BUDGET TRADE OFFS

*G. William Hoagland**
Committee on the Budget
U.S. Senate

Clearly one of the major public policy issues of the day relates to federal fiscal policies in general, and projected federal deficits in particular. We are a nation beginning to face the reality that we are living beyond our means. Whether we are willing to do something about deficits is, however, another matter.

It seems almost daily our elected officials are being admonished by well intended groups to adopt this plan or that plan to reduce the projected federal deficit. At one and the same moment, however, over 7,200 federal lobbyists are registered to, among other things, safeguard traditional spending in their areas of interest. It is, therefore, I think, appropriate that your conference has concentrated on this issue and concludes with a presentation of some factors impacting on possible future budget trade offs.

This paper is divided into two sections. In the final section I present the more traditional analysis of budget trade offs — reviewing where the federal budget stands today, where it is headed under current policies, and what that portends for possible deficit reduction decisions. In the first section, however, I discuss budget trade offs from a slightly less orthodox approach; that being some factors underlying broader public policy trade offs which have evolved from our basic democratic, political economy.

The Democratic Political Economy

The hard budget decisions that the Congress and the President must address almost defy categorization. And because of this, I am obliged to cast a skeptical note on the various deficit reduction proposals that are now being offered by elected officials, political candidates, and public policy organizations. For it seems to me that the "emerging

* The views and opinions expressed in this paper are those of the author and do not necessarily reflect those of the Senate Budget Committee, its members, or its staff. Budget figures for fiscal years 1985 through 1989 as shown in this paper do not reflect the actions of the Committee of the Conference on the First Concurrent Resolution on the Budget for fiscal year 1985 adopted on Sept. 25, and as adopted by the U.S. Senate on Sept. 26. The author is indebted to Carla Garcia, Senate Budget Committee, for her invaluable assistance in providing background data for this report.

issues" are not really new or necessarily emerging but go to the underlying structure and evolution of our free, democratic political economic system. "The issue is not economic," as a recent Wall Street Journal editorial suggested, "it's entirely political" [10, p. 28]. The basic political difficulty is simply that the adverse consequences of large deficits will not be felt until some future time, but correcting deficits creates pain now.

Further, the politics of the budget are intertwined with some fundamental principles of our government, such as: federal and state responsibilities; private and public rights; economic equity (social justice) and economic efficiency; access and nonaccess.

I believe almost all current day budget trade off debates (and agriculture policy formulation) can fit into these areas — and others admittedly more esoteric but fundamental to our democratic political system. I now turn to a few of these broader trade off issues.

Federalism: Nationalism versus States' Sovereignty

The issue of the limits of federal power has been a central one in the republic's history. Indeed, before the first year of operation was completed in 1790, the issue was joined in the historic confrontation between Hamilton and Jefferson over the proposed establishment of a national bank.

Jefferson, the strict constitutionalist, argued that the national government had no powers except such as were expressly conferred upon it in the Constitution. Hamilton, on the other hand, contended that the national government had all powers which could by any reasonable interpretation be regarded as implied in the letter of the granted powers.

In the course of time Hamilton's doctrine of implied powers — supported by the historic 1815 Supreme Court ruling in McCulloch v. Maryland — gained general acceptance. But certainly the debate continued, culminating at one point in the devastating Civil War fought on these surrounding farmlands. The failure of secession in 1860-65, and the acceptance that a state cannot secede, clinched the victory for nationalism. The doctrine not only gained acceptance, it is today embedded in our constitutional law. As one historian, however, has written:

> "Never yet has the question been answered at all points, nor in truth can it ever be; for in a dynamic, changing society governmental powers simply cannot be defined and circumscribed with such precision and finality as to prevent people from construing them differently in the face of new circumstances and needs" [5, p. 59].

The expansion of the federal government (brought about in part by the implied powers doctrine) is a subtle and yet key issue in the budget trade off debates of today. This is not necessarily an emerging issue, but a long-standing historic issue.

I hesitate to remind this audience that the Constitution says nothing about "agriculture," and indeed the first Agriculture Adjustment Act of 1933 was ruled unconstitutional. I raise this only to highlight how far agriculture policy has come with the broader definition of federal responsibilities.

The issue of appropriate federal-state roles has been made even more acute by the 1960's and 1970's, "a period," as Theodore H. White has observed, "of goodwill gone awry." The Reagan administration's New Federalism proposals in 1982 proved unacceptable. But the sorting-out process of federal and state responsibilities will continue and undoubtedly grow, particularly as we continue on a path of prolonged fiscal stress, straining the resources of each level of government.

Private versus Public Rights

We Americans fiercely value our independence. This, too, is not an emerging issue but a long established part of our national consciousness. The trouble is, the frontier, the country, indeed the world, has shrunk dramatically. Similarly, our food and fiber system while becoming more integrated and concentrated, also has shrunk from the perspective of individuals and groups who now participate in food and agriculture policy debates. Our independence has been challenged. We have become closely linked by advances in communication, technology, and an interrelated world economy.

How, for example, public policies address the rights of the public to a clean, safe, and healthy environment, while at the same time protect the rights of the free entrepreneur to invest, use advanced technology, produce, and succeed (or possibly fail), requires some fundamental rethinking of the trade offs in our free economic system.

In the area of agriculture, clearly public investments in agricultural research and technology development have been responsible for the high level of productivity in this sector over many decades. But as former Secretary Bergland has recently observed, "We have a classic collision — private versus public interests. There is a long-term interest in conserving soil and water, for example, but the private interest is immediate, the public interest is long-term" [9, p. 8].

The emphasis today on public rights clearly influences budget trade offs, however difficult those rights are to define. This issue is integral to the recent budget clashes over environmental laws, public lands development, and wilderness disputes. More directly, the budget trade offs in the area of public funds for agriculture research have been and will continue to be affected. The long cherished goal of increasing agriculture productivity and efficiency with public funds is being challenged when other agriculture policy goals, such as limiting production, and other societal goals of the environment and consuming public are included.

I see the private and public rights issue — along with the issue of federal-state roles — increasing federal budget restraints in agricultural research and intensifying the geopolitical distribution of federal funds. This can only exacerbate the federal-state conflict over research goals and further weaken federal funding for research having a truly national benefit.

Economic Equity and Economic Efficiency: Schumpeter versus Keynes

No two economists better represent the difficult budget trade offs today than do the two giants — Schumpeter and Keynes. The critical economic and budget issues we face today have, in large part, been debated and analyzed at great length by these brilliant men. Today's budget debates would benefit greatly from a careful review of the different perceptions of economic theory and economic policy embodied in their writings.

For it is my understanding that Keynes, through acceptance of the "symbol economy" of money and credit (versus the "real economy" of goods and services), believed one could maintain *permanent equilibrium* with full employment, prosperity, and stability with the manipulation of certain parameters — government spending, interest rates, the volume of credit, or the amount of money in circulation [4]. Through the achievement of equilibrium, economic equity would be achieved. Such a managed economic system would guarantee the transfer of national income to achieve social justice.

Schumpeter, on the other hand, insisted strongly that *innovation* is the very essence of economics and most certainly of a modern economy. For him the central question of economic policy became one of how capital formation and productivity could be maintained so that rapid technological change as well as employment could be sustained. To Schumpeter, capital formation and productivity were needed to maintain the wealth-producing capacity of the economy, maintain current jobs, and create new ones. His was not a world of static equilibrium, but one of dynamic change [7].

To Schumpeter's disappointment, however, to be popular, government would increasingly become the "tax state," would increasingly shift income from producer to nonproducer, would increasingly move income from savings for future capital formation to consumption in the present. Inflationary pressures would increase.

More recently Arthur Okun recognized the "trade offs" between economic equity and economic efficiency [6]. According to Okun, a society that emphasizes the elimination of inequality would have to pay the price of diminished economic vitality.

The deficits we face, I believe, are adding a new element to future inflationary pressures. Further price inflation in excess of productivity growth is likely to continue well into the future. From a practical viewpoint, however, unemployment remains high, relative to generally accepted definitions of full employment. And the distribution of income in this country is the unstated but fundamental facet of the so-called "fairness issue" of today. Therefore, the policy makers' decisions are one of risk acceptance and avoidance. How much is it worth to reduce unemployment, increase food stamps, or increase farm subsidies if those actions involve more general price inflation?

The economic efficiency versus economic equity arguments will continue long into the future. For agriculture, this means increasing attention paid to farm price support programs. A critical review of their efficiency in achieving price stability while also targeting program benefits to maximize economic equity will be integral to the final budget decisions affecting them.

Access and Nonaccess

The right to petition the government is a fundamental guarantee of the First Amendment of the Constitution. I approach the issue of access to the policy making process, therefore, with some trepidation. But it seems to me, that the role of lobbies, lobbyists, political action committees, and — to a much lesser extent — political parties, is becoming more of an issue than ever before in the formulation of legislation and, therefore, budget trade offs. Balancing the role of these groups with the interests of the general public becomes in itself a major trade off.

The Friedmans have written in their new book, *Tyranny of the Status Quo*:

> Special interest or single-issue politics are a frequent explanation for the growth in government. A government program, particularly at the federal level, almost always confers substantial benefits on a relatively small group while at the same time spreading the costs widely over the population. As a result, the few have a strong incentive to lobby intensively for the program. The many don't even bother to inform themselves about it, let alone to devote money and effort to opposing it [2, pp. 35-36].

The growth in the number of lobbyists has paralled the growth in federal spending — today there are over 7,200 lobbyists registered with the Congress. In the area of agriculture alone, the number of registered lobbyists (narrowly defined as having a particular interest in agriculture), has grown from less than 80 in 1960 to over 200 in 1983. Spending by these agriculture lobbyists has similarly increased from an estimated $800,000 in 1960 to over $5 million in 1983.

The number of registered political action committees (PACs) have similarly grown from about 600 in 1974 to over 3,500 last year. Their contribution to congressional candidates has increased from about $8.5 million in 1972 to $83.6 million in 1983. Of the top 20 PAC contributors to federal candidates in 1972, three were affiliated with the dairy industry ranking sixth, eighth, and tenth in contributions totalling $780,000. By 1983 only one dairy-affiliated PAC made the top 20 contributors list — the Committee for Thorough Agricultural Political Education, affiliated with Associated Milk Producers, Inc. Its contributions exceeded $960,000.

Political scientists that have examined the role of these groups on the legislative process are inconclusive as to their impact. But what does seem to be a general consensus is that their input into the political system has added to growing fragmentation and, therefore, their presence makes it more difficult to reach a national consensus on various issues. Some, of course, argue that in a pluralistic society that's not bad [1, p. 68].

Nowhere has this fragmentation been more apparent than in the budget arena in general, and in agriculture in particular. The efforts to slow government spending, beginning in 1980, have intensified competition for a smaller pot of money as lobbyists have competed to safeguard their traditional spending levels.

This pressure to reduce aggregate spending in agriculture has, I think, lessened the role of the historic farm lobby interest groups — the American Farm Bureau Federation; the National Grange; and The Farmers' Educational & Co-Operative Union of America (National Farmers Union) — and increased the number of more narrowly defined, commodity specific lobby groups such as the National Wheatgrowers Association; Dairymen, Inc.; and the National Cotton Council of America.

The intense competition for the dwindling federal dollar has also increased regional agriculture disputes — primarily along regional commodity lines. But even within the same commodity, where there are differences in production practices (such as dual cropping, and alternative dairy technologies) strong public policy disputes have become apparent these last few years. I also unfortunately observe, and expect it to grow, intense regional divergence between the water-rich versus water-poor agricultural states.

There are no magic answers as to how these various groups and coalitions will impact next year's farm bill. Even united to protect traditional spending levels, I believe they might fail. I do think, however, that the splintering that has occurred in the agriculture community could result in major budget reductions. David Stockman, in the infamous December, 1981, *Atlantic Monthly* article, believed budget victories over farm lobbies could be won by presenting Congress with a farm bill that was so unacceptable to all farm and food groups that "the whole thing begins to splinter" [3, p. 35].

In light of what I perceive to be a consensus of agriculture policy scholars for some fundamental changes in federal farm price-support programs as well as a general disenchantment with current programs by both producers and taxpayers, the continued warring of the special interest agriculture groups may bring on those changes a lot quicker.

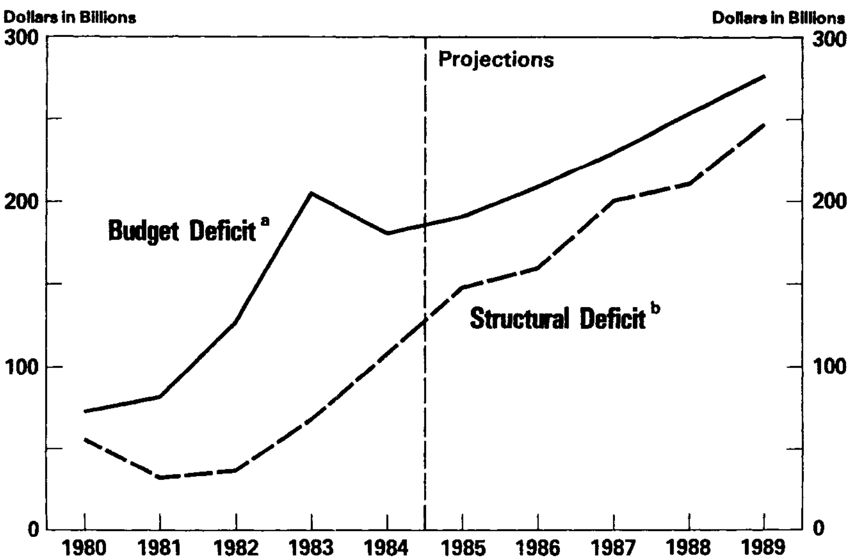
The Budget and "Trade Offs"

Other participants in this conference have discussed the deficit and its consequences for the general economy and agriculture in particular. I will try not to duplicate those presentations, but simply close with a quick review of where budget trade offs might lie — once you overcome or sort out some of the political and philosphical issues I've already discussed.

Deficit Outlook/Structural Deficit

Chart 1 displays the projected growth in the total federal deficit as estimated by the Congressional Budget Office last month. It does not reflect the assumptions embodied in the Budget Resolution for FY

Total Budget Deficit and Structural Deficit, FY1980-FY1989



Source: Congressional Budget Office, *The Economic and Budget Outlook: An Update*, August 1984.

[a] Includes off-budget Federal entities deficits.

[b] The structural deficit is a hypothetical deficit adjusted for the effects of business cycles. This structural deficit is standardized at a 6 percent unemployment rate.

Chart 1.

1985 just adopted by the Senate yesterday, but those changes would not significantly alter the trends presented.

The federal deficit, it is estimated, will increase from about $183 billion this year to $278 billion by the end of the decade. As a percentage of the gross national product (GNP), the deficit remains about 5.0 percent throughout this period, down slightly from a high of 6.4 percent in 1983, but up significantly from the low of 2.7 percent of 1981. Total debt held by the public would increase from about 36 percent of GNP in 1984, to 46 percent of GNP by 1989. This would be the highest ratio of debt to GNP since the early 1960's. By 1989 the total public debt would be $3.1 trillion.

A number of economists argue that an annual rate of growth in nominal GNP that is consistent with price stability is about 5 or 6 percent. To keep federal debt around its present GNP ratio of 36 percent, would require keeping the deficit to about 2 percent of GNP. Very simply this means reducing spending, increasing revenues, or a combination of the two, by approximately $100 billion in one year alone.

Total federal outlays as a percentage of GNP increase slightly throughout the period, averaging about 24.0 percent over the five year projection period. Revenues as a percentage of GNP also increase slightly throughout the period, averaging about 19.2 percent. It is this 4.8 percentage point gap between revenues and spending that, of course, precipitates the increasing deficit.

But what is more disturbing in Chart 1 is the underlying strong upward trend in the structural deficit. The structural deficit is a hypothetical deficit designed to eliminate the built-in deficit increases associated with swings in the business cycle. Some refer to the structural deficit as a high employment budget since it assumes a 6 percent unemployment rate.

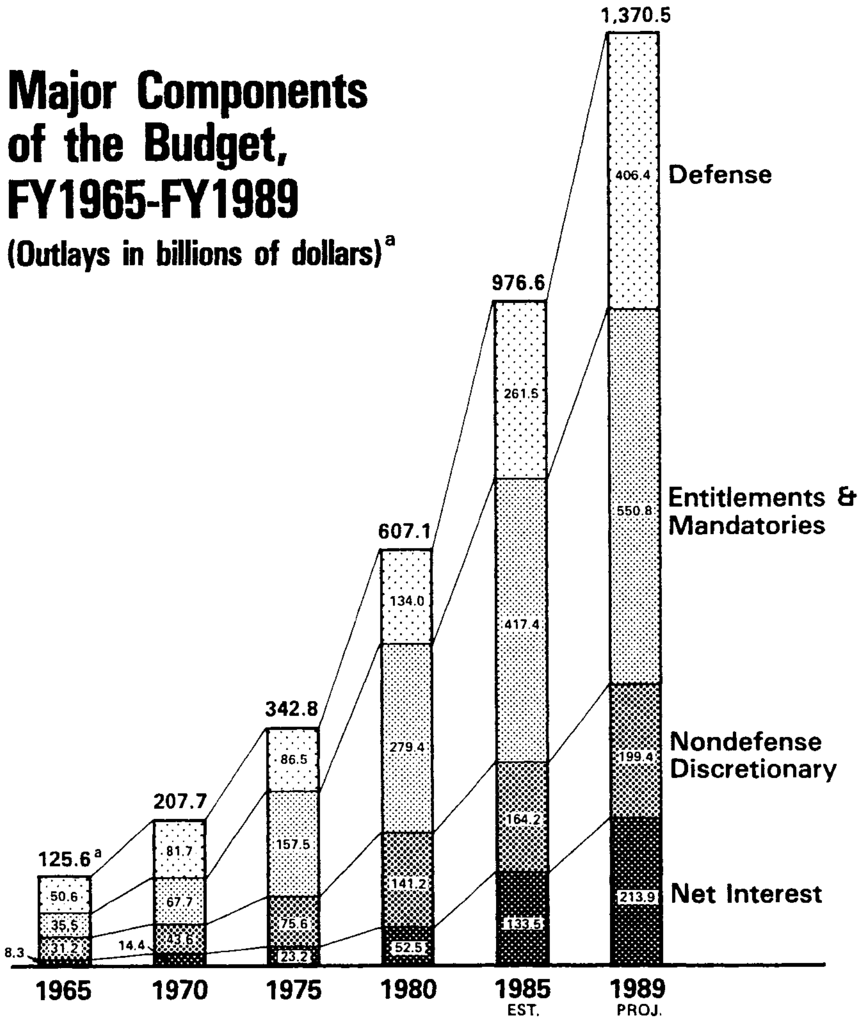
What Chart 1 so graphically depicts is the concern expressed by many that, even with a period of sustained economic growth, the deficit will continue to increase. While the structural deficit will constitute 63 percent of the overall deficit in 1985, it is projected to become 94 percent of the overall deficit by 1989.

We are not going to grow ourselves out of this problem. The problem depicted by Chart 1 suggests a long period of high real interest rates and a continued shift in national output toward relatively more consumption and less investment.

Spending by Major Categories

The major budget trade offs will not be fought at a programmatic level necessarily, but within the much broader areas of revenues, defense, entitlement programs, and the collection of remaining programs.

Chart 2 breaks down the federal expenditures into four major categories (excluding off-budget items such as REA and offsetting receipts such as mineral and mining receipts from public lands). For the fiscal year beginning in just a couple of days (FY 1985) federal outlays will reach approximately $977 billion. Of that total about 27 percent will outlay for defense; 43 percent for entitlement and mandatory pro-



Source: Congressional Budget Office, *The Economic and Budget Outlook: An Update,* August 1984, and unpublished CBO data.

[a] Total on-budget expenditures for the four major categories, excluding offsetting receipts and off-budget.

Chart 2.

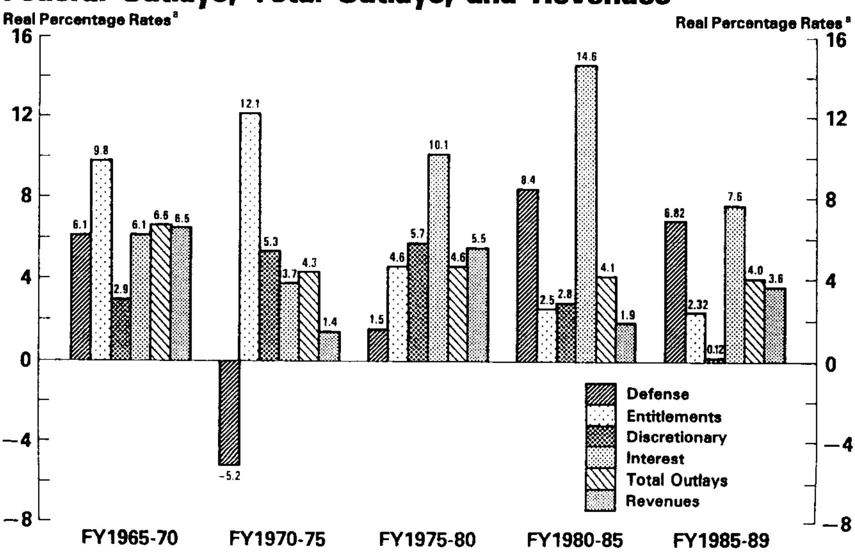
grams; 17 percent for nondefense discretionary programs; and about 14 percent for paying interest on the public debt.

Over the next four years, federal outlays will grow over 40 percent, and reach *$1.37 trillion* in FY 1989, assuming no changes in current legislative policies. Defense outlays will increase to about 30 percent of total outlays; entitlements and mandatories will decrease slightly to 40 percent; nondefense discretionary programs will also decrease to 15 percent of total outlays; and net interest will increase to 16 percent.

The priorities reflected in the federal spending patterns reflect certain trade offs this administration and the Congress have established among the various categories. These priorities can and will undoubtedly change. They also reflect past patterns of spending. Chart 3, as an example, breaks down the real rates of growth for each of the particular categories, along with total outlays and revenues. As is clear from this chart, while the period FY 1965-70 showed fairly comparable real increases in revenues and outlays, major divergences in the categories began in the early 1970's with a negative real rate of growth in defense and significant positive increases in entitlement and mandatory programs.

In the current period FY 1980-85, a shift to a real increase in defense spending began, and the rate of growth in outlays about doubled the

Annualized Rates of Change by Categories of Federal Outlays, Total Outlays, and Revenues



[a] Calculation of annualized real rate of change based on GNP price deflators.

Chart 3.

rate of growth in revenues. But the fastest growing component of the budget both now, and as projected to FY 1989, is the federal payment to service our growing debt. This remains the *real* uncontrollable portion of the budget and, from my viewpoint, the most dangerous.

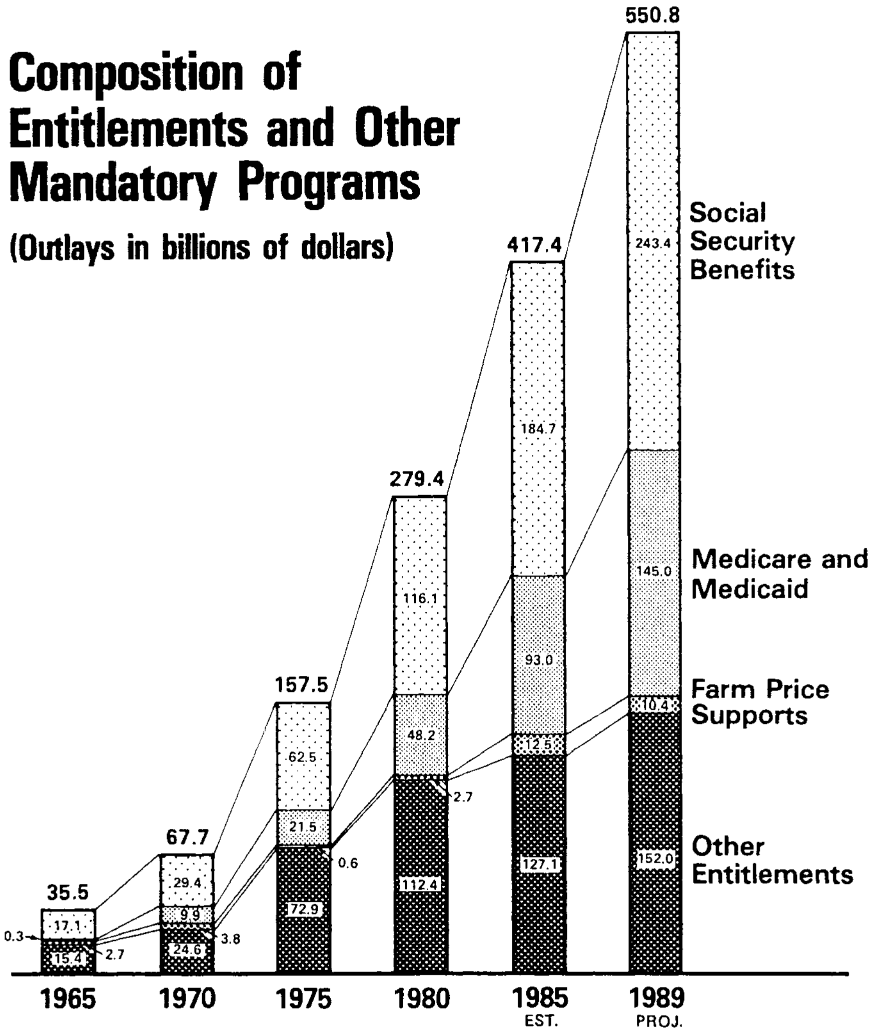
It is worth remembering that, while the federal budget consists of over 1,000 accounts and many more specific programs within those accounts, when we array the various programs almost all of the spending is found in just a few areas. Under current policy assumptions, by FY 1989 almost all the projected federal revenues (97 percent) will go to pay for five things — (1) defense, (2) social security, (3) Medicare, (4) Medicaid, and (5) interest on our public debt. Of course only four of these areas are subject to real policy manipulation, interest payments being basically uncontrollable except for what we do in the other areas.

Here, within these four major areas, are where the expenditure trade offs realistically have to be fought. Here, the budget committees will focus their attention. Here are where the lobbyists are the strongest, and the changing demographics portends even strong lobbying in the future.

I don't mean to diminish the importance budget restraints will have in formulating future agriculture policy. But if you look at the relative size of farm price support payments (Chart 4) to total entitlements spending in FYs 1985, 1989 (less than 3.0 percent) you can understand why the major focus will be on these other areas. In fact, I believe a convincing argument can be made that by addressing the federal deficit in these larger areas, farm price support payments will decline below the current policy projections as real interest rates decline and our agricultural commodities become more competitive worldwide.

Concerning the broader generic public policy issues of federal-state responsibilities, economic equity, and economic efficiency, to the extent they impact on any one federal program, they impact on all. And here I see an emerging theme that would impact on agriculture policy formulation — the targeting and limiting of federal "middle-class" subsidies and benefits. Such proposals as delaying or reducing the automatic indexation of the tax code or social security program, restricting the types of medical services covered, targeting direct farm payments to a specific group of producers, and imposing user fees for particular services will all increase in importance.

In the area of defense spending, major proposals to slow the rate of growth are expected. But, I must note that even the recently released Mondale budget calls for a 3.0 to 4.0 percent real increase in defense spending through 1989. Not a whole lot different than the 5.0 percent real growth that was assumed in the last two Congressional budget resolutions. "Providing for the common defense" remains a clear and stated function of the federal government.



Source: Congressional Budget Office, *The Economic and Budget Outlook: An Update,* August 1984, and unpublished CBO data.
Chart 4.

The issue of defense spending and the allocation of resources within the defense budget is complicated by a wide array of issues. The issues relate to differing perceptions of world threats and alternative deterrence strategies to deal with those threats. The budget trade offs within the defense area relate to alternative strategic defense and conventional force readiness strategies. While defense spending will increase — if for no other reason than the pipeline is full of obligations and awarded contracts — still, by FY 1989, defense spending will constitute about 7.6 percent of GNP, a comparable figure to FY 1965. I believe reductions can be achieved in the defense area, but those reductions will in no way reduce the projected deficits by the magnitude of figures being discussed.

Revenue

Finally, the other part of the deficit equation besides spending is, of course, revenues. There are basically three options: raise tax rates, broaden the existing tax base, or introduce new taxes. While there is a growing national consensus for simplifying and reforming the tax system, the consensus for additional federal tax revenues is not entirely clear. Most of the major tax reform proposals being discussed, such as Bradley-Gephardt, Kemp-Kasten, and the Siljander 10 percent flat tax, are intended by their sponsors to be revenue neutral. Other comprehensive federal consumption tax proposals such as a national sales tax or value added tax, while clearly raising federal revenues, are unlikely to receive quick enactment.

This leads me to conclude that the trade off between long-term tax reform measures and the short-term need for revenue will result in pressure to enact both marginal changes in the existing tax code to broaden the income base and new federal excise and user fee taxes.

It is not clear how many more "tax loopholes" can be closed. What can be identified and is likely to be carefully reviewed, however, is the wide array of tax expenditures — special exclusions, exemptions, credits, deductions, and preferential tax rates — which will total over $370.0 billion this year. For agriculture this means defending special rules for deducting certain items before the income from them is realized, supporting cooperative's deductions for "patronage dividends," and justifying the wide array of special agriculture depletion allowances while at the same time other public programs are attempting to conserve those same natural resources.

Major short-term revenue measures that are likely to be considered by the Congress involve some modification to the tax-indexation provisions due to go into effect in January or the implementation of a short-term surtax. Of particular concern to agriculture, however, is the increasing attention being given to a simple broad-based energy tax.

Conclusion

I end where I began — there is no end to the number of possibilities for correcting our growing budget deficit. Where the political will exists the problem can be solved. According to a recent survey of farmers in Oklahoma and Illinois conducted by Tweeten, farmers are willing to make some sacrifices in terms of commodity programs to lower the federal deficits [8].

The question is, are the other 227 million Americans willing to make similar sacrifices?

REFERENCES

[1] Congressional Quarterly. *Lobbies.* Washington DC: Guide to Current American Government, Fall, 1983.

[2] Friedman, Milton and Rose. *Tyranny of the Status Quo.* New York: Harcourt Brace Jovanovich, 1984.

[3] Greider, William. "The Education of David Stockman." *The Atlantic Monthly.* Dec. 1981.

[4] Keynes, John Maynard. *The General Theory of Employment, Interest and Money.* First Harbinger Ed. New York: Harcourt, Brace & World, Inc, 1965.

[5] Ogg, Frederick A. and P. Orman Ray. *Introduction to American Government.* New York: D. Appleton-Century Company, 1945.

[6] Okun, Arthur. *Equality and Efficiency: The Big Trade-Off.* Washington DC: Brookings Institution, 1975.

[7] Schumpeter, Joseph A. *The Theory of Economic Development.* New Brunswick NJ: Transaction Books, 1911.

[8] Tweeten, Luther. "Agricultural Programs in the Future." Paper presented at the TVA Fertilizer Conference, Des Moines IA, 11 Aug. 1984.

[9] WGBH Educational Foundation. "Down on the Farm." Transcript, 20 March 1984.

[10] *Wall Street Journal.* "Budget Mantras." 14 Sept. 1984.