Federal Reserve
Bank of
San Francisco
February 2, 1973

Federal Reserve Bank
of San Francisco
2 1973
LIBRARY

Business & Financial Letter

Reining in the Budget

While it will probably never show up on the list of best sellers of 1973, a thick hardcover green book which appeared this week promises to be one of the more controversial books of the year. The volume carries the not very catchy title of **The Budget of the United States Government, 1974.** Politicians will scrutinize it carefully because it proposes to abolish some of their favorite programs, but economists also will be watching because it is designed to remove at least some of the fiscal stimulus now supporting the business boom.

The document contains estimates of receipts and expenditures for the two fiscal years, 1973 and 1974, but since more than half of fiscal 1973 already has elapsed, its effective time horizon is limited to 18 months. For the current fiscal year, it calls for expenditures of $250 billion and receipts of $225 billion (a $25-billion deficit), while for fiscal 1974, it calls for expenditures of $269 billion and receipts of $256 billion (a $13-billion deficit).

Ceilings and Congresses

Budget-cutting has dominated the headlines for some months past, especially in view of the Administration's determined efforts to reduce expenditures for fiscal 1973 to the $250-billion level. At first glance, this might not appear too difficult, especially when it is remembered that fiscal-year expenditures originally were budgeted at $246 billion last January and were revised to $250 billion last June. But then, it must be remembered that the presentation of the Administration's budget to Congress is only part of the budgetary process.

Upon receipt of the budget, Congress proceeds to pass appropriations bills for the various Executive Departments and to pass tax bills to provide the necessary revenues—but not necessarily in matching totals. The actual budget thus consists of the combined expenditure and revenue actions taken by Congress subsequent to the presentation of the Administration's budget. During fiscal 1973, a number of such legislative additions—plus a certain number of executive actions such as the recent heavy bombing of North Vietnam—have combined to add $10 billion or more to the expenditure totals first proposed a year ago.

These budget figures have a strong economic impact, and in turn the budget is affected by the overall level of activity in the economy. Federal expenditures are a net addition to the income stream, and taxes are a net subtraction from the income stream. In the event that expenditures run ahead of receipts, the resultant budget deficit is considered stimulative; conversely, if receipts exceed expenditures, the budget surplus is considered restrictive.

Why full employment?

To make sense to economists, however, the actual budget figures must be converted to a "full-employment" basis, using a concept which was developed a decade or so ago, and is now widely accepted

(continued page 2)

by politicians and economists alike. According to this concept, the amount of stimulation or restrictiveness in a given budget can be measured more accurately by calculating the levels of receipts and expenditures at an assumed full-employment level of 4-percent unemployment than by relying on the actual budget figures. Revenues would be higher at full employment than at lower levels, because more people are working (and paying taxes) at that level; some expenditures, such as unemployment compensation, conversely would be lower in such a situation.

The full-employment budget concept has served as a useful policy guide throughout the past decade. During the relatively sluggish advance of 1962-63, economists saw that the Federal income-tax structure would yield a substantial surplus at full employment—the famous "fiscal drag"—and so recommended the tax cut which played such a major role in the solid yet noninflationary expansion of the mid-decade. Later, during the overheated Vietnam period, they saw the inflationary consequences of the $25-billion full-employment deficit of fiscal 1968, and so drew the necessary conclusion—the need for an income-tax surcharge to lessen some of the pressure.

Just a year ago, policymakers argued the case for an $8-billion full-employment deficit for fiscal 1972, evidently reasoning that that much of a stimulus would be needed to keep the expansion going. At the same time, they called for a modest full-employment surplus in the fiscal 1973 budget, providing for a relatively neutral (or mildly restrictive) economic impact.

What 1974 will bring

But as of today, the Administration projects a $2½ billion full-employment deficit for fiscal 1973—that is, a mildly stimulative budget—followed by a modest full-employment surplus for fiscal 1974. Thus, today as a year ago, the Administration estimates that the upcoming budget will exert only a neutral impact on the national economy.

The $31-billion rise in "actual" revenues for fiscal 1974 mainly reflects the impact of a fast-growing economy on tax receipts, especially since the budget document contains little in the way of tax-rate changes except for the recent social security tax hike. The $19-billion rise in "actual" expenditures is traceable in part to significant legislative changes in certain programs, especially the recent social-security benefit increase—but the most striking item in this post-Vietnam period is a $4-billion rise (to $79 billion) in defense spending.

With military spending rising in this fashion, most of the proposed cutbacks will show up in civilian programs, highlighted by the trimming or even dismantling of some of the social programs developed during the last several decades. Grants for hospital construction and subsidized loans for construction of higher education facilities are to be ended, in view of the present surplus of hospital rooms and decline in college enrollments. No new funds are to be provided for housing subsidies, although the authorizations in the pipeline will be slightly higher in calendar 1973. Moreover, farm subsidies will be lowered and farm-export subsidies will be terminated.

Complicating factors

The Administration's attempt to rein in the budget began several months ago with the announcement of a $250-billion ceiling on expenditures for fiscal 1973, which implied cuts of perhaps $8 billion concentrated in the current half-year. The task has been complicated, in this as in other years, by the fact that certain major areas are immune to reduction because of permanent authorizing legislation which automatically appropriates budget authority on a recurring basis. For example, social-security benefits are mandated trust-fund expenditures, while interest on the public debt must be paid to maintain the full faith and credit of U.S. Treasury securities.

Economic as well as political planning also can be frustrated by the open-ended nature of the appropriations process. Obligated balances need not be expended during the year the obligations are incurred, while unobligated balances of budget authority can be carried forward from one fiscal year to the next without further Congressional action. Thus, in fiscal 1973, about 39 percent of current outlays can be attributed to earlier appropriations, and about 45 percent of current appropriations will show up in future expenditures.

Looking a half-decade ahead, policymakers are faced with the conclusion of a recent Brookings Institution study, "Full-employment revenues under existing tax laws may not be large enough to match projected expenditures under current programs and policies." At the same time, pressures are building for large additional outlays for major new programs—property-tax relief, educational equalization, pollution control, expanded health care, and so on down the list. In this atmosphere, it will be difficult indeed to rein in the budget so as not to overstimulate a sharply expanding economy.

Herbert Runyon