

Statement of Alice M. Rivlin
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before the
Committee on the Budget
U.S. House of Representatives
January 24, 1977

Last September, in view of uncertainty about the vigor of economic expansion, this Committee noted in its report on the second concurrent resolution that it might wish to consider a further revision of the budget in early 1977. The report stated:

The Committee believes additional economic stimulus measures should be considered early next year if the slowdown in the recovery experienced this spring continues during the third and fourth quarters of 1976 Should a significant change in economic growth occur, it must be addressed quickly and effectively at the earliest practicable time by the 95th Congress. At that time, the Committee will have to decide whether a third budget resolution revising the totals for fiscal year 1977 is warranted.¹

Data for the last half of 1976 have confirmed fears of a disappointing recovery. Growth of real Gross National Product (GNP in dollars of constant purchasing power) fell below a 4 percent annual rate instead of the 5.5 to 6.0 percent path expected in framing the second concurrent resolution. The unemployment rate remains far above the 7.2 percent rate to which it was expected to fall by the end of 1976. The rate of inflation, while it is a bit more favorable than earlier assumptions, remains high by historical standards.

These economic developments are affecting the federal budget. Since GNP and hence personal income and profits are running below earlier projections, federal revenues for fiscal year 1977 are

1. Report of the Committee on the Budget, U.S. House of Representatives, to accompany H.Con.Res. 728, September 1, 1976, p. 5.

now estimated at \$356.0 billion, \$6.5 billion below the target of \$362.5 voted in the second concurrent resolution. Outlays for fiscal year 1977 are currently estimated as only slightly below the second resolution target of \$413.1 billion. The federal deficit for the fiscal year is now projected at \$54 to \$58 billion instead of the \$50.6 billion in the second concurrent resolution.

The most recent monthly reports indicate that the worst of the 1976 lull is ending. Automobile sales and industrial production have picked up. The Commerce Department's index of leading indicators rose a strong 1 percent in November following a period of decline. The unemployment rate fell slightly from 8.0 percent in November to 7.8 percent in December.

To some extent, however, recent good news reflects the end of the Ford Motor Company strike just as some of the more dismal reports in the fall reflected the strike's direct and indirect effects. The latest CBO report on the economy, The Disappointing Recovery, projects only moderate economic growth in the absence of any change in policy.

Under current policy our judgment is that the economy will achieve only 3.5 to 5.0 percent real growth from the end of 1976 to the end of 1977, although inventory restocking may take the rate higher early in the year. We would expect the growth rate to be about the same during 1978. The rate of unemployment is projected above 7 percent during the entire year 1977 and above 6.5 percent even by the end of 1978. The rate of inflation is projected as well below the double-digit rates of 1974 but little changed from recent experience. We expect the General Price

Index (the GNP deflator) to rise by 4.5 to 6.0 percent in 1977 and about the same in 1978. Table 1 summarizes our current-policy forecast.

Some of the main elements contributing to this forecast, in addition to the critical one of no change from current Congressional fiscal policy, are:

- growth in plant and equipment spending in line with the latest Commerce Department survey of investment plans, which in constant dollars is running well below earlier recoveries;
- housing starts at 1.7-2.0 million and auto sales at 10-11 million in 1977, both well above 1976 averages;
- slow growth in constant-dollar demands by state and local governments, behind earlier recoveries due to financial difficulties and a declining school population;
- only modest export growth, due to the slowdown in recovery in other industrial countries and to the increasing OPEC trade surplus.

POLICY ALTERNATIVES

Changes in policy could move the economy closer to the output and employment levels used in framing the second concurrent resolution. CBO has analyzed five widely discussed fiscal policy options:

- a \$16 billion personal tax rebate paid out in the third quarter of calendar year 1977;
- a \$10 billion (annual rate) permanent reduction in personal taxes beginning in the third quarter of 1977;
- a \$5 billion (annual rate) business tax reduction beginning in the third quarter of 1977, divided between an increase in the investment tax credit and a corporate rate reduction;

TABLE 3. ECONOMIC PROJECTIONS BASED ON CURRENT POLICY, 1977-78

Economic Variables	L e v e l s			Rates of Change (percent)	
	1976:4	1977:4	1978:4	1976:4 to 1977:4	1977:4 to 1978:4
GNP (billions of current dollars)	1745 to 1755	1890 to 1950	2040 to 2170	8.0 to 11.0	7.0 to 11.5
GNP (billions of 1972 dollars)	1282 to 1287	1325 to 1350	1370 to 1420	3.5 to 5.0	3.0 to 5.5
General Price Index (GNP deflator, 1972 = 100)	136 to 137	142 to 145	148 to 154	4.5 to 6.0	4.0 to 6.0
Consumer Price Index (1967 = 100)	173 to 174	181 to 184	188 to 195	4.3 to 5.8	3.8 to 5.8
Unemployment Rate (percentage points)	7.9	7.1 to 7.8	6.6 to 7.6	--	--

- a \$5 billion increase (annual rate) in countercyclical revenue sharing and public employment, the former beginning in the second quarter of 1977 and the latter building gradually during the second half of 1977;
- a \$16 billion authorization of public works projects, with outlays rising slowly during 1977 and 1978.

Some of the key estimated economic impacts of these policies are shown in Table 2.

The first option, the personal tax rebate, differs greatly from the other four in timing. The net budget cost of the rebate is \$15 billion in fiscal year 1977 but -\$3 billion in fiscal year 1978, when the economic stimulus continues to raise revenues but none of the rebate is paid out. The net budget costs of the other options all rise from 1977 to 1978. As Table 2 shows, this timing contrast carries over to the estimated employment and unemployment impacts, with the effect of the rebate fading out as the effect of the other options builds up. The tax rebate thus complements the other program options in the table in the timing of its impact.

The inflation effects of these spending options are estimated as fairly small. The rebate, because it is only a one-time payment, is estimated to have virtually no effect on the rate of inflation. Each of the other options has an inflation effect which builds gradually to an estimated 0.1 to 0.2 percentage points by 1980.² In other words, if inflation under current policy were

1. Estimates are based on a simplified two-equation wage-price model. A description is available on request to the Fiscal Analysis Division, Congressional Budget Office.

TABLE 4. ESTIMATED IMPACTS OF EXPANSIONARY FISCAL POLICY OPTIONS

Options	Net Budget Cost ^a (billions of dollars)		Unemployment Rate Impact (percentage points reduced unemployment)		Inflation Impact (percentage points additional inflation)	Employment Impact (thousands of additional jobs)	
	Fiscal	Fiscal	1977:4	1978:4	1980	1977:4	1978:4
	Year 1977	Year 1978					
1. \$16 Billion Personal Tax Rebate	+15	-3	-0.4	-0.1	0.0	500	170
2. \$10 Billion Permanent Personal Tax Reduction	+ 2	+7	-0.1	-0.3	0.1 to 0.2	110	350
3. \$5 Billion Business Tax Reduction	+ 1	+3	0	-0.1	0.1 to 0.2	10	190
4. \$5 Billion Increase in Countercyclical Revenue Sharing and Public Service Employment	+ 1	+2	-0.2	-0.3	0.1 to 0.2	260	410
5. \$6 Billion Authorization for Accelerated Public Works, Spending Rising Slowly to \$3 Billion Rate	0	+1	0	-0.1	0.1	40	140

a. The net budget cost of each option equals its direct spending increase or tax reduction minus the estimated higher revenues and lower income-support payments it causes.

4.5 percent in 1980, enactment of one of the last four options would raise it to an estimated 4.6 to 4.7 percent. These estimates reflect the view that expansionary policies at a time of substantial unemployment and excess capacity are much less inflationary than these same policies would be in a high-employment economy.

Combinations of these options could add substantially to the number of jobs. Three illustrative policy combinations analyzed in the report would add an estimated 310,000, 610,000 and 920,000 jobs, respectively, by the end of 1977, and more in 1978.

The three combinations are:

- half of each of the three tax options in the table, adding 310,000 jobs by the end of 1977 and 355,000 by the end of 1978, with a net budget cost of \$9 billion in fiscal year 1977 and \$3.5 billion in fiscal year 1978;
- half of the three tax options plus all of the two spending options in the table, adding 610,000 jobs by the end of 1977 and 905,000 by the end of 1978 with a net budget cost of \$10 billion in fiscal year 1977 and \$6.5 billion in fiscal year 1978; and
- all of the options in the table at full strength adding 920,000 jobs by the end of 1977 and 1,260,000 by the end of 1978, with a net budget cost of \$19 billion in fiscal year 1977 and \$10 billion in fiscal year 1978.

The second of these combinations resembles, although it is not identical to, the policy package which has been proposed by the Carter Administration.

The budget presented by the Ford Administration provides less stimulus than these three policy combinations. According to our analysis, the Ford budget proposals would add roughly 80,000 jobs above a current-policy budget by the end of 1977 and about

130,000 by the end of 1978. Employment changes of this magnitude would lower the unemployment rate by only about 0.1 percentage point below current-policy projections, to 7.0-7.7 percent at the end of 1977 and 6.5-7.5 percent at the end of 1978. The Ford Administration's own economic projections fall in the optimistic end of these ranges.

Under present margins of unemployment and unused capacity, expansionary measures would have relatively little effect on the rate of inflation. Expansionary fiscal policies would, however, entail a higher federal deficit. For fiscal year 1977, the deficit even in the absence of policy changes is now estimated at \$54 to \$58 billion, higher than the \$50.6 billion in the second concurrent resolution because of the weaker economy than was foreseen last September. The three policy combinations described above would add another \$9 to \$19 billion to the 1977 deficit.

The policy combinations analyzed in our report represent only a few of the numerous ways in which taxes and spending could be altered to increase output and reduce unemployment. Mr. Chairman, as other combinations are considered, the Congressional Budget Office is prepared to assist this Committee in analyzing their impacts on the economy and the budget.

