OBJECTIVES OF FISCAL POLICIES : LOOKING AT GOALS*

Prof. C. Lowell HARRISS
University of Columbia

The Federal government's "getting and spending" will each involve around $200 billion in 1968. Such huge activities warrant continuous examination, and for many reasons. Federal finances must be characterized as "multipurpose" if anything deserves that term. Economists frequently use the term "fiscal policy" to apply to one dimension or aspect of results or intended results. Usage cannot be praised for precision. Ordinarily, we include effects on the levels of employment and prices. Less agreement attaches to effects on distribution of cost and benefits, economic growth, Federal-state-local relations, and international economic affairs. Yet with amounts at the magnitudes of present budgets, each of these aspects of life, as well as others, will be affected. What can we seek in terms of objectives?

GOVERNMENT SPENDING

The objective of budget policy is to do what people want. Governments exist to serve people — the federal government everyone in the country. Such observations are trite and obvious, but they often share the not uncommon fate of the obvious, being overlooked. How tempting to focus on what the people "ought" to want, or what the speaker would like to see! Or to "solve" problems by assuming them away.

The public may have values different from those which academicians would like to assume. In any case, the means available to achieve objectives must affect the attainable and thus the objectives which can wisely be selected.

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

Two other points, almost obvious, require attention: (1) Whatever is done by government is done by people; by human beings with all their strenghts and limitations. (2) Most efforts of Americans devoted to achieving objectives are not directed through government as an agency for accomplishing individual of group desires. Production, for the most part, results from what we do privately — in the market. Most consumption is even more private. Collective desires are not always distinguishable from the purely personal, a fact of rather distressing complexity in defining the objectives we seek through government.

The President's budget for the coming fiscal year (1968) proposes for *non*-defense purposes *per capita* spending (in dollars of 1966 consumer purchasing power) $ 208 *greater* than that 10 years ago[1]. The *tax rise* to pay for a decade's *growth* of non-defense spending will be over rather than under $ 1,000 for a family of five.

The Making of Choices

What objectives, then, do we seek through the use of (national) government instead of other agencies for performing functions to achieve objectives. At one end of a sprectrum are things which *cannot* be done privately (through business organizations, philanthropy and nonprofit-oriented agencies, and households). National defense, conduct of foreign affairs, operation of the monetary mechanism, and regulation of interstate commerce are examples. Other things we are *not willing* to do privately, at least not to the extent many of us wish; aid to the needy provides one example, while quite a different case appears in the provision of transportation facilities.

The argumentation for use of government generally involves specific matters with little attention for the total effect of many programs, each having many ramifications. A common tendency, not least among academicians, is to conclude that if something seems doing it must be worth doing throogh (national) government.

High on the list of current objectives of national policy, I suggest, should be means to improve procedures for finding what people want.

1) The calculations are for the cash budget. The **per capita** rise in defense outlays appears as, $ 75 (in 1966 dollars) over the decade. C. Lowell Harriss, **The Budget for 1968,** Manufacturers Hanover Trust Co., February 1967. The 1968 total cash budget spending is estimated in the budget at $ 172 billion; postal, enterprise, trust funds, and other agency spending not included in the cash budget will be over $ 27 billion ..

With limited resources for satisfying wants, Americans must choose among alternatives. Which services and transfer payments do we value most highly? And in what relative amounts?

In buying and selling in the market place we "vote" many times a day. These votes indicate preferences; they rank priorities. The alternatives are repriced as the combinations of conditions of supply and demand change. The market process not only permits, but also compels, the evaluation of alternatives by the persons directly involved[2]. The market process permits more or less continuous adaptation of the myriads of shifting elements so that much adjustment takes place in small amounts.

Decisions on federal spending are made rather differently. The people to be served, or not served, have little *direct* participation. Those who bear the taxes have even less opportunity to guide the decisions on spending. Search for ways to improve expenditure decisions — and search is now a matter of active concern — deserves continuing support.

New Federal Programs

An unpublished tabulation by the Tax Foundation identifies some 40 new nondefense federal programs in 1966 an 1967 and nearly 100 since early 1961, moreover, many of those functioning in 1960 have been enlarged in ways other than the mere expansion of spending on what was then being done. Almost 20 new nondefense programs are proposed in the budget for 1968.

Nationwide Aspects of Objectives of Government Spending

One feels old-fashioned, out-of-step in today's parade, in asserting that each element of federal spending should serve the interests of *everyone* in the country. (One exception exists when service charges or fees paid by the beneficiaries defray the cost.) Extreme — even as an objective? Perhaps. The cost is borne by a tax system which burdens everyone. This latter fact makes for difficulty in justifying programs of less than national benefit.

2) Private actions affect "third parties" who have no voice in the decisions. One reason given to support government (rather than market) performance of a function is that the interests of third parties can —and presumably will— be taken into account more adequately. Needless to say, realizing the potentiality requires rather more effort than can be counted upon to be forthcoming.

The concept of "national interest" presents not a few difficulties. Identification of what really benefits the whole society will not always evident. Measurement of magnitudes will always be highly perplexing. A program which clearly benefits some people does not necessarily serve the public welfare. Scores of new programs have rather parochial aspects. In a world of interdependence, of course, one can always envision connections between the small group and the collectivity. One can dream of "trade-offs" by which various small interests seek to get more or less equal special benefits. Yet as particular federal programs get more detailed, the interests of 200 million Americans in this, that, and the other one become tenuous and remote. These relations are not unlike those third-party elements for which the market (and taxation) fails to take adequate account. Any justification for federal undertaking of an activity gets weaker, the more specific the program.

As spending comes to involve programs of increasing specificity, more types of activities, the problem of serving the entire public becomes increasingly complex. Tax rate reduction seems to me to offer relatively greater attractions as a means of achieving the myriad of objectives of tens of millions of Americans. Of course, no one can "know"; and the appeal of visible government action does seem to have attraction for many, as compared with reliance upon people acting privately.

The question of the kind of society being built needs to be faced. The cumulative effect of more programs, and larger total amounts, will have implications for the future which do not enter decision-making for the separate units. One objective deserving of explicit attention is the advance (as contrasted with the narrowing) of personal freedom. Taxes, of course, limit us. Yet so do federal outlays — obviously in some cases, but often more subtly. How many Americans have been "kicked around" by highway and urban renewal programs? How are businesses, and state-local governments, affected by the proliferation of federal spending? When actions of Uncle Sam, that is the men acting in his name with dollars more or less at their discretionary disposal, touch us at so many different points, how does the quality of life become altered?

OBJECTIVES AND INSTRUMENTS: ENDS AND MEANS

Objectives as Final Ends and as Means to Other Ends

Objectives — of individuals and of groups — are of many types. Some of life's "ultimates," as nearly as a mortal can express them, affection, beauty, security, excitement, peace, health, hope, humor, grace, and so on. Other things which we sometimes call ends or objectives are in a more accurate sense means. They are intermediate, to be judged on the basis of their effectiveness in serving more basic goals.

In discussing economics, we may seem to elevate some means so that they have the status of ends. Yet doing so can misguide policy. Low interest rates, budget balance, and retaining gold are examples of objectives which have no inherent importance. If they are desirable, the reasons must be found in whatever they help achieve[3]. Much the same applies to reducing cyclical instability.

Neither this country nor any other, except to some extent in time of war, will have an explicit, clearly articulated, formulation of collective objectives. For all its merits, the Employment Act of 1946 does not formulate a *set* of goals. No consensus emerges, nothing clear enough to indicate how to resolve hard questions. Nevertheless, decisions must be made.

Certainties, Possibilities, Probabilities, and Impossibilities

The decisions now involve *totals* whose magnitudes few of us can cope with as realities. Changes from year to year are large enough in relation to changes in other magnitudes of the economy to exert considerable influence. Yet neither the huge totals nor the changes which are feasible will permit us to do everything we wish. The budget is not yet an instrument for working miracles.

The real resources needed for accomplishment do not necessarily exist. Spending more dollars on a program or project may be essential to get bigger and better results. As a rule, however, dollars are not the only limiting factor. The skilled labor and other real elements will not always be avaiblable in quantity to permit large expansion. Such bottlenecks appear, not only in time of rapid expansion during war. Anti-poverty and urban renewal programs; among others, have encountered limiting factors which dollars alone could not overcome.

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3) A "low" interest rate in itself may seem desirable to the borrower if he can get loans at such a rate, but it will serve him poorly if it reduces supply and thus deprives him of what he wants. In either case, however, the owner of a savings account will be less impressed by the glories of low interest rates.

Our knowledge of how the economy operates has many gaps. The interrelations of processes are not understood fully. Predictions cannot be counted upon, and so on. The realm of the "possible" in "managing" the economy through fiscal (and monetary) policy has many limits — and we are not sure just what they are.

FULL EMPLOYMENT

"Full," "maximum" or "high" employment — "low" or "minimum,, unemployment — will appear generally, as to me, to be prime importance as an objective. To some extent it is almost a final end. But more, it is so powerful as a *means* as to command high priority in any ranking of goals of federal policy.

Undesired idleness of men and women, and of their non-human possessions, means loss of attainable income. Any avoidable deprivation of material well-bening is bad in itself. In a poor world or country — and ours will not soon be one of plenty — such losses are so obviously evil that further condemnation should need no underlining. The resoultion of racial conflict, the myriad problems of cities and farms, youth and aged, will be less difficult when employment is high. More, however, remains to be said. For many people, certainly, idleness brings loss of human dignity and of personal satisfaction. These qualities, though falling in a different scale from money equivalent, are very much part of the whole which should command attention. The value of meaningful activity must rank high.

Nevertheless, despite the desirability of full employment, some commentary is in order.

1. Does the public *really* endorse what is *really* at issue? (My question here does not exclude — but my discussion must — governmental policies which, perhaps inadvertantly, create unemployment — minimum wage rates above productivity.) The answer has troublesome implications. Experience of the last dozen years suggests a distressing thought: A public almost 'fully' employed — 95 percent or so — may have little enthusiasm for acting to do better on this score, to raise employment (or reduce unemployment) by one percentage point. That single point and the billions of national product it represents may seem rather important

to an economist, and highly so to the million or more workers and family members directly affected. To the vast majority of the public, however, the problem will appear remote, of rather low urgency, and less important than the possibility of inflation.

2. Both the (a) *definition* and (b) *measurement* of "unemployment" (and of such concepts as "plant capacity" and "labor force") need improvement. This point has been made often. "Hidden" unemployment can be very real but still very elusive to measure and deal with. Less widely recognized, and far from any prospect of being met, is the need for data on *unfilled jobs*. The closer the economy comes to full utilization of resources, the greater the difficulties of measuring what we *then* need to know.

3. *Causes* of unemployment sometimes seem clear and obvious. When unemployment reaches low levels, however, when job vacancies become relatively numerous, the reasons for the unemployment which remains are probably complex. Debates over the last few years have helped to clarify the nature and the relative importance of "aggregate demand" and "structural" forces. I add one comment: Discussions of causes of unemployment often omit one element of no small significance — the wage rate.

4. Full employment in itself has costs. Labor shortages create difficulties for those who cannot readily (e.g., by paying more) get what they want as promptly as otherwise — whether a taxi, nursing service, repairs, or manufactured products. Although total output and income exceed what would otherwise be, some disadvantages result, some costs which escape measurement.

5. Near-term and somewhat longer-run considerations do not necessarily harmonize. One hesitates to suggest that business recession is anything but evil. Perhaps, however, periods of economic slack — of unemployment which monetary and fiscal policy could eliminate — help prepare conditions for higher employment (at any given level of prices) later.

AVOIDANCE OF INFLATION

Employment has human value. Price-level stability in and of itself cannot claim comparable merit. Yet both price-level stability and employment are means to ends beyond themselves. Price-level changes affect

(1) the total of real output and (2) the way it is shared — both matters of true significance. The objective of price stability deserves greater respect than economists generally accord it. The tolerance among economists for "a little" inflation, the willingness to settle for "reasonable" price stability disturbs me.

Time does not permit even a brief discussion of the complex and imperfectly understood processes — the *causes* and the *effects* of changes in price levels. Budget policy has less independent significance for price-level change than is frequently implied; the results depend heavily upon monetary developments which are subject to separate controls. Nevertheless, decisions about the federal budget properly attach weight to price-level stability.

Need for Better Measures of Price Levels

Unfortunately, we do not know "the" price level has been or is. This country should have done more of what is possible to improve price indices. Some changes which are within our capabilities would be improvements. The merits of other possibilities arouse debate, and some problems defy solution. President Jonhson two years ago seemed officially to endorse the view that the Consumer Price Index has defects which on balance bias it by around 1-1/2 percent a year, i.e., if the index number rises 1-1/2 percent a year the true level has in fact been unchanged Perhaps the CPI does have a bias. If so, in what direction and in what probable amount? And if the White House or the BLS knows of the existence of error and has some judgment of the size, why not make corrections? If there is doubt, should not more be done to remove it? This country is rich enough to afford better data on price levels as well as on employment.

A Brief Comment on Deflation

The avoidance of price-level declines seems desirable as an objective even though, in principle, some benefits of rising productivity might well be taken in lower prices.

In an economy with rigidities and inflexibilities, the forces which lead to a general decline in the price level can also be counted upon to lead to decline in the utilization of labor and other productive capacity. Many wage rates and other prices are inflexible downward, at least for many months and even years. If money demand declines, the quantity of man-hours purchased will drop unless wage rates per hour go down.

Moreover, a decline in prices may create expectations of further declines. As a result, some purchases will be postponed, temporarily reducing total demand, perhaps for inventory for the next few weeks, perhaps for new construction over a much longer period.

Inflation, Jobs, and Production Over the Longer-Run

A rise in the general level of prices will hurt some people, benefit others. The effects of inflation on the distribution of real purchasing power have often been noted in experience. These effects may not be so unqualifiedly bad, or as harmless as is sometimes implied. *If* the choice lies between the distributional change brought by a price-level increase of, say 2 percent, and a difference in total production equal to that of 1 percent of employment for a year, the latter seems to win general support, and for reasons which command great support. Yet I doubt that in fact such is the real choice.

Other effects of price-level change are less familiar. Yet their combined influence can be substantial. Over the long run the accumulated results of inflation on growth, efficiency, and general well-being will be more adverse, and in more ways, than is generally recognized. Let me assert, briefly, dogmatically, the subject to correction.

1. Changes in the general *level* of prices do not work on (a) all prices with (b) the same force and timing. Price *relations* change for reasons other than the working of the forces of (real) demand and supply in their long-run context. As a result, the efficient conduct of business and of all economic affairs, becomes more difficult. Rational calculation in the comparison of alternatives becomes harder. Errors otherwise avoidable result. Resource allocation suffers.

2. The *longer-lived* an investment or a commitment, the greater will be the danger of error which arises out of changes in either (a) relative prices or (b) the general level. Calculations can go farther away if (a) the gap between decision and end-result is 20 years than if it is five and if (b) the price level is changing rather than stable. When the value of the monetary unit is *felt* to be uncertain (not merely when changes actually do occur), some undertakings which would benefit the community will be foregone or curtailed, but there will be others which are made to seem wise in dollar terms because of expected price-level changes, and these undertakings will get relatively more resources than is inhe-

rently desirable. Today's best judgments, in other words, will be made wrong by price-level changes which have no basis in underlying, real change (in resource availability, technological reality, consumer taste, etc[4].

3. The (a) *fact* of price-level change, given our tax laws and accounting practices, and (b) *uncertainty* about the purchasing power of money will, I think, reduce capital accumulation over the *long run.* Admittedly, the factors relevant to this subject are complex. Not all point unequivocally in the one direction. The saving which is essential for capital growth results from many causes whose relations to inflation are uncertain.

4. Uncertainty about price-level change will *discourage the use of debt contracts.* The greater the uncertainty, the greater will be the discouragement of long-term debts for borrowers or lenders or both. Uncertainty is a cost. No one will assume it willingly except for compensation. In debts, the characteristic device for reflecting cost is in the interest charge — a "premium" above some riskless rate. When the time period of a debt is a few months, the effect on interest rates of uncertainty about the price level will be of no great consequence. For five years, however, the magnitude attributable to uncertainty can be significant; for 20 or 40 years the amounts can be of great moment indeed. Would not interest rates go up, perhaps by amounts which would seem shockingly large?

What interest-rate *level* is consistent with degrees of uncertainty which lie within the range of probability? Let us imagine, for example, an expectation that the price level will probably rise by 1 percent a year but with a considerable possibility that in some years the rise will be 2 percent or more and with only a very slight probability that prices will decline. What terms would you as borrower or lender be willing to accept for a 20-year loan or one equal to the life of a new house? The *structure* of rates would also present problems. What would be the relation of rates for long-run debts to the rates for short-term debt?

The use of long-term debt instruments, leases, other long-term contracts expressed in money terms would be greatly impaired. Our economy

4) For example, if construction and other costs are expected to rise may it not seem wise to build productive capacity somewhat before the actual need? Some new capacity will then be idle (under-utilized) for a few weeks or months or even longer, representing a little waste in the form of unemployment of plant (idleness before full utilization). Moreover, building prematurely, will commit the future to reliance upon techniques which are slightly less than the best available when the decision would have been made if business had felt no reason try to anticipate a price-level increase.

has benefited from the financing of housing and other capital facilities by long-term debt. Expectation of price-level uncertainty would impede rather than help the use of debt having duration more or less in line with the life of housing and other productive capacity of no small significance.

5. The record of inflation in the past and any serious expectation that the price level will rise in the future, seems, likely to encourage or cause unemployment, indirectly. The belief that a little inflation is a low price to pay for fuller employment has wide acceptance. But it does not reflect the realistic choice. The expectation price-level increases is likely to lead to wage-rate rises which are greater than would otherwise occur. If so — and one cannot predict with confidence — such action will price some man-hours into idleness. The process can be gradual, indirect, and utterly impossible to isolate. Much will depend upon the visibility of prices and other factors, bargaining power, governmental policy (e.g., boosting minimum wage rates), etc. The "remedy" will be money creation to "validate" the higher wage rate[5].

6. Another, overlapping, reason for setting price-level stability as an objective is not easily expressed in terms concrete, realistic, and responsible: Economic life becomes more difficult at many points, let me give two illustrations. (a) Financing college operations, especially salaries, seems inherently difficult. Much hard effort has accomplished much over several years — at great cost to students and their parants, alumni and other donors, and taxpayers. Yet at this moment, I am sure, problems seem still huge because, in part, faculty members seek protection from an uncertain amount of future inflation. Treadmills get tiring and thereby make more difficult the rational, sympathetic, efficient solution of human problems of compensation, career commitment, and governmental-private balance in higher education. (b) Wages and salaries loom large in the costs of government. Rarely are there objective criteria for determining "proper" wage rates for even large groups of jobs (police with 10 years of service, elementary school teachers, mail carriers, etc.), to say nothing of particular individuals. Job security and pension systems can lead to

5) Lags complicate the casual interpretation of experience. The monetary and fiscal restraint of the late 1950s and of 1960 may have been costly in terms of unemployment then. But did it not thereby reduce the upward pressure of wage rates during the early 1960s and thus help make possible several years of general expansion without much price-level increase?

long lags in quantity adjustment. The employer's earning record does not help indicate productivity. Quality differences are often obscure. And so on. When the price level has changed and stability appears uncertain, negotiation of new wage rates becomes more than normally difficult. Problems of running the public business get harder as a result of doubts about the future purchasing power of the dollar.

7. The pressures of inflation are likely to invite *direct controls* — the "guideposts" approach converted into something more than "voluntary." Innocuous as some such restraints may seem (at first), narrowly restricted as to their original scope, direct controls will not do the job intended unless they do *force* people to act against what they believe to be to their advantage. No reasonably foreseeable controls are likely to affect the whole economy very much in the short run, for good or harm. Over any substantial period, however, direct controls can work much damage on the productive system and the social fabric. Yet unless the underlying forces making for inflation are themselves moderated, the realities of inflation will appear at different places and in different forms[6]. Many effects will be concealed and utterly beyond measurement. How can the public possibly learn what would have developed under freer conditions? The differences in production and consumption will be a change for the worse.

8. The balance of international payments will be influenced in ways not necessarily desired.

9. Ending an upward trend in prices will in itself involve strains and losses. One need not look to the extremes of Brazil or Chile for examples. Our own experience of the late 1950s how efforts to exorcize the devil of inflation can prove costly in terms of employment.

ECONOMIC GROWTH

Alexander Hamilton and Albert Gallatin, to go back a bit in history, made economic growth explicit goals of federal fiscal policy. The nineteenth century tariff debates reflected differences in views about *how*

6) At the risk of excessive oversimplification, I suggest that for the long run any anti-inflationary successes will result from those direct controls which keep (a) growth of the quantity of money and (b) velocity of circulation below what would otherwise be the case.

taxing power could be used to encourage growth. Andrew Mellon's years arguments for reducing World War I tax rates emphasizes his belief that doing so would facilitate economic progress. And so on. In short, as we assign economic growth a high priority among fiscal policy goals, we are not innovating but continuing a practice as old as the republic. Analysis of the methods proposed and rejected, the results achieved and foregone (good and bad), would find solid knowledge and many gaps, consensus and sharp disagreement. Most of what has been achieved has resulted from man's activities in the private sector. Government's role, for good and ill, has grown; and much concern about the possibilities demans attention.

Why growth? In specifying "growth" as an objective, we, by definition, say that we want something better than would come from achievement of the "full employment" objective alone, the full use of today's productive capacity. The precise content of the "betterness", unfortunately, cannot be entirely clear[7]. Some wants satisfied more adequately will be collective (social) — the ability to preserve the peace; most, however, will be more clearly private. They may be larger output (including better quality), lower cost per unit of output (more desired leisure then adding to real output), or some combination.

Economic growth involves the years, the decades, the generations. In making fiscal decisions for the long run, do the considerations which deserve heavy weighting differ from those which dominate the short run? Is growth properly a matter of collective, public, as distinguished from private concern? Whatever one's initial reaction in reply, good answers require more penetrating analysis than most of us may give it. Government uses coercion. The next generation will almost certainly be more prosperous than we are. Is it, then, appropriate to *force* people today to make sacrifices for others who will come later?

One fact can be pointed out at once: The market place cannot reflect today the prefences of future Americans. Consumer and investor sovereignty may not have quite the merit we attribute to them for allocating resources today. Society does have means, notably the family, for recognizing somehow, and somewhat, the interests of those who — being too

7) Gross National Product as a measure has drawbacks and deficiencies. Adjusting as well as possible for price-level change, we may find it reasonably satisfactory in comparing one year with that preceding. Over 10 years, or so however, comparability suffers.

young or unborn — are now too weak to protect themselves. The men and women voting today may, more or less deliberately, use federal finances to benefit the future at the sacrifice of the present. If someone today is worse off, the loss to him or her may be worth more than the benefit in the future — the childless widow with cancer might weight next year more highly than greater bountry in 1980.

You have perhaps noted my choice of verb, "may". The results can be disappointing when compared with hopes and costs. What does the record indicate? Have people in making national government decisions which involve a long time horizon (e.g., disposition of the federal public domain in the nineteenth century) generally acted more wisely than in making private decisions? How does one weight markedly different kinds of actions? And looking to the future, are there convincing *a priori* reasons to believe that from now on national government actions with a long time perspective will be better (or poorer) than in the past, and as compared with the private sector?

What can federal fiscal policy do to aid or hinder growth?[8] Means and ends get intertwinded, but one can distinguish between policies (1) which affect the quantity of productive capacity and those (2) which influence the efficiency of allocation and the effectiveness of resource utilization. At the risk of misleading oversimplification, I suggest that one group, the former, will generally require sacrifice of the present for the future; the group comprising allocation, however, if well devised will more often than, not benefit the present as well as the future.

Capital Accumulation

Budget (tax and spending) policy can be adapted deliberately to try to increase or reduce the rate of capital accumulation (tangible capital only or tangible plus human).[9] The recipe, however, must be rather more complex than is sometimes assumed.

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8) My own conclusions as of some years ago were summarized in two articles each as long as the space available to me here. To rewrite them would be no small task.

9) Monetary policy bears upon capital accumulation. Abstracting from anti-cyclical effects, I believe that the independent influence will be slight over any period of enough duration to classify as "long." On this conclusion, of course, professional opinions may differ.

A dollar more of federal tax collections does not necessarily lead to more capital accumulation (or in the short run net reduction of equal amount in pressures on monetary policy) than otherwise result. And when it does, the net addition may not be worth a dollar. The worth of outlays of a capital nature, as cost-benefit studies show, can be on the low side. "Rivers and harbors" projects do not epitomize wisdom in resource allocation. But not all private expenditures have borne fruits of positive net benefit. But space limits force me to stop at this point — except to say that forcing, compelling, people to save for collective benefit seems to me of questionable merit.

Resource Allocation: "Tax Incentives," Encouraging and Restraining

The relation of resource allocation to economic growth as a policy objective presents many challenges. Budget policy on the expenditure side deals, and deals explicitly, with not only aggregates ("macro" aspects of economics), but also with specific and particular elements ("micro"). Some may be designed to achieve growth (more or less regardless of capital-accumulation aspects). Federal tax policy does the same. Both might attempt more in this direction.

Preferable policy, however, would seem to me to make tax laws more general, reducing rather than enlarging differentiation. Here the objective resembles somewhat that of curtailing rather than enlarging the number of spending programs.

High tax rates, in one sense, create an opportunity. A barrier which is high can be lowered for those who do something especially desired. But here I see a danger — growth of inducements to misallocation. The possibility of utilizing such opportunity will increasingly seem acceptable, or even the right way to run society, as tax laws include more and more differentiation.

Provisions which reduce a tax obstacle are sometimes called "tax incentives." The term does not always seem apt. But terminology counts for little compared with fact. What are the facts? The tax structure can affect the economic structure — especially so if differences in taxes are substantial.

During the war and post-war years of very high tax rates more than one country has achieved more than one objective by the offer of opportunities to escape from very high tax burdens. Some of the objectives have unquestionably been worthy. But were they the most worthy? How can anyone judge with confidence? What would have happened otherwise? Perhaps some sectors and activities which received no favoritism would have been more desirable than parts of those which were undertaken.

With any given amount of revenue loss possible, general reduction in tax rates on business seems to me better for the long run than more concentrated reductions at a few points. I include even the investment credit in the object of my criticism here. (If for revenue or other reasons, higher tax burdens are required, adverse discriminations are subject to criticism as compared with equal application.) Why?

In general, special tax provisions are inconsistent with an element required for optimum efficiency, for the best in resource allocation. Such provisions introduce an element of coercion rather than free choice to influence decisions about what to produce, how, and for whom. The choices thus being made are to some extent influenced by persons not parties to the transactions, i.e., by lawmakers (or administrators). Opportunities are altered for reasons which reflect votes in the ballot box (and then, perhaps, only very, very indirectly). Each of us, I expect, could suggest ways in which the allocation of resources would be better. Housing would appeal to A, faster modernization of factoires would please B; C's top priority might go to the arts while D would be unable to decide between reduction of water pollution and better airports, and so on. Each leader means well for the whole society and feels confident that his proposal will serve the general interest.

Good intentions, however, are not enough, not even when supported by assurance that one has "the answer." In using taxation (or government expenditure), the political process must be used in selecting both the ends and the means. This process inevitably brings into the decision-making men with no special competence for the specific problem. How many will have an informed judgment about the comparative results of the relevant alternatives? Moreover, men whose interests differ widely are involved; their power also differs widely, as much so as where dollars rule in the market place. The compromises which are inevitable can hardly be assumed to be those for dealing with society's problems[10].

10) Obviously, I oversimplify, failing to distinguish (a) **broad** issues of allocation between the government sector and the private economy which only the political process can accomplish, from the (b) more specific

Special features are more likely to be adverse to the broadest public interest than are more general features of equal revenue amount.

Nor should anyone overlook the practical problems of keeping up-to-date. The resource allocation which is best for one time or place will become less nearly ideal as conditions change. Obsolescence may come suddenly. More often it creeps up, not appearing with the dramatic force needed to compel action. Removal, or even adaptation to changing conditions, will almost always be difficult, and perhaps verge on the impossible. Society ought to be better than we can count upon in keeping tax laws up to date. For any given amount of revenue the allocations distortions will be fewer when the effective tax rates are the same over all industry than when differentials are appreciable.

Special provisions of an "incentives" type have an often-noted disadvantage. Their "cost" tends to be high[11]. Legislatures as a rule have no way to limit tax concessions to those actions which are truly additional, those which would not be taken except for the special tax provision.

For the incremental benefit obtained, the public may pay rather dearly when the method used consists of granting tax favors to *all* in the general class (even though the group may not be large). Meanwhile, other objectives also desirable at the margin not only get no tax stimulus but go without benefit of lower tax rates which would otherwise be possible. Thus, while some results of special tax incentives may be dramatically impressive, the alternatives sacrificed rarely appear. How, then, can the public judge the true costs?

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detailed matters which get into granting tax favors for this, relative penalties for that. The injection of a variety of economic issues into politics complicates the truly important job of solving society's essentially political problems.

11) When government buys office supplies or motor fuel, it pays for what it gets and no more. When it tries to get something by granting a tax concession, however, it may "pay for" more than it gets. Suppose, for example, that lawmakers agree that the public interest will be served by enlarging investment in small businesses. Unquestionably, a tax concession can stimulate such investment. The favor is granted, therefore — but to **all** such investment. The public accords the favor to every company in the general class, including firms which in any case would have acted just much as they did. For what may be only a modest **additional** investment of the kind desired, society "pays" as well for those amounts which would have appeared without the tax concession.

In short, the best interests of long-run growth, and efficiency today, seem to me to call for reduction in "special provisions", not more. If time permitted, I could give what seems to me a convincing lecture on the folly of taxing "business." But by now this talk has strayed from objectives to means.

RELATIONS TO OTHER ECONOMIES

Fiscal policy involves, not ourselves alone but "foreigners" as well. Tariff debates in the past, and more recently gold flows and the tax treatment of foreign income, have related federal financial policies directly to the ties between our domestic economy and other parts of the world. The connections are more numerous than can be discussed here, and the minimum of discussion requires us to stray again from objectives as defined strictly.

Most trade and investment are conducted privately. Why is there governmental interest of a sort to involve fiscal policy? A complete answer would take us far afield. At one extreme are matters inherently governmental. Keeping the peace is almost as nearly and end in itself as anything imaginable — but not quite, as our record, even today in the Far East demonstrates.

Other goals are more nearly means than ends desirable in themselves, e.g., achieving balance in international accounts. There is no inherent reason why government must get involved, and life might te better if there were no such involvement. But government does. No economy can be master of its own fate — including the conditions under which its subjects deal with foreigners. By playing a part a few governments can, in effect, force others to act where, if free, their publics would prefer nonintervention. And when governments fix currency exchange rates, the "normal" processes of economic adjustment to imbalances in international payments may seem unsatisfactory. Government may then seek to use fiscal measures to alter conditions[12]. Why?

A nagging balance-of-payments problem has persisted for a decade. Amidst many uncertainties, there is one certaintly: we cannot count upon

12) The use of federal **spending** power, other than the rather minor costs of diplomacy, to achieve international objectives is relatively new in our history. Today, however, even if we look beyond defense, dollars constitute a source of repeated debate. Foreign aid comes to mind. The goals are mixed, and their merit disputed; the amount that can be accomplished with dollars and the most effective ways of using them are also

existing economic forces to bring a desirable adjustment automatically. The operations of private market forces will not be self-correcting. Government has a part to play, an essential part. One reason for government involvement is that reactions abroad bear upon the result and may work in the wrong way. For another, inflexibilities retard adjustment[13]. But why seek a solution? What objectives are at stake, recognizing, as asserted earlier, that in itself holding gold cannot be worth enough to warrant extensive sacrifice?

Our basic objective (beyond world peace, the preservation of freedom, and humanitarian concern for the world's poor) is to be able to import. Yet there are additional objectives. One is to extend, broaden markets to permit greater and greater economies of scale. Moreover, expanding the scope for market forces by making for competition over broader areas reduces the power of monopoly. Forces from outside any one land can then protect against the domestic pressures restricting output and efficiency.

Failure to solve the long-standing problem of the deficit could eventually bring sharp break, some sudden large strain would find Americans unable to meet obligations to foreigners. Our ability to import would then decline. More probable would be the growth of direct controls on trade and investment, with proliferation of evils[14].

One likely candidate will be capital flows. We know that capital has a crucial role in progress. We want capital where it will serve us best,

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debated. Use of the taxing power, in contrast, is as old as tariff history. Congress has considered recently the taxation of foreign business activities and of income from abroad. Why? Other countries have tax systems which differ from ours. Americans operating there may be subject to two sets of taxes involving not only very high burdens if piled on each other but also different sets of rules. Some resolution of conflict, some harmonization, is essential. Many countries tax business (account being taken of their tax treatment of dividens) less heavily than does the United States; in view of this difference, attempts of the United States to grant American companies equality of treatment with their foreign competitors will encourage capital export from the high-tax area, ours. And the contribution of the capital to paying for cost of government will remain abroad. Many complexities are involved.

13) Two are especially important. (a) Inflexible exchange rates, e.g., the dollar in relation to the pound, franc, mark, etc., insulate producers and consumers in different countries from forces which would otherwise operate to alter prices, output ,and consumption. (b) Central banks no longer permit gold movements to have the internal equilibrating effects which once worked to help restore balance-of-payments equilibrium and thus to end gold flows

14) Our government began several years ago to cut down the dollar drain which results from federal spending itself; most foreign aid spending

whether here or abroad. But when capital is located abroad, the taxes on it or its earnings will contribute to cost of government there rather than here. To the owner the location of any given total of taxes may be matter of indifference. The collectivities (societies), however, have high interest in location; and in the world today the physical situation vastly overshadows the source or ownership of funds in deciding the place where profit is taxed.

When capital leaves, the record shows up on the "wrong" side of the accounts of an economy with a balance-of-payments deficit. How much can taxes affect capital flows? In what ways? Once again, forces operate in ways too complex and obscure to be dealt with adequately here. A tax cut, however, will improve business profits and tend to make the economy more attractive for capital. In addition, tax reduction by increasing the rate of economic expansion will tend to raise interest rates and make the country a less attractive place for foreigners to borrow; the outflow of capital will be less than otherwise and perhaps turn around. But once again I stray from objectives to means.

CONCLUDING COMMENT

Taxation and expenditure on massive scales can profoundly influence the distribution of income and wealth. The many issues require analysis rather different from the kind undertaken in this talk — or at least too extensive to be added here.

One objective not mentioned so far may, or may not, overshadow the others. How could one say? In any case it calls for explicit reference, as a reminder to the economists that something outside his immediate sphere may be more important: Good government. But we can cite high authority. In the words of one of history's greatest economists, Alfred Marshall:

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

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has been concentrated in this country, and military agencies have been required to do more of their buying in this country even though the cost is higher than in foreign lands. To greater extent that we like to admit openly, Uncle Sam in his military buying and foreign aid is trying to achieve the the results which would follow from a devaluation of the dollar. The Interest Equalization Tax is in effect much the same as a selective devaluation of the dollar.