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The 1973 Federal Budget

THE 1973 BUDGET sent to Congress in January proposed unified federal expenditures of $246.3 billion, an increase over fiscal 1971 of nearly $35 billion. Receipts are expected to total $220.8 billion, an increase over fiscal 1971 of somewhat more than $32 billion. The estimated expenditures and receipts have both been affected by the slower than anticipated recovery from the recession. The budget document provides additional information for the analysis of fiscal policy on a full employment basis. For the first time, estimates of full employment expenditures were presented in the official documents, while this was the second time that estimates of full employment receipts appeared.[1] The increases in expenditures and receipts between fiscal 1971 and 1973, when calculated on the full employment basis, are approximately the same—$35 billion and $31 billion respectively. Even so, the pattern of the annual increases in expenditures is almost opposite to that of receipts. Whereas full employment expenditures are estimated to rise by $24 billion in fiscal 1972 and then by a more modest $11 billion in fiscal 1973, receipts rise first by $11 billion and then by $20 billion. The result, as can be seen in Table 1, is a planned shift from a full employment surplus of $4.9 billion in 1971 to a deficit of $8.1 billion in fiscal 1972, and then essentially to balance in 1973.

1. Budget outlays were adjusted only for unemployment insurance benefits and expenditures under the Emergency Employment Act. The possibility that some other expenditures might be lower and some (notably interest) higher was recognized, though they were not estimated.

Table 1. Full Employment Receipts and Expenditures, Unified Budget, Fiscal Years 1971–73

Billions of dollars

Budget item	*1971*	*1972*	*1973*
Full employment receipts	214.1	225.0	245.0
Full employment expenditures	209.2	233.1	244.3
Surplus or deficit	4.9	−8.1	0.7

Source: *The Budget of the United States Government, Fisal Year 1973*, p. 15.

However, the unified budget totals for the fiscal years tend to obscure the basically smoother pace of increase in expenditures seen in the national income accounts (NIA). In measuring federal expenditures, the national income accounts are generally much closer to the unified budget than they were to earlier budget concepts. The sharply widened gap between the two concepts in expenditures for fiscal 1973 is explained by three major items, which reduce unified budget expenditures relative to NIA spending (see Table 2). First, although more financial assets are to be sold in 1973 than in

Table 2. Reconciliation of Unified Budget Full Employment Expenditures to National Income Accounts, Fiscal Years 1971–73

Billions of dollars

Expenditure item	*1971*	*1972*	*1973*
Full employment expenditures, unified budget	209.2	233.1	244.3
Reconciliation			
Financial transactions	−3.2	−2.9	−1.3
Netting and grossing[a]	4.6	4.7	5.2
Defense timing adjustment[b]	−0.7	−0.7	3.0
Other	0.4	*	2.7
Full employment expenditures, national income accounts	210.3	234.3	253.9
Welfare payment adjustment[c]	...	−1.0	1.0
Adjusted full employment expenditures, national income accounts	210.3	233.3	254.9

Sources: *The Budget of the United States Government, Fiscal Year 1973; Special Analyses of the United States Government, Fiscal Year 1973*, pp. 15, 16; Charles A. Waite and Joseph C. Wakefield, "Federal Fiscal Programs," *Survey of Current Business*, Vol. 52 (February 1972), p. 16; Council of Economic Advisers, unpublished tabulations. Figures are rounded and may not add to totals.

a. Primarily government contributions for federal employee retirement funds.

b. Procurement items are recorded as purchases at time of delivery; work in progress is counted as part of private business inventories until the articles are completed and delivered to the federal government.

c. In fiscal year 1972 the federal government plans to make thirteen payments instead of twelve to the states for its share of public assistance and medicaid; eleven payments will be made in 1973.

* Less than $50 million.

Table 3. Reconciliation of Unified Budget Full Employment Receipts to National Income Accounts, and Surplus or Deficit, Fiscal Years 1971–73

Billions of dollars

Budget item	*1971*	*1972*	*1973*
Full employment receipts, unified budget	214.1	225.0	245.0
Reconciliation			
Netting and grossing[a]	4.6	4.7	5.2
Adjustment to accruals	−0.6	...	1.7
Other net	−0.1	−0.1	−0.5
Full employment receipts, national income accounts	218.0	229.6	251.4
Adjusted full employment expenditures	210.3	233.3	254.9
Surplus or deficit	7.7	−3.7	−3.5

Source: Same as Table 2.
a. Primarily government contributions for federal employee retirement funds.

previous years, the sharp reduction in other financial transactions, mainly loans, makes the NIA total higher relative to the unified total than has been true in previous years.[2] Second, the adjustment for the timing of defense expenditures is expected to shift from − \$700 million in 1972 to + \$3 billion in 1973 in reflection of a large volume of defense goods to be delivered in fiscal 1973 but paid for in other fiscal years. Third, mainly as a result of extraordinary receipts from offshore oil leases that appear as negative expenditures, a net adjustment of \$2.7 billion is made to the unified budget in reaching the NIA total. Another \$1 billion that is essentially a modification in the timing of expenditures that even the national income accounts concept does not adjust for probably has little economic significance: The budget proposes for 1972 a thirteenth monthly payment of the federal subsidy to state welfare expenditures, which will swell cash expenditures in 1972 and reduce them in 1973.

The relationship between unified and NIA receipts is shown in Table 3. The difference between the two grew from \$3.9 billion in fiscal 1971 to \$6.4 billion in fiscal 1973.

In an analysis of combined receipts and expenditures adjustments, the

2. In the recent past, the adjustment to exclude financial transactions was roughly offset by the adjustments to include certain items recorded on a net basis in the unified budget. Currently, the volume of financial transactions is declining. Thus, the gap between unified and NIA expenditures has widened.

fiscal policy revealed by the national income accounts concept is somewhat different from that implied by the unified budget. In both, there is a 1971–72 swing of roughly the same size from a full employment surplus to a deficit. However, once the financial transactions and pure timing factors are accounted for, the fiscal 1973 NIA budget does not move back to balance but has a deficit of about the same magnitude as fiscal 1972.

The planned fiscal impact of the budget program can be seen more clearly in estimates projected by half-year intervals (Table 4). All of the increase in stimulus is planned for the first half of calendar 1972, a result of both an unusually large increase in expenditures and a growth in revenues much smaller than normal because of reductions in individual and corporate income taxes legislated in 1971.

Of the $20 billion increase in expenditures estimated for the first half of

Table 4. Full Employment Expenditures and Receipts by Half Years, National Income Accounts, Second Half 1971–First Half 1973
Billions of dollars, seasonally adjusted annual rates

Budget item	*1971* *Second*	*1972* *First*	*1972* *Second*	*1973* *First*
Full employment expenditures				
Defense purchases	70.8	76	76	78
Nondefense purchases	28.2	31	30	30
Transfer payments	75.2	78	84	87
Grants-in-aid to state and local governments	30.9	41	40	41
Other	18.7	19	20	22
Total	223.8	245	250	258
Welfare payment adjustment[a]	...	−2	2	...
Adjusted total	223.8	243	252	258
Full employment receipts				
Personal tax liabilities	99.6	100	104	107
Corporate tax liabilities	44.1	45	48	51
Indirect taxes	22.6	22	23	24
Social security taxes	61.4	68	71	75
Total	227.7	235	246	257
Full employment surplus or deficit	3.9	−8	−6	−1

Sources: Totals, Waite and Wakefield, "Federal Fiscal Programs," p. 16; components, author's estimates.
a. Primarily government contributions for federal employee retirement funds.

1972, $5 billion is for higher civilian and military pay, and for the volunteer army, which is expected to cost $2.4 billion during the first half of the year and $2.8 billion thereafter (both estimates at annual rates). Grants-in-aid are expected to rise by $8 billion to $10 billion, depending on how the welfare prepayment is handled. Of that rise, revenue sharing made retroactive to the first of the year accounts for $5 billion. Transfer payments are expected to rise by $3 billion in the first half, reflecting primarily more beneficiaries. This estimate has been adjusted for the effect of economic slack on unemployment benefits, but not on other transfer programs.

After midyear, federal expenditures except for transfers are expected to grow more slowly. A 5 percent increase in social security benefits and other liberalizations passed the House in 1971, and are now under consideration in the Senate. If the legislation (H.R. 1) passes as proposed in the budget, it will cost $4.0 billion in fiscal 1973—$3.5 billion of benefit increase effective July 1, 1972, and $520 million for medicare for the disabled to take effect some time later.

Possible Changes in the Fiscal Outlook

There are four major changes in the fiscal outlook. Two of them are intertwined: The proposal to use dynamic assumptions in the long-range evaluation of the social security system will affect both expenditures and tax rates. The third change, the sharp increase in withheld taxes, will reduce the deficit for fiscal 1972 and probably increase it in 1973. The fourth involves delay in the enactment of revenue sharing.

THE IMPACT OF THE ACTUARIAL REFORM

The increase in social security benefits is likely to be considerably larger than anticipated in either H.R. 1 or the budget. The chairman of the House Ways and Means Committee, Wilbur D. Mills, has proposed in an amendment a 20 percent increase that would add about $6 billion annually to expenditures starting July 1, 1972, over and above what would be required by the 5 percent in the original bill. The Senate Finance Committee has not yet reported out the social security bill, but bills proposing the 20 percent increase have already been introduced in the upper chamber, as well.

The increase in benefits under H.R. 1 was to be financed out of the "unexpected" actuarial surplus that gradually built up because rising wages were not taken into account in calculating the tax rates needed to finance the old-age, survivors, and disability (OASDI) expenditures. In fact, this surplus was so large that H.R. 1 proposed lowering the OASDI tax rate from 9.2 to 8.4 percent and shifting the 0.8 percent difference to the hospital insurance (HI) tax rate (currently at 1.2 percent) to help finance medicare for the disabled. (Apparently no consideration was given to lowering the tax rate instead of inaugurating a new program.) The reduction in the OASDI tax rate was not quite adequate to finance the new HI program, which was expected to require a rate of 1.2 percent over and above the 1.2 now financing it. Consequently. H.R. 1 proposed raising the combined (OASDHI) tax rate from its current 10.4 to 10.8 percent—8.4 for OASDI; 2.4 for HI (see Table 5).

The further increase in benefits proposed by Chairman Mills would utilize not only the periodic actuarial surplus, but another surplus that would be created if Congress accepted the recommendations of the 1971 Ad-

Table 5. Actual and Proposed Tax Rates for Old-age, Survivors, and Disability Insurance and Hospital Insurance, 1972–2011 and After

Percent of taxable wages

Year	*Present law*[a]	*H.R. 1*[b]	*Mills proposal*[c]
	Old-age, survivors, and disability insurance		
1972	9.2	8.4	9.2
1973–74	10.0	8.4	9.2
1975	10.0	10.0	9.2
1976	10.3	10.0	9.2
1977–2010	10.3	12.2	9.8
2011 and thereafter	10.3	12.2	12.2
	Hospital insurance		
1972	1.2	2.4	...
1973–75	1.3	2.4	...
1976	1.4	2.4	...
1977–79	1.4	2.6	...
1980–86	1.6	2.6	...
1987 and thereafter	1.8	2.6	...

Sources: *Congressional Record*, daily ed., February 23, 1972, p. H1413, and *Social Security Amendments of 1971*, Report of the Committee on Ways and Means, H. Rept. 92-231, 92 Cong. 1 sess. (1971), p. 24.

a. $9,000 wage ceiling for 1972 and thereafter.

b. $10,200 wage ceiling for 1972 with automatic adjustment to increased earnings thereafter.

c. $10,200 wage ceiling in 1972, $12,000 in 1973, and automatic adjustment to increased earnings thereafter.

visory Council on Social Security made in its required periodic review of the program. In March 1971, following an evaluation of the program's long-term financing, the council recommended two major changes in the actuarial calculations. First, reasonable rates of increase should be assumed for both wages and prices; and second, the system should be placed on a pay-as-you-go basis. In the past, the long-range evaluation assumed (1) *no* increase in wages or prices for the seventy-five years into the future that the calculation covers (the level wage assumption), and (2) the need to impose in the relatively near future the tax rate required to finance the benefits over the entire period (the level cost assumption).[3] These two assumptions have led in the past to the "overfinancing" of social security benefits; that is, the revenues raised from the payroll tax have exceeded the benefits paid. The reason is that though the level wage assumption tended to understate both, the miscalculation was greater for receipts than for expenditures.

Under the level wage assumption, average taxable wages were assumed to remain the same as those in the year the calculation was made. Average benefits, however, were projected to rise in reflection of the history of wages: When, in fact, wages rose, revenues immediately increased above those projected, while benefits rose much less over projections than revenues because their calculation already incorporated the effect of past increases in wages on future benefits. Thus, a second actuarial surplus arose.

Adoption of the second recommendation—to put the system on a pay-as-you-go basis—would permit the delay of increases in the tax rate. The tax rate schedule currently written in the law provides for the level cost tax rate to take effect in 1976.[4] Because of demographic factors, the cost of the benefits (expressed as a percent of payroll) will be lower over the next forty years than after the first decade of the next century.[5] So early an implementation of the level cost tax rate would mean sizable annual sur-

3. The actuarial evaluation projects benefit payments based on demographic trends and wage histories. With the same assumed interest rate, the future streams of both benefit payments and taxable wages are discounted to present value. The present value of the benefits is then expressed as a percent of the present value of the wages and is known as the level cost of the benefits.

4. *1971 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Disability Insurance Trust Funds*, H. Doc. 92-88, 92 Cong. 1 sess. (1971), p. 35, and Table 5.

5. Because of the sharp increase in the birth rate between 1946 and 1957 and its subsequent decline, the number of retirees relative to the number of people of working age will begin to rise after 2010.

pluses in the trust funds during this period, and massive accumulation of U.S. government securities. The interest earned on these bonds was to be used to meet the higher costs of benefits in the twenty-first century caused by the increased number of beneficiaries. Since it also constitutes a government expenditure, it does not reduce the net real cost of the benefits in any year. The council therefore recommended that the program be put on a pay-as-you-go basis.[6]

The amendment to H.R. 1 submitted by Chairman Mills accepts both the dynamic wage assumption in the actuarial calculation and the pay-as-you-go principle. However, instead of devoting the actuarial surplus to a reduction of the tax rate, his amendment proposes using it to finance a 20 percent across-the-board increase in benefits, instead of the 5 percent in the original bill. The prescheduled tax rate increases are also spaced out to follow more closely the demographic patterns. Table 5 shows the OASDI tax rates as embodied in current law, as proposed by H.R. 1, and as envisaged in the Mills proposal. Chairman Mills has not proposed an alteration in the hospital insurance tax rate, and it is uncertain whether the HI rates proposed in H.R. 1 would be increments to the OASDI tax rates contained in his amendment. Table 5 also shows the current tax rates for hospital insurance and those proposed in H.R. 1.

Although the OASDI tax rate is not raised from the current 9.2 percent, an increase in the HI tax rate could make quite a difference in the resulting combined tax rate (Table 6). If the 9.2 percent OASDI tax rate is added to the 2.4 percent rate in H.R. 1, the combined rate would jump from its current 10.4 to 11.6 percent. If the OASDI rate is combined with the rates already scheduled for HI, the increase would be only 0.1 percentage point to 10.5, where it would remain until 1976.

In addition to the higher overall tax rate, the Mills proposal would increase the ceiling on wages subject to tax from the current $9,000 to $10,200 (as does H.R. 1) and then to $12,000 in 1973 with automatic adjustments thereafter tied to the increase in average earnings.[7] Both H.R. 1 and the Mills proposal assume, as do the revenue estimates in the budget, that the increase in the wage ceiling would be made retroactive to Janu-

6. A fuller discussion of the actuarial calculation and the recommendations is available in *Reports of the 1971 Advisory Council on Social Security*, H. Doc. 92-80, 92 Cong. 1 sess. (1971).

7. H.R. 1 provides for automatic increases in benefits for changes in the cost of living, to be financed by automatic increases in the wage ceiling.

Table 6. Actual and Proposed Combined Employee-Employer Tax Rate, OASDI and HI, 1972–2011 and After
Percent of taxable wages

Year	Present law	H.R. 1	Mills proposal: With medicare for disabled	Mills proposal: Without medicare for disabled
1972	10.4	10.8	11.6	10.4
1973–74	11.3	10.8	11.6	10.5
1975	11.3	12.4	11.6	10.5
1976	11.7	12.4	11.6	10.6
1977–79	11.7	14.8	12.4	11.2
1980–86	11.9	14.8	12.4	11.4
1987–2010	12.1	14.8	12.4	11.6
2011 and after	12.1	14.8	14.8	14.0

Sources: See Table 5.

ary 1, 1972. Historically, Congress has never legislated retroactive increases in either the tax rate or the wage ceiling. Even if it followed its precedent in this case and failed to raise the ceiling retroactively, passage of the 11.6 percent rate would incur the loss of at most $1 billion.

THE IMPACT OF INCREASED WITHHOLDING

The third major change affecting the fiscal outlook is the large increase in individual income taxes withheld (see Table 7). This increase resulted from a change in the withholding tax schedule designed to correct for underwithholding, and developed in spite of an accompanying liberalization in personal exemptions and in the low income allowance. In addition to the exemptions for each member of the family, an additional exemption can be claimed if the taxpayer is single or if one member of a married couple is not employed. If all the potential exemptions of these new types were claimed, eligible taxpayers with annual incomes of up to $17,000 would experience, depending on marital status, sizable reductions in their withholdings. In addition, a taxpayer can claim additional exemptions if his itemized deductions exceed certain ratios; for example, a taxpayer with income of $8,000 or less can claim one additional exemption if deductions are between 20 and 30 percent of income, two if they are between 30 and 40 percent, and so on.

The first quarter 1972 estimate for personal taxes (national income

Table 7. Percentage Change in Amount of Individual Income Taxes Withheld, by Selected Annual Wages, Marital Status, and Family Size, 1971–72

Annual wages	Single person	Married couple: No children	Married couple: 2 children
$ 3,600	14.8	23.0	[a]
6,000	6.0	3.8	−0.9
8,400	7.7	2.4	−1.1
10,000	6.2	1.8	−0.9
14,400	5.6	7.1	2.0
20,400	15.9	12.7	9.0

Sources: Commerce Clearing House, *New Federal Graduated Withholding Tax Tables Effective January 16, 1972* (CCH, 1971), pp. 14, 15, 24, 25; CCH, *New 1971 Federal Graduated Withholding Tax Tables Effective January 1, 1971* (CCH, 1970), pp. 14, 15, 24, 25.

a. Withholding was increased from zero to $0.60 a month.

accounts basis) of $103.9 billion—an increase of $10.9 billion at annual rates over the fourth quarter of 1971—argues that relatively few taxpayers amended their exemption statements to take advantage of the liberalized exemption provisions. The actual first quarter taxes were roughly $3 billion ($12 billion at annual rates) higher than what was anticipated consistent with the projected total of $91.3 billion for the fiscal 1972 year.

Perhaps with the final settlements on 1971 liabilities now past and with the publicity given the new exemptions, more people will adjust their withheld taxes. Even if they do, however, some of the withheld taxes already received will mean excess withholding for the year and larger refunds than otherwise would have been made in the spring of 1973. The increased withholding, bigger refunds, and changes in social security benefits will shift the timing of the fiscal stimulus planned in the 1973 budget.

THE IMPACT OF REVENUE SHARING

At this writing, the House Ways and Means Committee has reported out the revenue sharing bill, but its prospects remain uncertain. This delay obviously has reduced by $5 billion the annual rate of federal spending during the first half of 1972. If the bill is enacted promptly, the payment for the full calendar year may be made during the second half.

Table 8 shows the full employment expenditures and receipts adjusted for these changes. These estimates assume that the retroactive payment for revenue sharing will be made after midyear.

Table 8. Full Employment Expenditures and Receipts by Half Years Adjusted for Possible Changes, National Income Accounts, Second Half 1971–First Half 1973

Billions of dollars, seasonally adjusted annual rates

Budget item	*1971* Second	*1972* First	*1972* Second	*1973* First
Expenditures[a]	223.8	243	252	258
Possible changes				
Increase in social security benefits	...	...	6	6
Delay in revenue sharing	...	−5	5	...
Total	223.8	238	263	264
Receipts	227.7	235	246	257
Possible changes				
Social security taxes				
Delay in increase in wage ceiling	...	−2	−3	...
Increase in rate to 11.6 percent	...	...	...	+3
Accelerated withholding	...	+11	+10	+10
Refunds[b]	...	...	...	−10
Total	227.7	244	253	260
Surplus or deficit				
Adjusted	3.9	6	−10	−4
As originally planned	3.9	−8	−6	−1

Sources: Table 4 and author's estimates.

a. Adjusted for the prepayment of welfare expenditures. See Table 2, note *c*.

b. If, as assumed here, the overwithholding continues through calendar 1972, the refund will be shown in the NIA accounts on a seasonally adjusted basis at an annual rate of $10 billion in each half of 1973. However, the actual cash refunds will be heavily concentrated in the first half of the year.

The excess withholding drops to $10 billion in the second quarter and will remain at that level for the rest of the year. Under these assumptions, no fiscal stimulus is recorded in the first half of 1972, in marked contrast with what was planned. Instead, a sharp fiscal stimulus will appear in the second half of the year, arising partly from the retroactive payment for revenue sharing to state and local governments. Its impact on the economy will depend on the rate at which the state and local governments spend it.

What happens in the first half of 1973 depends on the social security tax rate that is finally legislated (an 11.6 percent rate effective January 1, 1973, is assumed in Table 8) and whether withheld tax rates are adjusted, either by legislation or because individuals file the new exemption form. If the overwithholding continues and social security tax rates are raised, the budget would move toward restraint in the first half of 1973, even though it would show a $4 billion full employment deficit (on the NIA basis) for that period. If the overwithholding is wholly or partially eliminated, the deficit would be larger. On the other hand, if part of the increased withholding reflects increased liabilities, the deficit will be smaller. Even if the changes are not as dramatic as those shown in Table 8, the fiscal 1972 budget is turning out to be much less stimulative, and the 1973 budget much more stimulative, than planned.

Discussion

WILLIAM BRAINARD SUGGESTED that the shift in the fiscal position due to overwithholding might have a substantially smaller impact on economic activity than would other fiscal actions of the same dollar amount. The permanent income hypothesis and, indeed, any theory of rational consumer behavior would put more weight on the size of tax liabilities than on the timing of tax payments. James Duesenberry replied that part of the problem associated with overwithholding is that most taxpayers do not know what is happening and cannot identify the drop in their take-home pay as purely transitory. Nancy Teeters and Barry Bosworth noted that increases in withholding were pronounced in the income brackets between $6,000 and $15,000, and also among single people, and married couples without children. They expected such groups to have particularly high marginal propensities to consume. Thomas Juster suggested, however, that the overwithholding is closely linked to home ownership, affecting particularly people who itemize large deductible home ownership costs; and he regarded this phenomenon, by and large, as concentrated toward the upper end of the income scale.

Arthur Okun wondered about the timing of the impact of any revenue-sharing payments that might be made later this year. He suspected that a payment to states and localities in the closing months of 1972 would not significantly increase expenditures of these governments or reduce their taxation within 1972. Bosworth concluded, however, that, even allowing for lags, the fiscal prospects outlined in the Teeters paper pointed to a new budgetary stimulus to economic activity late in 1972 and early in 1973.