FIVE-YEAR BUDGET PROJECTIONS
FISCAL YEARS 1977-81

AS REQUIRED BY THE CONGRESSIONAL BUDGET AND IMPOUNDMENT CONTROL ACT OF 1974, P.L. 93-344

JANUARY 26, 1976

CONGRESS OF THE UNITED STATES
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NOTES

Budget projections are given by fiscal year. Economic projections are given by calendar year, unless otherwise noted. Through 1976, fiscal years extend from July 1 to June 30 of the next calendar year. In 1977 and subsequent fiscal years, the year will begin on October 1 and end September 30. The July 1-September 30, 1976, period between the end of fiscal year 1976 and the beginning of fiscal year 1977 is called the transition quarter.

All budget classifications used in this report including functional classifications, are consistent with those used in the Presidential budget documents for 1976, and differ slightly from those in the 1977 Presidential budget documents.

Gross National Product and other national income account items do not reflect forthcoming February, 1976, benchmark revisions.

Details in tables may not add to totals due to rounding.

P R E F A C E

As required by section 308(c) of the Congressional Budget and Impoundment Control Act of 1974 (P.L. 93-344), this report by the Congressional Budget Office projects for a period of five fiscal years:

(1) total new budget authority and total outlays for each fiscal year in such period;

(2) revenues to be received and the major sources thereof, and the surplus or deficit, if any, for each fiscal year; and

(3) tax expenditures for each fiscal year.

The Act requires this report to be issued as soon as practicable after the beginning of each fiscal year. Since the report is to make a five-year projection of completed Congressional budget action, its issuance has been delayed until the Congress has substantially completed its action on the fiscal year 1976 budget.

The primary purpose of these projections is to provide a baseline from which the Congress can consider budget alternatives in its deliberations on the next annual budget. A longer-term framework is needed in making annual budget choices because these decisions frequently have little impact on the budget in the short-run but can influence significantly relative budget priorities over a period of several years.

The projections presented in this report are based on the estimated budget revenues and outlays specified in the Second Concurrent Resolution on the Budget--Fiscal Year 1976 (H. Con. Res. 466) and use a "no new policy change" concept for the 1977-1981 estimates. The projections represent only the estimated costs of continuing on-going federal programs and activities at 1976 levels, adjusted for inflation, but without any new policy initiatives to either expand or contract the budget. Thus, the budget estimates presented in these projections are in no sense inevitable or estimates of what will occur.

We would welcome any comments and suggestions for improvements in future five-year projections of the budget. Our objective is to make these projections as useful as possible to Members of Congress, Congressional staffs and others interested in the new Congressional budget process.

Alice M. Rivlin
Director

January 26, 1976

SUMMARY

This report presents estimates of what would happen to the federal budget over the next five years (fiscal years 1977-81) under specified economic conditions if spending and taxing policies were continued unchanged. That is, it projects the costs of continuing federal programs and activities at 1976 levels, allowing for such factors as inflation and increases in the number of persons entitled to benefits, but not for any new program initiatives. Similarly, it projects the revenues that would be generated if current tax laws remained unchanged.

In general, the projections indicate that if services were continued at their present levels:

- Federal spending would grow about 50 percent by 1981, as the economy grows and prices rise, even if current policies were not changed.

- Receipts would rise somewhat more rapidly than outlays, largely because inflation and growth in real income would push individuals into higher tax brackets.

- The faster the economy grows — and the more rapid inflation — the faster the budget would shift from deficit to surplus.

The projections also indicate that the relative shares of the federal budget allocated to broad categories of spending would remain relatively constant, although some changes would occur. For example:

- The share allocated to defense would remain at its present level of between 24 and 25 percent of the budget, compared to 44 percent in 1969.

- Benefit payments for individuals, such as veterans' benefits and social security, would rise only slightly, from 44 to 46 percent of the budget, compared to 28 percent in 1969.

Changes could be expected in the shares of revenues generated through personal income taxes, corporate profits taxes, and payroll (social insurance) taxes, again largely because inflation and real

growth in incomes would push individuals into higher tax brackets. Thus:

- The share of revenues derived from personal income tax collections would increase, from about 45 percent in 1976 to between 50 and 51 percent in 1981.

- The share derived from corporate profits taxes would rise only slightly, to 14 or 15 percent by 1981, after declining from 19.5 to 13 percent between 1969 and 1976.

- The relative growth in collections from payroll taxes would cease, with the share raised through this source declining from 31 to between 27 and 29 percent between 1976 and 1981.

The amount of outlays required to sustain services at current levels and the amount of revenues collected, of course, depend on overall economic conditions. Because of the uncertainty of the economic outlook, the CBO calculated its projections under two sets of assumptions. The first, path A, assumes a strong recovery from the current recession with the unemployment rate falling to 4.5 percent in 1980 and 1981. Under the second, path B, recovery would not be quite as strong: the unemployment rate would fall to just below 6 percent by 1981. The rate of inflation would remain at the historically high levels of 6 to 7 percent under path A, and would be somewhat lower under path B.

These are only two of many possible paths that the economy might follow; they are not predictions or targets. Neither is a necessary or predicted consequence of the spending and taxing projections associated with it. Indeed, neither path is likely to result unless private sector spending is exceptionally strong and unless changes are, in fact, made in current government economic policies. However, these projections do provide a useful benchmark against which the effects of new initiatives can be measured. Further, they illustrate the effects of continuing current policies under different economic conditions. For example:

- Federal outlays would decline under path A from 24 to 19 percent of Gross National Product (GNP) between fiscal years 1976 and 1981; under path B, the decline would be to 21 percent.

- Receipts would rise from 19 to 22 percent of GNP under path A and to 21 percent under path B.

- The deficit would disappear by 1979 under path A, but not until after 1981 under path B.

Five-Year Budget Projections
(Fiscal years, in billions of dollars)

	1976	1977 Path A	1977 Path B	1981 Path A	1981 Path B
Total outlays	375	420	425	560	563
Total receipts	301	383	360	652	550
Budget deficit	74	37	65	--	13
or surplus	--	--	--	92	--

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CHAPTER I
INTRODUCTION AND OVERVIEW

In considering proposed changes in federal spending or taxing programs, it is important to know what would happen to the federal budget if current policies were to be continued unchanged. Without any alteration in legislation or policy, budget figures can shift from one year to the next. For example, social security payments may rise because more elderly people claim benefits; or, income tax collections may fall because fewer people are employed. Careful consideration of the base from which a budgetary change is to be made contributes to the soundness of budgetary decisions.

Moreover, it is desirable to assess the implications of existing budgetary commitments for several years in the future before deciding to maintain or alter those commitments. Annual budget decisions often have little short-run impact on budget totals or on the composition of the budget, but in the longer run, they can significantly influence both the size of the budget and the relative priorities it implies.

As a preparatory step toward Congressional action on the budget for fiscal year 1977, this report presents projections through fiscal year 1981 of federal spending and receipts, developed on the assumption that current policies will continue unchanged. The budget totals presented in these projections are in no sense inevitable; they are intended neither as budget recommendations nor as predictions of what will actually occur. They are intended simply to provide a useful analytical base from which various budget alternatives may be judged.

Basis of Projections

The projections presented in this report are estimates of the receipts and outlays that would occur if present tax laws and all ongoing federal programs were to continue to operate for five more years at the levels specified for fiscal year 1976 (and the July-September, 1976, transition quarter) in the Second Concurrent Resolution on the 1976 Budget adopted by the Congress on December 12, 1975.

In the case of receipts, the basic assumption is a simple one: present tax laws are assumed to continue in force. In particular, the provisions of the Tax Reduction Act of 1975 (adopted in March) are assumed to continue in effect through 1981, in the manner provided for in the Revenue Adjustment Act of 1975 (adopted in December), which extended most provisions of the original tax cut for six months.

In the case of spending, the basic assumptions are necessarily more complicated:

- o The statutory authority for many federal programs will expire within a few years. These authorizations are assumed to be routinely renewed, except for programs that are clearly of a one-time nature (temporary study commissions, for example). General revenue sharing and several temporary employment assistance programs are assumed to be renewed.

- o The costs of a few federal programs (notably general revenue sharing) are specified by existing law; also, there are statutory ceilings on outlays for some programs, such as social services grants. These programs are assumed to remain at their statutory levels.

- o Some federal programs -- such as interest on the public debt, medicare and medicaid, and unemployment insurance — are open-ended, in the sense that their costs are determined primarily by population changes or economic factors (or by state and local governments, which establish benefit levels for unemployment insurance and public assistance). Estimates were made of the impact on these programs of specific economic assumptions (discussed below) and anticipated population changes.

- o Existing laws provide for automatic cost-of-living adjustments of some sort for virtually all federal programs providing direct benefit payments to individuals, except veterans' programs (for which benefit adjustments are legislated periodically). Even where cost-of-living adjustments are not automatic, however, they are assumed to occur for these programs.

- o For other programs (direct federal operations and many grants to state and local governments), program levels are discretionary; that is, outlays depend on the amount Congress chooses to authorize and appropriate each year. There is no requirement that appropriations for such programs receive inflation adjustments. Since much of the budget responds automatically to inflation, however, it seems useful to assume inflation adjustments in these programs as well, in order to have a consistent baseline against which to measure changes in both discretionary and nondiscretionary programs.

o The projections assume no change in military or civilian federal employment and virtually no change in the real volume of procurement from fiscal year 1976 levels. Federal pay scales are assumed to be adjusted annually in accordance with the Federal Pay Comparability Act of 1970, while costs of federal procurement are assumed to rise in proportion to inflation in the private sector of the economy. The projections assume a 12 percent increase in October, 1976, for general schedule and military pay. This includes a 3.7 percent "catch-up" from the October, 1975, pay adjustment, which was below comparability with the private sector.

In summary the spending projections assume that all current programs will continue (except where they are clearly temporary), that allowance will be made for inflation in all programs (except where ceilings are imposed by law), and that open-ended claims on the federal Treasury, such as interest on the public debt and social security payments, will respond to assumed economic and population changes in essentially the same way they have responded to such changes in the past.

Economic Assumptions

Inflation, unemployment rates, and other levels of economic activity strongly affect both receipts and outlays. In order to develop budget projections, therefore, explicit assumptions must be made about v/hat will happen to the economy over the next five years. In view of the uncertainty surrounding the economic outlook, this report presents budget projections on the basis of two sets of economic assumptions, designated path A and path B.

Path A assumes strong recovery from the current recession. Under this path the rate of increase in constant-dollar or real Gross National Product (6NP) would be 7 percent in 1977 and 1978 and would average 6 percent over the five-year period.[2] The unemployment rate would drop to 4.5 percent in 1980 and 1981. Inflation would remain at historically high levels of 6 to 7 percent. The average increase in current-dollar GNP would be 13 percent (see Table 1).

Under path B, recovery would not be quite as strong. The rate of increase of GNP would dip below 4 percent in 1977 and average about 5 percent over the five years. The unemployment rate would be just

Table 1.—Alternative Economic Assumptions, 1975–81

(Calendar years)

Selected economic variables	1975	1976	1977	1978	1979	1980	1981	Average annual increase, 1975–81
Path A—6 percent real GNP growth:								
Current dollar GNP (in billions)	1,476	1,695	1,933	2,205	2,485	2,780	3,075	13.0%
Real GNP (1958 dollars in billions)	796	856	916	980	1,036	1,085	1,126	6.0
Unemployment rate (percent)	8.5	7.4	6.4	5.4	4.8	4.5	4.5	------
Rates of change (percent):								
Real GNP	—3.1	7.5	7.0	7.0	5.7	4.7	3.8	6.0
GNP deflator	8.9	6.7	6.6	6.6	6.6	6.6	6.6	6.7
Consumer price index	9.2	7.2	7.1	7.0	6.8	6.6	6.6	7.0
Path B—5 percent real GNP growth:								
Current dollar GNP (in billions)	1,476	1,675	1,845	2,050	2,270	2,500	2,755	11.0%
Real GNP (1958 dollars in billions)	796	847	880	922	968	1,015	1,065	5.0
Unemployment rate (percent)	8.5	7.7	7.5	7.1	6.7	6.3	5.9	------
Rates of change (percent):								
Real GNP	—3.1	6.4	3.9	4.8	5.0	4.9	4.9	5.0
GNP deflator	8.9	6.7	6.1	6.0	5.5	5.0	5.0	5.8
Consumer price index	9.2	7.2	6.9	5.9	5.6	4.8	5.0	6.0

below 6 percent in 1981. Inflation rates would be somewhat lower than under path A, particularly in 1980 and 1981. Current-dollar GNP would increase at an 11 percent average annual rate.[3]

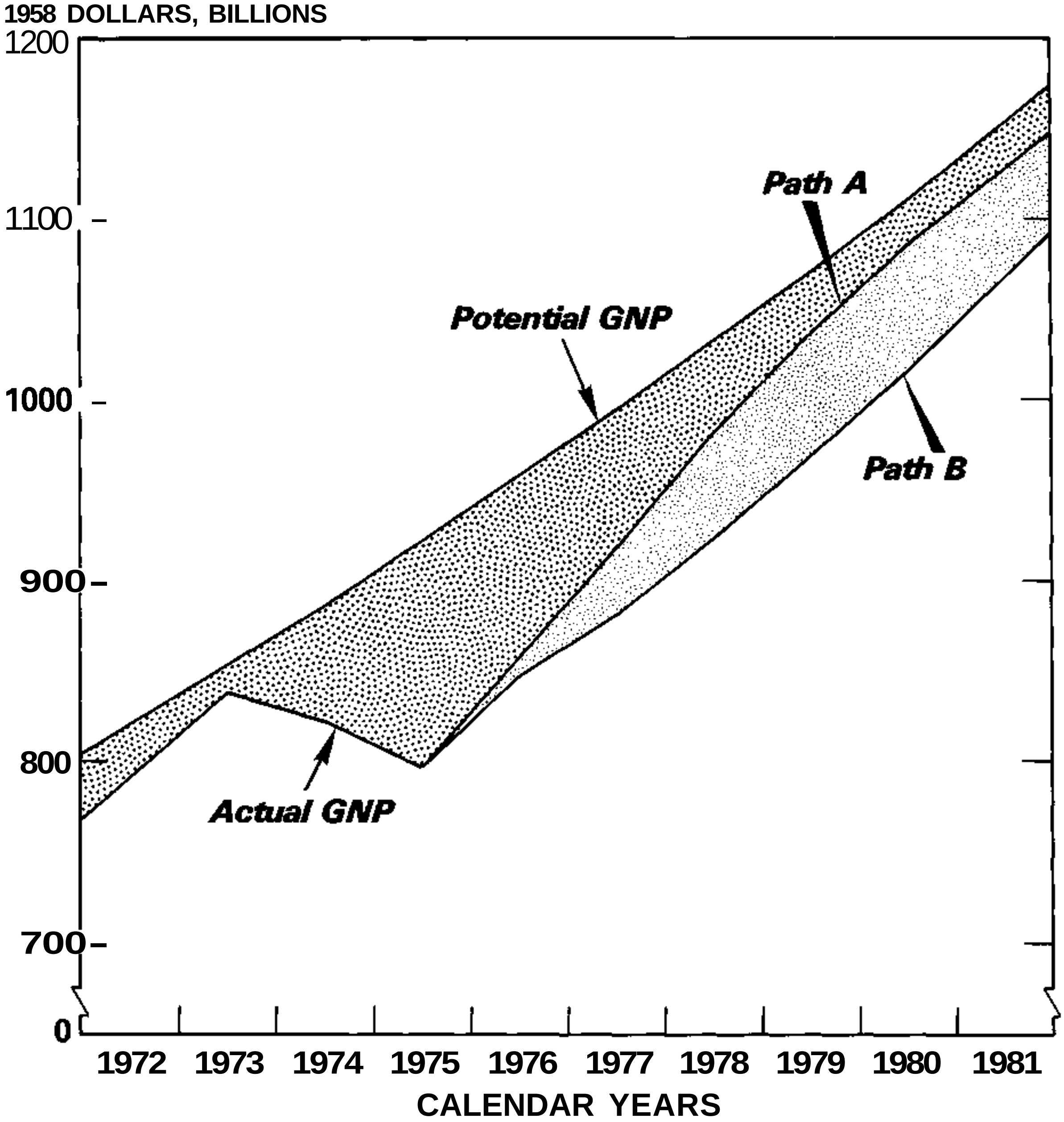
In terms of economic growth, neither of these assumed paths could be described as pessimistic. The rate of real economic growth assumed for path B, the less rapid of the two, is close to the most rapid five-year economic growth rate actually experienced since World War II. In terms of inflation and unemployment rates, however, both paths may be considered as disappointing. The five-year average inflation rate under path A and the five-year average unemployment rate under path B would be higher than experienced in the last 30 years.

Chart 1 compares real GNP (in constant 1958 dollars) under paths A and B with potential full-employment GNP (assuming a constant 4 percent unemployment rate). Potential output is assumed to grow by 3.75 percent a year from 1976 through 1981. Under path A real GNP reaches the area of full-employment by 1980. Under path 3 it is still some distance away at the end of 1981.

Several points concerning these economic assumptions should be emphasized. First, neither set is an economic forecast in the sense of being the best estimate of the Congressional Budget Office of how the economy is likely to behave over the projection period. Rather, these are two of many possible paths that the economy could follow during the next several years. Nothing explicit has been assumed about the sources of economic demand necessary to generate either of these growth paths.

Second, neither path is intended to represent a necessary or predicted consequence of the budgetary projections associated with it. The budget projections simply show what the federal budget would look like (if services were maintained at current levels) if the economy somehow -- as a result of foreign demands, monetary policy, or some other developments — achieved path A or path B. These projections do not necessarily represent the budgetary policy that would be required to achieve either path under particular assumptions about the rest of the economy. Indeed, it should be pointed out that unless nonfederal spending proves exceptionally strong, sustained economic recovery from the recession -- especially at the rates assumed in path A — would not be possible if current government taxing and spending policies are in fact continued unchanged. Plausible assumptions about nonfederal spending point to the conclusion that a more expansionary fiscal policy than that represented by these budget projections would be necessary to achieve path A, the higher of the two paths. Even to achieve path B, more fiscal stimulus would probably be required in the later years of the period.

CHART 1.
ACTUAL AND POTENTIAL GNP, 1972 - 1981



The shaded areas represent the short fall of **projected** actual GNP from its potential full-employment level (at 4% unemployment) resulting from the 1974-75 recession. Potential real GNP is assumed to increase by 3.75% from 1976 through **1981.**

Third, the tv/o economic paths are basically trend projections. Cyclical movements in the economy are largely ignored. Long-run historical patterns and relationships were used to generate the allocation of income shares, the required money stock growth, and other variables needed to project budget revenues and outlays. In both projections, corporate profits do have a cyclical element in that the exceptionally rapid growth rates assumed for 1976 and 1977 reflect their recovery from the low level of 1975. Also, path B shows some slowdown in economic growth in 1977 with a resumption in 1978 and later years.

Finally, neither path should be considered as a recommended or "target" path. The Congressional Budget Office makes no policy recommendations. It is possible for fiscal and monetary policies (or other forces) to decrease unemployment faster than is assumed under path A, but presumably at a cost of more rapid inflation. Similarly, it is possible for fiscal and monetary policies to hold inflation below the rates assumed under path B, but at a cost of higher unemployment. The purpose of the two alternative paths is simply to illustrate the effect of different economic assumptions on budget projections.

Budget Projections

Outlays. Total federal outlays are projected to be $560 billion under path A and $563 billion under path B by 1931 if current policies are continued. This would be an increase of $186 billion to $188 billion above the level specified in the second concurrent resolution ($375 billion), or an 8 percent average annual rate of increase. Under path A, federal outlays would decline from 24 percent of (current dollar) GNP in fiscal year 1976 to 19 percent in fiscal year 1981. Because GNP is lower under path B, the decline in outlays as a percentage of GNP under this path is only to 21 percent by 1981.

Although the dollar amount of total outlays under both paths reach roughly the same level in 1981, the growth of outlays during the five years follows slightly different patterns. Federal outlays would be somewhat higher if services were maintained at current levels from 1977 through 1981 for path B, primarily due to higher outlays for unemployment programs and interest on the debt. By 1981, however, the higher rate of inflation under path A causes outlays under that path to begin to catch up with path B outlays.

Receipts. Under path A, receipts from federal taxes would rise from $301 billion in 1976 to $652 billion in 1981. Receipts would rise faster than the GNP, largely because inflation and growth in real income would push individuals into higher income tax brackets. Under

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path A assumptions, federal tax receipts would rise from 19 percent of GNP in 1976 to 22 percent in 1981. Under path B, tax receipts would be lower because real income and inflation are assumed to be lower, but would still rise more rapidly than GNP over the five-year period.

Deficits and Budget Margins. In fiscal year 1976, federal outlays are expected to exceed receipts by $74 billion. This deficit results largely from the fact that recession has reduced federal tax receipts and increased federal outlays for some types of expenditures such as unemployment compensation.

Under path A — the stronger recovery assumption — the federal deficit would fall to $37 billion in 1977 and be entirely eliminated in 1979. By 1981 the budget shows a potential surplus of $92 billion. Under path B -- the slower recovery assumption — the deficit would be $65 billion in 1977 and would not disappear until after 1981. It must be emphasized that it is unlikely that either of these results, especially the budget margins shown for path A, would actually occur without a more expansionary fiscal policy than that represented by a budget that maintains services at current levels. These budget projections are shown in Table 2.

These projections illustrate some facts about the built-in changes in the federal budget that are useful for policymakers to keep in mind. As the economy grows and prices rise, federal spending will grow even if current policies remain unchanged. Receipts, however, would rise somewhat more rapidly than outlays. Hence, if policies are not changed, the current federal deficit would disappear over time. The faster the economy grows — and the more rapid the inflation — the faster the federal budget will shift from deficit to surplus, (see Chart 2).

The Full-Employment Budget

The full-employment budget concept used in recent Presidential budgets provides an alternative to viewing the budget in "actual" terms. This analytical tool makes allowance for the state of the national economy by ignoring that part of the budget surplus or deficit attributable to recession or (in an economic boom) employment at levels above the so-called full-employment level.[3] Full-employment receipts are computed as the receipts that would be generated if the economy were continually operating at full capacity. Similarly, full-employment outlays include only that portion of unemployment benefits that would be paid if the economy were continually operating at full-employment.

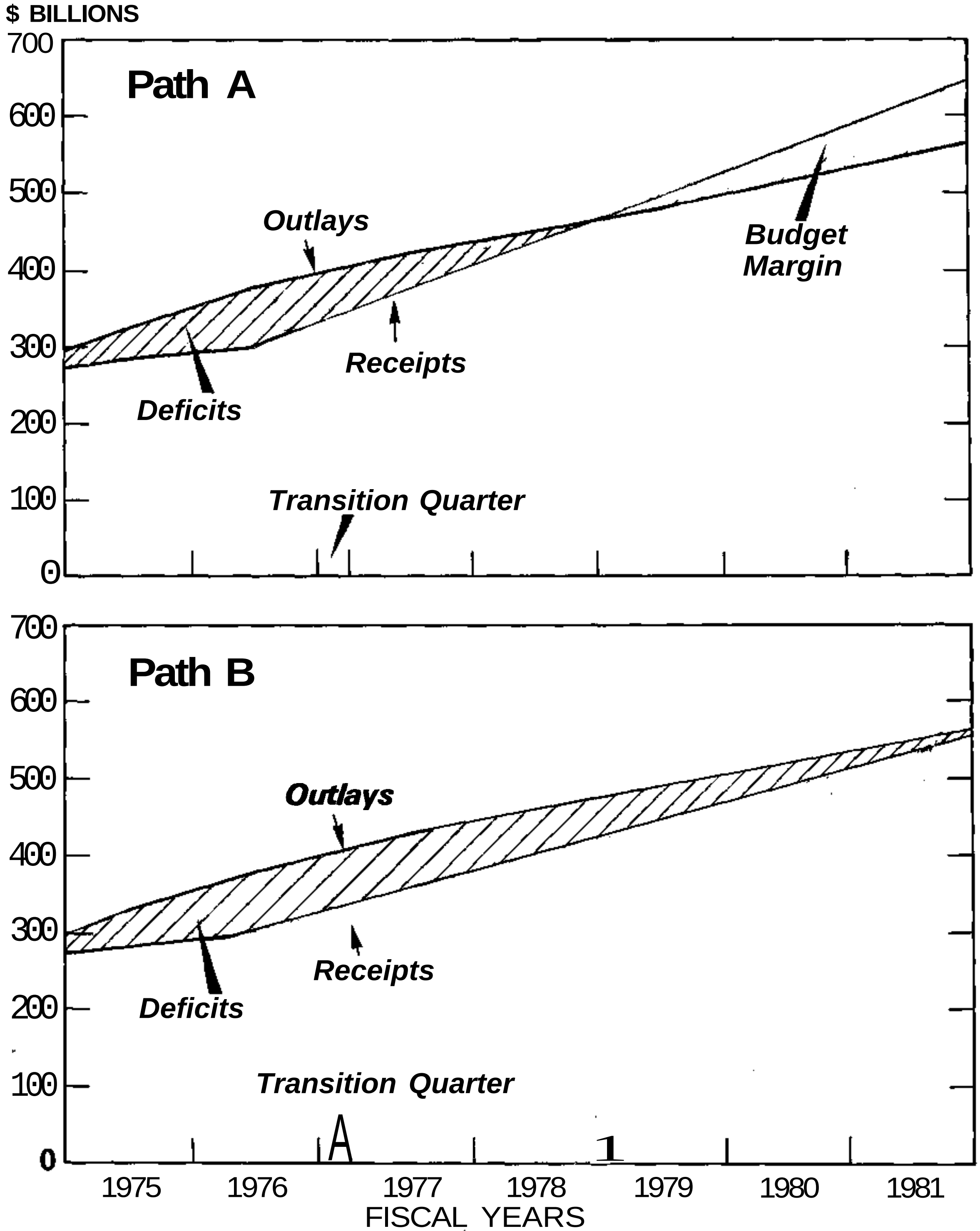
Table 2.—Projections of the Federal Budget, 1977–81

(Fiscal years, in billions of dollars)

Categories	1975 actual	1976 estimate	Transition quarter estimate	Projections 1977	1978	1979	1980	1981
Path A — 6 percent real GNP growth:								
Total outlays	324.6	374 9	101.7	419.9	448	480	518	560
Total receipts	281.0	300 8	86.0	383.3	445	509	577	652
Budget deficit	43.6	74.1	15.7	36.6	3	-	-	-
or surplus	-	-	-	-	-	29	58	92
Path B — 5 percent real GNP growth:								
Total outlays	324.6	374.9	101.7	424.9	464	495	530	563
Total receipts	281.0	300.8	86.0	360.0	401	448	497	550
Budget deficit	43 6	74.1	15.7	64.9	63	47	33	13
or surplus	-	-	-	-	-	-	-	-

CHART 2.

BUDGET PROJECTIONS TO 1981



The differences between the adjusted receipts and outlay estimates are called full-employment budget margins. Changes in the margins from one year to the next provide a rough measure of the impact of the budget on the economy. A decrease in the margin indicates fiscal stimulus; an increase indicates restraint.

Table 3 shows full-employment budget projections for 1975 through 1981. For 1976, the totals set in the second concurrent resolution result in an $2 billion full-employment budget surplus. Under path A economic assumptions, this surplus increases to $116 billion by 1981 -- assuming no changes in current law or budget policy. Under path B assumptions it rises to $68 billion.

The Composition of Spending and Taxes

Between 1969 and 1975, the defense budget declined from about 44 to 27 percent of total federal outlays. For 1976, the second concurrent resolution sets a defense ceiling that amounts to 25 percent of total outlays. The baseline projections show defense outlays maintaining a relatively constant share of projected total outlays: 25 percent in 1931 under path A, and 24 percent under path B.

The decline in the relative share of defense outlays between 1969 and 1975 was almost exactly matched by an increase in the relative share of outlays for individuals, which rose from 28 to 44 percent of total budget outlays. Much of this increase resulted from enactment of policy initiatives, rather than from built-in nondiscretionary increases in numbers of eligible beneficiaries or automatic cost-of-living increases. Thus, on a no-new-initiatives basis, the projected share of total outlays devoted to payments for individuals would rise more gradually than it has since 1969, reaching 47 percent in 1981 under path A and 46 percent under path B.

Other types of federal spending have, in the aggregate, maintained a fairly constant share of total spending in recent years, and this share is projected to remain reasonably constant through 1981. Further details on the composition of the spending projections are provided in the next chapter.

The personal income tax has been the most important source of federal receipts since World War II, supplying about 45 percent of total receipts over the past two decades. On a no-new-initiatives basis, however -- that is, in the absence of periodic tax cuts such as we have had in the past – inflation and real growth will push individuals into higher tax brackets over time; therefore, personal

Table 3.—Full-Employment Receipts and Outlays

(Fiscal years, in billions of dollars)

Categories	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A — 6 percent real GNP growth:								
Full-employment receipts	338	364	102	438	487	541	604	676
Full-employment outlays [1]	317	363	99	411	445	479	518	560
Full-employment budget margins	21	2	3	26	42	62	86	116
Change from previous year	—5	—19	------	+25	+16	+20	+23	+30
Path B — 5 percent real GNP growth:								
Full-employment receipts	338	364	102	433	479	525	574	625
Full-employment outlays [1]	317	363	99	413	453	485	522	557
Full-employment budget margins	21	2	3	20	26	40	52	68
Change from previous year	—5	—19	------	+18	+6	+14	+13	+16

[1] Reflects adjustment for regular unemployment compensation only, although outlays for many other programs are also affected by the unemployment rate.

income tax collections are projected to increase to 51 percent of total receipts in 1981 under path A, and 50 percent under path B.

Corporate profits taxes declined from 19.5 percent of total tax collections in 1969 to 13 percent in 1976. In the absence of further changes in corporate taxation rules, however, corporate profits tax collections are projected to rise somewhat, to 15 percent in 1981 under path A and 14 percent under path B.

Payroll (social insurance) taxes have risen from 21 percent of total receipts in 1969 to nearly 31 percent in 1975. On a no-new-initiatives basis, however, this relative growth is projected to cease during the next five years, with payroll taxes declining to 27 percent under path A and 29 percent under path B. Further details on the revenue projections are provided in Chapter III.

Tax Expenditures

Tax expenditures are revenue losses resulting from federal tax provisions that grant special relief designed to encourage certain kinds of economic behavior by taxpayers or to aid taxpayers in special circumstances. Since tax expenditures may be viewed as implicitly equivalent to a simultaneous collection of revenue and a direct budget outlay of a like amount to the beneficiary, they also should be examined to obtain a complete picture of the federal budget.

Because the effects of certain tax expenditures are dependent upon each other, the simple addition of the separate items is not an accurate measure of the total federal revenue loss. However, the revenue losses are certainly in the neighborhood of one-quarter of taxes collected. Currently, about 75 percent of tax expenditures accrue directly to individuals and 25 percent to corporations. During the 1976-81 period, it is projected that these shares will remain fairly constant.

Footnotes

1. Constant-dollar or real GNP has been adjusted for inflation, or "deflated" so that meaningful comparisons can be made between years. Current-dollar GNP has not been adjusted for inflation; it indicates the actual dollar figure for a given year.

2. Assumptions about major components of national income (e.g., corporate profits and employee compensation) are presented in Chapter III, which contains details on the revenue projections. The interest

rate assumptions are discussed in Chapter II, which deals with spending projections.

3. There is some controversy over what constitutes full-employment and what the composition of GNP would be at full-employment. While the full-employment concept has been conventionally defined in terms of a hypothetical 4 percent unemployment rate, any other rate would serve essentially the same purpose, provided that it remained fixed from year to year. Thus, an unemployment rate of 5 percent could be used, and would result in similar year-to-year changes in the full-employment budget margins. The full-employment budget estimates shown in Table 3 are based on the conventional 4 percent unemployment rate definition.

CHAPTER II
FEDERAL SPENDING

This chapter discusses the five-year projections of federal spending that would occur under alternative economic assumptions if current budget policies were to continue unchanged.

Total Federal Spending

Total federal spending increased almost fivefold between 1955 and 1975 — from $69 billion to $325 billion -- an average annual rate of increase of 8 percent. As a percentage of GNP, total federal outlays rose from 18 percent in 1955 to 22 percent in 1975. For 1976, total outlays under the second concurrent resolution are estimated to be $375 billion, a 15 percent increase from 1975 and an increase to 24 percent of GNP. The recent rise in federal spending relative to the size of the economy is largely a result of the recession, which has (1) raised federal outlays for some types of spending, such as unemployment compensation, and (2) lowered GNP from what it otherwise would be under a full-employment economy.

Assuming no change in current spending policies, total federal outlays are projected to increase almost 50 percent by 1981 to $560 billion under path A and $563 billion under path B. This increase is less than the assumed rate of growth for GNP so that federal spending as a percentage of GNP would fall to 19 percent under path A and to 21 percent under path B (GNP is assumed to grow at a lower rate under path B). Path B outlays exceed those of path A during 1977-81 largely because of greater spending for unemployment compensation and interest payments. However, path A outlays begin to catch up by 1981, due to the assumed higher rate of inflation under that path.

Major Components of Spending

The composition of federal spending has changed significantly during the last 20 years. The relative share of the budget allocated to benefit payments for individuals and grants to state and local governments has increased substantially, particularly since 1967. At the same time, the share of the budget devoted to national defense has fallen markedly. Spending for other federal programs, including

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interest on the debt, has remained a relatively constant share of the budget. These shifts in the relative shares of budget allocations are displayed in Charts 3 and 4 and in Table 4.

During the 1976-81 period covered by the projections, however, there is little further shift in the relative composition of the budget. This reflects the assumption of no policy changes or changes in existing laws and the application of relatively uniform projection techniques to the various spending categories.

Table 5 presents the five-year budget projections in terms of five major spending categories under the two sets of alternative economic assumptions. The program components of each of these major categories are described below.

National Defense

This category is identical with the national defense budget function and includes the military activities of the Department of Defense, military assistance, atomic energy activities, and defense-related activities of civilian agencies. The projections for this category hold constant, in real terms, the dollar value of resources to operate, maintain, and modernize defense forces. They are completely independent of any increase or decrease in external threats to our national security and do not necessarily imply a constant defense capability, constant deterrence levels, or even constant defense force levels. The dollar value of the resources required for a constant defense capability may in fact be quite different from those projected here, where the levels approved for 1976 are held constant in real terms over 1977-81.

Estimated outlays for national defense in 1976 under the second concurrent resolution total $92 billion, which represents 25 percent of the budget. This represents a significant shift in spending from 20 years ago, when national defense outlays were more than 50 percent of the budget. To maintain real defense resources at current levels, outlays for national defense are projected to rise to $141 billion under path A (25 percent of the projected budget total) and $136 billion under path B (24 percent of total outlays). As a percentage of GNP, projected defense outlays decline from 6 percent in 1976 to 5 percent in 1981, under both path A and path B.

National defense spending is about equally divided into (1) purchases of goods and services from the private sector and (2) compensation for military and civilian federal employees and retired military personnel. The budget projections for each of these components are shown in Table 6.

CHART 3.

COMPOSITION OF FEDERAL SPENDING

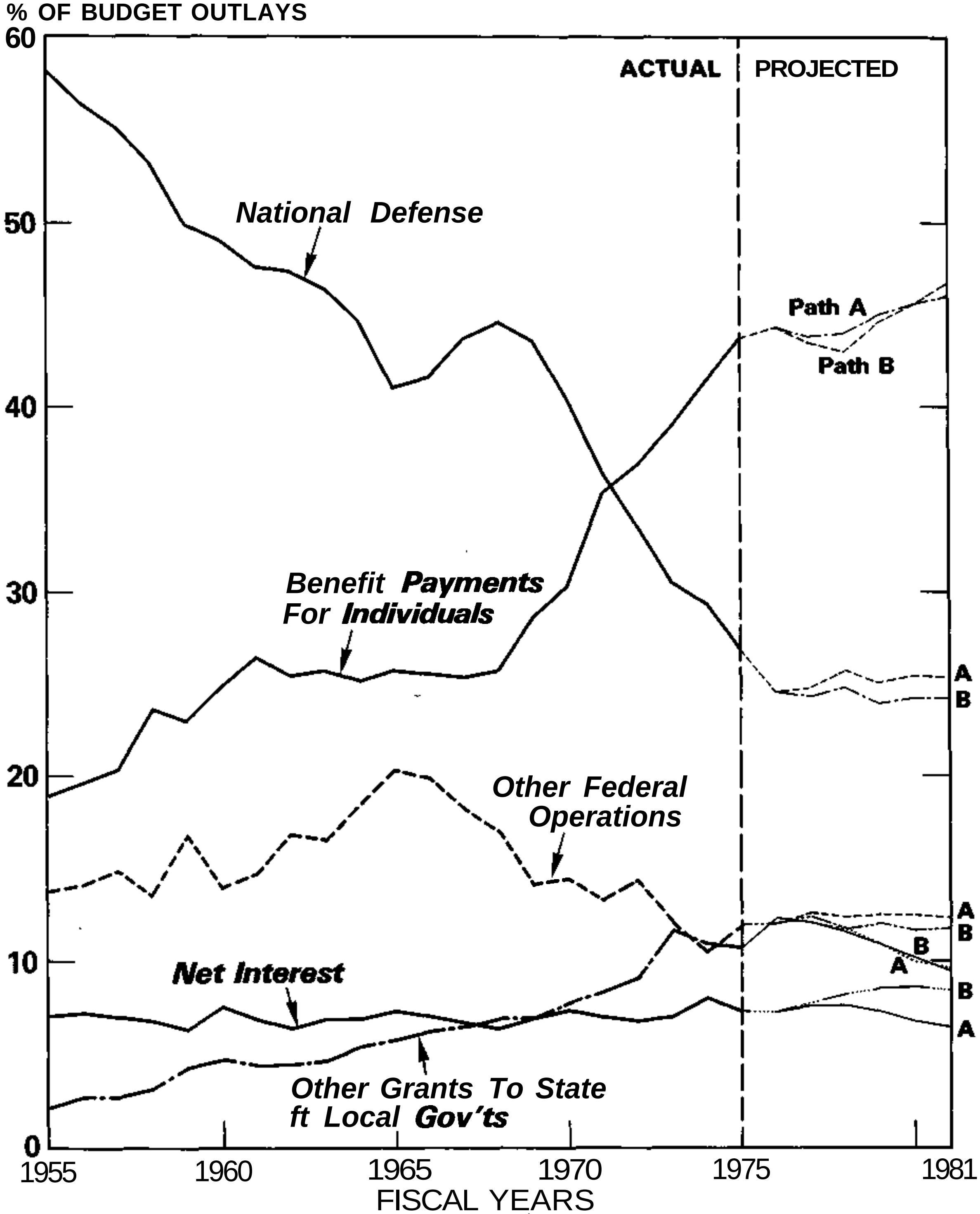

CHART 4.

COMPOSITION OF FEDERAL SPENDING AS A PERCENTAGE OF GNP

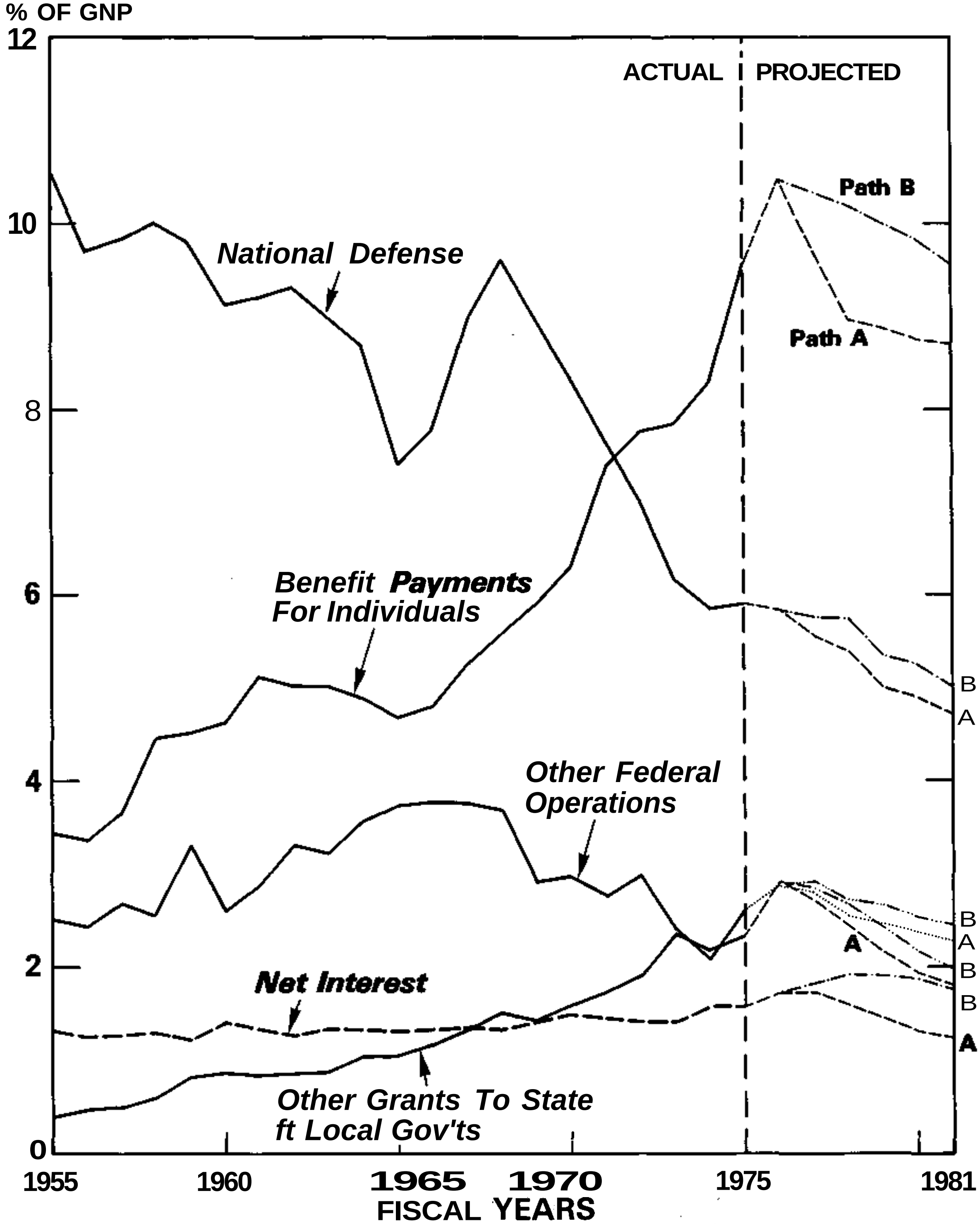

Table 4.—Composition of Federal Spending, 1955-81

A. As a Percentage of GNP

Major component	1955	1960	1965	1970	1975	1976	1977		1981	
							Path A	Path B	Path A	Path B
National defense	11	9	7	8	6	6	5	6	5	5
Benefit payments for individuals	3	5	5	6	9	10	9	10	9	10
Grants to state and local governments	1	1	1	2	2	3	3	3	2	2
Net interest	1	1	1	2	2	2	2	2	1	2
Other federal operations	2	3	4	3	3	3	3	3	2	2
Total budget outlays	18	19	18	21	22	24	22	24	19	21

B. As a Percentage of Total Budget Outlays

Major component	1955	1960	1965	1970	1975	1976	1977 Path A	1977 Path B	1981 Path A	1981 Path B
National defense	58	49	41	40	27	25	25	24	25	24
Benefit payments for individuals	19	25	26	30	44	44	43	44	47	46
Grants to state and local governments	2	5	6	8	11	12	12	12	9	9
Net interest	7	7	7	7	7	7	8	8	7	9
Other federal operations	14	14	20	14	12	12	12	12	12	12
Total budget outlays	100	100	100	100	100	100	100	100	100	100

Table 5.—Major Components of the Budget Outlay Projections

(Fiscal years, in billions of dollars)

Major component	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A — 6 percent real GNP growth:								
National defense	86.6	91.9	24.8	103.4	115.0	119.6	130.8	141.3
Benefit payments for individuals	141.4	165.5	43.7	181.3	192.0	213.3	235.5	261.0
Grants to state and local governments	34.7	45.7	13.1	49.6	51.6	51.9	51.6	52.6
Net interest	23.3	26.9	7.9	32.1	34.9	35.4	36.5	37.5
Other federal operations	38.6	44.9	12.2	53.5	54.7	60.1	64.1	68.1
Total budget outlays	324.6	374.9	101.7	419.9	448.2	480.3	518.5	560.5
Path B — 5 percent real GNP growth:								
National defense	86.6	91.9	24.8	103.4	114.5	118.0	127.2	135.6
Benefit payments for individuals	141.4	165.5	43.7	185.6	203.3	221.5	239.6	258.0
Grants to state and local governments	34.7	45.7	13.1	50.5	52.9	53.4	52.6	52.1
Net interest	23.3	26.9	7.9	33.2	39.4	43.9	48.3	51.6
Other federal operations	38.6	44.9	12.2	52.2	53.9	58.1	61.9	65.4
Total budget outlays	324.6	374.9	101.7	424.9	464.0	494.9	529.6	562.7

Table 6.—National Defense Projections

(Fiscal years, outlays in billions of dollars)

Major component	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A—6 percent real GNP growth:								
Military and civilian pay and allowances	40. 5	41.4	10. 5	46. 9	51.1	55. 3	60. 3	65. 3
Retired military pay	6. 1	7. 4	2. 0	8. 6	9. 6	10. 9	12. 0	13. 5
Purchases of goods and services	40. 0	43. 1	12.1	47. 9	54. 3	53. 4	58. 5	62. 5
Total national defense outlays	86. 6	91. 9	24. 6	103. 4	115. 0	119. 6	130. 8	141. 3
Path B—5 percent real GNP growth:								
Military and civilian pay and allowances	40. 5	41.4	10. 5	46.9	51.1	55. 3	59. 2	63. 3
Retired military pay	6. 1	7. 4	2. 0	8. 6	9. 7	10. 6	11. 7	12. 8
Purchases of goods and services	40. 0	43. 1	12.1	47. 9	53. 7	52. 1	56. 3	59. 5
Total national defense outlays	86. 6	91. 9	24. 6	103. 4	114. 5	118. 0	127. 2	135. 6

The projections of military and civilian pay are based on provisions of the Federal Pay Comparability Act of 1970, which was designed to maintain comparability with private sector wages and salaries. The projections assume a 12 percent increase in October, 1976, for general schedule and military pay. This includes a 3.7 percent "catch-up" from the October, 1975, pay adjustment, which was below comparability with the private sector.

Increases in military retirement pay costs are projected on the basis of automatic cost-of-living adjustments in benefits for retired military personnel, increases in the retired population, and the higher wage bases of new retirees.

The current services projections of defense purchases of goods and services are based on the budget authority targets in the second concurrent resolution and estimated spending from prior year appropriations. With one major exception, the estimated budget authority targets were simply adjusted for anticipated inflation during 1977-81. The exception is a one-time cost in 1976-78 that pays for escalation and cost growth in 1970-75 shipbuilding programs. This one-time cost coupled with faster spending rates projected for 1977-78 appropriations results in a slight dip in projected outlays in 1979 for defense purchases.

Benefit Payments for Individuals

The largest single component of federal outlays is benefit payments for retired, disabled, or unemployed workers; veterans; and low-income families and individuals. These payments are relatively uncontrollable under current law in that entitlement to payments is specified by statute. Thus, these payments will grow as eligible populations and program participation rates increase. Also, the laws governing payments under most of these programs mandate automatic cost-of-living adjustments.

Federal benefit payments are estimated to total $166 billion in fiscal year 1976 — 44 percent of the budget total. The relative share of the federal budget allocated to these programs has more than doubled in the last 20 years as new programs have been started and the benefits under older programs, such as social security, have been expanded. In 1955, these payments represented 3 percent of GNP, the best measure of the size of the nation's economy, and will rise to 10 percent in 1976. If services were maintained at current levels, these payments would remain relatively stable at 9 to 10 percent under both paths.

The major federal programs included in benefit payments for individuals are shown in Table 7. These programs include both direct payments from the federal government (such as social security benefits) and payments provided indirectly through state and local governments (such as public assistance). The category of payments for individuals also includes retirement pay for federal civilian employees. Military retirement pay is included under the national defense category.

Projections of benefit payment programs depend upon assumptions about future inflation and unemployment rates. As described in Chapter I, path A assumes that the unemployment rate will fall from 8.5 percent to 4.5 percent between calendar years 1975 and 1980 and remain at this level in 1981. Path B assumes that the unemployment rate will fall more gradually, reaching 5.9 percent in 1981. The difference in the two unemployment rate assumptions results in a $6 billion difference in the two projections for unemployment assistance in 1981 and a cumulative total of $34 billion for the entire 1977-81 period. Path A assumes that the Consumer Price Index (CPI) will increase by 50 percent between calendar years 1975 and 1981, compared to 42 percent under path B. This results in a $9 billion difference in the 1981 projections for benefit payments for the two paths.

Social security and railroad retirement benefits are projected to increase from $76 billion to $127 billion between fiscal years 1976-81 under path A and to $125 billion under path B. The automatic cost-of-living adjustment, based on increases in the CPI, accounts for approximately 55 percent of the projected cost increase. An additional 35 percent of the increase is the result of projected growth in the number of retirees, causing a corresponding growth in the number of monthly benefit payments. The remaining 10 percent is due to such factors as the rising wage base, (which leads to higher benefit entitlements for new retirees). Increases in federal civilian retirement costs result from essentially the same factors.

Outlays for unemployment assistance are projected to decline by $10 billion, or 50 percent, from fiscal years 1976 to 1981 under path A economic assumptions, but by only $4 billion, or 20 percent, under path B assumptions. These projections assume renewal of temporary legislation providing extended benefits to the unemployed who have exhausted their regular benefits and special unemployment assistance to those who are ineligible for regular unemployment insurance benefits. Under current law, authority for these programs will end in 1977.

Although veterans' pensions, compensation, insurance, and readjustment benefits are not automatically adjusted for increases in the cost of living under current law, the five-year outlay projections

Table 7.—Projections of Benefit Payments for Individuals

(Fiscal years, outlays in billions of dollars)

Major programs	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A — 6 percent real GNP growth:								
Social security and railroad retirement	68.4	76.1	20.8	87.5	95.4	106.3	116.5	127.3
Civil service retirement	7.0	8.6	2.4	10.2	11.7	13.7	15.5	17.7
Unemployment assistance	13.5	19.9	4.6	16.3	11.4	9.9	9.4	9.9
Veterans' benefits: pensions, compensation, readjustment benefits	12.2	14.2	3.3	13.4	13.8	14.3	14.7	15.3
Medicare and medicaid	21.6	25.8	6.9	29.9	34.6	39.9	46.0	53.0
Public assistance (AFDC) and supplemental security income (SSI)	9.9	11.3	3.2	12.3	13.3	14.3	15.7	17.2
Food stamps, housing assistance, and other benefit payment programs	8.8	9.6	2.5	11.7	11.8	14.9	17.7	20.6
Total, benefit payments for individuals	141.4	165.5	43.7	181.3	192.0	213.3	235.5	261.0
Path B — 5 percent real GNP growth:								
Social security and railroad retirement	68.4	76.1	20.8	88.2	97.3	106.6	115.8	124.9
Civil service retirement	7.0	8.6	2.4	10.2	11.8	13.2	15.0	16.8
Unemployment assistance	13.5	19.9	4.6	19.2	19.4	18.8	17.5	15.8
Veterans' benefits: pensions, compensation, readjustment benefits	12.2	14.2	3.3	13.4	13.7	14.0	14.3	14.6
Medicare and medicaid	21.6	25.8	6.9	30.0	34.4	38.8	43.4	48.5
Public assistance (AFDC) and supplemental security income (SSI)	9.9	11.3	3.2	12.7	13.9	15.0	16.2	17.5
Food stamps, housing assistance, and other benefit payment programs	8.8	9.6	2.5	11.9	12.8	15.1	17.4	19.9
Total, benefit payments for individuals	141.4	165.5	43.7	185.6	203.3	221.5	239.6	258.0

for these programs include inflation adjustments. The general practice of Congress has been to adjust these benefits periodically to reflect the increases in the cost of living; legislation being considered by the Congress would mandate cost-of-living adjustments for pensions and compensations. The effect of including this inflation adjustment in the projection is shown below:

	(Fiscal years, in billions of dollars)				
	1977	1978	1979	1980	1981
Path A	1.1	1.9	2.8	3.6	4.5
Path B	1.1	1.9	2.5	3.1	3.8

Veterans' benefits are projected to decline in fiscal year 1977, reflecting a limitation under current law on the period of eligibility for most GI Bill programs.

The projected increases in medicare and medicaid costs assume that medical costs will continue to increase somewhat more rapidly than the CPI. The projections also assume increases in the number of people benefiting from these programs.

The projections for the federal share of public assistance payments (AFDC) assume a 28 percent increase in the average number of monthly recipients from 1975-81 and a 33 percent increase in the average monthly benefit payment. Since 1973, average payments (which are set by state and local governments) have not been increasing as fast as the CPI; the projections assume that this trend will continue.

Projections for the federal portion of supplemental security income (SSI) payments assume a doubling of recipient rolls between fiscal years 1975 and 1981, due to expansion in the eligible population and anticipated increases in the participation rate. This is partially offset by an assumed 15 percent decline in average monthly benefits. The projections include an adjustment for anticipated increases in the cost of living, as required under current law, but the effect of these increases on average monthly benefits is more than offset by other factors, such as (1) an assumed lower average benefit payment for new enrollees, who are expected to be less needy; (2) the departure from the rolls of recipients who currently receive higher average payments because of mandatory supplementation; and (3) increases in social security benefits due to cost-of-living adjustments, which will generally reduce or hold constant the benefits of SSI recipients who also receive social security benefits.

The cost of food stamps is projected to increase from $5.9 billion in 1976 to $10 billion to $11 billion in 1981. Anticipated increases in the CPI account for approximately 40 percent of the projected increases. Growth in the number of recipients accounts for about half the projected increases, and the remaining 10 percent is accounted for by other factors — principally changes in the makeup of the food basket that forms the basis for food stamp benefits and changes in the demographic and economic characteristics of the eligible population.

The cost of housing assistance payments is projected to increase from $2.6 billion in 1976 to approximately $8 billion in 1981. This assumes that Congress will continue to provide sufficient authority for the Department of Housing and Urban Development to make new subsidy commitments for 400,000 housing units annually. This accounts for approximately two-thirds of the projected cost increases for these programs; the remaining one-third is attributable to anticipated price increases.

Other Grants to State and Local Governments

Many payments for individuals discussed above are channeled through state and local governments (e.g., public assistance, food stamps, and medicaid). Other grants to state and local governments that do not provide payments for individuals form the third largest component of federal spending. In 1976, they will total an estimated $46 billion and represent 12 percent of the budget. The relative share of the budget allocated to these programs has increased almost sixfold during the last 20 years. Outlays for these programs are projected to increase 14 to 15 percent to $52 billion to $53 billion by 1981 under path A and path B. Since the total budget is projected to increase almost 50 percent between 1976 and 1981 to maintain services at current levels, the share of the total allocated to these grants would decline to 9 percent in 1981. Table 8 shows the major programs in this category.

The projections assume that general revenue sharing will be extended and that budget authority will continue to increase by $150 million a year, as it does under current law (general revenue sharing otherwise will expire December 31, 1976). If revenue sharing were not renewed, outlays would be lower by $3.2 billion in 1977, and by about $7 billion in each subsequent year.

The projections for federal highway grants also assume renewal of current law, which now is scheduled to expire on October 1, 1977. Obligations are assumed to be about $6.8 billion for fiscal year 1976 and then reach the $7.5 billion ceiling specified in the 1975 Highway Act for the 1977-81 period. The outlay projections are based on historical rates of spending.

Table 8.—Projections of Grants to State and Local Governments, Other Than Grants for Payments for Individuals

(Fiscal years, outlays in billions of dollars)

Major programs	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A—6 percent real GNP growth:								
General revenue sharing	6.1	6.4	1.6	6.6	6.8	7.0	7.1	7.2
Highway grants	4.6	6.7	1.8	7.4	7.3	7.3	7.3	7.4
EPA construction grants	1.9	2.1	.8	3.7	4.2	3.9	2.3	1.1
Community development grants	3.5	5.5	1.7	6.0	6.6	6.3	6.2	6.5
Elementary and secondary education grants	3.3	3.5	.9	3.7	3.9	4.1	4.4	4.6
Manpower and social services grants	6.2	11.3	3.3	10.1	9.5	9.1	9.2	9.6
Child nutrition programs	2.0	2.8	.8	3.3	3.5	3.8	4.1	4.4
Law enforcement assistance	.9	.9	.2	1.0	1.0	1.0	1.0	1.1
All other grants	6.2	6.6	2.0	7.8	8.6	9.4	10.0	10.7
Total, other grants to state and local governments	34.7	45.7	13.1	49.6	51.6	51.9	51.6	52.6
Path B—5 percent real GNP growth:								
General revenue sharing	6.1	6.4	1.6	6.6	6.8	7.0	7.1	7.2
Highway grants	4.6	6.7	1.8	7.4	7.3	7.3	7.3	7.4
EPA construction grants	1.9	2.1	.8	3.7	4.2	3.9	2.3	1.1
Community development grants	3.5	5.5	1.7	6.0	6.6	6.2	6.1	6.3
Elementary and secondary education grants	3.3	3.5	.9	3.7	3.8	4.1	4.4	4.6
Manpower and social services grants	6.2	11.3	3.3	10.9	10.9	10.8	10.6	10.7
Child nutrition programs	2.0	2.7	.8	3.4	3.6	3.9	4.1	4.3
Law enforcement assistance	.9	.9	.2	1.0	1.0	1.0	1.0	1.1
All other grants	6.2	6.6	2.0	7.8	8.5	9.2	9.7	10.4
Total, other grants to state and local governments	34.7	45.7	13.1	50.5	52.9	53.4	52.6	52.1

The projections for Environmental Protection Agency (EPA) construction grants assume that no additional funds will be authorized during the projection period and that the remaining portion of the $18 billion from the 1972 Clean Water Act Amendments will be obligated by the end of fiscal year 1978.

Alternative assumptions that allow for inflation adjustments to general revenue sharing and highway funding, and continued funding of EPA construction grants at the 1977 real level of obligations in 1978-81 would increase projected outlays by the amounts shown below:

	(Fiscal years, in billions of dollars)				
	1977	1978	1979	1980	1981
Path A					
General revenue sharing	0.6	1.2	1.8	2.6	3.4
Federal highway grants	-	.1	.2	.8	1.4
EPA construction grants	-	.5	2.5	4.2	5.3
Path 8					
General revenue sharing	0.5	1.1	1.7	2.3	2.9
Federal highway grants	-	.1	.2	.8	1.2
EPA construction grants	-	.5	2.5	4.1	5.1

The projections for the other grant programs, with the exception of grants for the social services category, which has a $2.5 billion statutory ceiling, include adjustments for inflation. Projected outlays for education grants do not reflect expected future changes in student population. Projections for manpower grants do, however, reflect assumed decreases in the unemployment rate, and include temporary public sector employment measures provided for in the second concurrent resolution. Only child nutrition grants now include an automatic adjustment for increases in the cost of living. Adjustments for other grant programs are discretionary. The table below shows the projected cost of these discretionary inflation adjustments for grants included in Table 8:

	(Fiscal years, in billions of dollars)				
	1977	1978	1979	1980	1981
Path A	2.2	4.1	6.1	7.9	10.2
Path B	2.1	3.9	5.7	7.2	9.1

Net Interest

Net interest represents interest paid on that portion of the public debt that is held by the public. It excludes interest paid to government trust funds that hold federal securities; interest receipts of the U.S. Treasury are also deducted. Net interest payments in 1976 are estimated to total $27 billion, representing 7 percent of total spending. Their relative share of the total budget has remained constant during the last 20 years. These payments are projected to increase to $37.5 billion in 1981 under path A (7 percent of total outlays) and $51.6 billion under path B (9 percent of total outlays). These projections are presented in Table 9, which shows outlays for the interest function and for interest received by trust funds separately.

Net interest costs depend on the level of budget deficits and on interest rates. Interest rates, in turn, depend on the growth in the money supply and demand on the credit markets by both the public and private sectors. Table 10 gives the economic and budget assumptions used to derive the five-year projections of interest costs. The same interest rate assumptions are applied to paths A and B, so that the differences in projected net interest costs result solely from the differences assumed in the total amount of interest-bearing public debt outstanding each year. Rapid rates of growth in the money supply may be necessary to achieve the assumed interest rates. The substantial budget surpluses projected under path A beginning in 1979 are not assumed to be applied to reductions to the public debt (nor to any other specific purpose).

Other Federal Operations

This spending category includes purchase of goods and services for use in government programs such as space exploration and public works, compensation of civilian agency employees (but not retirement costs), and foreign economic and financial assistance. These programs will total $45 billion in 1976 and represent 12 percent of total outlays. They are projected to remain at 12 percent of total outlays in 1981 under both sets of economic assumptions. Table 11 shows the major programs included in this spending category.

International affairs programs include foreign economic and financial assistance, the conduct of foreign affairs, and foreign information and exchange activities. The projections for 1977-81 include the Export-Import Bank, (which is not included in the 1976 budget, but which will be included in federal budget totals beginning with fiscal year 1977). The projections also assume continuation of aid for the Middle East. Program levels are assumed to remain constant in real terms and are adjusted for inflation.

The major components of the general science, space, and technology category are National Aeronautical and Space Administration programs and National Science Foundation support of research and development. The projections for these programs include adjustments

Table 9.—Net Interest Projections

(Fiscal years, outlays in billions of dollars)

Major component	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A — 6 percent real GNP growth:								
Interest function	31.0	35.4	10.0	41.5	45.5	47.6	50.6	54.1
Interest received by trust funds	—7.7	—8.5	—2.1	—9.4	—10.6	—12.2	-14.1	—16.6
Net interest	23.3	26.9	7.9	32.1	34.9	35.4	36.5	37.5
Path B— 5 percent real GNP growth:								
Interest function	31.0	35.4	10.0	42.2	48.9	54.1	59.3	63.7
Interest received by trust funds	—7.7	—8.5	-2.1	—9.0	—9.5	—10.2	-11.0	-12.1
Net interest	23.3	26.9	7.9	33.2	39.4	43.9	48.3	51.6

Table 10.—Assumptions Related to Interest Projections

(Fiscal years, in billions of dollars)

Budget assumptions	1975	1976	Transition quarter	Fiscal years 1977	1978	1979	1980	1981
Path A:								
Budget deficits	43.6	74.1	15.7	36.6	3.2	------	------	------
Trust fund surpluses	7.1	------	−2.0	9.6	14.3	17.1	21.0	27.7
Deficits of off-budget agencies	9.3	14.3	2.7	13.0	14.0	15.0	16.0	17.0
Total interest-bearing public debt (end-of-year)	532.1	620.5	636.9	696.1	727.6	759.7	796.7	841.4
Path B:								
Budget deficits	43.6	74.1	15.7	64.9	62.9	46.9	32.9	13.0
Trust fund surpluses	7.1	------	−2.0	3.3	3.5	5.2	6.9	11.7
Deficits of off-budget agencies	9.3	14.3	2.7	13.0	14.0	15.0	16.0	17.0
Total interest-bearing public debt (end-of-year)	532.1	620.5	636.9	718.1	798.5	865.6	921.4	963.1

Economic assumptions	Calendar years 1975	1976	1977	1978	1979	1980	1981
Path A and path B:							
Treasury bill rate, 91 day bills (percent)	5.9	6.1	6.3	6.5	6.8	7.1	7.5
Yield on 3–5 year Treasury notes (percent)	7.5	7.6	7.7	7.8	8.1	8.3	8.6

Table 11.—Projections of Other Federal Operations

(Fiscal years, outlays in billions of dollars)

Major programs	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
Path A — 6 percent real GNP growth:								
International affairs	4.4	4.9	1.4	6.8	7.8	8.6	9.4	10.2
General science, space, and technology	4.2	4.6	1.3	5.0	5.4	5.8	6.1	6.3
Agriculture and natural resources	8.9	11.9	3.2	13.3	14.3	15.1	16.2	16.9
Commerce and transportation	10.5	10.3	3.3	9.5	9.4	9.7	10.1	10.2
Veterans' hospitals and medical care	3.5	4.0	1.0	4.3	4.6	4.9	5.2	5.6
Medical research	4.2	5.0	1.2	5.4	5.8	6.2	6.6	7.0
General government and law enforcement	4.9	5.8	1.7	6.4	6.8	7.2	7.7	8.3
All other	4.4	7.0	1.4	9.1	9.1	9.7	10.4	11.1
Undistributed offsetting receipts	-6.4	-8.6	-2.3	-6.3	-8.5	-7.1	-7.6	-7.5
Total, other federal operations	38.6	44.9	12.2	53.5	54.7	60.1	64.1	68.1
Path B—5 percent real GNP growth:								
International affairs	4.4	4.9	1.4	6.8	7.8	8.5	9.3	9.9
General science, space, and technology	4.2	4.6	1.3	5.0	5.4	5.8	6.0	6.1
Agriculture and natural resources	8.9	11.9	3.2	12.8	14.1	14.6	15.6	16.5
Commerce and transportation	10.5	10.3	3.3	9.3	9.4	9.6	9.8	10.0
Veterans' hospitals and medical care	3.5	4.0	1.0	4.3	4.5	4.8	5.0	5.3
Medical research	4.2	5.0	1.1	5.4	5.8	6.0	6.4	6.7
General government and law enforcement	4.9	5.8	1.7	6.3	6.7	7.0	7.5	8.1
All other	4.4	7.0	1.4	8.6	8.7	8.9	9.9	10.3
Undistributed offsetting receipts	-6.4	-8.6	-2.3	-6.3	-8.5	-7.1	-7.6	-7.5
Total other federal operations	38.6	44.9	12.2	52.2	53.9	58.1	61.9	65.4

for anticipated price increases in order to maintain current real program levels.

Agriculture and natural resources programs include farm income stabilization programs, Corps of Engineers construction projects, the Tennesee Valley Authority, the National Park Service, the U.S. Forest Service, energy research activities, and the Bureaus of Reclamation and Land Management. These projections include adjustments for anticipated price increases. In addition, it is assumed that there will be no deficiency payments for wheat or cotton, and that the level of export credit loans and disaster payments will remain constant.

Commerce and transportation programs include several financial funds that directly or indirectly assist housing and mortgage credit, payments to the Postal Service, the U.S. Coast Guard, Federal Aviation administration operations, railway and maritime subsidies, and the Small Business Administration. In projecting outlays for air transportation it is assumed that the ceilings on the trust fund in the 1970 Airport and Airways Development Act will be continued.

The remaining projections of spending in this category, which include the costs of veterans' hospitals and medical care; Department of Health, Education, and Welfare medical research; and various general government activities, are based on projected adjustments in federal pay to maintain comparability with the private sector, and inflation adjustments. The projections assume a 12 percent increase in October, 1976, for general schedule pay. This includes a 3.7 percent "catch-up" for the October, 1975 pay adjustment.

Undistributed offsetting receipts, which are deducted from federal spending to arrive at budget totals, include: (1) federal agency payments to the civil service retirement fund, representing the employer share of federal civilian employee retirement benefits; and (2) rents and royalties received by the federal government for off-shore oil leases. The former increases over time due to federal pay increases and the latter depends largely on the number and value of off-shore oil sites leased each year. The projections include the following estimates for off-shore oil receipts:

(Fiscal years, in billions of dollars)

	1977	1978	1979	1980	1981
Off-shore oil receipts	1.9	3.8	2.1	2.3	1.9

Major Functional Categories

Another useful classification of federal spending is by the major functions or purposes being served by federal programs. The

Congressional Budget and Impoundment Control Act of 1974 requires the Congress to estimate outlays and budget authority for each function. The functional classification is a means of presenting budget authority and outlays in terms of the principle purposes that federal programs are intended to serve, regardless of which agency carries out the activity, and without counting activities more than once.

Since inflation adjustments are relatively uniform for most federal programs, the percentage breakdown of projected total outlays by functional category changes little between 1976 and 1981. Income security, now the largest of the functions, increases slightly as a percentage of the budget total because of growth in beneficiary caseloads under most of its programs (except unemployment assistance). The budget share of the health function increases, largely because cost increases are assumed to continue to be more rapid in the medical sector than elsewhere. The interest function is projected to increase its share of the budget total under path B economic assumptions because of the projected deficits and because interest rates are assumed to increase from their present levels.

Several functional categories are projected to decline somewhat in relative importance: natural resources; agriculture; education, manpower, and social services; commerce and transportation; community and regional development; and revenue sharing. The alternative assumptions concerning funding for highway grants, revenue sharing, and EPA construction grants discussed earlier would tend to eliminate some of these declines in projected budget shares. On the other hand, if not adjustments were made for inflation for programs where such adjustments are discretionary (including federal pay, which can be limited by joint Presidential and Congressional action), these functional categories would decline even more in importance by 1981. These discretionary inflation adjustments, which account for roughly two-fifths of the projected rise in total federal spending during 1977-81, are shown below:

Discretionary Inflation Adjustments
Included in the Outlay Projections
(Fiscal years, in billions of dollars)

	1977	1978	1979	1980	1981
Path A					
Veterans' benefits	1.1	1.9	2.8	3.6	4.5
Grants to state and local governments	2.2	4.1	6.1	7.9	10.2
Defense purchases	1.8	4.3	7.4	10.8	14.5
Other federal purchases and subsidies	3.3	6.0	8.7	11.7	14.3
Federal civilian and military pay	6.9	12.7	18.7	25.8	32.6
	15.3	29.0	43.7	59.8	76.1
Path B					
Veterans' benefits	1.1	1.9	2.5	3.1	3.8
Grants to states and local governments	2.1	3.9	5.7	7.2	9.1
Defense purchases	1.8	4.0	6.6	9.2	12.0
Other federal purchases and subsidies	3.1	5.7	7.9	10.2	11.9
Federal civilian and military pay	6.9	12.7	18.7	24.2	29.9
Total	15.0	28.2	41.4	53.9	66.7

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1. Joint action by the President and one House of Congress is required under current law to prevent federal pay adjustments from maintaining comparability with private sector wages and salaries.

Tables 12, 13, 14, and 15 present the projections of budget authority and outlays by major function. Total new budget authority is projected to increase from $408 billion in 1976 as specified by the second concurrent resolution to $637 billion in 1981 under path A and $622 billion under path B.

Table 12.—Budget Authority Projections by Function: Path A—6 Percent Real GNP Growth

(Fiscal years, in billions of dollars)

Function	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
National defense	91.9	101,0	24.0	111.4	119.3	127.5	136.9	146.5
International affairs	4.4	6.0	1.0	9.6	10.4	11.1	11.8	12.6
General science, space, and technology	4.3	4.7	1.2	5.1	5.5	5.9	6.2	6.6
Natural resources, environment, and energy	16.2	18.7	2.4	9.6	10.4	10.9	11.7	12.2
Agriculture	5.9	4.1	.3	2.2	2.0	2.2	2.3	2.5
Commerce and transportation	32.4	19.0	2.6	17.4	18.2	19.0	19.9	20.7
Community and regional development	5.4	9.5	1.0	7.0	7.6	8.2	8.6	9.3
Education, manpower, and social services	15.5	21.3	7.0	21.5	21.6	22.0	22.8	24.6
Health	29.9	33.6	8.6	40.3	44.8	50.9	56.8	63.7
Income security	159.3	137.5	28.9	182.7	198.1	217.2	239.3	266.2
Veterans' benefits and services	16.7	19.9	4.7	18.9	19.7	20.5	21.3	22.3
Law enforcement and justice	3.0	3.3	.8	3.6	3.9	4.1	4.4	4.6
General government	3.1	3.3	.9	3.7	3.9	4.1	4.4	4.8
Revenue sharing and general purpose fiscal assistance	7.1	[1] 7.3	2.0	7.4	7.7	8.0	8.1	8.3
Interest	31.0	35.4	10.0	41.5	45.5	47.6	50.6	54.1
Allowances		0.5	.1	2.0	1.7	1.7	2.1	1.9
Undistributed offsetting receipts	—14.1	—17.1	—4.4	—15.7	—19.1	—19.3	—21.7	-24.1
Total	412.1	408.0	91.1	468.2	501.2	541.6	585.5	636.8

[1] Excludes $2.3 billion for seasonal aid to New York City (enacted but not included in Second Concurrent Resolution on the 1976 Budget).

Table 13.—Outlay Projections by Function: Path A—6 Percent Real GNP Growth

(Fiscal years, in billions of dollars)

Function	1975 actual	1976 estimate	Transition quarter estimate	Projections				
				1977	1978	1979	1980	1981
National defense	86.6	91.9	24.8	103.4	115.0	119.6	130.8	141.3
International affairs	4.4	4.9	1.4	6.8	7.8	8.6	9.4	10.2
Genera] science, space, and technology	4.2	4.6	1.3	5.0	5.4	5.8	6.1	6.3
Natural resources, environment, and energy	9.3	11.4	3.2	14.7	16.0	16.4	15.8	15.2
Agriculture	1.7	2.6	0.8	2.3	2.5	2.6	2.7	2.8
Commerce and transportation	16.0	18.3	5.4	18.6	18.7	19.3	19.9	20.2
Community and regional development	4.4	7.0	2.1	7.8	8.4	8.2	8.2	8.6
Education, manpower, and social services	15.2	20.9	5.4	21.5	21.6	22.0	22.8	24.6
Health	27.6	32.9	8.6	37.2	42.3	48.2	54.8	62.3
Income security	108.6	128.2	34.3	141.3	147.2	162.9	178.9	197.1
Veterans' benefits and services	16.6	19.1	4.8	18.8	19.5	20.3	21.1	22.1
Law enforcement and justice	2.9	3.4	0.9	3.7	3.9	4.1	4.3	4.6
General government	3.1	3.3	0.9	3.7	3.9	4.1	4.4	4.8
Revenue sharing and general purpose fiscal assistance	7.0	7.3	2.1	7.4	7.7	8.0	8.1	8.3
Interest	31.0	35.4	10.0	41.5	45.5	47.6	50.5	54.1
Allowances	------	0.8	0.1	2.1	1.9	1.9	2.3	2.1
Undistributed offsetting receipts	−14.1	−17.1	−4.4	−15.7	−19.1	−19.3	−21.7	−24.1
Total	324.6	374.9	101.7	419.9	448.2	480.3	518.5	560.5

Table 14.—Budget Authority Projections by Function: Path B—5 Percent Real GNP Growth

(Fiscal years, in billions of dollars)

Function	1975 actual	1976 estimate	Transition quarter estimate	Projections 1977	1978	1979	1980	1981
National defense	91.9	101.0	24.0	110.0	118.3	125.3	132.3	139.5
International affairs	4.4	6.0	1.0	9.5	10.3	11.0	11.6	12.3
General science, space, and technology	4.3	4.7	1.2	5.2	5.4	5.9	6.1	6.4
Natural resources, environment, and energy	16.2	18.7	2.4	9.3	10.1	10.4	11.2	12.0
Agriculture	5.9	4.1	.3	2.2	2.0	2.2	2.3	2.5
Commerce and transportation	32.4	19.0	2.6	17.4	18.2	18.9	19.7	20 5
Community and regional development	5.4	9.5	1.0	6.9	7.4	7.9	8.3	8.9
Education, manpower, and social services	15.5	21.3	7.0	21.8	22.7	23.6	23.9	24.8
Health	29.9	33.6	8.6	39.3	43.5	48.5	53.1	58.5
Income security	159.3	137.5	28.9	181.5	199.4	216.3	232.5	252.1
Veterans' benefits and services	16.7	19.9	4.7	19.0	19.6	20.2	20.9	21.6
Law enforcement and justice	3.0	3.3	.8	3.6	3.9	4.0	4.3	4.5
General government	3.1	3.3	.9	3.6	3.8	4.0	4.3	4.7
Revenue sharing and general purpose fiscal assistance	7.1	[1]7.3	2.0	7.4	7.7	8.0	8.1	8.3
Interest	31.0	35.4	10.0	42.2	48.9	54.1	59.3	63.7
Allowances	------	.5	.1	2.0	1.7	1.7	1.6	1.6
Undistributed offsetting receipts	—14.1	—17.1	—4.4	—15.3	—18.0	—17.3	—18.6	—19.6
Total	412.1	408.0	91.1	465.6	504.9	544.7	580.9	622.3

[1] Excludes $2.3 billion for seasonal aid to New York City (enacted but not included in Second Concurrent Resolution on the 1976 Budget).

Table 15.—Outlay Projections by Function: Path B—5 Percent Real GNP Growth

(Fiscal years, in billions of dollars)

Function	1975 actual	1976 estimate	Transition quarter estimate	Projections 1977	1978	1979	1980	1981
National defense	86.6	91.9	24.8	103.4	114.5	118.0	127.2	135.6
International affairs	4.4	4.9	1.4	6.8	7.8	8.5	9.3	9.9
General science, space, and technology	4.2	4.6	1.3	5.0	5.4	5.8	6.0	6.1
Natural resources, environment, and energy	9.3	11.4	3.2	14.2	15.8	15.9	15.2	14.8
Agriculture	1.7	2.6	0.8	2.3	2.5	2.6	2.7	2.8
Commerce and transportation	16.0	18.3	5.4	18.4	18.7	19.1	19.5	20.0
Community and regional development	4.4	7.0	2.1	7.6	8.3	8.0	8.0	8.3
Education, manpower, and social services	15.2	20.9	5.4	21.4	22.4	23.1	23.5	24.3
Health	27.6	32.9	8.6	37.7	42.1	46.8	52.7	57.3
Income security	108.6	128.2	34.3	145.6	158.8	172.6	186.0	199.2
Veterans' benefits and services	16.6	19.1	4.8	18.7	19.3	19.8	20.4	21.1
Law enforcement and justice	2.9	3.4	.9	3.7	3.9	4.0	4.2	4.5
General government	3.1	3.3	.9	3.6	3.8	4.0	4.3	4.7
Revenue sharing and general purpose fiscal assistance	7.0	7.3	2.1	7.4	7.7	8.0	8.1	8.3
Interest	31.0	35.4	10.0	42.2	48.9	54.1	59.3	63.7
Allowances	----------	.8	.1	2.2	1.9	1.9	1.8	1.8
Undistributed offsetting receipts	—14.1	—17.1	—4.4	—15.3	—18.0	—17.3	—18.6	—19.6
Total	324.6	374.9	101.7	424.9	464.0	494.9	529.6	562.7

CHAPTER III
TAXES AND TAX EXPENDITURES

This chapter presents projections of federal revenues for the next five years, assuming no change in current tax laws. Also discussed are estimates of tax expenditures — revenue losses which result from tax provisions that grant special tax relief to certain taxpayers. Since these provisions are implicitly equivalent to direct uncontrollable outlays, they should be examined along with the explicit spending and revenue estimates to gain a more complete picture of the total federal budget.

Federal Revenues

Total federal receipts have grown fourfold between 1956 and 1976 — from $75 billion to an estimated $301 billion. Relative to the size of the economy, however, receipts have increased very little; as a percentage of the GNP, they have increased only from 18 to 19 percent over the 20-year period. However, because tax receipts fluctuate greatly with economic cycles, there has been substantial variation in receipts within the interval as economic conditions changed. These relationships are shown by revenue source in Chart 5.

The degree to which the federal government relies on various sources of revenue has shifted markedly over the past two decades. Federal receipts by source, both as a percentage of GNP and of total budget receipts, are displayed in Table 16. Individual income, corporate profits, and social insurance taxes together now provide about 90 percent of total federal revenue. While the relative share of individual income taxes as a revenue source has remained roughly constant at 42 to 45 percent, the share of the social insurance taxes (primarily for social security and unemployment insurance) has increased from 12.5 percent to nearly one-third of total receipts because of increases in both the tax rates and in the taxable earnings base. For many families, payroll taxes now represent their major contribution to the federal government. Corporate income taxes have declined significantly in importance from 28 percent of total federal revenue in 1956 to 13 percent in 1976. This has resulted because of the introduction of such changes as the investment tax credit and accelerated depreciation, rather than explicit tax rate reductions. Other receipts, which include a large number of miscellaneous items,

CHART 5.

BUDGET RECEIPTS BY SOURCE AS A PERCENTAGE OF GIMP

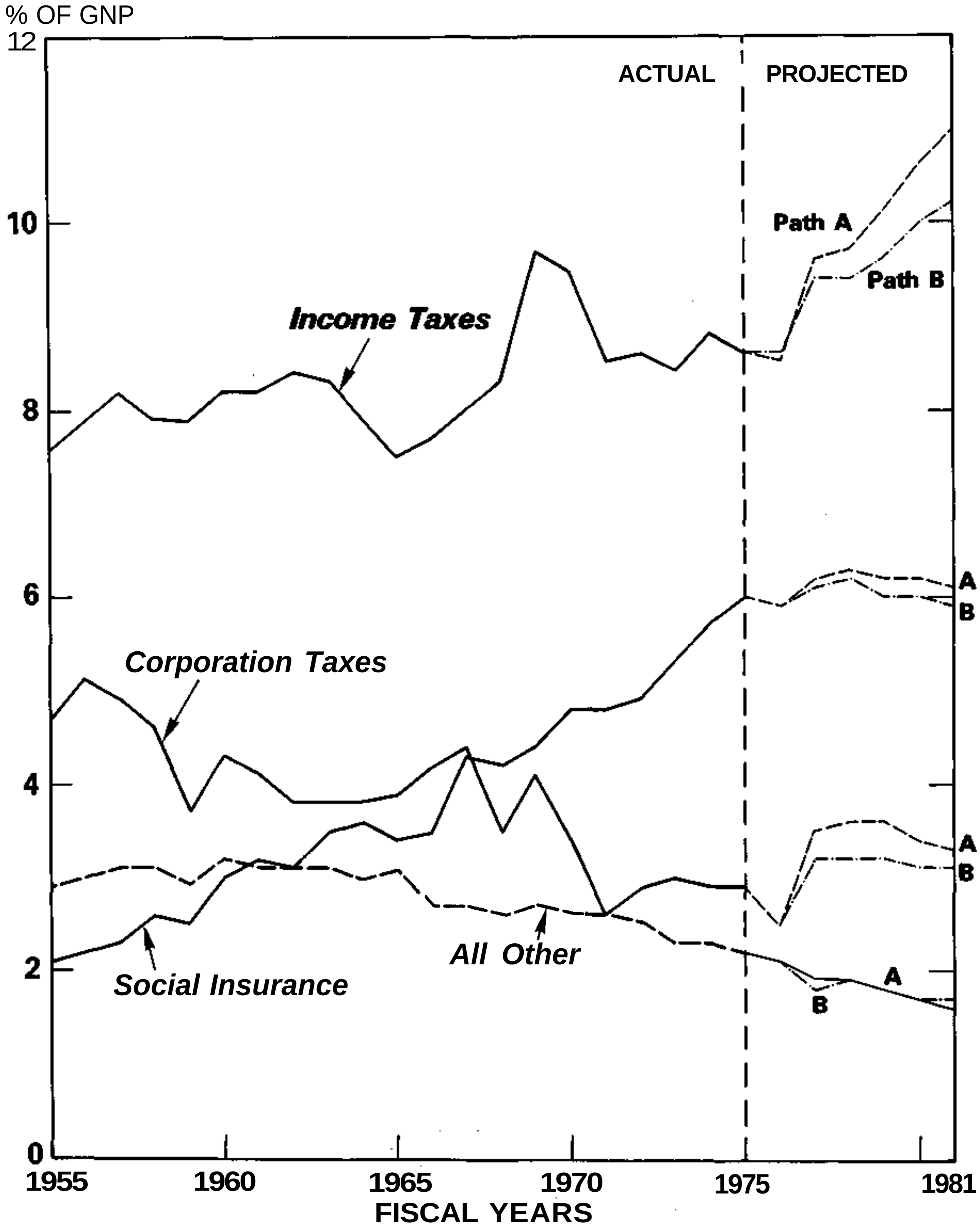

Table 16.—Federal Receipts by Source, 1955–81

A. As a Percentage of GNP

Source	1955	1960	1965	1970	1975	1976	1977		1981	
							Path A	Path B	Path A	Path B
Individual income taxes	8	8	8	9	9	8	10	9	11	10
Corporative profits taxes	5	4	4	3	3	3	3	3	3	3
Social insurance taxes and contributions	2	3	3	5	6	6	6	6	6	6
Other taxes and receipts	3	3	3	3	2	2	2	2	2	2
Total receipts	17	19	18	20	20	19	21	20	22	21

B. As a Percentage of Total Budget Receipts

Source	1955	1960	1965	1970	1975	1976	1977 Path A	1977 Path B	1981 Path A	1981 Path B
Individual income taxes	44	44	42	47	44	44	45	46	51	50
Corporate profits taxes	27	23	22	17	14	14	17	16	15	14
Social insurance taxes and contributions	12	16	19	23	31	31	29	30	27	29
Other taxes and receipts	17	17	17	13	11	11	9	9	8	7
Total receipts	100	100	100	100	100	100	100	100	100	100

CHART 6.

RECEIPTS BY SOURCE AS A PERCENTAGE OF TOTAL RECEIPTS

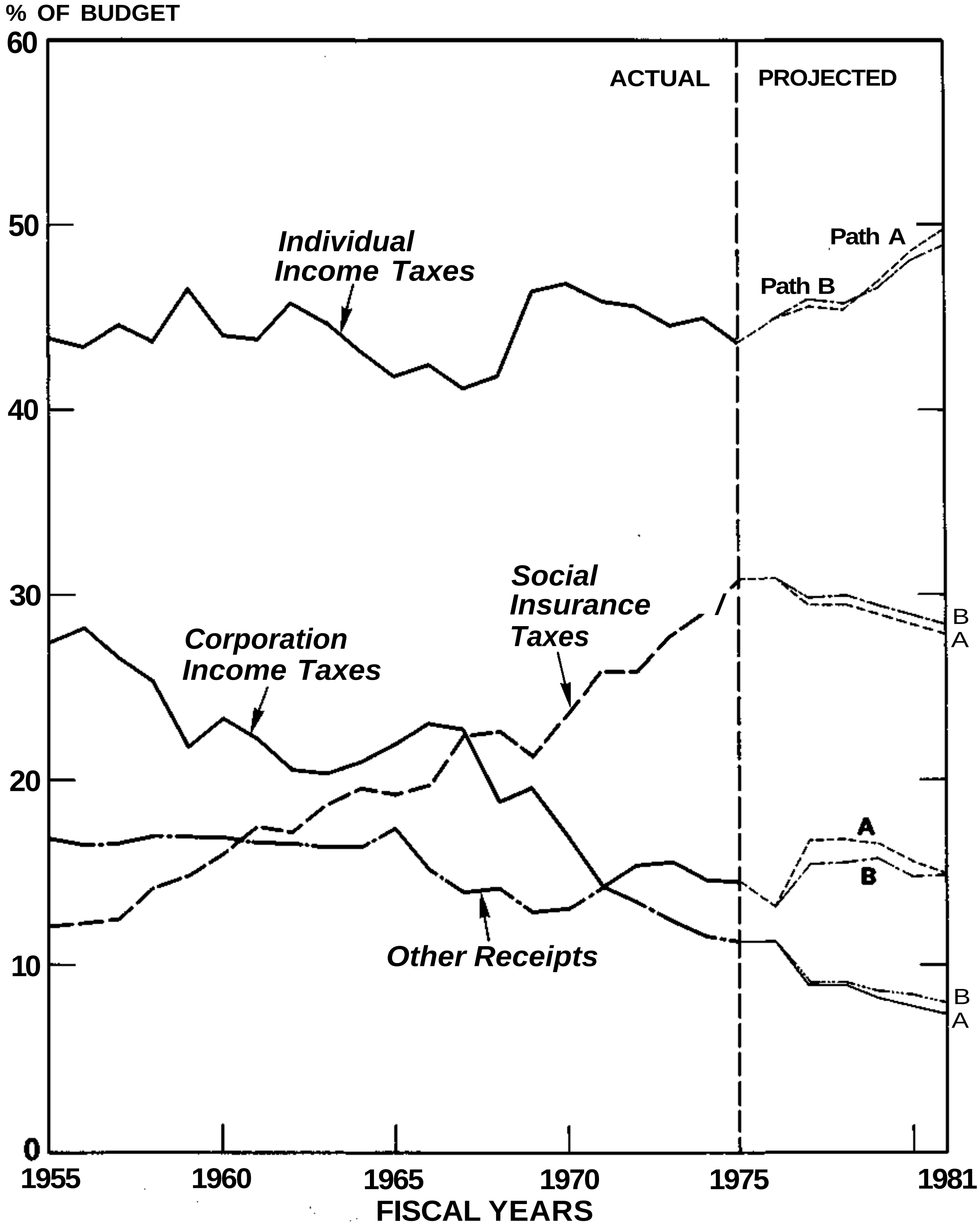

Table 17.—Selected Calendar Year Economic Variables Underlying the Revenue Estimates for Fiscal Years 1976–81 Under Path A and Path B Economic Assumptions

(In billions of dollars)

Calendar year	Path A			Path B		
	Wages and salaries	Corporate profits	Personal income	Wages and salaries	Corporate profits	Personal income
1975	789	122	1, 242	789	122	1, 242
1976	901	170	1, 407	890	163	1, 390
1977	1, 025	215	1, 608	974	188	1, 530
1978	1, 166	245	1, 800	1, 088	205	1, 700
1979	1, 311	271	2, 014	1, 205	226	1, 860
1980	1, 463	297	2, 250	1, 325	250	2, 045
1981	1, 614	323	2, 490	1, 455	275	2, 248

account for only about 10 percent of the total. These historical relationships are shown in Chart 6.

If tax laws were not changed, close to 90 percent of all federal revenue would continue to come from the individual income tax, the corporate profits tax, and the various social insurance taxes (mainly social security) during the next five years. However, a somewhat smaller share of the total would be generated from payroll taxes and larger shares would come from the individual income and corporate profits taxes. The share of federal revenue derived from the taxes on personal and corporate income will continue to rise because they are very sensitive to changes in underlying economic conditions and will increase at least as fast as the general economy.

Projection Assumptions

Two sets of revenue projections have been estimated, corresponding to the two sets of economic assumptions considered (path A and path B). The assumed values of the economic variables most important for projecting revenues are shown in Table 17. These include wage and salary income, corporate profits, and personal income.

Under path A assumptions, wages and salaries and personal income are projected to grow at a 12.5 percent average annual rate between 1975 and 1981; during the same period, corporate profits are expected to increase at just under 18 percent annually. Under the path B assumptions, the growth rates for personal income and wages drop to about 10.5 percent annually while the rate for corporate profits falls to 14.5 percent. The rates at which individual income tax and payroll tax collections increase depend heavily on the personal income and wage and salary growth rates. Similarly, corporate profits tax collections are almost solely related to the growth rate of corporate income. Thus, the revenue projections are quite sensitive to the assumptions made with respect to these economic variables.

Both sets of projections incorporate the same assumptions regarding future tax legislation. These are necessary because several existing provisions are due to change within the next five years. In these projections, it is assumed that the tax laws in effect on January 1, 1976, remain so through 1981.[4] The full amount of the earned income credit is treated as a tax reduction -- rather than an expenditure item — and has been subtracted in the calculation of the individual income tax receipts shown below.[5] Finally, under provisions of current law, the maximum taxable earnings ceiling for social security is assumed to rise from $15,300 in calendar year 1976 to about $22,000 in 1981 under path B assumptions and to $24,000 under path A.

Revenue Projections

Total federal receipts by source are shown in Table 18. Under the path A economic assumptions, total revenue is projected to rise from $301 billion to $652 billion from 1976 to 1981. This represents a 16 percent average annual rate of growth during the same period when current-dollar GNP is projected to rise at a 13 percent annual rate.

Under path A, total federal revenue is projected to climb by $351 billion between 1976 and 1981. Fifty-five percent of this increase is attributable to increased individual income tax collections and 16 percent to higher corporate profits tax collections; thus, together, 71 percent of the increase in total revenue comes from the individual and corporation income taxes. Of the remainder, 24 percent of the increase is from additional social insurance collections and the remaining 5 percent is due to the growth of all other revenues.

Because of these changes, the distribution of revenue by source is projected to shift somewhat between 1976 and 1981 — although the individual income, corporate profits, and social insurance taxes would still account for the main share of all federal receipts. The individual income and corporate profits taxes are expected to raise a larger share by 1981, increasing from 58 percent to 65 percent. And the share raised by the social insurance taxes is projected to fall from 31 percent to 27 percent in 1981.

Under path B assumptions, the total increase in federal revenue will be $249 billion during the next five years, representing an average annual increase of 12 percent during the period as compared with annual GNP increases averaging 11 percent. Changes in the distribution of revenue by source and of the aggregate revenue increases are quite similar to those projected under path A assumptions. Thus, the total share of revenue derived from the social insurance taxes declines to 29 percent in 1981 under the path B assumptions, and the proportion of the aggregate revenue change due to increased individual income taxes is slightly lower (50 percent) under path B than is the case under path A assumptions.

As indicated above, total revenue is projected to grow at a slightly faster rate than GNP during the next five years. By 1981, for each 1.0 percent increase in GNP an associated increase is projected in total revenue of 1.1 percent (path B) to 1.2 percent (path A). The individual income tax portion of total receipts, which is especially responsive to changes in economic conditions because of

Table 18.—Federal Budget Receipts, Fiscal Year 1975 and Estimated Receipts Fiscal Years 1976–81 Under Path A and Path B Economic Assumptions

(Fiscal years, in billions of dollars)

Source	Path A Economic Assumptions							
	1975 actual	1976 estimate	Transition quarter estimate	1977	1978	1979	1980	1981
Individual income taxes	122.4	135.0	38.7	175.5	206	241	282	330
Corporate profits tax	40.6	39.5	11.3	59.0	71	81	88	95
Social insurance taxes and contributions	86.4	92.6	26.5	113.0	130	144	160	178
Excise taxes	16.6	16.9	4.8	17.6	19	20	22	22
Estate and gift taxes	4.6	4.6	1.3	5.5	6	7	8	9
Customs duties	3.7	4.3	1.2	4.7	6	6	7	7
Miscellaneous receipts	6.7	7.9	2.2	8.0	8	9	11	11
Total	281.0	300.8	86.0	383.3	445	509	577	652

Source	Path B Economic Assumptions							
	1975 actual	1976 estimate	Transition quarter	1977	1978	1979	1980	1981
Individual income taxes	122.4	135.0	38.7	159.8	186	212	242	273
Corporate profits taxes	40.6	39.5	11.3	54.5	59	67	72	78
Social insurance taxes and contributions	86.4	92.6	26.5	110.2	121	133	144	159
Excise taxes	16.6	16.9	4.8	17.5	18	18	18	19
Estate and gift taxes	4.6	4.6	1.3	5.4	6	6	7	7
Customs duties	3.7	4.3	1.2	4.6	5	5	5	5
Miscellaneous receipts	6.7	7.9	2.2	8.0	8	8	9	9
Total	281.0	300.8	86.0	360.0	401	448	497	550

NOTE.—See text for definition of the current-services receipts concept.

its progressive structure, is estimated to increase substantially faster than total revenue by 1981. All the other major revenue sources increase at slower rates in response to a given change in the GNP growth rate.

Tax Expenditures

Tax expenditures are revenue losses resulting from federal tax provisions that grant special relief designed to encourage certain kinds of economic behavior by taxpayers or to aid taxpayers in special circumstances. These provisions may, in effect, be viewed as the equivalent of a simultaneous collection of revenue and a direct budget outlay of an equal amount to the beneficiary taxpayer.

Tax expenditures are only one of the many ways the federal government has to achieve its policy objectives; in most instances, the goals might also be achieved through the use of a direct expenditure, a loan program, or legal regulation. Because any qualified taxpayer may receive the benefits from tax expenditures, these provisions are equivalent to the entitlement programs under which benefits are paid to all eligible persons. Thus, the "spending level" associated with these tax and entitlement provisions is under the control of the beneficiaries rather than the government. Because of this equivalence between uncontrollable direct expenditure programs and tax expenditures, they should be considered along with the revenue and budget outlay estimates to gain a more complete picture of the total federal budget.

The tax expenditure projections indicate the estimated revenue foregone as a result of tax expenditures for 1976-81. These provisions may take any of the following possible forms:

- o Special exclusions, exemptions, and deductions, which reduce taxable income and, thus, result in a lesser amount of tax (for example, tax-exempt interest or the deduction of interest paid on consumer loans).
- o Preferential rates, which reduce taxes by applying lower rates to part or all of a taxpayer's income (for example, the special 50 percent marginal tax rate on earned income).
- o Special credits, which are subtracted from taxes as ordinarily computed (for example, the investment tax credit).
- o Deferrals of tax, which generally result from allowing in the current year deductions that are properly attributable to a future year (for example, accelerated depreciation). In the

meantime, the taxpayer has interest-free use of the deferred amount.

The inventory of tax expenditures here is essentially the same as that presented in the July, 1975, Congressional estimates report that included as tax expenditures nearly all items that had previously been so defined.[6] No judgment is made or implied about the desirability of purpose of any tax expenditure item or its effectiveness in achieving that purpose.

Measurement of Tax Expenditures

In calculating the revenue loss from each tax expenditure, it is assumed that only the provision in question is deleted and that all other aspects of the tax system remain the same. In the case of a tax credit, for example, the amount of the credit is the amount of the tax expenditure. If the tax expenditure takes the form of a special deduction, the deduction is added back into taxable income, and a new tax liability is computed by applying the appropriate tax rates to the increased amount of taxable income. The revenue loss is then computed as the difference between the new tax liability and that under existing law. In the case of a deferral, the revenue loss results from the fact that taxpayers obtain interest-free use of the deferred amount. The revenue loss due to a preferential rate, of course, is calculated by multiplying the difference between it and the "normal" tax rate times the base to which the special rate applies.

In using the tax expenditure estimates, several points should be noted. First, if two or more items were eliminated, the combination of changes would probably produce a lesser or greater revenue effect than the sum of the amounts shown for the individual items. For this reason, adding the revenue losses from the various items is of limited usefulness and totals are not shown except in the Table 19 notes.

Second, following the general practice in presenting revenue and expenditure estimates, the amounts shown for the various tax expenditure items do not take into account any effects that the removal of one or more of the items might have on investment and consumption patterns or on any other aspects of economic activity. In other words, the estimates shown do not consider any behavioral changes that might be induced by changing the provisions. Repeal of a provision, therefore, might not raise revenue by an amount equal to the revenue loss shown in the tax expenditure budget.

Finally, in recent years the revenue effect of new tax expenditure items added to the tax law usually has not been fully felt for several years. As a result, the eventual annual cost of some items is not fully reflected until some time after enactment. Similarly, if items now in the law were eliminated, it is unlikely that the full revenue effects would be immediately realized.[7]

Tax Expenditures by Functional Category

For easier comparison with direct expenditures, most of the tax expenditures in Table 19 are grouped in the same functional categories as the direct outlays in the federal budget. However, consistent with the format of the July, 1975 report, some tax expenditures are placed in three additional categories: business investment, personal investment, and other tax expenditures.[8] Where possible and relevant, estimates are shown separately for individuals and corporations.

The estimates of the tax expenditures were supplied to the CBO by the staffs of the Joint Committee on Internal Revenue Taxation and the U.S. Treasury Department. Unlike the other projections presented in this report, there is only a single set of tax expenditures shown with no distinction between the path A and path B economic assumptions. The projections, in fact, are not based on either of the two paths; however, they probably conform more closely with the path B economic assumptions. Under the faster-growth, path A economic assumptions, several of the items that are particularly sensitive to the rate of inflation — e.g., medical expenses and housing cost deductions — would undoubtedly be higher. However, it was technically impossible to take account of such differences when preparing the estimates. As with the revenue projections, the tax expenditure estimates assume that the tax laws in effect on January 1, 1976, remain applicable through 1981.

Trends in Tax Expenditures

As discussed above, the sum of all the separate tax expenditures — or even the sum of items in each functional category — for any given year is not an accurate measure of federal revenue loss and, hence, is a statistic of limited usefulness. However, the pattern of change in the annual levels can be meaningful because biases that might distort each total tend to be neutralized in the calculation of year-to-year changes. Because the tax expenditure projections are not based explicitly on either path A or path B economic assumptions, trends in these items should not be compared with revenue or direct outlay trends. On the other hand, comparisons of the projected trends for individual and corporate tax expenditures for each budget functional category can be informative.

Table 19.—Tax Expenditure Estimates, by Function[1]

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
National defense:												
Exclusion of benefits and allowances to Armed Forces personnel							650	650	650	650	650	650
Exclusion of military disability pensions							80	90	100	110	120	130
International affairs:												
Exclusion of income earned abroad by U.S. citizens							145	160	175	195	205	220
Exclusion of gross-up on dividends of LDC corporations	55	55	55	55	55	55						
Deferral of income of domestic international sales corporations (DISC)	1,340	1,420	1,460	1,495	1,580	1,735						
Deferral of income of controlled foreign corporations	525	365	365	365	365	365						
Special rate for Western Hemisphere trade corporations	50	50	50	50	50	50						
Agriculture:												
Expensing of certain capital outlays	105	115	120	130	135	150	355	360	370	380	390	400
Capital gains treatment of certain income	30	40	40	45	50	50	490	565	655	705	760	820
Natural resources, environment and energy:												
Exclusion of interest on state and local government pollution control bonds	110	170	220	265	300	330	50	75	100	125	145	160
Expensing of exploration and development costs	650	840	1,045	1,285	1,540	1,850	155	195	245	305	365	435

Footnotes at end of table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Natural resources—continued												
Excess of percentage over cost depletion	1,080	1,020	1,015	1,110	1,215	1,325	500	575	625	640	670	695
Pollution control: 5-year amortization	20	15	5	------	------	------	------	------	------	------	------	------
Capital gains treatment of royalties on coal and iron ore	15	20	20	25	25	30	45	50	60	65	75	85
Capital gains treatment of certain timber income	155	165	175	190	200	215	60	65	70	75	80	85
Commerce and transportation:												
Exemption of credit unions	125	135	145	155	165	175	------	------	------	------	------	------
Cooperatives: deductibility of noncash patronage dividends and certain other items	410	455	485	520	555	595	------	------	------	------	------	------
Corporate surtax exemption	5,015	6,185	6,745	7,300	7,865	8,455	------	------	------	------	------	------
Deferral of tax on shipping companies	105	130	155	180	205	230	------	------	------	------	------	------
Railroad rolling stock: 5-year amortization	30	10	5	------	------	------	------	------	------	------	------	------
Financial institutions: excess bad debt reserves	815	570	635	730	900	1,060	------	------	------	------	------	------
Deductibility of nonbusiness state gasoline taxes	------	------	------	------	------	------	575	600	665	735	815	910
Community and regional development:												
Housing rehabilitation: 5-year amortization	35	25	20	15	10	10	55	40	25	15	15	15

Footnotes at **end of** table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Education, manpower and social services:												
Exclusion of scholarships and fellowships							210	220	235	245	255	270
Parental personal exemption for student age 19 and over							690	715	735	760	780	805
Deductibility of contributions to educational institutions	215	280	325	355	390	430	450	500	555	610	670	735
Deductibility of child and dependent care expenses							330	420	460	510	560	615
Child care facilities: 5-year amortization	5	5	5									
Credit for employing AFDC recipients and public assistance recipients under work incentive program	10	10	10	10	10	10						
Health:												
Exclusion of employer contributions to medical insurance premiums and medical care							3, 665	4, 225	4, 730	5, 300	5, 935	6, 650
Deductibility of medical expenses							2, 020	2, 095	2, 325	2, 580	2, 865	3, 175
Income security:												
Exclusion of social security benefits:												
Disability insurance benefits							315	370	415	470	525	595
OASI benefits for aged							3, 045	3, 525	3, 965	4, 460	5, 020	5, 645
Benefits for dependents and survivors							495	565	635	715	805	905

Footnotes at end of table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Income security—continued												
Exclusion of railroad retirement system benefits							185	200	215	230	245	260
Exclusion of unemployment insurance benefits							3, 305	2, 855	2, 655	2, 470	2, 295	2, 135
Exclusion of workmen's compensation benefits							555	640	705	775	855	940
Exclusion of public assistance benefits							115	130	145	165	185	210
Exclusion of special benefits for disabled coal miners							50	50	50	50	50	50
Exclusion of sick pay							330	350	370	385	405	425
Net exclusion of pension contributions and earnings:												
Employer plans							5, 745	6, 475	7, 120	7, 835	8, 620	9, 480
Plans for self-employed and others							770	965	1, 065	1, 180	1, 300	1, 440
Exclusion of other employee benefits:												
Premiums on group term life insurance							805	895	965	1, 050	1, 135	1, 230
Premiums on accident and accidental death insurance							55	60	65	70	80	85
Income of trusts to finance supplementary unemployment benefits							5	5	5	5	5	5
Meals and lodging							285	305	320	335	350	365

Footnotes at end of table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Income security—continued												
Exclusion of capital gains on home sales if over 65							45	50	55	60	65	70
Excess of percentage standard deduction over minimum standard deduction							1,465	1,560	1,635	1,720	1,805	1,895
Additional exemption for the blind							20	25	25	25	25	25
Additional exemption for over 65							1,155	1,220	1,280	1,340	1,410	1,480
Retirement income credit							120	110	100	90	80	70
Earned income credit: nonrefundable portion							290	280	270	255	245	235
Earned income credit: refundable portion							1,165	1,110	1,065	1,025	985	945
Veterans' benefits and services:												
Exclusion of veterans' disability compensation							590	595	595	595	595	595
Exclusion of veterans' pensions							30	30	30	30	30	30
Exclusion of GI bill benefits							330	280	265	255	240	230
General government:												
Credits and deductions for political contributions							40	65	40	50	50	85
Revenue sharing and general purpose fiscal assistance:												
Exclusion of interest on general purpose state and local debt	2,890	3,150	3,375	3,630	3,925	4,300	1,280	1,390	1,490	1,605	1,735	1,880
Exclusion of income earned in U.S. possessions	240	285	305	325	350	375						

Footnotes at end of table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Revenue sharing—Continued												
Deductibility of nonbusiness state and local taxes (other than on owner-occupied homes and gasoline)	—	—	—	—	—	—	6, 505	6, 680	7, 415	8, 230	9, 140	10, 140
Interest:												
Deferral of interest on savings bonds	—	—	—	—	—	—	605	685	765	845	925	1, 005
Business investment:												
Exclusion of interest on state and local industrial development bonds	150	195	235	270	315	355	75	90	110	130	150	170
Excess first year depreciation	145	165	180	200	220	240	80	85	95	105	115	130
Depreciation on rental housing in excess of straight line	120	125	135	145	155	170	430	455	480	510	545	580
Depreciation on buildings (other than rental housing) in excess straight line	275	280	300	325	350	375	215	215	235	250	275	300
Expensing of research and development expenditures	660	695	725	755	785	815	—	—	—	—	—	—
Expensing of construction period interest and taxes	1, 020	1, 065	1, 110	1, 150	1, 190	1, 230	545	570	595	620	645	670
Capital gams: corporate (other than farming and timber)	760	900	1, 015	1, 090	1, 170	1, 260	—	—	—	—	—	—
Investment credit	6, 850	7, 585	8, 045	8, 480	8, 890	9, 310	1, 410	1, 530	1, 635	1, 750	1, 870	1, 995
Asset depreciation range	1, 435	1, 630	1, 825	2, 000	2, 095	2, 135	155	175	195	220	230	235

Footnotes at end of table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Personal Investment:												
Dividend exclusion							335	350	370	385	405	425
Capital gains: individual (other than farming and timber)							5, 455	6, 225	7, 360	7, 905	8, 490	9, 145
Capital gains at death							6, 720	7, 280	8, 120	9, 015	10, 005	11, 105
Exclusion of interest on life insurance savings							1, 695	1, 855	2, 025	2, 210	2, 410	2, 625
Deferral of capital gains on home sales							845	890	935	980	1, 030	1, 080
Deductibility of mortgage interest on owner-occupied homes							4, 545	4, 710	5, 225	5, 800	6, 440	7, 150
Deductibility of property taxes on owner-occupied homes							3, 690	3, 825	4, 245	4, 710	5, 230	5, 805
Deductibility of casualty losses							300	330	355	380	405	430
Credit for purchase of new homes							625	100				

Footnotes at end of table.

Table 19.—Tax Expenditure Estimates, by Function [1]—Continued

(Fiscal years, in millions of dollars)

Function	Corporations						Individuals					
	1976	1977	1978	1979	1980	1981	1976	1977	1978	1979	1980	1981
Other tax expenditures:												
Deductibility of charitable contributions (other than education)	395	525	600	665	730	800	3, 820	3, 955	4, 390	4, 870	5, 410	6, 000
Deductibility of interest on consumer credit							1, 040	1, 075	1, 195	1, 325	1, 475	1, 635
Maximum tax on earned income							385	430	485	540	605	680

[1] All estimates are based on the tax code as of January 1, 1976, and the assumption that all provisions are extended through 1981.

Source: Staffs of the Treasury Department and the Joint Committee on Internal Revenue Taxation.

NOTE.—Limitations on the use of totals are explained in the text.

Sum of the Tax Expenditure Items by Type of Taxpayer and Fiscal Year *

[In millions of dollars]

Fiscal year	Corporations and individuals	Corporations	Individuals
1976	98, 430	25, 840	72, 590
1977	105,895	28, 680	77, 215
1978	115, 505	30, 950	84, 555
1979	125, 345	33, 315	92, 030
1980	136,085	35, 790	100, 295
1981	147,955	38, 485	109, 470

* These totals represent the mathematical sum of the estimated fiscal year effect of each of the 82 tax expenditure items included in this table.

For 1977-81, the total amount of tax expenditures in both the individual and corporation income taxes is projected to grow at an 8.5 percent average annual rate, amounting to a total increase of 39 percent for the period (see Table 20). About 76 percent of the total increase is in individual income tax expenditures, which are expected to grow at an average annual rate of 9 percent — a 42 percent total increase, whereas corporation income tax expenditures are projected to rise at a 7.5 percent annual rate — for a total increase of 34 percent during the next five years.

Tax expenditures in the various budget functional categories are projected to grow at different rates between 1977 and 1981. For example, a particularly rapid 13 percent annual growth in the natural resources, environment, and energy tax expenditures category is projected, largely because of increases in deductions for costs of mineral exploration and development. Tax expenditures in tha health group are expected to grow at a 11.5 percent annual rate — with all benefits accruing to individual taxpayers, while those in the income security category will grow more slowly than the average, mainly because of a decline in the exclusion of unemployment insurance benefits. The share of business investment tax expenditures will fall, while personal investment tax expenditures will grow faster than average due to large increases in capital gains plus deductions for mortgage interest and property taxes on owner-occupied homes.

Footnotes

4. In most instances where the 1976 extension of calendar year 1975 provisions are more generous to taxpayers than those in the 1975 tax reduction law (e.g., the higher low-income allowance and greater per capita tax credit), the more generous provisions are assumed to continue in effect for the entire projection period. The $2 per barrel import fee on crude petroleum removed effective on December 22, 1975, is excluded.

5. In October, 1975, James Lynn, director of the Office of Management and Budget (OMB), announced that OMB had revised its accounting treatment for the refundable portion of the earned income credit and now treats this as an outlay in the income security category of the budget. Since a decision on whether to follow the OMB practice is still in abeyance in the Congressional Budget Committees, the full amount of the earned income credit is still shown in the revenue section of the budget in this report. However, to give a full picture of tax expenditures, this credit is also included in Table 19.

6. Estimates of Federal Tax Expenditures, prepared for the Committee on Ways and Means and the Committee on Finance by the staffs of the

Treasury Department and the Joint Committee on Internal Revenue Taxation, 94 Cong., 1 sess, (July 8, 1975).

7. For a further discussion of limitations of aspects of tax expenditures, see Estimates of Federal Tax Expenditures, pp. 4-5.

8. See Estimates of Federal Tax Expenditures, p. 9.

Table 20.—Tax Expenditures by Function, Average Annual Growth Rate and Percentage Distribution of Total, 1977 and 1981

[Fiscal years, in percentages]

Functional category	Percentage distribution of total		Average annual growth rate
	1977	1981	
National defense	1	1	1.5
International affairs	2	2	4.5
Agriculture	1	1	7.0
Natural resources, environment, and energy	3	4	13.0
Commerce and transportation	8	8	9.0
Community and regional development	([1])	([1])	−21.0
Education, manpower, and social services	2	2	7.5
Health	6	7	11.5
Income security	22	20	6.5
Veterans' benefits	1	1	−1.5
Revenue sharing	11	11	10.0
General government	([1])	([1])	7.0
Interest	1	1	10.0
Business investment	15	13	6.0
Personal investment	24	25	10.0
Other	5	6	11.0
Total	100	100	8.5

[1] Less than half of 1 percent.

NOTE.—Limitations on the use of totals is explained in the text. The effect of differences in projected growth rates for the functional categories can be seen by comparing percentage distributions. This is the purpose of presenting the first pair of columns in the table.