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 present budget trends in perspective.

The president sent his budget recommendations for fiscal year 1981 (FY 1981) to Congress on January 29, 1980. Outlays are expected to equal $615.8 billion in FY 1981, up 13.5% from $560.0 billion in FY 1980. Scheduled increases in social-security taxes and the proposed windfall-profits tax will contribute to this hefty increase in receipts. The deficit is expected to narrow to $15.8 billion in FY 1981, down 41.0% from $26.3 billion in FY 1980. These figures are not as favorable to the president as his economic and political outlooks; however, the estimates are useful in forming a base from which to analyze budget alternatives.

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 deficit in FY 1981 and beginning to reduce the surplus in FY 1982. To this end, no tax cuts are recommended by the president. On the other hand, the administration suggests no reduction in discretionary spending. This budget is consistent with the fiscal conservatism they have long espoused.

The budget includes some spending increases, most notably for defense and energy programs, are proposed. Moreover, the budget proposes some spending cuts in such areas as welfare benefits and federal programs historically have been difficult to achieve. The difficulty of assessing priorities in military outlays for FY 1981 (11.8%) than 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 programs.

Outlays and Receipts
The budget as summarized in table 1 suggests that federal spending will increase by $560.0 billion in FY 1981, 9.7% over FY 1980. This outlay figure represents the effects of inflation and policy changes. Various proposals, notably in the past.

The FY 1981 budget anticipates a mild recession and higher inflation than the administration. Many economists recently have revised upward their outlooks for real growth and inflation, partly in response to recent fiscal policy changes. Some no longer expect a recession. Nevertheless, forecasts tend to be conflicting, budget goals in the near future, such as simultaneously balancing the budget, increasing defense spending, and reducing inflationary pressures, may be difficult to achieve if the deficit is too small relative to GNP. The current estimate for outlays in FY 1980 is $3.2 billion, and the original estimate made in January 1979, $1 million higher.

DEFICIT
The usefulness of comparing President Carter's spending and taxing proposals with past budgets is limited by the indication of the capacity to achieve various, possibly conflicting, budget goals in the near future, such as simultaneously balancing the budget, increasing defense spending, and reducing inflationary pressures. The chart presents as a percentage of GNP in charts 1 and 2. Expressing the budget as a share of

Chart 1 The Growth of the Federal Budget

Percentage of GNP, National Income and Product Accounts Basis, Fiscal Year


Revenues
Expenditures
Net Borrowing
Nondefense Spending
Defense Spending

10 20 30 40 50 60 70 80 90


NOTE: Shading indicates periods of recession.

Table 1 Administration's Budget Estimates
Billions of dollars

FY 1979 (Actual) FY 1980 FY 1981
Outlays
Current services a 565.8 612.0 615.8
Priv. changes 3.0 3.8
Military 0.0 (3.7)
Energy 5.0 (12.4)
Other increases 1.7 (7.4)
Total 563.6 610.0 615.8
Receipts
Current services a 517.4 579.0
Social-security tax b 12.7 (28.7)
Policy changes 4.0 21.0
Windfall-profits tax 0.2 (14.4)
Netother 0.0 (8.0)
Total 476.9 528.5 600.0
Deficit 47.9 38.8 15.8
Deficit plus off-budget spending 40.2 56.0 39.9
Net public borrowing 33.6 44.3 33.1

a. Effect of continuing existing spending programs and taxing laws.
b. Includes the effects of all rate and base changes since January 1, 1979.

Spending and taxing proposals, and undoubtedly they will alter some proposals, disrupt current activity, and introduce complications. For example, 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 budget 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 cuts in the face of weak economic performance. Moreover, various measures proposed in the FY 1981 budget, such as the recommendations for hospital cost containment and accelerated income-tax payments, failed to pass Congress last year. Other initiatives, notably for defense and energy programs, are proposed. Moreover, the budget proposes some spending cuts in such areas as welfare benefits and federal programs.

The difficulty of assessing priorities in economic and political outlooks; however, the estimates are useful in forming a base from which to analyze budget alternatives.
All of the growth in total outlays relative to GNP resulted from non-defense spending. The share of GNP devoted to defense has fallen sharply since the Korean War buildup and particularly since 1970, although the trend was interrupted on a few occasions, most notably in the Viet Nam military buildup in the late 1960s. The $15.8 billion increase proposed in the FY 1981 defense budget represents only a 1970 level of military spending relative to GNP. 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 1957. Moreover, the increase is much as a reflection of slowdown in 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 1980. Even if Congress greatly augments the defense budget, 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 4 percent of GNP in the early 1950s, rose to around 9 percent of GNP during the late 1970s. They alone now constitute a large share of total GNP than military defense. Similarly, grants to state and local governments have risen rapidly from less than 1 percent of GNP to roughly 3.5 percent of GNP since the early 1960s. In contrast, the growth of all other nondefense spending categories has remained comparatively flat relative to GNP.

Growth in transfer payments and aid programs has been particularly strong since the mid-1960s, following the introduction of President Johnson's Great Society programs. Between FY 1969 and FY 1979, for example, social security benefits increased fourfold, Medicare and Medicaid outlays rose fivefold, and food stamp payments increased from nearly $2 billion in FY 1980, but still below the ratio in 1957. Moreover, the increase is much as a reflection of slowdown in 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 1980. Even if Congress greatly augments the defense budget, 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 lower the overall tax burden. These objectives may not be simultaneously feasible, particularly when considered in a strategic perspective. The United States, particularly since the mid-1960s, has dramatically increased both budget and defense spending. Although these programs have clearly had the tacit approval of Congress, the rapid expansion of transfer and grant programs has clearly had the tacit approval of Congress and the administration. These programs, however, serve a broad constituency that includes powerful interest groups. Consequently, past Congresses and administrations have been reluctant to re-examine the need for various programs or to tighten eligibility requirements. President Carter, however, in his FY 1981 budget, is attempting some relatively minor welfare reforms, proposes no major re-examination of these programs during FY 1981. Moreover, because these programs are indexed, inflation does not erode their relative importance in the budget.

1. The 1989 budge in the receipts series results from the surtax imposed to reduce inflationary pressures associated with the Viet Nam military buildup.


BULK RATE
U.S. Postage Paid
Cleveland, Ohio Permit No. 385