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The Battle for Fiscal Policy Control

It is a pleasure to talk with you today about one of my favorite subjects: The Federal Budget. It's a serious subject but colorful, too. It is often edged in blacks, and when it is deeply in the red it can make you pretty blue.

While my present responsibilities center on the problems of monetary policy, let me assure you that monetary policy, cannot be isolated from fiscal policy. This is particularly true when we are faced with large federal deficits which must be financed in an orderly and efficient way. When the Federal government imposes continuing large demands on the nation's credit markets monetary policy must be conducted in an environment which is far from optimum. But my interest in the problems of the Federal Budget arises not only from its impact on monetary policy, or even from my interest as a private citizen and taxpayer. I have had the opportunity to participate in an extensive study of the Federal Budget, in its preparation, in its presentation and interpretation to the Congress, and in supervision of its execution. While I would not have foregone that experience for anything, I must admit that I do not envy those carrying that burden today. The problems of management of federal revenue and expenditure continuously increase.

The President's budget for fiscal 1974 was submitted to the Congress six weeks ago. It is less than four months until the new year begins. The kinds of action which Congress takes on this budget will have a major impact on the nation's fiscal well-being for many years to come. In making its decisions on expenditure levels and program priorities for the coming year, the Congress will be selecting which of the three fiscal paths available to us is the one we are going to follow:

1. We can limit our spending to fall within the resources available from our present tax structure.
2. We can keep all our present spending plans and maybe even initiate some new ones, while simultaneously providing additional taxes to finance them.
3. We can continue to add spending programs without providing the corresponding tax revenues, accepting the renewed inflation which further large deficit spending would make inevitable.

Either of the first two choices could be made on logical grounds. The Administration has selected the first as its path by limiting fiscal 1973 spending to \$250 billion, substantially below the level implied by appropriations and by presenting a budget for 1974 which is a major step toward slowing the rate of growth of Federal expenditure. Most political observers have interpreted the results of last fall's election and the subsequent mood of public opinion to mean that the national consensus opposes any fiscal approach which involves further tax increases. And it seems rather clear at the moment that the present mood of the Congress

is opposed to increasing taxes as well.

So we come back to the first choice as a practical matter. Yet without some mechanism designed to keep expenditures within a predetermined goal, we run the risk 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 proportional or progressive, that it is hard to design a tax more regressive than the impact of inflation.

Late last year 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 severe inflationary blow which would inevitably result. The restraints on spending for the balance of 1973, the restrained mood of the 1974 budget, and the apparent consensus in the Congress that spending must be confined within the President's proposed level of about \$269 billion demonstrate that we have not yet let the system get too far out of our control. If that is the fate which eventually 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 have developed, and in large measure successfully applied, the concept of federal deficits when the economy slowed and surpluses when overexpansion threatened. 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. Thus far, however, the concept has been used to convince ourselves that the deficits were smaller than the actual numbers showed rather than striving for balance. This viewpoint contributed toward the development, in recent years, of 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 unused capacity, and stimulus was clearly the correct prescription. It continues to make some sense during fiscal 1973, with 5 percent of our labor force still unemployed, although the present rapid recovery makes it clear that stimulation of the economy is less and less desirable as we approach the maximum efficient utilization of our resources. A deficit in fiscal 1974 larger than the President has proposed 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 many 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 benefit payments on an annual appropriation basis. It makes less sense, however, to make commitments for several years for programs which warrant year-to-year reevaluation, 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 or a human resource 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 as much sense for community action programs as it does for procurement of the F-14. In fact, it is particularly in the area of human resources 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 three-quarters of our annual outlays are classed as "uncontrollable" expenses. Many of these items are defined as uncontrollable 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, voting to continue a colleague's programs is more likely to bring favorable action on your own pet projects than curtailing them will do. Nevertheless, when 75 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 or the 1960'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 are still-born.

Had the fiscal situation remained as it was left by the last session of Congress there was a third sense in which the overall budgeting process had gotten out of control. The combination of the cost of the "uncontrollable" portion of the budget with the minimum foreseeable growth rates in the "controllable" area totaled up to expenditures which would outpace revenues for several years to come. Our revenue resources were over-committed. In January 1970, Paul McCracken and I encouraged the President to break new ground by publishing five-year projections of present programs in the Federal Budget as well as 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 longer run outlook for the economy and the Federal Budget within the Administration. But they never saw the light of day before 1970, 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 been continued and expanded each year since--stimulated two of my Budget Director predecessors, Kermit Gordon and Charlie Schultze of the Brookings Institution, working with another long time student of Federal expenditures and a former associate of mine, Nancy Teeters, to get going with their long-considered project of publishing an independent critique of the Budget each spring. In their analysis of setting national priorities in the 1973 budget the Brookings group made a persuasive case for the fact that, if we continued as we were then going, with no major new programs and no significant new taxes, and if further, we were operating with a full employment economy, we might have a small surplus, or, if you will, leeway for a new program or two by 1977. However, between now and 1977, revenues would not be enough to cover the cost of the commitments we had already made. Since the time of that study, the Congress made additional changes and commitments which would have placed the time when our tax resources and our expenditures were balanced still farther out into the future than 1977.

The Administration has now mounted a three-pronged attack on the fiscal problem to insure that this dismal outlook does not occur. It has done this through:

1. Impoundment of appropriated funds to restrict fiscal 1973 spending to \$250 billion, the level proposed as a spending ceiling to the last Congress, but which was not enacted.

2. Proposals to reorganize the Executive branch to administer more efficiently the expenditure of tax receipts.
3. Redirection, alteration, and, where advisable, elimination of a wide range of programs to control the total expenditure growth rate to a level well below the growth in revenues.

As might be expected, these actions and proposals have produced a storm of political rhetoric, particularly over impoundment and over the proposed curtailment of certain programs next year. Impoundment has been assailed as unconstitutional, an infringement of the rights of Congress, and unwarranted use of presidential power. I make no pretense of being an expert on constitutional law, but I do know that if impoundment is unconstitutional the first well publicized offender was Thomas Jefferson, and his example has been followed by virtually every president since. However, it is unfortunate that the heat of political discussion has confused the question of impoundment of 1973 funds with the changes in many socially oriented programs which have been recommended for 1974. Impoundment has been made to appear synonymous with massive cutbacks in socially oriented programs. In fact, the impoundment of funds, totaling \$8.5 billion, has only limited impact on social action programs. Well over half the total comes from slowing down three major programs: completion of the Interstate Highway System, naval ship construction and alteration, and the overall Department of Defense construction program. We should also keep in mind that human resource programs now account for 47 percent of the budget, up from 30 percent in 1965. At the same time the defense share of the budget has fallen from 42 percent to less than 30 percent.

The impoundment of funds from the 1973 budget was the inevitable consequence of the failure of Congress to provide direction on holding total spending down last December. It was obvious then that the level of deficit spending authorized for 1973 could not be permitted to persist in the face of rapidly rising employment and resource utilization. The Administration's proposed 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, no implementing mechanism meeting congressional approval could have been devised. Despite the failure to get such a limit, the Administration more heavily than usual leaned on impoundment to hold spending significantly below the level which would occur if all the appropriation actions of the Congress were fully implemented. I would have welcomed a legal limit--although reluctantly. I say "reluctantly" because such limits are arbitrary 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 a larger 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 should 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. The President recently submitted the budget for fiscal 1974 to the Congress, as he is required to do each year by law. This document was 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. 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.

But the preparation of the Administration's budget is only the first step in the process. The President recommends; the Congress acts. So the most important step of all is the passage of the necessary authorization and appropriation legislation by the Congress, implementing the budget with those changes which properly result from legislative consideration. The end result of the budget authorization-appropriation process should 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 proper regard to

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

Unfortunately, unless reform comes with unexpected rapidity, Congress will probably again consider the budget piece-meal this year as it has for too many years in the past. If that is true, the end result again 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. Hopefully that is now changing--but how fast is a critical question.

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 and Federally sponsored 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 complicate the issues.

But 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.

Last December Congress took an important first step in reorganizing its approach to the appropriation process. 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 joint committee to study the whole budgetary problem and to recommend a course of action to the Congress. This could lead to substantive reforms. I still hope it will bear fruit in time to have an impact on the fiscal program for 1974. The Committee's interim report which was released last month is the clearest statement of the problem ever to come from Capitol Hill. Hearings are now being held which are designed to produce specific legislation.

Regardless of whether the Congress organizes itself this spring to handle the appropriation process efficiently or not, we are going to be making decisions this year for 1974 and succeeding years which will affect our fiscal position for many years to come. The President's proposals for special revenue sharing programs for education and for community development represent a second major step along the road toward

more local control which began with general revenue sharing last year. The restraint on the rate of growth implied not only by the 1974 budget, but by the preview of 1975 and succeeding years will result in having more than 10 percent of the 1978 revenue available for new programs or tax reduction. Proper allocation of future revenues can not be done solely on a program-by-program basis. This is the path of least resistance which led to the over-allocation of resources in the first place.

If we are to once again 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 members of Congress have broad contacts with the general population, and they have a responsibility to play a major role in allocating the nation's resources. The opportunity to reorganize to fulfill that responsibility in an orderly, reasoned, and efficient manner is within their reach this session, perhaps even in time to apply to the needs for fiscal 1974. Until Congress acts, a major part of the budget process will remain "out-of-control." We must give our elected representatives every encouragement we can, since fiscal reform is critical to proper control of our economic destiny.