Massachusetts Ave., N.W.
Washington, D.C. 20036
November 18, 1968

Honorable Richard M. Nixon
Hotel Pierre
New York, New York

Dear Mr. Nixon:

The Task Force on the Budget submits the enclosed report, "Management of the Federal Budget."

We have not dealt with the problem of improving the process by which Congress acts on the budget. There is much to be done there. However, we believe the most important contribution the President can make to improving congressional procedures is to improve executive procedures. If the executive decisions are the result of systematic, objective appraisal of the effectiveness of alternative programs in satisfying explicitly stated objectives, the whole national mode of thinking about government spending will change and in time congressional behavior will conform to that. We do urge as one additional step the President can take that effective liaison be established between the Bureau of the Budget and the congressional leadership to promote better congressional understanding of the President's budget strategy and procedures.

We call attention to the inauguration in 1968 of a new "unified budget" concept, resulting from the work of the President's Commission on Budget Concepts. Although there are always questions that can be raised about any definition of the budget, this step has done much to eliminate confusion and suspicions that previously existed. We recommend strongly that the new Administration should embrace the new concept and press forward with the work now under way to implement it by adequate measurement of federal subsidies, establishment of government-wide accrual accounting, and integration of the unified budget with the national income accounts.

This report, together with our November 5 report on "Budget Policy for Early 1969," completes the present assignment of the Task Force. The members of the Task Force again wish to assure you of their desire to be helpful to your Administration as it takes up the difficult and important burden of managing the federal budget.

Sincerely yours,

Herbert Stein

Herbert Stein, Chairman
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*Messrs. Harriss and Merriam contributed to the work of the Task Force but were unable to participate in drafting this report because of absence from the country.

Herbert Stein

December 3, 1968
Confidential

FISCAL POLICY FOR THE NEW ADMINISTRATION

The fiscal policy of the United States is now more uncertain and unsettled than at any time in the past forty years. During the past generation it seemed that the standard at which policy aimed - more or less imperfectly - was a compromise between budget balancing and use of the budget as an instrument of economic stabilization. Also, up to about 1966 movement was in the direction of greater weight to the economic stabilization, or "compensatory," part of the mixture. Certainly by 1965, if not much earlier, budget balancing had lost compelling force as a determinant of fiscal behavior. The budget-balancing rule was displaced by intellectual argument and even more by the observation that prolonged violation of the rule had no obvious ill effects. Around 1965, at the heyday of the "new economics," compensatory fiscal policy seemed to have established itself as the standard doctrine. But a few years of experience have greatly weakened confidence in this doctrine. The power of fiscal action to affect GNP, prices, and employment is much in doubt. Questions about our ability to direct that power in a stabilizing way are becoming more troublesome. The unwillingness of either the President or Congress to stick closely to the line of "compensatory" policy has become clear. Moreover, this unwillingness cannot be ascribed to mere ignorance, but is seen to reflect conflicting objectives that have some validity.

Thus, we are left without any standard and generally accepted guide to fiscal policy. This might seem to be an advantage since it permits the President to do what he wants without doctrinal limitations. However, that is not really the case. Neither the President nor anyone else can decide what he wants to do about fiscal policy unless he has some general view of what the main consequences of fiscal action are. Moreover, to carry out his fiscal policy the President will need the cooperation of the Congress, and it would be helpful to describe the fiscal policy as an application of some principles that the Congress recognizes to be sound and to bind the President as well as the Congress. In fact, the President cannot permanently keep fiscal policy at the level of *ad hoc* decision-making. Everything he does, and everything he says in justification of what he does, helps to influence public thinking about what fiscal policy should be and thereby builds up expectations which may limit or assist him in the future. For example, the words and deeds of the Kennedy-Johnson Administration over several years contributed to the demotion of the budget-balancing principle, a development which Johnson must surely have regretted when he came to fight for a tax increase. Also, exaggerated claims of the Administration on behalf of compensatory fiscal policy served later to weaken the effectiveness of arguments for fiscal action resting on that policy.

Therefore, it would seem necessary for the President to have some doctrine of fiscal policy as a basis for making his own decisions and influencing the decisions of others. One possibility might be to try to establish balancing the budget at high employment as the basic standard. This was the standard espoused in 1959 by the Cabinet Committee on Price Stability for Economic Growth, of which Richard Nixon was chairman. It has several advantages as compared with purer formulas of either budget-balancing or compensatory policy. However, whether any version of budget balancing can now command much support is doubtful. And even from the standpoint of the President this rule may be too inhibiting.

Probably there is no satisfactory alternative now to a discretionary fiscal policy, which would, however, differ from compensatory finance in giving weight to a number of other objectives in addition to economic stabilization. Policy would have to recognize and accommodate the following four considerations:

1. Despite growing skepticism about the effectiveness of fiscal action as an economic stabilizer, it is still not safe to assume that major changes in the relation between taxes and expenditures have no effect on economic activity, employment, and prices. A prudent course, from the standpoint of economic stabilization, would be to avoid radical shifts in the budget position unless there is strong evidence to suggest that such shifts would be in a stabilizing direction.

2. Although there are possible qualifications to this proposition, the size of the budget surplus or deficit affects the total saving in the economy - that total being higher when the surplus is larger. Therefore, a decision about the size of surplus or deficit

should reflect some decision about the desirable rate of saving. For example, if the government follows a policy of stimulating private investment, by tax incentives or otherwise, it may be appropriate to accompany this policy with a budget surplus to provide the saving out of which the investment can be financed.

3. The timing and dimension of federal expenditure decisions are mainly to be determined by the purposes to which they directly relate, rather than by their indirect effects on economic activity or total saving. We cannot decide to fight the Vietnam war when the economy needs stimulation and stop when it does not. This is an extreme example, but the point applies to most expenditures.

4. Tax decisions also have a life of their own and are not readily adapted, especially in the short run, to the overall requirements of fiscal policy. Frequent tax changes are at least a nuisance to taxpayers and may be a considerable impediment to efficient business management. Also, tax change packages, at least tax reduction packages, seem to have a necessary minimum size if the desirable structural consequences of change are to be achieved. Thus, the possibility of achieving tax reform is probably much smaller if five separate reductions of, say, $2 billion are made than if there is one reduction of $10 billion. The separate reductions are more likely to be totally absorbed in flat-rate reduction. Therefore, it may sometimes be appropriate to "save up" room for tax reduction rather than to make a series

of small reductions as soon as they are permitted by overall budget objectives. Moreover, tax changes tend to persist beyond the occasion that initially justified them and to evoke expenditure changes that may be undesirable. Thus, a tax increase is likely to result in expenditures subsequently being higher than they would otherwise have been, and this effect must be considered along with the immediate consequences of the tax increase.

The fiscal actions implied by each of these four considerations will usually be different. The surplus or deficit that is safest or most convenient for economic stabilization will often not be the one that would be chosen to yield the desired rate of total saving, and the specific objectives of expenditure and tax decisions will often conflict with achievement of the surplus or deficit that would be chosen on either stabilization or saving grounds. The severity of these conflicts can be reduced if monetary policy can be managed to make its maximum contribution to economic stability. It would also be reduced if it proved possible to manipulate some part of the tax structure flexibly and reversibly without serious consequences for business decision-making. Still, we must expect that all of the possible objectives of fiscal policy cannot be simultaneously achieved and that some imperfect compromise among them will be necessary. Moreover, the nature of the objectives and of our knowledge about them is such that the optimum compromise cannot be mechanically determined but can only be approximated by the exercise of judgment.

Despite these difficulties, the Administration in making its own decisions should be able to recognize more explicitly than heretofore the several considerations which must be balanced and should be able to explain its decisions more candidly and persuasively. It can avoid taking the unrealistic and unbelievable position that its fiscal recommendations are the "scientifically" determined outcome of devotion to a single objective, such as economic stability, or that they simultaneously and perfectly satisfy all objectives. There may seem to be a danger that exposing the Administration's recommendations as the outcome of judgment balancing a variety of objectives would weaken the Administration's leadership in fiscal matters in the country and in the Congress. However, the danger is greater the other way. The President starts with great advantages in the national debate about fiscal policy, because of the attention paid to everything he says, because of the unequalled amount of information he commands, and because of the breadth of the interests he represents. There is a natural tendency to accept his way of looking at things, and his recommendations, as sound, especially in a field where competing standards of soundness are weak. However, the President can himself dissipate this advantage if he allows major inconsistencies to appear between his avowed principles and his actual conduct.

One possible brief formulation of the kind of fiscal policy suggested here would be as follows: We shall try to avoid major shifts in the relation between revenues and expenditures at high employment while working gradually in the direction of a moderate surplus at high employment. However, we shall allow temporary departures from this program when precise adherence to it would require sacrifice of urgent expenditure objectives, unsettling tax variations, or tax commitments that would in the long run be undesirable.

A possible application of this policy to 1969 would be as follows: In the absence of an unexpectedly rapid decline of Vietnam spending, we shall retain the tax surcharge to the end of calendar 1969, in order to avoid a sharp jump in the deficit at mid-year. However, we do consider termination of the surcharge as important, in order to maintain the credibility of the government's decision to make a temporary tax increase and to continue pressure for restraint in spending. Therefore, we shall allow the surcharge to expire on December 31, 1969, by which time normal growth will have offset part of the revenue loss and the anti-inflationary effect of a restrictive monetary policy will be felt. We do not propose a crash effort to reduce expenditures but will work vigorously to initiate the reduction or restraint of the expenditures that are of low priority, with the expectation that this plus revenue growth will bring us to a position of budget surplus.

Task Force
on the Budget

November 18, 1968
Confidential

MANAGEMENT OF THE FEDERAL BUDGET

1. Introduction and Summary

The new President-elect must soon decide how to organize his budget planning and his procedures for setting program priorities. In particular, he must decide whether to keep or discard the defense programming framework introduced by McNamara, whether to press forward with its application to the entire federal government as begun by LBJ in 1965, and whether to continue the present system or to change it.

More fundamentally, the new President-elect must decide how much he cares about efficiency in government. The wasteful practices and programs in each agency have vested interests defending them, often powerfully represented in the Congress. The President and his Cabinet will face criticism and obstruction to every worthwhile reform, for which they should be well prepared. If the President fails to select capable, forceful leaders for his Cabinet and to give them a strong mandate to insist on efficiency in their departments, the game will be lost before it starts. The choice of Director of the Bureau of the Budget is equally critical. These officers can succeed only if they are willing and able to probe into the hard priority problems in their agencies and to demand reliable information bearing on these problems. They must also firmly put down every form of bureaucratic gamesmanship aimed at increasing budgets and staffs.

Appointing strong leadership for the Department and the Budget Bureau is one of two necessary steps. The second is to strengthen the budget management system, now called the planning-programming-budgeting system. Outside Defense the present system adds to every agency's paper work without revealing any wasteful programs and without helping set priorities. To help department heads and the White House fix priorities, program evaluation staffs must spend their time where it pays off, and waste no time on areas where analysis makes no difference. The new Administration's system should reflect this economy-of-staff principle.

2. Criteria for Effective Budget Management

The White House and the Congress can control the scope and content of federal activities only if they know the objectives and specific programs for which subordinate federal agencies are requesting funds. A good budget management system groups the requests and appropriations by purpose, relating them to the basic goals of government, and supports the requests with analysis that shows why the proposed programs are the most efficient ways to serve these goals. Moreover, it keeps track of future costs and commitments of actual and proposed programs, including all the associated and supporting activities that must help make the programs work, so that the President and the Congress know what they are letting themselves in for it they accept these programs. The analysis supporting each new proposal should reflect a diligent search for the best, most efficient way to serve its goals. Finally, for those programs the Administration adopts, the system should provide for almost automatic control and monitoring to assure that they continue to serve their intended purposes.

These aspects of good budget management require a functional or program approach to budgeting, as has been emphasized by a series of authors and commissions starting with the Taft Commission Report in 1912. The Kennedy-Johnson Administration applied this approach to the Department of Defense budget, grouping military objects of expenditures by such functions as strategic (nuclear) forces and general purpose (conventional) forces, and then by subfunctions such as tactical aviation and ground forces. In general, each of the main functions and subfunctions includes elements of two or more military services, and so cut across the military departments.

In addition to presenting, supporting, and executing its programs by function, an effective budget management system also requires good administration. In particular, it should do the following:

(a) It should enlist the cooperation, support, and participation of federal executives at all levels. It should let them know what is expected of them, what performance criteria apply to their agencies, and what supporting analysis they must provide.

(b) The system should largely run itself, and not require continuous intervention from the highest levels in matters of detail. The President, his staff, the Cabinet, and congressional committee staffs should be able to concentrate their time and attention on issues of major significance, where their efforts will do the most good.

(c) The system must provide reliable information on costs and benefits or effectiveness, both for existing and prospective programs. Interested agencies fail to provide this information, because they are interested, unless they know that the executive leadership checks on them and punishes for misrepresentation. Systematic, continuing data requirements can be supplied by the agencies when their submissions are easily audited; sensitive data likely to be subverted should come from a professional agency without substantive program responsibilities.

3. Where Has the Kennedy-Johnson Administration Fallen Short?

The present Administration has adopted the forms of functional budgeting, particularly in Defense, presenting programs by meaningful goals. It gets good marks on grouping appropriations by purpose, on presenting future costs and commitments, and on searching for efficient programs. However, this Administration has done very poorly in making sure it gets the intended results and in making the system work smoothly. So far from enlisting the support of executives at lower levels, Secretary McNamara aroused almost universal opposition among military officers and middle level executives in the military services. Although some controversy necessarily goes with the introduction of a new set of procedures, that it should have been so fierce and prolonged attests to poor leadership and administration on his part. He tried to do everything at the top level, and failed to delegate responsibility for good management to lower levels; as a result he failed to enlist the cooperation and support of the key people in his organization. The system failed to run itself, involved constant intervention in matters of detail by the Secretary, and failed to produce a flow of reliable information to the top.

When President Johnson directed the rest of the government to copy Defense programming methods wholesale, he cast his die for form and against substance. The right move would have been to extend these methods to selected areas with the highest expected payoff, to serve as models for possible further extension.

4. Priorities for Budget Management

The next administration should set practical, limited goals for itself designed to improve the present system without trying to reform it wholesale. It should concentrate on making budget management work much better than it has in those areas where this is practical, and accept the status quo in those areas where it is not. The following steps make up such a program.

(a) Fix definite, finite roles for the President's immediate staff and for the Bureau of the Budget. They should emphasize management by exception, rather than trying to study and review all programs in depth. They should concentrate on large issues and major programs rather than matters of detail. However, they must have unlimited access to agency data for their studies, and should constantly probe for weak programs, informing agency and department heads as they go. (Program analysts should work with or under budget examiners, and accompany them on field trips.)

Moreover, White House and Budget staffs should recognize the responsibility and authority of each department head. The White House staff's job is to assist the President on those goals and priorities he chooses not to delegate to the department heads; the Budget Bureau's job is to assure that the President's priority decisions prevail and to promote efficiency. Priority decisions not pre-empted by the President are the responsibility of department heads; the steps listed below are intended to give them the corresponding authority.

(b) <u>Establish and enforce criteria, standards, and major program objectives to guide all procedures for program evaluation and selection within the agencies</u>. These standards would cover proper valuation of benefits and costs, a standard for the interest rate, and so on. Approved concrete concepts for program objectives would directly reflect policy goals accepted by the President for planning purposes. An example is poverty reduction, and the programs that serve it include education, retraining, aids to ghetto businesses, and aid to dependent children. Other goals are national security, publication of social and economic data (served by the census, vital statistics, business statistics, etc.), regulation of commerce and industry (antitrust, labor-management regulation, common carrier rate regulation, etc.), and resource development (navigation, irrigation, public power, etc.). The Budget Bureau must assure that every program is in the right category, and that no weak or unauthorized programs hide in other programs' skirts.

Setting standards and concrete objectives will oblige agency heads to use qualified staffs for program evaluation. Selective parallel studies by an exceptionally qualified Budget Bureau staff will reinforce this effect. The Budget Bureau should also issue guidelines to the agencies on which programs to study intensively and which to brush over lightly. The census, for example, can safely be brushed over lightly, whereas antipoverty training programs, the SST, and navigation projects cannot.

(c) Concentrate decisions about choices among distinct national goals at the level of the President and department heads, except where they expressly delegate the decisions. It is too ambitious for the President's staff and the BOB to try to weigh different goals, such as guns versus butter, or economic growth versus present consumption, or poverty reduction versus resource development. These decisions are and should be the prerogative of the President, his Cabinet, and the Congress. The job of the agencies and of the President's official family is to present the available choices clearly. The official family should define the goals clearly, in terms that conform to the categories in which the President thinks about national priorities, and make sure that all program proposals accurately relate to these goals. With the enforcement of uniform high standards for the appraisal of programs, the budget presentation would enable the President and his Cabinet to choose among competing goals, knowing how much of one must be sacrificed to gain more of another.

(d) Require and enforce multiple-year financial plans for broad program areas. Give each agency a firm budget guideline before it submits proposals, with tentative budget guidance for future years. Forward-looking plans help to find the most efficient way to do any given job; they are also an important instrument of control. Future-year budget targets should be limited to controllable programs, and not cover such items as existing social security programs, interest on the federal debt, and veterans' benefits. Using Budget Bureau criteria, the agencies should report each year their binding obligations, their implied commitments, and the cost of continuing existing programs with realistic projection factors. With these estimates as a point of departure, and reflecting the President's policies and priorities, the Budget Bureau should respond with budget levels for several future years to be used by the agencies for planning purposes, where the sum of these levels for each year leaves room for selective upward revisions later. The President and the Budget Bureau should commit themselves to revise these levels up or down when and only when analysis supports such revision. Unexpected difficulties in a program should often provoke investigation, and seldom a budget increase.

Although the allocation of funds among the departments can only be the President's decision, not that of department heads singly or in coalition, the allocation of funds among goals within each department is the responsibility of the department heads. He can carry out this responsibility only if he knows what his budget will be;

otherwise having to play at budgetary gamesmanship makes him suppress information and turn the priority problem entirely over to the Budget Bureau. However, his authority is properly curtailed when the President pre-empts an issue or when comparison of a program in his department with a program with the same goal in another department shows that the other department's program is superior. (This latter factor will encourage a keen interest in efficiency within his own department.)

(e) Reject most proposals to increase budgets above the advance guideline. In fact, often use such a proposal from an agency as the pretext for a special study aimed at a soft part of the agency's program, so that each such proposal carries the risk that the agency's guideline budget will be cut. In general, new programs should be better justified than existing ones, and the purported benefits checked out with special care. The proposed method of retaliation for poorly supported proposals will assure that the agencies check their data and analysis carefully before submitting them. Moreover, the Budget Bureau should run special studies looking both for good new programs and bad old ones, to discourage mediocre agency heads from standing pat. When an agency gets too many good suggestions of either kind, the Budget Bureau should feel free to bring this discovery to the attention of the department head, and, if necessary, the President.

(f) If a program is politically hot, set up special procedures for its analysis. The Budget staff and the department head should run special, intensive studies for such programs, and the President may even want to appoint blue-chip commissions to oversee some of them. If such a study comes up with a strong enough case for reform, he may choose to do battle; if it does not, he may pocket it and possibly exempt the affected area from further attention.

(g) Move toward the alignment of appropriations with programs, without attempting major reorganization. The various departments have overlapping programs; this cannot be corrected, and may be desirable. For each department and agency, group its programs by function or goal, with rigidly enforced criteria. Then the programs of different agencies serving the same goal can be compared with sometimes devastating effect. Where possible, put various agencies into the role of subcontractors to an office with a strictly functional role. An example of this possibility is the OEO, which now tries to "coördinate" the poverty programs of many agencies. While leaving the separate programs where they are, Congress might agree to appropriate the funds for them to OEO, which in turn would pay for them by budget transfer to these agencies. OEO's power to coordinate and to build an effective, efficient program would then have some teeth, and the main pick-and-shovel work of program comparisons would be kept below the level of the Budget Bureau. Similar procedures can be employed within each department, when various agencies in the department have competing programs.

(h) Create new test and evaluation agencies where needed. In military developmental testing and evaluation, the present military service agencies should be turned over to a new professional civilian agency reporting no lower than the Secretary of Defense. This change would eliminate the present practice of rigging tests to cover past mistakes and to make bad weapons look good.

(i) Let's set up our ducks in advance. These proposals will provoke a rebellion in the Congress if the President and his Cabinet fail to coordinate carefully with congressional leaders and committees. Explain the reasons for each of the above steps patiently and repeatedly; support them with evidence of present inefficiency where available; and then insist. Moreover, the President should discreetly encourage the use of analytical staffs in GAO and under congressional committees, to help two-way communications and to give Congress a vested interest in good analysis for management.

(There is attached an annex, "Special Problems of Defense Budgeting and Management," by Martin J. Bailey and J. A. Stockfisch. In addition to throwing light on the problems of the Department of Defense, it illustrates many of the suggestions made here for the government in general. It does not, however, purport to represent the views of the Task Force as a whole.)