Carter's budget is a hoax

Like most of the Administration's undertakings, the Fiscal 1980 Federal Budget is a nearly transparent hoax, but a hoax in which the Administration is less the witting perpetrator than the pathetic plaything of events set in motion by others.

On two counts, the so-called austerity budget is dangerous and inflationary. On the first count, more dramatic (and in reality, less important), the Budget continues the pattern of 12 to 15 annual increases in combined "off-budget" (mainly Federal Financing Bank) and "Federal agency" borrowings which has prevailed since the 1975 "recession" year. Minus these borrowings, which built the biggest ball of economic fluff in U.S. business activity, the economy is still sitting on the 1975 trough. The net (after deduction of refinancing and the pass-along of assets to private lenders) of such borrowings by the FFB, mortgage support agencies, and others of such de facto Federal deficit spending for Fiscal 1980, is projected to be $58.5 billion, just double the official budget deficit estimate.

The problem has not gone unobserved in the past. **Executive Intelligence Review** noted the identical situation pertinent to the Fiscal 1979 Federal Budget. Economist Alan Greenspan, in a Nov. 23, 1979 analysis published in the Wall Street Journal, cited the inflationary growth of such "off-budget activity," although his proposal was to merely cease this activity and let the economy find its own way down.

But the far more inflationary feature of the budget is the decision to penalize precisely those sectors which contribute most to **fundamental counter-inflationary activity** in the economy, by way of compensation for the inflationary implications of past — including Ford Administration budget errors — including those taken while Alan Greenspan was Chairman of the Council of Economic Advisors.

According to the Economic Report of the President, issued on Jan. 25, 1979, "One of the most discouraging developments of 1978 was the very slow growth of productivity. Output per hour in the private non-farm business sector grew by only three-fourths of one percent during the year. Weakness in productivity growth did much to exacerbate inflation," now running at roughly 10 percent annually. This is not the occasion for a full discussion of the slowdown in the growth of productivity, but the disturbing trend is not a mystery. The life insurance companies and their first-cousins at bank trust departments have issued credit to the fluffiest sector of the economy at the expense of the most productive sector of the economy, while the government has discouraged the type of productivity-inducing programs in place, for example, at the height of the moonshot program.

The fact that productivity has failed to grow should be no surprise to anyone. The Carter Administration's great fault is that they have done the stupidest of all possible things in response to the inflationary result of this three-year development.

Writing off technology... and household income

First, what might be called the technology composition of the budget has plummeted, even relative to the decline of the last several years. The energy expenditures of the federal government will shift from encouragement of cost-reducing energy sources to cost-escalating sources. Allocation for research and construction in the nuclear fission area will fall from $1.24 billion to $1.037 billion, almost a one-quarter decrease when present rates of inflation are taken into account.

The increase in the military budget, which could positively or negatively affect productivity depending on its technological orientation, points in a similar direction. Military expenditures will rise from $114.5 billion in fiscal 1979 to $125.8 billion in fiscal 1980. All of the new programs, however, involve antiquated technology, e.g. the AEGIS destroyer, and the Sparrow, Pershing and Standard Missiles. Production of these items will not have the technological spinoff benefit of, for example, the scrapped B-1 bomber program or research into beam weapons.

Second, the main cutbacks in the budget directly affect household income, which has been stagnant or declining for the past ten years. Such changes include the following:

- Workmen's compensation rules used to allow the family of an injured worker to collect from 100 to 180 percent of his average weekly wage. Under the new budget, the upper collection limit will be set at 80 percent.
- Workers receiving federal government pensions will lose up to two-thirds of the dollar amount of their social security benefits that under current programs would be granted them when they retire. This affects more than 5 million federal workers.
- School lunch programs for the young will be trimmed by $400 million, spending for nutrition for the elderly will be sliced by $200 million, and government sponsored funeral payments for the indigent will be eliminated for all but the poorest.
- The Comprehensive Employment and Training Act (CETA) will be cut from its 1978 level of 725,000 jobs down to 546,000 by the end of the 1980 budget. While CETA was originally created to provide slave-labor jobs, it was diverted by most urban mayors into supplementing the city's payroll. The cuts in CETA could bankrupt some cities.

A quarter of a million summer youth jobs for 14 year olds will be cut to "save" $400 million. This will help to produce tens of thousands more drug addicts.

The elimination of youth programs, as well as the minimum level of maintenance of federal drug enforcement programs, point to a productivity problem that has escaped attention in most of the financial press, namely the effects of large-scale drug utilization on productivity. Roughly one-quarter of the nation's population between the ages of 12 and 25 are fairly regular drug users, a figure which includes a significant portion of the workforce, and reflects only somewhat lower rates of abuse among 25-to-35 year-old workers. Since official data show the rate of drug abuse on an exponential rate of increase, the effect on productivity is clearly enormous. The Southern Connecticut Manufacturers Association has prepared a study estimating that industrial accidents costing $30 billion annually can be attributed to drug abuse. No accurate data exist on the effect of drug abuse on the change in the rate of productivity increase, but the result is intuitively clear.

The drug abuse issue only illustrates the broader point in the budget's general approach, namely that it seeks to compensate for the inflationary effects of total federal government activity by cutting into areas of spending which immediately affect worker morale, and therefore productivity. What might be called the "second-order" effect of the inflationary orientation of previous budgets as described above, the penalization of household income, is far more inflationary in the long run than the "off-budget" spending.

Possibly, the reason that the budget's visible flaws have not been subject to public dissection (there has been more than sufficient griping of the predictable variety) is that the budget, on close examination, shows how badly rigged the economy is. To follow Alan Greenspan's suggestion and eliminate the inflationary **de facto** deficit spending elements would put the U.S. into recession which, on balance, the majority of the business community has decided they do not want.

Housing mortgage vs. construction

The mechanism of the problem centers on the housing sector and the mortgage market. The largest component of the 1975-1978 "recovery" occurred in the housing sector. The Economic Report of the President states that the "flattening out of residential investment outlays was a dominant element in the slower growth of real GNP in 1978," contrasting the 15 percent rate of increase in 1977 to the 3.5 percent rate of increase during 1978. Ignoring the stupendous level of federal-agency support for the mortgage market, the Report wonders whether credit market conditions played a role in depressing the rate of increase. It concludes that "the striking feature of the housing sector last year was its continued high level of activity in the face of sharply rising interest rates." The real constraint was more ominous: "The sharp rise in prices of a wide range of building materials suggests that the building industry was operating at close to capacity in 1978."

In other words, even though the housing sector was the center of aggravated speculative conditions during 1978, in which households took on large amounts of high-interest credit in order to acquire assets whose rate of price increase would outstrip the general rate of inflation, the relevant capital-goods sector was too weak to maintain the desired level of output without running into bottlenecks! That is pure shambles.

Between 1974 and 1977, the increase in total borrowing by households (from $48.6 billion to $139.6 billion) was roughly equal to the expansion of mortgage credit (from $55 billion to $131.0 billion, both numbers showing net new extensions in each year). What this reflects is the widespread use of mortgage credit by households to finance non-housing expenditures. Between 1975 and 1977, mortgage credit extensions jumped from one-quarter to two-fifths of total credit extensions.

This process locked the United States into a high-interest-rate, high-inflation environment, with the deleterious effects noted above. Given the failure to build additional or better capacity into the economy, the "off-budget" credit hoax is producing worse and worse results. Larger volumes of mortgage credit extensions are producing smaller increases in construction, and the entire perverse cycle is ready to give way. The "conclusion" is that somewhere, something has to come out of someone's hide. And that is what the Carter Budget proposes to extract. It is a prescription for disaster.

—*David Goldman*