

BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM

# Office Correspondence

Date November 19, 1938.

To Chairman Eccles

Subject: The Budget Presented in Terms

From Lauchlin Currie

of Its Effects on Consumption.

*LMC*

The attached was prepared for Mr. Ruml by Mr. Krost.

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#### THE BUDGET PRESENTED IN TERMS OF ITS EFFECTS ON CONSUMPTION

The following figures are presented to illustrate possible differences in the effects of the various types of Federal expenditures and receipts upon consumption expenditures. The basic figures relate to the fiscal year 1938. The multiplying factors applied to the various expenditures are based upon rough estimates of the proportion of a given type of expenditure spent for consumption during the time that the money transfers involved are distinguishable from the general flow of money transactions. It is assumed that in the course of a year consumption expenditures of an equivalent amount are induced by these initial consumption expenditures.

The multiplying factors applied to the various receipts are based upon rough estimates of the proportion of a given type of tax that represents reduced consumption by the taxpayer or the person upon whom the incidence of the tax falls. It is assumed that in the course of a year a reduction in consumption expenditures of an equivalent amount is induced by this initial reduction in consumption expenditures.

In the following classification of Treasury expenditures and receipts the assignment of the expenditures of particular agencies and of particular types of revenue to the various categories is necessarily somewhat arbitrary.

(Monetary amounts are in millions of dollars)

Expenditures	Amount	Consumption factor (Percent)	Consumption indirectly induced	Total consumption expenditures generated
I. Payments to needy persons and low-income groups	2,618	100	2,618	5,236
II. Salaries and operating expenses of administrative agencies	2,024	95	1,923	3,846
III. Public works and military construction	1,312	50	656	1,312
IV. Interest on public debt	926	50	463	926
V. Refinancing private obligations and providing capital for financial institutions, miscellaneous items	139	10	14	28
VI. Non-cash expenditures and redemption of own securities	672	0	0	0
	<b>7,691</b>	<b>-</b>	<b>5,674</b>	<b>11,348</b>

(Monetary Amounts in Millions of Dollars)

Receipts	Amount	Consumption factor (percent)	Reduction in consumption indirectly induced	Total reduction in consumption expenditures
I. Taxes on low-income groups or directly on consumption	2,447	95	2,325	4,650
II. Taxes on business units levied as a direct cost of doing business	468	90	421	842
III. Taxes on business net income.	1,476	50	738	1,476
IV. Taxes on higher-income groups and miscellaneous receipts	1,851	10	185	370
Total budgetary receipts	6,242		3,669	7,338

Consumption expenditures generated by Treasury expenditures	11,348
Reduction of expenditures attributable to taxes	<u>7,338</u>
Net consumption expenditures generated	4,010
Bookkeeping deficit	1,450

The above figures relate only to "budgetary" receipts and expenditures. Certain other receipts and expenditures of the Treasury, while not "budgetary", reflect legislative policy as expressed in recent statutes and, of course, affect consumption expenditures. The more important of these items are shown in the following table:

	Amount	Consumption factor	Indirect effect on consumption	Total effect on consumption
Receipts:				
Unemployment trust fund	763	90	687	1,374
Expenditures:				
Unemployment trust fund-benefits	191	100	191	382
Benefits-old-age reserve & railroad retirement	85	100	85	170
Redemption of adjusted service bonds	82	50	41	82

	Amount	Consumption factor	Indirect effect on consumption	Total effect on consumption
Total non-budgetary expenditures	358		317	634
Net effect of non-budgetary items				-740
Net effect - budgetary and non-budgetary items				3,270

DIFFICULTIES IN THE PRESENTATION OF THE FEDERAL BUDGET  
IN TERMS OF EFFECTS ON CONSUMPTION OR INCOME

The following considerations explain why the presentation of the Federal budget in terms of its effects on consumption or incomes is a matter of some difficulty, and why any figures presented for this purpose are likely to be of doubtful significance.

1. The diversity of Federal receipts and expenditures is bewildering. Consider the differences in the nature of the operations of the United States Navy, the WPA and the Library of Congress. Consider the differences in the economic repercussions of the collection of taxes on the wages of the sole clerk at a crossroads store in the Kentucky back woods, the collection of income taxes on the eight persons in the state of Delaware who have annual incomes of more than a million dollars, and the sale of official publications by the superintendent of documents. A rough classification of these diverse activities is possible and has been made for this present purpose, but a more satisfactory classification would require research on a large scale.

2. The "consumption factors" used are mere guesses. The basic data required to make reasonably accurate estimates on the expenditure side are the classification of expenditures into personal services, supplies and materials, rents, utility services, etc. Each type of material and each kind of service purchased have, of course, different consumption factors. The assignment of multiplying factors to

these different types of expenditures raises questions of fact to which no easy answers are available, and questions of theory as to how far the effects of a given expenditures can be traced back thru the <sup>service</sup> sales of processing and distributing operations which precede the sale of the article or the service to the Government.

3. If it is attempted to shift the analysis from the effects on consumption to the effects on income, an additional difficulty arises because the multiplying factors vary with the changing phases of the business cycle. When business is depressed, the consumption factor involved in the purchase of materials is high because the cost of business enterprises will equal and in some cases exceed the increase in their receipts. When business is active and profits are being made, the consumption factor involved in material purchase is low because business units are making savings (in the form of depreciation and undistributed earnings) out of the profits which the purchases bring with them. In so far as these profits are disbursed in the form of dividends, individual savings represent an additional influence which keeps the multiplying factor low. Consideration also has to be given to the question whether material purchases do not merely result in the reduction of inventories, and hence fail to generate directly any incomes at all.

4. It will be observed that the method of computation used in the accompanying tables results in a considerably greater effect on consumption than the bookkeeping deficit. It is probable that the

same method would show the Treasury making a contribution to consumption even when there was a bookkeeping surplus. The implications drawn from this fact are likely to be misleading. It would probably be correct to say that in this sense the Treasury is always making some contribution to consumption. This perennial contribution to consumption is matched however by a perennial withdrawal from consumption made by the personal and corporate savers of the community. The significance of the contribution to consumption made by the Treasury can only be assessed in relation to the magnitude of the community's savings and to the other stimulating influences that act in the same way as the Treasury contribution to offset the depressing effect of savings upon the national income.

The important problems of fiscal policy relate not to the question of whether there is or is not a net Treasury contribution to consumption or to incomes, but to the question of whether that contribution is greater or smaller than is necessary to produce a desirable rate of growth in the national income, after all the other forces at work upon the national income have been given due consideration.