

ECONOMY AND EFFICIENCY IN GOVERNMENT EXPENDITURES

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VIEWPOINT

The competence of the writer is the ability to analyze economic situations and to suggest appropriate policy and action to men responsible for the management of economic affairs. Because this is the competence and viewpoint employed, there is little unusual which can be offered for consideration by readers of this report. Instead, whatever value may be assigned to the ideas presented in this report must be attributed to the fact that the author is accustomed to evaluate the economic consequences of expenditure made by Government from the viewpoint of a person observing and appraising rather than as a participant.

ECONOMY, WASTE, EFFICIENCY

The task of describing standards which can be used to determine whether specific programs undertaken by the Federal Government are economical may begin with a statement of what is understood to be economy, waste, and efficiency.

Economy is understood to be the management of affairs with special regard for costs and involves the husbanding of resources. Expenditure is wasteful if it is not economical. Efficiency is understood to be the effectiveness of managerial action as measured by a comparison of the product obtained with the expenditure or cost.

ASSIGNMENT OF RESPONSIBILITY

A review of the organization of the Federal Government, and the operation of the Federal Government in the past, may be used to support the assumption that neither the Congress nor the executive branch of the Government actually is formally responsible for efficiency and economy in public expenditure.

Persons in both the executive and legislative branches of the Government unquestionably have been and are interested in seeing to it that Government expenditure is made efficiently and with economy. Yet neither the executive branch nor the Legislature is actually charged with formal responsibility for the performance of this function. The executive branch assembles budgetary data and presents the budget to the Congress. The Congress, on the other hand, can either add to the budget or refuse to appropriate funds necessary to finance items in the budget. Furthermore, with several notable exceptions, few Members of the Legislature have made efficiency and economy in Federal expenditure the basis for their political careers.

Long ago the lack of a formal assignment of responsibility for efficiency and economy in Government expenditure presumably was not a matter of large importance, because the magnitude of Federal expenditure was not such an important factor in the economy. This situation, obviously, has been changed.

In the operation of a popular government, in which political parties adopt specific programs and party discipline is observed, responsibility for efficiency and economy may be assigned by the electorate to the party in power. In such cases the high administrative officers are the leaders of the party or coalition which comprises a majority in the legislature. In this kind of a situation the citizen may hold the party responsible for economy and efficiency. Because these characteristics are not to be found in our form of political organization, economy and efficiency seem to be an interest of legislators and administrators as a consequence of their citizenship, and as responsible individuals, rather than as a formal responsibility related to their positions in the Government. While the lack of a formal assignment of responsibility presumably is a defect in the organization of the Federal Government it, also, may be noted that the management of Federal expenditure does not appear to have been less efficient than the performance of the comparable function by the popular governments of other countries in which responsibility seems to be formally assigned. This appears to be a tribute to the commonsense and statesmanship of American political leaders.

STANDARDS

The means of measuring economy, waste, and efficiency in government apparently are quite different from those which could be employed in the management of a business operation. In the management of a business the operating statement and balance sheet can be used to indicate whether or not operations have been conducted with efficiency. A comparison of these statements with those of similar enterprises may be used to determine whether the operation of one business is more efficient than the operation of another. Such measurements and references do not exist for the evaluation of efficiency in government and both the objectives and the responsibilities of a government are different from those involved in the management of a business.

Two different types of reference may be used to determine the economy and efficiency of expenditure. The first of these is the kind of reference called a "principle." Such principles, of course, are judgments or opinions derived from the observation of experience and developed by reasoning. The second type of standard consists of a definition of proposed expenditure, expressed in definite numbers. This is the "budget" which is used in managing expenditure made by both persons and organized groups, including government. In the conduct of business operations it is customary to seek ways and means of reducing the expenditure defined in the budget. The reduction of budgeted expenditure, without producing a commensurate reduction of the volume of production, is an important function of business management. In business the incentive to provide this function is large. In the management of group operations, where large material rewards are not obtainable by the persons who

perform the function of managing budgeted expenditure, the incentive must consist of personal satisfaction, approbation on the part of others, and dedication to attainment of the task. It is also apparent that the establishment of budgets and the actual management of budgeted expenditure can be only the function of managers or executives who are held responsible.

These considerations lead to the conclusion that the Congress can only use the kinds of standards known as principles in determining the economic and efficient types and volumes of expenditure—supplementing the use and application of principles by obtaining responsible assurance that the administration of expenditure budgeted is organized and performed with competence.

THREE ECONOMIC SITUATIONS

Government expenditure is made in at least three different types of situation. One of these types of situation is experienced when the Nation is mobilized for war. A second type of situation is when large numbers of the population are unemployed. The third type of situation, which may be considered as representing "normal," is when neither of the first two situations obtain. In each of these three different types of situation somewhat different concepts and standards may be adopted and used by the Congress in evaluating expenditure.

Because the third type of situation, in which the Nation is not mobilized for war and the number of unemployed is not large, is the kind of a situation experienced most of the time, as well as in the present, it is appropriate to give priority to a consideration of two principal or basic standards to be used in this kind of a period.

Principle I

A first principle which may be used by the Congress in appraising the economy and efficiency of Federal expenditure, in the situation defined, is derived from a consideration of the effects of Federal finance upon the financial system of the economy as a whole. The importance of this standard is that by observing it the Congress may avoid precipitating inflation and general economic disorganization leading to boom and depression, inflation, deflation, unemployment, and unnecessary social friction. The principle may be stated in the following terms. The difference between Federal expenditure and income should be adjusted to change in the demand for credit in the rest of the economy. Another way of stating the principle is that the change in Federal debt plus the change in other debt should be equal to the change in the market value of national output required by the increase in the population and technological improvement. If government expenditure is adjusted to fit this equation, Federal debt would be retired in periods when the increase in the aggregate debt incurred by the State and local governments and private borrowers would be larger than the volume which could be equated with the other factors. It is not enough merely to balance the Federal budget in a situation in which State and local governments and private borrowers are expanding their debt beyond the limits indicated in the equation outlined.

The consequence of violating Principle I.—The principle described may be used to avoid large-scale long-term inflation and deflation.

It is assumed that it is not necessary to support the contention that such inflation and deflation is undesirable and to be avoided. In each period of inflation sincere, respected and honorable voices may be heard advocating expenditure and financial procedure which is inflationary. Because decisions regarding government expenditure should be debated, it is reasonable to suppose that the arguments supporting inflationary expenditure should be heard. Inflation, however, has been experienced for centuries. It is normal experience avoided by only unusual nations with unusual leaders. The causes, development and consequences have been observed, understood, defined, and explained. There is nothing mysterious and little that is not known about the subject. Deflation, of course, is a consequence of inflation.

The primary origin of inflation invariably has been and will be an expansion of the money supply in excess of the expansion of the volume of commodities produced. The usual and almost invariable origin of inflation is the expansion of government debt or the debasement of the money supply as a consequence of political action. In this connection it is to be noted that public debt is an important part of the reserve held against the money supply of this country which was incurred for political purposes. For these reasons the change in the public debt should be adjusted to the changes indicated in the equation described if government expenditure is to be considered economic and efficient. If government expenditure is so large that public debt is not adjusted to the limits defined in the equation, government expenditure cannot be considered to be either efficient or economic.

The problem of velocity.—Although the primary origin of inflation is an improper political use of credit, it also may be observed that a change in the level of prices may be related to a change in the velocity of the circulation of the money supply. This, however, is a matter which is not amenable to control by a legislative body and may be considered the special province of the persons responsible for the formulation and application of monetary policy. In the United States the Federal Reserve Board, rather than the Congress, may be considered the proper authority to deal with the problems derived from changes in the velocity of the circulation of money.

Principle II

A second standard or principle which may be used to evaluate the economy and efficiency of government expenditure is the magnitude and incidence of tax rates required to raise an appropriate volume of income. It is evident that, if expenditure is so large that the taxation required to finance the expenditure reduces the incentive to produce on the part of the population, the expenditure can be considered neither economic nor efficient.

An examination of the economic consequences of the present hotchpotch of Federal tax legislation is not an appropriate subject to the development of this paper. In passing, however, it may be noted that existing legislation, while adequate for the purpose of obtaining the funds with which to finance expenditure, provides incentive to finance capital investment of all kinds with borrowed funds, provides incentive for small-business men to sell businesses before these become too large, and provides incentive for persons who are unusually competent in the management of economic affairs to avoid action which might increase personal tax liability.

A succinct general label for the existing legislation might be that it is the kind of extravagance which can be afforded temporarily by a wealthy country in a period of booming economic activity.

UNECONOMIC AND INEFFICIENT STANDARDS

A percentage of national income

From time to time it has been suggested that an appropriate volume of expenditure might be established by selecting some percentage of national income. This approach has the merit of reducing the standard to a definite number. Such a number, however, would have no relation to the use made of the funds thus obtained and would be a violation of principle I. For these reasons there seems to be no rational justification for the selection of a definite proportion of national output as a measure of the volume of expenditure which should be used for political purposes.

Need as a standard

A second standard sometimes used to justify government expenditure is "need." A need is a matter of opinion. Because needs are unlimited and the means available for satisfying needs are not, it would seem to be obvious that no expenditure should be made primarily because the expenditure is needed or wanted. When want or need is the criterion used to determine whether or not expenditure will be made it is to be expected that expenditure will be made without reference to what can be afforded and with little regard for either efficiency or economy.

EXPENDITURE WHEN UNEMPLOYMENT IS LARGE

When unemployment is large the public will demand expenditure by the Government to provide income for persons who would otherwise be unemployed. This public demand may be expected as a consequence of widespread acceptance of the theory of compensatory government spending, the planning of full employment and the use of fiscal policy to support "purchasing power."

In this connection it is interesting to observe that the only part of the theory of full employment by means of planning and the use of fiscal policy which has proven actually acceptable is the idea that government spending in excess of income is appropriate when unemployment is large. The other part of the theory has been proven unacceptable. When a situation of full employment has obtained governments have not been able to reduce or defer expenditure until a time when unemployment would be experienced.

Because the theory is widely accepted it is to be expected that there will be a large and important demand for government spending in excess of income when large-scale unemployment again is experienced.

It probably would be possible to observe principle I, described in this paper, concerning government in such a time. When business activity is reduced and unemployment is increased it is to be expected that private borrowing also will be reduced. This would permit government borrowing to be undertaken or increased without violating principle I. In this connection, however, it is important to note that if government deficits become too large, property owners and

entrepreneurs will fear that tax rates levied upon successful business venture may be increased. If this proves to be the case the fear of taxation will deter the undertaking of ventures and investment which will be needed to increase employment and income.

The theory that the volume of employment can be determined largely by fiscal policy actually can be used to produce a situation which would represent neither prosperity nor depression but economic stagnation. Government expenditure made for the purpose of supporting employment and income but which actually produces a stagnation of enterprise can be considered neither economic nor efficient.

MILITARY EXPENDITURE

Contrary to ideas which seem to be generally accepted the condition known as peace has rarely existed for very long in this world. What is now generally thought to be peace seems to be the kind of situation which existed when British naval power dominated the oceans and ports of the world. This situation has not obtained since 1914. In the present and prospective unstable political world it must be expected that a major proportion of Federal expenditure will consist of expenditure made for military purposes.

Because expenditure for military purposes probably will be the largest single item in the Federal budget for many years to come, it is apparent that this item will continue to be the part of government expenditure in which efficiency and economy will be most important.

Assuming that the strategic evaluation and planning of the military are adequate, rational and properly integrated, the problem of efficiency and economy in military expenditure will consist largely of the problem of administering the military budget. In this connection recommendations have been made by the second Hoover Commission which supported the recommendations of the Committee on the Business Organization of the Department of Defense.

Because the maintenance of a permanent large military organization is relatively new in the experience of the United States it is reasonable to assume that there is much which is not understood about how to manage the expenditure of such an organization. The development of such knowledge requires time, experience, and study. For these reasons it probably will be both desirable and appropriate to establish task forces and working groups from time to time, with functions similar to those of the Committee on the Business Organization of the Department of Defense. Groups commissioned for the performance of this task can be used by the Congress in the way that the managers or directors of a corporation sometimes employ the professional services of firms specializing in operations research or management engineering.

CONCLUSION

The review of the standards which may be employed by the Congress to determine the economy and efficiency of Government expenditure supports the assumption that these probably must be standards concerned with overall Federal expenditure supplemented by responsible assurance that funds budgeted and appropriated are being administered with competence.