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THE BUDGET DILEMMA

It is a pleasure for me to appear before this group today to discuss one of my favorite subjects: The Federal Budget. Those of you in this room have both the talent and the opportunity to contribute in an important way to the solution of the problems we are discussing today. My current responsibilities center on monetary policy problems rather than on fiscal problems. But let me assure you that monetary policy cannot be isolated from fiscal policy. This is particularly true when we are faced with recurring large federal budget deficits which must be financed in an efficient and orderly manner. Failure to control fiscal policy properly tends to produce an environment where monetary policy operates with less than optimum efficiency.

I am appearing before you today as a private citizen, but one who has had the rare opportunity to have participated in extensive study of the Federal Budget, in its preparation, presentation, and interpretation to the Congress, and in the supervision of its execution. I would not have foregone that opportunity for anything. Yet I must admit that I am not in the least disappointed that someone else is carrying that burden today. The problems of management of federal revenue and expenditure have become even more difficult than in my days as Budget Director.

During the last few weeks of the ninety-second Congress, particularly during the hectic debate over the spending ceiling, the standard cliché in the press, frequently repeated in speeches in both the House and Senate, was that the Federal Budget was out of control. The implication of some of the more lurid articles was that the whole revenue raising and appropriation process had become so unwieldy that we were doomed to a fate of ever-mounting deficits, expenditure programs growing without any restraint, poor resource allocation, and the death-dealing inflationary blow which would inevitably result. If that is the meaning of saying that the process is out of control then I consider the statement an exaggeration. If that is the fate which overtakes us then it will not be because we lack the ability to control the process, but because we lack the will to do so.

The concept that the budget is out of control still does, however, have meaning in some important ways. There was a time in our history when a deficit in federal fiscal operations carried with it the stigma of mismanagement. We have since then learned that deficits are sometimes necessary, indeed beneficial, to the nation's economy. Through a series of business cycles we developed, and, in large measure successfully applied, the concept of federal deficits when the economy slowed and surpluses when it showed signs of overexpansion. Out of this gradually evolved the concept of the balanced full employment budget. The theory is that if government expenditures are at a level which would give balanced operation in a prosperous, but not excessively exuberant economy, budget surpluses and deficits would automatically arise as needed to slow down or speed up economic activity. This is a very appealing idea. It seems to fit in with the computer world and the self-regulating efficiency of the automated factory. For all I know it

might even work, if given a chance, but it has never been tested. Instead of balance, we tend to use the full employment deficit to convince ourselves that we were not really overspending as much as the books seemed to show. So this is one sense in which federal expenditure is out of control. We have developed a willingness to appropriate funds without reference to the revenue needed to finance those expenditures. A large deficit made good economic sense in fiscal 1972. The economy had plenty of surplus capacity, and stimulus was clearly the correct prescription. It continues to make some sense during fiscal 1973, although the present rapid recovery implies that stimulation of the economy will be less and less desirable as we approach the maximum efficient utilization of our resources. A large deficit in fiscal 1974 would, in my judgment, run serious risks. We would be sowing the seeds of a new inflationary cycle; we would indeed be approaching a fiscal situation that was out of control.

Another sense in which the words "out of control" have important meaning is with respect to the way in which expenditures are determined. In recent years there has been an increasing trend to introduce programs in which expenditures are predetermined for several years to come, removing them from the annual budgetary process of review and evaluation. Some programs must, by their very nature, involve commitments of this type. It would obviously be self-defeating to place Social Security on an annual appropriation basis. It makes less sense, however, to make commitments for several years for programs which warrant year-to-year re-evaluation, or where changing conditions may alter or eliminate the need for them. No new programs are so certain of success in their original form to warrant the protection against periodic critical evaluation that long-term funding provides.

Whether it be a military program like the F-14 or a social action program like the poverty program, if events of the last decade have taught us anything, it is that reviews and recasting or elimination of less than satisfactory programs is essential to intelligent use of our resources. "Fly before you buy" makes at least as much sense for social action as it does for procurement of the F-14. In fact, it is particularly in the area of social action that we have most definitively demonstrated that dollars alone don't buy solutions, and that more dollars cannot be equated with faster results.

These long-term funded programs have been the major factor in our reaching the point where nearly three-quarters of our annual outlays are classed as "uncontrollable" expenses. Many of these items are uncontrollable only in the sense that they are mandated expenditures under existing law. It is at least theoretically possible to reduce them through enactment of alternative legislation by the Congress. However, as a matter of practical politics, curtailing an ongoing program, no matter how outmoded or unsuited to today's needs it may have become, is an extremely difficult task. Continuing or even increasing existing programs, no matter how inefficient they may be, is easier and simpler for the Congress than the difficult task of sifting through alternatives. As we all well know, continuing one's colleagues' programs is more likely to bring favorable action on one's own favorites than curtailing them will do. Nevertheless, when over 70 percent of total spending is preallocated to these existing programs there is very little room for new initiatives. The problems of the 1970's are not going to be attacked successfully by the approaches of the 1950's and '60's. Thus in a second sense the federal expenditure program is out of control. Ongoing programs take up so much of the total that new initiatives die

still-born.

A third way in which we can view the fiscal process as being out of control is the fact that our existing revenue sources are over-committed. In January 1970, Paul McCracken and I broke new ground by publishing a 5-year projection of present programs in the Federal Budget and the environment in which that budget might be likely to operate in the budget documents and the President's economic report. This was not the first time, of course, that careful studies had been made of the outlook for the economy and the Federal Budget within the Administration. But they never saw the light of day before 1969, as the Executive branch worried about the political ramifications of such projections. They were concerned that detailed projections might give too much aid and comfort to Federal bureaucrats administering specific programs. These objections were overcome by avoiding detailed projections for individual programs and concentrating on the "big picture."

The appearance of these figures--and they have continued each year since--stimulated two of my Budget Director predecessors, Kermit Gordon and Charlie Schultze of the Brookings Institution, to get going with their long-considered project of publishing an independent critique of the Budget each spring. In their current analysis, "Setting National Priorities--The 1973 Budget," the Brookings group, with Nancy Teeters playing a major role, has made a persuasive case for the fact that, if we continue as we are now going, with no major new programs and no significant new taxes, and if further, we are operating with a full employment economy, we will, perhaps, have a small surplus, or, if you will, leeway for a new program or two by 1977. However, between now and 1977, revenues will not be enough to cover the cost of the commitments we have already made. Since the time of that study, the Congress

has made additional changes and commitments which have probably placed the time when our tax resources and our appropriations are balanced still farther out in the future than 1977. Other studies of the subject-- the recent study by the American Enterprise Institute for Public Policy Research is just one example--have reached the same conclusion. In fact about the only difference between these various studies is where in time they place the date when revenues would again equal appropriations-- 1977, 1979, even 1980.

Now it is as obvious to both the Administration and the Congress as it is to you and me that continued deficits, particularly at high levels of employment, cannot be permitted to persist. The Administration's immediate solution for fiscal 1973 was to ask for a spending ceiling which would override the appropriations and backdoor spending already authorized. It is very clear from the debates and from the near passage of this limit, that an important part of the Congress was sympathetic to the need of such a limit. It was unfortunate that, in the rush to adjourn, an implementing mechanism meeting congressional approval could not have been devised. Despite the failure to get such a limit, the Administration has undertaken to hold spending significantly below the level which would occur if all the appropriation actions of the Congress were fully implemented. I applaud the idea of legal limit--although reluctantly. I say "reluctantly" because such limits are stop-gap measures, not substitutes for a well thought-out system of priorities for allocating our resources. Nor can they substitute for increasing our revenues by carefully considered tax legislation if, indeed, the higher level of spending truly represents the public's need and demand for that large a federal share of our total national capability. As long as we continue to appropriate funds without reference to the resources to meet them, and we then depend on "across-

the-board" or related restraints to substitute for hard priority decisions, the expenditure process is "out-of-control."

And there is yet another way in which I think the words "out-of-control" have real significance. The question can well be raised as to whether the process itself may be out of control. This is perhaps the key to the whole difficulty because all of the other problems--recurring deficits regardless of the economic climate, long-term appropriations to indeterminate programs and the resulting high "uncontrollable" proportion of the budget, and overcommitment of our revenue resources--all result from weaknesses in the total resource allocation process itself. Early in 1973, the President will be submitting the budget for fiscal 1974 to the Congress, as he is required to do each year by law. This document will be the culmination of the work of well over a year by a large, diversified, and highly competent staff aimed at summing up the Administration's views of our national priorities insofar as they can be described in dollar terms. But this is just one step in the process. The next, and perhaps most important, step is the enactment of the necessary authorization and appropriation legislation by the Congress, implementing the budget with those changes which properly result from legislative consideration. The Congress will undoubtedly continue to act on the budget piecemeal. The end result will not have a direct relationship to a carefully thought-out fiscal program. The mechanism just does not exist, as the Congress is now organized, to insure any other kind of result.

The end result of the budget authorization-appropriation process ought to be a carefully constructed plan which, within the resources provided by taxes, adequately reflects the nation's needs for operations that can best be carried out on a national level with

due regard to providing for a surplus or deficit which is in line with the state of the total economy. This does not require the Congress to slavishly follow the detailed recommendations of the White House, but it does mean that departures from the budget ought to be made through an independently reasoned, consistent process which always keeps the total result in view.

I do not mean to imply that the present Executive branch process of preparing the budget could not stand improvement. In fact it has several defects. Expenditures of certain Federal agencies are not even included in the budget. The budget inevitably has political overtones, and it must always be prepared with an eye to the vast sum of "uncontrollable" items which are, indeed, very difficult to change even over a period of many years. It would be pleasant to be able to weigh each individual expenditure by clean analytical techniques and select only those that get a certain minimum passing grade, but the appropriate analytical techniques don't often exist, and, even if they did, there are unescapable emotional and political considerations which would elude the computer. Nevertheless the budget is currently the one place where the whole operation of government can be scrutinized as a unit and where, annually, the Administration commits itself to a total program for the coming year. It defines the economic climate the Administration plans to foster, it delineates the program priorities which the Administration sees as the appropriate expression of the public will, and it even defines the stance the Administration expects to take with regard to international relationships.

We have reached a point in time where it is essential that the congressional responsibility for resource allocation is performed

with the same emphasis on the total outcome which is given to the preparation of the budget by the Executive branch. There are several possible frameworks within which this kind of deliberation can be accomplished. One approach, which I, among others, have advocated in the past, is the establishment of a joint congressional committee on the budget. Such a committee, with a staff large enough to make a critical review of the budget, would be in a position to provide Congress with an independent judgment of the budget, one which, when adopted, could provide defined limits within which the committees and subcommittees charged with specific authorization and appropriation responsibilities could work.

There is already an encouraging step in this direction. One of the provisions of the bill that passed at the end of the last session and raised the public debt limit, but failed to impose the spending ceiling, set up a temporary joint committee to study the resource allocation problem and to recommend a course of action to the Congress. This could lead to substantive reforms. I hope it will bear fruit in time to have a significant impact on the fiscal program for 1974. For, whether the 1974 and successive spending programs are determined piecemeal or with proper consideration of the total position of the government, we are going to make important decisions in 1973 about our fiscal position over the next several years. We have only three choices available to us:

1. We can limit our spending to coincide with the resources available from our present tax structure.
2. We can initiate additional spending programs, and simultaneously provide new tax revenues to finance them.

3. We can continue to add spending programs without providing the corresponding tax revenue and accept the renewed inflation which further deficit spending would bring.

Either of the first two are choices which could be made on rational grounds. The Administration has stated that it has selected the first choice for its planning, and, if my reading of the election results is correct, the public generally is opposed to a fiscal approach which requires higher taxes. And if what I hear is at all correct, the present sense of the Congress is opposed to increasing taxes as well. Yet without some mechanism designed to keep expenditures within a predetermined goal, even a mechanism as crude as a spending ceiling, I fear that authorized expenditures will continue to outrun revenues. This would mean we have inadvertently selected the third path of expanding deficits and inflation. This is the path of least resistance --the truly negative approach. But we should not deceive ourselves. Inflation is, in a sense, an added tax burden, just as real in its impact on the average citizen's pocketbook as an increase in income tax. In fact it should be borne in mind, particularly by those who feel strongly that all taxation should be neutral or progressive, that it is hard to design a tax more regressive than the impact of inflation.

Thus if we want to regain control of our expenditure machinery, the primary opportunity lies in the hands of the Congress. The Constitution places the formal responsibility for appropriation and revenue measures in its hands. The opportunity to reorganize to fulfill that responsibility in an orderly, reasoned, and efficient manner is also within the reach of the Congress in this new session.