file: Capital Budget

THE WHITE HOUSE

WASHINGTON

MEMORANDUM FOR BILL GALSTON
BRUCE REED
KATHI WAY

FROM: Carol H. Rasco CHR

SUBJ: Attached memo on Alternative Budget Methodologies

DATE: July 24, 1994

The attached was distributed late Friday, July 22. If you have time to review it I would appreciate any comments you have by 4 p.m. returned to Rosalyn who will get them to me for the NEC weekly meeting if held as scheduled.

Thank you.

cc: Rosalyn Miller

Carol Rasco

EXECUTIVE OFFICE OF THE PRESIDENT
COUNCIL OF ECONOMIC ADVISERS
WASHINGTON, D.C. 20500

JUL 22 REC'D

THE CHAIRMAN

July 22, 1994

MEMORANDUM FOR NEC PRINCIPALS

FROM: ROBERT E. RUBIN, NEC
LAURA D'ANDREA TYSON

SUBJECT: Alternative Budget Methodologies—Decision Memo

At the request of the President, we convened an interagency Working Group to develop a memorandum that would summarize the issues and controversies surrounding alternative budget methodologies intended to promote additional public investment.

The attached memorandum represents the work of the interagency group. As part of a strategy to emphasize public investment, some have suggested that the Federal Government adopt a form of capital budgeting or otherwise modify its budget system. The memorandum considers several alternative budgetary methodologies, with a range of budget impacts, that could increase public investment made by the Federal Government. The Working Group developed five specific budget alternatives, and the memorandum presents arguments for and against each alternative. One of the alternatives can be described as an operational capital budget—the other four represent smaller changes from the existing cash-based budget system.

This memorandum will be discussed at the NEC Principals meeting on Tuesday. The discussion will focus on views on the various alternatives and on whether to send the memorandum to the President in its current form or to develop a decision document that would indicate the level of support for the specific budget alternatives. We look forward to your comments.

Attachments

EXECUTIVE SUMMARY

This memo considers several alternative budgetary methodologies intended to increase public investment by the Federal Government without seriously eroding budget discipline. As part of a strategy to emphasize public investment, some have suggested that the Federal Government adopt a form of capital budgeting or otherwise modify its budget system. Five specific alternatives to the current budget system are discussed, with arguments presented for and against the alternatives. One of the alternatives can be described as an operational capital budget—the other four represent smaller changes from the existing cash-based budget system.

Choice of a budget method requires a balancing of multiple objectives: to measure and control the fiscal policy of the Federal Government; to allocate resources within the Federal Government; and to provide a public statement of the Administration's priorities. The current Federal budget is a cash-based system that records receipts when received and disbursements when made. The annual deficit (or surplus) is simply the difference between total spending and total receipts.

Some analysts claim that a shortcoming of the cash budget system is the identical treatment given to operating expenses, transfer spending, and government programs that can properly be termed "investment". These analysts argue that the current budget system imposes a higher political cost on public investment spending than on current consumption programs, because the entire amount of investment spending in a given year must fit under the discretionary spending caps for that year even though the expenditure provides a stream of returns in future years. Other analysts claim that the current cash-based budget system properly focuses attention on the costs of various programs, and ensures that the costs of current consumption programs are equated with the costs of other programs that may have future benefits.

A capital budget system has been proposed as a way to increase public investment spending. Such a budget system separates annual investment spending from other government spending by dividing the operations of government into a capital budget and an operating budget. The operating budget measures the current costs of government programs, including the annual decline in the value of long-lived investment assets (measured by depreciation expense). The capital budget collects all spending on investment items, regardless of how they are financed. In general, a capital budget system envisions a balanced operating budget, with borrowing supporting net investment (total investment in excess of depreciation).

If the Federal Government were to adopt a capital budget system, clear conceptual definitions of investment and depreciation would be required to help prevent "gaming" of the budget system. Moreover, any move toward capital budgeting would have to address many political issues. Among these is that undertaking a major

change of the budget process would require modifications to the Budget Enforcement Act (BEA) and it is unclear that the Administration would benefit from this.

Note that the designation of spending items as "investment" does not by itself address the issue of whether each individual item is a worthwhile public investment. This project-by-project decision is logically independent of the decision about budget systems and should be based on a thorough cost/benefit analysis. However, to the extent adoption of a capital budget increases the ability of the Federal Government to undertake greater "investment" spending than would occur under the current caps on discretionary spending, it must be realized that *all* investment spending will be made more attractive relative to spending on current consumption.

Finally, adopting a capital budget would not ensure that the Administration's priorities would be treated favorably in the budget process. For example, even rather broad definitions of investment would not encompass many of the Administration's investment spending priorities (as outlined, for example, in *A Vision of Change for America*).

The five alternatives developed and discussed by the Working Group are:

(1) Establish a "soft" target for public investment and enhance the presentation of public information contained in the annual Budget

(2) Establish separate discretionary caps (firewalls) for operating and investment expenditures

(3) Permit "pay-as-you-go" financing for increased discretionary spending

(4) Establish a Lifelong Learning Trust Fund to support human capital investments and offset this fund by reducing other discretionary spending

(5) Modify the budget law to establish an operational capital budget

The Working Group believes that the first four alternatives may increase public investment while maintaining budget discipline and also may be politically viable. However, the Working Group does not view the fifth alternative as a politically viable choice.

BUDGET ALTERNATIVES

MEMORANDUM

FINAL DRAFT

There has been a substantial amount of debate about whether the Federal Government should adopt a form of capital budgeting in lieu of its current cash budgeting system. This issue has received increased prominence, in part because the Administration has espoused the goal of increased investment spending. Under the current discretionary spending caps (and even before the current spending caps were enacted in 1990), many desired investment items (for example, FAA modernization and Head Start) have run into funding roadblocks. As part of a strategy to emphasize public investment relative to other government spending, it has been suggested that the Federal Government adopt a form of capital budgeting. (Background information on Federal investment spending over the past 15 years is provided in Table 1.)

This memorandum explains the basic distinctions between cash and capital budgets and identifies some of the complex definitional and measurement problems involved in moving toward the latter. These issues cut across virtually all types of capital budgeting systems and would have to be addressed before a form of capital budgeting could be adopted by the Federal Government. Finally, five separate budget strategies are presented, along with arguments for and against each alternative. The Working Group believes that the first four alternatives may increase public investment while maintaining budget discipline and also may be politically viable. However, the Working Group does not view the fifth alternative (an operational form of capital budgeting) as a politically viable choice. This fifth alternative is presented for completeness and to elucidate the strong theoretical and practical arguments on both sides of this policy option.

Cash vs. Capital Budgeting

Budgets are forward-looking planning documents used by organizations to allocate and control resources. The current Federal budget is a cash-based system that records receipts when received and disbursements when made. The annual deficit (or surplus) is simply the difference between total spending and total receipts.

The choice of budget method must balance multiple objectives: to measure and control the fiscal policy of government; to allocate resources within the Federal Government; and to provide a public statement of the Administration's priorities. The cash-based budget system provides financial accountability and maintains control over the total resources flowing into and out of the Federal Government. A surplus or deficit in a cash budget system focuses on total amounts received, expended, and borrowed or saved, without regard to the composition of spending. Some analysts claim that one shortcoming of the cash budget system is that it provides identical treatment to operating expenses, transfer spending, and government programs that can properly be termed "investment", since they provide future returns. These analysts argue that the current budget system imposes a higher political cost on public investment spending than on current consumption programs, because the entire

amount of investment spending in a given year must fit under the discretionary spending caps for that year even though the expenditure provides a stream of returns in future years.[1]

Public investment spending can take two forms: spending for the acquisition of long-lived physical assets (e.g., buildings or roads) or spending to create intangible assets that produce future benefits accruing to the Federal Government or to the economy as a whole (e.g., education and training programs that raise future earnings). In principle, both types of investment create "capital" that either adds to the economy's productivity or reduces the Federal Government's cost of operations over time.

A capital budget system separates annual investment spending from the rest of government spending by dividing the operations of government into a capital budget and an operating budget. The operating budget measures the current costs of government programs, including the annual decline in the value of long-lived investment assets (measured by depreciation expense). The capital budget collects all spending on investment items, regardless of how they are financed.

A capital budget could be used in a variety of ways. Most simply, a capital budget could be developed only for presentation purposes to distinguish between different types of Federal spending with no effect on how government spending and borrowing decisions are made or controlled. At the other extreme, a capital budget could be accompanied by changes in the budget law that would allow the government to borrow to finance all net investment (investment in excess of the depreciation of the existing capital stock) but would prohibit a deficit in the operating budget (including depreciation as an operating expense). In between these two extremes are many possible alternatives. For example, operating and capital expenditures could be subject to different spending caps, and limits could be placed on borrowing for each activity.[2]

Defining Investment and Depreciation

If the Federal Government were to adopt a capital budget system, clear conceptual definitions of investment and depreciation would be required. Segregating "investment" spending from all other government spending would create political pressure to

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[1] The term "investment spending" is used loosely in this context. Budget authority for capital projects generally is allocated to the year in which the project is initiated. Outlays for capital projects generally are spread over the actual period of construction or acquisition.

[2] This example assumes that no tax revenues or only specified tax revenues would be used to fund the capital budget.

categorize many spending programs as "investment" (especially if budgetary caps were eased for investment spending). Congress would have the responsibility for writing a revised budget law that would define "investment", and it is quite likely that the Congressional characterization of "investments" would differ from the definition favored by the Administration. Furthermore, capital budgeting would require legally defined measures of depreciation to provide a clear picture of the resources used by the Federal Government on an annual basis. Because investment is the key component of the capital budget and because depreciation is the link between the capital budget and the operating budget, clear definitions of these concepts could help prevent "gaming" of the budget system.

Public "investment" can be defined in a number of ways.[3] However, the range of possibilities can be understood by focusing on two extremes -- a narrow and a broad definition. The narrow definition of "investment", which is broadly consistent with business practice and with some State and local governments, includes only physical capital assets with useful lives of over one year.[4] According to this definition, investment spending would include spending on roads, buildings, parklands, equipment, and so on. Such a definition, however, fails to include public programs that create other long-lived assets, such as a stock of technical knowledge or a skilled workforce. A broad definition would include spending on these intangible assets in addition to spending on physical assets.

The designation of spending items as "investment" does not by itself address the issue of whether each individual item is a worthwhile public investment. This project-by-project decision is logically independent of the decision to adopt a capital budget or to retain the current cash-based budget and should be based on a thorough cost/benefit analysis. However, to the extent adoption of a capital budget increases the ability of the Federal Government to undertake greater "investment" spending than would occur under the current caps on discretionary spending, it must be realized that

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[3] The many existing definitions of "investment", include those put forth by the System of National Accounts, the General Accounting Office, the National Performance Review, the Congressional Budget Office, the Bureau of Economic Analysis, and the old Bureau of the Budget. The general principles of these definitions often do not lead to clear-cut determinations of the exact amount of investment undertaken by various programs.

[4] One separate issue is whether to characterize defense spending on military hardware as investment or as current consumption of national defense. A second issue is how to distinguish (if at all) between those capital assets owned by the Federal government and those owned by others but funded by Federal grants.

all investment spending will be made more attractive relative to spending on current consumption.[5]

Budget Process Modifications

Any move toward capital budgeting would have to address both the conceptual and measurement issues mentioned above and also numerous budget process issues. Resolution of these issues could take various forms. For example, the Budget Enforcement Act (BEA) could be amended to delineate separate categories of public investment, each with its own spending cap and definitional guidelines (e.g., infrastructure, R&D, and education and training programs could form three separate investment categories). Alternatively, an independent commission could be formed to establish a multi-year capital budget for the Federal Government. Such a commission could be responsible for determining what government spending constitutes "investment" and for determining appropriate depreciation rates for public assets. The Administration, working with Congress, could then determine if any spending caps should be applied to the capital and operating portions of the budget. In any event, the Office of Management and Budget (OMB) and the Congressional Budget Office (CBO) could play important policing roles, enforcing any spending caps and ensuring that the definitional and measurement guidelines are followed.

Political Issues

Undertaking a major change of the budget process would require opening up the BEA and it is unclear that the Administration would benefit from doing so. If Congress amended the BEA, it is possible that future budgetary choices would be even more constrained than they are under current law. For instance, Congress has actually reduced the discretionary spending caps over the past two years, indicating that tighter constraints are a real possibility. Moreover, promotion of a capital budget may lead to perceptions that the Administration does not view reducing the Federal budget deficit as a serious responsibility. If this were to occur, financial markets might react with increased interest rates, which could have adverse consequences for future economic growth.

A capital budget would generally reduce the political hurdles associated with spending on items designated as "investment". Sensing this, proponents of various programs (e.g., those Members of Congress who have advanced their own priorities at the expense of the Administration's) would attempt to have such programs classified as "investment". This could lead to politicization of the determination of items contained in the capital portion of the

[5] Much of what political pundits call "pork" would be classified as "investment" because many "pork barrel" projects involve the construction and acquisition of physical assets.

budget, with uncertain consequences for the programmatic priorities of the Administration. Under some definitions of capital, public investments favored by the Administration might be bypassed in favor of other discretionary spending. Even the rather broad definition of investment proposed by the General Accounting Office ("spending, either directly or through grants, directly intended to enhance the private sector's long-term productivity") would not encompass many of the Administration's investment spending priorities. Indeed, as mentioned above, many of the programs favored by the Administration might not be properly considered "investment" in the capital budgeting sense. For example, Table 2 (attached) indicates that a number of items called "investment" in *A Vision of Change for America* probably would not be classified as "investment" even under a relatively broad definition.

Finally, it is not clear that Congress would accept the Administration's proposed definitions of "investment" and "depreciation" or delegate the ability to define these concepts to an independent commission (as suggested above). And, if the BEA is reopened, it is not clear what policing responsibilities Congress would give to CBO and OMB under the revised law.

Alternative 1: A "Soft" Target for Public Investment Combined with Enhanced Presentation of Public Investment Information

Description: Use the annual Budget presentation to help advance public investment as a national priority by: enhancing and highlighting the information already included in the annual Budget; highlighting the President's investment priorities; and setting a "soft" target (as recommended by the independent Competitiveness Policy Council) for Federal investment in the annual appropriations process.[6] This investment target would be emphasized in public statements made by Federal officials at the time the Budget is published. Alternative 1 would also capitalize on the recent Executive Order requiring infrastructure investments to be subject to stringent cost-benefit analyses. Finally, this alternative would incorporate the National Performance Review (NPR) recommendation that agencies submit five-year investment plans and base investment decisions on the full costs over the life cycles of the assets.

Rationale: The current cash-based budget system is useful in making fiscal policy. Moreover, it provides enough information to create financial statements that emphasize the capital spending portion of the Federal Budget, without detracting from the presentation of the unified cash-based budget currently used. Reorganized presentation could help Congress make better decisions regarding public investment, while educating the public about the tradeoff between current spending and investment. In addition, emphasis on an investment target would serve to highlight the Administration's priorities and perhaps also serve to hold Congress accountable for its decisions on investment and non-investment spending.

Arguments for the alternative:

- The overall claims by the Federal Government on financial resources are best measured by the unified cash budget surplus or deficit, the main focus of current budget practice. This alternative may help maintain budget discipline, and in so doing, promote private as well as public investment.

- By defining "investment" in the budget document, the Administration, not the Congress, sets spending priorities. Setting an investment target may suggest a shift toward more spending on public investments and provides for public monitoring of Congressional spending decisions.

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[6] Since 1951, the annual Budget has presented data on the investment activities of the Federal government along with estimates of annual depreciation for the Federal capital stock. In the FY 1995 Budget, this information was included in the *Analytical Perspectives* volume.

Arguments against the alternative:

- Enhanced presentation does not change current budget practices that provide the same treatment to current consumption and equivalent spending for investment even though the latter provides long-lived benefits.

- This alternative simply rearranges present budget practices and may not affect real decisions about public investment at all.

Alternative 2: Establish separate discretionary spending caps (firewalls) for investment and operating spending.

Description: Establish firewalls (separate spending caps) for operating and capital items. These individual caps could sum up to the current discretionary caps or could be higher or lower. For example, the two caps could be set to increase investment spending and constrain non-investment spending over future fiscal years. (Another example, perhaps a subalternative, would establish a "one-way" firewall that would permit reductions in operating expenditures to offset increases in capital spending.)

Rationale: The current caps on discretionary spending are one of the main elements of budgetary control and accordingly, should be kept more or less intact. Separate caps for investment and operating items may act as firewalls and prevent investment programs from having to compete with current spending programs for scarce budget dollars.

Arguments for the alternative:

- This alternative would maintain some measure of budget discipline while encouraging use of a greater amount of total Federal discretionary spending for investment purposes.

- If the investment spending cap increased over time, Federal discretionary spending would tend to become more focused on investment programs.

Arguments against the alternative:

- The alternative pits investment programs against each other in the competition for scarce budget resources. Unless the cap on investment spending is raised, there may be little or no additional investment spending. Moreover, noninvestment discretionary spending could be squeezed under this alternative, which may be undesirable.

- If the Administration proposes spending caps higher than the existing discretionary caps, this may be seen as a sign of reduced budget discipline, with the attendant effects in financial markets.

- If Congress is presented with the option of reducing the size of the existing spending caps, they may take advantage of the opportunity to do so.

Alternative 3: Allow Pay-As-You-Go Financing for Discretionary Spending

(Subalternative: Prohibit changes in tax revenues from financing additional discretionary spending)

Description: Allow "pay-as-you-go" financing for discretionary spending or for investment spending in particular. Tax increases or entitlement cuts could be used to "pay for" higher discretionary spending caps, with the increase in the cap used to cover spending on investment programs. For example, an increase in the motor fuels excise tax could be used to raise the discretionary spending caps to accommodate increased highway spending. Similarly, a cut in entitlement spending could be used to "pay for" increased investment in a discretionary training or education program.

(Subalternative: Allow pay-as-you-go financing of additional discretionary spending only with entitlement spending cuts (or with either entitlement cuts or tax expenditure reductions.))

Rationale: The current caps on discretionary spending are one of the main elements of budgetary control and accordingly, should be kept more or less intact. However, extending the "pay-as-you-go" rules to discretionary investment programs could add new opportunities for expanding public investment without increasing the Federal budget deficit.

Arguments for the Alternative:

- Opportunities for investment could be expanded, without directly increasing the size of the Federal deficit.

- The firewall between defense and nondefense discretionary spending has been allowed to expire. This has created the possibility of tradeoffs between these two categories of spending to meet the priorities of the Federal Government. Similarly, removal of the firewall between mandatory and discretionary programs may also serve to allow more flexible responses to government spending priorities.

Argument for the Subalternative:

- Restricting pay-as-you-go funding sources to reductions in entitlement spending could help the Administration avoid the "tax and spend" label.

Arguments Against the Alternative:

- There would be a political price to pay for raising the possibility of tax increases to pay for additional discretionary spending. The Administration risks being tagged as "tax and spend".

- In theory, the process could also run in reverse, with reductions in discretionary spending caps being used to "pay for" overall tax reductions. This could further constrain opportunities for increased public investment.

- Discretionary spending is appropriated for one year at a time, while the "pay-as-you-go" process covers the five-year budget window. Applying the "pay-as-you-go" rules to discretionary spending may be technically difficult. In addition, this alternative could encourage Congress to extend the discretionary spending caps indefinitely.

- To some extent, the goals of the alternative may already be achievable through the use of "capped entitlements" to pay for programs that previously may have been structured as discretionary spending.

Arguments Against the Subalternative:

- Prohibiting tax changes from financing discretionary spending increases would pre-empt the possibility of using earmarked taxes to finance related investments (e.g., highway spending funded by increased motor fuels taxes would be precluded under the Subalternative).

- To the extent that health care reform reduces the ability to achieve entitlement reductions in the health area, the subalternative may be characterized by some as focusing on Social Security reductions to finance discretionary expenditure increases.

Alternative 4: Establish a Lifelong Learning Trust Fund

Description: Create a Lifelong Learning Trust Fund to provide for increased education and training expenditures. The Trust Fund would be phased in over several years. For example, the Trust Fund could begin in FY 1996 at $3 billion, with increases to $6 billion in FY 1997, to $9 billion in FY 1998, to $12 billion in FY 1999, and to $15 billion in FY 2000 (which would be the steady-state level). The Lifelong Learning Trust Fund would be financed by lowering the discretionary spending caps by amounts corresponding to the size of the Trust Fund. Ideally, the Lifelong Learning Trust Fund would finance a small number of key human capital investments. Examples of these key investments could include Head Start, National Service, School-to-Work, Goals 2000, and perhaps one or more new and innovative education programs (e.g., mentoring). Legislation to create the Trust Fund would prevent Trust Fund expenditures from being used for current or projected baseline funding of education or training programs.

Rationale: Creation of a Trust Fund can focus attention on a specific class of expenditures and provide these expenditures with priority standing in the budget process. By establishing the Fund, and specifying the programs it could support, the Administration's priority investment programs are clearly stated. The Trust Fund mechanism walls off a class of expenditures, which may force the budget process to find spending cuts elsewhere to fund these priorities. Moreover, the proposal maintains the existing discretionary spending caps, which should reinforce confidence in the Administration's budget discipline. Finally, Lifelong Learning can become a signature policy for the Administration and establishment of a separate Trust Fund may be the most realistic means to shift spending to these investments.

Arguments for the Proposal:

- The Trust Fund mechanism does not loosen the overall Federal discretionary spending caps nor lead to additional Federal borrowing. Consequently, it will maintain confidence in the overall deficit reduction program.

- The Trust Fund mechanism uses the political realities of the budget process to the advantage of investment. Abstract deficit reduction appeals to legislators since they do not have to confront specific trade-offs. This mechanism couples lower discretionary spending caps with additional investments in people -- leaving the specifics for the appropriations process. If the spending cuts are in lower priority areas than Lifelong Learning investments, this approach will lead to a more effective allocation of Federal resources.

- Polls show that people are willing to raise revenues for education. Therefore, the idea of cutting lower priority

spending to fund new education should be quite popular. The Lifelong Learning Trust Fund is a vehicle to present the Administration's vision of "cut and invest" to the American people.

Arguments Against the Proposal:

- Creation of a Lifelong Learning Trust Fund could lead to a proliferation of Federal trust funds for discretionary programs (e.g., trust funds for National Defense, administration of justice, agriculture support, etc.). This proliferation could hamstring the budget process by placing large portions of the Federal budget off limits to policy makers.

- Just like current law, the Trust Fund mechanism leaves the ultimate spending decisions up to Congress. There is a risk that other Administration investment priorities (e.g., research or physical infrastructure) could be cut to fund the Lifelong Learning Trust Fund.

- It will be difficult to prevent existing spending on education programs from being funded by the Lifelong Learning Trust Fund.

- Critics may deride the Lifelong Learning Trust Fund as a "gimmick" -- the same criticism that was levelled at the pending crime trust fund.

Alternative 5: An Operational Capital Budget

Description: Separate the Federal budget into its capital and operating components. Operating expenditures, including depreciation on existing capital assets, would be charged against current revenues. Capital expenditures in excess of depreciation would be financed by net borrowing. The definition of capital expenditures could be based on the one developed for the international System of National Accounts (SNA). The SNA definition of investment is limited to physical capital and includes non-defense government purchases of equipment and structures and defense purchases of structures (but not defense purchases of equipment; note the division between equipment and structures may be ambiguous). The general concept of a capital budget requires a balanced operating budget. Based on the SNA definition of investment, the FY 1995 operating budget would have a substantial deficit of perhaps $140 billion, compared to a unified budget deficit of $165 billion.[7] This alternative would require that the operating budget trend toward balance over time, implying the need for a substantial multi-year deficit-reduction program.

Rationale: Current budget rules are perceived as inhibiting long-lived capital investments. This alternative attempts to address the situation for investment in physical assets. Moreover, the alternative responds to the argument that for a growing economy, the unified Federal budget should be in deficit, by allowing net investment to be debt-financed (because in a growing economy, gross public investment generally exceeds depreciation on existing public assets). The SNA definition of investment has been determined outside the U.S. political process, which may lessen the risk of political processes eroding the definition of investment over time.[8] Finally, if the discretionary spending caps are not adjusted downward, adoption of this alternative could increase annual Federal spending by about $25 billion (the amount of net investment in FY 1995).

Arguments for the alternative:

- The Federal budget process should recognize that different types of spending have different long-term effects. In particular, the treatment of the costs of investment items should be distinguished from the costs of current consumption items. Many other types of organizations (e.g., private

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[7] The $25 billion difference approximately equals net investment in the FY 1995 budget, using the SNA definition.

[8] However, the SNA definition would probably require modification to accommodate Federal grants to subnational governments.

sector firms, State and local governments, non-profit entities) recognize a qualitative difference between operating and investment expenditures.

- The focus on physical capital, rather than broad investment, breaks the link between the Administration's spending priorities and the types of spending that can be debt-financed. This alternative may be viewed as a "businesslike" reform of process and not merely an effort to expand funding for certain priorities.

Arguments against the alternative:

- A capital budget may be perceived as lessening the Administration's commitment to deficit reduction. It will prove difficult to limit solely to physical capital the relatively favorable budget treatment provided to "investment" even though the proposal uses a standard international definition. Pressures will grow to include "human capital" and "research and development" expenditures in "investment" and the objectivity embodied in the SNA definition may be compromised. This process could severely erode budget discipline.

- Increased discretionary spending with a capital budget would require an amendment to the Budget Enforcement Act to maintain the overall discretionary spending caps at current levels. This may be politically difficult if the issue of fiscal responsibility becomes the focus of debate.

- Some analysts state that previous generations have borne the cost of public capital used by the current generation (ignoring the stock of public debt). Therefore, making future generations bear some of the cost of capital projects undertaken by the current generation may be perceived as an unfair and substantial windfall benefit.

- To the extent this alternative increases public investment at the expense of private investment (by "crowding out" private investment through a larger Federal budget deficit), the total stock of capital in the economy will not increase. Economic analysis suggests the economy benefits from more of <u>both</u> public and private investment, not simply trading one for the other.

- A capital budget increases the relative attractiveness of <u>all</u> capital spending projects, not only those that are desirable investments. Much of what pundits term "pork" would be classified as "investment" under the SNA definition.

- A capital budget, by itself, does nothing to address the substantial deficit in the operating budget. It might be very

difficult to find sufficient spending reductions among operating expenditures to offset a $140 billion annual operating deficit.

TABLE 1

Federal Investment Relative to the Size of the Economy 1980-1995

FISCAL YEAR	TOTAL INVESTMENT/GDP	NON-DEFENSE INVESTMENT/GDP	DEFENSE INVESTMENT/GDP
1980	4.49%	2.71%	1.78%
1981	4.45%	2.56%	1.89%
1982	4.33%	2.16%	2.17%
1983	4.42%	1.96%	2.46%
1984	4.46%	1.92%	2.54%
1985	4.70%	1.97%	2.73%
1986	4.74%	1.89%	2.85%
1987	4.58%	1.73%	2.84%
1988	4.33%	1.75%	2.57%
1989	4.26%	1.73%	2.53%
1990	4.15%	1.76%	2.39%
1991	4.06%	1.82%	2.24%
1992	3.94%	1.91%	2.03%
1993	3.76%	1.91%	1.85%
1994	3.52%	1.93%	1.59%
1995	3.33%	1.91%	1.42%

Notes: The Budget defines Federal investment as spending to create or acquire public physical assets, to conduct research and development, and to conduct education and training. The FY 1995 Budget shows $234 billion for Federal investment, of which $119.8 billion is to create or acquire public physical assets ($60.4 billion for national defense); $69.7 billion to conduct research and development ($39.4 billion for national defense); and $44.6 billion to conduct education and training.

Source: FY 1995 Budget, *Historical Tables*.

TABLE 2

Items Considered "Investment" in *Vision of Change for America* that Would Not be Classified as Investment in a Capital Budget

DOT -- Alcohol-related Highway Safety Grants
Interior and USDA -- Natural Resource Protection Grants (used for deferred maintenance)
Corps of Engineers -- Cyclic Maintenance Projects
DOE -- Clean up non-Defense sites and uranium enrichment facilities,
USDA -- "Forest of the Future" Grants used for Forest Resource Management
EPA -- "Green Lights" program
Rural Rental Assistance (e.g., vouchers)
HUD -- CBDG Monies used for backlogged maintenance projects
Empowerment Zone Wage Tax Credits
HUD -- Rental Housing Subsidies (e.g., vouchers)
HUD -- Public Housing Operating Subsidies
HUD -- Urban Partnership Against Crime
USDA -- Head Start Meals for Participants
HHS -- Head Start Medicaid Coverage
USDA -- Women, Infants, and Children (WIC) program
HHS -- Parenting and Family Support Initiatives
National Service (current costs of program, not higher-ed costs)
Labor -- Income support component of Dislocated Workers Program
Labor -- Establish "One Stop" Career Shops
Earned Income Tax Credit Expansion
Welfare Reform
Crime Initiative (e.g., increased community policing)
EEOC -- Increased enforcement
HHS -- Child Immunizations
HHS -- Substance Abuse and Prevention
USDA -- Food Safety and Inspection Service
VA -- Increased Medical Care
SSA -- Disability Insurance Processing
HIV/AIDS Prevention Initiatives