

FEDERAL EXPENDITURES IN MODERN AMERICA

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I welcome this study of the principles that should underlie Federal decisions to spend money. We have fallen into the habit of thinking that, where Federal expenditures are concerned, we should consider every case on its merits. Even in these terms, on a case-by-case basis, we do not do well—often what passes for merit has little relation to the national welfare. But, in addition, to consider each case on its merits is not really to consider the merits of any case. Each decision can be made properly only in the light of the other decisions that must simultaneously be made. And this is possible only if all decisions are illuminated by certain common principles. This is why I am pleased that one agency of the Congress is now discussing the principles of Federal expenditure policy.

In conducting this very valuable inquiry, I hope the subcommittee will bear in mind one important fact about the American economy that many people disregard in making recommendations about Federal expenditures. That fact is that we have developed in this country a set of private institutions which have demonstrated their capacity to meet most of our national needs through the individual efforts of our citizens, singly or organized in businesses, labor unions, and other associations. The basic impetus to satisfying these needs comes from the millions of decisionmaking units in the economy who direct their labor and financial resources into productive pursuits without interference from the Central Government.

The role of government, especially of central government, in a highly developed, private enterprise economy like ours is vastly different from its role in an underdeveloped country. Where the private economy is incapable of generating and sustaining growth, the Government must step in to stimulate the forces of expansion. Where the private economy is already growing at a rapid rate, the presumption runs the other way. Although certain limited exceptions should be recognized, it is true in general that government intervention is likely to do more harm than good, either because it might result in a misallocation of resources or because it might impair the incentives of private individuals to produce and to undertake risks.

There is still another reason for relying less on the Government in this country than elsewhere. Not only is our national product the largest in the world—it is also distributed more equally than in most other countries. This is partly the result of the tremendous growth

¹ While the views presented in this paper are within the general framework of policy statements issued by the Research and Policy Committee of the Committee for Economic Development, their particular expression and application here are the responsibility of the author alone.

we have already achieved and partly the result of our greater devotion to the ideal of equality of opportunity.

Although we have not completely eradicated the problem of extremely low incomes, we have developed efficient and equitable methods of dealing with many of its basic causes. Our system of universal education provides every child with the basic training needed to participate in the economy and to share in its output. We deal with unemployment and old age—two of the major causes of poverty—through social insurance and private pension arrangements. And we have a nationwide system of public assistance to help those who are poor for other reasons.

More needs to be done to improve the lot of the less fortunate among us, particularly to assist in developing the skills that will permit them to earn their own livelihoods. But growth in our production carries far more potential for removing poverty from our midst than does a redistribution of the output we have. This is one of the more important reasons why we must be sure that Federal expenditure programs promote, rather than retard, economic growth.

ROLE OF THE FEDERAL GOVERNMENT IN A GROWING ECONOMY

To determine the needs for Federal spending under conditions of growth, it is essential to discard ideas about the role of government that are the outgrowth of the depression psychology of the 1930's. The problem is no longer how to assist the economy in making use of the available human and physical resources. The problem now is how to allocate our existing scarce resources among the numerous demands that are placed upon them. This change is reflected in the reasons now being given by those who support more Federal spending. Proposals to maintain or increase the present level of Federal spending are advanced mainly on two grounds, neither of which is related to the high employment problem. Higher spending by the Federal Government is now justified either on the ground that growth itself creates demands for more government services or that increased spending is essential to promote further growth.²

I agree that economic growth increases the need for certain governmental services—particularly if the term "economic growth" is understood to include growth in population as well as in number, size, and geographic dispersion of the Nation's economic units. By and large, this growth-created demand for government services is concentrated in the traditional areas—police and fire protection, water supply, waste disposal, highways, education, postal services, provision for the aged, etc. We tend to take some of these services for granted, but they are extremely important for the health of the economy.

It is important to recognize, however, that in this country most of these traditional services are provided by the States and local governments, not by the Federal Government. Among the categories mentioned above, the Federal Government is responsible for postal services, interstate highways, and old-age and survivors' insurance. Otherwise, Federal expenditures consist largely of outlays for defense,

²This discussion is limited to the nondefense portion of the Federal budget, since our defense requirements are to an important extent independent of our growth needs. Although the research conducted under the defense programs has contributed to the development of new products and new techniques, I know of nobody who would argue for a larger defense budget on the ground that it would stimulate growth.

interest on the national debt, and a host of programs that subsidize particular groups, industries, or regions in the economy, the most important of which are farmers and veterans.

Although there is very little basis for measuring the increased needs of the community for the traditional governmental services as growth proceeds, it is probably not unrealistic to assume that, in the absence of accumulated backlogs, expenditures for these services would increase in absolute terms but would either rise proportionately with total output or perhaps decline slightly in relation to output, on the assumption that there would be some economies of large scale.

In actual fact, cash expenditures of the States and local governments³ have increased relative to total output in recent years, from 7.7 percent in fiscal year 1948 to 9.7 percent in 1956. This increase, instead of the sidewise movement or slight decline that might have been expected under ordinary conditions of growth, is easy to explain. State-local expenditures were kept to a minimum during World War II and, before the backlog of accumulated demands could be worked off, the Korean war intervened. On top of this, there has been a rapid rate of growth in population and a movement of population to the suburbs. As a result, road, school, and other public construction projects have lagged behind actual needs. State-local expenditures are still rising relative to total output, and this trend may be expected to continue until a substantial part of the backlog has been worked off.

At the Federal level, nondefense expenditures have also increased at a faster rate than total output. Cash expenditures, exclusive of outlays for defense, foreign aid, and interest, rose from 5.8 percent of the gross national product in fiscal year 1948 to an estimated 7 percent in fiscal year 1958. On a per capita basis, and corrected for price changes, these expenditures will be approximately 50 percent higher in the current fiscal year than they were 10 years earlier.

Even a cursory examination of the major categories in the budget will reveal that the recent rise in Federal nondefense expenditures cannot be attributed to needs created by growth. For example, Federal cash expenditures for agriculture increased from \$0.6 billion to \$4.9 billion in the past 10 years; matching grants to the states for assistance to the aged, the blind, and other categories of needy persons increased from \$0.7 billion to \$1.7 billion; and outlays for housing, community development, and related activities increased from \$0.2 billion to \$0.9 billion. Such expenditures might have been expected to decline with the steady increase in employment and the continued growth of the incomes and financial assets of the Nation's families; yet there is little evidence in recent budgets that such a decline is in prospect.

I must confess that I have great difficulty in understanding the argument that substantial additional Federal spending—over and above the spending required of States and local governments—is needed to stimulate growth. The argument seems to be that, since growth requires more investment, investment by the Federal Government should rise proportionately as much as—and perhaps even more than—investment by other sectors of the economy. This proposition is by no means self-evident. In fact, in an economy with so many

³ Including Federal grants-in-aid and retirement and insurance trust expenditures, but excluding outlays of utilities and liquor stores.

other institutions capable of supporting large-scale investment projects—individuals, businesses, State governments, local governments, quasi-public authorities, and voluntary associations—it would seem more reasonable to suppose that less reliance need be placed on the Federal Government as these other institutions expand their activities.

My own view is that, given our present institutional framework, the Federal Government should refrain from making an expenditure unless it is absolutely certain that it is needed and that other units in the economy cannot provide that expenditure more efficiently.

There are strong arguments for turning to the Federal Government only as a last resort. Spending decisions will be more economical and efficient if they are made directly by the people who pay the bills. The economy will grow more rapidly if the investment of savings must meet the test of profitability in a competitive market. The freedom of the individual and the vigor of State and local government will be better protected the more limited the size and power of the Central Government. And, in an economy where private demands are high, we can help avoid inflationary pressures by holding down the size of the Federal budget.

I do not want to imply that our needs for public assets are small. On the contrary, there is need to clear the slums in our large cities; to build more schoolrooms, hospitals, and roads; to improve our harbors and airports; and to conserve and develop our natural resources.

But should these be provided by the Federal Government? The answer, I believe, is that only few of these important programs may be clearly labeled a Federal responsibility. One of the clearest cases is the financing and planning of interstate roads. In constructing the Nation's highways, attention must be given to the needs of interstate traffic and to defense needs. Furthermore, the State-local highway programs must be coordinated so that they will result in a logical national network. For these reasons and one other—that the program can be financed through taxes levied on highway users and need not be a drain on the general revenues—CED has endorsed Federal participation in the construction of the Interstate Highway System.⁴

On the other hand, education and health are either a State-local or private responsibility. Airport improvement (as distinct from aids to navigation), slum clearance, and urban development programs must be tailored to the needs of individual cities or metropolitan areas. The improvement and operation of commercial harbor facilities is a local, State or regional problem for which the use of a quasi-public authority seems to best be suited. Conservation and development of natural resources is a matter of national as well as local concern, but Federal outlays for these purposes should be restricted to projects that cannot be undertaken by private businesses or State and local governments; and, in all cases, the full cost of construction and operation—including the cost of capital at market rates—should be borne by the beneficiaries of these projects.

I conclude that most of the governmental services and public assets required under conditions of growth should be provided by the States and local governments. Before turning to the reasons why the Fed-

⁴ Committee for Economic Development, *Modernizing the Nation's Highways*, January 1956.

eral budget for nondefense purposes is nonetheless at record levels, it is necessary to examine still another argument that has been used of late to justify increased Federal expenditures, namely, that the States and local governments do not have the financial resources to satisfy the growing demands upon them.

ROLE OF FEDERAL AID

Some people who agree that States and local governments have the primary responsibility in providing governmental services under conditions of growth nevertheless believe that a major share of these services should be financed by the Federal Government through grants-in-aid or similar devices.

Since 1940, the Federal Government has provided roughly 10 percent of total State-local revenues, with the exception of World War II years and the subsequent period of readjustment. In fiscal year 1956, total Federal aid accounted for \$3.3 billion of State-local revenues—an amount just short of 10 percent. Since then, however, the Federal highway program has been put into operation and the magnitude of Federal aid has been rising rapidly. According to the President's budget for fiscal year 1958, Federal grants (exclusive of the proposed school construction aid program, which was not enacted by this year's Congress) will amount to \$5.3 billion this fiscal year and, at this level, they will probably account for 12 to 13 percent of State-local revenues.

The use of Federal aid is not limited to a few small and isolated activities of the State and local governments. In fiscal year 1956, 87 percent of total Federal aid was allocated to education, highways, public welfare, health and hospitals, and natural resources—expenditure categories that accounted for 74 percent of total State-local expenditures. It is important to recognize, therefore, that the proposals to increase Federal aid would add greatly to an already bewildering variety of strongly entrenched programs.

There is a place in our financial system for Federal aid. Such assistance should be reserved for projects, like the road program, in which the Federal and State or local governments have a joint responsibility. In all cases, the State and local governments should finance a substantial portion of the cost of the joint program on a matching basis.

There are grave dangers in an excessive reliance by the State and local governments on the Federal Government for financial assistance.

In the first place, such aid may lead to an encroachment by the Federal Government on decisions that should be made by State, county, and city governments. Those who are familiar with local conditions are in a much better position to gauge the needs of their communities.

Second, even if Federal assistance is provided on a matching basis, there is always a tendency for States and municipalities to allocate more of their own resources to the areas in which Federal assistance is given merely to obtain the Federal funds. Thus, the use of funds provided by another government may result in a misallocation of resources, with some activities being supported too handsomely and other, more necessary, activities being starved. As nearly as possible, tax and expenditure decisions should be made at the same level of government, rather than at different levels.

Third, Federal aid has already placed a heavy burden on the Federal Government. In the current fiscal year, grants-in-aid will constitute approximately one-seventh of total Federal cash expenditures other than defense and foreign aid. The continuous rise in Federal aid during the past decade has been an important factor in preventing the moderation of the increase in Federal expenditures that is necessary before Federal tax reduction becomes practical. In view of the urgent need for Federal tax reduction and tax reform in the interest of promoting growth, augmentation of Federal aid programs could delay indefinitely the revisions that have already been postponed for much too long a period of time.

The financial problems that must be faced by the State and local governments are admittedly formidable. They can be solved within the traditions of our Federal system, if the States and subdivisions accept their responsibilities. In practice, Federal assistance cannot be confined to a few selected activities—once the assistance is extended to another area, there will always be requests for more Federal aid as new State-local problems arise. As the Kestnbaum Commission has pointed out:

If we are not willing to leave some room for diversity of policy, to tolerate some lack of uniformity in standards, even in matters which are of national concern and about which we may feel strongly, the essence of federalism, even if not the legal fiction, will have been lost. We must also realize that it can be lost, or its vitality sapped, by nonuse of State and local initiative as well as by overuse of national authority. We have, therefore, as citizens a responsibility to see to it that those legitimate needs of society that could be met by timely State and local action do not by default have to be met by the National Government.⁵

CAUSES OF HIGH AND RISING FEDERAL SPENDING

There are two major reasons why the Federal budget continues to rise even though it is already at record levels. First, a number of Federal programs are misdirected—we are trying to solve problems by spending more money, rather than by eliminating the causes that created them. Second, the Federal Government is doing things that the private economy or that State and local governments can do more efficiently.

The agriculture program is perhaps the best illustration of the type of program that should achieve the desired results at lower costs. In its statement on agricultural policy⁶ CED urged that emphasis should be placed on withdrawing whole farms from cultivation. We also warned that, unless price supports are gradually reduced to free market levels while the land retirement program is being carried out, it would be impossible to bring the supply of, and the demand for, farm products into balance. Finally, we suggested that assistance should be provided to help some farmers find new and more satisfactory means of earning a livelihood.

⁵ Report of the Commission on Intergovernmental Relations, June 1955, p. 5.

⁶ See *Economic Policy for Agriculture, 1956*.

In actual practice, the agricultural program has worked in the other direction in two of these respects. Price supports are being reduced, although the pace is too slow. However, whole farms are not being removed from cultivation under the soil-bank program; and enough is not being done to help farmers on uneconomical farms to move them to other occupations that provide higher income opportunities.

Another Federal activity that needs to be reexamined critically is the secondary mortgage purchase program of the Federal National Mortgage Association. This program was at one time to be converted to a self-supporting private mutual enterprise with the purpose of alleviating temporary shortages of mortgage funds. Instead it is being used to insulate the mortgage market from general monetary policy. In an economy with our efficient private capital markets, one logical remedy to try before the Federal Government intervenes is to permit the Federal agencies that insure and guarantee mortgages to meet the prevailing rates.

The stockpiling programs seem to be directed more at stabilizing prices of some metals and minerals than at meeting our security needs. Since our stockpile exceeds \$6 billion and our capacity to produce critically necessary materials has increased substantially in the past few years, it is time to consider revisions of these programs in the interest of reducing prospective Federal activities.

The postal deficit of \$600 million is such a self-evident disgrace that it is hard for the ordinary citizen to understand why the Congress does not eliminate it. Postal rates should be raised promptly to pay for the entire cost of the postal system, and user charges should be adopted in other cases where individuals and private businesses benefit directly from a Federal service.

Considerable savings can be made in the veterans' programs by revising payments in accordance with the recommendations of the President's Commission on Veterans' Pensions. In particular, the Commission's proposals for gradual elimination of benefits for non-service-connected disabilities should be implemented as soon as possible.

Finally, the Federal Government should restore to the State and local governments functions that they are in a better position to perform. Among these are sewage and pollution-control facilities, vocational education, disaster relief, urban redevelopment, and public assistance. The Joint Federal-State Action Committee, appointed by the President, is now considering the feasibility of shifting certain governmental functions and tax sources from the Federal Government to the State and local government. I hope that the results of this work will provide the basis for a clearer delineation of the role of the various levels of government in our Federal system.

The foregoing are only a few examples of the policies and programs that should be reviewed in order to reduce Federal expenditures.

THE NEED FOR BUDGETARY REFORM

There are, of course, great political obstacles to overcome if the Federal budget is to be trimmed to its absolute essentials. As CED indicated in its latest policy statement, the biggest obstacles are—public defeatism about the Federal budget and the pressures of particular groups to expand Federal programs in which they are interested. * * * Citizens will

have to be willing to forego Federal expenditures that are less valuable to the Nation and to themselves than tax reduction.⁷

The way to overcome defeatism and apathy is to reform Federal budgetary procedures in order to focus the attention of the public and the Congress on the consequences of expenditure decisions. In our study of Federal budget procedures,⁸ we found that the budgetary process is deficient in two important respects, each of which must be dealt with properly to achieve economy and discipline. First, adequate consideration is not given to the relation between total expenditures and taxes in the formulation of expenditure policy. Reduction of taxes seems to be subordinated in the budget process to the pressures for expanding the numerous activities of Government. Second, the Congress and the public are not adequately informed as to the long-range costs of particular programs. What seems to be a relatively small expenditure for a new program when it is initiated often mushrooms into billions of dollars. It is clearly impossible for Congress to judge the desirability of any program merely on the basis of the current costs.

To remedy these weaknesses we emphasize five recommendations:

1. The administration must take the leadership in formulating a policy that will leave room for tax reduction. In appraising the worthwhileness of government activities, we should remember that reliance on the free decisions of individuals, including their decisions about how they will spend their income, is fundamental to our democratic society.

2. Information on the purposes and relative values of budgeted expenditures should be presented to the Congress on a program budget basis, so that it can evaluate the purposes of the recommended programs and decide how much should be appropriated for the activities of Government and how much should be allocated for tax reduction. We urge the use of program budgets, because only in this way can the great mass of information now presented in the budget be organized to relate proposed and present programs to their costs. Under present procedures, expenditures and appropriations are subdivided by departments and agencies, rather than by type of activity. The Congress and the public will be able to understand the full scope of government activities if appropriations and expenditures are combined by programs rather than by departments. Some progress along these lines has already been made, but the development of the program budget should be pushed ahead more rapidly in the near future.

3. To make budget decisions properly, Congress should have before it estimates of revenues and expenditures, not only in the coming year but also for 4 or 5 years ahead. Along with overall budget totals, the estimates should include details for the major, long-term Federal programs, whether they are included in the administrative budget or in the cash budget.

4. The President should be given authority to veto individual items in appropriation bills. Under present procedures, the President cannot disapprove one item without disapproving many others and, as a result, too many wasteful expenditures creep into the annual budget.

⁷ Tax Reduction and Tax Reform—When and How. May 1956, p. 10.

⁸ Control of Federal Government Expenditures, January 1955.

5. Congressional procedures should be revised to encourage Congress to view government spending as a whole and to evaluate the effect of the budget on the private economy. A joint budget-policy conference, consisting of key congressional leaders, should be organized to coordinate revenue and expenditure decisions and to set guidelines for the separate tax and expenditure committees of the Congress.

CONCLUSION

With the Federal budget as high as it is now, it is imperative, in the interest of economic growth, that the current upward trend in Federal expenditures be moderated and, if possible, arrested. Federal expenditures are using up resources that might be more productively used in the private sector of the economy or by State and local governments. High Federal expenditures are absorbing incomes that might provide an incentive to effort and enterprise, and the high Federal tax rates needed to finance these high expenditures reduce effort and activity devoted to earning and producing income.

To say that Federal expenditures should be moderated is not the same thing as saying that needed governmental services should not be supported. Indeed, a growing economy requires more governmental services, but the major responsibility for providing these services should rest with the State and local governments. If we continue to spend more at the Federal level, the other units will not have the financial resources they will need to satisfy the demands imposed upon them by a growing economy.