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THE NATION'S STAKE IN CONGRESSIONAL BUDGET REFORM

Since the times of John Maynard Keynes, there has been substantial agreement that the Federal budget has great effect on the Nation's well-being. The Federal budget influences the economy in many ways -- both immediately and over extended periods of time -- and about 22 percent of the Nation's Gross National Product derives from Federal expenditures. A deficit or surplus can influence demand, price levels and employment substantially and it is in this area that the budget has greatest as well as most immediate impact.

The dollars specified in the Federal Budget for specific purposes should reflect national priorities. Fifty-five percent of the budget for fiscal year 1976 goes for social services in the form of direct payments to individuals and grants to States and localities. These expenditures are transfer payments, reflecting the cost of our society's current vision of social justice. National defense expenditures are about 27 percent, leaving 18 percent for other Federal operations, including interest on the national debt. This leaves 11 percent for the conduct of foreign affairs, energy, and the administration of government. Although the percentages are small for this last group, huge sums are involved. Energy programs, for example, are expected to cost $2.2 billion.

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The challenges facing our country are clear. The current state of the economy is unsatisfactory according to any yardstick, and as a nation, we face a whole series of long-term problems. Short-term remedies may have long-range implications. Steps taken today to reduce unemployment may lead to inflationary pressures tomorrow.

The determination of national priorities and decisions to devote resources to solving particular problems create the size and shape of the budget. These solutions in many cases involve enormous expenditures and long lead times. Take the plight of many of our large cities, as one example. Physically, their cores have deteriorated. They face social ills which seem to require hugh expenditures to remedy. Few retain a tax base large enough to finance their expenditures. State governments have been reluctant to send more tax dollars to assist the cities. But until taxing jurisdictions of these cities include the entire economic region of their metropolitan areas, the only alternative remaining seems to be Federal aid of one form or another.

Energy problems facing the United States are another example. These are too complex to be discussed in detail here. Their solution will require careful coordination of government programs over a long period of time.

The proper mix of public policy and private enterprise in dealing with these problems is not obvious. To a large extent, our society allows and encourages the market to allocate resources whether it be by the individual consumer in picking his favorite brand or by large corporations in making investment decisions.

Yet, the Nation faces many problems that simply cannot be solved without some action by the Federal government. The Federal budget should disclose future needs of the Nation, and some planning, in terms of determining current and long-term national priorities, is appropriate. "Government Planning" is a term which often causes eyebrows to be raised because it seems alien to our free-enterprise philosophy. Yet so long as the budget is so large and our problems are so fundamental, planning for the future is simple common sense. The Federal budget process is the necessary link between free enterprise and the need to plan to meet national goals.

A clearer understanding of the budget process is fundamental in these times. Let me describe this process in its historical context and the reforms now taking shape.

BUDGETARY REFORM

The job of fashioning an overall Federal budget in a fiscally responsible way is complex and difficult. It is a job which becomes more complicated and difficult as our economy becomes more complex.

Until 1921, the Federal budget was prepared largely on a piecemeal basis. Each department and agency submitted its budget requests and legislative proposals to the Congress for consideration and action. There was no central overview or control within the Executive Branch on behalf of the President.

The Budget and Accounting Act of 1921 changed this by creating a Bureau of the Budget, first located in the Treasury and later in the Executive Office of the President. The Bureau assisted the President in formulating an overall budget consistent with his views of national needs and priorities, including those relevant to the economy. It greatly facilitated the Government's ability to "look at the big picture," and to set objectives and priorities within an overall framework and constraints considered by the President and his advisors to be fiscally responsible.

This budget set a baseline for congressional consideration and action, during which Executive Branch judgments and recommendations were examined and questioned and frequently changed as committees and subcommittees had their say. Ultimately a budget was enacted.

The system worked relatively well for a long time. Congressional action on the budget, however, still was accomplished on a piece meal basis. Numerous revenue, authorizations and appropriations bills were considered by separate subcommittees and committees of both Houses before final floor action in the two Houses.

As the budget grew larger and more complex, with room for greater divergence of judgment on national objectives and priorities and the means to achieve them, the system became more and more cumbersome and less and less likely to produce a budget balanced properly with the functioning of the overall economy. This situation caused problems such as the following:

-- More and more legislation was enacted for veterans' pensions, welfare payments, subsidies, and a host of other activities which largely removed a large portion of the budget from effective annual review through the appropriations process. About all that the appropriations committees and the Congress could do was to ratify obligations already made. In effect, each of the legislative committees became an appropriations committee. Ultimately, the appropriations process covered less than half of total Federal expenditures.

-- Long delays occurred in the enactment of many parts of the budget. Often appropriations were not enacted before the start of a fiscal year, and the Congress had to resort to the expedient of continuing resolutions to keep departments and agencies of the Government functioning.

-- Bills submitted for the President's approval were often vetoed because he did not consider them to be in reasonable consonance with his overall budget and the needs of the economy. Vetoes resulted in further delay and controversy; in at least one case, as a result of delays and vetoes, the huge Department of Health, Education and Welfare ran on continuing resolutions throughout a full fiscal year and well into the next without any appropriation act becoming law.

-- Sometimes the President deferred or prohibited the use of appropriated funds -- the so-called impoundments -- raising constitutional questions concerning the separation of powers and generating considerable litigation, disrupting to the functioning of the Federal government, and raising concerns in the Nation in a social and economic sense as well as a political one.

Finally, the Congress recognized that it must modernize its process for enacting the Federal budget into law and do so in a way which insures that each part of the budget is considered an integral part of the whole. It needed a mechanism through which each part of the budget could be justified, not only on merit but in its relationship to the overall effect of the budget on our social and economic well being.

THE BUDGET AND IMPOUNDMENT CONTROL ACT

The result is the Congressional Budget and Impoundment Control Act enacted a year ago next month, which introduces very welcome and important changes.

. It lays down a strict, rather tight timetable for completion of all legislative actions required for formulating and enacting an overall budget before the start of a fiscal year.

. It requires that the Congress, early in each session (by May 15) reach a judgment, articulated through a concurrent resolution, on the overall budgetary picture, including both expected revenues and proposed expenditures with allocations by revenue source and major functional categories of the budget.

. It requires that all legislative actions either be consistent with the overall constraints spelled out in the first concurrent resolution or that the concurrent resolution be revised to accommodate judgments on the overall budget.

. It created a budget committee in each House of the Congress to serve as the focal point for looking at the budget in its entirety.

. It created a Congressional Budget Office to assist not only the Budget Committees but the Appropriations, Ways and Means, and Finance Committees, and other committees as well.

. It requires five-year forecasts of revenues, cost estimates for proposed legislation that is reported to the floor, and cost projections for all existing legislation. The Budget Committees must set an overall spending level dictated by stabilization goals, and spending on the various programs must be reconciled under this limit.

. It changes the fiscal year to October through September, with a transitional budget to cover the three months between June 30 of that year when fiscal year 1976 closes and October 1, 1976, when, under the new system, fiscal year 1977 starts.

The process is simple in concept, but will take the concerted efforts of many to make the process effective. With such a major change in congressional handling of the budget, it should be no great surprise that the machinery will not work entirely smoothly this year, the first time around, or perhaps even the second time around. The question is whether there will be sufficient patience to enable the readjustment to take place and give the new process sufficient opportunity to test itself. To date I am encouraged by the prospects.

This year the Congress is making kind of a dry run under the new law so that full implementation next year will be facilitated. The first concurrent resolution, passed last month, calls for a deficit of about $69 billion, up $17 billion from that shown in the President's budget submitted in February.

You may, of course choose to agree or disagree with the level of the budget deficit, the one proposed by the President, the one incorporated into the first concurrent resolution last month, or the one which will finally emerge at the completion of the budget formulation process.

There is no perfect answer. But for the first time, there is a target set by the Congress, against which it may judge the aggregate of its legislative actions.

We hope that the new process will let the best judgments on priorities rise to the surface, within a framework which deals with the budget and the relationship of it and its various components to the overall economy in a cohesive and comprehensive manner.

I have already alluded to the complex set of political processes through which this Nation assesses national needs and priorities and devises means for meeting them. Unfortunately, but necessarily, the new congressional budget process adds to this. It not only adds the budget committees each having a jurisdiction as broad as that of the Executive Branch, but adds new actors to the scene or expands the role of old ones.

THE CONGRESSIONAL BUDGET OFFICE

The one principal new actor is the Congressional Budget Office. It has a major role to play in the system by providing analyses of the effects of alternative levels of budget authority and revenues, and alternative allocations of these among various governmental purposes, on our societal condition, including the economy. The law specifically states that this new office, in its report to the Budget Committees due on or before each April 1st, discuss "national budget priorities, including alternative ways of allocating budget authority and budget outlays among major programs or functional categories, taking into account how such alternative allocations will meet major national needs and affect balanced growth and development of the United States.

This function -- offering clear choices together with their implications for the nation's welfare, to the Budget Committees as well as others -- is extremely important.

Other parts of the act enlarge upon the role of other congressional agencies, including the General Accounting Office. In essence, each of these agencies, with its own focus, is to act cooperatively with the others, to produce for the Congress the best information-base possible for making its decisions.

From its inception, GAO's charter has been extremely broad. We were told in the Budget and Accounting Act of 1921 to "investigate at the seat of Government and elsewhere, all matters relating to the receipt, disbursement, and application of public funds," and to make recommendations for the greater economy and efficiency of Government.

Our activities under this broad charter have evolved steadily over time, and at an increasing rate in more recent years.

From a modest beginning of being concerned principally with the fiscal accountability of the Federal Government -- that is, that funds and property were prudently safeguarded and used only for purposes authorized by law -- we have developed and pursued at least two additional types of accountability -- management accountability, concerned with whether resources are used efficiently toward their intended purpose, and program accountability, concerned with the extent to which programs achieve their intended objectives and with whether alternatives are available to meet these objectives more effectively or efficiently.

Each one of these is, of course, important for the proper and effective functioning of the Federal establishment. The studies undertaken in each area can be drawn upon by each of the congressional committees and agencies in the performance of their particular function.

As I have said, the new law expands upon these traditional responsibilities of the GAO. We are now responsible for assisting congressional committees in developing statements of legislation goals and methods of assessing program performance against such goals. We are charged with cooperating with the Office of Management and Budget and the Treasury in developing, establishing, and maintaining a standardized information system which will meet the needs not only of the Congress but also of the Executive Branch and, insofar as practicable, of the State and local governments.

And, we have two additional responsibilities:

-- For developing standard terminology definitions, classifications and codes for Federal fiscal, budgetary, and program-related data and information; and,

-- For reviewing impoundments--actions taken by the President when he chooses to either defer or rescind the use of budget authority enacted in legislation--and advising the Congress on their impact.

INFLATION AND THE BUDGET

The Nation has just experienced the deepest and longest recession since the Great Depression. Although there are a number of issues that pertain at this time to the relationship between the Federal budget and the economy, one is particularly illustrative. The inflationary situation has had demonstrable effects upon the Federal budget as well as on the performance of the economy. Let us step back from our recent experience with "double-digit" inflation and review some of the economic events that led up to our present problems.

In the early 1960s, inflation was in the neighborhood of one to two percent per year. The "creeping inflation" of those years appeared to be of little concern to policymakers. Later in the decade, the pace of inflation increased under the impetus of Vietnam war spending. The big jump in Government spending would have been serious enough, but the inflationary impact was heightened by a budgetary underestimate of the costs of the war, a reluctance to increase taxes to cover these costs, and strong consumer demands for goods and services from the private sector.

A second jolt to prices occurred during 1973 and 1974. A considerable part was due to cost-push factors -- commodity shortages and the emergence of the Organization of Petroleum Exporting Countries cartel. The higher oil prices, incidentally, had a peculiar economic impact. Not only did the higher prices act to increase the cost of living, but also, because the extra billions of dollars spent on oil were sent abroad, the effect was very much like a tax whose revenues were set aside and not returned to the economy. This was definitely a contributing factor to the current recession.

Thus, the Consumer Price Index has increased by 58 percent since 1967 and by 28 percent in the last two years. Prices of goods and services purchased by the government have increased at an even faster rate. This means that inflation, by itself, has led to an increase of about $100 billion in the cost of government purchases of goods and services in the past two years, not to mention the increase in transfer payments which are indexed to the Consumer Price Index.

Inflation has had demonstrable effects upon the Federal budget. The new budget process requires analysis and information of these influences for that process to work efficiently.

Personal income taxes, the largest single source of Federal revenue, are influenced dramatically by inflation. A person whose income increases right along with inflation naturally has to pay higher taxes. But if he compares his current tax rate to what it was a few years ago, he will be in for an unpleasant surprise -- his taxes as a percentage of total income will have increased because of our progressive tax system. The person's higher income pushes him into a higher tax bracket. Even if, by our assumption, his income increased enough to offset inflation, his real disposable income will have fallen, because taxes are taking a bigger piece of it.

What is the actual magnitude of this effect? According to an estimate by the Joint Committee on Internal Revenue Taxation, income tax revenues increased by $7 billion because inflation pushed people into higher tax brackets.

Inflation also distorts the corporate income tax. If a firm uses the first-in, first-out method of accounting, then inflation makes it appear that the real value of the firm's inventories has increased whereas, in fact, they may only have kept pace with inflation. Also, depreciation costs are understated, because they are calculated against the original cost, rather than the inflated replacement cost, of the capital equipment. For both of these reasons, profits are overstated and the firm winds up paying higher corporate profit taxes, even though the value of its profits in real terms may not have increased. In order to compensate for this effect, among other things, quite a number of firms are switching from first-in, first-out to last-in, first-out. There are several other ways in which inflation affects the corporate profit and loss statements, and little is known about the magnitudes of the resulting changes in tax liabilities.

Next, let's consider the relationship between inflation and Federal spending levels. As inflation proceeds, the government naturally spends more on the goods and services that it purchases. In addition, transfer payments, such as social security, inevitably grow . Most of these payments grow automatically because, by law, they are linked to the Consumer Price Index or to some other indicator of the cost of living. This is called "indexing."

The list of indexed retirement programs now includes social security, civil service, railroad workers, armed forces, and the foreign service. In addition, food stamps, school lunch and breakfast, and aid to the aged, blind, and disabled are all tied to a price index.

The point of indexing is to keep the value of these benefits constant, despite inflation, without Congress periodically having to revise the legislation. Whether indexing results in higher or lower spending is a debatable point. Some, looking at the effect that inflation has had, would say that spending on these programs is "out of control." Others would say that the indexing has preserved the original intent and that if Congress were to constantly revise the legislation, spending might be even higher than it is now.

Whatever the pros and cons of indexing, it is certainly true that inflation has greatly increased the budgetary cost of these programs. More than 70 million people benefit from some type of indexed program, and in the 1976 budget indexing alone will lead to an increase in spending of $3.8 billion.

Incidentally, the portion of wage earners and pensioners in the private sector whose income is indexed to the Consumer Price Index is considerably smaller although it is growing and will probably grow still further in the future as long as the high rates of inflation continue.

To conclude on a somewhat more optimistic note, the signs are clear that the current recession has run its course. There is consensus among forecasters that recovery is currently underway. Recent economic events indicate that the current recession has taken on characteristics of a "normal" recession; that is, the rate at which prices increase slows down as the unemployment rate increases. Stagflation may not be totally and permanently gone, but the unemployment-inflation tradeoff analysis is more applicable now than it was during 1974, when a large portion of the inflation was due to higher energy prices.

While there is a consensus that economic recovery is in progress, there is a great deal of uncertainty as to its trend. Most recoveries in the post war era involve growth in the 8 to 9 percent range during the first five quarters following the trough of a recession. Most econometric forecasters have concluded that recovery this time will progress more slowly, perhaps at a 6 to 7 percent growth rate. This forecast is based upon analysis of the major sectors of the economy. None of these sectors appears to be shaping up as the "Moses sector;" that is, the one that will lead the economy out of the recession. Traditionally, the housing and auto industries have had this role, but prospects in this area are still most uncertain despite the recent positive signals in housing permits and starts. More data is becoming available that will provide some insights as to the shape of the anticipated recovery. These data will also provide, hopefully, an indication of the fiscal impact of the Tax Reduction Act of 1975 and whether the tax rebates have provided a major stimulus to the economy.

Our present economic situation, those which will emerge in the future, and the well-being of our society in general, is a challenge to Government. The Federal Government must strive to articulate a budgetary policy which meets national needs and priorities in the best possible way. The answers will never be perfect, but with all our best efforts, and with the better mechanism for congressional decisionmaking on the budget and its relationships with our economy, the answers arrived at will be clearer answers and will improve in the years ahead.