Domestic Credit by Richard Freeman

Fact and fiction about the budget

Itemizing what Volcker's policy has added to the deficit, and what Stockman will deduct from output.

I want to re-emphasize two particularly disturbing features of the budget approach presented by Office of Management and Budget Director David Stockman for fiscal years 1981 and 1982. First, his approach completely ignores the way Fed Chairman Paul Volcker's credit contraction has wrecked federal and state revenues while adding to recession-induced fiscal outlays. Second, while some of the proposed budget cuts are unobjectionable or positively useful, most of them represent a direct attack on the industry-building legacy of Alexander Hamilton.

Budget deficits per se are *not* a major cause of inflation. They add at most 1 to 3 percent to the U.S. inflation rate, currently in the range of 13 to 14 percent. Those who piously invoke the need to cut budgets and tighten money supply to fight inflation are either incompetent or less than candid.

One of the elements contributing more to the U.S. inflation rates than budget deficits is Paul Volcker's loan-shark interest rates. They make any economic recovery impossible no matter how well targeted budget cuts may be; and, because they intentionally drain funds from the productive sector of the economy to feed the wasteful speculative section, high interest rates perpetuate double-digit inflation.

Volcker has added the following costs to the fiscal year 1981 budget: $22 billion in extra interest to be paid on the public debt; $5 billion at minimum in higher unemployment compensation payments; and $3 to $20 billion in lost tax revenues, for a total on this account of $30 to $47 billion.

Let us next look at what OMB Director Stockman proposes to cut. Slashes in funding for synthetic fuels, solar energy, the Public Broadcasting System (PBS), and a few other programs, are to be heartily welcomed. This would save several billions of dollars.

But beyond this, many of the proposed cuts are an attack on Hamilton's explicit policy of internal improvements. At the heart of Hamilton's program is the idea that government participation in financing internal improvements in the economy, that in turn facilitate the transport, increase the speed of shipment, and augment production of goods, is a tremendous gain to the nation's wealth. These improvements more than pay for themselves in the form of increased tax revenues and other tangible gains.

Stockman has proposed:

• Eliminating the access of the Rural Electrification Administration (REA) to the Federal Financing Bank (FFB). The Federal Financing Bank, an off-budget item, issues bonds on behalf of the Rural Electrification Administration at low interest rates. The REA provides for the electrification of the nation's farm areas, aiding utilities, industry, and consumers.

Stockman says this cut will save $699 million for the federal government in the fiscal year 1981 and $13.3 billion more through fiscal year 1985. While his figures on savings are dubious, the cost to utilities, already being hit by Volcker's high interest rates, will be far greater, and will quite rapidly lead to curtailment of service.

Two other cuts demonstrate the same principle:

• Cutting by an unspecified amount outlays for inland waterways and harbor dredging. Supporting Stockman's proposal, a Feb. 15 *Washington Post* lead editorial argues: "And should the costs of harbor dredging fall on the general public or the shippers? That is another half-billion dollars [in potential cuts] a year."

The American waterway system, which reduces overhead costs of food commodities, would be sacrificed for a saving that is, in dollar terms, a fraction of what the program adds to the general commerce.

• Cutting, also by an unspecified amount, the U.S. highway funds as well as the "unneeded" subsidy of essential rail lines.

Conjoined to these cuts in Hamiltonian necessities, Stockman has proposed slashing the NASA program down from a level of $6.7 billion in 1981 to a level of $5.5 billion in fiscal year 1985—a reduction in half, after the adjustment for inflation. Stockman is also seeking a sharp 30 percent cut in the funding of Eximbank. Together NASA and Eximbank keep high technology disseminated throughout the economy. With the reductions he proposes, such industries as the airlines will suffer further record drops in profitability.