Task Force on Budget Policy

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November 5, 1968
Confidential

DETERMINED TO BE AN
ADMINISTRATIVE MARKING
E.O. 12356, Section 1.1
By BCB NARS, Date 9/16/87

BUDGET POLICY FOR EARLY 1969

The new President should start at once to reduce or restrain the expenditures to which he assigns low priority. He must do this in order to increase his future freedom to make the moves--whether of expenditure increase, tax reduction, or debt reduction--that are of highest priority. Superficially it will appear that in the short run little can be done, because the existing expenditure commitments are so great, whereas in the long run little need be done, because the natural growth of revenues will provide ample room for carrying out the President's programs. But in fact the growth of revenues in excess of the built-in growth of spending will provide room for doing what the President wants only if the growth of competing claims upon the budget is restrained. The 1973 budget, for example, will look much "tighter" at the beginning of that year than it does today. To provide the room the President will want and need later, steps must be taken now, even though their immediate effects on spending may be small.

Early 1969 will present a critical opportunity to take the steps needed to reduce or restrain spending, for several reasons:

1. A new President typically has a "honeymoon" during which Congress is more amenable to his initiatives than it will be later in his term.

2. New agency heads will have more critical and independent views of the programs under their jurisdiction than they will have later.

3. As long as the Vietnam War lasts there will be a feeling of budgetary stringency, which provides a more favorable background for cutting programs than may exist later.

4. The statutory ceiling on expenditures for fiscal 1969 gives the President extraordinary support for using his authority to control spending.

We believe the President should use the opportunity of early 1969 to reduce programs selectively in order to reduce future spending on them permanently, or at least reduce their rate of growth. The primary objective of the strategy should not be to reduce spending in fiscal 1969 or 1970, although it would have some reduction in those years as a by-product. The strategy would thus differ from the "crash" efforts at expenditure restraint which the government sometimes makes. Such efforts usually concentrate on deferring capital expenditures and squeezing down federal lending. They cause no permanent reduction in spending but only push it into the future, and they are often wasteful.

We foresee no need for a crash effort to cut FY 1969 and 1970 spending. Given some freedom in the decision about the tax surcharge, we believe the fiscal needs of those years can be met without that. There may be economic and political considerations not now foreseen that will make an emergency effort to cut FY 1970 spending imperative, and we later suggest some ways of doing so. However, we urge that main emphasis be placed, not on how we can least painfully cut the FY 1970 expenditures but on how we can most effectively restrain the low-priority continuing programs, even though they may be the most difficult to influence quickly.

The Prospect for FY 1969 and FY 1970

The table on page 4 presents estimates of the fiscal 1969 and 1970 budgets, which are useful as a starting point for considering immediate fiscal decisions. The estimates for 1969 assume observance of the expenditure ceilings set by the Revenue and Expenditure Control Act of 1968, with the present exemptions. Although this is not assured, and we discuss below the problem of staying below the expenditure ceiling, it is still the most probable assumption.

The estimates shown here for fiscal 1970 are of a different character. They are not forecasts of what will happen in that year. Rather they are estimates of the expenditures that would result from a policy of no new programs or program expansions on the non-defense side and rigorous restraint in the execution of approved increases on the defense side. The increases from fiscal 1969 would be almost entirely the result of higher prices, wages, and interest rates; increases in the population eligible for social security and other benefits provided by formula; other "work-load" increases;

Expenditure Restraint Budgets

(For underlying assumptions see text)

Billions of Dollars - Unified Budget

	FY 1969	FY 1970 War Continues	FY 1970 "Peace"*
Total expenditures	186.0	195.5	183.0
Defense	79.0	83.0	70.0
Other	107.0	112.5	113.0
Social security trust funds	36.7	39.4	39.4
Other social programs	23.1	24.9	24.9
Interest	15.5	16.0	16.0
Pay increase	1.6	2.4	2.4
All other	35.1	34.8	35.3
Undistributed adjustments	-5.0	-5.0	-5.0
Total receipts			
With surcharge	182.0	192.0	192.0
Without surcharge		181.0	181.0
Deficit			
With surcharge	4.0	3.5	-9.0 (surplus)
Without surcharge		14.5	2.0

*"Peace" means cease-fire in Vietnam by January 1, 1969 and rapid withdrawal and demobilization of forces.

and some catching up of payments with obligations. Provision is made for raising social security benefits in line with cost-of-living increases, but for no other increase of social security benefits despite the rise that will be occurring in the social security trust fund surplus. The estimated reduction of defense spending on the "Peace" assumption is predicated on a cease-fire by January 1, 1969 and a rapid withdrawal and demobilization of forces. Thus it is near the high end of reductions possible without drastic efforts. The revenue estimates assume continued full employment and only gradual slowing of the rate of inflation.

To keep FY 1970 expenditures from exceeding the estimates shown here will be difficult. The budget to be submitted by President Johnson in January 1969 will probably exceed these totals, although we would expect some effort to keep the total below $200 billion. On the other hand, to get the budget below these estimates would not be impossible, and we shall suggest below some ways in which this might be accomplished.

The Need for a Budget Strategy

An effective policy requires the President to start with clear budgetary objectives for the next several years. Undoubtedly a President-elect has ideas on this subject when he is elected, but in most cases they are probably not specific enough to constitute a program or firm enough to be maintained in the face of strong opposition. These ideas must be developed into a firm and specific program, by the President with the assistance of his Budget Director and agency heads.

The program will have to be developed quickly to take advantage of the favorable situation of early 1969. Certainly a comprehensive plan of the new Administration for FY 1970 cannot be delayed beyond May, the time a decision must probably be taken on the extension of the tax surcharge. If the Administration is going to ask for an extension of the surcharge, it will want to show that it has made a rigorous effort to reduce spending; indeed, Congress may well insist on expenditure cuts as a condition for extending the surcharge. If the Administration is not going to ask for extension of the surcharge, or is going to ask for partial or temporary extension only, it may want to show that termination or reduction of the surcharge has been made possible by its economy efforts. In either case, unless the war has ended, the decision about the surcharge can be the occasion for enlisting support behind a policy of expenditure restraint.

There is a question whether the new Administration should try to formulate a comprehensive budget plan and reflect it in an overall revision of the Johnson budget for FY 1970 by some earlier date--say by March. In 1961 the Kennedy Administration did this in two messages near the end of March. Early action would assist Congress in deciding on the FY 1970 appropriations before that fiscal year is too far advanced, an end certainly to be desired. However, it is probably more important that the new Administration's recommendations should represent a carefully thought-out position, and in the circumstances of the transition probably better to wait for two months rather than make hasty decisions. This would not interfere with the earlier submission of recommendations for revision of the Johnson budget for particular programs when the new Administration is prepared to do so. The Eisenhower Administration followed this procedure in 1953, submitting a number of revisions early and a more comprehensive statement of its budget plans in May along with its recommendations on taxes, some of which were then scheduled to expire on June 30.

If the new Administration makes its decisions early enough, it will be able to start putting them into effect by controlling FY 1969 expenditures. With some exceptions, the President always has authority to hold back the rate of spending under existing appropriations at his discretion. However, the congressional directive to the President to hold FY 1969 expenditures under a ceiling specified in total gives him unusual support for the exercise of this authority, since Congress has explicitly abdicated control. The Johnson Administration will have prescribed expenditure limits for the various agencies in order to hold the FY 1969 total within the ceiling, in general by stop-gap measures avoiding program changes. The new Administration will be free to alter these agency assignments.

Moreover, the new Administration may find it desirable to reduce agency limits enough to create a reserve out of which contingencies could be met without breaching the overall ceiling. It would be desirable to make these FY 1969 reductions in programs which the new Administration has decided to reduce in the longer run, in order to establish a lower expenditure base from which later decisions will start. To have a significant effect on FY 1969, action would have to be taken by March 1.

The first necessary step is for the President and his advisers to formulate a budget strategy for several years ahead which can serve as guidance to the new agency heads. This strategy should reflect the President's priorities in the numerous substantive fields of his concern, and we cannot specify what that strategy should be. However, to illustrate what we mean by a strategy the following brief statement may serve:

We regard the prime objectives to be

a) To assure the security of the country,
b) To contribute significantly to meeting the new aspirations of the disadvantaged without disappointing the expectations of the rest of society,
c) To restrain the size and influence of the federal government,
d) To strengthen the capabilities and independence of the states and localities,
e) To avoid waste.

To these ends we shall look especially critically at, and seek to reduce,

a) Programs which subsidize particular industries or groups of the population whose subsidization is not justified by concern with the poor or other major national objectives,
b) Investment programs with low rates of return,
c) Programs whose functions could be efficiently performed in the private sector or by state and local governments.

We shall seek to redirect the poverty program in ways that will increase its effectiveness, but do not mean to reduce the total effort and will be prepared to increase it where there is a prospect of good results. We shall be receptive to experiments which will test the effectiveness of new approaches.

We shall consolidate and generalize grants-in-aid to states and localities in order to leave more freedom of decision making at lower levels of government.

We start from the proposition that the nation can afford to be secure. At the same time we recognize that decisions about the military program will profoundly affect our ability to achieve other budgetary objectives. We also recognize that responsible and well-informed people raise serious questions about what military policy will best promote the national security and about the efficiency with which military policy is executed. We shall study these questions as carefully and objectively as possible.

We place high priority on achieving general tax reduction, beyond elimination of the surcharge, by 1972.

Initial Guidance to Agencies

This may not be the strategy of the new Administration. However, we believe that some statement of strategy, at this level of generality, can provide a useful basis for guiding the agency heads in the initial review of their programs. Such a strategy could suggest lists of programs requiring particular attention because of their relation to the general strategy. Agency heads should be asked to supply recommendations for the future of these critical programs, not just for FY 1970 but for several years beyond that, say through FY 1973. They should also supply information on the steps necessary to effect these recommendations, including changes of law and transitional policies to get from where we are to where we want to be.

It would be extremely useful to provide the major agencies with tentative targets for expenditures on their chief programs for the next three or four years and ask for suggestions on program changes to meet those targets. The targets will undoubtedly have to be substantially revised before FY 1970 decisions are made, since they will have to be set in a short time and with limited information. Nevertheless, they will help to align the thinking of the new agency heads with the initial intentions of the President.

Every effort should be made to provide this kind of guidance to the agencies by January 21, with a request for an initial response within two months. We believe that in most cases the information and talent exist within the agencies to respond in that time.

A special approach would be needed for the poverty programs. Here the effectiveness of what is being done is unusually uncertain, operation is spread among many agencies, and the necessary talent for evaluation may not exist in the government. For this reason we recommend the creation of an expert task force to appraise the effectiveness of existing efforts and possible alternatives and to report to the President and his chief aides in this field. The task force should be set up promptly, before January 20. It should report on particular parts of the programs as quickly as it is able to do so, to enable the President to make decisions in stages without waiting for a comprehensive review. We believe it is important to begin taking a constructive position in this area as soon as possible.

Suggestions for Critical Review

After the election the staff of the Bureau of the Budget can be extremely helpful in identifying for the new Administration the programs about which questions should be asked in line with the new budget strategy. The following list is presented as a preliminary to the contribution to be obtained from the Bureau. It will be clear that all the items we list are "hot." Nothing is in the budget that someone does not want; the more questionable the program the more certain it is that strong support for it exists somewhere, and programs that are both large and questionable must have very strong support. There is no escape from this problem.

1. The military program. This is, of course, the largest part of the budget, and its potential expansion could absorb the largest part of the "fiscal dividend" that may emerge in the next few years. The military program, aside from Vietnam, has been held under restraint in the last few years, and we expect that the Johnson budget for FY 1970 will continue that restraint. Partly for this reason the new Administration will immediately be confronted with an unusual volume of expensive decisions. Weapon systems that are in late stages of development and which may be candidates for the costly production phase include an advanced strategic bomber (to replace the B-52), a new strategic missile, a new Air Force fighter, AWACS (airborne warning and control system), and a "thick" ABM. Also there are now a number of systems in early stages of production for which the choice of future production and spending

rates is still open. The difference between restrained and expansive decisions could easily amount to $10 billion in the annual spending rate by 1973, although the difference would be much smaller in FY 1970. These will be the most important budgetary decisions of the next Administration. The view held by some students of the subject that expansion of military forces beyond some point subtracts from national security rather than adds to it deserves the most careful attention. It has serious implications for national security as well as for the budget and the national economy.

2. <u>Maritime subsidies</u>. The Federal government is spending about $500 million a year to subsidize inefficient U. S. merchant ship construction and operation--inefficient in the sense that it is more cheaply done by other countries. The beneficiaries of this subsidy have no particular claim to public support except the fact that the support has been going on for a long time. The usual justification advanced is that national security requires a U.S. merchant ship building capacity and U.S. operated merchant fleet. The validity of this justification has been seriously questioned.

3. <u>Air transport facilities</u>. While commercial airlines pay in user charges for almost all of the costs incurred by the Federal government in providing facilities for them, this is not true for operators of private planes. It is estimated that appropriate user charges would reduce net Federal outlays by about $300 million a year.

4. Farm price and income supports. The Federal government is now, still, spending a variable amount which averages around $4 billion a year for farm price and income supports, some of which appears in the Budget as the cost of "Food for Freedom." This is an inefficient way to help poor people and leads to inefficient use of national resources. Plans to reduce these expenditures would have to be adapted to the conditions of the main supported products. For example, a recent study by GAO indicates that expenditures for the peanut program could be reduced about $80 million a year by shifting from acreage allotments to production quotas. Also a transitional period and programs would probably be required to assist farmers in adjusting to a less costly policy.

5. Land and Water Resource Development. Although expenditures of the Corps of Engineers and Bureau of Reclamation have been held back in recent years, they will still be near $2 billion in FY 1969. Moreover, because of the recent restraint there is a large backlog of approved projects waiting execution when the budget position eases. There is a common belief that the application of realistic cost benefit criteria, including appropriate discount rates, would screen out a large number of projects that currently get approved and thus reduce expenditures for the programs.

6. Highways. The Federal government is spending about $4 billion a year for highway construction, almost all of it in the form of grants to States. The rate of highway expenditure is now being held

down by a temporary freeze. Under ordinary arrangements it would soon rise to $5 billion a year. Much of this spending, especially in the rural areas, is not urgent now and some of it may never become urgent. These expenditures are financed by highway-user charges, and a reduction or long-deferral of the expenditure program should probably be matched by a reduction of the gasoline tax or other user charges. Thus, there would be no relief for the rest of the budget. Nevertheless, the present generation of highway users would be relieved of paying for highways that are not now needed.

7. The Post Office. The Kappel Commission has recently estimated that reorganization of the Post Office could reduce the costs of its operations by $1.5 billion a year. This is about twice the amount of the budgetary cost of postal service. All of the benefits of these economies would not be received by taxpayers; some would be received by users of the Post Office in lower rates and improved service. In any case, the gains would be substantial.

8. The Space Program. Expenditures for this program in FY 1969 will be about $4 billion, almost $2 billion below the peak reached in FY 1966. Basic decisions will have to be made about the objectives of the program beyond the landing of man on the moon. It has been estimated that keeping the manned space flight program to a low level after the lunar landing would reduce annual costs by $500 million, and elimination of manned space flight would reduce annual costs by another $1 to $1.5 billion. The benefits of these programs are peculiarly

intangible and speculative, which is not to say that they are necessarily small. They do need to be re-evaluated as realistically as possible in the light of current national problems and objectives.

9. Intelligence activities. Information on these programs is not generally available, but they are believed to be large. There is also a belief that inordinate amounts are spent for efforts whose probable contribution to useful knowledge is small or which could be more efficiently conducted by regular agencies of government. The scale and character of the intelligence activities is determined by the intelligence agencies themselves with little surveillance from the Bureau of the Budget or Congress, a situation almost certain to lead to excessive expenditures.

10. Atomic energy. Since the construction and operation of atomic energy generating facilities has become a large private industry in the United States, the continued need for much of the activity of the Atomic Energy Commission in this field needs to be re-examined. Informed private opinion holds that the AEC's development work in thermal energy could be reduced or discontinued, some of its laboratories consolidated and trimmed, and its fuel-producing facilities sold.

11. Impacted area school aid. This program, on which about $400 million a year is being spent, was initiated when it seemed difficult to find ways to get Federal money into general education. This hurdle has long since been surmounted. The justification for the program on the ground that the presence of Federal facilities reduces the capacity of localities to support education is weak.

12. Regional economic development. Loans and grants for this program, excluding Appalachia, are now running about $300 million a year. The program was initiated at a time of general economic slack, and partly in confusion about what were national problems and what were regional problems. Moreover, there is serious question about the effectiveness of the effort to date. The program should be reviewed in light of present conditions and seven years of experience.

13. Rural electrification loans. The justification for continuing net lending at the rate of about $300 million a year mainly to finance rural telephone installations is hard to see, especially when the government charges an interest rate of only 2%.

14. Other lending. In addition to loan programs already mentioned, Federal agencies make net loans commonly running $2 to $3 billion a year, much of it in the fields of housing and agriculture. Many of these activities were initiated when credit risks were much greater and private financial institutions less adequate than they now are. There should be a search for opportunities to make some of these lending operations genuinely private, and not just to put a private label on an activity that is still Federally controlled and financed.

This list could, of course, be expanded. It could, for example, mention the SST, compensation for veterans with no income impairment, and subsidize' school lunches for children of the well-to-do. Our main point is that it will be possible in a brief period to identify programs in almost every agency about which there is a sufficient presumption that major national objectives are not being served to call for critical review at once. We have not included the poverty-urban area in this list because we believe the need for review there is obvious and have suggested that a special mechanism will be needed for that purpose. Some parts of this area are being covered by the task force on manpower and by the task force on intergovernmental relations. We have also passed over the field of grants-in-aid because that is being thoroughly examined by the task force on intergovernmental relations.

It is tempting to ask how much could be saved by a determined effort in the fields we have listed, but impossible to answer. Everything depends on how determined the effort is. We would offer the guess that, leaving military programs aside, the difference between a determined but not impossible effort and a "politics as usual" policy would be $2 to $3 billion in the FY 1970 rate and about $5 to $7 billion in the FY 1973 rate of spending.

Further Cuts in FY 1970

The new Administration may wish to consider emergency reductions in FY 1970 expenditures beyond the outcome of the program review and revision we have suggested here. In that case there would probably be four main places at which to look for substantial reductions:

1. The costs of conducting the Vietnam War. The need for a crash reduction of FY 1970 expenditures would probably only arise if the war was continuing. If so, the belief that the conduct of the war is highly extravagant in the use of materials and manpower would deserve urgent consideration.

2. Public works programs. We have suggested above the possibility of reducing certain public works programs by application of

more realistic tests of benefits. Even if that is not done, or, if it is done, to achieve quicker reductions, it will be possible to push some expenditures out of FY 1970 into later years. This is, of course, one of the standard ways by which an expenditure cut is achieved.

3. Progress payments on military procurement. If defense contractors shifted from financing their working capital by progress payments from the government to financing it from their own or borrowed funds there would be a reduction of government spending during the period of the shift. To bring this about would require including the cost of borrowing working capital as a cost of contract performance, which is not now done. The shift would be essentially a bookkeeping change and in the long run would cost the government money because private borrowing costs exceed government borrowing costs. However, it would for a time reduce recorded outlays.

4. Government lending. Net government lending is now running about $2 to $3 billion a year, but the gross loans, before repayments are deducted, are about ten times that amount. For a period the net can be substantially reduced by cutting down the new loans. This can usually be done without much affecting the transactions being financed by the government lending, if necessary by substituting loan guarantees or interest subsidies.

<u>The Problem of the FY 1969 Expenditure Ceiling</u>

The Revenue and Expenditure Control Act of 1968 establishes a ceiling on expenditures for FY 1969, subject to exceptions for certain categories of expenditure. The new President will have the responsibility of either assuring that expenditures are held within the ceiling or obtaining relief from it. The Johnson Administration has allocated the ceiling among agencies and apportioned expenditures through the year. The new Administration will have to ascertain that the plan is likely to prevent a breach of the ceiling and to monitor expenditures to assure adherence to the plan.

Despite the plan, expenditures may threaten to breach the ceiling as the fiscal year nears its end, since expenditures for many programs are difficult to predict or control precisely. The total of expenditures subject to the ceiling is about $100 billion, and it would not take much of an error to produce an excess of one or two billion dollars. There are several ways in which this problem can be handled if it arises. Vietnam expenditures are excepted from the ceiling, and the decision to classify particular Defense Department expenditures as being for Vietnam is often arbitrary. Thus there would be an opportunity to keep within the ceiling by classifying more expenditures as "Vietnam". A second possibility would be to defer the payment of some bills from June to July. The most straightforward, although possibly embarrassing, approach would be to ask Congress to raise the ceiling or to except certain programs, either completely or up to a specified limit. The Johnson Administration requested and received four Congressional exceptions from the initial ceiling before the fiscal year was one-third over.

If the new Administration wants to be sure that it will not have to choose among these methods of avoiding a breach of the ceiling, it will have to act early to create a reserve by cutting the allocation of expenditures to the agencies so that they total one or two billion dollars less than the ceiling. This would probably have to be done by March 1 to be effective. In establishing such a reserve the Administration should try to reflect its goals for the course of expenditures beyond 1969, by cutting the 1969 expenditure ceilings of those programs which it hopes to restrain in the future.

(The 1969 situation is discussed further in the memo by Mr. Hugo which is attached.)

A New Congressional Mandate?

The President has authority to hold expenditures below appropriated amounts, with a few exceptions. However, Presidents have been reserved about the use of this authority because of a reluctance to contravene the Congressional intent expressed in the appropriations. The position in FY 1969 was changed by the action of Congress establishing a ceiling on expenditures. In effect, Congress said that it did not want the President to spend more than a specified amount regardless of the amounts Congress appropriated. Thus the President was directed to use his discretion and was given evidence of strong Congressional support in doing so.

The question should be considered whether it would be desirable and possible to recreate this condition for FY 1970. For the President to ask Congress to direct him to do what he is free to do anyway would be anomalous. Nevertheless, a statement of Congressional intent that his discretion to cut expenditures should be used would add moral support if not legal authority. The possibility of finding a formula which would serve this purpose should be explored in the light of the President's own intentions and of the composition of the Congress and the character of his relation to it.