

THE INFLATIONARY IMPACT OF THE FEDERAL BUDGET*

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An article in a recent issue of the *Journal of Finance* states, "If fiscal policy is to be developed into a more precise art, if not a science, then it is crucial to be able to pinpoint more accurately the timing and the extent of impact of fiscal measures."¹

The purpose of this article is to point out that the present time provides an important example of the need to understand the timing of the economic impact of fiscal measures. Moreover, an improved understanding may, it will be argued, lead to the conclusion that the inflationary impact of the January 1966 Budget submission has been underestimated and that fiscal policy measures may need to be modified substantially.

It has been pointed out in the literature on public finance that the impact on employment, production, and income of a military buildup may occur primarily at the point in time that budget recommendations are made, increased appropriations are enacted, and orders placed with military contractors. Although this may appear quite obvious to those acquainted with defense industries, the standard measures of Federal fiscal performance—such as the statement of Federal receipts and expenditures on national income account or the computation of the "high" employment budget surplus—confine the measurement to the actual delivery of completed weapons and other military "hard goods".

Immodestly, I cite the results of a detailed study of mine which examined the economic impact of each step in the long process between budget recommendations for military procurement and delivery of the completed items to the government and payment therefore.

The primary effect on productive activity, to the extent there is any, occurs in advance of the actual government expenditures. Under most circumstances, the placing of orders induces production on government accounts and such production remains in the private sector and does not show up as government expenditures until it is completed and the goods involved delivered to the public sector.²

This point was elaborated in testimony before the Joint Economic Committee in 1962 where it was shown that, conceptually, production on government order is not reflected in Government purchases of goods and services at the time the work is performed. This activity, as measured by the cost incurred, is currently included in the gross national product, in the change in business inventories. When the

*Reprinted from *Financial Analysts Journal*, July-August 1966.

¹ Joseph Scherer, "On Measuring Fiscal Policy," *Journal of Finance*, December 1965, p. 633.

² M. L. Weidenbaum, "The Timing of the Economic Impact of Government Spending," *National Tax Journal*, March 1959, p. 85.