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CHAPTER VIII

The Requirements of National Security and International Aid

In Chapter VI we considered the factors making for an increase in federal net debt resulting from following a countercyclical fiscal policy during a business contraction, and deferred to the present chapter questions relating to retirement of the added debt after the economy has recovered from the contraction. Conditions making for or against retirement of the debt incurred in the 1930's and conditions making for or against retirement of the war debt must obviously be considered together. And it will prove advantageous to have considered them before we attempt to examine the possible significance of a countercyclical fiscal policy for future changes in federal debt.

It will doubtless be conceded that a countercyclical fiscal policy necessarily requires net borrowing during a business contraction. If one asks why or how far a war should be financed by borrowing, or why or how far international aid should be so financed, the answer can hardly be such a clear-cut statement. But war financing has proverbially meant deficit financing, and the limited experience we have had to date with international aid suggests that at least in wartime such aid is likely to be financed in substantial part by borrowing.

In this chapter we will first note some factors making for wartime deficits that have hitherto received inadequate attention, next examine the bearing of international aid programs on federal financial requirements, and then turn to questions relating to debt retirement.

1. *Would It Be Feasible to Pay for a War as You Go?*

It has often been suggested¹ that from a purely theoretical economic viewpoint a war, even an all-out war, could be entirely financed by raising taxes and other revenues as fast and as far as expenditures are increased. Among the arguments advanced against such a pay-as-you-go program are: that it would be more dampening to the ardor of patriotism than some measure of deficit financing; that it would be likely to employ taxes that would entail discouragements to maximum production increases; that

We are here concerned neither with the case for this suggestion nor with that against it. In particular we are concerned neither to affirm nor to deny the proposition that a perfect pay-as-you-go policy—if one were feasible—would avoid price inflation.

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borrowing is a simpler, often a more equitable way to mop up the last dregs of excess purchasing power; and that price increases, if limited in extent, may be the easiest way to accomplish some of the necessary reallocations of resources.

TABLE 45
Federal Receipt and Expenditure Increases and Deficit Financing
in Four Wars

Year	Receipts (millions of dollars) (1)	Expenditures (2)	Receipts (per cent increase per year) (3)	Expenditures (4)	Percentage of Deficit Financing (5)
1811 ^a	14.42	8.06			
1814 ^a	11.18	34.72	-7	110	68
1860 ^b	56.1	63.1			
1865 ^c	333.7	1,297.6	99	392	74
1916 ^b	1,080.0	1,040.0			
1919 ^b	5,500.0	18,380.0	136	557	70
1940 ^a	8,600.0	10,800.0			
1944 ^a	58,200.0	109,000.0	144	227	46.5

^a Calendar year figures.

^b Fiscal year figures.

^c Fiscal year figures for Union only.

NOTE: Data for 1811-65 are from *Historical Statistics*. Data for 1916-44 are from Table 5.

These contentions have been dealt with extensively in various studies of war finance, and it would be in the nature of a digression to go into them here. For our present purpose it seems sufficient to note that, to the extent they are valid, they make a full-fledged pay-for-a-war-as-you-go policy both economically inexpedient and politically improbable.

But even if all these contentions were to be summarily rejected, there is reason to think some lag of revenues behind expenditures would be very difficult to avoid, and that an important part of the explanation of war deficits lies in the rapidity of wartime expenditure increases. Table 45 compares roughly computed rates of increase of receipts and of expenditures in four wars. It also shows the percentage of deficit financing in the year taken as the terminal year of each war. Nonfinancial expenditures rose rather more rapidly during World War I than during the Civil War, despite the fact that price increases were somewhat restrained. Taxes and other nonfinancial receipts were stepped up most rapidly during World War II. If there is a substantial problem of developing the techniques of stepping receipts up rapidly—and we argue below that there

is—Table 45 is consistent with the hypothesis that these techniques have been improving. At all events tax rate increases were prompt enough and large enough during World War I so that the percentage of deficit financing in 1919 was less than that in 1865; and tax rate increases during World War II were prompt enough and large enough so that the percentage of deficit financing in 1944 was markedly less than that in 1919.

It is evident that there was no real effort to make revenues increase with expenditures during the War of 1812. And apparently William G. McAdoo, Secretary of the Treasury in 1913–18, after studying the Civil War experience, concluded that that experience was of negative help only, “teaching him what not to do” to finance World War I.²

In respect to tax sources conditions were distinctly favorable in 1917 to a sharp step-up of tax receipts such as would be needed to implement a pay-as-you-go policy. The inheritance tax (along with stamp taxes on various business documents) had been successfully levied as a war emergency measure in 1898–1901; and it had been reimposed in the 1916 Revenue Act. The Payne-Aldrich Act (1909), had established a corporate income tax. And promptly after ratification of the 16th Amendment an individual income tax had been included in the Underwood Tariff Act (1913). But before our entry into the war the rates were modest. Only 16 per cent of 1916 budget receipts came from income and profits taxes, and the inheritance tax did not yield anything during that fiscal year.

It might seem that Congress, with these almost untapped tax sources at its disposal, could have enacted tax increases as rapidly as it enacted the appropriations. As we have seen, in an emergency Congress has been willing to adopt short cuts in the appropriation process. On the other hand, when it comes to a revenue bill even during a war Congress is apt to take its own time. In September 1916 to meet the expenditure increases involved in the preparedness program a revenue act had been passed that imposed moderate tax increases, and this had been followed by another in March 1917 which raised inheritance tax rates and imposed an 8 per cent excess profits tax. But despite the sharp increases in expenditures after our entry into the war, agreement in Congress on a war revenue act was not reached until more than three months after the armistice.³

But the fact that making war appropriations seems to be a more expeditious process than levying taxes is probably only a minor part of the explanation of the need for deficit financing during World War I. Anything approaching a pay-as-you-go policy would have required leadership from the executive; the administration never seriously entertained the idea

² Paul Studenski and Herman E. Krooss, *Financial History of the United States*, p. 286.

³ Under the Act of February 24, 1919, taxes on 1918 incomes were sharply increased. The effective rate on individual incomes of \$3,000 to \$5,000 was 0.86 per cent for 1917, 2.35 per cent for 1918, and 1.67 per cent for 1919 and 1920.

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of such a policy. And even if it had, in the absence of an executive budget, a planned balancing of receipts against expenditures would have been very difficult, particularly since to an important extent—\$4.7 billion in fiscal year 1918—United States war expenditures were planned in the first instance by allied foreign governments. Table 46 shows how far expenditures were underestimated for 1917–19. Of course the fiscal 1917 estimates went to Congress late in calendar 1915; and the fiscal 1918

TABLE 46
Estimated and Actual Federal Expenditures, 1917–20
(millions of dollars)

Fiscal Year	Estimated Expenditures (1)	Actual Expenditures (2)
1917	909	2,086
1918	1,269	13,792
1919	13,019	18,952
1920	7,443	6,142

NOTE: Prior to the Budget and Accounting Act of 1921 estimates were transmitted to Congress rather more than six months before the beginning of the fiscal year. These estimates were reprinted in Secretary of the Treasury, *Annual Reports*.

estimates were submitted several months before the United States entered the war.⁴

One aspect of fiscal procedures that complicates the problem of balancing revenues against expenditures is the lag of expenditures behind the incurring of the obligations to make them. No doubt this complication was more in evidence during World War I than in the 1920's and 1930's. But partly because so large a part of the war expenditures—those for loans to allied governments—were not particularly subject to this lag, it was not a major complication. However, it became so during World War II, as Table 47 makes clear. Column 2 shows not obligations incurred, but the newly enacted authority to incur them—that is, new appropriations and contract authorizations.⁵ Total new obligational authority in

⁴ Much as at present, revised (midyear) estimates were submitted some twelve months later. These midyear estimates for 1918–20 all erred significantly on the high side.

⁵ Contract authorizations, like appropriations, convey authority to an agency such as the Department of Defense to incur obligations to spend money. The Constitution provides that “no appropriation of money [to support armies] . . . shall be for a longer term than two years.” The contract authorization is used to authorize contracts involving expenditure commitments (not necessarily military) that run more than two years into the future (for naval vessels these were formerly expressed in tons rather than dollars). A contract authorization must be followed by an appropriation to provide for liquidating the obligations incurred under it. (Congress is morally but not legally bound to make such appropriations.) In addition to the appropriation and the contract authorization Congress has in recent years conveyed new authority to obligate funds in the form of “authorizations to expend from public debt receipts,” e.g. for making loans.

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1941-45 exceeded total expenditures by more than \$130 billion. Evidently one way Congress in effect delegated a part of its discretion over expenditures during this war was through granting somewhat more new obligational authority than the executive actually used.

Another fact that can be deduced from the table is that there must have been a number of years during the 1940's (probably 1942-45) for which the total of unliquidated obligations to spend money outstanding on July

TABLE 47
Federal Budget Expenditures, Appropriations, and Other Obligational Authority Enactments, 1941-47
(billions of dollars)

Fiscal Year	Expenditures (1)	New Obligational Authority (2)	Re-enacted Obligational Authority (3)
1941	12.7	41.0	^a
1942	32.4	124.6	^a
1943	78.2	81.0	22.0 ^b
1944	93.7	102.1	36.9
1945	100.4	54.6	51.2
1946	65.0	70.6	36.1
1947	42.5	39.0	1.1

^a Not shown in the *Budget*.

^b Appropriations to liquidate contract authorizations.

NOTE: Column 2 represents new appropriations plus contract authorizations plus authorizations treated as public debt transactions minus rescissions. Column 3 represents reappropriations plus appropriations to liquidate contract authorizations.

All figures refer to general and special account totals excluding debt retirement. Figures for 1941 and 1942 are from *Receipts, Expenditures and Balances of the United States Government*; figures for each other year are from the Budget for the second following year.

It was larger than total estimated expenditures for the year ahead. But the amount of unliquidated obligations can only be roughly inferred from Table 47, and from data presented in the wartime budgets. It was not until after the great disparity between estimated expenditures and estimated new obligational authority developed during the war that the need for presenting a reconciliation between them in the Budget became urgent. And then it took time and experience to develop a satisfactory way to present such reconciliation in detail without adding greatly to the bulk of an already exceedingly bulky document.⁶ But beginning with the 1953 Budget a reconciliation has been given.

With information on unliquidated obligations incurred at hand it would seem that the making of short-term expenditure estimates should be considerably facilitated. Indeed, a quarterly release of unliquidated

⁶ Among other things it took time to develop the concept "new obligational authority."

federal obligations giving well-chosen detail might prove to be a highly significant addition to our current business information. But for Congress during World War II the disparity between expenditures and new obligational authority must have been a very confusing one. In fact, this disparity seems to have caused a good deal of confusion ever since the Budget began giving figures on it. Presumably, though, it will cease to be a source of confusion once it comes to be generally understood. But general understanding will not necessarily make prompter tax increases any easier. Indeed, since the new obligational authority conferred on the executive stepped up more rapidly than expenditures in 1941-44, mistaking the former for the latter may have helped to encourage prompter and sharper tax increases.

On the whole in respect to both the information and the procedures available the situation in World War II was far more favorable to making prompt tax step-ups than it had been in World War I. By 1940 the executive budget system had been in operation for nearly two decades. This provided the expenditure estimates needed for a planned relation between expenditures and taxes. Under it, too, important progress had been made in the technique of estimating tax yields, so that the executive branch was in a much better position to give some leadership in the development of tax bills. Perhaps more important, however, was what had been learned since 1918 about the problems of financing a major war effort and the increased influence of economists in dealing with these problems. Throughout World War I Treasury officials, ignoring the effect of government spending on private incomes, based their financing plans on the assumption that with the government in the bond market on so large a scale the total demand for funds was likely to outrun the supply. If not by 1940, then not long after that, Treasury economists had come to understand that "the income earned in producing output is necessarily equal to the value of output produced Any level of production is potentially self-financing at any level of prices."⁷

Table 48 compares for 1939-54 the budget estimates of expenditures submitted nearly six months before the beginning of each fiscal year, the midyear estimates, and the actuals. If there are still serious errors in the budget figures in 1941-43, 1946, and 1953-54, the record is clearly a considerable improvement over that of World War I. And the midyear figures are in general quite good.

Between July 1, 1940, when the defense effort may be said to have begun, and V-J Day, Congress passed six main revenue acts. During the

⁷ Committee for Economic Development Research Staff, *Jobs and Markets*, p. 12. In other words, for all economic sectors (including the rest of the world) total nonfinancial sources of funds equal total nonfinancial uses; hence, if the government has a nonfinancial deficit, other sectors, taken collectively, must have an equal nonfinancial surplus and be adding this amount to their net financial assets.

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defense program, while unemployment was still high, the administration recommended tax increases and the imposition of an excess profits tax, but qualified its recommendations with a caution against taxes that might "restrict general consumption." Congress responded in three acts, delaying the imposition of a tax on excess profits until the second and in

TABLE 48
Total Federal Budget Expenditures, Actual and Budgeted, 1939-54
(billions of dollars)

Fiscal Year	Budget Estimate (1)	Midyear Estimate (2)	Actual ^a (3)
<i>1946 basis</i>			
1939	6.9	9.5	8.7
1940	8.5	9.1	9.0
1941	8.4	13.2	12.7
1942	17.5	30.6	32.4
1943	58.9	80.4	78.2
1944	104.1	96.0	93.7
1945	98.0	98.9	100.4
1946	82.5	67.4	65.0
1947	35.1	42.7	42.5 ^a
<i>1952 basis</i>			
1948	34.2	35.2	33.8
1949	37.5	40.2	40.1
1950	41.9	43.3	40.2
1951	42.4	47.2	44.6
1952	71.6	70.9	66.1
<i>1954 basis</i>			
1953	84.7	73.9	73.6
1954	77.9	67.1	67.8

^a This figure is on a 1947 basis. The difference between this and the 1946 basis was apparently small for 1947.

NOTE: There were three main changes during the period covered by this table in the definition of budget expenditures (formerly called general and special account expenditures excluding debt retirement). On the adjustments made in the figures appearing in the budget documents because of these changes see Appendix A.

general enacting smaller increases than those recommended by the President. After Pearl Harbor the executive recommendations became more categorical and in various messages President Roosevelt vigorously stated the case for tax increases as an anti-inflationary measure. The first of the war revenue acts, approved October 21, 1942, raised taxes substantially, but far less than he had proposed. The main accomplishment of the second, approved June 9, 1943, was shifting the individual income tax

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to a current-payments basis, which added to tax collections in a year when individual incomes were increasing. The third was considered so inadequate by the President that he vetoed it (this was the first revenue act ever to be vetoed). But Congress passed it over his veto February 25, 1944.

These comments on the experience during World War II make it clear that some of the factors that hindered moving toward a pay-for-the-war-as-you-go policy were primarily political. President Roosevelt never proposed anything like a full pay-as-you-go policy—his most famous anti-inflation message (April 1942) advocated no more than reducing the budget deficit to 50 per cent of total budget expenditures—but Congress could not see its way clear to going this far.

By way of giving some indication of the extent of the tax increases during the defense program and the war we may note the following:

	1939	1940	1941	1942	1943	1944	1945
Ratio of individual income taxes to personal income, per cent ^a	1.2	1.3	1.7	3.2	9.4	10.5	11.5
Ratio of corporation taxes to corporation net income, per cent ^b	14.0	22.9	39.7	51.2	55.3	54.9	48.7

^a Based on *Survey of Current Business; 1954 National Income Supplement*, Table 3; and *Flow of Funds in the United States, 1939-1953*, Table 17.

^b For corporations reporting net incomes. Taxes comprise income and property taxes levied on income of year indicated (fiscal year most nearly coinciding with calendar year, including fiscal year ending the following June 30). Figures are based on *Statistics of Income for 1948*, Part 2, Table 11.

During the defense program the expenditure increase was not so very sharp—nonfinancial expenditures were \$10.25 billion in 1939, \$22.2 billion in 1941. Yet over 43 per cent of the 1941 outlay was deficit financed. In 1942 nonfinancial expenditures totaled \$64.5 billion, and since tax collections did not yet fully reflect the rates of the 1942 act, 63 per cent of this amount was financed by borrowing. But in the following war years the ratio of deficit to nonfinancial expenditure declined; the \$50.8 billion deficit in 1944 was only 47 per cent of the \$109 billion expenditure total.⁸

Improved procedures and improved information helped to make the proportion of expenditures financed by taxes and other current revenues larger in World War II than in World War I. Presumably the proportion would have been higher still had Congress been more favorably impressed with the pay-as-you-go idea.

Let us imagine another occasion, and one on which Congress is persuaded that a pay-as-you-go policy is desirable. Even in such a situation it

⁸ These statements are based on Table 5.

seems probable that present legislative procedures would be so slow that tax receipts could not be pushed up fast enough to keep pace with expenditures. However, if Congress could somehow divorce its consideration of tax rates from its concern with amendments to the tax structure, the legislative process required to raise rates might be considerably expedited. A more radical possibility would be a tax statute authorizing and directing the executive to make specified changes in tax rates to accord with specified changes in economic conditions. In form this would be a delegation of taxing power; but if the changes in rates and changes in economic conditions were properly specified in the statute, there might well be less delegation of tax policy-making power than was involved in letting the executive plan and put into operation the various subsidy programs it did in World War II.

2. *How Far Need International Aid Be Financed by Borrowing?*

During and after both world wars the United States contributed large amounts of aid to other countries. The amounts are summarized in Table 49. Nearly all of the aid during and after World War I took the form of loans, although viewed in retrospect we are well advised to call the unpaid ones grants. Also, most of the international aid advanced during World War II was part of what has commonly (and somewhat misleadingly) been called the lend-lease program. But, subject to one exception of consequence and one qualification, we can say that operations under this program up to V-J Day ought in general to be regarded as grants rather than as loans or as lease agreements. The one exception is the silver loans—the 335 million ounces of silver “lend-leased” to foreign countries are classified in the table as credits. The qualification is that to date some 5 per cent of the grants have in retrospect been converted into credits (i.e. into debts of the countries receiving the aid). Since V-J Day the bulk of international aid has been quite frankly labeled “grants”. And the total of net new grants and credits extended to other countries, July 1, 1945, to December 31, 1953 (line M), was nearly 10 per cent larger than that of the grants and credits extended during the five preceding war years, only about a quarter of the \$44.3 billion for the postwar period being net new (and in-retrospect-converted) credits.

During the 1920's it became doubtful whether the debts of the allied governments to the United States could be collected. However, in the funding agreements (the war loans had been payable on demand) only limited concessions were made—concessions in amount of interest and in lengthened payment periods rather than in principal. Then with the coming of the recession, 1929–33, one country after another ceased making payments; and in June 1932 President Hoover issued a statement offering

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TABLE 49
International Aid during and after the Two World Wars, 1917-53
(billions of dollars)

	April 6, 1917 to November 30, 1918 (1)	After November 30, 1918 (2)	World War I Total (3)	July 1, 1940 to June 30, 1945 (4)	July 1, 1945 to December 31, 1953 (5)	World War II through 1953 (6)
A. Gross new grants	0	0	0	^a	10.5	^a
B. Military	0	0.1	0.1	^a	26.4	^a
C. Other	0	0.1	0.1	47.5 ^b	36.9	84.4
D. Total	0	0	0	7.8 ^c	1.4	9.2
E. Less reverse grants and returns	0	0	0	0	2.3	2.3
F. Less prior grants converted into credits	0	0.1	0.1	39.7	33.2	72.9
G. Net new grants	7.3	3.0	10.3	1.2 ^d	11.5	12.7
H. New credits	0	0	0	0	2.3	2.3
J. Plus prior grants converted into credits	0	0.8 ^e	0.8 ^e	0.4 ^d	2.7	3.1
K. Less principal collections	7.3	2.3 ^f	9.6 ^f	0.8	11.1	11.9
L. Net new credits	7.3	2.4	9.7	40.5	44.3	84.8
M. Net new grants and credits	7.3	2.4	9.7	40.5	44.3	84.8

^aNot available.

^bLend-lease \$46.1 billion.

^cReverse lend-lease.

^dLend-lease \$326 million less principal collection \$47 million plus loans held by government corporations, June 30.

^eTo November 15, 1940.

^fThe principal amount of the debts was increased under refunding agreements by the inclusion of nearly \$1.9 billion of accrued and unpaid interest, making the net principal amount \$11.4 billion as of November 15, 1940.

SOURCE: See Appendix A.

a moratorium. Most of the payments after the moratorium (there were revisions in some of the debt agreements) came from Finland. Finland paid \$3.1 million, 1935–40. Total payments on principal account by all countries from the start up to November 15, 1945, came to \$758 million. There is little prospect that any substantial part of the remaining principal—or of the accrued interest—will ever be paid.⁹

It is interesting to compare the \$11.9 billion of net new credits extended during and after World War II with the \$9.5 billion of unpaid principal of the earlier war period, despite the fact that the list of countries is not entirely the same in the two cases. One naturally wonders how much of the \$11.9 billion, if any, will go the way of the World War I credits.

It would not be easy to say just what part of the international aid recorded in Table 49 involved deficit financing. In retrospect we have reconstrued \$9.5 billion of net credits extended during the earlier war period as grants, and since grants are here treated as nonfinancial expenditures, this amount contributes to the financial requirement shown for the period. But we have—perhaps wrongly—treated the \$11.9 billion as credit extended and hence as an addition to the financial assets we deduct from gross debt in computing net debt.

Some of the aid extended after World War I and a major portion of that after World War II was extended during years in which the federal government had a nonfinancial surplus. On the other hand the aid advanced during both wars contributed to the sharp expenditure increases that were in substantial part financed by borrowing. There appears to be no reason why international grants-in-aid as such should require deficit financing, particularly in the case of an aid program spread more or less evenly over a number of years. Indeed, while a series of annual extensions of credit aid in which year-to-year variations are no wider than in the decade following World War II might well be excluded from a revised concept of budget expenditures, some would argue that the funds so advanced to other countries should in general be provided by taxes rather than by internal borrowing.

It happens that the net federal debt was decreased from its 1920 peak during the next eleven years by an amount not very different from \$9.5 billion of the net new credits on line L that have since been reconstrued as grants. But this approximate equality is doubtless a coincidence. If at some future time several billion of the credit aid extended after World War II were in retrospect to be reconstrued as grants, it is doubtful that the consequent increase in the net federal debt figure would occasion the retirement of a like amount of internal debt. But this possibility suggests the broader question which is the topic of the following section.

⁹ But these "loans" are still carried as debts due the United States in the *Annual Reports* of the Secretary of the Treasury.

3. *On the Retirement of Emergency-Incurred Debts*

After the War of 1812 and to a large extent after the Civil War the war debts were retired; but the retirements do not seem to have been the result of a vigorous debt retirement policy. Table 50 indicates the course of the debt (net of the general fund balance) after the two wars. At the end of 1815 the net debt stood at \$114.2 million. In all but three of the next twenty-one years there was a surplus, a major contributing factor to these

TABLE 50
Federal Debt Less General Fund Balance after Two Wars
(millions of dollars)

December 31	Net Debt	June 30	Net Debt
1811	44.5	1860	60.9
1814	98.1	1865	2,651.5
1815	114.2	1866	2,643.3
1817	88.5	1873	2,091.5
1818	94.1	1875	2,093.0
1830	34.4	1893	836.6
1836	-45.4		

NOTE: Figures on gross debt are from *Historical Statistics*; on general fund balance from Secretary of the Treasury, 1920 *Annual Report*, p. 776.

surpluses being the protective tariff. Although the rates imposed under the 1816 tariff act were in general below wartime levels, they were high enough so that the 1816 tariff has sometimes been considered the beginning of protectionism. Duties were increased in 1824 and again in 1828, then reduced in 1832 and 1833. Despite the duties, imports grew; the value of imports was 11 per cent higher in the decade ending 1836 than in that ending 1825.¹⁰ And of the total federal revenues¹¹ from December 31, 1815, to December 31, 1836, customs duties constituted almost 80 per cent. At the end of this period the general fund balance exceeded the small amount of obligations outstanding by more than \$45 million.

The process by which most of the Civil War debt was paid off was not so very different. In both cases debt retirement was in large measure a by-product of protectionism. Customs duties were increased during the Civil War, particularly by the acts of 1862 and 1864. The ratio of duties to value of total imports had been 15.7 per cent in 1860; it was 38.5 per cent in 1865.¹² A good deal of consideration was given to downward revision of the tariff in the next twenty-five years. But the principal results

¹⁰ *Historical Statistics*, M-54. Figures refer to years ending September 30.

¹¹ Total in the sense of total nonfinancial receipts other than postal revenues. See *Historical Statistics*, P-89.

¹² 1923 *Statistical Abstract*, p. 799.

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were a 10 per cent horizontal reduction enacted in 1872 and repealed in 1875; a mixture of upward and downward adjustments in the act of 1883; and the McKinley Act of 1890, which increased some duties and conferred on the President limited power to levy certain duties on a reciprocity basis by proclamation but substituted a subsidy on domestic sugar for the previous duty on raw sugar imports. The following ratios of customs duties to value of total imports indicate in a general way the changes in the level of the tariff from 1870 to 1895:¹³

<i>Year</i>	<i>Ratio of Duties to Total Imports (per cent)</i>
1870	44.9
1875	29.4
1880	29.1
1885	30.8
1890	29.6
1895	20.4

Again despite these postwar tariff levels imports grew. In the decade ending 1876 they totaled \$5.0 billion; in that ending 1893, \$7.4 billion.¹⁴ So during the twenty-eight years following the Civil War customs receipts were 43.5 per cent of total federal revenues.¹⁵ In every one of these years there was a surplus, and by June 30, 1893, the net federal debt had been reduced to \$836.6 million.

After both world wars political pressure to cut taxes was strong. It is much easier to maintain customs duties at high wartime levels than internal revenue rates. But there were other circumstances, too, that militated against a policy of retiring all or most of the emergency-incurred debt. During the 1920's, indeed, there was a good deal of discussion of such a policy, but the approximately \$10 billion incurred in connection with World War I to finance external loans was considered to be a justifiable debt. If we were to count all of these loans—including the uncollectable ones—as federal credit in 1929, and if we were to adjust the net debt figures on line J of Table 51 accordingly, the record would show a net debt of over \$15 billion as of June 30, 1919, about half of which was paid off during the next decade. Still this debt retirement—it amounted to about \$8 billion on the Table 51 basis—was accomplished somewhat inadvertently. As we noted in Chapter III, tax yields grew, reflecting the rapid growth of GNP during the 1920's, while nonfinancial expenditures were somewhat stable and the several cuts in tax rates were little

¹³ *Ibid.*

¹⁴ *Historical Statistics*, M-54. Figures refer to years ending June 30.

¹⁵ See footnote 10.

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enough and late enough to give us a decade of surpluses. Thus the process of partial debt repayment after World War I has something in common with the debt repayment processes after the War of 1812 and the Civil War; it was a by-product of a legislative procedure that was slow in making downward revisions in wartime tax rates.

After World War II there was little sentiment in favor of retiring any substantial part of the net debt accumulated during the war and the great depression preceding it. Indeed, there was a good deal of sentiment against

TABLE 51
Federal Debt and Financial Assets at Selected Dates, 1919-54
(billions of dollars)

	1919 (as of June 30)	1929	1945	1950 (as of December 31)	1953	1954
A. Cash balance	1.25	0.33	27.2	5.2	5.7	6.0
B. Federal obligations held by federal funds	0.59	1.02	37.8	44.7	58.3	61.4
C. Foreign loans and securities ^a	^b	^b	1.6	13.4	14.2	15.1
D. Other federal credit	0.75	1.62	7.4	8.4	10.5	11.4
E. Total financial assets (A + B + C + D)	2.59	2.97	74.0	71.7	88.7	93.9
F. Direct and agency obligations outstanding	25.95	18.80	292.6	266.4	289.3	294.4
G. Net accounts payable	^c	^c	1.5	0.7	0.6	0.0
H. Total obligations and accounts payable (F + G)	25.95	18.80	294.1	267.1	289.9	294.4
J. Net debt (H - E)	23.36	15.83	220.1	195.4	201.2	200.5

^a Includes capital subscriptions to IMF and IBRD.

^b World War I obligations of foreign governments are not counted here as financial assets. See Table 35, line L.

^c No estimate available.

SOURCE: See Appendix A.

debt retirement on any considerable scale, sentiment that was rationalized by the contention that government surpluses would be likely to reduce aggregate demand and cause unemployment.

Nonetheless net debt (see Table 51) decreased by some \$19 billion during the eight years ending December 31, 1953. And it seems highly probable the decrease would have been greater had it not been for the Korean War. Further, despite the contention regarding the depressing effect of government surpluses, it seems fair to say the decrease that did occur in some sense reflects a deliberate fiscal policy. However, as Table 51 makes clear, if there has been debt retirement since World War II it has mainly taken the form of a decrease in net debt. In 1946, indeed, as we noted in Chapter I, some \$20 billion of gross direct debt was retired

by drawing down the general fund balance. But since 1948 the gross direct debt has been increasing.

If one tries to explain how it happened that net debt decreased by \$19 billion during eight years in which there was a decrease of only about \$4 billion in total obligations and payables outstanding, both the \$16 billion expansion of federal credit and the more than \$20 billion increase in federal obligations held by federal funds should be taken into consideration. Also if one tries to construe the changes in debt during these years as reflecting fiscal policy, presumably it is the budget surplus or deficit rather than the \$19 billion nonfinancial surplus toward which that policy was immediately directed—and there was a budget deficit of some \$17 billion during these eight years. Most of the \$36 billion difference between these two computations is mainly the result of the expansion of federal credit (including the IMF and IBRD, it was chiefly external credit that was expanded) and the growth of social insurance funds. Thus the postwar decrease in net debt should be regarded as the joint product of a number of factors, principally a budget deficit of \$17 billion, a social insurance funds surplus of some \$21 billion, and a credit expansion of \$16 billion.

A comparison of the four periods of postwar debt retirement we have been reviewing strongly suggests two propositions. First, anything like complete debt retirement is a policy objective that commands relatively little political support. And second, there has been a marked downward trend in the degree of debt retirement achieved.

If there has been little political support for a program of retiring emergency-incurred federal debt, particularly since the 1930's, no doubt a part of the explanation is that while there have in recent years been no specific political interest groups that stood to gain by such a program there have been specific interest groups that would have opposed it had one been attempted. Such a program would have meant either substantially lower expenditures or substantially heavier taxation. And a considerable cut in expenditures almost inevitably would have meant a cut in objects of expenditure that someone had a special interest in seeing maintained. Likewise substantially heavier taxes obviously would have meant opposition from those who would have had to pay them.

However there is one kind of tax that a special interest group can be counted on to favor, namely, a "protective" tariff. We have noted that maintenance of import duty rates played a major role in debt retirement after the War of 1812 and the Civil War. No doubt the downward trend in the degree of retirement of emergency-incurred debt reflects in part the declining relative importance of customs as a source of federal tax revenues.

But special interest groups are not the whole story. Those who have been concerned in recent years about the possibility that retirement of any

considerable part of the federal debt might mean depressed business and a large volume of unemployment have been right to this extent. A decrease in the government's nonfinancial deficit or an increase in its surplus exerts a cyclically depressing influence on the level of aggregate demand. If the concern about this depressing influence was stronger after World War II than after World War I—and if accordingly there was less disposition to advocate war debt retirement—this was a natural consequence of the fact that federal fiscal operations had become so much larger in relation to the other parts of our economy.

These comments are pertinent to the circumstances influencing the prospects of retirement of our present federal debt. Of course different considerations apply in the case of a debt of a country that is held externally. The creditors are not a domestic special interest group.

Many writers, in discussing a countercyclical fiscal policy, have assumed an approximate balance of receipts and expenditures over the period of the cycle. But in our analysis of the circumstances influencing federal debt retirement no distinction has been drawn between war debt and the debt incurred in the 1930's. And this suggests a question: With both special interests and a general interest aligned against debt retirement, is it not more likely that the nonfinancial deficits incurred in periods of relatively slack business would tend to exceed the surpluses of the periods of brisker business? If so, the federal debt might continue to grow, cycle after cycle. But we cannot entirely rule out the contrary possibility. During the 1920's government revenues grew with the growth of the economy, and grew fast enough so that there was a series of surpluses. This could conceivably happen again.

What seems clear is that there is nothing in present fiscal procedures that constitutes a mechanism for achieving a balance of receipts and expenditures over the cycle, and that, in the absence of any such mechanism, a substantial imbalance one way or the other is far more likely than an approximate balance. But there is also the possibility that the government might develop a form of capital budget that would provide just such a mechanism by taking most of the cycle out of the current budget and making it possible to balance every year's current budget approximately. A budget system under which countercyclical expenditures on works projects, state and local grants-in-aid, etc. would be charged to capital account and amortized over a subsequent period of years such as a decade would be a step in this direction, for it should be possible substantially to smooth the cycle out of budget expenditures in this way. And presumably an analogous deferred-credits procedure could be applied to a portion of tax and other receipts during the upper stages of the cycle in such a way as to smooth year-to-year variations out of budget receipts. If so, and if the receipts thus "smoothed" balanced the "smoothed"

expenditures every year, there should be no secular trend either up or down in the cumulative total of the unsmoothed net budget expenditures. A well-devised budget system along these lines should provide a mechanism for implementing the idea of balancing the budget over the cycle.

4. *Summary*

One reason for deficit financing during World War I was the primitive nature of the then existing budgetary procedures. During World War II the lag of expenditures behind appropriations became extremely important. This complicated the problem of relating receipts and expenditures, but it may have done something to keep down the deficits. Shifting the individual income tax to a pay-as-you-go basis in mid-1943 undoubtedly helped thereafter to keep deficits down. The slowness of the legislative process in the case of tax bills worked in the opposite direction during both wars. This process might be expedited if Congress dealt separately with tax rates and tax bases. Also there is the possibility of what has been called formula-flexibility taxation.

The international aid extended during and after World War I and that extended during World War II involved extensive borrowing. The aid extended to other countries in the eight and one-half years following World War II did not. Even if all the more than \$44 billion extended during this period were to be counted as grants—and this would mean adding some \$11 billion to the nonfinancial expenditures shown in Table 5—there would still remain a substantial nonfinancial surplus. The difference in the time patterns of expenditures in these contrasting cases is undoubtedly the main significant one. Aid extended at a rate that does not vary too widely from year to year, no matter whether it takes the form of loans or of grants, can be financed by taxes. Aid that contributes to a rapid step-up of expenditures is likely to entail a resort to borrowing.

Such retirement of emergency-incurred federal debts as has occurred seems for the most part to have been inadvertent. And during the nineteenth century it was helped by the fact that import duties were the main source of federal revenues.

The lack of support for a debt retirement program, particularly after World War II, reflects in part the fact that special interest groups would have opposed such a program while there were no special interest groups that stood to gain by it. But there is also a more general kind of opposition. With federal fiscal operations on the scale they have now attained, any large increase in nonfinancial receipts or large cut in expenditures would exert temporarily a marked cyclically depressing influence on the level of economic activity.

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retirement raises a question regarding the possibility that a counter-cyclical federal fiscal policy might be followed in future in a fashion that would result in a long-run balance of receipts and expenditures. With present budgetary procedures an ever-growing federal debt seems far more likely. So does another period of persistent inadvertent surpluses like that of the 1920's. But an appropriate form of capital budget might provide a mechanism for achieving a long-run balance of receipts and expenditures.