more rather than less spending. Many economists assert that financing govern-
ment spending through deficits does bias the state of the business cycle.
... and the recent declines in the real purchasing power of wages and salaries to high levels of government spending, taxing, and persistent federal budget deficits. To the extent the general public associates federal spending with the current economic malaise, the perceived costs (measured in terms of disposable income) of not opposing federal spending programs rise. The average wage and salary worker is likely to become more vocal in his opposition to spending and taxing policies.

Moreover, the perceived costs to political interest groups and Congressmen of supporting such policies will rise. Defici-
ts, which may shift the costs of current federal spending to future generations, be-
... to the work of public sector employees. The Reagan administration is proposing to reduce federal budget spending since FY 1980. Many of the fastest-growing federal programs are also entitlement programs. Entitlement programs as unemployment compensation.

Economist Commentar y

The Reagan administration has set itself the herculean task of reducing the growth of federal spending. The administration plans to trim approximately $5 billion from the current budget for FY 1981. This includes an estimated $1.4 billion from FY 1982 budget. At the same time, the administration proposes to increase military spending and maintain basic services to the poor. The task of slowing federal spending is not insurmount-

The perception that spiraling government spending and persistent budget deficits have contributed to the current economic malaise provides a strong constraint against the in-
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automatically provide benefits directly to any person or state government that meets certain requirements set by the government. But federal spending, with its emphasis on national goals, is wasteful, politically difficult, and time-consuming. Unfortunately, no spending program is uncontrollable, and no budget has a life of its own. Congress, as stipulated in the Constitution, maintains the power of the purse. If federal spending is controllable, then what explains its relatively rapid growth, and what explains the recent dissatisfaction with this growth?

**LUXURY GOODS**

One reason why federal spending has been expanding relative to GNP may simply be that we want it to grow. Many government services are similar in some respects to "luxury goods." As standards of living rise, people are willing to devote a larger share of their incomes to such public services. Developed countries, for example, devote more resources than less-developed countries to such public goods and services as parks, space exploration, consumer information, environmental improvement, and advanced highways. In most respects the rapid growth of U.S. human resources spending, as measured by the net worth of middle- and upper-income families, is not related to income. Instead, the additional costs of providing public services are widely diffused and generally borne by all citizens, while the benefits are widely diffused and are obtained by all citizens.

Lobbying for Public Services

Most of the programs provided by the government are to be found among the consumption goods and services. Most of these goods and services are similar to goods and services produced in the private sector. If the government spends more on the same goods as the private sector, the result is that prices of goods and services provided by government are higher than those charged by the private sector. In some respects to "luxury goods"; as standards of living rise, people are willing to devote a larger share of their incomes to such public services. Developed countries, for example, devote more resources than less-developed countries to such public goods and services as parks, space exploration, consumer information, environmental improvement, and advanced highways. In most respects the rapid growth of U.S. human resources spending, as measured by the net worth of middle- and upper-income families, is not related to income. Instead, the additional costs of providing public services are widely diffused and generally borne by all citizens, while the benefits are widely diffused and are obtained by all citizens.

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automatically provide benefits to anyone or state or local government that meets re-

quirements set by U.S. law. Unless Congress is willing to change these arrangements, ra-

nally, politically difficult, and time-consuming pro-

cess—entitlement outlays in any given fis-

cal year are determined largely by the num-

ber of eligible recipients in that year. Entitle-

ment programs grew at a rapid 14.6 percent average annual rate between FY 1971 and FY 1985, and now account for 47.6 percent of total outlays over this period.

The budget, however, does not tell the whole story about the growth of the federal sector, because a significant portion of the government's business is not recorded in the budget. Beginning in 1971, for example, Congress rather arbitrarily moved some govern-

ment agencies "off-budget." So-called "off-budget" spending has grown enormously since that time, and is now estimated to be 34 percent of total spending in FY 1981. Moreover, the government spon-

sors many agencies, such as the Federal National Mortgage Association, and mortgage pools such as the Government National Mortgage Association's mortgage pool, which borrow and re-lend in the credit market. Gov-

ernment guarantees and the total amount of pools raised $48.7 billion from credit mar-

kets during FY 1980, or 11.8 percent of the total funds raised. Although such agencies technically provide credit to the private sector, if the government or part of the budget, they are similar to federal government agen-

cies in that their decisions are dictated by private markets to uses dictated through the political process. Federal govern-

ment services are part of the budget in a direct sense. Loan guarantees, however, are only re-
corded as federal budget expenditures if a borrower defaults on a guaranteed loan. In FY 1981, they were $6.3 billion, or about $32.4 billion, or 7.8 percent, of total credit-

market funds.

Moreover, inclusive of recessions, high unemployment, persistent inflation, and a growing proportion of retired persons, have been identified as contributing factors, seemingly uncontrolled growth of the fed-

eral sector in general and entitlement pro-

grams in particular. These factors explain

why federal spending has grown over the past ten years; why it sometimes grows in excess of budget projections; and why it is at times very difficult to reduce expenditures. Never-

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"LUXURY GOODS"

One reason why federal spending has been expanding relative to GNP may simply be that our society wants more government ser-

vices. Many government services are similar in some respects to "luxury goods," as stan-

dards of living rise, voters are willing to de-

vote a larger share of their incomes to such public services. Developed countries, for ex-

ample, devote more resources than less-devel-

oped countries to such public goods and ser-

vices as parks, space exploration, consumer information, environmental improvement, and advanced highway networks. In many respects the rapid growth of U.S. human services is tied to the results of the finite tax-

ation process. It is much easier to redistribute income when the average level of real dis-

posable income is low, and when income is low or falling. When incomes are rising,

transfers can be made without a reduction in the net worth of middle and upper-income groups, this is not true when incomes are fall-

ing. According to this luxury-goods view of government services, one should not be sur-

prised if the ratio of GNP devoted to human-resources spending (or to government) in general) rise as GNP grows. Although there is a limit to the share of GNP that Americans will vote to devote to the government sector, many European nations have signific-

antly larger government sectors than the United States.

Private Sector vs. Public Sector

Even if one accepts the luxury-goods view as a partial explanation for the growth in

government spending, there are reasons to believe that the amount of goods and services that the public sector provides will exceed the amount the private sector would provide if the private sector produced these same goods and services. In government, there is an in-

herent bias toward large budgets. In competing for profit, private-sector firms offer goods and services at a per-unit price that meets the wants of the customers. Individuals only purchase goods and services if the price does not exceed their subjective evaluation of the item's worth. Those who do not buy an item generally do not consider it worth the price from its consumption. In addition, the desire for profits, together with the fact that con-

sumption is less at the margin than production, gives the firms a strong incentive for firms to minimize pro-

duction costs.

Lobbying for Public Services

Most of the services provided by the govern-

ment to its citizens are not provided by the private sector. Social-Security payments benefit retirees, health-care payments those older than sixty-five. Food-stamp benefits benefit the poor, and trade re-

form to the amounts that each person con-

sumes or the benefits that each enjoys. Some services, such as national defense or disaster relief, are public goods. The benefits of public goods are widely available, many pro-

duction functions are spread widely across the country or group of citizens. Because governments cannot, by definition, limit participation via a price mechanism. Such services, such as national defense or public housing, are useful because they provide public goods and services they provide, consumption does not generate additional revenue. Because govern-

ments do not limit participation via a price me-

chism, more government spending actions from political interest groups to promote their causes. They lobby Congress, ex-

panding public services attempts to generate pro-

fits; the salaries earned by agency heads or manage mist are not related to profits. In-

stead, salaries, prestige, and political power of the bureaucracy are the determining factors in the size and scope of programs. If public goods and services could be produced in the private market, a profit-maximizing firm would produce at point A on chart 1. In con-

trast, a budget-maximizing government agency would produce up to point B. In the shaded area of chart 1, the incremental costs to society of expanding a program exceed the additional benefits. A private firm would go out of business and provide fewer. Government-agency heads are more closely tied to political interests often greatly exceed the cost of not providing the public service. Moreover, even if all groups generally agree on the need to cut government spending, each group naturally seeks to protect its own pro-

grams. No group is interested in the possibility of exodus of individual costs, interest groups may have little incentive to pay any taxes, including social-security and income taxes, for example, example to only $1.50. A group of interest groups can increase the size of a political coalition until the addi-

tional costs of trading support exceed the benefits of doing so. Together these issues mean that the political process seem bias federal spending upward. This bias does not exist in a competitive market. The additional benefits of such government services, however, are not borne by the beneficiary groups alone, but are more widely diffused through the tax sys-

tem. Often individuals who stand to benefit from government actions form political interest groups to promote their causes. They lobby Congress, ex-

panding public services in general) rise as GNP grows. Although there is a limit to the share of GNP that Americans will vote to devote to the government sector, many European nations have signific-

antly larger government sectors than the United States.

1. The government may establish certain eligibility requirements, such as being unemployed; however, all individuals who meet those requirements. The government does not limit participation via a price mechanism.

automatically provide benefits to any person or state or local government that meets re- quirements set by U.S. law. Unless Congress is willing to change these programs, pri- vately, politically difficult, and time-consuming process—entitlement outlays in any given fis- cal year are determined largely by the num- ber of eligible recipients in that year. Entitle- ment programs grew at a rapidly 14.6 percent average annual rate between FY 1971 and FY 1985, and now account for 47.6 percent of total outlays over this period. The budget, however, does not tell the whole story about the growth of the federal sector, because a significant portion of the government's business is not recorded in the budget. Beginning in 1971, for example, Congress restructured many existing govern- ment agencies "off-budget." So-called "off-budget" spending has grown enormously since that time, according to estimates available in FY 1981. Moreover, the government spon- sors many agencies, such as the Federal National Mortgage Association, and mortgage pools such as the Government National Mortgage Association's mortgage pool, which borrow and rely in the credit market. Gov- ernment sponsored agencies, such as mortgage pools raised $48.7 billion from credit mar- kets during FY 1980, or 11.8 percent of the total funds raised. Although such agencies technology, they do not have the same control over the government or part of the budget, they are similar to federal government agen- cies in that they are directed by decision-makers dictated by private markets to use dictated through the political process. Federal govern- ment agencies do not have the same incentive as effect. Loan guarantees, however, are only re- corded as federal budget expenditures if a borrower defaults on a guaranteed loan. In FY 1980, the government lent $32.4 billion, or 7.8 percent, of total credit- market funds. Many spending decisions, including recessions, high unemployment, persistent inflation, and a growing proportion of retired persons, have been identified as contributing to the rapid, seemingly uncontrollable growth of the fed- eral sector in general and entitlement pro- grams in particular. These factors explain why federal spending has grown over the past ten years; why it sometimes grows in excess of budget projections; and why it is at times very difficult to reduce expenditure. Never- theless, no spending program is uncontrol- lable, and no budget has a life of its own. Congress, as stipulated in the Constitution, maintains the power of the purse. If federal spending is controllable, then what explains its relatively rapid growth, and what explains the recent dissatisfaction with this growth? "LUXURY GOODS" One reason why federal spending has been expanding relative to GNP may simply be that our society wants more government ser- vices. Many government services are similar in some respects to "luxury goods" as stan- dards of living rise, voters are willing to de- dicate a larger share of their incomes to such public services. Developed countries, for ex- ample, devote more resources than less-develop- ed countries to such public goods and ser- vices as parks, space exploration, consumer information, environmental improvement, and advanced highways. In many respects the rapid growth of U.S. human- itarian transfers, for example, as a proportion of the Luxembourgization. It is much easier to redistribute incomes when the average level of real dis- parity is low than when it is high or falling. When incomes are rising, transfers can be made without a reduction in the net worth of middle and upper-income groups, this is not the case when incomes fall- ing. According to this luxury-goods view of government services, one should not be sur- prised to see the share of GNP devoted to human-resources spending (or to government in general) rise as GNP grows. Although there may not be a close correlation to the share of GNP that Americans will devote to the government sector, many European nations have significa- ntly larger government sectors than the United States. Private Sector vs. Public Sector Even if one accepts the luxury-goods view as a partial explanation for the growth in government spending, there are reasons to believe that the amount of goods and services that the public sector provides would not increase in excess of private sector would provide if the private sector produced these same goods and services. In government, there is an in- terest bias toward large budgets. In competing for profit, private-sector firms offer goods and services at a per-unit price that reflects the costs to society. Individuals only purchase goods and services if the price does not exceed their subjective evaluation of the item's worth. Those who do not buy an item generally find a substitute. The incentive to provide new products is strong once a consumer. In addition, the desire for, profits, together with the fact that con- sumers find it difficult to live on less at the margin, would likely be a strong incentive for firms to minimize pro- duction costs. Other government services provided by governments are potentially available for con- sumption by all citizens, and the costs also are borne by all taxpayers, but not in relation- ship to the amounts that each person con- sumes or the benefits that each enjoys. Other government services, such as elemen- tary and secondary education, do not neces- sarily benefit all individuals, but the govern- ment excludes no one from participating in the benefits. Because government does not, or can not, charge a unit price for the goods and services they provide, consumption does not decline when incomes fall. In other words, government redistribution maintains the benefits derived by society. More- over, while governments may attempt to minimize the costs of providing public goods and services, the absence of a competitive incentive eliminates the ultimate incentive to do so.

In the absence of a market mechanism, governments rely on a political mechanism to determine the amount of public services and to allocate their costs. In the United States this function is performed at the na- tional level through the leadership of the executive and legislative branches. Metro- politan Budget Making: The Peculiar Economics of Budgetary.
more rather than less spending. Many economists assert that financing govern-
ment spending through deficits also biases the market toward undervaluing
the burden of paying for current expenditures is shifted forward to future generations
that would redeem or service the debt. The ability of firms or individuals to borrow
in this manner is limited by their current and prospective net-worth posi-
tions, but such constraints do not apply to the U.S. government in any practical
sense. While the total amount of funds available in credit markets at any partic-
ular time is limited, the market views Treasury debt as virtually risk-free. Conse-
quently, the Treasury is a preferred borrower, and always finds a ready
market. If the Federal Reserve is unwilling to accommodate Treasury borrowing, pri-
vate borrowers may be squeezed when funds are scarce.
Prior to the 1960s, deficit finance was usually associated with periods of war or
business recession. Since the late 1950s, however, Treasury borrowing to finance deficits
has become increasingly common. In fact, since FY 1960, the budget has been in sur-
plus only twice. Over this period, deficits often have shown no tendency to narrow as the
economy approached full employment. Consequently, new Treasury borrowing from the public has increased from an average of 1.3 percent between 1955 and 1959 to 19.0
percent between 1975 and 1979. In addition, the federal government’s tax and transfer-pay-
ments were rapidly shifting real purchasing power from wage and salary earn-
ers to transfer recipients. After-tax wages and salaries, adjusted for inflation,
became declining in the second quarter of 1979, while transfer income, which is
automatically adjusted for inflation, grew rapidly (see chart 2). The divergence intensi-
fied through the election year.
The public—rightly or wrongly—seems to link inflation, lagging productivity growth,
and the recent declines in the real purchasing power of wages and salaries to high levels of
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The perception that spiraling government spending and persistent budget deficits have contributed to the current economic malaise provides a strong constraint against the in-
herent bias in government toward bigness. Today’s climate favors a significant reduc-
tion in federal budget growth.

Trimming the Budget

Concern for the expanding size and scope of the federal government is not a new phe-
nomenon; in fact, it is practically part of the national heritage. Nevertheless, criticisms about the growth of federal spending have been unusually vehement in recent years. By the late 1970s, the economic malaise of high inflation, lagging productivity growth, and large wealth transfers to foreign oil pro-
ducers brought real income growth to a halt. Tax burdens, however, continued to rise as inflation pushed individuals into higher tax brackets. Personal income taxes equaled 15.5 percent of personal income in 1979, a sharp increase from 15.0 percent in 1978 and 13.4 percent in 1975. Moreover, the federal government’s tax and transfer-pay-
ments were rapidly shifting real purchasing power from wage and salary earn-
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The Reagan administration has set itself to the herculean task of reducing the growth of federal spending. The administration plans to trim approximately $5 billion from the current budget ($71 billion to $66 billion) from FY 1980 to FY 1982. The

The Federal Sector

Despite repeated attempts to curb federal spending, it has grown as it propelled by its own momentum. Between FY 1970 and FY 1980, for example, federal expenditures, as measured in the budget, grew 11.5 percent per year on average, and the ratio of federal spending between FY 1970 and FY 1980 is attributable to expenditures for hu-
man resources. Aid to state and local govern-
moments, interest payments on federal debt, and expenditures for national resources, environ-
ment, and energy also have grown rapidly both in absolute terms and relative to total government spending since FY 1970. Federal expenditures for the fastest-growing federal programs are also entitlement programs. Entitlement programs

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more rather than less spending. Many economists assert that financing govern- 
ment spending through deficits also biases the outlays upward, because of the burden of paying for current expenditures is shifted forward to future generations that would redeem or service the debt.

The ability of firms or individuals to borrow in this manner is limited by their current and prospective net-worth positions, but such constraints do not apply to the U.S. government in any practical sense. While the total amount of funds available in credit markets at any particular time is limited, the market views Treasury debt as virtually risk-free. Conse- quently, the Treasury is a preferred borrower, and always finds it easy to accommodate. If the Federal Reserve is unwilling to accommodate Treasury borrowing, private borrowers may be squeezed when funds are scarce.

Prior to the 1960s, deficit finance was associated primarily with periods of war or business recession. Since the late 1960s, however, Treasury borrowing to finance deficits has become increasingly common. In fact, since FY 1960, the budget has been in surplus only twice. Over this period, deficits often have shown no tendency to narrow as the economy approached full employment.

Consequently, new Treasury borrowing from the public has increased from an average of 1.3 percent between 1955 and 1959 to 9.0 percent between 1976 and 1979 and 13.4 percent in 1975. Moreover, the federal government’s tax and transfer-pay- ment systems were rapidly shifting real purchasing power from wage and salary earners to transfer recipients. After-tax wages and salaries, adjusted for inflation, began declining in the second quarter of 1979, while transfer income, which is automatically adjusted for inflation, grew rapidly (see chart 2). The divergence intensified through the election year.

The public—rightly or wrongly—seems to link inflation, lagging productivity growth, and the recent declines in the real purchasing power of wages and salaries to high levels of government spending, taxing, and persistent federal budget deficits. To the extent that the general public associates federal spending with the current economic malaise, the perceived costs (measured in terms of disposable income) of not opposing federal spending programs rise. The average wage and salary worker is likely to become more vocal in his opposition to spending and taxing policies. Moreover, the perceived costs to political interest groups and Congressmen of trading support on various programs will rise. Defi- cits, which may shift the costs of current federal spending to future generations, be- come less attractive when the public associates deficits with current economic prob- lems. Moreover, the public will be more willing to reduce those federal programs that are luxury goods when its purchasing power is being strained.

The perception that spiraling government spending and persistent budget deficits have contributed to the current economic malaise provides a strong constraint against the in- herent bias in government toward bigness. Today’s climate for defending budget cuts, while weak economic activity is being strained.

Economic Commentary

The Reagan administration has set itself to the herculean task of reducing the growth of federal spending. The administration plans to trim approximately $5 billion from the current budget (FY 1981) and approximately $41 billion from the FY 1982 budget. At the same time, the administration proposes to increase military spending and maintain basic services to the poor. Although the task of slowing federal spending is not insurmountable, it is a national reaction. In addition, the Reagan administration is proposing budget cuts, while weak economic activity is automatically increasing expenditures in such areas as unemployment compensation.

This Economic Commentary discusses the seemingly uncontrollable growth of federal spending. It asserts, however, that no budget expenditure is uncontrollable in any but the narrowest, and misleading, sense of the word. Instead, this Economic Commentary argues that growth in federal expenditures toward “more” rather than “less” spending. This bias stems from a large number of factors that are institutional, political, and eco- nomic in character. At root, however, is the need to provide public services through a non-price, political system. The process focuses attention on benefits that usually are not necessarily those of the Federal Reserve System.

Does the Federal Government Spend Too Much?
by Owen F. Humphage

The Federal Reserve Bank of Cleveland February 9, 1981

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The increasing reliance on deficit finance since the late 1950s has been explained in terms of simultaneously growing acceptance of Keynesian economics, which legitimized the use of deficit spending for countercyclical management of the economy. In addition, in the mid-1960s, the supply-side policy shifted to minimizing GNP at its potential, or full-market level instead of balancing the budget over the business cycle. In a dynamic economy, po-