more rather than less spending. Many economists assert that financing government spending through deficits also biases the economy toward bigness, because of the burden of paying for current expenditures is shifted forward to future generations that would redeem or service the debt. The ability of firms or individuals to borrow in this manner is limited by their current and prospective net worth positions, but such constraints do not apply to the U.S. government in any practical sense. While the total amount of funds available in credit markets at any particular time is limited, the market views Treasury debt as virtually risk-free. Consequently, the Treasury is a preferred borrower, and always finds a ready market for its issue. If the Federal Reserve is unwilling to accommodate Treasury borrowing, private borrowers may be squeezed when funds are scarce.

Prior to the 1960s, deficit finance was associated primarily with war or business recession. Since the late 1960s, however, Treasury borrowing to finance deficits has become increasingly common. In fact, since FY 1960, the budget has run deficits over just two years. Over this period, deficits often have shown no tendency to narrow as the economy approached full employment. Consequently, new Treasury securities can be easily sold each year. Moreover, the public has increased its holdings of Treasury securities rapidly since the late 1950s. Since 1957, the real rate of interest on term securities has been unusually high in recent years. The increased reliance on deficit finance is reflected in an increased use of the public sector to accommodate Treasury borrowing. If the public were required to finance the government, interest rates would rise, and large wealth transfers to foreign oil producers could not occur.

The ability of firms or individuals to accommodate Treasury borrowing, private borrowers may be squeezed when funds are scarce.

The increasing reliance on deficit finance since the late 1950s has been explained in terms of simultaneously growing acceptance of Keynesian economics, which legitimized the use of deficit spending for countercyclical management of the economy. In addition, beginning in the mid-1960s, the Republican economic policy drifted to maintaining GNP at its potential, or full-market view level instead of balancing the budget over the business cycle. In a dynamic economy, potential output and full employment are complex and somewhat ambiguous concepts that are not easily quantified. Unfortunately, the numerical measures of GNP at its potential, or full-employment, focus of fiscal policy shifted to maintaining the economy to capacity and removing the last vestiges of unemployment, produced a continuous chain of deficits regardless of the state of the business cycle.

Chart 2 Select Measures of the Growth of Purchasing Power (1978=100)

<table>
<thead>
<tr>
<th>Index number</th>
<th>1978</th>
<th>1979</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real transfer payments</td>
<td>110</td>
<td>110</td>
</tr>
<tr>
<td>Real compensation less taxes</td>
<td>105</td>
<td></td>
</tr>
<tr>
<td>Real wages and salaries less taxes</td>
<td>100</td>
<td></td>
</tr>
</tbody>
</table>

Does the Federal Government Spend Too Much?

by Owen F. Humphage

The Reagan administration has set itself to the herculean task of reducing the growth of federal spending. The administration plans to trim approximately $5 billion from the current budget (FY 1981) and approximately $51 billion from the FY 1982 budget. At the same time, the administration proposes to increase military spending and maintain basic services to the poor. Although the task of slowing federal spending is not insurmountable, it is a natural reaction. In addition, the Reagan administration is proposing budget cuts, while weak economic activity is being strained. The perception that spiraling government spending and persistent budget deficits have contributed to the increase in federal malaise provides a strong constraint against the inherent bias in government toward bigness. Today’s climate demands a significant reduction in federal budget growth.

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The Federal Sector

Despite repeated attempts to curb federal spending, it has grown as it propels by its own momentum. Between FY 1970 and FY 1980, for example, federal expenditures, as measured in the budget, grew 11.5 percent per year on average, and the rate of federal spending to gross national product (GNP) rose from 20.3 percent in FY 1970 to 22.6 percent in FY 1980. Federal expenditures will top 23 percent of GNP in the current fiscal year.

Almost two-thirds of the growth in total federal spending between FY 1970 and FY 1980 is attributable to expenditures for human resources. Aid to state and local governments, interest payments on federal debt, and expenditures for natural resources, environment, and energy also have grown rapidly, both in absolute terms and relative to total federal spending since FY 1970. In addition, the fastest-growing federal programs are also entitlement programs. Entitlement programs...
One reason why federal spending has been expanding relative to GNP may simply be that our society wants more government services. Many government services are similar in some respects to "luxury goods" as standards of living rise, voters are willing to devote a larger share of their incomes to such public services. Developed countries, for example, devote more resources than less-developed countries to such public goods and services as parks, space exploration, consumer information, environmental improvement, and advanced highway networks. In many respects the rapid growth of U.S. human expenditures on a public-choice basis. For the budgetary process, this is much easier to reattribute income when the average level of real disposable income is rising, income is falling. When incomes are rising, transfers can be made without a reduction in the net worth of middle and upper-income groups, but this is not the case when incomes are falling. According to this luxury-goods view of government services, one should not be surprised at the rise in demand for GNP devoted to human-resources spending (or to government in general) rise as GNP grows. Although there is a prima facie demand for government services, the absence of a competitive alternative eliminates the ultimate incentive to do so. In the absence of a market mechanism, governments rely on a political mechanism to determine the amount of public services and to allocate their costs. In the United States this function is performed at the national, state, and local levels through the operations of the legislative and executive branches.

Lobbying for Public Services

Most of the services provided by the government are those that people want, at least to the extent that people can afford them. Moreover, even if all groups generally agree that a particular government program is necessary, many would like to have additional benefits derived by society. More-