## CHAPTER II

# Capital Requirements and the Budget

Historically speaking, governments have had recourse to borrowing mainly to finance wars, and this type of borrowing is still of prime importance. Around 90 per cent of our present federal debt can be attributed to the two world wars and their aftermaths. By and large, borrowing to finance tangible asset expenditures is a relatively recent development. During the past fifty or sixty years it has accounted for the major part of state and local borrowing. (Cf. Tables 2A, 2B, and 2C.)

The purposes for which debts have been incurred are pertinent facts if we try to answer the question, Why is total public debt as big as it is today? But by themselves they do not give us the answer. They do not tell us why the investments of state and local governments in tangible assets increased by more than $8 billion between 1929 and 1946, while their net indebtedness was reduced to a negligible figure in these seventeen years. They do not tell us why wars are not financed on a pay-as-you-go basis, or why war debts seldom get paid off.

One naturally wonders whether the purposes for which debts have been incurred, or, to be more precise, the functional types of expenditure financed by the debts, do not have something in common, some common characteristic which leads to deficit financing rather than pay-as-you-go financing. It might be suggested that this common characteristic is their "bunchiness," the fact that they are, for the most part, concentrated in a relatively short period and added on top of the more usual expenditures during that period. But this is doubtless an oversimplification. Bunchiness is important, particularly for the smaller units of government. But a marked increase in the level of total expenditures that has not been adequately anticipated may entail recourse to borrowing. Also the process of finding and employing new revenue sources may prove to be slower than the process of stepping up expenditures. And during a business recession financing an expenditure increase by an increase in taxes may be deemed inadvisable.

The fact of the matter is that we cannot get much understanding of government financial capital requirements by considering solely the expenditures which are said to occasion them. Since government accounting reports do not include a comprehensive balance sheet which specifically relates (unamortized) capital expenditures—assets—to debts, we must

seek to understand financial capital requirements in terms of the place of the particular expenditures that are said to be the occasion for borrowing in the budget as a whole. These expenditures must be considered in relation to others and to tax and miscellaneous receipts; for it is really deficits and not particular functional categories of expenditures that have to be financed.

To say that governments borrow because they incur deficits is, in effect, to pose a whole series of questions. Some of these questions are economic in the sense that they relate to economic policies which may be forwarded by operating at a deficit for a time. Some of them are procedural; they have to do with procedures which may make it difficult or impossible, when the rate of expenditures changes rapidly, to make changes in tax receipts to match. Some of them are politico-economic; they concern the special interest groups that favor or oppose a particular debt policy.

### 1. *What Is a Government Deficit?*

Before going into these broader questions, indeed before attempting a more detailed review of the course of government receipts, expenditures, and deficits, we need to dispose of a very technical question: What is a deficit and what is the connection between operating at a deficit and borrowing?

We have already noted some of the ways in which the accounting and fiscal procedures of governments differ from those of private business. The necessity for dealing with this question points up a further contrast. Most private enterprises that publish financial statements of their operations offer the public a single deficit (loss) or surplus (net income) figure only. To be sure, there are still unsettled questions as to how business net income for a fiscal period ought to be defined, and different businesses define it differently. But in general each individual business adopts one definition and makes that the basis for its financial reports.[1] The federal government, on the other hand, for some years has regularly published three quite different deficit—or surplus—computations and now publishes still another. For calendar 1946 one of these showed a surplus of $5.0 billion, another a surplus of $2.2 billion, a third a surplus of $0.2 billion, and the fourth (the official "budget" computation) a deficit of $2.5 billion. Evidently when one speaks of the federal deficit, he needs to say what deficit he is talking about. And it may be added that a budget deficit does not necessarily mean "deficit financing."

Somewhat similar comments apply to state and local governments, even though for most of them only one deficit computation receives much

[1] A textual comment in a corporation's financial report, however, sometimes gives alternative computations of net income.

attention, the official budget computation. This computation has not always been defined in the same way, and the size of the deficit may not be a measure of the increase in government indebtedness.

In considering what sort of deficit computation does give such a measure, and how this computation differs from the budget deficit, it will be convenient to take the federal government as an illustration. Some of the special problems involved in this case have little or no parallel in the case of other branches of government, but we omit no special problems of consequence by concentrating attention on the federal government.

Further, while the federal budget deficit computation and the computation that measures net borrowing are by no means the only possible computations, we propose to concentrate attention here on these two.[2]

We pose the question, What is a federal deficit? And in so doing we assume that a federal surplus is to be regarded as a negative deficit. Equally we might have asked, What is a federal surplus? and treated deficits as negative surpluses. We do not mean to prejudice issues by the way we ask the question. Our choice of phraseology is a matter of convenience only. No value judgment in regard to fiscal policy or the relative merits of surpluses and deficits is implied. Nor is it suggested that a deficit (or surplus) has much economic significance apart from its algebraic components. For most purposes the real significance is doubtless to be found in the several receipt and expenditure items that enter into its computation. But for the sake of brevity we will speak mostly of the summary net plus or minus figure, using this as a shorthand way of designating the full financial statement of receipts and expenditures of which it is the balancing item. And we will treat deficits as pluses and surpluses as minuses, partly because in comparing various ways of computing a federal deficit or surplus during the past thirty or so years we find rather more deficits than surpluses, partly also because we take federal deficits—appropriately defined—to measure federal capital requirements.

## 2. *The Federal Budget Deficit*

First let us examine the budget computation. When the President submits a budget to the Congress, this is the deficit computation for the coming fiscal year that receives principal attention. Presumably Congress has intended that it should. The budget deficit computation has been developed expressly to serve as a basis of legislative fiscal control and of

[2] A note appended to this chapter deals with the other two federal deficit computations referred to above (net operating cash outgo and the National Income and Product Account deficit), with their relations to the two here considered, and with the evolution of the present federal budget computation.

administrative management. A good deal of careful study has gone into the various revisions that have made the budget computation what it is today.

The federal budget deficit is quite different from a business deficit, but they have some things in common. Both distinguish between those receipts and expenditures that enter into the deficit computation and those that do not. And an idea of good and bad seems to underlie both. A federal budget surplus is in some sense good; a deficit something to be avoided if circumstances permit. But here the resemblance stops. A business surplus is an end in itself; a government surplus is not. The objective in the case of government is not a surplus. Rather it is a balance between the costs of government services and the tax levies and other receipts that finance those services, a balance to be achieved as economically and efficiently as possible. This objective was set forth in the Budget and Accounting Act of 1921, and the Bureau of the Budget established by that act has been at pains to devise a deficit computation appropriate to it. It is today not the sole objective of fiscal policy, but it is still a major and a statutory objective.

Obviously a method of computing the federal deficit that has been devised to implement a particular fiscal policy will reflect the way that policy has been conceived and interpreted. The conception of the policy in turn can conveniently be indicated by noting the main categories of federal receipts and expenditures that do not enter into the budget deficit computation and the reasons for their exclusion. The main exclusions are: (a) transactions of social insurance funds, (b) certain transactions of various business-type and credit agencies of the government, and (c) certain transactions connected with the increase in the mint price of gold in 1934. In general these exclusions have been accomplished by dividing government accounts into two parts, the accounts of the general government and the accounts of trust and miscellaneous funds. The budget deficit is computed from the receipts and expenditures of the general government accounts. Except that some payments out of (and into) general government accounts may go to (or come from) the trust and miscellaneous funds, the transactions of these segregated funds do not enter into the budget deficit computation.[3]

There are a number of federal social insurance funds. Much the largest is the Old Age and Survivors Insurance Fund, the fund most people think of as *the* social security fund. But there are various others: the Railroad Retirement Fund, the Unemployment Compensation Fund, several civilian employee retirement funds (for various categories of

[3] The accountant thinks of the government as a collection of funds, each fund being treated as a separate transactor that enters into transactions with other funds as well as with the public.

civilian employees), and two veterans' life insurance funds (one for the veterans of World War I, the other for those of World War II).

The chief transactions of these funds are payroll tax and premium receipts, interest income, benefit payments, and portfolio investments. These funds in many years have had cash surpluses or excesses of their payroll tax, premium, interest, and other current receipts over their benefit payments and other current outgo items and have invested these surpluses in government bonds. The cash surpluses so accumulated and invested constitute a kind of policy reserve, and the Bureau of the Budget therefore considered it improper to count an annual social insurance fund cash surplus as contributing to a balancing of the general government budget. To count such surpluses in this way would be in effect to nullify the principle of maintaining a reserve. Hence it was decided that they should not be included in the budget deficit computation. Whatever one may think about the wisdom or necessity of the policy reserve principle for social insurance funds, this would appear to be a very reasonable interpretation of the intent of the Budget and Accounting Act.

The list of other government funds whose transactions have been in greater or less measure excluded from the budget deficit computation comprises a wide variety of federal government business-type and credit agencies. Among these are the Reconstruction Finance Corporation, which was originally organized to make loans to financial institutions during the crisis of 1932–33; the Commodity Credit Corporation, which has had a major role in the price parity program for farmers; the Federal Deposit Insurance Corporation, which insures bank deposits; and the Tennessee Valley Authority. The considerations which have led to exclusion in these cases are somewhat more complex than in the case of the social insurance funds, and the method of treatment of these agencies in the budget computation has gone through a number of stages. Broadly the theory in recent years appears to be that such agencies should to some extent provide the means of financing their operations for themselves and that they should affect the budget deficit insofar and only insofar as general government funds are used to finance them.

Since the mid-1940's a systematic attempt has been made to get nearly all such agencies to present business-type financial statements, income statements, and balance sheets, actual and budgeted or estimated;[4] and some special treatment of their transactions in computing the budget deficit would seem to be a logical corollary of this development. Just what treatment is most appropriate is a rather technical question. The present procedure is outlined in a note on federal surplus and deficit concepts appended to this chapter. At this point it may suffice to say it seems a reasonable conclusion from the businesslike characteristics of these agencies

[4] Also statements of sources and uses of funds.

that their transactions should not be simply lumped together with general government transactions in determining what constitutes a budget deficit. Rather, they appear to call for budgeting procedures more like those of business.

The increase in the mint price of gold in 1934 brought the government a paper profit of $2.8 billion. Since this was a mere bookkeeping write-up of an asset, it seemed inappropriate to count it as balancing the budget. Had it been so counted, the budget for fiscal 1934 would in fact have been almost in balance, although expenditures were—except for 1918–20—at an all-time high. But we must qualify this hypothetical statement. Part of this paper profit—$1.8 billion—was invested in the newly created Exchange Stabilization Fund, and this investment was classified as a nonbudget expenditure.

Granting the budget-balancing objective of the act of 1921 it seems wise to exclude from the budget deficit computation the cash surpluses of the social insurance funds and the paper profit on gold and to give some special treatment to the receipts and expenditures of business-type and credit agencies. However, under modern conditions the budget deficit concept so far developed is necessarily one that requires a great deal of judgment when the budget figures are used as a guide to fiscal policy. The budget cannot in general be balanced on an annual basis, only on the basis of an average for a number of years. Nonetheless the budget submitted in January of each year is an extremely valuable means of promoting the budget-balancing objective, and—short of a capital budget system—the present budget deficit concept would appear to be the appropriate one for this purpose.[5]

We say short of a capital budget system because such a system could provide a kind of moving average deficit computation that would eliminate much of the problem caused by the fact that year-to-year variations in out-of-pocket expenditures do not match year-to-year variations in receipts.[6] A small step toward a capital budget system was taken when—beginning with the 1948 budget—a table classifying civil budget expenditures into current and capital was included in the budget document.

### 3. *The FOF Nonfinancial Computation*

When the Budget and Accounting Act was passed, balancing the budget was widely considered the main objective of over-all fiscal policy. The depression of the 1930's stimulated interest in another objective—economic stabilization. Indeed, because of the objective of economic stabilization there is today support for the idea that a so-called cash

[5] However, it would seem advisable to treat all transactions in government credit as transactions in government debt are treated—that is, to exclude them from the definitions of budget receipts and budget expenditures.

[6] See the writer's "Capital Budget and the War Effort," pp. 38ff.

deficit computation should replace the present budget deficit computation in the budget document. However, for the purposes of this inquiry it seems best to assume that both computations are needed, and that both the budget-balancing objective and the stabilization objective will continue to receive consideration.

The deficit computation we propose to use in analyzing financial capital requirements—state and local as well as federal—may be regarded as a variant of the cash deficit computation, although strictly speaking it is not entirely on a cash basis. And the type of financial statement which defines it we consider a particularly useful one for analyzing the impacts of government fiscal operations on the rest of the economy—that is, a statement particularly appropriate to serve as an informational basis for implementing a policy of economic stabilization.[7]

The deficit computation we propose to use in analyzing government financial requirements will be referred to as the FOF nonfinancial deficit computation. It is the excess of what the Federal Reserve calls "nonfinancial uses of funds" over "nonfinancial sources."[8] This computation treats the gold account (i.e. the Treasury's monetary gold fund) as does the budget deficit computation—excludes it. But unlike the budget deficit computation it lumps together substantially all other government funds[9]—including social insurance funds and the funds of government business-type and credit agencies—and treats them as a single fund. The financial statement that defines the "nonfinancial deficit"—the flow of funds statement—is a consolidated sources and uses account for this inclusive fund.[10] It reports the results of all transactions of this fund with state, local, and foreign governments as well as with private parties. It does not reflect transactions between one federal agency and another.

One way to think of the federal nonfinancial deficit—the direct approach—is as the excess of nonfinancial expenditures or uses of funds—chiefly payrolls, procurement and construction costs, aids and benefit payments, interest, and tax refunds—over tax collections and other nonfinance-type receipts or sources of funds. It is this excess or net nonfinancial expenditure that has to be financed.

[7] The technical characteristics which distinguish this variant are considered in a note appended to this chapter. Considered there, too, are the two alternative types of financial statement that have been regarded as appropriate in conjunction with the economic stabilization objective. The note deals specifically with statements for the federal government, but much of what is said applies to state and local units as well.

[8] See *Flow of Funds in the United States, 1939–1953.*

[9] Strictly speaking not quite all. The funds of the District of Columbia are here classified as "state and local." Further, the "Treasury currency" account, the gold and silver accounts, the postal savings system, and the Exchange Stabilization Fund are regarded as parts of the banking and monetary system rather than as parts of the federal government.

[10] Of course the statement that defines the budget deficit is also a sources and uses account.

The other way to think of this deficit is in terms of the method of financing, the increase in net federal debt where net federal debt is defined as total federal direct and agency obligations held by the public (including banks and state and local governments but not including federal agencies) plus federal accounts payable minus the federal cash balance and minus federal portfolios of loans and securities.[11] A deficit can be financed by an increase in direct plus agency debt held by the public and trade debt, by a liquidation of federal portfolios, or by a decrease in cash. Financial sources of funds mean precisely increases in debts outstanding, or drawing down the cash balance, or liquidating other financial assets. And financial uses of funds mean precisely acquisitions of financial assets or retirements of debts. All other sources and uses of funds are nonfinancial. Either the excess of nonfinancial expenditures over nonfinancial receipts or the increase in net debt measures the financial capital requirement. The FOF statement details the financial sources and uses of funds as well as the nonfinancial sources and uses.

To us it seems that the proper measure of the government's financial requirement is the measure of its net borrowing from the public rather than the technical—and it might be added currently somewhat politically determined—budget deficit. It seems too that the FOF computation is a more precise and, because of the financial detail available in connection with it, a more convenient measure of net borrowing from the public than either the National Income and Product computation or the Treasury net cash operating outgo computation.

It could be argued that increases in the financial assets held by social insurance funds should not be deducted from increases in outstanding government debt in computing net government borrowing. The case for a deficit computation that does not make this deduction rests on the assumption that the persons covered by social insurance at any date have an equity in the insurance funds equal to the assets the funds hold at that date. In other words, the argument assumed that the government's future obligations to pay social insurance benefits entail a present liability to prospective social insurance beneficiaries equal to the assets of the funds. It was originally expected that the size of the Old Age and Survivors Insurance Fund would be determined by an actuarial reserve calculation. Had this plan been followed, the argument for such a liability—and so against the deduction of social insurance fund assets in computing net debt—would be a much stronger one.[12] But as things stand there appears

[11] To be precise we should note that in the Federal Reserve FOF computation a small amount of trade credit and other financial assets is also deducted.

[12] The actuarial reserve argument does apply in the case of the United States Government Life Insurance Fund (for World War I veterans). But for this fund, as for the others, the fiscal impact of financial asset accumulation seems best portrayed by the definition of net borrowing here adopted.

to be no reason for saying that a future obligation to pay benefits constitutes a present liability—and even if one grants there is such a present liability there is no agreed-upon way to determine its size.

But the main reason for defining government net borrowing as net of the increment in social insurance funds is not the question whether a future obligation to pay benefits is a present liability. Rather, it is that many economists think the fiscal impact of the social insurance system is best portrayed when we take the FOF nonfinancial deficit computation as the measure of government net borrowing. Largely because of this we have decided to define the government's financial requirement as net borrowing in this sense.

Since a concern with the fiscal impact of government operations has been such an important factor in this decision it may be well at this point to add a disclaimer relating to the nature of that impact. We do not share the concern some economists feel for the inflationary effects they assume government borrowing involves. We think there is no evidence that a government deficit in and of itself makes for rising prices. The connection between deficits and prices is an indirect one. The government can add to aggregate demand, chiefly through increased purchases and transfer payments and decreased taxes, and the addition to aggregate demand may involve a deficit and may, when the level of demand is high, exert an upward "demand pull" on prices. Our concern about fiscal impact is primarily a concern about the way government operations influence aggregate demand.

### 4. *Summary*

Two broad objectives of fiscal policy are: (a) a balance of budget receipts and expenditures, at least as an average over a period of years, and (b) promoting economic stability. The budget deficit—or surplus—is a computation that has been developed to implement the first of these objectives. The FOF nonfinancial deficit computation, the National Income and Product computation, and the Treasury net cash operating outgo computation are all more or less pertinent to the objective of economic stabilization. We have given particular attention to the FOF statement both because it provides more pertinent information for this purpose than either of the others[13] and because of the financial details it provides.

Since the budget deficit computation excludes a substantial volume of federal transactions—both sources and uses of funds—taken by itself it does not measure the net borrowing of the federal government. The FOF nonfinancial computation is precisely a measure of the net financial

[13] In 1959 the Federal Reserve revised the form of its Flow of Funds accounts. In the revised form somewhat less detail is given for the nonfinancial transactions of both the federal and the state and local government sectors.

requirement. And since the FOF statement includes both financial and nonfinancial transactions, it provides also important information on the form taken by federal financing each year, or—when there has been a surplus—on the form in which federal funds have been advanced to other sectors of the economy.

### *A Note on Federal Surpluses and Deficits*

Prior to World War I official financial reports drew no line between budget transactions and trust and other account transactions, as they do today. The principal federal financial reports showed total receipts plus the increment in direct debt outstanding equal to total expenditures plus the increment in the general fund (cash) balance except for a small timing discrepancy. Moreover, the only difference of consequence between the receipts and expenditures reported by the Treasury and nonfinancial receipts and expenditures, as the latter terms are used in this monograph, was the netting of postal receipts against postal expenditures in the former. In the early years of the twentieth century the only government corporation was the Panama Railroad Company, and the principal trust accounts were those for the Indian tribal funds and for the District of Columbia.

The development of government corporations and business-type activities and the growth of trust funds have greatly complicated federal finances. Trust and other account receipts totaled over $9.5 billion in the year ending December 31, 1954. And we have today in addition to the budget surplus or deficit computation three other surplus or deficit computations.

The purpose of this note is twofold: first, to sketch the development of the budget surplus or deficit concept; and second, to relate the four types of concepts.

During World War I the timing discrepancy in the equation, receipts plus debt increase equals expenditures plus cash increase, became substantial. In 1927 in order to put the various reports on a uniform timing basis and to eliminate this discrepancy, expenditure reports were shifted from a warrants-issued to a checks-issued basis, with an adjustment for checks outstanding applied either to expenditures or to the general fund balance.

By 1930 the assets of the adjusted service certificate trust fund, civil service retirement funds, and government life insurance fund had grown to over $1 billion. And the total receipts of all trust funds in that year were nearly $130 million. It seemed wise, therefore, to show separately one surplus or deficit computation for general and special account (i.e. budget) transactions and another for trust accounts; and the latter computation was shortly expanded to cover the transactions of a number of

government corporations and the capital gain from the 1934 increase in the value of gold. For the corporations involved this expansion of the outside-the-budget area was completed in 1938. It meant that in general capital subscriptions were reported as budget expenditures (and trust etc. account receipts), capital retirements and earnings distributions as budget receipts (and trust etc. account expenditures); that other corporate transactions and Treasury loans to corporations were only trust etc. account transactions and were reported as a single net plus or minus expenditure item entitled "Transactions in the checking accounts of government agencies (net), etc."

Distinguishing between general and special account receipts and expenditures and the receipts and expenditures of trust and other accounts was a long step forward in fiscal procedures. It was a definite recognition that the budget-balancing objective should apply to general government accounts, not to all government accounts; that a social insurance fund surplus should not be offset against a deficiency in the taxes that support general government operations; and that government business-type operations should to some extent be self-supporting. However, in the case of government corporations it went too far. It was part of the process by which government corporations came to be exempt from various fiscal controls.

The Government Corporation Control Act of 1945 had as its object the establishment of adequate budgetary, accounting, and auditing controls over such federal agencies. To help effectuate the purposes of this act the item "Transactions in the checking accounts of government agencies (net), etc." as it applied to wholly owned corporations was divided into two parts: (a) redemptions minus sales of the obligations of these government agencies in the market; and (b) "other activities (net)." Beginning with the Secretary of the Treasury's 1947 *Annual Report* and the 1949 Budget, (b) was reported for each wholly owned government corporation as a budget expenditure.

The separation of general and special accounts from trust etc. accounts developed during the 1930's had had the desirable effect of excluding from general and special account receipts and expenditures the sales and purchases by government corporations of public debt securities. The 1947 changes in corporation accounting procedures to effectuate the 1945 act had one unfortunate by-product. They brought most of these transactions in government securities by wholly owned corporations back into the budget. Accordingly, in 1951 net purchases of public debt securities by such corporations were again excluded from budget expenditures.

But there was a good deal more than this to the accounting changes in handling the transactions of government corporations that were made

in 1951. Quite possibly the ideal treatment of this difficult class of transactions has not yet been reached, but the 1951 changes did provide for the first time a clear-cut logical basis for drawing the line between inside-the-budget transactions and outside-the-budget transactions. The Budget for 1953 and for subsequent years gives statements of sources and uses of funds for the wholly owned corporations in which funds provided by "operations" are distinguished from funds provided by (inside) "financing," and funds applied to "operations" are distinguished from funds applied to (inside) "financing."[14] The net budget expenditure item for each corporation equals the excess of funds applied to "operations" over funds provided by "operations," i.e. net outside-the-government transactions.[15]

In February 1954 a technical change was made in budget receipts and expenditures, a shift from a daily-statement basis to a new monthly-statement basis. The result is a more accurate assignment of items by months and years.

These are the main steps in the development of the present budget surplus or deficit concept. But there have been four changes in the definitions of budget receipts and budget expenditures since 1939 that have had no effect on the surplus or deficit:

1. Exclusion of receipts appropriated to the OASI fund from both budget receipts and budget expenditures, effective July 1, 1940.
2. Exclusion of payments to the Treasury, principally by wholly owned corporations for retirement of capital stock and for distribution of earnings, from both budget receipts and budget expenditures, effective July 1, 1948.
3. Reporting amounts refunded by the government, principally for the overpayment of taxes, not as a budget expenditure but as a deduction from budget receipts, effective January 3, 1949.
4. Exclusion of receipts appropriated to the RR Retirement Fund from both budget receipts and budget expenditures, effective July 1, 1952.

The budget surplus or deficit computation is designed to serve broadly the purposes of legislative control in levying taxes and making appropriations and the purposes of administrative management. The present definition has, as the above historical sketch makes clear, evolved through

[14] The terms are not too well chosen. Many "operations" transactions are clearly financing transactions; the "financing" transactions consist of inside-the-government sources and uses of funds and market transactions in public debt securities.

[15] This is of course equal to net funds provided by (inside) "financing" (including loans as well as capital subscriptions). Of course it may be a negative quantity.

a process of experimentation. It should be added that it is the result of a great deal of careful study to devise a computation that will best serve these purposes.[16]

With the development of a federal responsibility for economic stability has come the need for another kind of surplus or deficit computation, possibly for more than one other kind. At all events there are three others today, each of them in some sense pertinent to the objective of promoting economic stability. Exhibit A compares the four computations.

The computations differ in the first place in the funds or accounts covered. The budget computation, as already noted, distinguishes receipts and expenditures of budget accounts from receipts and expenditures of trust and other accounts and is confined to the former. The cash operating income and outgo computation comes from a consolidated financial statement for all federal funds. The coverage of the FOF nonfinancial computation is only slightly less comprehensive. It comes from a consolidated statement for all federal funds except (a) District of Columbia funds (these are classed as state and local government funds), and (b) funds classed as part of the banking system.[17] The National Income and Product Account computation comes from a consolidated statement for all federal funds except (a) District of Columbia funds and (c) funds of business-type activities.[18] However, the balance in the account for business-type activities is closed into this statement; hence differences between columns 3 and 4 do not result from differences in the funds covered.

Exhibits B, C, and D give reconciliations (each for an illustrative year) between columns 1 and 2, columns 2 and 3, and columns 2 and 4, respectively. (Exhibit D treats columns 2 and 4 as net borrowing computations rather than as net nonfinancial expenditure computations.) In a general way the relations between column 1 and columns 3 and 4 can be inferred from these exhibits.

[16] It can be cogently argued that these purposes would be better served if capital and current expenditures were distinguished somewhat along the lines of business accounting and budgeting practice. In this connection it should be noted that recent Budgets have included a special analysis that looks in the direction of such a distinction. In Special Analysis D in the 1956 Budget actual and estimated expenditures (apart from a contingency reserve and an overlapping national security item) are classified under the following main headings: (a) additions to federal assets; (b) expenditures for developmental purposes; (c) current expenses for aids and other services; (d) other services and current operating expenses. Under (a) loans and various categories of physical assets are distinguished, and under (b) state and local physical assets, private physical assets, and several other developmental purposes. The analysis does not extend these classifications to appropriation estimates.

[17] The gold, silver, and Treasury currency accounts, the postal savings system, and the Exchange Stabilization Fund.

[18] Since financial transactions (and some others) are lumped in a single residual item it cannot be determined whether the funds listed in footnote 14 are covered or not.

The cash operating income and outgo computation has two forms. One is an accounting determination made each month by the Treasury, the other is a partly statistical annual (and sometimes semiannual) determination made by the Bureau of the Budget. The Bureau of the Budget calls the source items in this computation "receipts from the public" and the use items "payments to the public," and the Treasury has recently adopted this terminology also.[19] The Bureau of the Budget detail of receipts and expenditures is on a combined object-and-function basis that is a good deal more useful in connection with the economic stabilization objective than is the detail in the Treasury's monthly statement. There are minor technical differences between the receipts totals and the expenditures totals in these two forms of the income-outgo compilation that we will not stop to discuss.[20]

The cash income and outgo statement, unlike the others, is on a strictly cash basis. As a result there are adjustments for the excess of interest accruals over interest payments and for the excess of issues of obligations used in settlement of transactions over redemptions of these obligations in Exhibit B, and counteradjustments in Exhibits C and D.

The budget and cash operating income and outgo statements differ from the other two in three important respects: (a) The expenditures of various business-type activities, notably the Post Office, are reported net of receipts in the former two. (b) Budget expenditures and cash outgo include purchases of a substantial amount of loans and securities; budget receipts and cash income to some extent include sales of loans and securities. (c) The budget and cash income and outgo statements report procurement expenditures on an accounts-settlements basis; the National Income and Product statement and the nonfinancial transactions statement report such expenditures on a book-credit basis (i.e. in the case of merchandise at the time of delivery). Difference (a) has no effect on the surplus or deficit computations. Difference (b) results in adjustments B and C in Exhibits C and D. Difference c leads to the adjustments entitled "Decrement in net payables," when settlements exceed purchases on account, procurement outgo will be larger than the procurement expenditures in the NIP and nonfinancial transaction statements, and the surplus in column 2 will to this extent be smaller than the surpluses in columns 3 and 4.[21]

The netting of enterprise receipts against expenditures and the lumping of various financial with the nonfinancial expenditures in the cash operating income and outgo statement and in the statement of receipts

[19] After having experimented with various other captions. In what follows, to avoid confusion we will use the older, more familiar income-outgo terminology rather than the terms "receipts from the public" and "payments to the public."

[20] For reconciliations see the 1956 Budget, p. 1132.

[21] This adjustment takes account of trade receivables as well as of trade payables.

from and payments to the public both make it awkward to use the latter as an analytical tool in connection with the objective of economic stabilization.[22]

The NIP statement and the FOF nonfinancial transactions statement differ in three main respects: (a) The latter is complemented by a statement of financial transactions; in the former the surplus or deficit is a mere residual computation from the receipts and expenditures affirmatively determined, and it includes some nonfinancial transactions.[23] (b) A number of items are reported on different timing bases in the two statements—notably the NIP statement shows corporate income tax accruals, and the FOF nonfinancial transactions statement shows corporate income tax collections. (c) A single net item covers enterprise transactions and subsidy payments in the NIP statement; these transactions are on a gross basis in the FOF statement. We may note, too, that in the former corporate tax accruals are net of refunds and purchases are net of (subsequent) renegotiation receipts; also refunds are deducted from noncorporation tax receipts, interest receipts from interest payments, and sales from purchases of goods and services. In the FOF nonfinancial transactions statement netting is avoided as far as seems feasible. Again, in the NIP statement the receipt and expenditure figures exclude transactions in existing capital assets; in the nonfinancial statement they count as nonfinancial receipts and expenditures.[24]

The monthly cash operating income and outgo computation of the Treasury includes a balancing statement of financial transactions. Exhibit D relates this computation to the FOF statement. There are four principal types of steps in translating the former into the latter: (1) adjustments to take account of credit as well as debt transactions and of changes in accounts payable; (2) adjustments for differences in the timing of transactions; (3) the small adjustment to eliminate District of Columbia transactions; and (4) the grossing up of the cash income and outgo figures to get rid of the nettings.

Since the FOF statement is on a consolidated basis, the total of outstanding federal obligations it shows excludes obligations held by federal agencies like the social insurance funds. Net debt is thus computed as total liabilities of the federal government held by other sectors of the economy minus total financial assets or claims on other sectors held by the Treasury and other federal agencies. Of course net debt can also be computed when

[22] However, some effort was made to show loan transactions separately. See, for example, the (January) *1952 Economic Report of the President*, p. 160.

[23] The transactions in existing capital assets noted below. In fiscal 1951 the net effect of these on the deficit was insignificant.

[24] But the netting of various nonfinancial items in the revised FOF statement for the federal government and in that for state and local governments (see footnote 11) somewhat restricts the usefulness of these statements.

the claims of federal agencies on each other are counted both as assets and as liabilities.[25]

We have traced the development of the budget surplus or deficit computation. It does not seem worth while to do the same for any of the others. However, the cash operating income and outgo computation in particular has undergone a number of revisions. And it may be of interest to note that when it was started in 1937 by the Federal Reserve a separate net expenditure figure was compiled for investments in (purchases minus sales of) loans and securities. In this respect its aim was more like that of the present Federal Reserve compilations of financial and nonfinancial transactions.

Because of the advantages of a statement that avoids netting receipts from against payments to the public and that clearly distinguishes government credit transactions from nonfinancial transactions like payrolls and procurement outlays, it would seem that the usefulness of the cash income and outgo compilation would be considerably increased if it were so amended as to simplify as far as possible translations to the NIP and the FOF nonfinancial and financial transactions statements. It may be added that a shift from a monthly to a quarterly basis would not involve any great informational loss.

EXHIBIT A

A Comparison of Four Government Surplus Computations, 1943–54
(millions of dollars)

| Year Ending December 31 | Budget Surplus (1) | Net Cash Operating Income (2) | NIP Accounts Surplus (3) | Nonfinancial Transactions Surplus (4) |
|---|---|---|---|---|
| 1943 | −55,691 | −51,068 | −46,714 | −52,900 |
| 1944 | −53,650 | −46,616 | −54,577 | −50,800 |
| 1945 | −43,594 | −36,534 | −42,331 | −36,800 |
| 1946 | −2,512 | 236 | 2,161 | 5,000 |
| 1947 | 2,434 | 5,703 | 12,222 | 10,800 |
| 1948 | 5,241 | 8,076 | 7,957 | 9,900 |
| 1949 | −3,592 | −1,267 | −2,398 | 500 |
| 1950 | −422 | 482 | 9,229 | −300 |
| 1951 | −3,358 | 1,304 | 6,517 | 700 |
| 1952 | −5,842 | −1,583 | −3,366 | −300 |
| 1953 | −9,157 | −6,089 | −6,214 | −6,700 |
| 1954 | −3,683[a] | 301[a] | −6,177 | −2,300 |

[a] On a new reporting basis. See text.

NOTE: Figures for columns 1 and 2, 1943–53, are as they appear in *Treasury Bulletin* for February 1954. Column 3, 1943–53, is from 1954 *National Income Supplement* to the *Survey of Current Business*. Column 4 is (preliminary) from the Federal Reserve study, *Flow of Funds in the United States, 1939–1953*.

[25] See Table 51 below.

## EXHIBIT B

Relations between Budget Receipts and Expenditures and Cash Income and Outgo, Fiscal Year 1953
(millions of dollars)

I. SURPLUS AND DEFICIT RELATIONSHIP

| | | | |
|---|---|---|---|
| A. | | Budget surplus | −9,389 |
| B. | plus | Net surplus in trust and miscellaneous accounts[a] | 3,737 |
| C. | plus | Excess of interest accruals over interest payments | 719 |
| D. | plus | Excess of issues of armed force leave bonds over redemptions[b] | −25 |
| E. | plus | IMF capital subscription adjustment[c] | 28 |
| F. | minus | Clearing account adjustment[d] | −312 |
| G. | plus | Other adjustments, net[e] | 25 |
| H. | equals | Net cash operating income | −5,217 |

II. RECEIPT-INCOME AND EXPENDITURE-OUTGO RELATIONSHIPS

| | | | *Sources* | *Uses* | *Net Sources* |
|---|---|---|---|---|---|
| J. | | Budget transactions | 65,218 | 74,607 | −9,389 |
| K. | plus | Trust and miscellaneous account transactions[a] | 8,932 | 5,195 | 3,737 |
| L. | minus | Net effect of lines C, D, E, and F | 0 | −410 | 410 |
| M. | plus | Net effects of line G | 35 | 10 | 25 |
| N. | minus | Internal transactions[f] | −2,840 | −2,840 | 0 |
| P. | equals | Cash operating income and outgo | 71,345 | 76,562 | −5,217 |

[a] Before expenditures on investments in government securities.
[b] Includes adjusted service bonds (and in earlier years excess profits tax refund bonds).
[c] Excess of issues of special United States notes over redemptions.
[d] For outstanding checks, etc.
[e] Includes repayment of capital stock and paid-in surplus by corporations not wholly owned and net redemptions minus issues in the market of government agency securities.
[f] Interest on government obligations held in government accounts 1,275
Reimbursements of general fund for trust account administrative expenses 66
Budget expenditures for transfers to trust accounts 1,079
Payroll deductions for government employees' retirement 420
Total 2,840

SOURCE: This reconciliation is based on *Treasury Bulletin* for August 1953, pp. 12–13.

## EXHIBIT C

Relations between Cash Income and Outgo and National Income and Product Accounts Receipts and Expenditures, Fiscal Year 1951
(billions of dollars)

| | | | |
|---|---|---|---|
| | | I. SURPLUS AND DEFICIT RELATIONSHIP | |
| A. | | Net cash operating income | −5.2 |
| B. | plus | Net portfolio acquisitions counted as net outgo | 1.0 |
| C. | plus | Net other financial transactions counted as net outgo | −0.6 |
| D. | minus | Excess of subsidies minus enterprise current surplus over enterprise transactions counted as net outgo | −0.3 |
| E. | plus | Excess of tax accruals over cash income | 0.3 |
| F. | plus | Excess of social insurance contribution accruals over cash income | 0.1 |
| G. | plus | Decrement in net payables | 1.0 |
| H. | minus | Excess of interest accruals over payments | −0.7 |
| J. | plus | Other timing difference adjustments[a] | 0.1 |
| K. | plus | Other adjustments, net | [b] |
| L. | equals | Net NIP Accounts surplus | −4.4 |

| | | | | | |
|---|---|---|---|---|---|
| | | II. INCOME-RECEIPT AND OUTGO-EXPENDITURE RELATIONSHIPS | *Sources* | *Uses* | *Net Sources* |
| M. | | Cash income and outgo | 71.3 | 76.6 | −5.2 |
| N. | plus | Positive adjustments above | 0.5 | 1.6 | 0.9 |
| P. | minus | Negative adjustments above | −1.1 | −3.1 | |
| Q. | minus | District of Columbia transactions | −0.1 | −0.1 | [b] |
| R. | minus | Existing asset transactions | −0.1 | −0.1 | [b] |
| S. | plus | Netting adjustment[c] | 0.8 | 0.8 | 0.0 |
| T. | equals | NIP Account receipts and expenditures | 71.3 | 75.6 | −4.4 |

[a] Includes redemptions minus issues of armed force leave bonds, adjusted service bonds, and excess profits tax refund bonds.

[b] Lies between ±$50 million.

[c] Government and government employees' contributions to retirement funds.

Details may not add to totals because of rounding.

SOURCE: This reconciliation is based on Marilyn Young, "Three Federal Budgets: A Reconciliation," (Studies in Income and Wealth, Vol. 20).

## EXHIBIT D

Relations between Cash Income and Outgo and Flow of Funds
Financial Transactions, Calendar Year 1947
(billions of dollars)

I. SURPLUS AND DEFICIT RELATIONSHIP

| | | | |
|---|---|---|---|
| A. | | Net cash operating income | 5.7 |
| B. | plus | Net portfolio acquisitions counted as net outgo | 4.8 |
| C. | plus | Other financial transactions counted as net outgo | 0.5 |
| D. | plus | Decrement in net payables[a] | 0.7 |
| E. | minus | Excess of interest accruals over interest payments | −0.5 |
| F. | minus | Excess of issues of armed force leave bonds, etc. over redemptions[b] | −0.2 |
| G. | minus | Other timing difference adjustments | −0.1 |
| H. | equals | Net nonfinancial receipts | 10.8 |

II. INCOME-RECEIPT AND OUTGO-EXPENDITURE RELATIONSHIPS

| | | | *Sources* | *Uses* | *Net Sources* |
|---|---|---|---|---|---|
| J. | | Cash income and outgo | 44.3 | 38.6 | 5.7 |
| K. | plus | Positive adjustments above | 0.2 | 0.3 | 5.2 |
| L. | minus | Negative adjustments above | −0.5 | −5.8 | |
| M. | minus | District of Columbia transactions | −0.1 | −0.1 | 0.0 |
| N. | plus | Netting of nonfinancial sources and uses on line J[c] | 8.6 | 8.6 | 0.0 |
| P. | equals | Nonfinancial sources and uses | 52.5 | 41.7 | 10.8 |

[a] Is net of receipts of counterpart funds (and in earlier years reverse lend-lease).
[b] Includes adjusted service bonds and excess profits tax refund bonds.
[c] Nonfinancial receipts of government corporations and agencies netted against expenditures 5.7
Tax refunds netted against tax receipts 2.6
Government employee contributions to retirement funds 0.2
Timing adjustment not included in I 0.1
Total 8.6

Details may not add to totals because of rounding.

SOURCE: This reconciliation is based on Tables 18 and 19 in Federal Reserve *Flow of Funds* study.