The Analysis of Fiscal Policies - Past and Present [1]

How may one characterize the fiscal policies and actions of the Kennedy Administration, and compare them with those of the Eisenhower Administration? I shall approach this subtle question by proposing a systematic set of criteria for analyzing Federal fiscal policies, and then applying these criteria to the available data of the fiscal years 1953 through 1962. On a basis of this analysis, it is possible to draw scientific and meaningful conclusions regarding the fiscal performance of the nation under the present Administration and under its predecessor.

Fiscal policies are those policies which govern the financial transactions of the Federal government (other than the Federal Reserve System) with the rest of the U.S. economy. There is no need to emphasize their importance to an economy in which Federal cash receipts from the public form about 20 percent of the gross national product. What is needed is a generally-accepted framework for analyzing fiscal policies which will reveal their essential characteristics, pose the salient issues, and guide our choices from among the alternative paths the nation may follow.

Popular discussions of fiscal policy are preoccupied with such questions as: When will the Federal budget be balanced? How can the Federal debt be reduced? What is the prospect of tax reduction? These are not fundamental questions; they are generally debated with such loose definition of terms that the results are vague

(1) This paper has benefitted from comments by Arthur F. Burns, Paul A. Samuelson, Harold M. Somers and Jacob A. Stockfisch, but none of them necessarily agrees with its conclusions. The central ideas were presented to the 54th Annual Conference of the National Tax Association at Seattle, Washington, on September 7, 1961.

or meaningless. The extensive professional economic literature does deal with fundamental issues, but nearly always with special aspects of fiscal policy rather than with policy as a whole.

An Analytical Framework

Use of a comprehensive framework for analyzing the fiscal policy of an Administration can assure that all of the basic issues are considered, and all of the salient changes are observed, so that the policy can be judged as a whole. It can thus show the bearing of fiscal policy upon the attainment of the primary national economic goals — full employment, steady and vigorous growth of output, and a reasonably stable price level (2). It is proposed that such a framework of analysis be based upon the consolidated cash budget as the relevant concept, and the principle of balancing this budget under conditions of full employment (3). A Federal budget so conceived should then be analyzed with respect to its (a) expenditure structure, (b) revenue structure, (c) level of balance, and (d) flexibility through business cycles. It is assumed that the object of a coherent fiscal policy is to bring about such changes in these budgetary factors as will move the economy most rapidly toward its goals.

The proposed analytical structure is summarized for the convenience of those who prefer a precise symbolic formulation in Figure 1. While its several elements are by no means novel, the effort to correlate them within a single analytical framework and to apply this framework to the fiscal data generated by successive Federal Administrations does appear to represent a novel and useful methodology. We shall first discuss the elements of the analytical scheme for the purpose of clarifying their meaning and showing their relevance.

(2) These three primary goals of economic policy were chosen both by the Commission on Money and Credit and the Joint Economic Committee of Congress. See *Money and Credit* (Englewood Cliffs: Prentice Hall, 1961), pp. 12 et ff., and *Report on Study of Employment Growth and Price Levels* by Joint Economic Committee (Washington: U.S. Govt. Printing Office, 1961). Equilibrium in the international balance of payments might be added.

(3) "Full employment" is used herein to mean that 96 percent of the civilian labor force is employed, on a seasonally adjusted basis.

FIGURE I

A FRAMEWORK FOR THE ANALYSIS OF FEDERAL FISCAL POLICY

Symbols (annual rates in current dollars)

Let G_c	=	consumption-type government cash expenditures
» G_i	=	investment-type government cash expenditures
» G	=	total government cash expenditures ($G_c + G_i = G$)
» G^*	=	total government cash expenditures at full employment
» G_i^*	=	investment-type government cash expenditures at full employment
» T_c	=	taxes primarily on consumption
» T_s	=	taxes primarily on savings
» T	=	total government cash revenue ($T_c + T_s = T$)
» T^*	=	total government cash revenue at full employment
» GNP	=	gross national product
» GNP*	=	gross national product at full employment

Premises

1. Cash Budget Balance at Full Employment ($T^* = G^*$; *not* $T = G$)
2. Use of a Consolidated Budget ($T^* = G^*$; *not* $T^* = G^* - G_i^*$)

Analytical Factors

1. Expenditure Structure
   a) Consumption expenditure ratio (G_c/G)
   b) Investment expenditure ratio (G_i/G)
2. Revenue Structure
   a) Consumption taxation ratio (T_c/T)
   b) Savings taxation ratio (T_s/T)
3. Level of Budget Balance
   a) Rising (G^*/GNP^* and T^*/GNP increasing)
   b) Falling (G^*/GNP and T^*/GNP decreasing)
4. Budget Flexibility Coefficients (both automatic and deliberate)
   a) Revenue ($dT/dGNP$)
   b) Expenditure ($dG/dGNP$)

Budget Balance at Full Employment

The idea that the Federal budget should be balanced each year has long commended itself to most citizens as a prudent and desirable fiscal policy. Certainly, it has long been an expressed aim of Congress and the Executive, excepting during wars or severe national emergencies. During recent years, mainly as a result of teachings by economists and the educational efforts of the Committee for Economic Development and the National Planning Association, this fiscal principle has been modified to call for budgetary balance *only under conditions of prosperity*, when the resources of the economy are fully employed (4). Budget deficits are now accepted by sophisticated people in times of economic recession and growing unemployment as a means of contributing to the early recovery of the economy. Surpluses arising in times of over-full employment are expected to be used to retire debt and to help curb excessive demand and price inflation.

The fiscal principle of balancing the Federal budget under conditions of full employment represents a rational basic rule of Federal finance. Federal fiscal policy has been moving toward this rule in practice. In their budget submissions to Congress our Presidents have tended to estimate Federal revenues in subsequent fiscal years on the assumption of prosperous conditions. They have tended to present budgets which balance on the premise of prosperity. Nowadays, few persons seriously propose to raise tax rates in a recession, or to cut taxes during a boom, simply to achieve annual equality of Federal revenues and expenditures. There is general public understanding of the stabilizing influence upon the economy of automatic changes in Federal budget surpluses or deficits as a result of cyclical gyrations of the economy.

This growing acceptance of the principle of balancing the Federal budget under conditions of full employment represents great

(4) In recent years CED appears to have retreated somewhat from its earlier espousal of this principle. In 1959 it endorsed President Eisenhower's proposal for a balanced cash budget for fiscal year 1960, and called for a substantial cash surplus at full employment. Moreover, despite its recognition that various Federal expenditures have differential impacts on the growth of output, CED did not analyze the relation of expenditure and revenue structures to growth. See *The Budget and Economic Growth* (New York: CED, April 1959), pp. 1-2, 5, and *Fiscal and Monetary Policy for High Employment* (New York: CED, December 1961), p. 26.

progress. Yet all of its implications have not yet been fully grasped. One implication is that there should not be any arbitrary overall limitation on the amount of the outstanding Federal debt. Positive or negative changes in the size of the Federal debt are necessarily equal to the amounts of deficits or surpluses in the Federal budget (5). The future size of the debt will therefore depend upon the degree of success achieved in maintaining full employment. If demand presses against the capacity of the economy most of the time, the debt will decline. If unwise economic policy in non-fiscal fields prevents the United States from enjoying full employment for extended periods, the debt will rise. U.S. economic goals cannot, of course, be attained by fiscal policy alone. Well-conceived monetary and credit policies are also required, as well as policies to reduce monopoly power and promote the mobility of resources and the flexibility of the price system. However, it would be illogical to reject a rational rule of fiscal policy on the ground that other economic policies will be faulty! In fact, a good measure of success was attained in maintaining full employment during the 1950's, and the Federal debt rose much less rapidly than did the GNP. Barring a world war, there are grounds for believing that this will also be true in the 1960's. One may conclude that the amount of the Federal debt can safely be allowed to vary in accordance with the requirements of the principle of full-employment balance of the Federal budget.

It should be noted also that the highly progressive Federal income tax structure, when applied to a growing economy, tends through time to produce an increasing budgetary surplus at full employment. This is so because Federal revenues rise more rapidly than previously programmed expenditures. Periodical reductions in taxes or increases in expenditures are therefore necessary to restore budgetary balance at full employment.

The Consolidated Cash Budget

There is now general agreement on the principle that balance should be sought in the *consolidated cash* budget of the Federal government, because it measures the outflow of all Federal cash

(5) Use of the consolidated cash budget implies, of course, that it is the *publicly-held* Federal debt rather than the total outstanding Federal debt which is relevant.

payments to the public against the inflow of all cash receipts from the public. Thus it provides a comprehensive measure of the impact of Federal finance upon the economy. The administrative budget presented to Congress by the President affords only a partial and even a misleading view of Federal fiscal policy. By excluding the Federal-aid Highway Fund, the Old Age and Survivors Fund, and other large and growing trust fund transactions, the administrative budget has become increasingly inadequate as a tool of fiscal analysis. Balance in the administrative budget may be associated with considerable imbalances in the consolidated cash budget. The tendency of recent years to exclude important Federal activities from the administrative budget is unfortunate. This point would be unimportant if the differences between the two budgets were trivial. In fact they differ by more than 25 percent (6).

Acceptance of the principle of balancing the consolidated cash budget means that *all* Federal expenditures should be balanced by *current* revenues. This, too, has important implications. Unlike many foreign countries, U.S. state and local governments, and American private enterprises, our Federal government attempts to finance all of its expenditures by current revenues. It does not divide outlays for current operations and outlays to acquire productive assets or to develop the economy, and finance the latter by long-term borrowing. This budgetary practice is important because investment-type Federal expenditures are very large. Huge Federal outlays are made every year to acquire earning assets such as loans, to construct socially-productive assets such as highways, dams, airports and public buildings, and to develop the economy through education and research. These outlays yield most of their returns to society long after the year in which the expenditures are made.

Investment-type expenditures are budgeted at $30.3 billions in the fiscal year 1962, and form more than 37 percent of total Federal expenditures in the administrative budget. To this should be added another $5 billions or more of highway construction, loan acquisitions, and other additions to national assets financed by the Federal trust funds. Even if one ignores all expenditures for military equip-

(6) Expenditures proposed for fiscal 1962 by President Kennedy in March 1961 were $84.3 billions under the administrative budget and $106.3 billions under the consolidated cash budget —26 percent more. The national income accounts budget is also comprehensive, and records government purchases and receipts when liabilities accrue rather than when cash is transferred.

ment and for research, development, test and evaluation of military weapons, on the grounds that they obsolesce rapidly and represent a form of consumption, roughly $15.5 billions of the Federal expenditures proposed for fiscal 1962 would finance additions to productive assets and other activities that promote the long-term growth of the economy. This is almost 20 percent of the administrative budget — one dollar in every five. If proposed Federal spending of $10.9 billions on asset acquisitions alone had been capitalized and financed by borrowing, a large surplus would have been forecast in the *operating* budget of the Federal government for fiscal 1962 (7). There is no doubt that the Federal government is an important agency of saving and capital formation (8).

Grave political as well as theoretical difficulties would be presented by use of separate capital and operating budgets in U.S. Federal finance, which justify the use of one consolidated cash budget. Experience in other countries shows that politicians tend to capitalize what are really current operating expenses in order to balance operating budgets. Also, the difficult problems of determining appropriate depreciation allowances on public assets can be avoided. Yet one should recognize the strongly conservative bias involved in this choice. Such a recognition should serve to moderate concern about the deficits occasionally entailed by acceptance of the principle of balancing the cash budget at full employment. One may feel more comfortable if the Federal debt rises in order to expand the productive power of the economy than if it rises to finance military activities or social consumption.

Finally, one should recognize that the fiscal principle of balancing the cash budget at full employment (or any other fiscal principle)

(7) The estimate was arrived at by adding: acquisitions of civilian assets of $4.8 billions, military sites and construction of $1.6 billions, Federal-aid highway expenditures of $3.2 billions, and Federally-financed additions to private and state and local assets of $1.3 billions, to give total asset acquisitions of $10.9 billions. Expenditures for education, training, and health are $1 billion, and for civilian research and development are $1.8 billions. To this was arbitrarily added $1.8 billions, 25% of the research and development expenditures of major national security agencies, on the ground that this fraction of the R. and D. expenditures of the Atomic Energy Commission and the Department of Defense would be made under civilian auspices in the absence of any national security programs. See Special Analysis D. Budget of the United States, 1962, pp. 997-1007.

(8) Goldsmith estimates that during 1954-58 Federal capital formation was 14% of national gross capital formation, defined to include consumer durables and durable military assets, and amounted to $19 billions per annum. *Studies in the Postwar Capital Markets: Summary Volume* (Nat .Bur. of Econ. Research, Mss., 1961), Table 3-3.

may have significant monetary consequences, because budget surpluses or deficits may affect the supply of money or the liquidity of the public's assets, depending upon methods of managing the Federal debt. A full discussion of these matters lies outside the scope of this paper. We may safely assert that there are no inherent difficulties in reconciling an appropriate monetary policy with this fiscal principle.

The Structure of Expenditures

An important and often neglected parameter of fiscal policy is the structure of Federal expenditures. Far from being one homogeneous undifferentiated total, a broad but vital economic distinction should be drawn between consumption-type and investment-type Federal expenditures. The former include those made on general government administration, interest on the debt, and aids to agriculture, business, housing, veterans or the aged which do not measurably increase society's productivity or stock of productive capital. Investment-type expenditures, such as those previously cited, do have these consequences. Federal outlays on housing subsidies, medical care for the aged, or pensions to indigent people may be justified on other grounds; but they are not growth-promoting in character (9).

If the nation intends to give priority to the goal of a higher rate of economic growth in the future, the implication is that there will be a *relative* shift in the structure of Federal spending, a reduction in the consumption-expenditure ratio, and an increase in the investment-expenditure ratio. There is urgent need for deeper analysis of governmental expenditures and their role in capital formation (10).

(9) Many outlays are difficult to classify. Thus, educational outlays by the Veterans Administration are undoubtedly growth-promoting while those on institutional and medical care to permanently disabled veterans are not. However, the dual classification is more important for policy than the usual distinction between government purchases and transfer payments.

(10) To ignore the distinction between consumption-type and investment-type expenditures of government in U.S. national economic accounting results in a large understatement of total gross investment in the U.S. economy. Gross *private* investment is usually compared with the GNP. But *public* investment by the Federal government of around $15 billions, and by the state and local governments of around $11 billions, total $26 billions. (See *Survey of Current Business*, March 1961, p. 18). This compares with $72.8 billions of gross private domestic investment in 1960 (*Economic Indicators*, May 1961, p. 7). Hence

The Structure of Revenues

The Federal revenues that enter into a cash budget balanced at full employment also need analysis. The most useful single distinction lies between taxes which rest mainly on consumption, such as the Federal sales and payroll taxes, and those which fall mainly upon savings and investment, notably on personal and corporate incomes and estates. Without entering into the complexities of tax incidence theory or attempting to evaluate divergent ideas about tax reform, it is possible to make two observations. First, the U.S. Federal revenue system bears relatively heavily upon the supply of savings, because two-thirds of all Federal receipts derives from taxes in individual and corporate incomes. Secondly, in the consensus of experts the present structure of Federal revenues appreciably blunts both the inducement and the ability to invest, notably by taxing corporate earnings doubly, first to corporations and again to stockholders as dividends are received. Consequently, the present structure of the Federal revenue system tends to produce significantly lower rates of saving, investment, capital formation and economic growth than would alternative structures, including those of such advanced industrial nations as West Germany or the Soviet Union (11). It is important to know, therefore, whether the relative reliance upon taxation of savings is diminishing or increasing, by observing movements in the savings-taxation and consumption-taxation ratios.

The Level of Budget Balance

Another important parameter of fiscal policy is the *level* at which the Federal budget is balanced under conditions of full employment. Obviously, balance may be achieved with any number

the gross investment/output ratio for the U.S. was about one-third higher than usually calculated — a fact of some importance in comparing this ratio with that of the U.S.S.R., where all investment is necessarily public.

(11) The implication is that the incidence of the bulk of taxes on corporate incomes is on the stockholders, at least in the short run. See "Business Income Taxation and Investment Incentives" by E. Cary Brown in *AEA Readings in the Economics of Taxation*, Musgrave and Shoup Eds. (Homewood, Illinois: Irwin, 1959), p. 535. The writer has presented a fuller statement of his views to the Committee on Ways and Means of Congress. See *Tax Revision Compendium*, Vol. I, pp. 157-167 (Washington: U.S. Govt. Printing Office, 1959).

of different combinations of equal revenues and expenditures. Because Federal revenues tend to rise more rapidly than previously programmed expenditures in a growing economy, as a result of a strongly progressive tax system, the central question is whether the ratio of budget level to the GNP rises or falls. In order to keep the Federal budget in balance at full employment, fiscal policymakers must face the question whether the growing budget surpluses generated by economic growth are to be eliminated by reducing taxes or by increasing expenditures. If balance is restored by reducing taxes, the level of budget balance will decline relative to the GNP; if it is restored by raising expenditures, the ratio will rise.

A rational decision will depend upon the point at which the social welfare produced by the marginal dollar of Federal expenditure just equals that produced by the marginal dollar of private expenditure. In practice a democratic political system produces a level of Federal spending (which in theory determines the amount of revenue required) that only roughly approximates this ideal. Some, like the National Association of Manufacturers, always consider the level of spending permitted by Congress to be too high; others, like the National Planning Association, usually argue it is too low. The economist, *qua* scientist, may not quarrel with the decisions of Congress. He may only point out that the level of budget balance can be as important to the economy as the amount of the current budget surplus or deficit, and that the margin of Federal and private expenditures itself shifts through time, as the relative social returns change with shifts in patterns of demand, incomes, and evolving technology. At certain times, maximum social welfare will result from a budget level rising in relation to the national product; at other times, the reverse will be true. In any event, it is important to know the current trend.

The Cyclical Flexibility of the Budget

The fourth key characteristic of a Federal budget is the degree of its sensitivity, on both the revenue and expenditure sides, to changes in the tempo of economic activity. Other things being equal, a budget which generates a large cash deficit as business activity declines below full employment, and a large cash surplus as the economy expands beyond the level of full employment, is superior to a budget which produces small deviations from a position of balance. This is true because the more sensitive budget exerts a more powerful stabilizing influence upon aggregate demand for final products of the economy. It is convenient to measure this sensitivity by the rates of change in budget receipts and in expenditures with respect to changes in the annual rate of GNP (See Figure 1).

The coefficients of automatic or " built-in " budget flexibility are determined primarily by the nature of the Federal revenue structure; and they tend to increase with the relative reliance upon personal and corporate income taxation. If, as we have argued, the Federal savings-taxation ratio is already so high as to appreciably reduce the amount of savings and investment, any further *permanent* increase in this ratio for the purpose of attaining greater cyclical budget flexibility will be purchased at the cost of a reduced long-term rate of growth of the economy, and will be unwise.

Total cyclical budget flexibility is the sum of the automatic changes " built-in " the basic revenue and expenditure structures, plus the deliberate changes that may be made by Congress or the Executive to enhance the stabilizing influence of the budget. In order that deliberate increases in taxes or reductions in Federal expenditure to curb booms, and deliberate reductions in taxes or increases in Federal expenditures to expand aggregate demand during recessions, may have a cyclical stabilizing effect without permanently altering the revenue and expenditure structures in ways which adversely affect long-term growth, it is vital that all deliberate changes made for purposes of cyclical stabilization be enacted and plainly labelled as temporary measures (12).

The simple analytical structure that has been developed may now be applied to the fiscal policies of the Eisenhower and Kennedy administrations.

Cash Budget Balance at Full Employment Under Two Administrations

Have the Eisenhower and Kennedy Administrations differed in regard to the principle of balancing the cash budget at full employment?

(12) Of course a long-term structural change in Federal taxation which happened simultaneously to serve the short-term cyclical needs of the economy could properly be enacted as a " permanent " measure.

Careful readers of President Eisenhower's budget messages and administrative record can be in no doubt that his Administration used the Federal budget as an instrumentality of economic stabilization. His budget proposals to Congress were generally predicated on revenue receipts estimated under reasonably prosperous conditions. If prosperity did not materialize and unexpected budget deficits emerged, as happened in the cyclical recessions of 1954, 1957, and 1960, they were accepted by the Executive. At no time were tax increases recommended in times of under-employment to cure budget deficits. Indeed, during the recession of 1953-54, tax reductions of $7.2 billions on an annual basis were accepted or deliberately made — in the face of a budget deficit — in order to stimulate aggregate demand (13).

Although the Eisenhower Administration in fact used the budget as a stabilizing instrument, it did *not explicitly* accept the principle of budget balance at high employment. On the contrary, President Eisenhower's budget messages and the statements of his Secretaries of the Treasury generally emphasized the desirability of balancing the budget as soon as possible. The fiscal actions of the Eisenhower administration were distinctly less orthodox than its preachments!

The Kennedy Administration has also operated implicitly on the basis of a compensatory fiscal policy. In the March 1961 revision of the Eisenhower budget proposals for fiscal year 1962, President Kennedy proposed to increase expenditures in the administrative budget by $3.4 billions, he estimated revenues at $0.9 billion less, and he foresaw a deficit of $4.3 billions for fiscal 1962. Subsequently, he made additional expenditure proposals that will greatly enlarge the prospective deficit. Yet Secretary of the Treasury Dillon justified the additional expenditures on the ground that a business boom would develop during 1962 and 1963 which would raise estimated revenues in fiscal 1963 to more than $90 billions and produce a budget surplus (14). Evidently, an approximation to the principle of budget balance at full employment also governs the fiscal policy of the Kennedy Administration, as the President's Budget message for fiscal year 1963 made clear (15).

(13) See *Economic Report of the President to the Congress*, January 1955, pp. 19-20.

(14) Address to the National Press Club, Washington, D.C., June 27, 1961.

(15) Progress has been made toward public understanding and acceptance of a compensatory fiscal policy since Heller made his assessment of this matter. Cf. WALTER W.

Unfortunately, the budget messages of neither Administration have focussed attention upon the consolidated cash budget, and have continued to discuss fiscal policy in terms of the analytically inferior administrative budget.

Expenditure Structure Under Two Administrations

The primary changes in the structure of Federal expenditures under the Eisenhower Administration are best shown by a comparison of the relative importance of major investment-type and consumption-type expenditures made in the fiscal year 1954 and proposed for the fiscal year 1962 in the administrative budget. (See Table 1). These fiscal years were the first and the last in which President Eisenhower had initiating authority over the administrative budgets (16).

Federal expenditures under the administrative budget were proposed to rise by 20 percent over the eight-year Eisenhower period, from \$67.8 billions to \$81.5 billions. This was only about half the 39 percent rise in the GNP between calendar years 1954 and 1960. However, a rising fraction of Federal expenditures were being made outside the administrative budget, through the Highway, OASI and other trust funds, so that cash payments of the Federal government were increasing *pari passu* with the GNP.

The most significant fact about the structure of Federal expenditures under Eisenhower is that a small shift was made from consumption-type expenditures (which fell from 61.9 percent of total expenditures in 1954 to 60.7 percent proposed in 1962) to investment-type expenditures (which rose from 38.2 percent to 39.3 percent). Research and development outlays especially rose sharply under the Eisenhower Administration. Among other actions, it established the National Federal-aid Highway Fund and the National Aviation and Space Agency, passed the National Defense Education Act, and

HELLER, "CED's Stabilizing Budget Policy after Ten Years". *American Economic Review*, Vol. XLVII, No. 4 (Sept. 1959), pp. 634-651.

(16) Comparison of expenditures under the consolidated cash budget would have been more meaningful but data are not available. Use of the fiscal years 1954 and 1962 is admittedly arbitrary to the degree that they may not have been accurately representative of preceding or succeeding fiscal years, and that Federal expenditures necessarily reflect forces beyond the control of a President. However, it is believed that the terminal years span a long enough period of time to reveal broad trends.

TABLE 1

ANALYSIS OF NET FEDERAL EXPENDITURES UNDER ADMINISTRATIVE BUDGETS ACTUAL 1954 AND PROPOSED 1962, FISCAL YEARS (1)

(Billions of dollars)

	Actual 1954		Proposed 1962	
	Amount	Percent	Amount	Percent
I. *Investment-Type Expenditures:*				
1) Additions to Assets				
Civil	\$ 2.8	4.1	\$ 4.8	5.9
Nat. Security	19.9	29.4	15.9	19.5
	22.7	33.5	20.7	25.4
2) Developmental				
Civil	1.6	2.4	4.2	5.2
Nat. Security	1.6	2.4	7.1	8.7
	3.2	4.7	11.3	13.9
Sub-total	25.9	38.2	32.0	39.3
II. *Consumption-Type Expenditures:*				
1) Aids to Specific Groups				
Civil	8.5	12.5	13.5	16.6
Nat. Security	3.7	5.5	1.7	2.1
	12.2	18.0	15.2	18.7
2) General				
Civil	8.5	12.5	11.6	14.2
Nat. Security	21.3	31.4	22.7	27.8
	29.8	43.9	34.3	42.1
Sub-total	42.0	61.9	49.5	60.7
Total	\$ 67.8 (2)	100.0	\$ 81.5 (2)	100.0

(1) *Source*, Special Analysis D, *Budget of the United States*, 1954 and 1962.
(2) Totals are *before* deducting interfund transfers. Figures do not necessarily add to totals because of rounding.

greatly expanded its support of basic research through the National Science Foundation. Shifts in the Federal expenditure structure under the Eisenhower administration thus gave relatively more impetus to economic growth.

President Kennedy proposed in March 1961 to increase Federal expenditures during fiscal 1962 by \$3.4 billions in the administrative budget and \$4.5 billions in the cash budget over the levels of fiscal 1961, despite the fact that his proposal for fiscal year 1961 already involved an increase in expenditures of $1.6 billions in the cash budget over Eisenhower's original budget recommendations. Data are not yet available for a detailed analysis of the proposed new outlays into investment-type or consumption-type expenditures. However, $1.3 billions is designated for labor and welfare, $0.6 billion for agriculture, and $1.5 billions for trust fund payments, mainly on account of increased old age and survivors and unemployment benefits. A major part of the proposed increment appears to represent consumption-type outlays (17). This may portend a reversal of the trend in Federal expenditure structure under Eisenhower — toward reducing the *relative* importance of investment-type expenditures. If more rapid economic growth is, indeed, to receive the increased emphasis called for by the Kennedy Administration, it appears that its changes in the structure of Federal expenditures may be the opposite of those required.

Revenue Structure Under Two Administrations

Salient changes in the structure of Federal revenues under the Eisenhower Administration are shown in Table 2. Therein cash receipts from the principal sources during fiscal year 1954 and estimated receipts for fiscal year 1962 are classified into taxes *primarily* upon savings and taxes *primarily* upon consumption. The implication is that more than half the burden of taxes in the first group is borne by the payers and reduces their saving, and that the major part of the burden of taxes in the second group is shifted to consumers and reduces consumption. The classification is admittedly arbitrary and debatable, because it depends upon judgments regarding the primary incidence of Federal taxes, a subject to which economic theory offers only incomplete or uncertain answers (18). It

(17) Since this paragraph was written President Kennedy proposed, and Congress appropriated, an additional $3.5 billions to strengthen the nation's defenses. Nearly all of this will be spent on consumption, as defined herein.

(18) The personal income tax has been classified herein as being primarily on savings, although a considerable part of taxes levied on the first bracket of income undoubtedly serve to reduce consumption.

The employment taxes levied on payrolls are treated as taxes primarily upon consumption on the ground that half the tax is paid by the employer and becomes a part of unit costs of production passed on to consumers in higher prices. An argument can be made for treating the one-half of employment taxes nominally levied on employees as a form of

TABLE 2

ANALYSIS OF FEDERAL GOVERNMENT RECEIPTS FROM THE PUBLIC, FISCAL YEARS 1954 AND 1962

(Billions of dollars)

	Actual 1954		Estimate 1962	
	Amount	Percent	Amount	Percent
Taxes Primarily on Savings				
Individual Incomes	$ 29.5	41.2	$ 45.5	44.1
Corporation Income and Excess Profits	21.1	29.5	20.9	20.3
Estate and Gifts	0.9	1.3	2.0	1.9
Veterans' Life Insurance Premiums	0.4	0.6	0.5	0.5
Sub-total	$ 51.9	72.6	$ 68.9	66.8
Taxes Primarily on Consumption				
Excises	10.0	14.0	13.0	12.6
Employment Taxes	5.4	7.5	13.1	12.7
Customs	0.5	0.7	1.1	1.1
Deposits by States, Unemployment Insurance	1.2	1.7	2.4	2.3
Other Receipts	2.5	3.5	4.6	4.5
Sub-total	$ 19.6	27.4	$ 34.2	33.2
Total	$ 71.6	100.0	$ 103.1	100.0

Source, Special Analysis A, *Budget of the U.S. Fiscal Year 1962*, p. 979.

is intended to reflect the consensus of tax theorists, and is of course capable of much refinement. However, a crude approximation to the truth suffices for the present purpose, which is only to discover broad trends rather than to measure incidence precisely at a point of time.

Taking Table 2 at its face value, it appears that a substantial shift occurred under the Eisenhower Administration toward greater *relative* reliance upon taxes burdening consumption and diminished reliance upon taxes bearing heavily on savings. Over the eight-year

personal income taxation. Because it is levied on all employees without exemptions or deductions, it differs from the Federal personal income tax and probably falls more on consumption than on saving.

period the percentage of Federal receipts coming from taxes primarily upon savings fell from 72.6 percent to 66.8 percent. The primary elements in this overall change of the revenue structure were sharp increases in revenues from employment taxes, and the absence of any expansion in revenues from corporate income taxes. During the eight-year period, payrolls rose and tax rates were successively increased. There was no change in the rate of taxation of corporate profits, and aggregate corporate profits failed to expand as rapidly as the economy. Hence the shift toward relative reliance upon consumption taxation was mainly fortuitous rather than deliberate. But it was consistent with fiscal efforts to foster more rapid growth of the U.S. economy.

In view of the emphasis placed by President Kennedy on the need to make the U.S. economy " move ahead " rapidly, one might infer that his revenue policy would favor tax reforms that strongly augment both savings and the inducement to invest (19). So far, the most important measure proposed by his Administration to stimulate business investment is to reduce the corporate income tax of a business corporation by 8 percent of its capital expenditures, at an estimated annual revenue cost of $1.7 billions. While this reform would stimulate business investment, its net effect would be diminished by other business tax reforms with which it was coupled, and it has been cogently criticized on grounds of capricious discrimination and inequity among business corporations. The proposal manifestly discriminates unjustly in favor of profitable and against unprofitable firms; in favor of new and against established firms; and in favor of firms just undertaking large equipment programs and against those which have recently completed them. It alters in unpredictable ways the time-path of business investment. Businessmen have been almost unanimous in expressing a preference for an outright reduction in the corporate profits tax and for greater latitude in depreciating business assets at rates

(19) More saving does not, of course, necessarily lead to more investment. It will do so only if investment incentives are sufficiently strong and if the conditions of the capital markets are favorable. This requires appropriate monetary policies as well as suitable tax and expenditure structures, both of which affect both current expenditures and investment. See HAROLD M. SOMERS, " Federal Expenditures and Economic Stability: The Fallacy of the Balanced Budget ", in *Federal Expenditure Policy for Economic Growth and Stability* (Government Printing Office, 1957), pp. 412-419.

approximating their economic lives. The Kennedy Administration has proposed to maintain the corporate profits tax at the Korean emergency rate of 52 percent, and has not brought forth comprehensive measures for structural reform of the Federal revenue system along growth-promoting lines.

Level of Budget Balance Under two Administrations

Under the Eisenhower Administration, Federal cash payments to the public increased by almost the same percentage as did the GNP, although expenditures under the administrative budget rose half that percentage. This may be seen by comparing the behaviour of Federal cash payments and budget expenditures over the eight fiscal years ending June 30, 1954, through 1961 with the GNP over the calendar years 1954 through 1960 (20). Although outlays under the administrative budget shrank relative to GNP, this budget covered a diminishing fraction of total cash payments which form the more accurate gauge of the relation of Federal government to the economy.

GNP (Calendar Years)		Cash Payments (Fiscal Years-ending 6 months later)	Budget Expenditures (Fiscal Years-ending 6 months later)
1954	$ 363.1 billion	$ 71.9 billion	$ 67.5 billion
1960	50.4 »	99.3 »	81.5 »
Increase Amt.	$ 141.3 »	$ 27.4 »	$ 14.0 »
Increase %	39.0	38.1	20.7

Despite the strong rise in cash outlays, it appears that the Eisenhower fiscal policy involved a substantial cash surplus under conditions of full employment. The actual cash surplus in fiscal 1960 was $0.8 billion, despite an unemployment ratio of 5.6 percent denoting about 40 percent more jobless persons than under full employment. The potential surplus that would have been generated under

(20) See *Budget of the U.S. Fiscal Year 1962*, and *Economic Indicators*, June 1961.

full employment conditions would probably have been of the order of $5 billions annually (21). The Eisenhower level of budget balance thus contained a moderate *deflationary* bias with respect to the economy, in the sense that either expenditures should have been enlarged or taxes reduced by this amount in order to restore balance at full employment.

The increases in Federal cash outlays so far proposed by the Kennedy Administration will involve a rise in the Federal expenditure level of about 8 percent within one fiscal year. Substantial annual increases are in prospect for subsequent years, if one may judge from the long-term obligational authority being requested from Congress for foreign aid, NASA, and other programs. We may tentatively conclude that the Kennedy fiscal proposals are quickly eliminating all deflationary bias in the cash budget, and probably will create an inflationary fiscal bias unless taxes are increased. The Kennedy Administration has begun a process of increasing the level of Federal expenditures relative to the GNP, whereas this relation was held near constancy during the Eisenhower Administration.

Cyclical Budget Flexibility Under Two Administrations

How may one contrast the Kennedy and Eisenhower Administrations with respect to their influence on automatic and deliberate budget flexibility? Other factors remaining the same, high coefficients of budget flexibility — resulting from both automatic changes built into established revenue and expenditure programs and deliberate countercyclical changes in such programs — are desirable attributes of fiscal policy.

Lusher estimated that the coefficient of stabilizing flexibility of the U.S. governmental budgets during 1954 was around 33 percent (22). No more recent and equally rigorous estimates of cyclical

(21) Stein and Denison estimate that the GNP during 1960 at full employment would have been $525 billions, or $21 billions more than was realized. See *Goals For Americans* (New York: Prentice-Hall, Inc., 1960), p. 168. Assuming that the average marginal Federal tax rate was 20%, Federal cash receipts would have been $4.2 billions greater. Adding this to the actual cash surplus of $0.8 billion yields a full-employment surplus of $5 billions.

(22) See his important paper, "The Stabilizing Effectiveness of Budget Flexibility", *Policies to Combat Depression* (Princeton: Princeton University Press, 1956), pp. 77-89, and

budget flexibility have been made; but we may use this estimate as a basis for comment on the direction and magnitude of probable changes in budget flexibility since 1954.

The most important determinants of the coefficient of budget flexibility are the tax rates on the initial brackets of personal and of corporate income. They did not change during the Eisenhower Administration. However, the coefficient of automatic budget flexibility probably rose as a consequence of the higher rates and broader coverages of payroll taxes and unemployment compensation. In addition, as has been noted, the Eisenhower Administration fortified the automatic stabilizing influence of the budget with weighty deliberate actions to reduce taxes and raise the rates of public expenditure during the recession of 1953-54. During the recession of 1957-58 automatic budget flexibility was again an important factor in reducing the decline. It was augmented by deliberate action to enlarge Federal expenditures but not by a reduction in tax rates.

Moderate further increases have occurred in the coefficients of automatic budget flexibility under the Kennedy Administration, as a result of the further broadening of coverage and increase in the period and scale of unemployment benefits. While deliberately speeding up Federal expenditures, the Kennedy Administration did not recommend a cut in taxes in the spring of 1961 in order to curb the existing recession. Opinions differ on the wisdom of this judgment. Those who believe that private expenditures will powerfully respond to tax reduction will argue that a *permanent* tax cut early in 1961 would have put the cash budget in full employment balance and would have been preferable to rising Federal expenditures as a stimulus to the economy. Others, impressed by the stagnation thesis, will take the opposite view. The Kennedy Administration, it may be noted, has officially espoused the proposal (recently endorsed by the Commission on Money and Credit) that Congress grant the President power to make *temporary* changes in the tax rate on the initial bracket of personal income, in the interest of more prompt and powerful deliberate economic stabilization.

comments by Cohn, Caplan, Colm, Hart, White and Schultze, pp. 90-122. Lusher's coefficient represents the algebraic sum of rate of change in revenues and expenditures of Federal, state and local governments.

Conclusions

Analysis reveals no sharp breaks in the fiscal policy of the Kennedy Administration from that of its predecessor; but it shows some definite changes of course. The principal findings may be summarized as follows:

1. Both Administrations have used the principle of balancing the Federal budget under conditions approximating full employment, and the Kennedy Administration has explicitly accepted this principle.

2. Both Administrations have continued to focus attention upon balance in the administrative budget rather than in the analytically superior consolidated cash or national income accounts budgets.

3. Under the Eisenhower Administration there was a relative rise in investment-type expenditures of the Federal government and in the proportion of Federal revenues derived from taxes primarily upon consumption, both of which changes tended to promote the growth of the economy. Under the Kennedy Administration, the Federal expenditure structure may have placed relatively greater emphasis upon social consumption and the revenue structure has not been changed to enhance the ability and inducement to make private investment. These policies are inconsistent with a goal of more rapid economic growth.

4. During the Eisenhower Administration Federal cash payments expanded by the same percentage as the GNP. The ratio of cash payments to the GNP has risen under the Kennedy Administration and appears destined to rise further, portending an enlargement of the role of government in the U.S. economy.

5. At least during the later years of the Eisenhower Administration the Federal cash budget had a deflationary bias, in the sense of generating a surplus under full employment conditions, thereby contributing to unemployment. Under the Kennedy Administration prospective cash budgets probably contain an inflationary bias and will develop deficits at full employment, unless taxes are raised.

6. Automatic budget flexibility has increased somewhat under both Administrations, and both have energetically taken deliberate

actions to dampen cyclical fluctuations. President Kennedy has sought discretionary power to adjust tax rates in the interest of prompt and powerful stabilizing action.

One finds strengths as well as defects in Federal fiscal policies under both Administrations when they are judged by rational and consistent standards. It is to be hoped that more intensive analysis along the lines sketched herein will in the future both enlarge the area of agreement on appropriate policies and improve the performance of the U.S. economy.

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POSTSCRIPT

This paper was sent to the printer before President Kennedy had transmitted to Congress a proposed budget for fiscal year 1963. Analysis of his proposals, made after the writer had received page proofs, indicates that they generally conform to the trends in fiscal policy of his Administration during 1961 described in the paper, and call for no major changes in the text.

The deficit in the administrative budget is now estimated at $7 billions for fiscal year 1962. It is proposed to cover this deficit, plus a further rise of $3.5 billions of Federal expenditures, with an $11 billion rise in revenues under present taxes, to yield a surplus of $0.5 billions in fiscal year 1963. Only a huge expansion of the U.S. economy, of personal incomes and of corporate profits will achieve this result. Because the actual rise in expenditures is likely to exceed the forecast, and the actual rise in revenues — unless there is renewed price inflation — is likely to fall short of the forecast, the prospect is that a moderate deficit will appear in fiscal year 1963 under conditions of full employment.

N. H. J.