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GOVERNMENT EXPENDITURES: SOME ECONOMIC ISSUES*

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Discussions of government spending often have a note of dissatisfaction — too much is spent, or too little, or not on the right things, or not efficiently. In the United States an insistent, unending, upward pressure for spending — in *real term per capita* — certainly calls for analysis.

First, let me say that many achievements will strike a reasonable man as impressive. Mistakes galore strew the record — or would if we could see them. Perhaps we are happier knowing as little as most of us do about the use which is actually made of some of our tax dollars. Totals are too great, however, make critical study unnecessary. But my interest here is rather different.

From time to time every family, city council, state legislature, and the national Congress may dream of good things obtainable if someone were to give blank check on a limitless bank account. What a happy vision. But, unhappily, one must look at the money and the real resources likely to be available. Many choices will be difficult. Some will strain tempers. Many will defy decision on any fully rational basis.

Men may speak of affluence, but not many of us in either private or governmental life will ever feel blessed with such plenty that choices will be limited to trivia. Even in the United States our wants rise every bit as rapidly as our ability to meet them.

Appetite-stimulating agencies do not wither away because they do less to satisfy wants than to create them. Men who earn their livelihood on Madison Avenue (the center of advertising in America), Capitol Hill, the White House, and at other places too numerous to mention, all these remind us repeatedly that many good things lie ahead — if someone will

*) Views expressed are my own and not necessarily those of any organization with which I am associated.

only provide the necessary money to pay. But we must choose. Selection within broad categories of expenditure possibilities (for example, between city streets and highways outside the cities) will uncover sharp disagreement. Choice becomes much more difficult when comparison involves largely different things — more or less national defense, hospitals, transportation facilities, or housing. The benefits each will provide must differ in kind even though all are desirable. Some things — of which national defense is much the most costly — can be provided *only* through government. Others, however, can be left to private, profit-seeking business plus philanthropy; or men may seek to satisfy them through government, and if government at more than one level. Many things on which modern governments spend are by no means essentially or inherently governmental.

Interest In Government Spending

An economist's interest in government spending comes from several sources. It takes more forms than I can touch upon. The *total* outlays are now so large that billions a year may depend upon an apparently small difference in the wisdom of decisions about what to do, how much, and in what way. The price tag on things *not done*, the worth of programs not adopted, will also be large. One might try to imagine what could have been accomplished, either privately or by government, with half of the amounts spent on farm programs to raise the price of food in the last decade or what might be done with half of the dollars to be spent to put a man on the moon.

The effects of government expenditures on employment and on the level of prices (inflation), will not be discussed here.

My concern will be for certain "allocative considerations", criteria for judging alternatives — chiefly the vexing question of governmental as against nongovernmental spending. Since the war, economists have written extensively on this range of problems. Articles and books range from the most abstract of theory to serious attempts to solve practical problems, including difficult issues measurement of costs and benefits. Some of the material seems esoteric, hardly designed to guide real-life decisions. Yet who knows the potential usefulness?

A few years ago a prominent economist, Professor Galbraith, in *The Affluent Society*, presented us with the argument that in America "public" wants were being slighted while private affluence was being indulged.

Caricatures of the argument, and of the criticisms, seem to have received about as much attention as the basic merits. One result was fuzziness where we need sharpness. The terms "government" or "public" when used to distinguish part of the economy the "private" will mislead. *People* do things. What institutions or agencies are best for each case? Can anyone think of a function performed exclusively by government? Or, at the other extreme, a function in which government has no participation? Not many of either extreme will come to mind. Modern man's economic problem involves, not a choice between two clearly distinguished types of activity, government and private spending. Choices must be made at many margins, a fact which explains why so many decisions are difficult.

As we look at services for which the United States has long relied heavily (but not exclusively) on government — local policing or the teaching of reading and arithmetic — all of us want performance. Does larger government spending follow as desirable? Not necessarily. Needs unmet in the private sector are just as evident. Tempting, indeed, may be the approach to "solution" — almost any unmet need seems to be soluble by more government spending. And many specific needs *can* be met in this way. Bearing the cost, however, will likely create other problems. Except as society can get the use of more resources because of policies which increase total output, our choice is not between government and private so much as between (a) more or less government performance and (b) more or less private activity, at many margins. Government expenditure can be expanded if private is reduced, and vice versa². Evaluation of the results of any such changes in proportion must require knowledge of the specific features of each.

Social Wants: Interdependence: Social Benefits³

Much government spending seeks to satisfy "social" wants—a concept both vague and real. Every time I try to define or explain it, I find myself dissatisfied. National defense and policing, to cite the two outstanding examples, serve social or group purposes which differ from our more typical individual wants⁴. But there are other group of interests. The prac-

2) As national income grows, all types of spending can, of course, rise without a cut in any one of them.

3) The term "collective" seems preferable except that it can be confused with "collectivist" as applied to communist societies.

4) Some essential functions of government can be performed with little expenditure — establishing standards of weights and measures, controlling

tical problems arise in deciding how best to serve many group or collective interests which are less embracing than national defense. The agencies for meeting the needs are, on the one hand, *compulsory* grouping: government — national, state, or local, and *voluntary* associations — families, businesses, clubs, churches. They differ, of course, in the degree of freedom people have to affiliate (to form groups or associate with those in existence) or not, ranging from almost none in the case of national government to complete freedom for associating with most private groups.

One presumption would seem to me clear. The amount of wellbeing achieved will be larger, the greater the use we make of voluntary associations to serve our group needs and the less the reliance placed upon compulsion. This conclusion may seem to beg question, but so does its opposite — and even more so. How can compulsion have enough positive worth to overcome the loss of benefits from freedom? Least one those people who would freely participate in sharing the cost. National defense, diplomacy, and the preservation of law and order are not the only examples. So let us look a bit farther.

Some of the economic case for government, as contrasted with market or philanthropic performance of functions, draws substantially on the argument that many types of activities have effects which extend beyond the persons directly involved. In the typical market transaction, the two parties presumably do as well for themselves as possible. The results can generally be assumed to be better than alternatives⁵. Some effects, however, extend to persons and groups who do not bargain in the process and whose interests are not represented. Smoke, water pollution, and street congestion stand as examples of cases in which the "social" nature of the objectives differs substantially from that of, say, national defense.

Economists argue that arrangements which would bring these "external", "third party", "spillover", or "neighborhood" results into the decisions would lead to better overall results. The existence of spillover effects does unquestionably invite search for methods of trying to take them into account. And government, because it can use force, is an agency

the monetary system, and providing laws such as those which govern contracts. Much regulation as such, whether or not men agree that one or another type is necessary, requires little government spending.

5) If not, the parties are free to change. The repetition of error will end as one of the parties becomes aware of the possibility of doing better.

for compelling such broadening of concern—by prohibition in some cases, in others by active positive participation, *e.g.* by spending.

What is the scope of "community" or "third party" interest? Has it expanded in our generation? Four points will suggest reasons for believing that there has been some such expansion.

1) Needs of national defense press heavily and involve vastly greater amounts than before World War II. The things each of us individually, and each state and locality as a government, do in education, health, research, and in paying taxes, all these bear at least a little upon the common defense. Here, then, exist a broad community of interest. Does this mean that the appropriate roles for government spending have expanded? Most of us would probably reply, "yes". Then, however, we, would begin to debate, not only about magnitudes but also about the forms of spending involved.

2) Mobility of population makes so many of us potential neighbors. Tomorrow's neighbor may now be getting education in a distant state. Some of the children with whom one's own will build their future are laying foundations for future physical and mental health, and attitudes toward society, in environments which leave something to be desired. (But will more government spending or lower taxes do most to improve environments?) Again. The fact of mobility as a source of interdependence seems clear—but not the amount.

3) Many economists would argue that deliberate concern for more rapid economic growth tends to broaden the scope of community interest. Without endorsing this argument, I record its existence as one which may be given for the expansion of government spending. No problem arises in suggesting ways in which more extra government expenditure could aid economic growth. The complete analysis, however, requires much more, notably the effects of the taxes required. And there will even be doubts about whether some programs do more good than harm. Here is the start of a big inquiry, one putting much demand upon our objectivity, analytical ability, and store of evidence.

4) Urbanization has increased, and urbanization brings to one's attention the fact that community of interest is often direct and close.

Let me cite an equal number of reasons—4—for "going slow" in using the argument that a broadening of third-party relations (externalities, neighborhood effects) will *in fact*, and *on balance*, provide justified reason for increase in the scope, or in the relative amount, of government spending.

1) Taxes have adverse, often concealed, disadvantages which extend beyond the taxpayer. Spending which requires that tax rates be higher than otherwise will thereby impose social costs. I speak of *more* than the simple counterpart of the positive externalities of spending, *i.e.*, more than negative externalities which result because the taxpayer must curtail his activities. Taxes do more than just absorb resources, as do prices. Taxes have secondary effects which differ from those of prices⁶. When tax rates were much lower, this difference between taxes and prices could generally be ignored without risk of appreciable error. Today's tax rates, however, require deeper consideration. Therefore, individuals and businesses do not always do what would be to their best interests if taxes were not escapable. To some extent taxes are escapable. Private and public interest can—and do—diverge. Resource allocation becomes less productive. Other realities should also be faced. Americans tolerate some things they cannot really want. Some of the tax on poor consumers must go to pay subsidies to relatively prosperous growers of food. There are older people in need of more medical care, and without many years of life, who bear taxes which could be reduced if someone were not so anxious to put a man on the moon soon. In many localities the property tax as administered discourages the replacement of slums by structures of high quality. In summary, the bad effects of taxes can, I submit, be large in relation to the third-party benefits of spending.

2) Now let us ask a question of practical significance. How can we take reasonably adequate account of the spillover effects (a) of governmental *and* private expenditures and (b) of taxes? To know that such results exist does not identify them—nor measure them. Nor do intuition or good sense or "general knowledge" show us, really, how to deal with externalities efficiently. It is so easy to write in generalities, while failing to make clear that one may be dealing with what in other connections economists call "empty boxes." My conclusion on this point is not "Nothing can be known with enough assurance to justify any action" but, rather, "Be cautious in claims to knowledge."

3) A large and richly varied country such as the United States has diverse, as well as common, interests. Any expenditure policy which

6) The payment of a tax, unlike the payment of a price, brings no *quid pro quo*, *i.e.*, the payer does not himself lose a government service if he fails to pay the tax. In contrast, he will not get a product sold in the market unless he pays the price. Consequently, he has a difference in incentive in avoiding or evading tax payments.

applies to the whole country (or even to a whole state or city) runs the risk of being relatively inefficient for some of the many non-typical cases. Those public and private interests not strongly represented in the law-making bodies or in the civil service can expect to be slighted. People with power will often use it in their own interests, and such interests will not always be those of the whole public. The larger the government, the greater the inadequacy of representation of minorities. Let me not romanticize about local and state government as they exist. Weaknesses abound. On the other hand, however, it is not only the young who at times romanticize a bit about the wisdom with which national government disposes of problems. To imply that because that national government is big, powerful, and undying it is also fair, objective, and rational — far more rational than mortal individuals — accepting such a view strikes me as less than scientific or sensible.

4) A final point overlaps the others. It will not receive complete support "in general" and certainly not in specific cases. Nevertheless, merit will be found in it. Increasing interdependence and specialization do enlarge the difficulties of wise, and the dangers of poor, governmental intervention. The ever more minute division of labor also, expands the relative advantages of articulation and coordination by the forces of the market place. As society becomes more complex, one sometimes hears, the economy needs more "social action", more "public intervention." Is there not, on the contrary, a strong presumption that the inevitable lack of knowledge by any human being, or group, will insure errors as the use of power grows power with remote and indirect effects? For answers we should carefully at experience. It will differ from case to case. Dreams or assumptions about how things "ought" to work cannot serve well: Actual results will give better basis for judgment — and indicate what we can hope for and what may be needed in practice.

Other Economic Considerations⁷

Only a few of the many other economic aspects of government spending can receive mention here.

7) Judgements can be misled by the methods used in valuing the product of government in national income accounts. The valuation of **output** in the government sector by the **cost of inputs** will not necessarily give a reliable guide about what is, and what is not, worth its cost — or which ought to be expanded.

1) One point dear to economists is a bit difficult to summarize briefly. Economies of large-scale operation can sometimes lead to falling cost of production per unit as output expands. In some cases the optimum consequences — optimum for the public as a whole — will be obtained when a single supplier provides the service at no charge; in other cases the “best” charge, equality of marginal revenue and long-run marginal cost, would bankrupt any private supplier. In either situation the natural conclusion seems to be: Let Government do the job. The public will then get more for its money than if supply comes from commercial sources. Government spending can bring advantages which may potentially be large in relation to the money spent — all this “in theory”.

Economists make this point more often than we face the implications realistically. The theoretical possibilities can seem glowingly attractive. But what are the practical probabilities? They may be impressively large. But have economists been notably successful in getting politicians to apply marginal cost pricing? Not to my knowledge. For any project proposed, what are the cost conditions for the relevant time period? Do we distinguish adequately between short and long run? Why does the public tolerate taxes, sometimes taxes higher than average, on those public utilities which may operate under conditions of decreasing cost? Such questions can lead to encouraging answers — but not inevitably. Empirical study is needed in specific cases.

2) Government is an agency which will endure long beyond any human being. It may be able to take a wiser view of the future than can the individual, family, or business. The argument that it *will* do so has been implied in discussions about spending, especially for projects with appeal as aids to development and growth. But is the “time horizon” of people when voting (using government) better than when act in the market? The evidence does not persuade me that the answer is “Yes.” The use of interest rates in judging government selection of capital projects and in allocating resources will give some indication of how guidance actually compares with an economically rational criterion. Objective study of behavior might throw clarifying light on this point. The theory is not simple.

3) *Regional* aspects of government spending raise no end of challenges to economic analysis. In the United States one sees the familiar but still unsolved problems of inter-governmental financial relations (national-state-local), the multipurpose project (a big dam or irrigation

project) which extends into several jurisdictions, the concentration of some types of spending (accentifies research) in one or a few areas. Society can be modified in more ways than one by noneconomic determinants of the geographical distribution of government spending. Concern over issues of this sort seems to be growing. One can hardly be surprised when the totals get bigger all the time.

4) The discussion of the President's 1964 proposals to Congress for new spending to deal with poverty (or *was* there "discussion" worthy of the term) led me to ask, not for the first time, "Can government, especially national government, be efficient for serving minorities, especially those which are poor?"⁸

In a group of men generally interested in public affairs, how many will have a rough idea of how much his city, or state government is spending? Not many. The process of making decisions does not necessarily represent the best of which man is capable in spending large amounts wisely. But can one really expect to get an informed public opinion?

Looking beyond aggregates, how can we judge whether the decisions on particular programs are reasonably good for an imperfect world? "Everybody's business is nobody's business" — not quite true but more so than we should like. The suggestion that government spending grows too rapidly—or that some function is being slighted—frequently elicits the question, "Well, what ought to be reduced (or enlarged)?" And few economists—or experts in other fields—are even within striking distance of being able to reply with confidence. Analysis of the results of government spending calls for more effort from more people. Fortunately, serious, objective study has been made, and is in process in the United States. Progress is on the way — not speedy or on a big scale but in process. Some constructive action has resulted. Yet both analysis and action need more support of many types. The larger the total of spending, and the more

8) The debate on anti-poverty proposals showed that even professional economists will let names rather than evidence determine a position on a controversial issue of policy. Since no one favors poverty, who can fail to support proposals labeled "anti-poverty?" The excellence or lack of it in the proposals is not my point here — nor was it the crucial element in deciding the attitudes of some of my professional friends. More than one indicated his support of the program. When I asked whether he had read the proposed law, or had even examined an explanation in non-legal English, I found only one economist outside government who had done so; he shared my lack of enthusiasm about the economic merits of important features.

numerous the types of projects, the more perplexing become the actual problems.

Concluding Comment

Many details of government spending are just that, small and unimportant. But many are big and of utmost significance. The quality of the decisions must influence profoundly the quality of society. In the words of one of history's greatest economists, Alfred Marshall:

"Government is the most precious of human possessions, and no care can be too great to be spent on enabling it to do its work in the best way: a chief condition to that end is that it should not be set to work for which it is not specially qualified, under the conditions of time and place."
