

PUBLIC POLICY PAMPHLE

HARRY D. GIDEONSE, Editor

---

# BALANCING THE BUDGET

FEDERAL FISCAL POLICY DURING  
DEPRESSION

A STATEMENT BY A UNIVERSITY OF  
CHICAGO ROUND TABLE



THE UNIVERSITY OF CHICAGO PRESS  
CHICAGO • ILLINOIS

COPYRIGHT 1933 BY THE UNIVERSITY OF CHICAGO  
ALL RIGHTS RESERVED. PUBLISHED JANUARY 1933  
SECOND IMPRESSION MARCH 1933

---

COMPOSED AND PRINTED BY THE UNIVERSITY OF CHICAGO PRESS  
CHICAGO, ILLINOIS, U.S.A.

## INTRODUCTION BY THE EDITOR

For many months there has been much discussion of balancing the federal budget. Unfortunately, most of those who have participated in the discussion have not been careful to define what they mean by balancing the budget or to analyze fully the problems involved. Evidently not a few have assumed that all outlays, whether for ordinary operating expenses, capital investments, loans, or emergency relief, should be covered by tax and miscellaneous revenues for the year. Informal discussion of the subject by some of the signers of this memorandum led to the formation of a round table which, beginning early in November last, held a series of meetings. A committee of three drafted a memorandum; this was considered by five economists who have specialized in government finance, a number of political scientists, and an equally large number of experts officially connected with associations in the field of public administration. A somewhat revised memorandum was then prepared and another meeting held. Working in this way, the statement herewith printed was evolved by the eleven persons who have signed it.

This is the first of a series of Public Policy Pamphlets which the University of Chicago Press is planning to publish. Frequently the scholarly journals give no attention at all to problems that have an acute but temporary interest, while the ordinary magazines can print little but superficial comment. The University might well perform a valuable public service by making available to the public whatever special training and information it may have at its disposal. The continuation of such a series will, of course, depend upon its reception by the public.

Perhaps it goes without saying that the authors of these pamphlets are individually responsible for their views and that they in no way involve the responsibility of the University of Chicago.

HARRY D. GIDEONSE

January 16, 1933.

## FEDERAL BUDGETARY POLICY DURING A DEPRESSION

Few problems confronting the American public transcend in importance that of federal financial policy. There appears to be grave danger that in balancing its budget the federal government may adopt policies, the inevitable consequence of which will be the retardation of business recovery and the impairment of the social usefulness of government. These evil consequences can be avoided.

In determining its fiscal policy for the coming year the federal government is faced with these major questions:

1. How should the budget be balanced?
2. Should expenditures be reduced?
3. What taxation policies and devices should be adopted?
4. What should be the debt policy of the national government in the near future?

The purpose of this memorandum is to shed light on these questions and to make such constructive suggestions as appear to be in point.

The determination of policies to be followed in dealing with governmental budgets concerns state and local units as well as the federal government. Though the principles to be observed are almost identical, they are capable of wider application to federal finances than to the finances of the state and local governments. In one important respect there is a vital difference between the fiscal operations of the national and those of other political units. For the federal government has control over the monetary system of the country, and its fiscal policies can and should be controlled with reference to the monetary and credit situation of the nation. The activities of the national government are of greater importance in reference to the swings of the business cycle than are those of state and local governments. Although this memorandum is primarily concerned with the issues of policy confronting the federal government, some of the fundamental principles

herein discussed may find proper application in the financial programs of other governmental bodies.

The present economic depression did not materially affect the fiscal operations of the federal government until the year 1931.<sup>1</sup> Beginning in 1920 and extending to 1930 a series of annual surpluses accrued to the Treasury. At the end of the fiscal year 1930 the surplus approximated \$184,000,000, but the fiscal year 1931 closed with a deficit of over \$903,000,000. At the end of the fiscal year on June 30, 1932, the annual deficit had grown to \$2,473,000,000, exclusive of debt retirement charges. To prevent a recurrence of deficits in 1933, expenditures were pruned and additional taxes were imposed; but these measures have not prevented the recurrence of a fiscal deficit. In his budget message to Congress, President Hoover estimated that the deficit for the fiscal year 1933 would be approximately \$1,146,000,000 exclusive of public debt retirements, which now may be affected by the failure of some of the European countries to make payments on account of their war debts. These payments have hitherto been devoted primarily to the retirement of the national public debt, and the consequences of their reduction or discontinuance must be faced in developing the federal fiscal policy.

---

<sup>1</sup>Unless otherwise specified, all references to years are to fiscal years ending June 30 of the year specified.

## BALANCING THE BUDGET

Should the 1934 budget be balanced? If so, how? These questions can be answered only by getting a clear idea of the nature of the budget and of precisely what is to be balanced.

## NATURE OF BUDGET

The federal budget for 1933-34 was presented to Congress by the President on December 8, 1932. It outlined a program of expenditures and presented revenue estimates presumed to be sufficient to carry into execution the activities indicated during the next fiscal year, except such as will be covered in the ever-recurrent deficiency bill. The executive budget recommends to Congress a program of activities, but the sums made available by Congress for expenditure during the ensuing year remain partially within the control of the executive. The amounts made available by appropriation need not necessarily be spent. Frequently, by executive order, as in the case of the naval limitations agreements affecting battleship construction, sums designated in the budget are "salvaged" or "recaptured."

On the revenue side of the budget, the power of the government is somewhat more limited. The budget should present honest estimates of probable income; but whatever the degree of care with which estimates are made, errors are inevitable. Apart from providing an efficient administrative and collection system, the government cannot control the payment of taxes, which will depend upon the ability, and to some extent on the will, of taxpayers to pay taxes. The recent decline in federal revenues, particularly from personal income taxes, reflects clearly the impairment of the economic circumstances of taxpayers.

## BALANCING THE BUDGET

"Balancing the budget" should be used to mean the attempt to secure sufficient revenue to defray the expenditures

of government. That portion of the budget not covered by revenues may be considered as unbalanced. Funds to meet the fiscal requirements of the unbalanced portion can be secured (1) by short-term borrowings, (2) by long-term funding, or (3) by issuance of fiat money. Given an expenditure program, the question Congress faces is: How much of the needed revenues should be obtained by taxation and how much by borrowing?

This question can be answered only after the expenditure program of the federal government is carefully analyzed. It is often erroneously assumed that every item of expenditure, regardless of its nature, should be covered by revenues derived exclusively from current taxation and miscellaneous current sources. Certain types of expenditures which ordinarily should be financed by current taxation may properly be financed by borrowing during a depression period.

Those expenditures which should be financed from current revenues can best be seen by the listing of items which need not be so financed. Among the types of expenditure which in this emergency should *not* be financed from current taxation are the following:

1. Non-recurrent emergency expenditures.
2. Loans and investments.
3. Expenditures for public works.
4. Permanent appropriations not to be spent during the current fiscal year.
5. Public debt retirements.

With the foregoing items excluded, the aim of the Treasury for the fiscal year 1934 should be to finance only normal operating expenses from current revenues. Relief, investments, loans, and public works should be financed from borrowings; and the federal debt during the next fiscal year should be increased by a sum not less than the amounts so expended.

In a period of prosperity some of the items for which borrowing should now be resorted to may properly be financed by taxation. In a deep depression the injury inflicted upon taxpayers by requiring them to defray the cost of every gov-

ernmental activity by current taxation in order to avoid increasing the public debt appears to be greater than can be justified. Of course, it is necessary to avoid borrowing to such an extent that the credit of the government becomes seriously impaired. But the credit strength of the government can be maintained without resort to taxation measures of such severity as to threaten to prolong the existing depression.

#### NON-RECURRENT EMERGENCY EXPENDITURES

The public should not be called upon at this time to furnish funds by taxation to finance non-recurrent emergency expenditures. The burden of normal taxation has already been made severe by the shrunken incomes and losses of the depression, to which have been added the weight of emergency taxes enacted by the last Congress. It is not desirable that relief from unforeseen disasters or flood, for example, should under existing circumstances be provided by current taxation.

#### LOANS AND INVESTMENTS

It is also inappropriate at this time to raise funds by taxation for investment and loan purposes. Subscription to the stock of government-owned corporations is a practice almost as old as the Republic, dating back to the formation of the Bank of North America in 1781. Among the other corporations to which the government has subscribed capital are the Panama Railroad Company, the United States Shipping Board, the Federal Land Bank, the Federal Intermediate Credit Banks, and the Reconstruction Finance Corporation. In some instances these subscriptions resemble other governmental expenditures, being only a method of financing particular services; in other cases they resemble ordinary investments or loans of government credit. The sums so advanced have often been returned to the Treasury, some of them yielding substantial profits, others huge losses. In the fiscal year 1932 the Treasury subscribed \$500,000,000 to the Reconstruction Finance Corporation and \$125,000,000 to the Federal Land Banks. Similar advances do not appear to have been included in the 1934 budget; but should additions to the capital of these agencies become necessary, or should

similar plans be adopted by Congress during the present emergency, the funds should be secured by borrowing, provision being made from current revenues for the creation of reserves for such losses of capital as may now reasonably be anticipated.

That many of these advances are merely loans of government credit is apparent from the operations of the Reconstruction Finance Corporation. Created with a capital of \$500,000,000 supplied by the Treasury, with potential resources aggregating \$3,800,000,000, of which \$3,300,000,000 was to be provided by the issue and sale of federal credit instruments, this arm of the government from February 2, 1932, up to the close of business on November 30, 1932, had authorized loans amounting to \$1,542,000,000 and had advanced in cash \$1,502,000,000, of which \$283,000,000 had been repaid. Loans to banks, trust companies, and financial institutions (including live stock and agricultural credit corporations) aggregated \$1,088,000,000, of which \$898,000,000 was for banks, trust companies, and their receivers; \$75,000,000 was advanced to the Secretary of Agriculture for the relief of agriculture, out of which loans aggregating \$64,000,000 had been made; \$328,000,000 in loans was authorized for railroads. Loans approximating \$146,000,000 were authorized for "self-liquidating" projects up to December 23, 1932, but the cash advances in aid of these projects up to December 31 amounted to only \$15,597,000. In addition, relief loans to states and cities, up to January 1, 1933, amounted to \$103,705,000. In his latest report the Secretary of the Treasury recognized that "these funds are represented by loans made by the corporation on security and will, at a not-too-distant date, be returned to the Treasury." During the continuance of this depression, capital for investment or reloaning operations should be secured by the federal government by borrowing rather than by taxation.

#### PUBLIC WORKS EXPENDITURES

Outlays for public works undertaken to stimulate employment are essentially capital investments which in this

<sup>1</sup> Of the \$75,000,000 so advanced, the Secretary of Agriculture has returned \$15,000,000 (November 30, 1932).

emergency should be financed by loans. These outlays are made to acquire permanent improvements, the life of which will extend over many budgetary periods. If sound practices of private businesses were followed, sums expended for such purposes might properly be distributed over the period of the useful life of the property, the original outlay being financed by the issuance of bonds.

It has been regarded as sound financial practice among larger units of government (as well as among corporations) to finance a certain amount of constantly recurring capital expenditures from current revenues. The federal government has not only done this but has financed through taxation over a long period of years many non-recurrent outlays. In times of prosperity this policy was the proper one for the government to pursue. In this depression, even some of the recurrent outlays should be financed from proceeds of loans. The financing of recurrent outlays by borrowing can, however, be justified only as a depression measure, and should be abandoned as soon as the country is well on the road to recovery.

#### PERMANENT APPROPRIATION BALANCES

Another type of budget item, commonly referred to as "continuing" or "permanent" appropriations, should not be financed entirely by the revenues of a single year, especially during a depression. Whereas unexpended balances in other appropriations usually revert to the general fund at the close of the fiscal year, these authorizations are exempt from lapsing or transfer, so that expenditures against them may continue until the sums initially appropriated are exhausted. To the extent that the taxation program is governed by the budget for expenditures, the inclusion in that budget of provision for permanent appropriations not to be expended during the fiscal year necessitates an increase in present tax burdens to provide for future expenditures. To the extent that the taxation program is not made to depend upon the budget for expenditures, balances not to be spent currently only add to the apparent (but not the real) difficulties of balancing the budget. Unused balances in appropriation accounts are to be expected; and so far as they accrue, they

lessen the need for providing current revenues or they make possible increased expenditures or further debt retirements. The budget for each fiscal year should contain definite appropriations only for that fiscal year. To the extent that permanent appropriations are financed by borrowing, the funds required are not borrowed until needed. The same practice should be followed as to expenditures financed by taxation. Funds should not be raised by taxation except in the fiscal year for which they are required, provision being made in prosperous times, however, for the acceleration of public debt retirements. The exclusion from the budget for any current year of expenditures continuing beyond such year will measurably reduce the apparent difficulty of the task of balancing the budget.

To assure the efficient execution of projects whose completion is impossible or undesirable during a single fiscal year, provision should be made for charges against future budgets. This can best be done by long-range financial planning—that is, by the preparation of long-term budgets into which annual budgets may be fitted.

#### PUBLIC DEBT RETIREMENTS

While the present depression lasts, no expenditures for the amortization of the federal debt should be made. Where specific requirements in the contract do not prevent, the retirement of the debt should be postponed to more prosperous times. In the 1934 budget the President, in estimating the Treasury deficit, deducted from the amounts payable by the Treasury public debt retirements scheduled for the next fiscal year, amounting to \$534,070,300.<sup>a</sup> This measurably lessened the apparent difficulty of balancing the federal budget, leaving, according to the President's estimate, a prospective

* Total payable from Treasury .....	\$3,790,425,200
Deduct public debt retirements .....	534,070,300
	<hr/>
Total other expenditures .....	\$3,256,354,900
Receipts .....	2,949,162,713
	<hr/>
Excess of expenditures .....	\$ 307,192,187
	<hr/>

deficit of \$307,000,000, to meet which special taxes were recommended.<sup>3</sup>

By not including public debt retirement allowances among expenditures to be covered by current revenues, the President gave partial recognition to the budgetary principles here being advanced. It would be useless, save for the purpose of creating certain psychological impressions, to continue to levy taxes to amortize the public debt at a time when the outstanding debt was being substantially increased. On the assumption that receipts and expenditures were not otherwise changed, the result of the continuance of amortization payments would be an increase in the annual fiscal deficit accompanied by an increase in new indebtedness. In the present emergency the President's treatment of public debt retirements is sound.

The implications of this policy logically extend to non-recurrent emergency expenditures, to loans and investments, and to expenditures for public works—all of which in this depression should be financed by borrowing rather than by increased taxation, to the extent that the credit of the government permits. Current revenues should now be provided to cover not more than the ordinary operating expenses of government.

#### SHOULD THE BUDGET BE BALANCED ANNUALLY?

It is by no means axiomatic that the federal government should annually collect revenues sufficient to cover even its ordinary operating expenses. This, of course, should be an aim of the Treasury; but if this policy involves too great hardship from the imposition of burdensome taxes, the government is justified in borrowing for a few years in order to meet deficits from current operations. As the Secretary of the Treasury said in his annual report presented to Congress, December 8, 1932:

In a period of deep depression with the income of the people greatly reduced, with their buying power drastically curtailed and

---

<sup>3</sup> The amount of this deficit will be increased by the failure of some of the European countries to make payments on account of their war debts.

with millions deprived of their earning capacity, it is not only unwise but impossible to bridge the gap in the budget entirely by increased taxation.

A historical survey of Treasury finances shows that deficits are a recurring phenomenon. These deficits are defensible if in accordance with deliberate and well-designed long-range planning. The planless character of past fiscal policy has made governmental burdens during this depression unduly severe.

The balancing of budgets should be regarded as a series of long-term operations in which deficits will be incurred and debts increased during years of economic adversity while Treasury surpluses and the rapid retirement of the public debt will be planned for during years of prosperity. When a series of annual budgets is thus put together, the result is the balancing of the long-term budget with reference to economic cycle periods. The equilibrium between revenue and expenditures is thus intentionally struck over a period of years rather than annually.

Balancing the budget on an annual basis is ordinarily not an impossibility; but if practiced during a severe depression, such a procedure, requiring as it does a heavy load of taxation at a peculiarly inappropriate period, will tend to prolong the depression. On the other hand, the failure to take advantage of a period of prosperity to build up financial reserves will tend to make inflationary and speculative booms the more pronounced. The more rapidly the debt is retired during prosperous times the greater will be the credit reserve during an economic emergency.

#### RELATION OF FEDERAL FINANCES TO THE CURRENCY SYSTEM

The repercussions of the ordinary fiscal operations of the federal government on the nation's currency system must not be ignored. The flow of funds in industry and commerce is favorably affected by the volume of public expenditures, if such expenditures are not financed by taxes falling directly or indirectly upon business. Taxation, on the contrary, by reducing the profit margin of business, tends to cut down both the

volume of credit created and its rate of use. It appears all the more desirable, therefore, for the government to finance emergency expenditures, loans, investments, and public works by borrowing instead of taxation. Such borrowings may be justified until a desirable degree of credit expansion has been secured or until the level of business activity has otherwise been brought back to an approach to a normal position.

## II

### THE REDUCTION OF PUBLIC EXPENDITURES

Should public expenditures be reduced? Can substantial reductions be made?

Every opportunity should be seized to reduce the cost of rendering public services. Citizens demand of government the efficient performance of certain functions at the lowest reasonable unit cost. They do not demand the expenditures of given sums of money. The unit cost of providing public services can and should be reduced.

The reduction of expenditures should not be confused with the curtailment of activities. It may be doubted whether citizens desire the curtailment of government functions; they have rather, for the most part, insisted upon their extension. The demand for economy properly considered is a demand for the reduction of unit costs rather than a demand for the curtailment of necessary and beneficial public services.

#### REDUCTION OF UNIT COSTS

If a will to effect economies exists, many savings can be accomplished without impairment of services. The political system upon which American governments rest exacts a heavy toll in the form of patronage. The Post Office Department, for example, has notoriously been manned at the top by spoilsmen. Many of the 15,032 presidential postmasters have been selected for political, rather than for service, qualifications. The collectors of customs, the internal revenue collectors, and many other offices outside the civil service represent to a large extent political overhead which could be eliminated in the interest of economy and efficiency. Expenditures for veterans include allowances for disabilities and hospitalization arising from injuries not connected with military service. Until the federal government undertakes the relief of destitution for all citizens, these allowances appear to constitute merely a bid for political support to a privileged group. Limitations of space prevent the multiplication of examples.

Efforts should be made to eliminate waste and inefficiency as fully as possible from the federal service. Party patronage and spoils should be replaced by a merit service fully protected from partisan influences. The reorganization of bureaus and departments to eliminate duplication should be undertaken at once. Improved and more economical methods of rendering services should be adopted. The efficient and economical performance of public business may well prove to constitute a more effective appeal for political support than the wasteful methods of the past.

#### ECONOMIES MADE POSSIBLE BY THE DEPRESSION

The depression has brought with it many realizable economies in governmental operations. Prices of commodities and materials have declined to 67.8 per cent of their 1929 level.<sup>1</sup> Governments are thus able to purchase materials more economically than a few years ago. In addition, wage-levels have decreased. A horizontal cut of  $8\frac{1}{2}$  per cent in the salaries of all federal employees receiving over \$1,000 per year was accomplished by a month's furlough without pay. In his message to Congress on December 6, 1932, the President recommended the continuance of this furlough system and the further reduction of salaries by 11 per cent, producing a saving estimated at \$55,382,000. It is difficult to imagine a worse method of reducing salaries than that involved in the furlough system. It carries an implication of excess personnel in the federal service or the performance of functions which can be immediately curtailed.

#### SALARY REDUCTIONS

Salaries should not be further cut unless steps are taken at the same time to accomplish all the other possible economies in the public service. Personnel surveys should be made, and their findings should be used immediately as a basis for the separation from pay-rolls of superfluous and inefficient employees, and for any cuts in wages which may be decided

---

<sup>1</sup> Yearly average index of wholesale prices computed by Bureau of Labor Statistics for 1929 was 96.5 (1926=100). Average for first nine months of 1932 was 65.4. Decline is 32.3 per cent from 1929 level.

upon. Where horizontal cuts alone are employed, the service is not purged of the incompetents nor of political "hangers-on." The "horizontal" method of retrenchment is an easy means for meeting the demand for economy, and only slightly reduces the cost of political patronage. In retrenchment the principle to be followed is to reduce expenditures and curtail operations where they will do the least social damage. No discrimination as to consequences is possible when horizontal or uniform percentage reductions are followed.

For those employees who are discharged from the federal service, adequate unemployment relief or employment in emergency services should be provided. These adjustments in personnel should be a phase of the reorganization of federal administrative departments now being considered by Congress.

#### POSTPONEMENT OF EXPENDITURES

Modest reductions in expenditures may be achieved by the postponement or complete elimination of certain projects included in the budget. For example, the surplus of agricultural land now under cultivation justifies the curtailment and postponement of expenditures for land reclamation and irrigation, save perhaps to the extent of salvaging capital already sunk in such projects. Substantial economies can be realized from the postponement of naval construction. The 1934 budget estimates for vessel construction are about \$21,000,000 in excess of appropriations for 1933. The modernization of battle-ships also calls for the expenditure of \$9,450,000. The total amount available for naval construction during 1934 is estimated by the President at \$53,380,000. Further reduction in expenditures may be achieved by postponing the acquisition of land and improvements not immediately needed. In the 1933 budget, for example, reductions in appropriations for the Department of Agriculture were accomplished, in part, by a reduction of \$1,750,000 in the estimate for the purchase of additional forest lands. Such savings as these may be used either to reduce total expenditures or to make possible the increase in appropriations for more pressing needs.

## CURTAILMENT OF SPECIAL SERVICES

Likewise, services undertaken primarily for the benefit of particular individuals and conferring little or no advantage upon the citizens as a whole should either be dropped completely from the budget or placed upon a self-supporting basis by the collection of charges for services rendered. Many activities of the Department of Commerce are illustrations in point; notably, the foreign services of the Bureau of Domestic and Foreign Commerce. Moreover, these duplicate, in part, the activities of the consular service.

## SUBSIDIES

Subsidies to special interests should also be speedily withdrawn. Some of these subsidies are disguised by excess payments for services. The least that can be asked is that such subsidies as are retained should be clearly designated as such in the budget. The postal deficit for 1934 is estimated at \$97,000,000, substantial portions of which are due to losses on parcel post and second-class mail, to the continuance of rural free delivery routes laid out for horse and buggy delivery, to excess rentals, and to excessive, as well as uneconomic, subsidies to steamships and air lines carrying mail. Economies can be effected here, without impairment of the quality of service.

## OBSTACLES TO EXPENDITURE REDUCTION

In the pursuit of any program of expenditure reduction numerous obstacles will be encountered. A survey of the budget discloses the fact that the reducible<sup>2</sup> portion of appropriations is small indeed. The 1934 budget called for appropriations totaling \$4,248,160,731,<sup>3</sup> which were reduced by additional recommendations in the President's "Budget Message" to \$4,218,808,344. Of this latter total (except for slight adjustments in amounts for specific items in the body of the budget to bring them into harmony with the modifications

---

<sup>2</sup> "Reducible" has reference to expenditures not called "non-reducible."

<sup>3</sup> Trust funds not included in this total; if they are included, appropriations amount to \$4,403,178,032 as stated in "Budget Message."

in the budget message), \$1,628,517,319 is for military functions (38.60 per cent); fixed debt charges take \$1,259,070,321 (29.84 per cent); public improvements call for \$122,108,690 (2.89 per cent); the postal deficit exacts \$97,000,000 (2.29 per cent); refunds call for \$85,238,800 (2.02 per cent); the construction of general government buildings is to receive \$69,060,000 (1.64 per cent); and \$42,458,590 is estimated as the cost of governing the District of Columbia and other territories<sup>4</sup> (1.01 per cent). These so-called "non-reducible" items call for the expenditure of \$3,303,453,720, or 78.30 per cent of the aggregate appropriations proposed for 1934. Included in the percentage just given are certain items referred to in the budget statements as "fixed charges" representing interest, pensions, retirement salaries, annuities, and World War allowances, together with subsidies, grants, and contributions,<sup>5</sup> which amount to \$1,723,436,793, or 40.85 per cent of proposed total appropriations. Unless curtailments are made in these items, improperly designated "non-reducible," substantial reduction of ordinary expenditures can be accomplished only with serious loss to the community.

#### INCREASED DEMANDS

The depression, it must be recognized, has brought with it an increased demand for federal services. Upward of 11,000,000 people are out of employment through no fault of their own. The resources of state and local governments, together with private philanthropy, have been unable to provide adequate relief. During the present winter the federal government probably will be forced to provide direct aid—not loans of its credit to states and cities—in order to mitigate human suffering. Yet in the 1934 budget the President provided only \$18,000 for relief expenditures, as compared with \$40,018,000 appropriated for the fiscal year 1933 and \$461,-

---

<sup>4</sup> Total for District of Columbia, \$39,743,270, of which only \$7,775,000 is directly appropriated from United States Treasury. The remainder comes from the combined revenues of the District of Columbia.

<sup>5</sup> See message of the President of the United States transmitting "The Budget for the Service of the Fiscal Year Ending June 30, 1934," 72d Congress, 2d Session, *House Document No. 439, Budget Statement No. 10*, p. A183.

651,000 for 1932.<sup>6</sup> Of this latter sum \$450,000,000 was represented by a subscription of that amount to the capital stock of the Reconstruction Finance Corporation, while the remaining subscription of \$50,000,000 to the capital stock of that body was charged to the promotion and regulation of agriculture. However, from the total resources of the Reconstruction Finance Corporation only \$300,000,000 was "to be used in furnishing relief and work relief to needy and distressed people and in relieving the hardship resulting from unemployment." In addition a curtailment of building construction and public works projects is recommended for 1934. Appropriations for general government buildings were \$212,638,000 in 1933, but only \$69,060,000 is recommended for 1934. Public improvements—roads, rivers, and harbors; flood control and others—received appropriations of \$402,482,000 in 1933, while only \$122,108,690 is proposed for 1934. The President did not deem "further building at this time in the public interest." It is doubtful whether the volume of useful public works should now be curtailed. Business recovery has not sufficiently advanced to warrant this retrenchment. Likewise, generous federal appropriations for the direct relief of the unemployed are recommended.

#### AID TO CITIES AND STATES

Another phase of the problem relates to financial aid to cities and states not by way of loans but through the direct sharing of public revenues. Local government revenues have been severely drained during the past two winters to provide unemployment relief. The depression has demoralized many state and local revenue systems whose chief reliance has been the property tax. The collapse of real estate values has been accompanied by unprecedented tax delinquency; and while revenues have dwindled, relief demands have prevented substantial reductions in expenditures and taxes. The constitutions of many states prevent any ready modernization of revenue systems or extension of borrowings. Hence the national government will soon be confronted with the problem

---

<sup>6</sup> *Ibid.*, p. A176.

of keeping the state and local governments functioning as well as solvent. The federal government cannot afford to allow its political subdivisions to cease to function. Curtailment of their functions will decrease the volume of social services needed during this emergency; will reduce the demand for labor and materials when they should be increased. If the subdivisions default on the payment of substantial amounts of bonds and other obligations, this may react unfavorably on the credit of the national government. Such defaults will tend to restrict the flow of funds in trade and commerce, and will undoubtedly restrict the volume of credit with which business is being transacted. Such consequences the government is endeavoring to prevent through the banking and currency system. Increased lending of credit to state and local governments and an increase in grants for their use would materially aid the efforts toward recovery which have already been made.

#### REDUCTION OF AGGREGATE EXPENDITURES

There finally arises the question: "Should the aggregate of public expenditures be reduced?" This question should not be confused with the reduction of unit costs and the re-allocation of appropriations among the items of expenditure. After all reasonable adjustments to effect economies and promote efficiency have been made, this question must still be faced.

What is needed today is an increase in the circulation of money and credit, an increase in the volume of purchases, more employment, larger aggregate pay-rolls, and an improvement in the morale of the people. The reduction of aggregate public expenditures, except as and if accompanied by reduction of current excise tax rates, will influence these factors in exactly the wrong direction. But if the government decreases the unit cost of providing present services as lower prices and wages enable it so to do, and if it eliminates all elements of waste in its operations, it should be encouraged to undertake such additional activities involving expenditures as the prevailing emergency makes urgent.

### III

## THE REVENUE PROBLEM

The major tax problem of the federal government during this depression is to find additional sources of revenue. The yield of existing taxes has declined and taxpayers resist the imposition of new taxes, so that additional productive sources of revenue can be found only with difficulty. In endeavoring to develop new sources of revenue, the government should avoid the adoption of taxes which tend to increase costs of production for private business or to reduce employment or production. If private business activity is not to be retarded, taxes falling on the margin between production costs and prices should be avoided. Sales, transaction, and production taxes have these untoward effects. Yet the President has proposed to balance the 1934 budget (or avoid increasing the public debt) by the continuance of the 1-cent federal tax on gasoline and the adoption of a general uniform sales tax of 2½ per cent on all commodities except food and certain grades of clothing.

#### SALES TAX

Such a sales tax is objectionable at all times but is especially dangerous when the country is in a severe depression. If such a tax were passed on to consumers by increasing the prices of goods, the volume of sales of many commodities would be decreased. Costs of living would be made higher; and since the tax applies to expenditures rather than to incomes or the surplus above minimum living costs, it would fall with greater severity upon the poor than upon the more wealthy. It would tend to increase with the necessity for expenditure rather than in proportion to ability to pay. The number of dependents to be supported would be an important factor determining the weight of the citizen's tax. The regressivity of sales taxation is enough to condemn the President's proposal. But if the tax could not be shifted forward to consumers, it would fall in an uncertain and arbitrary manner

upon industries and businesses and would still further reduce the already narrow excess of prices above costs—and in many cases convert this excess into a deficit—thus leading to a further curtailment of business activity. Such a tax might easily bring about the suspension of many enterprises, particularly if sales should dwindle following an attempt to raise prices so as to absorb the tax.

The present popularity of the sales tax, in certain quarters, is due to the mistaken belief of many business men that such taxes can always be passed on to consumers. Administrators look with favor upon it because it is easy of administration. Others favor it because they are exempt from its provisions or hope to secure reductions in other forms of taxation if a sales tax is adopted. These considerations are far outweighed by the regressive character and the business-disturbing propensities of general sales taxes.

Sales taxes are all the more objectionable if they are employed by both the federal government and the various states. Under such circumstances the pyramiding of taxes may be expected; but with business largely national in character, cumulative taxes upon sales will disastrously affect business recovery. Gasoline taxes are now found in every state; gross income taxes on some or all classes of public utilities are found in 43 states and the District of Columbia; severance taxes measured by sales are found in 14 states; taxes on chain stores are found in 12 states; and either general or selective sales taxes, or both, are found in 35 states. General sales taxes are found in Connecticut, Delaware, Georgia, Kentucky, Mississippi, North Carolina, Pennsylvania, Virginia, and West Virginia. Many of the state rates are low, but pressure is being exerted to bring about their increase and the more general adoption of this method of taxation. Products sold at wholesale in Pennsylvania, for example, are subject to the state mercantile license of one-twentieth of 1 per cent; and if sold at retail, to a similar tax of one-tenth of 1 per cent, to which is added the state emergency relief sales tax of 1 per cent. If a federal levy of  $2\frac{1}{2}$  per cent were also added, the combined rates would equal 3.4 per cent. In Mississippi the state wholesale and retail sales taxes equal  $2\frac{1}{2}$  per cent; and if the pro-

posed federal levy were added, the combined rate would reach 4.37 per cent, with no allowance for pyramiding. The federal government should not adopt a sales tax program in reckless indifference to existing state taxes and to the effect of both upon trade.

If there must be such a tax, then, in order to avoid undesired economic consequences resulting from the cumulation of sales taxes, the federal government should impose the tax and divide the revenue with the states, the sharing to be made conditional upon the repeal or avoidance of sales taxes by the states. The federal law should be so drafted as not to interfere with the operation of state gasoline, tobacco, malt, and perhaps, sumptuary taxes.

In advancing this and other proposals, it cannot be too strongly emphasized that there is urgent need for the co-ordination and integration of federal and state tax systems. A complete and thoroughgoing revision of the revenue systems of all levels of government is needed. The inability of the various tax systems to meet the present crisis is evidence of this need.

#### INCOME TAXES

Income taxes generally do not directly affect production or prices, although the impingement of taxes on income may reduce consumption—an effect which must be considered when the weight of taxation is increased. Objection is occasionally raised against income taxes as the principal source of federal revenues because their yield declines in times of depression, but it is rather one of the virtues of this form of taxation that its burdens automatically decrease when the economic circumstances of the taxpayer are adversely affected. The desirable degree of elasticity in the federal revenue system should be secured by the proper use of public credit.

In times of depression public credit should be expanded in order that tax burdens may be lessened. In times of prosperity the levels of taxation should be maintained or increased. If the income tax is progressive, a more than proportional increase in revenues will automatically follow any increase in incomes. With proper brackets and rates the income tax will not need adjustment at every session of Congress but can be

stabilized over a period of years. In prosperous years the revenue system should yield a surplus of revenues to the Treasury, to be devoted preferably to debt retirement rather than to the accumulation of reserves, so as to provide no temptation for its dissipation by profligate expenditure. In such times the burden of income taxation should not be lessened so long as any public debt remains unpaid. The time to lower tax rates is during a depression. Instead, governments have at such times too readily increased tax burdens, thereby augmenting tax delinquency, increasing the costs of living and of doing business, and postponing the improvement of economic conditions.

In searching for new sources of revenue with which to balance the 1934 budget, the Treasury has made no recommendations looking toward the improvement of income taxes. At the present time it is doubtful whether the rates in the higher brackets of the federal income tax can be increased without adversely affecting the productivity of the tax. The degree of progression may be modified somewhat by changing the limits of certain brackets and by reducing exemptions, all of which would be designed to secure increased payments from those in the lower-income levels. These changes would doubtless increase Treasury receipts. In comparison with taxes paid by Europeans, the American rates appear to be moderate; yet it must be recognized that substantial increases in tax levels can be achieved only gradually and that so long as state governments likewise tax incomes and exact other tax payments, many of which fall upon income, there are limitations upon the freedom with which the federal government can modify its practices in taxing the smaller incomes. In any case a closer integration of federal and state revenue systems is desirable. Similar changes might be effected in the federal estate tax. The gift tax can also be made more productive. The immediate revenue possibilities from changes in these taxes should be explored.

#### REVENUE TARIFF

A marked reduction in American tariffs would probably increase, instead of decrease, revenues from customs duties. Lower tariffs will also make possible the payment of a greater

portion of the war debts—if they are not completely canceled or repudiated. A revival of trade following a world-wide reduction of tariffs would not only directly increase customs receipts but would also increase the yield of income and other taxes which reflect the degree of business prosperity. Enlightened self-interest necessitates the reduction of tariffs.

Substantial revenues can be secured by the imposition of emergency customs duties on tea, coffee, and cocoa. These commodities are not commercially produced in the United States and only in nominal amounts in our insular possessions. Moderate revenue duties upon them will not affect their domestic production. The productivity of these duties should be substantial. They are easy of administration, can be collected by existing officials, and are distinctly preferable to general sales taxes or to levies on specially selected manufactured articles. The objection to them is that they are regressive in operation and make impossible "a free breakfast table."

Teas were subject to relatively heavy taxation in the early days of the Republic and during the Civil War. During the period from 1898 to 1903 a tariff of 10 cents per pound on tea was in effect. Today there is no duty on such imports. In 1901 the tea tax produced \$8,300,000 in revenue. Today the revenue from a similar tax should be about the same. In 1929, approximately 89,393,000 pounds of tea were imported—sufficient to produce a revenue of \$8,939,000 if taxed at 10 cents per pound, and if consumption did not fall because of the tax.

Coffee has been on the free list continuously since 1872. Prior to that date all tariff acts, except the tariff of 1832, imposed duties on coffee ranging from 2½ to 5 cents per pound. From 1926 to 1929 the importation of coffee averaged over 1,466,000,000 pounds per year, sufficient at 5 cents per pound to produce an annual revenue of more than \$70,000,000, with no allowance for curtailment of consumption caused by the imposition of the tax.

Cocoa beans (or unprepared cocoa) have been on the free list since 1872, while prepared cocoa has been dutiable almost continuously since 1789. The duty on cocoa beans, prior to

1872, ranged from 1 to 4 cents per pound. In 1931, 418,159,000 pounds of cocoa beans were imported. If these imports had been taxed at 2 cents per pound, the revenue produced would have been \$8,363,000.

Revenue duties on tea, coffee, and cocoa at the rates suggested could thus be relied on to produce at least \$75,000,000 per year.

#### BEER TAX

Substantial revenues should also be secured from the taxation of the sale of beer and wine if, as, and when the liquor prohibition laws are modified.

All of the foregoing proposals combined would have fewer deleterious effects upon trade and the revival of business than the proposed federal sales tax. Their combined productivity should amply care for the President's estimated budget deficiency of \$307,000,000, but probably would not cover additional deficiencies arising from the non-payment or postponement of war-debt obligations. Yet, if the method of balancing the budget suggested in this memorandum were adopted, it is not unreasonable to believe that the entire deficit could be covered.

## IV PUBLIC DEBTS

Throughout this memorandum it has been emphasized that the federal government should make use of extensive borrowing to assist in financing the operations of government during an economic crisis. It has been maintained that loans should be resorted to in order to finance emergency expenditures, public works, and loans or investments. Temporary borrowing to defray the cost of necessary services is also justifiable during an emergency. But, if the public debt were now expanded, steps should be taken quickly to reduce it during the next period of prosperity. The alternate expansion and contraction of the public debt with reference to the business cycle would not only help to minimize the swings of these cycles but would also give to the federal revenue system a desirable degree of elasticity.

These borrowings could now be undertaken on the basis of short-time loans in order to secure the advantage of extremely low rates of interest. This policy has recently been followed by the Treasury Department. On December 15, 1932, the Treasury borrowed \$250,000,000 on one-year certificates at an interest rate of three-fourths of 1 per cent—one of the lowest interest rates ever paid. This issue was nominally oversubscribed sixteen times. At the same time, \$350,000,000 was borrowed on four-year notes bearing  $2\frac{3}{4}$  per cent interest. This offering was nominally oversubscribed nearly twenty times. At present, therefore, there appears to be an ample market for federal loans. The one problem confronting the Treasury in its short-time borrowing is so to arrange maturities that the government does not become embarrassed in their payment or conversion when due. Too large a floating debt may make conversion into long-term indebtedness a difficult task.

As things now stand, there are limited possibilities for refunding a portion of the outstanding public debt. The aver-

age annual interest charge on this debt has been steadily declining since 1922, and a portion of the obligations is callable at the option of the Treasury. For example, the Fourth Liberty Loan of over \$6,000,000,000 is callable after October 15, 1933. The interest rate of  $4\frac{1}{4}$  per cent carried by these bonds is greater than the rates now being paid. A substantial amount of outstanding bonds might also be exchanged voluntarily for new issues, provided that ancillary inducements were offered. At any rate, the example of England in its recent refunding operations indicates what might be accomplished by the United States, particularly if a public subscription drive were inaugurated. The economies realizable through moderate refunding should be carefully explored.

## V

### SUMMARY OF SUGGESTIONS

In summary the following suggestions are presented by the signers of this statement:

1. We suggest that Congress, in undertaking the task of balancing the federal budget, should finance expenditures for relief, investments, loans, and public works from borrowings, and that the federal debt during the next fiscal year be increased by a sum not less than the amounts so expended.

2. We suggest that funds from current taxation should be applied to pay the ordinary operating expenses of government; that so far as these expenses cannot be defrayed from taxation they should be covered by temporary emergency borrowings.

3. We suggest that funds should not be raised by taxation (or borrowing) except in the fiscal year for which they are required; that the budget should limit appropriations at this time to sums to be expended during the next fiscal year.

4. We suggest that Congress, after making provision for discharging contractual obligations, should adopt the policy of not appropriating funds for the amortization of the federal debt during 1934, as proposed by the President in his "Budget Message."

5. We suggest that Congress and the President should adopt the policy of balancing the budget over a period of years, taking account of the swings of the business cycle, rather than attempt to balance each annual budget without reference to the effects of such policy on business and social welfare.

6. We suggest that every opportunity should be seized to reduce the cost of rendering public services; that political patronage be completely eliminated from the federal services; that every possible effort be made to reduce waste and inefficiency to a minimum; that the reorganization of departments should be speeded; that improved methods and procedures should be adopted wherever possible.

7. We suggest that salaries should not be further cut unless steps are taken at the same time to accomplish all other possible economies

in the public service; that personnel surveys be made and that the findings be used immediately as a basis for the separation from pay-rolls of superfluous and inefficient employees and for any cuts in wages which may be made.

8. We suggest that, in developing its retrenchment policy, Congress should not blindly follow arbitrary rules but should make reductions and curtailments after weighing the value and importance of each activity.

9. We suggest that services undertaken primarily for the benefit of particular individuals or groups and conferring little advantage to citizens as a whole should be curtailed and put on a self-supporting basis; we suggest that subsidies to special interests should be withdrawn.

10. We suggest that the volume of public works expenditures should not be curtailed during the fiscal year 1934.

11. We suggest that federal appropriations should be made at once for the direct relief of the unemployed.

12. We question whether the total of federal expenditures should be reduced lest the demand for goods and services be curtailed as a result of the restriction of government purchases and wage payments.

13. We assert that in developing new sources of revenue the federal government should avoid the adoption of taxes, such as the sales tax, which tend to increase costs of production and diminish the volume of production and employment.

14. If any new taxes are to be levied, we suggest first an increase in income, estate, and gift taxes, then the adoption of revenue duties on tea, coffee, and cocoa, together with a material reduction in existing tariffs, so that increased revenues may be secured from customs duties.

15. We suggest that taxes be imposed on the sale of beer and wine if the Prohibition Acts are modified.

16. We recommend that elasticity in federal revenues should be sought in the future by the planned control of the federal debt—that the federal debt should be permitted to increase in times of depression and be rapidly retired during prosperous times; that the borrowings for 1934 should be not less than the sums required to finance emergency relief, loans, investments, and public works.

It is our belief that if these suggestions are adopted the 1934 budget will be adequately balanced; that the general welfare will be enhanced; and that Congress will, by its action, hasten the return of better times.

*Signed:*

FRANK BANE

PAUL BETTERS

CARL CHATTERS

PAUL H. DOUGLAS

SIMEON E. LELAND

H. A. MILLIS

CLARENCE E. RIDLEY

H. C. SIMONS

DONALD SLESINGER

JACOB VINER

L. D. WHITE