
Windfall profit taxes	22.9	20.9	20.8	20.4
Other excise taxes	18.6	20.1	20.9	21.3
Other	30.7	31.1	33.0	34.0
Total	627.7	660.1	715.6	776.1

a/ These revenue estimates exclude supplemental medical insurance premiums and voluntary enrollee premiums for medicare coverage. These premiums, which were previously included in revenues, are shown in the February budget as offsets against outlays. The amounts involved range from $3.9 billion in 1982 to $5.3 billion in 1985.

While the corporate income tax structure is also progressive, progressivity is a less important factor in the estimation of corporate revenues. Corporate income taxes, however, are sensitive to assumptions about investment as well as to assumptions about corporate profits.

Social insurance tax estimates depend upon assumptions about wages and salaries, employment, and inflation. Inflation assumptions are important for the estimation of Social Security taxes since the maximum taxable wage for these taxes is indexed for inflation. Windfall profit tax estimates are particularly sensitive to assumptions about oil prices, as Federal Reserve payments estimates are to assumptions about interest rates. Estimates of customs duties and of excise taxes other than windfall profit taxes are more generally responsive to assumptions about the overall level of economic activity.

Unexpected changes in economic conditions can have significant effects on revenue projections. Weakening economic conditions alone are accountable for a $31 billion downward revision since March 1981 in the Administration's estimate of total revenues for fiscal year 1982.

CBO forecasts a slight drop in economic output and a decline in the rate of inflation in 1982, while the Administration projects a slight increase in economic output and a somewhat smaller decline in the rate of inflation. For 1983 and subsequent years, CBO assumes lower real growth and higher inflation in each year than does the Administration. Interest rates are higher throughout the period under the CBO assumptions.

CBO's assumptions of lower real growth and higher inflation over the period combine to provide projected levels of GNP that are quite close to those of the Administration. Since individual and corporate income taxes, which accounted for almost 60 percent of total revenues in 1981, are most sensitive to nominal incomes, these differences in economic assumptions have relatively minor effects on revenue estimates. Therefore, CBO projects total revenues only $3.5 billion below the Administration's estimate for the 1982-1985 period.

Reestimates Based on CBO Baseline Economic Assumptions

CBO assumes lower personal income than does the Administration in every year except 1984, when CBO's income level is higher. These income differences lower the CBO reestimates of individual income taxes relative to the Administration's estimates by about $3 billion in 1982 and $5 billion in 1983, raise CBO's reestimate by less than $1 billion in 1984, and lower CBO's reestimate by about $7 billion in 1985.

CBO's reestimates of corporate income taxes based on economic assumptions result from different assumptions about the level of corporate profits from current production and about the level of business activity, which affects the amount of depreciation deductions and investment credits taken by corporations. In 1982 and 1983, CBO assumes higher corporate profits than does the Administration, which raises the CBO reestimates of corporate income taxes above the Administration's by more than $2 billion in 1982 and $4 billion in 1983. In 1984, the difference in estimates of profits is insignificant. In 1985, CBO assumes lower profits than does the Administration, which lowers the CBO reestimate of corporate income taxes below the Administration's estimate by about $5 billion.

CBO's assumption of lower levels of business activity results in smaller amounts of depreciation deductions and investment credits, and thus raises CBO's reestimates of corporate income taxes relative to the Administration's estimates. The increases in revenues due to these assumptions grow from about $0.3 billion in 1982 to about $3.7 billion in 1985. Over 60 percent of this increase in revenues is attributable to the accelerated cost recovery provisions of the Economic Recovery Tax Act of 1981.

Social Security taxes dominate the differences in estimates of social insurance taxes attributable to economic assumptions. CBO assumes lower wages and salaries than does the Administration in 1982 and 1983. These differences reduce the CBO estimates of Social Security taxes below the Administration's by about $2 billion in 1982 and $1 billion in 1983. In 1984 and 1985, the situation is reversed--CBO assumes higher wages and salaries, raising the CBO estimates of Social Security taxes above those of the Administration by about $2 billion in each year.

Lower CBO oil price assumptions reduce the CBO estimate of windfall profit taxes relative to the Administration's estimates by $0.9 billion in both 1982 and 1983. By 1984, the oil price differential narrows, lowering the CBO windfall tax estimate by only $0.1 billion. By 1985, the CBO assumes oil prices slightly above those of the Administration but not by enough to affect significantly the estimate of windfall taxes in that year.

The largest reestimate of other taxes based on economic assumptions is attributable to the consistently higher CBO interest rate assumptions. These raise the CBO estimates of Federal Reserve System payments above the Administration's in each year. This differential grows from $0.2 billion in 1982 to $1.7 billion in 1985.

Reestimates Based on Pessimistic Economic Assumptions

In developing its baseline economic assumptions, CBO prepared two alternative sets of economic assumptions, one optimistic and the other pessimistic. CBO's optimistic alternative assumed higher economic growth, lower unemployment, and lower rates of inflation than did the baseline. The Administration's economic assumptions are somewhat similar to this optimistic alternative. The pessimistic alternative assumed lower real growth, higher unemployment, and higher rates of inflation than did the baseline.

If economic conditions were to be closer to those in the CBO pessimistic alternative, CBO reestimates of Administration budget receipts would place revenues below those estimated by the Administration in each year of the 1982-1985 period. Lower individual and corporate incomes would decrease total income taxes by slightly over $33 billion for the period. These revenue reductions would be partially offset by increases in excise taxes and Federal Reserve payments, both of which would be higher because of the assumption of higher prices and interest rates in the pessimistic economic alternative.

Substituting the CBO pessimistic assumptions for the Administration economic assumptions would lower net revenues by $4.3 billion in 1982, $3.2 billion in 1983, $0.7 billion in 1984, and $16.3 billion in 1985. For the entire period, total revenues would be about $24 billion below the Administration's estimates.

TECHNICAL ESTIMATING DIFFERENCES

Revenue estimation involves procedures and models which analyze a large amount of data in addition to the economic variables discussed above. For example, estimation of individual income taxes requires information about the portion of personal income that is subject to tax and about the distribution of income across the tax brackets, in addition to data on aggregate income levels. Estimation of corporate income taxes requires information about the distribution of investment between equipment and structures, about the average tax life for each category of investment, and about the amount of used capital purchased each year, in addition to data on aggregate corporate profits. All of the differences from such assumptions are included in the total differences not explained by quantifiable economic assumptions, called technical estimating differences.