The Report of the President's Commission on Budget Concepts: A Review

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The Federal budget to be presented by the President to the Congress this coming January will have a new look, if the recommendations of the President's Commission on Budget Concepts are adopted. The sixteen-member Commission, headed by David M. Kennedy, Chairman of the Board, Continental Illinois National Bank and Trust Company of Chicago, included Congressmen, businessmen, university professors, and Government officials. They were appointed by the President in March 1967 to "undertake a thorough review of the budget and recommend an approach to budgetary presentation which will assist both public and Congressional understanding of this vital document".[1] Hopefully, the new budget proposals would eliminate much of the confusion which arises from the current use of three different budget concepts—administrative budget, cash budget, and Federal sector in the national income accounts (NIA budget)—which differ in accounting methods and coverage.

The *Report of the President's Commission on Budget Concepts*, issued in October, is an impressive document with many suggestions which would markedly improve the quantity, quality, and availability of information about Federal Government activities. The adoption of the Commission's proposals, however, would create some new problems for those who study the Government's budget position and its impact on the economy, although the gains should far outweigh the potential losses. This article reviews the highlights of the Commission's proposals. After a brief summary and evaluation of the *Report*, the major proposals are examined in more detail.

The Commission proposed a comprehensive and interrelated set of accounts—"The President's Budget and Financial Plan"—as a substitute for the budget document now submitted by the President to the Congress each January. The new accounts would consist of four major subdivisions designed to tie together more closely the thread that runs from (1) budget appropriations to (2) receipts, expenditures, and net lending, to (3) the means of financing the budget deficit (or use of a surplus), and finally to (4) outstanding Federal securities and loans. The Commission's major proposals with respect to these accounts include the following:

1. The heart of the new budget format is a section entitled "budget receipts, expenditures, and lending", and the term "budget surplus or deficit" would be reserved *solely* for the net figure of this account. This new budget statement is designed to replace the present administrative budget, consolidated cash budget (receipts from and payments to the public), and the NIA budget.

2. As far as possible all receipts and expenditures should enter the new budget on an accrual accounting basis (i.e., recorded when the obligation to spend funds or pay taxes is incurred), so that the new budget would differ from all the present budget concepts. Loan activities would remain as a segment of total receipts and expenditures, but would be shown in a sub-account separately from all other expenditures and receipts.

3. Transactions of market-oriented, or business-type, Government agencies (for example, the Post Office) would continue to be reported on a net expenditures basis, and receipts and expenditures on a gross basis would continue to be provided for these agencies in a separate account.

4. Sales of participation certificates in Federal loans would be treated as a debt operation rather than as an offset to expenditures.

5. Government debt not only would consist of direct Treasury borrowing but also would include debt issued

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[1] From the letter to each Commission member, reproduced in the *Report of the President's Commission on Budget Concepts*, page 107.

by Government enterprises whose receipts and expenditures are included in the budget. The debt figure to be highlighted by the new budget would be a new "net" concept—Federal securities held by the public—rather than the present concept of total debt.[3] Use of such a debt figure would suggest that, if a debt ceiling is retained, it should be redefined. The Commission, however, states specifically that it "does not wish to endorse a public debt ceiling as a means of controlling the budget".

6. The Commission recommended that the January budget estimates should be revised more frequently and that estimates should be given not only as annual totals—which is the only way these figures are now provided—but also on a quarterly, or at least semiannual, basis.

Evaluating all the wide-ranging proposals of the Commission is beyond the scope of this review, but some broad observations may be useful. The new budget—with its complementary components—would summarize Federal Government activities more completely than any currently available budget. Moreover, it would provide new data which would contribute to a deeper understanding than is now possible of the Government's impact on the economy. Although the new budget could not be adopted in full until 1970 (fiscal 1971), due to the difficulties of shifting to accrual accounting, the President could—if time permitted—adopt the general format of the new budget for the January 1968 budget presentation.

A major disadvantage of the new budget is that it breaks the fairly close connection between the level of the present cash budget deficit or surplus and the cash financing needs of the Government. Because the new budget would use accrual accounting for all receipts and expenditures, the surplus or deficit figure in the new budget could differ widely from actual cash receipts and expenditures. Consequently, the new budget deficit or surplus would give no clue, except by happenstance, about Treasury cash borrowing needs (or debt repayment capability). While the "means of financing" section would show the Treasury's cash borrowing from the public for the fiscal year, additional cash data on a monthly or quarterly basis, consistent with the categories to be used in the new budget, are indispensable if analysts outside the Treasury are to have appropriate information for estimating Treasury cash borrowing needs and for fully evaluating the financial and economic impact of the Federal Government during the course of the year. Accrual accounting for Government spending, as will be noted later, raises the possibility of inconsistencies between the Government and other sectors in the national income accounts, and could pose serious problems in the reporting of business inventories. It is not clear from the Commission's report how these problems would be resolved.

[3] The "public" is defined to exclude all regular and special Government agencies and trust funds. The holdings of Government debt by the Federal Reserve System are defined as part of *public* holdings because Federal Reserve receipts and expenditures, continuing the practice of current budget concepts, are not included in the new budget. The current practice of treating as a receipt the payment to the Treasury by the Federal Reserve of its net earnings in excess of required surplus would be continued.

NEW BUDGET COVERAGE AND ACCOUNTING BASIS

The Commission's recommended budget and financial plan, as given in the *Report,* is reproduced as Table I. The new budget presentation would tie together the budget process in a more straightforward and understandable way

Table I

RECOMMENDED SUMMARY OF THE PRESIDENT'S BUDGET AND FINANCIAL PLAN

In billions of dollars

Structure of the budget	1968 estimate*
Budget appropriations	
Proposed for action by the Congress	133.2
Not requiring action by the Congress	59.6
Total appropriations	192.8
Budget receipts, expenditures, and lending	
Receipt-expenditure account:	
Receipts	165.2
Expenditures (excluding net lending)	171.1
Expenditures account surplus or deficit	− 5.9
Plus Loan account:	
Loan disbursements	19.0
Loan repayments	14.6
Net lending	4.4
Equals Total budget:	
Receipts	165.2
Expenditures and net lending	175.5
Budget surplus or deficit	− 10.3
Means of financing	
Borrowing from the public	9.1
Reduction of cash balances, etc.†	1.2
Total budget financing	10.3
Outstanding Federal securities and Federal loans, end of year	
Federal securities:	
Gross amount outstanding	354.3
Held by the public	275.6
Federal credit programs:	
Direct loans outstanding	38.5
Guaranteed and insured loans outstanding	104.1

* Estimates based on *The Budget, Fiscal 1968,* January 1967.

† Includes seigniorage, increase in expenditures accrued but not yet paid, and increase (or decrease) in taxes accrued but not yet collected.

Source: *Report of the President's Commission on Budget Concepts* (United States Government Printing Office, Washington, D.C., October 1967), pages 4 and 85.

Table II

BUDGET CONCEPTS: THE NEW AND THE OLD

Concept	New budget	Cash budget	NIA budget	Administrative budget
Coverage				
Receipts:				
Regular taxes	Included	Included	Included	Included
Trust fund taxes	Included	Included	Included	Excluded
Expenditures:				
Regular agencies	Included	Included	Included	Included
Trust funds	Included	Included	Included	Excluded
Loans	Included (but in separate sub-account)	Included (generally net on expenditures side)	Excluded	Included (generally net on expenditures side)
District of Columbia, Federal Home Loan Banks, and Federal land banks	Excluded	Included	Excluded	Excluded
Other				
Participation certificates	Excluded*	Included as negative expenditures	Excluded	Included as negative expenditures
Seigniorage	Excluded*	Excluded	Excluded	Included as receipts item
Accounting basis				
Receipts	Accrual	Cash collections	Combination of accrual and cash	Cash collections
Expenditures	Accrual	Cash payments—checks cashed	Combination of deliveries, cash, and accrual	Cash payments—checks issued, interest accrual

* Included in "means of financing" section (see Table I).

than is the case now. The heart of the new presentation is the section titled "budget receipts, expenditures, and lending", which in effect determines the content and organization of the other sections of the budget and financial plan. Consequently, this article will concentrate on this part of the Commission's recommendations.

The budget receipts, expenditures, and lending section is separated into two sub-accounts designed to isolate loan activities from other Federal receipt and expenditure programs. This separation is based on the view, widely held among economists, that the economic impact of lending programs is different from other Government programs which have a more direct effect on the levels of income and output.

The Commission recommended that the official designation of "budget surplus or deficit" should be reserved solely for the net figure of the budget receipts, expenditures, and lending section. All other net-type numbers should be given other labels in order to indicate clearly that they are not the budget surplus or deficit.

COVERAGE. On the expenditures side, the new budget includes all Government agencies—regular agencies, the trust funds, and Government corporations. In that sense, it is as inclusive of Federal Government activities as the cash budget, although it differs from cash budget accounts in a number of important ways. Table II highlights the differences between the new budget and currently used budget concepts.[3] Perhaps the most important difference in terms of dollar magnitudes is that the new budget would exclude Federal sales of participation certificates as an offset to expenditures; instead, these certificates would appear as a debt operation in the "means of financing" section of the new budget. (In both the cash and administrative budgets, they are treated as negative expenditures.)

The recommendation for changing the treatment of participation certificates was the only point of disagreement among the Commission's membership. The issues are complex and technical: in very simple terms, the disagreement can be viewed as a problem of defining when a capital asset is sold. There was unanimity among the Commission members that "receipts from the sales of assets—financial or physical—reduce the budget deficit, just as a purchase increases the deficit".

[3] A more complete explanation of current budget concepts can be found in "A Primer on Federal Budgets", this *Review* (April 1965), pages 79-88.

Since participation certificates sold by the Government are interest-bearing instruments which represent shares in a pool of loans held by the Government, their sale has been treated as the equivalent of a sale of assets. But most Commission members apparently did not regard the sale of these certificates as fully meeting the test of a sale of assets, because the Government continues to service the individual loans and is liable for the losses for any defaults on the loans in the pool. Thus, the Commission recommended that sales of participation certificates be treated as a debt item rather than as a sale of assets.

However, three members of the Commission—Secretary of the Treasury Fowler, Budget Director Schultze, and Professor Turner—held that the Government was acting essentially as a financial intermediary when it sells these certificates and that the funds raised through their sales reduce the amount of financing required by the Treasury for Government credit programs. Therefore, they advocated that the funds obtained from such sales should continue to be offset against expenditures. At present, it is uncertain how the disagreement over the treatment of participation certificates will be resolved.

Government loans would be separated into two elements. The loan, as such, appears in the new budget in the loans sub-account, but if there are any subsidy elements in the loan, the amount of subsidy would be treated as an expenditure in the expenditures sub-account. The purpose of this treatment is to separate out the "pure" lending activity. Total expenditures, however, are unaffected by these rearrangements of the loan components. Consequently, the new budget, by including loans, would differ from the NIA budget, which excludes lending activities and other financial transactions. The new budget, which includes trust fund expenditures, also would differ significantly from the administrative budget which excludes them.

On the receipts side, as far as coverage is concerned, the new budget is essentially similar to the current cash budget and the NIA budget. Again, as on the expenditures side, it differs substantially from the administrative budget by including trust fund receipts. In addition, certain items now included on the receipts side in currently used budgets will be offset against expenditures in the new budget (see below).

ACCOUNTING BASIS. The most important single innovation introduced by the new budget is the use of the accrual concept for all Government receipts and expenditures. The Commission's case for the accrual concept is convincing even though some reservations will be noted below. Broadly speaking, the accrual method records a receipt or expenditure at the time the credit or liability arises. In the case of expenditures, it would "time" spending when an actual liability is incurred. Use of the accrual method on the spending side is particularly significant for long-lead goods and construction expenditures which would be recorded as the work progressed, even though actual payments are not made. In the case of receipts, the accrual method would record taxes when an individual or business incurs the liability, even if the payment is made at a later date.

The accrual concept for expenditures probably would do a better job of timing the Government's impact on activity and incomes in the private sector than the expenditures figures in currently available budgets. The better timing is particularly significant for construction activity and the production of long-lead goods, notably defense equipment. At the present time, defense expenditures for long-lead items appear in the NIA budget when the goods are delivered so that, for something like a warship, the expenditure is recorded in the Government sector after the ship has been constructed, i.e., after production is completed and incomes have been earned. In the cash and administrative budgets, the timing of the procurement of a warship is likely to be somewhat better than in the NIA budget, because the Department of Defense would have made some advance and progress payments on the warship. Consequently, cash spending figures generally reflect partial payments for work on long-lead items as it is going on in the private sector. The extent to which these cash progress payments have approximated the work in progress, however, has varied since the pattern of progress payments has changed over the years. Certainly for long-lead items, cash expenditures have not fully reflected the Government-generated real activity in the economy at the time it was taking place. In the new budget, the warship would be recorded roughly as work progressed and, in the case of construction, as buildings were put "in place", regardless of whether cash payments had been made.

For the accrual accounts to be truly meaningful, it would be necessary that accurate records and a regular system of reporting be maintained. Since a number of Government agencies, including the Department of Defense, are not now using accrual accounting, the President's Commission recommended that the new budget not be fully implemented until 1970 (for fiscal 1971) to give these agencies time to develop the necessary accounting records.

The new budget would also record all taxes on an accrual basis. None of the other budgets use an accrual approach for receipts, although the NIA budget does use accruals for some receipt items, most notably corporate profits taxes.

While the Commission recommended that individual income and employment taxes be recorded on an accrual basis, it recognized that there may be some difficulties in doing this because there is little experience for compiling such data. Consequently, the Commission recommended that further study be made of the feasibility of using the accrual concept for income and employment taxes. In the event that a satisfactory accrual accounting basis cannot be developed for these taxes, then reporting them on a cash basis would not impair the usefulness of the new budget too seriously, since accrual taxes probably do not influence individual behavior much, if at all. In practice, the new budget may approximate the current NIA budget on the receipts side as far as the treatment of taxes is concerned. Unlike the NIA budget, however, the new budget also would include loan repayments, although, as noted below, these repayments usually would be "netted" against expenditures.

COMPARISON OF NEW BUDGET TOTALS WITH PRESENT BUDGETS. Estimates of the new budget—which are necessarily rough—are compared with existing budgets for total receipts and expenditures and the net budget surplus or deficit for the fiscal years 1965 to 1968 in Table III. On the receipts side, the total for the new budget is likely to be smaller than that in the cash budget or the NIA budget because there is more netting of receipts items in the new budget.[4] (Netting offsets the receipts of a particular program or agency against the expenditures of the program or agency, and the resultant net figure is recorded on the expenditures side of the ledger.) Moreover, a considerable variation in the gap between total cash receipts and accrual receipts in the new budget for the same fiscal year may arise in periods of wide cyclical swings, owing to the differences in the accrual basis of recording taxes and the payments basis, particularly in the case of profits taxes; for shorter periods, such as a month or a quarter, the dollar differences between cash and accruals are likely to be even larger than for full years.

Table III

HISTORICAL COMPARISON OF FOUR CONCEPTS OF BUDGET TOTALS

Fiscal years 1965-68

In billions of dollars

Receipts and expenditures	1965	1966	1967*	1968*
Administrative budget				
Receipts	93.1	104.7	117.0	126.9
Expenditures	96.5	107.0	126.7	135.0
Surplus (+) or deficit (−)	−3.4	−2.3	−9.7	−8.1
Receipts from and payments to the public (consolidated cash budget)				
Receipts	119.7	134.5	154.7	168.1
Payments	122.4	137.8	160.9	172.4
Surplus (+) or deficit (−)	−2.7	−3.3	−6.2	−4.3
Federal sector of national income accounts (NIA budget)				
Receipts	120.6	132.6	149.8	167.1
Expenditures	118.3	132.3	153.6	169.2
Surplus (+) or deficit (−)	+2.3	+0.3	−3.8	−2.1
Commission's recommended budget				
Receipts	118.9	131.1	147.7	165.2
Expenditures	119.0	135.7	155.5	171.1
Expenditures account surplus (+) or deficit (−)	−0.1	−4.6	−7.8	−5.9
Net lending	1.8	3.8	5.2	4.4
Total budget:				
Receipts	118.9	131.1	147.7	165.2
Expenditures	120.8	139.5	160.6	175.5
Surplus (+) or deficit (−)	−1.9	−8.4	−12.9	−10.3

* Estimates based on *The Budget, Fiscal 1968*, January 1967.
Source: *Report of the President's Commission on Budget Concepts*, page 92.

On the expenditures side, the greater use of netting in the new budget than in existing budgets operates to reduce spending as compared with the cash or NIA budgets. On the other hand, the removal of participation certificate sales as an offset to expenditures operates to make the new budget expenditures total larger than that in the cash budget for the same period. Finally, total expenditures in the new budget will be larger than total spending in the NIA budget because of the inclusion of lending programs (and other financial transactions) on the spending side of the new budget.

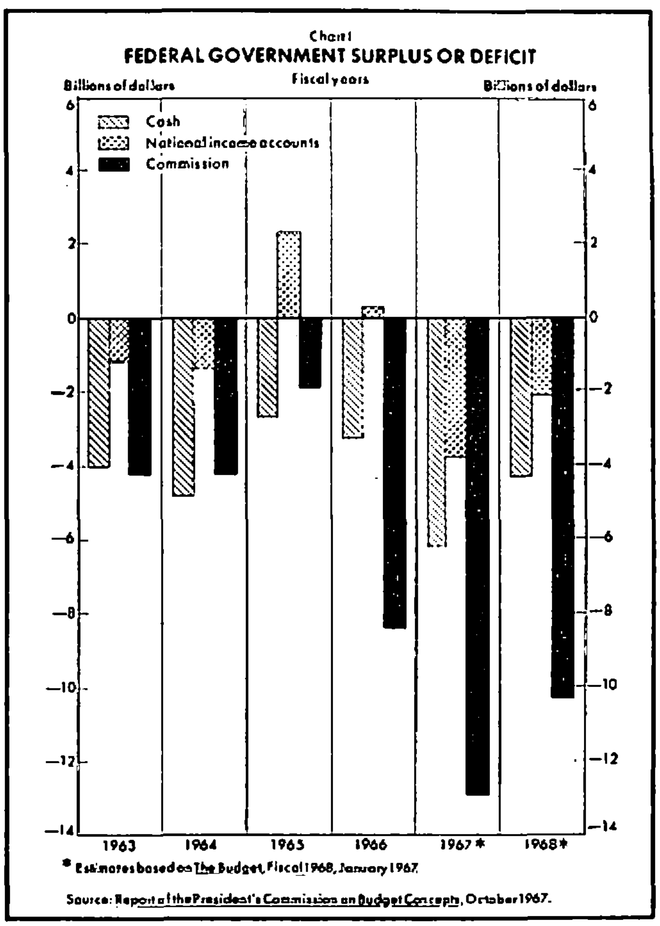
The estimates by the Commission for the new budget for previous years show that cash budget expenditures typically exceed total spending in the new budget which, in turn, exceed total expenditures in the NIA budget. For receipts, the order is somewhat different; again,

[4] The greater use of netting in the new budget arises from the Commission's view that ". . . receipts from activities which are essentially governmental in character, involving regulation or compulsion, should be reported as receipts. But receipts associated with activities which are operated as business-type enterprises, or which are market oriented in character, should be included as offsets to the expenditures to which they relate". The following categories of receipts are offsets to expenditures in the new budget: receipts of Government enterprises and enterprise funds; permits and fees; hunting and grazing licenses and fees; interest, dividends, rents, and royalties; sales of products; fees and charges for services and benefits of a voluntary character; sales of Government property; repayments of loans and advances; and recoveries and refunds of earlier expenditures. But, as noted previously, gross figures will be made available in supplementary accounts for the Government agencies whose receipts are offset against expenditures.

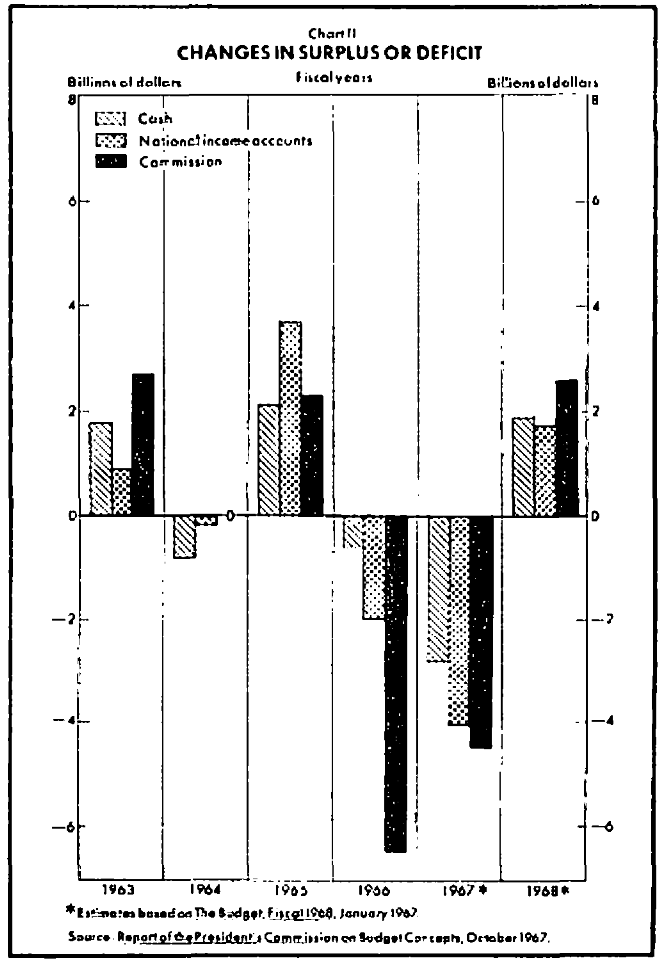
cash budget receipts are largest, but receipts in the new budget are smaller than NIA receipts.

It is not possible to generalize how the resultant surplus or deficit for the new budget will compare with net figures for the existing budgets of the same year, either in terms of magnitude or change in levels from one year to the next (see Chart I). Much depends on the relative importance of the various components of receipts and expenditures for the years being compared. Moreover, the data shown for the new budget in the charts and tables must be viewed with caution, since there is only the roughest kind of information to estimate the accruals for a number of components—particularly defense spending.

If we assume that the data prepared by the Commission for its recommended budget are reasonably good, however, then those who interpret the fiscal impact of the budget not from the *level* of the budget surplus or deficit but from the *changes* in the level of the surplus or deficit from one year to the next may find that the new budget gives a different reading at times from that provided by the NIA budget or the cash budget. For example, as shown in Chart II, the change from fiscal 1963 to 1964 in the new budget is zero (neutral), whereas in the cash and NIA budgets the changes were in the direction of deficit (stimulus). While these differences are small, nevertheless they are indicative of possible divergences. In other years, the changes are in the same direction but there are substantial differences in magnitudes.



* Estimates based on The Budget, Fiscal 1968, January 1967.
Source: Report of the President's Commission on Budget Concepts, October 1967.



* Estimates based on The Budget, Fiscal 1968, January 1967.
Source: Report of the President's Commission on Budget Concepts, October 1967.

OTHER FEATURES OF THE FINANCIAL PLAN

The Commission's recommendations for the definitions of budget receipts and expenditures lead to the definition of Government debt. If an agency is included in the budget (receipts and expenditures), then its debt is included as "Federal securities: gross amount outstanding". Thus agency debt is added to direct Treasury debt.[5] But in the new budget, as in the case of the cash budget, intragovernmental transactions are excluded and, consistent with the elimination of intragovernmental transactions, the relevant debt concept is "Federal securities: held by the public". Changes in Federal securities held by the public would show net Federal borrowing from the public for the period under consideration.

The means of financing section would be an explicit statement as to how a deficit would be financed or how a surplus would be used. As noted earlier, the new accrual accounting method would break the fairly close connection between actual Treasury borrowing (or repayment) and the budget deficit (or surplus) because the receipts and expenditures would be on an accrual accounting basis, whereas the Treasury's need to borrow or its ability to repay debt is determined by cash flows. Since cash payments of taxes—and most particularly corporate profits taxes—differ quite widely from the accrual of taxes, especially for a quarterly (or half-year) period, the deficit or surplus figure at any moment of time for the new budget cannot reflect the Treasury's financing requirements.

In the means of financing section, the discrepancy between cash flows and accruals on the receipts side would appear as accounts receivable for moneys owed (accrued) to the Government but not yet received; on the expenditures side, accounts payable to the private sector would be recorded for expenditure accruals for which the Government had not yet made payment. However, should accounts receivable be rising rapidly the proverbial man in the street is going to be puzzled, indeed, to learn that the Government is planning to borrow $4 billion at the same time that it is running a surplus of (for example) $8 billion.

In the budget appropriations section (see Table I), the account would show the relationship between appropriations and the expenditures which take place out of these appropriations. A detailed enumeration would be given of new appropriations that are needed, as well as appropriations available without further Congressional action. In addition, the appropriations concept would be broadened to include authorizations to spend that are not now subject to regular appropriations by the Congress. Consequently, the connection between appropriations and the ultimate spending of funds (including net lending) would be spelled out more clearly.

CONCLUDING COMMENTS

The President's Commission on Budget Concepts did an outstanding job in constructing a budget document which integrates the various elements of the budget process into a more meaningful whole. Information previously available would be made more accessible, and much new information, badly needed, would be provided. The overall conception of the new budget is very sound, but it would be most unfortunate if the adoption of the new accrual budget brought to an end publication of cash flow figures. It would be particularly useful to have detailed cash data provided for the same agencies and programs used in the new budget.

If the new budget is adopted, the Commission recommended that Federal expenditures in the national income accounts (which exclude lending activities and use a delivery basis for some items) be redefined to coincide with the new budget. While this would involve some inconsistencies in the overall accounting logic of the national income accounts, similar compromises are present in other parts of these accounts because of data problems or other reasons.

Perhaps the most important modification is the substitution of accruals for deliveries as the basis for calculating "Government purchases". The use of the purchases concept on an accrual basis for Government purchases, and on a delivery basis for purchases made by the other sectors, would result in an impairment of theoretical accounting purity (in the sense that the Government sector would be treated differently from other sectors in the national income accounts). But, as described earlier, the recording of accrual expenditures should follow closely the production taking place in the economy for Government purchases and, therefore, closely tie in with changes in the level of gross national product and personal income which are directly associated with Government procurement.

On the other hand, the recording of Government expenditures on an accrual basis would require modification of the business inventories component in the national income accounts. Many goods under production for future

[5] Under this definition, the securities of the following agencies are included: Federal Housing Administration (debentures), Tennessee Valley Authority, Commodity Credit Corporation, and Export-Import Bank, which are wholly owned corporations or agencies; and Federal intermediate credit banks, Banks for Cooperatives, and Federal National Mortgage Association (secondary market operations), which are mixed-ownership agencies. The Commission also recommended that the Federal Home Loan Banks and Federal land banks, which are excluded from the recommended new budget, would also be excluded from the "means of financing" section but their securities issues should be shown as memorandum items. This new definition would require a reconsideration of the debt ceiling definition, but as noted previously the Commission does not endorse the use of a debt ceiling as a method of budget control.

delivery to the Government, which are carried in business inventories until delivered, would be recorded as Government purchases under the accrual method, even though these goods may be physically located in, or legally owned by, private business. Thus, on an accrual basis, the level of inventories would be lower than if measured on the current basis and the "change in business inventories" component of the national income accounts might follow a different pattern than if measured on the current basis.

In addition to the new budget data and cash flow data, there remains one vital set of information still to be provided if the impact of the Government on the private sector is to be analyzed in depth. At present, there are no satisfactory data on orders originating from the Government sector, even though the available data have been expanded somewhat recently. A comprehensive orders series would greatly improve the ability of analysts to estimate the potential direction of the Government's influence. Presumably, the better organization of appropriations data in the first section of the new budget document would be of some help, but appropriations data are not adequate substitutes for "new orders". In the transition period before 1970, when the accounting basis for the new budget is to be established, an effort ought to be directed toward developing an orders series consistent with the expenditures categories used in the new budget.