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Budget Process Is Still Being Tested, TF Analysis Asserts

The jury is not yet in on the 1974 Congressional Budget Act, according to an analysis of the Act just published by the Tax Foundation. "The Congressional Budget Process at the Crossroads," written by Tax Foundation's budget specialist Maynard H. Waterfield, examines the operations of the agencies established by the 1974 Act—the Budget Committees and the Congressional Budget Office—and explores the strengths and weaknesses of the key elements of the budget process—the timetable, the budget resolutions, and the reconciliation process.

Such an analysis is cogent, Waterfield states, because "the confluence of record high inflation rates, public and political pressures for budget balance, and an economic downturn which may prove much more severe than predicted, is likely, over the coming months, not only to test the budget process severely but perhaps to determine whether or not it can survive as a viable budget tool for the Congress."

The Timetable

The timetable as a means of completing budget-related activities on schedule has not fared well, in Waterfield's eyes. "The timetable for budgetary actions," he notes, "has become almost more honored in the

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Tax Index Resumes Upward Climb After Slight Dip in 2nd Quarter

The Tax Index appears to have resumed its almost unmitigated sequence of advances, following a slight setback in the second quarter of 1980. Based on data which has just become available, Tax Foundation researchers calculate that the Tax Index in the third quarter of 1980 rose at an annual rate of almost 16 percent over the previous quarter.

In the second quarter of last year, the Index had declined at a yearly rate of about 5 percent, for its first quarterly slide since the 1973-75 recession. The second quarter's dip in the overall Index was a direct result of a shrinkage in corporate profits and the associated drop in tax accruals for both Uncle Sam and the state treasuries (see *Monthly Tax Features*, October 1980).

The Tax Index in third quarter, 1980, stood at 367.3 (1967 equals 100), up from 354.1 in the previous quarter. On a compounded annual rate basis, this was a hike of 15.8 percent for the quarter. At the same time, the annual rate of increase in nominal dollar gross national product was 10.8 percent, and in prices, 9.9 percent.

Although all major types of taxes moved up in the third quarter, the biggest increase was in corporate profits taxes. Annual rates of change in the separate taxes for the quarter were: corporate profits taxes, up 45

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Taxes, GNP, and Prices
Index Numbers,[a] 1967 = 100

Year and quarter		Tax Index	GNP Index[b]	Price Index[c]
1978	I	279.1	252.6	186.1
	II	295.3	264.2	190.9
	III	302.8	271.2	194.2
	IV	315.5	280.7	198.3
1979	I	322.3	287.8	202.8
	II	328.5	292.6	207.3
	III	340.3	301.0	211.6
	IV	351.7	308.5	215.9
1980	I[d]	359.6	316.6	220.8
	II[d]	354.1	316.6	226.5
	III[e]	367.3	324.8	231.9

[a]Quarterly, at seasonally adjusted annual rates.
[b]Gross national product in current dollars.
[c]Implicit price deflator for gross national product.
[d]Revised.
[e]Preliminary.
Source: U.S. Department of Commerce, Bureau of Economic Analysis; and Tax Foundation estimates and computations.

The Front Burner

By Robert C. Brown
Executive Vice President
Tax Foundation, Inc.

"The Budget Cuts—Some Modest Proposals"

In the wake of an election so heavily influenced by economic issues, the Federal budget cuts must occupy a prominent place on the front burner of both the Reagan Administration and the 97th Congress. The Budget's size, its rate of growth, its delineation of national priorities—these and other issues must be dealt with.

At the risk of stating the obvious, it seems worthwhile to suggest a few guideposts for making the Budget a more effective tool of fiscal discipline and for bringing the Budget into balance as soon as possible:

• Any effective cuts will be painful. Our bloated public sector will not lose weight easily. Our decision-makers, with a degree of resolution and political courage not usually demanded of them, must ask their constituents—and all Americans—to swallow a bitter pill if they want to get well.

• Sound fiscal policy—not politics—must guide the selection of cuts. This means grappling with the so-called "uncontrollables," off-budget items and still other programs which, however popular with special interests, are leaching the health out of our economy.

• Cuts must be bipartisan. Republicans would like to start a "new era." Democrats would like to limit that "era" to the next four years. No matter. Getting a handle on the public sector and unleashing the inherent healthiness of the private sector must take priority over political strategy aimed at 1982 and 1984.

• Cuts must be swift. The honeymoon in Washington is always short. Our leaders must act while some ardor still remains. Early cuts, however painful, will be more readily accepted and will hasten the convalescence of the economy.

• Cuts must be fair. Vendettas have no place. Just as we must put a lid on the pork barrel, we must make sure that no group shoulders an unfair portion of the burden.

• Maintaining an orderly progression through the stages outlined in the 1974 Budget Act will convince the public that their leaders mean business. Submerging the timetable in partisan squabbles or pork-barrel politics will only intensify disillusionment and further destabilize the orderly conduct of the economy.

There is a saying in management: "Don't let the urgent cause you to lose sight of the important." There is urgent business on every desk in Congress as well as in the Oval Office. Putting out fires, however, must not obscure the awareness that our ultimate goal is to keep the house from collapsing.

Tax Index

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percent; indirect business taxes (including the windfall excise tax on oil), up 20 percent; personal income taxes, up 12 percent; and social insurance taxes and contributions, up 7 percent.

In the year-over-year comparison, both the Tax Index and the GNP Index mirror to some extent the economic slowdown that began in January 1980, following the peak of the last economic expansion. Instead of rising within a range of 11.5 to 13 percent as in recent years, both index numbers rose by only 7.9 percent from the third quarter of 1979 to the same period in 1980. Apparently not so sensitive to the recession, the Price Index outperformed them both, rising by 9.6 percent for the year.

The Tax Index is a new fiscal yardstick unveiled in May 1980 by Tax Foundation economists. The Index is designed to provide a continuing measure of trends in taxes, on a basis comparable to official indexes for other segments of the economy. (For other perspectives on the Tax Index see *Monthly Tax Features*, May, August, and October 1980.)

Supply-Side Cuts To Spur Economy Urged by Rahn

Supply-side economics and its influence on future tax and fiscal policy furnished the theme for Richard W. Rahn's talk at Tax Foundation's 32nd National Conference. Rahn, Vice President and Chief Economist of the Economic Policy Division of the Chamber of Commerce of the United States, first discussed the nature of supply-side economics. He then described for the conference the role this concept played in the deliberations of the Tax Policy Task Force for the incoming Reagan Administration.

Incentives Needed

"Really, it's the economics of incentive," Rahn told the conference. "The question is," he said, "how do [people] achieve their particular needs?" Asserting that the incentive and reward structure in society motivates people, Rahn described the current scene in the U.S. as "having less work, more leisure, far less saving and investment, more consumption. The result of this, of course, has been a lower level of output."

"Now, if we look at our economic goals of essentially trying to increase real per capita income for all Americans," he asked, "how do we go about achieving that?"

Altering Behavior

Rahn saw the answer in focusing on the producers, "on what drives them, what motivates them, what their incentives are, or what the disincentives are. . . ." Asserting that a tax change is beneficial only if it alters behavior, Rahn favored a supply-side policy targeted on changing the work-leisure ratio and the savings-consumption ratio.

The "wedge—the wedge on capital, the wedge on labor—is a pivotal concept with supply-siders," Rahn said. He described how the "real cost" of hiring a $10-per-hour

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Budget at Crossroads

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breach than in the observance." And, Congressional foot-dragging is endangering the whole process. "The failure of Congress over the last two years to adhere to the budget timetable," he writes, "has resulted in the resumption of the use of the 'continuing resolution' device, and raised new questions about the efficacy of the budget process."

The Budget Resolutions

On the other hand, in Waterfield's opinion, "the most important single element of the congressional budget process is the consideration and adoption of the budget resolutions required under the 1974 Act." At the same time, this important tool has serious limitations: the concurrent resolutions are binding only on the Congress, not on the President. Since the resolutions relate to funding bills to provide spending authority and not to actual annual outlay levels, "Congress can directly affect actual spending only over a period of years, not on a year-to-year basis." Finally, even though the second resolution is said to be "binding," the totals can be adjusted through the adoption of additional concurrent resolutions—a device which has been employed "in all but one or two years since the budget process was set in place."

However, Waterfield cautions, "To cite these limitations is not to denigrate the process, which can and does enable, even force, the Congress to view the budget as a whole, in a more orderly, coordinated way than existed prior to its adoption."

The Reconciliation Process

Under the reconciliation process, the 1974 Budget Act seeks to provide a vehicle through which the Budget Committees, by means of the budget resolutions, "may direct other committees to determine and recommend revenue and/or spending actions deemed necessary to conform to the determinations made in the budget resolution." The use of reconciliation in the fiscal 1981 budget did affect savings. Waterfield writes, "It is estimated that outlay savings resulting in the fiscal year 1981-85 period will total more than $50 billion, with $29 billion in additional revenues projected over the same period."

Reconciliation does pose some unresolved problems. It may be put into effect by either a concurrent resolution or a bill. A resolution does not require Presidential signature, and there is a question of how changes made in this way assume the force and effect of law. On the other hand, if reconciliation is put into effect through a bill, this must pass both Houses and be signed by the President. There is no precedent for predicting what would happen if either House voted down such a bill or the President vetoed it.

Another possibility is that reconciliation may bring about unwarranted spending increases that would not otherwise pass the congressional process.

Such questions, however, should not downplay "the possibility for good in the reconciliation procedure," notes Waterfield. This process has enabled the Congress to make "some significant changes in ongoing Federal programs—including some of the so-called uncontrollable entitlement programs—which might not otherwise have been made." These will bring about "substantial savings" in the future, according to Waterfield.

He also feels that, "properly used," the reconciliation procedure could be a vehicle for greater cooperation between Congress and the White House, by which "the entire process of budgeting and budget control might be strengthened."

Indeed, Waterfield claims, "If the congressional budget process adopted in 1974 is to prove effective over the long pull, some kind of cooperative, workable enforcement procedure is a necessity."

Asserting that "the budget process has not yet proven to be either a spectacular success or a dismal failure," Waterfield points out that its merits will ultimately be demonstrated by the "test of congressional performance." And, he concludes, "six years later, that testing continues."

"The Congressional Budget Process at the Crossroads" by Maynard H. Waterfield may be ordered from the Tax Foundation for $1 per copy.

McCracken Calls For New Policies To Curtail Inflation

"The United States economy traditionally has operated with a rate of inflation of about 2 percent per year," Paul W. McCracken of The University of Michigan's Graduate School of Business, told the Tax Foundation's 32nd National Conference on December 3. Excluding several "disturbed periods," McCracken, who is past Chairman of the President's Council of Economic Advisers, explained, "the crude, compounded rate of rise of the consumer price index beginning in 1900 and ending in 1965 is 2.1 percent."

Inflation/Employment

In fact, in two periods spanning the years from 1900 to World War I and 1948 to 1965, according to McCracken, the average rates of inflation were 1.7 percent and 1.8 percent, respectively. Using these data to establish an inflation rate of 2 percent per year as "a kind of par for the course," McCracken asserted, "There was no secular tendency, in other words, as we moved through the decades of the twentieth century for the rate of inflation to accelerate."

"There is another sub-period here that I can't refrain from commenting on," said McCracken. "From 1922 to 1929 the price level rose 0.3 percent a year. Real output rose at the average rate of 4.7 percent per year, and the unemployment rate averaged 3.7 percent."

A similar case can be made for the rate of employment, McCracken explained, arguing, "The United States has been much more nearly a full employment economy throughout its history than we perhaps have given it credit for." He estimated the rate for unemployment from 1900 to 1965 at 4.7 percent, excluding "the patho-

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McCracken

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formance has deteriorated not only relative to our history but relative to the industrial world as a whole."

The economist from the University of Michigan then proceeded to identify a few key factors which helped to explain the problem.

• "The United States did become a seriously underinvesting economy during the 1970s by any kind of measure. . . . Somehow or other the rate at which new technology was being generated was slowing down. . . . If we have been generating technology more slowly and because of sluggish investment introducing it into the economy more slowly, then our economic processes inevitably are reflecting aging technology."

• "We are going to have to learn to manage basic so-called demand policies along a steadier and more moderate course. . . . In the area of monetary policy, somehow or other, we have to get on a steadier course."

• "Obviously we have to reorient policies in the direction of regaining our position as a high-investment economy. . . . The major direct efforts have to be in the area of tax policy."

• "It's very important at this juncture for the American economy to remain an open economy vis-a-vis the rest of the world. We must support a liberal multilateralized open kind of international trading and financial system. The great danger is that, just at the time when the United States is beginning to demonstrate its capability to participate more effectively in the world market, we are apt to turn in a protectionist direction."

• "The one thing we don't need in our concern about reindustrialization is some kind of master plan or master planning agency from government. . . . We don't want to have government arrogating too much direct responsibility for managing economic life. It's much better to do it by the liberal market-organized strategy for economic policy."

McCracken concluded his remarks by noting, "We have gotten into this economic wilderness because of the economic policies we have pursued. If we are going to get out, it will be because of the economic policies that we pursue, and they will have to be different from those of the past."

Now Available

"The Congressional Budget Process at the Crossroads" by Maynard H. Waterfield, (Special Report), January 1981, 14 pages, $1.00.

"Reducing Government Expenditures: Overcoming the Obstacles" by Richard A. Givens, Government Finance Brief No. 30, 14 pages, $1.00.

"The Tax Expenditure Budget: An Exercise in Fiscal Impressionism" by Richard E. Wagner, Government Finance Brief No. 29, 21 pages, $2.50.

"Federal Employee Retirement Systems," Research Publication No. 34, 57 pages, $3.00.

"A Value-Added Tax for the United States? Selected Viewpoints." (Special Report 3,) 19 pages, $2.00.

logical years of the Great Depression and, of course, also World War II."

"Obviously, we have not done so well recently," McCracken conceded. Noting that the same may be said for "the industrial world generally," he emphasized, "our own per-

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Supply-Side Cuts

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worker, after social security taxes, workmen's comp, unemployment comp, and so forth, may actually be $12 an hour. At the same time, the employee—after social security taxes, income taxes, and so forth—is "lucky" to be making $8 an hour. "So we really have government-induced unemployment," he asserted, "every time we increase the taxes on work."

Drawing examples from areas as diverse as New York City, the District of Columbia, and variations in the tax treatment of overseas earnings, Rahn faulted the Carter Administration for never really learning "the lessons of supply-side economics." His participation with the Reagan Tax Policy Task Force has convinced Rahn that the incoming Administration "has a very different perspective. . . . They realized the importance of the marginal tax reduction in terms of changes in behavior towards work, saving, and investment."

The main problem encountered by the Task Force, according to Rahn, was setting priorities among the many options available. "The highest priority, of course," he said, "is Kemp-Roth—a 10 percent across-the-board cut for each of three years for a total of 30 percent."

The second priority "was the Jones-Conable capital cost recovery proposal, also known as 10-5-3. The third highest priority was the reduction in the capital gains rate to a rate no higher than 20 percent both for individuals and for corporations."

Rahn attacked as "a great myth" the belief that "all tax cuts are inflationary," asserting that a supply-side tax cut can be neutral or even "deflationary."

Capping his remarks with an economic forecast, Rahn predicted, "The next few months, I think, are going to be dismal." By mid-1981, "If we get the type of tax cut that I've described or something very close to it," he said, "I think the recovery can begin, slowly gaining momentum."

Rahn foresaw "substantial gains in real income" and "inflation coming under control" by 1982.