

from Senator Bob Dole

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The Economic Recovery To Date

The economy continued its recovery during 1976, but the growth and output over the last nine months of the year was not enough to reduce the exceptionally high unemployment rate and to bring the economy near full capacity production. The real (constant dollars, adjusted for inflation) growth rates of 4.5%, 3.9%, and 3.0% recorded in the second, third, and fourth quarters, respectively, indicate continued strength in the economy, but have raised doubts about future trends when compared to the 7.4% real growth experienced during the first year of recovery. The pause from more rapid recovery lasted longer than expected for a number of reasons. Purchases of consumer durables have shown only modest growth, government purchases have not increased rapidly, and the demand for U.S. exports has weakened. Political uncertainties may have been a factor in these and other sectors of the economy, particularly investment. Table I displays the performance of the economy broken down by major GNP (Gross National Product) components and forecast ranges for 1977 and 1978, with and without additional economic stimulus policies.

As a consequence of the moderation in economic growth and continued large increases in the labor force, the official unemployment rate increased from an average of 7.6% in 1976:1 to 7.9% in 1976:4. The inflation rate measured by the Consumer Price Index registered 5.7% in 1976 compared with 9.1% in 1975.

The Economy in 1977 and 1978

Most economic projections still anticipate some pick up in economic growth in 1977 under current economic policies. Economic policy discussions have focused on whether the acceleration will be strong enough and whether it will persist through 1978.

The Congressional Budget Office foresees real economic growth of about 4.3% (with possibilities ranging from 3.5% to 5.0%) in 1977, consistent with commercial econometric model forecasts. Carter Administration economists are somewhat more optimistic, projecting growth of 4 1/2 to 4 3/4 percent.

The outlook for 1978 is less certain. Fears that the recovery will again slow down center around weakness in the international economy and the possibility that sales and production levels in 1977 will not be sufficient to generate a surge of business investment that could lead a continued strong recovery in 1978 and beyond. Non-residential fixed investment in 1977 is expected to grow by 5.0% to 5.5% in real terms, but larger increases would be needed in 1978 to sustain the recovery and to provide production capacity in future years that will allow high employment levels without a renewal of rapid inflation.

Growth prospects under current policies carry with them an unemployment rate which would probably remain above 7.0% throughout 1977 and decline only gradually in 1978. (The January drop in the unemployment rate to 7.3% was due mostly to a large decline in the labor force which is likely to be temporary.) Only slight improvement in the rate of inflation is forecast.

More Stimulus: Proposals, Cost, and Benefits

Most policymakers have concluded that additional economic stimulus through government initiatives is desirable at this time. Within the bounds of prudent action, the risk of over-stimulating the economy seems on balance far out-weighted by the likelihood of sluggish recovery and continued high unemployment. (A notable and significant exception to this view is Chairman Arthur Burns of the Federal Reserve Board.) There seems to be a healthy awareness, however, that the lower inflation rates experienced recently has contributed importantly to sustaining increased purchasing power and consumer and business confidence and that policy initiatives which would undermine this favorable trend may be self-defeating.

President Carter has proposed tax reductions of \$20.1 billion and spending increases of \$11.1 billion in fiscal years 1977 and 1978 combined, for a total economic stimulus of \$31.2 billion. (To provide some perspective, total Gross National Product for 1976 was roughly \$1,700 billion.) The central features of this two-year economic policy proposal are a one-time \$50 per person tax rebate in 1977 (\$11.4 billion total) and a variety of job creating government programs

building up from \$1.7 billion in 1977 to \$7.6 billion in 1978. In addition, permanent personal tax reduction amounting to \$6.9 billion in business tax cuts totalling \$3.5 billion in fiscal years 1977 and 1978 are proposed. (The President's plan has already been revised by the House Ways and Means Committee, and further modifications are expected prior to final Congressional action on the package.) With a quick boost to consumer spending followed by accelerated direct government employment incentives, the Administration hopes to push the economy's real growth rate into the 5.5 to 6 percent range and bring the unemployment rate below 7% by the end of 1977 and near 6% by the end of 1978.

Senate Republicans have proposed a set of economic policies which includes a permanent reduction in personal tax rates amounting to \$17.3 billion in 1977 and 1978, \$5.4 billion in employment and training programs and incentives to private employers targeted on the unemployed who experience greatest difficulty finding jobs, and \$2.8 billion in tax reductions emphasizing small businesses and investors and designed to encourage investment and future job opportunities. (A full analysis and description of these proposals is available upon request.) The Republican approach questions both the need for and the effectiveness of the quick tax rebate, emphasizes targeted programs which address the special nature of the unemployment problem stemming from greater labor force participation, and urges new types of economic policies that yield private sector jobs at less cost and inflation risk -- such as a tax credit for businesses that increase employment.

Congressional Action and The Budget

In order to take action on President Carter's proposals or some alternatives, Congress must first revise the Budget Resolution for fiscal year 1977 approved last September. Based on economic projections at that time, the Budget Resolution set a limit of \$413.1 billion on government outlays, \$362.5 billion on revenues, and \$50.6 billion on the deficit. Since that time, the weaker performance of the economy (and other factors such as the number of people participating in various programs) has reduced revenue estimates by \$6 billion, reduced outlay projections by \$3 billion, and consequently raised the estimated deficit to \$53.6 billion. Congressional action to accommodate the President's proposals would require new limits of \$412.1 billion in outlays, \$346.9 billion in revenues, and \$65.2 billion for the deficit. (These adjustments are somewhat less than the full amount of the President's proposed spending and tax initiatives because of presumed favorable effects on the economy and some consequent off-setting effects on outlays and revenues.)

The Senate Budget Committee and the House Budget Committee have separately set the revised budget recommendations shown on Table II. While both Committees have provided enough room for the President's proposals (and more), neither has endorsed the specific proposals. Action on each separate proposal is left to the recommendation of the appropriate Committees and to approval by the full Congress. The President's proposals have met with some skepticism in Congressional hearings. While Committee deliberations have not yet been completed, there has been noticeable sentiment against the rebate approach to cutting taxes, in favor of larger public works and public employment programs, and for a different business tax reduction. At this point, it seems possible that Congress will send the President a somewhat different and slightly larger economic stimulus package.

Action on all of the President's proposals will not be fully determined until after the fiscal year 1978 Budget Resolution is approved in May. Under unchanged economic policies and projections (no stimulus measures or other adjustments) a budget deficit of approximately \$60 billion would be expected for fiscal year 1978 based on revenues of \$395 billion and outlays of \$455 billion. A combination of tax and spending reductions proposed in the Ford Administration's 1978 budget combined to give an estimated \$47 billion estimated budget deficit. President Carter is expected to submit adjustments to that budget, including elements and the effects of his stimulus proposals, that yield approximately a \$57 billion budget deficit.

Toward A Healthy Economy and A Balanced Budget

The unemployment rate, the rate of inflation, and the status of the federal budget are the most conspicuous indicators of the health of the national economy. The relationships between these and other economic factors is complex. Nevertheless, policymakers must have a clear image of how their decisions will influence these variables, both immediately and over time.

It is particularly disturbing to be confronted with a revised

TABLE I

Gross National Product	
Consumption	
Durables	
Non-Durables	
Services	
Fixed Investment	
Non-Residential	
Residential	
Inventory Investment	
Exports Less Imports ³	
Government Purchases	
Federal	
State-Local	
	1975
Inflation (Consumer Price Index)	9.1
Unemployment rate	8.5

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1. Values recorded are averages
 2. Government stimulus policies
 3. Values are billions of 1972 c
 4. Based on Congressional Budget

Budget Resolution for fiscal year 1977 that would set the deficit at \$65 billion or greater, little changed from the \$66.5 billion deficit of fiscal year 1976. The economy has been growing, but the deficit does not seem to be melting away. What sense does this make, and where does it lead in the coming years?

Economic and budget analysis (Congressional Budget Office and Senate Budget Committee minority staff) clearly demonstrates that with existing social and income support programs, there is little hope of a balanced budget until the economy is fully recovered. Since few seriously favor elimination or massive reduction of these programs as a way of quickly eliminating the budget deficit, balanced budget plans hinge mostly on the performance of the economy. Increased employment automatically generates more tax revenues and reduced unemployment automatically cuts spending. The central question, then, is what is best for the economy. There are clearly many facets of government policy affecting the economy in need of improvement which have little immediate budget cost or impact, such as government regulations and the structure and incentives of our tax and income support systems. These policies take more time to change politically and are thought to produce economic effects more slowly. Activist budget policies, in contrast, have achieved widespread popular acceptance as a means to improving economic performance in the new term. Differences of opinion resolve mainly around which policies work best and the extent to which Federal Reserve monetary policies place limits on the effects of budget policy.

In this context, the rationale behind the impending economic policy actions is more clear. The larger deficit now is viewed as an installment to be paid in return for an improved economy and smaller deficits next year and beyond. Whether the strategy will work remains an open question. The economic policies adopted in 1975 and 1976 brought the deficit from an anticipated \$75 billion to an actual \$66.5 billion for fiscal year 1976, and an expected \$53.6 billion for fiscal year 1977. But with further economic and budget improvement for fiscal year 1978 appearing questionable, a policy adjustment that concedes a delay but hopes

RECOVERY TO DATE				RECOVERY PROJECTIONS ⁴					
rates of growth, constant dollar (real) terms ¹				rates of growth, constant dollar (real) terms ²					
75:2 - 76:1	76:2 - 76:4		1976:4 ³	No Stimulus 1977		With Stimulus ² 1977	1978		
7.4%	3.8%			4.1-4.5%		4.8-5.5%	4.6-4.9%		
6.1	4.4			4.0-4.5		4.5-5.2	4.2		
17.5	2.9			6.5-8.0		7.5-12.5	5.6		
4.7	4.7			2.7-3.3		2.8-3.4	3.5		
4.0	4.6			4.1-4.2		4.4-4.5	4.2		
6.4	10.5			5.0-6.0		6.1-7.5	5.1		
1.8	6.2			5.0-5.5		5.3-6.4	6.2		
19.8	23.3			5.0-7.0		6.3-9.6	2.8		
	8.7			5.1-5.5		7.1-8.2	11.8		
21.7	15.7			12.0-12.3		16.1-16.6	18.0		
1.9	2.0			2.8-2.9		3.2-5.0	4.1		
2.8	3.8			2.6-2.7		2.7-2.9	5.7		
1.0	0.9			2.8-3.1		3.4-6.2	3.3		
1975	1975:4	1976	1976:4	No Stimulus 1977	1977:4	With Stimulus 1977	1978	1978:4	
9.1	6.5	5.7	4.6	4.9-5.8	5.1-5.5	5.3-5.8	5.5-5.6	5.4-5.5	5.0-5.6
8.5	8.5	7.7	7.9	7.4-7.7	7.1-7.6	7.1-7.3	6.8-7.0	6.4-6.5	6.2-6.3

averages of quarterly values.

policies roughly the same size and composition as the Administration's proposals.

f 1972 constant dollars.

l Budget Office, Administration, and commercial econometric model estimates.

to re-establish the trend is in the making. If that adjustment manages to keep the economy on course for the next two or three years, and if new spending programs are not excessive, then a healthy economy and a balanced budget are at least possible.

TABLE II

BUDGET HISTORY

(values are \$ billions)

<u>Fiscal Years</u>	<u>Outlays</u>	<u>Receipts</u>	<u>Surplus or (-) Deficits</u>	<u>Gross National Product (calendar year)</u>
1968	178.8	153.7	-25.1	868.5
1969	184.5	187.8	3.2	935.5
1970	196.6	193.7	- 2.9	982.4
1971	211.4	188.4	-23.0	1063.4
1972	232.0	208.7	-23.3	1171.1
1973	247.1	232.2	-14.9	1306.6
1974	269.6	264.9	- 4.7	1413.2
1975	326.1	281.0	-45.1	1516.3
1976	366.5	300.0	-66.5	1692.4
Transition Quarter (Jul-Sep)	94.7	81.8	-12.9	
1977				1864.4e
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Congress Budget Res. (Sep, 76)	413.1	362.5	-50.6	
Revised Estimates	410.1	356.5	-53.6	
If Adjusted To Accommo- date Adminis- tration Proposals	412.1	346.9	-65.2	
Senate Budget Committee Recom.	415.0	346.8	-68.2	
House Budget Committee Recom.	418.8	348.5	-70.3	