

Fifty Billion To Play With? The Fear of Fiscal Drag

The famed economist analyzes the distortions and recklessness of a recent article by one of the *Times'* kept Keynesians. Not pretty, eh, Watson?

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"For three long years," warned President Roosevelt on March 10, 1933, when he had been in office only a week, "the Federal Government has been on the road to bankruptcy. . . . [By the end of the fiscal year 1934] we shall have piled up an accumulated deficit of \$5 billion. . . . Too often in recent history Liberal governments have been wrecked on the rocks of loose fiscal policy."

Since that warning we have drifted far in fiscal philosophy. For the current fiscal year President Johnson deliberately planned to have a deficit of \$5 billion, and it will probably come to much more than that. It will be the thirtieth deficit in 36 years. It will bring the accumulated deficit since the end of 1930 not to \$5 billion, but to more than \$306 billion.

In the next fiscal year, as the result of Great Society programs, it is unofficially estimated that federal spending will increase some \$13 billion over that in the current fiscal year. Until we get the budget figures in January, the fiscal outlook, on the basis of the best private estimates, runs something like this:

In the current fiscal year total cash revenues (including Social Security taxes, etc.) may run to some \$125 billion (or \$1.5 billion above the original official estimate). Total cash spending will be about \$130 billion. Next fiscal year revenues from the same taxes may increase to \$130 billion, or even \$132 billion. But total cash spending is expected to jump to at least \$143 billion.

If we wanted to stop the deficits and the inflation and balance the budget, what new or higher taxes could we levy to raise the needed \$10 to \$14 billion new revenue? And what would be the effect of such a tax hike in undermining incentives, reducing new capital investment, restricting

output, and depressing business? If we do not cut our planned expenditures, our only choice is between repressive tax increases and serious inflation.

This problem troubles some of us, but it does not trouble Edwin L. Dale Jr., of the *New York Times* (*Sunday Magazine*, Nov. 7). He seems completely unaware of the very existence of such a problem. On the contrary, what worries him to the point of obsession is whether Lyndon Johnson and his advisers will be able to think up enough ways to spend or otherwise get rid of what he contends is a threatened surplus of \$50 billion in the next five years.

Errors and Omissions

Here is his anxiety: Because of our constantly rising GNP, tax revenues will keep increasing year by year even if we don't increase tax rates. Tax receipts in the fiscal year 1970 will be \$50 billion higher than in 1965—\$170 billion instead of \$120 billion, counting in Social Security. Next year we will have "at least \$7 billion more than this year. The year after that the increase will be \$8 or \$9 billion. By 1970 the increase will reach \$50 billion, as compared with 1965." Unless the President and Congress can think of means to get rid of this dreadful surplus—either by dreaming up new ways of spending it or even by cutting taxes—"the money may never materialize," and the country will be plunged into unemployment and depression. "In a word, you give away the money to get the money; if you don't give away the money, you don't get the money."

Let us begin with the factual exaggerations, errors, or omissions in Mr. Dale's theory.

Over the last five years tax revenues have risen an average of \$2.8 billion a year in the administrative budget, and of \$4.7 billion a year in the total cash budget. A further rise of "\$7 or \$8 billion" next year, therefore, though it cannot be ruled out as impossible (particularly if we have enough price inflation), seems too much to count on.

And Dale combines this extremely generous estimate of a "regular" growth of \$50 billion in revenues over the next five years with an amazingly low estimate of the "regular, expected, . . . 'built-in' growth" in expenditures. "This . . . can be calculated with some precision, and it comes to about \$15 billion, the great bulk of it Social Security." Now as total federal cash expenditures have actually risen \$30 billion, or twice that much, even in the last five years, and as such expenditures are scheduled to increase \$13 billion in the next fiscal year alone, what excuse can there be for such a low estimate for the whole next five years?

Most incredible of all, in his article of more than 3,500 words, Dale never finds space to remind his readers that we have had thirty deficits in the last 36 fiscal years, or that we already face a prospective cash deficit of \$4 to \$6 billion in the current fiscal year.

So if, instead of viewing so complacently the revenue outlook for the next five years, and devising new ways of spending an imaginary \$50 billion surplus, Dale had confined himself to an earnest study merely of the next fiscal year, he might have seen that the real problem was, not how to think up ways of spending a \$7 billion surplus, but how to think up taxes to avoid a \$10 to \$14 billion deficit.

So much for factual unrealities. Dale's theoretical fallacies are so

numerous that we must confine ourselves to a few outstanding ones.

What worries him is what he calls "fiscal drag." This is the dreadful consequence of "eliminating money from the total spending stream." But Dale is extremely vague regarding the conditions under which "fiscal drag" occurs, and constantly confuses fiscal with monetary policies.

Even if we take Dale's concept seriously, "fiscal drag," if it occurred, would occur only when and to the extent that there was an actual cash budget surplus. With a balanced budget there would be merely fiscal neutrality. And with a deficit, of any size, there would be an actual fiscal push. If this is so, then we have had nothing but fiscal forward shoves in the last six years, and a much bigger one is in prospect for next year.

But Dale never mentions this. He talks as if not only an actual surplus but even a balanced budget would produce a serious "fiscal drag." In fact his whole article tacitly implies that anything less than the average \$4 billion annual cash deficit we have had in the last six years would bring on a dangerous "fiscal drag."

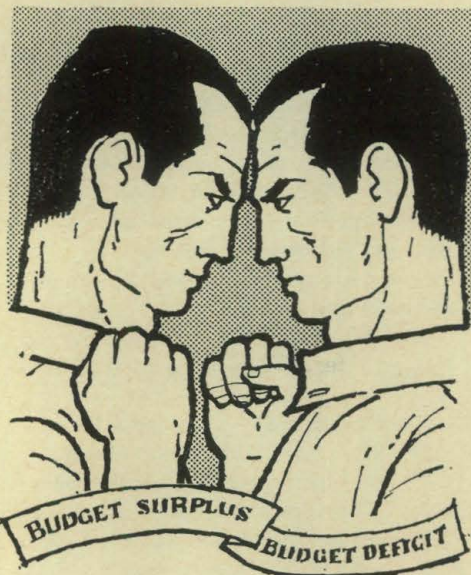
Nor does he ever make it quite clear whether it is a budget surplus in itself or a reduction of the money supply that is the real thing to be feared. And he is very vague concerning what actions or policies actually reduce the money supply.

Apparently the worst thing we could do, in his opinion (in an all but explosive inflation), is to achieve a surplus and use the money to reduce the national debt. He first says, quite correctly, that "paying off the debt *could* have the effect of simply eliminating money from the total spending stream." (My italics.) He then talks as if it *must* have that effect: "If the economy still has some unemployment and idle capacity, *as it has now*, debt reduction would simply make this condition worse." (My italics.)

Let's see. The national debt now stands at \$319 billion. About \$61 billion of government securities are held by the commercial banks and \$40 billion by the Federal Reserve banks. Against these \$101 billion of government securities, deposits and bank notes exist. But two-thirds of the national debt, or nearly \$218 billion, is held by individuals or non-banking institutions.

If a \$1,000 bond held by any of the latter is paid off, the individual owner, say, once more has the \$1,000 cash, and can use it either to spend or to invest. Neither the money supply nor the spending-and-investment "stream" has been reduced.

It is true that if the bond held by a member bank or a Federal Reserve bank is paid off, it will presumably mean at least a corresponding wiping out of a deposit credit, and so far a shrinkage of the "money supply." But if the bank wants to hold the same amount of government securities as before, it can simply use the refunded money to buy the same holdings of governments from individuals in the open market. Hence, not until our \$319 billion federal debt has been reduced to \$100 billion need its re-



duction mean any reduction at all in the money and credit supply.

The fear of a budget surplus, the fear of a debt reduction, the fear even of a balanced budget (all of which fears are shared by the Council of Economic Advisers) are based on the ultra-Keynesian conviction that the economy needs constant injections of additional money to maintain full employment, prosperity, and "economic growth." What the Keynesians still fail to recognize or admit is that the apparent successes of their remedy in the last few years have occurred because monetary inflation is a crude, cruel, and unjust blanket method of *offsetting* discoordination of price-cost relationships (commonly brought about by excessive wage-rate increases in individual industries), and that the proper remedy would be

the multitude of individual price-cost adjustments that a genuine free market economy would automatically bring about. (Dale's article never mentions wage-price maladjustments as a cause of unemployment.)

The Keynesian fallacies lead straight on to the gospel of big government and the gospel of extravagance and waste. The big problem for Dale, for example, is how to dream up new ways for the government to spend money. If a budget surplus is threatened, debt reduction is a recourse to be thought of only in an economy "overheated" to the point of catching fire. He regards even tax reduction as only "a *residual* use of part of the \$50 billion [expected surplus]: if sound and useful means of spending the money cannot be found." (My italics.)

In other words, the government need merely show that any expenditure it makes is of *some* conceivable use. It never occurs to Dale that not a dollar of government spending can be justified unless it can be proved that it is being spent for a purpose that is *more* useful and *more* urgent than the purpose for which it would have been spent by the taxpayers from whom it was seized.

As he warms up to his theme, Dale tells us at one point: "Defense spending, in fact, could be either higher or lower in 1970 than it is today, and if it is lower, *there will be even more than \$50 billion to play with.*" (My italics.) Billions for bureaucrats "to play with." This sums it up. The Dale philosophy—which on the past year's evidence is also the Administration's philosophy—leads to complete fiscal irresponsibility.

And it should not be necessary to spell out what fiscal irresponsibility leads to. The answer is becoming clearer every day. It leads, besides waste, to monetary inflation: which leads to wage rises and price rises: which lead to "voluntary guidelines," to foreign investment control and to arbitrary and extra-legal price controls: which will lead to more and still tighter controls: which will lead to business unsettlement and reduced, unbalanced and unsynchronized production: which will lead. . . . But let us not try to look more than five years ahead. The one thing there won't be is an accumulated \$50 billion budget surplus.