Economic Policy Institute

Briefing Paper

1730 Rhode Island Ave., NW • #200 • Washington, DC 20036 • 202/775-8810

INVESTING THE PEACE DIVIDEND

HOW TO BREAK THE GRAMM-RUDMAN-HOLLINGS STALEMATE

by Jeff Faux and Max Sawicky

But if one is seriously interested in the effects of budget policy on the future, one must get beyond the cash budget frame of reference represented by [Gramm-Rudman-Hollings] and consolidated deficit calculations.

-- Richard G. Darman

Introduction

In order to avoid a drop in living standards over the next decade, the United States must increase its rate of public capital investment *now.*

Expanding public investment is at least as important as reducing the fiscal deficit, and certainly more important than eliminating the deficit altogether. The U.S. is like a fundamentally profitable company that has been mismanaged to the verge of bankruptcy. Reducing debt alone will not rescue the enterprise: fresh capital investment in schools, transportation, research and development, and the like is essential to promote productivity and economic growth. Unlike a troubled company, the U.S. economy does not have the luxury of shrinking in size: it *must* grow to accommodate an increasingly aging population and stiffening competition in international trade.

Yet, for all practical purposes, stimulating economic *growth* has ceased to be a major policy concern in Washington. It has been supplanted by the political obsession with the federal deficit. After a long period in which public investments were neglected for ideological reasons, they are now neglected because, we are told, the federal government cannot afford them. Thus, the recent upward revisions in the budget deficit resulting from a slowdown in economic growth have been followed by a rush to the summit by the White House and the Congress to cut a deal on the deficit. But there is no summit on the question of economic growth, nor is the issue of Federal Reserve Board's maintenance of high real interest rates "on the table" along with higher taxes and further budget cuts.

The deficit is an important issue, but it is as much a symptom as a cause of our economic troubles. Yet the current political climate is such that further cuts in domestic investment are likely to be made as part of a deficit agreement between the Administration and Congressional Democrats. If taxes are raised, they will be exclusively devoted to deficit reduction. Moreover, given the erosion of real family incomes of the last decade, if new revenues are extracted in the form of regressive fees, excises and other consumption taxes, citizen resistance to paying for needed public investments will stiffen further. Indeed, imposing taxes that repress consumer spending at this point in the business cycle may further weaken economic growth. Despite the widespread misconception, we Americans have not been "overconsuming," we have been ***underproducing*** -- which is why there is such a desperate need for productive investment.

Therefore, our **only** serious chance to stimulate public reinvestment lies in the unique opportunity handed to us by the ending of the Cold War. In order to seize this opportunity we must:

1. Shift resources from military spending to civilian Investment;

2. Revise the Gramm-Rudman-Hollings budget formulas to reflect the primacy of economic growth rather than accounting concerns, and to provide incentives to make ***all*** relevant government institutions -- including the Federal Reserve System -- accountable for deficit reduction.

The landscape of international competition has shifted from the battlefield to the marketplace. If we do not capture and invest the Peace Dividend now, we are condemning our children to a fiercely competitive world without the tools, skills, and infrastructure to compete in it.

The Public Investment Deficit

The decline in federal support for education, training, child development, civilian research and development, transportation, natural resources and similar factors of national production has already reached crisis proportions. Federal spending on such investments fell by almost one-third in the 1980s. In 1980 federal spending for such purposes stood at 3.6 percent of GNP: to reach that investment share in 1989 would have required spending about $85 billion more (Democratic Study Group, 1990). Even that figure would not have made up for the cumulative effects of bridges not repaired, children not educated, and rivers not cleaned up during the 1980s.

Adding up the bffl from individual sectors which have suffered **from** underinvestment gives an even higher total. For example, it would take another $20 billion annually just to bring the U.S. up to the average share of GNP spent on K- 12 education by our major industrial competitors

(Mishel and Rasell, 1990). $19 billion annually to reach the share of our income going to employment and retraining programs a decade ago, another $45 billion to repair existing public works and build needed new ones, $17 billion in new solid waste disposal construction...and so on (Democratic Study Group, 1990). One may quibble about the precise numbers, but however one measures the gap, it is large.

State and local governments have not picked up the slack: in fact, their capital investment has decelerated. Most civilian public investment in the U.S. is actually carried out by state and local governments, but in the post-World War II period these efforts have always been leveraged by federal aid. Since 1980, federal grants to state and local governments for physical infrastructure have fallen 19 percent in real terms (OMB, 1990, p. 36). Federal support for other investment categories through aid or direct spending also has seen sharp declines in the past ten years. Budget authority in constant dollars has decreased for transportation (down 20 percent), education (down two percent), job training (down 65 percent), environment (down 17 percent), energy (down 79 percent), and community and regional development (down 56 percent) (Democratic Study Group, 1990).

The contraction of public capital over the last decade exacerbated a trend that began ten years earlier. Between 1950 and 1970, the civilian public capital stock grew at an annual rate of four percent. Since 1970 the rate has averaged 1.6 percent, reflecting substantially lower rates of growth at federal, state, and local government levels. While the U.S. was cutting back on its public capital investment, our major competitors were adding to theirs at a higher rate. Japan, for example, invested 5.1 percent of its GNP in public capital between 1973 and 1985, while the corresponding figure for the U.S. was 0.3 percent (Aschauer, 1988, 1989a, 1989b; Munnell, 1990).

Despite the slowdown in growth, civilian public capital represents an enormously important factor in the nation's economy. Public non-military physical capital amounts to 45 percent of the total amount of private physical capital in America (Munnell, 1990). Among economists there is general agreement on the common sense proposition that public and private investment complement each other. Government investment in schools, roads, and science are followed by private investment in books, autos, and high-technology. Both types of investment increase labor productivity. In a public statement before the Joint Economic Committee (JEC) of the U.S. Congress last year, 327 economists -- including six Nobel Prize winners -- warned that "we cannot eliminate the twin deficits and maintain our living standards unless we expand our public capital" (Economic Policy Institute, 1989). At a subsequent hearing, economists James Tobin of Yale, Alan Blinder of Princeton, and Donald Straszheim of Merrill-Lynch told JEC Chairman Lee Hamilton that they supported increased federal spending for civilian investment even if it meant increasing the federal deficit.

Recent research has confirmed the importance of public capital to both investment in private capital and national productivity. Economist David Aschauer of the Federal Reserve Bank of Chicago has shown a strong link between the decline in public sector physical investment and the decline in private sector productivity. He concludes that the public sector has been so starved that an extra dollar spent on public investment today generates a higher economic return to the country than a dollar spent on private investment (1989a, 1989b).

On the basis of her research on productivity trends, Alicia Munnell, chief economist of the Federal Reserve Bank of Boston, concludes that "the drop in labor productivity has not been due to a decline in the growth of some mystical concept of multifactor productivity or technical progress. Rather, it has been due to a decline in the growth of public infrastructure" (1990, pp. 3-22).

Gramm-Rudman-Hollings has exacerbated the problem. Although the federal budget runs over $1.2 trillion, less than ten percent includes programs in support of public investment, and it is this same ten percent which bears almost the entire brunt of the domestic portion of any Gramm-Rudman-Hollings sequester. In FY 1991, for instance, a sequester would cut $16.4 billion from this $120 billion category, or 14 percent. The remainder of the domestic budget, or $816 billion, only takes a $1.9 billion cut (OMB, 1990, p. A-35: House Committee on the Budget, 1990, p. 118) — representing two-tenths of one percent.

Thus, despite the overwhelming evidence that public investment has been neglected and that this neglect has a crippling effect on the nation's productive health, present budgetary policies -- ostensibly aimed at increasing investment by cutting the deficit and thereby raising national savings -- are in fact inhibiting investment.

The President's rhetorical enthusiasm for spending on education, transportation, and the environment suggests that these themes make political as well as economic sense. Voter polls have tracked the swing of the political pendulum in the direction of a more favorable attitude toward government responsibility, and the language the White House has chosen for presidential speeches has wisely followed. But the necessary fiscal commitment has not materialized. The Administration has instead urged state and local government officials to raise taxes, i.e., to enter the politically risky zones into which the President is not only unwilling to tread, but which he himself has booby-trapped with his own anti-tax campaign.

It is reasonable to expect state and local governments to shoulder their share of the public investment burden, as they did when the Reagan-Bush Administration was cutting federal investments. But this does not relieve the national government of responsibility for problems which urgently need solutions precisely because *national* objectives, such as international competitiveness, are at stake.

As unmet domestic needs pile up, the financial noose of the federal deficit tightens around the neck of domestic spending. The political stalemate over the federal deficit has so constrained the policy dialogue that even many who agree on the importance of public investment are prepared to acquiesce to large cuts now, on the theory that we must "get the deficit problem behind us," in order to afford domestic investments at some unspecified time in the future. The inevitable result will be more drop-outs, more untrained workers, more crumbling bridges, more polluted air and water.

Lip-reading

With the recent announcement that the deficit may be $20 billion higher than anticipated, George Bush apparently has stopped moving his lips on the subject of taxes.

Previous deficit projections of the Office of Management and Budget implied a Gramm-Rudman-Hollings sequester figure of $36 billion. This meant that if the Administration and Congress failed to reach agreement on a budget, cuts equal to half of the sequester figure would be made in both defense spending and in the domestic discretionary budget. Until recently the Administration, in order to avoid a tax increase, seemed to be prepared to take an $18 billion defense cut in return for equal cuts on the domestic side. But a $56 billion sequester raises the ante among other consequences. It implies a $28 billion cut in defense outlays under Gramm-Rudman-Hollings, which, while feasible, is more than the Administration is willing to swallow. Some balance has thus been restored in the negotiating strengths of the Democratic Congress and the White House.

This does not necessarily mean that a major tax increase will be forthcoming. "No-new-taxes" may still be the key to the Bush 1992 re-election strategy. All signs are that even if the President agrees that he will not personally attack Democrats for putting taxes on the table, other Republicans will have no such compunction, and once-burned Democrats may shy away from a deal that makes them bear political responsibility for cleaning up the Reagan-Bush fiscal mess.

Moreover, if the current strong resistance of the Administration to increasing the income tax is not dented, any final compromise would undoubtedly place the greatest burden on those who have already been paying for the Reagan-Bush party -- working people who make less than $50,000 a year. Payroll tax rates, for example, have increased from 13.3 percent in 198 1 to 15.3 percent today. The burden of paying for government has shifted in the last ten years to poor and middle income people who work for a living and away from those in upper income brackets who receive a larger share of their earnings through interest and dividends (House Committee on the Budget, 1990, pp. 19-23).

The last decade saw an extraordinary upward shift in the distribution of income and wealth (Mishel and Simon, 1988 and McIntyre, 1988). Moreover, contrary to a widespread misconception, the consumer spending "binge" of the eighties was almost entirely concentrated among people in the top 20 percent of the income bracket (Blecker, 1990). It would therefore seem reasonable that any new burden required to pay down the deficit be placed on the shoulders of the upper income people who gamed the most benefit (Faux, 1987). It is an amazing political phenomenon that many leading Democrats have responded to the President's intransigence on income taxes by proposing regressive consumption taxes and program cuts that impose still more burden on the Democrats* own constituency.

A case in point is Congressman Rostenkowski's plan for reducing the fiscal deficit over five years. He calls for an immediate freeze on domestic spending, higher taxes on consumption, and the allocation of *all* savings from defense cuts to deficit reduction. Additional domestic spending would be on a pay-as-you-go basis which, given the President's opposition to new taxes for new spending, really means continued *disinuestment in the* public sector for the foreseeable future.

The deficit notwithstanding, there remain opportunities for increasing tax equity without reducing public revenues. We could, for example, remove the ceiling on income that is subject to the Social Security tax and reduce the tax rate on earnings of *less* than $51,300. Eliminating the ceiling on earnings taxable under the payroll tax would yield $49 billion in FY 1991 ($40 billion for OASDI and $9 billion for the Medicare component). Applying $49 billion to rate reduction would make it possible to reduce the combined tax rate on workers and business firms by about 1.5 percentage points (Congressional Budget Office, 1990a, p. 399; 1990b).

Under current law, taxing higher incomes would increase benefits to that group slightly in the short run and significantly later on. The prospect of an increase in future benefits from Social Security would have to be addressed by modifying the benefit formulae or increasing the federal government's ability to meet these future obligations. (Since those with higher wages already get full Medicare benefits, no additional payout from that program now or later would result from removing the cap on taxable earnings.)'

Whatever the result of this year's budget negotiations, the logic of the deficit dilemma and the political calendar make the chances of a tax increase to finance public investment even more remote after this year. Next year the willingness of both Democrats and Republicans for taking the political heat for raising taxes will shrink further. The budget debate in calendar 1991 will concern FY 1992, which ends a month before the next presidential election. And after that comes 1992 -- the election year itself. Bush's current rigidity therefore locks us into a public disinvestment policy until October 1993 at the earliest.

In the event of a recession, which may in fact be hard upon us, the fiscal deficit will soar and the prospects for public investment will be further diminished. Tax increases would suffer the dual disadvantages of slowing down the economy and being earmarked for deficit reduction.

Given the terms in which the fiscal debate is currently defined, the Democratic candidate in 1992 cannot be expected to make a frontal assault on Bush's anti-spending position. On the contrary, political logic tells us that he or she will echo that pledge to some degree. As a result, even if Bush were defeated in 1992, it would be extremely difficult for the newly elected president to increase taxes soon after the inauguration in January 1993, when the new administration would present its revisions to Bush's last budget. Thus the first clear shot to work up and gather support for a major tax increase to finance new public investment and undo the damage of Reaganomics doesn't come until early 1994, for the fiscal year ending in September 19951

Finding the Peace Dividend

There is only one avenue of escape from this fiscal trap: it leads directly to the military budget.

The Cold War is over. There is simply no rationale for a defense budget of the size now contemplated by the Administration. One need not be an expert in military strategy or international affairs to understand that spending anywhere near $300 billion dollars on defense in FY 1991 is a monumentally irresponsible waste of money that we cannot afford.

The Administration's budget proposes that it be given the authority in FY 1991 to commit $307 billion to be spent for military purposes. Actual spending would be about $303 billion, representing a 2.3 percent increase in nominal terms, which an assumed 4.9 percent inflation rate translates into a 2.6 percent cut in real terms. This budget provides for only a slight change in the rate of decline since the defense budget peak of FY 1987; in real terms that decline has averaged 2 percent per year in spending and 2.9 percent per year in budgetary authority. Given the dramatic change in the international political climate, Bush's budget is completely isolated from reality.

The first step in bringing the military budget in sync with the world as it now exists is to ask the right question. Before determining how much we can *cut* from the present budget, we first must ask: "How much do we need to spend?" Prevailing practice takes the present budget as a point of departure, making what we did yesterday the principal yardstick for judging what we should do tomorrow. It is ironically reminiscent of the bureaucratic planning style that by general agreement has failed in Eastern Europe. If, on the other hand, we begin by determining what we *need* to spend, we have a chance to separate actual defense considerations from the financial interests and bureaucratic inertia that stand in the way of a rational defense budget.

One place to begin is with the lowest level of spending in real dollars with which we were able to defend ourselves adequately when the Cold War was in full swing. By this measure, as recently as 1976 under a Republican President, when a united Warsaw Pact was armed to the teeth, the U.S. defense budget was $203 billion in 1990 dollars (Kaufmann, 1990, Table 1). It is impossible to take seriously the argument that under present conditions -- when the Warsaw Pact is irrelevant, the Berlin Wall obliterated, Germany on the brink of unification, democratic and economic reforms sweeping the Soviet Union, and international communism virtually eliminated as a force in the world -- we need to spend more, in real terms, than we did in 1976.

If we answer the question of how much we need from the "bottom up" -- from an analysis of the minimum necessary weapons systems and troop deployments to defend our interests -- we get an even smaller figure.

Over the past year several expert studies -- by former DOD official William Kaufmann (1990, Table 1), by the World Policy Institute (Bamet, Brown, Browne, et *al.*, 1989), and by a group headed by former Assistant Secretary of Defense Lawrence Korb and former CIA Director William Colby (Cain and Goldring, 1990) -- have shown that the defense budget could be cut in half over ten years and still leave the United States and its allies secure. A number of other experts, including former Defense Secretaries Robert McNamara and James Schlesinger have supported the general thrust of these studies (Senate Committee on the Budget, 1989).

These defense reduction plans are based on similar strategic considerations: 1) maintaining a second strike capability of between 3,000 and 4,000 submarine- and bomber-launched nuclear warheads, 2) reducing troops and eliminating battlefield nuclear weapons in Europe, 3) maintaining flexible, mobile forces capable of being deployed around the world, and 4) continuing research on new weapons technology.

The studies differ somewhat on what the composition of defense would look like after the reductions. Kaufmann and the Korb group would maintain a sizeable number of troops in Europe and a smaller navy than the WPI group, for example. But the important point is the agreement -- among many people who themselves were major players in the buildup of U.S. military power during the Cold War -- that the U.S. and its allies would be fully protected and the U.S. would be left with a formidable capacity for deploying military force at half the current price.

Thus, whether looked at in aggregate or in terms of specific weapons systems, the financial cost of national security has declined dramatically. *A Peace Dividend of between $100 and $150 billion already exists. The President's budget however, proposes that it be spent on the Pentagon.*

In view of the urgent need to find new resources for the **economic** competition that lies ahead, we must also ask: Why should it take ten years to reach a more reasonable level of military spending? Granted that it takes time to demobilize troops, to phase out contracts, to prepare workers and communities for dislocation, but it is not apparent that the reductions should take a decade.

There are two sets of policy considerations in judging this question -- one pertaining to foreign policy and national security, the other concerning the domestic economy.

On the national security side, several arguments on behalf of caution have been advanced:

1. The U.S. **should** not *reduce its strategic arsenal without corresponding reductions on the Soviet side.* **Specifically,** *this means we should wait for success&l* **conclusions** *to the* **START** *negotiations, which might not be completed for four or* **five** *years.*

The current negotiating framework is obsolete. The START talks, for example, were intended to ratify unlimited modernization on both sides in exchange for the destruction of existing warheads. But there is no point in modernizing forces which are already vastly **inflated** beyond current needs, particularly at a time when the Soviets are desperate to reduce their own defense commitment. Nuclear deterrence was aimed at preventing a Soviet attack on ourselves or our allies in Europe. Events of the past year have made it clear that the probabilities of either event are now about zero, as a wide assortment of defense experts have admitted.

There is as little reason to link reductions in defense spending to protracted arms talks as there is to play out the last half of the ninth inning when the home team is ahead.

2. *The U.S. should not withdraw* **from** *Europe without corresponding reductions by the Soviet side, and should maintain some forces there* **indefinitely** *for the stability of Europe, entirely apart* **from** *the Soviet presence.*

The case for delay here is even weaker. Gorbachev has already made unilateral cuts in Soviet conventional forces, and, in effect, has been forced to undergo a 55 division cut in the form of the de *facto* collapse of the Warsaw Pact. (Indeed, in any Soviet attempt to invade Western Europe a large part of those 55 divisions probably would be turned against the Soviets) (Kaufmann, 1990). And the U.S. battlefleld nuclear weapons'range is limited to those nations which are now rapidly aligning with the West.

Nor has a case been made that the U.S. must now be responsible for European "stability" -- a euphemism for fear of German **reunification.** There is no serious argument that a united Germany is in the foreseeable future a military threat to Europe. The concern is that Europe will be dominated economically -- and therefore politically -- by the Germans. This may or may not be so. But keeping U.S. troops in Europe will scarcely prevent this: if anything, the dram on our resources will make it easier for the Germans to dominate us economically. Many of the European nations have now come close to, and in some cases surpassed, America's levels of per capita wealth and income. Moreover, with the coming of Western European economic integration and the further integration of Eastern Europe into a massive market, Europe stands on the brink of extraordinary economic opportunities. We have clearly reached the point where the Europeans themselves must take on the responsibility for sorting out the economic and political power balances on that continent.

These considerations should not rule out *any* American participation in a truly multinational military presence in Europe. And in any event, the studies cited show that we could keep up to 100,000 troops in Europe and still cut the military budget in half.

3. The U.S. ***must currently expand its capacities to conduct "low-intensity" operations in Third World nations to support democracy, to respond to terrorism, to stop the flow of drugs, and to maintain oil supplies from the Middle East.***

This is clearly a case of a bureaucracy looking for ways to **justify** its existence. And rationales can always be found for new missions. The question is whether any of these considerations **justify** the immense economic cost of our current defense **commitments.** The answer is no. It was the menace of a Communist Russia in control of Eastern Europe that persuaded the war-weary American people to reshoulder the burden of armaments after World War II. The menace is gone. And there is no comparable contemporary threat to the United States.

The end of the Cold War does not guarantee peace in the world. But we have neither the political consensus nor the economic strength to be the world's peacekeeper -- either to maintain a "balance of power" in Europe, to assure that every nation in the world has a constitutional democracy, or to maintain the safely of Middle Eastern oil. This is not an argument for isolationism. Nor is it to say that a reconfigured military force more appropriate to the new era will not involve additional costs. The U.S., both in its own interests and as a good world citizen, should be willing to shoulder its share of the collective military burden of deterring aggression, supporting democracy, and assisting the developing world. But it is nonsensical to maintain that the United States -- with a massive chronic trade deficit and the world's largest debt -- must continue to shoulder the immense cost of protecting its European and Asian trade competitors from the threat of disruption of their Middle East oil supplies and the world's other uncertainties.

4. ***Reductions must proceed very slowly so as to be "reversible" in case Gorbachev should fail* and *"hardliners"* take *back control of the Soviet Union.***

Obviously, it is possible that Gorbachev could be overthrown, **snuffing** out ***perestroika*** and returning the Soviet Union to totalitarian dictatorship. But whatever happens within the Soviet Union, the military threat that it formerly represented has no significant chance of reappearing in the foreseeable future. The new priorities of revitalizing the economy and preventing the internal breakup of the Soviet Union will inevitably preoccupy Gorbachev and his successors for decades.

The Director of the U.S. Central Intelligence Agency has concluded that the contraction of the Soviet Unions offensive military posture is all but irreversible. "Even if a **hardline** regime were able to regain power in Moscow," he notes, "it would have little incentive to engage in major confrontations with the United States" (Webster, 1990). Moreover, should the Cold War return there will be ample opportunity for the U.S. to rearm: history has shown that no nation in the world has the ability to gear up to a military economy as quickly as the United States.

As this is being written, the Lithuanian people are struggling to attain total independence, and President Gorbachev is struggling to stave off the dual dangers of a disintegration of the Soviet federation and an internal counterrevolution. Our case for defense cuts follows regardless of the fate of Lithuania. Given that the United States is not going to war for the independence of the Baltic republics, even the worst-case scenario of Russian military aggression does not **magnify** the Soviet threat to the ***United States.*** On the contrary, a Soviet regime preoccupied with holding its own country together, stemming the tide of non-Russian military deserters, and saddled with repressing a hostile population in the **Baltics**, is ***less*** powerful, not more.

One of the best ways to assure the continuation of Gorbachev's revolution is to cut back on U.S. forces threatening the Soviets as quickly as possible. The Soviets are desperate to reduce the burden of armaments on their economy. Delay only strengthens the remaining hardliners in both camps and prevents us from ridding ourselves of a similar burden. Our contribution to the process going on within the Soviet Union is to provide evidence to the Russians that Gorbachev's policies can free up Soviet economic resources without an added threat of military vulnerability to the West.

The second set of rationales for taking as long as a decade to reduce defense spending are domestic.

We cannot, of course, simply wish away a $300 billion military spending industry with its complex flow of monies between military personnel, contractors, workers, managers, shareholders, and politicians. Because the stakes are so high -- nothing less than the ability of the nation to recover its economic strength -- the process of military spending reductions must be driven by a sense of urgency. The **final** burden of proof should not be on those who press for more rapid change, but on those who resist it.

One reasonable concern about the pace of military budget cuts is the impact that such a shift in resource demand might have on the economy. It is conceivable that large and sudden disruptions in important sectors of the economy could endanger the nation's economic growth. But evidence from previous military cutbacks suggests that we can go considerably beyond even the reductions proposed by Kaufmann and the other cited defense analysts (which in turn are far beyond the Administration's proposals) before having to worry about the impact on the U.S. economy.

To evaluate the possibility of general decline in economic growth resulting from military spending cuts, the size of any such cuts should be compared to GNP. U.S. experience provides some guidance on this question. The one-year drop in outlays after the Korean War was as large as 2.2 percent of GNP, which in today's economy would be over $100 billion. This large cut may have helped to produce a short recession in 1954 (Schultz, 1989), but largely because the defense cuts were not offset with increases in non-defense public spending. In any event, the economy recovered quickly in 1955 despite the fact that military spending cuts continued.

The largest one-year post-Vietnam cut was 0.9 percent of GNP, the equivalent of almost $50 billion today, and still much larger than anything now being contemplated. But government spending in the aggregate did not decline and there was no impact on the overall economy.

On the whole, therefore, one-year cuts in defense of less than $50 billion hold no risk of macroeconomic harm, unless all or most of it is devoted to fiscal deficit reduction.

A second obstacle to quick military reductions is the existence of contractual obligations already extended by the Pentagon but not yet paid for. At the beginning of the next fiscal year, these unpaid obligations -- contracts already made or committed to -- amounted to about $270 billion. Of this, we can expect about $117 billion to be spent in FY 1991 (Kaufmann, 1990, Table 6). Assuming that this represents the most difficult portion of the defense budget to cut, it still leaves a pool of $187 billion in new expenditures (out of a total Administration budget of $303 billion) that can be cut without violating existing contracts or commitments. In terms of the new budgetary authority for defense being requested by the Administration, there is a pool of about $120 billion earmarked for new projects and therefore easiest to cut.

Many of the defense contracts signed by the Reagan Administration gave away the government's rights by providing for heavy penalties in the event of cancellation by the United States. But the federal government still has overwhelmingly superior bargaining power. If the Defense Department negotiated contract cancellations with a serious effort to get the best deal for the taxpayer, the pool of cutable spending would be even larger.

The major obstacle in reducing the military budget is the political resistance of those whose economic fortunes will suffer -- Pentagon generals, industry executives, politicians from areas with military bases, and anxious workers. This resistance is the Administration's high card in the budget game. As Richard Darman has commented, a defense spending cut, "while politically popular in the abstract will not be politically popular in all its particulars" (OMB, 1990).

We cannot, of course, prevent all of the dislocation that will be caused by defense budget reductions. Nor would we want to. The whole point is to "dislocate" resources out of the defense sector. We can, however, do several things to smooth the transition and mitigate the resistance.

The first priority is to make it unequivocally clear that the military budget will be reduced sharply over the next five years. In the past, expectations (reasonable in view of the historical experience) that the defense business would return created an attitude among contractors of indifference to efforts at conversion.

Given that commitment, defense conversion efforts should be built around the following principles:

1. Generous severance pay and retraining for affected workers.

2. Economic development planning assistance for affected firms and communities.

3. Establishment of a civilian equivalent of the Defense Advanced Research Projects Agency to begin immediately to finance research and development projects with civilian payoffs.

4. Identification of "dual use" military technologies with civilian applications (e.g., high speed computers, vertical takeoff aircraft, specialized machine tools), which are now classified or otherwise restricted from commercial development. These technologies would be made available to U.S. companies, with, if necessary, government support for long-term financing.

5. Eliminating obsolete Cold War restrictions on the export of U.S. commercial equipment to Eastern Europe which have had the effect of ceding markets to Western European competitors.

Using the Peace Dividend for domestic investment is the best way to assure that the market will eventually find new uses for labor and capital currently committed to defense production. Even so, temporary periods of unemployment are bound to result. The best way to ease such transition costs is to make a concerted effort to involve communities and defense firms likely to suffer cutbacks in the business of servicing areas where the public budget will be expanding: infrastructure, civilian research and development, and environmental technologies. Here is a precisely a case where *planning* for conversion is essential.

In addition to helping overcome political resistance and to preserving useful past investment in our technological capacities, there is another virtue to a serious effort to save a part of the defense industry for civilian purposes: if the need arises to expand our armament again, we will have a civilian base upon which to build.

After translating these obstacles into spending constraints, we are still left with much more leeway than the President's budget suggests. History indicates that we could shift up to $50 billion without concern that it would lead to recession. Even after contractual obligations are accounted for we are left with a pool of $120 billion in new budgetary authority and $187 billion in outlays from which to select the most appropriate specific cuts. Political obstacles are, of course, harder to quantify and their strength is unknown until tested, but the Administration has given us a clue as to what its politically acceptable maximum cut in defense spending is for this year. By stating publicly that the Administration is "prepared to live with" the Gramm-Rudman-Hollings sequestration, OMB Director Darman has, perhaps inadvertently, told us that a crude and mechanical across-the-board-cut of $18 billion -- the defense share of the sequestration burden -- is presently acceptable.

In a practical political sense, this defense cut implied by sequestration may also be the maximum obtainable this year: the President will presumably veto any budget that contains more than whatever defense would lose under sequestration.

Thus, although it clearly takes time to close down facilities, cancel or withdraw from contracts, turn over any remaining responsibilities to the Europeans themselves. etc., both history and logic suggest that ten years is an unnecessarily prolonged time period over which to cut away half of the military budget. No demobilization has ever taken that long. Indeed, the emergence of ten years as the period over which the military budget could be cut in half is quite arbitrary, and to some degree may be the product of Pentagon planners who think in terms of five year plans. Nowhere in the Kaufmann or Korb reports is there a satisfactory rationale for it. ***The only*** benchmark in either report is the expectation that the START and the CFE (Conventional Forces in Europe) talks will take five years. But, as indicated, those talks can be accelerated. Moreover, given the reality of the world situation, reductions can begin before all the talks are completed because there is no real penalty for one side or the other in moving faster. Indeed, the greatest beneficiary of a shrinkage in the military budget is the economy of the country doing the shrinking. If we are in less danger now than we were in 1976, and if one-half of the military budget is sufficient for our present defense needs, then something less than a ten year phase down period is clearly in order.

Table 1 describes such a reduction occurring over a five year period. Of course, a five year period is as arbitrary as ten years, but -- aside from uncertainty about the future -- there is no evidence that it is too short. It has the advantage of delivering the savings that much sooner, and of providing much less time for the military bureaucracy to concoct new missions.

The spending reduction path illustrated in the table begins modestly in the first year because of the current Gramm-Rudman-Hollings obstacle, and in recognition of the need to prepare for an orderly demobilization. Reductions then accelerate, reaching a current dollar budget level of about $191 billion by FY 1995 ($152 billion in 1990 dollars). By that year, the cuts will have freed up a cumulative peace dividend of about $450 billion in 1990 dollars.

TABLE 1

Path for Halving Military Budget in Five Years

(Billions of current dollars except where otherwise noted.)

	Base 1990	1991	1992	1993	1994	1995
CBO Baseline Outlays	297	307	318	328	345	355
Proposed Percentage Fall		3	6	9	11	13
Proposed Outlays		288	271	246	219	191
Savings Made Available for Public Investment		19	47	82	126	164
Proposed Outlays, $1990		276	248	216	184	152

Source: Congressional Budget Office, 1990.

Cuts are measured as a percentage of the previous year's nominal outlays. Savings are defined as the difference between the CBO baseline and our proposed outlays.

It should be noted that the above reductions require much larger cuts in ***budget authority*** in the early years. Much current year spending is locked-m by prior year budget authority, and it takes time for reductions in authority to translate into reduction in outlays.

Revisiting Gramm-Rudman-Hollings

The question of whether and how to revise Gramm-Rudman-Hollings has been put on the political table by those who believe that we should separate Social Security and the other trust funds from the measurement of progress toward the deficit. Because this would make meeting the current Gramm-Rudman-Hollings targets virtually impossible, the targets would have to be adjusted and the time frame for deficit elimination lengthened.

Gramm-Rudman-Hollings is now a counterproductive and ineffective approach to budget policy. Among other flaws, it focuses attention on short-term budgetary gimmicks which have already added unnecessarily to the long-term burden on savings and investment.

Obsession with the Gramm-Rudman-Hollings targets has obscured the progress already being made in reducing the budget deficit as a percentage of our GNP. The Congressional Budget Office, more conservative in its forecasts than the Office of Management and Budget, projects a drop in the federal deficit as a share of GNP from 2.9 in 1990 to 1.5 in 1995. This calculation includes the steadily expanding revenues in the Social Security Trust funds that would not be available if the Moynihan proposal became law. But if the revenue from reduced payroll tax contributions was replaced, the cited downward trend of the baseline deficit would continue.

We are therefore approaching deficit levels that compare favorably with international norms. A central government deficit of lower than two percent of GNP would be at or below levels prevailing in most of our industrial competitors over the last 20 years. For instance, the central government deficit of Germany as a percentage of Gross Domestic Product ranged between one and two percent of GDP after 1975. Levels in the United Kingdom and Canada were substantially higher (between two and five percent most of the time), while those in Italy were usually in double digits. The lowest deficit levels in France were more in line with where the U.S. is headed now, while their high points were close to Britain's (International Monetary Fund, 1989).

The core economic issue has become less the size of the federal deficit as much as the composition of the budget and its contribution to economic growth. The modest levels of the deficit share of GNP we are approaching are quite compatible with a prosperous high-investment economy. In revising Gramm-Rudman-Hollings, therefore, we should start shifting our goals away from the unnecessarily rigid objective of eliminating an irrationally defined budget deficit, and toward the more sensible need to increase productive investment and improve the incentives for all of the relevant institutions to promote economic growth.

Two changes in particular should be considered:

1. ***Capital Budgeting.***

Judgments about the adequacy of public investment are obscured by the way the federal government keeps its books. If the federal government's budget were kept in a more "business-like" manner -- one that reflected the economic realities underlying financial management -- it would separate its operating **deficits** (profit and loss) from its capital account. Investments would be carried as assets and depreciation charges would be levied against the operating budget (Eisner, 1989; Heilbroner and Bernstein, 1989).

There are technical problems in coming up with a comprehensive capital budget for the U.S. government, but there is general agreement that many expenditures of the U.S. government do generate future income streams and should be interpreted as capital investment. Highways, education, training, and civilian research and development would clearly fall into that category. Investments in defense hardware and structures last for several years and would be considered capital in an accounting sense, but they do not increase future income and therefore would, from our standpoint, be excluded from a capital budget.

In economic terms then, a shift of government spending from military to civilian investment has the effect of decreasing the federal government's operating deficit and increasing its capital investment by the amount of the reduction in military spending. Inasmuch as the purpose of ***reducing*** the U.S. federal ***deficit*** is said by ***all*** proponents to be to increase the amount of savings available for investment, this ***shift*** in the composition of the federal budget has the same effect as a decrease in the ***deficit*** which goes entirely towards an increase in national savings. Indeed, because al.2 of the savings from defense in this case go into investment, such a shift provides more in new savings and investment than a mere reduction in deficit spending, the proceeds of which may or may not be reinvested, and which may or may not be saved and may or may not be reinvested in America, depending on the proclivities of private investors.

The shift of government spending from military consumption to civilian investment would be similar to a business reducing the cost of its operations and using the savings to invest in its expansion. The result would be an increase in its operating profit or a decrease in its operating loss. Its cash position would not change, of course, but it would be operating more profitably. Regrettably, the cash-flow deficit of the U.S. government as defined by Gramm-Rudman-Hollings does not change with a shift from military consumption to civilian investment, even though the economically meaningful operating deficit declines.

Although many industrialized countries use capital budgeting, establishing a capital budget process for the U.S. government will take years. But given the crisis in public capital investment, and the bias of the Gramm-Rudman-Hollings formula against capital investment, the framework for deficit reduction can certainly be altered to more accurately reflect the economics of capital budgeting. Specifically, shifts of funds from the military budget to those civilian accounts that both the Administration and the Congress agree constitute capital investments should be treated as savings, as they would in a capital budget.

Table 2 displays the budgetary impact of such a procedure. The first line shows the projected baseline budget deficit estimated by OMB. Their "current services" projection assumes no change in current law and continuity in existing policy. Programs which are scheduled to expire by law but which are expected to be renewed (such as Food Stamps) are included. Entitlement spending is projected on the basis of estimated changes in the number and composition of recipients.

It can be seen that assuming the three percent annual rate of economic growth underlying the OMB projections, the growth of federal revenues relative to the growth of "current services" spending is sufficient to eliminate the baseline deficit by FY 1995. However, the Gramm-Rudman-Hollings law requires that the earlier targets be met. Given these targets in the second row and the allowed "cushion" (the amount by which the law permits the budget to fall short of the Gramm-Rudman-Hollings deficit targets) in the third, the fourth row shows the amount of combined new revenues and program cuts needed to hit the targets.

The fifth row shows the increases in revenues and offsetting receipts over baseline levels that the OMB estimates result from the FY 1991 Bush budget proposal (excluding changes in capital gains and payroll taxes for state and local employees, to which there is substantial Congressional opposition). Next on line 6, from Table 1, is the proposed path of transfers from defense outlays to civilian public investment.

Combining these new revenues and investments (savings) yields the "Adjusted Operating Deficit" on the seventh line (negative signs signify a budget surplus in excess of the deficit targets). As shown, the investments and new revenues are more than sufficient to satisfy even the existing deficit targets.

In order to reconstruct the total budget deficit, the "cushion" and targets are added back to the adjusted operating deficit, yielding the "Adjusted Net Operating Deficit" shown both in constant dollar terms and as a percentage of GNP. Depreciation on the new capital investment is also added.[2] The resulting Adjusted Net Operating Deficit falls sufficiently within the deficit targets (including the cushion) to avoid sequestration. As can be seen, the deficit immediately drops below two percent of GNP and goes into surplus in two years.

Again, the point being illustrated is that in economic terms, military spending diverted to accounts that are unambiguous sources of public investment should not contribute to the federal deficit, properly interpreted. Thus, the cut in military spending can be spent entirely on public investment with no change in the Adjusted Net Operating Deficit. Moreover, the size of the Adjusted Net Operating Surplus could be prudently reduced over time to strengthen our commitment to other domestic priorities.

Should the baseline deficit projection increase, due to signs of rising interest rates and slow growth, the adjusted operating deficits in line 7 would increase, dollar for dollar. They might also increase because of lower-than-expected revenues resulting from President Bush's proposals in line 5.

A $20 billion dollar increase, for instance, in the FY 1991 deficit would wipe out the cushion of $3.5 billion shown in Table 2, line 7 and necessitate the recovery of **16.5** additional in spending cuts and tax increases under Gramm-Rudman-Hollings.

There are two ways to look at this problem. Since the projections are premised on Bush's no-new-taxes pledge, there remains a lot of slack in terms of the government's ability to raise more tax revenue. Steps might also be taken to reduce the cost of health care and get some savings out of the Medicare program.

Alternatively, a $20 billion increase in the deficit amounts to **one**-third of one percent of the $6,000 billion GNP previously projected by the Administration for 199 1. While ignoring this $20 billion violates **Gramm**-Rudman-Hollings, it is of negligible concern to the economy as a whole. This points up the arbitrariness of the G-R-H legislation, and the way in which it prevents us from addressing the fundamental problem faced by the U.S.: providing for our future.

TABLE 2

Budgetary Consequences of Shifting Resources from Military Spending to Civilian Public Investment

	FY1991	FY1992	FY1993	FY1994	FY1995
1. Baseline Deficit (- Surplus)	100.5	72.9	39.2	13.1	-13.1
2. - Gramm-Rudman-Hollings Target	64.0	**28.0**	**0.0**	**0.0**	**0.0**
3. - Cushion	10.0	10.0	0.0	0.0	0.0
4. = Required Reallocation	26.5	34.9	39.2	13.1	-13.4
5. - New Bush Revenues	10.8	8.5	4.1	3.4	5.0
6. - Cut in Military Outlays (= Increase in Public Investment)	19.2	41.7	65.5	98.3	125.5
7. = Adjusted Operating Deficit	-3.5	-15.3	-30.4	-88.6	-143.9
8. + Cushion and G-R-H Target	74.0	38.0	0.0	0.0	0.0
9. + Depreciation of New Capital	0.0	1.0	2.1	3.3	4.9
10. = Adjusted Net Operating Deficit	70.5	23.6	-28.3	-85.3	-139.0
11. Adjusted Net Operating Deficit as Percent of GNP:	1.2%	0.4%	-0.4%	-1.2%	-1.8%

Note: Projections of baseline deficit, new Bush revenues, and GNP as calculated by the Office of Management and Budget.

2. Strengthening the *Incentives* **for Growth**

Initial promises that the Reagan tax cuts would spur harder work and more capital investment and rebalance the budget have turned out to be fantasies. But in recent years, continued economic growth *has* been an important factor in the gradual shrinkage of the deficit as a share of GNP. In fact, in the past few years the "rosier" scenarios of OMB have proven to be more on target than the more pessimistic Congressional Budget Office (CBO) projections. The difference between the OMB and CBO forecasts for the next five year period is the result of differences in economic assumptions. CBO guesses that the economy will grow seven-tenths of a percent slower per year than the OMB does. Faster growth means higher revenues and lower outlays for unemployment compensation and similar entitlements. The lower deficit in turn means lower interest charges. OMB also assumes slightly lower inflation after 1992 and lower real interest rates (Congressional Budget Office, 1990).

Several important points should be made about these forecasts. First, although small changes in economic assumptions produce large changes in the deficit, the economic assumptions are not dramatically different, as Table 3 shows.

TABLE 3

Economic Forecasting by **the**
Administration and the Congressional Budget Office

	Average, FY1991-1995	
	OMB	CBO
% Real GNP Growth (% Change)	3.1	2.4
Unemployment Rate	5.1	5.5
Inflation (CPI)	3.6	4.3
Interest Rates		
3-Month T-bill Rate	5.0	6.5
lo-year Govt. Note Rate	6.0	7.5

Source: Congressional Budget Office, 1990.

Second, the more optimistic OMB growth and inflation forecasts are easily within the capacity of the economy and, although on the high side, within the range of private forecasts.

Third, economic ***growth is not independent of*** government policy. In particular, achieving the higher OMB growth rate depends on the actions of the Federal Reserve Board in keeping interest rates low.

But so far the Federal Reserve has escaped all responsibility for helping to solve the deficit problem. Even more than the President, the Fed Chairman has been out of the loop of accountability, despite the fact that the Fed's monetary policy plays a crucial role in permitting the economy to grow fast enough to reduce the deficit. Freed of responsibility for the deficit, the Federal Reserve has been able to pursue tight money policies with other objectives in mind -- such as zero inflation. The result has been to undercut the growth needed for steady deficit reduction and to exacerbate the problem by expanding the burden of interest payments in the federal budget.

The dependence of the U.S. on foreign lending and the internationalization and deregulation of finance undoubtedly has restricted the power of the Fed to affect domestic economic growth and stability. The experience of the past few years has called into question the capacity of any central bank to act independently of international exchange rate and currency movements. Nevertheless, the Fed still has considerable power over the economy, reflected by the constant attention financial markets give to its decisionmaking process. And to the **extent** that the globalization of the economy has weakened the power of all U.S. institutions to influence the domestic economy, it is all the more essential that the Fed be a more involved partner in maintaining growth.

Making the more optimistic but still reasonable OMB forecast a ***goal*** instead of just a prediction would be one step toward making deficit reduction more of an economic problem and less of a purely budgetary one. By having the Administration, the Congress, and the Fed focus more on achieving the growth targets, such a policy could bring the Federal Reserve explicitly into the policy loop, encouraging a more supportive domestic monetary policy and the inclusion of U.S. growth goals in its efforts at coordination with other nations' central banks. This does not guarantee that the OMB targets will be reached, but it does put the Fed on the right side of the equation. And since it is widely accepted that deficit reduction must be accompanied by lower interest rates, rational policymaking dictates that the Fed be part of any fiscal plan.

The current Gramm-Rudman-Hollings incentives have proven inadequate in the past and are increasingly inappropriate and out of balance for the economic era in which we now find ourselves. As we have mentioned, given the expected decline in defense spending. sequestration holds no terror for the Administration and provides no incentive for the

Federal Reserve to do its part to promote growth.

There *is* a penalty that would have an effect on all three Institutions that must do their part: the failure to reach the targets could be punished with a tax surcharge on corporate and individual incomes. Clearly, in the present political climate, both the President and the Congress will have an incentive to avoid having to raise taxes as a result of their failure to reduce the deficit. Neither would the Federal Reserve enjoy the onus of failing to achieve enough growth to avoid raising corporate and individual incomes. Adding an income tax surcharge to the current mandated cuts in military and civilian spending in the event the Gramm-Rudman-Hollings targets are not met would help bring all the relevant players into the deficit reduction game.

Some have voiced fears that the Peace Dividend has already been whisked out from under our noses by the savings and loan bailout. The General Accounting Office's revised estimates of the cost of the savings and loan bailout range from $325 billion to a worst case scenario of $500 billion (Bowsher, 1990). In general, the cost is expected to be spread over the next 33 years, although it is conceivable that as much as $243 billion would have to be allocated to the bailout in the first ten (Quint, 1990 and Thomas, 1990). However, our Peace Dividend accumulates in the next five years and recurs ***every*** year ***thereafter.*** Furthermore, the S&L bailout is not a loss to the economy in the same sense that the Peace Dividend is a gain, since the bailout spending merely finances transfers from taxpayers to S&L depositors. In contrast, the Peace Dividend entails the benefit of real resources transferred to beneficial civilian uses. The S&L crisis is no excuse for not realizing a Peace Dividend. If anything, the failure of Congress and the President to address the S&L problem before it became so costly suggests the need for farsightedness now with respect to America's need for public investment.

Any serious reading of the economic and political forces influencing the budget and investment crisis leads to the inescapable conclusion that we must begin now making substantial shifts of resources from military consumption to civilian investment. Many and varied arguments are being offered to support continuation of present defense spending levels. But security and progress must now be defined in economic, not military, terms. The ending of the Cold War represents America's last best hope for preventing a long-term economic slide.

May 1990

Endnotes

1. Inasmuch as Social Security is an ***income security*** system, the focus should be on ensuring an adequate minimum standard of living for future retirees, rather than on a dollar-for-dollar payback to workers in all income brackets. To date Social Security **beneficiaries** in ***all*** income brackets have received significantly more than the value of their contributions from the system. This generosity to the elderly rich has come at the expense of means-tested programs that aid the non-elderly poor, and of public investment that will make workers of the future more productive and more able to support the **pay-as-you-**go system in the future.

2. Depreciation costs are based on a estimate of depreciation of five percent -- which is roughly double typical estimates for depreciation of non-military public capital and therefore overstates somewhat the additional burden to the operating budget. Some might object that depreciation of preexisting public capital or capital that would be financed by baseline spending has been left out. That is indeed the case, but these costs have been left out of the original baseline deficit, so this presentation does not understate the change in the true economic deficit that would be brought about by our proposal If a true capital budget were being presented, baseline costs, revenues, and deficits would all change, as would the associated Gramm-Rudman-Hollings targets.

Bibliography

Aschauer, David Alan. "Rx for Productivity: Build Infrastructure." Chicago Fed *Letter,* No. 13, September 1988.

Aschauer, David Alan. "Is Public Expenditure Productive?" *Journal* of Monetary *Economics,* 23, 1989a, pp. 177-200.

Aschauer, David Alan. "Public Investment and Productivity Growth in the Group of Seven." Economic *Perspectives,* September/October, 1989b, pp. 17-25.

Barnet, Richard J., Lester R. Brown, Robert S. Browne, et *al. American* Priorities in a New *World Era.* A statement prepared under the auspices of the World Policy Institute. New York: World Policy Institute, 1989.

Blecker, Robert A. *Are Americans on a Consumption Binge? The Evidence Reconsidered.* Washington, D.C.: Economic Policy Institute, 1990.

Bowsher, Charles A. Comptroller General, General Accounting Office. Testimony before the Senate Banking Committee, April 6, 1990.

Cain, Stephen Alexis and Natalie Goldring. Restructuring *the U.S. Military: Defense Needs in the 21st Century.* A Report by the Committee for National Security and Defense Budget Project. Washington, D.C.: Committee for National Security and Defense Budget Project, 1990.

Congressional Budget Office. An *Analysis of the President's Budgetary Proposals for Fiscal Year 1991.* Washington, D.C.: Congress of the United States, March 1990.

Congressional Budget Office. *Reducing the Deficit: Spending and Revenue Options*, Washington, D.C.: Congress of the United States, February 1990a, p. 399.

Congressional Budget Office. Letter to Representative Bill Schuette, February 27, 1990b.

Democratic Study Group (DSG). "More Talk, Less Money: Investment and the Bush Budget." *DSG Special Report, No.* 101-28, March 1, 1990.

Economic Policy Institute. "A Warning to the Congress and the President from 327 American Economists: America Needs Increased Public Investment, Now." Washington, D.C.: EPI, 1989.

Eisner, Robert. "Divergences of Measurement and Theory and Some Implications for Economic Policy." The *American Economic Review*, Vol. 79, No. 1. March 1989. pp. 1-13.

Faux, Jeff. *Reducing the Deficits: Send the Bill to Those Who* Went to *the Party.* Washington, D.C.: Economic Policy Institute, November 1987.

Heilbroner, Robert and Peter Bernstein. "The *Debt and the Deficit: False Alarms/Real* Possibilities." New York: Norton, 1989.

House Committee on the Budget. *President* Bush's Fiscal Year *1991 Budget, Serial No.* CP-3, U.S. House of Representatives, Washington, DC: U.S. Government Printing Office. February 2. 1990.

International Monetary Fund. *International Financial Statistics, Yearbook,* 1989. Washington, DC.: IMF, 1989.

Kaufmann, William W. *Glasnost, Perestroika, and U.S. Defense Spending.* Washington, D.C.: The Brookings Institution, 1990.

McIntyre, Robert S. *Inequality & The Federal Budget Deficit.* Washington, D.C.: Citizens for Tax Justice, November 1988.

Mishel, Lawrence and M. Edith Rasell. "Does the U.S. Spend More on Education?" Testimony before the House Committee on Education and Labor Oversight Hearing on Education Funding, February 28, 1990.

Mishel, Lawrence and Jacqueline Simon. The *State of Working America.* Washington, D.C.: Economic Policy Institute, 1988.

Munnell, Alicia H. "Why Has Productivity Growth Declined? Productivity and Public Investment." New *England Economic Review,* January/February 1990, pp. 3-22.

Office of Management and Budget (OMB), Executive Office of the President. *Budget* of the *United States Gouemment, Fiscal Year 1991.* Washington, DC: U.S. Government Printing Office, 1990.

Quint, Michael. "New Estimate on Savings Bailout Says Cost Could be $500 Billion." New *York Times,* April 7, 1990.

Schultze, Charles L. Statement before the Joint Economic Committee of Congress, December 19, 1989. Mimeo. Washington, D.C., 1989.

Senate Committee on the Budget. "After the Thaw: National Security Objectives in the Post-Cold War Era." Transcript of Proceedings, December 12, 1989.

Thomas, Paulette. "GAO Head Says Tax Increase Is Needed to Pay for Cost of the Thrift Bailout." Wall *Street Journal,* April 9, 1990.

Webster, William. Director, Central Intelligence Agency. Testimony before House Armed Services Committee, March 1, 1990.