ECONOMY IN GOVERNMENT SPENDING: THE CONCEPT

C. Lowell Harriss, associate professor of economics, Columbia University

The literature on government spending—official, academic, and popular—contains relatively little discussion of the concept of efficiency or economy. Theories about the meaning of “economy” are implicit in the terms of reference, in the method of approach, or in the coverage of the special commissions that seek greater efficiency. Also largely implicit rather than clearly defined are the concepts of economy which underlie the normal workings of the budgetary process (conceived most broadly). The writings of economists, so far as I am aware, give the problem little explicit attention. Yet in a world where governments have the role they do today, efficiency in government spending has an importance that calls for our best intellectual efforts.

THE GENERAL CONCEPT OF ECONOMY (EFFICIENCY)

Economizing is the process of getting good (better) value or, essentially the same thing, higher efficiency; success is achieved when the use of resources yields the best result possible. The crucial element is a relationship between (a) what is used up and (b) what is received, i.e., between input and output. Only when one compares this relationship can one study economizing.

A reduction in expenditure is not necessarily a move toward economy; perhaps the loss of output is even greater. In fact, one persistent fallacy in discussions of government economy is an assumption that not spending is economy; a person terminating his expenditure on food would find himself with more money to starve—not my idea of economy. On the other hand, an improvement in accomplishment which yields something highly desired is not necessarily evidence of greater efficiency; the cost may have been excessive.

There are some other things that are not necessarily guides to economy. The recent concern over the size of the budget totals as such, for example, seems to me misplaced. A rising or falling expenditure trend, in itself, gives no indication of efficiency. No per capita figure, no percentage relationship to national income, no comparison with another era or another land—no such measure—can res...
veal whether spending is economical. Such figures do not compare what we get with what we pay.

The inputs of a business or a government are resources, human time and effort, materials, the use of equipment. In most cases they have money prices; consequently, a reasonably reliable money measure of cost is available. In a more fundamental sense cost is the best alternative sacrificed; money measures may not indicate the complete worth of the alternatives sacrificed. Consequently, a look beyond money figures is needed if costs (inputs of any economic process) are to be measured fully. Yet these more fundamental measurements are rarely feasible; for the most part we assume that people spending their dollars freely take as good account of alternatives as an imperfect world permits. Where compulsion rather than free market choice determines—and this is characteristic of the way governments get funds—there is a presumption that dollars do not give an accurate measure of the worth of alternatives sacrificed. Yet I know of no way to allow for distortions in cost measurement that result from compulsion.

Still greater difficulty arises in measuring outputs of government. The procedure used in national income accounting (valuing output precisely at money cost, i.e., treating input and output as identical in money value) is utterly inappropriate for judging economy and efficiency. Yet there is no other simple or precise measure of output. Therefore, government spending presents a strikingly different problem from that of either business or family spending.

Business has a tangible measure of output—the dollars customers will pay; these dollars are just like the dollars in which costs are paid; comparison of inputs and outputs is easy (except as gaps in time separate them). Families as ultimate consumers draw upon immediate and direct experience to make their judgments of the worth of spending. What the public gets from government expenditure varies from indispensable elements of existence itself to services of insignificant worth, perhaps even positively harmful. What are these varied outputs worth? And what about outputs that could be obtained from more or different spending? Some might be worth a great deal more than they would cost, but so long as they are not "purchased" we have little basis for judgment. The difficulties of measuring outputs create the chief obstacle to applying the traditional economic or business concept of efficiency in government affairs.

**IMPROVING METHODS OF OPERATION**

Yet there is a level at which the problem of efficiency can be studied and mastered without raising the more difficult issues. Here we see the most readily understandable concept of economy. It involves choice of methods of achieving immediate, specific objectives. The objectives ordinarily involve operation—heating a hospital, processing a voucher, dredging a channel, building a barracks. The thing to be

---

3 Government spending which transfers command over resources rather than uses them to create goods and services presents problems treated later. The definition of "government expenditure" is in fact much more complex than may appear. See C. Lowell Harriss, Government Expenditure: Significant Issues of Definition, Journal of Finance, December 1954, pp. 351-364.

4 Not all the objectives businesses and businessmen seek through profitmaking activity are sold in the market. The pure exceptions raise problems very like those that characterize government spending.
ECONOMIC GROWTH AND STABILITY

accomplished has been decided upon and defined with considerable precision. Then the reasonably possible methods of achieving it can be compared and the cheapest selected. The problem may closely resemble one which business firms face; their solutions can be extremely helpful. So can the solutions of other governments.

This approach, the application of businesslike methods, has helped improve government efficiency. (A change in operating methods to cut spending may also change the accomplishment; if the output is better, the desirability of the change clear; if accomplishment suffers, the wisdom of the change is very much harder to judge.) Frequently, the use of business methods will require at least a temporary increase in outlays, such as for mechanization; spending more saves money later. So much government spending is on wages and salaries that improvement in personnel policies (in the broadest sense) may offer the greatest challenges to those striving for more efficiency. Promising opportunities for bettering methods lie ahead, I suspect. However, in view of the determined efforts of recent years, I should be surprised if the application of business methods offers promise of great improvements in efficiency at the Federal level except as better methods are devised in business; Members of Congress are in a better position than I to judge the possibilities. Yet, as has been pointed out so often, the big problems lie elsewhere, in the formulation of programs.

Before passing to the larger issues, however, it is wise to note some issues which may confuse the choice of one as against another operating method.

A government spending program may seek mixed objectives. Consequently, a businesslike method that is best for getting one part of the objective, perhaps the dominant one, may need to be discarded because it is ill suited for another. One thinks of the Walsh-Healey Act, the requirement that United States ships be used for transporting a portion of foreign-aid cargoes, the desire to channel procurement orders to depressed areas, or “Buy American.” One also thinks of our desire to prevent corruption, dishonesty, personal favoritism—the “spoils system”—even at the sacrifice of flexibility and speed. A systematic survey of Federal spending policies would probably reveal many examples of mixtures of objectives which influence operating methods. All the objectives may be worthy. That is not the point here. The point is that combination of objectives may impede the choice of the least expensive operating method of achieving the main goal. Even worse, the “mixing” adds difficulty in identifying the method which will give the best combined result.

Difficulty in finding and using the cheapest method of achieving a stated objective also arises from government methods of accounting for capital items.6 If spending projects provide services over different stretches of time, or if projects involve costs that extend over varying periods, judgments of economy can be reliable only if an appropriate interest (discount) factor is used. The choice of an appropriate

---

6 Successful businesses sometimes use different methods for performing an essentially similar function. The business world will not always contain one procedure which all recognize as best.

6* Developments since I last studied this problem may have altered some of the problems described here.
figure is itself a matter for debate. Yet the essentiality of including the calculation in decision making is (or ought to be) beyond dispute.

A second problem of capital accounting is depreciation (including obsolescence). The traditional method of treating capital spending plus maintenance as current expense and ignoring depreciation may give tolerably good results for the budget as a whole, though I have great doubts. For individual projects, such a method is certainly not the best man can devise. The treatment of capital expenditures on long-lived projects as current outlays on the same basis as payment for labor services yielding only momentary worth (delivery of today's mail) must distort judgments on the wisdom of capital outlays. The concept of economy in executing programs ought to include allowance for depreciation. Differences between leasing and ownership must sometimes complicate measurement of efficiency.

The problem of tax exemption also arises in evaluation of one as against another method of achieving a social objective. This country has chosen to get much of the money for financing government from businesses, or more generally, from the process of creating income. Taxes are a significant element of cost for most productive organizations (creative activities). An activity that does not need to include expense of government as a cost will appear to operate more cheaply than activities which do pay taxes; yet the apparent "saving" is not a reliable guide to economy.

A less generally recognized aspect of the tax problem as it bears upon comparisons of efficiency arises from tax exemption as a substitute for expenditure. Seeking an objective that requires use of resources, Congress may rely on some form of tax exemption. Occasionally, perhaps, the taxes that might otherwise be collected can be determined to provide a good index of cost; I can think of no case, however, in which the cost is treated along with dollar outlays as an expense of government.

Appraising the efficiency of guaranties and insurance as devices for achieving objectives presents other perplexing problems. Without either an outlay or a sacrifice of revenue, government can perhaps bring changes in the private economy. Yet how much guaranty (or insurance) will produce how much result? and what kind? Moreover, there is the chance that sometime the Treasury may be called upon to make cash payments to cover losses. But how much? Business concepts of economy cannot really be applied to evaluate "operating" methods in such cases.

---

8 The rate used should probably be that for which Government can borrow freely in the market for a period equal to that of the services and costs involved.
9 A third problem, the treatment of loan transactions, would be discussed in a more complete study.
10 For this purpose, the provision of housing services, through rental or owner occupancy, is a form of income creation. The chief tax is the local property tax.
11 In trying to improve the Nation's transportation system, for example, we still fail to solve the problem of differences between forms of transport which cover less than they cost (airlines not paying all expenses of terminals), those which pay approximately their cost (some trucks), and those (railroads) which, in addition to paying their own expenses, contribute to the treasuries of local, State, and the National Government for nontransportation functions. In trying to improve communication, comparison of the postal and telephone systems should take account of the widely different tax treatment.
12 Accelerated amortization is even more difficult to appraise than tax exemption. The interest lost to the Treasury from the tax deferment cannot be determined when the decision to grant rapid amortization is made. Nor can we judge how much will be accomplished that would otherwise not be done.
13 The history of "606 housing" insurance suggests that all results of a well-intentioned policy are not desirable. Perhaps generous provisions for guaranty and insurance of home mortgages, by stimulating demand, have raised land prices and building costs; if so, some of the basic objectives were partially defeated. How could one, then, judge the efficiency of the Government's methods for getting the results it sought?
Costs: Conceptual Issues Involved in Judging Efficiency

Dollars raised by either taxes or government borrowing do not necessarily give an accurate measure of the worth of sacrificed alternatives. Some of the problems involved are inherently insoluble, but there is point in understanding them.

Most taxes are compulsory contributions, clear or hidden. They exist because of the approval (or the absence of strong disapproval) of representatives of a majority of the voting public. Yet even casual familiarity with the process of tax legislation should leave no doubt that the total an individual pays can be quite different from what would represent his freely but responsibly and conscientiously made judgment of his proper contribution. His marginal taxes—whether in a high personal income bracket, a tax on business earnings that is a cost of what he buys or a reduction of his income, or an excise tax—may or may not seem more desirable than some (marginal) government services. Few if any of us, I suppose, could make such a calculation for ourselves. How can we (our representatives) do so for others? How validly can any vote of taxes—forcing payment even from those unable to vote or voting in opposition—reflect the worth of alternatives sacrificed?

Some resources in private hands undoubtedly serve purposes of slight usefulness. To take them in taxes is to impose little sacrifice of a truly desirable alternative. The fact that this situation undoubtedly exists has been used to justify some (a large amount of) high bracket rates even when there is no basis for determining how much of the money collected will actually come from such sources. Yet it is wrong, I think but cannot prove, to attempt to justify any significant amount of government spending on the grounds that payment can be made with tax dollars that impose slight cost on the taxpayer. Still less justification exists for implying that we know which dollars have such low cost.

Taxes impose a type of cost unlike that of prices. This cost results from tax-induced distortion of economic (and social) life. The individual (or business), with some exceptions, gets the same services whether or not he (it) pays a Federal tax. Any one person's or firm's failure to pay tax brings no loss of government service. This situation contrasts with market transactions in which the product or service can be obtained only if the price is paid. Consequently, the incentives to escape taxes are quite different from those to avoid paying prices. The escape (evasion or avoidance) requires time and effort, costs which are largely pure waste for the economy; in addition, the escape will often involve choice of actions less desirable than one would otherwise choose. The allocation of resources becomes somewhat less efficient. Sheer losses to the economy result, but losses which cannot be measured.

---

246  ECONOMIC GROWTH AND STABILITY

Revenues from charges are more likely to measure the worth of sacrificed alternatives tolerably well.

Unlike many State and local taxes, Federal levies are not the result of constitutional or charter provisions that decisively limit the freedom of the voting public. Yet the dead hand of the past has powerful influence. Congress, the administration, and the courts cannot in fact make frequent, large revisions in the revenue system.

The cost of administering some taxes may be less than that of charging prices.

When tax rates are moderate, such distortions are insignificant; when rates are high, the losses, while not large in the national accounts, may be more than insignificant in relation to the revenue from the top rates. Some dollars the government gets may cost the economy very much more than the average.
What the Treasury pays for funds obtained by borrowing may represent a good measure of sacrificed alternatives. This is probably true of proceeds of loans sold in open competitive markets when information is compete and no appeals to patriotism or other such considerations sway decisions. To the extent that sentiment or ignorance influences the loan terms, however, the expense to the government may represent a less good measure of cost than might be obtained. When the loan is compulsory, as in the case of social security, how can one judge cost? A person compelled to lend to the Treasury for 2 percent when he is paying, say, 6 or 12 percent on his own (marginal) borrowings may in a significant sense be incurring a greater cost than the Treasury pays.

A still clearer departure of apparent money cost from the worth of sacrificed alternatives arises when borrowings come from the banking system, especially in times of substantial unemployment. Little or no sacrifice of desired alternatives may then be required. At this point we have reached more complex considerations than my space permits me to examine.

The upshot of these comments on cost seems to be that tax dollars are likely to impose sacrifices worth somewhat more than the dollars suggest, especially when tax rates are high. So will compulsory borrowing. Finally, conscription and other compulsion will likely involve costs above those shown in the Treasury’s figures.

Attainments: Goods and Services

Now we return to the heart of the problem, the need to evaluate what is or might be obtained. Here is the task of program formulation. It involves two essentially different kinds of outlays: (a) Spending to get goods and services (national defense, postal services, tax collection); and (b) transfer spending (welfare, subsidies to farmers). The first buys goods and services which are thereby taken from other uses; government use imposes real sacrifice, real cost. Transfers, however, do not use up resources (except for the relatively minor expense of administration); they do not take productive capacity from other uses to create government output.

How much benefit does society get from an element of government spending that yields goods or services? The gains may be incalculable in the sense of being great beyond measure. Almost always the results (good or bad) are incalculable in the sense of not being measurable. Rarely can fruits be evaluated with anything like the precision with which a business can value what its spending programs bring. It is even harder to envision accurately the gains from spending programs that might be but are not being made. The difficulties are likely to create a sense of frustration. Yet we must do something.

The start is to define objectives, both ultimate and immediate, as clearly as possible. What constitutes a better life? Peace, victory, personal freedom, to be liked abroad, reduction of poverty, health, the development of human personality and opportunity, justice, equality before the law—so goes the list of things most of us want, things that seem basic. Then one faces the choice of more

17 The two groups are not sharply distinct.
instrumental objectives, desirable as means to help achieve the basic ends. Some of these instrumental objectives may (or must) be sought through government spending. Much of the analysis of objectives at both levels is intuitive. We cannot have all we want; so we must choose from among a host of good things. Few of us as individuals, I suspect, can measure and balance basic values to our own satisfaction. Doing so as a group is even harder.

Confusion of instrumental objectives with those that are more fundamental is a recurring source of difficulty; means get mixed with ends. Success in achieving some specific goal this year—new knowledge about disease or improvement in recruiting Foreign Service officers—may be a fine move toward a more basic goal—better health or diplomacy. Yet this year's success may only conflict with the achievement of a more basic objective. The low-interest rate policies of the late 1940's and more than one feature of agricultural policy seem to me examples; failure to raise salaries of senior civil servants may save money now but cost heavily in longer run quality of government services. Moreover, it is not economical to do efficiently something desirable if the accomplishment of something still more important becomes harder as a result.

The definition and redefinition of objectives, fundamental and instrumental, must be a continuous process if we are to make the wisest decisions. In a dynamic society both needs and opportunities change. Economy requires more keeping up to date than we may think. Enough modernization of goals to prevent the continuation of serious waste—including waste in the form of failure to take advantage of new spending possibilities that offer more than they would cost—is difficult in a world where so many things press for attention.

Choice of objectives would be easier if the public had clear knowledge of its wants in order of priority. Unfortunately, however, the world is too complex for public opinion to be clear on more than the broadest matters. We must rely upon our elected representatives (and, in my view, the civil service). One of the greatest of the difficulties they face is the identification of the general public interest.

Government undertakes a spending program because the public as a whole will benefit. Unless there is such a paramount general concern, the use of public funds is not justified. Or so it seems to me. Yet the total gain from any program will include some more or less specific benefits; not all individuals will be affected equally. Those aware of greater benefits—from this dam, that research, or any military installation—are likely to press for the spending more insistently than the average person. There may, in fact, be a bias against general benefit spending in favor of that for special interests; the strongest pressures do not necessarily—even "in theory"—reflect what will best serve the general interest.

Another factor adds confusion. The many elements of our society are so interdependent that the prosperity of one influences that of

---

20 The analysis will involve the question, "If this goal is one people in general want, why will the free market not provide the means to reach it if the worth exceeds the cost?"

21 Federal-State local rivalry for funds may offer examples. Many localities, I suspect, spend less on schools than they would if Federal spending (and taxes) were lower. Some of the Federal spending may be done efficiently, but on projects less important than additions to school facilities.

22 Programs financed by charges on the user constitute exceptions.

23 Although this view has been dominant in the legal and scholarly writings, the "man in the street" might not hold to it strongly.
Consequently, groups press for government spending to bring them special benefits; they rest their plea on the claim that the public as a whole will benefit; this general benefit is to come not from the products or services created but from the diffusion through the economy of secondary benefits which result from the improved position of the special groups.\(^2\) The pressure on Congress to vote for spending on the basis of special, rather than the general public, interest must complicate the determination (as well as the achievement) of what is most economical. The relative persuasiveness of special interests is not necessarily proportionate to the contribution of their programs to the general public interest.

Up to this point we have shown, I hope, that economy in spending requires knowledge of \((a)\) what the public wants (developed to a rather refined degree) and \((b)\) what specific programs do contribute, not in their totality but to the general interest.\(^3\) Our ability to judge what the goods and services really do provide will vary. Newer budgetary procedures help focus on this problem, but they cannot yield all the answers we should like about what the public is now getting.\(^4\)

The most serious problems arise, I suppose, in protective functions. This is true not only because the amounts are so large but also because the strength of the thing to be protected against (the physical capacity and the willingness to use it) is unknown.\(^5\) In the case of national defense, the ideal minimum and maximum expenditure would seem to be the same—the amount that will just prevent the need to use force actively. Not knowing what this amount is, however, Congress will act economically in providing a margin over what appears essential; the losses can be so tragic that the risk of error which might bring war cannot be assumed. (Yet other outlays—on foreign service, information, foreign aid—also influence the amount of our need for defense spending.) Success may appear as waste, perhaps sheer extravagance. The whole concept of economy in protective (defense) spending bristles with difficult problems, to say nothing of those that arise in implementing a program.

Each of the other major categories of Federal spending presents its own problems of relating \((a)\) what the public wants to, \((b)\) what actual (and possible) spending does accomplish. The specialized papers presented later will doubtless do much to illuminate the issues—how Congress has come to decide what the public wants, how money is spent, what the results are, and perhaps what might be gained from greater spending.

One more point. The use of government as an agency to achieve objectives offers a way to serve the public interest where individuals and voluntary associations will do nothing or too little. Sometimes such spending can, as it were, tip a balance or fill a gap and thereby stimulate private activities that are highly desirable. Outlays to pro-

\(^{2}\) The hurt to the general public from the necessary taxes is likely to be ignored except as some other group may point out the connection.

\(^{3}\) To the extent that a program is paid for by charges on users or beneficiaries, the general interest criterion does not necessarily apply.

\(^{4}\) It is my impression that as a rule the budget process throws little light on what might be obtained from programs not in operation or even from bigger outlays on existing programs.

\(^{5}\) Spending for research, inquiry into the unknown, presents problems that in some ways are more perplexing than those of protection. It is inherently impossible to know what can be obtained until the job is done.
mote competition or expand knowledge are two widely different examples. Spending of this sort can have a powerfully multiplying effect; it may induce or force a mass of private activity into more productive channels. In the case of economic growth there are important examples.

ATTAINMENTS: TRANSFER EXPENDITURES

The concept of economy in transfer spending has received less attention than the growth of such spending would seem to require. The recipient's benefit may be substantial, a dollar for every dollar received. Often, he makes no sacrifice of desirable alternatives to get it. Sometimes there is sacrifice but of minor nature only. Normal "economizing" forces do not motivate the recipient in limiting his "demand."

What is the general public benefit? It is rarely tangible, not even as clear as better courts, cheaper food, or less congested transport. What the public gains is membership in a society some of whose members are in better situations than otherwise. The result may be a true benefit to the general public. The gain is hardly measurable, however. And who really bears the burden? One cannot be sure there is net gain until costs and fruits are compared. The diffusion of cost is likely to be over a group so large that no real identification of burden is possible. Those who pay may be in no position to take effective action to press their interests.

Is any approach to a concept of "economy" feasible? Within limits, certainly.

The essential start is a clear definition of purpose or objective. What is the need, in general and specifically? Immediate and more permanent? What is the public concern in meeting it? Why? Are there gradations in urgency? If so, what is the relative significance of possible priorities? It is questions such as these that must be answered. Persons concerned directly, including potential recipients, must be consulted. Yet we can expect objective, balanced judgments—those reflecting real concern for economy—only if final evaluations are made by persons who can and will make the general interest paramount.

The next step is to compare alternative ways of attaining the goals, considering, of course, but looking beyond administrative feasibility. Some methods, for example, may do more than others to remove causes.

---

26 The situation is usually either one in which benefits cannot be captured by a private creator (for sale at their worth to the public) or if captured for sale will not yield their full potential because the private owner will charge more than marginal cost.
28 Space limits, plus my own uncertainty, preclude a discussion here of the meaning of "transfer payment" and the "transfer" element in government spending which purchases goods and services. In some respects any government expenditure which yields substantial benefits to specific groups is a transfer, but more common usage limits the concept of transfer to payments for which no goods or services are received.
29 The Government employee or a seller to the Government makes sacrifices for the dollars he gets. If he were not working for Government, he would do something else with his time and other resources. Ordinarily what he could earn would be almost as great.
30 If interest on Government debt is a transfer—I doubt that this is the most helpful method of thinking of interest—the public gain is largely some form of freedom from the costs of inflation.
31 One of the blessings of modern productivity, in my view, is the power it gives to alleviate destitution.
32 This statement assumes that the decision is not made by popular referendum.
The most economical program may be one which for a time costs more than others but which accomplishes proportionately more. Some transfer programs, I suspect, are less economical than they might be because they offer benefits broadly; aid goes even where the need is much less than that which "sells" the plan to the public. The broader program may gain wider support than one more economical, one that would concentrate help where it would most efficiently achieve the objectives of general public interest. Programs in operation call for continual examination—the basic objectives, the methods possible under current conditions, and the procedures in use.

The concept of economy in transfer spending can, I hope, be sharpened. Final answers, however, will always rest on judgment. Yet whose judgment? And how formed—on the basis of what questions asked, what facts analyzed, what values appraised? The papers and hearings stimulated by the Joint Economic Committee will undoubtedly make possible improved judgment.