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Volume Author/Editor: William Leonard Crum, John F. Fennelly, and Lawrence Howard Seltzer

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Chapter Author: William Leonard Crum, John F. Fennelly, Lawrence Howard Seltzer

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APPENDIX

The Outlook for Non-Military Expenditures

AN ANALYSIS of the financial task of the federal government during the war would be decidedly incomplete without some understanding of the probable level of non-military expenditures during the next two or three years. Comprising all items of federal expenditure, excluding statutory debt retirement, other than those incurred directly in connection with the war, they totaled some \$7.4 billion in the fiscal year 1940, when defense outlays amounted to only \$1.6 billion. They declined in 1941, the first year of the defense program, to approximately \$7 billion, and to about \$6.4 billion for the fiscal year 1942. In the federal budget for the fiscal year 1943, as presented by President Roosevelt to Congress on January 7, 1942, non-military expenditures were estimated at approximately \$6.1 billion. In the fiscal year 1930 they were approximately one-third the total for the fiscal year 1940.

Although non-military expenditures amounted to only about one-fifth of total federal outlays for the fiscal year 1942, and will probably amount to less than one-tenth in 1943, they have an importance for our problem that transcends their relative magnitude. From the standpoint of the taxpayer, they have psychological implications of the greatest significance, as can be seen by the incessant demand during the last eighteen months in the press and by such organizations as the National Economy League for radical curtailment. It is easy to understand that the sacrifices necessitated by the emergency will be borne more cheerfully by taxpayers

if they feel every reasonable effort is being made to reduce all expenditures not absolutely essential to the war.

From the standpoint of the successful prosecution of the war, non-military expenditures have a twofold importance. To the extent that they are spent on scarce materials, equipment, and skilled labor, which might be diverted to military production, they must be considered as competitive with the war program, just as similar activities on the part of private industry are. As will be demonstrated below, their significance in this connection is not great. Of greater importance is the fiscal or budgetary aspect of these expenditures. Thus, although non-military outlays will account for a relatively small proportion of total expenditures, they will contribute substantially to the federal deficits. Any reduction in these expenditures will, therefore, lessen the existing and prospective dangers of inflation.

Fortunately for our analysis, the theoretical side of this problem has been greatly simplified by the rapid unfolding of events during the last few months. In the early stages of the defense effort, while considerable slack still existed throughout our economy, many economists could argue with sincere conviction that curtailment of federal non-defense activities would be both unwarranted and unwise. They felt that, until a state of full employment had been reached, no useful purpose would be served and that the growth in national output would be checked and the morale of the nation impaired by throwing large numbers of governmental employees and relief beneficiaries out of work. This argument strongly supported the natural resistance of an entrenched bureaucracy to such a move, as well as the expressed determination of the President to achieve the defense goal without the sacrifice of any social objectives for which the New Deal had fought so vigorously.

Today the picture is quite different. The United States is now engaged in an all-out war, and the pressure of shortages in materials, plant, and skilled labor is becoming steadily

more apparent. Moreover, the threat of inflation, formerly viewed as a remote contingency, is now seen as a danger almost as real as the striking power of the German army. Under such circumstances, the theoretical economic argument against curtailment has become largely irrelevant. We are already face to face with the necessity of choosing between substantial curtailment in federal non-military activities or being satisfied with something less than full efficiency in our war effort. There is now no reasonable argument, theoretical or practical, against reducing non-military outlays, as far as is consistent with maintaining the efficiency of our governmental organization and the morale of the country.

In attempting to analyze this problem, we are faced at the outset with the very real difficulty of drawing a sharp distinction between military expenditures and those which properly may be classed as non-military. The figures prepared by the Bureau of the Budget (Table 24) may be accepted as the official classification of military and non-military expenditures, but even these are admittedly rough and inexact. Included in many of the so-called non-military items are substantial outlays which are directly or indirectly connected with defense and war activities. For example, a large part of the work of the regular governmental departments, such as the State Department, the Treasury, and the Department of Agriculture, is devoted directly to furthering the war program, although officially classified as non-military. In addition, numerous public works, listed in the non-military category, are being undertaken in connection with the military program. Even a substantial percentage of the work relief activity might properly be considered a contribution to the war.

The other side of the picture is the indisputable fact that nearly every governmental bureau is attempting to justify its existence by demonstrating its essential importance to the war effort. While admitting that a successful prosecution of the war could be seriously jeopardized by the reduction or

elimination of certain non-military outlays, citizens may still maintain that many are not essential for the achievement of this goal, and that some of the claims in this connection are grossly exaggerated.

Table 24 indicates clearly that a substantial proportion of total non-military expenditures cannot be reduced because

TABLE 24

Non-Military Expenditures, 1941-1943
(millions of dollars)

	FISCAL YEAR		
	1941	1942	Est. ^a 1943
<i>Contractual (or Mandatory)</i>			
Interest on public debt	1,111	1,260	1,750
Transfers to trust accounts	325	375	299
Tax refunds	90	94	87
Veterans' pensions & benefits	553	555	590
Social security payments	423	473	538
Total contractual	2,502	2,757	3,264
<i>Non-Contractual</i>			
General public works	703	651	578
Work relief (WPA)	1,285	882	480
Aids to youth	347	251	100
Benefits to agriculture	1,199 ^b	976	854
Regular government departments	831	908	841
Supplemental items	136	18	25
Total non-contractual	4,501	3,686	2,878
Total	7,003	6,443	6,142

This tabulation follows in general the classification used by the Bureau of the Budget, but has been modified somewhat in form in order to distinguish between contractual and non-contractual payments. Data for fiscal years 1941 and 1942 are from the Treasury Department, press release, July 2, 1942.

^a The estimates for the fiscal year 1943 are from President Roosevelt's budget message to Congress, Jan. 7, 1942.

^b The compilation prepared by the Bureau of the Budget shows a net figure of \$880 million for Benefits to Agriculture in the fiscal year 1941. This figure was attained by deducting from total expenditures of \$1,199 million an item of \$319 million representing a return of surplus funds from governmental corporations. The total includes regular expenditures by the Department of Agriculture.

certain important items are of mandatory or contractual nature; e.g., interest on the public debt, transfers to trust accounts, and tax refunds. Interest payments are not only obligatory, but the total is almost certain to rise steadily and appreciably during the next two or three years along with an expansion of the public debt. For the fiscal year 1943 total interest payments are estimated at \$1,750 million against \$1,260 million for the fiscal year 1942. If the war continues into 1944, total interest payments could easily reach \$2,500 million annually. Of a somewhat similar mandatory character are veterans' pensions and benefits and social security payments. Both are largely contractual and probably cannot be curtailed, although the second item may decline moderately with less unemployment. The total for all mandatory and contractual items is estimated at approximately \$3.3 billion for the fiscal year 1943, and probably will rise to almost \$4.0 billion in 1944, if the war continues.

The remaining items are classified as non-contractual because they do not involve continuing fixed obligations from one fiscal year to the next, and therefore are very largely dependent for their existence upon annual appropriations by Congress. Totalling about \$3.7 billion for the fiscal year 1942, and estimated at about \$2.9 for the fiscal year 1943, they constitute the only areas in which curtailments seem reasonably feasible during the war. A reduction of about \$800 million was achieved in the fiscal year 1942 compared with 1941, and, if the budget estimates for 1943 are adhered to, a further cut of approximately \$800 million is in prospect.

An examination of the non-contractual items from the standpoint of their utilization of scarce resources which may be essential to military production reveals that merely a small proportion can be so classified. Most of the outlays listed under general public works are of this general character, but the other items include merely an insignificant amount of such expenditures.

There can be little argument against all possible curtail-

ment of outlays on general public works for the duration, except as they may be of prime importance for defense. Expenditures in this category amounted to \$651 million for the fiscal year 1942, and are estimated at \$578 million for 1943. A substantial part of the 1942 total (various electric power projects as well as the special 'defense' highway appropriation of \$170 million) was appropriated by Congress on the ground that it was important for defense. On the other hand, at least two-thirds of the total of \$651 million, including expenditures for flood control, improvement of rivers and harbors, reclamation projects, general highway grants, etc., have only the most remote connection with defense, and were justified very largely because the work was already in progress and stopping would involve waste as well as breach of faith.

In brief, we believe that general public works expenditures for the fiscal year 1943, now estimated at \$578 million, might be at least halved without sacrificing any important war objectives.

Work relief is accounted for almost entirely today by the activities of the Work Projects Administration, and amounted to \$882 million in the fiscal year 1942 as compared with almost \$1.3 actually expended in 1941. In his budget message of January 7, 1942, President Roosevelt announced his intention of reducing this item in the fiscal year 1943 to \$480 million, but the Congressional appropriation for this purpose has pared the amount down to \$280 million.¹ Although the WPA provided employment in 1941 for approximately one million workers, probably not more than a fraction of 1 per cent could be considered skilled workers of a type essential to the war effort. Furthermore, the legal authorization for this activity requires that at least 80 per cent of total outlays be expended on wages, and only the balance on materials and equipment. It seems clear that the WPA competes in merely a minor degree with military production. Indeed by employing more than two hundred thousand work-

ers in preparing emergency airports, building military roads, etc., it has been contributing positively to defense.

Many advocates of governmental economy in non-military items have argued that the WPA should be eliminated now that we are rapidly approaching full employment. Careful study, however, shows that the solution is not so simple. According to statements by WPA officials, this organization in 1941 was providing employment for not more than half of those on the rolls and certified by proper authorities as eligible for relief work. The total of workers so certified declined from about 3.5 million to approximately 2.2 million during the twelve months ended July 1, 1941, but the decline since that date has probably been at a slower rate. Moreover, the average age of WPA workers has been rising rapidly and is now stated to be over 43 years. The clear implication is that the WPA is tending more and more to include only those who are relatively unemployable from the standpoint of private industry and military production. In other words, elimination of the WPA would throw a large number out of work, a great many of whom would find great difficulty in obtaining other employment even in the face of a large shortage of younger and more skilled labor.

The other side of the picture is that the outright need of most WPA workers is undoubtedly much less today than it was one or two years ago. It is probably safe to say that, in the great majority of cases, members of their families are now employed and are in a better position to assist them financially. Thus, it seems reasonable to assume that a conscientious effort to weed out all who can find other employment, and all who would not be destitute if unemployed would further reduce relief rolls drastically during the next two or three years without causing much actual hardship. On the whole, we believe that the \$280 million now appropriated for this service by Congress for the fiscal year 1943 should provide adequately for the great bulk of semi-unemployables who would otherwise be destitute, but we doubt

that the total could be reduced much below this figure without creating real hardship for this group and without some loss of efficiency in the war effort.

A drastic curtailment of expenditures listed under aids to youth presents a less difficult problem. Amounting to \$251 million in the fiscal year 1942, they include the activities of the Civilian Conservation Corps and the National Youth Administration. Both were products of depression and both undoubtedly have served laudable social purposes. Nevertheless, neither seems essential under present conditions, and the nation can ill afford the cost from either a fiscal standpoint or that of the loss of young manhood that might otherwise be available to the war effort. We believe that the activities of the Civilian Conservation Corps could be suspended for the duration without any detriment to our war effort, and those of the National Youth Administration reduced to a point where it would be little more than an agency for directing and training young men and women for employment in industry.² A general conclusion of this kind was implied in the reduction to only \$100 million in the 1943 budget, and President Roosevelt's statement that probably not even this amount would actually be needed.

Benefits to agriculture are the most difficult to discuss intelligently within a brief compass because governmental policy is in such a state of rapid flux. Amounting to \$967 million in the fiscal year 1942, they do not include loans to farmers by various governmental corporations and agencies, such as the Commodity Credit Corporation and the Reconstruction Finance Corporation.

The great bulk of the expenditures in this category has been accounted for by three items: soil conservation payments, parity payments, and food and cotton stamp plans. The whole complex system was evolved during a period of plenty when agriculture was one of the more depressed segments of the national economy. Soil conservation payments arose primarily to induce growers to reduce the acreage

planted to leading surplus crops and thus create an artificial scarcity, and secondarily to improve the soil. Parity payments were evolved to pay farmers direct cash subsidies representing the difference between the prices actually received for their principal crops and theoretical parity prices, based upon 1909-13 average levels. The food and cotton stamp plans were created for the dual purpose of disposing of surplus commodities and providing inexpensive food and clothing to needy families.

With all this machinery in force, we have suddenly discovered that we are no longer in an era of plenty but have now reverted, at least temporarily, to an economy of scarcity. Meanwhile, the Department of Agriculture has been struggling to reorient itself to the changed state of affairs, and is already urging increased output in many lines rather than a general condition of artificial scarcity. Although, as pointed out in Chapter 2, there is little likelihood of serious shortages in our principal food supplies, prices of all farm products have risen sharply during the last year. Cash farm income for 1941 is estimated at nearly \$11 billion and may approach \$13 billion in 1942.³ These figures compare with an average level of \$5.9 billion in 1931-35 and \$8.2 billion in 1936-40. Since the price mechanism is now operating strongly in favor of agriculture, it is progressively difficult to justify a continuance of these subsidies.

Because political influences are almost certain to prevent the imposition of unduly low price ceilings on farm products, and because Lend-Lease appropriations are providing what is, in effect, a tremendous subsidy for the disposal of agricultural products, and consequently for the maintenance of agricultural prices, we believe that the price mechanism itself should furnish sufficient incentive for adequate agricultural production during the emergency. Under present circumstances, these farm benefits serve no useful purpose from the standpoint of winning the war and relatively little from that of any other rational social objective. Instead, they represent

little more than excess spending power of a highly inflationary character which is being injected into the economy. We therefore conclude that, with the exception of some minor administrative outlays, the entire program of agricultural benefits could be eliminated with no detriment to the war effort and with full justice to our farm population. That no such drastic action is now contemplated by the Administration was made clear by President Roosevelt's budget message in which total expenditures for agricultural benefits in the fiscal year 1943 were estimated at \$854 million against actual expenditures of \$976 million in 1942.

As a matter of fact, the elimination of all agricultural benefit payments in the fiscal year 1943 would probably prove impossible, because a substantial proportion will be made in compliance with contracts entered into with farmers in the calendar year 1941, and to eliminate them would involve a breach of contract. This means that action would have to be taken in the calendar year 1942 to eliminate such contractual payments in the fiscal year 1944.

The only other important item in our list is that covering the cost of maintaining the regular peacetime functions of the federal government. The cost amounted to \$908 million in the fiscal year 1942, and is estimated at \$841 million for 1943. Although it has tended to rise year by year as bureaus and activities have multiplied, estimating what economies might be achieved without impairing efficiency is very difficult. Furthermore, because of the entrenched political strength of every government bureau once established, economies in this field will not come without tremendous pressure. We know also that there will be strong pressure for increased expenditures in many departments because of expanded defense activities and the upward trend of all costs, particularly living costs in Washington. On the whole, we do not believe any substantial net reduction in this item can reasonably be expected. About all one can hope is that

the total will be maintained at approximately the present level during the war, although moderate savings might be achieved in the fiscal year 1943.

The above analysis reveals that in only two categories in the non-defense expenditure totals could substantial savings in excess of those now contemplated in the 1943 budget be achieved. An elimination of the entire program of agricultural benefits would mean a further saving of some \$800 million, and some \$250-300 million might be saved from the total allocated to general public works. We believe that these combined savings of about \$1.1 billion could be attained without any detriment to our war effort; also that some minor savings, aggregating perhaps \$200-300 million, in several of the other non-contractual categories are possible without any sacrifice of efficiency in the operations of the federal government.

The suggested savings would mean that total non-military expenditures could be reduced to slightly under \$5 billion, whereas the budget estimate was \$6.1 billion for 1943. On the whole, \$5 billion seem to be the lowest level that, from a practical standpoint, one might hope to attain for these expenditures. Even if this goal should be achieved in the fiscal year 1943, we can be sure that rapidly rising interest costs alone would lead to higher totals in ensuing years if the war continues.

What are the actual prospects for achieving all or any part of these suggested savings during the next year or two? Some months ago there was a general attitude of defeatism regarding this prospect, but the atmosphere has recently changed in marked degree. The growing fear of inflation and the struggle to find new sources of revenue are exerting steadily increasing pressure in the direction of governmental economy. The forceful statements by the Secretary of the Treasury bear eloquent witness to the changed attitude of the administration. Another notable straw in the wind was the recent action of Congress in eliminating the Civilian Con-

servation Corps, and sharply reducing the appropriation for the Work Projects Administration.

Partly because certain economies will take place automatically and partly because of the rising general pressure for economy, we believe that actual non-military expenditures in 1943 will probably be somewhat lower than the budget estimate of \$6.1 billion. If the war continues, the outlook is for an appreciably higher total in the fiscal year 1944, unless a substantial part of the possible savings indicated above should be achieved. With interest charges certain to rise rapidly, and with a probable increase in general costs, about the best one could hope for would be a level somewhere in the neighborhood of that now contemplated for the fiscal year 1943.

State and Local Expenditures

Although not a central element in our problem, the outlook for expenditures by state and local governmental bodies is sufficiently important to require a few brief comments. In the first place, they are important because of their very magnitude. Their total averaged approximately \$9 billion annually in recent years, or almost the same as total federal outlays in the immediate pre-defense period.⁴ They are also important so far as they compete with the war effort for scarce and essential resources.

Fortunately for the fiscal outlook of the nation, state and local budgets as a whole are fairly well in balance at present. If substantial deficits were being incurred or were likely in the near future, we would have to reckon with an inflationary influence in addition to that created by the federal deficits. If, on the other hand, large surpluses pile up in these political subdivisions either from smaller expenditures or larger revenues, savings will be created that will act as an offset to the excess purchasing power being injected into the economy by the federal deficits. Finally, if local taxes are reduced hand in hand with a curtailment of

expenditures, the over-all tax burden will obviously be lightened.

The experience of the first World War does not provide any reason for optimism concerning the prospect for curtailing state and local expenditures. During that period they rose steadily and substantially. However, the total in 1913 amounted to only about \$2.2 billion, and was accounted for very largely by essential services that could not be eliminated, such as police and fire protection, water supply, and schools. The expansion during the war years was caused mainly by the rapid rise in prices and in the cost of living.

The present situation differs considerably. Included in the annual total, about \$9 billion, are substantial items which cannot be considered absolutely essential, some of which will tend to decline automatically under the conditions created by the war. The first is the construction and maintenance of public works. This item totaled almost exactly \$2 billion for the fiscal year 1939, and was divided approximately two-thirds for new construction and one-third for maintenance.⁵ Just as we have seen in the case of federal public works, this item is almost certain to decline under the influence of priorities in scarce materials and shortages in skilled labor. Another restraining influence may come from a federal prohibition against the creation of debt for such purposes by state and local authorities. As a rough guess, the total of such outlays may be somewhat less than \$1 billion in the fiscal year 1943, and should not rise above that level during the war.

Another important category comprises relief, public assistance, and unemployment compensation. It totaled approximately \$1.8 billion in the fiscal year 1939 and declined slightly in the fiscal year 1940. Direct and work relief accounted for about \$1 billion, unemployment compensation for about \$500 million, and public assistance (provision for the aged poor, dependent children, and the blind) for the balance. The outlook for relatively full employment should substantially reduce outlays for direct and work relief and

unemployment compensation. Smaller declines are likely in expenditures on public assistance. In all, we estimate that the total outlays in this category will fall to not more than \$1 billion in the fiscal year 1943.

Total interest payments, which amounted to about \$700 million in the fiscal year 1940, may decline slightly if outstanding debt is reduced by recurring surpluses. Not much reduction can be expected, however, especially if interest rates advance.

In essential services, such as public education, on which slightly more than \$2 billion is expended annually, police protection and fire protection, no savings are expected. On the contrary, these items are likely to increase in cost hand in hand with rising prices and wages, just as they did in World War I. On the whole, we believe that for each of the next two or three years, total state and local expenditures are likely to average between \$1 billion and \$1.5 billion below the levels of the immediate pre-defense period, if the current advance in general costs is held within reasonable limits.

The outlook for state and local tax revenues is also moderately encouraging. More than 90 per cent of local revenues, or approximately \$4.5 billion, is derived from property taxes. This is a highly stable source of revenue, but will normally tend to expand with rising national income because of the decline in delinquent tax payments. Approximately 70 per cent of state tax revenues is derived from excises, such as on general sales, motor fuel and vehicles, payrolls, and liquor. About 20 per cent comes from corporate and individual income, and estate and inheritance taxes. All these sources can be expected to show satisfactory returns during the period of high national income, despite a probable tendency of certain excises, such as on motor fuel, to decline as a result of rationing.

Thus, unless tax rates are sharply cut, substantial surpluses in state and local budgets seem a reasonable expectation. The

effect of such budget surpluses would be to withdraw a roughly equivalent amount of excess purchasing power from circulation and to serve as an offset to the inflationary influence of the excess federal expenditures. The effect would be much the same whether these surpluses are invested in Savings Bonds, or merely left as idle cash balances in banks. If, however, they are used to retire local debt, or if state and local taxes are reduced, additional purchasing power will remain in the hands of the public and will tend to augment the federal government's problem of coping with inflation.

NOTES

¹ *Evening Star*, Washington, D. C., July 1, 1942.

² The Civilian Conservation Corps was abolished on June 30, 1942, when Congress refused to appropriate funds for this purpose for the fiscal year 1943 (*ibid.*).

³ Department of Agriculture, *The Agricultural Situation*, Oct. 1941, Annual Outlook Issue, pp. 8-10.

⁴ The data and figures in this section have been gathered from various sources but chiefly from the following: Clarence Heer, State and Local Expenditures in the Emergency Period, *Annals*, March 1941, p. 25; *Economic Record*, Vol. I, No. 9, and Vol. III, No. 8 (National Industrial Conference Board); *Survey of Current Business*, Sept. 1940; *Tax Facts and Figures*, 1941 (Tax Foundation).

⁵ *Survey of Current Business*, Sept. 1940, p. 14.

