

THE GROWTH OF GOVERNMENT OVER THE PAST 50 YEARS: AN ANALYTICAL REVIEW

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INTRODUCTION

Although American citizens are largely inured to the colossal and spectacular, they are acutely aware of the spectacular growth of government in recent decades—higher taxes, increased spending, more government regulation, and so forth. The statistics of growth, however expressed, are always overwhelming, and it has already become a cliché to point out, for example, that today's interest charges on the national debt are more than four times total government spending only 50 years ago.

Only slightly less obvious is the fact that our whole conception of government's responsibility is far different today from what it was in 1900. Compare, for example, the following excerpts from two messages to Congress:¹

* * * I do not believe that the power and duty of the General Government ought to be extended to the relief of individual suffering which is in no manner properly related to the public service or benefit. A prevalent tendency to disregard the limited mission of this power and duty should, I think, be steadfastly resisted, to the end that the lesson should be constantly enforced that though the people support the Government, the Government should not support the people (Grover Cleveland, February 16, 1887).

The human problems of individual citizens are a proper and important concern of our Government. One such problem that faces every individual is the provision of economic security for his old age and economic security for his family in the event of his death. To help individuals provide for that security—to reduce both the fear and the incidence of destitution to the minimum—to promote the confidence of every individual in the future—these are proper aims of all levels of government, including the Federal Government (Dwight D. Eisenhower, January 14, 1954).

The overall growth of government in the United States implied in this contrast of views, and the distribution of that growth among all three levels of our government—Federal, State, and local—have had tremendous impact on the whole economic climate. It is the purpose of this paper to examine (1) the aggregate growth of government in the United States over roughly the past 50 years; (2) the basic causes

¹ Cited in *Social Welfare in the United States*, Poyntz Tyler, editor, the Reference Shelf, vol. 27, No. 3, H. W. Wilson Co., New York, 1955, p. 10.

of government's growth; (3) the relative growth of Federal, State, and local governments.

This analytical review will, it is hoped, provide some strong implications, if not conclusions, about the future course of government activity in the United States.

MEASURES OF GROWTH

There are a number of different indexes by which the growth and importance of government in the total economy can be gaged.² One such measure is government's absorption of productive resources—labor and capital. With respect to labor, in 1900, Federal, State, and local governments together employed less than 1.2 million people, about 4.2 percent of all employed workers. In 1956, total government employment was just under 10 million, roughly 17 percent of total full-time employment.³ Thus, government growth, as measured by increased direct employment, was over 700 percent. It can also be summarized as follows: In 1900, 1 out of every 25 employed workers worked for the government; in 1954, 1 out of every 5.9 employed workers worked for the government.

The growth of government's share of the national stock of capital goods has been little less impressive than its growth in direct employment. Government's share of total investment from 1902 to 1946 was 32 percent, almost one-third, and its share of total national capital asset value increased from 6.6 percent to 20.6 percent.⁴ Thus, while in 1902 the total value of government property, excluding military assets, roads and streets, and land was \$6.7 billion, by 1946, the latest year for which data are available, such property was valued at \$45.3 billion (1929 prices).⁵ Measured in constant prices, from 1902 to 1946 government's capital asset holdings, including land, grew by 326 percent.⁶

In addition to the labor and capital government employs directly, it also absorbs great amounts of these resources through its purchases of goods and services from the private sector of the economy. To measure the total volume of resources absorbed by government, we must add to the labor and capital directly employed the value of government's purchases of goods and services from the rest of the economy.

In 1903, government purchases of goods and services from the private sector were about \$752 million, and in 1956 they were some \$80.2 billion.⁷

² Great contributions to the understanding of the growth of government have been made recently in: *The Trend of Government Activity in the United States Since 1900*, Solomon Fabricant, National Bureau of Economic Research, Inc., New York, 1952; *America's Needs and Resources*, a New Survey, Dewhurst and Associates, Twentieth Century Fund, New York, 1955, ch. 18; *A Century and a Half of Federal Expenditures*, M. Slade Kendrick, National Bureau of Economic Research, Occasional Paper 48, New York, 1955.

³ Government employment and total employment for 1956 are in full-time equivalent numbers, but, for 1900, we used the census figure for "Employed," cf. Fabricant, *op. cit.*, appendix B; series D-62-76, *Historical Statistics of the United States, 1789-1945*, a supplement to the *Statistical Abstract of the United States*, Census Bureau; *Survey of Current Business*, July 1957.

⁴ Fabricant, *op. cit.*, table 4, p. 20.

⁵ *Ibid.*, table 3, p. 19. Military assets, roads, streets, and land are excluded from these comparisons except as noted.

⁶ This figure includes land, but excludes roads, streets, and related assets, and assets of defense corporations. *Ibid.*, table 6, p. 24.

⁷ Government purchases of goods and services prior to 1929 are estimates derived from Fabricant, *op. cit.*, table 5, p. 22; gross national product for 1913 is Kuznets' estimate; other data computed from *Survey of Current Business*, July and August 1955.

As a share of gross national product, government purchases of goods and services rose from 3.6 percent in 1913 to 9.7 percent in 1956. Thus, the fraction of total national output (GNP) absorbed by government through its purchases from the private sector of the economy was almost 3 times greater in 1956 than it was in 1913. The magnitude of the absolute increase again looms clearly when we recall that in the same period the gross national product itself grew 10 times larger, from \$40 billion in 1913 to over \$414 billion by 1956.

The inputs of labor and capital for the production of government services together give a total measure of government's absorption of productive resources. It is estimated that total real resources put into government's nondefense activity rose over 400 percent between 1900 and 1949; and into all government activities, "probably over 700 percent".⁸ Even with a most liberal allowance for error, it is patently clear that the growth of government measured by its absorption of productive resources has been very great indeed; but, at the very best, this measure alone is too restricted for our purpose. We are here concerned with the growth of government in a broader sense than that which measuring only inputs of labor and capital affords.

Total government expenditures is a more inclusive measure because it includes expenditures for transfer and net interest payments in addition to the value of government's absorption of productive resources.⁹ Although transfer and net interest payments do not represent additional absorption of real resources, they reflect, just as much as any other expenditures, increases in government activity called forth by the complex of national circumstance. Therefore, total government expenditure is, for us, a more useful index of government growth.

Total government expenditure in current dollars rose from \$1.5 billion in 1902 to \$104 billion in 1955, an increase of 69 times, while the gross national product increased by roughly 20 times in the same 54-year period.¹⁰

Although government expenditure provides the most inclusive index of the quantitatively measurable growth in government, obviously it falls far short of measuring the full growth of government's impact on the Nation's economy. The effects of new legislation, court decisions, and administrative regulations, in such fields as labor relations, industrial organization, agriculture, natural resources, and transportation, is not easily measured in dollar terms.

For a full evaluation of government's growth, however, these aspects of government activity should be considered along with the growth in government expenditure. Although we cannot give them quantitative significance we shall have them in mind as we turn to a brief analysis of the underlying causes of governmental growth.

⁸ These estimates are given, and should be taken, only as rough approximations. Aside from the many statistical problems inherent in the construction of such a broad index over so long a period, some of the vital data—value of military assets used by Government, for example—are not available. For our purpose, however, the possible margin of error involved in these estimates is of little consequence.

⁹ Fabricants' expenditure figures include an imputed net rent of 4 percent on the 1939 book value of government nonmilitary capital assets, but in most calculations, as he points out, interest on the public debt is taken as the measure of the services of government capital, or these services are ignored (pp. 12, 26). We are following conventional procedure and using the Department of Commerce figures for total government expenditures, which, therefore, will exceed Fabricant's measure of total input by the difference between his imputed rent and net interest payments on the public debt, and by the addition of transfer payments.

¹⁰ The gross national product for 1902 is estimated at some \$20.7 billions on the basis of Kuznet's figures for annual average gross national product in current prices for the decades 1894-1903 (\$15.7 billion) and 1899-1908 (\$21.6 billion). Cf. Kuznets, S., *National Product Since 1869*, National Bureau of Economic Research, New York, 1946.

SOME MAJOR ELEMENTS UNDERLYING THE GROWTH IN GOVERNMENT EXPENDITURES

Population growth

Between 1900 and 1957 the population of the United States grew from 76 million to 170 million. Although a larger citizenry does not ordinarily require an equal proportionate increase in expenditures for all types of government activity, this population increase of 217 percent obviously would itself call forth a sizable increase in aggregate government expenditures. For the period 1913-50, for example, it is estimated that population growth alone was responsible for \$4.6 billion, or 6.9 percent, of the total government expenditure increase of \$66.4 billion (1950 prices).¹¹ This estimate, however, does not take into account important changes in population characteristics and therefore understates the effect of population changes on government expenditure.

Among the changes in population characteristics which also imply greater government expenditures there is, for example, the fact that the median age of the population rose from 22.9 years in 1900 to 30.9 years in 1950. The greater proportion of older people in the 1950 total is underscored by the fact that the percentage of those over 65 years of age almost doubled—from 4.1 percent in 1900 to 8.1 percent by 1950. Although the proportion of school-age people—5 to 19—dropped from 36.7 percent in 1900 to only 23.3 percent in 1950, the actual number rose from 27.9 million persons to 35.1 million persons, and the proportion attending school rose from 62.6 percent to 79 percent.

Even more significant than the change in age distribution in terms of its effect on government costs, was the shift of population from rural to urban status. In 1900, the population of the United States was divided 60 percent rural and 40 percent urban. By 1950, the proportions had more than switched: 64 percent urban and only 36 percent rural.¹² The move from a dominantly rural status also involved a multiplication of urban centers, and while in 1900 we had only 38 centers of more than 100,000 population, by 1950 we had 107. Similarly, the proportion of people living in communities of more than 10,000 grew from 31.7 percent in 1900 to 49 percent by 1950.

A related factor with definite cost implications for government is that the growth of population was not evenly spread through the Nation. From 1900 to 1950 the Northeast lost 1.5 percent of its proportion of total national population; the South lost 1 percent; the North Central region lost 5.2 percent; and the West gained 13.1 percent. Although the day of the Indian wars and two-gun desperadoes had passed by 1913, it would seem that the growth of population in the relatively newly settled West called forth larger amounts of government expenditure than would have been required had population growth been restricted to the older, established areas of the country.

Price level changes

The secularly rising price level has been another obvious influence raising the dollar volume of government expenditure. The long-period decline of the purchasing power of the dollar, in evidence

¹¹ Dewhurst, *op. cit.*, p. 595.

¹² New census definition. All data in these comparisons from Census of Population.

since about 1850, has continued through the present. There has been some irregularity, occasioned by cyclical ups and downs, but, for the period as a whole, the purchasing power of the dollar has moved in a downward direction. For example, a 1939 consumer dollar had the purchasing power equivalent of \$2.58 in 1850, \$1.80 in 1900, and only \$0.52 in 1953.¹³ The wholesale dollar moved somewhat less dramatically over the past 100 years but it, too, has definitely tended downward—from a 1939 purchasing power equivalent of \$1.23 in 1850 to \$0.45 in 1953.

Neither the consumer nor wholesale price index is completely adequate, however, for accurately translating government expenditures into dollars of constant buying power and thus making expenditures in different years comparable without distortion from price changes. This is so because the effect of price changes on government expenditure varies with the different proportions of special kinds of goods and services which make up the government expenditure total. For example, a 1913 dollar spent on education would have bought \$3.94 worth of service in 1950, but a 1913 dollar for interest on the debt would have purchased only \$0.86 worth in 1950. Similarly, a 1913 dollar for current supplies would have bought \$4.72 worth in 1950, but a 1913 dollar for construction would have bought only \$2.32 worth in 1950.¹⁴ Because of such variations a composite index is not an accurate guide for deflating government expenditures. Fortunately, however, separate price indexes for 27 major categories of government expenditures have been computed for several benchmark years with 1950 as the base year.¹⁵

Using these indexes, government expenditures in 1950 dollars increased 7.2 times from 1913 to 1950, while in current dollars the increase was 22.4 times. It is estimated also that 31.2 percent of the total dollar increase (of \$66.4 billion) of government expenditures between 1913 and 1950 was due to price level changes alone.¹⁶ That is, some \$20.7 billion of a total 1950 expenditure of \$69.5 billion was due solely to the upward movement of prices since 1913.

Increased services

Increased services was the greatest single cause of the rise in government expenditure over the past half century. The expansion of existing services and the introduction of new services alone caused a rise of \$27.1 billion (1950 dollars) in government expenditure between 1913 and 1950.¹⁷ Thus, while population increase accounted for 6.9 percent, the expanded scope of government services accounted for 40.9 percent. The remaining 21 percent of the increase in government expenditure is attributed to the interaction of all three causes: population growth, price-level change, and increased services.

Increased services is not only the most important single cause of the growth in government expenditures over the past decades, it is also much the most interesting.

¹³ Estimates from Department of Labor, Bureau of Labor Statistics, and the Industrial Conference Board.

¹⁴ Cf. Dewhurst, *op. cit.*, pp. 590–593. All following estimates are also from this.

¹⁵ These indexes were constructed by Owen C. Gretton of the Census Bureau, in consultation with Kilpatrick & Drury. Cf. Dewhurst, *op. cit.*, p. 590.

¹⁶ *Ibid.*, p. 592.

¹⁷ *Ibid.*, p. 597.

THE PUBLIC DEMAND

When we study people's behavior in the private sector of the economy we use certain concepts, such as consumer demand and consumption function, which help us to understand why people spend their money as they do. We have learned, for example, that the proportion of an individual's income which he will spend on consumption goods and services is related, among other things, to his present level of income, his past income, experience, and his future expectations. We know, too, that as a person's income increases he spends a greater absolute amount on consumption goods. He not only buys more clothing, entertainment, and medical care, but he also tends to buy better quality products. Also, as income rises, people spend more on new kinds of purchases. They carry more and different types of insurance, they increase the amount of their charitable contributions, and in general they tend to exploit more fully the opportunities of life in an advanced society.

Much of what the study of consumer demand in the private economy has taught us about people's private behavior is also applicable to their communal behavior. The spending patterns of private individuals are not determined by influences which are restricted uniquely to the private sector of the economy. Indeed, not only is the public spending pattern largely determined by the same general influences, but public and private spending often are complementary in a high degree. There would be little sense, for example, in spending a large amount privately for a high-speed, low-slung, 304-horsepower automobile if we did not also spend publicly for the superhighway on which it could be driven.

What, then, were the major influences on spending—public and private—over the past half century?

The single most pervasive economic fact of the past 50 years has been the great rise in our national output. The value of goods and services produced per man-hour of labor in the private sector of the economy rose from 75.5 cents to 203.1 cents (1950 dollars) between 1900 and 1952.¹⁸ This 170-percent increase in man-hour productivity is reflected in the growth of national income from 79.7 billion in 1909 to \$274.7 billion in 1953 (1950 dollars).¹⁹ Per capita disposable income rose from about \$775 in 1909 to about \$1,350 by 1953 (1950 dollars). There is also ample evidence of a marked upward shift in the income distribution of family units, particularly since the 1930's.²⁰ All of this means that increased output has made us collectively, as a nation and as individual and family consuming units, much richer now than we were at the turn of the century.

It was not possible for our society to become so much richer without experiencing, at the same time, other significant changes. We could not have our increased productivity and keep everything else as it was. In the process of becoming richer, life in our society, and for us as individuals, became more complex. Today's techniques of production in industry and agriculture require bigger, more complicated,

¹⁸ Dewhurst, *op. cit.*, p. 89, table 30.

¹⁹ *Ibid.*, appendix 4-2, table B, pp. 959-960.

²⁰ Cf. Goldsmith, Jaszi, Kaitz, Goldenburg, *Size Distribution of Income Since the Mid-Thirties*, Review of Economics and Statistics, February 1954, also for 1944 to 1954, *Income Distribution in the United States, A Supplement to the Survey of Current Business*, U. S. Department of Commerce, Office of Business Economics, Washington, D. C., 1953.

and more expensive machinery. To organize efficiently production and distribution of the things we produce, we use larger plants and business units today than we did in 1900. From the standpoint both of the supply of labor and the provision of concentrated market areas for our increased output we had to leave the pastoral countryside and move to congested urban centers. Urbanization was in this respect basic to the great technological progress we have had; but, in fact, the whole technology of life has changed.

The greatly increased volume and variety of goods and services we consume not only have raised our standard of living; they have also changed our way of life.

Another major, though not unrelated, influence on the national spending pattern is the fact that we have become a high-preparedness nation. From 1952 through 1955, for example, we spent annually, on the average, about \$45 billion on Government purchases of goods and services for national-security purposes. If this was only a short-period budgetary phenomenon, it would still exert great influence on the Nation's spending, but there is considerable likelihood that this is a condition which will be with us for many years to come. As part of the indefinite future, it will continue to shape a large part of our private as well as public life, even though military spending is cut back a few billions or stretched out over a longer period. No important economic or political issue is unaffected by the need for maintaining a high state of national preparedness over the coming years.

How have our increased wealth and income, urbanization, technological advances, and national-security requirements influenced public and private spending?

The evidence is clear that as we grew richer we spent privately a smaller proportion of our income on necessities and a larger share on luxuries and semiluxuries. Measured in constant dollars of 1950 buying power, per capita consumption expenditures rose from \$840 in 1909 to \$1,400 in 1952, or 66 percent. Spending increased on all major categories of consumption goods and services but the relative gains were substantially different for different classes of goods and services. Percentage gains, measured in current dollars, between 1909 and 1952, were as follows:²¹

Food, liquor, and tobacco.....	695
Clothing, accessories, and personal care.....	535
Housing and utilities.....	360
Household equipment and operation.....	810
Consumer transportation.....	1,500
Medical care and insurance.....	1,100
Recreation.....	1,060
Education (private).....	750
Religion.....	330
Welfare (private).....	100

The large percentage increases in expenditure for consumer transportation, that is, the automobile, and for medical care and insurance, and recreation, are clearly consistent with our increased income and wealth status. Within the categories where percentage increases were not as outstanding, however, there were also substitutions of more

²¹ Dewhurst, *op. cit.*, pp. 101-105. This volume contains a comprehensive analysis of consumption trends. See chapters 4 through 13, especially table 33, and appendix tables 4-4 and 4-5, from which most of the following data is taken.

luxury-type expenditures for traditional necessities. The composition of food purchases changed, for example, so that while the annual per capita consumption of potatoes and grain products went down from 473 pounds in 1910-14 to 270 pounds in 1951-52, the consumption of dairy products, eggs, citrus fruits, leafy vegetables, sugar, coffee, tea, and cocoa, all rose. The rise in real incomes has increased the relative consumption of more expensive foods (although part of the increases was also due to urbanization, education-induced changes in our eating habits and other factors).²² Similarly, while expenditures on clothing, accessories, and personal care have remained much the same as a proportion of total consumption expenditures, there has been a relative rise in spending for sports clothes, cosmetics, and beauty-parlor services, and a mild decline in the demand for staple articles of clothing. The same general pattern is in evidence for virtually all the major fields of consumption expenditure. As we grew richer, we consumed more "rich man's" goods and services.

The combined effect of increased wealth, urbanization, and technological advances, on private-consumer spending patterns has been profound, and is in general quite obvious. We now have different standards of "necessity," and as a nation we have higher consumption aspirations than we had in the past.

The same facts, not surprisingly, also hold with respect to our public spending. Just as we have come to demand more and better quality products from the private sector of the economy, we have come to demand more and better quality "products" from government—the public sector. We want more and better quality schools, roads, hospitals, and recreational facilities, more adequate provision for the aged, unemployed, infirm, and needy children, increased attention to our natural resources, more provision for public safety, etc. As a consequence of this growth in public demand, virtually every government function has been expanded since 1900. This is true whether the expansion is measured by workers employed, capital assets, or expenditures (allowing even for price changes).²³ Furthermore, the composition of the expansion by government functions clearly reflects the influence of increased income and wealth, urbanization, technological advances, and defense requirements. Government's per capita expenditure on education, for example, measured in 1950 dollars, increased by almost 200 percent between 1913 and 1950.²⁴ It is significant, too, that spending for higher education grew by 29 times, in current dollars, while expenditure on elementary and secondary schools grew less than 12 times. The public demand has been for more and better physical plant, for better trained teachers, and for expansion of public education at the college and professional school level as well as for vocational training, kindergartens, and other special educational services. We want these added educational services because we are richer, but we also need them to insure the supply of adequately trained personnel for our complicated production machine. We need people also to man our Defense Establishment, who cannot only read and write, but who are technically trained. In-

²² *Ibid.*, table 44, p. 131, and ch. 5.

²³ Fabricant, *op. cit.*, pp. 82-83.

²⁴ Dewhurst, *op. cit.*, table 263, p. 632. Following data also from this source, pp. 625 to 637.

creased income and technological progress in peace and war activities together underlie the public demand for more and better education.

Similarly, measured in 1950 dollars, per capita expenditure on health and community facilities increased by 176 percent between 1913 and 1950. In this category, increased expenditures for health, hospitals, and public housing, reflect an increased sense of social responsibility which grew with our wealth. It also reflects, as do more clearly our increased expenditures on public water supply, local utilities and sanitation, the growth of public demand stemming from urbanization. These last items, and other local services, would not have figured as heavily in the growth of public demand had we remained primarily a rural people. Sanitation, sewerage, water supply, even the protection of life and property, are problems which a farmer largely meets by himself, but the conditions of city life are such that government must take the responsibility in order to safeguard the general health and well-being of the people.

Without laboring the point unnecessarily, it should be apparent that the same set of related influences—increased wealth, urbanization, technological advances, defense requirements—have caused us to increase also our expenditures for public welfare (397 percent), regulation of business and labor (149 percent), transportation (115 percent), agriculture and natural resources (more than 1,000 percent), social insurance (more than 1,000 percent) and national defense (865.1 percent).²⁵

This upward trend of government expenditure has not, of course, proceeded at an even annual rate. Like the growth of our national product, it has been sporadic or steplike. Wars and depressions, though they have been most important through their influence on Federal expenditures gave the total upward movement some strong boosts in particular years.²⁶ Despite some irregularity, however, the increased interdependence of all groups and individuals in the economy, a hallmark of our economic growth, and the high state of international tension, now presumably a fixture in our daily lives, have added directly and indirectly to the demand for an expanded scope and scale of government.

In brief, the growth of the public demand which underlay the growth of government stems from the same basic causes that led to the growth of big business, big labor, big agriculture, big wars—and big depressions.

This, then, is the essence of the public demand which has brought about the great growth of government over the past half century. But, the general tendencies which we have explored were not something new to America, or to the 20th century.²⁷ Although we have

²⁵ All percentage increases refer to the period 1913–50. They are on a per capita basis computed in 1950 dollars. Cf. Dewhurst, *op. cit.*, table 263, p. 632.

²⁶ Cf., for example, *A Century and a Half of Federal Expenditures*, M. Slade Kendrick, Occasional Paper 48, National Bureau of Economic Research, Inc., New York, 1955.

²⁷ Charles J. Bullock, *Selected Readings in Public Finance*, 3d edition, Ginn & Co., 1924, ch. III, includes summaries of studies by other writers on the growth of government expenditures in England, France, Belgium, Switzerland, Russia, Italy, for the 19th century and sometimes earlier. The relative growth of government and the private economy are not clear, however, because we lack data on the measures of total economic growth as well as other elements such as we discussed above. The data are useful and interesting, nevertheless, and provide some greater historical perspective on the issue. Bullock's own estimates of the growth of Federal Government expenditures in the United States show a rise in per capita terms from \$1.17 in 1800 to \$6.36 in 1900, with definite acceleration of the rate of increase in the post-Civil War period.

There is also an increasing flow of data from other countries for relatively recent times. One study, *The Trend of Public Employment in Great Britain and the United States*, Moses

no comparable statistical measures for earlier times or other countries, there is considerable evidence that the growth of government has been a regular concomitant of general economic progress.

For example, as table IV indicates, for 14 countries for which we have data, in the fiscal year 1951, there was a distinct correlation between per capita national product and per capita national government expenditures; the wealthier countries spent more per capita and the poorer countries spent less.²⁸ That the United States is not far out of line with other nations' experience is also clear. The ratio of National Government expenditures to gross national product was lower in the United States at 15.1 percent than it was in 11 of the 14 countries cited. The exclusion of State and local expenditures, however, understates government spending more in the United States than in other countries. Inadequate data for many of the countries preclude comparing other than national government spending, but using per capita total taxes of all levels of government the same general conclusion emerges. Taxes relative to gross national product were lower than in the United States only in those countries (Denmark, Iceland, Portugal, Greece, and Turkey) having either very small defense expenditures or very low income.

Wagner's celebrated "law of the increase of state activities":²⁹

Comprehensive comparisons of different countries and different times show that, among progressive peoples, with which alone we are concerned, an increase regularly takes place in the activity of both the central and the local governments. This increase is both extensive and intensive; the central and local governments constantly undertake new functions, while they perform both old and new functions more efficiently and completely. In this way the economic needs of the people, to an increasing extent and in a more satisfactory fashion, are satisfied. * * *

assumes real meaning when the emphasis is placed on "progressive peoples"—which implies economic growth—and on the influence, especially in a political democracy, of the "needs of the people."

THE RELATIVE GROWTH OF FEDERAL AND STATE AND LOCAL GOVERNMENTS

At the beginning of this century, the Federal Government collected 38 percent of all tax revenues, the States, 11 percent, the local governments, 51 percent; and, the distribution of government expenditures corresponded closely to these relative shares of tax receipts. In 1956, the Federal share of all taxes was about 71 percent and its share of total government expenditures was 65 percent. The States and local governments shared almost equally the remaining 29 percent of tax collections and spent 35 percent of the government total.

Abramovitz and Vera Eliasberg, *American Economic Review*, vol. XLIII, No. 2, May 1953, finds, for example, that in Great Britain, "toward the end of the 19th century, not 1 worker in 25 was on the Government payroll. In the middle of the 20th century, 1 in 7 was working in a regular Government agency and nearly 1 in 4 either in such an agency or in a nationalized industry or service" (p. 205). Cf., also in the same journal, Lyle C. Fitch, *Trends in Federal, State, and Local Government Expenditures Since 1890*, pp. 216-233.

²⁸ Dewhurst, *op. cit.*, table 236, p. 579.

²⁹ *Grundlegung der politischen Oekonomie*, book VI, ch. 3 (3d edition, 1893), cited in Charles J. Bullock, *ibid.*

The changeover from a State-local to a Federal dominated public fisc did not follow a smooth or consistent trend line. Two World Wars and the great depression gave dramatic boosts to the Federal role, but wars and depression alone fall far short of adequately explaining the changing pattern of intergovernmental relations. For an understanding of the growth of the role of the Federal Government it is hardly sufficient only to point to the great rises in Federal expenditures which occurred under war and depression stimuli. Why, for example, did the Federal Government grow so much in power and prestige in the depressed thirties and State and local governments lag so far behind? The depression alone, though it was the most serious in our history, did not resolve the course of intergovernmental events in that unhappy decade.

Throughout these past 50 years there was at work, as there is now, a complex of economic and political forces which, though subject to alteration by great events, are fashioned fundamentally by more consistent threads of the historical process. Improved communication and transportation, the growth of a national economy, urbanization, increased wealth, all the elements which led to the growth in the public demand, were part of this historical process.

The great events, wars and depression, give us, however, some convenient focal points for analysis. Accordingly, to facilitate our discussion we have divided the period roughly as follows: 1900-29, 1930-40, 1941-46, 1946-56. The major breaks after the turn of the century come, therefore, at the start of the great depression, the start and the end of World War II.

Federal Government expenditures: 1900-1929

The United States emerged as a full-fledged great power during this period, particularly after World War I, but the rise in Federal Government expenditures only partially reflected the tremendous economic and population growth of the Nation in the same years. Total Federal expenditure increased from about \$521 million in 1900 to \$2,900 million in 1929, but as a fraction of gross national product remained virtually the same: 2.9 percent in 1900 and 3.0 percent in 1929.³⁰ Total per capita expenditures, measured in 1926 prices, roughly doubled, from \$12.31 in 1900 to \$24.76 in 1929.³¹

World War I contributed more by far than any other factor to the expenditure rise. Total Federal spending in 1914, for example, was on the order of \$735 million; in 1919 it was 25 times greater at \$18,448 million, and although it fell sharply in the next decade the lowest point it ever reached was \$2,774 million—in 1927—still some 3.8 times higher than prewar. Increased spending for defense and on war-connected charges—mainly veteran's benefits and services and interest on the debt—accounted for about 85 percent of the total expenditure increase between 1900 and 1929. But, aside from defense

³⁰ These percentages are from Kendrick, *op. cit.*, but they apply to a somewhat different year than the rest of our data. Actually, total expenditures for this computation represent an average of the two fiscal years which include the calendar year. This adjustment does no violence to our comparisons, however, because of the time interval involved.

³¹ Expenditure figures in this section are also from Kendrick, *op. cit.*, except as otherwise noted. Deflation to constant 1926 dollars was accomplished by Kendrick with the use of the B. L. S. Wholesale Price Index. Although we have previously indicated the inadequacy of such a composite index, it does serve as a crude measure of price-level changes and is acceptable for the work at hand which does not require a high degree of accuracy. Tables 1 and 4 (below) were constructed by applying the same index to State and local government expenditure data.

and war charges there was little change in the volume of Federal spending.

Expenditures for civil purposes, i. e., other than defense, veteran's benefits and services, international affairs and interest on the debt—increased in all only by some \$657 million. In constant 1926 prices this amounted to a rise of \$3.13 per capita. Most of this increase went for transportation and communication facilities—mainly the provision of navigational aids, and grants-in-aid to the States for highway development—and general government. Somewhat more attention was being paid to the development and improvement of agriculture and natural resources, aid for the aged and infirm, the promotion of public health, and crime prevention and control. But for civil functions, clearly, Federal expenditure was not very much different in 1929 from what it had been at the dawn of the century.

Furthermore, the bulk of the Federal Government's growth took place in the first 20 years of the period. After World War I, the return to normalcy was accompanied by a drop in total Federal spending during most of the twenties as debt charges and veterans' costs incident to the war decreased.

Grants-in-aid

Although Federal Government expenditure in this period was characterized by an extension of regular Government services and there was little innovation of quantitative budgetary importance, there were clear indications that the forces of change were strongly affecting its role. Federal aid to the States for highways increased under the Federal Aid Road Act (1916), from nothing in 1900 to \$81 million by 1927; for education, from less than \$1 million to \$11 million, including assistance to States in paying the salaries of teachers of vocational education (Smith-Hughes Act of 1917); and there were also small increases for other purposes as well as some aid paid directly to the local governments. Small as these aid programs appear in retrospect, they mark a growing realization of the national nature which some of the traditionally State and local functions were assuming under the pressure of general economic growth. Similar signs were evidenced by the participation of the Federal Government in the cost of agricultural extension work (Smith-Lever Act of 1914) in addition to the annual cash payments already offered land-grant colleges under the second Morrill Act (1890); the extension of Federal assistance to States for forest-fire protection (Weeks Act of 1911); and in the years from 1916 to 1921, by aid offered the States to combat venereal disease, for the rehabilitation of persons injured in industrial accidents, and for maternal and child health.

In summary, Federal aid to the State and local governments rose from some \$7 million in 1902 to \$12 million in 1913. From 1913 to 1922 there was a much more substantial rise, to \$108 million, and then a period of consolidation but little expansion so that by 1927 the total of aid payments to State and local units was \$116 million. It is clear, too, that the increased flow of aid payments closely paralleled the rising need for highways as the automobile transformed our national transportation system. All other aid programs, especially public welfare, did not fare nearly as well as the highways.³²

³² For a full discussion of the development of the grants-in-aid program see James A. Maxwell, *The Fiscal Impact of Federalism in the United States*, Harvard University Press, 1946.

State and local government expenditures: 1900-29

State and local government expenditures increased more than Federal expenditures, both in absolute amount and relatively, for the first three decades of the century. Per capita State and local expenditures, measured in 1926 prices increased by \$44.85 from 1902 to 1927 (in contrast to Federal increases of \$13.21). As a fraction of gross national product State and local expenditures grew from 5.2 percent in 1902 to 8.7 percent in 1927 (in contrast to Federal growth from 2.3 to 3.1 percent).

The greatest increases in State and local expenditures were for education and highways which together accounted for more than half the total increase. The impact of the automobile on government finances is clearly indicated by the more than tenfold increase in highway expenditures during the 25 years from 1902 to 1927. The increased expenditure on education was a function of the population increase and the demand for more and better schools which we have discussed above. There were also substantial additions to expenditure on hospitals, sanitation, police, and fire protection—on almost every established function of State and local governments. And as urbanization progressed, other local functions such as the provision of utilities and transit facilities emerged with new importance.

In brief, increased expenditure on schools, highways, and local services were the most important cause of increased government expenditure—Federal, State, and local—during the period 1900 to 1929, and the role of the State and local governments, measured by expenditures, significantly increased relative to that of the Federal Government during this period. From 1902 to 1927, for example, the State and local share of all government expenditures rose from about 69 percent to 74 percent; and for civil functions only, from 88 percent to 92 percent. The State and local governments clearly dominated the public fiscal scene.

Beyond expenditures

In addition to participating in the costs of more State and local functions through the use of grants-in-aid, the Federal Government established a number of agencies to deal directly with developmental and regulatory programs which had become important largely as a result of general economic growth and the increased interdependence which marked the development of a national economy. Some of the more significant were:

- Bureau of Standards (1901)
- Bureau of Reclamation (1902)
- Forest Service (1905)
- National Park Service (1906)
- Federal Bureau of Investigation (1908)
- Bureau of Mines (1910)
- Bureau of Foreign and Domestic Commerce (1912)
- Children's Bureau (1912)
- Federal Reserve System (1913)
- Conciliation Service (1913)
- Federal Trade Commission (1914)
- National Advisory Committee for Aeronautics (1915)

Farm Credit Administration (1916)
Women's Bureau (1918)
Federal Power Commission (1920)

There were, thus, significant changes in the scope of the Federal Government which tend to be understated somewhat in statistical time series, and especially by per capita comparisons of expenditure, because they did not loom large in the Federal budget. While there was little deviation from the traditional laissez-faire line in public pronouncements that the business of government was governing—in a narrow sense—there was considerable expansion in the actual range of government activity, and even more in the potential range for government action.

It is important, too, to observe the kinds of functions in which the Federal Government took a stronger hand. Although the Federal Reserve System, for example, had strong roots in our history, many of the other activities which the Federal Government entered into had been more exclusively the preserve of the State and local governments. Welfare activities, like those involved in the Children's Bureau, had been a traditionally local function since the time of the Elizabethan poor laws; labor conditions and industrial-relations problems had been a matter primarily for State or local action; law enforcement, likewise; and more or less similarly for the regulation of domestic trade, conservation—insofar as it was practiced—and power development. It is only fair to say, too, that none of these activities was undertaken by virtue of an autonomous decision on the part of the Federal Government. Strong pressures were required before the Government, under either political party, entered any of these fields. And underlying the pressures for extending the scope of Federal Government activity were some of the basic forces discussed above—the development of a national economy in which State and local boundaries had progressively less economic significance, rapid industrialization, and urbanization, a growing sense of social responsibility, and so forth. For example, as communication, commerce, and industry became more interstate in character, the Federal Government was forced to expand its regulatory role—just as it did, through the establishment of the Federal Bureau of Investigation, as crime also became a serious interstate matter. In fact, the Federal Government stepped in mainly where there was strong public pressure to which the State and local governments could not, or would not, give effective satisfaction.

Actually, the importance of these extensions of Federal Government activity was perhaps greatest in that they represented cumulatively a considerable expansion of established limits for Federal Government concern. Court decisions subsequent to cases arising from instances of Federal Government action also added markedly to the recognition of Federal powers—and their potential.

Thus, while the expenditure comparisons for this period show a much greater growth for the State and local governments, the Federal Government was having initiative forced upon it for the assumption of new functions, many formerly State or local.

As we have previously noted, however, the development of both increased expenditure and increased scope took place prior to the twenties. In fact, from 1923 to 1929, the Federal Government not only cut

expenditures, but also reduced its debt by about \$1 billion, on the average, each year. Andrew W. Mellon, Secretary of the Treasury, summarized general policies when he wrote in 1924:

Since the war, two guiding principles have dominated the financial policies of the Government. One is the balancing of the budget, and the other is the payment of the debt.³³

Thus, while the Federal Government was enjoying prosperity—taking in more than it spent—the State and local governments were already caught in a squeeze between burgeoning expenditure requirements and limited fiscal capacity. The growth of public demand—for schools and highways, especially—was so rapid in the first half of this century that public adjustment to the concurrent need for higher taxes apparently could not keep pace. This was particularly true for the local governments. As school and local service expansion necessitated large outlays for plant and equipment, they were forced to borrow more heavily. Total State and local debt rose from \$2.1 billion in 1902 to \$14.9 billion by 1927, and the local share of that total went from roughly 80 to 87 percent. School districts, special districts, and cities shared the bulk of the increase³⁴ as they did the bulk of functional responsibility. Many were faced by serious financial problems before 1929.

Summary—The background for crisis

Federal, State, and local relations. For the period under review as a whole, and particularly after World War I, there was a disproportionate growth of expenditures and revenues for the Federal and State and local governments. The Federal share of total tax receipts went up, while its share of total expenditures went down, and, conversely, as the State and local share of all taxes went down, their share of all expenditures went up. Consequently, during the twenties, the Federal Government was able to reduce its indebtedness by about \$1 billion, on the average, annually. Its credit position, always good, was made even better. The State and local governments, whose credit was never as good as that of the Federal Government, increased their indebtedness by about \$1 billion annually, causing the total of Government obligations outstanding to remain about the same with a shift toward more State and local debt in the total, local debt particularly.

The Federal share of tax receipts went up as a result of the Federal Government's exploitation of income and profits taxes after 1913. The prosperity of the twenties caused increased yields for these taxes, even after wartime rates were cut. The State and local governments, on the other hand, still depended mainly on property taxation for their revenues. The States also drew heavily on vehicular taxes during the twenties, but in that otherwise prosperous decade the value of farmlands and buildings declined substantially and, in the aggregate, the property tax lost much of its yield elasticity. In a great many localities, it was already proving to be overburdened.

³³ Cited in *Main Currents in Modern Economic Life*, vol. II, Horace Taylor, editor, Harcourt, Brace & Co., New York, 1941, p. 280.

³⁴ From 1902 to 1922, school-district debt rose from 2.1 to 11 percent of total State and local debt; special-district debt from 0.2 to 6.2 percent; county debt from 9.3 to 13.5 percent; and city debt, though it fell from 73.2 to 56.6 percent, had by far the largest dollar increase—about \$4.2 billion. Cf., *Historical Review of State and Local Finances*, Special Study 25, Bureau of Census, Washington, 1948.

Despite revenue surpluses, the Federal Government avoided any significant increase in functional responsibility and expenditure after World War I. From 1922 to 1929, in fact, it was able to reduce expenditures as war-connected charges declined. The State and local governments, on the other hand, were unable to resist a substantial expansion in expenditures for their traditional responsibilities—mainly highways and education. During the twenties, therefore, the Federal Government hewed closely to a laissez-faire financial policy, while the State and local governments, often against strong opposition from tax-conscious groups, increased their involvement in basic governmental services.

State-local relations.—The big difference between the situation of the States and that of most local governments was that the States, by tradition, were one step further removed from the demand for most governmental services. Outlays by the States for education and highways, which accounted for more than 70 percent of the growth in total State expenditures (including aid to localities) between 1902 and 1927, remained small compared to local outlays (less than one-half in 1927) for the same purposes. The local governments also had to face the great bulk of increased costs for public welfare, sanitation, recreation, police, and fire protection, etc. The States, insofar as they were able to disassociate themselves from local problems, had no pressing financial problem. Revenues from motor-vehicle taxes met the greatest part of highway requirements, and other revenue resources more than took care of other direct State expenditures. Despite their parental obligations, the States, in fact, generally did resist local demands for more aid and even for more "home rule." They showed great restraint in the use of the State tax power and left local responsibility largely intact.

The local governments were severely limited in the kinds of revenue sources they could tap, not only because (a) most State constitutions or statutes restricted local tax and borrowing authority, but also because (b) the growth of a truly national economy made it more difficult for smaller jurisdictions to use new taxes on business and persons whose activities were not restricted by political boundaries. The result was that the local governments faced an ever bigger job with relatively little additional help. Thus, while, from 1900 to 1929, the number of pupils enrolled in public schools increased by 10 million, motor-vehicle registrations grew from a few thousand to more than 26 million, and urbanization multiplied the need for local services, the local governments still depended on the property tax for more than two-thirds of all their revenue. The aid they received through grants from the States, and a little additional from the Federal Government, grew, but never even approximated the volume that would have been required to balance local budgets. So, the local units continued to borrow heavily, even during the prosperous twenties, and found themselves, even here, restricted by assorted local debt limits in State statutes.

By 1929, therefore, as the country stood on the brink of what we call now, somewhat optimistically, the great depression, the maladjustment of governmental functions and financial resources was already clear. The obverse to the financial problems we have explored is the matter of the Government spending which never took place and which, now it is generally agreed, would have well served the national inter-

est. Before one-third of the Nation also became "ill clad and ill nourished," it was already ill housed, ill schooled, and ill protected from sickness and disaster.

The great depression, 1929-40

The "great crash" of the New York stock market in October 1929 resounded throughout the financial world. Although it heralded greater tragedy to come, the financial panic and the downward spiral of employment and income took a little time to gather full momentum. But by 1932 the situation was tragically clear to the country at large. Unemployment had risen from 1.5 million in 1929 to 12.1 million by 1932, so that one-fourth of the civilian labor force was without work. Personal consumption expenditures had dropped by more than one-third in actual dollars, and by almost one-fifth in constant (1947) dollars. Gross private domestic investment had gone down from over \$16 billion to less than \$1 billion, and the Federal Reserve Board Index of Industrial Production showed a drop from 110 to 58 (1935-39 = 100). The gross national product had fallen from \$104.4 billion to \$58.5 billion, and per capita personal income from \$684 to \$320. Even correcting for the 20-percent drop in consumer prices, per capita incomes had fallen by more than 40 percent. In that brief span, from 1929 to 1932, the forced sales of farms—foreclosures—doubled, personal savings turned negative, even the marriage rate went down by more than 20 percent, and the birth rate also dropped noticeably.

The depression, obviously, also had devastating effects on Government revenues. All Government tax collections dropped, between 1929 and 1932, by 17.3 percent. Federal tax receipts, heavily dependent on cyclically responsive income and profits taxes, fell most sharply, by 47 percent. The States, whose income came largely from motor vehicles and property taxes, lost 3.1 percent of their tax receipts; and the local governments, depending almost exclusively on property taxes whose yield is relatively insensitive to changes in business conditions, lost less than one-half of 1 percent of their tax receipts. Even with this drop in receipts, tax collections in 1932 amounted to 19 percent of the national income as opposed to 12 percent in 1929—an increase of more than 50 percent in the tax burden relative to the national income.

In previous depressions, when it was felt that conditions were sufficiently bad, local governments had supplemented private charity with work relief and small amounts of poor relief. The States did very little, if anything, and the Federal Government had abided by Grover Cleveland's admonition that "though the people support the Government, the Government should not support the people."

This was a new kind of depression—much more severe and much more persistent than any the Nation had known. Great changes which had marked our growing output and wealth now became specters: industrialization and urbanization meant that most of the people now depended on wages and lived in cities, and when they lost their jobs, they were left without means to obtain food, shelter, and other necessities; the growth of a national economy and technological progress meant, among other things, the commercialization of agriculture and consequently a crucial relationship between farm product prices and costs of production, in which fixed mortgage payments and interest figured heavily and led to so much hardship. In general, greater

economic interdependence spread the deepening blight more widely throughout the economy, and the need for emergency relief alone was beyond the capacity of most State and local governments to meet.

For the State and/or local governments to cope with the new kind of depression emergency they would have had to have greatly increased financial support from either much higher tax collections or increased borrowing. In fact, neither was really possible.

The tax structure of most of the States, as we have seen, had not been strongly developed by 1929, and with the onset of depression conditions it became more difficult to apply effectively new levies or strengthen old ones. Between 1929 and 1932, 4 States added moderate income taxes, 2 States added death taxes, some scattered excises appeared, but the several motor-vehicle taxes were the only ones whose revenue yield grew at all and, as we have observed, total State tax revenues fell by some 3 percent. Conditions were such that even had the States possessed the ability to levy new taxes, the total economic base was shrinking so rapidly that there was hardly a spot which could conceivably carry increased taxation without adding to the disaster. With income, employment, sales volume, inventory, and property values all spiraling downward, where could additional taxes be placed? Even with a determination born of ignorance and obstinacy, which was at times evidenced, the States could not meet large-scale emergency fiscal needs by raising additional revenues from tax sources while the economy was still moving down into the deep trough of the depression.

Clearly, too, the local governments were in an even more difficult situation than the States with respect to tax-raising capacity. Although the property tax had the most stable yield record of any tax, it had become terribly burdensome as personal and business incomes fell. Even though the total assessed value of all taxable property had been reduced by \$28 billion—from \$169.3 billion in 1930 to \$141.3 billion in 1933—market values of property and, more important, the capacity of property owners to pay taxes had fallen much more. In fact, tax delinquency became a major problem, rising for 150 of the largest cities from 10.1 percent in 1930 to 26.3 percent in 1933.³⁵

What about increased borrowing to meet emergency needs?

Both the State and local governments were relatively eager to increase their debt obligations to meet emergency relief costs despite the prevalence of orthodox views on the need for annually balanced budgets. Throughout most of the previous decade they had sold debt obligations on the security market at the rate of roughly \$1 billion annually, and through 1931 they were able to continue borrowing at about the same level. But then they were brought up short by two important barriers: (1) Since 1842, when Rhode Island wrote a borrowing limit into its constitution, the practice had grown so that some form of debt limitation was a part of nearly all State constitutions.³⁶ The result was that most of the States could not borrow on the necessary scale without referral to the public or other difficult and time-

³⁵ Cf., *State and Local Finances in the National Economy*, Alvin H. Hansen and Harvey S. Perloff; W. W. Norton & Co., New York, 1944, p. 51. This pioneering work is still, to a remarkable extent, considering all that has happened since it was written, timely and instructive.

³⁶ Cf., *Constitutional Debt Control in the States*, The Tax Foundation, Inc., New York, 1954. At present all but 5 States have such limitations: Connecticut, Mississippi, New Hampshire, Tennessee, and Vermont.

consuming preliminaries. Local government borrowing was also sharply limited by State jurisdiction. Not only was new borrowing thus restricted, but the decline in assessed values forced localities to contract existing debt margins and undermined their credit standing.³⁷

(2) The State and local governments were dependent for their borrowing, in the main, on the willingness of banks and private investors to accept their debt obligations. There were established criteria of soundness set up in the security market and "adequate" security usually meant a favorable economic background, good tax collections, a low volume of tax delinquency, balanced budgets, and self-liquidating projects. Although these criteria were more strictly held for local governments, the States had to meet substantially the same requirements and it became almost impossible to borrow even under very costly terms. By 1932, in fact, 78.7 percent of all State and local issues bore interest rates of 4.5 percent and higher.

Even with these high interest rates the localities, in particular, had to meet additional rigorous requirements set up by the banking community. These usually involved economy provisions cutting back activities and expenditures, agreements on tax collection and tax delinquency policies, etc. All of these provisions were made, for example, in the so-called bankers agreement under which New York City was enabled, after some difficulty, to fund its pressing short-term debt obligations. The New York State Legislature also obliged the city by reducing the mandatory pay scale for teachers so that the city's expenses could be more readily reduced. In Detroit, Chicago, and other cities, heavy cuts were forced in relief payments and other city expenditures in order to enable them to place loans and qualify for temporary credit in the financial market.

High interest rates, short-term maturities, and severe contractual agreements for the borrowing governments were still inadequate for enticing an adequate supply of private funds into the security market during the rough years of the depression, 1932 to 1934. Investors had become ultraconservative and were even leery of State and local government obligations, especially after 3 States, Arkansas, Louisiana, and South Carolina, and 37 large cities, were forced to default on their debts. At one point, in fact, defaults reached approximately 15 percent of outstanding local debt issues. Not surprisingly, therefore, in 1932, 697 issues totaling \$260 million could not be sold; in 1933, 528 issues totaling \$212 million failed to find buyers—even though these issues included debt obligations of such governments as Buffalo, Philadelphia, Cleveland, Toledo, Mississippi, and Montana.

In summary, then, the State and local governments could not, in general, muster large additional revenues during the trough years of the depression either by taxation or borrowing. Local governments, carrying the greatest part of the unemployment relief burden, were forced to slash public services to meet emergency needs, and the States, too, were forced to adopt strong deflationary policies at a time when private spending was already hitting bottom. In addition to those States and localities which were forced to default on their debt obligations, many others came dangerously close to bankruptcy—a word which had become common currency with reference to public as well as private institutions.

³⁷ Much of this section on debt finance by State and local governments is taken almost verbatim from Hansen and Perloff, *op. cit.*

Why the Federal Government grew

The Federal Government, as opposed to the State and local governments, was sheltered for a brief time (1929-30) from the effects of the deepening depression. It was not immediately faced with rapidly rising emergency relief demands—those were still local matters—nor were there any other sizable increases in expenditure impending in the proximate future, and anticipated tax receipts remained high. The Federal surplus for the fiscal year 1929 had been about 185 millions, and Andrew Mellon, the Secretary of the Treasury, expected higher Treasury receipts in the following year.³⁸ President Hoover, acting on the advice of his Secretary of the Treasury, accordingly suggested to the Congress that income tax rates on 1929 income, payable in 1930, be cut in order to relieve the taxpayers. Within a month, on December 1929, Congress enacted a new tax bill which followed the President's recommendations and cut the normal tax rates on individual income from 1.5 percent, 3 percent, and 5 percent to 0.5 percent, 2 percent, and 4 percent, respectively, and the corporate tax rate from 12 to 11 percent. Even with this tax cut, Federal revenues at \$3.6 billion for the fiscal year ending June 1930 were higher than those of previous years and the surplus, \$184 million, was only slightly below the level of the year before.³⁹ Within 1 year, however, the picture was completely changed. For the fiscal year 1931 the Federal Government showed a gross deficit of \$902 million, and it was clear that the unexpected decline in business and personal incomes had cut the Federal tax base much more heavily than had been anticipated.

Despite the deficit, Federal expenditures were allowed to move upward during 1931 as aid to agriculture and veterans was somewhat increased and public-works enterprises were moderately expanded in the hope that they would stimulate business and help rebuild confidence in the economy's future.

The economy continued downward, however, and the pressure for increased Federal action to speed relief and recovery grew rapidly. Faced with a prospective deficit of almost \$3 billion developing for the fiscal year 1932,⁴⁰ the Hoover administration, following accepted doctrine, moved to return to a balanced budget by raising taxes and cutting expenditures. President Hoover concisely summarized his administration's point of view when he declared, in January 1932, that "we cannot squander ourselves into prosperity."⁴¹ But, in the same month, the Reconstruction Finance Corporation was created with a Government-subscribed capital of \$500 million. Under the RFC, home-loan banks were organized, the Federal farm-loan system was expanded, and relief and public works activities were somewhat en-

³⁸ Cf., *American Taxation, Its History as a Social Force in Democracy*, Sidney Ratner, W. W. Norton & Co., New York, 1942, pp. 437 ff.

³⁹ I. e., the surplus of Treasury receipts over Treasury expenditures, including debt retirement expenditures. This is the "gross" surplus as contrasted to "net" surplus (or "net" deficit) where public-debt retirements are deducted from total expenditures.

⁴⁰ The deficit for 1932 was \$2,885.4 million, or almost \$2 billion more than for 1931. Ordinary receipts declined by about \$1.2 billion, and expenditures increased by \$787 million. The increased expenditure was accounted for largely by a \$500 million subscription to the capital stock of the newly formed Reconstruction Finance Corporation, and a subscription of \$125 million to the capital stock of the Federal land banks. These expenditures were made in the effort to expand credit facilities and represented the great bulk of recovery and relief spending for the time, although the Emergency Relief Act (July 1932) also provided for Federal loans to help local governments carry their relief loads. An \$803 million drop in income-tax collections was the most important factor in the decline of ordinary receipts. Cf., *Federal Finance, 1923-32*, National Industrial Conference Board, Inc., New York, 1933, pp. 60-64.

⁴¹ Mitchell, *op. cit.*, p. 37.

larged. To compensate for the Government's depression spending activity, however, the Revenue Act of 1932, which became law on June 6, 1932, sharply raised all income-tax rates, lowered exemptions and deductions for individuals and corporations, doubled the estate-tax rates, restored the gift tax, and imposed excise taxes on a wide variety of goods and services. This tax legislation represented one of the sharpest increases in tax rates and liabilities ever enacted in time of peace—so great was the drive for a balanced budget even as the national economy plummeted downward.

In the ensuing fiscal year, 1933, receipts from income and profits taxes fell, nevertheless, by about one-quarter of a billion dollars to one-third of their 1930 level, and were not quite offset by increased receipts from the excises and other special levies, so that total tax revenues dropped by about \$15 million.⁴² Even though expenditures for the same year were reduced, there was another deficit of over \$2.6 billion, and the Federal debt grew to \$22.5 billion. The Hoover government, unhappy though it was with unbalanced budgets, also could not raise large, additional tax revenues during the downswing of the depression while the national income was being cut in half.

The New Deal, 1933-40

The spring of 1933 marked the lowest point of the great depression. State and local governments, as we have seen, were largely without resources to meet emergency relief needs, and the Congress, after the November 1932 elections, was dominated by "lame ducks" who refused to take any vigorous action to ease the crisis. Not only was a fourth of the work force unemployed and essential credit for farmers and businessmen unavailable, but the whole banking system was in danger of imminent collapse as bank after bank was forced to close its doors during the month preceding Franklin D. Roosevelt's inauguration. A sense of extreme national crisis pervaded the entire country.

Roosevelt assumed the Presidency on March 4, 1933, and the new administration moved with unparalleled speed in an effort to achieve "relief, recovery, and reform" through "the farflung, highly varied, sometimes contradictory program known as the New Deal."⁴³

The emergency relief nature of the expansion of Federal Government activity in the first years of the New Deal is amply clear from the titles and purposes of the principal agencies created to handle the job: (1) The Federal Emergency Relief Administration (May 1933) was established by Congress for the purpose of assisting the States and localities in furnishing outright relief to the needy. The States were given grants of Federal funds to supplement relief funds available from State and local sources, with the provision that one-half of the funds was to be matched on the basis of \$1 Federal for every \$2 from State and local sources. By the end of 1935, when liquidation of the agency was begun, the FERA had funneled more than \$3 billion to the States. (2) The Civil Works Administration (November 1933) was designed to employ 4 million jobless men on work projects which could be promptly organized. Appropriations for this program came entirely from the Federal Government, while State CWA authorities passed on projects which were generally sponsored and supervised by

⁴² Cf. Cost of Government in the United States, 1933-35, National Industrial Conference Board, Inc., New York, May 1936, p. 41. This drop in tax receipts takes into account subsequent refunds of income and profits tax receipts.

⁴³ Ratner, *op. cit.*, p. 453 ff.

local governments. Repair and improvement of roads, streets, school buildings, and community facilities figured prominently in the work undertaken, as well as park, stadium, and airport construction. It was closed out on March 31, 1934, after having spent about \$1 billion on work relief. (3) The Federal Emergency Administration of Public Works, known popularly as the PWA, was established under the National Industrial Recovery Act (June 1933) to forward public-works activities as a means of offering employment to the unemployed and aid to State and local governments for their public-works needs.

Many of these measures were never intended to be anything more than temporary relief expedients. The speed with which they were established, revised, abandoned, or replaced stands in the legislative record book as a commentary on the vigor, if not the certitude, with which the Roosevelt administration met the worst period of the depression emergency. "It is evident," writes Professor Hansen, "that the major effort was directed toward salvaging human and capital resources."⁴⁴

The character and scale of almost all these emergency salvage activities were something new to Federal Government experience, and both administrative and policy shifts were, in the early years, inevitable. Along the line, too, the fiscal commandment for an annually balanced budget lost much of its sanctity, and new ideas on the role and method of Government finance in the economy came to the fore.⁴⁵

Beginning with the 1934 budget, the first New Deal budget, the Federal Government's role in the national economy assumed a significance which had been visible previously only briefly during severe war emergencies. From 1933 to 1934, Federal spending increased by over \$2 billion, most of the increase coming through grants to the States and localities under a variety of emergency relief programs. These grants jumped by more than 9 times in 1 year, from \$201 million in 1933 to \$1,848 million in 1934, and accounted for almost 30 percent of total State and local expenditures. Approximately 60 percent of all Federal appropriations were for "recovery and relief,"⁴⁶ and Federal appropriations, exclusive of those for the Reconstruction Finance Corporation, conservation, flood control, public works other than through the Public Works Administration and work-relief programs, amounted to 43 percent of total Federal expenditures. The Federal deficit for 1934, at \$3.6 billion, was a billion dollars higher than in 1933, and the public debt at the close of the year stood at a record height of \$27.1 billion—higher even than in 1919.

In 1935, Federal expenditures rose by about \$1 billion, grants to States and localities accounting for somewhat less than half of the rise, and the "relief and recovery" programs, even with the exclusions noted above, took an even greater share—almost 58 percent of total expenditures. By 1935, however, the national income was well on its

⁴⁴ Hansen, *Fiscal Policy and Business Cycles*, op. cit., p. 89. Professor Hansen categorized as chiefly a "salvage" operation the bulk of Federal policies during the thirties.

⁴⁵ The effect of J. M. Keynes' influence, especially after his visit to Washington in July 1934, and the American proponents of the "new economics," particularly Professor Hansen, is too well known to require even a footnote reference.

⁴⁶ Horace Taylor, op. cit., p. 229.

way back up,⁴⁷ and Federal revenues increased, so that the deficit was some \$0.8 billion smaller than in the preceding year; 1935 was also an important year for reappraisal and consolidation of Federal relief activities. First, on April 8, Congress passed the Work Relief Act, which substituted the Works Progress Administration (WPA) for the Federal Emergency Relief Administration (FERA). With the establishment of the WPA, the Federal Government took responsibility for the unemployed who were employable, but left to the States and localities responsibility for all other relief programs.

State and local government relief responsibilities were promptly and substantially modified by the passage of the Social Security Act on August 14 of the same year.⁴⁸ This was the most significant piece of welfare legislation in the Nation's history, but at the time it was adopted it was closely related to the new work-relief program.

While the Social Security Act of 1935 was a major New Deal achievement, it was largely a synthesis of earlier proposals, antecedent State laws, and similar programs long established in other countries. The British compulsory unemployment insurance law dated from 1911; during the twenties unemployment compensation was adopted in many other countries; and Wisconsin had enacted an unemployment-compensation law in 1932. Also, by 1925, 22 foreign countries, among them France, Germany, Italy, Russia, and Argentina, had compulsory old-age insurance and, following Arizona's 1915 act, by 1933, 46 States had some form of old-age pension program. Other parts of the social-security program enacted in 1935 and adjusted in 1939 had similar historical precedents.

In retrospect, it was only to be expected that the adoption of unemployment and old-age insurance and the other welfare-aid programs would come with the great depression. For the first time in our national history, we were faced with persistent mass unemployment, and the depression forcefully highlighted basic economic changes which had been underway for many years and which mandated a new conception of personal and family security requirements.⁴⁹ It was not by accident that the original Social Security Act was intimately connected with the Work Relief Act passed a few months earlier, and neither was the great depression merely a historical accident.

Actually, the Social Security Act was the second major depression-

⁴⁷ National-income estimates by the Department of Commerce for the years 1929-41 are as follows:

[Billions]					
1929-----	\$87.8	1934-----	\$49.0	1939-----	\$72.8
1930-----	75.7	1935-----	57.1	1940-----	81.6
1931-----	59.7	1936-----	64.9	1941-----	104.7
1932-----	42.6	1937-----	73.6		
1933-----	40.2	1938-----	67.6		

⁴⁸ For an excellent brief summary of the Social Security Act, cf. William Anderson, *op. cit.*, pp. 30-39. For a detailed analysis of the grants programs, particularly their cyclical aspects, cf. J. A. Maxwell, *Federal Grants and the Business Cycle*, *op. cit.*

⁴⁹ Speaking of the social-security legislation which initiated the system of grants to the States and for old-age assistance, dependent or crippled children, the blind, etc., and the old-age and survivors insurance programs, the railroad retirement program, and the unemployment insurance programs, Professor Kendrick states: "In view of the progress that had already been made in this country toward public acceptance of the purposes served by such legislation, and in view of the actual application of similar legislation in various foreign countries, it appears fairly certain that, irrespective of the state of employment and trade, social legislation of the character described would, at some time, have been enacted. The depression, however, caused the passage of these measures to come sooner than otherwise, and, almost certainly, operated to increase the financial provision for their implementation." Cf. Kendrick, *A Century and a Half of Federal Expenditures*, *op. cit.*, pp. 35-36.

stimulated program which was to have lasting impact on the budget of the Federal Government.

The first such program was embodied in the Agricultural Adjustment Act of 1933, which, when it was declared unconstitutional in 1936, was immediately followed by the Soil Conservation Act (1936) and, in 1939, by the Agricultural Adjustment Act. All of these acts were designed to provide (a) temporary subsidies through income supplements, and (b) long-range output readjustment by subsidies and production restrictions.⁵⁰ The support of farm income through income supplements was adopted as an emergency measure, but it became a regular feature, and in many instances the main issue, in subsequent agricultural legislation. Long-range readjustments were to be obtained by subsidizing the shift from cotton growing to dairying or grasslands farming, for example, and although some success was achieved in the conservation aspects of the program, later developments, notably World War II requirements, reversed much of the movement.

The agricultural legislation of the New Deal firmly established broad-scale Federal responsibility for the economic welfare of a sizable portion of the agricultural population, but the approach here, too, was not at all revolutionary. The agricultural sector of the economy had been in a sad state since 1921. During World War I, agricultural output had been greatly increased, mainly to meet the demand for foodstuffs from the warring nations whose own output had been sharply cut. Farmers borrowed in order to bring more land under cultivation and to use the new equipment which the continuing agricultural revolution produced. Commercial farming became increasingly more important, and, after the war was over, agricultural production continued to rise as the tractor replaced the horse and electrical and mechanical innovation accompanied general scientific progress in soil chemistry, animal husbandry, seed selection, etc. While farm-capital requirements and production kept rising, the market for output constricted. Foreign purchases of United States farm surpluses fell off sharply as European production was restored, and as Europe's purchasing power in the United States was cut when United States loans abroad were reduced, and our tariff barriers against foreign imports were raised. After 1925, because of the disparity in price movements between agricultural goods and manufactured goods, farm costs increased relative to farm prices, and the condition of agriculture worsened even more.

The "farm bloc" in Congress was actively engaged in the pursuit of aid for agriculture from the early twenties on.⁵¹ Emergency agricultural tariffs, marketing regulations, increased farm credit and aid to farm cooperatives all figured in legislative proposals and were all defeated. The McNary-Haugen bills vetoed by President Coolidge in 1927 and 1928 proposed the establishment of an "equalization fee" which would compensate farmers for losses sustained in selling surpluses abroad at low prices while they obtained higher prices from segregated domestic sales. The domestic prices were to be raised at least high enough to restore the purchasing power parity between ag-

⁵⁰ Mitchell, *op. cit.*, ch. VI, presents a thorough and lively discussion of this part of New Deal policy.

⁵¹ Cf. H. G. Halcrow, *Agricultural Policy of the United States*, Prentice-Hall, New York, 1953.

ricultural and industrial prices which had existed in 1909-14. The National Grange supported another scheme which provided, in effect, for a Federal subsidy on agricultural exports to be paid out of tariff receipts. Another plan, backed by the Farmers Union, provided for a reduction of farm output through "domestic allotment."

Despite the spate of suggestions and recommendations, no action was taken, except for some small aid to cooperatives and an extension of farm credit, until President Hoover established the Federal Farm Board in 1929. This agency undertook to stabilize prices of some farm products through a subsidized-storage system for surpluses, but it soon proved inadequate in the face of mounting difficulties which followed the crash of 1929. Experience with the Federal Farm Board indicated that a surplus-storage program could not effectively control farm prices unless it was coupled with production controls. When the New Deal Congress undertook to meet the farm problem, it adopted the previously proposed principle of domestic allotment through acreage and output adjustments in the first Agricultural Adjustment Act, and, by Executive order, the President established the Commodity Credit Corporation (CCC) to loan money on farm commodities held in storage.

Without going into all the details of the first and subsequent New Deal agricultural programs, it is clear that the basic outlines of its policy had strong antecedent roots. The whole field of agricultural aid had become a matter of Federal concern during the twenties, and, while it was the intensified misery of the depression that forced vigorous Federal action, it seems clear that long-range maladjustments in the agricultural sector would ultimately have brought Federal participation anyway. It had long since been clear that no independent State or local action would suffice, and the "farm problem" thus achieved a lasting importance in Federal Government operations, just as the industrial sector was provided for under the Social Security Act.

In fact, the agricultural-aid and social-security programs (plus the Railroad Retirement Act of 1939) together represent the bulk of New Deal legislation which has had a lasting impact on the Federal budget, and, though both programs were induced by the depression, they had longer run justification in the great changes in the American economy as well as previous histories here and abroad.

In much the same way, we could trace through the history of virtually every New Deal program. The TVA, for example, was made more expedient by the need for public-works projects in 1933, but agitation for such a Government program dated back at least to Senator George W. Norris' proposals from 1921 on, and similar development for the St. Lawrence seaway, Boulder Dam, and the Columbia River also had all been widely discussed well before the New Deal came to power.

The pattern of government expenditures

The outstanding fiscal development of the depression period was, of course, that Federal spending on civil functions—direct and through grants-in-aid—increased eightfold between 1929 and 1940. Total Federal spending rose from \$2.9 billion in 1929 to \$4.8 billion in 1932 and then doubled to \$9.6 billion in 1940. Of this overall increase of \$6.7 billion, civil spending accounted for more than \$5.7 billion. The Fed-

eral Government in 1940 spent \$1.9 billion on relief and work relief, \$1.4 billion on aid to agriculture, \$1 billion on social-security programs, interest on depression debt, and public-works administration.⁵² Other sizable amounts went for conservation, flood control, and other programs which also had been initiated during the depression.

In contrast to the great rise in Federal spending, State and local government spending remained below the 1932 level of \$8.4 billion until 1935-36, and then rose gradually to \$11.2 billion in 1940. A considerable part of this rise was made possible, however, by the expansion of Federal aid to State and local governments, and State and local government spending exclusive of Federal aid did not recover to the 1932 level until 1937-38, and by 1940 stood at \$10.3 billion.

By 1940, total State spending was higher than in 1932 by \$2.4 billion. But the greatest part of this rise, some \$1.4 billion, was accounted for by expenditures under the unemployment-compensation programs of the social-security system, increased spending for public welfare by the States directly, and increased aid to localities for their relief and welfare activities.

State aid to localities for education also ran higher by \$300 million in 1940, but it was mainly expenditure on relief and welfare that brought State spending up. The States themselves had not undertaken any other significant programs and, aside from their direct and contributory relief activities, they had left local responsibilities virtually unaltered.

Total local government spending was \$1.3 billion higher, at \$7.7 billion, in 1940 than in 1932, but net of Federal and State aid which had been increased by \$1.1 billion, it barely exceeded its 1932 level in 1940. For most of the regular local-government functions—police, fire protection, sanitation—expenditures had been cut during the worst years of the depression and recovered only gradually after 1935. Highway expenditure, which had amounted to \$1.3 billion in 1927, had fallen to \$898 million in 1932 and remained below that level until 1946. The only important rise in local government general expenditures, especially for the large cities, came in public welfare. There was also increased spending on such things as housing and community redevelopment, natural resources, electric power services, and transit facilities, but this spending also was largely a function of emergency aid programs developed by the Federal Government and drew special revenues through service charges. The chief strain on local budgets continued to come from the relief and welfare needs of a large number of depression victims and the indigent who were not covered by the several programs of the Social Security Act. The local governments still carried the great bulk of the general assistance relief burden as well as their traditional functional responsibilities.

In brief, by 1940, Federal spending had advanced very much more than State and local spending and reflected the new quantitative importance of Federal Government activity in public works and welfare activities—which previously had been primarily the preserve of the States and localities—and in agricultural aid—which had been relatively unattended. Other than for these changes which were, of

⁵² Public-works administration took \$348 million; social-security grants to States took \$369 million; old-age retirement took \$28 million; railroad employees' retirement and unemployment payments took \$136 million; and interest on depression debt was \$247 million. Cf. Kendrick, *op. cit.*, p. 32.

course, quite considerable, the spending pattern and functional responsibilities of all three levels of government were not significantly altered.

With respect to a quantitative measure of the changed relative importance of Federal and State and local expenditures, however, there is no clear line along which a completely unambiguous conception of relative growth can be drawn. That part of the growth in Federal Government spending which developed via the expansion of grants in aid to the States and localities should not, for example, be considered solely as a measure of Federal growth. Although in most cases Federal action was critical in the establishment of grants programs, and Federal controls were exercised in their administration, the use of grants also enhanced the powers and responsibility of the States and the localities. For many purposes the final spending units—the States and localities in the case of Federal grants—gained as much effective power as did the Federal Government. Public-assistance grants under the social-security system, for example, are handled through the States. The needy aged, dependent children, the blind, and since 1950 the permanent and totally disabled, deal directly with their State governments and not with Washington, D. C. Similarly, grants which make possible improved public works, highways, housing, and community redevelopment, etc., add to the governing capacity and to the effective authority of State and local governments as well as to that of the Federal Government.

In summary, increased Federal spending was the outstanding feature of depression period finance, and the consequent growth in relative importance of the Federal Government was most striking. But, in absolute terms the State and local governments also emerged with increased expenditure budgets and with a broader range of responsibilities—particularly in the field of public welfare.

From the vantage point of historical perspective it might appear that alternatives could or should have been developed allowing for more independent State and local fiscal action in the latter thirties. But, whatever alternatives might have been developed were inhibited by a postcrisis lethargy among State and local governments. The impress of the depression was fresh upon them, indeed they were not yet free of emergency needs, and their major effort was in striving to regain their sense of fiscal security by a return, in general, to stricter practices of fiscal orthodoxy. Their alleged profligacy during the fat years of the 1920's was not to be a charge which could be brought against them in the lean years of the 1930's. At the same time the Federal Government was able and willing to expand its own efforts—and it was infinitely easier to supplicate Washington for help than it was to provide it from resources within most State and local jurisdictions.

The great growth of the Federal Government during the decade of the thirties frequently is referred to as the start of "the march of power to Washington."⁵³ The growth of the Federal Government during the depression epic might be described at least as accurately as "the flight of responsibility to Washington." Any lasting significant increase in Federal activity or power came about as a corollary to its assumption of responsibility for functions which the States and

⁵³ Cf., for example, White, *The States and the Nation*, op. cit.

localities could not by themselves, or would not, undertake—and which the public demanded from government.

WORLD WAR II DEVELOPMENTS: 1940–46

Federal Government finances

The absolute and relative growth of the Federal Government during the depression decade appears very small, indeed, when compared with what happened in the war years: total Federal spending rocketed from \$9.6 billion to a high of \$95.2 billion in 1945; net budget receipts jumped from \$5.4 billion to \$46.5 billion; Federal debt outstanding went from almost \$43 billion to over \$279 billion in 1946. Just the change in sheer money magnitudes should be enough to give a sense of the impact of (then) modern warfare on the national economy. But dollar volumes alone actually understate substantially the wartime participation of the Government in the daily life of the Nation. Aside from spending, taxing, and borrowing on a plane that would have defied imagination even as late as 1940, the Federal Government had to undertake to control virtually everything that was controllable. Prices, wages, rents, profits, the distribution of consumer goods, and the allocation of productive resources—all came under the purview of the Federal Government because they were critical factors in the prosecution of full-scale warfare.⁵⁴

Federal spending

The war effort completely dominated the Federal budget from 1941 through 1946. The height of the war effort came in fiscal 1944 and 1945, but the budget for fiscal 1946 was still primarily a war budget. Through these years civil expenditures only advanced some \$1.6 billion, and much of this rise was due to the effects of inflation and to the extension of services which, although they are classified as civil, were closely related to the war effort. In constant (1926) prices, per capita expenditures on the civil functions actually fell from \$63.40 in 1940 to a low of \$41.03 in 1945—but recovered to \$53.56 in 1946. Similarly, as a percentage of the gross national product, spending on civil functions dropped from 6.5 percent in 1940 to 3.9 percent in 1946. The major reductions came, of course, in spending for relief and work relief, public works, aid to agriculture.

Because so much of Federal welfare spending was in the form of grants-in-aid established during the depression, the grants programs underwent substantial alteration as first the defense, and then the war boom brought the economy out of the persisting doldrums of depression. Unemployment, still above 8 million in 1940, dropped to 670,000 in 1944, and Federal spending for emergency grants was sharply cut. Total Federal grants had reached their peak at \$2.9 billion in 1939, were cut to \$2.4 billion in 1940, and petered down to \$900 million in 1946.⁵⁵

The emergency grants—those instituted to provide relief and welfare aid during the depression—brought the total down as they fell

⁵⁴ However, while the major policy decisions and regulations were formulated in Washington, State and local governments carried considerable responsibility for the administration of many war programs. Civil defense, selective service, rationing, and price control were among the programs undertaken cooperatively by Federal and State and local governmental agencies.

⁵⁵ Data from Maxwell, *Grants in Aid and the Business Cycle*, op. cit.

from \$2.3 billion in 1939 to \$151 million by 1946. The regular grants, on the other hand, ran substantially higher during the war years—averaging about \$743 million from 1941 to 1946 as compared with \$488 million in 1938 and \$616 million in 1939.

Spending through grants was increased mainly for such things as defense housing and transportation and the training of defense workers. National-defense requirements governed Federal spending through grants just as they did direct Federal spending, and the expansion of grants which resulted from the exigencies of war was essentially of a temporary nature.

It is unnecessary to detail the other wartime expenditures of the Federal Government, the bulk of which obviously was for direct military needs. But the magnitudes are interesting. Spending for war activities, as defined in the annual statement of the Secretary of the Treasury, rose from \$1.7 billion in 1940 to a high of more than \$90 billion in 1945. In constant (1926) dollars, per capita spending for military purposes, interest on the debt, and international affairs, rose from \$14.49 in 1940 to a high of \$585.39 in 1944, and tapered down to \$285.93 in 1946. Again, as a proportion of the gross national product, spending for these functions rose from 3 percent to almost 26 percent.

The tremendous rise in purely military expenditures deserves special mention. In constant (1926) prices total military spending increased from under \$2 billion in 1940 to over \$80 billion in 1944 and 1945, and the cost per serviceman rose from almost \$5,000 in 1940 to an annual average of \$8,741 for the years 1941 through 1945.⁵⁶ Actually the sharp upward movement of military spending measured by cost per serviceman, or by any other index, was part of a trend that started at least a century and a half earlier. Toward the latter part of the 19th century the upward movement became more pronounced and the cost per serviceman (in 1926 prices) moved from the vicinity of \$1,500 after the Civil War to over \$2,500 by the early 1900's. World War I boosted the figure to over the \$3,000 mark, and during the 1930's the annual average was close to \$4,000. Professor Kendrick writes as follows:

* * * the great increase * * * in the cost per serviceman over the century and a half cannot be explained by rising prices. Doubtless part of the upward movement is accounted for by a trend toward higher pay and better clothing, food, and medical care. But by no means all the increase can be so explained. * * * Rather, the chief reason lies in the mounting and ultimately immense technological advance in the weapons and equipment of the Armed Forces. * * * It is clear that an important, and probably the major, explanation of the rising cost per serviceman over our history has been the continuing increase in the quality, kinds, and quantity of weapons and equipment, and of ammunition and supplies. The rate of this increase, slow at first, has mounted from period to period with the rising tempo of research and invention. And as the improved and more expensive military goods have been adopted, the old have been discarded. Thus not only has the cost of the original equipment been increasing, but the useful

⁵⁶ Data from Kendrick, *A Century and a Half of Federal Expenditures*, op. cit.

life of the units acquired has been becoming shorter. Military expenditures have increased on both counts.⁵⁷

This particular aspect of technological advance obviously holds important implications for the future of Federal-State-local fiscal relations.

*State and local government finances*⁵⁸

Spending.—The relative fiscal decline of the State and local governments, as opposed to the increased importance of the Federal Government, which began during the depression period, was sharply accentuated during the war years. Despite wartime price inflation, civil-defense programs, and other war-related expenses, actual dollar spending by State and local governments was lower for most of the war period than it had been in 1940. The great drop came in expenditures for capital outlay. Highway and school construction, for example, were cut to the lowest possible amount, except where they were directly related to needs arising from the relocation of labor and other aspects of the defense effort. Total capital outlay fell, therefore, from over \$2.5 billion in 1940 to \$379 million in 1944—the lowest level by far since World War I. Other than for the cutback in capital outlay, however, total spending on almost every function increased somewhat between 1940 and 1946, but not enough to make up for the drop in capital expenditure. Although the war brought a tremendous economic revival, even public-welfare spending by States and localities was a little higher through most of the war period. Welfare spending was increased to match Federal public-assistance grants, nullifying a drop in the need for general relief expenditure. By 1946, however, with capital expenditures again rising to \$937 million, and with the enactment of long-deferred increases in government pay scales to compensate, at least in part, for the price inflation, State and local spending took a sharp jump to \$14 billion—some \$3 billion higher than in 1940. In constant (1926) prices, however, per capita expenditures were still more than 20 percent below the 1940 level. State spending per capita in 1926 prices dropped from \$50.16 in 1940 to \$35.86 in 1944, and recovered to \$41.27 by 1946. Local-government spending was cut proportionately more—from \$74.01 in 1940 to \$49.89 in 1944, recovering only to \$53.10 in 1946. In short, State and local spending in real terms, particularly local spending, was cut substantially during the war, and only partially recovered in 1946. With respect to the gross national product, State spending dropped from 5.2 to 3.4 percent, and local spending from 7.6 to 4.4 percent.

Taxation.—While the cutback in capital outlays kept total dollar spending down during the war, tax receipts increased steadily. General revenues ran well above general expenditures and, for the first time in many years, State and local governments experienced budgetary surpluses instead of deficits. Between 1941 and 1946, the only important new tax adoptions occurred when 3 States enacted gift taxes and 5 States added cigarette taxes. There was, in fact, considerable pressure for reduction in State taxation as receipts from established taxes increased with the economic revival. A number of States did

⁵⁷ *Ibid.*, pp. 45 and 48.

⁵⁸ For a more complete review of the nature of wartime problems, cf. the symposium, *Wartime Problems of State and Local Finance*, Tax Institute, Philadelphia, 1943.

reduce taxes,⁵⁹ and the increase in aggregate tax yields resulted almost entirely from the rise in incomes and consumer spending. For the local governments, the property tax brought in moderately higher yields, but the greatest increase came from charges and miscellaneous revenues. In brief, State and local tax effort was not inordinately strained during the war—mainly because tax collections grew with prosperity, and war conditions precluded spending on capital improvements which otherwise would have been undertaken. Also, of course, States and localities, for the most part, were able to resist maintaining their wage scales in parity with the inflationary rise of consumer-goods prices. Civil servants as a group were among the hardest hit by the wartime inflation.

Debt policy.—Because capital-investment programs were restricted by war priorities, and revenues exceeded expenditures, from 1940 to 1946 State and local governments were able to effect substantial debt reductions. Outstanding State debt was reduced by one-third, from \$3.6 billion to \$2.4 billion, and local debt by about one-fifth, from \$16.7 billion to \$13.6 billion.⁶⁰

Also, because the interest rate continued to decline, States and localities were able to refund some of their higher rate obligations with new issues carrying lower interest charges. The rate on triple A securities, for example, according to Moody's index, dropped from 2.84 percent in 1940 to 2.53 percent in 1946, and the annual interest cost on combined State and local debt outstanding was cut by about 29 percent—in greater proportion than the actual reduction in the capital amount of the debt.⁶¹

Postwar Federal finances

When the war ended, there was intense pressure for immediate relaxation of wartime restraints and controls. Although there were already threatening signs of growing international tension, public pressure to return to peacetime living was so great that the decision was made to demobilize the Armed Forces and to pursue as rapid a transition to a peacetime economy as could be accomplished without engendering severe economic dislocations. Once again, and quite understandably, the Nation wanted a "return to normalcy." But, clearly, not to the prewar normalcy of many millions unemployed and relief or make-work programs. Even during the years of extreme war effort, national consumption of consumer goods and services in real terms had increased by over 16 percent, and there was no disposition to allow military victory to diminish the glory or dimension of national prosperity. Both major political parties joined in enacting the Employment Act of 1946, which set forth the following declaration of policy:

The Congress declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and

⁵⁹ As early as 1942, for example, New York reduced its personal-income tax by 25 percent; in 1943, Iowa followed with a 50-percent cut, Maryland with a one-third cut, South Dakota and West Virginia eliminated their personal-income taxes completely, while Illinois lowered its general sales tax, Indiana its gross-receipts tax, etc. Cf. Hansen and Perloff, *op. cit.*, pp. 8-9.

⁶⁰ These figures include enterprise debt.

⁶¹ Combined State and local debt outstanding dropped from \$20.3 billion to \$15.9 billion, or by about 22 percent.

local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competition enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power.⁶²

Only a brief moment of reflection is all that is required to recognize how much different is this bipartisan view of Federal responsibility for national economic welfare from the view that prevailed prior to 1933. The specter of a possible postwar depression was perhaps a more powerful influence than systematic economic logic in obtaining almost unanimous support for the Employment Act, but, nevertheless, the result gave clear, statutory voice to the universal postwar question: If we can have high-level prosperity in time of war, why not in time of peace?

Actually, the fear of depression in the immediate postwar situation was quite misplaced. The problem was inflation. There was a huge backlog of pent-up demand for consumer goods, particularly automobiles, household appliances, and other durables whose production had been eliminated or severely curtailed during the war; similarly, for housing to meet the requirements of a population grown by 9 million since 1940, and showing new high rates of family formation and births; for public works, especially roads, hospitals, schools, etc.; and, in greater or lesser degree, for the whole range of private and public goods and services which constitute our proud standard of living.

To back up their material wants, the consuming public had large accumulations of buying power in the form of wartime cash savings, convertible Government securities, and high current incomes from employment and investment. State and local governments had improved tax yields, strengthened credit positions, and a receptive market for their debt obligations. And, while money and credit were plentiful, it took time for industry to retool and reorganize to meet peacetime demands. Consequently, we experienced an inflationary disturbance in postwar years that heightened the trend begun in 1940, when we had started seriously to prepare for war. The buying power of the dollar, which had dropped by 35 percent, as measured by wholesale prices between 1940 and 1946, dropped by another 25 percent between 1946 and 1948. The buying power of the consumer dollar had dropped by 28 percent between 1940 and 1946, and it, too, dropped by another 25 percent in the 2-year span between 1946 and 1948.⁶³ The price rises which caused this depreciation of the dollar came despite the temporary extension of many price and wage controls—some in attenuated form—and the maintenance of fairly rigid rent controls. But the new, almost refreshing, experience with inflation added another dimension to Federal responsibility for the economic welfare; stability in the relationship between prices, wages, and other costs, was recog-

⁶² The Employment Act of 1946, approved February 20, 1946, sec. 2, 15 U. S. C. 1021. The act also provided for the establishment of the Council of Economic Advisers in the Executive Office of the President, the submission of the President's Economic Report, the establishment of the Joint (Senate-House) Committee on the Economic Report, and provided for attendant staff needs, etc.

⁶³ Data from Statistical Abstract of the United States, 1955, op. cit., p. 316.

nized as another important objective of national, peacetime economic policy. Thus, in a very few years, as our perspective fought free of narrow concentration on deep depression, fiscal and monetary measures were turned increasingly on the threat of inflation. In sum, the Federal Government now carries a more general responsibility for maintaining a sound and healthy economy—to avoid excessive inflation as well as depression—by the use of all the fiscal and monetary means which such a complete objective required.⁶⁴ But inflationary pressures in the postwar years caused considerable difficulty for all three levels of government. And, obviously, the degree of difficulty varied inversely with the intensity of demand for expenditure and increases in responsiveness of their respective tax structures to price and income changes.

Spending

Once actual hostilities ceased, the first order of Federal fiscal business was a sharp cutback in military spending. From a high of almost \$85 billion in 1945, military spending was cut to \$45 billion in 1946 and down to \$12 billion in 1947 through 1950. But even with this sharp drop in military spending, the Federal budget was to remain many times larger than ever before in time of peace. Arthur Smithies writes:

With the end of hostilities, the President's budget returned to the center of the stage. In fact, in a different political context the attitudes toward the budget in the late forties were not unlike those of the twenties. Demands for cuts in expenditures and taxes were insistent, but this insistence was to yield more frustration than it did in the twenties. The President discovered that much of the budget was uncontrollable. The interest bill was of course regarded as a contractual obligation. Expenditures under the GI bill were considered in much the same light and were likewise exempted from the competition of the budgetary process. Aid to agriculture was largely determined by the price-support legislation. A large backlog of public-construction authorizations made it impossible for the President to resist expansion in that area. The main areas left for budgetary debate were the international programs and national defense.⁶⁵

The decision to demobilize and the concurrent reduction of military spending were effectuated, as we have already noted, almost simultaneously with the end of actual fighting. The international programs were increased almost fourfold, however, and rose from just under \$1.5 billion in 1946 to an average of over \$5.8 billion for the years 1947 through 1950. Veterans' benefits became a major budgetary factor and took slightly less than \$7 billion in each year from 1947 through 1949, and were up to \$9.3 billion in 1950. Interest charges went from \$2.8 billion in 1945 to about \$3.8 billion until 1950, when they reached \$4.3 billion. Taken together, expenditures on the military, international affairs, interest, and veterans accounted for over three-fourths of total

⁶⁴ For a measure of the announced devotion to this responsibility see, for example, any of the letters of transmittal accompanying the Economic Report of the President since 1947—and enduring past the change of administration in 1952.

⁶⁵ Arthur Smithies, *The Budgetary Process in the United States*, McGraw-Hill Book Co., New York, 1955, p. 121.

Federal spending from 1946 through 1950. But in each of those years the relative share taken by these categories of expenditure declined as follows:

	Percent		Percent
1946-----	87	1949-----	73
1947-----	80	1950-----	71
1948-----	78		

Civil expenditures thus increased in relative importance in each of the postwar years through 1950. But, actual spending, as opposed to budgetary authorization, for civil functions was below the 1946 level of \$8.2 billion until 1949, when it jumped to \$11 billion, and then to \$12.5 billion in 1950. The more important increases in civil spending between 1946 and 1950 came in support of agricultural prices and farm income—which fluctuated widely depending on farm prices and in the years cited went from \$452 million to \$1.8 billion; natural resources—from \$251 million to over \$1 billion; social security, welfare and health—from \$738 million to \$1.6 billion, and transportation and communication, particularly increased highway aid and a larger postal deficit, from \$817 million to \$1.8 billion. Much of this increased spending came in the form of increased grants to the States and to local governments—grants-in-aid rose from \$900 million in 1946 to \$2.3 billion in 1950, and shared revenues from \$12.4 million to over \$20 million⁶⁶—with the localities getting direct help for such things as hospitals, airports, housing and redevelopment, and the States the great bulk of the aid for education, highways, social welfare, health and security.

Although civil spending in dollar terms showed a 50 percent jump, from \$8.2 billion in 1946 to \$12.5 billion in 1950, in constant (1926) dollars the change was only from \$7.6 billion to \$8.1 billion; and, in constant per capita dollars there was virtually no difference—from \$53.56 to \$53.60. In fact, civil spending in constant per capita dollars was less in 1947 and 1948 than it had been for most of the 1930's. As a percentage of the gross national product, however, civil spending rose from 3.9 percent to 4.4 percent, less than its proportion in the thirties, but roughly six times greater than in the twenties, while in the same terms other Federal spending dropped from 26 percent to under 11 percent, still a substantial share of the national product.

The tendency of civil expenditures to increase, and military expenditures to decrease, both absolutely and relative to total spending, after major wars has been established as part of the historic pattern of expenditure growth.⁶⁷ But, such budgetary adjustments were never fully accomplished until after several years of transition to peace. Although there was a very sharp drop in purely military spending immediately after World War II, there really was no adequate period of time within which a new peacetime budgetary philosophy could be developed. The initial drive was "to reduce the budget total to some figure that was tolerable."⁶⁸ The administration was in accord with

⁶⁶ Data are from annual budgets.

⁶⁷ Cf. Kendrick, *A Century and a Half of Federal Expenditures*, op. cit.

⁶⁸ Smithies, op. cit., p. 122. Smithies continued: "During the entire discussion no one produced any definition of tolerable, and it rested on no economic analysis worthy of the name. But the combination of intuitions and prejudices of those in authority produced the conviction that \$40 billion of expenditures was definitely too high." And later he states: "The methods employed (to cut the budget) would have delighted Presidents Harding and Coolidge, although they would have been stupefied by the size of the budget after all cuts had been made." Ibid., p. 122.

the Congress and the business community on the imperative nature of cutting Federal spending.

But the shape of postwar events hardly allowed enough time for a full reduction of military spending to a stable peacetime level. International tension between the Soviet Union and the Western Powers began to mount even before final peace had been established, and with the crisis in the spring of 1948 the United States decided to rearm immediately. Although budget authorizations for 1950 were raised, actual spending was not substantially increased until later, when we were already involved in the Korean war, because of the lags between authorization, programing expenditure, and actual production of material.

In brief, although we were not in a shooting war between 1946 and 1950, the United States never got back to a peacetime budget. From cold war we went to Korea and hot war, and any potential long-run budgetary readjustments to a stable peacetime situation were thus foreclosed. Aside from the rise in military spending which came mainly after 1950, there were other factors which operated against expenditure reduction.

First, there were the fixed costs and contractual obligations we mentioned above; second, inflation raised the cost of Government purchases of goods and services as well as consumer goods prices; third, even aside from inflation-caused price increases, the rate of technological advance in the weapons and other equipment of war was so great in the short span between 1946 and 1950, that military costs moved higher than ever. For example, the outfitting of an infantry division cost \$40 million in World War II and \$200 million in 1950.⁶⁹ Jet planes, rockets, atomic bombs—all added to the cost of waging war and maintaining peace. In sum, despite a deep and widespread conviction that the level of Federal spending should be reduced more than it was actually at any time after World War II, it seems clear that a conspiracy of events with the fiscal heritage of the past war combined to frustrate efforts at further large budget reductions.

Although the Korean war, which lasted roughly 3 years, was on a much smaller scale than World War II, its effects on the economy and on Government finance were quite profound. Unemployment, which had mounted to a postwar high of 3.4 million in 1949, declined to 3.1 million in 1950, 1.9 million in 1951, and to 1.6 million in 1953. Industrial production (1947-49=100) rose from 97 in 1949 to 134 in 1953.⁷⁰ The national income rose from \$216.2 billion in 1949 to \$303.6 billion by 1953, and after their brief respite in 1949-50, inflationary pressures resumed and the price level climbed again.⁷¹

Underlying the renewed upward surge of the economy was the sharp increase in spending for national defense. Defense spending was budgeted at \$13 billion for 1950, but was raised to \$22.3 billion in 1951, \$43.9 billion in 1952, and \$50.3 billion in 1953. Also, although spending on international programs and for veterans' services and benefits

⁶⁹ Kendrick, *op. cit.*, p. 60.

⁷⁰ Data from the Economic Almanac, 1956, the Conference Board, T. Y., Crowell & Co., New York, 1956, pp. 316-317.

⁷¹ The Bureau of Labor Statistics index (1947-49=100) showed wholesale commodity prices up from 99.2 in 1949 to 103.1 in 1950, 114.8 in 1951, down to 111.6 in 1952, and relatively stable between 110 and 112 through 1955. Consumer prices advanced from a 1949-50 level of roughly 102 to a 1953-55 level of about 114.5—with a mild upward tendency since mid-1955.

dropped off rapidly, Federal spending for almost every civil function of government increased steadily during the Korean war years. By 1953 total Federal expenditures stood at \$76.6 billion.

With the end of the Korean war in early 1953, spending for national security was again cut back. But, unlike the situation immediately after World War II, when military spending was cut from a war-year level of \$85 billion in 1945 to only \$12 billion in 1947, major national security spending was only reduced from \$50.3 billion in fiscal 1953 to \$46.5 billion in 1954 and has since kept in the vicinity of \$40 billion. And, of course, there is little prospect that national-security spending can be cut in the proximate future. Civil spending, since 1954, has also reached new highs. From about 20 percent of the budget in 1954, civil spending grew to 27 percent in 1956, and is estimated to reach about 30 percent in fiscal 1958.

In the decade of the 1930's civil spending took 61 percent of the total budget, but national defense expenditure, of course, was very small.

At our new high budget levels, the high proportion of defense and defense-connected spending relative to civil spending represents a situation unlike any this Nation has faced before. Although civil spending accounted for only 20 percent of the Federal budget for the decade of the 1920's, the proportionate difference then was due not nearly as much to the large volume of defense spending as it was to the extremely low level of nondefense spending. With present high levels of military spending superimposed on civil spending, which has itself grown greatly since the thirties, we are actually in a new budgetary epoch.

Postwar State and local finances

To many observers the financial position of State and local governments at the close of the war appeared better than it had been for many decades. Tax collections reflected full and overtime employment at high wages, rising real property values, high consumption levels for taxed commodities and services. The States had a combined cash surplus of about \$3 billion, which exceeded their gross indebtedness by more than \$500 million, and the cost of borrowing for States and localities was down to a point where, in January 1946, the net interest cost to the borrower was less than 1 percent.⁷²

It was clear, of course, that State and local governments would have to make large expenditures on capital plant and equipment to catch up on public improvements put off during the war years. In anticipation of their postwar needs many States and localities had reduced their outstanding debt or set aside a wartime revenue surplus; and in 1945, when the end of the war seemed reasonably close at hand, there was a concerted rush of planning and preparation for large-scale capital investment programs. Even the foreseeable heavy expenditure needs of the States and localities did little to dampen the optimism of most observers. State and local government capital expenditures would help cushion the widely expected postwar economic decline, the Federal Government was expected to assist generously in financing these expenditure programs, and the market for State and local debt obliga-

⁷² Cf. Monthly Newsletter of the National City Bank of New York, February 1946, p. 22. Also, the gross debt of States and localities had been reduced by over 18 percent since 1940, and troublesome short-term debt had been cut from \$315 million to about \$25 million. The States had contributed only about 30 percent of the total reduction in dollar terms, but percentage-wise had made about twice the progress of local governments.

tions was more than receptive—especially since these issues carried exemption from Federal income taxation and income tax rates were so high. Furthermore, the financial position of the States, particularly, was felt to be so strong that in their financial estimates they anticipated meeting upward of 80 percent of their capital needs from accumulated surpluses, another 11 percent was to come from Federal aid, and only 5 percent from bond financing.⁷³ “Pay as you go” seemed to have a ring as true as it was pleasant, and the financial community was concerned more than a little lest there be a dearth of State and local bonds offered in the market.

But, almost as soon as the cheers on VJ-Day joined the historical echoes, it became apparent that the contented look of State and local affairs was largely unwarranted. Prices, and consequently government costs, rose substantially in 1946 and 1947. Wage scales, including now—with some vengeance—government wage scales, were forced upward, labor remained scarce instead of unemployed, and construction materials were so vigorously bid for by private enterprise in gray or black markets, as well as through normal channels, that they were hard to obtain and far more costly than had been anticipated. In many cases costs rose so rapidly during the inevitable interval between project planning and project authorization that the whole process had to be repeated and scaled down on the basis of new cost estimates, with the result that heavy expenditures to meet the backlog of capital needs were delayed. Also, State bonuses to veterans caused a sharp increase in the need for cash, and, for this and other purposes, as early as 1947 State and municipal bond issues for new money totaled over \$2.3 billion—approximately double the \$1.2 billion in 1946 and by far the highest volume ever recorded in any one year.⁷⁴ The interest rate on State and municipal bonds also rose sharply during the years from 1946 through 1948, and, according to the Dow-Jones service and other such agencies, the rise amounted to about 85 percent of the average rate on tax-exempt issues. The interest cost was still low in a historical sense, but substantially higher than it had been.

In brief, the States and localities were not able to accomplish the capital improvements and additions which they needed as rapidly and as easily as they had hoped. The record high tax receipts which had nourished so much optimism during the war period soon appeared inadequate again in the face of postwar inflation and the magnitude of capital requirements. By 1947, State and local debt outstanding was growing again and accumulated wartime surpluses were being reduced year by year to meet general spending requirements.⁷⁵ And, as if to punish us for our earlier optimism, new expenditure demands appeared at a faster rate than the wartime backlog could be disposed of. By 1954, most States found their general fund balances dropping sharply, or depleted, as the upward climb of revenues slowed while increased needs for schools, highways, and other institutions were exerting even greater pressure on State and local budgets.

Thus, State and local expenditures are being forced upward (from \$37 billion in 1954 to \$43 billion in 1956, for example) by a complex

⁷³ *Ibid.*, p. 23.

⁷⁴ *Ibid.*, issue of March 1948, p. 34.

⁷⁵ The Korean war provided a revenue windfall to the States as tax receipts, which had been leveling off between 1948 and 1950, rose rapidly as a result of a renewed inflationary upsurge. The windfall allowed some further revenue surpluses, but its benefit was illusory in the long run.

of causes which are basically related to the following: The need to make up for the deficiencies in capital programs during the war period; the growth and shifts of population; and, of course, inflation. To these, we must add the influence of our increased real wealth. The public demand in the postwar period, as never before, had been for better as well as more public services. With personal income up from \$78.7 billion in 1940 to \$178 billion in 1946 and to \$327 billion in 1956, our tastes have become more expensive than ever. And, our tastes for publicly provided goods and services have reacted in essentially the same way as our tastes in private consumption. So far, although at rising interest costs, our State and local governments have been able to debt-finance much of their capital spending. But current operating costs, which account for two-thirds of the increased total State and local spending, have added huge pressures to State and local finance. There does not yet appear to be any substantial movement toward effective rationalization of their financial systems.

The problem today

The skeletal history presented in the preceding pages aimed at defining (1) the important underlying causes of the overall growth of government in the past half century; (2) the principal factors which determined the distribution of that growth between the Federal Government and the State and local governments; (3) the fiscal problems which developed in the course of events. Our major purpose was to document these summary conclusions:

The growth of government was a necessary concomitant to the overall growth of the country. That is, the rise in total government spending from an amount equal to roughly 7 percent of the gross national product in 1902 to almost 28 percent in 1956, and the consequent rise in taxes from something like 8 percent of the national income to about 25 percent, are best explained in terms of the basic factors which shaped our history: Population growth, technological advance, urbanization, increased productivity and wealth, increased interdependence in the national and world economies, the course of international affairs—a depression of unprecedented severity sandwiched between two world wars and followed by persisting cold war, a little hot war, and the ever-present threat of atomic and hydrogen annihilation.

The spectacular growth of the Federal Government since 1929, which brought such a striking shift in the relative magnitudes of Federal and State and local government operations, represents a necessary response to changed national circumstances. First, the depression dramatized the high degree of interdependence of all groups in the economy, the practical impossibility of developing local solutions, and, consequently, the need for a new national approach to problems of economic security. Second, World War II and the absence of real peace after victory brought the full cost of advanced military technology into a position of persistent dominance in the Nation's economic budget. Furthermore, the technological requirements of modern war, or preparing for defense against it, ramify quickly to all aspects of life in our society, and, hence, to almost all reaches of social policy. Only the National Government can handle this responsibility,

and it has had to expand its concern over a broad range of activities as they have become closely correlated with national defense and national security.

Despite the overwhelming impression of the increased importance of the Federal Government, domestic governmental functions are still handled primarily at the State and local level. In fact, more than four-fifths of the growth in Federal spending since 1929 is attributable to national defense and national security programs, and less than one-fifth to expanded civil functions.

Thus, while the Federal Government in 1956 spent an amount equal to 4.8 percent of the gross national product on civil functions, the States and localities spent an amount equal to 10.4 percent. Although the Federal Government's influence on internal functions may be greater than the proportion of its expenditure indicates—through controls over grants-in-aid and subsidy programs, for example—the States and localities are themselves doing more in both scope and scale than they have ever done before. In constant (1926) dollars since 1927, for example, their spending has increased by 2.6 times and their tax collections have almost doubled.

As a result of population growth, inflation, and higher standards of public demand, the burden of civil functions resting on State and local governments for education, highways, welfare, health, hospitals, housing, protection, etc., has grown faster than State and local revenue. Although disparity between spending needs and revenue sources has characterized almost the entire half century, the situation of the States and localities has been made more critical since World War II. The fact is that Federal financial requirements for the support of national defense and security programs have become so great they made increased State and local taxation more difficult.⁷⁶ States and localities, in addition to rising operating costs, still have a backlog of capital investment needs dating from depression and war years which is being augmented constantly at a rapid rate by new plant and equipment requirements.

On the basis of these conclusions, it seems clear that the future course of intergovernmental relations will depend in greatest measure on the degree of success the States and localities achieve in meeting their pressing fiscal problems. The issue, in purely pragmatic terms, is whether and how the States and localities can develop the fiscal resources they will need to finance a satisfactory level of service in the functions for which they are responsible. In other words, we know for certain that Government spending for most domestic purposes will have to go up by large amounts in the coming years, but we are not nearly so certain that the States and localities can meet the challenge. To the extent that they fail, the Federal Government will have to fill the breach.

⁷⁶ War-connected purposes required about 2 percent of the national income at the turn of the century and 4 percent in 1940, but in recent years have amounted to between 18 and 20 percent. Roger A. Freeman writes: "This prior claim on the output of goods and services and the concomitant tax burden inevitably depress our ability to support more liberally other public services. * * *" Cf., Crisis in School Finance, Part I, National Tax Journal, vol. IX, No. 1, March 1956, p. 4.

TABLE I.—Government expenditures, selected years, 1902–56

[In millions of dollars]

Year	Federal		State and local, ³ total	State ⁴	Local ⁵
	Total ¹	Civil ²			
1902.....	485.2	149.1	1,095	188	950
1913.....	728.0	273.0	2,257	388	1,950
1922.....	3,296.0	677.0	5,652	1,397	4,507
1927.....	2,774.0	699.0	7,810	2,047	6,359
1929.....	2,900.0	621.0	(⁶)	(⁶)	(⁶)
1932.....	4,800.0	2,455.0	8,403	2,829	6,375
1938.....	7,200.0	4,684.0	9,988	4,598	6,906
1940.....	9,600.0	6,550.0	11,240	5,209	7,685
1944.....	93,956.0	7,237.0	10,499	5,161	7,180
1946.....	61,738.0	8,170.0	14,067	7,066	9,093
1948.....	36,524.0	7,926.0	21,260	11,181	13,363
1950.....	43,160.0	12,459.0	27,905	15,082	17,041
1952.....	67,968.0	12,602.0	30,863	15,834	20,229
1954.....	71,868.0	13,953.0	36,607	18,686	23,814
1956.....	72,611.0	19,792.0	43,152	21,686	23,273
1958 ⁶	82,970.0	25,331.0			

¹ Totals for fiscal years 1902 through 1952, from M. Slade Kendrick, op. cit., table B-1, pp. 76-77. Kendrick's figures are adjusted from Treasury data to come as close as he could make them to the measure of actual cash payments to the public. See his appendix B for detailed notes on sources and method, pp. 63-73. For later fiscal years Special Analysis A, Receipts From and Payments to the Public, Budget of the United States, 1955 and 1958.

² Residual after deducting sum of expenditures for military purposes, veterans, interest, and after 1915, foreign affairs.

³ Direct expenditure, as defined by the Bureau of the Census, includes all general government expenditure plus utility, liquor store, and insurance trust expenditures. These figures are not completely consistent with the actual cash payments measure used in the Federal Government column, but they represent the best comparable long series for State and local governments. Cf., Historical Statistics on State and Local Government Finances, 1902-53, tables 1, 2, and 3, and Summary of Governmental Finances in 1954, 1956, U. S. Department of Commerce, Bureau of the Census, Washington.

⁴ Total State expenditure including payments to local governments. Note that totals of columns 5 and 6 exceed column 4. This is due to the inclusion of State payments to local units in both expenditures of State and local governments.

⁵ Not available on census basis.

⁶ Estimate from the Budget of the United States, 1958.

TABLE II.—Government expenditures as percent of gross national product—selected years 1902–56

Year	Gross national product in current prices (billions of dollars)	Percent of gross national product				
		Federal	Civil	State and local	State	Local
1902.....	20.7	2.34	0.72	5.29	0.91	4.63
1913.....	40.1	1.81	.68	5.63	.97	4.86
1922.....	68.4	4.82	.99	8.26	2.04	6.68
1927.....	89.6	3.10	.78	8.72	2.28	7.10
1929.....	104.4	2.78	.79	(¹)	(¹)	(¹)
1932.....	58.5	8.20	4.20	14.36	4.83	10.89
1938.....	85.2	8.45	5.50	11.73	5.40	8.11
1940.....	100.6	9.54	6.51	11.17	5.18	7.64
1946.....	209.2	29.51	3.91	6.72	3.38	4.35
1950.....	285.1	15.14	4.37	9.79	5.29	5.98
1952.....	345.5	19.69	3.65	8.94	4.59	5.86
1954.....	361.2	19.94	3.87	10.15	5.18	6.61
1956.....	414.7	17.5	4.8	10.2	5.2	5.6

¹ Not available.

Sources: Gross national product for 1929-56, Survey of Current Business, Department of Commerce. Gross national product for 1922-27, National Product Since 1869, Kuznets, N. B. E. R., N. Y., 1946, p. 51, and gross national product for 1902 and 1913 were estimated from p. 119. (The 1902 figure was found by interpolation of the 2 overlapping 10-year estimates, 1899-1908 average equal to \$21,530,000,000, and 1894-1903 average to \$15,700,000,000.)

TABLE III.—Percentage distribution of all government taxes—selected years 1902–56

Year	Federal	State and local	State	Local
1902.....	38.0	62.0	11.3	50.8
1913.....	29.2	70.8	13.2	57.6
1922.....	46.9	53.1	12.5	40.5
1927.....	36.3	63.7	16.8	46.9
1929.....	35.5	64.5	19.6	45.0
1932.....	23.4	76.6	23.5	53.1
1934.....	33.5	66.4	22.2	44.2
1936.....	36.7	63.3	24.7	38.6
1940.....	38.2	61.8	26.2	35.6
1946.....	79.6	20.4	10.0	10.4
1950.....	69.8	30.2	15.1	15.2
1952.....	76.0	24.0	12.3	11.8
1954.....	73.9	26.1	13.6	13.5
1956.....	71.2	28.8	14.6	14.2

Sources: Annual Reports of the Secretary of the Treasury on the State of the Finances. Historical Statistics of the United States 1789–1945, U. S. Bureau of the Census, Washington, 1945, Series P 90–131, pp. 298–304. Summary of Governmental Finances in the United States: 1956, U. S. Bureau of the Census Washington, 1957.

TABLE IV.—International comparisons of public finance and gross national product, fiscal year 1951

Country	Gross national product per capita	Percent of gross national product				
		Taxes of all governments	National government expenditure ¹	Defense expenditure	National government gross debt	
United States.....	\$2,023	22.3	15.1	7.1		83
Canada.....	1,432	23.1	² 17.0	4.7	(*)	
Denmark.....	800	19.7	12.4	1.6		42
Iceland.....	792	² 19.0	14.9			21
Great Britain.....	779	34.4	27.3	6.7		188
Belgium.....	760	25.0	24.0	2.9		75
Norway.....	736	26.1	16.0	2.8		65
France.....	690	29.8	25.6	7.8		47
Netherlands.....	529	29.0	24.7	4.2		130
Germany.....	509	31.0	21.7	4.9		23
Italy.....	324	20.7	19.3	4.2		34
Austria.....	308	30.9	34.0	.9		31
Portugal.....	285	9.7	7.6	2.1		16
Greece.....	243	16.7	33.7	9.8		10
Turkey.....	161	17.9	20.1	6.5		18

¹ "National" refers to the central governmental authority; in the United States it refers to the Federal Government.

² Preliminary figure.

³ Not available.

Source: Division of Statistics and Reports, Mutual Security Administration (table IV, Dewhurst, *op. cit.*, table 236, p. 579).