The ratio of receipts to GNP provides a rough indicator of the overall tax burdens that the economy bears (see chart 1). During the postwar period. Higher energy and inflation-induced increases in income-tax pressures associated with the Viet Nam military buildup in the late 1960s. The $15.8 billion increase proposed in the FY 1981 defense budget would represent only a 1.9 percent of the increase in military spending relative to GNP. The proposed military spending would equal 4.8 percent of GNP in FY 1980, up from a low of 4.6 percent in FY 1979, but still below the ratio in FY 1977. Moreover, the increase is as much a reflection of slower economic growth as it is a change in spending patterns. If GNP grows at 11 percent, which is less than the average growth experienced over the past five years, defense spending would not rise relative to GNP in FY 1981. Even if Congress greatly augments the defense buildup, the ratio would remain well below that experienced in the early 1970s.

Chart 2 The Rise of Nondefense Spending

The rapid growth of nondefense federal spending relative to GNP reflects the expansion of federal transfer payments to individuals and grants-in-aid to state and local governments. Transfer payments to individuals, which equal less than 3 percent of GNP, have increased from approximately $200 million to $4.8 billion in FY 1980, up from a low of 4.6 percent in FY 1979, but still below the ratio in FY 1977. Moreover, the increase is as much a reflection of slower economic growth as it is a change in spending patterns. If GNP grows at 11 percent, which is less than the average growth experienced over the past five years, defense spending would not rise relative to GNP in FY 1981. Even if Congress greatly augments the defense buildup, the ratio would remain well below that experienced in the early 1970s.

Nondesense Spending

The rapid growth of nondefense federal spending relative to GNP reflects the expansion of federal transfer payments to individuals and grants-in-aid to state and local governments. Transfer payments to individuals, which equal less than 3 percent of GNP, have increased from approximately $200 million to $4.8 billion in FY 1980, up from a low of 4.6 percent in FY 1979, but still below the ratio in FY 1977. Moreover, the increase is as much a reflection of slower economic growth as it is a change in spending patterns. If GNP grows at 11 percent, which is less than the average growth experienced over the past five years, defense spending would not rise relative to GNP in FY 1981. Even if Congress greatly augments the defense buildup, the ratio would remain well below that experienced in the early 1970s.

Conclusion

The FY 1981 budget recognizes the need to move toward balancing the budget in coming fiscal years, to increase expenditures for defense, and to hold down the tax burden. Since 1976, the ratio of total federal receipts to GNP has risen rapidly, reflecting the expansion of federal transfer payments to individuals and grants-in-aid to state and local governments. Transfer payments to individuals, which equal less than 3 percent of GNP, have increased from approximately $200 million to $4.8 billion in FY 1980, up from a low of 4.6 percent in FY 1979, but still below the ratio in FY 1977. Moreover, the increase is as much a reflection of slower economic growth as it is a change in spending patterns. If GNP grows at 11 percent, which is less than the average growth experienced over the past five years, defense spending would not rise relative to GNP in FY 1981. Even if Congress greatly augments the defense buildup, the ratio would remain well below that experienced in the early 1970s.

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The FY 1981 budget recognizes the need to move toward balancing the budget in coming fiscal years, to increase expenditures for defense, and to hold down the tax burden. Since 1976, the ratio of total federal receipts to GNP has risen rapidly, reflecting the expansion of federal transfer payments to individuals and grants-in-aid to state and local governments. Transfer payments to individuals, which equal less than 3 percent of GNP, have increased from approximately $200 million to $4.8 billion in FY 1980, up from a low of 4.6 percent in FY 1979, but still below the ratio in FY 1977. Moreover, the increase is as much a reflection of slower economic growth as it is a change in spending patterns. If GNP grows at 11 percent, which is less than the average growth experienced over the past five years, defense spending would not rise relative to GNP in FY 1981. Even if Congress greatly augments the defense buildup, the ratio would remain well below that experienced in the early 1970s.

1. The 1969 bulge in the receipts series results from the surtax imposed to reduce inflationary pressures associated with the Viet Nam military buildup.


The difficulty of assessing priorities in FY 1981 adds to the uncertainty about the future course of budgetary policy. Moreover, as suggested below, the simultaneous attainment of a balanced budget, increased defense spending, and lower tax burdens may not be achievable. The budgetary process is subject to many interpretations, and many of the assumptions do not hold, actual spending and taxing totals could be much different than currently forecast. Projections of economic activity that span a period as long as a fiscal year are obviously subject to considerable error, yet such projections are crucial for constructing the budget. Economic developments, to a large extent, automatically determine the levels of taxing and spending. Many receipts, such as income taxes, and expenditures, such as unemployment compensation, are directly influenced by the levels of production, employment, income, and inflation. At the same time, economic activity is influenced by budget decisions, which in part are designed to promote economic growth. A stated policy is to increase the nation's defense budget priority.

Budget Priorities

Administration budget recommendations contain, explicitly or implicitly, a set of priorities that presumably would guide policy over coming fiscal years. A stated primary objective of this year's budget is to reduce inflationary pressures by lowering the budget deficit in FY 1981 and beginning to balance the budget.

Administration budget recommendations, most notably the planned defense increases, are recommended by the president. On the other hand, the administration suggests no major spending cuts to promote this objective. Nevertheless, the increases proposed in military outlays for FY 1981 over, the previously planned objective to reduce inflationary pressures by lowering the budget deficit in FY 1981 and beginning to balance the budget. Some no longer expect a deficit in FY 1981. The president's defense increases, to a large extent, automatically determine the levels of taxing and spending. Moreover, the budget proposes some spending cuts in areas such as welfare benefits and federal compensation, where it has been difficult to gain congressional acceptance in the past.

The budget as summarized in table 1 suggests that federal spending will increase by 9.0 percent during FY 1981 (11.8 percent in the previous 10 fiscal years) and that receipts will increase by 13.5 percent. This increase in receipts will be largely due to higher inflation, upward pressure on interest rates and a broader measure of inflation, is forecast to increase 9.0 percent in FY 1980 and 8.6 percent in FY 1981. While the federal government expects to raise $44.3 billion from the public in FY 1980 and FY 1981, this represents a fiscal deficit because recent events in Iran and Afghanistan have increased public support for military spending. Similarly, in the coming election year, Congress may be more inclined than the president to raise discretionary counter-cyclical spending or to offer tax relief in the face of weak economic performance. Moreover, recent events in Iran and Afghanistan have increased public support for military spending.

Outlays and Receipts

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Fiscal 1981 Budget Recommendations

This Economic Commentary summarizes the president's budget, highlighting the many uncertainties surrounding the estimates; it then places postwar budget trends in perspective.

The president sent his budget recommendations for fiscal year (FY) 1981 to Congress on January 29, 1980. Outlays are expected to equal $591.5 billion in FY 1981, which is 15.4 percent higher than in the previous fiscal year. The budget includes some spending proposals that are most notably expected to be lower in fiscal year 1981 than in FY 1980. These include the tax increases and the current administration's willingness to impose substantial reductions in the growth of military and nondefense programs. Fiscal year 1981, in view of the current administration's policy on fiscal stimulus, is probably the most challenging year in which to implement budgetary policies.

This objective is to be achieved by the reduction of the deficit to about $30 billion, which is 13.5 percent smaller than in the previous fiscal year. This was considered a target in the President's economic and political outlooks; however, the estimates are useful in forming a base which to analyze budgetary alternatives.

Budget Priorities

Administration budget recommendations, despite being explicit, or implicitly, a set of priorities that presumably would guide policy over coming fiscal years. A stated primary objective of this year's budget is to help reduce inflationary pressures by lowering the deficit to $30 billion in FY 1981 and bring about the deflationary economic and political outlooks; however, the estimates are useful in forming a base which to analyze budgetary alternatives.

Outlays and Receipts

The budget as summarized in Table 1 suggests that federal budget will increase by $591.5 billion in FY 1981 (11.8%) than in the previous fiscal years (10.4%). Although the increases represent, in part, the costs of maintaining existing budgetary programs, spending initiatives, notably for military defense and energy programs, are proposed. Moreover, the budget proposes some spending cuts in such areas as welfare benefits and federal employee compensation, where it has been difficult to gain congressional acceptance in the past.

Receipts will grow 13.5 percent on average during FY 1980 and FY 1981, compared with an average 0.7 percent over the past two years. This represents the effects of inflation and petroleum price increases. Various proposals, notably the recommendation for hospital- and medical-care programs, transfer and aid programs. Cuts in these programs historically have been difficult to achieve.

The difficulty of assessing priorities in FY 1981 adds to the uncertainty of this future course of budgetary policy. Moreover, as suggested below, the simultaneous attainment of a balanced budget, increased defense spending, and lower tax burdens may not be compatible in the long run, especially under current budgetary initiatives. These service reductions, and the current administration are willing to impose substantial reductions in the growth of military and nondefense programs. Fiscal year 1981, in view of the current administration's policy on fiscal stimulus, is probably the most challenging year in which to implement budgetary policies.

### Table 1: Administration's Budget Estimates (in billions of dollars)

<table>
<thead>
<tr>
<th>Year</th>
<th>Outlays</th>
<th>Current services</th>
<th>Policy changes</th>
<th>Military</th>
<th>Energy</th>
<th>Other reductions</th>
<th>Total</th>
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<td>565.6</td>
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<td>FY 1980</td>
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<td>3.8</td>
<td>657.4</td>
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<tr>
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<td>615.8</td>
<td>615.8</td>
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<td>3.8</td>
<td>681.0</td>
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</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Receipts</th>
<th>Current services</th>
<th>Social-security tax</th>
<th>Policy changes</th>
<th>Windfall-profits tax</th>
<th>Other</th>
<th>Total</th>
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<tr>
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<td>517.4</td>
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<td>28.7</td>
<td>12.7</td>
<td>28.7</td>
<td>570.0</td>
</tr>
<tr>
<td>FY 1980</td>
<td>580.0</td>
<td>580.0</td>
<td>28.7</td>
<td>28.7</td>
<td>28.7</td>
<td>28.7</td>
<td>608.0</td>
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<tr>
<td>FY 1981</td>
<td>615.8</td>
<td>615.8</td>
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<table>
<thead>
<tr>
<th>Year</th>
<th>Outlays minus receipts</th>
<th>Deficit</th>
<th>Deficit plus-off budget spending</th>
<th>Net public borrowing</th>
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<tr>
<td>FY 1979</td>
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<td>76</td>
<td>532.8</td>
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<tr>
<td>FY 1980</td>
<td>579.0</td>
<td>76</td>
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<tr>
<td>FY 1981</td>
<td>615.8</td>
<td>76</td>
<td>589.8</td>
<td>672.0</td>
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### Perspectives

It is useful to compare President Carter's spending and taxing proposals with past budgets. In the following charts, percent changes are indicated by the indication of the capacity to achieve various, possibly conflicting, budget goals in the near term, such as simultaneously balancing the budget, increasing defense spending, and reducing taxes. Note that the budget is presented as a percentage of net GNP in charts 1 and 2. Expressing the budget as a share of GNP.
Fiscal 1981 Budget Recommendations
Owen F. Humpage

This Economic Commentary summarizes the president's budget, highlighting the many uncertainties surrounding the estimates; it then places postwar budget trends in perspective.

The president sent his budget recommendations for fiscal year (FY) 1981 to Congress on January 29, 1980. Outlays are expected to equal $515.8 billion in FY 1981, or 26.1 percent higher than the 1980 total, the highest increase in the past eight years. The budget includes some spending cutbacks, most notably in the area of social security taxes, and the proposed $53 billion increase in military spending.

The difficulty of assessing priorities in FY 1981 adds to the uncertainty about the future course of budgetary policy. Moreover, as suggested below, the simultaneous attainment of a balanced budget, increased defense spending, and lower tax burdens may not be compatible in the next five years. Unit labor costs and the current and the administration are willing to make substantial reductions in the growth of transfer and aid programs. Cuts in these programs historically have been difficult to achieve.

Outlays and Receipts

The budget as summarized in table 1 suggests that federal spending will increase by almost $16 billion in FY 1981, compared with FY 1980 (11.8% in the previous 10 fiscal years, 10.4%). Although the increase represents, in part, the costs of maintaining existing budgetary programs, spending initiatives, notably for military defense and energy programs, are proposed. Moreover, the budget proposes some spending cuts in such areas as welfare benefits and federal employee compensation, where it has been difficult to gain congressional acceptance in the past.

Receipts will grow 13.5 percent on average during FY 1980 and FY 1981, compared with an average 0.7 percent over the past 10 fiscal years. Much of this growth represents the effects of inflation and petroleum price increases. Various proposals, notably the Lajeunie tax cut, would add $21.2 billion in receipts to FY 1981.

When the net spending of off-budget agencies is added to the budget, the total deficit to be financed rises to $56.9 billion in FY 1981. The federal government expects to raise $44.3 billion from the public in FY 1981, which reduces upward pressure on interest rates and reduces the amount of government funds available for private borrowing.

Budget Uncertainties

The administration's budget proposals are based on a number of assumptions about the economic outlook and congressional acceptance of policy proposals. If these assumptions do not hold, actual spending and taxing totals could be much different than currently forecast.

Projections of economic activity that span the past 10 fiscal years are obviously subject to considerable error, yet such projections are crucial in constructing the budget. Economic developments, to a large extent, automatically influence the levels of taxing and spending. Many receipts, such as income taxes, and expenditures, such as unemployment compensation, are directly influenced by the levels of production, employment, income, and inflation. At the same time, economic activity is influenced by budget decisions, which in part are designed to promote economic objectives.

The FY 1981 budget anticipates a mild recession. Real GNP is projected to fall 1.0 percent in FY 1980 (fourth quarter to fourth quarter) and then increase 2.8 percent in 1981. The unemployment rate is expected to rise to 7.5 percent by the final quarter of this year and then decrease to 7.3 percent by year-end 1981. The GNP deflator, the broad measure of inflation, is forecast to increase 9.0 percent in 1980 and 8.6 percent in 1981.

Many economists recently have revised upward their outlooks for real growth and inflation, partly in response to anticipated fiscal and monetary tax cuts. Nevertheless, it remains possible that the structural recession and higher inflation than the administration.

For example, real economic activity is worse than forecast in the administration's budget. Federal expenditures would be smaller, receipts would be smaller, and the deficit would expand. If, however, inflation proves higher than the administration predicts, outlays and receipts would be higher. The reduction in the deficit impact most likely would be a slight reduction in the deficit.

The administration's January budget, which is but one of many steps in the budgetary process, is based on numerous legislative assumptions. Various congressional committees will review the president's spending and taxing proposals, and undoubtedly they will alter some proposals, delay others, and introduce suggestions the president proposed, for example, a $15.8 billion increase in military spending during FY 1981. Although this represents a 3.3 percent real addition to the defense budget, it does not significantly increase the military's share of the total federal budget or of GNP. Many analysts expect Congress to augment greatly the president's defense initiative because recent events in the Soviet Union and Afghanistan have increased public support for military spending. Similarly, in the coming economic outlook, Congress may be more inclined than the president to raise discretionary counter-cyclical spending or to offer tax relief in the face of weak economic performance. Moreover, some measures proposed in the FY 1981 budget, such as the recommendations for hospital costs containment and accelerated income-tax payment, failed to pass Congress last year. Other measures, such as the cuts in social security tax, have required the patience and political skills of federal employees and lower wages and veteran's benefits may not receive congressional support this year. The congressional budget process spans over eight months.

The uncertainties concerning the economic and political outcomes of the administration's policy initiatives could easily cause the deficit to be much different than currently anticipated. For example, the current estimate for outlays in FY 1980 is $32 billion, while the original estimate made in January 1979, was $20 billion above the original, and the anticipated deficit is $12 billion higher.

Perspectives

It is useful to compare President Carter's spending and taxing proposals with past budgets in order to examine the extent to which the budget's direction reflects the administration's policy initiatives. The administration's budget proposals have been presented as a percentage of GNP in charts 1 and 2. Expressing the budget as a share of the Gross National Product, National Income and Private Disposable Income.
During intervening years, the proposed budget provides a framework by which to judge the relative size of government spending or taxing and to standardize the data for comparison over time. The ratio of receipts to GNP provides a rough indicator of the overall tax burdens that the economy bears (see chart 1). Between 1950 and 1979, the ratio generally remained within the 18 to 20 percent range, although an upward trend in the ratio is discernible. Over the 29-year period, the composition of taxes also changed. Contributions for social insurance rose from approximately $200 million to $15.8 billion in 1979. Personal income taxes also increased from 1.5 percent, respectively, in 1979.

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The rise of nondefense spending

The rapid growth of nondefense federal spending relative to GNP reflects the expansion of federal transfer payments to individuals and grants-in-aid to state and local governments. The figures are based on two assumptions, most notably in the Vietnam military buildup in the late 1960s. The $15.8 billion increase proposed in the FY 1981 defense budget represents only 1 percent of GNP. If Congress greatly augments the defense budget, the ratio would remain well below that experienced in the early 1970s.

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Conclusion

The FY 1981 budget recognizes the need to move toward balancing the budget in coming fiscal years, to increase expenditures for defense, and to reduce the tax burden. These objectives may not be simultaneously feasible, particularly when viewed in a historic perspective. The United States, particularly since the mid-1960s, has dramatically increased domestic transfer and grants-in-aid spending by incurring large deficits and reducing the real value of the defense budget. If the budget is to be balanced, military spending increased, and tax burdens lowered over the coming fiscal years, the growth of nondefense spending must be sharply reduced. The traditional reluctance to re-examine nondefense programs suggests that budget priorities as defined in the administration's FY 1981 budget may have to be re-evaluated.


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The FY 1981 budget recognizes the need to move toward balancing the budget in coming fiscal years, to increase expenditures for defense, and to lower the overall tax burden. These objectives may not be simultaneously feasible, particularly when viewed in a historic perspective. The United States, particularly since the mid-1960s, has dramatically increased domestic transfer and grant-in-aid spending by incurring large deficits and reducing the real value of the defense budget. If the budget is to be balanced, military spending increased, and tax burdens lowered over the coming fiscal years, the growth of nondefense spending must be sharply reined. The traditional reluctance to re-examine nondefense programs suggests that budget priorities as implied in the administration’s FY 1981 budget may have to be re-evaluated.
