Not for publication
May, 1935 17

FEDERAL INCOME-INCREASING EXPENDITURES, 1932 - 1935

by

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It is not the intention in this paper to take any stand on the desirability of a Federal income-increasing program. The purpose, rather, is to attempt to state and clarify the issues involved, and to present estimates of the magnitude of Federal income-increasing expenditures.

The case for Federal income-increasing expenditures as a recovery measure may be stated as follows:

It is assumed that in the present circumstances neither money wages nor the prices of any of the other important elements in costs can be reduced. It follows that the unemployed cannot be absorbed without a general increase in the demand for goods resulting in a rise in prices, or an increase of sales at existing prices. No appreciable increase in demand can occur without an increase in the national money income. The national money income can be increased only as a consequence of current investment being in excess of current saving. 1/ In the depths of a severe depression the desire and/or the ability to invest is weak; the desire, if not the ability, to save is strong. Since ours is a predominantly profit economy, increased investment is in large part conditioned upon expectations of enhanced profit. But increased profits are in turn conditioned upon reduced unit costs, and/or an increase in sales. It has been assumed at the outset that it is impossible to effect any substantial reduction in

1/ The term "saving" is used in the sense of the difference between the community expenditures on consumer goods and the aggregate money income of the community.

costs like real property taxes, freight rates, power rates, trade union wage rates, and, for concerns in a weak financial position, interest charges. Technological improvements which would permit reduction in unit costs proceed but slowly. An increase in demand is conditioned largely by an increase in incomes, which in turn is largely dependent upon increased investment. Moreover, even after expectations of enhanced profits are firmly established, the existence of unutilized productive capacity enables a substantial increase in demand to be met with but little necessity for an increase in investment in new plant facilities.

There are various other considerations which in the present depression have militated against an increase in investment relative to saving. It is estimated that cities and countries spent over two billion dollars annually on construction in the period 1925-30, and that their expenditures for this purpose in 1934 amounted only to between six and seven hundred million. An explanation of this decline is to be found in the reduced incomes and property values in municipalities, and the existence of legal debt limitations. The electric power industry alone spent nearly one billion dollars on construction in 1929 and in 1930. Despite the fact that there is less unutilized capacity in this industry than in almost any other, its expenditure for construction in 1933 and in 1934 was only $130,000,000 and $100,000,000 respectively. The explanation of the low level of construction commonly offered is the uncertainty whether the industry will be permitted to earn enough on new equipment to justify its construction. Railroads, which spent over a billion dollars annually up to 1929 on plant and equipment, have reduced their expenditures drastically. It is generally recognized that they cannot and will not spend more on equipment until their traffic and revenues expand, but expansion of revenues depends upon expansion of business.

Another large outlet for investment is in residential construction. In the years 1925-28 expenditures in this field amounted to over three billion dollars annually. In 1933 to 1934 they amounted to some 250 million. The explanation of the virtual cessation of building appears to be twofold. In the first place, the shrinkage in individual incomes decreased people's ability to build. Secondly, the shrinkage in incomes resulted in a drastic fall in rents, while building costs did not fall correspondingly. Hence, by and large, it has been cheaper to buy or rent than to build. A fall in costs is dependent upon (a) lower rates of wages in the building trades, (b) lower transportation charges, (c) lower material costs, and (d) lower interest rates. Some progress has been made in lowering interest rates, but it is clearly unrealistic to expect much lowering of other costs. Higher rents would follow increased incomes; but increased incomes, leaving Government expenditures out of consideration, are mainly dependent upon increased construction and equipment expenditures.

The argument for Government deficit spending to this point may be summarized as follows: After a drastic decline in business activity it is questionable whether sufficient new investment will take place "naturally" to offset the current disinvestment and current saving. Broadly speaking, increased expenditures wait on increased demand, and increased demand waits on increased expenditures. Some help may be expected from necessary replacements and from the introduction of new machinery which is expected to reduce current costs radically. Some help may also be expected from new products, such as breweries and distilleries in 1933, which require new productive equipment. It is, however, highly questionable whether expenditures for such purposes will be sufficient to counterbalance the continuance of deflationary forces.

The magnitude of the deflationary forces that continue after the trough of a severe depression may easily be underestimated. In the first place, there is a widespread repugnance, amounting almost to dread, of indebtedness. A substantial portion of any increased revenues may be used for the reduction of such indebtedness, or held in the form of cash to meet maturities in the future. Corporations which adopted the policy in the depression of converting part of their equipment into cash by postponing repairs and replacements will be slow to depart from this policy. Individuals who have witnessed or experienced economic insecurity may be eager to devote any increases in incomes to insurance and saving. In addition, a portion of any increased income will be devoted to the repayment of debt incurred in the course of the depression, to payment of arrears of rents and taxes, and to reduction of loans on insurance policies.

Advocates of an income-increasing deficit take the position that the amount of new investment or decreased saving that may be expected to come about "naturally" will be insufficient to offset continuing disinvestment and saving. Most of them concede that in time investment will exce~~ss~~ed saving, but consider that the cost to the community arising from the continued non-utilization of its productive facilities is too high a price to pay for a "natural" recovery. They maintain that an excess of investment over saving brought about by Government action has substantially the same effect as one brought about by private action, and hence is equally efficacious in bringing about recovery.

Opponents of increased Government spending, on the other hand, maintain that there is a profound difference between an excess in investment resulting from private initiative and one resulting from Government action. Some even hold the view that an excess in investment cannot be brought about by Government spending, since such spending for various reasons tends in itself to result in a decrease of private spending. Others believe that an excess of investment can be brought about in this manner, but that it ~~is~~ is contingent upon a continuance of Government deficit spending; that, in other words, circumstances accompanying Government spending differ so widely from those accompanying private spending that no secondary expansion can be expected. The water will flow as long as the pump is being primed but only as long. . .

There are at least three important ways in which Government spending may have effects different from private spending. The first we shall consider is psychological. A large public works program, involving a substantial deficit, may arouse expectations of (a) eventual "inflation", or (b) eventual "collapse", or (c) general misgivings as to the soundness and continuance of the recovery thus engineered. It may be felt that such spending cannot be continued for long and that when it ceases a renewed slump will ensue.

Expectations that a public works program will result in inflation might be expected to lead to increased investment, particularly in the form of inventories. Expectations, however, are rarely free from uncertainty.

If the chances of inflation are conceived to be even as high as ten to one, it may still appear the prudent course to delay expenditures until recovery is well under way and there is assurance that new equipment may be utilized immediately. A fairly widespread expectation of eventual inflation, in other words, need not necessarily express itself in increased private investment. On the other hand, it appears very unlikely that it should express itself in increased disinvestment.

It is difficult to surmise how an expectation of eventual "collapse" would affect current spending policies, particularly since the occurrence and the date of the collapse are even more uncertain than the circumstances of the expected inflation, because they belong to a more remote future. If, however, a corporation had bonds outstanding that matured within five or ten years, it might very readily cut down its repairs, maintenance, and renewal expenditures, for the purpose of accumulating cash or marketable securities to meet its bond maturities.

If the recovery is believed to be dependent upon continuing deficit-increasing expenditures, and if it is believed that such expenditures cannot be long continued, business men may be led to keep their own expenditures at a minimum. Because of its effects on business expectations, therefore, an excess of investment brought about by Government action may have different and less favorable effects on private investment and saving policies than an excess brought about "naturally".

Another way in which Government spending may have deterrent effects on the volume of private investment is through its possible effect on the general price and cost structure. If, for example, it is believed that high wage rates in the building trades are an obstacle to a revival of private building, and if Government spending results in a maintenance of such rates, it may be held that Government action is retarding inevitable and necessary readjustments, and hence is prolonging the depression. Private spending will presumably take place only in such places and in such lines where necessary readjustments have already occurred. The answer to this argument made by defenders of Government spending on the basis of existing wage rates is that readjustments are necessary and inevitable only on the basis of current prices and incomes. If incomes are increased sufficiently, existing wage rates will become economic rates.

Again, if Government expenditures take a form competitive with private enterprise the resulting disinvestment may more than offset Government investment. This is all the more likely if such spending is accompanied by a widespread threat of further expenditures of a like nature.

In all the cases just considered the amount of disinvestment or postponed investment arising from Government spending is affected by the volume of current investment. If, for example, no houses are being built, current investment in new houses cannot be decreased; though, of course, existing houses may not be kept in as good repair. The larger the volume of current investment, the greater the possible amount of private investment that may be decreased. This might be considered an argument for delay in inaugurating public works until the depression has reached an acute stage.

Advocates of Government spending argue that so far from Government action leading to decreased or postponed private spending it actually tends to make private spending greater than it would otherwise be. This argument does not rest only upon the familiar point that the expectation of rising prices should encourage spending and discourage saving, but also on the theory that Government spending will be interpreted as an assurance that business will get no worse. It is argued, therefore, that those types of expenditures which were postponed from fear that business conditions would become worse will be undertaken when the Government finally commits itself to a "reflation" program.

There may again be some differences in the amount of secondary spending arising from Government and from private spending. It seems likely that the immediate recipients of income from Government spending will spend more than those having their incomes increased through private spending. This is for the reason that a larger proportion of the former are completely destitute. On the other hand, manufacturers into whose hands the money spent on consumer goods eventually goes may possibly be more reluctant to spend than if they felt their increased sales arose from "natural" causes. It does not appear feasible even to make a guess at the amount of secondary spending. Circumstances can easily be imagined in which it may be almost nil and others in which it may be manifold.

Underlying the statistical difficulties is the analytical difficulty of disentangling the flow of payments which has its source in Government expenditures from the flow of payments which has a multitude of sources in private decisions to spend rather than save. If a given person spends more this month than last, is this because his income has been increased by payments made by people who have had <u>their</u> incomes increased by Government spending or is it because he is taking advantage of a bargain or a favorable investment which he would have bought even at the old level of income. It is worth pointing out, however, that no investment, either public or private, is self-perpetuating. At every stage of the production-consumption cycle there are leakages, or rather saving. An initial expansion of income due to investment must, if it is to be maintained, be fed continually by new investment to offset the steady succession of savings.

Still another difference between a "natural" recovery and one brought about by Government spending may lie in the sequence of events in the recovery. In the former case, the initial increase in spending may either be in the capital goods industry or in the residential housing field. In the latter case, however, the sequence of events may be, first, an expansion of consumers' incomes; second, an increase in demand for consumer goods; third, increased expenditures incurred in the production of consumer goods; and, finally, an increase in expenditures on equipment and plant, both in the consumers and producers goods industries. Advocates of a stimulated recovery claim that the demand for consumer goods must be increased considerably before it becomes profitable for industry to add to its facilities, and look for a substantial expansion of producers goods only in the later stage of the recovery movement. On these grounds they refuse to admit as evidence of the failure of the Government spending program the absence of revival of the capital goods industries in 1933-1934.

This general type of discussion is, it must be admitted, very unsatisfactory. We are, however, treating of a most controversial field of motivation, and the statistical material available does not permit verification of any hypothesis as to what the effects of Government spending have been. Critics of Government deficit spending may claim that such spending has been more than offset by the consequent shrinkage in private investment, so that business activity is lower today than it would have been had the budget been balanced throughout the depression. Advocates of Government spending, on the other hand, may claim that the fact that there has been but moderate recovery despite a continuing deficit with its accompanying secondary spending indicates the presence of factors adverse to business recovery, against which the stimulating influence of Government expenditures has had to work; that it is these factors, and not the effects of the deficit, which have checked private investment, and that without such a deficit business conditions would have been very much worse than they were. To settle this question it is not enough to know how business men behaved during the period when the budget was unbalanced. One must also know how they would have behaved if the other conditions of the period had been the same but the budget had been balanced. In the absence of that information, we know of no way to determine the effects of deficit spending.

THE IDEAL TIMING AND MAGNITUDE OF FEDERAL INCOME-INCREASING EXPENDITURES

While in agreement on the main issue, advocates of Government spending differ as to the manner in which it should be undertaken. Should income-increasing expenditures be undertaken at the beginning of the downturn or only after the depression has reached an acute phase? Should they be spread over a period of years or concentrated in a comparatively short period of time? Should they be designed merely to offset the deficiency of investment relative to saving or to bring about a large excess of investment? Here again it is unfortunately difficult to secure any very good grounds for generalization. A few factors that should be considered may, however, be pointed out.

Whether income-increasing expenditures should be incurred immediately upon the downturn depends in large part upon the nature of business conditions immediately preceding the downturn. If a boom was in progress it may be argued that a transition to a lower level of prices is necessary, and hence that expenditures should be delayed. If, on the other hand, the dominant characteristics of the preceding period were those of moderate prosperity, and no factors were present which in themselves might be expected to lead to a general recession, weighty arguments for an immediate vigorous anti-deflationary program can be advanced. Other factors that must be taken into consideration are, of course, those associated with the question of motivation and expectation, which were discussed above.

Advocates of income-increasing expenditures are sharply divided on the question whether such expenditures should be spread or concentrated.

Most of them believe that they should be large and concentrated, partly on the grounds of the pump-priming analogy and partly because of the possible adverse effect on public sentiment of a long-continuing Federal deficit. It is, however, dangerous to rely too heavily on mechanical analogies for the purpose of economic analysis. The processes of recovery are time-consuming. Much liquidation must be completed; time is necessary for the gradual transition from depression to recovery psychology; and business men may readily regard any sudden spurt as a flash in the pan. It is noticeable that the boomlet of 1933 was confined almost entirely to investment in inventories and was not sufficiently sustained to induce any expenditures on durable producers' goods. It would appear that the chances of success of concentrated and large income-increasing expenditures are better immediately following a downturn from comparatively stable business conditions than after business activity has reached a very low level.

After a severe depression the argument for continuing income-increasing expenditures sufficient in magnitude to bring about only a mild excess of investment over saving and, hence, to stimulate a moderate though continuing degree of recovery, is strong. If the recovery is moderate and orderly in character a better control over costs is possible; there is less danger of nullifying price rises; less danger of inventory buying of a speculative nature; necessary time is afforded for completing the process of liquidation and for the transition from depression to recovery psychology; and there is a better chance of avoiding a boom and subsequent depression. For the purpose of maintaining confidence in the soundness of the recovery, a steady rather than a rapid upward movement seems to be what is needed. From this point of view, the ideal policy would be a sharp increase in expenditures during recessions to be checked during periods of upswing, a course which it would be very difficult to realize in practice.

The chief objection to an extended though moderate program of income-increasing expenditures is the possible adverse effect on public sentiment of a long-continuing deficit. The arguments on this question are substantially the same which have been covered in the discussion of whether a deficit is desirable at all. Nothing can be added here which would advance the discussion beyond a similarly inconclusive outcome.

If income-increasing expenditures are continued at a constant rate, say, at 3 billion dollars a year, it might at first appear that no actual net increase from year to year is being made in the national income and that the expenditures merely have the effect of maintaining the status quo. This view, however, would be valid only if there were no secondary spending. Assuming other private investment and saving to remain unchanged, the net addition to the national income under conditions of an unvarying rate of Federal income-increasing expenditures would be measured for any period after the first by the amount of secondary expenditures attributable to the primary spending of that and any preceding periods. An interesting corollary arising from this conclusion is that, again assuming other private investment and saving to remain unchanged, the budget can be balanced without decreasing the national income only if the secondary spending in the period in which the budget is being balanced is equal to the previous primary income-increasing expenditure. The amount of secondary expenditures necessary to avoid deflationary consequences when the budget is balanced would, of course, be smaller if private investment exceeded saving and would be larger if private saving exceeded investment, than the amount necessary if private saving and investment were equal.

FEDERAL INCOME-INCREASING EXPENDITURES FROM JANUARY 1932 TO OCTOBER 1935

There are various reasons why the reported figures of the Federal deficit are not satisfactory measures of the contribution of the Government to private incomes. These reasons are discussed and the derivation of what we consider to be a more satisfactory measurement is explained in detail in the Appendix to this article. Briefly, what we have tried to measure is the net flow of income directly attributable to Government activity; that is, all income received directly from Government agencies and from persons and institutions which are financing their expenditures by borrowing from Government agencies, minus all deductions from income paid over to the Government as taxes, fees, etc. For the purpose of this definition, income means money receipts derived from the sale of services currently rendered. The term "income-increasing" as used here is roughly equivalent to "business stimulating" and "pump-priming", terms which in popular usage denote an all-around increase in cash receipts both of business men and those who are employed by business men.

Our estimates of income-increasing expenditures are given in Table I, together with the reported deficit for the same period. Estimated Federal income-increasing expenditures for the fiscal years ending June 30, 1933, 1934, and 1935 were $1,953,000,000, $2,467,000,000 and $3,288,000,000.

TABLE I

Net Income-Increasing Expenditures of the Federal Government
and the Reported Deficit

(Unit: $1,000,000)

	1932		1933		1934		1935	
	Net Exp.	Reported	Net Exp.	Reported	Net Exp.	Reported	Net Exp.	Reported
January	106	127	174	112	397	770	276	266
February	151	268	145	89	257	430	293	284
March	173	104	196	1	259	190	182	(-) 50 1/
April	183	449	205	224	268	792	267	569
May	184	351	182	99	213	313	254	365
June	228	195	225	102	286	342	392	441
July	136	236	109	108	297	248	234	449
August	158	135	85	122	264	227	166	223
September	100	3	94	8	182	66	281	160
October	119	228	73	244	277	499	296	561
November	141	121	154	291	300	392		
December	172	408	272	381	304	268		
Fiscal year		2,880	1,953	1,786	2,467	3,989	3,288	3,575
Calendar year	1,851	2,625	1,914	1,781	3,304	4,537	2,641 2/	3,268 2/

1/ Excess of receipts over expenditures
2/ First ten months

May expenditures of this magnitude be expected to have effects on business activity of any significance, and should those effects be clearly discernible, for example, in simultaneous or lagging correlation between expenditures and indicators of business activity? No definite answer is possible. When it is considered that they amounted to only six percent of an estimated national income of $47,000,000,000 in 1933, these expenditures appear very much smaller than they do in the comparisons with the amounts involved in Federal finance in the past in which they usually appear. They also appear small in relation to total investment in a prosperous year. The volume of construction alone is estimated to have been between twelve and sixteen billion dollars in 1928.[1/]

On the other hand, income-increasing expenditures of three billion dollars per annum may be sufficient to convert excess savings into excess investment, and so would change the trend of business activity. In 1933 and 1934 these expenditures were probably equal to the total value of new non-Governmental construction in those years. If we take into account the fact that there must have been in addition a considerable amount of secondary expenditures in these years, the resulting stimulus to business may have been an important element in the situation, even though the primary income-increasing expenditures probably at no time exceeded more than ten percent of the national income. It appears evident, however, that a full recovery could not have reasonably been expected to result as the immediate effect of a Federal income-increasing program of three to four billions, operating in a period in which other important factors were unfavorable to

1/ National Bureau of Economic Research, Bulletin 52, p. 17.

revival. In such a situation substantial amounts of secondary expenditures, together with a considerable volume of private investment not directly connected with Government activities must take place before relatively full employment can be secured. In any case, the relation between Federal expenditures and the general business situation is too complex to expect any close correspondence between Federal expenditures on the scale of this period and the commonly-used indicators of general business activity.1/

No attempt has been made in this study to trace quantitatively the amount of secondary expenditures. One scrap of information, however, may be of some encouragement to advocates of a Federal spending program. The automobile industry has to date staged perhaps the most spectacular comeback in output and earnings, General Motors and Chrysler received $1,206,000,000 from the sale of products in 1934, which was $398,000,000 more than in 1933. Of this $1,206,000,000 they used $24,000,000 dollars to reduce debt, to purchase marketable securities, or to invest in affiliated companies. The remainder was disbursed in wages, materials, maintenance, dividends and taxes. Ford's total sales are not reported, but they must have been considerably greater than Chrysler's which were $362,000,000. Ford's total holdings of cash investments and accounts receivable increased by only $19,000,000 dollars. Since part of this increase may be attributed to increased accounts receivable it appears that almost all of the proceeds of sales were disbursed. One swallow, of course, does not make a summer, but it is at least encouraging that the industry which was in the vanguard of the recovery movement should have disbursed such a large portion of its receipts in 1934.

1/ Month-to-month movements in Federal expenditures, whether measured by the reported deficit or our adjusted figures, do not accurately reflect actual transfers to the public, because certain expenditures are made sometime before collection from the Treasury takes place and others are charged at the Treasury sometime before actual disbursement to the public.

Federal income-increasing expenditures, by involving a Federal deficit, resulted in an expansion of money. It is estimated that adjusted demand deposits in all banks in the United States increased from June 1933 to June 1935 by $6,000,000,000 or about 42 percent. This figure, however, was still some 10 percent short of the adjusted demand deposits of all banks on June 30, 1929. Non-Government adjusted demand deposits of member banks in New York City, where a substantial portion of large corporation balances are held, were 33 percent higher on June 30, 1935, than on June 30, 1929, an indication both of the disinvestment and saving policies of the large corporations, and also of their highly liquid position at the present time.

APPENDIX

The Measurement of the Net Income-Increasing Expenditure of the Federal Government[1]

The term "income-increasing" is used in this study in a somewhat special sense. As applied to a given transaction, it means that the money changing hands is either itself a payment for current services, or that the nature of the transaction implies that the money will be used as payment for current services in the near future. The distinction between income-increasing and non-income-increasing expenditures does not correspond to the distinction between transactions "on capital account" and "on income account" either from the point of view of the Government or of the person receiving the payment. Similarly, to say that a transaction is income-decreasing means that the volume of spending on current services is less than it would have been had the transaction not taken place. The meaning of these terms will become clearer as they are applied to specific transactions in the following pages.

The effects of a given transaction cannot be traced with any certainty beyond a very few subsequent steps in the flow of payments. In certain cases the immediate results are predictable because of the economic position of the person to whom payment is being made. For instance, there is not much doubt as to what disposition is made of relief payments. In other cases the nature of the transaction is sufficient indication of the use to which the funds will be put. For instance, loans to business by the RFC are likely to be used almost as soon as made, both because of the interest factor and

1/ The method used here is based upon an earlier unpublished study by Mr. Albert G. Hart. It has also been influenced by the comments and ideas of Professor Jacob Viner.

because of the purposes for which they are extended. Unfortunately, not all transactions can be as easily classified as these. The doubtful cases which necessitate the exercise of more or less arbitrary judgment are listed below, together with the grounds on which their classification was based. The general rule followed throughout was to assume that no increase in income occurred unless there was convincing evidence to the contrary.

The sources used are as follows:

The Treasury Daily Statement of the fifteenth of each month contains, besides the information which is available daily, a detailed statement on page 5 of receipts and expenditures during the preceding months of the current fiscal year. The outstanding loans of the Reconstruction Finance Corporation and the constituent agencies of the Farm Credit Administration are reported monthly in the Federal Reserve Bulletin. Monthly figures on collections of internal revenue and the computed annual interest charge on the public debt are made available by the Treasury. Certain information which is not of great quantitative significance is not available in any of these publications and must be obtained by special arrangement with the agencies concerned. It is clear that most receipts fall into the income-decreasing category. The exceptions are estate taxes, proceeds of foreign obligations held by the Government, seigniorage, increment resulting from reduction in the weight of the gold dollar, and proceeds of borrowing. Government borrowing is the most important example of a considerable number of items which shift from one category to another according to the prevailing phase of the business cycle. Over the whole period covered by this study the desire to invest was weak, and attractive investment opportunities were scarce. Therefore, the funds invested in new Government securities may properly be considered to have been either newly-created deposits (the creation of which did not deprive the banks of the ability to make other loans and investments), or idle balances (which would otherwise not have been spent at all). Neither of these sources of funds are available to any great extent in periods of normal or active business. At such times funds invested in Government securities are probably diverted from other uses. Hence, in prosperity and perhaps in mild recessions Government borrowing is income-decreasing in its effects, while in depression and the early stages of revival it is non-income-decreasing. Confusion will be avoided if readers will note that these statements do not refer to the complete chain of events which begins with the transfer of a given sum by investors to the Government, and ends with the transfer of an equal sum by the Government to those from whom it buys goods and services. The discussion at this point relates only to the effects of the first link in that chain.

The effects of the collection of the estate tax vary in the same manner between different phases of the business cycle. In depression most estates probably hold enough cash and liquid assets to pay the tax without reducing the volume of spending which would have been done had no tax been paid. It is only in prosperity that the funds which are held by the estate (or by the buyer of the assets which it must dispose of to obtain cash for tax purposes) can be assumed to be fully employed. This treatment of estate taxes may raise the question as to why income taxes, (especially in the higher brackets) are not similarly treated. Any guess about how the payers of income tax would behave if relieved of their tax obligations is extremely hazardous, but in the light of a strong popular feeling to the contrary it would require stronger evidence than is available to lend plausibility to the suggestion that they would simply let the money lie idle. There is the additional practical difficulty that no figures on the size-distribution of the incomes on which taxations are paid are available for periods shorter than a year. It is clear in the case of the other items which have been mentioned that they do not decrease the income of anyone in this country.

Do the large receipts of income tax on quarterly tax payment dates mean that private spending is correspondingly reduced during these months? It is much more probable that funds are accumulated from pervious periods and that customary holdings of cash are temporarily drawn upon and restored to their usual level by saving during succeeding periods. In other words, tax payments reduce both past and future spending. A rough way of taking account of this is to substitute for collections of income tax actually made a three-months' moving average, centered at the second month. Corporations, no doubt, make provision for payment for a much longer period ahead, but practice in this respect must vary a great deal and a special adjustment on this account would involve the practical difficulty of estimating the tax collections of an uncertain future in order to establish the effect of provision for their payment on spending in the present and recent past.

In following the treatment of expenditures, the reader may find it helpful to have before him a summary list of Government accounts, for example, that on pages A5--A6 of the <u>Budget of the United States Government</u> for 1936, where the classification of accounts corresponds roughly to that adopted in the <u>Daily Treasury Statement</u> at the beginning of fiscal 1936. Under the first four main heads, "Legislative, Judicial, and Executive", "Civil Departments and Agencies", "National Defense", and "Veterans' Pensions and Benefits", the items fall without exception into the income-increasing category. It is only necessary to point out the total annual appropriations are transferred to the Government Retirement Fund and to the Adjusted Service Certificate Fund on the first day of each fiscal year, while expenditures from these funds are more or less evenly distributed over the year. One-twelfth of the annual appropriations on these accounts has been allocated to each month.

Payments of interest, classified under the heading "Debt Charges", have been considered as income-increasing, while debt retirements have been classified as non-income-increasing. The proceeds of such retirements are not likely to have been invested during the period under consideration. A special adjustment is required to give a more accurate picture of the effects of interest disbursements at fixed dates each year. Most holders of Government securities, financial institutions of various kinds, charitable institutions, corporations, trust funds, private holding companies, and the like, do their accounting on an accrual basis and adjust their expenditures accordingly. This practice results in a distribution of expenditures which probably corresponds roughly with the result obtained by taking one-twelfth of the annual interest charge on public debt as computed at the end of each month. For a period in which the amount of the public debt or the interest rates carried by Government securities are changing, this method gives a total for the fiscal year which differs from interest payments actually made, since the public debt and the rate of interest on it at the end of most months will differ from the average debt outstanding and the average rate over the month. Hence, at the end of the fiscal year it is necessary to adjust the monthly estimates by the percentage by which the total of the estimates differs from the actual total. Refunds of taxation have been considered income-increasing.

Under the heading "Recovery Relief" the activities of the Agricultural Adjustment Administration and the Commodity Credit Corporation are clearly income-increasing. The Farm Credit Administration presents some difficult problems. Of the agencies under its supervision, the Federal Land Banks and the Land Bank Commissioner are engaged primarily in refinancing private agricultural debts. The use of funds made available to private creditors in this way is so doubtful that they must be excluded from the list of pump-priming activities. The Federal Intermediate Credit Banks and the Federal Farm Mortgage Corporation lend to other Government agricultural credit agencies. The inclusion of such loans would obviously involve double counting. It must be remembered, however, that administrative expenses in connection with loans of both these types are on the same footing with other income-increasing expenditures. The salaries of their employees are as much a Government contribution to the flow of income as the salaries of other Government employees. The Federal Land Banks and the Joint Stock Land Banks, however, are exceptions. Since private investors furnish most of their capital, neither the loans nor the administrative expenses of these institutions are Government contributions to the national income. In the remaining agencies, Emergency Crop Loan Offices, Regional Credit Corporations, Banks for Cooperatives, and the Production Credit Associations, the Government is the principal source of capital (either as stockholder or as creditor), and the loans which they extend are fairly certain to be spent by the recipients not long after they are made. For these agencies both loans and administrative expenses are included.

Relief expenditures under the Federal Emergency Relief Administration, the Federal Surplus Relief Corporation, the Civil Works Administration, the Civilian Conservation Corps, and the Department of Agriculture, raise no important question of principle. The same is true of items under the heading "Public Works", where both grants, loans, and administrative expenses of the Public Works Administration, the Bureau of Public Roads, expenditures on Boulder Canyon, Rivers and Harbors, and a large number of minor items appear. Two new agencies, the Works Progress Administration, and the Rural Electrification Administration, will also be classified under this heading.

Under "Aid to Home Owners", purchases of Home Loan Bank stock are excluded from the income-increasing category. These institutions are rediscounting agencies for building and loan associations. In the circumstances of the period under consideration it is doubtful if the funds advanced in this way were expended on actual new construction. This is not to say, of course, that the activities of these agencies were not responsible in bringing about improvement in the general economic situation in other ways. The same is true of subscriptions to the preferred stock of Federal savings and loan associations. Most of the operations of the Home Owners Loan Corporation have consisted in refinancing privately-held mortgages. The uses to which private creditors have put cash or securities they have received in exchange for these obligations are uncertain. Here, as in other cases, we know that some spending on consumers' goods, and possibly a little spending on investment goods, took place, but the bulk of the funds must have been simply held idle or devoted by the mortgage holders to the repayment of <u>their</u> debts. In the absence of special information, no estimate of the resulting increase in income-creating expenditure can be made. The Home Owners Loan Corporation makes certain loans directly to home owners, however, for the payment of taxes and for necessary repairs, and these have been included in the income-creating expenditures. The other items under this heading also fall in this category. These include housing activities under the Public Works Administration, the expenditures of the Federal Housing Administration, and Subsistence Homesteads. The new Rural Rehabilitation Administration will also come under this heading.

Of the items under the heading "Miscellaneous", the Federal Deposit Insurance Corporation must be excluded since over half of its capital comes from sources other than the Treasury. The following types of loans made by the Reconstruction Finance Corporation must also be excluded:

Loans to financial institutions, except the Agricultural Credit Corporations, because in most cases such loans have been intended merely to increase the liquidity of the borrowing institutions.

Loans to railroads, because in most cases such loans have been used to repay private creditors, (in constrast to the loans to railroads made by the P. W. A.).

Loans on the assets of closed banks, because the bulk of such loans have probably been used to restore the private savings and working balances represented by the deposits involved in failures. Here again we know that some spending was done by the depositors of closed banks either immediately upon receipt of the dividend or over a period of time as programs of saving designed to rebuild the lost balances were abandoned, but there is no way of estimating these expenditures and our general rule must assign this case to the non-income-increasing category.

Loans and allocations made by the Reconstruction Finance Corporation to other Government agencies are properly accounter for by recording expenditures of those agencies. The remaining loans and expenditures of the Reconstruction Finance Corporation are properly considered as income-increasing, as are also the expenditures of the Export-Import Banks, the National Recovery Administration, and the Tennessee Valley Authority.

The trust funds administered by the Treasury are properly speaking not the property of the United States Government; nevertheless, the expenditures from most of these funds are controlled by policies laid down by the legislative or executive branches of the Government, and some of them have been built up very largely out of appropriations by Congress. Since the investments of these funds consist almost exclusively of Government securities, a part of their expenditures equal to interest on these investments has already been taken into account by the inclusion of interest payments on the national debt as a whole. The remaining part of the income of these funds consists of deductions from salaries of Government employees, gifts, etc., and a corresponding part of their expenditures merely restores to private incomes what has been taken from them in these ways. An excess of expenditures over receipts, however, represents a net addition to incomes arising from a decrease in the idle balances or other assets of these funds, and an excess of receipts over expenditures represents a net deduction from incomes resulting in an increase in the assets of these funds.

There remain a few items which have been treated by the Treasury as chargeable against the increment on gold resulting from reduction in the weight of the gold dollar, and therefore do not appear as expenditures from the general and special accounts. Of these the only one which needs special consideration is payment made to Federal Reserve banks for industrial loans. These may be considered as the Government share of loans made by the Reserve banks to provide working capital for private business enterprises, and as such they are income-increasing.

From the discussion above it should be clear that any coincidence of the income-increasing deficit and the reported deficit is purely accidental. It may be convenient to summarize the reasons why this is so. For any period the totals are likely to differ because of the exclusion from our computations of certain receipts and expenditures which affect the Treasury Statement. In any given month they may differ because of the adjustments of income tax collections and interest payments mentioned above, although totals of these items for fiscal years must agree with the Treasury figures. They may also differ because of the fact that our figures for the activities of some agencies which have independent accounting systems are taken directly from the accounts of those agencies, that is, the attempt has been made to take account of transactions between Government agencies and the outside public rather than between Government agencies and the Treasury.1/

It is the "income-increasing deficit" and not the reported deficit which measures the direct impact of Federal fiscal policy upon the economic situation. It follows that there is no necessary conflict between people who want the budget balanced simply because they feel that it is a good thing for the Government to adjust its expenditures to its income and people who

1/ This has not been possible in all cases.

want the Government to prime the pump of business activity. By selecting income-increasing types of expenditure and non-income-decreasing methods of raising revenue it is conceivable that a balanced budget could be maintained and at the same time a considerable stimulus given to business. People who want the budget balanced because otherwise "inflation" will result probably do have a fundamental quarrel with the pump primers, but they are in danger of expressing alarm at the wrong times. The situation is not necessarily "sound", in the sense in which they use that term, merely because the Government does not have to borrow; that is, an increase in the receipts of business men directly attributable to Government activity may be occurring at such times. On the other hand, no inflationary increase in the receipts of business men need occur at periods when the Government is borrowing heavily if the borrowing merely diverts funds from other uses and does not call new funds into existence, or idle funds into activity; or if Government expenditures merely enable the accumulation of idle balances by private holders.