CONGRESSIONAL BUDGET OFFICE

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before the

Subcommittee on Legislative Branch

Committee on Appropriations

U.S. Senate

Appropriation Request for Fiscal Year 1981

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Mr. Chairman and Members of the Subcommittee, in my testimony today, I will address two subjects. First, I will present a summary of the key elements of the 1981 appropriations request for the Congressional Budget Office. The comprehensive statement and justification material previously submitted has been printed in Volume I of the 1981 hearings. I will then as you requested turn to a discussion of inflation. I know this is a topic of vital concern to you, Mr. Chairman, as evidenced by your hearings in Nashville last November.

Appropriations Request

For fiscal year 1981, I am requesting an appropriation of $13,544,000, an increase over fiscal year 1980 of approximately 8 percent. This budget allows for no growth except a moderate inflation allowance. It does not contain funds for expanded responsibilities nor for additional staff positions. Rather it would simply continue CBO's current organization and services to the Congress.

CBO's authorized personnel ceiling is 218. The actual staff has been held slightly below that level, however, in order to stay within fiscal year 1980 budget limitations. Our fiscal year 1981 request would allow us to bring the staff to the fully authorized level.

You will recall that the conference committee substantially reduced our fiscal year 1980 request. Because of this limitation on funds we have had to operate on very limited resources and hold actual staff level below our authorized ceiling. We have submitted a fiscal year 1980 supplemental budget request for $414,000 to cover the incremental costs of salaries and benefits resulting from the October 1979 federal comparability pay increase. In our recent hearing before the House Subcommittee on Legislative, we were asked whether we could absorb these increased costs within our fiscal year 1980 budget. We have, therefore, again carefully examined the resources currently available to us and have concluded that we cannot absorb this amount without firing staff and sharply reducing services to the Congress.

Mr. Chairman, I have explained in capsule form some highlights of our budget request. I would be pleased to discuss further any items in our budget request or review CBO's activities.

I will now turn to the discussion of inflation unless you have some specific questions on CBO's budget.

Inflationary Trends in the U.S. Economy

Throughout the 1970s, the United States struggled with the problem of inflation. The rising prices we faced at the start of that decade were in part a legacy of deficit spending in the 1960s when the economy was operating at a high level of capacity utilization; in part, they also reflected a trend of wages rising faster than productivity. The wage and price controls imposed during the Nixon Administration gave only temporary respite. When they were removed, the devaluation of the dollar, the huge OPEC oil price increase, worldwide economic expansion, and commodity and inventory speculation all led to an explosion of prices. Inflation reached double-digit rates. A severe recession in 1974-1975 slowed inflation somewhat, but lagging productivity growth, repeated OPEC price increases, and episodes of rising food prices kept the inflation rate from returning to the level of the 1960s.

During this period economic policymaking has been extraordinarily difficult. Because of the slow recovery from the recession and the rapid growth in the labor force, unemployment rates stayed at relatively high levels. At the same time, price increases persisted despite considerable slack in the economy. An effort to dampen inflation through more restrictive fiscal and monetary policy would, it was feared, worsen the unemployment situation. Instead, the Congress began to try to protect various groups from the effects of rising prices by such measures as tying federal benefits to the Consumer Price Index, increasing the minimum wage, raising farm crop support levels, and imposing restrictions on international trade. These accommodations have, in many cases, added to the rise in prices and increased the momentum of the inflationary process.

Recently there has been a resurgence of inflation. The Consumer Price Index rose at about a 13 percent rate during most of 1979, and it is virtually certain to accelerate further in the first quarter of 1980. An important cause of this reacceleration is the huge round of OPEC price increases that occurred in 1979. The consequences of the jump in crude oil prices are quite widespread. Not only did the prices of petroleum products rise abruptly, but the prices of goods and services that use oil and oil products as inputs also accelerated. The inflationary impact of the deregulation of domestic oil prices has also increased. The huge drain on the balance of payments caused by rising oil import prices puts pressure on the exchange value of the dollar, thus raising the cost of other imports. Attempts made by the Federal Reserve to defend the dollar and to slow inflation lead to higher interest rates; these in turn affect the cost to firms of doing business and the cost to consumers of purchasing durable goods on credit.

At the same time, other factors have contributed to price acceleration: reduced meat supplies have kept food prices high; the demographic structure of the population has put a heavy demand on housing construction; and the inclusion of health insurance as a normal part of employee benefits has been a factor in the rapid increases in health care costs.

The future does not look reassuring as far as inflation is concerned. Until our economy fully absorbs the increase in energy prices, and until we reduce our dependence on imported oil, the dollar will continue to be under pressure. This will keep interest rates high. Without increased investment in capital goods, the prospects for a return to more rapid productivity growth are diminished. Without productivity gains, wage increases are quickly translated into more price increases.

These problems are not insurmountable, but we should not expect to find quick, easy, costless solutions. It will likely take years, not months, to bring inflation under control. As a nation, we will have to endure a period of less rapid gains in our level of consumption. It is during such periods of lagging, or even falling, real income that competition over shares of the national income becomes most intense. Frequently, this struggle leads to legislative proposals to redress the burdens felt by various groups in the economy. The problem with such proposals is that if passed they would often undercut or dilute the fight against inflation.

Examples of measures that weaken the fight against inflation are easy to cite. Granting trade protection by limiting import competition forces the consuming public to subsidize high-cost and possibly inefficient domestic industries. Higher farm price supports raise prices to consumers and require measures to reduce surplus production and keep out cheaper foreign products. Higher minimum wages increase labor costs and make it harder for young people to find jobs. Increases in Social Security payroll taxes raise labor costs and show up in higher prices.

In the Congress, as in the country at large, there is a heightened awareness that many policies that have useful social benefits may also have adverse effects on prices. In order to weigh more carefully its decisions on such policies, the Congress has expressed a desire for analyses of the price impacts of these legislative proposals as well as studies of fiscal policy options that would affect inflation.

CBO has responded to this concern with a number of studies, including the following:

- Understanding Fiscal Policy (April 1978) summarized the impact on economic activity and prices of various fiscal policy tools.
- The Effect of Inflation on Federal Expenditures (June 1976) measured the sensitivity of revenue and expenditures to changes in the inflation rate.
- Inflation and Growth: The Economic Policy Dilemma (July 1978) set out a framework for understanding the inflation phenomenon.
- The Fiscal Policy Response to Inflation (January 1979) analyzed the prospects for the Wage and Price Guidelines program.
- Entering the 1980s: Fiscal Policy Choices (January 1980) analyzed strategies to encourage economic growth and assessed the limitations of the Consumer Price Index as a measure of inflation.

Currently we are engaged in a broad study of policy options for increasing productivity growth.

In addition, at the request of the Congress, CBO has organized an Inflation Impact Unit which has undertaken to identify and analyze legislative proposals that may have a significant inflationary impact. In the past 12 months, inflation impact studies have been produced for proposals to:

- o Raise farm crop supports to 90 percent of parity;
- o Raise sugar price supports;
- o Raise milk price supports;
- o Ratify the International Coffee Agreement;
- o Contain hospital costs;
- o Make beef import quotas vary countercyclically;
- o Deregulate domestic crude oil; and
- o Deregulate railroads.

The inflation unit is working on a series of background papers on topics dealing with the causes and behavior of inflation as they relate to economic policymaking. One that is nearing completion explores the impact of railroad deregulation on overall transportation costs. Another topic of concern at this time is the role played in inflation by indexation measures that tie income payments to changes in the Consumer Price Index.

In conclusion, I might say that no single measure will suffice to combat inflation. An anti-inflationary fiscal policy can be made more effective, however, if it is combined with measures to stimulate productivity growth, policies to reduce the impact of high energy costs, and short-run policies to reduce the upward pressure on prices.