ECONOMICS, LABOR & BUSINESS

What Budget Deficit?

"Is the Federal Budget Out of Control?" by Richard W. Kopcke, in *New England Economic Review* (Nov.-Dec. 1981), Research Dept., Federal Reserve Bank of Boston, 600 Atlantic Ave., Boston, Mass. 02106.

A federal budget deficit simply reflects the government's irresponsible penchant for spending more than it earns; right? Wrong, says Kopcke, an economist with the Federal Reserve Bank of Boston. The federal budget is not even a conventional budget. Its "bottom line" has little to do with the "basic" balance between receipts and expenditures.

Unlike budgets of businesses and many state governments, the federal budget is a "cash flow statement," which fails to distinguish between capital investments [e.g., buying an aircraft carrier] and operating expenses [e.g., running and maintaining the ship]. A well-managed business can borrow funds for expansion and improvements, just as a well-run family can borrow money to buy a house. Yet a cash flow statement for either could well show a deficit. U.S. nonfinancial corporations reported $136 billion in profits after taxes in 1980 and a surplus of $77 billion after dividends were paid. But because of $331 billion in new investments, a cash flow statement would have shown the corporations with a deficit of $104 billion.

If the federal budget were put on a "businesslike" basis, it, too, would often show a surplus in its "current" or "operating" budget. Thus, the fiscal 1980 "budget" (i.e., cash flow statement) has a $74 billion deficit (including $14 billion in outlays of off-budget agencies). But if that budget were divided into operating and capital budgets, the record would indicate a $33 billion surplus.

A cash flow statement, whether for government or business, has another blind spot, at least in times of inflation: Higher interest costs show up in the statement, but the similarly higher values of capital assets do not. Thus, that $74 billion federal deficit for fiscal 1980 was matched by a hidden $76 billion hike in the value of existing government capital. Finally, a federal budget deficit (or surplus), however defined, by itself says little about how government fiscal policy is working. Too much taxation, by slowing the growth of the tax base, may have been what caused the erosion of the federal budget surplus during the 1970s, not too much spending.

Evaluating the "propriety" of a federal budget deficit requires looking at the costs of investments versus their promised payoffs and at the tax burden versus spending programs' social benefits. "The same care used in business financial analysis," says Kopcke, "must be applied to the government's accounts before policies can be judged." No single number tells the story.