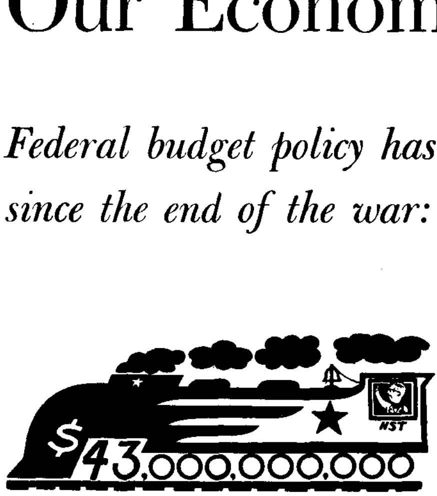
Our Economic Gyroscope

Federal budget policy has helped stabilize the economy since the end of the war: Can it continue to do so?



Everything the Federal government does costs money. Every question about what the Federal government does or does not do—from the Marshall Plan to counting bathtubs—is in part a question about the Federal budget. But the budget is more than an anthology of government programs. It has two sides—revenues and expenditures; the two sides can be totaled, and the comparison between the totals has meaning. The distinctively "budgetary" problems are those raised by the total size of the budget and by the size of the surplus or deficit.

There are two main issues about the budget, not only for 1951, but also for 1961 and 1971:

Can we manage the budget so that it will help us to avoid depressions and inflations?

Can we manage the budget so that it will not retard economic growth?

As far as the budget is concerned, the question of economic stability is mainly a question of timely deficits and surpluses. Can we manage the budget so that in depression we take less money from taxpayers and pay out more? This would leave more income in private hands and sustain the total demand—public and private—for goods and services. Can we do the reverse in time of inflation?

This is not a matter of some all-wise economist manipulating the budget to produce perfect stability. The budget is not so delicate or precise an instrument, and no economist is all-wise. We *can* hope to harness the budget, in a rough-and-ready way, to the job of avoiding big economic ups and downs.

How are we doing by that test? The case of 1949 is illuminating. In fiscal 1949 we had a billion-dollar cash surplus and in fiscal 1950 we shall have a five-billion-dollar cash deficit. This six-billion-dollar swing from surplus to deficit has been important in keeping the 1949 recession small. That is a pretty good performance. But we need to know how it happened and whether we can count on its happening regularly in case of a slump.

About three billion dollars, or half, of the six-billion swing from surplus to deficit resulted from the slump itself. As incomes fell, tax receipts fell; as unemployment rose, payments for unemployment compensation rose. Some part of the increase in farm-price supports and veterans' benefits was also due to the recession. This kind of thing will happen regularly when there is a slump. It is an automatic and reliable stabilizing force in the budget.

But the other half of the swing was pure luck—as far as the slump is concerned. Part of this change in the budget position was foreseen a year ago, when President Truman submitted his budget message. But insofar as it *was* foreseen, neither the President nor Congress wanted it. They accepted it, not in order to help cushion a slump, but because they couldn't agree on a way to prevent it. As for the rest—it just happened. The question of accepting it or not didn't arise. It reflected chance factors—like the good weather for agriculture and the unexpectedly great desire of veterans to go to school. Thus, half of the swing from surplus to deficit would have happened if there had been no slump. And if there had been no slump, this accidental rise in the deficit would have worked for instability rather than for stability.

It looks as if the random and accidental forces that influence the budget will work in a deflationary, or anti-inflationary, direction next year. According to the budget message, the cash deficit will fall from about five billion dollars in fiscal 1950 to about $2.7 billion in fiscal 1951, assuming no change in business conditions. If this happens, it won't be because anyone has decided that the economic situation or outlook calls for a reduction of the deficit. It will be the net result of a lot of separate movements in different parts of the budget, none of them primarily determined by the over-all state of the economy. If we have a problem of inflation in 1950-1951, this accidental cut in the deficit will be helpful. But if our problem is deflation, the accidental cut in the deficit will hinder its solution.

Although this is not a satisfactory situation, we are still better off today than we were twenty-five years ago. Our present situation is that there is a strong natural tendency for the budget to yield deficits in depressions and surpluses in booms. Tax receipts automatically fall when the national income falls, and rise when it rises. This is a force for stability, but there is a possibility that random movements in the budget will either offset or supplement the natural stabilizing influence.

Twenty-five years ago it would have been deliberate policy to prevent the natural stabilizing forces in the budget from working. "Balancing the budget" meant that if tax receipts fell in a depression, taxes had to be raised to prevent a deficit. This policy sterilized the budget as an influence for stability.

"Balancing the budget" is still a phrase that commands allegiance, but its meaning has changed. The new meaning is most significantly expressed by President Truman: "Our general objective should be a tax system which will yield sufficient revenue in times of high employment, production, and national income to meet the necessary expenditures of the Government and leave some surplus for debt reduction." The new clause is "in times of high employment, production, and national income." This clearly means that if we get deficits in depression we will accept them. We will not deliberately prevent the natural stabilizing force in the budget from working.

While our budgetary practice is still unsatisfactory from the standpoint of stability, agreement is emerging on the minimum ingredients necessary to a policy that will make for national economic stability. This agreement is best shown by the testimony of academic economists, businessmen, and government officials before Senator Paul Douglas's Congressional subcommittee on fiscal policies, as well as by the report of the committee itself.

The great danger in regard to the budget is that we may be unable to prevent its growth from interfering with the growth of the economy. It would probably be agreed that a growing economy can stand, and may require, a growing Federal budget—not necessarily this year but over the long haul. It would probably also be agreed that if the budget grows too fast it can be a serious drag on economic progress. The tax burden can then become so heavy that it weakens incentives for increased production, and dries up funds for business expansion.

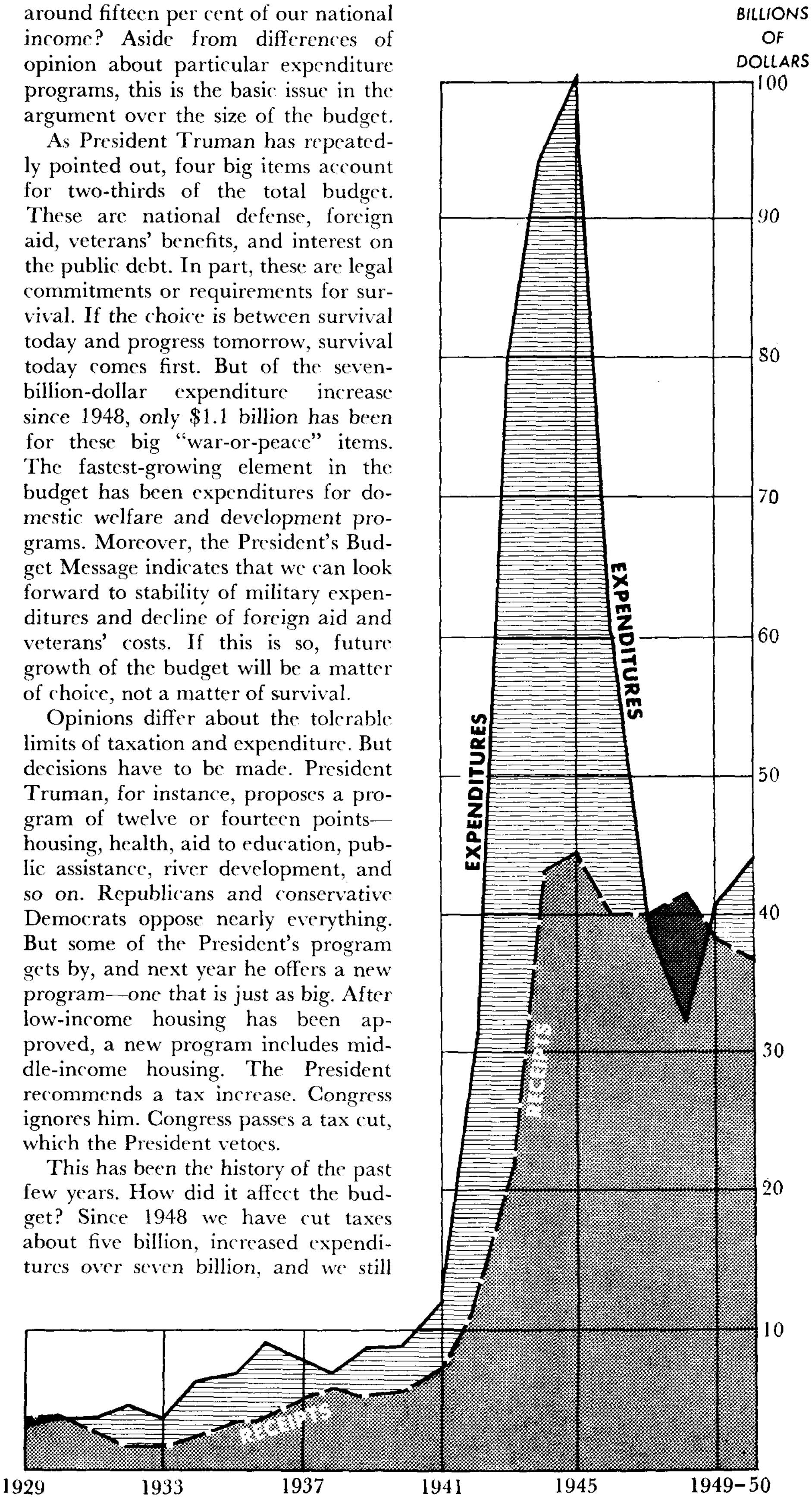
Five years ago it was generally agreed that after the war we should get lower tax rates than we now have. But that was agreement when agreement was cheap. We thought that the end of the war would automatically and painlessly permit a very large tax reduction. In 1939, Federal cash receipts were about nine per cent of the national income; by 1945 the proportion had risen to twenty-six per cent. Ideas of a postwar normal probably ranged around twelve to fifteen per cent.

Now we have a tax burden equal to about nineteen per cent of the national income at high employment. Is this a new "normal"? Or is it still a point on a gradual decline to a new normal of around fifteen per cent of our national income? Aside from differences of opinion about particular expenditure programs, this is the basic issue in the argument over the size of the budget.

As President Truman has repeatedly pointed out, four big items account for two-thirds of the total budget. These are national defense, foreign aid, veterans' benefits, and interest on the public debt. In part, these are legal commitments or requirements for survival. If the choice is between survival today and progress tomorrow, survival today comes first. But of the seven-billion-dollar expenditure increase since 1948, only $1.1 billion has been for these big "war-or-peace" items. The fastest-growing element in the budget has been expenditures for domestic welfare and development programs. Moreover, the President's Budget Message indicates that we can look forward to stability of military expenditures and decline of foreign aid and veterans' costs. If this is so, future growth of the budget will be a matter of choice, not a matter of survival.

Opinions differ about the tolerable limits of taxation and expenditure. But decisions have to be made. President Truman, for instance, proposes a program of twelve or fourteen points—housing, health, aid to education, public assistance, river development, and so on. Republicans and conservative Democrats oppose nearly everything. But some of the President's program gets by, and next year he offers a new program—one that is just as big. After low-income housing has been approved, a new program includes middle-income housing. The President recommends a tax increase. Congress ignores him. Congress passes a tax cut, which the President vetoes.

This has been the history of the past few years. How did it affect the budget? Since 1948 we have cut taxes about five billion, increased expenditures over seven billion, and we still



FEDERAL INCOME AND OUTGO

(FISCAL YEARS 1929 to 1950)

have a budget that will balance if there is high employment in fiscal 1951.

We have been able to cut taxes five billion and raise expenditures seven billion dollars since 1948 because we started with a surplus of more than eight billion. Now that surplus is gone. From now on, barring inflation or continuously *increasing* deficits, expenditure increases plus tax cuts will be limited to the growth in revenue that results from a growing economy. That means about a billion a year—which is the increase in revenues that the existing tax system will yield in the early 1950's if the national income increases at its past average rate of about 2½ per cent a year. We can raise expenditures one billion a year without raising taxes. We can cut taxes one billion a year without cutting expenditures. Or we can raise expenditures a little and cut taxes a little.

Possibly the balance of political power will work out to give us some tax reduction and some expenditure increase within the limits set by the growth of the economy. If the costs of foreign aid and veterans' benefits decline, we can finance larger social programs with small net increases in the budget. Also, a great deal could be accomplished by some rather inexpensive tax reforms.

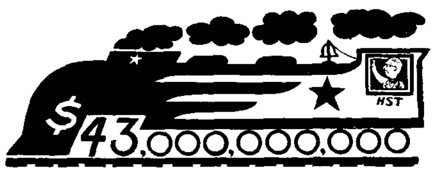
While we do not know the "best" course for expenditures and taxes, this would probably not be a bad one. However it depends upon a precarious balance of political power between the President and the conservatives.

It is not clear how far the difference between the President and the conservatives over the budget corresponds to any real division of sentiment within the country. "Economy and tax reduction" does not seem to be a program that wins elections.

Not all at once, but one by one and issue by issue, the Republicans may decide to give up opposition for competition—to try to win by offering more benefits through public expenditure. They are already in competition to see who can offer the farmers the most; they could easily be in competition over, say, reclamation, or housing, or aid to small business. The tug-of-war over the budget would become a race. If such a race develops, it will be hard to see any stopping point for the growth of the budget. —HERBERT STEIN

Keeping Farmers Solvent

Brannan's plan might also help consumers, but, like the present one, it is a stopgap



If Secretary of Agriculture Brannan were out to lampoon the Agricultural Act of 1949, passed over his protest last fall, he could not have arranged a better show than the one the public has been treated to these last few weeks. The comic peak was, of course, reached with the sale of potatoes for export at a cent a hundred pounds. Soon after that, Brannan, unable to move his potatoes even at this price, authorized the destruction of an estimated twenty-five million bushels. Earlier, the Secretary had asked Congress for an additional two billion dollars for the Commodity Credit Corporation (CCC), the outfit that supports farm prices. Now Congressmen are asking for substantial increases in the acreages of crops which have come under acreage restrictions according to the provisions of the 1949 Act.

What all this adds up to is bigger and fuller storage bins of wheat, corn, cotton, potatoes, and a host of other farm products that U. S. farmers appear to be producing less for the consumer than for the government pawnshop.

Attacks against Brannan's own plan for maintaining agricultural prices, which was advanced in April, 1949, reached a high during the 1949 convention of the American Farm Bureau Federation in Chicago. "Waste of the taxpayer's money" and "regimentation of the American farmer" were the main indictments. In having to pass the hat for another two billion dollars to pay the expenses of Congress's own law, Brannan has delivered a striking reply to such cries of "waste." The potato pile-up indicates that severe controls are the only thing that can save the price-support system from falling into utter disrepute.

Perhaps this development may enable the public to learn that, far from being a radical departure from past history, the Brannan plan is only the latest in a series of stopgap agricultural measures which started with the setting up of the Federal Farm Board in 1929, and have unfortunately never been moved into the realm of long-range policy. When Brannan presented his program to Congress eleven months ago, he said that the result of his studies was not "likely to startle anyone. I have no revolutionary ideas," he went on, "to present to you. . . . These recommendations are not advanced as the final and exclusive answers to our farm problems. I would much rather have a program that will work well in the immediate future than one which will partly do the job for twenty years."

Brannan's idea that his plan would startle no one turned out to be wrong, but the rest of his statement indicates clearly the limited objectives of the program he offered. In fact, during his appearance before the Congressional Committee on Agriculture the Secretary went to considerable pains to prove that practically all of his suggestions had been contained in some form or other in previously proposed legislation, particularly the Agricultural Act of 1948, most of which never went into effect.

If Brannan's plan is merely a new variation on an old theme, and not a wide variation at that, what accounts for all the shouting and the insults traded between the pro-Brannanites and the anti-Brannanites? For one