FEDERAL BUDGETING IN TODAY'S ECONOMY

Remarks by Mr. Robert P. Mayo
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It is indeed a pleasure to be with all of you today. I always feel at home with accountants since I had a major in accounting in college myself, although I will confess that I never went through the rigors of preparing for the CPA exam. This accounting background has held me in good stead, not only as an auditor for the Washington State Tax Commission but also in many other ways, including my work as staff director of President Johnson's Commission on Budget Concepts.

Government accounting, of course, has a life of its own, and its tie in with the budget process is of critical importance. Simply stated, the Federal Government's budget is the financial plan which the President submits annually to the Congress. It is embodied in documents running to some two thousand pages of data and descriptive detail, classified and analyzed in a great many different ways to satisfy the needs of the Congress whose responsibility in the budgetary process is to authorize the spending needed to run the Government--and of the scholar, the financial community, the news media and the public at large.

As a financial plan the budget is concerned with resource allocation and the determination of national priorities. Initially, the budget indicates the share of resources taken by the government and, thus, the allocation of resources between the private and

Federal sectors. But it also establishes priorities within the Federal sector and by way of Federal grants influences the share of resources taken by State and local governments, as well as the composition of spending. Through its influence on financial markets, the Federal budget affects the availability of funds and interest rates and, thereby, investment and consumption decisions in the private sector.

Because of the pervasive influence of Government spending, an orderly process of resource planning and firm control over spending is essential if we are to meet the objectives of many individual programs with the resources available. But the President's budget is never intended as an accurate projection of how any Administration feels that the upcoming year will in fact turn out. This may seem like a startling statement, but really it is not. The President's financial plan logically includes much proposed legislation; some of this is on the tax side, some is on the side of revenue other than from taxes as for example an increase in postal rates (although this is technically recorded as a negative expediture), some will entail the request for extension of certain excise taxes, or a request for imposition of a surtax. Frequently, the budget will request the adoption of a new tax, such as that recently proposed for lead used in the manufacture of gasoline. In due course, some of these proposals will be accepted by the Congress, but some will not. The actual outcome may be very difficult for the President to predict.

On the expenditure side, the President may propose the elimination of marginal programs as he did in February in offering the Economy Act of 1970 designed to terminate literally dozens of established Federal activities. Inevitably, too, there will be suggested increases in on-going programs and often proposals for wholly new Federal activities--each bearing a set of price tags reflecting the best estimates that can be put together on its likely cost. Proposals such as these are all a legitimate part of his financial plan and full details on them should be included in the budget presentation as part of total expenditures, total receipts, and the resulting surplus or deficit.

The President is fully aware, of course, that his recommendations will receive a mixed response on Capitol Hill. He may feel, for example, that on average they have only a 50 percent chance of success insofar as Congressional enactment is concerned. But surely no one will argue that he should leave 50 percent of them out of the budget--if, indeed, he knew which 50 percent--because to do so could easily result in no financial plan at all other than a continuation of present legislation.

It is inevitable, then, that regardless of which political party is in power there will be a tendency toward Congressional unwillingness to follow Administration recommendations to either cut expenditures or to add to revenues. Moreover, the Congressional response to the Administration's fiscal plans will reflect the pressures on Congress to spend over and above the budget, coupled with the understandable reluctance of the lawmakers to face up fully to the tax implications of expenditures. It logically follows, then, that there is a tendency for the Administration's financial plan to show a larger surplus (or a smaller deficit) than final results will eventually show. When this is combined lower than expected levels of corporate income, and higher than expected payments to the unemployed--the situation we find ourselves in this year--it is no wonder that the actual results may seem disappointing in relation to the original projections. I must suggest, however, that--as I said long before I left Washington--it still appears that the Nation has not yet gone on a spending spree as far as the fiscal year 1971 is concerned. Indeed, if it were not for the fall in economic activity (an essential price that has to be paid if we are to contain inflation), we would be headed toward a budget surplus rather than a budget deficit. The deficit in prospect, moreover, serves the constructive purpose of cushioning the economy's weakness and resisting any tendency otherwise for the weakness to cumulate in a downward spiral. Whether this will still be true in 1972 or not, is still an open question.

Accounting and budgeting in the Federal Government present many problems--other than those just arising out of sheer size--that are of far less concern in corporation accounting and budgeting. Those of you who have spent your lives in corporate accounting have at least been able to feel somewhat secure in defining your universe. Even with a corporation having many subsidiaries, the problem of definition is not unduly complicated.

Debate about the proper definition of the Federal Government is unending, however, and was put to rest only temporarily by decisions of the President's Commission on Budget Concepts in 1967--decisions accepted by both the Johnson and Nixon administrations. Obviously, controversy over the definition of the Federal Government has to do with agencies and activities at the margin. No one questions the practice of detailing the Defense Department's and the Commerce Department's receipts and outlays in the budget, but what about the quasi-public corporations? What about a so-called fully private agency such as the new Fanny May, which has succeeded to the powers and responsibilities of a predecessor that was a full-fledged member of the Federal establishment?

Among the major purposes of the President's Commission was the development of a unified budget which would have close to universal acceptance. A concept was needed which would eliminate the growing confusion arising from the common use in the earlier 1960's of three budget concepts--a practice that went far toward discrediting the whole budget presentation because of the open invitation to select and use whichever budget concept served to prove a particular point.

Serious consideration was given by the Budget Commission to a concept of the Federal Government which would embrace all Federal agencies--even those whose capital stock was all privately owned. The unwillingness of the Congress to place agencies such as the Federal Home Loan Banks and the Federal Land Banks under the Government Corporation Control Act, and, therefore, under the Budget and Accounting Act, doomed that effort to failure, however. This is true despite the fact that these agencies quite openly are considered as Federal agencies in all of their borrowing operations--thus entitling them to a better borrowing rate than they would enjoy if they borrowed in the regular corporate security market.

The Budget Commission did, however, agree to include the Federal National Mortgage Association, the Federal Intermediate Credit Banks, the Banks for Cooperatives, the Export-Import Bank, the Tennessee Valley Authority, the Farmers Home Administration, and the Rural Electrification Administration within the proper definition of the Federal Government since, in no case, was there full private ownership.

Despite its lack of all-inclusiveness, this expansion of the traditional concept of the budget represented a victory for proper definition--but the victory was short-lived. The first three agencies mentioned were so eager to get out from under budget control that they were able in the latter days of the Johnson Administration to secure the necessary legislation to have their government capital stock paid off, thus putting them outside of the budget. This was a serious blow to the comprehensiveness of the budget, and, although there was no further erosion during my term as Budget Director, the pressures were very strong to take other agencies out of the formal domain of the Federal Government. In recent months, these have led to introduction of legislation to exempt the Export-Import Bank from the budget, and, if this move is successful, it will doubtless encourage others who seek to have the budget's integrity eroded further.

The broad definition of the Federal Government is under attack in other quarters. It was the unanimous recommendation of the Budget Commission--again accepted by both the Johnson and Nixon Administrations--to include trust fund receipts and expenditures in the budget. From both an accounting and economic point of view, the activities of the trust funds are truly activities of the Federal Government even though trust fund receipts and expenditures are carefully segregated and fully invested in the same kinds of U. S. Government securities that are purchased by banks and insurance companies, corporations, State and local governments, and individuals. The only way to appraise the overall impact of the Nation's tax structure is through a full disclosure of all tax sources and the only way that the Federal budget can make any sense as an effective instrument of resource allocation is by consdering all of the ways in which money flows into and out of the Federal Treasury. The economic effect of the deduction from a worker's paycheck for Social Security taxes is no different from the effect of a similar dollar deduction for his income tax. Similarly, from an economic point of view it makes no difference to a retired veteran that as a technical matter one of his monthly checks comes out of the social security trust fund and the other comes out of the Treasury's general tax revenues. Yet, even though four members of the Budget Concepts Commission were senators or congressmen, the Congress has shown increasing unwillingness to accept the idea of the unified budget's inclusion of the trust funds. Thus bipartisan opposition has thwarted full implementation of the unified budget as proposed by both Democratic and Republican Administrations, particularly as it applies to that peculiarly American instrument of expenditure "control"--the public debt limit.

The Budget Concepts Commission came up with two other unanimous recommendations which still are far from fully implemented. One of them is the proposal that the entire

Federal Government be placed on an accrual accounting basis. The budget today is essentially a reflection of "cash flow" without full reflection on a prompt basis of changes in Federal Government spending plans--particularly in public works and procurement--or significant shifts in income tax revenues. The latter shifts, although less significant now than they used to be because of pay-as-you-go for both corporations and individuals, nevertheless, can be quite important during a period of sudden shifts in economic activity. The former can be even more significant in understating a defense buildup, as in 1966 and 1967, or in overstating spending in periods of declining defense activity, as at the present time. Unfortunately, the Defense Department has still, after many years of work, been unable to come up with satisfactory measures of accrued spending even though accrual accounting is now quite firmly established in most of the rest of the Government. Until the Defense Department can overcome some of these obstacles and until the Treasury Department can estimate with greater confidence corporation tax accruals, we are still disappointingly short of the Budget Commission's goal on accrual accounting.

Little progress has been made on the Budget Commission's recommendation that Government subsidies be properly identified and evaluated so that they can no longer be hidden as part of Government figures on loans. It is quite likely that little progress will be made as long as the obstacles to effective accrual accounting have not been surmounted--if only for the very practical reason that many of the same people are involved in both projects.

This interest in budgetary concepts and procedures is essentially a reflection of concern about effective resource planning. And nowhere was this concern more evident than in the 1971 Budget. The budget made a break with tradition by taking a comprehensive and systematic look at the future--another step growing out of Budget Commission recommendations in 1967.

Long-range projections of Government finances had not been published in the budget before. I am glad to have played a role in this innovation. Such projections are an essential part of an enlightened discussion of public policies, even though precise figures are, of course, not possible.

The reason for the interest in the long-range implications of budget decisions is no surprise to anyone who is even a casual student of the budget. The ability of either the President or the Congress to control budget outlays is limited by the long-range impact of past decisions. If we are to achieve greater control, therefore, we must begin to make program and budget decisions in the context of a longer-range view.

The controllability problem, which has such an important effect on our ability to reorder priorities, is undoubtedly well known to you. Stated simply: In the short run, a large portion of budget outlays is not subject to discretionary control.

Programs that are uncontrollable under existing legislation dominate the budget. The disproportionate growth of relatively uncontrollable programs in recent years--from 64% of total outlays in fiscal year 1969, to 66% in 1970, and 69% in 1971--is a measure of the problem. The lesson is clear. Long-range implications of today's budget decisions can be ignored only at great risk--both to our economic well-being and to our ability to meet the urgent needs of tomorrow.

The principal value of long-range projections is to measure in broad, general magnitudes the gap that may exist in the future between Federal revenues under existing and currently proposed legislation and projected Federal spending for programs proposed in the budget. The difference between Federal receipts and outlays may be called a "margin remaining for new initiatives" --tax reduction, debt reduction, a surplus for housing, or new or expanded spending programs. The margin can be increased, of course, if we can cut further into the existing budget base, or if we decide to raise taxes to finance urgently needed programs or to provide a surplus which in turn would permit greater credit availability in the financial markets.

Almost certainly, the budget five years down the road will not fit any projection that might be made now. For example, the $22 billion margin projected for 1975 in the 1971 budget is not available for spending now and--because of actions taken in the interim--undoubtedly will not be available by the time we get to 1975. Clearly, in fact, the projections serve the important function of highlighting the fact that our resources are not likely to be sufficient to satisfy all potential meritorious claims on them.

This type of approach does not provide a solution to the problem of allocating limited resources, but it does suggest a framework for improving decisions on budget policy. We must all realize, of course, that regardless of how useful such analytical approach is to the President in preparing his plans, the Congress doubtless will have its own ideas of resource allocation--and it has the last word for all practical purposes.

Certainly, as soon as the margin was indicated, many groups were bidding about their share of the pie. Each of us has different priorities, and these differences always will be--as they are now--the source of much debate. These differences are resolved through the budget process--as the President makes his budget recommendations and the Congress acts on them. Budget formulation is, therefore--as it must be--a highly political exercise in the American democratic system.

But clearly the practice of evaluating programs solely on the basis of costs in the current and next years' budget is no longer acceptable. By introducing published long-range projections into Federal budgeting, a broader perspective is provided in which the annual budget process can be carried out by the executive branch, the Congress, and the public.

In concluding, I want to emphasize to all of you here today that despite the remaining shortcomings, and, despite the fact that we have a great deal yet to learn in the evaluation processes which must lie at the heart of good budgeting, we do have a budget system in the country second to none in the world. The Administration is continually frustrated by the fact that the Congress, unlike a parliamentary system, has an independent view on many parts of the budget process. But the advantages of adequate checks and balances in our system of government far outweigh these frustrations. Despite the great need for improvement in our delivery system of Government programs, and despite the crying need for better management of the biggest enterprise on earth, there is still, hopefully, less waste of resources than in many other nations of the world.