

LOOKING AHEAD ON BUDGET POLICY

Statement at the invitation of the Subcommittee on Trade, Productivity, and Economic Growth of the Joint Economic Committee, U.S. Congress, March 1986, by C. Lowell Harriss, Executive Director; Academy of Political Science; Professor Emeritus of Economics, Columbia University; Associate, Lincoln Institute of Land Policy; formerly Economic Consultant, Tax Foundation, Inc. Views expressed are the author's and not necessarily those of any organization with which he is associated.

It is always attractive to do good things--with the other fellow's money. Good things for others. Good things for oneself. The attraction of getting the benefits of spending without providing the money! This observation helps to explain the upward pressure on Federal spending and why that pressure will continue--unless human nature changes.

New estimates present a Federal budget outlook fundamentally different from that accepted only a few weeks earlier. The deficit, we are informed, will grow smaller. Yet difficult policy issues must still be faced.

Pressures for Spending

There are many good things that can be done by spending money. There are some that are stupid, selfish, and counterproductive. When the dollars are the other person's taxes--taxes paid by others--or, it may seem, no one's--Federal borrowings--it is easy to focus on the benefits and to overlook the costs.

A volume that I recently (1985) edited, Control of Federal Spending (Academy of Political Science), contains information from many sources about aspects of the broad problem. No member of Congress needs words from an academician to emphasize the power of forces to enlarge Federal spending--and the power of forces to prevent the reduction or ending of programs that do not serve the general public well.

Rising Trends

Federal spending has increased relative to the size of the economy.^{*} Outlays including off-budget amounts were well below 20 percent of GNP (except briefly during Korean hostilities) until Vietnam fighting. The 1969 figure of 19.8 was 0.6 above that of 1959.

Then in the 1970s, even though national defense spending declined (relatively), Federal outlays as a percentage of rising GNP fluctuated but ended the decade 2.3 percentage points--more than one tenth--above the level at the start--22.2 in 1980 and 19.9 in 1971. You may remember as I do a recurring refrain during the 1970s under three presidents. We heard repeatedly of the importance of curbing the rise of expenditure and of the resolve to do so. A new budget process (1974) reflected determination to get more effective control. Yet the 1980 amount was \$591 billion, compared with the \$210 billion of 1971.

^{*} Measuring Federal expenditure presents difficulties, and assessing the significance requires examination beyond money figures. The full influence of commitments will not often appear in this year's outlays. The dollars in Federal grants can have multiplied significance through conditions to which State and local governments respond. Business firms with Federal contracts may alter practices of the entire company. Insurance and guarantees will accrue liabilities not shown currently in governmental accounts.

New Estimates

The OBM estimates 1986 spending at 23.4 percent of GNP, down from the 1985 figure of 24.0 percent. OBM projects a declining rate so that the 1990 percentage of GNP would be under that of 1971 (19.5 versus 19.9). At \$1.1 trillion (eleven hundred times one thousand million dollars), projected spending is almost five times the 1971 amount and 90 percent above 1980. The Congressional Budget Office baseline projections are somewhat higher but also show a dramatic turnaround and significant decline in the deficit.

The five-year increase in Federal debt (OMB) would be more than \$700 billion.

Projecting the economy and the Federal sector calls for specialized effort. I have not devoted the time to feel qualified to do more than suggest reasons for caution in relying on the official projections.

Economic growth can suffer more interruption than assumed. My instincts give me confidence that the economy will perform well. Yet some of the next five years will probably produce lower rates of increase in GNP than assumed in the calculations. Deficits might then be larger by more than negligible amounts. I am not forecasting any major recession.

Expenditures will exceed OMB figures if only because Congress will not accept all of the President's recommendations. (Nor will all fees and other such increases incorporated in the budget proposals be approved.) Spending will almost certainly go up more than assumed. Despite the restraints in Gramm-Rudman-Hollings (GRH), and despite

the talk about control, too many Americans have too strong a desire for the fruits of Federal spending for the fort to hold. Human ingenuity will find ways to get around restrictions. By how much? No one can know. But it seems to me unrealistic to act on the assumption that spending will be held to levels used in projections now before us.

The questions raised in the Chairman's letter of invitation have political as well as economic aspects. The former outweigh the latter, it seems to me; but I cannot limit comments to economic elements because political aspects are intertwined with everything. My observation of governmental processes has extended more than half a century since I began as a university student. Yet a member of Congress has far more knowledge of politics than an outside observer. And politics are crucial.

Rising Public Debt

Are there enough disadvantages to the growth of Federal debt to warrant sacrifices and unpleasantness now? Although the issues are more complex than recognized in typical public comment, a large and growing debt should cause concern. Yet the economy also gets larger. Even big increases ^{in the debt} do not ensure a decline in the worth of the dollar (inflation). Witness the decline in inflation in the last few years. Nor does the need for huge borrowings (debt growth and refundings) inevitably raise the cost of borrowing (interest rates). Witness recent experience as interest rates have come down.

Nevertheless, the interest required does absorb tax and borrowing capacity. Would it not be welcome to have some of those funds for current services? And cumulative increase in debt can build to conditions with ominous prospects although such is not the immediate outlook. Still, much of the present debt is relatively short-term. Refundings always lie ahead. We, the debtors, could face appreciably higher interest bills if (short-term) interest rates were to go up to, say, the 10 percent range of not so long ago--compared with the 6.5 percent range assumed by OMB for 1987 or the 5.4 percent range assumed by CBO for 1991. The bigger the debt and faster its growth, the larger our vulnerability to rising interest rates. At the moment, rising inflation as a source of higher interest rates seems little cause for concern. But conditions can change.

How much American debt will foreigners finance in the years ahead? Perhaps this supply of funds will decline with some upward pressure on interest rates.

Some of us feel that we and others have an obligation to pay our way, to pay for what we get. What kind of a value system will support bequeathing to those who come later a rising bill for interest on debt incurred to pay for current services as against income-producing assets?*

* The capital and depreciation aspects of Federal finances present complex issues of accounting. Suffice it to say that existing measures leave much to be desired. Human capital and research outlays, for example, present especially difficult problems. Accruals of unfunded pension obligations run into large amounts.

Deficits and Discipline

Incurring deficits deserves consideration for a reason different from the growth of debt as such. When people can spend "off the cuff" --off the other fellow's cuff!--will they not yield to the temptation to spend to indulge in selfish, near-term indulgences? To feel comfortable in getting without sacrificing? Tolerance for deficits helps to explain the growth of Federal spending.

If taxes must be paid to finance expenditures, then proposals will be subject to more demanding and more constructive examination than if borrowing is accepted and expected. In the massive totals of Federal finances today, the discipline of the balanced-budget rule might seem weak, almost remote. But it would force restraint. Its absence must lead to Federal spending on things not worth the cost.

Government spending in itself, whether paid for by taxes or borrowing, utilizes resources. Sometimes it is said, not incorrectly, that the spending is the real "tax." And, of course, revenues from taxes and fees--perhaps those to balance a budget--are not available for private use. A society with a high level of Federal spending and taxes to pay the entire bill will be different from the society with a budget balanced at an appreciably lower level.

A Tax Increase Now? No.

Would America benefit from a tax increase? I think not.

By "tax increase," I mean a yield above that of the present system. The CBO projects a revenue increase of \$366 billion from the present

system, i.e., 1991 over 1986, almost 50 percent and a 0.4 percent increase in the percentage of GNP. Does the country need more? I side with opponents of any substantial revenue increases.

Frequently we hear of the inevitability of higher taxes. The new budget projections will mute the arguments somewhat, but not remove the substance.

Thinking as a responsible economist, I recognize the merits of the case for a modest--perhaps 3 to 5 percent--boost in taxes to help pay for what our legislators will vote for us in spending. Moreover, trying to act responsibly as an economist, I must endorse the proposed Business Transfer Tax as a potential improvement in the tax structure.

The BTT would certainly be superior to the income tax as applied to businesses. Through the years I have dreamed of improvements in the Federal tax system that involve drastic reduction of the corporation income tax. Until that objective is realized, we should, I believe, continue to work for reform that would reduce burdens on productive enterprise. The BTT could be used to do so. It would raise revenue, potentially large amounts, with a minimum (per dollar of revenue) of adverse effects on the economy. It could be a major element of an improved tax structure.

Yet I see a convincing reason for holding back on any tax increase--the prospect of its leading to undesirable growth of spending. A BTT as a "money machine" would invite higher spending and bigger, but not necessarily better, government over the years.

Both political and economic considerations are involved. The political aspect grows out of the belief that funds available will be spent; debt reduction would be almost accidental and temporary. (This is not the nineteenth century when, with minor exceptions, Federal debts incurred during war were twice paid off, or the 1920s when budget surpluses reduced debt year after year.) Spending increases from present programs could take many forms.

Each of us can think of spending increases we would welcome. Some might benefit the general public. But could we really expect the political process--legislative, bureaucratic, judicial, and military--to lead to better use of resources than would result in free markets? How can one evaluate the results of Federal spending and compare them with the substantially unknowable effects of taxes or borrowing? The consequences would often, I fear but cannot by any means prove, be inferior in terms of human values than the results that would be produced by decisions in the market place.

Although Federal deficits are often attributed to tax reductions, Federal revenues have gone up enormously. Thirty years ago after a major tax reduction they were, at \$75 billion, higher than ever before. Twenty years ago, shortly after another major tax rate reduction, they were \$131 billion-- a new peak. Ten years ago they were more than twice (\$298 billion) the figure of 10 years earlier. And the 1986 estimate is almost two and a half times that of 1976. Only once, the recession year of 1983, have revenues been down from the preceding year. The

1987 estimate of \$850 billion far exceeds the \$599 billion of 1981 before the tax changes of that year had significant effect.

The present deficit is certainly acting as a curb on the rise in spending. Some of the results are probably not very good. The deficit is a crude device. But perhaps for the present it serves better than would a tax increase. No one can know what would develop if government had more resources at its disposal. On balance I come out against a tax increase at this time.

